The heresy option for prudent savers

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One rather subversive book I enjoyed reading over the holiday was *Worry-free Investing* , by Zvi Bodie, a professor at Boston University, and Ian Sykes, a consulting actuary*.

On the surface it may not sound like a dangerous tome, but it seeks to undermine much of the received wisdom on which most advice about long-term investing is based.

The book I read is a version adapted for UK-based readers of the original US-oriented book first published in 2003 (the US edition having been co-written by Michael Clowes rather than Ian Sykes).

Neither version makes comfortable reading for the investment industry, as the authors take issue with the idea that equities should form the basis of most people's retirement savings portfolios.

They are too risky, even over the long term, the book asserts. It gives short shrift to the conventional wisdom that the risk of holding equities decreases over time, and to the idea that equities are more or less guaranteed to outperform bonds over the longer term.

The random nature of annual stock market returns means savers cannot rely on an equity portfolio to provide what they need at any point in the future. A strategy of switching from equities to bonds in the run-up to a target date does not help, "because you may be locking in a loss rather than a gain", the authors assert.

The approach recommended instead is to invest in index-linked gilts or savings certificates, which are the only products guaranteed to keep pace with inflation.

Readers are advised to work out how much they will need to save to reach a specified retirement goal, assuming a particular life expectancy and a 2 per cent real rate of interest.

Investing in risky assets is not ruled out completely, but the suggestion is that it should be restricted to savings that can be made beyond the level needed to reach the target via investments in index-linked gilts. "Put at risk only as much money as you can afford to lose," the book says in bold lettering.

It also tells readers to consider their ability to take risk in the context of their overall situation. Young people, usually considered able to bear most risk, may be highly exposed to stock market risk already through their jobs - if they work for a company that could go bust in a recession, for example.

For those in a position to invest in shares, it suggests constructing a capital- guaranteed portfolio by investing enough in index-linked bonds or cash to return the original capital over a specified period and the balance in stock options. For those who prefer to invest in stocks, index funds are the recommended investment vehicle. There is no evidence that funds charging high fees for active management deliver better net returns than passive index funds, according to Mr Bodie and Mr Sykes.

According to this book, then, the conventional investment management industry might as well pack up and go home. Active fund managers are no use to savers who want a certain outcome.

Guaranteed equity products sold by banks and other financial services organisations are best avoided, too, as they cost more than the DIY version and are less secure.

Savers would need the services of an adviser to run their bond and options portfolio, the book acknowledges, and possibly to help open a personal pension and channel savings into an index-linked gilt fund, or directly into linkers in a self-invested personal pension (Sipp). But they do not need the whole panoply of products vying for investors' money.

The idea that there is a simple, low-cost and risk-free way to save for retirement is beguiling. But it is likely to be way out of reach for many people unless they are prepared to sacrifice consumption now for income later, and save a lot more.

There are already concerns that people are not saving enough to provide a decent retirement income, and that is assuming they earn returns of 6.5 or 7 per cent a year from stock market investment.

In spite of this caveat, *Worry-free Investing* should be required reading for anyone saving for retirement - or for anything else. It provides a different perspective, which is always valuable, and although written by an academic and an actuary it is easy to follow.

Much thought is being expended on how to make retirement ends meet as populations age and returns fall.

The search for outperformance is taking investors into increasingly illiquid and opaque investments, although appetite for those may have fallen in the wake of the credit squeeze.

Most investors, and pension funds, cannot hope to earn that outperformance and, even if they do, the costs could outweigh the additional return.

They may have to settle for security, spiced with a little extra from capital-protected equity investments. It is also inescapable that people will have to work longer and save more. Maybe that is the real message of the book - and it is subversive indeed.

**'Worry-free Investing: A sure way to achieve your lifetime financial goals', published by Financial Times Prentice Hall*

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