

It's never too early

Saving for retirement

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I am surprised each time I come across people who simply cannot afford to retire at age 65 (and older), and are forced to keep working or are left with small amounts of capital that afford them very little dignity in retirement.

In today's world of instant global communications, the web and the fast pace of change, we have become a consumer generation where instant gratification is a way of life. It is no wonder then, that most of us spend little time thinking of our future, or what will happen when we retire. The possibility of getting old is one that we are simply not prepared to entertain - not even for a second.

Couple these points with the recent financial crisis and the erosion of confidence in the financial system and it is little wonder that the savings culture in most economies has been on a steep decline in recent years.

The pension and savings landscape in South Africa

In days gone by, most employment took place in the formal sector. Job turnover was low and most people stayed with the same company for most of their careers. The standard pension fund at the time was 'defined benefit' - i.e. there was a value at retirement, determined using a formula of final salary and number of years employed. For many this provided a formal level of saving and a value at retirement that took cognisance of earnings and inflation. But even then it wasn't always enough.

Today, South Africa does not yet have compulsory preservation (i.e. everyone is not required by law to contribute a portion of their salary to a retirement fund or savings vehicle), nor mandatory saving. This means that many people do not even consider saving for retirement until late into their 40s. Further, virtually all remaining retirement funds within the formal sector are no longer 'defined benefit' in nature, but 'defined contribution'. This means that there is no pre-determined benefit at retirement and the employee has the option to cash in his/her investment should there be a change in employment. Regrettably, most people choose this option, using the cash to finance a host of possibilities with little thought for his/her needs into retirement.

Historic returns allow for complacency

Domestic markets have delivered outstanding returns over the last decade as seen in the table below.

| | 1 year | 3 years | 5 years | 10 years |
|--------------------|--------|------------|---------|----------|
| All Share | 19.0% | 6.5% | 15.2% | 18.1% |
| All Bond | 15.0% | 10.0% | 7.9% | 11.7% |
| SA Listed Property | 29.6% | 12.2% | 18.1% | 25.1% |
| AF Money Market | 6.9% | 9.4% | 9.2% | 9.7% |
| MSCI (ZAR) | 0.5% | (5.2) % | 4.0% | 1.5% |
| CPI | 3.5% | 6.4% | 6.8% | 5.8% |

To end December 2010, figures annualised

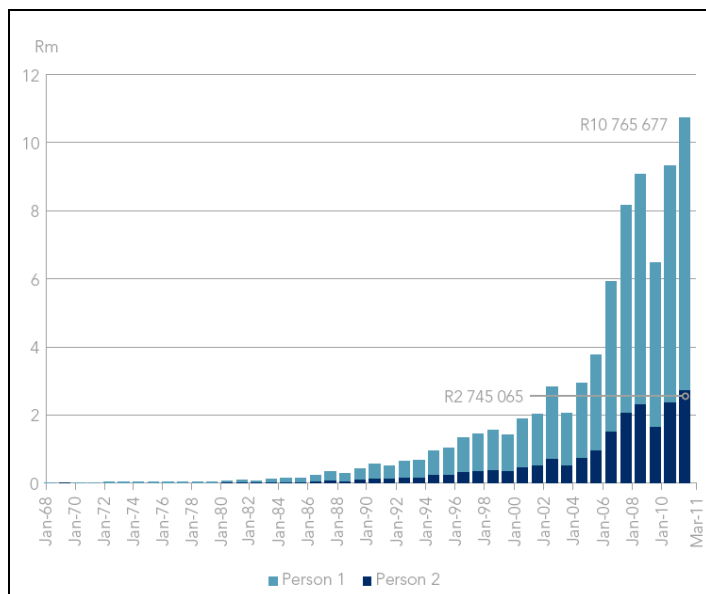
For most it is normal human behaviour to forecast future returns based on these long-term numbers, believing that if they save large amounts closer to retirement, the great returns from the market will bail them out. This is very dangerous. It makes the key assumption that the trends and drivers that supported returns historically remain in place and will continue contributing to growth in the same way. We do not believe this to be true. High historic returns in South Africa were a function of a structural change in inflation, resulting in lower interest rates, declining tax rates, the utilisation of underused capacity and productivity gains. All of which provided support to both the equity and bond markets.

It's about time in the markets

At Coronation we do not believe it is possible to time markets, but rather it is time in the markets that pays dividends.

The chart below shows the powerful effect of compounding over long periods of time. Person 1 is an individual who contributes R100 per month every month from age 21 to 31. At 31 he elects to stop but leaves the money in the equity market (defined as the FTSE/JSE All Share Index). The end value is calculated when he turns age 65. Person 2 also contributes R100 per month, but from the age 31 to 65 (i.e. 34 years). This money is also invested in the same equity market over the full duration.

THE POWER OF COMPOUNDING

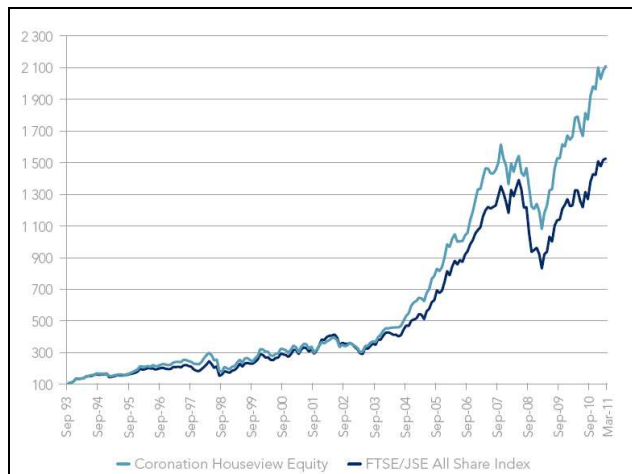


Source: Coronation

The really scary number is that the end value for person 1 is 3 times higher than that of person 2, despite only contributing for 10 years. This is a clear illustration of the powerful effect of starting to save early - and if one does, the required amount is less than what one would need if one started to save at age 40 with a retirement age of 65.

For person 2 to achieve the same end value as person 1, he needs to invest approximately R3 100 per month. An amount that becomes even more onerous if the markets return less in the next few decades (than they have in the past) as we forecast.

Let us take the example one step further and look at the effect of investing with a good manager, where the aim is to outperform the market over the same long-term period. In the example, we have shown the value an investor would have if they had invested R1 000 in the FTSE/JSE All Share Index in September 1993 versus the Coronation Houseview Equity Fund. Once again, one can see that the investor would have an end value that is 38.5% higher than that of the index from being invested with a manager that added alpha of 2.2% p.a. over the duration of the period.



Source: Coronation

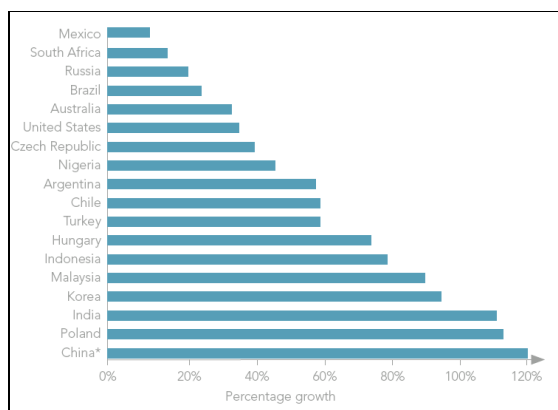
Going forward we are concerned about returns

We have repeatedly written about our growing concern over future inflation rates globally. We believe that the current and previous decade of artificially low interest rates (and the corresponding credit bubble) will result in higher inflation over the long term. We are also concerned about the returns one can expect from asset classes going forward. Our forecasts are muted compared to historic returns for the following reasons:

- We do not believe that South Africa is competitive from a global perspective - we need to increase our productivity and efficiency. Unfortunately labour costs are a large element of this and any reduction under the current environment is unlikely, making us solely reliant on productivity gains.

From the following graph, it is clear to see that labour productivity growth in South Africa versus the rest of the world over the last decade has been extremely poor.

LABOUR PRODUCTIVITY GROWTH, 1990 - 2008



*China's labour productivity growth was 305% over this period

Source: International Labour Organisation

- Fiscal policy is no longer prudent. Government has signalled its intention to spend more and run larger deficits. Higher spending not paid through higher taxes needs to be funded through net new issuance of government bonds and money market instruments. As a result, government expects to borrow more than R150 billion a year from the bond and money markets over the next three years.
- Government's resultant larger share of the economy and increases in prices administered by government and its associated parastatals will contribute to crowding out the private sector through higher taxes and municipal rates, higher electricity and water costs, toll roads, etc.

The table below shows expected returns from each of the asset classes over the next decade. All are low by historic standards.

CORONATION 10-YEAR FORECAST

| | |
|---------------|----------|
| Growth assets | |
| Local equity | 9-11% |
| Global equity | 13-15% |
| Property | 8.5-9.5% |
| Income assets | |
| Bonds | 8.5-9% |
| Cash | 7.5-8.5% |
| Inflation | 6%(+?) |

Source: Coronation Fund Managers research and I-Net Bridge

Faced with this reality there are two options - start saving early or save more to compensate for the effect of lower returns. For most there simply is not enough available cash to save the extra that is needed. Thus, the best option is to start saving early.

In summary:

Start investing for your retirement early - use the current tax advantage of saving in a retirement fund or retirement annuity - it really is an efficient way to save.

- If you start later - you need a higher allocation.
 - Choose the right product - to have a decent standard of living in retirement you need to earn returns of at least inflation plus 5% p.a. over 20 years. Hence, it's necessary to assume some risk in the markets over this time (i.e. equity exposure).
 - Choose a good manager and stick with them. The compounded effect of consistent delivery of long-term market outperformance is material to your investment value at retirement.
 - If you have started late, top-up with additional amounts on a consistent basis (while the tax incentive remains).
 - If and when you change jobs, keep your retirement savings in some form of preservation fund. Do not be tempted to take the cash to spend on short-term needs.
 - If you are fortunate enough, top-up your pension savings with additional contributions to a long-term unit trust with a good manager. Do not chop and change - save for the long term.
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