INTUITION

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Protecting your income from inflation

Last week, we presented to residents at a local retirement village. Instead of choosing the topic ourselves, we asked them in advance which investment questions mattered most. Their responses centred on one concern: how can I protect my investment income from inflation? This was ideal for us, as it gave me the opportunity to revisit our investment philosophy and approach. In an increasingly unpredictable world, where uncertainty is driving greater volatility, this article offers a timely - and timeless - reminder of what matters most for a financially secure retirement.

Michael Porter

The starting point for any analysis about retirement funding must begin with an understanding of inflation, and the impact that it will have on your costs and income. We call inflation the silent killer. It is always there, and failure to acknowledge its destructive power is probably the most fatal mistake anyone can make. Furthermore, any conversation about inflation invariably carries the same response – something along the following lines: "I don't believe you. Headline inflation might be 4%, but I can tell you that inflation is much higher than that. Just ask my wife after she has visited the supermarket." Investors acknowledge the presence of inflation yet fail to extrapolate that into their financial planning.

SPEED READ

- **Retirement can span twenty-five years, or more. That is a long time to fund an income.**
- **Inflation is the silent killer – and personal inflation usually runs ahead of Headline CPI thanks to higher inflation rates for food, administered items and medical expenses.**
- **Being too conservative carries its own risk. Our analysis confirms that cash is a non-starter for long term investments.**
- **Investors watch the balance sheet- what am I worth – when the income statement is what pays the bills.**
- **It is absolutely imperative that your income grows over time. This trumps all other considerations.**
- **Your level of drawing and annual increase greatly influence how long your capital will last. Financial discipline is still required in retirement.**

In addition, let me remind you of the cost cycle throughout retirement. Once retired, costs can escalate as you enjoy more leisure time. But those costs moderate as the years pass and you enter a more sedentary phase. Unfortunately, thereafter, costs can rise rapidly, driven by medical and frail care, as old age takes hold. That is what makes retirement planning so difficult. None of us know our own longevity, and neither do we know the condition of our health as we get older. Misjudging both can be financially fatal.

Over the past fifteen years, headline inflation has averaged 4.9% per annum. However, a deeper analysis shows that food inflation has averaged 6.1% p.a., administered prices (electricity, water, rates etc) averaged 7.0% p.a., and medical averaged 8.4% p.a. Clients are therefore quite justified to complain that their inflation rate is higher than Headline CPI because those three categories that I have singled out account for a far larger proportion of spending in retirement than for a working person. In a nutshell, inflation is relentless. Compounding the problem is the fact that inflation rates in retirement can be even higher due to the composition of your spending. Ouch!

To illustrate the behaviour of asset classes over time, I have compared the income generated from R1 million invested in a high-yield call account, the R186 government bond, Vukile Property Fund, or Bidvest. These represent the four major asset classes - cash, bonds, property and equity respectively. I have further assumed that an investor retired in December 2009 at the age of 65 (so he started to invest in January 2010 and is now 81 years of age), wanted an income draw equivalent to 5% of his capital, and also required that his income grow by inflation every year. Not an unreasonable request. We are faced with similar scenarios every day.

There is insufficient space to show the analysis for each asset class, so I have summarised the results in the table below.

	Cash	Bonds	Property	Equity
Represented by	High-yield call account earning repo rate	R186 Bond (issued in 1998, coupon of 10.5%, matures in 2026)	92,593 shares (R1m worth) in Vukile Property Fund	10,417 shares (R1m worth) in Bidvest (later split into both Bidvest and Bidcorp)
Income type	Interest	Interest	Distributions	Dividends
Income Frequency	Monthly	Payable twice a year	Payable twice a year	Payable twice a year
Starting monthly income in Jan 2010	R5,833	R8,750	R7,465	R3,699
Current monthly income	R5,833	R9,005	R13,311	R21,442
Total income earned since 2010	R1,010,000	R1,763,497	R2,037,089	R1,976,449
Capital value today	R1 million	R1.2 million	R2.3 million	R7.1 million
Capital	No growth	Modest growth	Growth	Growth
Income	No growth	No growth	Growth	Growth

To ensure that each asset class is treated fairly, where payments are made twice a year, I have assumed the investor will draw the income evenly over six months, but that he will earn interest on the positive balance in the intervening months.

What conclusions can we draw?

- Interest rates today are at exactly the same level as they were in January 2010 – 7.25%. Consequently, the amount of interest earned on a cash investment is identical to fifteen years ago, even though there have been fluctuations over the years.
- A bond investment would have yielded an annual interest rate of 10.5% (the coupon.) This would have generated significantly more total income than cash (R1.76 million vs R1.01 million) yet the income level today is virtually unchanged from 2010. The only reason why its slightly higher is because of the interest earned on the cash balance.
- Property, represented by Vukile, has generated the most income despite the harsh reset during Covid. Furthermore, the shares have more than doubled in value, from 1080c in December 2009 to 2400c today.
- An equity investment (represented by Bidvest) started with the lowest level of income but has delivered the best growth. It is now generating significantly more income than the other options, and the capital value has grown to reflect the higher income earned.

Having understood the behaviour of each asset class over the past sixteen years, let us now return to our retired investor. His requirement was for an income draw equivalent to 5% of his capital – i.e. R50,000 per annum or R4,167 per month. Furthermore, he wanted an inflation-linked increase every year. That implies that his income requirement today would have grown to R9,008.

The table below assesses the performance of each asset class (taken from the analysis above) relative to our investor's income requirement of 5% with an annual inflationary increase. It is immediately clear that when inflation is introduced, assets with no income growth soon start to fall short of requirements.

	Cash	Bonds	Property	Equity	Portfolio
Income required in 2010	R4,167	R4,167	R4,167	R4,167	R4,167
Income required now	R9,008	R9,008	R9,008	R9,008	R9,008
Starting Income	R5,833	R8,750	R7,465	R3,699	R4,640
Current Income	R5,833	R9,005	R13,311	R21,442	R19,409
Total Income earned	R1,010,000	R1,763,497	R2,037,089	R1,976,449	R1,985,545
Monthly surplus / shortfall	-R3,175	-R3	R4,303	R12,434	R11,214
Cumult.surplus / shortfall	-R252,435	R501,062	R774,654	R714,015	R723,111

Again, we make the following observations:

1. Cash investments lose pace against inflation quickly. Furthermore, a cash investment has generated a cumulative R252,000 less income than our investor required. That implies he would have been forced to draw down on capital, a scenario that I have not factored into this analysis.
2. Due to the higher coupon, the bond investment has performed better but is now moving into negative

	Cash	Bonds	Property	Equity	Portfolio
Scenario 1 (CPI +3%)					
Monthly surplus / shortfall	-R8,308	-R5,136	R831	R7,300	R5,267
Cumult.surplus / shortfall	-R630,432	R123,065	R396,657	R336,017	R351,177
Scenario 2 (7% & CPI +3%)					
Monthly surplus / shortfall	-R13,965	-R10,793	-R6,487	R1,643	-R2,422
Cumult.surplus / shortfall	-R1,286,605	-R533,108	-R259,516	-R320,155	-R289,836

territory. The shortfall will grow with each passing month.

3. Property and equity have performed well and delivered substantial surplus income relative to requirements. We would argue that it is this surplus that funds the extras – holidays, new cars etc.
4. However, there is one small problem with equity. At the outset it produced less income than the investor required – R3,699 vs a requirement of R4,167. How do we overcome that? Simply by having a portfolio of investments that blend different asset classes together. The portfolio example in the last column blends 15% property with 85% equity. The combination generates sufficient income with good growth and a pleasing cumulative surplus.

The above is all well and good, but I want to return to the opening paragraphs of this article where I argued that retirees rarely face an inflation rate equal to Headline CPI. Rather, due to the changing composition of your spending, your inflation rate is much higher. Whilst the above analysis is thought-provoking, are we being realistic in our assumptions? To answer that question, we analysed two alternative scenarios:

1. A starting income of 5% of capital but escalating at CPI + 3% per annum.
2. A starting income of 7% of capital also escalating at CPI +3% per annum.

In the interests of space, I am not going to show the entire analysis, but rather just the summary for each scenario. As you might expect, a higher inflation rate decimates both the cash and bond investment as inflation far outstrips the income generated. Under the first scenario, property just keeps pace with inflation, and equity is the only asset class that comfortably beats it. Again, a portfolio of property and equity would deliver the required income, but due to the different inflation dynamics, the portfolio had to be adjusted to a 75% equity / 25% property combination to deliver the necessary result.

Finally, when the starting income is raised to 7% of capital rather than 5%, and that income is escalated at CPI + 3%, virtually no asset class was able to keep up. Equity barely broke even, but all asset classes produced a substantial cumulative shortfall, and no portfolio combination was able to deliver the required income. That should send shivers down every investor's spine.

Before I conclude, let me mull over a few final thoughts. This analysis spans the years from 2010 to 2026. Financial conditions have changed substantially over that period. Firstly, bonds are no longer issued with coupons of 10.5%. Coupons on bonds issued today range between 6% and 8.5% - substantially lower than what was used in this analysis. So, whilst bonds might look attractive, we would caution about extrapolating these results.

On the flipside, we have endured 12 years of sub 1% GDP growth, which has heavily impacted equity and property returns. As we have argued so many times in recent years, we see momentum improving in our economy, notwithstanding external events in the Middle East. Even a 2% GDP growth rate going forward would materially improve equity and property returns.

In conclusion, improved longevity requires a different approach to retirement funding: your capital must last as long as you do. Cash is clearly unsuitable for long-term investing because it does not protect against inflation. While its lack of capital volatility may appeal in the short term, it can become costly over time. The same applies to bonds. Furthermore, our analysis also highlights the danger of expecting too much from your investments – too high an income draw can be equally detrimental. Financial discipline is still required in retirement.

Our entire investment process is built around the core pillars discussed in this article, namely that:

1. Inflation risk is a far bigger risk than market risk.
2. Investments must produce income, and the income must grow over time,
3. Keep costs as reasonable as possible.

It is a simple philosophy, but one that has delivered, and continues to deliver, results over many years. Please reach out to us if you would like a copy of the full presentation.

Our next seminar will delve into the complicated world of AI and articulate how we have positioned portfolios to benefit from this fast-moving technology.”

Topic:	**Positioning your portfolio for AI**
Natal Midlands	
Date:	10th of September, 2026
Venue:	Christ Church Howick, 23 Mare Street, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	8th of September, 2026
Venue:	Rosebank Union Church, Cnr Winne Mandela Drive and St Andrews Road, Hurlingham
Time:	7am for 7.30am

Cape Town	
Date:	N/A
Venue:	J&J Belmont Square, Belmont Road, Rondebosch
Time:	7.30am
Venue:	Helderberg Village Lifestyle Estate, 63 Bakkerskloof Rd, Helderberg Village, Cape Town
Time:	5.30pm for 6pm

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