# WHAT HISTORY TEACHES US
## ABOUT LIVING ANNUITIES

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### ABOUT **THE AUTHOR**

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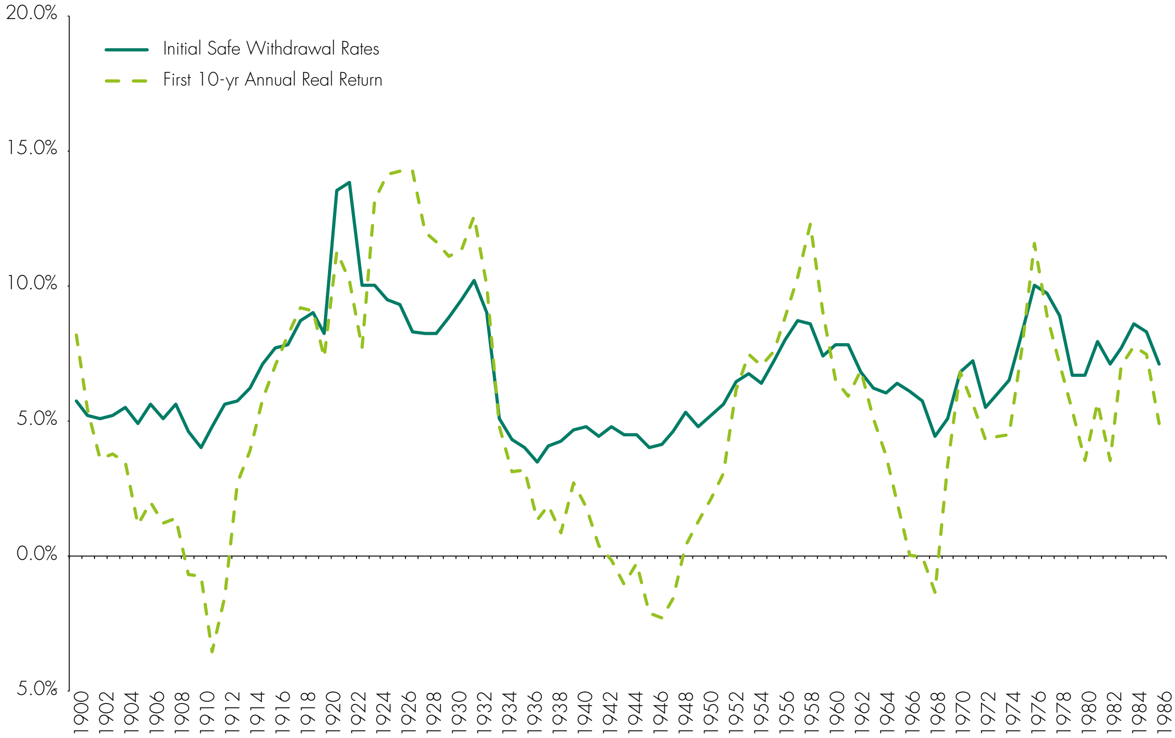
Retirement can be a daunting prospect. Not only is it a time of personal adjustment, but also a time to make financial decisions that will impact your lifestyle for the rest of your life. Retired investors commonly face the dilemma of either maintaining a certain lifestyle or adjusting it in order to preserve their savings. Typically, the more income you draw and spend today, the less is available to create future income. When inflation is added to this quandary, it becomes important to also grow that income over time to retain your buying power. Marriott has researched the sustainable levels of income that retirees were able to draw historically, to better understand the difficulties retirees face and why, in retirement, you should spend the income and not the capital.

### HISTORIC ANALYSIS OF LIVING ANNUITIES IN SOUTH AFRICA

Marriott's research, using returns for South African asset classes going back to 1900, tested how much retirees could safely draw from their savings without running out of capital for 30 years. We assumed each retiree invested R1million in a typical balanced fund (comprising 60% equities, 30% bonds and 10% cash) and drew an annual income that kept up with inflation.

The graph below shows the maximum initial safe withdrawal rates retirees were able to draw without running out of capital over a 30-year period.

### THE GRAPH BELOW SHOWS THE MAXIMUM INITIAL SAFE WITHDRAWAL RATES RETIREES WERE ABLE TO DRAW WITHOUT RUNNING OUT OF CAPITAL OVER A 30-YEAR PERIOD.




Sources: Calculations: Marriott. Data: I-Net and Professor C. Firer's studies on the history of capital markets

**KEY TAKEOUTS:**

- HANDS OFF THE CAPITAL
- TAILOR YOUR LIFESTYLE TO YOUR INCOME
- CHOOSE INVESTMENTS THAT GENERATE INCOME
- CAPITAL PRESERVATION IS PARAMOUNT

Initial safe withdrawal rates have fluctuated significantly over time. Some retirees were able to start with a withdrawal rate as high as 13%, grow their income in line with inflation and still have a successful retirement (capital lasted for 30 years). A closer look at the data revealed that maximum safe withdrawal rates correlated with the first 10-year annual real returns the investor experienced. In other words, lower maximum safe withdrawal rates coincided with lower real returns and vice versa. This seems obvious, but the difficulty retirees face is that future returns are very difficult to predict.

The table below summarises the percentage of retirees who failed (failure rates) using different drawdown rates for all 88 retirees with a 30-year investment horizon.

| Drawdown rates | Failure Rates (+100 years) |
|---|---|
| 4% | 6% |
| 5% | 27% |
| 6% | 47% |
| 7% | 64% |

Sources: Calculations: Marriott. Data: I-Net and Professor C. Firer's studies on the history of capital markets

The drawdown rate of 6% is common in the marketplace, but our research shows that at that rate, almost half of the retirees would have failed. The concern for retired investors today is that market returns are expected to be below average for the next decade, due to demanding valuations combined with lower growth expectations. This suggests many living annuities will come under pressure in the years ahead.

## MARRIOTT HAS TWO SUGGESTIONS FOR RETIRED INVESTORS:

**1. Match the income drawn with the income produced**

Investors should be aware of how much income their portfolio is generating and try to draw no more than the income produced – thus avoiding capital erosion. Investments that produce reliable and consistent income streams assist investors to avoid capital erosion over time. If an investor can avoid capital erosion they can secure their future income. It is especially important in the early stages of retirement that capital should be preserved as far as possible. If investors wish to draw more income than what their investment is producing, they should take note that they are eroding their capital.

Marriott funds are managed with an income focus – to produce a certain amount of income as well as income and capital growth. This investment style is in contrast to many others where the investments are managed with a capital growth objective. The basis of a capital growth objective is that investment growth will offset the income withdrawals. This appears to work well when capital values are increasing because capital erosion is masked by the market rise. When markets decline, however, the value of the investment will decrease sharply due to the twin effects of an eroded capital base and decreasing capital values.

**2. Choose investments which produce consistent income streams that grow over time**

Investors not only need to preserve capital, but also need to ensure they protect themselves against the impact of rising living costs over time. Investments that produce a reliable income stream that grows over time, like equities, are critical for a successful retirement, as the income produced from these investments tends to grow ahead of inflation. By including equities with a reliable, growing income stream, investors will be able to ensure growth in income over time. The trade-off of including equities, however, is that an investor's portfolio will produce less income initially. Investors need to find the appropriate level of exposure between the different asset classes that will give them enough income and income growth over time.

At Marriott, we suggest that investors examine their situation carefully when considering using capital to supplement their income. We strongly urge investors to preserve capital until they reach a stage in their retirement years when it may become safer to draw down on capital. While investors may find it challenging to restrict their annuity income to the income produced in the current low-yielding environment, this is preferable to finding that one's capital has been partially or even completely eroded. Rather be conservative now than risk having to find another source of income, such as going back to work or having to reduce one's standard of living at some point in the future.

The simple truth is, if you spend more than you earn, you will erode your capital and ultimately erode your income. When it comes to investing, particularly in retirement when capital preservation is paramount, this age-old wisdom rings true even today.