Smart investing *for a smart retirement*

Time-tested strategies to protect your retirement nest egg

You're almost there. You've saved your money, invested wisely and have a nice retirement nest egg set aside. Retirement is within your grasp.

But now, as you near retirement – or perhaps you've already arrived – you have to invest that nest egg to ensure it's there when you need it. You want to be sure you get the retirement income you've worked so hard for.

When you are 20 years from retirement, the occasional dip in the market probably won't do much harm. However, as you get closer to retirement, those dips can feel a lot bigger... and the effects can be a lot worse. You just don't have as much time to recover from an investment faux pas or a market decline.

The good news is that there are some time-tested strategies you can use to help protect your retirement nest egg, increase your earnings potential, and reduce your taxes.

Shift your risk

Different investments offer different levels of financial reward – and carry different levels of risk. Generally, the greater the potential for reward (or the higher the return), the greater the risk in the form of variability of the market value of the asset.

Because the time available to recoup losses decreases as you get closer to retirement, it makes sense to periodically review your investment portfolio and, where necessary, "shift your risk." This simply means moving some of your assets to more conservative – or less variable – investments. Note non-registered investments switching out of equities may produce taxable capital gains.

What's risky and what's not? Let's start with some basics. There are three types of assets you can invest in – each with a different risk-reward potential.

- **Cash equivalent assets** – This category of assets includes cash and cash-like investments such as Canada Savings Bonds, Treasury Bills, and short-term deposits. They are often referred to as "liquid assets" because they can be readily converted to cash. This type of asset offers a high degree of security, but this security generally comes with lower potential returns.
- **Fixed income assets** – Fixed income assets include bonds, guaranteed investment certificates (GICs), guaranteed interest accounts in accumulation annuities, mortgages, and debentures. These assets combine relative safety of principal with a regular income stream. But once again, safety comes at the expense of lower potential returns. (There are some risks from interest rate fluctuations and from inflation with fixed income assets. For example, an increase in interest rates can undermine the market value of an existing bond, while lower interest rates can reduce your income from new GICs and mortgages.)
- **Growth assets** – The classic growth asset is "equity" – usually in the form of common or preferred shares (i.e. stocks) in a company. Each share represents a small ownership piece of that company. Stocks offer the highest potential returns, so are associated with asset growth. At the same time, however, their market values are more variable. Other types of equities are mutual funds and interests in segregated funds which provide investment management expertise and diversification that can reduce the variability found with single stocks.

As a general rule of thumb, you can very roughly determine how much of your investment should be in lower-risk investments by simply putting a percentage sign after your age. For example, if you are age 60, you might want to have about 60 per cent of your money in more conservative investments that are more conservative.

Defining "risk"

When it comes to the investment game, risk simply refers to a given investment's volatility – that is, the potential that the value of the investment will rise or fall in the short term. In investment terms, stocks tend to be "riskier" (i.e. more volatile) than, say, savings bonds. Historically, these "riskier" investments have tended to provide better rates of return over the long term.

How much is enough?

Will you have enough to retire? It depends.

As a general rule of thumb, many retirement planning experts say you need to replace about 50-70 per cent of your pre-retirement income. But you may need more or less than that. It depends on a number of factors, such as when you retire, your retirement lifestyle, life expectancy, inflation, and how much income your savings generate.

The good news is that many of your current expenses will likely shrink once you stop working. You probably won't be spending as much on work clothes, commuting costs, lunches, and union or professional dues. You also won't need to save for retirement anymore.

If you're an empty-nester, you may decide to "downsize" and move to a smaller house – possibly freeing up money and lowering your home maintenance fees.

At the same time, some new costs could surface. You may want to travel more or take up new hobbies. Your healthcare and dental costs might go up as you get older. In addition, you may find that you need to hire people to look after some of the household chores – such as lawn care or painting.

The inflation factor

It's also important to factor inflation into your calculations. By inflation, we mean the overall increase in the cost of living caused by a rise in prices. Over the past two decades, we've experienced inflation averaging about two per cent per year.[5]

Inflation can have a devastating effect on your retirement income. Inflation of just two per cent compounded over 20 years would erode the buying power of your retirement income by about one half. Life expectancy is another key factor to consider. Canadians are living longer. According to recent Statistics Canada data, the average male who is age 65 lives to age 82, while the average female who is age 65 lives to almost 86.[6] These are averages and 50 per cent of people who are age 65 will live longer.

Nailing it down

Your best bet is to sit down and draw up a detailed budget of what you think your post-retirement expenses will be. The best way to do that is to track your expenses for an entire year to find out where your money goes.

If worst comes to worst and you think you might be short of money, you may work part-time or downsize your home. Alternatively, if you own your own home – you may want to consider a reverse mortgage. This is simply an arrangement that allows you to draw on the equity you've built in your home.

In any event, you'll want to closely monitor how much you withdraw from your retirement savings once you retire. Taking too much too early can leave you short down the road. You want to try to have your money last at least 10 minutes longer than you do.

When it comes to calculating whether you'll have enough in retirement, be conservative. It's better to end up with too much money than too little. You don't want your retirement years to be anything but golden

[5] TD economists
[6] Statistics Canada