

5 Timeless Tips

on Managing Market Ups and Downs

Market volatility can be unsettling, for even the savviest of investors. In this article we provide you with some tips on how to manage – and potentially benefit from – market volatility.

The notion of investing in the stock market without volatility is as illusory as a car without an engine. Like it or not, the two concepts invariably go hand in hand. But does that mean you should avoid volatility – and investing – altogether?

The short answer is no. Market uncertainty can naturally cause panic and lead to poor investment decisions. Yet, by recognizing short-term market uncertainty for what it is, you can help ensure that it doesn't derail your long-term goals. Here are five tried and tested principles that can help you gain needed perspective.



Investing is most intelligent when it is most businesslike.

BENJAMIN GRAHAM

1. Keep calm and carry on

Investors generally feel a financial loss about two and a half times more than a gain of the same magnitude. Understandably, many of us experience a roller coaster of emotions when investing (as the diagram below illustrates), which can translate into poor buy and sell decisions.

Being aware of these emotions during periods of increased volatility can help you avoid panic, keep calm, remain disciplined and focused on reaching your long-term goals.

Cycle of Market Emotions



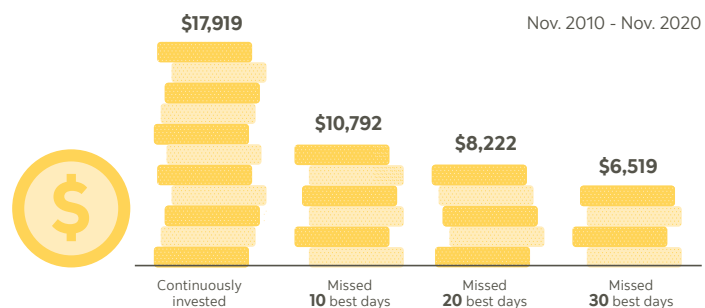
Source: Darst, David M. (Morgan Stanley and Companies, Inc.). The Art of Asset Allocation, 2003.

2. Stay invested...it's time, not timing

Trying to time the ups and downs of the market is a bit like the roll of a dice. Consider the impact of missing the best 10, 20 and 30 days on the value of \$10,000 invested in Canadian stocks over the past 10 years.

As the illustration below shows, sitting on the sidelines can be costly. Over a 10-year period if you're out of the market for even a small number of days when the market is outperforming, you can substantially reduce your return potential.

Staying invested – while not always easy – can potentially translate into a better outcome.



Source: Bloomberg. S&P/TSX Composite Total Return Index, November 30, 2010 to November 30, 2020. It is not possible to invest directly in an index. Assumes reinvestment of all income and no transaction costs or taxes. Value of investment calculated using compounded daily returns. Missing 10, 20 and 30 best days, excludes the top respective return days.

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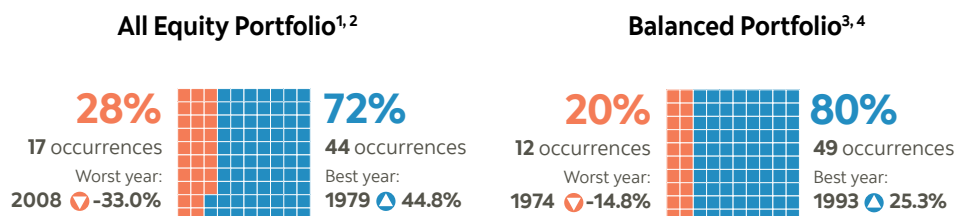
3. Manage risk, don't avoid it

Risk can be a loaded term when it comes to investing and is often misunderstood. You often hear about risk and volatility in investment parlance, the two concepts are related but are not the same thing.

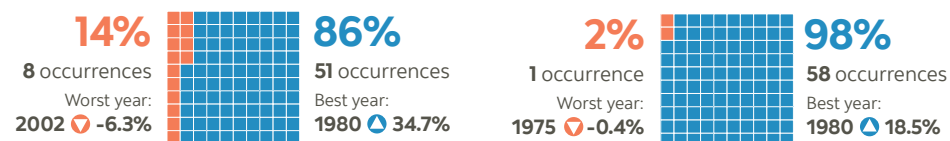
Risk refers to the degree of uncertainty and/or potential financial loss inherent in an investment decision. On the other hand, volatility simply measures how much the return of an investment or the broader market fluctuates up and down. While some may fixate on these fluctuations, the permanent loss of capital should be of greater concern. Reducing exposure to securities that are perceived as 'risky' will certainly lower market risk, but by doing so, long-term investors could potentially see the purchasing power of their savings erode faster and outlive their savings quicker.

Whether we like it or not, investing in the stock market and risk are a package deal. The key to long-term success is to manage your exposure to risk by using time and diversification to your advantage.

The illustration below shows the calendar-year returns for a hypothetical All Equity and Balanced portfolio. It shows that while the performance of any portfolio can swing significantly each year, a balanced portfolio has historically resulted in fewer negative returns compared to an All equity portfolio over the long term.



When you look at the performance of the same two portfolios over a 3-year period, the frequency of negative occurrences significantly declines, highlighting the positive impact of time in further reducing volatility.



Orange = negative occurrences, **Blue** = positive occurrences

Source: Morningstar. Returns are calculated in Canadian currency. Assumes reinvestment of all income and no transaction costs or taxes. Best and worst year rate of returns based on each time period specified. The portfolios are hypothetical and for illustrative purposes only. It is not possible to invest directly in an index.

¹ Based on the calendar year returns of the S&P/TSX Composite Total Return Index from 1960 to 2020.

² Based on 3-year annualized returns ending December 31 of the S&P/TSX Composite Total Return Index from 1960 to 2020.

³ Based on the calendar year returns of a portfolio of 50% the S&P/TSX Composite Total Return Index and 50% Canadian Fixed Income Composite from 1960 to 2020.

⁴ Based on 3-year annualized returns ending December 31 of a portfolio of 50% the S&P/TSX Composite Total Return Index and 50% Canadian Fixed Income Composite from 1960 to 2020.

Canadian Fixed Income Composite consists of 80% FTSE Canada LT Bond & 20% FTSE Canada Residential Mortgage Index from 1960 to 1979; 100% FTSE Canada Universe Bond Index from 1980 to 2020.

Best and worst year rate of returns based on each time period specified.

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4. Put diversification to work

Often equated to not putting all your eggs in one basket, diversification is a tried-and-tested technique that combines different types of investments in a portfolio to lower risk.

No single asset class is consistently among the top performers, and the best and worst performers can change from one year to the next.

ASSET CLASS	INDEX
Canadian Small Cap	BMO Small Cap Index
U.S. Equities	S&P 500 Index
Canadian Equities	S&P/TSX Composite Total Return Index
Canadian Bonds	FTSE Canada Universe Bond Index
International Equities	MSCI EAFE Index
Emerging Markets	MSCI Emerging Markets Free Index
U.S. Small Cap	Russell 2000 Index
Global Bonds	Barclays Global Aggregate Bond Index
Canadian Home Prices	Teranet-National Bank Composite House Price Index - Composite 11
Balanced Portfolio	40% FTSE Canada Universe Bond Index, 30% S&P/TSX Composite Total Return Index, 30% MSCI World Index

By including investments that are less correlated to one another – or react differently to economic and market events – gains in some can help offset losses in others.

As the chart below illustrates, a diversified portfolio with different asset classes provides the opportunity to participate in potential gains of each year's top winners while aiming to lessen the negative impact of those at the bottom.

Calendar year returns (in Canadian dollars)

%	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
HIGHEST	9.7%	16.0%	48.1%	23.9%	21.6%	35.4%	28.7%	7.7%	24.8%	17.9%
	8.3%	15.3%	41.3%	14.4%	19.5%	21.1%	17.4%	4.2%	22.9%	16.6%
	6.8%	13.8%	31.6%	11.2% Balanced Portfolio	16.2%	17.1%	13.8%	2.5%	19.2%	16.3%
	4.6%	13.4%	13.3% Balanced Portfolio	10.6%	14.6%	12.3%	9.1%	1.4%	19.2%	14.4%
	0.4% Balanced Portfolio	7.9% Balanced Portfolio	13.0%	9.7%	6.5%	8.2% Balanced Portfolio	8.9%	-2.0% Balanced Portfolio	16.5%	10.0% Balanced Portfolio
	-1.8%	7.2%	7.8%	8.8%	4.4% Balanced Portfolio	8.1%	8.2% Balanced Portfolio	-3.0%	16.1% Balanced Portfolio	9.4%
	-8.7%	3.6%	4.3%	7.0%	3.5%	7.7%	7.1%	-5.6%	12.9%	8.7%
	-9.6%	3.1%	3.9%	5.4%	2.4%	1.7%	6.4%	-6.5%	6.9%	7.3%
	-14.2%	2.5%	3.8%	4.1%	-8.3%	-1.5%	2.5%	-8.9%	1.5%	6.4%
LOWEST	-16.2%	2.0%	-1.2%	-0.1%	-13.8%	-2.0%	0.3%	-18.2%	1.4%	5.6%

Source: Morningstar. Priced in Canadian currency, as at December 31, 2020. Assumes reinvestment of all income and no transaction costs or taxes. Annual returns compounded monthly. The asset classes are represented by their indicated indices and the balanced portfolio is hypothetical in nature. This information is for illustrative purposes only. It is not possible to invest directly in an index.



Achieving diversification for individual investors can be challenging. Some investors may find it easier to diversify within each asset class by purchasing mutual funds rather than through individual securities.

A **mutual fund** pools money from many investors and invests the money in stocks, bonds, and other investments, making it easy for investors to diversify their portfolio.

Portfolio Solutions are designed to take advantage of market opportunities and manage risk by diversifying across asset class, geography, economic sector and investment approach.

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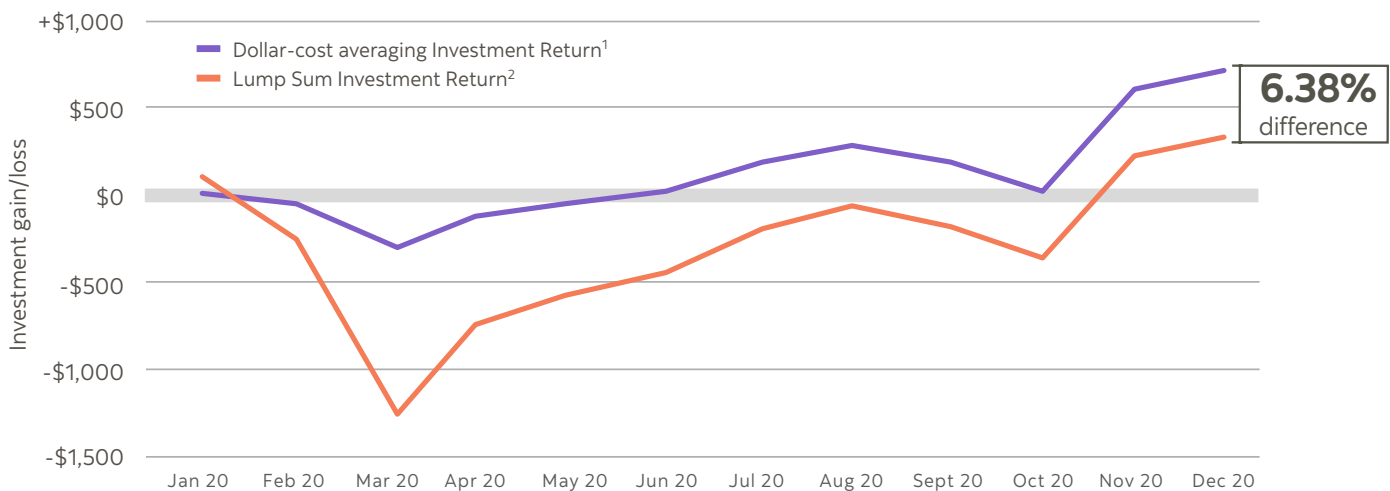
5. Take Advantage of Dollar-Cost Averaging

Dollar-cost averaging is an investment method used to help reduce the risk of timing a lump-sum investment. By investing a fixed dollar amount on a regular basis, the “dollar-cost averaging” (DCA) process helps control the effect of market volatility by smoothing out the average cost per unit of mutual funds purchased.

Over time, and in certain market conditions, it could result in a lower average cost and a higher return. The

graph (below) illustrates how a dollar-cost-averaging strategy compares to a lump sum purchase in 2020, a period punctuated by extreme market volatility and a significant correction.

While it’s important to note that DCA doesn’t always produce a higher return versus lump sum investing, this systematic approach can help investors stay the course by taking the guesswork out of when to invest.



Source: 1832 Asset Management LP and Morningstar Direct. Illustration is based on a hypothetical investment in the S&P/TSX Composite Total Return Index. It is not possible to invest directly in an index.

¹ Dollar-Cost Averaging illustration assumes 12 contributions of \$500/month made between January 1, 2020 and December 31, 2020, totaling \$6,000 in contributions.

² Lump Sum illustration assumes a one-time \$6,000 contribution was made on January 1, 2020.



Pre-Authorized Contributions (PACs)

Pre-authorized Contributions (PACs) can help you build your savings easily and automatically. PACs are a great way to participate in Dollar-Cost Averaging (DCA).

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The value of advice

Short-term market ups and downs can cause even the most experienced of investors to lose sight of the big picture.

An advisor can help you develop a financial plan, recommend suitable investments and navigate rough waters. In fact, research on the value of advice has shown that investors find they have better savings and investment habits and almost four times the wealth of those who don't have an advisor.

With the help of your advisor, understanding your initial reactions to market ups and downs can help you make better investment choices, view your portfolio more objectively, stay the course and ultimately reach your goals.



¹ Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry, Pollara 2020. IFIC Investor Survey (2019)

² Scotia Global Asset Management Investor Sentiment Survey (November 2020).

Staying invested during market ups and downs is simple – but not always easy.

Contact your Scotiabank advisor today to develop a plan that makes sense for you.

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