Getting started on your pension journey

Eoghan Gavigan, a specialist investment adviser and certified financial planner at Highfield Financial Planning, has advice for those looking to start a pension, writes Siobhán Maguire

The low rate of pension penetration in Ireland is a common topic when subjects such as auto enrolment and possible changes to pension tax relief are being discussed. That's according to Eoghan Gavigan, a specialist investment adviser and certified financial planner at Highfield Financial Planning.

Gavigan said statistics can make it seem like there is a lack of urgency among consumers in relation to starting a pension, and this in turn can produce a herding effect where people follow what others are doing, or not doing, and put pensions on the long finger.

"Someone once said that deciding to start a pension is like deciding to have a baby, if you wait until you can afford it, you'll probably never do it," he said. "How early you start is critical, and far more important than how much you contribute at the start.

"If a person starts contributing to a pension at a young age, most people find relatively quickly that they have capacity to increase their contributions and the earlier you commence investing, the earlier you start to benefit from the effect of compounding of returns, which is a very powerful driver of investment returns."

To explain his point, Gavigan uses the following statistic as a way of showing the pensions landscape.

"As of Q3 2018, only 16.3 per cent of workers between 20 and 24 years old had a pension, whereas in the 45-to-54 age group almost 71 per cent had a pension," he said. "It is likely that the 29 per cent who haven't funded one by age 45 are primarily low-paid workers.

"When you factor in the fact that low-paid workers may not ever fund a pension due to affordability and because, in theory, they won't need one as the state pension will provide them with over 50 per cent of their pre-retirement income, we can see that although the vast majority of young people eschew pensions, it seems that in time most who can afford pensions change their minds. This is a pity as if you are going to do it, starting early makes the job so much easier."

Eoghan Gavigan, Highfield Financial Planning

Gavigan said a common objection to starting a pension is the fear of investment risk. "However, this argument holds the least weight when the investment of a pension is being discussed," he said.

"Investing, broadly speaking, takes one of two forms, lump-sum investing or instalment investing. Of these, lump-sum investing carries the higher risk as whatever happens in the market happens to your lump sum, whereas with instalment investing, short-term market weakness during the term of your pension will actually enhance your eventual return as you will acquire more units when prices are low. This presumes that you don't crystallise losses before the market recovers, which is why prudent management of the investment, especially in the later years, is important."

Another factor affecting risk is the term of the investment as an investor who has a longer investment timeframe can ride out dips in the market. However, an investor with a short timeframe to a defined maturity date will, to a large extent, be a victim, or a beneficiary, of whatever happens in the market.

"Taken together, we can see that instalment type investing over a long term – which is the form that pension investing normally takes – is a comparatively low-risk endeavour," said Gavigan.

"We regularly see claims by funds of superior performance over a given period, but no fund beats the market over the long term. As well at this, if you believe in reversion to the mean – that deviations from the long-term average price will revert to the average – you would have to conclude that going with last year's best performer is a flawed strategy. Investment advice isn't about guessing which fund will outperform in any given year or timing the next correction in the market."

Gavigan said an adviser cannot reasonably recommend an investment portfolio for a client without a financial plan. The plan determines the rate of return required to achieve the financial objective, and this, and assessment of your risk profile, your capacity for risk and your risk tolerance, informs asset allocation.

"A key thing about this process is to remember that if you manage to achieve your return objective, the additional satisfaction you may get from exceeding it is less than the disappointment you will experience if you take too much risk and fall short," he said. "A comprehensive financial plan will facilitate you in selecting investments which should help you to grow your pension assets with only as much volatility as you can comfortably bear.

> **"How early you start is critical, and far more important than how much you contribute at the start**

"Advisers often talk of clients being upset because their fund value didn't increase during a 12-month period or fell by, say two per cent, but what this actually means is that the way that investments markets work wasn't adequately explained to the client to begin with. Pensions are a long-term game and history shows that those who stay invested reap the rewards."

For more information on Highfield Financial Planning, see hfp.ie