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THE NEW RULES OF MONEY

How low bond yields, weaker stock returns and longer lives have **sabotaged** the rules of money. It's time to rewrite the guidelines that planners and investors rely on for saving and spending

SUCCESS WITH MONEY is always built on a solid plan. Set your goals and then, with a long-term perspective, take the steps to reach them. But what if those actions only worked in the past? What if the rules have changed?

The good news is that the basic tenets of common sense are alive and well—so no need to panic. You will still get ahead if you simply pay yourself first, consistently spend less than you make, continue paying your highest interest rate debt first, and continue advancing your career and upping your income as the years progress. Simple wisdom never goes out of style.

But as markets become more global and interest rates remain low, some rules about saving, spending, investing and retirement may be out of date, may be misunderstood or be just plain wrong. In all cases, the math needs revisiting.

What we do know is that the major factors at play in undermining the rules boil down to two major trends. One, we're living longer. And two, market returns are anemic and experts don't see that changing any time soon. Of course, the first trend is a good thing and the fix fairly easy—a slightly bigger nest egg, a little less spending in retirement or a delay in your retirement by just a few years. As for the second trend, we all need to prepare for a long run of puny returns from bonds and likely only half the gains we've grown accustomed to from stocks.

To help you out, we've asked *MoneySense* experts to come up with some of the key rules that they figure need to be tossed, or at the least updated. You may discover your plans need to overhauled— or that you're still on track. Either way, we expect these pages will kickstart some constructive conversations. *—David Thomas*

Save

RAINY DAY SAVINGS ACCOUNTS ARE A ~~GOOD~~ BAD IDEA

BY JULIE CAZZIN

(Use credit instead—for emergencies only)

In this new age of low interest rates, rainy day savings make a lot less sense. It's hard to justify keeping six months' salary in a plain-vanilla account. "If you have a mortgage, money in a savings account is better spent putting it towards the mortgage," says Dan Bortolotti, *MoneySense* columnist and certified financial planner with PWL Capital in Toronto. As well, if you have a mortgage, an equity line of credit on your home makes sense. "Just ensure you get the equity line of credit approved while you're employed," says Bortolotti. A word of caution—only tap the line of credit in a real emergency. It's tempting to dip into it for impulse buys like a new car or trip to Vegas. "You have to avoid that," says Bortolotti. And if you don't have a mortgage? Then you likely have money sitting in either a TFSA or RRSP. Simply put a portion of the TFSA money in investments you can access quickly in a pinch—say, if the car needs engine repairs or your home needs a new roof. The trick is to keep $20,000 or so in your TFSA invested in some form of liquid fund (but not GICs as they're often locked in for a year or more). Your money will [illegible] better returns while allowing you to scoop it easily when you really need it.

NEWS FLASH

Debt is not always #1 on your hate list

The idea of good debt versus bad debt still holds. But if your debt is a manageable amount, if it is being used to purchase good investments such as stocks that will grow your net worth in the long term AND if you're not stretching the household budget to do it, then debt is okay. "Investing in a home or your education is also a good use of debt—but the education debt has to be thoughtful debt," says Vickie Campbell, a certified financial planner with Ryan Lamontagne in Ottawa. "In any case, if you borrow money to invest in property, stocks or your education, you need to have a long-term, actionable investment strategy in place so the money is not simply wasted," says Campbell. What else does that mean? Having a plan to pay off your debt. "Sure, interest rates are low but paying even a small bit of interest each year adds up over the long term," says Campbell. So borrow, but borrow with a purpose.

We hate to say it but... .... Ø%...$ ... ...

Saving 10% of your gross income doesn't add up

In most cases, saving 10% of your gross income every year isn't enough to guarantee you a good retirement. "This was never a good savings rule, because the amount you need to save varies according to your income," says Dan Bortolotti, a certified financial planner with PWL Capital in Toronto. Sure, if you have an annual gross income of $50,000, then saving 10% is probably enough to guarantee you a comfortable retirement. That's because CPP and OAS will make up a big chunk of the $50,000-a-year income. "But if you earn $150,000, you should be saving a lot more than 10%," says Bortolotti, who says 20% or more may be required. So as your income grows over the years, the amount you save in dollars will likely grow and so should the amount you save as a percentage. Once you reach the empty-nester stage and mortgage payments and kid-related expenses are gone, saving becomes easier. But with longevity playing a larger role in financial planning and with interest rates and equity returns tracking much lower, "it's best to have a financial plan that will take all of these changing variables into account," says Vickie Campbell, a CFP with Ryan Lamontagne in Ottawa. "One size no longer fits all."

USTED

Budgeting

Psst! We'll let you in on a secret—you don't have to budget every cent you earn. The only people who should be keeping a spread sheet of their spending—or a journal tracking every nickel and dime—are the ones who have no idea where their money is going. Top-down budgeting works best for most people. That's where you figure out, roughly, what you are spending monthly. Then, you set up an automatic savings plan (either through your bank or employer for stock plans and pensions) and then simply spend the rest. So set your savings goal first—say 15% of gross income—and then you're okay just spending what's left. "Not everyone will be capable of doing this," says CFP Dan Bortolotti, "but if you're even slightly disciplined, you should be okay."

Spend MORE THAN REAL ESTATE IS JUST A PLACE TO LIVE

BY ROMANA KING

(It's a key retirement planning pillar built on forced savings, if you stay within your means)

A home is now an integral part of your financial plan but it wasn't always this way. According to the Canadian Real Estate Association data, the average Canadian home cost just $76,534 in 1984. It rose to $226,604 by 2004 and currently sits at $442,264, a stunning 478% increase in just three decades.

"At one point, a home was considered a place to live," says Talbot Stevens, author of *The Smart Debt Coach*. "It wasn't part of the investment decision." But with rapidly increasing housing prices, our attitude toward real estate has changed.

"Real estate is clearly very important," says CIBC deputy chief economist Benjamin Tal. "Many people are using the valuation of their house as a forced savings plan, but there are negative implications to this strategy."

Like most assets, housing is subject to market conditions and investor sentiment. But CFP Vicki Campbell with Ottawa-based financial planning firm Ryan Lamontagne points out: "it's also not like any other investment."

It's one part investment, one part forced savings plan and one part necessity. (We all need a place to live). "To make a smart housing decision, you need to look at the overall financial picture." And in this new era of slow growth and low interest rates, the golden rule is still diversification, explains Ayana Forward, CFP, also with Ryan Lamontagne. "You don't want all your money tied up in a home, leaving you little left over for savings."

Yet, according to a recent report by HSBC, 48% of working-age Canadians either haven't started or stopped saving for retirement. And 20% felt that selling their home would help to make up their shortfall.

"There's this idea that you have to get in before the train leaves the station," says Stevens. Combine this with two stock market crashes since 2000, and it's easy to see why property is so tempting. We fail to recognize that record low rates helped to inflate home prices, making "a reliance on housing unwise," says Tal.

NEW

Renting is now the smart choice

Deciding whether or not a house is a good investment comes down to good, old-fashioned budget analysis, says Vicki Campbell, certified financial planner with Ryan Lamontagne. "Decades ago, people bought a house without planning. Now, the move has to be weighed against the costs and the trade-offs." And sometimes it just makes more sense to rent and invest the savings. It's a decision faced by many millennials, particularly those drawn to Vancouver and Toronto—where 25% of Canada's jobs are currently found. In Toronto the average rent for a downtown condo is about $1,700, while the average resale value of that same condo hovers just above $375,000. Factor in the monthly maintenance fees and the cost to own can add $200 or more per month. Rent, invest the extra, and in 10 years you could save $31,300 (assuming a 5% annual return and no change in rental rates).

We hate to say it but...

Forget the 30% rule

Don't spend more than 30% of your income on shelter costs. It's a popular rule but it's also "an arbitrary number," says associate professor of urban affairs at Virginia Tech, David Bieri. "It creates more distortions than it actually solves." A more practical rule to follow? Try the "residual income" approach: The amount of income left over after all personal debts and expenses, including shelter costs, have been paid. Those with higher incomes will have higher residual incomes so they can afford to pay more in housing costs. It's also why families with two incomes and no kids can spend more on housing then families with children for whom more income will go to child-related costs, such as clothing and daycare.

BUSTED

Timing the market

"Timing the real estate market is never wise," explains Ted Rechtshaffen, president and CEO of TriDelta Financial. He explains that when buying a home, "it's not about the home price, but the mortgage rate." If you can afford to pay the mortgage now—and you can still afford to pay the mortgage five years from now after rates have risen, then you can afford to buy the home. For today's home buyer that means calculating whether or not you can afford monthly payments for your dream home at rates of 4% or 5% or even 6%.

BUSTED

Too bullish

Lower your expectations. You can't bank on 8% gains for the long term anymore. Canadians are living longer and in some cases saving less for retirement. Sorry to be the ones to break bad news, but those of you counting on historic returns to make up the difference need to rethink your strategy. Bank of Canada governor Stephen Poloz told businesses in September "that in the current and prospective environment, 4% will probably turn out to be a pretty good return." The average investor shouldn't expect to do any better.

Invest

~~BE CONSERVATIVE~~ MORE AGGRESSIVE ABOUT STOCKS & RISK TOLERANCE

BY MARK BROWN

(A 60-40 portfolio makes less sense. And let your total picture guide your mix)

If you've been reading *MoneySense* for any period of time you know how important it is to diversify your portfolio between stocks and fixed income. There is no shortage of rules to help. Your age should match the percentage you allocate to bonds. Or subtract your age from 100 to get your allocation to stocks.

Unfortunately, with yields on bonds near zero, you will have to take on more equities (with added risk) to keep your nest egg growing and not run out of money before you die (remember we're living longer now). A more general rule for many has been for a 60-40 split between stocks and fixed income as a solid retirement savings strategy. That's not really true either; at least not the way most of us understand it.

"That's just the beginning of the conversation," says Moshe Milevsky, associate professor of finance at the Schulich School of Business and an expert in the nuances of portfolio allocation. It may work for some people, but as Milevsky explains, it's terribly inappropriate for a large percentage of the population. The 60-40 rule oversimplifies things. It goads investors into thinking it only refers to investments when it really should encompass all of your assets, your job and your CPP and OAS and your pension (if you have one).

"What you do for a living should have a huge impact on your asset allocation," says Milevsky, a tenured professor with a secure pension. "My job is relatively secure so in some sense my job is my bond... And when I retire I get a pension so there is no need for bonds in my portfolio." By extension, someone with little job security should invest in more fixed income.

Those without tenure or a pension might want to shift more to equities, preferred shares or even riskier bonds to make up some ground. But before you start adding risk to the fixed-income portion of your retirement savings, just remember bonds are actually supposed to be about safety.

We hate to say it but...

Stop investing at home

It's been 10 years since Ottawa lifted the 30% foreign content limit on RRSPs, but you'd never know it. The average Canadian invests only 40% of their portfolio abroad, according to Vanguard. The home bias increases risk—due to how concentrated a market Canada's is—and it hurts your returns. A passive equity portfolio invested 60% in Canada and 40% abroad would have returned roughly 75% in the past decade. Reverse the allocation and you'd be ahead by six percentage points.

NEWS FLASH

GICs are a smart investment

Scoff all you want at the lowly GIC but for the first time, perhaps ever, it may be a better option for your fixed-income portfolio than government bonds. Right now you can easily find a five-year 2.5% compounding GIC. To find an investment as safe as that you would have to go all the way down the yield curve on Canadian government bonds to get comparative return. And because GICs are covered by CDIC up to $100,000 they're as safe an investment as you are going to make. GICs shouldn't be seen as a replacement to all fixed income, but for the secure portion of your fixed-income portfolio they should be in the mix.

Retire

THE RETIREE'S 4% RULE FOR WITHDRAWAL RATE IS BANKABLE RUPT

BY JULIE CAZZIN

(Unless you plan on dying younger, you might just need a plan B to avoid outliving your money)

It's the one rule that retirement analysts say is the most misunderstood. The 4% withdrawal rule, which refers to the amount you can withdraw from your nest egg (usually plus some extra for inflation) to make your money last 30 years. The father of the 4% rule was William P. Bengen, by virtue of an essay he published in the 1990s in the *Journal of Financial Planning*. In it, Bengen looked at retirement plan withdrawal rates against historical market data for the period 1926 to 1976, on a $1-million portfolio divided equally between stocks and bonds. The 4% solution was a formula to calculate how to fund a particular lifestyle and then maintain it over time. "Now, 20-odd years later, clients and advisors alike are constantly struggling to find something which, in my experience, does not exist: *The perfectly reliable withdrawal rate*," says CIBC Wood Gundy portfolio manager Luke Kratz. "In the real world, this means that there is no way to know if the strategy that we recommend will produce an income that will last or if the client will still be alive tomorrow to receive it."

In reality, says retired actuary Malcolm Hamilton, the 4% rule was only a sensible rule for people age 65. "It was much too low for older people. Having said that, with today's low interest rates (negative after inflation) the 4% rule is probably too high at 65, but it is still too low if you are 75 or 85." So for extra insurance, you should always have a plan B if your plans undershoot—and it might include a part-time job.

We hate to say it but... You need more stocks

Payments from pension plans, CPP and OAS change things when it comes to how your portfolio should be structured. "All three are considered fixed income so in retirement they should be included as such in your mix," says John DeGoey, portfolio manager at Industrial Alliance in Toronto. So if you've decided that a 60% equity, 40% fixed-income portfolio mix is right for you in retirement, then your CPP, OAS and company pension may be enough fixed income to reach 40%. "And if you don't need the money for a longer term, then holding [more] equities can be a viable option—no matter what your age."

BUSTED Freedom 55

"Retiring at 55, or 'Freedom 55' as commercials like to call it, is for the fortunate few who have the means to retire comfortably at that age," says Spencer Tilley, a portfolio manager with RT Mosaic Wealth Management Ltd. in Calgary. Why? Because retiring at 55 often means working for 35 years and being retired for 35 years. For most people to attain this, it requires early planning and major savings due to significant longevity 'risks'.

Forget Freedom 65, too?

Even though Prime Minisiter Justin Trudeau just redialed CPP payouts to age 65, retirement won't kick off at that time for many of us. "Retiring at 65 was a milestone that was picked at a time when people were only expected to live a few years beyond that," says personal finance expert Preet Banerjee. "That's no longer the case."

But don't get stressed out—not retiring can still be a good thing. "Retirement" as we know it has changed a lot. In fact, 20 years ago, people thought of it as the end of working altogether. "Now, people are averse to the idea of a full-stop retirement," says Julia Chung, a certified financial planner in South Surrey, B.C. "They want to reach a 'financial freedom' point where they can chose to allocate their time towards whatever most interests them—and that time period can last 30 years or more."

The new rule should be retire at 70, says John DeGoey, portfolio manager at Industrial Alliance in Toronto. Why? Longevity has increased and CPP, OAS and company pension plans are simply inadequate to sustain a comfortable life style for 30-plus years.