February 2022

Steadyhand

The Five Essentials

A closer look at the foundations
of successful investing

Table of Contents

02 Introduction

03 Be realistic

05 Have a long-term plan

07 Commit to a routine

09 Prepare for extremes

10 You're the CEO

12 Summary

This report was first published on May 21, 2013, by Steadyhand Investment Management Ltd. This version was published on February 14, 2022.

steadyhand.com

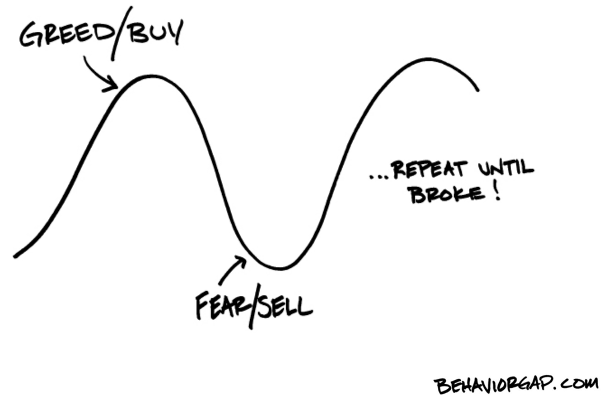
1.888.888.3147
1747 West 3rd Avenue
Vancouver, BC V6J 1K7

Steadyhand Investment Funds is an independent investment manager that offers a straightforward lineup of low-fee funds directly to investors. Steadyhand's funds are concentrated and non-benchmark oriented with low portfolio turnover. The firm offers clear-cut advice and simple tools to assist investors with their asset mix and portfolio strategy. Steadyhand's only business is managing money for individual investors.

Carl Richards is an American fee-based financial planner and writer. His articles have appeared in a number of publications and his sketches appear regularly in the New York Times Bucks Blog. Through simple drawings, he makes complex financial concepts easy to understand. We admire that. Richards is the author of The Behavior Gap and its related website. A number of his sketches are reproduced in this report with permission.

Introduction

This report presents our view of what makes a successful investor. It focuses on the structural and behavioural elements of investing rather than the nitty gritty of picking stocks.



We believe that a successful investor needs to take to heart the five essential elements laid out in this report. Specifically, you need to:

- Be **Realistic**
- Have a **Plan**
- Commit to a **Routine**
- Be **Prepared** for extremes
- Be a good **CEO**

Investment beliefs

Before getting started, it's important to understand the core investment beliefs that are embedded in this report.

Maintaining a long-term perspective is of paramount importance. One of the great advantages individuals have over other investors is the ability to take a long view. You have no regulations or marketing pressures to prevent you from taking advantage of the most enduring opportunity in the capital markets—time horizon.

Diversification is the only 'free lunch' in investing. Owning a variety of securities that are linked to different economic and market factors will moderate portfolio swings, without reducing returns.

There are no other free lunches. Investing is all about making tradeoffs—absorbing a bumpier road when pursuing higher returns or accepting lower returns when pursuing a smoother road. Higher and smoother is not an option.

Markets are more volatile than the fundamentals that underpin them. They tend to overreact to short-term news, but over time, security prices will reflect the underlying value of the companies.

The psychological element of investing is the most difficult. IQ is important, but no investor will be successful without taking care of the EQ (emotional quotient). Investing is all about discipline, patience and courage.

Successful investors make lots of small errors (i.e. poor stock or fund purchases), but avoid the big ones (i.e. selling out at the bottom of the market).

Simple is better. A tightly focused portfolio is easier to understand and maintain, and is generally cheaper than one with a multitude of firms, products and people involved.

Costs matter. Vanguard, the U.S. mutual fund giant, refers to fees as 'Lost Return.' This is an appropriate way to think about it. Fees and commissions are the only certainty in any return calculation and always have a minus sign attached to them.

Be realistic

Successful investors are realistic about:

- their investing skills
- the predictability of markets, and
- the potential for future returns.

Look in the mirror

It's important that you critically assess: (1) your investment knowledge and skills, (2) the time you're willing to spend overseeing your investments, (3) your ongoing interest, and most importantly, (4) your investing temperament. You need to design a process and support system, and ultimately a portfolio, that fits with your individual makeup.

Ability to predict the markets

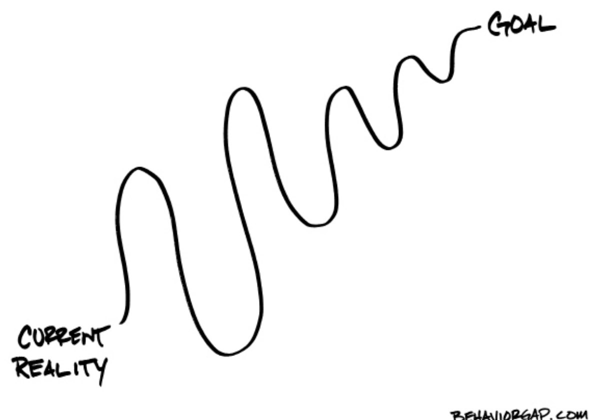
You not only need to be realistic about your own abilities, but those of the industry professional(s) you work with. Advisors, analysts, portfolio managers and economists are confident and well-informed, but they can't consistently predict what's going to happen in the short to medium term. With so many political and economic factors at play (some visible, many not), the direction markets take on any given day, week, month or even year is virtually random. In other words, the experts are always sure, but often wrong.

To be clear, it doesn't mean you shouldn't read sound research and listen to learned opinion. Quite the opposite. But we strongly suggest you avoid people who confidently and repeatedly make short-term market calls and keep listening to people whose approach and experience you respect (even if their recent views have proven incorrect).

Future returns

In the short term, you should expect anything and everything from the markets, including big ups and downs that nobody predicted. For growth-oriented investors, the ups and downs could be 20-30%+ in any given year. Even conservatively positioned portfolios will go down from quarter to quarter, and even year to year. But remember, attractive long-term returns include plenty of bad short-term periods.

We suggest following the Goldilocks approach when setting long-term return expectations—plan for returns that are not too high and not too low (see box A). If you don't and your assumptions are too high, you'll be disappointed and may start to take inappropriate risks to achieve an unattainable goal. If they're too low, you won't fully utilize your nest egg in retirement.



While this report is intent on helping you do better, at the end of the day you can only take what the markets give you. No matter how your portfolio is structured, or what securities you hold, the single most important factor influencing how you do is the performance of the bond and stock markets. You can do better than the market, but your results are unlikely to be wildly different than the returns produced by the core asset classes.

As noted earlier, there will always be tradeoffs. A focus on safety and predictability will result in lower long-term returns. The pursuit of higher returns will come with more volatility and a greater risk of capital loss.

A. Return expectations

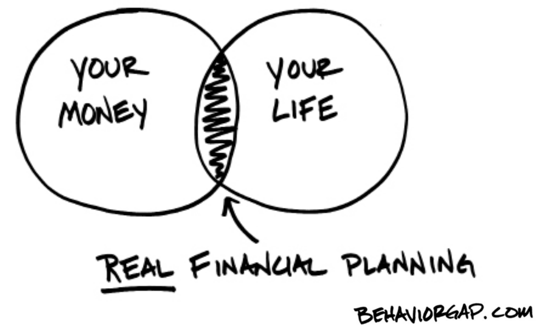
Future returns for bonds and stocks are impacted by a number of factors, not the least of which is the starting point. For example, bond returns have been excellent over the last 35 years. Investors received interest income and also captured capital gains as yields fell from the high teens in the early 80's to low single digits today (when interest rates drop, bond prices rise). Over the last 10 years (ending Dec 31, 2020), the FTSE Canada Universe Bond Index, which is a good proxy for the overall bond market in Canada, achieved a return of 4.5% per year.

When setting expectations for the next 5-10 years, it's important to remember that the starting point for yields on government bonds and GICs is now close to zero. Therefore, income will be modest going forward and the chance of further capital gains will be small. The level of current yields is a simple and reliable indicator of what future bond returns will be. If yields are 2%, you should expect a 2% return from the bond portion of your portfolio.

Starting points and valuations are also critical factors with stock investing. Dividends and profits ebb and flow, but have a consistent trend over time. The big swing factor on future returns is what the market will pay for those dividends (yields) and profits (price-to-earnings ratios). Where valuation measures are with respect to their historical ranges will go a long way to determining what future returns will be.

Have a long-term plan

Successful investors have a plan. They know where they're going and have a road map to keep them on course.



A plan is important because humans tend to have short attention spans and investing for retirement is one of the longest endeavours we ever take on. It will go as long, or longer, than your marriage, your Canucks or Leafs fan club membership, and longer than the time it takes to pay down your mortgage.

Whether you design a plan on your own, or enlist the help of an advisor or independent fee-only planner, it should: (1) reflect your life situation, (2) encompass all your financial assets, and (3) include at least the basic elements of a financial plan.

B. Fee-Only planners

You're likely familiar with the investment services offered at your bank branch or by a full-service advisor (formerly known as a broker). You may not be aware, however, of independent, fee-only planners. 'Independent' refers to the fact that these planners don't manage assets, sell products or get paid a commission, so their advice is unbiased. They are planning specialists. 'Fee-only' (or 'fee for service') means they charge by the hour or by the assignment.

Most fee-only planners service a local or regional market, although there are a few firms that work with clients across the country.

Life considerations

It's at the planning stage that you connect your investment portfolio to what's going on in your life. Ultimately, your portfolio needs to take into account your:

- Age and investing horizon
- Dependents
- Career opportunities and risk
- Retirement goals and spending needs
- Sources of income—now and in retirement (i.e. pension or inheritance)
- Debts and other assets

The whole picture

It's important that you include all your investments when developing a plan. It makes no sense to come up with a strategy for your RRSP or TFSA without considering your non-registered investments, including GICs at the bank and any income properties or private investments you may have. Every decision you make should be done in the context of your total portfolio. (Note: Generally, we don't include a client's primary residence in the mix, partly to be conservative and partly because he/she will always need a place to live.)

The basics

The investment part of your financial plan should have the following elements:

- *Current state of affairs:* What does your current asset base look like?
- *Objectives:* What returns are you trying to achieve?
- *Time horizon:* When will you need to start drawing an income from your portfolio? How long does it need to last?
- *Cash flow projections:* What do you anticipate your contributions or income needs to be?
- *Investment philosophy and approach:* Do you have a bias towards a certain type of investing (i.e. active management, indexing, gold, small, medium or large stocks)?
- *Strategic Asset Mix:* What long-term mix fits your needs?
- *Security selection:* How will you implement your strategy (i.e. individual securities or funds)?

It's beyond the scope of this report to lay out a detailed outline for a financial plan, but we don't think it needs to be complicated. For all but the most complex situations, you should be able to design a plan on your own, or with the help of a financial planner. With that caveat, we do want to drill into one aspect of a financial plan that's a key to successful investing—your strategic asset mix.

Strategic asset mix (SAM)

We call it SAM. It's the long-term asset mix that fits your financial plan. It's an educated guess as to what blend of asset types have the best chance of achieving your goals. For example, an investor in her forties might have a SAM that looks like this:

Bonds	20%
Canadian stocks	30%
U.S. and International stocks	50%
	100%

The SAM for an investor in his 70's might be:

Cash and GICs	10%
Bonds	40%
Canadian stocks	35%
U.S. and International stocks	15%
	100%

Your SAM is the starting point for building your portfolio, and the baseline from which decisions are made and investment returns are compared.

Your SAM should be simple and easy to calculate. Your goal is to get it 'approximately right'. It doesn't need to be calculated to three decimal points or broken into an excessive number of asset classes.

Your SAM will evolve over time with age and/or major life changes, but shouldn't be altered based on what's happening in the market in the short term. It's particularly important to not make significant changes in response to extreme market conditions.

Commit to a routine

Successful investors have a regiment that breeds discipline, patience and courage. Discipline to follow a specific plan. Patience to let it play out over many years. And the courage to stick with it when times are tough.

MONEY = EMOTION

BEHAVIORGAP.COM

After your portfolio has been set up, there's still important work to be done. Ongoing management includes cash flow management, rebalancing, and for some, tactical shifts.

Cash flow management

Whether you're in the accumulation phase of your investment life cycle and contributing new money to your portfolio, or are retired and in the de-accumulation phase, you need a cash flow strategy. We're referring to a plan that lays out when you're going to contribute (or withdraw), how much it will be, and to (from) which account.

In most cases, contributions are easy and require little thought. New money is simply allocated to the holdings that bring your portfolio in line with its SAM. Regular withdrawals, on the other hand, require more thought. You need to determine which account(s) the money is coming from (savings, investment or registered accounts) and which securities to sell so as to minimize taxes and maximize flexibility.

Rebalancing

Rebalancing involves bringing your portfolio back in line with the asset mix you've laid out (SAM). Over time, the securities that have not kept up with your other holdings will drop below their desired long-term allocations, while top performing ones will grow to become a larger proportion of your portfolio. To get back in balance, you need to buy moreW of the former and sell some of the latter (or at least, buy less).

Behind the concept of rebalancing is the assumption that your SAM is the best approximation of what's going to work for you over the long term. All things being equal, you want your portfolio aligned with your SAM.

It's preferable that your rebalancing routine be automatic. In other words, no matter what's happening in the markets, you'll rebalance based on one or more of the pre-set triggers:

- A regular date—semi-annually or annually.
- A set limit that triggers an adjustment—i.e. bonds are more than 5% above/below the long-term target.
- Every contribution or withdrawal.

There are two primary benefits to automatic rebalancing. First, it prevents your portfolio from straying from your SAM inadvertently and second, it takes the emotion out of the process.

Rebalancing will enhance returns in some market environments (choppy, non-trending markets) and detract in others (long-running, consistent trends), but the risk management benefit is all-weather. If you rebalance consistently, you won't set yourself up for a fall by getting too carried away in good markets, or too discouraged in down markets such that you miss out on the inevitable recovery.

Getting tactical

You may choose to diverge from your SAM in the short to medium term by pursuing different strategies or hiring asset managers who purposefully take your portfolio in a different direction. Tactical strategies are beyond the scope of this report, but suffice to say, you should know why moves are being made and how they fit with your overall portfolio.

No matter how actively your portfolio is managed, we suggest you set limits as to how far you are willing to deviate from your SAM. If you're less experienced, or don't have the time or interest, then you should have little or no range around your SAM. You shouldn't do anything other than rebalance automatically. If you're more experienced, or have confidence in your managers' abilities, you may operate with wider ranges.

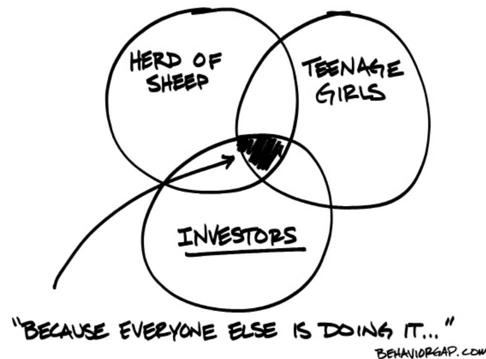
A simple SAM—Target and ranges

	Long-term target	Range	Current Allocation
Cash	0%	0-20%	5%
Bonds	50%	40-60%	40%
Equities	50%	40-60%	55%

No matter where you are on the skill spectrum, we firmly believe you should have limits on how far you go in pursuing a theme or strategy, and how much of one type of security you will hold. Asset allocation is difficult and nobody has a perfect record. Limiting how far you go (in buying gold, focusing on bank stocks or making a major move like getting out of the market) will prevent the inevitable mistakes from causing irreparable damage.

Prepare for extremes

Successful investors stick to their plan and are disciplined, patient and courageous at the extreme points in the market cycle.



It's not a matter of 'if' markets sky rocket or take a sharp drop, but 'when'. Capital markets move in mysterious ways and are rarely in tune with your day-to-day life. It's important that you're prepared, not surprised.

Down markets

Remember that down markets are inevitable and a necessary part of long-term investing. A case in point is the U.S. stock market (as measured by the S&P 500 Index, in Canadian dollar terms). For the 15 years ending December 31, 2020, the S&P 500 had an average annual return of 10.5%. During that period of excellent returns, there were two negative years, one in which the index was down significantly (-21.9% in 2008).

Not only should you be prepared for down markets, but also the negativity and hyperbole that goes along with them. Investors, advisors and the media become very short-term oriented at extreme times and too often use words like *plunge, collapse, crash* and *capital preservation*. Conversely, in times of euphoria words like *soar*, *skyrocket*, *upside* and *potential* are common.

Temperament

Having the right temperament (or working with someone who does) is of paramount importance. If you're going to behave well at extremes, you not only need IQ, but EQ (Emotional Quotient). It's good to know whose shoulder you're going to lean on.

When your portfolio returns don't match up with what others are doing or the headlines are saying, you're likely to suffer some dissonance. It will feel uncomfortable when your plan calls for you to do one thing while your taxi driver, squash partner and every newspaper you read is telling you to do the exact opposite. For example, it's unlikely you'll get any support when adding to your European holdings while Italy is reeling or trimming your bonds when they're viewed as the only place to hide.

Unforced errors

"Wall Street makes its money on activity. You make your money on inactivity." - Warren Buffett

When markets and investor sentiment are at extreme highs or lows, it's not a good time to make significant changes to your portfolio, or long-term plan. It's at these highly-charged, emotional times that the biggest mistakes are made. Perversely, you need to rely on your investment plan the most at times when you trust it the least.

Market extremes are an opportunity. You can dread the jolts and volatility, and try to hide from them, or you can embrace them and use them to your advantage. We highly recommend the latter.

You're the CEO

Successful investors are the CEO of their portfolios. They allocate time for managing people (including hiring and firing), judiciously watch expenses and regularly assess performance.

Hiring and firing

Like a good CEO, you need to be an effective delegator (see box C). Unless you're a pure do-it-yourself investor, you'll be assigning at least some activities to another person or firm. In doing so, it's important to find a balance between getting the help you need and not involving more people needlessly. There's an old adage: *The more people that touch your money, the lower the return.* Whether it's immediately apparent or not, everyone who works on your account is getting paid (more on cost below).

Needless to say, you're in charge of hiring and firing, which means you need to find a person(s) who has experience, expertise, and is someone you can rely on during challenging times. And given your wish to establish a lasting relationship, someone you genuinely like and want to spend time with.

When you're hiring an advisor or portfolio manager, there's a natural tendency to be heavily influenced by recent returns. To counteract this, we suggest using a framework called the 'Seven P's'. Past Performance is one of the P's, but the focus here is on future wealth generation. The other six—Philosophy, Process, People, Parent, Price and Passion—address the sustainability of those returns.

C. Delegation, not abdication

Many people don't have the time or interest to manage a portfolio on their own. They need to 'delegate' some of their duties. That does not mean 'abdicate', however. There are still things investors need to do. In our view, the following list represents the bare minimum:

- Read two quarterly reports a year (out of four).
- Do an annual review of your portfolio.
- Meet your advisor/portfolio manager once a year or attend a group presentation.
- Ask questions. The more you ask, the more revealing the answers will be.

The 7 P's

Philosophy	What is the portfolio manager's approach?
Process	How is research done and decisions made?
People	Who are the key individuals and how stable has the team been?
Parent	Does the advisor work for a stable, supportive organization?
Price	Do the fees and costs align with the services provided?
Passion	Does the advisor live and breathe investing?
Performance	Have they generated good returns over the long term?

Managing costs

Just like a company, your portfolio's return (profit) is the result of both revenues and expenses. CEOs don't focus on one to the exclusion of the other and neither should you. When you're paying fees for management and advice, make sure it's something you need and if so, make sure you're getting value for money. You should always be evaluating whether the extra cost is producing additional return.

Monitoring

As the CEO, one of your most important roles is monitoring progress and assessing performance. No matter how engaged you are in the investment process, you need to know:

- What you own
- How each holding fits into the plan
- How you've done—in absolute terms and compared to your SAM
- How much you're paying and to whom

We strongly recommend that you do an annual review to re-confirm your plan, assess performance and do a general checkup on your portfolio. A thorough, annual review is better than multiple glances over the course of the year.

D. Interviewing advisors and portfolio managers

Finding someone you can work with for a long time is extremely important, so you shouldn't hesitate to conduct thorough interviews with multiple candidates. In trying to determine who will be the best fit, you should probe the following areas:

- Background and credentials.
- Investment philosophy.
- Reasons for making career shifts and/or changing firms.
- Successes/mistakes—they should have examples of both.
- How is their money invested?

Even after interviewing potential candidates, it may still be a tough decision. There are situations, however, where an advisor or investment manager eliminates her/himself with one answer. In our view, the following responses (or non-responses) are deal breakers:

- The advisor recommends a strategy or fund before he's asked you about your situation.
- The advisor hesitates when asked about fees.
- The manager betrays the confidentiality of other clients—i.e. name drops.
- The manager has never made a mistake.
- The manager has no way of reporting investment returns, fees, and asset mix for your total portfolio.

Summary

Being a successful investor will lead to a greater likelihood of achieving your long-term investment objectives, plain and simple.

We believe there are five essential elements to being a successful investor. More than anything, they're behavioural and pragmatic in nature. You don't need to be a math whiz or Rhodes Scholar. What you do need is to: (1) be realistic, (2) have a long-term plan, (3) commit to a routine, (4) be prepared for the extremes, and (5) be a good CEO of your portfolio.

Being **realistic** means critically assessing your own knowledge, interest and temperament and designing a process and portfolio that fits with your individual makeup. It also means being realistic about your return expectations and recognizing that markets are totally unpredictable in the short term.

Having a **long-term plan** is crucial. It doesn't need to be a lengthy or highly detailed document; rather, it should be a road map to keep you on course. Integral to any plan is a Strategic Asset Mix (SAM), which is an educated guess as to what blend of asset types are best suited to your situation and will give you the best chance of achieving your goals.

Committing to a **routine** involves cash flow management, rebalancing, and for more engaged investors, tactical shifts. A regiment that breeds patience and discipline (not to mention courage) is a valuable crutch in difficult market conditions.

Being prepared for **extremes** is a must. Markets never move in a straight line, and it's not a matter of 'if' there will be another sharp downturn, but 'when'. Having the right temperament and recognizing when, and when not, to make adjustments to your portfolio is of paramount importance.

Being a good **CEO** (of your portfolio) is important. You need to be an effective delegator and recognize when to make changes to the people and firms you've hired to help manage your money. As well, like any good boss, you need to watch expenses and regularly assess performance.

Steadyhand

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

This report was published on February 14, 2022, by Steadyhand Investment Management Ltd.

steadyhand.com

1.888.888.3147
1747 West 3rd Avenue
Vancouver, BC V6J 1K7