



How investors can maximise their retirement savings



Many South Africans, regardless of their income level, are uncertain about whether their retirement savings will be sufficient for a comfortable retirement. Despite regular reminders from experts and the media about the pitfalls of improper retirement wealth accumulation, approximately 60% of South Africans remain uncertain, according to the Just Retirement Insights Quantitative Research Results of 2022.

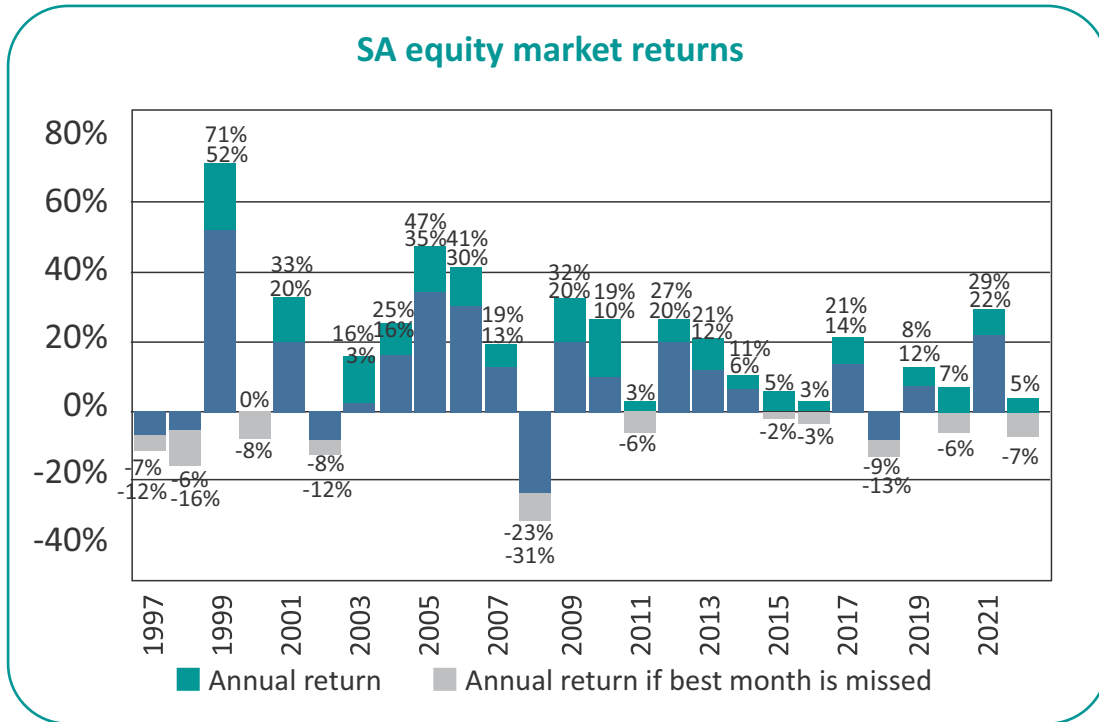
Eugene Botha, Deputy Chief Investment Officer, Momentum Investments

To boost the chances of long term success, it is crucial to understand the effects of not staying invested, the dangers of emotional decision making, and the trade-offs between risk and return in retirement investing.

Investing for the long term is a fundamental principle that increases the likelihood of a comfortable retirement. However, staying invested can be challenging due to our innate desire to control and manage investment outcomes. The fear of losing money often leads to short term thinking, causing investors to make emotional decisions based on market fluctuations. Unfortunately, these reactive behaviours, such as switching to more conservative portfolios or exiting the market entirely after experiencing negative returns, often result in missed opportunities for growth and participation in market recoveries.

The potential effects of not staying invested due to emotional decision making can be detrimental. A study by Momentum Investments shows that missing out on the one month with the highest return in any calendar year can have significant consequences on potential returns. By only receiving a cash return for that specific month, investors could experience an average annual difference in returns of 8.7% over a 26 year period. This demonstrates the significant potential return that can be missed by switching investments at the wrong time into a conservative portfolio.

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Additionally, fear driven reactions to market downturns often lead to missed opportunities for growth. For instance, historical data shows that in five out of the last 14 years and more startlingly, three out of the last six years, the largest positive month in each calendar year was preceded by the largest negative month. By reacting to the negative month and switching to cash, investors could experience opportunity losses ranging from 3.2% to 4.1% over the analysed periods. These missed opportunities can have a detrimental effect on long term capital growth.

While taking on more risk can result in a bumpier investment journey, it can also lead to increased wealth accumulation over time. In a further study, two portfolios with different risk profiles were compared. These portfolios were modelled to potentially experience drawdowns of 10% and 20% respectively. The individual investing in the lower risk portfolio is expected to generate an annual return of 8%, while the higher risk portfolio is expected to generate a return of 10%. Although the lower risk portfolio reduces drawdown risk by half, it also sacrifices potential returns of only 2%. By halving the potential risk (10% compared to 20% drawdown), the lower risk portfolio sacrifices around 10% in potential value over a longer term wealth accumulation period compared to the higher risk portfolio.

It's crucial to note that these trade-offs can only be realised if the investor remains invested throughout the journey. The benefits of taking on more risk are contingent on sticking to the plan and investors should avoid making knee-jerk reactions based on market returns.

Extreme market events can occur at any time, affecting the delivery of returns and disappointing savings growth. For instance, a 15% market fall at various stages of the retirement savings journey can have a significant impact on the final value of retirement savings. The effect ranges from a 6.5% decrease if the fall occurs 35 years before retirement to a 21.69% decrease if it happens just 5 years before retirement – all else being equal, compared to a static 10% compounded growth target. The proximity to retirement plays a crucial role, as there is less time for the investment strategy to recover from the market downturn.

Furthermore, assuming a quick and sharp market recovery following a severe drawdown, the impact on the value of the retirement fund is less significant. For example, if the market recovers with a 20% return after a 15% fall, the effect on the retirement fund's value is mitigated. However, if fear drives investors to switch to a more conservative option immediately after the drawdown, such as cash, the detrimental effect on long term returns can be amplified.

Investors need to recognise the potential returns destroyed by emotional decision making. Making impulsive decisions based on short term market fluctuations can be extremely detrimental, even for those who are still far from retirement. By understanding the potential effects of not staying invested and avoiding emotional reactions, investors can maximise their chances of retiring comfortably. It is crucial to formulate a plan and remain committed to it, only reviewing it when circumstances change, and not reacting to market returns. These are all key to maximising retirement savings.