FINANCIAL FACELIFT

How can this student start a socially responsible investing portfolio with her savings?

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Laura.

FRED LUM/THE GLOBE AND MAIL

Just 20, Laura already has a clear idea of what she wants when it comes to education and finances. "I will complete my undergraduate degree this year with no debt and would really like some guidance on how to build an ethical-sustainable investment portfolio," Laura writes in an e-mail. "As a university student who works part-time but also has financial support from my parents, I recognize that I may not necessarily fit the target demographic [for a Financial Facelift]," Laura writes. "That being said, I think it would be really helpful for younger readers to understand how they might start investing and how to best prepare for financial independence."

After she graduates this fall, Laura plans to travel in Europe once restrictions are lifted and work for a year or two in London before continuing on with her higher education. Her ambition is to get a masters degree from Harvard, and work experience is an admission requirement. "I would only go if offered financial aid or a scholarship," Laura writes.

Laura has been working two part-time jobs during the school year and full time in the summers. This, and financial help from her parents, have enabled her to save $35,000.

We asked Barbara Knoblach, a certified financial planner at Money Coaches Canada in Edmonton, to look at Laura's situation.

WHAT THE EXPERT SAYS

Laura wants to enter the combined Master in Business Administration/Master in Public Policy program at the Harvard Kennedy School, which comes with a price tag of more than $200,000, Ms. Knoblach says. When Laura graduates, "she expects to bring in above-average earnings," the planner says. "She would like to be financially free early in life and has set a target of $2-million as a retirement nest egg."

Laura has already done well with her finances. On an average net monthly income of $1,333, she has expenses of $460 a month. Laura's parents pay her rent and undergraduate tuition. "Laura will therefore be able to graduate free of debt," the planner says. Laura sets aside about $875 a month for savings. "In other words, she maintains a savings rate of 65 per cent of her after-tax income!"

By depositing the entire $35,000 in her TFSA, Laura inadvertently overcontributed, the planner says. "She only turned 18 in 2018 and so had contribution room of $23,500 ($5,500 for 2018 and $6,000 each for 2019, 2020 and 2021)." Laura should immediately withdraw any

funds over and above the $23,500 contribution limit. "The Canada Revenue Agency may otherwise impose a penalty of 1 per cent per month on the amount of excess contribution," she notes. In Laura's case, this would be $115 a month on an overcontribution of $11,500.

Now for the investing. Up until recently, socially responsible investing (SRI) was a niche market fraught with above-average investment costs that often translated to a subpar performance, Ms. Knoblach says. "As this investment style is now going mainstream, it is possible to pick from a variety of different products that fall within the SRI spectrum," she says. Laura could invest her money in SRI-themed mutual funds; use an online portfolio manager or robo-adviser, offering exchange-traded funds that are screened for environmental or social impact; or start building her own portfolio of individually selected stocks or ETFs.

"Because Laura is new to investing, I recommend a hands-off approach at first," the planner says. "A robo-adviser will fit her initial requirements nicely." Laura will be required to answer questions assessing her risk tolerance and time horizon to determine what type of portfolio is best suited for her. Then she can open a TFSA account and transfer the $23,500. "Because of her young age and lack of debt, I recommend that Laura select a growth portfolio."

Ideally, Laura should fill up her TFSA contribution room at the start of each year. This ensures that her investments will compound in a tax-sheltered environment as long as possible. If Laura moves to Britain after graduation, she will not get more TFSA contribution room while she is a non-resident. Laura can keep the TFSA open and let the funds grow, but she will only be able to resume TFSA contributions once she re-establishes residency in Canada.

Laura has an additional $11,500 that does not "fit" into her TFSA. "I recommend that she maintain at least $5,000 in cash, which can serve for emergencies," the planner says. The money should be deposited in a high-interest savings account at an online bank. Any funds over the $5,000 amount should be invested in accord with Laura's preferences for SRI investments. The easiest thing would be to open a non-registered (taxable) account at the robo-adviser and invest any funds exceeding the TFSA limit, minus her emergency funds. "It is not recommended that she start making RRSP contributions at this time because her earnings are too low to provide her with a significant tax refund," Ms. Knoblach says.

Laura has set aside $5,000 for her intended trip to Britain and travel abroad. Once she has a firm timeline on her move, she should save up an additional $5,000 in cash, the planner says. Laura would then have about $10,000 in cash available for travel and as an emergency backup.

Working in London will enable Laura to save for her graduate studies. She expects to earn the equivalent of about $50,000 a year. As well, she plans to apply for financial assistance from the school itself. She may also get some financial help from her family. “If Laura can keep her overhead low, she could save a substantial sum,” Ms. Knoblach says.

Laura will have to set aside most of her earnings in a taxable account because she won’t have any more contribution room in her TFSA until she returns to Canada. “Because she will have to use a good portion of these monies for her education, she should adopt a more conservative approach for investing the funds earned during these years,” the planner says. She recommends Laura invest no more than half the money she saves while working in London in equities. “Once Laura begins the [graduate] program, she should always have sufficient cash put aside to cover her expenses for any rolling 12-month period,” Ms. Knoblach says. This way, Laura will not risk having to sell stock holdings during a market downturn.

A final recommendation is that Laura never fully deplete her savings. If she can hold onto the funds deposited in her TFSA this year and let them compound at a rate of 7 per cent a year – not unrealistic for a growth-oriented portfolio – without ever making any additional contributions or withdrawals, Laura’s initial $23,500 will have grown to $380,000 by 2060, the year she turns 60, the planner says.

If Laura could continue to make TFSA contributions of $6,000 a year all the way to age 60 – without ever making a withdrawal – her TFSA alone could grow to $1,571,000 by then. Adjusted for an annual inflation rate of 2 per cent, this lump sum would provide Laura with purchasing power of $712,000 in today’s dollars, the planner says.

“Given her earning potential, it is unlikely that Laura will only be making TFSA contributions,” Ms. Knoblach says. “The above calculations show the power of starting early and letting compounding do its job. Laura will have a good head start in reaching her $2-million retirement target if she can hold on to these early savings.”

CLIENT SITUATION

The person: Laura, age 20

The problem: How to begin building a socially responsible investment portfolio with her $35,000 in savings.

The plan: Open a TFSA at an online portfolio management firm and deposit the maximum allowed. Open a second account for non-registered or taxable investments. Keep $5,000 in a high-interest savings account for emergencies.

The payoff: A solid foundation for whatever the future brings.

Monthly net income: $1,333

Assets: TFSA $35,000; GIC $500. Total: $35,500

Monthly outlays: Utilities $60; groceries $300; dining out $100. Total: $460

Liabilities: None

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