MORNINGSTAR

Investing Compass





Is your ETF
at Risk of Failure?



4 Financial Ratios That Matter More
Than Net Worth



What Happens If You Lose
Your Job Tomorrow?



Wills and Taxes –
The Catch Most Australians Miss



Earnings Beat, Inflation Concerns
For The RBA



Why Isn't Vanguard the Cheapest
ETF Provider?

Available on all podcast platforms

Subscribe to us on /@morningstaraus

Important Information

© Morningstar, Inc. All rights reserved. Neither Morningstar, its affiliates, nor the content providers guarantee the data or content contained herein to be accurate, complete or timely nor will they have any liability for its use or distribution. No part of this document may be reproduced or distributed in any form without the prior written consent of Morningstar. This presentation has been prepared for clients of Morningstar Australasia Pty Ltd (ABN: 95 090 665 544, AFSL: 240892) and/or New Zealand wholesale clients of Morningstar Research Ltd, subsidiaries of Morningstar, Inc.

Any general advice has been provided without reference to your financial objectives, situation or needs. For more information refer to our Financial Services Guide at www.morningstar.com.au/s/fsg.pdf. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest.

This presentation may contain certain forward-looking statements. We use words such as “expects”, “anticipates”, “believes”, “estimates”, “forecasts”, and similar expressions to identify forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results to differ materially and/or substantially from any future results, performance or achievements expressed or implied by those projected in the forward-looking statements for any reason.

Our publications, ratings and products should be viewed as an additional investment resource, not as your sole source of information. Past performance does not necessarily indicate a financial product’s future performance. Morningstar’s full research reports are the source of any Morningstar Ratings and are available from Morningstar or your adviser. To obtain advice tailored to your situation, contact a financial adviser. Some material is copyright and published under licence from ASX Operations Pty Ltd ACN 004 523 782. .

Morningstar retirement bootcamp

Webinar 1 – Understanding the maths of retirement

Webinar 2 – Estimating how much you will spend in retirement

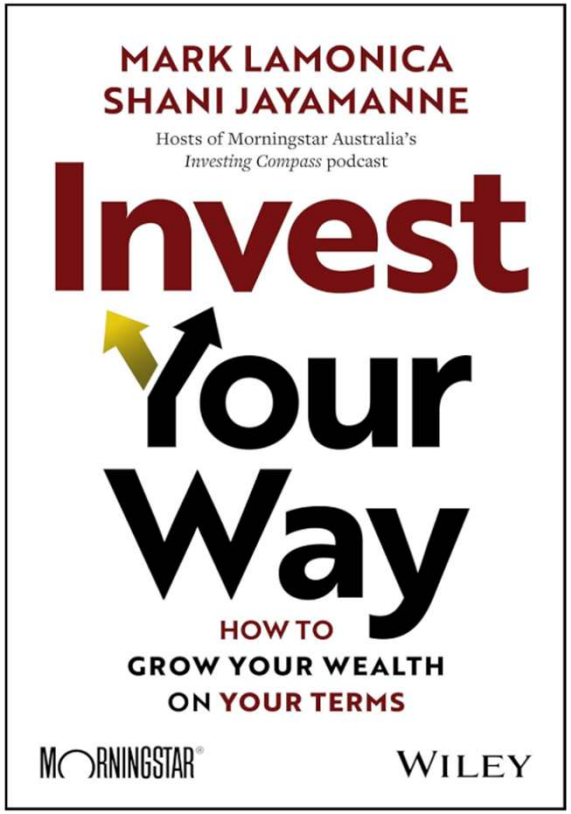
Webinar 3 – How much money you need to retire

Webinar 4 – Figuring out your retirement asset allocation

Learning objectives

Learn about creating a personalised withdrawal rate to estimate how much money you need to retire.

Getting the foundations right



- The biggest issue many investors face is undermining their own outcomes by letting emotions influence decision making and making mistakes
- ETFs exacerbate these tendencies given the ease of trading, the proliferation of new ETFs and compelling marketing based on recent performance
- The key is adding structure to decision making by establishing goals, setting an investment strategy and developing a process to guide decision making

MORNINGSTAR

Setting up a personalised retirement plan

There are several steps to set up a personalised retirement plan:

1. Estimating how much you will spend in retirement
2. Calculating the amount you need to retire by setting your personalised withdrawal rate
3. Defining a plan to hit your retirement goal by figuring out your savings target, asset allocation and investment strategy
4. Creating a retirement investment strategy including your asset allocation and spending plan

Estimating how much you will spend in retirement

Estimating how much you will spend annually is the foundation of retirement planning.

How much you need for retirement = **Your annual spending for your first year of retirement** ÷ **Your withdrawal rate**

An evolving goal is better than no goal at all. Even if you are far from retirement, it is worth coming up with an estimate and a plan. The plan can be adjusted as time goes on.

For people closer to retirement your estimate can get more specific.

Withdrawal rate considerations

Small changes make a big difference. Increasing your withdrawal rate from 4% to 4.50% increases annual spending by 12.50%.

Given the impact on a retiree's lifestyle from even small differences in a withdrawal rate it is worthwhile setting a personal rate which requires several considerations:

- Inflation
- Length or retirement
- Certainty of retirement
- Taxes

Withdrawal rate considerations: Inflation

There are two components of inflation to consider:

How your personal inflation compares to official measures:

Category	Share of spending
Housing	21.39%
Food and non-alcoholic beverages	17.44%
Recreation and culture	12.74%
Transport	11.45%
Furnishings / household equipment	8.02%
Health	6.73%
Alcohol and tobacco	6.58%
Insurance & financial services	5.58%
Education	4.69%
Clothing & footwear	3.25%
Communication	2.13%

High level categories of your spending between wants and needs:

- Needs: There may be little flexibility for spending on housing, food and medical care
- Wants: Greater flexibility and opportunities for substitution for spending on wants

Withdrawal rate considerations: Inflation implications

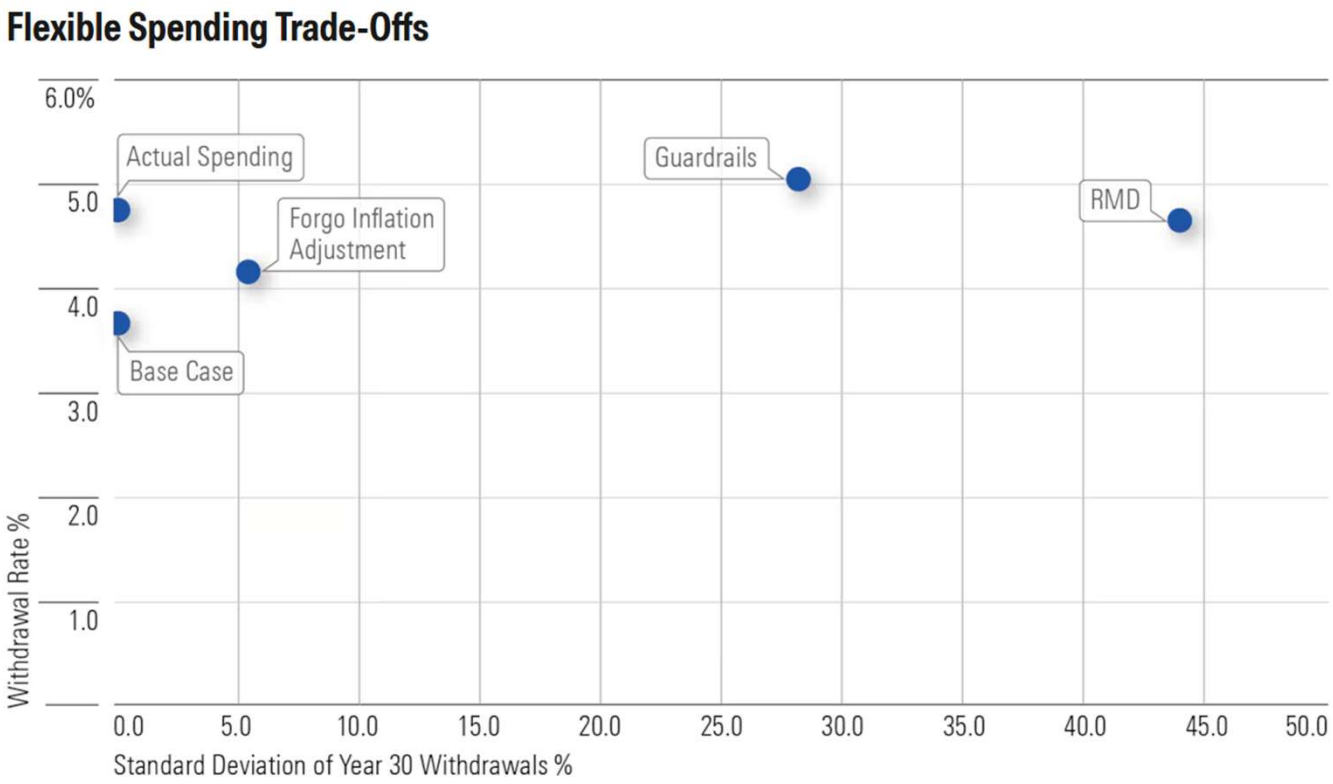
There are two components of inflation to consider:

The more your personal spending differs from the official spending categories the less meaningful inflation is to your retirement outcomes.

This may be an opportunity for a higher withdrawal rate by using a method that doesn't try and maintain real spending levels or a risk if category specific inflation impacts your budget.

Some retirees may want to put a higher withdrawal rate on wants than needs given the increased flexibility with that category of spending and the tendency for spending on wants to diminish with age.

Withdrawal rate considerations: Inflation implications



Source: Morningstar. Data as of Sept. 30, 2024. Data is based on a 40% equity/60% fixed-income portfolio with a 90% chance of success over a 30-year period.

Method 1: Forgoing inflation adjustments following annual portfolio loss.

Method 2: Required minimum distributions

Method 3: Guardrails

Method 4: Spending declines in line with historic retiree spending data

MORNINGSTAR®

Withdrawal rate considerations: The length of retirement

The withdrawal rate is linked with the length of an expected retirement. If you believe your retirement is likely to last more or less than the baseline 30-year retirement you should take that into account with your withdrawal rate.

I've run a scenario of a 75% share and 25% cash portfolio using a consistent real spending rate starting at a 4% withdrawal rate. The probability of success for different retirement lengths are as follows:

- 30 years: 90.85%
- 35 years: 87.91%
- 40 years: 84.50%
- 45 years: 82.07%
- 50 years: 80.78%

Withdrawal rate considerations: Certainty of retirement

It is easy to focus on the success rate of different retirement outcomes. But remember 'failure' takes the bad luck of retiring in poor economic conditions ***and not doing anything about it.***

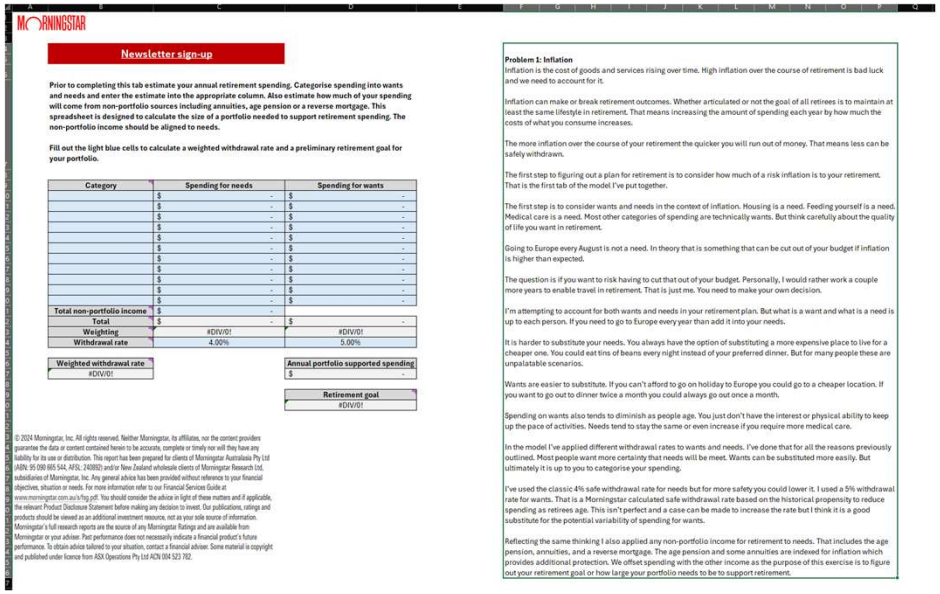
You can adjust your investment strategy, changing your spending and / or come up with ways to mitigate bad luck prior to retirement.

Withdrawal rate considerations: Taxes

This is only applicable if you retire prior to your preservation age. However, the 4% rule is intended for pre-tax withdrawals which leaves less to spend if taxes are applicable. If you retire early the new 30% minimum capital gains tax may make it more challenging to fund pre-preservation age spending.

Morningstar retirement model

I've created a spreadsheet that can help you model out potential scenarios and set a personalised withdrawal rate based on a series of assumptions.



MORNINGSTAR

Newsletter sign-up

Prior to completing this tab estimate your annual retirement spending. Categorise spending into wants and needs and enter the estimate into the appropriate column. Also estimate how much of your spending will come from non-portfolio sources including annuities, age pension or a reverse mortgage. This spreadsheet is designed to calculate the size of a portfolio needed to support retirement spending. The non-portfolio income should be aligned to needs.

Fill out the light blue cells to calculate a weighted withdrawal rate and a preliminary retirement goal for your portfolio.

Category	Spending for needs	Spending for wants
	$ -	$ -
	$ -	$ -
	$ -	$ -
	$ -	$ -
	$ -	$ -
	$ -	$ -
	$ -	$ -
	$ -	$ -
	$ -	$ -
	$ -	$ -
	$ -	$ -
Total non-portfolio income	$ -	
Total	$ -	$ -
Weighting	#DIV/0!	#DIV/0!
Withdrawal rate	4.00%	5.00%

Weighted withdrawal rate
#DIV/0!

Annual portfolio supported spending
$ -

Retirement goal
#DIV/0!

© 2024 Morningstar, Inc. All rights reserved. Neither Morningstar, its affiliates, nor the content providers guarantee the data or content contained herein to be accurate, complete or timely nor will they have any liability for its use or distribution. This report has been prepared for clients of Morningstar Australasia Pty Ltd (ABN: 95 090 665 544, AFSL: 240892) and/or New Zealand wholesale clients of Morningstar Research Ltd, subsidiaries of Morningstar, Inc. Any general advice has been provided without reference to your financial objectives, situation or needs. For more information refer to our Financial Services Guide at www.morningstar.com.au/s/fsg.pdf. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest. Our publications, ratings and products should be viewed as an additional investment resource, not as your sole source of information. Morningstar's full research reports are the source of any Morningstar Ratings and are available from Morningstar or your adviser. Past performance does not necessarily indicate a financial product's future performance. To obtain advice tailored to your situation, contact a financial adviser. Some material is copyright and published under licence from ASX Operations Pty Ltd ACN 004 523 782.

Problem 1: Inflation

Inflation is the cost of goods and services rising over time. High inflation over the course of retirement is bad luck and we need to account for it.

Inflation can make or break retirement outcomes. Whether articulated or not the goal of all retirees is to maintain at least the same lifestyle in retirement. That means increasing the amount of spending each year by how much the costs of what you consume increases.

The more inflation over the course of your retirement the quicker you will run out of money. That means less can be safely withdrawn.

The first step to figuring out a plan for retirement is to consider how much of a risk inflation is to your retirement. That is the first tab of the model I've put together.

The first step is to consider wants and needs in the context of inflation. Housing is a need. Feeding yourself is a need. Medical care is a need. Most other categories of spending are technically wants. But think carefully about the quality of life you want in retirement.

Going to Europe every August is not a need. In theory that is something that can be cut out of your budget if inflation is higher than expected.

The question is if you want to risk having to cut that out of your budget. Personally, I would rather work a couple more years to enable travel in retirement. That is just me. You need to make your own decision.

I'm attempting to account for both wants and needs in your retirement plan. But what is a want and what is a need is up to each person. If you need to go to Europe every year than add it into your needs.

It is harder to substitute your needs. You always have the option of substituting a more expensive place to live for a cheaper one. You could eat tins of beans every night instead of your preferred dinner. But for many people these are unpalatable scenarios.

Wants are easier to substitute. If you can't afford to go on holiday to Europe you could go to a cheaper location. If you want to go out to dinner twice a month you could always go out once a month.

Spending on wants also tends to diminish as people age. You just don't have the interest or physical ability to keep up the pace of activities. Needs tend to stay the same or even increase if you require more medical care.

In the model I've applied different withdrawal rates to wants and needs. I've done that for all the reasons previously outlined. Most people want more certainty that needs will be meet. Wants can be substituted more easily. But ultimately it is up to you to categorise your spending.

I've used the classic 4% safe withdrawal rate for needs but for more safety you could lower it. I used a 5% withdrawal rate for wants. That is a Morningstar calculated safe withdrawal rate based on the historical propensity to reduce spending as retirees age. This isn't perfect and a case can be made to increase the rate but I think it is a good substitute for the potential variability of spending for wants.

Reflecting the same thinking I also applied any non-portfolio income for retirement to needs. That includes the age pension, annuities, and a reverse mortgage. The age pension and some annuities are indexed for inflation which provides additional protection. We offset spending with the other income as the purpose of this exercise is to figure out your retirement goal or how large your portfolio needs to be to support retirement.

MORNINGSTAR®