

False start

Falling markets hit those in early retirement hardest

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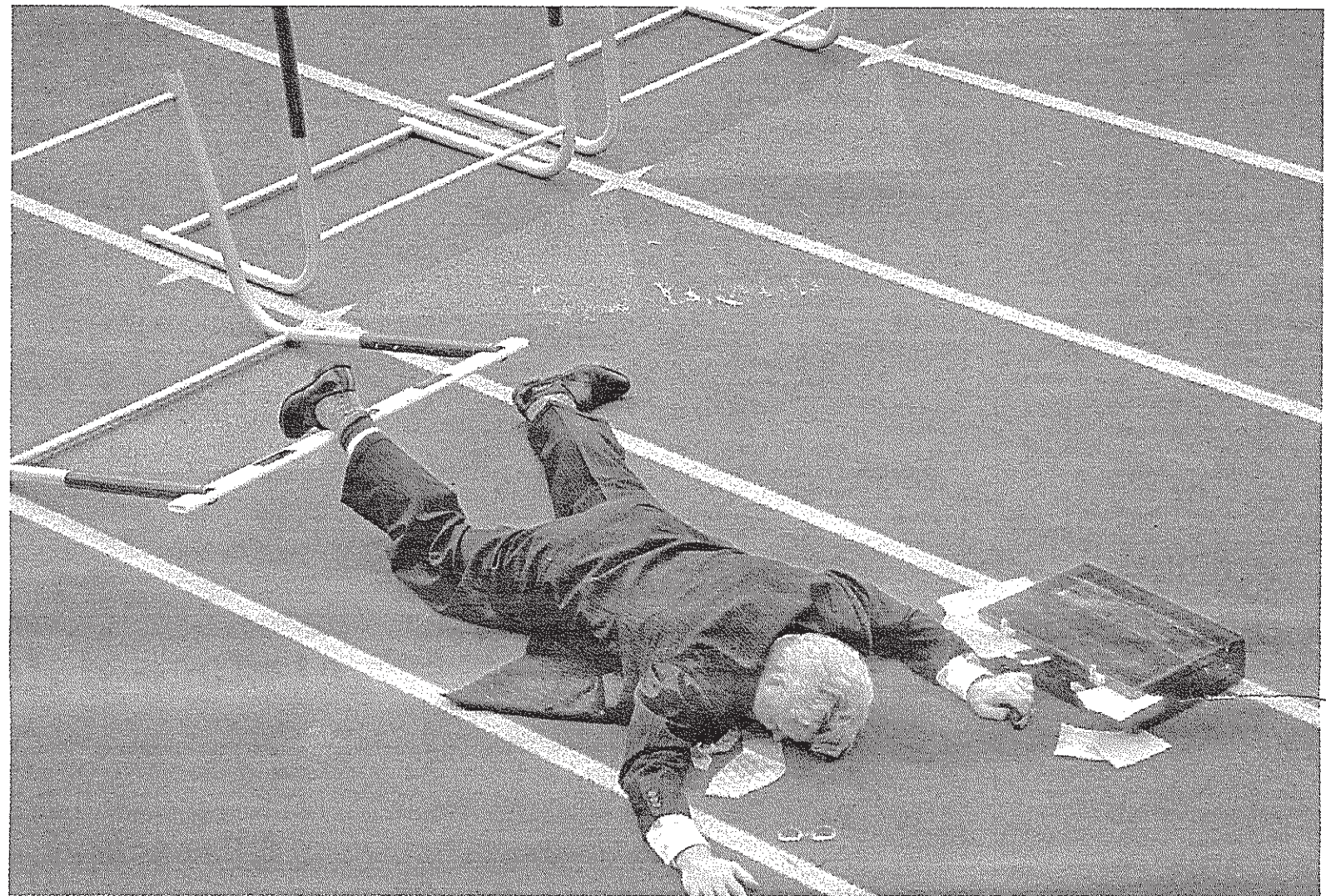
VOLATILE markets following the wave of natural disasters worldwide have many retirees worried about whether their money is invested properly.

The fallout from the tragic events in Japan has shaken world investment markets, at one stage wiping out in March the gains that were made in January and February.

According to Jeff Bresnahan, of SuperRatings, returns in March at one point dropped 2 per cent, all but erasing the approximate rise of 1 per cent in each of the first two months of the year. However, further reflecting the volatility of markets, much of this slide was recouped by the end of the month.

While many retirees have become even more cautious in the wake of the global financial crisis, one needs to question how justified this fear is.

While three consecutive years of falling markets can knock a retirement portfolio about, it is only potentially a bigger disaster if the crash hits at the start of the retirement journey. Later on it is less of an issue. "The first few years of retirement are when you see



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the biggest growth; those years are the absolute key to your money seeing you through," says Tim Furlan, superannuation director at Russell Investments.

By way of example Russell looks at two 20-year scenarios: in one the first three years of an account-based pension deliver negative returns and in the

other the market performance is flipped, with the last three years showing negative returns. The case study assumes you start out with \$1 million at age 65 and have a 5 per cent initial withdrawal rate, increasing by 3 per cent every year to allow for inflation.

If your first three years are negative

then you will run out of money after 18 years. In contrast, if the last three years were negative, then your balance would be a comfortable \$1,708,748 at the end of the 20-year period.

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"The first few years of retirement are when you see the biggest growth"

Beware of the false start in retirement

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their account-based pension arrangement enough to switch limited periods such as retirement and then flow. self-managed super direct investments in income rather than go-aged fund, you can give flexibility to take advantage of market conditions while

in case of a couple who they had 10 months' term deposits maturing 10 months. Every couple would look at how to sell or redeem to meet needs. As they receive dividends from their equity had cash coming in they sold shares when it was best as they had made

in a managed fund you have in a direct share investment. You might have to put in more money and it may be needed as a direct in-

vestment or without a guarantee always fall back on which acts as a safety net. And this may come in your life when you first retired. And flexibility in your investment components of a retirement lifestyle, but most people you have sufficient assets to meet your retirement have that, you can ask.

The solution to this dilemma is that if you are faced with early negative returns, try to draw down as little money as possible from your account-based pension during those years.

In response to the GFC, the federal government came to the party in 2009-10, halving the minimum drawdown of a pension to help retirees' money last longer. Rather than having to draw down 4 per cent as a minimum for those aged 55 to 64, this was cut to 2 per cent, and for those aged 65 to 74 from 5 per cent to 2.5 per cent. This relief was extended for 2010-11 at the 11th hour, but the general view is that the concession will end this financial year.

"There is not an overwhelming case to do it again," says Ross Clare, a director of research at ASFA. "But we suggest the government announces its intentions in the budget rather than wait for the end of the financial year."

Of course, the flexibility offered by the halving of the drawdown is of use only to those who have sufficient retirement funds to not need the full amount.

How much you need in retirement will always depend on your lifestyle. The more money you have and the lower your financial requirements, the less you have to worry about market downturns as you can use other money to weather the storm.

Martin Murden, of Partners Superannuation Services, says that if you are hoping to have \$60,000 a year in retirement and you have only \$500,000 in savings then "you must be dreaming". "You would need a 12 per cent return to pay that sort of money [out of a \$500,000 account-based pension] and then you would need 3 per cent on top to keep up with inflation," Murden says. "That's 15 per cent and that's just not going to happen."

In contrast, if you have \$1m and hope to live off \$60,000 a year, then this is far more realistic as you would need only a 9 per cent return to keep up with inflation

EARLY NEGATIVE RETURNS HURT THE MOST

Year	Withdrawal (\$)	SCENARIO 1		SCENARIO 2	
		Return	Balance (\$)	Return	Balance (\$)
0	—	—	1,000,000	—	1,000,000
1	50,000	15%	1,100,000	-17%	780,000
2	51,500	5%	1,103,500	-15%	611,500
3	53,045	19%	1,260,120	-9%	503,420
4	54,636	15%	1,394,502	16%	529,331
5	56,275	17%	1,575,291	10%	525,988
6	57,964	9%	1,659,104	12%	531,143
7	59,703	8%	1,732,130	7%	508,621
8	61,494	-1%	1,653,315	-5%	421,696
9	63,339	18%	1,887,573	7%	387,876
10	65,239	9%	1,992,216	19%	396,334
11	67,196	19%	2,303,541	9%	364,808
12	69,212	7%	2,395,577	18%	361,262
13	71,288	-5%	2,204,510	-1%	286,362
14	73,427	7%	2,285,399	8%	235,844
15	75,629	12%	2,484,018	9%	181,440
16	77,898	10%	2,654,521	17%	134,387
17	80,235	16%	2,999,009	15%	74,309
18	82,642	-9%	2,646,456	19%	5,786
19	85,122	-15%	2,164,366	5%	—
20	87,675	-17%	1,708,748	15%	—
Arithmetic mean		7%		7%	
standard deviation		11%		11%	

• \$1m beginning portfolio balance • 5% initial withdrawal rate; increased by 3% every year for inflation • Withdrawal begins at age 65

Source: Yuan-An Fan, Ph.D., Richard K. Fullmer

and service your drawdown and that is the roughly the average return during the past 30 years anyway.

The general mantra is that you should still have a growth portfolio as you enter retirement as there is a reasonable chance you will live for another 30 years.

But not everybody agrees. Stephen Nash, director of strategy and market development at Fixed Interest Investment Group, says you should target having a percentage in fixed income that is roughly equal to your age.

His argument is that at 65, you should have 65 per cent in bonds, such as traditional fixed debt, floating rate notes and inflation linked, and the balance in equities. He says you can still have exposure to growth, just less as you get older as it is harder to bear the volatility of equities.

He also favours long-term bonds as they will work even more in your favour if there is an equity downturn.

Nash says that if you add about 50 per cent of corporate bonds to a portfolio of equities then you can cut your risk in half

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MARTIN MURDEN, PARTNERS SUPERANNUATION SERVICES, LEFT

while not substantially dragging down your return from equities. He sees bonds as the third way to invest: equities, cash and bonds.

But Kevin Smith, of the Professional Super Advisers, disagrees. "Although there is a tendency to take some risk off the table at retirement, you need to take into account your own individual circumstances and attitude towards volatility."

Many advisers suggest that you keep two years' cash in hand so that you can access this money in the early years should markets turn sour, helping you ride the market volatility.

If you wanted \$60,000 a year and only had \$500,000 then the two-year cash rule would see you with \$120,000 on the short-term money market earning 6 per cent and only \$380,000 in growth assets that would need to be earning 13.9 per cent a year to deliver \$60,000 annually.

"In such cases you may want to have a lesser amount of cash," Murden says.

But Macquarie's David Shirlow is not a great fan of the cash option for the duration of a pension if you are merely holding extra cash to avoid selling growth assets down when market prices are low.

"What this permanent cash holding amounts to is selling up growth assets earlier than they would otherwise have been sold and typically missing higher returns in the process," he says. "If pension payments are made regularly then selling up growth assets at regular times to pay them means some assets are sold when the market is high and others when it is low; overall you get a dollar-cost averaging effect."