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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

TABLE OF CONTENT

LOCAL NEWS

- Fund administrators tackle R42 billion in unclaimed pension benefits
- What experts want you to know about retirement
- An African solution to a South African problem
- What should I consider when purchasing an annuity?

INTERNATIONAL NEWS

- UK pensions regulator warns pension schemes on climate disclosures
- UK universities propose cutting benefits to save pension scheme

OUT OF INTEREST NEWS

- How to grow a meaningful nest egg with little money but a lot of time

LOCAL NEWS

Fund administrators tackle R42 billion in unclaimed pension benefits

The retirement age in South Africa is 65, which means that many people have spent an average of 47 years working hard and are then entitled to their pension benefit funds. According to the FSCA, almost 4.8 million South Africans have not yet claimed their pension savings, worth almost R42 billion. This amount of money has the potential to change and impact the lives of many and contribute to the financial freedom of communities. Speaking during a Money Smart Week South Africa 2021 event last week, Project lead of Unclaimed Benefits at Liberty, Kabelo van de Merwe, described unclaimed benefits as any money from a retirement fund that is not claimed for a period of 24 months from the time it is due for payment.

The lack of knowledge and education has resulted in many citizens not being aware that they must make the necessary claims for their retirement savings. Whether the citizen has recently retired, left employment or is a dependent of someone deceased who was a contributor to a pension fund, it is important to follow the correct channels and to be aware of scams and fraudulent individuals who may claim to assist them with receiving their funds. The Financial Services Conduct Authority (FSCA) offers to help all South African citizens with their claims at no cost, with beneficiaries and recipients having access the FSCA website and portal to source all the information about possible claims and the correct process to follow.

From there, they can contact the retirement fund processors should there be a claim to process. Once the beneficiary has received the claim form, they will need to complete the details of both who the main member of the fund is as well as person's relationship to the person they are claiming for. To do this, a tax number is required, as well as proof of identity and a proof of residence. The required documents are used to validate that the money is indeed going to the right person. Additional procedures are followed by SARS to ensure that the correct tax amounts are deducted whether the beneficiary chooses to transfer the money to a different retirement fund, or if they choose to receive a cash pay-out.

It is vital that all citizens always check their pay slips to learn about the total amount being deducted to contribute to a retirement fund. It is also important for the employee to keep their information updated with their employer, which includes contact details and residential information. Citizens are also encouraged to communicate with their families and ensure that they are informed about the money being invested and saved for their retirement. This is one of the many topics addressed last week during Money Smart Week South Africa, a campaign

aimed at motivating and empowering South Africans to become better educated about their finances. This campaign saw over 100 free financial education events being live streamed between 22 and 28 March. Recordings of all these events will be available soon on the website library at www.mswsa.co.za

Personal Finance | 1 April 2021

What experts want you to know about retirement

Retirement isn't a once-off event – it's a life stage. So, what do the experts want you to know to make yours a rewarding one? Read on to find out.

Retirement is just a tax event
Janet Hugo, Director of **Sterling Private Wealth** and FPI Financial Planner of the Year 2018. Putting an unconventional spin on her top tip for retirement, Janet suggests you shouldn't retire – at least not in the traditional sense. "[Retirement] should be treated as an opportunity, if you have sufficient money, to incorporate flexibility into your lifestyle," she explains. "The clients that I've seen who embrace retirement and have done it successfully are the ones who continue participating in their community and in work to some degree." For richer, more meaningful retirement years, engage with different areas of life or different parts of your community, and don't allow financial worries to ruin this well-earned phase of your life. "Work with a financial adviser so that your cash flow requirements and your investment strategies are dealt with properly, and hand those over to them to get that worry out of the way," she adds.

It's your positively selfish season
Linda Remke, COMENSA Master Coach, **EVEOLVE Coaching**
Linda is a firm believer in recognising that retirement is your season to give yourself permission to seek what matters most to you, and how you can impact others. "This starts by looking inward, realigning and reaffirming who you are and how you would like to see this season play out," she says. "Many call it a season of 'making a difference' and of performing meaningful work, which is often, if not always, linked to your purpose and passion – the legacy you would like to leave behind."

Your financial starting point should never be fees, but the correct vehicle for your needs
Rocco Carr, Business Development Manager, **Glacier**
Rocco draws an analogy for selecting the best retirement income solutions suited to you: "When you want to start 4X4 driving, you don't start with the cheapest vehicle, as you may end up with one that is unsuited to the terrain you want to drive on. You start with the right vehicle

(solution: living annuity, life annuity, with-profit annuity), then you select the correct engine (low-risk, high-risk etc.) that would be perfect for your needs. Part of this will be the maintenance plan you need and select (financial adviser and ongoing advice) and only then, once you have made sure these aspects are correct, do you start negotiating the price."

Don't limit the growth assets in your portfolio

Hester van der Merwe, Financial Planner at **Ultima Financial Planners** and FPI Financial Planner of the Year 2020 "Think of the number of years spent on building your retirement portfolio compared to the number of years you now have to rely on that portfolio to provide an income," says Hester. "This is key, because inflation is the biggest enemy of people in retirement and must not be ignored or underplayed."

Ensure that you are mentally and physically ready for the journey ahead

Dr Lerato Masemola, Resident Doctor at **Thari Health Excellence**

"Being ready can be the difference between enjoying many golden years, or many years being miserable, with subsequent unwanted mental and even physical ill health," says Dr Masemola. If you let your diet and exercise regime slide during your working years, it's not too late to get back into healthy habits. "It is never too late to make better food choices and start exercising. Do any exercise that you can," says Dr Masemola. "Even walking daily or doing gentle exercise classes offer great health benefits, including boosting your mood."

Taking care of your mental health is vitally important too, as one of the biggest changes in your daily routine will be adjusting to less social interaction than you were accustomed to while working alongside colleagues. "The change of the daily routine can result in anxiety with or without depression," says Dr Masemola. "Being in a retirement village or social clubs for the retired can benefit some, while it can be daunting for others as they struggle to accept that they are now 'old'," she continues. "It is important to keep a balanced outlook and do the best to be proactive about the changes that come up in your life."

Now is the time to enjoy your money

Hardi Swart, Director of **Autus Private Clients** and FPI Financial Planner of the Year 2019 Instead of focusing on leaving assets to your children and therefore adopting a financially conservative lifestyle, rather channel funds into experiences or purchases that make you happy. "My philosophy is that your responsibility towards your kids is that you give them love and a good education. Other than that, you've got no responsibility towards them," says Hardi. "When I talk to my retired clients, I say, 'Rather enjoy your money and do stuff that makes you happy, or use your money to go visit your children and spend time with them, rather than holding on to your money because you just want to leave them something when you pass away.'"

Work out your 'why'

Hilary Henderson, Retirement Coach at Valueneurs

Hilary believes you can only get so far worrying about your financial needs if you don't know how you'll spend your retirement. Reflecting on your reason for existing will shape how your retirement years will be used and, in turn, the financial needs these present. "The central consideration is: what is going to get you out of bed in the morning when you don't have to be at work on time?" she says. "Whether you end up working part-time, looking after grandchildren or an elderly parent, travelling the world or simply developing your hobbies, you would do well to start by working out your 'why', the reason for your existence, which leads on to planning the kind of retirement you want."

FA News | 7 April 2021

An African solution to a South African problem

Over the last two decades, many companies have delisted from the JSE. In its 1988 peak, it had 754 companies listed, which was down to 274 at the end of 2020, with no slowdown in sight. Although the reasons for delisting differ, major contributors include the popularity of private equity investment vehicles and the high regulatory burden placed on listed companies. This has been further exacerbated by low market values generally trending sideways and the COVID-19 pandemic. For South African asset managers running Regulation 28 compliant funds for the retirement industry, this has caused a peculiar problem as their South African equity component, over time, has become less diversified, which is posing an increased concentration risk.

Current South African retirement fund regulation allows funds to invest 30% offshore, and over the years, asset managers have maximised on this allocation, bringing a market advantage to their investors. This has allowed retirement fund members to gain access to tech-heavy developed markets and fast-growing emerging markets while also benefiting from a weakening South African Rand. But an often underutilised and misunderstood offshore allowance is the additional 10% offshore African allocation, allowing a Regulation 28 compliant fund to invest a maximum of 40% offshore.

This can ease the concentration risk posed by the contracting South African equity universe, while at the same time; allow fund managers to avoid decreasing their current developed market and emerging market offshore allocations. It's important not to disregard Africa over negative headlines, even if some countries seem to be poorly run and saddled with corruption. Negative headlines do not warrant the dismissal of the entire continent as an investment

destination. As an example, recent South African newspaper headlines don't paint SA in a positive light necessarily, but living here, we know that life goes on and there are many attractive investment opportunities. Dig a little deeper and you will find about 180 well-run listed companies across Africa outside of SA, with sufficient liquidity, operating in fast-growing economies, at incredibly attractive multiples to invest in. Re-allocating South African equity exposure to African equity is a good option to boost investment diversification.

Africa as an asset class has historically been quite volatile but importantly, weakly correlated to other asset classes. By adding 5% African equity exposure, the entire portfolio volatility decreases, while also increasing the rand hedge component of the portfolio. The best way to gain access to Africa is through a specialised, active African equity manager. Investing in Africa has certain nuances and requires many onsite visits that are performed best when you are 100% focused on the single asset class. It helps to have this focused specialist.

The underdeveloped nature of African financial markets enables a talented manager to add sufficient alpha. Additionally, passive managers seldom consider Africa as an asset class. And with index investing in its infancy in Africa, passive strategies ultimately prevent access to this asset class and are capturing additional capital in South Africa. Within the current regulatory constraints, pension fund trustees should encourage their Regulation 28 compliant fund managers to resolve a uniquely South African problem by investing in Africa.

FA News | 8 April 2021

What should I consider when purchasing an annuity?

And what costs should I expect to pay?

I am now 56 and I would like to retire when I turn 57 in late December. My company pension fund will provide me with an annuity of about R20 000 (after tax). I have no debts. My investments are about R4 million and my other retirement annuities are around R2 million. My current expenses are around R20 000 per month. But I would like about R50 000 after tax per month as I might need to travel. My questions are: which companies offer the best annuity? What should I ask for and look out for when purchasing an annuity and what costs could I expect to pay? If I draw down 4% do I need to increase this drawdown annually to account for inflation?

Thank you for your question. We are assuming that your company fund is a pension fund and not a provident fund and that you have not retired from any of your retirement savings yet. In answering your question, we have taken into account the following:

Life annuity vs living annuity

In choosing an annuity, you have the option to choose between a life or a living annuity. A living annuity would be invested in the market and subject to an annual drawdown between 2,5% and 17,5% per year. Your fund value would fluctuate depending on how the underlying funds perform. A life annuity is where you purchase a guaranteed income from a service provider where you have no market risk and the service provider pays you a monthly income for the remainder of your life.

To answer your question more fully, we have researched what after-tax monthly income you could purchase with R6 million, assuming that your income increases annually in line with CPI (consumer price index). Our research shows that you should be able to purchase a life annuity that would provide you with an approximate after-tax income of R24 000 per month. However, considering your need for capital expenditure in retirement, we have assumed that you would prefer to make use of a living annuity structure. When choosing a living annuity, you will need to consider the following:

Liquidity

Liquidity in your retirement portfolio would be the first matter to consider. When you retire from both your pension fund and your retirement annuity, you have the option to take up to one-third of the funds in cash, while the remaining two-thirds must be used to purchase a living or life annuity. Any portion taken in cash will be subject to the retirement tax tables. Should you take the full one-third as a cash lump sum, being R2 million, you would pay tax of approximately R477 000. Keep in mind, however, that the first R500 000 withdrawal is tax-free so we would definitely recommend taking out this portion.

Thereafter, depending on your capital needs in retirement and your need for emergency funding, it might make sense to pay a bit of tax by drawing more in order to create liquidity in retirement. The alternative to this would be to use your full R6 million to purchase a living annuity, although this would mean that you would be subject to the living annuity drawdown rules where you can only draw between 2,5 and 17,5% of the fund value per annum. While this might not result in liquidity issues early on in your retirement, it may cause liquidity issues later on.

Costs

It would be advisable to make use of a unit trust-based living annuity structure where fees and costs are transparent. Depending on whether you have a financial advisor or not, the fees you

can expect to pay would be an administration fee, investment management fee and financial advisor fee.

Underlying investment choice

Provided you are not taking out an in-fund living annuity, your living annuity would no longer be subject to Regulation 28 of the Pension Funds Act. This means you will have a lot more flexibility in fund choice and asset allocation when tailoring your portfolio. It is, however, always advisable to speak to your financial advisor when making such a decision.

Your drawdown

When choosing a living annuity structure, keep in mind that your drawdown will need to change as the general cost of living increases. Each year, at the anniversary, you will have an option to amend your drawdown on your living annuity. Since these drawings are taxable, it is advisable to work with your financial advisor to select a drawdown level that is most appropriate to your needs. An option worth considering in this regard is to withdraw a portion of your capital at retirement and to reinvest these proceeds into a discretionary investment. These funds can then be used to supplement your living annuity drawdowns and to help reduce your tax liability. Bear in mind that, once the funds in your discretionary investment are depleted, you are not able to make an ad hoc withdrawal from your living annuity.

Estimated retirement plan

Doing a rough estimation of your retirement plan, we have assumed that your retirement savings would be R6 million at the date of retirement. Assuming you allocate R1 million for travel expenditure, you would need to draw out R1.2 million from your retirement savings. Applying the retirement tax table, you would pay approximately R200 000 in tax, leaving with R1 million to invest in an inflation plus 4.5% per year discretionary investment which you could allocate towards your travel expenses.

We have assumed that the remaining R4.8 million would be invested in a living annuity which targets returns of inflation plus 4.5% per year net of all fees. Assuming you draw an income of R20 000 per month from this investment, increasing annually in line with inflation, your capital would be depleted by age 90. Keep in mind, however, that there are a number of moving parts in a retirement plan and our experience shows that changing circumstances can affect your plan. It is highly recommended that you consult your financial advisor before starting your retirement journey.

Moneyweb | 7 April 2021

INTERNATIONAL NEWS

UK pensions regulator warns pension schemes on climate disclosures

LONDON (Reuters) - Britain's pension's regulator will consider enforcement action against pension schemes that do not make mandatory climate risk disclosures, it said on Wednesday. The Pensions Regulator (TPR) said it was calling on scheme trustees to protect pension's savers from climate risk, ahead of proposed regulations requiring trustees of larger schemes to keep track of their climate change exposure. "Where we do not see schemes complying with the rules, we will consider enforcement action," David Fairs, the watchdog's executive director of regulatory policy, analysis and advice said in a statement.

UK regulators and policymakers have urged financial services groups and companies across a range of sectors to better understand and plan for climate change-related risks and opportunities. Proposals under the Pension Schemes Act will require larger schemes to make public their assessment of climate-related risks using the Taskforce on Climate-related Financial Disclosures (TCFD) framework. Later in the year, TPR will publish guidance for schemes to help them comply with the new rules, and will also encourage trustees to reflect climate change in the building of their investment portfolios and talks with their investment managers.

Will Martindale, group head of sustainability at pensions consultant Cardano UK, said he expected the regulator's strategy to lead to "major progress in climate-related financial governance, reporting and investment decision-making". By the end of 2023, TPR said it expects 81% of pension scheme members and 74% of occupational pension scheme assets to be covered by the TCFD reporting rules.

Financial Times | 7 April 2021

UK universities propose cutting benefits to save pension scheme

Measures are employers' response to shortfall in funding rising from £3.6bn to £18bn in 2 years

Hundreds of thousands of university sector staff in the UK would see their retirement benefits cut under employer proposals to avert "unaffordable" rises in contributions as the sector struggles with a years-long pension's crisis. Plans outlined on Wednesday by Universities UK, which represents more than 340 higher education sector employers, would see guaranteed pensions for about 200,000 of the 460,000 members become less generous, with higher-earning academics taking the biggest cuts.

The measures, presented to members as part of a seven-week consultation, are the response to a recent financial health check that estimated the funding shortfall for the £80bn Universities Superannuation Scheme had risen from £3.6bn to up to £18bn in two years. To plug the hole, USS had said contributions from employers and members would need to increase from the combined current 30.7 per cent of salary to as much as 56 per cent to keep current pensions intact. But both employers and employees branded the increases "unaffordable", and UUK hopes its alternative proposals can protect benefits as much as possible while keeping contributions at the same rate.

The USS is a hybrid scheme with defined benefits accrued up to earnings of £60,000. Contributions on salary above this threshold are paid into a riskier defined contribution plan, where retirement income is not guaranteed. The UUK has proposed introducing a "flexible" option for lower-paid staff. Instead of paying into the guaranteed, defined benefit scheme, they can opt to save into a riskier defined contribution scheme at a lower contribution rate than they do currently into the defined benefit scheme. It has also suggested that the salary threshold for defined contributions would drop to £40,000 so higher earners would see much less of their pensions guaranteed.

At present, about 45 per cent of members in the scheme earn £45,000 or less. Julia Buckingham, president of UUK, said the employer proposals sought to retain a valuable pension scheme, while keeping contributions affordable and reducing the number priced out of pensions. The employers body said it would also continue pushing USS to reconsider its valuation of the pension scheme, which both employees and employers have argued is overly pessimistic. Buckingham said UUK had "expressed disappointment" at the valuation, which "undervalued the collective strength of participating employers".

“It would be a dreadful outcome if an overly cautious approach by the USS trustees would lead to unnecessary and unjustified cuts to the scheme,” she said. However, the University College Union, which represents staff, said UUK's attempts to confront the pension scheme trustees over the valuation looked “weak” and accused the group of “proposing unnecessary and damaging cuts” when they could “afford to take a more progressive approach”. “University staff deserve much better than the weak commitments and half-baked proposals which employers are putting forward,” said Jo Grady, UCU general secretary.

“As it stands, employers have offered very little to dissuade members from voting for another round of industrial action.” Employers are also being asked if they can provide additional financial backing to reduce the rise in contributions, and if the period for which they are obliged to remain in the scheme could be increased. This would address USS concerns that large employers could weaken the scheme by leaving, and would mean the deficit could be repaid over a longer period, reducing annual costs to individual staff members.

Separately on Wednesday, UUK urged the government to allow students to return to university for face-to-face education, after universities were not included in its updated road map for release from lockdown. Buckingham said it was “illogical” that students doing non-essential practical courses were not allowed to return when gyms, parks, theme parks, public libraries and community centers were allowed to open. In response, the Department for Education said it would be “reviewing options for the timing of the return of all remaining students by the end of the Easter holidays”.

Financial Times | 17 February 2021

OUT OF INTEREST

How to grow a meaningful nest egg with little money but a lot of time

A common and unfortunate misconception is that investing is for the rich and that building wealth requires a sizeable amount of money, according to Darius van der Walt, actuary and member of the Investments Committee of the Actuarial Society of South Africa (ASSA). Van der Walt explains that successful investors are those who understand that time is the critical factor when building wealth and not necessarily the amount of money at your disposal. "While you definitely need some spare cash in order to invest, having a lot of time ahead of you is far more important than the amount of money you can spare every month.

The earlier in life you start investing, even if it is a small amount, the bigger your nest egg will be when you need it most." According to Van der Walt, time is a key factor when investing, because it enables compound growth. "The compounding effect over time is what significantly accelerates the growth of your investment." Considered to be one of the world's most successful investors, Warren Buffett credits his wealth to "a combination of living in America, some lucky genes, and compound interest". Van der Walt says while the first two could be considered either fate or luck, depending on your outlook, the power of compounding is available to anyone earning at least a living wage and willing to invest a portion for the long-term.

Why compounding is so powerful

Van der Walt explains that compounding is enabled when income (dividends, interest or rental income) is reinvested and capital growth is left to attract further gains. The effect of earning income on income and further growth on capital gains is referred to as compounding. "While reinvesting income is key, compounding of capital growth is also critical and even more so when a portfolio has higher exposure to riskier assets with higher expected returns such as equities. It's important to stay invested and not cash in your capital gains, so that you can have growth on your previous gains."

To illustrate this better, Van der Walt calculated the following example, using the average returns (net of fees) achieved by unit trust portfolios in the South African Multi Asset High Equity category. These portfolios are best suited for long-term investing and are structured to earn both dividends and interest in addition to capital growth.

How a R60 000 investment outperformed a R120 000 investment

Starting at age 25, Anne started investing R500 a month in a SA Multi Asset High Equity portfolio. Over the next 10 years she invested a total of R60 000 and she also reinvested the income earned. She stopped her monthly investment at age 35, when her personal circumstances changed. Although she was no longer investing, she took the wise decision not to dip into her investment and left it to grow for another 10 years. At the end of February 2021, assuming the average return (net of costs) achieved by portfolios in the SA Multi Asset High Equity category, Anne's investment was now worth R265 782.

Kaya on the other hand only started investing at age 35. To make up for lost time he invested R1 000 every month in a SA Multi Asset High Equity portfolio for 10 years – a total of R120 000. At the end of February 2021, when Anne and Kaya compared their investment returns, Kaya's investment was worth only R174 290. Van der Walt points out that Anne had accumulated R91 492 more than Kaya despite investing half as much, because her investment benefitted from an additional 10 years of compound growth.

He explains that the compounding effect over 10 years would also have given Anne an advantage over Kaya, even if both had invested their money in a much less volatile portfolio like an SA Interest Bearing Money Market portfolio. Money market unit trust portfolios earn only interest and are not impacted by stock market volatility. Assuming the average return of portfolios in the SA Interest Bearing Money Market category, Anne's R60 000 investments would have been worth R174 021 at the end of February 2021, and Kaya's R120 000 investments would have been worth R168 078.

Compounding requires a long-term commitment

Van der Walt acknowledges that it is hard to think about long-term investing when your current focus is on keeping a roof over your family's head and food on the table. "The past year has been incredibly tough for South Africans and job losses, salary cuts and an increase in living expenses is likely to have left consumers feeling despondent. Tightening the belt even further to squeeze out another R500 for an investment is probably the last thing on your mind. The hard truth is, however, that the benefit of having savings and investments becomes most apparent when times are tough."

Van der Walt makes the point that the best time to start investing was always yesterday and that the second best time is today. "The reality is that there will likely never be a comfortable time to start investing. The discipline of committing a fixed amount every month to a long-term investment will secure a better financial situation for yourself and your family in the future. Once that amount has been deducted from your bank account, you can no longer spend it and before you know it, you will have learned to make do without it." Van der Walt says the powerful effect

of compounding applies to any amount invested, as long as the investment achieves capital growth and earns interest and/or dividends. “The more you are able to invest over a long period of time, the bigger the multiplying effect,” says Van der Walt. Van der Walt has calculated the example below based on a monthly investment of R500 into either a SA Interest Bearing Money Market unit trust portfolio or a SA Multi Asset High Equity unit trust portfolio over a number of periods. The returns are based on the average return for each unit trust category.

He points out that the investment returns below were achieved without adjusting the investment amounts for inflation every year. He adds that over the 20 year period, investors would have been exposed to three significant events that sent stock markets around the world into free fall, namely the Dotcom Crash in 2001, the Subprime Crisis in 2008 and the Covid-19 pandemic in 2020. Van der Walt says stock markets not only recovered their losses every single time, but they also reached new heights. “Investors who panicked at the time and sold their investments would have locked in those losses, while those who stayed benefitted not only from the recovery, but also the resulting compounding effect.”

Investment period to 28 Feb 2021	**Total Invested** (R500 per month)	**SA Interest Bearing Money Market – value at 28 Feb 2021**	**SA Multi Asset High Equity – value at 28 Feb 2021**
1 year	R6 000	R6 123 (4.6% annualised net of fees)	R6 795 (15.9% annualised net of fees)
3 yrs	R18 000	R19 655 (6.5%)	R20 775 (6.1%)
5 yrs	R30 000	R35 312 (7.0%)	R35 776 (5.9%)
10 yrs	R60 000	R84 039 (6.3%)	R87 145 (8.3%)
15 yrs	R90 000	R152 897 (7.2%)	R169 315 (8.6%)
20 yrs	R120 000	R258 060 (7.7%)	R352 927 (10.9%)

Starting small beats not starting at all

Van der Walt says the first step towards becoming a successful investor is to recognise that every little bit counts. “Like with all good habits, investing requires practice and self-discipline.”

He suggests the following guidelines to get started:

• Identify a unit trust portfolio that accepts a monthly amount that you can afford. While the majority of unit trust portfolios require a minimum monthly investment of R500, there are some that accept R200.

• Make sure that you adjust your monthly investment amount with inflation (or a percentage roughly equal to inflation, say 5%) at least once a year.

• As soon as your financial situation allows it, add another investment to your portfolio. Your goal should be a diversified portfolio.

• If you are unsure, speak to a financial adviser about your risk profile. Over time unit trusts with high equity exposure tend to outperform interest bearing portfolios, but they also tend to be more volatile over shorter periods. While this should not matter to long-term investors, not everyone can stomach the extreme volatility.

• If you find yourself in a difficult financial position along the way, you can stop your monthly contributions. However, referring back to the example of Anne and Kaya, if at all possible leave your accumulated investment amount to continue benefitting from compound growth.

FA News | 19 February 2021

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