Stocks Down, Bonds Down - What to Do?

Generally, the investment world can be split between Equities (stocks) & Fixed Income (bonds). Investors typically divide their portfolio between these two based on their goals and comfort. Some of our clients are 100% in bonds while others are 100% in stocks; however, most investors fall somewhere in the middle which we refer to as a balanced investor.

According to Reuters, to battle inflation in 2022, the Bank of Canada and US Federal Reserve have raised interest rates from 0.25% to 3.75%. Additional rate increases are expected, with the projected terminal rate forecast to peak around 4.4% early 2023.

This rate is considered the "risk-free rate" and is the starting point for evaluating and comparing investment options. As a general guide, bond investors typically demand an additional 1.0% over the risk-free rate. Equity investors between 5.0%-6.0%. This would suggest bonds and stocks could return approximately 5.5% and 10% in the future. Coincidentally, over the last 150 years the S&P 500 has averaged 9.05%, as of September 30, 2022. Adjusted for inflation, the real return was 6.8%. It is our opinion that equity returns will revert to their long-term averages.

Because inflation has persisted and we have yet to hit peak rates, both stocks and bonds have been under significant pressure and both are in bear market territory. Typically, owning bonds can help bolster a portfolio when stocks underperform, but this year has been a double-whammy for investors with bonds facing their worst performance since 1926.


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Here are some current year-to-date returns up to October 31st, 2022:

Benchmark	Return
S&P/TSX Composite Index	-8%
S&P 500 Index	-19%
Nasdaq Composite	-30%
S&P Canadian Aggregate Bond Index	-13%
S&P US Aggregate Bond Index	-16%

Other notable times when balanced investors have been hit as hard include: the 2008 financial crisis, 2000 dot com bubble, hyper inflation of early 1970s and the Great Depression in the 1930s.

When analyzing bonds, some of the key attributes to consider are credit ratings, duration, and yield to maturity. In our client portfolios, we carry a shorter duration of 3 years and a net yield of approximately 6.0% with an above average credit rating.

For investors who want total security without any volatility they can consider Guaranteed Investment Certificates (GICs) which are paying between 4.9% - 5.2% for 1-year to 5-year terms (as at Oct 31, 2022). GICs typically offer less return than bonds, as well as no liquidity (access) before maturity but they provide 100% certainty when fully CDIC insured. For tax efficiency where appropriate, we tend to recommend investors allocate GICs within their tax-sheltered accounts: RSP, RIFs or TFSAs.

One of our favourite strategies is Dividend investing. Some high yielding Canadian companies include:

Company	Sector	Symbol	Dividend
Enbridge Inc	Energy	ENB	6.5%
Bank of Nova Scotia	Financials	BNS	6.2%
Manulife Financial	Financials	MFC	5.8%
BCE Inc.	Telecom	BCE	6.0%
Algonquin Power	Utility	AQN	6.6%

Source: Thompson One as of Oct 31, 2022

Dividend investors get a major tax break by way of the Canadian dividend tax credit. Looked at another way, an investor would have to earn about 1.3x more from a bond to end up with the same after-tax result. For example, the above companies provide average dividend flows of 6.4% which, after tax, would be equivalent to the interest payments of an 8.3% bond.

2022 Taxable Income	BC 2022 Marginal Tax	
	Other Income	Canadian Eligible
< $43,070	20.1%	-9.6%
$43,070 ~ $50,197	22.7%	-6.0%
$50,197 ~ $86,141	28.2%	1.6%
$86,141 ~ $98,901	31.0%	5.5%
$98,901 ~ $100,392	32.8%	8.0%
$100,392 ~ $120,094	38.3%	15.6%
$120,094 ~ $155,625	40.7%	18.9%
$155,625 ~ $162,832	44.1%	23.5%
$162,832 ~ $221,708	46.2%	26.4%
$221,708 ~ $227,091	49.8%	31.4%
$227,091+	53.5%	36.5%
Source: Taxtips.ca		

Note that BC residents earning less than $50,197 a year actually get money back from dividends (negative tax bracket) and pay only 1.6% tax up to $86,141 income!

Despite the pain of 2022, the good news is bear markets take an average of 12 months to bottom and we are in month 11. After that, it can take on average two years to recover. We expect investors to be rewarded for enduring this year's wild ride.

Written By Eric

Until next time... Invest Well. Live Well.