



CIBC
Asset Management

GUIDE TO PORTFOLIO CONSTRUCTION

5 ways that portfolio construction
can elevate your investing

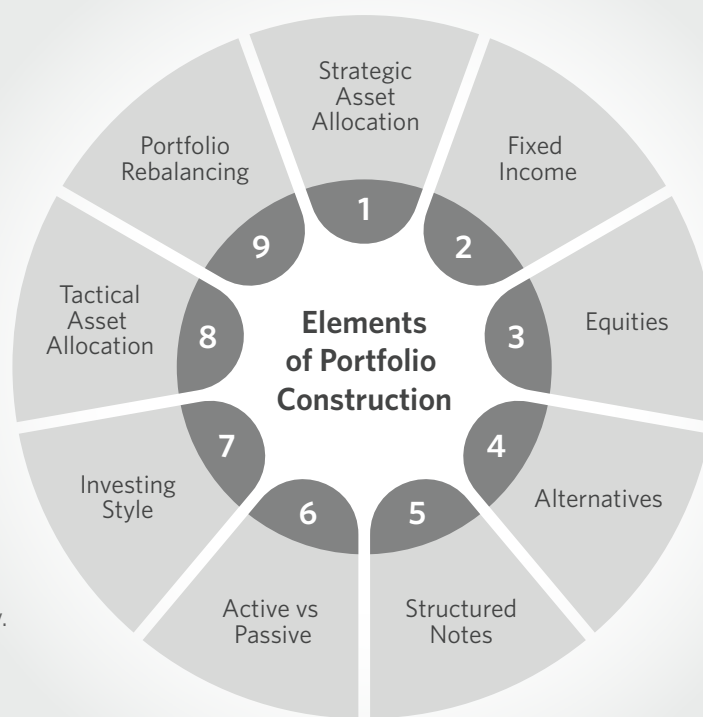


Guide to portfolio construction

Market and economic uncertainty, combined with relatively low expected returns for many asset classes, are making it harder for individuals and institutions to reach their financial goals. A thoughtfully designed portfolio that helps you embrace market opportunities while preparing for the unexpected has never been more important.

There are several components of a well-constructed portfolio, including a robust strategic asset allocation that's consistent with your long-term goals and objectives. A mix of asset classes such as equities, fixed income and alternatives, and strategies such as tactical asset allocation, active versus passive investing, and portfolio rebalancing all have a role to play.

This guide highlights some of the benefits of a well-constructed, diversified portfolio and the role it can play in helping you achieve your ambitions.



Portfolio construction—A key driver in meeting your investment goals

There are a number of asset classes available to investors, but choosing the right combination of assets to meet your specific objectives can be difficult. A disciplined and purposeful approach to portfolio construction is critical to investing success.

Here are 5 ways that professional portfolio construction can add value and help you reach your goals:

1. Reduce home-country bias
2. Minimize negative impact of market timing
3. Optimize asset class diversification
4. Help protect portfolios from unintended risks
5. Tailor portfolios to align with investment objectives



1. Reduce home-country bias

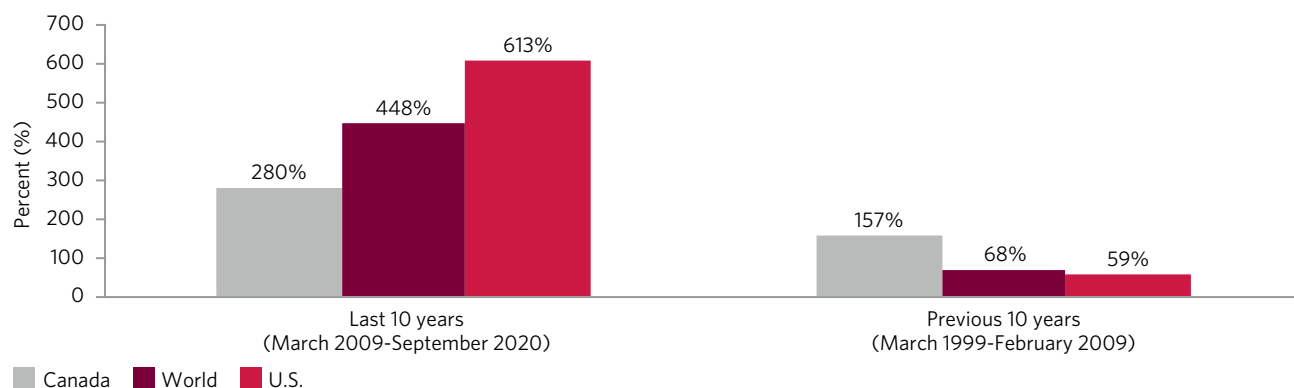
Although Canada makes up only about 3% of all global equities¹, Canadian investors hold about 50% of their equity holdings in Canadian equities. This is known as “home-country bias”.

Home-country bias exposes Canadian investors to a specific kind of portfolio risk. It creates a concentration in three highly correlated sectors that make up nearly two-thirds of the S&P/TSX Composite Index—financials, energy, and industrials. When these sectors do well, Canadian investors can benefit. However, these same investors are penalized when these sectors fall out of favour.

Consider two different time periods. The Canadian stock market was a leading global performer for the 10 years between March 1999 and February 2009, a period that included the 2008 Global Financial Crisis. However, its performance has lagged the main global indices since March 2009. (Figure 1)

Well-designed portfolio construction can address home-country bias and improve diversification by strategically including many global regions in the mix.

Figure 1 – Canadian vs. developed market equities—Cumulative performance



Source: Bloomberg, CIBC Asset Management, as at September 30, 2019. Canadian Equities = S&P/TSX Index; U.S. Equities = S&P 500 Index; World Equities = MSCI All Country World Index.

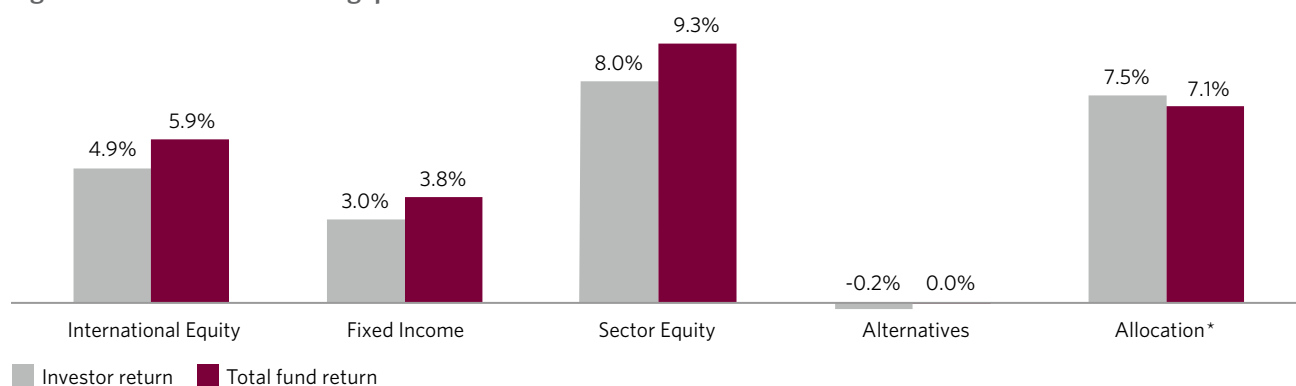
¹3% of the MSCI All Country World Index

2. Minimize negative impacts of market timing

Investors often chase performance by buying an asset class when it's outperforming and selling it when it's underperforming. These decisions are frequently emotional rather than guided by a long-term asset allocation strategy.

The negative impact of this common investor mistake can be measured by comparing the returns of average investors in a mutual fund and the return of the fund itself. (Figure 2) Investors often miss out on the full fund return and one of the principal reasons is clear. They tend to sell near the bottom of a market move, miss out on dramatic rebounds and purchase when much of the price rise has already occurred. In contrast, a long-term strategic asset mix with regular contributions that ignores market prices and includes regular rebalancing often results in stronger performance.

Figure 2 - The investor return gap



Source: Morningstar Study: "Mind the Gap 2020." August 18, 2020. Data as of December 31, 2019. Investor return gap (by U.S. categories) is measured as the average of total returns for the fund versus returns that investors actually receive over five separate 10-year periods (years ending 2014, 2015, 2016, 2017 and 2018). *Allocation funds combine stocks, bonds, and other asset classes.



3. Optimize asset class diversification

Investors who invest in just a small number of familiar asset classes can miss the benefits of a more diversified portfolio. A properly diversified portfolio with a broad set of asset classes will typically outperform individual asset classes² over the long term.

Investors that diversify can benefit from periods when different asset classes perform better than others. (Figure 3) Monitoring and rebalancing the strategic mix, in conjunction with a financial professional, helps ensure at least some participation in the highest-performing asset classes at any given time.

Figure 3 - Annual returns and volatility for major asset classes (2009-2019)

Rank	2019	2018	2017	2016	2015	2014	2013	2012	2011	Volatility
1	US Equity 24.8%	Global Fixed Income 7.7%	EM Equity 28.7%	Canadian Equity 21.1%	US Equity 21.6%	US Equity 23.9%	US Equity 41.3%	EM Equity 16.0%	Canadian Fixed Income 9.7%	International Equities 13.6%
2	Canadian Equity 22.8%	US High Yield 6.5%	International Equity 17.4%	US High Yield 13.4%	International Equity 19.5%	Real Assets 13.8%	International Equity 31.6%	International Equity 15.3%	Global Fixed Income 8.3%	EM Equity 12.9%
3	International Equity 16.5%	US Equity 4.2%	US Equity 13.8%	Balanced Profile 8.4%	Global Fixed Income 16.2%	US High Yield 11.7%	US High Yield 14.6%	US Equity 13.4%	US High Yield 7.0%	Canadian Equity 12.4%
4	Balanced Profile 13.6%	Canadian Fixed Income 1.4%	Canadian Equity 9.1%	US Equity 8.1%	US High Yield 14.4%	Canadian Equity 10.6%	Balanced Profile 14.1%	US High Yield 13.0%	US Equity 4.6%	US Equity 11.9%
5	EM Equity 12.9%	Balanced Profile -0.2%	Balanced Profile 6.5%	EM Equity 7.7%	EM Fixed Income 12.4%	Balanced Profile 10.5%	Canadian Equity 13.0%	Balanced Profile 8.1%	EM Fixed Income 2.2%	EM Fixed Income 7.9%
6	US High Yield 8.6%	International Equity -5.5%	Canadian Fixed Income 2.5%	Canadian Fixed Income 1.7%	Balanced Profile 6.9%	Global Fixed Income 9.7%	Real Assets 6.5%	Real Assets 7.3%	Balanced Profile 0.5%	Real Assets 7.7%
7	Real Assets 7.3%	EM Equity -6.5%	US High Yield 0.4%	Global Fixed Income -1.4%	Canadian Fixed Income 3.5%	Canadian Fixed Income 8.8%	EM Equity 4.3%	Canadian Equity 7.2%	Real Assets -3.7%	Global Fixed Income 5.6%
8	Canadian Fixed Income 6.9%	EM Fixed Income -6.5%	Global Fixed Income 0.4%	International Equity -2.0%	EM Equity 2.4%	EM Equity 7.0%	Global Fixed Income 4.0%	EM Fixed Income 5.7%	Canadian Equity -8.7%	Balanced Profile 5.0%
9	Global Fixed Income 1.4%	Real Assets -8.9%	Real Assets -5.1%	EM Fixed Income -3.9%	Real Assets -0.4%	EM Fixed Income 6.0%	Canadian Fixed Income -1.2%	Canadian Fixed Income 3.6%	International Equity -9.5%	US High Yield 4.7%
10	EM Fixed Income -2.8%	Canadian Equity -8.9%	EM Fixed Income -8.5%	Real Assets -5.5%	Canadian Equity -8.3%	International Equity 4.1%	EM Fixed Income -11.9%	Global Fixed Income 2.0%	EM Equity -16.1%	Canadian Fixed Income 3.6%

Source: Bloomberg, CIBC Asset Management, as at December 31, 2019. EM = Emerging Markets. Please see full disclaimer on page 7.

4. Help protect portfolios from unintended risks

Regular portfolio monitoring and rebalancing can help ensure that your portfolio doesn't take on undue active risk. Because asset class correlations tend to increase during financial crises when equity risk dominates, even a traditional balanced portfolio (60% equities, 40% fixed income) would underperform during periods of stress.

Investing in alternative asset classes³, for example, with their distinct risk and return profiles, can help smooth performance and mitigate the downside risk in balanced portfolios. They can also provide a source of additional return.

² on a risk-adjusted basis

³ e.g. real assets, private assets and liquid alternatives

5. Tailor portfolios to match investment objectives

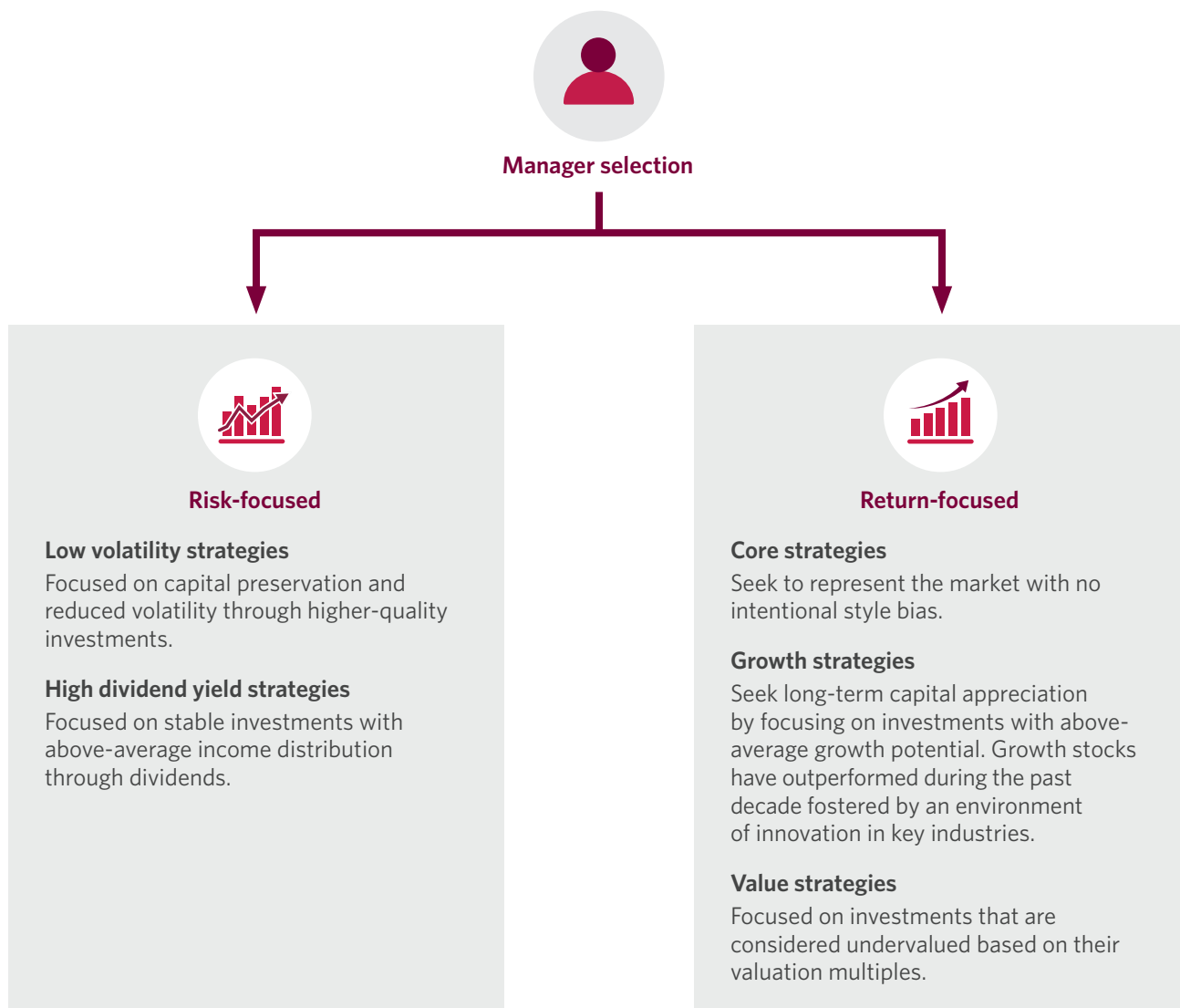
An effective asset allocation strategy tailors your portfolio to match your unique objectives. These might include a specific return target or protection from downside losses or volatility.

Portfolios can first be optimized using a number of different approaches:

- **Return-optimized** for return-focused investors
- **Risk-optimized** for risk-focused investors
- **Downside risk management** for conservative investors with specific return targets

Second, by selecting managers with differing investment styles, we can further align the portfolios to investors' specific objectives. The chart below illustrates possible strategies for risk-focused and return-focused investor profiles.

Figure 4 – Risk-focused versus return-focused portfolio optimization



Let's partner on your portfolio construction

Changing market conditions don't change your goals, whether it's saving for a home, a child's education or investing for retirement. Careful portfolio construction that helps you embrace market opportunities while preparing for the unexpected has never been more important.

Your CIBC advisor can help you develop a targeted investment approach using the multi-asset solutions that work best for you.

Contact us today to tailor your portfolio and help you get where you want to be.

To learn more, contact your CIBC advisor.

Figure 3 source: Bloomberg, CIBC Asset Management, as at December 31, 2019. Canadian Equity = S&P/TSX Composite; US Equity = S&P 500 Index (CAD); Global Fixed Income = Barclays Global Aggregate Bond Index (CAD); Canadian Fixed Income = FTSE Canada Universe Bond Index; US High Yield = BofA Merrill Lynch US High Yield (CAD); Emerging Market Fixed Income = JPM Emerging Markets Bond Index Plus (CAD); Real Assets = Blend of 40% Real Estate Equities (FTSE EPRA/NAREIT Developed Real Estate Index), 50% Infrastructure Equities (Dow Jones Brookfield Global Infrastructure Index) and 10% Real Asset Debt (70% Bank of America Merrill Lynch Global High Yield Index + 30% Bank of America Merrill Lynch Global Corporate Index); International Equity = MSCI EAFE® (CAD); Emerging Market Equity = MSCI Emerging Markets Index (CAD); Balanced Profile = 25% Canadian Equity, 25% Global Equities, 10% Global Fixed Income, 15% Canadian Fixed Income, 15% US High Yield, 10% Canadian Money Markets.

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