5 Ways Canadians Can Avoid Running Out of Money in Retirement

Description

Canadian investors worry about a lot of things these days, but the top-of-mind concern for many people is whether or not they will be able to retire.

In the past, retirement planning was simple. You found a job at a company, stayed there for 35 or 40 years, and left with a handshake and a generous defined-benefit pension.

For the most part, that strategy is no longer viable and people who once believed a good job would be enough to secure a comfortable living beyond 65 are looking at the numbers and wondering if they are going to die broke. It's not just something that haunts the Gen-Xers or Millennials; a number of Boomers are also looking at their finances and scratching their heads.

Fortunately, there is still time for most people to put a plan together, and it can be implemented by savers of all ages.

Here are five tips to help ensure you don't run out of money in the "golden years."

1. Pay off the mortgage

Housing eats up the largest part of most monthly budgets. You need to have a roof over your head and the sooner you can get to the point where you own it, the more flexibility you are going to have when you retire.

Paying off the house provides protection against rising interest rates and gives you a shot at retiring early. It also provides a cash-flow safety net. As home prices increase in value, some retirees are using a reverse mortgage to finance living expenses. Ideally, you won't have to do this, but knowing the option is there makes retirement planning a bit easier.

2. Use credit cards for convenience, not credit

Credit card debt is the fast lane to retirement poverty, so you want to avoid it as much as possible. With interest rates of 19.9%, most cards will quickly wipe out hard-earned cash that could be used to pay off the house or build an investment portfolio.

3. Plan carefully for retirement expenses

In Canada you can get retirement income from a variety of sources, and the objective is to ensure the sum of those payments covers your expected living costs.

On the revenue side, the Canada Pension Plan (CPP) and Old Age Security (OAS) are easy to calculate. So is a defined-benefit pension plan, if you are fortunate enough to have one. The rest of the money has to come from other sources, including investments.

How much do you need to save?

This is the tricky part; it all depends on how big the gap is between the money you think you will need, and the amount you expect to receive from the government and your company pension. People who own their homes might need very little, or none at all. Others could need a lot.

Ideally, the savings should be large enough that you can spend the investment income and leave the principal intact. Otherwise, it's time to fire up the spreadsheet program and make various draw-down calculations to see how long you can afford to live. As you might imagine, this process can be stressful.

4. Use your TFSAs and RRSPs wisely

The new TFSA limit means people could conceivably hold all their retirement investments in their TFSAs. This is a smart idea if you believe your income in retirement is going to be higher than your current income because you won't be taxed on the TFSA withdrawals and you can minimize, or even avoid, the OAS claw-back.

RRSPs are still useful if you think your retirement income will be lower than your current income, or if you have the cash to max out the RRSP and fill up the TFSA.

5. Invest in dividend-paying stocks and take advantage of the DRIP

These days, bonds and GICs don't pay much and that situation isn't likely to change for some time. One way to slowly build a substantial retirement portfolio is to buy a reliable dividend-growth stock like **Royal Bank of Canada** (TSX:RY)(NYSE:RY) and automatically reinvest all the dividends into new shares. The compounding effect can be staggering.

For example, a single $10,000 investment in Royal Bank just 10 years ago would now be worth about $20,000 without reinvesting the dividends. Using the DRIP, that amount would be closer to $30,000. That's not bad considering the time frame includes the worst financial crisis since the Great Depression.

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aswalker