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Financial advice

Top Tips from financial experts

Our experts' advice for the decade ahead.

By MoneySense staff

To help you navigate the decade ahead, we asked some of our favorite experts for their top tips. Four themes emerged.

BUILD YOUR MARGIN OF SAFETY

Benjamin Graham, the father of value investing, considered it vital for investors to build a margin of safety into their calculations. According to Graham, if you're buying a stock, you should insist on paying a price so low that even if the market turns sour and the stock turns out to be a dud, you still recover most of your money.

It's an excellent idea to apply the same thinking to all aspects of your personal finances. The next decade is shaping up as a tumultuous time. You should plan your future with a margin of safety so that unexpected expenses or emergencies can't derail you.

A good place to start is by stowing a couple of months of living expenses in a savings account or money market fund. A stash of cash ensures that if your job disappears, or you fall ill, you can survive until you find a more permanent solution.

Another way to increase your margin of safety is to eschew debt. "There are only two reasons you might want to consider borrowing — for your first home and for your education," says Jim Otar, a certified financial planner and founder of retirementoptimizer.com.

If you're newly married and thinking about buying a home, leave yourself room to breathe. Norm Rothery, chief investment strategist at Dan Hallett & Associates, says newlyweds often buy as much house as they can afford. But if one of you loses your job, or if one of you decides to stay home when

Junior comes along, panic can ensue. “It’s a good idea to make sure that you can afford the mortgage on one salary — just in case,” says Rothery.

As you edge into retirement, a margin of safety becomes even more vital. Don’t assume your portfolio will generate double-digit returns. Don’t even assume the market will always go up.

The greatest danger comes if you hit a major market downturn in the first couple of years after you quit work. Say you start out with a $200,000 portfolio that you are counting on to produce 7% annual returns — in other words, $14,000 a year in income.

That doesn’t sound wildly unrealistic. But what if the market falls by a third in the first year of your retirement? What if it plateaus for the next five years while you keep on withdrawing $14,000 a year? By the time the turnaround finally comes, you will have only about $65,000 left. Even a vigorous recovery won’t provide enough profit to maintain the level of withdrawals you would like.

To avoid this dire situation, insist on a margin of safety. Experts say you should count on withdrawing no more than an inflation-adjusted 4% of your initial portfolio every year. If you have a $200,000 retirement portfolio, withdraw only $8,000 in income the first year. Every year bump up that amount by the rate of inflation. History demonstrates that keeping your withdrawals to 4% should allow you to weather even the market’s worst storms.

SEEK GOOD ADVICE

Did your financial planner warn you to get out of the market ahead of last year’s crash? Probably not. If there’s one thing that the recent market turmoil has demonstrated, it’s that experts have no more insight into what is going to happen next than you or I do.

If you want to prosper over the next decade, you should think twice about whether you really need professional advice — and how much you’re willing to pay for it. If you’re a typical Canadian, who invests primarily through mutual funds, you already hand over about $2,000 a year in fees for every $100,000 you have invested. You pay that year after year after year. You don’t notice the bite, because mutual funds deduct fees before reporting results to you, but as a general rule, the fees on a typical fund chew up a quarter to a half of the after-inflation gains your money will generate.

You can slash your fees and keep more of the profits for yourself by investing in low-cost index funds. (For more on this strategy, see the Couch Potato portfolio section of moneysense.ca.) If this plan doesn’t appeal, you should look for ways to drive a better deal with your financial planner.

Start by understanding what a planner can — and can’t — do for you. The right planner can be a huge help if you’re dealing with complicated tax issues or estate planning problems or insurance questions. But financial planners are not investment gurus. They can’t reliably predict which stocks will pop, which mutual funds will do best next year or how the economy will perform in the months ahead. No one can. If you’re looking to a planner primarily for market tips, it’s time to think again.

While you’re thinking, devote a bit of attention to how your planner is getting paid. Most planners work on a commission basis and earn money for selling you products. The more products they sell you, the more they make. “No matter how conscientious they may be, there is an inherent conflict of interest if your financial planner only gets paid when they sell you something like a mutual fund,” says Marc Lamontagne, a fee-only planner with the planning firm of Ryan Lamontagne in Ottawa. “If you’re looking for independent financial advice from an advocate who works for you, and not the mutual fund

company, you should choose a financial planner who is compensated in a way that aligns your interest with theirs."

The best plan is to seek out a planner whom you can pay by the hour. This removes any conflict of interest. You'll pay more upfront for the advice — $500 to $2,000 would be typical for a detailed consultation, complete with budget and portfolio plan — but most of that is a one-time expense. (You may want to pay smaller amounts for an annual update with the same planner, but that's entirely up to you.) Once your plan is in place, you'll save money over the long run because you won't be paying hidden fees for unnecessary products. For a list of fee-only planners, visit moneysense.ca.

PAY DEBTS. OR SAVE. BUT NOT BOTH

It happens time and time again. A young couple pinches pennies, lives on Kraft Dinner and forgoes vacations so they can pay their mortgage, cover their daycare bills — and contribute to an RRSP. They complain about feeling trapped and penniless.

No wonder. By trying to simultaneously save and pay down debt, they guarantee slow progress on both fronts.

A better strategy is to focus first on erasing debt. This guarantees you a good return on your money. Simply paying down credit card bills gives you an after-tax return of 18% a year with absolutely no risk. Even paying down your mortgage provides you with a guaranteed after-tax return of 5% or so. Those returns are better than you can expect in an RRSP. And since you can carry forward your RRSP contribution room to future years, you're not losing the ability to save for your retirement. Once your mortgage and other debts are paid off, you can redirect the income that you were previously using to pay down debt and pour it into your RRSP.

If nothing else, this debt-first strategy will improve your mood because it will allow you to focus on a single goal. "Many Canadians are stretched to the limit in their 30s and early 40s," says Malcolm Hamilton, a consulting actuary with the benefits consultant Mercer. "They have debts to repay and children to raise. Not much is left for retirement savings. The important thing is to live frugally and pay down your debts as fast as you can without cheating yourself of what should be an enjoyable part of your life. For young families with children, frugality is a virtue… savings, not so much."

DON'T PREDICT. PREPARE

It's tempting to try and predict how the future is going to unfold, then bet everything on that scenario. Most of the time, though, that strategy doesn't work. Economists who spend every day following the market rarely get the future right. It's optimistic to assume that you can do better than the pros in a few hours of your spare time.

A better strategy is to prepare yourself in a way that will pay off no matter which way the future bends.

Exactly how you do this depends upon your individual situation. Is your problem that you're not saving any money? Then buy a pocket notepad. "Keep it with you wherever you go," says Debbie Gillis of K3C/Kingston Credit Counselling in Kingston, Ont. "Track what you spend every day for a few months. Write down every cent you spend. This is a very powerful tool. It shows very clearly just where you are spending your money." Once you know where you're spending, it's often obvious where you can trim back spending.

For many of us, problems are more subtle. Consider your investing portfolio. Is it risky enough to generate the returns you need? Or too risky? David Martin, an associate with Second Opinion Investor Services in Halifax, says he sees many clients who are either too cautious or too aggressive with their investments.

He recommends you look ahead to see how much money you will need down the road, then work backwards from there. Using realistic assumptions, figure out how much you will have to save to amass the amount you desire. One common mistake is for people on the verge of retirement to still have a high-risk portfolio, full of stocks, when their goals could easily be met with a more conservative mix. “You have to have a plan with goals and objectives and you have to invest according to it,” says Martin. “Don’t take on more risk than you have to.”

Bear markets are going to occur every four to six years and you have to be prepared to weather them. Richard Deaves, author of What Kind of an Investor Are You?, says your best bet is to pick a mix of stocks and bonds that fits your needs and temperament and stick to it no matter what the market is doing. “There is abundant evidence that even sophisticated market practitioners have little success in timing the market,” says Deaves. If in doubt about how to build your portfolio, consider a 60-40 blend of stocks and bonds. This mix provides both growth (in the form of stocks) as well as a solid base of income (from bonds). Once a year, rebalance things, taking a bit of money out of the investments that have done the best over the past year and investing it back in the areas that have lagged. This simple technique ensures you always buy low and sell high.