Planning makes the difference

One uncertainty strikes fear into the hearts of many Canadians thinking about their retirement savings – no matter what their income or asset level.

How much is enough?

The anxiety intensifies as retirement approaches and after significant equity market volatility.

Defined benefit pensions, where employers pay their retired employees a specific benefit for life, are no longer the norm for private sector employees. Affluent Canadians in particular now look to their own investments as the main source of their future income.

Three threats to your peace of mind

Moshe Milevsky, York University professor, Executive Director of The Individual Finance and Insurance Decisions Centre, and a member of the BMO Advisory Council on Retirement, has identified three significant risks to a prosperous retirement.

Living much longer than anticipated: if you're a 65-year-old couple today, there's a 75-per-cent chance at least one of you will survive for another 20 years, and a 50-per-cent chance one of you will be around to blow out 90 birthday candles.

Unexpected inflation: $1000 shrivels to $610 of purchasing power after 25 years of inflation at a modest two-per-cent per annum. Your own personal inflation rate will likely be higher and is more relevant. It reflects the cost escalation in the pricey goods and services you'll actually consume as you age, including health care. For example, long-term assisted living can total as much as $100,000 annually per person.

Poor portfolio performance in the first few years of retirement: the strategy for preserving and growing your nest egg is as important as its dollar value. You need the right mix of components in your retirement portfolio, which may include traditional investments (stocks and bonds), as well as pension-like products with features that may include downside-protection and/or guaranteed income. The inherent risk, or volatility, of your investment portfolio also plays a vital role. Withdrawing income from a portfolio in a bear market can prematurely exhaust your capital because of the sequence-of-returns effect (see chart on next page).

Prof. Milevsky, a widely recognized, award-winning researcher and innovator in the field of retirement-income planning, insurance and pensions, urges people to take action to reduce their vulnerability to each of these risks.

Planning to the rescue

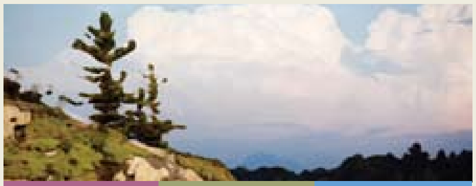
Planning for your retirement involves taking a conventional financial plan and immunizing it as far as possible against these risks, says Richard Mason, the head of Investment Management and senior vice president at BMO Harris Private Banking.

Sounds like something everyone would want to do; yet many people fail to do it because they are unaware these risks pose a threat.

"The challenge for most people is they don't know what their income needs will be in retirement, and they don't know how to generate sufficient assets to provide that income," Richard says.

"As advisors, we really have to step up. As Moshe points out, advisors are risk managers. They have to help clients diversify their risk factors based on each client's individual balance sheet, and understand what each client needs to meet his or her retirement objectives. Then an advisor must assist each client in achieving those objectives."

A good retirement plan replicates the structure of a pension plan (aligning assets with future liabilities – i.e. expected spending needs in retirement) that would generate ample income to live comfortably.



Retirement Tips
- Moshe Milevsky

- By all means enjoy your retirement; however, try to pace the big-ticket purchases on your bucket list. Spend smoothly over time.
- Before you stop working, pay off high-interest consumer or mortgage debt.
- Set aside an untouchable rainy-day account for extremely unlikely but extremely costly events instead of insuring every small risk in your life.

If you have enough wealth to ensure a comfortable retirement, the goal becomes protecting wealth for the next generation, supporting a charitable cause, or leaving a legacy that makes you proud.

"Making ends meet in retirement is a universal concern. As income and wealth levels rise, the definition changes. Retirement income security means different things to different people."

Prosperity in peril

Further confusing the picture are the vague guidelines, myths and generalizations about retirement finances. They can lead people to false conclusions about their own situation – or deter them from thinking about it at all.

Affluence does not necessarily provide immunity against the above-mentioned threats, Richard notes. Some high-net-worth individuals don't see the value of planning their spending. They may be less likely to budget. They may not take the time to calculate the tab for a golden old age because they believe they'll have enough, or that their current *(continued on next page)*

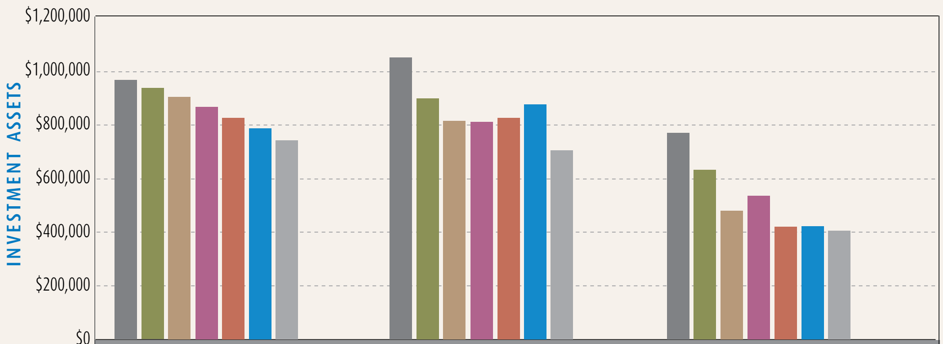
Where did you get on the retirement investment portfolio merry-go-round?

Volatile returns are hazardous to the timing of your retirement.

Sequence of returns is the order and type of returns (positive or negative) earned over a period of time. In the three scenarios illustrated below, the average annual return rate in each case is 7% over a seven-year period.

Capital Accumulation and Depletion over a 7-year period

Each scenario has an average annual 7% per year return and assumes a $100,000 withdrawal per year from an initial capital investment of $1 million.



	Retirement Capital-Constant Return	Constant Return Rate	Retirement Capital-Var. Rtn-High start	Variable Return Rate (High start)	Retirement Capital-Var. Rtn-Low start	Variable Return Rate (Low start)
yr 1	$970,000	7%	$1,050,000	15%	$770,000	-13%
yr 2	$937,900	7%	$897,500	-5%	$631,500	-5%
yr 3	$903,553	7%	$815,450	2%	$480,980	-8%
yr 4	$866,802	7%	$813,304	12%	$534,894	32%
yr 5	$827,478	7%	$827,167	14%	$418,847	-3%
yr 6	$785,401	7%	$876,057	18%	$419,370	24%
yr 7	$740,379	7%	$705,972	-8%	$403,244	20%

Notice how the difference in the sequence of returns impacts your total retirement capital when the portfolio experiences negative returns as capital begins to be withdrawn.

high income will somehow translate into a comfortable retirement.

Another pitfall: the newly retired tend to splurge in the first two years.

"Fledgling retirees naturally want to travel, treat themselves to expensive hobbies, and do all the things they put off in favour of their careers."

Without proper planning, sizeable withdrawals in the early stages of retirement can compromise your nest egg's sustainability.

Start with a needs analysis

A good planning conversation should answer two basic questions.

First, the advisor asks how much the client thinks he or she will need. Most clients wouldn't be able to answer without some serious thought, calculations and input from a planner, Richard says.

The client asks the advisor the second question: How much can I make?

Where the advisor adds value is identifying the factors that will add risk to a plan and, more importantly, the factors that can ensure success in a plan.

"It's never too late, and you're never too old, to have a conversation so your advisor truly understands your situation. Of course, the earlier you start, the better the outcome will be. The process of profiling must be ongoing. This is a living exercise. It doesn't stop at retirement."

If you've been putting off planning, or haven't looked at your plan lately, please contact your client advisor.

The first 50 clients who contact Bernice.lau@bmo.com will receive a complimentary copy of Moshe Milevsky's new book, Your Money Milestones: A Guide to Making the 9 Most Important Financial Decisions of Your Life.

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