



Blending cuts the risk

Aggressive, moderate or conservative? The quality of your returns depends not so much on the stocks or funds you buy, but on how you divide your investments

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SPECIAL TO THE STAR

Wondering just what is the right mix of assets you should be holding in your portfolio? Congratulations, you're well along the path to successfully funding your retirement, given that nearly half of us don't hold the right mix of stocks, bonds and cash in our portfolios.

Deciding on the right mix of holdings, or asset allocation as it is known among investment professionals, is really a "don't try this at home" type of exercise, unless you are prepared to do the homework necessary for self-directed investing.

What assets to put in your investment portfolio and RRSPs is less a function of where the market is today in the regular up and down cycle or what sectors are deemed hot (or not), than your stomach for losses and your retirement horizon.

The vast majority of us get that part all wrong.

"We spend 80 per cent to 90 per cent of the time thinking about what stock we want to invest in or what fund we want to invest in and only 10 per cent thinking about the blend across our portfolios," said Andrew Dierdorf, a portfolio manager with Fidelity Investments.

That is just human nature. "Stocks are sexy and individual security selection is fun to talk about."

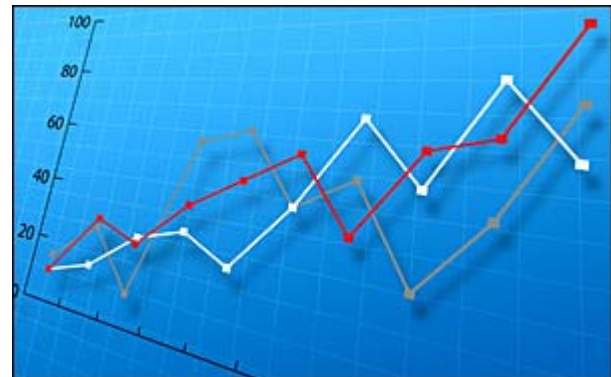
He said a number of studies show that the major variable when it comes to investment returns is the blend of stocks, cash and bonds, rather than the choice of equities or funds.

Deciding upon the right mix of investment assets depends on a person's time horizon. If you are a baby boomer in your mid-to late 50s, your investment portfolio should hold a higher proportion of "safe" stocks and short-term liquid holdings in comparison to a 20- or 30-something who has 30 or 40 years to contribute and will likely live through a number of market cycles.

While most people carry around a definition of their investment mindset, whether it be aggressive or cautious, the Fidelity manager said research conducted on American investors has found the state of the stock market has far more to do with peoples' courage than any set of tightly held beliefs.

The pre- and post-bust study gathered a group of investors at the height of the late Nineties technology boom and asked them to rank themselves as either aggressive, moderate or conservative. Most, perhaps unsurprising in a market of high returns, characterized themselves as aggressive.

A few years later, after the tech market meltdown, those same investors were polled, and most then



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described themselves as conservative.

"A couple of years of experience, should their risk profile have changed that much?" asked Dierdorf. "No, they were responding more to their market experience and returns than an intuitive thought of what their risk tolerance really was."

Preservation of capital and ensuring you have the amount of money that you or your financial planner has deemed necessary for retirement should be a key part of the process of determining the right asset allocation mix, instead of following the hot stock or sector.

"You use asset allocation to reduce your risk as opposed to gaining excess returns," said Steve Lowrie, a Toronto-based financial planner.

"My advice to clients is, 'We don't make active bets on specific sectors whether they be precious metals or income trusts. We'll have a market weight of oil and gas, and a market weight of gold,'" he said.

Lowrie will, however, tweak a particular portfolio in favour of proven long-term winners such as small capitalization companies as well as value stocks, which both having achieved a comparatively high return over time.

What he doesn't recommend is over-weighting a particular section.

"Income trusts are an example," he said. "If you made a big bet on income trusts, you have had your head handed to you over the last few days."

If the sting of the federal government's policy change on income trusts is still too fresh and painful to think about, investors can recall the implosion of the technology bubble in 2000, an event that made day traders an endangered species and served as a potent reminder of what happens when investors bet heavily on one particular sector.

The tech-heavy U.S. Nasdaq composite index serves as a warning of sorts for unwary investors, given it has yet to recover from the tech meltdown, notes ScotiaMcLeod adviser David Bruce. He favours so-called value stocks, which don't carry the price premium (and potential risk) of a sector leader such as a Wal-Mart, which can be punished severely when it fails to meet or exceed its quarterly profit expectations.

Bruce's favourite example is a hypothetical stock purchase choice in 1989 between communications company Motorola and Hormel Foods Corp., the maker of Spam canned meat. The majority of people state confidently that Motorola was the better investment over the last decade and half. They are reassured when he states Motorola's total return was about 900 per cent over that span.

That is until he tells them that humble Hormel returned about 4,000 per cent over that period. "People forget, you didn't pay much for Hormel Foods."

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