The Stan Clark Financial Team

What's *your* Best Mix

Some people invest aggressively in the stock market hoping for fast gains. Others play it safe, sticking to bonds. Too often, both types of people lose. The first type loses money by over-estimating their ability to withstand volatility. The second type loses by failing to keep up with inflation or their future financial needs.

Everyone should have an equities target, which is the mix between equities (stocks) and bonds. It's probably the most important decision when it comes to investing. Bonds provide stability but the average returns are relatively low. Stocks can provide much higher returns, but also come with volatility.

	Average Nominal Returns	Average Real* Returns	Real growth from $100,000				
			1 Year	5 Years	10 Years	15 Years	20 Years
Stocks	9.6%	7.6%	$7,559	$48,759	$111,884	$187,809	$306,287
Bonds	4.5%	2.5%	$2,483	$10,180	$20,240	$30,518	$49,372
Difference in growth ($)			+$5,076	+$38,579	+$91,644	+$157,291	+$256,915

Below is our process in determining an equities target that is best suited for your goals and comfort with volatility.

Can stocks be safer than bonds?

It depends on how much time you have. As you can see in the chart, bonds are safer than stocks in the short-term. But in the long-term, the opposite is true – stocks are safer than bonds. History shows that down markets have always been more than offset by up markets, resulting in reliable returns for stocks in the long-term. That implies that the risk of losing money in stocks *decreases* as you invest for longer time periods.

RISKS

Worst returns	1 Year	5 Years	10 Years	15 Years	20 Years
Stocks	-$35,026	-$46,214	-$33,289	-$25,053	$13,418
Bonds	-$13,636	-$37,256	-$30,164	-$34,979	-$29,995
Extra risks for stocks	**$21,390**	**$8,957**	**$3,125**	**n/a**	**n/a**
Extra risks for bonds	**n/a**	**n/a**	**n/a**	**$9,926**	**$43,413**
Chance of negative return					
Stocks	31%	14%	6%	1%	0%
Bonds	29%	25%	25%	20%	15%
Extra risks for bonds	**-2%**	**12%**	**19%**	**18%**	**15%**
Chance of worse returns					
Stocks	37%	27%	11%	3%	1%
Bonds	63%	73%	89%	97%	99%
Extra risks for bonds	**26%**	**47%**	**77%**	**94%**	**98%**

Source: Siegel, Shiller, CRSP, Cdn Institute of Acutaries, TSX, Bank of Canada.

Our general rule is that money you will need soon should be invested in bonds. Money that you won't need for several years should go into stocks. So how do you know how much to put in each?

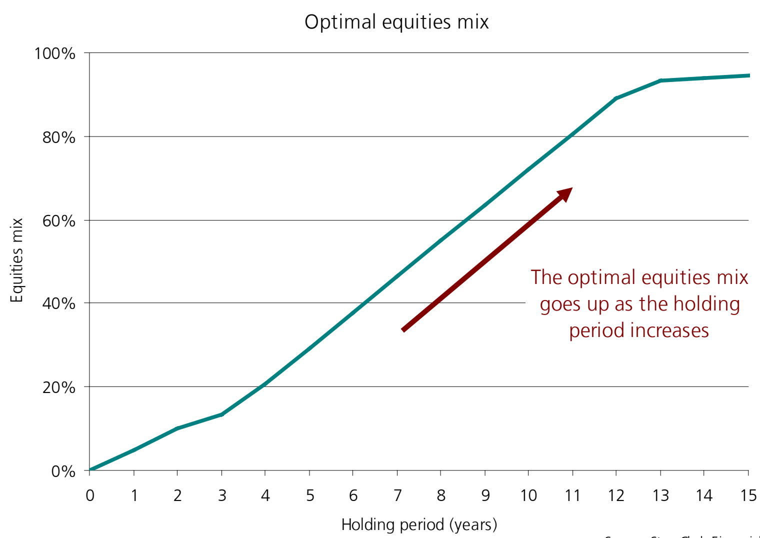
When do you need?

Our approach to determining your mix is based on your financial needs and is very numbers driven. It involves figuring out each of your future needs such as retirement expenses, your children's education, vacations, etc. But it's not just how much you need – it's *when* you need. This is a key point. Needs that are further down the road give us more time. This allows us to be invested more in stocks – to sustain volatility and maximize returns. Shorter term needs should be more in bonds – to ensure the money is available when you need it.

Mix and match

Let's say we've indentified each of your future needs and their timing. We then group them together on when they occur. When we do an actual financial plan, there are many needs and groups. But to keep things simple in our example, let's say we can sort each of your needs into three groups. Group A will be needs two years from now (perhaps a vacation). Group B will be your needs occurring five years from now (such a new car). And Group C will be your needs ten years from now (such as retirement).

So what mix do we use for each group? This is a critical part. We've gone back and examined historical returns (after inflation) for the past 100+ years. We analyzed the trade-offs between risk and return which, as mentioned, are dependent on how much time you have. Basically, we've determined an optimal mix for every possible holding period for needs that are one year from now to 30+ years from now.



Source: Stan Clark Financial Team

Now we know how the groups should be matched with what equities mix. Going back to our example, Group A which has needs two years from now, should have a mix of only 10% in stocks. Group B with needs five years from now, should have a mix of 30% in stocks. And Group C, which has needs 10 years from now, should have a mix of 70% in stocks.

As you can see, groups occurring in the short-term will have a low amount in stocks, because we need to make sure the money is available. And then groups with your longer-term needs won't occur for several years, so they have a higher amount in stocks. We then add up all the groups to calculate an overall mix. In this case the overall mix might be around 60% in stocks. We call this your Best Mix. It is the optimal mix to meet your needs and is dependent on when those needs occur.

This method of determining your optimal mix depending on when you need your money is different from traditional methods. It was developed by the Stan Clark Financial Team and is exclusive to our clients.

Keeping comfortable

Being comfortable with your investments is important. One of the worst things that could happen is selling out if things get tough in the markets only to watch them recover soon after. That's why we add a second approach that we call volatility tolerance. This approach also determines a mix, but it's based on your comfort level with price fluctuations – so it's more emotion-oriented. There are some simple rules of thumb that we look at, for example, your age. But, like everything, we like to dig deeper with a more comprehensive approach. So we also explore your risk behaviour, attitude towards volatility and financial capacity to withstand fluctuation. Understanding your comfort level with volatility will help ensure that you have a mix that allows you to sleep well during the downtimes. We take care to avoid setting a mix that will cause you to worry.

The Stan Clark Financial Team's comprehensive approach to determining your equities target

Each of the two distinct approaches will produce an equities mix. The Best Mix approach tells us what you *should* do to meet your goals – if you were completely objective. The volatility tolerance tells us what you are *able* to do, given that being comfortable with your investments is important too. In our example, your Best Mix was 60%. But your volatility tolerance suggested that you would be comfortable with a 50% mix. In collaboration with you, we would typically suggest averaging the two numbers together – but with a limit that we don't go too far over your volatility tolerance. So we're just fine-tuning your original Best Mix, with your comfort level with stocks, to give us your *adjusted* Best Mix. In this case, it might be 55%. We refer to this as your *equities target*.

The bottom line

Everyone is different and should have a personalized equities target. Your equities target is based on a combination of methods of when you need your money and your comfort with volatility. Our collaborative approach ensures that your investment strategy is properly customized to you. Remember, having an equities target is a key part of a resilient financial plan that allows you to be calm during market downturns while having confidence in your future.

Things change over time and your equities target can also change. So it's important to review your mix every couple of years or if there is a major life event.

So, what's your Best Mix equities target?

To learn more about CIBC Wood Gundy, The Stan Clark Financial Team and how the Best Mix approach can help you, please call 604-641-4361.

You can also reach us by email at StanClarkFinancialTeam@cibc.ca, or visit us online at www.stanclark.ca

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