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4 Retirement Planning Mistakes – and How to Avoid Them

Jason Teh, Chief Investment Officer at Vertium Asset Management | 21 April 2021

Successfully preparing for retirement can present many challenges. Here are four common mistakes to avoid when selecting your retirement investment strategy.

Mistake #1 – Keeping your accumulation fund

Accumulation funds may not be suitable for retirees, because their main objective is to deliver a strong total return outcome – not a lower risk profile. So, it's no surprise that when you measure the risk characteristics of many accumulation funds, they mirror or exceed the risk profile of the market.

By comparison, decumulation funds are lower risk and may therefore be better suited to retirees' needs. This is because the overarching goal for retirees is to ensure their nest egg lasts the full duration of their retirement.

To do so effectively involves applying three strategies – not independently, but concurrently.

- First, retirees should aim for a reasonable return outcome so that inflation risks can be minimised for the duration of the retirement phase.
- Second, capital preservation is extremely important. It's about minimising that sequencing risk during the critical 25 years around your retirement date, also known as the retirement risk zone. This is when retirees' nest eggs are peaking and are at the greatest risk of significant loss from any market corrections.
- And third, high levels of income are required to minimise drawing down on those investments.

Over the past decade, equity income has become a popular strategy among investors and retirees who are using it to deliver better outcomes for their retirement life. An equity income strategy delivers a reasonable return over the long term because it has the equity exposure to provide a hedge against inflation.

Mistake #2 – Falling into yield traps

In today's low interest rate environment, the allure of higher dividend yields may still seem attractive. However, just like equities, dividends are not risk-free.

Whenever the market experiences some sort of crisis, earnings tend to fall and so do dividend yields. Added to this, there's the risk of capital loss when stock prices collapse, creating a yield trap for investors and retirees.

The COVID-19 crisis has shown that at certain times, dividends can be just as risky as stocks. Share values typically collapse during periods when global growth slows as earnings are revised down. It is no surprise that yield traps can often appear when company earnings are unable to support dividend payments during those chaotic periods.

The deepest dividend cuts of around 50% occurred during the 1990s recession and the Global Financial Crisis in 2008. However, at that time interest rates were relatively high and offered an appealing alternative to the yield on equities. Today, with low interest rates and greater asset allocation to equities in search of income, the impact on retirees' portfolios may be larger.

Mistake #3 – Neglecting option income

Consistent income from equities may prove to be elusive if investors and retirees focus solely on dividends and franking credits. Instead, there is another aspect of equity markets to consider that can boost portfolio returns – option income. And while dividends are often cut during a crisis, selling options can provide both a sustainable and reliable way to derive further income from equities.

Market corrections often occur when company earnings are expected to come under pressure, which can lead to dividend cuts. However, during market corrections market volatility typically rises, and this can lead to option prices increasing substantially. So, when dividends are slashed, increased income from selling options can provide a timely boost to portfolio income.

The combination of dividends, franking credits and option income can substantially improve the yield universe in equities. This means investors and retirees don't have to chase dividends for income and can avoid yield traps. Additionally, it limits the need for any large exposure to high income sectors if they are expensive, making your investment portfolio more diversified.

Mistake #4 – Using hope as a retirement investment strategy

Do not leave your retirement outcome to luck or chance. Hope is not a viable retirement strategy.

Instead, retirees should be aware that they all have unique objectives that need to be met to achieve a comfortable retirement. Being exposed to reasonable returns over the long term will help mitigate any inflation risk that they may face during their retirement.

Retirees should also be exposed to lower-risk investments as this will help mitigate any sequencing risk if market corrections occur when their nest egg is at its peak balance as they approach or enter retirement. Additionally, higher levels of income will help mitigate drawing down too much from their valuable savings pool.

How Vertium can help

Vertium Asset Management, in partnership with Copia Investment Partners, is a specialist Australian equity income investment manager focused on delivering Australians better investment outcomes in the lead-up and during their retirement.

The Vertium Equity Income Fund is suitable for investors looking for lower risk equity market exposure or those drawing down on their savings. The fund invests in quality Australian companies with attractive valuations that pay consistent and sustainable distributions with the aim of delivering more income with less risk than the Australian share market.

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.

About Vertium Asset Management

Founded in 2017 by Jason Teh, one of Australia's leading equity income investors, Vertium is a specialist Australian equity income investment manager focused on delivering Australians better investment outcomes in the lead-up to and during retirement.

Vertium is a proud investment manager partner of Copia Investment Partners, an independent multi-boutique investment management group.

Copia provides the resources and infrastructure our team needs to prosper, including distribution, marketing, operations and compliance services, enabling us to focus solely on delivering our investors superior long-term investment outcomes.

Further information

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