CHAPTER 1

The Road to Retirement

Take a good look at Figure 1.1. For those of you who have had to watch a loved one succumb to a critical illness, this chart might not surprise you. For others who assume they will sail through their first decade or two of retirement with no problem more serious than how to pay for the next Caribbean cruise, the chart may be a wake-up call.

In a time when we are constantly being told that we are living so much longer than we used to, it may be hard to believe that the average person has little better than a 50–50 chance of making it from age 50 to age 70 without dying or incurring a critical illness. By critical illness, I mean something really serious, such as a life-threatening cancer, cardiovascular disease, or kidney failure. (The full list is given in Chapter 21.) We might be living longer, but we humans continue to be a fragile species.

So why dwell on the morbid? These statistics are an important part of one's retirement planning. If we can change our focus from how many years we will live to how many years of healthy living we have left, it will better inform our actions while we still have the time and ability to act.

If you are age 50, for example, you might be thinking you have 35 to 40 years to go and possibly more. On the other hand, if you can expect to enjoy only 20 more disability-free years (or less), it might very well affect when you retire, what you do in your 60s and how quickly you draw down your retirement savings. Healthy life expectancy is just one of the issues we will consider in this book. But I am getting ahead of myself.

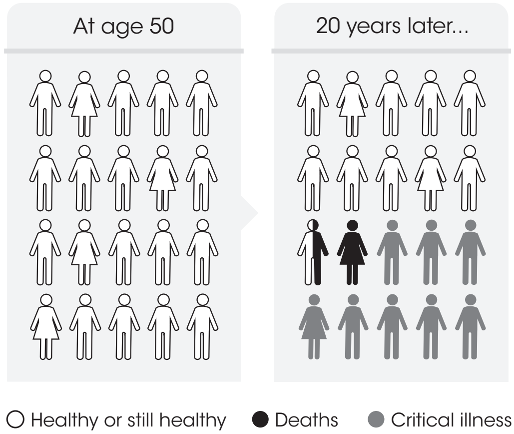

Figure 1.1 The Fragility of Life
Source: Canadian Critical Illness Tables (2008), reconfigured by Morneau Shepell

I will let you in on a little secret. Retirement planning can be as straightforward as following these six steps:

1. Save 10 percent of your pay each year.
2. Invest it in low-cost pooled funds, weighted toward equities.
3. Keep the asset mix the same, through good times and bad.
4. Apart from the mortgage on your home, avoid going into debt.
5. Pay off your mortgage by the time you retire.
6. Buy a life annuity at retirement.

This road map sounds rather simple, and it is. If you are able to follow it to the letter for your entire working lifetime—and experience no long-term unemployment or critical illnesses along the way—you will not go far wrong. In fact, you will fare better than most of your contemporaries. So why do you need this book, or any book on retirement planning, for that matter?

If arriving at your retirement goal was analogous to traveling to a destination, then the above six steps might get you to the right country but possibly not the right state or province. Moreover, the route may not be the cheapest, the shortest, or the most pleasant way to get there. At the risk of beating this metaphor into the ground, you might not be able to recognize the potential hazards along the way without a little more knowledge to guide you.

In this book, I try to define your retirement goal as well as the possible ways to reach it. I will use the following process to do so:

1. Define your retirement income needs as a percentage of your final employment earnings. We will call this your retirement income target.
2. Using your retirement income target, determine how much money you will need to have saved up as of the day you retire. We will call this your wealth target. Knowing this figure makes it much easier for you to monitor your progress toward becoming retirement-ready.
3. Having established your personal wealth target, consider the possible savings strategies that will get you there.
4. Assuming you arrive at your wealth target by the time you are ready to retire, you now need a strategy for drawing it down in a sensible and sustainable fashion throughout your retirement years.

My intent is not so much to be prescriptive as it is to provide useful and hopefully interesting, information. Along the way we will learn these realities:

- Saving 10 percent a year is not a bad rule of thumb if you could follow it, but the odds are, it will be too difficult to maintain in the early stages of your career and it might not even be advisable that you try.
- Retirement planning is as much about how you manage your cash flows during your working career as it is about accumulating wealth for your retirement.
- Most people never spend more than 50 percent of their gross income on themselves before retirement, which is why the retirement income target is usually much less than 70 percent.
- Interest rates will probably stay very low for the next 20 years or longer, which will affect how much you need to save.
- A constant asset mix for your retirement savings such as 60 percent equities and 40 percent bonds is not bad, but you can improve the odds of reaching your wealth target with a more advanced strategy.
- Your lifestyle can materially affect how long you will live and how many healthy years you can expect.

- You can withdraw 5 percent or more of your retirement savings each year in retirement, even if your total investment return is a little less than 5 percent.
- As people reach the later stages of retirement, they become progressively less capable of managing their finances, even though they grow more confident of their ability to do so.
- Annuities have become very expensive, but they still make sense for a host of reasons.

Detours

Although it is important to optimize your retirement planning strategy on the basis that everything goes smoothly, you will also need to be able to deal with adversity. When the preparation process takes as long as 30 or 40 years, you are bound to encounter some problems along the way. Below are a few of the events that can complicate your life:

- Losing your job and not finding another for a prolonged period
- Incurring a significant investment loss
- Suffering a business setback that forces you to draw down your life savings
- Being exposed to high inflation after you retire
- Having to help a family member in financial need
- Experiencing a serious illness or an accident involving yourself or someone within the immediate family
- Getting divorced, requiring you to split your assets

I wish I could tell you how to avoid trouble, but the truth is that we are not in as much control of our lives as we think. Yes, we can insulate ourselves from some of these calamities, but ultimately, success in retirement planning is best measured not by how adept or lucky we are at avoiding trouble, but rather, how we respond to trouble when it arises. Your best protection against misfortune is knowledge.

Of course, unforeseen events are not always bad news. Sometimes, good things happen that bring you that much closer to your retirement goal. It could be a big promotion, an inheritance, or an unexpected capital gain from an investment. It could even be something less dramatic like joining the pension plan in your workplace, which you might not think of as good news when you are 25, but you will eventually come to appreciate it.

Just as negative events in life call for a change in retirement strategy, so do the positive events. Either way, the key is to modify your planning appropriately whenever something happens. The better you understand the science behind retirement planning, the greater your chances of success.