

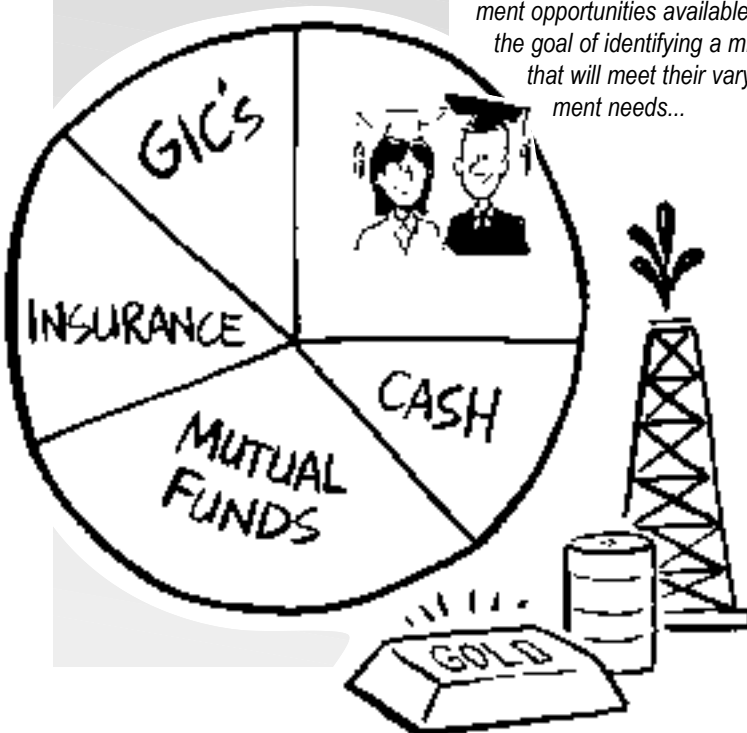
Diversification and Asset Allocation



Diversifying your portfolio to incorporate winners; winners and losers; asset allocation based on wealth, age, geography; taking care of short-term, immediate and long-term needs; Templeton revisited; lump sums and dollar-cost averaging

It has become clear that with today's earlier retirement and longer life expectancy, investors must be more prudent than ever to ensure an adequate retirement income. The proliferation of investment products adds to the challenge.

Speaking about challenges, in the next chapter Kate, Jack and Clive will be sifting through the wide array of investment opportunities available, each with the goal of identifying a mix of assets that will meet their varying investment needs...



It's another Thursday night at Jack's place and the boys are throwing darts. Thanks to Jack's recent venture into the world of finance, he finds he can now participate when the conversation turns to investments. Hey Jimmy, he asks his buddy who plans to retire in five years, how did you decide on the mix of investments in your portfolio?

Jimmy, a whiz in darts as well as playing the market, pauses and launches a dart. Bulls'-eye! Well Jack, he says, it's not like throwing at a dart board. You've got to carefully sift through the options, considering tax, liquidity, maturity, risk and other implications. Another throw by Jimmy - double 18! And then, he continues, you have to make sure your portfolio is diversified in order to spread the risk and increase your chances of picking winners and minimizing the impact of losers. Remember, you don't hit the bull's-eye! with every throw.

Some financial advisors rely on the rule of five when it comes to portfolio diversification. In any diversified portfolio of five sound stocks, each with good long-term growth potential, the rule of five says that in a good market one will perform poorly, three will perform well and one will strike gold for you. If you have a variety of investments, the chances are greater you will have one or two big winners. Jack, Clive and Kate are each best off spreading their

investments among different classes of products so they can participate in any gains and, at the same time, protect themselves from losses.

That said, investors of different ages tend to have different mixes of products. Typically, younger players like Kate seek a high percentage of growth-related investments while older investors like Clive tend to switch from more aggressive investments into a diversified mix of more conservative vehicles such as Government bonds, GICs, mortgage-backed securities or money-market funds, reflecting the need to preserve wealth rather than create it. And not only should his investments be mixed according to asset classes, they should also be staggered according to their date of maturity. This spreads the interest-rate risk.

It is sometimes said that retiree's should have a percentage of their portfolio equal to their age in fixed-income investments. But this is too simplistic an approach; Clive and Ida have all sorts of needs - for health care, for U.S. housing - and resources that render that equation useless.

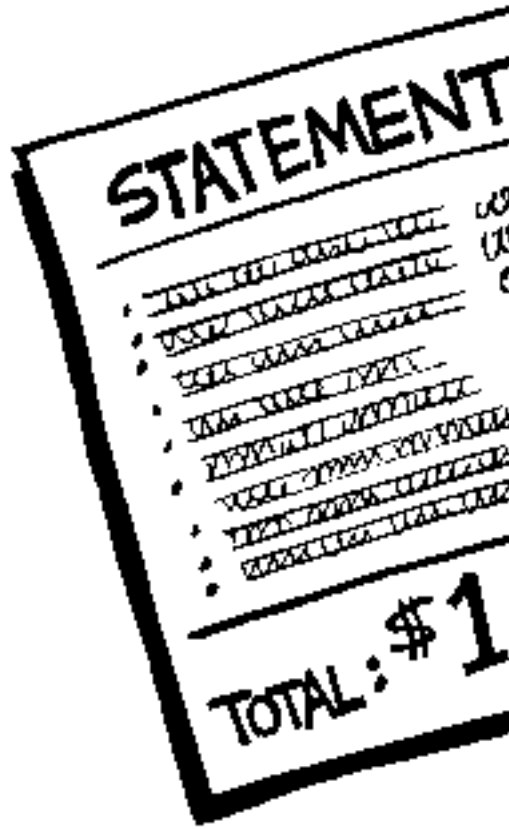
In determining an appropriate investment mix, investors should understand the nature of the products in their portfolio as well as how those investments react

to the market in general. Clive, who may decide to buy some bonds when he sells his business, is well enough versed in the principles of investing to know that as interest rates go up, bond prices go down. That equation matters if he goes to sell a bond prior to maturity, in which case it could be worth less than he paid for it if interest rates have risen.

The lesson to be learned from considering different investment vehicles, new-styled or traditional, is that caution should be exercised and all consequences - taxation, risk, liquidity and others - should be weighed before moving ahead with a purchase. As Kate might say as she climbs the mountain, look before you leap.

When is the best time to invest? John Templeton is often quoted as saying that the best time to invest is when you have the money. He pointed to one study in which a hypothetical investor in the Templeton Growth Fund who "bought low" once every year from 1969 to 1991 would see average annual growth only one per cent greater than the investor who "bought high" once per year during that time period.

But that analysis can be challenged when an individual has a short time horizon and a lump sum of money. If Jack takes on the extra project he has been offered and intends to invest a



lump sum he would be wise to plan his moves with due consideration of the degree of market volatility at that time. If the market is way up, it might not be wise for him to invest all of his extra money into stocks or a mutual fund at once. If the investment falls in value by 25 per cent in the first half year, he finds himself having to make up that loss first before he sees any investment returns. If Jack tries to do too much too soon, it can work against him.

But if he were to invest that sum over time, at a set amount

each month, he would have dollar-cost averaging working for him on the purchasing side. That is, instead of having the whole amount fall in value by 25 percent, he is investing small sums periodically. If the fund falls abruptly, the next purchase is 25 per cent cheaper. So the market volatility is working for him.

\$600,000 in the market at once. It may work for him - but it may work against him if the market slips and stays down for a while, for he doesn't have the time to make up for substantial losses.

Investing partial amounts over a comfortable time frame would be a safer approach for Clive.

The basic rule for conservative investing is that what you buy has to be based on value. First, you ask, should I buy a GIC? and then you ask, is this good value for a GIC?

When we next check in with Kate, Jack and Clive, we will assess different strategies for

But Kate, with a longer investment horizon, might not have the same concern. She has time to recover from losses and is projecting portfolio growth over a period of decades, so she might just be content to put her \$10,000 sales bonus into a good mutual fund and wait for it to grow over the long term. On the time continuum, it is less of a risk for Kate to invest a lump sum than Jack or Clive.



monitoring their investments. No surprise - each will have different considerations, with their positions on the life path the main factor, as they watch their portfolios mature.

So Templeton's rule is not hard and fast. The older a person is, the more caution they would want to exercise in investing a lump sum. If Clive gets \$200,000 for selling his house and \$400,000 for selling his business, he would have to think twice before investing the whole