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Managing retirement income in a crisis

Ancient Rome is an unusual source of inspiration for surviving a financial crisis, but those in retirement considering selling risk assets – and particularly equities – might want to pause to think about Marcus Licinius Crassus.

Crassus was the wealthiest man in Rome. Much of his wealth came from his unusual model for building a property portfolio. Rome did not have a fire brigade. Crassus did – staffed by slaves (which was his other line of business). When a property was ablaze Crassus would rush round with his slaves and offer to buy it – and neighbouring properties – at 'firesale' prices. If they declined he let the houses burn down so that they became worthless.

There will be many people who have had their fingers burned in this crisis who will be forced sellers. If you join them at this point you will get a firesale price.

That poses a challenge for the growing number of people in retirement who have chosen not to buy a low-paying annuity and opted instead to draw regular income from their investments in what is known as 'pensions drawdown'. The danger is that these people are hit by the phenomenon of pound cost ravaging – to maintain your income you have to sell more units of equities when their price has fallen, but you then undermine the ability of what is left of your portfolio to recover.

This is a growing problem. Historically, many savers liked to live off the income from their shares and not touch the capital, which they saw as their legacy pot.

As interest rates and dividend incomes have fallen in the past decade, this approach has encouraged some investors to opt for high-yielding shares and to miss out on areas of the market that offered growth but little income. For example, during 2019 the total return from Microsoft was around 51% in sterling terms. Of that return, just over 1% was dividend income; the rest was capital growth. BP, which many see as a classic income stock, yielded around 6%, but its total return was just over 1%. Savvy retirees invest instead for a combination of growth and yield and draw down income from a mixture of capital and dividends.

Unfortunately, that strategy now leaves you most vulnerable to pound cost ravaging. You have a combination of four alternative income sources.

The first is cash. We advise clients who have secure incomes – from annuities or final salary pension schemes – to keep six months' worth of income in cash

for emergencies. But if the bulk of your income comes from drawdown then we suggest having two years' supply, which you can access in times like this to take the strain off your portfolio. This is the time to dip into that pot.

If you have to sell assets within your portfolio then the sensible strategy is likely to be to sell the most liquid assets first. This means things like bonds and treasuries.

Within your portfolio your shares will still be yielding dividends. Some will be unsustainable and there may be some corrections ahead, but most portfolios will still generate a couple of percentage points of income. If you can avoid drawing on this income and use it instead to reinvest in shares – switching income funds to accumulation funds that do this automatically for you, for example – you should be in a stronger position in the recovery.

The fourth option may sound drastic. In some cases it might be worth considering whether to borrow. If you have property behind you and plenty of assets in illiquid form then it could be reasonably cheap to take out a loan. Figures from A J Bell show that since the inception of the FTSE All-Share in 1962 there have been 10 bear markets. Their average duration has been just over a year, and the average drop has been 36%. Just be aware that the recovery from this recession may be slow, so there is a risk of this loan lasting longer than you expect. Only take this option if you and your adviser feel there is a reasonable probability that the loan costs will be more than covered by the gains of your shares when they recover, and that you are comfortable with the risk.

There are other steps you can take in this current market, not least to tighten your belts and delay discretionary spending. Many of us will be postponing things like a car purchase or a new sofa. I would only point out that now (or when the shops reopen) is arguably a time to spend if you can afford it – as a public duty to support businesses that are going to struggle.

Finally, a word for those who are looking to give away wealth. Although you should not overstretch yourselves, this could be a good point at which to pass wealth on. The optimum time to trigger Capital Gains Tax is when your assets have shrunk in value. And potentially exempt transfers will be lower at current prices, too, which may reduce Inheritance Tax liabilities for your loved ones.

Whatever you do, talk to your adviser to ensure you are taking the right steps to protect your portfolio in this tricky time and taking advantage of any opportunities for smart wealth planning.

And if this is leaving you feeling panicked then I end with another unlikely source of inspiration – the words of Eeyore: "The nicest thing about rain is that it always stops. Eventually."