



CANADIAN INVESTORS' COURSE

Session 15 – Rules Based Investing



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



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Let's Set Our Perspective Straight:

1. There are many versions of 'Rules-Based Investing'. Just because you are told that a Rules Based technique is being employed, it doesn't mean it is true Rules-Based Investing.
2. We advocate that investors should investigate other versions of Rules Based Investing solutions, with the exception of a 'Buy and Hold' static portfolio.
3. We believe that investors should Buy and Hold a set of Rules or Discipline, in other words, **Buy & Rule**®, not Buy and Hold a rigid set of 'pie-chart' portfolios (refer to previous lessons).
4. With, most likely, the 30 year Bull market in Bonds, or falling interest rates coming to an end, the era of 'Buy and Hold' may be in question. Although there is the argument that over a multi-decade period, markets recover and go to new highs, investors may not have a long enough investment time horizon to wait.
5. This course's version of Rules Based Investing is NOT focused on constantly outperforming the underlying markets that you are investing in. It is focused on long term growth through using Fundamental and Technical analysis to minimizing losses that can occur, for example, in Bear Markets. We don't want to participate for 2 to 5 years in a growing markets just to have a major part taken away in a Bear market and then spending the next 2 to 4 years trying to get it back. This is a stressful event that most investors can't stomach.



Rules-Based Investing: Getting Started

- Create a personalized IPS (Investment Policy Statement). Refer to Session 13 to do this. An IIROC advisor should always create your IPS in this manner.
- Your IIROC Investment Advisor, along with yourself, should determine what your current asset allocation mix will be, based on:
 - A. the Fundamental conditions of the economy and valuations of the markets themselves relative to historic norms,
 - B. Technical Analysis that determines market trends,
 - C. both Fundamental and Technical Analysis to determine individual security selection and investment into the portfolio based on the asset allocation chosen. (percentage of Cash, Fixed Income and Equities)
 - D. Monitor market indicators and be prepared to shift security allocation 'ranges' accordingly. This is important work and is crucial to a 'safety approach' to investing.

Note: Steps A through D, are constantly repeated, whether it be weekly, monthly or quarterly. This is your IIROC investment advisor working for you.



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Rules-Based Investing; An Example

Investors: John and Ingrid Doe, both age 55, Portfolio Size: \$500,000 joint account. After a financial plan and risk tolerance analysis, the Advisor presents this IPS to John and Ingrid :



CASH	Minimum 10%	Maximum 60%
FIXED INCOME	Minimum 20%	Maximum 60%
EQUITIES	Minimum 20%	Maximum 70%

These are strict guidelines for managing a portfolio for this couple. Yours may be different. Please note that these guidelines will change as time passes.



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Rules-Based Investing: An Example

Note: Please refer to Sessions 1, 2, and 4 as appropriate. These Sessions deal with the introduction to Income and equity definitions and equity selection.

The Example begins with understanding Security Selection, which stocks, bonds, etc ...should be held within the portfolio. The different types of ratio analysis that will be used to find a 'Fundamental' value stock.

Market and/or Economic Conditions, as well as, Technical Analysis, will determine the critical tactical Asset Allocation range in the Portfolio. This range must lie within the restricted Strategic Established Range (please refer back to Joe and Ingrid's Strategic range).

The CIC course was designed to help investors understand the various types of security analysis. This is NOT a portfolio manager or security analysts course (which require many courses and years of experience). Most IIROC licenced Advisors have access to this research and can create a complete list of portfolios with track records.

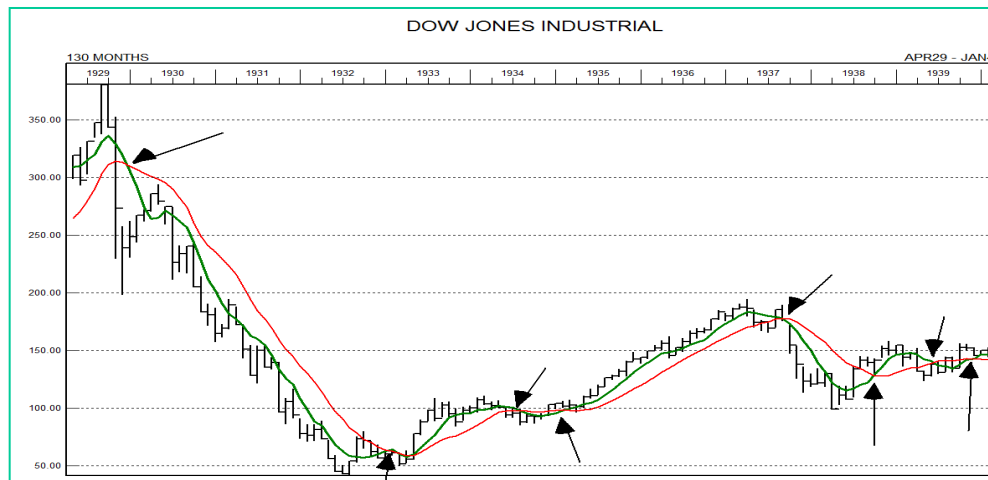


Rules-Based Investing: An Example

Below is one form of Technical Analysis that an IIROC Advisor has access to, the 'Crosses'.

The 1930s Dow Jones Index chart is presented below. There are 2 moving averages, the **Green line** and **Red line**. The Investor SELLS when the **Green line** crosses below the **Red line** and BUYS when the **Green line** crosses above the **Red line**.

DOW JONES INDEX 1929-1940



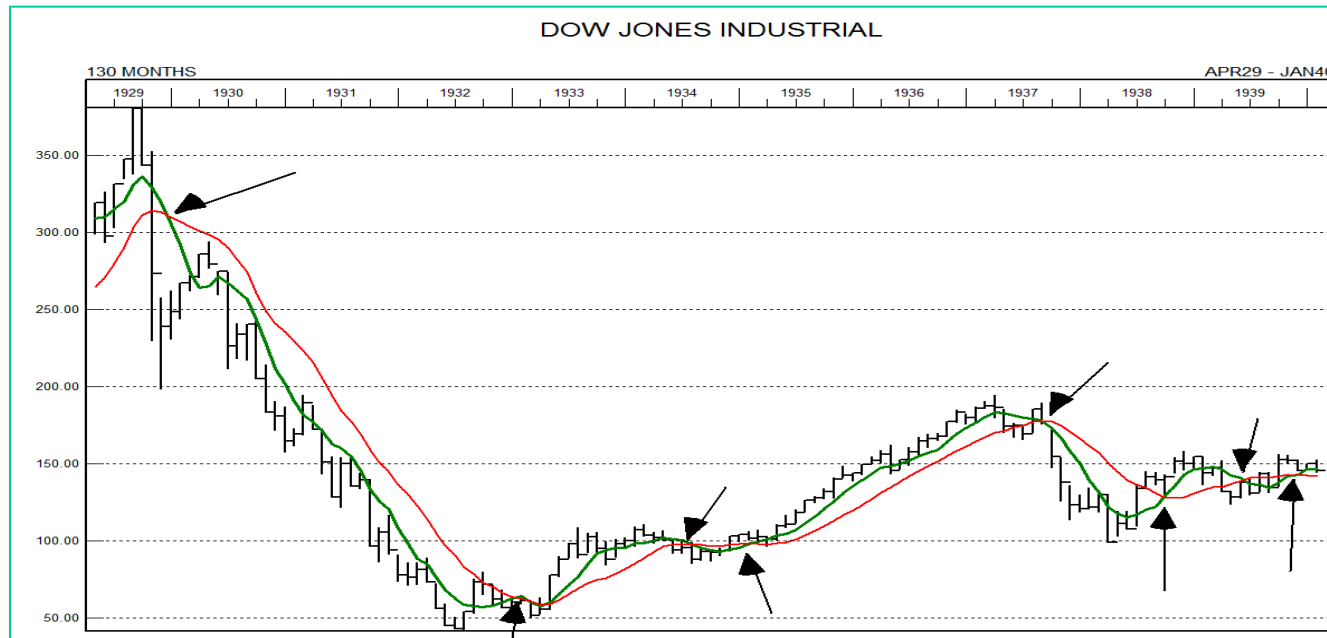
Notice that it can take a long time before you change allocations. Sometimes it can occur twice in one year. The market itself triggers changes, no one knows when until it happens. Look at all the decades returns since 1929 in Session 4. Take time to look. You will be amazed.



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DOW JONES INDEX 1929-1940



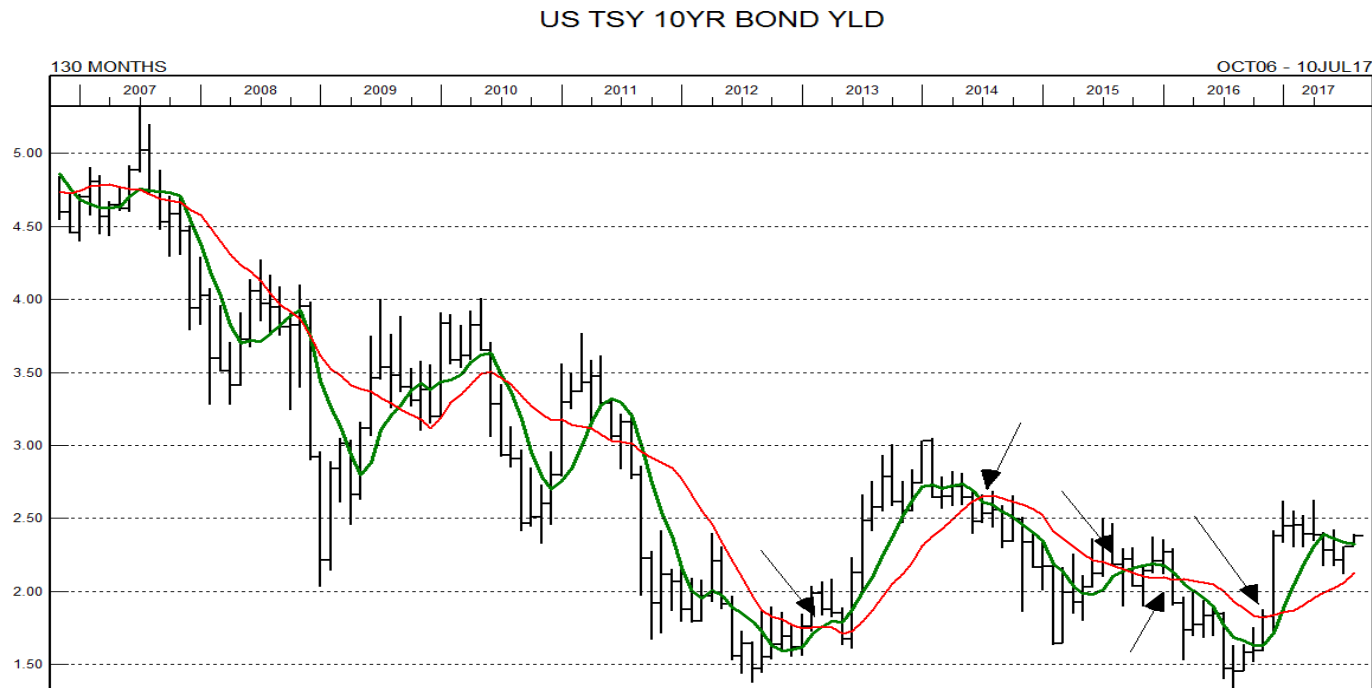
If we just relied on the 'Crosses' for signals, then we would be fully invested in the DJIA Index when the **Green line** is above the **Red line**. Then we would be ALL CASH when the **Green line** is below the **Red line**. If an Investor had unfortunately invested their money in the stock market at the very top in 1929, then practiced rules Based Investing for the remainder of the decade, they would have ended the decade with a return of over +6%. A Buy and Hold investor would have had a total loss of over -60% of their money during this time period and not broke even until 1954, that's 25 years to break even! We like to use the 1930's example because the Rules-Based-Investing method earned a profit during the worst market in history.



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Bond Market 2007 - 2017



If the 10 year Government yields moving averages cause the **Green line** to cross up through the **Red line**, then the Fixed income allocation would drop to 20%, in fact, this did occur in November, 2016 and Bonds still remain a Sell. 10 to 20 year Bonds have lost 10% since then (Feb.2017). There may come a time when Joe and Ingrid will hold 60% Cash or money market in the portfolio.



Rules-Based Investing: Continued

Maintaining a portfolio of no more than 30 stocks, prevents the 'Indexing Affect' described in Session 13.

Can an Investor further use an investment tool to limit downside risk? Definitely.

Use a technique that an IIROC Advisor has easy access to, namely the **STOP LOSS** order.

Ask your current advisor if they can place a **STOP LOSS** on all your investments; including any mutual funds you hold. You will soon discover whether you truly have a Full-Service IIROC Advisor or not.



Rules-Based Investing: STOP-LOSSes

When buying a stock for the portfolio, you can place a STOP LOSS for US stocks and a Trailing Stop Loss for Canadian stocks automatically. These are usually placed for no more than a one month period allowing the Advisor to re-new and review the STOP-LOSS order.

If you Buy a stock for \$50 per share, you can place, for example, a 'one month, \$45 Stop Loss order' that will limit your downside. If you get 'sold-out' on a fall to \$45, you can decide whether this stock should be repurchased or not. This is a very Conservative strategy. This prevents stocks in your portfolio from falling 30% to 60% and then you are told to 'hang in there'. The STOP LOSS technique helps alleviate this problem.

If Investors only need to be successful in 60% of stocks they invest in to do well but would be it wise to limit the downside of the other 40%. If the stock price goes higher then you don't get 'STOPed OUT'.

Rules Based investing includes the usage of this STOP LOSS practice. Use of this technique illustrates how valuable a full-service IIROC advisor can be within a fee-based investment account. Please refer to Session 9, the Investment Industry and Fees to understand how the IIROC advisor compares to the rest of the industry.



Rules-Based Investing: Summary

1. Create a Financial Plan (preferable but not totally essential to IPS formation)
2. Complete Investors' Risk Tolerance assessment.
3. Calculate the 'Required Risk' to achieve the rate of return goal for the portfolio.
You don't need to take more risk than is required.
4. Construct an IPS. MUST have Strategic Asset Allocation ranges (as per Ingrid and John for Cash, Fixed Income and Equity components).
5. Based on Fundamental, Technical and Economic analysis, determine a Tactical Allocation within the restricted range. Determine what percentage of Cash, Fixed Income and Equities make up the Investment portfolio.
6. Create the Investment portfolio with securities selected through analysis.
7. When purchasing individual stocks or ETFs, place a 5% to 10% STOP LOSS on each security to further protect downside risk. This is work, but no problem for the IIROC Advisor to monitor.
8. Monitor and Repeat Step 5. And Step 7. Constantly.
9. Review IPS allocation restrictions on an annual basis.



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