FINANCIAL POST

Saturday, March 17th, 2012

9 ways to turbocharge your returns

Michael Nairne, Serious Money

Kerem Uzel/Bloomberg

Gold worth $300 an ounce ten years ago is not the same investment as gold today at $1,700 an ounce. Yet, many investors dazzled by its phenomenal track record just keep on buying more.

Stock returns over the past five years have been downright dismal. In fact, many investors knocking on our door these days have earned virtually nothing since 2007 once you deduct management fees. And with interest rates now so low, unless we enter into a Japanese-style deflationary lost decade, the best days of bonds are behind us. So here are nine tactics that you can consider to improve your long-term performance in the years ahead.

1. Cut out the deadwood. A decade ago, Canadians had little choice but to use pricey active investment managers. With the advent of exchange-traded funds, investors can dramatically reduce their costs. Vanguard, using Morningstar data, calculated that Canadians were paying 2.23% and 1.3% for actively managed equity and bond mutual funds respectively as of December 2010. The best ETF's are available at a fraction of these costs.

2. Focus on after-tax returns. Unfortunately, the typical affluent Canadian never integrates their tax and investment planning and ends up paying needless taxes. Make sure your finances are structured to minimize this drag.

3. Earn the free lunch. Modern finance has shown that investors who diversify broadly will, on average, earn a higher return over the long-run than their poorly diversified counterparts and — this is the critical distinction — without necessarily taking any more risk. So diversify, diversify, and diversify!

4. Don't chase last decade's winners. Many investors cannot seem to resist overloading their portfolios with the hot performers of yesteryear. Remember it was little more than a decade ago that most investors were ploughing their money into expensive U.S. and international equities just as the Canadian dollar slid to an all-time low.

Today, with their eyes fixed firmly on the rearview mirror, many investors are loading up on Canadian bond and balanced funds and dumping their stocks, particularly global equities, at a time when bond yields are paltry, global stock valuations are reasonable and the Canadian dollar is trading at par with the U.S. Sure, if the world economy takes a dive, this might appear to be a smart move for a year or two. However, the odds are soundly against it being a winning strategy ten years from now.

Or take gold. Gold worth $300 an ounce ten years ago is not the same investment as gold today at $1,700 an ounce. Yet, many investors dazzled by its phenomenal track record just keep on buying more.

5. Move down the credit ladder. You can improve bond yields by moving out of federal government bonds into provincial and municipal bonds as well as investment grade corporate bonds. If you are prepared to take a much bigger bite of credit risk, look at preferred shares and high yield bonds. Remember these asset classes have much higher downgrade and default risk and are much more volatile.

6. Increase your allocation to equities. Most experts believe that stocks today have much higher, long-term expected returns than bonds. However, an expected return is not a guaranteed return and you have to be able to endure those torturous bear markets.

7. Own value and small cap stocks. Value stocks, ones priced inexpensively in relation to earnings, dividends or book values, and stocks of smaller companies have historically earned returns greater than the market overall. Heads up though – value stocks can fall out of favour for years while small cap stocks are incredibly volatile and their performance is also streaky.

8. Earn the illiquidity premium. Illiquid investments like direct real estate investment, mortgages and private equity often earn a premium to publicly traded investments. The price, of course, is that your money is locked-in for years.

9. Use leverage. Using leverage directly or through aggressive private managers can boost returns. Of course, it also magnifies losses.

Focus first on the initial four tactics – cutting active management costs, reducing taxes, diversifying robustly and avoiding return chasing – as these improve results without taking on more risk. Think carefully before you adopt tactics 5 to 9 as they all require the assumption of more risk.

-Michael Nairne, CFP, RFP, CFA, is the president of Tacita Capital Inc., a private family office and investment counselling firm in Toronto. Visit tacitacapital.com