Age gracefully and plan for very long retirement

TONY NEGLINE

Anyone in their forties and fifties should be financially planning to live well into their nineties ... anyone younger than 40 should be assuming they will live beyond 100.

Does this sound fanciful?

Every new government report shows that Australians are living longer. As an investor it will be well worth understanding the key developments in this area of so-called longevity risk.

To put this into some perspective consider the following.

- The 1881/90 Australian Life Tables said that on average more than 115 out of 100 000 baby girls would die before reaching their first birthday.
- The 2010/12 life tables show that the average is now just three deaths for every 100 000 little girls in this age group.

This is a remarkable and wonderful 97 per cent reduction in infant mortality.

Through most ages the rate at which women are dying has continually declined.

For example, in 1881/90, over 124 females in every 100 000 aged 80 died.

Today the figure is just over 33 deaths for 100 000 women of the same age.

On average over this 130 year period, female mortality has fallen by an average of more than 80 per cent across all ages.

Males have also experienced falls in the mortality rate across all ages, but it has not been as impressive as what women have experienced.

For both sexes there have been some occasions when the rate that the population is expected to die actually increased from one set of life tables to the next.

Surprisingly, these increases don't appear to have occurred when a large number of people died during conflicts — such as the world wars.

Couples live longer

But the story doesn't end here. Couples actually live longer than single people.

The latest life tables (2010/12) say that on average a single male currently aged 65 can expect to live another 21.79 years or roughly to age 87.

A female of the same age is expected to live on average to age 89 — that is a 50 per cent chance of living to that age.

Accurium, an actuarial firm, has developed a calculator, using Australian life table data, for "joint lives" which estimates one or both of a couple surviving to a particular age.

If we look at a male and female couple both aged 65 then Accurium thinks that the chance of both of them living to age 89 — the female average life expectancy — is 27 per cent but the chances of one off them surviving is 77 per cent, if we assume the improvements in life expectancies over the last 25 years continue into the future.

If we ignore the recent improvements in life expectancies, then the chances of one of our couple surviving to age 89 declines to 68 per cent, which is still a high probability.

Let's look at another case — a male and female couple currently aged 30. At present there is about an 87 per cent chance that one of them will be alive at age 90, assuming the recent increases in life expectancies continue for the next 60 years and a 40 per cent chance that both will be alive at that age.

Retirement goes on

What is clear from this life expectancy data is that we all have good prospects of a long life. It seems plain common sense to me to plan for the longest likely outcome. For those aged in their sixties, assuming survival to age 90 seems sensible. In other words, as I said at the start, if you are in your forties or fifties you should be financially planning to live well into your nineties. If you are younger than 40 you should assume that you will live beyond 100.

In reality anyone younger than 70 will be investing for more than 20 years, which makes them a long-term investor. For many people this reality should change how they invest their retirement nest egg.

If the age pension age remains at age 67 then those in their early fifties or younger could find themselves retired for more than 30 years, which is a long time for future working taxpayers to be funding these payments.

Tony Negline is author of The Essential SMSF Guide 2016/16 published by Thomson Reuters

Keeping an eye on volatility

iTraxx is the best gauge of the market's direction

ELIZABETH MORAN

Each day, investors keep an eye on the ASX200 and the S&P500 as well as other financial market indicators such as the gold and oil price and cross currency prices. Though it is hardly as well known, there is a similar indicator for bonds: it's known as the Australian iTraxx.

Those of us working in the fixed income market, including large institutional investors, constantly watch the iTraxx group of indices, which concentrate largely on corporate bonds.

The Australian iTraxx is to bond investors what the ASX All Ordinaries Index is to equity investors: It shows movements and trends and enables bond investors to benchmark changes in their own bonds versus the broader market. It can also be used, together with other indices and information sources such as equity indices, the Volatility Index, interest rates and yield curves to gauge market sentiment and likely future direction.

How does the iTraxx help us?

First, it tells us that it is hard to get a decent return in the top 25 most liquid bonds, which make up the investment-grade index. The benchmark three-month bank bill swap rate is about 190 basis points and if we add the spread of 110 bps, returns on offer average 300 bps, or 3 per cent, a year. The rate is similar to good term deposit rates but doesn't have the upside potential nor liquidity available in these bonds.

Second, the differential in peak to trough on iTraxx is significant and dictates the momentum in the market to lower returns. It's always good to invest over time and keep some funds on hand to invest in opportunities as they arise but the increasing possibility of an interest rate cut next month or in September should now focus investors' attention on the composition of their portfolios, and allocation to fixed-rate assets that lock in returns.

In essence, the Aussie iTraxx is a "proxy" for credit spreads in the Australian market that is the return investors demand over the benchmark rate to invest in an investment-grade corporate bond. Put simply, when the market is nervous, it demands a higher credit spread to invest and when it is relaxed, it's willing to earn lower spreads and overall returns.

AFP

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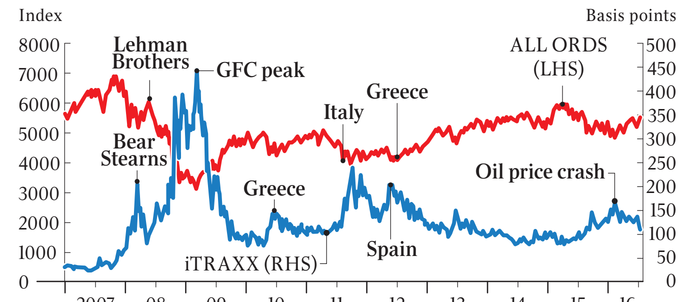
Importantly, the iTraxx does not incorporate outright yields, that is, the movement in base interest rates such as the government bond risk-free rate, the Reserve Bank of Australia cash rate or the bank bill swap rate. The Aussie iTraxx looks only at the credit spread component that is overlaid or added to the base interest rates or yield curve.

Aussie iTraxx is the best gauge of the direction of the market and if you are a bond investor or interested in the market, the indices are constructed on a set of regulations, the key criterion being that of liquidity of the underlying credit default swaps.

It is difficult for non-institutional investors to access the iTraxx but bond dealers and brokers should be able to provide you data if you ask for it.

iTraxx versus equities



Source: FIIG

To get a better understanding, take a look at the graph today: The blue lower line on the graph shows the change in spreads investors demanded to invest in the most liquid, investment-grade bonds over the past eight years. You can see spreads pre GFC traded around 30 bps (100 bps equals 1 per cent) but peaked as a consequence at around 430 bps in March 2009.

This year, the index has been quite volatile given its more recent stable past. It reached a peak mid-February of 172 bps, coinciding with the fall in oil prices, and a low last week of 110 bps. That's a big move.

The Brexit vote caused significant global volatility, and while the iTraxx spiked from 123 bps on June 23 to 138 bps on June 27, it was relatively steady compared to other financial market moves.

Generally, spreads continue to compress given the expectation that growth and interest rates will be lower for longer, but we are still some way off historical lows, leaving room for further compression.

What is interesting is that the cash prices of the bonds in the index haven't changed anywhere near to the extent as the index. Against expectations, prices are more stable.

Fund managers are wary of selling bonds as they are afraid they won't be able to buy the bonds back at a later date.

One traditional way to increase returns has been to invest for longer but benchmark interest rates out to 10 years are offering little incentive to do so.

Elizabeth Moran is a director of education and research at FIIG Fixed Income Specialists.

www.fiig.com.au

FLOAT WATCH

Property trust taps into servo market

Viva Energy REIT

ASX CODE: VVR
SHARES ON OFFER: 414.1 million
LISTING PRICE: $2.20
MARKET CAPITALISATION: $1.518bn
LISTING DATE: August 3

SIMON HERMANN

Specialist property trusts that collect and manage assets in a specific sector such as childcare or aged accommodation have been popular with investors in recent times.

Viva Energy REIT is an Australian property group that — upon settlement — will own 425 service station site locations in Australia.

The float is a real estate investment trust (REIT), which will be the landlord of these sites. The properties will be leased to Viva Energy (Tenant) and the sites are operated by Coles Express.

Put simply, Viva Energy REIT will generate income by collecting rent from Viva Energy.

Aiming to raise more than $900 million, the IPO is one of the largest listings so far this year and is expected to attract yield-hungry investors. The REIT has high income visibility with an average lease expiry of 15.3 years and 100 per cent occupancy.

> REITs tend to move in line with their net asset value

What is more, the REIT is uniquely positioned as entry barriers to the industry are high and service stations are operated under a long-term alliance agreement.

The REIT's forecasted distribution yield is about 5.9 per cent. However, investors should be aware that the fund carries a concentration risk as all of its properties are characterised as service stations.

Net tangible assets (NTA) of the REIT stand at $2 per share and the IPO will list at $2.20, which represents a 10 per cent premium to the NTA immediately.

It is not uncommon that REITs trade at a discount or premium to their book value. However, it is important to understand that REITs tend to move in line with their net asset value. As the IPO is valued at $2.20, the potential for capital growth in the medium term may be limited.

Overall, Viva Energy REIT offers profitable exposure to a portfolio of service stations across Australia.

Primary hurdles include concentration risk, gearing and valuation. But the forecast distribution yield is attractive for investors seeking income.

Simon Hermann is an analyst at wise-owl.com

Terminally ill can rest assured their super is accessible to take burden off family

MONICA RULE

There are very few ways you can access your super for purposes other than paying a pension — but special circumstances do exist for people who find themselves in difficult circumstances. Perhaps the most important of these circumstances is when there is a terminal illness.

When an SMSF member is diagnosed with a terminal illness, often the first thing they think of is how their family is going to survive without them. Choosing the best way to access their superannuation can reduce tax and leave more money for loved ones.

A terminally ill member may be able to access their superannuation under the following grounds.

1. Severe financial hardship grounds. The member must satisfy the SMSF trustee that they are unable to meet reasonable and immediate family living expenses; have received a Commonwealth income support payment for 26 weeks if the member is under their preservation age; or 39 weeks if the member has reached their preservation age and is not gainfully employed on the date of the application.

The benefit is restricted to one payment of no more than $10,000 in each 12-month period for members below the preservation age. There is no payment restriction for those who have reached their preservation age. A Commonwealth income support payment is a social security benefit or an income support supplement.

2. Compassionate grounds. The member may access their superannuation for: medical treatment not readily accessible through the public health system; making a mortgage payment to prevent a foreclosure; funeral expenses; or, modifying the family home to meet special needs. The application must be made to the Department of Human Services.

If the member can access their superannuation under financial hardship or compassionate grounds, then the benefit is paid as a lump sum. The benefit is tax free if the member is aged 60 or over. If the member is below their preservation age, then tax is payable at a maximum of 20 per cent on the taxable component of the benefit. If the member has reached their preservation age, then the first $195,000 of the taxable component is tax free and the balance is taxed at a maximum of 15 per cent.

3. Terminal medical condition grounds. If two medical professionals (where one is a specialist in the area related to the illness) certify that the member's condition is likely to result in their death in the next 24 months, then the member can elect to receive the terminal illness benefit as a lump sum or a pension.

A lump sum terminal illness benefit is paid tax free. If the member decides to receive the benefit as a pension, then tax is payable at the member's marginal tax rate on the taxable component of the pension if the member is below their preservation age. If the member has reached their preservation age, then they will receive a 15 per cent tax offset on the taxable component. If the member is aged 60 or above, the pension is tax free.

4. Permanent incapacity grounds. If the member has ceased gainful employment and is unlikely, because of physical or mental ill-health, to ever engage in gainful employment for which they are reasonably qualified by education, training or experience, then they can access a benefit as a lump sum or a pension.

One other item to consider is the treatment of the benefits.

If the member receives the benefit as a lump sum and they are below their preservation age, then tax is payable on the taxable component at maximum of 20 per cent. If the member has reached their preservation age, then the amount of the taxable component up to $195,000 is tax free and the balance is taxed at a maximum of 15 per cent. If the member is aged 60 or over, then the whole benefit is tax free.

If the member receives the benefit as a pension, then tax is payable at the member's marginal tax rate on the taxable component of the pension with a 15 per cent tax offset for members under the age of 60. If the member is aged 60 or above, the pension is tax free.

If the member decides not to access their superannuation, then a death benefit must be paid out to either their dependants or their legal personal representative upon their death.

Recognising the most tax effective way to access superannuation before you pass away can give you some comfort in knowing that your family will be taken care of after you are gone.

Monica Rule is an SMSF specialist and author of "The Self Managed Super Handbook"
www.monicarule.com.au