Rules to live comfortably in retirement

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- From:The Australian
- July 03, 2012 12:00AM

ONE of the biggest problems retirees face is knowing how to provide income for the rest of their lives. This is an easier problem to solve than most people think. Here I'm going to give you five simple rules.

Step one: Regardless of your age, invest in assets that pay you inflation-linked income. Before you retire, you simply reinvest those earnings into the same or similar assets to earn more inflation-linked income. Once you retire, you live off the income generated by your investments.

The reality is that only good investments can pay you income linked to inflation across many years. You need to select investments that will pay you this income regardless of the tradable value of an asset. The key point is that the income you receive from your investments won't vary as the market value of your assets fluctuates.

The reason you want to live solely off the income from investments is to reduce the impact of the incessant and nerve-racking changes to asset prices.

An actuary, Geoff Walker, said in April 2008 that unitised managed funds won't give you the income you need because of the way they are structured. At the same time, unitised super funds are also inappropriate from an income-paying perspective because they make no income distributions. In both vehicles all you see is asset price movements.

Step two: Know how much income you'll need to live on in retirement in fine granular detail. In simple terms, do an income and expense budget and refine it regularly based on personal experience. For those who aren't retired, this can be difficult job because you may not be sure how much retirement will cost.

Step three: Accept that you cannot retire until your assets generate the income that covers your retirement living expenses.

Step four: Two or three years before your retirement, stop reinvesting your inflation-linked investment income and put it aside in a safe place, say a suitable high-interest savings account.

This money will be used to pay your income needs in your first retirement years.

The interest income paid from this bank account will protect you if your investment income falls unexpectedly.

Step five: Avoid at all costs using your assets to provide your income needs in retirement. If you do this, then you'll be in the express lane to going broke and maybe even insane with worry.

All asset prices are highly volatile. Selling assets to pay yourself an income means you will be speculating on the constant movement in asset prices.

Walker said that "an investor gets his reward from the maintenance of his holding whereas a speculator gets his reward from the disposal of his holding".

As you may have gathered, these steps are more helpful for those who are yet to retire, but even those who are retired can benefit from following the above steps.

If you're retired then you may not like the thought of living off the income from your investments alone because it may lead to a significant reduction in your income.

If you want your retirement assets to last, then some adjustments may have to be made.

If you're retired and you want to implement the above steps, then I suggest you take 10 per cent of your retirement assets and put it into a high-interest savings account. This money will provide your income for the next two years because it'll pay you 5 per cent of your remaining assets.

For example suppose you have $500,000 in retirement money. You would put aside $50,000 and begin receiving 5 per cent of the remaining $450,000: that is $22,500 in year one.

Obviously you may need to adjust your asset holdings and the retirement products so you can generate inflation-linked income. Before you jump into this you'll need to consider the costs involved in this process.

For a successful outcome, you should deal with advisers who have appropriate income-earning experience with their own investments across the medium to long term.