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THE RETIREMENT SPECIALIST

RETIREMENT INCOME

BLACK SWANS, GRAY RHINOS AND DOCTOR WHO

Guy Anderson, Director of Retirement Income Distribution at Just, considers the differences between black swan and gray rhino events, the potential impact they can have on advisers and how Just can help the latest generation of asset management focused financial advisers, as they face the first big challenge to their Assets under management (AUM) value propositions.

Until the late 17th century, it was widely regarded that, a bit like the opposite of the Model T Ford, swans only came in white. The unexpected discovery of some black versions by a Dutch explorer, Willem de Vlamingh in Australia in 1697 profoundly changed the world of zoology.

The black swan has subsequently found its way into the world of metaphors; representing an event that comes as a surprise, has a major effect and which is, with the benefit of hindsight, often inappropriately rationalised. Events such as the collapse of Lehman Brothers and the resulting 2008 financial crisis, the dotcom bubble, and more recently the COVID pandemic, are cited as examples of black swan events.

So what's a Gray Rhino?

The concept of a gray rhino event can be seen as a derivation of the black swan. In Michele Wucker's book – The Gray Rhino: how to recognise and act on the obvious dangers we ignore[1], she explains that much like a black swan event, they have a significant impact when they occur. But unlike black swans, the event can be seen as highly probable. Yet all too often the threat is ignored or neglected. To draw a link to one of my other articles, a blind eye is turned.

So, what do you think? Was the collapse of Lehman Brothers for example, really a black swan event, only obvious with the benefit of hindsight? Or was it a gray rhino, a probable outcome based on Lehman's activities in the years before? Activities that were largely ignored or neglected by those who should have been paying attention.

This is all very enlightening I hear you say, but so what?

Let's bring this into the world of retail investment clients, financial planning, centralised investment propositions, investment committees and standardised risk aligned asset allocation. And focus on those clients who are relying on their accumulated invested wealth to fund their retirement.

The financial advice community has proved to be far more resilient than many industry experts have predicted over the years, with challenges such as polarisation and commission disclosure dealt with along with the way. In fact, I recently heard an industry commentator drawing similarities between the regenerative powers of Dr Who and the ability of advisers to reinvent themselves, in particular around the paradigm shift of the FCA's Retail Distribution Review (RDR). To use his language, advisers entered the Tardis largely as transactional advisers operating on commission via product sales, and re-emerged as investment managers, charging ongoing fees for building and managing client portfolios.

I think the comments were somewhat tongue in cheek. However, there was a genuine point they were trying to make, which I'm largely in agreement with. The point being that the investment markets had been extremely kind to investors and their advisers since that 'regeneration' took place, with strong tail winds in most markets. Those tail winds changed direction last year. Since then they've been blowing a gale force head wind into advisers centralised investment propositions. Stress testing them and their ability to explain what drives investment markets, for the very first time.

Managing clients' wealth brings with it certain client expectations

The pre-RDR adviser would've been able to distance themselves from poor periods of investment performance by blaming the product provider. For the regenerated 'new model' adviser, that's become much harder, as they're now closely involved, directly or indirectly, in the day-to-day running of their clients' portfolios.

Being more closely associated with managing clients' wealth brings with it the expectation from those clients, that their adviser has a reasonable level of understanding of:

- what affects the performance of the various asset classes they've recommended; and
- how they meet and continue to meet their personal goals and objectives from a suitability perspective.

Clearly, the actual future performance of any capital market investment is unknown and unknowable, but some of the things that influence that performance are known. For example, how movements in interest rates can impact the overall returns within collective fixed income holdings, is something that can be predicted.

Many may cite black swans like the war in Ukraine and supply side issues as the global economy emerges from COVID, to explain the worst year for multi-asset investing since the 1930s. Others might point to the fact that after many years of near zero interest rates and quantitative easing, there was only one direction yields and therefore capital values within existing fixed income holdings could go.

Evidencing the foreseeable using robust modelling

Whether factors are predictable or unknowable; a gray rhino or a black swan, potentially matters when we think about the second cross-cutting rule within the FCA's Consumer Duty — Avoid foreseeable harm to retail customers — that we looked at in another of my articles, 'What do Nils Bohlin and the FCA have in common?'.

A gray rhino event is by definition, predictable... Another word for that is FORSEEABLE!

Evidencing the fact that foreseeable events have been recognised and allowed for within a retirement income plan suggests to me the need for robust modelling that builds in the possibility of black swans and the probability of gray rhinos. In my view, that really requires stochastic modelling, rather than the still common single straight line deterministic approach, favoured by many on the basis of simplicity.

Clients in decumulation don't have the luxury of time when things go wrong.

So it becomes even more important that any foreseeable harm is proactively identified within any advice process, resulting suitability and the investments recommended. With many retirees hoping for and expecting regular and reliable income, anything that can be foreseen to interfere with that should be identified.

Including a new asset

As I've stated in other articles, we at Just believe that one way of making a retirement income portfolio more resilient and robust is to include an element of a new fixed income guaranteed asset within the overall portfolio. This is in the form of Secure Lifetime Income, which is available via the Novia and 7IM platform SIPPs.

With guaranteed income rates up over 40% year to date, the effects of a very difficult period for multi-asset portfolios can be offset.

If you'd like to hear more about how we can help you improve the predictability of 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.wucker.com/writing/the-gray-rhino/

FOR MORE INFORMATION

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