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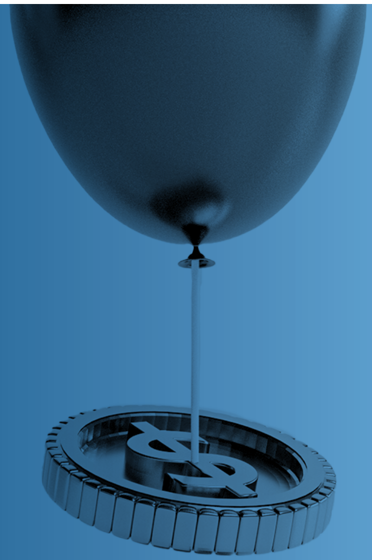
Retiring during times of uncertainty

Rising inflation and market volatility don't have to derail your retirement plans



If you're approaching or already in retirement, you may be worried about the recent spike in inflation and market volatility (of fixed income and equities). Watching your investments lose value can be stressful, especially if you need to withdraw from them in the near term, for your retirement income.

While uncertain times can pose risks to the longevity of retirees' investments, there are ways your advisor can help you reduce those risks.

That's why it's important to diversify your portfolio across different asset classes (such as equity and fixed income), investment styles, and geographical regions, that align with your risk tolerance and retirement goals. The key to managing any market environment is a retirement portfolio that balances income and growth, and limits potential reductions in your portfolio's value.

Let's take a look at the risks you need to be aware of, what causes them and some strategies to help protect your investments.

What are the top retirement risks?

In retirement, you may face three potential risks:

1. **Inflation risk:** the cost of living becomes higher than you planned for.
2. **Longevity risk:** the possibility of outliving your savings.
3. **Sequence of returns risk:** negative returns in your portfolio at or near the beginning of your retirement or withdrawal period.

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Let's take a closer look at each of them.

1 Inflation risk explained

Inflation is the rate of increase in prices over a period of time (usually a year). If the rate of inflation increases more than your investments' overall returns (that is, their increase in value, yields, dividends and interest), your standard of living can fall, because prices of goods and services are going up faster than your investments.

The recent spike in inflation has seriously impacted the cost of living, which can be particularly problematic for retirees who can no longer rely on their wages increasing over time to help absorb higher living costs.

Thankfully, having a comprehensive investment strategy can help offset this. And while your retirement plan should be built around the long-term expected inflation rate, there are strategies that are effective at offsetting short-term, high inflation. See the "How to adjust your portfolio to manage inflation" section below to learn more.

For example, the Mackenzie Monthly Income Portfolios have a modest amount of direct inflation protection with exposure to inflation linked bonds and gold bullion. More importantly, they are built to mitigate downside risk, which tends to rise substantially during periods of high inflation. Additionally, the Mackenzie Monthly Income Balanced Portfolio and the Mackenzie Monthly Income Growth Portfolio contain higher allocation to equities, which are generally a good hedge against inflation over the long term. There are also other ways to adjust your portfolio to manage inflation risk. Contact your advisor to see how Mackenzie can help.

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2 What is longevity risk?

Life expectancy for Canadians 100 years ago was just under 60 years of age.[1] In 2022, that number shot up to just over 82 years.[2] If you retire at 65 and live to be 82, you'll need your retirement investments to last 17 years.

If you're among the 346,000 Canadians who are expected to live beyond 90 each year, you'll need your savings to last 25 years or longer.[3] To avoid outliving your retirement investments, you'll need a portfolio designed to mitigate inflation and strategies to limit sequence of returns risk.

> **To avoid outliving your retirement investments, you'll need a portfolio designed to mitigate inflation and strategies to limit sequence of returns risk.**

3 What is the sequence of returns risk?

The sequence of returns is the order in which your portfolio experiences gains or losses at or near your retirement date. When negative returns occur at the beginning of your retirement, this could lead to reduced retirement income or your savings running out sooner than expected.

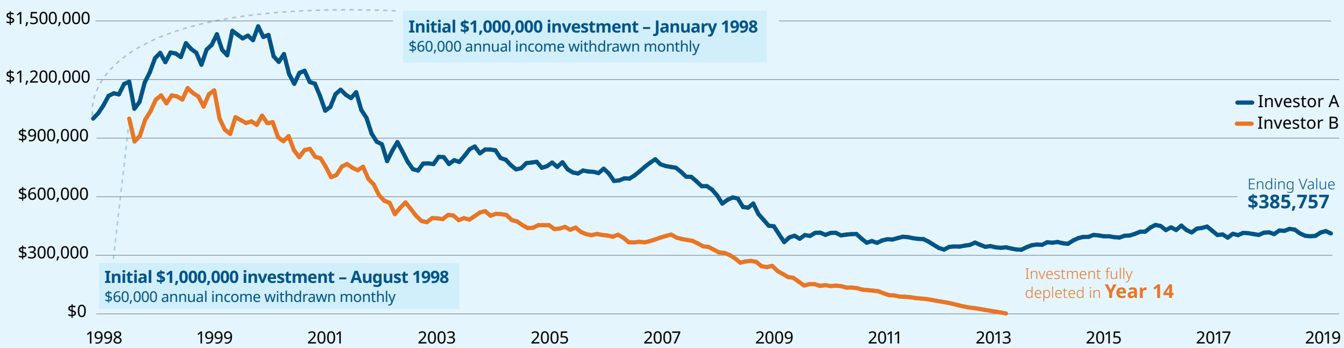
How does sequence of returns work?

The example below illustrates how differently a portfolio's market value can be affected by negative portfolio returns at the beginning of retirement, when there are constant, regular withdrawals for retirement living expenses.

The blue line represents Investor A, who retires with a million-dollar portfolio that has the chance to grow before the market dips eight months later. The orange line represents Investor B, who has a million-dollar portfolio that immediately experiences that market dip.

Investor B's savings never fully recover from that market dip, and their money runs out within 15 years. Investor A's savings have the benefit of the initial increase in value. As a result, they still have a considerable amount that they can continue to draw from, over 20 years into retirement. The sequence of returns risk is magnified when regular monthly withdrawals are made during the market downturn.

Sequence of returns risk with withdrawals



Source: Morningstar, based on the S&P 500. For illustrative purposes only

There are ways to limit sequence of returns risk, such as having a portfolio that's designed to limit losses during market downturns. Managed solutions, such as the Mackenzie Monthly Income Portfolios, use strategies that can help manage longevity, inflation and sequence of return risks.

Let's take a closer look at some of the strategies that can help protect your investments during periods of volatility and high inflation.

Strategies to protect against volatility and inflation

How can a cash wedge strategy protect you from losses?

If your portfolio has experienced losses because of a market downturn, the last thing you want to do is sell some of those assets when they are down. This would “lock-in” those losses, and you may never make them back.

A cash wedge strategy allows you to avoid having to cash in assets that have lost value to meet your immediate income needs. It’s a very simple, but effective strategy: as you approach retirement, hold one to two years’ worth of retirement expenses, depending on your risk tolerance, in cash accounts or their equivalents.

If your portfolio declines in value, you can use this money to cover your expenses. This means that your investments that have lost value have time to recoup most, if not all, of their losses, before you have to start drawing income from them.

When your portfolio recovers you can use the gains your investments make to replenish your cash reserve.

Why you should consider using a cash wedge strategy:

It reduces the impact of sequence of returns risk.

It allows the rest of your portfolio to be suitably diversified, so that it meets your long-term income and growth needs.

It increases liquidity so you can manage short-term income needs.

It helps protect part of your portfolio from short-term market volatility.

How to adjust your portfolio to manage inflation

In addition to diversifying your portfolio’s investment types and geographical regions, your advisor can use different strategies to help manage inflation risk in your portfolio. Strategies include increasing exposure to various real assets and alternatives such as real estate, infrastructure and commodities.

This can be done by investing in mutual funds or ETFs. Within your equity investments you could also increase your Canadian equities, given the higher weight of energy and commodities in the Canadian stock market, relative to most other equity markets.

It may also be appropriate to use inflation-linked or real return bonds, whose annual interest and principal are adjusted based on the rate of inflation.

How can alternative investments help?

An option beyond the traditional stocks and bonds mix is one that institutional and wealthy investors have used for years: alternative investments. Alternatives tap into new and different asset classes, markets and investment strategies that can improve your portfolio’s performance.

They bring stronger diversification and are designed to deliver attractive returns and reduced volatility, while preserving capital over a longer period of time. Mackenzie has alternative funds which can help mitigate the impact of inflation and the sequence of returns risk.

> **Mackenzie has alternative funds which can help mitigate the impact of inflation and the sequence of returns risk.**

Other options to help reduce inflation risk

Your planned withdrawal amount (the amount of money you need to withdraw from your investments to help pay for monthly expenses) can sometimes deplete your portfolio too much. This could lead to you running out of money during your retirement. Here are some options to manage this risk:

1. Temporarily reduce the withdrawal rate and make some adjustments to your lifestyle to allow for less income while your portfolio recovers. You could also explore other sources of income. For example, if you decided to postpone receiving CPP/QPP and/or OAS to a later date, bringing that forward could help reduce your withdrawal rate.
2. If you have enough equity in your home, another option worth considering is to take out a home equity line of credit or a reverse mortgage: this could bridge the gap until your investment portfolio recovers.

Speak with your advisor to learn more about these and other potential options and to ensure that they remain consistent with your retirement plan.

How Mackenzie helps you get through uncertain times

With over $200 billion in assets under management and a comprehensive line of investment products, Mackenzie is one of the leading asset management companies in Canada. By partnering with advisors, we believe we can create a more invested world by helping investors become more knowledgeable, educated and invested, so they can meet their full potential.

We have the retirement income products that can help you to navigate these turbulent times. We also have the expertise in portfolio construction to help protect your investments from high inflation and sequence of returns risk, so you can enjoy a more comfortable retirement.

To find out more about how Mackenzie can help strengthen your retirement portfolio, talk to your advisor today.

Sources:

[1] Statistics Canada: Life expectancy, 1920–1922 to 2009–2011.

[2] Macrotrends: Canada Life Expectancy 1950-2022.

[3] Statistics Canada: Population estimates on July 1, by age and sex.

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