



### The 21<sup>st</sup> Century Income Revolution - a trilogy.

1. The art of self-reliance  
*(What are you doing the rest of your life?)*
2. The art of spending capital  
*(Investing for income in a low interest environment.)*
3. The art of suspending judgment  
*(Buy an annuity to-day . . . . you crazy?)*

## 2. Investing for income in a low-interest environment

### *The art of spending capital*

#### Introduction

The object overall, in particularly testing times, is to bring fresh, challenging thinking to the area of lifestyle finance, essentially to loosen purse-strings in situations where a traditional or conservative mind-set serves to curtail the family budget unduly or un-necessarily. A central hypothesis is that it isn't a punishable crime to spend capital, ideally in a controlled environment, and in pursuance of this mind-set, comes the proposition that it's a *cash-flow requirement* rather than *income* or *return-on-investment* that ideally would dictate our lifestyle spending pattern.

And then two additional jigsaw pieces serve to complete the picture where the end result, in a matter-of-fact, reasoned argument, witnesses a dramatic income-boost: one is that we'd revisit and perhaps adjust our appetite for and/or attitude to risk however moderately, secondly that we'd look, in part at least, to investment instruments that blur lines of demarcation as between "income" and "capital." Two such examples are offered.

#### The art of spending capital made easy in two ready-made examples:

Overleaf is an extract from a dedicated *Moneywise* model that summarises how a basket of *unitised funds* masks *capital* and *interest* demarcation and delivers a tax-paid automatic income-stream pre-determined solely by lifestyle cash-flow requirement.

The key differentiating factor that positions this as option no. 1 is that it triggers merely a 10% erosion of capital over a 10 year period (in that investment growth isn't geared to match draw-down.)



Example no. 2. is a Government Bond that affords a major "income" boost (when it comes to market) inasmuch as it delivers a phased year-on-year return of capital, supplementing the interest element. Opportune as it will prove for some, it's relegated to position no. 2 inasmuch as when the bond's term comes to an end, the cupboard is bare. Can't have your cake and have eaten it.

### A Government-led revolution!

It's surprising, to a point, that it has taken until the 21<sup>st</sup>. Century for the Government to offer a Bond (Gilt) where the year-on-year return-on-investment delivers a phased capital repayment element along with the interest content.

Then again maybe it's just a sign of the times; as in a reinforcement of the notion that as circumstances might dictate it's ok to dip into capital resources in pursuit of a desired lifestyle.

This said, at time of writing we're looking at something embryonic – and, as such, as much as this theme-paper seeks to inform, by same token it embodies something in the lobbying strategy.

What's in focus is an exciting instrument as yet obscured in rarefied atmosphere of "large pension fund actuarial deficits" – the *Irish Amortising Bond (IAB)* – a fixed-term-annuity aka a *Sovereign Annuity*.

Where a 20 yr. Gilt @ say 4.25% rate of interest delivers precisely this yield, the capital return element in an IAB hikes the yield to 7.5% p.a. Bring it on.

A call to arms:

Our under-the-cosh guinea-pig has say €400K in deposit-based instruments earning 2% p.a. after-tax.

Step 1 is to embrace the “*spend some capital*” or *decumulation* agenda.

Step 2 is to revisit individual risk-tolerance – to check if, perchance a one or two rung shift from say 1 to 2 or 3 on risk-barometer (below) spanning scale 1 to 7 might present opportunities; in the event, all things being equal, a shift from 2% p.a. in a deposit-setting can reasonably be expected to deliver say 3% p.a. net return

Step 3. Is to bring this risk-tolerance into *unitised investment fund* arena in search of accommodating or matching risk-exposure; funds that blur the distinction as between capital and interest and deliver a tax-paid draw-down or income-stream on demand.

In the background there is *exit-tax* at source on the *growth element* of each draw-down, as well as an *exit-tax* settlement on 8<sup>th</sup> anniversaries – to complicate a numbers’ presentation somewhat. Full detail, including the incidence of exit-tax is accessible online or for the asking.

At current 36% *exit-tax* rate investment growth at a rate of 4.68% p.a. requires to chalk-up by way of delivering our 3% p.a. net yield; against which backdrop a tax-paid draw-down of €16K. p.a. is targeted.

Who might buy into this fixed-term annuity (the IAB)?

Apart from hard-pressed pension funds, the IAB is poised for general release even if something of a chicken-and-egg syndrome clouds demand and supply factors.

What’s known is that *the Sovereign Annuity* was not conceived solely as to serve the pension-fund arena.

And so, on general release it will serve private investors in search of enhanced yields in the face of negligible deposit interest, citizens perhaps seeking to repatriate offshore funds dispatched in hairy times, individuals pre-disposed to spending some capital year-on-year, retirees seeking annuity-type security in respect of part of their retirement kitty.

Yr.	Capital		Resource		
	Deposits	Income	Various	Cash-flow	Decumulation
	€400,000	2.00%	€400,000	4.68%	4.00%
1	€400,000	€8,000	€396,000	€16,000	(€4,000)
3	€400,000	€8,000	€388,220	€16,000	(€11,780)
5	€400,000	€8,000	€380,703	€16,000	(€19,297)
7	€400,000	€8,000	€373,415	€16,000	(€26,585)
8	€400,000	€8,000	€369,845	€16,000	(€30,155)
9	€400,000	€8,000	€364,941	€16,000	(€35,059)
10	€400,000	€8,000	€360,068	€16,000	(€39,932)
	€400,000	€80,000	€360,068	€160,000	(€39,932)
		Change	(€39,932)	€80,000	

Individual risk-tolerance

U.K.-based research undertaken at the behest of AXA insurance reveals that we’re perhaps not as risk-averse (independently assessed) as we might perceive ourselves to be. Below is the self-assessment model.



**Warning:** These figures are estimates only. They are not a reliable guide to the future performance of this investment.

**Warning:** The value of your investment may go down as well as up.

**Warning:** The income you get from this investment may go down as well as up.

*Narrative:* Risk-tolerance elasticity, all things being equal, facilitates a hike in yield/return from 2% to 4.68% p.a., falling to 3% p.a. net of *exit-tax*. This added 1% p.a. effective enhanced return puts c. €40K into the kitty over 10 years. Over-and-above this boost to resources, which we plan to spend, we’re choosing to spend another €40K. of capital (in a covert sort of way!) So overall we have an extra €80K in lifestyle income at a cost of €40K. (10%) in capital dilution or *decumulation*. Q.E.D.

