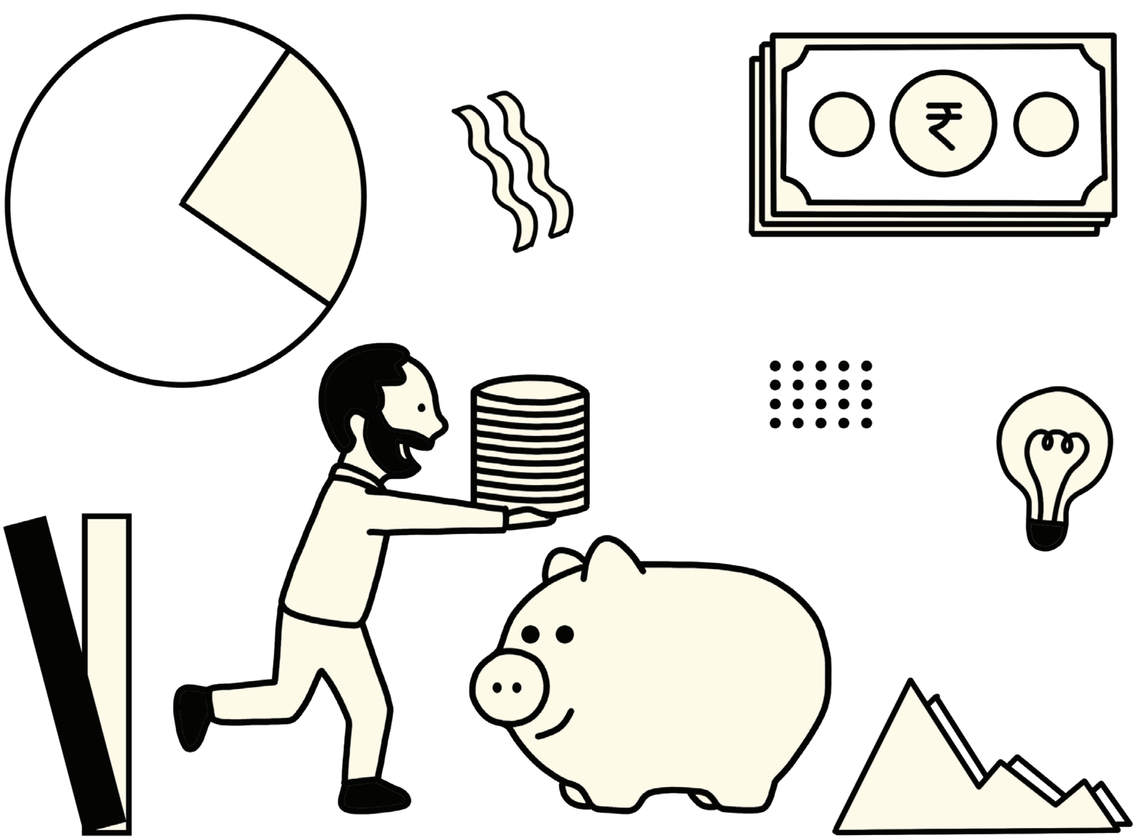
INFLATION-PROOF INCOME PLAN FOR RETIREES

Learn where and how much to invest so your golden years are stress-free



With rising inflation overshadowing the returns of fixed deposits, debt mutual funds delivering muted returns and equities in a shaky state, the going gets tougher for those who are retiring now. Given that, where should retirees invest? What should be their income-generation plan?

The answer was easier earlier; however, now dynamics continue to become increasingly complex. Anyone retiring now needs to be extra careful. Needless to say, the problem is much bigger for those who have not been able to accumulate a large corpus. They have little scope to go wrong with their investment and withdrawal plans. If you are one of them, here are some suggestions for you to rise to this challenge.

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Start with a conservative withdrawal plan

This is the most important thing to do.While you may not feel the pinch of making huge withdrawals in the initial years, it may have an irreversible impact on the later years of your retirement. You may end up utilising a huge chunk of the corpus in the initial years, leaving little to generate inflation-adjusted income afterwards. Remember if you are able to meet your expenses today with ₹20,000, that's not going to be sufficient after 10 or 20 years. You would need a much larger amount for the same set of expenses and lifestyle.

We suggest that one should not make an annual withdrawal of more than 5 per cent. A lower withdrawal rate in the initial years will ensure a larger corpus to generate inflation-adjusted income for the later years of your retirement.

Don't try to generate extra returns

These days, many fixed-income options are coming up with the potential for higher returns. However, the investor forgets the basic underlying of credit default safety. For instance, even within debt funds, credit-risk funds may generate over 15 per cent in a year, which may be more than the returns of even equity funds.

But remember, return and risk go hand in hand. To generate extra returns, these options assume extra risk. By the mandate itself, credit-risk funds invest a minimum of 65 per cent of their portfolio in low-quality bonds. Such bonds are usually high on the risk of making default in the repayment of the interest or even the principal, thereby putting your invested money at risk.

It's okay for someone to take a bit of risk, provided they have a sufficiently huge corpus to withstand the consequences if anything goes wrong. But it can be disastrous for someone who has limited resources to meet their ends. So, it's better to avoid investing in these options unless you are ready to withstand the consequences in the worst-case scenario.

Have exposure to equity

It is essential to invest in equity even after retirement. Allocate at least a third of your portfolio to equity. It will help grow the accumulated corpus over the long term and in turn, ensure inflation-adjusted income during the later years of your retirement.

Select two or three good equity funds with a conservative approach. You can opt for flexi-cap, large-cap or even index funds if you wish to be extremely conservative. But do invest in equity.

If you already have a third of your portfolio invested in equity, stay invested. Otherwise, spread your investments over the next two years. Don't put all your money in one go. This will help reduce the risk of investing at a market high.

If you are able to meet your expenses today with ₹20,000, that's not going to be sufficient after 10 or 20 years. You would need a much larger amount for the same set of expenses and lifestyle.

Make the most of government schemes

After allocating about a third of your portfolio to equities, the rest can be allocated to fixed-income options. Within your fixed-income portfolio, the first choice should be Senior Citizen Savings Scheme (SCSS) and Pradhan Mantri Vaya Vandana Yojana (PMVVY). Both of them are backed by the Government of India and assure guaranteed regular income. As of September 14 2022, 7.4 per cent per annum, the highest among fixed-income options that come with guaranteed income. However, you cannot invest more than ₹15 lakh in these two options. Besides, the investment in PMVVY is open only until March 2023. Thereafter, the government may or may not extend the scheme. Nevertheless, if you invest in PMVVY now, your money will continue to get an annual return of 7.4 per cent over the next 10 years.

In addition to SCSS and PMVVY, you may also choose to invest in Post Office Monthly Income Scheme (PO-MIS) but it yields comparatively less return. As of September 14 2022, deposits made in PO-MIS generate an annual return of 6.60 per cent over the next five years.

Invest the rest in short-duration funds

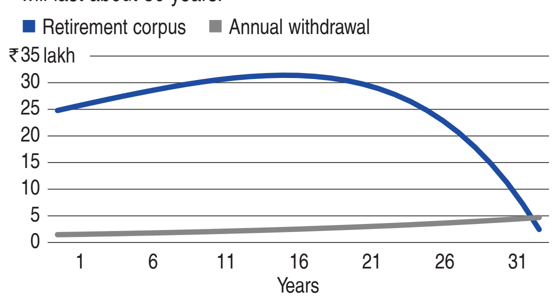
Whatever is left should be parked in high-quality short-duration funds. This investment will provide for the additional income required over and above the one provided through government-backed schemes. You can also use it to make higher withdrawals to adjust your income for inflation in subsequent years. Besides, you can use it to rebalance your portfolio. It is suggested that you start rebalancing your portfolio after five years (thus giving sufficient time to your equity investments for growth) and then, maintain an allocation of roughly 70:30 in fixed income and equity.

Have a couple of lakhs extra in this bucket to support yourself during an emergency. Invest a little less in government-backed schemes for this purpose if you have a small corpus and won't be left with a sufficient amount after investing your money in equity and government-backed schemes. Although you can redeem your money from SCSS anytime, it comes at a penalty. On the other hand, the money parked in PMVVY can be withdrawn before 10 years only in certain specified situations, that too, at a penalty of about 2 per cent. The money required immediately over the next year or so can well be parked in a liquid fund from where you can set up a systematic withdrawal plan (SWP) to your bank account.

See the graphic 'Your sample action plan' to see the allocations across different investment avenues.

How long will ₹25 lakh last?

Based on the assumptions given below, a corpus of ₹25 lakh will last about 30 years.



Assumptions: ₹8 lakh invested in equities at 10 per cent; ₹32,000 invested in liquid funds; ₹4.68 lakh invested in short-duration funds at 6 per cent; ₹12 lakh invested in Senior Citizen Savings Scheme (SCSS) at 7.4 per cent p.a. An annual withdrawal of 5 per cent has been assumed, increasing at 5 per cent every year.

Your sample action plan

Where and how much you should invest

In ₹

Retirement corpus	25 lakh	50 lakh	75 lakh	1 crore
Suggested monthly income	10,000	20,000	30,000	40,000
Senior Citizen Savings Scheme (SCSS)	12 lakh	15 lakh	15 lakh	15 lakh
Pradhan Mantri Vaya Vandana Yojana (PMVVY)	0	11.5 lakh	15 lakh	15 lakh
Liquid fund	32,000	44,000	1.38 lakh	2.58 lakh
Short-duration funds	4.68 lakh	6.56 lakh	18.62 lakh	34.42 lakh
Flexi-cap funds/large-cap funds/index funds	8 lakh	16.5 lakh	25 lakh	33 lakh

Steps to follow

- Set up an SWP from the liquid fund to your bank account. Split it into 12 equal instalments. This will provide for the income required over and above the one provided through government-backed guaranteed-return schemes.
- Revise your annual income by 5 per cent to adjust for inflation. Transfer the required amount from short-duration funds to the liquid fund every year.
- Start re-balancing your portfolio after five years, as it will give sufficient time to equities for growth.
- Maintain at least a third of your portfolio in equities thereafter.
- If you have a slightly higher corpus, say ₹75 lakh or ₹1 cr, you can choose to allocate a higher portion to equities, 40 per cent and 50 per cent, respectively. This will increase your long-term returns and would ensure inflation-adjusted income for a higher number of years.

How much you will get from where on a monthly basis during the first year

In ₹

Retirement corpus	25 lakh	50 lakh	75 lakh	1 crore
Senior Citizen Savings Scheme (SCSS)	7,400	9,250	9,250	9,250
Pradhan Mantri Vaya Vandana Yojana (PMVVY)	0	7,092	9,250	9,250
Liquid fund	2,667	3,667	11,500	21,500
Total	10,067	20,009	30,000	40,000

How long will your retirement corpus last?

It entirely depends on your yearly withdrawal rate. We simulated the above model with certain assumptions. And in each case, the corpus lasted for about 28–30 years. We had assumed the returns on equity and short-duration funds to be 10 per cent and 6 per cent, respectively. For government-backed schemes, we considered their prevailing rates (7.4 per cent) with a further assumption that they will continue to return at the same rate throughout the tenure.

One may wonder why the corpus ended when the withdrawal was increased by 5 per cent but the returns were in the range of 6 to 10 per cent. This happened because the 5 per cent increase in withdrawal was on an increasing amount, i.e., expenses. But the returns of 6 to 10 per cent were on a diminishing amount, i.e., the remaining corpus. Hence, at a certain point, the increase in withdrawal started eating into the corpus itself, thus bringing it to zero.

If you can cap your withdrawals to 6 per cent of the corpus at any point in time, your corpus can well run into perpetuity.

If you would like the corpus to last longer, you can do two things. If you have a sufficiently huge corpus, you may initiate an annual withdrawal of a much smaller amount like 3 per cent. This will provide you a few more years before your corpus finishes. Secondly, if you can cap your withdrawals to 6 per cent of the corpus at any point in time, your corpus can well run into perpetuity. ☑

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