Manulife Investments

WealthStyles®

The retirement revolution

There is a lot of talk about retirement these days – and with good reason. The generation that changed the world is now in the process of changing the face of retirement. Baby boomers – the generation born between 1946 and 1966 – are on the cusp of their golden years. And if current studies prove to be accurate, traditional notions of retirement are about to undergo a significant shift.

Gone are the stereotypical images of retirees whiling away long afternoons passively playing card games, shuffleboard or lawn bowling at the local club. Today's retirees are considering second careers, volunteering for favourite causes, travelling the world and renewing their pursuit of unfulfilled dreams and ambitions. It would seem that if boomers have it their way, they won't be going quietly as they coast into their sunset years.

As they redefine retirement, boomers will need some help along the way. With many people now expected to spend up to a third of their lives enjoying retirement – whether that means working only part-time or not at all – it will be important to address the financial needs of an entire generation that is expected to live longer than the generation before.

In an independent survey,[1] Manulife Investments asked Canadian boomers about their biggest financial concerns as they face their retirement years. Top of mind were outliving retirement savings, the corrosive effects of inflation on savings and the potential impact of market volatility on their long-term financial plans.

CONCERN #1: OUTLIVING RETIREMENT SAVINGS

Immediately after World War II, life expectancy was only 63 years for men and 66 years for women. Today's advances in health care and the adoption of healthier lifestyles are largely behind predictions for longer life spans. Yet living longer comes with its own challenges. A couple now aged 65 has a 94 per cent chance of one partner living to age 80, and a 63 per cent chance of one partner living to age 90. This means that today's boomers may have to fund their retirement for 25 years or longer.

[1] Source: Poll of 902 Canadians between the ages of 50 and 70 years by Maritz Research conducted between July 6 and 12, 2006. The results have a margin of error of +/- 3.3 per cent, 19 times out of 20.

CONCERN #2: INFLATION

When looking at a retirement period that may last 20, 30 or even 40 years, another risk boomers will have to consider is the effect inflation will have on their retirement savings. Planning for 30 years of retirement income is very realistic, especially for a couple, but inflation will constantly erode the buying power of your savings.

To illustrate this point, in the last 30 years the price of a cup of coffee in a restaurant has risen approximately 348 per cent, while the cost of a simple postage stamp has gone up by 650 per cent.[2] Indeed, drawing income in the later stages of retirement will be difficult if the combination of retirement savings withdrawals and inflation outstrips the returns you are receiving on your investments.

According to Statistics Canada's 2001 Survey of Household Spending, retirees are more exposed to inflation-driven price changes than the rest of the population. Between 1992 and 2004, prices rose 26.1 per cent for Canadians 65 years of age and older, compared to 24.4 per cent for non-seniors.[3] Why? Because there are some fairly significant differences in spending patterns.

THE PROBABILITY OF A HEALTHY 65-YEAR-OLD LIVING UNTIL...

Age	Single female	Single male	At least one member of a couple
70	96%	93%	99%
80	81%	71%	94%
90	44%	33%	63%
95	23%	16%	36%

Source: Annuity 2000 Mortality Table, Society of Actuaries

EFFECTS OF INFLATION ON $1,000

Number of years	Rate of inflation				
	0%	**1%**	**2%**	**3%**	**4%**
1	$1,000	$990	$980	$970	$962
10	$1,000	$905	$820	$739	$676
20	$1,000	$820	$673	$545	$456
30	$1,000	$742	$552	$402	$308

2 Based on a $0.08 stamp and $0.46 coffee in 1977 and a $0.52 stamp and $1.60 coffee in 2007.
3 Source: Statistics Canada, 2001 Survey of Household Spending.

Seniors spend more per household on medical expenses, travel, reading materials, utilities, rent and tenants' expenses. For every $100 of expenditures, seniors, on average, spend $56 on food, shelter and utilities, compared with only $45 for other households.

Of all these expenses, perhaps the greatest area of concern is the rising cost of health care. Canadians enjoy one of the most comprehensive public health care systems in the world, yet rising health care costs and provincial and federal budget restraints are causing governments to download the costs of some services to consumers. And as boomers age, it is expected that their increasing health care needs will place considerably more stress on Canada's medical system. Unless governments are able to cover spending shortfalls, future retirees should be prepared to pay for more medical costs on their own.

STRATEGIES THAT CAN HELP

The attitude of the typical retiree is changing. Instead of retiring *from* something, today's boomer is looking forward to retiring *to* something. This change in attitude bodes well for boomers, since generating supplementary income by working during retirement may be necessary to fund the retirement they want.

But beyond working past age 65, there are a number of financial strategies that can make the transition to retirement a less stressful evolution from a financial perspective. Perhaps the most important involves asset allocation – or the percentage of your assets held in stocks, bonds and cash.

In the past, many retirees would invest the vast majority of their assets in fixed-income investments, such as bonds and GICs, which can provide a reliable stream of income and a guarantee of principal. This was considered to be a prudent approach, since investing in stocks can be considerably more risky. Retirees who adopted this strategy were trying to reduce market risk.

The problem with this approach in today's economic environment is that traditional income-producing investments such as bonds, GICs and annuities, pay rates of interest that barely keep up with inflation. It's also important to remember that the income generated by these types of investments can attract the highest tax rates of any investment in Canada. This means that once inflation and tax are factored in, these apparently safe investments may actually be costing you money.

To avoid these pitfalls, you may want to consider adding a growth component to your investment portfolio. That means investing a portion of your holdings in equities for potentially superior long-term returns that can help you keep ahead of inflation. Of course, adding equities to a portfolio means that retired boomers will have to embrace some degree of market risk to help ensure that their money will last.

CONCERN #3: MARKET VOLATILITY

That said, unpredictable market conditions are certainly a source of concern for investors entering the retirement phase of their lives. Losing money because of poorly timed investment decisions or market volatility is a major cause for anxiety since money, once lost, can be very difficult to replace. This is especially true if you have already left the workforce or if your health no longer allows you to work.

Research conducted by Moshe Milevsky, a York University finance professor and Canadian financial expert, outlines the scope of this problem.[4] Professor

[4] Moshe A. Milevsky and Thomas S. Salisbury, *Asset Allocation and the Transition to Income: The Importance of Product Allocation in the Retirement Risk Zone*. September 27, 2006.

Milevsky recently identified a factor that can affect your ability to fund your retirement. The period of time five to 10 years before and after retirement can have a very important impact on your ability to generate consistent and dependable income throughout your retirement years. This period of time is so critical that Professor Milevsky refers to it as the Retirement Risk Zone.

THE SEQUENCE OF RETURNS

Let's examine why you are at greater risk from stock market declines near or at retirement, compared to when you're saving for retirement.

When you are in the saving phase of your life, the order – or sequence – of your investment returns is less important, assuming that you remain invested and ride out times of market volatility. For example, if you received a return of seven per cent in year one, lost 13 per cent in year two, and gained 27 per cent in year three, you would earn an average seven per cent annual return on your investment over the three-year time period. Even if the sequence of these returns changed, your outcome would remain the same.

However, if you're in the Retirement Risk Zone, experiencing poor market returns early in retirement can significantly reduce your ability to withdraw income for as long as you'll need it. The reason is that your portfolio may not have time to recover the way it could for a younger investor, even if the market does eventually rebound. In addition, there is a good chance you'll be making withdrawals from your savings for income during times when markets are dropping. Withdrawing money from investments that have declined in value may mean that you are depleting your savings much more quickly than you'd expect.

Let's assume you are a 65-year-old investor with $100,000 in retirement savings and you need to withdraw nine per cent of your savings annually to provide you with a source of income. The following three scenarios describe how the sequence of returns can affect the health of your portfolio.

SCENARIO #1 (7, 7, 7...)

If you achieve a seven per cent annual return on your investment every year, your money could last for 21 years, or until you reach age 86.

SCENARIO #2 (27, 7, -13...)

If you earn a 27 per cent return the first year, gain seven per cent the second year and lose 13 per cent in year three, and this pattern of returns continues to repeat itself throughout the rest of your retirement, the average rate of return over the time period will remain seven per cent. However, this time, because of the two good years at the beginning of each cycle, your money can actually last an additional nine years, or until you reach age 95.

SCENARIO #3 (-13, 7, 27...)

If we change the sequence of returns again so that you lose 13 per cent in the first year, and then gain seven per cent in the second year and 27 per cent in the third year, the average return will remain seven per cent. However, something dramatic happens. Under this scenario, your portfolio would be depleted by the time you reach age 81 – a full 14 years earlier than if you had received two early years of positive returns as outlined in Scenario #2.

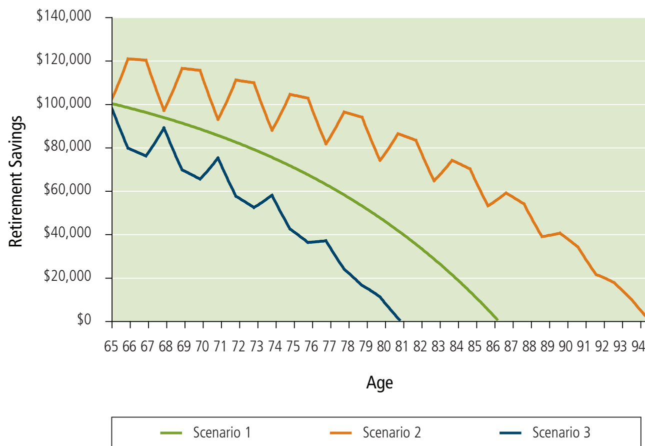


Chart assumptions: 65-year-old investor with $100,000 in retirement savings, withdrawing nine per cent each year.
For illustrative purposes only.

THE SEQUENCE OF RETURNS AFFECTS HOW LONG YOUR MONEY WILL LAST

What is most disturbing about the significance of the sequence of returns is that it reveals the role of luck when it comes to ensuring your savings will last. Even if you adopt an asset allocation strategy to help offset the effects of longevity and inflation, there is no guarantee that your money will last your entire lifetime. The financial risks inherent within the period five to 10 years before and after retirement illustrate the need for creative financial solutions for the boomer generation as they head into their retirement years.

GMWBS - A GREAT OPTION

If losing money because of poorly timed investment decisions or market volatility is of concern to you, there is a solution that can help you manage the risks associated with the Retirement Risk Zone.

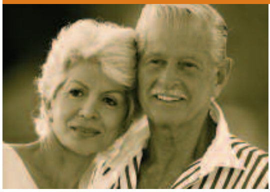
Investment funds that include a Guaranteed Minimum Withdrawal Benefit (GMWB) provide much of the same investment growth potential as mutual funds, but include additional features and benefits that are designed to provide predictable, sustainable and potentially increasing income. GMWBs accomplish this through a combination of principal protection features, bonuses and guarantees that are designed to help you navigate the Retirement Risk Zone with a lot more confidence – and the amount of income you receive can be guaranteed for life.

PROTECTION FEATURES OF GMWBS

Creditor protection – You have the potential to protect your assets from creditors, which is an attractive benefit for business owners and investors.

Estate benefits – In the event of your death, the proceeds of your contract have the ability to pass directly to your designated beneficiaries without the time delay and expense of probate.

There is a lot to think about when it comes to financing your retirement years. If you would like to avoid the financial risks that go hand in hand with increased longevity, inflation and market volatility, investment products that feature a GMWB can help.



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GMWB FEATURES AND BENEFITS

FEATURE	BENEFIT
Income for a guaranteed period of time, or for life	Regardless of how the markets perform, you can be guaranteed income for at least 20 years or longer, and there is a new option to guarantee income for life.*
Principal guarantee	You're guaranteed that, at a minimum, all of your principal investment will be returned to you, no matter how the underlying investments perform.*
Potentially increasing income	With bonuses and opportunities to lock in market gains, the amount of your income payments and the number of payments has the potential to increase significantly over time.
Consistent income that won't decrease	You're guaranteed a stream of income that will not decrease, through regular withdrawals of up to five per cent for at least 20 years, with an option to guarantee them for life.*
Flexibility	You can switch between funds and fund managers as you wish, and you can access your savings at any time should the need arise.
Tax-efficient income	When held in a non-registered account, these investment products offer the potential for tax-efficient income.

*Exceeding the withdrawal thresholds may have a negative impact on future payments. Other conditions may apply.

SPEAK TO YOUR ADVISOR

Your advisor can provide an in-depth overview of how the various features and benefits of these products work together to create predictable, sustainable and potentially increasing income that can last for the rest of your life. When combined with a proper asset allocation strategy that allows for long-term growth, the GMWB is a powerful tool that can take some of the worry out of your retirement years.

Compliments of:

Manulife Investments is the brand name identifying the personal wealth management lines of business offered by Manulife Financial and its subsidiaries in Canada. As one of Canada's largest integrated financial services providers, Manulife Investments offers a variety of products and services including: segregated funds, mutual funds, principal protected notes, annuities and guaranteed interest contracts.

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