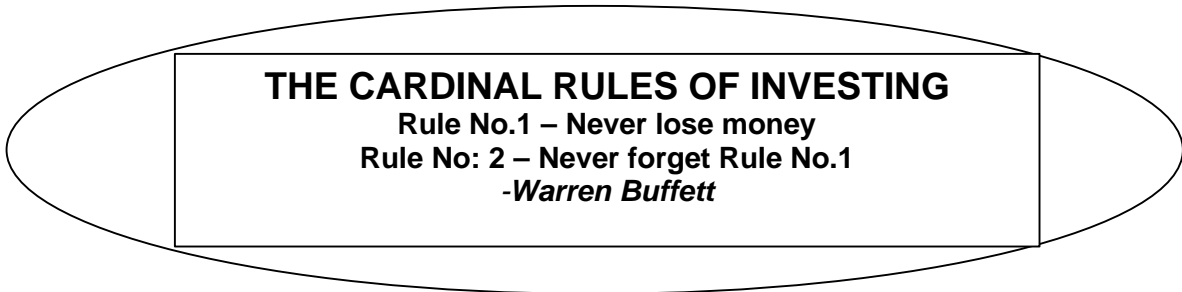


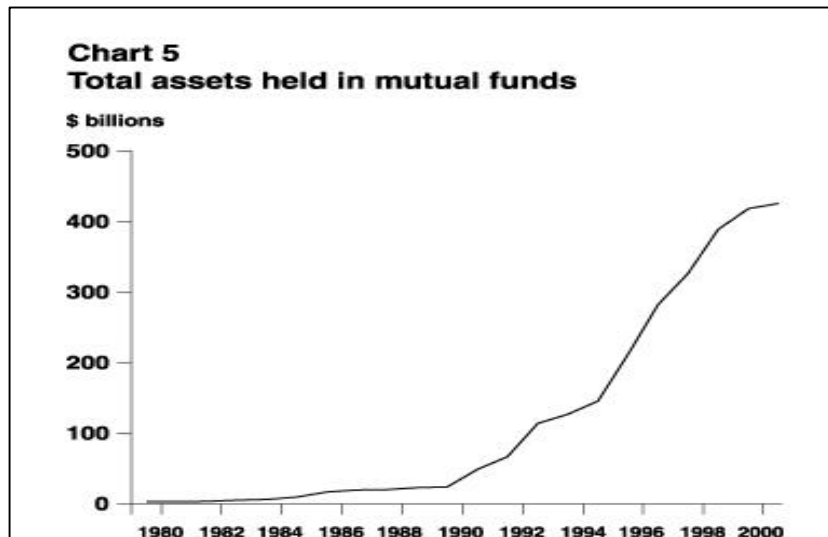
## Mutual fund investors- influencers, knowledge and behaviors



### INTRODUCTION

Money is regarded by most of us as a means to an end. As human beings we want to enjoy life -money allows us to have peace of mind, own a home and live a comfortable retirement. Admittedly, there are also those whom money represents power, influence fame, ego- satisfaction and social status. For the purposes of this Document we'll assume your financial plan is geared toward meeting more basic needs-your children's higher education, proper insurance (life, property, auto, liability, health, disability), savings for emergencies, good medical care and a host of other wonderful things money can provide.

Personal finance management is therefore a key aspect of modern living. If you're just barely getting by, Maslow's hierarchy of needs (see Attachment I) makes clear what you must do. If you're extremely wealthy then even low GIC rates can provide all your needs- sound financial management may still be important but not critical. For the large part of Canadian society in the middle, a sound financial plan is critical. Complacency is not a healthy characteristic. Once you have developed such a plan, the question of what to do with your savings arises. If you do not have the time, inclination, knowledge or patience to manage your own money, mutual funds are one possibility among a growing number of very strong competitors. (e.g. income trusts, REIT's, ETF's, index-linked GIC's and segregated funds). Indeed, since the precipitous decline in GIC interest rates, mutual fund growth in Canada has been exponential.



Mutual funds provide ease of purchase, diversification, flexibility, liquidity and professional management. But even mutual funds investing requires knowledge and periodic monitoring. Mutual funds have their own specialized vocabulary, cost structure, tax issues and conditions of sale. There are well over 3000 funds to choose from with different loads, tax considerations, fees, risk profiles, volatility, styles, mandates and of course, after-tax results. Changes in fees, deterioration in returns, a change in manager or an alteration in the method of distribution can dramatically alter the investment attributes and returns of a fund.

## **CANADIAN MUTUAL FUND INVESTOR PROFILES**

Economic theory assumes rational informed decisions are made. In practice this is an idealized model. Behavioural finance, recognizing that we are all too human, studies the real-world decisions of actual investors. For example, many Canadian mutual fund investors still don't realize that any fees are charged. A May, 1997 study by Scudder Funds of Canada found that 45% of Canadians who bought mutual funds during the reviewed year believed their funds didn't charge management fees at all; 8% were unsure. Worse, even those that are aware of the MER's existence have never thought about it in dollar terms. (According to Money magazine, the average Canadian equity fund MER is 2.1%; whereas the average U.S. MER is 1.41 %.)

An April 1999 Angus Reid telephone poll performed for the Canadian Securities Administrators found that:

- investors account for two-thirds of the Canadian adult population (these are investors who currently own a mutual fund, GIC, common shares, government bond or limited partnership)
- 74 percent of investors currently invests in mutual funds, the most common type of investment
- 26 percent of investors rely entirely on the advice of their financial advisers; 56 percent consider the advice of their advisers
- 51 percent had a household income of less than \$50,000
- 41 percent of investors had a poor understanding of MER's and 29 percent had a poor understanding of mutual fund sales charges

According to a Feb. 2002 report in the Globe and Mail, in 1999, Canadians used only 9 % of available RRSP contribution room of \$306 billion, indicating investors have a long way to go in making any contributions, let alone making regularly scheduled investments.

A February 2002 study for the Ontario Securities Commission showed that among investors who dealt with either a financial adviser or a financial institution only 53% of respondents said they receive information about fees and costs. According to an OSC

survey of 400 Ontarians by the Consumers Council of Canada, a disappointing 30 percent of investors receive information about how their advisers are compensated.

Another February 2002 poll by Ipsos-Reid/RBC Investments revealed that 70 % of **Canadians with a \$ 100,000 or more in financial assets do not have a written plan for the financial management of their estates upon death.** Such plans normally involve a tax plan, insurance, trusts and a will. Assets can include RRSP's, mutual funds, bonds, GIC's and stocks but also illiquid investments like a principal residence, a cottage investment properties, stamp collections and automobiles upon which tax might have to be paid by unprepared beneficiaries.

A Summer 2002 multiple-choice financial literacy test sponsored by Cartier Partners Financial Group found that two-thirds of Canadians are financially illiterate.

- Fully 46 per at percent incorrectly believe that the value of bond mutual funds increases when interest rates rise
- thirty-three percent wrongly believed mutual funds were protected by CDIC investor protection insurance.
- Eight percent got all 10 questions wrong. (the full test can be found at [www.cartierpartners.ca](http://www.cartierpartners.ca))
- Just one person out of the 4000 surveyed –an unidentified woman from Ontario- answered all 10 questions right
- 30 % got all 10 questions wrong

A 2002 Ipsos-Reid survey of 1000 Canadians concluded that 4 percent believed they were sophisticated investors, 38 percent above average, 49 percent claimed to be average and only nine percent admitted to having little or no investment knowledge. Either the test was too hard (which it wasn't), or Canadians are dramatically overconfident in their investing knowledge.

All in all, not a bright picture.

*“A restaurant that serves bad food can fool the public for only so long. Mutual fund companies, on the other hand, have a remarkable ability to sell funds with dismal returns –and get paid handsomely for it-year after year. This is especially true where banks are involved. Some bank-owned funds have awful records and exorbitant management fees but people get sucked in anyway because they couldn't be bothered to take a more active approach to investing. Many folks are content to show up at their branch during RRSP season, dump some money into the bank's balanced portfolio or growth fund and hope for the best.”*

- Peter Verberg

*Canadian Business, Feb. 4,2002*

On the lighter side, Jonathan Chevreau has classified mutual fund investors into 13 categories -- abbreviated descriptions follow:

The Dog's Breakfast: \$50,000 spread among 17 funds originally sold by a rookie salesperson, then some do-it-yourself no-loads, finally consolidated into self-directed RRSP at a discount broker.

The Sector Savant: This sector savant knows he can't choose individual stocks, preferring instead to lose money choosing the wrong industrial sector funds or regional equity funds.

The Bonus commission portfolio: Portfolio chock-full of high-MER, rear-end load funds that paid salesperson connector commissioned for selling at it

The New-fund junkie: This investor never saw a new-fund launch she didn't like

Last year's winners: Always in search of the next hot fund, tends to sell previously held dogs just as they're set to recover

Just show me the numbers Portfolio: Close cousin of Last year's Winners, this investor has never examined the actual holdings of any fund or investigated the manager behind it

The "Just in case" 50 fund Portfolio: Treats every fund like a stock, and therefore tries to diversify with no more than 2 percent weighting per fund just in case she misses out on a triple in India or quick double in Latin America

The "Been asleep five year's" Portfolio: Buy and Hold combined with no adviser or an indifferent adviser content with trailer fees

The "I don't know what I own" Portfolio: I think I own the Mackenzie Fund or is it the Trimark True North? Something like that. I don't know what it invests in; in mutual funds, I think. Stocks are too risky from me"

The global equity Junkie: Emerging markets, Asia, Latin America, U.S. small caps, global resources. So many countries, so little foreign content room.

The "I thought mutual funds always hold stocks" Portfolio: Investor is 83 and portfolio is 100 percent equity funds

The "I let the gurus Pick em' Portfolio: Not content with delegating stock picking to the pros, this investor even lets the gurus pick the funds, but forgets about the 1 percent fees on top of fees that entails.

The "Have my cake and eat it too" Portfolio: Torn between greed, envy and fear, investor is happy to double her fees in order to guarantee her principal against a stock decline and still make money if the bull market continues.

Source: "Jonathan Chevreau "The Wealthy Boomer-Life after Mutual Funds"

### THE TOP 10 MISTAKES

The above noted investor types actually quite accurately characterize the most common mistakes real-life mutual fund investors make. These are:

1. **overconfidence** regarding your true level of investment knowledge-

**setting unrealistic expectations of return** .In January, 2001 the OSC launched a dummy web-site which guaranteed a 30 % monthly return on a RRSP eligible "international debenture". The site had 16,000 hits, 11,000 visitors looked around the site and 12 people actually tried to send in their money!

2. **not planning**-preparing an **integrated financial plan** with time-phased quantitative objectives
3. letting **greed and avarice** determine what you buy-chasing last years highly promoted winners with a heavy dose of irrational exuberance  
*"Bulls make money, bears make money, but pigs seldom do."*  
-anonymous
4. **not understanding the investment products** you buy (or hold) and their associated fees, risks, terms and conditions
5. **not comprehending or adhering to time-proven investment principles**-compounding, low investment costs, diversification, asset/sector allocation and periodic portfolio review-being unduly swayed by brokers, advisers, shills and slick marketing brochures that may not have your best interests of mind
6. **myopic loss aversion**-letting fear, panic or rashness determine what and when you sell-obsessing about volatility can get in the way of your goals. It may cause you to invest too conservatively. Volatility also may lead you to sell an investment based on short-term performance rather than on how this sale will help you reach your goals. In short, volatility can prevent you from seeing the forest for the trees.
7. **tax-illiteracy** -not planning for tax-efficiency and not knowing your actual after-tax rate of return on your investment dollars

*"I often say that when you can measure what you are speaking about, and express it in numbers, you know something about it; but when you cannot measure it, when you cannot express it in numbers, your knowledge is of a meagre and unsatisfactory kind; it may be the beginning of knowledge, but you have scarcely in your thoughts advanced to the state of Science, whatever the matter may be "*  
- Thomson, [Lord Kelvin] William (1824-1907)

A high proportion of investors unwisely hold bond funds in their unsheltered accounts and tax-advantaged equity funds in their RRSP.ETF index funds have no turnover unless there is a change in the index so they are very tax-efficient with low trading costs. Plus, ETF's don't have to deal with redemptions, which in a bear market can mean high brokerage fees (not part of MER).

8. trying to **time the market**

*"Good timing can't be beat;  
it just can't be done"*  
- John Markene, Amer. Assoc. of Individual Investors

9. **blindly following vastly oversimplified industry catch- phrases**-"buy and hold", "dollar- cost- average", "stay fully invested"
10. **not facing reality** regarding (a) your own loss/ risk tolerance (b) your unwillingness to admit mistakes & deal with them [**cognitive dissonance**]

These can be encapsulated into three broad categories:

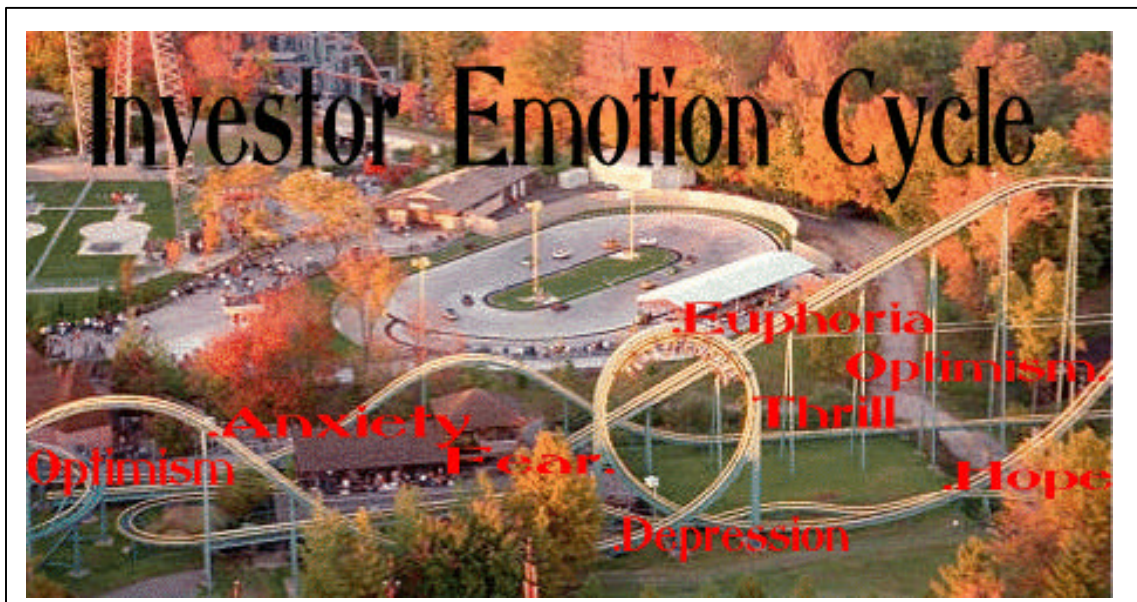
- A. industry sales and marketing practices-the influencers

- B. financial literacy -education and knowledge of primary investment products and terminology, basic economics, market dynamics, elementary portfolio theory, simple risk analysis, high school math and personal taxation situation
- C. emotional behavior and psychology

### INVESTOR BEHAVIOUR

It should be noted that the three categories are related and interactive. The use of celebrity skills, biased advice based on lucrative trailer fees, incomplete financial reporting and non-representative return rate information, aggressive sales practices and finely tuned marketing can cause investors financial grief. An effective partnership with the media has helped fund companies grow and expand. Lack of investment knowledge can drive behavior and emotions often overwhelm even knowledge and logic. Education, keeping current and possibly employing a competent independent trusted adviser (finding one is easier said than done and getting harder each year) are key investment success factors. Truly independent financial advisors are an endangered species in Canada. Formerly independent financial planning firms are being swallowed by huge national consolidators, some of whom blur the lines of independence by promoting in-house or "proprietary" wrap programs thus adding to conflict of interest concerns..

The principles for maintaining financial health are similar to those for maintaining medical health-eat well, exercise, be alert and conduct annual check-ups. The emotional aspect is perhaps a little trickier. Equity investing puts an investor through a roller coaster ride of emotions.



Let's take a look at how some of these mistakes and emotions play out in practice. If you pay too high an MER you are almost certain to underperform. Bond funds for example,

have a 100 percent negative correlation of return vs. MER. Although the effect of the MER appears negligible, it's true effect over time is very significant.

- The first year you lose 2.3 %.
- The second year you lose 2.3 % of the remaining 97.7 %,
- the third year you lose 2.3 % of the remaining 95.4 % and so on.

This occurs because of the compounding nature of the fees levied- the dark side of compounding, fund Companies don't tell you about. After 25 years with a 3 % MER fund you would get half the profits and the fund the other half! [how's that for equality?]. Shop around and consider a portfolio of low-cost/low turnover Exchange traded index funds (ETF'S). Several observers and researchers have concluded that for most investors, costs are on at least a par with investment strategy and asset allocation in determining end returns.

*"Partly because Canadians have been under- educated and complacent about fund fees, an odd situation has evolved: the equity funds with the most assets and investors are the funds with the highest MER's and several of these funds have significantly lagged the TSE 300 in recent years."*

- Andrew Bell, *Mutual Funds For Dummies For Canadians*

According to John Bogle, Vanguard fund Company founder, for small retail investors, low investment costs (low MER and low trading costs) can be the single most important factor in long-term pre-tax investment performance. It has been well documented that:

- Investors with less education and knowledge end up paying more than those with education and knowledge
- When investment product sellers know more about a product than buyers, investors end up with an inferior product at too high a price

If you are **underdiversified**, a bear market can savage your portfolio and the whopping losses can cause depression. **Buying the flavor- of- the- month fund** almost always means you're buying at the market peak. Avoid the temptation to chase returns-don't be a dot.bomber. **Following the herd** probably won't necessarily get you closer to your financial goals. Selling when your fund falls 10 % is most likely an overreaction. It may also trigger deferred sales charges further reducing returns. Keep **panic** in check. Understandably, some investors sell their stocks during a crisis hoping to avoid further losses. But this strategy can sometimes backfire, as the Chart below demonstrates.

Event	Initial market Response (S&P 500 Index)	One month from low	Three years from low
1950 Korean War	-12.0%	+9.0 %	+36.0 %
1962 Cuban Missile crisis	-9.4 %	+15.6 %	+70.7 %
1991 Iraq Bombing	-5.7%	+15.4 %	+54.7 %

**Over-diversifying** by holding 15 or 20 funds likely means you're hurting returns and paying excessive fees-don't let aggressive sales pitches influence your investments. What gets measured gets managed -be sure to know what your annual rate of return is, not the funds'. Understand that trailer fees can cause conflicted advice - have your adviser explain his recommendations to Buy, Sell or switch. Useful decision/educational Checklists are available at [www.investorism.com](http://www.investorism.com) .No one likes unpleasant surprises. If you have a low risk tolerance, minimize exposure to narrow sector funds-the result will be less stress and anxiety. Never chase last years' winners or hot sector-history has shown they rarely maintain exceptional performance. Greed is not a virtue. Keep **euphoria** under control. Always look at after-tax returns; high portfolio turnover results in excessive taxable gain distributions. Unexpected tax liabilities in April can cause insomnia. If you're retired or in ill- health don't get too excited about buy and hold promotions. Limit your quantity and nature of equity investments if you can't handle the downside risk or its consequences. Several fund companies offer basic self-assessment risk tolerance questionnaires that can be useful. Quantifying a worst-case scenario in dollars and sense usually makes the decision easier. Decision analysts also recommend thinking of uncertainty in terms of *confidence intervals* rather than point estimates. Be honest with yourself and your adviser.

*"A study done in 2001 by Financial Research Corp. (FRC) found that on average funds do about 20 percent better than most fund investors in those very same funds. How is that possible? It's the phenomenon of chasing returns. Most investors jump into a fund after it has made most of its gains, so a fund can have, say a 15 percent Annualized rate of return yet most of its investors will see only a 12 percent annual gain or less. It's long been known that investors don't hold their funds long enough, and have a nasty habit of investing just after a fund's top performing quarter, when most of the gains have been made. The FRC study found on a three-year rolling return basis from January 1990to March 2000 the average U. S. mutual funds' mean three-year return was 10.9 percent while the average invested dollar gained only 8.7 percent. FRC also reports that American fund investors hold their funds for a fraction under three years. Four years ago, their patience lasted five and a half years. There's no reason to think the Canadian experience is much different."*

*-Source: Atkinson H.J., "The New Investment Frontier"*

Beware of fees, especially deferred sales charge (DSC) funds also known as back-end loaded funds -they frustrate and cloud your decision-making ability to sell and can detract from returns. Insult can be added to injury if the DSC charge is levied against the original

investment and your fund has fallen in value. Study the fund Prospectus, Annual Information Form and Annual report before you invest. Buy (or sell/switch) only on the basis of facts and analysis, not the advisers soothing voice or a colorful brochure/ video .He may be pursuing commissions rather than returns. Ask your adviser or fund company to provide you with certain key metrics like worst twelve-month return, the standard deviation and the Sharpe (or Sortino) ratio and explain them to you- ask questions, it's your money. Avoid buying a fund whose metrics you don't know or comprehend. Most of these important metrics are not required by regulators to be included in the Prospectus. If the fund has a high standard deviation expect high volatility of returns- do you really enjoy roller coaster rides? Switching funds every three years (typical) can be unwise and lead to poor returns; equity investing requires a longer-term perspective and some degree of reasonable patience. Be prepared to take a loss on chronic losers, admit the mistake, learn from it and let your ego take a back seat to reality. Pride can be a hindrance. "**Anchoring**", a tendency of investors to give too much credence to their most recent experience, immobilizes investors, preventing them from making adjustments when new information becomes available-a form of psychological inertia. Remember, the idea is to buy low and sell high NOT to sell low and buy high.

In an article entitled "When clients don't listen ", Financial Post columnist Jonathan Chevreau gave some cogent examples of clients who ignored their advisers. In the tech bubble some investor's bombarded advisers with hot tips for dubious securities selling on the NASDAQ, CDNX and even the NASDAQ Bulletin Board. One investor refused to lighten up on Nortel even when valuations became outrageous. Clients bullied advisers into implementing their ideas like buying the hot biotech stock that they heard about through a tip (maybe on a Internet Chat-Line, from a taxi driver or brother-in law?). **Acting on hot tips** has not proven to be a robust investment practice. Too many folks switched their well-balanced portfolios into tech portfolios .Ten percent over the long-term just couldn't compete with 40 percent or more from an IPO. One adviser recalls a client who opposed his recommendations to lighten up on global telecommunications funds during the bubble-in October he cashed out on equities just as the market was rallying. Today too many investors face statement shock as they see their portfolios down 30 percent to 50 percent. Some still hope their funds or stocks will return to former levels. Carleen Gray Hewett an adviser with Canaccord Capital Corporation summed it up neatly" People only saw the upside but didn't fully comprehend how the downside would impact their portfolios, financial objectives and even their sleep. The term risk tolerance might better have been named loss tolerance." **Lack of discipline** coupled with greed and **hope** makes a toxic mixture to be sure-depression isn't pleasant.

**Overreaction** is another negative investor behavior. U.S.-based Low fee fund Company Vanguard has a problem. Its CEO John Brennan is concerned its investors, 70 percent of which in a recent poll didn't know that bond prices fall when interest rates rise, are piling into bond funds. Brennan expressed it this way "It's no different than stocks in 1999. The risk is disappointment and surprise". Of \$ 34 billion of net cash inflows in the first three quarters of 2002, two-thirds went into bond funds. Brennan cautions that investors who have moved entirely into bonds since March, 2000 are "investing by looking in the rearview mirror and... probably moved to bonds too late to get the returns they were seeking". So concerned is Vanguard about this emotional response to the bear market in equities that it has posted warnings on its Web site.

## **A WORD ABOUT HOPE AND OPTIMISM**

It's human nature to hope and be optimistic. Hope is the opposite of negativity. Negativity in life can lead to anger, disappointment and depression. Ironically, in the stock market, hope is a hindrance, not an aid. Once you take a position in a fund or stock, you obviously want that fund to appreciate. If the fund or stock that you bought is a real value, possesses solid fundamentals and you bought it right -- you should be content to sit with that fund in the knowledge that over time its value will unfold without your help, without your hoping. So, in the case of this fund, you have value on your side -- what you need is patience (and perhaps steely nerves) and self-confidence. In the end, your discipline will pay off with a higher price and a capital gain for you.

Any time you find yourself hoping in the investment business, the odds are that you are on the wrong path -- or that you did something wrong that should be corrected. This is counter-intuitive but true. Hope will keep you holding a stock that is headed down. Hope will keep you from taking a small loss and instead, allowing that small loss to develop into a large loss. In the stock market, hope gets in the way of reality. Remember, when a fund falls 50%, it has to rise 100% to get back to where it started. This **fear of regret** gets in the way of common sense. Independent advisors can be a help in these circumstances to bring discipline in and cast emotions out. One of the first rules in investing is "Don't take the big loss." In order to do that, you've got to be willing to take a small loss. If the stock market turns bearish, and you're staying put with your whole position. and you're HOPING that what you see is not really happening -- then welcome to prolonged anxiety. In this situation, all your hoping isn't going to save you or make you a dime. In fact, in this situation hoping is the devil that bids you to sit -- while your mutual fund portfolio goes down the drain. Pessimism in fact produces attractive prices and valuations ;optimism is the enemy of the rational buyer. In your investing, forget the siren, hope -- instead embrace cold, clear reality and hard facts. The combination of optimism and overconfidence is a potent brew which causes investors to underestimate risks and overestimate their knowledge.

Investors also practice a behavior called **nonlinear –weighting of probabilities**. Earning \$1000 with a 1 % chance of success will be chosen over a gift of \$10. This is the basis for racetracks, casinos and lotteries not investments. This is also why an investor will purchase a high MER actively managed mutual fund over a low MER ETF index fund despite the fact that the vast majority of mutual funds fail to beat their benchmark index over the long-term. The small chance of beating the index is the irrational motivator for this decision. This in spite of the fact that the ETF is also more tax- efficient due to its low turnover ratio. Optimism and hope are deep-rooted human behaviours that can hurt investment performance.

### THE IMPACT OF TIME

Time enters the investment equation in several important ways. Short-term money should not go into equities or volatile investments. The earlier in life you invest the greater the impact of compounding. (estimates have put the number of RRSP investors at 75 % investing 10 days before the March 1 deadline thus losing over a year of compounding --**procrastination** can be expensive). Market timing has been difficult to achieve even for seasoned investors so it's usually best to stick with an intelligent buy-and hold- strategy. Time also mitigates risk. Dr. M. Milevsky of York University defines financial risk as the probability that you will look back in time -with 20/20 hindsight -and regret the original investment decision. Perhaps it would have been better to purchase a GIC than an equity fund? It is meaningless to talk about risk without delineating a time horizon for the investment. Using this definition, a standard GIC may actually be riskier

than a well-diversified low MER equity fund over the long-term due to inflation, taxes on interest income and generally lower return rates. Over the course of a single year, a GIC may win out. However, history has convincingly demonstrated that the probability of regret in GIC investing is relatively high vs. stocks over a 10,15 or 20 five-year period. As the time horizon increases, the probability of a shortfall decreases exponentially. Despite the daily, monthly or annual volatility, statistical theory supports the notion that the longer the holding period, the greater the chance that the mean return of the asset class will prevail. This is one of the arguments in support of an intelligently applied buy and hold strategy. It is also an argument in favor of equities, since as an asset class they generally outperform GIC's (pre- and especially after-tax) over the long-term.

## CONCLUSION

We often hear about the many benefits of owning an actively managed mutual fund. Fund Company marketing hype, some bordering on false advertising, is a regular part of the RRSP season. "Buy and Hold", "Prosper with us", "Freedom 55", "Convenient investing" "Enjoy the benefits of dollar cost averaging" and "Leave investing to the pros" and "3 year annualized return 22.1%!"[In the latter case, the return consisted of a stellar 1999 performance but losses in 1998 and 2000: Remember-figures never lie but liars figure]. Skills can be persuasive. . Also, fund Companies tend to come out with higher-risk funds as the trend grows. Until the late 1990s, tech funds were generally broadly diversified within tech. Thus, you got semiconductors, software companies, networking, and PC and server makers. Some funds even threw in health-care or media stocks. However, as time went on, Internet funds, emerging tech funds, biotech funds and more funds that were narrowly focused on a single industry. The reason is that a more aggressive fund could attract more assets by putting up huge short-term numbers, and greedy investors gave less thought to risks. Investors need to understand not just the financial products but how they fit into a long-term financial plan. Be an informed investor-do your homework, that's what the Prospectus is for. Never forget the old industry barb," Mutual funds are sold, not bought".

Canadian investors are not as financially literate as they believe they are. More education is urgently needed. Ministries of Education need to beef up financial training at elementary and high school levels and regulators /SRO's must do a lot more investor education and protection in the form of legislation, monitoring, enforcement and aggressive litigation with penalties that stick. Investors also need to be proactive, critical, and be more demanding of advisers, brokers and fund Companies'. Mutual fund distributions and how they'll be taxed can have a major impact on your long-term results. The AIC Value Fund, among a few others, stresses tax-efficiency and low portfolio turnover. Be sure to incorporate basic tax planning in your investment program.

A variety of economical quasi-independent financial Newsletters provide buy/sell advice both electronically and hardcopy. Specialized books on personal investing, RRSP/financial planning and tax optimization are available. The media have introduced dedicated financial channels such as CNBC/ROBTV. which have some educational elements (but also excessive stock cheerleading). The Internet has opened up of vast research pool to individuals. Canada has several good web sites, including [www.investorlearning.ca](http://www.investorlearning.ca). One U.S. site, [www.fundalarm.com](http://www.fundalarm.com) is filled with facts, barbs, jabs and gossip about the world of mutual funds. Other trends such as discount brokers, e- trading, a wide selection of low MER exchange traded funds and extended hours

trading have also given individual investors more personal power. The new OSC site [www.fairdealingmodel.com](http://www.fairdealingmodel.com) (use of this site requires the Micromedia Flash 6 plug-in) provides a good source for understanding the adviser-investor relationship. It represents a departure from the past OSC practice of simply treating people as clients instead of individuals who deserve and need to be protected and informed.

Smart investing, starting from your 20's is essential for contemporary living. You need to learn about mutual funds, stocks, bonds, RRSP's, RESP's and debt management. It's not that complicated and can even be fun. Longer lifetimes, the threat of inflation, unexpected expenditures, increasing energy costs, the rising cost of health-care and who knows about the future direction of taxes, all make intelligent long-term investment crucial. Canadian mutual fund investors must spend some time on financial education, preparing a specific, time-linked financial plan and making investments with a clear understanding of goals and how to manage risk for optimum financial return. Additionally, Canadian investors simply must get more tax sensitive and smart. Other parts of the integrated plan must include insurance and debt/liabilities. Investing in mutual funds when you're paying 18 percent + non-deductible interest on a credit card balance isn't the smartest use of cash. (during the third quarter of 2002, 65.2% of Canadian cardholders held a balance on their card suggesting that credit card interest rates were being paid on \$21.25 billion). Contemporary RESP's provide a tax-efficient way to save for your children's higher education and coupled with Government grants are a very attractive investment vehicle. Spousal RRSP's permit not only tax-deferral but also income-splitting if one spouse is in a significantly higher tax bracket. A penny saved is a penny earned.

**Emotions** play a very large role in degrading long-term returns. If you need a independent financial planner, by all means use one but be sure he/she is a fit with your personality, level of knowledge and loss /risk profile and is truly independent. Ensure advisers and mutual fund companies earn your trust before freely giving it. As investor advocate Joe Killoran says "**DON'T trust any advice until you autopsy the PROFILE of the practitioner behind it**". The Adviser PROFILE one-pager on [www.investoriam.com](http://www.investoriam.com) clearly discloses what licensing/advice limitations an investor might face dealing with a particular adviser. The more knowledge, experience and support you have, the less likely you are to let emotions drive your investment decisions. Never buy a mutual fund you don't understand or feel comfortable with. If something sounds too good to be true, run don't walk. Be aware and fully conscious of how psychology can impact returns. Caveat emptor. Control your own destiny, or somebody else will.

## **DISCLAIMER**

**Information contained herein is obtained from sources believed to be reliable, but the accuracy is not guaranteed. The material does not constitute a recommendation to buy, hold or sell. The purpose of this Document and others in the series is to educate investors by bringing together personal finance information from a variety of sources. It is not intended to provide legal, investment, accounting or tax advice and should not be relied upon in that regard. If legal or investment advice or other**

**professional assistance is needed, the services of a competent professional should be obtained.**

**RECOMMENDED READING**

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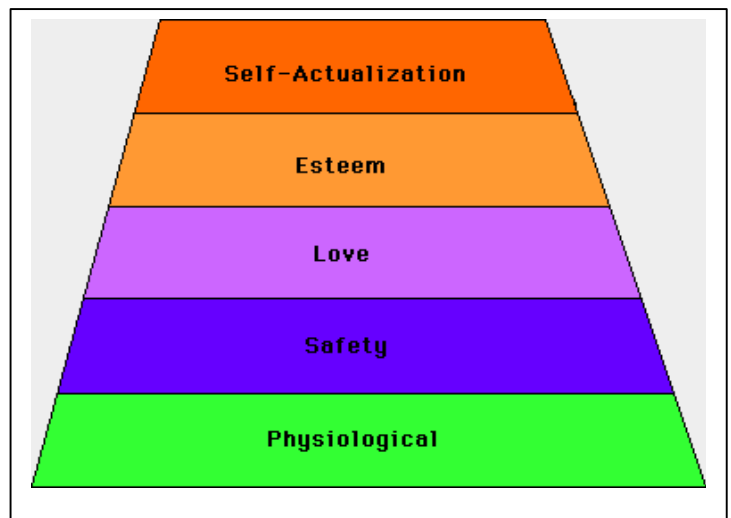
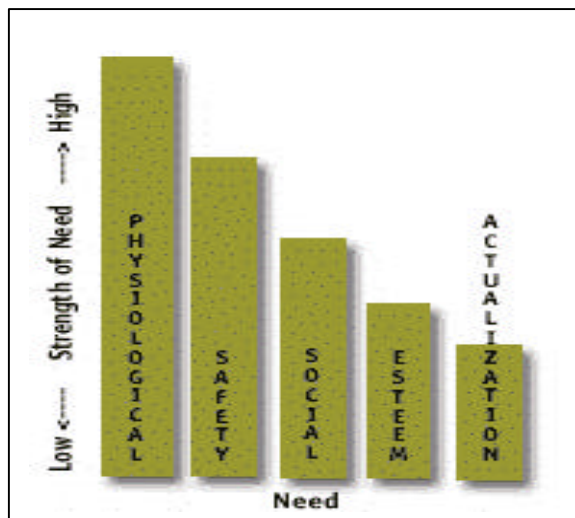
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## Attachment I Maslow's Hierarchy of Needs



Abraham Maslow (1908-1970), the noted psychologist, motivation researcher and educator, is known for establishing the theory of a hierarchy of needs, writing that human beings are motivated by unsatisfied needs, and that certain lower needs must be satisfied before higher needs can be satisfied. Maslow studied exemplary people such as Albert Einstein, Jane Addams, Eleanor Roosevelt, and Frederick Douglas rather than mentally ill or neurotic people. This was a radical departure from two of the chief schools of psychology of his day; S.Freud and B.F. Skinner

Maslow's hierarchy of needs was an alternative to the depressing determinism of Freud and Skinner. He felt that people are basically trustworthy, self-protecting, and self-governing. Humans tend toward growth and love. Although there is a continuous cycle of human wars, fraud, deceit, etc., he believed that violence is not what human nature is meant to be like. Violence and other evils occur when human needs are thwarted. In other words, people who are deprived of lower needs such as safety, may defend themselves by violent means. He did not believe that humans are violent because they enjoy violence or that they lie, cheat, and steal because they enjoy doing it.

According to Maslow, there are general types of needs (physiological, safety, love, and esteem) that must be satisfied before a person can act unselfishly. He called these needs "deficiency needs." As long as we are motivated to satisfy these cravings, we are moving towards growth, toward self-actualization. Satisfying needs is healthy; blocking gratification makes us sick or evil. In other words, we are all "needs junkies" with cravings that must be satisfied and should be satisfied. Needs are prepotent. A prepotent need is one that has the greatest influence over our actions. Everyone has a prepotent need, but that need will vary among individuals. A teenager may have a need to feel that he/she is accepted by a group. A drug addict will need to satisfy his/her cravings for drugs and will not worry about acceptance by other people. According to Maslow, when the deficiency needs are met:

*At once other (and higher) needs emerge, and these, rather than physiological hungers, dominate the organism. And when these in turn are satisfied, again new (and still higher) needs emerge, and so on. As one desire is satisfied, another pops up to take its place.*

### **Physiological Needs**

Physiological needs are very basic needs such as air, water, food, sleep, shelter, etc. When these are not satisfied we may feel sickness, pain, discomfort, irritation etc. These feelings motivate us to alleviate them as soon as possible to establish homeostasis. This is characterized by hard work and modest savings. Once they are alleviated, we may think about other things.

### **Safety Needs**

Safety needs have to do with establishing stability and consistency in a chaotic world. These needs are mostly psychological in nature. We need the security of a home and family. However, if a family is dysfunctional, i.e., an abusive husband, the wife cannot move to the next level because she is constantly concerned for her safety. Love, belongingness and investing have to wait until she is no longer cringing in fear.

### **Social (Love) Needs**

Social needs and belongingness are next on the ladder. Humans have a desire to belong to groups: clubs, work groups, religious groups, family, trade Associations, etc. We need to feel loved by others, to be accepted by others. Extra money allows us to participate and mix in ever sophisticated social and business circles. Perhaps we trust advisers so as not to offend them.

### **Esteem Needs**

There are two types of esteem needs. First is self-esteem which results from competence or mastery of a task. Second, there's the attention and recognition that comes from others. This is similar to the belongingness level, However, wanting admiration has also to do with the need for recognition and power. People who have all of their lower needs satisfied, often drive expensive, foreign cars because doing so raises their level of esteem. Money provides the basis for these expensive needs and tastes. Greed raises its head here.

### **Self-Actualization**

The need for self-actualization is "the desire to become more and more what one is, to become everything that one is capable of becoming." People who have everything can maximize their potential. They can seek knowledge, peace, esthetic experiences, self-fulfillment, etc. It is usually the middle-class to upper-class who lead charitable organizations, assist poverty groups, fight injustice, etc.