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George and Jaclyn are angling for early retirement. Can they make it work?

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As they approach retirement, George and Jaclyn want to build up their savings, refine their investments and determine whether they've saved enough to meet their spending goal.

George is 55, Jaclyn is 53. Their daughter, who is 21, is in university and spends summers with her parents.

Jaclyn, who works in communications, earns about $95,000 a year plus another $21,600 in freelance work. George, who works in sales, earns about $115,000 a year. Jaclyn has an indexed defined benefit pension that will pay $20,500 a year.

They have substantial registered investments, a mortgage-free home in Atlantic Canada and no debt. Their combined portfolio is split between dividend-paying and growth stocks. "Should we be moving to a 100 per cent dividend portfolio?" George asks in an e-mail. As well, they wonder whether they should consolidate their investments.

Their goal is to retire from work in a couple of years with $120,000 after tax in annual spending, more than they are spending now. They hope to spend one month a year in a warmer climate.

"Can we afford to both retire in 2023 if we maintain this trajectory? If not, what can we do to get there?" George asks.

We asked Ian Calvert, a financial planner and vice-president and principal at HighView Financial Group in Toronto, to look at George and Jaclyn's situation.

WHAT THE EXPERT SAYS

Because they are considering retiring so early, George and Jaclyn must ensure they have a well-defined and strategic investment policy to help them meet their goals, Mr. Calvert says.

"Their investment strategy has served them well and allowed them to obtain a healthy balance of income and growth," he says. But they should revisit this allocation now that they are nearing retirement and their focus changes from saving to spending.

Choosing to increase the dividend yield on the portfolio at the expense of growth-oriented stocks will reduce the risk and volatility of their retirement plan, Mr. Calvert says. Dividend-paying companies, particularly companies that have steadily increased their dividends, tend to be more stable, have stronger balance sheets and offer more predictable long-term total returns. With a constant stream of portfolio cash flow, they will not be forced to liquidate positions for cash during bear markets, the planner says.

"As with all investment decisions, George and Jaclyn's strategy involves trade-offs," Mr. Calvert says. Holding all of their wealth in stocks boosts potential dividend income and total returns. But they have to be comfortable with the deep price swings (and potential dividend cuts) that come with investing 100 per cent in stocks. "In my experience, very few investors have the temperament for this kind of volatility, particularly after they are no longer working." If they decided to reduce their equity exposure for a more balanced and diversified approach that includes bonds in their portfolio, they would need to consider the current challenges in the fixed income environment, he adds.

George and Jaclyn have their investments divided across five different financial institutions with multiple product and service offerings. Consolidating their portfolio could result in some meaningful benefits, the planner says. Most investment-related costs are based on the total assets under management, with fees declining as a percentage of an investor's portfolio value.

"If they could lower their fees by consolidating with one firm without jeopardizing their investment strategy, it would be a great idea." Also, by combining their funds, they may be able to access new and more attractive investment options not available to all investors, he says.

Alternatively, if they consolidate all their investments in their self-directed account, they could likely realize the lowest cost by taking on the investment and financial planning decisions, he says.

Spending of $120,000 a year, indexed to inflation, would result in some significant upfront withdrawals from their portfolio, particularly between their retirement date (ages 55 and 57) and when they begin receiving Canada Pension Plan and Old Age Security benefits at 65. In these years, the only source of recurring income from outside the portfolio is Jaclyn's pension of $20,500 a year.

"To fund this gap, George and Jaclyn will need to build a tax efficient withdrawal plan from their portfolio," the planner says. George's taxable income will consist entirely of investment income from his non-registered account.

Because their income and tax rate will be low during this period, they should convert their registered retirement savings plans to registered retirement income funds rather than waiting until they are 72, Mr. Calvert says.

Introducing taxable income from their portfolio should start in 2024, the first full year without employment income. Taxable income will consist of $80,000 in RRIF withdrawals, $20,500 in pension income and $15,500 in combined investment income and dividends.

If George and Jaclyn take a combined $80,000 a year from their RRIFs starting in 2024, they will still need about $41,000 from their non-registered portfolio to reach their spending goal. This would result in taxable income of about $58,000 each and a total income of $141,500 to fund $120,000 of lifestyle expenses and $21,500 combined income taxes, the planner says. This total withdrawal of $121,000 from their registered and non-registered portfolio would be a withdrawal rate of about 8 per cent of their portfolio assets by 2024.

"Even with a portfolio of 100 per cent equities, their probability of consistently returning 8 per cent a year is very uncertain," the planner says. "If we assume on average, they can earn a net return of 5 per cent, at this rate of withdrawal their retirement assets would be depleted by 2048 when they are 80/83 years of age," Mr. Calvert says. "Having a retirement plan where the assets are expected to be exhausted in their early 80s will simply not work." Worse, this rate of decline doesn't account for any unexpected or longer-term health care costs.

George and Jaclyn have three options, Mr. Calvert says. They can work for a few more years, reduce the target spending of $120,000 a year, or reach for a higher return on their investment portfolio. "Taking on a riskier portfolio would be the most reckless and unpredictable of the three options." A more appropriate option would be to lower their retirement spending target. "Annual after-tax spending of $100,000 would be a more suitable figure," the planner says. "If they can find a reduction of $20,000 per year, it would allow their savings to extend until their mid-90s."

CLIENT SITUATION

The people: George, 55, Jaclyn, 53, and their daughter, 21

The problem: Can they retire in 2023 with $120,000 in after-tax spending?

The plan: Work longer or trim their spending target. Avoid taking on more risk in hope of earning higher returns.

The payoff: A solid financial footing

Monthly net income: $14,450

Assets: Cash $5,000; non-registered $341,400; her TFSA $87,000; her TFSA $89,000; her RRSP $496,000; his RRSP $383,000; estimated present value of her DB pension $315,000; registered education savings plan $80,000; his locked-in retirement account from previous job $2,745; residence $300,000. Total: $2.1-million

Monthly outlays: Property tax $475; home insurance $100; utilities $350; maintenance, garden $200; transportation $280; groceries $800; clothing $100; gifts, charity $75; vacation, travel $600; other discretionary $50; dining, drinks, entertainment $475; personal care $50; sports, hobbies $75; pets $30; subscriptions, other $110; heath care $105; life, disability insurance $325; phones, TV, internet $190; RRSPs $2,400; TFSAs $1,000; her pension plan contribution $765. Total: $8,555

Liabilities: None

Ian Calvert is a Vice President & Principal at HighView Financial Group.