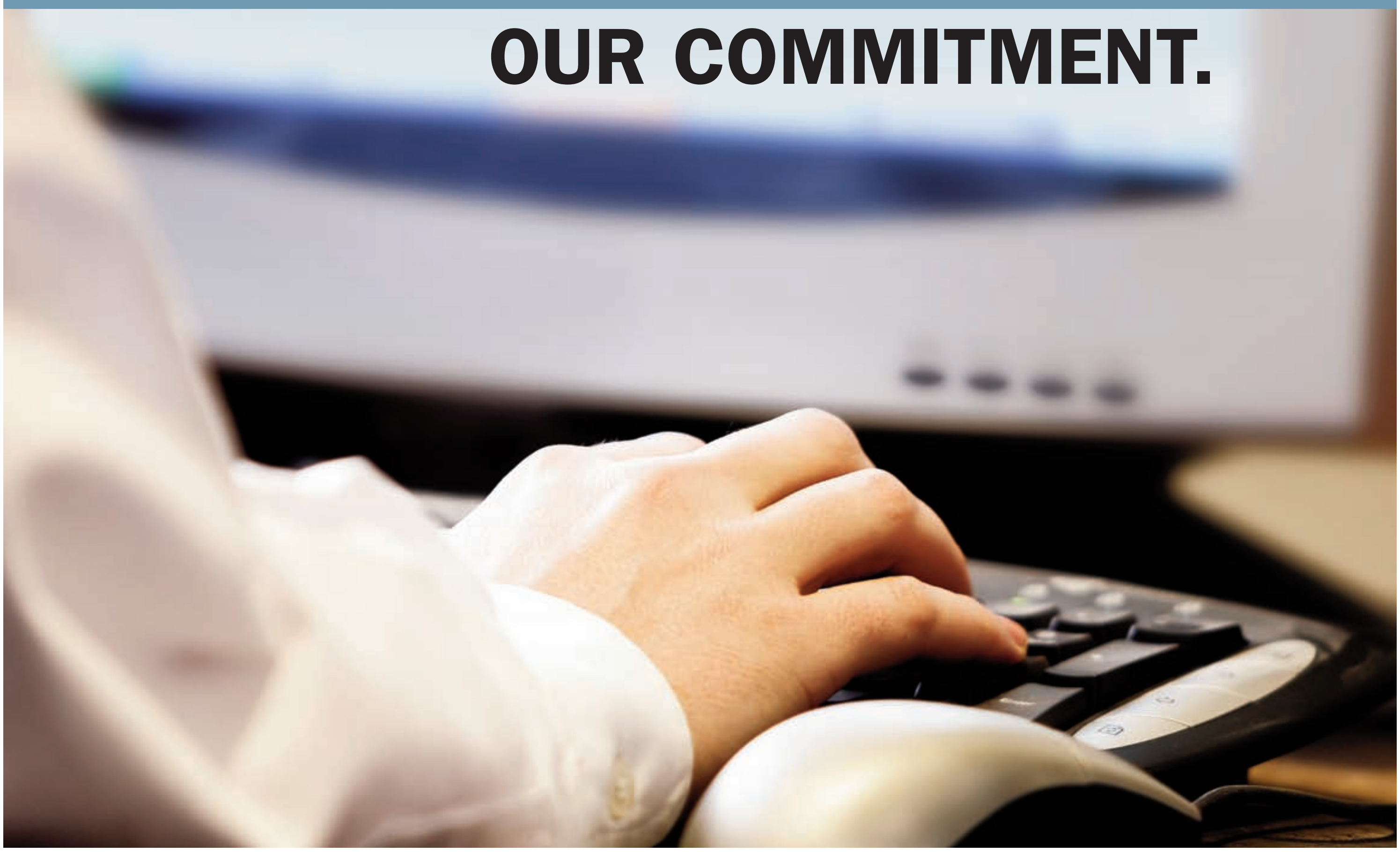
INTRODUCTION TO FIXED INCOME

YOUR KNOWLEDGE.

OUR COMMITMENT.



CANACCORD Wealth Management

Fixed Income products, such as bonds, are an important part of many people's investment portfolios. Whether they are used as a complementary component to other investment strategies, or as a single investment tool, they provide clients with an established rate of return and better predictability than other investment solutions.

Many clients have questions about how fixed income products work. The information on the following pages provides you with answers to common questions about fixed income products.

We hope you find this information helpful.

As with all investing decisions, we recommend you discuss fixed income investment opportunities with your Canaccord Advisor to ensure they suited appropriately for your complete Wealth Strategy.

FIXED INCOME

Both governments and companies can issue bonds to borrow money. As with a regular loan, the people lending the money expect to be paid interest (the coupon), and the monies must be repaid in a specific period of time (the maturity date).

BOND ISSUERS:

Bonds can be issued from a wide variety of sources, such as governments, banks and corporations. As such, they also come with vastly different credit ratings and associated credit risk. The following are some of the different bond issuers:

Government of Canada:
The Federal Government is the largest and most frequent issuer of debt. They hold quarterly refundings for maturities ranging from 2-30 years. The minimum denomination is $1000 and they trade in increments of 1000. As these bonds are direct obligations of the Federal Government, they carry the highest credit rating - AAA.

Canada Housing Trust (CHT) / Government Agencies:
These bonds are issued by CMHC (Canada Mortgage and Housing Corporation) and are guaranteed by the Federal Government. They are rated AAA. CHT bonds trade in increments of 1000 and are issued generally, in maturities of 5 and 10 years. There are also other government agencies that issue debt on an ad hoc basis such as Export Development Company (EDC).

Provincial and Municipal Bonds:
Each Province in Canada has the ability to issue bonds, and does so, depending on their financing needs. Ontario and Quebec are the most frequent issuers. All Provincial bonds trade in increments of 1000 and are issued in maturities ranging from 2 to 30 years. The credit rating of the bonds depends on the individual Province and range from A to AAA.

Municipalities and Cities can also issue bonds when they need financing. As well, there are "collectives" such as MFABC (British Columbia Municipal Financing Authority) that will borrow on behalf of cities.

Corporate Bonds:
These bonds are issued by companies as a way of obtaining financing. Companies can also issue common shares, preferred shares and bonds. The bonds can range in maturities from 2 to 30 years and trade in increments of 1000. Each bond will carry the credit rating assigned to it by the various rating agencies.

Coupons and Residuals:
These issues are created by "stripping" the various components of a bond. The coupons and the residual (the lump sum at the end of the contract that matures at par) are all sold separately. These are the only issues that can trade in increments less than par. The coupons and the residual carry the credit rating of the various issuers.

Money Market:
Bonds are typically defined as having a maturity greater than 1 year at issuance and make interest payments, whereas money market instruments are less than one year and trade at a discount to maturity. Bonds are purchased at a price below 100 and mature at $100 (par). The yield of a money market instrument is calculated as follows: Yield = ((face value-price)/ face value) x (360 – days to maturity) x 100%

The following are some types of money market instruments:

Canada Treasury Bills:
These are direct obligations of the Government of Canada. They are rated AAA and are the most liquid of money market debt. They trade in increments of 1000 and are generally issued with maturities ranging from one month to one year.

Bankers Acceptance and BDNs:
BAs are issued by banks. They are actually loans that the bank has stamped with their guarantee and resold into the market. They carry the rating of the issuing bank and trade in denominations of 1000.

BDNs are bank deposit notes. They are issued by the bank's Treasury Department as a method of short term funding. They carry the rating of the issuing bank and trade in denominations of 1000.

Commercial Paper:
CP is issued by individual companies for short term funding. The rating is determined by the rating agency and may differ from the bond rating. CP trades in increments of 1000. Investments in CP require careful consideration because repayment at maturity is dependant on the company having the cash flow or ability to re-issue. The company itself should also be considered over and above the rating.

FREQUENTLY ASKED QUESTIONS

Below are some of the more commonly asked questions about fixed income products. Your Canaccord Advisor is available to answer any additional questions you may have.

Will I get all of my money back if I sell my bond before maturity?

That depends on factors such as the coupon rate of the bond, the prevailing interest rate, the term left to maturity and the current credit rating of the issuer. You could get more than face value if the coupon rate is significantly higher than current rates for similar securities.

Why do bonds trade for less than face value?

Let's assume a $1,000 Government of Canada Bond is paying an interest or coupon rate of 3% with 10 years left to maturity. That means the income per year is $30. If other bonds are available with an interest rate of 5%, this one could seem less desirable. So market pressure forces a price cut, perhaps to $900, which looks like a good discount. But if you average out that $100 capital gain which a buyer would make when it is cashed in 10 years later, it only comes to $10 a year. Add that to the $30 interest and the total return is $40 per year. Taken as a percentage of the discounted price, this return is only 4.5%. Clearly, if the dealer wants to sell this bond, the discount will have to be more.

However, if the bond had only five years to run, the picture changes. Now that same $100 capital gain (assuming the bond is sold for the same discount) is equal to $20 a year. That makes for a $50 per year return at the 3% interest rate. $50 as a percentage of $900 equates to about 5.6% which now makes the bond more attractive.

How are capital gains made on bonds?

Besides making money by collecting interest on a bond, you can also make a capital gain on a bond. Bonds are often sold for less than face value. If you buy one at a discount from face value and hold it to maturity you will make a capital gain when you cash it in. You will also make a capital gain if you buy your bond at par (face value) then sell it for more, which is called selling at a premium. But you can also take a capital loss if you sell the bond for less than what you paid for it.

How do I know if a bond is suitable?

There are many factors to consider.

The credit rating will help you determine if the bond meets the criterion of "investment grade". The typical guideline for investment grade is anything rated BBB or higher. Liquidity, or the ability to sell the bond in a reasonable amount of time, is also important. There are several factors that impact liquidity including the coupon and the term to maturity. The higher the coupon and the longer the maturity the less liquid the bond will be. This is especially true with corporate issues.

Of course, the most important factor is the client's investment criteria. Since bonds are available with many different levels of risk, there is a fixed income product that is best suited to meet their individual needs.

What are GICs (Guaranteed Investment Certificates)?

Technically, GICs are not considered bonds.

GICs are issued to investors by financial institutions such as banks, trust companies and credit unions for fixed periods of time at fixed rates of interest. These GICs are backed by the assets of the institution and are insured by the Canadian Deposit Insurance Corporation (CDIC), a federal government Crown Corporation. GICs are insured by the CDIC up to $100,000 per beneficial account. Your Canaccord Advisor can provide you with further information on how this insurance program works. The most frequent term of GICs is one to five years. Canaccord maintains distribution relationships with a number of financial institutions so that we can provide you with GIC's from a variety of different issuers. With access to a number of GIC issuers Canaccord Advisors can actively sample the market prior to making a specific recommendation to you.

Most GICs do not offer any option for liquidity, which means an investor is locked into the investment until maturity. For investors with a portfolio of investments spread over a variety of different investments and terms. This lack of liquidity may not be an issue, but it is worth considering should the need for liquidity be a priority.

What are Structured Notes or Principal Protected Notes (PPNs)?

These are not considered fixed income instruments with respect to trading. Structured notes have many complicated variables and are best discussed with your Canaccord Advisor.

FIXED INCOME DEFINITIONS

Learning about fixed income products can be challenging, often the result of the terminology used to describe their creation and terms. Below are definitions of many of the commonly used words associated with fixed income products.

Accrued Interest: The interest accumulated on a bond or debenture since the last interest payment date.

Ask: The lowest price at which someone is willing to sell a security. This is the price where you would be willing to BUY a bond.

Basis Point: One hundredth of a percentage point. It is also used to describe differences in bond yields. For example: if one bond has a yield of 4.00% and other has a yield of 4.25% the difference between the two is 25 basis points (bps).

Bid: The highest price a person is willing to pay for a security. This is the price where you would be willing to SELL a bond.

Business Day: The days when most corporate and government offices are open for business, usually any day except Saturday, Sunday and legal holidays.

Callable: Securities that can be redeemed at the issuers' request. Issuers may reserve the right to pay off a bond before maturity to take advantage of lower interest rates.

Compound Interest: Interest earned on an investment at periodic intervals and added to the original amount of the investment. Future interest payments are then calculated and paid at the original rate on the new increased total. Interest on interest.

Coupon: This typically represents the six month interest payment on the face value of the bond.

Current Yield: The annual income from an investment stated as a percentage of the current value. This is calculated by dividing yearly interest by current price. For example: if the income is $50 per year on a $1000 face the current yield is 5%.

Debenture: A note issued by a company or government secured only by the general credit of the issuer, not by property or assets.

Debt: Money borrowed for general use. The issuer pays interest on the loan and is obligated to repay the principal on a fixed date.

Default: A bond is in default when the issuer fails to meet the obligations of the note. Examples would be failure to pay interest or to redeem the bonds at maturity.

Discount: The amount at which at bond sells below its par value.

Extendible Bond or Debenture: An issue with a fixed maturity date, but the holder has the option to extend the maturity date by a specified number of years.

Face Value: The amount that the issuer pays on maturity. Face value is not an indication of market value.

Income Bond: This bond will repay the principal but only pay interest when the company earns a certain amount of money.

Liquidity: This refers to how easily large blocks of bonds can be traded without a significant change in price. This is probably one of the most important characteristics of a market.

Long Bond: A bond that has a maturity date greater than 10 years.

Market Price: The most recent price of a security.

Maturity: The date at which a bond is paid off.

Money Market: The short term part of the fixed income market. Generally this market is for securities with a term to maturity of less than two years. It includes Treasury bills, BAs and commercial paper.

Mortgage Backed Securities: Similar to a bond but backed by a pool of mortgages.

Nominal Interest Rate: The stated interest rate which does not take inflation into consideration.

Offer: Is the same as "ask". It is the side of the market where you would be willing to buy a bond.

Par Value: The stated face value of a bond.

Premium: The part of the bond that is in excess of face value or market price.

Return: The income earned or a capital gain made on an investment.

Senior Bond Issue: A corporate bond issue which has priority over other bonds as to its claim on the company's assets and earnings.

Senior Debt: This issue ranks ahead of other issues in terms of claims on assets in the event of any issuer break up.

Settlement Date: This is the day that the purchaser must remit payment for their securities and the seller must deliver the securities.

Short Bond: A bond that matures within 3 years.

Spread: The difference between the bid and ask price.

Subject: A bid or offer indicated for a security that does not commit the market maker to that specific price.

Transaction Date: The date on which a purchase or sale of a security takes place.

Yield: The return of an investment shown as a percentage.

Yield to Maturity: The rate of return an investor receives if a bond is held to maturity.

Canaccord Wealth Management professionals work to safeguard your investments and preserve capital through strict adherence to investment guidelines. The result is sound portfolio performance with a vigilant eye on controlling risk.

For more information about fixed income products, or to discuss appropriate fixed income solutions for your wealth strategy, please contact your Canaccord Advisor.