Canso Corporate Value Fund vs. GICs: A Historical Perspective

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The Argument for GICs

We all know interest rates are very low, but they also seem to be rising. Rising interest rates are negative for bond prices. "In the 'safe' section of my portfolio, I don't want to lose money." Presently, the yield-to-maturity of the Canso Corporate Value Fund ("Fund") is about 2.7%. After fees, it is less. Longer-term investors may ask: "if credit spreads are poised to widen and rates are rising, wouldn't I be better off in a GIC? At least I'll know what my return will be."

History

We looked at GIC yields going back to the inception of the Fund in December 2000. These are available from Statistics Canada[1] and we used 1, 3, and 5-year GIC yields. We then compared those yields with what one would have earned in the following 1, 3, and 5-year periods. This makes sense, as you buy a GIC knowing what the return will be in advance. To make the comparison more valid, we added 1% per annum to the posted GIC rates to allow for smart buying of GICs, as a savvy shopper can usually get a better rate than that provided by the large banks.

In 87% of the 1-year periods from January 1st, 2001 through June of 2018, the Fund outperformed the 1-year GIC, at times by a substantial margin. In other words, if you bought a 1-year GIC every month since January 1st, 2001, you would outperform the subsequent 1-year return of the Fund only 13% of the time. For longer periods, the Fund did even better. It outperformed in 98% of the 3-year periods and 100% of the 5-year periods. The clear winner would appear to be the Fund.

	1-Year	3-Years	5-Years
Frequency of Fund Outperformance	**87%**	**98%**	**100%**

[1] Chartered bank - Guaranteed Investment Certificates: 1 year (v122524), 3 year (v122525), and 5 year (v122526)

Look at this another way. Let's say you had some money to invest. You could pick a GIC, where you knew the return in advance. This would be extremely compelling. Unless the bank defaults, and you are not covered by deposit insurance, you would know with certainty how much you would have at the end of the period.

Alternatively, you could have invested in the Fund. At the time of investment, you wouldn't have known what your return would have been in the future, so it would appear to have been a far more uncertain bet. However, your investment in the Fund in January 2001 would have outperformed an investment in GICs during the same period by June 2018.

More importantly, when the Fund outperformed, it often did so by quite a wide margin. See Chart 1 below.

Chart 1

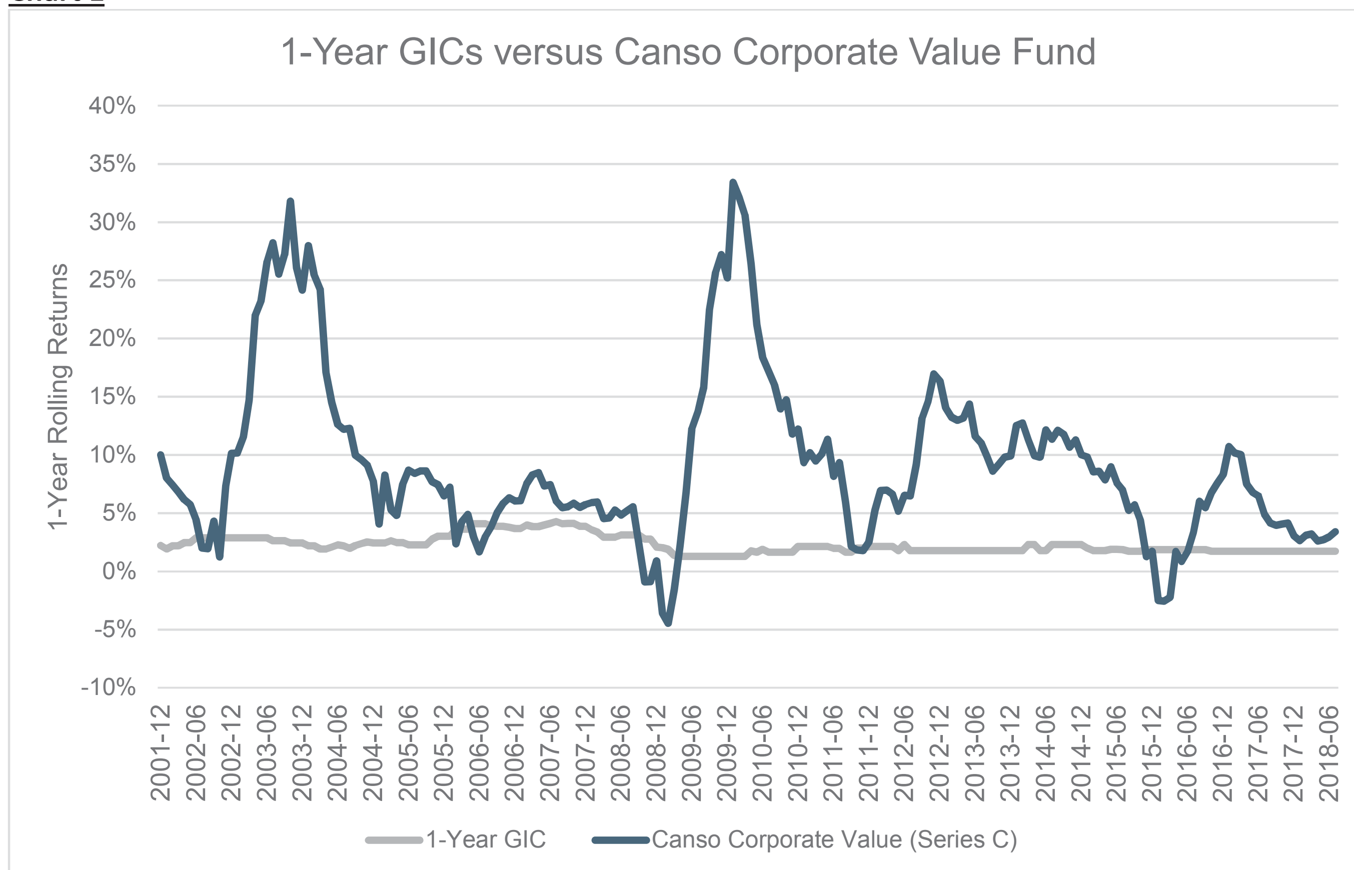

Chart 2

CANSO CORPORATE VALUE (CFM111)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q4	Q2
Yield to Maturity (%)	13.8	13.3	8.8	4.7	5.1	3.9	4.9	8.6	5.9	5.5	7.1	5.2	4.7	4.1	5.2	3.3	3.0	2.7

One might argue we are at an extraordinary time. Credit spreads on high yield bonds are very tight and interest rates are rising. This could be negative for corporate bonds if spreads widen or interest rates rise. But, our view is the portfolio of the Fund is already well positioned for this, with a high-quality bias (67% of the Fund is in bonds rated A or higher) and its duration is only 1.4 years. Also, if you are fortunate enough to have over $100,000 invested in GICs, you have to normally spread your GIC assets among multiple banks to have full deposit insurance. With the Fund, you are already invested across multiple issuers, although this is admittedly not the same as deposit insurance.

There have been other periods when credit spreads have been tight. From 2004 through 2007, high yield spreads were similar to what they are now. As shown in Chart 1, even over that period the Fund outperformed GICs most of the time. The Fund's worst one-year return was -4.5% for the 12-month period ended February 2009; but the 1-year return a year later was 32.1%.

Yield versus Return

Some take the view that the prevailing yield-to-maturity of the Fund of about 2.7% compares unfavourably with prevailing GIC rates. But, yield and return are two different things, as shown by Charts 1 (one-year rolling returns) and Chart 2 (yields). A key assumption of yield-to-maturity is that the bonds are held until maturity, which may be an appropriate assumption for some bond strategies. A key reason for the difference between the returns of the Canso Corporate Value Fund and its yield-to-maturities over time is because Canso actively manages the portfolio, purchasing securities we believe represent good value and replacing bonds in the portfolio that are fully valued or overvalued.

As a seemingly clever option, you could buy a GIC and then switch to the Fund when spreads widen. But, to exit a GIC early normally involves substantial penalties. More importantly, we think it takes courage to buy corporate bonds in an environment when the investment pendulum has shifted from greed to fear. In our view, many investors overestimate their ability to do this.

To Sum Up

- The Fund outperformed GICs most of the time, based on the 1, 3 and 5-year returns during the period from January 1st, 2001 to June 2018;

- The historical record of the Fund shows significant outperformance as compared to GICs, especially over periods longer than one year; and,

- A strategy of tactically switching from GICs to the Fund at what the investor would consider as the "right" moment, would be severely hampered by early redemption penalties on GICs and the difficulty of calling the right time to switch.

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