



INVESTMENTS

PLANNING FOR RETIREMENT: INFLATION'S PERMANENT FOOTPRINT

By PPS Investments.

Every adviser is familiar with sequence-of-returns risk. The danger of a market crash occurring in the first few years of a client's retirement is a foundational concept in wealth management. Advisers stress-test for it, some build cash buffers to mitigate it and manage client psychology around it.

However, sequence-of-inflation risk is frequently overlooked yet it has the same capacity to permanently derail a well-constructed financial plan. It refers to the danger of experiencing a spike in the cost of living during the early years of retirement. This has been particularly relevant over the past few years, with South African inflation peaking at nearly 8% in 2022 and concerns resurfacing as the Iran conflict drags on.

Unlike a market drawdown, where asset prices can recover, an inflation shock can permanently elevate the client's baseline cost of living. This forces higher capital withdrawals from the outset, irreversibly eroding the portfolio's compounding ability.

INFLATION'S ABILITY TO DISRUPT THE PLAN

To understand the severity of this risk, it is necessary to examine the mechanics of compounding in reverse. Prices rarely deflate and once the cost of goods and services rises, that new price level typically becomes the permanent floor.

Consider a practical example. A client retires with a portfolio of R10 000 000 and requires an initial income of R500 000 per year, equating to a 5% initial withdrawal rate. The financial plan assumes a steady long-term inflation rate of 5%.

If inflation behaves exactly as modelled, the client's income needs rise predictably. In year 1 the income required is R500 000. In year 2 it increases to R525 000. In year 3 it rises to R551 250 and in year 4 to R578 812.

Now introduce a sequence-of-inflation shock. Assume that global supply chain disruptions or currency depreciation cause inflation to spike to 10% for the first three years of retirement before settling back to 5% thereafter. In this scenario the income required in year 1 remains R500 000. In year 2 it jumps to R550 000. In year 3 it increases to R605 000 and in year 4 to R665 500.

By year 4 the client is forced to withdraw almost R87 000 more than the steady-inflation scenario dictates. Even if inflation moderates immediately thereafter, the client remains permanently anchored to this elevated R665 500 baseline.

With professional clients needing to plan for up to 40 years in retirement, it can translate into millions of rands in excess withdrawals. That capital is permanently removed from the market, losing its ability to generate future real returns, dividends and compound growth.

THE CONVERGENCE OF WITHDRAWALS, FEES AND PERFORMANCE

Sequence-of-inflation risk rarely occurs in isolation. It interacts aggressively with other portfolio pressures, creating a compounding cycle of stress for the retiree.

As the Rand amount required to maintain a lifestyle increases, the portfolio's withdrawal rate accelerates. If the initial R10 000 000 portfolio declines to R9 000 000 due to normal market volatility and the client now needs R665 500 to purchase the same basket of goods, the effective withdrawal rate rises to 7.4%. This level sits well outside sustainable bounds.

Platform and advice fees are typically charged as a percentage of assets under management. While these fees are a necessary component of professional wealth management, their relative impact increases as a portfolio shrinks. When inflation-adjusted withdrawals aggressively erode the capital base, the fee drag becomes mathematically heavier, requiring the underlying assets to work harder merely to preserve value.

During inflationary spikes central banks typically raise interest rates. This often depresses both bond prices and equity valuations. An early inflation shock can therefore coincide with a sequence-of-returns shock. The client is then forced to sell an increasing number of depreciated units to fund a rising cost of living, permanently locking in capital losses. In this environment a portfolio generating an 8% nominal return against 10% inflation delivers a -2% real return. The portfolio deteriorates despite nominal growth.

FUTURE-PROOFING THE PORTFOLIO

To protect clients from early inflation shocks, advisers require retirement portfolios that explicitly preserve purchasing power while managing drawdown risk over extended time horizons.

The PPS Retirement Income Solutions are deliberately structured to address these risks by targeting a sustainable withdrawal rate with a high probability of success for up to 40 years after all fees. The solutions aim to balance income certainty with long-term real growth, recognising that early inflation shocks can permanently impair capital if not managed effectively.

A meaningful allocation to growth assets remains non-negotiable. Cash and nominal bonds offer limited long-term inflation protection. By combining traditional growth assets with carefully selected hedge funds, the portfolios seek to improve diversification, dampen volatility and enhance real return potential. Assets with pricing power and differentiated return drivers support the preservation of purchasing power across varying inflation regimes.

Where appropriate, inflation-linked instruments are incorporated to provide explicit CPI hedging within the fixed income allocation. This approach enables part of the portfolio to maintain real value during unexpected inflation spikes, reducing pressure on growth assets during stressed periods.

Inflation is often underestimated because it acts quietly and cumulatively. By recognising that the timing of inflation matters as much as its long-term average, advisers can align with solutions designed to deliver resilient, long-term outcomes and support a lifetime of shared success for clients, regardless of the inflationary backdrop at retirement.

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