



Playing it safe on the battlefield

THERESA EBDEN

19:55 EST Wednesday, Feb 27, 2008

Deciding how conservative to be with your investments can be a lot like deciding what to wear for a special occasion.

Most people would rather show up at a party overdressed than risk being the only one in sandals. Similarly, knowing that your money is growing slowly but surely in bond funds can often be more reassuring than buying equity funds and living in fear of losing 20 per cent in one quarter.

"Any time there is a lot of volatility in the markets, people tend to become more conservative than they otherwise might be," says David O'Leary, manager of fund analysis at Morningstar Canada.

"Many people invest even more conservatively than they should," he cautions. It's important to remember that risk isn't only about the chance of losing money: "It's also the risk of not having enough money when you do retire to fund your lifestyle."

That said, if your investment horizon is short, or if you're trying to reduce volatility risk, there's no better place to be than fixed income, says David Paterson, independent fund analyst at Toronto-based Paterson & Associates.

Here are what these experts have to say about some of the more conservative options for your retirement portfolio.

Buying bonds

If you have many thousands of dollars in your portfolio, and you're relatively savvy about investing, it sometimes pays to buy bonds instead of a mutual fund that holds bonds. This way you know what your return will be; you redeem the "coupon" every year for the bond's maturity, and then you get your principal back. No surprises.

But there's a flipside: bonds are expensive - often \$1,000 face value for a single one, not including the fees to buy them from a broker - and you need to manage a "ladder" of them so that some mature every year over several years. This way you are buying some new bonds every year, and diversifying your interest-rate exposure. This strategy is very hands-on, and isn't for everyone, cautions Mr. Paterson.

Also remember that, as a small investor compared to the professional money managers' billion-dollar buying programs, you're not going to get the best rates when you buy bonds. As well, you will have a limited inventory of mostly government debt available, compared to the diverse array of products available to a professional.

That said, if this is the path you choose, longer-term bonds such as 10-year maturities will net you more than short-term bonds, such as two-year.

Bond mutual funds

These big pools are managed by professionals who have access to the best rates when it comes to buying bonds. Depending on the fund, they may be able to buy not only government bonds, but also corporate debt, high-yielding "junk" bonds, bonds from overseas issuers, and even bonds whose returns are indexed to inflation (called "real return bonds").

"It's often best to buy a diversified bond fund and let the manager make the decisions [about which bonds to buy]," Mr. O'Leary says. For this expertise and buying power, you will pay a management expense ratio, or MER, which in today's low interest-rate environment may take a big bite out of the bond fund's total return.

There are specialty bond funds, such as high-yield, or global bond funds. Given the uncertainty in debt markets in the past few quarters, with the U.S. subprime meltdown, Mr. Paterson is not fond of high-yield

debt, which is basically debt of corporations whose lower credit ratings necessitate paying a premium on their bonds to attract investors.

"I'd be leery going into any corporate bonds, and if I did it would have to be blue, blue, blue-chip," he stresses.

As for global bonds, many have had negative returns in recent years because of the Canadian dollar's meteoric rise. Unless a fund hedges out currency risk, such as the RBC Global Bond Fund, Mr. Paterson avoids this asset class altogether. And even with this fund, he's not overwhelmed by the 1.75 per cent MER.

Money-market funds

Bond fund managers are buying longer-term bonds for a reason: they pay more, and are less sensitive to plunging overnight lending targets set by central banks and used as benchmarks for the banking industry. So it's little wonder that few experts recommend you try on a money-market mutual fund right now. These pools of short-term fixed-income investments barely averaged 2 per cent last year.

Even so, they do have their uses - if only fleetingly. "In an RRSP, the only reason I could see holding money markets is if it's temporary and you're waiting for an opportunity to come along," Mr. O'Leary says.

GICs

Even for conservative investors, guaranteed investment certificates are often too conservative. With rates slightly above 2 per cent for a one-year term, many GICs don't measure up to a non-registered, high-interest savings account. And with a GIC, your money is locked in for a specific time, while other investments give you more leeway.

If you want a bit more from your GIC, you can opt for products that keep their principal investment protected for the term, while any return is linked to a more volatile investment. For example, the CIBC Stock Market Advantage GIC is linked to the S&P/TSX 60 Index and has a term of three or five years.

Theresa Ebdon is a producer for Business News Network.