CIBC ASSET MANAGEMENT

Guide to portfolio construction

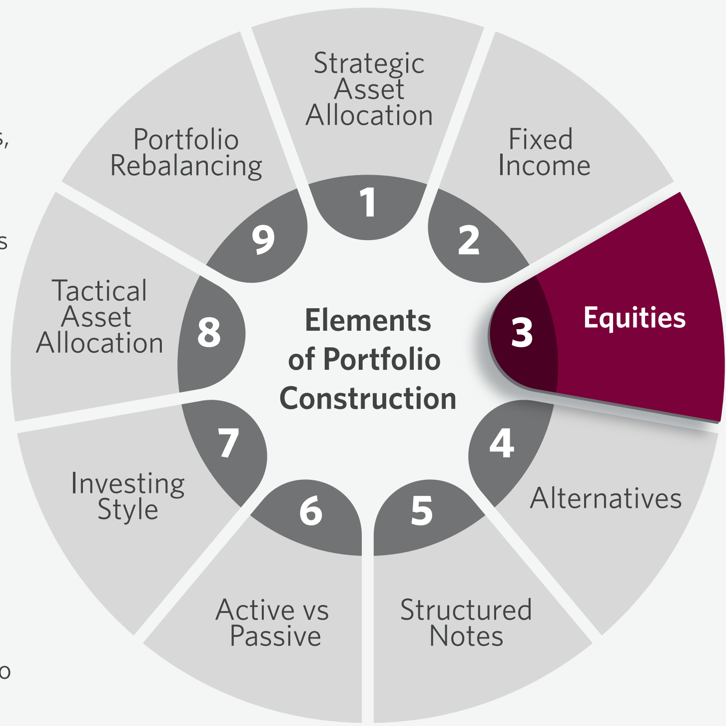
The role of equities

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 how equities can improve portfolio performance and help you achieve your ambitions.



Equities—Creating enhanced wealth opportunities over time

Equities have historically been the cornerstone of investment portfolios, producing the bulk of capital wealth creation. There are many different kinds of equity, and all can contribute to investors' long-term performance objectives of capital gains, income, and diversification.

Investing in equities provides the opportunity to invest in and benefit from significant growth as an owner. Although shareholders don't have a stated income stream from the company in the same way bondholders do, they can benefit significantly from the growth of corporate profits.

Equities will likely continue to contribute the bulk of capital wealth creation, but this contribution is only maximized when investors stay invested for the long term.

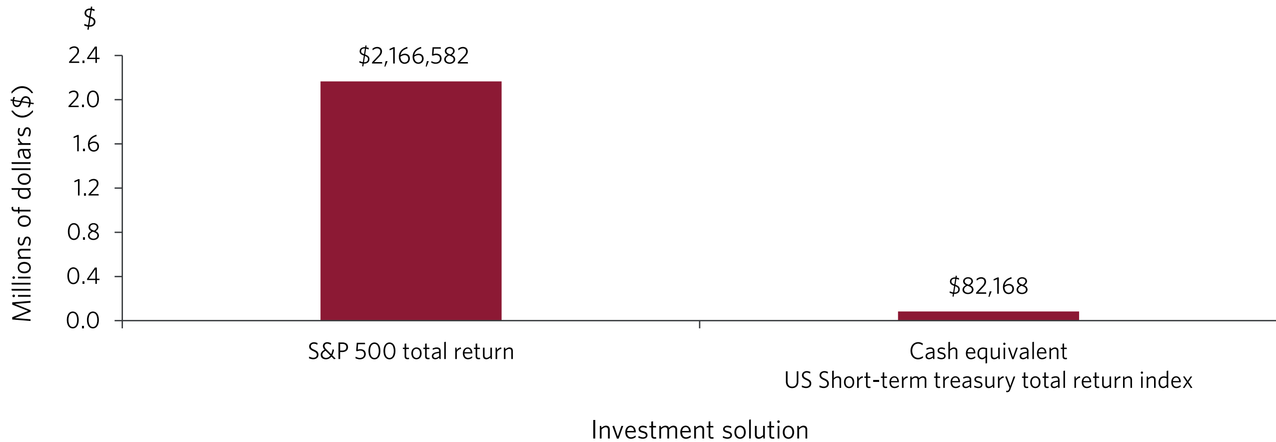
Explore the key benefits of equities within portfolios, including:

1. A strong source of expected returns
2. Unique opportunities to diversify
3. Patience is rewarded
4. Decreased volatility in the long term
5. Potential tax advantages

Benefit #1: A strong source of expected returns

Growth investments like equities offer the best chance for inflation-beating, long-term returns, although they pose the greatest risk of volatility due to short-term market movements. Equities have significantly outperformed both cash and inflation over the last almost 50 years (Figure 1). We expect this outperformance to continue.

Figure 1 – Growth of $10,000 since January 31, 1978



Source: Bloomberg®. As at January 31, 1978 - December 31, 2024.

Benefit #2: Unique opportunities to diversify

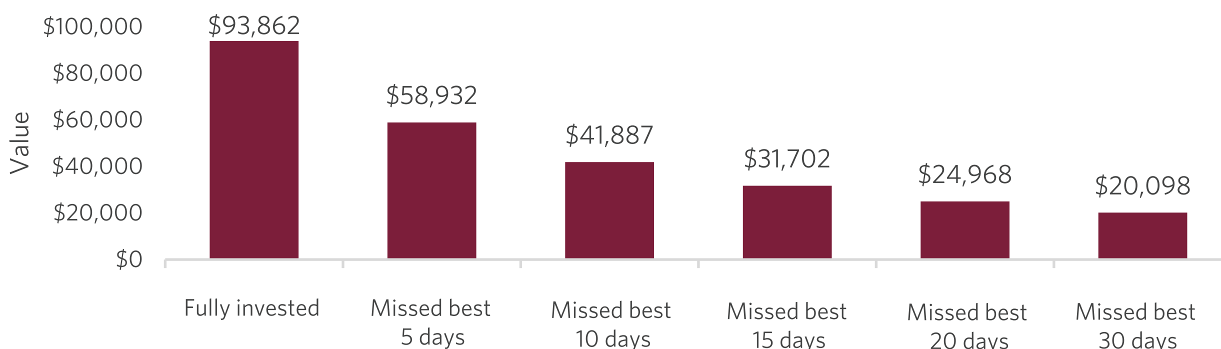
Diversifying equity exposure away from the home-country market allows investors to participate in the fastest growing regions and companies. Although we live in an increasingly connected world with closer equity correlations, there are still opportunities to include equity exposure geared to specific economic regions. Investments in Europe, for example, allow exposure to innovative businesses and industries that benefit from the European Union and closer proximity to Asia. Emerging markets offer another alternative. They provide unique opportunities to diversify exposure and participate in the upside of rapidly growing economies—although this comes at the cost of a little more volatility.

Benefit #3: Patience is rewarded

Achieving the benefits of diversification and equity market returns requires a long-term, goal-oriented perspective. Many investors feel the urge to take action, particularly during periods of temporary equity weakness. However, the tendency to "time the market" has historically been detrimental to realized performance for the average investor.

The majority of annual equity returns are often achieved over relatively few days each year. Figure 2 (below) shows how $10,000 would have grown if fully invested since January 2000, and how much it would have diminished if it missed the best days in the market. For instance, if an investor missed the best 25-day performance in each of those years, realized returns for the whole time period would have been 79% worse compared to investors who remained fully invested the entire time.

Figure 2 – The benefits of staying invested: Growth of $10,000 in the S&P 500

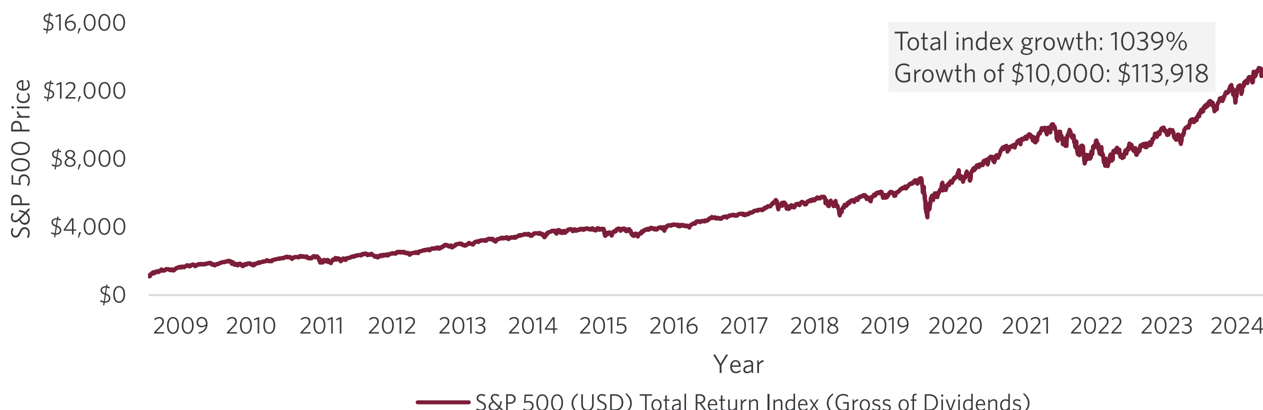


Source: Bloomberg®. As at January 1, 2000 – December 31, 2024.

The benefits of staying invested

When staying invested, an investor has the potential for strong market returns as well as volatility reduction. Figure 3 highlights the returns of the S&P 500 (USD) from March 2009 to December 2024. Over this time period, the index experienced both bull and bear markets,. However, despite short-term market downturns, the index continued to exhibit positive returns, annualized at 16% gross of dividends.

Figure 3 - S&P 500 (USD Index) growth since March 2009.

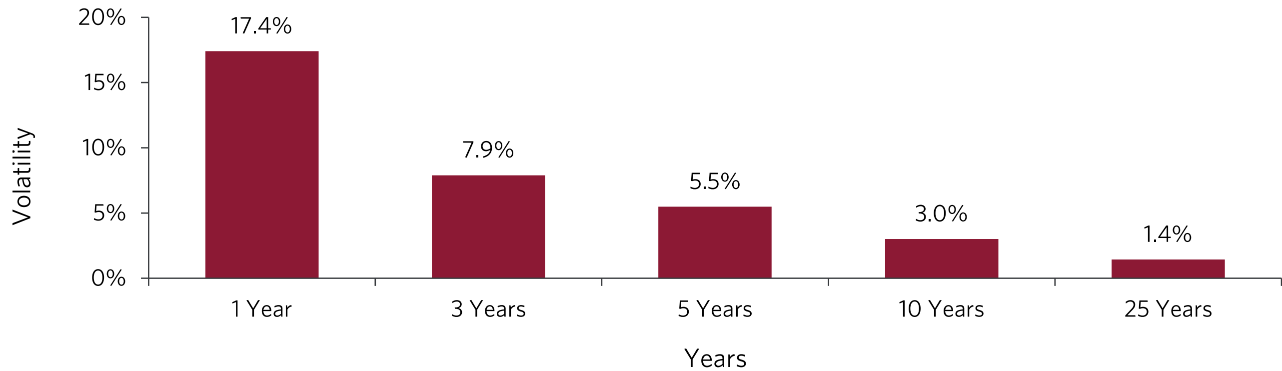


Source: Bloomberg®. S&P 500 returns were used as the proxy for the investor who remained fully invested expressed in USD. Returns are gross of dividends.. As at December 31, 2024.

Benefit #4: Decreased volatility in the long term

Equities exhibit episodic, short-lived periods of relatively high volatility.[1] However, holding equities for the long term smooths equity returns, and leads to a substantial reduction in both realized equity and total portfolio volatility (Figure 4).

Figure 4 – Equity volatility[2] declines as investor horizons increase



Source: Bloomberg®. As at January 1, 1990 – December 31, 2024.
Note: Volatility is measured by standard deviation.

Benefit #5: Potential tax advantages

Taxes in non-registered accounts can significantly erode investment returns. Equity investing may provide significant tax benefits that compound over time.

Capital gains receive preferential treatment, relative to interest payments that are fully taxed. If capital gains and losses total more than zero in a year, only 50% of the total is included in income as a taxable capital gain. If the total is less than zero, there's no income inclusion – instead, 50% of the total can be carried over to the prior 3 years or a future year, to potentially reduce tax on taxable capital gains. Capital gains are not taxed until they are realized, meaning that an investor may not have to pay taxes for 20 or 30 years if gains are not realized until then. In contrast, investors are required to pay annual taxes on dividend and interest income.

Although dividend income is taxed annually, a dividend tax credit is generally available to reduce the tax you pay on dividends from Canadian corporations.

Key equity considerations:

- Equities have been the cornerstone of wealth generation opportunities for decades, and are expected to continue to fill that role
- Equities allow investors to gain diversified exposure to regions all around the world, often with preferential tax treatment
- To realize the full benefits of an allocation to equities, investors should focus on long-term goals, remain invested, and resist the temptation to attempt timing the market

Source: cibc.com/en/personal-banking/smart-advice/tax-savings-tips.html.

[1] Measured by the standard deviation of returns.
[2] Volatility is measured by standard deviation

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.

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