Final media release

HOW OUR RECKLESS CONSERVATISM COULD RUIN OUR RETIREMENT

Many South Africans are buckling down and becoming increasingly cautious around all money matters including investments. Given all the negative headlines in the media, it may make complete sense. However, from a long-term saving perspective, it doesn't. Retirement fund members, especially those with many years before retirement, may think that by investing conservatively, mostly in cash and money market portfolios, they are protecting themselves. In reality they may be recklessly impairing their retirement savings goals. We refer to this phenomenon as "reckless conservativism". Reckless conservatism can have big negative implications for retirement down-the-line. So, somehow, South Africans must be bolder and fight a natural inclination to risk aversion.

It doesn't take much deep diving to find that South Africans are struggling. A quick landscape barometer paints a depressing picture of imminent retrenchments and high levels of indebtedness.

A study from TymeBank suggests 76% of South Africans are out of money by the middle of the month.

When times get tough like this, many South Africans instinctively react by becoming conservative with their money...

Danie van Zyl, Head of Guaranteed Investments for Sanlam Employee Benefits, says, "Our recently published Benchmark Survey showed that South Africans' financial resilience has been steadily decreasing for the last three years. Additionally, the five-year return on the FTSE/JSE All Share Index has been muted at just 6.8% pa. Our data shows that persistent poor investment returns and market volatility leads to many South Africans to overcompensate with reckless conservatism. This means that some retirement fund members, especially younger members, aren't invested aggressively enough in the market. Our surveys over the past few years have also shown that members seldom re-evaluate their investment strategy and may therefore inadvertently remain conservatively invested for many years, losing out on returns."

Boitshepo Gaitate, a behavioural economist from Genesis Analytics, highlights loss aversion as one of the key drivers behind this conservatism. "Given that we typically feel the sting of losses twice as strongly as we feel the joy of equal gains, we tend to lean towards conservative investment choices. Additionally, with volatile economic performance, the representativeness heuristic bias contributes to our unbalanced reaction to changes in economic indicators. We are constantly falling into the trap of believing that certain events are more heavily-linked to investment performance than they actually are in reality."

The implications of reckless conservatism?

The biggest risk is not being able to save enough for retirement. An overly conservative portfolio severely reduces the likelihood of decent returns because there's limited market exposure. Van Zyl says cash, especially, struggle to provide a meaningful real return over the long-term.

It is not only younger members who struggle with the temptation to be ultra-conservative. Members who at retirement opt for a living annuity on average still have a 20 – 30 year investment horizon. Too many of these members cannot stomach a market downturn and invest too conservatively in retirement.

So how do we overcome our risk aversion?

Gaitate believes that it comes down to i) how investment journeys are positioned and framed, ii) increasing the likelihood of closing any intention-action gap through the use of commitment devices, and iii) a bit of handholding. "Positioning investment journeys from the standpoint of future losses if one does not stay the course - as opposed to highlighting gains – makes for more impactful conversations around investment behaviour and improves long-term investment perceptions. While many people intend to make better provisions for retirement, affordability is often a barrier. In a TED talk by Daniel Goldstein, commitment devices are outlined as good tools for encouraging behaviour change towards better choices."

The power of reassurance should not be underrated. Sometimes, we need an external person like a financial adviser to give us a little push to be bolder when it's in our best interests. While South African's are struggling to push through a difficult landscape, their mental bandwidth to make the right investment choices becomes increasingly limited, says Gaitate. Advisers have a key role to play in this regard.

Van Zyl agrees and adds that there are ways to combine a conservative and more aggressive approach, which should satisfy our desire for conservatism plus the need for market exposure. "A Living Annuity is a good example. One of the worries is that few of us know if the day we retire will coincide with a market crash. If it does, a portfolio can lose 15%-20% of its value overnight. If you continue to draw a fixed retirement income from the living annuity it will have a lasting negative effect and reduce the amount of income you can withdraw over your lifetime. This is because you are selling more “cheaper” units in your portfolio to fund your income, thereby reducing the number of units that are available to participate in a subsequent market recovery. However, managing your living annuity with a protection component (portfolios protecting against negative investment markets) and a market-related Component (a selection of moderate aggressive to aggressive portfolios) can reduce this risk. The strategy involves drawing your retirement income from the protection component, which means it’s protected from any market volatility. It also means the market-related component is not income-linked, so has time to recover and keep yielding you real long-term returns.”

He says smooth bonus portfolios are increasingly being used by worried retirement fund members. “These portfolios can give you the peace of mind to invest in growth assets such as equities and property as your investments returns are “smoothed”. The benefit of smoothing is that members get stable, more predictable returns, so you don’t suffer from short-term market volatility.”

How does smoothing work? It delivers stable returns through monthly bonuses. In periods of strong investment performance, some of the underlying investment return is held back. This then supplements bonuses in periods of lower growth. So, regardless of the market, returns are stable

His last words to South Africans? “Fortune favours the brave. Seek a trusted partner to be alongside you on the journey and give you the reassurance you need. A financial adviser is the ideal person to guide you to get more comfortable with risk.”

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