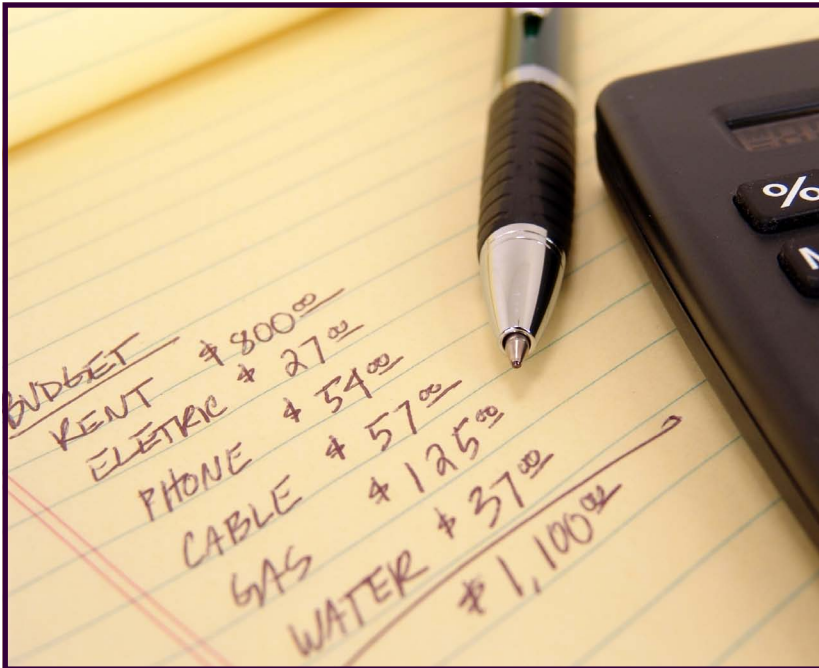

FINANCIAL PLANNING IN A TIME OF LOW YIELDS



MODERATE OUR EXPECTATIONS AND ACCEPT THAT THINGS HAVE CHANGED AND ASSET RETURNS ARE LIKELY TO BE LOWER FOR A PERIOD OF TIME.

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For many retirees or conservative investors who are relying on interest from fixed deposits as a primary source of income, the present low level of interest rates poses the problem of generating insufficient income. This is especially so in the recent past, when deposit rates have dropped to close to zero even as the cost of living has started to rise.

So what has accounted for the low level of interest rates despite the strong economic growth that we have seen in Singapore? Why have not deposit rates risen even as inflation has picked up? As the chart shows, short term interest rates in Singapore are not so much influenced by domestic growth and inflation. Rather, interest rates here track the movement of global interest rates, almost always staying below US interest rates, given the openness of our economy. As the US cut interest rates to almost zero in the wake of the Global Financial Crisis, local interest rates have followed suit and stayed down. With the US Federal Reserve embarking on its second round of quantitative easing, it

is likely that local interest rates will stay low for some time even in the face of higher inflation. MAS looks to keep inflation down by strengthening the Singapore Dollar and this trend is likely to continue this year.

THE INVESTMENT RESPONSE

What are some of the alternatives to fixed deposits for the conservative investor in the environment of low interest rates?

Invest in short term, currency-hedged bonds

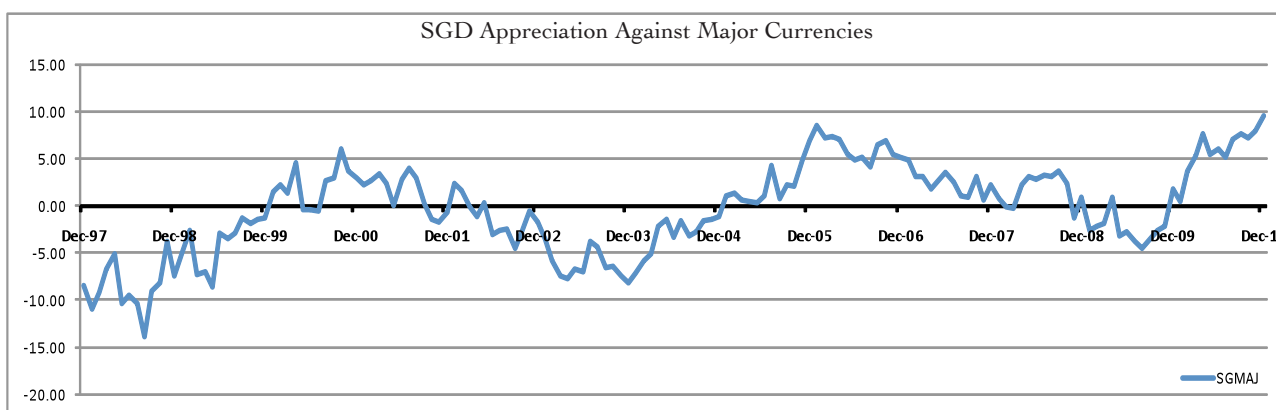
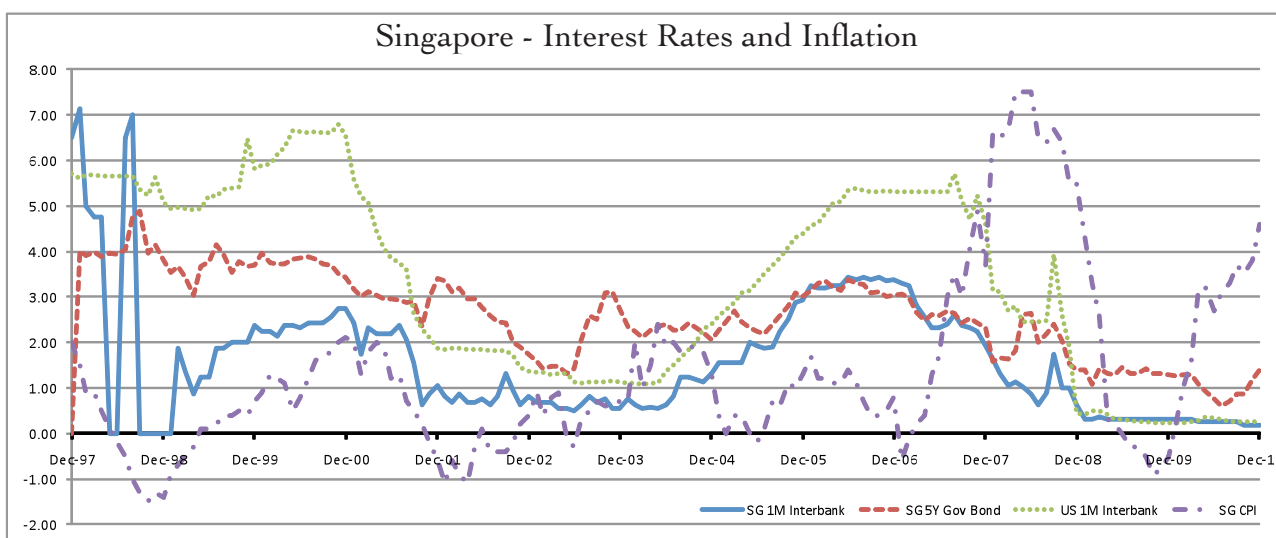
“The best time to invest in bonds is when yield levels are high and falling. The next best time is when yield levels are simply high.” The present situation of low interest rates obviously does not qualify as one of those times. However, for a conservative investor looking to enhance returns, an investment in bonds may be a better choice than staying in fixed deposits. Through investment in bonds, an investor can increase the yield he gets in two ways:

taking on credit exposure, and extending maturity of his interest rate exposure. By taking on credit exposure, say through investing in corporate bonds, an investor can increase the yield he gets since credit exposure offers an additional yield called a credit spread. Extension of interest maturity offers significant yield enhancement when the yield curve is steep. Investors should be aware that given the already low levels today, the next move in interest rates is likely to be higher than lower, so investors should balance the enhanced yield with potential interest rate risk.

Moving away from deposits into bonds also

offers a greater choice of interest rate plays as different countries are at different stages of the interest cycle. Countries in the emerging markets have started to tighten monetary policy even as developed economies have refrained from such tightening. However, given that the Singapore Dollar is likely to strengthen this year, the investor should be careful in his choice foreign currency exposure, or should hedge such exposure back to the Singapore Dollar.

Short duration bond funds with a focus on achieving positive returns in Singapore Dollar terms would be a good choice for investors.



REITs

While REITs entail moving away from the safety of fixed deposits, taking some exposure to REITs allows for the opportunity for additional returns for the limited risk taken. A 10% exposure to REITs

in one's portfolio could contribute 0.5 - 0.6% to returns, while portfolio downside would be fairly limited even in an equity market downturn. REITs can offer some degree of protection against the impact of inflation on the purchasing power of one's savings, as REITs would appreciate in line with inflation.

REITS CAN OFFER SOME DEGREE OF PROTECTION AGAINST THE IMPACT OF INFLATION ON THE PURCHASING POWER OF ONE'S SAVINGS.



Take some market risk

Generalizing from the REITs example, identifying potential investment opportunities that are likely to do well in the current environment, for example agricultural commodities, but limiting exposure so as to control potential downside could enhance returns for the conservative investor.

THE FINANCIAL PLANNING RESPONSE

In this post-Financial Crisis period where economic growth are expected to be slower and asset growth smaller than in the past, what does it mean to the average Singaporeans who are planning for their retirement and for others who are already retirees?

Before proceeding into the financial planning responses, perhaps it is important to begin with this: moderate our expectations and accept that things have changed and asset returns are likely to be lower for a period of time. Hence if your financial plans were previously prepared assuming a high return projection for assets, it may no longer be realistic. The following are six possible responses to improve your financial plans.

Increase savings

This relates to accumulators who are still earning an income. Increasing saving is one of the surest ways to achieve your financial

goals. The more you can save the greater your flexibility to be risk averse in selecting investment options and hence higher certainty of achieving the amount you need. On the other hand, if your propensity to save is low, you would need to rely on the higher-risk investment to achieve your target amount, which implies higher uncertainty.

How can you increase your savings? Look at those discretionary expenses, like expensive vacations, electronic gadgets or that new car you are eyeing, and ask if you should do without or switch to less expensive alternatives. Not spending that one or two months' bonus is the quickest way to increase your savings.

Reduce consumption

For retirees the appropriate response is to trim living expenses during this period and adjust back when things improve. Otherwise, a high consumption rate when asset returns are low would cause the nest egg to deplete much earlier.

Delay Retirement

Those who are nearing retirement may consider delaying it by a couple of years to allow your nest egg to grow. Finding a retirement job may not be a bad idea too since it provides some social activity and the income to enjoy your golden years.

Paying Off High Interest Loans

Loans from renovation, hire-purchase and credit cards attract high interest rates. When investment returns are low, you should channel more money to pay down such loans first before investing.

Taking More Risk in Investment (as highlighted above)

You should discuss with your financial planner and assess if taking more risk on your investment is appropriate for your risk profile. It may be that things have changed in your need, ability and willingness to bear risk to allow for higher risk to get the return you need.

Finally, Review Your Financial Plan Annually

What the Financial Crisis reminded us is that the only certainty is the certainty of change. Things do change with time and

the right response is to recognise and adapt as early as possible. Financial planning is a process, not a one-time exercise. Hence it is necessary to review your plans regularly so that small painless adjustments can be made early to avoid the big surprises in the future.

In this period of possibly lower returns across asset classes, while adjusting your investment approach may help to mitigate it, we think it is more conservative to think that your overall investment returns may still be lower than what you need. As such, it is only prudent to make some adjustments to your financial plan. A suitable investment response, matched with the correct financial planning response is a surer way to reach your objectives.

THIS IS AN ORIGINAL ARTICLE WRITTEN BY PHOON CHIONG TUCK, HEAD OF INVESTMENTS, AND EDDY CHEONG, HEAD OF FINANCIAL PLANNING. THE EDITED COPY APPEARED IN THE BUSINESS TIMES (WEALTH SUPPLEMENT) ON 30 MARCH 2011 TITLED "MAKING THE RIGHT ADJUSTMENTS".
