Fixed Income Investing – Part II
Money Market Investments

The money market offers investors access to short-term debt securities issued by governments, financial institutions, and corporations. With terms of one day to one year, these securities appeal to investors with funds available to place for short periods or who require a high degree of liquidity. Due to their high quality, relatively short term to maturity, and competitive yield, money market investments are an attractive alternative to cash.

**Treasury Bills**

Treasury Bills, or T-bills, are short-term debt obligations issued by the federal and provincial governments, and mature in less than one year. T-bills represent the highest quality short-term investment as they have the full guarantee of the issuing government which is able to raise taxes or, in theory, “print money” to honour their debt obligations. Issued with a maximum term of 12 months, T-bills are purchased at a discount to their maturity (or par) value. The difference between the discounted purchase price and the maturity value is the T-bill’s return. T-bills are used by investors looking for safety of capital and the security of knowing that their investment is highly liquid should they need to sell it prior to maturity.

**Guaranteed Investment Certificates**

Guaranteed Investment Certificates (“GICs”) provide investors with a guaranteed rate of return. They are bought at a par amount and interest is paid either periodically or at maturity, depending on the structure of the GIC purchased. GIC also have the added protection of Canada Deposit Insurance Corporation (“CDIC”) coverage on amounts up to $100,000 (principal and interest combined), for GICs issued by a CDIC member institution with an original maturity of five years or less. Short-term GICs are issued with one-, two-, three-, six-, nine- and 12-month maturities, and cannot be sold prior to their stated maturity date. If your timeframe for a cash requirement is unknown, GICs with a “cashable” feature are available and can be redeemed prior to maturity; however, the interest rate offered on these GICs will be lower than a non-cashable GIC.

**High Interest Savings Accounts**

Since the financial crisis of 2007-08, High Interest Savings Account (“HISA”) investments have become extremely popular due to their competitive interest rates, liquidity, and CDIC guarantee (on amounts up to $100,000 CAD; U.S. dollar deposits are not insured). Withdrawals can be received the day after they are requested and interest is calculated daily and paid out monthly in the form of additional units.

**Banker’s Acceptances**

A Banker’s Acceptance (“BA”) is a bill of exchange or negotiable financial instrument, drawn by a corporate borrower requiring short-term funds. Repayment of the debt is guaranteed (or “accepted”) by the borrower’s bank and is considered an unconditional liability of the issuing bank. Typically, BAs are issued for terms of up to six months, trade at a discount to their redemption value, and can be sold prior to maturity in the secondary market.

Fixed income investments are an important component of a well-diversified and risk-controlled portfolio. This article is the second in a series of articles by the BMO Nesbitt Burns Portfolio Advisory Team, and is intended to help investors better understand the various aspects of fixed income investing and the range of fixed income investments available.
Bearer Deposit Notes

Bearer Deposit Notes (“BDNs”) are similar to Banker’s Acceptances in that they are issued by banks that guarantee the debt; however, unlike a Banker’s Acceptance, a BDN can be issued with a maturity of up to one year. BDNs trade at a discount to their redemption value and can be sold prior to maturity in the secondary market.

Commercial Paper

Commercial Paper (“CP”) is an unsecured (i.e., not backed by collateral), short-term debt instrument issued by major corporations to meet their short-term liabilities. The corporation is restricted to using the CP proceeds to fund current assets or inventories only, and the funds cannot be used to fund fixed assets such as a new plant. CPs are issued with a maximum term of 270 days and like T-bills, trade at a discount to their maturity value. The discount rate will depend on the term to maturity and the credit worthiness of the issuing corporation. Since the secondary market for CP can be limited, investors should be prepared to hold the security until maturity. As shown in Figure 1, the supply of Canadian CP has fallen dramatically since the financial crisis of 2007-08, and coincides with the mainstream introduction of High Interest Savings Account investments into Canada.

Factors influencing short-term rates

The following have an impact on the rate of return of a money market investment:

- All short-term interest rates are influenced by the Bank of Canada’s overnight target rate. As the interest rate is raised or lowered, the yields on money market investments will tend to follow.

- The rates on Banker’s Acceptances, Bearer Deposit Notes, and Commercial Paper are typically tied to the Canadian Deposit Offered Rate, which is the rate at which banks are willing to lend funds to each other for specific terms-to-maturity; this rate is set each day at 10:15am ET.

- The Canadian government bond yield curve impacts the rates of return for investments maturing beyond six months. For example, if the yield curve is relatively steep, the return on a one-year GIC will be higher than that of a one-month GIC, while a flatter yield curve could produce GIC rates much closer, or even equal, between these two terms.

- The credit quality of the debt issuer has a significant bearing on the investment return offered. The major credit rating agencies, such as Dominion Bond Rating Services (“DBRS”), evaluate debt issuers for their short-term ability to repay their obligations; similar to how they rate a debt issuer’s long-term ability to meet their debt liabilities (Figure 2).
**Figure 2 – Dominion Bond Rating Services credit ratings**

<table>
<thead>
<tr>
<th>Long-term rating</th>
<th>Short-term rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>R-1 (high)</td>
</tr>
<tr>
<td>AA</td>
<td>R-1 (mid)</td>
</tr>
<tr>
<td>A</td>
<td>R-1 (low)</td>
</tr>
<tr>
<td>BBB</td>
<td>R-2 (high)</td>
</tr>
<tr>
<td></td>
<td>R-2 (mid)</td>
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<tr>
<td></td>
<td>R-2 (low)</td>
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</tbody>
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**Superior Credit Quality**
Protection is substantial/high.

**Adequate Credit Quality**
More susceptible to adverse changes in financial and economic conditions.

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**Speak to your Investment Advisor**

Whether you’re seeking an alternative to cash, a high degree of liquidity, or asset diversification, the money market offers many investment opportunities.

Please contact your BMO Nesbitt Burns Investment Advisor for more information about the choice of investments and returns currently available in the money market.