



# A fresh approach to investing

Putting the lifecycle concept to work for you



We all have financial goals – saving for retirement, education, a home or some other personal dream. But what's the best way to save for those goals? A new approach, lifecycle investing, may provide the solution.



# A new way to reach your financial goals

## How do you feel about risk?

Markets are volatile. What's up one month may be down the next and vice versa.

This doesn't bother some people. They may not worry about losing money; some are even willing to lose a lot if they're confident their investment strategy will work out in the long run.

Others lose sleep over even the *possibility* that their investments might lose money.

## Your risk tolerance

You've probably already thought about how much volatility you feel comfortable with. Maybe you've discussed it with your advisor. It's an important consideration.

But it's not the only consideration. You also need to think about your savings goals and whether you've chosen the right investment strategy to help you reach them.

Fortunately, there are ways to deal with both these issues, to feel comfortable about the volatility of your investments while you're achieving your long-term savings goals.

### The bottom line

When thinking about how much investment risk you're willing to take on, you also need to consider what your savings goals are and whether you can reach them in the time available.

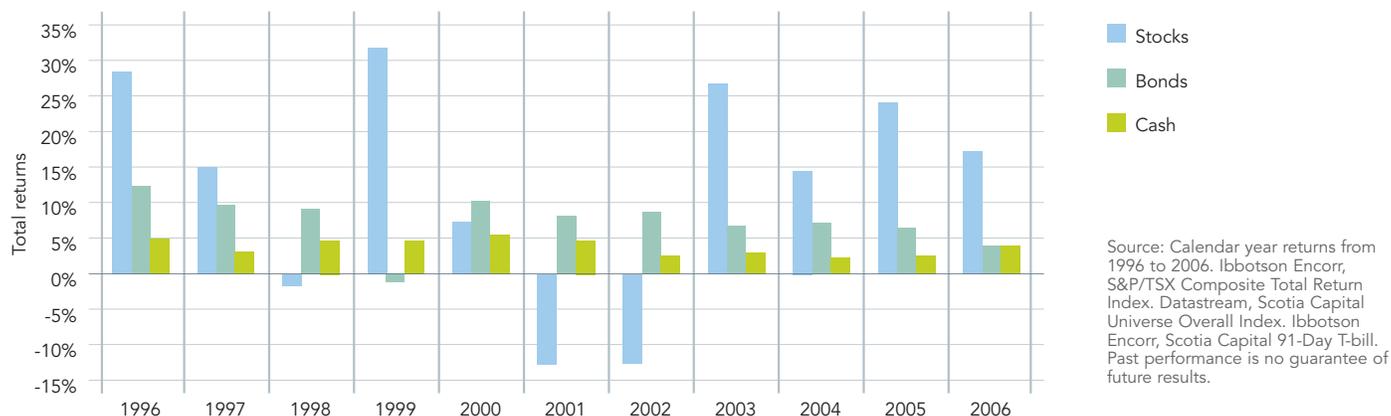
# How different types of assets behave

## FIRST, A LITTLE BACKGROUND.

By studying the behaviour of different types of investments, or asset classes, we've learned a fair bit about how they typically perform. While nobody can guarantee what will happen in the future, we can feel fairly confident about the sorts of results different asset classes will produce in the long term.

The chart below shows how different types of investments have performed in the past. Stock market investments, also known as equities, tend to be more volatile than bonds. The least volatile are cash investments – short-term places to park your money and earn a bit of interest, such as treasury bills (T-bills) and guaranteed investment certificates (GICs).

Calendar year returns of Canadian stocks, bonds and cash from 1996 to 2006



At the same time, the most volatile investments are also the ones that tend to produce the best returns.

This poses a challenge. Investors who have a low risk tolerance may prefer the less volatile investments, but they will have to sacrifice the possibility of getting better returns. Investors with a high risk tolerance may want to invest only in equities. But they run the risk that their investments will be at a low point when they need their savings.

### The bottom line

Once you understand how different types of investments tend to behave, they can be combined to give you a better chance of getting the results you want.

# A mix of assets can help you lower your risk

YOU CAN DEAL WITH THIS ISSUE BY COMBINING DIFFERENT TYPES OF ASSET CLASSES IN your investment portfolio. This is known as asset allocation. Based on your risk tolerance, your advisor will design a mix of investments that should give you the right balance of protection and potential for higher returns.

The chart below shows examples of different asset allocations. Portfolios that have more equities will tend to have higher returns. But portfolios with more bonds and cash will suffer fewer drops, and those drops will not be as severe.

## Mixing asset classes can help investors moderate risk



Asset allocation – combining different types of investments to lower your risk and still have the potential for better returns – is based on Modern Portfolio Theory. It was first proposed in 1952, by a student at the University of Chicago, Harry Markowitz, who later won the Nobel Prize for economics.

Source: Calendar year returns from 1957 to 2006. Ibbotson Encorr, S&P/TSX Composite Total Return Index. Prior to 1960, Global Financial Data, S&P 500 Total Return Index; since 1960, Ibbotson Encorr, S&P 500 Total Return Index. Prior to 1970, Global Financial Data, a synthetic EAFE that was constructed from individual EAFE country total returns weighted by historical gross domestic product for each country; since 1970, Ibbotson Encorr, MSCI EAFE Total Return Index. Ibbotson Encorr, Scotia Capital 91-Day T-bill. Prior to 1980, Scotia Capital, Scotia Capital Long Bond Overall Index; since 1980, Datastream, Scotia Capital Universe Overall Index. Past performance is no guarantee of future results. All returns in Canadian dollars.



# But asset allocation is not enough ...

**PROBLEM SOLVED? NOT QUITE. YOU MAY HAVE A PORTFOLIO THAT SUITS YOUR COMFORT** with the ups and downs of the market. But what about that other risk – not reaching your goal? Over the long term, will this portfolio give you the results you need?

Let's take retirement as an example, since that is the most important long-term goal for many people.

Say you choose the most conservative portfolio in the chart on page 3. Unless you can afford to put a large amount into your savings on a regular basis, you may have trouble saving enough for a financially secure retirement.

But if you choose the more aggressive mix of assets, you could also have problems. What if the market dips just as you're approaching retirement, and you don't have enough?



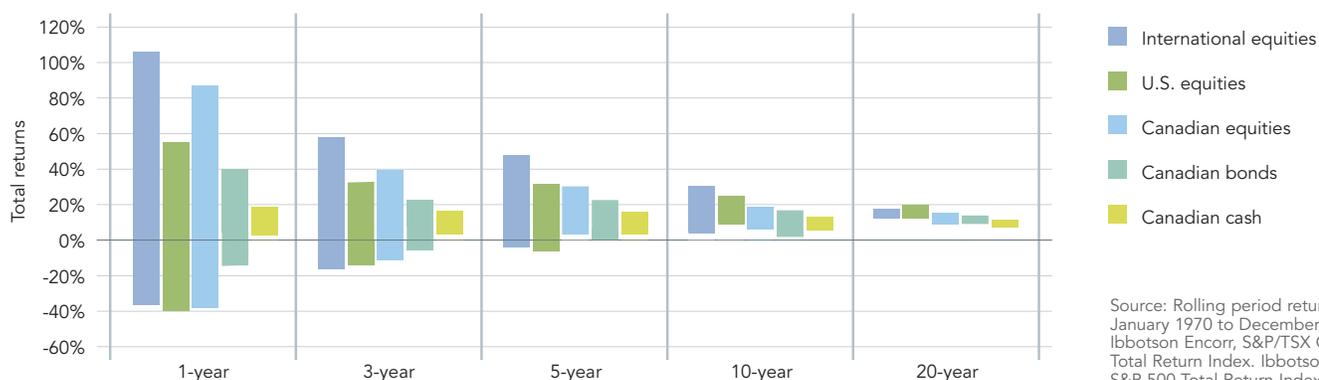
# Adding time to the equation

SO HERE'S ANOTHER WAY TO THINK ABOUT RISK – THE AMOUNT OF RISK YOU SHOULD take changes depending where you are on your journey to your goal. This is known as lifecycle risk capacity or age-appropriate risk.

When your goal is far off, you have time to recover from losses. But as you get closer to needing the money, losses become more serious.

## Over time, investment returns tend to even out

Range of annualized returns 1970-2006



Source: Rolling period returns from January 1970 to December 2006. Ibbotson Encorr, S&P/TSX Composite Total Return Index. Ibbotson Encorr, S&P 500 Total Return Index. Ibbotson Encorr, MSCI EAFE Total Return Index. Ibbotson Encorr, Scotia Capital 91-Day T-bill. Prior to 1980, Scotia Capital, Scotia Capital Long Bond Overall index; since 1980, Datastream, Scotia Capital Universe Overall Index. Past performance is no guarantee of future results. All returns in Canadian dollars.

As you can see in the chart above, as the years go by investment returns tend to even out. If retirement is 20 years off, that long-ago loss will make little difference by the time you're ready to start living on your savings.

But what would happen if that loss occurs a year before you plan to retire?

## Time and your asset allocation

If the amount of risk you can afford to take changes over time, then your asset allocation should also change. If your goal is far off, then you can afford to put more of your money into equities. Since equities also tend to provide higher returns, you're increasing your chances of having enough money saved when you're ready to retire.

But as you get closer to your goal, you'll want to move your savings into assets that are less volatile, so you can feel comfortable that your money will be there when you need it.

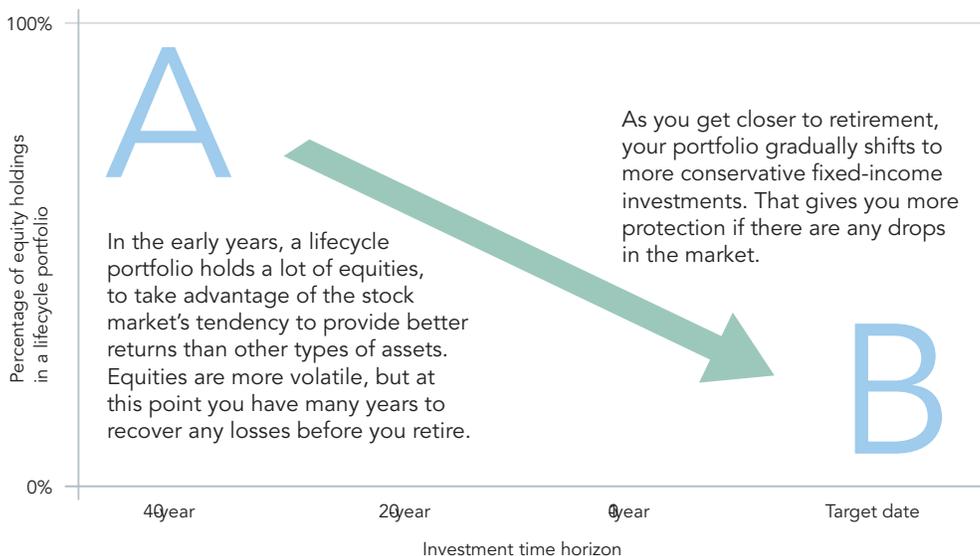
### The bottom line

When designing an investment strategy, you need to think about the long term. The amount of risk you can afford to take depends on your age and where you are on the journey to your goal. This is known as "age-appropriate risk."

# Lifecycle investing

AGE-APPROPRIATE RISK IS A COMMON-SENSE IDEA THAT'S BEEN AROUND FOR A LONG TIME. But it's only recently that the investment industry has started to design products to help investors apply it. Fidelity has been one of the first companies to create lifecycle investments for all Canadians.

## How a lifecycle portfolio works



The illustration above gives a simple picture of how this approach, called lifecycle investing, works. While the research that goes into creating a lifecycle investment plan can be complex, the concept is straightforward. Over time, your portfolio gradually changes from investing heavily in equities, which are more volatile but tend to produce higher returns, to bonds and cash, which have lower returns but have fewer and milder drops.

### The bottom line:

With lifecycle investing, your portfolio has more risk when you are younger and have time to recover from market declines. It gradually becomes less risky as you get closer to the time when you plan to use your savings. A lifecycle portfolio is designed to give you the best possible combination of protection and potential for better returns.

# Does lifecycle investing really work?

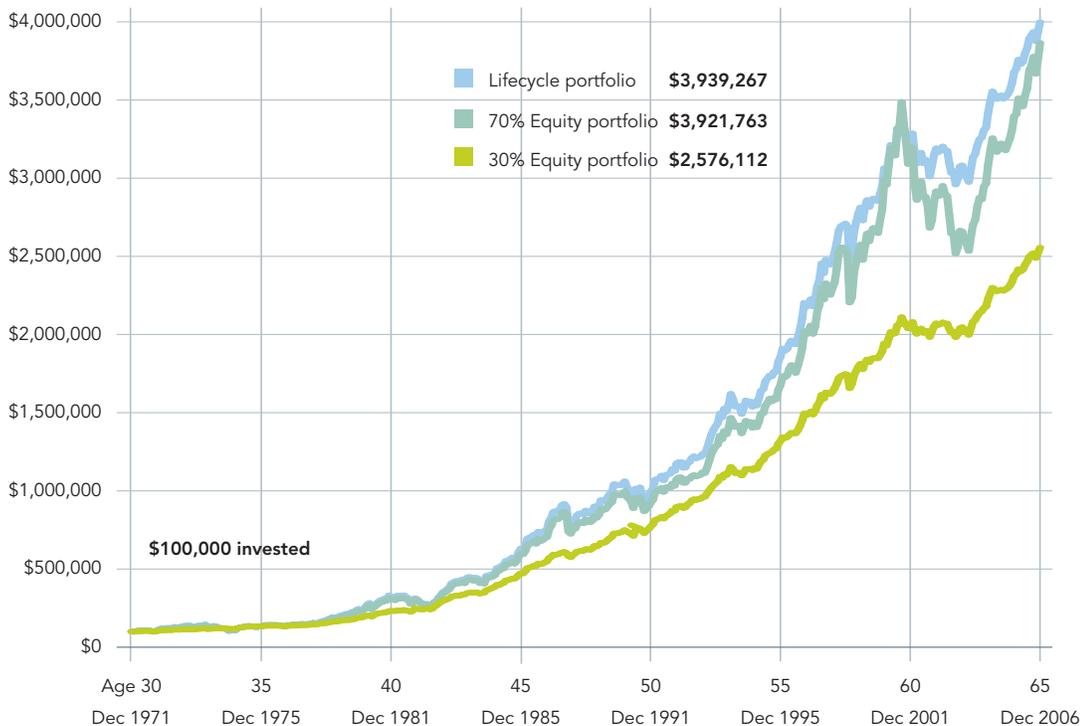
IN THE CHART BELOW, WE'VE USED HISTORICAL DATA TO TEST THE LIFECYCLE CONCEPT.

In this example, an investor began to save for retirement at the end of 1971 and retired 35 years later, at the end of 2006. The chart shows how three different portfolios would have performed:

- a more aggressive portfolio (70% stocks, 20% bonds, 10% cash)
- a more conservative portfolio (30% stocks, 35% bonds, 35% cash)
- a lifecycle portfolio that changes over time from an aggressive initial mix (85% stocks, 15% bonds) to a more conservative mix (38% stocks, 34% bonds and 28% cash)

If you chose the more conservative portfolio, your results in the first 10 years would not be that different from the other two. But if you stuck with that same portfolio for the whole 35 years, there would be a big difference between your end results and those of the other portfolios – over \$1 million. Depending on your situation, you might face a very real risk of not having enough retirement savings.

## Lifecycle portfolio vs. static portfolios – a historical example



Source: Fidelity Investments.

Growth of a \$100,000 lump sum invested at the end of December 1971 and held until December 2006 in three portfolios. The 70% equity portfolio is made up of 45% Canadian equities, 12.5% U.S. equities, 12.5% international equities, 20% Canadian bonds and 10% Canadian cash. The 30% equity portfolio is invested in 15% Canadian equities, 7.5% U.S. equities, 7.5% international equities, 35% Canadian bonds and 35% Canadian cash. The lifecycle portfolio begins with an equity weighting of 84.38% (54.38% Canadian, 15% U.S. and 15% International), a Canadian bond weighting of 15.26% and a Canadian cash weighting of 0% and rolls down, using a Fidelity proprietary non-linear methodology, to an equity weighting of 38% (18.48% Canadian, 9.76% U.S. and 9.76% International), a Canadian bond weighting of 34.28% and a Canadian cash weighting of 27.72%: Ibbotson Encorr, S&P/TSX Composite Total Return Index. Ibbotson Encorr, S&P 500 Total Return Index. Ibbotson Encorr, MSCI EAFE Total Return Index. Prior to 1980, Scotia Capital, Scotia Capital Long Bond Overall index; since 1980, Datastream, Scotia Capital Universe Overall Index. Ibbotson Encorr, Scotia Capital 91-Day T-bill. Past performance does not guarantee future results. All returns in Canadian dollars.

If you chose the more aggressive portfolio, you'd certainly be financially better off. But look what happens in 2000. That was the year the technology bubble burst. The stock market dropped abruptly and took several years to recover. By the time you were ready to retire, you would have had less than the lifecycle portfolio. And if your target date had been in the years immediately following the bubble burst, you would have been caught short and might have had to put off your plans to retire.



Q: In a ten-year period, on average how many years will show a downturn in the stock market?

A: Three

The most successful portfolio is the lifecycle portfolio. In the early years, it benefits from having a lot of equities. But as you get closer to retirement, it shifts to carrying more cash and bonds. So when the market dropped in 2000, your savings would not have suffered as much as the more aggressive portfolio. The lifecycle portfolio has helped you get better returns when you had lots of time to recover from any losses. And it has also given you protection when you needed it most.

No investment strategy is guaranteed. And the results you get will depend on your situation. But Fidelity analysts have been researching and testing the lifecycle investing concept for over 15 years, and we're convinced that for many people it's an excellent strategy that will give them a better chance of reaching their savings goals, while still sleeping comfortably.

# How can you take advantage of lifecycle investing?

VARIOUS INVESTMENT PRODUCTS THAT USE THE LIFECYCLE INVESTING APPROACH are available. These can offer several practical benefits, depending which you choose:

- **Investment discipline** Changes to your portfolio are managed for you, over time. So there's no problem staying on track.
- **Simplicity** These products are usually easy to use and understand.
- **Efficiency** Your investments are monitored on your behalf. You don't need to do anything.
- **Research** A good lifecycle investment plan is based on sophisticated, in-depth research aimed at giving you the best combination of potential returns and risk reduction.

## Your advisor and Fidelity are here to help

Fidelity is a leader in researching and developing lifecycle strategies. Our Fidelity Clear Solutions™ investments give you the chance to use this innovative approach. Your advisor can provide you with further information and help you determine if lifecycle investing is right for you and which product could serve you best.

For important information about the methodology used for the various charts, please refer to Fidelity's Viewpoint report, *The case for age-based lifecycle investing*.

### The bottom line

Fidelity was one of the first companies to create mutual funds based on the lifecycle investing concept. We have over ten years of experience managing lifecycle funds in the U.S. We believe that, for many investors, lifecycle investing provides a better chance of achieving their goals.

**If you're interested in lifecycle investing,  
the following products may be right for you.**

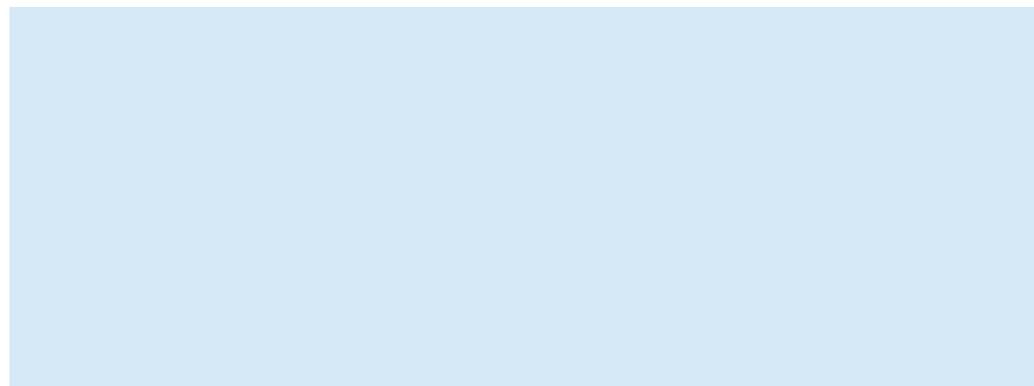
Saving for retirement?

- Fidelity ClearPath™ Retirement Portfolios or
- Fidelity ClearPlan™ Custom Fund Portfolios

Saving for a goal such as education or buying a house?

- Fidelity ClearPlan™ Custom Fund Portfolios

**Talk to your advisor.**



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