The One-Fund Solution

Getting started in index investing with the Tangerine Investment Funds

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Toronto, Ontario
May 2014

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The One-Fund Solution

What's the best way to get started with index investing? The financial media have fallen in love with exchange-traded funds, and investors are bombarded with the message that ETFs are the best tools available. For professional advisors and experienced investors with large portfolios, they usually are. But ETFs are generally a poor choice for those just getting started. We believe beginners should keep things simple, and the **Tangerine Investment Funds** (formerly the ING DIRECT Streetwise Portfolios) are the easiest and most cost-effective way for small investors to build a globally diversified index portfolio.

The Tangerine Investment Funds are a family of index mutual funds launched in 2008 and sold online. *(They are not available from advisors or through discount brokerages.)* There are three balanced funds with various mixes of stocks and bonds, and a fourth fund that is 100% equities:

The Tangerine Investment Funds

	Balanced Income Portfolio	Balanced Portfolio	Balanced Growth Portfolio	Equity Growth Portfolio
Canadian bonds	70%	40%	25%	0%
Canadian stocks	10%	20%	25%	50%
U.S. stocks	10%	20%	25%	25%
International stocks	10%	20%	25%	25%

Source: Tangerine

The Tangerine Investment Funds are the only fund family in Canada tracking the most popular stock and bond indexes with a single product. Previously investors needed three or four individual index funds to build the Global Couch Potato portfolio, popularized by *MoneySense* magazine and the **Canadian Couch Potato** blog. Now they can achieve this same asset mix with the Tangerine Balanced Portfolio.

Using a single balanced fund has several advantages. One is convenience: investors don't need to manage a portfolio with several moving parts, which is a boon for novices. More important, a one-fund solution removes the temptation to tinker with one's asset allocation. Research by Vanguard found the lack of flexibility of one-fund portfolios—sometimes offered as a criticism—was actually an advantage during the 2008 financial crisis and the five years that followed:

> *"Although popular financial media analysts sometimes deride these investments as being too simple or generic, such strategies may actually help to insulate investors from one of the most insidious risks their investment portfolios face: their own behavior … Lack of ability by an investor to fine-tune his or her portfolio and respond to market events—especially in times of market turmoil—clearly was not a detriment in the period studied; instead, it was a key positive feature."*[1]

[1] Stephen M. Weber, *Most Vanguard IRA investors shot par by staying the course: 2008–2012,* Vanguard Investment Strategy Group, May 2013.

What's inside a Tangerine Investment Fund?

The Tangerine Investment Funds include various blends of four asset classes: Canadian bonds, Canadian stocks, U.S. stocks and international stocks. Each part of the portfolio is pegged to a well-known third-party index.

The bond component is based on the **DEX Universe Bond Index**, which includes about 1,200 Canadian bonds. (The Tangerine Investment Funds, like all comparable funds, include only a representative sampling.) The index is about 70% government bonds—federal, provincial, municipal and agencies—and 30% corporate bonds, with maturities from one to 25 years and an average term of about 10 years. All the bonds are "investment grade," which means they have an extremely low likelihood of default.

The Canadian equity holdings are based on the **S&P/TSX 60 Index**. This includes 60 of the largest public companies in Canada and covers about 75% of the country's stock market. About one-third of the index is made up of the big banks and other financial institutions, and another quarter is energy producers (oil and gas).

The **S&P 500 Index** is used for U.S. equities. It provides exposure to 500 companies and covers about 80% of the U.S. stock market, which is the largest and most broadly diversified in the world. The index includes significant holdings in information technology, healthcare and consumer retailers, all of which are lacking in the Canadian market.

The international equity component is based on the **MSCI EAFE Index**, which tracks more than 900 stocks in developed countries outside North America. The index covers about 85% of the available stocks in each country. About two-thirds of its holdings are in Europe (primarily the UK, France, Switzerland, and Germany), and about one-third is in the Asia-Pacific region (primarily Japan and Australia).

"But ETFs are cheaper!"

Index investors are keenly aware of costs, and many have noted that the Tangerine Investment Funds carry a management expense ratio (MER) of 1.07%. While that's about half the cost of the average Canadian balanced fund,[2] it's relatively high compared with portfolios of ETFs or TD e-Series funds, which typically cost between 0.20% and 0.50%.

However, it's important to put these percentages in dollar terms: for investors with small portfolios, the MER differences may be insignificant. An additional 10 basis points (0.10%) of MER works out to just $1 a year on every $1,000 invested. Applied to a large portfolio over several decades, even a few basis points of MER can have a significant effect. But when a portfolio is small—and even a maxed-out TFSA is likely to be less than $35,000—the impact is less than many people realize.

Moreover, in terms of *overall* costs—including trading commissions and administrative fees—the Tangerine Investment Funds may even come out ahead. This is because the 1.07% MER is the only cost associated with the ING DIRECT funds. By contrast, ETF investors typically pay a commission of $10 for every transaction. At some brokerages, the commissions are even higher ($19 to $29) on smaller accounts. Most discount brokerages also charge an annual fee on RRSPs below a certain minimum ($100 plus tax for accounts under $25,000 is common). Some even charge inactivity fees when clients don't make enough trades. These additional costs can easily wipe out any potential savings from using ETFs with a lower MER.

We've illustrated this idea with an example of an investor with a $20,000 RRSP:

	Streetwise Balanced Portfolio	Balanced ETF Portfolio
Account size	$20,000	$20,000
MER (%)	1.07%	0.20%
Estimated annual MER ($)	$214	$40
Estimated annual commissions @ $10	$0	$80
Estimated annual account fee	$0	$113
Total cost	**$214**	**$233**

Source: PWL Capital

[2] *Morningstar Global Fund Investor Experience 2013 Report*

The Tangerine Investment Funds also offer many practical and behavioural benefits that justify their higher management fee for small investors:

Easy account setup. Discount brokerages require a lot of paperwork from new clients. Getting started with Tangerine is much easier: if you already have a client account, opening a new investment account can be done online in about 10 minutes. The process is slightly longer for investors who do not have a relationship with Tangerine, but it can still be done almost entirely online. (For complete details, see "How to open a Tangerine account," below.)

No need to learn how to trade. Investing with ETFs means learning how to make trades with a discount brokerage: that is often intimidating for novices, and mistakes can be expensive. With the Tangerine Investment Funds you make all your contributions and withdrawals through the Tangerine website, which is much more user-friendly.

A single monthly contribution. Making preauthorized monthly contributions is generally not possible with ETFs: you need to manually buy new shares every time you add money. That's inconvenient and costly, especially if a portfolio includes several ETFs and the monthly contribution is small. The TD e-Series mutual funds carry no trading commissions, but it may be necessary to set up multiple Systematic Investment Plans. Tangerine clients can set up a single weekly, biweekly or monthly **Automatic Savings Program** with a minimum of just $25.

Automatic rebalancing. If you use multiple ETFs or index mutual funds, rebalancing requires you to monitor your portfolio and make calculations with a spreadsheet. It also means you need the emotional discipline to sell assets after they have gone up and purchase others that have fallen in value. The Tangerine Investment Funds make all that unnecessary, as they are automatically rebalanced quarterly.

Client support. Some discount brokerages—including Questrade and Virtual Brokers—have enticed investors with commission-free ETFs, but customer service can be uneven. Remember that discount brokerages only make money when investors trade frequently, so they may not be inclined to support small investors who stick to commission-free ETFs. Tangerine, by contrast, has a track record of excellent customer support, and their mutual fund reps have been specifically trained to answer questions about index investing.

> *If you already have a savings account with Tangerine, you should be aware that the banking and mutual fund divisions are separate. If you have questions about your investment funds, the banking representatives may not be able to help you. Call the Tangerine Investment Funds customer service line directly: 1-877-464-5678.*

Combining the Tangerine Investment Funds and GICs

The most aggressive member of the Tangerine family is the Equity Growth Portfolio, which is 100% stocks.

Most investors—especially those without much experience—can't handle the volatility of an all-equity portfolio, so we generally don't recommend the Equity Growth Portfolio as a one-fund solution. However, if you don't mind some extra maintenance, you might consider combining it with a ladder of GICs to reduce your costs.

Instead of using the Balanced Portfolio, for example, you might put 60% of your money in the Equity Growth Portfolio and use the other 40% to build a five-year ladder of GICs, which can also be purchased through Tangerine. Since GICs have no management fee, this would lower your overall cost to 0.64% while maintaining the same mix of stocks and fixed income found in the Balanced Portfolio.

There are a few trade-offs, however. First, the Equity Growth Portfolio is half Canadian stocks, so it is not as globally diversified as the balanced portfolios, which allocate only one-third of the equities to Canada. Second, adding a GIC ladder means a little more work: every year when one of the GICs matures, you will have to purchase a new five-year GIC to maintain the ladder. Finally, rebalancing is difficult. If your mutual fund plummets in value, you will need to wait until a GIC matures—or add new money to the account—to get back to your original target mix.

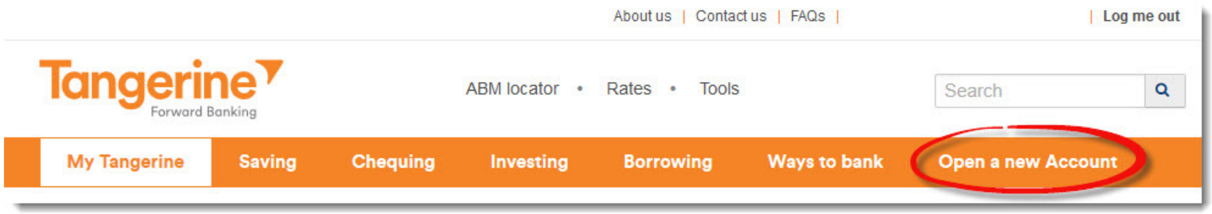
How to open a Tangerine account

Opening an investment funds account with Tangerine is straightforward, and almost all of the process can be completed online.

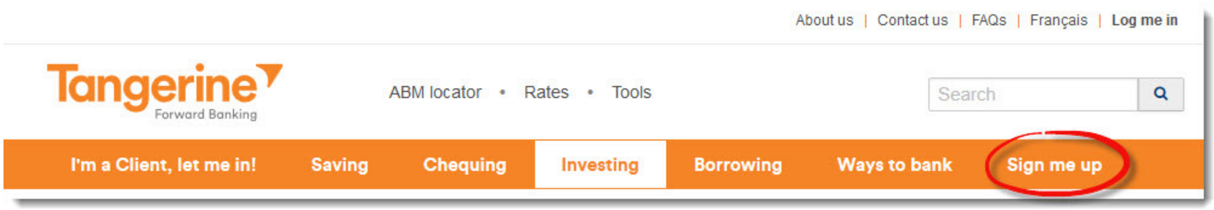
Step 1: Choose the account type

The Tangerine Investment Funds can be purchased in a nonregistered account, a Tax-Free Savings Account, an RRSP or a RRIF. The first step varies depending on whether you are an existing Tangerine client:

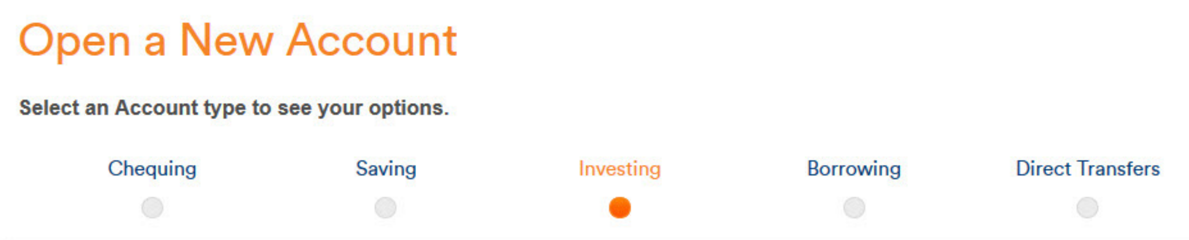
If you are an existing Tangerine client, visit **www.tangerine.ca** and log in with your client number and PIN. Then click the "Open new account" tab:



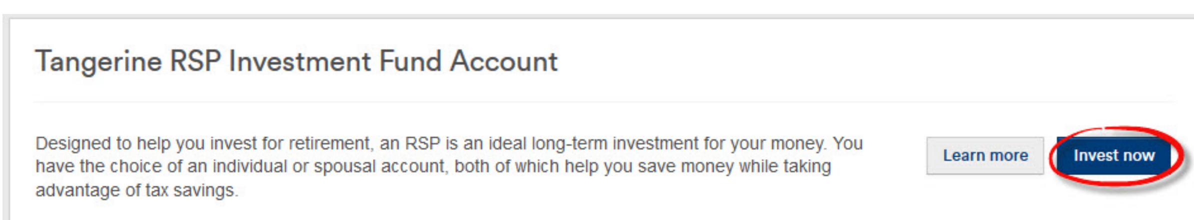
If you are *not* an existing Tangerine client, visit **www.tangerine.ca** and click the "Sign Me Up" tab:



On the next screen, you'll be asked what type of account you'd like to open. Select "Investing":



A menu will appear below and you'll be asked to choose between an Investment Fund Account (non-registered), a TFSA, an RRSP or RRIF. Select the one you want and click "Invest Now":

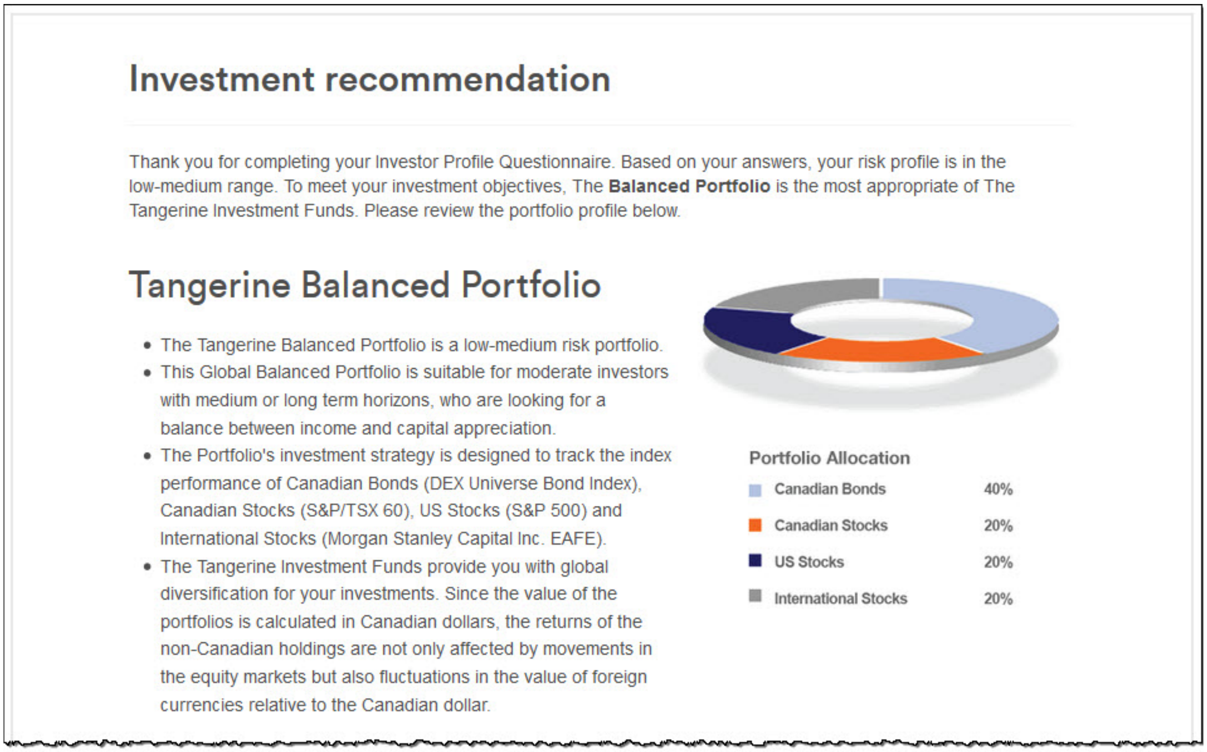


Step 2: Provide your personal information

You'll be asked for your name, address, phone number, Social Insurance Number and employment information. If you are an existing Tangerine client, some of this will already be filled in for you.

Step 3: Complete the Investor Profile Questionnaire

Next you'll fill out a brief questionnaire that asks your age, income, net worth, level of investment knowledge, risk tolerance, investment objective and time horizon. Tangerine will use this information to recommend the investment fund most suited to your goals and your risk profile. For example:



Investment recommendation

Thank you for completing your Investor Profile Questionnaire. Based on your answers, your risk profile is in the low-medium range. To meet your investment objectives, The **Balanced Portfolio** is the most appropriate of The Tangerine Investment Funds. Please review the portfolio profile below.

Tangerine Balanced Portfolio

- The Tangerine Balanced Portfolio is a low-medium risk portfolio.
- This Global Balanced Portfolio is suitable for moderate investors with medium or long term horizons, who are looking for a balance between income and capital appreciation.
- The Portfolio's investment strategy is designed to track the index performance of Canadian Bonds (DEX Universe Bond Index), Canadian Stocks (S&P/TSX 60), US Stocks (S&P 500) and International Stocks (Morgan Stanley Capital Inc. EAFE).
- The Tangerine Investment Funds provide you with global diversification for your investments. Since the value of the portfolios is calculated in Canadian dollars, the returns of the non-Canadian holdings are not only affected by movements in the equity markets but also fluctuations in the value of foreign currencies relative to the Canadian dollar.

Portfolio Allocation

Canadian Bonds	40%
Canadian Stocks	20%
US Stocks	20%
International Stocks	20%

Note: *Mutual fund dealers are required to have investors fill out this type of risk questionnaire to ensure they make appropriate recommendations. For example, if you indicate "My objective is to generate income from my investments and I am less concerned with capital appreciation," Tangerine will not allow you to invest in the Equity Growth Portfolio, even if that is the fund you want. If you disagree with Tangerine's recommendation for any reason, call the customer service department to discuss your situation. They will override the default choice if they're confident you understand the risks.*

Step 4: Fund your new account

The next step is to arrange the initial deposit. If you're already a Tangerine banking client, you can immediately link one of your chequing or savings accounts and transfer money from there. If you're not already a client, you will need to mail a cheque with your initial deposit to establish a link with another bank account. (Tangerine requires a physical cheque to verify your identity.)

You can also arrange to transfer cash from an existing RRSP or TFSA account to your new Tangerine fund. If your existing account includes mutual funds, stocks, bonds or other securities, these will be sold and the proceeds sent to Tangerine in cash within two to six weeks. (There are no tax consequences if you are transferring funds from one RRSP or TFSA to another account of the same type.) The transfer form needs a signature, so it must be faxed to 1-877-464-7797 or mailed to Tangerine, 3389 Steeles Avenue East, Toronto, Ontario, M2H 3S8.

Now you'll be asked to set up an **Automatic Savings Program** to add new money to your account weekly, biweekly or monthly. The minimum amount is $25, regardless of the frequency you choose. This is optional, but highly recommended: an automated savings plan is the best way to grow your portfolio.

Step 5: Sign the disclosure documents

Finally, you'll be asked to sign a Mutual Fund Account Terms and Client Relationship Disclosure document. If you're already a Tangerine client, you can accept this agreement electronically. If you're not a client, you'll need to send it by fax or mail.

Which portfolio is right for you?

Tangerine will select the most appropriate investment fund based on your answers to the Investor Profile Questionnaire. You should understand the reasoning behind this decision and be aware of the level of risk inherent in each of the portfolios.

Larry Swedroe's **The Only Guide You'll Ever Need for the Right Financial Plan** includes some helpful insights. Swedroe explains that your *ability* to take risk depends on your investment horizon and the stability of your income (or human capital). If you're 25 years from tapping your savings, or if you're a senior public servant, you can keep a large portion of your portfolio in stocks. But if you're a few years from retirement, or if you're a commissioned salesperson, you should hold a far greater proportion of fixed-income investments.

Swedroe offers these guidelines when considering the appropriate equity allocation for your investment horizon. (You can increase or decrease these suggestions based on your income security.) We've noted an approximate time horizon for each of the Tangerine Investment Funds:

Investment horizon (years)	Maximum equity allocation	Tangerine Investment Fund
0-3	0%	
4	10%	
5	20%	
6	30%	*Balanced Income Portfolio*
7	40%	
8	50%	
9	60%	*Balanced Portfolio*
10	70%	
11-14	80%	*Balanced Growth Portfolio*
15-19	90%	
20+	100%	*Equity Growth Portfolio*

Source: Larry Swedroe, *The Only Guide You'll Ever Need for the Right Financial Plan*, Bloomberg (2010)

Swedroe also reminds investors to consider their willingness to take risk. How likely are you to panic when your portfolio loses value, as it inevitably will? Is a 25% drop going to give you ulcers? Here are his guidelines for determining a portfolio's equity allocation based on the degree of loss you can tolerate without abandoning your investment plan. Again, we have noted the approximate loss you should be prepared to accept for each of the Tangerine Investment Funds:

Maximum loss you'll tolerate	Maximum equity allocation	Tangerine Investment Fund
5%	20%	
10%	30%	*Balanced Income Portfolio*
15%	40%	
20%	50%	
25%	60%	*Balanced Portfolio*
30%	70%	
35%	80%	*Balanced Growth Portfolio*
40%	90%	
50%	100%	*Equity Growth Portfolio*

Source: Larry Swedroe, *The Only Guide You'll Ever Need for the Right Financial Plan*, Bloomberg (2010)

Sometimes your ability and willingness to take risk will be at odds with one another. For example, you might have a 20-year time horizon but still be unwilling to accept a loss of more than 25%. In that case, always err on the side of caution and choose the risk level you're most willing to tolerate.

How have the Tangerine Investment Funds performed?

Index investors should expect the performance of their portfolios to lag their benchmarks by an amount roughly equal to the fees charged by the funds. Since the Tangerine Investment Funds have an MER of 1.07%, it's reasonable to expect them to trail a comparable index benchmark by approximately that much.

To test this idea, we compared the three balanced funds to hypothetical portfolios based on index data in the appropriate proportions (see table below). We rebalanced these index portfolios quarterly to match the frequency used by the Tangerine Investment Funds.

	Balanced Income Index Benchmark	Balanced Index Benchmark	Balanced Growth Index Benchmark
DEX Universe Bond Index	70%	40%	25%
S&P/TSX 60 Index	10%	20%	25%
S&P 500 Index	10%	20%	25%
MSCI EAFE Index (net div.)	10%	20%	25%

As shown in the performance numbers below, the Tangerine Investment Funds have done a good job of matching the returns of the index portfolios after accounting for fees.

	1-Year Return	3-Year Annualized	Since Inception
Tangerine Balanced Income Portfolio	**6.76**	**6.00**	**4.62**
Balanced Income Index Benchmark	7.82	7.18	5.71
Difference	-1.06	-1.18	-1.09
Tangerine Balanced Portfolio	**13.96**	**8.17**	**4.83**
Balanced Index Benchmark	15.12	9.24	5.91
Difference	-1.16	-1.07	-1.08
Tangerine Balanced Growth Portfolio	**17.66**	**9.14**	**4.92**
Balanced Growth Index Benchmark	18.90	10.21	5.92
Difference	-1.24	-1.07	-1.00

Sources: Tangerine, Dimensional Returns 2.0, Morningstar. Inception date measured from first full month (February 2008). Period ending March 31, 2014.

An ideal place to start

As investors grow their wealth and gain experience, they may outgrow the Tangerine Investment Funds: using ETFs in a discount brokerage account will be significantly less expensive and more flexible in the long run. But only a small percentage of Canadians have the time, ability and inclination to properly maintain an ETF portfolio on their own. For the rest, the Tangerine Investment Funds are an ideal starting point. Indeed, we believe they are appropriate for some investors with portfolios as large as $100,000. The broad diversification, relatively low cost and simplicity of these one-fund solutions are the ideal gateway to index investing.

Notes

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