GRAYISSUE

Delayed gratification is priceless

2 December 2011
Issue no. 125

Acknowledging your future financial needs and making concrete plans to meet these is a discipline that will benefit you and your family enormously. It is the most valuable gift you can give yourself.

It has been a difficult year financially worldwide, with doom and gloom dominating global news headlines. In this context, not every company will be able to pay out annual bonuses. If you are lucky enough to receive a bonus, it may be tempting to spend it now, but before you satisfy that short-term urge, here are a few reasons why it may be better to invest your bonus, or at least a portion of it.

Invested money (generally) creates money

If the growth in an investment exceeds inflation then it creates more buying power. In addition, future growth is on the enlarged portion, so an ever-growing investment is created. When looked at on a year-by-year basis, the figures appear small; however the cumulative effect is large.

If you had invested a bonus equivalent to R25 000 in today's money since 1990 in the equivalent of Allan Gray's Balanced Fund, the investment would currently be worth approximately R970 000. If you were retiring now you could invest this amount conservatively and still draw a sustainable annual income in excess of R29 000, growing at inflation (assumed at 3% of capital value: inflation-linked government bonds currently yield in excess of 2.5% above inflation).

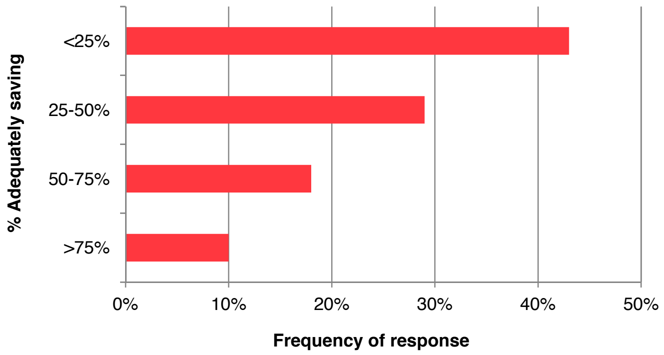
An invested bonus gives you options

It is never clear what will happen next in life. You may stumble across the opportunity of a lifetime and need excess funds to buy into this opportunity. You may have health difficulties and need additional cash for hospital bills. Building up an investment is important as it gives you options and buffers you against unforeseen elements. If you spend your bonus you forgo this opportunity.

Inflation takes some beating

Over the long term the risk of inflation eroding the buying power of your money is probably greater than the risk of volatility of the markets, which tends to be a shorter-term phenomenon. Consumables and certain possessions, such as cars, do not protect you as these tend to lose value over time. The rising cost of living is a real issue and should be considered when planning for the future.

Graph 1 | Survey to a number of independent advisers: what portion of your clients are saving enough for retirement?



n = 800
Source: Allan Gray research

Economic freedom is a series of small steps

Anecdotally, only 34% of advised clients are saving enough for retirement (see Graph 1). Given that these investors have seen the necessity for advice in their financial affairs, it is likely that they are more proactive than average, and yet they are still under saving. It has been argued that one of the particular dangers of the HIV/Aids pandemic is that the consequences in acquiring HIV/Aids and the effects of full blown Aids are separated by many years; as result the latter does not stop the former. Retirement is no different. It is all too easy to justify spending now, as the affects of not having money to retire are only felt many, many years later. Investing a bonus is a step towards having enough when you need it. With each step it becomes easier and with each step the benefits become more apparent.

While it is tempting to focus on short-term gratification and avoid long-term decisions, your patience will pay off. You may only receive 20 or 30 annual bonus payouts in your working life, so you should consider rewarding yourself with long-term financial stability instead of short-term purchases. It is important to carefully research the investment options available to you and choose one to suit your time horizon, return objectives and your ability to stomach uncertainty or ups and downs in returns over different time periods. If you need help making financial decisions you should consider using an independent financial adviser.

Commentary by Rob Formby, Director of Retail Operations, Allan Gray