

Retirement planning in uncertain times

Taking a balanced view to riding out a recession

As if it wasn't difficult enough already to put together a financial strategy for our retirement recent financial and economic upheaval has thrown everything into confusion, for how long we don't really know – possibly a few years. And we're not only talking about those who are close to retirement but possibly more so those who are in their twenties, thirties and forties who still have to lay down plans and accumulate resources for their later years.

Recently we have seen the economy slowly sliding into recession together with the near collapse of the banking system, one of the fundamental pillars on which our modern society is founded; all this on a global basis. Share prices have fallen dramatically, banks have failed, house prices have dropped although general inflation has risen, and many jobs now look under threat. The causes will be debated for years to come and the reasons may never be fully explained. But there will have to be change to ensure that such a situation does not arise again.

Understanding the fundamentals

In the short term there is going to be a lot of heartache as the situation unravels. But the world will not collapse – it never does. And people will still be living to a ripe old age. And will need funds to support themselves.

So what are the long term implications for us as future pensioners? It is unlikely that anyone has escaped financially unharmed from the current battering unless they have been very astute or very lucky.

Share prices have dropped and so the “values” of pension pots, whether in pension schemes or in direct investments, have fallen. Even cash savings, which ought to have been safe, have been under threat. We know shares are risky - but deposits in banks and building societies? With confidence blown, is it really worth doing without things now to put money away for the future? And if we're going to have to tighten our belts can we really afford to save anyway, even if we wanted to?

Well, we must do some hard thinking – and we must do it for ourselves. The state cannot afford to fully finance us through our old age even if they wanted to.

The fundamentals aren't going to change so it's worth understanding what they are. Someone retiring at 65 is likely to live until they are about 90. So they will have worked for 45-50 years and then might expect to live work-free for another 25 years. In other words, although it's a glorious over-simplification, for each year we work we must plan to support ourselves for up to one and a half years – one year while working and another six months sometime in the future. Some of this requirement will be met by our contributions to our state pension through National Insurance, but there is still much that will be down to us. We might also argue that our financial demands will be smaller when we're retired but evidence doesn't support this, even without the spectre of needing to cover care costs in the future.

So what do we have to get our heads around? Plenty of things. It is almost certain that people will not be retiring at 65 – definitely not fully. We already know that the state pension age is going to be increased to 68 and we will just have to work longer so that we have more years of earning and fewer of non-earning. The sooner that we grasp this the sooner we and employers will realise that something must be done. Everyone must take on board that continued motivation, health, skill levels and participation of our older citizens are essential for individual and national well-being.

But what do we do right now?

Pensions and investments

If we are close to retirement then a fall in share prices is not good news if we are about to buy a retirement annuity. It will not now produce as much as we had hoped even without the growing realisation that life expectancy is increasing and we will have to eke out our savings over more years. Possibly the best bet is to carry on working and delay taking the annuity until things recover. If

we are going down the pension drawdown route instead then we probably have more flexibility. If we're in a defined benefit (final salary) scheme then we may count ourselves lucky; our employer has to meet the shortfall. But we will be part of a dwindling band. Companies are increasingly unwilling to continue to bear the cost and uncertainty inherent in these schemes and so the latest turmoil is likely to hasten their demise. The risk is being shifted to the individual in the form of defined contribution schemes whereby falls in the value of shares would have to be made up by the individual themselves if they want to preserve their ultimate pension.

However, whether inside or outside a pension scheme, it is worth considering share values in a little more detail. Certainly the market prices of shares have fallen but have the value? In the short term prices are dictated by supply and demand. Prices have fallen recently for two main reasons. One is the general uncertainty surrounding the financial environment. This, in itself, has not affected the underlying companies concerned. The other is a real belief that we are heading for poorer economic conditions and that companies will fare worse and their profits performance decline, followed by a reduction in dividends.

It is quite probable that for long term investors share prices have now fallen below their intrinsic value and so, in the current climate, it is best to sit it out and see at least some of the share price recover. Some respected investors are even suggesting that now is a good time to invest – but that may only be for the brave. Once this part of the recovery phase is over then will be the time to review our investments in general. For those who are committed to saving regularly into pension or long term saving schemes it would seem sensible to keep the contributions going.

Equity and savings

Despite the present apparent drop in house prices, a house to live in, also as a form of investment, still seems like a very sensible idea provided that we can obtain the funds, are reasonably confident about our jobs, and do not overstretch ourselves financially. It is still unclear whether there is a general fall in prices or whether a lack of available finance generally has turned everything into a buyer's market. The message is *don't sell if you don't have to*. The national stock of houses is still too low and house prices over the long term will rise.

However, what must be realised, as part of pension planning, is that one day in the future we will have to downsize or release equity from our house and that we must assume that there may be little or nothing left over for our dependants. Passing on large legacies to future generations just won't be happening.

In the current climate equity release schemes have pretty much dried up and the industry is all doom and gloom. Part of this is due to the funding shortage and part of this is people reflecting a little harder on why they might be releasing money and whether it is necessary or appropriate. However, in the longer term releasing equity will be a valuable source of funds for us or our children and the present situation may even force lenders to become more mainstream and more attractive to potential customers.

Savings on deposit now seem to be sorting themselves out following government intervention and so for the risk averse they are a sensible place to invest (as is National Savings for the really cautious). However, investors should always look hard at where they are investing and the nature of the guarantees involved. Two old adages come to mind. "Don't put all your eggs into one basket" and "if a return looks too good to be true it probably is".

Managing the process

In summary, what are the messages for our retirement planning in the current economic climate? Firstly, life goes on and we must still consider how we are going to finance our later years. Almost certainly we will be working longer than maybe we had anticipated, although not necessarily in a full-time capacity. But we will be living longer - so it's not all bad.

There are still only relatively few ways available to accumulate enough wealth to retire on, unless we are prepared to invest in, say, paintings and antiques and so it is in all our interests to ensure that a stable, transparent, fair and honest financial market exists. As citizens we must demand this.

Whether or not we believe our jobs are safe, now is definitely the time to batten down the hatches and draw in our horns. Cutting back on expenditure to preserve funds for current needs and for future savings should be high priority until we see what eventuates. More and more we must realise that we enter the world with nothing and we leave with nothing, and it is up to us to manage the process financially, socially, health-wise and work-wise. There will be millions like us and a smaller and smaller proportion of younger working people in the economy to support us. The state will just not be able to pay for our aspirations in terms of pensions, health and care costs.

If we want to have a comfortable, meaningful and healthy old age we must look after ourselves. Just as moderation will help us to maintain our health so we must take a balanced view towards our finances. Taking a hard and realistic look at the overpriced designer goods we might have our eyes on, living within our means, and squirreling something away for the future will go a long way to help.