Quadrant
Private Wealth

What Can You Do?

QPW Perspectives – May 2023

After experiencing negative financial market returns for 2022, balanced portfolios have generated positive returns on a year-to-date basis so far in 2023. Regardless, the majority of Canadian banks and economists are forecasting a recession in the latter part of this year.

In our last newsletter (This Too Shall Pass), we provided information about what a recession is, its potential impacts, and what recessionary experiences in the past have taught us. The best course of action for investors during periods of recession or market volatility is often inaction. However, regardless of this fact, investors are often inclined to make emotionally driven decisions that are not in their best long term interests.

People, by their very nature, are fixers and problem solvers. It is a natural human tendency to want to "do something" to protect your portfolio. So, what can you do? This is the question we will explore.

What Can You Do?

Below are four things you can do to benefit your portfolio. These are applicable anytime, but are particularly important during times of heightened uncertainty or volatility.

1. Avoid Investor Behavioural Biases

It is natural to feel a degree of anxiety during recessionary time periods. This can sway individuals towards certain investor behavioural biases. One can manage these psychological biases by being aware of their existence and applying critical thinking. Below are two of the more common biases to surface during recessionary times.

Loss Aversion:

Loss aversion is the tendency to emphasize the avoidance of losses over the achievement of equivalent gains. People feel pain from losses more acutely than they feel pleasure from gains of the same size. Loss aversion can result in avoiding risk to such a degree that it leads to an overly conservative portfolio that may not meet its long term financial goals. Loss aversion can also lead to the decision to sell investments during market downturns simply to avoid further downturns, potentially missing out on subsequent gains. During times of recessions and market volatility, loss aversion can cause an individual to make reactionary investment decisions that are not in their best long term interests.

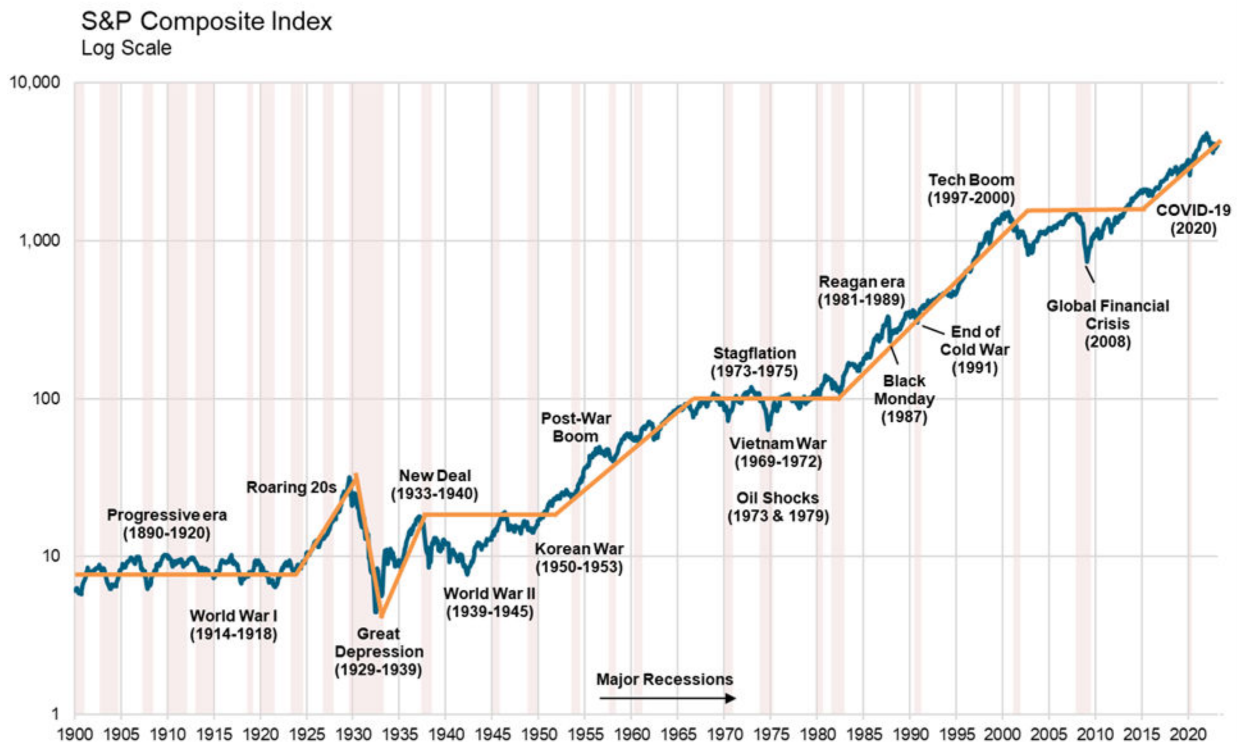
Recency Bias:

Recency bias is the tendency to overemphasize the importance of recent events or place too much emphasis on experiences that are freshest in your memory, even if they are not the most relevant or reliable. This includes being influenced by recent news, events or experiences. Currently, there is an overabundance of recessionary news and headlines, including fear-mongering to get readers' attention. Falling prey to these headlines could cause an investor to make emotionally driven portfolio decisions at the worst time. Rather, investment or portfolio decisions should be based on an objective and rational decision-making approach that takes all relevant information into consideration.

2. Maintain Long Term Thinking

Participation in the financial markets affords an individual the opportunity to grow their wealth over the long term, but shorter time periods of volatility and negative returns are also part of the investing

journey. Said differently, financial markets move up and down over shorter time periods, with an overall positive trend over the long term.



Source: Bloomberg

Portfolio management is a marathon, not a sprint. Recessions and volatile financial market conditions come and go. During times of turbulence, keeping focus on long term thinking is key. Investors who have a long term financial plan, which clearly articulates their goals and needs, including an Investment Policy Statement, are better equipped to maintain a long term perspective during challenging shorter time periods.

3. Diversify your Portfolio

Diversifying your portfolio increases its resilience and allows it to better weather recessionary conditions and volatile financial markets. Diversification is the process of allocating capital in a way that reduces the exposure to any one particular asset class or risk. In simple terms, "Don't put all of your eggs in one basket". Diversification can be achieved in several ways:

- Diversification between broad asset classes such as equities, fixed income and cash. The weighting of each of these components will depend on the time horizon, risk tolerance and investment objectives of the investor.
- Beyond broad asset classes, there are many additional considerations to further enhance diversification including:
  - Geographic location,
  - Market capitalization (or size) of companies,
  - Industry sector,
  - Credit quality, and
  - Number of holdings.

Diversification of an investment portfolio goes far beyond just "not putting your eggs in one basket". It involves in-depth quantitative analysis coupled with a comprehensive and ongoing understanding of each client's circumstances.

4. Commit to Open and Honest Communication

Honest and open communication with your financial advisor is key when it comes to developing and maintaining a financial plan to meet long term goals. Financial plans take into account an investor's goals, requirements, risk tolerances and timelines. If these inputs are not openly shared and communicated, the plan is at risk of not being appropriate for the client and may ultimately lead to the intended goals not being achieved.

Communicating with your financial advisor should also include discussing any anxiety you may be feeling in the current market environment. Your advisor should be able to explore any concerns you may have as well as confirm whether your long term financial plan requires any adjustments. If you are not comfortable having these types of conversations with your advisor, it may be a red flag that you should be considering whether this is the right advisor for you.

Maintaining Perspective and Staying the Course

Investors will experience multiple recessions in their lifetime. The key is to understand that an appropriately designed long term financial plan already takes into account multiple business cycles, including recessionary times. Investors are encouraged to reference their Investment Policy Statement, resist emotionally driven decisions, and focus on the long term as opposed to the short term. In other words, to reach your goals, stay the course.

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Quadrant Private Wealth
Suite 720, One Lombard Pl
Winnipeg, MB
Ph: (204) 944-8124
email: inquiries@quadrantprivate.com
web: www.quadrantprivate.com

If you or someone you know could benefit from our services, please have them contact our offices at 204-944-8124 or email us at inquiries@quadrantprivate.com.

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