VALUE *investor*

BY J VONG

DIY YOUR RETIREMENT PLANNING

WHEN it comes to investing, certain theories, guidelines and principles applicable are evergreen. Let's consider those that are applicable to investing for retirement, along with a formula that you can use to plan your nest egg.

The first and obvious guideline is to identify how much you will need when you are no longer able to earn an active income. The simplest way to do this is to estimate your expenditure in the future, and any possible emergencies. Some emergencies should be covered by insurance. Then, factor in inflation. This final amount that you need (per month or per annum) must be funded by a passive income stream that should not require a lot of effort or monitoring on your part.

As a general rule, a return of 8% to 10% per annum in passive income provides reasonable purchasing power in today's terms. Thus, a RM100,000 investment can yield RM8,000 to RM10,000 per annum in terms of income. An investment amount of RM500,000 can give a retiree passive income of RM40,000 to RM50,000 after an initial moratorium period of three years. But, how do you find this elusive 8% to 10% per annum?

There is the option of financial products that offer passive income. The problem with most of them is that returns are low (negative to 6% per annum) and your money is locked in for a considerable period of time. This is clearly not ideal. Another option are unit trusts. But it is difficult to select a fund and identify the right time to switch or sell. Furthermore, most unit trust companies have a patchy record of generating adequate returns.

A DIY FORMULA

For every RM100,000 that you put in as an initial equity investment, you must ensure that it will bring in the needed income. To do this, use the 35/65 rule for diversifying your investment. Place RM35,000 in an equity investment account that targets a 10% net return annually and the remainder of RM65,000 in a property investment that can yield 7% net per annum (most probably a real estate investment trust [REIT] as the amount invested is quite small).

Based on the initial investment and ignoring compound returns, you will earn RM3,500 (10% x RM35,000) from your equity investments annually and RM4,550 (7% x RM65,000) from your REIT. Thus, your annual return will be RM8,050 per annum for one year and RM24,150 in total over three years. Add the three-year return of RM24,150 to your initial investment of RM100,000 and you will have RM124,150 (RM45,500 in your equity investment account and RM78,650 in your REIT).

After three years, again on a non-compound basis, you will earn RM4,550 per annum on your equity investments (10% of RM45,500) and RM5,505 per annum on your REIT (7% of RM78,650). This will give you an annual return of RM10,055 thereafter or RM838 a month for you to draw down from your portfolio.

By using this formula, if you want a monthly income of RM3,000, you need to invest RM358,000 initially. An initial investable sum of RM500,000 can generate a monthly income of RM4,190.

The above returns are based on assumptions on certain market conditions, general interest rates and economic growth. The assumptions for returns will change over time and will need to be adjusted. However, the format and arithmetic principles for computing your returns do not change. And, if you are more skilful, you can of course modify the parameters to suit your risk appetite for higher or lower returns.

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