HOW MUCH SUPER YOU NEED - & HOW TO WORK IT OUT IN JUST 15 SECONDS

It's official. We're living longer, just ask the government actuary. Women now have an average life expectancy of 86 years and men 81 years – the reasons for the difference between the sexes I'll leave you to ponder. The real significance in these ever-increasing numbers is that we now need to plan for at least 20 years in retirement!

Most of us have high expectations of a "holiday lifestyle" in retirement. For many this expectation is unlikely to be met because no plan has been implemented to achieve the goal.

The holiday lifestyle goal is achievable for most; it simply takes some strategic investment planning and of course financial discipline. However, one of the biggest hurdles for many of us is working out how much we need to accumulate to fund our retirement lifestyle. One of the most asked questions by clients has always been "How much do I need to retire on?"

In my view the helplessness felt by many investors on how to get a simple answer to this simple question has often been the reason that little or no thought has been given to implementing an investment plan to deliver the desired retirement lifestyle. It's just been too hard.

Of course, that's not to say that they haven't tried! I have no doubt they have been exposed to the computer–generated, spreadsheet–moulded, mind-boggling projections indicating that they will need $4million in 2012 to meet their retirement needs.

All this after they have meticulously filled out a questionnaire with 756 questions on every detail of their finances and present and future lifestyle needs, only to get back a similar 12cm computer-generated report – which tells them on pages 1-40 how old they are along with all the other answers to the 756 questions! Yep, it's just too hard – and what if a loaf of bread costs $2 million in 2012 anyway?

How much do I need in retirement? Is a simple question and there is a simple way to get a simple answer – in just 15 seconds or less. Here's how:

STEP 1: Assume you are retiring today
STEP 2: Guesstimate the annual retirement income you would like from today
STEP 3: Guesstimate what you believe is an achievable long-term investment return
STEP 4: Guesstimate what you think the long-term annual inflation rate might be
STEP 5: Subtract answer to STEP4 from answer to STEP 3 to get your after-inflation after-tax investment return
STEP 6: Divide your desired annual income by your estimated Real Rate of Return ie your answer to STEP 5

You may find working through an example helps. Let's keep the numbers easy so we can focus on the process – we will assume you would like an annual after-tax income of $50,000 and that this income must have the same purchasing power in 20 years time as it does today. You believe that an 8% per annum investment return is achievable over the longer term and that the inflation rate will remain under control at around 3% per annum (that's STEPS 1-4 out of the way!)

To calculate your estimated long term real rate of return just subtract 3%pa from 8%pa to get a net investment return of 5% per annum (the real rate of return simply makes sure that we are always talking in today's dollars – so that loaf of bread is going to always cost as much as it does today!)

We then divide your income goal by the real rate of return ie $50,000 divided by 5% or 0.05 and you discover you need $1 million. So there, you have your estimate of the capital you need to fund your retirement income – so now you can start developing and implementing your strategies to achieve your now clearly defined goal.

Just to summarise, if you have $1 million invested and you achieve an after tax and after inflation return of 5% per annum it will provide you with an annual income of $50,000 forever, while also maintaining your $1 million capital base. Obviously if you don't care whether you spend your capital you will need less. In "tech terms" you've just completed your first perpetuity calculation.

Remember that you said you would like $50,000 pa after tax and you may recall that from our last column that the effects of taxation on your investment returns can be quite significant.

In the past tax rates have been as high as 48.5%, you will need to earn a pre-tax investment return of over 7% pa from your investments after inflation to achieve your retirement income goal of $50,000. This is because you will pay around $20,000 in tax on income and will need to earn over $70,000 before tax to end up with your $50,000.

However, one way which has been made available to all Australians is the superannuation environment which allows people to invest in an environment where all earnings on your investment and income paid out of your investment to you are all tax free (this assumes that you have your money invested in an allocated pension after age 60).

Don't forget you need to add back the 3% inflation figure to arrive at your pre-inflation investment rate of return that you require to hit your income target (in our example the headline amount is 8%).

A key thing to recognise is that this return is bigger than the current cash rate, so investing the money in cash will not give you the return that you need.

Now that you know what you need it is up to you to start saving and building for your retirement. For strategies and ways to help you do this we always recommend the help of a fully qualified financial advisor to ensure that you are able to meet your financial goals.

Happy investing and good luck!

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