RETIREMENT INCOME MODEL PORTFOLIO SOLUTION

DELIVERING AN IDEAL LIVING ANNUITY INVESTMENT STRATEGY

Financial advisers and investors are constantly faced with the question of how to achieve growth and avoid volatility for clients drawing income from a living annuity investment.

Living annuities have to provide income for life, sustaining the real value of income. Typical withdrawal rates are approximately 5% but the maximum allowed rate is 17.5%. In addition, people are living longer and most people have not saved enough money to provide for their retirement.

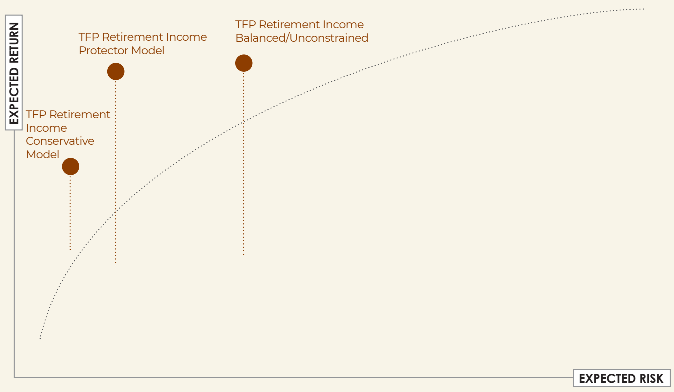
To address these challenges clients typically need to invest in high risk strategies that are more volatile. However, exposure to volatile assets leads to increased downside risk. Coupled with regular withdrawals, this ultimately increases the risk of capital depletion. We know that a reduction in volatility can enable a higher withdrawal rate, but risk cannot be reduced without reducing long-term growth. Therefore investing in more conservative strategies, means lower growth rates which cannot sustain the typical required withdrawal rates.

The financial adviser is thus faced with advice risk that is strongly linked to market cycles. Attempts to time the market cycle should be avoided at all costs.

WHY THE RETIREMENT INCOME RANGE?

The Tailored Fund Portfolios Retirement Income Range of Portfolios represent model investment strategies that seek to target inflation-beating returns over the long term for post-retirement investors with an investment horizon in excess of ten years. It invests in a blend of a smooth growth fund together with a range of unit trust funds, in order to offer a high long-term growth rate, but with significantly lower volatility than typical balanced funds. The model aims to provide an investment strategy that targets returns in line with the income requirements and risk appetite of the client. This combination provides the investor with more sustainable income, whilst reducing risk through the inclusion of a smooth bonus fund allocation.

THE CORE RANGE RISK AND RETURN PROFILES



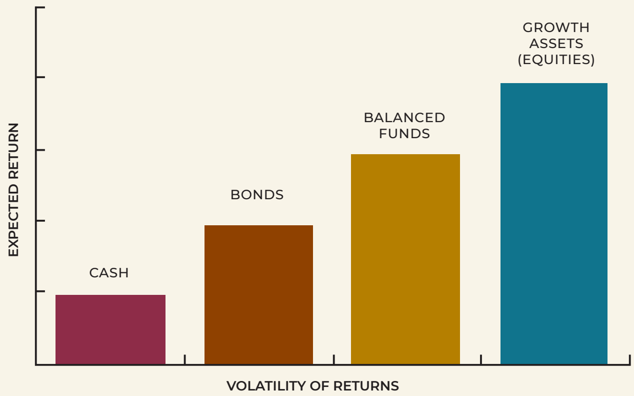
WHAT ARE SMOOTHED BONUS FUNDS?

Smoothed Bonus Funds invest in a range of assets such as equities, bonds, property and alternative assets. The growth in these assets is then passed on to investors by means of a regular bonus. When markets are doing well, a part of the return is put aside to smooth out future ups and downs in investment returns caused by market movements.

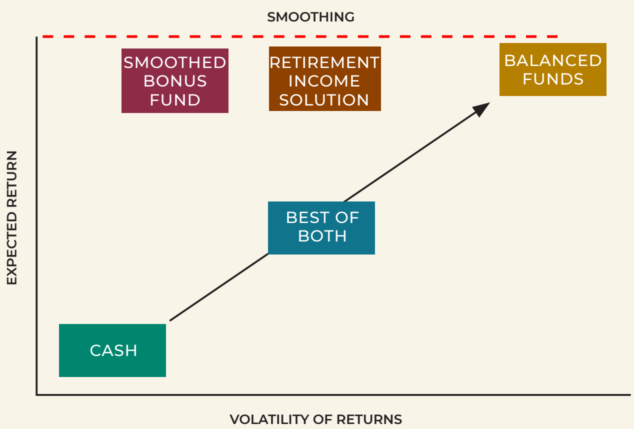
Smoothed Bonus Funds offer the best of both worlds, by providing steady long-term growth while minimising 'bumps' along the way. In other words, these funds help you to grow your money when the markets are doing well, and manage the risk of lower returns when markets do badly.

HOW DO THEY WORK?

In order to provide investors with good real returns, Smoothed Bonus Funds invest significantly in growth assets. Normally this type of high growth approach makes it more likely that the returns could be more volatile (go up and down) in the short term. This relationship between growth assets and volatile returns is illustrated in the graph below. As you move from cash to bonds, to a typical balanced fund and then to growth assets (such as equities), your chance of getting higher returns over the long-term goes up, but so does the volatility of those returns.



The inclusion of a Smoothed Bonus Fund helps to overcome this by providing good long-term returns much like a similar balanced fund, but at the same time smoothing out the ups and downs, that you would usually experience with these types of funds.



WHY WE DON'T THINK KEEPING A PORTION IN MONEY MARKET IS BEST FOR LIVING ANNUITY SOLUTIONS?

A common approach used to manage market cycle risk is to allocate approximately 3 years of income to a money market investment as a source of income, to allow a growth strategy time to grow or recover. The challenge with this approach is that should the market fall over the 3 years and income is depleted, planners are forced into a market timing call to disinvest capital again at a lower level than 3 years ago (selling at 'bottom'), or to draw income from the growth strategy capital (the approach planners are planning to avoid). If markets rise sharply over 3 years, money market assets underperform and represent an opportunity cost. If markets fall and recover to the starting point over the 3 years, the money market allocation had little impact. As unit trusts have daily liquidity, there is no need to draw income from a specific asset class. By having material allocations to cash that vary over time, the investment risk of the client actually fluctuates over time, which is not an ideal outcome.

Our solution ensures that risk is kept relatively constant over time. The planner makes no asset allocation decisions and does not have to instruct switches as withdrawals are managed proportionately across the portfolio and the risk of the strategy remains constant.

CONCLUSION

Investors will always compare performance with balanced funds in the same category. Therefore investing only in a smoothed bonus fund may also not be an ideal solution. By investing 50% in a smooth bonus fund, the investor enjoys significant protection in bear markets. The 50% invested in a high growth model portfolio strategy allows the investor to participate more directly in bull markets. The combination means that the retirement income solution aligns performance more to the market cycle, giving the investor the best of both worlds. This strategy makes for easier client conversations during market volatility and allows an increased chance of clients sticking to the strategy over the long term. Advisers are encouraged to consider this approach, as it is in their client's best interest to formulate a long- term investment strategy that is equipped to deal with normal market cycles, instead of reacting to market cycles based on hindsight.

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