

Russell Insight

Stay Balanced in Volatile Markets

With the markets as volatile as they've been of late, some investors might consider switching to GICs. However, keep in mind that there are still implicit risks and cost associated with GICs.

How much are you willing to pay to *potentially* protect against downside risk?

Opportunity Costs

A key issue that should be taken into account when comparing GICs to balanced funds (60% equities/ 40% fixed income) is return potential – especially over the long run. There is a considerable risk-reward trade-off when choosing to put most of your money into GICs to safeguard against market downturns.

According to Morningstar Canada statistics ending June 30, 2008 - over the past 15 years, the average Canadian balanced fund's annualized return of 7.4% was about three percentage points higher than the average five-year GIC's (bond) return of 4.5%.

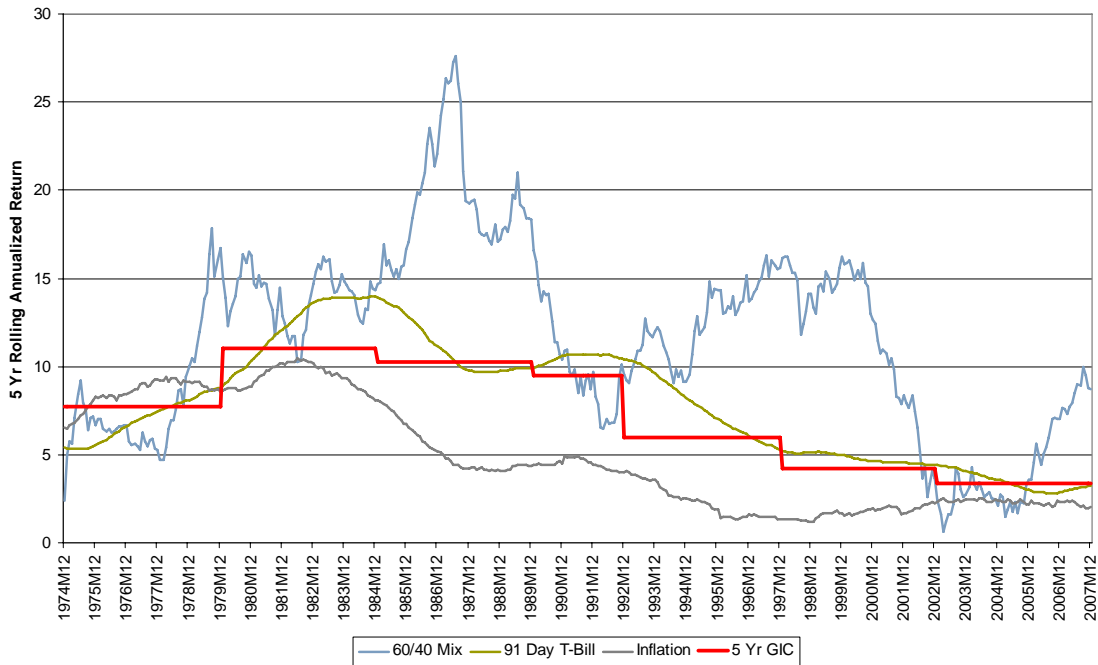
That approximately three-point gap -- a risk-reward premium to investors who tolerated the ups and downs of the stock market -- adds up.

For instance, an initial \$10,000 invested in the average Canadian balanced fund would have grown to \$29,000 – a difference of \$10,000 over the same amount and time invested into the “safe” GIC choice.”

It has been historically proven that it pays to ride out market turbulence with a balanced portfolio, rather than shift most of your money to GICs. Figure 1 compares a 5-year GIC (red line) to a global balanced fund (blue line) and 91 day Treasury bills (green line) to assess the relative differences in historical results.

As you can see, over the last 30+ years, the balanced investor has significantly and consistently outperformed the GIC. Interestingly, in most cases, the GIC investor would have fared the same with a T-bill portfolio, which has higher quality and liquidity than a GIC.

Figure 1: 60/40 Mix – 5 Year Rolling Annualized Return



Source: Russell Investments Canada Limited, BNY Mellon Asset Servicing and Bank of Canada

Taxation Costs

It is also important to consider the higher taxation rates of GICs in non-registered accounts. Balanced funds that distribute capital gains or Canadian dividends are taxed at lower rates than bank deposits. Depending on the fund's tax efficiency and how it is structured, balanced funds can also enable you to defer taxes for extended periods, if not indefinitely. With GICs, however, the interest income you earn outside registered plans is fully taxable each year.

The Keys to Balancing Risk & Reward

At the end of the day, you should keep in mind three key points before moving your assets to GICs whenever the markets are in a slump:

- 1) Patient investors are rewarded because equity markets go up more than they go down.
- 2) GICs can be expensive, both in lost opportunity and higher taxes.
- 3) A properly diversified balanced portfolio can minimize risk during bear markets and still allow you to participate in bull markets – effectively balancing risk and reward.

Above all this, it literally pays to keep a level-head during times of market volatility. Staying invested in a diversified portfolio - rather than hiding in GICs - has historically resulted in rewarding long-term results.

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