

Spending patterns in retirement

An analysis by Russell Investments to help Canadians plan for a financially healthy retirement

From where do Canadian retirees¹ derive income? How do they spend it? And what are the financial planning implications for those approaching retirement? Russell Investments is pleased to present a number of insights gleaned by combining our proprietary retirement research with a detailed analysis of the Statistics Canada 2007 Survey of Household Spending.

At Russell, we believe that a financially healthy retirement is well within the reach of most Canadians. However, issues such as income level, marital status, age, and retirement date can present unique financial challenges along the way. For example, Table 1 ranks the relative risks to financial well-being Canadians may face in retirement based on their income level and marital status. Whatever your personal risk factors may be, this report is designed to help you and your financial advisor better define a financially healthy retirement and develop a concrete plan of action to achieve it.

Table 1: Risks to financial well-being in retirement

RISK IN RETIREMENT MATRIX	SINGLE	COUPLE
Less than \$35K	Highest	High
Between \$35 - \$60K	Medium	Medium
Greater than \$60K	Low	Lowest

Source: Russell Investments

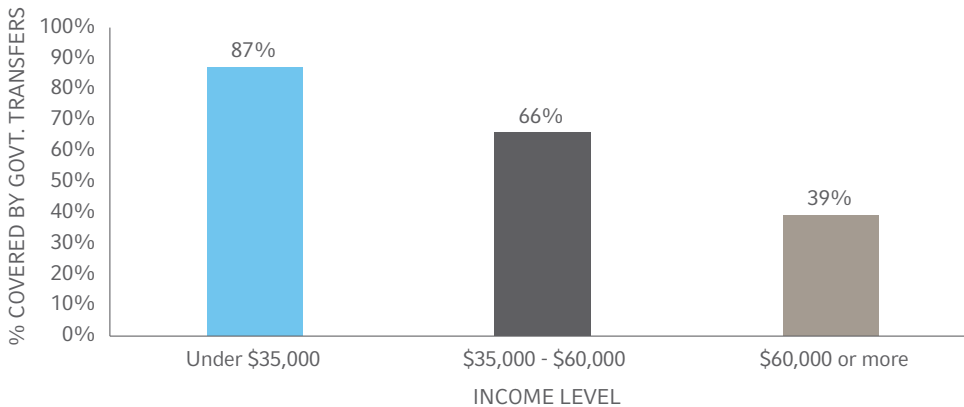
Part 1: The role of Essentials and Lifestyle expenses

More important than what one earns in retirement is what one *needs* to earn in retirement—and that need may only be addressed once expenses are fully understood. It’s absolutely critical to have enough income to cover the Essentials of retirement, such as food, shelter, and transportation. And virtually all retirees also want to have enough income to cover the Lifestyle expenses that make retirement enjoyable, such as travel and dining out.

Our analysis shows that, on average, a little more than 50% of household income in retirement comes from government transfers, such as the Canada Pension Plan and Old Age Security. However, these transfers are generally not sufficient to cover the Essentials of retirement—less than 70% coverage for the average retiree, and as little as 39% for higher-income retirees.

¹ This report focuses on data pertaining to Canadian households in the prime of their retirement, aged 65 to 74.

Percentage of Essential expenses covered by government transfers



Source: Russell Investments, Statistics Canada. Adopted from Statistics Canada, 2007 Survey of Household Spending (CD-ROM), 62M0004XCB, 2007.

This problem is magnified for single retirees. For example, in the \$35,000-\$60,000 income category, couples spend only about 12% more than singles on Essentials, yet receive about 80% more in government transfers.

For all retirees, government transfers are simply insufficient to cover any portion of Lifestyle expenses. Therefore, retirees must plan to fund their entire Lifestyle expense and at least part of their Essentials expense through employer pensions (where applicable) and personal retirement savings, such as RRSPs.

Part 2: Setting a retirement savings goal

For the average retiree, annual Essential and Lifestyle expenses total roughly \$34,400. Applying Russell's Retirement Rule of \$20², and accounting for government transfers, that means a retiree would need to accumulate roughly \$322,000 in retirement savings.

This total, however, can vary greatly, depending on your income level. For example, those projected to earn under \$35,000 in retirement will need on average about \$128,000 to fund Essentials and Lifestyle expenses (net of government transfers), while those projected to earn more than \$60,000 will need on average over \$1 million in savings. The following chart further illustrates these total asset ranges based on the respective projected income level as well as household type in retirement.*

Your age upon retirement is another significant variable, and one that may be easier to control than your income level. For instance, an investor who calculates a savings need of \$269,000 in order to retire at age 65 might require only \$254,000 if they postpone retirement until age 67. This reflects the fact that a later retirement date results in a shorter retirement, and the need for less total income.

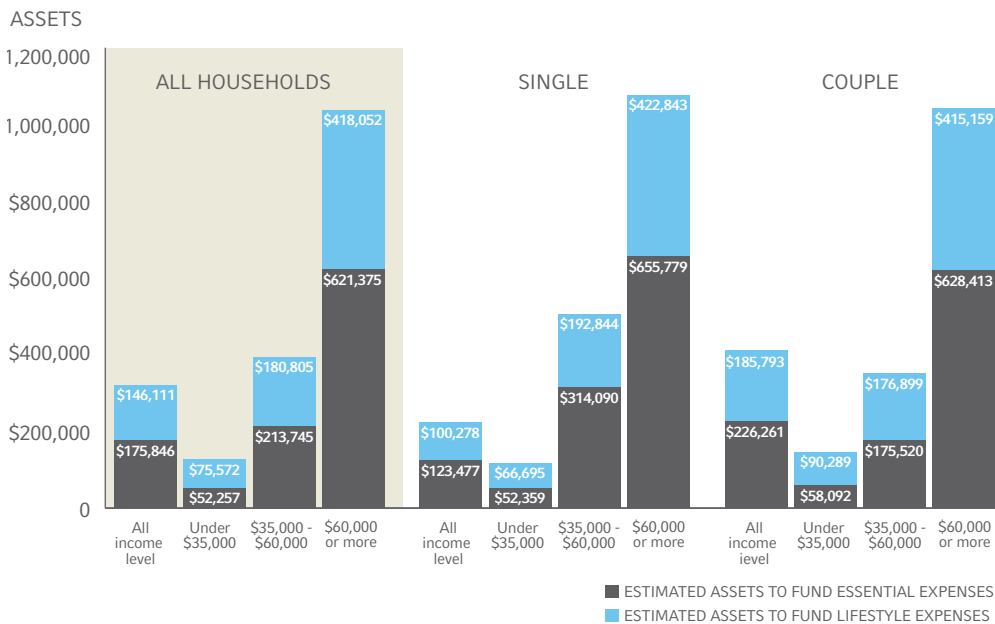
Key insight

In order to set a realistic target for investment income in retirement, investors need to estimate their annual Essentials and Lifestyle expenses in retirement, and subtract expected government transfer payments.

² Russell's Retirement Rule of \$20 is a quick approximation of retirement funding that works in two ways. 1) Multiply a desired amount of annual income by \$20 to arrive at an approximation of the required retirement savings, or 2) Given an amount of retirement savings, divide by \$20 to arrive at an approximation of the annual income that can potentially be generated. Results will vary based on a variety of individual circumstances. Please see *Russell Investor* Volume 9, Issue 1 for further information.

* Required asset level projections are based on statistical data of historical spending patterns only and does not purport to apply to each individual or household's unique circumstances.

Estimated total assets to fund all retirement expenses



Source: Russell Investments, Statistics Canada. Adopted from Statistics Canada, 2007 Survey of Household Spending (CD-ROM), 62M0004XCB, 2007.

Key insight

The Russell Retirement Rule of 20 is a simple equation that can help you set your retirement savings goal: $(\text{Annual Essentials expense} - \text{Annual government transfers} + \text{Annual Lifestyle expense}) \times \$20 = \text{Total savings required at retirement}$.

Part 3: Income replacement ratio

How much retirement income do investors need as a percentage of their pre-retirement income? Our analysis shows that roughly 60% of pre-retirement income is sufficient to cover both Essentials and Lifestyle expenses, and as little as 47% is needed to cover the bare minimum Essentials.

Table 2: Income Replacement Ratio³

EXPENSE COVERAGE RATIO (Income replacement Ratio)	ALL HOUSEHOLDS	SINGLE	COUPLE
Essential expenses only	47%	50%	52%
Total Expenses (E+L)	60%	63%	66%

Source: *New insights into a financially healthy retirement*, Russell Investments Canada and Harris/Decima, January 2010. Russell Investments, Statistics Canada. Adopted from Statistics Canada, 2007 Survey of Household Spending (CD-ROM), 62M0004XCB, 2007.

These figures contradict other research that has pegged the income replacement ratio at closer to 80%⁴. However, many household expenses are reduced or eliminated around the time of retirement, including mortgage payments, income taxes, and costs associated with raising and educating children. There's another item that is often overlooked: households no longer have the "expense" of saving for retirement.

Key insight

Despite the anxiety many Canadians feel about achieving adequate retirement income, recent research conducted by Russell shows that 90% of Canadian retirees rate their financial health as "good", "very good", or "excellent". Almost as many say retirement is a period of life characterized by feelings of happiness, excitement, freedom, and relief.

³ The All Households income replacement ratio is lower than the Singles and Couples ratios primarily due to the effect of applying a weighted average to the data. We estimated the average pre-retirement income for fully-retired households in the 65-74 age group based on the earnings of the not-yet-retired households in the 60-64 age group. There were substantially fewer singles in the 60-64 group compared to the 65-74 group, which skewed the average income for all households higher and, consequently, the income replacement ratio lower.

⁴ Fidelity Investments in their report *The changing state of retirement in Canada*, 2007, recommended a retirement income replacement rate of 80%.

Russell Investments

At Russell, we have a rich heritage of directing the investments of some of the world's largest investors—many of whom have billion-dollar portfolios such as Alcoa, AmerisourceBergen Corp., Barclays Bank, BHP Billiton, Bill & Melinda Gates Foundation Trust, Boeing, Caterpillar, Coca-Cola Bottling Co., General Motors, Public School & Education Employee Retirement Systems of Missouri, Toyota Motor Pension Fund, and Wilfrid Laurier University.⁵

We're the experts on retirement

Russell conducts extensive research into the needs of retirees and responds with innovative, proprietary products and strategies. With more than three decades of money manager research experience and more dedicated manager research analysts than any other firm, we perform the vital work to keep your portfolio focused on your retirement goals.

It takes planning to achieve a financially healthy retirement. But with the help of your financial advisor and intelligent solutions from Russell, it doesn't have to be difficult. To learn more or to obtain our full-length research paper on spending patterns in retirement visit us online or speak with your financial advisor.

www.myfinanciallyhealthyretirement.ca

Nothing in this publication is intended to constitute legal, tax, securities or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. This is a publication of Russell Investments Canada Limited and has been prepared solely for information purposes. It is made available on an "as is" basis. Russell Investments Canada Limited does not make any warranty or representation regarding the information.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. The Russell Investments logo is a trademark of Frank Russell Company and used under license by Russell Investments Canada Limited. Copyright © Russell Investments Canada Limited 2010. All rights reserved. Date of first publication: February 2010.

⁵ U.S. and non-U.S. clients on this representative list were selected from Russell Investments' complete client roster from those who have given permission to publish their names (as of the date of this publication). U.S. publicly-held companies listed are Russell clients that appear on the 2008 Fortune 100 list. The non-public company client and endowment/foundation client are those with the highest total assets. Non-U.S. clients listed represent those with the highest total assets in each of the following regions: Austral-Asia, Japan, Canada, and Europe. Performance-based data was not used in selecting listed clients. The identification of the clients listed does not constitute an endorsement or recommendation of Russell's products or services by such client.