Retirement Planning - A Simple Guide for Individuals

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A gem on retirement planning, this is a book that all individuals, irrespective of age and income bracket must read. Written from the perspective of Indian investors, Retirement Planning – A Simple Guide for Individuals by R K Mohapatra, offers retirement planning strategies along with solid financial management tips. The book empowers you, as an individual, to plan for your retirement and invest in opportunities that are most capable of helping you meet your retirement goals. Written in a simple and direct manner, readers will find it easy to spot the retirement gems in the book.

Key Takeaways

- It is never too early to start saving. Savings should essentially start as soon as you start earning
- Retirement planning should form an integral part of your financial planning. Even though retirement seems far out, planning for it should be done early on
- Financial planning should be long-term in nature. One should ignore short-term market movements and volatility
- Focus on your long-term goals and utilize the investment avenues most suited to your risk/return appetite
- Retirement planning has three major stages: the accumulation stage, the preservation stage and the distribution stage
- Succession and legacy planning form an integral part of retirement planning
- Mutual funds are a good way of investing – however, investors should be cognisant of the impact of expense ratios on returns and choose the funds wisely
- Systematic Investment Plans (SIPs) are a great way to invest in equity mutual funds. They inculcate discipline and help investors take advantage of the power of compounding and rupee cost averaging
- Individuals have unique needs – thus, every individual will have a unique financial plan that will reflect his personal goals, aspirations, return requirements and risk profile

Planning and Budgeting

"Joy and happiness comes when you spend your hard earned money according to your needs. To see a better tomorrow, you must plan today"

The common elements necessary for financial planning include your income, expenditures and savings. The more you spend today, the less you save today, which creates imbalances in financial planning for your future requirement.

INCOME – EXPENDITURE = SAVINGS

Factors / Options for retirement planning:
- Spend less now and save more
- Get better net, after tax returns on your investments
- Work longer

Long-term Financial Planning

An individual works hard to earn money and ensure that he is able to fulfil his own goals, as well as, the goals of his family. However, just earning money will not help you reach your goals. In order to fulfil your goals, you need to save and invest that money in a meticulous manner, according to a financial plan. Money saved today will not have the same value tomorrow due to the eroding effects of inflation. Inflation basically means that the price of the same commodity today will increase tomorrow. This essentially means that the money you have today, will not be sufficient to fund the same expenses tomorrow. Which is why it is important to save your money and invest it in instruments that can, at the very least, generate inflation-beating returns.

For example: If the inflation in the country is 4%, then a product that cost Rs. 100 today may cost Rs. 104 in a few years. However, without investing, the value of your Rs. 100 earned today will not increase to Rs. 104. In order to increase the value of your savings, you must choose to invest your money in an instrument that generates at least 4% returns.

In the short-term, the value of investments fluctuates due to external forces and stock market volatility. It is important for investors to ignore these short-term fluctuations and continue to stay invested. For investors who are truly looking to create a robust and enduring financial plan, long-term financial planning is essential. When you start on your investment journey, you must chalk out a long-term financial plan that clearly articulates your sources of income, expenses, goals and risk profile. This long-term plan serves as a guide for all your investment decisions.

Why you need retirement planning?

At the very onset, an individual should carefully map out his or her plans for ensuring a secure retired life. Envision your post-retirement life. Think about what you would like to do once you have turned 60. Would you like to take up part-time employment, would you like to travel the world or would you like to start an alternate business? Also, think about how you would manage your expense, especially your medical expenses post retirement. Retirement planning is about thinking about your future life and also about your loved ones. To achieve your retirement goals, you need the right amount of corpus to take care of your needs and key commitments and provide regular retirement income to maintain your lifestyle post retirement.

The growing financial pressure on retirement systems worldwide is forcing individuals to change the way they think about and plan for retirement. It is imperative that individuals start their retirement planning at an early stage and create an investment corpus that would be able to meet their retirement goals.

The main goal of a retirement plan is to provide you with the means to lead a happy and comfortable life even after you no longer have a steady income from employment or business. All the activities in the post-retirement period need money and without money, one cannot survive in society. Like financial planning, retirement planning has become an integral part of human life today. Many people think that if they have enough money invested in gold / house / banks / PPF, then they can lead a comfortable retired life. However, the retirement corpus built via traditional avenues such as bank fixed deposits, investment in gold and house, may not be sufficient to fulfil your retirement needs due to increased life expectancy, growing trend of a nuclear family set-up, high rate of inflation and absence of social security. It is advisable to start retirement planning with mutual funds to generate an optimal retirement corpus while diversifying investment risk.

Every individual has his or her own unique set of needs and thus, each person's financial plan would be different. Therefore, it is important to determine various objectives like regular income, corpus building etc. You should also determine your risk appetite and time horizon to retirement before choosing the investments for your retirement corpus.

The Three Stage of Retirement Planning

Retirement planning generally includes three stages: the accumulation stage, the preservation stage and the distribution stage. The plan should be to create a big retirement corpus during the pre-retirement stage (accumulation stage) without taking too much risk so that your post-retirement expenses and requirements are taken care of in the distribution stage.

Accumulation stage is that stage when you create a corpus over the period generally up to retirement. The distribution stage starts thereafter, when you live off the retirement corpus created. The preservation stage falls in-between, when you need to preserve and grow the corpus so that it can continue meeting your post-retirement needs.

"A small amount of investment fulfils your dreams; one must think about it."

Some of the investment instruments that can be a huge part of a retirement plan during the accumulation stage include, Pension Plan, National Pension System (NPS), Public provident fund (PPF), Gold, e-gold & Gold Bond, land & building, debt instruments, NCD and bonds, and equity & equity related instruments (mutual funds).

These are some of the investment instruments that can form a part of a retirement plan during the distribution stage:

- Bank deposits
- Company fix deposits
- Senior Citizen Savings Scheme (SCSS)
- Pension Yojana
- Annuity of Life Insurance Company
- Post office MIS.

You can arrange to use the corpus in the distribution stage through interest, dividends, annuity and withdrawing the capital which you have accumulated during the working period of your life. It is important to note that as we get closer to the post retirement stage, our ability to absorb risk reduces. Hence, the investment instruments that we choose should reflect this reduced ability to absorb risk.

Identify various key commitments, responsibilities and goals to estimate the corpus required for your retirement goal. The earlier you distinguish between your income and investment; more attractive is the corpus that you can generate for your retirement. At the age of 30, if your monthly expenses are Rs. 30000/-and assuming an inflation rate of 4% per annum, you require Rs.97302/- per month at the age of 60. You start investing in equity mutual funds by the time you turn 30. A very small amount, of say Rs.4000/- per month(SIP) can be initiated specifically for your retirement. This has the potential to grow into Rs.1.50 cores after 30 years, with an annual return of 12.30%, which is sufficient to generate Rs.97300/- per month. At the very minimum, this should take care of your basic post-retirement expenses.

"Retirement is not an age; it's a monetary amount you have thought about for the rest of your life."

Mutual Funds – An Optimal Option

Like our retirement planning, the investment landscape also goes through various stages. Investment products and their returns often correspond to the changes in the wider economy and accordingly go through troughs and peaks. Certain assets like stocks can witnesses sharper movements and wider swings as compared to fixed interest bearing instruments. However, as an investor, you must look for the best opportunities in the market rather than allocating your entire corpus to conventional instruments. Individual behaviour is such that we tend to exit our investment when they are at their lowest and initiate investments when prices are at the highest. Trying to time the markets is a losing battle. Instead, investors can choose to gain exposure to the markets by investing in mutual funds through SIPs. There are myriad benefits to investing through an SIP:

Inculcates discipline: when you start an SIP, you commit to investing a certain sum of money at a certain frequency. This means that irrespective of the prices or market environment, you continue on your investment journey in a focused and disciplined manner.

The power of compounding: The compounding process ensures that both the capital and interest earned from an investment, earn interest, as time passes. The magic of compounding is best enjoyed by an investor who stays invested for the long-term. It's not just the principal amount but also the cumulative interest that earns more interest for you.

Rupee cost averaging: the fundamental principle of investing guides an investor to 'buy low' and 'sell high'. An SIP entails investing a fixed amount of money in the markets, at regular intervals. Since the amount invested is the same at all levels of the market, rupee cost averaging ensures that we buy less quantity when the markets are high and buy more quantity when the markets are down. It ensures you buy more units of the fund when the market goes down and less when it goes up so that you can average out the overall cost of buying SIPs.

An SIP can help an investor create a big retirement corpus without taking the risk of direct equity exposure. However, when investing in mutual funds, investors must pay attention to the fund's expense ratio. A higher expense ratio can have a significant impact on overall portfolio returns.

Mutual funds are a good way to gain exposure to debt investments as well. Debt mutual funds and Fixed maturity plans (FMPs) are a better option for investment for a period of three years and more, in comparison to tax-free bonds/debentures/fixed deposits.

No investments are without risk. Thus, it is important to measure the risks in mutual funds. Popular ratios to measure this risk are:

- Standard Deviation
- Beta
- Sharpe Ratio
- Treynor Ratio
- Alpha
- Covariance and coefficient of correlations

Every investor invests to reap returns. In order to assess the return potential of your portfolio, you should review your portfolio periodically. When you think about your portfolio, you should understand what to buy, sell or hold. These decisions are not simple and are governed by the principle of Margin of Safety. This is basically the difference between the intrinsic value of the investment and the price that you have paid for it. A higher margin of safety ie. a lower purchase price relative to the intrinsic value is always preferred.

Insurance

Purchasing a life insurance policy may be considered an investment. Insurance plays an important role in financial planning for an individual. After reviewing your portfolio, a financial advisor can suggest the amount of insurance coverage that is required to meet your family's needs if any unfortunate incident were to occur in your life. Term insurance protects your family in your absence and makes secured repayment of your liabilities such as a home loan, car loan instalments and the education expenses of your children.

Succession Planning

"Succession and legacy plan protect your property in case of any eventuality or due to the circumstances beyond your control. Otherwise, your property gets distributed equally among your heirs according to the succession laws in lieu of a perfect will."

Succession planning is an important part of financial planning. Without succession planning, it is meaningless for you to create investments and property that cannot be used by your spouse and children. Thus, it is important to create a will. A will is basically a statement that declares the intention of the person with regard to his/her wealth and property and how they want it to be distributed after their death. This document not only signifies the distribution of wealth but also allocates responsibilities to family members.

Individuals should also ensure that all documents are filed properly and the nominees are registered. The first and foremost duty of a retiree is to collect all the personal documents and make sure that your spouse and at least one other family member is fully aware of your financial plan and investments. This exercise should be carried out in the pre-retirement stage and not left for a later date. Check all the investment accounts along with bank accounts and confirm whether nomination is available or not. It is always best to do all investment in the joint names of self and spouse, with a nomination facility.

Starting a new Phase

Retirement is an opportunity for us to start our life afresh. It is the time to enjoy your life to its fullest and follow the things that you are most passionate about. Restart some of your hobbies, which were left behind due to work pressure. Start living the life you always wanted to. Get back into shape; make yoga and brisk walking a part of your daily life. Physical exercises like cycling, walking, and yoga can make you fit and reduce your medical expenses. It is also the time to reflect upon your life and a chance to make amends for the mistakes that you might have made.

All this is only possible if you plan for your retirement. If you make judicious investments in the accumulation phase, then you reap returns of those investments and enjoy in the post retirement phase.