

## **LIFE ANNUITIES: THE COMEBACK KID OF THE 2020s**

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Almost four decades ago Daniel La Russo won a fight he wasn't supposed to, defeating his arch-nemesis Johnny Lawrence in the final scene of *The Karate Kid*. Considered an unforgettable 'David versus Goliath' narrative for those of the eighties generation, in recent years, *The Karate Kid* franchise has created its own comeback story, with the new Netflix series, *Cobra Kai*.

If you're wondering what any of this has to do with life annuities, it's this: at Just SA, we see life annuities as the 2020's Comeback Kid – an underdog story. A comeback is something that repeatedly demonstrates the ability to overcome downturns, or periods of bad publicity, and rebound to victory or popularity. And this is exactly what life annuities have done over the last 20 years.

Another reason it's an underdog story is because of its **rivalry with living annuities**, vying for a high-stakes object of desire; namely a long-lasting income in retirement.

But why are life annuities making such a comeback in the 2020s? In our view, there are three main reasons for this, which we explore below.

### **Annuities provide certainty during uncertain times**

In the last few years, the world has experienced some major market events that will have spooked many investors. It started off with Covid in early 2020, which triggered generally poor returns in South Africa, followed by Russia's invasion of Ukraine, which, unbelievably, is still unfolding a year on.

An additional risk to those who do *not* hold a life annuity is that these types of events could cause them to panic and act irrationally in the moment. So, apart from life annuities giving certainty during such uncertain times, they also manage the behavioural risk of knee-jerk reactions, which could have permanent repercussions if left unchecked.

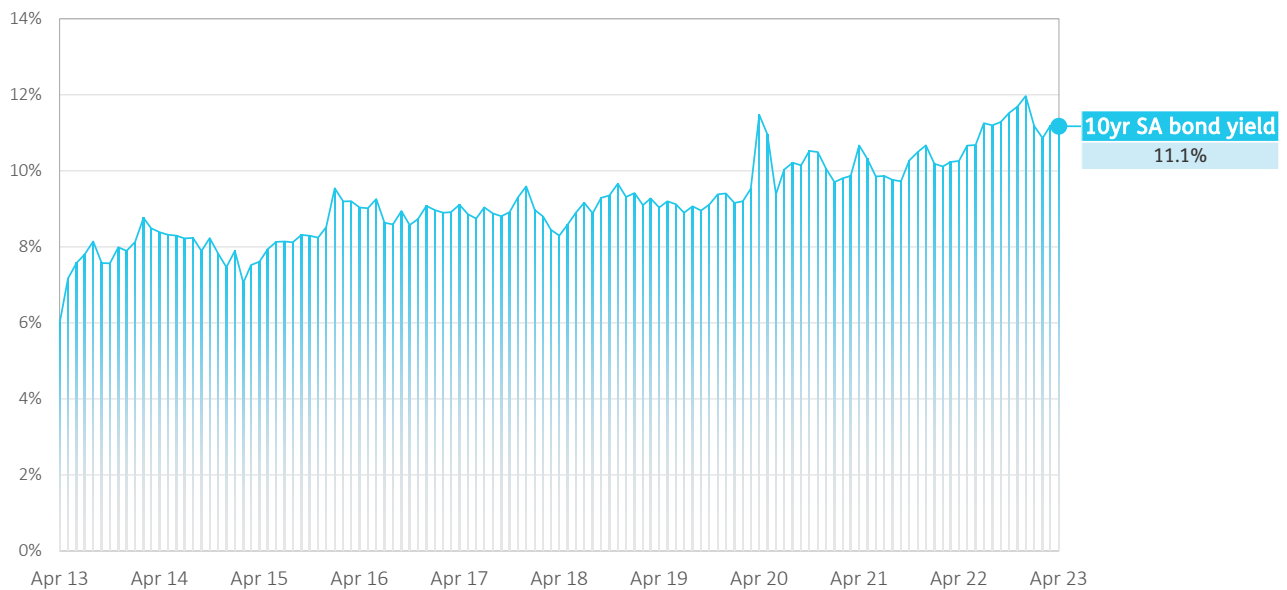
### **Markets have generally been poor; and inflation high**

Performance-wise, the last five years in the market have not been good for investors. For example, when considering the JSE All-Share Index (ALSI) over the period April 2018 to April 2023, figures reveal flat returns until March 2020, then a massive fall in March 2020, followed by nominal recovery until January 2022, tailed by another spell of poor returns. All in all, the JSE ALSI experienced a meagre 6% growth p.a. over the five-year period. And, as we know from the fairly well publicised "sequencing risk", this can be very problematic in a living annuity, especially when compared to the stable income generated by a life annuity.

### **Long-term interest rates are at decade-high levels**

The final reason that life annuities are making a comeback, is because of current high annuity rates, which are largely driven by the fact that long-term bond yields are high, and a material portion of life annuity assets are invested in bonds.

Using the 10-year bond yield over the last ten years as an example, the chart on the following page shows that we are generally at the highest levels seen in more than a decade.



Source: Just SA

When looking at bond yields, it's important to note that annuity rates are driven by long-term interest rates, and not prime or interbank lending rates, which are short-term interest rates. Short-term interest rates could impact longer term bond yields but only to the extent that future increases in interest rates have not yet been priced in. In other words, if short-term interest rates rise quicker than expected, it may cause an increase in longer term yields too, if that impact is expected to persist.

What's more, bond yields are currently high given the future outlook of prevalent interest rates, which are at elevated levels. This in turn would be caused by various macro-economic factors, of which expected inflation levels is a material driving factor.

Against this backdrop, an effective and easier way to manage certain risks in retirement is with a life annuity, fueling their big comeback in the 2020s, thanks to people's search for **certainty**.

The combination of these three factors above has contributed to a higher demand for life annuities, together with the growing realisation that a third of living annuitants are at risk of running out of money unnecessarily. So, as Mr Miagi says – to make honey, you need the right stuff.

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