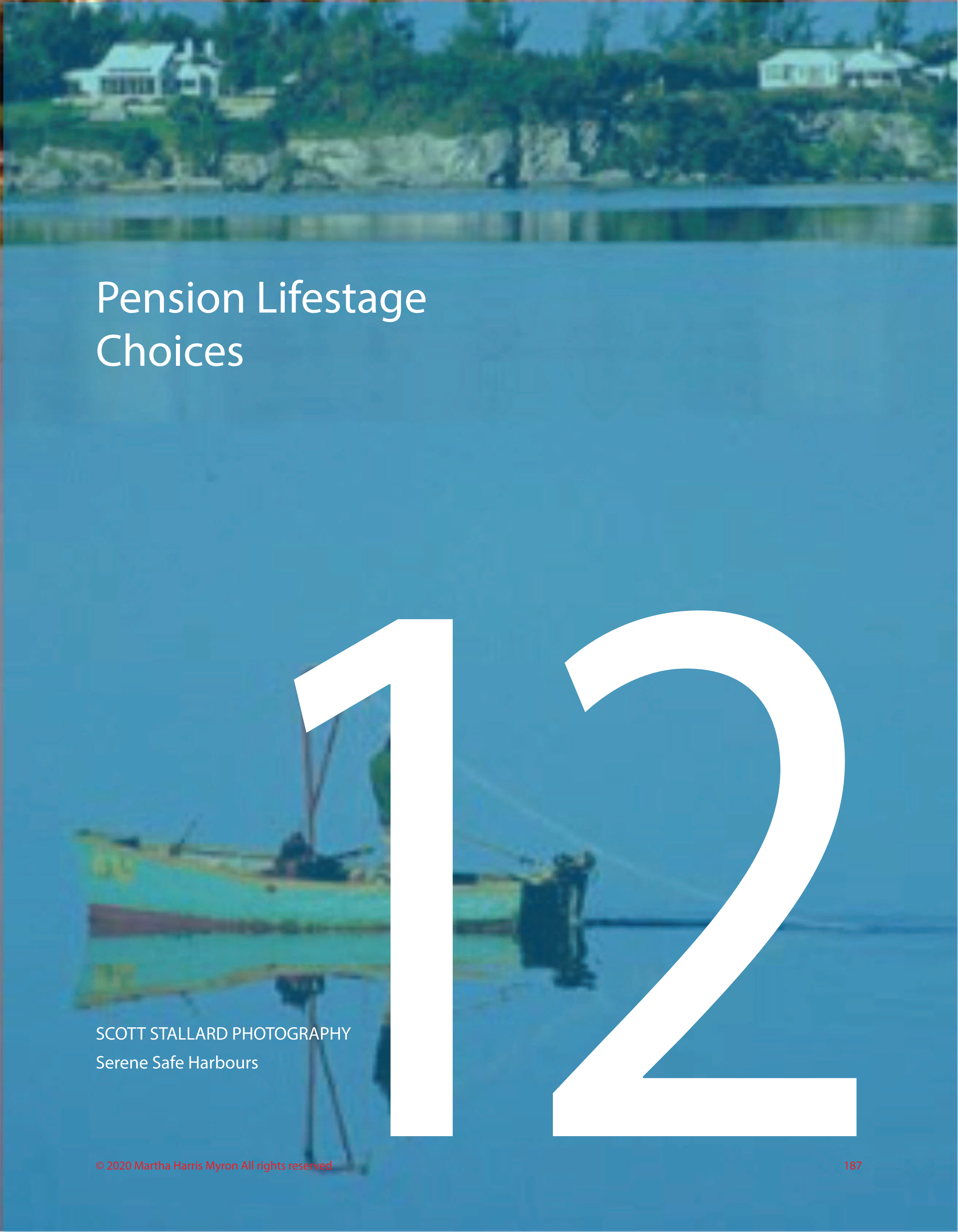
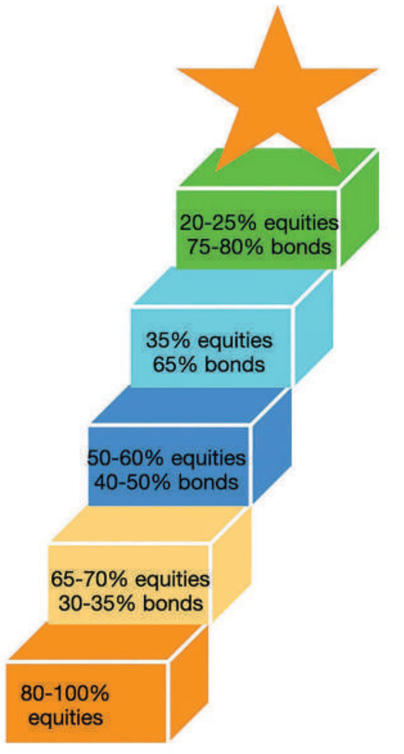
Pension Lifestage Choices

12



SCOTT STALLARD PHOTOGRAPHY
Serene Safe Harbours



INVESTMENT ALLOCATIONS PLANNING
STEPS TO RETIREMENT

YEARS to RETIREMENT

RETIREMENT pending! Revisit all allocations in your portfolio.

- 2-4 years of living expenses in cash or low risk, safe money market funds
- Mortgage must be paid off
- Line up part-time work
- Redo retirement calculator with new information
- Gradually reduce equity, and more risky exposures – you can always reinvest later when retirement financial picture is clear
- Assess capital market conditions at least a year before retiring - to be sure when you cash out that you are not selling at a low valuation point!

05-10 YEARS to go

Take position for preservation of capital (shorter-term bonds, money market funds, term deposits), along with building a cash cushion and focus on financial independence, e.g. pay down mortgage, but you still need a percentage in appreciating equities. This time may also be your very best earnings years, allowing significant additional savings/investments. You will need the extra capital as you may be in retirement a very long time, in some cases longer than your entire career.

10-20 YEARS to go

Time to lighten up a bit on more risky investments. Pay real attention to your work environment. You are now approaching your best earnings years, but also vulnerable to industry changes and repositioning. Upgrade skills. Initiate proactive healthy lifestyles. Capitalise on your expertise and experience.
Save, invest in appreciating assets.

20-30 YEARS to go

Your proportional investment position can carry more equities if you have been able to reduce long-term debt to manageable levels. These years are also heavy in family responsibilities, elder-care issues,

30-40 YEARS to go

You can be more heavily invested in equities. This is your opportunity to grow your career and accumulate a significant portion of your life savings. **Go for it.**

Step Twelve - Pension Lifestage Choices

Pension Monitoring, LifeStage Choices, Annuity/Drawdown & Calculators

We are now at the process to review the performance of a illustrative selected pension account:

A. Monitoring the performance of a balanced pension fund;

B. Discuss Lifestage differences in allocations and rates of return for conservative, balanced and aggressive portfolio relative to your age and years of employment in the workforce;

C. Comparing your investment drawdown account versus the annuity pension choice;

D. Walk-through a couple of different retirement calculators to project some possible estimated amounts to expect for retirement.

Everyone, who invests, yes, even in one's pension, wants their investment to be the one where values only go one way – upward.

In other words, investments guaranteed to succeed that never, ever show losses. We cannot help wishfully thinking that such an investment utopia is really true, but this is not how capital markets and investment valuations work.

Investments in capital markets are subject to many oscillating variances and trends: interest rates, consumer drift (away from once-in-demand products), global currency fluctuations, political instability, consumer inflation, employment statistics, governmental firm hands – or not, credibility of security valuations, and so on. These often- unexpected variables can increase or decrease volatility on a short-term basis to affect the value of investments.

Pension fund management, generally, is geared toward much longer timeline environments. And, statistically, long-term stable investments and their indexes, for example, tend to appreciate upwards, albeit with short-term losses (on paper) along the way.

Feedback received over the years on pension investment activity goes like this: "Why do I, as an ordinary person, have to cope with all of these crazy terms, try to pick what I think is best for me when investments are so hard to understand, and then have to watch their performance run up, go down, and vice versa? Sometimes, I feel so helpless with so little control."

Then, some individuals may go on to say that they would rather have all of their cash in savings accounts – cause at least they know where it is.

Why does anyone invest in capital markets and its underlying securities, of all types?

- Cash in term deposits just may not accomplish the savings goals for many people, heavily dependent on prevailing market interest rates, and no excess appreciation - yet investments have done the job.

- Appreciation opportunity is significantly better, sometimes astronomically so, rather than placing pension funds into cash accounts, then eroded by inflation. Additionally, the universe of securities is full of diverse choices, allowing a portfolio manager to pick hundreds, sometimes thousands of small security positions over a very broad range thereby minimising the risk of loss.
- Stretching your purchasing power and beating inflation is critical for a satisfactory lifestyle. Your money needs to earn something (interest, dividends, capital gains) to outpace inflation in Bermuda, particularly, with the incessant increase in cost of living – and what you actually receive for each dollar you spend.
- Broad diversification (otherwise known as asset allocation) to spread out the concentration of risk with currencies, country-specific securities, businesses, and industries. Remember that local Bermuda investors concentrated in domestic investments experienced higher losses in security values than those in more diversified global investments during the ill-fated SUBPRIME capital market downturn of 2007-2008.

Your pension asset allocation is an integral part of your entire portfolio strategy.

Yet so many of us do not make the time to give these long-term accumulations the attention and the respect that they deserve.

Perhaps, it is because the money is unreachable, untouchable until retirement that we tend to be a 'tiny bit' **indifferent**.

As employees get closer to the golden handshake, pension accumulations should be scrutinised very closely indeed. If you haven't been paying much attention, and your final lump sum appears to be significantly less than expected, emotional behaviour patterns can override logic.

Sometimes too much so, with magical thinking, "if I just increase my asset allocation to more aggressive for the next couple of years, I will have the amount that I am counting on for the big day."

It does not always work that way.

If you are lucky and the investment gods are with you, you may cash out a huge winner; but in the short term, you have a random chance that the market could stall out just around that happy lifestyle change. Even if the investment market is kind, you could have a lovely sum to retire on, only to realise that in a low interest rate environment, your annuitisation distribution formula for the rest of your life will be nowhere what you thought it would be.

An appropriate asset allocation for you is truly critical for a well-balanced portfolio.

Regrettably, we have had the truly tragic, recent COVID-19 Global Market Crash March 2020 where investors allocated strictly to stocks, and other more risky assets: emerging market and high-yield bonds, mortgage-backed REITS, ex-change-traded funds, any leveraged products, commercial paper liquidity problems, hedge fund issues, and many more, saw significant asset devaluations on paper and actual realised losses, if they cashed out.

Sovereign debt, particularly US Treasury issues performed at the top of the heap with unbelievably high price values and very, very unprecedented low yields.

And we cannot forget the tragic loss of lives due to this pandemic - the worst human and economic debacle of this century.

If you are completely turned off investment markets, your pension should be invested only in a cash product.

This means that you will have to save significantly more cash due to the low com- pounding interest rate environment – that seems to be staying for another significant period of time while economies begin to grow again - if experienced market pundit opinions and market watchers of the US Federal Reserve are to be believed.

And as I have stated before, investing in a GIC or like retirement product means that you have turned your pension monies over to the insurance pension administrator to manage for you. It also means that in order to return a decent interest rate, said pension administrator will have to invest in capital markets, generally high-grade bonds to achieve the savings rate. So, even though you personally are not in the market, your insurance company probably is. Please be sure to ask exactly what your GIC account contains in invested assets.

What is a pension fund generally comprised of?

Let's stick to a simple formula for now:

- stocks of large and small publicly traded companies (think Apple (APPL) and say Netflix (NFLX),
- bonds of sovereign governments, large and small corporations, etc. (think US Treasuries, UK gilts, Bank of America bonds, Deutsche Bank bonds),
- cash (generally, money market funds that can be converted into real cash).
- far smaller percentages may be invested in more aggressive securities (funds) such as real estate, commodities, hedge funds, and private equity. See balanced fund chart courtesy of About Money. http:// www.about.com/money/

A. Monitoring the performance of a balanced pension fund

How is my pension portfolio doing (and constructed)? It depends upon the pension administrator firm and its investment managers.

A balanced fund is very popular and is offered by Bermuda pension providers, along with conservative, capital growth, aggressive choices, etc.

Balanced fund risk is relative in that it is not too conservative, not too aggressive.

Composition of the balanced portfolio security holdings is focused generally around 50-60% stock and 40-50% bond positions.

See the pie chart example on PAGE 163

General Average Returns

Balanced mutual fund returns average 6.0%-7.5%. These numbers are based upon US mutual fund reports from various mutual fund firms, here displayed at beginning of STEP TWELVE are asset allocations from Vanguard.

Your pension returns may be more or less than the average, due to different fee structures and investment management style.

Conservative allocations will be lower than balanced.

Capital and aggressive portfolio allocations, generally, a higher concentration in equities will have a higher return (and a larger loss in a downturn) - remember: the higher the return, the greater the risk.

Your reward (rate of return) is based upon the amount of risk you are willing to accept.

More risk, more return.

- stock returns, generally, beat bonds
- bond returns beat cash
- cash is there for liquidity and expediency sake, possibly earning a little interest.

See average risk rating chart on page 165!

For a good idea on the differences in asset allocations, local balanced and other asset allocated mutual funds' fact sheets are provided by all eight investment firms in Bermuda. You can simply download the fact sheets and begin your comparisons.

However, it is worth noting that these average returns will now also reflect the coronavirus global capital market crises in March 2020 where returns overall were significantly lower until capital markets fully recovered - and they will if history lessons are true. Note, they have!

The Proper Asset Allocation Of Stocks & Bonds By Age

Conventional Model

Age	Stocks	Bonds
0 - 25	100%	0%
30	70%	30%
35	65%	35%
40	60%	40%
45	55%	45%
50	50%	50%
55	45%	55%
60	40%	60%
65	35%	65%
70	30%	70%
75+	25%	75%

Source: FinancialSamurai.com

B. Lifestage Changes in Pension and Personal Assets' Allocations

Your Quick Personal Financial Life Plan to Help with Your Asset Allocations

No matter your age, whether 22 or 62, develop a simple financial plan for yourself by using the following steps.

One – in monetary and emotional terms, define your goals, five, ten, fifteen, twenty, and further out if you can really stretch your imagination.

Two - consider your entire financial picture including items that could torpedo your financial success, such as helping your extended family with nursing home care, for instance. Remember that every financial decision you make, or ignore making, affects the rest of your finances. Maybe not now, but ultimately it will.

Three - Count your assets: what do you have, what have you saved, what do you owe, what do you think your earnings potential will be?

Four – assume only good debt, responsible debt, debt that will allow you to become financially independent. For good debt reading go to STEP Seven. Credit card debt may buy you what you want to make you feel good momentarily, but it will never make you rich.

Five – review your job and employee benefits. Look for opportunities to increase your skills and your compensation, then track your progress, year by year. Some sage advice: the moment you acquire a new job, you should be planning for the next one. Complacency cannot exist in this totally wired New World.

Six – start tracking what you are spending, then lay out a consistent savings plan for your outside cash, keeping in mind how much risk you want to take on to make this cash grow. Should you be invested in the same manner as your pension, it depends? You will need to make that determination after some serious investment research, but what an opportunity to learn!

Seven – review and learn to understand your pension asset allocations.

Eight - Review your individual investment outlook every five years or so as your career progresses, always with a view as you arrive closer to retirement to consider reallocating investments for capital preservation.

Individual Life Stage Asset Allocation Suggested Guidelines:

As individuals, each working age group has different needs, is in different life stages, has different conflicts and stresses getting along in this world.

Starting with young careerists (22-35), the demands of everyday life are diametrically devoted to the present. Middle to old age might as well be a remote wilderness when one is young. Young careerists can afford to be more aggressive with their portfolio; older workers who have scrimped and saved have to think about preserving their capital.

How should you allocate your pension dollars? Not sure? This is a hint to encourage you to learn all you can about investments. Try www.financialsamuai.com a real common sense approach to investing and finance and www.investpedia.com, a bit more sophisticated, but excellent teaching website for the beginning investor.

Why should you invest at all?

Why not just put your money in a Guaranteed Investment Certificate (GIC) choice?

Nothing wrong there if you are extremely conservative. But consider this. If you cannot access your pension for 40 years wouldn't you like to see it grow faster than the rate of inflation over that time frame? Cash and near cash for the most part will not outperform inflation and keep pace with your purchasing power.

Keep in mind also that even your GIC is invested in capital markets - completely managed by your pension administrator/ provider.

C. What Will Your Distribution Choice Be? Drawdown account vs annuity pension choice

What is an annuity?

One of the options upon retirement and the retrieval of your accumulated Bermuda National Pension invested capital is a plain vanilla annuity; that is a series of immediate payments for a set number of periods or for life, guaranteed by the annuity issuer, usually an insurance company.

How is it constructed?

From a layman's perspective (the math equation is more complicated), it is actually fairly simple, and it looks like this. We will use the example of a then 45- year old individual who started with the Bermuda National Pension plan in the year 2000, and will fully retire in 2020 with an estimated $100,000 pension benefit.

This number was arrived at as follows.

- Salary $50,000 per year.
- Her employer started with a 1% contribution and a 1% employee match that was raised each year until the contribution and the match hit 5% for both participants.
- Thereafter, pension contributions continued at 10% of salary every year.
- We also assume that the salary remained the same over the demonstrated time frame, even though it is a given fact that generally employees receive salary raises, possible bonuses, etc.
- There is some luck involved, as in this current pandemic environment, this individual still has full employment. Certainly, the numbers would be different in a job change, been made redundant, or had other contributing factors that lessened the total contributions over time.

Readers will note that while this pension is invested in the Balanced Asset Allocation, we have not counted that investment growth percentage over the time frame into the equation – just to keep the computation simple. Capital markets are uncertain. Different pension portfolio managers may achieve different results over the same time frame even with a similar asset allocation mandate.

The Next Step in Choosing the Pension Pay-out Option

We know what the total pension accumulation is and must now make a decision on how to receive this monthly pension.

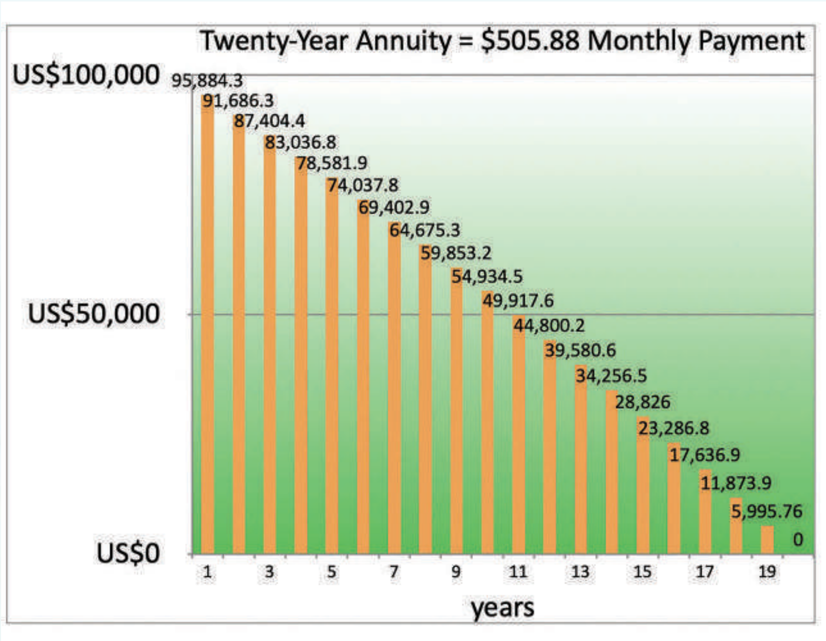
Currently, there are two options to choose from.

- The first is the traditional annuity. Her total accumulation, possibly less a 25% lump sum cash pay-out will be converted to an annuity (monthly payments for a certain time frame) along with a current interest rate amount attached, and a fee charged from the preferred pension provider for guaranteeing/managing the payments for the time prescribed.
- The second is a drawdown account (pension portfolio remains fully invested in capital markets) where the percentage payment (generally around 4%, annually) is mathematically calculated based upon general mortality tables and other criteria.

While the choices may seem easy, in order to truly choose the right options for her retirement, however, it is extremely important to understand the individual's complete personal financial profile and how these monthly payments fit in the picture.

Illustration of a Generic example of an immediate annuity.

Our illustrative person may receive more of $100,000. 20 years monthly 2% interest



Your Pension May Represent a Quarter of Your Total Financial Retirement

Will it become one quarter of the retirement quadrant along with a home owned debt-free, a steady income, and other capital asset appreciation to control inflation for the future.

- Are the recurring payments needed immediately, or can they be deferred?
- What time frame should be chosen for annuity payments: five years, ten years, 20 years, a monthly payment for the rest of natural life? What will the differences mean for this individual's annual budget?
- Should the entire sum convert to an annuity, withdraw 25% lump sum, or be left in the investment portfolio (a drawdown account) where it will continue to appreciate, or possibly depreciate at times?
- Taking the annuity solution passes the risk of continued payment to the insurance company.
- Leaving the investment component intact under your asset allocation choice generates a continued exposure to capital market risk.
- How does insurance annuity issuer who now has your full pension accumulation invest the money to fund the annuity?
- What kind of fees do they charge?
- Are the annuity interest rates locked in, or are they adjusted according to market interest rate fluctuations?
- The annuity is guaranteed to arrive, month after month, year after year, but who will guarantee the financial strength of the annuity issuer if the company has financial problems?
- What happens if our person lives longer than the total accumulation?
- Who is working with our person to construct the drawdown investment product and what is their experience and background?

It is important to also note that under the amendments to the Bermuda Investment Act that every pension representative in the pension provider product chain has a fiduciary responsibility to be sure that the recommendations for you are appropriate, and suitable for your personal financial profile.

What Are the Differences in Our Illustrative Pension Pay- out Choices?

The Annuity Set-up Factors

- the accumulation amount
- current market interest rate, can be high or low
- term choices: 5yr, 10yr, 20yr, for life
- administration fees
- foreign currency purchase tax conversion from USD back to Bermuda dollars, appears to be exempt for government, but there may be a fee by the local pension / bank administrator
- an annuity is a legal contract – once signed, there is no reversal

The Drawdown Set-up Factors

- the accumulation amount
- investment asset allocation choice
- investment account
- drawdown percentage per year, may generally be around 4%, annually, divided into twelve monthly payments
- investment values subject to capital market activity
- may be converted to an annuity later on

Which Pension Distribution Choice Is Better?

There is no correct answer. The final choice will depend upon various investment and personal criteria. In other words, assessing this soon-to-be retiree's complete financial picture.

*Current interest rate applied to the initial annuity conversion value – if very low, by the time administrative fees, etc. are calculated, the additional interest income generated will be depleted by the fees. An annuity is generally not recommended in this circumstance, but other factors such as the immediate need for a distribution, or fear of losing value in capital markets may override low interest rate consideration.

*Capital markets are subject to risk and volatility. The pension may continue to appreciate in value, even with the annual drawdowns, or lose such value that it never recovers.

*Serious thought and comparison between the two choices must be taken. The soon-to- be retiree should evaluate the choices based upon what-if situations and her remaining financial assets and liabilities; it is recommended to work with your pension administrator who can calculate your pen- sion payouts based upon your accumulated pension value, a more accurate solution.

- Another Explanation of Annuity Structures: Financial Consumer Agency of Canada
- Mycalculators.com
- Retirement Withdrawal Calculator

D. Walking-through a couple of What-If retirement calculators to project possible estimated amounts to expect for retirement.

The BallPark Estimator. The Ballpark E$timate is an easy-to-use, interactive tool that helps you quickly identify approximately how much you need to save to fund a comfortable retirement. The Ballpark E$timate takes complicated issues like projected Social Security benefits and earnings assumptions on savings and turns them into language and mathematics that are easy to understand. This is a US-based web- site, you can ignore the tax inputs at zero. https://www.choosetosave.org/ballpark/

Financial Independence Retire Early. FIRE- Calc®: How long will your money last? The big question:

"With what you have today, and what it costs you to live, can you retire and maintain the same life-style?

Ball park estimator -ASEC

RISE Retirement Income Security Evaluation Score™ by non profit Alliance for Life-time Income - take the retirement readiness test.
https:// www.protectedincome.org/retirement-tools/rise-calculator/

Warning: Pension Taxation Complexity for Multinational Individuals.

See also STEP EIGHTEEN Pondstraddler International financial planning for US citizens working and residing in Bermuda, Bermudians with dual citizenship with the United States, green card holders and foreign nationals who are US residents for income purposes. Conversion to purchasing foreign annuities or attempting to roll foreign pensions into US pension / annuity type plans (won't happen) are decisions that may be saturated with current and future United States tax implications and complications, as well as other countries.

In this viral US Internal Revenue Service, and US Treasury global compliance environment, every financial strategy has significant tax outcomes.

Do not even consider making this decision without consulting US tax practitioners / financial planners with international investment, tax and pension experience. This is a minefield that could have you caught in compliance reporting loops, with significant tax liabilities long after your local pension decision was implemented.

Who can you seek recourse from then?

Multinationals with burdensome tax compliance with other countries need to feel comfortable with the level of sales representative expertise in tax, investments, and pension portability challenges.

Exhibit Examples of annuity payments, drawdown calculations and retirement calculator models are hypothetical - for illustrative purposes only. These hypothetical illustrations cannot, nor should not, be used for your own personal financial retirement situation.

[Listen to Part 1 - Pension Life Stages](https://tinyurl.com/yztg66mh)

https://tinyurl.com/yztg66mh

[Listen to Part 2 - Pension Annuity - Drawdown Comparison](https://tinyurl.com/ye4be76q)

https://tinyurl.com/ye4be76q

References & Resources

Investopedia

360 Degrees of Financial Literacy. American Institute of CPAs

My calculators.com Home of Many Financial Calculators

Financial Samurai. The Proper Asset Allocation of Stocks And Bonds By Age

Don't panic over your pension fund Martha Myron, Moneywise April 11, 2020 The Royal Gazette