Core Capital & Surplus Management

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Associate Portfolio Manager: Sarah Anderson, CFA

Thinking Beyond Retirement Funding

Can you confidently estimate the total amount of funds that you need in your investment account today in order to support your future retirement? The majority of individuals must answer "no." The reality is that most people are unable to do this due to the inherent complexity of not only estimating the future, but also converting the amount back into present dollars.

Why is this an important topic in the first place?

Simply put, we live in a society that revolves around the accumulation of wealth. The more the merrier: efficiency, optimization, and growth are the primary goals for all individuals that seek to possess a strong financial position. But to what end? Without a holistic understanding of your goals and lifestyle needs, it is nearly impossible to know whether you are over or under saving.

While it is a great privilege to be in such a position, overfunding for retirement can be harmful, especially for those who do not have goals of leaving an estate behind. This accumulated excess wealth could be otherwise used to upgrade an individual's current quality of life—purchasing a brand-new car to replace your old model or finally taking your dream vacation. Although saving is an important practice, it is not more important than avoiding unnecessary reductions to your current quality of life.

As mentioned earlier, the solution to this dilemma is not a simple one, and that is exactly why we must preface by highlighting the importance of a wealth manager when considering this approach. Your wealth manager will work with you to explore your own unique situation, goals, and financial journey. The assumptions that need to be made for this approach are complex in nature and require expert justification.

Core Capital: the Minimum to Maintain

In the simplest form, Core Capital is the minimum invested amount that an individual needs today in order to maintain their quality of life in retirement.

Maslow's Hierarchy of Needs is a theory of motivation that suggests individuals are motivated to fulfill their basic needs first before satisfying any advanced needs. Maslow's framework is divided into three levels that form a pyramid. Each level in the hierarchy becomes progressively more aspirational, with fundamental needs at the bottom two levels. These fundamental needs are put in lower risk (less volatile) investment allocations.

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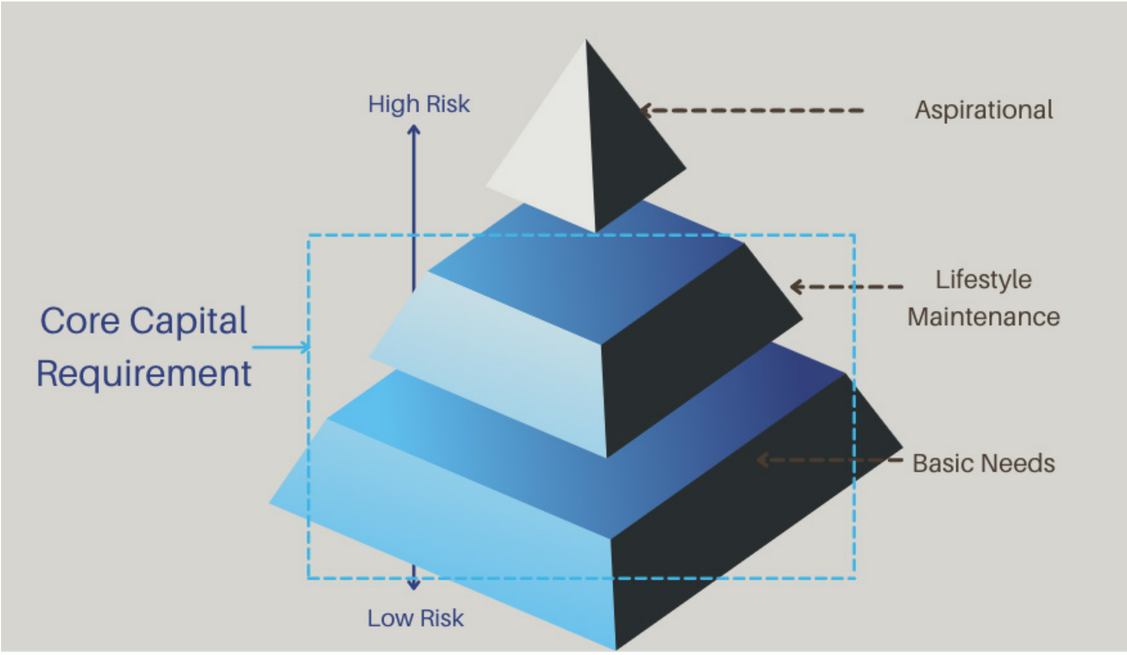


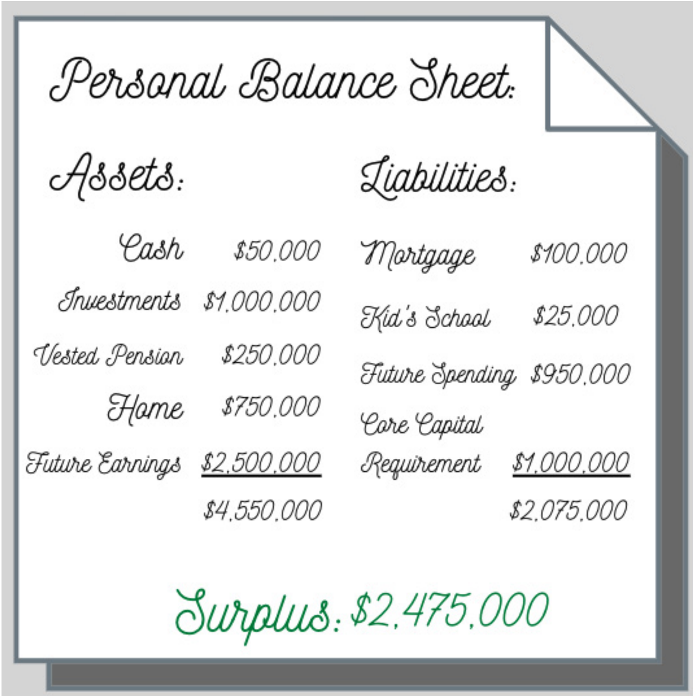
Core Capital encompasses not only an individual's basic needs like food, shelter, and clothing, but also includes the costs that maintain an individual's quality of life. These costs include vacation funds, gifts for children, maintenance of your property (or properties), and—depending on your lifestyle goals—an estate value.

It is important to highlight here that there are several expenses that you may currently have that will not be incorporated in your future retirement expenses. These can include mortgage payments, working expenses such as clothing and commuting costs, and daycare expenses. Most likely, these will not be relevant when you are retired.

How Does it Work?

Step 1

The first step in Core Capital Analysis is to clearly visualize and define your goals. What do you want your retirement to look like? Do you want to travel, do you want to upgrade or downgrade your home or living situation?



Step 2

Once you have defined your objectives, we can then analyze your current spending, taxes, and savings per year. By breaking your expenses apart, we are able to estimate what spending needs will remain in retirement. By "needs," remember that we are including all of the luxury costs you are used to today like dinners, shopping, vacations. We will also determine what will be irrelevant. Most people will have finished their mortgage payments before retirement or no longer need to incur work-related expenses. This step is important because if we assume that all your expenses will remain relevant in retirement, we will be causing you to over-save today. Pension plans and government income should also be considered when determining retirement income needs. You can read more about what we have to say on the Canada Pension Plan here.

Step 3

The third step is to create a holistic balance sheet. Although widely used as a tool for corporate accounting, it is also useful as a technique for determining an investor's risk capacity. A holistic balance sheet accounts for all liabilities, such as debts owing and Core Capital requirements, and all assets, such as your investment accounts and human capital. This tool not only provides an understanding of an individual's aggregate current and potential financial position, but also shows the total (if any) amount of surplus that an individual possesses.

The Problem of Leftover Capital

Simply put, surplus is the excess capital that an individual possesses once they have funded their liabilities and Core Capital needs. Individuals that possess a material amount of surplus can often be overwhelmed when it comes to managing their finances. They may have difficulty in establishing a true sense of confidence in their future liability projections. This is where a wealth manager comes in to assist individuals using financial planning techniques.

There are a number of options for investors who wish to give away their excess capital. Giving while living allows benefactors the ability to watch, firsthand, the impact that their wealth can have on loved ones and charities. Giving can be done vida charitable donations, providing loved ones with a living inheritance to fund the purchase of a new home, paying off grandchildren's student loans, or increasing an individual's current lifestyle.

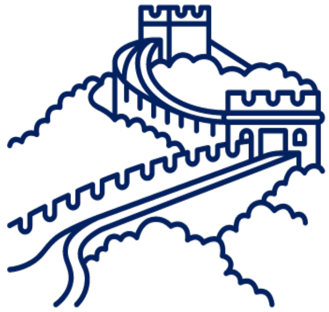
If you wish to donate to charity, there are techniques you can use to maximize the effect of your gift. Click here to discover how.

Surplus Techniques

Goals-Based Asset Allocation (GBAA)

GBAA involves setting aspirational goals by using the least amount of risk possible to meet defined objectives. Each goal will be invested differently, being assigned risk exposure that correlates with the desired level of confidence in success. Your Investment Portfolio Manager will be able to use statistical and quantitative methods to determine an estimated level of success.

For example, your core capital should be invested with a 90% statistical level of confidence. The higher the level of confidence means the lower the amount of risk you should be taking with the goal. However, you may have a goal to see the Great Wall of China in the next five years; your quality of life is not dependent on this goal, and you determine it to be “aspirational.” Therefore, a lower level of confidence and higher amount of risk is justifiable for this goal.



Surplus Optimization

Alternatively, individuals can implement the Surplus Management method. This technique does not involve defining aspirational goals. Rather, as opposed to GBAA, the entire portfolio is placed into a higher risk allocation (even your core capital). By doing this, we establish a threshold that the portfolio value can fluctuate above until risk-reducing intervention is needed. This essentially allows us to use the surplus to afford increasing our expected return for the portfolio as a whole (more risk equals more expected reward).

Individuals seeking to utilize the Surplus Management technique must have a **healthy tolerance for risk.** This method can prove to be detrimental to those that cannot handle market fluctuations.

In Conclusion...

When contemplating the implementation of one of these strategies or any other financial planning tactic, investors will benefit from the services of a Portfolio Manager. Unencumbered by alternative motivations, your Portfolio Manager will work with you to delve deep into your unique, personal circumstances and investment preferences, consider your specific financial goals, risk tolerance, and ongoing needs.

Our team at Qube is committed to providing you with a holistic, diversified, and personalized investment experience. If you would like to learn more, please contact us using the details below. Our team at Qube is committed to providing you with a holistic investment experience tailored to your unique financial hopes and obligations. If you would like to learn more about financial planning, reach out to us by email or call (780) 463-2688.