RETIRED INVESTORS - WHAT NOW?

PILANESBERG: Retired investors have been severely affected by the stock market roller coaster over the last two years. In addition to the significant drops that we saw in 2008/9, we are now seeing massive changes of direction on a weekly basis. These kinds of movements are very unsettling for all investors however retirees are most severely impacted. During these difficult times, it is important to return to basic principles to help you navigate these turbulent times.

YOUR ROAD MAP

Every investor should have a long term investment plan that guides all their investment decisions. This investment plan will be very helpful when the investment world is in a mess. If you spend any length of time looking at the history of stock markets, you will quickly realize that the investment world is almost always in a state of instability. This makes the need for your own investment plan even more critical. A proper investment plan is determined by your age and financial position in equal measures. The most important part of your investment plan should be the allocation to shares, bonds, property and cash. This combination will have the greatest impact on your investment performance over your lifetime, so it is critical to get it right. The best way to illustrate this is to look at three people of different ages.

Table A: Age as the only determinant of asset allocation

Asset class & % of your capital invested in the asset class	**35 year old**	**55 year old**	**70 year old**
Shares	65%	45%	30%
Bonds	5%	20%	30%
Property (excluding your home)	25%	25%	20%
Cash	5%	10%	20%
TOTAL	**100%**	**100%**	**100%**

If you only considered age as the SINGLE determining factor for your asset allocation, you could use the table above as a good guide for the remainder of your life. Unfortunately, life is not that simple; you also need to consider your current financial position. If we consider the example of a 70 year old lady who is very wealthy, it is likely that she is planning to leave the bulk of her assets to her children and grandchildren. This would require a totally different asset allocation as she could invest a greater percentage in shares and property and a much smaller portion in cash and bonds. Any major stock market movements are unlikely to impact her lifestyle significantly as she will always have sufficient capital to meet her expenses.

In contrast, if we consider a 70 year old man who is in a poor financial position, he should have very little capital invested in shares. This might seem like a bad recommendation as he needs as much capital growth as possible. Unfortunately, you can only get capital growth if you are prepared to take risk - the greater the potential growth, the higher the potential risk. An elderly investor with insufficient capital cannot afford to lose any money and therefore needs really low risk investments. This means he should have minimal equity exposure.

INFLATION IS A BIGER THREAT THAN A STOCK MARKET CRASH

Retirees should be most concerned about inflation and less concerned about stock market crashes. Most stock market crashes are followed by recoveries within 3 to 5 years – there have been only a few crashes where recoveries have taken longer. By contrast, inflation is a guaranteed corroder of wealth but it does this so slowly that we only realise its full effect after it is too late. For a retired person who has the correct amount invested in shares, a stock market crash should not necessitate a change in your investment plan. As an example, a normal 70 year old with 30% in shares should not reduce her equity investment after a market crash. It is most probable that the stock market will recover and reward her patience with continued capital growth. During the time when the market is low, she can rely on her cash, bonds and property. Unfortunately, many retired investors panic and sell their remaining shares after a crash but before the recovery. By doing this, they have guaranteed that their shares cannot recover which means they now have no inflation protection. They are guaranteeing that their capital will erode in value by the inflation rate every year. One could argue that a 70 year old should not have any share investments but what happens if they live to age 85 or 90 – anyone who advises them to avoid shares would be irresponsible.

IT IS NOT TOO LATE TO CREATE YOUR OWN PLAN

If you have been caught out by the most recent crash because you investments were incorrectly structured, it is not too late to develop your own plan now. If you are in your 60's - you need to remember that you should be planning to invest for another 20 to 35 years. Whilst retirement is a transition phase in your life, it is not the end of your time as an investor. If your financial position necessitates a 35% investment in shares, you should start adjusting your investments to reach that target. If you need to increase your investment in shares, you should phase your share purchases over a period of 6 to 9 months. This will reduce the impact of the enormous market swings that we are seeing now. The same principle applies if you have too much invested in shares but perhaps you should plan your phase-out over a longer period i.e. 9 to 15 months.

In summary, the market will always be uncertain and we will always have commentators telling us that the world is going to end soon – in financial terms. We cannot let ourselves be swayed by these events as uncertainty creates the opportunities to beat inflation. The price of certainty for retired investors is simply too high, you are sacrificing inflation protection for short term, psychological well being.