Volume 8, Issue 2 www. AlternativChronicle.com March 2, 2015

AlternativChronicle

The Biggest Investment Question Today

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What's the most important investment question that investors (both individual and institutional) are faced with these days?

In my opinion, that question deals with which method of investing provides a combination of good returns, a degree of safety and a high likelihood of achieving one's goals without suffering capital losses.

Risk-free yields (interest rates) on government debt in many developed countries are currently at historic lows. In some places, the nominal yields have become negative, which is counter-intuitive. It means lenders actually pay borrowers for the privilege of lending money. In such an environment, familiar investment rules need to be reconsidered.

If investing money into relatively safe fixed-income securities result in a negative return, what is the correct course of action? You might expect the answer to be…"avoid this investment at all cost." But that's not happening. All sorts of investors are funnelling huge sums of money into low yielding or negative yielding debt.

One possible reason for buying bonds when yields are negative is that investors expect deflation to occur soon. If this happens, debt instruments won't lose as much as many other alternatives. Relatively speaking, a small loss is better than a bigger one. What contributed to today's low yields?

Over the past few decades (since the late 70s) there has been a global coordinated effort to reduce inflation. This was a response to runaway inflation in the 60s and the social unrest it spawned. More recently, we can also point to demographics in North America, Europe and Japan. Because of an aging population, there was a real shift towards buying safe fixed-income securities. Simultaneously, many large pension plans reached their maturity phase. They also shifted assets to fixed income securities in order to meet annual payout needs.

And of course, since 2008 a painful global recession has lowered the GDP of many countries. To offset the recession, the world's central banks were given unprecedented monetary powers. At the same time, revamped financial regulations designed to stabilize the global banking system resulted in deleveraging.

In finance, there are just two main investing methods. **Method 1** seeks to maximize the returns for a pre-set level of risk (or Return Seeking). **Method 2** seeks to match assets to liabilities (thus, Asset Liability Matching, or ALM). Sophisticated investors (such as institutional plans) appreciate both and use them in tandem.

So in today's low yielding environment, the biggest question investors face is what percentage belongs in the Return Seeking bucket (Method 1) and what percentage belongs in the other ALM (Method 2) bucket. The mix is difficult to determine.

With yields so low, the return seeking component should have a higher weight than normal. Of course, anyone at or near retirement will find this unsettling. They were expecting to increase the risk-free part of their portfolios. But at today's yields, that means a slow reduction in the standard of living. ◻

Alzheimer's research needs <u>YOUR HELP</u>…...I am participating in the 2015 Scotiabank Pro-Am with former NHL stars to raise funds for Alzheimer's Disease.

Can you donate to this worthy cause??? If yes….just click on the logo ==>

Inside this issue:

<u>Alzheimer's Fundraising:</u>

So far, I have raised over $2000 to my goal of raising $6500.

If you are able to support this cause, please click on the logo and it will take you to my donation page. Thanks in advance !!!

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Mr. Klar is a faculty member at the Schulich School of Business and a senior advisor to York University's $1.9 billion pension plan.

….Cheers, GMK