

FINANCE : WEALTHY BOOMER



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Dr. Moshe Milevsky, a professor at York University, warns that employers are transferring longevity risk from their balance sheets to the personal balance sheets of their employees.

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The future investment income in all of us

It's time to find out: Are you a stock or a bond?



JONATHAN CHEVREAU
Wealthy Boomer

At age 41, Dr. Moshe Milevsky is arguably the most influential and prolific author of personal-finance books in Canada, if not North America. The York University finance professor has just published his sixth book, bearing the intriguing title *Are You a Stock or a Bond?* This time around, Milevsky is focusing on human capital or one's future earning capacity. In that sense, each of us is like a security that generates future investment income. An entrepreneur who can one day sell her business is more of a stock. A tenured professor such as Milevsky is a bond because he has a steady salary and a secure defined-benefit pension plan in retirement. Most of us are a bit of both, he says, making us the equivalent of balanced mutual funds. But few Baby Boomers will enjoy the bond-like pensions their parents had. The book begins by lamenting the decline of traditional employer-sponsored DB pension plans. Companies are moving away from providing pension in-

gains in longevity have made the pension promise too costly. He notes there are now 5,000 Canadian centenarians, while the oldest pensioner at General Motors was 110 in 2006. Milevsky includes a chart that shows GM has 320 retirees per 100 workers. Compare that to Toyota, with just two per 100. Thus, "Generous Motors is not really a car manufacturer but a pension-fund and health-care provider for its retirees," he writes. Little wonder that GM, IBM and other corporations are scaling back on the pension promise to new hires. In effect, employers are transferring longevity risk from their balance sheets to the personal balance sheets of their employees. Increasingly, workers are on their own when it comes to generating income in retirement. Milevsky is quick to disabuse those who think market-sensitive defined-contribution pensions, RRSPs or (since the book is also aimed at Americans) IRAs or 401(k) plans are pensions. "A 401(k) is a number, not a pension," he says. That's why Milevsky subtitled his book *Create your own pension plan for a secure financial future*. Once you've decided whether you're a stock or a bond, you estimate your total financial and human capital. Even if you're in debt and have no savings, if you're young and healthy, you still have a major human

productivity and earnings potential, worth potentially millions of dollars. As Scotiabank argues, "you're richer than you think." For most of us, human capital will be the biggest asset we have until well into middle age. Over the decades, this will gradually fall but should be converted into financial capital. This perspective sheds new light on all aspects of our financial lives. It means spending on education should be viewed as an investment, while life insurance becomes a hedge for our human capital. (Hence, insurance is critical for the young, when human capital is high and financial assets low; it's also essential for highly paid young athletes.) It also means debt may be "good at all ages," Milevsky

Earlier in his career, Milevsky was viewed as a skeptic on variable annuities. But he has softened his stance: "I can no longer claim that you are being overcharged for their guarantees or that you can achieve similar goals at a lower cost." The penultimate chapter, *Product Allocation is the New Asset Allocation*, will challenge even knowledgeable financial advisors and do-it-yourself investors who think they know everything about generating retirement income. He identifies three main risks facing retirees: longevity risk, inflation risk and market risk. He then focuses on three main goals: liquidity, investor behaviour and estate planning. Finally, he devises three major categories of financial and insurance products that handle these risks in different proportions: income annuities; systematic withdrawal plans from mutual funds or ETFs; and variable annuities with embedded guarantees (think Manulife Income Plus). This section is not easy reading, but Milevsky sugarcoats it with case studies. His bottom line is most retirees will "not be able to finance a sustainable retirement income with only one or two traditional product classes, basic mutual funds or conventional income annuities." Individuals need to work with financial advisors to design the optimum mix of these three product categories and the gist of the task is to "diversify across products and across time." The first of Jonathan Chevreau's three video interviews with Dr. Milevsky is now online at www.wealthy-boomer.ca.

Financial Post