SHORT BRIEFINGS ON LONG TERM THINKING – EPISODE 14

LIVING LONGER: CAN WE AFFORD IT?

MB Malcolm Borthwick

AS Andrew Scott

SH Steven Hay

MB Hello and welcome to *Short Briefings on Long Term Thinking*. Thanks for joining us. I'm Malcolm Borthwick, managing editor of Intellectual Capital at Baillie Gifford.

What are the chances of living to 105? Well, if you're a child born in the west today, it's over 50 per cent, according to the authors of *The 100-Year Life*. A century ago, the chances were less than 1 per cent. More of us are living longer, staying healthier for longer, and working for longer. So, what are the implications for investing and financing this longer life?

I'm joined by Steven Hay, who is joint manager of Baillie Gifford's Managed Fund and the Multi Asset Income Fund, but before we start, some important information. Please remember that, as with all investments, your capital is at risk and your income is not guaranteed. This podcast has been recorded during the coronavirus pandemic, so Steven and I are both at home as opposed to in the usual Edinburgh studio.

But first, the idea for this podcast was inspired by *The 100-Year Life: Living and Working in an Age of Longevity* by Andrew Scott and Lynda Gratton. I started by asking Andrew what the options are for financing our longer lives.

AS Most people go straight to that question when they discover what life expectancy trends imply for them. Obviously, a longer life means you have to save more, but I think that's probably not the main way of looking at the challenge. You probably also have to work for longer. Of course, if you're going to work for longer, you have to think about a whole bunch of things. You've got to think about your skills, you have to think about your relationships, and you've got to think about your sense of purpose and motivation.

I think the real implication of a 100-year life is, actually, thinking about investment and your portfolio in much broader terms. Investing more is certainly part of it and investing differently is part of it; thinking that your life is what should be driving your finances, rather than your finances driving your life. Longer life means that this three-stage life that we invented in the 20th century of education, work, and retirement I don't think can be stretched out to last for 90 or 100 years. You'll be working to your early 70s and, if you think about that, that's a long time to work. So, it's thinking differently about all aspects of life planning and, of course, that means thinking differently about financial planning, too.

MB Steven, I think the really interesting point that Andrew mentions there is about your life driving your finances as opposed to the other way around. A lot of these choices are very individual, aren't they?

SH Yes. I think that's right. One of the themes that comes through from Andrew's book, which is a really interesting read, is the need for individual responsibility in terms of your life and taking charge of it and getting your finances to work for you. We've got much more pension freedom than we used to have. It is about the individual understanding how they're going to want their finances to work for them during their life and how they're going to be able to achieve that through their different investments.

The second big point there is that we need to have an awful lot more flexibility in terms of how we invest and for our retirement and how we think about that. The investment and savings products that we're able to access to help us through that period need to really improve in terms of how they're described to people, how they're explained to people, and how they do the different jobs that people will need them to do in order to fund that longer retirement.

MB Are we saving enough for a longer life?

SH I don't think we are. No. I think the amount the average person is saving is woefully short of what's required. Part of the answer here is to save more. That in combination with working a bit longer in different ways and having the right investments and the right investment approach is what is going to get us to the point where people can enjoy a long and happy retirement.

MB What are the different mix of assets that we should be thinking about for the longer life?

SH It really does hinge on those growth assets, and equities are the primary growth asset. So, for me, it would be a case of keeping your pension pot invested in equities for as long as you possibly can. As they talk about in the book, equities have traditionally delivered something like 6 per cent return over and above inflation whereas fixed income has delivered about 2 per cent above inflation. I think there's a lot of doubts about whether even that number would be able to be achieved in the next ten to 20 years.

When it comes to the point when you are looking to get a bit more stability, then you will be introducing other assets. I would personally question whether some parts of the fixed income market that traditionally played this role are as suitable going forward. Certainly, in the current environment, it doesn't feel that they'll be playing as good a role given gilt yields are so close to zero. Although there are parts of the fixed income market that can still play a role.

Who knows how this will change over the next 30 or 40 years? One of the things I would also add is that you will be looking, at some point, to start generating an income from your portfolio. Traditionally this has been done through buying an annuity. This is so expensive to do that it just does not make sense for people, in my opinion. I think we will not be able to afford these longer lives and longer retirements by doing that. So, it's about generating a natural income from your portfolio and there's lots of different ways of doing this. There are some great assets that we think we can put in portfolios instead of your traditional government bonds or corporate bonds.

Things like infrastructure, where you have very steady, regulated streams of cash flows - they're not 100 per cent guaranteed like on your fixed income side - but we believe they're very steady and can be extremely good income producers while holding value in real terms. So, there are other options there. As you approach that point in life where you need to get an income from your portfolio, it's important to have a mix of assets, so that you have good diversification across the portfolio to be able to meet your spending needs over time.

MB So without annuities, how can investors generate a stable income?

SH Of course, the traditional way has been an annuity and it's something that is important for people, to feel comfortable that they have that reliability of income during their retirement. I know from my dad's experience. He does have some annuities, or an annuity from a previous pension, but relies on an investment portfolio mainly of UK equities to supplement his income. What we've seen in the last three to six months has been a fairly huge dividend crisis in the UK, with almost 50 per cent of UK companies stopping their dividend.

This has had quite a big impact on him, in terms of his income flow that he's expecting this year. I feel this first-hand because we both go to the rugby together. We go to watch Glasgow Warriors and he normally pays for my rugby season ticket, very kindly. But this year, he came to me and said, "do you know what, the income I'm going to get from these investments is going to fall so much, would you mind paying for it yourself this year?"

Of course, I said, "that's absolutely fine", but it does illustrate that you really do want to have that reliability. An annuity gives you that, but given how expensive an annuity is these days, we have to think about what could act as an annuity replacement, that would give enough stability of income but wouldn't be as expensive as an annuity? That's where you need to think about income-producing assets that can be blended together to give you a diversified source of income.

If you're very reliant on UK equities to pay your income, then you may suffer. But if you can blend together a global equity portfolio, with infrastructure assets or some property, and some bits of the fixed income market such as emerging market or corporate bonds where you get a decent yield, then even if one of those areas does suffer some lower income, you have other bits of income which can supplement it.

People can build their own portfolios to do this or invest in a multi-asset income portfolio, but what you need to have is a stability of income. We are really looking for those types of investments that will offer a resilient and stable income. We know that people can tolerate a little bit of volatility in their income, but any more than, say, a 10 per cent fall in income would be too much for people to tolerate.

MB I think what's interesting here is the psychology. It's very easy for us to judge what we need here now, but it's much harder to judge what we need in the distant future.

SH Yes. I think that's right. There's widespread evidence in academic literature about how much people think they will need in their retirement. Interestingly, what Andrew and Lynda say in the book is that they think people should aim for 50 per cent of their last working income for retirement. It's a fairly conservative number. They think that should more-or-less take account of your spending needs. But you're right, there's a huge variation. Some people think they need 100 per cent of their pre-retirement income. Other people think they can survive on much less. A number, maybe, around 50 to 60 per cent is probably what people should think about, in terms of the amount of their pre-retirement income they will need as they go into their retirement.

MB How do you view this personally, Steven, in planning for your longer life?

SH It's an interesting one. To put it into context, I'm just approaching 50. So, yes, these things do come to mind. I have six children, so there's not as much opportunity to save as I would like at the moment. Certainly, once I'm in my 60s, I would think much more about flexible working. Maybe scaling down my hours in the investment job. Something I've always been very interested in is in psychology and counselling. Maybe I'd do a bit of training and counselling as part of my working week. I'm also really interested in bikes and bike mechanics, so perhaps working in a bike shop or helping to repair or recycle bikes would be something that I'd quite like to do.

So certainly, I have ideas of what I could do to generate a bit of income. Maybe less than during my main working career, but something that can help me to not go into my pension pot as early, and therefore leave my growth assets for as long as possible. Then, once I'm in my 70s, maybe mid-to-late 70s, and I'm not wanting to do much of even those types of jobs, I will scale down my work commitments. I would think I would be switching into income-producing assets at that point, into assets such as infrastructure or those equities that do provide a good income, and something that's diversified and more stable. That would hopefully provide enough income for me to live off.

Then, as you move into the later years, when you're in drawdown phase, I probably will want my assets to be in something much more stable. Like fixed income, where I'd just be drawing down that capital over the last years of my life. It's a fascinating topic and it's something that I do think about quite a lot.

MB Thanks very much for joining us on the podcast, Steven, and I hope you'll join us again soon.

SH Thank you.

MB But before we go, let's go back to Andrew Scott, who we kicked off this podcast with, to have the last word. I asked him, is the 100-year life a blessing or a curse?

AS A child born today in the west has a very plausible chance of living to 100, but there's all sorts of debates about whether it's 500 or whether improvements are slowing down. So, the question then is, what do you do with your time and how healthy are you? The more you can invest in that future, the more you prepare your finances, your skills, your relationships, and your sense of purpose, it should be a blessing. However, if we carry on behaving as if we're going to live to 70 and we live to 100, then it isn't a blessing. That's the reason why that longevity insurance is so important, making sure that you don't outlive your assets, relationships, purpose, and health.

MB Andrew Scott, ending our podcast. And you can find *Short Briefings on Long Term Thinking* at bailliegifford.com/podcasts and you can subscribe at Apple Podcasts, Spotify and TuneIn. And if you enjoyed the podcast, please spread the word.

In our next edition, we'll be focusing on China and looking at how the coronavirus pandemic could accelerate divergence between the east and west. What are the implications for investing? Tune in to find out.

Many thanks to Lord of the Isles for the music. The track we've used is called *Horizon Effect*, which was released on Permanent Vacation. If you're listening at home, stay well and we look forward to bringing you more insights in our next podcast.