



Stability back in fashion

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Three years after the peak of the global financial crisis, retirees and pre-retirees remain wary, saying they would rather have peace of mind than chase high returns, according to new research.

In a survey late last year, researcher Investment Trends asked 1000 retirees and pre-retirees what they thought was most important in a retirement investment product and they overwhelmingly valued stability over high returns.

The five features the respondents ranked most highly were tax effectiveness (which was rated as essential, very important or important by 91 per cent of those surveyed); easy access to their money (87 per cent); a product that was easy to understand (86 per cent); stable returns (86 per cent) and protection against market falls (77 per cent).

"These results turn established wisdom on its head, with stable returns proving much more important than higher returns or lower costs," says the chief operating officer of Investment Trends, Tim Cobb. "That may reflect investors' experiences during the GFC, with many experiencing large and unpredictable fluctuations in their retirement savings."

ANNUITIES AND GUARANTEES

Cobb says the results indicate it might be "time for investors and advisers to take another look at annuities and some of the innovative new retirement income products which offer protection against market falls".

Annuity-style products, with their contracted rates of return, have been a hard sell for many years and especially while the sharemarket offered double-digit returns.

However, anyone who watches television will have seen how Challenger's ad campaign taps into the anxiety retirees are feeling by promoting "safe, reliable retirement income" from its annuity products.

With these products, you make an initial investment in return for agreed income payments over a contracted period. The rate of return is fixed at the outset and doesn't fall if markets go down - but it doesn't rise if markets go up, either.

Then there are "capital-protected" products. AXA's North product, for instance, offers an optional "protected retirement guarantee" feature that locks in guaranteed income.

Advisers say clients, particularly retirees, are more wary because of the GFC but their advice to them is not to give up on risk - market risk - only to take on other forms of risk, such as the danger that inflation will erode the value of their retirement savings.

An HLB Mann Judd financial adviser, Chris Hogan, says that while most of his older clients are more risk-averse, "they still recognise that growth assets are an essential component of their investment portfolios".

NO FREE LUNCH

A financial adviser and director of Multiforte Financial Services, Kate McCallum, who also finds retirees in particular are more risk-aware, says "it comes down to the practical challenge of how to protect capital while achieving the return they want".

She gets the occasional inquiry from a client about annuity or capital-protected products "but we're not fans of protected products as they're very expensive and we believe a well-constructed portfolio that's managed - not set-and-forget - can be a better option". "I suppose the key message here is: there's no free lunch," McCallum says.

"There's a cost of having the capital protection and the certainty and this needs to be evaluated for each client [with regard to] their comfort level with volatility and their return requirements."

Hogan says he doesn't see much interest in annuities and capital-protected products, either. "Our view is that we don't need to get too tricky with innovative products," he says. "Protection is available simply and cheaply through holding term deposits, uncomplicated fixed-interest funds and cash", as part of a diversified portfolio.

He, too, notes that capital protection typically comes at a cost. "For an annuity, the cost is lack of liquidity," he says, with your capital sum locked up for a set period.

People also need to compare the return being offered on an annuity with term deposits, which currently have quite high interest rates.

"For other structured products with capital protection built in, the underlying fees can be very high," he says. "We generally don't think the cost is worth it."

(In a recent relaunch of the North platform, AXA - well aware of criticisms concerning cost - cut its standard administration fees, halving the rate for smaller account sizes from about 0.9 per cent to 0.4 per cent.)

McCallum notes that with many capital-protected products there's a set period for the protection to work. "If you have to break the set term, there are usually hefty penalties associated with that."

DIVERSIFICATION IS BEST

The head of retail for Australian Unity Investments, Cameron Dickman, says those who keep their money in cash aren't necessarily working towards their ultimate goal of having a retirement income that lasts as long as they do.

While keeping a significant proportion of retirement savings in cash options such as term deposits minimises market risk, "it exposes investors to a number of other risks, including inflation risk, income risk and opportunity risk", he says.

Inflation risk is the risk that capital locked up in non-growth assets, such as term deposits, will have less value at the end of, say, a two-, three- or five-year term.

Opportunity risk is the risk that you'll miss out on better returns and capital growth from opportunities that might become available while your money is locked up.

Perhaps the biggest risk at the moment is income risk, Dickman says.

A stable, regular income will become a priority for the baby boomers now starting to enter retirement but they won't get that from a term deposit for which interest is often paid at the end of the term, he says.

"Retirees, in particular, need to ... find a balance between their desire for low-risk investments and their need for returns that will generate ongoing income in their retirement," Dickman says. "It comes back to the value of taking a balanced approach through a diversified portfolio and understanding that different investments offer different benefits, returns and risks."

Key points

- Retirees are more interested in stable returns than high returns or low costs.

- Capital-protected and annuity products tap into this concern.
- But advisers say the cost of such products has to be weighed against the promised peace of mind.
- They warn that being in cash to avoid market risk means you take on other risks, such as inflation.
- Diversification is the best protection, they say.

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