Search for income takes a turn

The economic recovery is not yet on solid footing, so getting income from traditional products such as bonds, GICs and annuities is an exercise in futility. Here are some ideas for getting income and returns for your risk-averse clients

BY CATHERINE HARRIS

IT'S NO SURPRISE THAT THE GLOBAL financial crisis has made investing more difficult for your risk-averse clients who are approaching retirement.

That's because interest rates are so low that clients won't get much income from the guaranteed income certificates, bonds and annuities they typically would buy now. And, to add insult to injury, consumers continue to see inflation eat away at their purchasing power.

Furthermore, bonds purchased today will lose value once interest rates start their inevitable climb back to normal levels. That will result in losses if clients have to sell their bonds before maturity.

Thus, many financial advisors are suggesting their clients use any spare cash they may have to buy dividend-paying stocks, which both offer the possibility of higher dividends and/or stock price appreciation and benefit from the dividend tax credit if the issuing companies are Canadian.

Says Avery Shenfield, chief economist with **CIBC World Markets Inc.** in Toronto: "The yields on stocks that pay good dividends and whose earnings are growing are currently more attractive than

in the U.S. and Canada will pick up gradually, with interest rates also moving upward at the same pace. This delay in the return to normal conditions means that although you should draw up financial plans based on a normal interest rate environment, you also have to figure out how to make the transition to the target asset mix.

You could, for example, hold off on reducing equities, if that's part of the plan,

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until interest rates have returned to normal — and even increase dividend-paying equities with any spare cash your clients may have. There is no harm in holding

or more. However, a debt of $50 billion will still be only $50 billion in 10 years, so it will be much easier to pay it off if inflation has averaged 5% vs 2%.

Even if governments don't encourage inflation, your clients need to understand what inflation of even 1% or 2% can do to their purchasing power. For example, $30,000 in GIC, bond or annuity income would be equivalent to $27,100 in today's dollars in 10 years if inflation is 1%; $24,500 if inflation is 2%. In 30 years, that income would be equivalent to $22,200 with 1% inflation or $16,400 with 2% inflation.

It's also important to discuss inflation and how it may change in the future. For example, Sheila Munch and Glenda Baker, senior financial planning advisors with **Assante Wealth Management (Canada) Ltd.** in Oshawa, Ont., typically use a historical 3% inflation rate in most of their projections; they will use a higher rate at the clients' request. They recommend using a higher rate — normally 5% — when dealing with educational costs because tuition fees have been increasing at a fast clip. Institutional-term care costs have also been rising more than

has little or no representation in other important economic sectors. There are, for example, no car manufacturers or drug companies on the index.

It's worth considering non-correlated assets — those whose returns do not move in tandem with global stock and financial markets — to provide steadier returns and less volatility. Garbens, for example, recommends investing in gold, other resources commodities, real estate and dividend-paying stocks for this kind of diversification. "There may not be great highs," she explains, "but there shouldn't be big lows."

Besides a mix of non-correlated assets, Garbens also recommends a mix of products, with some aimed at producing an income stream, some with growth potential to protect against the erosion of purchasing power from inflation and some guaranteed investments linked to equities to ensure clients get some of the upside if stock markets do well.

One question that hasn't changed is how much exposure Canadians should have to foreign currencies. Many experts recommend geographical diversification even though exchange rate movements can play havoc with financial plans. The rise in the value of the Canadian dollar vs its U.S. counterpart to US$1.03 in late 2007