FINANCIAL POST

Retirement is decades away for millennials — and that's why now is the time to start saving

Danielle Kubes, Special to Financial Post
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Let's say you estimate you need $1 million to retire comfortably. If you start at 25, you'll only need to make annual contributions of around $8,280 at a five per cent annual return. If you don't start saving until 35, you'll need to contribute $15,050 every year! Fotolia

Retirement may seem ages away for millennials — and it is — but there's no better time to start investing for it than now.

Both the Registered Retirement Savings Plan and the tax-free savings account have their distinct benefits and drawbacks, but far more essential than which registered account you choose, is that you contribute to one (or both) sooner rather than later.

"The younger they are the more they should invest," says Ngoc Day, a fee-only financial adviser at Vancouver-based Macdonald, Shymko and Co. Ltd. "Time and compounding are their best friends."

Take $100, invested by a 25-year-old, that earns five per cent annually. By the time our young adult is ready to retire at 65, the funds will have grown to $704. The same $100 made by a 35-year-old will have only grown to $432.19 — about 63 per cent less.

Or, to put it another way, let's say you estimate you need $1 million to retire comfortably. If you start at 25, you'll only need to make annual contributions of around $8,280 at a five per cent annual return. If you don't start saving until 35, you'll need to contribute $15,050 every year!

"Even if you invest a small amount and do it consistently the compounding will do wonders for you," Day says.

Best of all, if you invest within either a TFSA or RRSP your money will grow completely tax-free — you would normally pay income tax on any investment you sold for a profit or on any dividends you earned. Tax-sheltered growth is by far the greatest benefit of registered accounts.

Another advantage both accounts share is that you can purchase almost any investment within them — GICs, bonds, ETFs, stocks etc. The real only reason you should be investing outside of a registered account, Day says, is if you've maxed them both out.

But if you only have enough room in your budget to utilize one account, the choice of which should primarily be based on your income and financial goals, not your age.

For example, lets say you earn $60,000 and have a federal tax rate of 20.5 per cent. If you contribute $100 of your paycheque every month to an RRSP stock-buying plan, not only will that entire $100 be compounding for you, you'll get a refund of $20.50 which you can later add to that contribution. But the same $100 in a TFSA or elsewhere will only ever be $100.

High-income earners may be better off putting money in an RRSP, Day says. When you contribute to an RRSP, you're essentially paying yourself before the government takes a bite out of your income. So not only do you have the full force of pre-tax dollars working for you, you can also deduct any contributions from your income, allowing you to pay less income tax in that year.

You'll eventually pay tax on the money in your RRSP (can't escape it!) but not until you retire and start drawing on your savings, when you'll hopefully be in a lower tax bracket. Of course, with such a long time horizon, it's hard to tell what your tax circumstances or the tax laws will be by then.

The TFSA, on the other hand, is great for lower-income earners who expect to earn a higher income in retirement. Since you've already paid tax on anything you contribute to a TFSA, any withdrawal is entirely yours to keep.

The TFSA may also be the better option if you prefer more flexibility, since there are no penalties for withdrawing money — an important quality for young people who have uncertain futures.

"If (people) have short-term goals like, for example, if they might buy a car, perhaps even go back to school in a year or two, or take more degrees, then the TFSA is probably better for them," Day says.

This flexibility can also backfire, however, if you start treating the TFSA like a savings account you can dip into, as opposed to a retirement investment vehicle. It may just be too easy to take funds out, unlike the RRSP, which penalizes you for early withdrawals outside set exceptions (buying a first home, for example).

Ultimately, one account may be slightly more suitable for you than another, but it's impossible to go wrong if you simply follow Day's advice: "Save as much as you can as early as you can."

Another reason you should start early, is that it's never been easier to invest. It may actually be easier for millennials than their parents, since so many new investing platforms are primarily online. If you're perhaps more gifted in the tech department than the investment know-how department, there are now a wide variety of options.

Robo-advisers and online discount brokerages, for example, both offer low-cost ways to invest that have low minimum balances, low fees and automated programs where a small percentage is painlessly shaved off your paycheque each week and deposited into an investment fund. They all offer the full spectrum of registered accounts, which you can sign up for easily online and link to your bank account through a void cheque, just like setting up a direct deposit. They also offer user friendly interfaces, apps and the ability to manage your money from your computer. Managing a registered retirement investment account can now be as easy as paying your monthly credit card bill, or emailing money to a friend.

Day emphasizes the importance of educating yourself no matter which route you take to save for retirement.

"The best investment is actually education. A person really needs to invest time to learn what's out there," Day says. "When you're young, that's the best time to learn."