

7 INSIGHTS

TO AVOID A RUINED RETIREMENT



Wealth Adviser



Before you get started

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Information in this handbook is no substitute for professional financial advice.

We encourage you to seek professional financial advice before making any investment or financial decisions. We would obviously love the opportunity to have that conversation with you, and at the rear of this handbook you will find information about our authorized representative and how to go about booking an appointment.

If ultimately you decide not to meet with us we still encourage you to consult with another suitably licensed and qualified financial adviser.

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Letter from the Wealth Adviser Library

Dear **Reader**

Welcome to the Wealth Adviser Library

This library was built specifically to facilitate the provision of sound financial information to everyday Australians.

Our mission is to build an accessible, comprehensively supported team of members who share our vision and commitment to providing tailored financial advice and a new foundation of financial understanding and security for everyone.

With a national network of likeminded experts, we have the potential to provide the financial building blocks for future generations.

Knowledge gives you a huge advantage

We believe that knowledge gives you a huge advantage in creating and effectively managing wealth; in planning to reach your goals; and in being prepared for whatever unexpected twists and turns life may present.

That's why our team of experts has created this series of digital handbooks and manuals that seek to inform you of not only the benefits but also the potential risks and pitfalls of various strategies and investments.

We trust you enjoy this publication and find it informative and professionally presented. Of course, your feedback is always welcome as we strive to continually offer content in a format that is relevant to you.

Take the next step

Wealth Adviser (a division of WT Financial Group Limited) supports more than 400 privately owned and operated advice practices around the country. We invite you to engage with one of our advisers to discuss what it was you were hoping to achieve when you obtained this handbook, and to establish if they can help you achieve your goals and objectives.

At the rear of this handbook you will find details on how to book an appointment.

Wealth Adviser Library



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Background

The Australian government has seen the problem of an ageing population coming for some time as the “baby boomers” (those born between the years 1945 and 1965) inch closer and closer to the day of retirement. Those in the early part of the baby boomer years of birth have already commenced retirement, right when the world financial system was thrown into complete chaos by the Global Financial Crisis (GFC) of 2008/9.

These people know only too well how this kind of financial shock can affect the best of financial plans for budding retirees.

The main problem we have in our superannuation system is that it relies on share markets always rising.

For the budding self-funded retiree, a financial shock in markets at or near

retirement can drastically reduce income potential. For the low to modest self-funded retiree already utilising their superannuation account-based pension, investment downturns can render their cash flow situation ranging from dire to catastrophic.

We believe there is a better way for self-funded retirees to secure their future cash flows.



Insight 1: Volatility in the Share Market

Volatility in share markets and the unpredictable sequence in which investment returns occur can make a big difference to your account balance once you start spending your retirement savings to live.

If you enjoy strong investment returns in the first few years of retirement, your savings will be more likely to ride market slumps without eating into your capital too much. However, if market returns are negative early in your retirement, more capital will be needed to pay for ongoing living expenses. This reduces the potential for future growth and your money will run out earlier, even if later returns are good.

Tips to keep a cool head in times of volatility include:

1. Selling shares or switching to a more conservative investment strategy or superannuation option after a major fall just locks in a loss. The best way to guard against making a decision to sell, based on emotion after a sharp fall in markets, is to adopt a well thought out long-term investment strategy and stick to it.

Shares have a tendency to literally climb a wall of worry over many years with numerous events dragging them down periodically, but with the long-term trend ultimately rising and providing higher returns than other more stable assets. Keep in mind, bouts of volatility are the price we pay for typically higher, longer-term returns from shares.

2. When shares and growth assets fall they are cheaper and offer higher long-term return prospects. So, the key is to look for opportunities that the pullback provides.
3. While shares may sometimes fall in value, the dividends from the market haven't. So, the income flow you are receiving from a well-diversified portfolio of shares continues to remain attractive, particularly against bank deposits.
4. Interest rates in Australia remain at historically low levels (at the time of reviewing this eBook) making debt relatively cheap, which encourages investment.

Strategies and products exist which can minimise market risk, while giving your growth assets time to grow. Your financial adviser can provide guidance in this area.





Insight 2: Time in the Market, Not timing the Market

Many investors try to time the market to predict the best time to invest but shares are known for their volatile behaviour. This makes perfectly timing an investment almost impossible and usually not recommended by fund managers.

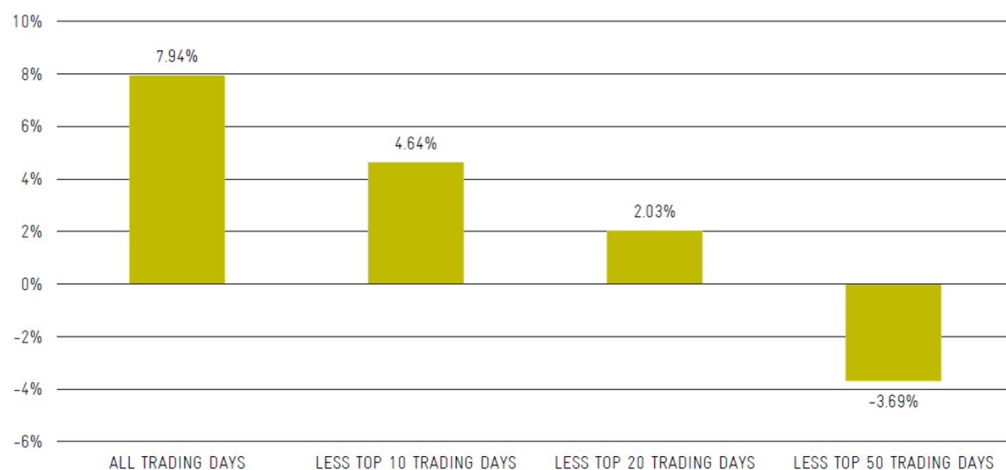
There is a clear need to understand the difference between timing the market and time in the market. Time in the market is an important aspect of investing.

The time in the market theory states that the timing of an investment is not relevant for long term investments. It is the time frame of an investment that counts, because over time the volatility of the market will smooth out. Though it's arguable that by investing at the "right moment" can be profitable, investors don't often consider the opportunity cost of waiting for that "right moment". While you're waiting, you could be missing out on some of the investment days.

The majority of investors who try timing the markets in fact usually make less of a return on their investment than those people who 'get in and stay in' for the long-term. This is illustrated by the graph below, which shows the impact of missing the best trading days (those with the largest increases) of the Australian share market, using the S&P/ASX 300 Accumulation Index.

The illustration below shows that if you invested in the market from January 2002 to December 2016, you would have received an annualised return of 7.94%. However, if you had mistimed the market by buying and selling into the market, and missed the top 50 trading days over the same period, the annualised return would have been -3.69%. By being out of the market you miss out on the rallies that tend to follow market falls.

What counts is time in the market. When reading a product disclosure statement, the investment time frame is usually suggested. Investment time frames gives you an indication of how long the investment should be held to enjoy higher returns. For example, an investment horizon of five or more years is commonly suggested for shares, this is because in the short-term shares are volatile but they recover in the longer term. Whilst cash and fixed interest investments attract shorter suggested time frames because they provide relatively stable returns in the short term.



Source: Lonsec Research, FE Data



Insight 3: How does the Superannuation Funds Management Industry Work?

Superannuation funds provide investors with many options for you to select the most appropriate balance between growth and capital protection.

A younger investor may choose an allocation to riskier but higher performing growth assets as their time to retirement is a long way out. Recovery from a downturn is possible in the medium to long term.

A baby boomer, on the other hand, has a shorter time to retirement and may be willing to forgo some capital growth for capital preservation.

Retail and industry superannuation funds, which many employees are members of, have their investments allocated by a fund manager.

All funds also have a default election, whereby if the event the investor does not make a conscious instruction to the super fund, the fund will automatically select an investment strategy. Most funds either select a balanced allocation (such as a 50/50 allocation of growth assets like shares to cash and fixed interest), or higher.

As most investors do not make an election of an investment strategy when they join a fund, the vast majority of superannuation funds are in a high exposure to shares; hence why so many superannuation funds lose so much value when the economy goes into prolonged recession.

The other major role of the fund manager is to maintain the weighting of the fund according to the investment strategy. In other words, even if the share market is collapsing, as it was in the GFC, the fund manager must maintain the investments according to the instructions of the fund.

Even if the share market falls to zero, the fund manager must maintain the allocation of your investment according to funds' objectives (which are to be invested even in a falling market). As such the job of the fund manager is to ride it to the bottom if they must.

A different perspective on a "simple" transaction

A superannuation fund is typically invested in a one way bet on the performance of the underlying investment. The vast majority of managed funds/superannuation funds are equity-based (linked to share market). The main reason for this is that equities (both Australian and international shares) provide ample liquidity for the fund managers to buy and sell the shares daily.

The reason for the daily buying and selling is to deal with the large volumes of new clients' funds going in and the existing clients' income payments and withdrawals going out. Without this liquidity, the entire equities trading system would not work.

Even if you look at a typical balanced fund (typically used for most superannuation funds), approximately 60-70% is in the share market. There is nothing wrong with the share market, so long as it goes up and continues to do so.



Account Based Pensions – How Do They Work?

Account based pensions can only be purchased from superannuation money and form the accepted basis for income in retirement for all self-funded retirees.

They normally provide tax-free income if you are 60 or over. A minimum amount must be withdrawn each year. However, income drawn must be between a minimum and maximum amount each year.

Within your account based pension, you will have to make your asset allocation choices. They offer a choice of investment options including share market investments.

For many however, unfortunately, their superannuation accounts are insufficient to provide an income that supports basic living expenses and should be topped up with Government pension.





Insight 4: We Will Outlive Our Money

The average life expectancy has risen substantially in recent years and it continues to increase, particularly for people over the age of 65.

Australian post-retirement life expectancy is amongst the highest in the world. Further to this, continuing increases in life expectancy and reductions in mortality rates indicate that we will continue to live a lot longer than previous generations.

Once you allow for the impacts of future mortality improvements, there are estimates that an Australian male retiring at 65 years of age could expect to live to 90 while a woman retiring at 65 years of age could expect to live to 92. And, though it's hard to believe, for a couple aged 65, there is a 50% chance that at least one partner will live to 98.

So, if you are planning to retire at 65, your money may need to last around 30 years. But what if it had to last for 40 years? Could you afford to support yourself? Or would you be dependent on the Government Age Pension?

While living longer and healthier is undoubtedly a good thing, it does increase the risk of your retirement income running out. This is known as longevity risk. It is therefore important to aim to ensure that your superannuation and other investments can keep generating income for you for many decades after retirement.

Another important risk which must be considered is investment risk. During a major fall in the share market superannuation may decrease in value. Just when longevity risk meant they would probably be living longer, investment risk meant they had less money to stretch out.

Insight 5: The Impact of Inflation

Another risk to your retirement income is inflation risk. A basket of groceries that cost \$100 in 1979 now costs approximately \$300. This erosion of purchasing power can prevent you from meeting your lifestyle needs and goals. As such your retirement income needs to keep pace with inflation, which is a challenging task if the share market is heading south.

The inflation risk is second only to longevity risk. Together they can combine to destroy any retirement plan. A sound understanding of the risks and tools to combat them are needed.

Some maths:

- Assume your income today is \$48,000 per annum
- Assume inflation is 3% per annum

Now fast forward 30 years. If you are unable to increase your income in line with inflation then, the buying power of your \$48,000 has crashed to \$19,857

But this would not happen overnight. It would happen quietly and in slow motion; almost invisibly. You would have ever so slowly adjusted your lifestyle and daily spending and quite possibly transitioned from a retiree that was independent to one that is now dependent on either the government or your family. Do you really want to be in this situation?

Inflation is a ratchet. If the economy is working well then prices are always rising. The impact of this is profound especially when discussed in terms of 30 years in retirement. If you retire today and inflation is 3% next year, then your cost of living has increased by 3% permanently for the next 30 years.

Your retirement strategy must contend with and counter this wealth and independence destroying phenomenon.



Insight 6: Sequence of Returns – Yet Another Enemy

All retirement projections are based on a linear and simple average assumption of annual returns. However, the market reality of returns is very different.

The sequencing of your returns is a critical issue for self-funded retirees, as a shock to the income stream anywhere along the chain will have a compounding detrimental effect on the longevity of your investment.

As an example, let's assume you have \$100,000 to invest over 10 years. In the table below, we show the average return being the same for both columns.

Initial investment	\$100,000	\$100,000
Historical Returns	-10%	18%
	-7%	15%
	-3%	10%
	-1%	6%
	5%	8%
	8%	5%
	6%	-1%
	10%	-3%
	15%	-7%
	18%	-10%

Of the above 2 sequences of return series, which would provide you with the highest return?

If you chose neither, you would be correct. In a perfectly inverse sequence of returns, both will return the same result of \$144,219. Now, however, let's introduce the self-funded retiree's normal behaviour of a withdrawal every year let's say \$5,000. Which would provide the higher return in this case?

Well, the left-hand side sequence of return will render a final balance of \$73,135, which is 28.6% less than the right-hand side sequence of return of \$102,423. As such the sequence of the return on your investment has an astounding effect on the overall value of your investments where you are making a regular withdrawal of capital, just like you will be as a self-funded retiree.

This fact is never discussed by retirement income planners.

Once again, the whole game of retirement incomes leaves you carrying all the risk!



Insight 7: The Emotional Journey

Retirement is one of life's biggest transitions, and, as with any major change, it comes with a combination of excitement, apprehension, and the risk of mental health challenges. These risks can be managed with support and planning, to ensure your psychological health is well looked after.

When retirement planning, most people consider finances to be the top priority. While this is vital, psychological preparation is also key to a successful, happy retirement.

Some non-financial factors to consider are listed below:

Emotional issues to consider include:

- Stopping one's vocation may result in some people feeling a loss of self-worth once they stop working.
- Daily routine and activities add purpose to life. If there is nothing in particular to do or look forward to on any given day, a person is more likely to feel bored and depressed than a person who lives an active meaningful life.
- Spending time on hobbies and interests, for example, may not turn out to be as rewarding and meaningful as anticipated.
- Grandparents may find they are expected to baby sit all the time.

Partner issues to consider include:

- One partner has retired or plans to retire, while the other wants to continue working.
- Ideas on retirement lifestyle may clash; for example, one partner may want to keep busy with travel, hobbies and volunteer work, while the other expects a more relaxed daily routine.
- It can be difficult at first to work out how much time to spend together. This is particularly the case if one partner is outgoing and social, while the other is more introspective. In this scenario, the outgoing partner may feel ignored, while the introspective partner could feel harassed.
- Some people may try to do everything as a couple, but lack of personal space can cause stress and relationship conflicts.

There are support and social networks to assist the transition to retirement. You can think about your retirement expectations, establish social and emotional support networks, and think about the lifestyle factors you would like to continue. Being proactive early will set you up for the retirement you hope for, and create contingencies for when the unexpected occurs.





What do Pre-Retirees Need to Do?

What you need vs. what you get

What a retiree needs are:

- Certainty
- Appropriate and realistic expectations
- Inflation protection
- Income for life (regardless of how long they live)

What a retiree gets:

- No certainty (of anything)
- Inappropriate expectations of returns and growth
- No inflation protection
- Income that runs out once their account runs dry

There is a better way than a long only account based pension.

You need to be very careful about how you invest your precious nest egg.

- Be flexible in when you retire

If you're able to work a few extra years in the event the market does poorly in the last few years of your career, then you can weather a period of poor market returns.

- Be flexible in your retirement needs

If you're able to live on less, then you can retire when you want even if you don't end up with as much in your nest egg as you had planned. If you have great stock market returns, then you'll be able to enjoy a few extra luxuries in retirement.

If luck goes your way, you might be able to enjoy vacations in the Maldives during retirement.

- Optimize the parts of your investment returns that you can control

Your returns aren't completely out of your control. You can improve your returns by minimizing the fees in your accounts. You can invest in a tax-efficient manner. You can control and minimize the amount of trading in your accounts. You can maximize your contributions to retirement accounts. The combination of these factors can boost your returns by up to 3% or 4% a year, which can be the difference between an adequate retirement and an awesome retirement.

- Hold a diversified portfolio

The best way to reduce your risk is to hold a diversified portfolio. Diversification is one of the few free lunches in investing, and using low-cost index funds gets you the most diversification in the most efficient way possible. You can build a diversified portfolio with individual stocks, but this typically requires at least 30 stocks.

You need to act now to further investigate how you can protect your wealth!



Take the next step

We trust you enjoyed this publication and found it informative and professionally presented. Of course, your feedback is always welcome as we strive to continually offer content in a format that is relevant to you.

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We look forward to meeting you soon.



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Date _____

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Readers Notes



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