Bulletin – Bond Funds

KLT Group

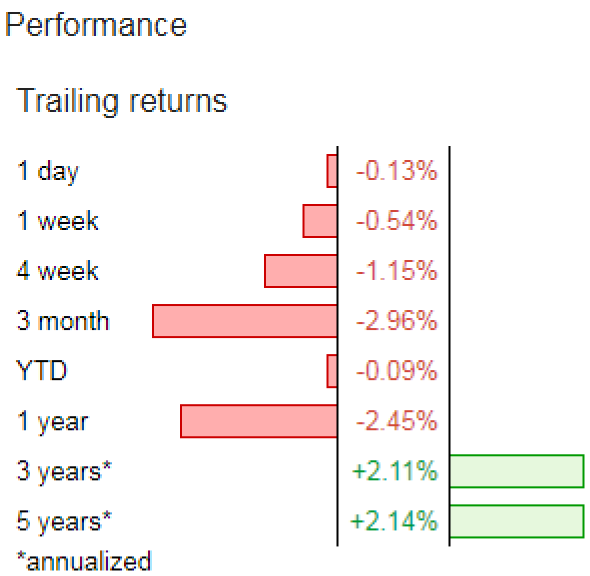
13423 112 Ave.
Surrey, BC
V3R 2E7
604-357-7064

www.kltgroup.ca

Solving one client problem at a time – every day

September 2017

I have been warning about the risks bond funds are facing and now these risks are coming home to roost. The recent BoC rate increase is just the first of many rate increases to come. The best way to hold fixed income product such as bonds is to put it in a laddered portfolio (where you have a segment maturing every year) and hold them to maturity (in the industry we call this YTM, or Yield to Maturity). Bond funds are based on the resale value of the bonds, not on simply the principal and interest.



This performance is of the RBC Canadian Bond Index Fund; it tracks a broad index of bonds. As you can see, it has lost 2.54% over the year – and this is the safest part of a mutual fund portfolio! Safely losing close to 3% isn't exactly what I would consider safe. With further rate increases on the horizon, expect more of the same, ongoing, until the BoC overnight rate reaches about 4%.

What is even more alarming is that the fund manager is charging almost 1% to manage this clunker of a fund; most other bond funds are similar. Holding the bonds directly in a YTM state an investor would not have only not been exposed to the interest rate risk due to the lower resale value, but would have added close to 1% to the return, mitigating the 3 month loss down to 1.96% rather than 2.96%.

This is why having a professional advisor, rather than a person entering your risk profile into a simple computer program is very advisable for the conservative investor. The safest part of your portfolio should not be losing money – cash is safer and there are better yielding products that aren't so interest sensitive.