BMO Retirement Institute

Retirement Strategies for Volatile Markets

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Decades of market history provide proof that it is vitally important not to let short-term volatility alter your long-term investment goals. Like it or not, bear markets (i.e. a market condition in which the prices of securities are falling) are a fact of life for equity investors. According to JPMorgan Research, including this recent instance, there have been 31 bear markets since 1900 in the United States – or approximately one every three years. It has been noted in the past that roughly speaking, the equity market runs on a four-year cycle. Of that, roughly two and a half years are bullish, when prices are rising, and one and a half years, are bearish. The 1980s and 1990s were glaring exceptions to this trend.

There is no doubt about the fact that no matter how often we hear that stock markets can be volatile and to prepare for volatility, we are greatly unnerved by market action and wonder if there is anything that can or should be done in response. This situation can be particularly troublesome for those who are nearing or living in retirement. With market volatility at hand, Canadians not only want to know how much money they will need to retire, but if they will have enough money to retire. These are tough questions to answer. Fortunately, there are sound retirement and investment strategies that when implemented, can go a long way to help address retirement concerns and put an action plan in place.

Approaching Retirement – stay the course and keep saving

If you are 5-10 years away from retirement, time is on your side and you can afford to wait for and will benefit from a stock market recovery. Your best strategy is to continue to save as much as you can to build your portfolio. Increased investment savings during a bear market can help you enhance your retirement nest egg by means of dollar cost averaging. This means that with lower stock prices you are able to buy more units or shares now than when the price was higher in the past.

Investment Strategies

Over an extended period of time, the return of the overall market will only be experienced by those who have stayed continually invested. The high returns experienced by the long-term investor are often a result of those investors who forgo those returns by abandoning their equity investments when markets are down.

The discipline of regularly adjusting the holdings in a portfolio allows investors to take advantage of the difference in performance between asset classes. So, at a time like the present, rebalancing to a strategic target asset allocation allows an investor to reduce the proportion of the portfolio in well-performing assets, in this case bonds, and to increase holdings of the poorer performing assets, stocks. Rebalancing then, allows investors to buy low and sell high. Investors generally miss out on the returns of the overall market, for exactly the same reasons – panicking and selling in a falling market, and chasing the ensuing bull market.

Retirement Planning Strategies

With only a few years away from retirement, we recommend that you continue to contribute as much money as possible to a Registered Retirement Savings Plan (RRSP) each year. This is especially the case for those in an above-average tax bracket. RRSP earnings grow on a tax-deferred basis and contributions provide significant tax savings as a result of the tax deduction which can be used to make additional investments.

Another way to boost the growth potential of your savings is to eliminate income tax as much as possible. Beginning January 2009, you can make a contribution of up to $5,000 to a Tax Free Savings Account (TSFA) where all investment income is earned tax free. Your TFSA contribution is separate from your RRSP contribution and allows one more way to save money for retirement. Even when you are ready to withdraw money from the TFSA, the withdrawal is tax free so it won't affect government

The BMO Retirement Institute was established in 2008 to provide thought provoking insight and financial strategies for those individuals planning for, or currently in their retirement years.

benefits. Investing in a tax-free savings account goes a long way to building your retirement portfolio. Here's how it works:

Example: comparing the rate of return in a TFSA with a regular account

	Investment Account	TFSA
Account Balance	$5,000	$5,000
Income 8%	$400	$400
Tax 30%	($120)	$0
Net earnings	$280	$400 =43% higher

How do you know if you'll have enough money to do the things you want to do in retirement? Create or update your retirement plan. A retirement plan will clearly show if you are still on track and will help you to focus on what you need to do between now and retirement to get on track. It will help answer questions such as; will I need to work longer, save more or spend less?

How do you know when you can retire? In the past, the common response to that question has been solely a financial one, however, today, 'baby boomers' are the first generation to consider delaying retirement in an effort to stay mentally and physically fit. They are not looking at a specific retirement "start date," preferring instead to undertake a gradual retirement. The **BMO Retirement Transition Illustrator*** can show you how the impact of working for a few more years can enhance your accumulated savings, delay the need to access these funds, and allow your retirement nest egg to grow in value for when you are ready to retire.

If retiring this year, proceed with caution

As you enter retirement your portfolio should reflect a variety of asset classes in proportion to the return you expect to achieve, your time horizon, risk tolerance and overall income and income needs. When and how much income you need from your portfolio will determine how long your money will last.

Investment Strategies

We know that retirement can last 25-30 years which means there is plenty of opportunity left in your portfolio for long-term investing. For retiree investors with long-term investment horizons for at least part of their portfolios, equity investments should be included to take advantage of the long-term dominance of future stock market returns over those of cash and bonds.

Times of high stock market volatility serve to remind us of the importance of diversifying portfolios, as diversification makes the periodic stock market setbacks more tolerable, and minimizes the risk that investors might reduce or eliminate equity exposure in times of crisis.

Retirement Planning Strategies

Drawing retirement income from an equity portfolio during a market downturn increases the risk of running out of money. A systematic redemption of equity fund units, or the selling of equity shares (the reverse of dollar cost averaging), during a market downturn means more lower-priced units have to be redeemed to generate a fixed level of income. This activity will deplete the number of units in a client's portfolio, and the longer it continues the faster the depletion rate will occur. The following recommendations can help cushion the impact.

Delay portfolio withdrawals for as long as possible to allow a full or partial recovery of equity prices and portfolio values. Consider deferring major purchases in the first year of retirement and, where possible, curb expenditures for a modest period.

Individuals who enter retirement with less debt are more confident about having sufficient income. One way to significantly reduce interest costs is to consolidate high interest rate debt with a home equity line of credit. Lower interest rate costs will minimize the drain on that all-important retirement income which leaves more to pay off the line of credit.

*The BMO Retirement Transition Illustrator can be found at **bmo.com/retirementyourway**

Use the Tax-Free Savings Account (TFSA) to build assets over the short term. TFSA earnings and withdrawals are always tax-free. For those over 65, investing with a TFSA may help to eliminate or reduce the claw back of OAS and other government benefits.

If currently retired, minimize withdrawals within a registered plan portfolio

If you converted your RRSP to a Registered Retirement Income Fund (RRIF) in a previous year, you will have to take a minimum withdrawal out this year, that is based on your age and account balance at the beginning of the year. Taking out too much can cause you to run out of money during retirement.

Investment Strategies

In times of market volatility, one thing that is often overlooked is the fact that your existing portfolio may still be generating sufficient income from interest, dividends or other distributions so that investments do not have to be sold to create the income needed in retirement. Having some investments set aside in an emergency fund that will last one or two years invested in cash or similar investments will also protect you from having to sell securities when they have declined in value.

Retirement Planning Strategies

If you don't need retirement income from your RRIF, consider an in-kind withdrawal instead of cashing in securities and withdrawing cash. Although you pay tax on the market value of the securities withdrawn from the RRIF, the securities won't have to be sold at an unrecoverable loss within the RRIF. Later, when the values of the withdrawn securities recover, growth will be treated as a capital gain outside of the RRIF and will be taxed at one-half the rate normally applied to an RRIF withdrawal.

Consider the following example:

RRIF in-kind withdrawal: $10,000 taxed as ordinary income and taxed at 45% equals $5,500 net. You now hold investments with a cost base of $10,000 outside of your RRIF. If those investments have grow to $15,000 when sold, the tax rate on the $5,000 capital gain is only half of the rate you would have paid if the $5,000 was withdrawn from the RRIF. Using half of the 45% tax rate used before, the tax on growth of $5,000 equals just $1,125. What's more, if these investments were put into a Tax Free Savings Account, then there would be no tax at all on the capital gain.

Lower market values provide opportunities for Canadians to unlock small locked-in registered accounts. There are regulatory provisions that allow small locked-in plans to be rolled into a regular RRSP or RRIF on a tax-deferred basis. Governing rules vary by province so get advice before proceeding.

Maintaining financial flexibility during retirement years is very important. By combining retirement funds into one account, you will get one statement, one withdrawal and make better retirement income planning and investment management decisions.

If you are under age 71 and have a RRIF and you do not need the income from the plan, consider rolling the RRIF back into an RRSP on a tax-free basis. You will still have to take the prescribed minimum withdrawal for the year in which the rollover occurs, and pay income tax on the proceeds, but you can avoid making any further withdrawals before the end of the year in which you turn 71.

Stay the course

By understanding your investment and retirement options you will have better control over your financial picture. The key retirement strategies presented here, when implemented, can go a long way to help address your retirement concerns and put an action plan in place.

We recommend that investors concerned about this recent market volatility consult with their investment professional to confirm that their strategic asset allocation is in line with their return objectives and tolerance for risk. There's no better time than today to review your retirement plan and stay on track to achieving your financial goals.