Scotia Funds™

Managing investment fluctuations

Investment Insights

In the current “information age”, we are constantly being exposed to more news than ever before.

Unfortunately, when listening to the news, a lot of focus is not put into what is doing well - quite the opposite. The feature stories tend to be about the negative topics, like conflict, political unrest, natural disasters, and stock market chaos - to name a few.

Many types of events, good or bad, can play an active role in how any particular investment performs. A few of the major types of events that can shake a stock market include: the political or economic playing field in any given geographic region; a financial crisis in a County; or an individual company that is experiencing tough times such as fraud or bankruptcy. These events are usually linked in some way and can cause a ripple effect.

For example, Greece went through a period of significantly tough economic times during their debt crisis. After years of the Country trying to solve this problem, they then faced liquidity issues. Banks closed their doors, leaving individual clients and pensioners with limited access to their savings, and individual businesses were unable to transact effectively. That’s just what we saw on the ground. The Greece (Athens) stock market (ASE) shut down temporarily, while foreign currencies and interest rates also felt the impact.

While this is an example of a major event, many similar events happened numerous times throughout history, and over time, have seen a healthy recovery. These types of occurances have the potential to cause a ripple effect, affecting multiple markets across many borders. Combined with the abundance of news in the media, uncertainty prevails and the result is often large swings in the markets which can have an increased impact on individual investments. The good news is that there are ways to reduce your exposure to these fluctuations by practicing good investment strategies.

How much fluctuation can your investments handle?

Not all investments react the same way to swings in the market. Selecting a portfolio suitable to your investment objectives and risk tolerance is key to the success of your investments and your peace of mind.

What is volatility?

In order to adequately protect your investments from pronounced fluctuations in the markets, it is important to first understand volatility and it’s causes. Simply put, volatlity is the amount of fluctuation that in investment can sustain in a given time period - the ups and downs.

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All investments are exposed to certain types of risks. Some of the more common types of risks associated with investing in Mutual Funds are: Market Risk, Liquidity Risk, Interest Rate Risk, Currency Risk, Credit Risk and Country Risk. The extent to which these risks impact an investment is determined largely by the type of investment. The general rule is that a more conservative investment will fluctuate less than a more aggressive investment.

Your investment advisor can help you understand the risks specific to your investments or consult the Mutual Fund Prospectus or Unit Trust Offering Circular.

Type of Risk	Type of investment affected	How the investment could lose money
Market risk	All types	The value of its investments decline because of unavoidable risks that affect the entire market
Liquidity risk	All types	The fund can't sell an investment that is declining in value because there are no buyers
Interest rate risk	Fixed income securities	The value of fixed income securities generally falls when interest rates rise
Currency risk	Investments denominated in a currency other than the local currency	If the currency declines against the local currency, the investment will lose value
Credit risk	Fixed income securities	If a bond issuer can't repay a bond, it may end up being a worthless investment
Country risk	Foreign investments	The value of a foreign investment declines because of politcal changes or instability in the country where the investment was issued

Source: Canadian Securities Administrators. More information can be found at: www.securities-administrators.ca

Help your investments weather the storms

Too much of a 'good thing' works well when markets are up - not always the case when volatility strikes

Diverify. Diversify. Then diversify some more.

Investing heavily in any one stock, country, industry, or asset class creates what is known as "concentration risk". The downside of being too concentrated is that when the investment is impacted by any of the market risks discussed earlier (or others), the effect can be detrimental.

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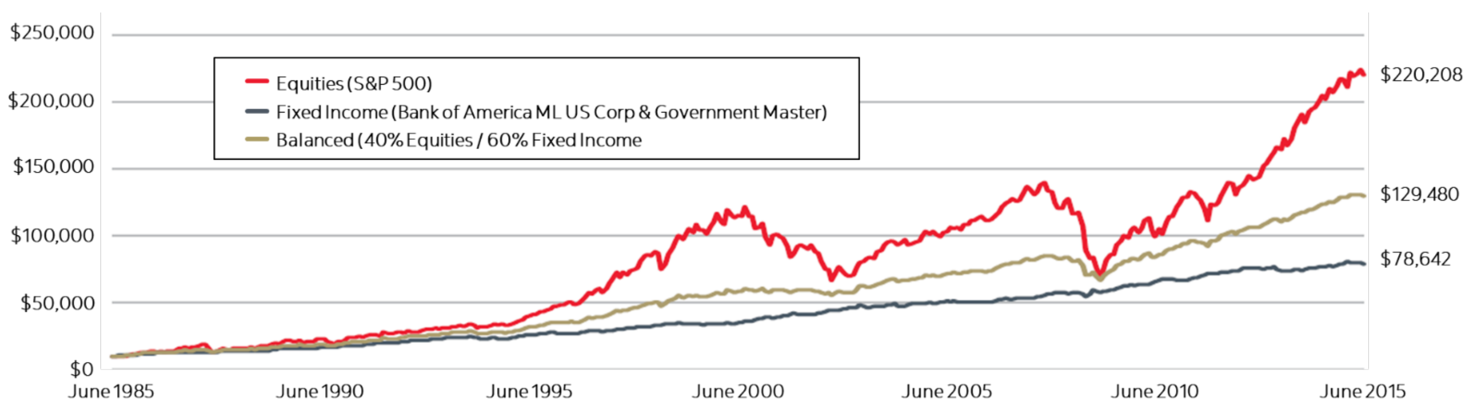
For example, if the majority of your assets are concentrated in energy, and the price of oil drops, your entire portfolio will be impacted, not just a portion of it. The solution to withstanding these ups and downs is to create a balanced portfolio, using a concept called "diversification". By spreading your investments out across various asset classes (stocks, bonds, cash etc.), sectors, and geographic regions, your portfolio becomes less exposed when something does not go according to plan.

As previously mentioned, various asset classes behave differently in volatile times. Equities, which historically have outperformed fixed income in the long run, are a more volatile asset class overall. This means that even though historically the performance of the asset class trended upward, the ups and downs along the way were more pronounced.

The hypothetical chart below shows an initial investment of $10,000 made on June 1, 1985. An investment made entirely in equities (using the S&P 500 index) at that time would have grown to $220,208 ,30 years later, on June 30, 2015. Over the same time period, an investment in fixed income securities (using the Bank of America ML US Corp & Government Master index) would have grown to $78,642. It is important to note that in addition to the higher returns generated by the equity investment, the fluctuations in value during the period were much more dramatic - the highs were much higher, and the lows were also much lower. As you can see, the fixed income growth line charted was a much smoother line. In the end, the fixed income investor had more peace of mind but less growth.

By combining these two types of investments into a portfolio - in this case, keeping it simple at 60% fixed income, 40% equities, both the overall growth in the investment and the fluctuations were moderated, protecting the investment portfolio from the full extent of the risks that the market encountered.

Growth of $10,000 as of June 1, 1985



Source: Morningstar Direct

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Legal disclaimer

Important information concerning the investment goals, risks, charges and expenses of investing in mutual funds is contained in the relevant prospectus or unit trust offering circulars. Investors should carefully consider these before investing. Copies are available from the financial institution where you are buying the mutual fund and should be read carefully before investing. Commissions, management fees and expenses all may be associated with investing in mutual funds. Mutual funds are not guaranteed or covered by your local deposit insurance corporation, other government deposit insurer, The Bank of Nova Scotia, or its subsidiaries/affiliates. Their values change frequently, including the amount of income that you may receive (where applicable), and you may not get back the original amount you invested. The foregoing is for informational purposes only and is subject to change without notice. Always consult your professional tax and legal advisors with respect to your particular circumstances. Nothing herein is intended to constitute an offer or solicitation to transact business for products or services in any jurisdiction where such an offer or solicitation would be unlawful. This does not constitute an invitation to purchase or sell shares of the Funds. ™ Trademark of The Bank of Nova Scotia, used under license where applicable.