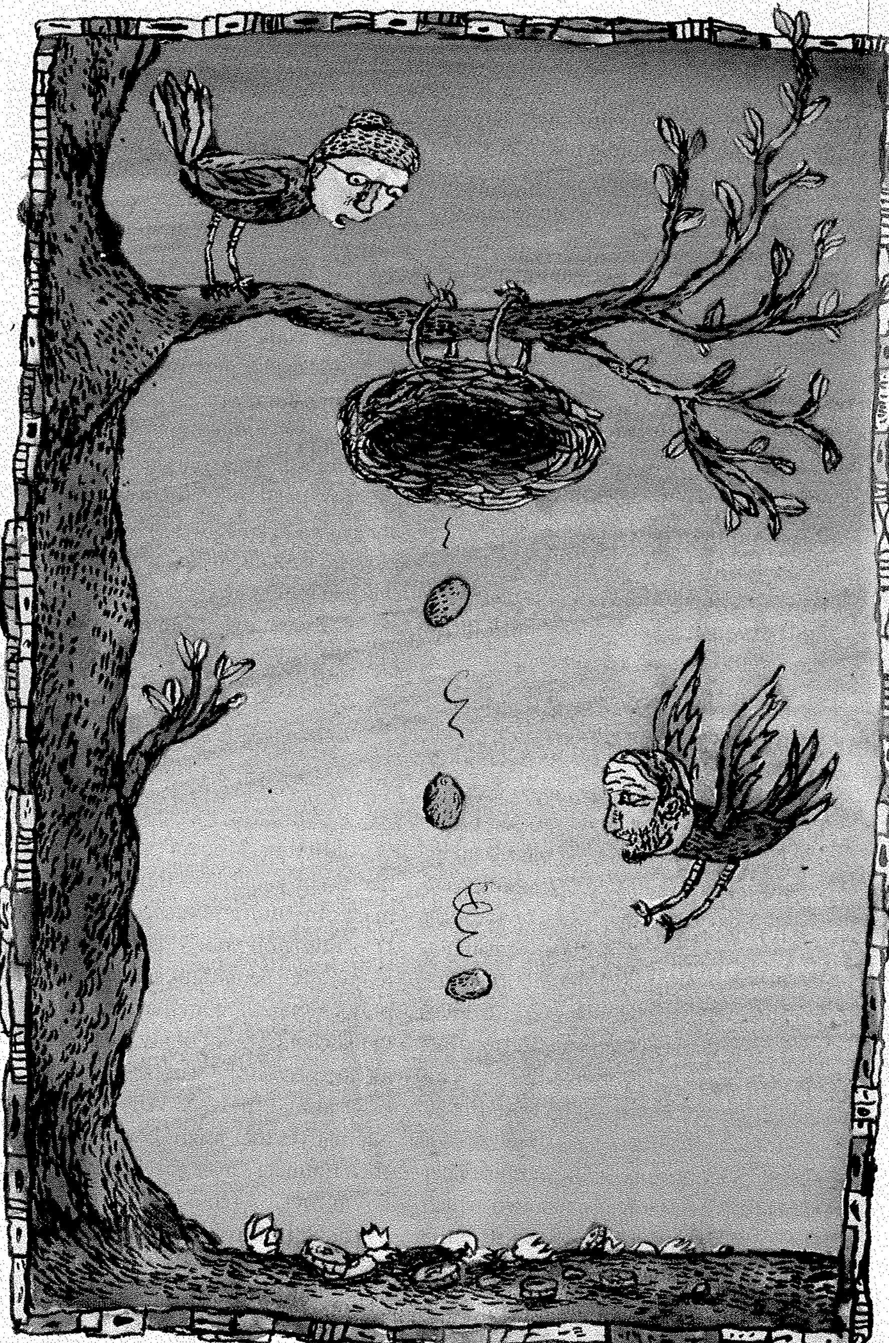
Damage Control

Here's what to do if your nest egg has been scrambled by the crash

by David Aston



A STOCK MARKET crash is a blow for any investor, but it can be devastating if you're a retiree. You depend on your nest egg to support your standard of living and your net worth has just taken a big hit. What do you do now?

Your first step should be to assess the damage. Opening your brokerage statements will create a sinking feeling in your stomach, but facing the music will make you feel better in the long run. If your net worth is still ample, you can breathe a sigh of relief. If your portfolio has shrunk to the point where it no longer meets your needs, you can begin planning what to do about it. Here are some possibilities.

Update your financial plan—or get one. If you're uncertain about your financial situation, it's time for your financial adviser to prove his or her value. Get your adviser to update your financial plan to reflect the new reality. Don't have a financial adviser or your broker doesn't do plans? Consider getting a fee-for-service financial planner to prepare one. While a good plan won't come cheap, the peace of mind you might get from it could prove invaluable.

Stop the bleeding. If your plan comes up short, don't panic. It's probably not as bad as you think. Categorize your expenses into basic needs (the must-haves) and discretionary expenses (the nice-to-haves). If you find that your portfolio covers your must-haves but not all your nice-to-haves, that's discomforting but not disastrous. "It relieves anxiety to be able to say 'Maybe it's not quite the lifestyle I want, but I am going to be OK'," says Karin Mizgala, a financial planner and educator with the Women's Financial Learning Centre in Vancouver.

If there is a gap between your income and your expenses, clamp down on your spending until you have a chance to think through the situation. You might be surprised how much difference a few economies can make. Tony Mahabir, a financial adviser with Canfin Financial Group in Oakville, Ont., points to the example of two of his clients, a Mississauga, Ont., couple in their early 60s who were about to retire with just enough money to cover their spending needs. The recent crash slashed the value of their holdings and created a $600-a-month gap between their needs and their means, says Mahabir. The couple discovered they can cut $300 a month by reducing restaurant meals, gifts and vacations, as well saving insurance on a second car by parking it in their garage for the time being. They'll see if markets recover before making longer-term changes.

If the gap between your needs and your means can't be easily resolved, start rethinking how you live. You're likely to find that many nice-to-haves, and maybe even some of your must-haves, aren't so necessary after all. Mizgala gets new clients to

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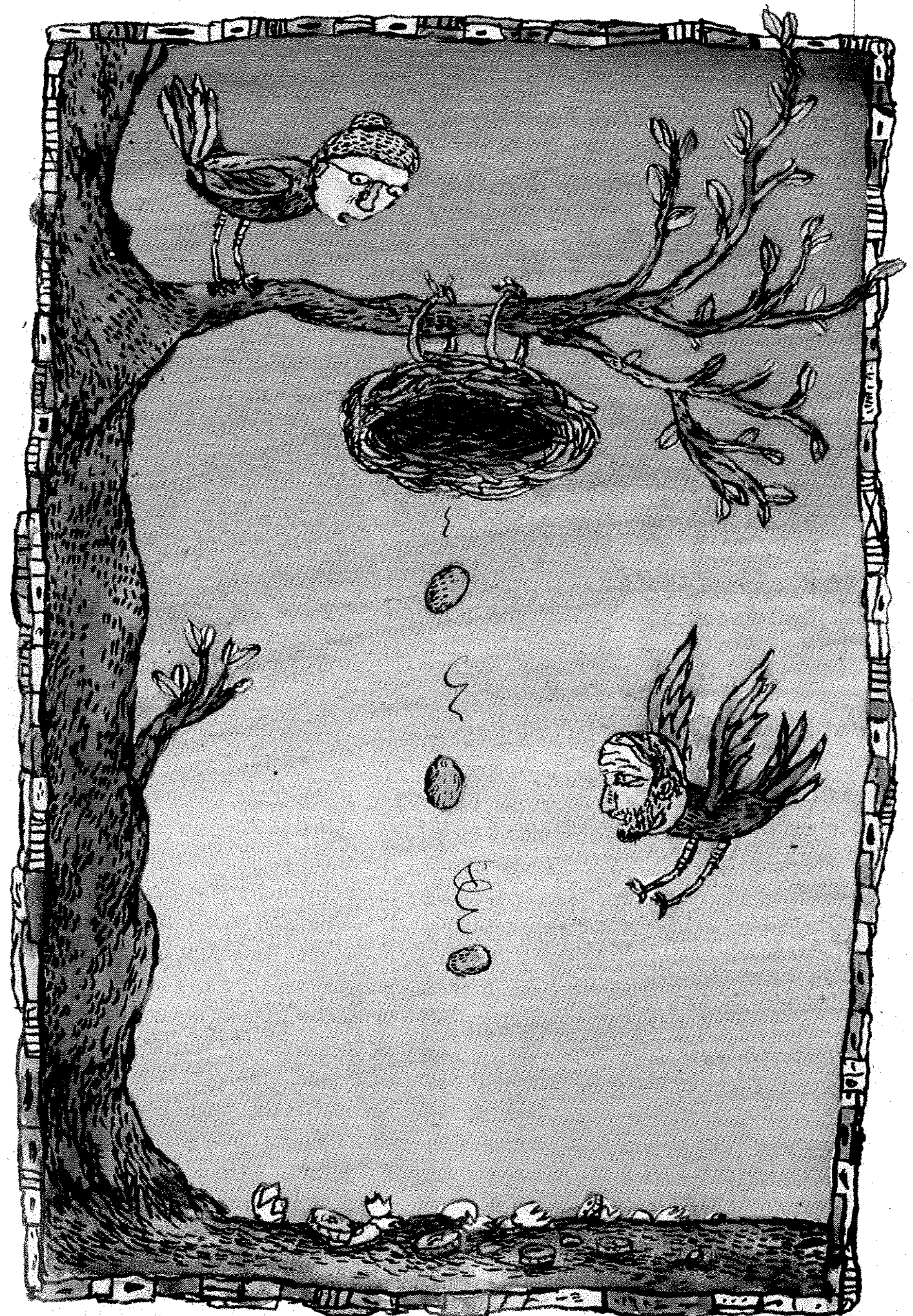

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If the gap between your needs and your means can't be easily resolved, start rethinking how you live. You're likely to find that many nice-to-haves, and maybe even some of your must-haves, aren't so necessary after all. Mizgala gets new clients to fill out a questionnaire, which includes questions about what they would like to do if money was no object. Surprisingly, most of the answers turn out to be non-material things, such as volunteering, and taking courses in art and music. "Maybe this is a chance to focus less on the material," she says. You can save thousands of dollars a year by selling a second car. You can also take cheaper vacations, cut back on golf, curb gifts, and have family dinners at home instead of at a restaurant. Chances are that these economies will affect your happiness less than you think.

Work part-time. If you're still relatively young and healthy, consider finding part-time work that you also enjoy. Use those earnings to help pay the bills until your portfolio has time to recover.

Part-time work provides benefits, such as social contacts and stimulation, that go beyond money, says Wayne Taylor, a financial planner with Taylor Financial Group in Edmonton. "You shouldn't sit around and be a couch potato," he says. To keep active, Taylor's retiree clients work at a huge range of jobs: developing training programs for financial advisers, driving empty trailer units between Edmonton and Ft. McMurray, serving customers at a home renovation store, selling cars, and working at a greenhouse.

Even a bit of part-time work can make a big difference. Teresa Black Hughes of Solguard Financial Ltd./PEAK Securities Inc. in Vancouver has been advising a couple in their mid-60s who made a poor investment in a small business. They had been planning to work part-time for three years in retirement to help rebuild their finances. As a result of the recent crash, they will need to keep working an additional one to two years to get their finances back on track. That will be a chore, but it is not a huge penalty to pay for suffering through a major stock market crash.

Practice patience. Most portfolios aim for some long-term balance between stocks and fixed-income investments such as bonds and GICs. For example, some retirees choose a 50-50 asset allocation—in other words, half stocks and half fixed income. But the market crash is likely to have knocked this careful balance awry. Since stock prices have been hammered, your holdings of stocks will probably make up a far smaller part of your portfolio than before.

For the time being, that's fine. It makes sense to satisfy your cash needs by selling down the GIC or bond part of your portfolio. That will give your beaten-down stocks a chance to recover.

You may eventually consider getting back to your target asset allocation by rebalancing—in other words, by selling some of the fixed income portion of your portfolio and buying more stocks. However, most retirees should err on the side of caution. Given the huge uncertainties out there, rebalancing your portfolio now is only for braver investors. More cautious investors should wait until the market has settled down.

Balance risk and reward. You've now seen the fury of a full-scale stock market crash. How do you know if it makes sense to stay invested in stocks? How do you know when it's safe to put some money back in?

Reading a bit of stock market history can help put things into perspective. You'll find that crashes are more common than you may think, but rebounds always come eventually. The best long-term combination of risk and reward comes from maintaining a balanced menu of investments—a mixture of stocks as well as fixed-income investments such as GICs and bonds. Stocks have historically provided the best long-term returns, but are risky. In contrast, fixed-income investments offer lower profits, but are a lot more dependable.

Experts generally recommend that retirees keep no more than half their money in stocks and ride out the market swings. But that assumes you can patiently wait for a market recovery at an unknown date. Only you can assess whether this general advice works for you. Are you still OK with taking risks with stocks? Can you still afford to take those risks? Can you afford not to? Many retirees with limited resources face a real dilemma—the more they need the higher long-term returns that stocks can deliver, the less they can afford to take on the risks that go with stocks.

Consider the case of a single woman in her mid-70s who lives in a Toronto suburb. Her finances were already stretched before the October crash. She relied on income from her $70,000 investment in a balanced mutual fund to top up what she received from government pensions and annuities, says her financial adviser, Sailesh Raythatha of Investment Planning Counsel in Mississauga. The woman had already tightened her expenses over the years and regarded spending of about $3,000 a month as essential.

Then came the October crash. The value of her balanced fund tumbled to about $60,000. She and Raythatha realized that she would probably be better off in the long run sticking with the balanced fund and giving it a chance to recover. But with a potential recession looming on the horizon, there was a distinct possibility that stocks could drag her balanced fund farther down for a long time.

There was another option—she could convert her nest egg to GICs. This would

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provide much greater safety, but the modest returns would probably be too low to allow her to maintain her current level of spending past her mid-80s, according to Raythatha's calculations. She faced a strong chance of outliving her savings. So should she risk further declines with the balanced fund or go with the inadequate but safe returns from GICs?

In the end, she chose to follow Raythatha's recommendation and convert to GICs. "It was a tough decision," says Raythatha. "I didn't want to advise her to take the risk that her portfolio might go down another 10% or 15%." Fortunately, her client also owns a house worth about $200,000 that she can tap into as a last resort if she runs out of investment money. In a case like this, there is no perfect answer. But by working through the numbers, you can assess just how much risk you are prepared to take on. ■

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