THE GLOBE AND MAIL

How should Kathy, 60, diversify her portfolio after recently retiring?

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Special to The Globe and Mail

Published Friday, December 27, 2024

Kathy retired recently from her decades-long career in sales. She is 60 years old with two children, 23 and 28. The younger child is living at home and going to university.

Among the perks Kathy enjoyed working for a major multinational corporation is a defined benefit pension, indexed to inflation, that pays $120,500 a year. She also has $700,000 worth of company stock. She has a house in British Columbia valued at $1.5-million and no debt.

"I could use some advice in three areas," Kathy writes in an e-mail: "How best to draw down my investments? Should I diversify my stock portfolio? How much can I give my two children to help them buy their first home?"

"Although the [company] stock has performed very well, I am a bit concerned about having so much of my assets tied up in one area," Kathy writes.

Her retirement spending target is $120,000 a year after tax.

We asked Ian Calvert, a principal and certified financial planner at HighView Financial Group, to look at Kathy's situation.

WHAT THE EXPERT SAYS

"Overall, Kathy is in a terrific financial position," Mr. Calvert says. Her net worth is

about $3.35-million. This includes a principal residence of $1.5-million, non-registered investments of $1.175-million, an RRSP of $500,000 and a tax-free savings account of $125,000.

In addition to a solid balance sheet and no liabilities, she has a defined benefit pension from working her entire career with one employer in the private sector. "Given this financial position, it is unlikely that Kathy will encounter cash flow or longevity concerns – outliving her money," the planner says. Her focus should be on tax management, diversification of her portfolio and helping her children financially.

Her 2025 pension income will be $120,500, less $39,000 in total income taxes. With a lifestyle target of $120,000 a year, she needs about $38,500 a year from her portfolio assets. "With a non-registered asset base of $1.175-million, most of this shortfall could be funded by dividend yield from her portfolio with an asset allocation that generates a 3-per-cent dividend yield," Mr. Calvert says.

She also has $500,000 in her RRSP she could use, which would be taxable withdrawals. "With her taxable income projected to be about $155,750 from her pension and portfolio income, she will be in the combined tax bracket of 40.7 per cent, the planner says. "In other words, the lower, more favourable tax brackets are already filled up."

If she starts to withdraw from her non-registered assets, she should also use this as an opportunity to diversify and rebalance her portfolio, Mr. Calvert says. Kathy's company stock represents about 21 per cent of her total assets, and 38 per cent of her total investment portfolio. Her previous employer is a large cap, blue-chip, consumer staple stock with a stable dividend. "There are a lot of reasons to like and hold this stock over the long run," the planner says. "However, 38 per cent of the total investment portfolio is a high level of concentration risk."

If Kathy wants to reduce this risk and gradually diversify her portfolio, she could start a plan to decrease her position slowly, Mr. Calvert says. "A sound strategy would be to reduce both the timing risk and spread the capital gains over many years, reducing the possibility of a one-year spike in her taxable income," he says.

A figure to aim for is $40,000 per year, he says. "This is a good target number for a few reasons." Firstly, it's a manageable figure each year, which dovetails nicely into her cash flow needs. Secondly, if this was executed over the next 10 years, it would be complete by the time she is 70, when she will certainly experience a rise in her taxable income from her Canada Pension Plan benefit.

"Lastly, by reducing her position by $400,000, this would ideally trim her position to about 15 per cent of her total portfolio," the planner says. This ultimately depends on the future size of the total portfolio and the growth of the particular stock over the next 10 years. "This is still a strong allocation to one holding, but she has reduced a lot of risk."

With her defined benefit pension, which is the cornerstone of her retirement income, she is certainly in a position to consider delaying both her CPP and Old Age Security until age 70, Mr. Calvert says. "Not only is the income not needed, but by delaying another 10 years, she can use those years to trigger the annual capital gains from her company stock."

By waiting until age 70, she will receive the enhanced CPP benefit that is 42-per-cent higher. For her OAS, there is a high probability it will be fully clawed back each year, the planner says. "When it comes to the optimal age for receiving government benefits, there is not a one-size-fits-all answer," he says. It should be based on cash flow, asset base and expected longevity, which is the most challenging variable to plan for.

Kathy has asked about giving funds to her children. This is certainly an achievable goal. She will eventually hit an age where she has three income sources – her pension, her CPP, and her RRSP/registered retirement income fund (RRIF) withdrawals. "Once all three pillars of income are turned on, her withdrawal requirements from her other assets will be reduced, creating a favourable position for gifting."

Her gifting strategy should be guided by her desired timing, he says For instance, if she was planning to help over a period, she could easily take $20,000 to $30,000 a year over a 10-year period from her non-registered portfolio. These additional outlays would not be disruptive to her longer-term asset base.

If she wanted to give a larger gift as a lump sum, she would have some decisions to make, Mr. Calvert says. If she took a large amount from her non-registered assets, she would have to report the larger realized gain in that particular year.

She could soften the tax hit by also utilizing her TFSA, he says. "The TFSA is a great account to continue to build and accumulate wealth, but it can also be a useful tool for these one-time events," he notes. If she completed a TFSA withdrawal, she can replenish the amount, starting in the next calendar year.

CLIENT SITUATION

The people: Kathy, 60, and her children, 23 and 28.

The problem: How best to draw down her savings. Should she sell some company stock? Can she help her children with a down payment?

The plan: Draw on her non-registered dividend income to supplement her pension. Gradually reduce her holding in her company stock. Consider using funds from her TFSA to gift to the children.

The payoff: A clear roadmap to where she wants to go.

Monthly net income from pension:
$8,300, remainder from savings.

Assets: Bank accounts $50,000; company stock $700,000; mutual funds $475,000; tax-free savings account $125,000; RRSP $500,000; residence $1,500,000. Total: $3.35-million.

The estimated present value of Kathy's pension: $1.7-million. That is what someone with no pension would have to save to generate the same income.

Monthly outlays: Property tax $535; water, sewer, garbage $125; home insurance $125; electricity $85; heating $85; security $50; maintenance $850; garden $25; transportation $450; groceries $400; clothing $135; gifts, charity $625; vacation, travel $1,250; other discretionary $1,000; dining, drinks, entertainment $1,060; golf $85; club memberships $60; subscriptions $210; dentist, doctor $40; phones, TV, internet $290; TFSA $585. Total: $8,070.

Liabilities: None.

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