

Globe and Mail - RRSP 2007

Is your portfolio right for your needs?

There is no one-size-fits-all RRSP strategy. But for most, the best plan is a balanced and diversified portfolio, JAMES YIH writes

Everyone wants the best investments for their registered retirement savings plan. The problem for many people, though, is that there are too many RRSP choices and too much clutter in the investment world, which can lead to confusion and indecision.

Here's a look at three of the most common questions investors ask when selecting investments for their RRSPs, with general guidelines to help you make better decisions for your own portfolio. Which vehicles are best?

Investors come in all shapes and sizes, and Canadian financial institutions try to offer a variety of products, or investment "vehicles," to suit different types of people with different needs and goals. In general, the type of RRSP vehicle you choose should be based on five key factors:

- * Your tolerance for risk;
- * Your savings time frame;
- * Your investment objectives;
- * Your financial knowledge; and
- * Your financial picture.

Fixed-income investments such as guaranteed investment certificates (GICs) and bonds are designed for the more conservative investor with a shorter time frame available for RRSP donations. This would suit someone nearing retirement, for example, someone who is closer to needing to rely on RRSP savings to replace their job income. Fixed-income investments are also better suited to people who want to keep things simple or can't afford to take big financial risks.

Equity investing, or putting your money in stocks, is usually of interest to people who are more financially knowledgeable, can tolerate more risk or have a longer time frame to retirement. It has also been said that investors who can tolerate losing money are better suited to equity investing. Given the current low interest rates for GICs, bonds and savings accounts, many people are turning to equity investments because they are looking for higher returns to help build their portfolios. Although this makes sense, it is important to understand that there is no free lunch - with higher potential returns comes higher risk.

The best guideline is to do what makes you comfortable. I remember a lesson passed down from my parents: When in doubt, err on the side of being more conservative.

What does "balancing" mean?

Everyone talks about the importance of having a balanced portfolio (a fancy way of saying don't put all your eggs in one basket). The basic premise is that your investments should be diversified, with a combination of asset classes or stocks, bonds and cash in your portfolio. But achieving balance is much more complicated than it used to be. There are more asset classes than ever, such as income trusts, and hybrid investments such as protected notes. And within each asset class, there are subcategories.

If you are investing in stocks, for example, many portfolio managers will suggest that you invest in small-cap, medium-cap and large-cap stocks for proper balance. And there are subcategories in fixed-income vehicles, too, such as government bonds, corporate bonds, high-yield bonds and real-return bonds.

Many experts also believe that a portfolio is not properly diversified or balanced unless you invest in many different geographic regions of the world. If last year is a sign of things to come, Canadians should take a closer look at global diversification.

Finding the right balance can be complicated and confusing, but many financial institutions offer products to try to simplify your planning. Sometimes keeping it simple can be good. While balance and diversification are important, don't over-think it. If it seems too daunting, seek the help of a professional financial adviser. Should a portfolio change over time?

AIC Mutual Funds coined the slogan "Buy. Hold. And prosper." Although many financial professionals adhere to the belief of buy and hold, times are changing too much and too quickly to let your portfolio stay static. I believe there are three catalysts for change in a portfolio.

The first catalyst is because of life changes, such as a new job, marriage, kids, paying off a mortgage, retirement. There will be times in your life where you will feel more financially secure and other times you will feel vulnerable. At times you will feel you can be more aggressive in your investments; at other times, you will want to be more conservative. Your portfolio should change as your circumstances change.

The next catalyst to change is investment merit. I've always said that when an investment vehicle loses its stamp of quality, it is time to sell it. The financial industry is just like any other, changing all the time. In an environment where new products are being developed every year, some are bound to be better than anything offered before.

The third catalyst for change is rebalancing your investments. According to John Davis, a financial adviser in Edmonton, "Rebalancing a portfolio is one of the easiest and best changes an investor can make to their portfolio. Rebalancing forces investors to practice buy-low and sell-high, which common sense suggests is the best investment strategy for success."

Rebalancing is a systematic approach to managing a portfolio that helps investors avoid emotional mistakes, such as chasing performance. People tend to look backward when investing, choosing a stock or mutual fund that did well in the past. Although one might think investments that did the best in the past will do better in the future, past performance isn't always the best indicator. As they say in hockey, go where the puck is going, not where it is. In short, RRSP investing can be as simple or as complicated as you want to make it.

My own formula for investment success is fairly simple, and looks like this:
Diversification + Research + Discipline + Tax Efficiency + Management = Success.

James Yih is an Edmonton-based financial adviser and author of Mutual Fundamentals and Seven Strategies to Guarantee Your Investments.