Altering your investment strategy in today's uncertain market could impact achieving your retirement goal

Dear member,

As a society, we are going through a social and economic situation which most of us have not seen before. Words like 'unprecedented' and 'once in a lifetime' are commonly used in conversations and in what we read and hear from news and social media.

Investors have been taken by surprise by just how widespread the impact of the COVID-19 pandemic is on the global economy, as well as different types of investments and investment markets.

Equity markets are typically volatile by nature, with this characteristic particularly highlighted during global crises such as the current COVID-19 pandemic. You may be concerned about the equity exposure of your hard-earned retirement savings, and changing your investment strategy by moving into perceived safe-havens, such as cash, may feel like a safer move. But, is this really the best one for your long-term retirement outlook?

Movements in equity markets during uncertain times

In the past, events such as times of war, financial crises and technological advances have caused significant market shocks. However, in each of these instances, the basic principles of economics have always applied, and it is therefore unlikely that this event will prove to be different. An example of one of the key economic principles is that 'people face trade-offs' - in other words, 'the higher the risks taken, the greater the expected rewards'. Investments in volatile markets, such as equity markets, are seen as high risk investments, but often prove to result in greater than expected long-term returns.

Equity markets often fall and then rise again, and throughout history we have seen this pattern repeat itself. Significant events between 1930 and 2012 have caused South African equity market falls of more than 20%. This, together with the length of time taken to its subsequent recovery, has shown that market recoveries following uncertain times happen relatively quickly. This can be seen in the table below. Historically, the market has taken on average two years to recover fully from a drop of more than 20%.

Event	Start date	End date	Observed fall in the market	Number of years before market recovered
Stay on gold standard	June 1931	February 1933	35 %	2
Great Depression	November 1936	May 1941	23 %	5
Post-world war recession	February 1948	September 1959	38 %	12
Economic recession	March 1960	January 1962	30 %	2
End of gold standard	May 1969	May 1973	58 %	4
OPEC oil price shock	June 1973	December 1973	26 %	1
Oil crisis	April 1974	June 1978	43 %	4
Energy crisis	November 1980	October 1982	39 %	2
Black Monday	August 1987	February 1989	43 %	2
Asian financial crisis	May 1998	October 1999	39 %	2
Tech bubble burst	May 2002	December 2003	30 %	2
Global financial crisis	June 2008	September 2010	40 %	2

Also shown in this table, is that the period during the post-world war recession proved to be vastly different. Between 1948 and 1959, the market spent more than a decade recovering from the recession along with the rest of the world.

Could this happen again due to COVID-19? With the constant and extensive focus on the current health crisis from governments and central banks around the world, a fall and recovery period of this magnitude is unlikely to reoccur.

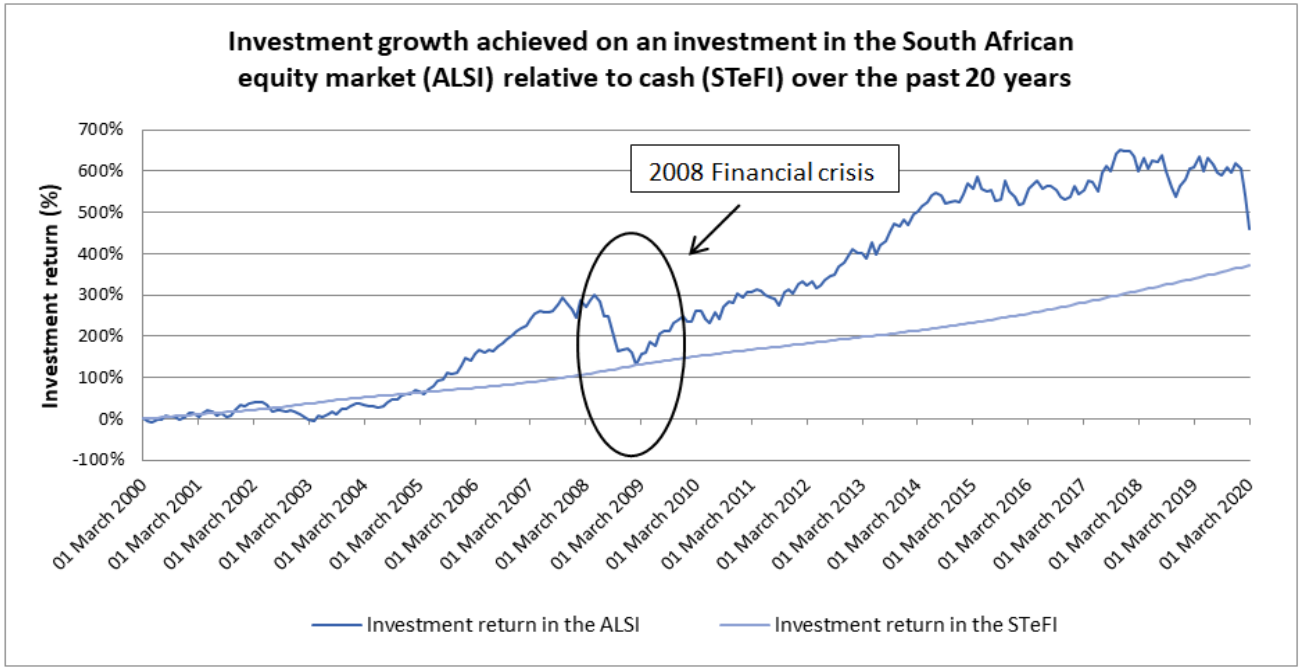
On the worst day recorded so far this year, the South African equity market fell by 33% (year-to-date as at 23 March 2020). This is less than the falls seen in markets from most events tabulated above, over the last 90 years. The South African equity market, however, improved by 22% in less than a month following the time of this year's low.

Many historical events have shown us that in times of crises, markets may fall and short-term volatility may be significant, but they have also shown that markets recover, and that they tend to do so relatively quickly. In times of uncertainty, it is therefore important to remain invested in your long-term investment strategy, in order to benefit from any investment returns that may arise from future recoveries and upward movements of the market.

What about cash as an alternative investment strategy or a 'safe-haven'?

In times of uncertainty, cash is believed to be a safer investment in comparison to equity. Cash is generally stable and less risky, but also produces a lower expected return over the long-term. While the equity market is not as stable as cash, and is typically more volatile in the short-term, it has proven to produce higher long-term expected returns to reward for taking higher risk.

The growth achieved on an investment in the equity market (in the ALSI) relative to the same investment in cash (in the STeFI) over the past 20 years, as graphed below, illustrates the point above of risk vs reward. It shows that over the short-term, equities appear more volatile and hence riskier, while over the long- term, shows a steady increase in growth over time, and proves to significantly outperform cash.



*For illustration purposes, all fees in the graph above have been ignored

This means that an investment made 20 years ago would be in a better position today if it was invested in the South African equity market rather than in cash alone. The 20-year period considered above also covers the 2008 financial crisis, where we observed a fall and subsequent recovery of the South African equity market. Similarly, the fall in the equity market in March 2020, due to the current pandemic, could be viewed as short-term volatility, with a future subsequent 20-year period possibly showing a repeat of a recovery in the equity market and a rising trend in growth.

The above is evidence of why one would expect an investment in the equity market to outperform an investment in cash when saving towards a long-term goal, such as retirement.

How changing your investment strategy during uncertain times could impact your retirement outcome

Making emotional and uninformed decisions in times of heightened uncertainty should be cautioned against, as it could impact your retirement outcome.

As an illustration, consider a simple example of an individual who turned 55 years old in 2008 with accumulated retirement savings of R1 million in that year, and 10 years away from retiring. Every month thereafter, this individual contributed R1 000 towards their retirement savings, which was invested in a portfolio comprising of 70% in equities and 30% in cash. The 2008 financial crisis, which caused a significant fall in the equity market, resulted in this individual making the decision to change their investment strategy in 2009. The individual then chose to move all of their current savings and any future contributions into a portfolio comprising of 70% cash and only 30% equities.

In 2018, at the time of retiring, the total retirement savings amounted to R1.96 million, which allowed the individual to purchase an income of R8 177 per month for the rest of their life. However, had this individual remained invested in the original investment strategy, which was made up of a higher proportion of equities, the individual would have retired in 2018 with a total of R2.1 million in their retirement savings account, which would have allowed for the purchase of an income of R8 768 per month.

If, through the uncertain economic times, the individual instead remained invested in their long-term investment strategy suitable for their long-term goal, the individual would have retired with an income of 7.2% greater than what they ended up receiving.

Note:
This example is for illustrative purposes only.
Assumptions: Equity exposure is invested in the ALSI; Cash exposure is invested in the SteFI; All fees are ignored; The R1 000 monthly contribution remained flat throughout the 10 year period prior to retirement; The prescribed FSCA Living Annuity female drawdown rates were used to determine the monthly income after retirement. The annuity rates used to determine the retirement income in the illustration are based on a female gender.

Keep your retirement goal in mind

Yes, the current COVID-19 health crisis, and its impact on the equity market, may have an impact on your retirement savings over the short-term. The important thing to remember, however, is that your retirement savings is a long-term investment.

Historically, equity markets, by nature, can be highly volatile in the short-term but yield higher expected returns over the long-term compared to an investment in cash. We caution you to be careful about making changes to your investment strategy for your retirement savings, particularly if your retirement goals have not changed.

What you can do next

If you are unsure about your investments, you can contact our benefits counselling team regarding the options available to you as a Liberty Corporate member by calling 011 558 2999 or emailing benefitcounselling@liberty.co.za. You can also speak to your personal financial adviser or your retirement fund's financial adviser should you require financial advice.

Sources: Professor Colin Firer (University of Cape Town), Iress

Glossary:
Principles of economics: The way in which it is expected that markets will behave, based on research and analysis.
ALSI (JSE All Share Index): This index tracks most listed South African companies' share performance. It can be used to measure the overall performance of South African shares.
STeFI (Short-Term Fixed-Interest index): This index measures the performance of money market investment instruments in South Africa, which is also commonly termed 'cash'.
Investment strategy: The style of investing, choice of investment types or portfolios used to achieve a member's retirement objective such as having enough income in retirement.
Volatility: Unpredictable movement (rise or fall) of the market.

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