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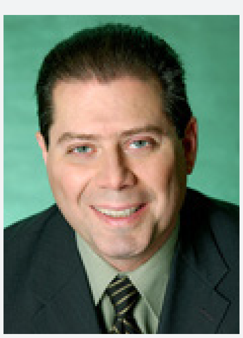

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INVESTING

Keep investing: 3 ways that mutual funds help you stay on track

In this year of the pandemic, you may be tempted to put your investing habits on hold. If you've lost income, that may be a prudent course of action. However, for many of us, fear of market volatility may be at play. But life goes on and our investment goals – like retirement – remain as pressing as ever. These three features of mutual fund investing can help you during this time.

Low minimum monthly contribution limits. Even small amounts invested today could have a big impact on reaching your goals in the long-term. That's because of the power of compound growth. Many mutual funds have low initial contribution amounts and even lower monthly contributions limits – often as low as $50 a month – making it easy to stay committed to keep investing.

Dividend reinvestment. In most cases, the profits made inside your mutual fund are automatically reinvested in more units of the fund. Indeed, this automatic reinvestment is one of the key benefits of mutual fund investing. Mutual funds are one of the few types of investments where earnings can be reinvested to compound and grow.

A regular investment plan. Putting large amounts of money – like a big Registered Retirement Savings Plan (RRSP) contribution, for example – into the markets may seem daunting just now. But by investing smaller amounts regularly, you may hardly notice the effect on your monthly budget. With a regular purchase plan, you can have a set amount withdrawn from your bank account and invested in fund units right away. This "set it and forget it" approach can be a worry-free way to commit to meeting your long-term investment goals.

If you're not already investing regularly, let's talk about whether now is the right time to get started. If this year's market volatility has shaken your investing confidence, we're here to help.

Overdiversification: too much of a good thing?

When you invest in mutual funds, you get instant diversification as your money is spread across the securities held in that fund. But can diversification get out of hand? And if so, is it actually harmful for your investing goals?

Diversification is a time-tested way of dealing with investment risk. The idea is that by spreading your investments across a number of securities or types of investments you limit the effect of a decline in holding just one type. Most investors will know the most basic kind of diversification as holding fixed-income funds as well as equity funds so that a drop in one will be mitigated by the other. Diversification can also be achieved across asset types, geographic regions, company size, bond durations and many other factors.

Getting out of hand

But just as diversification mitigates the loss, it can mitigate the gain as well. That's the first way that overdiversification can present a problem. Imagine that an equity fund holds the stock of 50 companies. If five of those perform exceptionally, it can provide a big boost to the performance of the fund. However, if the fund holds shares of 250 companies, the effect of those five outperformers may be blunted (depending, of course, on what percentage of the fund is held in each security).

A similar thing can happen within your own portfolio. When starting out you may have held just a few funds or even a single balanced fund. Over time, as you had more money to invest, you may have added new funds to increase your diversification or to take advantage of new opportunities or new investment products.

Sometimes this may be compounded by the structure of the funds themselves. Some funds such as balanced funds have diversification build into the fund itself. Other multi-manager funds or "funds of funds" have diversification happening within individual funds and diversification happening at the fund of funds level.

Left unchecked, your portfolio can end up with needless duplication and unnecessary complications and administration. And you may be blunting the effect of the high performers in your portfolio. This is over diversification, sometimes called "diworsification" because it's making things worse.

True diversification

So, should you just simplify by cutting the number of funds you hold? While it certainly will make things less complicated, remember you want to maintain the benefit of true diversification: to manage risk by investing in a variety of investments that don't behave in the same way.

One way to get closer to true diversification is by looking at how correlated this behaviour is by different types of investments. Mutual fund professionals can do this by looking at correlation coefficients. Using this measure, two asset classes that are perfectly correlated, meaning they can expect to move in tandem, score +1.00. Those that are reversely correlated score -1.00, meaning they will move together but in opposite directions. A score of zero means there is no relation between the two variables.

For average investors, these correlations can show some surprising results. When looking at correlations with the S&P500, a broad measure of U.S. stocks, in the decade 2010 to 2019, Guggenheim found that International Equities (MSCI EAFE Index) had a score of 0.85 while Global Equities (MSCI World Net TR Index) scored 0.97.[1] While both asset classes provide geographic diversification with the U.S.-based S&P500, they likely provide much less true diversification.

While surprising to most of us, professional asset managers know that in today's globalized economy and investment markets, asset classes are more correlated than they have historically been. This illustrates an important point for investors: while diversification is a relatively simple concept to understand, achieving meaningful diversification in your portfolio requires more knowledge and skills than ever.

What to do

To avoid overdiversification, remember that diversification is not just a matter of "more is better." In today's world, it takes skill and access to information to get the benefits of true diversification. Professional portfolio construction provided through your investment funds advisor is the best antidote to this predicament. ◂

[1] Guggenheim Investments, *Historical Correlation of Various Asset Classes vs. S&P500 January 2010-December 31, 2019.* https://www.guggenheiminvestments.com/mutual-funds/resources/interactive-tools/asset-class-correlation-map

FUND TIME

Tips and lessons in mutual fund investing

Fund Facts

What is it? Fund Facts is a document that contains the key information about a mutual fund. It is a simpler version of the information contained in the mutual fund prospectus. A mutual fund manager is required to create both these documents for each fund they launch, and investors are usually advised to consult both before investing.

What's in it? The Fund Facts document contains all the key information about the fund that an investor should know, including the mandate of the fund, the risks inherent in the fund and the cost of investing in it. It will also include a summary of the fund's past performance over the short and long term.

Why should you use it? Because the Fund Facts document contains all the key information about a fund, written in plain language, and is usually no more that two pages long, it is the ideal way to be informed about what you are investing in. By contrast, many investors will find the fund prospectus a more difficult and time-consuming read.

How do I get one? Call us first and we'd be happy to provide you with the Fund Facts for any fund you own or have an interest in. You'll also find that many mutual fund companies make their Fund Facts available online. ◂

When retirement is a reality, these funds are here to help

For most of your saving and investing life, you have probably focussed on capital accumulation, looking to maximize the growth of your money, within your own risk tolerance. But things change when you retire, and you want your hard-earned savings to provide retirement income. As a mutual fund investor, you'll want to get comfortable with two key concepts: capital preservation and income generation.

Income and growth

Conventional wisdom dictates that after you retire you should focus on preserving the money you have – capital preservation – and less on growing it. This usually means a tilting of your funds away from equities towards fixed income and other less volatile assets. But keep in mind that depending on your situation, especially your age at retirement and the amount of your savings, you may be looking at financing a retirement of 25 to 30 years. That could be as long a period as your capital accumulation years!

You will likely still need growth investments as part of your retirement mutual fund portfolio. Consider these types of funds for their ability to provide investment growth in retirement:

Conservatively managed equity funds. While invested primarily in stocks, these funds are designed to have lower volatility than many other equity funds. Often they invest in large, "blue chip" companies with stable performance, such as banks and utilities.

Dividend and Income Equity funds. These funds are looking for companies that have a solid record of paying dividends to shareholders.

Neutral Balanced or Balanced Growth funds. While these are balanced funds, meaning a mixture of equities and fixed income or other investments, by definition they contain a large proportion of equity holdings. This means you are likely to get some growth, though likely less than a pure equity fund.

Generating income

Because you need your investments to provide money to live on, you'll want to hold investments that generate income – ideally tax-efficient income. Here are some fund types to consider:

Income or Monthly Income funds. Many mutual fund companies have created funds especially designed for investors who need a steady stream of income. Monthly income funds, for instance, emphasize current income on a monthly or quarterly basis and target tax-efficient payouts. Income funds can vary widely in their focus, however, so it's important to make sure the fund's goals align with your income needs.

Fixed-income or bond funds. Bond funds have been a traditional choice for income with their low volatility and predictable payouts. On the downside, the interest income they generate is less tax-efficient than other kinds of income.

Dividend and Income Equity funds. As noted above, these funds invest in companies that regularly pay dividends – an income source that is tax-advantaged.

Unique needs

An effective retirement income strategy is not just a matter of choosing the right investment products. You'll need to know how much income you require and when you require it, based on your living expenses and your desired retirement lifestyle. You will also want a strategy that orders your withdrawals effectively – usually prioritizing non-registered accounts and your Tax-Free Savings Account (TFSA) over other registered accounts to assist with tax planning.

Your individual situation and income needs are unique. That's why devising a retirement income strategy from your mutual funds is best done with professional advice. ◀

The first bear market in a decade was also the shortest ever

Much was made in the media on March 11 when the longest bull market in history (in Canadian and U.S. stocks) came to an end after 11 years. As the COVID-19 crisis took its toll on the global economy, stock markets around the world tumbled and most indexes entered "bear market" territory.

A bear market is declared when an asset or an index closes down at least 20% from its most recent 52-week highs.

That decline in the indexes was certainly newsworthy, and investors rightly continue to be concerned about the effects of the virus on the global economy and on asset prices. But, by the same definitions, this bear market was the shortest in history as major North American stock indexes entered a new bull market by mid-April after climbing more than 20%.[1]

For mutual fund investors, however, the numbers that really matter are those in your individual mutual fund portfolio and the extent to which you remain on track to meet your financial goals. While the bulls and bears can provide a broad indication of the sentiments in the markets, they are just concepts. And, as 2020 showed us, they can be of limited value in telling us what is going on in the real world. ◀

[1] Nasdaq.com, *How To Trade The New Bull Market As The Economy Begins To Reopen*. April 24, 2020 https://www.nasdaq.com/articles/how-to-trade-the-new-bull-market-as-the-economy-begins-to-reopen-2020-04-24

Flight to safety? These funds are your port of call

This past spring, at the height of the pandemic, many investors flocked to safe havens and away from equities. While many people think of savings accounts at such times, these mutual funds offer safety, liquidity, and diversification away from equities.

Money market funds. These may not offer much returns potential in a time of historically low interest rates, but your holdings are extremely secure. Money market funds are generally considered the safest mutual fund investments and also provide liquidity for easy access to funds when other investment opportunities arise.

Mortgage funds. These funds hold Canadian residential and commercial mortgages and are designed to provide a steady stream of income. They're considered close to money market funds in terms of security of capital.

Fixed-income funds. These funds focus on providing a steady stream of income, often along with some possibility of capital gains. Some of the best choices for stability include short-term bond funds and government bond funds.

It's important not to sacrifice growth potential when investing for long-term goals, but if you need liquidity or have money that you're not ready to commit to equities just yet, these funds may fit the bill. ◀

Buying funds near year end? Plan carefully

Buying mutual fund units for your non-registered accounts near the end of the year? You may want to be careful around the payout date of any pending distributions. Here's why.

If the fund has earnings in a given year, it must pay taxes on them. Fund managers typically pay distributions to unitholders, which transfers that tax liability onto the investors in the fund. If you held the fund on the date of the distribution, then you will incur this tax liability. As most funds pay out distributions in December, year-end purchases require special attention.

Note that if you are purchasing your fund units inside a Registered Retirement Savings Plan (RRSP) or a Tax-Free Savings Account (TFSA) this won't be an issue for you.

To avoid this tax hit, you could wait until January or research the payout dates of the fund to ensure you buy after the distribution date. Remember, this isn't an issue specific to the calendar year end. You should always check a fund's history to make sure it isn't about to pay a distribution. For instance, some income funds may have distributions throughout the year. Professional advice can assist you to plan your transactions carefully. ◀