Low rates, rising costs make it tough for many retirees

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Self-funded retirees have been doing it tough since the global financial crisis, battling constant changes to superannuation law, age pension limits and Australian interest rates at record lows and seemingly staying there.

Historically, term deposits form a big part of investment returns for retirees because they're low risk and generate a solid and reliable rate of return. However, with such low rates today and rising cost of living, it's more difficult to obtain returns that will meet day-to-day income needs.

Many retirees who are averse to risk would have planned 4 to 5 per cent a year interest on their term deposits to fund their cost of living, but are now barely returning 2.5 per cent.

The pain could also be set to get worse with major banks recently cutting rates further.

The good news is there are alternatives to term deposits.

Blue-chip Australian shares pay dividends to shareholders historically at about 5 per cent a year and added to the cash dividend, there is usually a tax credit worth up to an additional 2 per cent, making income from shares extremely attractive. There is danger, though, in buying shares as a direct replacement for term deposits because they tend to fluctuate in price and will have periods of time where their capital value diminishes. Government bonds see you lend your money to the government and they pay you an interest rate in return. These are usually very low risk as the Government taxes us to pay the interest. Currently the 10-year government bond yield in Australia is 2.64 per cent. That's not much better than a term deposit and even though they are extremely low risk, the reward for taking on even such a low risk is simply not there if using these on their own.

Investing in a corporate fixed income involves lending money to a business that makes interest payments to you in return. At the end of the term, all the capital is repaid. The risk with a corporate bond is that the company gets into trouble and might not be able to pay all the interest, or return all the capital at the end of the term. These securities have become increasingly attractive as many pay over 4 per cent income, and as high as 6 per cent when tax-effective franking credits are added back.

Building an income-oriented portfolio is not about investing in government bonds, as these alone will not help you boost your income. It is more likely to involve a multi-pronged approach involving high-quality bonds which will help provide stability and smooth returns should markets hit another rough patch. You might consider a mix of semi-government and corporate debt allowing access to higher rates of income with relatively little added risk and, for those who can handle a little volatility, some high-yielding Australian shares are worth considering. Dividend yields are attractive and they also provide scope for capital growth over time.

Other alternatives might include spending less which might involve completing a budget to see what expenses can be reduced, drawing more of your capital while interest rates are low or taking up some part-time work to help supplement your income.

Securing a high and stable income stream is difficult in our current low growth, low interest rate environment so it is worth considering a diversified approach.

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