POLARIS WEALTH
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2019 Annual Commentary - Fire Drill!

A big part of the job of a financial advisor is to set expectations for clients. Nearly a dozen years have passed since the global financial crisis and great recession and as time marches on, memories fade and some investors may have forgotten what happens when markets turn south. This is further complicated following last year when most equities generated double digits returns. This is why we thought it would be appropriate to dust off the article *Heat of the Fire* by Brad Steiman, head of wealth management at Dimension Fund Advisors. It walks investors through a "fire drill" to prepare them for the next downturn when it arrives.

Polaris is not predicting an imminent market correction or economic downturn – no one can predict the future. The article is five years old and we have yet to experience a sustained downturn. As your investment advisor, our job is to prepare you for this eventuality. We do not know when it will happen but it is important that you are ready when the time comes.

How prepared do you need to be? **Exhibit 1** shows how a model 100% equity global portfolio would have weathered the past six major market declines of at least 20% back to the 1970s. On average, a downturn of this magnitude occurred once every seven or eight years. A 100% equity portfolio invested one-third in Canadian equities, one-third in U.S. equities, and one-third in international equities would have declined between 20% and 42% in those markets, with the portfolio's high-to-low duration ranging from three to 31 months.

Exhibit 1 MODEL GLOBAL PORTFOLIO PERFORMANCE

Past Six Major Market Declines (1973–2009)

				VALUE OF $1 MILLION 100% EQUITY GLOBAL PORTFOLIO			
HIGH	LOW	MONTHS	TOTAL RETURN	AT LOW		5 YEARS AFTER HIGH ($1 million)	
Oct 1973	Sep 1974	11	-37.9%	Sep 1974	$620,785	Oct 1978	$1,374,074
Nov 1980	Jul 1982	20	-20.9%	Jul 1982	$791,120	Nov 1985	$1,943,573
Aug 1987	Nov 1987	3	-23.5%	Nov 1987	$765,314	Aug 1992	$1,099,456
Dec 1989	Sep 1990	9	-20.2%	Sep 1990	$797,549	Dec 1994	$1,470,487
Aug 2000	Mar 2003	31	-42.1%	Mar 2003	$579,131	Aug 2005	$863,019
May 2007	Feb 2009	21	-41.3%	Feb 2009	$587,004	May 2012	$843,474

In CAD. Global portfolio models are for illustrative purposes only. Their returns are based on back-tested model allocation mixes designed with the benefit of hindsight and do not represent actual investment performance. Not to be construed as investment advice. Portfolios are composed of one-third Canadian equities, one-third US equities, and one-third international equities. Canadian equities are represented by the S&P/TSX Composite Index; US equities are represented by the S&P 500 Index; international developed equities are represented by the MSCI EAFE Index (net dividends). S&P/TSX data provided by S&P/TSX. S&P data provided by Standard & Poor's Index Services Group. MSCI data © MSCI 2014, all rights reserved. **Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Diversification neither ensures a profit nor guarantees against loss in a declining market.**

In all but two of these examples, each portfolio recovered to more than the high value five-years prior. In the August 2000 and May 2007 corrections, you would have needed to wait a little longer, but they also recovered and went on to set new highs. Keep in mind that most portfolios would have a significant portion invested in fixed income and the declines on these more conservative portfolios would have been much less dramatic.

What should you do to prepare?

Appropriate Asset Mix: Make sure you have an appropriate asset mix. A portfolio with 50% fixed income would likely have experienced half the losses shown in **Exhibit 1**. If you have a 100% equity portfolio and will have trouble sleeping at night after a 42% market decline, then you should consider lowering your equity exposure and increasing your fixed income exposure.

Time horizon: Can you wait five-years (or longer) for markets to recover? If not then you should adjust your asset mix in favour of fixed income.

Caveat: Keep in mind that the expected return of fixed income is very low – likely in the range of 2% to 3% long-term. If you reduce your equity exposure in favour of fixed income, you will be lowering your overall expected rate of return of your portfolio. It is a balancing act.

We at Polaris are confident that you have the appropriate asset mix. However, if you would like to review your portfolio in more detail, please contact us. Your best defense is an appropriate asset allocation for your unique circumstance and to stay on course with your investment strategy. This requires discipline.

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