In Managing Your Pension, Cut Speculation as You Age

Returns from bonds may be slim, but be careful about seeking more risk, warns **Colin Bloodworth**

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 percent for a short time. That was extreme but interest rates were generally above 6 percent 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 percent. 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 higher, but there is the risk of currency devaluation, which can quickly erode purchasing power.

Not many individuals buy government bonds but many are invested in them indirectly. Pension schemes now tend to hold higher percentages in bonds for fear of stock market volatility, so scheme members will feel the impact of low returns. But that is preferable to the surprises that have hit pension funds 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 accepting the reality and bearing the hardship. Others are looking for alternative investments to enhance their income. This is not a problem if they leave their core pensions untouched, 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 that discretion so temptation to take risks is out of their reach. In the US, 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 over 100 funds to choose from. The temptation is to look at past performance and select funds accordingly, despite the warnings that past performance is no guarantee of the future. Bond funds are rarely selected because their returns are relatively flat, but they can be your best friend when stocks are volatile. If you are retired or are getting there, ignore past performance and select a range of funds that will predominantly protect your capital. No harm in having some stock and commodity funds but the core of the plan should be in "low risk" or "balanced" funds.

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When should you start saving for retirement?
The day you start working! In many countries the government will start collecting contributions toward your retirement. It would be wise to supplement those contributions by saving toward 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. The fund should be invested in growth assets but these should be converted to more conservative assets as retirement approaches.

In Indonesia, barely 10 percent of the population is covered by the national pension and insurance fund, Jamsostek. In 2014, the number is projected to increase significantly. That's good, since increased life expectancy is likely to see more pressure on families to support older members. The challenge for a greatly expanded fund — it currently stands at more than Rp 130 trillion ($14 billion) — is to ensure it is professionally managed and wisely invested. Individuals should plan early for retirement and avoid the temptation to speculate later.

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