Growing guarantees

GICs are a silver lining amid rising interest rates, providing guaranteed returns today not seen in two decades, but even these low-risk investments aren’t without their downsides

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Much like fashion, what was once in style eventually becomes on trend once again in the world of investments.

Case in point are guaranteed investment certificates.

We all know them as GICs, and they’ve got a bit of a reputation over the last 20 years as where grandparents invest their money.

The reason: GICs are among the safest, if not the safest, investments in Canada.

Yet for more than a decade, they’ve been a least-worst option for individuals who could not afford to lose their money in the stock market, or had no interest in the more sophisticated cousin of GICs: bonds.

Paying two per cent or less, GICs were indeed a tough pill to swallow for low-risk investors until recently.

Today, these low-risk investments have more cachet among Canadians; interest rates offered on new GICs have jumped since spring because they are connected to the overnight rate set by the Bank of Canada, which has been hiking its benchmark since March 2.

“So now we’re seeing the highest rates on GICs in 20 years,” says Natasha Macmillan, director of everyday banking at Ratehub.ca, which compares GIC products from dozens of providers.

As a result, many one-year GICs are paying more than four per cent today, while the best five-year GICs offer five per cent or higher.

By the time you read this, they may pay even more; the GIC market is highly competitive, with providers increasing interest payments on new products every time the Bank of Canada hikes rates, as it did this week.

All of this means GIC rates are significantly higher than a few months ago, says Jeanette Power, senior wealth adviser at CIBC Wood Gundy.

“A one-year in March 2021 paid 0.65 per cent, for example, so there’s been a substantial change in returns.”

Interest in GICs from Canadians is also on the rise.

“We’ve seen them become quite a bit more popular,” Macmillan says, pointing to Google search data showing GIC-related keywords on the rise.

From May 2021 to this past May, searches increased by 180 per cent and are up 78 per cent since the start of this year, she adds.

“There is currently quite a bit of volatility in the stock market, so people are turning to GICs.”

Of course, higher returns not seen since 2001 are also driving demand, including among clients of investment advisers.

“When clients ask about them, we have a conversation about why they feel they need them,” says Ian Wood, certified financial planner with Cardinal Capital Management Inc.

That leads to discussions about risk tolerance, which comes in two forms, he adds. “There is the ability to take risk, and then there is the willingness to take it.”

For individuals who need money within a short timeframe and cannot afford to lose even one dollar, they do not have the ability to take risk.

So GICs are a good option because their capital is guaranteed.

Others may want to invest in GICs but do not need the money for several years. So they have no willingness to take on risk because they do not like seeing their investments fall in value.

“Their view of risk can boil down to a misunderstanding,” Wood says.

While they fear losing money, by not considering other options such as stocks and bonds, they are exposing themselves to another risk: losing purchasing power over time.

“Even though GIC rates look attractive today, they still won’t outperform inflation,” Power further explains.

With inflation running about eight per cent, even if you’re earning six per cent on a GIC, that money is losing purchasing power in real terms.

What’s more, if held outside a tax-free savings account (TFSA), RRSP or RRIF (registered retirement income fund), even more return is eroded by taxes.

In turn, considering other options may be worthwhile, including Government of Canada bonds. Their value will fluctuate on your statements — notably downward in a rising interest rate environment. But investors do get all their money back at term’s end. (FYI: These investments are different from Canada Savings Bonds, which were discontinued a few years ago due falling demand and rising costs of running the program.)

One advantage of bonds over GICs is “liquidity” — the ability to sell them if you need cash, Wood says.

“With GICs, the rates you often see are for non-redeemable GICs, so the money is locked-in for that period,” he says, adding some are redeemable, but pay less. In contrast, bonds can often be sold if you need money in a hurry.

Due to their general illiquidity, it’s important to pay attention to GIC term length, especially these days.

Power notes many investors are doing just that, buying GICs with one- and two-year terms instead of five-year terms even though the interest rate is higher.

“That’s because they are expecting rates to continue to climb for the next several months,” she says, and so these individuals want to be able to reinvest a little sooner down the road in GICs paying even higher interest rates.

Still, investors with longer time horizons for their money and wanting better growth should consider other strategies.

That includes generating income from dividends from stocks of high-quality companies — like Canada’s big banks, which sell GICs.

Then again, most GIC investors are happy to take the higher interest payments offered today and rest easy, Power says.

“After all, who wouldn’t be happy about higher returns on risk-free money?”