

Investment Management for Settlement Trusts

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Risk and Return

- ▶ What is Risk?
- ▶ The Risk Return Tradeoff
- ▶ A look at Past Returns
- ▶ Aligning Return Expectations with Risk Tolerance
- ▶ Forecasting Long-Term Growth of Trust Funds

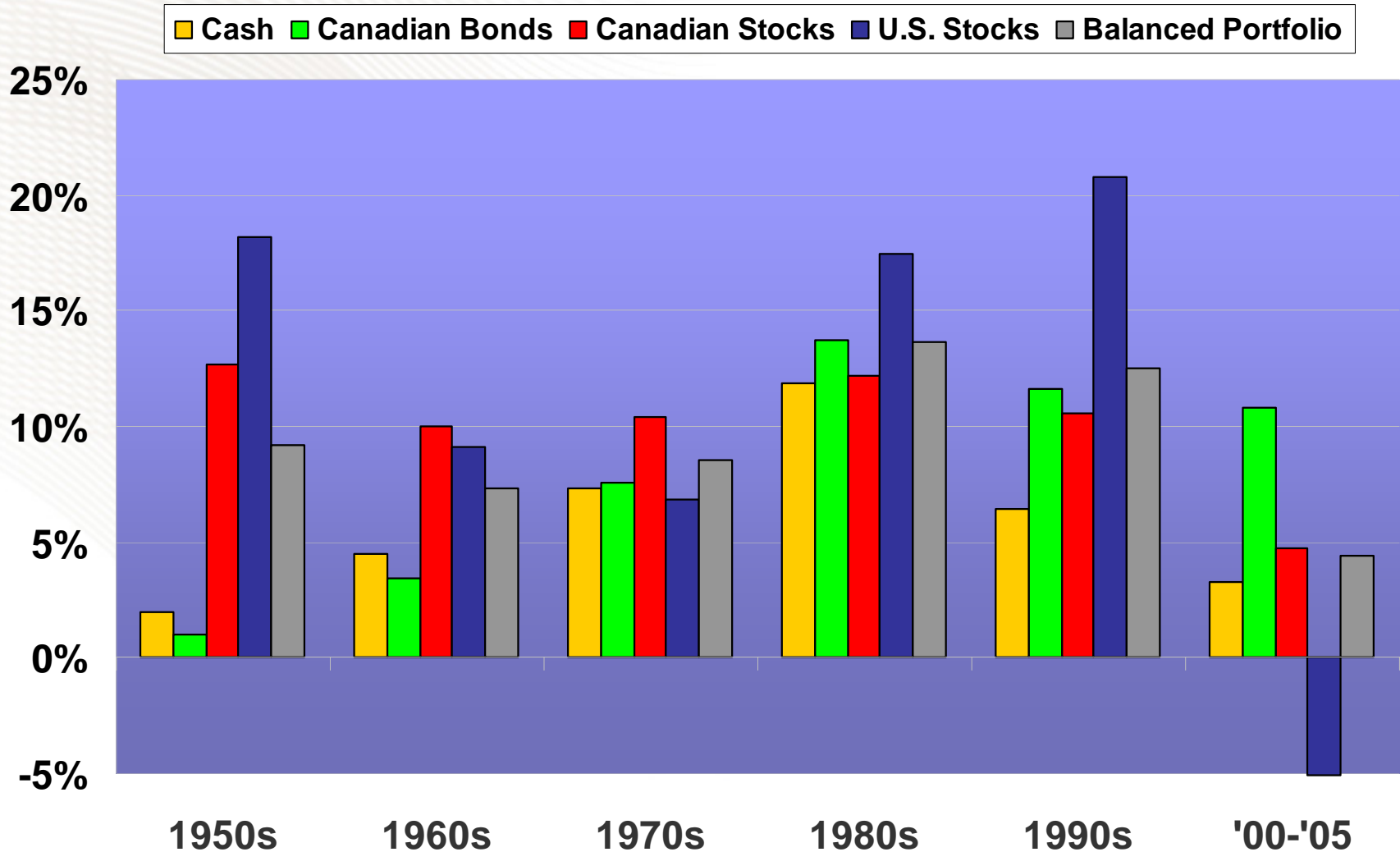
What is Risk?

- ▶ Risk of Default (Money Market and Bonds)
- ▶ Loss of Capital (Stocks and Bonds)
- ▶ Benchmark Risk/Tracking Error (All Asset Classes)
- ▶ Volatility of Returns (Stocks and Bonds)
 - ▶ Usually measured as Standard Deviation

The Risk Return Tradeoff



Historical Average Annual Returns by Asset Class



Source: Andex Charts 2005

Balanced Portfolio: 10% Cash, 30% Bonds, 40% Cdn Stocks, 20% U.S. Stocks

Determining an Appropriate Return Objective

Considerations:

- Spending forecast
- Inflation expectations
- Real growth objective
- Expected rates of return for suitable asset classes
- Risk tolerance

Scenarios:	1	2	3
Current spending forecast	2%	3%	4%
Inflation (preserving the value of investments)	3%	3%	3%
Growth (Real growth above inflation)	0%	1.5%	2%
Total Required Return	5%	7.5%	9%

Determining an Appropriate Asset Mix

- ▶ Based on expected risk/return for different asset classes, risk tolerance, time horizon.
- ▶ Asset mix is the most important determinant of portfolio return and risk

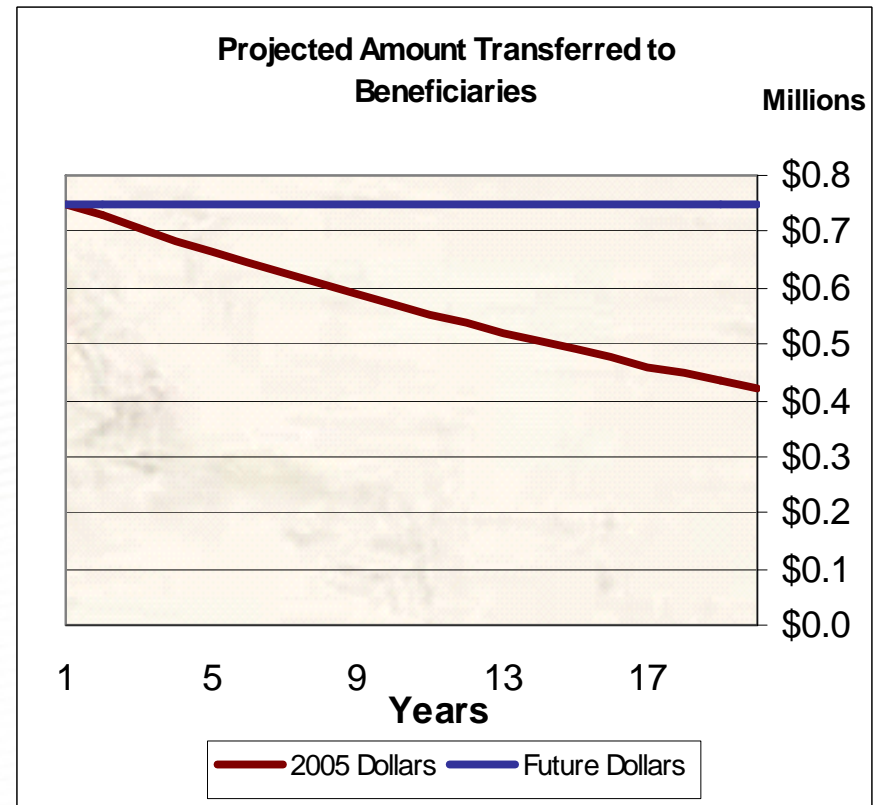
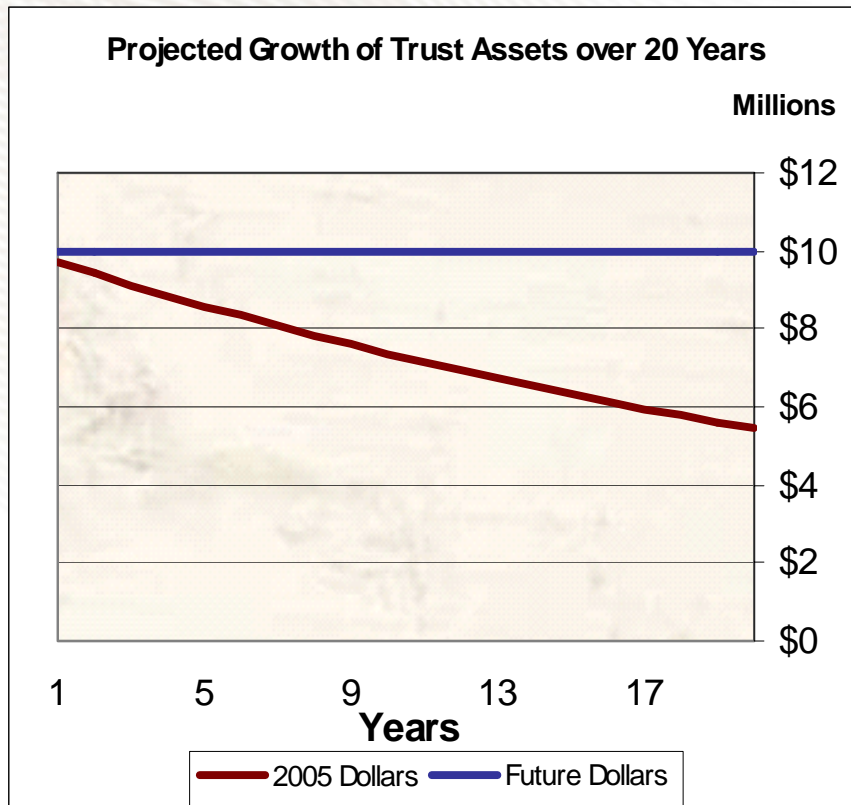
Asset Class	Historical Return	Expected Return	Risk (Volatility)
Money Market	6.1	4.0	Low
Bonds	9.5	5.0	Low to medium
Canadian Stocks	9.5	9.0	High
US Stocks	11.5	9.0	High
International Stocks	11.5	10.0	High

Asset Allocation Process

Asset Class	Target Portfolio			Expected Return
	1	2	3	
Money Market	10%	5%	0%	4.0%
Bonds	90%	35%	20%	5.0%
Canadian Stocks	0%	30%	40%	9.0%
US Stocks	0%	20%	20%	9.0%
International Stocks	0%	10%	20%	10.0%
Total Expected Return	5%	7.5%	9%	
Standard Deviation	5%	12%	16%	
Maximum Return	10%	20%	25%	
Minimum Return	0%	-5%	-7%	

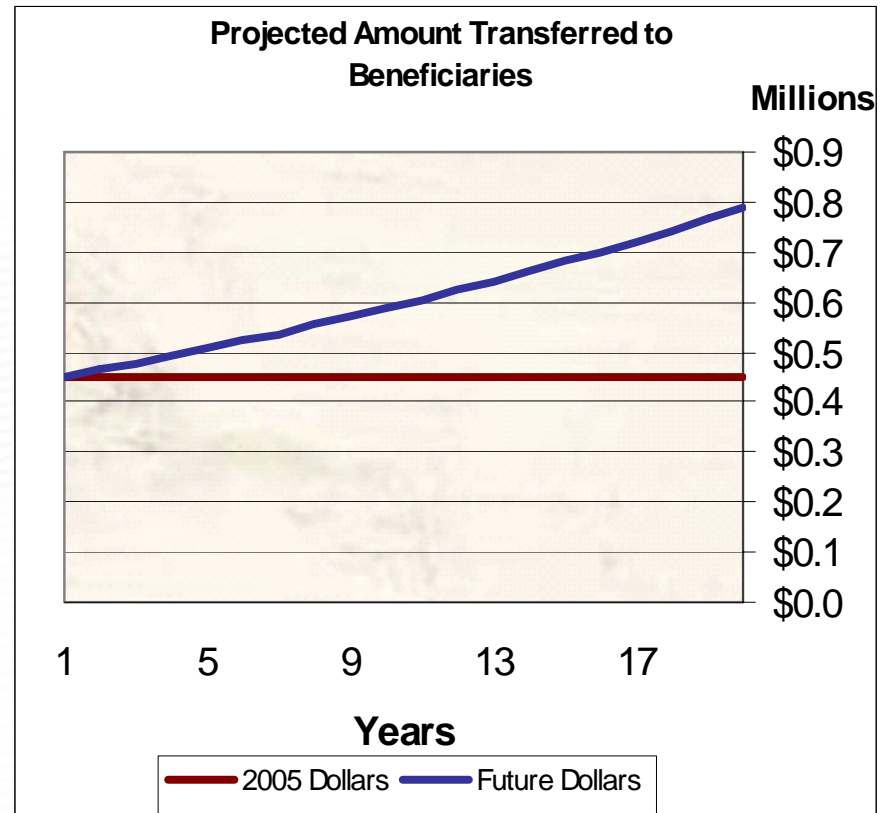
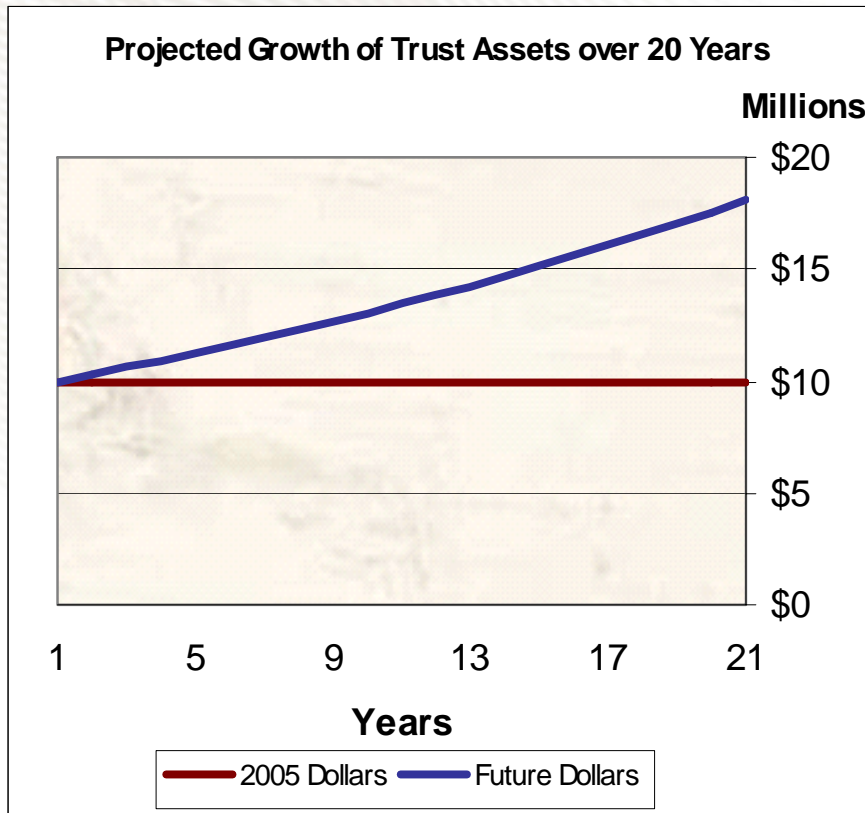
Return and standard deviation numbers are for illustrative purposes and do not necessarily reflect Scotia Cassels' views.

Forecasting Long-Term Growth of Trust Funds Scenario 1



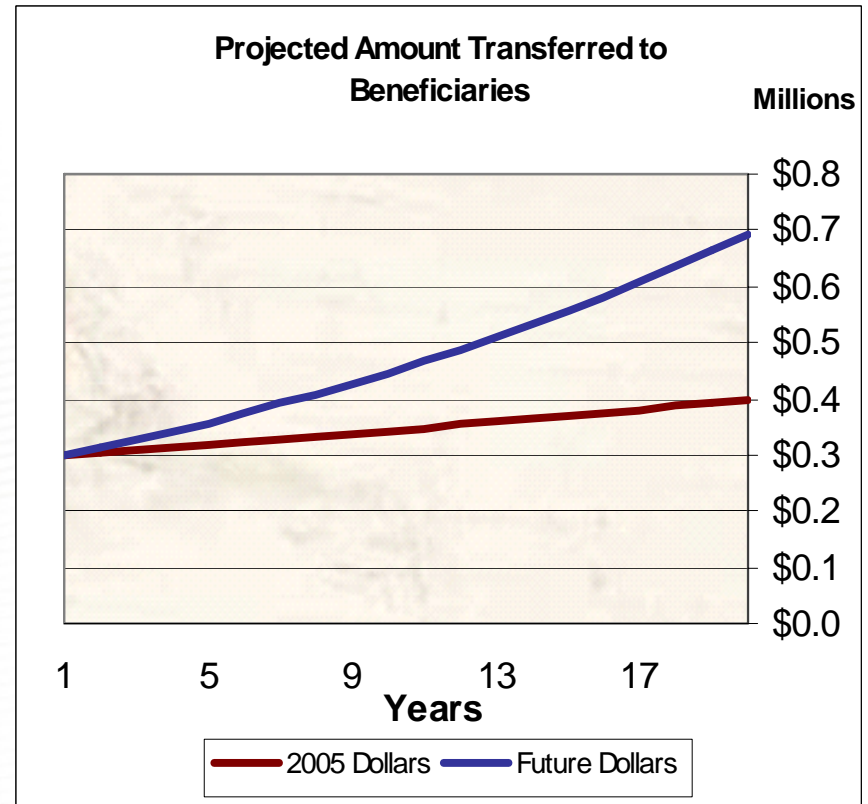
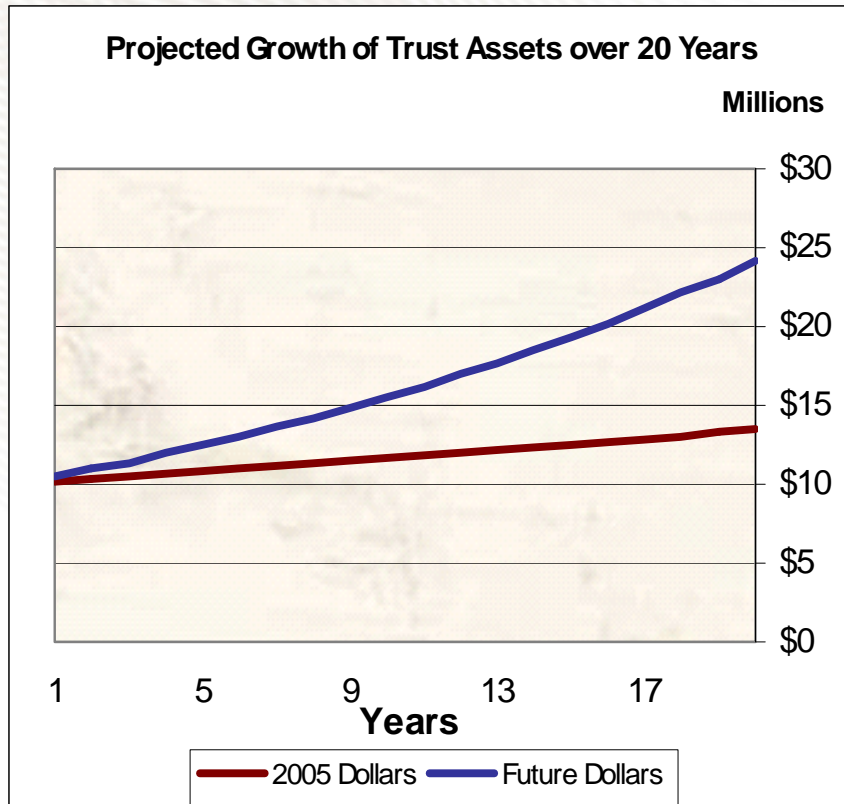
Assuming 7.5% annual return, 3% inflation and all income and capital growth paid out to the beneficiaries

Forecasting Long-Term Growth of Trust Funds Scenario 2



Assuming 7.5% annual return, 3% inflation and reinvestment of a portion of income to maintain real purchasing power

Forecasting Long-Term Growth of Trust Funds Scenario 3



Assuming 7.5% annual return, 3% inflation and reinvestment of a portion of income to maintain real purchasing power plus real growth of 1.5% annually