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Time for a reality check

Pragmatism Pays

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It's a simple enough question: How much money are you going to need in retirement to live comfortably on? Unfortunately, there appears to be no simple answer. The magic formula, whether it's 40% of your pre-retirement annual income all the way to up to 80%, seems to depend on who you ask.

"There is no one-size-fits-all" answer, says Patricia Lovett-Reid, a senior vice-president with TD Waterhouse Canada Inc. Ms. Reid says the million dollar question -- "How much do I realistically need?" -- has come to the forefront with the recent market meltdown.

Her first piece of advice for the millions of Canadians who are afraid to open their investment statements is to relax, at least a little bit. "When you hear that the market is down 40%, not everyone is totally 40% exposed to the market."

Canadians worried about just how they are going to pay for their retirement should sit down and work out just how much they realistically need for retirement and just what their sources are for retirement income.

Perhaps the biggest hurdle people face when contemplating retirement is the unrealistic vision they have of their post-work life -- one that, in many cases, has been raised to an impossibly high standard by advertising from financial firms that depict smiling, grey-haired people plunked down in exotic locales. "People say to me all the time, 'I want to travel in retirement' when they don't travel now," Ms. Reid says. "You typically enjoy the same lifestyle you enjoyed prior to retirement."

The Web is a great place to find retirement calculators that allow you to plug in sources of income from government programs, RRSPs, company pensions and other sources. Most, such as TD Canada Trust's, say you need between 60% and 80% of your pre-retirement income.

You should be able to live on less in retirement for obvious reasons: no mortgage payments or dependent children (hopefully) and none of those work-related costs (clothing, lunches and commuting).

Being presented with a sudden influx of free time, however, can result in a temporary spending surge as the newly retired take those expensive vacations they have long denied themselves, buy retirement properties and other expensive toys.

For those unfortunate Canadians whose retirement savings have been decimated by the collapse in the markets, Ms. Reid says they may have to consider measures such as temporarily downscaling their lifestyle, delaying retirement and, strange as it might sound, increasing their equity exposure in the investment portfolios.

The reining in of lifestyle is already happening. According to Boston Consulting Group, Canadians are tightening their belts in tough times more than Americans or Europeans. It found 62% of Canadian consumers said they planned to reduce spending in the coming year by an average of 15%.

As a nation, we also have reason to feel a bit less stressed than Americans: Our savings rate is double theirs at 3% in 2008, average household credit-card debt is \$3,100 in Canada versus \$8,200 in the United States and housing prices have slumped far less here.

Described as more conservative than Americans -- a finding that should surprise few -- the Boston Consulting survey of 1,000 Canadian heads of households, which was conducted in November and December, found 33% described themselves as not being financially secure, while another 8% admitted they were in financial trouble.

If the market collapse has taught Canadians anything, it is that risk-return ratio is real and is embedded into equities. The stock market may, on average, outperform most other investments but one is "paying" for that theoretically better return with the risk of the sort of gut-wrenching volatility we have suffered through the past year.

"People need to know how much risk they have to take," says Frank Wiginton, a certified financial planner with TriDelta Financial Partners.

"It's fine to say 'I'm investing for retirement,' but how much do you need for retirement? Do you need to be aggressive, or can you get to where you need to be at 5%" in annual returns.

"People are going out and trying to get 12% returns and ending up with 30% to 40% losses," he said.

The market plunge has got more Canadians thinking twice about their retirement plans. A study conducted in November by the Bank of Nova Scotia found that more than 33% of investors over 50 have are delaying retirement because of the retreat in equities.

The same poll found nearly four in 10 were paying more attention to their investments and that they were seeking a second opinion on their holdings.

As a start, Mr. Wiginton advises shell-shocked investors to get a financial plan created to get a better understanding of just how much risk needs to be taken on to reach their income goals in retirement.

Too often, he has found people walking a tightrope in the hope of achieving unnecessarily ambitious returns. "Many, many times I run into people who, if I can get them a 6% average annual return, are more than adequately covered," Mr. Wiginton says.

"Yet, I catch them investing in portfolios that are full of emerging markets and junior gold stocks, stuff that they don't need to be involved in."