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The importance of staying active: investing for retirement in uncertain times

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Retirees around the world face common challenges, with the most significant being the end of a decades-long period of reliable investment returns. This is due to an environment of record-low interest rates and lower growth, and the effects of COVID-19 have also exacerbated the situation. In response, some governments have allowed employees to reduce or defer pension payments, or to draw down from their existing pension pots to meet immediate needs. That's sensible from a short-term perspective, but there is no avoiding the consequence that those people will one day have less in their portfolios. The situation for retirees in Hong Kong is no different.

Chart 1: Real interest rate (deposit) in Asia, i.e. the interest rate after inflation, in China, Hong Kong, Japan and Vietnam are all below zero percent, which makes it impossible to generate income replacement from these sources.[1]

[1] Real interest rates (deposit) in Asia are presented on per annum basis by subtracting average headline CPI inflation from average 3-month time deposit rate (October 2019-September 2020). Bloomberg, websites of Asian central banks and major banks; data as of September 2020. Over a one-year period, these markets are experiencing deflation: Malaysia (-0.508%), Taiwan (-0.053%) and Thailand (-0.645%).

But there is still hope. Our latest study found that if Hongkongers start saving by just 4 years earlier, they reduce the risk of running out of money in retirement by approximately three folds. In this article, we look into how taking early action and staying invested during retirement could help Hongkongers avoid the serious prospect of running out of funds in their later years. We also offer recommendations to help boost retirement savings and reduce risks.

The study draws on a scenario that a Hong Kong couple who are now aged 55. They began investing 25% of their income since 47 years old and will continue to do so until they retire at 65. By that time, they are able to build up investment capital of about HK$6.6 million – savings that are invested, not held as cash. With their life expectancy of 85 years[2], their savings look substantial, but using inflation and household expenditure modelling, the study concludes that the probability of them running out of funds during their 20 years of retirement is 23.21% – almost a one-in-four chance.

However, we found that if the couple starts saving four years earlier at age 43, the initial investing capital would increase by 40%, with the probability of a shortfall dropping to 8.25. It's the power of compounding returns on a larger sum of investment capital.

We also had the couple starting to de-risk their portfolio when they retire to a more conservative 60/40 split in equities and fixed income, but this actually increased the probability of a shortfall to 26.98%.

[2] Centre for Health Protection, Department of Health, Hong Kong. See: https://www.chp.gov.hk/en/statistics/data/10/27/111.html

Save up and invest early

These findings are revealing, especially as Hongkongers' cash holding continued to be on the high side. The 2018 Manulife Investor Sentiment Survey showed that Hong Kong households allocate 40% of their assets in cash. Alarmingly, though, the more recent Manulife Asia Care Survey revealed that Hongkongers' cash holding stood at 53%.

The good news is Hongkongers do understand the importance of retirement planning and investment. In the face of COVID-19, Manulife's recent Asia Care Survey[3] said the majority of Hong Kongers (55%) has raised their awareness on the importance of retirement planning. These survey findings send out a clear message: don't sit on your hands waiting for something to happen. Start investing now – the sooner the better, in order to form a financially-secured retirement.

And while beating inflation is crucial, the situation is different for older people whose budgets are dominated by food, housing, and medical costs.

Hong Kong saw housing and medical costs rise at an annualised rate of 6.83% and 8.1%, respectively[4], over the past decade. Yet, Hongkongers enjoy the longest life expectancy in the world, currently 85 years of age with the trajectory upwards. An estimated half of Hong Kong's population will live beyond 90, meaning they will have decades in retirement[5].

[3] https://www.manulife.com.hk/en/individual/about/newsroom/asia-care-survey-hk-20210210.html

[4] Rating and Valuation Department; Global Medical Trend Rates, Aon Hewitt.

[5] Spotlight on retirement, Asia, LIMRA and the Society of Actuaries (2018). See: https://www.soa.org/resources/research-reports/2018/spotlight-on-retirement/

Stay invested and de-risk carefully

Investing early and staying invested in an active way is, therefore, critically important. Not only that, but the whole concept of de-risking portfolios when approaching retirement needs to be considered and planned carefully. De-risking, or shifting some of the equity allocation into bonds – has been the standard approach for decades. However, the current low-interest environment means a portfolio comprising 60 percent equities and 40 percent bonds might not generate enough income. Pushing back de-risking, or, alternatively, saving up and investing earlier are important food for thoughts for Hongkongers.

To help boost retirement savings and reduce risks, here are five recommendations:

1. **Make your money work overtime**. That means staying invested for longer and ensuring that funds that aren't needed today or tomorrow are placed where they can continue to grow to boost returns.

2. **Take only what's needed**. Again, the more capital that can stay invested, the better. Cash currently earns close to zero (and erodes in real terms) – that's unlikely to change in the coming years. Draw down only what's needed for immediate spending needs.

3. **Go for the combo: spend less, continue to work if possible (even part- time), and check out government subsidies.** Find out what subsidies you and/or your spouse may be eligible for.

4. **Be inquisitive – Seek innovative solutions to manage cashflow**. This might include a reverse mortgage, or other income-generating solutions to provide enough cashflow for retirement years. Pre- and post-retirement, investors should also familiarise themselves with the range of innovative products and solutions available in order to ensure a well-balanced portfolio.

5. **Stay healthy, mentally and physically**. Studies show the importance of age-appropriate exercise – for instance, in slowing the ageing process – while the COVID-19 pandemic has reinforced the importance of health and our relationships. A healthier retirement is a more enjoyable one and avoids a significant drain on finances due to medical costs.

Investing early and staying invested in an active way, then, is a core message. Our hope is that retirees across Asia – for whom we've written this article – will look at some of the options we've outlined and make changes that will help them to better meet their retirement needs.

About HKRSA

The Hong Kong Retirement Schemes Association (HKRSA) was established in 1996 to promote the interests and best practices of retirement schemes in Hong Kong including provident and pooled retirement funds. The HKRSA is a not-for-profit, non-political association, which represents retirement schemes and their members, providing a forum for discussion of issues of current and topical interest.

About Manulife Investment Management

Manulife Investment Management is the global wealth and asset management segment of Manulife Financial Corporation. We draw on more than a century of financial stewardship and the full resources of our parent company to serve individuals, institutions, and retirement plan members worldwide. Headquartered in Toronto, our leading capabilities in public and private markets are strengthened by an investment footprint that spans 17 countries and territories. We complement these capabilities by providing access to a network of unaffiliated asset managers from around the world. We're committed to investing responsibly across our businesses. We develop innovative global frameworks for sustainable investing, collaboratively engage with companies in our securities portfolios, and maintain a high standard of stewardship where we own and operate assets, and we believe in supporting financial well-being through our workplace retirement plans. Today, plan sponsors around the world rely on our retirement plan administration and investment expertise to help their employees plan for, save for, and live a better retirement.