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Your Financial Goals

Yes, you want to make the big bucks. Or maybe you just want to get back the big bucks you lost in stocks during a *recent market correction* (a short period of falling prices usually accompanied by lots of volatility). Either way, you want your money to grow so that you can have a better life.

But before you make reservations for that Caribbean cruise you're dreaming about, you have to map out your action plan to get there. Investing in stocks can be a great component of most wealth-building programs, but you must first do some homework on a topic that you should be very familiar with — yourself. That's right. More than ever before, you need to understand your current financial situation and clearly define

your financial goals as the first steps to successful and careful investing.

Here's an example. Steve had a million dollars' worth of Procter & Gamble (PG) stock and was nearing retirement. Steve wondered about selling this stock and becoming more growth-oriented by investing in a batch of *small cap* stocks (stocks of a company worth \$300 million to \$2 billion). Because Steve already had enough assets to retire on at that time, getting more aggressive wasn't necessary. In fact, Steve had too much tied to a single stock, even though it was a solid, large company. What would happen to Steve's assets if problems arose at PG?

A diversified stock portfolio should include multiple stocks (more than 20) from various sectors and countries. Shrinking his stock portfolio and putting that money elsewhere — by paying off debt, adding a guaranteed investment certificate (GIC) from a Canadian bank, or buying a U.S. Treasury bill (a fixed-income security) for diversification, for example — seemed obvious.

This chapter is undoubtedly one of the most important chapters in this book. At first, you may think it's a chapter more suitable for some general book on personal finance. Wrong! The greatest weakness of unsuccessful investors is not understanding their financial situations and how stocks fit in.

People should stay out of the stock market if they aren't prepared for the responsibilities of stock investing, such as regularly reviewing corporate financial statements and the progress of the companies they invest in.

Investing in stocks requires balance. Investors sometimes tie up too much money in stocks, putting themselves at risk of losing a significant portion of their wealth if the market plunges. This approach is especially dangerous for the many Canadians who hold on to excessive personal debt, which has been rising nationally over the years. Then again, other Canadian investors place little or no money in stocks and therefore miss out on excellent opportunities to meaningfully grow their wealth and keep up with inflation.



Canadians should make stocks a part of their investment portfolios, but the operative word is *part*. Most investors hold a balanced portfolio, composed of stocks, bonds, and other financial assets. You should let stocks take up only a *portion* of your money. A disciplined investor also has money in bank accounts, investment-grade bonds, precious metals, and other assets that offer growth or income opportunities. Diversification is the key to minimizing risk. (For more on risk, see Chapter 3.)

Different Types of Financial Goals

Consider stocks as tools for living, just like any other investment — no more, no less. Stocks are among the many tools you use to accomplish something — to achieve a goal. Yes, successfully investing in stocks is the goal that you're probably shooting for because you're reading this book. However, you must complete the following sentence: "I want to be successful in my stock investing program to accomplish ____." You must consider stock investing as a means to an end.

Know the difference between long-term, intermediate-term, and short-term goals, and then set some of each (see Chapter 2 for more information):

- *Long-term goals* refer to projects or financial goals that need funding more than ten years from now.
- *Intermediate-term goals* refer to financial goals that need funding five to ten years from now.
- *Short-term goals* need funding less than five years from now.



Stocks, in general, are best suited for long-term goals such as achieving financial independence (think retirement funding), paying for future college or university costs, or paying for any long-term expenditure or project.

Some categories of stock (such as conservative or large cap) may be suitable for intermediate-term financial goals. If, for example, you'll retire six years from now, conservative stocks combined with some quality fixed-income investments can be appropriate. If you're optimistic (*bullish*) about the stock market and confident that stock prices will rise, go ahead and invest. However, if you're negative about the market (*bearish*) and believe that stock prices will decline, you may want to wait until the economy starts to forge a clear path. To explore some exciting and emerging megatrends, sectors, and industries within sectors, flip to Chapter 6.



In recent years, investors have sought quick, short-term profits by trading and speculating in stocks. Lured by the fantastic returns generated by the stock market in the original dot-com and internet 2.0 eras (about when Meta Platforms and Alphabet, formerly known as Facebook and Google respectively, came to town) investors saw stocks as a get-rich-quick scheme. Understanding the differences among *investing*, *saving*, and *speculating* is important. Which one do you want to do? Knowing the answer to this question is crucial to your goals and aspirations. Investors who don't know the differences tend to get burned. The following will help you distinguish among these actions:

- ***Investing* is the act of putting your current funds into securities or tangible assets to gain future**

appreciation, income, or both. You need time, knowledge, and discipline to invest. The investment can fluctuate in price but has been chosen for long-term potential.

- ***Saving is the safe accumulation of funds for a future use.*** Savings don't fluctuate and are generally free of financial risk. The emphasis is on safety and liquidity.
- ***Speculating is the financial world's equivalent of gambling.*** An investor who speculates is seeking quick profits gained from short-term price movements in a particular asset or investment. In recent years, many folks have been trading stocks (buying and selling in the short term with frequency), which is in the realm of short-term speculating.

These distinctly different concepts are often confused, even among so-called financial experts.

Canadians in Their 20s and 30s: How to Set the Foundation

One key piece of stock investing is understanding how your age will influence your stock-investing decisions.

Canadians in their 20s and 30s are a logical place to begin. This cohort enjoys a tremendous luxury in addition to being young — they have a long-term time frame before retirement comes into the picture. If you're young, the amount of funds you can allocate to stock investing is a lot greater than if you are an older Canadian. That's because you can ride any stock market corrections and storms that will come along from time to time. In fact, stock market turbulence creates an ideal opportunity to buy low and sell high, or just buy low and hold for now. The younger you are, the more opportunities you have to rinse and repeat this dynamic process. That's a lot better than ending up at the cleaners.

Another luxury a young Canadian stock investor can enjoy is the development of a mindset with a focus on investment planning, a critical success factor in stock investing. *Planning* in this case means taking the time to master the fundamentals of stock investing and to learn from mistakes. If you do so, the invariable hiccups and slumps in stock prices won't jeopardize your entire stock portfolio because you will have a longer time frame to recoup any losses and a more confident and less fearful mindset. As long as you embrace the reality, opportunity, and risks presented by stock market volatility, this is the time in life to invest a bit more aggressively.

With a better understanding of your net assets, cash inflows and outflows, and personal goals and investment return expect-

tations, you're poised to make better sense of your investing options. These options include equities as well as bonds, real estate, and other areas you can park your hard-earned cash into. The younger you are, the more risk you can tolerate and the more compounding of returns you can take advantage of. This is where you begin the even more fun part of your stock-investing journey.

Determine the right allocation to stocks and other equities

Whatever age you may be, most of the principles in this book will apply. In other words, this book is age-agnostic. However, one important exception is how age relates to your risk tolerance and appetite and therefore how much you devote to stocks.



One key concept is simple: the younger you are — say, in your 20s and 30s — the more risk you can afford to take on. In fact, *failure* to seize an opportunity to make outsized returns, due especially to the power of compounding and reinvested returns, is itself a risk. Inflation is also an enemy because it can quickly eat up cash savings.

This section outlines some general guidelines for optimal equity-asset allocations relative to your young age. It

introduces the concepts of passive and aggressive investing, and taxation, although you'll hear more about those things in later chapters as well.

To be sure, stocks are riskier than bonds, but that's over shorter time frames, when you're likely to run into significant price volatility. Long-term history shows time and again that dips in the stock market are invariably made up after some time passes.



A prevailing view, and these are just judgement calls, is that Canadians in their 20s and 30s should have about 70 percent in equities and the balance in fixed-income investments such as bonds. If this is held in a tax-free savings account, or TFSA, the ratio in equities could be even higher. TFSAs in the context of stock investing are introduced in the next section.



Because younger Canadians can afford, time-wise, to take a more aggressive and less risk-averse stance on stocks, they're more prone to look for growth stocks and stories. They're likely, even more than older investors, to be familiar with stocks of growing technology companies such as Twitter, Amazon, Spotify, and Apple. However, anyone in this age cohort shouldn't put an excessive amount of money into one particular area, such as going all-in for growth stocks,

which is a category known for high volatility. In other words, it's important to diversify, especially if you're just learning the stock-investing ropes.

When it comes to choosing one type of equity instrument over another, equity mutual funds aren't a great choice as compared to stocks or ETFs (exchange-traded funds). Mutual funds do not typically generate high growth. They also come with higher and often hidden fees that eat into your returns. They're more expensive than ETFs. Although they're less volatile during downturns, they often defeat the purpose of growth investing. Equity ETFs, on the other hand, at least offer you better growth prospects. Equity mutual funds may bury you in a sea of fees and offer you low-end returns.



Start off by investing in big picture themes

The Internet of Things. Cannabis and marijuana. Electric vehicles. Stock markets in China and the rest of Asia. Even the blockchain. These are but a few of the exciting and innovative themes, concepts, and stories that drive investment headlines worldwide today. Handled properly, stock investing in these areas can provide equally exciting returns. Chapter 6 provides you with insights on how to seize investment opportunities in

some of these new domains. It also discusses even more traditional but continuously growing sectors and industries, such as healthcare, travel, real estate, and resources.

But if you're in your 20s or 30s, your most significant investments likely to compete with and complement stock investing are investments in real estate and your education, including educating yourself in stock investing.

Home sweet home

In much the same way that equity investing does not have to be restricted to pure stock investing, what with the availability of alternatives such as equity ETFs and mutual funds, real estate investing can vary as well.

For example, you might invest in a home, condominium, or commercial or residential investment property. Yet once again, the stock market offers alternatives to even these traditional investment opportunities. Real estate investment trusts (REITs) are traded on Canadian and U.S. stock exchanges and relate to all types of real estate — malls, apartments, offices, and even prisons. With the current frothy and often inaccessible Canadian real estate market, especially in cities such as Toronto and Vancouver, it can make good personal and financial sense to still be in the game. You can achieve this by investing in property through the REIT option.

As you can see, the stock market has something for everyone. But it has to be navigated carefully, and this book provides you with a compass to traverse the market's choppy waters.

Education and personal development

Perhaps the most important investment is the investment you make in your education. The best annuity in the world is one powered and inspired by the knowledge you build in your head and intellect.

This book contains proven, tried, and tested investing and financial fundamentals. You won't be disappointed, no matter what your current knowledge level is. Your 20s and 30s are an ideal time to get that knowledge.

Your tax-free savings account (TFSA) as a tax-free stock investing account

One tax-smart strategy needs a basic introduction. It's the *tax-free savings account*, or *TFSA*. The TFSA was designed by the government with stocks top of mind. TFSAs are presented here in the context of age because the more time and risk appetite you have to invest in stocks, the more conducive a TFSA will be to your investment portfolio structure.

You may invest not only in stocks but also in guaranteed investment certificates (GICs), bonds, mutual funds, simple cash, and more. The key tax and total return advantage is that a TFSA allows you to invest in eligible investments and lets those savings grow tax free throughout your lifetime. For example, dividends, capital gains, and interest earned in a TFSA are tax free for life. You can take out your accumulated TFSA savings

from your account at any time, and for any reason. This tax-free growth also means that all withdrawals are tax free.

Although you can save for any personal goal you want (such as a new car, home, or vacation), TFSAs are ideal for *growth* stocks. Stocks grow in two key ways: by capital gains (if the stock value rises) and by dividends (assuming the stock you hold in the tax-free account pays dividends).



Whether you're just beginning to build your financial portfolio or just placing all your savings in a TFSA as you begin to pay off your new mortgage, credit card, auto loan, or student loans, just note that you have two stock-allocation decisions:

- How much of your overall net investable cash do you want to allocate to stocks and other equities?
- Do you want this allocation to be inside or outside of a tax-smart savings account such as a TFSA?

Invest in your company registered pension or retirement savings plan

Young Canadians should consider registered pension plans. These tax and savings plans are primarily your *registered retirement savings plan (RRSP)* as well as your company registered

pension plan (if offered by your employer). Most Canadians strive to make or match employer contributions into one or both of these savings vehicles. So, in addition to TFSAs, be mindful of these latter plans as you consider your total portfolio and percentage allocation to stocks. Like TFSAs, RRSPs and employer pension plans exist to help to set you up for a stable financial future. For more on retirement planning, see the *Canadian's Guide to Retirement Planning* (Wiley).

Canadian Stock Investors in Their 40s

If you're in the 40+ age bracket, you're in or are approaching your peak earning years and are likely reducing personal debt. As a result, you may have a bit more to sock away into stocks. If that's not your reality, this is the ideal time to take stock investing seriously. You still have plenty of time to take advantage of the potential for much better growth than bonds or just plain old cash can offer. This assumes you have embraced a longer-term mindset, which is a luxury you can still have in your 40s.

This section explores reasonable allocations to stocks, as well as potential tax and pension options and strategies you should be aware of.

Common investment portfolio allocations to stocks

As Canadian stock investors get older, the asset-allocation equation typically begins to shift toward fixed investments such as bonds. However, this recalibration over time still depends on your existing risk tolerance or appetite, and that in turn is driven by your goals and financial plans and needs.

If you're in your 40s and consider yourself to be risk averse — a deeper discussion of conservative, aggressive, and other approaches to stock investing follows in Chapter 2 — you may be comfortable with a 50 to 60 percent stock and 50 to 40 percent bond allocation range. If you're a more aggressive investor in this age bracket, you may very well be at ease with a 70 to 80 percent stock allocation, if not more.

Yet another perspective is time to retirement. If you have 25 years to retire, 85 percent can be in stocks; if you have 15 years to retire, that figure for stocks versus bonds goes down to about 70 percent. In a low-interest-rate environment, where your potential for outsized fixed-income returns is limited, a reasonable rule of thumb promoted by the investment industry is that you should invest 75 percent of your assets in stocks and 25 percent in bonds in your 40s. Whenever interest rates rise, as they have been lately, adjust that ratio accordingly.

The point of these examples or conventions is much more substantive — your allocation depends on several variables over and above just age. These additional variables include

risk tolerance, interest rates, market conditions, and investor acumen, something you'll sharpen as you read this book. Another key point is that the more assets you allocate to stock holdings, the more volatile your stock-investing experience will be, both on the upside and on the downside.

Always keep in mind that investment diversification — which is really risk mitigation or risk management — is not just a binary stock-versus-bond equation or debate. As you discover in this book, you can exploit many shades of grey. As mentioned, equities include not just stocks but also exchange-traded funds and real estate investment trusts. Diversify even more deeply, still within equities per se, by holding not just domestic stocks, ETFs, and REITs but also international equivalents. You must absolutely know about these lower-fee and easy-to-trade ETF and REIT alternatives, which are great ways to keep more money in your hands rather than in the hands of sometimes expensive fund managers or inexperienced financial advisors.



Taxes, company pensions, and registered retirement savings plans (RRSPs)

It's always a good idea to park as much as you can in a pension plan, but that's a lot easier said than done. Competing

priorities and associated costs related to marriage, buying a home, travel, healthcare, and just plain old living life stand in the way of pension planning. Yet, for many Canadians in their 40s, this is the exact time when some extra cash can be found. Perhaps a raise, a bequest, or a seriously dented mortgage balance has found its way to you. If so, you may find yourself in a great position to invest in an existing or a new pension plan, and — as importantly — to make stocks a key part of that plan.

If you're lucky, you have a company pension plan that invests on your behalf, likely in lots of stocks. If you are really lucky, that pension plan is of the *defined benefit* variety. Even with such a plan, consider investing more within a registered retirement saving plan, or RRSP. We cover RRSPs and the tax implications and fun new rules (okay, they're not really fun) in Chapter 8.



The key message is that if you have not yet saved in your employer's pension plan or don't have that option, start thinking about RRSPs now.

RRSPs are a future-oriented "forced" savings vehicle with a tax structure that benefits you (you get a deduction in high tax-bracket years and are taxed on RRSP withdrawals in later and lower tax-bracket retirement years). In contrast, TFSAs are more mid-range in terms of planning horizons. Within RRSPs, and as your stock-investing expertise and comfort grows, you can look at more company- and industry-specific stocks and away from themes.

50-Something Canadian Stock Investors

As Canadians move into their 50s, stock-investing decisions should be geared towards safer stocks (that is, ones that are financially stable, and less cyclical and volatile) and dividend-paying stocks.

Canadians who are 50-plus and 60-plus years old may still be in their peak earning years. But as far as their investment time horizon is concerned, their peak investing years are behind them. At the same time, though, what with the average life expectancy in Canada pushing into the mid-80s, Canadian stock investors still need to consider their investment portfolios. Sitting still can be hazardous to financial health. The goal in your late 50s and 60s is to have an investment portfolio that will sustain you throughout your retirement years.



If you are in your 60s, you want to calibrate your portfolio away from stocks and more toward an income stream. But recall what was said in the previous section, namely, that equities come in different shapes, sizes, and, more importantly, risk profiles. You can lower your stock-investing risk and still stay in stocks by considering exchange-traded funds as well as real estate investment trusts. In your 50+ years, don't just

hold domestic equities — consider some stable international equities as well. Dividend-paying stocks and international stock investing are extremely important for 50+ investors.

Revisit your allocation to stocks

The 50+ age zone is the time to examine your retirement goals and desired retirement lifestyle. You can't do that in a vacuum. Consider your existing income flows, projected income streams, and your tax situation, including special tax rules for older Canadians. Just because you're older is not a reason to take your foot off the investing accelerator. Rather, it's more of a time to pay special attention to hazard signs. You've learned a lot about investing by this time, so you don't have to throw that knowledge away. Warren Buffett doesn't. Even if you're older and are new to stock investing, growth is still a consideration. Equities are still a very real alternative.



A typical rule of thumb for those in their 50s and 60s is to have about half of your portfolio in conservative equities and the rest in fixed-income financial instruments such as bonds. Note that *equities* refer to stocks, ETFs, and equity mutual funds. Also recall that if, for example, you have 15 years to retirement, one of several rules of thumb is that the ratio of equities versus bonds can be 70 percent. No golden year rule exists.

If you're a savvy and careful stock investor, you may want to invest as much as 75 percent in equities and 25 percent in fixed-income financial instruments, again depending on other variables already mentioned in this chapter. Decades ago, a half-and-half ratio of equities to bonds was reasonable and effective. That's when interest rates were high and heavily rewarded savers. Today, interest-rates are lower, so finding significant, guaranteed fixed-income returns is difficult.

A final variable to consider when determining your investment allocation to stocks is the nature, extent, and timing of your withdrawal of investment resources. What will you sell first — your house, cottage, or other assets? Will you continue to work part-time past your retirement age? In addition, when do you expect to draw from your Canadian government entitlements such as Canada Pension Plan (CPP) or Old Age Security (OAS)? This is where tax-planning and stock-investing decisions have to be integrated — topics that are beyond the scope of this book. These more complex considerations will also drive your decisions regarding allocations to stocks at this stage of life.



For all stock-allocation decisions for all stages of life, don't just look at one investment or savings account in isolation. Be mindful of your big picture. Look at your entire investment portfolio. Consider company pensions, RRSPs, TFSAs, and government retirement annuities you're entitled to. As one Canadian bank

commercial reminds us: “You may be richer than you think!” If so, you can continue to delve into the exciting and potentially rewarding realm of stock investing, with an even greater allocation.

Taxes, registered pensions, and registered retirement income funds (RRIFs)

If you’re over 50, note the importance of taxes and financial planning. Although extreme tax planning is beyond the intent of this book, the relevant (stock-investing) basics of Canadian taxation appear in Chapter 8.

Registered retirement income funds (RRIFs) allow you to withdraw some of your registered savings in a tax-smart way.

As for other retirement-planning decisions regarding estate planning, income splitting, foreign taxes, and the use of TFSAs versus RRSPs to park your money, you should seek the specialized expertise of a qualified professional. But if you have a simpler portfolio, see Chapter 4, which introduces you to the latest innovation in financial technology, called *robo-advisors*.

