Putting cash to work

Fixed Income ETFs with more earning potential

Oct 14, 2020

Ways to invest excess cash

Today, most bank accounts offer minimal interest. Comparable alternatives, such as money market funds and GICs, hardly keep up with inflation. This means that the purchasing power from cash and cash equivalents can diminish over time.

If an investor holds excess cash, she may want to consider investing it to earn a higher income. However, there is no one-size-fits-all solution. The investor needs to determine what is most suitable for her individual needs. We suggest segmenting cash needs into short, medium and longer-term needs, based on how soon she will need access to cash. This helps determine her risk tolerance. As a general rule, the sooner the investor needs to use the cash, the less risk she may want to take on with an investment.

In **Table 1**, we provide detailed descriptions, objectives, and recommended investment types for each cash segment. We also give examples of ETFs that may be suitable within each cash segment.

Table 1 - Cash segmentation & ETF solutions

Time Horizon	Short-term (3-6 months)		Medium-term (6-18 months)		Longer-term (18 months and beyond)	
Typical Use	Short-term expenses and emergency funds		Larger future purchases or unexpected expenses		Longer-term savings	
Cash Objective	Stability with incremental income		Incremental income with low risk		Income generation or income growth with some risk	
Investment Type	Ultra-short duration bonds and cash alternatives		Short duration bonds		Short duration corporate bonds	
	Potential ETF solutions					
ETF Ticker	CMR[1]	XFR	XSTB	XSB	RCDB	XSH
ETF Name	iShares Premium Money Market ETF	iShares Floating Rate Index ETF	iShares ESG Canadian Short Term Bond Index ETF	iShares Core Canadian Short Term Bond Index ETF	RBC Canadian Discount Bond ETF	iShares Core Canadian Short Term Corporate Bond Index ETF
Description	Exposure to high-quality short-term debt securities to help meet current income and liquidity needs	Exposure to Canadian floating rate bonds, whose interest payments adjust to reflect changes in interest rates	Exposure to short term Canadian government and corporate bonds emphasizing issuers that have positive environmental, social, and governance characteristics	Low cost, broad exposure to Canadian investment grade bonds with maturities ranging from 1 to 5 years	A diversified portfolio of Canadian government and corporate bonds that are purchased below the weighted average price of the universe of Canadian short term bonds	Low-cost portfolio of short term, investment grade Canadian corporate bonds, which generally pay higher interest than government bonds
Yield to Maturity	0.26%	0.30%	0.59%	0.63%	0.88%	1.20%
Duration	0.24 yrs	0.20 yrs	2.83 yrs	2.89 yrs	2.78 yrs	2.94 yrs
MER	0.28%	0.22%	0.20%	0.10%	0.17%	0.10%

Source: BlackRock, as of Oct 2, 2020. Yield to Maturity is gross of fund fees. The MER is as reported in its most recent MRFP.

[1] The money market ETF CMR's current yield is 0.0%.

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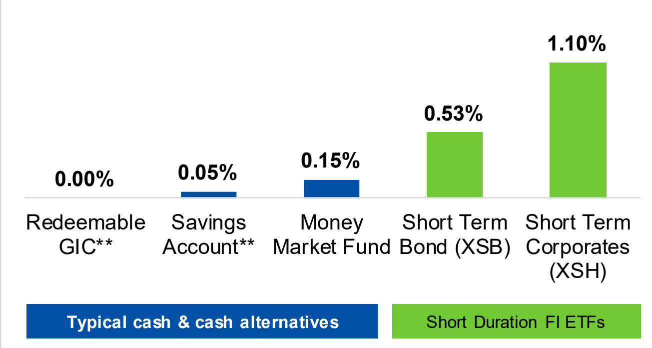
Putting cash to work with RBC iShares ETFs

Global bond yields have declined sharply as COVID-19 has caused economic uncertainty. The U.S. 10-year government bond yield fell from nearly 1.92% at the beginning of the year to an all-time low of just 0.31% in early March, and is currently yielding 0.75%[2]. We expect that the hangover in economic activity due to the virus will continue for some time. As a result, bond yields should stay near their recent lows as unemployment remains high, inflation low and central banks accommodative.[3]

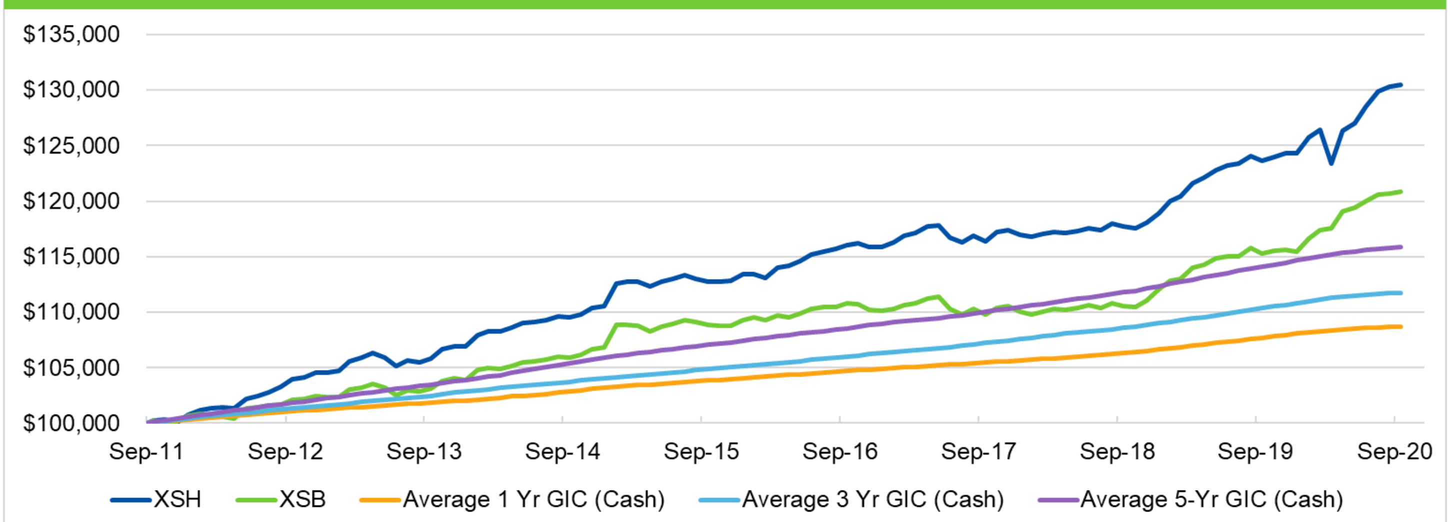
Chart 1 - Yield-to-maturity (net of fund fees)*



In this new era of low interest rates, typical saving accounts, GICs, and ultra-short duration fixed income instruments generate low, net-of-fee returns. Investors thus need to bear additional risks to earn incremental yields.

Given that current low interest rates are not expected to change in the near future, we believe that short duration fixed income ETFs can help earn more income with moderate, incremental risks. The charts highlights ETFs such as **XSB** and **XSH**, which could provide a palatable alternative to holding cash alone. Chart 1 compares XSB and XSH's net-of-fee yields with saving accounts and other cash alternatives. In Chart 2, we show that the longer the time horizon, the greater the yield. Thus, investors can potentially earn higher returns with these short duration fixed income ETFs.

Chart 2 – Total return performance for an $100,000 investment



Source: BlackRock, Morningstar Direct. Data between Sep 13, 2011 (ETFs' common inception) and Sep 30, 2020.

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[2] As of Oct 2, 2020.
[3] Source: RBC GAM Global Investment Outlook Summer 2020
*Source: BlackRock, RBC GAM as of Oct 2, 2020.
**Based on available products at RBC. Money market fund: RBC Canadian Money Market Fund F Series 7-day average net yield.

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Table 2 – Standard performance

Ticker	Name	Inception	YTD (%)	1Y (%)	Annualized 3Y (%)	Annualized 5Y (%)	Annualized 10Y (%)	Annual. Since Incept.(%)
CMR	iShares Premium Money Market ETF	Feb 19, 2008	0.48	0.87	1.21	0.91	0.83	0.90
XFR	iShares Floating Rate Index ETF	Dec 06, 2011	0.95	1.53	1.61	1.40	-	1.34
XSTB	iShares ESG Canadian Short Term Bond Index ETF	Mar 18, 2019	4.54	4.67	-	-	-	3.94
XSB	iShares Core Canadian Short Term Bond Index ETF	Nov 20, 2000	4.69	4.83	3.27	2.12	2.26	3.98
XSH	iShares Core Canadian Short Term Corporate Bond Index ETF	Sep 13, 2011	5.02	5.55	3.90	2.97	-	2.99
RCDB	RBC Canadian Discount Bond ETF	Jun 12, 2019	4.66	4.91	-	-	-	4.09

Source: BlackRock; Data as of Sep 30, 2020; Past performance is not a guarantee of future results.

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