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In the last issue of "The Fortnighter" I commented on the current attractiveness of GIC rates relative to those on bonds.

To re-cap – the current demand for bonds (especially from big, institutional investors) is extremely strong. And that is driving bond prices UP and yields down. The same supply/demand equation doesn't seem to be applicable to GICs – leaving their yields (for a similar term and credit rating) much higher.

What's not readily apparent when talking about the current environment for bonds (and other fixed-income investments like mortgages) is that there is a large amount of RISK building in the marketplace.

It's my opinion that risk is something that most investors don't think about often enough – rate-of-return is usually more front and center. Or, any discussion of risk is focused on the equity holdings in the portfolio – not the fixed income side.

Even though they are "guaranteed", fixed-income holdings have imbedded risk, just like any other investment. Off the top of my head, I can think of at least five ways in which holding bonds (or owning a mortgage, for that matter) is "risky".

The most obvious current risk with owning fixed-income investments is interest-rate risk. Or, to put it another way, the risk that your investment will lose money should interest rates increase.

For instance, if you were to buy a 10-year US Treasury bond today yielding 2.6% and rates increased quickly to 3%, your bond would fall in value by about 4%. That's not "equity-like" volatility, but it does highlight the fact that bonds can lose value just like anything else – and it can happen quickly. Furthermore, a move from 2.6% to 3% is a pretty modest increase – a lot of market pundits feel that 10-year bond rates should be much higher than 3% in order to compensate bond investors for current levels of inflation (which also appears to be nudging higher).

That might beg the question "why then are institutional investors (who are assumed to be smarter than us) buying so many bonds"? Well, a large part of the reason is structural, not strategic. There is a shortage of bonds in the marketplace due to reduced bond availability – and many institutions (like pension funds) are mandated to buy a minimum % of bonds by their investment policy statements. Furthermore, many lending institutions (especially in places like Europe) still seem reluctant to re-lever their balance sheets by lending out accumulated cash – they'd rather park it in the "safety" of the bond market – even if it's in countries like Italy and Greece!

Make no doubt, higher rates will eventually manifest themselves. When that happens, investors with short-duration/high-quality fixed-income portfolios will ride out the storm with ease. The time to start that transition is sooner, rather than later.

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