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JUST.

THE RETIREMENT SPECIALIST

RETIREMENT INCOME

WELL, THEY WOULD SAY THAT WOULDN'T THEY!

Guy Anderson, Director of Retirement Income Distribution at Just, considers the impact of the need for new fixed income money, the use of bond ladders and how you could use alternative solutions to make a retirement portfolio more resilient and robust.

In this day and age, it's really hard to find commentators who are truly impartial and free from bias or vested interests. Some would argue that the consumer champion Martin Lewis is probably one of the most trusted financial commentators partly for this reason; he doesn't represent big finance or get paid by them.

Understanding whether a message or recommendation is being influenced by vested interests is important if individuals are to make good decisions. Especially when it comes to key areas such as personal and family finances, which are often influenced by sentiment and emotion rather than rationality and logic.

Fixed income funds - the need for new money

We're in the wake of an annus horribilis for fixed income funds and their managers. Virtually every email I receive from the online trade papers seems to contain at least one link to an article from a fixed income manager, suggesting now is the time to invest in fixed income. There's no doubt the yields now available across a wide range of sovereign and corporate debt look far more attractive than the near zero coupons their funds are currently stuffed with. But how can they get their hands on them without selling their current holdings, holdings that have suffered significant capital losses as interest rates have increased? They may have some maturities to provide liquidity but outside of that, the answer is obvious... They need new money!

Putting new money to one side, what's the story for all those who were already invested, often holding anywhere from 30% - 50% of their retirement income portfolios in a variety of fixed income funds?

It's worth pointing out at this stage, that it's perfectly feasible for a retiree to buy individual gilts and corporate bonds through a stockbroking account and hold them to maturity, something that is often referred to as a 'bond ladder'. But the use of bond ladders in retirement income planning is rare here in the UK, where we prefer holding fixed income instruments inside collective fund structures such as Open Ended Investment Companies (OEICs) and unit trusts, often containing many hundreds of bonds of varying types and durations.

Investing in hundreds of bonds from governments and corporates around the globe obviously provides diversification. However, the collective nature introduces sensitivity to interest rate movements in the form of duration risk, as measured by modified duration. This is how much of the underlying capital value will move in response to a 1% change in interest rates, which is where the pain has come from for existing investors.

As interest rates have moved up quickly from the historic lows of the last 15 years, a fund with a modified duration of 10 years for example, will have experienced a 10% loss of capital value for every 1% rise in interest rates.

One of the well known strategic bond funds popular with advisers has a modified duration of 7.92 years and as a result, is down by 15.62% in 2022[1].

So, if the preference for holding fixed income in collective funds rather than holding specific bonds to maturity introduces interest rate risk, is there a better solution to hold at least some of the fixed income portfolio allocation rather than a collective fund?

Unsurprisingly, I believe the answer to this is yes.

A better solution?

Insurance companies, and Just in particular, are able to offer a solution that uses fixed income instruments in a different way to holding them individually or within a collective fund. The approach enables all of the main retirement risks to be pooled whilst providing a lifelong

guaranteed return. As such it removes the majority of the risks inherent with fixed income investing, such as interest rate risk, credit risk, default risk and reinvestment risk.

We've developed statistically robust modelling to evidence how holding some of a portfolio's fixed income allocation in this solution, called Secure Lifetime Income, can make a retirement income portfolio more sustainable. We can demonstrate this through independent third party planning software too.

Bonds don't bounce

Very interesting I hear you say... but my client is sitting on a 20%+ loss within their fixed income funds so I can't crystalise that without having some very difficult conversations.

Let me answer that this way. I've recently started to hear a new phrase mentioned around this subject, which is 'Bonds don't Bounce'. As yield and capital value are at opposite ends of the same seesaw, it's very unlikely that the capital losses experienced during 2022 will be recouped quickly. So it's being suggested that cautious investors will need to be patient and prepared for a long, slow recovery taking many years.

But those taking regular income in decumulation don't really have the luxury of time.

There is some good news. Back to the yield/ capital value seesaw, increasing yields are good for guaranteed lifetime income rates. So, whilst capital values within fixed income collective funds dropped by around 20% or more last year, Secure Lifetime Income rates increased over the same period by around 40%.

You don't need to have a difficult conversation with your client. It's totally the opposite. Because you can buy a higher amount of guaranteed lifelong income now than a year ago, even though the portfolio value has dropped.

And I know... you're thinking to yourself... 'well, they would say that wouldn't they'!

If you'd like to hear more about how our alternative solution can help you with blending to deliver better outcomes for your clients' retirement income portfolios, please get in touch with us, either by phone on 0345 302 2287 or via email at support@wearejust.co.uk.

[1]https://www.trustnet.com/factsheets/O/09Q3/jupiter-strategic-bond-i-acc

FOR MORE INFORMATION

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

Email: **support@wearejust.co.uk**
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