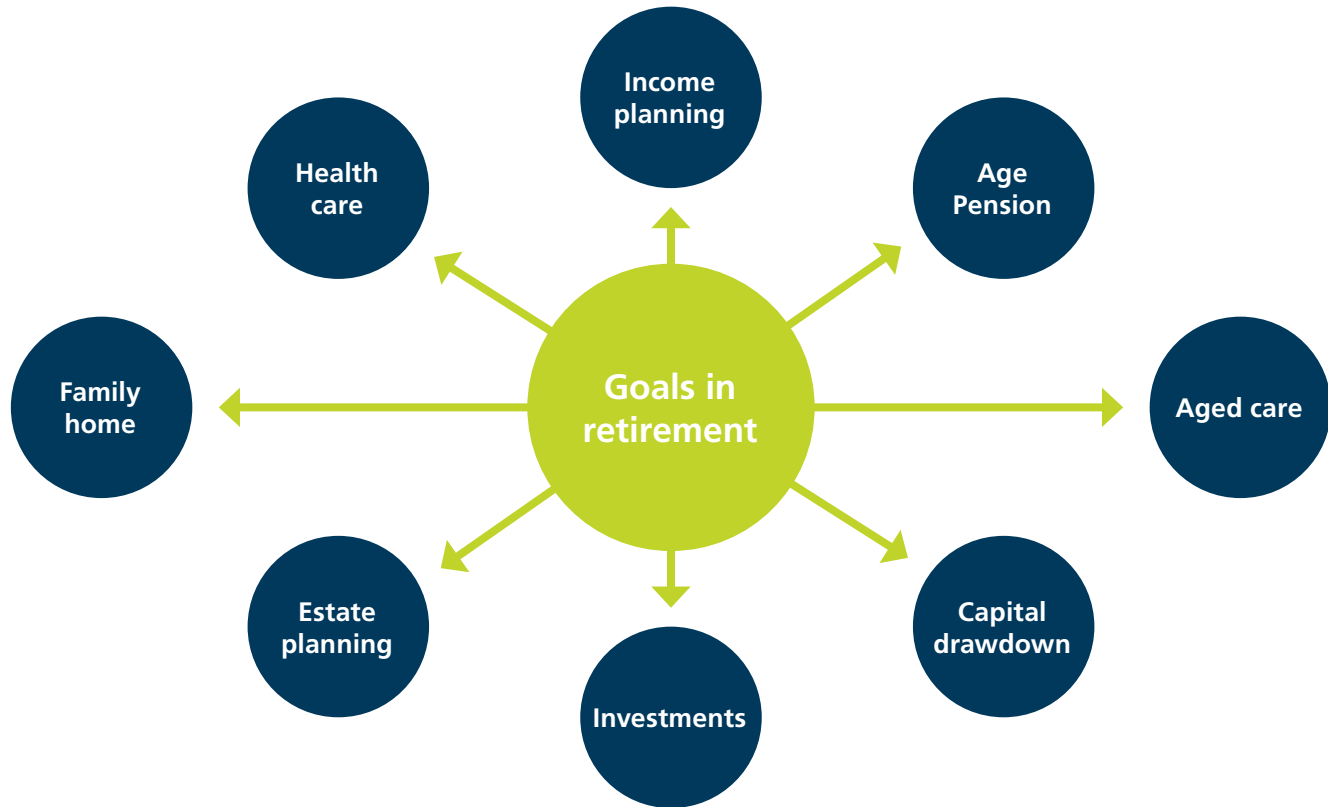


# Key challenges in retirement



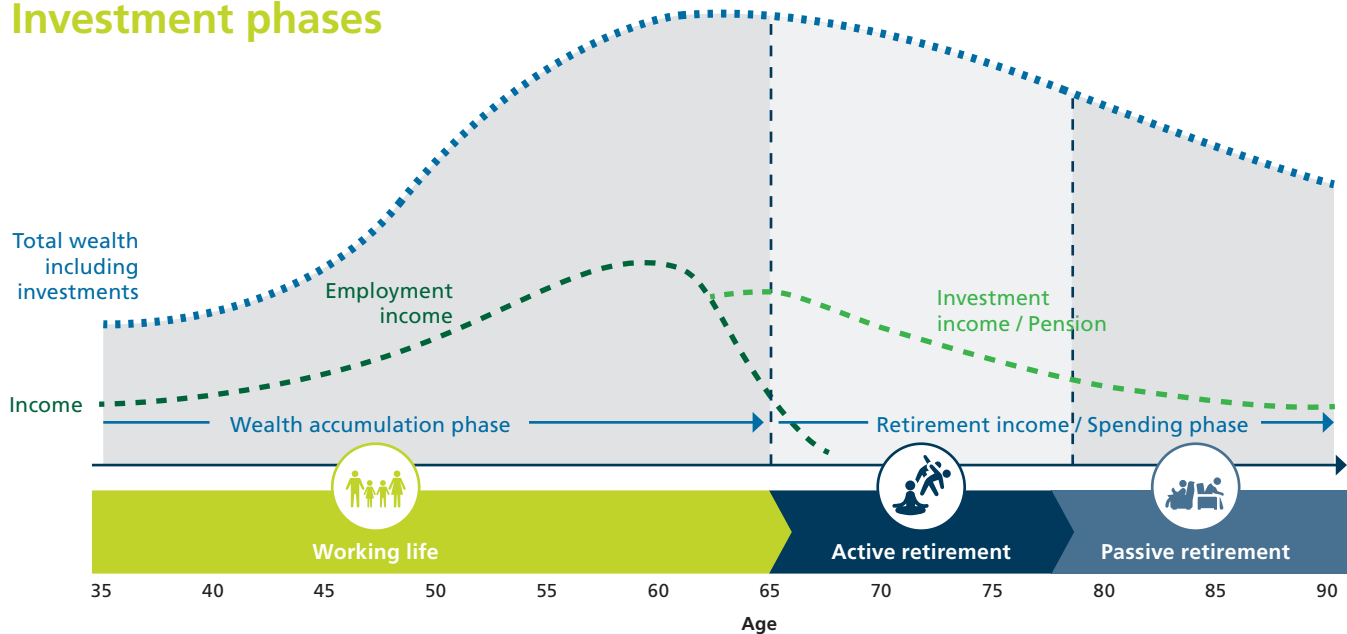
# Retirement is different

## Managing different goals



# Retirement is different

## Investment phases



### Your goals

- Grow your career and income
- Support your children through school
- Pay off your house
- Save for retirement

### Your focus during retirement

- Cash flow to support your everyday needs, i.e. utility bills
- Protect your income so you can spend confidently in retirement
- Make your income last for an unknown timeframe
- Consider potential need for aged care

As a **transition into retirement** is made, there needs to be a much bigger focus on **income stability and wealth protection** rather than wealth accumulation.



# Retirement is different

## Managing different risks

### Longevity risk

The risk of living longer than expected, resulting in retirement funds being insufficient to finance your lifestyle for life

### Market/ sequencing risk

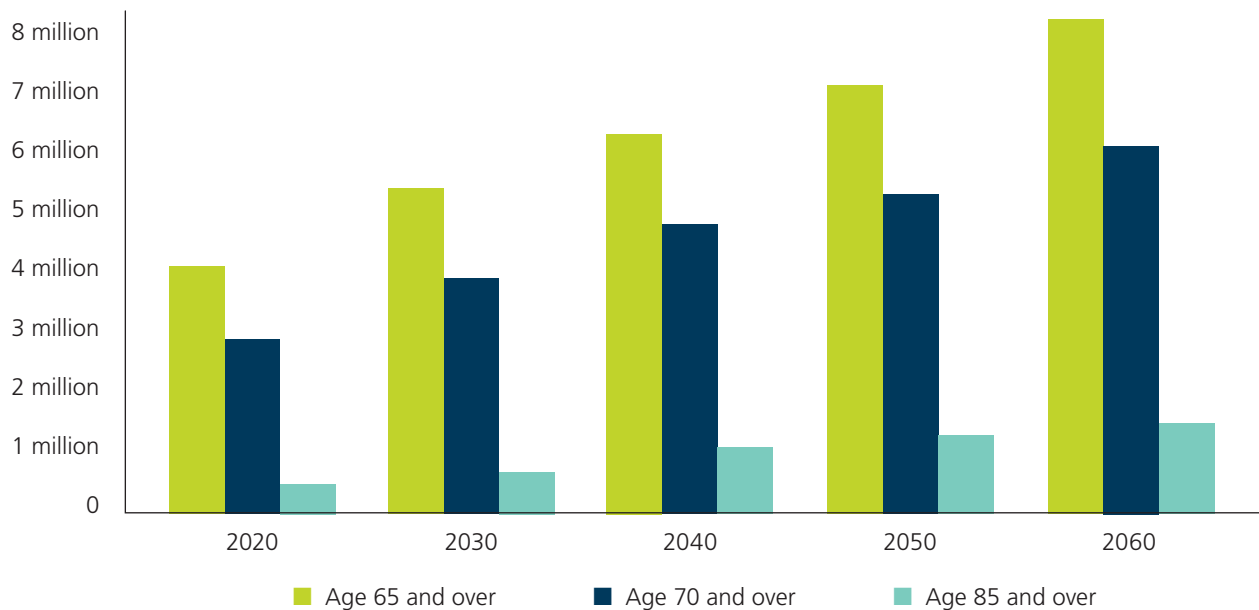
The impact of varying investment returns (especially negative returns) on the value of your investments during retirement

### Inflation risk

The risk that over time inflation will increase the cost of living. This means the income received from investments must also increase in line with inflation to maintain your standard of living

# Making your money last

## Australians are living longer



The number of Australians 85+  
is **expected to grow** 35% by 2029.

In fact, an Australian who is 65 today, has a  
good chance of living **well into their 90s**.

Department of Health 2018/19 Report –  
The operation of the Aged Care Act 1997



# Making your money last

## Average life expectancies

Average life expectancy	From birth	From age 66	From age 66 with mortality improvements
Males	81	85	88
Females	85	88	90





The average 65-year old **underestimates  
their life expectancy** by almost  
five years

– National Seniors research 2015



# Making your money last

## Australians underestimate their life expectancies

Age group	Average estimation of own life expectancy	Intergenerational Report	Underestimation
50 to 54	81.4	88.5	-7.1
55 to 59	82.8	88.2	-5.4
60 to 64	83.5	88	-4.5
65 to 69	84	88	-4
70 to 74	85.4	88.3	-2.9
75 to 79	86.9	88.9	-2

# Making your money last

## Probability a diversified investment amount will last the term

Investment term	Initial withdrawal rate							
	3%	4%	5%	6%	7%	8%	9%	10%
20 years	100%	98%	88%	67%	55%	41%	28%	16%
25 years	100%	93%	69%	51%	38%	29%	18%	6%
30 years	100%	81%	60%	38%	28%	18%	7%	5%
35 years	96%	68%	53%	33%	20%	9%	4%	1%
40 years	93%	59%	41%	25%	16%	5%	4%	1%

Source: Pfau and Cooper (2020), 'The Yin and Yang of retirement income philosophies', using Dimson, Marsh and Staunton Global Returns Dataset (1900-2013).

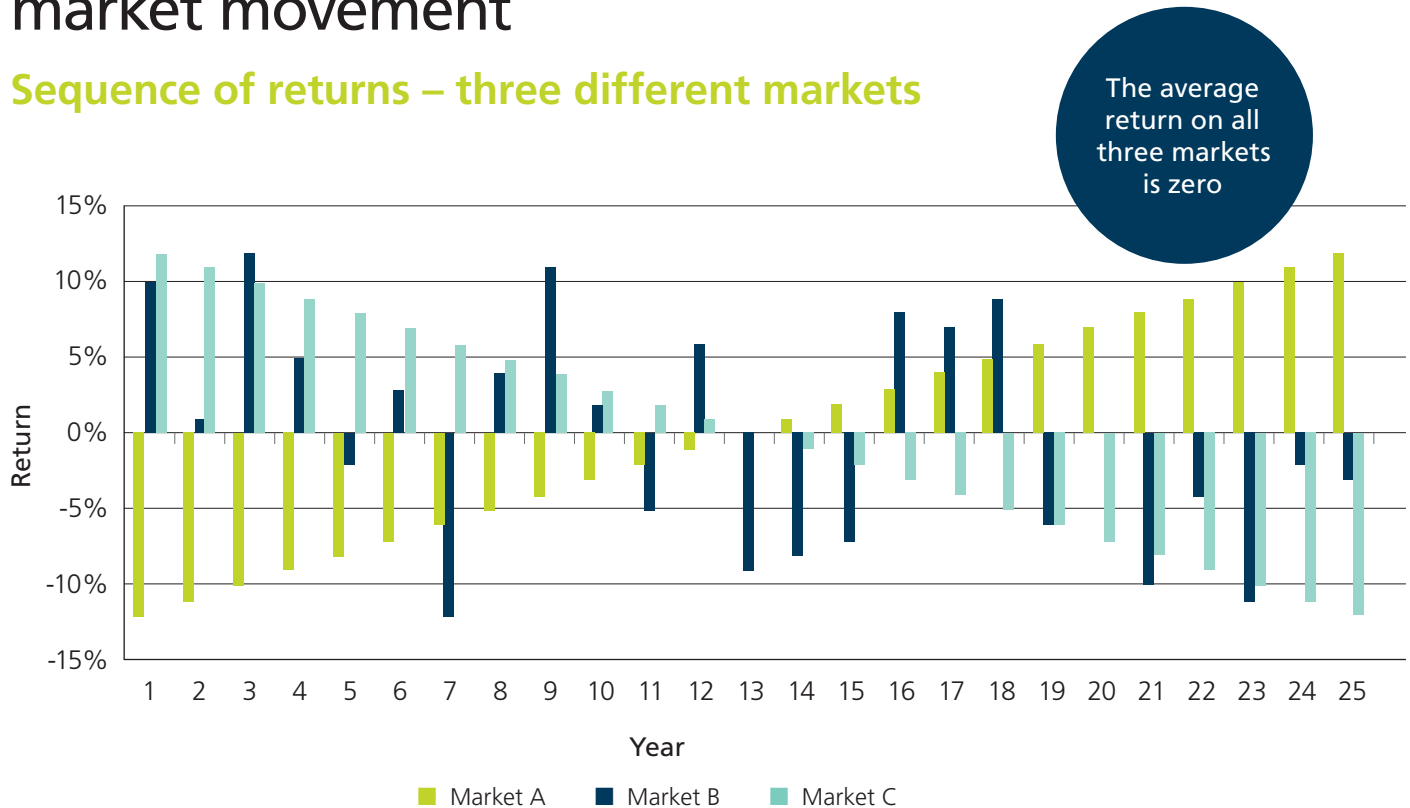
Assumptions: investment mix of 50% Australian stocks, 40% Australian bonds, 10% Australian bills.

When investment returns can be negative, the timing and order (sequence) of these returns can be **critical to the overall impact** on your savings.



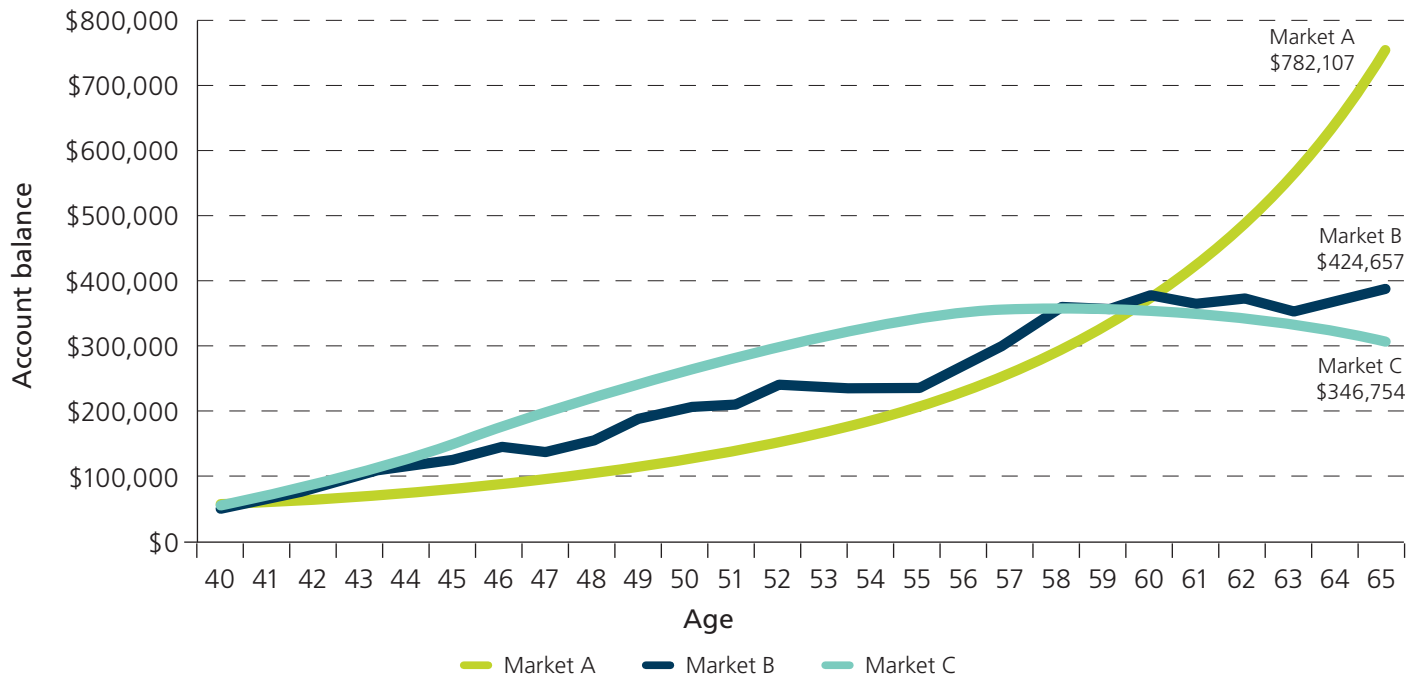
# Protecting your income from share market movement

## Sequence of returns – three different markets



# Protecting your income from share market movement

Cash flow in – Regular savings in accumulation

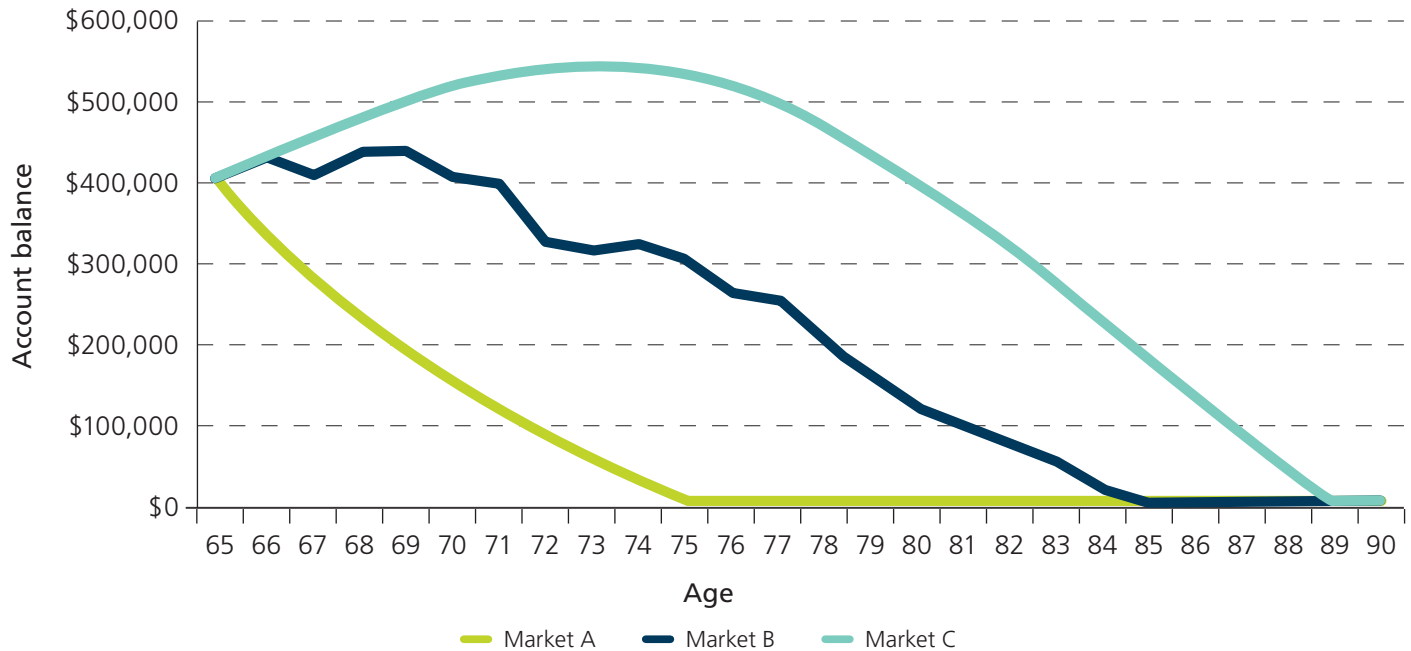


1. Source: Challenger.

2. Assumptions: Initial balance of \$50,000. Contribution of \$10,000 in first year, increasing by 4% every year.

# Protecting your income from share market movement

## Cash flow out – Regular drawdown in pension phase



1. Source: Challenger.

2. Assumptions: Initial balance of \$400,000. Withdrawal of \$20,000 in first year, increasing by 2.5% every year.

“ ...luck plays a huge factor in how long the funds are going to last. And what we have to do when we get to retirement is to minimise the impact of luck. We have to **invest in things that don't expose us** to this sort of risk. We have to reduce the impact of the sequence of returns. ”

**Moshe A. Milevsky, Ph.D. Associate Professor of  
Finance York University, Toronto.**

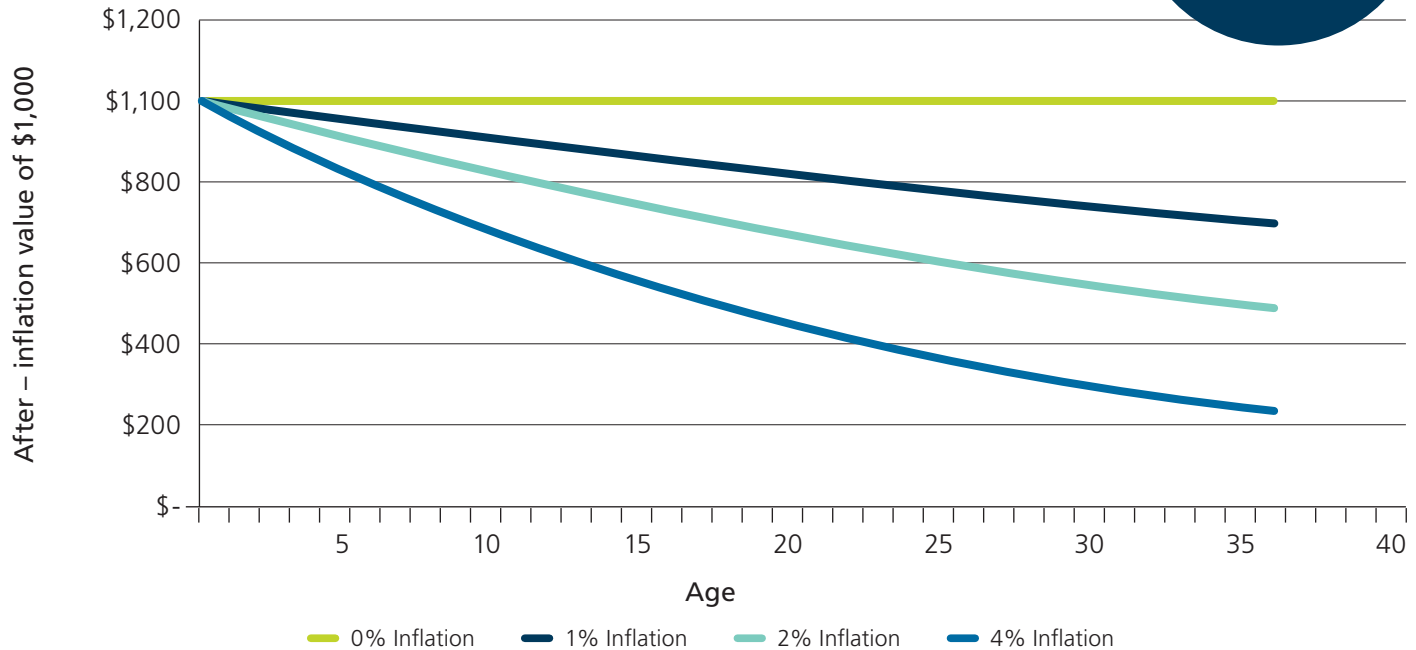




# Protecting against inflation

Inflation takes on a new dimension in retirement because retirees' savings are disconnected from wage rises

## Cash flow in – Regular drawdown in pension phase



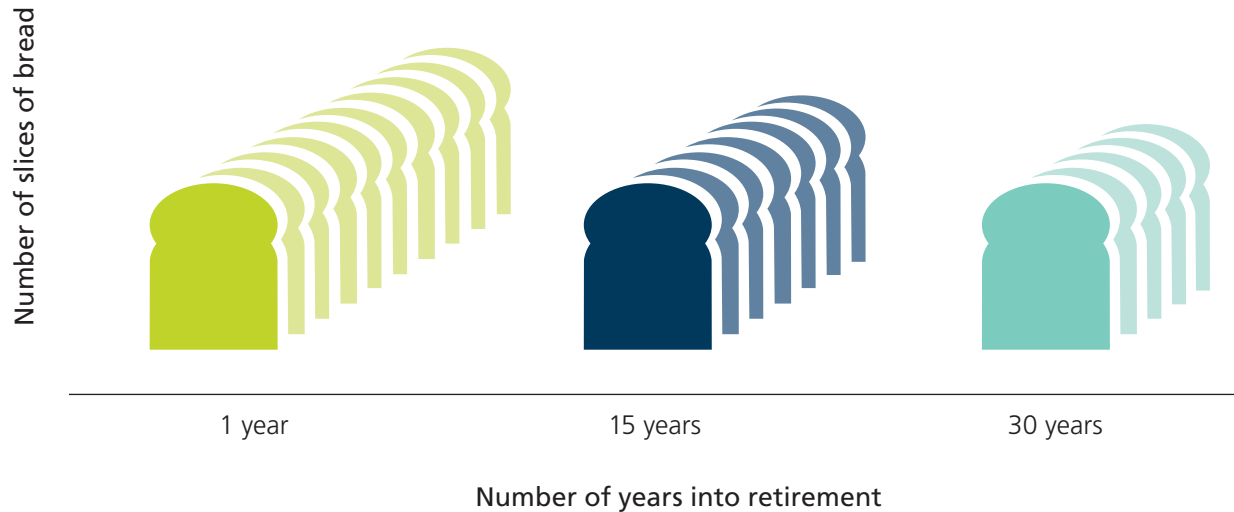
The average inflation rate over the last 25 years has been 2.4% per year.  
That means a dollar today is worth around **half of what it was** 25 years ago.

– ABS, March 2020



# Protecting against inflation risk

How many slices of bread will you get in the future?

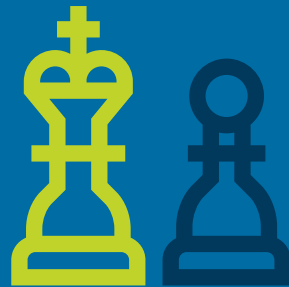


The diagram is illustrative only.

Source: Challenger.

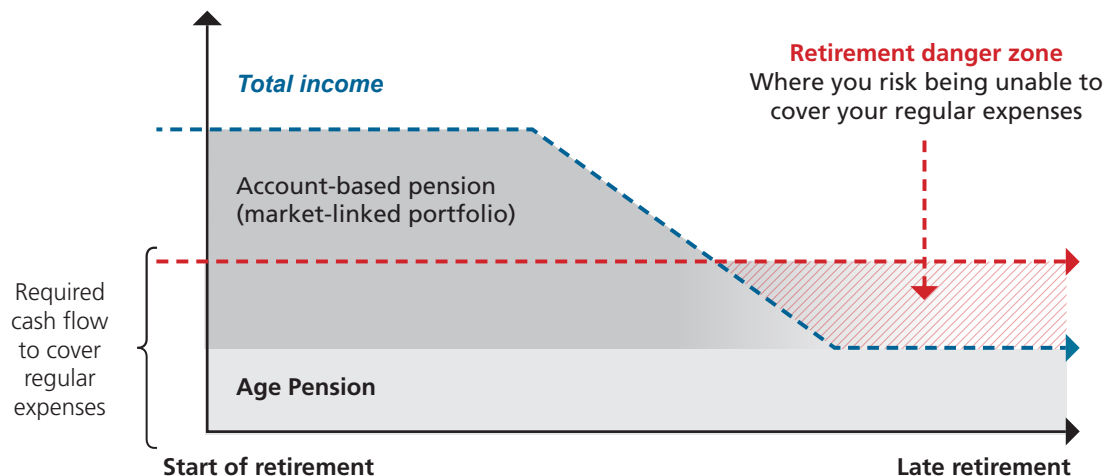
Assumptions: Average inflation of 2.5% p.a.

In the later stages of retirement, these **retirement risks** mean that if you only invest in an account-based pension there is a real chance you will no longer be able to meet your regular expenses – this period is called **the retirement danger zone.**



# Consider a different approach in retirement

An income layering strategy can help keep you out of the retirement danger zone

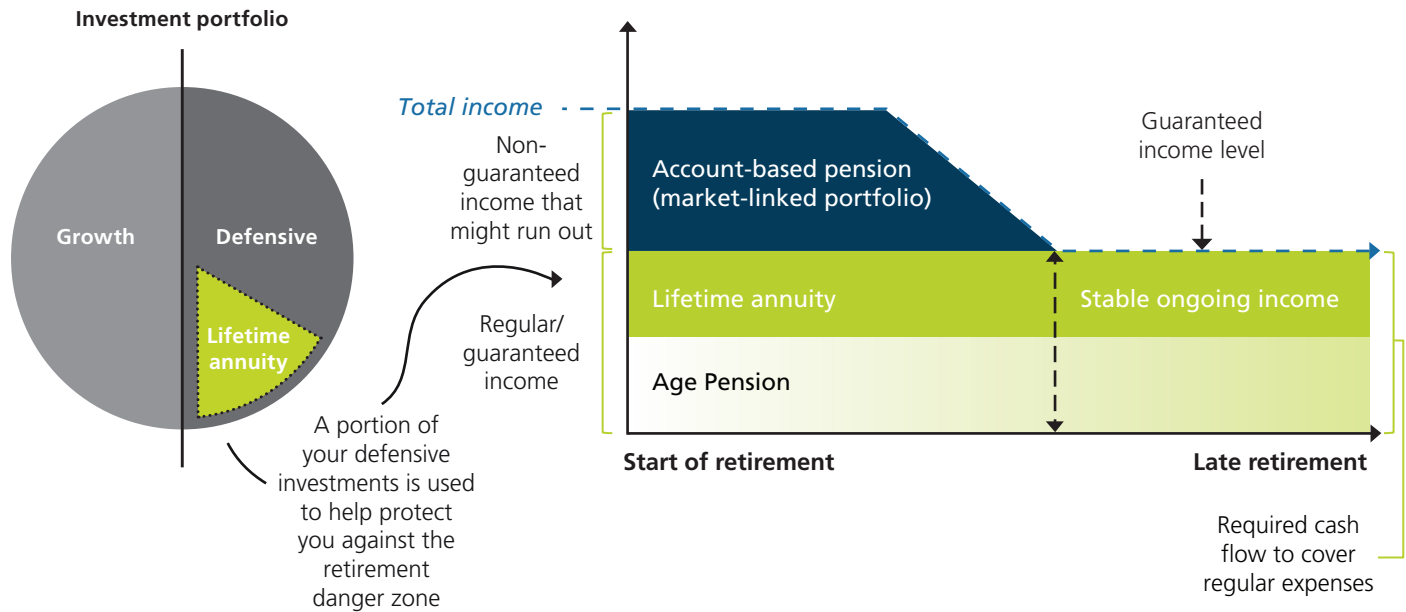


It is vital you can cover your **regular living expenses** and maintain your standard of living in retirement. This means ensuring you have enough income to get by day-to-day for however long you live. The Age Pension alone may **not be enough** to cover even a modest cost of living, so combining these payments with regular income from a lifetime annuity can top up your income to help cover your essential expenses.



# A comprehensive retirement income plan

## Income layering strategy



# Retirement can be emotional

## **Lump sum bias**

The tendency to overvalue a capital sum as opposed to its actuarially fair income value.

## **Hyperbolic discounting**

The tendency to undervalue future income in favour of immediate income.

## **Loss aversion**

Retirees' aversion to loss is greatly increased compared to the accumulation phase as they are no longer working.





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