How Much Do I Need to Retire?

Jason Armstrong, CA, CPA, CIM
Portfolio Manager
(403) 262-0813
Jason.armstrong@nbpcd.com

Devin Antony, CFA
Portfolio Manager
(403) 261-9542
devin.antony@nbpcd.com

Ross Slaneff, CFA
Associate Investment Advisor
(403) 262-0815
ross.slaneff@nbpcd.com

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There is no easy answer and no silver bullet. It varies by person (even within the same household), depending on a variety of factors not limited to:

(i) desired lifestyle and other sources of income;
(ii) intergenerational or charitable objectives;
(iii) age and health;
(iv) financial resources; and
(v) investment risk tolerance and suitability.

When we engage with clients on this topic, we first seek to understand their planning goals and objectives and then to reconcile their lifestyle considerations with current and projected financial resources. We encourage a 5-7 year time horizon and planning window (both pre- and post-retirement), so the onset of retirement is not generally an event, but rather a deliberate and thoughtful process.

Those who we have engaged with in wealth planning are familiar with the pre-retirement accumulation phase, which emphasizes having a defined savings strategy to build up investment capital (savings) to produce passive income in retirement. While saving/accumulating, any investment income generated is ideally reinvested within the target savings vehicle (ex: RRSPs, RESPs, TFSAs, non-registered investment accounts, real estate, permanent life insurance, etc) to build growth upon growth.

The importance of commencing your savings strategy early is best illustrated by example:

- if a 40 year old invests $20k/year for 5 years ($100k total) earning 6% inside an RRSP, at age 65 the RRSP will be worth $400k.
- if the savings strategy is deferred to start at age 50, the investor would need to set aside $36k/year for 5 years ($180k total) to arrive at the same $400k.
- if deferred to age 55? It will take $49k/year ($243k) to generate $400k by age 65.

Once retirement moves from concept to a reality, the discussion shifts from accumulating and saving to producing sustainable cash flows to support a retirement lifestyle that keeps pace with inflation. This needs to take into consideration all income sources (CPP, other pension income, rental income, etc) so as to determine the required drawdown on investments.

We advise clients to use a maximum 4% drawdown rate on consolidated investment values as a sustainable rate of withdrawal. This implies that $1m of investment value should be counted on to generate $40k of cash flow, before deducting any applicable income taxes. This rule of thumb applies for most growth-oriented portfolios, which we believe is necessary to keep pace with inflation and maintain (or grow) purchasing power.

Why 4%? Admittedly it is a rule-of-thumb, but we believe it is a decent conceptual starting point. From a planning perspective, we use an expected rate of return over a full economic cycle (5-7 years)- we would make the case for 6-8%. From that range, we would deduct a reasonable estimate for inflation, say 2-4%, to be retained and reinvested in the portfolio to maintain purchasing power over time- that yields 4% (6% minus 2% or 8% minus 4%). We have to remind ourselves not to ascribe false precision to what could be a 30-40 year forecasting exercise. We're seeking to be directionally prudent in our approach.

We have made no mention of asset allocation or other investment considerations- and we will save those topics for a more fulsome discussion in a future post- but we believe it is a mistake for investors (and their advisors) to decrease stock market exposure using their age as the determining factor. The common rule of thumb many advisors and investors use is to have a stock allocation equal to 100 less your age, so that a 65-year-old would have only 35 per cent in stocks. We believe this lacks long-term perspective and leads to unnecessarily poor investment returns.

Events over the past (nearly) two years have been an accelerant for change and many of our client households have engaged us to develop or update their personalized wealth and estate plans. This work can include but has not been limited to: cash flow and retirement planning; pension analysis; real estate purchases and financing; US property and snowbird considerations; intergenerational wealth planning; philanthropy; Will and Estate review; and insurance. By planning prudently, you can retire earlier, spend more in retirement, or leave a larger inheritance for your beneficiaries.

We're here to help. Please reach out if you have questions or points for clarification on the topic(s) above. Over the coming weeks, we intend to examine and discuss additional wealth planning and investment topics that may be of interest. If you have any suggestions, we would be happy to consider for a future publication.