BMO Wealth Institute™

/Report
CANADIAN EDITION

# Retirement Strategies for Volatile Markets

The BMO Wealth Institute provides insights and strategies around wealth planning and financial decisions to better prepare you for a confident financial future.

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No matter how often we hear and are told to prepare for stock market volatility, we are often greatly unnerved by it and wonder if there is anything that can or should be done in response. This situation can be particularly troublesome for those who are nearing or living in retirement. With market volatility at hand, Canadians not only want to know how much money they will need to retire, but if they will have saved up enough to do so. Fortunately, an action plan that incorporates sound retirement and investment strategies can go a long way to help address retirement concerns.

## Approaching Retirement – stay the course and keep saving

If you are 5-10 years away from retirement, time is on your side and you can benefit from stock market returns, both share price appreciation and dividends. With bond yields at historic lows, dividends provide an excellent opportunity to enhance your return and reduce volatility in your investment portfolio. Your optimal strategy is to continue to save as much as you can to build your portfolio. Increased investment savings during the early stages of an economic recovery can help you enhance your retirement nest egg by means of dollar cost averaging. This means that with lower stock prices you are able to buy more units or shares now than when the price was higher in the past.

## Investment Strategies

Since retirement goals are long term, investment focus should also be long term. Staying invested in a diversified portfolio will pay-off in the long run, compared to trying to time the market by placing assets in cash and not having any market exposure. Staying invested will avoid the dilemma of deciding when to get back into the market after exiting when markets are down.

The discipline of regularly adjusting the asset mix in a portfolio allows investors to take advantage of the difference in performance between asset classes. This process, known as rebalancing to your strategic target allocation, will ensure your portfolio is re-aligned with your risk tolerance and goals.

## Retirement Planning Strategies

With only a few years away from retirement, we recommend that you continue to contribute as much money as possible to a Registered Retirement Savings Plan (RRSP) each year. RRSP earnings grow on a tax-deferred basis and contributions can provide significant tax savings as a result of the tax deduction which can be used to make additional investments or pay down existing debts. For those in a higher tax bracket, there may be an opportunity to shift income to a lower income spouse by making contributions to a spousal RRSP. A spousal RRSP allows the lower income spouse to build income in their name over time so that withdrawals from the spousal RRSP at retirement can be taxed at their lower tax rate.

Another way to boost the growth potential of your savings is to eliminate income tax as much as possible. Since January 2009, it has been possible to make a contribution of up to $5,000 every year to a Tax Free Savings Account (TSFA) where all investment income is earned tax free. Your unused TFSA contribution room carries forward and accumulates for future years. Your TFSA contribution is separate from your RRSP contribution and allows one more way to save money for retirement. Even when you are ready to withdraw money from the TFSA, the withdrawal is tax free so it won't affect income-tested government benefits such as Old Age Security (OAS). Investing in a tax-free savings account goes a long way to building your retirement portfolio. Here's how it works:

Example: comparing the after tax rate of return in a TFSA with a regular investment account.

| | Regular Investment Account | TFSA |
|---|---|---|
| **Account Balance** | $5,000 | $5,000 |
| **Projected Income 5%** | $250 | $250 |
| **Tax 30%** | $75 | $0 |
| **Net earnings** | $175 | $250<br>**= 43% higher** |

How do you know if you'll have enough money to do the things you want to do in retirement? Creating or updating a retirement plan will clearly show if you are still on track and will help you to focus on what you need to do between now and retirement to get on track. It will help answer questions such as; will I need to work longer, save more or spend less?

## If retiring this year, proceed with caution

As you enter retirement your portfolio should reflect a variety of asset classes in proportion to the return you expect to achieve, your time horizon, risk tolerance and overall income needs. When and how much income you need from your portfolio will drive the appropriate investment mix and determine how long your money will last.

### Investment Strategies

We know that retirement can last 25-30 years which means there is plenty of opportunity left in your portfolio for long-term investing. For retiree investors with long-term investment horizons for at least part of their portfolios, equity investments should be included to take advantage of the potential long-term dominance of future stock market returns over those of cash and bonds.

Times of high stock market volatility serve to remind us of the importance of diversifying portfolios, as diversification makes the periodic stock market setbacks more tolerable, and minimizes the risk that investors might reduce or eliminate their equity exposure in times of crisis.

### Retirement Planning Strategies

Drawing retirement income from an equity portfolio during a market downturn increases the risk of running out of money. A systematic redemption of equity fund units, or the selling of equity shares (the reverse of dollar cost averaging), during a market downturn means more lower priced units have to be redeemed to generate a fixed level of income. This activity will deplete the number of units in your portfolio, and the longer it continues the faster the depletion rate will occur. The following recommendations can help cushion the impact.

**How do you know when you can retire?**

**Today's baby boomers' are the first generation to consider delaying retirement in an effort to stay mentally and physically fit. The BMO Retirement Savings Calculator can show you how the impact of working for a few more years can enhance your accumulated savings, delay the need to access these funds, and allow your retirement nest egg to grow in value for when you are ready to retire.**

**Visit www.bmo.com/financial-calculators/retirement-savings/**

Delay portfolio withdrawals for as long as possible to allow a full or partial recovery of equity prices and portfolio values. Consider deferring major purchases in the first year of retirement and, where possible, curb expenditures for a modest period.

Individuals who enter retirement with less debt are more confident about having sufficient income. One way to significantly reduce interest costs is to consolidate high interest rate debt with a home equity line of credit. Lower interest rate costs will minimize the drain on that all-important retirement income which leaves more to pay-off the home equity line of credit.

Since there is no age restriction on making contributions to a TFSA, continue to take advantage of the opportunity to build tax-sheltered investment assets. TFSA earnings and withdrawals are tax-free. If you are over 65, continuing to invest with a TFSA may help to eliminate or reduce the claw back of OAS government benefits and the unnecessary loss of tax credits.

### If currently retired, minimize withdrawals within a registered plan portfolio

If you converted your RRSP to a Registered Retirement Income Fund (RRIF) in a previous year, you will have to take a minimum withdrawal out this year, that is based on your age (or the age of your younger spouse, if applicable) and account balance at the beginning of the year. Taking out too much can cause you to run out of money during retirement.

### Investment Strategies

In times of market volatility, one thing that is often overlooked is the fact that your existing portfolio may still be generating sufficient income from interest, dividends or other distributions so that investments do not have to be sold to create the income needed in retirement. To protect you from having to sell securities when they have declined in value, dedicate a portion of investments to liquid or cashable investments to cover one to five years of income needs.

### Retirement Planning Strategies

Although you may be required to make a minimum withdrawal from your RRIF, you may not need the retirement income to fund your expenses. In that case, you may want to consider an in-kind withdrawal instead of

selling the securities and withdrawing cash. Although you pay tax on the market value of the securities withdrawn from the RRIF, the securities won't have to be sold at an unrecoverable loss within the RRIF. Later, when the values of the withdrawn securities recover, growth will be treated as a capital gain outside of the RRIF and will be taxed at one-half the rate normally applied to an RRIF withdrawal.

Consider the following example:

**RRIF in-kind withdrawal:**
A $10,000 RRIF in-kind withdrawal is fully taxable as ordinary income. The in-kind withdrawn investments are now held in a non-registered account with a cost base of $10,000. If those investments grow to $15,000, when sold, the tax rate on the $5,000 capital gain is only half of the rate you would have paid if the $5,000 was withdrawn from the RRIF.

Assuming a 45% tax rate, the tax on the growth of the $5,000 in the non-registered account equals just $1,125 as opposed to the $2,250 that would be incurred by a withdrawal from the RRIF. What's more, if an in-kind withdrawal was put into a Tax Free Savings Account, then there would be no tax at all on the capital gain.

**If you are under age 71, have a RRIF and you do not need the income from the plan, consider rolling the RRIF back into an RRSP on a tax-free basis.**

**You will still have to take the prescribed minimum withdrawal for the year in which the rollover occurs, and pay income tax on the proceeds, but you can avoid making any further withdrawals before the end of the year in which you turn 71.**

## Stay the course

A thorough understanding of your investment and retirement options will allow you to take better control of your financial future. Implementing these key retirement strategies into your action plan can go a long way to help address your retirement concerns and ensure your portfolio's target asset allocation is line with your projected return, income objectives and tolerance for risk. There's no better time than today to review your retirement plan to stay on track and achieve your financial goals.

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