# Lower-risk investing a sound strategy amid market instability

**BY RAY TURCHANSKY, FREELANCE** JUNE 25, 2010

Institutional investment guru Harry Marmer suggests that investors switch strategies during this period of high stock-market volatility, placing a premium on minimizing risk.

Marmer, executive vice-president with Toronto-based Hillsdale Investment Management Inc., says that rather than weighting investment holdings by size, namely market capitalization, people weight their holdings by minimum risk, namely lowest volatility.

"When you re-weight the stocks you end up with a mid-cap bias, lower earnings variability, higher return on equity, lower price-to-earnings, higher dividend yield," said Marmer, speaking to chartered financial analysts at an Edmonton CFA Society luncheon.

He explained the perception of a "new normal," in which de-leveraging, re-regulation and de-globalization should lead to slower growth ahead, which in turn should cause reduced asset-class returns.

He said the new normal and the growing number of day traders both contribute to the volatility we've been experiencing on stock markets recently. The VIX, also called the fear index, which measures implied volatility of S&P 500 index options, doubled between April 15 and May 15, which was "nothing we've ever experienced before."

Volatility often comes from knee-jerk reaction to news and rumours.

"I think the new normal really has a lot of noise in it," Marmer said.

"Re-regulation creates more noise. De-globalization is not good, because you're doing things you shouldn't do. De-leveraging is good, because it got too far to begin with. So, two out of three things happening are bad.

"What we're finding in the marketplace is that it's becoming more and more dominated by investors with short-term horizons, guys doing daily trading, using technical models and trying to use momentum. Questrade is one of the fastest-growing brokerages in Canada.

"Technical trending strategies only do well when there's very strong trending up or very strong trending down, when there'll be a bandwagon effect."

But at times like this with little direction or conviction, Marmer suggests switching to a Canadianequities minimum-risk portfolio, specifically companies with low "unsystematic risk," which is defined as "firm, specific risk caused by events peculiar to one company only and not to the entire market."

The concept of a minimum-risk portfolio was born nearly 20 years ago and started taking root five years later.

He showed a comparison between the top 10 holdings in the S&P/TSX 60 index according to size or market capitalization, and a minimum-risk portfolio of the top 10 stocks weighted according to lowest volatility.

The top-market-cap companies included the major Canadian banks, plus energy companies like Suncor and Canadian Natural Resources, as well as gold companies like Gold Corp and Barrick Gold. Conversely, the minimum-risk group included firms like Shaw Communications, Cenovus Energy, Shoppers Drug Mart and Telus.

"The minimum-risk portfolio was a mirror image of stocks in the top 60 index, because the top-weighted stocks in the index are the ones that have had a good run. So the stocks in the minimum-risk portfolio are now your grandmother stocks, very conservative blue-chip, strong balance sheets, very good income statements, very good dividend yields."

The result?

"The minimum-risk portfolio averaged a return of 11 per cent with a vol (volatility) of 10, while the index averaged a return of 7.9 and a vol of 14.4. You wound up with a better return and 30 to 40 per cent less vol than the index."

Marmer said he's "astounded by the millions who are indexed to a benchmark that is nonsensical. Nine years ago Nortel was 45 per cent of the index."

The move toward investing according to risk is a continuation of changes in investment strategy that started a few years ago.

"What we found in '09 was the big winners were the types of investors that you would not have expected: the spec traders, the aggressive-growth guys and the deep-value guys. The traditional approaches simply didn't perform in '09. Institutional investors and pension funds were shell-shocked and were reallocating from equities into fixed income."

But looking at the larger picture, we are coming off what has been called the "lost decade" for investors. From 2000 through 2009, the S&P/TSX in Canada had an average yearly return of 5.44 per cent, but the S&P 500 in the United States had an annual loss of 0.23 per cent.

During the decade, investors moved from one trendy type of investment to another, from tech stocks without actual profits to income trusts that often couldn't maintain distributions to leveraged exchange-traded funds advertising great results.

Forensic accountant Al Rosen of Toronto warned that the decade was lost because "a new investment promises higher returns, but the hidden risks are not explained."

When markets are spiking and diving, minimizing risk can be rewarding.

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