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Steadyhand

The toughest decision in investing

By Tom Bradley

An interest-rate strategist at the Royal Bank of Scotland got his 15 minutes of fame this week, when his 55-page report was translated into two words: "Sell Everything." This powerful headline reverberated around the world.

I read the report and am sympathetic to RBS's gloomy view. I've been cautious for a while due mainly to the world's addiction to what I call the "unsustainables" – near-zero interest rates, China's growth and rising debt levels. Things that can't last don't provide a good foundation on which to build a portfolio.

But do I agree with the headline? No, not even close. Even if RBS's bearish scenario was to play out, selling everything is not a winning strategy.

For those who are thinking about following RBS's advice, it would be prudent to first walk in the shoes of someone who has previously sold everything. Meet Jason, a fictional investor who has been out of the market since September, 2011, waiting for the kind of turbulence we have today.

Tough call

Jason is feeling pretty good right now, but he faces the toughest decision in investing: when and how to get back into the market.

There are several things that make it hard. First of all, Jason, like others in his situation, is under a lot of stress after missing out on years of good returns.

Second, he's heavily invested in his negative view. He's lived with it for a while and is well-versed on the reasons why he shouldn't hold stocks.

Third, he's waiting for something that will never occur – the perfect time to buy. That only happens in the movies. In real life there are no signals or flashing lights at the bottom of the market. In fact, it will be quite the opposite. The news on the front page of the paper will be abysmal, serving to validate his concerns.

And finally, nobody will be telling Jason to buy. In the history of the capital markets, there's never been a buying opportunity that wasn't obscured by extremely negative investor sentiment. There will be more people looking to join him than the other way around.

Indeed, Jason already has lots of company. According to a BlackRock survey, Canadians hold over 60% of their financial assets in "cash-like" instruments – savings accounts, GICs and short-term notes. I repeat: if you get out, it's bloody hard to get back in.

Reality check

If Jason is going to be successful, he needs to do a reality check. He may be celebrating currently, but he's not in a good situation. He's taking a huge risk by betting against his long-term plan. In this period of near-zero interest rates, very few investors should have less than half their portfolio in stocks.

He also has to accept that he can't time the market. He's proven that, so he needs to get comfortable with the notion of being approximately right. Perfection is not an option.

And related to that, Jason should forget about setting predetermined buying targets. It's not ordained that the market will drop to a certain level. Stock markets rise over time and leave previous levels behind.

The road back

To get to a better place, Jason needs to determine what his overall asset mix should be for the long run. He needs to know where he's going, even if it takes a while to get there.

He needs to have a plan for getting there. It might involve a number of purchases over six to 18 months. And he needs to get started. He's been given a gift and he better take it. If the market goes down further, the next purchase will be even better. If it rallies as it could, he'll be glad to have done something.

It's hard being Jason

If you're thinking about selling everything, Jason's situation should give you pause. Being uncomfortable with volatile markets is understandable, but if you're planning on living another 20-50 years, you need to be willing to absorb some short-term ups and downs in order to earn a return in excess of inflation and build your wealth.

Broadly diversified portfolios have consistently served Canadian investors well. I'm not talking about ones focused on Canadian financial, real estate and resource stocks, but rather portfolios that hold cash, government and corporate bonds, and small, medium and large companies across a range of industries, geographies and currencies.

Through all the turmoil last year, diversified portfolios had positive returns. They won't always avoid market corrections, but as they did after the 2008 crisis and subsequent pullbacks, they recover.

Rather than following Jason, you should focus on making sure your portfolio is where you want it for the long term – approximately. You might use your RRSP and TFSA contributions (it's not the season to miss them) to adjust back to your long-term asset mix. Today, stocks make up less of your portfolio than they did a month ago. My former partner and mentor Bob Hager was a portfolio manager who thrived in uncertain markets. His mantra in times like these was simply, *"Don't go back up with less than you went down with."*

After that, get ready to take advantage of cheaper valuations and extremely negative sentiment, both of which will set you up for higher returns in the future.

Tom Bradley is the President of Steadyhand. A version of this article was published on January 16, 2016, as a Special to the Globe and Mail.