Saving for retirement: the long and the short of it

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When faced with a short-term shock affecting not only our health but also our financial wellbeing, it gives reason to reflect on whether focus is in the correct areas and if all the old adages about financial planning are still valid. Our analysis picks up some new surprising insights and confirms many old ones.

A client naturally assumes that asset managers are experts and therefore likely to deliver superior returns, even in times of volatility. Volatility in this sense is not just the industry euphemism for negative returns, but the dispersion in returns caused by the imperfect information on which buyers and sellers rely on to determine the value of a security.

The consequence of this volatility is stark. If one looks at the range between the highest and lowest returns in the Association for Savings and Investment South Africa (Asisa) High equity performance survey, the difference is a startling 43,1%. By contrast, the equivalent range for the nine months to September 2019 was 20,8%. This reinforces the adage that a blend of managers reduces the single manager performance risk.

Time is your friend, and this annualised return range reduces to 9,5% over 10 years and 5,8% over 20 years to September 2020 (although there are far fewer participants in the survey with this length of track record and there will be a strong survivorship bias).

The extent of the negative returns would be of significant concern to anyone close to retirement. High equity exposure from this unit trust category is clearly not appropriate to achieve a specific rand value on which to retire. At the depth of the COVID-19 crisis at the end of first quarter of the year, high equity portfolios had suffered high teen losses, but the long-term interest rates had also significantly increased. The consequence of the change in the shape of the yield curve was a similar but opposite move in the price of purchasing a life annuity at that point (or matching future expected lifetime pension payments with a bond portfolio). The lesson learnt here is that planning to secure a level of income at retirement rather than targeting a specific number leads to much lower volatility in the outcome and more rational long-term planning and reaction.

Once the initial fear of the spread of the pandemic was replaced by concern as to the economic effect of the lockdown, there were calls for emergency access to retirement funds. The favourable tax treatment of retirement monies means that it is generally locked up until retirement (or in the case of employer-sponsored arrangements when employment status changes). The calls for access to these funds would have been difficult to achieve legislatively and administratively. This also highlighted the fact that few South Africans have ready access to savings for emergencies.

Given the call was made to gain access to retirement funding arrangements, it underscores that retail savings bonds and tax-free savings accounts have not yet built up enough balances or got enough support so that they could provide relief. The maxim that investment products are sold and not bought seems to further explain this predicament given low adviser incentives on these two products.

Of concern, over three-quarters of members in several large commercial umbrella funds had retirement balances of less than six months salary. This implies that not only is access to savings for emergencies a significant problem, but the lack of preservation in employer arrangements leaves their members with small balances.

The plight of self-employed retirement annuitants was emphasised as, unlike their employed peers, they only have access to their retirement savings at early retirement from age 55. Financial planning for this segment of the market requires more attention.

It would be expected that given the financial crisis, those individuals who have secured their retirement savings in preservation funds would use this opportunity to take their one withdrawal as relief. What was remarkable was that the overwhelming majority still have the option and that less than 5% did so over the period. Disciplined South African savers who understands the power of compound interest and the value of good financial advice are able, within the system, to ensure their financial wellbeing.

It is clear many South Africans need good financial advice, but those armed with advice have ably weathered the Covid storm. We need to focus more on retirement income outcomes and buffers to protect against short-term shocks.