Spotlight on Risk

When considering the big picture it's easy to take our eyes off of the horizon while we focus on what is right in front of us. Many of our decisions are based on our comfort with taking risks. In this issue of the Spotlight series, we look at some of the key risk factors long-term investors contend with and how they can be managed.

Impact of Time

"Time is on my side."

– Rolling Stones hit song, 1964

When first charting a long-term financial plan, time is generally on our side. Consider the "rule of 72" which is a way to estimate the number of years it would take to double an investment at a specific annual compound rate of return. The rule states that you divide 72 by the return to determine how long it would take to double an investment. For example, it would take over 14 years to double your money with a return of 5% (72/5 = 14.4). As shown in the illustration below, the power of compounding can help make a little go a long way. Investing $200 biweekly for 20 years at an annual rate of 5% results in a nest egg of $176,372. By sticking to the strategies of investing early and investing regularly through a Pre-Authorized Contribution Plan, it is easier to stay on track to reaching your financial goals.

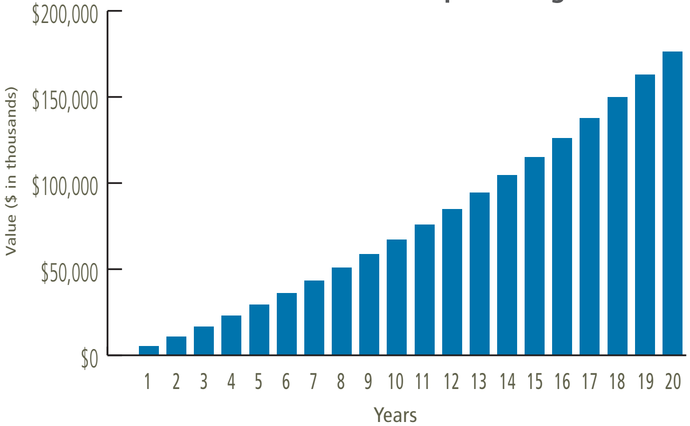
Impact of Inflation

"A nickel ain't worth a dime anymore."

– Yogi Berra

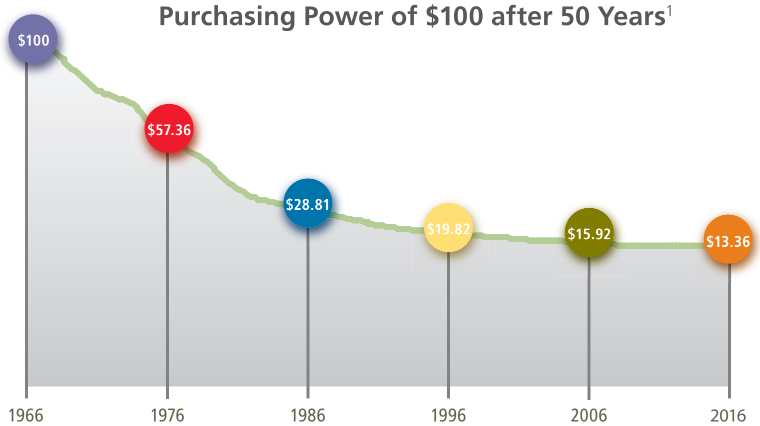
Have you ever heard someone say, "When I was your age, that only cost a dollar"? When saving for a long-term goal, we typically plan for the future while being very much rooted in the present. Often the dollar value assigned to our finish line is the cost of items today – and doesn't account for the impact that inflation can have on the purchasing power of our savings over time, as illustrated in the chart below. Between 1960 and 2016, the value of $100 has been eroded to $13.36 due to inflation. Factoring in inflation is an important consideration when completing a financial plan. One strategy to consider is to give your plan a boost through an annual incremental increase to the Pre-Authorized Contribution. Your Scotiabank advisor can help.

The Power of Compounding



Note: The example is hypothetical and is for illustrative purposes only. Assumes $200 biweekly savings and a 5% annual compound rate of return. The rate of return is hypothetical and does not reflect actual results or the future returns or future value of a mutual fund or any other investment. Assumes reinvestment of all income and no transaction costs or taxes.

Purchasing Power of $100 after 50 Years[1]



Source: Statistics Canada. Core Canadian CPI from December 31, 1966 to November 30, 2016.

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Market Risk

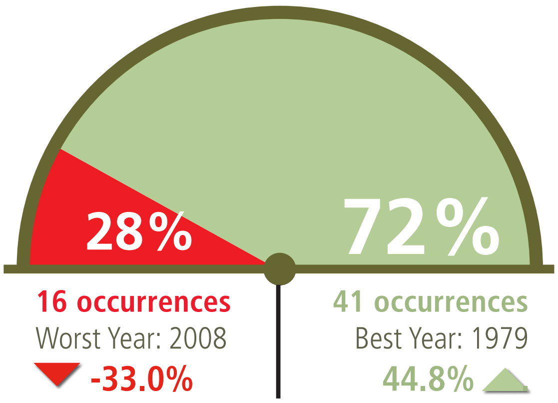
"You can never cross the ocean unless you have the courage to lose sight of the shore."

– Christopher Columbus

Typically, when people think about market risk, they can become very focused on the day-to-day fluctuations in the markets and their investments, with a heavy emphasis on recent activity.

Throughout recent history, there have been notable periods of increased risk and volatility that shouldn't be understated: the crashes of 1929 and 1987, the oil crisis in the 1970s, the collapse of the dot com sector in the early 2000s, and the financial crisis of 2008. And yet despite this, when you look at the markets through a wider lens, the picture offers greater optimism. In fact, since 1960, the number of positive years for Canadian equities has far outweighed the negative ones *(see below).*

Calendar-Year Returns of an All Equity Portfolio†



Longevity Risk

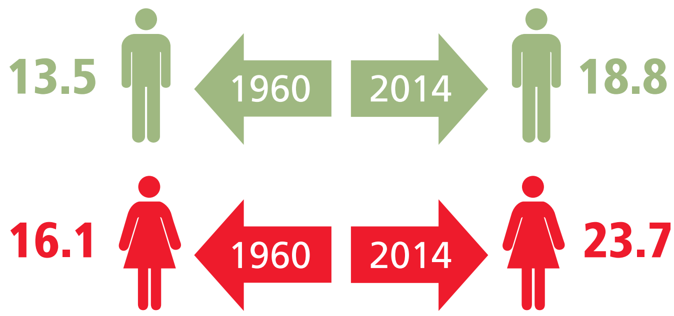
"Life's tragedy is that we get old too soon and wise too late."

– Benjamin Franklin

The average life expectancy of Canadians has jumped over the past years. This increase in life expectancy also means that people are enjoying longer retirements.

Outliving your retirement savings is a very real risk for many, but one that can be managed with proper planning and the right balance of investments for each stage of your life.

Average years spent in retirement‡
(1960 vs. 2014)



‡ Source: Life expectancy and health life expectancy at age 65, Organization for Economic Co-operation and Development, 2014.

† Based on annualized returns ending December 31st of the S&P/TSX Composite Total Return Index from 1960 to 2016. For 3 year rate of return, 85% of returns were positive and 15% were negative. For 5 year rates of return, 98% of returns were positive and 2% negative. Source: Morningstar. Returns are calculated in Canadian currency. Assumes reinvestment of all income and no transaction costs or taxes. The portfolio is for illustrative purposes only and is not meant to reflect future values or future performance of any investment. It is not possible to invest directly in an index.

Final Thoughts

While an aggressive investment strategy can be too much for many to stomach, an overly conservative approach can hinder growth potential and increase the risk of falling short of goals, especially after factoring in inflation.

Having the right strategies customized for your needs can help strike a balance. Over the course of a lifetime, the ebb and flow of events like saving for a home, raising a family, downsizing, and drawing income from savings requires a holistic view – one that's immediate, medium, and long-term.

A Scotiabank advisor can help you put the elements of time, purchasing power, market, and longevity risk into perspective by developing a plan tailored for you.

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