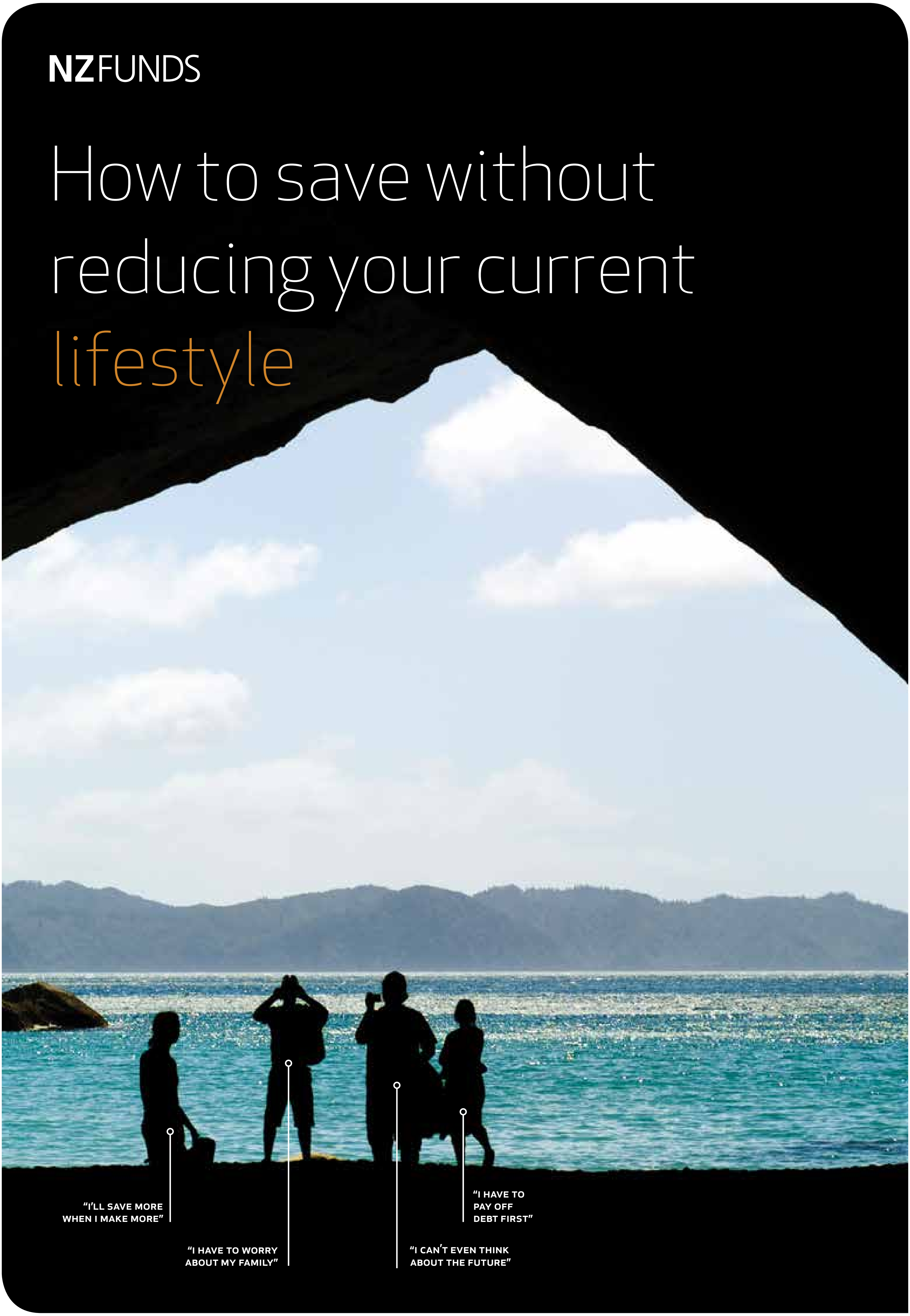
NZ FUNDS

How to save without reducing your current lifestyle



Ways to Save

Overview

Designing a savings strategy for retirement is one of the wealth management roles we, and the Authorised Financial Advisers we partner with, perform for clients.

Saving for retirement is one of the most important financial activities you will undertake along with managing your career and purchasing a home. It is also extremely difficult to achieve without help.

This document discusses how much you need to save to retire, and sets out five practical steps you can take to ensure you accumulate a retirement fund.

Why saving is harder than it looks

The perception is that saving is simple in theory, but hard in practice. We have found that it is more complicated in both theory and practice. Even before we get to the conundrum of how we can save for tomorrow and still lead the life we wish to today, few of us have been taught how much we are likely to need for retirement.

When confronted with uncertainty it is no surprise that we tend to procrastinate. As a result, 77% of employees surveyed as part of NZ Funds' Wealth at Work programme had little or no confidence in their retirement strategy.

How we can help

The good news is that most New Zealanders can significantly improve their financial position, with little or no reduction in their current level of spending. This article can help you by, first, teaching you how much you will need to save for retirement and second, by setting out another four practical steps that will enable you to accumulate a retirement fund.

Let's get started.

Work out how much you need to save

How much do I need to save?

To find out how much you need to save for retirement, you will need to know when you wish to retire, how long you are likely to live, and how much you wish to spend each year.

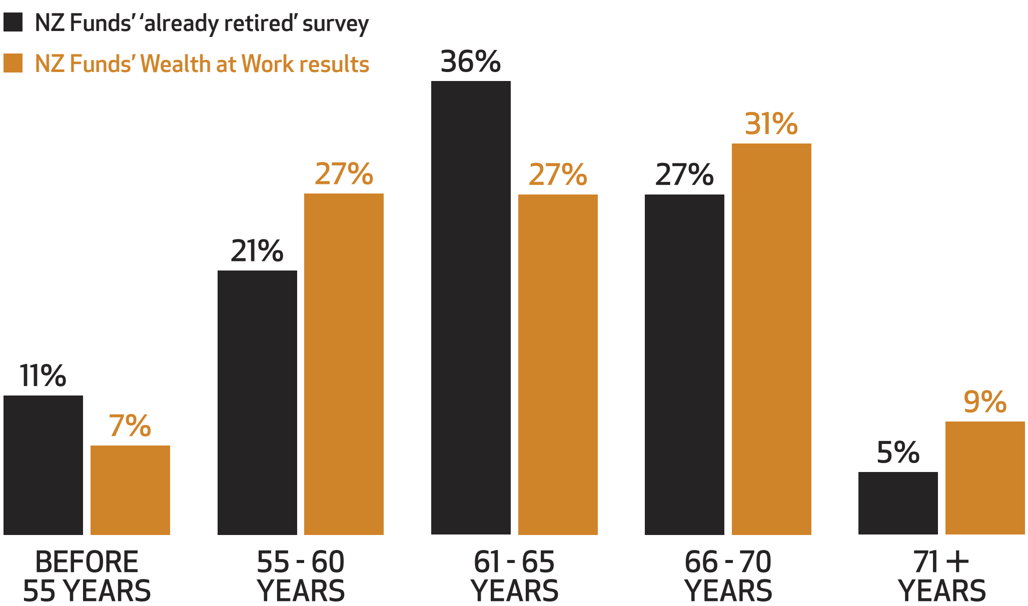
HOW MUCH DO I NEED TO SAVE?

To answer these questions it often helps to compare notes with other New Zealanders in a similar position. In order to help our clients do so, NZ Funds surveyed over 300 retired New Zealanders. We have also developed an online financial planning software tool called myWealth which enables you to calculate your retirement fund and compare this with other New Zealanders.

When should I retire?

Historically, many New Zealanders chose to retire at either 60 or 65 years. However, over the past decade our retirement age has been steadily rising along with our life expectancy. The Government's decision to increase the age of eligibility for New Zealand Superannuation from 60 to 65 years of age in 1991 has also influenced the retirement age. The targeted retirement age for clients who are currently still working is 67 years of age, which seems sensible.

WHEN WILL I RETIRE?

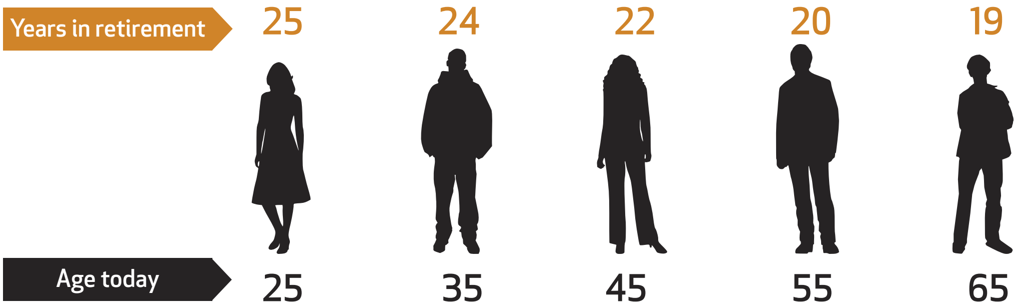


SOURCE: NZ FUNDS 2013 SPENDING PATTERNS IN RETIREMENT SURVEY. WEALTH AT WORK WORKSHOP RESULTS.

How long will I be retired for?

The average New Zealander is living longer which means there is a high chance you will be spending longer in retirement than you thought. If you had reached retirement in 1980 you could expect to spend 15 years in retirement. In contrast, today's average retiree can expect to spend approximately 20 years in retirement. Males are likely to live two or three years less than females.

HOW LONG WILL I BE RETIRED FOR?



SOURCE: STATISTICS NEW ZEALAND, NZ FUNDS CALCULATIONS. DETAILS: RETIRING AT AGE 65.

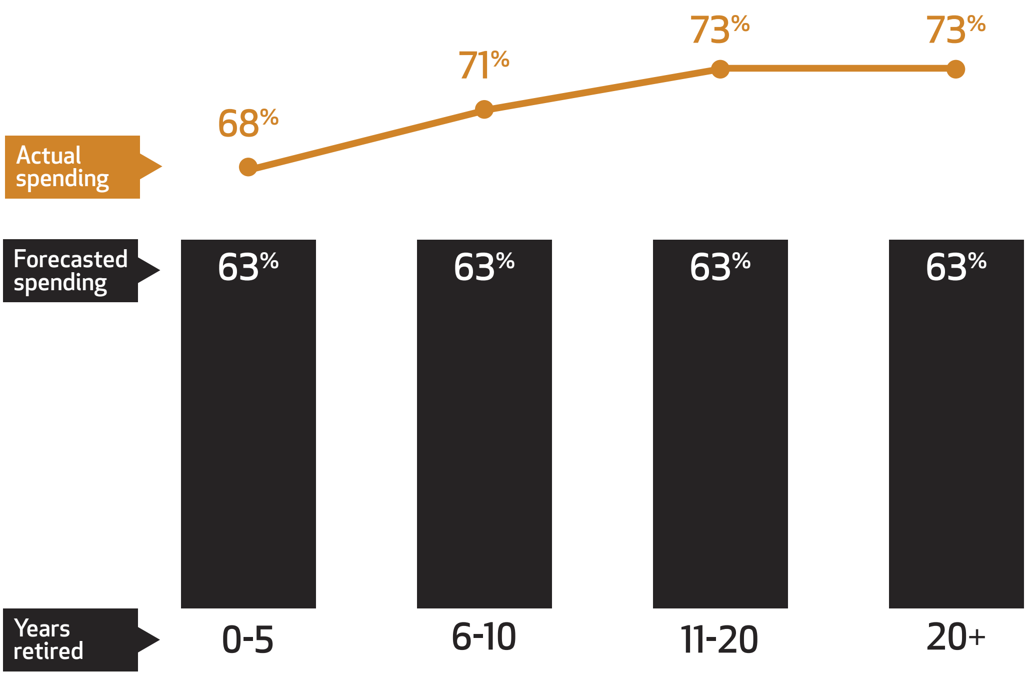
How much am I likely to spend?

Having discussed longevity, we now have two of the three ingredients needed to determine our wealth target. The third, and perhaps the most commonly misunderstood, is how much we are likely to spend each year in retirement.

Most of us wish to enjoy a retirement that is similar to the standard of living we currently enjoy, which is of course based on our current income. In preparing for retirement, the average retired New Zealander expected to spend around 63% of their pre-retirement household income. This is virtually identical to the average working client, who expects to spend 62% of their pre-retirement income in retirement.

There is however a difference between planned spending and actual spending. Again, surveying New Zealanders in retirement, we found the average New Zealand couple spent 5% more a year of their pre-retirement income than they forecasted. As a consequence you may wish to consider increasing your ratio of spending in retirement, relative to your pre-retirement income, to around 68%.

CONSIDER ADDING 5% TO YOUR NUMBER

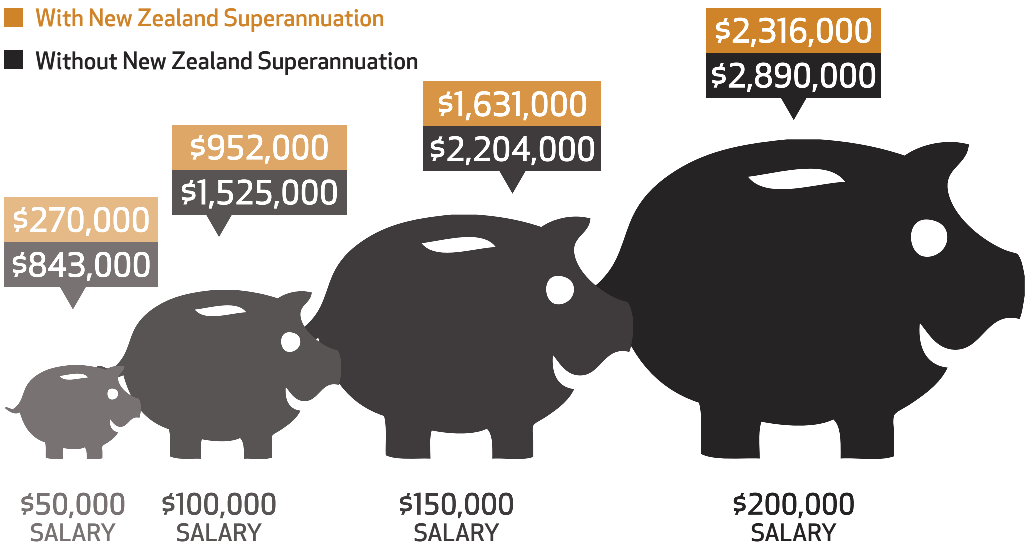


SOURCE: NZ FUNDS 2013 SPENDING PATTERNS IN RETIREMENT SURVEY.

How much do I need to save?

You can now estimate what you might need to save for retirement using the formula on page 3 or by using NZ Funds' myWealth software. Your retirement fund may include part of the value of your house, with an expectation that you downsize this to help fund your retirement. If you wish to live in your home throughout retirement, then you will need to exclude its value from your retirement fund.

RETIREMENT FUND BASED ON 68% OF SALARY



SOURCE: NZ FUNDS CALCULATIONS, BASED ON AVERAGE MYWEALTH USER DATED 7 APRIL 2014.

How do I save without reducing my current lifestyle?

Your wealth target, or the amount you will need to save by the time you retire, may look like an intimidating number, but reaching it is not as hard as you think if you follow a practical five step programme.

NZ FUNDS MYWEALTH SOFTWARE

Write your story

I'm 43 years old and single. My gross annual salary is $ 100,686 which is $ 1,444 net weekly and grows annually at 2%

I'd like to retire when I'm 64 for around 27 years. The proportion of my current income I'd like to retire on is 61% excluding NZ Superannuation. My investment risk preference is conservative.

In general, investors with a conservative risk profile prefer knowing that their capital is less volatile, and will trade off more security for less return. They may have less experience with investment beyond bank accounts.

Conservative investors will usually suffer from a lot of regret if their decisions turn out badly, and may get upset or anxious if they see their wealth fluctuating in value. They need to understand that their caution leads to lower expectations around long-term growth for their investments.

Conservative investors with time horizons of ten years or more will typically have a lesser inclination to invest for growth, and relative to others, will therefore want to have a greater part of their wealth invested in defensive assets.

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Maximise your KiwiSaver

Make sure you have joined

If you have not joined KiwiSaver yet, do so. To date over 2.2 million New Zealanders have joined and collectively they have already accumulated over $20 billion. Much of the wealth that has been accumulated to date comes from employers. Under the KiwiSaver regulations employers are required to contribute a minimum of 3% of your salary so long as you are a contributing KiwiSaver member. This has enabled many New Zealanders to grow their savings with a minimum of disruption to their current lifestyle.

A QUICK LOOK AT OUR NEIGHBOURS -
THE AVERAGE MYWEALTH USER'S KIWISAVER BALANCE

SOURCE: NZ FUNDS CALCULATIONS, BASED ON AVERAGE MYWEALTH USER DATED 7 APRIL 2014.

Who is missing out?

In our experience four groups are currently under-represented in KiwiSaver. First, senior management, who perceive KiwiSaver as being for lower earning employees. Second, self-employed New Zealanders, who are often unaware of the extent of the benefits for the self-employed. Third, family members performing unremunerated work, for example a stay at home parent. Finally, children over the age of 18 who are unemployed or studying, and those saving for their first home, are also often left out.

Irrespective of whether you are a high or low earner, employed, self-employed or currently unemployed, KiwiSaver offers every New Zealander a well regulated, low cost structure to save into. It also offers every New Zealander structural benefits which you will not find anywhere else, such as the annual member tax credit, which is a payment into your KiwiSaver account of $521 a year by the Government, so long as you are aged between 18 and 65 and contribute a minimum of $1,043 a year.

Over a 20 year period, an annual contribution of $1,043, combined with the Government's annual member tax credit (which has nothing to do with your tax by the way), could snowball to approximately $71,600 in a moderate investment environment. KiwiSaver should therefore be a savings tool used by every member of the family.

Make your money work harder

Get the right mix of growth and income

The higher your returns, the greater your final balance. Over long periods of time shares have historically outperformed most other assets.

For example, a hypothetical KiwiSaver investor earning $50,000 a year and saving 3% from the age of 25 onward, would be approximately $318,000 better off by the time they retire by selecting growth assets over income assets during their working life. That is equivalent to a bach, a boat or five, six-month long world cruises for two .

MAKE YOUR MONEY WORK HARDER - ACTUAL INVESTMENT RETURNS 1991 TO 2012

SOURCE: NZ FUNDS CALCULATIONS. RETURNS: INCOME STRATEGY AND GROWTH STRATEGY FROM MYWEALTH AVERAGE MARKET EXPERIENCE (1991-2012), AFTER MANAGEMENT FEES. CALCULATED ON 4 DECEMBER 2013.

Understand your risk profile

However, there are a couple of additional factors which are well worth considering before you rush to put all your savings into share-orientated schemes.

While shares may offer the highest rate of return over the long term, you may not wish to save into a scheme which is volatile. Over the last 20 years the global share market has twice declined in value by around 40%. Investors had to wait from five to 12 years before shares fully recovered in value.

If you are not comfortable with a higher level of volatility (and risk) you are more likely to sell shares (or switch schemes) into cash and income at precisely the wrong time – after a large decline. If you do this, it takes much longer for your investment to recover in value.

You are much more likely to stay the course and maximise the value of your retirement fund if you invest in a scheme which matches your comfort level. You can determine your risk profile using NZ Funds' risk profiler which is built in to our myWealth software and is also available at www.nzfunds.co.nz.

Ensure your scheme matches your time horizon

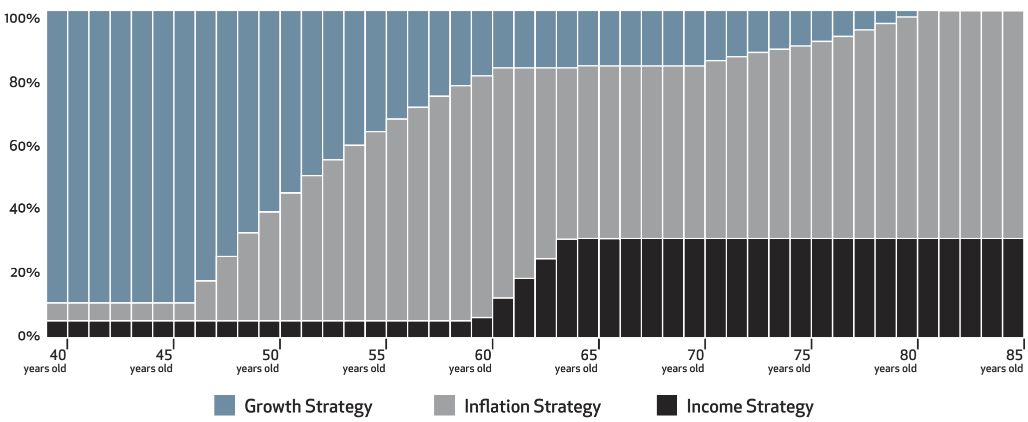
THE 401K LESSON

About 40 years ago the United States introduced a similar concept to KiwiSaver called 401k. Many Americans having a long-term investment horizon chose to invest in shares. Over the next 40 years this proved to be a terrific strategy. Those who held a high exposure to shares accumulated significantly more to retire on than those who did not. However, when the global financial crisis struck in 2007 many of those same individuals were still heavily invested in shares despite being 20 or 30 years older. What had been the right decision in their 30's, 40's and 50's was wrong for them in their 60's. Interestingly, in some cases their risk profile had not changed, however their ability to wait patiently while their savings recovered in value had, as they now needed to retire and spend those savings.

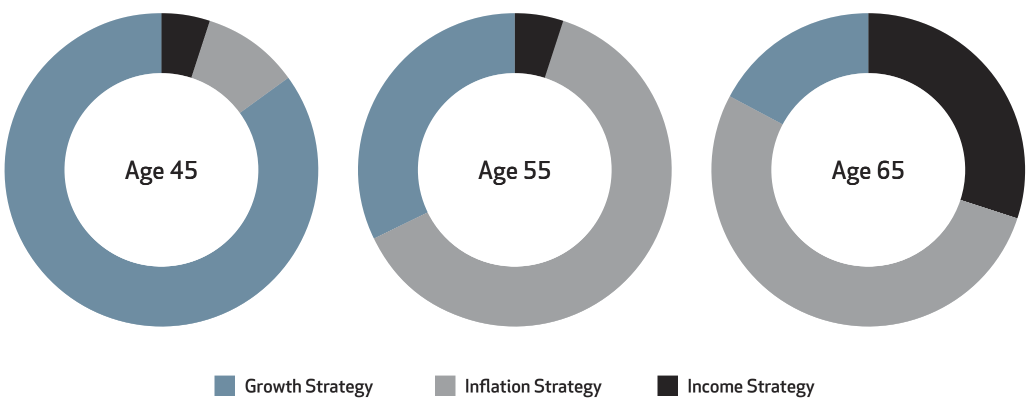
REBALANCE REGULARLY

Irrespective of whether your risk profile changes over time, the number of years you have until you wish to retire will. In order not to get caught out as many Americans did, it is important that you change the mix of assets in your scheme as you get closer to retirement. You can do this manually, or use the NZ Funds KiwiSaver Scheme LifeCycle® process (which does this automatically for each member, based on their age), or talk to your Authorised Financial Adviser about taking your age into account when your portfolio is rebalanced annually.

NZ FUNDS KIWISAVER SCHEME LIFECYCLE® PROCESS – AGE-BASED ASSET ALLOCATION*



NZ FUNDS KIWISAVER SCHEME LIFECYCLE® PROCESS – POINT IN TIME ASSET ALLOCATION*



*TO LEARN MORE ABOUT THE NZ FUNDS' LIFECYCLE® PROCESS, SEE THE NZ FUNDS KIWISAVER INVESTMENT STATEMENT OR GO TO WWW.NZFUNDS.CO.NZ/KIWISAVER_PORTFOLIO_INFORMATION.HTML

Start a workplace savings escalator programme

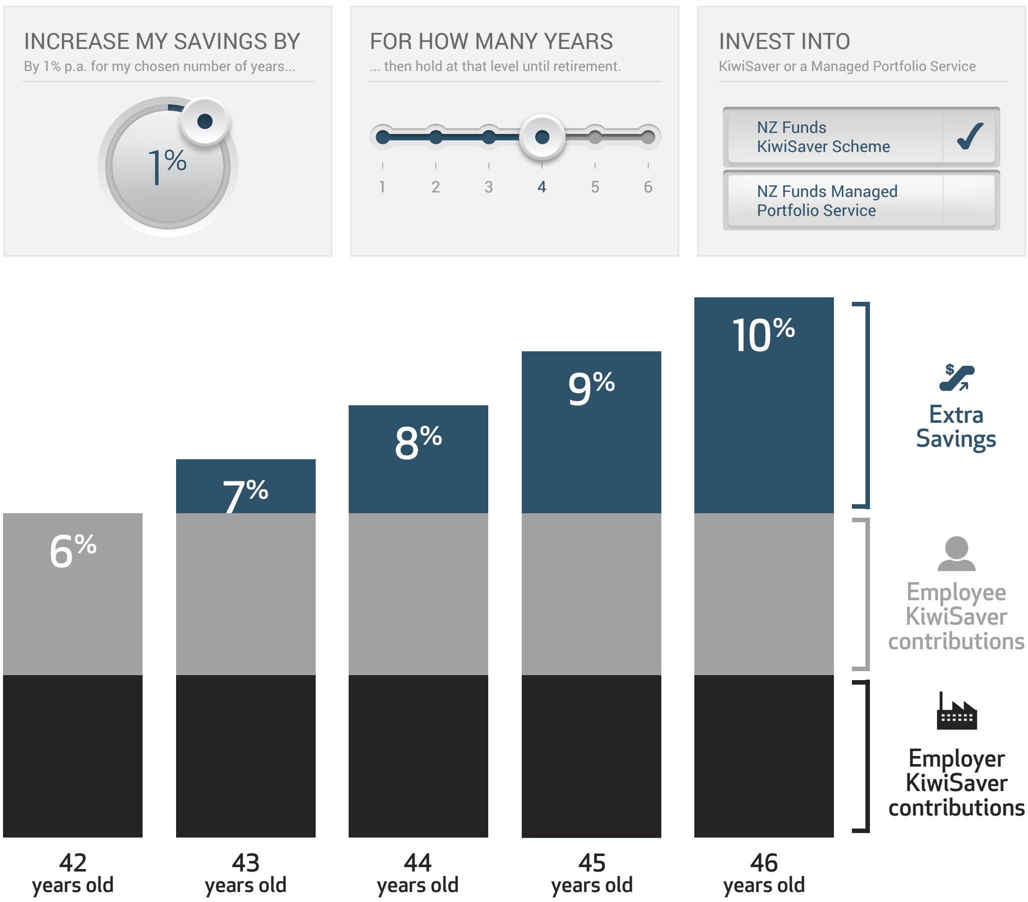
The easiest way to save without a reduction in current lifestyle is to ring-fence a portion of future increases in your income.

Over the course of our working careers all of us will enjoy periodic pay rises. These occur as our contribution to an organisation increases with time and experience, and as our income grows with inflation.

By committing to save a portion of your future pay rises for your future self, you can incrementally increase your savings rate from the statutory minimum of 3% for employees, to 10%, a number closer to the average savings rate in the United States or the United Kingdom. In fact, you should still be able to enjoy a rising standard of living.

By way of example, a 42 year old, with an annual salary of $104,000 which is growing at 2% a year, would accumulate approximately $101,000 more by the age of 65 if they committed to increase their workplace savings by 1% of their salary each year for the next four years. That is equivalent to approximately 14 ski trips for two – not a bad way to enjoy retirement.

SAVINGS RATE AS A PERCENTAGE OF SALARY INCLUDING KIWISAVER



SOURCE: NZ FUNDS CALCULATIONS. TAX ON EMPLOYER'S CONTRIBUTION APPLIES.

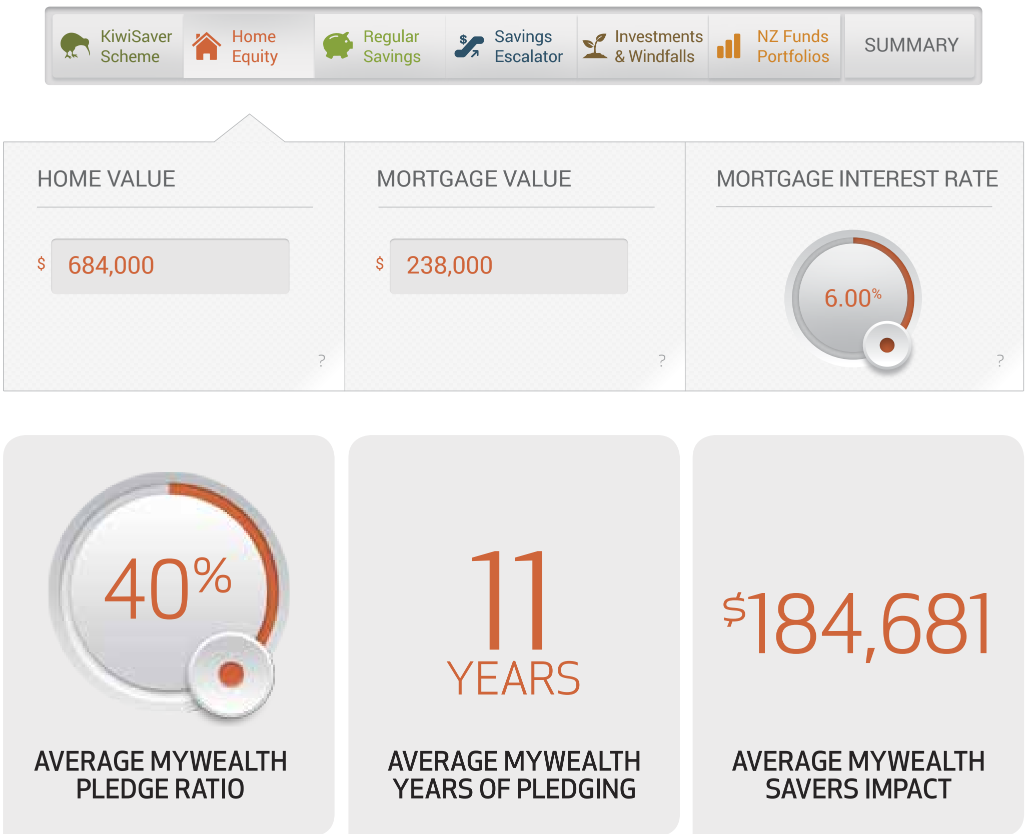
Act on your mortgage pledge

68% of us purchase our own home[1]. Our home is likely to be one of the biggest (and best) investments we make. While we can use the equity in our home to help fund our retirement, many New Zealanders aspire to keep their home throughout retirement.

Most of us contribute a portion of our salary to paying off the mortgage on our home over several decades. During that time we become used to a lifestyle determined by what is left over after our regular mortgage payment. When the day arrives that we do not need to pay the bank any more (and it will), we tend to celebrate. Unfortunately, for many New Zealanders the celebration goes on much longer than intended. Before long there are just not as many saving years left before retirement.

Paying off the mortgage is one of the few times in your life when you will be in a position to spend a little more on yourself, and save a little more for the future you, both at the same time. Instead of spending all your former mortgage payments upgrading your lifestyle, we recommend you pledge to save a portion of your mortgage payments and begin (or increase) a regular savings programme the month your mortgage ends.

TURN YOUR MORTGAGE PLEDGE INTO A REGULAR SAVINGS PROGRAMME



SOURCE: NZ FUNDS CALCULATIONS, BASED ON AVERAGE MYWEALTH USER DATED 7 APRIL 2014.

[1] Source: Statistics New Zealand data to 2001.

Tomorrow is good. Today is better.

Whatever your personal circumstances, following these five steps should enable you to accumulate a meaningful retirement fund. Whether you are motivated to take them is up to you.

It is human nature to procrastinate, especially when effort is required today for something with a long-term, and at times uncertain, payback.

Somehow we think we will feel more 'motivated' to begin saving tomorrow. But tomorrow is likely to feel just like today. If we do not have the motivation today, we are just as unlikely to have it in the future.

Unfortunately, when saving for retirement, things tend to get harder over time, not easier. A dollar saved today could be worth $1.60 in ten years time thanks to the power of compounding returns. Most of us have always known it is better to begin a savings plan now, than hope to be able to save more in the future. Now there is a way you can.

INVESTMENT STATEMENT(S): FOR FURTHER INFORMATION OR TO REQUEST A COPY OF THE NZ FUNDS MANAGED PORTFOLIO SERVICE INVESTMENT STATEMENT OR THE NZ FUNDS KIWISAVER SCHEME INVESTMENT STATEMENT, PLEASE CONTACT NZ FUNDS OR SEE OUR WEBSITE WWW.NZFUNDS.CO.NZ

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