

Investment principles: Match your priorities

All working South Africans need to save responsibly, whatever they're goals. On 23 January, we pointed out how much the country depends on the effectiveness of private-sector retirement arrangements. The next week, the transfer of risk from employers to fund members in the big switch from defined benefit (DB) to defined contribution (DC) was described. Last week, the flip side of this was argued, the imperative for working South Africans to take responsibility for their saving. But how? This week we start this journey by sketching the attributes of the key asset types available for the investment of accumulated saving. The key message: match your assets to your priorities.

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What are you saving for? Perhaps you are putting aside money for next year's school fees or for a deposit on a home. The first is a short-term commitment of known amount, the second perhaps a little further in the future. You may be saving for a trip away, or for a rainy day. You are probably also saving for your retirement, which could be just around the corner, or decades away. If there is one message in this article it is this: what you are saving for determines how you allocate your saving.

Key asset classes

Since the prices of most asset classes fluctuate, you must understand the risks of investing in them. You may need to sell at a lower price than you bought. You could even lose all your money. A brief scrutiny of the world's major exchanges will show how many of the early stalwarts have fallen by the wayside over the years.

For long-term investments, shares are important. These are also called equities. Share prices can be volatile it is true, but if you are in it for the long run, the exposure to economic growth in a competitive environment is critical for savings that grow with your salary, which is what pension savings should do. The theory suggests reward in the long run for the additional risk; the data bears this out. But shares are not appropriate for short-term saving, precisely because they fluctuate so much in value.

Bonds are next. These are debt instruments, issued by governments, cities, parastatals, companies and others. They typically pay interest once or twice a year and return the initial capital at the end of the term. But they are traded, which means that their price floats, so they are also risky. You wouldn't lend money to your government? Your concern is understandable, but a lot of investors do and have done for many years. Bonds are the income-producing anchors of most short- and medium-term portfolios and a big part of their long-term counterparts, like retirement funds.

Bonds are also available in short-term issues. Overnight loans and other short-term securities are often called money market funds. They are more stable than long-term bonds, typically paying interest at a lower rate, the price of reliability. Alternatively, you can save cash at the bank. Current accounts typically do not pay interest, but fixed and notice deposits can pay quite decent rates of interest on the condition that the money is untouched for a specified period, like until those school fees are due.

What about the exciting alternatives

Of course, you have options. You can buy property, either directly or through property shares. You can allocate some of your saving to gold, bitcoin or hedge funds. Except for your home though, these alternatives should be used to spread your risk, not for the core assets that you most depend on.

Do not be distracted by the hype. Do not buy the latest fad or chase yesterday's top performer. And if it sounds too good to be true, it nearly always is. You should trade as little as possible. Rather stay calm, make sound long-term decisions and stay the course. If you take risks, then do so with just a little of your available assets.

Do you have to buy your own share and bonds? You can, and it is much easier now than it used to be, but there are easier ways to save in the markets. You can buy unit trusts, which are portfolios of stocks, or index-trackers, that follow the market average. As always, watch the fees that you are paying. One or two percent a year looks tiny, but these deductions are eating away at your pension!

Finally, the key reason for this topic in the first place, your retirement saving. This pool of funds may be your key to survival when you are old. Take care of it. Read everything that you are given. Research your options. Build on the straightforward principles set out in this note. You do not need to be an expert, but a little homework may help to avoid serious errors.

How does this tie in with my priorities? If I am saving for a known short-term obligation, then I must keep it safe rather than chasing returns. A fixed deposit is good for this. At the other end of the spectrum, for retirement savings, a long-term, balanced, equity-rich approach is typically considered the best, but it depends on your needs and your plans. Next week: how to prepare your glide path to retirement.

Rob Rusconi