

This is an original article written by Philip Loh; the edited version appeared in the Business Times 28th March 2007.

Construct your own retirement plan to make your money last forever

Four vital strategies for retirees and near-retirees

Coming up with a retirement plan to make your nest egg last for two or three decades is a daunting task. This is made worse by the fact that you cannot afford to make any critical mistakes, since it can be almost impossible for you to recover from a capital loss if you incur one in your latter years.

So to start constructing your own ideal retirement plan, make sure that there is a good balance between growth, fixed income and liquid assets.

Growth Assets – These investments help you maintain accumulation potential within your portfolio so that your assets can outpace inflation and last longer than you do. Although they provide historically greater returns, they tend to carry a higher level of risk too. Examples of such assets include equities.

Fixed Income Assets – This type of investment usually provides fixed and stable overall returns. Examples include pension payments, rental income and monthly retirement withdrawals from your CPF minimum sum. Bear in mind that some fixed income instruments like corporate bonds and mortgage-backed assets can be subject to interest and default risks.

Liquid Assets – As these assets pose a lower level of risk, their returns tend to be less attractive too. But they can be converted into cash quickly so they are ideal for tapping into for your daily expenses. Fixed deposits and money market funds are some examples of the liquid assets.

Below are some useful pointers to bear in mind when putting together your ideal retirement portfolio.

1) Avoid investment bubbles at all cost.

Remember the red-hot technology stocks of the late 1990s? Many people who bought into a technology fund at the peak may be left with 50 percent of their original investment after seven years. Most of them were saddled with such severe losses because there is usually no warning before the bubble bursts. Generally, by the time you hear about an investment idea, the bubble is usually on its way to bursting already, so steer clear of such bubbles at all cost or you may never be able to fully recoup your losses in time.

2) Consider investing in dividend stocks.

As the name indicates, dividend-paying stocks provide good dividend payout. With several Straits Times Index component stocks like banks and property counters trading at historical highs, a better place to find such cash gems may be in the second liners. Small-sized but well-run companies flush with cash are also worth considering. You can switch to other cash-loaded companies when dividend payouts from existing

dividend stocks start to drop. This will ensure that you continue to enjoy a regular dividend stream year after year.

3) Strike a balance between bond and money market funds.

Every retirement portfolio should consist of some bonds. Retail investors usually invest in fixed income instruments through a professionally managed bond fund as directly buying individual bond issues require a much bigger investment pool. But the difficulty in constructing a bond portfolio today lies in the fact that long-term interest rates are now lower or almost on par with short-term rates.

This creates an abnormality in the sense that by buying shorter-term maturity notes, your yield may be higher than that from long-term bonds (those that mature in 10 years or longer). Hence money market funds may give a comparable or better yield compared to a typical bond fund with less risk.

The only plausible reason then, why a retiree may find a bond fund more attractive than a money market fund is that he expects long-term interest rates to drop, which will generate capital gains for the bond fund, since the longer the duration of the bond, the sharper the price appreciation when interest rates head south. However, anticipating the direction of interest rate movements can be difficult and even experts in the field often get it wrong.

4) Stick to equity-based unit trusts.

My general rule is, stick to broadly diversified global equity or regional funds. Avoid narrowly focused country-specific or sector funds unless you know exactly what you are doing or the investment involves only a small portion of your capital. The potential losses from country-specific funds or sector funds may be much higher than the general tolerance level of most retirees. There are however many investment-savvy retirees that I know personally who understand fully what they are doing and have well-thought-out investment game plans. For the rest of you, it is better to err on the side of caution.

With rising longevity risks, it is important that you focus on total returns rather than how much income your investment can generate. Your total returns include the gains on your stocks, as well as dividend payments and bond interest. A sufficient portion of the portfolio should also be invested in growth assets to offset longevity and inflation risks. Meanwhile, the balance, which should be invested in fixed income, can offset some of the equity risk.

Besides relying on fixed income and dividend payouts for the cash you need to live on, you can also sell shares or unit trusts systemically to fund your retirement lifestyle. Follow these time-tested principles and enjoy a long and blissful retirement!