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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

TABLE OF CONTENT

LOCAL NEWS

- The Two-Pot System can help 70% of SA workers save
- Minimising the 'luck' actor in the passive phase of retirement
- Tax- Income, Black or Pension?
- Focus on what matters when investing for retirement
- The pros and cons of having multiple retirement annuities

INTERNATIONAL NEWS

- U.S. corporate pension plan funding ratios down slightly in August
- Canada's largest pension fund trims staff as it puts China deals on hold

OUT OF INTEREST NEWS

- August economic update

LOCAL NEWS

The Two-Pot System can help 70% of SA workers save

South Africa's retirement savings crisis has reached a critical point, with more and more workers unable to preserve their retirement funds, according to the latest 2023 Old Mutual Savings and Investment Monitor Survey. In response to this growing retirement crisis, the South African government has proposed a retirement reform aptly named Two-Pot.

The new system promises to provide a sustainable and practical means for South Africans to balance managing immediate financial needs and long-term retirement planning. However, its ultimate success will depend on individual discipline and comprehensive financial education. Set for implementation on 1 March 2024, this system, at its core, requires that every pension fund member saves two-thirds of their future contributions in a “retirement pot” specifically for income at retirement. The balance of the contributions will be allocated to a “savings pot”, which is specifically for lump sum at retirement. However, a member may access before retirement, subject to some limitations a convenience that comes with risks.

This means that for every R100 a member contributes, R66.67 will be added to a “retirement pot”, which cannot be accessed until retirement and the remaining R33.33 into a “savings pot” that can be withdrawn once a year. Any savings pot balance not accessed prior to retirement can be taken as a lump sum at retirement. The rationale is simple. When most South Africans leave a job due to retrenchment, termination, or resignation, they typically withdraw their retirement savings instead of transferring them to a new employer or putting them in a preservation fund. The 2023 Old Mutual Savings and Investment Monitor confirmed this disconcerting trend of early withdrawals. With a sample size of just over 1500 participants, the survey showed that less than a third (29%) had saved all their retirement money when they left their employer.

Approximately 1 in 3 people decided to cash out all their retirement savings. This trend is worrying as it could mean these individuals may not have enough money for a comfortable retirement. The survey also revealed that 62% of those with retirement funds would likely use some of their retirement money before they retire if the rules allowed it. These findings highlight the importance of the Two-Pot reform, a change designed to help people plan their retirement savings more responsibly. Under the Two-Pot system, retirement fund members facing financial need can withdraw some of their accessible cash pot before retirement without quitting or resigning from their job. A maximum of 10%, capped at R25,000, of the member’s existing

savings will be used to seed the savings pot on day one from existing retirement savings. The minimum withdrawal amount from the savings pot is R2,000, with no maximum amount specified. For example - let's say you have a total of R100,000 in your retirement fund. With the Two-Pot system, 10% or R10,000 will be transferred into an accessible “savings pot” when the system starts. You can withdraw a minimum of R2000 or the entire amount within the savings pot.

Economic challenges

Economic factors such as inflation, interest rates, and overall market performance could influence the growth and value of retirement savings in both pots. Beyond this, unfavourable economic conditions, such as recessions or job losses, drive more people to access their savings prematurely, affecting long-term retirement security. The Covid-19 pandemic was the ‘perfect storm’ to highlight South Africa’s savings crisis. During the pandemic, many individuals had no emergency funds for necessities, medical or funeral expenses to bury loved ones. This savings crisis has had a far-reaching impact on long-term financial health and retirement planning, and despite the global economic recovery, under-saving for retirement remains an issue. Even before the pandemic, less than 6% of employees could afford to retire comfortably at age 65, according to estimates from National Treasury. The odds are that many retirees will outlive their retirement savings due to reduced protection and longer life expectancy and will have to accept a standard of living far below what they envisioned.

The benefits of early access

As we’ve seen in the statistics above, when members don’t have money to take care of an unexpected event or are pressured to pay off debt, they resign to access their pension savings, often depleting it. Therefore, the Two-Pot accessible pot option provides a buffer against the depletion of retirement savings, making it easier for members to preserve their long-term retirement savings. One of the pillars of sound personal financial management is having an emergency savings fund, a designated amount to cover unforeseen expenses. It acts as a financial safety net, providing a readily available reserve of cash that can be accessed easily when unexpected events occur, such as medical emergencies, car repairs, job loss, or any other unforeseen financial challenges. The purpose of an emergency fund is to discourage over-reliance on high-interest debt, such as credit cards or loans, during times of crisis.

Instead, it allows individuals to handle unexpected expenses without derailing their budget or long-term financial goals. Unfortunately, many South African households do not have emergency savings and rely on credit or, in desperation, cash in their pension savings when the opportunity arises. Therefore, the anticipated benefits of this new pension system with built-in access are manifold. This system is projected to encourage a culture of savings. By providing a safety net, the accessible savings pot reduces the perceived risk of locking away

retirement funds. Consequently, this could stimulate a higher participation rate in pension schemes and, thus, contribute to mitigating the retirement savings crisis. Early access to one-third of their retirement savings can prevent pension fund members from falling into a debt trap due to unforeseen emergencies or financial shocks. Members can use their savings to weather financial hardships instead of resorting to high-interest loans or detrimental debt cycles. Maintaining a substantial portion of retirement savings, two-thirds, until retirement provides a disciplined structure to ensure retirees have sufficient funds to maintain a standard of living beyond their working years.

This portion will continue to grow over time, compounded by the returns from the pension fund's investments. However, this reform is not a magic wand to be wielded indiscriminately in the short term but rather a long-term mechanism to ensure a better standard of living at retirement. Individual discipline in preserving even accessible retirement funds remains critical. Additionally, widespread financial education is essential for the system's success. By empowering individuals to make informed decisions about their savings, we can look forward to a solution for the current crisis and a significant shift towards a culture of sustainable retirement planning.

Personal Finance | 3 September 2023

Minimising the 'luck' actor in the passive phase of retirement

This is the fourth article in a series on planning for retirement, focusing on the different phases of the journey. Our first article looked at pre-retirement planning considerations, the second looked at navigating the transition phase of retirement, and the third explored the active phase. In this article, we look at the fourth, or passive, phase of retirement and making sure your retirement funding goes the distance.

We sometimes hear people say their retirement savings will last for as long as they live – if they're lucky. While it's true you can't predict how long you'll live, and you can't predict how investment markets will perform, there are ways to minimise the role of luck in your retirement planning. One of the reasons luck plays a role in whether your retirement savings will go the distance is the fact that investment markets are essentially random. In other words, they often go up and down for some reason and there's not much anyone can do to predict or control this. Fortunately, short-term market movements play a relatively small role in how long your retirement investments will last. On the other hand, long-term market trends can either set you up for a happy retirement with enough money to last a lifetime, or a potentially unhappy retirement where you run out of money prematurely. This is because the returns your portfolio

delivers early in retirement have a disproportionate impact on the overall outcome. If you're lucky, you retire at the beginning of a long-term bull run, where markets go up in value overall. But if you aren't and you retire in a bear market where markets go down, you're more likely to run out of money. However, if you weren't lucky enough to retire into a bull market, you can still minimise the role of luck in your retirement finances. Even if you have saved a substantial sum of money that should be more than sufficient to fund a comfortable retirement, if you invested your retirement savings in a living annuity, and your withdrawal rate rises above a sustainable level, then luck plays an increasingly important role. Minimising the role of luck, then, is strongly related to keeping a tight rein on your withdrawals.

What is the right level of withdrawal? If you're a 65-year-old male when you retire, the most you should draw from your capital is 5.5% a year. So, for example, if you've saved R1 million, the most you should take as an income is R55 000 a year, or R4 583 a month. The figure for a 65-year-old woman is 5%, or R50 000 a year, as women tend to live longer. This is based on the average lifespan of a man who retires at 65, which is 82 years. For women retiring at 65 the average lifespan is 87. Cutting your spending is a good way to help your retirement savings last. In the fourth, or passive, phase of retirement you will probably start to slow down a little, take fewer trips and maybe even downsize your primary residence. It makes sense that if you're doing less, you're also spending less money.

However, this is also the phase where health concerns such as an illness or the need to take expensive medications may arise. This should be taken into account as some expenses during the passive phase may be higher than you've planned for. A rule of thumb is to budget for medical costs to increase by 2–3% a year more than general inflation. So, if inflation is running at 7% per year, make sure you budget for your medical expenses to increase by 9–10% a year. Also, what happens if you live beyond the averages? If you are budgeting to meet your living and medical expenses from your own savings in a living annuity, you need to allow for the fact that you may live to age 95 if you're a man or 100 if you're a woman. This is used as a rule as there is a 10% chance of that happening – planning for anything shorter is thus risky.

A further way to help minimise the role of luck in this phase of retirement is to take another look at how you've invested your capital. If you invested all your savings solely in a living annuity, perhaps it's time to consider switching some of it into a life or guaranteed annuity. Remember, investing only in a living annuity for the duration of your retirement is only appropriate if you've saved enough capital to give you a sustainable income for life. If you haven't saved enough, don't rely on luck to grow your capital once you retire. Luck isn't a strategy. With a life or guaranteed annuity, on the other hand, the monthly income cannot go down and it is guaranteed for as long as you live, which eliminates the luck factor.

In summary, here are a few ways to minimise the role of luck and ensure your retirement savings go the distance: Realise that even if you're less active, your monthly expenses won't necessarily go down because your medical expenses are likely to increase. Consider securing some of your income by investing in a life or guaranteed annuity. Ask your financial adviser to look at your options. Make sure to regularly review your retirement planning and investment strategy. Now is a good time to re-evaluate where you are and for how long your savings will need to last.

Tax- Income, Black or Pension?

The one thing all of us try to avoid, or at least reduce to the minimum, is paying any form of tax. Tax can take the form of a compulsory contribution that we all have to make from our salaries to the state coffers in terms of the Income Tax Act. It can also come in the form of the heavy demands that are sometimes based on unrealistic expectations placed on us as professionals by our close and extended family members, which is lovingly referred to in some communities as "Black Tax". A third type of "tax" is the one our future, retired selves put on us today in the form of retirement fund contributions that we must make now to eventually have enough money to sustain ourselves when we are no longer willing or able to work.

In her article, "Black tax- burden or investment?" Zenkosi Dyomfana, Investment Manager at Investec Wealth & Investment, defines black tax as "the financial support that a professional or entrepreneur of colour is obligated to provide to their family on an ongoing basis outside of their own living expenses". In terms of our common law, parents must support children, children must support parents, and spouses must support each other where one party has a basic need for food, shelter, medical care or education, and the other has the financial means to meet those needs. The challenge usually comes in the form of unrealistic expectations from extended family members who feel that they are entitled to enjoy some of the financial spoils of "the one who made it out of the township".

In full disclosure, I was raised by an amazing, single, black mother who supported me financially to obtain two law degrees as a full-time student. She made personal and financial sacrifices to give me the opportunities in life that she never had, and I will forever be grateful to her. When she had to take early retirement from her teaching position due to health issues, I stepped up and assumed some financial responsibilities on her behalf. I have always considered it an honour to assist her where and when I was able to do so, and I have never considered it as a constraint on my ability to create wealth or to reach my financial goals. So, does black tax hold professionals back from achieving their financial goals? In my opinion, it will depend on the ability of the black professional to manage expectations.

Firstly, you must manage your own expectations by targeting achievable financial goals. When competing in the marketplace with other professionals, black and white, who come from generational wealth, we sometimes create the unrealistic expectation of achieving generational wealth in one generation on a salary-based income stream. We want to buy the same house in the same area and drive the same car as our generational wealth beneficiary peers because we feel that we deserve the same lifestyle because we are paid the same salary, and we sometimes do not consider that those cars and houses might have been acquired with legacy income streams and assets and not with the salary that that person is earning. Going into a debate concerning the reasons for past unequal income and wealth patterns can only lead to frustration and not to wealth creation.

Secondly, you must manage the expectations of your family members. One salary cannot sustain two or more households on the same level of luxury. Put differently, you cannot maintain the same lifestyle for your household, your parents, your uncles and aunts and your siblings on your salary alone. It is, therefore, important to manage the expectations that your extended family members might have of your ability to provide financial support to them. You can, at best, assist family members in meeting their basic needs if they are not able to provide for those needs themselves, but you cannot assist them to maintain the lifestyle that they want but cannot afford.

We often forget to consider that our older selves levy a tax on us in the form of provision for retirement. The contributions to retirement funds and the prudent management of our retirement savings will ensure that we are not financially dependent on our children or grandchildren when we are no longer able to earn an income. If charity begins at home, the first tax that we should take into consideration is the tax that we must levy on ourselves by ensuring that we contribute as much as possible to our retirement funds. This delayed gratification will have a positive impact by reducing the income tax that we must pay today, but it might also reduce the after-tax income we will have available to assist family members who are in need.

To strike the right balance between the amount of tax we pay to the state, to ourselves and to our family members, we need to take the following steps:

1. Calculate your financial resources and responsibilities:

- What is my gross income?
- What is my income tax liability?
- What is my take-home pay?
- What are my monthly household expenses?
- How much do I want to save in my emergency fund

- How much to I have left to assist family members
- What are the financial needs of my family members?

2. Determine your financial goals:

- How much do I want to save for retirement?
- What is the ideal lifestyle that I can afford to maintain?
- How much money do I want to save or invest?
- To what extent can I contribute to the well-being of family members?

3. Balance conflicting interests and determine what is in the best interest of all parties:

- Put yourself, your retirement and the needs of your household first.
- Determine how much you can contribute to the needs of your parents.
- Determine how much you can contribute to the needs of your siblings.
- Determine how much you can contribute to the needs of your extended family members.

4. Have honest conversations:

- Be honest with yourself by setting high, but achievable financial goals.
- Communicate your financial ability and goals with your spouse, partner and children.
- Communicate the extent to which you can assist financially to the relevant family members.

5. Execute:

- Stick to your plan and negotiated payments.
- Where you receive additional income on an ad-hoc basis, for example, a bonus, contribute to your retirement fund first, then to your household needs, and thereafter to the financial needs of family members.
- Hold your family members accountable. You do not have the resources or responsibility to resolve every self-inflicted financial crisis that every family member creates.
- Learn to say no. You are not a registered credit provider in terms of the National Credit Act. You are, therefore, not allowed to grant loans to family members and friends. Every loan you make to a family member or friend is, therefore, a donation, and you will never have the legal right to claim it back if they decide not to pay you back.

Paying tax is less painful when you have a plan in place to manage your tax liabilities effectively that takes your income, obligations and financial goals into consideration. Without a plan, you will end up paying too much in income and black tax at the expense of saving enough for your carefree retirement.

MANAGING TAX LIABILITIES TAKING INCOME, OBLIGATIONS AND FINANCIAL GOALS INTO CONSIDERATION.

	Income Tax	Black Tax	Retirement Fund Contribution
Order of importance from tax perspective	Second. Gets deducted from taxable income after retirement fund contribution.	Third. Gets paid from after-tax income.	First. Gets deducted from taxable income before income tax.
Obligation	18-45% of taxable income.	Whatever is demanded or what you can afford.	27.5% of taxable income or R350 000.
Who must be paid?	Government.	Family members outside household.	Retirement fund on your behalf.
Beneficiaries	Citizens of South Africa.	Family members outside household.	Me after retirement.
Benefit	Not going to jail for tax evasion.	Meeting moral obligations.	My carefree retirement.

Graphic: Timothy Alexander/Independent Media

Personal Finance | 27 August 2023

Focus on what matters when investing for retirement

South Africans are searching for investment opportunities in the dark. The past five years have been a challenging period with the various crises we've experienced. From the revelations of state capture to COVID-19 and the ensuing stock market crash of February 2020, the riots in July 2021, Phala Phala, the national energy crisis and globally, the ripple effects of the Russia-Ukraine war have resulted in a pervasive sense of instability. Coupled with that, many are asking if South Africa has become 'uninvestable' as we experience extended periods of below-average market returns (also called beta).

As an example, we're seeing multi-asset high equity funds underperforming interest-bearing short-term funds over 7-year rolling periods – quite an unusual phenomenon. How can investors, financial advisers and investment managers help mitigate these poor conditions?While nothing can be done about financial market behaviour, investors can do something about their own behaviour to help boost their retirement savings. This is by focusing on other factors that matter but are controllable: maintaining appropriate portfolio risk in retirement; avoiding costly switching behaviour; and choosing a fund manager with a track record of delivering strong returns over time.

De-risking means missing out on 28 months of retirement savings

Off the back of these market developments, one of the trends is the shift in flows from multi-asset portfolios to fixed income assets across the industry. For the six years to 2016, there was

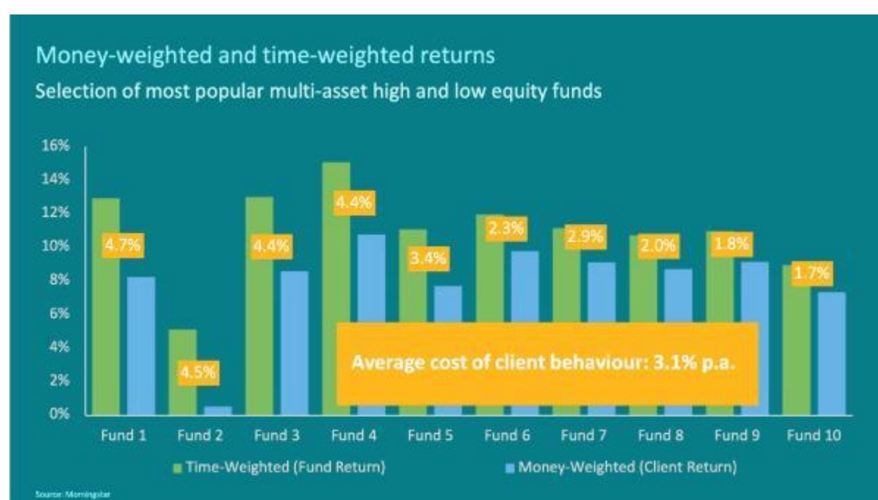
R406 billion invested in multi-asset portfolios compared to R155 billion in fixed income assets, which is a typical split we can expect to see. But following the pandemic-induced market crash of 2020, the trend accelerated where investors parked their investments in cash and patiently awaited the recovery. For the latest six-year period to end 2022, only R42 billion was invested in multi-asset funds, compared to approximately R522 billion in fixed income funds.

Typically, investors opt for balanced funds when saving towards retirement, but then de-risk at retirement, taking more conservative investment options like cash. But does that generate sufficient growth to sustain a post-retirement income in the current conditions? We analysed the pre- and post- retirement books (in other words the underlying investments according to ASISA categories of retirement annuities [RAs] and living annuities [LAs]) of a few of South African's largest LISPs. In RAs, just over half (54%) of the investments were in multi-asset high equity portfolios, but at the point of retirement, the allocation to balanced funds in LAs effectively halves to only 27%, moving to lower-risk categories such as multi-asset medium and low equity funds or offshore.

To quantify the impact of this de-risking, we analysed the historic returns since inception of all these ASISA categories against the forward-looking return expectations of each asset class. Based on this data, our calculation revealed a total expected real return for the RA book of 4.85% p.a. versus 4.05% p.a. for the LA book, which is a 0.8% p.a. difference in returns. Meaning that if investors de-risk at retirement, their return is likely to be 0.8% p.a. lower than if they had not de-risked. On face value, 0.8% may not sound like much, but when it is compounded over time, the effect over the long term is highly detrimental. For example, we factored in the 0.8% p.a. lower return into the living annuity modelling, and it shows that retirees will deplete their retirement capital 28 months earlier than the scenario where they did not de-risk.

Switching behaviour costs 12 years of retirement savings

We also compared the time-weighted and money-weighted returns of the ten biggest multi-asset funds in South Africa and found that on average, clients earned an average of 3.1% p.a. less than what the funds actually delivered. This difference is considered the cost of client behaviour due to switching into or out of a portfolio at disadvantageous times. Time-weighted returns are the returns achieved by the investment manager, while money-weighted returns represent the eventual return received by investors, considering the impact of cashflows into and out of a portfolio. Once again 3.1% p.a. may not seem material, but the compounded effect over time in a living annuity simulation shows that a retiree would run out of money 12 years earlier. The remaining growth after the impact of client behaviour, advice and platform costs, as well as the effect of inflation, means that your real return needs to be at least 3% above inflation.



The impact of alpha and volatility

Alpha (above-market returns), or the lack thereof, will naturally have a substantial impact on the retirement outcomes clients are able to enjoy, so the performance of your portfolio manager is important. Looking at an investment of R1 million into the M&G Balanced Fund 20 years ago, an investor would now have R11,102,274, which is a return of 7% p.a. (after fees) above inflation. For the M&G Inflation Plus Fund, the same R1 million would now be worth R7,234,049, a return of 5% p.a. (after fees) above inflation. In addition, these returns were produced with less volatility than an SA equity portfolio (using the JSE All Share Index as a proxy). While nobody can control the markets, we can help clients focus on what is within their control, such as fund selection. Targeting inflation-beating returns at lower levels of volatility, can help clients improve their possible retirement outcomes.

FA News | 4 September 2023

The pros and cons of having multiple retirement annuities

While reducing one's tax liability is an important consideration, there are multiple other factors involved when structuring one's retirement portfolio. Retirement annuities (RA) are extremely tax-efficient vehicles for those wanting to save towards their retirement, and while tax efficiency is often touted as their main advantage, it should not be the only factor considered when investing in this type of vehicle. RAs can be used to serve a range of purposes in one's overall financial portfolio and, as such, should be used strategically to achieve those goals. Further, while consolidating one's retirement investments through a single RA may have certain advantages, there may be value in contributing towards more than one RA. If you're unsure whether to retain your existing RA or take out another one, here's what to consider:

The type of RAs you currently have in place

Old-school, insurance-based RAs generally have quite inflexible structures with higher investment fees and can include heft penalties should you need to change the terms of the contract. On the other hand, unit trust RAs provide greater investment flexibility, more cost-effective fees, and no cancellation fees or penalties should you wish to pause or adjust your contributions at any stage. As such, if you are currently contributing towards an old-school RA and have not maximised your tax-deductible contributions, it may be worthwhile opening up a unit trust RA as an alternative. As a word of caution, do not cancel your old RA before first understanding what penalties or fees are involved. Your financial advisor can assist you with obtaining this information from the insurance company and prepare a cost-benefit analysis to determine the most appropriate course of action.

Your liquidity needs in retirement

There are inherent risks in housing all your retirement funding capital in compulsory investment structures such as pension funds and RAs, specifically when it comes to accessing capital after formal retirement. As such, it is important to carefully assess any potential capital outflows in retirement, such as the costs of overseas travel, home renovations, or vehicle upgrades, as well as your emergency funding requirements. Before committing all your investment contributions towards compulsory funds, be sure you have carefully assessed your cash flow needs in retirement to ensure that you don't run into liquidity problems later on. Finding the balance between investing in the most tax-efficient manner while also ensuring liquidity takes careful planning.

Estate planning considerations

The type of structure that your funds are invested in can impact your estate planning, and it's important to take this into account before setting up another RA. Remember, the funds invested

in your RAs do not form part of your deceased estate and, in the event of your death, will be distributed in terms of Section 37C of the Pension Funds Act to those who are deemed to be financially dependent on you (in whole or in part) at the time of your death. This means that while you are able to nominate beneficiaries to your RAs, the final distribution of the death benefits rests in the hands of the fund trustees. On the other hand, money held in a discretionary investment will be distributed as per your wishes. As such, it is important to take your broader estate plan into account before taking out an additional RA.

Investment flexibility

It is important to keep in mind that any funds invested in an approved retirement fund (such as your pension fund and RAs) are subject to the limitations set out in Regulation 28 of the Pension Funds Act, which places certain limits on your investment's exposure to riskier assets such as equities and offshore assets.On the other hand, should you invest towards a discretionary investment such as a LISP (unit-trust-type investments offered by 'linked investment service providers'), you have full investment flexibility and can construct a portfolio entirely aligned with the investment returns you require, and your propensity for risk. As such, before taking out another RA, it is important to understand what investment returns you will need to achieve to reach your retirement goals together with your investment horizon.

Your income needs in retirement

As mentioned at the outset, there are benefits to having multiple retirement annuities in place, although the decision should be made strategically with a long-term view of your retirement plan. Remember, when retiring from a RA, you are required to use at least two-thirds of the investment to purchase an annuity income, either in the form of a life or living annuity or a combination of both. If you set up a living annuity, you can only adjust your drawdown rate each year on the policy's anniversary, which can be somewhat restrictive. One significant benefit of having multiple retirement annuities in place is that you can stagger your respective retirement dates, which, in turn, will give you the equivalent number of opportunities in each tax year to adjust your drawdowns – thereby providing you with some income flexibility in your retirement years.

The status of your existing Ras

Another factor to consider before taking out an additional RA is whether or not your existing one enjoys what is referred to as 'grandfathered' status, which effectively means that it is exempt from complying with the provisions of Regulation 28 of the Pension Funds Act. Those RAs that were taken out before 1 April 2011 (when Regulation 28 became effective) are not required to comply with the investment limitations imposed by this piece of legislation. However, if material changes – such as a contribution increase – are made, the investment will need to comply with Regulation 28, which can, in turn, impact your investment returns over the

longer term. As such, if you want to make additional contributions towards your retirement funds, increasing your contributions to a 'grandfathered' RA will have the effect of triggering compliance with Regulation 28, and it may be more appropriate to set up an entirely new RA. As is evident from the above, while reducing one's tax liability is an important consideration, there are multiple other factors involved when structuring one's retirement funding portfolio, and our advice is to seek the guidance of an independent financial advisor.

Moneyweb | 31 August 2023

INTERNATIONAL NEWS

U.S. corporate pension plan funding ratios down slightly in August

U.S. corporate pension plan funding ratios dipped slightly in August, but they still remain well above 100%, according to three new reports.

Legal & General Investment Management America estimated the average funding ratio of the typical U.S. corporate pension plan fell to 103.6% as of Aug. 31 from 104.9% a month earlier. In its latest monthly Pension Solutions Monitor, LGIMA said the estimated average funding ratio rose despite liability values dropping, because both global and domestic equities suffered weak performance during August. The monitor cited the MSCI ACWI Total Gross index and the S&P 500 index dropping 2.8% and 1.6%, respectively, during the period. Also, the monitor estimates plan discount rates increased 18 basis points during July, with the Treasury component increasing 19 basis points and the credit component tightening by 1 basis point. The Pension Solutions Monitor assumes a typical liability profile using a duration of 12 years and an asset allocation of 50% MSCI ACWI and 50% Bloomberg U.S. Long Government/Credit index.

In another monthly report, Insight Investment said the funding ratio for U.S. corporate pension plans dipped to 106.5% as of Aug. 31 from 106.9% a month earlier. Insight's report also cited a week equity markets that dragged down asset values even as liabilities dropped during the same period. According to Insight's estimate, the discount rate rose to 5.3% as of Aug. 31 from 5.15% as of July 31. In another monthly report, Aon said the aggregate funding ratio of S&P 500 companies that sponsor defined benefit plans fell to 101.5% as of Aug. 31, down from 101.7% a month earlier. Aon said pension assets returned -1.7% during August, and the interest rates used to value pension liabilities rose to 5.32% from the previous rate of 5.14% estimated a month earlier.

Pensions & Investments | 5 September 2023

Canada's largest pension fund trims staff as it puts China deals on hold

HONG KONG, Sept 1 (Reuters) - CPP Investments, Canada's biggest pension fund, has laid off at least five investment professionals at its Hong Kong office as it steps back from deals in China, three people with knowledge of the matter said. Most were on the fund's private equity team and were informed early last month, according to two of the people. The departures have not been previously reported. They added that a managing director who was in charge of the firm's Greater China real estate portfolio had been told he was losing his position weeks earlier.

The fund has paused new investments in China, including direct investments as well as those in China-focused fund managers, discouraged by the country's faltering economic recovery and tensions with the West, said the people. They were not authorised to speak to media and declined to be identified. CPP, which employs more than 150 people in Hong Kong, its Asia hub, declined to comment. It had flagged in its latest annual report that evolving relationships between Canada, the U.S. and China would be a factor as it reviewed its approach to emerging markets.

Political tension between Canada and China has been quite fraught over the past few years. More generally, the business climate for foreign firms in the world's second-largest economy has also chilled amid intensifying trade and political tension with the U.S. that has led to Washington imposing export controls on key tech such as some semiconductors. U.S. Commerce Secretary Gina Raimondo noted during her China visit this week that U.S. companies have complained that China has become uninvestable, pointing to fines, raids and other actions that have made doing business in China risky.

Other Canadian pension funds are also pulling back from China.
The Ontario Teachers' Pension Plan (OTPP) closed down its China equity investment team based in Hong Kong in April, Reuters has reported. Canada's second-largest pension fund, Caisse de dépôt et placement du Québec (CDPQ), has also stopped making private deals in China and will close its Shanghai office this year, the Financial Times reported in June. China accounts for 9.8% of CPP's total investments, according to Michel Leduc, a senior CPP managing director, who was speaking before a parliamentary committee studying Canada-China relations in May. At the time, he said China was an "important source" for CPP's portfolio. CPP managed $575 billion in assets globally as of end-June. China-focused private equity funds have raised just $11.6 billion this year.

That compares with $74 billion raised for all of 2022, according to data from research firm Preqin. The numbers are a far cry from a peak in 2016 when more than 1,500 China-focused funds raised around $300 billion. There have been $3.2 billion worth of acquisitions of firms in China by private equity so far this year. That's up from $2.7 billion last year but still far below the $49 billion for 2021, data from Dealogic shows.

Reuters | 1 September 2023

OUT OF INTEREST NEWS

August economic update

- Global markets eased off highs in August due to persistent indications of slowing growth in the United Kingdom, Europe, and China. Additionally, yields increased in the United States (US) as a response to the hawkish comments made by Federal Reserve Chair Jerome Powell. This move dampened risk sentiment and led to a decline in longer duration equities. Consequently, the Morgan Stanley Capital International (MSCI) All Country World index ended August with a 3.0% decline. Emerging markets, primarily influenced by discouraging data from China, performed less favourably than their developed counterparts. The MSCI Emerging Markets index lost 6.4%, in contrast to the 2.6% decline in the MSCI World index.
- While the US labour market remains relatively robust, recent data indicates a gradual deceleration. The Nonfarm Payrolls report revealed that the US economy added 187 000 jobs in July, falling short of the projected 200 000. More recent data indicated a decrease of 338 000 job openings, bringing the total to 8.827 million in July, marking the lowest level in over two years. Although this still translates to a relatively high ratio of 1.51 jobs per unemployed individual, the prevailing trend in recent reports has been downward.
- More good news was received on the inflation front, as the July Consumer Price Index (CPI) report came in lower than expectations. The annual headline CPI rose to 3.2%, while up from the previous month, the market had anticipated a 3.3% increase due to base effects from July of the previous year. Diminishing inflationary pressures and a slowing labour market have prompted investors to increase bets that the Federal Reserve will keep rates unchanged at their next meeting in September.
- China remains a significant drag on global growth expectations, as economic data consistently disappoints on the downside. Recent figures revealed that China’s economy slipped into deflation in July, with consumer prices contracting by 0.3% year-on-year. This underscores the bleak demand outlook for the world’s second-largest economy and has raised concerns about the potential for a period of stagnation. In

response, the People's Bank of China has lowered policy rates, but many believe that more will need to be done to shore up confidence.

- In early August, the Bank of England implemented another 25 basis point hike in an attempt to tame inflation. However, with annual CPI still running hot at 6.8% and wage data showing record growth of 7.8% year-on-year, the Bank of England will likely need to maintain their hawkish stance in the future. Unfortunately, this comes at a price, as the economy is already displaying signs of slowing down and is at risk of slipping into a recession. Recent data highlights that both the manufacturing and services sectors have entered contractionary territory. Additionally, retail sales declined by 3.2% year-on-year, underscoring the impact of elevated rates and prices on consumer demand.
- Locally, a sense of relief was felt about the battle against inflation, as all figures for July surprised on the downside. Particularly noteworthy was the decrease in both the annual headline and core CPI, which now stand at 4.8% and 4.7%, respectively. With inflation comfortably within the South African Reserve Bank's target range of 4%-6%, many expect rates to remain unchanged in the upcoming meetings. While this is promising, the local consumer is already facing significant pressure, evident from the June 0.9% year-on-year decline in retail sales. This marks the seventh consecutive month of contraction and highlights the negative impact of the challenging economic environment and higher interest rates.
- The weak domestic data and a resurgence in the dollar has sent the rand lower in August. The local currency has depreciated against all three major currencies, experiencing losses of 5.7% against the dollar, 4.4% against the pound, and 4.3% against the euro. Similarly, South African equities have also ended the month lower, with the JSE All Share index losing 5.1%. The resources sector was the primary contributor to this decline, experiencing a significant 10.3% drop, followed by industrials and financials with -5.1% and -2.0%, respectively. On the other hand, South African listed property advanced 0.8%, marking the third consecutive month of gains.

One-month index movements:

- JSE All Share Index: -5.10%
- S&P 500 Index (US): -1.77%
- FTSE 100 Index (UK): -3.38%
- Hang Seng Index (Hong Kong): -8.40%

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