The Fortnighter

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Markets are off to a tumultuous start in 2023, with major indices like the TSX Composite and the S&P 500 showing ever-so-slight gains at time of writing. That might come as a surprise with all the "bad news" out there, but that's where we are.

Of course, the big news over the past few weeks was the dramatic failure of Silicon Valley Bank – an institution that I bet you never heard of before last week! Ever notice that when crises hit, they are usually about debt? Too much debt, the wrong type of debt, the wrong term, etc., etc. It's a (frequently) recurring theme.

Ironically, SVB failed largely because it owned a ton of the safest debt possible – 100%-guaranteed U.S. Treasury bonds. Look up "riskless" in the dictionary and U.S. Treasuries will probably be in the description!

Now, you also probably own bonds in your investment portfolio – after all, they're a key component of any diversified asset mix. And chances are that many of those bonds now show a "loss" on your statement. That's because rates have gone up. If you bought a bond two years ago to yield 2% to maturity and rates are now 4%, that bond is worth less on the open market (which is how they're priced). That's essentially what sunk SVB.

On the flip side, you might also notice that your GICs don't show any losses. That's not because GICs are better (or worse) than bonds – it's simply that there's no active re-sale market for these things. You buy 'em, you get a fixed rate, and that's it. Simple.

This "No Loss" feature seems to be driving a huge uptick in the popularity of GICs these days (especially in the short term where rates are higher). Not hard to figure out. In times of increased uncertainty, we're compelled to do these types of things – it's human nature. Another trend I'm seeing: "Investment A is doing better than Investment B – so give me more of A"!

These strategies make us feel good in the short term, but they're often not in our best long-term interests. Yes, cash & GICs are "safe", but is there a better option in today's market environment? I believe there is (and it's not stocks)!

Those of you viewing your investments lately may have noticed another "asset class" appearing in your portfolio – Bond Funds. As their name suggests, bond funds are a professionally managed portfolio of, well, bonds. I've never been huge fan of these in the past because I've always worried about the risk of rising rates – which, as we saw in 2022, clobbered bond portfolios. But now rates are HIGH.

I believe that the real risk to economies over the next several years is DEFLATION, not inflation. Rates should come down. If this plays out, the ***reverse*** of what sunk SVB should occur – capital appreciation on fixed-income investments like bonds. If rates decline a lot, the "lift" could be significant – and you won't get it with GICs.