COMMENT

These are the new retirement savings rules

Forget what you think you know: the pandemic has rendered the old rules of thumb irrelevant

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Many of the things we took for granted have been thrown into doubt by the Covid pandemic. How we work, travel and amuse ourselves are among the biggest changes.

Less well understood is the way in which some of the rules of thumb we use to guide our investments may have become obsolete too. Here are three.

A mainstay of prudent investing for decades has been the 60/40 portfolio that holds 60pc in shares and 40pc in bonds.

Since 1980 there have only been a handful of years when this combination of assets has delivered a negative return, so for the boomer generation it has provided a smooth and relatively stress-free way of saving towards retirement.

In the US, where the data is better, the approach has delivered a 10pc annual

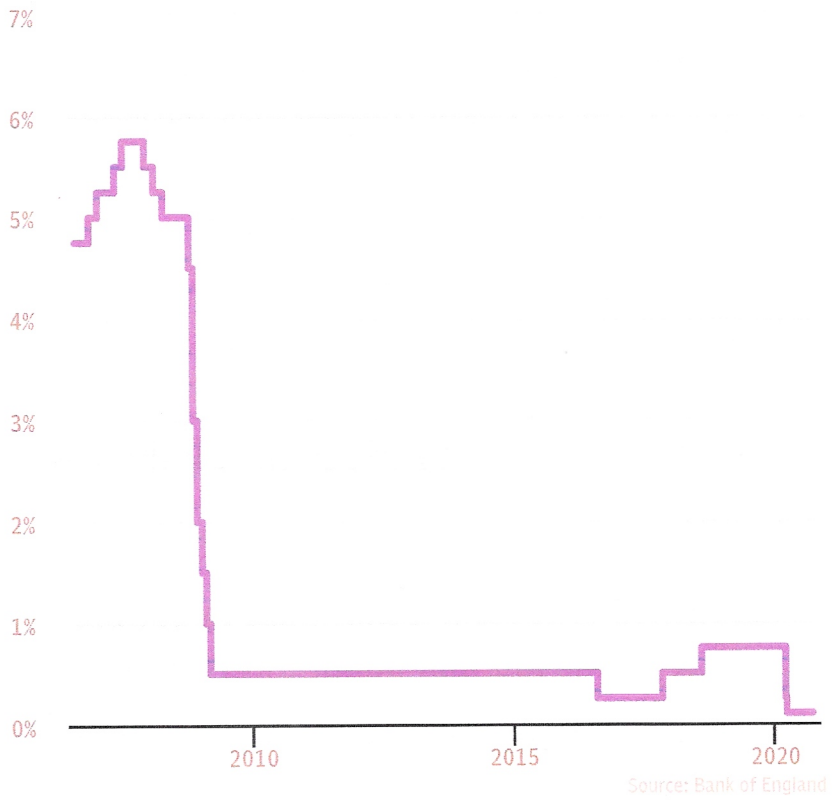
return over the past four decades, which compounds up nicely over time. The shares, the performance of which reflect the growth in the economy, have provided most of the oomph.

They have been ably supported by fixed-income investments, which are less choppy and tend to do well at times of market stress. Over most of this period, the price of bonds has also benefited from a secular decline in interest rates from historically very high to historically very low levels.

The US Federal Reserve first lowered interest rates to almost zero in March 2020 in response to the coronavirus crisis. In the UK, the Bank of England has held them at a record low of 0.1pc.

As expected, the Monetary Policy Committee left interest rates untouched

Bank of England Bank Rate



Looking ahead, both assets face challenges. Shares are pricier than the long term average (22 times earnings in the US, versus 15 on average since 2000). Bond valuations are even more extreme, with yields at a level that looks vulnerable to even a modest return of inflation and consequently higher interest rates.

Relying on just these two asset classes looks risky now.

At the very least, it makes sense for the bond portion to include some high-quality corporate debt, which offers a better yield than the paltry returns from government bonds. Most likely it will require a multi-asset approach that throws property, commodities, infrastructure and private equity into the mix.

The lower-than-expected returns from both shares and bonds casts doubt on the second formerly reliable rule of thumb. This says that retirees can safely draw down 4pc of their accumulated savings as income every year without fear of running out of money in later life. Again, this is a rule that has worked well for many years.

It has done so for the simple reason that the total returns, income and capital gains combined, from shares and bonds have been well ahead of the 4pc income requirement. The occasional bad years in which you have needed to dip into capital to hit that level of drawdown have quickly been offset by more productive years in which the pot has been refilled and then some.

At recent average total returns, withdrawing cash at 4pc leaves more than enough growth to compensate for today's low inflation rate. In real terms, even after you've taken out what you need to live on, the value of your savings has been higher at the end of the year than at the start. Lucky you, and lucky beneficiaries of your will when that time duly arrives.

The problem looking into the future is that bond yields cannot go much lower.

Bond villains

The yield on UK 2-year bonds has reached a new low

Therefore it would be foolish to count on a total return much in excess of the low single digit income from the fixed income element of your savings. That means you may need to raise the proportion held in shares to deliver the required return. However, as a result you will have more years when you are eating into capital thanks to temporary falls in the market.

Before going down this riskier path, it is worth remembering the other reason you have bonds in your portfolio. As well as providing a reliable, if unexciting, income, bonds ensure that after a downturn in the market you have the assets available to benefit from the subsequent recovery. If you are too heavily invested in shares, you won't have the dry powder to take advantage.

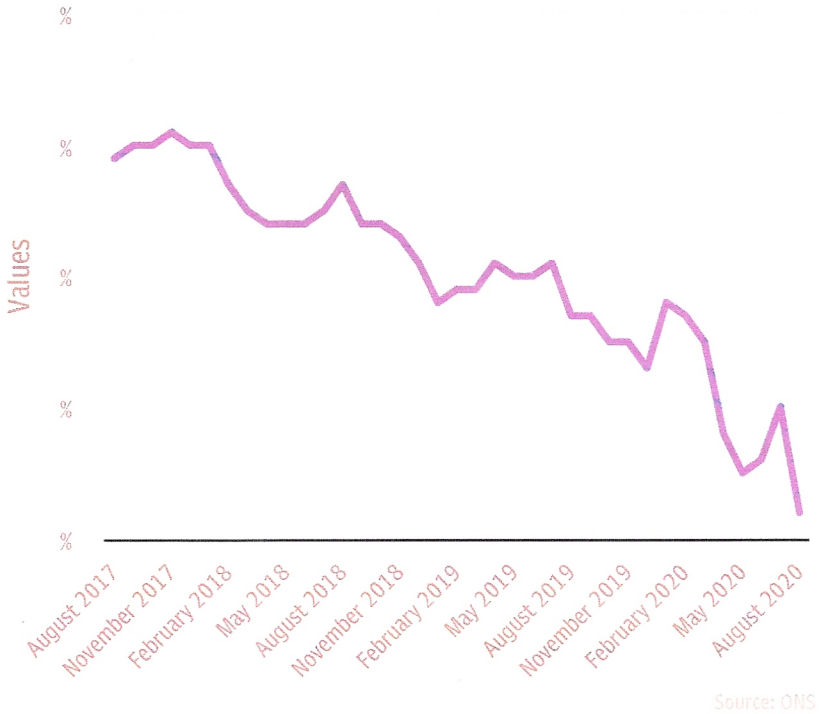
The third rule of thumb is related to this need for stability in a portfolio. It says that the proportion of bonds you hold should mirror your age. So, someone at the traditional retirement age should have two-thirds of their portfolio in fixed income investments. Again, this is intuitively right but no longer really reflects the world we live in, for a couple of reasons.

First, it fails to take account of the fact that we are all living for longer than our grandparents did. If you only need your retirement savings to last for 10 years you can settle for a relatively low rate of return each year. If you are in the lucky position of enjoying 30 years of leisure, then you might need much more than today's bond market can offer you.

The second, related, reason is that inflation, which has been notably absent for a generation now, may not remain in abeyance for much longer.

Inflation has fallen to a very low base

Consumer prices index



The scale of government support for economies the world over has been necessary, but it significantly raises the risks of a price spiral in the years ahead. The rule of 72 tells us that a 3pc inflation rate will halve the purchasing power of your money in just 24 years.

The unavoidable logic of rising inflation and longer retirement is that we must find a way to achieve a higher rate of return than is likely with a bond weighting that reflects our advancing years. Like it or not we must accept more short-term volatility in the value of our savings to achieve the returns we need to live

comfortably for longer.

The new rules of thumb to replace these three are simple, if not very agreeable. If we want to avoid retiring later and spending less than we hoped, we probably need to save more, broaden the scope of our investments and accept a bit more risk than we expected.

Tom Stevenson is an investment director at Fidelity International. The views are his own. He tweets at @tomstevenson63

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