Dollars and $ense

September 2014

Over the years, we have enjoyed answering many important questions posed by our clients. In the early days, we fielded questions mostly related to the performance of our funds and how we were able to generate superior returns on a consistent basis. (Our last **Dollars & $ense** issue from May 2014 provides our latest answer to this critical question). More recently, the topic of conversation has turned to matters which would be more correctly labeled as dealing with "life planning" issues such as retirement, tax minimization and family wealth succession. As these types of discussions grew in number, we realized we had an opportunity to help simplify the lives of our clients and give them a sense of security about their current and future financial position. As a result, we began to catalogue the many ways we have worked with clients on issues beyond just managing the STYLUS funds.

We thought it appropriate to start with the most popular financial planning question we face …

HOW MUCH DO I NEED TO RETIRE?

This is truly the "million-dollar" question since surveys show that at least 50% of people believe they will not have enough money when it comes time to retire. When developing an answer, it is crucial to remember that everyone's personal circumstances are different. There is no "rule of thumb" that will give you an easy answer, despite the myriad of calculation methodologies available on the internet. We cringe when we read about guidelines like "If you're 60 years old, you should have 60% of your money invested in bonds!" We say … rubbish! Your age is just one small input in the overall equation. Remember … don't be tempted to take any penny-ante shortcuts when answering the million dollar question.

In order to properly address the above question and start working towards a solution, we follow a structured and disciplined process with every client individually (yes, even in financial planning, discipline is an integral part of the STYLUS approach!). We don't want you to be caught saying "I wish I'd gone through this process earlier" (like so many people do). You need to roll up your sleeves and start developing your plan right now.

Step 1: Create Personal Financial Statements

As portfolio managers, we know the importance of studying a company's financial statements to assess their investment-worthiness. It is equally important

for individuals to think of themselves as a corporation and build a set of *personal* financial statements. Only then can you properly assess your own financial health. We provide easy-to-use spreadsheet templates to initiate this process because *knowing where to start is the biggest speed bump that keeps people from developing a financial plan*.

First, create a personal **Balance Sheet**, a simple summation of your assets (what you *own*) and liabilities (what you *owe*). Your assets are broken down into *current* (cash/savings, non-registered investments), *long-term* (RRSP/RRIFs, pension plan), and *fixed* (house, cottage, personal valuables, real estate investments). Likewise, your liabilities are divided into two categories: *current* (credit cards, line of credit), and *long-term* (mortgage, personal loans).

NET WORTH is the value of your assets minus your liabilities. An important part of this exercise is to distinguish which assets can be used for future needs and how your net worth might change as you get closer to retirement.

Second, develop a personal **Income Statement** that outlines your *household revenue* i.e. your pre-tax income from all sources (salary, pension earnings, investment income) and *household expenses*. The expense side of the ledger gets a little more complicated as it incorporates daily living needs (groceries, cell phone, gas, etc), monthly budget items (mortgage payments, property taxes, utilities, etc), and projected capital expenses (house repair & renovations, vehicles). You also have to determine how your expenses might change over time. Remember, it costs about $25,000 per year to send a child to university. In addition, you will need a new car at some point, and how about your child's wedding? These non-recurring items all need to be built into the plan. Many of our clients have told us they appreciate our help in this area of the planning process more than any other. *"I never realized it cost me $25,000 a year of after-tax dollars just to feed my family of five, and we don't even eat out that much…WOW!"* For many, the process of building a personal income statement is a true eye opener, and in the end, a great stress reliever.

One final budgeting question we pose to all clients: *Are you prepared for the unexpected*? A major change in your life, business, family, health – can force you to re-write your plans if you are not prepared. Think about what could happen to you, and ask yourself if your plan could handle that occurrence.

Step 2: Establish Your Retirement Objective

How do you want to spend your investment savings in retirement? We will ask you which category you fall into:

1. CAPITAL PRESERVATION: "I want to live off only what my investments earn for me."

2. SPEND-TO-ZERO: "I want the cheque to bounce at my funeral."

3. The HYBRID: "I want to maintain a nice lifestyle in retirement, and I am willing to spend some of my savings, but I want to make sure I don't use it all up."

All of these models require a unique investment approach. The **SPEND-TO-ZERO** option is more of a guessing game than an objective since life expentancy is impossible to predict. Since you would be constantly eating away at your capital, you would need to generate ever-increasing returns from the money you have left to pay for your needs. We really don't think it's a good idea to build a model where you need to add *more risk* to the equation as you get older!

Now it's time for the part of the process that doesn't involve spreadsheets and mathematical assumptions. Sit down and have a heartfelt discussion with your spouse/partner and your family. Everyone has a different personality and tolerance for volatility which needs to be understood if a family is going to be on the same page. We recommend you write down your goals and objectives and communicate them to your team of affiliated professionals: investment (STYLUS), tax & accounting, and legal. The process works best when everyone works together.

Step 3: Creating an Investment Plan to Achieve Your Objectives

Once STYLUS has collected all of the important information from you, we start charting a course and setting the directions on how we plan to get to the desired destination. This part of the process involves inputs such as inflation assumptions, income taxes, and projected long-term return expectations for a variety of different investments. (eg. STYLUS funds, GICs, bonds).

This is where STYLUS will introduce you to "The Bucket Approach" to managing your various investments. The basic premise is that "bucketing" segments your money into time horizons. Why do this? Because not all of your money will be spent at the same time, so not all of your money should be invested the same way! What you will need over the next 12-18 months (i.e. your short-term bucket) is going to be invested in something very safe and secure so that short term fluctuations in financial markets will not impact your lifestyle or ability to meet your expenses. Similarly, the money that you are not going to spend for 5+ years can be invested to generate larger expected future returns. In five years, these returns can be used to "re-fill" your short-term bucket while leaving sufficient capital to continue to grow for the future. The Bucket Approach is similar to the concept that not all your groceries are stored in the same place. Some are left on the counter for current consumption, while others are stored in the freezer for later. You will find that the STYLUS approach to asset allocation with The Buckets is based on common sense and is extremely practical.

Step 4: Consider Options for your Investment Plan

STYLUS will provide you with different options for your investment plan, with varying risk profiles. We will work with you to help you find the right balance between your objectives and tolerance for risk. An effective investment program should address cash flow management and risk mitigation, be simple to understand, and most importantly, provide peace of mind.

Step 5: Monitor and Review

Effective investment and financial planning is a dynamic process based on the fact that your life is always changing, and nothing ever happens in a smooth and straight line! STYLUS will help monitor your customized plan to ensure that you remain on target, and keep you informed of where you are on the journey.

The answer to the "How Much Do I Need to Retire" is not a number. The answer to the question is the result of a series of steps that charts your roadmap to a future destination.

The next logical question is **WHEN WILL I BE ABLE TO RETIRE?** - but we'll have to address that in a future issue of our newsletter. We strongly encourage you to work with the STYLUS team to help put together a plan that is suited to your needs, goals & objectives.