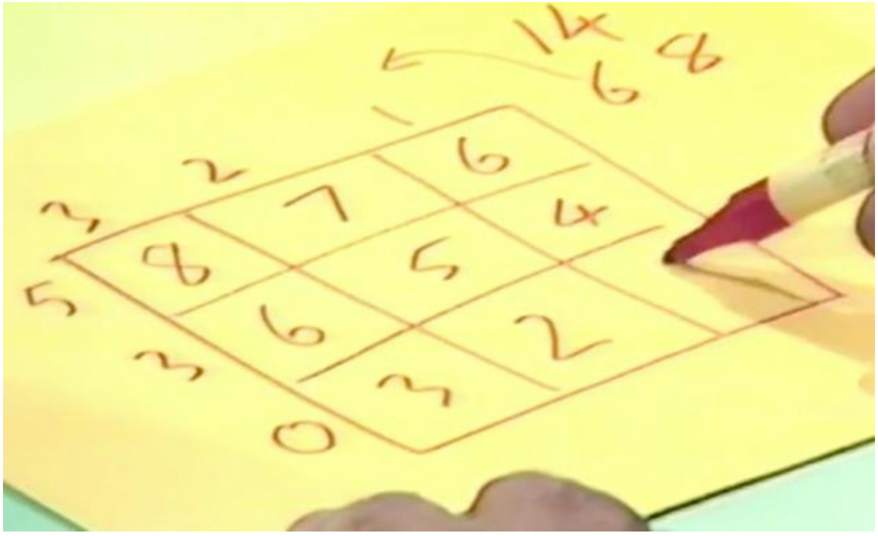
M4MONEY

JOURNEY TOWARDS FINANCIAL BLISS



What is the "Magic Number"

Your Magic Number is the amount of money you need to have saved and invested in order to quit work and enjoy retirement. In other words, a lump sum of money that can provide interest income to live off of.

Magic Number is how much one need to replace his/her active income and pay for the expenses... after one has quit the 9-5 job.

And why "the **magic number**" is so important.

Because it represents a free pass to a great life without financial stress.

Have you ever tried to calculate how much money you'll need to retire? Good chances are that most of us haven't. Most of these people fail to achieve their retirement dreams

Most people in their 40s and 50s will work with a psychology of avoidance and denial about their years ahead. They think it is too early for any serious retirement planning. They refuse to face the truth and procrastinate. Other people don't know how to calculate their Magic Numbers, they just pick up some arbitrary numbers.

Just don’t commit these mistakes. After all, you are doing it for your own future life.

Steps to work out your Magic Number

FIRST step is to calculate the amount of money needed each year to enjoy your lifestyle.

It's easy to determine this number. Simply calculate how much you are currently spending to live life each year.

Mostly our expenses fall into six categories: (a) **housing** (including maintenance and taxes), (b) **basic living expenses** (food, clothing, etc.), (c) healthcare (d) **education** (if applicable**), (e) entertainment** (including travel), and (f) **charity** (if you believe in it). Don’t guess and use your actual costs in past one year. For our calculations, we are assuming them to be Rs,25000, Rs,50,000, Rs,5000, Rs,10000, Rs,5000 and Rs,5000, for the above six categories, respectively.

Even this simple step could be eye-opener for you as it will reveal how much you are spending, say on smoking or drinking, and will shake you up to rethink and revise it.

SECOND step is the one most people start with: deciding how much money you'll be spending each year in your retirement to enjoy the lifestyle you want.

Take your current expenses you just figured out above. Then, add to it any "extras" you want to enjoy during retirement and remove any expenses you won't have in retirement.

Let's say, for example, that your current expenses are Rs.1,00,000 per month. To enjoy more fun, you want to travel more frequently, including foreign travel. This will cost you an extra Rs.10,000 p.m. Add Rs.10,000 to the Rs.1,00,000 to make it Rs.1,10,000.

Now subtract from this number (Rs.1,10,000) the expenses (like children's education, loan repayments, etc.) which wont be there once you are retired.

For example, if those expenses are currently Rs 25,000, you will deduct that from the Rs.1,10,000. That would leave you with Rs.85,000 per month, or Rs.10,20,000 per annum. Similarly, if you already own a house, your rent expenses would also be lower and can be reduced.

THIRD step is to subtract any income (pension, side business, etc.) you'll receive during your retirement.

In our above example, where you needed Rs.85,000 per month, deduct, say, Rs.15,000 per month you expect to get from some pension, another Rs.20,000 per month you expect to earn as a consultant.

This reduces your net expenses from Rs.85,000 p.m. to Rs.50,000 p.m. i.e. Rs.6.00 lac per year.

It is an important number, so work it out with reasonable assumptions.

FOURTH and an important step is to figure out the rate of return you expect to get on your retirement savings. For example, if the expected rate of return is 10% p.a., then the amount would be Rs.60,00,000 (it will generate annual income of Rs.600,000, at 10%). This rate is a critical assumption, would depend on prevailing financial market scenario, available investment options for various asset class. Don't assume to put all your wealth in one asset class and accordingly, assume an average rate of return from combination of asset class.

Further, this expected return also need to be updated each year depending on market conditions. But for simplicity's sake, let's assume the expected post-tax rate of return at 10%. With current rates of personal taxation in India, your total income of Rs.6,00,000/- would attract income tax liability of Rs.45000/- i.e. 7.5%. Assuming the post rate return on investment at 10% would mean a gross rate of return at 10.8%. With various asset classes yielding different rates of return, 10% is assumed as an average post tax rate of return; of course, it can vary as per the components of investments in each asset class.

You now know how much money you need to earn annually to enjoy your retirement. And you know the rate of return expected from your lump sum of allocated investments. That means you have the basic tools to calculate your **Magic Number**.

FIFTH and the last step is to figure out your Magic Number. In our running example of total annual expenses at Rs.6,00,000, divide it by the expected rate of return we just calculated. One would need

Rs.60,00,000 (i.e.Rs 6,00,000 earned at the expected rate of return of 10%).

That is your Magic Number! If you had this amount of money invested right now making 10% each year, you could peacefully retire right now and enjoy the life without financial worries.

Take its mental note or write it down on a post-it sticker. Put it on your office desk or file cabinet. Always keep this number in front of you. It is the **magic number** you need to hit.

However, this **Magic Number** would be affected by Inflation.

Like any other country, Indian economy would also have inflation; may be higher than other countries due to our peculiar conditions. So, we have to suitably account for the inflation also.

Inflation is the rate at which the general level of prices for goods and services rise each year. Thus, the total expenses of Rs.85,000 p.m. assumed by us above would gradually go up due to inflation, towards the same level of lifestyle expenses.

So how do you factor inflation impact in your Magic Number calculations?

As a most simple method, you can simply use a lower interest rate to calculate your Magic Number.

In our existing example, we're dividing Rs.600,000 by a 10% interest rate. This gives us a Magic Number of Rs.60,00,000. But to be more conservative, you could lower your interest rate to 5%. This would increase your magic number to Rs.1,20,00,000.

If you have 20 or 30 years to go before retirement, you might want to use this more conservative interest rate.

*Having learnt to calculate the **Magic number**, next exercise would be how to achieve this **Magic number**.*