Dealing with client portfolios in a low interest rate environment

Managing a portfolio for a new retiree in a low interest rate environment can be challenging - but there are ways to get results

May 2014 seems like years away now but it was at that point that fixed term deposits for less than one year had dipped below the four per cent mark and longer-term rates were receding fast.

So designing our usual bucket strategy for clients suddenly became a little harder and we had to look for opportunities to add yield where we could find it. Drip-feeding into a portfolio was going to make it even harder to meet targets when you are only getting 3.5 per cent for cash.

For new clients Colin and Margaret it came with a major change to their lifestyle as Colin was told by his specialist to quit working before health issues got the better of him. He ran a successful small business but put in long, stressful hours. Luckily he had planned [for his future] and his younger partner was now ready to buy him out.

After the sale went through, their accountant brought me into the relationship and we were tasked with investing $950,000 to provide a target income of $60,000 a year.

Seven hundred thousand dollars had already been invested in an SMSF but all on a platform and mostly in actively managed funds. Two hundred and fifty thousand dollars was outside in cash and term deposits.

We checked that no further lump sums, such as inheritances, were expected and agreed as part of our plan to keep the $250,000 in their personal names as a hedge against future government legislative changes to superannuation. We also got an agreement to take most of the funds off [the] platform to save on fees.

We moved the clients to pension phase immediately and set up a regular pension payment of $4,200 per month ($50,400 per annum) with the remainder of their target income coming from the cash earnings on the $250,000 held outside of super.

As Colin and Margaret were concerned about risking too much capital in the early years of their retirement we agreed on a drip-feed of the funds into investments over an 18-month period starting from 25 per cent growth and ending with 50 per cent growth assets by December 2015. We are now just over halfway so here is what we have done to date.

Portfolio design

Moving quickly we locked in some of our medium-term funds (1-5 years) in a range of term deposits using the Money Market Facility.

ANZ 4.65% TD (May 2019)	$75,000
ANZ 4.2% TD (May 2016)	$75,000
ING Direct 4.0% TD (May 2015)	$150,000

We put funds to be invested later in the strategy in the highest-rate cash products available.

ING Direct Business Optimiser 4.25% for 4 months (ended and switched to AMP Business Saver)	$100,000
ING Direct Savings Maximiser 4.35% for 4 months Personal Money (ended and switched to AMP Personal Saver)	$150,000
ANZ 4.2% TD (May 2016) Personal Money	$100,000

Here were the first set of investments made in May 2014 as part of the drip feed.

Property for income

BWP Trust @ $2.52	$15,000
Australian Unity Wholesale Health-care Trust @ $1.34 per unit	$30,000
HPI Hotel Property Inv @ $2.09	$15,000
Dexus Property Group Stapled @ $6.80	$10,000

Direct Australian shares and ETFs

Telstra Corporation @ $5.29	$20,000
Russell High Div ETF @ $29.64	$25,000
BHP Billiton Limited FPO @ $37.29	$10,000
APA Group Stapled @ $6.66	$10,000
Vanguard Aus high-yield ETF (vhy) @ $67.46	$30,000
Ishares S&P/ASX 20 ETF (ILC) @ $25.19	$50,000

International shares for growth exposure

ISHS Global 100 ETF @ $85.72	$20,000
Magellan Fin Grp Ltd @ $11.90	$15,000
VNGD US total market CDI @ $105.80	$25,000

The above investments formed the base of the portfolio and from there on we looked for opportunistic purchases over last nine months. We saw the launch of QVE by Investors Mutual and PIC by Perpetual as opportunities to access a drip-feed strategy run by quality managers in the Ex-20 ASX stocks where we believed there were still companies at or below fair value, but a manager would be better resourced to find them.

At our six-month review with the clients we were able to show progress towards meeting their goal of a steady income from the portfolio without taking on too much risk. They were especially pleased with the long-term term deposits as they could see the rates had now dropped and previously they had only ever considered six-month terms. We showed them the Top 10 holdings in each of the LICS and ETFs and they were well aware of 90 per cent of those companies, which added to their confidence in the portfolio.

We used funds that had been placed in ING Direct Business Optimiser accounts to fund these purchases after the honeymoon rates ended. We kept the surplus cash available in an AMP Saver account (via Australian Money Market) to pay regular pensions.

Drip feed investments

Genworth Mortgage FPO on IPO @ $2.65	$10,000
QV Equities Limited @ $1	$25,000
QV Equities Limited Options $0	$0.00
Perpetual Equity Ltd @ $1	$25,000

Perpetual Equity Ltd Options @ $0	$0.00
Medibank Private Ltd @ $2.00	$12,000

In December 2014 there was a slight shock after the review of research into hybrids and we felt they were a good buy so we added a small exposure to the portfolio. We were looking to add stable income and made it clear they carry additional risk.

ANZ Banking Grp Ltd Cap Note ANZPD @ $98.32	$10,000
Westpac Banking Corp Perpetual WBCPD @ $98.23	$10,000
Woolworths Limited FRN NOV36 WOWHC @ $103.73	$10,000

So nine months in to an 18-month strategy we have established a portfolio return of just over $40,000 income per annum and are less than 35 per cent allocated to growth assets (we treat hybrids as growth/aggressive assets). We are now exploring some additional corporate bond exposure via FIIG to add to the defensive sector as cash becomes available from TDs.

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Our portfolio has also had capital growth of over $50,000 so we are taking some profits by selling up to 20 per cent of our exposure to Genworth, Magellan, BWP, HPI and VTS. This will help us to reach our client's goal of $60,000 pension without eating into their original capital. We have explained to the clients that international equities do not provide very good dividends and as such we will take profits when available to add to income from these sectors.

Once the ING Direct one-year term deposit matures in May 2015 we will look to add further purchases to the portfolio.

We have no doubt that we have been fortunate that the Aussie dollar dropped and that there has been a chase for yield meaning that our investments in unhedged international investments, property trusts as well as blue chips like Telstra and high-yield ETFs have done very well. However these were part of a diversified strategy where we expected to receive some of these advantages. We have likewise taken a hit on BHP and some of the hybrids have struggled, but all are providing decent income.

Should the markets take a significant drop in the coming 9–12 months we have plenty of cash to take advantage of buying opportunities. Likewise PIC and QVE managers are still not fully invested and we expect them to add strength to the portfolio. If they outperform then we will exercise the options on those stocks to increase our exposure at the initial $1 cost and little or no additional risk.

The key has been to lock in longer rates, diversify and take tilts to sectors like international and property in the market that faced us nine months ago and look for opportunities as they arise to add income and growth potential at a fair cost. ●

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