NZFUNDS

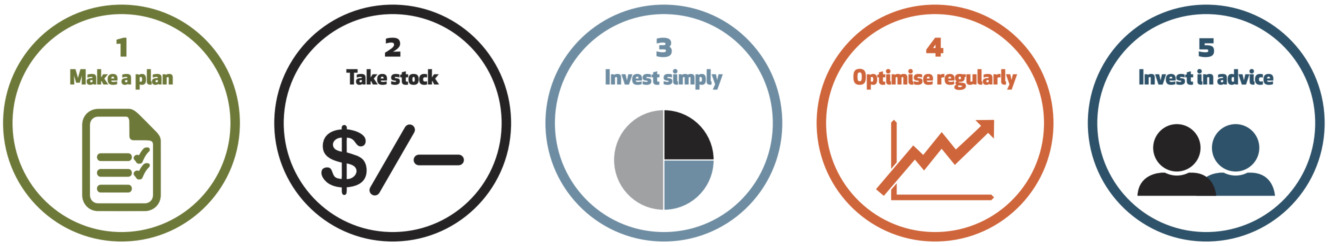
Wealth after Work

Thanks to the vision painted by media, experts and financial firms, for many New Zealanders retirement conjures up images of soup dinners and an inability to pay the heating bill in winter. It should not. In general, retirement has never been more attractive.

We are living longer and therefore working longer, and our retirement is also lasting longer. In general, our health is better and we are more active, so we are able to spend more time doing the things we enjoy. And while preparing for and managing our wealth in retirement can be stressful, innovative retirement plans and the increasing prominence of quality financial advice point to a richer future than many New Zealanders currently imagine.

IMAGE: 'RARANGI, MARLBOROUGH'
PHOTOGRAPHER: CHERIE PALMER

While everyone's circumstances are different, this article sets out five practical steps to manage your wealth in retirement. It also discusses some of the retirement solutions NZ Funds has developed to help New Zealanders' retirement savings last longer.



1 Make a plan

Make a lifestyle plan

Broadly speaking there are three stages to retirement: the initial active period, a semi active period and a less active period. Many clients liken retirement to taking an overseas trip: it helps to have planned ahead. For example, give some thought to where you will be retiring as the cost of living can vary markedly between different regions. Without thinking too far ahead, will you stay in the same location, or move closer to family and friends, or a warmer climate?

Many retirees list the feeling of isolation caused by a loss of social interaction that work provided as a downside of retirement. Planning a retirement activity can help. The most popular are sports, volunteering, reading, gardening and family. Consider joining a group or club before you retire. Whatever your lifestyle plan, make sure you discuss it with your friends and family. There are also an increasing number of interesting books and articles on retirement which are well worth reading.

Make a financial plan

Once you have a feel for the lifestyle you wish to lead and the activities you will undertake, it should be relatively easy to put some numbers alongside your lifestyle plan to create a financial plan. Consider breaking your estimated expenditure into the cost of your basic lifestyle and bonus activities (such as travel or one-off expenses).

You would expect that as your activity level declines, so too would the cost of living. However, our 2013 research into retirement found that most retirees spend a constant dollar amount throughout their retirement, for example $60,000 p.a. This is because, while the amount they spend on bonus activities and travel reduces over time, inflation drives up the basic cost of living filling the spending "gap". The average retiree surveyed forecast spending 63% of their pre-retirement salary, but ended up spending between 68% and 73% of their pre-retirement salary over the course of their retirement[1].

MAKING A LIFESTYLE PLAN

SOURCE: NZ FUNDS, 1 AUGUST 2014.

MAKING A FINANCIAL PLAN

	Active 5-10 years	Semi-active 10-15 years	Less active 15-20 years
Regular	$X p.a.	$X p.a.	$X p.a.
Periodic	$X p.a. or $XX	$X p.a. or $XX	$X p.a. or $XX
Total	A	B	C

Retirement cost = A + B + C

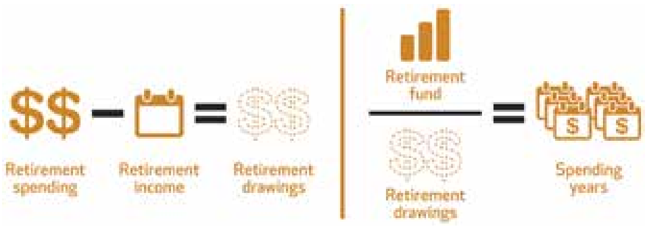
SOURCE: NZ FUNDS, 1 AUGUST 2014.

② Take stock

Before finalising your financial plan, understand which sources of income and what assets are available to you to fund your retirement. NZ Funds' retirement equation is an easy way to assess how you are tracking. The first input is your retirement spending, the output of your financial plan in Step 1. The second input is your source(s) of income. This will likely be New Zealand Superannuation, and may include a defined benefit pension plan.

Many investments also generate some income (for example interest, dividends or rent). However, for most retirees, that income is unlikely to be enough to bridge the gap between retirement spending and retirement income. Instead they are likely to use both their investments' income and capital value over the course of their retirement to fund their retirement shortfall. It therefore makes more sense to count income generating assets in the retirement fund. The number of spending years you can sustain your planned lifestyle for is determined by how many years of retirement shortfall can be funded out of your retirement fund.

THE RETIREMENT EQUATION



SOURCE: NZ FUNDS, 1 AUGUST 2014.

Your retirement fund

Your retirement fund is made up of your assets less any debts. It may be helpful to divide your retirement fund assets into three categories. First, those assets which do not require your active management, are easily accessible, and can be sold in part, or in whole. You should think of these as your core capital. You may wish to consider holding at least ten years of spending needs in core capital to be able to respond quickly to any adverse change in your circumstances. The types of assets retirees traditionally hold here include term deposits, shares, bonds and managed funds. Once you are eligible to access your KiwiSaver scheme, it can also be included in your core capital calculation.

Second, assets which require your active oversight, are usually only saleable as one lump sum and may take time to sell in order to realise a full price. These should be classified as risk capital. By holding a number of years of spending needs in core capital, retirees minimise the risk that they become forced sellers of assets in this category at a time when the price is depressed. Risk capital usually consists of a rental property or share of a private business, for example a farm.

Third, you may wish to include your home, boat or bach, and other lifestyle orientated assets. While they may be in use now, as your retirement progresses you may wish to realise the value in your lifestyle assets by, for example, downsizing your home. After any debt owed, these three categories of assets represent the funds available to you in retirement.

RETIREMENT FUND

SOURCE: NZ FUNDS, 1 AUGUST 2014.

3 Invest simply

Your funding options

Many retirees plan to use all the assets in their retirement fund over the course of their retirement. However, there are broadly speaking three different options: consume your savings and lifestyle assets, consume your savings and plan to leave your lifestyle assets as an inheritance, or plan to leave your lifestyle assets and a legacy to future generations or charity. The right option for you will depend on your planned expenditure and how your retirement unfolds. Many clients plan to leave some of the equity in their home to future generations, but also take it into account as a financial backstop, should they live longer than expected or incur an unexpected expense.

Ensure your retirement fund has liquidity

How you manage your retirement assets has the potential to affect not only your retirement income but also your retirement peace of mind. Many New Zealanders enter retirement with an array of assets: rental properties, one or two shares, bonds or a term deposit, a legacy superannuation scheme and (most recently) a KiwiSaver scheme. All have merit. However, preparing for retirement is a good opportunity to simplify your financial affairs. By keeping things simple and liquid, retirees minimise the chance of needing major asset restructuring during retirement.

There are four commonly occurring retirement surprises: the loss of an income which was critical to your retirement preparation, for example early redundancy, or a work inhibiting injury; an unexpected expense such as having to support a family member; higher than anticipated inflation; and a loss of retirement savings. A well structured, simple and liquid retirement portfolio may not prevent some of these things from happening, but it should help you mitigate your way through.

FUNDING OPTIONS

SOURCE: NZ FUNDS, 1 AUGUST 2014.

ENSURE PART OF YOUR RETIREMENT FUND IS HELD IN LIQUID ASSETS

SOURCE: ESTIMATES ONLY, BASED ON NZ FUNDS CLIENT DISCUSSIONS, 1 AUGUST 2014.

Ensure your retirement fund is diversified

Ensure your retirement fund is diversified. There are different levels of diversification. Owning a single bond, share or rental property is clearly not diversification. Similarly, owning a number of the same assets, for example five residential rental properties or ten New Zealand shares, offers some, but still insufficient diversification. Diversification comes from owning a variety of different asset classes, for example cash, income, inflation and growth and ideally owning them in different countries as well. Directly held shares or rental property may have a part to play in achieving diversification, but this needs to be considered against the backdrop of how complex you want to make your affairs.

NZ FUNDS' MANAGED PORTFOLIO SERVICE

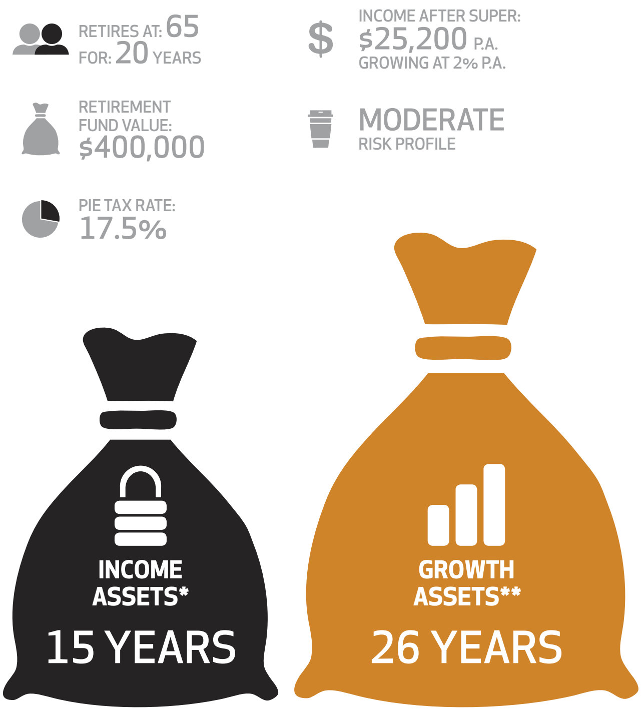
Investment Category	Managed PIE Portfolio(s)	Asset classes currently held	Managers currently used	Estimated number of holdings/ exposures
Cash	1	1	5*	6
Income	2	5	5	630
Inflation	3	9	7	5,500
Growth	4	9	10	5,546

SOURCE: NZ FUNDS, 30 JUNE 2014. *EXPOSURE TO: BNZ, ANZ, ASB, WESTPAC AND KIWIBANK.

Do not abandon growth

Do not assume retirement means abandoning growth. On average, a 65 year old retiree will spend 21 years in retirement[2]. Over the last 19 years, $1 invested in NZ Funds' Dividend and Growth Portfolio of predominantly New Zealand shares has snowballed into $2.81. Ensuring a portion of your retirement funds which you do not need to access in the near-term is invested in growth assets can help your retirement fund last a number of years longer. Your risk profile and age are two useful indicators of how much you may wish to hold in growth assets. As a general rule of thumb, your exposure to growth assets should be around 100% less your age, for example a 65 year old might hold: 100 - 65 = 35% in growth assets. This is subject to your risk profile and a level of volatility that you are comfortable with. Stress testing your portfolio by using historic share market or property price collapses can also be instructive.

THE BENEFIT OF GROWTH: YEARS OF SPENDING - INVESTMENT RETURNS FROM INCOME AND GROWTH ASSETS OVER THE PERIOD 1991 TO 2012



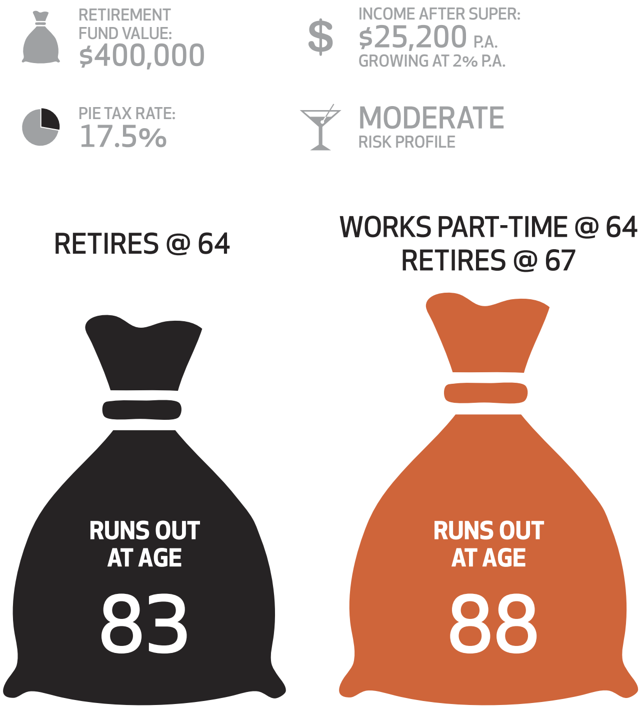
SOURCE: NZ FUNDS CALCULATIONS. *90 DAY BANK BILL RATE AND RESERVE BANK OF NEW ZEALAND SIX MONTH TERM DEPOSIT RATE (FIVE YEARS TO JUNE 2014). **RETURNS FROM MYWEALTH AVERAGE MARKET EXPERIENCE (1991-2012). ALL RETURNS AFTER MANAGEMENT FEES AND TAX, 30 APRIL 2015.

4 Optimise regularly

Varying your "income" to match your portfolio will extend the life of your retirement fund. Just as you would vary your lifestyle as your income and working circumstances changed, consider doing the same in retirement. While it is possible to spend a fixed amount every year, varying your drawings, particularly if your retirement fund is temporarily depressed, is a simple way to get more out of your portfolio over time.

Significant investment market drops tend only to occur intermittently: most recently twice in the last 20 years for shares, and once in the last 20 years for property. During these periods, an adjustment in your retirement spending by, for example, 30% by perhaps postponing some of your bonus spending activities, can add one or more years of income to the life of your retirement fund.

THE BENEFIT OF PART-TIME WORK



SOURCE: NZ FUNDS CALCULATIONS. INCOME RETURNS: 90 DAY BANK BILL RATE AND RESERVE BANK OF NEW ZEALAND SIX MONTH TERM DEPOSIT RATE (FIVE YEARS TO JUNE 2014). GROWTH RETURNS: MYWEALTH AVERAGE MARKET EXPERIENCE (1991-2012). ALL RETURNS AFTER MANAGEMENT FEES AND TAX, 30 APRIL 2015.

5 Consider investing in financial advice

Finally, consider the merits of investing in advice. Advice does cost, but consider it an investment. If cost is your primary concern, discuss it. Most Authorised Financial Advisers offer a range of different options and fee structures.

Investing in regulated financial advice can provide you with an alternative perspective; whether you wish to follow it is entirely up to you. It can help to have someone other than a spouse or your children to share the decision making burden with, especially during periods of change or volatility.

As with any long-term fiduciary relationship, such as a trustee, lawyer or accountant, the longer you work together, the better the mutual understanding, respect and trust. Investing in financial advice earlier, rather than later, should also help provide more continuity in your affairs, should one spouse pass away before another, or if you are no longer willing or able to actively manage your retirement savings.

MERITS OF INVESTING IN ADVICE

SOURCE: NZ FUNDS, 1 AUGUST 2014.

Summary

All of this is not to understate the challenges of retirement. It is to point out that there are a number of practical steps that anyone can take to ensure their financial affairs are more likely to fulfil their retirement expectations.

NZ Funds, in conjunction with the Authorised Financial Advisers we work with, has developed a simple, intuitive and personalised software programme for retirees, which enables them to manage their affairs in retirement. The software incorporates many of the concepts discussed in this article. If you wish to discuss any aspect of our research further, your Authorised Financial Adviser, or one of NZ Funds' team, is happy to help. Using NZ Funds' software they can also model a variety of different retirement scenarios to help ensure your retirement is more relaxing than restless.

2015 BUDGET ANNOUNCEMENT

ALL CALCULATIONS IN THIS DOCUMENT UNDERTAKEN AT 30 APRIL 2015. THEREFORE, WHERE APPROPRIATE THEY INCLUDE THE GOVERNMENT KICK START CONTRIBUTION. THIS WAS REMOVED FOR MEMBERS WHO JOINED KIWISAVER FOR THE FIRST TIME AFTER 22 MAY 2015.

[1] Source: NZ Funds' Investment Bulletin: Issue 6 August 2014, Researching Retirement, Paul van Wetering.

[2] Source: NZ Funds calculations, Statistics New Zealand.

NZ FUNDS

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