Money Ideas

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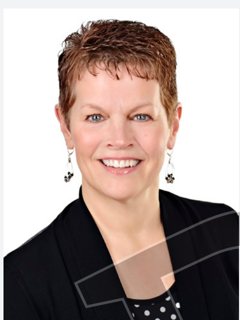

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It can be hard to think about the future when current events so preoccupy us. As your financial partner, we work with you so that you'll be ready when tomorrow comes. In this unpredictable year, let's discuss how we can keep your portfolio on track. In the meantime, enjoy the summer as best you can.

Credential® Asset Management

MUTUAL FUND INVESTING

Feeling fearful when markets turn? Time for a risk reality check

Depending on your age and investing experience, the market downturn in March caused by the COVID-19 crisis may have been a real shock or just the latest in a series of unfortunate events in your life as a mutual fund investor. Either way, these types of market gyrations bring to the fore our personal relationship with risk.

While we may understand risk as a concept, especially easy to do when the markets are up, it takes a serious downturn to face our emotional reactions to risk. If you've been feeling anxious, it may be time to re-evaluate your tolerance for risk.

The risk/return relationship

Every type of investment, including every class of fund, carries some kind of risk. Even if you choose not to invest, you experience what we call opportunity risk – because you could have made more money by investing than by staying on the sidelines.

Lower-risk funds like Money Market Funds may protect capital, but you trade off any significant potential for growth. Over time, this could mean falling short of your goals. To compensate, you may need to save more, spend less, generate more income, or delay the achievement of your objective (for example, retiring at 65 instead of 60).

Equity Funds can offer greater returns, but these come with higher-risk profiles. Keep in mind there is a wide variety of Equity Funds across a broad risk spectrum. Dividend Funds that invest in companies with a history of price growth that pay dividends will fall lower on the spectrum. Conversely, Specialty Funds may invest in companies that operate in more volatile markets, or are denominated in foreign currencies that carry greater – and different kinds of – risks. These have the potential for very high rates of returns, but you need to assess if these are appropriate for your portfolio given your objectives.

Remember, too, that risks can be managed. A diversified fund portfolio helps to reduce the impact of a temporary downturn in any one class of fund.

Keep perspective

It's human nature to overestimate our ability to handle risk when times are good – and to be fearful after a big loss. At the end of the day, your mutual fund portfolio should take enough risk to help generate the returns needed to meet your long-term objectives – but not so much as to make you uncomfortable. If you're ever feeling uneasy, let's talk. ◀

Professional management: what does that actually mean?

When you invest in mutual funds, you entrust your money to the professional managers of that fund. Indeed, professional management is often cited as one of the key benefits of fund investing. But what does that actually mean?

Who are the managers?

We tend to think of a fund manager as a person, but today most funds are managed by teams. At the core of the team are the managers themselves who are responsible for the day-to-day management of the fund, choosing which stocks to buy and sell and when, and shaping the overall composition of the fund. Each fund may have a lead manager may or be run by a team of managers. They may be supported by a wide variety of staff, such as analysts providing them with information and traders carrying out the daily administration of the fund.

Some fund companies may also have an Investment Committee where the most senior, experienced staff provide guidance to the fund managers and ensure that each fund's objectives are being met. It should be obvious that a considerable amount of knowledge and experience is brought to the management of your mutual fund – far more than any individual investor can bring to bear on their own investment choices.

How do they manage?

Central to the management of a mutual fund is the fund's mandate, which sets out the key objectives and characteristics of the fund. This mandate guides the decisions of the fund's managers. For instance, if the fund's mandate is "to seek long-term capital appreciation by investing in large-cap Canadian equities with strong balance sheets and good cash flow," then the fund's managers will build expertise in this sector (Canadian large-cap equities) and analyze individual companies that meet the investing criteria.

Some managers will meet with the companies in the fund to understand their businesses better, while others may concentrate on analyzing the companies' data in corporate reports, results, as well as evaluations from third-party sources. Beyond stock selection, managers must also analyze and react to changing market conditions and manage the inflows and redemptions of clients' money to maintain the integrity of the fund.

Most funds will also identify a benchmark index against which the fund is measured, usually one that closely mimics the fund's mandate. For Canadian equities, it may be the S&P/TSX Composite Index. Though it won't affect choices on a short-term basis, most fund managers will look to match, and ideally outperform, their fund's benchmark over a number of years.

Specialist expertise

Professional management is especially important for funds that specialize in a sector, geographical region, or a particular kind of investments like small-cap companies, single country funds or high-yield bonds. Specialist funds require specialist knowledge, and often fund managers have direct experience in the sector or many years of studying it. Some fund companies have offices in other regions to better incorporate important local knowledge when making investment decisions.

The benefit of numbers

The fundamental idea of a mutual fund is that investors can benefit when they pool their money together. Even the smartest individual investor can't match the information, expertise and experience that a team of professional managers can put at your disposal. ◄

FUND TIME

Tips and lessons in mutual fund investing

Target date funds

What are they? A target date fund is a mutual fund that is managed toward an end or "target" date. These funds are usually named for the year they are targeted to end. For example, "ABC Target 2030 Fund" has a planned end date of 2030.

How do they work? Typically, the fund is managed to get more conservative over time as it moves towards the end date. The mix of assets in the fund will be weighted toward equities earlier in its life, gradually moving to a mix with more fixed-income or cash equivalents. In its termination year, the fund is usually wound down with the proceeds returned to investors or converted into a highly liquid Money Market Fund.

What are they for? As their name suggests, these funds are designed to help investors save for a goal where the date can be predicted – typically the education of their children or their own retirement.

Are they for me? Target date funds offer an easy, "one-stop" saving vehicle when you know your goal and when it will happen. However, they lack some flexibility. What if you decide to retire earlier or later, or your child doesn't pursue further education or decides to do so at a later date? Investors working with an advisor will find that the same ends can be reached with more flexible investments – as planning and helping their clients to invest towards a goal is what advisors do for their clients every day. ◄

Let U.S. mutual funds help you access this global powerhouse

As the largest economy in the world, the United States attracts the attention and capital of investors across the globe. For Canadian investors, the best and most practical way to access these opportunities is through mutual funds. Here we look at why America is so attractive and the best funds to get you investing there.

How big is big?

The U.S. capital markets are the deepest and most liquid worldwide. In fact, the New York Stock Exchange (NYSE) is the largest stock exchange in the world, accounting for roughly 40% of global stock market capitalization. The U.S. is also home to some of the world's largest and most successful companies, many of them with a global presence. In many sectors American firms dominate, and investors looking to buy into them will find it impossible to ignore these U.S.-based companies.

Many options

Below are a some examples of sectors with considerable U.S. clout (see table this page based on the S&P Global Broad Market Index[1]).

Technology. The dominance of U.S. firms in tech is well known. In 2019, seven out of 10 of the largest technology companies in the world were American.[2] As the table shows, this pre-eminence is especially strong in software, with 86% of the sector in the index being U.S. owned.

Health care. Over $7.8 trillion (USD) a year is spent on health care globally. Nearly half of that total – $3.5 trillion – is spent in the United States.[3] It's no surprise then that American firms hold sway in this sector too, with an especially strong presence in the Health Care Provider and Biotech areas.

Consumer Segments. With its large, affluent market and powerful brands, the United States is home to some heavy hitters providing products and services to the consumer market. U.S. companies making household products dominate their sector and American specialty retailers hold supremacy in their space.

Easy access

For Canadians, it's difficult to access U.S. markets directly. Mutual funds offer a way in, with the added benefits of diversification across a number of holdings within the fund, as well as the expertise of the fund's professional managers.

U.S. Equity Funds. The most obvious choice for access to American firms, these funds make up a wide category including large, mid, and small-cap funds as well as funds that are actively managed or that follow popular indexes like the Dow Jones Industry Average or the broader S&P500.

Global Funds. There is a good chance that a broad-based global equity fund will have a large percentage invested in U.S. assets. It's important not to take that for granted, however, as the fund's mandate may put an emphasis on other regions such as Asia. Note also that funds labelled as "International Funds" typical exclude American firms.

Specialty Funds. Specialty funds that concentrate on technology, health care or financial services will also have a big American presence. The same may be true for funds that look for "global leaders" that dominate their sector or market.

Chances are funds like these are already working for you in your portfolio. If you'd like to understand more about mutual funds that invest in U.S. firms or the role they play in your portfolio, let's review your portfolio soon. ◀

[1] *World Economic Forum with data from S&P.* https://www.weforum.org/agenda/2020/02/dominance-american-companies-global-markets-industry/
[2] *Forbes Global 2000 List,* Investopedia, November 2019. https://www.investopedia.com/articles/markets/030816/worlds-top-10-technology-companies-aapl-googl.asp
[3] *Investing in Health Care Stocks,* April 2020. https://www.fool.com/investing/stock-market/market-sectors/healthcare/

Where America dominates

One of the key benefits of investing in the U.S. is to gain access to sectors that are underrepresented in our own country's stock market. As this chart shows, in sectors such as IT, software, and health care, American companies really dominate.

Source: *World Economic Forum with data from S&P.* https://www.weforum.org/agenda/2020/02/dominance-american-companies-global-markets-industry/

Percentage U.S. dominance by sector, S&P Global Broad Market Index

Sector	% of U.S.-based Companies	Most U.S.-heavy Subsector
Information technology	73%	Software (86%)
Health care	65%	Health care providers (82%)
Utilities	53%	Electric utilities (57%)
Real estate	51%	Equity REITs (69%)
Consumer discretionary	49%	Specialty retail (73%)
Consumer staples	46%	Household products (74%)
Industrials	46%	Aerospace & defense (73%)
Energy	44%	Energy – other (73%)
Financials	44%	Financials – other (73%)
Materials	30%	Chemicals (41%)

Dipping into TFSAs? Caution: both tax rules and mutual funds rules may apply

The Tax-free Savings Accounts' (TFSA) withdrawal provisions are ideal when you need to tap your savings, as many of us were reminded during the COVID-19 pandemic. If you're a mutual fund investor, be alert to the rules: not just of the account, but of your funds as well.

When it comes to withdrawals, TFSAs have real advantages: Any amount withdrawn is not subject to tax. Plus, there are no restrictions on the amount or the timing of your withdrawals. Even better, you can put that money back in – subject to the rules regarding re-contributions.

Generally, the rule is that the amount of your withdrawal from your TFSA will be added back to your TSFA contribution room the following year. If you want to replace the money you withdrew, you'll need to wait for the new year.

If you are holding mutual funds in your TFSA, be aware of any early redemption fees that may apply to the fund, usually if you have held it for less than 90 days. Fund units that are subject to a redemption fee are determined based upon the "first in, first out" (FIFO) method, where shares bought first are redeemed first, and shares bought last are redeemed last.

When re-contributing and buying mutual fund units, keep in mind that the fund may have minimum purchase requirements on a one-time or monthly purchase basis. ◀

Most Canadians want their financial advice from a human being

Three quarters of Canadian investors say they want financial advice to come from a human, according to new research from the Investment Industry Regulatory Organization of Canada (IIROC).

Are we talking digital dinosaurs here? Not at all. While the survey found that 79% of current investors are comfortable doing financial business online – witness the widespread popularity of online banking – less than 20% have tried automated investment services.

Respondents seem to value the personalized service they perceive coming from a real person. Just 40% thought that automated investment services provide services that are "personalized." They also want their financial advisor to take into account their immediate family as part of the investment planning process.

As for the digital services, investors said that are concerned about "privacy and security" and worried that regulatory standards might not be as high.

As more and more of our lives move online, for now at least, it seems we value the personal touch when it comes to managing our money. ◀

Source: *Access to Advice, IIROC and The Strategic Counsel,* December 2019.

Which funds are ideal for getting kids or grandkids started?

If you're looking to get your minor children or grandchildren interested in investing, mutual funds can be a great way to get started. Depending on your intentions, here are two great approaches.

Habits learned during childhood can last a lifetime and that's true for investing as well. If you are looking to model good savings and investing habits, a simple approach is to use a balanced fund. Most balanced funds include both fixed income and equity investments, giving your protégés some basic diversification. And many of these funds have low minimum contribution amounts, often starting at just $50 a month. Setting up a regular contribution plan can demonstrate the power of regular investing to help the reach a goal, such as saving for higher education.

If you're looking to teach your kids or grandkids a little more about the dynamics of investing – perhaps they are a little older or seem especially keen – then use individual funds. A simple portfolio of one fixed-income fund and one core equity fund will offer them the chance to observe how the different asset classes behave: slow and steady for the fixed income and likely some greater price movement for the equity class.

Be sure to seek advice on setting up the accounts. Options may include an informal in-trust account or a Registered Education Savings Plan (RESP). There are important tax, attribution, and ownership rules you'll want to understand before you proceed. ◀