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Four ways the limits to aggressive investing are being tested

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Surging investor confidence in early 2018 is starting to look like reckless enthusiasm.

Investors have lately shown a willingness to take on risk in search of home-run returns, and the investment industry is serving up products to capitalize.

The stock markets are not the problem, particularly the Canadian market. Annualized returns over all periods – from the past 12 months to the past 20 years – are far from excessive and could even be called modest. The U.S. market has been a lot stronger in the past decade, but it's now supported by a growing economy. Remember, it's recessions that usually cause a bear market.

Strong market fundamentals support aggressive investing, but there's a limit. Here are four examples of how these limits are being tested right now.

Adviser shame

Financial planner Rona Birenbaum has noticed a trend lately of people disparaging advisers on the basis of it being so easy to invest for yourself that paying someone to do it for you is pointless and a waste. "I'm starting to hear client comments like 'my brother thinks I'm an idiot for using an adviser,'" she said. "You're almost afraid to say you pay for financial advice."

You can see this same thinking in a recent exchange on The Globe and Mail's Gen Y Money Facebook page. After someone asked for referrals to a financial adviser, other members of the community tried to convince him to invest on his own.

Dismissing advisers sends a message that investing is easy, which is an attitude that develops when a bull market is in full swing. There are simple ways to invest on your own – the exchange-traded fund portfolio with just four funds I wrote about recently is one example. But the overall investing process involves a lot more than just buying four ETFs.

You have to rebalance a portfolio when the mix of stocks and bonds gets out of sync, resist the temptation to sell at market lows and tamp down your greed in market highs. And then there's the question of whether the results you're getting are sufficient to achieve your financial goals.

DIY investing is a righteous choice, but it's harder than it looks in today's investing climate. There's no shame in paying a reasonable price for help.

The rise in margin debt

Buying on margin means putting down some of your own money to buy stocks and covering the rest of the cost by borrowing from your broker. If the shares go up in price, you make more of a profit than if you just used your own money. Falling share prices would likewise magnify your losses.

The total amount of debt in investment accounts set up for clients to buy on margin was up 8 per cent between the end of 2016 and Nov. 30, 2017. But this number undersells the extent to which investors are embracing margin.

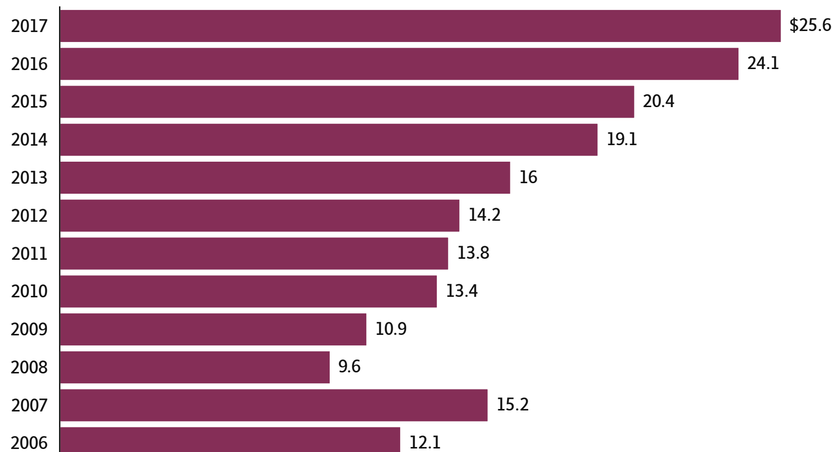
The Investment Industry Regulatory Organization of Canada reports that margin debt soared to $25.6-billion at Nov. 30 from $15.9-billion in June, 2008, which is just before the last bear market began.

Low interest rates explain a lot of this increase, just as they do the rise in mortgage debt and house prices. But rising margin borrowing also signals a growing acceptance of risk.

In the Maclean's list of the 91 most important economic charts to watch this year, analyst Alexander MacDonald of Cowan Asset Management noted that margin debt no longer closely tracks the ups and downs of the S&P/TSX composite index. Since 2013, margin debt has grown steadily despite an up-and-down market.

Investors getting comfortable with debt

Buying securities on margin–with borrowed money–has been on a sharp, steady rise in recent years. It's a sign of rising investor aggressiveness. Monthly client debt in margin accounts, at Nov. 30. In $billions



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ETFs tied to current trends

Marijuana stocks are driving the unprecedented trading volumes that have jammed up websites and phone lines at some online brokerage firms in early 2018. A few exchange-traded fund companies are capitalizing on this and other hot investing trends.

The Horizons Marijuana Life Sciences Index ETF (HMMJ-TSX) has been a big hit for a fund not even a year old, with a one-month gain to midweek of 47 per cent and high trading volumes that one day this month reached a stunning 5.6 million shares. Horizons now plans an encore – the Horizons Junior Marijuana Growers Index ETF, which must still be approved by regulators.

One other ETF provider has filed a preliminary prospectus for a marijuana ETF, while still other firms are readying niche products in cryptocurrencies such as bitcoin and the blockchain technology on which these currencies are based. Preliminary prospectuses have been submitted for such miscellany as the Harvest Blockchain Technologies ETF, Purpose Investments' Bitcoin Trust and the Evolve Bitcoin ETF.

National Bank Financial reports that 72 per cent of ETF flows in 2017 went into traditional index-tracking products, which is a positive trend because these funds tend to be cheapest to own. But the success of HMMJ highlights the strong potential for lucrative niche ETFs as well. The management expense ratio for this ETF is 0.89 per cent, compared with 0.06 per cent for a cheap Canadian equity ETF.

The "must buy stocks" mindset

The growing thirst for stocks can most clearly be seen in the unprecedented levels of trading done by individuals through online brokerage firms. Basically, investors have broken their brokers' websites by logging on in swarms to trade stocks and see how their accounts are performing.

Brokers were unprepared for this onslaught, which is a fail on their part. But let's understand that the level of trading people are doing today is not normal. It's a speculative surge triggered by a few hot sectors.

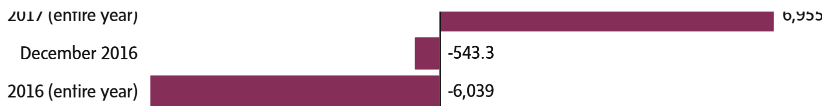
A quieter but no less noteworthy move into stocks is being made by mutual fund investors. The Investment Funds Institute of Canada reports net sales of $7-billion in equity funds last year, compared with $6-billion in net redemptions in 2016. More speculative specialty funds generated net sales of close to $2.6-billion, compared with $36.7-million in redemption in 2016.

Mutual funds are typically sold by advisers, a point that raises questions about the advice industry's claim to deliver value by tempering client urges to get aggressive after stock markets rise and to lose heart after declines.

This isn't any kind of stock market forecast, but it does seem late in the game for investors – DIY or advised – to recast themselves as aggressive stock jocks.

Investors getting comfortable with stocks

The mutual fund industry last year saw a pronounced 180-degree turn in sentiment when it came to investing in stocks. Here's a look at net sales of equity funds ($millions)



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