How to influence your retirement outcome

CEE Investment conference, CFA Istanbul

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Schroders

Charting a course

Outline

I. Protecting your money!
   - Money – vs. time-weighted returns
   - Inflation and volatility

Question?

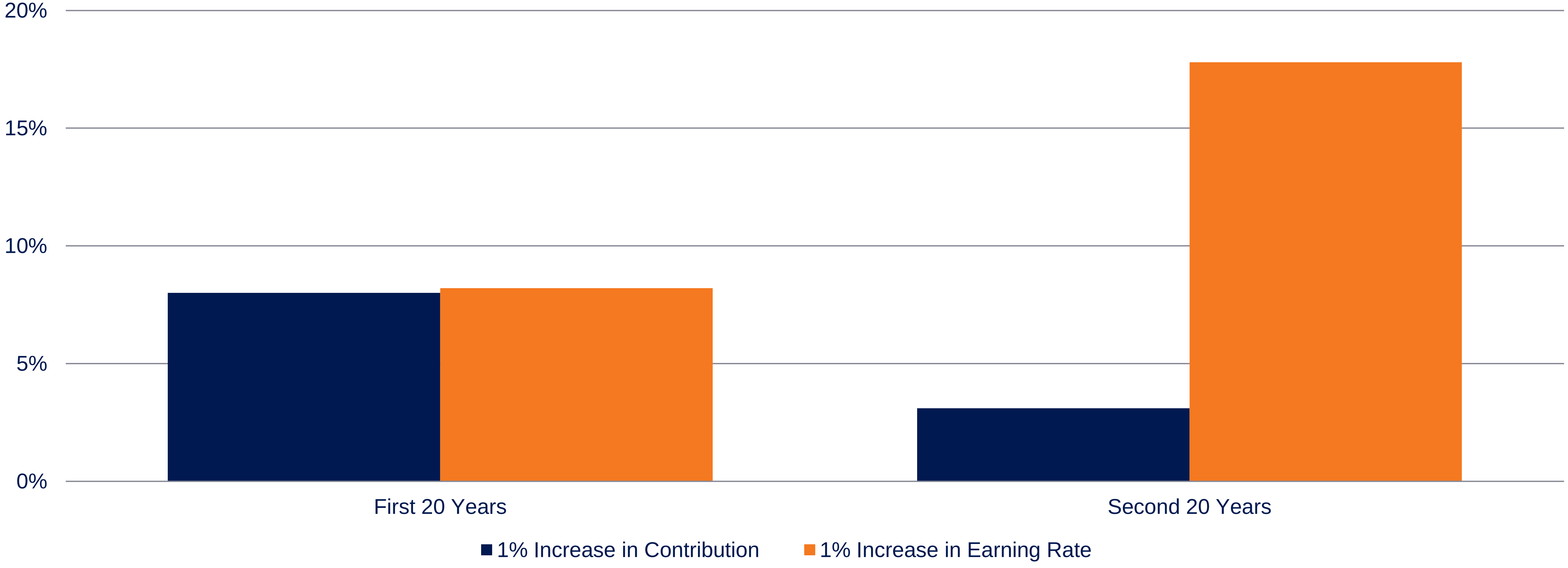
- You will save for 40 years and want 50% income replacement
  - You want the pension to grow at 3% p.a.
  - You want a 50% Spouses pension
  - And you will earn a 4% real return after costs
- How much do you need to save?
  - 10%
  - 15%
  - 20%
  - 25%

Houston, we have a problem!

Path dependency – The money weighted problem

Impact of contributions and investment returns as members age

% increase in end benefit

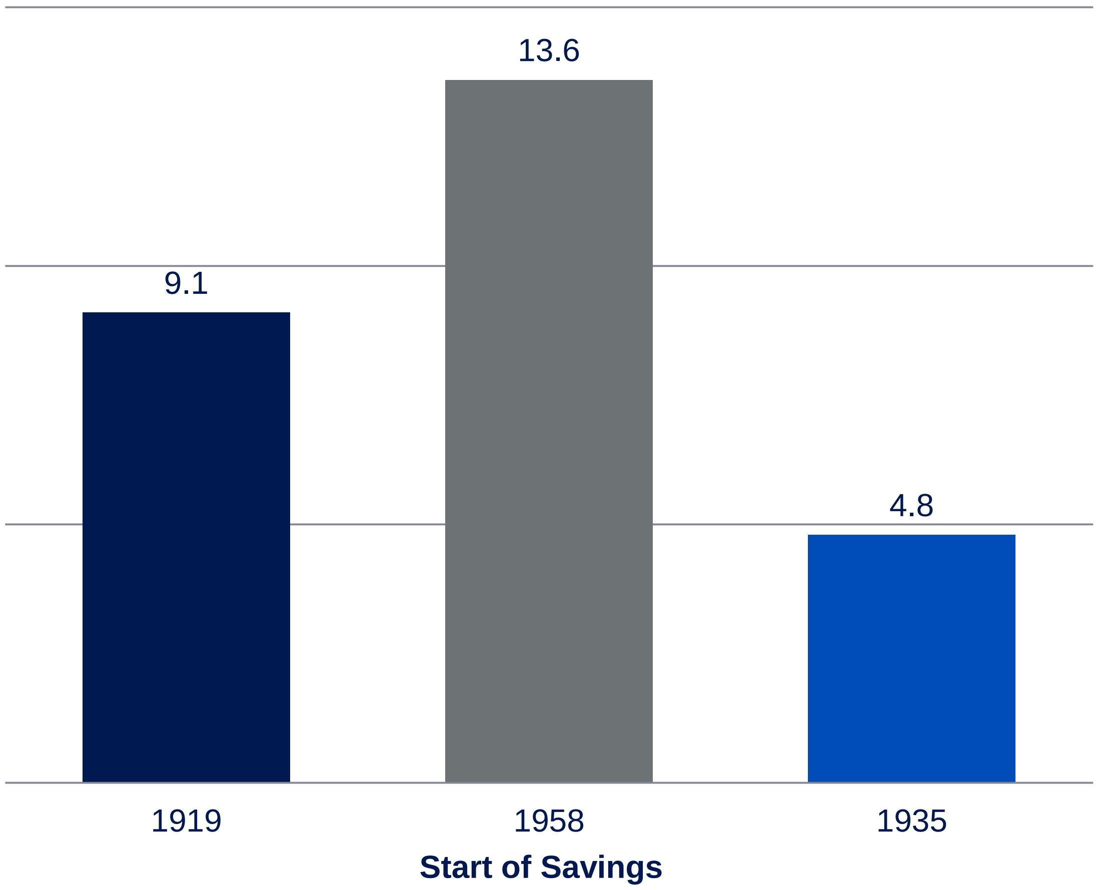


Source: Schroders. 40 Year contributions at base contribution rate of 9% of salary, indexed at 3%p.a. Annualised earning base rate 8%p.a.

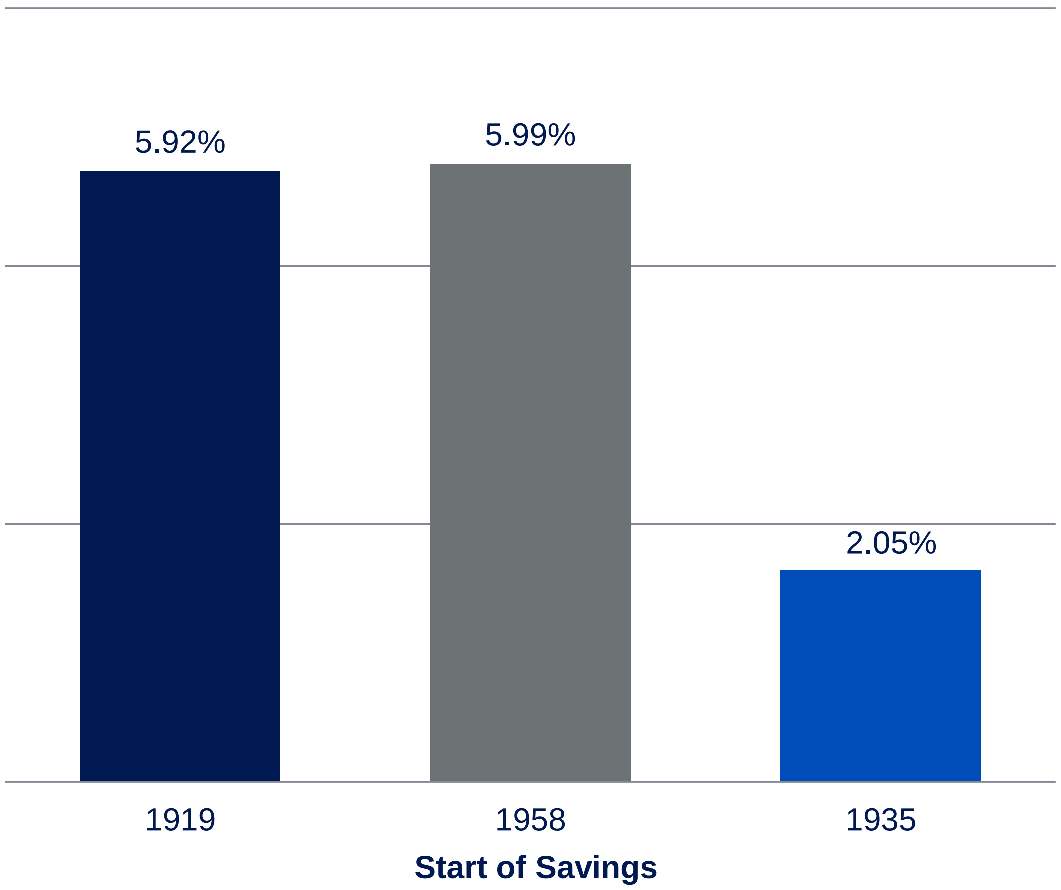
40 Year Savings Outcomes

Impact of contributions and investment returns as members age

End Benefit as a Multiple of Salary



40 Year Average Rate of Return



Source: Why SAA is Flawed, Schroders, April 2012

Meeting Expectations

“Doing what we say on the side of the tin”

Investments are inherently uncertain

- Public understanding of investments is (very) low
- In particular, understanding the impact of time and contributions on reaching goals

(Secular Bear Markets)		
Period	Duration	Annual real return
1802–1815	13	+2.8%
1835–1843	8	-1.1%
1853–1861	8	-2.8%
1881–1896	15	+3.7%
1906–1921	15	-1.9%
1929–1949	20	+1.2%
1966–1982	16	-1.5%
Overall	**95**	**+0.3%**

(Secular Bull Markets)		
Period	Duration	Annual real return
1815–1835	20	+9.6%
1843–1853	10	+12.5%
1861–1881	20	+11.5%
1896–1906	10	+11.5%
1921–1929	8	+24.8%
1949–1966	17	+14.1%
1982–2000	18	+14.8%
Overall	**103**	**+13.2%**

US Equities
Source: Stock Cycles: Why Stocks Won’t Beat Money Markets Over the Next Twenty Years, Michael A. Alexander

Income – when it is time to cash in

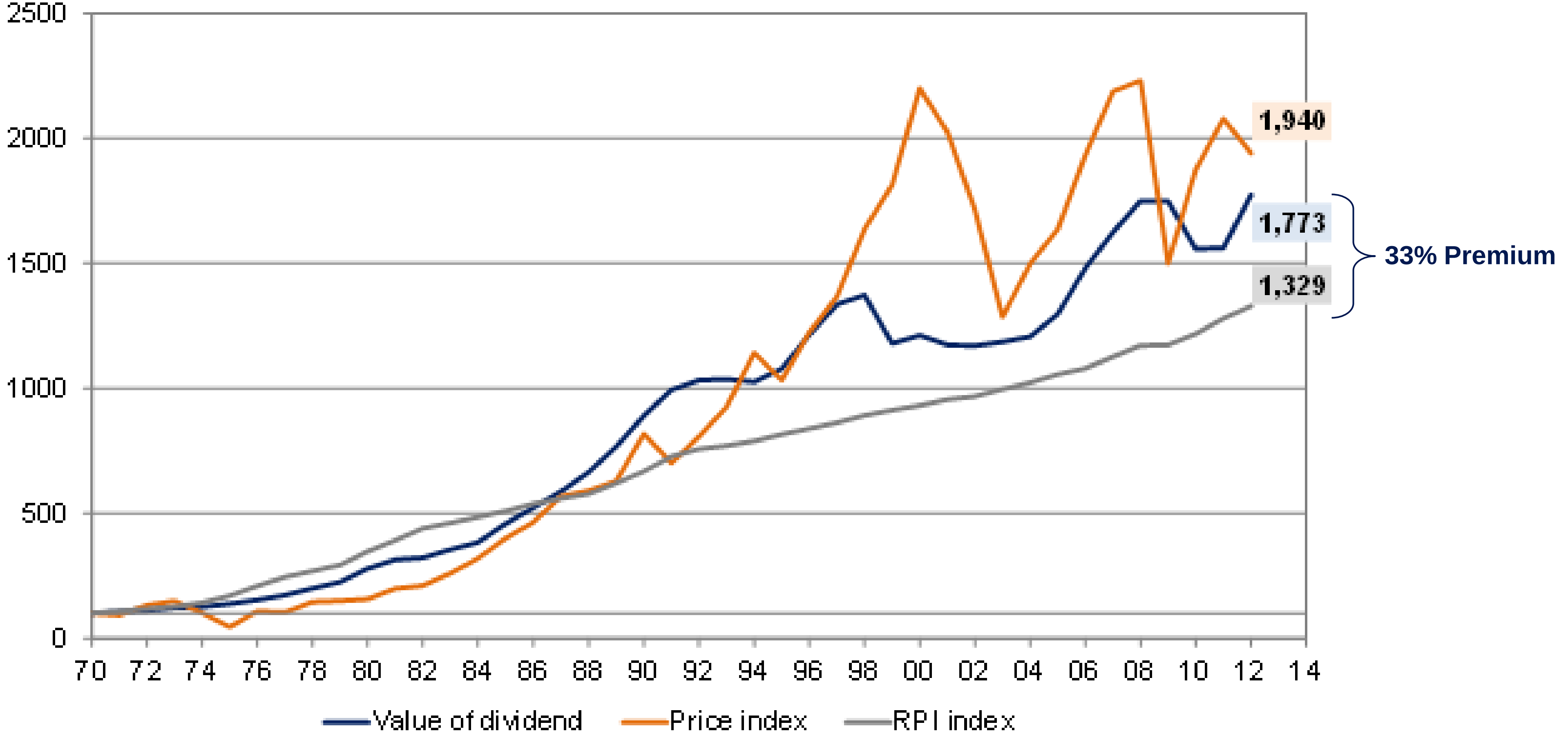
An important risk management tool

- Protection against inflation
  - May be not now, but later???
  - Dividends have a record of growing faster than inflation in the long-run
  - And we understand why
- Protection against volatility
  - Reduces the risk of having to sell assets at depressed prices
  - Averaging out!

Income vs. Inflation

UK All Share Index

Annual index (1970 = 100)

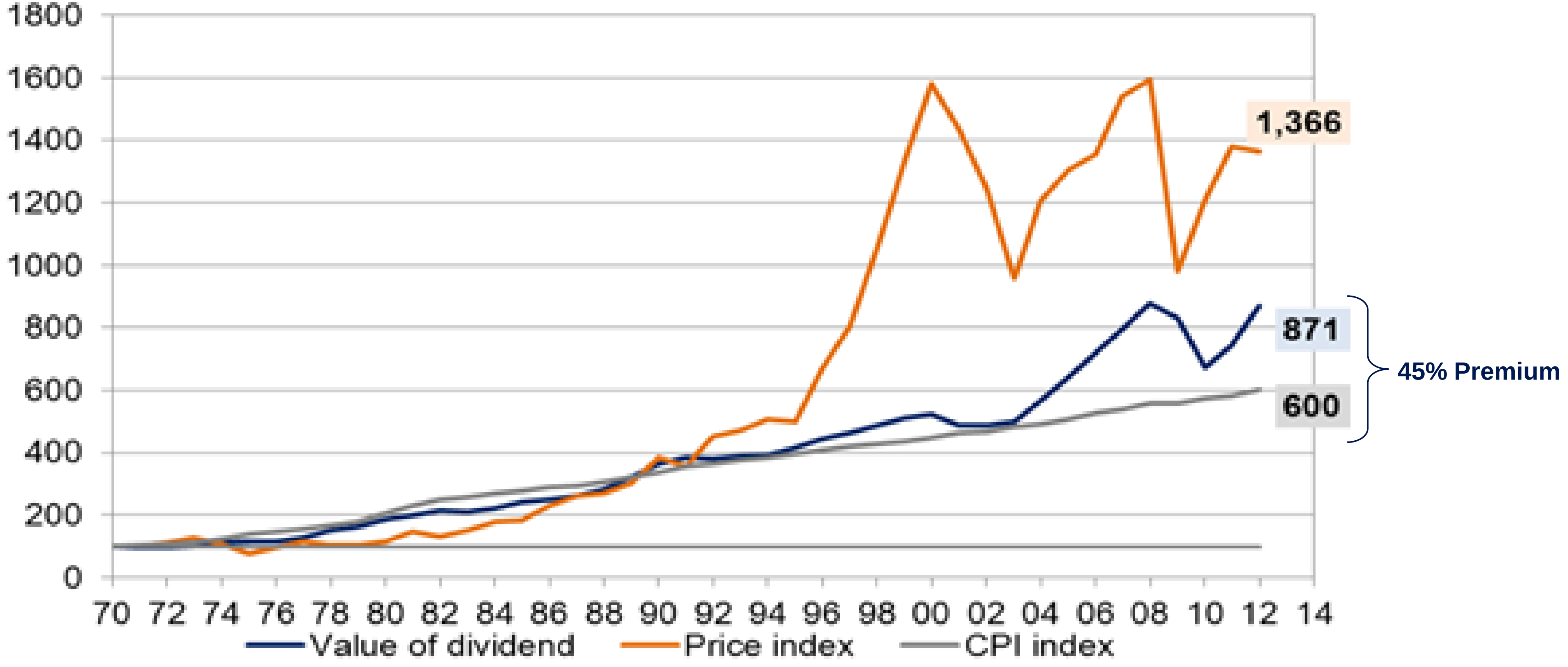


Source: Thomson Datastream, Schroders

Income vs. Inflation

S&P 500 Index

Annual index (1970 = 100)



Source: Thomson Datastream, Schroders

A test of two strategies in two periods

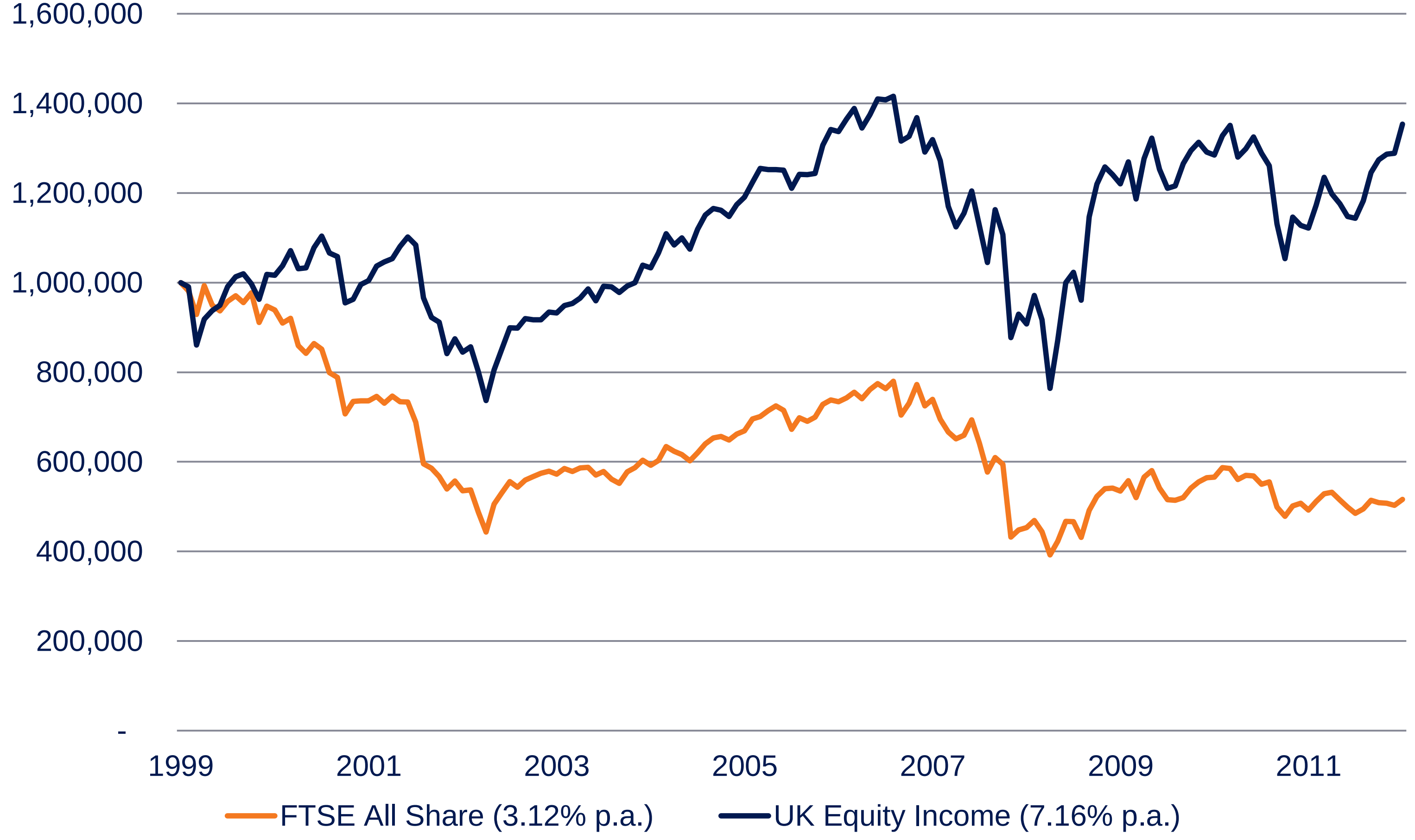
Bear period 2000 – 2012, Bull period 1988 – 1999

%	1988 – 1999	2000 – 2012
UK Allshare Index		
Time weighted return p.a.	15.77	3.12
Average yield	3.92	3.19
UK Equity Income Fund		
Time weighted return p.a.	14.61	7.16
Average yield	5.03	3.88

Income as a Risk Management Tool (Bear phase)

£50,000 p.a. Initial portfolio £1,000,000

Income Drawdown Simulations



Source: Thomson Datastream, Schroders

Actual Returns:

Schroder UK Equity Income Fund

FTSE All Share Index

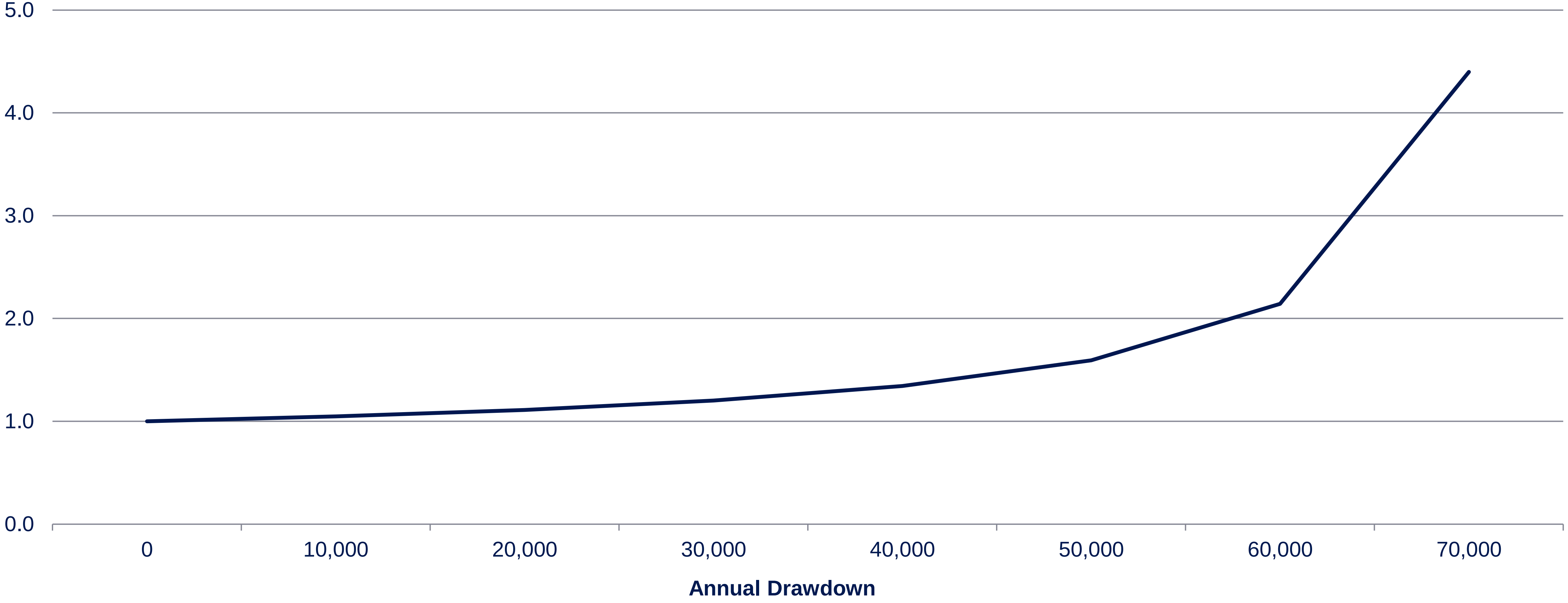
Ratio of Total Return Indices 1.65 to 1

Ratio of Wealth Outcomes 2.62 to 1

Ratio of Money Weighted to Time Weighted Outcomes

(Identifies the money-weighted as opposed to the alpha impact)

Ratio of Money Weighted to Time Weighted Outcomes (2000 – 2012)

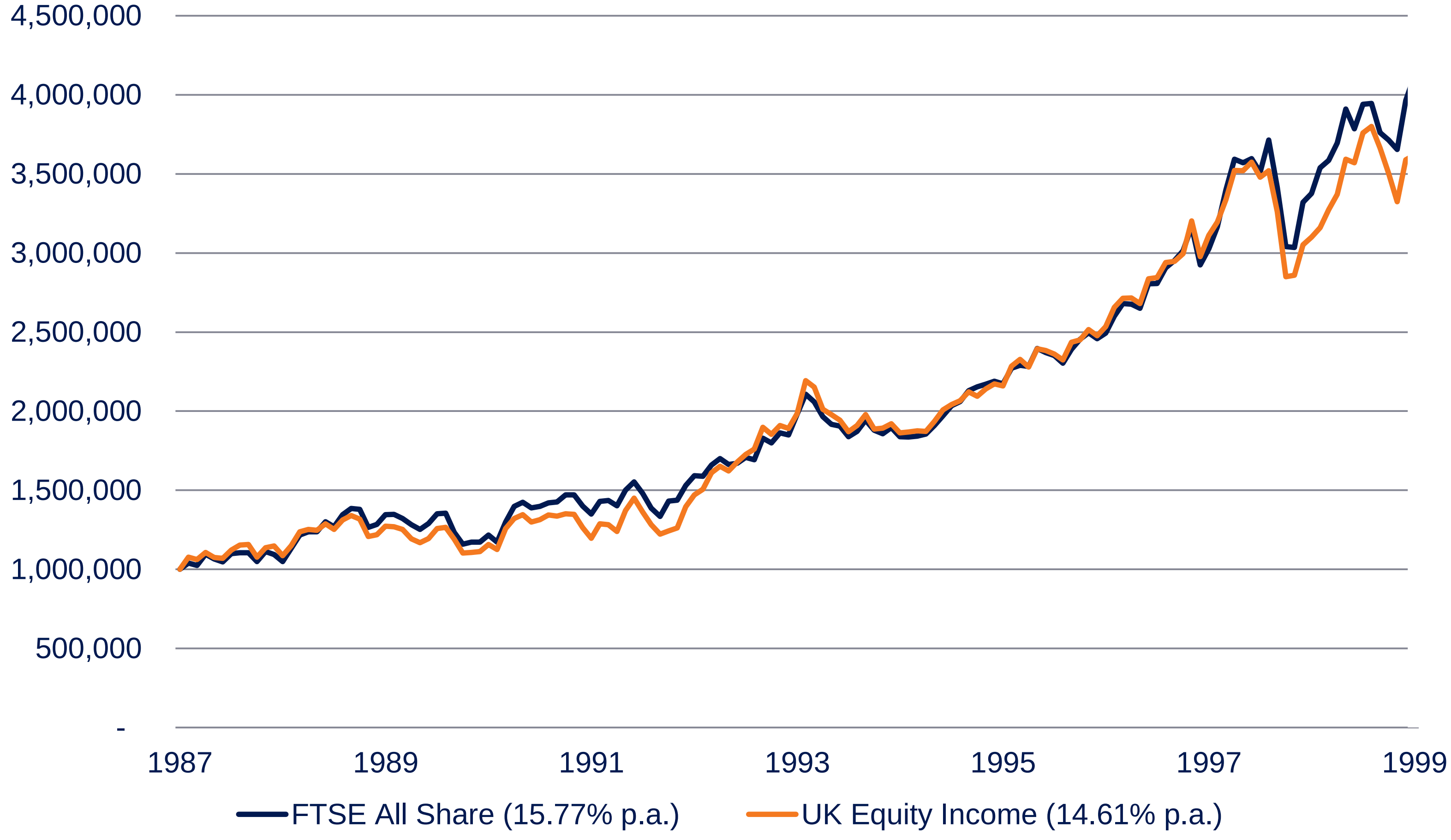


Source: Thomson Datastream, Schroders

Income as a Risk Management Tool (Bull phase)

£50,000 p.a. Initial portfolio £1,000,000

Income Drawdown Simulations



Source: Thomson Datastream, Schroders

Actual Returns:

Schroder UK Equity Income Fund

FTSE All Share Index

Ratio of Total Return Indices 1 to 1.13

Ratio of Wealth Outcomes 1 to 1.14

Conclusion

Today's market pricing raises important questions

- Valuation arguments:
  - Unprecedented uncertainty and extraordinary monetary policy initiatives (ZIRP, QE, LTROs) have stretched valuations to the limit
  - Government bonds are extraordinarily expensive to the point that they are no longer risk free assets
  - Equities look cheap/fair value
  - The relative value of equities over bonds is compelling
  - Questions the suitability of target date/lifestyle funds
- Money vs. Time weighted returns
  - A problem the industry has no answer to
  - Important for investors to recognise the reality
  - It's only when the tide goes out that you discover who's been swimming naked! (Warren Buffett)
- Income
  - In the long-term dividends have protected against inflation
  - In the short-term high levels of income can reduce the risk of having to sell assets at depressed prices
  - Reducing volatility of returns also reduces the money-weighted problem
  - Multi-asset income solutions

Conclusion (Continued)

The four determinants

- Four determinants of the outcome in retirement:
  1. The size of the savings pot
  2. The level of returns
  3. The volatility of returns
  4. The degree to which cash needs are met by “natural” income arising
- As an industry we have concentrated on 1. and 2.
- We need to also focus on 3. and 4.

Thank you!

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