



The Prudent Investor

by Randal Perram

RETHINK THE WAY YOU INVEST.

Professional Wealth Management Since 1901



**RBC
Dominion
Securities**



MISSION

To educate, advise and support affluent investors in the prudent management of their wealth, allowing them to achieve their financial goals.

REALIZING YOUR TRUE POTENTIAL

When it comes to realizing your potential we all think in terms of providing for our families, fulfilling our passions and giving back to our communities.

You may want to make it possible for your children or grandchildren to attend the university that gives them the best opportunities, or you may want to provide some seed capital to help them launch that great new business. You may even want to help them with their first home.

When it comes to passions we are all different and to you that could mean the dream vacation, the cottage at the lake, or your very own art collection.

You may also feel strongly about leaving a legacy for your favourite charity or community project.

Whatever your dreams, they are important in a very personal way. This resource guide will equip you with the means to realize your true potential and give you the opportunity to realize your dreams.

UNDERSTANDING THE TWO PHILOSOPHIES

The investment industry is notorious for complicating the investment experience with confusing jargon and convoluted methods. This can be very intimidating and makes investing difficult to understand.

In reality, investing is not that complicated. There are two major philosophies:

1. You believe in the ability to consistently “pick a winner” and that you can consistently “time the markets.”
or
2. You believe in the Efficient Market Theory that price movements are unpredictable and random and that it is nearly impossible to consistently out-perform the market over time.

By examining these two ideas you can decide which belief system more closely matches your own.



Exhibit 1 Investment Decision Matrix

		Market Timing	
		Yes	No
Security Selection	Yes	Noise Quadrant (1) Most individual investors Financial Journalists	Conventional Wisdom Quadrant (2) Financial Planners Stock Brokers Most Mutual Funds
	No	Tactical Allocation Quadrant (3) Pure market timers Asset Allocation Funds	Information Quadrant (4) Academics 40% of Institutional Investors

Source: CEG Worldwide

The Investment Decision Matrix (Exhibit 1) classifies people according to how they make investment decisions.

Quadrant One is the Noise Quadrant. It's made up of individual investors and financial journalists that believe they can systematically pick the winning stock and determine which market segments will out-perform and be able to predict the right time to jump in or out of the market.

In reality the majority of these methods fail to even match the market let alone beat it, particularly after costs.

Quadrant Two is the Conventional Wisdom Quadrant. Experienced investment professionals know that they cannot, with any degree of accuracy, predict major market swings or mispriced securities. They do, however, believe that there are many analysts and portfolio managers with Ivy League educations and high-tech information systems that can consistently make these predictions. Unfortunately, in an efficient capital market, these methods add no value, on average and actually add significant cost to the process. Study after study proves that capital markets work.

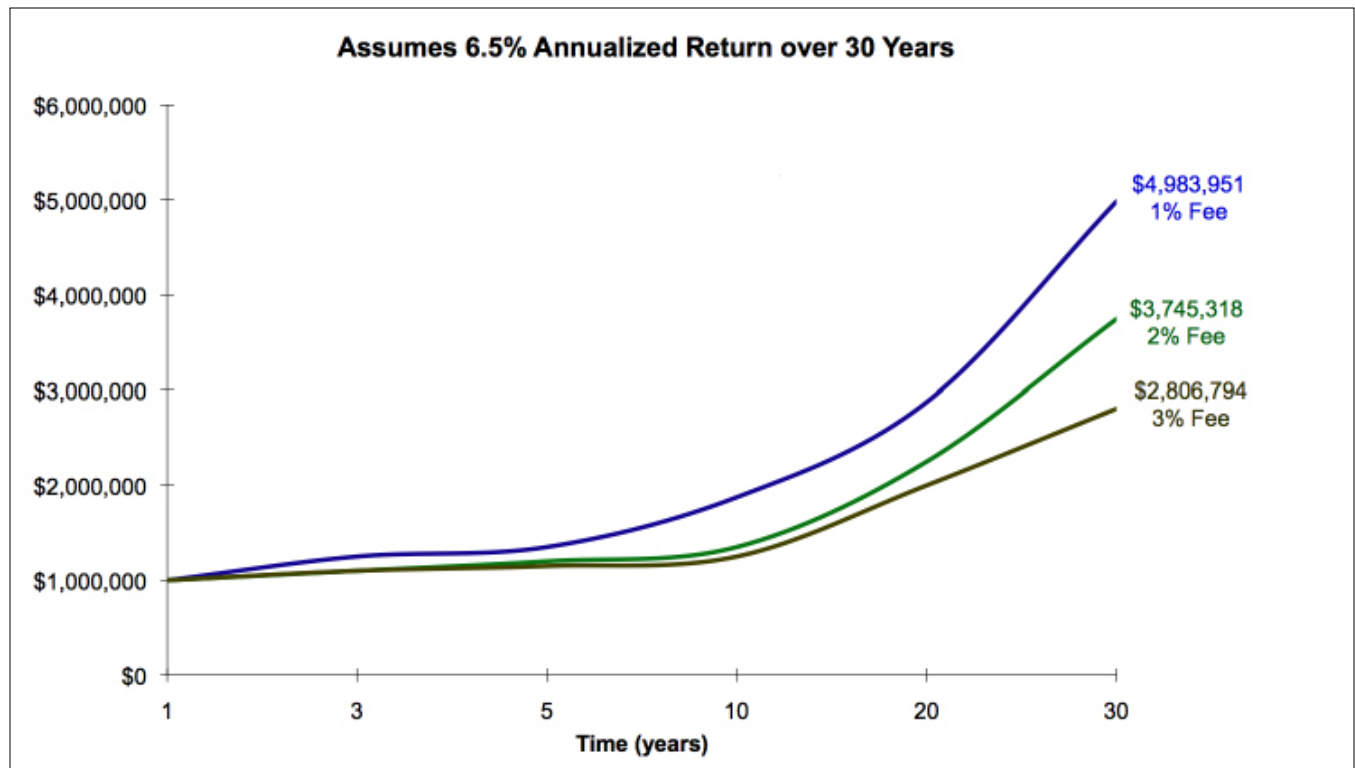
Quadrant Three is the Tactical Asset Allocation Quadrant. Investors in this quadrant believe that although individual securities are efficiently priced they, in their infinite wisdom, can identify whole sectors that are undervalued and have the ability to recognize that before anyone else. They intend to capture the move from undervalue to fair value.

If, on one hand, you believe securities are fairly valued you cannot also believe that whole sectors, of which the fairly valued securities belong, are mispriced. These beliefs are mutually exclusive.

Quadrant Four is the Information Quadrant. This is where a majority of the academic community resides as well as 40 percent of institutional investors. Investors in this quadrant rely on academic data to identify what works and then implement a disciplined and unemotional strategy. Academic studies have proven that the net returns of the other three quadrants are lower than the overall market returns. This is due in large part to higher turnover, which translates into higher fees and more taxes. Quadrant four is the optimal place to be and where you will find all prudent investors.

POWER OF COMPOUNDING

Exhibit 2



Source: Dimensional Funds

THE REAL COST OF FEES

Fees have a very dramatic effect on returns over time. We all understand the fundamental impact of compounding returns. The same can be said for the negative effect of compounding when fees are factored in. Exhibit 2, clearly demonstrates the importance of keeping fees low. Excessive turnover by portfolio

managers can lead to higher transaction costs, higher commissions, wider spreads and market impact costs. The average retail mutual fund has a turnover ratio of 97 percent. For every \$100,000 portfolio, \$97,000 is traded in a 12-month period.

LOWER TURNOVER AND TAXES

Mutual fund companies are required to distribute 98 percent of taxable income each year. Every time a mutual fund sells a security for a gain it must make a capital distribution to its shareholders.

A study by Stanford University economists John B. Shoven and Joel M. Dickson (Tax Externalities of Equity Mutual Funds - April 2000) found that taxable distributions had a negative effect on the rate of return for many well-known retail equity mutual funds. High tax-bracket investors ended up with only 45 percent of the funds published performance after reinvesting the after-tax distribution. A middle tax bracket investor realized just 55 percent of published performance. Lower turnover results in significantly lower taxes,

which in turn increases the overall net return.

VOLATILITY AND ITS IMPACT ON RETURNS

Volatility essentially means the degree to which a security, index or portfolio moves in price. Wide swings in price indicate a high level of volatility. As indicated in Exhibit 3 even though both portfolios had an average return of 8 percent over five years the net effect is that the “consistent portfolio” realized an additional 2.61 percent or \$16,933. As a prudent investor you definitely want to lower the volatility in your portfolio.

Exhibit 3 CONSISTENCY BEATS VOLATILITY

CONSISTENT INVESTMENT			VOLATILE INVESTMENT		
	Rate of Return	End Value		Rate of Return	End Value
Beginning Value		\$100,000	Beginning Value		\$100,000
Year 1	8%	\$108,000	Year 1	30%	\$130,000
Year 2	8%	\$116,640	Year 2	-20%	\$104,000
Year 3	8%	\$125,971	Year 3	25%	\$130,000
Year 4	8%	\$136,049	Year 4	-20%	\$104,000
Year 5	8%	\$146,933	Year 5	25%	\$130,000
Average Return	8%			8%	
Compound Return		8%			5.39%

Source: CEG Worldwide - 2006

THE INVESTING ROLLERCOASTER

We are all poorly wired for investing. Emotions are a powerful force and more often than not they cause us to make the wrong decisions.

How many times have you gotten a “hot tip” from a friend or acquaintance? You probably decided that you wanted to watch for a while first. You’ve no doubt been burned before and you aren’t going to just jump in quickly. Before too long the “hot tip” starts making a move and you are starting to be a real believer. You move from feeling hopeful to feeling that this is the one; greed kicks in and you buy the stock.

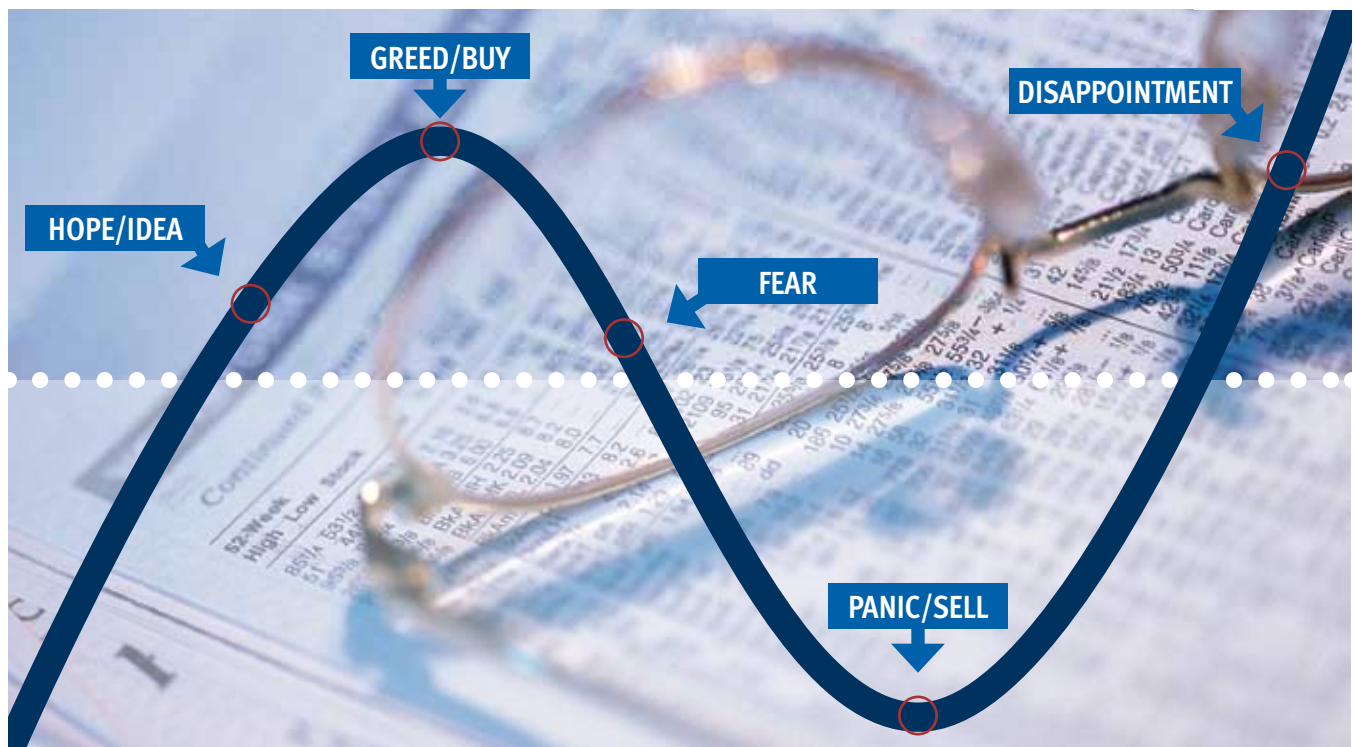
You know what comes next. Soon after you buy the “hot tip” it starts to drop.

Almost immediately you start feeling that you made a big mistake and you get that sick feeling in the pit of your stomach. You can only watch in dismay as the “hot tip” keeps going lower. Finally you can’t take it anymore and you capitulate, you throw in the towel and sell.

Many times new information comes out and the “hot tip” starts moving to new highs and all you are left with is a deep sense of disappointment and a lighter wallet.

This is a classic investing scenario that everyone has experienced. If we allow emotions to drive our investing we run the risk of doing serious damage to our nest egg and to all our financial dreams.

EXHIBIT 4: THE EMOTIONAL CURVE OF INVESTING



MODERN PORTFOLIO DESIGN

Prudent investors need to keep the following in mind when building an efficient portfolio.

1. Determine Acceptable Risk Level
2. Academic Research
3. Employ Asset Class Investing
4. Global Diversification
5. Lower fees and taxes

Determine Acceptable Risk Level

The first order of business is to determine the ratio between fixed income and equities in your portfolio makeup. Volatility does lower as fixed income increases. The correct balance of higher expected returns with equities and the defensive nature of fixed income is a personal decision taking into consideration your age, your tolerance for risk as well as your time horizon.



Academic Research

We subscribe to the Modern Portfolio Theory that supports the idea that markets are efficient and that most information is already priced into stocks. What really moves stock prices are unexpected news or new information. This is both random and unpredictable. It is dangerous to believe that any one financial guru has superior skill in stock selection. The research is irrefutable. The following are only a few examples of what the experts are saying:

"The investment management business is built upon a simple and basic belief: professional managers can beat the market. That premise appears to be false, particularly for very large institutions that manage most pension funds, endowments, and the personal assets of most individual investors, because these institutions have effectively become the market."

CHARLES ELLIS, FINANCIAL ANALYSTS JOURNAL

"If «active» and «passive» management styles are defined in sensible ways, it must be the case that, (1) before costs, the return on the average actively managed dollar will equal the return on the average passively managed dollar and, (2) after costs, the return on the average actively managed dollar will be less than the return on the average passively managed dollar. These assertions will hold for any time period. Moreover, they depend only on the laws of addition, subtraction, multiplication and division. Nothing else is required."

WILLIAM F. SHARPE, PROFESSOR OF FINANCE,
NOBEL LAUREATE

"I have personally tried to invest money, my client's money and my own, in every single anomaly and predictive device that academics have dreamed up – and I have yet to make a nickel on any of these supposed market inefficiencies."

RICHARD ROLL, PROFESSOR OF FINANCE, ECONOMIC
CONSULTANT & MONEY MANAGER

"Our stay-put behaviour reflects our view that the stock market serves as a relocation center at which money is moved from the active to the passive."

WARREN BUFFETT

"I am no longer an advocate of elaborate techniques of security analysis in order to find superior value opportunities. This was a rewarding activity, say forty years ago, when Graham and Dodd was first published; but the situation has changed... [Today] I doubt whether such extensive efforts will generate sufficiently superior selections to justify their costs... I'm on the side of the «efficient» market school of thought."

BENJAMIN GRAHAM, LEGENDARY INVESTOR;
CONSIDERED TO BE THE FATHER OF FUNDAMENTAL SECURITY
ANALYSIS, THE BASIS OF ACTIVE MANAGEMENT DECISIONS



These are but a few of the experts that have recognized that the efficient market philosophy is the prudent investment method.

Employ Asset Class Investing

Exposure to different asset classes will give you the diversification required to lower risk. An asset class is a group of investments with the same risk factors and expected returns. If you own many securities in the same asset class you are not adequately diversified because they tend to move in a similar fashion throughout market cycles.

Global Diversification

Adding to this theme we look at global markets because international markets do not move in the same fashion as Canadian or American markets. By definition they are a separate and distinct asset class.

Lower Fees and Taxes

Unlike the average fund that has a turnover ratio of 97 percent, the prudent strategy is to deliver a specific asset class return with as low a cost as possible. Because mutual funds cannot keep capital gains on the books it must distribute 98 percent of these to unit holders every year. The reality is that taxes on gains must be paid and the benefits of tax deferral are lost.

As your personal success grows the impact of fees are dramatic. While the average broker – investor relationship works for most, it doesn't meet the needs of high-net-worth individuals. Your situation is unique and our job is to tailor a plan to meet those needs, including limiting fees and taxes.

Next Steps

Given today's market volatility, one of the most important things you can do as an investor is to ensure that your investment plan is current. Your plan should examine where you are now and where you need to go

to realize your financial goals, and should also identify the gaps you need to overcome.

It is important to recognize that it's very difficult to be good at all things. Because most of us are not wired, from an emotional standpoint, to effectively develop and maintain our investment plan, you may want to consider working with a qualified financial advisor.

One major survey of affluent investors found that 90.2 percent of them want to work with financial advisors. If you do choose to work with a financial advisor to update and implement your investment plan, you should be aware that not all advisors would approach your investments in the same way.

There are two types of advisors: those who are *transactional* and those who are *consultative*. The difference? Transactional advisors are primarily focused on recommending a variety of investment products to their clients. Consultative advisors, on the other hand, are primarily concerned with offering their clients a holistic approach that will help them meet their clients' investment needs. These Advisors are committed to uncovering your true financial needs and goals, and crafting a long-range investment plan that will meet those needs and goals over time, we recommend that you choose the consultative approach.

And what should you expect from a consultative advisor? The most successful advisors use a systematic process, usually spread over a series of meetings, to design an investment plan that maximizes the probability of achieving your financial goals. These meetings typically involve the following:

A discovery meeting. We will determine your current financial situation, where you want to go with respect to your goals and the obstacles you face in achieving what is important to you.

An investment plan meeting: Using the information gathered at your first meeting, will present you with a complete diagnostic analysis of where you are now and specific recommendations for how you can bridge the identified gaps in order to achieve your goals.

A mutual commitment meeting: At this meeting, assuming that we can truly add value, a mutual decision will be made to work together. You will now officially become a client.

Follow-up meetings: These meetings are typically held quarterly (but can be more or less often, depending on your specific needs) and this is where we report to you the progress you're making towards achieving your goals. If you are currently working with a financial advisor and are unsure if he or she is using a consultative approach or the proven methodologies we've discussed here, you should have us complete a diagnostic analysis of your situation so that you can have a second opinion.

You should always expect outstanding service from any financial advisor you choose. Your phone calls should be returned on the same day, you should receive quick and complete responses to all your questions, you should be able to meet with your advisor as often as you wish, and your advisor should always take your unique needs and preferences into account. In short,

you should expect to be treated like what you are — a very important client.



OUR PLEDGE

Our deep commitment to each of our clients is built upon foundational values like honesty, hard work, and a strong sense of personal dedication. As financial markets have inevitably advanced and declined, the clients we've been privileged to serve have relied on our strong sense of personal dedication, and our deep, unwavering commitment to foundational values. They know that our business is grounded in an authentic care for clients, and a genuine concern for their financial success and well-being.

Each member of our team clearly understands that we are here to help our clients use their wealth to gain peace of mind, while adding significance and meaning to their lives. We have never taken for granted the fact that our clients trust us with far more than their financial assets. We know that their dreams, their goals, and the well-being of their families also depend on our expert counsel. The deep and lasting partnerships we have forged with our clients and their families begin with trust, and are sustained by a high level of service and competency. These partnerships endure over years because in the end, what we care about most is making a difference in the lives of our clients and to ensure that our clients are on the road to financial freedom.

ABOUT THE AUTHOR

Randal (Randy) Perram, Investment Advisor

Randy Perram offers a wealth of experience as an Investment Advisor. Following his graduation from the University of Alberta with a diploma in Business, Randy enjoyed a 20-year career as an entrepreneur in the Edmonton area. He developed several businesses and successfully sold them at their prime. Randy decided to fulfill a lifelong dream to work in the investment world and accepted an invitation to join RBC Dominion Securities. In 2007 Randy accepted an offer to move into management. He is currently the Assistant Branch Manager of the Edmonton Oxford Branch as well as an Investment Advisor. Randy has been very successful growing his practice providing enhanced wealth management services to his clients.

ABOUT RBC DOMINION SECURITIES

THE EXPERTISE OF CANADA'S MOST TRUSTED CORPORATION

Through Randy and his team, you have access to the resources and expertise of RBC Dominion Securities – Canada's leader in wealth management. This includes an unparalleled selection of investments, plus top ranked research and strategy to help you make informed choices. And because investing is just one aspect of managing your wealth, Randy also provides a range of services that address your various tax, estate and financial planning needs. In addition, several banking and insurance services are available through our partners in RBC Financial Group – Canada's "Most Respected Corporation" for four consecutive years. *

For a complete background summary of the firm, or for more information, please visit our website at www.randperram.com or contact us at 780-493-7757.

PROFESSIONAL REFERRALS

The best results are achieved working in partnership with a team of professionals with expertise in other areas related to the management of your wealth. This includes legal, accounting and banking professionals. If you have an existing relationship with professionals in these areas, we will be happy to work with them to ensure we're all on the same page. If you require a referral, we are happy to offer you access to our extensive professional network.



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