the FIX IS IN

»» by Lori Bamber

A financial first-aid kit for retirement plans bloodied by savage bear attacks

Sheila Maguire welcomed the year 2000 as the beginning of a new and promising era in her life. A vibrant 51-year-old, she felt she was finally over her divorce, ready to move on. She'd paid off the mortgage on a home she loved and knew she had the means to retire any time she wanted. In just a few years, she had parlayed her divorce settlement into more than $500,000 in retirement assets. Her successful experiment with mutual fund investing had convinced her that her advisor was right – she could count on her assets growing by something close to the 13-per-cent long-term average used in her financial plan calculations. ¶ Life was good. She might even try that internet dating thing everyone was talking about.

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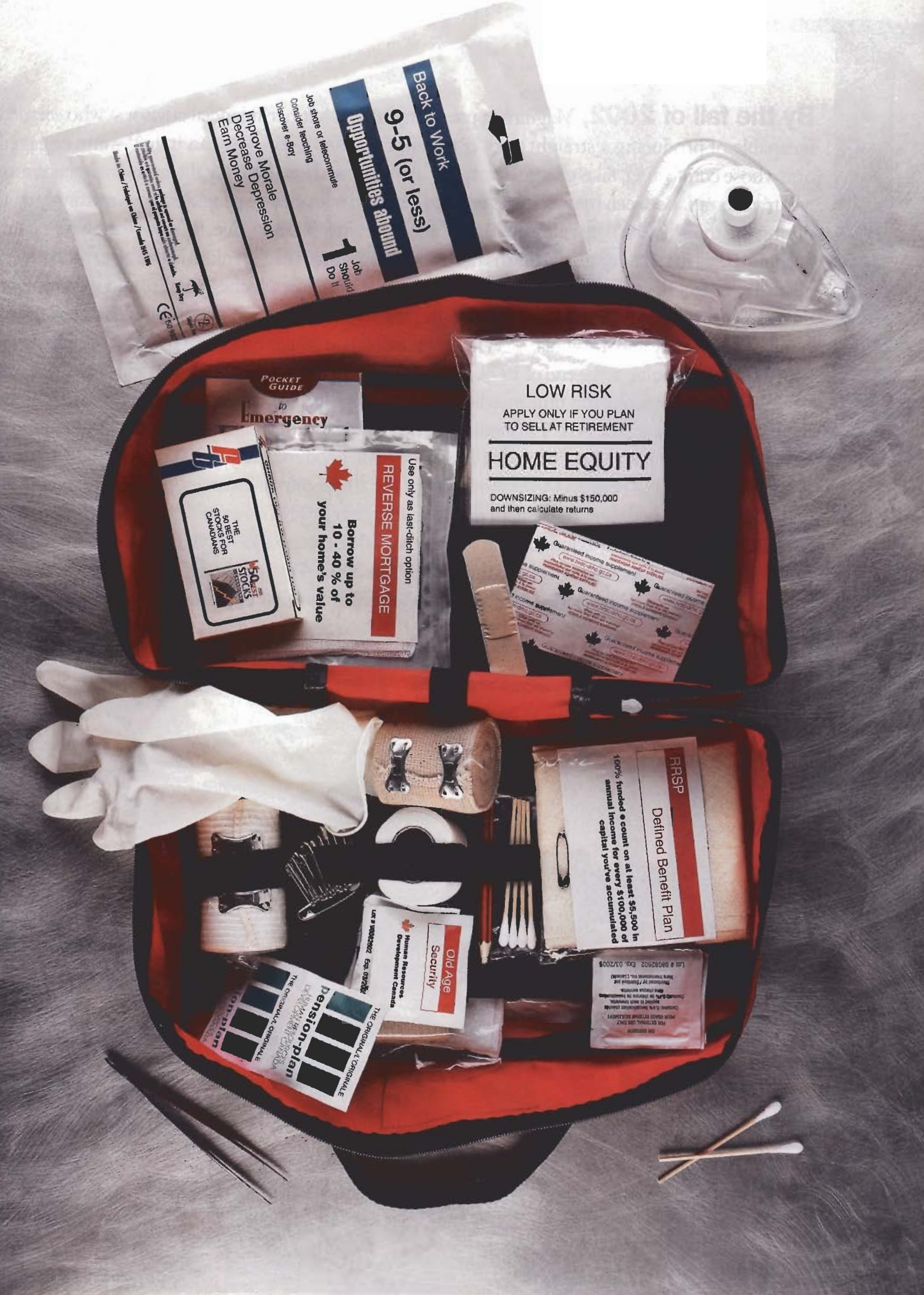
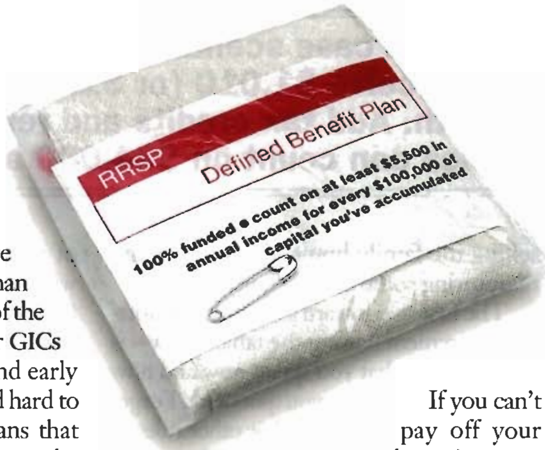

Back to Work
9-5 (or less)
Opportunities abound
Job share or telecommute
Consider teaching
Discover e-Bay
Improve Morale
Decrease Depression
Earn Money
1 Job Should Do It
LOW RISK
APPLY ONLY IF YOU PLAN TO SELL AT RETIREMENT
HOME EQUITY
DOWNSIZING: Minus $150,000 and then calculate returns
POCKET GUIDE to Emergency
Use only as last-ditch option
REVERSE MORTGAGE
Borrow up to 10 - 40 % of your home's value
THE 50 BEST STOCKS FOR CANADIANS
Guaranteed Income Supplement
RRSP
Defined Benefit Plan
100% funded • count on at least $5,500 in annual income for every $100,000 of capital you've accumulated
Old Age Security
Human Resources Development Canada
pension-plan
THE ORIGINAL/L'ORIGINALE

By the fall of 2002, Maguire (a pseudonym) had left her financial advisor – who seemed incapable of producing a straight answer to questions like 'How low can it go?' – and engaged one whose comforting, take-charge demeanor had morphed into bullying the moment her account was transferred. Between market losses and the deferred sales charge penalties she unwittingly paid during the transfer, she'd lost almost 40 per cent of her investment value. ¶ More than a year later, Maguire is still in recovery mode. She has a new job, and is grateful she enjoys it, because she wonders if she'll ever feel financially secure enough to stop working. She pinches pennies and worries. She doesn't sleep well and her health continues to be poor – she feels her job performance is suffering as a result of her anxiety and insomnia. ¶ With her portfolio up 30 per cent from its lows, but still down $100,000 from its value at the end of 1999, Maguire's current investment strategy is denial. She's moved her investments yet again, this time to a discount brokerage firm, and hasn't opened a statement since the last transfer was confirmed. ¶ Although she describes her experience as being terribly isolating – something she can't talk about, even to her family – she is in good company. A 2002 poll by the American Association of Retired Persons (AARP) found that fully 20 per cent of investors between the ages of 50 and 70 had postponed their retirement due to investment losses. Maguire's denial is common, too. An RBC/Ipsos Reid study conducted in November 2002 found that 72 per cent of Canadians had not made any changes whatsoever to their RRSPs in 2002, 41 per cent didn't know what kind of mutual funds they owned, and 36 per cent didn't even know what their holdings were worth.

Maguire feels her investment losses keenly, but she's one of the lucky ones. She moved into the market in 1997, so even after three years of losses, she had more money in her investment portfolio than she originally put in. That isn't true of the many investors who cashed in their GICs and moved into equities in 1999 and early 2000. For them, money they worked hard to save is gone, and the financial plans that seemed so solid in 1999 have proven to be fictions based on vastly inflated projected returns.



It's time for a return to realism. So, for Sheila Maguire, and for everyone else who gets butterflies in their stomach when the word 'retirement' is mentioned, we've designed a financial first aid kit.

The Diagnosis

Where does it hurt? What will make it better?

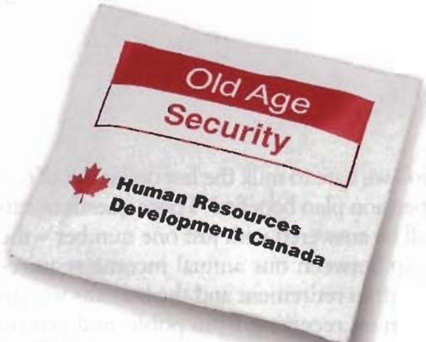
For all of us, the crux of retirement planning is paying off all debt, including the mortgage. If you can't pay off your mortgage by retirement, sell the house and buy a less expensive home. Avoiding debt is key to financial well-being at any time, but in retirement, it is absolutely vital.

Deciding today how we're going to account for our needs much later is tricky. Sure, we'd all love to have it all. But for most of us, there are trade-offs. Do we work longer when we're young in order to have more money when we're 80? Buy expensive long-term care insurance in case we are one of the five per cent of 65-year-olds who will end up in a nursing home? Do we stay in a job we hate to milk the last dollar out of our pension plan benefits? Those questions can all be answered with just one number – the gap between our annual income requirement in retirement and the benefits we can plan on receiving from public and private pension plans.

The more lavish our lifestyle, the more we have to worry about. Replacing just $10,000 in annual income between age 65 and 90, assuming an average annual return of eight per cent, requires that we accumulate $150,000, about $180,000 if we want the security of guaranteed investments.

The good news is that the opposite is also true – if we can pay off our home, for example, retire our mortgage payments, thereby reducing our income needs by $10,000, we've also reduced our savings requirement by at least $150,000. We're living in the same home, with the same lifestyle, but our income needs and tax burden have both been lightened.

According to research done by famed Ontario actuary Malcolm Hamilton, the



The worst case scenario? At retirement, you'll receive $1,010 (or $1,637 per couple) a month. Add tax credits and refunds, and couples can count on $24,000 a year

average Canadian family spends $30,000 a year. Couples who have only CPP, OAS, GIS, GST rebates and the age tax credit to rely on will receive about $26,000. As those programs are indexed to inflation, even an average family only has to worry about replacing $4,000 in annual income. With 10-year government bond rates yielding about five per cent, that would require savings of $80,000, an amount that can often be realized just by selling the family home, downsizing and recapturing some of our equity.

The first step toward a healthy, comfortable retirement – using the table below – is to figure out what you spend now and how that will change when you quit work. Forget the '70 per cent of income' or other rules of thumb tossed about. If you are a 55-year-old late bloomer with little in savings, two children you plan to put through university, a big mortgage, and a taste for skiing and golf trips, you'd better like your job; you're going to need it for a while.

It's more likely, however, that you are one of those blessed Canadian boomers who will manage to pay off their homes by 65 (currently the majority), who will have raised their families on average annual incomes of $50,000 (the majority) and whose adult children will be independently employed. If so, despite your fears, retirement is likely to be the most financially comfortable period in your life.

To see into your financial future, begin by using this table to calculate your annual personal or family retirement income requirements. We've used Sheila Maguire as an example. ▼

Sheila Maguire currently has a net income of $46,000. To assess her annual retirement income needs, we've listed her annual expenses and how much they will change. Follow along to see how your costs will change

CURRENT EXPENSES	SHEILA'S SITUATION	ADD/SUBTRACT PER ANNUM	YOUR SCORE
Family dependents	Sheila is currently supporting two teenage kids	-$9,000	
Housing	Mortgage paid off. Will downsize, reducing taxes and maintenance by $100/month	-$1,200	
Commuting	Public transit	-$1,800	
Food and clothes for work	Sheila anticipates spending $2,100 less in retirement	-$2,100	
Health care	She anticipates her costs increasing	+$2,400	
Leisure and entertainment	Spends $1,800 on travelling. No changes planned	$0	
RRSP investments	She contributes $6,000 annually	-$6,000	
Net income	She currently earns $46,000	$46,000	
Total expense reductions		-$20,100	
Total expense increases		+$2,400	
Annual retirement income needed		$28,300	

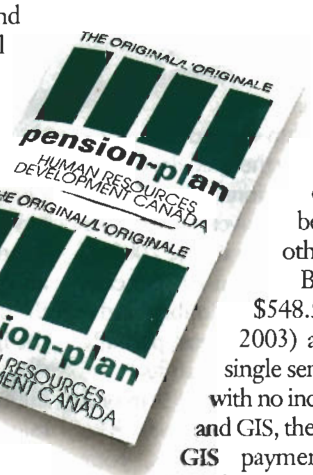
Now that we've established how much income you need, it's time to tally up what you can expect to receive. Take heart – it's likely to be a lot more than you thought.

The Cures

Government Crutches

If you listen to the financial industry, you may be under the impression that our public retirement programs are in a more precarious state than the spotted owl population. Since being re-jigged in the late 1990s, however, the Canada Pension Plan is both sound and sustainable. Moreover, in the face of a rapidly expanding cohort of senior and soon-to-be-senior voters, the only real threat to our public retirement plans – political pressure from the radical right – becomes ever more impotent.

In addition to providing the political will to keep our retirement programs in place, baby boomers will feed the coffers that sustain them. The average Canadian is 38 this year, just about to move into the two highest income-generating and tax-paying decades – their 40s and 50s.



Here is what you can expect from the Canada Pension Plan (CPP), Old Age Security (OAS) and the Guaranteed Income Supplement (GIS). All three programs are indexed to inflation, so you can expect the benefits to have the same buying power 30 years from now as they do today.

Canada Pension Plan

Maximum monthly CPP benefits are currently $801.25 per month, with the average recipient receiving about $470 per month (most of today's retired women were less than fully employed during their working years, a situation that has changed with the baby boomers). To find out how much you can expect to receive, refer to your annual Canada Pension Plan Benefit statement, or call Human Resources Development Canada (HRDC). Remember, each year your income is higher than your previous annual average income (to a maximum of $39,900, beyond which no further contributions are allowed) you're increasing your eventual monthly benefit.

Old Age Security

If you've lived in Canada for at least 40 years, you'll be entitled to full OAS benefits of $453.36 per month. (You may be qualified for partial benefits if you've lived here for 10 years or more – check with HRDC.) Benefits will be reduced once you earn more than $57,879 in any single year of your retirement and are clawed back entirely once you earn $94,148.

Guaranteed Income Supplement

Single senior women are far more likely to fall below the poverty line ($18,189 in Vancouver) than either married seniors or single senior men. That is likely to change, at least to a degree, as female boomers, most of whom have worked full time throughout their life in paid employment, join the ranks of retirees. For now, though, a significant number of Canadians, most of them women, receive GIS benefits because they didn't work outside the home long enough to qualify for full CPP benefits and have no other source of income. Benefits of up to $548.53 per month (in 2003) are available. For a single senior, male or female, with no income other than OAS and GIS, the combined OAS and GIS payment is $1,010.08 per month. For married or common-law partners both receiving OAS, the maximum benefit is $357.30 each, for a total combined OAS/GIS benefit of $818.85 per recipient, per month. (If you are married or in a common-law relationship, but your spouse does not receive OAS, your benefits will be the same as that of a single senior.)

So, that's the worst-case scenario for any Canadian who has lived here for 40 years or more. In the absence of any other income, you will receive $1,010.08 if you are single or a combined $1,637.70 per couple. Add GST refunds, old age tax credits, and property tax rebates and you can count on about $26,000 per couple. Not a luxurious lifestyle, but if you've managed to pay off a home or rent anywhere but a major city, not cat-food country either. (Singles may want to start thinking about the brand they prefer.)

The Pension Airway

When 'under-funded' private pensions hit the headlines in 2002, a chill was felt by the 40 per cent of Canadians counting on pension benefits. As most pension participants have figured out since then, however, even as rising markets have taken the edge off the crisis, a funding shortage at a solvent company erodes shareholder profits, not pension benefits.

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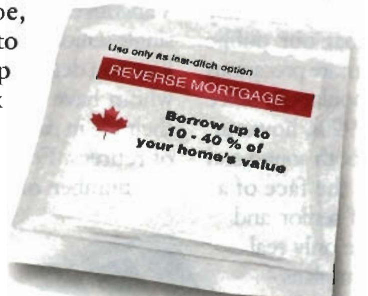
At least for now. Over the longer term, employers may continue trending toward group RRSPs and Defined Contribution Plans, both of which shift investment risk from the employer to the pension recipient. One thing is sure: any pension plan or group RRSP your employer contributes to on your behalf is a very good thing, and as long as you have some idea what the eventual benefits will be, you also have the power to supplement any income gap with private savings. Ask questions to find out exactly what you'll be entitled to, and if you're in a Defined Benefit Plan find out how much of the plan is 'funded' (held in trust for beneficiaries) and 'un-funded' (not yet held in trust). In the salad days of the late '90s, Canadian pensions were 120 per cent funded, but fell to an average of 75 per cent by the market bottom in late 2002. If your pension plan is less than 100 per cent funded, you'll want to work doubly hard – your pension benefits are at least partially contingent on future company profits.



With a Defined Contribution Plan or a Group RRSP, your retirement income will be a product of your contributions, your employer's contributions, and the investment returns on both. Using an online or financial calculator, enter your total annual contributions and your anticipated average annual returns to find your balance at retirement. Count on at least $5,500 in annual income for every $100,000 of capital you've accumulated by retirement age.

The Home-Equity Pill

As gains on your primary residence are non-taxable, one of the lowest-risk ways of accumulating retirement equity is to buy and pay off the home you live in. Unfortunately, many of us get very attached to those homes and don't want to sell to recapture the equity at retirement.

If that describes you, don't include your home value in your retirement calculations – it's not an investment, it's an expense. If you plan on downsizing, though, and are realistic about what your home value minus $150,000 – or whatever sum you want to subtract from your home equity to add to your retirement portfolio – buys, you've just created another $10,000 in retirement income.

Another option is the controversial reverse mortgage. Unlike traditional mortgages, which must be repaid, a reverse mortgage allows you to borrow money (10 to 40 per cent of the value of your home, depending on your age). If you have a mortgage or home equity line of credit, it will have to be paid off before you receive the balance of the loan proceeds. Until both you and your spouse die, or you sell the home, the mortgage does not have to be repaid, but the interest clock keeps ticking. Once you die, or sell your home, the principal and interest must be repaid. The balance of the sale price belongs to you or your estate.

There are two downsides. First, your children may think it's a bad idea if they lose out on any inheritance. Second, your home equity value will be gobbled up much faster than you anticipate; if at 75 or 80, you decide it's time to sell and move into a seniors' facility, you may find yourself with no equity left with which to do so.

Reverse mortgages should really be considered a last-ditch option. But since applying for traditional home equity lines of credit (the time to do that is while you're working) and mortgages doesn't work for retirees (due to the substantial monthly income required for loan approval), they do provide a welcome alternative for seniors who would otherwise have no choice but to sell their home.

MAGUIRE'S MONTHLY INCOME	EXAMPLE	YOUR MONTHLY FAMILY INCOME
CPP, OAS, GIS and tax credits	$1,200	
Indexed private pension benefits	$350	
Income from recaptured home equity of $100,000	$556	
Total:	$2,106	
Monthly income requirement:	$2,333	
Gap:	$227	

Now, add it all up:

Based on the calculations in the chart, Sheila Maguire, whose anxiety about retirement is affecting her health and job performance, never needs to save or make another dime in order to maintain her current lifestyle. If she were to transfer her entire portfolio (now about $400,000) into completely secure Government of Canada bonds at an average yield of just five per cent, her monthly income would be $1,667 – bringing her monthly income to $3,773, almost $1,500 more than she needs.

For many of us, though, particularly those of us without access to employer-sponsored pension plans, the gap is going to be a lot bigger. There are two ways to fill it – employment income and investment income.

The Job Band-Aid

We're living longer and living healthier so clearly we're going to need money to entertain ourselves.

If the solution doesn't seem obvious – more work – it may be because we haven't yet experienced a demographic shift of this proportion. The opportunities promise to be plentiful, and work is going to get a lot more fun.

A recent Conference Board of Canada report predicted that by 2011 employers will offer higher compensation or other incentives to keep boomers in the workforce

In a report released last year, the Conference Board of Canada warned that the aging of the baby boomers would create a critical skilled labor shortage beginning in 2011 and lasting until 2025 when the last boomers retire. They predict employers will offer higher compensation or other incentives, like reduced hours, job sharing and telecommuting to keep boomers in the workforce past 65.

Rather than diminishing quality of life, a study by Cornell University found that the highest morale and lowest rates of depression among men were found in those who continued to work after 'retirement'. (Women in the study were about equally happy whether they were in paid employment or not.)

But if the idea of a more fulfilling life doesn't do it for you, the financial impact might. In the current interest rate environment, for example, you'll need about $100,000 (at age 65) to buy an annuity that pays monthly benefits of $741 for a man and $641 for a woman because of our longer life expectancies. At only $15 an hour, you can replace that income in just 50 hours or 42 hours per month, respectively. If you're a professional and manage to get elected to the board of directors of a publicly traded corporation (average annual stipend about $24,000), you can replace the income earning ability of $300,000 of savings – and serve the world at the same time.

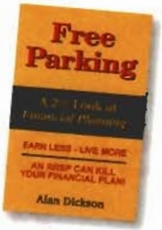
For high income earners, working even a bit longer can pay huge dividends. Work just three additional years – and add $75,000 to your nest egg in the process – and at eight per cent you've created an additional $5,000 in annual income.

The key is to find work you enjoy and don't have to do full time unless you want to. Some suggestions:

- Endless options lie in the service sector, and gregarious seniors are becoming almost as common as teenagers on the front lines of fast food restaurants. Opportunities in tourism-related businesses abound, and Avis Rent-a-Car, one of *BCBusiness*'s top 10 employers in 2003, actively recruits and hires retirees.
- eBay has become a way of life – almost US$15 billion in goods were sold in 2002 alone. Whether you resell items or sell your own creations, the store is open 24 hours and you only need to check in when you want to. There are no warehouses to rent, no payroll to meet, no credit to check – just find a product with a market, and Paypal (*paypal.com*) will transfer the proceeds right to your bank account.
- Many skills translate into home-based or part-time employment. Writing and editing, data-processing, administration, tax return preparation, telephone marketing and research, accounting and tutoring are all growing fields.
- What do you know that other people want to learn? Many artists supplement their income giving classes in everything from dance to painting with water colors to alternative home construction.
- Consider teaching – research indicates there will be a major shortage of teachers and professors beginning as soon as 2006. If you have a university degree, a teaching certificate will allow you to transfer your business acumen into the classroom – and help shape the world for another generation.
- The fastest growing demographic in

No First-Aid Needed

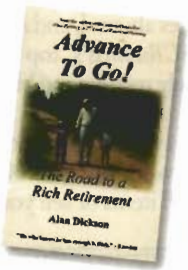
Boomers Alan Dickson and his wife are moving inexorably toward an impoverished retirement. They expect to scrape by on a combination of CPP and OAS benefits, supplemented only by $200 in monthly interest income on the scant savings they've managed to accumulate.



No worries. Like many relatively low income Canadians who have chosen to work less, spend less and live more, he feels luckier than most. Describing himself as a "recovering financial planner," Dickson is the best-selling author of *Free Parking – a 2nd Look at Financial Planning* and the newly released *Advance to Go! – The Road to a Rich Retirement*. His message? Canadians have been sold a bill of goods about retirement, and the impoverished future we're worrying about is a masterful sales campaign, not a likely reality.

"I don't understand why people ask financial planners how much they need for retirement," Dickson says in a phone interview from his home in Duncan. "Why don't they ask their parents? Why don't they ask people that are actually living the experience?"

His advice is so outside the box and contrarian that *Vancouver Sun* finance writer Michael Kane wrote, "Some gullible readers could be persuaded to choose terminal poverty when they have the means to plan for a comfortable retirement."



Dickson's response? "A fair comment … except that I neither live in, nor promote poverty. My family does live at or below the official poverty line … an arbitrary number that has little to do with reality. I have always planned for a comfortable retirement. I'm comfortable now and I have no plans to change my financial situation when I retire."

Canada is the 80-plus segment, and they need help. Consider shopping, cleaning, organizing, entertaining or providing meals for the elderly.

- There is nothing like aging to make us more conscious of maintaining our health. No surprise, then, that yoga, Pilates and health care alternatives like acupuncture are among the fast-growing businesses in North America. Learn … then do … then teach.
- For business professionals, the growing field of independent corporate governance is a natural fit. Remuneration can range from zero (for community and not-for-profit boards) to upwards of $30,000 per year for plumb corporate board positions. But the greatest range of opportunity may lie in the small business sector where owners are finding that senior advisors provide a wealth of knowledge and experience they couldn't otherwise afford. Evaluate your skills, print a business card with 'Business Consultant' on it, and start introducing yourself to business owners who might benefit from your advice.
- Good with a hammer? Or a wrench? Anyone in the trades is going to be in great demand over the next 20 years, and that high demand will translate into plumb part-time handy-man jobs and training opportunities.

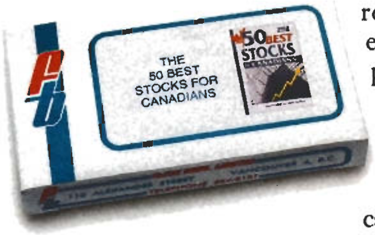
Portfolio Crash Cart

Let me be frank: investors within 15 years of retirement who suffered losses of more than 15 per cent in any of the last three years were over-weighted in equity investments. Rather than worrying about what the market is going to do next, fix your portfolio.

Even the most bullish portfolio managers rarely have more than 70 per cent of their assets in equities, and the most pessimistic rarely have less than 35 per cent. Many people should never own stock because any loss is intolerable to them. The rest of us belong somewhere between the pessimistic and optimistic portfolio weighting.

To figure out where you should be, consider the following data from the Vanguard Group.

Over the 76 years ending in 2001, a portfolio consisting of 100 per cent equities lost money in 22 of 76 years – and the greatest single decline in a year was a heart-wrenching 43.1 per cent. Contrast that with a balanced portfolio of 50 per cent stocks and 50 per cent bonds, with average annual returns of 8.7 per cent versus the equity portfolio's 10.7 per cent. A balanced portfolio lost money in only 17 of 76 years, and the greatest annual loss was 22.5 per cent. For the truly loss-averse, a conservative portfolio of 80 per cent bonds and 20 per cent delivered average annual returns of seven per cent, and lost money in only 13 of 76 years. The greatest annual decline was a livable 10.1 per cent.



Once you've decided how much potential loss you can tolerate, both emotionally and practically, it's time to re-allocate your portfolio. Consider investing in low-cost exchange-traded index funds (ETF) as your core equity holdings. Not only do 80 per cent of mutual fund managers under-perform the indexes, but each extra one per cent you pay in management costs reduces your portfolio returns by as much as 20 per cent over 20 years. The average management expense ratio (MER) for Canadian equity funds is now 2.8 per cent, while ETFs are available at 0.3 per cent. Unless your fund manager walks on water, that isn't good value.

There is a vast selection of ETFs trading on North American exchanges, but a good place to begin is with the extremely low-cost iUnits that trade on our own TSX. You can buy them through any discount or full service broker, but to find more information, visit *iunits.com*. (For more general information on index funds, including ETFs, visit *bylo.org*, an independent site dedicated to the subject.)

There are some excellent low-cost managed funds, however, that can reduce risk and provide style diversification. Begin your own research with these low management expense ratio (MER) standouts:

Canadian Equity: RBC O'Shaughnessy (MER 1.72); Sceptre Equity Growth (MER 1.78); Beutel Goodman Small Cap* (MER 1.52); and Chou RRSP (MER 1.83). (**Beware: small cap stocks are more volatile by nature than larger companies. This fund is only suitable for the higher-risk portion of your portfolio.*)

Global Equity: Trimark Fund (MER 1.63); Chou Associates (MER 1.87); and Saxon World Growth (MER 1.75).

Also worth taking a look at are any of the Vancouver-based Phillips Hager & North fund family.

A final note of caution for income-oriented investors: If you're investing in income trusts, remember that they are equity investments, with risk profiles similar to stocks.

The Pain is Gone

There is nothing to set the cat-food-anxieties clanging like hearing that we'll need at least $1 million to retire. The bad news is that it's true – the good news is that it won't be much of a stretch for today's 40-year-old.

If we add the annuity value equivalent of our CPP and OAS entitlements to the equity value of an average Lower Mainland home (current value $350,000) and index both by just two per cent per year over the next 25 years, we'll have the equivalent of $941,842. To save the $58,000 that will push us over the $1-million mark, even with a two per cent return, we only need to put aside an additional $150 per month.

Based on our earlier calculations, however, we know we'll probably need a fair bit more than $58,000 in investment assets unless we have a rich private pension plan or a frugal lifestyle.

Here is the key to wealth accumulation, Canuck-style: save it before you spend it. Even if you are only in an average tax bracket, by the time you pay income and sales tax, you need to earn $1.42 or more for every $1 you spend. Conversely, every $1 you do not spend gives you $1.42 to put into an RRSP. If you have RRSP contribution room, reduce your spending by $500 each month – and you have $710 to invest. At eight per cent, you'll have $406,589 by age 65. If you continue to average returns of eight per cent, your nest will be feathered with an additional $27,106 each year. ■

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