THE GLOBE AND MAIL

Luke, 58 and Nora, 52, are sitting on a pile of cash. How should they start investing it?

DIANNE MALEY
Special to The Globe and Mail

Published Friday, November 29, 2024

Luke and Nora have two children in university and a mortgage-free home in a desirable area of rural British Columbia. Luke, who is 58, wants to retire from his $190,000-a-year tech job. Nora, who is 52, wants to keep working at her $49,000-a-year job in the health care industry until she is 65.

Nora has a defined benefit pension plan from a previous employer that will pay her $47,000 a year at age 65, not indexed to inflation. While Luke has no work pension, he does have substantial savings. As well, they have set aside $200,000 in a registered education savings plans (RESPs) for their children's postsecondary education.

"We think our kids should have enough, with their RESPs, scholarships and summer jobs, to complete their studies," Luke writes in an e-mail.

He thinks they should be in good shape for him to retire now. Their spending goal is somewhere between $80,000 and $100,000 a year after tax, with an additional $40,000 to $50,000 every four years for unusual items such as travel, replacing a car or home renovations.

"Our biggest problem – which I believe many others might share – is that we have too much money sitting on the sidelines," Luke writes. About 64 per cent of their portfolio is in cash. "We don't know the best way to get into the stock market or if that would be a good idea right now, given it is near all-time highs," Luke adds.

We asked Ian Calvert, a principal and portfolio manager at HighView Financial Group of Oakville, Ont., to look at Luke and Nora's situation. Mr. Calvert is a certified financial planner.

WHAT THE EXPERT SAYS

Luke and Nora have a great balance sheet at this stage in life, Mr. Calvert says. Including their house, they have assets of $4,475,000 with no liabilities.

"A unique aspect to their retirement plan is that Luke and Nora have very different retirement dates," the planner says. Luke would like to retire now and Nora plans to work for another 13 years.

"If Luke decides to fully retire in 2025, he will have a significant drop in his taxable income because he has no corporate pension plan," Mr. Calvert says. Given the value and estimated income from his portfolio, he will be reporting about $25,000 to $30,000 of taxable income, assuming a 2.5 per cent to 3-per-cent yield.

"The years between 2025 and 2036 will be his lowest-income years because he is planning to delay both his Canada Pension Plan and Old Age Security benefits to age 70. Starting in 2025, Luke should start drawing on his RRSP – $35,000 a year would be an optimal figure from a tax perspective because most of his income would stay within or below the combined tax bracket of 22.7 per cent, federal and provincial," the planner says.

This, plus Nora's employment income of $49,000 a year, would still leave them short of their after-tax spending target, estimated at $90,000 a year – that's the number they settled on when filling out the planner's questionnaire. To fund the difference, they could start to withdraw the investment income from their non-registered portfolios rather than reinvesting it, Mr. Calvert says. They would need about $26,000, plus an additional $14,000 for contributions to their tax-free savings accounts (TFSAs).

Until Nora retires, their family cash flow would consist of Luke's RRSP/registered retirement income fund (RRIF) withdrawals of $35,000 a year, Nora's employment income of $49,000, and $26,000 from their non-registered portfolio. This adds up to $110,000 a year less $20,000 for income tax, leaving $90,000 for spending.

In 2036 and 2037, the family will experience some positive changes to their retirement cash flow. In 2036, Luke will receive his delayed CPP and OAS. Then in 2037, when Nora retires, she will have a non-indexed pension of $47,750 a year and will start her CPP and OAS the same year. The government benefits and pension will increase the family's total income and reduce the withdrawal requirement from the portfolio.

"Their retirement plan would run comfortably, and without any encroachment on capital, if they could achieve, on average, a return of 5 per cent per annum," the planner says. In fact, given the expected withdrawal rate from the portfolio, they should expect some modest accumulation during their retirement years. This assumes a long-term annual rate of inflation of 2.5 per cent.

Although they have a healthy balance of investable assets, they are sitting on about 65 per cent in high-interest savings accounts. The past two years or so have benefited those with high-interest savings and short-term guaranteed investment certificates (GICs), the planner says. "Still, this has come with a significant opportunity cost. Holding excessive cash will be a drag on the portfolio over the long run."

Luke and Nora are uneasy about putting their cash to work today given the downside risk posed by stock market indexes at or near record highs. "But waiting for the right entry point is challenging and is likely to be paralyzing." Instead, they should focus on what they can control. He suggests drawing up a financial plan that will help them align their investment assets with their risk tolerance and desired rate of return.

"If a well-designed plan doesn't relieve their fear of the stock market dropping right after they invest, they could deploy their cash in equal installments over the next 12-18 months," he says. "This is not without risk because the market can continue to march higher, extending the cash drag on their portfolio." This strategy, however, will reduce the probability of making a poorly timed lump-sum investment. "For this strategy to work, staying disciplined as to the timing, installments amounts, and desired asset mix will be paramount."

Luke and Nora are self-directed investors using a basket of index-tracking exchange-traded funds and a few large-cap Canadian stocks. "This is a relatively easy approach to gain broad exposure with a relatively low cost," the planner says.

"Because they are already exposed to the major equity indexes, they don't necessarily need to introduce new investments, but they should add to their existing positions strategically," Mr. Calvert says. To build a balanced portfolio, they should aim for a long-term equity allocation of 60 per cent to 70 per cent with the balance in fixed income.

As well, they should be careful not to be too heavily weighted in Canadian stocks. "Exposure to large-cap U.S. dividend-growing stocks would be advisable given the predictable dividend yield and opportunity for long-term appreciation," he says. From a tax perspective, they should aim to hold their Canadian stocks in their non-registered portfolio to take advantage of the dividend tax credit.

CLIENT SITUATION

The people: Luke, 58, Nora, 52, and their two children.

The problem: Can they afford for Luke to retire now? How should they go about investing their cash?

The plan: Luke retires in the New Year and begins to draw $35,000 a year from his RRSP/RRIF to supplement his investment income and Nora's salary. They prepare a detailed plan to add to their existing stock ETFs to achieve a more balanced and diversified portfolio.

The payoff: More than enough to meet their needs.

Monthly net income: $13,525.

Assets: His savings account $362,480; her savings account $322,980; her GICs $100,000; his non-registered ETFs $547,760; her non-registered $218,870; his TFSA $113,445; her TFSA $120,000; his RRSP $738,465; her RRST $154,490; RESP $200,000; residence $1,470,000. Total: $4,348,490

Estimated present value of her DB pension: $425,000. This is what someone with no pension would have to save to generate the same income.

Monthly outlays: Property tax $530; water, sewer, garbage $70; home insurance $170; electricity $190; heating $30; maintenance $420; transportation $1,690; groceries $1,200; clothing $100; gifts, charity $470; vacation, travel $500; other discretionary $450; dining, entertainment $765; sports, hobbies $200; subscriptions $145; health care $155; phones, TV, internet $275. Total: $7,360. Surplus goes to savings.

Liabilities: None.

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