STREETPROOFING FOR INVESTORS - STROMBERG

Remarks of Glorianne Stromberg to the Small Investor Protection Association Public Forum - Canada Room - Markham Civic Centre Markham Ontario – 6 June 1999

Streetproofing For Investors: Strategies For Moving Beyond Hope, Greed And Fear

by Glorianne Stromberg

Thank you for the warm welcome to your community. And good evening everyone. I am delighted to be asked to join you. I thought I would talk this evening about "streetproofing". Now before any of you get up to leave, let me assure you that you have come to the right place! The "streetproofing" that I am going to talk about is "streetproofing for investors" and I am going to suggest some strategies for moving beyond the emotions of hope, greed and fear that so frequently form the basis for so many of the investment decisions that we make. All too often what we do in the name of investing is nothing more than pure speculation.

The two should not be confused. Yet often they are. Think of how many times you talk about - or hear others talk about - "playing the market". Think about how often you - or people you know or read about - choose to invest: (i) in a stock because it was at the top of a "best seller" list, or (ii) in a mutual fund because its performance numbers outperformed all others, or (iii) in a limited partnership because it offered huge tax write-offs with a glimmer of an interest in the promised land or in herds of holy cattle. Think about how often you - or people that you know or read about - end up buying one of these "hot investments" from some nice salesperson - who assures you that he or she has only your interests at heart - just because you, or a friend or someone in your family, met the salesperson at an investment seminar - or just because he or she is Aunt Nellie's son or daughter or adviser. Think about the fact that many people have no idea of what they have bought despite the fact that the amount of their purchase is almost as much as they paid for their house or their car and that they may well have mortgaged their house and car to raise the money to invest. Think about how often these hot investments "go bad". Think about how long it took you to save the money you just parted with.

Think about what will happen to your lifestyle if you lose that money. Think about how long it will take you to earn enough money to replace your lost savings and opportunity costs if this investment or speculation declines in value. If you borrowed the money or if you promised to pay more money in the future, think about how long it will take you to make these payments and how you will be able to make them. Remember that the payments will have to be made even if your investment is worthless. The time to do this thinking is now - before you make these investments - and not afterwards where your refrain will be "If only ?" and your ability to meet your lifetime needs will be seriously impaired. My remarks this evening are aimed at helping you become a more aware investor. I'd like to see you "be aware" rather than having "to beware". But remember, my remarks can only alert you to what will help you "become aware" and to the fact that becoming aware is something that you have to do for yourself. It is not something that government, regulators or the industry can do for you and you should not expect them to do so. If you do, you are likely only to be disappointed and disillusioned.

You should, however, expect governments, and the regulatory system put in place by governments, to recognize your integrated financial needs regardless of where you live and work in Canada. You should expect governments, and the resulting regulatory system, to put in place the foundations for helping Canadians achieve their goals of lifetime self-sufficiency.

Achieving lifetime self-sufficiency is a dynamic planning process. This process begins at birth and continues until death and, in some cases, beyond. This is why I have placed so much emphasis in my Review on the factors needed to achieve lifetime self sufficiency and how these factors are, and need to be, integrated. The factors that I am talking about include: the need to increase knowledge and awareness through youth and adult learning programs, the need to align regulatory structure, the need to make systemic changes to regulation, the need to harmonize and update basic laws, the need to provide for effective disclosure by making sure the information has been communicated to and understood by investors, and the need to ensure that good governance measures permeate every aspect of the financial marketplace.

Each of these factors has a role to play in enabling you to achieve lifetime self-sufficiency. Unfortunately, studies indicate that there is no area of daily life for which most Canadians feel more ill-prepared than that of economic life - the decisions that they are called on to make on a daily basis, as workers, consumers, investors, savers, borrowers, voters, or entrepreneurs, and that will affect their ability to achieve lifetime self-sufficiency.

Many of us live in a state of anxiety. There are relatively few among us who do not feel the pressure of anxiety. It affects every age group. Many of us want to do something about it. Fortunately, what we can do about it coincides with the streetproofing strategies that I said that I was going to talk about tonight. I've picked three strategies to talk about.

\Streetproofing Strategy Number One relates to building your knowledge and awareness. Remember, you can never know too much nor be too aware. Building knowledge and awareness is a continuous lifelong process. It should begin at birth but it's never too late to start. Start now. Don't delay.

Set aside some time in your daily or weekly schedule to do this. Write it in on your calendar. Building knowledge and awareness may sound like a lot of work. But keep in mind that this is your best investment in your future. The more you know and the more aware you are, the better off you will be. You will be better able to plan and manage your financial resources to improve your personal circumstances. You will be better able to make the personal decisions that will help you meet your lifetime needs for financial self-sufficiency. If I could make only one recommendation that would make a difference to you, it would be to work on reducing your "knowledge gap". This is the gap between those who know and those who do not.

Knowledge gaps usually operate to the disadvantage of consumer/investors and result in their receiving too little value at too high a cost. This is what happens when the "sellers" know a lot more about the nature of the investment and the services than the "buyers" generally do. This is what happens when the economic interests of the "sellers" and the "buyers" are not aligned.

Alignment of economic interests and knowledge and awareness usually go hand-in-hand. An example of the knowledge gap is that many people do not realize that they are paying fees and charges on their investments and they do not realize the impact of these fees and charges on their investments. They do not realize that for every 1% they pay in fees and charges they are giving up 20% of the end capital amount that they would otherwise have after approximately 20 years. For example, if the management expense ratio on your investment in a mutual fund (or in a mutual fund look-alike product) is 2.5%, this means that by the end of approximately 20 years, you will have paid an amount equal to 50% of your end capital to other people - such as mutual fund managers, insurance companies and financial planners and advisers.

When someone sells you an asset allocation program or a segregated fund or a wrap account, there is usually another fee of 1% to 2% tacked on. This added fee increases the hit on your end capital. I'll leave it to you to do the math. You should also recognize that your end capital amount will be further reduced by any front end sales charges you pay, by any transaction fees that you pay and by the expenses incurred for portfolio transactions executed for the mutual fund, segregated fund, asset allocation program or wrap account. And all this is before any income taxes are deducted. The message is that "costs matter". You need to be aware of them.

A separate but related message is "don't just chase after performance numbers like a weather vane turning in the wind". Performance numbers mask a myriad of factors that you should be aware of - like risk and volatility and the costs associated with them. These factors tend not to show up in times of a rising or steady market. They become very visible in times of a declining market - and remember, many of the costs are constant. Let me caution you. There is no quick and easy way to build your knowledge and awareness. It involves some work on your part. No one can do it for you. It isn't just a matter of turning to an expert although experts can help you. It isn't something that you can just leave to someone else to do for you although others can help you. Remember that the more you know, the better able you are to make effective use of the help you can get from others. Keep in mind that no-one has your interests more at heart than you do.

You are the one who has to live with the consequences of the decisions that are taken or not taken. Abandoning your personal decision-making to someone else, no matter how trusted or skilled the person is, is not an answer. It's foolhardy. It's often the prime source of complaints when things don't work out. Building your knowledge and awareness will allow you to take control of your own life. Here are some suggestions for getting started. Start reading the financial and business sections of newspapers and magazines. If you're not used to doing this, you will probably find it heavy-going at first. Start by just becoming familiar with what's in these sections. It won't be long before you are finding articles that are of special interest to you. Think of it as exercise. Set aside some time each day to do it. Start lightly and do a little more each day. Explore internet sites such as those of the Investors' Learning Centre, the Canadian Bankers Association, GlobeFunds and Canoe. There is a wealth of information about investing and investment-related issues on these sites.

Contact the mutual fund management companies and ask for a list of their publications on investing and planning for retirement. Then choose the topics that are of interest to you. They have helpful information on understanding what a mutual fund is, how to choose one, how to plan for your children's education, things you should know about the use of in-trust accounts, the importance of appointing a guardian for your children, retirement planning, estate planning, the importance of a will and many other topics. Consider taking a course on investing and planning for retirement but beware of "investment seminars" that appear to be educational but are really aimed at selling you products or advice that may not be appropriate for you or that may reflect a product bias or an institutional bias. I warn you - your challenge will be to find a truly non-partisan course that is not biased towards any particular financial products, financial institutions or financial service providers.

Look for a course that offers some help in upgrading your math and reading skills if you haven't used these skills for awhile. This will help you immensely in understanding basic concepts. Look for a course that helps you understand and apply basic concepts such as the time value of money, the effect of compounding, the difference between total return and a return of capital, and the need to assess opportunity cost - which involves learning to recognize that every decision results in the loss of the next best alternative with the resulting need to assess the value of the trade-offs.

Streetproofing Strategy Number Two is to develop your personal financial plan. Having a plan is crucial to your being able to achieve financial self-sufficiency. It's essential. Sit down - and if you have a family - involve your family (or at least your spouse) - and determine what's important to you and your family - what your goals and objectives are and how you are going to achieve them. Put specifics on time-frames and dollar amounts. If you're like most people, you are going to have to make some trade-offs and set some priorities. This is tough to do because most of us want things here and now. Unfortunately, this is at odds with planning for the future. Setting priorities may challenge your will and strength of character. Remember that the choice between spending $100 today and saving $100 for the future is not a one-for-one trade-off. Time can significantly enhance the value of the $100 that is saved and can make the reflection of a frivolous consumer decision look particularly costly down the road. Making a plan involves knowing how you spend your money, what you spend it on and what you have in the way of assets, income, bank accounts, loans, mortgages, investments, insurance and so on. Keeping good records is your starting point. These records don't have to be very complicated. Keep them simple - but keep them. Learn how to budget. This is a key planning tool in being able to achieve your goals.

Don't become overwhelmed by the process. Remember all you are doing is figuring out what you have, what you need and how you're going to arrange your affairs to meet your needs. For those of you who like labels, you are developing a personal strategic plan. Base your plan on events that you can control rather than on those you can't. For example, you can't control investment returns and tax tactics. You can, however, control things like lifestyle choices, wealth management and wealth creation. You can do this by living in a smaller home, taking lower cost vacations, increasing your income by holding two jobs, reducing or adjusting your spending, buying a new car every five years instead of every three years and similar things. A planning process based on what you can control should assist you in getting a clear vision of what you want to achieve in your life, the ways you can do this and it should provide the motivation to do so by understanding how the choices you make today will affect your ability to meet your goals and objectives.

One of the most important things that you should recognize - if you haven't already - is that wealth management, wealth creation and lifestyle choices apply to all of us - not just to the super-rich. You can - and must - take charge of and manage this process for yourself. Remember a plan is not static. You need to review how you're doing against your plan and how to identify the gaps between what you have and what you want or need to have. You need to identify how you are going to modify your actions and your plans to deal with the gaps. You need to remember that changes in your life circumstances (such as happens in the event of marriage, divorce, remarriage, a job transfer, a job loss or a death) should prompt a review of your goals, strategies, priorities and portfolios.

Streetproofing Strategy Number Three is to get your affairs in order. This strategy is an extension of the first two strategies of increasing your knowledge and awareness and developing your personal financial plan. This third strategy of getting your affairs in order includes the following: Pay off your debts as quickly as you can. Get them under control. Get rid of your credit card if you are not paying off the balance owing every month. If you are overwhelmed by debt, seek help from the credit counselling bureau or from your bank, trust company or credit union. Build up an emergency fund – the usual rule of thumb is to set aside enough to cover four months' living expenses. Keep this money invested in a cashable investment such as an interest-bearing bank account, a GIC or a low-cost, no load money market fund. Make a will. It's too costly to die without one. If you have children under 19, be sure to name a guardian for them.

If you decide that you need advice or help, choose your advisors very carefully. Make sure the persons you choose have the skills you need. Do not be misled by the terms "financial planner", "financial adviser", "financial consultant", "investment adviser" or other words describing some special expertise. There's no regulation of the use of these terms in Ontario. Don't think that just because someone has lots of letters after their name that this guarantees that they have any special ability to give you sound advice. Be aware that some of the people who hold themselves out as providing advice are really there just to sell you a product such as a mutual fund, a segregated fund, an insurance policy or whatever. They may tell you that it doesn't cost you anything but it does through commissions - which may not be obvious to you - and other costs. Be prepared to pay for good advice. Sometimes, a flat fee offers you the best value. Don't just automatically agree to pay a continuing fee.

Don't be the victim of blind trust. Pay attention to what is happening in your account. Promptly read and understand your confirmation statements and account statements. Ask questions immediately if there is anything that you don't understand. If you don't understand the answer, keep on asking questions until you do. Keep good records of your conversations and meetings with your advisers. Make notes as you go along. If someone recommends that you buy or sell something, ask them to tell you in writing why they are making this recommendation and how it fits into your plan. Understand why your adviser thinks this investment is suitable for you. Before committing yourself, make sure that you are comfortable with this assessment of suitability for you. Ask for prospectuses and information statements before you make a purchase. Read the material. If this doesn't sound like what you're comfortable with, ask questions. Ask them before you buy.

Understand what you are committing to. Think about whether there are lower cost alternatives that offer comparable performance, diversification and stability. Lower cost alternatives offer two advantages in your planning process. They mean that you can set aside up to half of the amount that you would otherwise set aside for long term savings (which means that you will have extra money for other needs). Alternatively they mean that by setting aside the same amount, you would have up to twice as much end capital available to fund your retirement needs. Remember the example I gave you earlier about how costs matter. Be very cautious about giving your adviser a power of attorney. Don't do it. If you do, be sure it is very limited and specific. Be very cautious about withdrawal plans - particularly if you are using them to repay investment or other loans. Make sure your adviser gives you different sensitivity scenarios so that you can see what happens if the rate of return on your investments declines. Read and understand this information and its implications.

Make sure your investments are registered in your name. Don't let your adviser register your investments in his or her name or in the firm name either alone or jointly with you. There are some exceptions to this such as in the case of investments held in a registered plan where the registration must by law be in the name of the trustee of the plan. These are just some examples of what you can do to "streetproof" yourself.

Let me conclude by saying that there are a lot of things that need to change in the area of financial services regulation and in providing financial services. I've highlighted these areas in the two reports I wrote. Get them and read them. They will open your eyes to a lot of things that need to change and that will help you be more aware and to protect yourself. The more you know and the more you do, the more likely it is that your voice will be heard. Our current regulatory system is failing. One reason for this is that the voice of the consumer/investor has not been heard.

Your complacency is working against you. As long as you remain passive, unknowing and uninterested, nothing will happen. Regulators are not going to lead the way nor will government and industry. For change to happen, you must make it happen. Your "outrage" will spur government and industry to respond. Your "outrage" or "consumer resistance" will be the catalyst that spurs industry to offer better value to investors. Your demand for governments to get their acts together to make our regulatory structures and our basic laws work better throughout Canada will be the impetus for governments to act. Right now governments are hearing from only one segment of the public - those who sell financial services products who think the status quo is just fine. And why wouldn't they. After all, it's a pretty profitable business for them. Get involved. Your well-being depends on it.