A cautionary tale

Hobson’s Choice

If annuities are being thrown into doubt, here is a question for you: knowing what you know today, if you were taking your pension pot out in April 2015 – where exactly would you put it?

It’s a tough question. And at this stage, it’s hard to say if proposed changes to retirement planning will make that decision any easier in the future, least of all for any financial intermediary involved. The truth is, by trying to simplify the process, things probably just got a whole lot more complicated.

It’s fair to suggest a few people are probably looking forward to the day they can now get their hands on their whole fund. Our research showed it’s around 7%*, but that’s still quite a large number of individuals. There are a lot more, however, who’ve been left even more confused about what the ‘best possible option’ looks like for their hard-earned pension pots.

So, where do you fit into this puzzle? Well, if you have clients who are counting down the days to April 2015, then it’s time for you to start talking to them now. The choices are endless. What we all know though, is that those choices also fall into three general categories:

- investing in equities, fixed interest or commercial property – either directly or through a unitised vehicle such as an ISA or other investment wrapper;
- buying residential property – either as an investment, like a buy to let or as ‘something to fall back on’;
- or savings – cash, in other words. Usually in the short term, but potentially for longer.

Whichever route your clients choose, they’ll have questions about the pros and cons of each one. They’ll also be at the mercy of their chosen market, hoping to ride the highs and avoid the lows, so you’ll need to be well prepared and able to answer those questions confidently.

And while every provider and adviser is right to be pragmatic, and quick to point out ‘you may get back less than you originally invested’, it may pay dividends to take a quick look back at historic performance, and see if there are any lessons we can learn.
Stocks and shares, bulls and bears

Any retirees considering an investment in equities will probably use the FTSE 100 as a reasonable benchmark to judge their performance as a category in its own right.

The FTSE represents a good range of blue chip companies with which people are probably familiar. So, using it as our benchmark, taking a steer on what the future may hold for anyone re-investing ‘pension pounds’ in the markets, let’s remind ourselves of some notable moments to date…

Technically speaking…

Yuppies. Red braces. Mobile phones the size of a house brick and Gordon Gekko reminding us that, technically speaking, greed was good. The 1980s were a decade of debatable fashion, but it was also a time when people made a lot of money on the stock markets … until the 19 October 1987, that is.

The financial markets had been climbing steadily in the first part of 1987, but the markets crashed without warning in the autumn of that year. With no notice at all, billions were wiped out and the FTSE 100 crashed from a high of 2443 on 16 July to a low of just 1565 on 9 November – that’s 36%, in less than six months.

Most people blamed ‘programme trading’ (computers performing rapid transactions against the market), or a crisis in confidence following monetary policy disputes between larger economies – but the ‘why’ wasn’t important. It was the ‘what’ that mattered.
Totally technology…

Moving forwards, do you remember partying like it was 1999? It seems ridiculous now, but at the turn of the century, the markets went into a frenzy about dot.coms. With outrageous valuations, many technology companies went through massive expansion with the promise of future revenue but at the cost of profits and credibility.

From 2000 to 2001, it became clear that many had spent all their venture capital – and the tech-bubble burst with a bang. The FTSE 100 dropped from a high of 6930 points on 3 January 2000 to a low of just 5994 points by 17 April 2000 – that’s 14%, in less than three months – and that was just the first leg of a sustained bear market: it continued falling more than it rose, right through to 2003.

… and total collapse.

Bearing in mind the consequences, it’s been called the worst financial crisis in living memory. Collapsing Icelandic banks, teetering Northern Rocks, housing markets in freefall, bankrupt countries and (on the upside) cheap holidays in Greece.

Hardly anyone escaped. The collapse of the housing market and its alignment to some poorly judged lending policies led to seriously under-capitalised banks falling apart at the seams. And the sudden lack of credit and confidence in those time-honoured institutions had an inevitable impact on the markets, which went into free-fall from a high of 6456 (for the FTSE 100) on 1 January 2008, down to a low of just 3512 by 3 March 2009. To put this another way, six years of growth was wiped out – and we pretty much went straight back to where we were, in 2003.

Only recently are things looking a little more rosy in the financial garden. Even now though, many are saying the biggest lesson learned over the last 100 years is that we’ll never learn our lesson when it comes to stocks and shares. Worth remembering, too, that it’s not just technical hitches to blame. No one could have predicted 9/11 – or the immediate associated drop in market values – and no one knows what’ll happen tomorrow, either.

Bricks ‘n’ mortar

If the markets don’t move you, there’d always be bricks and mortar – that’s as safe as houses, right? Maybe. Maybe not. House prices have gone up: true. Many retirees still have equity in their homes: true (as opposed to the negative equity trends of the 80s). But there’s still a great deal of volatility in the housing market and there could be more in the run up to a general election next year. Again – it’s hard to predict what will happen, but it’s easy to see what’s already been proven: ups and downs, highs and lows, just slower timeframes and less ease of access. ‘As safe as houses’ has its drawbacks, it has to be said.
Here’s an example: house prices in real terms. As you can see, values have suffered from market bubbles bursting. The big difference is that recoveries have taken even longer. So if you were to think about investing in bricks and mortar as part of a retirement plan, well, it could be harder still to work out if you’re capitalising on a rise in the mortgage market or just seeing the peak – and there’s a crash around the corner.

![Real House Prices](source: Nationwide 2014)

On top of that, it’s worth remembering that the equity in property isn’t easy to access: timing is everything. Depending on when you’d like to withdraw capital, you may have to wait for a market to – hopefully – recover, if there’s been a bit of a dip. Recent comments in the press have been biased towards the housing market becoming overheated yet again – and the associated surge and dip of property values is something not to be underestimated, if that’s where you’d put your money.
Money in the bank

Last but not least, we have the bedrock of many retirees: hard cash. Unless it’s been in a mattress, most people’s savings spend time in Cash ISAs, or if ISA limits were reached, in ‘higher’ interest savings accounts. But many seasoned savers will tell you that bank interest rates just aren’t what they used to be – as you can see here:

Double digit base rates haven’t been seen for over 20 years. So as many retired people have discovered, the idea of keeping their capital intact and living off the interest really is wishful thinking: tangible funds are more likely be eroded by inflation, and that can be devastating – especially for the ‘asset rich, income poor’ retiree.

Summary

So let’s ask that question again. Thinking about what you know to be hard facts connected to some of the alternatives and volatility in recent years, if you were taking your pension pot out in April 2015 then where exactly would you put it?

Annuities start to look good again, don’t they? For anyone who wants consistent, guaranteed returns, at least – they still have a great role to play in people’s financial futures.
The options involving a move outside the current pension regime have grabbed the headlines. The truth is, there’s always been plenty of choice surrounding the destination for a pension fund, large or small. But we’d urge you, and more so your clients, to think twice — at least — before making rash decisions that could last them a lifetime.

There are good reasons why annuities have been around for so long. Yes, rates have fallen from just over 10% back in January 1994 to around 5.7% in January 2014 — but before making any decisions about the future, it’s worth remembering what we DO know about the past. Let’s face it — when you think back to the guarantees (or non-guarantees) associated with equities, and the uncertainty or volatility around some of the other options – is there any other investment vehicle that offers:

- an income of around 5% (or higher if you qualify for an enhancement), with no investment performance risk – none whatsoever.
- a level of insurance in that product – a guarantee that it will carry on paying out for as long as you live, which could be much longer than the original capital invested.
- and certainties in terms of access to capital, in the event of an early death, if the option was taken?

There are some valuable lessons to be learned. And like Hobson, with his horses, sometimes what seems like a great alternative to the obvious choice is really not a sensible option at all.

*Just Retirement Research 2014. The study comprised an online quantitative survey of 1,000 consumers aged 55+.