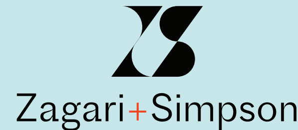

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Learn a little, improve a lot:
Why investors should be actively involved with their portfolio

Imagine you've just met with your investment advisor to discuss your retirement plan.

Based on reasonable projections and reliable data, you conclude it's likely you will run into a deficit in about 20 years. Besides the fact that you'd risk outliving your money at that rate, what more can your investment advisor really tell you?

A suitable advisory approach would suggest that you either save more, spend less, or delay your retirement date. After carefully considering your options, you decide you're not ready to make any changes to your lifestyle, so you do nothing.

This is a scenario that many Canadians face at some point leading up to their retirement. We want to change that. This whitepaper explores the difference between suitable advice and a mindset of accountability, and why we believe investors should play an active role in their long-term investment strategy.

WHAT IS SUITABLE VS. ACCOUNTABLE MINDSET?

- **Suitable advice** is the investment industry standard. Providing clients with suitable advice is considered the bare minimum when matching financial products to financial circumstances. For example, if a client has a conservative risk tolerance, that will limit the virtual shelf of financial products suitable for that client.
- **Accountable mindset**, a term that has deep meaning to our firm is a mindset. It is not law. In our opinion, a mindset of accountability combined with suitable advice is a mentorship-driven approach. We believe this mindset is unique and can provide clients with ongoing guidance to help increase their investment knowledge, which can widen the range of their investment options and reduce stress during the holding period.

We will weave examples of these advisory approaches into the rest of this whitepaper, but for now, let's start at the beginning of the investor-advisor relationship: the account-opening process.

WHAT IS KNOW YOUR CLIENT (KYC)?

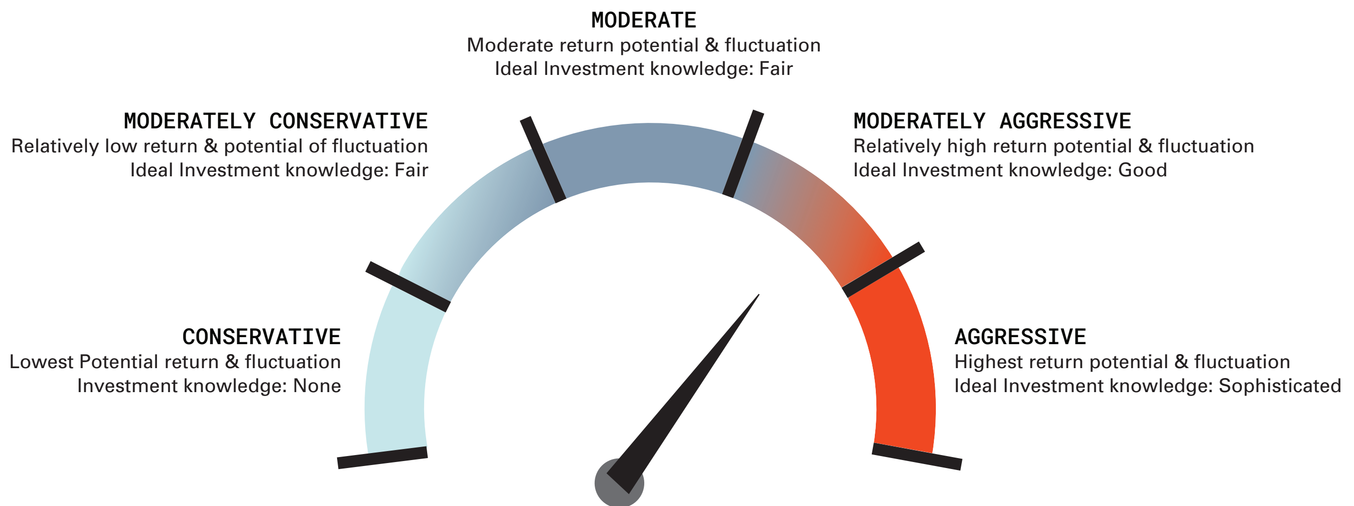
Know Your Client is a regulatory requirement and guideline (rule 3202) enforced by the Investment Industry Regulatory Organization of Canada (IIROC). It ensures investment advisors have detailed information about their client's investment knowledge, risk tolerance, and financial situation from the moment they begin their professional relationship. These details need to be collected before any account is formally opened and any money is placed inside the account.

KYC offers protection for all parties involved: clients make sure their advisor understands their complete personal situation, and advisors know what they can and cannot include in their client's portfolio. Other financial details involved in the KYC guideline include fixed and liquid assets, liabilities, and annual income.

UNDERSTANDING RISK PROFILES

If someone believes they are a conservative investor, their risk profile might fall between low and medium risk. In terms of their financial objectives, the same investor might select a strategy that blends preservation of capital, capital appreciation, income generation, and tax efficiency. Some investors might choose to allocate 100% of their funds to one of those options.

One way in which advisors must tailor their approach to a client's risk profile is determining the appropriate time horizon for a specific account. An investment time horizon is the time period during which investors hold a position in order to achieve a specific financial goal. Generally speaking, the longer the time horizon, the more risk an investor can accept in their portfolio. Conversely, the shorter the time horizon, the more conservative, or less risky, the investment strategy.



THE RETIREMENT DEFICIT

Let's revisit the meeting between you and your investment advisor.

Theoretically, the investment advisor could address a potential deficit by considering a higher rate of return when building out their projections. However, that would involve higher risk and higher volatility. Since performance is not guaranteed and projections are just that, projections, this plan can only work if you are willing to step outside your comfort zone. That means assuming more risk today in an attempt to compound your money faster over time.

From an accountability perspective, proposing a higher risk tolerance might be the optimal solution for the client. However, from a suitability perspective, risk is objective and based on facts. If a client is willing to address his or her retirement deficit by increasing their risk tolerance, the investment advisor will need to clearly identify why the risk tolerance has changed.

The fact that a retirement deficit has been identified does not mean the advisor can independently decide to add more risk into the mix. They would need to provide a detailed explanation as to why these changes might be necessary, and the client would need to accept the increased risk before any modifications could be made.

If the client is not willing to take on more risk, the advisor would have no choice but to prioritize the client's current tolerance and accept the projected retirement deficit. This is suitable advice.

In the battle between accountability and suitability, suitability wins 10 out of 10 times. If an advisor is not working towards educating their clients, the only option they have is to go this route. However, if an advisor is striving to provide a combination of suitable and accountable mindset, the client will have a wider selection of investments available to them, and their strategy will be that much more refined.

CLOSING THE KNOWLEDGE GAP

We believe that you should be an active part of your investment journey, not just an observer. Your investment knowledge should improve over time, and advisors should be educating their clients so they are better prepared for turbulence that can happen at any time.

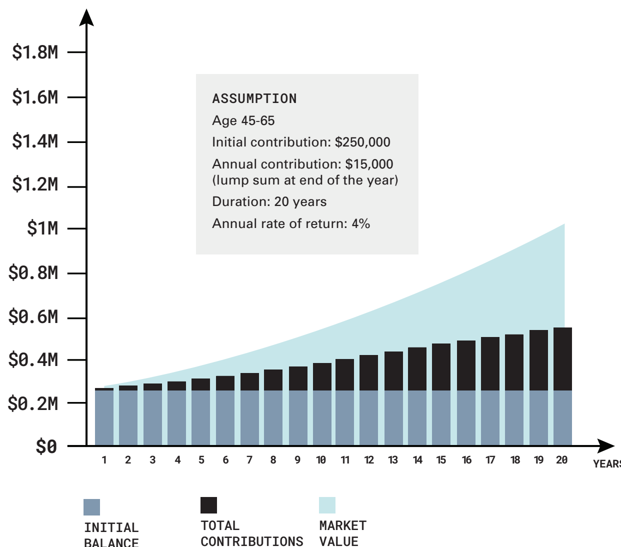
When you build a financial plan with a retirement that's 20 years away, a lot can happen – from a financial crisis to a pandemic. That's why it's important to work with an advisor who is teaching you something new each time you connect. Over time, you will begin to view turbulence not as a setback, but as an opportunity. Once your investment knowledge reaches that level, your investment strategy can become significantly more advanced.

In our experience, as the client's investment knowledge improves, as does their ability to handle volatility, which in turn can help generate higher returns. Ultimately, this can help clients address a retirement deficit without changing their lifestyle today.

Client 1 – Conservative

Lowest potential return & fluctuation
Investment knowledge: None

Initial Balance	Annual contribution age 45-65 (for 20 years)	Projected Annual retirement income age 65-94
$250,000	$15,000	$58,000



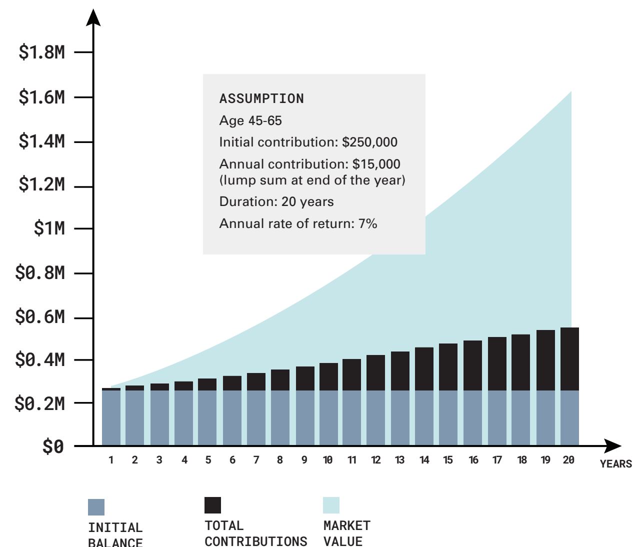
Age 65-94

Starting Retirement Capital: $1,010,775
Annual rate of return: 4%
Annual pre-tax retirement income: $58,000
Withdrawal type: Monthly
Duration: 29 years
End of plan capital value: $0

Client 2 – Moderate Aggressive

Relatively high return potential & fluctuation
Investment knowledge: Good

Initial Balance	Annual contribution age 45-65 (for 20 years)	Projected Annual retirement income age 65-94
$250,000	$15,000	$126,667



Age 65-94

Starting Retirement Capital: $1,621,583
Annual rate of return: 7%
Annual pre-tax retirement income: $126,667
Withdrawal type: Monthly
Duration: 29 years
End of plan capital value: $0

THE POWER OF CONCENTRATED PORTFOLIOS

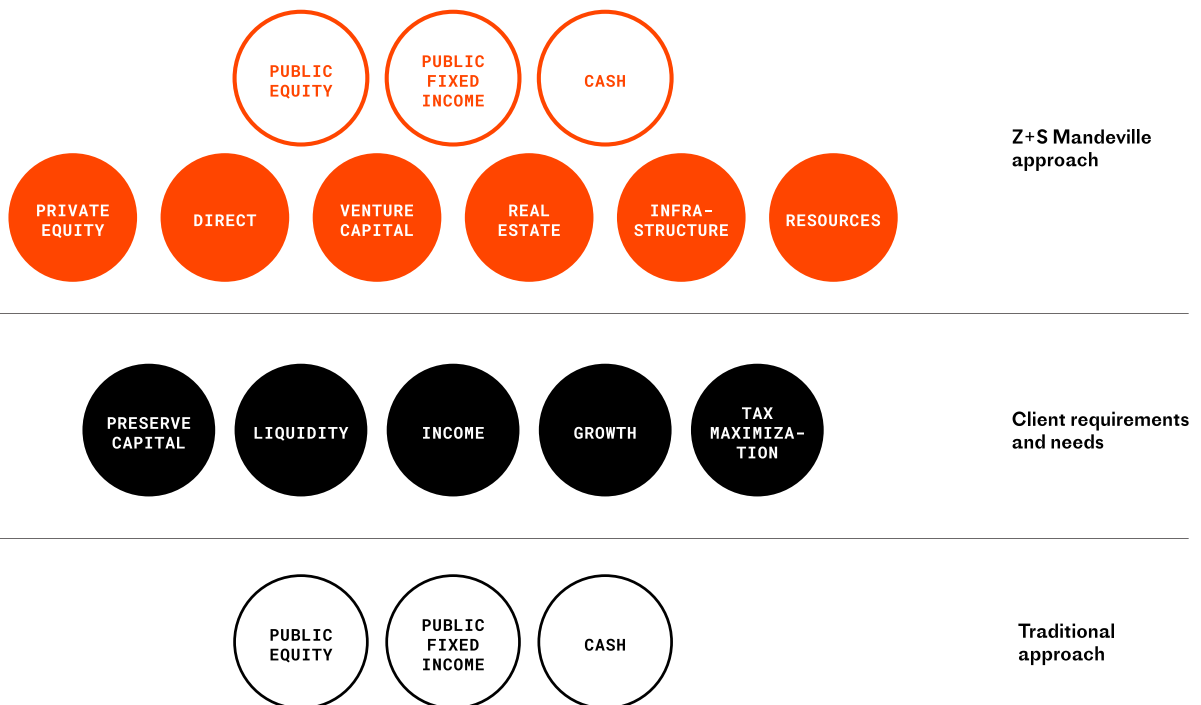
We believe concentrated portfolios that include a mix of public and private investment options can help address retirement deficits. These portfolios typically hold a few public stocks, as well as private equity, real estate, infrastructure, venture capital, and resources.

Historically speaking, investment portfolios that have high industry concentrations typically outperform their less-concentrated benchmarks and peers.

The simplest way to measure a portfolio's concentration is its number of holdings. The lower the number of holdings, the higher the concentration. Portfolios with low concentration – i.e. those that have more holdings – are less likely to perform well.

While a more concentrated portfolio that includes a mix of public and private investments can increase risk and reduce liquidity, it also can increase potential gains.

If you cannot save more or do not want to change your lifestyle by spending less, you may want to consider using time as your strategy. By taking on more risk and spreading that risk over a longer period, a concentrated portfolio may just be what you need.



SUMMARY

- If we increase your investment knowledge, you're creating more suitable investment options to consider. We believe suitable advice, combined with a mentorship-type approach is the ideal alignment for clients.

- Although taking on more risk with your investment choices is not a guaranteed way to generate higher returns, it can certainly be an option worth looking into if you're facing a potential deficit. No matter the situation, increasing your investment knowledge is a lifetime benefit.

- There are also a variety of other benefits that come with a more in-depth knowledge of investing. Some people will feel less stressed when the markets are volatile, and others will take comfort knowing they are proactively doing something to address a projected problem.

We hope that this piece has helped you along your journey to becoming a more informed investor.

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Zagari+Simpson is a family wealth management office that provides clients with timely and effective financial guidance to bring their dreams and life goals to fruition.

As a Mandeville Private Client Inc. partner, we offer our clientele broad access to a diversified suite of public and private investment options.

Through rigorous analysis, planning, and the application of individualized financial growth strategies, we will help you leverage present opportunities to build a prosperous future.

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