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Should Rowan, 78, and Willow, 58, be more conservative with their investing approach?

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Rowan, 78, wonders whether he and Willow, 58, have enough resources that she can fully retire and they can enjoy their planned lifestyle.

"I have good genes and based upon family history I anticipate living to 100," he writes in an e-mail.

Willow is interested in continuing to work part time from home, "but not so much that it impinges on our desire to travel extensively," he adds.

Their income comes from Rowan's registered retirement income fund (RRIF), his government benefits and Willow's contract work, for a combined $101,450 a year. Rowan wants to pay off their line of credit this year and wonders whether he should take the money from his tax-free savings account, his non-registered investment account or his RRIF. They also want to buy a used car.

They have substantial savings and investments and a mortgage-free house north of Toronto, all of which adds up to about $4.2-million. Their retirement spending target is roughly $96,000 a year after tax.

"We are currently 100-per-cent invested in the stock market in primarily Canadian dividend-paying stocks," Rowan writes. "Should we be more conservative?" They also ask about establishing education trusts for their four grandchildren.

We asked Ian Calvert, vice-president and principal at HighView Financial Group of Oakville, Ont., to look at Rowan and Willow's situation.

WHAT THE EXPERT SAYS

Rowan is retired and living off his RRIF withdrawals and government benefits, Mr. Calvert says. Willow is working part-time making $14,500 a year and planning to retire shortly.

Rowan is withdrawing $6,000 gross each month from his RRIF accounts, about $17,000 higher than his annual minimum withdrawal, the planner says. He does not recommend adjusting this amount when Willow retires. Instead, Willow should draw on the assets in her registered retirement savings plan (RRSP) when she retires fully.

"With no pension income and her Canadian Pension Plan and Old Age Security still five or six years away, the only income she will be reporting is the investment income in her non-registered portfolio, putting her in very low marginal tax bracket," Mr. Calvert says. He suggests she withdraw $25,000 a year. Before making the withdrawal, she should convert her entire RRSP to a RRIF to avoid fees associated with the RRSP.

Under this scenario, their income in 2024 would be $72,000 from Rowan's RRIF, $25,000 from Willow's RRIF, $15,000 from Rowan's CPP and $8,900 from his OAS, leaving $15,000 needed from their non-registered savings, of which $13,000 will go to their TFSA contributions. (Total income of $135,900 a year, less $25,500 for income taxes and $13,000 for TFSA contributions, leaves about $98,000 for after-tax expenses.)

Adding in $25,000 from Willow's RRSP/RRIF would be an ideal figure for both managing longevity of their retirement assets and managing their tax brackets, keeping them both near the top of the 29.65-per-cent combined marginal tax bracket.

Under this plan, and after splitting Rowan's RRIF withdrawal ($36,000), they are expected to have income of $84,000 for Rowan and $77,000 for Willow. Rowan's income is higher because he is receiving CPP and OAS, and has a larger non-registered portfolio.

In 2029, when Willow turns 65 and starts to receive her CPP and OAS, their income will rise to the point there is some clawback of their OAS, Mr. Calvert says. "At this age, they could simply trim their RRIF withdrawals, which are well above the mandatory minimums each year," the planner says. OAS benefits start to be reduced when net income reaches $86,912 a year. This amount is expected to increase each year.

The total withdrawal from their $2.7-million portfolio is about $100,000 – about 3.7 percent of their portfolio value, Mr. Calvert says. "If they can manage this rate of withdrawal and maintain on average a 5-per-cent rate of return on their portfolio, longevity of their investment assets won't be a major long-term concern," he says. This is before Willow begins collecting government benefits, which are expected to add a combined $18,500 per year. Long term, inflation is forecast to rise by at least 2 percent to 3 percent a year.

This rate of withdrawal has several advantages, the planner says. First, they are both reducing their RRIF assets at a strategic rate, which will have a significant impact on the taxes payable on the transition of wealth to their beneficiaries, the planner says. Second, the withdrawal requirements from their non-registered portfolio are minimal, giving them long-term flexibility if their lifestyle changes and they need to make larger withdrawals, he adds. Last, they are building up their TFSA for a more tax-efficient balance sheet that will also enhance the transfer of wealth.

Rowan and Willow have a line of credit for $82,500 at 6.5 percent. They should consider paying this off entirely, Mr. Calvert says.

Their portfolio is entirely invested in stocks, of which 85 percent are Canadian stocks with an average 4-per-cent dividend yield. "The 4-per-cent dividend yield is great and will substantially help the longevity of their assets by funding and smoothing the withdrawals from both their RRIFs and non-registered portfolio," the planner says.

This strong allocation to Canadian dividend stocks is intuitively appealing but comes at the expense of proper global and asset-class diversification, Mr. Calvert says. "Rowan and Willow should consider an investment strategy that balances income generation and capital appreciation – and generating this performance from a wider variety of investment assets."

If they choose to maintain their current all-stock strategy they should keep two things in mind, he says.

First, any U.S. dividend stocks should not be held in TFSAs because non-resident withholding tax is applied and cannot be recovered. Second, they need to take an honest look at the sustainability of their strategy because it needs to fund their expenses for the rest of their lives. "There is an abundance of academic research showing that individuals make poor decisions with individual stocks," Mr. Calvert says. As well, one spouse usually takes the lead in do-it-yourself investing decisions. As that decision-maker grows older, sustainability can become questionable, the planner says.

If they decide to increase their U.S. exposure with some U.S. dividend stocks, their RRIFs would be the best location for these new holdings for three reasons, Mr. Calvert says. They could rebalance without triggering any capital gains. This would leave the Canadian dividend stocks in their non-registered portfolio to continue to receive preferential tax treatment. "Finally, and very importantly, U.S. stock dividends paid into an RRSP/RRIF are free from withholding taxes for Canadian residents," the planner says.

For Rowan and Willow, leaving funds for their grandchildren is top priority. They should start by setting up registered retirement education plans for each grandchild and making an annual contribution of $2,500 each. The RESP is a terrific account for several reasons, he says. It will allow the funds to grow with a tax deferral and will be eligible for a $500 annual education savings grant on contributions of $2,500, up to a maximum of $7,200. "When establishing this account, they should consider setting it up as a joint subscriber account and appointing a successor subscriber in their will for estate-planning purposes," Mr. Calvert says.

They also ask about establishing a trust for the grandchildren. A testamentary trust can be an effective estate-planning tool under the right conditions, he says. This type of structure, typically established upon death, would allow them to control the timing and distribution of their assets after their passing, he says. Before exploring this option, they should consult with an estate-planning specialist to fully understand not just the benefits, but also the complexities and costs of maintaining the trust.

CLIENT SITUATION

The people: Rowan, age 78, and Willow, 58.

The problem: Can they afford for Willow to retire now and to travel extensively while still leaving some money for their grandchildren? Should they invest more conservatively?

The plan: When she retires fully, Willow taps into her RRSP. They split Rowan's RRIF income to keep their income roughly equal and below the OAS clawback range. They take steps to diversify their investment portfolio both globally and by asset class. Open RESPs for the grandchildren and contribute the maximum.

The payoff: All their financial goals achieved.

Monthly net income: $8,100.

Assets: Cash $4,000; his non-registered $707,600; her non-registered $459,000; his TFSA $214,000; her TFSA $75,000; his RRIF $877,300; her RRSP $305,300, residence $1,500,000. Total: $4.2-million.

Monthly outlays: Property tax $400; water, sewer, garbage $30; home insurance $275; electricity $155; heating $135; maintenance, security, garden $235; transportation $350; groceries $750; clothing $90; line of credit $415; gifts, charity $225; vacation, travel $2,500; travel insurance $90; dining, drinks, entertainment $375; personal care $50; club memberships $130; golf $75; sports, hobbies $100; subscriptions $50; health care $115; communications $370; TFSAs $1,085. Total: $8,000.

Liabilities: Line of credit $82,500 at 6.5 percent.

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