The big shift

Adjusting retirement income in a challenging environment

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The new retirement reality

It's no secret that the road to building a comfortable retirement has become much more difficult over the last few decades. In today's economic environment, retirees will have to adjust their retirement planning to meet a number of evolving challenges.

Key retirement challenges

The inflation effect

Inflation can erode the purchasing power of money, weigh on bond portfolios and generate headwinds for equity values. With the Consumer Price Index hovering near four-decade highs in both Canada and the U.S., retirees must look to invest in assets that can deliver positive inflation-adjusted returns over time.

Markets are becoming more volatile

From the Asian financial crisis and dot-com bubble to the Great Recession and a global pandemic, markets have seen a number of significant swings over the past few decades. Increased volatility adds uncertainty to one's retirement plans, and the timing of market drawdowns can severely impact long-term cash flow.

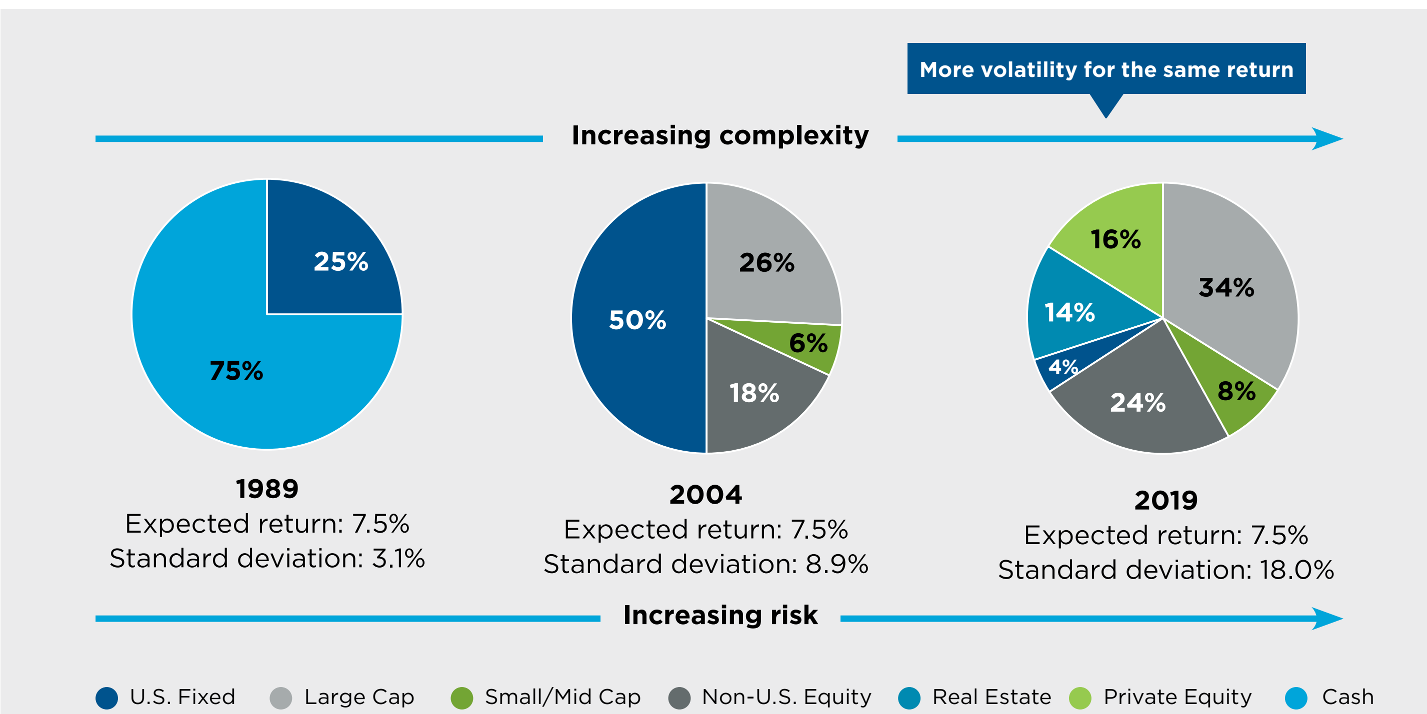
Running out of money

The good news is that Canadians are living longer. However, living longer means that retirees need to accumulate more to fund their desired retirement lifestyle. With retirement periods now stretching more than two decades, the risk of running out of money has become a real concern for many Canadians.

A riskier proposition: the retirement portfolio has changed

In today's volatile markets, trying to generate consistent retirement income has become increasingly complex and has forced retirees to take on more risk to generate the same return from 20 years ago.

Figure 1: Evolution of the risk-return trade-off over the past two decades



Source: Callan Capital Markets Projections

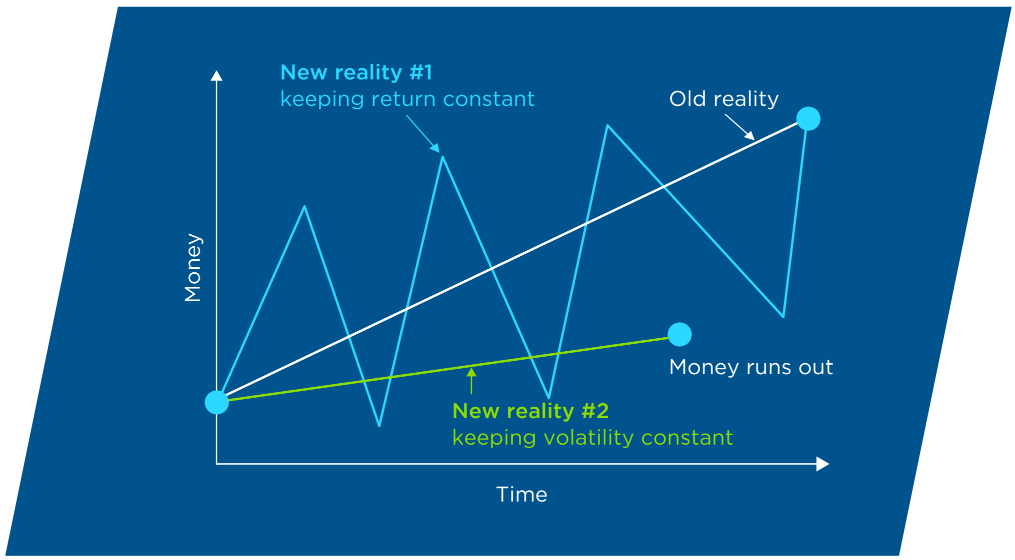
Today's retirement dilemma: two perilous paths

Unfortunately, it's a volatile world. That leaves us with two potential choices:

Aggressive
In order to keep returns constant, we have to take on greater risk – and risk greater drawdowns.

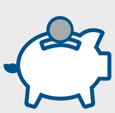
Play it safe
By trying to manage volatility, we run the risk of generating lower returns – and possibly running out of money.

Figure 2: Evolution of the risk-return trade-off over the past two decades

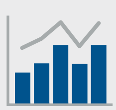


Potential retirement roadblocks

There are five potential risks to achieving your retirement goals. It will be important to learn the common retirement risk factors and consider them in your planning.



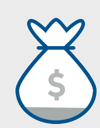
Greater contributions necessary



Greater risk of drawdowns

Longer time to retirement

Decreased cash flow

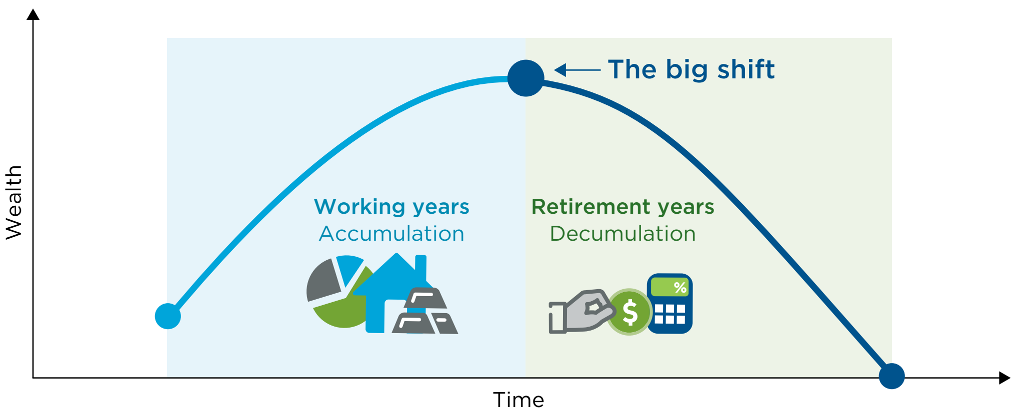


Money runs out

Seeing retirement in a new light

While a traditional asset-allocation approach works well during one's working years, today's volatile markets make that approach unfeasible in the retirement spending phase. At a certain point in the retirement journey, portfolios must shift focus from accumulation to decumulation.

Figure 3: The big shift: From working years to retirement



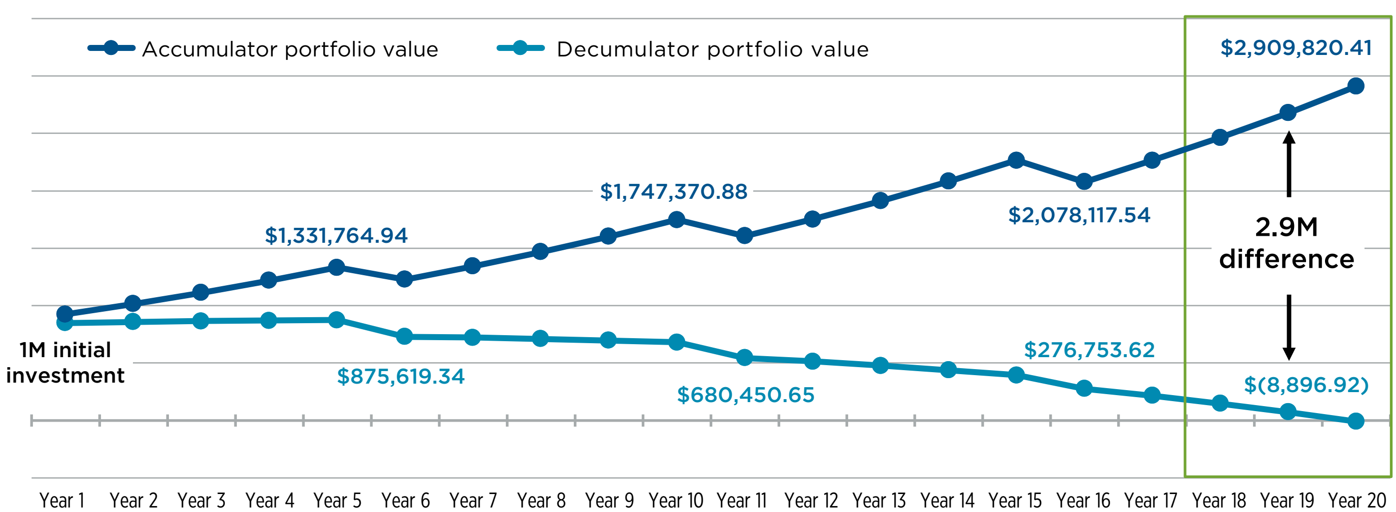
Asset allocation works very well during one's working years, but upon entering retirement there is a point of change where the focus shifts to cash-flow allocation.

Accumulators vs. decumulators

During the accumulation period, market drawdowns have minimal effect on the end value of the portfolio because an investor's time horizon is typically longer, and they are not withdrawing assets from their portfolio. For investors in the decumulation phase, it's a different story.

As you can see below, even with regular market downturns, the accumulator has almost tripled their portfolio, while the investor in decumulation phase has run out of assets after 19 years. This is because the added effect of systematic withdrawals and market drawdowns deteriorates capital significantly faster.

Figure 4: A tale of two investors: Accumulation vs. Decumulation



For illustrative purposes only.

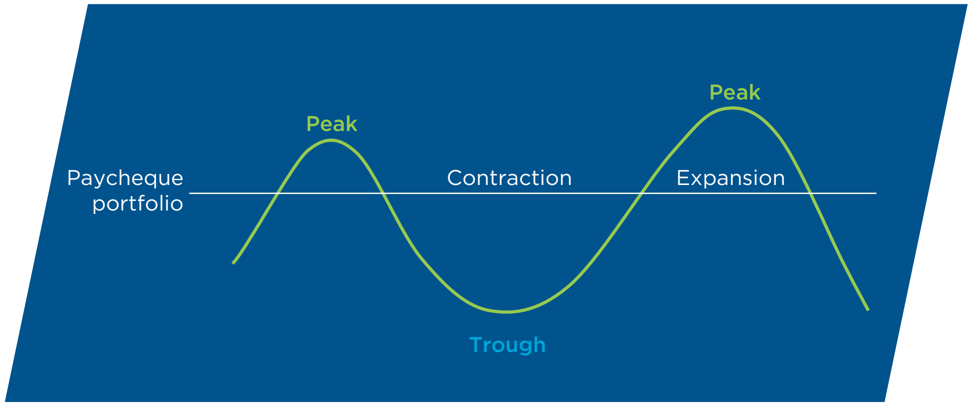
Assumptions: scenario assumes an initial 50k cash flow withdrawn annually at the end of year, a 7% return for both accumulation and decumulation, the first correction occurs in the first year and every 5 years after at the same time, 3% annual inflation is assumed for the cash flow only

A better way: Creating paycheque portfolios

Given the uncontrollable nature of the markets and volatility, we believe there's a better way to build retirement portfolios. Instead of using the traditional asset-allocation model (with systematic withdrawals) during retirement, the "cash flow-bucketing" allocation approach provides an alternative with potentially less risk. By prioritizing cash flow-producing assets, investors can create sustainable cash flow in order to avoid withdrawing assets during market downturns. The result is a paycheque-like cash-flow stream that pays out regardless of market conditions.

Figure 5:
With paycheque portfolios, the focus changes to the 4Ms:

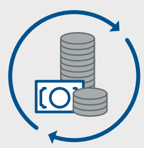
- Maximizing cash flow
- Minimizing taxes
- Minimizing drawdowns
- Maintaining purchasing power



Paycheque portfolios: Three keys

Not all cash flows are created equal. For this reason, investors should consider the following three keys when choosing cash flow-producing assets:

Consistency:
Is the cash flow consistent every month, quarter & year?

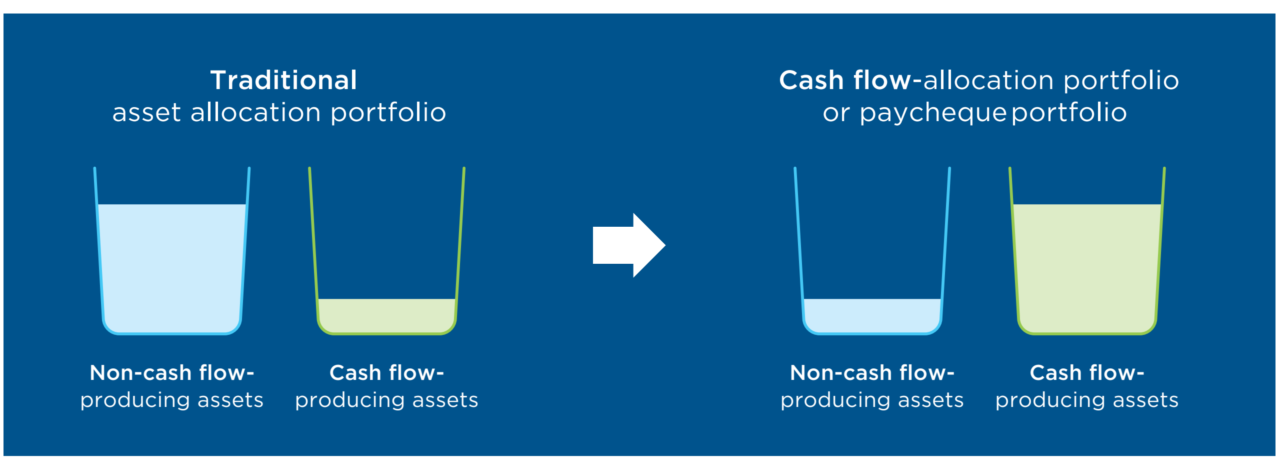


Sustainability:
Is the cash flow sustainable for the foreseeable future?

Taxation:
Is the after-tax cash flow relevant?

By considering these three elements, investors can create a steady cash-flow stream – regardless of market conditions.

Figure 6: Accumulation vs. decumulation focuses



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