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RETIREMENT

'Low risk' may be dangerous

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Fear and anxiety about market volatility, coupled with a low-growth environment, often drive retirement investors to low-risk investment options. Avoiding risk in retirement is prudent in many instances, but given significantly improved longevity, this may have the unintended outcome of completely depleting capital.

Even retirement portfolios need to include some riskier asset classes in an income-generating portfolio. Many investors make the correct choices during the wealth-accumulation phase of their lives, through investing in diversified portfolios with exposure to different asset classes, locally and offshore. When retirement day arrives they become instantly risk averse and fearful of market volatility.

The risk averse approach may have dire consequences for the income needed during retirement, as investors could run out of money completely if no capital growth is achieved.

Currently, legislation allows an investor to draw an income of 2.5% to 17.5% per annum on their living annuity. With interest rates at a two-year low (and expectation of further repo rate cuts) coupled with a drawdown level of 6% to 8%, the low-to-no-risk investor will experience a negative real return, after fees and inflation. Depleting capital is a very big, real risk. In most instances investors realise their mistake too late to rectify it.

By taking on fewer growth assets the investor is effectively reducing his/her income-earning potential by at least ten years, versus an investor who included a balanced type portfolio in the overall investment strategy.

With a moderate growth asset allocation portfolio – and a real return of 4%, you'll most likely deplete your capital at age 83.

With a conservative asset allocation portfolio – and a real return of 1%, you'll most likely deplete your capital at age 76.

An aggressive asset allocation portfolio will result in a 6% real return after retirement. Once the investor is no longer bound by Regulation 28 constraints for retirement investment selection, [it] allows for a more aggressive long-term investment approach. While more volatile, this offers a much stronger probability that the capital won't be depleted.

These examples are based on an annual income percentage of no more than 5% and show the importance of taking on risk in a retirement income portfolio.

It's as important to have a diversified investment approach in retirement as it is while accumulating wealth.

It's advisable to consult an accredited financial advisor to devise an investment plan suited to your requirements and goals.

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