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Retirement income. Are we any better off since GFC?

Jason Teh, Chief Investment Officer

You've got to feel for those in our industry charged with constructing retirement portfolios for financial advice groups. It's hard to recall a more challenging time in which to build a portfolio that can yield liveable income, while satisfying the risk criteria of the average retiree.

And it's not because the risk appetite of retirees has changed. What makes this period significantly different is the fact that the directional indicators are pointing to a potentially bigger problem, not an easier solution.

Rates are at record lows, and not expected to go anywhere north soon. That feeds into low TD and annuity rates. Bond yields are compressed, and you get the feeling if they rise sharply, there'll be a lot of duration-based fixed income investors feeling nervous. Equities seem to motor on, but that only increases the fear that at a PE of 16.5, markets may be poised for correction.

You may think the GFC was challenging, and it was, but even then, there was a place to go for safety – and yield. With equities losing half their value in March 2009, the 6-plus per cent rate on TDs and annuities a year later must have felt like a warm winter fireplace. That TD yield is what equities are delivering today.

You'd be forgiven for thinking there is no easy solution. TDs simply won't deliver an income you can live off – unless you have millions in your nest egg, in which case your investment aspirations are probably elsewhere.

It you were constructing model portfolios for advice groups in the early 2000's, it was probably a lot easier then to deliver yield within reasonable risk constraints.

Pleasingly, there has been product development in the retirement space in the past decade, and that's been a positive. There is now a myriad of income based, credit, real return and absolute return strategies and new capital protected offerings – but the old adage still applies. The best advice is to fully understand why the fund manager is able to deliver the investor a better yield than a risk free bond, because chances are, there is risk somewhere and it may be in a different form or repackaged from what you're used to.

But the big elephant in the retirement room is equities.

A March 2019 national survey conducted by National Seniors Australia and Challenger suggests Australians want financial security but feel locked into 'gambling' their life savings on sharemarket dominated superannuation.

Gambling is an interesting description. It suggests equities still has an image problem among retirees, and is probably still perceived through the prism of a 55% loss during the GFC.

That will be hard to shake, and this is a key challenge for advisers trying to coax nervous retirees to dip their elbow back into the equities bathwater.

But today equities comes in different guises – and there has been significant product development.

The main development has been in the equity income space. Pioneered by BT's Imputation Fund over 20 years ago, this is a segment that focuses on providing attractive income for retirees, at lower risk volatility than traditional equities funds gunning for capital growth and wealth accumulation.

You can hopefully see the sense in having a decumulation sister of the accumulation equity strategy.

The basic premise is that equities is a core component of many retirement portfolios because it can deliver an expected yield far superior than government bonds in the current environment, But it still has a capital volatility stigma, because after all, it is still equities.

There just needs to be a way to dampen the damn volatility.

Pleasingly, most equity income funds generally achieve lower risk (as measured by standard deviation) against the Australian sharemarket index, which is a good outcome.

But if you sift through the results of the Australian equity income universe, you soon see stark differences in their risk levels – while on the income side, there is not as much to separate them, relatively speaking.

When it comes to decumulation, one of your tools to measure risk is sharemarket sensitivity, otherwise known as Beta. Put simply, if the market goes up 1% and you are highly sensitive to the market (high Beta), your portfolio will also potentially go up by 1% – maybe even more of you're hyper-sensitive (Beta above 1). But by the same token, if markets fall, you'll probably go down with it.

If you have low sensitivity, the capital value is less affected by the sharemarket movement. You have low Beta, and have probably underperformed in the current heated market. That's expected.

Now, think about the retiree that requires a high level of income from equities, but feels nervous about sharemarket risk especially in this late part of the market cycle.

What level of sensitivity do you think they would want?

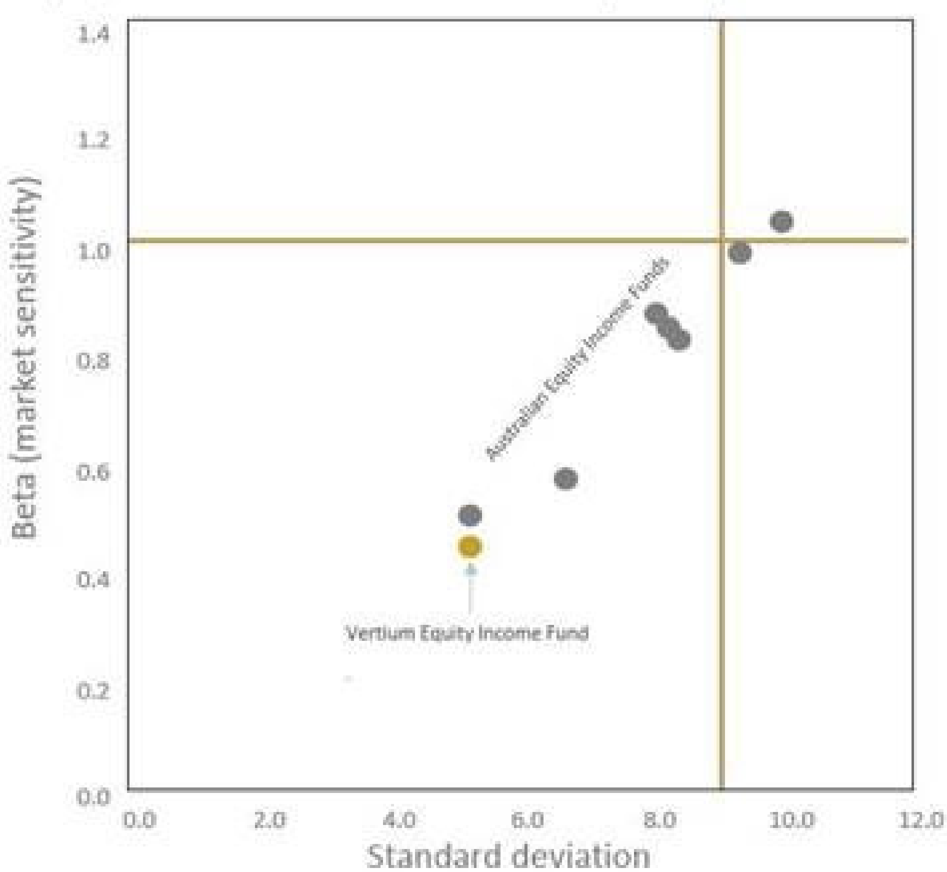
Most likely low sensitivity. And probably by a very long country mile.

But if you plot all the Beta results for equity income fund managers since April 2017 they appear as a spectrum, some high, and only three fund managers considered very low – below 0.6.

And out of those three, two of those are fund managers with significant funds under management – and although they are both quality investors – their size means they may be less agile in trades as a smaller manager.

Which leaves one equity income fund manager with the dual crown of low Beta, and low funds under management. That fund manager is Vertium Asset Management.

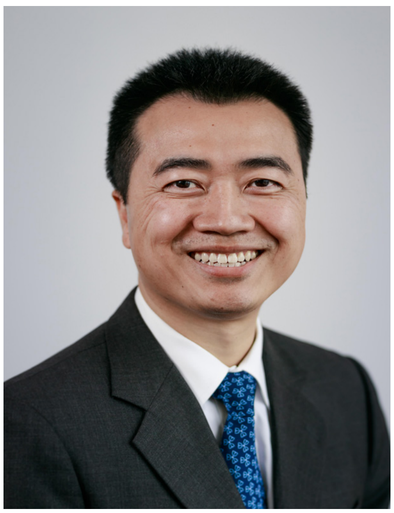
Equity income fund risk statistics since inception: April 2017 to June 2019



Source: Morningstar. Past performance is not a reliable indicator of future performance.

Measured by standard deviation, Vertium's volatility is almost half the risk of the Australian sharemarket, and it's lower than all other equity income funds in its peer group.
So it all boils down to this: if you subscribe to the notion that the sharemarket is overvalued and possibly due for a correction, perhaps a low Beta allocation is worth considering to help protect capital values.

About the author



Jason Teh, Chief Investment Officer
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Jason founded Vertium Asset Management in 2017 and has around 20 years' Australian equity investment management experience. He leads Vertium's investment team and is responsible for the firm's investment philosophy, process and portfolio management.

Before establishing Vertium, Jason was a Senior Portfolio Manager at Investors Mutual. He was the architect of the Investors Mutual Equity Income Fund, which he successfully managed for almost six years. As the second-longest serving employee at Investors Mutual spanning over 16 years, he had a variety of roles including managing a share of the Investors Mutual Australian Share Fund and as an Equity Analyst and Senior Quantitative Analyst.

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