

How interest rates affect bond funds

In this newsletter, we regularly discuss anticipated changes in financial markets and their potential impact on investors. One aspect of economic markets that we continually monitor is interest rates, as they can have a significant effect on the returns of bond funds in your portfolios.

What's happening with interest rates?

The Bank of Canada policy interest rate was at 2.00% at the beginning of 2020. As COVID hit the financial markets, the Bank of Canada dropped the rate rapidly in March, as a quantitative easing measure to help support the economy. The rate reached a low of 0.25%, where it remains in May 2021.

The interest rates can't go much lower, and the Bank of Canada expects a rate hike potentially as early as the second half of 2022: this means we are facing a period of rising interest rates in the coming years.

Rising interest rates create low or negative bond fund returns

During periods of rising interest rates, the value of currently-held bonds declines, resulting in a lower or negative rate of return on these types of funds. This can come as a shock to investors who have been accustomed to steady positive returns on bond funds in recent years.



This decline in value will have a noticeable impact on investors who hold a conservative market-based fund such as a Conservative or Moderate Asset Allocation Fund, a Retirement Date Fund approaching its year of maturity, or bond/fixed income funds.

The challenge for retiring members

If interest rates go up, members who are soon to retire and start drawing income could be at risk of realizing investment losses at the time of withdrawal, if they take their withdrawals from funds holding high bond content.

As always, we suggest that members review their portfolio on a periodic basis to ensure it is well-positioned to withstand potential changes in interest rates, market conditions and volatility.

However, we do urge members who are closer to retirement to review on a more frequent basis, with the assistance of one of our licensed investment representatives — particularly if you are a conservative investor, as you may hold a higher-than-average proportion of bonds in your investment mix.

To discuss your retirement portfolio and investment strategy, contact Reuter Benefits by phone at 1-800-666-0142 or by email at retire@reuterbenefits.com.