Smart investment moves for smoother transition to retirement

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The years leading up to retirement can be anxious and exciting at the same time. After years of plugging away at a job, it's nice to think about having your days to yourself and being able to pick up and travel as you desire.

But to achieve the latter, you'll need a healthy level of retirement planning and income. In fact, you'll need a solid amount of income to support not just leisure spending, but your essential bills, from housing to food to healthcare.

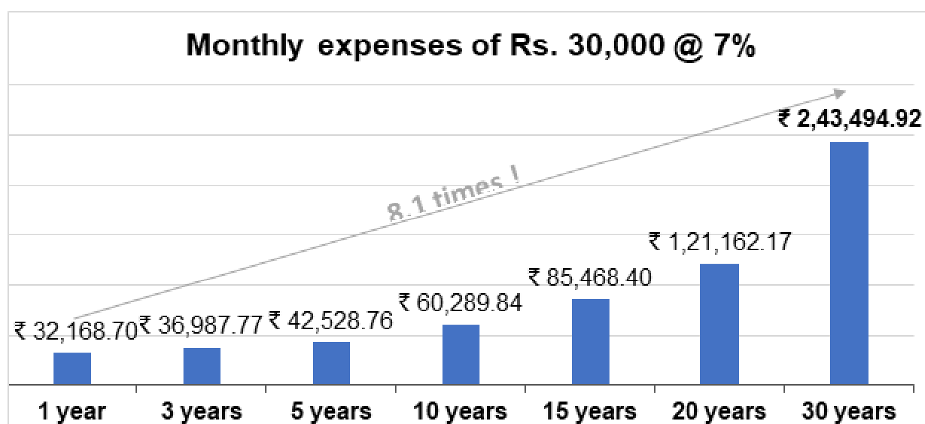
WHAT IS RETIREMENT PLANNING?

Retirement planning is a process of creating a suitable retirement corpus to take care of retirement expenses comfortably. It is also devising withdrawal strategies, so that necessary expenses can be comfortably taken care of, without negatively impacting the retirement corpus.

Let's explore the importance of retirement planning.

Rising expenses of lifestyle: Considering the current annual inflation rate, certain amount of expenses are expected to increase to a new higher amount in future. An investor's retirement kitty will have to grow at a rate which is high enough to factor in the rise in living expenses.

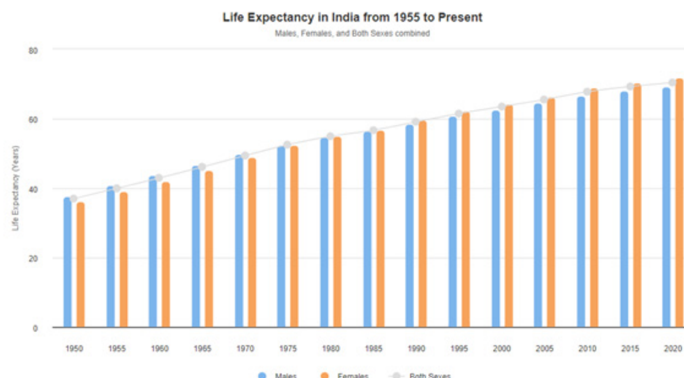
Work out the inflation adjusted value of your monthly spends



The above example is for illustrative purpose only

Span of retirement: With improved healthcare delivery and higher economic growth, Indians are expected to live longer. According to World Health Organisation data, the expected lifespan of an average Indian is ~68 years at present and is expected to rise in the coming decades.

Life Expectancy Trend in India



Trends show that over the last decade, with improved access to healthcare and medical advances, many more people may live up to 20 or 30, or more years post-retirement than ever before.

Nuclearisation of family: Indian households are becoming more nuclear; the average number** of people in a house have decreased to less than five from over five a decade ago. This means that most retirees are expected to fend for themselves rather than look at the traditional joint family system.

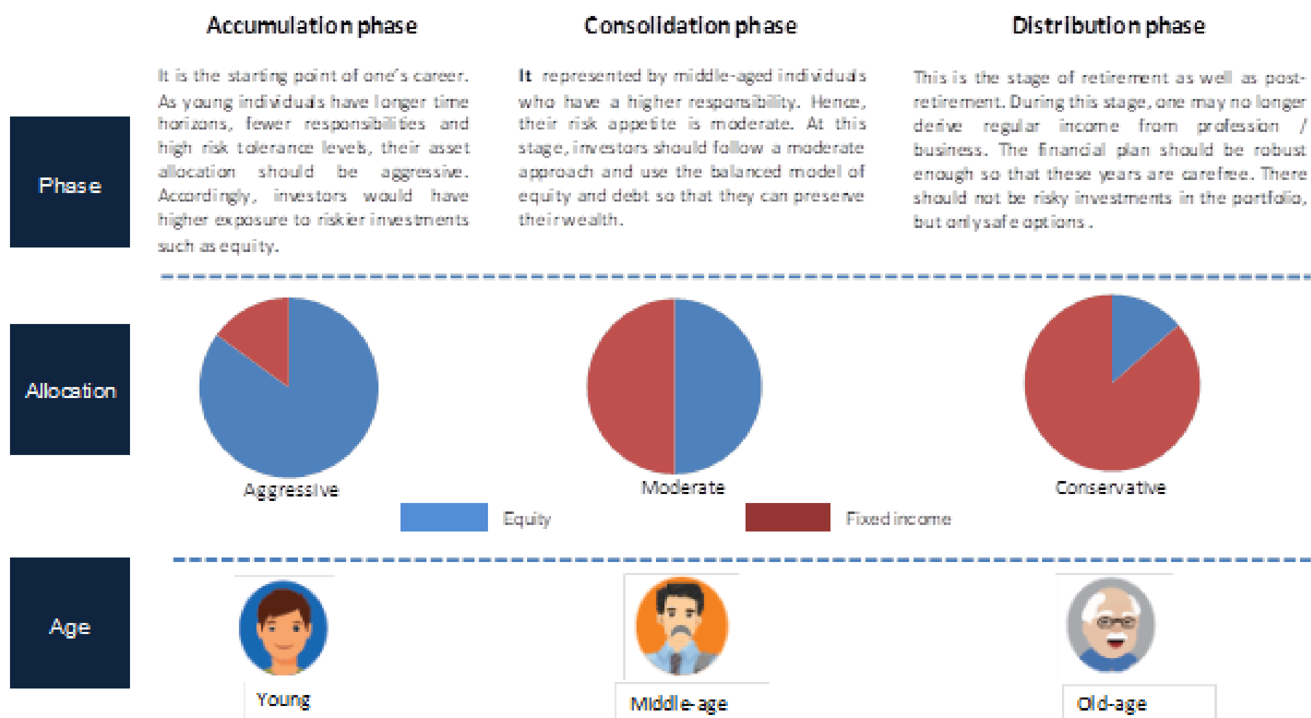
Working out post retirement income needs: Make a list of all retirement expenses in the order of priority one by one.

a. **Running Expenses:** Utility, Grocery, Internet, Subscriptions (Digital Streaming, Mobile Connection etc.)
b. **Health Care Expenses:** Medicines, Hospitalization expenses
c. **Create a Contingency Fund:** Unplanned expenses/ Unforeseen events, Medical Emergencies
d. **Discretionary Expense:** World Trip, Destination Wedding of Children, Golf and Club Memberships

THREE PHASES OF RETIREMENT PLANNING

To optimise the retirement planning process, investors must follow a glide path wherein allocation to equities is gradually reduced with the advancement of age. This maps the reduction in risk appetite accurately with the change in invested asset class.

This is also known as lifecycle-based investment, wherein the retirement planning is split into three phases - accumulation, consolidation and distribution



During Accumulation stage, the focus should be on growth-oriented products. As the individual comes closer to retirement, the portfolio should be periodically rebalanced, to shift away from risky assets to less risky ones. This protects the portfolio both from end-point volatility and value erosion.

	Years to goal	Equity Allocation %
TODAY	10	70%
After 5 yrs	5	60%
After 7 yrs	3	40%
After 9 yrs	1	10%

During the consolidation phase, it usually makes sense to shift asset allocation mix so there's less exposure to investments that may be more volatile in the short term and more exposure to those that generally have less volatility, such as fixed-income investments (like bonds) and cash equivalents.

Once an investor enters the distribution phase, she/he should probably adjust their asset allocation again. Traditionally, many retirees have shifted the bulk of their retirement portfolios to investments that generate current income they can tap to support their retirement lifestyle while preserving their principal.

So, how do you make sure you're on the right path towards creating that ideal financial future?

There are several ways to build that nest. List down your expenses in order of priority and cover them one by one. You may not have a steady income, but you can live your post-retirement life, the way you want to. Be it your child's destination wedding, a world tour with your wife, owning a beach house or having your own organic farm. You can plan for each of this luxury, if you plan early. Have a timeline for all such events. Designate a budget for every expense.

Here's a checklist to follow to keep you on track when nearing retirement via mutual funds. Build independent portfolios for equity and fixed income instruments and give the equity assets sufficient time to stabilize.

MITIGATING THE SHORTFALL RISK USING BUCKET STRATEGIES

Dividing up the retirement period into different short, medium- and longer-term time frames, and investing in different types of asset classes & products for each specific time frame.

Bucket 1 is for emergency expenses upto 1-year, anticipated health expenses not covered through medical insurance & any other critical expenses – EMERGENCY BUCKET

Only for medical, emergency, and other critical emergencies & unforeseen events and not for other expenses

- These funds can be held in the form of cash, and cash equivalents or liquid securities.
- Possible investment avenues:
  - Overnight Funds, Liquid Funds, Ultrashort Duration Funds, Money Market Funds,

Bucket 2 is for running expenses that will be incurred beginning with a time frame of 1-3 years

Possible investment avenues:

- Low Duration, Short-Duration Funds, Banking & PSU Funds, Conservative Hybrid Funds

Bucket 3 is for running expenses that will be incurred beginning with a time frame of 3-7 years

- Possible investment avenues:
  - Duration Funds, Dynamic Bond Funds, Moderate/Aggressive Hybrid Funds, Large Cap Oriented Funds, Index Funds

Bucket 4 is for expenses required from 7 plus years onwards. Equity oriented investment has the potential to outpace inflation and aim to generate wealth over the long term

- Possible investment avenues:
  - Multi Cap Mutual Funds, Mid & Small Cap Mutual, Thematic Funds

Systematic withdrawal plan (SWP) and dividend option are two ways of generating regular cash flow from a mutual fund without exiting the scheme completely.

Systematic Withdrawal Plan (SWP)

- A Systematic Withdrawal Plan or SWP allows investors to withdraw a fixed or variable amount from their mutual fund scheme on a present date every month, quarterly, semi-annually or annually based on their needs.

Partial exit load waiver

- Most mutual fund schemes offer an option where upto 10% of the units can be redeemed without any exit load every year under the partial exit load waiver.

Tax efficiency

- Systematic withdrawals may offer tax efficiency in the form of lower net tax as the load free units (LFU) redeemed will be liable to short-term capital gains tax only to the extent of capital appreciation in the NAV of LFU.

Dividend Option of Mutual Fund Schemes

- Mutual fund schemes may distribute profits to the unit holders as dividends from time to time.

Investors must pay tax on dividend income from 1st April 2020

- Dividends obtained from a mutual fund used to be tax-free for investors until 31st March 2020 (FY 2019-20). That was because the company declaring such dividend already paid dividend distribution tax (DDT) before making payment.
- However, as per the Finance Act, 2020, all dividend income received on or after 1st April 2020 is taxable in the hands of the investor. The DDT liability on mutual funds stands withdrawn.

PRIME 30 YEARS

CONCLUSION

Retirement planning is something that should be started as early as possible. In the case of long-term plans like retirement, the real rate of return depends on multiple financial factors such as inflation, interest rates, rising medical costs, etc.

For retirees, making the best use of their retirement corpus that would help keep tax liability at bay and provide a regular stream of income is of prime importance. Therefore, it is always advisable to consult a financial advisor. A certified financial advisor can help you map out a plan to ensure that you have the resources needed to support yourself during retirement.

Source – Bloomberg, CRISIL, HSBC MF

*** According to Census 2020 data*

An Investor Education & Awareness Initiative

Investors should deal only with Registered Mutual Funds, to be verified on SEBI website under Intermediaries/Market Infrastructure Institutions". Refer to www.assetmanagement.hsbc.co.in for details on completing a one-time KYC (Know Your Customer) process, change of details like address, phone number etc. and change of bank details, etc. For complaints redressal, either visit www.assetmanagement.hsbc.co.in or SEBI's website www.scores.gov.in. Investors may refer to the section on 'Investor Education' on the website of Mutual Fund for the details on all 'Investor Education' on the website of Mutual Fund for the details on all 'Investor Education and Awareness Initiatives' undertaken by the AMC.

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