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In Praise of CPF Savings

One of the scariest things I see in my job is not plunging stock markets but investors who take big bets with their CPF savings. They could be investing their life savings in one or two funds, or in a motley collection of shares. These investors seem compelled to “do something” – anything rather than sit tight.

More unsettling still is when those investments are high-risk, like single-country funds, or technology stocks. The potential for losing their hard-earned retirement savings is breathtaking. But even the more stolid investor should think twice before investing their CPF savings.

Consider how CPF savings stack up against products from professional fund managers

	Sales charge	Annual mgmt fee	Capital protection?	Returns guaranteed?	Net annual returns*
CPF Account Ordinary	0%	0%	100%	Yes	2.5%
CPF Account Special	0%	0%	100%	Yes	4%
Typical guaranteed fund	0-5%	0.5-1.5%	100% after sales charges	No	2-5%
Typical global equity fund	2.5-5%	1.5%	None	No	10-12%

Comparison of CPF savings accounts and typical unit trusts

Source: dollarDEX

* Long-term, average returns after fees. CPF savings rates as of 24/4/02

Suddenly the attractiveness of CPF savings accounts comes into focus! So why do anything when you can get risk-free returns by leaving your money in a CPF account? Surely this is a victory for the conservative, who urge us to keep our money in fixed deposits and take no risk at all.

Not quite. In fact, it is entirely rational to invest your CPF savings, but only under certain conditions. William Mercer, the investment consultant to the CPF Board, did a useful study of this issue. They considered a CPF member who is aged 40, expecting to retire in 20 years time and has a CPF account balance of \$50,000.

In their analysis the hypothetical investor could do one of three things with his money:

- leave the money in his Ordinary Account rate
- transfer the money to his Special Account, or
- invest the full amount in a balanced fund with a medium to high risk profile, assumed to earn around 6.5% per year.

Mercer then simulated 1,500 possible outcomes of annual returns over the 20-year period. With this they were able to derive the probabilities that the investor would do *worse* with the balanced fund than by not investing (that is, earning the CPF interest rates).

Over a 20-year period the probability the balanced fund underperforms the two “do nothing” alternatives years is small – around 2% in the case of the Ordinary Account (OA) rate, and around 10% in the case of the Special Account (SA) rate.

Or in other words, you have a 98% chance of doing better than the current CPF OA savings rate by buying a balanced fund, and holding for 20 years. Hence, most investors would rightly conclude that the balanced fund is worth buying with their CPF savings, at least over a very long period.

But over short periods the conclusion is not so cut and dried. With SA savings you wouldn’t rationally invest for less than 10 years – below that and you have 20-35% of being worse off.

With OA, the cut off period is around 5 years. Yes, with OA you can invest in higher return instruments such as equity funds, which would shorten this time, yet it’s not advisable to start speculating with your CPF savings. Certainly no one should blindly invest their OA savings on a 12-24 month “bet” if they are relying on that money for retirement.

Of course, this simulation doesn’t consider the use of CPF savings for other purposes, such as house purchases or insurance coverage. But it is a salutary reminder of the generosity of the CPF Board to their members. In summary, here are my rules of thumb for those pondering how to invest their CPF savings.

	Investment Timeframe	Recommendation	Investment Timeframe	Recommendation
CPF Ordinary Account	Less than 3-5 years	Leave in CPF savings account	More than 3-5 years	Prudent mix of global equity funds
CPF Special Account	Less than 10 years	Leave in CPF savings account	More than 10 years	Balanced fund

Recommended strategy for CPFIS investments