NEWSLETTER

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MAKING YOUR SAVINGS LAST IN RETIREMENT

By John Orford, Senior portfolio manager, MacroaSolutions

Brief History of Retirement

The Chancellor of Germany, Otto von Bismarck, was called a socialist for introducing the first modern pension in 1889.

The initial retirement age was set at 70 years (subsequently reduced to 65 years) – hardly generous as it was more or less linked to life expectancy in Germany at the time.

Demographics of Aging

Today, the retirement age in Germany is 65, life expectancy is 81 years and closer to 85 for current 65-year-olds.

Retirement ages around the globe are now around 60-70 years as the dramatic increase in average life expectancy continues to rise.

Back in 1889, pensioners were unlikely to enjoy their pension for more than a few years, while today's retirees may need to draw a pension for over two decades.

Growing Your Retirement Capital

When building up your pension pots, the main challenge is making your income last through your retirement years.

The first step to achieving this is to invest for the long term throughout your working live.

However, this is by no means the end of your investing lifespan. Some of your investment objectives are likely to change once you retire.

For example, once retired you might often need to draw a regular income from your investments and be more concerned with preserving your capital. However, if you are already in retirement, you still have to focus on growing your capital.

Increased longevity means that, unless you start with a very large capital sum, you will have to continue growing your capital to sustain a reasonable monthly income through retirement.

Beating Inflation in Retirement

In addition to sustaining an income over a longer period of time, you also need to ensure that you compensate for inflation risk.

Whilst being employed you are receiving an inflation-linked salary. You will need to make provision for an inflation-linked retirement income as well, to prevent facing a steep decline in living standards.

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South Arica's inflation rate has averaged 5.4% annually over the past 106 years and will be close to 5.5% per year over the next ten years.

The chart below shows the impact of inflation on a fixed monthly retirement income.

INFLATION CORRODES SPENDING POWER

Take a look at what a 6% inflation rate effectively does to your money:

TODAY	10 YRS LATER	20 YRS LATER
R10 000	R5 584	R3 118

Growth Assets Are the Key Contributor to Long-Term Retirement

In Summary

You have to remain focused on achieving long-term capital growth even when retired or close to retirement. If not, it is very likely that your standard of living and income will decline. Although cash may offer temporary attractive returns during times of volatility, it is important to remember that its returns are poor over time.

South African cash has delivered a real return of only 0.6% per annum since 1929 compared to South African equities at 7.5% per year.

To put this in perspective, it would have taken nine years to double your money in real terms investing in South African equities, but more than 92 years to do the same in cash!

Therefore, it is important to retain some exposure to grow assets beyond retirement.

INVESTING IN A ROLLER COASTER STOCK MARKET

By Henry van Deventer, Head of Wealth Development

It has been quite a challenging twelve months for investors. Wherever we turn, the media is reporting on the rand reaching record lows, negative investment returns and doom and gloom for South Africa's economy.

Added to this, are the Brexit vote, turmoil in Europe and the prospect of Donald Trump as the next president of the world's largest economy leaving many investors in a state of concern and uncertainty.

In times like these, we start asking questions like "Is it not better to earn interest in a fixed deposit?" or "Should I not cash in my investments and wait for the tide to turn?"

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When you equip yourselves in trying times, most of what you read focuses on the economy, the rand, political uncertainty and market trends.

Although this is important, you need to understand that there are two sides to being a successful investor: managing your investments and managing your behavior.

Although it is impossible to control investment markets, you can choose how you react to these events.

Understanding the consequences of your decisions and how it will affect your portfolio over time can be hugely beneficial.

Daniel Kahneman, winner of the Nobel Prize in Economic Sciences, draws a clear distinction between thinking fast and thinking slow when it comes to investing.

Fast thinking is instinctive and emotional – our knee-jerk reactions.

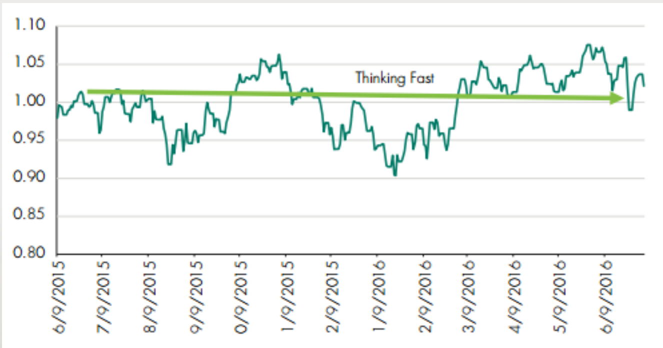
This is also the first reaction to uncertain markets when fear and uncertainty prevail.

Slow thinking is about making more considered, thought-through decisions. Having a framework for making these decisions will help you be more successful over time.

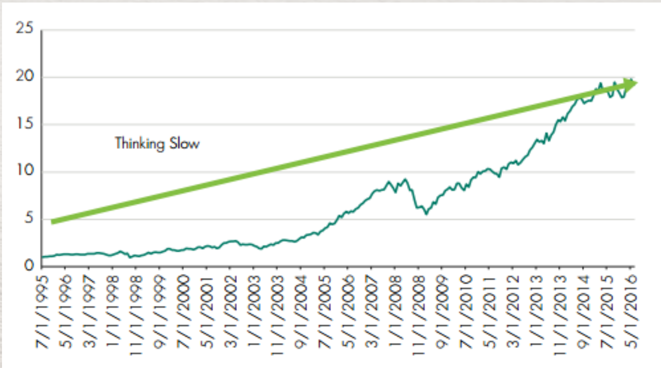
So how do you think slow in difficult times?

Reports on the South African share market tend to focus on the short term. The graph below shows how the South African share market performed over the last year:

The South African Share Market Over the Last 12 Months



The South African Share Market Over the Last 20 Years



Here is a list of the four key things you can do to manage your investments more effectively:

1. Don't measure investments against the market.

Instead of focusing on the share market, the rand or the best-performing funds, rather focus on achieving the returns you need and measuring your progress against that.

Investing successfully is about getting your money to work for you over time.

2. Control exposure to risk.

More than ninety percent of an investment's risks and returns are determined by its underlying asset allocation (such as shares, property, cash, bonds, local and international exposure).

The best way to control risk is to actively manage your asset allocation of an investment.

An actively managed investment strategy focuses on doing this on an ongoing basis.

With such an investment, you can rest assured that you don't need to make any changes yourself to deal with market risk – it's already being done.

3. Know what to expect.

You need to understand how likely your investment is to make or lose money, and how big those gains or losses can be.

4. Monitor risk tolerance in line with your framework.

Rather than focusing on whether you are winning or losing money in the short term, the question should rather be if you are on track to achieve your desired returns.

Old Mutual Wealth did some research on the impact of sticking to the above framework.

Over the last ten years, investors who followed these guidelines were, on average, 1.24% per year better off than investors who didn't.

On a R1 million investment over 20 years, this amounts to additional growth of almost 27% (about R600 000).

Having a framework to help you think slower will not only better your investment returns, but will also give you the peace of mind that comes with having power of the things we can control.