CIBC ASSET MANAGEMENT

GUIDE TO PORTFOLIO CONSTRUCTION

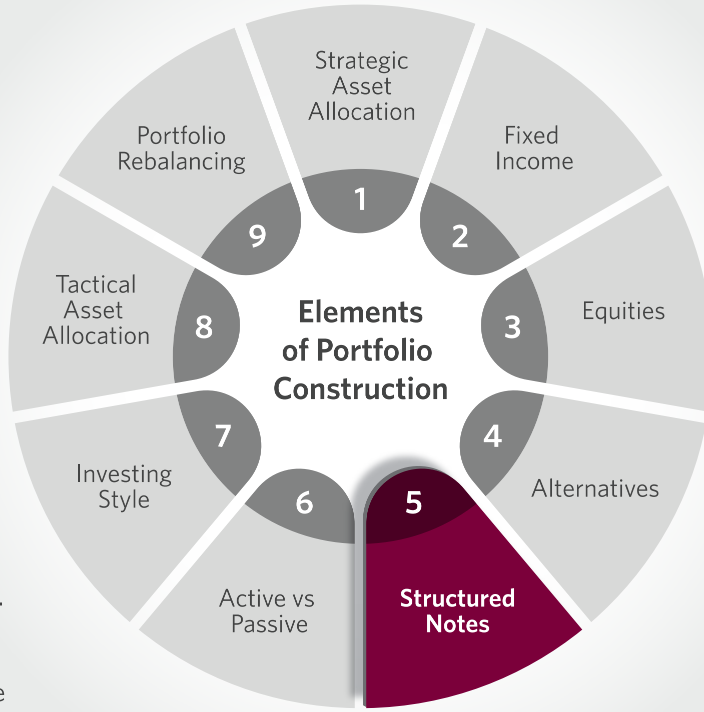
The role of Market Linked GICs

Guide to portfolio construction

Market and economic uncertainty, combined with relatively low expected returns for many asset classes, are making it harder for individuals and institutions to reach their financial goals. A thoughtfully designed portfolio that helps you embrace market opportunities while preparing for the unexpected has never been more important.

There are several components of a well-constructed portfolio, including a robust strategic asset allocation that's consistent with your long-term goals and objectives. A mix of asset classes such as equities, fixed income and alternatives, and strategies such as tactical asset allocation, active versus passive investing, and portfolio rebalancing all have a role to play.

This guide highlights how Market Linked GICs (a type of Structured Note) can help improve portfolio performance and smooth the path to achieving your ambitions.



Market Linked GICs—Participate in the markets while managing downside risk.

In spring 2020, equity markets experienced sharp losses as they responded to the reality of the COVID-19 pandemic. Although many markets soon recovered, an increased level of volatility has remained. The resulting market events encouraged investors to focus on effective strategies to manage downside risk. Market Linked GICs (MLGICs) are one option to help protect portfolios, while also allowing investors to participate in market price increases.

Explore this guide to learn more about Market Linked GICs:

1. Comparing GICs and MLGICs
2. Where to put cash when rates are low
3. Opportunity for downside protection
4. MLGICs vs equities

Comparing GICs and Market Linked GICs

Guaranteed Investment Certificates (GICs) are safe and secure investments that earn a guaranteed return for a fixed term and can't be redeemed until the end of the term. The rate of return is higher than a deposit account—this compensates for the liquidity investors sacrifice for the term of the GIC.

Like GICs, **Market Linked GICs (MLGICs)** are designed to preserve capital. However, in contrast to a GIC, MLGICs don't guarantee a fixed rate of return and instead offer participation in the realized gains of an underlying equity or bond market.[1] MLGICs have fixed investment terms that are typically two, three or five years, and are eligible for Canada Deposit Insurance Corporate (CDIC) Insurance.[2]

An investor won't know the total return of a MLGIC until the end of its term. It could be more or less than a traditional GIC over the same period, depending on the performance of the underlying linked assets (see Figure 1). When financial market returns are negative, an investor receives only the original principal amount invested with an MLGIC. In this case, GICs, with their guaranteed return, will outperform MLGICs. Over the long term, however, MLGICs are expected to outperform GICs, reflecting the higher expected returns of equities and bonds.

Why Market Linked GICs?

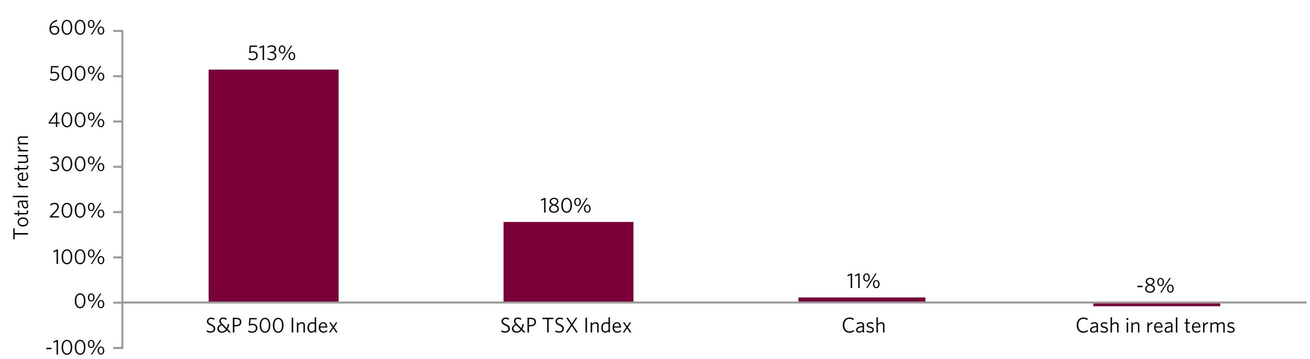
Like a traditional GIC, **100% repayment of your principal is always guaranteed at maturity**, regardless of any down market movement. But if the market goes up, you have the **potential to outperform** traditional GICs.

Where to put cash when rates are low

Since March 2009, cash has returned a cumulative 11% in nominal terms, but lost 8% of its real purchasing power due to inflation. For example, an initial cash deposit of $1,000 in March 2009 increased to $1,110 by the end of 2019. A similar investment in Canadian and U.S. equities would have increased to $2,800 and $6,130, respectively, over the same period (Figure 1).

By reallocating cash holdings to MLGICs, investors can gain some exposure to equities without sacrificing principal protection. In this way, investors can potentially improve expected returns from their cash holdings and therefore improve expected overall portfolio returns.

Figure 1 – Returns to cash and equities since March 2009



Source: CIBC Asset Management Inc., Bloomberg. Sample as of March 2009 – September 2020.

[1] The gains are capped and exclude dividends. Some MLGICs have historically offered a minimum guaranteed coupon.

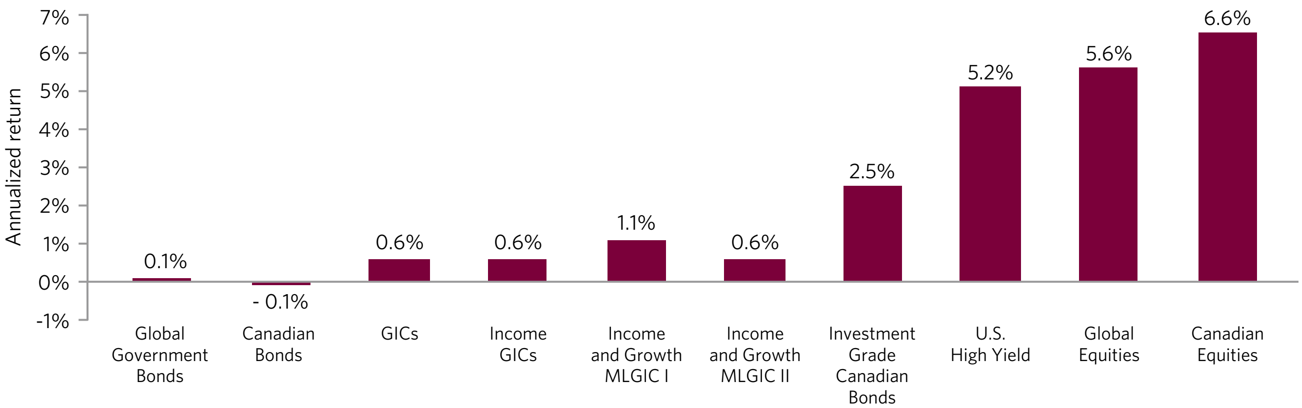
[2] Canadian dollar denominated market linked GICs are eligible for CDIC insurance, subject to CDIC rules and regulations. CIBC also offers CDIC-insured U.S. dollar MLGICs. Canadian Imperial Bank of Commerce is a member of CDIC. Visit www.cdic.ca or call 1 800 461-CDIC (2342) for details.

Opportunity for downside protection

MLGICs can also be used to protect capital in the event of an equity market correction, while providing upside potential if equities rise. This downside principal protection is similar to that traditionally expected from a core fixed income investment. Given the current low level of interest rates, the ability of core fixed income to protect is muted. This is encouraging some investors to turn to MLGICs.

CIBC Asset Management's 10-year annual expected returns for Canadian and global government bonds are 0.11% and -0.1%, respectively (Figure 2). This compares to 0.6% to 1.1% for MLGICs, indicating the potential to add value by reallocating at least some capital from government bonds to MLGICs.

Figure 2 – Expected long-term asset class returns (%, CAD)



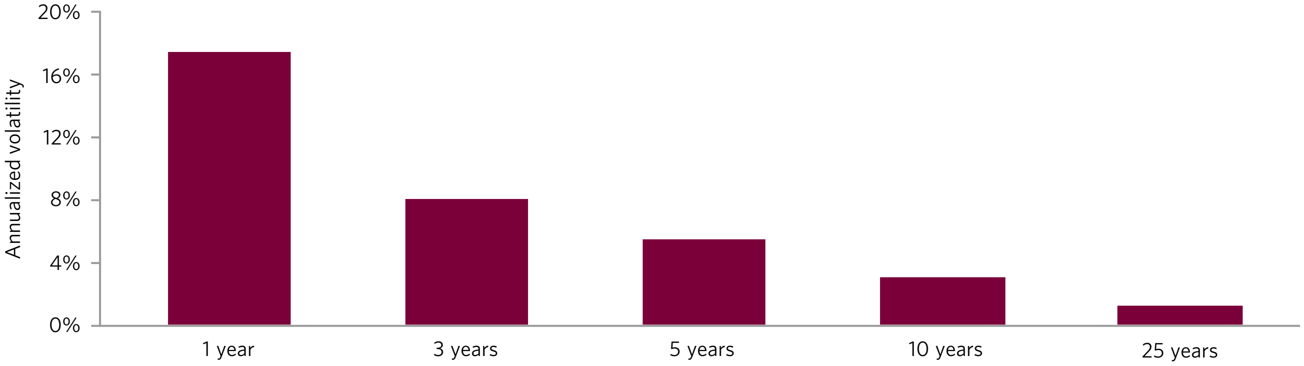
Source: CIBC Asset Management Inc. Returns reported in CAD terms. As at April 1, 2020.

MLGICs vs equities

For relatively conservative investors with shorter-term horizons and a focus on returns: Consider MLGICs

MLGICs can be an attractive substitute for a majority of existing cash holdings, allowing some participation in the expected annualized returns of the linked asset classes. Additionally, for investors focused on capital preservation, MLGICs can provide downside protection in volatile equity markets. This is a bigger consideration for shorter investment horizons, where volatility is greatest (Figure 3).

Figure 3 – Canadian equity (S&P TSX Composite Index) volatility over 1-, 3-, 5-, 10- and 25-year periods



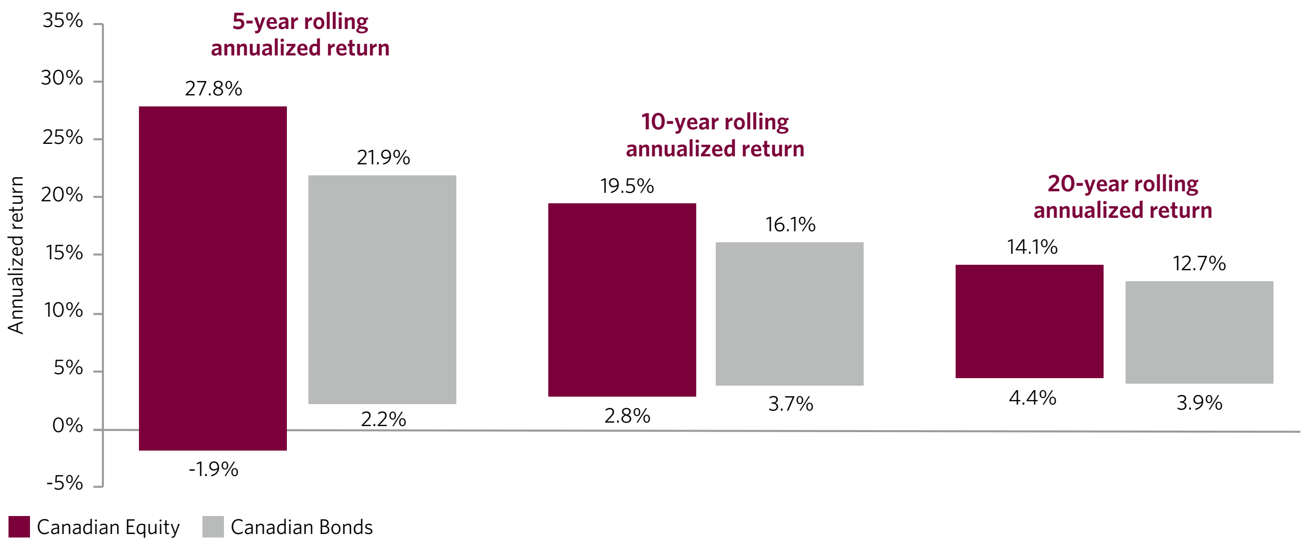
Source: CIBC Asset Management Inc., Bloomberg. Data as at September 2020.

MLGICs can address the needs of risk-averse investors with short to medium time horizons. Reallocating from equity holdings to MLGICs may bring greater peace of mind when markets become volatile. However, it comes at the cost of a reduced expected return relative to long-term investors with greater risk tolerance. An allocation to MLGICs should typically be small and tactical, not a key component of longer-term strategic investing.

For investors focused on longer-term capital appreciation: Consider equities

For investors focused upon longer-term capital growth, a direct allocation to equities has historically represented the cornerstone of portfolios. This can be complemented by a smaller safety-oriented asset allocation to bonds and MLGICs. This approach provides the opportunity to participate in any potential equity market upside, along with some principal protection to provide comfort against shorter-term equity volatility (Figure 4).

Figure 4 – Probability of negative returns across asset classes declines as investment horizon lengthens



Source: CIBC Asset Management Inc., Bloomberg 1950-2019. Canadian Equities and Canadian Bonds represented by S&P TSX Composite Index and FTSE FTSE TMX Bond Universe, respectively.

Key MLGIC considerations:

- Incorporating MLGICs into the safety-oriented allocation of your portfolio may help enhance your overall portfolio diversification, and lower your risk while increasing your return potential.
- MLGICs combine the security of traditional GICs with the potential to earn a higher market-linked return.
- As always, an appropriate mix of investment solutions, in a portfolio that reflects your life stage and investment objectives, can help you achieve your goals.

Let’s partner on your portfolio construction

Changing market conditions don’t change your goals, whether it’s saving for a home, a child’s education or investing for retirement. Careful portfolio construction that helps you embrace market opportunities while preparing for the unexpected has never been more important.

Your CIBC advisor can help you develop a targeted investment approach using the multi-asset solutions that work best for you.

Contact us today to tailor your portfolio and help you get where you want to be.

To learn more, contact your CIBC advisor.

All information in this document is as of September 1, 2020 unless otherwise indicated and is subject to change.

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