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Challenging Conventional Wisdom

NEWSLETTER

Monthly Newsletter – November 2013

A Note from Theo and Warren

Tips for a successful retirement

Here are some pointers to help you make smart financial decisions during retirement. These have been gathered over the last 20 years from successfully retired individuals in South Africa and the US.

1. Don't underestimate your spending

It is a myth to think that your expenses will decrease continuously until you die. The mix of spending might change as you spend less money on leisure activities and more on health costs. Try to plan for your expenses to remain the same over your lifetime, and adjusted for inflation.

2. Focus on an optimal portfolio

You can't control the returns of your investments: they will always be affected by stock markets, interest rates and inflation. Your best chance of coping with these variables is to build the optimal retirement portfolio, one that's designed to minimise stock market volatility while ensuring that you still outpace inflation over your lifetime. Controlling costs is a huge factor in this decision and indexation is one of the best ways to eliminate costs.

3. Plan for volatility

You have to be prepared for major stock market crashes over your lifetime. It is impossible to anticipate a stock market crash and any strategy that aims to predict these events will end up costing you a lot of money and stress. To cope with volatility, ensure that you are well diversified across cash, government bonds, listed property and shares. If you are invested in a living annuity, you can also manage your withdrawal rates from your annuity to draw a smaller percentage when markets are falling. An ideal withdrawal rate from a living annuity ranges from 4% to 8% depending on your wealth, age and health.

4. Learn the lessons of Behavioural Finance

Unfortunately people are not rational in their investment decisions, especially in pressurised situations. You need to be aware of any personal shortcomings that could impair your ability to make good decisions. Here are some of the decision-making errors that investors make on a regular basis:

- Overconfidence: Men, in particular, tend to believe they are great investment selectors, despite research to the contrary.

- Representativeness: We tend to jump to conclusions, assuming, for example, that an 80% gain followed by a 60% loss should leave a 20% gain. (In reality, it means a net 28% loss.) This also applies to unit trust rankings where we assume that a fund that has performed well in the past will continue to do so in future. Very often, investors would be well placed to select the funds that have performed worst over the last year.

- Framing: We make decisions based on how information is framed, such as the recent returns of your investments. If you started investing in shares for the first time in 2008, you might think shares are terrible investments, which is simply not true. Your initial experience with an investment can often set your expectations for your lifetime, which is dangerous.

5. Be sceptical of market timing

A retiree's first priority with investments is to guard against a permanent loss of capital through poor decisions. Secondly, they need to protect their capital against inflation, which means they cannot be too conservative with their investment decisions. You need to maintain a minimum exposure to shares of at least 35% of your portfolio to ensure that your capital keeps pace with inflation.

6. Keep your home as a last reserve

A paid-off home can be your financial reserve if you are in financial difficulty at a late stage of retirement. A home is a great source of emotional security but it is a dead asset that costs you money. If you are in a difficult financial position, you can sell your home, rent an apartment and use the proceeds from the sale of your home to fund your living expenses for the rest of your life.

-- Theo and Warren

Managing personal bandwidth

A recent TIME article by Sendhil Mullainathan points to an interesting idea – not just time management, but personal 'bandwidth' management.

The article points out that busy people all assume they are short on time only, but they're also short on basic cognitive resources like working memory and executive control, which are used in every activity, and which he terms bandwidth. "Bandwidth is what allows us to reason, to focus, to learn new ideas, to make creative leaps and to resist our immediate impulses," he writes. "We use bandwidth to be a good participant at an important meeting, to be a good boss to an employee who frustrates us and to be attentive parent or spouse."

He explains that when we schedule things, we don't want to just show up, we want to be effective when we get there. This means we need to manage bandwidth and not just manage time.

To do this, we must recognise that different tasks require more or less bandwidth. Second, realise that some tasks tax your bandwidth even when you are not working on them – a looming deadline or a challenging decision call your mind away from whatever you're working on. Finally, other tasks do not tax bandwidth but refresh it – time with family, watching a rugby game, time at the gym or simply doing nothing are some examples.

This can help you to plan your days more effectively. Don't place tasks requiring heavy bandwidth right after tasks that tax bandwidth. Give yourself more time than you need to get the previous meeting off your mind. For bandwidth-demanding tasks, recognise that big contiguous blocks are better than smaller blocks. Finally, find those tasks that refresh bandwidth and make time for them.

Digital-media use is off the charts

A new study on the time Americans spend on their digital devices is just as relevant for us – you can be sure South Africans will be following in their footsteps. According to a University of Southern California report, Americans spend an average of 11 hours per person per day consuming digital media, and those numbers are expected to increase in the years ahead.

By 2015, the numbers indicate that Americans will consume media for an average of 15.5 hours per person per day. And mobile messaging hours, which last year accounted for about 9% of voice call hours, will double to more than 18% of voice hours, a year-over-year growth rate of more than 27%, the report said.

The study also found that viewing video in the Internet, which averaged fewer than 3 hours a month in 2008 and nearly 6 hours a month last year, will increase to nearly 11 hours a month by 2015.