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Nearing the finish line

A Couple Needs To Boost Savings, Improve Investments for Comfortable Retirement

Andrew Allentuck | October 15, 2013

ILLUSTRATION BY BYRON EGGENSCHWILER

Stuart Tischmer*, 57, and his wife, Ginger, 56, are headed toward retirement in three-and-a-half years with nearly $1.3 million in financial assets. The Tischmers worry they are abandoning their careers — his in technology management, hers in health care — with insufficient savings to carry them through what could be three or more decades of dependence on their capital and Ginger's fairly modest work pension of $9,000 per year.

The Ontario couple have already made extensive preparations for retirement. They recently downsized their two-storey, five-bedroom, four-bathroom home to a new bungalow with three bedrooms and three bathrooms. They plan a life of golf in summer, cycling as the seasons allow, trips to the Caribbean in winter, and spending time with their three grown children, all of whom have nearby homes of their own and are self-supporting. The couple have been accustomed to putting in days as long as 12 hours, and one of their problems will be to fill the time. Their hobbies will help, of course, but there will always be the temptation to do more and to spend more than they did in the limited time they had in their working years.

The dilemma is whether their moderate level of financial assets, plus one modest work pension that will be below five figures per year and government CPP and OAS, will be sufficient to provide for their desired lifestyle, which is to be at the same not-too-lavish standard they have had while working. For example, they plan on buying the same wines always below $20 they have bought for decades. Their retirement lifestyle will have more time for leisure and more time to shop advantageously, such as the ability to join last-minute clubs for deeply discounted trips.

"We will be bargain hunters with ample means, but we need an honest evaluation of whether we have enough saved for the retirement we want," Ginger says. "Our aim is to have an after-tax income of $50,000 to $60,000 per year in retirement." They currently take home $10,500 per month on $16,000 monthly gross income, but have amassed a $1.3 million portfolio of mutual funds to backstop their planned retirement.

"Their accomplishment in building up their net worth, which, including their $475,000 house, is almost $1.8 million, is noteworthy," says Benoit Poliquin, a financial planner and chartered financial analyst at Exponent Investment Management Inc. in Ottawa. "They have no debts, but they do have problems. They are not quite at the point at which their retirement income will meet their retirement goal."

Poliquin points out they will be hindered by an inefficient investment portfolio that contains more than two dozen mutual funds, which span sectors from global bonds, floating rate income units and assorted yield plays to growth stocks, value stocks and large caps. There is no evident plan or pattern, so the portfolio will perform as the business cycle moves along, but, at worst, will be unpredictable and perhaps unknowable. "In a sense, it is money out of control," he says.

For now, the Tischmers take home $10,500 monthly, though that will substantially drop next year when Ginger becomes a part-time worker. Despite the income drop, they can add about $3,000 per month to their RRSPs and taxable accounts. If they continue saving at this rate until their planned retirement date, their total financial assets, assuming they grow at 4% per year after 2% estimated annual inflation, will rise to about $1.6 million.

The portfolio will then support $35,000 in annual withdrawals beginning around June 2017 and leave a margin for future growth or inflation compensation. Adding Ginger's $9,000 annual pension brings their total income to $44,000 per year. In three years when they want to begin retirement, Stuart will be 60 and able to take CPP benefits with a 36% penalty of the age 65 benefit which, in his case, would be $12,150 per year in 2013 dollars. Ginger's CPP benefits, equal to Stuart's, would be subject to the same penalty.

Their income at this point will be about $3,500 per month, just $250 short of their current monthly allocations with all savings removed. They could draw CPP, but rather than pay penalties, a total of $4,375 per year in 2013 values for as long as they draw benefits, they could easily tap their savings for a few years to make up any cash needs.

At 65, they can take their CPP benefits, worth a combined $24,300 per year. Ginger will lose a $1,000 annual bridge to age 65, leaving them with pre-tax income of $67,300 per year. After pension splitting and 12.5% average income tax, they would have $58,900 in annual after-tax income or about $4,900 per month to spend. At 67, each will receive Old Age Security benefits, currently $6,600 per year, leaving them with a final and permanent retirement annual pre-tax income of $80,620. If they split pension income, they will not be affected by the OAS clawback which, in 2013, begins at $70,954 per person. After 15% average tax, they would have $5,700 per month to spend. They will have a small surplus over costs and, if they raise investment returns, could do even better depending on how their investments perform.

PORTFOLIO MANAGER

Stuart and Ginger Tischmer need to transform their two dozen mutual funds into a focused and rationalized portfolio. Moreover, they are paying heavily for the funds with annual fees that average 2% — or $26,000 per year. That needs to change, says Nigel Roberts, head of Bluenose Investment Management Inc. in Lake Country, BC.

If the $1.3 million portfolio, which is about 63% in equities, 28% in fixed-income assets and 9% cash, generates a 4% annual cash flow, or $52,000, then their present management fees are taking half of their gross cash returns. The cost is excessive.

First, the asset balance should be adjusted to 65% stocks and 35% fixed income. The equity component of the new portfolio should be common shares in 20 companies in equal amounts; each should be 3.2% of the portfolio. It should include three financials — TD Bank, Bank of Nova Scotia and Intact Financial Corp.; two telecoms in Telus Corp. and BCE Inc.; five utilities or pipelines, namely Enbridge Inc., TransCanada Corp., Altagas Ltd., Inter Pipeline Ltd. And Atco Ltd.; three energy companies in Cenovus Energy, Conoco Phillips and Baytex Energy Corp.; a couple of real estate investment trusts, H&R REIT and Artis REIT; and five U.S. and global consumer products companies, Proctor & Gamble Co., Nestle SA, Coca-Cola Co., Mondelez International Inc. and McDonald's Corp. The common shares should have a history of rising dividends paid without fail.

For fixed income, 10% of the portfolio can be in preferred shares spread among eight investment-grade issues that reset their rates every five years or so. The preferreds should be held in non-registered accounts. Another 20% should go into provincial bonds with maturities no more than five years. The Tischmers should hold actual bonds (more specifically, bond credits in a book-based asset system that has replaced paper bonds) that revert to cash when they mature, rather than units in bond funds that can indefinitely carry capital gains or losses. The final 5% should be in investment-grade corporate bonds with a maturity of five years or less. The bonds produce income that is fully taxable and so should be held in registered accounts, Roberts cautions.

But the Tischmers have outgrown mutual funds. They have sufficient capital to justify hiring an investment manager at a 1% annual fee. A saving of one percentage point on their present asset management costs would be $13,000 per year. Assuming a 4% return, such a saving would add nearly $50,000 between now and the couple's retirement date.

If built from scratch with stocks and bonds, the new portfolio would be substantially immune from forced sales, a frequent problem for mutual funds that are run fully invested and have no choice but to sell when their investors demand their money back. When funds held outside of registered plans sell assets to meet redemption calls from investors, which often happens in falling markets, the funds can cause taxes payable by investors to exceed their funds' gains.