Five Tips on Managing Market Ups and Downs

Market volatility is unnerving, for even the savviest of investors. In this article we provide you with some key tips on how to manage — and potentially benefit from — market volatility.

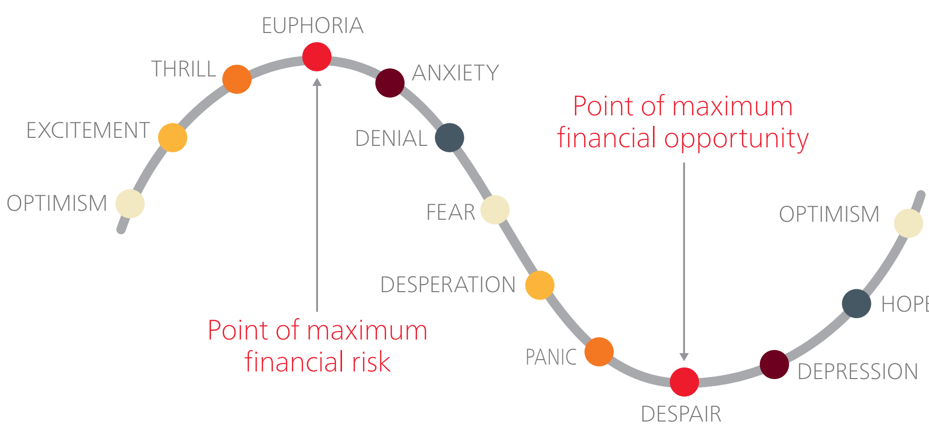
The notion of investing without volatility is as illusory as a car without an engine. Like it or not, the two concepts invariably go hand-in-hand, but does that mean you should avoid volatility — and investing — altogether? Market uncertainty can naturally cause panic and lead to poor investment decisions. But by recognizing short-term market uncertainty for what it is, you can help ensure that it doesn't derail your long-term financial plan. Here are five tried and tested principles that can help you gain needed perspective:

> *"Investing is more intelligent when it is most businesslike."*
>
> *— Billionaire investor Warren Buffett —*

1. Keep calm and carry on

Investors generally feel a financial loss about two and a half times more than a gain of the same magnitude.* Understandably, many of us experience a roller coaster of emotions when investing (as the diagram below illustrates), which can translate into poor buy and sell decisions. Being aware of these emotions during times of volatility will help you stay on the straight and narrow and away from the cycle of market emotions.

Cycle of Market Emotions



*Daniel Kahneman and Amos Tversky, "Prospect Theory: An Analysis of Decisions Under Risk", Econometrica, 47,2, pp. 263–91.

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2. It's time, not timing

Why shouldn't you automatically trim your investments when market uncertainty sets in? Because trying to time the ups and downs of the market is a bit like rolling the dice and sitting on the sidelines; it can cost you.

As the illustration below shows, over a 10-year period, if you're not invested for only a small fraction of days when the market is performing at its peak, you can substantially erode your savings. Staying invested — sometimes referred to as the 'grin and bear it' approach — can potentially translate into a better outcome.

Sitting on the Sidelines Can Cost You

The impact of missing the best performing days from December 2005 to 2015 on a $10,000 investment

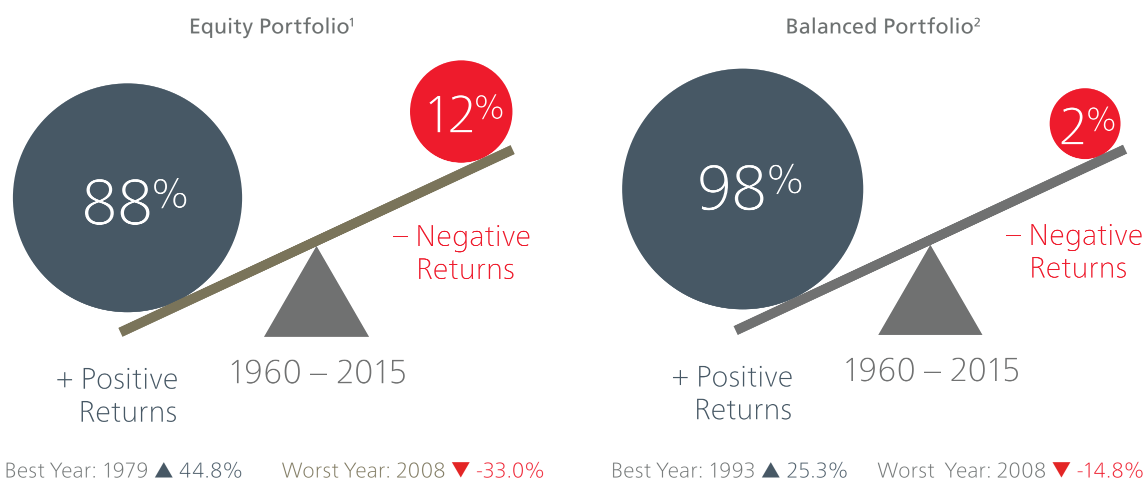
Source: Bloomberg. S&P/ TSX Composite Total Returns Index November 30, 2005 to November 30, 2015. It is not possible to invest directly in an index. Assumes reinvestment of all income and no transaction costs or taxes. Value of investment calculated using compounded daily returns. Missing 10, 20, 30 best days, excludes the top respective return days.

3. Manage risk, don't avoid it

Risk can be a loaded term when it comes to investing — and is often misunderstood. For example, volatility is often seen as synonymous with risk, but in fact volatility simply measures how much a return fluctuates. While investors may fixate on these fluctuations, the permanent loss of capital should be of greater concern. Often, investors believe that reducing exposure to securities that are perceived as 'risky' helps to lower risk, but some investors ignore other risks altogether, such as longevity risk — the risk that they'll outlive their retirement savings.

Whether we like it or not, investing and risk are a package deal — you can't have one without the other. The key to long-term investment success is to manage your exposure to risk by using time and diversification to your advantage. While the performance of any portfolio can swing significantly each year, a balanced portfolio has historically resulted in fewer negative returns when compared to an all equity portfolio over the long-term. The charts below illustrate this concept.

Diversification's impact on three-year returns



1. Based on 3-year annualized returns ending December 31 of the S&P/TSX Composite Total Return Index from 1960 to 2015.

2. Based on 3-year annualized returns ending December 31 of a portfolio of 50% the S&P/TSX Composite Total Return Index and 50% Canadian Fixed Income Composite from 1960 to 2015. Canadian fixed income composite consists of 80% FTSE TMX Canada LT Bond & 20% TMX Canada Residential Mortgage Index from 1960 to 1980; 100% FTSE TMX Canada Universe Bond Index from 1981 to 2015. Source: Morningstar. Returns are calculated in Canadian currency. Assumes reinvestment of all income and no transaction costs or taxes. The portfolios are hypothetical and for illustrative purposes only. It is not possible to invest directly in an index.

4. Put diversification to work

Often equated to not putting all your eggs in one basket, diversification is a technique that mixes different types of investments in a portfolio to help smooth out returns over time.

By including investments that have different reactions to economic trends — or have a negative correlation to one another — as one type of security falls the other should rise, which can help to offset the negative effects. As the chart below illustrates, a diversified portfolio of different asset classes provides the opportunity to participate in potential gains of each year's top winner while aiming to lessen the negative impact of those at the bottom.

Chasing Returns not a Winning Strategy

Calendar year returns (in Canadian dollars) (%)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
HIGHEST	32.1%	18.6%	31.1%	75.1%	38.5%	9.7%	16.0%	48.1%	23.9%	21.6%
	26.4%	9.8%	6.4%	52.0%	20.2%	8.3%	15.3%	41.3%	14.4%	19.5%
	17.9%	3.7%	-16.1% Balanced Portfolio	35.1%	17.6%	4.6%	13.8%	31.6%	11.2% Balanced Portfolio	16.2%
	17.3%	2.3% Balanced Portfolio	-17.2%	15.9% Balanced Portfolio	13.0%	0.4% Balanced Portfolio	13.4%	13.3% Balanced Portfolio	10.6%	14.6%
	16.6%	2.0%	-21.2%	12.5%	10.1% Balanced Portfolio	-1.8%	7.9% Balanced Portfolio	13.0%	9.7%	11.1% Balanced Portfolio
	15.4%	-5.3%	-28.8%	8.0%	9.1%	-8.7%	7.2%	7.8%	8.8%	3.5%
	12.8% Balanced Portfolio	-7.2%	-33.0%	7.4%	6.7%	-9.6%	3.6%	4.3%	7.0%	2.4%
	6.2%	-10.5%	-41.4%	5.4%	2.6%	-14.2%	2.5%	3.9%	4.1%	-8.3%
LOWEST	4.1%	-16.5%	-46.6%	-9.2%	0.0%	-16.2%	2.0%	-1.2%	-0.1%	-13.8%

ASSET CLASS	INDEX
Canadian Small Cap	BMO Small Cap Index
U.S. Equities	S&P 500 Index
Canadian Equities	S&P/TSX Composite Total Return Index
Canadian Bonds	FTSE TMX Canada Universe Bond Index
International Equities	MSCI EAFE Index
Emerging Markets	MSCI Emerging Markets Free Index
U.S. Small Cap	Russell 2000 Index
Global Bonds	Barclays Global Aggregate Bond Index
Balanced Portfolio	40% FTSE TMX Canada Universe Bond Index, 30% S&P/TSX Composite Total Return Index, 30% MSCI World Index

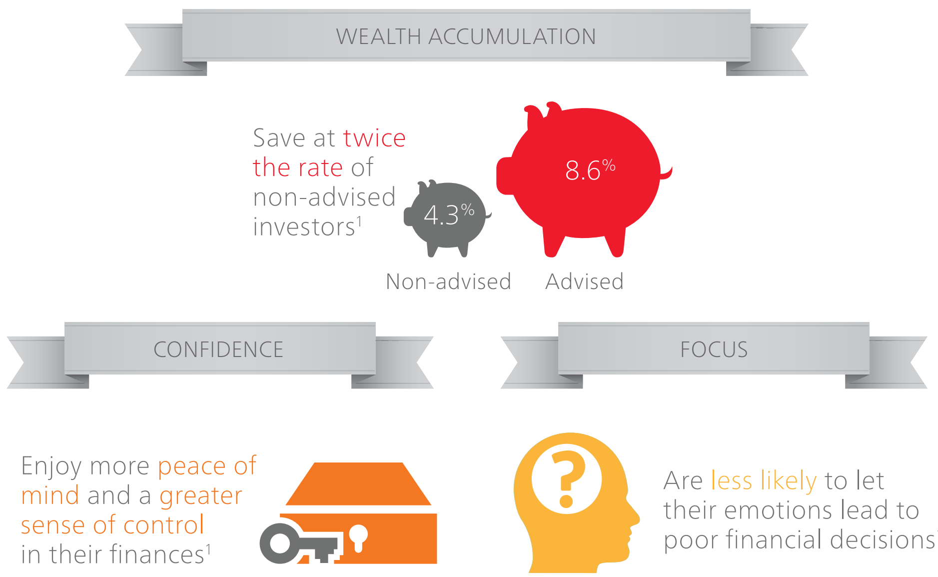
Source: Morningstar. Priced in Canadian currency, as at December 31, 2015. Assumes reinvestment of all income and no transaction costs or taxes. Annual returns compounded monthly. The asset classes are represented by their indicated indices and the balanced portfolio is hypothetical in nature. This information is for illustrative purposes only. It is not possible to invest directly in an index.

5. Focus on the big picture

Short-term ups and downs can cause you to lose sight of the big picture, which is why it is so important to seek advice and develop a financial plan. Research on the value of advice has shown that investors who work with a financial advisor not only save at a higher rate than non-advised investors, but they also have a greater feeling of confidence about their financial future than those who don't work with an advisor.

If you have taken the time to determine what your financial goals are and have a financial plan to help you reach those goals, this can go a long way to keeping you on track and remind you why you're investing in the first place, whether it's for retirement, your child's education or some other goal important to you.

The Value of Advice



1. The Value of Advice Report 2012 (IFIC).

Understanding your initial reactions to market ups and downs can help you make better investment choices and view your portfolio more objectively.

Staying invested during market ups and downs is simple — but not always easy.

Contact your relationship manager today to develop a plan that makes sense for you.