The benefits of integrated solutions

Creating better retirement outcomes

Adviser Solutions

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Introduction

Paul Squirrell
Head of Retirement and Savings Development

There are a number of moving parts to navigate throughout retirement to successfully help clients manage their finances. Often these are interrelated and sometimes they conflict with each other. For example, the best long-term outcome, subject to the client's capacity and tolerance for risk, is usually achieved by investing significantly in equities or other real assets. Yet the impact of falling markets in the early years of retirement can lead to strategies that detract from this objective.

Strategies designed to combat the risk of market falls in the early years may require cash reserves or reduce equity exposure, which can act as a brake on performance. Alternatively, some methods can lead to a fluctuating income from year to year, which may be impractical.

Our latest report reviews some of the pros and cons of different approaches to dealing with sequencing risk and explores whether there may be better options? New solutions that can deliver optimal long-term outcomes, commensurate with the clients' risk tolerance and capacity, without exposing clients to market falls in the early years.

Of course, there's no one strategy that's right for everyone. Different strategies could all be appropriate in the right circumstances – depending on the individual client. The importance of taking into account the different needs of clients is one of the key findings in the FCA's thematic review of retirement income advice[1]. Adding to the range of solutions available can provide a more comprehensive toolkit for advisers to meet a diverse range of needs.

1. Retirement income advice thematic review, FCA, March 2024.

Contents

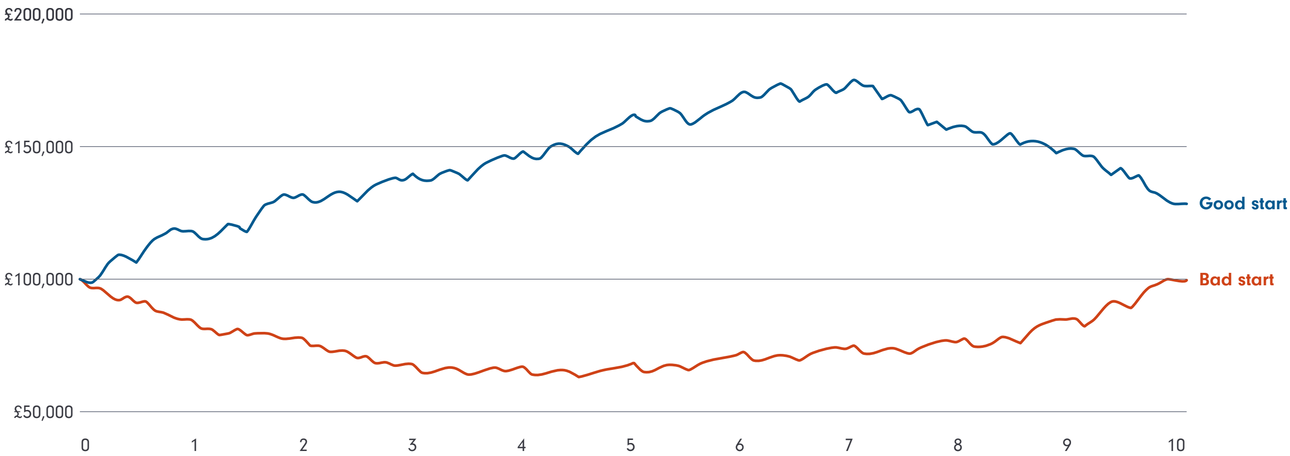
Funding retirement successfully

Funding a comfortable retirement presents challenges. For example, defining withdrawal rates; anticipating longevity; allowing for inflation; identifying changes in expenditure; and assessing the impact of ill health on care needs. These are just some of the issues advisers face as they support their clients throughout retirement.

There is a further distinction between accumulation and decumulation advisers must address: The spectre of sequencing risk. The potentially devastating impact of selling investments when markets fall in the early years of retirement. Chart 1 will be familiar to advisers. It shows how two funds with an annual average return of 5% can end up in a different place depending on when market falls occur. Various strategies have been developed to combat sequencing risk. These strategies may all be appropriate in the right circumstances, but there is usually a price to pay. This may be a drain on performance or restrictions on withdrawals.

> **While sequencing risk is a real and present danger for retirees in the early years, it's not the sole or necessarily the most important determinant of a successful portfolio**

Chart 1: The insidious impact of sequencing risk



Source: Fidelity International. For illustrative purposes only, based on withdrawals of 4% each year.

It's also worth pointing out that, while sequencing risk is a real and present danger for retirees in the early years, it's not the sole or necessarily the most important determinant of a successful portfolio. Analysis undertaken in 2023, suggested that only around 25% of the variance in returns arises as a result of sequencing risk (though the same analysis suggests that a combination of both de-risking a portfolio and withdrawing increases this figure to 45%)[2]. The results were based on a multi asset portfolio, which you would expect to soften the impact of a fall in stock markets.

Nevertheless, falling markets in the early years can undermine retirement plans. So how can advisers mitigate sequencing risk without detracting from the long-term goal of generating optimal outcomes for clients? In the next section, we'll take a look at the pros and cons of some of the current strategies deployed.

2. Sequence risk in decumulation – smaller than you think? John Southall, L&G, November 2023.

Strategies for dealing with sequencing risk

The efficient frontier theory introduced by Nobel Laureate Harry Markowitz in 1952 highlighted the benefit of diversification resulting from the curvature of the efficient frontier.

Commonly, diversification means a split of bonds and equities usually in favour of equities given that over most long-term time periods equities will tend to outperform bonds[3]. However, the benefit of a mixed portfolio of bonds and equities is the negative correlation between these asset classes. The conventional wisdom is that when equities rise bonds fall and vice versa. The first point to make is that this is a relatively recent phenomenon.

The Bloomberg US Aggregate Bond Index provides 46 years (1976-2022) of data to explore. Comparing this with corresponding data from the S&P 500 reveals that equities and bonds often moved in different directions about one third of the time. However, in nearly one quarter out of every ten, both equities and bonds were down. Adjusting for inflation, bonds and stocks were both down approximately one quarter out of six. About once every year and a half[4].

The relationship between equities and bonds is, in part, a function of inflation. The nominal interest rates that define bond prices reflect inflationary forecasts and real interest rates. When these are both high, bond prices tend to fall. In contrast, equity prices are a function of the strength of the economy. When weaker market growth signals decreasing company profits in the future, the price of equities will usually fall. That means when a combination of high inflation, and high real interest rates, occur simultaneously with a weak economy, both equities and bonds are likely to fall.

The positive bond-equity correlation experienced during 2022 suggests markets are concerned that inflation will continue to impact both bond yields and equities at the same time, with the prospect of 'higher for longer' rates being the main cause. Indeed, some commentators are calling it the death knell for the classic 60/40 portfolio. This would seem premature. It's worth bearing in mind that not only are these asset classes negatively correlated much of the time, but positive correlations are often short lived. Over a rolling correlation of stock and bond returns over both a 60 day and two year period between January 2002 and April 2023, positive correlations occur over the shorter time horizon, but have been negative over the two year period for the last 20 years[5].

"The relationship between equities and bonds is, in part, a function of inflation. The nominal interest rates that define bond prices reflect inflationary forecasts and real interest rates

3. In the long run, stocks outperform bonds... or do they?, Larry Swedroe, Kitces, April 2024.
4. Bloomberg US Aggregate Bond Index returns 1946-2022, (Rick Miller, Sensible Financial Planning), Forbes, Aug 2022.
5. Understanding the dynamics of stock/bond correlations, Vanguard, December 2023.

Given the insidious impact of sequencing risk, it could be inappropriate to rely solely on the diversification benefits of a negative correlation between bonds and equities to tackle this risk without further modification. Here are some of the strategies often used:

Living off natural income or yield

With this strategy, clients use the interest, dividends and income generated by their fund and withdraw this each year. Sequencing risk is mitigated because income isn't taken from capital. Capital values could still be eroded by market falls but, as the assets aren't realised, they should recover. The key attraction of this strategy is that capital is preserved. The obvious disadvantage is that income will vary year by year. It's also worth pointing out that investing for income can introduce bias into a portfolio, which may be unintended but can impact performance.

Investing for income can introduce bias into a portfolio, which may be unintended but can impact performance

Fixed percentage of the fund

A variation on this is to take a fixed percentage of the fund value each year (as opposed to a fixed percentage of the initial fund value). In years where markets are falling, less income is taken. The opposite is also true: income will increase when markets are rising. As with the previous strategy, income can rise and fall from year to year. What's more, in poor market conditions the income could be a trivial amount.

> **While holding a cash buffer is a valuable strategy to deal with sequencing risk, holding more than the minimum in cash may have a detrimental impact on performance**

Cash bucket

Another approach is to hold a series of buckets. This usually involves dividing the fund into sub-funds, typically cash, bonds and equities. The cash bucket might equate to say 2 years income to ride out market falls. Significant market falls, without a relatively quick recovery are rare. US data reveals that the average length of a bear market is 289 days, or about 9.6 months. Since 1945, there have been 15 bear markets – one about every 5.1 years[6]. This suggests that over most time periods, markets rise. Consequently, while holding a cash buffer is a valuable strategy to deal with sequencing risk, holding more than the minimum in cash may have a detrimental impact on performance.

What's more, the implementation of a bucket strategy can be complicated. For example, is the cash bucket refilled each year? If so, are assets sold to achieve this (which could be subject to sequencing risk)? Alternatively, is the cash bucket only refilled from dividends and income from the portfolio? This avoids sequencing risk, but what if there's a shortfall?

Other strategies have been developed, but the construction of a bucket approach may not be straightforward.

This approach is also consistent with what behavioural economists call 'mental accounting', which describes how individuals are inclined to categorise and manage money in different mental 'accounts' rather than treating all money as fungible.

Rising equity glide path

This approach was developed by Michael Kitces and Wade Pfau. It involves starting with a low exposure to equities, usually between 20-40%, rising over time to between 40-80%. The benefit of this approach is that the equity proportion of a drawdown fund is lower in the early years when sequencing risk can be most damaging. In contrast, market volatility has less impact later in retirement when equity exposure is much higher. If markets rise during the early years, there is an opportunity cost.

6. 10 Things You Should Know About Bear Markets, Hartford Funds, 2023.

Guardrails

Developed by financial planner Jonathan Guyton and business professor William Klinger, the guardrails approach is a dynamic process, which protects the fund by imposing limits. An initial withdrawal amount is defined, say 5%. The amount may then be adjusted each year based on the previous year's performance. If the fund has risen over the previous year, and the new withdrawal amount (after increasing by inflation) is below 20% of its initial level, the income can be increased by the rate of inflation plus 10%. In contrast, if the portfolio performed poorly in the previous year, income is reduced by 10% if the withdrawal rate plus inflation is more than 20% of the initial amount.

	Pros	Cons
Living off natural income or yield	■ Does combat sequencing risk. ■ Preserves capital for legacy planning. ■ Assets can be fully invested.	■ Income will likely vary from year to year. ■ Focus on income producing assets may lead to unintended bias. ■ Preserving capital may be less relevant given IHT proposals.
Fixed percentage of the fund	■ Helps combat sequencing risk. ■ Assets can be fully invested. ■ Income can increase in rising markets.	■ Doesn't entirely combat sequencing risk. ■ Income will likely vary from year to year. ■ In poor years, income may be trivial.
Cash bucket	■ Can combat sequencing risk. ■ Consistent with concept of 'mental accounting'. ■ Conceptually, simple to understand.	■ Holding cash can be a drain on performance. ■ Over most time periods markets rise. ■ Can be difficult in practice to execute efficiently.
Rising equity glide path	■ Does protect against sequencing risk to a point, but could be vulnerable if bonds and equities both fall in early years.	■ Low exposure to equities in early years can be costly if markets rising. ■ Even though portfolio may be protected in early years, the experience of witnessing market falls could lead to reluctance to increase equity holdings later.
Guardrails	■ Can help tackle sequencing risk. ■ Can lead to increasing income in rising markets.	■ May not completely eliminate sequencing risk. ■ Income can vary up or down. ■ Reductions in income after market falls may be overly severe.

There are variations on many of these strategies that have evolved over the years to eradicate some of the potential issues. For example, an alternative to the classic guardrail strategy is a risk based approach based on a financial plans probability of success. This approach could lead to much smaller reductions in income. For instance, those retiring just before the Global Financial Crisis would have only seen a 3% income reduction from the initial withdrawal rate using risk-based guardrails, compared to 28% for the classic approach[7].

Ultimately all of these strategies can be effective in the right circumstances and continual refinement can lead to better outcomes. In the next section, we'll explore another approach that could be more appropriate for some clients.

Ultimately all of these strategies can be effective in the right circumstances and continual refinement can lead to better outcomes

Key points

- Retirement presents challenges including the need to consider sequencing risk in the early years of retirement.
- Sequencing risk isn't the only risk, or even the most significant risk, in a multi asset portfolio but can undermine retirement planning.
- Various strategies have been identified that can combat sequencing risk, which may be right in individual circumstances, but can raise issues.
- Some may result in variations in income which might not work for many people, while others seek to de-risk a portfolio in the early years which can act as a drain on performance.
- Innovation and refinement to these strategies can lead to better outcomes, but there may be another approach that could improve outcomes.

7. Why Guyton-Klinger Guardrails Are Too Risky For Most Retirees (And How Risk-Based Guardrails Can Help), Derek Tharp and Justin Fitzpatrick, Kitces, March 2024.

The lure of complementary colours

Complementary colours are pairs of colours that contrast with each other more than any other colour, but when placed side-by-side make each other look brighter. Annuities and drawdown are polar opposites in so many ways, but in combination they mitigate each other's weaknesses and bolster each other's strengths.

A similar analogy can be found in nutrition. We know that fruit and vegetables are good for our health, but studies have shown that blending different fruits and vegetables together creates something greater than the sum of the parts.

Research reveals that certainty and flexibility are both highly valued by retirees[8], but when the product choice is framed as a binary option the client has to choose: Either the flexibility of drawdown or the security of an annuity (see chart 2)

Chart 2: Complementary colours

It's now possible to include an annuity type product, commonly called a guaranteed income for life, within a drawdown portfolio. What's more, these products are available on investment platforms. Despite this initiative, blended or integrated solutions don't appear to have gained significant traction in the market to date.

8. Retirement Voice 2024, Standard Life.

Nice landing, wrong airport

It could be we're looking in the wrong place? An oft-cited benefit of including a guaranteed lifetime income into a drawdown portfolio is the ability to cover essential expenses against living too long. But how significant a concern is this for advised clients, many of whom will be higher income households? As income increases the proportion of the household budget required to cover essential expenses will decrease. For example, the wealthiest households spend around 15% of their income on housing, fuel and power compared with almost 28% of the total income of the poorest households[9]. What's more, many people in this category are likely to enjoy a full State Pension and perhaps some defined benefits income too.

For more affluent retirees, retirement isn't just about surviving. These people will often have ambitious goals for their retirement. This may include fees to an exclusive golf club, extensive overseas travel or expensive new hobbies and interests. While not essential, this can be important expenditure. If these aspirations could seriously compromise someone's quality of life, it may make sense to cover the expenditure with a guaranteed income stream. Adding this to essential expenditure could require more guaranteed income than the State Pension and any defined benefit income. This might provide scope for further guaranteed lifetime income, but doesn't feel like a compelling argument in and of itself.

Nevertheless, there are other reasons to include a guaranteed income for life within a drawdown portfolio. These include the peace of mind and happiness that comes from knowing that a regular guaranteed income is payable for life. Research reveals that people who bought an annuity were 51% more likely to report lower levels of stress compared to those without an annuity[10]. Knowing that a guaranteed income will be paid every month, irrespective of market movements, can make people likely to spend more freely. When guaranteed lifetime income is included within drawdown, there will always be an income stream, even if the remaining drawdown fund is exhausted.

So why isn't an integrated approach more popular?

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For more affluent retirees, retirement isn't just about surviving. These people will often have ambitious goals for their retirement. This may include fees to an exclusive golf club, extensive overseas travel or expensive new hobbies and interests

9. Family spending in the UK: April 2022 to March 2023, ONS, August 2024.
10. Analyses were conducted by the Happiness Research Institute on a population-weighted sample of 3,000 UK retirees that responded to a cross-sectional online survey conducted by Opinium in April 2024.

The elephant in the room?

Many of the benefits mentioned above could be considered nebulous or intangible. Security is a key benefit providing reassurance and comfort, helping people to sleep at night. It satisfies the basest of needs. The primal urge to feel safe and secure, to have enough food, drink, shelter, clothing, and warmth. For all that, perhaps these benefits appear inferior against the more tangible, visible objectives of maximising income or building legacy within a drawdown portfolio. For example, even where value protection is selected, over the long term there is a reducing death benefit. This may matter less given the government's decision to subject unspent pensions to IHT from April 2027, but it's too early to tell. And there is no potential to benefit from future market growth with a guaranteed lifetime income. Consequently, could these products be perceived as an impediment to achieving a client's financial goals?

If so, is it accurate to assume that using part of a drawdown portfolio to provide a guaranteed lifetime income could hamper overall performance and/or impact legacy objectives? There've been a succession of studies that have redefined the role of guaranteed income as an asset class. Peace of mind may be an imprecise concept, but the data suggests there's nothing indistinct about the role of guaranteed lifetime income as an asset class. Here's a summary of the latest data on this subject. Much of the research is based on a traditional lifetime annuity, but the results are likely to apply to contemporary guaranteed income for life solutions.

"Peace of mind may be an imprecise concept, but the data suggests there's nothing indistinct about the role of guaranteed lifetime income as an asset class

Chart 3: Adding an annuity can deliver better outcomes

Organisation	Source	Methodology	Insights	Considerations
Institute and Faculty of Actuaries	Can we help consumers avoid running out of money in retirement? (2018)	The Institute and Faculty of Actuaries modelled a range of strategies involving drawdown and annuitisation and concluded that by adopting an integrated strategy 'consumers can potentially generate a larger overall income from their pension pot'. The study also considered phased annuitisation (see insights).	The model compared taking an income of £3,500 from a drawdown portfolio with various phased annuity options. For example, starting with £3,500 income from a £100k fund at age 65 the data shows that, on average, income is expected to start to reduce from age 85. However, if 50% of the pot is used to buy an annuity at 70 and the rest of the fund used to buy an annuity at 75 income would increase to £6,600 from age 75.	It should be noted that the average incomes shown are based a range of investment strategies, which might be considered conservative when applied to more affluent clients.
Milliman	Annuities reinvented: Are annuities the missing asset class for sustainable drawdown solutions? (2018)	Milliman modelled displacing the bond element in a balanced portfolio (55% equity, 5% cash and 40% bonds) with a single life, level annuity, guaranteed.	The model revealed that substituting the bond element with an annuity can improve the safe withdrawal rate over 30 years from 3.10% to 3.30% for a 65-year-old assuming a 90% probability of success. The data also revealed that after around 22 years death benefits can be higher under an annuity-equity strategy than a bond-equity strategy assuming the same withdrawal from both strategies.	Reasons for the difference in the strategies include: – The higher income from an annuity, compared to the bond element, means less has to be withdrawn from the equity proportion of a given level of income. – The bond-equity strategy is rebalanced each year but, as annuities can't be bought and sold, the annuity-equity strategy is not rebalanced.
Timeline	The science of blending – annuities and drawdown in synergy, Professional Adviser (2023) and Rethinking Retirement webinar with Just Group	Timeline explored blending annuities with drawdown portfolios by replacing half of the bond portion in a 60/40 portfolio with an annuity. This resulted in a 60/20/20 split between equities, bonds, and annuity.	Abraham Okusanya, CEO of Timeline, states that adding an annuity can increase the sustainability and longevity of a portfolio particularly for clients with a balanced or conservative portfolio.	Abraham Okusanya felt that the benefits of this approach may not work for high equity portfolios say 80/20 or 90/10. Also, this strategy may not make sense if equities are being sacrificed rather than bonds to purchase the annuity.
Standard Life	Want certainty and flexibility in retirement? Combining drawdown and phased annuitising provides a way for both, Standard Life (2025)	Analysed a saver with £150,000: – Buying a level annuity with the entire pension aged 65. – Alternatively, buying a RPI-linked annuity with the entire pension at 65. – A combined approach buying a level annuity in 4 phases: £90,000 at 65, followed by c£20,000 every five years, with the balance invested in drawdown, assuming a 5% pa investment return and an income of 3% a year taken from this portion of the pension.	The combined strategy can produce the highest overall income throughout a 25-year retirement. By age 90, the total income from a combined approach could yield £259,115. In contrast, by age 90, the total income from a level annuity would reach £253,775, compared to £255,706 with an inflation-linked annuity.	The combined approach comes with more investment risk compared to a single annuity purchase.

The evidence does appear to point to a persuasive reason to adopt an integrated approach. It can bring tangible benefits beyond the intangible concept of peace of mind. It's also worth noting that annuity rates are now much higher than assumed in some of these studies. For example, the level, single life rate for a 65-year-old used in the Institute and Faculty of Actuaries study was £5,308 per £100,000 purchase price. This compares with an equivalent rate currently of more than £7,500 per £100,000 purchase price[11]. These rates are for healthy lives and could be higher for those in poor health or whose lifestyle could impact their life expectancy. It should be noted that bond yields have increased over this period too.

> **Flexibility and certainty are both valued by people approaching retirement. An integrated approach can provide both**

That's not all...

There are tax advantages from integrating a guaranteed income product into drawdown too:

- If the income isn't needed at any point, it is simply added to the drawdown pot. This could be helpful for someone who is still working and wants to take advantage of higher rates. Assuming the income payments aren't required, they would be added to the fund without income tax being levied.
- There is the option to choose value protection at outset under a guaranteed income for life solution. On death after 75, this could be payable as a regular income, which may be taxable at a lower rate than would be the case if death benefits were payable from a separate annuity. The treatment of death benefits is set to change from April 2027, which may have implications for this approach.

Flexibility and certainty are both valued by people approaching retirement. An integrated approach can provide both: The certainty of a guaranteed income for life with the flexibility of drawdown. And deliver better outcomes in many circumstances. This strategy can also help combat sequencing risk without the need to hold a significant cash bucket, reduce equity exposure substantially or lead to a variable income from year to year. This is explored in the next section.

Key points

- Annuities and drawdown can complement each other's strengths and counter each other's weaknesses to provide both certainty and flexibility.
- Guaranteed lifetime income can help cover essential expenditure within drawdown, but this may have limited applicability for many affluent clients.
- The benefits of a guaranteed income for life are often framed in an abstract way – peace of mind, reassurance – but there are tangible benefits if the product is treated as an asset class within a drawdown fund.
- There is a growing body of evidence that suggests including guaranteed lifetime income into a drawdown portfolio can deliver better outcomes over the long term and protect against sequencing risk in the near term.
- There are also tax advantages if income isn't required. Alternatively, death benefits can be paid as a regular income.

11. Sharing Pensions, June 2025 (based on a single life, level annuity for a 65-year-old).

Combating sequencing risk

As shown earlier, different strategies can mitigate sequencing risk. Some of these are likely to result in fluctuating incomes – living off natural yield or fixed percentage of the fund, while others may impact performance, such as cash buckets and rising equity glide path.

Including a guaranteed income for life within drawdown can help combat sequencing risk without significant cash reserves or sacrificing equity holdings in the early years. Using current annuity rates as an example, consider a 65-year-old with a £500,000 fund planning to withdraw 4% each year. Applying £200,000 to buy a single life, level annuity would provide roughly £15,500 each year[12]. That means the client only needs to withdraw around £4,500 or 1.5% from the remaining £300,000 fund, so less has to be disinvested each year or set aside as a cash bucket. This is based on a level annuity, so future inflationary increase would need to be provided by the remaining fund.

In this example, 40% of the fund is used to buy a guaranteed income for life. In practice, this could leave 60% invested in equities (perhaps minus a small cash reserve). This means there would be no bond allocation. Bonds could be added to aid diversification, but this would reduce the equity allocation.

Including a guaranteed income for life within drawdown can help combat sequencing risk without significant cash reserves or sacrificing equity holdings in the early years

12. Sharing Pensions, June 2025 (based on a single life, level annuity for a 65-year-old).

Let's consider a different approach. What if we use 20% of our £500,000 fund to buy a guaranteed lifetime income, keep 20% invested in bonds and the remaining 60% invested in equities? Again, using current annuity rates as a proxy for the likely level of income payable from a guaranteed income for life product, single life, level annuity rates at age 65 would provide over £7,800 for £100,000 purchase price leaving £12,200 to be found from the remaining £400,000 fund. This means just over 3% still needs to be withdrawn, which might still leave the client exposed to sequencing risk. A cash reserve could mitigate this. Alternatively, income could be taken from the bond element of the portfolio assuming a negative correlation with equities in any market fall.

What other options could be used to manage volatility? We could add a smoothed managed fund into the mix. These are diversified funds that seek to cushion investors from the volatility of investment markets by including a smoothing mechanism. The smoothing mechanism means the value of the funds will move up and down, but rounds off the sharp edges of stock market investing. When markets fall, the value of the fund may fall, but by less than the actual movement in the price of the underlying assets. This has two advantages:

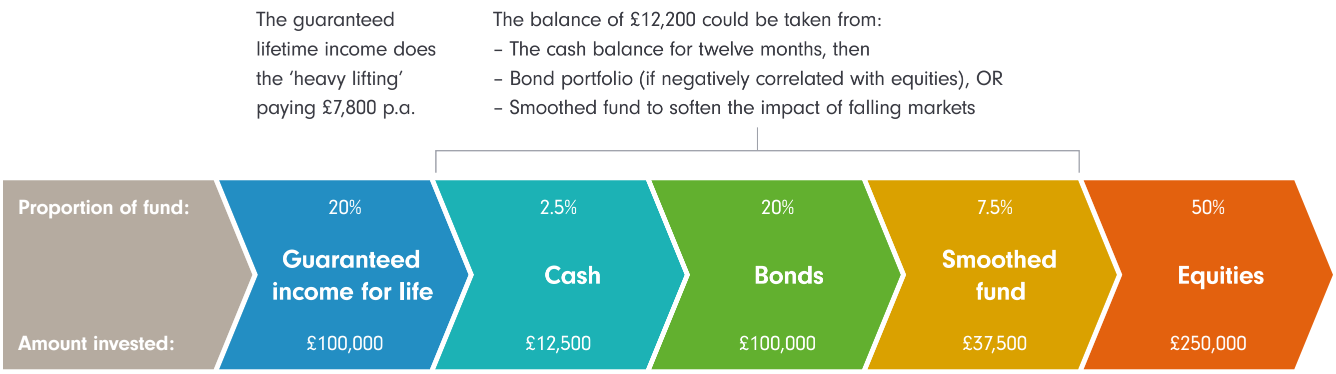
- Some clients find the prospect of equity investment unsettling. Knowing their funds are less volatile can bring peace of mind.
- By cushioning the funds during significant market falls, smoothed funds provide some mitigation against sequencing risk.

The addition of a smoothed fund provides an alternative source to make up any shortfall if bonds and equities are positively correlated and any cash reserve has been exhausted.

Chart 3 shows how different assets could be deployed to mitigate sequencing risk in this way. without holding significant cash reserves or at the expense of significantly limiting exposure to equities. This approach should also provide a stable income, without fluctuations to reflect market conditions. Of course, the efficacy of this approach will depend on the client's individual circumstances and the percentages are simply examples.

The addition of a smoothed fund provides an alternative source to make up any shortfall if bonds and equities are positively correlated and any cash reserve has been exhausted

Chart 4: Guaranteed income for life and a smoothed fund could protect retirees



There are several benefits to this strategy:

- The guaranteed lifetime income generates a significant share of the income required in the early years.
- A small cash reserve of 2.5% could still provide the balance of 12 months' income in the first year.
- Bonds could be used to generate further income if bond values rise when equities fall.
- If bonds and equities both fall, a smoothed managed fund could cushion the impact.

It should be noted that the annuity rates used may be higher or lower than the rates payable from a guaranteed income for life product available on an investment platform. Also, this is not intended as a panacea. In any particular instance, any of the other strategies reviewed could be more appropriate. It will depend on the objectives and circumstances of each case.

How different strategies could play out

So how could a strategy similar to this compare with a more traditional approach both over the long term and in combating sequencing risk in the early years? Let's consider a simple comparison between a bucket strategy and a strategy adding a guaranteed income for life.

The assumptions in this example are:

- **Fund size:** £500,000
- **Retirement age:** 67
- **Income withdrawal:** 4% inflation linked
- **Inflation:** 2.5%
- **Annual investment returns (net of charges):** equities 6%, bonds 4% and cash 1%
- **Guaranteed income for life (GLI):** £7,956.66 per £100,000 (FE CashCalc)
- **Asset allocation:**

Strategy A	Strategy B
60% equities	50% equities
30% bonds	30% GLI
10% cash	15% Bonds
	5% cash

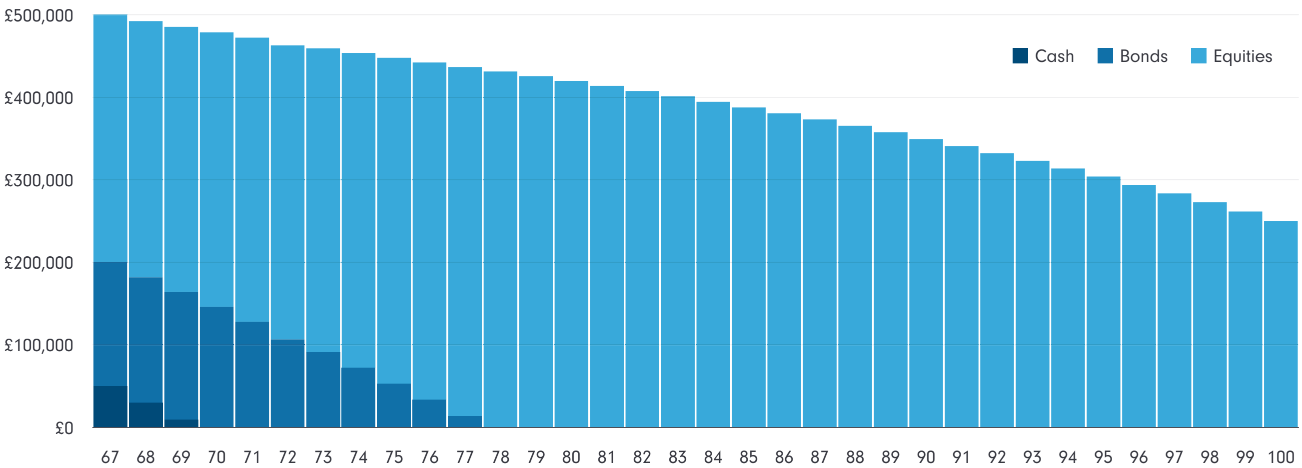
The comparison below (charts 5 and 6) uses linear growth rates. The results broadly mirror the Milliman research that, far from reducing the value of the fund longer term, investing in a lifetime income product, can increase the fund value[13].

However, the fund value is lower in the early years. There is an option to add value protection to the guaranteed lifetime income. This boosts the death benefit under strategy B short term, but at the expense of the long-term fund value (though the fund at age 100 would still be significantly higher under strategy B). In contrast, even with value protection, the total value on death in the early years is still higher under strategy A.

It's also worth pointing out that the higher the investment return assumed from equities, and the higher the proportion invested in equities, the less beneficial it's likely to be to invest in a guaranteed lifetime income product for long term growth. For example, if the net return from equities rose to 8% p.a. compound and the return from bonds increased to 6% p.a. compound, then the fund values under both strategies at age 100 would be broadly in the range £950,000 to £1m. Higher returns than these would continue to favour strategy A.

In both examples, the fund isn't rebalanced to reflect the initial asset allocation (this is consistent across both strategies). It's also worth mentioning that the software uses all of the cash and bonds to provide an income rather than just the shortfall after the annuity income is taken into account. Furthermore, for strategy B to be effective, Abraham Okusanya, CEO of Timeline, makes the point that the purchase price of the guaranteed lifetime income product should be taken from the allocation of funds to bonds not from the equity allocation[14].

Chart 5: Under strategy A the fund would be worth £250,000 at age 100

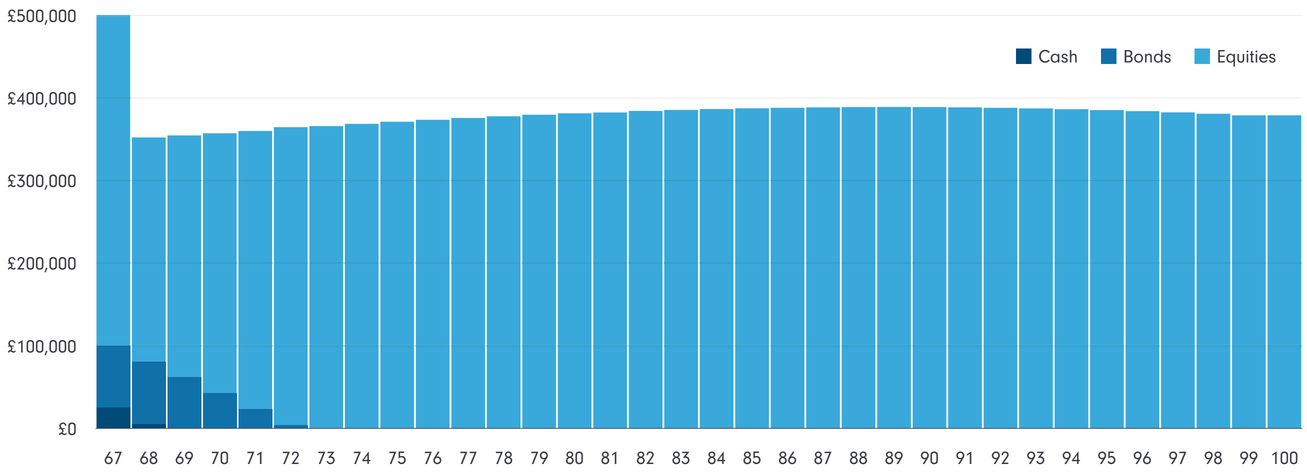


Source: FE CashCalc, July 2025.

13. Annuities reinvented: Are annuities the missing asset class for sustainable drawdown solutions? (2018).

14. The science of blending – annuities and drawdown in synergy, Professional Adviser (2023) and Rethinking Retirement webinar with Just Group.

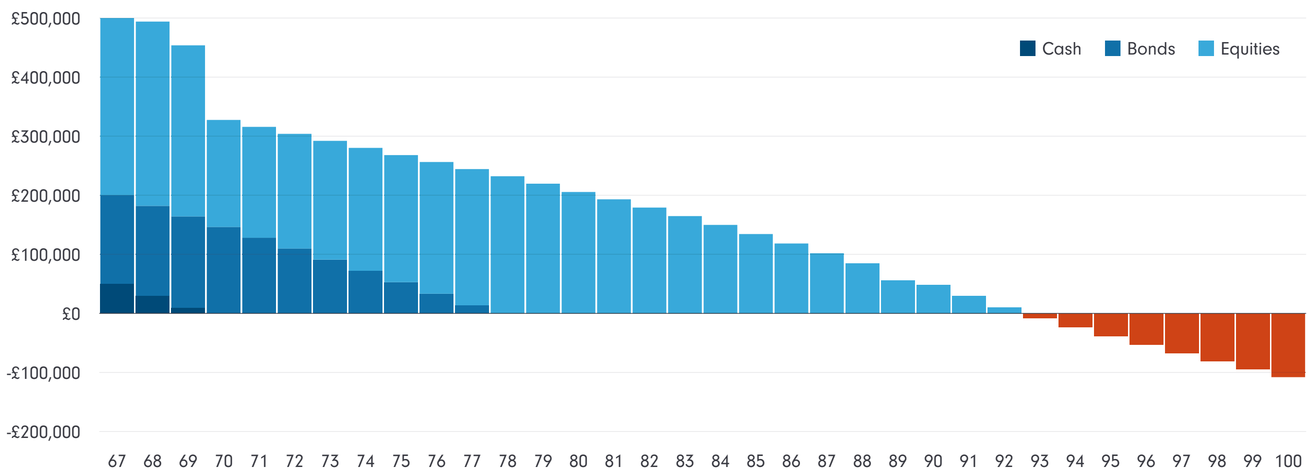
Chart 6: Under strategy B the fund would be worth £379,000 at age 100



Source: FE CashCalc, July 2025.

It might be useful to see how the strategies compare if markets fall in the early years of taking income. The software allows us to model the 2007-2009 market crash. Over this period, Morningstar analysis shows that US stocks fell by more than a third in value[15]. Charts 6 and 7 below compare the two strategies if markets fell like this in the early years.

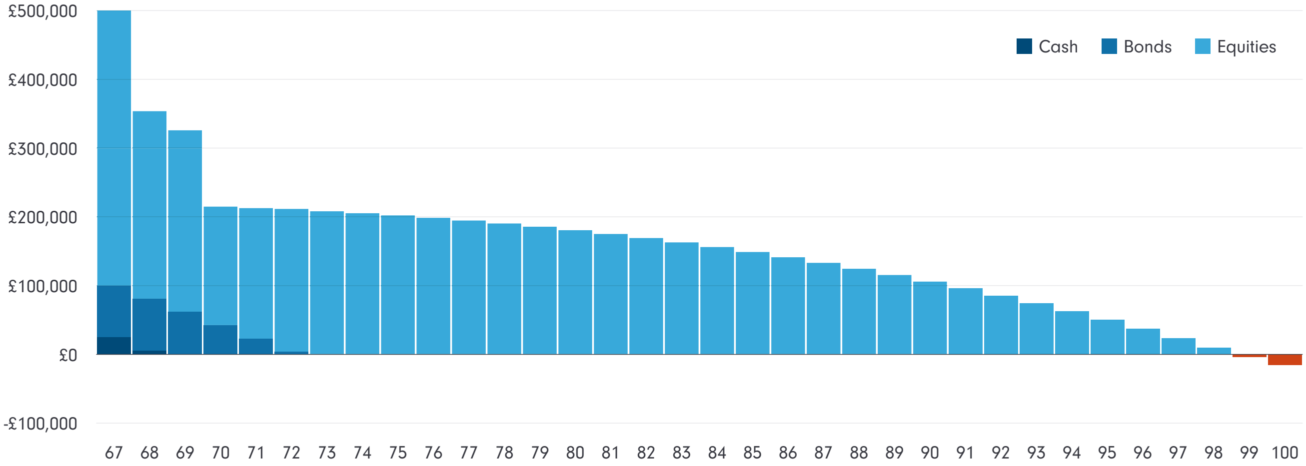
Chart 7: By age 92 funds would be exhausted using strategy A



Source: FE CashCalc, July 2025.

15. Are Bonds Safe During a Recession or Market Crash?, Kristin McKenna, Darrow Wealth Management, February 2025.

Chart 8: By age 98 funds would be exhausted using strategy B



Source: FE CashCalc, July 2025.

There are a couple of points to bear in mind that impact this analysis:

- **Market rebound.** After the 2007-2009 market crash the market rebounded quite spectacularly. US data shows that the average annual return on US stocks in the five-year period after the worst one day fall on 15 October of 9% equalled 15.9%[16].
- **Negative correlation.** The model shows bonds maintaining an estimated growth rate of 4% throughout the crash. Bond yields generally do rise when equities fall and did increase over the period of the crash.

16. How stock markets perform after heavy falls, David Brett, Schroders Wealth Management, October 2020.

Both these occurrences would have benefited each strategy (though strategy A would likely benefit more than strategy B). If we consider the first point and build in post-crash returns of 10% p.a. compound the result would be quite different. Both approaches would have enough funds to comfortably last until 100, despite the substantial market falls in the early years of retirement.

A smoothed managed fund could also be beneficial in either portfolio particularly if a market fall results in a positive correlation between equities and bonds. A smoothed managed fund isn't immune to market falls, but is likely to fall by less than the actual movement in the price of the underlying assets.

Overall, adding a guaranteed lifetime income can deliver better long-term outcomes and help combat sequencing risk. And of course, there are other benefits: The peace of mind that comes from knowing that all or a proportion of essential or important expenditure is covered even if the remaining funds are exhausted. However, in the short term, even if value protection is selected, the fund value on death is likely to be higher under strategy A.

The FCA thematic review of retirement income advice confirmed the need to consider a combination of solutions[17]. The development of guaranteed lifetime income options that sit on investment platforms means these products can be integrated seamlessly within drawdown. This should make this option more attractive to advisers and their clients in the right circumstances.

It should also be borne in mind that the results are sensitive to the investment returns and the asset allocation. An aggressive equity allocation and strong equity returns are much less likely to favour the inclusion of a guaranteed lifetime income based purely on the potential to maximise long term growth.

> **A smoothed managed fund isn't immune to market falls, but is likely to fall by less than the actual movement in the price of the underlying assets**

Key points

- As well as providing better outcomes in many instances, adding a guaranteed income for life can help combat sequencing risk without the need to hold substantial cash reserves, reduce equity exposure or vary income payments.
- By potentially providing the bulk of a client's income much less needs to be withdrawn from the remaining fund. Any residual income could be taken from a small cash reserve or encashing bonds.
- However, if only a small cash reserve is held and the correlation between bonds and equities is positive, this could still leave the client exposed (notwithstanding any small cash reserve).
- The addition of a smoothed managed fund could provide a further option to protect against market falls in the early years; while not immune from market falls, the impact is cushioned which could further combat sequencing risk.
- Cashflow forecasting reinforces the benefits of adding a degree of guaranteed income to a drawdown portfolio in boosting long term fund values and combating sequencing risk.

17. Retirement income advice thematic review, FCA, March 2024.

Summary

- The decumulation phase differs markedly from the accumulation phase. It requires the skilful management of a number of variables that can easily derail a client's retirement plans if not reviewed regularly. These include anticipating longevity, reviewing inflation, calculating client specific withdrawal rates and monitoring these throughout retirement.
- A significant risk that can arise early in retirement is the impact of market falls while taking income. A balanced, diversified portfolio usually comprised primarily of equities and bonds can help manage this risk, but there are occasions when these assets are positively correlated and both fall at the same time.
- A range of strategies have been developed to combat this. However, they can potentially impact the long-term aim of maximising returns for a given level of risk. They may reduce equity exposure in the early years or hold significant cash reserves. Alternatively, there are strategies that vary income which may be impractical.
- Including guaranteed lifetime income within a drawdown portfolio has traditionally been viewed as a method of covering essential expenditure. This may have little application for affluent clients for whom essential expenditure is a smaller proportion of their outgoings, compared to less affluent households, and may be adequately covered largely by the State Pension and any defined benefit income.
- There is a growing body of evidence that demonstrates that including guaranteed income for life within a drawdown portfolio can deliver tangible results: Better outcomes by way of a higher sustainable withdrawal rate and/or greater benefits on death long term. This approach can also help combat the insidious impact of sequencing risk, by reducing the amount needed to be realised from other assets.
- Ultimately, what is right for any client will depend on their particular circumstances. This point is reinforced in the FCA thematic review of retirement income advice. There is no one universal solution that will work for everyone. The key is to ensure that each possible solution is considered and assessed in defining the retirement strategy most likely to achieve the client's retirement objectives.

Important information

This document provides information and is only intended to provide an overview of the current law in this area and does not constitute financial advice, tax advice or legal advice, or provide any recommendations. The value of benefits depends on individual circumstances. The minimum age clients can normally access their pension savings is currently 55, and is due to rise to 57 on 6 April 2028, unless they have a lower protected pension age. Different options may have different effects for tax purposes, different implications for pension provision and different impacts on other assets and financial planning

The value of investments and the income from them, can go down as well as up, so clients may get back less than they invest.

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