rise financial

canberra times: q&a

Q 1: I have just retired at age 60 and have $300,000 in superannuation. My intention is to invest in term deposits and live on the interest whilst preserving my capital. Does this sound like a good idea for someone my age?

Withheld, Canberra

A 1: There are other ways for you to invest your capital which you should be aware of, and your situation is an opportunity to illustrate this. Here are some points:

1) If you simply invest your capital in fixed interest based assets within superannuation, and assuming these funds earn a return of 6% pa, then you would be drawing a tax free income (from super assets over age 60) of $18,000 pa
2) If you spend the income earned each year in full, then in 25 years time at age 85, you would still have capital of $300,000, which you have "preserved"
3) Allowing for inflation of 3% pa, which has the effect of eroding the purchasing power of your capital over time, then in 25 years your capital will have the purchasing power that we know today of only $140,092
4) In addition, the $18,000 income you draw each year after allowing for the erosion of the purchasing power over time would buy you only $8,405 in today's dollars in 25 years time

The point here is that by investing your capital conservatively and spending all earnings, you actually erode the value of the capital and income stream over time.

An alternative would be to invest your capital with a reasonable exposure to growth assets including shares and property, to provide a long term return of say 9% pa (statistically this is achievable when investing 6 years or longer). This way you could continue to spend 6% pa on the capital invested, maintaining your purchasing power during retirement, while still increasing the capital value by 3% pa to properly "preserve" the value of the asset. In 25 years the capital has increased from $300,000 to $628,133, and the 6% pa income stream has increased from $18,000 to $37,688 pa. You of course need to be comfortable with the added investment risk and volatility involved.

While this may sound good, you may think that achieving a return of 9% pa over the long term is not achievable, particularly in light of poor sharemarket performances in recent years following the global financial crisis, and poor property performances. However, you need to understand that money moves in a predictable way over the long term in capital markets in capitalist economies, and the better returns from growths assets in shares and property will come in time. A simple cautious approach would be to try not to spend as much while market performance is poor and then enjoy some more spending when markets are going well.

A final word of warning too would be to avoid chasing higher 'fixed interest' returns, otherwise you may fall foul of a Banksia Securities type scenario where investors may lose a significant portion of their investment. While investors may have felt their investment was low risk in a term deposit, they did not understand that their money was being lent out to higher risk

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borrowers. The simple reminder is 'the higher the return, the higher the risk.' even in the fixed interest / term deposit space. You need to understand your investment – a reputable institution with good diversification is key.

Phil Thompson is a certified financial planner and authorized representative of Rise Financial Pty Ltd (ABN 86350987645), AFSL 311718, an Approved Financial Planning Association Professional Practice. Answers should be used as a general guide only and professional advice should be sought before making investment decisions.

Send your financial questions to phil@risefinancial.com.au

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