BROADLEAF
FINANCIAL SERVICES

YOUR GUIDE TO RETIREMENT INCOME

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What are your retirement goals?

What is your plan for retirement? Indulging a lifelong passion? Travelling? Spending time with your grandchildren? Continuing to work part-time?

In our experience, there are many ways clients want to spend their retirement. But from a financial perspective, we've found most people want to achieve one – or often more – of the following goals. Before you focus on anything else, it is vital you work out what your goals are for retirement.

Avoid running out of money?

For many, this is their number one goal – and their number one retirement fear. Being forced to turn to your children, or go back to work during retirement is a source of anxiety for many current and future retirees. Many people think the key to achieving this goal is having only very low-volatility investments, such as government bonds, but as we will discuss later, this may not always be the case. On the other hand, some people truly wish to simply preserve the value of their assets even if their investments will not keep up with inflation.

Maintain or improve lifestyle?

Most people have worked hard for their retirement and want to enjoy it. As such, a common goal for many is to maintain or improve their lifestyle during retirement. The key is to maintain or grow purchasing power over time. This requires income growth to offset the impact of inflation.

Increase Wealth?

Some people can easily enjoy the retirement lifestyle of their choosing with no fear of running out of money. For these fortunate individuals, the goal is often to grow their wealth over the long term – typically for a legacy, whether that's for their children, grand-children or a charity. Most people with this goal take a growth-oriented approach to their investments.

Spend Everything?

Some people want to spend all their money before they die. But this can be a risky proposition as there's no way to know exactly how long your retirement will last. People who try this need to remember that life expectancies have been trading upwards over time due to medical advancements.

Before you focus on anything else, figure out which of these goals are most important to you. You can't figure out how to get there if you don't know where you are going!

How much will retirement cost?

Once you've worked out your goals for retirement, you can start calculating how much your retirement will cost. Four factors to consider are non-discretionary spending, discretionary spending, inflation and your investment time horizon, such as your life expectancy.

Non-discretionary spending

This is the spending you don't have a lot of control over. There may be some wiggle room, but for the most part, you can't avoid these costs.

1. Living expenses:

Day-to-day, how much does it cost to maintain your lifestyle? You'll want to consider everything from shopping and fuel to heating bills. If you aren't planning on relocating in retirement, you probably have a good idea of what these expenses are already.

2. Debt:

This can be credit card debt, your mortgage or loans. Anything you owe needs to be accounted for when identifying your expenses. That's because you'll have to keep paying off the main loan and making periodic interest payments.

3. Taxes:

Whilst taxes are often lower for retirees, the government still wants its cut. It pays to keep money set aside to settle your tax bill at the end of the year.

Discretionary spending

Once you get past basic living expenses, you have to account for discretionary spending. Discretionary spending depends on your personal situation. For example, you may view your TV package as discretionary but holidays as a non-discretionary expense. This is just an example, but the message is that if you have a hobby or another expense you can't imagine living without, you'll need to include it in your non-discretionary expenses. Here are some of the more common discretionary items in retirees' budgets:

1. Travel:

Many people look forward to travelling in retirement. This could include visiting grandchildren or spending time overseas. If you've been thinking about a dream holiday for years, now could be an ideal time to budget for it.

2. Hobbies:

Retirement is a great time to restart old hobbies or pick up new ones. Ready to master fly casting or finish researching your family history? Hobbies almost always incur some costs, even if many are small.

3. Luxuries:

This is partly subject to your own budget and definition of luxury. But whether you enjoy fine wines or simply meeting friends for coffee, you'll need to factor non-essential purchases into your expenses.

4. Children and grandchildren:

For many, this last category includes aspects of all the others. Your family could require travel and luxury purchases, and be your favourite hobby all at once. If you need a generous budget to make children and grandchildren a focus in your retirement, you'll need to think about how much cash flow you will need to support it.

Inflation

Inflation is insidious. It decreases purchasing power over time and erodes real savings and investment returns. Investors may fail to realise how much impact inflation can have. Since 1915, inflation has averaged about 4% a year*. If the average inflation rate continues in the future, a person, who currently requires £50,000 to cover annual living expenses would need approximately £115,000 in 20 years and around £175,000 in 30 years just to maintain the same purchasing power.

Investment time horizon

Your investment time horizon is a major determinant of your total retirement expenses and perhaps one of the most overlooked factors among today's retirees. And people can live longer than they might expect.

Your investment time horizon can be our life expectancy, the life expectancy of a younger spouse, or a longer or shorter time horizon, depending on your investment objectives.

Current Age	Life Expectancy	Current Age	Life Expectancy	Current Age	Life Expectancy	Current Age	Life Expectancy
51	81	61	83	71	85	81	89
52	81	62	83	72	85	82	89
53	81	63	83	73	86	83	90
54	82	64	83	74	86	84	90
55	82	65	83	75	86	85	91
56	82	66	84	76	87	86	91
57	82	67	84	77	87	87	92
58	82	68	84	78	87	88	93
59	82	69	84	79	88	89	93
60	82	70	85	80	88	90	94

Source: UK Office of National Statistics, 2013-2015. Life expectancy rounded to nearest year.

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*Source: Global Financial Data, as of 01/11/2017. Based on UK Retain Price Index in GBP from 1915-2016.

How will you pay for retirement?

Once you have an idea of how much your retirement will cost, you can start working out how you're going to pay for it. We suggest you calculate all the income you generate without relying on your investments. The most common categories of non-investment income are listed below;

Non-investment income

1. Salary:

Will you work at all in retirement? If so, you'll need to estimate how much salary you can expect. To do this, don't count money you make from a business investment or partnership; just consider direct financial transfers from your employer to you.

2. Pension:

If you employer offers a pension, you should determine how much you can expect to receive from it regularly. Will it increase or decrease over time?

3. State Pension:

The State Pension will be available to you when you reach the State Pension age. To find out how much you might receive, you can request a State Pension statement from the government's website (www.gov.uk/check-state-pension).

3. Business and real estate:

If you maintain an interest in a business or investment property, this could produce non-investment income. When calculating how much to expect, consider these sources of income to be more susceptible to market conditions than the State Pension or a guaranteed pension.

Using your investments to pay for your retirement

The difference between your total income and your total expenses is your net savings. If this is negative (as it is for many affluent retirees), you may need more cash flow from your investment portfolio to ensure you can cover all of your expenses.

The remainder of this guide focuses mainly on generating cash flow from your portfolio to bridge this gap. But before we explain specific strategies, we'll discuss some important principles of retirement investing.

Income vs. cash flow

There is a key difference between income and cash flow. Income is money received and cash flow is money withdrawn. For example, dividends and bond interest payments are considered income – you report them as such on your tax returns. These are two acceptable sources of income, but they are not the only sources of cash flow. Selling an investment also generates cash flow. When you sell an investment, the difference between what you put in and what you take out is considered a capital gain (or loss).

Please note, cash flow withdrawn from your portfolio isn't necessarily a bad thing. It can be an important component of your overall retirement strategy.

Consider: If you have a portfolio of £1,000,000 growing at 8% a year, and you realise £80,000 in annual gains, this really isn't any different than a portfolio growing at 4% a year that pays £40,000 in dividends. The total return (capital gains plus dividends) is the same on a pre-tax basis; and, depending on your situation, selling an investment and paying tax on the capital gains may be more tax-efficient than dividend income.

Conclusion: When it comes to paying for your retirement, it could be wise to focus on the total return of your portfolio and cash flow – whether or not it comes from regular income or selling investments.

However, before you can generate income, you'll need to decide what assets will make up your portfolio.

Over longer time periods, equities actually have lower volatility (standard deviation) than fixed interest. This means if you have a longer investment time horizon and/or higher return needs, you may want to consider a higher proportion of equities for your portfolio. This could be especially true when you factor in withdrawals over the course of your retirement. Of course, you also need to factor in your personal circumstances and attitude to risk (i.e. how comfortable you are taking risk).

If you're taking £50,000 out of a £1,000,000 portfolio every year in withdrawals, you're more likely to deplete it if your rate of return is too low. You would need a 5% total rate of return every year just to keep your balance the same and that's before accounting for inflation. If you're worried about having 'safe' investments with low volatility, consider that another risk may be running out of money due to a low rate of return over the lifetime of your investments. Weighing these trade offs is an important consideration.

Next, we'll address a problem just as serious as returns that are too low: taking withdrawals that are too high.

Risk of high withdrawals

A common assumption is that since equities have historically delivered a roughly 10% annualised average return over the long term*, it must be safe to withdraw 10% from the equity portion of your portfolio without drawing down the original amount you invested.

This isn't the case. Though equity markets may annualise around 10% over time, returns vary greatly from year to year. Miscalculating withdrawals during market downturns can substantially decrease the probability of maintaining the original invested amount. For example, if your portfolio is down 20% and you take 10% distribution, you will need around a 39% gain just to return to the initial value.

When you consider how damaging years of too-high withdrawals could be, it's clear how important it is to properly manage your cash-flow expectations and discretionary spending.

Difficult decisions

Investing requires trade-offs, such as more short-term volatility for higher returns or less volatility for lower returns. Another trade-off you may have to consider is between different discretionary purchases. Sometimes you may have multiple expenses that are important to you personally, such as paying for a grandchild's education or taking a dream holiday with your spouse. However, to meet your investing goals, you'll need to be clear about what's affordable. It's not advisable to risk depleting your portfolio for non-essential spending. This isn't to say that helping with university fees or paying for holidays are off limits; rather that they need to be budgeted for realistically in the context of your overall goals, cash-flow needs, return expectations and attitude to risk. Maybe you can do both, one or possibly neither.

It's also helpful to be clear with yourself and others about how much you can spend beforehand. Once spending is expected, emotions can come into play and you could face a bigger bill than you're comfortable with. Any time you're taking more than 5% from your portfolio, you could be greatly increasing the risk of depleting y our assets.

Now it's time to consider what investments you'll use to generate income.

*Source: Global Financial Data, Inc; as of 06.04.2016. Based on 10.16% annualised GFD's World Index returns from 1926-2015. GFD's World Return Index in GB.

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