Perpetual

Volatility bites – how retirees can manage jumpy markets

By Perpetual Private Insights

28 March 2022

The big issue for investors in or close to retirement, is risk. The 2020 COVID-19 share sell off and recent equity market volatility shows just how quickly share prices can move. Volatility can have different meanings for different investors, those with a long-term horizon can be less concerned, knowing they have time on their side. But what about retirees? How can they

manage the mental challenge of watching their hard-earned capital shrink before their eyes? And do it without becoming so conservative they have to downgrade their lifestyle?

It's a pertinent question right now because higher inflation, rising interest rates and the Russian invasion of Ukraine are making markets nervous.

Perpetual Private's Associate Partner, Daniel Elias says volatility is more *tangible* for retirees. "The numbers on your portfolio spreadsheet aren't theoretical – they pay your bills. Because that capital is so important, the challenge for retirees is reining in the fear and anxiety that can lead them to irrational decisions."

In the years around retirement, the risk that a market downturn occurs right before you retire, or soon after, is called sequencing risk. To manage sequencing risk, having a diversified portfolio of assets can help dampen the effect on your portfolio when markets fall.

That's when things go V-shaped

When COVID-19 lockdowns first hit in March 2020, markets fell, quickly and sharply. As people stayed at home and started upgrading their Netflix accounts, economists and analysts were arguing about the shape of a potential recovery. Would markets fall even further, then bump along the bottom before gradually rising again (U-shaped)? Or stay down for years (the dreaded L-shape)?

Ultimately, we surfed a dramatic V-shaped recovery. Writing in January 2022, Mano Mohankumar from superannuation researcher Chant West said, "Since the market low-point at March 2020, growth funds have surged an astonishing 31%, which now sees them sitting 16% higher than the pre-COVID-19 crisis peak…."

"Investors who looked through the dramatic market falls associated with COVID-19 were rewarded for sticking to their strategy," says Daniel Elias. "But many who reacted emotionally paid a price."

In May 2021, the McKell Institute estimate that those who redeemed via the Early Release of Super scheme at the nadir of the COVID-19 crisis gave up nearly five billion dollars in lost returns during the markets' rebound.[1]

Remaining rational in times of crisis is a difficult challenge for all investors, but ensuring you listen to the financial advice and don't react with emotions is the key to not making the wrong decision during times of market stress.

Ask yourself – how much risk is right for you?

The key to investment selection and portfolio management is optimising 'risk efficiency' by choosing the right mix of assets to give you the maximum return for the level of risk you're able to absorb.

Before making any changes to your investment strategy, ask yourself, “Am I still comfortable with the level of risk I originally implemented in my portfolio.” Understanding your risk tolerance will help you find the right mix of assets that will have enough risk to grow your portfolio, but not so much that you can’t sleep at night or you are led to sell at the wrong time.

As you approach retirement, you have fewer years of earnings to save and invest and may need to draw down on your savings. This shorter time horizon limits the ability to overcome a market downturn. As a result, the amount of investment risk in your portfolio matters.

Diversification – your best defence

The other great weapon retirees can wield against market volatility is diversification. Whilst the volatility in January and February 2022 was felt in the majority of retiree portfolios, losses would have been lower than the broader equity market because many retiree portfolios are diversified across other asset classes including bonds, credit assets, property and increasingly, alternative assets.

Amanda MacDonald, Investment Director at Perpetual Private says “Diversification helps to smooth returns across different economic conditions. This is because of the low or negative correlation between certain asset classes, so if one asset class falls in value in response to an economic or geopolitical event, another might rise”. Bonds can also play an excellent role in protection against equity market risk in times of market volatility and help to minimise sequencing risk.

There are Alternatives...

In times of ultra-low interest rates and share market volatility, alternative assets can add another source of income and an additional layer of diversification to an investor’s portfolio. Alternatives include things like private equity, venture capital, opportunistic property and private debt. They can add returns to clients’ portfolios but must be considered in context of each retiree’s overall investment goals, portfolio size, time horizon and their appetite and tolerance for risk.

Investors must clearly understand the risks associated with investing in alternative assets as they can have long lock up periods, and are less liquid than more traditional assets, meaning they can’t be sold as quickly and converted into cash.

Building a resilient portfolio

The final volatility management tip from Daniel and Amanda is all about managing expectations. Volatility will persist while the world adjusts to a changing economic and geopolitical order. That could mean a wider range of returns – but not necessarily a poorer real-life outcome if you stick to a robust, diversified strategy that’s attuned to your needs.

Remaining diversified across asset classes can help ensure you have the optimal blend of assets in your portfolio to weather a variety of market conditions. When it comes to ensuring you

don’t let your emotions influence your investment decisions, a financial adviser can really help.

For more on how Perpetual Private's Investment Team are responding to recent market volatility click here.

---

[1] https://mckellinstitute.org.au/research/articles/buy-high-sell-low-the-early-super-access-scheme-and-foregone-returns-on-investment/

Perpetual Private advice and services are provided by Perpetual Trustee Company Limited (PTCo) ABN 42 000 001 007, AFSL 236643. This information has been prepared by PTCo. It contains general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial or other adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. To view the Perpetual Private's Financial Services Guide, please visit here.