`HOW MUCH DO YOU NEED TO RETIRE COMFORTABLY?

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The COVID-19 pandemic hasn't just played havoc with many investors' finances, but many of them have been forced to withdraw from their retirement savings in, for example, the form of a preservation fund, just to survive. They know they have to somehow replenish their retirement savings, but a more pressing question these days is, "how much do I need to retire comfortably?"

EXPECTED MONTHLY INCOME

Let's start at the beginning. In this case, it will be the amount of money you need to live from right now. Many experts recommend that you use 80% of this amount as a benchmark for what you will need to cover your monthly expenses once retired. I won't personally guarantee the accuracy of this figure, but it does give us a basis to start from.

For the sake of this illustration, I will keep things as simple as possible, but it will be wise for you to also take into account any possible variables that may affect you personally such as declining health, possibly having to move into a retirement home with assisted living facilities or the possibility that you may still have to cover mortgage payments after retirement.

Let's suggest that you currently earn R15 000 per month. By applying the 80% rule, you will need at least R12 000 per month after retirement in order to maintain your current living standard.

SAFE WITHDRAWAL RATE

Unlike food products, human beings don't have a "use by" date, so we have to rely on a safe withdrawal rate to ensure that we do not outlive our savings. According to this rate, you should be able to withdraw 5% of your portfolio yearly, without having to use any of your remaining capital.

This approach is based on the fact that the historical return on the South African stock market (since 1964) was about 8% higher than the local inflation rate, and that you would expect to earn slightly less than that in a typical balanced fund portfolio (over time). By limiting your withdrawals to 5% of your portfolio, you should still have an additional 5% to 6% growth to cover inflation (in the long run). Based on a 5% annual withdrawal rate after retirement, the amount you will need to save in rand terms will look something like this:

R12 000 x 12 months = R144 000 (annual income) ÷ 0.05 (5% safe withdrawal rate) = R2 880 000.

INFLATION FACTOR

One of the biggest variables that may affect your retirement planning is inflation. If you don't properly compensate for inflation in your portfolio, you may fall short of your required total after retirement. Unfortunately, inflation is also one of the most difficult variables to take into account, as you effectively have to try and calculate something that still needs to happen.

Let's assume that you are 40 years old and you plan to retire at age 65 (25 years). By using the top of the South African Reserve Bank's target range, the best calculated guess we can offer on annual inflation is around 6%. What this means, is that if your current needs dictate that you require R2 880 000 to retire in today's rand terms, you will actually need around R12 360 588 when you retire in 25 years' time, when you take inflation into account.

As shocking as this figure may be, you’re one step ahead, because you can now determine how much you will have to save on a monthly basis to reach this target. With the help of a tool such as a retirement calculator, you can simplify this process even further.

If you are already saving towards your retirement by contributing the maximum towards a retirement annuity or pension fund, you have a good head start. It is an absolute fact that very few people can survive on the current government old age pension grant of a maximum of R1 890 per month (or R1 910 for people older than 75 years) as their only source of income after retirement. If you’re not making sufficient contributions towards your retirement by means of something like an employer pension fund or a retirement annuity, you will have to start or increase your contributions now to avoid paying for your mistakes after retirement.