



CANADIAN INVESTORS' COURSE

Session 15 – Rules Based Investing Commentary



**Building a portfolio by bringing together
Fundamental and Technical Analysis**



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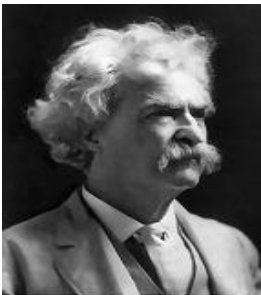




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Rules Based Application Using Fundamental and Technical Analysis Today (March, 2017)



Mark Twain

***“History Does Not Repeat
Itself, But It Rhymes”***

“this time must be different.”

“this time must be different.”

“this time must be different.”

“it usually is never different!!”

Experience has always been the best teacher in life, love, and money. Those that tend to disregard what experience has tried to teach them are often doomed to repeat the same mistakes over and over again. What is generally wrong with Investment analysis is the context from which the assumptions are made. Despite the weight of evidence from the long-term perspective that investors will likely 'lose the investing game', investors continue to ignore economic and valuation realities to play short-term gains. This is investor psychology at work, that's why, emotionally, 'Being right, but being early, is the same as being wrong.' This is the 'immediacy trap.' The trap is assuming that just because valuation, deviation or price analysis has not created an immediate mean reverting event, then 'this time must be different.' What experience teaches us, is there is a lag effect between the weight of evidence and the eventual outcome. Why? Because of human nature.



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Remember Ingrid and Joe Doe?



Let's look at their own Investment Policy Statement (IPS) and let's apply the current state of market analysis to what we should do with the Portfolio.



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Joe and Ingrid Doe's IPS

CASH	0% minimum	60% maximum
FIXED INCOME	20% minimum	60% maximum
EQUITIES	20% minimum	70% maximum

A Fully Invested Portfolio with 0% CASH, using ETFs instead of individual securities (for simplicity sake) would look like this for Joe and Ingrid with 10% STOP LOSSES:

CASH	0% money market securities
FIXED INCOME	15% BMO Rate reset preferred (ZPR)
	15% I-Shares laddered bonds (DEX)
EQUITIES	10% NASDAQ index (QQQ)
	30% S&P500 index (SPY)
	30% TSX 60 index (XIU)



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There are a multitude of Fundamental/Economic indicators and Technical Analysis tools that assist in managing Risk in a portfolio. In this commentary, we are just going to use one of each that will show you how you may keep your wealth when Risk presents itself:

1. **Cyclically Adjusted Price Earnings (CAPE) ratio**
2. **Using Monthly moving average to enter and exit**

Note: An IIROC Advisor has many more indicators that help confirm signals, however, these 2 are popular and very useful.

Cyclically Adjusted Price Earnings (CAPE) ratio: Helps determine how well a business or portfolio will perform in the long term as the CAPE uses 10 year averages for earnings in order to eliminate cyclical influences. Every business does well in an expansion, what's important to know is how it will fare in a complete cycle, including a recession.

Using Monthly crossing using 2 specific moving averages: refer to CIC Session 4 for explanation and proof examples to understand the use of this analysis

The next 3 slides will give recent updates (March,2017) and how this is applied to the allocation of assets in the Joe and Ingrid Doe portfolio.

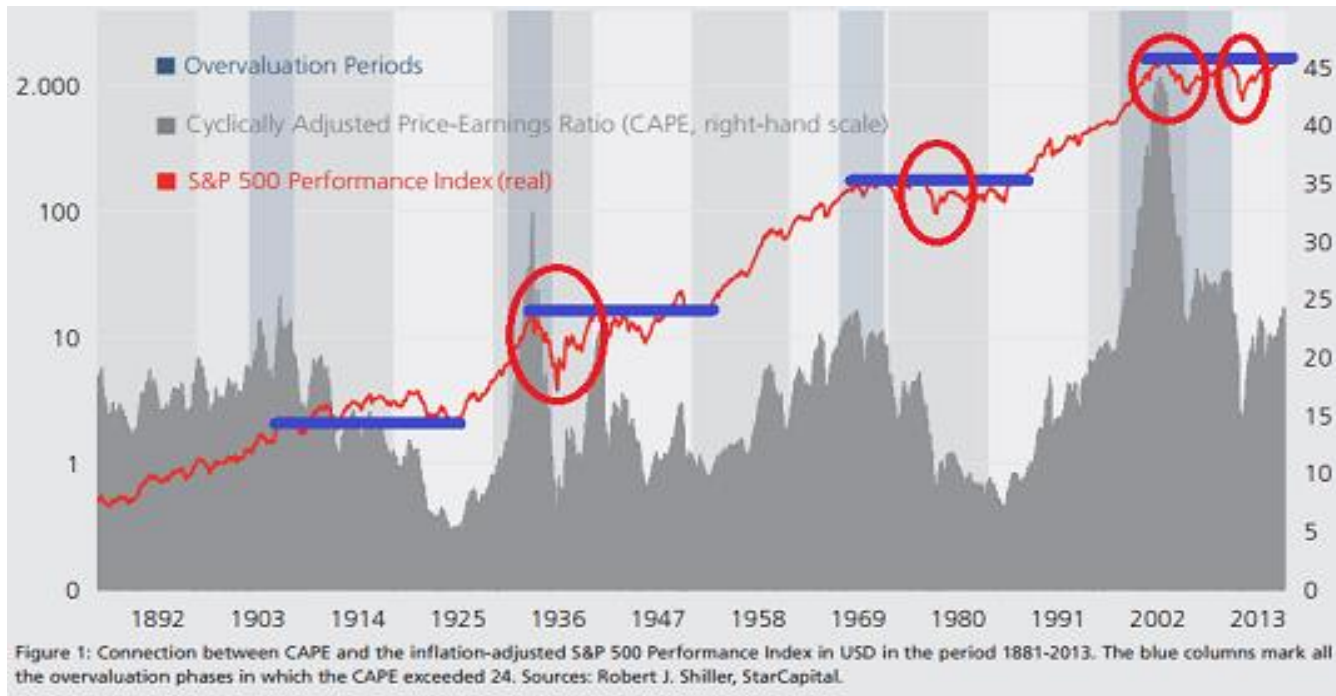


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Cyclically Adjusted Price Earnings (CAPE) ratio S&P500 chart

This CAPE level indicates that if an investor were to put all their money in the S&P500 today, they would earn a total of 4% (including dividends) over the next 15 years. 2% over the next 10 years. Current Ratio level: 26 X



There have been six times in history when the CAPE ratio exceeded 24 -- 1903, 1929, 1970, 2000, 2007, and now. Four out of the five past cases have seen the S&P 500 go nowhere for the next 15 years (don't yet know for 2007).

In addition to going nowhere for 15 years (blue line), each high CAPE period precipitated an extreme bear market. From 1929 to 1932, stocks lost almost 80%. In 1974, stocks lost 42%. In the 2000s, stocks lost 45%, while in 2009, stocks lost 48%. All investors owning an S&P 500 or similar portfolio should know that they run the risk of a 50% temporary decline for a 4% average yearly return for the next 15 years. The positive is that the 50% decline will be only temporary so it isn't a risk of permanent loss, but it still isn't nice to look at.

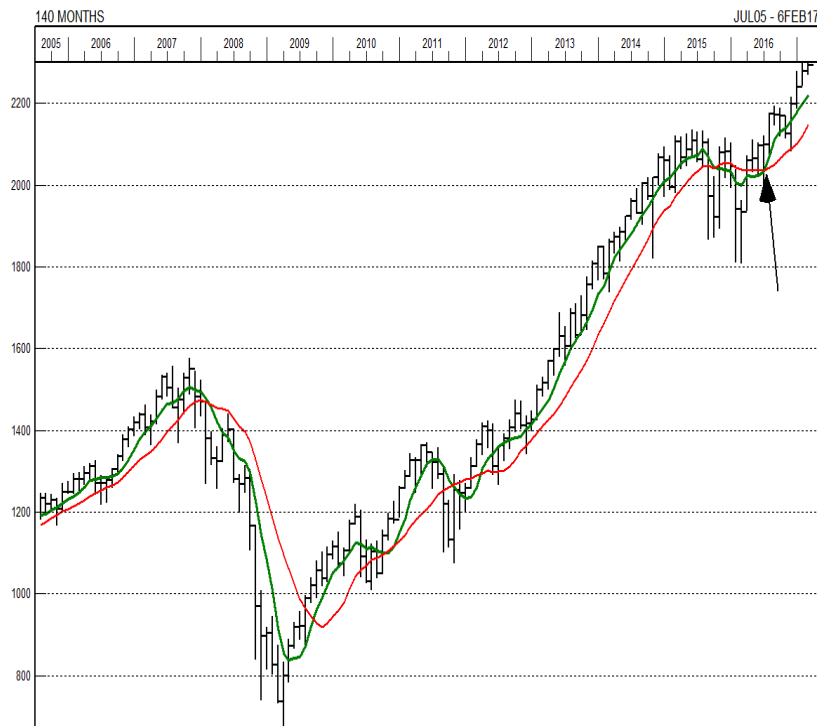


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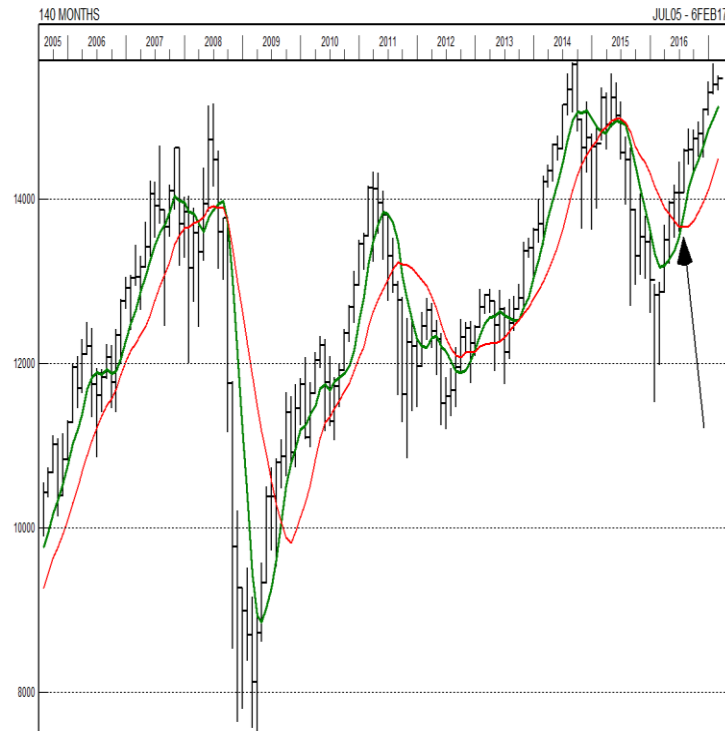


Using Monthly Moving Average Crosses: to determine allocation to Cash, Bonds and Equities in The Doe's portfolio.

S&P 500 COMPOSITE



S&P/TSX COMP IDX



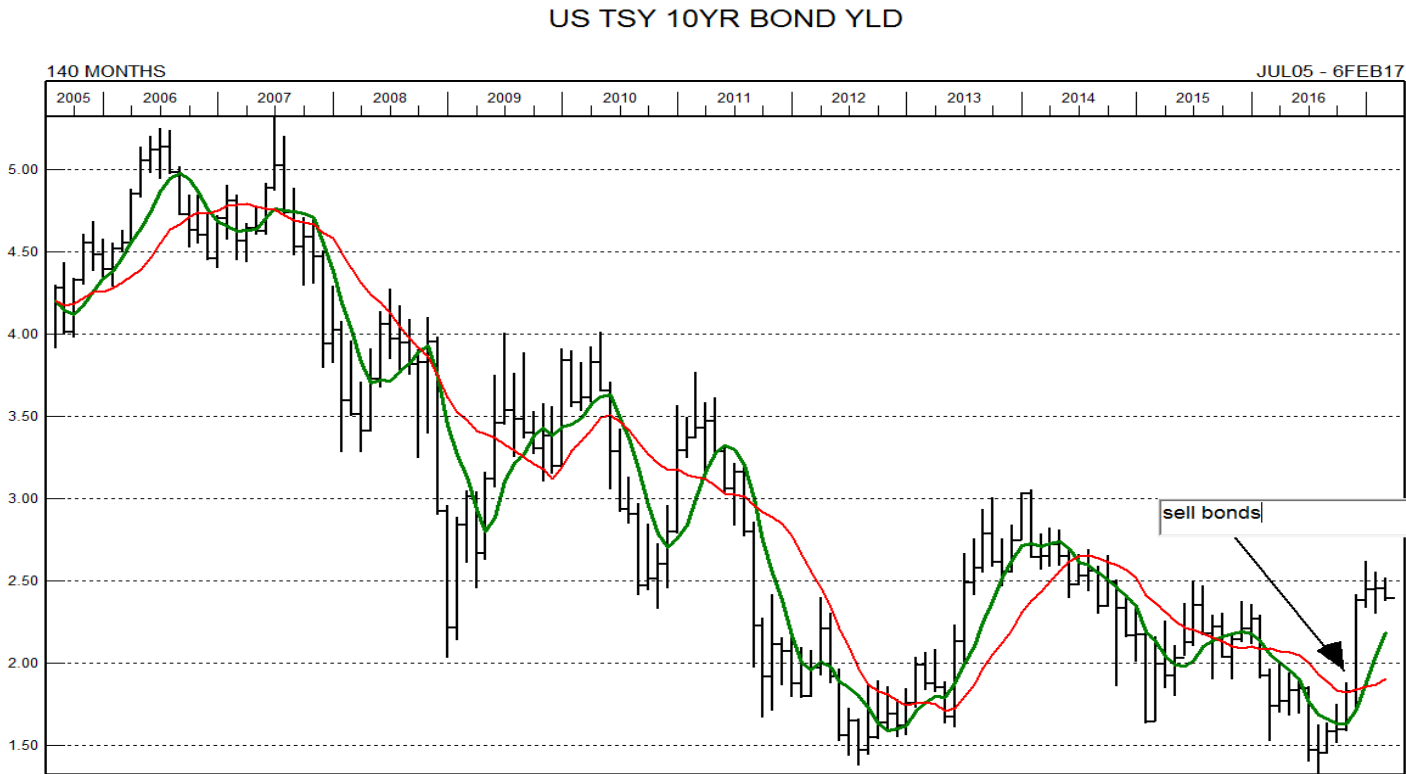
As can be observed the **Green line** moving averages are above the **Red line** moving averages (LOOK AT POINTERS), therefore we maintain a 70% equity allocation exposure for the Joe and Ingrid's portfolio. The CAPE is pointing to high risk, but we won't move to 20% equity exposure until the moving averages Cross down. IIROC Advisors must monitor these Crosses carefully for changes.



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Fixed Income Allocation is a Different Story:



A moving average Cross was recorded on November, 2016. At that point the Doe's Fixed Income allocation drops to 20% from 50% with the remaining 30% going to CASH. This Fixed Income allocation will remain this way until it crosses again. Simple method but very useful.

Remember, for this example, we are ONLY using 2 indicators, but when used together they are very powerful. Look back at the charts and review all Crosses. Why wouldn't you use this Investment Style if minimizing loss is important to you?



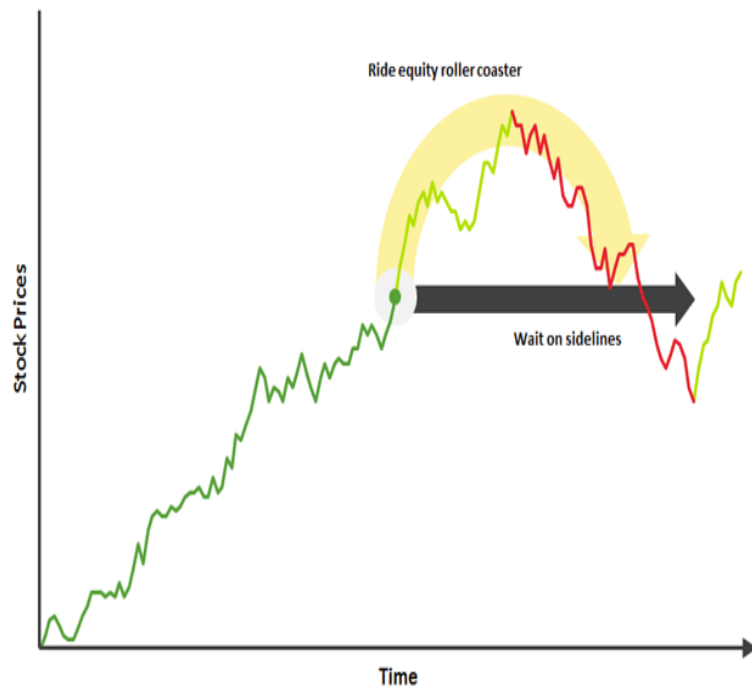
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Going Back to 1932, the Average Bear Market Loss was 38%!

“Portfolio growth is governed by the mathematics of compounding, which means that, for example, a 100% gain is erased by a 50% loss, and the same 50% loss requires a 100% gain to get back to even. If we assume that the next bear market will deliver losses in-line with what we have experienced from Bear markets through history, then at the bottom of the next Bear market investors will have lost 38% of their portfolio value.

The question is, how much do current investors expect stocks to gain before peaking to justify owning them here instead of waiting to purchase them in the next Bear market?



If history is the benchmark, then the next Bear market will cause the market to fall 38%. Using the math of compounding, we can determine that a 38% loss requires a 61% gain to break-even. If that is the case, then investors, who choose to hold stocks today, and experience a Bear market decline of 38%, must expect gains of at least 61% in order to justify being fully invested. Otherwise they would eliminate the anxiety simply by investing in cash.

And this is the opportunity for you, the investor, to converse with your full-service IIROC advisor about protecting your profits/gains with Rules-Based-Investing and STOP-LOSSES.



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