



Di Iorio Family Wealth of RBC Dominion Securities

Think bigger. Act bolder. Invest better.

Answering Some of Your Frequently-Asked Questions

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Over the last couple of months, in addition to our regular blog posts, we have recorded a few webcasts. Back in April we shared some of the reasons we were very excited about the investment opportunities we were finding ([Why We Are Really Excited Right Now](#)), and in May we shared some insight into our core methodology, “The DM5”, and how we apply it to all aspects of our work ([Our Core Methodology – The DM5](#)). Between the responses to these, as well as some of our recent conversations with clients, colleagues, and partners, we have fielded quite a few questions. We decided it would be worthwhile to focus a post on some of the more common questions we’ve heard, as it is very likely that many readers or listeners may have wondered the same things.

Q. What exactly do you mean when you talk about “portfolio insurance”, and how did you implement this strategy at the start of the year?

A. This is a question we have gotten relatively often in our conversations with clients, as it is something we have spoken about quite often. When we talk about “portfolio insurance”, we are really referring to the use of options contracts whose value is tied to the performance of the market.

In this case, we are referring to something called “Put” options, which when purchased provide investors with the option to sell a security at a set price, regardless of what the market price is at the time. If the price of the underlying asset decreases, the value of the Put option increases because you have the right to sell it at a predetermined price.

If you apply this concept to the market as a whole, Put options can be used to offset the risk of a market-wide decline by purchasing them on ETFs that track something like the S&P 500. However, purchasing protection like this of course comes at a price (a “premium” in options-terminology). This cost is based on various factors, most notably:

1. **Strike Price:** The price at which you are purchasing the option to sell
2. **Time to Expiration:** How long the option remains valid for before expiring
3. **Volatility:** How much volatility the market is expecting over the options lifetime

Without getting too much into detail, the simple rule to remember is that it's better to buy portfolio insurance when volatility is low, and market sentiment is very positive. This is exactly what we did at the very beginning of the year, when the market had been trending upwards for multiple months, volatility was low, and investors were in our view becoming very complacent in assuming this would continue. It only cost us about 1-2% of overall portfolio values to offset the vast majority of the market risk we had at the time, whereas if we had waited for things to start to turn ugly in February and March, these premiums would have been many times higher (think 10%+) to do the same thing.

Q. How do you find new investment ideas?

A. We love this question, and we would say that there are two main sources from which we generate our investment ideas.

1. **The Structured Approach** – For this, we try to use as much data as possible to have ideas screened for and pushed towards us. We leverage third-party sources which use AI and more quantitative/technical based data to try to identify which securities, industries, markets, asset classes, etc. are performing the best relative to others. This provides us with pools of potential ideas, or themes, to then start our own analysis on and select our preferred investments from. We also use a similar approach to work backwards, and if there is a specific trend or industry we want to research we can quickly screen for stocks associated with that area, see how they are performing relative to one another, and select investment candidates.
2. **The Research and Analysis Approach** – This essentially boils down to finding high quality sources of research or analysis, and building on the groundwork laid by these sources to generate ideas. We have access to research and analysis from various internal and external sources, and over time we become familiar with the work of certain analysts – enough to trust and build off of their work in making our own selections.

Idea generation is a crucial step in the portfolio management process, but just as important is the analysis, selection, and execution that comes afterwards before something is actually integrated to our portfolios.

Q. How risky is a portfolio that is focused so much on growth?

A. In our view, “Growth” is often mistakenly perceived aligned with “Risk”. We believe that responsibly investing for growth is a long-term risk mitigator. Here are three of the main reasons why we believe this is the case:

1. Companies with long track records of high-quality growth are also generally able to fully finance their operations from their cash flows, meaning they tend to take on less debt and have more financial flexibility
2. During periods of economic stress, companies that would be categorized as “growth” often have more resilient business models, and are less affected by economic slowdowns
3. During periods of recovery, often the first area that investors come back to are businesses that can re-accelerate quickly, generally due to the increased flexibility stemming from well-managed growth

On top of this, a more growth-oriented portfolio also tends to be a portfolio that derives more of returns from capital gains. This means it is by nature a more tax-efficient portfolio, as capital gains are the most attractive source of return for tax purposes.

Q. How do you decide when to sell a stock?

A. There is no exact science when it comes to timing buying or selling. When it comes to our core position, which are most often the same companies we would call “Generational Leaders”, we tend not to be overly concerned about selling, and more focused on systematic rebalancing. What we mean by this is that they tend to have so many avenues towards achieving sustained growth that we are extremely comfortable simply owning them and allowing them to compound over time. However, what we will do with these core names, is increase or decrease the sizes of our positions in them as opportunities present themselves. For example, in Q4 2018, we felt that many of our core positions had been unjustly punished along with the rest of the market, and we decided to increase our concentrations in them significantly in anticipation of them being some of the leaders in the eventual recovery.

When it comes to other investments we hold at a given time (“non-core”), buying and selling tends to be more active. We will look at things like how a company is valued relative to peers, or how it has performed relative to the market. We maintain a scoring system for all investments in our portfolios, which looks at a variety of factors, and helps us to select and size our investments, as well as decide when it is time to sell, or replace one with a new idea.

The last few months have been interesting to say the least, and in many ways we have found some of the changes to be quite refreshing. In particular, the new avenue of communication with our clients and partners through webcasts has given us the ability to provide additional insight, share more stories, and highlight certain points that often get lost in the broader focus of, for example, a blog post. We certainly plan on continuing to produce regular webcasts long after the COVID pandemic is behind us.

While there are many other questions and answers we would love to share, in the interest of readability we will save those for another time. As always, if you would like to know more, feel free to reach out to us directly. We continue to take on new clients who fit with our team and share in our beliefs, and we encourage you to share these blogs and our webcasts with anyone you think could benefit from reading or listening in.

Sincerely,
Di Iorio Family Wealth

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