The Fortnighter

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In normal times, markets often take a "bit of break" during the summer months. We talk of the "summer doldrums" and recite the old market adage "Sell in May and go away".

Of course, these are not normal times - and any investor who took money off the table in the spring (in the hopes of buying back "when the dust settled") has missed out on a pretty impressive market rally.

I know that for most of us, we're just relieved that portfolios have largely recovered from the shellacking we took in the first quarter. But the "What just happened?" question is still important – especially if we want to get a handle on what comes next.

A large part of what we're seeing in the markets may NOT be directly about the pandemic. It may simply be about "real yields". To understand this, we need to do a bit of math.

Investing is ultimately about income. You can't "spend" 100 shares of Telus – but you can use the cash flow from those shares to buy things. I feel badly for those investors who derive their incomes from bonds and GICs. Yields on these investments are now not only incredibly low, they can actually be negative in real terms.

"Real yield" means the yield less the rate of inflation – which is another way of saying actual purchasing power. Yes, we've all heard about how the pandemic has brought down the inflation rate, but how many of us still seem to be paying more for things like property taxes, gas or our kids' education? I would argue that inflation is alive and well for most of us – and actually has the potential to go higher here.

As I scan our list of GICs, I see that 5-year rates max out at about 1.5% and anything less than 3 years is at 1% or less. And if you think GIC rates are low, you'd be floored by what government bonds are paying. 5-year government of Canada bonds are currently paying about 0.4%.

If "your" inflation rate is 2%, the real yield on that 5-year GIC is now negative - and on that 5-year Canada bond it's -1.6%. For comparison, the dividend on those Telus common shares is 4.8%, so at 2% inflation its real yield is +2.8%. Telus shares are obviously higher-risk, but at least its yield is moving the investor forward in real terms, not backward.

Please note that I'm not saying investors should "ditch" their GICs and bonds for stocks – 100% guaranteed investments still play a very important role in any balanced portfolio. I'm simply pointing out that the decline in real yields we're seeing here is driving money towards stocks.

A final comment. If investing is ultimately about protecting our purchasing power, could traditional fixed-income investments now be considered "high risk"? I don't think I'd go there yet, but it does suggest investors looking for both returns and risk reduction might need to expand their investment horizons.