51% of South African retirees can't make ends meet. Here's how to avoid this

How to make your dream retirement an achievable reality

Most of us dream of a secure retirement – and many of us plan for this too – yet 51% of South African retirees aren't able to make ends meet. How do you ensure you aren't part of this 51% in your retirement planning?

We all know well that the reality of the end result doesn't always match our expectations. How about the cake you baked with your child: looked better in the pictures than in real life, didn't it? Or the DIY décor job you did that definitely didn't match the images on your Pinterest board. The same holds true for retirement. We all have expectations, dreams and goals, and yet research shows us that in reality, 51% of South African retirees aren't able to make ends meet.

"The past five years have been an incredibly tough time for retirees with living annuities," says Paul Wilson, Chief Investment Officer at Glacier Invest. "This is due to the fact that asset classes that generally provide growth, i.e. equity and property, haven't done so. Added to this, figures from ASISA show that income withdrawal rates in SA – averaging between 6.5% and 7% – are still significantly too high. And then still add on to that ever-increasing longevity rates, and the picture starts to look dire."

So, what can you adopt in your retirement planning to ensure your retirement lives up to your hopes and expectations?

Understand your two key risks, and plan for them in your retirement planning

“Coupled with longevity risk, retirees also face sequence-of-returns risk,” explains Paul. “This refers to the possibility of a market downturn in the lead up to retirement, or just shortly after retirement. Drawing income from a lower capital base can seriously hurt an investor’s retirement savings. Reducing the withdrawal rate after a downturn can help the portfolio recover, but not all retirees are in a position to do so.”

Let’s consider an average retiree drawing 7% per year, and who needs to increase this by inflation each year to meet their needs. Assume that the inflation rate is 5% and total fees are 2%. This translates into a total required return of 14% (or CPI +9%). There isn’t a single traditional asset class today that will deliver that return for you over the long term.

Historically, equities, which have been the best performing traditional asset class, have delivered 6-7% above inflation. We therefore need to broaden our thinking and include other non-traditional asset classes into our portfolios which are capable of generating better returns and can assist in controlling risk – particularly for retirees needing their income to last for the rest of their life.

As an example, private equity – a form of alternative investment – is able to return 9-10% above inflation because of the illiquidity premium. This means that investors are compensated – in the form of the extra return – because of the time their capital is locked-in.

Use a new approach to retirement planning to achieve security

The above two risks can be translated into investment risks which need to be managed. Others include capital loss and market volatility. The investment philosophy which we feel maximises the probability of managing these risks is called ‘asymmetric returns. What does this mean? It means managing the downside so that you don’t need as much of the upside (or capturing more of the upside than you do of the downside) – giving a smoother return profile.

If, for example. we capture two-thirds of the upside of the equity market and only one-third of the downside, our returns over the long term equal that of the equity market, but at half the volatility. This is step one in managing for volatility.

By including non-traditional assets in the portfolio as well, we can further reduce volatility while still keeping growth assets in the portfolio. As a result, we’re able to address both longevity (risk of running out of money) and sequence (risk of a drawdown at the wrong time) risks.

New thinking is required to solve the living annuity problem faced by many retirees. We believe that solving the sequence-of-risk conundrum can improve the odds of a retiree’s money lasting the course. It’s time to change the paradigm and use all the tools at our disposal.

New solutions for a new way of thinking about retirement

planning

This has resulted in the launch of the Glacier Invest Living Annuity Income Solutions. The offering is comprised of collective investment scheme (CIS) funds (65%), hedge funds (10%), and a smooth bonus fund (25%), known as the Multi-Manager Smooth Growth Fund. Alternative investments will be added in due course.

The solutions use an asymmetrical return approach, which simply means minimising downside risk and capturing as much of the upside as possible. This approach is designed to reduce volatility in returns while preserving capital. The smoothing mechanism is used to smooth out the volatility over time, while the addition of hedge funds adds to performance.

Because hedge funds have a low correlation to other asset classes, they will tend to outperform when other asset classes are struggling. This will help to cushion the portfolio when markets are falling.

Coupled with this, the smoothing technique used holds back excess returns when markets are high and releases these amounts back to investors when markets pull back. This means the investor will see less volatility over longer periods of time.

There are five Income Solutions, catering to different risk profiles:

- The Glacier Invest 2.5% Real Income Solution targets an investment return of 2.5% after taking inflation into account (therefore, a return of inflation + 2.5%). Investors in this solution are expected to draw an annual income of 2.5% of their investment value.
- The Glacier Invest 3.0% Real Income Solution targets an investment return of 3.0% after taking inflation into account;
- The Glacier Invest 4.0% Real Income Solution targets an investment return of 4.0% after taking inflation into account;
- The Glacier Invest 5.0% Real Income Solution targets an investment return of 5.0% after taking inflation into account;
- The Glacier Invest 6.0% Real Income Solution targets an investment return of 6.0% after taking inflation into account.

Your financial adviser is best placed to advise you on the best option within this new solution to suit your unique needs and goals.

Please consult with a financial adviser before you take any action regarding your savings and investments.

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