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# Delivering income for retirees

In December 2014, the final Financial System Inquiry report was released. The section entitled 'The retirement phase of superannuation' is informative and depicts the desired features of a retirement income solution for investors; being a combination of products to provide a balance between risk management, high income and flexibility (see Figures 1 and 2).

While these diagrams are relatively simplistic, they start to highlight the complex nature of the issues a retiree faces. They also help to underscore the need for financial advice so that the investor can build a portfolio that meets their short, medium and long term goals. The idea of using a blend of annuitised products alongside income focused investment solutions highlights both the opportunities that are available and the need to find the right types of returns to meet the risk appetite of a retiree. With this backdrop advice has never been more important; especially given the current economic environment.

## Retiree needs vs. real world investing: a conundrum

Sitting beside their Government Pension and Term Annuity, retirees need a sustainable and growing income stream as well as capital growth.

In seeking the right solution investors face record low deposit rates, low bond yields, low growth and the risk of rising inflation. These challenges are then compounded by meaningful growth in life expectancy.

In addition, the primary focus in decision making is no longer around the perceived capital risk as it was during the accumulation phase, now it switches to the risk to income produced. The steady fall in interest rates over the past seven years has exposed investors to heightened income risk and inflation risk. Investors need to focus on solutions that can provide a sustainable, growing and real (after inflation) income stream, while also protecting their capital base.

Historically, many investors have turned to

term deposits. However, Figure 3 below shows the results of income from \$30,000 invested five years ago. It confirms past performance is not a guide to future returns. In our view, a change in investor behaviour is increasingly required.

## For flexibility and control – buy local

In a traditional asset allocation approach the greater the diversification the better. However, care needs to be taken in building a diversified income solution for Australian based investors. The cost of living and inflation risks that Australian retirees face are largely Australian in nature and therefore it makes sense that the invested assets match that risk. If the investor liabilities are in Australian dollars then assets should be held in the same currency.

Legg Mason affiliate investment manager, Martin Currie Australia, has developed two solutions that are designed to deliver high income plus flexibility and maximise the after-tax income generated.

### 1. Real assets – real income

In 2010, Legg Mason was a pioneer in creating a portfolio of deeply researched and carefully selected listed real assets for the income investor, with listed real assets being the missing link between equities and fixed income. That is, we believe they provide a long-term income stream similar to a fixed income security and have the potential for capital growth, typically with lower risk than a traditional equity strategy.

The benefit of real assets in client portfolios is their ability to provide natural inflation protection, so income is expected to go up, not down over time. Many real assets (for example toll roads) have operating contracts that allow them to increase revenues in line with (or sometimes above) the inflation rate.

The Legg Mason Martin Currie Real Income Fund has over six years of proven results,

The investment community is switching gears. From specialising in products and services for accumulators, they are now designing a variety of options for retirees and those approaching retirement.

One of the more innovative offerings in this field come from investment powerhouse Legg Mason and its affiliate Martin Currie Australia. Through their products that deftly mitigates inflation, longevity and sequencing risk, financial advisers have an effective option to solve the retirement income needs of their clients.

I invite you to watch my interview with Reece Birtles, the chief investment officer of Martin Currie Australia and read this article on how advisers can help their clients cultivate a sustainable income stream.

*Michelle Baltazar*

Michelle Baltazar  
Director of Media & Publishing



### The quote

*The portfolio is designed with the right mix of assets to deliver the return objective at lower levels of risk.*

### More information

To find out more about Legg Mason's range of Income Solutions visit [www.leggmason.com.au/income-solutions-for-life](http://www.leggmason.com.au/income-solutions-for-life) or email us at [enquiries@leggmason.com](mailto:enquiries@leggmason.com)

giving investors a strategy that can help diversify in a well balanced portfolio and solve the need for a sustainable, high and growing income.

### 2. Equity income by design

Traditional portfolio construction guides investors to accept more risk to generate higher returns. However, when designing income solutions, reducing the volatility of the income stream is a primary consideration for our portfolio managers. The aim being investors don't necessarily need to take on more risk to generate more income.

In June 2011, Legg Mason Martin Currie adopted a unique design in its Equity Income Fund. Investing across the entire Australian sharemarket, it incorporated two distinctive elements. Firstly the stock selection process is focused on finding those companies that offer attractive sustainable income. These are rigorously tested by our analysts to ensure this can still be delivered in difficult times. Secondly, the portfolio construction process is designed to reduce concentration risk so that the income produced by the portfolio is well diversified and is not dominated by a particular company or industry sector.

### The results are clear

Figure 3 highlighted how income from Term Deposits has collapsed over the past five years. The chart below shows that the two income funds discussed above have delivered a completely different outcome.

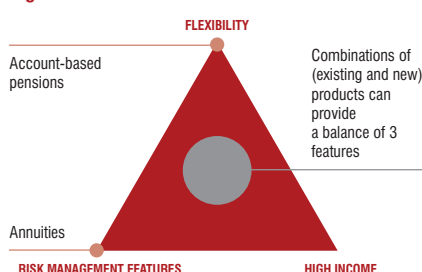
The two funds introduced in this paper show how well designed income solutions are a valuable part of a total investment program designed to meet the central need for any retiree: a sustainable and growing income stream allied to the potential to grow the capital base over time. We believe these funds merit inclusion in any diversified portfolio. **FS**



Watch the video on [www.fsitv.com](http://www.fsitv.com)

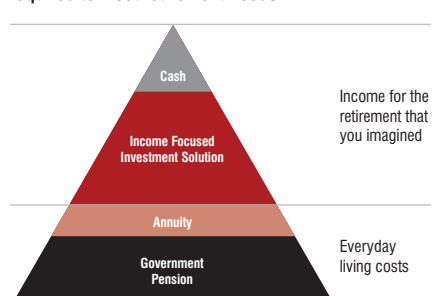
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**Figure 1: Desired features of retirement income**

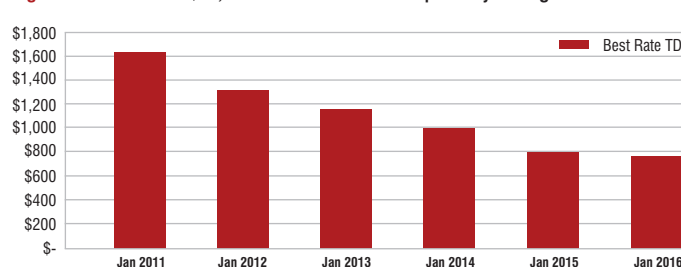


Source: Financial System Inquiry: Chapter 2: Superannuation and retirement incomes. "The retirement phase of Superannuation"

**Figure 2: Income from different sources is required to meet retirement needs**



**Figure 3: Income from \$30,000 invested in a Term Deposit 5 years ago**



Based on next 12 months income. Past performance is not a guide to future returns.

Source: Martin Currie Australia, RBA, as at 31 December 2016.