“I used to pick sectors or individual companies that I thought would outperform the market. But I just don’t do that anymore. Now I buy all of the world’s markets for my clients. It’s the ultimate diversification
— Albert Brandstatter, National Bank Financial

THE NOVICE INVESTOR

FOR THOSE WHO ARE THINKING OF, HAVE RECENTLY ENTERED OR HAVE HAD LIMITED EXPOSURE TO THE INVESTMENT MARKETS. IN SHORT: YOU HAVE LIMITED EXPERIENCE AND KNOWLEDGE AND WANT TO LEARN MORE

DIVERSIFYING WILL HELP EASE RISK

PLANNING FOR 2012

By David Chilton Saggers

Albert Brandstatter of National Bank Financial recommends portfolio diversification.

If the ducking and diving necessary last year had much of an impact on Albert Brandstatter, the affable vice-president at National Bank Financial doesn’t show it. Time, he reasons, is on the side of his novice investors, many of whom are the sons and daughters of his long-standing clients.

Portfolio diversification, one of the hallmarks of Mr. Brandstatter’s advice, won’t get rid of the volatility in the market but it does spread the risks.

“And over time, with savings, with dividends that come in from the equities and interest that comes in from the bonds, slowly that portfolio will grow,” Mr. Brandstatter says. “It’s very important not to look for that quick gain. I think a lot of younger investors are looking for something that’s fast, right?”

As a consequence these novice investors have a tendency, he has noticed, to buy individual stocks even though it’s much riskier for them, as is a fondness for talking up market tips they’ve heard.

Warming to his theme of slow and steady — Mr. Brandstatter recalls his Austrian-born father who, in post-WWII Toronto, wouldn’t even spend a dime on ice cream until he’d saved enough for a house — the Mississauga, Ont.-based advisor notes the Dow broke 1,000 in 1972 but took another 11 years to do it again. The point, Mr. Brandstatter says, is that there are often periods where the market doesn’t do very much, and that’s the time investors have to be patient.

“But history has shown us that, over the long term, stock markets do outperform bonds. That’s why it’s important to be diversified, to have bonds and equities. And not just Canadian equities, either. That’s something else I do for my clients, whether novice or not: If we’re going to be in equities it’s not just Canada,” Mr. Brandstatter says. After all, he points out, this country makes up only 4% of the total world stock market capitalization.

With 2011 now a year for economists and historians, Mr. Brandstatter looks at 2012 with caution. He says the problem with predictions is that something unexpected always happens. So, for example, he says to a certain extent the situation in Europe was unexpected even if everyone knew about a sovereign debt problem with some countries at the beginning of 2011. And who thought, he adds, that the credit rating of U.S. debt would be downgraded. Still, Mr. Brandstatter will suggest a forecast or two for 2012 based on analysis by colleague Stefane Marion, chief economist and strategist at National Bank Financial Group and ranked first among forecasters for Canada by *Bloomberg Markets* magazine in its January 2012 issue.

Using interest rates as a guide to what may happen this year, Mr. Brandstatter says they are 0.02% on three-month treasury bills in the United States, and in Canada they’re 0.89%. A year from now, Mr. Marion sees interest remaining very low in the United States at 0.05%, Mr. Brandstatter says, and north of the border he predicts 1.88% interest, again on three-month T-bills. On 10-year U.S. government bonds, 12 months out, Mr. Marion pegs the interest at 2.84% and 2.92% on its Canadian equivalent.

However, these and other predictions come with a caveat, Mr. Brandstatter says: “The caveat is whatever happens in Europe. And if you were to ask me what could make headlines in 2012, I would suspect it’s politicians,” he notes. “Isn’t that funny? But it’s true, especially in Europe.” Not only will they have to deal with the anger of their respective populations, Mr. Brandstatter says, they will also have to rewrite some of the “social contracts” they set up, including pension schemes that are too generous.

For the novice investor to counter or contain these difficulties in the year ahead, Mr. Brandstatter preaches the gospel of diversification, a word he repeats often. It is vitally important to diversify a portfolio, he says. Looking at National Bank Financial’s recommended asset allocation, Mr. Brandstatter says it’s roughly 50% equities and 50% in bonds and cash, with the equities portion of the portfolio spread across the entire market, not just one industry.

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Those equities he buys for his clients are divided up about one-third Canadian, one-third U.S. and one-third international, including emerging markets. And should a client ask him to pick one sector or one company he refuses, because past experience in taking that approach has been a costly lesson.

Of course, his novice clients are not identical, so Mr. Brandstatter acknowledges that important criteria such as risk tolerance, life stage and even family background growing up play a part. There are some clients who just want to save, because that’s what they observed as youngsters, and there are others who are more entrepreneurial, he says.

Mr. Brandstatter, who says he didn’t have to explain more or offer increased handholding during last year’s roller coaster ride — he works up a detailed financial plan for his novices from the start, which eased a lot of anxiety — nevertheless has some counsel for novice investors feeling investment angst.

“Ignore the noise,” he says, describing that combination of thick, black headlines and gloom-peddling TV pundits that creates both fear and uncertainty. Markets should be expected to fall, Mr. Brandstatter says, but one year is not a yardstick to measure anything. Stay the course, he advises novices, and don’t make emotional decisions. If they’re worried, he says, they can call their advisor for reassurance and discuss whether in fact they overestimated their tolerance for risk and whether they should rebalance their portfolios.

One thing that he has found to be a big help in ensuring that clients do stay the course is to check that the portfolio is a good “fit” with their profile before actually making the investments. By showing clients the worst single-year return their 50% stock/50% bond portfolio would have earned over the past couple of decades as well as the target average compound annual return, Mr. Brandstatter immediately sees whether they will be able to live with the short-term volatility that has to be accepted in order to earn higher long-term returns.

Unlike many resolutions — which are just notional, anyway — Mr. Brandstatter’s are concrete. Of course, a commitment to diversification is a given. But beyond that he says novice investors should take notes and write down their financial goals and what their financial advisors have counselled, so when their statements arrive they don’t panic or have trouble remembering what they said they wanted.

One more resolution for novice and typically younger investors would be not allowing an older advisor to intimidate them, he cautions. They should recognize that they are paying for professional advice and thus can make certain demands, Mr. Brandstatter says.

After all, time is required to grow their portfolios but age, time’s corollary, doesn’t offer any guarantee.

IIAC vows more support for its membership

MEMBERS

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While the large firms have extensive in-house resources and programs for compliance staff and investment advisors, the small firms in particular will benefit from an educational effort aimed at understanding their significant compliance obligations and the assistance available from the association to help fulfill them.

As a second step, all firms should benefit from a major IIAC effort that will be devoted to developing best practices and industry guidelines in certain areas, and the drafting of generic policies and procedures for certain rules, which can then be modified for individual firms.

We hope to engage the staff of the Investment Industry Regulatory Organization of Canada (IIROC) in the development of guidelines and policy procedures for the CRM rules.

Finally, firms will need significant technology to assist in rule compliance, particularly meeting client ongoing suitability requirements. The association and its working groups will identify third-party compliance technology available in Canadian and U.S. markets relevant to compliance obligations, and it may make arrangements, if feasible, for group purchase.

It will be important to reach out to member firms in all regions of the country. We will engage member firm professionals, both advisors and compliance staff, at regional firms through presentations in major cities, the use of internet webcasts and working group sessions linked through teleconference facilities.

CHANGES IN U.S. TAX REPORTING REQUIREMENTS

We will initiate further educational efforts building on the considerable progress we have made over the past two years in our efforts to mitigate the overly burdensome tax reporting obligations, proposed as part of FATCA, to U.S. authorities in connection with Canadian and foreign clients of member firms. We anticipate draft regulations in the New Year and are hopeful the tax-reporting burden will be scaled back from earlier proposals.

The association will engage in education and awareness initiatives for larger firms that already carry out certain tax reporting obligations to the IRS and U.S. Treasury, as well as for smaller firms that will have to implement new tax-reporting requirements for the first time.

IIAC will also assist in developing compliance tools as appropriate, once the final rules are set by the end of 2012, to help meet these obligations.

EFFECTIVE SUPPORT

Member support has always been an important component of the association’s strategic agenda, particularly the design of industry templates and best practices. However, this year the anticipated implementation of far-reaching regulatory requirements related to the advisor-broker relationship and U.S. tax reporting require a more comprehensive program.

The association will expand its workload and resources to meet these responsibilities. This effort will not only meet an important need of our member firms to ensure compliance with new rules, but it will contribute importantly to helping the firms further build an internal client-first culture.

Moreover, the member support agenda will also offer the benefit of raising IIAC’s profile with industry professionals, including both advisory and compliance personnel, and other industry stakeholders.

We have often been successful in rolling back inefficient proposed rules, but these efforts can be much more successful if everyone is engaged in developing effective and workable regulations. As we implement final rules, the exercise will fill an important need and should broaden recognition and understanding of our advocacy efforts. We’re not just helping to change the rules; we’re helping member firms adjust to the changes.

This will, in turn, help members assist their clients to achieve their financial goals.

Ian C.W. Russell is president and CEO of the Investment Industry Association of Canada.