Dan Bortolotti

Financial Journalist

Dan is the editor-at-large at MoneySense.

Creator of Canadian Couch Potato, chosen by the Globe and Mail as Canada’s top investing blog.

Building a Perfect Portfolio

In partnership with MoneySense by BlackRock
9 Steps to the Perfect ETF Portfolio

Dan Bortolotti
November 16, 2013
STEP 1

Set a realistic goal
1. Set a realistic goal

• Before you choose the right tool, you need to define the job

• Your goal should be specific and attainable

• Ideally done with a financial planner, but an online calculator can help
1. Set a realistic goal

Sample goal:

• I currently have $175,000
• I am saving $500 a month
• I would like to have $500,000 when I retire in 15 years
STEP 2

Determine your risk profile
2. Determine your risk profile

• Your portfolio should consider your ability, willingness and need to take risk
2. Determine your risk profile

Your ability to take risk depends on:

• Your time horizon

• The stability of your income
2. Determine your risk profile

Your **willingness** to take risk depends on:

- Your tolerance for losses
- Your experience with investing
2. Determine your risk profile

Your need to take risk depends on:

• How close you are to achieving your financial goal

• Your target rate of return
STEP 3

Choose your asset mix
3. Choose your asset mix

• Your portfolio’s mix of stocks and bonds is determined by your **target rate of return** and your **risk tolerance**

• The idea is to take as much risk as you need to, **but no more**
3. Choose your asset mix

Consider expected returns for stocks and bonds. For example:

• 7.2% for stocks
• 3% for bonds

Subtract investment costs:

• 0.5% for ETFs
3. Choose your asset mix

Expected return on a portfolio of 60% stocks and 40% bonds:

\[
\begin{align*}
7.2\% \times 60\% & = 4.3\% \\
3\% \times 40\% & = 1.2\% \\
\text{Minus fees} & = -0.5\% \\
\text{Total} & = 5.0\%
\end{align*}
\]
3. Choose your asset mix

Is 5% enough to reach our goal?

If we start at $175,000
and contribute $500 a month
and achieve a 5% annual return
we’ll have $504,099 in 15 years
STEP 4

Select your ETFs
4. Select your ETFs

• There are now more than 300 exchange-traded products on the Toronto Stock Exchange

• Stick to broadly diversified, plain vanilla, low-cost funds

• You need only three to six ETFs to build a diversified portfolio
4. Select your ETFs

- 20% Canadian stocks
- 15% U.S. stocks
- 15% International stocks
- 10% Real estate
- 30% Government and corporate bonds
- 10% Real-return bonds
4. Select your ETFs

- 20% iShares S&P/TSX Capped Composite (XIC)
- 15% U.S. stocks
- 15% International stocks
- 10% Real estate
- 30% Government and corporate bonds
- 10% Real-return bonds
4. Select your ETFs

- 20% iShares S&P/TSX Capped Composite (XIC)
- 15% iShares S&P 500 (XUS)
- 15% International stocks
- 10% Real estate
- 30% Government and corporate bonds
- 10% Real-return bonds
4. Select your ETFs

- 20% iShares S&P/TSX Capped Composite (XIC)
- 15% iShares S&P 500 (XUS)
- 15% iShares MSCI EAFE IMI (XEF)
- 10% Real estate
- 30% Government and corporate bonds
- 10% Real-return bonds
4. Select your ETFs

- 20% iShares S&P/TSX Capped Composite (XIC)
- 15% iShares S&P 500 (XUS)
- 15% iShares MSCI EAFE IMI (XEF)
- 10% iShares S&P/TSX Capped REITs (XRE)
- 30% Government and corporate bonds
- 10% Real-return bonds
4. Select your ETFs

- 20% iShares S&P/TSX Capped Composite (XIC)
- 15% iShares S&P 500 (XUS)
- 15% iShares MSCI EAFE IMI (XEF)
- 10% iShares S&P/TSX Capped REITs (XRE)
- 30% iShares DEX Universe Bond (XBB)
- 10% Real-return bonds
4. Select your ETFs

- 20% iShares S&P/TSX Capped Composite (XIC)
- 15% iShares S&P 500 (XUS)
- 15% iShares MSCI EAFE IMI (XEF)
- 10% iShares S&P/TSX Capped REITs (XRE)
- 30% iShares DEX Universe Bond (XBB)
- 10% iShares DEX Real Return Bond (XRB)
4. Select your ETFs

- 3,000+ stocks in more than 20 countries and several currencies
- Real estate
- 800 government and corporate bonds of all maturities
- Inflation-protected bonds
- Total cost: 0.32%
STEP 5

Open your brokerage account
5. Open your brokerage account

• Big bank brokerages have similar options

• $50,000 should ensure you pay no account fees and get $10 trades

• Independent brokerages have lower fees and commissions

• Some offer commission-free ETFs
STEP 6

Place your ETF trades
6. Place your ETF trades

How to read an ETF quote:

ISHARES S&P/TSX CAPPED COMPOSITE INDEX FUND
XIC:TSX

<table>
<thead>
<tr>
<th>Last</th>
<th>Change</th>
<th>Bid (size)</th>
<th>Ask (size)</th>
<th>Volume</th>
<th>Day Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>$21.13</td>
<td>+$0.140 (0.66698%)</td>
<td>21.12 (2)</td>
<td>21.15 (170)</td>
<td>120,492</td>
<td>20.96 - 21.14</td>
</tr>
</tbody>
</table>

Show Level Two Quotes
6. Place your ETF trades

How to read an ETF quote:

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</tr>
</tbody>
</table>
6. Place your ETF trades

Assuming a $175,000 portfolio, a 20% holding in Canadian stocks is $35,000:

\[ \frac{35,000}{21.15} = 1,654.846 \text{ shares} \]

\[ \approx 1,650 \text{ shares of XIC} \]
6. Place your ETF trades

Place a **limit order** for 1,650 shares:
6. Place your ETF trades

- Trading volume has little to do with ETF liquidity
- Be aware of bid ask-spreads, which can be higher than commissions
- Always trade when market is open and avoid first and last few minutes
Rebalance your portfolio
7. Rebalance your portfolio

• Your portfolio will **stray from its target** asset mix as markets move

• **Rebalancing** means selling what has gone up and buying what has gone down

• **Can be done annually**, by thresholds or whenever you add a lump sum
7. Rebalance your portfolio

<table>
<thead>
<tr>
<th>Security</th>
<th>Current Allocation</th>
<th>Difference</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>iShares S&amp;P/TSX Composite</td>
<td>41,200</td>
<td>21.7%</td>
<td>1.7%</td>
</tr>
<tr>
<td>iShares S&amp;P 500</td>
<td>33,500</td>
<td>17.6%</td>
<td>2.6%</td>
</tr>
<tr>
<td>iShares MSCI EAFE IMI</td>
<td>32,300</td>
<td>17.0%</td>
<td>2.0%</td>
</tr>
<tr>
<td>iShares S&amp;P/TSX Capped REIT</td>
<td>22,500</td>
<td>11.8%</td>
<td>1.8%</td>
</tr>
<tr>
<td><strong>Total Equity</strong></td>
<td><strong>129,500</strong></td>
<td><strong>68.2%</strong></td>
<td><strong>8.2%</strong></td>
</tr>
<tr>
<td>iShare DEX Universe Bond</td>
<td>42,400</td>
<td>22.3%</td>
<td>-7.7%</td>
</tr>
<tr>
<td>iShares DEX Real-Return Bond</td>
<td>16,600</td>
<td>8.7%</td>
<td>-1.3%</td>
</tr>
<tr>
<td><strong>Total Fixed Income</strong></td>
<td><strong>59,000</strong></td>
<td><strong>31.1%</strong></td>
<td><strong>-8.9%</strong></td>
</tr>
<tr>
<td>Cash</td>
<td>1,500</td>
<td>0.8%</td>
<td></td>
</tr>
<tr>
<td><strong>$190,000</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
7. Rebalance your portfolio

<table>
<thead>
<tr>
<th>Investment</th>
<th>Current Allocation</th>
<th>Allocations</th>
</tr>
</thead>
<tbody>
<tr>
<td>iShares S&amp;P/TSX Composite</td>
<td>38,000</td>
<td>20.0%</td>
</tr>
<tr>
<td>iShares S&amp;P 500</td>
<td>28,500</td>
<td>15.0%</td>
</tr>
<tr>
<td>iShares MSCI EAFE IMI</td>
<td>28,500</td>
<td>15.0%</td>
</tr>
<tr>
<td>iShares S&amp;P/TSX Capped REIT</td>
<td>19,000</td>
<td>10.0%</td>
</tr>
<tr>
<td><strong>Total Equity</strong></td>
<td><strong>114,000</strong></td>
<td><strong>60.0%</strong></td>
</tr>
<tr>
<td>iShare DEX Universe Bond</td>
<td>57,000</td>
<td>30.0%</td>
</tr>
<tr>
<td>iShares DEX Real-Return Bond</td>
<td>19,000</td>
<td>10.0%</td>
</tr>
<tr>
<td><strong>Total Fixed Income</strong></td>
<td><strong>76,000</strong></td>
<td><strong>40.0%</strong></td>
</tr>
<tr>
<td>Cash</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>190,000</strong></td>
<td></td>
</tr>
</tbody>
</table>
7. Rebalance your portfolio

• Rebalancing encourages buying low and selling high
• It imposes discipline by discouraging market timing
• It keeps risk at a consistent level
• May enhance returns
• Always consider costs and taxes
STEP 8

Monitor your performance
8. Monitor your performance

• Most investors **don’t know** their portfolio’s rate of return
• Contributions and withdrawals make the **calculation difficult**
• Advisors and brokerages are often **unhelpful**
8. Monitor your performance

• Your brokerage statement shows only price changes, not dividends or interest

• This can lead to huge misunderstandings about your performance
8. Monitor your performance

iShares 1-5 Year Laddered Government Bond (CLF)

- October 31, 2010: $20.45
- October 31, 2013: $19.13
- Your brokerage would show a loss of $20.45 of 6.45% over those three years
8. Monitor your performance

iShares 1-5 Year Laddered Government Bond (CLF)

<table>
<thead>
<tr>
<th>Total Returns (%)</th>
<th>as of 31-Oct-2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Quarter-End</td>
</tr>
<tr>
<td>1 Month</td>
<td>0.66</td>
</tr>
<tr>
<td>3 Month</td>
<td>0.96</td>
</tr>
<tr>
<td>6 Months</td>
<td>0.49</td>
</tr>
<tr>
<td>YTD</td>
<td>1.59</td>
</tr>
<tr>
<td>1 Year</td>
<td>1.76</td>
</tr>
<tr>
<td>3 Year</td>
<td>2.50</td>
</tr>
<tr>
<td>5 Year</td>
<td>3.50</td>
</tr>
</tbody>
</table>

| NAV | 0.66 | 0.96 |
| Index | 0.65 | 1.01 |

MoneySense
STEP 9

Stay the course
9. Stay the course

• This is how the **smart money** invests

• Some asset classes will always be **underperforming**: that’s why we diversify

• **Forecasts** are usually wrong

• Your friends are only sharing their successes not their **failures**