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## Tailor RRSP investment to risk reassessment

Mark Noble / January 30, 2008



You have a client, you have a plan, and you have his or her RRSP contribution — that's the easy part this year. The hard part is what to do with that money in a volatile market so you still have that client next year.

If there is any consensus right now, it's that the double-digit returns of the past few years are not going to be attained with the same ease and certainty, so advisors are going to want to adhere to their clients' financial plans without losing their money.

Opinions on how to do this vary, as do the types of asset allocation needs of clients. Nevertheless, most portfolios are constructed with a longer term investment horizon, which if appropriately diversified is positioned to weather short-term volatility. So the first thing that should be examined is whether rebalancing is necessary.

Paul Adair is the managing director of BMO Nesbitt Burns Wealth Group, which oversees managed account products such as the company's Quadrant and Architect programs. He says good portfolio management requires sticking to your investment plan, but you should be wary of opportunities that arise during volatility.

For example, Adair says, many of the managed portfolios have an 18-month investment horizon, so managers look for opportunities that enhance the portfolio to outperform during that horizon.

"We are positioned according to what we anticipate the market to be 18 months out from now, as opposed to three months from now. I think that means that you are trying to look through that volatility to see where the endgame is," Adair says. "If volatility is presenting opportunities where prices are dipping down, in some cases you're going to be buying back into the market on some of that stuff. You need to stay the course in terms of where you are positioned."

Adair notes that periods of volatility are good times to look at your client portfolio because it can provide a form of stress testing that may highlight that the portfolio was not as well constructed as initially thought.

For instance, rarely would clients fault their advisors for keeping their money in Canadian equities over the past few years since they have performed well. But sudden volatility can reveal that a client portfolio is indeed a little too overweight in this asset class. If this were the case, Adair suggests allocating your clients' RRSP contributions to rebalance the portfolio so that it is more in line with the long-term asset allocation strategy.

"If you have an asset mix in place, it probably makes sense to allocate [the contribution] across your asset mix, but you may need to allocate it tactically to adhere to what your current [investment] policy should be," he says.

Rebalancing may also be necessary if your client has overestimated his or her risk tolerance, says Winnie Go, an associate portfolio manager and senior investment executive at Scotia Private Client Group.

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"We look at their financial plan and we advise them to stick to their plan. We are not trying to time the market. For some clients, turbulent markets can be a good time to review their strategy, risk tolerance and rebalance if necessary," Go says. "Investing is partly about a client's risk tolerance. They will still make their contribution, but how they invest it may change. If they are comfortable to stick with the plan, then they'll invest with the plan."

In the case of the extremely risk-averse client, an advisor may want to consider investing his or her contribution in a high-interest savings account or just plain old cash, says Frank Wiginton, a CFP and senior financial planner with TriDelta Financial Partners.

"Clients aren't hesitant to make contributions, but they are concerned about the bigger picture goal of whether [volatility] will affect them achieving the goals we set out for them. Most of my clients understand just because you make an RRSP contribution doesn't mean it has to be invested in the volatile equity markets," he says. "If they are not comfortable with the volatility of the markets, the contributions can be simply deposited to a high-interest savings account within the RRSP."

Wiginton believes investors should be more defensive right now. For the past six months, he's been rebalancing his clients' asset mix, moving away from equities and into defensive positions such as gold and short-term bonds. Wiginton notes his client portfolio rebalancing is done in consultation with investment counsel firms, which actually manage his clients' money after the investment direction is agreed upon.

"We have spent the last six months moving more and more of the portfolios into defensive and conservative investments — this has mitigated losses by more than 10%," he says. "We moved more out of equities in general and basically into short-term bonds, expecting rate cuts over the last four to six months. The values of short-term bonds tend to go up when interest rates get cut."

Where his clients are invested in equities, he says, they have moved more from tech companies like Research in Motion, which he says typically have higher volatility, and into more defensive areas such as energy and stocks with historically high dividends.

"We are starting to purchase high-quality companies that are trading at historically low multiples and that are paying out historically high dividends," he says. "On the fixed income side, we are supplementing the low-yielding high-tax interest bonds with some very attractive high-yielding low-tax dividend preferred shares."

Not all clients have the means to create separately managed accounts. A good substitute, though, can be a well-managed portfolio or wrap program, says Kim Buitenhuis, vice-president of marketing and communication at RBC Asset Management.

"For many investors, a portfolio solution is a good option because it's a diversified portfolio. It is professionally managed, rebalanced on an ongoing basis, and there is a long-term horizon," she says. "Certainly at RBC we have regular meetings and make tactical adjustments as events dictate, so I do think it's a good alternative to just putting it in cash."

So just what is a tactical portfolio manager doing these days?

According to Paul Vaillancourt, senior vice-president and portfolio manager for Fiduciary Trust Company of Canada, which manages the assets of Franklin Templeton's wrap Quotential and Tapestry portfolio programs, last week's stock market downturn will be short-lived. His funds are actually overweight in equities right now.

"Our mandate is to basically look one year from now. If you ask us right now, one year from now, what will have better performance — stocks or bonds — our view is stocks," he says.

Vaillancourt says Fiduciary Trust's benchmark is the generic balanced portfolio with a 60/40 split, with 60% of the holdings in equities and 40% in fixed income. On the equity side, the benchmark is 35% Canadian stocks, 13% U.S. stocks and 12% international stocks.

"That's our balanced view," he says. "Based on our views of the world and current themes and how they will play out going forward, we are going to overweight or underweight certain sectors. Right now we happen to be about 36% fixed income, 34% Canadian stocks, 18% international and 12% U.S. We are therefore underweight at 36% fixed income and slightly overweight in the equities benchmark."

Valliancourt says there is nothing in the company's metrics to suggest we are headed toward a bear market.

"We've been talking about volatility and anticipating a correction, but in the short-term markets, investors move because of greed and fear. Our view is to stay forward-looking and stay invested," he says. "If we thought we were looking at a secular prolonged bear period, hopefully our indicators would have identified that, and it would have skewed our position towards fixed income. That's just not what we see here."

He adds, "A lot of people have overreacted, and over last week [the week of January 25], they may have lost between 15% and 20%. What people have to avoid here is making two bad mistakes in a row. If you bought in late and bought overvalued assets, that's one problem, but if you panic and then sell them, that's a second problem, particularly if the stocks recover. Our view is to make one good decision, and that's to stay fully invested, and hopefully fully diversified."

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