Prudential Investment Managers
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Temptation and your retirement savings

The problem with the future is that it often seems so very, very far away. This is especially true for your retirement. You might be planning on retiring when you're 55, 60 or 65. South Africa has no legally-determined retirement age, so it's really up to you – or, more likely, your employer – when you receive that gold watch and start enjoying your golden years. Right now, though, that day might seem like a distant dream… which is why it can be so tempting to dip into your retirement savings early – or to simply cash them in and spend the money now.

It's easy to understand the thinking behind that choice, especially when you consider that many people cash out their retirement funds early (usually when they change jobs) in order to pay off debt.

On the face of it, using tomorrow's money to pay off today's debts doesn't sound like such a bad idea. But, in almost every circumstance, cashing in your retirement savings early can have far-reaching consequences – for two important reasons.
First, if you're taking money out of your retirement savings to pay off your debt, then you're solving the immediate problem without really addressing the root cause of the problem. You may be out of debt now, but you haven't learned anything about budgeting, about financial planning or about how to appropriately manage credit. All you've learned is that there are (apparently) no short-term

consequences to getting into debt. And without learning those lessons, in all likelihood you'll be back in debt again before too long.

The long-term effects of this can be disastrous. According to some estimates, one in three South African retirees are in debt when they retire – and many can't afford to retire because they've spent the bulk of their retirement savings already.

The second reason is closely tied to the idea of long-term thinking. When it comes to long-term savings and investments – like retirement in particular – the most powerful tool you have is compound interest or compound returns. Compounding interest or returns is the process of reinvesting the income earned on an investment, and in doing so creating a larger base upon which future returns can accumulate. Its effects are significant, and are best realised over the long term. If you withdraw your long-term savings – or even cash in just a portion of those savings – you'll rob yourself of the effects of compounding interest.

There may well be penalties for early withdrawal, together with costly tax implications. What's more, there's also an opportunity cost. Opportunity cost is a term that's most commonly used in economics, but you experience its effects every day in countless ways – often without even realising it. Opportunity cost is defined by what you lose when you choose between two alternatives. If you choose, for example, to spend an hour watching a TV show, the opportunity cost is whatever else you could have done with that hour of your life. Similarly, when you choose to withdraw your retirement savings early, the opportunity cost is the money you would have had on your retirement, plus – and it's a big plus – the compounding interest that you would have accrued on top of that!

To get an idea of what you might stand to lose if you cash in your long-term investment early, play around with our goal calculator. You may be surprised at the size of the opportunity cost.
Still not sure what to do? Speak to your financial adviser, or contact our Client Services Team on 0860 105 775 or at query@prudential.co.za.