M&G Investments

M&G Insights

Focus on what matters when investing for retirement

August 2023

Pieter Hugo

Chief Client and Distribution Officer

South Africans are searching for investment opportunities in the dark. The past five years have been a challenging period with the various crises we've experienced. From the revelations of state capture to COVID-19 and the ensuing stock market crash of February 2020, the riots in July 2021, Phala Phala, the national energy crisis and globally, the ripple effects of the Russia-Ukraine war have resulted in a pervasive sense of instability. Coupled with that, many are asking if South Africa has become 'uninvestable' as we experience extended periods of below-average market returns (also called beta). As an example, we're seeing multi-asset high equity funds underperforming interest-bearing short-term funds over 7-year rolling periods – quite an unusual phenomenon.

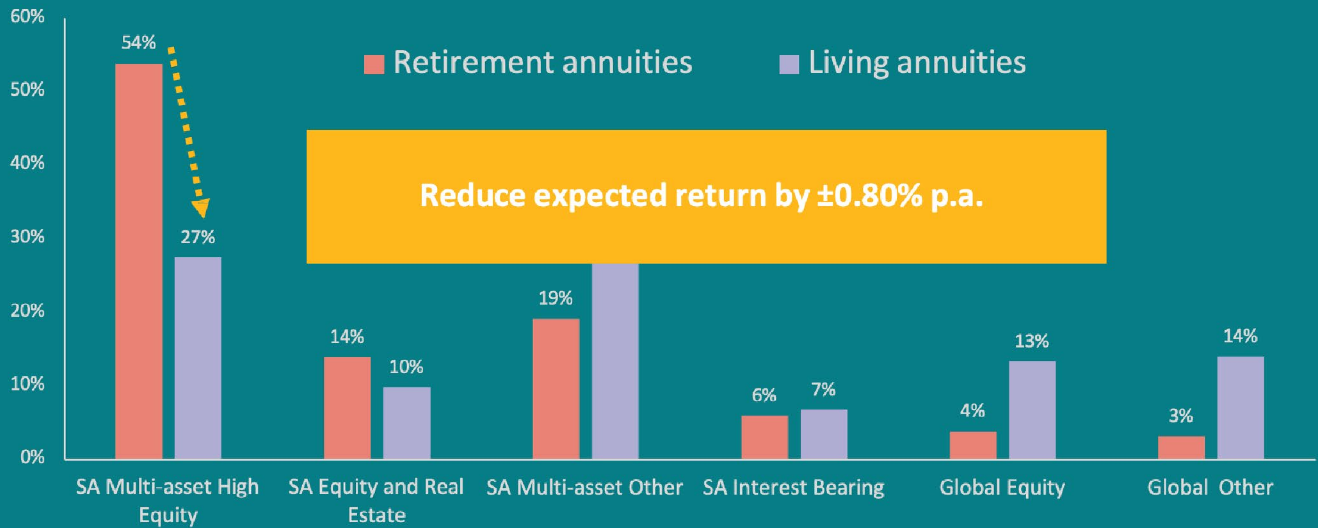
How can investors, financial advisers and investment managers help mitigate these poor conditions? While nothing can be done about financial market behaviour, investors can do something about their own behaviour to help boost their retirement savings. This is by focusing on other factors that matter but are controllable: maintaining appropriate portfolio risk in retirement; avoiding costly switching behaviour; and choosing a fund manager with a track record of delivering strong returns over time.

De-risking means missing out on 28 months of retirement savings

Off the back of these market developments, one of the trends is the shift in flows from multi-asset portfolios to fixed income assets across the industry. For the six years to 2016, there was R406 billion invested in multi-asset portfolios* compared to R155 billion in fixed income assets, which is a typical split we can expect to see. But following the pandemic-induced market crash of 2020, the trend accelerated where investors parked their investments in cash and patiently awaited the recovery. For the latest six-year period to end 2022, only R42 billion was invested in multi-asset funds, compared to approximately R522 billion in fixed income funds.

Typically, investors opt for balanced funds when saving towards retirement, but then de-risk at retirement, taking more conservative investment options like cash. But does that generate sufficient growth to sustain a post-retirement income in the current conditions? We analysed the pre- and post- retirement books (in other words the underlying investments according to ASISA categories of retirement annuities [RAs] and living annuities [LAs]) of a few of South African's largest LISPs. In RAs, just over half (54%) of the investments were in multi-asset high equity portfolios, but at the point of retirement, the allocation to balanced funds in LAs effectively halves to only 27%, moving to lower-risk categories such as multi-asset medium and low equity funds or offshore. To quantify the impact of this de-risking, we analysed the historic returns since inception of all these ASISA categories against the forward-looking return expectations of each asset class.

Based on this data, our calculation revealed a total expected real return for the RA book of 4.85% p.a. versus 4.05% p.a. for the LA book, which is a 0.8% p.a. difference in returns. Meaning that if investors de-risk at retirement, their return is likely to be 0.8% p.a. lower than if they had not de-risked. On face value, 0.8% may not sound like much, but when it is compounded over time, the effect over the long term is highly detrimental. For example, we factored in the 0.8% p.a. lower return into the living annuity modelling, and it shows that retirees will deplete their retirement capital 28 months earlier than the scenario where they did not de-risk.

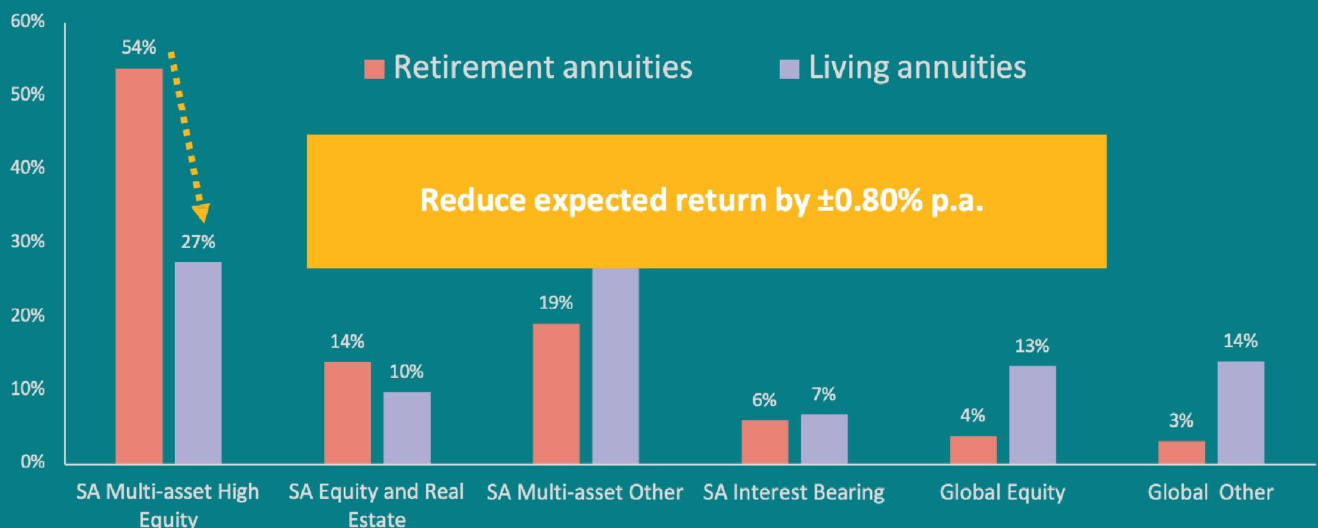


Switching behaviour costs 12 years of retirement savings

We also compared the time-weighted and money-weighted returns of the ten biggest multi-asset funds in South Africa and found that on average, clients earned an average of 3.1% p.a. less than what the funds actually delivered. This difference is considered the cost of client behaviour due to switching into or out of a portfolio at disadvantageous times. Time-weighted returns are the returns achieved by the investment manager, while money-weighted returns represent the eventual return received by investors, considering the impact of cashflows into and out of a portfolio.

Once again 3.1% p.a. may not seem material, but the compounded effect over time in a living annuity simulation shows that a retiree would run out of money 12 years earlier.

The remaining growth after the impact of client behaviour, advice and platform costs, as well as the effect of inflation, means that your real return needs to be at least 3% above inflation.



The impact of alpha and volatility

Alpha (above-market returns), or the lack thereof, will naturally have a substantial impact on the retirement outcomes clients are able to enjoy, so the performance of your portfolio manager is important. Looking at an investment of R1 million into the M&G Balanced Fund 20 years ago, an investor would now have R11,102,274, which is a return of 7% p.a. (after fees) above inflation. For the M&G Inflation Plus Fund, the same R1 million would now be worth R7,234,049, a return of 5% p.a. (after fees) above inflation. In addition, these returns were produced with less volatility than an SA equity portfolio (using the JSE All Share Index as a proxy).

While nobody can control the markets, we can help clients focus on what is within their control, such as fund selection. Targeting inflation-beating returns at lower levels of volatility, can help clients improve their possible retirement outcomes.

ENDS

Disclaimer.

This document is for information purposes only and is not an offer to or solicitation for investors to invest in any of the capabilities or products offered by MandG Investment Managers (Pty) Ltd [M&G Investment Managers] (Registration no. 2013/051515/07) and MandG Investments (Namibia) (Pty) Ltd (Registration no. 1996/85) [M&G Namibia] or any of their associates, being MandG Investments Unit Trusts South Africa (RF) Ltd (Registration no 1999/005242/06) and MandG Investments Unit Trusts (Namibia) Ltd Registration no. 2007/609. M&G Investment Managers is an authorised discretionary financial services provider by the Financial Sector Conduct Authority of South Africa [FSP45199] in terms of the Financial Advisory and Intermediary Services Act, and has it's registered offices at 5th Floor Protea Place, 30 Dreyer Street, Claremont, 7708. M&G Namibia is an approved person in terms of section 4 of Stock Exchanges Control Act and has it's registered offices at 6 Feld Street, Windhoek, Namibia. Information given in this document has been obtained from, or based upon sources believed to be from an accurate and timely source but M& Investment Managers and M&G Namibia make no representations or warranty, express or implied, with respect to the correctness, accuracy or completeness of the information and opinions. This information is not intended to constitute a basis for any specific investment decision. Investors are advised to familiarise themselves with the unique risks pertaining to their investment choices. Investors should seek the advice of a properly qualified financial consultant/adviser before investing. The value of an investment will fluctuate and past performance is not necessarily an indication of future returns.