The Stan Clark Financial Team's

PERSPECTIVES

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Asset allocation

Asset Allocation: Your best mix – putting it all together

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Asset allocation is the mix between equities and fixed income. We've been devoting a lot of time to this subject, because it's probably the most important decision when it comes to investing. Equities and fixed income are fundamentally different from each other. And the mix between the two will have a significant effect on the risk and return of your portfolio.

Previously, we've pointed out that returns from stocks are much higher than from bonds. The risks of each are also very different, and they may not be what they seem. We've learned that the risks of each asset class depend on how long you can invest for. In the short term, bonds are safer and stocks are riskier. But in the long term, the opposite is true. Stocks are safer and bonds are riskier. So, what's the right mix for you?

During this series on asset allocation, we've discussed two distinct approaches to figuring out that right mix. The first method, which we called *needs-based*, is numbers-oriented. It essentially compartmentalizes each of your future needs, such as retirement, education expenses, vacations, etc. And then, based on when those needs occur, we determine your best mix to meet them. Remember: Needs that occur further down the road can be invested more in equities – to maximize returns. And shorter-term needs should be invested in guaranteed fixed income. This makes sure the funds are available when you need them.

The second approach we use is what we call *volatility tolerance*. This is more feelings-oriented. It bases your mix on your comfort level with price fluctuations. We look at things like general rules-of-thumb, risk behaviour, attitude towards volatility, and financial capacity.

Each of the two methods produces a suggested asset mix. Then we combine these two mixes to come up with your *best overall mix*. But first – it's important to know what each number means.

Think of the numbers-based method as what you should do if you were completely objective. Now think of the feelings-based method as what you are able to do, given that being comfortable with your investments is important, too. You can now see that your best mix is a combination of the two: the mix you should have – but limited to what you can have.

Based on your needs, we factor in when and how much money you need. Let's say that this mix comes out to 80 percent. Again, this is purely numbers based. Before determining your best mix, we must also consider your volatility tolerance. Based on your answers, let's say your volatility tolerance comes out to 60 percent. So, your best mix is somewhere between 60 and 80 percent. In talking this over with you, we would typically suggest averaging the two numbers together – but within a limit, so we don't go too far above your volatility tolerance. In this case, your best mix might be around 70 percent.

Needs-based target: 80%

Volatility tolerance: 60%

▶ Best mix: 70%

In conclusion, the best mix for you is based on a combination of your needs and your volatility tolerance. This ensures that your investment strategy is properly customized to you. Things change over time, and your best mix can also change. That's why it's important to have regular reviews to make sure you stay on track.

Sylvia Ellis is the Senior Estate Planning Advisor for the Stan Clark Financial Team at CIBC Wood Gundy. Sylvia provides support to the team in projecting and planning client financial affairs.

To learn more about CIBC Wood Gundy, the Stan Clark Financial Team and the many ways we can help manage your wealth, please contact us by phone or by email as listed below.

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