CFA Montréal

INVESTMENT PRINCIPLES

INFORMATION SHEET FOR CFA PROFESSIONALS

WHY SAVING IS IMPORTANT

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IMPORTANT NOTICE

The term "financial advisor" is used here in a general and generic way to refer to any duly authorized person who works in the field of financial services, including the following:

- Investment brokers
- Mutual fund brokers
- Scholarship plan dealers
- Exempt market dealers
- Portfolio managers
- Investment fund managers
- Life insurance agents
- Financial planners (F.Pl.)

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WHY SAVING IS IMPORTANT

We save for two reasons. First, life is full of unpleasant uncertainties. For example, 80% of adults will struggle at some point in their lives with joblessness or near poverty issues. An emergency fund can make all the difference when a person is trying to live through a difficult situation and facilitate a transition. Second, we must plan for many circumstances. We may have important life goals that we want to achieve, such as funding our children's higher education or preparing for a comfortable retirement. In the end, saving is about managing current consumption to fund future consumption. It is a great challenge because our social environment constantly tempts us to spend as much as we earn and to take on more debt than necessary. Spending is easy but saving is hard; and, as with any good habit, getting started is the toughest part.

SAVING FOR EMERGENCIES

None of us want to think about the possibility that we could be out of a job, encounter a medical emergency or face unexpected expenses, such as helping a family member in need. Despite the social safety nets designed to help with some of these circumstances, such as unemployment insurance, they are often not enough and not timely enough. We should avoid having to borrow to cover living expenses. At a minimum we must have the ability to cover three to six months of living expenses to deal with life's unexpected and unfortunate challenges.

SAVING TO MEET IMPORTANT LIFE GOALS

Saving for emergencies is essential but it is still a minor part of our overall financial needs. We must also prepare for several life goals to enhance our future quality of life and that of our loved ones. This process is more complex than building an emergency fund because it requires a planning effort that can extend from several years to several decades. For example, we may save to accumulate a down payment on a house, fund our kids' higher education, or plan for a comfortable retirement. Saving for retirement requires the most extensive planning, for the following reasons:

- It is usually the most expensive goal to achieve;
- It is often the most distant goal. It can begin as much as 35 years before retirement. Furthermore, appropriate planning is still required after retirement, a period that can last more than 20 years;
- There is significant uncertainty in terms of investment returns on our capital during this entire period. Individuals who started saving in the early 1980s benefitted from a favourable return environment for nearly 20 years, but it has been more challenging for those who started saving in the 2000s;
- Life expectancy is uncertain. Retirement planning must account for the possibility that we may live much longer than the average life expectancy. Furthermore, the level of financial need will be affected significantly by our health, which is almost impossible to foresee;
- Other intermediate goals, such as funding higher education, compete for each dollar of savings.

Retirement is an expensive goal, so it requires a more aggressive investment portfolio than would usually be appropriate for short-term goals. Otherwise, the amount of savings required to achieve a comfortable retirement can be substantially and unnecessarily higher. That being said, because the planning horizon extends over several decades, a riskier portfolio is financially tolerable if the investor can sustain the anxieties caused by losses over the short or medium term, especially if risk mitigating strategies are incorporated. Without a doubt, a well-managed financial plan greatly improves the odds of achieving our goals and helps manage our anxieties.

We save partly because we cannot predict with certainty. We simply cannot forecast all future circumstances. Furthermore, we cannot save appropriately if we do not have the discipline to do so. A good step toward achieving the required discipline is to better understand the importance of planning for the future and the consequences of not doing so. Despite the importance of this matter, the great majority of individuals are ill-equipped to deal with financial issues. For many, retirement is such a faraway eventuality that they simply do not care enough. They are making a huge mistake. The documents that follow are meant to demystify the challenges of saving and investing for retirement and show how you can do it better while avoiding common mistakes.