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MONEY WISE

SPECULATE LESS AS YOU GET OLDER

The past few years have not been kind to those counting on government bonds or bank deposits to provide them with a living in retirement. In 1982 US interest rates reached 15% for a short time. That was extreme but interest rates were generally above 6% from 1968 to 1999. For many that was sufficient to enable them to live on the interest once they had built up a modest capital sum.

Today however, US Treasury rates are below 3%. Meaning that if you invested $100,000 in 30-year Treasury Bonds you would be looking forward to a fixed income of less than $3,000 a year for the next 30 years. There would be no allowance for inflation. Worse, should interest rates rise during the term and you decided to sell your bond it would be worth less since buyers could get a higher return from new issues.

Indonesian rates are much higher but there is the historical risk of currency devaluation which can quickly erode purchasing power.

Not too many individuals buy government bonds but many are invested in them indirectly. Pension schemes now tend to hold much higher percentages in bonds due to fear of stock market volatility so scheme members will feel the impact of low returns. But that is preferable to the nasty surprises that have hit pension funds in the past when over-exposed to stock markets.

Annuity rates are also linked to bond rates at the outset making annuities less attractive at current interest rates.

How are pensioners reacting?

Most are just accepting the reality and are bearing the hardship. Others however are looking for alternative investments to enhance their income. This is not a problem if they leave untouched their core pensions but if they put those at risk the result could be disastrous. Most state or company pension schemes fortunately do not allow members to exercise their discretion so temptation to take risks is out of their reach. In the US however, creative financial engineers have found ways to entice retirement fund holders to abandon the conventional assets of stocks and bonds and switch into more aggressive commodity holdings or even private equity ventures or business franchises, still within the framework of a pension with its tax advantages. The returns are potentially high but the reality is that many, if not most, of these ventures or franchises fail, leaving the pensioner penniless.

If you hold a personal pension plan with a life company the chances are you will have a choice of over 100 funds to choose from. The temptation is always to look at past performance and select funds accordingly, despite the frequent warnings that past performance is no guarantee of future performance. Bond funds are rarely selected because their returns are relatively flat but they can be your best friend when stock markets are volatile. If you are retired or approaching retirement ignore past performance and select a range of funds that will predominantly protect your capital. No harm in having a sprinkling of stock and commodity funds but the core of the plan should be in 'low risk' or 'balanced' funds.

When should you start saving for retirement?

Quick answer – the day you start working! In many countries this is exactly what happens as the government will start collecting contributions towards your retirement. It would be wise however to supplement those contributions by saving towards at least a couple of private schemes since a state scheme is likely to fall woefully short of a comfortable pension. Expatriates will normally be unable to continue membership of their countries' schemes so it is imperative they allocate part of their overseas income to a retirement fund. In the early years the fund should be invested in growth assets but these should be converted to more conservative assets as retirement approaches.

In Indonesia barely 10% of the population is covered by the national pension and insurance fund, Jamsostek. In 2014 the number to be covered is projected to be increased significantly. Not a moment too soon since increased life expectancy is likely to see greater hardship and more pressure on families to support their older members. The challenge for a greatly expanded fund – it currently stands at over Rp.130 trillion – is to ensure it is professionally managed and wisely invested. The challenge for individuals is not to relay on the state but to plan early for retirement and avoid the temptation to speculate in the later years.

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