UPPER CANADA CAPITAL
PRIVATE WEALTH MANAGEMENT

Mitigating Volatility With Non-Traditional Investment Portfolio Diversification

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When you think about what products to buy for your RRSP, RRIF or Tax Free account, you may consider cash savings products, GICs, stocks, bonds, mutual funds or ETF indexes as some possibilities.

These are the products that most people buy – often purchased through a financial advisor working at a specific investment dealer. Both the advisor and the dealer may have preferences for what they offer you and even have limits on the range of product offering available due to licensing and other considerations.

We also need to remember that registered accounts like RRSPs, RRIFs and Tax Free investment accounts may only be able to hold certain types of products according to their design by the federal government.

But note that taxable personal investment accounts, corporation investment accounts and trust investment accounts have broad investment potential and are not generally limited by government design rules. Corporations and trusts may however be limited by their own internal policies often set by boards of directors and trustees on how to run the corporation, trust or estate.

But there are a lot more products that one can buy to build wealth.

This newsletter edition takes you off the beaten path to examine some non-traditional investments that can add value to one's portfolio by improving returns or reducing risk.

Do I Need to Buy Non-Traditional Investments?
No, you don't. Many of the world's richest people have invested with traditional securities (e.g. Warren Buffett) and have done very well. Stocks, bonds, GICs, ETFs and mutual funds may be easier to buy and maintain, may have lower fees, offer better liquidity if you need to sell, may have better tax results, can be lower risk and can keep your money management strategies simple. So don't read this newsletter like you are doing anything wrong. You are not. This newsletter is written to show you what else is out there – but whether it is right for you is a function of further analysis, your financial plan, your goals and preferences and more.

Why Buy Non-Traditional Investments?
There are three main reasons to buy non-traditional investments:
1. You are hoping for better investment returns.
2. You are hoping for less risk.
3. You are hoping for less income tax.

Most non-traditional investments offer one of these characteristics. Some offer two. But only a few offer all three traits. Let's start our review by looking at products you can buy that offer all three advantages.

Permanent Life Insurance Policy
Universal life or whole life insurance policies are a popular investment with Canada's wealthy, thanks to their strong long-term returns, tax free pay out on death, tax deferred growth during your lifetime and generally low risk approach to investing. Anyone healthy can buy these policies for wealth growth. Permanent insurance policies are products that meet the three goals of non-traditional investments. For a Canadian who can invest money that they don't need for other means in their life, permanent life insurance can be another cornerstone investment you consider at any age. With a proven winning strategy and a long track record in Canada, these tax shelters and wealth building products are offered by some of Canada's biggest insurance companies and endorsed in the Income Tax Act. They are protected against bankruptcy in Canada and offer both a tax effective investment strategy as well as a smooth and less costly way to move inheritances to the next generation. Finally, it is not uncommon for these insurance products to offer rates of return that exceed stocks and bonds that you otherwise might buy.

The disadvantage of buying permanent life insurance as an investment is that it can tie up large amounts of your money for the rest of your life so you should not use any money you otherwise may need to live your life out – this product should be considered for surplus savings where you are seeking a tax smart inter-generational goal.

Investment Real Estate
If you have owned a commercial strip mall in Toronto, a vacation chalet in Whistler, a detached winter home in Arizona, a student townhouse rental in Halifax, a triplex in Toronto or a condo in Montreal, you have likely seen your investment value rise significantly over the last ten years.

And if you rent out the unit, then you have also earned tax smart rental profit or paid down your mortgage at the lowest interest rates in decades. Many of the world's richest people have made their wealth in real estate using other people's money (through rent) to pay the mortgage. Real estate is something you can touch – not like stocks that show your money shrinking on paper when markets fall. With Canadian population growth expected to continue and continued low interest rates, investment real estate or even investing in your own home continues to look promising. The only catch: direct real estate ownership can be a lot of work and dealing with tenants can test anyone's patience. Investment real estate can also meet the three advantages for non-traditional investments listed above.

Bitcoin

With the development of the world of crypto-currencies, you can now convert your regular money into a variety of digital currencies created through electronic means. Open an electronic wallet on your phone and buy some Bitcoin, Ethereum or other currencies, 24/7. They are not stocks and bonds, but rather trading currencies that can be viewed as investments. We view these crypto-currencies like Bitcoin similar to investing in gold. It is a possible investment, operates off the beaten path and valuations may not be easy to determine day to day. Crypto-currencies are not regulated by governments (some governments have banned them), have been subject to high profile thefts and value can swing wildly in a day. At this point, buying crypto-currency is a bit of a novelty. Globally however, digital currencies are coming for all of us, and it won't be long until you can use a digital currency on your phone to pay for groceries, in our opinion.

Hedge Funds

Hedge funds are portfolios of people's money, where a professional manager or firm invests the money into non-traditional investments and manages the investments over time on your behalf. These funds look like mutual funds (baskets of investments) but their mandates to invest are often very unique and can be dangerous or exciting. The hedge fund may purchase private companies entirely to hold or buy commodities like oil futures, gold bullion or USD currency forward contracts. They may invest in startup businesses. They may use derivatives (e.g. puts and calls) to bet against market direction every day or over time. They may invest in currencies or government debt. Hedge funds try to promise to deliver positive returns in any market conditions as they have the ability to short the market and even make money when stocks fall. So why are they not more popular?

First, they have high minimum investment thresholds – often $150,000 or more to start. Second, there have been some high-profile failures that have scared investors. Third, results of some of these funds regularly have lagged the regular stock market and may have high fees.

Private Debt

Two examples of private debt are loaning money to a building contractor to build condos for sale or lending money to a new Canadian citizen to buy a principal residence because they cannot get or don't want credit from a traditional bank. Often these investments are found through real estate agents or real estate lawyers. Some people invest directly with buyers while others prefer to go through companies as a middleman. Rates of return of 8% to 12% / year have been possible as an interest rate on your loan to the borrower. Yes, there is the risk of default by the borrower, but investors that like this form of investment feel comfortable that they are secured by owning the real estate as collateral for the loan. You are however, largely on your own in this market as there is no regulating body in Canada and no insurance on your investments. And the value of the collateral greatly depends on the facts of each situation.

Collectors' Items

Antique cars. Art. Hockey cards. And more. Owning these types of hard assets offer a unique store of value that have gone up and up in many cases over time. The only real issues are storage costs and safety and the expertise to know what is real vs fake. And clearly these items won't be flexible enough to use for spending money for your everyday food purchases – they are illiquid investments. But owning a Wayne Gretzky rookie hockey card or a Robert Bateman painting or a 1957 corvette has been a good investment for many.

Precious Metals

At your local bank or through currency and commodity exchanges, you can order gold and silver wafers and coins that you can then hold in a safety deposit box or vault you have at home. And you can buy diamonds at any jeweler. Often precious metals are considered a hedge against turmoil in the world. In the past they have risen in value during times of war, terrorism, unstable politics and some stock market meltdowns. They continue to be a form of currency globally despite the challenge of safe storage and illiquidity. But when you compare precious metals to the stock market generally, they have lagged in performance over time in many cases.

Private Equity

Ok, here is the fun stuff you see on TV shows like Dragon's Den. The opportunity to buy into a fledgling company before it becomes hugely successful is what many aggressive investors dream of. Get in early, then it goes public and the stock price goes up 100 times! Google and Tesla and so many more organizations have experienced this.

But it can also be the purchase of a McDonald's store franchise or starting your own apartment rental business. Some people access these investments by joining local "angel investor" groups. Others just get lucky by having a friend involved with a new business and they let them invest too. Or you work at a startup tech company that takes off. And there are hundreds of companies in the newspaper (often called "small cap") where you can read about their potential and invest in them. The last few years in Canada were full of stories of new cannabis companies you could invest in. Or a biotech startup looking at cancer cures. Or an industrial company with a new way to manufacture widgets.

The list of potential investments is long in the startup, emerging or small cap category – some are available through investment advisors and brokerages while others you invest directly or through specialty organizations. In all cases, be careful as your investment could go to zero and if you don't structure them properly you may not even get a tax write off. Look to your tax counsel as well as your specialist financial advisor for guidance before buying.

Linked Notes

These "GICs on steroids" have been around for years and are widely available. They are a hybrid product where for as little as a $1,000 you can buy an investment that looks like a term deposit or GIC (meaning your capital is guaranteed) but the investment return is linked to stock market returns instead of a fixed interest rate. So, if the stocks go up a lot you get a portion of the upside and the potential to make more than the GIC would offer. These products are popular with nervous stock market investors who seek more than a GIC return but don't want big risk. Your money is locked in until maturity and there is the potential for a zero return if the markets don't go up – but you can never lose your original capital.

Your Kids' Lives
Sounds corny, but helping out family members, namely your adult children may be a better investment than buying a GIC or sitting with cash. Clearly you need to be careful how to structure gifts and sharing money with others to protect yourself legally, but once you do that then helping fund an RESP for grandchildren, paying down your adult child's mortgage or funding your adult child's RRSP may not lead to more money in your bank account but as a family unit and inter-generationally, it can lead to better overall family wealth and more cash flow breathing room for the kids. Helping them avoid paying a 3% mortgage rate equates to better financial math than you buying a 1.5% earning GIC and paying tax on that return as well.

Where Do I Look For Non-Traditional Investments?
Start with us. We know a lot about your choices even if we cannot offer the product. And we have likely had experience with whatever you are considering and can provide some tips along the way. Lastly, we may be able to refer you to resources that will help you explore what you want to purchase. In some cases, we will not be able to provide advice on the product due to regulations.

What Are My Next Steps?
Well, not necessarily anything.

Keep in mind that we know you and your goals and resources. If we thought you were "missing something" we would have recommended it already.

But if you want to consider some of these alternative products then give us a call, email us or wait until our next meeting and we can start a discussion about non-traditional investments that may be right for you and your family.

At a minimum, I hope this look into alternative investments was educational and informative.

Warm regards,

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