

# Investing Independently

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# Overview

Before investing

Investing the surplus

Easy things to control

- ✓ Fees
- ✓ Taxes
- ✓ Trading

Why Indexing is worth considering

- ✓ A few ETFs & index funds

Diversification

- ✓ Historical perspective
- ✓ Asset allocation
- ✓ Asset mixer

State of the markets

- ✓ History of bear markets
- ✓ Stock valuation
- ✓ Moderation

Further reading

# Before investing

## Be debt free

- ✓ No Credit Card Balances
- ✓ No Loans
- ✓ No Mortgages

"I've seen more people fail because of liquor and leverage  
- leverage being borrowed money."

- Warren Buffett

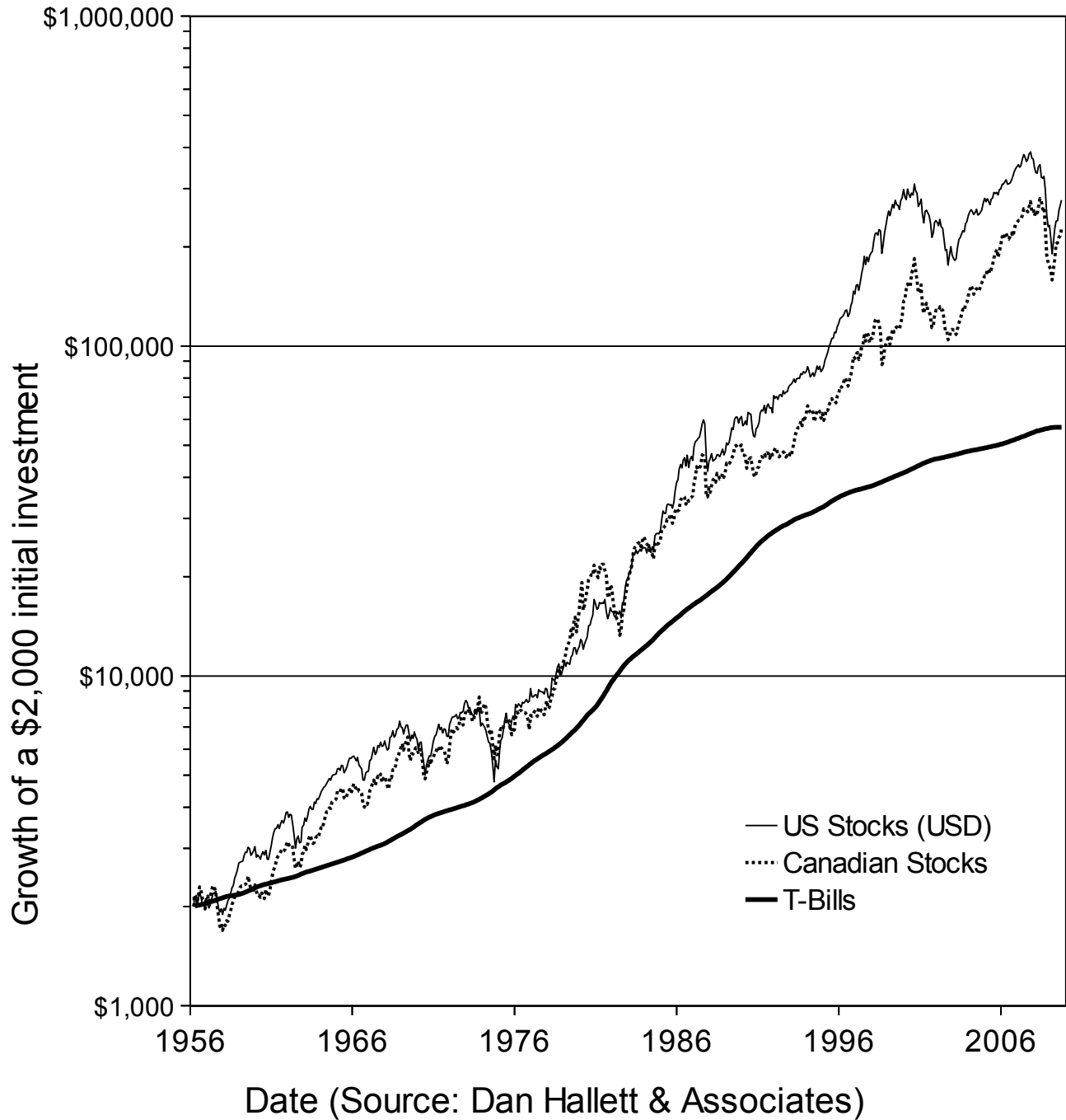
## Have a rainy day fund

- ✓ Stash 3-6 months of income in short term notes
  - ✓ High interest bank accounts (ING Direct, etc.)
  - ✓ Short-term GICs  
(T-Bills ~0.5%, GICs ~1.0%, Savings ~1.0% 1yr)
- ✓ Save for large ticket items
  - ✓ Homes
  - ✓ Cars
  - ✓ Tuition
  - ✓ Medical

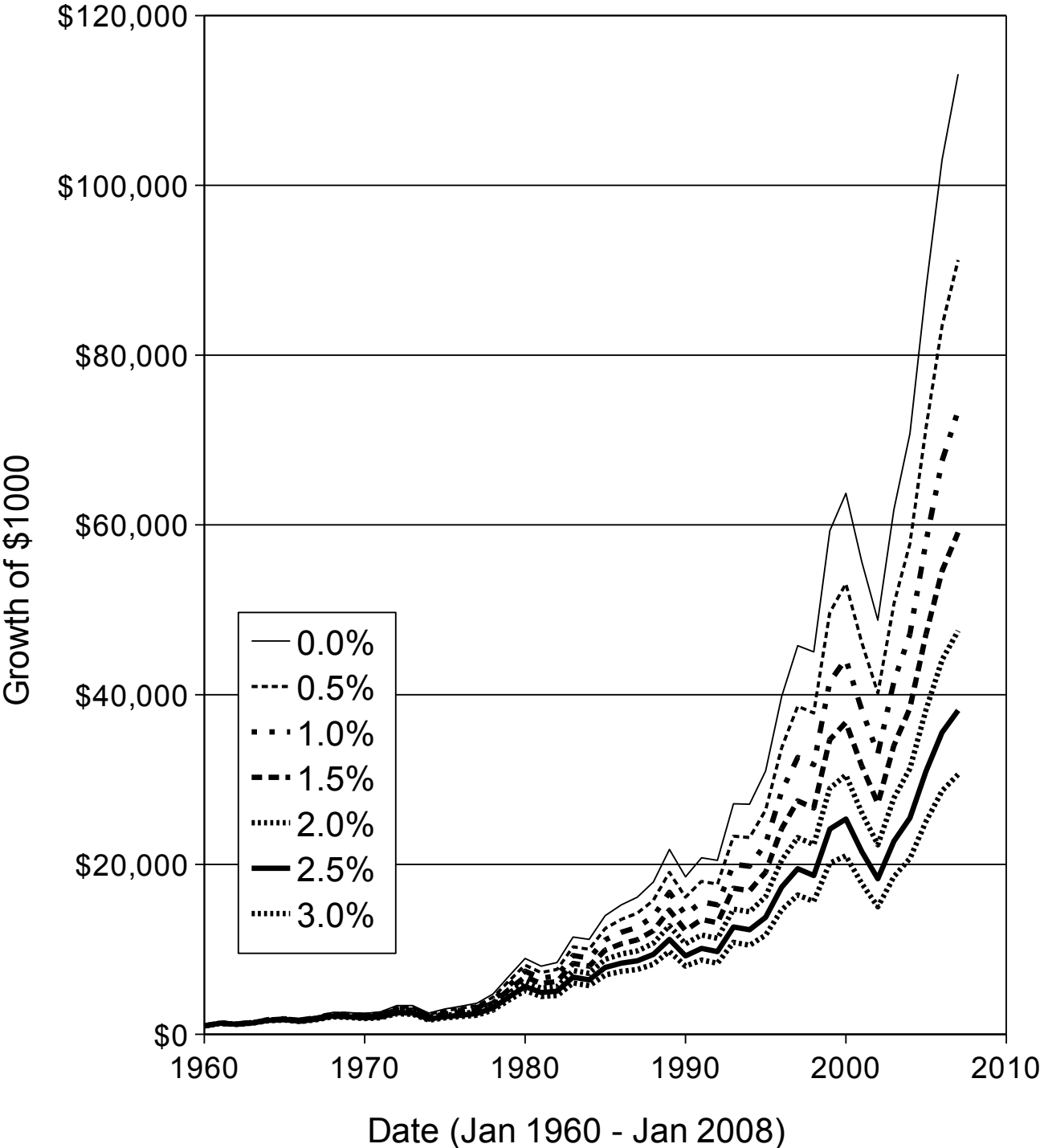
## Insurance

- ✓ Make sure that your family is fully covered

# Investing the surplus

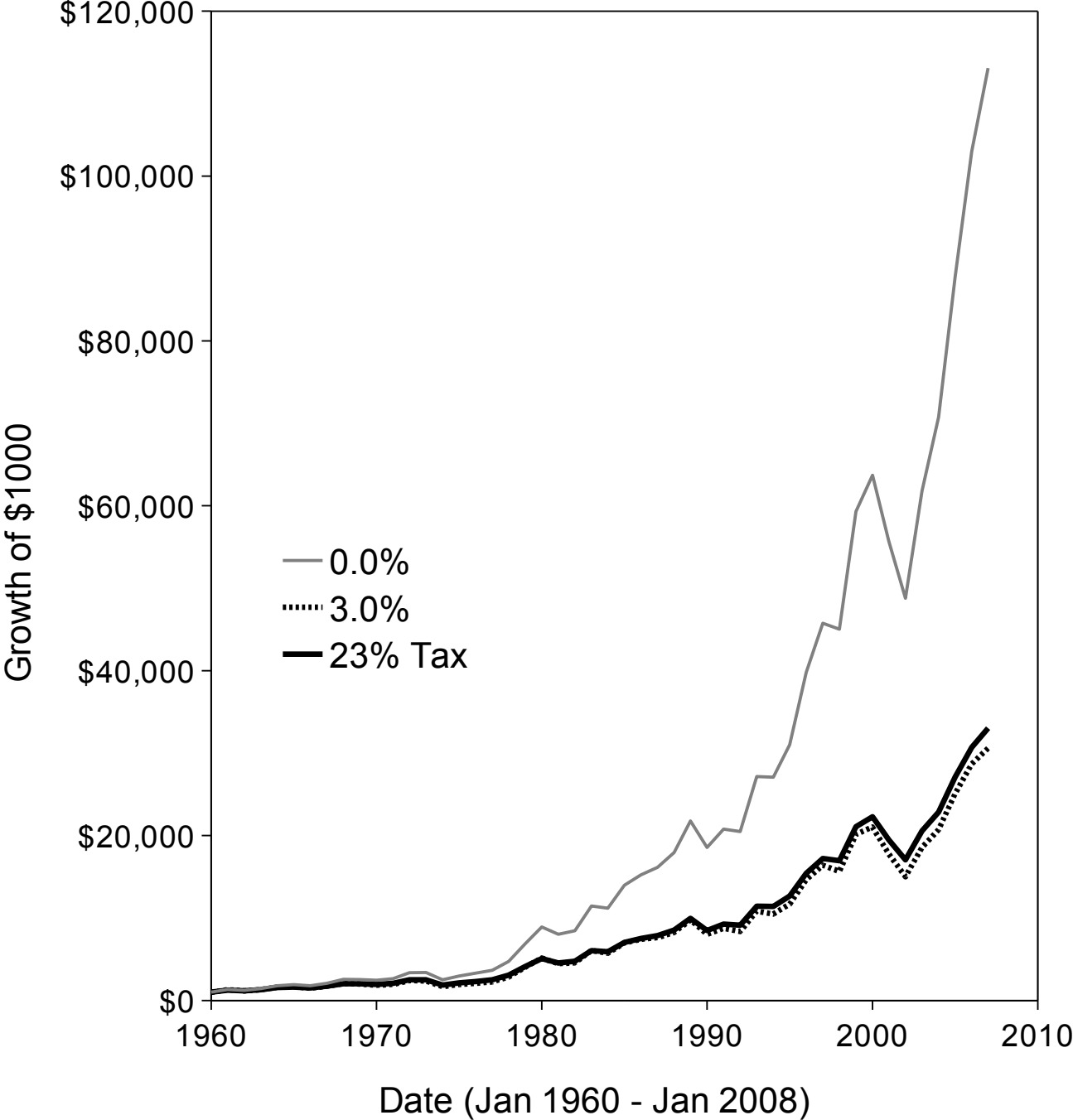


# Control Fees: TSX return after fund fees



*If possible, use low fee funds / investments.*

# Cut Taxes: TSX return with a tax on gains



*If possible, use RRSPs / TFSA's / etc. to reduce taxes.*

# Trading can be dangerous

## Taiwan Stock Exchange 1995-2000

- x Average turnover between 308% and 630%
- x Average annual trading losses of 350 bps.  
- Who Gains from Trade? (Barber et al.)

The average U.S. mutual fund earned 5.7% annually from 1998 to 2001 and the average fund investor earned 1%. Poor timing reduced returns by 470 bps a year.

- June 2002 Money Magazine (Jason Zweig)

The S&P500 fund (SPY) gained 0.3% annually over the last 5 years but the average fund investor lost 4.3% a year. Poor timing reduced returns by 460 bps a year.

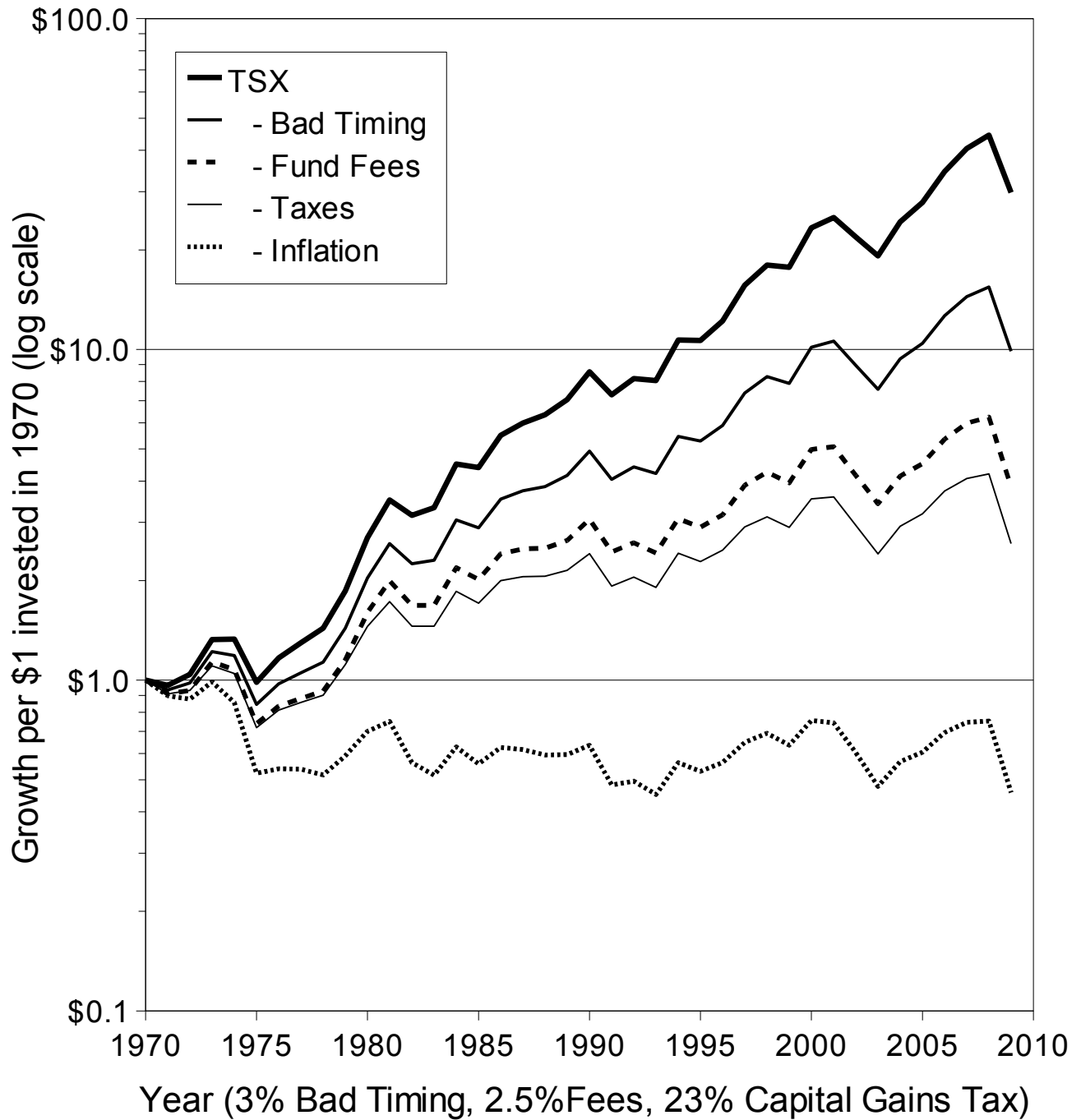
- October 31, 2009 (Morningstar.com)

## Potential Defenses

- ✓ Opt for long holding periods
- ✓ Move to less volatile investments
- ✓ Consider low-fee balanced funds to avoid regret

"Be fearful when others are greedy. Be greedy when others are fearful." - Warren Buffett

# Investing with friction: TSX with costs





# Why indexing might be a good choice

Simply buy a basket of stocks that mimics an index.

## Potential Advantages

- ✓ low cost
- ✓ broad diversification
- ✓ tax efficiency through low turnover

## S&P 500 vs. Large Cap Equity Funds to 12/31/2003

Years	1	3	5	10	20
% S&P Outperformed	73%	72%	63%	86%	90%

Source: Burton G. Malkiel, Lipper, Wilshire & the Vanguard Group

## Potential Disadvantages

- x selecting a good index
- x high-fee index funds & ETFs
- x limited diversification from specialty indexes
- x high turnover on specialty funds
- x valuation

# Select ETFs & index funds

<b>Index Funds</b>	<b>MER</b>
TD Balanced Index	0.84%
TD Canadian Index eFund	0.31%
TD Government Bond Index eFund	0.48%
TD U.S. Index eFund	0.33%
TD International Index eFund	0.48%

<b>Canadian Exchange Traded Funds</b>	<b>MER</b>
iShares S&P/TSX 60 (T:XIU)	0.17%
iShares S&P/TSX Composite (T:CIX)	0.25%
iShares Canadian Bond (T:XBB)	0.30%
iShares Canadian Dividend (T:XDV)	0.50%
iShares Canadian Value (T:XCV)	0.50%

<b>U.S. &amp; International Exchange Traded Funds</b>	<b>MER</b>
Vanguard Total Stock Market (N:VTI)	0.07%
Vanguard FTSE All-World ex-US (N:VEU)	0.25%
Vanguard Total World Stock (N:VT)	0.25%
Vanguard Dividend Appreciation (N:VIG)	0.28%
Vanguard High Dividend Yield (N:VYM)	0.25%

<b>Balanced Exchange Traded Funds</b>	<b>MER</b>
Claymore Balanced Income (T:CBD)	0.25%
Claymore Balanced Growth (T:CBN)	0.25%

# Diversification

"Divide your fortune into four equal parts: stocks, real estate, bonds, and gold coins. Be prepared to lose on one of them most of the time. During inflation, you will lose on bonds and win on gold and real estate; during deflation, you will lose on real estate and win on bonds while your stocks will see you through both periods, though in a mixed fashion. Whenever performance differences cause a major imbalance, rebalance your fortunes back to the four equal parts."

- Jacob Fugger the Rich, 1459-1525

# Asset Allocation

## The Couch Potato

- ✓ Select a simple asset allocation and stick with it

Couch Potato Portfolios	Canadian Bonds	Canadian Stocks	U.S. Stocks	International Stocks
Classic	34%	33%	33%	
Global	40%	20%	20%	20%
High-Growth	25%	25%	25%	25%

## Age Determined

- ✓ Set the % in Bonds to one's age. That way you move into less risky assets over time. Bonus points for living to 100+.

## Individualized

- ✓ Allocation based on an involved analysis which includes a discussion of return objectives, investment time horizon, risk tolerance, liquidity needs, constraints, etc.

## Potential Problems

- x Special needs or constraints.
- x Bonds may be risky. (Inflation & default)
- x Above average wealth may allow for more stocks.
- x The value offered by any particular asset may be poor.
- x Just because you can take on more risk doesn't mean that you should.

# Asset Mixer

## The Stingy Investor Asset Mixer

Portfolio by Asset Class			
Asset Class	Start Year	Alpha	Weight
3 month T-bills	1961	0.00 %	0.00 % ± ▬
Short Canadian Bonds	1980	0.00 %	0.00 % ± ▬
Long Canadian Bonds	1970	0.00 %	0.00 % ± ▬
All Canadian Bonds	1961	0.00 %	25.00 % ± ▬
Real Return Bonds	1992	0.00 %	0.00 % ± ▬
TSX Composite	1961	0.00 %	25.00 % ± ▬
S&P500	1961	0.00 %	25.00 % ± ▬
Wilshire 5000	1975	0.00 %	0.00 % ± ▬
MSCI EAFE	1961	0.00 %	25.00 % ± ▬
MSCI Emerging Markets	1988	0.00 %	0.00 % ± ▬
Gold Bullion	1970	0.00 %	0.00 % ± ▬

**Options:**

Annual Withdrawal Rate (%):

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Starting Portfolio Size (\$):

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Year Range Start:  Stop:

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Set Global Alpha Assumption:

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pretax returns in Canadian dollars.

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Use  returns.

URL: [http://www.stingyinvestor.com/cgi-bin/downside\\_adv.cgi](http://www.stingyinvestor.com/cgi-bin/downside_adv.cgi)

# Asset Mixer: Select Results

## Return vs Volatility (1961 to 2008)

Asset	Alpha	Arithmetic Avg Return	Standard Deviation
Portfolio	0.00%	10.73%	12.39%
3 month T-bills	0.00%	6.86%	3.82%
Long Canadian Bonds	0.00%	8.72%	10.36%
All Canadian Bonds	0.00%	8.29%	7.42%
TSX Composite	0.00%	10.75%	16.64%
S&P500	0.00%	11.17%	17.44%
MSCI EAFE	0.00%	12.70%	21.41%
Gold Bullion	0.00%	9.77%	26.64%

## Periodic Table of Annual Returns (2003 to 2008)

2003	2004	2005	2006	2007	2008
+28.4% Emerg Mkt	+17.5% RRBs	+30.2% Emerg Mkt	+32.9% Emerg Mkt	+18.9% Emerg Mkt	+28.2% Gold
+26.7% TSX	+16.8% Emerg Mkt	+24.1% TSX	+27.1% EAFE	+12.2% Gold	+8.6% S. Bond
+14.4% EAFE	+14.5% TSX	+15.2% RRBs	+23.5% Gold	+9.8% TSX	+6.4% All Bond
+13.4% Portfolio	+11.9% EAFE	+13.9% Gold	+17.3% TSX	+4.3% T-Bill	+2.8% T-Bill
+13.2% RRBs	+10.3% L. Bond	+13.8% L. Bond	+16.1% Portfolio	+4.1% S. Bond	+2.7% L. Bond
+9.1% L. Bond	+9.1% Portfolio	+10.6% Portfolio	+16.1% Wilshire	+3.7% All Bond	+0.4% RRBs
+8.2% Wilshire	+7.1% All Bond	+10.3% EAFE	+16.0% S&P500	+3.4% L. Bond	-19.8% Portfolio
+6.7% All Bond	+5.1% S. Bond	+6.5% All Bond	+4.1% L. Bond	+1.6% RRBs	-22.6% S&P500
+5.8% S&P500	+4.4% Wilshire	+2.9% Wilshire	+4.1% All Bond	-0.4% Portfolio	-23.0% Wilshire
+5.1% S. Bond	+2.8% S&P500	+2.6% T-Bill	+4.0% T-Bill	-5.0% EAFE	-30.0% EAFE
+2.9% T-Bill	+2.3% T-Bill	+2.4% S. Bond	+4.0% S. Bond	-10.1% Wilshire	-33.0% TSX
-1.5% Gold	-3.0% Gold	+1.5% S&P500	-2.9% RRBs	-10.3% S&P500	-42.5% Emerg Mkt

# Asset Mixer: Select Results

## Overall Portfolio Stats (1961 to 2008)

Average Gain (Geometric)	10.011%
Average Gain (Arithmetic)	10.726%
Median Annual Gain	13.237%
Standard Deviation	12.385%
Total Growth (%)	9649%
Total Value of a \$1000 Investment	\$97491.91
Total Down Years	10 years (21%)
Total Years < 5.00%	14 years (29%)
Total Years < 10.00%	18 years (38%)
Total Time Span	48 years

## Worst Drops (1961 to 2008)

Drop Starts	Drop	Recovery Time
1973	-22.25%	3 years
2008	-19.80%	still down
1974	-16.83%	1 year
2001	-16.82%	3 years
2002	-10.75%	1 year

Scenario	Return
1929-32 US-style equity decline (down 89%)	-66.75%
1906-07 US-style equity decline (down 49%)	-36.75%
1973-74 US-style equity decline (down 45%)	-33.75%
1987-87 US-style equity decline (down 36%)	-27.00%
1923-24 German-style hyperinflation (bonds down 99.99%)	-25.00%

# U.S. Bear Markets

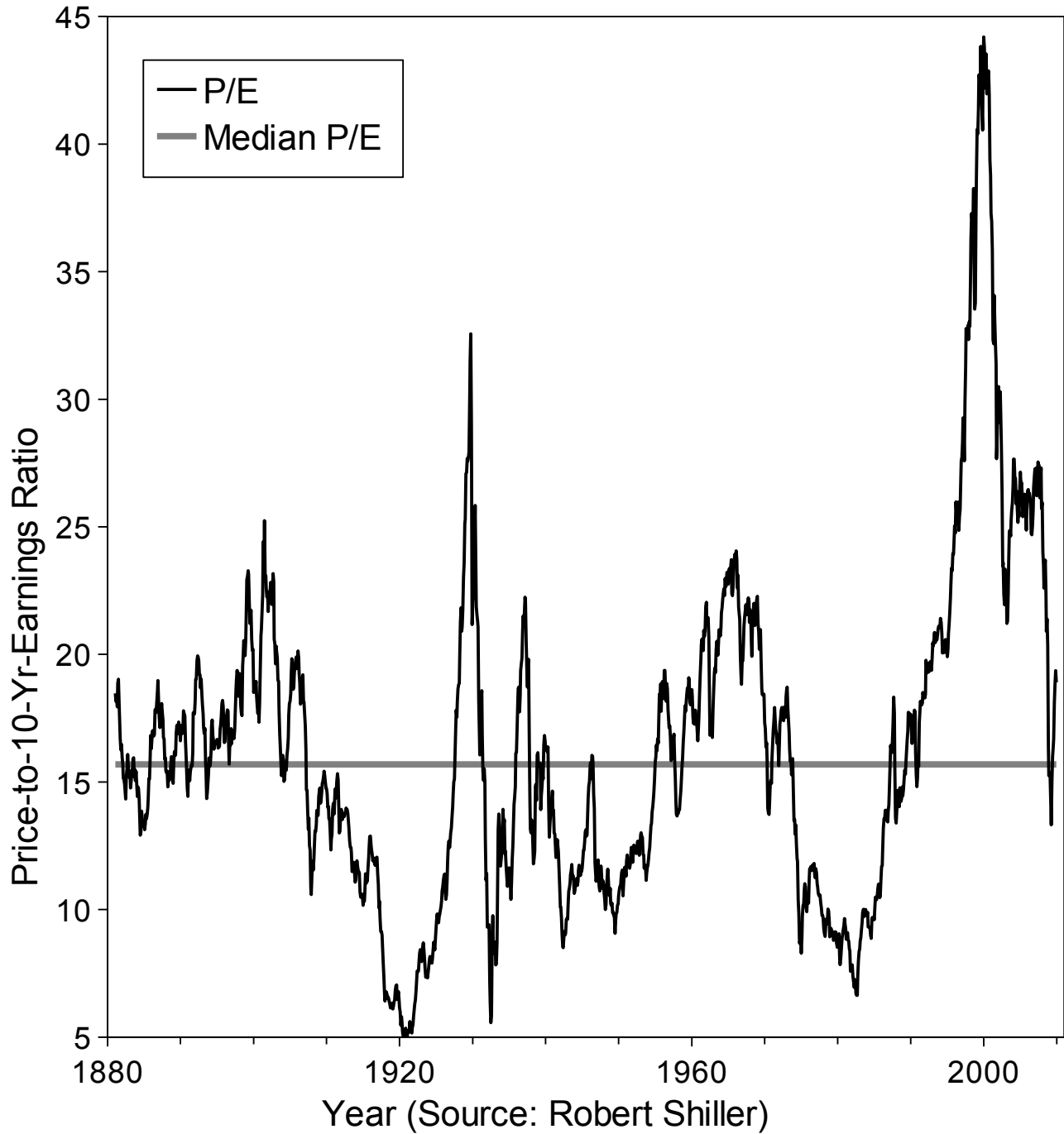
<b>Bear markets for the S&amp;P500 based on monthly data</b>				
Period		Peak-Trough	Months to	Months to
Start	End	Decline	Trough	Recovery
Mar-1876	Feb-1879	-33.1%	15	20
Sep-1882	Nov-1885	-20.8%	21	17
Jan-1893	Aug-1897	-25.1%	4	48
Sep-1902	Nov-1904	-25.8%	13	13
Sep-1906	Dec-1908	-34.0%	14	13
Nov-1916	May-1919	-28.0%	13	17
Oct-1919	Apr-1922	-22.8%	22	10
Aug-1929	Jan-1945	-83.4%	33	151
Nov-1947	Oct-1949	-21.8%	6	35
Jun-1962	Apr-1963	-22.3%	6	10
Dec-1968	Jan-1972	-31.5%	19	19
Jan-1973	Sep-1976	-43.3%	21	24
Sep-1987	Jul-1989	-30.2%	3	20
Sep-2000	Mar-2006	-43.3%	25	42
Oct-2007	Mar-2009	-50.8% (?)	17 (?)	?
<b>Averages</b>		<b>-34.4%</b>	<b>15</b>	<b>31</b>

Sources: Robert Schiller, indexfunds.com, S&P/Citigroup, Based on Month End Data

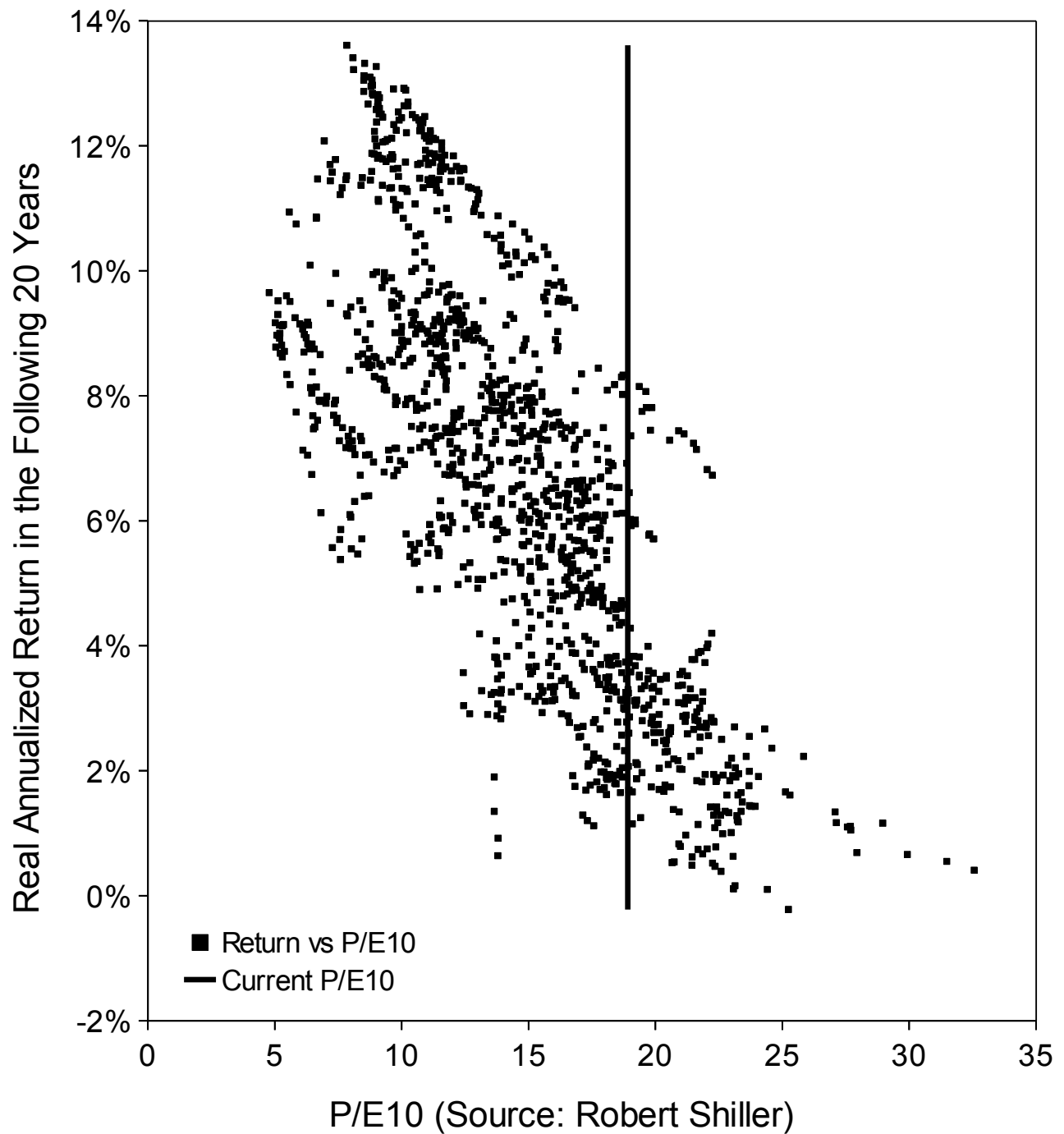
The October 2007 peak is ~50% higher than the index's October 2009 price.



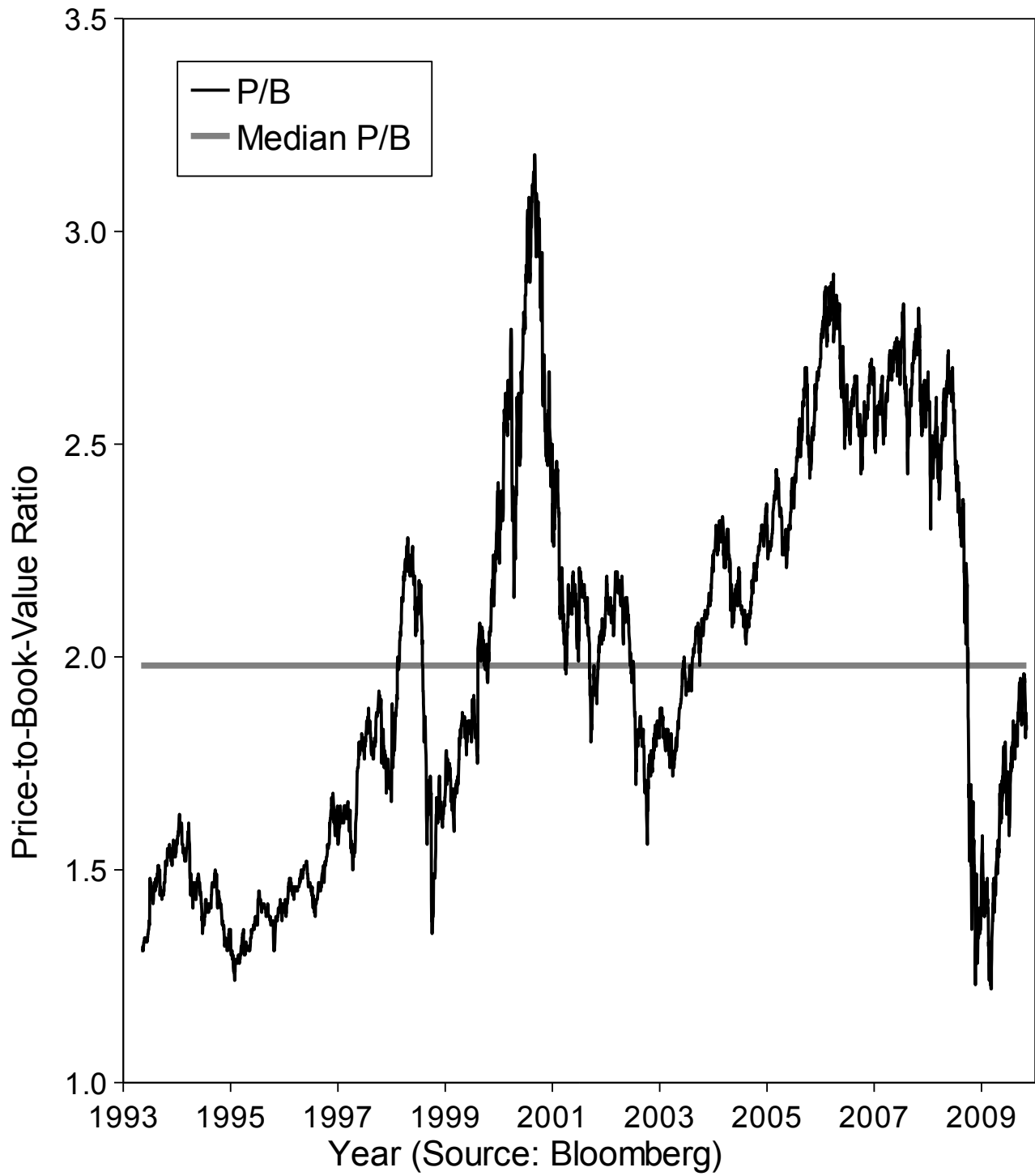
# U.S. Stock Valuation: Back to the Future?



# Forward Returns: 20Yr Returns vs P/E10



# Canadian Stock Valuation by the Book



# Risk, Moderation & Advanced Topics

Avoid lottos and sure things.

## Bonds

- ✓ It pays to go with 3-to-5 year bonds.
- ✓ Opt for BBB bonds over AAAs, but Bs aren't better.

## Stocks

- ✓ Avoid risky stocks with lotto like characteristics
  - x High beta, high volatility
  - x High leverage, low debt ratings (B & below)
  - x High valuation, IPOs

Stingy Investor Asset Mixer

[http://www.stingyinvestor.com/cgi-bin/downside\\_adv.cgi](http://www.stingyinvestor.com/cgi-bin/downside_adv.cgi)

Stingy Investor *Free* email newsletters

<http://www.stingyinvestor.com/cgi-bin/email.cgi>

Practical Portfolio Construction Slides

[http://www.stingyinvestor.com/Sl/articles/talk\\_1109.pdf](http://www.stingyinvestor.com/Sl/articles/talk_1109.pdf)

Useful Books

A Random Walk Down Wall Street	by Burton G. Malkiel
The Intelligent Investor	by Benjamin Graham
Contrarian Investment Strategies	by David Dreman
What Works on Wall Street	by James P. O'Schaugnessy
Fooled by Randomness	by Nassim Taleb

Advanced Topics

Security Analysis	by Benjamin Graham
Behavioural Investing	by James Montier

Market History

A Splendid Exchange	by William J. Bernstein
Extraordinary Popular Delusions	by Charles Mackay
Confusión de Confusiones	by Joseph de la Vega
The Ascent of Money	by Niall Ferguson