How to Build Your Own Pension With a TFSA

Description

If you're lucky enough to have a pension, then congratulations. Having a pension is a *huge* advantage during retirement. Still, everyone can use a backup plan in the form of their own capital. If you don't have a pension, this is even more important.

It's important to know that you can build your own private pension through proper planning. Whether you want a pension that delivers $10,000 or $100,000 per year is up to you, but everything helps when you're trying to avoid outliving your money.

How do you create your own pension? All it takes is three simple steps.

Find your number

The first step is to figure out how big you'd like your pension to be. Be realistic with this. Should it be supplementary or comprehensive? Don't worry about how much you need to save; that math is easy. Simply determine how much you'd like your pension to deliver on an annual basis.

Let's assume you'd like an annual pension of $40,000. Simply multiply that amount by 20 to determine how much you need to save. In this case, it would be $800,000. Multiplying by 20 assumes a 5% withdrawal rate. That figure helps account for additional growth, inflation, and market volatility, plus a small cushion to avoid outliving the income stream. Using a TFSA, you don't need to worry about taxes at all.

Crunch that number

Once you have your number — in this example, $800,000 — you can work backwards to determine how much you'll need to save. There are several calculators available on the internet that can help you with this math. They're most commonly referred to as "future value calculators."

These calculators typically have three variables. The first input is how much you've already saved that will go towards this goal. The second input is how much you'll be contributing per year. The third input is how long this money will stay invested for. The last variable is that rate that you assume this money will grow at. I typically use a conservative 8% per year. Some advisors will suggest using a higher figure, but when it comes to retirement, it's better to be safe than sorry.

The biggest numbers to play with are the duration and annual savings rate. Add a few years to your investing horizon and watch how quickly the compound interest adds up. Additionally, experiment with different savings rates to see which combination of numbers helps you reach your investing goal.

To reach $800,000 in savings, for example, you'd need to invest $6,000 per year for 31 years. That's starting at $0, however. Run multiple scenarios to know how much wiggle room you have on any assumption. Without understanding this math, you'll be investing with your eyes half shut.

Invest in long-term winners

Everyone wants to find the next big stock, but the most effective approach is to buy proven, long-term winners. **Enbridge** and **Fairfax Financial Holdings**, for example, have beaten the market for *decades*. Due to their structural competitive advantages, this outperformance could persist for decades more.

If you want to ensure your money compounds at the highest rate possible, you need to fill your portfolio with wealth-generating stocks that can deliver during all phases of retirement.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:ENB (Enbridge Inc.)
2. TSX:ENB (Enbridge Inc.)
3. TSX:FFH (Fairfax Financial Holdings Limited)

PARTNER-FEEDS

1. Business Insider
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