*M*oney, *F*unds, *G*rowth & *I*ncome

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2013 was another great year for *MFGI* clients

The TSX index closed 2013 at 13,621, up 9.5%. Most of this gain came late in the year. As you know, an index does not factor-in the cost of doing business.

We did not have another of our 30% plus years for all clients, but everyone following *MFGI* advice again experienced substantially higher returns than the TSE gain. Our recommended stock funds rose by **37%, 21.5%, 18%, 15.3% and 14.9%** - after allowing for the MER. Individual client returns depended upon the mix of funds; however, **the vast majority of you gained 18%**, after MER.

Clients positioned in lower risk (Balanced/Asset Allocation) funds also experienced outperformance of their relevant benchmarks, gaining **15.3%, 13.3% and 9%,** again after MER.

In our opinion, Canada is in the early stage of a new Bull market. We feel that 2014 will be the year when the TSX finally returns to its pre-recession number of 15,047 - requiring an increase of 11% from yesterday's close - and goes on to new highs.

However, as you have heard me say in the past, "While my record on forecasting the direction of the markets is significantly better than competitors, it is not 100%."

In this newsletter, the focus will be on the

Looming Retirement crisis

A global retirement crisis lies ahead. Spawned years before the recent Great Recession/sub-prime fiasco, the crisis was significantly worsened by those twin traumas. It will play out for decades, and the consequences will be far-reaching.

The problems are emerging as the generation born after World War II moves into retirement. People will be forced to work long past the traditional retirement age, even into their seventies.

"The first wave of under-prepared workers is going to try to go into retirement and will find they can't afford to do so," says Norman Dreger, retirement specialist with Mercer, a prominent worldwide consulting firm.

The crisis results essentially from the convergence of these three factors:

- Nations are awash in debt after overspending during the last decade and racking up enormous deficits since the recession. Now, they face a demographics disaster as retirees live longer and falling birth rates mean there will be fewer workers to support them. Countries are slashing retirement benefits and raising the eligibility age to start collecting them.

- Internationally, most major companies eliminated traditional pension plans, which guaranteed employees a monthly check in retirement.

- Individuals who spent at will and failed to save, saw much of their wealth disappear once the recent recession hit.

A Washington think-tank, "Center for Strategic and International Studies," concluded in a recent report that "Most countries are not ready to meet what is sure to be one of the defining challenges of the 21st century."

History

The notion of extended, leisurely retirements is relatively new. During review meetings, I have often shared that in 1889, German Chancellor Otto von Bismarck established the world's first government pension system. He determined that workers should be able to retire at age 65 and live comfortably. At that time, German life expectancy was 43 years!

In Canada, the old-age pension program was introduced in 1927. We copied the German precedent of starting at age 65. If we look at life expectancy statistics from the period, we might come to the conclusion that our Social Insurance program was designed in such a way that people would work for decades paying into the system, but would not live long enough to collect benefits. Life expectancy at birth was then only 58 for men and 62 for women. Now, our life expectancy is 80 for men and 84 for women, ranking Canada at number 4 worldwide - tied with 13 other countries. At age 83 and 85, Switzerland ranks number 1.

In 1935, when the U.S. introduced their Social Security system, they also applied the age 65 precedent - as did Australia and many European countries. Thus, the OECD nations {The Organization for Economic Cooperation and Development} tied themselves to a formula that did not allow for increased life expectancy!

In the prosperous years after World War II, governments in rich countries expanded their pension systems. In addition, companies began to offer pensions that paid employees a guaranteed amount each month in retirement - defined-benefit pensions.

It got even better in the 1980s when many countries began to coax older employees to leave the workforce, making way for their young citizens. They did so by reducing the age at which the employees became eligible to receive full government pension benefits. The average age fell from 65 years in 1949 to 62 years in 1999, in the relatively wealthy countries which comprise the Organization for Economic Cooperation and Development

That created a new, and perhaps unrealistic, "concept of retirement as an extended period of leisure," says Mercer retirement consultant Norman Dreger. "You'd take long vacations. That was the Golden Age."

The 1980s was also the decade when the futurists forecasted that by the millennium, advances in technology would impact our lives to the point that we would work a 3-day week and have four days weekly for recreation. So, we went ahead and built recreation centres and golf courses to accommodate the anticipated demand.

In the early years of this century, governments and businesses both revisited actuarial tables and birth rates. From these studies, it was determined that the pensions they had promised could no longer be sustained. The average person in the 30 countries the OECD surveyed will live 19 to 20 years after retirement.

That is up dramatically from when countries were devising their generous pension plans. People are not only living longer, they are living much longer.

The OECD calculated that the average retirement age would have to increase by at least four years to maintain control of the cost of pensions.

The higher the percentage of older people, the harder it is for a country to finance its pension system because relatively fewer younger workers are paying into the tax systems. Compounding the problem is that birth rates are falling as the bulge of people born in developed countries after World War II enters retirement.

This challenge is even more significant in Canada, the United States, Australia and New Zealand because it was principally to these four countries that millions of Europeans emigrated after the devastation of their home nations by World War II.

In response to this foreseeable, yet long-ignored challenge, the governments are now increasing the retirement age and slashing benefits. In 30 OECD countries, the average age at which full retirement benefits will be payable will rise. In the wealthy countries it studied, the OECD found that the pension reforms will cut retirement benefits by an average 20%. Business was earlier to act upon the challenge, moving away from defined pension plans to defined contribution options. It is now very rare for even major corporations to provide the once-common defined benefit pension.

Even France, where government-provided pensions have long been very generous, has started to reduce costs by introducing some modest reforms. The number of years French people must work before they can receive a full pension has been raised from 41 to 43. More changes are likely coming. Richard Jackson, fellow at the Center for Strategic & International Studies says that "France is a retirees' paradise now, "but in 20 to 25 years, you're not going to want to retire there."

In China, where adult children traditionally provided for their parents in old age this is no longer the norm. It is estimated that their 65-and-older population will rise from 11% of the working-age population to 42% by 2050. In Canada, this old-age dependency ratio will rise from 20% to 35% in the same time-period.

The fate of government pensions is important because they are the cornerstone of retirement income. Across the OECD governments provide approximately 60% of pensioners' income, on average. The government's share ranges down from a high of 86% in Hungary to 38% in the world's largest economy, the U.S.A.

If rich countries don't cut pension costs even more, warns credit-rating agency Standard & Poor's, their government debt will more than triple as a percentage of annual economic output by 2050. The debt of most countries would drop to what is commonly called junk status.

Most of those facing a financial squeeze in retirement can look to themselves for part of the blame. They spent many years before the recession borrowing and spending instead of setting money aside for old age. Too few have sought the services of professional financial planners. Households in the U.S., took on an additional $5.4 trillion in debt - an increase of 75% - in the five years prior to the sub-prime fiasco hit, according to the Federal Reserve Bank of New York. Moreover, the savings rate fell from nearly 13% of after-tax income in the early 1980s to 2% in 2005. While I do not have the exact numbers for Canada, I can advise that, although the average Canadian is now wealthier than the average American (CBC 2012), the trends on increasing household debt and lower savings rates are similar.

Estimates suggest that Canadians are at least $1 trillion short of what they need to have saved for a comfortable retirement. Alicia Munnell, director of the Center for Retirement Research, recently stated that "People are going to be shocked {at retirement} at how little they have {accumulated}."

As if demographics were not burden enough, the outlook became worse when the global banking system went into panic mode in the fall of 2008, tipping the entire world into the Great Recession - the worst recession since the 1930s.

Government deficits - the budget gap between what governments collect in taxes and what they actually spend annually - swelled. This was particularly the case in the U.S.A. and in some European countries where the governments pumped money into financing unemployment benefits and their welfare programs and into saving their banks. When the term "Too big to fail" became unpopular it was dropped in favour of the more politically correct "Quantitative Easing" or, simply, "Q.E." While a rose by any other name may smell as sweet, there is nothing sweet about printing money, which is the reality behind "Q.E." Its immediate effect is to devalue currency and lower standards of living.

The Great Recession threw tens of millions of people out of work worldwide. Those who kept their jobs have seen their pay stagnate over the past five years; even as living costs have risen, making it tougher to save for retirement. There has been no significant increase in inflation because high unemployment has kept down salary increases. According to Mercer's Global Compensation Planning Report, released today, increases will be minimal in 2014.

With increasing deficits, the debt of these countries soared. As an example, the U.S.A. debt has almost doubled in the past 5 years - from $9 trillion to $17.3 trillion, or $54,755 per citizen.

This escalated pressure on governments to reduce spending on pensions or raise revenue. Hungary took one of the most draconian steps: It demanded that its citizens surrender their *private retirement accounts* to their government or give up the right to government pensions. Poland has actually seized a portion of private retirement accounts.

Less money from a government pension and lower expectations for salary increases are not the only factors weighing on future retirees. When the financial crisis struck five years ago, the world's central banks cut interest rates to record lows to stop the economic free-fall. That action also had the effect of punishing people who keep their money in interest-bearing accounts.

Catherine Collinson, director of the Transamerica Center for Retirement Studies said last month that "The low-interest rate environment has been brutal. A $1,000,000 in savings would yield $50,000 a year at an interest rate of 5%, but only $5,000 at 0.5%."

The crisis also frightened many away from the stock market. Stocks can be riskier than some other investments, but they yield more long-term. The past five years have been so tumultuous that many previous investors have have been reluctant to invest since the collapse.

END OF TRADITIONAL PENSIONS

Governments are not alone in cutting pensions, corporations are, too. The defined-benefit pensions, which I have mentioned above, are vanishing. Companies no longer want to bear the risks and costs of guaranteeing pensions to their employees. Instead, they have moved to the defined-contribution model which shifts responsibility for retirement savings to employees. There are various challenges with these plans:

- Many employees are inept at taking advantage of and managing them effectively.
- Some don't even enroll.
- Those who do, frequently fail to contribute enough.
- Many dip into the accounts when they need money.
- It is too easy to access the accounts to pay bills.
- They make bad investment choices; often buying stocks when times are good and share prices are high and selling when prices are low.

According to both a Canadian bank report and a 2013 Financial Post article, 36% of Canadians withdrew money from their RRSP account in 2011. Reasons given included covering of day-to-day expenses, paying down of debt, vacations and home renovations. The bank reported that the average withdrawal was $24,531, which amount greatly exceeds the average annual deposit made to individual RRSPs. Six years prior; the percentage who made a withdrawal from an RRSP was 23% and the average amount withdrawn was $10,716. So, more people are making withdrawals and the average amount has significantly increased.

Astonishingly, the poll found that: "Canadians aged 55+ (41%) are more likely than 18-34 year olds (32%) and 45-54 year olds (30%) to have taken money out of their RRSPs." Although people older than 55 years have larger RRSPs from which to withdraw, one would think that those closest to retirement would consider their RRSP accounts as sacrosanct.

EASING THE PAIN?

Rebounding stock prices around the world and a rise in housing prices are helping households recover their net worth. However, net worth is merely climbing slowly toward a level considered inadequate when at its peak in 2007. The Center for Retirement Research says that even with the recovery in housing and stock prices it still leaves 51% of households in the U.S. at risk of being unable to maintain their standard of living in retirement.

That’s down from 2010 but up from 43% before the Great Recession hit. This, the slowest U.S.A. post-recession recovery on record, does not help us. As the United States is our biggest trading partner, their continuing weak economy makes more difficult the challenges for our exporters. In turn, this contributes very significantly to the stagnation in Canadian salaries, making it more difficult for Canadians to maximize contributions to RRSP and TFSA accounts. Losing out on the compounding effect over many years will lead to smaller income being available for RRIF and/or annuity payments during the retirement years.

In Japan, only half of the people say they’ve even thought about how to finance their retirement. Approximately two-thirds (63%) are counting on getting most of their retirement income from a government pension system that is almost bankrupt.

When they look into the future, retirement experts see more changes in government pensions and longer careers than many workers had expected.

Pension cuts are likely to hit most retirees but will fall hardest on the wealthy. Governments are likely to spend more on the poorest among the elderly, recognizing that the oldest will be in danger of outliving their savings.

Those planning to work past 65 can take some comfort knowing they’ll be healthier, overall, than older workers in years past. They’ll also be doing jobs that aren’t as physically demanding. “My parents retired during the Golden Age of retirement,” says Mercer consultant Dreger, “My dad retired at age 57. That’s not going to happen to somebody in my generation.”

WHAT CAN BE DONE?

Many countries are encouraging workers to save more for retirement. Australia was the first country to recognize the coming challenge and take action. Back in 1993, a law was passed that makes mandatory for Australians the holding of a retirement plan and prevents the withdrawal of money from their accounts prior to their retirement date. When the law was passed, only about half of Australians supported it. Within six months, approval rose to 85%.

The difference: Workers started receiving statements that showed retirement savings piling up, says Nick Sherry, who was the cabinet minister who designed the plan.

Since 2006, the U.S.A. has been encouraging businesses to make “opt in” the default choice for company-sponsored pensions. As a result, unless an employee requests to not be included, s/he automatically starts saving for retirement.

As of 2012, Britain has required employers to automatically enroll most employees in a pension plan.

In Canada, CPP deposits have, in recent years, been rising steadily for both employer and employee.

This newsletter began with the good news of another terrific year for our clients. While we have had the occasional disappointing year, we continue to outperform our stock market significantly, over all recognized time periods (3 / 5 / 10 years). The key to your financial success includes:

- ✓ Making time available when I request a review meeting,
- ✓ Acting upon my advice when I suggest that it is important to reposition your investments,
- ✓ Maximizing contributions to your RRSP,
- ✓ Utilizing the tax deferral within Investment grade insurance.

The looming retirement challenge will not then become a personal retirement crisis for you.

A REMINDER

While most clients are current with RRSP contributions, those who need to make a top-up payment are requested to please forward a cheque to

Monaghan Financial Group Inc.

3550, 199 Street N.W.

Edmonton, AB T6M 2N5

to reach me by February 15th. This will allow me sufficient time to speak with you, should I need to clarify anything. Cheques may be post-dated as late as March 1.

Monaghan Financial Group Inc.