PRUDENTIAL
INVESTMENT MANAGERS

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Table Talk: Am I still on track to retire at 60?

ARTICLE SUMMARY

Pieter Hugo, MD of Prudential Unit Trusts, shares some insights on every investing issues.

Q: I have been working for nearly 10 years now and have been saving regularly towards my retirement, but don't really have a long-term investment plan. Now I'm worried that I'm not saving enough since my family is growing and my expenses are rising all the time. How can I tell if I'm on track in terms of how much I've invested and how much my investments need to be earning to be comfortable in retirement? I don't want to have to work after I'm 60.

A: You're certainly not alone in your worries. With most people living much longer these days, and consequently spending more years in retirement, investors are worrying more than ever about whether they're saving enough to be able to live comfortably once they do stop working. The best option by far is to get help from a qualified financial adviser who can analyse all your individual needs, current investments, budget, etc. and develop a personal financial plan for you and your family.

However, Prudential has conducted some high-level analysis that can provide a rough indication – to be used as an approximate guide only – of how you're progressing toward building up an adequate “retirement pot” by age 60. It also sheds some light on how much you need to save (as a multiple of your current salary at any age) to reach your retirement goal, and what rate of investment return you need to be successful.

The numbers in the below table yield an important general insight: if you are to reach your goal, it is essential that you have sufficient exposure to growth assets like equities throughout both your investing years and your retirement years. If you go along with the current widely accepted practice of switching your retirement pot into a more conservative strategy at retirement (such as cash or bonds instead of a diversified portfolio with sufficient exposure to growth assets like equities), you run the risk of running out of money in your retirement, potentially being forced to live on a lower monthly income than you had planned, or being reliant on others to provide for you. This is a key strategy for investors to employ, based on the parameters we have used.

Tracking your retirement savings

TIME IN RETIREMENT Real return	20 YEARS 4% real return throughout life	30 YEARS 4% real return throughout life	30 YEARS 4% pre-retirement, 2% post-retirement
Retirement allocation (average % of salary over time)	15%	19%	24%
Age	**Salary Multiple**		
30	0.8	1.1	1.4
35	1.9	2.4	3.0
40	3.1	3.9	5.0
45	4.5	5.8	7.4
50	6.3	8.1	10.2
55	8.4	10.8	13.7
60	10.9	14.0	17.8

Source: Prudential

The top half of the table illustrates that if you plan to retire at age 60 after 35 years of working and investing, you would need to have invested an annual average of 15% of your salary over your working life to build up a comfortable 20-year retirement income. However, today’s 30-year-olds will more likely need 30 years of retirement income. To stretch this far, you would have to lift your average saving rate to 19%. And, to attain either of these results you will require an after-inflation (real) return from your investments of 4% p.a. over the entire period, including both your working and retirement years. This real return target of 4% p.a. (also after all fees) could be obtained from investing in well-diversified, multi-asset portfolios such as the Prudential Inflation Plus Fund and the Prudential Balanced Fund. This strategy should help ensure your funds last throughout your retirement, with your income in retirement at 80% of your last salary (called your “replacement ratio”).

However, if at retirement you decide to move from a 4% real return portfolio to a more conservative (less volatile) strategy, such as a fixed income portfolio (consisting mainly of cash and bonds), your after-inflation returns will be reduced to around 2% p.a. Therefore, in order to build up the same retirement amount, so that it lasts for 30 years, you will have had to have saved an average of 24% of your annual income over your entire 35-year career. This level of retirement savings is exceptionally difficult for most people to achieve. In fact, any strategy earning less than a 4% real return over time will make it much less likely that you will have a comfortable retirement.

Why does the switch to a more conservative portfolio have such a significant impact on the outcome of your retirement savings? It’s because of the effect of compounding returns. In this example, your retirement savings have been building up for 35 years, so this large amount keeps earning compounded returns in retirement as you draw down small amounts of monthly income. Your total pot actually peaks well into retirement, and the majority of your lifetime investment returns (well over 70%) are earned in retirement. So unless you have already built up an exceptionally large retirement fund with no need to assume any investment risk, it makes very little sense to move your entire retirement pot to a very conservative strategy when you retire.

The bottom part of the table gives a broad guideline to allow you to see if you’re on track to meet your retirement goals, based on the assumed investment parameters. It assumes you started working and investing at age 25, with your annual retirement contributions escalating in line with 6% inflation and earning a net of fees real return of 4% p.a. For example, if you are age 30, you should have already built up investments equivalent to 0.8 times your annual salary for your retirement pot to last for 20 years in retirement, with an income level at 80% of your last salary. That annual salary multiple rises to 1.1 times for it to extend to 30 years. And if you'd prefer to move your portfolio to a 2% real return strategy at retirement, you would need to have saved 1.4 times your annual salary by age 30 to ensure a sufficient 30-year retirement pot .

Finally, at age 60, if you're aiming for a 30-year retirement pot, you can likely rest easy if you have amassed a portfolio equal to 14 times your average annual salary over your career, and keep it invested in a portfolio expected to earn a real 4% return over time.

If you find that you aren't on track with your retirement goal, don't panic – you have many options, including: immediately start saving more; move to a strategy designed to offer a higher targeted real return (and be prepared to experience more short-term volatility); retire later; opt for a part-time job in retirement; or plan to live on less than 80% of your salary at retirement. Any combination of these would go a long way toward putting you back on the road to a comfortable retirement, and a financial adviser would be able to assist you in finding the right combination of these.