Tourism, Hospitality & Catering Pension Fund

Member communication – 2 April 2020

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

Investment markets have been brutal over the past month. Share prices of South African and global shares were down over 20% over the past month. This is the biggest drop in share prices since the Global Financial Crisis of 2008/2009.

The fall in investment market prices reflects investors' fears around the effect that the coronavirus is having on global economies. Markets are forward-looking, which means that the fall in market prices shows that investors expect the economy to perform worse ***in the near future***. If things change, and the outlook gets better, or worse, investors will then change their expectations again, and market prices will consequently change again. This is why market prices can change direction, and even back again, in a short space of time, and this is called "volatility".

The situation caused by the coronavirus is unprecedented. And the result is an especially tough investment environment, with an extreme amount of volatility.

As you will be aware South Africa, has just entered a period of almost total lockdown. Many people are already fearful and anxious about their health and that of their loved ones, and their jobs. The recent falls in the investment markets have made many people now also worry about their retirement savings. Such fear and anxiety are entirely understandable; we are hard-wired to react like that when faced with adversity.

Our instinctive reaction of fear and anxiety is designed to help us to survive. But sometimes problems are so complex that we need to pause and think about what the best response may be. In working out that response you need to consider the evidence. After looking at the evidence, you need to decide whether it is necessary for you to take action, and what that course of action should be, or even if you need to take any action at all.

Let's consider the evidence.

Where are your retirement savings invested?

Most importantly you need to know how your retirement savings are invested. All retirement funds are required by law to have a so-called "default investment strategy" – the best practice, most appropriate strategy for the fund and the majority of its membership. Your retirement savings will be invested according to this default strategy. The default strategy has been carefully designed by the Fund's Trustees, supported by the guidance of professional advisers and investment experts, based on many years of investment experience and research, specifically related to managing retirement fund savings.

The default strategy in the THACSA Fund follows a so-called "life stage model". This model invests your retirement savings more conservatively (which means with less risk, which means it experiences less volatility) as you approach the age at which your company requires you to retire. The model starts to move your retirement savings into this conservative strategy from age 50 onwards.

It is best to check where your retirement savings are indeed invested, but if you are within four years of retirement age, most of your retirement savings would be invested in Momentum Multi-Manager Smooth Growth Fund (Global). This is a purpose-built capital protection portfolio which is guaranteed by an insurer (Momentum) to not lose money in most scenarios even if investment returns are negative. In other words, your retirement savings are largely protected.

The share market crash experienced recently has the most effect on your retirement savings if you are not yet invested in the capital protection portfolio, in other words if you are younger than 50 years old. However, in this instance, you will have time before you retire for your retirement savings to recover the loss, the topic to which we now turn.

Investment markets are likely to recover

Over the stock market's history so far, it has always recovered, and even grown to new highs, following a market crash such as we are experiencing now.

There have been seven significant investment market crashes over the last 51 years, so they happen more often than most of us remember. How many of these crises do you recall?

Over these 51 years, the local South African share market has generated a return of around 15% per year, compared to inflation, which averaged between 5% and 6% per year. So, local shares have delivered a return that easily exceeded inflation over the full period, despite us measuring this return from just before one market crash (May 1969) to initial stages of another (March 2020), and including five other big market crashes in between – in other words, from high prices to low prices.

The obvious and critical question is: "Why have share markets always recovered?" The most fundamental reason is the resilience of humanity. Government and society must work together to find a "win-win" solution, or else society falls apart. Mankind, by nature wants things to be better. So when faced with adversity, people that live in democratic societies, as we do, collaborate to solve the problem.

While there is never any guarantee that investment markets will recover this time round, based on history, there must be a very good chance that they indeed will. And there is every confidence that this recovery will come. However, the bigger unknown is when.

Reality check: it is very difficult to switch into cash and then get back into the share market <u>at the right time</u>

Even though the evidence is that markets recover after a crash, you, like many others, may still be discomforted by the reality that there is no guarantee that such a recovery will indeed happen and the uncertainty over how long it might be before such a recovery does happen. Your immediate instinct may be to take your retirement savings out of the market and re-invest them later when you can be more certain that markets will perform well again.

Whilst this might seem like a sensible approach, the big challenge you will have to overcome is when to put your retirement savings back into the investment markets. Remember that things are cheapest when nobody wants to buy them. This means that, for the best outcome, you will need to put your retirement savings back into the market while everyone else still thinks it is a bad idea. To do so will be very difficult (some would argue, backed by decades of research, practically impossible), especially as this would need to be a very brave decision, going against the very instinct that caused you to switch out in the first place. And, if you were brave enough to reinvest while prices are still low, how would you identify the right moment, particularly when everyone is still at their most fearful?

If you do switch into cash now, you are assuming that the market could still go down a lot more and that there is no guarantee that it cannot fall a lot further. However, you will now have the added stress of having to decide when you must switch back into the share market, which is a tough decision and almost impossible to get right – even for the experts. Remember that, if you are under 50, you are a long-term investor and have time on your side to wait this period of volatility out.

What should you be doing?

The key messages from the above are:

1. Check where your retirement savings are invested. If you are **close to retirement age** and your retirement savings are invested according to the life stage model, the coronavirus market volatility

is likely to have less impact on your savings and will have almost no impact if you are within a year or two of retirement.

However, most members are **younger than 50**, and for these members the next two points are important.

2. The long-term history of investment markets shows that investment markets recover and make up their losses, although this outcome cannot be guaranteed and the timing of it is uncertain.

3. A sharp fall in investment markets, together with uncertainty regarding their recovery, leads many investors to want to switch into cash and then switch back into the market when things are clearer. Careful thinking and consideration of the evidence will probably lead you to the conclusion that getting this right in practice is extremely difficult. This is because the time when the market is cheapest, and when you should be invested, is also the exact time when almost all investors are most fearful. So, having disinvested due to fear, you would now need to be brave and re-enter the market when fear is still likely at its highest and most others think it is a terrible idea!

The above analysis suggests that all members should think carefully before making any dramatic or reactive change to their retirement fund investment strategy.

Remembering their responsibility for the good governance of the Fund, including the investments, a good question to ask would be, what are the Trustees doing to ensure that the default strategy is still appropriate, given the extreme environment we are in now?

What are the Trustees doing to make sure that our strategy is still the right one to be following?

Adjusting flows to the capital protection portfolio

The capital protection portfolio, held with Momentum, is a "smooth bonus" portfolio. This portfolio "smooths" investment returns over time so that those invested in it have a very low chance of negative returns. However, after the size of the recent falls in market prices, this portfolio is now "underfunded" because it has been protecting members, by giving them a zero return while the value of its assets are, in reality, falling and the actual returns are deeply negative.

The returns from this portfolio will benefit from any future recovery, but in order recover, the returns will likely need to be zero or very low, for some time to come. The future returns will likely be lower than returns on cash (which also protects against negative returns). Therefore, the Trustees have temporarily stopped making additional investments into the "smooth bonus" portfolio and are directing these flows straight into cash (the Investec Money Market Fund). The Trustees will reconsider directing flows to the "smoothed bonus' portfolio at a future point if appropriate.

Note that this change only affects those members aged 50 years and older who are invested in the default strategy.

What about younger members, not close to retirement?

Members below age 50 have time on their side. Based on market crashes experienced in the past, there is enough time for the retirement savings of these members to recover and grow again before their retirement. Therefore, members below the age of 50 do not have the same need to move to a less risky portfolio. It is possible, wise even, to simply sit tight and wait the volatility out. During this time when so much is out of our control, avoiding locking in losses is within your control.

Some final words

The Trustees, together with the Fund's professional advisers and the Fund's appointed expert investment managers, are carefully monitoring the situation and how it develops. If it becomes clear that the current investment strategy is, for any reason, no longer appropriate, the Trustees are able, and will, take appropriate and necessary actions. You can be assured that extreme care has been taken to create a robust default strategy that should not need to be changed, even through times of extreme market conditions.

This is one of the toughest times that any of us has ever had to deal with, with so many things to worry about. Our hope is that this communication has lifted some of the load for you, in terms of how to approach the investment of your retirement savings in a time of crisis. We also hope it gives you some comfort that there are experienced and professional experts looking after your retirement savings on your behalf, in the midst of all the uncertainty and disruption that we currently face.

Panic is your worst enemy in a crisis and disciplined action based on calm, reasoned thinking is your friend - not just with regard to your investments but in all aspects of life.

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