THE VALUE OF ADVICE

SECURITY

Peace of mind in the "retirement risk zone"

Just as investing early has a huge impact on the value of a portfolio over time, market losses in the "retirement risk zone" – the 10 years before and after retirement – have a disproportionally damaging effect on retirement security.

In an example provided by Manulife Financial, two investors start with portfolios of $206,049 and withdraw five per cent per year. Both portfolios average eight per cent annual returns, but the first portfolio incurs significant losses in the first two years. Despite the same average annual returns (that is, the first portfolio earns significantly more than eight per cent in later years), the first portfolio is completely depleted after only 14 years.

But even after 25 years of withdrawals, the second portfolio is still worth almost $800,000.

Protecting a retirement portfolio from early losses is the key to retirement security, particularly for Canadians who don't have the benefit of a pension, says Dessa Kaspardlov, a financial advisor with Manulife and author of The Fireman and the Waitress. "It is important that they see their RRSP as their pension plan. An advisor can help identify products that provide a guaranteed minimum income so that market volatility won't affect their financial security."

"There is nothing we can do about market volatility. If you're in that retirement risk zone, knowing that the income you need is secure, predictable and sustainable provides peace of mind."

Dessa Kaspardlov,
Financial Advisor, Manulife

A valuable option for Canadians is segregated fund contracts, which provide downside guarantees on investments at maturity. Some also guarantee future income, backed by insurance, through a feature called "guaranteed minimum withdrawal benefits."

"There is nothing we can do about market volatility. If you're in that retirement risk zone, knowing that the income you need is secure, predictable and sustainable provides peace of mind," says Ms. Kaspardlov. "You can sleep at night, knowing that, for about one per cent of your investment, market risk has been transferred from you to the insurance company."

Just as there are insurance products that protect our home, cars and our employment income, it's also possible to insure retirement income, says Ms. Kaspardlov. "When markets are down, my clients' equity asset values are down too. That's unavoidable. But they never have to worry about the monthly income they need to live on in retirement – it's guaranteed."

DIVERSIFICATION

What assets classes belong in your retirement portfolio?

"I'm not convinced that there are any assets that should be excluded from a retirement portfolio," says Robert McCullagh, chair of Advocis, the Financial Advisors Association of Canada. "The key is to manage overall risk and return."

An overly conservative approach can be as damaging to a portfolio as an overly aggressive approach, he cautions. In an aggressive portfolio, consisting of 15 per cent bonds and 85 per cent stocks, with an annual withdrawal rate of four per cent, an extended downturn in the markets would reduce the available income to 22 years, compared with 88 years in average markets. A very conservative portfolio (60 per cent cash, 20 per cent stock, 20 per cent bonds) would provide 26 years of withdrawal capacity in an extended bear market and 33 years in an average market, he notes, citing research by Fidelity Investments Inc.

In other words, the ultra-conservative investor has gained four years of income capacity in an extended downturn, but lost more than 50 years of withdrawal capacity in an average market.

"With a balanced portfolio in an extended downturn, annual withdrawals of four per cent would provide 25 years of income. At seven per cent, that drops to 13 years."

Robert McCullagh,
Chair, Advocis

An overly conservative approach can be as damaging to a portfolio as one that is overly aggressive. PHOTO: ISTOCKPHOTO.COM

An aggressive withdrawal rate can be much more problematic. "With a balanced portfolio in an extended downturn, annual withdrawals of four per cent would provide 25 years of income. At seven per cent, that drops to 13 years," Mr. McCullagh says.

Longevity and inflation risk must be considered along with market risk, he says. At 65, a man has a 25 per cent chance of reaching 89; a 65-year-old woman has a 25 per cent chance of living to 92. For a couple, there is a 50 per cent chance of one partner reaching age 90. "My father retired in 1981 at the age of 55, and he is celebrating 30 years of retirement this summer," Mr. McCullagh notes. "He is now seven years away from being retired longer than he worked, and inflation has significantly eroded his purchasing power."

Working with a financial advisor can help ensure that all of the risks that threaten a secure retirement are managed, he says.

"The most effective way to make decisions about your portfolio is to ask your financial advisor," agrees Paul Lorentz, president of Manulife Investments. "Your advisor is in the best position to provide you with financial recommendations that will protect your savings and prepare you for all of life's stages, including retirement."

THE VALUE OF ADVICE

Third party published data from Ipsos Reid illustrates the strong and enduring values that financial advisors provide to their clients:

- Advisors provide durable values that benefit their clients throughout their investing lifetimes, such as the early adoption of a savings and investment culture, the avoidance of common behavioural investment errors, and the value of developing and following a financial plan.
- Advisors help individuals navigate through a wide array of financial products, vehicles and plans to arrive at solutions that fit their individual goals.
- Advisors help their clients build wealth through developing plans that are tax efficient and utilize the right asset mix for their circumstances and risk tolerance.
- Advisors contribute to the financial literacy of Canadians and have earned high levels of trust from their clients as sources of financial information for themselves and their children.
- Advisors operate in regulated channels which are proven to provide safety and soundness for the Canadian retail investor.

Source: The IFIC 2011 Value of Advice Report. To read the full report, visit www.ific.ca.

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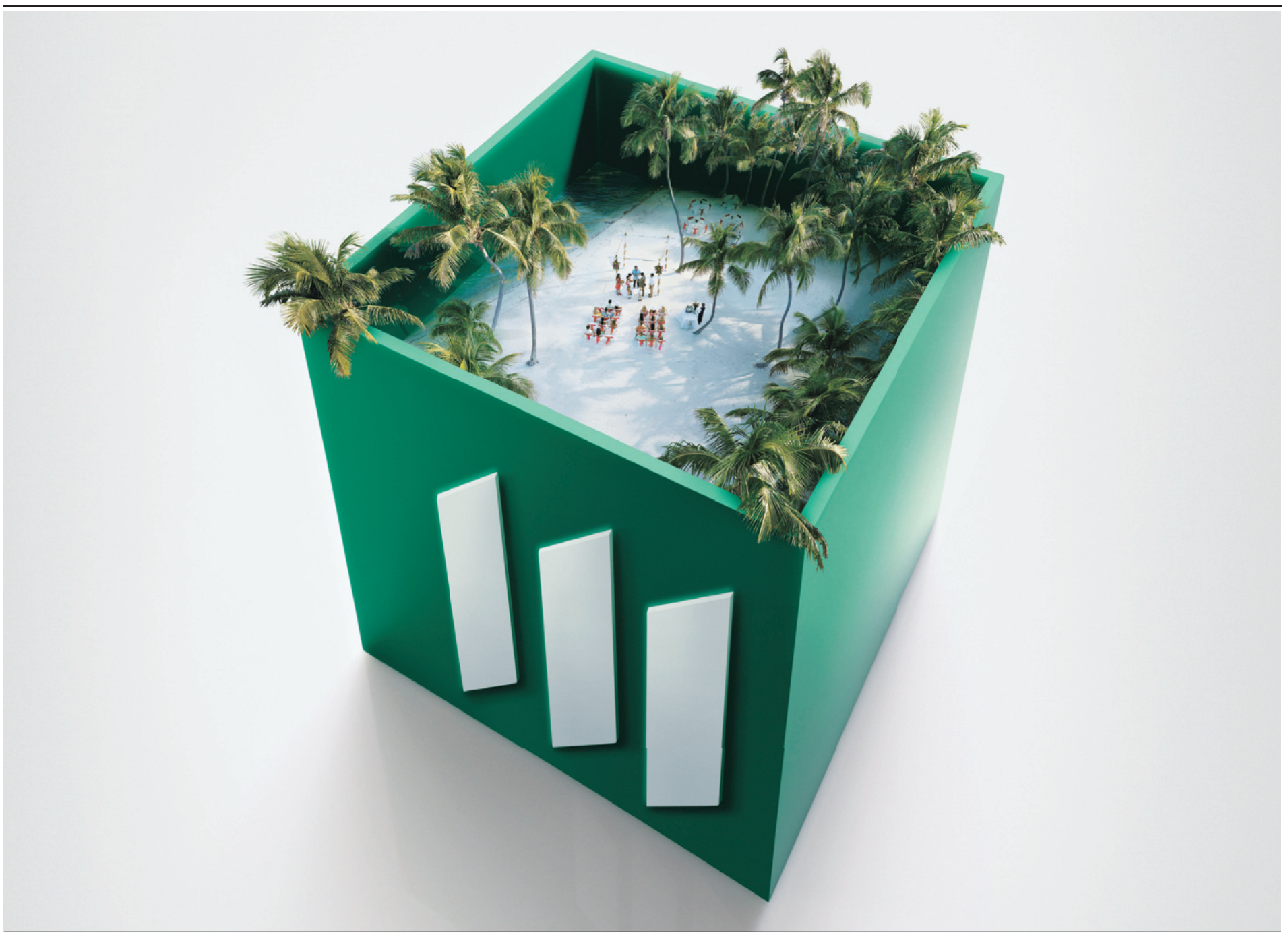

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