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Investment Planning for Retirement

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If medical science proves to be as effective as it claims and we begin to lead a healthier lifestyle, then we may well see people in Singapore living to a ripe old age of 90. This means that a reasonably healthy person, retiring at the age of 60 to 65, will be able to live for another 25 to 30 years in retirement. This must warrant some serious investment planning. Simply investing in some annuities, bonds or stocks will not be adequate. Nothing short of a comprehensive investment plan must be considered in retirement planning.

In this article, I will attempt to illustrate how the factors in the investment planning process affect both your financial position and financial needs in retirement. More importantly, you must make an effort to understand the concept of investment planning and take a more proactive role to find out what you have invested in. Once these factors are determined, then an appropriate investment strategy or strategies can be put in place to help you achieve your retirement goals.

Know your retirement objectives and cash flow needs

Instead of searching through the papers or the internet for “good” investment instruments or suggestions, we should start with determining our retirement objectives and expected financial outflows on retirement. Understanding our objectives and cash outflows is the key to effective investment planning. Why? Because it tells us how much we need, and when we need them. It gives us a realistic expectation of the cash flow time frame and the amount needed.

Investing according to a time frame

As the first dollar we need upon retirement begins the day we retire, and the last dollar may well be 25 years from now, it is obvious that the investment strategies for both cannot be the same. For example, funds needed in the near future, within 4 to 5 years, should be invested in low risk instruments such as deposits, bonds or short term single premium endowments. Funds needed 10 to 20 years after retirement can be invested in higher-risk instruments to yield higher returns.

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Diversification

Putting all your eggs in one basket is certainly most unwise. You will certainly not be comfortable seeing your investment values fluctuating with the market cycles. Investment returns need not necessarily be achieved by taking on high risk investments all the time. Combining several investments with low or negative correlations will offer lower volatility as a whole. Instead of depending on a single asset or asset class and subjecting yourself to the volatility or a narrowly-defined investment mandate, you can select several assets or asset classes to form an investment portfolio that can offer similar or higher returns for the same volatility. You must not be blinded by the fact that just because you diversify your investments, you will earn a higher return or be subjected to a lower risk. If you are not careful and invest in a group of assets that has a high level of correlation, than you may be subjecting yourself to a higher risk. Nevertheless, diversification is especially important when you retire as one of your key concerns would certainly be wealth preservation.

Asset allocation

Attempting to beat the market by overweighting or underweighting the investment in certain asset classes may not always work. Such strategies usually involve more risks and require constant monitoring in the market place. Even the best investment guru may be caught off guard by sudden market movements. Investment structures that attempt to pre-empt the movement of some market indices and derive returns from a correct prediction may sound too good to be true. Usually, the justification for the market prediction appears to be very sound in the beginning, attracting many investors to go along with it. However when these markets take a turn against the prediction, any investment upside will be difficult to achieve.

Investing into any asset class requires you to understand what the asset class is and how it correlates with one another. Investing across various asset classes through an asset allocation strategy allows you to diversify your investments and possibly enhance your portfolio returns without having to increase your risks.

Return expectation

Seeking a reasonable return on investment so as to achieve your retirement objective is crucial. The targeted return is dependent on the financial goal you want to achieve on retirement. You must also have a realistic expectation of the investment returns that can be achieved by the various types of instruments. There have been occasions where a certain asset or its class has provided extraordinary investment gains. In the long run the investment instruments cannot possibly deliver a return that is very different from those of its own class. We must have a realistic expectation of the investment returns and understand what the investment can and cannot do.

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Risk

Practically every type of investment comes with some form of risk. Risk typically means volatility, and is measured by the term called standard deviation. Higher investment returns will equate to higher risks. This relationship should not be overlooked. Investors should be aware of the sources of risks for any investment. For instance, currency risk is primarily due to investing in assets of another currency. Sometimes we face currency risk indirectly when the class of assets we invest in involves assets of a foreign country. Interest rate risk comes from the fact that the investment is affected by changes in the interest rates. Market risk is due to the fluctuations in the entire market that affect the value of the investment. Inflation risk will affect the purchasing power of the investment. Business risk comes with the risk of investing in a particular asset or asset class. Financial risk is due to the investments associated with the use of debts. Liquidity risk comes from the ability to liquidate the investments without significant price changes. Country risk stems from the political and economic stability of the country in which the investment is invested in.

While it is not always possible for you to understand the exact implications of the risks mentioned above to the investments you have made, it should be clear to you that such risks will affect the value of your investments. You should therefore consult your adviser on how such risks will affect your investments and whether you are able to take such risks. Sometimes we are blind to the risks simply because it is a capital-protected investment. Such investments will also have risks. For instance, the bonds in which the investment uses to protect the principal value may default, hence affecting the principal value of the investment negatively.

What you must fully be aware of is the fact that investment returns come with risks. However risks are not necessarily bad and you may not need to avoid it completely. Instead you should manage risks with a strategy in accordance with your risk appetite.

Amount to invest

Finally, the amount you have to invest will determine your investment strategy. Generally, those with more funds to invest should be taking more risks, whilst those with less funds should take less risks. However, in reality, those with more than sufficient funds often do not see the necessity to take more risks, while those with inadequate retirement funds often invest in higher-risk investments, with the hope of making up the shortfall in their retirement funds. This is the kind of contradiction that leads retirees to make some major investment mistakes. Hence investment planning becomes even more critical.

Periodic investment review

Once an investment is made, the review begins. You must review your investment portfolios regularly to ensure that your investment portfolios are in accordance with your current risk appetite. Investment reviews may require adjustments and changes to the asset and its class. This should be done with full knowledge of how the changes will help to align your investments to your goals, as well as take into account any costs involved.

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Factors affecting Investment Planning

You must review your investment portfolios regularly to ensure that your investment portfolio risks are in accordance with your current risk appetite.

Investment Strategies

The investment strategy for retirement planning must take into consideration the above mentioned factors. At First Principal, we further apportion the investment assets into several tranches based on the time frames in which funds are needed. We then use different strategies to manage the different risks identified. With the various portfolios we have designed in our company, it makes it easier for anyone planning for retirement or already in retirement, to select the portfolios based on their risk appetites. This way, you need not rely on a single strategy for your entire investment funds, and you will be able to use an array of portfolios which we have designed without the hassle of selecting individual types of investments. We call this Retirement Tranche Planning and Portfolio Asset Management.

In the final analysis, if you are planning for retirement, you must understand that financial planning does not end when you retire. In fact, financial and investment planning continues to be important even after you retire. The funds that you would have accumulated over the last 30 to 40 years must now be used for the next 25 to 30 years, and hence should be appropriately managed and invested. Seemingly quick and simple ideas that claim to achieve high investment yields should be carefully studied. Remember, there are no free lunches in investment!

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