

Variable or fixed? It's no contest

Fixed-rate mortgage is now your best bet: Not only has the prime rate dipped, but banks have snuffed out variable-rate discounts



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Variable-rate mortgages are so over.

Go fixed rate if you're arranging or renewing a mortgage, and think hard about the four-year term. If you take in all the recent developments in the mortgage market, this is the most logical strategy.

Variable-rate mortgages are being sold at the prime rate in many cases right now, which is 3 per cent. The traditional discount off prime? Snuffed out by the banks. They've decided they aren't making enough money from discounted variable-rate mortgages, so goodbye discount for the most part. If you shop around, maybe you'll get 0.2 of a point off prime.

Now for the fixed-rate alternative. Global economic uncertainty and sluggish growth mean you'll pay in the area of 3 per cent for a four-year term. This explains why veteran mortgage broker Peter Majthenyi has pretty much given up on variable-rate mortgages.

"For 10 years, I've said don't waste your money on a fixed-rate mortgage," Mr. Majthenyi said. "Today, I just cannot in good conscience put a borrower into a 3-per-cent variable when for the same rate I can put them in a four-year fixed."

Mr. Majthenyi calls this a "temporary break" from variable-rate mortgages. He'll see what happens when today's four-year terms expire. Meantime, he's gone from writing about 98-per-cent variable-rate mortgages a year ago to virtually zero now.

Numbers from the Canadian Association of Accredited Mortgage Professionals (mortgage brokers, to put it in English) show that variable-rate mortgages had about one-third of the market as of this past spring, compared to 21 per cent four years ago. Interest in variable-rate mortgages was as strong as ever going into the summer as a result of an uncertain global economic outlook that was expected to keep interest rates low. Variable-rate mortgages could be had back then for 2.25 per cent, which represented a discount off prime of 0.75 of a point. Four- and five-year fixed-rate mortgages would



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DISAPPEARING DISCOUNT

A short history of variable-rate mortgage discounts:

- pre-financial crisis**
Prime minus 0.9 to 1 percentage point (at best)
- mid-financial crisis**
Prime plus 1
- post-financial crisis**
Prime minus 0.75 to 0.8
- now**
Prime to prime minus 0.2

have cost roughly 3 to 3.5 per cent, and that included a strong discount.

This was an ideal environment for variable-rate mortgages. The prime rate, used by lenders as a reference for many of their loans, was low and expected to stay that way for as long as it took for the global economic mess to resolve itself. The prognosis was for continued savings versus a fixed-rate mortgage.

Then came two developments that led to Mr. Majthenyi's 180-degree-turn against variable-rate mortgages. One, the cost of fixed-rate mortgages fell a little as a result of the stock market uproar in August and September. Here's how that worked: Money flowed out of stocks and into bonds, which set the trend for mortgage rates. When a bond's price rises, its yield falls. And so, as bond yields moved lower in the late

summer, so did rates on fixed-term mortgages.

The second development was a decision by the big banks to clamp down on discounts given to customers going variable. "Bottom line, the banks have been stuck with too many variable-rate mortgages that are not profitable," Mr. Majthenyi said. "How do they make them more profitable? They have to increase their profit on each mortgage."

A few mortgage brokerage firms now advertise variable-rate mortgages at 2.8 per cent, or prime minus 0.2 of a point. But Mr. Majthenyi said many of the big lenders he deals with as a broker are now at prime. Looking ahead, he sees the market settling into prime plus or minus 0.2 for variable-rate mortgages.

You may still be able to save a token amount with a variable-rate mortgage over a fixed-rate

mortgage with a term of four or five years. But it's not hard to imagine the advantage of the variable rate disappearing in a year or so as the economy rallies. Then, you could be looking at a long period of rising rates.

So get over any ideas you have about variable-rate mortgages being cheap enough in the here and now to overlook the risk posed by future rate increases. In today's market, variable-rate mortgages are yesterday's news.

Finally, a quick word from Mr. Majthenyi for people who are in the middle of variable-rate mortgages with those juicy discounts of days gone by: Enjoy.

"You should hug and love those mortgages to the last possible moment because you're probably not going to get them again."

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Insurer's surprise loss suggests stock is more risky than cheap

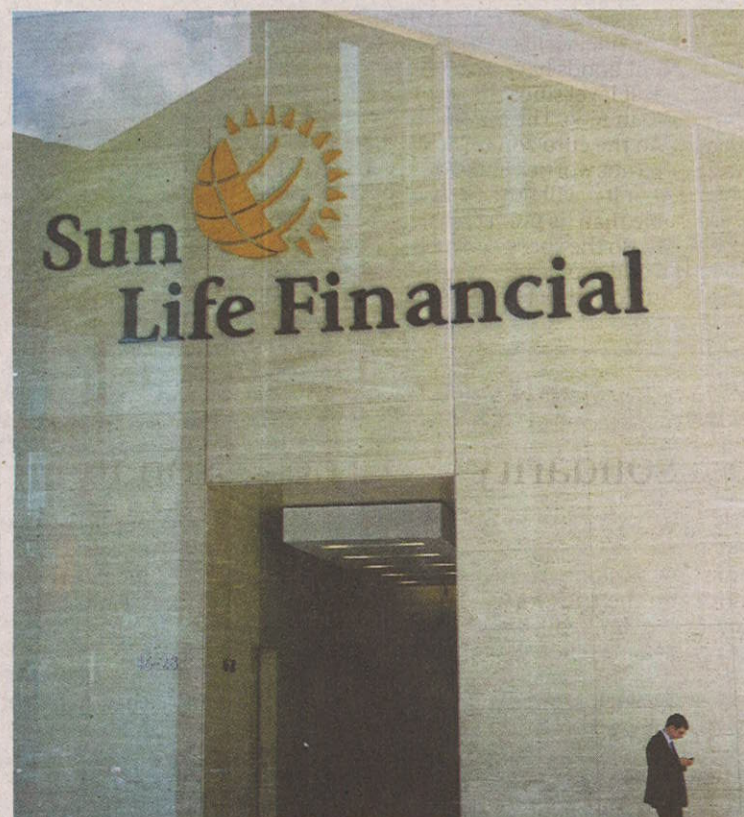


DAVID MILSTEAD
VOX

I was preparing a column on how Sun Life Financial, having emerged from the financial crisis with a strong capital position, yet priced at just about its book value, seemed a good buy. But I didn't get it written before Oct. 17.

Good for me (and you), since that was the day Sun Life shocked and disappointed investors with the news it would report a third-quarter loss of \$621-million, compared with the roughly \$260-million profit analysts had been expecting. The stock dropped 9 per cent that day and still struggles to recover. (The company reports quarterly results Wednesday.)

The scope of that loss, and the fact it was a surprise, is a strong



has "more granular disclosure and guidance on macro impacts." Manulife reports third-quarter results Thursday.)

Sun Life still shows up when value-oriented investors screen stocks for hot prospects; its dividend yield topped 6 per cent while its price-to-book ratio, a key indicator for financial stock, was below 1.0, making it indisputably cheap. With the recent declines, both measures have made it seem an even better buy.

Yet Mr. Lederer of Veritas, who now has a "sell" rating on the company, notes the loss Sun Life will take in the third quarter will drop its primary capital ratio from 231 per cent to 210 per cent, leaving it vulnerable to continued negative moves in equities and fixed income. "Two-thirds of its capital buffer over 200 per cent is gone in just one quarter; today, Sun Life is a company with a small(er) capital buffer, likely heightened sensitivities to markets, and potentially lower underlying profitability."

And analyst Peter Routledge of National Bank Financial Inc., who initiated coverage with a

BNN MARKET CALL

MICHAEL SMEDLEY



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PAST PICKS: OCT. 29, 2010

Air Canada (AC.B-TSX)
Then: \$3.77 Now: \$1.44
Total return: -61.8%

Brick Ltd. (BRK-TSX)
Then: \$2.54 Now: \$2.89
Total return: +13.8%

Canacol Energy Ltd. (CNE-TSX)
Then: \$1.80 Now: 66¢
Total return: -63.3%

TOP PICKS

Brick Ltd. (BRK-TSX)
Now: \$2.89

"The turnaround of largest furniture chain in Canada seems to