

## SMOOTHING OUT MARKET VOLATILITY TO SUSTAIN RETIREMENT INCOME

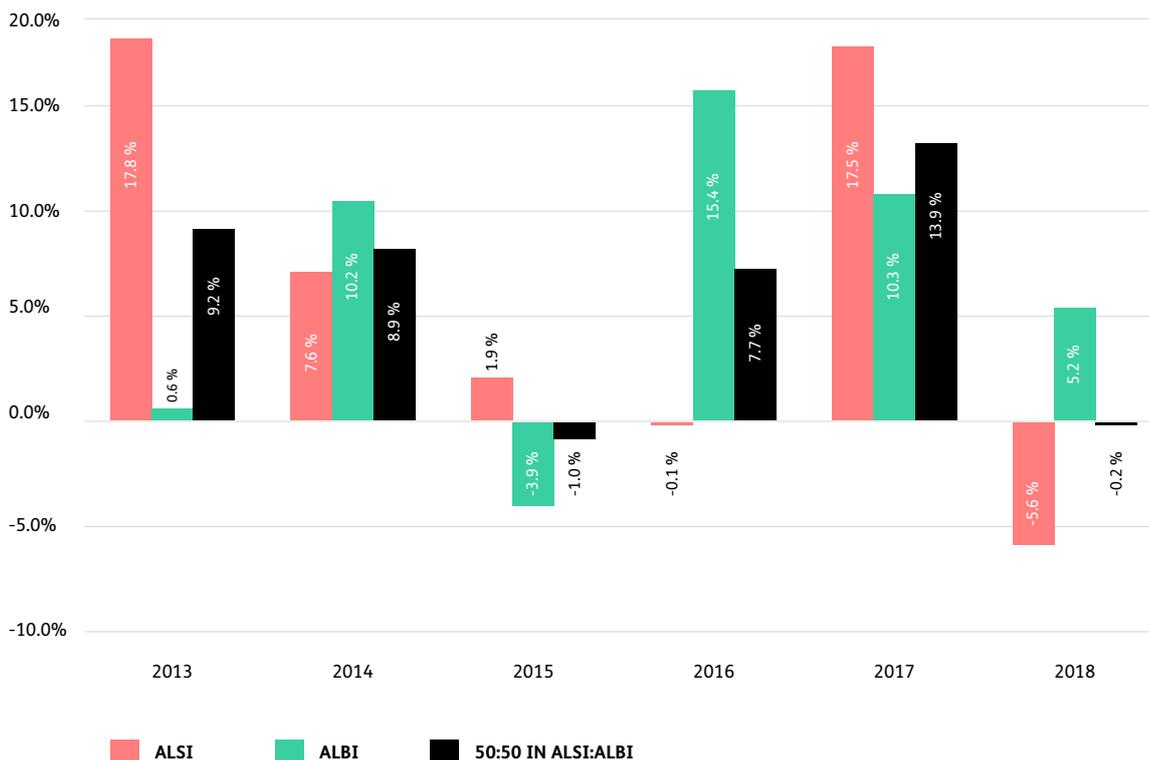
Markets are volatile. Late last year, Steinhoff's demise destroyed billions in shareholder value when its share price dropped by 90%. Can you afford to be exposed to highly volatile markets in retirement when you are dependent on that same investment vehicle to provide you with stable income?

"The fact is that market volatility can wipe out significant value from your investments. When this happens, the problem is magnified if you're at a stage where you have to withdraw income from your investment, as you do in a living annuity. An investment that offers smoothing, income which is guaranteed for life, and increases in income which target inflation, may just be the answer.

A with-profit life annuity offers precisely that," says Bjorn Ladewig, Longevity Actuary at Just.

When retirees consider which product offers the best income during retirement, they should think about the impact that market volatility can have on their investment and income.

This article looks at the experience of investors in recent history from 1 January 2013 to 31 May 2018. The actual JSE All Share Index (ALSI) and JSE All Bond Index (ALBI) returns over the period were as follows:



For 2018, we show the returns from 1 January 2018 until 31 May 2018. Below we will use that to represent the sixth year of return.

If you bought a Just Lifetime Income (JuLI) product today with a purchase price of R1m for a male aged 65 with a 10-year minimum payment

period, the starting income would be R84 097 per year, or R7 008 per month. If we now assume that the returns on the investment portfolio linked to this JuLI are such that the above history repeated itself for the next six years, the income over time would be as follows:

Just Lifetime Income		
	Annual	Monthly
2018	84 097	7 008
2019	88 569	7 381
2020	92 951	7 746
2021	95 950	7 996
2022	98 674	8 223
2023	102 427	8 536
2024	104 112	8 676

Now, assuming we invested the same R1m today in a living annuity, split 50:50 into the ALSI and ALBI index and rebalanced annually, and that the same returns as the above repeat itself (with no additional fees allowed for), the buildup of our investment would look as follows:

Year	Balance at start		JuLI income	Balance at end	
	ALSI	ALBI		ALSI	ALBI
2018	500 000	500 000	84 097	539 694	460 865
2019	500 279	500 279	88 569	490 640	502 378
2020	496 509	496 509	92 951	458 380	432 370
2021	445 375	445 375	95 950	397 085	458 569
2022	427 827	427 827	98 674	444 627	417 361
2023	430 994	430 994	102 427	358 420	399 427

For the above example, we begin each year with the total balance at that point, and split this 50:50 between the ALSI and ALBI. We draw the same income as the income paid on the JuLI with-profit life annuity each year. We then add ALSI and ALBI returns as shown above for the last six years, and rebalance each year so that 50% of the total balance is again invested in the ALSI and 50% in the ALBI.

From the table above, we can see the following results:

- At the end of 2023, the investment will be worth R757 847 = R358 420 + R399 427, which is significantly lower than the R1 000 000 at outset.
- Assuming the same person is now six years older, the purchase price required to provide R104 112 of annual income in 2024 is R1 077 852. This is calculated using today’s annuity rates.
- There will thus be a shortfall of R320 005 if our retiree were to try to secure a lifetime income at that stage.

- Differently put, this is the opportunity cost of not having invested in the life annuity at the outset, when looking at our specific example.
- Furthermore, the life annuity offers income that is guaranteed for life, can never decrease, and targets increases equal to inflation.

The above example shows that – for the same assumed returns and income as the lifetime income product – the living annuity has lost significant value over six years in Rand terms. Furthermore, the balance available at the end will not be sufficient to purchase a life annuity to secure a sustainable income.

But how have the increases in lifetime income for this lifetime income product compared to inflation in the past?

The below table illustrates past increases for the JuLI compared to inflation and the average of ALSI and ALBI returns over the same period:

Period	JuLI increase	Average inflation *	Average of ALSI and ALBI returns **
Last 5 years	6,1%	5,5%	6,0%
Last 10 years	7,4%	6,0%	5,8%

\* Source: StatsSA \*\* Source: Bloomberg

“There are valuable lessons to be learnt from the recent Steinhoff scandal, not to mention the fall in the Capitec share price earlier this year: markets can be extremely volatile and thus short-term returns can suffer. If you want an investment that

offers sustainable income and is not as exposed to these short-term market swings, then it is worth considering a with-profit annuity that offers smoothing, a guaranteed income for life, and increases that target inflation,” concludes Ladewig.

**Note:** We reference the Total Return Index of the JSE All Bond Index for the example above.

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