Put your super to work so that you don't have to

Retirees have the freedom to enjoy more leisure after a lifetime in the workforce. But for their investments, the work is just beginning. There are smart ways to boost post-retirement income without taking on more risk. It just needs the right portfolio strategy.

Client	Maria
Age	70
Portfolio	$300,000 equities and cash outside of the family home
Portfolio Income requirement	$27,000 p.a.
Objective	Minimise risk of needing to sell assets to meet income requirements and ensure portfolio purchasing power keeps up with inflation

A comfortable retirement starts with some uncomfortable questions

Ask what the ideal retirement looks like, and you'll get as many answers as there are people.

But while every retiree has unique dreams and circumstances, they often share common concerns about their financial wellbeing. How much money does it take to enjoy a comfortable retirement? How long will their money last? And, most confronting of all, how long does their money **need** to last?

Increasing life expectancies mean that retirement income needs to be stretched over a longer period. Australian women and men currently aged 65 can expect to live for a further 22 years and 19 years on average respectively[1].

Factor in economic uncertainty, rising healthcare costs and fluctuating markets, and it's no surprise that retirees face very real concerns about maintaining their lifestyle over the long-term.

Investments must deliver what retirees need

Are there alternatives to cutting costs of living when it comes to funding retirement?

There are certain products with features that meet the specific needs of this life stage. These needs are very different to what investors seek during their working lives when growth is the main goal for their retirement savings.

Increased income

Retirees need regular cash flows to meet living expenses and one-off costs. Franking credits are valuable to all tax payers.

However, super or pension phase investors may receive direct cash refunds due to the low marginal tax rate on these accounts.

Increased capital

Retirees need their capital to keep pace with inflation so the buying power of their savings is not eroded over time. Retirees face some costs like healthcare which are rising faster than other expenses.

Reduced risk

Retirees need more consistent investment performance. As contributions cease and the balance starts to be drawn down, market shocks are magnified, taking longer to recover from.

More return and less risk might sound like an impossibility. After all, the trade-off that higher returns involve higher risk is one of the most basic principles of investing. It's also one that's frequently misunderstood.

Overturning some common assumptions

Choices that at first glance seem sensible have a habit of bringing even careful investors unstuck.

1 Australian Bureau of Statistics

Problem #1: A low appetite for risk compromises income

We're well past the era of stashing our life savings under the mattress to 'keep them safe'. Or are we?

The practice of transitioning from a share-based portfolio when accumulating wealth to lower risk cash and bonds in retirement is a common one. While investors adopting this approach have accepted lower returns in exchange for protecting their capital, historically low interest rates mean investments like term deposits, and bonds no longer generate the income retirees need.

It is an issue of rising importance given we're all living longer but day-to-day costs, particularly healthcare, keep rising over time. If capital growth is neglected, a retiree's income is less likely to be able to keep up with the rising cost of living.

This means defensive assets such as bonds can still have a role to play but equities, whose income and value tends to grow over time with growth in corporate earnings, are also essential to provide the income, franking credits and a way of keeping pace with inflation.

Problem #2: Chasing returns compromises risk

Changing strategies to chase 'hot' investments means magnifying the likelihood of locking in losses by selling when assets are underperforming, then buying in at the top of the cycle when prices are at their highest. That double whammy can deliver a major blow to investment values. Retirees are particularly vulnerable here, as they have less time to recoup those losses.

This means retirees need to stick to a consistent investment strategy based on proven long-term investment decisions and employing strong risk management practices with the aim of limiting capital losses.

Introducing the Merlon Australian Share Income Fund

With the Merlon Australian Share Income Fund, it is possible to increase income, earn more franking credit rebates and still achieve capital growth – all while not taking on any additional market risk.

This is possible because Merlon's rigorous research allows it to invest in a select group of companies where the market under-appreciates their true cash flows. After all, it is this cash flow that underpins higher dividends and franking credits that flow through to investors.

Investing in our best research ideas as opposed to the banking and mining stock dominated ASX index produces better long-term capital growth. To safeguard investors from occasional market declines, Merlon also employs a downside protection overlay to protect 30% of the capital from losses.

A historical case study

To see the potential difference the Merlon strategy may make to financial wellbeing in retirement, let's meet Maria.

Maria was 70 years old in June 2012, and had retired from work several years ago. Maria had:

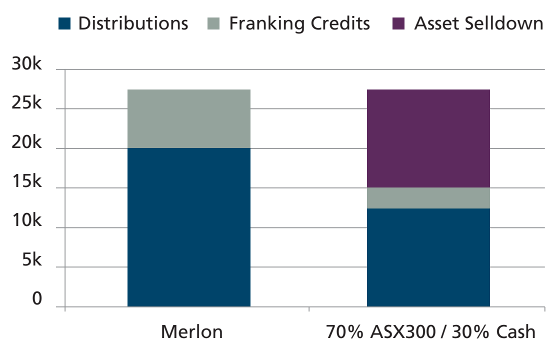
- **A $300,000 investment portfolio, which was allocated between 70% in the one of most widely held and cheapest Australian share index funds, which tracks the ASX 300 ($210,000) and 30% cash ($90,000).**
- She is also single, owns her own home, and doesn't have any debt.

Maria had chosen this investment mix because she recognised a meaningful equity allocation was essential to preserving the long term buying power of her savings. Maria worked through her budget and estimated that she would **need around $27,000 per annum after tax to support her lifestyle in addition to her aged pension payments**[2].

With the benefit of hindsight, it became clear that this portfolio would not deliver this level of income and thus required her to sell some of her capital periodically over the course of the subsequent five years to maintain this income level.

As an alternative scenario, **Maria could have invested her $300,000 investment portfolio to Merlon's Australian Share Income Fund in June 2012.** Thus, she would have received annual average income of $27,000 over each of the next five years, and would not have needed to sell any capital to maintain this.

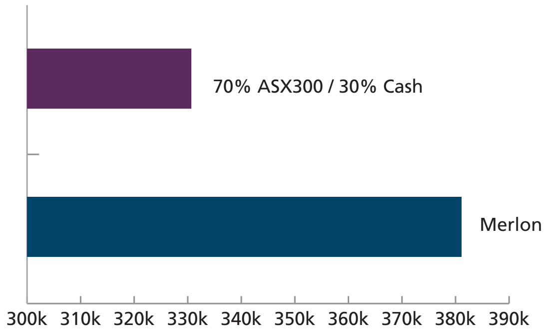
Average Annual Income Composition



2 Example may not contemplate all applicable pension and tax rules and is not meant to constitute any form of tax or financial advice

As her capital base would have remained untouched and Merlon's rigorous investment research and investment into only their best ideas delivered strong returns, Maria's capital would have also increased over the period to $381,000 by June 2017.

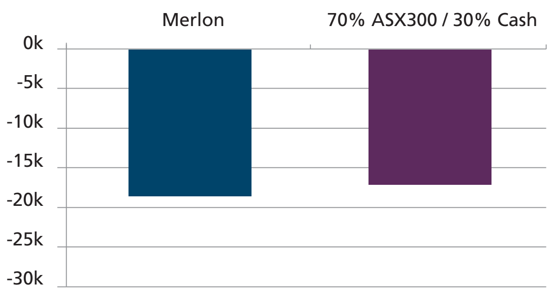
Closing Capital Value



But for retirees like Maria, it's not just about returns. The risk of capital loss is also a significant influence on decision making.

The downside protection overlay meant the Merlon strategy, which was fully invested in dividend paying shares, was broadly inline with Maria's strategy of investing 70% in an index-tracking fund and 30% in the bank. The Merlon strategy and the index tracking fund both had similar levels of downside risk in situations where the Australian equity market fell more than 5%, otherwise known as a market 'drawdown'.

Drawdown Risk



Drawdown risk is average fall in portfolio capital value over the time period of analysis when the ASX200 falls more than 5%. Time period of all analysis above is 1 July 2012 to 30 June 2017. ASX300 proxy fund is the Vanguard Australian Share Index Fund ETF. All returns net of fees. 1 Month Bank Bills used for cash return.

The income from the Merlon strategy would have been sufficient to meet Maria's goals (barring any unforeseen or lumpy expenses) without needing to draw on capital, unlike her existing index fund and cash strategy.

The end result was that Maria's remaining capital with Merlon would have been $52,000 higher than would have been the case, where she had to progressively sell down her portfolio to meet her lifestyle expenses.

Applying sensible reality to natural caution

Share investments can play an important role in the retirement asset allocation mix as they have the potential to deliver strong returns, but do come with the risk of capital losses. It's understandable that many retirees choose to invest heavily in cash instead of shares to reduce the risk of capital losses. Unfortunately, record low interest rates simply won't generate enough income to fund the type of lifestyle they want. Meanwhile, rising inflation will erode the purchasing power of their savings.

The case study with Maria demonstrates a strategy exists with a similar risk profile as having 70% in shares and 30% in cash but with significantly higher historical dividends, franking credits, and the potential for capital growth to ensure older Australians enjoy their retirement.

Benefits of investing with Merlon

- ✓ Monthly income above fixed interest alternatives
- ✓ Franking credits boost cash flow further
- ✓ Capital growth based on long-term investing
- ✓ Lower risk profile than typical share portfolios

Find out more

For more information, please contact your financial adviser or call the Fidante Partners Investor Services team on +61 13 51 53

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