GRAYISSUE

Life in a month

1 July 2015
Issue no. 168

July has been designated 'Savings Month' by the Savings Institute of South Africa. It is a good time to reflect on the choice we make between saving and spending; a choice that pits our future needs against what we need and want now. Many of us struggle with this trade-off because it's difficult to have a tangible concept of the future and to understand how little time we actually have to save money over a lifetime. Despite procrastinating we think we will have enough time to save the money we need for retirement.

South Africans, especially, have a tendency to delay the decision to save until it is too late, as shown by our dismal household gross savings rate of 0.2% of GDP – a fraction of the savings rate in many other countries of similar means, particularly those in Asia.

Why do we fail to account for the future?

Most of us underestimate the time it will take to complete a future task. This planning fallacy is at work when that little weekend kitchen repair job turns into a month-long saga and it gets worse with more complex tasks. In terms of your financial life few tasks are as complex, or challenging, as saving for retirement.

Many of us will set aside our 40s and 50s as time enough to save for retirement, while living the good life in our 20s and 30s, when the sober truth is that there is no time to waste. We convince ourselves that we will save more of our income later in life to catch up on the years of not saving, but that invites a similar cognitive trap: excessive optimism about the future. It also fails to take into account that time allows our money to grow exponentially thanks to the power of compounding.

A practical thought experiment to illustrate just how little time we have to save is to think about the long term as a very short period of time.

Consider your lifetime as 31 days

Imagine for a moment that your life began on 1 July and ended on the 31st – say, 80 years of a life shrunk down to 31 days. What would your savings picture look like then?

In this scenario, you will typically start your first job promptly at 4:30pm on 10 July at the age of 25, after growing up and completing your education. If you are smart you will start saving as soon as your first pay cheque slides into your bank account 47 minutes later: a month in real-time.

But most of us choose to dally. Instead of starting to save at 25 – we wait until 30 (12 July at 3pm), 40 (16 July at midday) or even 50 (20 July at 9am).

It may seem like there is still plenty of time in this hypothetical lifetime – but remember that although we think of 65 as our normal retirement age, employment often ends at 60. So when 24 July rolls around and the steady stream of employment income dries up, the situation begins to look dire; much like when your salary runs out well before the next payday.

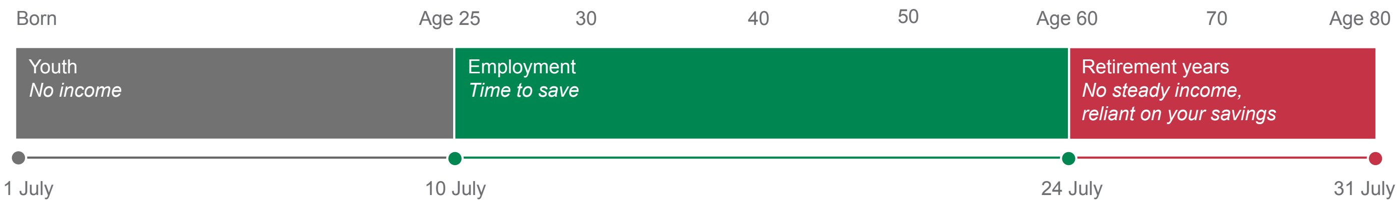
The 13 days of work from the 10th to the 24th make up your entire working life and the only opportunity you will have to accumulate enough savings to last you the rest of your life (i.e. a month in this hypothetical scenario). You only have 13 days to pay for the last seven days (retirement) if you start saving at 25. If you start at 30, you have only have 11 days to save for retirement. At 40 – seven days to save. At 50 – only three days!

The present is a gift

The point of this exercise is to highlight the urgency of the need to save and not delay. Time is an irreplaceable asset that can never be recovered and it allows your money to grow. Starting early and saving consistently in a long-term investment, like a balanced unit trust, will help a lot to create the wealth you need to sustain your lifestyle in retirement.

So the next time you are faced with the decision between waiting or taking action now, think of your lifetime as just one month and remember: the clock is always ticking.

Image 1 | Your life over a month



Source: Allan Gray

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