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## An alternative income play to bonds

*The Financial Post takes a weekly look at tools and strategies that will help make your investment decisions. This week: **floating-rate funds.***

Rising yields this year have sparked one of the biggest shifts out of bond funds since the financial crisis, which has left investors scrambling for alternative forms of income.

It's no surprise then that the popularity of floating-rate income funds is also on the rise. As their name suggests, such funds invest in floating-rate bonds, which tend to do better in rising-rate environments.

Standard fixed-rate income plays often lose their value when yields rise, because investors seek out new issues with higher rates. Floating rate bonds, on the other, tend to hold their value better because their interest rate "floats," or moves, with the market.

Floating-rate funds are relatively new in Canada - the first one was the Horizons AlphaPro Floating Rate Bond ETF launched in 2010 - but there are now 10 income funds and ETFs available, with roughly half being launched this year.

CIBC Asset Management last week added the latest offering with the Renaissance Floating Rate Income Fund. Steve Geist, managing director and president of CIBC Asset Management, said the decision to launch the fund was due to investor demand in light of the recent bond yield spikes. He adds that preliminary sales figures show demand was quite strong.

"We thought this product was perfect for the current market environment because it gives clients a chance to diversify their fixed-income holdings without having to get out of fixed income," he said. "If they hold a portion of this, it protects them against rising rates."

CIBC Asset Management partnered with Los Angeles-based investment advisor Ares Management to manage the fund, which invests primarily in corporate bank loans in the U.S., all of which are floating rate.

Of course, investing in floating-rate funds does carry risk. Part of their current appeal is because the U.S. economy is expected to continue growing, which will result in tapering of the considerable monetary stimulus the Federal Reserve is currently pumping into the market. The first hint of tapering came during a Fed announcement on May 22, which led to a spike in bond yields over the next several months.

But if surprise economic shocks cause the global economy to cool again, and interest rates subsequently fall, floating-rate funds usually underperform.

For instance, after the Horizons floating-rate ETF launched in December 2010, it fell below its net asset value of \$10 per unit for the following year as bond yields moved to new record lows. However, given the recent rise of bond yields this year, the ETF has been performing well.

Mr. Geist says even if yields do move downward in the near term, interest rate hikes in both Canada and the U.S. are at most a couple of years away, meaning investors should make sure they're positioned now for the inevitable.