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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

What does history teach us about living annuities?

Retirement can be a daunting prospect.

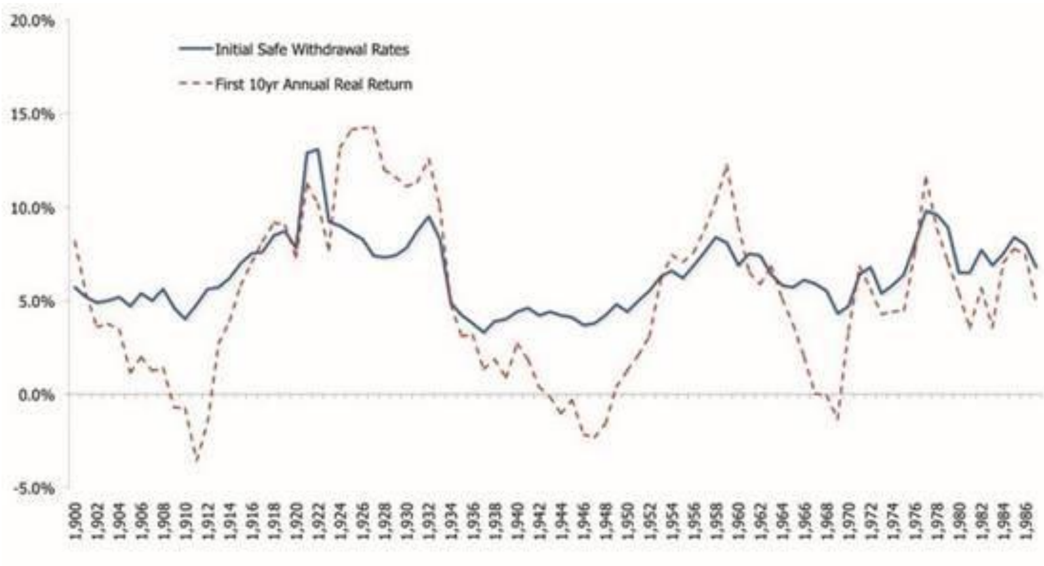
Not only is it a time of personal adjustment but it is also a time to make financial decisions that will impact your lifestyle for the rest of your life. Retired investors commonly face the dilemma of either maintaining a certain lifestyle or adjusting it in order to preserve their savings. Typically the more income one draws and spends today, the less is available to create future income.

When inflation is added to this quandary, it becomes important to also grow that income over time to retain one's buying power. Marriott has researched the sustainable levels of income that retirees were able to draw historically, to better understand the difficulties retirees face and why in retirement you should spend the income and not the capital.

Historic analysis of living annuities in South Africa

Marriott's research, using returns for South African asset classes going back to 1900, tested how much retirees could safely draw from their savings without running out of capital for 30 years. We assumed each retiree invested R1million in a typical balanced fund (comprising 60% equities, 30% bonds and 10% cash) and drew an annual income that kept up with inflation.

The graph below shows the maximum initial safe withdrawal rates retirees were able to draw and not run out of capital over a 30 year period.



Initial safe withdrawal rates have fluctuated significantly over time. Some retirees were able to start with a withdrawal rate as high as 13%, grow their income in line with inflation and still have a successful retirement (capital lasted for 30 years). A closer look at the data revealed that maximum safe withdrawal rates correlated with the first 10 year annual real returns the investor experienced. In other words lower maximum safe withdrawal rates coincided with lower real returns and visa-versa. This seems obvious but the difficulty retirees face is that future returns are very difficult to predict.

The table below summarises the percentage of retires who failed (failure rates) using different drawdown rates for all 88 retirees with a 30 year investment horizon.

Drawdown Rate	Failure Rates (+100 years)
4%	6%
5%	27%
6%	47%
7%	64%

Professor C. Firer's studies on the history of capital markets

A drawdown rate of 6% is common in the marketplace but our research shows that at that rate, almost half of retirees would have failed. The concern for retired investors today is that market returns are expected to be below average for the next decade, due to demanding valuations combined with lower growth expectations. **This suggests many living annuities will come under pressure in the years ahead.**

Marriott has two suggestions for retired investors:

1. Match the income drawn with the income produced

Investors should be aware of how much income their portfolio is generating and try to draw no more than the income produced – thus avoiding capital erosion. Investments that produce reliable and consistent income streams assist investors to avoid capital erosion over time. If an investor can avoid capital erosion they can secure their future income. It is especially important in the early stages of retirement that capital is preserved as far as possible. If investors wish to draw more income than what their investment is producing, it should be with the knowledge that they are eroding their capital.

Marriott funds are managed with an income focus – to produce a certain amount of income as well as income and capital growth.

This investment style is in contrast to many others where the investments are managed with a capital growth objective. The basis of a capital growth objective is that investment growth will offset the income withdrawals. This appears to work well when capital values are increasing because capital erosion is masked by the market rise. When markets decline however, the value of the investment will decrease sharply due to the twin effects of an eroded capital base and decreasing capital values.

2. Choose investments which produce consistent income streams that grow over time

Investors not only need to preserve capital but also need to ensure they protect themselves against the impact of rising living costs over time. Investments that produce a reliable income stream that grow over time, like equities, are critical for a successful retirement as the income produced from these investments tend to grow ahead of inflation. By including equities with a reliable growing income stream, investors will be able to ensure growth in income over time. The trade-off of including equities, however, is that an investor's portfolio will produce less income initially. Investors need to find the appropriate level of exposure between the different asset classes that will give them enough income and income growth over time.

At Marriott, we suggest that investors examine their situation carefully when considering using capital to supplement their income. We strongly urge investors to preserve capital until they reach a stage in their retirement years when it may become safer to drawdown on capital.

While investors may find it challenging to restrict their annuity income to the income produced in the current low yielding environment, it is preferable to finding that one's capital has been partially or even completely eroded. Rather be conservative now than risk having to find another source of income, such as going back to work or having to reduce one's standard of living at some point in the future.

The simple truth is, if you spend more than you earn, you will erode your capital and ultimately erode your income. When it comes to investing, particularly in retirement when capital preservation is paramount, this age-old wisdom rings true even today.

FA News | 9 December 2019

Talks on increasing offshore investment 'progressing well', says state pension fund

The Government Employees Pension Fund, which expressed a desire last year to invest more of its members' funds offshore, says government is close to deciding on whether it can go ahead.

Speaking at the launch of the fund's 2018/20, 19 annual report on Thursday, GEPF principal officer, Abel Sithole, said while the fund increased its assets invested in foreign unit trusts, it still had close to 90% invested in South Africa.

While he did not view this as a bad thing, Sithole said the "very strong home bias" was affecting GEPF's members returns.

In the financial year under review, the fund only earned 2.6% in investment returns, which was largely driven by performance of its investments on alternative assets like bonds and fixed income. "The engagements with [the national] Treasury have been progressing very well," said Sithole, regarding the GEPF's negotiations with government to invest more money outside South Africa.

"The recent indications indicate that we are much closer to the decision than we've been last time I spoke about the matter."

The GEPF, which had assets in excess of R1.8trn at the end of its 2019 financial year, houses almost half of the country's pension assets. In July 2018, Sithole said the fund wanted to diversify its exposure by investing more money other geographies and alternative asset classes, like unlisted investments so that it's less dependent on performance of local equities.

At present, the fund has less than 10% of its assets invested outside South Africa while private retirement funds can invest up to 30% offshore and 10% more elsewhere in the continent. But given the current state of the economy – the country's GDP has contracted for two quarters this year – Sithole said it was understandable for government to take its time in weighing the pros and cons of allowing the fund to take money outside of the country.

Fin24 | 6 December 2019

Changing jobs? Make sure you take care of your pension fund

People need to be educated on what to do to preserve their ultimate retirement benefit, explains Elio E'Silva from Alexander Forbes.

ROFHIWA MADZENA: It's a tough economic environment and the first thing you might think of doing when you are getting a new job in the coming year is to dip into your pension savings. But that is probably not the best idea. I've got Elio E'Silva, who is the head of the Alexander Forbes Retirement Fund, to talk us through this worrying trend.

Elio, this not something many people with constrained pockets want to be hearing – not being able to dip into that pension fund when I get a new job.

ELIO E'SILVA: Good evening to you. That is 100% correct.
Most people, when they change jobs, the first thing they do is they look at their fund credit and they say: "What can I do, can I settle some debt, and then start saving again?" But that is probably the worst thing anyone can do, particularly if you look at the preservation rates in our funds in South Africa.

If you remember the survey we did, we've probably got 8.7% of people actually preserving the benefit when they leave – which is pretty scary.

ROFHIWA MADZENA: When we talk about it being scary, I want to understand why I can't take a little bit of it and pay off some debt, as you've just mentioned, and perhaps when I get my new job the interest might be able to make up for what I've lost in paying off some of my debt. Is that not a rationale that may be used?

ELIO E'SILVA: That's a good rationale, and we are seeing some people use it pretty well. The problem we see is that you settle your debt, and a couple of months down the line your debt is back, and you are starting from zero. As you mentioned earlier, the markets are taking a bit of strain at the moment and the returns are muted. So trying to get your losses back due to compound interest is pretty difficult.

ROFHIWA MADZENA: When I do get a new job, what are my options in terms of transferring those funds into other savings vehicle and refraining from spending them?

ELIO E'SILVA: When someone is leaving now, I think they've got three options. With what's come through in March 1 this year, members may actually just leave their money in the current fund where they are invested, in their current investment strategy.

The second option they've got is taking their money, following it to their new employer's account or, like you've mentioned, take a little bit of it, settle any of your short-term debt, and then take the rest and keep it there for retirement one day.

ROFHIWA MADZENA: If I do choose to take this money out – and I think this is a very important question – how much tax would I be paying on it? Is it worth taking out in the first place?

ELIO E'SILVA: The tax brackets are specific to retirement and to withdrawal of your benefit. So you get R25 000 tax-free, and that's a once-off amount; then it's taxed at 18 to 36%, depending on the size of the benefit. So it is very important to ensure you seek financial advice when you are looking at that, and don't just pay away your hard-earned cash.

ROFHIWA MADZENA: Just give us a sense – a lot of young people listening to this interview will probably be entering, or have just entered, the working world. At what age would you advise us to start saving and not touch that, so that we are comfortable by the time we get to the age of say, 60, 65?

ELIO E'SILVA: You mentioned a retirement age of 65. From our studies and from our member watch surveys, we believe that 40 years of contributing at 17% would allow them to retire with a replacement ratio of approximately 75%. So 40 years at 17% – that would be quite a comfortable one.

ROFHIWA MADZENA: What are we seeing in terms of trends? Are we seeing more and more people being unable to retire at a comfortable age, just because they haven't had enough savings put away? What are we seeing in terms of trends there?

ELIO E'SILVA: We are seeing the average actual replacement ratio of retirees sitting at about 28% at the moment, which means that if your salary at retirement was R10 000, your replacement rate should be 75% of that. So you should retire with R7 500 per month. The problem we are seeing is that the actual ratio to that is about 28%, so you are looking at someone earning R10 000 purchasing an income of R2 800.

What you are seeing is that you can't keep the life that you've had prior to going on retirement. You have to cut back and that is not what we want to encourage members to do. By educating them and telling them what they should be doing helps to preserve the benefit. That is what we are trying to do. We have updated our withdrawal notification form to guide members and educate them when they get to a milestone in their career and are withdrawing the benefit – educating them and saying: "This is what you should be doing, this is what you are looking at."

ROFHIWA MADZENA: A very big theme that comes out of what you've just said is education – we need people to be financially literate and understand how to make their finances work for them in the best

Moneyweb | 9 December 2019 | Nompu Siziba

Understanding the psychology behind retirement

For many people, the thought of retirement is no less stressful than the thought of retrenchment, and financial planners need to be fully cognisant of this when advising clients on their future financial situation.

This important factor was recognised recently when the South African Independent Financial Advisors Association (SAIFAA) held the first in a series of certification workshops aimed specifically at advising independent financial advisors on post-retirement planning.

“Many financial advisors simply push product in exchange for commission, but there’s a psychology around retirement that needs to be carefully understood, particularly when you appreciate that people are living much longer, often well beyond their working careers,” notes SAIFAA chairperson, Derek Smorenburg.

Financial advisors need to fully comprehend and truthfully answer one very powerful question at this stage in their client’s financial planning, and that is: ‘Is the client’s money your client, or is the client your client?’

It’s an entirely different mind and skill set that needs to be mastered, according to Smorenburg: “You’re dealing with people during the decumulation stage of their lives – where they often need to scale down quite radically. Not only must advisors understand that this can be traumatic for their clients, but that they may need to convince their clients to plan for a life span well beyond what those clients had envisaged in their heads.”

Speaking at the first workshop, psychologist Dr Hannetjie van Zyl-Edeling (author of Over the Moon – a Guide to Positive Ageing”), noted that people were now easily starting to live 35 years or more beyond retirement. This, in itself, could be a terrifying concept for clients to grasp: “They will worry about: ‘How do we find the resources to fund this and how do we make this time in our lives meaningful?’

In many respects, this would mean broadening the horizon beyond traditional avenues of planning, including how and where retirees will want to live, and what their own priorities are in terms of living comfortably and ensuring that they will be taken care of.

“For example, in many ways, we’ve evolved significantly from the traditional family,” noted speaker Arthur Case, Brand Marketing Director for Evergreen Lifestyle Villages, which – together with its shareholders, the Amdec Group and PSG Group – provides retirement villages across South Africa exclusively under the life right option.

“In the past, you tended to have extended families, children and parents living in close proximity to, or with each other, with a network of care in place, but these days we often see children living in other parts of the country, or even abroad. The nuclear family these days usually excludes Granny and Grandpa who need to find their own retirement living solutions.

“Values are also vastly different – baby boomers, the oldest of whom are now in their early 70,s have very different values to their parents. This means that retirement places designed with their parents in mind will be unattractive to the boomer. They are looking to extend their independence, enjoy youthful activities and enjoy a lock-up-and-go lifestyle.

These, believes Case, are some of the compelling reasons why the marketplace began to swing towards life right options, transforming the traditional belief in buying only into sectional title schemes: “A life right is, in many ways, like buying a life insurance policy; it will not increase in capital value the way a sectional title property will, but it guarantees purchasers a home for the rest of their lives, at a cost they know from the get go they can afford."

Part of understanding the financial commitments that would be required in retirement was also to understand that needs would change over time, should one half of a couple pass on or should the retirees wish or need to scale down even further.

"Again, life right meets this need as it enables people to change their options at a time of their lives, particularly when the last thing they need to be stressing about is selling a property," noted Case.

There are also misconceptions around life right options, with the belief that they provide nothing to an occupants estate when those occupants passed away. Explained Case: "In all legitimate life right schemes, the estate will always still receive an agreed percentage of the original purchase price, ensuring that the life right has legacy value. "But more than anything else, it's a product that gives peace of mind to someone who is retiring about what will perhaps be their greatest concern – where will they live and how will they be able to afford it."

A full understanding of the value that this offers clients, along with an understanding of the overall psychology of retirement and decumulation, these are powerful tools for any financial advisor to have in their service offerings.

FA News | 9 December 2019

INTERNATIONAL NEWS

KPMG agrees to management buy-out of UK pensions division

KPMG has agreed a deal for the buy-out of its UK pensions division, which will continue to serve clients under the ownership of its current management team. The management buy-out is understood to have been backed by Exponent Private Equity, the private equity firm which entered into exclusive talks with KPMG for the purchase in October.

In recent months, KPMG has been conducting a continuous restructuring of its UK operations. The Big Four firm sunk a £45 million investment into its Audit arm in order to beef up quality, following revelations that KPMG had carried out deeply flawed audits at a number of clients in the UK. Following a slowing of revenue growth, KPMG also announced it was set to downsize its Partner count by around one-tenth.

Further to all this, in July it was first suggested that KPMG was flirting with the idea of offloading its pensions consulting unit. The division employs about 20 partners and 500 people and works for some of UK's largest pension companies, holding around £50 billion of pension assets under advice.

After initially holding discussions with a number of interested parties – including Lane Clark & Peacock and Duff & Phelps – by October, KPMG had picked out a viable candidate for exclusive merger & acquisition talks. According to Sky News, Exponent Private Equity – an investor that has previously backed companies such as vegetarian food producer Quorn and Loch Lomond Distillery – was expected to be chasing a deal worth in excess of £200 million. Now, just over a month later, news has broken that the private equity group has sealed the deal.

Exponent – established in 2004 – specialises in companies headquartered in the UK and Ireland, with enterprise values of between £100 million and £400 million. It currently owns stakes in discount website Wowcher, daily newspaper The Racing Post, and sightseeing organiser Big Bus Tours, among others, and is providing the funding for KPMG's current pensions division management team to buy-out the practice. No official figures relating to the sale have been released, though the price tag of £120 million has been floated by various outlets – and if true, this would be significantly less than the initial figure bandied about.

The deal has seen KPMG sign a conditional agreement with NewCo, a vehicle through which the 20 Partners and 500 staff currently employed by KPMG will carry on the business once the sale is completed. The move will install KPMG UK Head of Pensions Andrew Coles as NewCo's Chief Executive Officer.

In a statement, KPMG said, "The Company will announce further details upon completion."

Consultancy.uk | 9 December 2019

Striking unions battle Macron in pensions showdown

Protest threatens to paralyse France for days.

Railway workers, teachers and emergency room medics launched one of the biggest public sector strikes in France for decades on Thursday, determined to force President Emmanuel Macron to abandon plans to overhaul France's generous pension system.

Transport networks in Paris and beyond ground to a near halt as unions dug in for a protest that threatens to paralyse France for days and poses the severest challenge to Macron's reform agenda since the "yellow vest" protests erupted. Riot police in Nantes, western France, fired tear gas at masked protesters who hurled projectiles at them. In Lyon and Marseille, thousands more protesters carried banners that read “Macron get lost” and “Don’t touch our pensions”.

“What we’ve got to do is shut the economy down,” Christian Grolier, a senior official from the hard-left Force Ouvriere union, told Reuters.

“People are spoiling for a fight.”

Rail workers voted to extend their strike through Friday, while labour unions at the Paris bus and metro operator RATP said their walkout would continue until Monday. Commuters in Paris dusted off bicycles, turned to carpooling apps or worked from home to avoid the crush on the limited train and metro services that operated in the morning rush hour.

Airport workers, truck drivers and police are joining the strike at a time of widespread discontent towards Macron’s drive to make France’s economy more competitive and cut public spending. French law requires minimum public services are maintained during a strike.

Macron wants to simplify France’s unwieldy pension system, which comprises more than 40 different plans, many with different retirement ages and benefits. Rail workers, mariners and Paris Opera House ballet dancers can retire up to a decade earlier than the average worker. Macron says the system is unfair and too costly. He wants a single, points-based system under which for each euro contributed, every pensioner has equal rights. For the former investment banker, the showdown with strikers will set the tone for the second half of his mandate, with more difficult reforms to come, including to unemployment benefits.

Nor is it without risk for the hard-left unions whose membership and influence have diminished in recent years. They face a delicate balancing act of needing to pressure the executive while not creating a public backlash.

“For 30 years successive governments have tried to bring reform and fail because the unions cripple the country,” said 56-year-old cafe owner Isabelle Guibal. “People can work around it today and tomorrow, but next week people may get annoyed.”

Street protests

In Paris, Riot police erected barriers in streets surrounding the president and prime minister’s offices ahead street protests in the capital.

Interior Minister Christophe Castaner said thousands of anarchist “black bloc” and hardcore “yellow vest” protesters, who took to the streets for months over the cost of living and perceived elitism of political class, might try to wreak havoc.

Castaner ordered shops along the route to close. Some 6 000 police will be deployed, including dozens of rapid-response officers on motorbikes.

The SNCF state railway said only one in 10 high-speed TGV trains would run and police reported power cables on the line linking Paris and the Riviera had been vandalised. The civil aviation authority asked airlines to cancel 20% of flights because of knock-on effects from the strike.

Past attempts at pension reform have ended badly. Former president Jacques Chirac's conservative government in 1995 caved into union demands after weeks of crippling protests.

"It's not a question of clinging to special benefits," said teacher Anne Stéphanie Jarreaud. "It is the fact that the current system compensates for extremely low wages." A survey on the eve of the strike showed public opinion was split over Macron's pension reform.

Reuters | 5 December 2019

OUT OF INTEREST NEWS

Growing pains

South Africa's economic performance made headlines for all the wrong reasons last week, hardly the start to the festive season we all would have liked. The reality is that the road to economic recovery for South Africa is going to be long and bumpy. In our final weekly commentary for the year, we look at what went wrong, what needs to happen for things to turn around and the implications for our investors.

Contraction

The local economy contracted at an annualised rate of 0.6% in the three months to end September compared to the previous quarter. This is the headline number reported in the media, and represents the real or after-inflation growth of gross domestic product (GDP), adjusted for seasonally. Quarterly numbers can be quite volatile, and since the second quarter was quite strong (3.2%), a repeat performance would be difficult. However, the GDP number was even worse than most economists expected. Year-on-year growth numbers are less volatile, but this time it was not much better: there was no growth in the four quarters to end September. It looks like 2019 growth will be even lower than last year's already low 0.8%. It is truly a sad state of affairs.

Looking into some of the details, the quarterly contraction was driven mainly by sectors that can be volatile from quarter to quarter, namely agriculture, mining and manufacturing. Electricity, a small sector in the GDP numbers but a crucial input for the rest of the economy, also contracted as Eskom was forced to resume load-shedding, as was the case in the first quarter (and unfortunately last week too). The biggest sectors of the economy are service-orientated, less volatile, and driven largely by consumer spending. However, the underlying growth trend in services has also weakened as household finances have come under pressure. Household consumption spending grew just 0.2% quarter-on-quarter.

The reason for this is the decline in income growth. Employee compensation, or the economy's wage bill, grew by only 4% from a year ago. This is a nominal number, not adjusted for inflation but rather reflecting the growth (or lack thereof) of the rand amounts paid out to South African workers. It was the lowest growth rate since the start of the data series in 1994, and largely reflects the dramatic decline in inflation over the past few years, as well as the lack of job creation. Nominal GDP growth similarly declined to a record low of 3.75% year-on-year. With zero real growth, it implies that GDP inflation (which is a broader measure than the consumer price index) was also 3.7%.

As recently as 2017, nominal economic growth was still consistently in the region of 7% per year. In fact, the February 2019 Budget was based on assumed growth of 7% for the coming three years. The collapse in inflation is therefore a big factor behind the government's tax revenue shortfall. Together with the fact that budgeted spending has not been reduced, it explains the widening fiscal deficit. ***Full Report: https://www.fanews.co.za/article/investments/8***

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Switchboard : 011 450 1670 / 081 559 1960
Fax : 011 450 1579
Email : reception@irf.org.za
Website : www.irf.org.za

2nd Floor Leppan House
No 1 Skeen Boulevard
Bedfordview 2008