

### **Old Mutual Absolute Growth Portfolio caters for individual risk appetites**

Over the last few years, an increasing number of retirement funds have elected to offer their members a life-stage investment option, whereby each individual's savings are invested in a portfolio according to their age and time to retirement.

Roger Birt (Pictured right), Head of Guaranteed Investment Portfolios at Old Mutual Corporate, believes that a well designed life-staging model should take into account the risk appetite of members during different phases of their working life, as well as the financial needs of members after they have retired.

"A proper life-staging model will appropriately cater for both young and old members by providing suitable portfolios for both accumulation in the years before retirement and preservation after retirement, and ensuring a smooth transition between these phases," he says.

Before retirement, younger retirement fund members will tend to look for higher returns from riskier investments, and most life-stage models cater for this. Most life-stage models also cater for members nearing retirement by shifting their focus towards lower risk assets to ensure a comfortable monthly income in retirement.

What tends to be given little focus is what risk profile a member is likely to be comfortable with after retirement, based on their choice of post-retirement vehicle.

Birt further explains that people who desire cash at retirement are likely to be best suited to avoiding losses on capital from risky investments, like the stock market, as retirement approaches.

In this case, cash may be deemed a good option as an investment close to retirement.

Another option would be investment products that guarantee capital and returns declared as bonuses, since these products behave like cash from a protection perspective, but improve prospects for higher returns depending on the nature of markets.

Alternatively, people who opt for a life annuity will want protection from interest rate movements as retirement approaches.

"A life annuity pays a guaranteed income until death, and the price paid for a life annuity depends heavily on interest rates and bond yields. As such, any drastic yield change close to retirement could significantly impact on the level of income secured for life," says Birt.

At the other extreme, there are those members who opt for a living annuity at retirement.

"With a living annuity, the individual decides on the level of income they need to draw down every year from an investment fund based on their risk appetite. In contrast to life annuities, these members take on the risk of potentially running out of their savings pool before death."

"As such, taking on some investment risk to increase the likelihood of favourable returns on those investments over a reasonable time frame is a consideration."

"As a result, these members will probably place less value on completely avoiding stock market losses, as recoveries in losses after retirement are fairly likely for them."

"Riskier investments are likely to be considered, although these members are still likely to desire their return each year to at least meet the minimum living annuity drawdown rate of 2.5%," he says.

Birt believes that life-staging should be a priority for defined contribution funds.

"In contrast to a defined benefit fund, where the employer carries the risk; under a defined contribution structure, the member carries the full investment risk."

"Members of defined contribution funds therefore need to place significant importance on investment management and ensure that their trustees provide them with a range of solutions to cater for a wide spectrum of needs," he says.

According to Birt, a good example of a portfolio that caters for individual risk appetites is the Old Mutual Absolute Growth Portfolio, which invests a significant proportion (80%) of its underlying portfolio in 'growth' assets, including equities, direct property and private equity.

However the portfolio gradually distributes returns to members over time, thereby removing 80% of the volatility in returns associated with such a risky underlying portfolio.

In addition, the portfolio is flexible in terms of whether a high level of guarantee is provided, and at what level, depending on a member's risk appetite.

With such a portfolio design, all members benefit from an aggressive underlying portfolio with low volatility risk, but younger members could opt for a very low, or no guarantee, while it is not desired.

Members closer to retirement can simply ratchet up the guarantee to as much as 100% of capital and returns to fully protect accumulated savings and subsequent bonuses, while retaining the same growth focus of the underlying portfolio.

This should promote savings at return levels above cash when equity markets perform.

Members that are targeting a living annuity could see value in these portfolios after retirement. Because the underlying investment targets good long-term returns, while returns over shorter periods are not very volatile, this provides an optimal living annuity vehicle.

The benefits are that the annuitant would increase the likelihood of sufficient savings many years into retirement through higher long term returns than more conservatively managed portfolios, while the low volatility of those returns increases the likelihood of at least meeting the minimum drawdown rate each year.

A moderate guarantee of, say, 80% could be considered.

When approaching retirement, these members may wish to match their targeted living annuity before retirement date, thereby avoiding the need to change strategy at retirement.

Alternatives are available from Old Mutual for members aiming for a life annuity. These products are appropriate close to retirement as they aim to match the movement in yields and move in tandem with the price of life annuities, reducing the risk of an unaffordable retirement.

