Income

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The Critical 10

Fifth year of retirement

How am I tracking versus my projected income and consumption needs?

In 2013, U.S. News published a report on how people in retirement spend their time. This article reported a few bits of interesting data. People age 65 -75 generally spend an average of about seven hours a day on leisure activity. Watching TV made up about 4 hours of the day and that amount increases as people age. While retirees may have extra time for exercise than employed people, they generally only spend a few more minutes a day exercising than when they were working. Reading time increases in retirement as do time spent with friends and family. Volunteering increases significantly after one retires. A University of Pennsylvania professor is quoted as saying major hospitals, libraries and community organizations could not function without their core of retired volunteer help they have come to rely on. Against this backdrop of time spent with friends, family, meaningful activities and increased leisure, there may always be the nagging worry that the financial service industry helped promote, which is that you may out live your money.

After four years of retirement you probably have established a spending pattern for expenses and have settled into a routine of daily activity as well as seasonal events or travel. This may be a good opportunity to dust off that financial plan you had done a couple years ago and review where you are in terms of net worth compared to where the plan projected you would be. Many Canadians view a financial plan as a tool for short term decision making. They often forget it can be used as a benchmark that can guide future behavior. If your net worth is close to projected values or above that, there is less need to worry about a change in spending patterns or in your asset allocation. By reviewing your plan periodically you can make small adjustments to accommodate inconsistencies with the plan before they become too big.

The "Longevity of your investments" chart on the next page illustrates how long your investments would last based on various rates of return and different withdrawal rates. This assumes a 2.5% inflation factor, which requires modest amount of increased withdrawals to continue to fund purchasing power. It is easy to conclude that if you want your money to last long enough to fund your desired retirement lifestyle that you need to increase your rate of return. Perhaps this logic may move you toward a more volatile asset mix than you are comfortable during your retirement years. What this chart doesn't show is what we intuitively know, but has been proven by a number of studies. You will actually need less money as go further into retirement since you will most likely spend less.

Longevity of your investments

Withdrawal rate	Rate of return					
	5%	**6%**	**7%**	**8%**	**9%**	**10%**
7%	17 years	19 years	22 years	26 years	35 years	*
8%	15 years	16 years	18 years	20 years	25 years	31 years
9%	13 years	14 years	15 years	16 years	18 years	22 years
10%	11 years	12 years	13 years	14 years	15 years	17 years

A 2012 study of retirees in Germany found that retiree net worth often dropped in the early years of retirement, but started to increase again after age 75 simply because they spent less money. Spending was down about 19% after age 75 and by about 34% after age 85. While spending increased in predictable items such as prescription drugs, hearing aids and condo fees, the drop in household durables, travel, entertainment and (interestingly) cigarettes and alcohol more than offset the increased expenses. We can extend this general spending pattern to the Canadian experience and remember that government CPP and OAS benefits are indexed to inflation. Funds accumulated in RRSP accounts are withdrawn at an increasing rate over time after age 71 as well. At a period of time when you may be spending less, you will likely be receiving increased earned income.

Perhaps the worry that you may outlive your money and that you will need an increasing amount every year for the rest of your life is wrong. If we do not apply an inflation factor to the "Longevity of your investments" table the data changes.

Longevity of your investments

Withdrawal rate	Rate of return					
	5%	**6%**	**7%**	**8%**	**9%**	**10%**
7%	25 years	33 years				
8%	20 years	23 years	30 years			
9%	16 years	18 years	22 years	29 years		
10%	14 years	15 years	17 years	21 years		

Comparing this to the inflation adjusted chart you can see how even reducing an inflation amount of 2.5% can extend the life of your investment assets. This chart does not even consider the fact that after you are retired 20 years your spending pattern may reduce by over 20%. This brings us back to that financial plan we talked about earlier. You may wish to build into the plan a reduced income need assumption later in life and then review the new results. If longevity of your assets is not a concern, reviewing the plan now may allow you the confidence to redirect some money earlier in retirement to charities, family or increased leisure and travel. If you are concerned about the value of your current retirement assets at this point, it may be wiser to build in a reduced spending need to the plan than to be tempted to try for higher returns by investing in more volatile assets.