Investing for retirement portfolios

By Perpetual Private Insights
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Record market highs in recent months, even in the face of the Delta variant and fresh lockdowns, show that markets are inherently forward-looking. But with so much economic uncertainty, what does this mean for your retirement portfolio?

In this article, we explore different approaches to investing that benefit from different economic outlooks, and with higher inflation on the horizon, Perpetual Private's experts weigh in on what investors should consider when preparing their portfolios for retirement.

We also share Perpetual Private's investments that saw us achieve a record year for the Perpetual Private's share portfolio.

A look at investing styles

For stock markets, it's been a roller coaster since the emergence of COVID-19 in early 2020. In the early stages of the pandemic investors moved into **defensive** stocks. Defensive stocks are companies that have steady demand no matter what stage of the economic cycle, such as health care and consumer staples.

Investors also shifted into **growth** stocks that support the new ways we're living and working remotely and shopping online and sold stocks we're no longer enjoying, such as airlines. The rapid vaccine development then triggered a shift to **cyclical** and **value** stocks that traditionally benefit from an economic recovery.

"Cyclical stocks are those tied to economic conditions - that is, they tend to rise as the economy does, and fall when it doesn't", says Stephen Kench, Head of Direct Equities at Perpetual Private.

"Mining stocks, where production of raw materials is dependent on demand for the final product, are considered cyclical stocks. There are also discretionary stocks, such as luxury brands.

The pandemic has reignited an ages old debate between proponents of growth and value investment styles. Value and growth investing focus on different types of stocks, with their own characteristics and strengths.

"Growth investors look for companies that have above average growth relative to the economy", says Stephen. "Typically, they are newer disruptive style companies with untested business models; they trade with investor enthusiasm and momentum, and with the promise of blue-sky future cash flows."

"Value investors, on the other hand, focus on good quality companies, proven over time and with established cash flows" added Stephen. "Value stocks are more likely to be aligned with the broader economy and value investors seek to buy these attributes at the right price - that is, when they are undervalued by the market.

What drives performance of different investing styles?

Over the last thirty years, growth and value stocks have each had their time in the sun. Equally, for long periods value and growth have largely been in sync. However, in the last few years growth companies, led by the multinational tech giants such as Apple, Facebook and Amazon, have outperformed the market.

What are the economic drivers which have seen growth stocks outperform traditional value and cyclical stocks, such as the miners and banks?

Firstly, many of these large cap tech stocks now make up the bulk of growth indexes as they have matured and are now firmly established in everyday life for billions of people. Pandemic-enforced lockdowns have further fuelled the rally of tech stocks as people moved increasingly online for their shopping and other digital experiences, for example Zoom.

Secondly, current low interest rates are adding to high valuations for growth stocks. This is because when interest rates are low, so too is the discount rate' which is used to estimate the present value of a company's potential future cashflows. When future earnings are discounted at a lower rate, growth style companies are valued a lot higher.

Over the last year, the threat of recession and subsequent enormous cash stimulus provided by governments globally have been the catalyst for a rotational shift away from defensive and growth investing into value/cyclical investment styles. Simply put, value stocks that were out of favour for several years leading into 2020 at the height of pandemic uncertainty, have rallied the most into 2021.

Meanwhile, stimulus triggered inflation is also raising the prospects of higher interest rates for markets. While interest rates are unchanged from November 2020 lows, any actual increase – or even a clear signal from the central banks that they intend to raise interest rates – should also see a shift from growth to cyclical and value stocks.

Building the right retirement portfolio

With a shifting investment outlook for the 2020s, investors should check that their investment portfolios are still aligned with their financial objectives believes Marisa Senese, Senior Financial Adviser at Perpetual Private.

"Many of our clients at Perpetual Private are seeking advice for the all-important years before and shortly after retirement when wealth is at its peak and stable returns are paramount", says Marisa, "our focus is to help them restructure their investment portfolios from accumulation stage towards meeting income needs for retirement."

"Growth stocks provide scope for anticipated future growth, but can come with higher volatility and can be more suited for long-term investors, meaning it may not be appropriate for investors nearing retirement", Marisa added.

"The prospect of higher inflation means that markets, for the first time in over a decade, are facing higher interest rates and may present greater risks for growth stocks. This tends to be good news for value stocks".

How active, value investors are responding

Perpetual Private are traditionally quality investors with a value-bias. We're also active investors which means we make portfolio changes based on the opportunities we see in the market. As a result, our Core share portfolio returned 37.9% for the 2021 fiscal year (11.3% per annum compounded over 5 years), with the March quarter being the best three months on record.

Here's how we invested during the year to 30 June 2021.

"Between June and October 2020, we saw the benefits of the support from ‘Team Australia’ – the government, RBA and the banks", says Stephen, "and we saw more certainty around market direction following this willingness and ability to keep the economy open."

"We looked at stocks that could benefit from a reopening of the economy – cyclical companies such as James Hardie and Aristocrat; and value opportunities, such as Scentre Group."

"We also sold Coles and Wesfarmers which were great at the beginning of the pandemic defensively", Stephen added "but as the global vaccine rollout began this year, we shifted to stocks, such as Macquarie, that would benefit from people being back in the economy and capital investment being reinvigorated."

With deeper vaccine penetration globally, economies are gradually opening up. However, the path is not linear as we are witnessing in Australia. The Perpetual Private investment team feel that portfolio success to date is just the half-time scoreboard. Benefits from a progressive return to a new-normal lifestyle should see further upside from our positioning in quality companies that should benefit from cyclical and value-based drivers.

> To 30 June 2021, active management delivered an additional +3.5% return across Perpetual Private’s Core portfolio, relative to being left untouched from 30 June 2020.*

What lies ahead?

While markets are facing the prospect of higher inflation, there is an ongoing debate whether the current inflation spike is transitory or more permanent, and whether sustained inflation could force major central banks to raise interest rates sooner than current 2023 or 2024 forecasts.

The rise of the Delta variant that is causing ongoing lockdowns around Australia could also affect company earnings which present risks, and opportunities, for investors.

If you're approaching retirement, or recently retired, it's important that your portfolio is appropriately positioned for the opportunities and risks ahead, while also preparing you to efficiently draw down on your investments in the years ahead.

The wealthy investors' guide to retirement investing

Written for individuals with more than one million in investible assets, this free ebook contains eight thought-provoking chapters on how you can generate a retirement income in a low-rate world. It provides practical tips and advice on alternative investment options, tax effective investments and investing responsibly without compromising on returns. It's the essential guide for those seeking to grow their wealth in retirement.

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