PREPARING FOR THE NEXT DOWNTURN

How to Safeguard Your Money

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TABLE OF CONTENT

INTRODUCTION

If you are like most people, you are uncomfortable investing your own money because you feel that you lack competence. To avoid this discomfort, you give your money to a 'financial advisor'. And while this puts you at his or her mercy, you feel better having delegated the responsibility to someone else. In other words, you won't have to blame yourself when and if something goes wrong. The problem with this scenario, however, is that the advisor, in most cases, charges a very high fee for accepting that responsibility. He either does this through mutual fund fees or by trading stocks or other instruments in your investment accounts; and sometimes these fees are deeply hidden.

In this guide, I am about to show you a way to have your cake and eat it too…as the old saying goes. By using the method that I have used for many years and learned from some very wise people, you will reduce your risk, lower your fees and ultimately have more money. But there is a downside; it's simple, and people prefer complexity. However, when it comes to money, 'complexity' loses and 'simple' wins…every time. This is the message that Warren Buffett, John Bogle and other great investors have advocated for years. Keep it simple and win.

The purpose of this mini guide is not to give financial advice but to provide education and perspective. I want to make you aware that with minimal effort you can become very capable of managing your own money and protecting your savings in the next big financial debacle. There is no need to fall victim to slick talking mutual fund and insurance salespeople or so called 'financial advisors'. This guide will help you take a different route than the crowd. By doing so you will greatly increase your prospects for prosperity. The enhanced sales promotions and 'talking heads' of the financial services industry will no longer be able to threaten your hard-earned money. You will also not have to fear the next big panic on the stock market. Your savings deserve better treatment than being put at risk.

I know that what follows may seem unfamiliar to most people. But walk with me through the pages and you will be in a better position to construct a more secure financial future. I will share with you some of the simple truths learned by great investors. Along with their wisdom, I will also refer you to their practical solutions for building wealth and protecting your money. Wise investors never gamble or take unnecessary risks. Warren Buffett says that rule No. l is “never lose your capital”, and rule No. 2 is “never forget rule No. 1”. We will keep this in mind as we continue with our investing for the future. We want simple, low-risk, practical investment programs that deliver maximum results with minimum risk. You will like what I have presented here. It is the approach that Joanne and I use to manage our own investments and it works.

Please be sure to make notes, read the recommended material and contact the suggested agencies. And above all, make it fun.

R. J. (Jim) Cougle

The Most Important Decision First

Before you even think about investing money, you must answer this question: How much of my money will I need in the next seven to ten years? This money should be put in a high interest bank account, GICs, CDs, short-term bond fund or one of the new cash-based Exchange Traded Funds (ETFs). The reason for doing this is that you don't want to be selling things to raise cash in a down market. This is how many people will lose a lot of money in the next recession or depression.

Mutual Funds: The Good, the Bad and the Somewhat Ugly

Unfortunately, most people reading this little guide either have mutual funds or have been encouraged to buy them without truly understanding what they are getting into. While not all mutual funds are bad, the vast majority are substandard investment vehicles for most people. The reason for this is not difficult to understand.

Mutual funds are constructed with the sole purpose of making money for those who build them and those who sell them. A group of people at a bank or other financial institution pick a bundle of stocks (equities) from the stock market and sometimes a portion of bonds, parcel them together, write up a prospectus to protect themselves from lawsuits if the product fails to perform, and give the package to their marketing department. These people put together a glossy sales brochure that usually makes the product look far better than it is and then give it to their salespeople. They carry such titles as financial advisor, wealth manager, broker, financial planner, etc. However, they are first and foremost commissioned salespeople and that is exactly what is often stated on their licence … which you don't see.

There are also other major drawbacks with mutual funds. The biggest one is that their performance is dependent upon the manager's ability to pick the right stocks and then to trade them more effectively than the other managers who are also very smart guys. The idea is to beat their peers (or at least match them) and outperform the market. This seldom happens. In the past 25 years only about 10% - 20% of those 'smart guys' beat the overall market. Yet the public has paid a huge price. You see, whether the mutual fund does well or not, the unit holders still pay – big time. Most people don't realize this. The person who sold you the mutual fund units receives a commission of usually between 5 and 7 percent of your money as a commission. They also get 1% every year for as long as you hold the fund. And on top of that, the management company/bank gets 1.5 – 2% of your hard-earned cash. You pay them these fees (and often a few hidden ones) even in years when the fund loses money - and for all the years that the mutual fund underperforms the market. This may not seem serious, but it is. Canadians pay the highest MERs (management expense ratios) in the world.

Probably the worst aspect of owning mutual funds or other packaged products is the crowd you're with. Most mutual fund owners have no idea what they own (I didn't), how they operate, or who the managers are. So, as in 2008 and 2009 when the market crashed, they sell en masse. This means the first ones out have the best chance of getting most of their money. Those that remain pay for those who jumped ship. Worse, in a down market when the manager is forced to redeem units for panicked investors, he/she often must sell his best stocks because those are often the only ones for which there is a market. What can happen is that the unit holders who remain in the fund are left at the end of the crash with nothing but units of the poorest stocks that the manager couldn't sell. This is somewhat like being the little pig that got to the trough last.

That same little pig who got to the trough last may also be one of the first ones called in by his broker/advisor for a "portfolio review". When this happens, it is always best to run the other way. The big bad wolf wants you in his office so that he/she can get rid of your current mutual funds or stocks and replace them with new ones – which they will claim is better for you. But if the old ones are bad, why did she put you in them in the first place? In almost every case, this is not a good move for the client. It is better for your broker/advisor, because he/she will get a commission getting you out of your current holdings and another commission getting you into new ones. And if it happens to involve mutual funds, they still get their trailer fees[1], but with an added benefit - when they switch you into the new funds, they will have you hooked for up to seven more years because in many cases, it will cost you too much to leave. This is often why financial advisors live a much better lifestyle than those to whom they are giving advice. Maybe it's time we stop financing someone else's lifestyle and look after our own.

[1] Trailer fee: A commission that the salesperson of a mutual fund receives each year an investor remains a shareholder. That is, the salesperson receives the first trailer fee when the investor first buys shares in the fund, and a new trailer fee each year thereafter.

Index Funds and ETFs– The Basics

The focal point of this mini guide is indexing, or passive investing. This term refers to the process whereby instead of having a manager buying and selling stocks or bonds, they simply buy a representative sample of the whole market and maintain it by balancing periodically. The two primary products are index funds (sometimes referred to as index mutual funds) and ETFs (Exchange Traded Funds); I will explain how to use these excellent wealth creating vehicles as we go along. They are very similar in that they are both passive because they are not actively managed like a regular mutual fund. In other words, they just represent the whole or part of the market with no one buying and selling stocks on a regular basis as I just mentioned. Index funds can be purchased through a bank or a discount brokerage account. In the last section I will show you how you can do this yourself and save even more money. Stock and bond ETFs form the core of my portfolio, augmented with dividend paying stocks.

While index funds and ETFs are very similar, index funds can sometimes be more beneficial for those just starting out because small amounts of money can be invested each month. TD Bank e-funds are considered by many people to have the most versatile index funds for this purpose. Indexing is said to be the absolute best way for the average person to invest money. Less expensive than regular mutual funds and less risky than individual stocks or bonds, they are the essence of safety and simplicity. Index funds and ETFs are the mainstay of many pension funds and the choice of some of the greatest investors. Even Warren Buffett, the world's most successful investor, says they are ideal for "95% of the population". Indexing keeps you from having to study the market and worry about the economy. They are the corner stone of sleep-easy investing. It is a shame that more people are not familiar with these simple, easy-to-use products.

So, how do ETFs differ from index funds? Like index funds, ETFs are passive and represent the whole, or part of, the entire stock or bond market. Also, like an index fund each stock or bond is represented as a percentage (usually capped at a maximum) depending on size. Thus, a big company like Wal-Mart will have higher weighting than a comparatively smaller company like Shoppers Drug Mart.

The major difference between an index fund and an ETF is that ETFs can be more easily bought and sold. In this regard they are no different than buying a stock.

They trade on the Canadian (SP/TSX) and American (NYSE) stock market using stock symbols and are priced as the market moves each day. Examples are XIC which represents about 200 stocks on the SP/TSX, the major Canadian stock exchange. XSP represents a similar number on the New York Stock Exchange (NYSE), the largest American exchange. Canadian real estate investment trusts (REITs) are represented by the symbol XRE for example and there are many other index funds. We will deal with them in the last section where I will introduce you to some basic ETFs and company websites from which you can construct a portfolio suited to your situation and personality. Some people may wish to take the easy route and just buy one or two of the new type of ETFs that do the work for you. In January 2018, Vanguard Corporation introduced new ETF portfolios that act like index funds but can be bought and sold on the stock market through an online discount brokerage account. These ETFs are composed of both equities (stocks) and bonds, are balanced on a regular basis and only charge .22% for management fees. They seem ideal for most investors and will be discussed in detail later. Until we get to that section, let's just walk together through the process of learning the basics. For many people, self included, this has been a life changing experience. And the process is no more complicated than paying bills online.

But maybe you would like to take a little break now and go to www.globeinvestor.com or www.finance.yahoo.com on your iPad or computer and enter XIC in the search bar. This ETF by iShares (owned by BlackRock) represents a basket of stocks on the Toronto Stock Exchange. You will see the price, the price range in the past 52 weeks and you can also get a graph that gives the performance in the past five years or from its inception. For the dividend payout and history go to blackrock.com, then at the bottom of the page click on iSharesETFs. In a few pages I will walk you through the process of index and ETF investing, this is just a sneak preview.

There are also specialty index funds and ETFs that represent only part of the stock or bond market. Some represent a specific segment of the market like energy, real estate, income trusts or health care. Bond index funds are the same. There are corporate bond index funds; ones that represent a basket of government bonds and others that have a mixture of both. Some even specialize in Junk Bonds which are more speculative (risky) but pay much higher interest. Index funds and ETFs also have the added benefit of reducing investment risk because each stock or bond is a small percentage of the whole basket. Another benefit is that they have much lower fees than regular mutual funds – usually about one percent for index funds and about half that for ETFs. A real bargain.

Glenn Kohaly of Kelowna, BC in a MoneySense magazine article, summarizes his financial situation for all to read. "I'm in a good position now because of the planning I did in my 50s. I tracked all my spending over a year, and I used it to figure out how much I thought I'd need to live on in retirement. …. I realized I had to be more diligent about saving and invest wisely. …. Now I have my money in exchange-traded funds (ETFs). I like ETFs because they give me a broad basket of investments without the high fees of mutual funds. These days we live a good middle-class life".

It begs the question however: If index funds and ETFs are so great why don't I know about them and why has my financial advisor not mentioned them? The answer is very simple. Financial salespeople make far less money when you own index funds or ETFs than when you own mutual funds. Although a basic index fund that just represents the market beats 80-90% of mutual funds, most people don't own them. Advisors (unless they are fee-only planners) are, as previously stated, mainly commissioned salespeople. The more expensive the product, the more money they make. Therefore, they invariably sell you mutual funds or some other high-priced packaged product, like segregated (SEG) funds or a wrap account (bundled account). Both of these are nothing but a basket of high-priced mutual funds grouped together and sold to people by using slick sales tactics and high sounding promises. As Rob Carrick, the Globe and Mail commentator, points out, "Wrap programs are an exercise in packaging and marketing more than anything else." This also applies to SEG funds. Any gimmick to get your money – the latest one being life-cycle funds which I talk about later.

Another reason why most advisors don't mention index funds is that you can buy them yourself directly from your bank or a discount broker. ETFs are not sold through banks but can easily be purchased online after setting up a discount brokerage account through your bank. This makes far more money for you but cuts your advisor/salesperson out of the loop. The process is so simple that it will shock you. If you can pay bills online or order something from Amazon, you can do your own online investing. Honest.

My financial situation has improved dramatically since I started investing on my own using mostly ETFs. After learning the basics, most people can set up an effective portfolio in about 15 minutes. You can then balance it every year yourself or buy ETF products that include automatic balancing for a very small fee as previously discussed.

But just to reinforce my point about financial advisors/salespeople not wanting you to know, I am including an actual e-mail that I received in 2007 from my former advisor at a large bank-owned brokerage firm.

> Hi Jim:
>
> I think the whole concept of you using ETFs has merit –
> and will reduce your costs to the point where you can have
> less money in equity investments and more in the more
> secure bond and preferred share area of the markets.
> The downside (if you view it that way) is that with the ETF
> structure there is no provision for advisor compensation. That
> means that you either pay a flat fee to an advisor (as a percentage
> of assets under management) to work with you using these vehicles
> OR you do it yourself in a self-managed account setting.
>
> There are loads of resources available for investors who'd like
> to minimize costs and are confident enough to work without
> help.
>
> Kind Regards,

Shortly after receiving this e-mail from my financial advisor, I transferred my accounts to the discount brokerage firm owned by the same bank. With minimal effort and some help from the index fund people at iShares, BMO (Bank of Montreal) and Vanguard, I set up a simple portfolio. The new portfolio is better than anything my advisor ever did and saves me thousands of dollars in management and brokerage fees.

As a bonus, when the markets crashed in 2008-2009, I did not panic because I knew that I was well diversified and had just the right amount of money in stocks.

Even though the investing area of my life has improved, it was difficult to leave my advisor. She is a fine woman and we had become friends over the years. But when a relationship is having a negative impact on one's finances, it is time to sever the ties. As one writer stated, "Your broker is not your buddy". The very nature of the commission-based compensation paradigm precludes equality in the advisor-client relationship. The advisor/broker must live off his clients - the pressure is on to produce and unfortunately the investor usually comes last. Advisors are forced to make maximum compensation for themselves and for the bank or financial institution for which they work. Hence, being client-centered is not the way to get ahead as a broker/advisor. Sorry, but that is how the system works. Usually there is nothing wrong with the individual; it is simply the system in which he or she operates. In most cases, for them to win you must suffer from overpayment and substandard returns. His or her lifestyle is directly proportional to how many over-priced packaged financial products they persuade you to purchase or trades made in your account.

For example, some index mutual funds and most regular mutual funds have "A" class categories which can only be purchased by financial salespeople and "D" class categories that can be purchased by individual investors with no fee and lower management costs. The 'A' funds pay a trailer fee back to the salesperson for as long as you own them. So, what could have cost you far less money through an online discount brokerage account, you are now paying someone a large fee for doing what you could have easily done yourself.

Following is an article written by Seth Jayson which appeared on the Motley Fools website (www.fool.com). The people at Motley Fool, (don't let the name mislead you) are among the best financial commentators in the world. The article is an excellent comparison between Mutual Funds and ETFs.

Mutual Funds vs ETFs

How they work

Mutual Funds: Traditional, actively managed mutual funds, usually begin with a load of cash and a fund management team. Investors send their money to the fund, are issued shares, and the Porsche piloting team of investment managers figures out what to buy. Some of these stock pickers are very good at this. The other 80% of them, not so much.

Index mutual funds work similarly to traditional ones except that the managers ride the bus and eat sack lunches. (Actually, there are rarely human managers - most index funds are computer driven.) More importantly, index mutual funds put money into stocks that, as a whole, track a chosen benchmark (or indices such as the SP/TSX - Toronto or the NYSE - New York). Because there is less 'research' to pay for – like trips to California to visit a refinery's headquarters (and a little wine tasting, "…since we're in the neighbourhood…") – index mutual funds generally have lower expenses. If the fund is popular, or if salesmen make it so (yes, funds often have a sales force) it attracts gobs of money. The more money that comes in, the more shares that must be created, and the more stocks investment managers (or Hal, the index robot) must go out and buy for the fund.

ETFs: ETFs (exchanged-traded funds or index funds as they are often called) work almost in reverse. They begin with an idea – tracking an index – and are born of stocks instead of money.

What does that mean? Major investing institutions, like Fidelity Investments or the Vanguard Group already control billions of shares. To create an ETF, they simply peel a few million shares off the top of the pile, putting together a basket of stocks to represent the appropriate index. They deposit the shares with the holder and receive a number of *creation units* in return. (They then sell these units to the public usually through discount brokers).

That's the birds and the bees of ETFs and mutual funds.

Most investment products have their place as you will see. It's just that index funds and ETFs tend to be less expensive and more efficient.

The Basics of Simplified Investing

Step 1: **Who will make your investment decisions – you or someone else?**

Since the whole point of this mini-guide, and indeed the entire process, is financial security, I'm going to argue for self-directed investing. I believe that the average person, with very little effort, can become an efficient investor and save thousands of dollars in the process. By following the simple paradigm laid out in this guide, you will be ahead of 90% of investors. As I stated in the introduction, and will repeat often, "**simplicity is the essence of investment success**".

As previously mentioned, professional money managers, mutual fund salespeople and commission-compensated investment advisors often claim otherwise, but they are not correct. If people learn to invest on their own, the investment industry loses money. That simple. If you don't buy mutual funds and other expensive managed products, they can't collect their commissions and management fees. There will also be no lifelong trailer fees for the sales force.

A simple breakdown

Following is a breakdown of how the financial industry works against investors. You buy a mutual fund or other packaged product from your advisor. He/she usually receives a commission either up front or later of approximately 5-7%. Plus, as long as the money remains in the fund, she receives about 1% each year as a trailer fee. The management company usually charges between 2.5% and 3.5% to manage your money. This does not sound like much until you start doing the math. Let's take the example of someone who has accumulated a $50,000.00 portfolio. Here is roughly the cost for 20 years not considering growth, etc.:

$50,000 x 2.5% = $1,250 x 20 yrs = $25,000.00
or, do it yourself
$50,000 x .6% = $ 300 x 20 yrs = $ 6,000.00
Difference = $19,000.00 (in your pocket)

It gets worse. Not only do the managed investments cost you about four times more in fees, you will almost certainly get less in another way. If, as has happened before, there are long periods of fund losses, the 2.5% is eating into your precious capital. All that hard-earned money is going to your advisor, the brokerage firm and the fund company. They always make money whether you do or not. It is always a win-win situation for them.

To add insult to injury, not only are you going to pay thousands of dollars more for someone to manage your money, they are, in most cases, going to do it less well than you can do yourself. Using one of the simple approaches that I outline later in this guide, you can do just fine. In fact, you can do better than 80% of the professional money managers since only about 10% of mutual funds consistently beat the indices (stock or bond market) in the past 20 years. That means if you bought a simple index fund that matches the SP/TSX (Toronto Stock Exchange) or NYSE (New York Stock Exchange), not only would you save thousands of dollars but would also have beaten about 90% of the professional money managers. How is this possible? How can an ordinary person ever beat all these super smart people on Bay Street and Wall Street? Simple. The mutual fund money managers must charge those big fees, time the markets, and trade stocks better than the other managers using the same pool of stocks. Only about 10% can do it over an extended period. So, when you buy a mutual fund, there is approximately a 1 in 10 chance that your fund will beat the market over any 10-year period. The smart people that you are about to meet in this guide say, "don't buy mutual funds or other packaged financial products". They use index funds and/or ETFs and advise that you keep your investing simple and make more money. You can easily do it.

Remember — there are only two ways that your investment advisor/broker can make money. He/she either must sell you expensive financial products and get a commission and trailer fee or sell you stocks and bonds and keep trading them. There is no other way for them to stay in business. I know I sound like a broken record, but you can't hear this enough.

Another problem in dealing with a full-service brokerage (financial advisor) or mutual fund/insurance salesperson, is that their commission fee structure is so high. Therefore, they must sell you relatively large quantities of everything you buy to keep the percentages in a realistic range. This is a major concern for those investors who prefer to buy individual stocks and bonds. What happens is that you can end up with far more shares or units than you should have in your portfolio. An example would be a typical full-service broker who must charge a minimum of $250.00. If he/she sold you 100 shares of ABC Corporation at $10.00 per share and charged her minimum fee, your cost is 25% of the transaction. You may only need one hundred shares for your portfolio, but he/she will sell you one thousand.

Dr. William Bernstein, a retired neurologist and one of America's best investment writers, tells it this way, "The financial industry, which just cost American taxpayers over a trillion dollars in the big scam-oriented meltdown, should be approached as 'an urban combat zone'". He suggests that if investors assume, "every broker, insurance salesman, mutual fund salesperson and financial advisor you encounter is a hardened criminal, you will do just fine". Tough language but wise counsel from the good doctor.

Rob Carrick, the financial reporter for the Globe and Mail, and "one of Canada's most widely read and best respected financial experts" tells it this way. "The investment industry is forever casting itself in its marketing efforts as a wise and friendly helper that just wants to make you wealthy. Actually, banks, brokerages, fund companies and other financial firms want to make themselves rich, first and foremost. With this end in mind, financial companies spew out all kinds of self-serving chatter designed to make you receptive to the kinds of products and services they sell".

One of the biggest self-serving products that the investment industry is pushing right now is their so-called "life-cycle funds". The terminology can be confusing. Some companies use "target date funds", "age-based funds" etc., but they are all just a basket of high-priced mutual funds. They add more bonds as you get older. In most cases the MERs are high and the effectiveness questionable. There is also no evidence that any of them can outperform a well-designed portfolio using index funds or a simple all-in-one ETF like the new ones from Vanguard. Charles Kirk (thekirkreport.com) says that: "I don't like life-cycle funds. In my experience they under perform, they are too conservative, they're not very tax efficient and I think allocation should be determined by more than just age…. you need to take an active role with your money. No one is going to defend your best interests the way you can".

This about says it all. Anyone who has ever met with a so-called financial advisor, mutual fund salesperson or insurance salesperson, knows how they can manipulate data to show why you should buy their products. However, it's usually what they don't tell you that hurts your investing future. By simply going the index investing route, the average person could have about 40% more money at retirement.

Summary:
Learn to invest on your own and stay away from packaged products. You will have more money, and fewer worries. Never trust your financial future to someone else. You must be involved. As Harry Newton said, "Prayer is your biggest tool when dealing with investments that are managed by someone else".

Is there an alternative to self-managed investing? Absolutely. If after going through this mini-guide you are still not comfortable investing on your own, consider using a fee-only financial planner like those found at adviceonlyplanners.ca, canadianmoneysaver.ca or at moneysense.ca. At yahoo.finance.com there are others listed. You can also get plenty of help from the investor relations people who are employed by index fund companies and on their websites such as blackrock.com and others listed later. There are also new suppliers coming on stream. Bank of Montreal for example, has developed its own family of index funds. TD Waterhouse has developed a series of index mutual funds that can only be purchased online. They also have so-called robo advisors that will set up a simple portfolio for you. Their 'e-series funds' offer the lowest MERs and according to Rob Carrick "…. represent a good alternative to ETFs for investors who want to make regular monthly purchases." For details, see www.tdwaterhouse.com. These financial institutions also have one-size-fits-all products that are cheaper and more efficient than regular mutual funds. These alternatives, which I like very much, will be discussed in a later section. The main thing is to get a good basic knowledge and know that lots of friendly, inexpensive help is available.

A Simple Plan

To understand and utilize simplicity you must become familiar with a few basic concepts. Learning these will make your eventual portfolio construction easier and give you the confidence to go wisely through good times and bad.

Let's start by getting rid of some of the myths surrounding investing. Many people feel they lack the intelligence and education to look after their own money. Warren Buffet says that when it comes to investing, "an IQ over 150 is a waste".

You don't have to be a genius. A simple plan and the wisdom to follow it will suffice. Mr. Buffett advocates "prudence, patience and thrift" for all people who wish to acquire wealth. He became a multi-billionaire partially by using such simple old-fashioned guidelines.

As for education, this is another myth. Some lawyers, doctors, teachers and even economists are among the poorest money managers - while some very ordinary people are among the richest people I know. My friend John and his wife always spent less than they earned and invested the difference. They eventually accumulated well over a million dollars. Not bad for two ordinary people who also raised two children over that period. In a few pages, I will show you how they did it.

It can sometimes be more difficult for well-educated people to save than for those with less education. The well-educated tend to have more expensive tastes. So even though they normally have more earning power they also tend to spend more on expensive vacations, big homes, fancy cars, etc. So, if their propensity for spending is greater than their ability to save, they may have little or nothing left to invest. All you must do is spend less than you earn and wisely invest the difference. This is what my grandfather did, and he retired with plenty of money to enjoy his later years.

Please note that I am not knocking education. I was fortunate enough to be able to get a university education. What I am pointing out is that education is not necessary for financial success and neither is above average intelligence. All that is required is to save for the future and invest with low risk financial vehicles and let time and compounding do the rest.

The Stock Market: The Great Unknown

Another myth is that the stock market is knowable and that it is understood by certain wise people. This is false. The market is totally unknowable and unpredictable. While it is true that there are (or seem to be) certain cause and effect relationships, the market is nonetheless virtually unpredictable. Market timing doesn't work — don't try it. The only thing that works consistently over time is putting money in low cost index funds or ETFs on a consistent basis and balancing every year or so. This will be discussed under 'Portfolio Construction'. For now, we will concentrate on understanding the reasoning behind what we are going to do later. Just remember what an old stockbroker once said to his young protégé, the now famous John C. Bogle, founder of the Vanguard Group Inc.: “Here’s all you need to understand to succeed in this business: nobody knows nuthin”. Therefore, a simple, low-risk plan that ignores market gyrations is so important. No one can know what the market is going to do. Not even Warren Buffett; a fact that he readily admits. When the market imploded in 2008-2009 it caught almost everyone off guard. Not even the professionals were spared. It will be the same next time … and that could be sooner than we think.

So, if we can’t know what the market is going to do, what can we know for certain? How do we dare have money in the stock market either through mutual funds, index funds, ETFs or just plain shares? Who can we trust if the investment industry is corrupt? What happens to my hard-earned money if the market crashes? How will I be able to retire? These are the types of questions that people are asking as we sail into the somewhat uncharted waters of this new century. They are good questions that deserve good answers.

To best answer the questions dealing with future uncertainty, I am going to list those things we can know for certain. Knowing these certain things will best prepare us to deal with the uncertain things. Wise investing is more about not doing the wrong thing than it is about doing the right thing. My point here is to prevent you from doing the wrong things. Unlike my own early experience, I want to get you off on the right footing. I will intersperse these investment truths with wise counsel from some of the greatest investors in the world. The road to financial freedom through a good investment portfolio is much easier than you might think.

The Least You Need to Know

Here are a few simple truths that you can count on for accuracy. These ten things are the least you need to know about investing.

1. Most people, regardless of their intelligence, cannot trade individual stocks and do better than the market. What they make in good markets they give back in bad ones. In fact, only about one in four expert money managers can beat the market over any 10, 15 or 20-year period. The market is smarter than most people. That is why Warren Buffett advises people to simply buy the whole market and reap the benefits: “I recommend index funds for people who don’t

want to spend time studying the market. They are good for 95 percent of the population."

2. The market is always in a state of flux but mostly it's just boring. It goes up and down each day, sometimes a lot, but over time it always treads upward no matter what is happening. Huge declines are followed by huge rallies and periods of stagnation are followed by periods of life. Overall, both the Canadian and American stock markets have returned about 10% per year over the past 50 years. This includes the reinvestment of dividends.

3. The market is both unpredictable and unknowable. It runs mostly on fear and greed which are highly contagious. Bad news or good news can send the market and/or certain stocks much higher or much lower very quickly. To quote Warren Buffett again, "unless you can watch your stock holding decline by 50 percent without becoming panic stricken, you should not be in the stock market". Most people cannot handle abrupt changes in their stock holdings or mutual funds. For this reason, the average person will always buy high and sell low. A good risk-adjusted investment plan can help prevent this losing scenario from happening. It is recommended that the fixed income (bond/cash) portion of your portfolio match your age (as a percentage), your personality and your risk tolerance. It is far better to 'sleep well than eat well' as a friend once said. Hold just enough equities in ETFs or index funds so that if they drop 50% you won't panic. They will eventually return to normal and unless you sell them you will not lose any money. You make more money in a down market because your reinvested dividends are buying more units at a lower price … something people often forget. For long-term investors a market drop can be a good thing.

4. Media reporting regarding the market is almost always irrelevant. Something that "acts randomly and irrationally cannot be explained logically". For the most part commentators are just repeating hearsay. They don't have a clue about what is really happening. Ignore all financial reporting. Make a plan and stick to it - pay no attention to media noise. Their chatter is only entertainment. Focus on the long-term and make money.

5. People are predisposed to make the wrong moves when buying and selling stocks. That is why so few people ever make serious money. Fear, greed and the herd instinct predominate when we approach the market. Our human

nature prevents us from "being fearful when others are greedy and from being greedy when others are fearful". We fail to zig when others are zagging. We lack "the temperament to control the urges that get other people into trouble". Henry Blodget, formerly of Merrill Lynch, says we are "born suckers". "Human beings are wired to make dumb investing mistakes. What's more we are wired not to learn from them, but to make them again and again." A primary goal of this mini guide is to keep you from making dumb mistakes by using indexing.

6. Asset allocation is the best way to manage risk. This is basically the old adage of "don't put all of your eggs in one basket". Have some cash, some bonds and some equities. The best way to own these items is to open a discount brokerage account and buy index funds or ETFs which are composed of these items. If you have a stock index fund or ETF that holds 300 stocks, it won't hurt you much if a few turn out bad. Diversification works. As Henry Blodget says: "The way to give yourself the best chance of success in the markets is to diversify, buy low-cost index funds and hold them forever". Sound investment advice is always boring, but it works.

7. There is essentially no right or wrong in investing if you have a plan and stick to it. Buy good quality items, invest for the long term, diversify and balance each year. This is very common, old-fashioned advice but it is surprising how few people follow it. They get sidetracked by the investment industry and mutual fund ads on television. Mark Hulbert admonishes investors to "…. tie yourself to your chosen approach – whether it be through mechanical rules or dogged willpower – and don't let the siren song of the market-of-the-moment lure your portfolio underwater". As Dick Davis says, "the most important aspect of any market approach is consistency. The investor needs the emotional discipline to rise above distraction, temptation and frustration, and remain resolute". This means month after month, year after year following your plan no matter what the market is doing or how bad the world news is. This is not always easy. You will require courage to contribute to your investments when they are down, and the news media is predicting the end of civilization. Yet consistency, not comfort, is the key to investment success. As Mr. Davis says, "If you feel frustrated and left out, you're probably on the right track".

8. The average person cannot read an annual report or a mutual fund/packaged product prospectus. This is nothing to be ashamed of. They are written to be intentionally vague, convoluted and in many cases, deceptive. This is another reason that many well-known commentators favour index funds and ETFs for most of their money and possibly a few select mutual funds or individual dividend stocks for certain situations. “Investing is all about putting the odds in our favour, and this is the best way to do it.”

9. Reinvesting dividends is one of the best and safest ways to increase wealth. DRIPS (Dividend Reinvestment Programs) automatically buy more shares when the company pays out their monthly dividends (or semi-annually, quarterly, etc.) This also applies to index funds and ETFs. Examples of ETFs that specialize in companies that have been raising their dividends for many years are CDZ and XEI in Canada and DVY in the US. (We will talk about these later). Reinvesting dividends will literally make you wealthy while you sleep. They’re like a forest growing Christmas trees quietly in your portfolio.

10. Investing in a good balanced portfolio of index funds and/or ETFs will not make you rich in the short term. However, it will give you a good return over time. How much? A lot less than most people think — or the mutual fund people would have you believe. Over the past fifty years, stocks have provided a return of about 10% a year including reinvested dividends. Bonds have returned about 8%. Therefore, if you had a portfolio of half stocks and half bonds, your portfolio returned about 9% per year on average if all dividends and interest were reinvested. From that you must deduct about 2.5% for inflation and if in index funds, about .5% for management fees and 2.5% if you are in mutual funds. This leaves you with about 5% before taxes. But this is not the whole story. If, instead of spending your 5%, you reinvested it, the situation is altered appreciably – the magic of compounding kicks in.

Example:	$10,000 x 25 years x 5% (not reinvested)	=	$22,500 (principal+ interest)
	$10,000 x 25 years x 5% (reinvested)	=	$33,863

You can see why Albert Einstein said that one of the things that impressed him most in life was “the magic of compound interest”.

Getting Ready to Invest Your Money

Before you construct a suitable portfolio and buy the ingredients, there are a few more things we should consider.

Do you wish to be a completely passive investor e.g., just buy index funds or the new all-in-one ETFs? Do you want to mix in some active investing? Both scenarios work fine. The major determinates are your personality, your risk tolerance, your interest in investing and the time available before you need the money (closeness to retirement, etc.).

Personality Matters

Regardless of whether you want to be a totally passive investor or wish to throw a few mutual funds and/or stocks into the mix, personality matters. If you are, for example, a person who worries all the time and change your mind frequently, you are unlikely to be successful with any investment scenario. Also, if you are naturally fearful or pessimistic, you will have trouble. Successful investing requires above all, an ability to stay the course no matter what is happening. If you are investing a lump sum, divide it appropriately for your age and risk tolerance, then don't look at it for at least six months — and, unless there has been some very significant change (up or down 20%) you don't balance for one year. (Two years if you have a small portfolio without much deviation from the original mix). Stick with this plan for as long as you are invested. Again, as already mentioned, index funds and some ETFs do the balancing for you. We will get to these in a moment.

Sleeping Nights

To reinforce my bias toward passive investing, I will once again quote the world's greatest investor. "By periodically investing in an index fund, the know-nothing investor can actually outperform most investment professionals. Paradoxically, when "dumb" money acknowledges its limitations, it ceases to be dumb." No more complicated than that. Once you realize that you cannot beat the market or trade stocks effectively, you are on the road to wisdom. When you further acknowledge that most mutual funds and packaged products are monetarily toxic, you are almost there. <u>Investment wisdom is learning to let the market do the work for you while you enjoy your life</u>. Invest in a passive portfolio and live happily ever after. That is the essence of simple investing. And thus, wisdom itself. Why? Because it is the most money that 90% of the population will ever make from investing for their future. And it is the greatest peace of mind that 100% of the people will ever get from protecting their money.

Note: It is important to sleep well. Always make sure that you can sleep well no matter what the market or the economy is doing. The litmus test of a well-balanced portfolio is that it lets you sleep at night. There is nothing wrong with a portfolio that is weighted more heavily in cash and bonds if that is what will facilitate a good night's sleep.

What Is Your Risk Type?

Part of a healthy personality assessment is your tolerance for risk. There are essentially three types of risk: Investment risk, market risk and psychological risk. The latter is far more difficult to assess and ameliorate.

Investment risk means that the investment itself goes bad. This normally involves some internal catastrophe that either causes the company to go bankrupt, like Nortel in Canada and Lehman Brothers in the United States, or their shares to plummet like BP. These problems are essentially eliminated if you buy an index fund because one company usually only represents a small portion of the entire index — another reason why I, and many others, prefer index investing over individual stocks or bonds.

Market risk is something very different. While you can essentially nullify the effect of investment risk by using an ETF you cannot escape market risk. That old market can fall anytime and any amount without notice. It can also rise just as fast although it normally falls much faster than it rises. Therefore, an investor, unless he/she has invested in an all-in-one index product, should hold bonds, cash, real estate and equity ETFs. These asset classes often move in opposite directions, so balancing will normally mean locking yourself into a wonderful pattern of buying low and selling high when you balance each year. Another way to offset market volatility is dollar cost averaging (DCA). This means investing a set dollar value at regular intervals. DCA and balancing will, over time, greatly reduce – but not eliminate - the effects of market volatility.

Psychological risk, on the other hand, refers primarily to panic when the market drops precipitously, and people sell their investments at a loss instead of waiting until the market recovers. Basically, it is being unduly influenced by market activity and media scare mongering which can result in poor decision-making. Once you have set your allocation, leave it there – no matter what the market is doing at any given time.

Beware of a ploy that investment advisors/brokers use to retain their clients and nab new ones. These people often claim that they will be there to support you when markets crash. This is a farce. Most people only suffer in market downturns because their advisor had them too heavily in equities or equity mutual funds in the first place. As you can guess, they do this because that is where they make the most money. Don't fall into this trap.

Along with dollar cost averaging, Burton Malkiel, professor of economics at Princeton University, says that one should also hold more than just one major index. His contention is that a diversified list of broad-based index funds will produce the best results. For example, real estate investment trusts (REITs) have outperformed the broad market over time. My own approach is to hold a diversified portfolio of ETFs and a few dividend-paying stocks. But this may be no better than just holding three or four broad ETFs or one of the new all-in-one balanced products. I would undoubtedly use these if I was starting out now.

Gordon Pape, one of Canada's most prolific investment commentators, recommends a portfolio of only four broad-based ETFs all from iShares: XBB, XSP, XIU and XIN. This covers bonds, the US market, the Canadian market and the foreign market. Don Dony, a superstar technical analyst, claims that for those with less than $100,000 there is no need for more than two ETFs. He says to buy just XBB for bonds and XIU for equities, and balance every year. Excellent US equivalents for these recommendations are discussed in later pages.

Portfolio construction is based largely on personality and perspective as you will see further on. There are several low-worry, low maintenance and low-cost ways of investing. Some people make a much bigger issue about allocation than it deserves. They should just keep it simple and enjoy life.

One of the greatest benefits of self-directed index investing, besides cost savings, is control. You get to control your own economic future. This is important. Once you have basic investment knowledge, your feelings of helplessness will be replaced with confidence and optimism - two characteristics that are essential for financial success.

As a final preparation for the last section here are a few other things to consider.

1. Not everyone agrees that rebalancing is necessary or necessarily a good idea. John Bogle, one of the fathers of indexing, can quote studies to show that the difference between rebalancing and not rebalancing is minor over time. He says there is nothing wrong with rebalancing, but he doesn't do it. Others disagree claiming that periodic rebalancing forces one to sell high and buy low. Jonathan Clements, writing in the Wall Street Journal, says that, "If a market segment is bouncing back after a rotten stretch, don't rebalance every year. Instead, hold off rebalancing for two or three years so you can capture more of the rebound". Richard Ferri, author of *All About Asset Allocation (2005)* provides this perspective: "By taking some money out of things that did well and putting it into things that were down, you'll pick up 1% more on your equity portfolio per year over the long term. That's a good deal". This is my own approach and I am pleased with the results.

   Because as investors most of us tend to procrastinate, a strictly mechanized rebalance method is probably best. This will eliminate judgement calls and get us doing something. Balancing can be worthwhile even if it only gets us to look at our portfolio. Procrastination is not only "a thief of time" but when it comes to investing it can be a thief of money. What we do is mark on our calendar, "Portfolio review/rebalance day".

2. Don't buy the whole portfolio at once. Although there are dissenting opinions, most agree that one should take time in setting up a portfolio. The best approach for most people is to accumulate a position in pieces over time, using a long-term process of dollar cost averaging. Warren Buffett claims that people who average into a low-cost index portfolio over ten years will do better than 90% of those who put all their money in at once. Mr. Buffett says to "keep accumulating regularly over time. If you do, you won't buy at the bottom, but you won't buy it all at the top either". The path is never clear when it comes to investing, but a measured approach will help smooth out the

trail. For older investors, the buy-in period can be condensed. They could, for example, put an equal amount into ETFs over 24 months.

As with many other aspects of investing, not all agree that you should invest your money over time. Some, including Shelby Davis, have a different opinion. Mr. Davis says, “Having been in the stock market for more than four decades, I believe that the best time to invest for those with a long-term horizon is when they have the money”. Both DCA and investing when you have the money will work fine. Often, it is a matter of personal preference. Just stick to your program and all will be fine.

3. There is no magic formula for asset allocation. How much to put in each category depends on your age, your personality, how soon you need the money and your tolerance for risk. Many suggest that the bond portion of your portfolio should match your age. This is probably not a bad formula but can be modified to match your own situation. What matters most is commitment. A firm resolve to stick with your program no matter what the market or the economy is doing is more important than how much of your assets you put in each category. Balancing will correct most imbalances over time. <u>It is commitment that matters</u>.

Your Retirement – Four Basic Rules (from yahoo.finance.com)

- Rule 1: If you need the money in the next year, it should be in cash or a money market fund.
- Rule 2: If you need the money in the next one to five (or even seven) years, choose safe, income-producing investments such as GICs, Certificate of Deposits (CDs) or use bond ETFs, Treasury Bills or low-cost bond mutual funds.
- Rule 3: Any money you don’t need for more than seven years is a candidate for the equity (stock portion) of your portfolio.
- Rule 4: Always own equities. For most investors, this can best be accomplished through equity index funds (ETFs) or no-load, low-cost equity mutual funds.

4. Regression to the mean. This basically refers to, what goes down normally comes up and what goes up normally comes down to middle ground over time. Richard Ferri recommends that “you have a little bit everywhere and once a year, on your birthday or after New Year’s you rebalance your portfolio. You get it back to your original targets”. He goes on to say that there are certain segments that help to reduce risk in a portfolio and increase long-term returns. His reasoning is that these three asset classes deviate substantially from the performance of the overall stock market. They are worth knowing about, but most investors need only a good real estate investment trust ETF to perform this task. I incorporate real estate ETFs in my portfolio and don’t include microcap (very small companies) or small cap index funds. My main reason for using REITs is that I like the generous monthly dividend payout.

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5. To benefit fully from the best aspects of index funds, they must be bought at a reasonable price and held for a long time. Jumping in and out will nullify the effects of dollar cost averaging and compounding. It’s the passage of time that makes a well-diversified, reasonably purchased portfolio produce good results.

This method also provides the positive psychological benefit of knowing you are on the right track. As one of my mentors, Dick Davis, points out: “Instead of tying your fortunes to just one group or style or class and waiting until it regains popularity, owning an entire diversified portfolio permits asset allocation to perform its risk-balancing function over time. Some part of the portfolio will always be doing well or relatively well in all but no-escape bear markets”.

It is also comforting to know that other great investors favour indexing; Gordon Pape, Peter Lynch, Rob Carrick, Burton Malkiel, Mark Hebner, Daniel Solin, John Bogle and Charles Schwab. Mr. Schwab, founder of Schwab Bank, has 75% of his own money invested in index funds. Burton Malkiel, Princeton economics professor and famous author, has “about 80% of his personal retirement money invested in index funds”. Should you choose this approach you will be in good company.

This ends the first two sections. You should now be ready to choose a portfolio suitable to your situation and personality. I hope that you have enjoyed the mini guide to this point and that you have learned the basics of investing the easy way. As a bit of a synopsis, I am going to list some simple truths in point form at the end of the last section. Above all, I hope that you have learned that simplicity is the essence of good investing.

> "Nobel Prizes have been awarded to academics for their analysis of how stock markets work. Their findings are not based on a need to earn a commission or sell you an IPO (Initial Public Offering). More than a hundred years of academic research has concluded that index funds are an investor's best investment."
>
> - Mark Hebner, President, IFA

The Time is NOW

Should You Get Out of Your Mutual Funds?

Julie Cazzen, author of "The 15-minute portfolio MAKEOVER" (MoneySense magazine, February/March 2010) has a section on getting out of mutual funds.

> "Once all your funds have been transferred into your discount brokerage account, you'll need to cash them in. But be aware that there could be complications… investments have deferred sales charge (DSC) penalties. That means investors can be charged a fee if they sell their mutual funds before holding them for a full six years. But if your funds do have DSC penalties, you could incur big fees for cashing out of them early. To find out if you'll incur DSC penalties for selling, call the advisor who sold the funds to you".

It is often possible for you to call the fund company directly to get the information on DSC penalties rather than going to your advisor. Even if there are DSC penalties, they may have diminished to the point, depending on circumstances, where it will pay you to sell the funds anyway. One of the main considerations is how much overall money you would lose - in other words, is there more there now than what you initially put in the fund? If it has been a pig for years, it might be time to butcher it before it gets any thinner. One way that some investors have mitigated their loss is to sell their mutual funds and buy ETFs that have declined in price. This is essentially sliding your money sideways with a better potential for long term gains. A recent landmark study called “Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry” (Harvard Business School, 2006) found that of the participants investing in mutual funds, people working on their own made more than twice as much as those who used advisors. (The entire study is available online).

Portfolio Construction

Choosing one of the custom designed ETF portfolios or personalizing one of the professional portfolios outlined in the following pages will put you well ahead of most investors. And while you won’t necessarily become another Warren Buffett, you should, over time, get a very good return on your money with the added advantage of being able to sleep well at night.

What I am going to do is introduce you to my favourite suppliers and their index products first. Then we will look at a selection of simple, effective portfolios. Once we have done this, I will show you how to establish your own discount brokerage account through your bank. To accomplish this, I will use the same step-by-step approach that my wife and I used to realign our own finances. We are more than pleased and I think you will be too.

As an added benefit I suggest that if you have over $100,000 you may wish to consult a fee-only Certified Financial Planner (CFP). They can add value by considering your entire financial picture as well as your portfolio. Please see those sources listed earlier.

There are several suppliers of index funds in North America: iShares, BMO and Vanguard are the largest and the ones that I use. They all have sufficient products in Canada, the United States and globally. All are worth considering since they have certain unique features but are about the same in representing a particular category. Canadian Money Saver, my favorite financial magazine, lists a simple portfolio using ETFs from all three companies.

While there are relatively few index fund suppliers, there are numerous index fund products. Most of these are of no benefit to the average investor because they represent only a narrow segment of the market. Most professionals recommend using only the major indices or large segments of them. There is no need to be complicated to be effective. As I mentioned earlier, “simplicity is the essence of wise investing". Remember, Warren Buffett only has about 10 stocks in his portfolio and those professionals who use indexing use only a few ETFs. As I have stated throughout this guide, indexing is a simple and effective way to make a very efficient investment portfolio using only a few items. In the resource section I have listed some products from several suppliers, but most don't apply to the ordinary investor. We just need a basic bond index ETF and a few equity ETFs and one place for your cash.

Each index fund supplier takes a slightly different approach when representing their particular index. iShares uses a straight weighted average approach. Which means if a certain stock is 8% of the top 60 on the SP/TSX it will be 8% in XIU, their representative index fund. Vanguard and BMO take a bit different approach with their comparable index ETF by limiting the percentage for any single stock. All three companies provide good products — choosing one or the other becomes somewhat of a personal preference. I use some products from each one. The best approach is to look at the products from each supplier and then call their investor relations department if you have questions.

Most people become overwhelmed when it comes to their own finances. They are terrified of making a mistake and losing money. The common reaction is to simply throw up their hands and say they are not up to the task. This is how so many get sucked in by mutual fund salespeople and the financial industry in general. Merely by the fact that you are reading this mini-guide and persevered to this point means that you are different. We are going to keep portfolio construction simple and very easy to implement.

We will start this last part of our journey by beginning with the very easy and progressing to the less simple for those who want to go that route. All the following approaches are excellent, yield similar results and can be easily implemented. There is no right or wrong.

It takes about half an hour to construct and purchase a suitable portfolio. After that, balancing requires about 15 minutes once a year. Once you visit your bank and get their help in setting up a discount brokerage account the rest is a breeze. As mentioned, if you can do online banking or pay bills online, you can do online investing. The steps are the same and the discount brokerage will provide easy-to-understand instructions and practice sessions. You can also call and get them to walk you through the simple process. Seriously, if you can send an email, pay bills or do online banking you can easily handle online investing.

Recommended Steps to Assemble a Good Portfolio:

1. Determine how much to keep in cash using non risk type instruments. ***
2. Familiarize yourself with the various ETF products by going to the supplier's website. Look at the various portfolios and pick the one most suitable to you or adapt one to suit your preference. Excellent, easy-to-use tools are available online from iShares, Vanguard, BMO and most other ETF suppliers.
3. Meet with a representative of the bank who sponsors your chosen discount brokerage firm and open a self-managed/discount brokerage account. They can transfer your current investments to your online account from wherever they may be.
4. Go online using the simple instructions provided, or with help from the brokerage firm, and buy your chosen index funds and/or ETFs. (You can also do this by phone through their toll-free line, but it costs a bit more).
5. Instruct your discount broker to automatically reinvest all dividends and interest (DRIP) unless you require the income. In this case ask them to mail you a cheque each month (or semi-annually, quarterly, etc.)
6. Balance your portfolio each year as needed, unless you choose an all-in-one portfolio that does this for you. When you add new money keep the percentages balanced.
7. Sleep well and live happily ever after.

*** My favorite places for cash are PSA (Purpose High Interest Savings ETF), CSAV (CI First Asset High Interest Savings ETF), GICs and short-term bond ETFs like XSB, etc. These instruments only pay about 2.2% net interest, but my money is safe for when I need it.

Note: I can not give financial advice, but I can answer questions. Please don't hesitate to e-mail Jim at cougle@rogers.com or call 506-459-7460.

Simple Portfolios for Wise Investors

> "Design a portfolio you are not likely to trade…akin to premarital counselling advice; try to build a portfolio that you can live with for a long, long time."
>
> - Robert D. Arnott

The Ultimate Simple Portfolio (My favorite)

In January 2018, Vanguard introduced three all-in-one ETFs which are the new ultimate in simplicity and low cost. These were quickly followed by similar products from BMO and iShares. With VCIP, VCNS, VBAL and VGRO, Vanguard has chosen the portfolio components and balances them on a regular basis all for only 0.22% - one for each type of investor. See their new balanced ETF portfolios at www.vanguardcanada.ca.

See also, *Everything an investor needs in a single ETF* by Jonathan Chevreau, www.moneysense.ca/save/investing/etfs/finally-everything-an-investor-needs-in-a-single-etf/ See also *Vanguard, iShares or BMO?* A side-by-side comparison of the new all-in-one diversified ETF portfolios, February 2019 by Dan Bortolotti. Mr. Bortolotti is considered Canada's most authoritative commentator regarding ETFs. These three new portfolio families are essentially everything you need at a great price. They range from Conservative for older people or those a bit timid, Balanced, for those in the saving years and Growth, for more aggressive investors.

Joanne and I are retired and plan to put new money in a conservative portfolio which has 60% fixed income and only 40% equity. After you look at these new products and read the articles you will probably agree that one of these investment vehicles is all that you need for the rest of your investing life. Essentially, they are like a balanced mutual fund without the high fees, are easily bought and sold, can be liquidated anytime and have no front end or backend fees. I think Warren Buffett would agree with me that these are perfect for about 95% of Canadians. However, should you wish to construct your own portfolio, I will list below a few easy alternatives.

Couch Potato Portfolios – The Essence of Simplicity

The Couch Potato Portfolios are the original index portfolios and are the next most simple behind the new all-in-one ETFs. They are hard to beat in terms of simplicity and effectiveness. The term "Couch Potato Portfolio" was coined by Scott Burns (Dallas News) and has come to be a generic term for passive, no effort investing using ETFs. These portfolios can be found at www.dallasnews.com for US citizens and www.canadiancouchpotato.com or www.moneysense.ca for Canadians. Please also see the article from Money Sense titled *How I Became A Couch Potato* available online.

Classic Canadian Couch Potato

		iShares	**BMO**
33.3%	Total Canadian bond index	XBB	ZAG
33.3%	Total Canadian stock index	XIC	ZCN
33.3%	US stock index	XSP	ZDJ

Global Couch Potato

		iShares	**BMO**
40%	Total Canadian bond index	XBB	ZAG
20%	Total Canadian stock index	XIC	ZCN
20%	US stock index	XSP or SPY	ZDJ
20%	International Index	XIN	ZDM

Note: Talk to all suppliers if you decide to go this route. The percentages are those that have done well over the years. The classic has returned on average 10% over the past 30 years. All you do is buy and balance each year.

Canadian Couch Potato Income Portfolio (Examples only)

For those who want income from their portfolio there are several variations that can be easily constructed and modified to suit your situation. The various suppliers will help you. Retirement portfolios can be as simple or as complex as you like.

Classic Income – super simple mix and match portfolio for retirees

		iShares	BMO
40%	Canadian Bond Index	XBB	ZAG
20%	Canadian Dividend Index	CDZ or XEI	ZDV
20%	US Dividend Index	XSP	ZDY
20%	Preferred Share Index	CPD	ZPR

Modified Income Portfolio – simple construction

		iShares	BMO
50%	Canadian Bond Index	XBB	ZAG
10%	Canadian Dividend Index	CDZ or XEI	ZDV
10%	Canadian Preferred Share Index	CPD	ZPR
10%	Real Estate Investment Trust Index	XRE	ZRE
5%	Energy Index	XEG	ZEO
5%	High Yield Bond Index	XHY	ZHY
5%	Utilities	XUT	ZUT

Remember: The percentage in each category will depend on your age, your risk tolerance and your personal preferences – adjust them to suit your situation. The ETF suppliers' websites have tools to help you decide the percentage to put in each category or ask an advice-only advisor/financial planner. Your bank and/or discount brokerage can also help you in this regard. All categories will fluctuate with the market; however, they will keep paying. This is what I like about them.

U.S. Retirement and Income Portfolios (Examples only)

33.3%	Street Tracks Wilshire REIT	RWR
33.3%	iShares Dow Jones Select Dividend	DVY
33.3%	iShares Lehman 1-3 yr. Bond	SHY

20%	Street Tracks Wilshire REIT	RWR
20%	iShares Dow Jones Select Dividend	DVY
20%	iShares Lehman 1-3 yr. Bond	SHY
20%	iShares Lehman 7-10 year bonds	IEF
20%	Health Care	XLV

20%	iShares Lehman Aggregate Bond	AGG
20%	iShares Lehman TIPS Bond	TIP
20%	Vanguard REIT	VNQ
20%	Health Care	XLV
20%	iShares Dow Jones Select Dividend	DVY

For further information please see Kiplinger.com or Morningstar.com

Split Potato

Some writers, including Gordon Pape and Dick Davis, believe that a percentage of one's portfolio should be actively managed. This means a combination of ETFs, low-cost mutual funds and dividend paying stocks. Normally the mutual funds would be specialty equity funds to add a growth component to the mix. This is only an added benefit if you happen to choose funds that significantly outperform the market and that becomes a challenge. A list of the best performing mutual funds is available on-line from several sources. My favourite ones are www.globeinvestor.com in Canada and www.morninstar.com in the United States.

See also www.yahoo.finance.com and www.canadianmoneysaver.ca. I do not use mutual funds in my portfolio but do a have a few blue-chip dividend-paying stocks and high yield (junk bond) ETFs. These will fluctuate more than regular bond ETFs but they pay well and I will take the extra bit of risk. That said, I still think that most people are better off with one of the new all-in-one diversified portfolios. Picking stocks and specialty funds is not practical unless you have the time and the interest.

Here is what a split potato portfolio might look like if you decide to go that route. It must be adjusted for age, time until use, personality and whether the portfolio is in a registered account or a regular account. (See *Sleep-Easy Investing* by Gordon Pape).

5%	Cash (CSAV or PSA)	GIC etc.
20%	Bonds	XBB
10%	Preferred Shares	CPD
10%	Real Estate Investment Trusts	XRE
15%	Income Funds	
20%	Canadian Equity Funds	
20%	Foreign Equity Funds	

Note: Instead of funds you can also substitute conservative, blue chip dividend paying stocks. A list of these can be found in the Resource Section and on-line.

I found the public relations people at all the suppliers to be very pleasant and eager to help. Their websites are also user-friendly and provide all pertinent data. Contact information is as follows:

iShares – www.ishares.ca 1-866-474-2737 or blackrock.com and click on isharesETFs

iShares US – www.ishares.com 1-866-474-2737

ING Direct – www.ingdirect.ca 1-877-464-5678

TD Waterhouse – www.tdwaterhouse.ca 1-800-465-5463

BMO – www.bmo.com/etfs 1-800-361-1392

United States - One Size Fits All

For those who wish to use an asset allocation approach in the US, there are several options. Compare State Street (SPYDRS) www.statestreet.com, Vanguard, www.vanguard.com and iShares. Claymore does not have an asset allocation product comparable to their Canadian division but will help with portfolio construction as will the other suppliers.

iShares US Asset Allocation Funds

AOK	Conservative
AOA	Aggressive
AOR	Growth
AOM	Moderate

Another great alternative for Americans is Index Funds Advisors (IFA). These people have several managed, low-cost index fund portfolios that have stood the test of time. Please see their excellent website at www.IFA.com .

Summary

This ends my overview of low-risk, passive investing. I hope this has been of benefit and that you will continue into the resource section. First, please read the Ten Essential Facts. These are a summary of simple, safe investing.

Ten Essential Facts

1. Financial advisors (except fee-only) are commissioned salespeople who can only make money by selling you high-priced packaged products, like various types of mutual funds or by constantly buying and selling stocks.
2. You can easily set up an online self-managed brokerage account and construct a simple portfolio using an all-in-one ETF or build a simple Couch Potato portfolio on your own.
3. It is highly unlikely that you can trade stocks and make money.
4. Mixing a few specialized, low-cost mutual funds and/or conservative, dividend paying stocks with index funds might improve the overall performance of your portfolio.
5. It is essential that your portfolio suit both your personality and your risk tolerance. Consideration must also be given to your age and the time span you have before you want to start withdrawing money (e.g. years left before retirement, etc.).
6. A balanced portfolio will normally produce between 5% and 8% before inflation over any ten-year period.
7. If you don't choose an all-in-one ETF, you should balance your portfolio periodically and continue to add money on a regular basis no matter what the stock or bond markets are doing. Reinvesting dividends and interest will greatly improve the performance of your portfolio.
8. You must <u>not pay any attention</u> to the daily gyrations of the stock market. Its short-term direction is unpredictable and dynamics essentially unknowable. Market timing is virtually impossible.
9. You must also learn to shut out media reports regarding the stock market and the economy. They are usually little more than entertainment and have no effect on the long-term performance of a balanced portfolio.
10. It is essential to ignore all the marketing propaganda that comes from the investment industry. Most of it is slick, numerically enhanced bovine excrement designed to suck you into buying high-priced mutual funds or other packaged products.

Simple Online Direct Investing (Sample procedure)

I use Scotia Bank (itrade.ca) for my direct investing, but most financial institutions have self directed investing (discount brokerage) on their web sites and they are all essentially the same. They give people the choice of investing for themselves online or calling a 1-800 number and having a discount broker do it for them. A 1-800 number is also available should one have questions regarding their account or need help buying and selling. I have found the staff at itrade to be very helpful and always pleasant. It should also be noted that most financial institutions have online 'practice accounts' to get you started. The staff at the 1-800 number will also assist you with this learning process. Keep in mind that this is a very simple procedure and you will have absolutely no trouble learning it.

<u>Step-by-step for do-it yourself online investing</u>

The steps I am providing here are for itrade. Although they might be slightly different on your financial institution's website, they are all very similar. Please remember that **your financial institution will work with you until you are completely comfortable.** They also have a practice site and to get you already do basic online banking and investing, this will make it even easier. Here is the procedure for the website that I use:

1. Go to the bank of your choice and tell them you want to set up a self-directed investing account. This is just a matter of signing a few forms. You can also ask the bank to transfer money or accounts from another institution to your new discount brokerage account. The person at the bank will show you what the website will look like with your new accounts on it. You will probably want to open two accounts – Regular and Registered. In Canada you can also open a tax-free savings account (TFSA). There is a great perk with these accounts because your dividends and/or interest can be taken out without paying any taxes.

2. Once you are set up, go to the institution's online website and get familiar with how to operate it; enter your bank card number and your password, as you would when you do regular online banking. You will see, along with your ordinary bank accounts, your new self-directed investment accounts.

3. Click on the tab that says 'Investing'. Again, it might be slightly different if you are using a different financial institution.

4. Click on 'Trading'.

5. Choose which account you wish to buy or sell from.

6. a) Enter the ETF (or stock, etc.) symbol
   b) You will want to check the current price. With Scotia Direct I have the option of getting it by clicking on 'Quick Quote'
   c) 'Order action' – enter number of units to buy or sell after calculating this by dividing the money you wish to invest by the price of the unit.
   d) 'Price' – enter the unit price and hit 'Limit Price' (you can use 'Market Order' or 'Limit Price' (limits the amount you want to pay for the unit). ETF daily fluctuations tend to be slight.
   e) 'Good through' – allow at least a few days
   f) 'Settlement option' – select your direct account
   g) 'Settlement currency' – Canadian dollars, if in Canada
   h) 'Account type' – cash
   i) 'Submit Order' – hit button
   j) Check order for accuracy and hit 'Confirm'.

7. The online brokerage will send you an e-mail when the transaction(s) is complete. You can also check the 'Equity Order Status' on the site at any time. This is how you will know if your order went through.

This may seem a bit scary at first but once you complete this process, you will be amazed at how simple it is. Start with a small amount to get the feel of online investing. It probably sounds complicated reading the instructions, but online they are a breeze. You will quickly see that it is a hassle-free way of investing. The helpful people at the bank and the discount brokerage will help you see the simplicity. I am not very computer savvy, but this process was easy for me to learn and it took about ten minutes. You will have very little difficulty in mastering this process, and if you do have any difficulties, the staff at the 1-800 number will be glad to help you.

Here is a link to Scotia iTRADE's online resource centre; it is full of excellent tools and videos to get you started. Other financial institutions have similar resources.
https://www.scotiaitrade.com/en/direct-investing-and-online-trading/why-scotia-itrade/how-to-make-it-happen.html

Resource Section

I have included this little resource section to round out the mini guide. We all suffer from too much information so don't feel compelled to read this in one sitting. These are great little things to pick away at. Read some of the articles and one or two of the books, then come back for more when time allows. If you have stayed with me this far, you are well on your way to success. Don't stress out - keep it simple, get plenty of rest, exercise, eat well, love, relax and be happy. Remember that your portfolio is just money and will only make between 6 and 8 percent over a long period of time if it is balanced between stocks and bonds (this includes the reinvestment of dividends and interest). Investing is not a way to get rich – it is only a way to preserve your money and grow it a reasonable amount over a long period of time. What really count are all the other things in your life. As they say up home, "You never see the Brinks truck following the hearse".

My Favourite Investment Books

What's Good, Bad and Downright Awful in Canadian Investments Today – Rob Carrick (2010)
Sleep-Easy Investing – Gordon Pape (2009)
The Smartest Investment Book You'll Ever Read – Daniel R. Solin (2006)
The Investment Zoo – Taming the Bulls and the Bears – Stephen A. Jarislowsky (2007)
Investment Traps and How to Avoid Them – Hilliard MacBeth (1999)
The Dick Davis Dividend – Dick Davis (2008)
The Little Book of Common Sense Investing – John Bogle (2006)
The Best Investment Advice I Ever Received – Liz Claman (2006)
One Up On Wall Street – Peter Lynch (2002)
Unconventional Success – David Swensen (2000)
How to Get Rich and Stay Rich – Fred J. Young (1995)
The Elements of Investing - Burton Malkiel & Charles Ellis (2010)

Great Websites

globeinvestor.com
canadianmoneysaver.ca
iShares.com (US)
iShares.ca (Canada)
tdwaterhouse.ca
moneysense.ca
finance.yahoo.com/etf
stingyinvestor.com
indexinvestor.com
morningstar.com (ETF Investor newsletter)

Note: **Be sure not to drive yourself crazy with too much information**
Keep it simple and enjoy life!

My Favourite Magazines
Canadian Money Saver (canadianmoneysaver.ca)
The Economist (economist.com)
MoneySense (now online only - moneysense.ca)
Mother Jones (motherjones.com)
Utne Reader (utne.com)
The Atlantic (theatlantic.com)
Time Magazine (time.com)
Harper's (harpers.org)

Advice from Investing Articles
Investing articles can be gleaned from my favourite magazines and websites. They support the position of most successful investors and my thesis in this mini guide which is, "simple is better".

Read a few articles at your leisure if you wish but don't stress over them; they are only to round out your education. All most investors need is a simple all-in-one ETF portfolio or a few ETFs and balance them every year. Possibly mix in a few good mutual funds and/or a few good dividend-paying stocks. Nothing more is required. You will see from various articles that most commentators suggest only 0ETFs and balancing. There is no real right or wrong if you stick with your program and don't take on too much risk. Bond percentage to match your age and balance on your birthday, are probably right for most investors.

Index Fund List
A list of popular index funds can be obtained from any bank website. They are ideal for people starting out but, in my opinion, not as good as an all-in-one ETF as previously mentioned. Please go to the appropriate websites and talk to their investor relations people if you have any questions.

Mutual Fund Selection
Some investors like to include mutual funds in their mix. This can be fine for those who currently own them or want to use certain specialty funds. Most are far too expensive and inefficient for what you are paying. I recommend that every investor in Canada has a subscription to Canadian Money Saver magazine (try a

copy first from your local bookstore). You can get a current list of their mutual fund selection from their website at www.canadianmoneysaver.ca. There are dozens of other sites as well; www.globeinvestor.com has an excellent screening system for mutual funds and so does MoneySense. American readers can use this site too and/or go to finance.yahoo.com, www.morningstar.com or www.vanguard.com . There are plenty of no-load and low-load funds available.

Top US & Canadian Stocks

Some people like to add a few stocks along with their core ETF portfolio. This can be easily accomplished online by selecting stocks from various sources and purchased through your discount brokerage account. I like using '**Beat The TSX'** from Canadian Money Saver, MoneySense magazine's annual stock rating or the Rothery Report simply because I like their method of screening for value.

The **Rothery Report** provides research on select deep-value stocks in North America. They often discover overlooked and undervalued stock in their quarterly investment reports which provide detailed analysis of Canadian and US stocks. Norman Rothery provides his subscribers with useful information about new opportunities and developments. For those who want to choose stocks, a good place to begin might be with a trip to www.stingyinvestor.com. There are numerous other sources as well, but I like the ones I have listed. I must caution however, that stock selection is not for everyone. Be sure this is the route you want to take. **Most people don't need them.**

Following is an example of the top ten dividend paying US and Canadian stocks from Canadian Money Saver, January 2020.

Top US Dividend Stocks (2020)	Top Canadian Dividend Stocks (2020)
Verizon (VZ)	Enbridge (ENB)
Int. Business Machines (IBM)	Telus (T)
Pfizer (PFE)	BCE (BCE)
Exon Mobile (XOM)	Bank of Montreal (BMO)
Chevron (CVX)	Emera (EMA)
Merck & Co. (MRK)	Shaw Communications (SJR.B)
Coke (KO)	TransCanada Corp. (TRP)
Cisco (CSCO)	National Bank (NA)
Proctor & Gamble (PG)	Power Financial PWF(POW)
Johnson & Johnson (JNJ)	Bank of Nova Scotia (BNS)

Portfolio Boosters (for those who want to be more hands on)

Some investors use certain techniques and products to enhance their returns. You will eventually encounter some of these, so I have included a few of the more conservative ones. Most professionals don't think these are necessary. A simple ETF portfolio is all that most people need.

a) **DRIPs.** I have already mentioned this one. Dividend Reinvestment Programs are almost universally known to be an excellent means of enhancing portfolio returns. Over time a person will acquire more shares at an average price. These in turn produce more dividends. A win-win situation.

b) **Laddering**. This method can be very effective, as Humberto Cruz says, "…… to smooth out the overall volatility of a portfolio and create a stable and dependable source of cash flow". The laddering effect comes from buying bonds or GICs etc., with progressive maturity dates. A simple illustration is putting $5,000.00 into GICs. You buy them so that $1,000.00 is maturing every year for five years. When the year one GIC matures you use the proceeds to buy a five-year GIC. This can be done year after year until you need the money.

This can also be done for bonds of varying maturity. I don't do this because I use CLF and CBO from iShares and they do the laddering for me. There are also several bond mutual funds that do laddering, however check the MERs. Two examples are Phillips, Hagar and North in Canada and Thornburg Limited Term Income Fund in the United States. There are others, but these companies are a good place to start. I still like bond ETFs better than mutual funds. To me, individual laddering is most effective with GICs, CDs or strip bonds, which are essentially cash. These can be purchased through your local bank or your discount broker. If you have chosen an all-in-one ETF portfolio the laddering is done for you.

d) **Bank stocks.** According to Biff Matthews, Chairman of Manitou Investment Management Ltd., "Companies with higher dividend yields have, on average, provided far better total returns to investors… In Canada (possibly U.S. too), the strategy of investing for the next twelve months in the highest yielding bank stock at the beginning of each year has been shown to far outperform the best performing bank stock held over a 10-year period". This can be a great annual strategy for those who like buying and selling stock. If nothing else, you would get a good dividend.

And remember, although we are not able to control the major debts of some countries, financial reforms, etc., we can control our investment behaviour. We can keep it simple and make money.

Please be sure to enter your email address on our website to be notified of new publications and updates on existing ones. We will also let you know of newly posted blogs.