For professional advisers only

Helping your clients to meet the decumulation challenge

BROOKS MACDONALD

Changing gear: Welcome to the decumulation phase

Decumulation. It might sound like a slightly scary financial term to your clients, but it's really all about changing gears from saving to spending.

Whether they call it income drawdown, decumulation, withdrawal, or just 'enjoying their nest egg', your clients are faced with more challenges than ever when they come to consider retirement spending plans.

Do they have enough income? Are they making the most of their money? Will their money run out? Can they achieve their life goals? As an adviser, the pressure is on you to make it work; you'll need a plan – and we're here to help.

Help required

You may have noticed more clients asking for help with decumulation:

Huge numbers of baby boomers are starting to draw down on their substantial savings and they're living longer than previous generations.

Greater freedoms around access to pensions savings and fewer defined benefit pension schemes mean more people are having to manage their own drawdown, and the choices have never been more complex.

Low interest rates, increasing living costs and volatile markets are undermining people's confidence in their own ability to manage their investments and income drawdown.

The big decumulation challenge

Coming up with an effective decumulation strategy for an unpredictable economic climate is a huge challenge. You need to balance money coming out of the pot for income now with money staying in the pot to generate growth for income in the future.

Add a few other complex risk factors to the mix and this is a particularly tricky task.

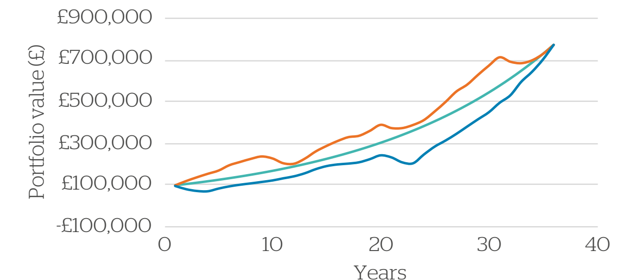
Moving markets – sequencing risk

Markets always have the potential to go up and down, as we were reminded of in dramatic style in 2008. More recently, COVID-19, Brexit and the war in Ukraine have all led to unpredictable times.

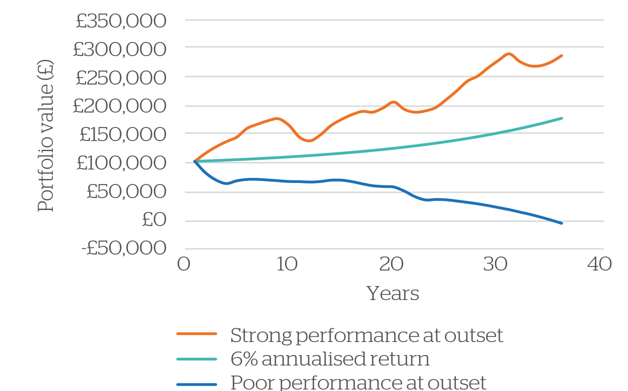
The problem for those clients who are ready to decumulate is that if they start to take money out of their savings pot when returns are weak it can seriously impact the size of their pot over the long-term. This is called **sequencing risk**; a combination of the returns generated and the sequence of income requirements.

These charts illustrate how sequencing risk works. When clients are accumulating money, investing is all about the long game, and it's best not to worry too much about the twists and turns along the way. But for those decumulating during a period of poor performance, there can be a significant reduction in the size of a savings pot over time, so an actively managed plan can really help.

Portfolio in accumulation - no withdrawals



Portfolio in decumulation - withdrawing £5,000 each year



For illustrative purposes only

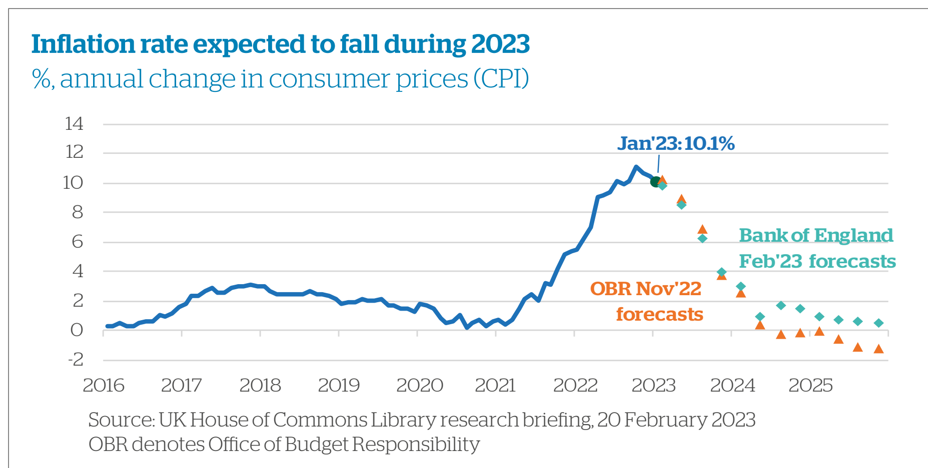
The big decumulation challenge

[1] commonslibrary.parliament.uk/research-briefings/cbp-9428

[2] www.ons.gov.uk/peoplepopulationandcommunity/healthandsocialcare/healthandlifeexpectancies/articles/whatismylifeexpectancyandhowmightitchange/2017-12-01

Rising living costs – inflation risk

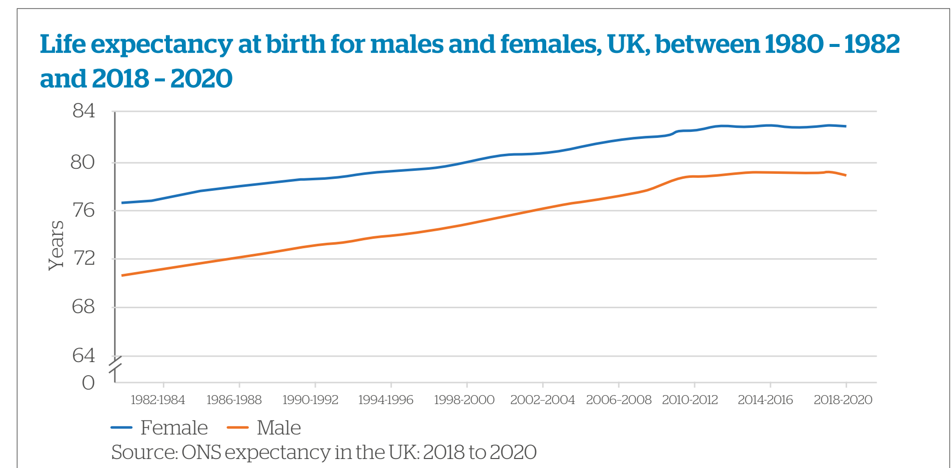
Many people taking money out of their pot are using it for day-to-day living expenses. For those living on their savings, **inflation** can pile on the pressure[1].



Although some forecasts point to a return to lower inflation, recently many clients have had serious concerns over their spending plans. And when the cost of living increases, as it has done at a startling rate recently, clients may need to withdraw more. Investing can help preserve the real value of money over time, helping to achieve income needs in the long-term.

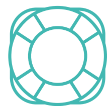
Living longer – longevity risk

Over the last 40 years, life expectancy in the UK has been increasing, albeit at a slower pace in the last decade[2].



Living longer can be a wonderful thing, but it costs more money. It can also leave your clients more exposed to unpredictable financial factors like the need for medical treatment or personal care.

An actively managed, bespoke solution



Who can we help?

Clients who are either withdrawing income from their portfolio, or planning to do so within the next seven years. See our case studies for some inspiring examples.

What about risk?

For clients with low-medium, medium, medium-high and high risk profiles.

How much do clients need to invest?

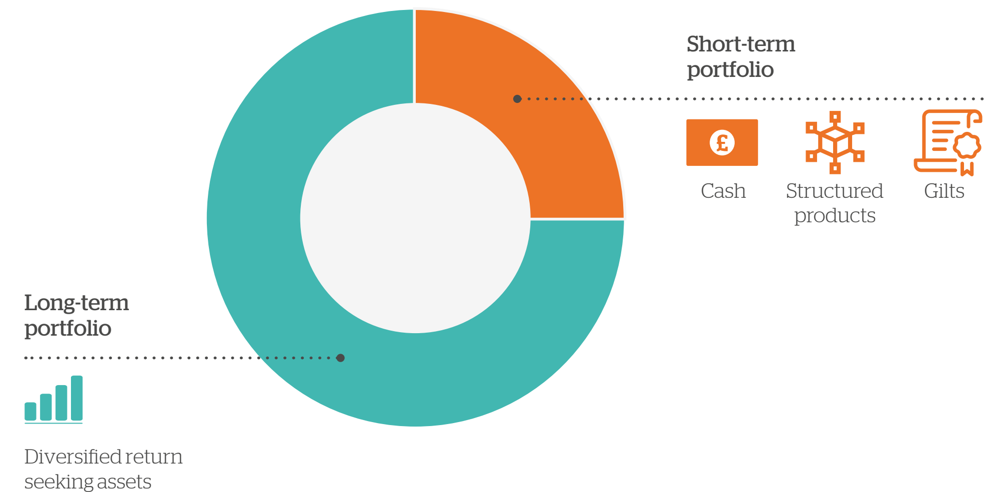
Minimum £500,000

How is the service accessed?

Through our Bespoke Portfolio Service, aligned with cashflow planning systems and with regular reporting.

Two portfolios can be better than one

We've developed an innovative two-portfolio structure, to address the risks of decumulation and help your clients meet their long-term income needs.



Short-term portfolio

Varying combinations of cash, structured products and gilts covering individual client income needs for up to seven years.

Long-term portfolio

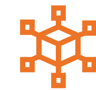
A diversified and carefully selected collection of assets aiming to generate long-term growth.

Short-term portfolio

The short-term portfolio aims to **reduce the possible effects of sequencing risk** by shielding the client from downturns in the early years of withdrawing.

Short-term portfolio

Cash



Structured products

Gilts

It siphons off the soon-to-be-needed income into varying combinations of cash, gilts and short-term structured products.

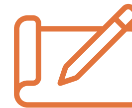
Short-term portfolio

Structured products for short-term returns

Structured products are typically issued by banks and aim to provide set returns over an agreed period. The returns depend on certain conditions being met on an underlying asset – often a market index.

They're ideal for the short-term portfolio because equity markets don't have to grow for the returns to be paid. Some products can even withstand substantial falls in equity markets and still pay out in full.

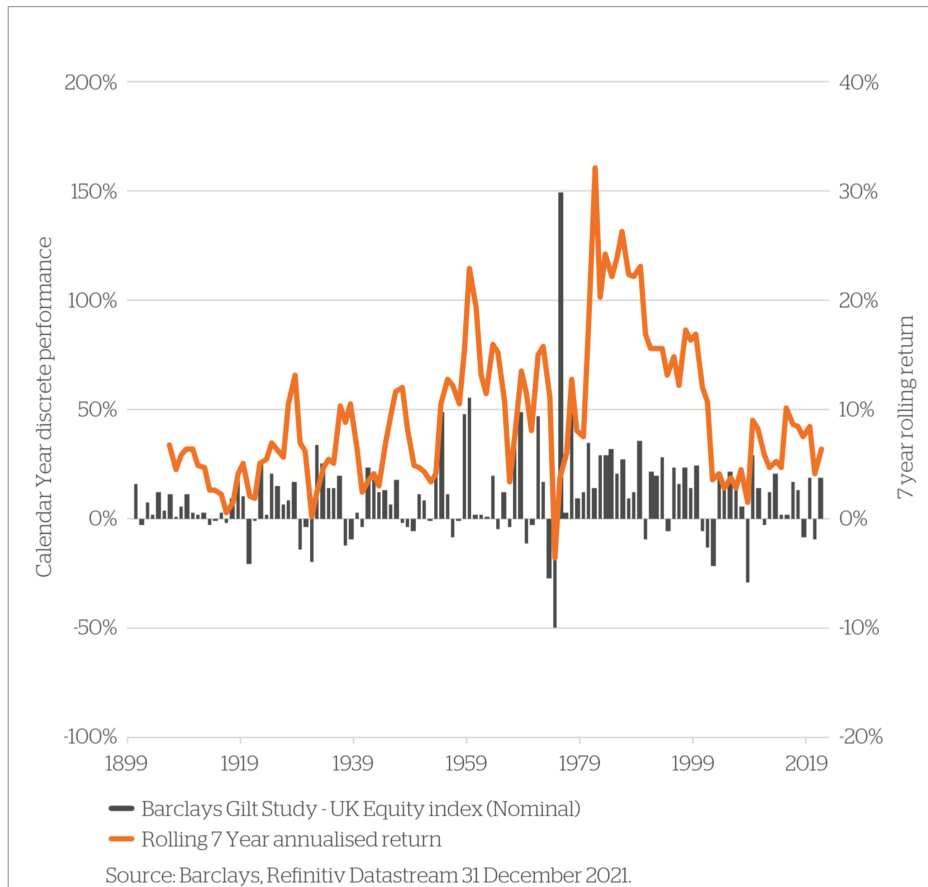
We've worked with structured products for more than 25 years, and our relationships with the sector put us in a strong position to negotiate on price and develop products that meet our clients' needs.



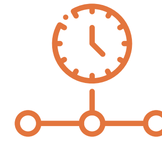
Innovative product design

To **match your clients' income requirements**, we invest in a range of structured products. We create a new structured product every six months and allow them to mature. This way, they will pay a half yearly income as long as the underlying index is not 40% lower than its starting point. Our research shows that, to date, there has never been a 6.5-year period where the indices would have been 40% lower.

Short-term portfolio



Source: Barclays, Refinitiv Datastream 31 December 2021.



Seven year timescale

The short-term portfolio aims to meet clients' income needs for the next seven years. Our research suggests this could be enough time to to navigate sequencing risk – in other words, starting to take money out when returns have fallen.

The chart illustrates that since the early 20th century, there has been only one rolling seven-year period (in the 1970s) where investors in UK equities suffered a negative return. So, as the short-term strategy aims to contain sequencing risk in the first seven years, the long-term portfolio is left to fluctuate and grow unhampered by regular withdrawals.

Comprehensive due diligence

Structured products involve **counterparty risk** – the risk that the issuer won't be able to pay back the amount invested, as promised under the terms.

- We work closely with our counterparties to make sure they always meet our high standards, undertaking in-depth due diligence.
- No more than 25% of the structured product allocation is held with any single counterparty.
- Structured products that mature one after the other must be with different counterparties.

However, if an issuer does not pay out in full, we would need to meet income needs with money from somewhere else in the portfolio.

Long-term portfolio

The long-term portfolio aims to provide growth to **combat inflation and longevity risks**. It invests in a diversified portfolio aiming for long-term growth

Diversified investments

This portfolio incorporates a wide range of asset classes, investment vehicles and markets. It can invest in equities, fixed income, structured products, property and other alternative assets, both in the UK and internationally.

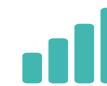
Bespoke design

Every long-term portfolio is designed to meet the client's specific objectives and, if they change, we change the portfolio. Risk management is applied by monitoring and controlling the level of risk in a portfolio and the asset allocation. We check exposure to any single stock, fund or investment house to ensure a portfolio stays in step with your client's goals.

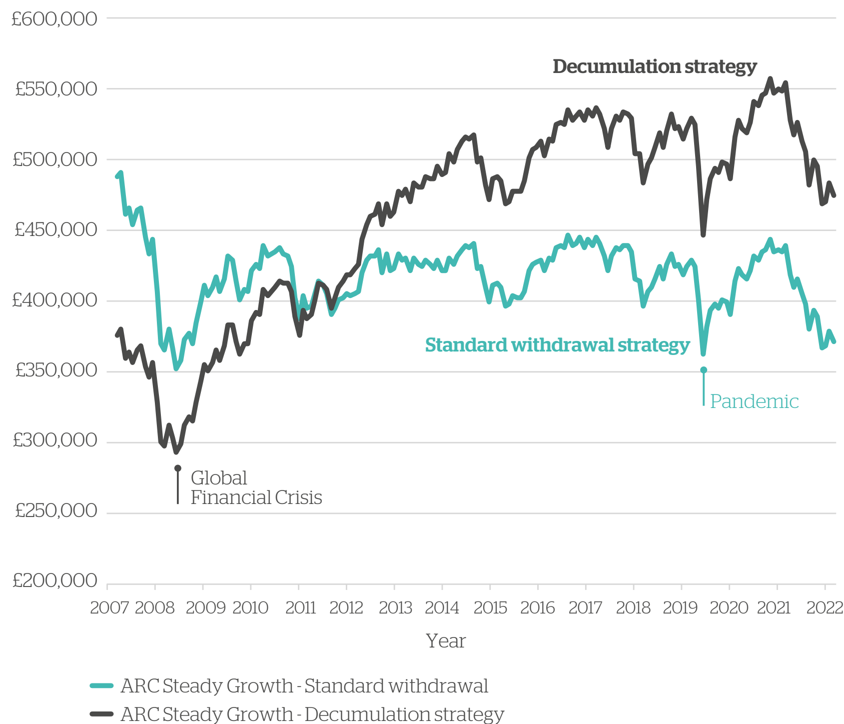
Expert service

And, of course, all our clients benefit from our 30 years + of experience as investment managers, along with our helpful service.

Long-term portfolio



Long-term portfolio



What a difference a decumulation strategy makes

The chart compares the different experiences of someone investing via a decumulation strategy, through the Global Financial Crisis, then later through the COVID-19 pandemic.

The light green line shows a client investing in a growth portfolio whilst taking a regular income.

The dark line starts at a lower level, due to the client's income needs for the first seven years being stripped out and placed in our short-term strategy.

The result is clear to see, unhampered by regular withdrawals, the decumulation strategy performs strongly in the first seven years when sequencing risk is high, then continues to perform well once income begins to be drawn after 2014.

Important information

This document is intended for professional advisers only and should not be relied upon by any persons that do not have professional experience in matters relating to investments. Investors should be aware that the price of your investments and the income from them can go down as well as up and that neither is guaranteed. Past performance is not a reliable indicator of future results. Investors may not get back the amount invested.

Please be aware that this service utilises structured products as part of the portfolio construction/strategy which comes with specific risks. Information on the relevant structured products and their risks are described on pages five to eight of this document. Should the counterparty fail, you may not have access to the Financial Services Compensation Scheme (FSCS). Investors should speak to their advisers for further information and to ensure they understand the risk and return factors applicable in their case.

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More information about the Brooks Macdonald Group can be found at www.brooksmacdonald.com.

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If you'd like more information about helping your clients have a happier decumulation experience, please get in touch with us at:

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