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Al Gair, MBA, CFP, CIM
Vice President &
Associate Portfolio Manager

Bonnie Walmsley
Associate

2500 - 666 Burrard Street,
Vancouver, B.C. V6C 3B1

T: 604.665.5526

E: al.gair@rbc.com
E: bonnie.walmsley@rbc.com

www.gairwealthmanagement.com

In the last couple of issues of the Fortnighter, I spent some time discussing the two most important issues for any long-term investor – RISK and RETURN.

Ultimately, all investors are trying to accomplish the same thing – achieve the best possible rate of return with the least amount of risk. Some of us are "return oriented" (i.e. "I need to double my money over the next 10 years") and some of us are "risk oriented" (i.e. "I need my capital completely protected") but the risk/return trade-off plays out in every portfolio.

My own bias is toward the return end of the spectrum. My clients are typically looking at a target rate of return to achieve a specific investment goal (like funding a retirement). If the return isn't met, the goal isn't achieved – end of story. My "behind the scenes" goal is then achieving that rate of return with the least amount of risk (or portfolio volatility). That's because no long-term investment program is going to achieve its objective if the investor abandons it before it gets the job done!

A focus on rate-of-return as a primary objective leads me to use portfolio models that are a bit more equity-oriented than what you might typically read about in the financial press. If you believe what you read, the old adage "your age = the % of fixed income" in your portfolio is de rigeur in the investment industry. That is, if you are 40, your portfolio should contain 40% bonds/GICs and 60% stocks. If you're 60, it's 60% bonds/GICs and 40% stocks - and so on. I don't think I've ever read an article that recommended a fixed-income weighting of less than 40%!

The skeptic in me believes that these comments are influenced by the fact that they are appearing in the press – being "conservative" in the public eye always makes for good copy. The reality is that most of our portfolios need a healthy dose of growth to meet our objectives. Having 50% of your portfolio earning a 2% return may not cut it when there's still 15 years to grow that nest egg before retirement.

If I had to choose an "age vs. portfolio balance" rule-of-thumb for investors, I like the formula "age squared/100" – ie. for a 50-year old this yields 50x50/100 = 25% fixed income, for a 60-year old, 36% fixed income, etc. That's because rates on most fixed income investments barely exceed inflation and people are living a lot longer – capital both needs to grow – and last.

Higher risk? Yes, but there are other ways to mitigate risk besides just adding income investments – like diversification. And ultimately, the real risk for most of us is not portfolio volatility; it's running out of money. I'll gladly put up with a little extra "risk" today if it means maintaining my standard of living when I'm 80 or 90!

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