TURNER INVESTMENTS COMMENTARY

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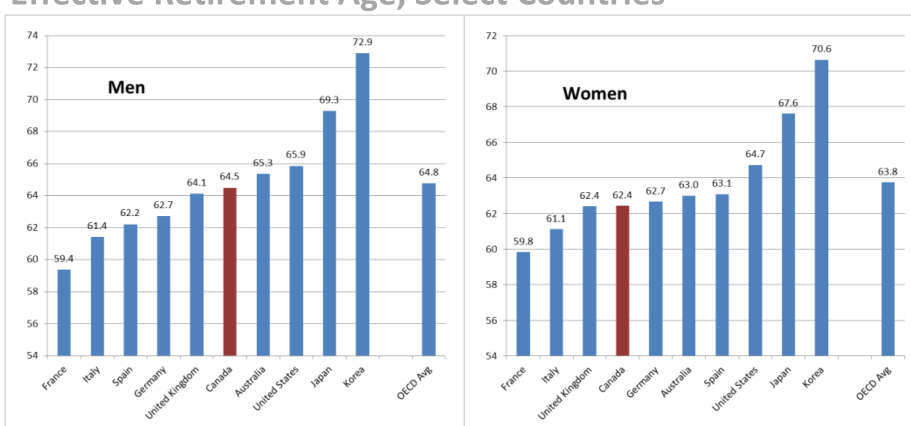
WHEN CAN YOU RETIRE?

“When can I retire?” As you might expect, this is the question most frequently asked by our clients. Naturally, we work individually and in great detail with each of our clients to determine when retirement may be possible. In some cases, it is remarkably soon, as we have clients who have retired in their early 30s. Others might have to wait longer than they initially expected.

Of course, the factors that can influence a retirement date are enormous: future sources of income, tax situation, life expectancy (and associated health costs) and debt obligations to name but a few. Some factors, such as exact health costs, may never be known until the distant future. Another critical item is lifestyle. Only *you* can decide what income level will make for a satisfying and comfortable retirement. Want a Porsche and vacations every month? Well, you’ll need a portfolio that can support this. If you can establish a detailed and realistic budget, so much the better. This will give you even more insight into your potential retirement date and allow you to ‘flex’ the date by better controlling expenses (and wants).

Effective Retirement Age, Select Countries

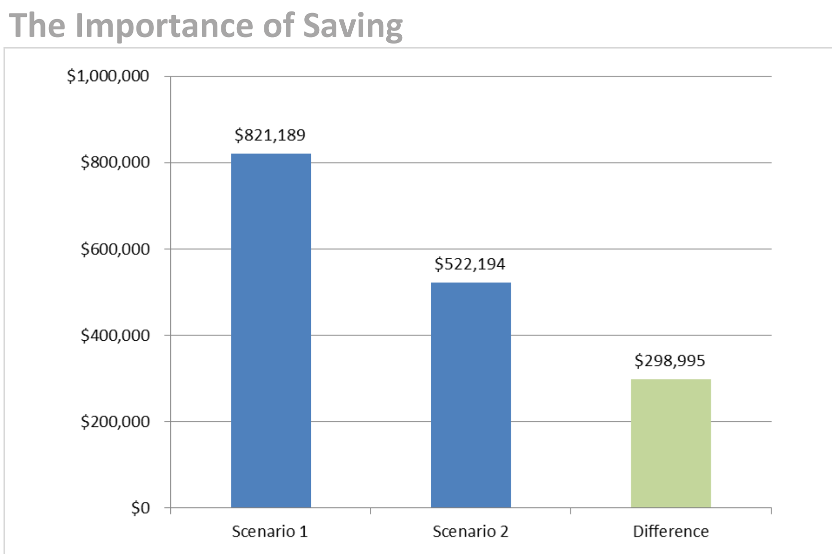


Source: OECD. Effective retirement age refers to the age at which older workers withdraw from the labour force, not necessarily the age when they’re eligible for government pensions. OECD average is average of 34 countries.

Answering all of these questions is obviously beyond the scope of a simple newsletter, but there are still some basic retirement planning considerations that can be addressed here. We'll go through each of these key points beginning with determining what your investment portfolio could potentially be worth in the future.

YOUR FUTURE PORTFOLIO VALUE

Naturally, one of the most important considerations when setting a retirement date is estimating the future worth of your investment portfolio. Unfortunately, the variables affecting this future value are considerable. Market conditions, interest rates, inflation, government taxation and your annual savings rate can all have tremendous influence on portfolio growth. However, you need start somewhere. We have several helpful calculators posted on our www.turnerinvestments.ca website (under 'Resources') and we would encourage you to perform some basic scenario analysis based on your own investments. We ran one hypothetical scenario for illustration purposes in the adjacent chart. We assumed a 40-year-old investor with portfolio assets of $150,000 saved $500 monthly over 25 years and earned a 5% annualized rate of return. We ran the same scenario where the savings rate was zero. Under the first scenario the portfolio grew to approximately $821,000. Under scenario 2 the portfolio grew to only $522,000, a difference of almost $300,000—a dramatic illustration of the power of savings.



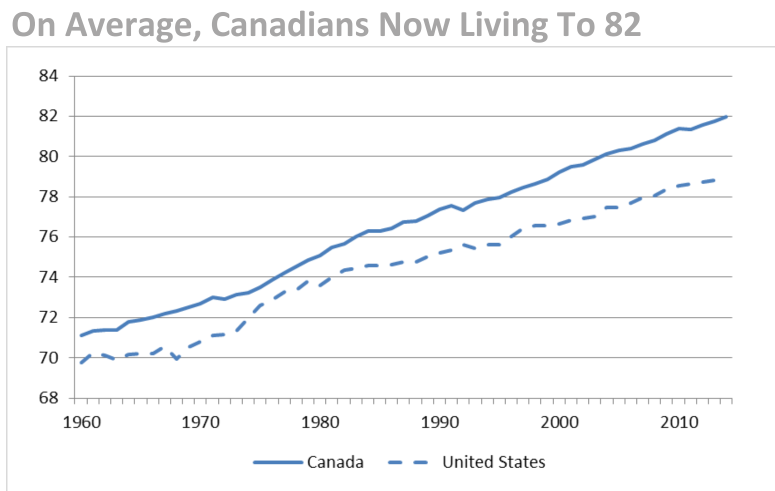
Source: Ativa. For both scenarios starting values are $150,000 with a 5% annual rate of return over 25 years. Scenario 1 assumes $500 added monthly. Scenario 2 assumes zero savings.

Another simpler, but useful, shortcut for determining portfolio growth is the rule of 72. The number of years required to double your portfolio value (assuming no withdrawals or deposits) can be determined by selecting a compound annual growth rate and dividing it into 72. Therefore it takes roughly 10 years to double your investment based on 7% annual growth (72 / 7 = 10.3 years). A more conservative 5% annual rate of return would double your money in about 14 years.

Once you establish your potential portfolio value you then need to determine what amount this portfolio could reasonably provide for you each year in retirement. We believe an annualized 5% *long-term* after-fee growth rate is a relatively conservative assumption for a balanced and globally diversified portfolio, which most of our clients own, and therefore this figure can also serve as a reasonable annual withdrawal rate. A $750,000 portfolio, for example, could provide $37,500 in annual pre-tax income. Dividends and interest income alone are unlikely to make up all of this 5% return, so to achieve the $37,500 in cash flow some harvesting of growth would be required (i.e., selling of securities). Because growth is not a certainty every year, clients must be aware that there is some risk to a 5% return assumption. However, the only true risk-free rate of return is the 1–2% coupons most Government of Canada bonds currently provide, but good luck funding your retirement strictly with government bonds. It's important to remember also that you have significant control over your annual withdrawal rate as you can adjust your household budget and lifestyle to reduce the amount required from your portfolio. You must also decide what you want your financial legacy to your family to be. Do you want to leave them an inheritance or are you content to run your investments down to zero? Obviously, if your answer is the latter, this provides much more flexibility with withdrawal amounts. Again, the calculators on our website will allow for more complex scenario analysis including adding inflation assumptions or more ambitious rates of return.

LIFE EXPECTANCY

Aside from your future portfolio value, the second most important consideration in establishing a retirement date is life expectancy. Currently, the average Canadian can expect to live until age 82 (see adjacent chart) and because life expectancy consistently rises, younger Canadians should expect to live even longer. So, at minimum, if you retire in your early 60s, you should assume that you'll live another 20 years and that your investments will need to last at least this long. Assuming that you'll live beyond the average is also sensible and you should have clarity regarding what your investments might be able to provide for you if your retirement were to last 30 years instead of 20.

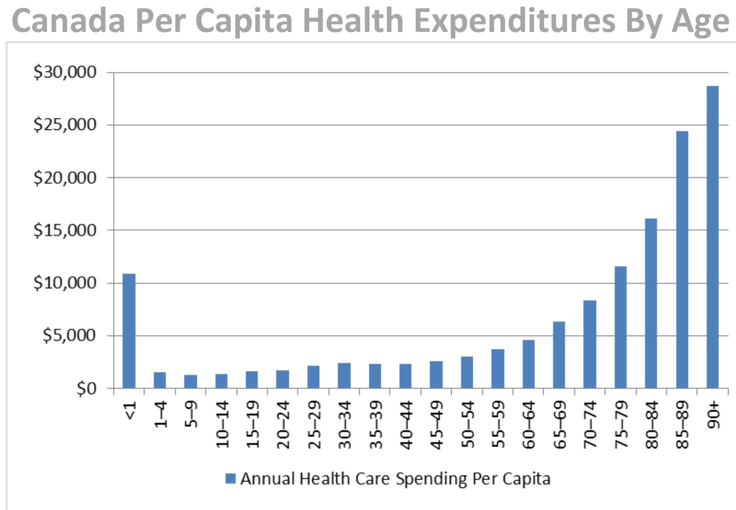


Source: World Bank

HEALTH: YOUR MOST VALUABLE ASSET

It's one thing to live a long life, but it's also important to have insight into the quality of your health during your retirement years. As you head towards retirement, you might have great visibility into your health situation, but most young people don't have this understanding—they assume old age, and the ensuing health issues, is simply a club that they can opt out of. However, eventually, we will all get ill and health care expenses will increase. This should be built into your future budgeting. Naturally, we encourage our clients to be conscious of diet, exercise and stress to reduce health-related costs, but it's still helpful to look at some basic averages to get a general sense of the health-related expenses you might incur. According to the Canadian Institute for Health Information, total health care expenditure in Canada last year was approximately $220 bln, or more than $6,000 per person. Health care spending has also been growing at a 6% annual pace over the past 40 years, well in excess of inflation. While many of these costs are covered by government resources, roughly a quarter are not. Keep in mind also that these costs ramp up significantly as we get older with the average annual health care expenditure *tripling* by the time you're in your 80s.

Further, these statistics include the cost of physicians, drugs and hospital stays, but they don't include the cost of long-term care facilities. Sun Life estimates that such facilities can cost as much as $2,500/month for a private room in a government-subsidized facility. A non-subsidized, private-residence retirement home can cost as much as $13,000/month. Home care costs vary, but a trained nurse can run $100/hour and a live-in caregiver as much as $50/hour. While your ultimate expense will depend on lifestyle wants, private insurance coverage and care level required, Canadians age 65 and over should budget for at least $50,000/year in health care and related accommodation costs. While some of these costs will replace other expenses (cost of food, rent or mortgage, for example) the amount is still substantial and increases quickly the older you get.



Source: CIHI. 2013 data.

WORK PENSIONS AND GROUP RRSPs

Generally speaking, we like work pension and other group retirement savings programs and we recommend clients participate in these offerings whenever possible. While the limited selection of high-cost mutual funds that you're typically forced to invest in are a drawback, the advantage of the employer matching usually outweighs this. We encourage you to create a balanced, globally diversified portfolio with these plans. This way you are mirroring (to the best extent possible) the investment strategy you have here with us at Turner Investments. Further, if you can buy more than one fund in each area, so much the better to enhance diversification. You never know, for instance, when a high-profile fund manager may depart or when a particular fund strategy will fall on hard times, so it's better to own a number of funds in each category. When you get a new job, don't wait—enroll in the work plans as soon as possible.

With respect to employer stock incentive plans, these are usually worthwhile as well. While the attractiveness of these plans varies, they typically allow you to purchase employer stock at a 20% to 50% discount to its recent trading price. This creates considerable downside protection. However, concentration risk can often become a concern. You should never allow your company-stock weighting to exceed 10% of your overall portfolio. If your employer is a non-blue chip company (not a big five bank or major telco, for example) then a maximum 5% weighting is a better rule. Remember: by owning company stock you are doubling up your risk—if the company's stock starts to underperform, chances are your job is now less secure as well. Normally, you are given a chance to divest your shares during certain windows. These opportunities should be taken advantage of to rotate out of your single company-stock position into a balanced, globally diversified portfolio.

RRSP OR NON-RRSP?

Next to "When can I retire?", "How much should I contribute to my RRSP?" is the second most frequently asked question by our clients. While we'll be dealing with this question in more detail in a future newsletter, we can provide some general guidelines here. First, RRSPs allow tax deferral not tax avoidance, so you will have to pay tax on these funds eventually. What an RRSP does offer however, is an opportunity to strategize with your tax planning because RRSPs allow for advantageous "tax shifting". For instance, it makes the most sense to contribute to an RRSP during periods when your income is high and withdraw from it when your income is lower. Simply put, you want your withdrawals to occur at a time when your tax bracket is more favourable than when the initial contribution was made. For most investors, because they're no longer working, their income will be lower in retirement; however, this is not necessarily always the case. A few things to consider regarding retirement income:

- Will you maintain a part time job?
- What income will your government or work pension provide? Keep in mind, your current employer may not have a pension program, but a future employer might.
- What income will your investment portfolio provide?
- Do you expect an inheritance or an asset sale?
- Other income? A rental property, for example.
- What will future marginal tax rates be? Because of high Canadian debt levels there's a case to be made for higher taxes down the road meaning you could be charged more in the future on the funds coming out of an RRSP.

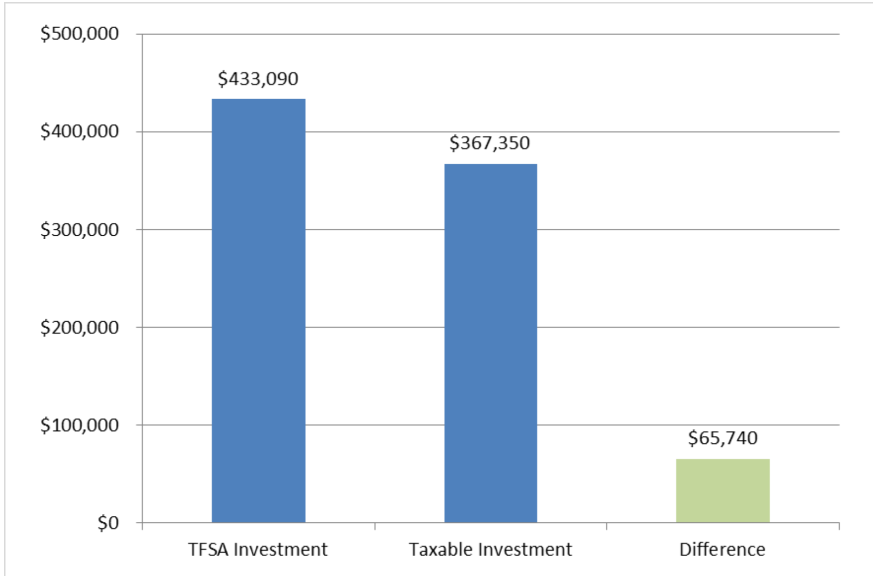
All of these factors could push your tax bracket higher in retirement and need to be taken into account when determining the amount of your RRSP contributions. RRSP strategies involve assumptions, which can be very difficult to make particularly if your retirement date is decades away. Therefore, unfortunately, there is no simple answer to RRSP contribution amounts.

RRSP contributions should always be made in a year when you have a tax liability and maxing out RRSP contribution room usually makes sense when you're younger because an RRSP has utility besides as a retirement tool. It's likely (sorry) that you will lose your job at some point in the future, may go on maternity or paternity leave, or may simply decide to take time off for a sabbatical or continuing education. Building an RRSP nest egg is useful in these circumstances as your income may be close to zero at these times. RRSPs also provide flexibility for funding a first-time home purchase or full-time education costs. For example, RRSP funds can be withdrawn without tax penalty as a down payment on a first home through the Home Buyer's Plan. Eventually, these RRSP withdrawals must be returned, but the repayment schedule is usually quite manageable.

Maxing out contribution room also makes sense during your highest income years, but, again, making this determination is difficult (congratulations on your big promotion…five years from now!). So, again, there are no definitive answers regarding RRSP contributions. However, to hedge the risks of an unknowable future, avoid overconcentration—there is rarely a good reason to have 80% or 90% of your portfolio in an RRSP and, vice versa, to have such a high percentage in non-registered accounts. If your future retirement income is difficult to estimate (and it almost always is), strive for a balance between registered and non-registered funds.

Remember too that while RRSPs can be beneficial if used correctly, our preferred account type remains the TFSA since, unlike an RRSP, you can withdraw from a TFSA at any time without tax consequences and you can continue to contribute to one even after the age of 71, the limit for RRSPs. The growth inside a TFSA is also free of capital-gains tax consequences. For most investors, TFSAs are not yet of a size to meaningfully impact retirement plans—the lifetime contribution room currently sits at only $46,500—but every year TFSAs become a more important retirement tool. All things being equal, TFSAs should always be fully funded before other account types, particularly non-registered accounts. The adjacent chart illustrates the long-term advantage of contributing to a TFSA vs. a taxable account. The chart assumes that your TFSA starts at the maximum ($46,500) and that you add the current limit ($5,500) each year over the next 25 years at an annual rate of return of 5%. The TFSA advantage is substantial.

The TFSA Advantage



Source: Ativa. Chart assumes starting value of $46,500 and $5,500 contributed each year at a 5% annual rate of return over 25 years. Return on the taxable investment consists of 33.3% interest, 33.3% eligible dividends and 33.3% capital gains. Calculations are based on the Ontario tax rate.

RETIREMENT PLANNING: NOT FOR SISSIES

So, there's a lot to consider. Bette Davis once said, "Old age ain't no place for sissies" and we would argue that the same can be said of retirement planning. If this were a big bank newsletter, at this point we would include a picture of a cardigan-clad, grey-haired couple calmly piloting their giant sailboat across beautiful, sun-drenched seas. We're not saying that it can't be this easy, but we know that retirement planning is a complicated issue, filled with many challenges and difficult-to-make forecasts. Even if your retirement sailboat is looking a little bit more like Robert Redford's in "All Is Lost" (btw, a good movie, if you haven't seen it), we're here to help navigate the uncertain waters. It's your retirement, but we're piloting this boat together.

Retirement Planning: It Ain't Easy

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