JUST.

THE RETIREMENT SPECIALIST

RETIREMENT INCOME

HURRY... SALE ENDS MONDAY

Guy Anderson, Director of Retirement Income Distribution at Just, considers the dilemma today's bond investors are facing over whether to stay invested in the hope that values will climb or to sell out for higher yields, crystallising capital losses.

Much of the well-established marketeers playbook, used across countless industries, looks to harness a particular human behavioural weakness, FOMO.

If you're unaware, FOMO stands for **Fear of Missing Out**. It's defined as an emotional response to the belief that other people are living better, more satisfying lives, or that important opportunities are being missed.

The retail asset management industry makes good use of the latter part of the FOMO definition. They use an almost endless supply of data, statistics and charts to suggest that a particular asset class, geographical area or industry is the next opportunity not to be missed... And that they have a particular fund with a particularly good fund manager to help you take advantage of this timely opportunity.

Now that all of us in the retail financial planning and wealth management space are able to look back at the annus horribilis that was 2022, we can, and must turn our attentions to how we can rebuild the wealth it took away from so many clients. I'm talking about those who were caught in the eye of the storm, the individuals and couples who have recently transitioned from accumulators to spenders.

Based on the number of market commentaries and articles published online over the recent month or so, one of the areas asset managers are promoting as a great buying opportunity is high yield bond funds. Presumably this is as a way of rebuilding the fixed income holdings that bore the brunt of the battering in 2022. If we think about this, I suppose it's pretty logical.

Opposite ends of the same seesaw

Fixed income managers have seen their existing holdings badly affected by the rise in interest rates and inflation. But, as we know, a drop in the market value of a bond increases the effective yield as they are at opposite ends of the same seesaw. This means the yields available to buy in the market are more attractive, but the fixed income manager has a problem. If they sell existing holdings to access these improved yields, they crystalise the capital losses, so over and above redemptions and reinvestments, the manager needs to create positive inflows if they're going to be able to reposition their funds to take advantage of these increased yields.

But is there any truly new money out there to be invested?

The recent net asset flows onto retail investment platforms tends to suggest that the vast majority of available assets are already in the system as it were, and have therefore suffered the impacts of 2022. That leaves advisers with a significant dilemma when it comes to the fixed income holdings of those clients who are spending down their portfolios. There is a term in use now, **'Bonds don't Bounce'** which recognises the fact that, unlike equities, the return on fixed income is far more predictable; the balance of the overall return between income and capital may vary as interest rates and inflation move, but the total return at redemption is known.

What this means is a collective fund which now has a running yield of 4% but which has suffered a 20% capital loss will take approximately five years to get back to par if there are no further increases in interest rates.

And that is ignoring any withdrawals to help fund retirement spending.

A client could decide to sell their existing fixed income holdings and crystalise their losses so they can access the higher yield opportunities being promoted by the fixed income managers (FOMO in action). That should mean that the increased yield effectively rebuilds their losses quicker than staying put, but in the world of fixed income there is no such thing as a free lunch. Higher yields can only be generated by taking a greater degree of risk, especially if those yields are coming from lower grade corporate debt, where things like credit and default risk in the shadow of a global slow down loom large.

So fixed income managers really need individual investors to take the haircut so they can create inflows that allow them to reposition their funds and take advantage of higher yields. Meanwhile individuals, especially the 'spenders' as we've said, are faced with this (and taking on extra risk) or waiting a lengthy period for their existing fixed income holdings to recoup 2022's losses...not great!

Now it's worth mentioning that fixed income instruments do not have to be held in a collective wrapper such as an Open Ended Investment Company (OEIC) or an insured fund, and if things like UK Gilts are purchased directly and held to maturity, they are immune from market turbulence. But, the reality in the retail wealth management sector is that fixed income exposure is gained via collective structures.

Fixed income and decumulation

That said, is there another way to hold fixed income type assets that helps to deal with the current dilemma faced by spenders and their advisers?

Fixed income's place in a decumulation portfolio is not to provide capital growth, but to provide income and some stability to the greater volatility of equities. Yet, as we have seen, the capital value can still move based on interest rates and inflation.

Another way of holding fixed income type assets is within a particular insurance-based structure, which invests in a range of similar income generating assets, with the valuable additional benefit of sharing longevity risk, which enhances the level of income payable.

At Just, we've been pioneering this type of solution through platform partners Novia and 7IM. We're also working with third party tool providers to evidence how directing some of a portfolio's fixed income allocation into a guaranteed income solution, in the form of Secure Lifetime Income, can enhance customer outcomes by protecting Assets Under Management (AUM) in the longer term.

In terms of dealing with the dilemma, guaranteed income rates increased by approximately 40% during 2022. This means 'spenders' can buy a higher level of guaranteed income now than they could at the beginning of 2022, even though their portfolios' values have reduced.

Now that could really be an important opportunity for your clients to be aware of, and avoid FOMO.

If you'd like to hear more, we'd love to share impartial evidence that shows how incorporating guaranteed income into drawdown SIPP portfolios could deliver improved client outcomes. Please get in touch with us, either by phone 0345 302 2287 or via email at support@wearejust.co.uk.

FOR MORE INFORMATION

Call: **0345 302 2287**
Lines are open Monday to Friday, 8.30am to 5.30pm

Email: **support@wearejust.co.uk**
Or visit: **justadviser.com**

Please contact us if you would like this document in an alternative format.

Please note your call may be monitored and recorded and call charges may apply.

FT ADVISER

Financial Adviser · SERVICE AWARDS 2022 ·