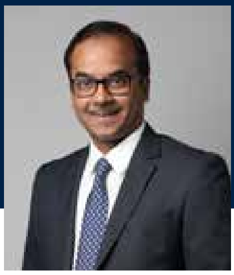
PGIM India Mutual Fund

How do I arrive at my Retirement corpus number?



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In my last letter, I had mentioned about thumb rules that are useful for getting a sense of various aspects of a financial plan. I hope to cover a few more of these thumb rules related to planning your finances. One caveat though is that each individual is unique and it is difficult to generalise a subject like this. Meeting and appointing a qualified financial advisor for your specific needs would always be my first recommendation.

Thumb rules are meant to help give a broad and simple direction in approaching the subject. In this letter I intend to cover thumb rules applicable for an often ignored aspect of financial planning i.e. retirement.

Over the last few decades, we have witnessed quite a few changes that have impacted the way individuals traditionally approach the retirement phase of their life. The biggest impact has come from transition from joint families to nuclear families that took away the safety net of joint income. Even within nuclear families, increasingly the parents do not wish to depend on the children in the post retirement phase for financial needs, at least in the larger metros. There is also a rising trend of individuals who want to retire early to pursue their interests, hobbies or calling. Most importantly, nobody would like to compromise on their lifestyle post retirement, though very few jobs today have the benefit of a robust pension post retirement. These factors together are slowly bringing in the concept of retirement planning by building a corpus that will act as a safety net.

This corpus serves as the source of primary income post retirement. A question that is often asked is - How much is enough to retire? While there are elaborate financial planning exercises to arrive at the same, for an individual without an outstanding loan at the time of retirement there is a simple thumb rule. The thumb rule suggests that 20 times the annual expenses adjusted for inflation is the corpus needed to retire.

To explain in simple terms, lets say you are going to retire in 10 years and your current annual expense is Rs. 9,00,000. Reported inflation in India has come down but can be estimated to be in the range of 5-6%. Your annual expenses adjusted for inflation would therefore rise to ~ Rs. 16,00,000 per annum by year 10 as cost of living goes up. At a projected annual expense of Rs.16,00,000 at time of retirement, using the thumb rule, the retirement corpus required would be 20 X 16,00,000 i.e. Rs. 3, 20,00,000.

One other question related to this is how much should one withdraw and how long would the corpus last. Internationally, the thumb rule for withdrawal is called the 4 percent rule. This means that in the withdrawal phase you should limit withdrawals to 4% of the corpus every year. The basic assumption is that the portfolio consists of equity as well as debt to take care of future inflation in the retirement years. If a discipline is followed, the corpus would last for 30 years. Of course if the investor wishes to leave behind some money for his family then the equation would change.

These thumb rules offer broad guidelines, to create simple investment plans to achieve specific financial goals. However there are other important aspects to take into consideration like the quality and consistency of the funds and other financial products that you have invested in, medical insurance, will creation etc So as mentioned earlier, it is best to consult an investment advisor to create a customised financial plan that incorporates various aspects related to your financial wellness.

Oftentimes retirement evokes a negative emotion for many people and for others its a happy second innings. By increasing your awareness of some of the financial math around it and especially with the help of a good advisor, you can take charge of this very important but often ignored aspect of your financial plan. A good starting point would therefore be to re-label this aspect as - financial freedom.

Happy investing.