PORTFOLIO INSIGHTS
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INNOVA
ASSET MANAGEMENT

INVESTMENT MANAGEMENT INSIGHTS FOR PROFESSIONAL FINANCIAL ADVISERS AND THEIR CLIENTS

WHY INVESTMENT RETURNS AREN'T EVERYTHING FOR RETIREES

No-one can blame retirees for thinking 'There Is No Alternative' (TINA) but to climb the risk spectrum. Interest rates are stuck at historic lows while equity markets are at record highs.

But it's worth re-considering the premise and the other levers that investors can adjust given an equity market downturn can easily destroy their retirement savings.

When the COVID-19 crisis first hit in March 2020, it was older super fund members with large balances who switched to cash at the worst time and **missed out on the rebound**. They are the collateral damage of every crisis.

Their decisions are often swayed by behavioural biases and misassumptions about their own needs in retirement. It represents the great unknown, which is why many retirees over-estimate their retirement expenditure and assume they will run out of money.

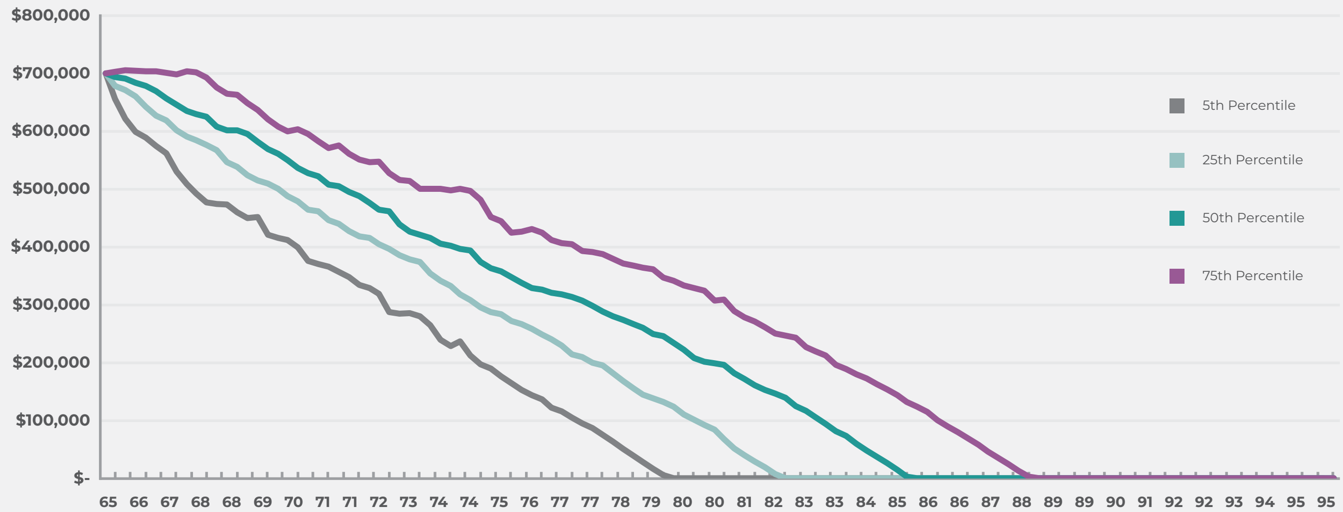
While everyone's needs are different, the government's **Retirement Income Review** cited some common misunderstandings and misconceptions that are generally not supported by evidence:

- 'I need to preserve my assets in case I get sick or need aged care.'
- 'I will need to pay for most of my health costs in retirement.'
- 'I need $1,000,000 in superannuation for an adequate retirement income.'

Retirees are so scared they'll run out of money, that many underspend. But cutting retirement expenditure has a far bigger impact on retirement savings than they realise.

A 65-year-old retiree with $700,000 at retirement spending $50,000 a year would end up with a median $27,669 in savings by age 85, according to an Innova analysis.

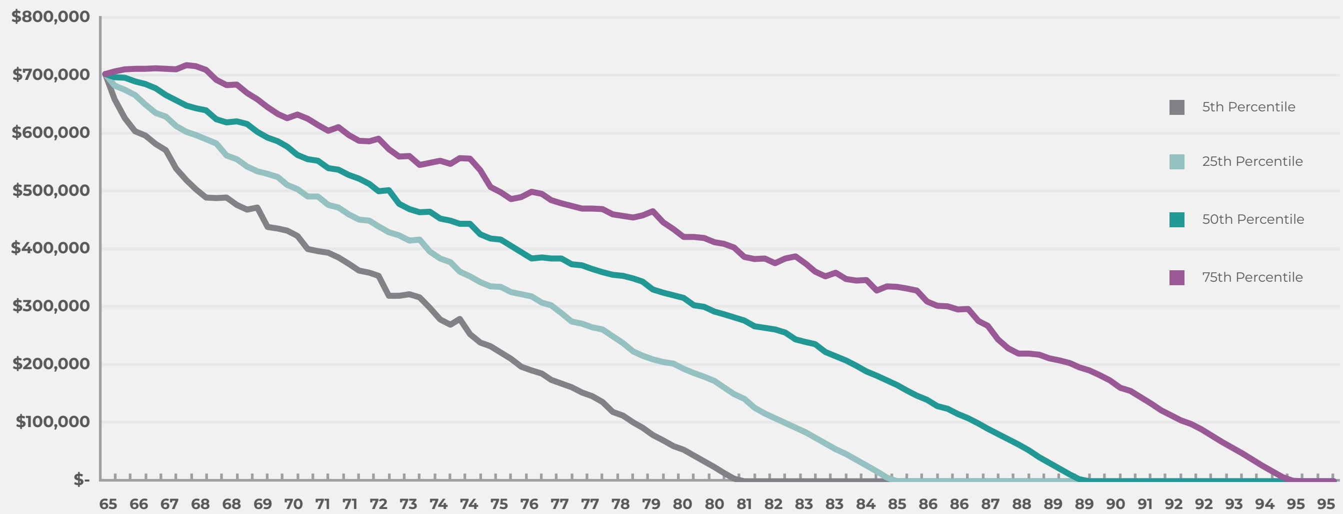
WEALTH SIMULATION (BASE SCENARIO)



But if the same retiree cut their retirement spending by $5000 a year, they would have a median $177,592 balance by age 85.

The probability of their wealth meeting or exceeding a life expectancy of 90 years of age rises from 20 per cent to 42 per cent.

WEALTH SIMULATION (LOWER SPENDING)



Retirees need to consider these types of trade-offs such as expenditure versus taking on higher investment risk, particularly if they are already likely to spend less in retirement than they predict.

The average household spent $1,425 per week on goods and services in 2015-16, according to the **Australian Bureau of Statistics**[1].

Yet households where the main person was at least 65 years of age spent almost two-thirds of that amount ($888). Those aged 75 years and over spent less than half ($671) per week.

However, common retirement expenditure benchmarks such as the **ASFA Comfortable Standard** use the same expenditure target from aged 67 and only moderately lower it from age 85. Retirement expenditure is not a straight line that increases with CPI with every year.

These are not compelling reasons for retirees to take on excessive risk to generate higher returns.

In fact, taking on more investment risk may increase their uncertainty, which can exacerbate underspending.

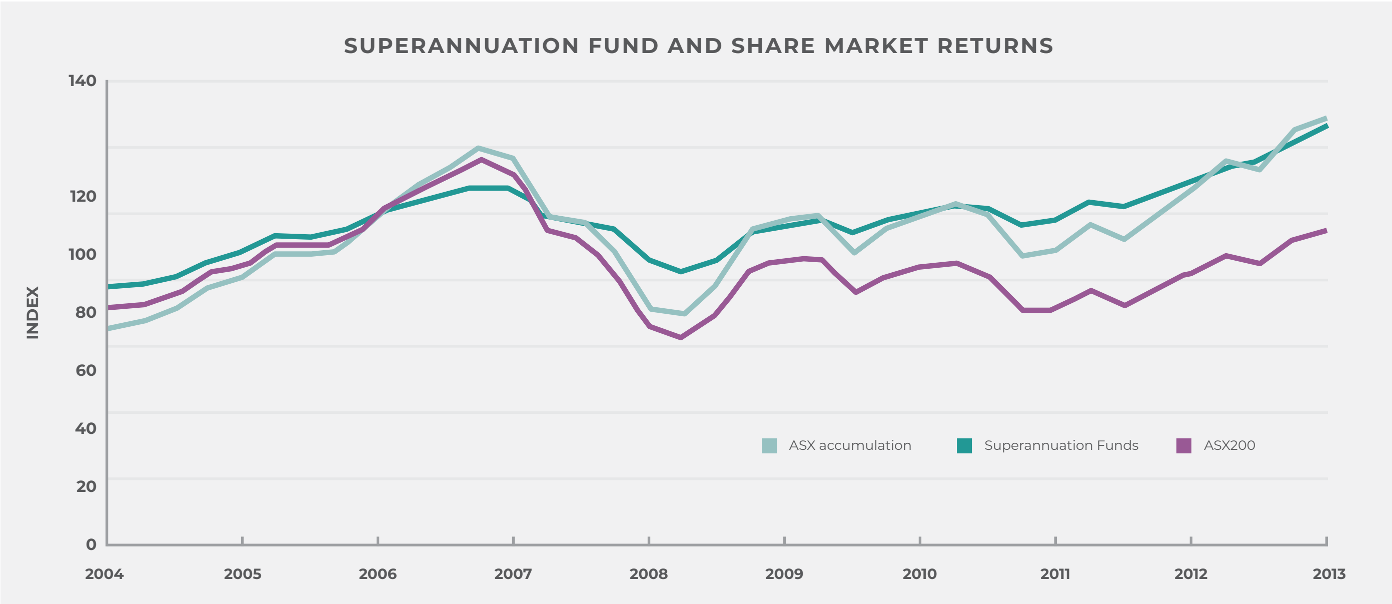
This is a key reason why Innova manages our portfolios by defining not just targeted investment return, but maximum volatility and drawdown.

[1]*Household Expenditure Survey, Australia: Summary of Results, 2015-16 financial year. (2021, September 27). Retrieved from https://www.abs.gov.au/statistics/economy/finance/household-expenditure-survey-australia-summary-results/latest-release#household-characteristics-and-spending.*

Yet many retirees remain invested in traditional 70:30 balanced funds when drawing down an allocated pension, even though these portfolios are no longer expected to perform at the same levels and are carrying more risk in a low-rate environment.

Superannuation fund returns fell 24 per cent during the Global Financial Crisis (between September 2007 and March 2009)[2], as shown in the graph below.

This looks good against the ASX Accumulation index's fall of 41 per cent but remains devastating for older investors. These types of balanced funds no longer have the buffer they once had and are likely to perform worse than during the GFC (as we discussed in a previous **Portfolio Insight**).



Source: Retirement Income Review. Note: The ASX accumulation series includes dividends and is more comparable to fund returns. Index 100 = Dec 2006. Source: (Australian Prudential Regulation Authority, 2020c; Market Index, 2020).

Returns are just one component of building a retirement income and lifestyle. A good planner knows there are multiple levers to pull, such as expenditure.

At every stage of life, Australians change how they live, including expenditure. Retirement is no different. With a good planner to keep them on track, they can lower (or increase) spending to meet their lifestyle needs or market movements.

Don't just climb the risk curve – manage risk as well as returns.

[2]*Retirement Income Review - Final Report | Treasury.gov.au. Page 188. (2021, September 28). Retrieved from https://treasury.gov.au/publication/p2020-100554*

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Sophie Temperton is the General Manager of Innova Asset Management. Innova is a boutique risk-focused portfolio manager that has been managing client portfolios for 8 years. Innova was founded on the principles of providing robust and research-intensive insights to help investors meet their financial goals. The firm focuses on managing the multi-faceted nature of investment risks for clients.

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