Behavioural Finance and The Post Retirement Crisis

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Polling Question

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The Post Retirement Crisis

The post retirement crisis is about outliving your assets

The average life expectancy 20+ years once you hit 65

Post retirement crisis is magnified by poor financial decision making of retirees

61% of retirees fear running out of money more than death.

Source:

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Retirement Case Study
What does good look like in Retirement?

- Balanced portfolio
- Starting balance $300k
- 5% withdrawals p.a
- 5000 stochastic simulations

$300,000 starting balance taking out 5% p.a. indexed to simulated inflation. The above are results of 5,000 portfolio simulations conducted by Milliman.

The performance shown is hypothetical/non-actual performance information that shows results based on stochastic model simulations constructed by commissioned research houses. The calculations are based on various portfolio allocation and financial assumptions that are predictive in nature. The outcomes actually achieved may differ materially from these projections. Past performance is not a reliable indicator of future performance.
Retirees must make the following decisions:

- **Predict how much to keep in reserve in case they outlive their life expectancy**
- **Calculate their life expectancy**
- **Forecast future returns and inflation**
- **Decide what amount to withdraw as regular income and ensure this money lasts**
- **Manage their nest egg for growth as well as optimise downside protection**

Vital to understand how behaviour shapes our ability to make decisions.
Behavioural Finance Strategies to use with Retirees
Strategy 1: Framing

‘Framing’ scenarios and strategies in an appealing light can have a remarkable impact on their attractiveness to investors

Rethink traditional portfolio construction

+ Definition of ‘risk’ – it’s not ‘volatility’ in retirement
+ Accumulation vs Decumulation
+ Traditional SAA vs Goals Based Advice

Change the conversation to…

+ Frame in terms of ‘income’ and ‘mitigating worst outcomes’ instead of ‘average returns’
+ Increase probability that money will last
+ Talk about how retirees feel in retirement
Strategy 2: Vividness

Strengthening retirees’ connection to their future self could improve the quality of decisions they make about their retirement income strategies.

People have doubled their savings rates after seeing age adjusted images of themselves compared to peers.

Source:
1. University of Illinois Professor Jeffrey Brown (Brown et al 2008)
2. Imagery: Aging Booth App for photos
Case Study: CBUS CEPAR

‘Retirement Income Estimator’

+ Salary sacrifice contributions were 33% higher among those who received the RIE
+ Members who received the RIE on average sacrificed 32% more than members who did not
+ Of those who made voluntary contributions, members who received the RIE on average contributed 35% more than members who did not
+ Members making investment choices 33% higher among those who received the RIE
+ The RIE group interactions with CBUS were 46% higher than those without

The RIE is “new” information about savings adequacy that changes retirees behaviour.

Vividness represents a huge opportunity for retirement advice.

Source:
University of Illinois Professor Jeffrey Brown (Brown et al 2008)
Refer to research report by CEPAR The impact of projections on superannuation contributions, investment choices and engagement
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Strategy 3: Hyper Loss Aversion

Drawdown rates from superannuation per age group

Retirees fear a loss TEN times as much as they value a gain, whereas the average person fears the loss only twice as much as they value a gain.

Retirees respond with frugal living. A 65 yr old male, taking only SIS min will only use 69% of his super.

More than half of Australian retirees are spending less than the Age Pension each year.

Don’t underestimate the impact of loss aversion

Source:
1. AARP and the American Council of Life Insurers – How Retirees Manage Money to Make it Last Through Retirement (2007)
4. Centrepoint Alliance analysis
Executive Summary

“Las Vegas is busy every day, so we know that not everyone is rational.”
- Charles Ellis

“The investor’s chief problem – and even his worst enemy – is likely to be himself
- Benjamin Graham

Behavioural finance proves that people think differently in retirement – we MUST adopt a different approach to investing in retirement.
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