momentum
consultants & actuaries

Q&A

Momentum Consultants and Actuaries webinar - 7 July 2020

Questions to Rowan Burger:

Q: When should I start working out what annuity I should take at retirement?

A: This is a decision that should not be taken the day of your retirement. Every five years from when you start working you should perform a proper assessment of whether you are on track towards a comfortable retirement. From about ten years to retirement you will have a far better sense of what your living expenses will be in retirement. You can start to think about how much money you may need to retire comfortably, and therefore what sort of balance you are likely to strike between an income for old age and potentially leaving monies for a legacy. This should become a regular conversation every two years before retirement.

Q: What will the impact be on existing pensioners in a with-profit annuity regarding pension increases?

A: With-profit annuitants receive increases based on the underlying investment returns within the balanced fund backing the annuity. These are smoothed over a number of years. The market fall would mean lower returns and therefore lower increases until these returns work themselves out of the smoothing formula. The counter to this is that the market is likely to recover more strongly from a low point. We hope for a number of stronger years in future which will compensate for this. A with-profit annuity cannot reduce so regardless of how bad the market returns are, increases will never be negative.

Q: How much of my retirement should be invested in annuities?

A: This is very much dependent on your personal circumstances and you will need financial advice. The two extremes are having much more than you require, in which case a large portion will be invested to provide a legacy. If you have too little, the costs of an annuity policy could erode the income provided and it is better to take cash. For everyone in

the middle it will be some combination, also taking into account other savings. You should never retire having debt. As with all investment choices, these are a function of personal circumstances and seeking expert advice is recommended.

Q: What will the long term impact be on current living annuity pensioners regarding the future drawdown period?

A: We advocate living annuities for persons with large capital sums. The risk for living annuities is a deep market fall that reduces the capital on which the income is derived. As far as possible drawdown levels should reduce to prevent the sale of investments at depressed prices. The fall in investment value results in a fall in expected future income. It would be prudent to only increase this income once asset prices have recovered. The level of drawdown is a function of personal circumstances and seeking expert advice is recommended.

Q: Can I have more than one type of annuity and if so, how do I structure my pre-retirement investments?

A: If you have multiple retirement savings vehicles you can retire from each of these at different times and select new annuity options or top up existing ones. You should align each of those investment strategies to the intended annuity purchase. You can also split a large retirement balance into different annuities. There are also products on the market at the moment that allow splitting within the product. These are called hybrid annuities. As with all choices, these are a function of personal circumstances and seeking expert advice is recommended.

Questions to Sanisha Packirisamy:

Q: Is there a genuine future in investing in property in SA going forward?

A: The SA listed property asset class has been through a torrid period, but we believe that the market is currently pricing in a far worse scenario than what we have assumed in our base case or even bear case scenario. Share prices reflect an anticipated 28% fall in listed property values. In our base case, we assume a 20% drop over a three-year period and even in our stressed worst case scenario, we only see property values declining by 25%. The relative rating of listed property to nominal bonds is at all-time extremes, suggesting that valuations look very cheap, with a lot of bad news already being discounted. Incorporating the risk perspective, we maintain a cautious stance on listed property in the near term in the event of another leg down in global risky assets, but we believe that the return profile is asymmetric to the upside beyond that.

Q: What is the impact of the downgrade on SA's lending?

A: A lower sovereign rating reflects the (perceived) reduced ability of a country to repay its debt obligations. As such, this raises the cost of borrowing for government and crowds out other more useful forms of expenditure as funds are redirected away from economic priorities and social delivery towards servicing government's interest bill. A lower sovereign rating reflects the riskiness of a country and can place SA further on the back foot relative to its emerging market peers, with which it competes for foreign capital. As a result, the rand can weaken and in the absence of a demand/supply driven downside shock can raise prices of goods and services, which erodes the

purchasing power of consumers. In SA's context of elevated inequality, this hurts our lowest-income earners more disproportionately and exacerbates the poverty cycle.

Q: When can we expect the SA economy to recover from the impact of COVID-19?

A: SA entered the crisis on poor economic and fiscal footing. This means that we had less (fiscal) ammunition to deploy in light of COVID-19 and as a result SA will likely take longer to emerge from the crisis than some other parts of the world which may experience a more sustainable economic bounce. SA's output gap (gap between actual and potential growth) is likely to remain negative into 2023/2024, implying a slow and protracted recovery. A number of small businesses in the informal sector have been negatively impacted and may be forced to shut down while there is pressure on firms in general to shed workers in order to protect the bottom line. This will have longer term negative consequences for spending in the economy. Moreover, private sector firms are unlikely to rush into expanding capacity/infrastructure in an environment where policy uncertainty remains high and where there are question marks around sufficient levels of demand.

Q: Will interest rates remain the same for a while or can we expect an increase soon?

A: Globally, high levels of debt dictate lower interest rates for longer so that governments around the world can continue to service these elevated debt levels. Muted inflation gives central banks some breathing room to keep interest rates lower for longer, as well. In SA's case, we are expecting modest additional easing from here, before interest rates start going up again next year. The SA Reserve Bank is uncomfortable to allow real interest rates (nominal less inflation) to trend in negative territory for an extended period of time as this can be damaging to bank profitability, financial stability and the real economy in general.

Q: When can we expect the rand to recover and become stronger against the British pound, US dollar and the EURO?

A: We believe that the rand weakness seen in the COVID-19 crisis was overdone and we are likely to experience some retracement in the currency against developed market currencies in the next year. That said, we do not believe we will see the rand retracing all the way back to its fair value. Weak macro fundamentals are likely to temper the expected strength in the currency.