INVESTMENT PRINCIPLES

INFORMATION SHEET FOR CFA PROFESSIONALS

WHAT TRULY MATTERS

INTRODUCTION

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IMPORTANT NOTICE

The term "financial advisor" is used here in a general and generic way to refer to any duly authorized person who works in the field of financial services, including the following:

- Investment brokers
- Mutual fund brokers
- Scholarship plan dealers
- Exempt market dealers
- Portfolio managers
- Investment fund managers
- Life insurance agents
- Financial planners (F.Pl.)

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5 Take full advantage of tax-saving opportunities and of any work program designed to match your savings. Nothing outperforms free money and untaxed returns.

6 Know yourself and do not assume more risk than you can emotionally handle. If you are extremely conservative, work with an advisor to try to overcome some of your fears. Being excessively conservative for 50 years will hurt you in the long run. By being too conservative and avoiding risk in the short term, you actually increase your long-term risk.

7 Have an understanding of the overall savings effort (in dollars) required to achieve your retirement goals. The estimate may not be as precise as you would like, especially if you are decades from retirement (there are so many unknowns), but it's a start and it will get more refined over time.

8 Do not assume that maintaining an investment portfolio and living on its income alone is your only income option. If you can live on less than 75% of your expected portfolio income, an income approach based solely on an investment portfolio may be acceptable; but otherwise you might want to consider other retirement products to help mitigate extreme risks.

9 Even if your strategy is well designed at the outset, it may need some adjustments to reflect lifestyle changes; but otherwise you should resist the temptation to invest in new products that performed well recently. It is preferable to plan rather than to react. As you will learn, past performance provides no indication of future performance. Good performances over a short horizon may be explained by nothing more than good luck.

10 Even though there is tremendous value in having a trusted and competent advisor, investors should avoid paying too much for investment products and advice. It is conceptually preferable to pay 0.25% instead of 2% in total fees, but in between these two alternatives there is an option that will confidently bring you closer to your goal of a well-advised and more comfortable retirement. Furthermore, you should understand that the role of an advisor is to help you plan your retirement and stay the course, not to make forecasts.

There is also an added consideration that is of the utmost importance. Research shows that our ability to benefit from learned skills and knowledge declines in our 60s, and our ability to solve new problems starts declining even before, as early as our 20s. Slightly more than 50% of individuals in their 50s had the right answer to the question "If five people all have the winning lottery numbers and the prize is two million dollars, how much will each of them get?" but fewer than 10% for individuals in their 90s did.[1] A degree of cognitive impairment without dementia affects nearly 30% of individuals in their 80s and 40% of those in their 90s. Cognitive changes explain why basic financial literacy skills decline, on average, when we are in our 60s. And this process worsens gradually in our 70s, 80s, and 90s. As we age, we are less likely to make rational and informed decisions and, unfortunately, more prone to be taken advantage of.

All these factors make a **trusted** credentialed advisor and proper planning while the investor is still cognitively healthy even more important as we age.

The Future of Finance starts with proper education and a relevant body of financial knowledge. These 17 documents are is meant to support this effort.

Jacques Lussier, CFA

[1] Agarwal, S., Driscoll, J. C., Gabaix, X., and Laibson, D. (2009), The Age of Reason: Financial Decisions over the Life Cycle with Implications for Regulation, Brookings Papers on Economic Activity.

WHAT TRULY MATTERS

A well designed retirement plan has an important and lasting impact on the standard of living of individuals at retirement. It improves the income they can expect from their accumulated savings by as much as a third or even more. Yet, it is a process fraught with difficulties and uncertainties. For example, even if we set specific income goals for retirement, it is difficult to estimate how savings capabilities will evolve and what investment returns financial markets will deliver. In addition, there are complexities related to the long-term impact of taxation of investment income, investment fees, asset allocation, risk, inflation, family obligations, and so on.

The purpose of this book is to demystify the most significant aspects of retirement planning. Even if all the concepts that will be discussed are understood, the task of implementing and integrating all this knowledge in the specific context of one individual (each of us is unique) is a tremendous challenge, even for experts. For that reason, appropriate tools (software) are normally required to support advisors and investors.

The relevant material is covered in 17 documents. These documents explain the 10 principles investors should live by:

1. Start early and understand the power of compound returns. Waiting is extremely costly.
2. Understand the mechanics of asset returns. Low current yields indicate low future returns. We should not be fooled by historical performances.
3. Build a portfolio that is diversified in terms of asset classes (and risk factors), geographic regions, and management styles. Understand the impact of your own currency on diversification benefits and portfolio allocation.
4. Implement a rebalancing strategy and remain consistent and disciplined. Consider more effective rebalancing strategies as you become more knowledgeable and confident.

THE AGENDA OF ALL 17 DOCUMENTS

SECTION 1 - WHY SAVING IS IMPORTANT

SECTION 2 - THE POWER OF COMPOUNDED RETURNS

2A - THE IMPACT OF TIME AND PERFORMANCE

2B - THE IMPACT OF VOLATILITY

SECTION 3 - THE BENEFITS OF DIVERSIFICATION

3A - HOW DIVERSIFICATION REDUCES RISK AND ENHANCES COMPOUNDED RETURNS

3B - THE FACTORS THAT DRIVE ASSET RETURNS AND THE EFFICIENCY OF DIVERSIFICATION

3C - DIFFERENT WAYS PORTFOLIOS CAN BE DIVERSIFIED

3D - THE IMPACT OF THE CURRENCY AND COUNTRY OF ORIGIN ON GLOBAL DIVERSIFICATION REQUIREMENTS

3E - THE ACTIVE-PASSIVE DEBATE

3F - HOW TO REBALANCE

SECTION 4 - ISSUES AFFECTING BENEFITS

4A - THE IMPACT OF FEES

4B - THE IMPACT OF TAXES

4C - THE IMPACT OF INFLATION

SECTION 5 - EVALUATING YOUR FINANCIAL NEEDS

5A - THE ROLE OF ADVISORS

5B - UNDERSTANDING MY RISK PROFILE

5C - BUILDING A PORTFOLIO

5D - HOW MUCH MUST BE SAVED TO RETIRE WELL

5E - FINANCIAL RISKS, RISK MITIGATION, AND COMMON SENSE