Navigating Financial Repression for Better Retirement Income Planning

Between lower-for-longer rates, rising inflation, negative real yields, and rising equity volatility, investors should re-think their nest egg allocations.

Clinical as it may sound, the term “financial repression” can be used to describe some of the angst in markets today. That’s when savers are punished by lower-for-longer interest rates despite higher inflation and significant growth in GDP. For investors looking to augment their retirement income, allocation decisions and dislocation risks loom large, especially when unprecedented liquidity has driven equity prices to record heights.

There are four major headwinds at work against investors in the current climate of financial repression. Overcoming each requires redefining what risk really means to an investor today.

**FINANCIAL REPRESSION MAGNIFIES FOUR BIG HEADWINDS**

1. **Income Scarcity**
   - Low yields make it harder for investors to generate income

2. **Inflation**
   - Inflation erodes savings, regardless of whether it is transitory or persistent

3. **Rising Volatility**
   - Richly valued equities and expectations of tighter monetary policy produce elevated volatility

4. **Investor Behavior**
   - Risk aversion and market timing typically end badly

Investors must take on more risk to generate income, but few are properly allocated.

Source: Allianz Global Investors US LLC.
1. **Income Scarcity.** Negative-yielding global debt is an astonishing $16.5 trillion today. Too many investors are choosing to grow poor slowly by sitting in low-interest investments when they could look beyond traditional income sources.

**PORTFOLIO IDEAS FOR GENERATING INCOME IN A LOW-RATE ENVIRONMENT**

![Diagram showing portfolio ideas for generating income in a low-rate environment.](image)

Source: Allianz Global Investors US LLC. The chart shown is for illustrative purposes only and is not indicative of any Virtus strategy.

2. **Inflation.** Whether transitory or persistent, pockets of inflation erode the real value of an investment, especially fixed income, in a lower-for-longer rate environment—ample reason to add asset classes that have tended to perform well in inflationary environments.

**INFLATION: THE STEALTH THREAT TO RETIREMENT INCOME**

Effect of Inflation on a $50,000 Portfolio over a 25-Year Period

![Graph showing effect of inflation on a $50,000 portfolio over 25 years.](image)

*Past performance is no guarantee of future results. Source: Virtus Performance Analytics. For illustrative purposes only. Calculations based on hypothetical inflation rates of 2%, 3%, and 4% to demonstrate the impact of inflation over time. Actual inflation rates will vary and may be more or less than shown.*
3. Rising Volatility. Equity markets sitting at or near all-time highs may become fragile with the removal of accommodative policy. Since the Fed announced “QE4” on March 20, 2020, the correlation between S&P 500 Index price return and Fed balance sheet expansion was 0.93. What happens when the Fed eventually starts tapering asset purchases? Expect more volatility going forward as investors shift focus from the Fed to fundamentals.

RISING VOLATILITY MAY EXACERBATE INVESTOR RISK
CBOE Volatility Index (VIX)

![Graph showing volatility index](image)


4. Investor Behavior. A veteran financial journalist once said our investing brains often drive us to do things that make no logical sense—but make perfect emotional sense.1 Take, for example, how much investors let risk aversion take control since the beginning of the pandemic. Investors largely and consistently favored fixed income and cash (the top three selling categories shown below) over equities, thereby missing the opportunity to participate in the stock market’s remarkable climb. Sadly enough, such self-sabotage tends to be repeated through risk aversion and market timing.

RIGHT TIME BUT WRONG PLACE
Total Flows, April 2020–September 2021 (Billions)

<table>
<thead>
<tr>
<th>Category</th>
<th>April 2020</th>
<th>May 2020</th>
<th>June 2020</th>
<th>July 2020</th>
<th>August 2020</th>
<th>September 2021</th>
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</thead>
<tbody>
<tr>
<td>Taxable Bond</td>
<td>$1,060</td>
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<td>Municipal Bond</td>
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<td>$169</td>
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<tr>
<td>Money Market</td>
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<tr>
<td>U.S. Equity</td>
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What should investors near or already in retirement do in such an environment? Here are four ways they can reassess risk in the face of key issues that could weigh on returns:

<table>
<thead>
<tr>
<th>Issue</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Duration Risk</td>
<td>If duration, a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates, is too high, short-term bonds may reduce the risk of rising interest rates. Exposure to credit may help in rising rate environments as well.</td>
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<tr>
<td>2. Income Scarcity</td>
<td>Look beyond traditional income sources. Investors can move out the credit spectrum to enhance yield potential. Active security selection may help manage risk.</td>
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<td>3. Inflation</td>
<td>Add assets for growth and real, after-inflation gains.</td>
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<tr>
<td>4. Investor Behavior/Sequence of Returns Risk</td>
<td>What happens if the markets take a deep dive just when you’re ready to start taking withdrawals? This is known as “sequence of returns risk.” Among the allocation opportunities investors may want to consider in such a scenario are hybrid asset classes that offer exposure to the equity risk premium and may drive long-term growth in a risk-managed way.</td>
</tr>
</tbody>
</table>

To learn more about strategies that may help address longevity risk, please contact us at 800-243-4361 or visit virtus.com.