3 Reasons Why You Absolutely Need an Investment Policy Statement

Description

When you hire a financial advisor, one of the first things they do is have you complete an Investment Policy Statement (IPS). This is a document that outlines your investing objectives, risk tolerance, time horizon, and a detailed set of plans for investment selection and asset allocation that are in line with your profile.

Even if you don't have a financial advisor and are DIYing it, like many Canadians, it still makes sense to write an IPS. Having a physical plan to refer to can help you maximize rewards and minimize risks down the line by keeping the behavioural components of investing under control.

An IPS helps you avoid bad investments

Have you ever been tempted to YOLO your money into cryptocurrency, the latest hot meme stock, or some penny stock your uncle texted you about? If you gave in to the fear of missing out (FOMO) and did so, you could lose a tonne of money.

Having a well-written IPS that outlines the exact types of assets you can own will help you stay on track. When the urge hits, simply take it out and read it. Remember when and why you wrote it and affirm to stick closely to it.

An IPS keeps you invested during trouble

Bear markets, recessions, and stock market crashes can rattle even the most iron-willed of investors. The worst thing you can do during a downturn is to panic sell. This would effectively lock in your loss and make you miss your investment goals.

Having an IPS written during calmer times in a rational mindset can serve as an anchor to keep you thinking straight during a crisis. When the stocks are in free fall, referring to your IPS can serve as a good reminder of the quality of your investments and why you need to hold the line.

An IPS keeps you from tinkering

You heard it on the news: “Growth stocks are out; the value rotation has started,” or “the energy sector is well poised to outperform this year due to inflation!” You then get the itch to tilt your portfolio towards these types of stocks or sectors.

An IPS will help you remember that in the long run, these cyclical trends smooth out and revert back to the mean. An IPS will remind you that nobody can predict the market, so the best choice is a well-diversified portfolio held through whatever market conditions are prevailing at the time.

A sample IPS to help you understand

I’ve included a hypothetical example of an IPS below for a fictional investor. Your IPS will differ in terms of content, but it should follow this general format:

- **Background:** John Smith, age 50, living in British Columbia.
- **Investable assets:** $500,000 in an RRSP, $100,000 in a TFSA, $100,000 in a taxable account.
- **Objectives:** Balanced mixture of capital appreciation and safety of principal for retirement at age 60.
- **Long-term return expectations:** 6% compound annual growth rate.
- **Risk tolerance and time horizon:** Balanced; money will be needed for income in 10 years.
- **Short-term liquidity needs:** None; no debts, medical expenses, etc.
- **Permitted assets:** Large-cap U.S., Canadian, developed, and emerging market equities. U.S. and Canadian treasuries and corporate bonds of investment-grade quality.
- **Portfolio management:** Portfolio will be re-balanced quarterly on the first trading day. Weighted management expense ratios will be kept under 0.20%.
- **Asset allocation:** 60/40 equities to fixed-income ratio for all three accounts combined. Specific asset allocation depends on tax efficiency based on which account is used (e.g., U.S.-listed equity in an RRSP).

CATEGORY

1. Personal Finance

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Smart News

PP NOTIFY USER

1. kduncombe

2. tdong

Category

1. Personal Finance

Date
2025/08/19
Date Created
2022/01/31
Author
tdong