PortfolioAdvisor

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Brian Neale Wealth Management Team

Brian Neale
Vice President
Investment Advisor
613-721-4672
brian.neale@rbc.com

Patrick Funk
Senior Associate Advisor
613-721-4678
patrick.funk@rbc.com

Simonne LaRonde
Associate Advisor
613-721-8012
simonne.laronde@rbc.com

Suite 5500, 303 Moodie Drive
Nepean, ON K2H 9R4

www.brianneale.ca

10 Principles of Successful Investing in Volatile Markets

Stock market volatility is a normal part of investing. But what you do – and don't do – during times of higher volatility can make the difference between success and failure as an investor. The following 10 principles can help you manage volatility and achieve your long-term investment goals.

1. Stay Calm and Invest On
2. Avoid Market Timing
3. Maintain Your Sense of Perspective
4. Reassess Your Comfort Level with Risk
5. Stay Diversified
6. Look for Opportunities
7. Regularly Rebalance
8. Stay Focused on the Long Term
9. Put Time on Your Side
10. Review Your Portfolio

Key Terms

Volatility: The degree of price fluctuations in individual investments or markets

Pullback: When markets go down 5-10%

Correction: When markets go down 10-20%

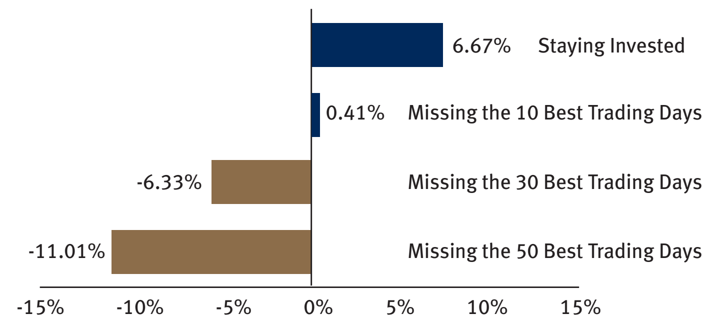
Bear Market: When markets go down more than 20%

1. Stay Calm and Invest On

When the markets are particularly volatile, there's a natural tendency for investors to move into safer investments, hoping to avoid further losses, and wait until the markets recover. But unfortunately it's nearly impossible to predict when the markets will recover. As a result, investors may miss out on the eventual recovery, which can negatively affect their long-term investment goals. As the chart to the right shows, the investor who stays invested tends to do better than the investor who bails out and misses even some of the recovery.

Why It's Best to Stay Invested

Missing just the 10 best days in the market over the past 10 years would have reduced returns significantly.



Source: RBC Dominion Securities.

Based on annualized returns of the S&P/TSX Composite Index for 10 years ending July 2015.

2. Avoid Market Timing

On a related note, some investors try to improve their returns by attempting to "time" the market – selling right before the markets go down, then buying right before they go up again. In theory, this sounds great. But in practice, it rarely works, simply because it's so difficult to predict when the markets will go up or down. Unfortunately, that doesn't stop investors from trying, which is why the "average investor" tends to underperform virtually every asset class.

3. Maintain Your Sense of Perspective

Unquestionably, stock market downturns can be painful, especially when you're in the middle of one. It's not always easy, but it's important to remember that downturns have happened before – and will happen again – and that historically, as the table to the right shows, the markets have always recovered and reached new highs.

Market Recoveries Following Major Downturns (S&P/TSX)

Year (event)	Return	Return in the following year	Average return over next 5 years
1974 (oil embargo)	-25.0%	+18.5%	+22.3%
1981 (double-digit inflation)	-10.2%	+5.5%	+13.7%
1990 (Gulf war)	-14.8%	+12.9%	+10.8%
2002 ("Tech Wreck")	-12.4%	+26.7%	+18.3%
2008 ("Subprime crisis")	-35.03%	+30.7%	+8.7%

Source: Based on the returns of the S&P/TSX Composite Total

4. Reassess Your Comfort Level with Risk

It's one thing to say you are comfortable with a higher level of risk when the markets are only going up, and another thing when the markets are volatile. If you are finding it difficult to sleep at night because of market volatility, then it might be time to consider how much risk you are truly comfortable taking with your investments.

5. Stay Diversified

Diversifying your investments is a proven way to reduce market volatility. It involves including a certain mix of stocks, bonds and cash in your investment portfolio, as well as investments representing different industry sectors or geographic areas. At any given time, one type of investment may do better than another. So by diversifying between them, you can offset weaker performers with stronger performers, reducing volatility. What's more, as the table to the right shows, it can be difficult to determine exactly when one type of investment will do better than another, which is why it makes sense to stay diversified.

6. Look for Opportunities

"Summer sale! Prices slashed!" When it's a retail store saying those words, it's usually a good thing. Yet when it's the stock markets, people often have the opposite reaction. When prices drop, they sell instead of buy. But when the stock markets go down, it can be fairly indiscriminate: both good and bad stocks can be caught up in the sell-off. What that means is, during a market downturn, there can be some high-quality stocks, likely to be among the first to bounce back, available at temporarily reduced prices.

7. Regularly Rebalance

How you diversify your portfolio between different investments plays an important role in how much volatility you can expect. In general, if you include more stocks in your portfolio, you will experience greater volatility, but also greater long-term growth potential. Conversely, if you include more bonds, you will experience lower volatility, but also lower growth potential. Everyone has an ideal balance, based on factors such as:

- How long you have to invest
- How much growth you need
- How much risk you are willing to take

But over time, market fluctuations can cause the balance to shift in your portfolio (see chart at right), as one asset class outperforms another and eventually represents a greater percentage of your portfolio than you had originally intended. As a result, it makes sense to regularly rebalance your portfolio, to get back to your ideal balance.

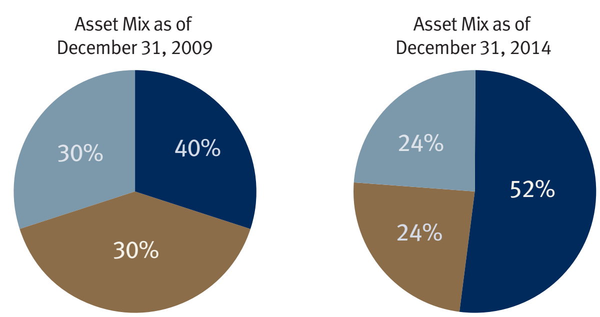
Different Investments Perform Differently Year to Year

2010	2011	2012	2013	2014
US Small Cap 26.9%	EM Equities 18.2%	EM Equities 18.6%	US Small Cap 38.8%	US Large Cap 13.2%
EM Equities 19.2%	Int'l Equities 11.7%	Int'l Equities 17.9%	US Large Cap 33.1%	Fixed Income 6.0%
US Large Cap 16.1%	Fixed Income 7.8%	US Large Cap 16.4%	Int'l Equities 23.3%	US Small Cap 4.9%
Int'l Equities 8.2%	US Small Cap 4.2%	US Small Cap 16.3%	EM Equities 2.3%	Int'l Equities 4.5%
Fixed Income 6.5%	US Large Cap 1.5%	Fixed Income 4.2%	Fixed Income 2.0%	EM Equities 1.8%
Cash 0.1%	Cash 0.1%	Cash 0.1%	Cash 0.0%	Cash 0.0%

Cash	3-month Treasury	Fixed Income	Barclays Agg.
US Large Cap	Russell 1000	US Small Cap	Russell 2000
Int'l Equities	MSCI EAFE	EM Equities	MSCI EM

Source: RBC Wealth Management.

The Impact of Portfolio Drift

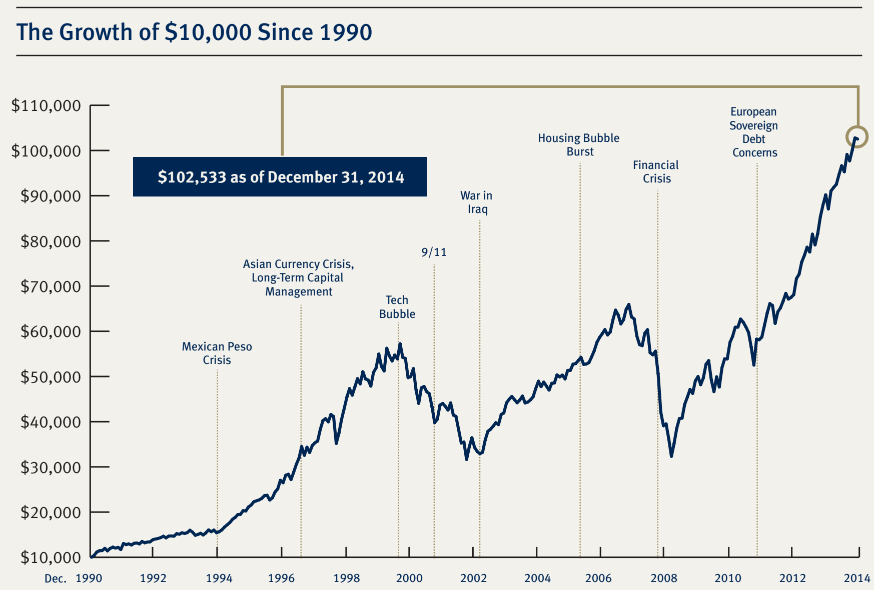


■ US Equities ■ International Equities ■ Fixed Income

Source: RBC Global Asset Management.
Canadian equities – S&P/TSX Composite Total Return Index. Fixed income – FTSE TMX Canada Universe Bond Total Return Index. U.S. equities – S&P 500 Total Return Index.

8. Stay Focused on the Long Term

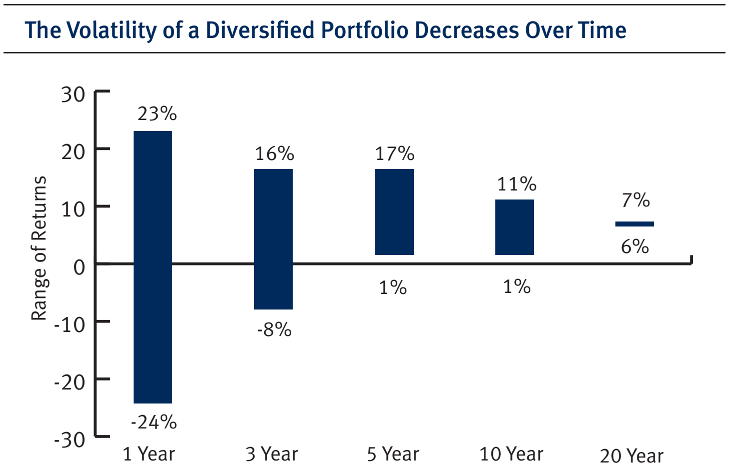
Markets may go down in the short term, often in response to a global economic crisis, but over the longer term they tend to go up.



An investment cannot be made directly in an index. Graph does not reflect transaction costs, investment management fees or taxes. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results. Performance data as of December 31, 2014.
Source: RBC Portfolio Advisory Group

9. Put Time on Your Side

In the short term, volatility can seem like the "Salt & Pepper" ride at your local amusement park. But over time, volatility smooths out. And the longer you have to invest, the more it tends to smooth out.



Source: Bloomberg, RBC Global Asset Management.

Rolling 1-, 3-, 5-, 10-, 20- and 30-year average annual returns from January 1980 to December 2013. Based on a diversified portfolio of: 45% bonds (DEX Universe TR Index), 20% U.S. equity (S&P 500 TR Index), 20% Canadian equity (S&P/TSX Composite TR Index) and 15% international equity (MSCI World TR Index).

10. Review Your Portfolio

Have questions about your investments? Should you make any changes given the recent market volatility? We would be happy to help you review your investments to ensure your portfolio is right for you.

Get Insights for Your Portfolio

Where will the markets go from here? How should investors position their portfolios for today's changing markets?

Get the latest insights from our portfolio strategists on global equity, fixed-income, commodity and currency markets. Request your complimentary copy of *Global Insights* today.