Association of Financial Advisers (Singapore)

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Poor market performance hits CPFIS-linked funds; should CPF members invest in them?

1) CPFIS-related funds performed poorly in 2018, according to Refinitiv. Would you recommend CPF contributors to divert money out of their ordinary and special accounts to invest in CPFIS-related funds? Why?

2) If you do not recommend CPF contributors to invest in CPFIS-related funds, would you recommend them to divert money out of their ordinary and special accounts to invest in FDs, bonds and treasury bills, shares and property funds under CPFIS? Why?

3) Or would it be better to just leave the monies in ordinary and special accounts as it is? Why?

From CPF's website:

"What is CPF?

The Central Provident Fund (CPF) is a comprehensive social security system that enables working Singapore Citizens and Permanent Residents to set aside funds for retirement. It also addresses healthcare, home ownership, family protection and asset enhancement.

How does the CPF system work?

Both employees and employers make monthly CPF contributions. These contributions go into three accounts:

Uses of CPF Savings	
Ordinary Account (OA)	For housing, insurance, investment and education.
Special Account (SA)	For old age and investment in retirement-related financial products.
MediSave Account (MA)	For hospitalisation expenses and approved medical insurance.
Retirement Account (RA)	On your 55th birthday, a fourth account, the Retirement Account (RA), is automatically created

Interest Rates*	
Ordinary Account (OA)	Currently up to 3.5% p.a.
Special Account (SA)	Currently up to 5% p.a.
MediSave Account (MA)	
Retirement Account (RA)	Currently up to 5% p.a.

* The above interest rates include 1% p.a. extra interest on the first $60,000 of combined CPF balances, with up to $20,000 from the OA. From January 2016, those aged 55 and above also earn 1% p.a. additional extra interest on the first $30,000 of combined balances, with up to $20,000 from the OA, thus earning up to 6% p.a. on their retirement balances."

The funds in CPF are meant to be used for Singaporeans and PRs' retirement. The use has been expended to cover Housing, Medicals expenses and Investment and Insurance responding to the needs of CPF members. Given that most CPF members OA and SA accounts have more than $20,000 and $30,000 respectively, we can safely assume the interest rate to be 2.5% for OA and 4% for SA.

Firstly, let me address question 1 that CPFIS funds performed poorly in 2018. It is a fact that all asset classes performed poorly in 2018 therefore I feel it is unfair to only point out CPFIS funds as the under-performer.

I will take Question 2 and 3 together.

Knowing that CPF funds are meant for retirement, we can safely look at long time investment horizon and compared the returns of Fixed Deposit, bonds, Treasury bills, shares, and property funds. The returns for these asset classes should be bench marked against the average allocation. I assumed that the population distribution is even and that CPF members retires at age 65. This benchmark figures comes out to be 3.305% as per attached table.

Age of employee	Allocation for OA	Allocation for SA	Allocation for Medisave	Total Contribution	Total of CPF SA and OA	Benchmark Return
Up to 35 years old	23%	6%	8%	37%	14%	3.068%
35 to 45 years old	21%	7%	9%	37%	16%	3.149%
45 to 50 years old	19%	8%	10%	37%	18%	3.230%
50 to 55 years old	15%	11.50%	10.50%	37%	22%	3.392%
55 to 60 years old	12%	3.50%	10.50%	26%	14%	3.308%
60 to 65 years old	3.50%	2.50%	10.50%	17%	13%	3.682%
					Average	3.305%

Now that we have a benchmark of 3.305% to measure against, let us look at the returns of the other asset classes that you have mentioned namely "FDs, bonds and treasury bills, shares and property funds under CPFIS".

Fixed deposits yield can be assumed at 1% p.a. and bonds that are investable under CPFIS would probably be Investment Grade that pays around 3% p.a. YTM, 30 Years Singapore Government Bond yield about 2.5%, STI annualised returns over 10 years was 9.2% p.a. and Singapore REITS yielded about 8% p.a. on average.

Now let us look at how the other assets classes have done. As UTs represent a diversified investment under professional management and CPF funds are meant for retirement indicating long investment horizon, we can look at the asset class returns and volatility in 25 years.

You can see that in general, as returns increases, volatility follows, and that long-time horizon helps to smooth out the volatility of risky asset classes. However, the real power comes when you look at your investment from a portfolio perspective. Although the returns of 9.2% from STI and 8% from REITs seems attractive, you are taking significantly high risk when your portfolio is concentrated in a small basket of stocks and REITS. Getting into a portfolio using funds under CPFIS with a good balance of stocks and bonds will significantly reduce risk and improve the risk/return profile for the general investors.

In conclusion, we should not look at just one year of poor performance and write off the long-term benefits of portfolio investing using CPFIS funds. Remember it is time in the market and not timing the market. A disciplined approach in Dollar-Cost -Averaging will work very well. As the CPF funds are essentially ties up (other than for housing and Medical Expense), we should use it to our advantage and let the power of compounding do its work for us in growing our wealth. As Einstein once said: "Compound interest is the eighth wonder of the world. He who understands it, earns it. He who doesn't, pays it."