Prescient
INVESTMENT MANAGEMENT

ESG: A Crucial Fixture in Modern Risk Management

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When it comes to savings and retirement planning in particular, balanced funds stand out for their simplicity, effectiveness, and ability to weather market storms. These versatile investment vehicles typically combine multiple asset classes in a single portfolio, with the lion's share invested in equities and bonds. They offer retirees and investors still building their retirement savings a powerful tool to withstand market volatility through the diversity of a multi-asset portfolio, assisting individuals in achieving their financial goals over time.

In South Africa, Regulation 28 of the Pension Funds Act governs retirement investments and provides regulatory support for multi-asset retirement investments. The regulation sets various retirement saving limits for different asset classes, restricting equity exposure to a maximum of 75%, property exposure to a maximum of 25%, and international assets to a ceiling of 45%.

One of the most significant risks retirees face is experiencing poor investment returns in the early retirement years when their portfolio value is at its highest. Drawing income from a fund that experiences a significant drawdown in the early years of retirement can be detrimental to the longevity of the capital sum. Balanced funds help mitigate the potential sequence risk by providing a buffer against equity market downturns via the diversification benefits of the spread of assets it is permitted to hold.

Funds such as the Prescient Balanced Fund demonstrate that they are well-suited for pre- and post-retirement savings. In South Africa, balanced funds have grown from representing just 6% of the unit trust industry assets in 1999 to nearly 35% by the end of Q2 2024. This growth is a testament to a multi-asset fund's ability to meet retirement savers' financial goals.

Balanced funds have also delivered solid long-term performance. While past performance doesn't guarantee future results, this track record demonstrates the potential of multi-asset balanced funds with a high equity exposure to grow retirement savings over time.

A Morningstar study found that balanced portfolios supported the requirement of higher withdrawal rates over 30-year retirement periods, as opposed to all-equity or all-bond portfolios. This means retirees can potentially withdraw more of their income with confidence from their retirement savings without running the risk of their funds running out prematurely.

The power of balance and diversification

Balanced funds confer certain advantages to retirement investors that are not available to investors whose retirement strategy is based on investing in individual single-asset funds. These include:

1. **Diversification and smoother returns:** Balanced funds combine equities and bonds, as well as offshore assets to help reduce overall portfolio volatility therefore generate smoother returns over time. Diversification can be particularly important for retirees who rely solely on their retirement investments for income and who may be more sensitive to market fluctuations.

   Building multi-asset portfolios, that reap the best rewards rely on sophisticated investment processes from fund managers with proven track records. Prescient Investment Management's systematic investment process is purpose-built to deliver consistent returns, drawing on data-driven and human insights to make informed, unemotional, repeatable investment decisions.

2. **Professional investment management:** Balanced funds are overseen by experienced and skilled investment professionals who make asset allocation and security selection decisions. The manager's track record is important, so it's crucial to consider how consistent the fund's performance has been and whether it has a sufficiently long track record to inspire confidence in its ability to perform during different market conditions.

3. **Automatic rebalancing:** The fund managers adjust the portfolio to maintain the target asset allocation as market conditions change. This eliminates the need for retirees to manually rebalance their investments, saving time and potentially reducing costly errors.

4. **Flexibility for changing needs:** Retirement investment needs shift over time, and balanced funds offer the flexibility to adjust the proportion of stocks versus bonds to match these changing requirements. Investors in the early retirement years may need a greater allocation to stocks to guard against longevity risk. In contrast, retirees in their later years need to prioritise income generation and capital preservation. Balanced funds enable a gradual shift towards more conservative allocations when market conditions dictate, which helps protect retirees' nest eggs while still providing growth opportunities.

5. **Annual Management Fees**: Those funds that deliver the required consistency via a balanced approach must also demonstrate an appropriate pricing structure that is aligned with the client's investment goals.

The bottom line

Balanced funds with a proven track record are well-suited for individuals seeking a comfortable and financially secure retirement. They provide exposure to a diverse portfolio of investments, with equity exposure providing capital growth potential and, due to the diversification across local and offshore assets, the stability one requires over the long term.

As with any investment decision, it's crucial to consider every person's circumstances and consult a financial advisor. However, for many retirees, balanced funds offer a compelling solution to the challenge of retirement investing and achieving long-term financial goals. At Prescient, we believe our Balanced Fund is an ideal vehicle for consideration.

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