Budget Booster
+ wealth + security

May 2015

Is $1 million enough?

Recently, there has been a flurry of activity around some articles appearing in the mainstream media that suggest that a retirement nest-egg of $1,000,000 is not sufficient to provide for a comfortable income in retirement.

You might recall from previous blogs that figures modelled by the Association of Superannuation Funds of Australia (ASFA) suggest that a comfortable retirement lifestyle will cost a couple $58,364 and a single $42,604. These figures were current for the December 2014 quarter.

The current spate of comments about $1,000,000 being inadequate are attributed to Jeremy Cooper, the chairman of retirement income at Challenger (Australia's largest provider of annuities). He also chaired the review of Australia's superannuation system which tabled its final report in June 2010.

However, before prospective retirees resign themselves to the thought of having to work forever, these comments need to be put into some context.

An annuity is an investment product that provides a regular income in exchange for a lump sum. The income is paid at agreed intervals (e.g. each month) for the term of the annuity. This may be for the life of the annuitant, or for a fixed number of years. Annuities are generally long-term contracts that could be paid for 20 years or longer.

From an investment perspective, annuities tend to be conservatively managed and the rate of return offered is generally close to interest rates available in the broader financial community. With the interest rate for a lifetime annuity issued to a 65 year old currently being a little over 3%, an annuity purchased with $1,000,000 will provide an agreed income (indexed in line with inflation) of around $32,000[1] in the first full year. This is roughly the same as the full age pension for a couple.

The reason for the low rate of income being quoted for annuities reflects the historically low interest rates available in Australia at the current time. The guarantee of future income comes at a price.

However, the reality is that it is unlikely a person with a $1,000,000 retirement nest egg will be investing all their savings into an annuity. Retirement savings will generally be invested in a range of investment asset classes that provide for capital growth and income. Such retirement savings, even when invested in a managed funds or through a superannuation fund will generally include exposure to fixed interest securities (bonds etc.), cash, shares and property. For some retirees, investing a portion of their savings in an annuity might be an appropriate strategy.

It is reasonable to expect that a balanced portfolio, spread over a number of asset classes will, over time, provide a return that exceed the current cash rates by a respectable margin. A return, over time, from a balanced portfolio of 5% to 7% per annum should not be difficult to achieve. This would provide a real return of 2% to 4% after taking inflation in to account.

The real secret to successful retirement planning lies in having a plan in place and receiving good quality financial advice that addresses strategy and management of investments, as early as possible.

[1] Challenger Lifetime Annuity Quote – 20 April 2015

Source | Peter Kelly | Centrepoint Alliance

Glennen
FINANCIAL PLANNING
Tailored Solutions

PO Box 170 – 50 Heygarth Street Echuca Vic 3564
Ph: 03 5480 0300 M: 0417 157 606
E: info@glennenfinancialplanning.com.au
www.glennenfinancialplanning.com.au