Investments

The Critical 10

RICHARDSONGMP
McKENZIE BROOK
WEALTH COUNSEL

Five years before retirement

What is my growth to income asset allocation ratio?

Retirement lifestyle specialist, Barry Lavalley, writes that retirement is a continuation of your current life, not a different one where you become a new person. The concepts of Critical 10 support this idea. Issues will arise and should be addressed in the 5 years before retirement and ongoing issues can be addressed in the 5 years after retirement to ensure your financial security for this new phase in life.

Perhaps the biggest change coming as you prepare to retire is the loss of revenue from your human capital. This is the skills, knowledge and ability you have to work and earn income. Other forms of capital become more important to fund your retirement lifestyle. The proportion of income provided from pensions and fixed capital can have an effect on the amount of growth tilt you take for your investment capital.

As a general rule, retirement planning encourages investors who are 5 years away from retirement to maintain a higher portion of portfolio weighting in equities. Funds are not needed immediately to fund retirement and your portfolio can withstand some market volatility since not all funds would be required the day you quit work. It is important, however, to design your portfolio according to your individual circumstances and retirement expectations, not according to general conventions.

Steven Covey is famous for coining the phrase “begin with the end in mind”. Having a vison of your goals can help create a personal direction that guides daily activities to support those goals. Goals based investing considers risk capacity, not risk tolerance when designing asset allocations. Five years before retirement is a very good time to critically consider what your retirement income needs really are and how much of these needs can be met from the sale of a fixed capital or from pension capital. Individuals that have generous pension plans which meets almost all their retirement income needs would have a lower risk capacity and as such do not need to have a high growth profile in their investment portfolio. Those individuals who have a substantial amount of funds set aside for retirement may also have a lower risk capacity. If projected income needs can be met with great certainty five years before retirement, then the bias in allocating your investment assets can be more toward lower volatile fixed income options.

While ongoing portfolio maintenance and reviews are important, five years before retirement may be a good time to commit to a comprehensive investment and retirement planning process. A good comprehensive wealth plan is designed to provide you a roadmap to help you preserve the wealth you have worked so hard to create and to enhance it without taking undue risk. Income projections from all sources of capital can be considered, including some form of increased income expectations to account for inflation. Your investment portfolio can be the source that makes up any gap between required income and the income provided from pensions or the future sale of fixed assets. If that gap is very wide, there is still plenty of time five years before you retire to continue with an accumulation and growth strategy. Market volatility can be offset with potential higher returns earned by capital gains and dividends than interest income. If that gap is rather narrow, however, you have the luxury of moving your asset allocation toward a more conservative bias.

Human nature is such that most people wait until a life event before undertaking the wealth planning process. The roadmap you create five years before retirement will help you allocate income earned while working in an appropriate ways that suit your personal risk capacity. This is also a document that can be reviewed regularly before and even during retirement to ensure you are on the right road to a happy and successful retirement.