HOW MUCH TO SAVE FOR RETIREMENT?

UVONGO: How much should you save if you want to retire with enough money? A new study is challenging the conventional wisdom that rules much of the thinking about retirement planning in South Africa. Sadly, many people (financial advisors included) will ignore the findings of this study resulting in long term financial hardship. What makes it worse is that a small dose of financial discipline at an early stage can make all the difference.

ECONOMIC & MARKET CONDITIONS HAVE AN IMPACT

I think it is safe to assume that the world's economy is due for a long slow recovery that could take years. If the global economy moves at a snail's pace for the next few years, this will have a major impact on the growth rate of all assets including shares and property. One of the problems with retirement planning is that you need to make assumptions about how much capital growth you will have every year for the remainder of your life. The main asset class that provides this growth is shares. Over the very long term, shares have grown by 13% to 15% per year however; there have been long periods where this growth has been much less. At present we could be experiencing one of those periods where shares only grow by 6% to10% per year for the next few years. For retirees or those close to retirement, this could be a major concern because it means their capital might not keep pace with inflation or even their monthly expenses. We all need to be aware of this because if we make changes now, we might prevent years of hardship later.

SAVE EVEN MORE

When younger people start saving, they often want to know how much they should save for retirement. Most people would tell them that it is okay to save 10% of their gross salary every month. So, if they earn R5,000 per month before deductions, they should save R500 every month. This was the advice given to me when I started work and was based on a well-known book about saving called "The Richest Man in Babylon" by George Samuel Clason. I have often given this advice to young family members and staff. After reading a new study (Towards a Sustainable Retirement Plan) by Daniel R Wessels from Martin Eksteen Jordaan Wessels, I will need to re-consider my views. Wessels' study shows that you will need to save 16% of your total salary every month to be very certain that you retire comfortably. So, if you earn R5,000 per month, you will need to save R800 per month which is a much higher percentage than most people currently save. This does not change the fact that we should all aim to save this percentage – the fact that it is difficult does not change the reality of what we need to do. We are all living longer and we need to make sure that our capital lasts.

HOW MUCH CAPITAL DO YOU NEED AT RETIREMENT?

There are a few ways to work out if you have sufficient capital to retire. Many advisors use a multiple of your final salary. As an example, if you earn R120,000 in the last year before retirement; you need 14 x R120,000 = R1.68m which will pay out R98,000 per year. I prefer to use your actual monthly expenses as a basis for determining how much capital you need at retirement. If you need R10,000 per month after tax; you should multiply this by 12 (to get an annual amount) and multiply this by 20 = R2.4m. This will allow you to draw R10,000 per month from your capital every month and to increase this with inflation every year for the remainder of your life. This is quite a conservative calculation but the study by Wessels shows that even this might not be enough. His findings show that you will need R2.664m to be certain that you have sufficient capital in all market conditions.

YOU MIGHT NEED TO SPEND LESS

Wessels' study shows that conventional thinking about how much you can safely draw from your capital might be wrong in many instances. Many advisors will tell you that it is okay to draw up to 11% or 12% from your retirement capital. This was certainly possible in times when the market was growing strongly but it will be financial suicide now. Wessels' study shows that you should only draw 4.5% from your capital if you want to be very certain that your capital will last in all market conditions for 30 years or more. For people who are close to retirement, this could be horrifying news because you will either need to work longer or spend less if you want to be financially secure.

WHAT ARE YOUR OPTIONS?

I believe that you should always be pessimistic in your retirement planning, try to plan for the worst and be positively surprised. For those who are saving for retirement, try to save 16% of your gross income so that you will be very certain that you have enough money at retirement. For those who are close to retirement, try to work a few years longer than planned or try to get some part time work to supplement your retirement capital. People are generally living much longer than previous generations but their retirement planning has not kept pace with this reality. In addition, investment assets might not grow at the same rate as they did in the past. For those who are already retired and have little chance of generating income, you need to reduce your expenses and ensure that your remaining investments are correctly structured. This means you should balance the requirement to generate as much growth as possible with the need to manage your risks so that your remaining capital is protected from major stock market losses. The worst thing you can do now is put your head in the sand and hope for things to get better.