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Who needs stocks? Not this believer in GICs

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With interest rates at historic lows and stocks having all the fun, the lowly guaranteed investment certificate doesn't get much respect.

Why lock in your money at 2 or 3 per cent when you can make that before lunchtime on the stock market? Who in their right mind would settle for such pitiful returns, anyway?

Meet David Trahair, a chartered accountant, GIC booster and author of *Enough Bull*, a new book that takes aim at the notion that investors need the stock market to retire comfortably.

Nonsense, Mr. Trahair says. Most people can get by just fine by cutting their expenses, paying off their mortgage and investing their savings in GICs. There's no need to endure the torturous swings of the market to achieve financial security.

The Beauty Of GICs

GICs have several benefits, he says. They're easy to understand, have no hidden fees and in most cases they're protected by the Canada Deposit Insurance Corp. for up to $100,000. (More on that later.) Best of all, you won't wake up one morning to find your GICs plunging in price.

With GICs, "what you see is what you get. It's plain as day. Here's the interest rate you are going to get for the period you selected," he says.

As for the criticism that GICs deliver inferior returns to stocks, that's largely a misconception, he says. We may be in an ultralow rate environment now, but over the past 50 years the rate on five-year GICs has averaged a healthy 7.3 per cent. Canada's benchmark stock index, by comparison, has risen by an average of 6 per cent over the same period, he says.

SAFETY, AT A PRICE

The latter figure excludes dividends, which is one reason some investment advisers don't buy the nothing-but-GICs argument.

"When you start adding up dividends, there's absolutely no comparison" between stocks and GICs, says Robert Cable, director of wealth management at ScotiaMcLeod in Mississauga. According to Bloomberg, if you include reinvested dividends, the S&P/TSX has gained an average of about 8.4 per cent over the past 15 years.

What's more, outside a registered account, dividends are taxed more favourably than interest income. GICs "have their place in portfolios. ... It's your sleep-at-night money," Mr. Cable says. But devoting 100 per cent of one's portfolio to GICs is "extreme."

"I know people who, if they lost $10, wouldn't be able to sleep at night. So, for those people, a 100-per-cent GIC portfolio and a low standard of living is what they're going to have to accept," he says.

"But all of the people I know who have real wealth owned a business. And when you own stocks, you own part of a business."

THE PEACE-OF-MIND FACTOR

There is, however, another advantage that GICs have over stocks: Because GICs don't fluctuate in price - and because the money is locked in - investors aren't tempted to dump them when the market crashes, or buy more when the market soars. With stocks, many investors do just that - they sell low and buy high - and that self-defeating behaviour ends up costing them dearly.

CLIMB THE LADDER

So you're convinced GICs have their advantages. What's the best way to incorporate them into your portfolio?

Mr. Trahair is a big fan of "laddering."

Compared with assembling a portfolio of stocks, building a GIC ladder is a piece of cake. First, take the amount of cash you're planning to invest - say $100,000 - and divide it into five equal parts.

Now, invest the first $20,000 in a one-year GIC, the second $20,000 in a two-year GIC, and so on. Your final $20,000 goes into a five-year GIC, which usually offers the highest interest rate because your money is locked in the longest.

When the one-year GIC matures, take the cash - including interest - and reinvest it in a new five-year GIC. Do the same a year later when the two-year GIC matures. By following this approach, you'll always be reinvesting your money for a five-year term, so you'll be benefiting from the highest rates.

Laddering has other benefits. Because a portion of your principal will be maturing every year, you'll have access to the cash if you need it. What's more, you won't face a situation where 100 per cent of your principal matures during a period of very low rates. Rather, you'll be reinvesting gradually, reducing the impact of interest rate fluctuations on your returns.

SHOP AROUND

Mr. Trahair has some other advice: Don't simply take the rate your bank offers you. You can usually do better by shopping on the Internet or using a deposit broker, who will search for the best rates on your behalf. Also be sure to ask whether the financial institution is covered by the CDIC.

Credit unions often have higher rates. The tradeoff is that they're backed by provincially run insurance plans. That's a non-issue for many advisers, but if you want the full backing of the federal government protecting your savings, as Mr. Trahair does, then stick with CDIC-insured institutions. Either way, your money should be safe.

"For me, I'd rather not spend the rest of my life worrying about what the stock market might do," he says. "I'd rather sleep at night knowing that it makes absolutely no difference to me or my family."