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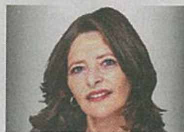
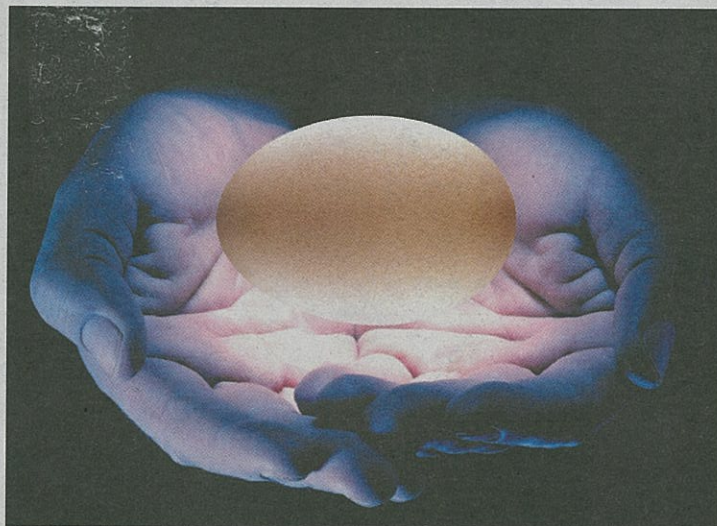
# Keeping a nest egg in safe hands

Sufficient funds and diversification can lower the financial risks for retirees

GILLIAN BULLOCK

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> 'It's important to have an annual review with a professional to make sure you are making the most of the opportunity'
>
> ANDREW HEAVEN
> WEALTH PARTNERS

THE prospect of living off your savings in retirement can be daunting after a lifetime of receiving a weekly pay packet.

It's a balancing act between being able to sleep at night and earning sufficient funds through dividends and interest to cover part if not all your living expenses.

The more money you have in retirement the lower the risk you need to take to achieve your goals.

Structuring your portfolio correctly to suit your needs is central to the success of your retirement portfolio. And it's worth noting that your money works its hardest in retirement.

Russell Investments says that for every $1 you draw down in retirement, 10c will come from your initial superannuation contribution, 30c from your investment earnings in the accumulation phase and the remaining 60c from your investment earnings in retirement.

The reason for this is you have the most money as you embark on retirement and that is why you stand to lose so much should markets turn sour in those first years.

Depending on who you talk to, there are many so-called rules that can be applied to your retirement strategy, ranging from different weightings of asset mixes to choosing an annuity or guaranteed product as part of your portfolio.

Percentages pop up frequently in planners' guidelines. For instance, AXA North's general manager marketing and strategy Barry Wyatt suggests people take the 40-30-20-10 approach to their retirement portfolio.

Assuming you have $500,000 in retirement, Wyatt says 40 per cent should go into a guaranteed income product ($200,000), 30 per cent into a moderately defensive portfolio such as high-yielding shares and fixed-income securities ($150,000), 20 per cent into a high-growth portfolio ($100,000) and 10 per cent into a cash strategy ($50,000).

Others who push the growth-asset boat say there is no reason to stop your 70 per cent growth assets, 30 per cent cash and fixed interest when you may have 30 years ahead of you.

And many stress the importance of diversification. Martin Murden of Partners Superannuation Services warns against having 100 per cent in one asset class.

"Diversification is necessary in case something goes wrong," says Murden. "But the split depends on the individual. If you want $60,000 a year then if you have $1 million you need a 9 per cent return but if you have $2 million you only need 4 per cent plus a further 3 per cent for inflation.

"The more money you have the more conservative you can be. If you only need 7 per cent then it is less than the return a middle-of-the-road retiree gets. But if you only have $500,000 then you may have to be more aggressive to fund your retirement."

And that's the point. If you have sufficient funds — a minimum probably of $1m — plus a life span of a further 30 years, you can afford to ride most downturns as you will live through three market cycles. It's just a problem if the downturn is at the start of your retirement.

Colin Lewis, head of technical services at Ipac Securities, warns against relying too heavily on lumpy assets such as property, where you may have insufficient cash flow to meet your pension payments. If you can't meet your minimum withdrawal requirement then you will lose your pension tax exempt status. This means the earnings and capital growth on the assets supporting the pension will not be tax free, but taxed up to 15 per cent as if they had been in the accumulation phase all along.

And this is an even greater tragedy if you are over 60, running a transition-to-retirement pension and drawing down on preserved benefits. If you can't meet your minimum pension payment, the money drawn down will no longer be tax free and you may have to pay your marginal tax rate and lose the 15 per cent tax offset rather than paying nothing.

Flexibility is also important in a pension. Kevin Smith of the Professional Super Advisers says investments in retirement should be dynamic.

"As world circumstances change, you should consider changing your investments to take advantage of market conditions," says Smith. "It's all about strategic and tactical asset allocation.

"Let's say over the long term you want to have 70 per cent of your super invested in growth assets — that's your strategic asset allocation. If markets drop by 30 per cent then, all other things being equal, this would reduce the percentage of growth assets to 62 per cent.

"Tactically this would not be a good time to get out. If you can remove the emotion, then you should be buying back into the market or at least selling down non-growth assets to fund pension payments."

Andrew Heaven of Wealth Partners agrees with the need to move away from a set-and-forget approach to your retirement investment strategy, stressing the importance of ongoing financial advice.

"Say your portfolio comprises 70 per cent growth and 30 per cent defensive assets, including one to two years in cash," says Heaven. "You don't need to tie up two years' worth of cash to provide for income as dividends from growth assets will top up your cash account. But it's important to have an annual review with a professional to make sure you are making the most of the opportunity."

Whatever investment mix you decide on, it will largely be premised on your risk profile. And given the global financial crisis, many risk profiles have become more conservative than in the past.

Wyatt uses the SMILE mnemonic to describe risk. S stands for sequencing risk. For example, if you get three negative years in a row you can face negative dollar cost averaging if you are drawing income. M is market risk, whereby if the market falls, say, 6 per cent you don't have the opportunity to buy on the fall because you are in the decumulation phase.

I is for the inflation risk, and with inflation running at 3 per cent a year this means your money is halved every 24 years. L is the longevity risk: because the average male now lives to 84 years this means 50 per cent will still be alive beyond 84. E is the emotional risk.

To handle these risks, Wyatt suggests using a product such as North, in which part of your money is in an account-based pension that will pay a guaranteed minimum return.

Equally retirees might look at something like the Challenger Guaranteed Allocated Pension.

But such products and guarantees come at a price, not only in terms of additional fees but also in opportunity costs lost. And it's important to check what happens when you die. Is there any principal left to return to your estate or is the money gone?

If you have sufficient monies for your retirement needs, you can probably don't need a guaranteed product.

"As you get up to the $1 million mark, provided your income needs are not outrageous, you may not need a guarantee but you might want a product that offers a capital guarantee so you have money to pass on to your children," says Wyatt.

Macquarie's David Shirlow agrees, saying wealthier clients can often manage the longevity risk through the underlying assets in their account-based pension.

"Others may want a pension arrangement that is flexible enough to switch guarantees on for limited periods such as in the early years of retirement and then off again," says Shirlow.

If you are in a self-managed super fund, by choosing direct investments in equities and fixed income rather than going through a managed fund, you can give yourself greater flexibility to take advantage of changing market conditions while reducing fees.

Murden cites the case of a couple who always made sure they had 10 months' pension in cash or term deposits maturing over the following 10 months. Every six months the couple would look at how much they needed to sell or redeem to meet their retirement needs. As they were getting regular dividends from their share investments, they had cash coming in. The couple only sold shares when it was in their best interest as they had made a capital gain.

"If you are in a managed fund you have less control than in direct share investments," says Murden.

"With a fund you might have to put in writing that you want to sell and it may not happen as immediately as a direct investment."

Of course with or without a guaranteed product, you can always fall back on the aged pension, which acts as a safety net for all Australians. And this may coincide with a period in your life when your needs are less than when you first retired.

Diversification and flexibility in your portfolio are the key components of a successful retirement lifestyle, but most important, make sure you have sufficient funds in the first place to meet your retirement needs. If you have that, you can afford to take less risk.

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**WHEN someone asks me if I've changed my mind yet and now want one of Apple's new iPads, I tell them: "Well, even if I did, I probably wouldn't want to spend $2000 on one."**