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NFB PRIVATE WEALTH MANAGEMENT

PROFICIO

NFB FINANCIAL UPDATE

View from the Chair

Since my previous message, much has changed both locally and globally. I have been wondering if these changes are equally relevant or if some are more significant than others.

As I reflect on our country, I recognise that we don't shape up well when we see our economy as a percentage of the global economy: we represent less than 1%, in fact! This is a sobering thought when we consider how important the economy, politics, social dynamics and other high-profile aspects of South Africa feel to us.

Dearth and Demand

What can be noted from data I include in this article is that, as a Developing Economy rich in minerals and other resources, we benefit materially from significant global demand, typically created by growth in the Developed Markets. There is also a close correlation between these periods of growth and strength in the Rand – and likewise, a strengthening of other Emerging Market resource-based economies and currencies.

It is typical - in times of slower economic activity or austerity - that countries and companies cut purchases to the minimum, sometimes even below safe levels.

Then the economy recovers, or a sector faces a predicament in which there is a shortage of supplies, and a dramatic surge in demand often takes place. This so-called “boom or bust” mentality can be found with alarming regularity in even sophisticated industries and economies.

The Japanese auto industry became the focus of many MBA class studies as a result of this industry applying a revolutionary strategy called JIT or Just in Time. It recommended that a motor 'manufacturer' (for example, Toyota), change its approach by outsourcing the manufacture of parts to others, whose contractual responsibility it was to deliver JIT whatever Toyota needed. This worked perfectly but introduced the risk that, should an extreme event take place (such as Fukushima or Covid-19), massive disruption results and supply chains could be severely stretched.

Currently, as an example, we are aware of the substantial shortage of microchips.

Covid has exacerbated this scarcity of resources and products. Shipping both on the water (few ships sailing) and in the dock (harbours without staff due to Covid) has been compromised. Getting stuff has become a mission in itself! This is particularly pertinent to bulky items like coal, iron and steel, timber and copper. Note the escalation in the prices of commodities listed in the tweet cited on page 3 and remember that this is what South Africa produces.

Add these factors together and then add the wall of liquidity, government assistance and the sluggish rollout of vaccinations, and we find ourselves in this place of uncertainty. Nobody can call the likely timeline. As the USA distributes big Bucks and China commits to a massive infrastructure spend, with others following, what seems likely is that the demand for resources and commodities will extend for quite some time.

Resilience in Resources and the Rand

Our resource companies, who have enjoyed a remarkable recovery of late, will continue to benefit; there are also several significantly positive side-effects to growing demand for resources.

Let's consider a few:

- SARS will be collecting through tax revenue, dividend taxes, VAT and personal tax revenues, not expected in recent estimates, in the context of improved employment conditions.
- Other businesses allied to mining and farming in South Africa will enjoy a material uptick in demand for their services and products.
- Secondary beneficiaries such as taxis, transport, tech, timber, engineering and countless others also benefit.
- Finally, and of material importance, our bigger financial institutions, including banks, asset managers and life assurers are in much better shape.

As noted above, these more positive periods need to be enjoyed and recognised, as they rationalise, for most of us, the sense in long-term investments which deliver real growth over time. This positivity hasn't been obvious to most South Africans who have had a torrid time on the JSE and in property (both private and commercial), with scant alternatives as cash rates have been on a steady decline!

Equally important is that the JSE, having delivered well post the Covid-led meltdown, is still offering good value. South Africa is by no means a lush Utopia, but it does have a habit of surprising us with its resilience and capacity to repair. Certain political developments seem to be shaping up.

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Mike Estment CFP®
Executive Chairman
NFB Private Wealth Management JHB

To RA or not to RA

Can you still invest successfully for retirement?

Recently the financial press has been encouraging investors to disinvest from retirement products and move funds offshore. In this article, you will read the risks and benefits of retirement products to establish whether the latter outweighs the potential risks highlighted by media commentators.

Two risk realities

1. ***Limited choice regarding asset allocation***
   - Retirement funds may not invest more than 30% offshore, according to Regulation 28.
   - Ironically, Regulation 28 was introduced to protect investors from losing money due to overexposure to offshore assets; but, since the regulation came into effect in 2011, offshore Investments have significantly outperformed local investments, as indicated here:

     JSE 181.31% or 11.21% per annum in Rand versus **MSCI World Index** 357.19% or 16.9% per annum in Rand
   - Talk about unintended consequences! More than anything, I think this kind of regulation shows that attempting to regulate human behaviour is often a mistake. The solution to poor investment decisions is not regulation, but education.

2. ***The Risk of Government intervention, especially in the form of prescribed assets***
   - The way is currently being paved for Government to require retirement funds to invest in specific assets by allowing fund managers to invest in infrastructure projects. This move may sound innocuous and, in its present form, very well may be. The fear is, however, that this requirement is just a small step away from compelling fund managers into investments that potentially could lose money for their clients, owing to the history of corruption within such projects.

Positive planning is essential

It would be unwise to diminish these fears - they are legitimate and could have severe consequences on retirement provisions. Nevertheless, there is no need to create a false dichotomy because, through holistic planning, investors can mitigate their risks and move funds offshore while not losing out on the benefits of Retirement Funds.

This planning is client-specific and is imperative for achieving positive long-term results. The risk is that investors will blindly follow the media's advice and will cash in retirement products (thereby incurring negative tax consequences) and move funds offshore. This trend will result in funds being placed into the market at near all-time highs at the tail end of the longest bull run in history. To achieve positive returns offshore, funds will need to be placed into Equity Markets as other assets in developed markets (Cash and Bonds) are yielding low or, in some cases, negative returns. The risk is that when these low-yielding markets recover as they inevitably will, investors will have sacrificed the benefits and followed the herd headlong into long-term capital losses.

The benefits of Retirement Funds are:

- Contributions are tax-deductible up to a maximum of the lesser of R350 000 or 27.5% of taxable income. This means that, if you are in the top tax bracket, you receive R0.45 deduction for every R1.00 invested.
- No tax is levied on Interest, Capital Growth, or Dividends.
- No Estate Duty is levied at death.
- No Executors Fees are levied at death.

Courtesy of Ninety One Asset Management, the below example illustrates the significant outperformance these compounding benefits create over time. The following scenario is based on the performance of Ninety One Opportunity Fund A:

> For a term of 15 years ending 31 December 2020, R10 000 per month is invested in a Retirement Annuity (RA) while R5 500 per month (R10 000 – 45% Tax Saving) is portioned to a discretionary investment with both investments escalating at 5% per annum. Furthermore, we consider the following assumptions:
>
> - The R10 000 RA contribution is within the investor's allowable deduction for retirement fund contributions.
> - 20% of the fund's generated return is of an income nature.
> - The previously mentioned is taxed at 45% for the discretionary investment .
> - The investor's annual interest exemption has already been maximised and is not available in this case .
> - There are no fund disposals.
>
> At the end of the 15-year term, the RA and the Discretionary Investment would be worth R4 867 324 and R2 541 623, respectively. Evidently, the investment increased by R2 325 701 or 91% over the term. This increase is attributable to the effect of compounding growth on the additional capital which awards the investor greater returns, the longer the investment horizon.
>
> It can be argued that had it not been for the restrictions of Regulation 28, investors could have 100% of the fund asset allocation offshore. We can also argue that the investor could have invested 100% offshore had it not been for the Regulation 28 restrictions. Although typically the MSCI World Index significantly

outperforms the JSE on a pre-deduction basis, once the tax deductions have been factored in, the perspective of performance is widely different. In accordance with the above figures and assumptions, if, alternatively, 100% of the funds were to be invested offshore, the RA and discretionary values would be R2 200 604 and R1 875 923, respectively. This translates into a R324 681 or a 17% increase in the investment over the 15-year term. Evidently, the comparatives speak for themselves.
It is important to remember that business markets exhibit cyclical trends and although offshore investments have outperformed South Africa's local investments over the past ten years, the opposite is true for the previous decade. From 2000 to 2010, the JSE All Share Index delivered growth margins of 18.2%pa while the MSCI World Index delivered -0.9%pa in Rands. Admittedly, South Africa has its problems, but so does the rest of the world and the JSE may very well outperform the MSCI yet again.

This scenario, however, illustrates only half of the picture. We need to be aware of post-retirement tax implications or those arising from the fund's conversion to a living annuity. If this were the full picture you would still be better off due to the enhanced capital value of no tax being paid on interest, dividends, and capital growth. The investor still receives the same tax and estate planning benefits as noted earlier; however, they are required to withdraw a fully taxable income.

I often hear the argument that this simply means that whatever you received as a deduction *on the way in* is now paid as income tax on the way out. However, if you have done your financial planning carefully, you will delay or limit the withdrawal from the RA and utilise your discretionary investments held in Tax Free Savings Accounts (TFSA) and Endowments, taxed at 30%. Sound financial planning will ensure that your income withdrawals from the living annuity are taxed at a rate substantially lower than the tax deduction received on investing.

Therefore, I recommend that instead of a generic push to encourage investors to withdraw their retirement funds and transfer them offshore, investors should undergo a *comprehensive financial planning* exercise that takes their specific requirements into account. This plan will collectively utilise all available options including geographic and tactical asset allocation while also employing available tax structures to maximise long-term returns. ■

> ***The solution to poor investment decisions is not regulation, but education.***

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View from the **Chair**

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If we are honest, we will acknowledge that most of us doubted that the political will existed for these developments to be followed through. It is still far too early to tell, but the winds of change are blowing. Should this become significantly positive, the attitude of key Ratings Agencies, and the commitment of local and importantly global investors can add to the positive backdrop.

Charlie Bilello @charliebilello
Global Inflation rates...

Global Inflation Rates

Country	CPI Inflation (YoY %)
JAPAN	-0.2%
SWITZERLAND	0.3%
HONG KONG	0.5%
PORTUGAL	0.6%
UK	0.7%
CHINA	0.9%
IRELAND	1.1%
ITALY	1.1%
AUSTRALIA	1.1%
FRANCE	1.2%
SINGAPORE	1.3%
FINLAND	1.3%
INDONESIA	1.4%
NEW ZEALAND	1.5%
GERMANY	2.0%
CANADA	2.2%
SPAIN	2.2%
SWEDEN	2.2%
SOUTH KOREA	2.3%
SOUTH AFRICA	3.2%
US	4.2%
INDIA	4.3%
POLAND	4.3%
PHILIPPINES	4.5%
SAUDI ARABIA	4.9%
RUSSIA	5.5%
MEXICO	6.1%
BRAZIL	6.8%
TURKEY	17.1%
ARGENTINA	42.6%
VENEZUELA	3012%

Just before you think I'm not thinking clearly, there is always the other side of the coin to consider. Firstly, trends do end - sometimes without warning and viciously. My favourite is the Rand. Do we think diversifying remains a good idea? Sure! Diversifying both across markets and countries will always make sense. Do you take funds out now? Yes. Remember the Rand was over R19/1$ last year March! You can see this story reflected in the below graph.

Charlie Bilello @charliebilello
Commodity prices over last year...
Lumber: +104%
Natural Gas: +98%
WTI Crude: +81%
Heating Oil: +78%
Brent Crude +76%
Gasoline: +75%
Corn: +65%
Copper: +63%
Coffee: +57%
Soybeans: +49%
Cotton: +46%
Silver: +45%
Sugar: +43%
Wheat: +35%
Palladium: +35%
Platinum: +28%
Gold: +0.1%

In conclusion, we at NFB wish you all a safe and secure time as we continue to negotiate these extraordinary times. Thank you for your custom, thank you for "staying the chase" and please contact us for any advice or assistance required. We are still able to lock in tax-efficient income where needed at levels far superior to call funds (after tax). Reach out to your advisor to discuss this opportunity should you be requiring more tax-efficient income in your portfolio. ■

Rand/Dollar Exchange rate

What to consider a year **before retiring as a member of the GEPF**

Even if your retirement seems some time away, you can greatly benefit your financial security in retirement by knowing whether to retire or to resign from your Government Employees' Pension Fund. The decision is dependent on your individual needs and circumstances.

Retire or resign

By ***retiring*** from the GEPF, you receive a guaranteed income, through the GEPF. ***Resigning*** from the GEPF enables you to manage your own post-retirement capital and income.

One consideration is period of service at time of career retirement:

- Fewer than 10 years - receive a once-off lump sum (gratuity)
- More than 10 years – benefits consist in two parts:
  - i. a once-off lump sum (gratuity), and
  - ii. a monthly pension
- This article focuses on members with more than 10 years of service.

Considerations when choosing to retire or resign:

- Do you have a spouse? If so, do they have retirement funds or other sources of income?
- When you die, do you want to transfer the available funds from your retirement to your beneficiaries as a legacy?
- Do you have any other sources of income at retirement?
- Do you have any chronic illnesses?
- Do you prefer controlling your capital and income, or rather having a guaranteed income option with no control?

Although a retiring member is guaranteed to receive a pension until death, this may not be the best option depending on their circumstances.

Here are two scenarios to illustrate the different outcomes:

1. Tim, a widower and government-employee of 31 years; he owns properties providing him with a monthly rental income, and his other investments also provide him with income – these are potential legacies for his children. He wants his grandchildren to inherit from his retirement benefits.

   Tim may either:
   - ***retire*** within the GEPF where he will be entitled to take the gratuity lump sum and monthly pension which pays until his death; or
   - ***resign*** from the GEPF before the retirement date. On resignation, he can transfer the funds to an approved retirement fund. Thereafter, he can retire from the retirement fund, transfer the funds to a Living Annuity and nominate beneficiaries. With this option, the medical aid subsidy from his employer ceases.

   Tim might choose to resign, so as to leave a legacy of his retirement benefits to his grandchildren.

2. Busisiwe, who is diabetic, retires from the GEPF in a year, after 15 years' service. Her retired husband receives an income from his Living Annuity. They have no dependants.

   Busisiwe has the same options as Tim, but may opt to retire within the GEPF, to give her a lump sum gratuity portion and a guaranteed income until death. Since she is diabetic, retiring within the GEPF is favourable as her employer pays a portion of her monthly medical aid membership for the rest of her life, provided she has been a main member of her recognised medical aid scheme for the last 12 months without a break before retirement. If she dies within five years of her retirement, her dependants receive a calculated lump sum amount and her spouse receives a monthly pension (50% or 75% of what she was receiving) until he dies. If she dies five or more years after retirement, her spouse receives 50% or 75% of the pension she was receiving, depending on which percentage option she selected at retirement.

There is no superior choice: the decision depends on your financial objectives and circumstances. ■

Rudo Gombera
Financial Paraplanner
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Sources: FundNews_First_Edition_2017.pdf (gepf.co.za) Government Employees Pension Fund Member Guide