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Business Matters

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INVESTMENT

Investing for Retirement

Saving for retirement can be approached in several ways.

Media ads constantly bombard us with images of happy, attractive couples enjoying their retirement years on a sunny beach in Jamaica or on a cruise ship in the Mediterranean. But to reach that dream, it is necessary to invest today's earnings so that they will grow into tomorrow's retirement fund. Certainly, the earlier one starts a systematic investment program, the greater the probability that today's fantasy will become tomorrow's reality.

Investing is more than just putting money in Guaranteed Investment Certificates or the stock market. From the start until you actually retire, you must keep reassessing your financial and other life circumstances to determine whether the strategy chosen yesterday is still valid today. Several approaches to investing are available but each is dependent upon your personality, your age and your life situation.

Traders

Financial institutions have made self-directed investment websites user friendly for easy buying and selling online. This type of investing requires substantial knowledge of the listed companies, their values and constantly changing prices. This is the approach favoured by traders whose thinking is geared to making short-term profits. However, most people are too busy with a regular occupation to get all the knowledge they need to be active investors, and the risks are enormous.

Invest and Hold Investors

These investors usually build a portfolio of stocks with a history of capital growth and regular dividend payments such as financial institutions, utilities and established corporations. Certainly, there is never a guarantee that quality stocks will always increase in value; however, this approach minimizes risk, and also reduces transaction costs.

For long-term investing, diversification is an essential risk management strategy. The usual basic diversification is to hold about 60% of your portfolio in high-quality fixed-income investments and 40% in common stock. Within the common stock portion, diversification can be achieved through owning companies in various industries, countries, or through exchange-traded funds (i.e., similar to mutual funds but traded like stocks), which give the investor access to a wide variety of asset classes such as commodities and currencies.

It is very hard to make money consistently through speculation.

Speculative Investors

Speculative investors buy securities which, in the investor's judgment, have the potential of doubling or tripling or more in a very short time. These investors think the risk of huge gain outweighs the risk of substantial loss. The difference between investment and speculation is that in speculation the risk of quick gain or loss is much greater than in an investment. Speculators often use leverage (i.e., investing borrowed money) in the hope that a short-term gain in the value of the investment will enable them to repay the debt after making a quick and substantial capital gain.

Companies whose stocks are considered speculative often have no earnings or dividend history and depend for their financing on the company issuing new shares since there are no earnings to reinvest. This is common with junior companies in the natural resources and technology industries. Raising capital with new share issues before the company strikes it rich, however, constantly dilutes the speculator's original holding and makes hoped-for capital gains dependent on a spectacular discovery. This way of investing is highly risky and not particularly

useful for the accumulation of a retirement fund.

Value Investors

Value investing is based on the principle that the prices of stocks of high intrinsic value sometimes sell well below that value. This happened in 2008 and 2009, for example, when the collapse of the subprime mortgage market caused the failure of important financial institutions, which, in turn precipitated the collapse of the stock market. At that time, many fine companies that are the backbone of the economy also saw their share prices drop far below their intrinsic value to levels that were catnip to the value investor.

The stock price of big-name companies can, however, also sometimes decline substantially even under normal market conditions. These companies must be examined carefully before investing because factors such as bad management, risk of a dividend cut, inability to compete, a highly leveraged balance sheet and many other factors can be the real reason they have lost their value. Buyers of these stocks are not value investors; they are speculators making a bet the companies' performance will turn around and produce capital gains.

Index Investors

Many studies have shown that even the most astute professional fund manager finds it impossible to outperform the market averages year after year by picking stocks. In fact, a great many mutual funds do worse than the market as measured by the Dow Jones, S&P 500 or other indices. As a result, so-called passive investing through funds structured to match the performance of the indices can be expected to perform at least as well as the market overall. Because index-based funds usually do not have research analysts and other expensive overhead, their management fees are lower than conventional mutual funds. Investors who are not confident self-managing their portfolio and are risk averse, may be comfortable holding one or more index funds.

Know Your Objectives and Risks

Your investor profile is a function of your age, ability to take risks, level of investment knowledge and your objectives. Even though young investors have more time to recover market losses, slow and steady saving and systematic investing seems to be the best strategy over the long term.

No matter what kind of a portfolio you have (non-registered, RRSP/RIF/TFSA), or how it is managed (self-directed, or managed by an investment advisor), have a well-defined objective and understand the risk you can tolerate to get there.

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