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Generating retirement income through real return investing

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No "one size fits all" solution

- Need to manage
  - Longevity risk
  - Sequencing risk
  - Inflation risk
  - Adequacy of savings
- And incorporate
  - Social security
  - Tax
  - Unique circumstances and risk tolerance of each individual

But broadly… an important component is a return seeking portfolio

- Earn a positive, and relatively high real (inflation adjusted) return
- Have a reasonably smooth path for these returns (sleep at night)
- Manage longevity risk with higher returns, and sequencing risk with lower volatility

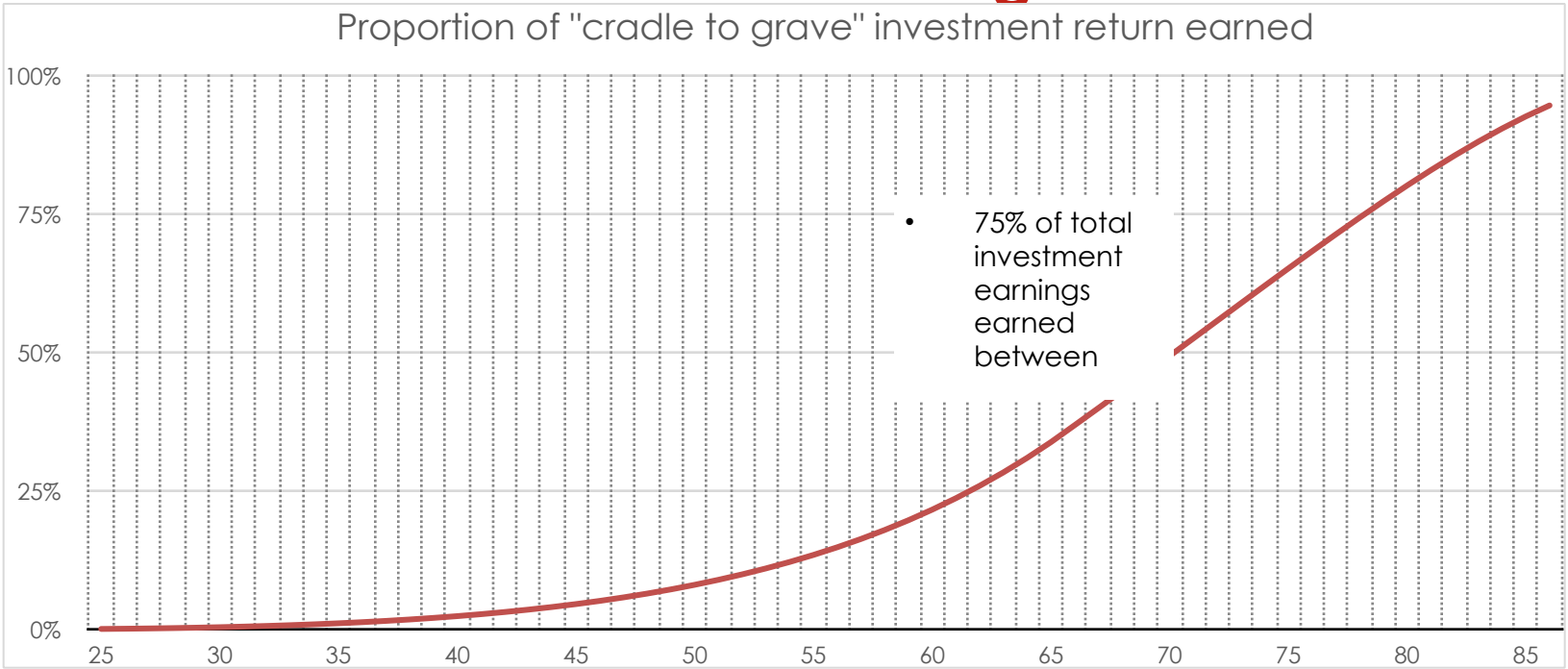
What "real return" is needed and when?

Gross Return	Years money lasts in retirement
CPI+6 to age 55, CPI+3 thereafter (simple lifecycle)	*17*
CPI+3 to age 55, CPI+6 thereafter (contrarian to a lifecyle)	*20*
CPI + 5 throughout	*22*

- Aggressive de-risking in later years will not be the right answer for many people

- *Above analysis assumes a reasonable balance that can be turned into a retirement income, rather than the individual placing reliance largely on the age pension. See appendix for assumptions.*

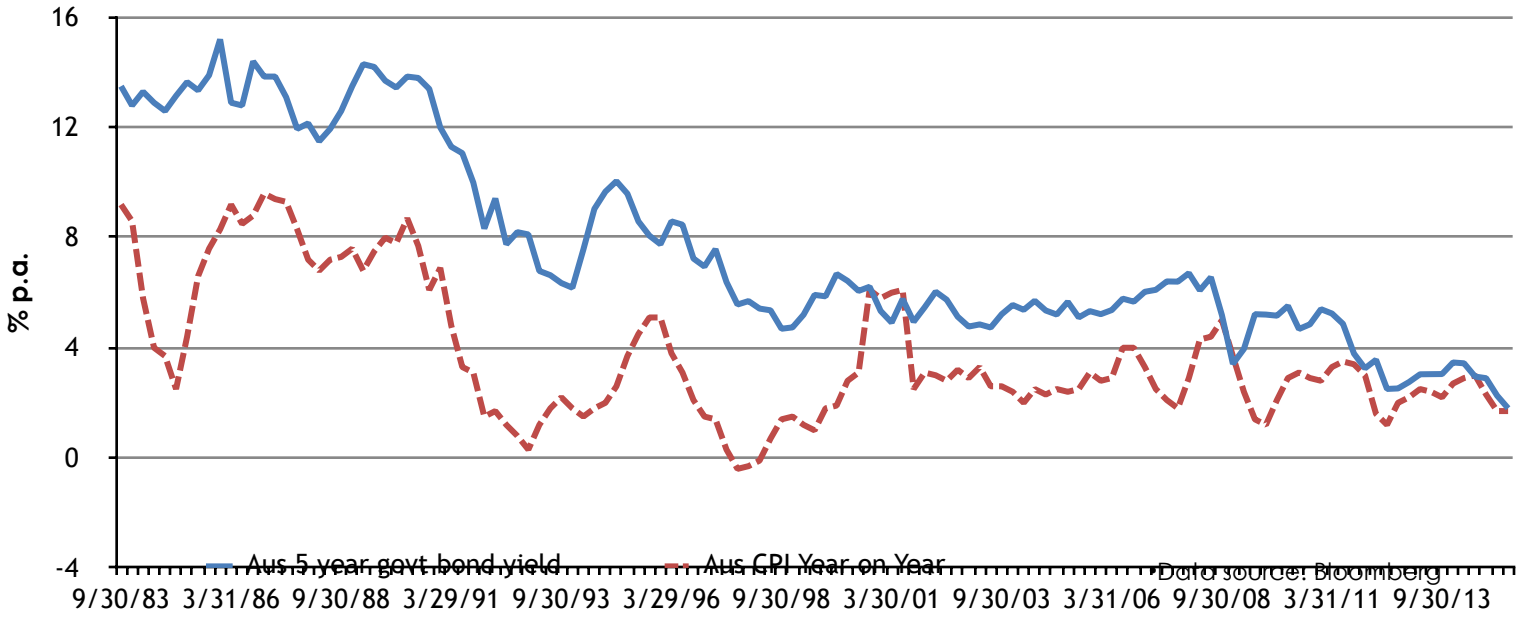
Investment returns in the later years are crucial to retirement savings



➢ *See appendix for assumptions.*

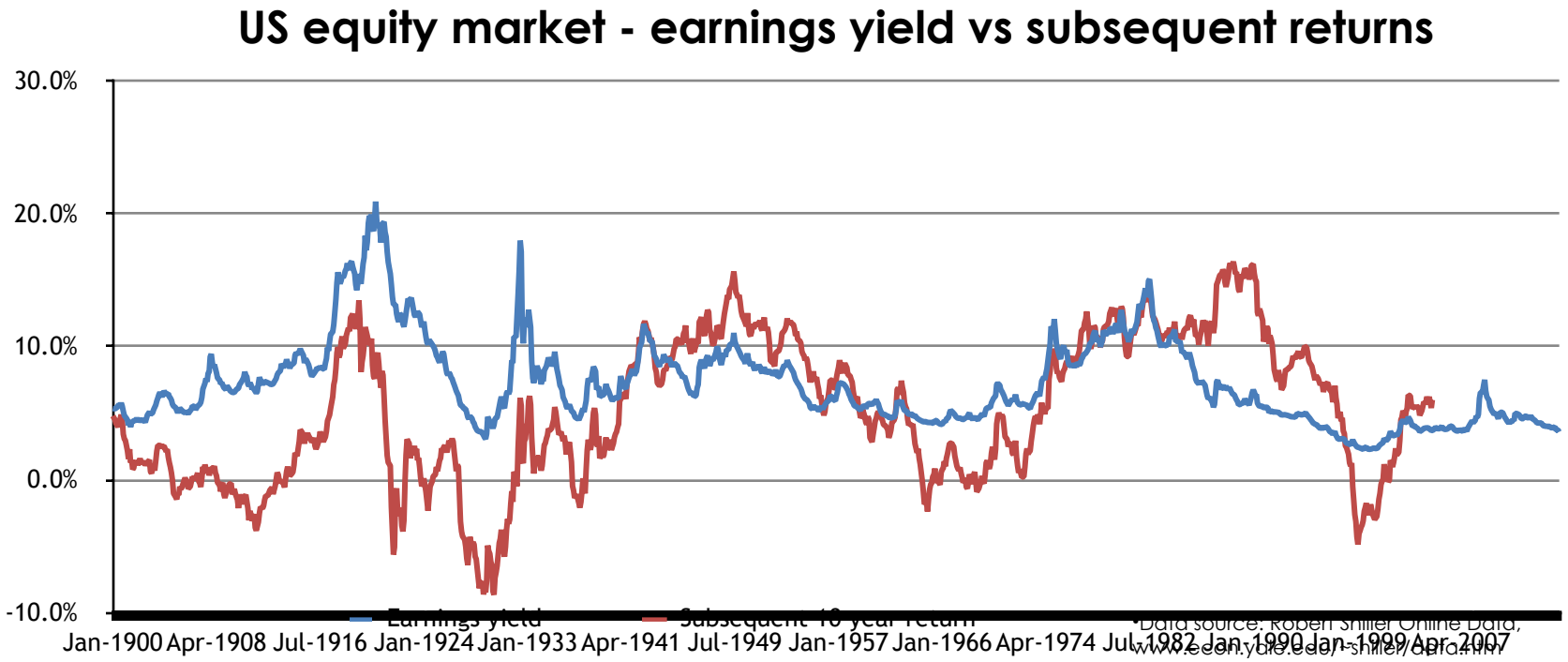
Low risk assets now offer no real return

Australia - 5 year government bond yields and inflation



- *Does it really make sense to lock in a return like this for a retiree's capital?*

Prospective returns from equities are also muted



*Data source: Robert Shiller Online Data, www.econ.yale.edu/~shiller/data.htm

- If we look back, prior to the persistently high valuations of the last two decades, then US equities are as expensive as almost any time in history

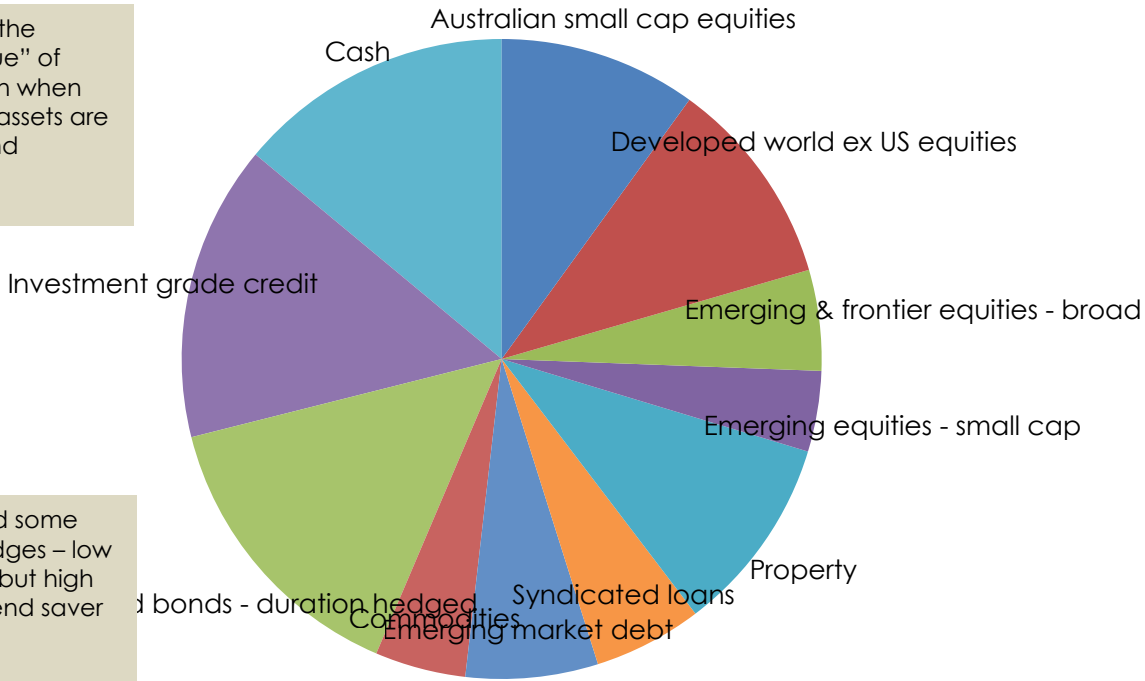
Traditional set and forget SAA is not fit for purpose in post-retirement

- A more dynamic approach is needed
  - Seek out well priced assets in a benchmark and "asset class bucket" agnostic way
  - Find cost effective protection – what's best is time varying

Snapshot of a less conventional strategy

•Recognise the "option value" of holding cash when well priced assets are harder to find

•Hold the best relative value across markets in equities. Cheaper prices = margin of safety



•Always hold some inflation hedges – low probability, but high impact on end saver

- + Time varying risk hedges:
- Long duration
- Yield curve flatteners
- Put options
- Foreign currency

Source: First State Super Pilot / Internal Real Return Portfolio

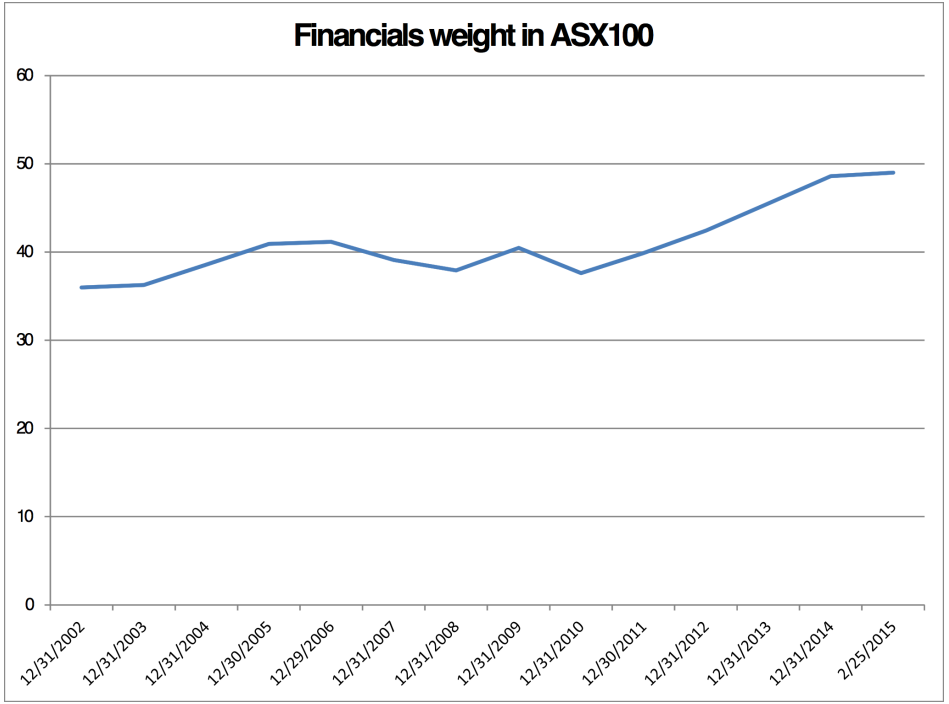
APPENDICES

The impact of volatility in the draw-down phase

Years money lasts in retirement (CPI+5	0% volatility	8% volatility	16% volatility
Median	***22***	***21***	***19***
5th percentile	***22***	***15***	***12***

- With the same expected return, volatility adversely impacts not just the adverse (5th percentile) outcomes, but also the median outcomes.

Australian equities are more reasonably valued, but with increasing concentration risk



Data source: Bloomberg, S&P

Assumptions

- Gross salary of $70,000 per annum indexed with AWE at 3.5% per annum. CPI assumed to be 2.5% per annum. Contributions in line with the schedule for the superannuation guarantee. Tax assumed to be 15% on contributions, 8% effective rate on pre-retirement investment earnings and 0% in retirement. Retirement income set at 50% of pre-retirement gross salary. Fees of 0.55% per annum plus $52 per year assumed. Retirement age assumed to be age 65, and contributions assumed to commence at age 23. Example is illustrative only, and not intended to reflect the specific circumstances of any individual. For illustrative purposes age pension is not included in the analysis.

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