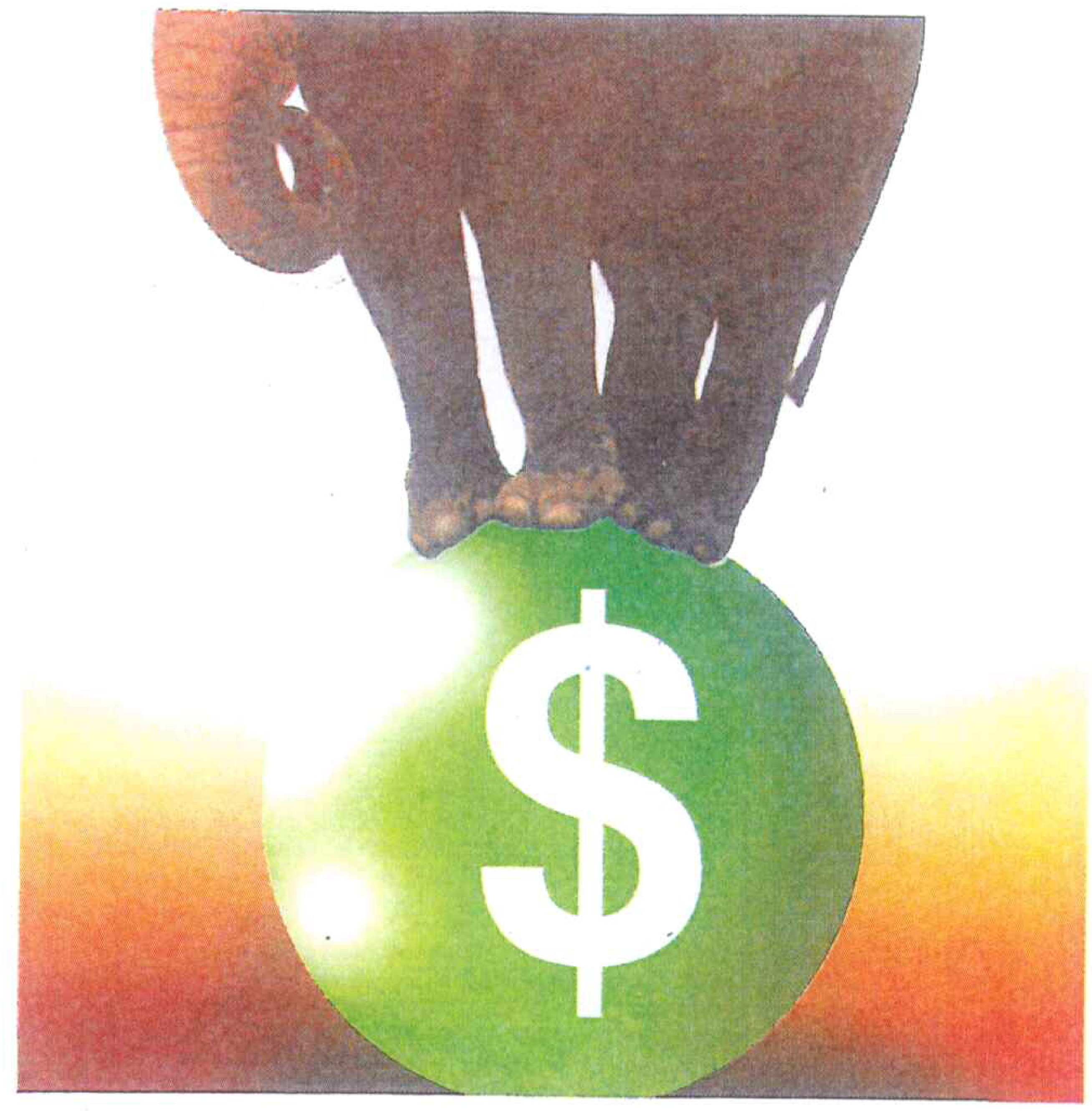
Building a Retirement Foundation

Planning today can have a big impact in later years, Colin Bloodworth writes



The previous three articles on this subject reviewed the advances being made in some developing countries to provide for people in retirement, but also highlighted the growing pensions crisis in the West, where citizens who had enjoyed generous benefits in the past are now seeing them rapidly eroding.

People whose parents had enjoyed several decades of state pensions adequate to cover basic necessities are now faced with having to work longer for less due to aging populations. And those who worked for large companies are finding that they can no longer count on a pension linked to their final salary, instead having to share the same risks that private investors took in the financial markets.

Fortunately, it is possible to build a solid foundation over time and have adequate savings to last throughout retirement. It requires careful planning throughout your working years, building sufficient cash reserves and securing solid investments.

Self-help is the only sure solution

There is no point in demonstrating in the streets against loss of benefits as they do in Europe and no use going on strike against employers. It is a fact of life that governments, or should we say taxpayers, cannot afford to allocate huge resources

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to support growing numbers of retirees. And cash-strapped companies can no longer afford to fund pension schemes that were designed at a time when people had shorter lives and before financial markets became so unstable. The bottom line is that people must take responsibility for ensuring that they have made adequate provisions for retirement.

Calculating needs in retirement

Before looking at ways to build up wealth, some homework is necessary to calculate how much is likely to be needed to reach a target income. A big unknown is future inflation, so it is best to work on today's figures and periodically make adjustments. Ask yourself, how much would you need to live comfortably if you retired today? Let's say the figure you arrive at is $2,000 a month. To generate such an income would require a capital sum of $480,000 if we assume this can generate an income of 5 percent annually. But keep in mind that the rate of return is still an assumption and the figures relate to today's money so they will need to be adjusted upwards each year until retirement. Now that we've arrived at a target figure, what's next?

Building a foundation on cash

It is vitally important to build a solid cash foundation, ideally across several banks and accounts, before contemplating long-term investing. Plunging into the stock market, a long-term savings plan, a property investment or private business without ample cash reserves is the surest way to disaster if you have to liquidate any of these in a hurry. Cash may be a poor long-term investment, but it will keep the wolf from the door and allow you to make longer term investments in safety.

How much should you hold in cash reserves? No two persons' situations are the same, but a good rule of thumb is to have enough cash in the bank to meet all your needs for at least two years. If it is impossible to build up cash reserves, then it is best to face the reality that you may have to forgo other wealth-building opportunities.

Investing in the financial markets

Assuming you can meet the cash reserve target, the next thing is to build up savings in the financial markets such as stocks, bonds, commodities and more. Provided you can meet the commitment and have enough time until retirement (at least 10 years), a regular savings plan is a disciplined way to build up wealth. Seek sound advice on fund selections however, as this can make a big difference.

If you are fortunate enough to have a significant amount of disposable cash (say $100,000), a portfolio of diverse assets will give you access to funds not normally available within savings plans. The portfolio should grow over the years and ultimately provide you with an income in retirement. If you then draw down just 5 percent annually, you should also be able to preserve the capital. The 5 percent would become part of your regular income in retirement.

If you can afford it, then more than one savings plan is desirable and a portfolio can also be supplemented by ad hoc lump sum investments from time to time, with each top-up enabling you to access a new asset or fund.

But so far we are still relying on conventional market-sensitive investments, so we need to consider wider opportunities. Next time we will look at annuities, structured products, real assets including gold, collectibles and, not to be overlooked, real estate.

Colin Bloodworth is the president director of Professional Portfolio International Indonesia.