THE

Empowered Investor Guide

KEITH MATTHEWS

TULETT, MATTHEWS
& ASSOCIATES

Contents

IMPORTANT NOTE

The information presented in this guide was originally published in the 4th edition of *The Empowered Investor* by Keith Matthews. This guide contains the opinions of the author but not necessarily those of Tulett, Matthews & Associates Inc. It does not represent a recommendation of any particular security, strategy, or investment product. The opinions of the author are subject to change without notice.

All efforts have been made to assure the accuracy and integrity of the information in this guide. Although all facts have been obtained from sources believed to be reliable, the information is not guaranteed, and neither the author nor the publisher is liable for any errors, omissions, or contradictions found in the text.

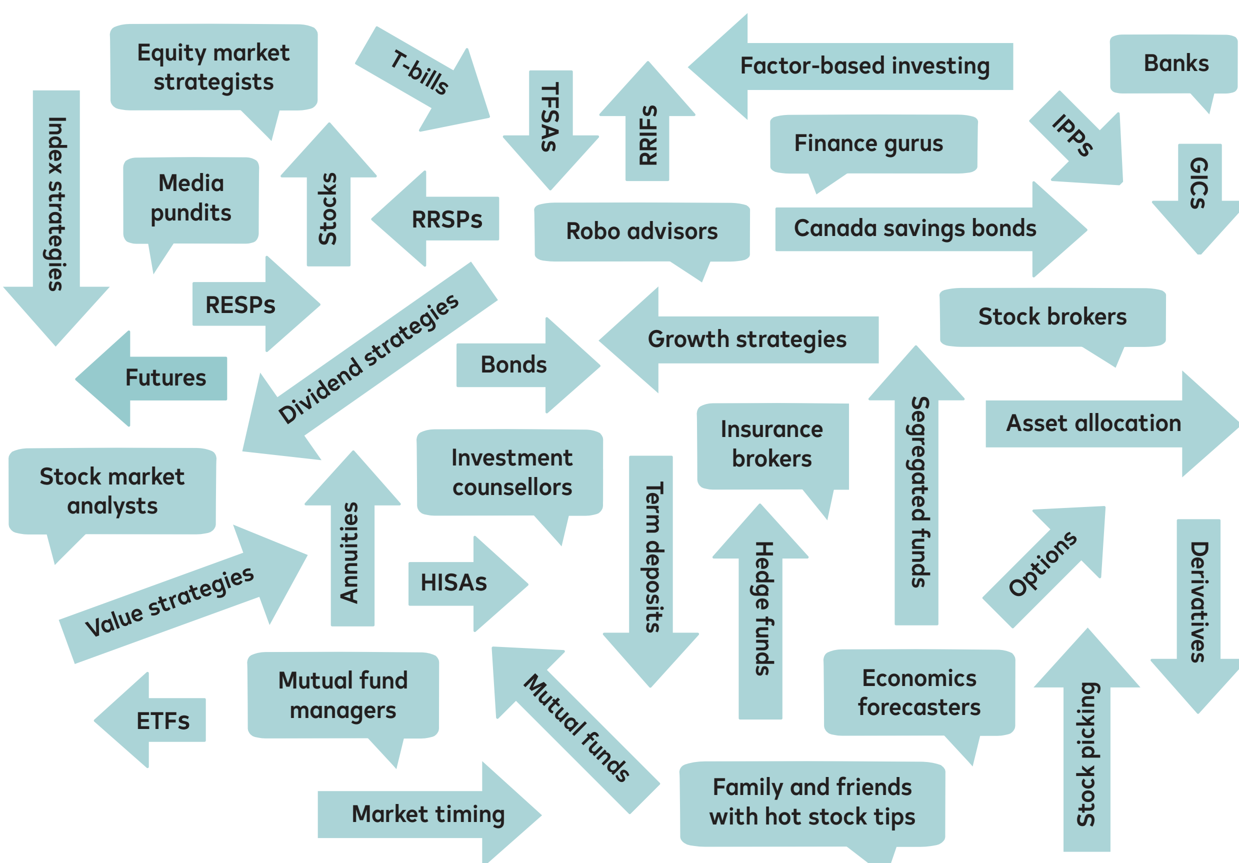
Investments and investing strategies should be evaluated based on your own objectives. Readers should use their best judgment and consult a financial expert prior to making any investment decisions based on the information found in this guide.

Too Many Choices, Too Many Voices

You shouldn't feel in the dark about your financial future.

You've worked hard to get where you are, putting money aside, sacrificing and saving today to provide for tomorrow. You want to know that you're doing the right thing with your investment portfolio and your retirement savings. But you may still feel unsure. Does it feel like there are too many choices and too many voices telling you how to invest?

There are hundreds of strategies, thousands of advisors, and seemingly endless investment offerings. In the face of so many options and opinions, even the thought of trying to manage your investments and plan your retirement can be daunting. It's no wonder that so many people fall prey to self-doubt and second-guessing, or that others are frustrated with and alienated by the complexity of the process.



You deserve transparent, conflict-free counsel that puts your interests first. You deserve access to the knowledge and insights of the sharpest minds in the financial industry. You deserve a detailed, in-depth plan for preserving and enhancing your wealth. You deserve to be financially secure. Forever.

The Empowered Investor Guide shines a spotlight on the winning principles of evidence-based investing, an approach supported by decades of sound academic research. It describes proven investment and planning methods and explains how to integrate them into a roadmap for realizing your personal financial goals.

Tune Out the Noise

As an investor, the most important lesson you can learn is that all of the voices—the advice, predictions, forecasts, and recommendations—are all just so much NOISE.

Noise from the financial services industry, noise from the media, noise from your social and professional networks, and noise from your own mind.

No matter how trustworthy the source, listening to this noise and letting it affect your emotions and influence your decisions can have a negative impact on your investments. The most critical skill you need to develop is the ability to *tune it out*.

LOOK BEYOND THE HEADLINES

Daily market news and financial media headlines can convince investors that they need to act fast to protect themselves from harm or to take advantage of a great opportunity. A long-term philosophy cannot be built on a foundation of short-term decisions. Staying disciplined and following your plan will result in a more positive investment experience.

MANAGE YOUR EMOTIONS

The human brain is not hardwired to be good at investing. Emotions and biases can cloud your judgment and prompt you to make investment decisions that are counterproductive or even dangerous. Take the time to manage your emotions—otherwise, they will manage you.

If you aren't able to shut out the noise, the sheer volume of voices and choices can buffet and bemuse you. Worse yet, being distracted by the hubbub increases your vulnerability to committing one of seven common investment mistakes that can sabotage your portfolio and your future financial security.

AVOID THE SEVEN CRITICAL INVESTMENT MISTAKES

1. Not having an investment philosophy
2. Not understanding the mathematics of a sustainable retirement
3. Basing portfolios on predictions
4. Trying to outsmart the market
5. Chasing performance
6. Not diversifying properly
7. Letting emotions and behavioural biases hold sway

One Voice—Your Personal Financial Plan

For an empowered investor, there is only one voice—your personal financial plan.

A personal financial plan goes far beyond investments to look at the big picture, focusing on the unique circumstances of you and your family—on your dreams, your opportunities, and your challenges.

While a retirement plan and an investment plan are the key components of long-term financial security, other areas of your personal financial plan will require additional attention during different phases of your life.

The figure on the next page illustrates how your personal financial plan unifies investment and retirement planning, risk and debt management strategies, tax planning, and estate planning, and describes how this plan will evolve as changing life phases influence your financial priorities.

YOUR PERSONAL FINANCIAL PLAN — EVOLVING WITH YOU

	ACCUMULATION PHASE (age 25–50)	PRE-RETIREMENT PHASE (age 50–65)	RETIREMENT PHASE (age 65+)
RETIREMENT PLAN	• save 15–20% of family earnings • save for children's education	• increase saving rate to 20% or more of family earnings	• determine a sustainable portfolio draw-down rate
DEBT MGMT	• more important in this life phase • pay off debt	• pay off debt	
INVESTMENT PLAN	• focus on long-term growth	• focus on moderate growth	• focus on preserving capital with some long-term growth
RISK MGMT	• more important in this life phase • protect your family with insurance	• protect your family with insurance	• protect your family with insurance
TAX PLAN			• more important in this life phase • minimize tax on investment withdrawals
ESTATE PLAN	• prepare wills and powers of attorney (POAs)	• keep wills and POAs updated	• more important in this life phase • wills and POAs • plan legacy and charitable giving

Although insurance, tax, and estate planning are important—and all adult Canadians should have an up-to-date will and powers of attorney—to help you become an *empowered investor*, this guide focuses on your retirement and investment plans.

CREATE YOUR RETIREMENT PLAN

A recent survey conducted for the Ontario Securities Commission found that over half of Canadian pre-retirees over the age of 50 are stressed about retirement planning. The fact that the same proportion of respondents admitted to *not* having a retirement plan suggests a direct link between the two. Without a comprehensive plan, it's natural to worry that you won't have enough money to fund your retirement.

Not ready for retirement

RETIREMENT PLANNING

In a survey of pre-retirees over age 50

57%

are stressed about retirement planning

56%

do NOT have a retirement plan

42%

are afraid of running out of money in retirement

RETIREMENT SAVINGS

1-in-5 has not starting saving for retirement

2-in-5 have no idea of the amount they need to fund their retirement

Establishing a sustainable retirement starts with an in-depth examination of where you are now, a detailed picture of where you want to go, and a clear plan for how you are going to get there. Whether you long to travel the world or hope to fill your ideal home with family and friends, whether you are anticipating new adventures or keen to have more time to pursue lifelong interests, your vision of your future will drive your retirement plan. Your financial advisor can help you place a price tag on your objectives and use the mathematics of a sustainable retirement to show you what you need to do to achieve your goals.

The mathematics of a sustainable retirement

Your retirement will be funded by the pensions you have earned over your working years, your savings, and your investments. The mathematics of a sustainable retirement is based on the following figures:

- your *annual retirement expenses* (home, transportation, insurance, food, clothing, travel, gifts, and all other discretionary spending)

- your expected *after-tax or net income* from your pensions, both private and government (all Canadians have access to government pensions, either the Canada Pension Plan, the Quebec Pension Plan, and/or Old Age Security)

- your expected *after-tax accumulated retirement savings*

You can use these amounts to calculate your "annual retirement funding gap"—the shortfall between your pension income and your expenses—by subtracting your yearly expenses from your annual pension income. To fill your retirement funding gap, you will need to turn to your retirement savings.

HOW MUCH SHOULD I SAVE? SAVINGS GUIDELINES

If you don't have a private- or public-sector, defined-benefit pension, an accepted savings target—regardless of your income level—is between 15 and 20 per cent of your gross family income. However, if you don't start saving until later in life (for example, until age 40), your savings rate will need to be higher to make up for the years you have lost.

HOW MUCH CAN I SPEND? "BURN" OR DRAW-DOWN RATE GUIDELINES

Your "burn" or draw-down rate is the percentage of your savings you will need to withdraw each year to fill your retirement funding gap. The more you withdraw, the faster you will "burn" through your savings. As a general rule, and assuming that you will have a diversified, balanced portfolio throughout your retirement, a sustainable "burn" rate for a retirement that lasts from the age of 65 to your early 90s is 3.5 to 4.5 per cent.

While the framework described above is a great place to start thinking about your retirement, retirement projections using planning software can help more precisely determine how much you need to save to support the retirement you want to enjoy. We recommend having projections done at ages 40, 50, and 60, again just prior to retiring and every three to four years during your retirement.

One of the reasons 56 per cent of pre-retirees are stressed about retirement planning is because they are NOT doing retirement planning. Empower yourself and start now.

CREATE YOUR INVESTMENT PLAN

You wouldn't prepare to build a new home or renovate your existing one without refining your vision, drawing up architectural plans, selecting the right contractors and tradespeople, and planning ahead for possible budget overruns and surprises. Yet many people approach their investments without any plan at all.

An investment plan—sometimes called an investment policy statement or IPS—is a written document that you create with your financial advisor to keep you and your investments on track. A proper IPS brings discipline and structure to the investment process and is integral to your long-term investment success.

THE COMPONENTS OF YOUR INVESTMENT PLAN

As you and your financial advisor draft your IPS, these aspects will require careful thought and analysis:

YOUR INVESTMENT GOALS | Are you investing for capital preservation, long-term growth, or a mix of both? Adding new money to your portfolio or drawing on it for income?

YOUR RETURN EXPECTATIONS | What return do you hope to receive? What return can you reasonably expect?

YOUR TIME HORIZON | How soon will you need to access your savings?

YOUR RISK TOLERANCE | How comfortable are you with risk? What type of risks are associated with your portfolio?

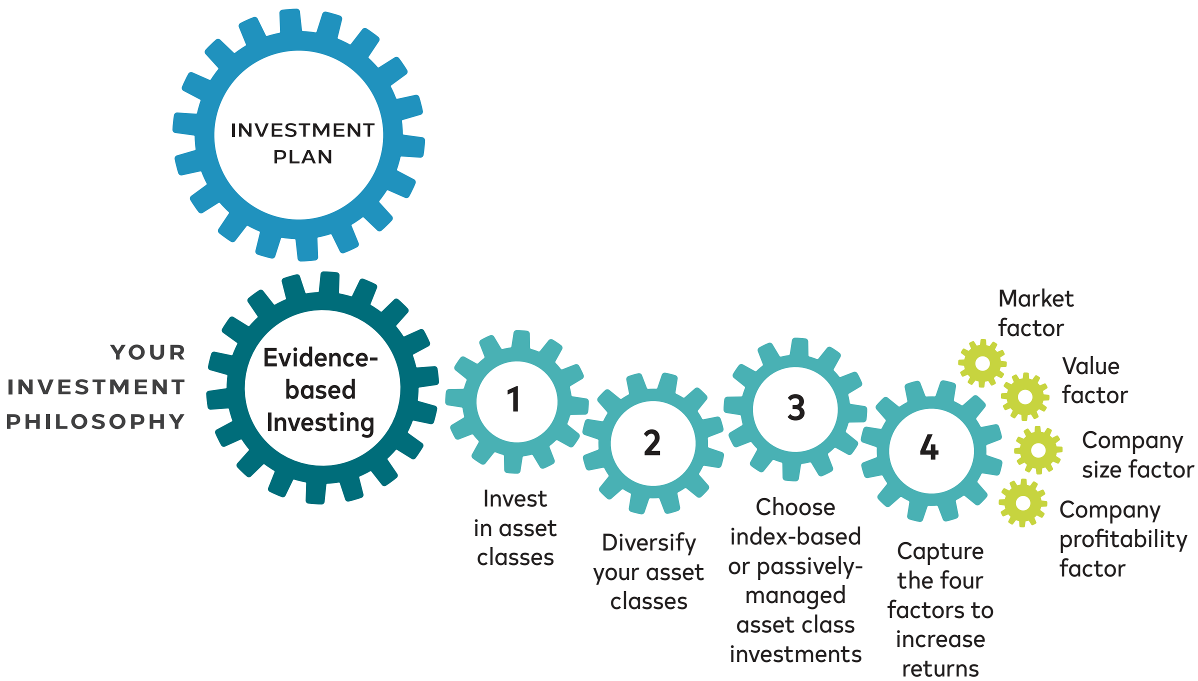
YOUR TAX SITUATION | What tax-efficiency practices will be used to minimize taxes in non-registered accounts?

Your investment policy statement should document the outcome of your discussions to ensure that you and your advisor are on the same page with respect to your investor profile and your investment goals.

An ongoing IPS dialogue with a trusted advisor can produce a better investment experience over the long haul by making you more aware of how markets work, letting you set realistic objectives and reducing the chance of unwelcome surprises.

The final purpose of an IPS is to define an explicit investment philosophy, a set of guidelines that will shape and inform the decision-making process of you, your advisor, and/or your advisory firm. Your investment philosophy defines how and where your money will be invested and how those investments will be managed. It provides full transparency concerning your investments and the role of your advisor or advisory firm.

One Choice—Evidence-based Investing



For an empowered investor, there is only one choice—the philosophy of evidence-based investing.

There are three basic types of investing: stock picking, market timing, and asset class investing. Stock picking is an attempt to identify winning stocks and presumes that someone—whether you, your financial advisor, or the latest guru—can *consistently* unearth underpriced securities that others have failed to discover. Market timing presumes that someone can *consistently* deduce when the entire market or a specific market sector is over- or under-priced and buy or sell equities accordingly. Successful stock picking and market timing would entail the accurate prediction of future geopolitical, economic, financial, or technological events and advances. As this is patently impossible, stock-picking and market-timing recommendations tend to appeal to emotion rather than reason.

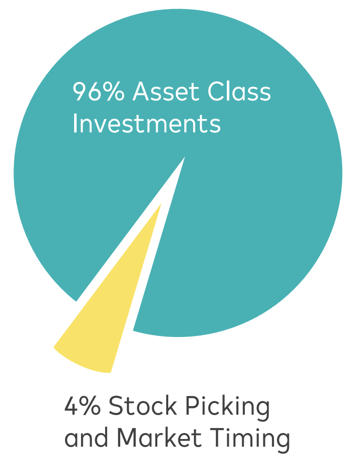
Evidence-based investing cuts through that noise. Over the past seven decades, some of the brightest minds in the economic sciences have applied scientific and mathematical methods to determine the source of investment returns. The four principles of evidence-based investing derive from this scholarly research.

The Four Principles of Evidence-based Investing

1 INVEST IN ASSET CLASSES

When you invest in an asset class, you are investing in hundreds, if not thousands, of securities within that asset class, as opposed to investing in a single or small number of securities. Although stock-picking and market-timing forecasts grab the headlines, asset class investing is a much more prudent—and *proven*—way to invest.

A research study comparing returns from a large sample of institutional portfolios demonstrated that returns from asset class investments may determine up to 96 per cent of the variation between the returns of different portfolios.[1] The returns from stock picking and market timing, on the other hand, accounted for a mere 4 per cent of the variation between returns. Asset classes thus have a considerably larger impact on your investment results than either stock picking or market timing.



Ideally, your asset classes should be as diversified as possible to promote steady growth over time and to protect your investments from the constant fluctuations of a single kind of security.

2 DIVERSIFY YOUR ASSET CLASSES

Among all the voices telling you where to invest, there are likely quite a few admonishing you to "Diversify!" But what does this actually entail? Should you invest in the top ten mutual funds in the two trendiest sectors? In a dozen of the hottest individual stocks?

Good asset class diversification occurs when many distinct and productive asset classes are added together to build an effective, long-term portfolio strategy.

In the figure below, Portfolio 1 represents a typical single asset class strategy with all capital invested in Canadian stocks. As new classes are added to each subsequent portfolio—Portfolios 2, 3, and 4—the rates of return increase and the total risk (as measured by standard deviation) decreases. By Portfolio 4, where the investment is spread over eight different asset classes, the annualized rate of return of 8.47 per cent in Portfolio 1 has risen to 10.6 per cent—2.13 per cent more in absolute terms—while the volatility has dropped from 14.58 to 11.92 per cent. Assuming a starting investment of $10,000 in January 1982, Portfolio 4 would generate $213,400 or approximately 110.8 per cent more money over this 36-year period than Portfolio 1.[2]

Diversification improves results and decreases risk*

PORTFOLIO	1	2	3	4
ASSET CLASS*				
Canadian large companies	100%	33.4%	30%	30%
US large companies		33.3%	30%	10%
US value companies				10%
US small companies				10%
International large companies		33.3%	30%	10%
International small companies				10%
International value companies				10%
US REITs			10%	10%
Total	100%	100%	100%	100%
Annualized return	8.47%	9.94%	10.13%	10.60%
Standard deviation	14.58%	12.20%	11.82%	11.92%
Growth of $10,000	$202,600	$333,100	$354,900	$416,000

* These portfolios do not represent suggested or recommended allocations but are merely examples used to demonstrate the effects and benefits of portfolio diversification.

Practicing smart diversification across market segments can help manage overall risk. But diversifying within your home market may not be enough. Global diversification can broaden your investment universe.

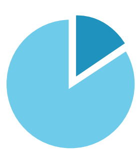
3 CHOOSE INDEX-BASED OR PASSIVELY-MANAGED ASSET CLASS INVESTMENTS

In the simplest terms, an index-based investment is an investment that aims to deliver the average return of a market sector or of the stock market as a whole. Index-based asset class investments track the index of a specific asset class and can be said to represent the entire asset class.

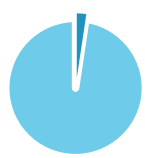
Because their aim is to achieve the average return, index-based asset class investments do not require an active manager to continually buy and sell securities in an attempt to outperform the market. They are, by their very nature, passively managed. However, not all passively-managed asset class investments are index based. There are also funds that represent entire asset classes by investing in that asset class according to a set of rules of ownership that are held constant.

INDEX-BASED OR PASSIVELY-MANAGED ASSET CLASS INVESTMENTS OUTPERFORM ACTIVELY-MANAGED STRATEGIES

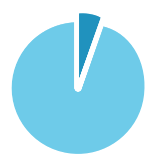
Over the long-term, few actively-managed strategies have been able to match the returns from index-based or passively-managed asset class investments. The pie charts below show the low percentage of actively-managed strategies that have outperformed relevant benchmarks in the ten years that ended 30 June 2018.[3]



Only **11.11%** of Canadian equity funds beat the S&P/TSX



Only **2.33%** of US equity funds beat the S&P 500 Index



Only **4.79%** of International equity funds beat the S&P Large/Mid Cap Index

There are many reasons why we prefer to use index-based (in the form of Exchange Traded Funds) or passively-managed asset class investments (in the form of Dimensional Fund Advisor funds) when building and managing long-term diversified portfolios. Long-term performance is one of them. Other benefits to your portfolio include: transparency, no risk of manager drift, low fees, lower survivorship risks, and higher levels of tax efficiency.

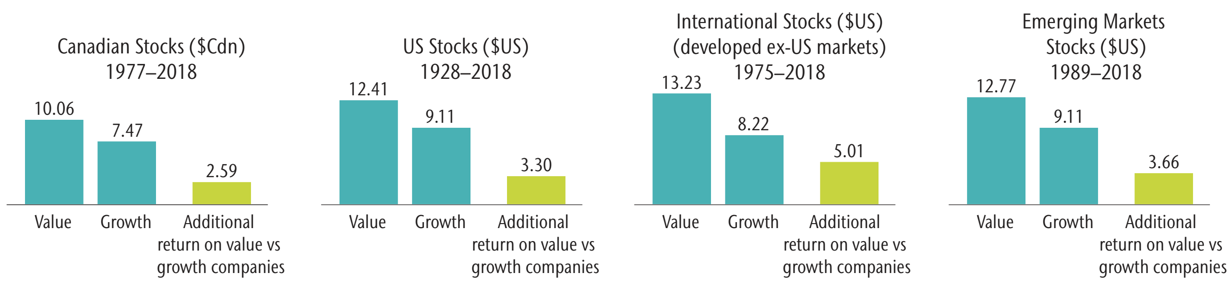
Index-based and passively-managed asset class investments work in any kind of market—up, down, or sideways. Like the proverbial tortoise, index-based and passively-managed asset class investments grow slowly and steadily, outpacing actively-managed strategies where it matters most—in your investment returns.

CAPTURE THE FOUR FACTORS TO INCREASE RETURNS

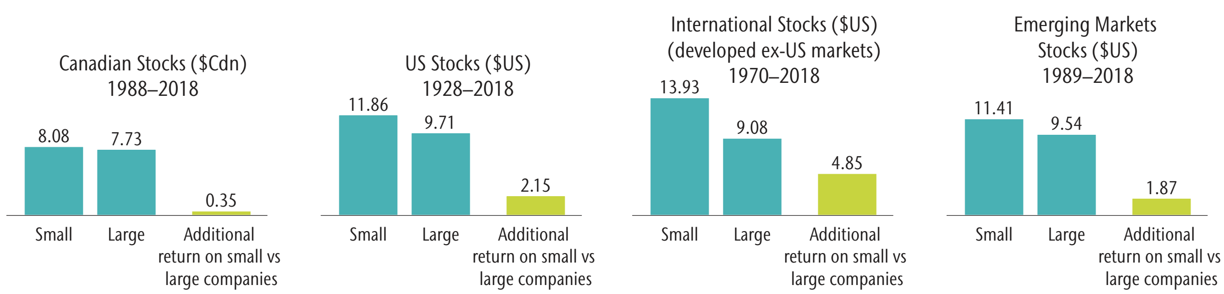
Investors can pursue higher expected portfolio returns by including the four equity factors in their portfolio allocations.

Market factor Stocks have higher expected returns than bonds

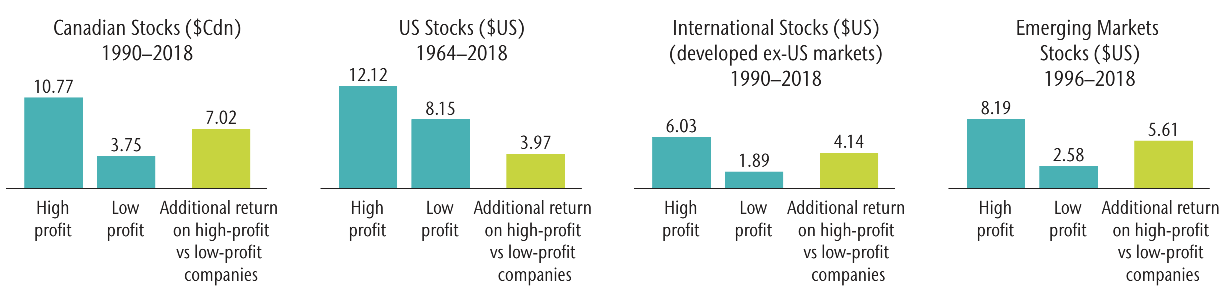
Value factor Low-priced "value" stocks have higher expected returns than high-priced "growth" stocks[4]



Size factor Small company ("small cap") stocks have higher expected returns than large company ("large cap") stocks[5]



Profitability factor Companies with a high gross profitability have higher expected returns than companies with a low gross profitability[6]



The Empowered Investor

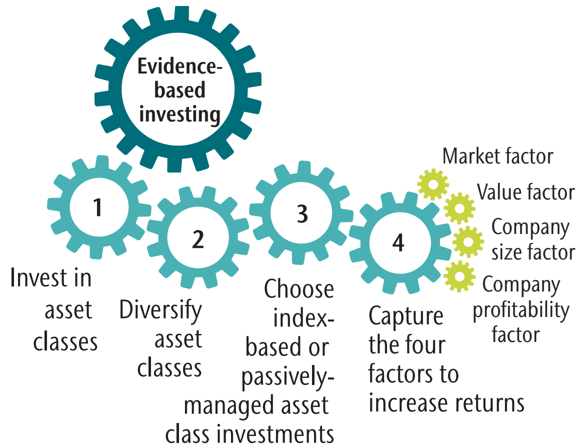
As an empowered investor, when you heed that one voice—your personal financial plan—and make that one choice—the philosophy of evidence-based investing, you will take control, achieve success, and be transformed.

HAS ONE VOICE

Has a comprehensive personal financial plan that unifies

- retirement planning
- debt management
- an investment plan
- risk management
- tax planning
- an estate plan

HAS ONE CHOICE



TAKES CONTROL

- Understands the mathematics of a sustainable retirement
- Has a retirement projection
- Has a savings plan to fund a comfortable retirement
- Has a detailed Investment Policy Statement (IPS) that covers investment goals, return expectations, time horizon, risk tolerance, and tax situation
- Uses strategies to minimize tax consequences

ACHIEVES SUCCESS

- Recognizes and steers clear of conflicts of interest in the financial services industry
- Avoids making any of the seven critical investment mistakes (including stock picking, market timing, chasing performance, and basing portfolios on predictions)
- Obtains full transparency regarding investments and role of a financial advisor
- Is protected from the ups and downs of the markets
- Realizes higher and more consistent returns over the long term
- Incurs lower investment fees and trading costs
- Has improved the odds of being financially secure forever

IS TRANSFORMED

- Is better able to tune out **noise**
- Feels more in control of and has more confidence in plans
- Has less stress and anxiety regarding investment and planning
- Has the freedom to dedicate more time and energy to the things that matter most: family, friends, and retirement
- Enjoys peace of mind

By reading *The Empowered Investor Guide*, you have taken the first step to gaining control of your finances and replacing anxiety, frustration, and confusion with confidence, focus, and enlightenment.

At Tulett, Matthews & Associates, it is our sincere hope that this guide has helped you discover a clear path to long-term financial security. If there is any aspect of this guide you wish to discuss, or if you are ready to take advantage of these strategies, please feel free to reach out to us. It would be our pleasure to work with you.

Sincerely,

Keith P. Matthews

Keith Matthews
Author of *The Empowered Investor*
Partner and Portfolio Manager
Tulett, Matthews & Associates
keith@tma-invest.com
514-695-0096 (106)

We made the decision to invest with Keith after reading the second edition of *The Empowered Investor* in 2008 and we have never looked back. Keith and his team have helped us to surpass our financial goals through an intelligent, unbiased, and transparent approach that has always put our best interests first.
~ DR. EARL & MAVIS MORGAN
Amherstburg, Ontario

I love our meetings. The counsel I receive is straightforward and easy to understand. I come away feeling very financially secure. For this, I thank you!
~ JULIANA A.

We have been clients of Keith Matthews since 1999 and of Tulett, Matthews & Assoc. since 2005. From the very beginning, Keith and TMA have consistently followed a transparent, client-centred philosophy and an approach based on index investing. Keith and his caring team treat us like family, and we trust them because we know that they will always have our best interests at heart.
~ KEITH WILCOX & JUDY MACARTHUR
Georgeville, Quebec

SOURCES

1 Dimensional Fund Advisors study (2002) of 44 institutional equity pension plans with $452 billion total assets based on total plan dollar amounts as of December 2001.

2 Canadian large companies = S&P/TSX Composite Index; US large companies = S&P 500 Index; US value companies = Russell 1000 Value Index; US small companies = CRSP Deciles 6-10 Index; International large companies = MSCI EAFE Index (net div.); International small companies = Dimensional International Small Cap Index; International value companies = MSCI EAFE Value Index (net div.); US REITs = Dow Jones US Select REIT Index. 31 January 1982 to 31 December 2018.

3 Standard & Poor's Indices Versus Active Funds Scorecard, 30 June 2018.

4 Fama/French Canada Value Index minus Fama/French Canada Growth Index; Fama/French US Value Research Index minus Fama/French US Growth Research Index; Fama/French International Value Index minus Fama/French International Growth Index; Fama/French Emerging Markets Value Index minus Fama/French Emerging Markets Growth Index. Information provided by Dimensional Fund Advisors LP.

5 Dimensional Canada Small Index minus S&P/TSX Composite Index; Dimensional US Small Cap Index minus the S&P 500 Index; Dimensional International Small Cap Index minus the MSCI World ex-US Index (gross dividends); Dimensional Emerging Markets Small Cap Index minus MSCI Emerging Markets Index (gross dividends). S&P and S&P/TSX data © 2019 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. MSCI data © MSCI 2019, all rights reserved. Information provided by Dimensional Fund Advisors LP.

6 Dimensional Canada High Profitability Index minus Dimensional Canada Low Profitability Index; Dimensional US High Profitability Index minus Dimensional US Low Profitability Index; Dimensional International High Profitability Index minus Dimensional International Low Profitability Index; Dimensional Emerging Markets High Profitability Index minus Dimensional Emerging Markets Low Profitability Index. Profitability is measured as operating income before depreciation and amortization minus interest expense, scaled by book. Information provided by Dimensional Fund Advisors LP.