The balancing act – the reality of a sound retirement

In order to provide retirement funding which will allow members to retire in a way that will support their standard of living, a net replacement value of 75% of their income would need to be secured. While the first principle of retirement savings is to match your assets to your liabilities and in doing so, generate sufficient capital at retirement to buy a pension, the reality is very different.

In fact, only 6% of South Africans have accumulated enough savings to retire comfortably. Additionally, mirroring global trends, South Africans are living to be older and as a result need to work longer or save more in order to maintain their standard of living.

In order to achieve this 75% net replacement value, investment strategies range from conservative, balanced, aggressive, member choice to life staging, and generate a great deal of controversy in the process.

These investment strategies are often promoted by providers based on their house views. Choosing the one that best suits the first principle goal is not an easy task.

Figure A illustrates the difference between these retirement investment strategies by considering the past performance of the major assets classes based on typical asset allocations and fees. The model depicts the retirement savings growth secured by various investment strategies to achieve a retirement lump sum (depicted by the blue line) to purchase an annuity at retirement. In all cases industry averages were used and that the member started saving for retirement at the age of 25, based on the following specific assumptions:

- A salary at retirement of R120 000 p.a.
- A contribution rate of 14% throughout.
- An annuity rate of 7.5%.
- A salary growth rate of 4% p.a. on top of inflation.
- A retirement age of 65.

The model produced some interesting results:

- Both the aggressive and balanced investment strategies surpassed the required retirement lump sum saving.
- The other investment strategies fell short of the mark.
- Conservative and member choice investment strategies produced the worst result.
- Over the period there is a lot of volatility in performance between the investment strategies, as expected.

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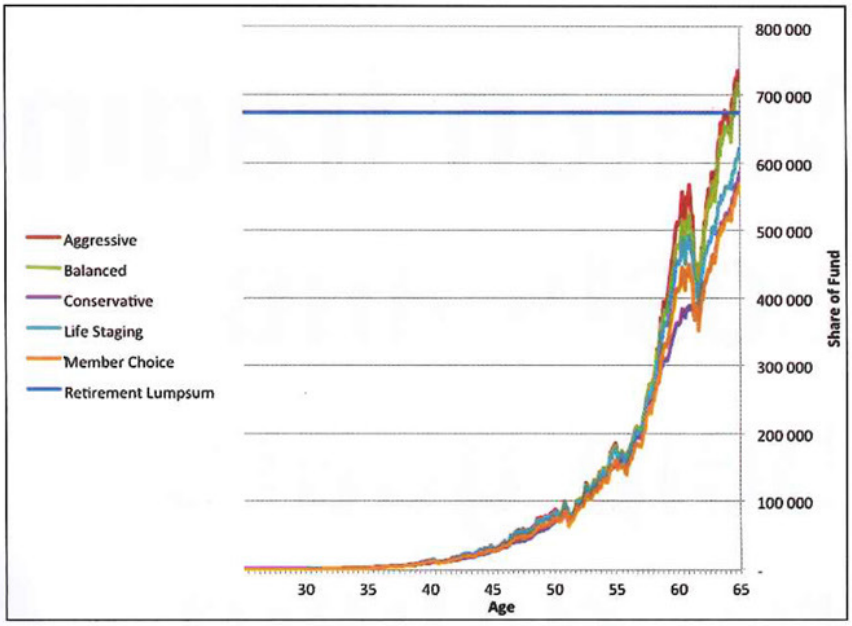

Figure A. A retirement model depicting the return secured by various investment strategies

Paying the price

The member choice investment strategy yielded a low return, which could be attributed to the significantly higher fees incurred. Here, members are set back even further, as they are often ill equipped to make informed decisions. Often reactive to "market noise", these members ping pong between conservative and aggressive, losing return in the process.

Not faring much better than member choice, a conservative strategy is incapable of achieving the returns required for a retirement with a sufficiently high enough net replacement value.

Ultimately, by investing in conservative assets, it would be a struggle to generate the returns needed to sustain a quality of life throughout retirement.

Stages of life

The model reflects that life staging presents a mediocre return. It is based on the principle of matching asset allocation to age based on life stages. This strategy suggests a more aggressive strategy for younger members and a more conservative one for those moving closer to retirement.

While life staging can, in some cases, allow a member to be "better off", the associated fee often results in a member losing out on performance.

High risk, high reward?

In theory, an aggressive strategy rewards an investor with high returns. The calculated retirement lump sum from an aggressive strategy is the highest. However, when it comes to balancing risk, there seems to be little gained for the extra risk when compared to a balanced strategy.

Finding your balance

A balanced strategy secures a return just below that of an aggressive strategy – without the added risk. Focused on the approach of "not placing all your apples into one basket", a balanced strategy aims to allocate assets across conservative and aggressive asset classes. In doing so, it reduces risk and produces a stable, balanced growth. To ensure that old age is provided for, and quality of life is maintained, retirement savings should be balanced across conservative and aggressive asset classes. A balanced investment strategy should secure a retirement worthy of distinction – a net replacement value greater than 75%. ❐