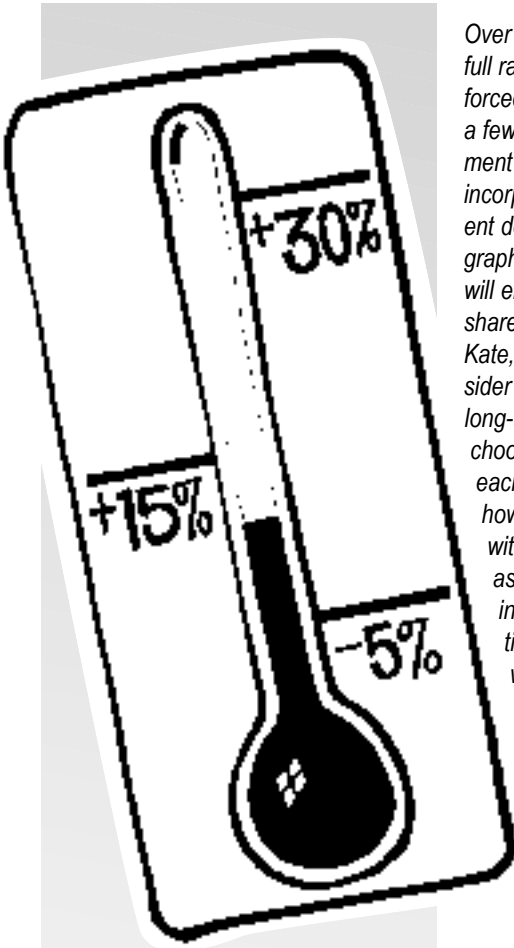


Monitoring and Buy-and-Hold



Monitoring your plan from a time perspective; the luxury of buy- and-hold; the value of investment experience; market cycles and the balanced portfolio; dealing with market downturns; forced savings; re-examining your portfolio; taking advantage of low prices



Over time, every investor who owns a full range of investment products will be forced to face the fact that there will be a few weak performers in their investment mix. Diversifying your portfolio by incorporating products reflecting different degrees of risk as well as geographic balance, among other factors, will ensure that you will have your fair share of winners.

Kate, Jack and Clive each have to consider their short-term, immediate and long-term financial needs as they choose among investment options. And each may be faced with a decision on how to invest a lump sum. An investor with a long investment horizon, such as Kate, would find it less of a risk to invest the whole lump sum at one time than someone older, like Jack, who could not recover from investment losses as easily.

You know, sometimes life just isn't fair. Kate has the least complicated life of our three characters, with no dependents, no education financing to worry about, no spouse in poor health and a good job with a strong future. Jack meanwhile has different priorities to choose from, lifestyle changes to get used to (he has to fit in those overtime hours at work) and of course his insomnia problem, which is worsened by the stresses in his life. So guess who has it easier when it comes to monitoring their investments? It's Kate. Not only does she have relatively high risk tolerance, which means she isn't panicked by volatility in the market, but her investment horizon is so long that she doesn't have to closely inspect her short term returns. Jack on the other hand will need more frequent reviews of his portfolio performance to ensure his investments are on track.

Though he is 50 years of age, Jack is essentially a rookie investor who has never been a player in the market. For him, a drop of 25 per cent in the value of his investments would be a catastrophe. He will no doubt react to fluctuations with emotion. And when times are good, he may tend to get over-eager. He must learn that moderation and patience are just as important during good times as bad. Further along in the life path, Clive has some

immediate and important decisions facing him. First and foremost, like all Canadians aged 69, he must reallocate his RRSPs into RRIFs or annuities. Then he must decide what to do about accommodation, take care of possible future long-term-care needs and reassess his will and estate plans.

Experienced investor that Clive is, he has seen it all and learned not to panic at the first sign of a nervous market. He realizes that daily moves of 130 points on an index of 6000 is the same as 65 points on an index of 3000 in the early '90s. In 1987, during one bear market, you would have found Clive in a conference with his financial advisor listening to a lesson on how, for example, buying when the market drops can be used to take advantage of volatility. There was an avalanche of horror stories in the newspapers and on television - but hardly anyone remarked that in less than a year, the market had fully recovered. Clive, however, took note.

Clive has always had balance in his portfolio, and never felt the need to panic and sell off his stocks and mutual funds when the markets dropped. And now as he approaches the age of 70 and is incorporating less risk into his portfolio, he doesn't have to watch the markets like a hawk.

Kate, as studious as she is, may have done her homework and learned about market fluctuations, but she hasn't lived through a half-dozen recessions and hair-raising stock-market dips like an older investor has. Her temperament, as gauged by a risk-tolerance test, indicates she is not averse to putting some of her savings into more volatile investments and living with the ups and downs of the market. But if she really wanted to make it easy for herself, she could, by relying on a philosophy known as buy-and-hold. For a 25-year-old with a good salary, like Kate, investment planning at its most simple can be a matter of putting aside some of her savings into any reasonably reliable investment, and watching it grow. She is aware that, while the stock market fluctuates from day to day, over the long term the stock market has outperformed all other investments. So she may consider having a portion of her portfolio invested in stocks.

Thanks to compound interest, even if she buys low-interest investment certificates and holds onto them for the long term, she can rest assured that she will have a nice nest egg when she retires. She can't just forget about her investments, but she doesn't have to be worrying about them all the time either. At her age, there is no need for her to micro-manage her portfolio when she has the luxury of

letting buy-and-hold work for her.

Kate has been counselled not to panic with every downturn. Between 1920 and 1998, the Toronto Stock Exchange experienced 54 up years and 24 down. She knows that the key target over a lifetime of investing is a good average annualized rate of return. That is, the average of her returns over the long term expressed as an annual rate.

And don't forget Kate's decision to allot a certain amount each month for investment purchases as part of a pre-authorized deposit plan. That approach permits the investor to dollar-cost-average and take advantage of fluctuations in the purchase price.

Since she is always buying, she isn't overly concerned if the market falls off because she is still buying more at those lower prices, and it takes away from the need to flip money back and forth. And compare another option that Kate has open

to her that Jack and Clive do not. Most Canadians accumulate wealth by taking advantage of forced savings, of which the principle investment is home



ownership. But Kate might choose to follow another path. What if she ignores conventional wisdom about home ownership and continues to rent inexpensive lodgings? This is of course a lifestyle decision as much as an investment one - she has no plans at present to prepare for a family, and so treats her monthly rent payment as simply another expense. As an active woman with no ties, and an open-ended career path, renting could be a sensible choice. She could then put the money she saves into the market, sit on the investments for

25 years and possibly emerge with more wealth to her name than if she invested in a home. The end result is uncertain, given the fluctuations of the real-estate market, but for footloose Kate, it's an option worth considering, because she has time working for her in two different ways. Firstly, over time, sound investments riding the market will generally gain in value, and secondly, Kate is so young that she will have an opportunity to change course if, a few years down the road, the strategy appears to be losing.

Clive, on the other hand, no longer thinks completely in terms of buy and hold, mainly because he is not looking ahead 15 or 20 years for his investments. He should be wary of prolonged downturns in the market because he does not have the luxury of time to wait for his investments to rebound. The truth is, you only have one chance to get old. If his portfolio happens to lose 25 per cent of its value in one year - in Canada, the TSE had a 25-per cent drop four times between 1920 and 1998 - Clive suffers. He is better served by reducing his holdings of more volatile investments and switching more to GICs or other safer but lower-yielding investments.

Jack once again finds himself the middle. He can't really commit himself as aggressively to buy-and-hold as Kate,



because he is more vulnerable to large market drops. If he chooses a poor-performing mutual fund or if the market drops in the first year or two, Jack has to make up the loss first before going on to enjoy growth. But on the other hand he needs the returns that aggressive, high-yield investments bring.

Again, it all points to Kate having easier decisions to make than Jack thanks to her long investment horizon. A 50-year-old who is unprepared for retirement has a totally different agenda from someone like Kate, who has the human capital and the drive to start planning now for her retirement.

When Jack has a few more years under his belt as an investor, he may begin to take advantage of the lessons he has learned to profit from fluctuations in the market. The experienced investor looks at a market that has fallen 20 per cent and says to himself, well at least there are going to be some bargains out there. I see that there are some big losers, some small losers and some investments that have held their value, so I now have a better idea of what has real value.

The experienced investor looks beyond a short-term period of losses and says, well in the last 10 years I have enjoyed strong gains with these funds, and the market fundamentals have not

changed, so there's a good chance that over the next 10 years I will continue to see profits. I may make some adjustments to my portfolio but not panic.

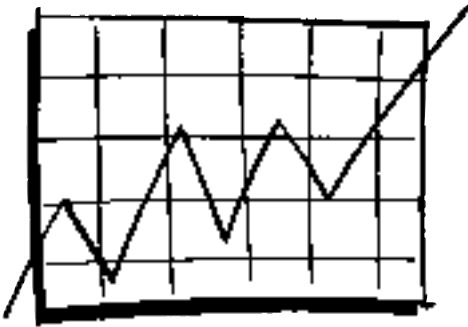
The point is, a good financial plan should be able to withstand downturns in the market. If the plan has been prepared properly in the first place, it will remain a good plan during a bear market as well as a bull.

The stock market is just like a retail store where the prices go up and down. Investors who panic and sell because the market is down are running from the store when there's a sale on. They wouldn't do that if they were buying clothes or food, so they shouldn't do it with their investments.

When you buy and sell can be compared to a love affair. You may fall in love and have a terrific relationship but soon enough you realize it was only infatuation. Now you ask yourself, when do I break it off? It's tough to make a decision so you hang on and on and on.

It's the same thing with a favourite stock. What happens when a favourite stock looks to have become a long-term loser? You may hang on because you don't want to think of yourself as a fool, but sooner or later you'll realize that sentiment should have no place in investment decisions.

Plans should be re-examined in times of major economic or personal change. Substantial shifts in tax laws, government policy, foreign or domestic economic situations, employment status or other family situations should prompt you to sit down with your spouse or advisor and reconsider the direction of your portfolio. The contrast here is between modest change within predictable parameters, which your financial plan should already be able to accommodate, versus substantive change.



In any event, portfolios should be updated periodically over time. Wise investors may be able to profit from changing markets by buying products that are new, or show new potential.

Instead of being concerned about short-term fluctuations, it is better to monitor the overall composition of the portfolio to determine if it remains balanced as its components experience different rates of growth. What started off as a perfectly balanced mix can become

skewed as certain sectors grow more than others.

Another important aspect to monitor is how well your investments are doing in relation to overall market trends. If your investments are underperforming, you should be thinking of making changes.

The experienced investor may enjoy the cut and thrust of playing the market and watching for winners and losers, but there's a danger of over-doing it - there is a tendency to believe everything you read.

Newspapers are in the business to sell newspapers, especially in today's competitive media climate, and investors should take alarming headlines with a grain of salt and not panic over what they read over breakfast every day. Why not let your financial planner do his job of keeping on top of trends?

It goes without saying that it's best to buy low and sell high but some people end up buying high and selling low. Investors ought to realize that investment decisions must be contemplated in the context of a good financial plan. If you have developed a financial blueprint that you believe in, there is no need to panic when the market experiences moderate volatility.