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Securing retirement

The art of de-risking

For many individuals, their pension investments are allocated to funds. These could be funds selected by their pension provider or ones they've chosen independently. Traditionally, retirement planning has centred around investing in shares-based funds during one's younger years. As retirement approaches, the strategy typically shifts to de-risking the portfolio, diversifying into bonds, cash and shares.

However, this strategic shift could leave some savers worse off if they fail to communicate their planned retirement age to their pension provider. De-risking pension savings is a common practice many individuals and organisations adopt as they approach retirement. The traditional convention involves transferring assets into less risky investments to protect them from market volatility in the lead-up to retirement.

This strategy is often implemented in defined contribution (DC) schemes, where clients' funds are automatically shifted into cash and bonds as they near their standard retirement age. Pension schemes transition money from higher-risk stocks and shares to lower-risk assets like government bonds as you near retirement – the process is also known as adopting a 'lifestyle' strategy.

DE-RISKING TIMELINE

Investing in stocks and shares is inherently more volatile than bonds, making this shift a protective measure for your pension value, especially when there's less time for investments to recover from a sudden dip.

The pension provider decides the de-risking timeline based on your expected retirement age. Hence, savers must keep their pension scheme updated about their retirement plans and clearly understand how their money is managed.

TARGET RETIREMENT AGE

At the age of 50, it might be challenging to ascertain precisely when you plan to retire. However, ensuring your pension scheme knows your target retirement age is vital for timely de-risking. Otherwise, you may miss out on the full benefits of the investment growth phase, resulting in less money than anticipated at retirement.

Pension schemes typically shift your money from a growth fund, primarily composed of stocks and shares, to a consolidation fund dominated by bonds five to fifteen years before your stated retirement date. Bonds, essentially loans to governments or companies, offer a fixed interest rate or coupon, providing a lower investment risk avenue.

SCHEME'S DEFAULT FUND

However, prematurely transitioning from equities could affect your investment returns. Should you then stick with risk? Bonds are typically viewed as a shield against stock market fluctuations, as they usually rise in value when share prices drop. This makes them appear as a safe haven against market volatility.

However, the turbulence witnessed in stock and bond markets over the past few years challenges this long-standing theory. If you prefer not to de-risk your investments, you could request your money to be moved out of the scheme's default fund and into an alternative one that won't be 'lifestyled'.

VARIOUS LIFESTYLING OPTIONS

Lifestyling is a unique investment approach designed to protect your pension savings by automatically transferring them into lower-risk funds as you retire. This strategy aims to align your pension savings with your retirement plans, reducing risk as you edge closer to your golden years.

There are various lifestyling options, each tailored to the specific needs of different pension plans. Your choice of lifestyling strategy could shield you from short-term falls in your pension savings value as you near retirement. It's all about aligning your pension savings with your future plans and aspirations.

ADVERSE EFFECTS OF INFLATION

The reality of inflation is that everyday essentials become more expensive over time, causing your money's buying power to diminish. This is where lifestyling can come in handy, acting as a protective barrier against the adverse effects of inflation on your pension savings.

Despite its focus on risk reduction, it's crucial to remember that lifestyling only partially eliminates risk. Like any investment, the value can fluctuate, potentially decreasing and increasing. As such, your returns may not equal your initial investment.

INDIVIDUAL SITUATIONS AND NEEDS

When choosing a lifestyle strategy, it's essential to consider how you plan to utilise your pension savings. Every individual's situation and needs are unique, so a one-size-fits-all approach may not be the best route.

Remember, everyone's retirement needs and risk tolerance vary. A standardised lifestyling approach may not align with your unique financial goals and circumstances. ■

NEED MORE INFORMATION?

If you have any questions or require further information about managing your pension investments effectively, don't hesitate to contact us. We are here to assist you in navigating the complexities of retirement planning. Your financial future is our top priority.

A PENSION IS A LONG-TERM INVESTMENT NOT NORMALLY ACCESSIBLE UNTIL AGE 55 (57 FROM APRIL 2028 UNLESS THE PLAN HAS A PROTECTED PENSION AGE).

THE VALUE OF YOUR INVESTMENTS (AND ANY INCOME FROM THEM) CAN GO DOWN AS WELL AS UP, WHICH WOULD HAVE AN IMPACT ON THE LEVEL OF PENSION BENEFITS AVAILABLE.

YOUR PENSION INCOME COULD ALSO BE AFFECTED BY THE INTEREST RATES AT THE TIME YOU TAKE YOUR BENEFITS.

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