



CANADIAN INVESTORS' COURSE

Session 13: Portfolio Construction



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Constructing a Customized Investment Portfolio ...



"So what makes you want to apply for the job of Equity Fund Manager?"

... is not as easy as it sounds





Types of Investment Accounts

(dealing with an IIROC Advisor or Portfolio Manager)

1. Cash Account
2. Margin Account
3. Option / Margin Account (Session 12- Options)
4. Delivery Against Payment Account (rare)
5. Different Currencies: can have up to 5 different currencies in one account



How to Construct a Portfolio



1. Create the Investment Policy Statement

This is the cornerstone of a Portfolio and should include the following:

- **sets the rules for the portfolio make-up (allocation range)**
- **Advisor uses this as a guideline**
- **types of investments are listed that can be used**
- **fees are listed**
- **reporting of activities are listed and frequency of reports**
- **portfolio \$ amount and types of accounts are listed (cash, RSPs)**



2. Set Portfolio Allocation Rules

IPS implementation has been completed

Types of Asset Allocation:

1. Strategic Asset Allocation
2. Tactical Asset Allocation



Strategic Asset Allocation

Creating a restricted exposure of assets (cash, fixed income, equities) based on personal risk tolerance and needs. This is a customized mix of assets and/or asset ranges.

2 Types:

1. Fixed Strategic Mix (most widely used)
2. Strategic Range: may ONLY be available via an IIROC licensed Advisor/Portfolio manager

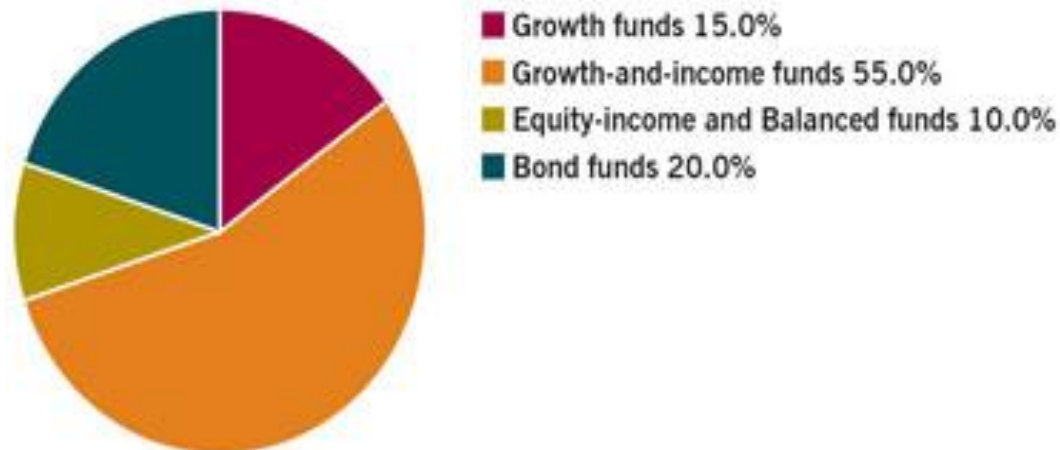


Type 1: Fixed Allocation model

This approach is very typical of individuals that invest in mutual funds or Wrap Accounts. Investor is presented with a 'pie chart' containing a series of assets and a fixed allocation.

A feature that may be provided with this approach is asset 're-balancing' where the investors' fixed portions are maintained. If, for example, the fixed income portion grows and the equity portion shrinks, then fixed income investments (bond funds) are sold and equity investments are purchased to bring the allocation back into balance.

Here is an example of a Fixed allocation portfolio:





Type 2: Creating a Strategic Range

Typical Asset Allocation Rules that are part of an Investment Policy Statement through an IIROC Advisor/Portfolio Manager

Strategic Asset Allocation Range is established. This is customized to each investor and defines the investment parameters the Advisor must work within. This 'range' method is used to manage risk.

Example:

<u>ASSET</u>	<u>RANGE</u>	
	MINIMUM	MAXIMUM
Cash (money market)	0%	55%
Fixed Income	25%	75%
Equities	20%	70%



Tactical Asset Allocation

- creating an exposure of assets based on market condition (risk /reward)
- can be 0% to 100% exposed to the 3 asset classes described in the Strategic range

ASSET	RANGE	
	MINIMUM	MAXIMUM
Cash (money market)	0%	100%
Fixed Income	0%	100%
Equities	0%	100%

This 'FIXED' range is used as a Central model and is applied to the Strategic range. See example.



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Combining Both Strategic with Tactical Allocation

Step 1: Based on Market, economic, interest rates, etc. determine the Central tactical range

i.e. tactical model dictates:

- 20% cash
- 30% bonds
- 50% equities

Using the Strategic asset allocation model example earlier, translate the Tactical model allocations through the Strategic to get the customized portfolio mix required:

ASSET	Mix based on Tactical model above
Cash (money market)	42.5%
Fixed Income	22.5%
Equities	35%



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Two Investors:

1. Jane White – 67 years old. Has investment experience, mostly in mutual funds and wants something more and lower fees. Wants a customized portfolio. She has \$500,000 to invest. She doesn't want a lot of risk but understands portfolio fluctuations. She would like \$10,000 per year income plus some growth in capital.
2. John Black – 50 years old. Understands risk in investing. Doesn't mind being over weighted in stocks if it makes sense and they present good value. Income isn't a priority, but doesn't mind it either. Has \$500,000 to invest. Wants Rules based investment approach to try to alleviate a big downside in Bear markets.

Portfolio advisor's firm's Central Tactical Model

Strategic range

Cash	0%	100%
Fixed Income	0%	100%
Equities	0%	100%



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Jane's IPS (investment policy statement)

Strategic range

Cash	0%	65%
Fixed Income	25%	75%
Equities	10%	50%

John's IPS (investment policy statement)

Strategic range

Cash	0%	60%
Fixed Income	10%	50%
Equities	30%	90%



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Portfolio advisor's firm Central Tactical Model. Recommended asset mix based on markets and economy

Allocation	
Cash	0%
Fixed Income	30%
Equities	70%

Use this guideline to determine the customized allocation for both investors.



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Jane's portfolio asset mix

allocation

Cash	25%
Fixed Income	40%
Equities	35%

John's portfolio asset mix

allocation

Cash	20%
Fixed Income	15%
Equities	65%

What would the portfolios look like?



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To simplify this exercise we will use very few investments to choose from:

Cash – money market 1%

Fixed Income - ABC rate reset Preferred share 5%

DEF rate reset preferred share 4.75%

Equities – 5 stocks: AAA utility 4% dividend yield

BBB BANK 3.50% yield

CCC high tech INC. 1% yield

DDD Recourse Inc. 2.0%

EEE Apartment REIT 4.5% yield

Fundamental and Technical analysis were used to select the securities.



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Both portfolios start with \$500,000

Jane's Initial Portfolio:

		Income/year
25% cash	\$125,000 money market	\$1,250
40% Fixed income	\$100,000 ABC preferred	\$5,000
	\$100,000 DEF preferred	\$4,750
35%	\$35,000 AAA utility	\$1,400
	\$35,000 BBB Bank	\$1,225
	\$35,000 CCC high tech	\$350
	\$35,000 DDD recourse	\$700
	\$35,000 EEE Reit	\$1,575
TOTAL INCOME :		\$16,250

John's Initial Portfolio:

		Income/year
20% cash	\$100,000 money market	\$1,000
15% Fixed income	\$37,500 ABC preferred	\$1,875
	\$37,500 DEF preferred	\$1,687.50
65%	\$65,000 AAA utility	\$2,600
	\$65,000 BBB Bank	\$2,275
	\$65,000 CCC high tech	\$650
	\$65,000 DDD resource	\$1,300
	\$65,000 EEE Reit	\$2,925
TOTAL INCOME :		\$14,312.50

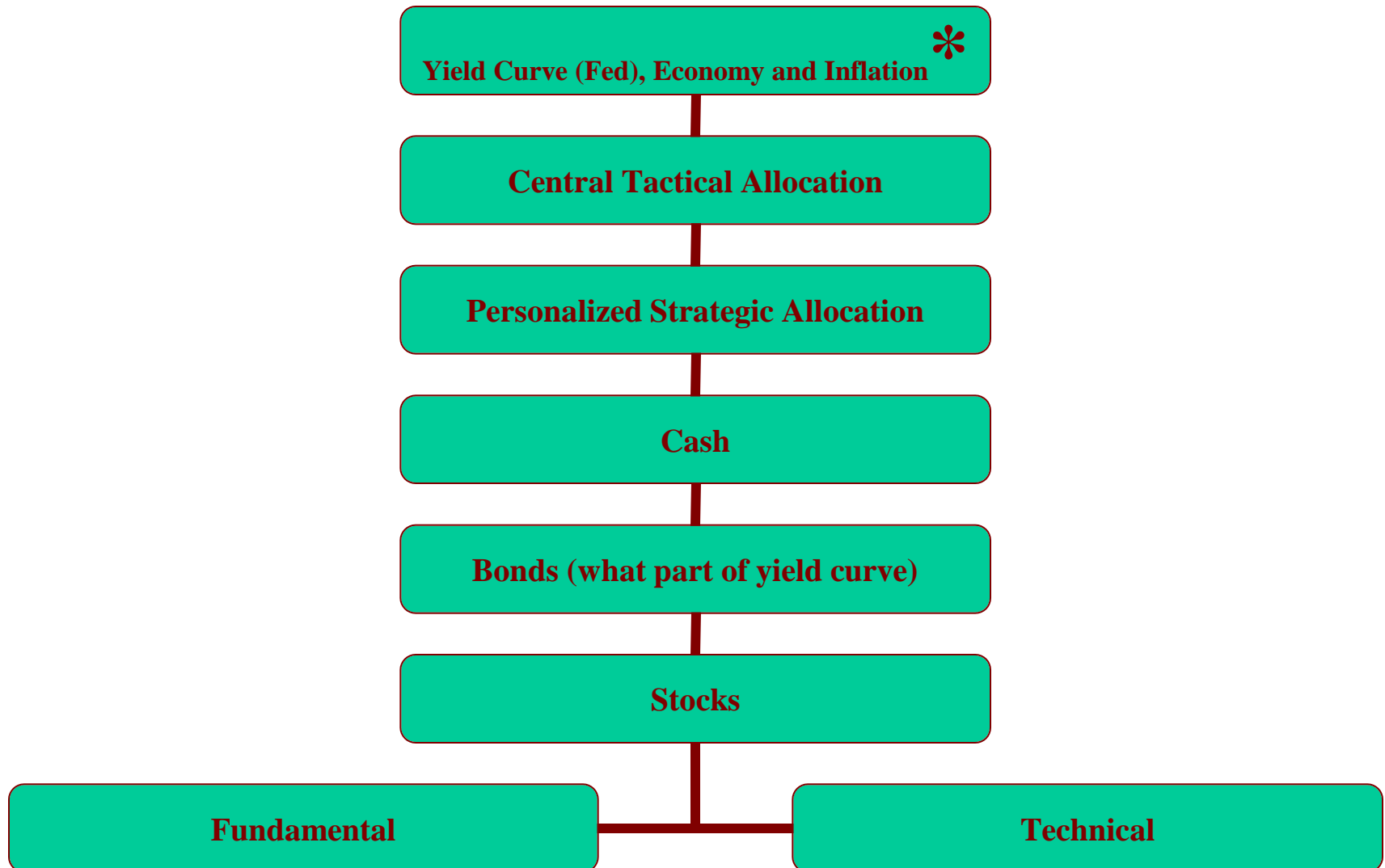
Both have portfolios have identical securities but different proportions and risks.



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Portfolio Construction Flow Chart





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Please refer to Session 15 on Rules Based Investing to get a better insight on creating and practicing similar portfolios



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