Are you letting volatility derail your retirement plan?

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IN BRIEF

- Retirement is a long-term goal.
- Instead of letting short-term volatility derail your retirement plan, focus on taking the appropriate level of risk for your life stage, based on balancing your risk tolerance and your time horizon.
- Get invested early and regularly; diversify and adjust your allocation over time as your time horizon changes.

ARE YOU LETTING VOLATILITY DERAIL YOUR RETIREMENT PLAN?

There will always be some bumps along the way as we invest for our retirement, our children's education or the dream house that we call home. But as volatility emerges and emotional anxiety sets in, the impulse tends to veer toward "flight" instead of "fight."

According to our latest survey on investor confidence and behaviour in Hong Kong, sentiment is fragile as investors are grappling with lingering trade tensions, higher market volatility and slowing economic growth globally.

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INVESTORS ARE ON EDGE[1]

Our survey showed that 56% of respondents shifted their portfolio to a more conservative mix as a direct result of U.S.-China trade tensions. Nearly one in three investors (29%) indicated reducing their exposure to risk assets such as equities, and 30% considered increasing their cash holdings.

Even though eight in 10 working investors in Hong Kong have started saving for their retirement beyond the city's Mandatory Provident Fund (MPF) and Occupational Retirement Schemes Ordinance programmes, Hong Kong investors on average allocate 37% of their retirement savings to so-called "risk-free," cash-like products such as savings accounts, time deposits or insurance savings products **(Exhibit 1)**.

Moreover, when they reach the age of 65, 83% of Hong Kong investors plan to fully withdraw their funds from MPF and to put over 50% of their assets into cash.

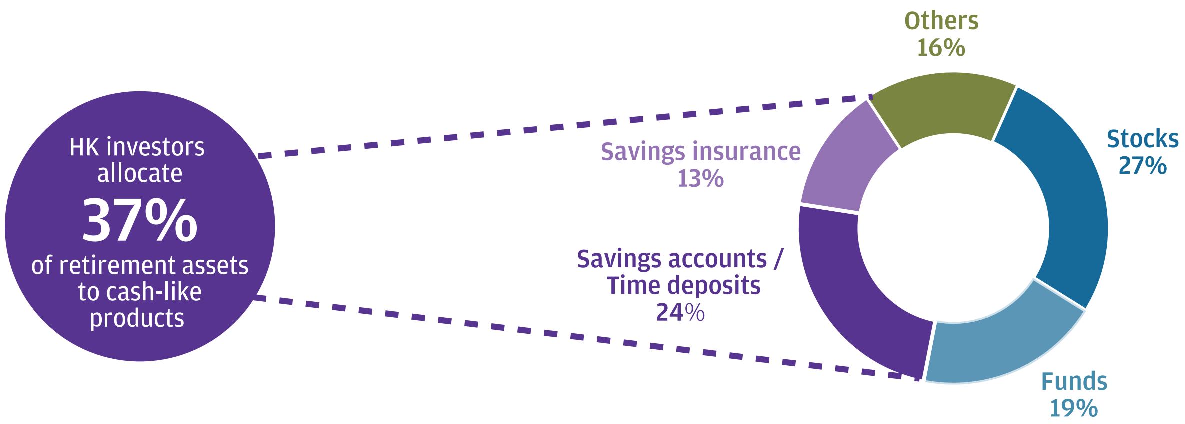
Although these options may be perceived to be "safe," they tend to achieve lower returns that may lag the rate of inflation. This could curb investors' chances of accumulating sufficient funds to achieve their retirement goals, especially young investors with a long runway before retirement who can and should use their biggest asset – time – to improve their savings growth potential. For those investors in retirement, a knee-jerk allocation to cash could expose them to risks including the danger that they outlive their money, or longevity risk.

The "flight" instinct that this survey reflects is understandable, but for long-term financial health, investors would be better served to take a "fight" response instead.

To "fight", investors should put volatility in the context of time – near-term volatility is negligible if the time horizon is long term. They should get invested early and do so regularly. They should also stay invested with a long-term time horizon, and keep a diversified portfolio. More importantly, they should consider adjusting their investment base on their time horizon.

Hong Kong investors allocate a big part of their retirement savings to cash-like products

Exhibit 1: % allocation of retirement savings



[1]Source: J.P. Morgan Asset Management, "Hong Kong Investor Confidence Index, December 2018."

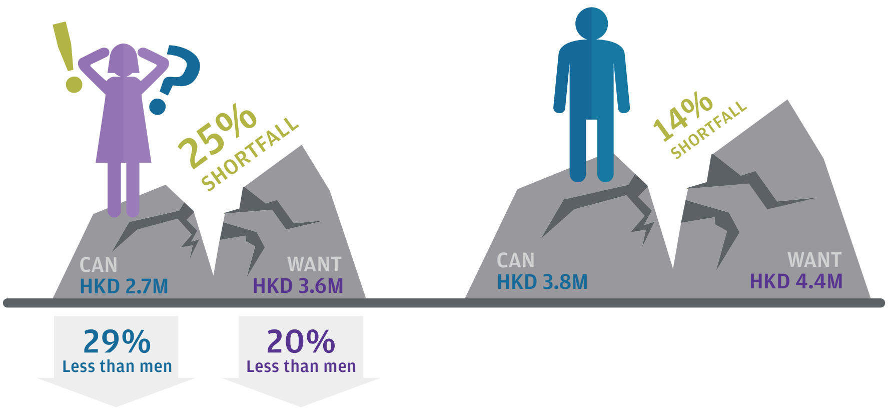
RETIREMENT HEADWINDS

According to our June 2018 survey[2] on investor confidence and behaviour, Hong Kong investors estimate they will need HKD 4.1 million by the time they retire to maintain the same lifestyle after they stop working. However, they feel that they are only able to save HKD 3.4 million by the time they retire – a shortfall of 17%.

Another headwind is inflation risk. For example, if an investor is holding HKD 1 million in a bank account with annual inflation, which in 2018 was 2.6%[3], that meant losing HKD 26,000 of purchasing power. Because of inflation, the value of money may be worth much less 20-30 years later.

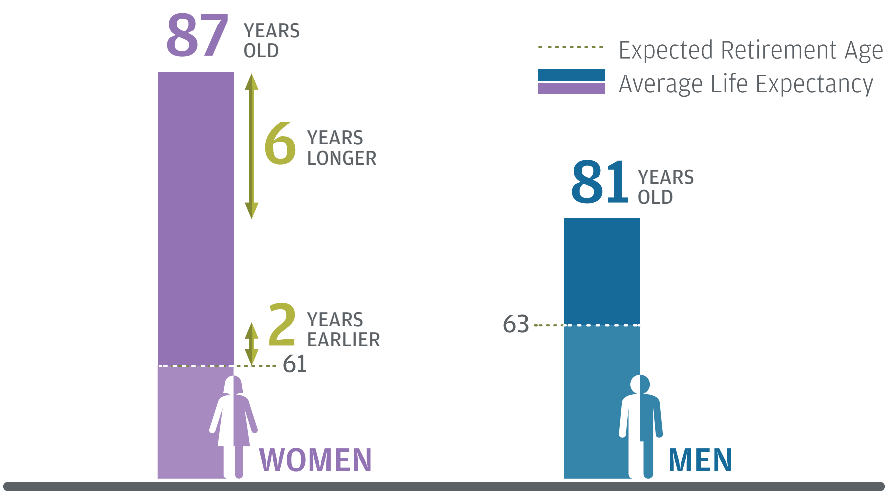
FEMALE INVESTORS FACE EVEN BIGGER RETIREMENT HEADWINDS[2]

Unfortunately, it may be a more severe picture for female investors.



Women expect to save 29% less for retirement than men, and face a bigger shortfall than male investors.

Women would need 25% more money than what they expect to have saved to maintain their current lifestyle through retirement, compared with a 14% shortfall for men.



Women are expected to spend eight years longer in retirement than men because they are expected to live 6 years longer (women's average life expectancy is 87 years[4] compared with 81 for men); and they also hope to retire at 61, two years earlier than men.

Overall, their smaller retirement nest egg will need to be stretched over a longer retired life, exposing them to higher risk of outliving their savings.

Ironically, female investors are less willing to take on risk to grow their portfolios. Our survey found women tended to be more cautious with investing for retirement, with only 70% investing in stocks compared with 93% of men, and 56% investing in mutual funds (71% of men). This could curb their chances of accumulating sufficient wealth to achieve their retirement goals.

We recommend that women use the longer time horizon that they have to their advantage, and make their money work harder for them.

[2]Source: J.P. Morgan Asset Management, "Hong Kong Investor Confidence Index, June 2018."
[3]Source: Census and Statistics Department, Hong Kong. Annual Report on the Consumer Price Index, 2018.
[4]Source: Census and Statistics Department, The Government of the Hong Kong Special Administrative Region of the People's Republic of China, 2016 life tables.

WE RECOMMEND A "FIGHT" PLAN …

While the previous statistics may seem daunting, it is important to recognize that investors do have control over how much they save and how they invest.

We found in our survey that only 20% of investors feel confident enough to know how much they need to maintain their lifestyle in retirement even though they have a ballpark number in mind.

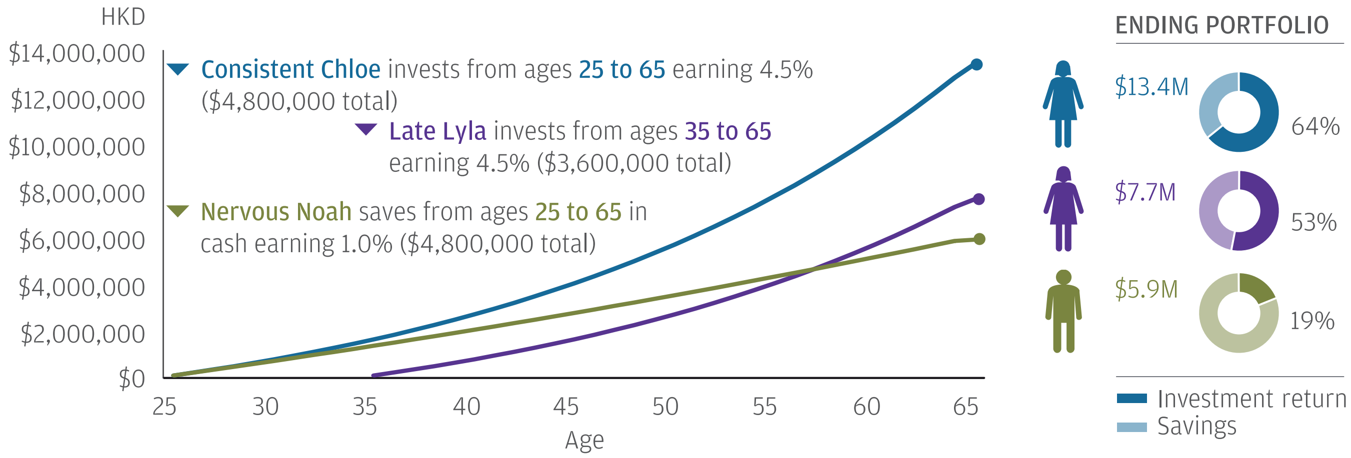
A good starting point is to reference the checkpoints in our ***Principles for a successful retirement***. It provides a gauge of how much you need to maintain your current lifestyle based on your age and household income. With this as an initial guide, you can further personalise your goal based on your lifestyle and when you want to retire. As you map out how to accomplish your goal, assess if your current saving and investing behaviour will allow you to achieve your goal and the changes you may need to make. Be sure to review and update your plan over time as your circumstances change.

Once a plan is in place, it is important to "fight" by getting invested early and regularly, as well as diversify and adjust over time as the time horizon changes.

1) **Start early and invest regularly**: Starting to invest early allows you to take advantage of the power of compounding and can help you achieve your long-term goal at a lower cost, as illustrated in **Exhibit 2**. Consistent Chloe, who started investing early, ends up with nearly double the amount of Late Lyla, who started only 10 years later. Nervous Noah saves as much and as often as Chloe, but chooses not to invest his money, so he only manages to accumulate less than half of Chloe's final amount at 65. Saving early and regularly, and investing what you save, are some of the keys to a successful retirement due to the power of compounding over the long term.

Harnessing the power of compounding can help achieve long-term goals at a lower cost

Exhibit 2: Account growth of HKD 12,000 invested/saved annually



The above example is for illustrative purposes only and not indicative of any investment. Account value in this example assumes a 4.5% annual return and cash assumes a 1.0% annual return. Source: J.P. Morgan Asset Management. Compounding refers to the process of earning return on principal plus the return that was earned earlier.

Starting early also helps you build the habit of investing regularly, which allows you to reap various benefits. Investing regularly...

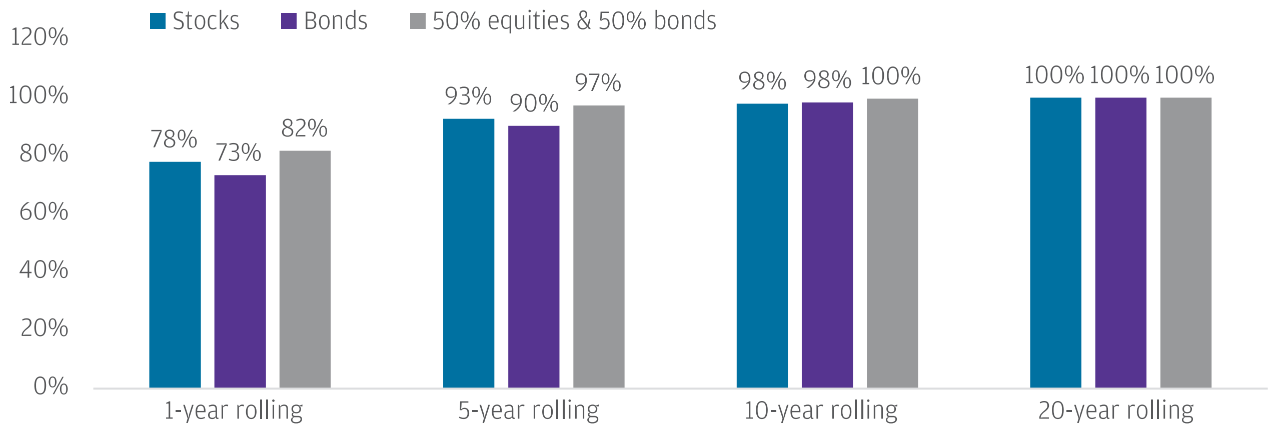
a) **Provides discipline/helps avoid emotions interfering with investing decisions**: It is often tempting to try to "time the market" by buying low and selling high. It rarely works, even for the savviest professionals. History shows that investors tend to follow the herd. When prices are rising, their confidence grows as the bull market matures. By the time they drum up the courage to enter the market, it is usually at market peaks, especially right before a crash. By then, they have missed all the growth opportunities and have to bear with the decline. On the flip side, when prices are falling, they sell out of panic just before a recovery is about to begin. In other words, investors tend to buy high and sell low. These ill-timed moves are usually driven by emotions. While emotions can't be eliminated, they can be tamed if you take a disciplined approach of investing regularly. Take a step back and think about it – investing into a falling market is where the best investments are made because the prices are low. But this takes courage. To guarantee that you will buy throughout varying market cycles is to invest regularly, to capture opportunities at times when emotion might inhibit getting invested.

b) **Averages out costs**: A consistent savings amount is being invested periodically regardless of net asset value and market level. This means that investors will buy more shares when prices are low and buy fewer shares when prices are higher. The result is averaging out of the cost and spreading out the risk. In fact, history suggests that no matter at what market level you start investing regularly, the longer you stay invested the higher the probability of a positive return (as shown in **Exhibit 3** below). So, by investing regularly you do not have to worry about deciding "when" to invest – this can help reduce the mental burden.

c) **Enables you to pay your future-self first**: There are many platforms that can help you set up a regular investment plan; one example is *J.P. Morgan's eTrading platform*. The platform can automatically help you invest a fixed amount regularly on a fixed date of the month. This way you do not need to think about it or take any actions. At the same time, you won't forget. And because you are paying your future-self first, you won't inadvertently use the money for other purposes.

Diversifying and staying invested can provide higher probability of positive returns

Exhibit 3: % of historical positive annualized IRR between 1947 and 2018



Probability of positive returns

	1-year rolling	5-year rolling	10-year rolling	20-year rolling
Stocks	78%	93%	98%	100%
Bonds	73%	90%	98%	100%
50/50	82%	97%	100%	100%

Source: Morningstar, J.P. Morgan Asset Management.
Returns shown are based on monthly returns from 1947 to 2018. Data represented as annualized internal rate of return (IRR) of regular monthly investing. Equities represents the IA SBBI U.S. Large Cap Total Return Index, bonds represents 40% IA SBBI U.S. Long Term Government Bond Total Return Index & 60% IA SBBI U.S. Long Term Corporate Bond Total Return Index, 50% equity & 50% bonds portfolio consists of the aforementioned sub-allocations for equities and bonds, cash represents IA SBBI U.S. 30Day TBill Total Return Index. Past performance is not a reliable indicator of current and future results. Currency in U.S. dollar.

2) **Diversify and staying invested**: To tame your "flight" instinct, being diversified and staying invested for the long term is key, as it can provide smoother returns over varying market cycles. This is a sensible way to batten down the hatches against volatility and avoid emotional investing errors like selling the market at the bottom.

   In **Exhibit 3** on the previous page, the diversified 50% equities and 50% bonds portfolio has a higher probability of achieving positive returns, compared to pure stock or bond investments. And this probability rises the longer you stay invested. This means that even though the market may have a bad day, month or year, if you diversify and stay invested over a longer term, you have time to weather market volatility and earn a solid return.

   Seek advice from an asset manager with a long-term view and global reach to help you build a well-diversified portfolio that matches your needs.

3) **Adjust your allocation as your time horizon changes**: At different points in life, investors have different needs and face different risks **(Exhibit 4)**. In general, we see three distinct life phases:

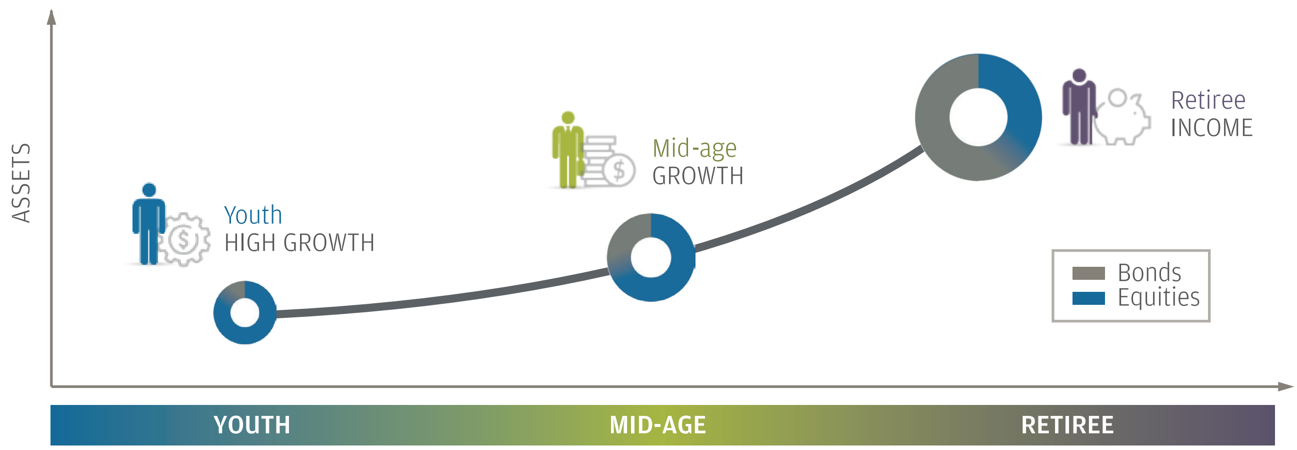
- When you are **young**, because markets tend to produce positive returns over the long term, time is your friend. The longer you leave your money invested, the more compound returns will grow your portfolio. As you have risk capacity, you can allocate more to equities to participate in market growth.
- When you approach your **40s-50s**, your time horizon becomes shorter. Your financial commitments to the family may have increased significantly. And savings become more uncertain. At this point, it is important to dial back risk. Shift to a more conservative strategy to protect the wealth you have accumulated while still seeking some growth during your remaining working years.
- In **retirement**, you may worry about having a stable income, so it is important to dial back risk even more. But at the same time, you may be worried about the possibility of living to 100 or beyond. You need to make sure your portfolio grows and generates stable return at the same time.

It is important to understand the appropriate level of risk for your retirement savings, based on balancing your risk tolerance with your time horizons (aka risk capacity). Try not to let your emotions get the best of you and flee the market in times of turbulence.

Remember to stay focused on the appropriate level of risk for your life stage. Dynamically adjust your investment based on your time horizon but don't let short-term volatility derail your long-term retirement goal.

Adjust allocation over time for better retirement outcome

Exhibit 4: Portfolio framework



Source: J.P. Morgan Asset Management. For illustrative purposes only. Bonds are subject to interest rate risks. Bond prices generally fall when interest rates rise. The price of equity securities may rise or fall because of changes in the broad market or changes in a company's financial condition, sometimes rapidly or unpredictably. Equity securities are subject to stock market risk, meaning that stock prices in general may decline over short or extended periods of time.

CONCLUSION

Retirement is a long-term goal. Instead of succumbing to your "flight" instinct and letting short-term volatility derail your financial future, as observed in our survey, you would be better served to take a "fight" response.

"Fight" by focusing on what can be controlled: saving and asset allocation. Start early and invest regularly to reap the benefit of compounding assets, and to help you keep pace with inflation. Besides, diversifying and staying invested can provide better risk-adjusted returns with lower volatility over time.

Finally, be thoughtful of your investment horizon and dynamically adjust your portfolio as you move into different phases of your life.

Seek advice from an active manager with a long-term view and global reach to help you achieve your retirement goals.

NEXT STEPS

For additional information, please contact your J.P. Morgan representative.

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