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PFA

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50(+) Ages of Grey

by PFA

Is 50 the ideal age to start preparing for retirement? And what would be the good percentage of income to save and invest for retirement?

There are many rules of thumb when it comes to retirement planning. One is the 20:20 rule.

The 20:20 rule says that if you want to be in retirement for 20 years, you should plan for retirement 20 years before your retirement age. So, if you want to be in retirement for 20 years after the age of 60, you need to start preparing by the age of 40.

Intuitively, you can modify the rule to 15:15, 10:10 or even 5:5. The basic principle is that the period of retirement should be equal to the period of preparation prior to retirement age. But a limitation of the 20:20 rule is that it does not take into consideration both inflation and investment returns.

Another rule states that you should be earning at least 75% of your pre-retirement income during retirement for you to enjoy the same lifestyle prior to retiring. And if you are only earning 40% of your pre-retirement income or less you will be in deep financial trouble.

The more practical way of preparing for retirement is to take the expenses of your desired retirement lifestyle if you were to retire today and then inflate them to when you want to retire. Then you have to derive the investment return you will need to earn to grow your starting funds, periodic additions and lump sum retirement pay to meet such future inflated expenses.

Finally, you have to determine if the risks associated with the return that you need to earn are within your preference. If they are, well and good. If not, you will need to do some recalculations on the current cost of retirement, length of retirement, period of investing, starting investment, periodic investments, the risk you are willing to take and the return you need to make.

There are other factors that are commonly forgotten in trying to make retirement lifestyle more affordable. One category is that of government-sponsored retirement and health benefits. Pension benefits from the Social Security System and the Government Service Insurance System can provide great support for retirement living. There is also Philhealth, which can help defray the cost of long-term healthcare at a time of increased susceptibility to sickness.

Others assume that they will continue to work and earn even after retiring albeit at a reduced pace given their advanced age. That income in retirement may be from a business, part-time employment, consultation work, and the like. The added benefit of continuing to work is that both the mind and body are kept in tip-top shape, which tends to promote longevity.

People may be older and grey. But they bear a lifetime of experience that still keep them in demand.

So, to sum up the long-winded answer, there is no ideal age nor amount of savings and investments for starting retirement planning as it will be based on the plan you create given your unique circumstances. And please note that there is no financial product that is a retirement or pension plan. Your retirement plan is what you make it. Financial products are there to just help you execute your plan.

Peso Cost Averaging in Crises

by PFA

So, which is the better strategy to take, one time big time investing or Peso cost averaging?

One view is that stocks around the world were pummeled by the pandemic and resulted in one of the worst performances in history. The opposite view is that the huge drop in prices presented an opportunity to make short-term profits on whatever rebound that may ensue.

What is clear though is that the pandemic did not lead to the first major downturn in stock prices. In fact, history is replete with major crises that sent prices tumbling. Wikipedia lists more than 50 from the Tulip mania bubble in 1637 to the Wall Street Crash of 1929 to the present CoVid-19 pandemic.

Crises are here to stay, and experienced investors know that continuous investing in both the highs and the lows of markets is the best strategy to weather such crises. The strategy is called cost-averaging.

Cost-averaging simply means that you invest a fixed currency amount periodically. When prices are high, your fixed currency amount buys fewer investments. When prices are low, your fixed currency amount buys more investments. And over time, you are likely to have a better average cost than if you were to invest everything at the start or "time" the market.

Consider the PSEi from 2007 to 2019. If you had invested all of Php1.2 million at the end of 2007, the value of your investment by end 2019 would be a whopping Php5 million. And if you go by the PSEi TRI (i.e. the PSEi with dividends reinvested), your Php1.2 million at the end of 2007 would have grown to Php6.6 million by end of 2019. The implicit effective annual returns would be 6.62% under the PSEi and 9.42% under the PSEi TRI.

But wait, many of us do not possess that huge chunk of money to invest with at the start. The more viable alternative is periodic investing through cost averaging.

So, if you had Php100,000 to invest at the end of each year from 2008 to 2019, wherein your total investments would also amount to Php1.2 million, the value of such investments would amount to Php2.2 million if you go by the PSEi and Php2.6 million if you go by the PSEi TRI. The implicit effective annual returns will even be much higher at 8.71% under the PSEi and 11.21% under the PSEi TRI.

Of course, people with a trader's mentality will say that they can probably outperform if they just time the market. The problem with timing the market is that the probability of hitting the right buy and sell prices is exceedingly small.

You will know when a stock price is at its highest after the fact simply because you will need the subsequent day's stock price to confirm that conclusion. By then, you will have missed selling at that supposed high price. By the same token, you will need the subsequent day's price to confirm that indeed a certain stock price is the lowest. By then, you will have missed buying at the supposed low price.

That is why advocates of cost-averaging say that instead of trying to do the impossible, why not just do it the easy way by buying a fixed amount periodically. If your holding period is long enough (i.e. at least 5 years), chances are you will withdraw part if not all of your investments at a greater profit.

It is also said that when it comes to investment performance, 92% of the time is it generated by asset allocation, 5% of the time by security selection, 2% of the time by timing, and 1% of the time by sheer luck. That is why they say, "Time in the market is much more important than timing the market."

One last thing, if your income is growing, do not just be happy with cost averaging. Grow your periodic investments as fast as your income growth. That would be the wiser way of investing periodically.

Editor's Note

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Scam One, Scam All

The quickest way to find out if an investment offer is a scam or not is to check if the company has a secondary registration license with the Securities and Exchange Commission (SEC) to sell investment securities to the general public.

When a company is registered with the SEC, it automatically gets its primary license. But that license only allows the company to do regular business. If that company intends to sell investments to the general public, the law requires that the company apply for a secondary license to register such securities. The implementing rules of the Securities Regulation Code state that:

"No securities shall be sold or offered for sale, or distributed by any person or entity within the Philippines unless such securities are duly registered with the Commission through Form 12-1, and the registration statement has been declared effective by the Commission except of a class exempt under Section 9 of the Code or unless sold in any transaction exempt under Section 10 thereof and these Rules."

The rules on exemption from registration are very strict and specific. Changing the term of the amount being solicited from investment to donation, for example, does not automatically change the nature of the transaction if what are being solicited are investments for all intents and purposes.

And even if the registration of the securities is approved by the SEC, such approval does not constitute an endorsement of the securities by the regulator. The investor must make his own determination.