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MONEY WISE

BUILDING A SOLID FOUNDATION FOR RETIREMENT

The last three articles on this subject reviewed the advances being made in some developing countries to provide for people who previously had to rely on family support in retirement but also highlighted the growing pensions crisis in the west where citizens of countries who had enjoyed generous benefits in the past were now seeing them being rapidly eroded.

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

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 in going on strike against employers. It is a fact of life that governments, or should we say taxpayers, cannot afford to allocate huge resources to support growing numbers of retirees. And cash-strapped companies can no longer afford to fund pension schemes that were designed in times when people had shorter lives and before financial markets became so unstable. The bottom line is that people must take responsibility for ensuring they have made adequate provision for retirement.

Calculating needs in retirement

Before even 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 factor is future inflation so it is best to work on today's figures and periodically make adjustments. The first question is how much would you need to live comfortably if you were retiring today? Let's say the figure you arrive at is US$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% per annum. The rate of return is still an assumption and the figures relate to today's money so will need to be adjusted upwards each year until retirement. Having arrived at a target figure where do we start?

First build a foundation on cash

As I have said many times 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 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 cash reserves should you hold? 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 which means accessing stocks, bonds, commodities and perhaps more exotic instruments. Provided you can meet the commitment and have enough time till retirement (at least 10 years) then a regular savings plan is a disciplined way to build up wealth. Get best advice on fund selection however as this can make a big difference.

If you are fortunate enough to have a significant amount of disposable cash (say $100,000) then a portfolio of diverse assets will give you access to funds not normally accessible 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% per annum you should also be able to preserve the capital. The 5% 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.

Planning and action today can have a big impact on lifestyle in later years.

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