

# Portfolio advisor

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## **Get the professional advice you need**

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## Weathering the storm

### Strategies for surviving stormy stock markets



During periods of stock market volatility, the common wisdom is to sit tight and wait for it to pass. For the most part, that's good advice, especially when your investment portfolio is properly designed to weather volatile markets.

However, with the volatility extending into a second year, many people are starting to wonder if there's something they should be doing. And, depending on the situation, there could be. Following are some key strategies to help you make sure your investments are correctly structured for today's volatile markets.

### Take a rational look at your investments

So far you've resisted the urge to sell everything and stuff your money under the mattress. Now's not the time to start second-guessing yourself. But it is time to take a rational look at your investments to ensure they're still right for you.

Market volatility can be very indiscriminate, affecting good, bad and indifferent stocks. The key is determining which stocks are most likely to bounce back when the volatility abates – and which ones aren't.

Volatility can expose underlying weaknesses in certain stocks, which were previously buoyed up by generally positive markets. Even when the market volatility settles down, these stocks may take a longer time to recover – if they recover at all. On the other hand, stocks with strong underlying fundamentals are more likely to recover quickly and continue growing.



## The income conundrum

Greater security or higher income potential? If you're investing for income, it's the classic conundrum.

Safe choices like GICs provide modest interest payments – and interest rates are once again on the decline. Other choices like income trusts can boost your income, but there are no guarantees. So what do you do?

Following are some strategies to help you enhance your income – while keeping risk in check:

### Ladder your bonds

Government bonds offer guaranteed interest payments, but after taxes and inflation, there's often very little left over. It can also be difficult to choose between short-term and long-term bonds. If interest rates go up, you want short-term bonds. If they go down, you want long-term bonds. But accurately predicting which way interest rates will go is very tricky, even for experts.

With a laddered bond portfolio, you don't have to choose. You invest equal amounts in several different bonds maturing at successively longer dates. For example, you invest in 10 bonds, with the first one maturing in one year, the second in two years, the third in three years and so on until you get to 10 years. As each bond matures, you reinvest in a new 10-year bond. This way, you smooth out fluctuations in interest rates for more predictable income. Plus, your income typically rises over time, as longer-term bonds tend to pay higher rates.

## Diversify beyond bonds

Guaranteed investments like GICs and government bonds are the foundation of most income-oriented portfolios. However, by allocating a certain percentage of your portfolio to other types of investments, you can enhance your income – without taking on significant risk.

Consider alternatives such as:

- › Insured annuities, which offer higher yields than conventional bonds or GICs.
- › Investment-grade corporate bonds that pay higher interest than government bonds, often for a modest increase in risk.
- › Income trusts that can provide considerably higher yields, although yields are not guaranteed and values can fluctuate.
- › Dividend-paying stocks, which can boost returns and long-term growth potential to enhance the longevity of your savings.

While some of these alternatives are not guaranteed, you can reduce the risk through diversification.

We can show you how to enhance your income, while managing risk. Please contact us for more information.

### Second opinion service for volatile markets

If you know someone who is concerned about the impact of market volatility on their portfolio, we would be pleased to offer them a complimentary second opinion. This complimentary service provides an honest evaluation of how well their portfolio is designed to withstand market volatility and meet their investment objectives.

Please ask us for a copy of our Second Opinion Service brochure, which explains how we evaluate a portfolio in detail.



\*The Strategy Focus List is a list of recommended securities that may form the basis for an investment portfolio strategy. The Strategy Focus List is not a mutual fund. The indicated rate of return is the historical annual compounded total return since Dec 31, 1984, as of February 28, 2008 but does not reflect applicable taxes, account and transaction fees, which would lower actual returns. The indicated rate of return assumes additions and deletions from the list are priced using previous day closing values. As a result, the beginning and ending prices used in the Strategy Focus List model are not subject to actual market fluctuations and your portfolio return may vary from our results. Past performance may not be repeated. This information is not investment advice and should be used only in conjunction with a discussion with your RBC Dominion Securities Inc. Investment Advisor. This will ensure that your own circumstances have been considered properly and that action is taken on the latest available information. The information contained herein has been obtained from sources believed to be reliable at the time obtained but neither RBC Dominion Securities Inc. nor its employees, agents, or information

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## Is the storm over yet?

Stock markets remain volatile, but have recovered from their recent lows. The economy continues to feel the effects of the U.S. subprime mortgage crisis, but central banks have come to the rescue with interest rate cuts.

Does this mean the worst of the “storm” is over? According to the RBC Investment Strategy Committee, there’s reason to think so. Following is a summary of the committee’s most recent outlook for the economy and markets.

### U.S. recession not inevitable, stronger second half likely

The turmoil in financial markets has kept risks elevated but our forecast remains essentially unchanged: the U.S. economy is likely to endure much slower growth through the first half, but a recession is not a foregone conclusion. Rate cuts and fiscal stimulus should produce a reacceleration in the second half. The global economic expansion (and Canada’s) should extend over the next one to two years. This would be generally positive for the sustainability of earnings and for equities.

### Monetary policy massively accommodative

The U.S. Federal Reserve has now cut its target rate by a massive 225 basis points since September 2007. The Bank of Canada has cut by 150 basis points. Other central banks have either joined the Fed in lowering rates or look about to do so. Fed easing has



typically underwritten a stock market advance over the year following the first cut. It usually also ushers in a period over which bond yields rise (i.e., prices fall).

### Canadian stocks attractive but carry added risk

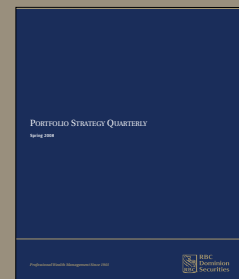
Credit market “aftershocks” will remain a fact of life for some time but our forecast for an extended global economic expansion with contained inflation is basically a good one for equities. All the more so because most major equity markets, like the U.S., are trading well below calculated “fair value”. The exception is the Canadian market where the degree of over-valuation presents an additional risk that would loom larger if our economic forecast proved to be too optimistic.

### Stocks favoured over bonds

Our view is generally a positive one for earnings and for equities. We favour stocks over fixed income and continue to carry a below-normal exposure to bonds. Fed cutting and the prospects for a reacceleration of the U.S. economy have improved the outlook and underpinning for stocks.

#### Get our full report on where the markets are going

Ask us for your complimentary copy of *Portfolio Strategy Quarterly* produced by the RBC Investment Strategy Committee. This in-depth report highlights our outlook for the global economy, inflation, interest rates, currencies, corporate earnings, stock market returns and more. It also highlights our recommended stocks on our U.S. and Canadian Focus Lists. Since it was established in 1984, the Canadian Focus List has achieved annualized returns of 18.2% versus 10.5% for the benchmark S&P/TSX Index.†



## Regard it as a buying opportunity

Normally when something goes on sale, people regard it as an opportunity to get a good bargain. But when stocks go on sale, people tend to shy away or even sell what they already have. Regard stocks like you would anything else that goes on sale. If they're on sale because there's a problem, don't buy them. But if they're on sale simply because there's a sale, consider buying. It could be an excellent opportunity to buy something with a higher intrinsic value at a temporarily lower price.

## Review your level of diversification

You've heard it before and you'll hear it again – diversification is the key to reducing risk in your portfolio. The idea is simple – you invest in a variety of different types of investments, so that if one investment goes down, you don't lose your shirt. But how you diversify can be quite complex. Beyond the tried-and-true technique of diversifying by asset class (stocks, bonds and cash), there are several other techniques. You can diversify by geographic area, industry sector and investment style – just to name a few.

What's more, diversification isn't a one-time thing. Especially during volatile markets it's important to stay on top of it, as moving markets can shift your asset mix too heavily in one direction or another. Everyone has an optimum level of diversification determined by their comfort with investment risk, their growth and income requirements, the amount of time they have to invest and other factors. Maintaining this optimum level requires constant adjustments – particularly when markets are in flux.

## Reassess your own comfort with risk

The stock markets were unusually calm between 2003 and mid-2007, lulling many investors into a false sense of security. It's easy to become complacent about investment risk when the markets are well behaved, leading many investors to overstate their true risk tolerance and choose a more aggressive investment strategy.

Then, when the markets go into a period of volatility, these investors find themselves suddenly uncomfortable with the risks they were perfectly comfortable with before (when the markets were going up). Aggressive investors discover that they're really balanced investors. Balanced investors realize that they are actually conservative investors. And conservative investors buy new mattresses.

If you're feeling uncomfortable about the current volatility, it may be a sign that you should take an honest look at your real risk tolerance and possibly adjust your investment strategy so you can get a good night's sleep (maybe even on your new mattress).

## Keep your investment plan up to date

Think long term. Stay the course. Stick to your plan. These commonly prescribed remedies for market volatility all sound good in theory, but what if your plan needs to be changed? Investment plans do need to be updated regularly, not only as market conditions change, but also as your personal circumstances and goals change. You should review your plan at regular intervals and whenever there's an important life event, such as starting a new job or business, changing your marital status or receiving an inheritance.

## Get professional advice

Managing stock market volatility isn't easy, but we can help. Ask us for more information about structuring your investment portfolio for today's volatile markets.

### Keep your sense of perspective

Historically, the S&P/TSX Index goes through periods of higher volatility (sharp ups and downs), but the general trend is up, as the chart below shows.



Source: RBC Asset Management, September 2007