The basics of investing

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Types of investments

Some of the most common types of investments include the following:

Annuity

An annuity is a type of investment contract that pays you income at regular intervals, usually after retirement.

Bond

A bond is a certificate you receive for a loan you make to a company or government (an issuer). In return, the issuer of the bond promises to pay you interest at a set rate and to repay the loan on a set date.

Canada Savings Bond (CSB (Canada Savings Bond))

A Canada Savings Bond is a savings product issued and guaranteed by the federal government. It offers a minimum guaranteed interest rate. Canada Savings Bonds have a three-year term to maturity, with interest rates remaining in effect for that period. At the end of the period, the Minister of Finance announces the new rates based on prevailing market conditions. It may be cashed at any time and earns interest up to the date it is cashed.

Canada Savings Bonds are only available through the Payroll Savings Program, which allows Canadians to purchase bonds through payroll deductions.

Learn about current interest rates and how to buy Canada Savings Bonds.

Exchange traded fund (ETF (Exchange Traded Fund))

An exchange traded fund is an investment fund that holds assets such as stocks, commodities or bonds. Exchange traded funds trade on stock exchanges and have a value that is similar to the total value of the assets they contain. This means that the value of an exchange traded fund can change throughout the day.

The risk level of an exchange traded fund depends on the assets it contains. If it contains high-risk assets, like some stocks, then the risk level will be high.

Guaranteed investment certificate (GIC (Guaranteed Investment Certificate))

A GIC is an investment that protects your invested capital. You will not lose money on the investment. GIC (Guaranteed investment certificate)s can have either a fixed or a variable interest rate.

Mutual fund

A mutual fund is a type of investment in which the money of many investors is pooled together to buy a portfolio of different securities. A professional manages the fund. They invest the money in stocks, bonds, options, money market instruments or other securities.

Security

A security is a transferable certificate of ownership of an investment product such as a note, bond, stock, futures contract or option.

Segregated fund

A pooled investment fund, much like a mutual fund, is set up by an insurance company and segregated from the general capital of the company. The main difference between a segregated fund and a mutual fund is the guarantee that, regardless of fund performance, at least a minimum percentage of the investor’s payments into the fund will be returned when the fund matures.

Stock

A stock is a unit of ownership in a company which is bought and sold on a stock exchange. Stocks are also called “shares” or “equities”.

Treasury bill (T-bill (Treasury bill))

A T-bill (Treasury bill) is a short-term, low-risk investment issued by a federal or provincial government. It is sold in amounts ranging from $1,000 to $1 million, and must be held for a fixed term which can range from one month to a year.

Common investment terms

Before making investment decisions, it is important to understand basic concepts.

Risk

Risk is the potential of losing your money when investing, or the level of uncertainty regarding what you will earn or lose on your investment.

Almost every type of investment involves some risk. Generally, the higher the potential return, the higher the risk.

Return

Return on your investment, also known as ROI (Return on investment), is the profit or growth that you make on an investment. It can vary greatly. For some investments, it can't be predicted with certainty.

An investment’s return can come in two forms:

- Income, including interest or dividends. A dividend is a portion of a company’s profit that is paid to its shareholders
- Increased value, also called “capital gain,” which lets you sell your investment for a profit

You can also have a negative return if your investment loses value. This is also called a “capital loss.”

Risk tolerance

Risk tolerance is how comfortable you are with risk and not knowing what you will earn or lose on your investment.

If you prefer little or no risk, you have a low risk tolerance, or are “risk averse."

You have a high risk tolerance if you are willing to risk losing some or all of your investment in exchange for the potential to earn more money.

You can ask yourself the following questions to help determine your risk tolerance:

- when will you need the money
- do you have enough money set aside for an emergency and to cover debts

- is your job stable
- can you tolerate investments where returns may be unpredictable or subject to sudden changes in value
- how would you react if your investments declined in value

Liquidity

Liquid assets or investments are those you are able to cash in or sell quickly. Examples of liquid assets include savings accounts and most stocks. A house is considered a non-liquid asset.

Liquidity can be important if you are planning to use your savings or investments in the short term.

Diversification

Having a mix of investments in different asset classes is called diversification. This can help you to reduce risk.

There are two ways to diversify your investments: portfolio diversification and asset allocation.

Portfolio diversification means having a mix of investments to reduce risk. For example, having investments in many companies instead of just one. When you hold a variety of investments, you reduce the possibility that all of them will lose value at the same time. If you only own one stock and that company loses value, then you risk losing all of the money you invested.

Asset allocation means having different types of asset classes in your investment portfolio, for example: stocks, bonds and cash. When you have different types of assets, you reduce the risk that all assets will lose value at the same time.

Risk level of investments

Each type of investment option has its own level of complexity and risk. Before choosing an investment, it's important to understand what level of risk you are comfortable with.

The most common categories of investments have varying levels of risk.

Low, or no, risk investments

Savings-like investments are generally low-risk, or even no-risk, investments. This is because the capital, and often the return, is guaranteed.

Examples of savings-like investments include:

- guaranteed investment certificates (GIC (Guaranteed Investment Certificates)s)
- treasury bills

Fixed-income securities are also considered low-risk investments.

Examples of fixed-income securities include:

- government bonds
- corporate bonds

High-risk investments

Equities, also called stocks or shares, are considered high-risk investments.

The risk level of mutual funds and exchange-traded funds depends on the type of investment included in the fund.

Get an overview of different investment types in Investments at a glance, published by the Canadian Securities Administrators.

How taxes apply to investments

You may need to pay taxes on the money you make from your investments. There are different tax rules for different types of investments.

Unless your investments are very simple, seek professional advice on tax planning.

Learn more about filing your taxes by taking an online course, Learning About Taxes.

Fees and costs of investments

There are different fees and costs depending on the investment type. These costs can impact your return, so it's important to be aware of them.

Most fees and costs relating to investments fall into the following categories:

- costs to buy an investment
- costs when you sell an investment
- investment management fees
- financial advisor fees
- administration fees for registered plans

Not all costs apply to all investments. For example, the sales commissions when you buy bonds are often included in the purchase price.

Cost of buying an investment depends on the type of investment.

The cost of buying an investment depends on the type of investment. You may pay a trading fee every time you buy a stock or exchange traded fund. For this reason, you may want to limit the frequency of your purchases. Brokerages and investment firms set their own fees, so the trading fee depends on the company you use.

Mutual funds can have different fees when you buy them:

- “front-end load” mutual funds do have a fee. The fee is generally a percentage of the fund’s purchase price
- “no load” mutual funds don't involve an up-front fee

Costs when you sell an investment

The cost of selling an investment depends on the type of investment. With some mutual funds, instead of paying a fee, or “front-end load” fee when you buy, you pay a fee when you sell. This is known as a “back-end load” fee.

The back-end load fee:

- is generally a percentage of your selling price
- is normally highest in the first year after purchase
- gradually decreases for every year you hold the investment
- may be waived by the fund dealer if you hold the investment long enough

Think carefully before buying funds with “back-end load” fees. The fees are charged when you sell the funds and are based on a percentage of the selling price. You may be charged fees as high as 7% if you sell in the first year. To avoid this cost, you may have to hold the investment for several years.

Costs to manage the fund

Investment funds, including mutual funds, charge a fee for managing the fund. The fees are called the management expense ratio (MER (Management Expense Ratio)).

The MER (Management Expense Ratio):

- may include an ongoing commission paid to advisors who sell the fund (also known as a trailer fee)
- is paid regardless of whether the fund makes money
- is deducted before calculating the investor’s return
- is set at a percentage of the fund’s value

The percentage varies depending on the fund. This can be from less than 1% to over 3%. For example, you may have a fund with an annual return of 5%. If the fund's MER was 3%, your net annual return would be 2%.

Table 1: How the management expense ratio may affect the return on your investment

	Fund A	Fund B	Fund C
Total investment ($1,000 a year over 20 years)	$20,000	$20,000	$20,000
Annual return (before MER is deducted)	5.0%	5.0%	5.0%
MER	3.0%	1.5%	0.5%
Net annual return (after MER)	2.0%	3.5%	4.5%
Fund value after 20 years[2]	$24,783	$29,269	$32,783
Difference from fund A	n/a	+$4,486	+$8,000

1. For illustration purposes only
2. Assumes the annual return was 5% over 20 years. In real life, a fund's return could vary from year to year

The fund must tell you about the MER (Management Expense Ratio). The fund's prospectus shows returns with the MER already removed. Beyond the MER, you may pay other financial advisor fees.

Calculate how fees and other costs affect your mutual funds with the Ontario Securities Commission's mutual fund fee calculator.

Related links

- Setting savings and investment goals
- Choosing a financial advisor
- Savings and investments: rights and responsibilities

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