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Reaching for Yield in a World of Low Interest Rates

Tags: investment planning [1]

While we can talk about concepts such as inflation and purchasing power the struggle for many people today is earning enough income on their savings to meet their lifestyle needs. Interest rates and the earnings from capital through dividends, bonds and real estate rental income have dropped dramatically in the past few years.

Government bond yields are near 400-year historic lows! According to Global Financial Data's Chief Economist, Bryan Taylor: Since 1700, well developed markets for bonds have existed in London and New York enabling the yields on government bonds to be traced with accuracy. Since the mid-1600s, the average yield on government bonds has been around 4%.?

Bond interest paid since 2008 on 10-year Government of Canada bonds has ranged from a record low of 1.58% in July of 2012 to a rate of 2.47% in early 2014.* The rates paid on GICs and daily interest accounts are even lower, leading many retirees to look for alternative investments to boost their income and meet their living expenses.

Imagine being a retiree in Japan looking to generate sufficient income in a world where Japanese Government Bonds are and have paid returns of as little as .50% since the early 1990's as the Japanese government combats deflation. Traditional retirement planning goes out the window in this situation. To generate a modest pension of $25,000 at 0.5% you would need to accumulate Canadian assets of $5 million a daunting prospect for most Canadians.

The result is that some Canadians have increasingly moved outside their comfort zones to riskier investments to meet their income needs. Some have turned to global and Canadian dividend investment funds, while others have turned to income producing assets that invest in a variety of sectors such as REITs (Real Estate Investment Trusts), corporate bonds and foreign market government bonds amongst other options.

The same thing happened around 2000 when consumers went looking for greater investment yields following the technology crash. The danger is a rush by consumers to buy any type of yield product without examining the quality of the underlying assets and the potential for capital losses, never mind earning the advertised returns. The longer interest rates remain below historical levels, the greater the risk that consumers will be drawn into buying investments with high advertised income returns without bothering to assess the underlying quality of the actual investment and the risk of permanent capital losses.

This risk of permanent capital loss is manifest in the government bond market where some $4 trillion dollars has been invested globally since 2008 as consumers moved en masse to the perceived safety of government bonds. Consumers risk the permanent loss of capital as interest rates are expected to increase sometime in the future to more normal levels from today's historic low levels.

For example, the quality of some recent offerings in the REIT market has shown this pattern of deteriorating quality as fund managers have grown more cautious about investing in this sector. One new REIT offering in late 2013 had no operating track record, no assets and no way to generate immediate income but was being promoted to income seeking investors.

Call us today to review your income needs and the various quality options available to assist you in preserving your wealth.

*For more information on bond yields go to:

Canadian Government Bond 10Y [2]

Please call us today to discuss your financial planning goals and how we can assist you in meeting them!

Questions about retirement income planning?
Contact our office today ! **[3]**

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