The simpler way to a good retirement

BUSINESS COMMENTARY *David Quinn*

Before anyone heads for the hills, this is not the ubiquitous "pensions time bomb" handwringing article but a look at how pensions are managed, especially as retirement approaches, to make sure they meet the needs they were set up to fulfil.

The economy, the workplace, lifestyles, longevity and expectation are all changing, and so must the way we look at pension investments. I would argue, contrary to a lot of current thinking and practice, that equities have a big part to play after retirement, even at their present "high" valuations.

I attended a conference in London this week called Science of Retirement 2018, which opened my eyes to new ways of thinking about pension funds. One speaker in particular, Nick Murray, stood out. Murray has more than 50 years' experience in the financial services industry and some of his messages run completely contrary to the advice given by pension fund managers today.

Let's focus on a "rule of thumb" in the pensions industry that has the potential to cause significant damage to retirement plans; the investment approach known as lifestyling.

If you are a member of your employer group pension scheme, this is very likely to be the default investment choice. Your pension starts out with a high allocation to the stock market. Then the fund manager will start, when you are about 55, to move some of your stock market exposure gradually across to "safer" bond and cash holdings with the intention of leaving only a small percentage of your fund in the stock market by the time you are 65.

The strategy dates back to a time when employees were forced to purchase a pension for life, called an annuity, on the date of their retirement. Because the full pension fund was handed over to a life

provide a sustainable income. The retired person needs the fund to keep growing to provide an income that can match inflation.

When I meet ARF clients, I always find they are obsessed with maintaining the capital value of their ARFs every year, but Murray convinced me at the London conference that the focus should be firmly on the income generated each year and not on the capital value.

Therefore, the question we need to ask ourselves has a few dimensions. Where should our ARFs be invested so that they can achieve enough growth to cover our present income requirements while also protecting against inflation, fees and tax, and ensuring that, in the longer term, we do not risk running out of money?

This is a problem that looks difficult to solve, but there may be one very simple answer. There is only one asset class that has consistently achieved this set of goals over the past 100 years, and that is the stock market.

Most pension advisers will be screaming right now, insisting that equities are far too risky for a pension fund at retirement, or indeed for an ARF. I would challenge this view, however, and argue that the biggest threat to an ARF in the long term is inflation.

The conventional ARF has a high weighting to bonds and cash as a diversification tool to reduce risk. The reality may be, however, that as a side-effect this ensures that the fund cannot grow enough to meet the needs of its owner.

The most challenging aspect of investing an ARF into the stock market is not market risk, but human behaviour. We are hard-wired to react to short-term news in the investment markets, and to take action quickly. We cannot help ourselves; I have