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

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Given the poor performance of funds under the Central Provident Fund Investment Scheme in 2018, CPF members may be deterred from investing their CPF savings in CPFIS-included funds. According to data from Refinitiv, the 85 unit trusts (UTs) and 156 investment-linked policies (ILPs) under CPFIS posted an average negative return of 9% and 7.27% respectively. Overall, the CPFIS-included funds recorded an average negative return of 7.91% during the year. By contrast, CPF ordinary account (OA) and special account (SA) balances earn 2.5% and 4% a year.

The weak performance of CPFIS-included funds, however, was not that different from that of two of the three key benchmark indices during the year. The MSCI World Index and MSCI AC Asia ex-Japan Index plunged 6.38% and 12.41% respectively, though the FTSE World Government Bond Index rose 1.13%.

Still, the 2018 performance of the CPFIS-included funds was by far the worst in the last six years, according to Refinitiv, which is a 55:45 joint venture between Blackstone Group and Thomson Reuters that specialises in financial data. Their best performance was in 2017, when the average return was 15.82%.

Refinitiv notes that the weak performance of CPFIS-included funds was particularly apparent in the last quarter of 2018. UTs and ILPs averaged a negative return of 8.74% and 6.69% respectively, leading to an overall negative return of 7.45%. In comparison, the MSCI World Index and MSCI AC Asia ex Japan Index plummeted 13.52% and 8.83% respectively, while the FTSE World Government Bond Index rose 1.5%.

Xav Feng, head of Asia-Pacific research at Refinitiv, says market fluctuations in 4Q2018 led to the plunge in most equity markets around the world. This was despite the US Federal Reserve’s conviction of the strength of the US economy and its readiness to alter the current run-off of its balance sheet. At the same time, the US and China were trying to resolve their trade differences by signing a temporary truce that ended on March 1 without a deal — so

far. “Investors should continue watching out for further progress and potential market volatility,” Feng says.

The poor performance of the CPFIS included funds in 2018 may hasten the trend of decreasing popularity of the scheme. According to CPF’s annual reports, the number of CPF members who have invested their CPF savings from OA into CPFIS increased by 3.7% from 896,275 in 2012 to 929,714 in 2017. However, the total amount invested dropped by 22.1% from $22.24 billion to $17.32 billion over the same period.

On the other hand, the number of CPF members who have invested their CPF savings from SA into CPFIS has dropped 26.5% from 440,829 in 2012 to 324,032 in 2017. In tandem, the amount invested has dropped by 18.1% from $6.17 billion in 2012 to $5.05 billion in 2017. CPF did not directly answer queries from on the reasons for the decreasing popularity of the scheme, except to say: “The CPFIS is a voluntary scheme for members who have the knowledge and time to invest, and are prepared to take investment risks in expectation of getting higher returns than the risk-free CPF interest rates. Members make their own decisions on whether and how much they wish to invest under the CPFIS at any point in time depending on their investment objective, risk tolerance level and other factors.”
So, should CPF members take the risk of investing their CPF savings in CPFIS included funds? Or should they play it safe by earning interest on their CPF savings?

‘Time in the market’
Under CPF’s rules, members who meet the criteria are allowed to invest their OA and SA savings in CPFIS-related investments to enhance their retirement nest egg. They must be at least 18 years old and not an undischarged bankrupt. They must also have more than $20,000 in their OA and/or more than $40,000 in their SA.

The list of investment options allowed under CPFIS includes stocks, bonds, fixed deposits and gold products. The list also includes funds, such as exchange-traded funds, UTs and ILPs that are managed by local and international fund management firms. The UTs and ILPs invest mainly in equities and bonds across various market-cap sizes, geographies, strategies and themes. Many of the CPFIS-included funds are classified as “higher risk” by CPF.

Financial advisers who spoke to say that CPF members, in general, should continue investing in CPFIS-included funds because these are long-term investments. “CPF contributors should still continue to divert money out of their ordinary and special accounts to invest in CPFIS-included funds. In fact, I would recommend that one starts investing early [to] harness the power of compounding,” says Kelvin Loo, research & standard manager at Synergy Financial Advisers.

Wong Kwek Yong, director and head of wealth management at PromiseLand Independent, agrees. “We should not look at just one year of poor performance and write off the long-term benefits of portfolio investing using CPFIS-included funds. Remember, it is time in the market and not timing the market,” he says.

Pros and cons

As Wong explains it, contributions made by CPF members over the years — on the assumption that one retires at 65 — would generate an average return of 3.305%. This is better than the yield returns of fixed deposits, Singapore government bonds and investment-grade bonds, which Wong estimates will generate 1%, 2.5% and 3% a year respectively. The 3.305% does, however, fall below the Straits Times Index's annualised returns over 10 years of 9.2% and the average yield of Singapore real estate investment trusts (REITs) of 8%.

Still, certain funds can generate even better returns. Using an illustration (see Chart 4), Wong says that if an investor had invested $10,000 in the BlackRock Global Allocation Fund (A) in March 1989, he would have returned more than a 10-bagger (an investment that increases in value by at least 10 times) in March 2015. In comparison, the FTSE World Index would have returned only slightly more than a six-bagger in the same period. Similarly, the FTSE World Government Bond Index would have returned more than a four-bagger. "You can see that, in general, as returns increase, volatility follows [but] that long time horizon actually helps to smoothen the volatility of risky asset classes," he says.

This is true of the performance of the CPFIS-included funds over a three-year period to 2018. According to Refinitiv, the UTs and ILPs registered an average return of 12.39% and 11.67% respectively. Overall, the CPFIS-included funds posted an average return of 11.94%. This compares to the MSCI World Index's 17.4%, MSCI AC Asia ex Japan's 23.99% and FTSE World Government Bond Index's 4.05%.

Besides that, funds provide the inherent advantage of diversification. "Although the returns of 9.2% from the STI and 8% from REITs seem attractive, you are taking significantly higher risk when your portfolio is concentrated in a small basket of stocks and REITs," Wong says. "Using funds under CPFIS, [which comes] with a [higher number] of stocks and bonds, will significantly reduce risk and improve the risk/return profile for investors."

That said, there are circumstances in which CPF members might be better off leaving their CPF savings untouched in their OA and SA. This is because investments in CPFIS-included funds carry risks and require a long investment horizon to ride out volatility. So, "if you are risk-averse and nearing retirement age, it may be better to keep your savings in CPF. The returns are risk-free and higher than the fixed deposit rate. Interest in SA is even more attractive," says Alfred Chia, CEO of SingCapital.

As Loo of Synergy Financial Capital points out, CPF members who are aged 55 and above will receive 6% interest a year on their retirement balance. This is because an additional interest of 1% a year will be paid on the first $30,000 of their combined balances in OA and SA. This is paid over and above an additional 1% interest that is earned on the first $60,000 of their combined balances in the two accounts, with up to $20,000 from the OA. Without this additional interest, CPF OA and SA earn interest of 2.5% and 4% a year.

This additional interest received on the OA balance will go into the CPF members' retirement account to enhance retirement savings. If these CPF members have participated in the CPF LIFE scheme, the extra interest will still be earned on the combined balances in

OA and SA, which include the savings used for the CPF LIFE scheme. “As such, it may make sense for them to reduce their portfolio risk and shift most of their CPF monies from CPFIS-included funds back to their CPF accounts for reliable potential returns as they enter retirement phase,” Loo says.

Ultimately, CPF members need to weigh the pros and cons themselves, says Chia. “Before embarking on any investment, [CPF] members should always ask whether the investment instrument’s return can beat the CPF OA and SA rates and evaluate the risks that come with it. In addition, [they need to assess whether] they have the necessary knowledge or [require the services of a] trusted, competent [financial] adviser,” he adds.