Russell Investments

Longevity Risk

Canadians are living longer and longer. Most of us will likely see our 80th birthday and a growing number of us are expected to live to 100. And while many of us do plan to keep working well after turning 65 — or even indefinitely — the majority are looking forward to some form of retirement when we hit our 60s.

That means we need to ensure that the nest egg we accumulate over our working life lasts long enough to support us through 30 or even 40 years of retirement. This has become even more important as many of the companies and organizations we work for are moving away from defined benefit plans, leaving it on us to know how and where to invest our savings.

No matter what kind of a portfolio we have built – whether it is in high-growth equities, Guaranteed Investment Certificates, a balanced selection of bonds and dividend-paying companies or even gold coins in a box under the mattress – all of us face one common risk: longevity risk.

Longevity risk is the risk of outliving your savings. One of the biggest fears retirees have is running out of money in their old age. Benjamin Franklin once famously noted that nothing is certain except death and taxes. The TIMING of death, however, is quite uncertain.

That's why it's so difficult to plan for your retirement: none of us knows exactly how long we will need our nest egg to last.

According to Statistics Canada, average life expectancy in Canada is projected to have risen by 2031 to 81.9 for males and 86.0 for females. This is significantly higher than it was only a few years ago, as you can see from the chart.

The steady increase in life expectancy over the past centuries has been attributed to improved nutrition, better hygiene, access to safe drinking water, effective birth control and immunization and other medical interventions.

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Life expectancy at birth *(in Canada)*

CANADA	MALES (YEARS)	FEMALES (YEARS)
1920 to 1922	59	61
1930 to 1932	60	62
1940 to 1942	63	66
1950 to 1952	66	71
1960 to 1962	68	74
1970 to 1972	69	76
1980 to 1982	72	79
1990 to 1992	75	81
2000 to 2002	77	82
2007 to 2009	79	83

Source: Statistics Canada, CANSIM, table 102-0512 and Catalogue no. 84-537-XIE.

In fact, Statistics Canada says an increasing number of Canadians are reaching the age of 100. According to the 2011 Census, there were 5,825 people aged 100 years and older, compared to 4,653 in 2006 and 3,795 in 2001.

By definition, half of the population will live longer than their life expectancy, which means they will underestimate how long they will need their savings to last.

To ensure your retirement portfolio remains "sustainable" throughout your lifetime, you need to keep in mind the following three factors:

- **rate of spending** – the withdrawals from the portfolio
- **rate of investment return** – the returns achieved by the portfolio
- **life expectancy** – your remaining lifetime

There are a number of other issues that will also need to be considered: taxation, inflation, and the cost of health care, all of which can impact the sustainability of your nest egg.

What can you do?

Purchase an annuity. An annuity is an insurance contract that guarantees a fixed retirement income, meaning you'll know exactly how much income you'll receive each month for life. However, this benefit can come at a price. First, your income is based on the prevailing interest rate when you sign the contract. Even if interest rates rise – or the cost of living increases – your monthly income stays the same. Second, while you are protected from any future market declines, you are also prevented from participating in any upward growth in the market. Finally, you can't take out lump-sum amounts for unforseen events. These restrictions may make annuities a less than ideal retirement income choice for many investors.

Build a yield-focused portfolio. Adding securities that offer yield such as dividend-paying equities, preferred shares, infrastructure, Real Estate Investment Trusts (REITs), and a variety of bonds including corporate debt, to a portfolio can help provide ongoing income while leaving principal generally untouched. However, the current low-yield environment may not give you the level of income you need. And buying higher-yielding securities (such as Emerging Markets debt or high-yield bonds) comes with higher risks than more traditional fixed-income securities.

Opt for a Total Return strategy. A Total Return approach focuses on the overall return of an investment portfolio — including capital appreciation, dividends and interest — in order to provide income.

A Total Return investing approach is arguably more transparent than a yield-focused portfolio and allows for greater diversification. While positive returns are not guaranteed, a qualified investment advisor can recommend appropriate changes in asset allocation to respond to changes in the market environment.

This strategy allows you greater flexibility, not only in the types of securities you can choose, but also in choosing the type of income you want — dividends, interest, Return of Capital, and capital gains (or losses) which can help you manage your tax liabilities.

Dial down your spending. This is an effective but not always palatable option.

For more information on how Russell Investments can help you pursue your investment goals, please ask your advisor or contact us at 1-888-509-1792 or visit us at russellinvestments.com/ca

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Date of first use: June 2014. Revised: September 2016. // RETAIL-2015-07-30-1379 (EXP-08-2017)