HOW BIG SHOULD YOUR NEST EGG BE?

PART 1 OF THE SERIES:

"Can you really afford to retire?"

MUIRFIELD

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Chapters covered in this series:

1. How big should your nest egg be?

2. The impact of inflation and living longer.

3. Reducing the risks of inflation and outliving your nest egg.

4. The SMSF Revolution: Why it might not be right for you.

5. Can you afford NOT to be an investor?

6. How to sack the tax man and live a tax-free retirement.

Letter from the author

Dear Reader,

I am glad you have chosen to receive our 6-part email series 'Can you really afford to retire?'.

We certainly live in interesting times, both financial and social, and the advance in technology and turmoil of investment markets have made long term decision making very difficult. This is especially the case as you embark on the transition from a stable and dependable employment income to the unknown realm of retirement.

We are hearing more and more from our clients that the most important and influential decision they have made in both the final stages of their working lives and into their retirement was finding someone they can trust. After all, you are relying on someone to guide you through the confusing maze of options and strategies available and not to mention you need to know that your superannuation investments are safe. Finding that person is becoming more difficult in Australia.

The aim of this 6 part email series is to provide you with the knowledge of what strategies are available, how much super is enough to retire comfortably, how to replace your income in retirement and much more. We hope that after reading the complete series you are better armed to make the important decisions that will shape your retirement.

It is important to note that this guide is for general illustrative purposes only and for personal advice you should find a trusted adviser and work with them to develop a plan specific to your own situation.

Hopefully we get a chance to meet at some stage so I can outline why our clients have trusted Muirfield Financial Services with their retirement plans since 1989.

Regards

Melinda Planken
CERTIFIED FINANCIAL PLANNER®
Employee Representative
Partner

I have 2 questions for you to answer before we get started.

1. How much super is enough for retirement?

2. How long is a piece of string?

If you are like most Australians your answers would go something like this:

1. "I have absolutely no idea".

2. "I need to know more about the string before I can answer".

It is funny how two very innocent questions can result in a very different approach to formulate an answer. The idea of having to put a figure on how long your superannuation will last you in retirement sparks fear into the minds of retirees and they cannot even begin to formulate an answer. The approach should be similar to the question about the string. "Give me some more details and I will come up with an answer".

The result? It is best to work backwards from your retirement income goal to determine how much you need in savings to generate a comfortable income throughout your retirement. It is much easier to start with an income amount in mind than start with a blank canvass.

So let's get started.

How big should your nest egg be?

The majority of Australians are working to age 60 or 65 simply because that is the only way they can hope to accumulate enough capital to survive on in retirement.

Successful investment, like most other rational objectives in life, depends on setting achievable goals and then working out a strategy to achieve them. For most Australians in their 40s or 50s this has become a process of working out the lump sum they will need on the day they retire in order to invest it to deliver today's income. But is this really an adequate answer to an anticipated retirement of up to 30 years?

In September 2008, the New York Times interviewed 'poor millionaires' in Silicon Valley for a feature. These were wealthy individuals in the information technology business who were still working stressful 50 hour weeks in spite of the fact that they were worth millions. When one respondent was asked why they had still not given up their day job, in spite of the fact that at age 51 they owned a $1.3 million house, had another $2 million in the bank and were in the top 2% of American incomes,

they replied: 'I know people looking in from the outside will ask why someone like me keeps working so hard, but a few million doesn't go as far as it used to'.

What makes the 'how much is enough' equation invalid is that your life and your need to grow your assets is not going to end or change on the day you retire. Thanks to modern medical research you could easily have 25 – 30 years ahead of you at age 50, hopefully in good physical and mental health. In fact, you may not actually stop working until your 70s, though not at the same job you were doing at 60. This means that you will need to nurture and grow your assets just as diligently when you are 70 as you do at age 50. The need for active investment management lasts as long as you do, so we should correctly regard financial planning as one long continuum stretching from around age 25 when you have your first serious job until your 70s or 80s.

The myth of the social security net

Is there such a thing as a social security safety net? After all previous generations seem to have survived well enough on a pension. Take a look at the following table:

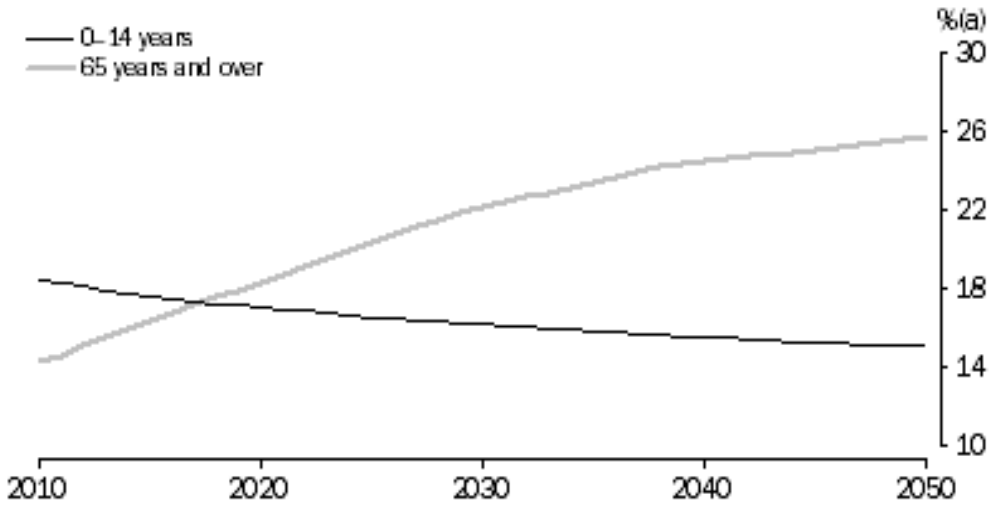
Description	Born	Population (million)	% of population
Builders	before 1946	3.5m	17%
Boomers	1946-1964	5.3m	26%
Gen X	1965-1979	4.4m	21.5%
Gen Y	1980-1994	4.2m	20.5%
Gen Z	1995-2009	3.1m	15%

The table shows how the demographic bulge – the "pig in the python" - moving through society will impact the national accounts in a major way. A significant proportion of the 5.3 million boomers will be impacting on the national accounts from this year. Is an age-related safety net viable?

Here's another example of how misinformed Australians of all ages are about age-related social security benefits. Study after study suggests that Australians don't have a handle on when social security begins, how much better off they might be if they delay retirement, or how much of their income age-related benefits replace.

Projected young and older Australians

'The Headless Fish Phenomenon'



(a) Proportion of the total population.

Source: Population Projections, Australia (3222.0).

What we notice from the above numbers is that right now around 43 per cent of the population was born before 1964. That would mean that some 8.8 million people will be 65 years or older by 2029. That's a three-fold increase from 25 years ago. That is galvanizing Government economists looking to balance Federal budgets. It simply is foolhardy to expect social security safety nets to look after you when you are no longer capable of earning an income from your employment.

Currently, nearly 90 per cent of the 2.4 million people older than 65 get some form of age pension, with a majority getting the full amount of $22,200 a year for a single person or $33,500 a year for a couple (current at time of writing). Most have their homes paid off so most will live frugally. Many were born in the Depression years and most recycle tea bags. If you look at the table below you will see how unrealistic it is to expect to live comfortably on the pension income alone;

ASFA Retirement Standard – December quarter 2013

Expenditure items	Comfortable couple	Modest couple	Comfortable single female	Modest single female
Building and contents insurance	27.56	21.82	22.97	21.90
Rates	32.36	27.56	27.56	27.67
Home improvements	9.18	0.00	9.18	0.00
Repairs and maintenance	16.07	11.48	13.77	13.83
Total housing	**85.18**	**60.86**	**73.48**	**63.40**
Electricity and gas	59.16	57.09	43.62	42.98
Total energy	**59.16**	**57.09**	**43.62**	**42.98**
Food – groceries and other fresh food	194.51	156.69	108.06	75.64
Total food	**194.51**	**156.69**	**108.06**	**75.64**
Bundle of home phone, broadband, mobile	33.61	16.82	26.41	9.61
Total communications	**33.61**	**16.82**	**26.41**	**9.61**
Household cleaning and other supplies	25.47	15.28	18.34	10.19
Cosmetic and personal care items	3.04	2.92	6.83	1.96
Barber or hairdressing	20.38	8.78	14.64	4.90
Music and CDs	2.13	0.00	0.32	0.00
Newspapers and magazines	8.16	1.90	7.97	2.38
Computer, printer and software	4.18	4.18	4.18	4.18
Househld appliances	11.70	2.97	9.97	2.97
Pest control, alarm service	12.51	0.00	12.51	0.00
Total household goods and services	**87.57**	**36.03**	**74.75**	**26.57**
Clothing	58.30	29.15	38.87	17.96
Total clothing and footwear	**58.30**	**29.15**	**38.87**	**17.96**
Car transport and running costs	140.01	93.06	140.01	93.06
Public transport	5.43	5.43	2.721	2.71
Total transport	**145.44**	**98.49**	**142.73**	**95.78**
Health insurance	74.66	59.87	37.98	29.94
Chemist	21.95	2.99	12.11	1.68
Co-payment and out of pocket	38.52	11.61	26.47	6.97
Total health services	**135.12**	**74.48**	**76.56**	**38.59**

Expenditure items	Comfortable couple	Modest couple	Comfortable single female	Modest single female
Membership clubs	9.66	1.94	4.85	0.97
TV, DVD, digital camera	1.78	0.90	1.78	0.90
Alcohol consumed in home (or equivalent spent)	40.32	15.12	25.20	10.08
Lunches and dinners out	80.63	25.10	60.24	30.13
Cinema, plays, sport and day trips	13.52	18.83	6.75	5.80
Domestic vacations	77.24	36.69	65.65	18.34
Overseas vacations	54.05	0.00	36.69	0.00
Sundry items	29.81	11.58	22.87	7.72
Total leisure	**307.01**	**110.14**	**224.03**	**73.93**
Gifts and/or alcohol or tobacco	**0.00**	**0.00**	**0.00**	**0.00**
Total weekly expenditure	**$1,105.91**	**$639.74**	**$808.51**	**$444.46**
Total annual expenditure	**$57,665**	**$33,358**	**$42,158**	**$23,175**

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Thus, the total 'basic needs' cost of living for a retired couple per annum, according to the above table, is $33,358 and $23,175 for a single retiree. However, we need to keep in mind that we are talking about the genuine basics, about the level of expenses that will allow us to survive. Boomers will not be like their parents. If they use recycled tea bags it's because they're 'green', not poor.

They have great aspirations for their retirement, but they all cost. It is surely better to rely instead on those factors that *are* under our control: our savings, our investments and our capacity to earn money.

The intention here is to put a current reality check on some of the financial aspects of life; not to alarm you, nor to lead you astray from our work in this guide and provide solutions that will fulfill as well as help pay for your lifestyle of choice.

But we need to examine a couple of financial areas that *will* help you frame your current financial reality. The first is to examine some rough cut numbers of what to expect when you draw down from your nest egg. Here we look at how costs and income need to be framed to avoid the *Headless Fish* phenomenon (see earlier chart) becoming a picture of your future.

In part 2 of the series we will cover the impact of inflation and living longer which are fast becoming two of the major influences determining the size your nest egg needs to be to support you throughout your retirement.

About the author:

Melinda Planken is a Certified Financial Planner® with Muirfield Financial Services, AFSL 243287. Muirfield have been the trusted finance professionals in Geelong since 1989 with specialist knowledge of retirement planning strategies and advice. As a Partner of the firm, Melinda is well positioned to guide you through the process of retirement and into the next phase of your lives.

This guide is one section out of the 6-part series 'Can you really afford to retire?' We wrote this series to outline the most important issues facing retirees in Australia and how you can avoid the most common mistakes made by many retirees before you. It is intended to get you thinking more pro-actively about your retirement.

I encourage you to book your complimentary retirement strategy session with me to discuss your specific retirement goals. The best way to take advantage of the information you have learned so far is to speak with a CERTIFIED FINANCIAL PLANNER® practitioner about strategies specific to your personal situation. This guide has armed you with the knowledge to know what questions to ask so please click here to book your free appointment and I look forward to meeting with you.

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