2023 PERSPECTIVES

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GICs – a taxing opportunity cost?

A key factor in the resiliency of the consumer has been the accumulation of personal savings. Statistics Canada's National Balance Sheet Accounts data indicated that Canadian households held a total of C$2.06 trillion in currency and deposits at the end of Q1 2023 – a new record. Within these excess savings, there has been a significant spike in fixed-term deposits (i.e., GICs), which currently stand at C$647 billion – also a new record.

Personal deposits at Canadian chartered banks by type

(billions of Canadian dollars)

Source: Guardian Capital based on data from the Bank of Canada to August 2023

While it's sensible for investors to lock in at some of the highest interest rates we've seen in decades (at least for a portion of their portfolio), we believe there are some important points to consider.

For one, there is an adage that while you should not let the "tax tail wag the dog", you should be aware of the tax impact of your investments. High-income earners who hold GICs in non-registered accounts will see half of their returns go to tax. So, while the headline return is attractive, the after-tax return is just keeping up with inflation, at best. Alternatively, shorter-term bonds that are currently being sold at a discount will produce capital gains, which will enhance the after-tax return.

Another consideration is the potential opportunity cost of locking in capital. For this reason, investors may want to consider short-term instruments that don't have lock-in periods so they can quickly take advantage of the prevailing market environment.

For example, while the expectation of "higher for longer" is the consensus view, central banks appear poised to halt or at least slow the series of rate hikes they started in 2022. Should a rate-cutting cycle begin, investors will want the flexibility to shift from short rates to longer-dated bonds (longer-duration bonds), which will likely outperform short-term instruments in this scenario.

And despite the challenges over the last year and a half, equities remain one of the best ways to grow capital over time and protect against inflation. The ability to quickly move out of short-term investments can be a great way to take advantage of equity volatility. For investors with significant cash on the sidelines, utilizing a liquid short-term investment can be an excellent way to "average in" to the market and set up their portfolios for long-term success.

If you would like to learn more about how you can flexibly take advantage of today's attractive short-term rates, please reach out to your Client Portfolio Manager.

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