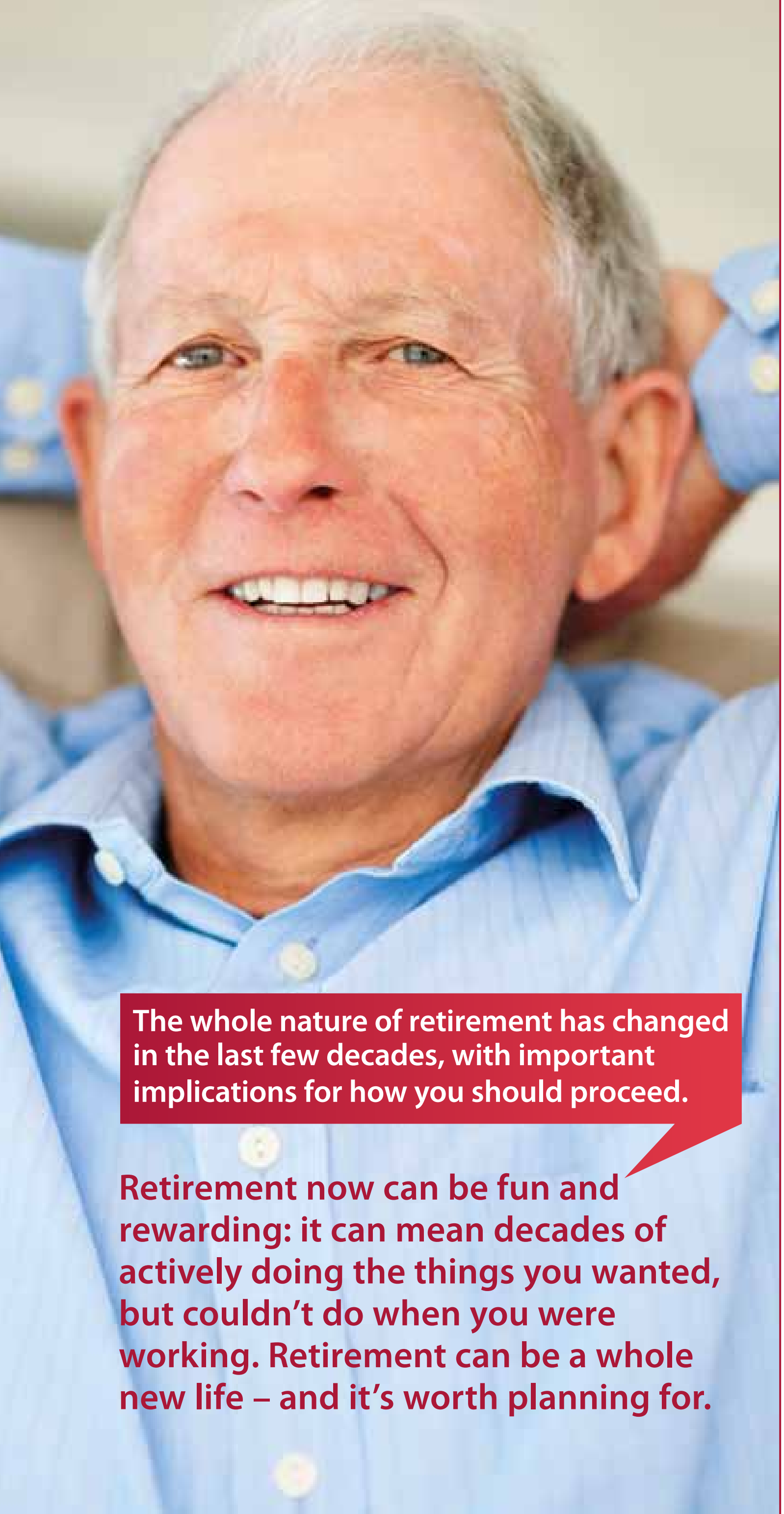
July 2011

Black Swan Event
FINANCIAL PLANNING

THE NEW ERA of Retirement Planning

THE LOWER YOUR RETIREMENT SAVINGS,
THE MORE IMPORTANT THIS ARTICLE IS TO YOU.

Level 11, 28 The Esplanade Perth WA 6000 • P (08) 9322 7818 • F (08) 9481 5570 • E perth@blackswanevent.com.au • W www.blackswanevent.com.au



The whole nature of retirement has changed in the last few decades, with important implications for how you should proceed.

Retirement now can be fun and rewarding: it can mean decades of actively doing the things you wanted, but couldn't do when you were working. Retirement can be a whole new life – and it's worth planning for.

People increasingly look for an active retirement, with more of the things they love plus new experiences and achievements.

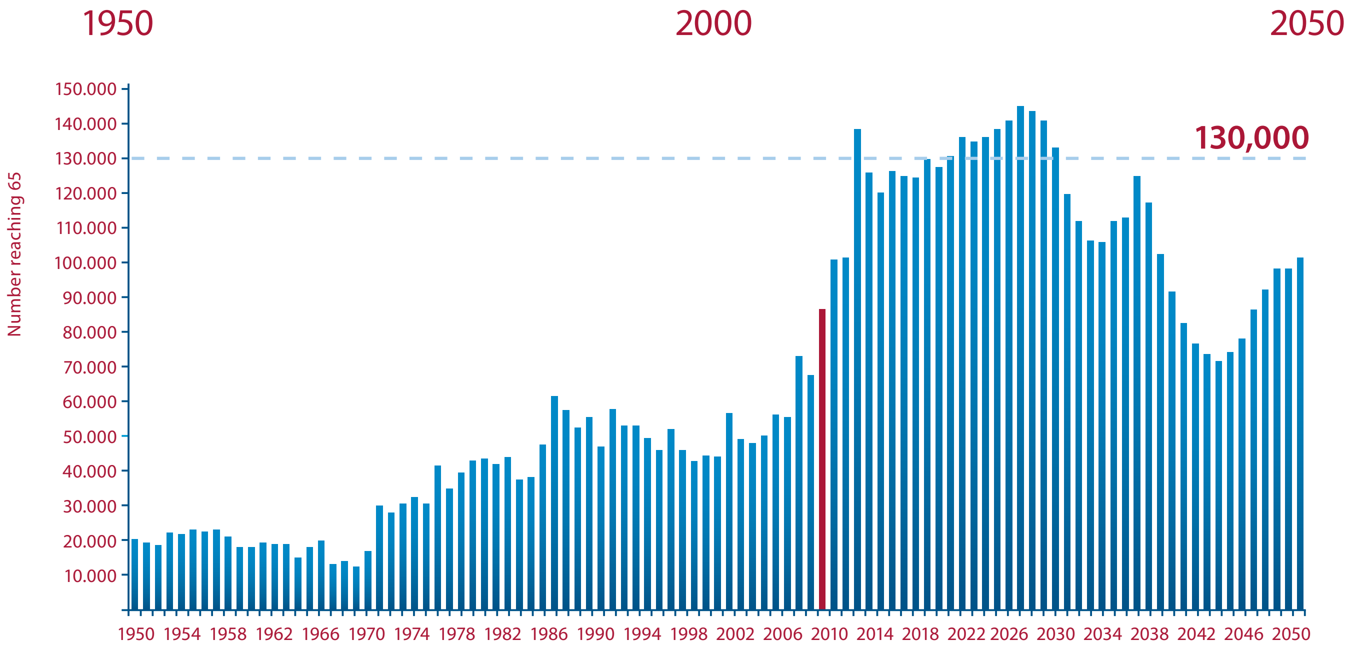
- More and more people are continuing to work (often part time) into their retirement years. Often they want some extra, optional income, sometimes this is how they choose to stay active and involved.

- People retiring now have bigger superannuation balances than previous generations – they are the first generation to reap significant benefits from the evolving superannuation system.

- There are more people than ever moving into retirement age. The following chart shows the number of people in Australia turning 65 in coming years.

- Services for retired people are expanding (eg, advanced hearing aids, home-delivered medical services, specialised travel) but governments are backing away from being the primary financial supporter of retirement and increasingly services are market priced.

- Financial institutions are now developing new products specifically targeted to retirement income. Up until recently we have had to make do with products where the money could run out after a few years. (Many people who retired just before the GFC saw their capital, and lifestyle, severely affected by the GFC. More on this later.)



Net growth in population (65+) over 100 years in Australia

Source: Challenger Financial

Retirement means different things to different people. However, one theme keeps cropping up – Financial Security. Retirement should be free from worries about your financial position, and it is this freedom from financial worry that gives you the confidence to pursue other activities and interests – in other words do the things you have long wanted to do, but haven't been able to.

PLANNING

With good planning, it is now possible to lock in a high degree of certainty and security, to your retirement.
On the subject of planning, the sooner you start the better.

There are a number of strategies to build your capital, over the years prior to retirement. However, the area can be complex and we can certainly help you onto the right path.

Now, back to the main subject.

At last, the superannuation system is starting to shift its focus to the retirement phase of life. Up until now, it has largely been focused on the accumulation phase. However, to get this security, there are a number of "ducks that need to be lined up". Exactly how these ducks are lined up will vary from family to family depending on things such as:

- How much money or other assets you have
- Your age
- Your goals, including preferred lifestyle
- Your health and life expectancy
- Your family situation and Estate Planning goals
- Your cost of living
- Your risk preference

While the possible mix of factors is great, there are a few important settings.

Age Pension

The Age Pension continues to be an important income source for many Australians. To qualify, men must be 65 years old (64 years for woman rising to 65 by 2014) and meet other requirements. (Eligibility for the age pension will rise to 67, in stages starting from 2017.)
Also, to qualify, people must meet both an Assets and Incomes Test. (The test which gives the lowest pension, applies.)
The limits differ for the different housing and family situations. Below are the figures for homeowners.

Assets (Homeowners)		
	To get full pension assets must be below	Pension cuts out when assets exceed
Single	$186,750	$673,000
Couple (combined)	$265,000	$998,000

Note: Figures as at July 2011. Limits are indexed regularly.

Income		
	Full pension if other income below	No age pension if other income above
Single	$150 p.f. ($3,900 p.a.)	$1,608.60 p.f. ($41,823 p.a.)
Couple (combined)	$264 p.f. ($6,864 p.a.)	$2,462.80 p.f. ($64,032 p.a.)

Note:
1) Your home is excluded. Superannuation is also excluded under retirement age.
2) There are special rules for calculating income received from financial assets and income streams, which can result in the income as calculated by Centrelink being a lot less than you actually receive.

Arranging your investments in a way that will help you get the most out of Centrelink, can greatly boost your retirement lifestyle.

Taxation

The system contains a number of tax breaks for those of retirement age. Some are :

- Superannuation payments (lump sum or pension) are tax-free after age 60.
- Earnings within pension funds are tax-free.
- Various offsets which enable retirees to greatly reduce tax on income from other sources (i.e. from sources other than superannuation) and possibly eliminate tax completely.

Income

It's worth repeating that the last couple of years has seen great improvements in the quality of retirement income products on the market. You may need to update your knowledge – and your expectations. It is now possible to invest in products that:

- Provide a guaranteed lifetime income, which is indexed to movements in the cost of living, with access to capital in the first 15 years.

OR

- A guaranteed lifetime income based on the amount of capital invested. If the investments do well, and capital value rises, income also may rise (but will not fall if investments drop in value). Also, available capital can readily be withdrawn in whole or part, at anytime (but this will reduce income).
- Some products are limited to superannuation money, whereas others can be purchased by either superannuation money or non-superannuation money.

In other words, you can have the twin benefits of guaranteed income, and access to capital. Access to capital overcomes one of the big failings of some old income stream products – loss of capital in the event of death, soon after investing.

Investments

Income-oriented investments described above provide high security, but earn moderate returns. As well as day to day income, there is also a need for other investments to meet emergencies, or provide for the additional "luxuries" or to meet increased health or accommodation costs in old age. Thus an investment in longer term growth investments such as shares is usually warranted. Often the preferred result is a combination of investments that provide guaranteed income, plus some funds invested in cash; variable rate interest bearing securities, term deposits and shares.

WHERE

So where does this get us and how can I help?

Expertise and experience count

At Black Swan Event Financial Planning we have had over two decades experience in the specialised design of retirement plans.

With the new products now available, we can offer you real security and stability to assist in protecting you even from "Black Swan Events" like the Global Financial Crisis.

And you don't have to be rich to take advantage; a lot of our clients receive part pensions that extend their own savings into a comfortable retirement income. We'll give you the same conscientious, personal service even if you are not a "high net worth individual".

Choose the right tools – and the right craftsman

There is a multitude of retirement products on offer. Many are aggressively promoted, and it is no wonder that many people are confused. All of the products now available, even the best of them, are only tools to do a job (provide retirement income).

I liken it to repairing a broken door at home. To fix it, you will need tools. Probably more than one – say a screwdriver and hammer. Not just any screwdriver and hammer, but ones suited to the job: a Phillips head if there are Phillips head screws and one that is the right size, for example. A sledgehammer probably won't be the right hammer.

Whether it's a financial plan or a door, it's also true that tools alone won't get it done. You need someone who knows how to choose and use the tools to get the right result.

At Black Swan Event Financial Planning one of our primary roles is helping people choose which products to use (often it is more than one) and putting them together in a combination that may assist you in achieving your goals.

After years of hard work, the last thing you want to face in retirement is the constant worry about your finances. Unfortunately, many people who retired in the last couple of decades have faced just that – continuing market volatility, erosion of capital, diminishing income and reduced lifestyle. Not at all what they hoped for!

It doesn't need to be like that.

A bit more background:

FORECASTS, AVERAGES AND THE IMPORTANCE OF THE FIRST FEW YEARS

Forecasting

One of the hardest parts about retirement planning is forecasting the future and what sort of returns will be available from investments.

Planners have traditionally tried to reduce variation by looking at averages. They would for example take a long term average return and plot how a portfolio would perform after allowing for withdrawals, assuming that the average was always true.

This was convenient for planners, but recent experience, and now research, shows it does not work.

Why averages can be very misleading.

It turns out that averages, by themselves, are just about meaningless. To add meaning, you also need to know how much variance there is around the average – if there's not much, the average is a good guide. If there is lots of variance the average is just about meaningless. And financial markets, as we all know, have lots of variance.

Think about a person standing with one foot in a bucket of ice and the other foot in a fire. The average based model predicts that they are feeling quite comfortable, with a pleasant average temperature. In reality they will be freezing and frying at the same time. The actual experience of people in retirement varies hugely – and averages are a very poor guide.

THE CRITICAL IMPORTANCE OF THE FIRST FEW YEARS

A very important, often overlooked, lesson of retirement financial history is that it can matter more when you retire than how much you retire with. Prior to the introduction of new income streams, the first few years of retirement were critical in determining what sort of retirement you had. If you happened to retire in a good investment climate, your asset base could grow strongly, even after meeting your income needs. You may never run out of money, your real income may even go up. But if you happen to retire into a bad investment climate, your earnings may not cover your drawings, your capital will run down and if it falls below a critical point relative to your drawings it will set you on a path to run out of money. This is what happened to many people who retired just before the Global Financial Crisis.

The good news, is that it doesn't have to be like that now.

Let's look at an example of how things can go wrong under the "old" system.

Consider a person with $400,000 in superannuation who starts an allocated pension of $20,000 p.a. (5% of account balance). Assume that they earn 25% p.a. in each of the first 2 years (yes, that sort of thing actually happened in the 1980s). Then at the end of 2 years, the account balance would be :

(A) $564,000 (rounded)

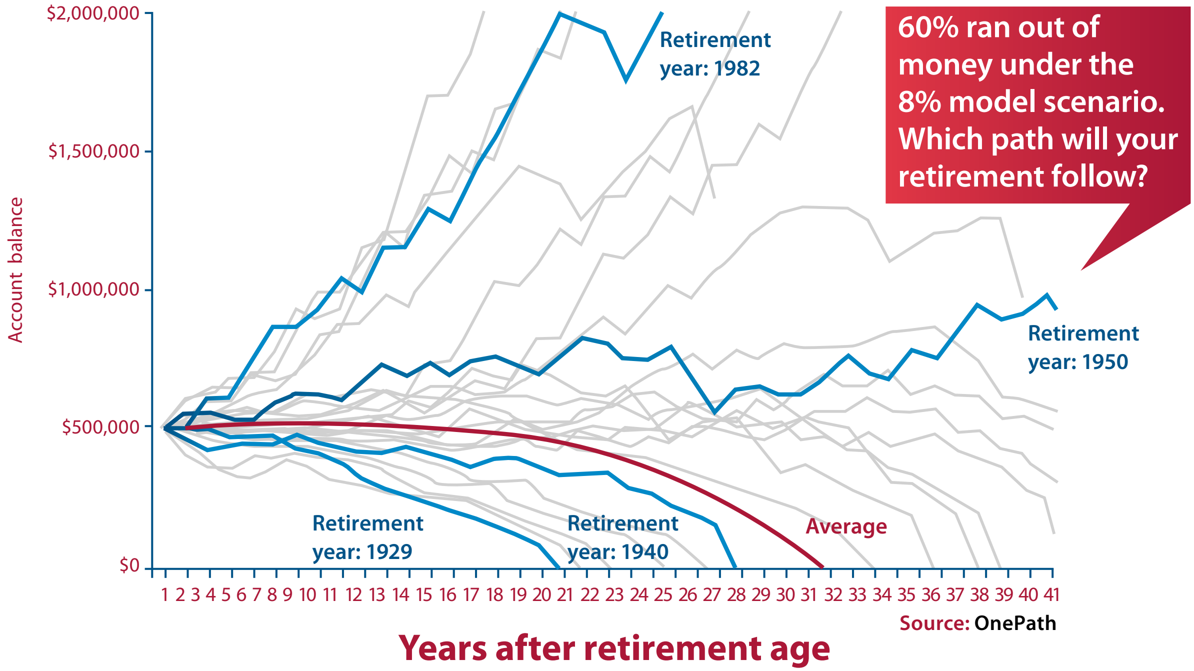
If, however, markets returned ***minus 25%*** *in each of the first 2 years (think GFC), the balance would be :*

(B) $203,000 (rounded)

Obviously, the situation would be much worse in case (B). In that case, the people face an almost impossible task to recover their position and chances are that their retirement lifestyle will be permanently damaged. In case (A), however, people have got off to a flying start, and have built a good buffer against any future falls. Their retirement lifestyle is in much better shape.

Financial services companies have recently delved deeper into this. The graph on the next page plots the position if investment returns following retirement were to mimic that shown in the starting year. (The line marked "1982" for example, shows the account balance if returns were to mimic those achieved in each year following 1982). The lines show the account balances, after taking an income and adding investment returns.

There are important conclusions that come out of this.



Data and assumptions:
$500,000 invested in a diversified, multi-sector balanced portfolio comprising 25% Australian shares, 25% International shares, 30% International bonds and 20% Australian bonds rebalanced annually. Historic retirements commence in 1875 and every 2nd and 5th year thereafter until last commencing in 1985. Each portfolio funds an initial 5% drawdown in year one, thereafter an amount adjusted by the historical average of 3% inflation. Inc 1.8% fees.

Source: **Wealth BenchmarksTM**

A wide range of outcomes

As you can see in the chart, even though everybody started at the same point and drew the same income, the range of outcomes is huge:

Somebody who retired in 1982 hit the jackpot. Not only have they drawn an income, but their capital has quadrupled, so they will never run out of money.

Somebody who retired in a year equivalent to 1929 would see their money run out in 19 years.

Some people have truly prospered, others have done OK and others have truly struggled, even though they started with the same capital and took the same drawings. In other words, relying on “averages” is just about useless – the range of possible outcomes is far too wide.

THE SOLUTIONS

There are now two types of solutions available:

1. Indexed Lifetime Annuity

An annuity provides a guaranteed income, in exchange for an amount of capital. In the case of a lifetime annuity, the income is payable for life. Indexation, means that payments are fully adjusted each year, to take account of changes in the cost of living. In the case of couples, the payments can continue until the last survivor passes away.

Annuities can be started with either superannuation money or non-superannuation money.

One of the traditional problems with annuities, was a potential loss of capital, if you passed away shortly after taking it out (and you had not had the time to receive sufficient income to recoup your capital). The new generation of annuities addresses this issue, by allowing you to redeem (or commute, to use the terminology) all or part of your capital in the first 15 years (either out of choice, or in the event of death). This is an important development and one which (together with indexation) makes annuities attractive.

Also, annuities combine well with the assets test and incomes test, to help you get the maximum amount of age pension, that you can.

2. Money For Life

Another recent entry to the guaranteed retirement income field is "money for life".

"Money for Life", and how it works.

Protected Income Base

Protection commences from day 1.

When you invest in MoneyforLife a Protected Income Base will be established. Your Protected Income Base is used to determine your income payment. While your account balance may fluctuate day to day, your Protected Income Base may rise but will not fall with the markets.

Ratchet

Positive performance can increase your income.

Your Protected Income Base is recalculated every year and when you begin drawing income. This ensures that you capture investment growth and are protected from market downturns.

Income Payments

Certainty of Income in retirement.

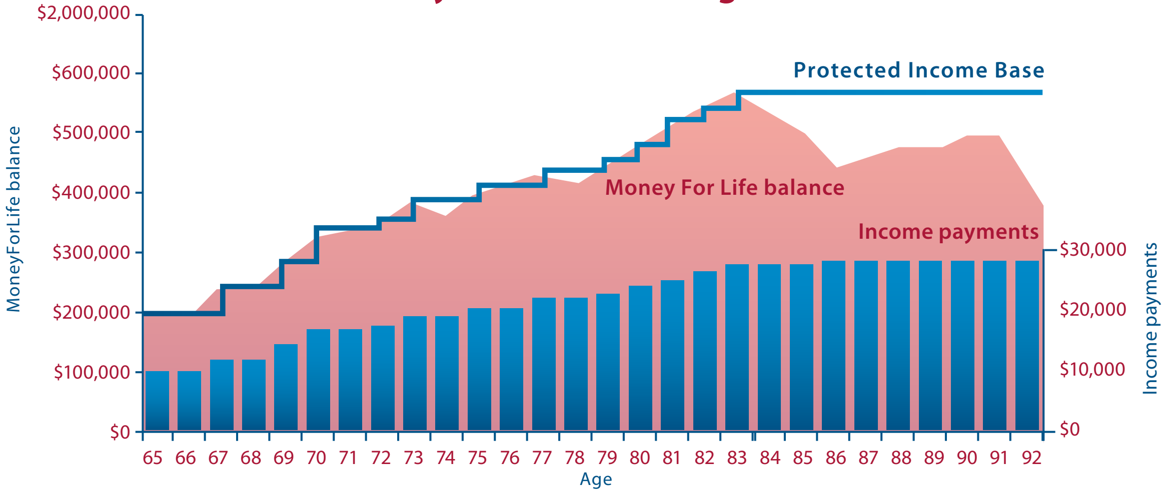
You will receive an annual income payment which is calculated by multiplying an income rate by your Protected Income Base. If you are between preservation age and 64 the income rate is 4%, if you are 65 or older the rate is 5%. This rate is set on your first income payment from your MoneyforLife investment funds and will be retained for the duration of your account. If your account balance rises, then 5% of the new account balance will translate into a permanent, higher income. But, if the account balance falls, your income will not fall. In other words, your income can rise, but will not fall.

MoneyforLife Balance

Access and control.

You always have access to the balance of your MoneyForLife investment funds and control over which investment funds you invest into. If you decide you no longer need the protection, you can access your account value (subject to superannuation rules.)

MoneyForLife in a strong market



Source: OnePath

Guaranteed Income Payments

Income for Life.

Even when the balance of your MoneyForLife investment funds run out, you will continue to receive guaranteed income payments for life.

Retire on your terms

Deciding when to retire should be determined by your own personal goals, not the current market cycle. But with standard products this is not the case: whether you retire at the start of a strong market phase or at the beginning of a downturn, it can have a significant impact on your account balance, and therefore your retirement income.

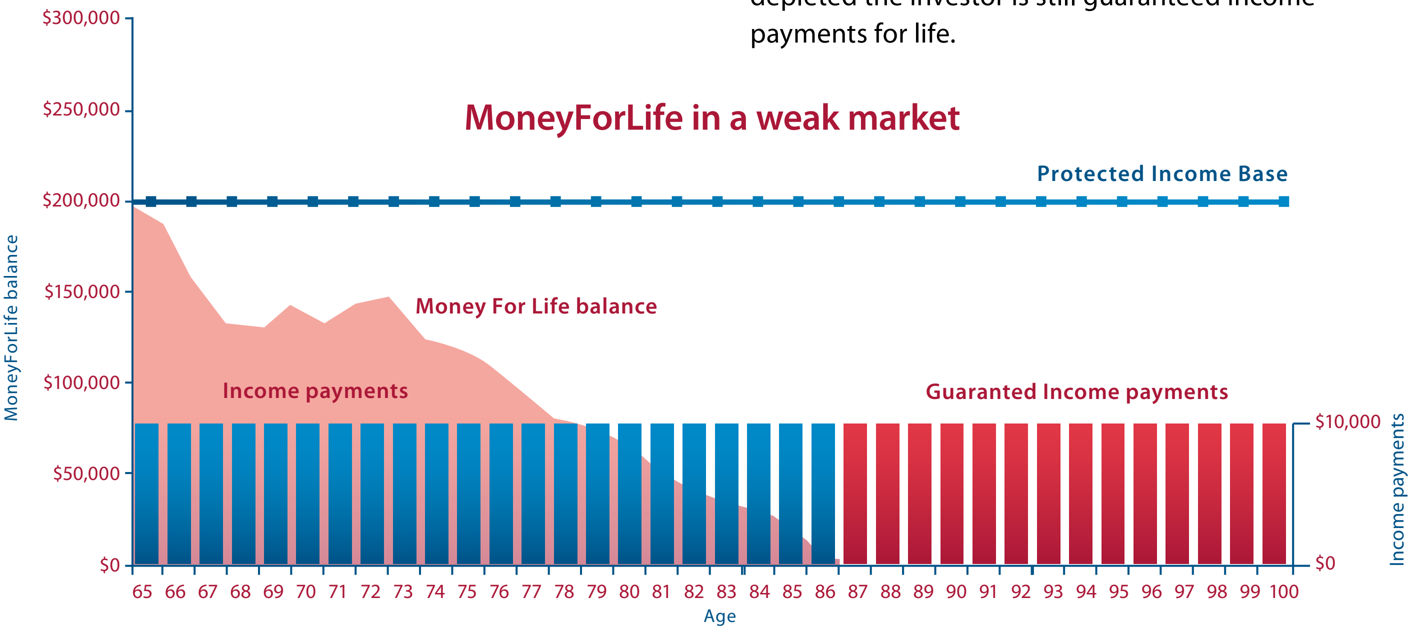
Fortunately, the new MoneyForLife offers you certainty in how much income you will receive each year, no matter how markets are performing when you retire.

Best case scenario

Looking back in history, if you invested in MoneyForLife at the start of a strong market, for example in 1982, your Protected Income Base would capture the gains through the annual ratchet.
As the market strengthens the Protected Income Base continues to rise and therefore your income payments would also increase.

Worst case scenario

On the other hand, if you invested in MoneyForLife at the start of a downturn, your account balance would fall but your Protected Income Base would remain protected.
1929 marked the end of the roaring twenties and the beginning of the Great Depression. If you invested in MoneyForLife at this time, your Protected Income Base would remain at the amount established on the day you invested.
Although the account balance would have been depleted the investor is still guaranteed income payments for life.



Source: OnePath

I said that you did not have to accept the luck of the draw on this.

Here is what you can do:

(I) Guarantee at least a part of your income.

There are now a number of institutions that may provide you with a guaranteed, lifetime income on reasonable terms (for more, see "MoneyForLife" below).

At least part of your money should go into one of these, guaranteeing you a basic income.

(II) Keep a cash buffer

In the non-guaranteed portion, always keep some of your money in cash. Then, during down periods, you can draw your income from cash and avoid having to sell your growth assets at depressed prices – and thus be better placed to recover when things pickup.

(III) Review

Review your portfolio from time to time, and be prepared to make changes if necessary.

While it is true that growth assets such as shares outperform in the long run, there can still be long periods when this is not the case.

(IV) Tax and Pension

Maximise benefits such as taxation and the Age Pension, especially in the early years.
In addition to the tax free income from superannuation, there are a number of other tax rebates and breaks for people of retirement age.
Also, the age pension has reasonably attractive upper limits (of income and assets) that enable many people to receive a part age pension (for example, a home owning couple can have assets (other than their home) of up to $998,000 and still receive a part pension.) Other limits apply for people in different situations. Call us for details.

(V) Estate Planning

Make sure your will is up to date. It is also usually advisable to have an Enduring Power of Attorney

(VI) Seek competent professional help

Yes, this is a little complex and it requires a sound working knowledge of the area.
At Black Swan Event Financial Planning we have decades of experience helping people set up retirement packages, as well as access to the whole range of products and services that we can use to put together an individual solution for you.

Black Swan Event
FINANCIAL PLANNING

Please note that any recommendations do not take full account of all of your circumstances and you should decide whether or not they are appropriate for you before deciding to act. Any decision to act should only be made after reading the relevant Product Disclosure Statement (PDS). You can obtain copies of the PDS from us.

While Black Swan Event has made every reasonable effort to ensure the reliability of the sources used in this document, neither Black Swan Event nor the licensee makes any warranty, express or implied, or assumes any legal liability or responsibility for the accuracy, completeness, or timeliness of any information disclosed, or represents that its use would not infringe on privatley owned rights. The opinions of the authors expressed herein do not necessarily reflect those of Paragem Pty Ltd.

Black Swan Event Financial Planning is an authorised representative of Paragem Pty Ltd who hold AFS Licence 297276, issued by ASIC.

Level 11, 28 The Esplanade Perth WA 6000 • P (08) 9322 7818 • F (08) 9481 5570 • E perth@blackswanevent.com.au • W www.blackswanevent.com.au