Investing for retirement

How InvestSMART can help you to secure your wealth.

INVESTSMART

LET'S MAKE WEALTH HAPPEN

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About InvestSMART

Founded in 1999, InvestSMART Group Ltd is a leading Australian digital wealth adviser. It owns Intelligent Investor, Eureka Report and has launched a number of its own funds.

InvestSMART's goal is to provide quality advice, research and easy-to-use tools, free from the jargon and complexities so commonly found in the finance industry, to help you meet your financial aspirations.

A note to Investors

Whether you're a DIY investor, or have a self-managed super fund (SMSF), you've both voted with your feet, and decided to make your own (or independent) investment decisions, rather than entrust a financial institution do it for you.

After the damning report by the Royal Commission into Australia's banking and superannuation sector, the decision to go it alone is hardly surprising, and more Australians are doing it. But while the desire by a growing number of Australians to become self-funded retirees is only to be commended, it does bring with it mixed blessings.

During my 40-plus years as a senior financial adviser, I've witnessed countless occasions when too much freedom of investment choice has backfired. Research conducted by the Australian Securities and Investment Commission (ASIC) back in June 2018 concluded that too much freedom over where to invest, wasn't necessarily in the best interests of all DIY investors, and SMSF members holding just a single property were seen as most at risk.

When it comes to de-risking your financial future, it's important to remember that four key considerations highlighted by ASIC – risk and return, liquidity, diversification and cash flow are equally relevant, regardless of the investment vehicle you've chosen. Whether you have a SMSF or not, InvestSMART can help you develop an investment strategy that's adequately diversified.

Contrary to the popular notion held by many, especially retirees, income doesn't have to be, nor should it be all about reaching that extra percentage of yield. Here at InvestSMART, we want investors to think more about total returns than just interest alone.

In other words, in addition to the dividends and franking credits you earn, in your quest for yield, you shouldn't overlook capital growth. It's important to note that yield is just as much about risk and return as growth investing, and the higher the yield, the higher the risk you're typically taking.

With that in mind, we strongly urge investors to consider a total return approach that allows capital gains to supplement the modest income generated elsewhere within the portfolio.

Whether you embarked on your saving journey years or decades ago, this white paper is all about showing you how you can use an InvestSMART Portfolio to protect your wealth, and generate income, while having the right exposure to capital growth.

We want to walk you through the options available to you as an InvestSMART investor and how they work. That means helping you choose a portfolio with the right diversification of growth and defensive assets necessary to deliver total returns that everything being equal, will be higher than yield off a single asset, (like shares or property).

As well as guiding you through the steps you need to take to set the wheels in motion, we'll show you exactly how an InvestSMART portfolio provides for your short, medium and long-term income needs, regardless of what life-stage you've reached.

Paul Clitheroe

Chairman of InvestSMART Group

InvestSMART and your super obligations

ASIC research conducted in June 2018 revealed that far too many SMSF members didn't adequately understand the importance of diversification, which in turn put their financial future at risk. So concerned was the Australian Tax Office (ATO) at ASIC's findings that late in 2019 it wrote to around 18,000 SMSFs reminding them of their obligation (under operating standard SIS Regulation 4.09) to be adequately diversified.

The ATO also reminded SMSFs' that the all too common practise of holding 90-plus percent of a fund's assets in just one asset or a single asset class – which so very often is a single residential rental property – is not something SMSF trustees have the right to do. If risking their financial future isn't enough to force compliance, SMSF members who breach their obligations to suitably diversify, can also cop administrative penalties.

Four key requirements your SMSF strategy must consider

The regulations require SMSF investment strategies to adequately consider:

Risk & return

The ATO expects SMSFs to weigh up the risks involved in holding and then realising (~aka selling) the assets their portfolio invests in, against their expected investments objectives and cash flow requirements. Assuming your risk and return profile properly matches your investment strategy and timeframes, you'll be able to meet your short, medium and long-term income requirements.

To do this, SMSFs should focus on the benefits of offsetting volatility (~aka market movements up and down) and short-term downside investment risks, preserving capital and the long-run goal of achieving higher overall returns.

Instead of having to reinvent the wheel, InvestSMART has four portfolios ranging from conservative through to high growth so you can adequately gauge your risk and return profiles. To further reduce risk, you can even blend these portfolio options, any time and at no extra cost. By spreading your investments across different asset classes and markets offering different risks and returns, InvestSMART's portfolios ensure you're better positioned for a secure retirement.

Diversification

Once you know exactly what you're risk profile looks like, it's time to look for a mix of investments in one portfolio that most closely matches your need for cash flow at future points in time. Given the risks associated with having too many investment eggs in one basket -especially when there's a sharp fall in value - the ATO expects SMSFs to give due consideration to the overall composition of their investments through adequate diversification.

The beauty of diversification is the defensive element that comes from constructing your portfolio with non-correlated assets. This is a fancy term for describing how the price movements of different assets classes typically don't directly impact each other. For example, within normal markets when growth assets underperform, they're typically offset by more defensive assets classes – hence smoothing out overall performance and minimising the risk of negative returns.

The trick to getting diversification right is to identify the right multi-asset class mix that best reflects your stated approach to achieving your predetermined goals, whether its saving for retirement or some other objective. Given that InvestSMART has instantly diversified portfolios to meet this requirement, there's no need to labour over multi-asset decision making.

We have diversification both across multiple asset classes and again within asset classes to ensure you get the right weighting of growth assets and defensive assets to best reflect your tolerance for risk.

Liquidity

Under ATO instructions, SMSFs' need to contemplate the liquidity and cash-flow requirements of their fund. Liquidity typically refers to the ease with which a portfolio can access capital or access cash by selling assets. Given that InvestSMART's portfolios invest exclusively in exchange traded funds (ETFs) which trade on the Australian Securities Exchange (ASX) as ordinary shares, they provide excellent levels of liquidity.

The ease with which the ETF issuer can simply create more units to meet demand (~aka being 'open-ended') also means they should remain as liquid as the underlying stocks that are held within them. The ease with which the underlying mix of ETFs within your portfolio can be bought and sold, means rebalancing your mix of assets, to better reflect your changing financial circumstances, can also be done quickly and cost-effectively at any time.

Within the highly volatile markets the need to easily get in and out of an asset takes on added importance. Here at InvestSMART we recognise that you may need to make quick decisions without being constrained, and where here to help.

For example, if you started out with a Conservative Portfolio and suddenly received an unexpected windfall, you may wish to rebalance your portfolio to better reflect your future need for income.

Liabilities

Under ATO guidelines, it is also incumbent on SMSFs to establish how they plan to discharge the liabilities of the fund. There are three withdrawal methods for InvestSMART professionally Managed Account (PMA) investors to meet their draw down requirements, these include:

i. A regular withdrawal plan allows you to set a dollar amount for drawn down each month.

ii. The income sweep option means all income earned each month, including all dividends and interest received is tallied up and swept out into your bank management account.

iii. Flexibility with income/distributions also allows you to choose to withdraw directly from your account on an ad hoc basis. This means you can select whatever dollar value you want at whatever time you want.

Alternatively, you may choose to combine all or any of the above and have the income sweep turned on, and then top up any shortfall through an ad hoc withdrawal. While we don't have the means to automatically meet draw down rates, InvestSMART does provide the mechanisms for you to do that effortlessly online, and without any need for paperwork.

For example, all the above functionality can be managed by you directly through your InvestSMART Dashboard and account management section. Whether you're in pension mode or not, anyone regardless of the account they have, can have these dashboard settings turned on.

Understanding your living expenses in retirement

How much income will you need?

How much you need to live on once you stop working, will depend on what sort lifestyle aspirations you have in retirement. But if you're planning to maintain the same standard of living once you retire, ASIC's MoneySmart website suggests you'll need roughly two thirds (66%) of your pre-retirement income.

As a rule of thumb, research by the Association of Superannuation Funds of Australia (ASFA), suggests that for a "modest" retirement lifestyle - which while better than the age pension only provides for basic activities – requires an annual income of $30,063 and $43,250 for singles and couples respectively.

By comparison, for a more "comfortable" retirement lifestyle, ASFA data suggests singles and couples will require annual income of $47,383 and $66,725 respectively. This equates to a combined lump sum for you and your partner of around $640,000 (or $545,000 for a single person) for a comfortable retirement, assuming you both also receive a partial age pension.

ASFA defines a comfortable retirement as enabling healthy retirees to participate in numerous leisure/recreational activities, buy household goods and electronics, private health insurance, a reasonable car, good clothes, plus domestic and occasional international holiday travel.

To ascertain how much you'll need in addition to minimum draw down rates governing super and SMSFs, (currently 2% for those under 65, and 2.5% for those 65 to 74) – it might be worth walking through this with your financial adviser.

Budgets for various households and living standards

	Modest lifestyle		Comfortable lifestyle	
	Single	Couple	Single	Couple
Total per year	$30,063	$43,250	$44,183	$62,435

Source: ASFA Retirement Standard, June quarter 2022

Thinking about your total return

Rather than fixating on the yield from interest or dividends, it's better to take a total returns approach. Total returns investing is all about maximising the overall return of the portfolio, rather than simply preferencing income over growth.

One of the benefits of total return investing is that it allows you to maintain diversification which reduces the risk of capital loss. It also provides better control over the size and timing of withdrawals, and InvestSMART withdrawal options help you set this on autopilot. For example, you get to decide how much and how often you take cash, rather than waiting for a schedule of dividend payments and distributions.

As well reducing your chances of running out of money in retirement, being able to reduce withdrawals when markets are down – using a total returns approach - means your portfolio can support your lifestyle for longer.

Total returns: A snapshot

Here's a breakdown of the total returns delivered by InvestSMART's five portfolios over the past five years:

	Conservative	Balanced	Growth	Ethical Growth*	High Growth
Capital return	-0.53%	0.88%	1.97%	1.42%	3.10%
Income return	2.55%	2.75%	3.06%	2.24%	3.13%
Total return	**2.02%**	**3.63%**	**5.03%**	**3.66%**	**6.23%**
Average of Peers	1.76%	2.88%	3.87%	5.36%	5.28%
Excess to Peers	**0.26%**	**0.75%**	**1.16%**	**-1.70%**	**0.95%**

Source: InvestSMART. Performance as at 31 December 2022. *Ethical Growth return is since inception, 01 Nov 2020.

The 10/30/60 rule

Contrary to conventional wisdom, retirement isn't the time to be slamming on the breaks within your investment strategy. In fact, research suggests that the vast majority of your total balance comes in earnings when you're actually in retirement. So with that in mind, you won't want your portfolio to be cast adrift at that very moment when it's supposed to be performing at its peak.

In summary, the 10/30/60 rule states that while 10% and 30% of retirement funds come from contributions while a) working, and B) investment earnings during the working phase respectively, a whopping 60% come from investment earnings during the retirement phase.

A case in practice

Let's assume there's a 40-year working life (say aged 22 to 62) followed by a 30-year retirement (age 62 to 92). What the following example proves convincingly is the importance of the returns achieved during the pension phase of a fund. With the right blending of assets, an InvestSMART portfolio will ensure that your earnings in retirement are given every opportunity to make the biggest contribution they can to your total return over time.

Contributions while working	**$257,000**	17.36%
Superannuation Earnings while working	**$364,000**	24.59%
Earnings once in retirement	**$859,000**	58.04%

Source: Eureka Report

The assumptions are based on:

1. Super contributions of 9.5%, less 15% contributions tax
2. After-tax investment return of 4.25% in superannuation phase
3. After-tax investment return of 4.67% in pension phase.
4. Draw-down rate post-retirement of 4.5% pa.

Your biggest unseen expense

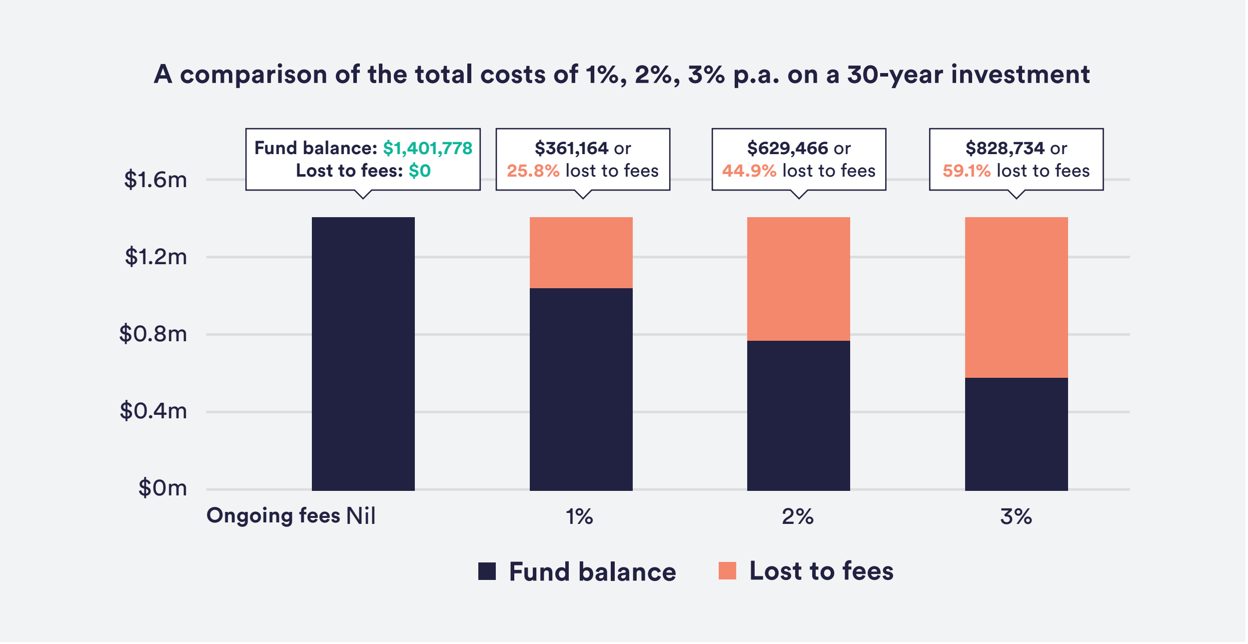
Unbeknown to most investors, investment fees are a significant part of their living expenses, and as such need to be kept in check, just like their discretionary spending. While it's easy to assume that total fees charged, based on small percentage of your funds under investment is incidental - typically between 0.5% and 2.0% - even at 1% it still probably the single biggest bill you'll pay all year.

Just because investment fees aren't in your face, like the mechanic's bill to fix your car, doesn't mean they should be overlooked. Over time, the impact of these fees becomes progressively bigger, and the more you're paying in fees, the less capital goes to work in the market for you, and consequently there's less income going into your pocket.

It's true, many investors are seemingly comfortable paying higher fees on the pre-text that it will be offset by their actively managed fund's ability to outperform. But the grim reality is that the extra cost incurred in fees is more often than not wasted money. That's because a whopping 81% of funds underperform their industry standard benchmark over 10 years.

Based on our research, the average fee charged for underperformance was 1.79%. To put that number in context, it's important to note that even at 1% in fees, an investor is sacrificing 26% of what their portfolio would have been worth (over 30 years), had they paid no fees at all. Double the fee to 2%, and amount lost to fees is almost a whopping half (45%).

Fees on $100,000 over 30 years

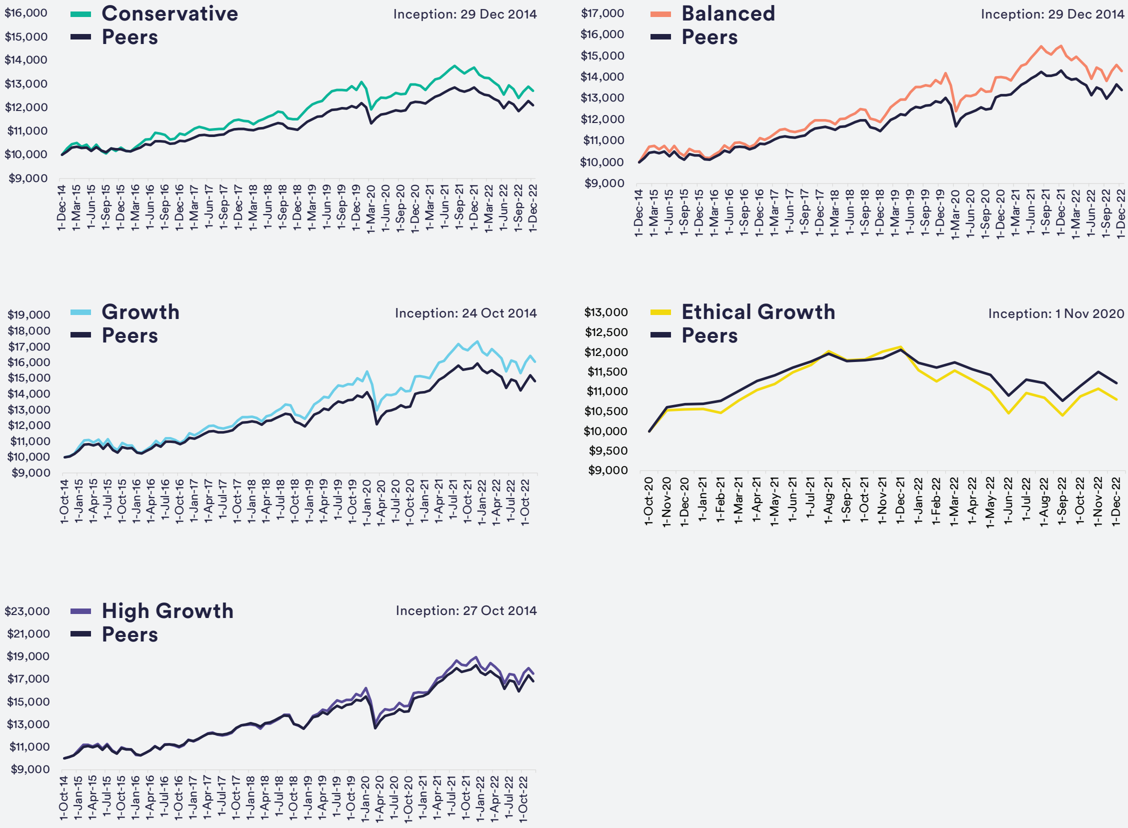


Assumptions: Initial investment amount $100,000; Investment earnings 9.2%

Source: ASIC's MoneySmart managed funds fee calculator

Growth of $10,000 since inception

As at 31 Decemeber 2022



Capped fees and outperformance: A potent mix

The refusal by investors to pay for underwhelming performance is the very foundation on which InvestSMART came to market as an online financial adviser in 1999. As the first Australian company to offer capped investment fees, InvestSMART maximises your savings.

Within InvestSMART's capped fee portfolios you will pay no more than $550 annually, regardless how much you have to invest. When you can grow your investments without growing your costs, the results – as InvestSMART's investors have witnessed - can be truly astounding.

For example, despite our lower fees, we're proud to reveal that over the past five years, the InvestSMART Conservative, Balanced and Growth portfolios beat 91%, 90%, and 87% of its peers respectively.

By choosing a low-cost fund manager like InvestSMART, who cap their management fees, you will most likely be ahead of most other similar fund managers over the long run. We're proud of this track-record, and it's one we'll work hard to continue repeating.

Portfolio strategy

Three buckets: One overarching goal

1 The Here and Now account

While it's not designed to provide investment returns, this account has sufficient liquidity to meet your near-term living expenses. It provides the peace of mind that comes from knowing that your cash management account has sufficient capital to meet your financial needs that aren't covered by other income, over a 2 to 3 year period.

2 The Re-fill account

Designed to top up the 'Here and Now' account through income generation as living expenses are drawn, this account provides income and stability for your retirement portfolio. It is designed to be stable, however due to its higher income orientation it will have a higher level of risk than the first bucket which caters for more immediate needs.

A good place to start looking at the type of assets to hold in the re-fill account, would be the InvestSMART Diversified Conservative Portfolio, which is heavily weighted towards Australian and international fixed income. However, those who are earlier in their retirement phase or with a slightly higher risk appetite, may look for a spread of assets held in the InvestSMART Diversified Balanced Portfolio.

While these portfolios invest in the same assets, it's the weightings that are different. These portfolios will give you a good idea of where to start with the re-fill account.

3 The Building Future Wealth account

As this is the growth account, the assets in bucket 3 – which will include more Australian and international equities - are not sold if the market declines. Instead, their job is to ride out any return volatility, increase your investment capital over the long-term, and keep ahead of inflation.

If you are at the start of your retirement journey, take an extra close look at the portfolio breakdown of the InvestSMART High Growth Portfolio, which has a recommended time horizon of 7 years. Alternatively, if you are already some years into your journey, or have less appetite for risk, the weightings of the InvestSMART Diversified Growth Portfolio may be more suitable for this building future wealth bucket.

Keep all three buckets spinning

Once the bucket strategy is up and running, it's important to note that only bucket 1 has automatic withdrawals.

The onus is on you to manually adjust the other two buckets as required, with funds from bucket 3 refilling bucket 2 and bucket 2 refilling bucket 1. It's this refilling that will help you avoid having to sell your portfolio when the market is down or to meet regular living expenses.

While replenishing, the shortfall in the cash bucket can be done systematically, or opportunistically during the market's good times, it's never a good idea to try and time the market.

How your retirement buckets are invested

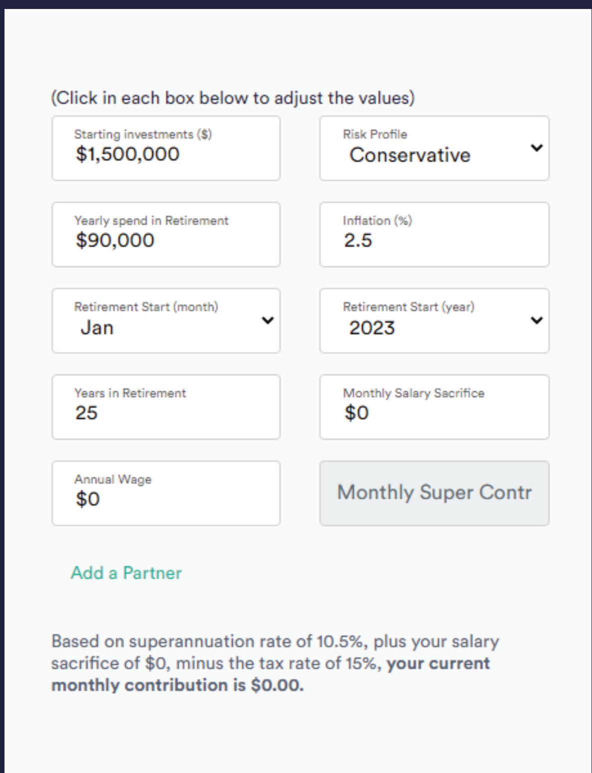
	Time period	Investment goal	Asset allocation
1 **Here and Now account**	Short-term	• Provide income for your living expenses over the next 2 - 3 years • Provide immediate cash for emergencies	Invested in cash or accessible short-term deposits
2 **Re-fill account**	Medium-term	• Provide income for years 3 - 6 of your retirement • Hold money to refill bucket 1 annually as it reduces	• Invested in a conservative investment option, or a high-quality portfolio of assets such as bonds • Small component may be allocated to high-quality, dividend-paying shares
3 **Buildng Future Wealth account**	Long-term	• Provide income for 7-plus years after retirement • Grow retirement savings to protect against inflation	Invested in diversified growth investment option, or growth assets like shares

Using InvestSMART's calculators

By using the InvestSMART retirement calculator you can easily work out how much you need to invest and the monthly contributions you need to make to reach your goal. Don't be put off if you're unsure of how much you've got you to invest. The calculator is designed to encourage you to play around with figures so you can quickly see what impact different amounts will have on your ability to save, and within what timeframes.

How to use the Retirement Savings Calculator

Using the calculator is easy, here are the key steps to calculating retirement savings:

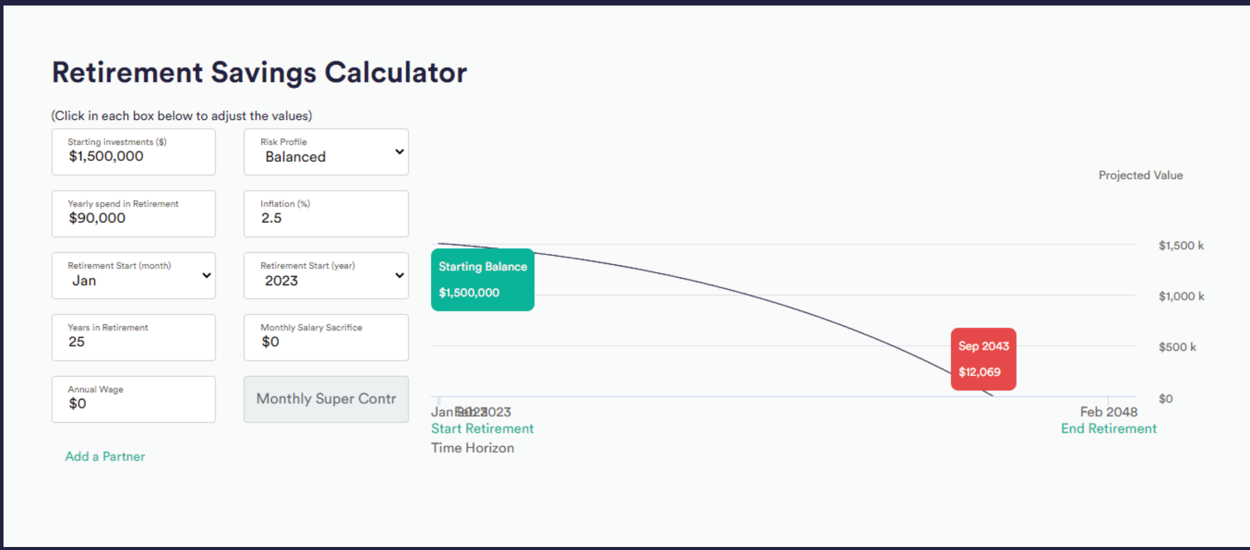


- Enter your SMSF or total personal balance
- Select your risk profile
- Enter your estimated yearly spend

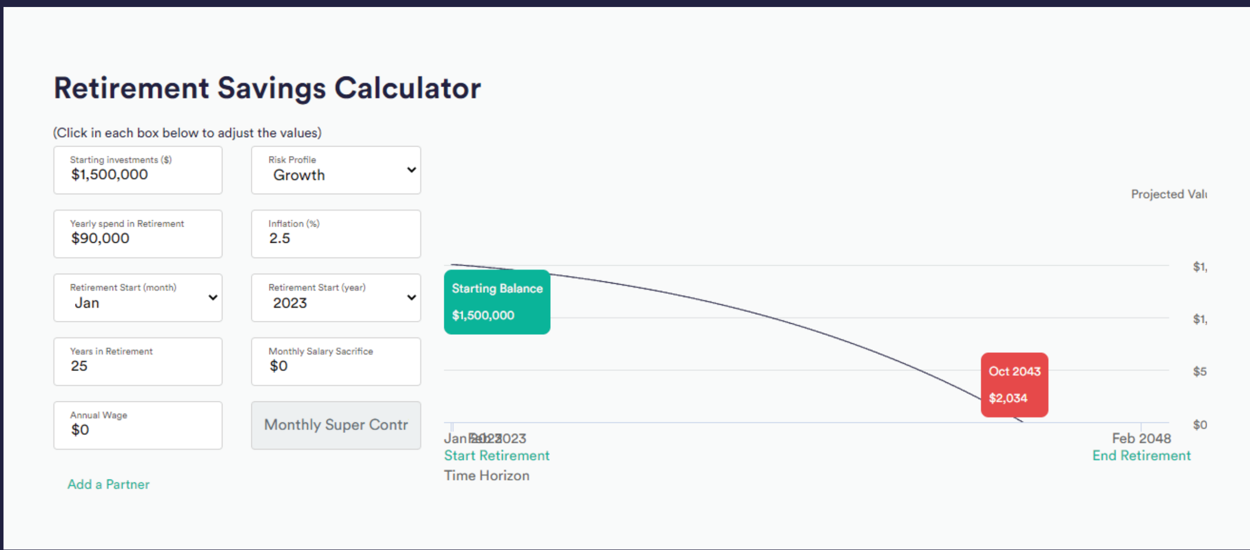
What if you're already retired?

- Set the start retirement month and year to right now
- Now estimate how many years you expect to have in retirement
- Set salary sacrifice and annual wage to $0 or as appropriate

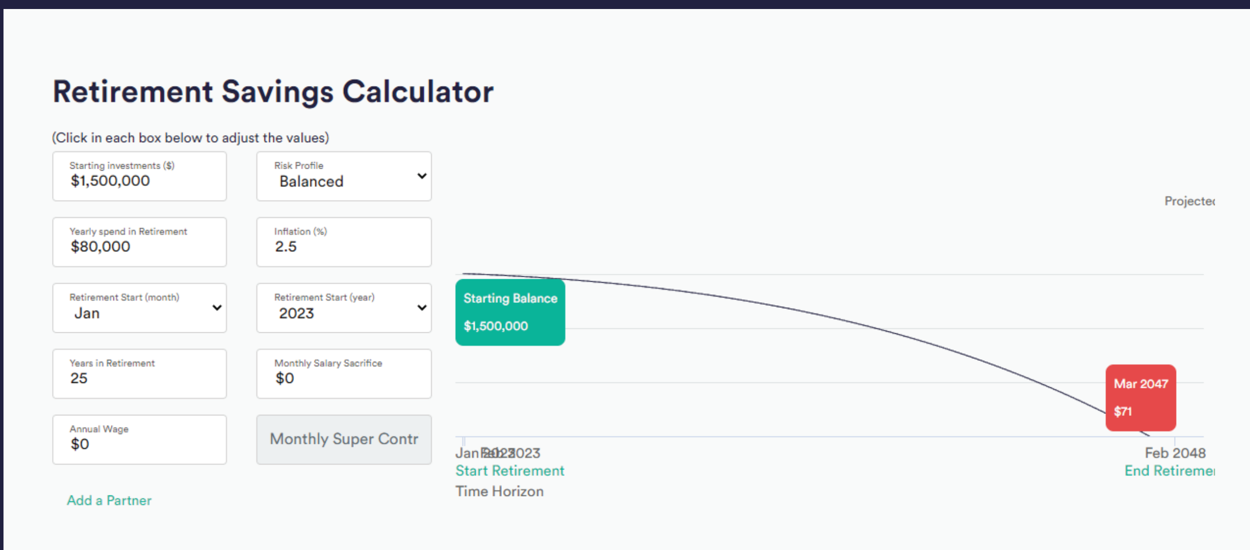
Coming up short on a portfolio with a balanced profile



Changing your profile to growth



The impact of reducing your yearly spending



As the following example illustrates, you don't have to reduce your spending by much annually for you to make up any shortfall. This may prove to be a better alternative to moving up a risk profile.

What if my retirement savings fall short of my life expectancy?

If having entered all your numbers correctly, you discover your projected retirement savings fall short, there's no need to panic. The trick is to look at what various inputs are most logical to adjust.

You can't change either what dollar value you have (if you're already retired) or how long you're going to live. However, what you can do change is your annual spending. You can also change your risk profile, and while this may expose you to higher returns, it will also expose you to greater declines in portfolio value during market corrections.

Start playing with the numbers

Now that you've got a feel for how the calculator works, go ahead and start playing with some numbers. Rather than being overwhelmed by the results, start juggling them a little. For example, if you can spend less annually, prolong the date you retire and start drawing down an annual income, or have the means to make some monthly contributions, you'll be amazed what a difference it can make.

Putting it all together

By investing in a more diverse range of asset classes (~aka multi-asset class mix) you'll not only keep the regulator (ASIC) happy if you're a SMSF, you'll also avoid putting all your eggs in too few baskets: The net effect of which will be more wealth protection (less risk), and greater returns.

At InvestSMART, we show you how a simple strategy executed well, will keep your fund SMSF compliant, while maximising your retirement income over time. Here are some key points to consider:

- Whether you have an SMSF or not, giving due consideration to risk and return, diversification, liquidity and liabilities (cash flow) will significantly de-risk your portfolio and improve investment outcomes.
- In addition to yield through dividends and franking credits, your quest for income should also include capital growth.
- By taking a total returns strategy, InvestSMART portfolios help you maintain diversification, while reducing the risk of capital loss.
- Keep in mind that the vast majority of your total balance comes in earnings when you're actually in retirement.
- By capping our management fees, InvestSMART investors will most likely be ahead of most similar fund managers over the long run.
- By applying the 'three bucket' strategy, InvestSMART portfolios satisfy your need for income stability, while adding to your wealth in retirement through capital growth.
- Get started now by using InvestSMART's retirement calculator, and you'll quickly see if your planned retirement savings will give you enough to live on.

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