UCTRF

www.uctrf.co.za

uctrf-enquiries@uct.ac.za 021 650 2934

How to look after your retirement savings in a time of a crisis

Dear Member

These are especially tough times. Many people are fearful and anxious about their health, and that of their loved ones, as well as possibly their jobs. Additionally, many University of Cape Town Retirement Fund (UCTRF) members will be deeply concerned to see the value of their retirement savings falling at the same time.

Such fear and anxiety are entirely understandable and, in many instances, helpful in making immediate decisions. Sometimes, however, problems are so complex that one needs to pause and think about what the best solution may be. In working out that solution you need to consider the evidence.

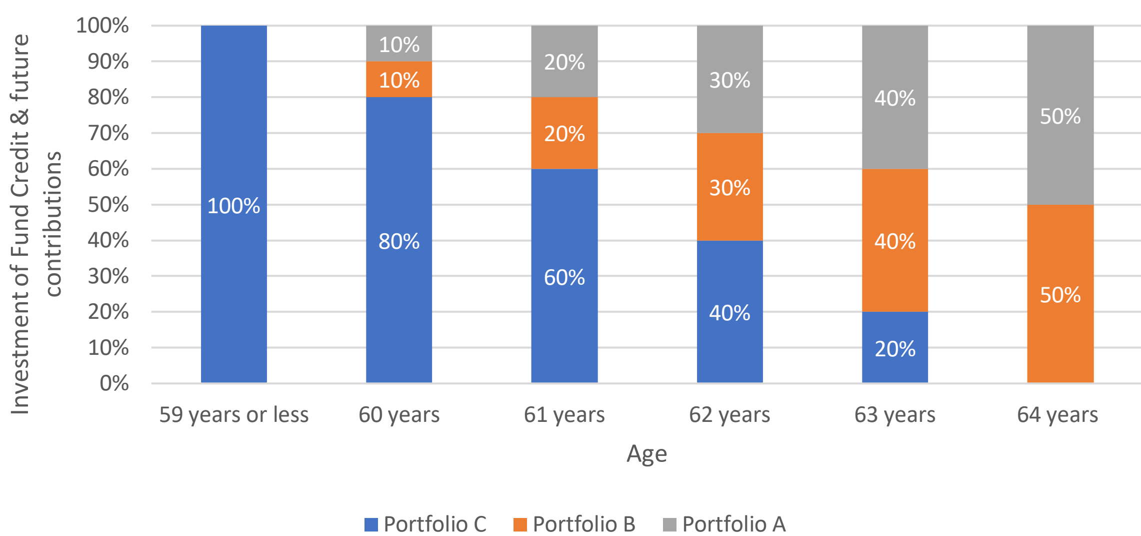
After looking at the evidence you need to decide on your course of action. Of course, it is critical that you are comfortable with whatever decision you make.

Now let's consider the evidence around your investments.

How are your retirement savings invested?

First and most importantly, you need to know how your retirement savings are invested. The UCTRF operates a Life Stage Model as the basis of investment for active members who feel that they don't know enough about investments to choose their own strategy. Many people feel this way, and a significant proportion of the UCTRF members have their retirement savings invested according to the Life Stage Model. On the other hand, a large number of members have decided to make their own investment choices. The chart below shows how members'' savings are distributed according to the UCTRF Life Stage Model.

The UCTRF's Life Stage Model



It is best to check where your retirement savings are indeed invested, but you can see from this chart that if you are in the **Life Stage Model** and very close to retirement then some or most of your money will be invested in the Income Fund (Portfolio A), which is unaffected by the current declines in share prices. You will also have some money invested in the Smoothed Bonus Fund (Portfolio B) which offers some (but not complete) protection against market losses. We have included a separate note on the Smoothed Bonus Fund as an Appendix.

If, however, you have not yet reached the year in which you turn 60, then your retirement savings will be fully invested in the Balanced Fund (Portfolio C). This is the UCTRF portfolio that has been most negatively affected by the fall in share markets, but at the same time it is important to take stock of the fact that you still have a long period of time before you are expected to retire. There is reason to believe that your savings can recover from the recent losses with this fairly long time horizon.

Of course if you are close to retirement and you have chosen to be fully invested in the Balanced Fund (Portfolio C) or the Shari'ah Fund (Portfolio D), rather than following the Life Stage Model, you will feel some pain as a result of the market falls.

How bad is the impact on investment returns?

The table below sets out the monthly and cumulative investment returns earned on the UCTRF's four investment portfolios in the first 3 months of 2020.

	Income Fund (A)	Smoothed Bonus Fund (B)	Balanced Fund (C)	Shari'ah Fund (D)
January	0.72%	0.38%	0.69%	0.98%
February	0.56%	0.58%	-5.64%	-3.64%
March	0.64%	0.43%	-12.86%	-5.73%
2020 year-to-date	**1.92%**	**1.39%**	**-17.21%**	**-8.27%**

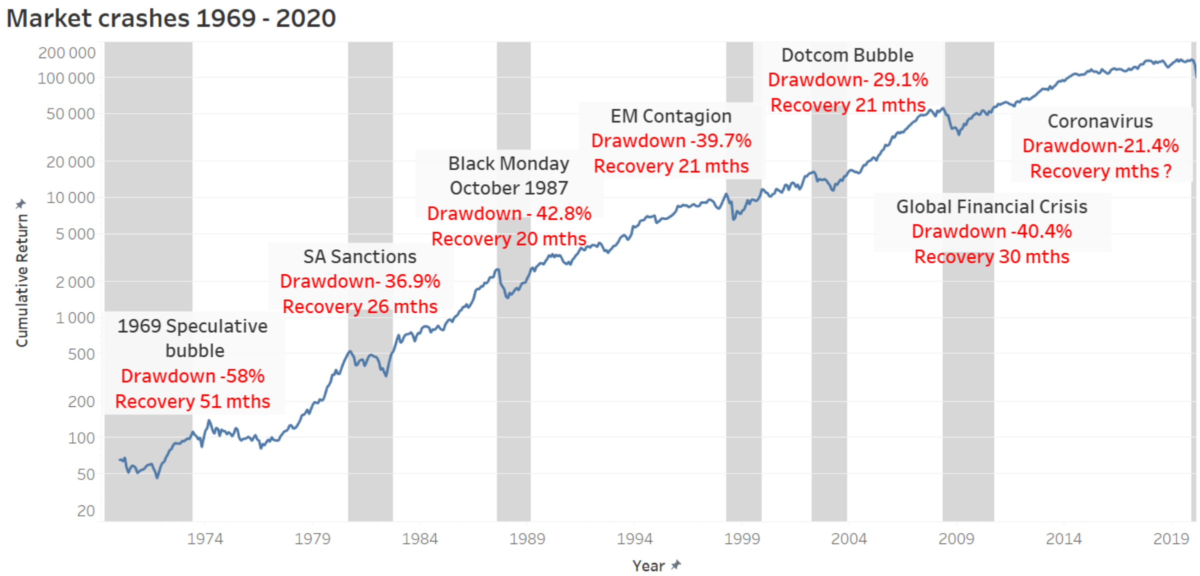
It is evident from the above that the recent share market falls have had a very negative impact on the investment returns for the Balanced and Shari'ah Funds.

Investment markets are likely to recover

In order to target a high level of investment return over long time periods (such as is targeted by the Balanced and Shari'ah Funds) you need to invest a large proportion of the portfolio in growth assets such as shares. However, share prices are volatile, and inevitably there are times when share prices fall a lot, causing the very fear and anxiety that you are experiencing today.

Nevertheless, so far, the market has always recovered from such "crashes" and in time moved to new highs. The chart overleaf shows the market crashes of the Johannesburg Securities Exchange ("JSE") share index during the last 51 years. This somewhat unusual period was chosen to include the market slump of October 1969, which is the worst decline on record. For each crash the chart shows the extent of the "drawdown", i.e. the negative return on the share market index caused by the crash, and the recovery period in months for the index to get back to this level (it does not allow for the effect of inflation, which would make the recovery longer).

Market crashes 1969 – 2020



Should I switch into cash and then get back into the share market at the right time?

Even though the evidence is that markets have always recovered after a slump, you, like many others, may still be discomforted by the reality that there is no guarantee that such a recovery will indeed happen before you retire. Your immediate instinct may be to take your money out of the Balanced Fund (or Shari'ah Fund) and move to the Income Fund, with the aim of re-investing it a later date when things are clearer.

Whilst this seems like a sensible approach when markets are falling, the big challenge you will have to overcome is to decide when to put your money back into the market. You must remember that the bottom of the market happens when share prices are at their cheapest and when nobody wants to buy shares because of the negative sentiment. This means that you would need to put your money back into the market when everyone else thinks it is time to remove money from the market. To do so will be very difficult (and some would argue impossible).

The other important point is that a significant part of the recovery can happen very quickly after the market reaches its lowest level. The table overleaf demonstrates the point – it shows for each crisis the date when the market bottomed, how many months it took to recover the loss and the two months which delivered the highest return in the recovery period.

Time markets take to reach the bottom, recovery time and best two months

Crises	1969 stock market bubble	Sanctions against SA	1987 Black Monday	Emerging Market contagion	Dotcom bubble	Global Financial Crisis
Date when market bottomed	Oct-71	Jun-82	Feb-88	Aug-98	Apr-02	Feb-09
Months it took to reach the bottom	31	22	7	5	13	10
Your loss at the bottom of the market	-58.0%	-36.8%	-42.6%	-39.7%	-29.1%	-40.4%
Months it took recover your loss	20	4	13	16	8	20
Best month return in recovery period	12.1%	17.8%	11.2%	14.6%	14.1%	11.0%
No. of months this happened after bottom	2	1	13	2	1	1
2nd best month return	11.7%	16.7%	11.1%	13.3%	9.8%	10.3%
No. of months this happened after bottom	1	2	1	16	6	3

For instance, in the global financial crisis, the market bottomed in February 2009, but it had made up its loss by the end of October 2010 or 20 months later. In March and May 2009, the market achieved returns of 11.0% and 10.3% respectively. Clearly, if you did not put your money back into the market just after it bottomed, it would have taken you an even longer period to make up your loss.

The shaded rows on the previous page highlight the importance of putting your money back into the share market at the time when most other investors would be too anxious to do so. Except for the 1987 Black Monday episode, you had to get your money re-invested at most two months after the market bottomed. Do you think you can call the bottom of the market and be so brave?

So, if you switch your retirement savings into the Income Fund now, you are assuming that the market could still go down a lot. If the market continues to fall – and of course there is no guarantee that it cannot fall a lot further. It may, for a while, seem as though you have made a good decision, but you will also have the stress of knowing that at some time you must switch back into the other UCTRF investment portfolios if you wish to achieve your long-term investment goal.

What should I be doing?

The key messages from the above are:

1. Check which UCTRF portfolios your retirement savings are actually invested. If you are very close to retirement age and your money is invested according to the Life Stage Model (or if you made your own choices and decided to invest quite conservatively, i.e. in a portfolio with little or no exposure to share markets), the current market slump is likely to have had less impact on your money as some/most of your retirement savings will be invested in the Income and/or Smoothed Bonus Funds. However, most members will have their money invested in the other UCTRF portfolios, where losses have been incurred. For these members the next two points are important.
2. The history of markets shows that the share market has always recovered and recovered its losses after previous market crashes, although this outcome and length of time to recovery are not certain.
3. A sharp fall in markets such as we are experiencing, together with the uncertainty as to whether they will recover, leads many investors to consider switching into cash (i.e. the Income Fund). They do so based on the idea that they will then put money back into the market when it is less volatile/uncertain. The Trustees believe that this approach is extremely difficult to implement. This is because the time when the market is cheapest is the point when almost all investors are most fearful. To reinvest at this point would therefore require you to re-enter the market when most others think that it is time to exit the market.

You might also think about switching into the Smoothed Bonus Fund, but you must keep in mind that the bonuses will be very close to zero until *after* the markets have recovered somewhat. This is because the Smoothed Bonus portfolio is still sitting with accumulated losses on its underlying investments, which must be recovered before the bonuses can start to rise again. (And please read the Appendix to this note, which deals with the Smoothed Bonus Fund specifically.)

The above suggests that most members should not change their investment strategy in reaction to the current market falls. However, investments are not only about academic thinking; how you feel about your investment is also very important.

If, after considering the evidence, you are still fearful and anxious about how your money is invested, then it could be better to do something. In this way you reduce your anxiety, and if the market does fall further, at least you have taken some action.

Maybe you can do something simple like investing your future retirement savings contributions into the Income Fund or switching a small percentage of any money you have invested in the Balanced Fund to the Income Fund. If you do not have a financial advisor, it may be worth considering appointing one. If you already have a financial advisor, it may be worth getting their guidance. If you decide to do this, you must make a note to review your decision in, at most, 12 months' time.

In conclusion

This is the toughest of times, with so many things to worry about. The Trustees hope that this communication has lifted some of the load as to how to approach the investment of your retirement savings in this time of crisis.

Most importantly, the Trustees would like to extend their sincere wishes to all the UCTRF's members and your families and friends at this difficult time. Please continue to focus on your safety and let us all come through this experience together.

To read further about the topic of a market crash, **see this article** by GMI's Wynand Gouws.

Disclaimer

This communication (including the Appendix) has been prepared by the UCTRF Board. It aims to highlight some of the factors members should consider in deciding on their investment strategy. It does not constitute advice by the UCTRF Board and any of its service providers. Furthermore, no guarantees are provided in terms of performance and past performance is not necessarily a good predictor of future performance. Members are strongly encouraged to seek advice from a duly licensed financial advisor when considering their investment decisions.

Should you require more information you are welcome to contact the UCTRF Office at:

Email: uctrf-enquiries@uct.ac.za | **Telephone:** +27 21 650 2934 | **Website:** www.uctrf.co.za

The UCTRF Board
15 April 2020

Appendix: Smoothed Bonus Fund (UCTRF Portfolio B)

If you have (or are considering) an investment in the Smoothed Bonus Fund, we encourage you to read the detailed explanatory material on the UCTRF website (www.uctrf.co.za), e.g. the Investment Guide, which can be downloaded. However, there are some points that we want to make sure members are aware of.

- The essence of investment smoothing is that the insurer (Momentum Metropolitan Life Ltd) holds back some of the investment growth in the good times, to support the bonuses declared when times are bad. So in the good times, the bonuses will lag the investment growth on the underlying assets which the insurer holds to back the Smoothed Bonus Fund, so that a "bonus smoothing account" (or reserve) builds up which can then be used to support the bonuses when the investment growth is weak or even negative.
- The problem arises when the "bonus smoothing account" balance has been used up, and the bad times continue – i.e. the investment returns on the underlying assets continue to be negative. **This is the situation at present** – there is no more "bonus smoothing account", and in fact the value of the underlying assets is quite significantly **less** than the amounts promised to members, i.e. the "face value" of members' investments in the Smoothed Bonus Fund. This position is sometimes described as a "negative bonus smoothing account".
- We know that, when there is a "negative bonus smoothing account", the short-term outlook for further bonuses is very poor – the insurer will not declare bonuses of 1% or even 0.5% per month in this situation – in fact the bonuses will be very close to zero. This will change if the markets recover quickly – but until this happens, it does not make much sense to **switch into** the Smoothed Bonus Fund. It is even debatable whether it is a good idea to carry on investing monthly contributions in the portfolio. (The insurer **may** consider starting a "new bonus series", i.e. a new investment pool, in which to receive new contributions – this was done in 2009 during the Global Financial Crisis. This is explained in the Investment Guide, which may be downloaded from the UCTRF website.)
- There are complicated rules relating to **switches out of** the Smoothed Bonus Fund – and these differ between members who have a Smoothed Bonus investment in terms of the UCTRF's Life Stage Model and those who have made their own decision to invest in the Smoothed Bonus Fund ("own choice" investors). Basically, if you choose to switch out at the present time (when the markets are weak), you are **likely to face a switching penalty**, **unless** you are an "own choice" member and you have been invested in the portfolio for longer than 5 years. (And even then, the situation is more complicated if you started investing in the Smoothed Bonus Fund more than 5 years ago, but have switched or transferred further amounts into the portfolio during the last 5 years.) We cannot give all the detail in this short note – more detail is provided on the UCTRF website. Also remember that these "switching rules" do **not** apply to benefit payments – e.g. if you retire or resign from employment at UCT and take benefits from the UCTRF.
- The bonuses which the insurer declares on the amounts invested are split between a "vested" bonus and a "non-vested" bonus. In extremely adverse market conditions, the "non-vested" bonuses (which could be as much as 25% of your total investment in the Smoothed Bonus Fund, if you have been invested in the portfolio for a long time) could be reduced by the insurer, or even removed completely. We have been advised that there are no short-term plans to reduce the non-vested bonuses, and we do not believe this is very likely to happen, but you need to be aware of this possibility.