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Way too scared; In this low-rate world, playing it safe can very easily mean falling behind on savings

Stephen Geist, President of CIBC Asset Management
Tyler Anderson/National Post

As Canadians enter the home stretch of the annual RRSP season, a CIBC poll has uncovered a disconnect between the rate of return investors think they need to retire and their actual behaviour.

A whopping 45% of 1,000 adults polled by Harris/ Decima did not even know what annual rate of return they need to meet their retirement goals. And 57% of those who did know nevertheless chose low-risk guaranteed investments that CIBC Asset Management president Steve Geist says are unlikely even to keep pace with inflation.

Geist worries this ignorance of likely rates of return is being used as an excuse to bail on making substantive investment decisions. "They think that by taking no risks they are playing it safe, when in reality they are falling further behind." Just adding a percentage point or two to returns can have more impact than the annual contribution.

Few have a concrete "magic number" to project their retirement income. "It's a moving target as time passes," Geist said in an interview, "I thought more people would have a handle on what sort of range they expected."

While 7% think they could attain their objectives with a return under 3%, they'd be lucky to get even that from money market funds, five-year GICs or savings bonds. Government of Canada bonds currently yield only 1.2%, GICs 1% to 2% depending on the term and money market funds a paltry 0.75%. Those are all negative real returns after inflation.

The problem with a 3% return is you need a ton of capital to generate a liveable income. If you wanted $90,000 a year from an instrument paying 3% a year, you'd need a $3-million portfolio to generate it. Those hoping for $60,000 a year would need $2-million at 3%. I'd venture to say only a tiny minority of Canadians have that much capital. Worse, if it's interest income outside registered portfolios, the income may be highly taxed at the top marginal tax rate (on the order of 46%).

The other danger is that if investors think they can get only 3% and therefore need an unachievable level of capital to fund financial independence, "they may just give up and not bother to save at all," says Warren Baldwin, regional vice-president for Toronto-based T. E. Wealth.

The flip side is those with small portfolios and short time horizons may feel tempted to take excessive risks to achieve their unrealistic goals, trying to compensate by going further out on the risk/ reward continuum. CIBC found that 8% think they'll need an annual return over 10%, which can only be generated by stocks and fairly aggressive ones at that. This can backfire and inflict unwanted losses. Geist says there are three factors at play: the level of the RRSP contribution, the return and time. "If you're weak on any one, the other two must make up for it. If you're weak on two of them, you're in a bad spot: you have to extend the time horizon, pick up the pace on contributions or attempt to generate a better return."

Baldwin agrees there is no free lunch and no such thing as an accelerator pedal on portfolios. He often straightens out clients who think they can push the envelope on risk merely because they have a long investment time horizon.

"Nope, just as driving too fast down an icy road can leave you hung up in a ditch, so too can your entire portfolio be sidelined by a too-aggressive mix."

As always, a balance between these extremes is best. The classic balanced blend of stocks, bonds and cash is more likely to generate more realistic annual returns of 3% to 9%. CIBC found 10% shooting for 3% to 4.9%; 11% aiming for 5% to 6.9% and 8% with their eye on 7% to 9.9% returns.

In his book Master Your Retirement, Winnipeg-based financial planner Douglas Nelson says for every pecentage of additional return investors desire, they will increase their risk level threefold.

Realistic returns for an ultraconservative portfolio two thirds in bonds is 4% to 6%, Nelson says, while a growth portfolio two thirds in equities will have expected annual returns of 6% to 8%.

Baldwin uses 5% as an expected annual return, assuming inflation at 2% and 3% real growth. In more normal markets, he might pencil in 6%. Ten or 15 years ago, advisors used 8% in projections, which clients thought was too low, Baldwin says. "Now if we use 6% or 7%, people feel that's too high."

Natalie Jamieson, Oakville-based investment advisor with RBC Dominion Securities, also uses 5%, based on annuities paying 6% these days. Most clients expect only single-digit returns.

Warren Mackenzie, president of Toronto-based Weigh House Investor Services, assumes a 5.25% return on balanced portfolios, although until the European crisis is resolved he's not banking on 5.25% in 2012. However, "over the next five to seven years it is a reasonable number."

Most client statements seldom show investors total portfolio returns, which is why Weigh House created a tool for calculating portfolio returns between certain start and end dates. It can be found at showmethereturn.ca.

Investors should ask advisors for detailed financial plans showing the rate of return necessary to achieve their goals, then choose an asset mix consistent with that objective.

They should "take no more risk than necessary to achieve their goals but they must take at least the amount of risk necessary to achieve those goals," Mackenzie says.

"If they run out of money when they're 85, the pain will be the same regardless of whether they took too much or not enough risk. For people with 20 years to go to normal life expectancy, the risk of losing purchasing power due to inflation is one of the biggest risks."

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