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How to grow a meaningful nest egg with little money but a lot of time

A common and unfortunate misconception is that investing is for the rich and that building wealth requires a sizeable amount of money, according to Darius van der Walt, actuary and member of the Investments Committee of the Actuarial Society of South Africa (ASSA).

Van der Walt explains that successful investors are those who understand that time is the critical factor when building wealth and not necessarily the amount of money at your disposal.

“While you definitely need some spare cash in order to invest, having a lot of time ahead of you is far more important than the amount of money you can spare every month. The earlier in life you start investing, even if it is a small amount, the bigger your nest egg will be when you need it most.”

According to Van der Walt, time is a key factor when investing, because it enables compound growth. “The compounding effect over time is what significantly accelerates the growth of your investment.”

Considered to be one of the world’s most successful investors, Warren Buffett credits his wealth to “a combination of living in America, some lucky genes, and compound interest”.

Van der Walt says while the first two could be considered either fate or luck, depending on your outlook, the power of compounding is available to anyone earning at least a living wage and willing to invest a portion for the long-term.

Why compounding is so powerful

Van der Walt explains that compounding is enabled when income (dividends, interest or rental income) is reinvested and capital growth is left to attract further gains. The effect of earning income on income and further growth on capital gains is referred to as compounding.

“While reinvesting income is key, compounding of capital growth is also critical and even more so when a portfolio has higher exposure to riskier assets with higher expected returns such as equities. It’s important to stay invested and not cash in your capital gains, so that you can have growth on your previous gains.”

To illustrate this better, Van der Walt calculated the following example, using the average returns (net of fees) achieved by unit trust portfolios in the South African Multi Asset High Equity category. These portfolios are best suited for long-term investing and are structured to earn both dividends and interest in addition to capital growth.

How a R60 000 investment outperformed a R120 000 investment

Starting at age 25, Anne started investing R500 a month in a SA Multi Asset High Equity portfolio. Over the next 10 years she invested a total of R60 000 and she also reinvested the income earned. She stopped her monthly investment at age 35, when her personal circumstances changed. Although she was no longer investing, she took the wise decision not to dip into her investment and left it to grow for another 10 years. At the end of February 2021, assuming the average return (net of costs) achieved by portfolios in the SA Multi Asset High Equity category, Anne's investment was now worth R265 782.

Kaya on the other hand only started investing at age 35. To make up for lost time he invested R1 000 every month in a SA Multi Asset High Equity portfolio for 10 years – a total of R120 000. At the end of February 2021, when Anne and Kaya compared their investment returns, Kaya's investment was worth only R174 290.

Van der Walt points out that Anne had accumulated R91 492 more than Kaya despite investing half as much, because her investment benefitted from an additional 10 years of compound growth.

He explains that the compounding effect over 10 years would also have given Anne an advantage over Kaya, even if both had invested their money in a much less volatile portfolio like an SA Interest Bearing Money Market portfolio. Money market unit trust portfolios earn only interest and are not impacted by stock market volatility. Assuming the average return of portfolios in the SA Interest Bearing Money Market category, Anne's R60 000 investment would have been worth R174 021 at the end of February 2021, and Kaya's R120 000 investment would have been worth R168 078.

Compounding requires a long-term commitment

Van der Walt acknowledges that it is hard to think about long-term investing when your current focus is on keeping a roof over your family's head and food on the table.

"The past year has been incredibly tough for South Africans and job losses, salary cuts and an increase in living expenses is likely to have left consumers feeling despondent. Tightening the belt even further to squeeze out another R500 for an investment is probably the last thing on your mind. The hard truth is, however, that the benefit of having savings and investments becomes most apparent when times are tough."

Van der Walt makes the point that the best time to start investing was always yesterday and that the second best time is today. "The reality is that there will likely never be a comfortable time to start investing. The discipline of committing a fixed amount every month to a long-term investment will secure a better financial situation for yourself and your family in the future. Once that amount has been deducted from your bank account, you can no longer spend it and before you know it, you will have learned to make do without it."

Van der Walt says the powerful effect of compounding applies to any amount invested, as long as the investment achieves capital growth and earns interest and/or dividends.

“The more you are able to invest over a long period of time, the bigger the multiplying effect,” says Van der Walt.

Van der Walt has calculated the example below based on a monthly investment of R500 into either a SA Interest Bearing Money Market unit trust portfolio or a SA Multi Asset High Equity unit trust portfolio over a number of periods. The returns are based on the average return for each unit trust category.

He points out that the investment returns below were achieved without adjusting the investment amounts for inflation every year. He adds that over the 20 year period, investors would have been exposed to three significant events that sent stock markets around the world into free fall, namely the Dotcom Crash in 2001, the Subprime Crisis in 2008 and the Covid-19 pandemic in 2020.

Van der Walt says stock markets not only recovered their losses every single time, but they also reached new heights. “Investors who panicked at the time and sold their investments would have locked in those losses, while those who stayed benefitted not only from the recovery, but also the resulting compounding effect.”

Investment period to 28 Feb 2021	**Total Invested** (R500 per month)	**SA Interest Bearing Money Market – value at 28 Feb 2021**	**SA Multi Asset High Equity – value at 28 Feb 2021**
1 year	R6 000	R6 123 (4.6% annualised net of fees)	R6 795 (15.9% annualised net of fees)
3 yrs	R18 000	R19 655 (6.5%)	R20 775 (6.1%)
5 yrs	R30 000	R35 312 (7.0%)	R35 776 (5.9%)
10 yrs	R60 000	R84 039 (6.3%)	R87 145 (8.3%)
15 yrs	R90 000	R152 897 (7.2%)	R169 315 (8.6%)
20 yrs	R120 000	R258 060 (7.7%)	R352 927 (10.9%)

Starting small beats not starting at all

Van der Walt says the first step towards becoming a successful investor is to recognise that every little bit counts. “Like with all good habits, investing requires practice and self-discipline.”

He suggests the following guidelines to get started:

- Identify a unit trust portfolio that accepts a monthly amount that you can afford. While the majority of unit trust portfolios require a minimum monthly investment of R500, there are some that accept R200.
- Make sure that you adjust your monthly investment amount with inflation (or a percentage roughly equal to inflation, say 5%) at least once a year.
- As soon as your financial situation allows it, add another investment to your portfolio. Your goal should be a diversified portfolio.
- If you are unsure, speak to a financial adviser about your risk profile. Over time unit trusts with high equity exposure tend to outperform interest bearing portfolios, but they also tend to be more volatile over shorter periods. While this

should not matter to long-term investors, not everyone can stomach the extreme volatility.

- If you find yourself in a difficult financial position along the way, you can stop your monthly contributions. However, referring back to the example of Anne and Kaya, if at all possible leave your accumulated investment amount to continue benefitting from compound growth.

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To set up interviews please contact:
Lucienne Fild
Independent Communications Consultant
082 567 1533
lucienne@fild.co

Issued on behalf of:
Darius van der Walt
The Actuarial Society of South Africa

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