

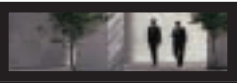


FIXED-INCOME SECURITIES

Safe, attractive
returns



**NATIONAL
BANK
FINANCIAL**



Discover them!

Not everyone is aware that today's financial markets offer a whole group of securities with three very attractive features:

- *they're safe,*
- *they offer a high yield,*
- *and they can be purchased without fees or commissions.*

If you're disappointed with the returns you are currently earning, you'll want to know more about fixed-income securities.

This brochure contains the information you need.



Securing your future

Most investors take a fairly cautious approach to managing their savings.

Because of habit more than anything else, they generally fall back on guaranteed deposits, if not the good old savings account. The return may be nothing to write home about, but at least it's guaranteed.

In fact, safe investments such as these are part of a large *family* of investments known as **fixed-income securities**. All of them guarantee a fixed rate of return and repayment of the capital on a predetermined date. However, some fixed-income securities offer extra advantages that conventional deposits do not.

This document explains the full range of these safe, guaranteed investment vehicles. For additional information, please contact your National Bank Financial Investment Advisor.

A debt to you

In a way, a fixed-income security is like an I.O.U. given to you by the issuer.

It's the same principle that governs regular bank deposits: in return for the use of your money, the institution that issues the security promises to pay you interest and return your capital on a predetermined date.

The concept is not unlike rent. You give a financial establishment free use of your capital, and it pays you "rent" on your money in the form of interest. Depending on the type of securities you purchase, that interest may be regular or compound, or a combination of the two.

Aside from banks and trust companies that offer the certificates of deposit and GICs (guaranteed investment certificates) with which most people are familiar, a number of other institutions issue fixed-income securities to finance their operations. Major issuers include the federal, provincial and municipal governments, Crown corporations and public-sector companies.

Some private-sector corporations also issue these types of securities, although the quality of the accompanying guarantee is not in the same league as those just named. That's why this brochure focuses primarily on government-issued securities.

Securities issued by Canadian governments or their related corporations are unanimously considered to be the safest on the Canadian financial market because of the governments' exclusive power to levy taxes. These securities are guaranteed **directly and without limit** by the governments. Compare this to the traditional guarantee provided by deposit insurance, which only covers up to a maximum of \$60,000 per issuing institution, and is only **indirectly** backed by the government.

Keep your options open

When you're thinking of purchasing fixed-income securities, there's an important factor to be considered.

Some securities, once purchased, can be *redeemed* at any time by the issuer upon the bearer's request; others may be *resold* on the secondary market (a very active and liquid market) before maturity. Still others may *not* be traded or redeemed under any circumstances: you must hold them to maturity.

The *liquidity* of your investment, i.e. how easily you can convert it back into cash, is a key aspect to consider when choosing a fixed-income security.

Illiquid securities confine you to a fixed maturity date and predetermined yield. Liquid securities allow you to review your investment strategy at any time, so that you can take advantage of new opportunities, adjust to changing market conditions, or have access to your cash if an unexpected need arises.

The following table shows a partial list of the main types of fixed-income securities available.

Most common fixed-income securities

Fixed-income securities that are redeemed by the issuer upon your demand

- Demand deposits
- Canada Savings Bonds
- Provincial government savings bonds

Fixed-income securities that may be resold at any time on the secondary market

- Treasury Bills
- Federal and provincial government bonds
- Retirement savings bonds
- Municipal bonds
- Stripped coupons and bonds
- NHA mortgage-backed securities
- Corporate bonds

Fixed-income securities that may not be negotiated or redeemed before maturity

- Guaranteed investment certificates (GICs)

Guarantee, flexibility and return

Guarantee

The main advantage common to all fixed-income securities is the degree of protection they offer you. Generally speaking, both the value of your investment at maturity and your overall rate of return are guaranteed.

Government securities offer the additional advantage of an *unconditional, unlimited* guarantee. You don't have to worry about the \$60,000 limit imposed by deposit insurance coverage, because you get direct, unlimited coverage from the issuing government.

Flexibility

Fixed-income securities are a particularly flexible type of investment that can be easily adapted to your requirements and investor profile. A large number of new securities are issued regularly with a full range of interest rates and terms (from 30 days... to 30 years!). By varying the terms of your securities, you can create a balanced portfolio that provides an attractive return, regular cash flow and capital returned to you when you need it.

What's more, depending on the type of securities you purchase, interest may be paid annually, semi-annually or monthly. For example, a \$10,000 Government of Canada bond maturing on August 1, 2004, and bearing an interest rate of 10%, will bring you two \$500 payments every year, without fail, until maturity. A GIC in the same amount with the same interest rate would pay \$1,000 once a year until maturity.

With the help of your National Bank Financial Investment Advisor, you can decide what maturity dates and payment terms are most suitable for your situation.

Yield

Government securities are generally purchased by major institutional investors, such as pension funds, insurance companies or mutual funds. In order to attract this expert clientele, who are not likely to accept “ordinary” rates of return, governments must offer a higher rate. National Bank Financial makes this preferred class of investments available to you.

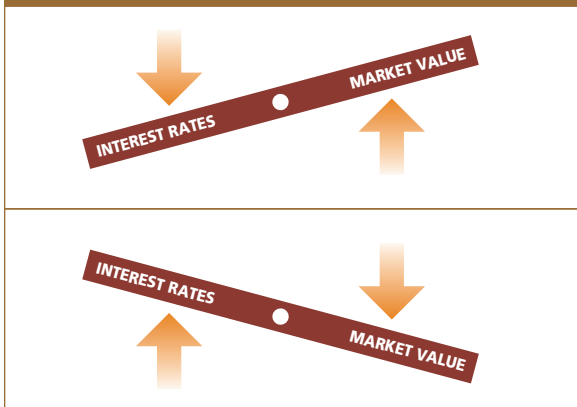
Tremendous potential

The ability to trade a fixed-income security on the secondary market is an extremely important feature.

If market conditions are right, you can resell these securities and profit from a considerable capital gain, in addition to the interest already earned. It all depends on interest rates.

Here's how it works.

Interest rates and market value:
an inversely proportional relationship



First, let's make one important distinction. With the exception of illiquid securities that may only be cashed in at maturity, fixed-income securities have two "values":

- a value *at maturity*, which is always guaranteed by the issuer; and
- a *market value*, i.e. the price that can be obtained if you sell the security on the secondary market, before maturity.

The value at maturity, like the interest rate of the security, is fixed. But the market value, as the name indicates, is subject to the laws of the market and fluctuates constantly.

The market for fixed-income securities is driven by interest rates as illustrated by the diagram opposite. When interest rates rise, the market value of a fixed-income security purchased previously diminishes accordingly, since securities issued more recently offer better returns. When interest rates are on the upswing, it makes sense to hang on to your securities until maturity in order to obtain the guaranteed value and return. If you had to sell them prior to maturity, you could incur a loss.

Conversely, when interest rates fall, market value increases proportionately: it might be to your benefit to resell your securities before maturity to obtain a higher price than you originally paid. The profit you earn will depend on how much interest rates have dropped since you made your investment. The possibility of ending up not only with interest income, but also with a capital gain or loss on your investments, is of prime importance from a tax point of view. Interest income is fully taxable, but capital gains are only taxed at 75%. This means that a bond which earns you a capital gain could turn out to be a better investment *after taxes* than a security that earns only interest, even if the latter's stated rate of interest is higher. You have to build your portfolio of fixed-income securities with such tax considerations in mind, to ensure optimum returns.

Because of the variety of terms, not all fixed-income securities are affected by interest rate fluctuations in the same way. A security maturing in the near future – in a few months, for example – will hardly be affected by changing interest rates, since its market value cannot vary that much from the value at maturity to be realized in a short while. A security with a 30-year term, however, will be much more sensitive to interest rate swings, and present greater potential for gain – or loss – upon resale. As a general rule, the volatility of a security's market value is directly proportional to the length of its term.

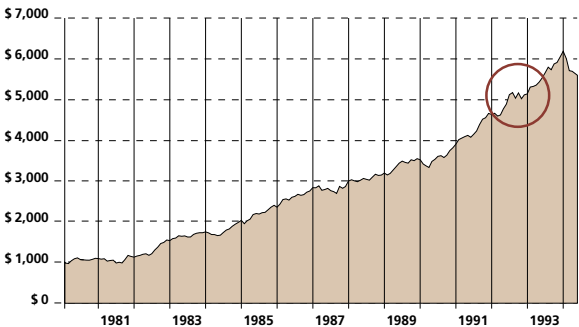
It's important to understand this dynamic and realize that it does not affect the value at maturity or the yield-to-maturity of your security. If this sounds complicated and you're feeling confused, don't worry: your National Bank Financial Investment Advisor can demystify the theory for you and show you how to apply it to your own investments, to your own advantage.

A safe and flourishing market

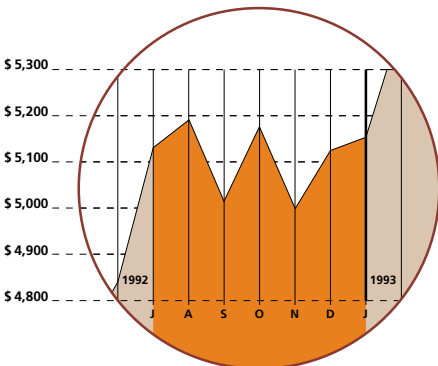
The graph below illustrates the full potential of the fixed-income securities market.

The curve shows a bond index representing the yield of a typical bond portfolio of medium-term securities.

As you can see, a \$1,000 investment made in 1980 with interest compounded grew to approximately \$5,500 by 1994. That's a growth rate of 550%, which translates into an average annual compound return of about 12.9% over the 14 years – not bad for a risk-free investment!



However, as the close-up shows, over a given short-term period, the market value of the investment varied abruptly. If certificates of deposit or GICs could be traded like bonds, their market value would also fluctuate constantly. But they don't offer that flexibility.



This is why most investors take a long-term view of their fixed-income securities portfolio, although they are prepared to act quickly if the opportunity for a profit presents itself in the short term.

Your National Bank Financial Investment Advisor can help you put together your fixed-income securities portfolio. You'll get advice and assistance in choosing maturity dates, and diversifying them for optimum return and protection against changing economic conditions. Your advisor will also help you reinvest your interest income, or choose securities with compound interest that is automatically reinvested.

Easy access to fixed-income securities

You don't necessarily have to purchase fixed-income securities directly in order to benefit from them.

For example, if you have only a small amount to invest and cannot build a diversified portfolio of fixed-income securities yourself, you might consider purchasing units of a fixed-income investment fund. With even a small investment in such a fund, you benefit from economies of scale, since your investment is part of the fund's multi-million dollar portfolio. Another advantage to fixed-income funds is the expertise of a professional money manager. Some fixed-income funds invest in globally diversified portfolios of bonds. Managers of such funds may seek to capitalize on currency market fluctuations as well as opportunities afforded by international bond markets.

You should remember one thing, however. Although these funds are generally safe, since the yield and value at maturity of the securities they hold are guaranteed, the *market value* of the fund's units at the time you resell them is not at all guaranteed. That value will be determined by the market, and interest rate fluctuations. If capital protection and predictability are important to you, you may be better off purchasing fixed-income securities directly, as opposed to units of a fixed-income fund.

Remember, too, that the services of the fund manager are not free. Notwithstanding the economies of scale, you still have to pay fund management fees, which are built into the product. All this must be considered when making an investment decision.

How to choose

Every fixed-income security has its own rate of return, maturity date, degree of risk, etc. To make sure you're choosing the most suitable securities for your situation, we suggest you keep these three questions in mind:

1. When will I need my capital?

Capital is the money you invest in a fixed-income security which the issuer of the security agrees to repay you on a specified date. Obviously, it's important to know when you would like to have the capital back for other uses. Fixed-income securities come with a great variety of maturity dates. Which ones best meet your needs?

2. When will I need my income?

The income is the money, or interest, that a fixed-income security earns. Some securities pay interest on specific dates, while others offer substantial future gains without any regular interest payments. Which is better for you?

You can choose between regular and compound interest vehicles, depending on your needs. If you purchase securities that pay interest regularly and you do not need current income, you have to reinvest the interest income in order to make it grow. Is this interest going to be reinvested at a higher or lower rate than the initial investment offers? Your overall yield to maturity will be greatly affected by your reinvestment rate. It's always wise to consult your Investment Advisor when making such decisions.

3. *Which risk/return ratio is best for me?*

Most fixed-income securities are extremely low-risk. Some, however – usually those issued by private-sector companies – present a higher risk, which is generally offset by a more attractive rate of return. Any investment must always be considered in terms of its risk/return ratio: the return offered is in direct proportion to the degree of risk. Ratings issued by various credit rating agencies indicate the relative risk of each issuer's fixed-income securities. As a general rule, rates of return rise and credit ratings drop in the following order: federal government, provincial governments, public and Crown corporations, municipalities and private-sector corporations. Common shares are obviously even more risky, but they have the potential for much higher returns. When choosing your investment vehicles, you must always consider the "risk hierarchy" and the risk/return ratio you're prepared to accept.

No fees, no risk, no surprises

You can buy any fixed-income security as easily as you buy a certificate of deposit or GIC.

There are no fees, no risk and no surprises (unless, of course, you decide to opt for higher risk fixed-income securities, such as those issued by private-sector corporations).

Professional management

The best way to purchase fixed-income securities is through your National Bank Financial Investment Advisor. After analysing your financial needs, your advisor will help you choose the most suitable securities and maturity dates. If it turns out that investment funds are your best option, you'll be assisted in your choice there, too.

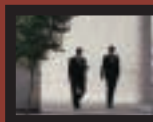
Ideally, all investors should have a competent, trustworthy professional to help manage their portfolios. Your National Bank Financial Investment Advisor is well qualified to meet your needs. Call today for more information about how fixed-income securities can work for you: you'll get sound advice and expert assistance in building that portion of your portfolio.

For a more detailed description of the different types of fixed-income securities available, ask your National Bank Financial Investment Advisor for the fact sheets on the specific products of interest to you.

NATIONAL
BANK
FINANCIAL

MANAGING
THE WORLD'S
MOST IMPORTANT
INVESTMENTS:

YOURS!



www.nbfinancial.com

