INVEST

RRSP rescue

Here's what investors are doing in a market gone wild—and what they should be doing

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Annus horribilis—horrible year—is a Latin phrase dusted off by Queen Elizabeth II in 1992 to describe an awful period in which the marriages of her children fell apart and Windsor Castle caught fire.

With all due respect to Canada's putative head of state, 2008 just might trump Her Highness's horrible year. That is certainly true for investors, who have seen their hard-won retirement savings fall into a toxic vat of subprime mortgages, leveraged- to-the-hilt investment banks, clueless insurers and conflicted ratings agencies. Safe havens? Ha! That's a good one. Whatever the causes of the RRSP carnage, not all investors feel like opening a vein and slipping into a warm bath. Take Toronto radio producer Sascha Hastings: If you'd told the 39-year-old a couple of years ago that she would be navigating the markets like a pro, "I'd have laughed in your face," she says.

Psst…you're not as great as you think

It's great for investors to want to take charge of their own portfolios. But know this: Most people's natural instincts about the market are basically wrong. To find out more about how investors can hedge their own terrible instincts, we talked to Lisa Kramer, behavioral economist and a finance professor at the University of Toronto.

GI » *What should people do with their portfolios after this dramatic downturn?*

LK » The cows have left the barn already. For people who are wanting to make dramatic changes right now, my sense is, it's not a good time any more. At this point, you should probably stick with what you've got.

Should people be looking at their RRSP statements, or not?

When markets are volatile, people tend to want to look more often. Then, when it's really bad, they don't want to look at all. The best thing is to develop a long-term investment strategy and then maybe look at it a couple of times a year, at most.

How can people keep themselves from making bad decisions?

You should probably talk with a financial adviser—ideally, a fee-only adviser who doesn't have an incentive to steer you into securities they have a financial interest in. If more people spoke to someone for unbiased advice, there might be less panicked rebalancing and fewer mistakes being made.

By being proactive about her retirement savings, Hastings managed to skate through the biggest stock-market collapse in generations. Early last year, with the market still near its all-time high, she felt things were “out of control; [the situation] reminded me of the late 1980s,” she remembers. So she pulled about twothirds of her RRSP money out of equities and stashed it in plain-vanilla money market funds.

Score one for Sascha Hastings. But she didn’t stop there: She was also honest enough to admit she knew “pretty much nothing” about things like priceto- earnings and debt-to-equity ratios, and so she committed to boosting her investing IQ. Hastings became a rabid fan of the Value Line Investment Survey; she opened her own self-directed account with discount broker Questrade (declining to inform her CIBC financial adviser); and she cranked up her RRSP contributions to almost 30% of salary. Now that valuations are at rock bottom, she’s dipping her toes back in, buying recession-resistant stocks like Johnson & Johnson and salivating over every new bargain that crops up. As a programming wonk for CBC Radio’s Wachtel on the Arts, Hastings never thought she’d be on tenterhooks waiting for fourth-quarter earnings reports. But Hastings admits that she finds this once-in-a-century market kind of thrilling: “I’m trying hard not to get too obsessed.”

For every investor like Hastings, though, there are countless others who have taken it on the chin. By the time 2008 sputtered to a close, the Dow had fallen from 14,000 to below 9,000, and many investors had taken a hit of 40% or more on their retirement portfolios. Those optimistic assumptions you’d plugged into online calculators, assuming a healthy 8% to 10% a year of compounded returns, leading to an early retirement on the sands of the Turks & Caicos? Um, you might want to check your RRSP statement.

Portfolio First-Aid

Now that so many portfolios have been beaten, bloodied and left for dead… what to do? We asked a few financial experts for their best advice on how you can shore up your retirement savings and pick the right investments for the years to come.

Dynamic Value Fund Helmed by manager David Taylor, the fund embraces “predominant themes like gold, oil, infrastructure and agriculture,” says Solguard Financial’s Teresa Black Hughes.

Utilities, consumer staple s and telec ommunications

“Stay defensive for the moment with those sectors,” says ScotiaMcLeod’s Gareth Watson. “We’re still facing major headwinds, although the economy could start turning around by the end of 2009.”

Manulife Financial

“An ideal holding for the next 20 years,” says TriDelta’s Ted Rechtshaffen. “It has a strong balance sheet, is trading at just eight times forward earnings, and pays a 4.6% dividend. I wouldn’t be surprised to see Manulife emerge as one of the three largest insurers in the world.”

MacIvy Foreign Equity, PH&N U.S. Equity, Mawer U.S. Equity

These top funds “focus on high-quality businesses,” says Morningstar Canada

“Investors have been like deer in the headlights,” says Teresa Black Hughes, a planner with Vancouver’s Solguard Financial and past chair of Advocis, the Financial Advisors Association of Canada. “Everyone, without fail, is shocked by the degree of the drop. You can see the fear in their faces. It’s especially stressful for those approaching retirement: They’re cutting back, not taking vacations, wondering if they’ll even be able to make the mortgage or pay the bills any more.”

Which isn’t to say there’s nothing to be done about your ravaged RRSP. In fact, many investors are using the bloodbath to get serious and take their retirement planning to the next level. Some investors are rebalancing their holdings to get back to their ideal asset mix; some are boosting contributions radically to make up ground and take advantage of historically low P/Es; some are choosing to dock in the harbour of ultraconservative investments, at least until the storm passes.

To wit, a just-released Scotiabank investment study reveals that a quarter of Canadians are now opting for safer investments; a third of 50-plus investors are pushing back their target retirement age; and almost 40% are paying much more attention to their investments. Amazingly, more than half are even seeking out financial second-opinions, cheating on their primary advisers, so to speak. “If you want to get your kitchen done, you go out and get a bunch of estimates,” says Gareth Watson, director of the portfolio advisory group for ScotiaMcLeod. “If you’ve got a serious illness, you’ll probably get a second opinion from another doctor. Now, investing has become the same thing.”

So much for the cliché of terrified investors stashing their RRSP statements in a drawer. Rather, they now seem to be doing the opposite: getting proactive, getting involved, and trying to tack their way through the most violent financial storm in years. “Investors spent the better part of October and November not looking at their statements,” says Hughes. “Then the bad news continued to come, and come, and finally they said, ‘Okay, I’d better look.’ Now the closing-youreyes part is over. They want to feel like they’re doing something, like they have some control over all this.”

A caveat: While staying on top of your investments is a good thing, the emotional urge to swing into immediate action isn’t always your best guide. Just ask any financial adviser: As the bearers of bad news, they’re increasingly finding themselves in the business of talking clients down from the rafters. Some shellshocked investors are cashing it all in and buying laddered portfolios of GICs, just to be able to sleep at night, reports David Phipps, an Ottawa-based financial adviser with Assante Capital Management. Others are taking one look at their RRSP statements and making up for the loss by slashing daily costs to the bone, according to Ted Rechtshaffen, president and CEO of TriDelta Financial Partners, a Toronto planning firm. One woman with a multimillion-dollar net worth has stopped eating red meat to save a few pennies; another client in his 60s, also financially set for life, fretted about buying a new pair of skates.

Such is the level of panic on the streets, and you can get a sense of it from how Canadians have been directing their investments. The market niche with the biggest inflows through the end of December, 2008: boring old money-market funds, with $14.3 billion coming in, according to the Investment Funds Institute of Canada (IFIC). Equity funds, in comparison, saw $12.2 billion go out the door. Even balanced funds lost

$1.1 billion net. In short, investors are sprinting for shelter. “People are just sitting on the sidelines right now,” says Dennis Yanchus, statistics manager for IFIC, which represents Canada’s mutual fund industry. “They’re sticking with conservative options at this point, until they see a dampening of volatility. Only when they feel there’s a floor will they be moving back in.”

Terry Lapain has felt this downturn as much as anybody, even though he’s a former math teacher who used to instruct his students in the art of investing. “I always taught my kids to stay diversified,” says the 55-year-old father of three boys from Oldcastle, Ontario. “But in this downturn, it hasn’t really mattered.” To wit: Before the market tanked, he made an ill-timed foray into Latin American stocks in his RRSP, and those holdings fell by half. He even had to say no, when financial advisers told him to shovel more cash into the hard-hit region. “One of the best decisions I ever made,” he says.

On a positive note, many of his other holdings, with advisers like Scotia McLeod, are dividend-oriented funds whose yields have “buffered” him from the worst of the slump. Still, he wishes he had been like his 84-year-old mother’s significant other, who “pulled everything out at just the right time and is not sitting on a bank-load of money,” he laughs. “Now he’s getting back into stocks, at 93 years old. He just can’t resist.”

Lapain himself hasn’t been turned off by equities yet, as he was after Black Monday in 1987, when he abandoned the markets entirely. In fact, he’s a long-time user of BMO’s direct-investing website, dating back to 1992, and enjoys monitoring the $150,000 kitty he’s amassed to supplement his teacher’s pension in the years to come. “These are sale prices, and these days you can do research right from your own computer.”

One reason for the burgeoning do-ityourself ethic? Battered investors don’t see much sense in forking over a percentage of assets for subpar returns. In a down market, every dollar counts, and so people are pocketing the fees and assuming the responsibility themselves. In a recent report, Toronto-based consulting firm Investor Economics marvelled at the jump in DIY investing: “Explanations for the account surge since the end of September have ranged from clients wanting to take advantage of opportunities, to cost, to a desire for more control over, and more involvement in, their portfolios.”

Some investors are actually blaming financial advisers for the carnage—sometimes fairly, but often not. Ted Rechtshaffen knows of one investor, worth $8 million, whose adviser (with the client’s blessing and encouragement) slotted almost all of his portfolio into small-cap energy stocks. “So far, he’s down 70%,” he marvels. David Phipps now advises a couple in their 60s who had asked their previous planner to construct a conservative portfolio—they’d been crammed 95% into stocks, lost $300,000 in short order, and came begging for financial first-aid. “I’ve heard some real horror stories,” he says. “There’s a lot of bad advice out there.” (Good news for Phipps, though: It’s turned out to be his best year ever for new clients.) There’s also been a curious marital phenomenon popping up: More and more spouses are attending critical money meetings. “I’m not sure who’s driving that,” says Phipps. “Maybe it’s the unengaged spouse who’s becoming nervous about finances and asking to be brought in. Or maybe it’s the controlling spouse who’s fearful that their partner is going to hold them solely responsible for what has happened.”

Whatever the reason for the rampedup attention, it’s a good thing. After all, RRSPs are becoming more important than ever to the financial future of Canadians. In the past, defined-benefit pension plans provided a retirement cushion, but now the idea of relying solely on a pension plan looks risky: Many plans sustained heavy damages in the market and are now seriously underfunded, to the point where they require emergency injections from the federal government.

Fewer Canadians than ever have pension plans to begin with. Coverage is down to all-time lows of 17.2% in the private sector and 30.3% overall, according to Statistics Canada. That means the defined-contribution RRSP is emerging as a critical line of defence against a future of premium cat food. To wit: In 2007, 6.3 million Canadians shovelled a record $34.1 billion into their registered retirement plans. And despite the market mauling, a new poll by Investors Group suggests that two-thirds of Canadians are planning to contribute the same or more to their RRSPs this year.

“What’s different from past downturns is the gradual decline in pension plans,” says Peter Drake, VP of retirement and economic research for Fidelity Investments Canada. “When you’re covered by a defined-benefit plan, you tend to think less about market volatility. These days, more people are saving for retirement in a way that they need to pay real attention to what's going on in the markets." Now that the markets have secured your attention, job one is to evaluate where you are personally, not where market maniacs like CNBC's Jim Cramer say you are. Because even if the general market is down 40%, you may only be down 15% or 20%, depending on how much cash and fixed income you've salted into your portfolio. "Your personal situation isn't necessarily the same as those terrible headlines," says Rechtshaffen. "Every day, people are hearing about things blowing up and going to zero, and portfolios losing 80% of their value. But if you have a smart financial plan in place, you could still be in relatively good shape."

Rebalancing might be in order, though, to get back to your ideal asset mix—not based on daily market swings, but at regularly scheduled intervals, perhaps once or twice a year. If equities were 60% of your portfolio and bonds 40%, for instance, you might discover that split has now been reversed. These days, "many clients use programs to perform automatic rebalancing, which is very effective for buying low and selling high," says Phipps. You can get back to your target asset allocation by shaving back some of your fixed income, or by simply directing most of your new investments toward equities.

You could also hedge against ongoing stock-price weakness by investing for income. While dividend-oriented mutual funds have long been associated with blue-haired grandmas, they're a useful harbour in tough times, since many companies are now yielding 5% or more. "As long as dividends aren't cut, you'll be earning the same income today that you were a year ago," says Rechtshaffen, pointing to Bank of Montreal as an example of a solid firm yielding almost double digits annually. "Even if the underlying assets drop for a year or two and then come back, it doesn't matter all that much."

One strategy suggested by Phipps: Think of yourself as a badly overleveraged bank, like Citigroup. Your capital base has likely shrunk dramatically, and you discovered that you were taking on more risk than you should have been. As such, it's time to get back to basics. "The banks have been forced by regulators to top up their capital to meet their obligations," says Phipps. "Individuals should make the same calculations and increase their RRSP contributions. It's tough medicine, no one likes it, but it's reality. As one of my clients said, 'I guess I just have to keep shovelling coal.' "

Lastly, try not to give in to the sick gnawing in your stomach and cash out entirely, now that the market has already taken a mortal blow. "I remind clients that when you're rejigging your RRSP, you can't take advantage of this year's losses," says Tony Mahabir, vice-chair of the Canadian Institute of Financial Planners. "In an open account, you can use losses to offset future gains, but with RRSPs, you just don't have that opportunity."

Not to mention that an ultra-safe portfolio of cash, bonds and GICs likely isn't going to get you where you need to be. The market will rebound eventually, and you don't want to sell at the bottom and miss the entire upshot, says Mahabir. In fact, there are some fresh signs that Canadians are starting to shake off the shock and dabble in equities once again. November and December saw an uptick in inflows to Canadian equity funds. "Investors might be perceiving that the market, finally, might be at a low," says IFIC's Yanchus. "They're moving back in slowly."

That's Sascha Hastings's strategy, and she's sticking to it. She's already quintupled how much she's directing into her retirement accounts, brushed up on investing guru Warren Buffett's methodologies, and eschewed mutual funds with high expense ratios in favour of selected stocks such as Nestlé and Diageo. "A lot of people have lost a lot of money in this market, and I admit that sometimes I'm not able to sleep," she says. "But this could be a buying opportunity of a lifetime, and I'm ready for it."