Vickers & Peters

LIFESTYLE AND ASSET PLANNING

"Around the Table with Vickers & Peters Financial Planning"

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10 Retirement Wrecking Moves

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Retirement should be a time to relax and enjoy the fruits of a lifetime of labour. Unfortunately, for many people bad decisions push the retirement horizon out of reach. As such, it is imperative that individuals understand the effects of these bad choices and take steps to avoid them. Let's examine 10 mistakes that can sabotage your retirement plans.

1. The Benefits of Starting Early

Many individuals are forced to postpone retirement because their nest eggs are not sufficient or their objectives unrealistic. This can be avoided by starting to save early or adjusting lifestyle needs. The amount you will need to contribute each year depends on how soon you start your savings program.

Even in instances where you can't afford to add the maximum amount that projections determine you need to save for the year, adding what you can afford can go a long way toward reaching your goal.

2. Thinking it's Too Late to Get in the Game

Some of the common reasons for starting to save for retirement late in the game include pure procrastination, having to start over after a divorce, retrenchment or a business going insolvent. Regardless of the reason, thinking that it's too late will only compound the issue. Instead, you should look for ways to start saving. This may mean redoing your budget and going without many items that are not basic necessities. It is possible for individuals to achieve their post-work goals, even if retirement is just around the corner.

3. Budgeting

The problem with many households is that they "leak" money by simply not having a proper budget. Managing your cash flow better will increase the likelihood of having that extra cash and not extra expense to deal with at the end of the month.

As your balance sheet and cost of living changes, so does the need to reassess your budget. The re-budgeting process will help you determine whether you should cut back on some expenses, or perhaps even whether you require additional income to maintain the standard of living you expect. A revision of the budget will help you to make important decisions relating to retirement savings, such as whether to increase or decrease the budgeted amount that you add to your nest egg.

4. Missing Opportunities

My father's recital of the poem from Agatha Christies "TAKEN AT THE FLOOD"* springs to mind when I think of the need to recognize and take advantage of the opportunities that retirement savings has to offer. While saving can be challenging, there are many opportunities that make it easier. Unfortunately, many people overlook these opportunities and miss out on the benefits. For example, using tax advantaged investments. It is no secret that income tax rates in South Africa are relatively high. For this reason, tax will pay an important role in planning your investments. There are many investments where tax concessions exist and it's important to use these to maximum advantage.

Don't let opportunities to save or increase your investment savings pass you by; there are only a limited number of bull markets in a lifetime….. *"Omitted, all the voyage of their life is bound in shallows and in miseries"…..*

5. Not Considering Healthcare Needs

The need for healthcare increases with age. This includes the need for more frequent check-ups and preventative healthcare, as well as the need for long term care, both at home and in nursing homes. Individuals who fail to implement contingency planning to cover health-related expenses could find that a large percentage of their savings must be used to cover these costs. Prevent this by ensuring you have adequate health insurance or a voluntary savings fund.

6. Spending Too Much Too Soon or Too Late

Those entering retirement are often faced with the fear of spending too much too soon and, as a result, may hoard their savings to the point of just barely getting by. While caution should be exercised to ensure that your nest egg lasts throughout retirement, living on a diet of bread and water takes caution too. On the other hand, individuals who decide to splurge during their early retirement years without any regard for the future may find their bank accounts running dry. The right balance can be maintained by implementing a flexible retirement plan.

7. Managing Debt

Debt consolidation usually involves consolidating multiple loans under the umbrella of the lowest (or a lower) interest rate, which can sometimes shorten the repayment period. The goal of debt consolidation is usually to reduce the overall amount of interest paid on credit and the amounts paid in installments. For example, refinancing your bond can be advantageous, provided it either increases the individual's available cash by lowering the monthly payments, or reduces the amounts paid for interest over the period of the loan.

An individual, who pays less for a bond on a monthly basis, will likely have the difference available for use in other areas, including increasing the amount contributed to a retirement fund.

8. Avoid Raiding

Often liquid investments such as unit trusts become the target of regular raiding to fund holidays or luxury items. This leaves little or nothing to provide an income for retirement. Ways to overcome this shortfall would be to set up a fund with a specific objective and enforce a disciplined savings routine on a contractual basis.

Retirement savings should be treated as a recurring expense. This helps to make sure the amount is saved regularly, making it easier to add to your nest egg. If your employer offers contributions via tax-deferral or after-tax payroll deductions, you should take advantage of this opportunity to increase your savings. After all, it's easier to treat the amounts deducted from a pay cheque as non-disposable income, and there is a lower risk of the amount being used for other purposes.

9. Don't Rely on Your Pension Fund Alone

A number of people in employment fail to take additional responsibility for their retirement, believing that their pension or provident fund will provide for all their needs. The following factors are a major threat to this premise:

- On average, employees change employment seven times prior to retirement and fail to preserve their fund benefits, preferring to use the withdrawal benefit for current needs or speculative investing (get rich quick schemes)
- Retrenchment leads to a premature termination of contributions to retirement funds, which diminishes the projected amount of retirement capital which is relied on.
- If employees are close to retirement age when they are retrenched they may receive an early retirement package, causing them to rely on their pension income earlier than expected.
- The most crucial compounding growth, which takes place in the last years before retirement, is lost.

It is therefore vitally important to supplement your retirement capital with other forms of liquid retirement assets. Tying up all your retirement assets in brick and mortar can also have its downsides. Being a non liquid asset it might prove difficult to correctly time your exit point. This can often lead to disastrous consequences such as a realization value far below what was expected, notwithstanding Capital Gains Tax (CGT) implications.

Although you still need to supplement shortfalls that may arise because your pension fund will not provide adequate benefits at retirement, retirement funds remain the cornerstone of an individual's retirement provision. Therefore it's important to see these funds as sacred and untouchable until retirement, despite their accessibility on termination of employment.

The benefit of Preservation Funds (Aftree Bewarings Opsie) is that members may make one withdrawal prior to retirement (age 55). The option to withdraw the funds, although taxable, is an important safety net. However, it must be exercised responsibly. When your financial situation becomes more buoyant, you should endeavour to build up the capital you withdrew in another investment vehicle.

10. Financial Reassessment

Clients may have already conducted a financial needs analysis at an earlier age; however, regardless of whether you've already done this, a reassessment must be done periodically to determine whether changes must be made to your financial habits, including those that affect your budgeting and debt analysis. The frequency with which a financial analysis must be done will vary among individuals, and may also be affected by other factors, such as changes in interest rates, fiscal responsibilities and recurring expenses. For instance, if the interest rates on home loans have been reduced since an individual received a loan; it may make sense to determine whether the loan should be refinanced. Also, if the individual's marital status has changed, retirement goals may need to be redefined.

Only careful and timeous financial management can stretch retirement income to cater for the extension of a desired standard of living after you have stopped working. Financial risk and retirement cannot be separated, but the good news is they can be managed. It’s therefore never too late to start planning for retirement, but it’s often too late to delay.

A financial analysis is a necessity and is one of the most important steps toward identifying areas in which you are doing well and areas in which improvements are required. It may be worthwhile to have the analysis redone sooner rather than later.

Please contact one of our Certified Financial Planners® for a free Financial Needs Analysis

*TAKEN AT THE FLOOD

There is a tide in the affairs of men,
Which, taken at the flood, leads on to fortune;
Omitted, all the voyage of their life
Is bound in shallows and in miseries.
On such a full sea we are now afloat,
And we must take the current when it serves,
Or lose our ventures.

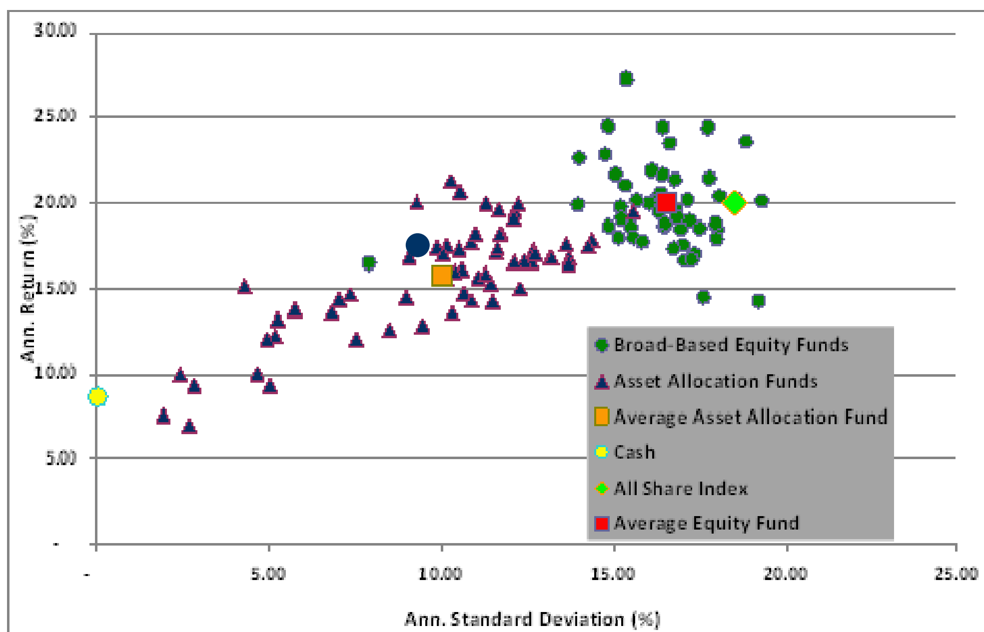
Asset Allocation Funds – Why they make cents!

Between April 2003 (when the All Share Index was at about 7,360) and May 2008, when the (ALSI) reached more than 33,200, our local equity market knew just one direction - up, up and away! Between May 2008 and March 2009: down, down, down and down!

The total return of the ALSI over this period was an annualised and remarkable **20.5%.** During the initial period above (nearly 5 years), investors became almost myopically focused on the one side of the investment coin - returns, and blissfully ignorant of the other side of the coin, risk. 2008-2009 was a stark reminder of how important it can be to be cognizant of risk. Today we'd like to give praise to those funds whose importance may have been forgotten during the heady days of the bull market, the Asset Allocation Funds.

Graph 1 below shows the risk and return characteristics of the broad-based equity funds (General, Value and Growth) and the asset allocation funds (the four prudential sectors (Variable Equity, High Equity, Medium Equity and Low Equity), the Flexible sector and the Targeted and Real Return sector). The equity funds are the dark green circles and the asset allocation funds are the blue triangles. The yellow dot alongside the left axis is the return which cash gave over the full period; the light green diamond depicts the ALSI, the gold square the average asset allocation fund and the large red square the average equity fund. The optimal place to be on this graph is in the top left-hand corner (where the fund would give the highest return (left axis) at the lowest risk (bottom axis).

Graph 1 source: Alphen



As can be seen in the graph, the average equity fund produced an annualised return of 20.02% at an annualised standard deviation of 16.52%. This return was very much in line with the ALSI, but achieved at just less than 90% of the risk of the index. The average asset allocation fund, on the other hand, produced an annualised return of 16.12% at an annualised standard deviation of 12.96%. It is worth noting that there is a wide range of mandates within the asset allocation funds, and thus looking within these sectors would be useful.

By looking at the **Sharpe Ratios** of the various asset allocation sectors, we would see that the average of the Asset Allocation Prudential (Variable Equity) funds was the highest, showing which funds generally gave the best risk adjusted returns. (Sharpe

ratios, are one way of measuring risk-adjusted returns. The higher the number the better).

Here are the results per sector, ranked by average annualised return, together with the sector's Sharpe ratio alongside.

Table 1

Sector	Funds	Ann. Growth	Ann. Std Dev	Sharpe Ratio of Average Fund
Equity – Value	7	22.65%	16.93%	0.69 (combined)
Equity – General	38	19.61%	16.31%	
Equity – Growth	5	19.46%	17.54%	
AA – Flexible	15	17.59%	12.01%	0.74
AA – Prudential (Variable Equity)	16	17.19%	10.83%	0.80
AA – Prudential (High Equity)	2	16.60%	12.25%	0.69
AA – Prudential (Medium Equity)	9	15.59%	10.26%	0.66
AA – Prudential (Low Equity)	6	12.42%	5.25%	0.72
AA – Targeted A&R Return	10	11.80%	5.32%	0.59

So, if we are to take a more balanced approach to investing and keep an eye on both sides of the coin, we must ask ourselves why the asset allocation funds have done so well? It's simple really.

Firstly, sector rules constrain the equity funds to being **at least 75% net invested in equities at all times**. These funds were thus compelled to have at least 75% exposure to equities during the 2008/2009 bear market, whilst their asset allocation friends were not so constrained. There are times when, relative to a fund's long-term (strategic) asset allocation benchmark, a tactical over- or under-weight is both sensible and necessary. Leading up to and during the majority of last year's correction, the good asset allocators would have been underweight equities, both domestically and globally. Similar principles apply to the other asset classes. Being overweight cash during 2008/2009 was undoubtedly the most defensive play.

Secondly, the asset allocation funds can take advantage of **diversification of asset classes**. We have written repeatedly in this forum of the benefits of diversification and how, by diversifying a portfolio (via different asset classes and geographically within the same asset class), a good asset allocation fund can provide significantly better risk-adjusted returns. As highlighted above, by diversifying a fund's long-term (strategic) asset allocation, the manager can take advantage of significantly better optionality.

What we can see from this exercise is that a well-diversified portfolio will usually, over time, provide excellent reward for each unit of risk.

All the VPFP Funds, namely, the VPFP CPI +2, 4 and 6 are Asset Allocation Funds.
Which VPFP fund or combination of funds is appropriate for your particular circumstances will depend on an appropriate asset allocation which must be determined by taking into account your financial situation, your comprehensive risk profile and your needs. A good financial planner can assist you to get the appropriate blend of risk and return.

We would like to thank Alphen Asset Management for their contribution to this edition of Around the Table.

www.alphenam.co.za.

Market Update – the last quarter

The performance of the VPFP Funds for the last quarter end 30 Sep 09 is illustrated below.

Table 1

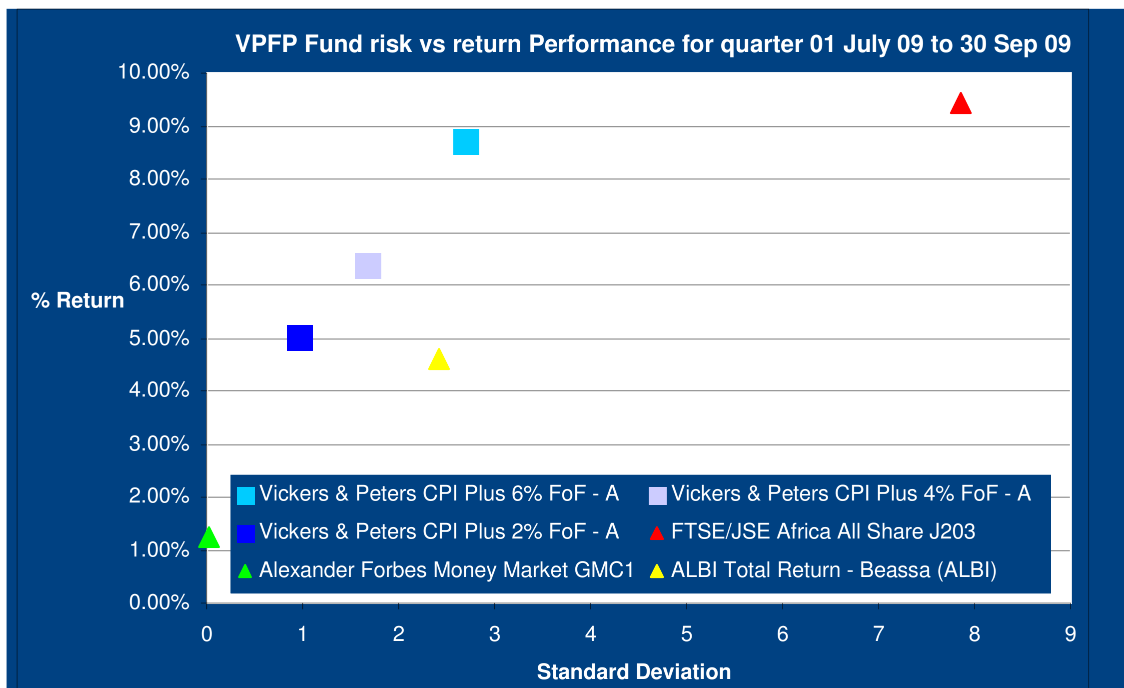
Performance Report
NAV to NAV - Local Currency
From: 01/07/2009 To: 30/09/2009

Name:	Performance	Annualised Standard Deviation
Funds		
South African Unit Trusts		
Vickers & Peters CPI Plus 6% FoF - A	**8.72%**	**2.68**
Vickers & Peters CPI Plus 4% FoF - A	**6.38%**	**1.67**
Vickers & Peters CPI Plus 2% FoF - A	**5.02%**	**0.94**
Indices		
FTSE/JSE Africa All Share J203	**9.44%**	**7.85**
Alexander Forbes Money Market GMC1	**1.26%**	**0.02**
ALBI Total Return - Bonds	**4.59%**	**2.41**

Income Reinvested on Payment Date
Indices shown in Local Currency

Source: Moneymate

Graph 2



Source: Moneymate

*Standard deviation – the degree to which returns fluctuate around their average. The higher the standard deviation the higher the risk.

For further information on the VPFP Funds please send us an e-mail or visit our website www.vpfp.co.za where you can access our latest information and download the VPFP Fund fact sheets.

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Our services include…

- Pre and Post Retirement Planning
- Local and Global Investments
- Business Assurance – Keyman and Partnership
- Personal and Group Life Assurance
- Employee Benefit Advice and Products
- Tax and Estate Planning

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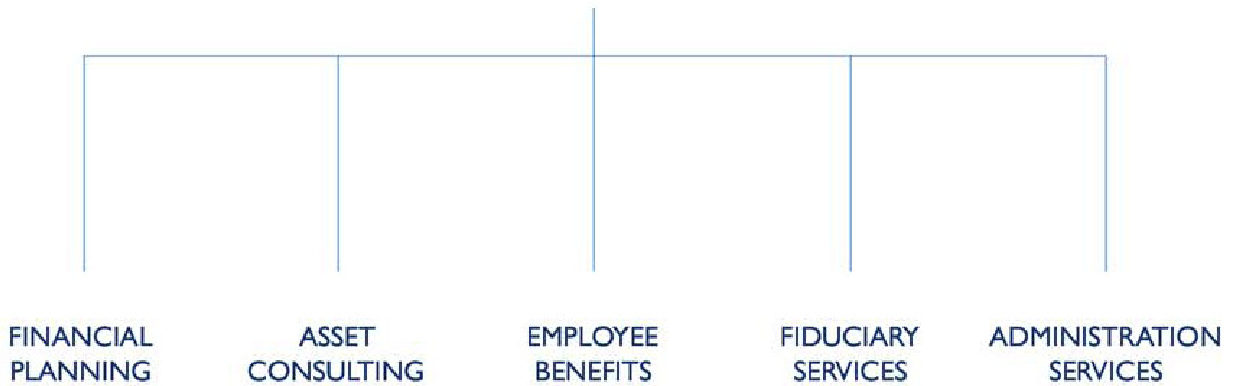
LIFESTYLE AND ASSET PLANNING



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