FIRST QUARTER | 2019

PWM CONNECT

WHERE WEALTH AND LIFESTYLE MEET

BUDGET BLUES AND THE ESKOM BOGEYMAN

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PRIVATEWEALTH MANAGEMENT | OLDMUTUAL

WHAT'S INSIDE

A WORD FROM RUDOLPH

I would like to start off by wishing you a very successful 2019.

The year started on a good note, with positive movements experienced in the markets in general, and we trust this will continue into the latter part of the year. The first quarter of 2019 saw a fast start to the year, with a lot of activities on the political landscape as we head to the polling stations during the second quarter. From an economic perspective, South Africa was well represented at the 2019 World Economic Forum, which happened at the end of January in Davos, and I am convinced we will see foreign investment happening as a result of the work done by the delegation representing SA. The State of the Nation Address by President Cyril Ramaphosa, which took place early in February, was uninterrupted and a fairly balanced address. By now you would have also seen some reporting and communications around the 2019 Budget Speech, delivered by Finance Minister Tito Mboweni. We've included an article by Izak Odendaal, Investment Strategist at Old Mutual Multi-Managers, in which he shares his views on the Budget Speech outcomes.

PWM ON A NEW JOURNEY

As part of our continuous efforts to become the financial planning partner of choice in South Africa, and to offer you a wide range of solutions across multiple solution providers, Private Wealth Management (PWM) is embarking on a new journey. The introduction of the proposed regulatory reform by the Financial Sector Conduct Authority (FSCA), known as the Retail Distribution Review (RDR), will significantly impact PWM.

The implementation of RDR will mean that in future PWM will no longer be able to function as an independent advice-led business within Old Mutual Limited, if it retains its current business structure.

PWM HAD TWO OPTIONS

- PWM could either become 'tied' to Old Mutual Limited (OML) and offer advice with implementation using only Old Mutual products, platforms, and solutions

OR

- Become a Registered Financial Adviser (RFA) firm, free of product supplier influence, and continue to offer advice with implementation using the solutions and investment platforms of a wide range of solution providers and companies.

After months of research, planning and engagement with stakeholders, it was agreed that an independent Registered Financial Advice company structure, within the Old Mutual Group, would be best suited for PWM's clients, financial planners and employees.

The new company structure will ensure that we achieve our end goal, which is to ensure that PWM continues to offer you world-class lifestyle financial planning, specialist advice, and bespoke solutions and choice from across the industry. We will keep you updated as we progress with the implementation of the new structure.

As always, we remain committed to helping you grow your wealth and achieve your financial goals.

Kind regards

RUDOLPH **VAN ECK**
Head of Private Wealth Management

BUDGET BLUES AND THE ESKOM BOGEYMAN

IZAK ODENDAAL
INVESTMENT STRATEGIST: OLD MUTUAL MULTI-MANAGERS

If it's February, it means Cape Town is hot, windy and dry. It also means there is a hive of activity around the Parliamentary precinct, as the annual State of the Nation Address (SONA) and Budget Speech take centre stage.

The SONA is the official opening of Parliament for the new year, and also an opportunity for the President to set out his agenda for the coming months. Usually, the SONA is full of pomp and circumstance on the red carpet outside, and mostly hot air and vague promises inside the National Assembly chamber.

This year's SONA struck a different note, with a strong focus on reviving the domestic economy, making it easier to do business and tackling corruption. Notably, there has been a shift in the extent to which the private sector is seen as the engine of growth, and the extent to which Government and business are talking to one another. A few days earlier, President Ramaphosa became the first sitting president to address the annual Mining Indaba. Of course, the most significant announcement in the SONA was that Eskom would be unbundled into three separate entities – distribution, transmission and generation. Together with planned cost reductions, it marks a first step on the long road to financial sustainability for the troubled utility. A failure to implement these reforms, described by President Ramaphosa as 'painful', risks crippling not only Eskom, but also the economy as a whole.

KUSILE AND MEDUPI, THE TERRIBLE TWINS

How did we get here? In simple terms, Eskom borrowed enormous amounts of money to fund the construction of two of the world's largest coal-fired power plants, Kusile and Medupi. With both being way over budget and years behind schedule (and apparently suffering from serious design flaws), Eskom has not been able to generate revenue to service that debt, with its total liabilities now at R475 billion. Corruption and mismanagement have also been a factor in its underperformance, but there is a deeper structural reality: Eskom's entire cost base is too high, particularly employee costs. Eskom's board has noted that the company is overstaffed by a third (the World Bank estimated that it is two-thirds overstaffed). Moreover, power utilities globally face what is known as the 'utility death spiral': technological advances increasingly allow consumers to 'defect' off the grid, meaning that costs have to be spread over a smaller customer base. The remaining customers face steep tariff increases to make up for lost revenue, and then have an even greater incentive to defect.

The week following SONA saw a return of load-shedding. Though the timing was probably a coincidence, it did highlight the absolute importance of sorting out Eskom's operational and financial problems, and meant that it would dominate the upcoming Budget Speech. However, years of overspending and disappointing tax revenues mean that Government's ability to support and fix Eskom is constrained.

THE BUDGET ELEMENTS

The annual Budget Speech essentially has four elements. Firstly, it sets out Government's spending plans for the next three years – not only the total planned amount, but also the mix of spending between different priorities. Secondly, it sets out how much revenue Government expects to raise over the three-year period, and from which sources, including the various types of direct and indirect taxes. Thirdly, the difference between spending and revenue is the budget balance. If it is in deficit, Government will have to borrow to make up the shortfall, and this borrowing adds to Government's total debt stock. Finally, it is an opportunity for the Finance Minister to set out any major economic policy initiatives.

Looking at these four elements in turn, the spending side saw additional commitments of R23 billion a year to help Eskom make interest payments on its massive debt. This will be funded by R50 billion in spending cuts over three years elsewhere, particularly trimming the bloated public sector wage bill through natural attrition and making allowance for early retirement.

On the revenue side, Government once again collected less tax revenue than it expected in

ECONOMIC & MARKET OVERVIEW

the fiscal year ending in March. For the last number of years, the weak economy has persistently delivered less revenue than anticipated. More recently, this has been compounded by operational problems at the SA Revenue Service. No major tax changes were announced to compensate for this though, with Government taking the view that taxpayers cannot be squeezed further. Hikes in the VAT rate last year and the personal income tax rate in 2015 did not deliver a revenue boost, and further increases in headline rates might be counterproductive. A more effective, and stealthy, way is to allow inflation to raise some more revenue by pushing taxpayers into higher tax brackets. Relief for this so-called fiscal drag was the lowest in 20 years, only R1.2 billon, while not increasing the medical tax credit will save Government R1 billion.

LARGER DEFICITS AND MORE DEBT

The combination of more spending commitments and a revenue shortfall means the budget deficit will remain stuck at more than 4% of GDP for the foreseeable future, despite promises over the years to reduce it. As a result, the government debt-to-GDP ratio will rise to 60% over the next few years. This number is not high in a global context, but the International Monetary Fund (IMF) has warned that emerging markets like South Africa should not have debt ratios above this as they are prone to shocks that require a fiscal cushion. The fact that Government has been unable to stabilise the debt ratio is the biggest risk to our credit rating.

The silver lining is that spending cuts in the unsustainable public sector wage bill and elsewhere mean the deficit is not ballooning and the growth in debt is gradual. If it weren't for Eskom, the deficit would have narrowed.

NOT AN ELECTIONEERING BUDGET

On the fourth element of the Budget, policy changes, there were a few encouraging steps. But perhaps more noticeable is what was not announced, There was no mention of prescribed assets or any other populist measures or pre-election giveaways. The planned reconfiguration of the electricity sector by unbundling Eskom and introducing more competition is positive. The emphasis on crowding in private sector money when it comes to infrastructure spending, and on working with the private sector in general, is very welcome, but words need to become action.

While the Budget will not hurt economic growth in the short term by maintaining reasonable growth in government spending and by ensuring that Eskom remains a going concern, it also does not contain anything that suggests economic growth will accelerate. Indeed, the Treasury's own forecasts are muted, pointing to growth of 1.5% in 2019, rising to only 2.1% in 2021.

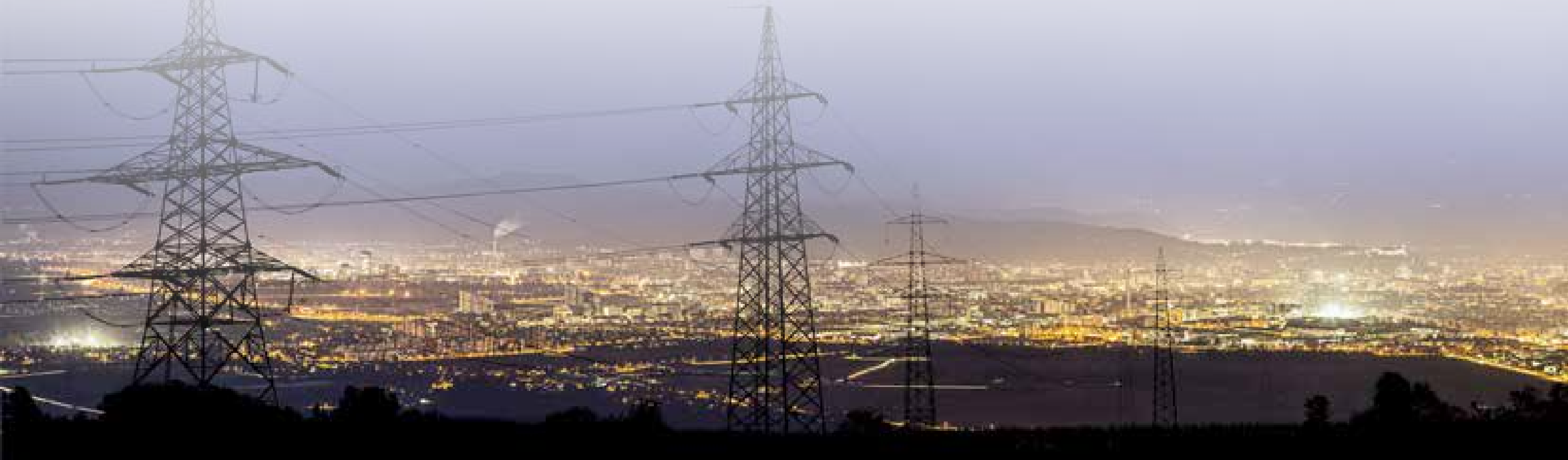
BAD NEWS PRICED IN

Only Moody's still maintains an investment grade rating for South African local currency bonds. If they were to downgrade us, it would mean exclusion from the FTSE World Government Bond Index (WGBI). Many investors fear that the subsequent capital outflows would result in a crippling collapse of the rand and surge in bond yields. It is highly unlikely though, since money tracking the WGBI only represents one source out of many when it comes to foreign buyers of our bonds. There are also domestic buyers. 2018 saw R70 billion in foreign net selling, and yet bond yields did not spike. Ultimately, markets price in real time and do not wait for a ratings agency to tell them what to do.

South Africa has long been priced as a junk status economy, and neither the SONA nor the Budget changed that. But the market's scepticism means that there is scope for an upward surprise if the elections go smoothly – which they should – and President Ramaphosa can push ahead with his project of economic and governance reform.

Finally, while the content of South Africa's budget might make for scary reading, the budgeting process is clear and sensible. We know what is there and what is not there. Indeed, it is routinely rated among the top countries globally in terms of transparency according to the Open Budget Index (only New Zealand scored better in the latest version). In contrast, for instance, the US has a rather dysfunctional way of drawing up and approving budgets. The federal government shut down for more than a month recently because the two chambers of Congress and the White House couldn't agree on the budget for the next fiscal year, with the sticking point being President Trump's pet project of a wall on the Mexican border.

Where the Americans have the edge is that borrowing costs in the US and Europe are historically low, and lower than national income growth. US nominal economic growth is around 5% and long-term borrowing costs only 3%. It makes sense for the US government (and even more so in Europe) to borrow to fund long-term investments that will pay for themselves, such as infrastructure upgrades. Unfortunately, instead, it used much of its fiscal space to fund tax cuts for corporations and wealthy individuals. South African nominal growth is 7% and long-term bond yields are 9%. The arithmetic is as brutal as it is simple. Hence, it is crucial to stabilise the debt levels. The best way to do this is to raise the economic growth rate by creating policy certainty and removing the barriers that constrain the strong entrepreneurial spirit of South Africans.



BEHAVIOURAL FINANCE

THE IMPORTANCE OF REVIEWING YOUR RETIREMENT PLAN SHOULD NOT BE OVERLOOKED

ALEC RIDDLE
FINANCIAL PLANNER PWM PORT ELIZABETH

As a financial planning professional I have found that I can add tremendous value when assisting clients with their retirement planning. However, the most value is added on the journey through retirement.

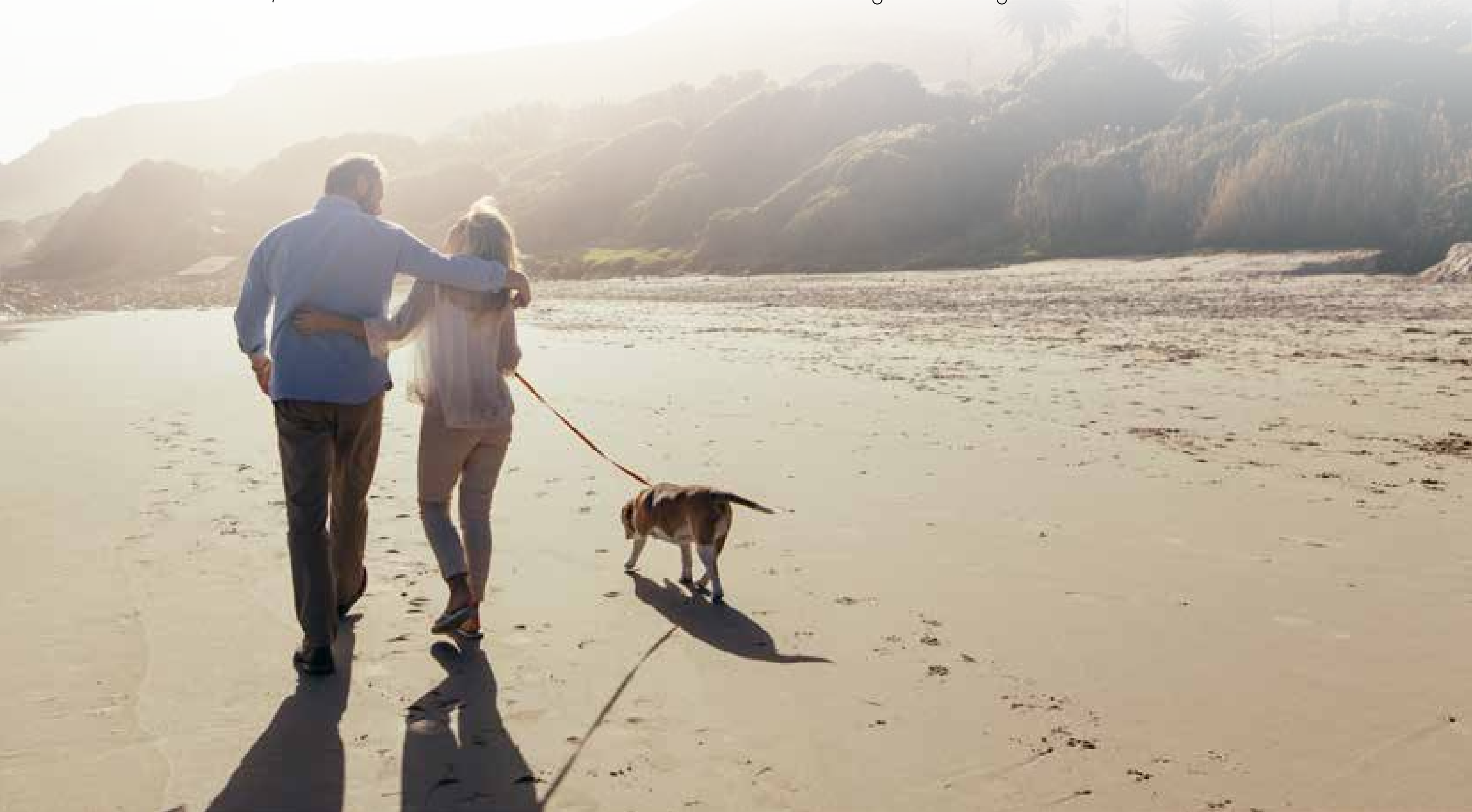
The reviewing of a retirement plan is the most important cog in the chain, so let me explain why. Each and every year there is a Budget Speech, which normally brings with it perceived threats and opportunities for our clients.

In using the retirement landscape as an example, I will illustrate the vast impact that legislative changes have had, which more often than not has created excellent planning opportunities for clients. These opportunities are not limited to those clients creating wealth for their retirement, but also for those clients in retirement (whether they are drawing a company pension or drawing from a living annuity, or have another source of income in retirement).

1. THERE IS NO LONGER AN UPPER AGE LIMIT ON RETIREMENT ANNUITIES

   In the past a retirement annuity had to be cashed in by the age of 70. Retirement annuities are very flexible and should be considered by retirees whose unique circumstances warrant it. The fact that there is no upper age limit means that clients can use a retirement annuity as an estate planning tool. Bear in mind that all allowable contributions and all growth within the retirement annuity remain outside of the estate and thus avoid estate duty.

   However, contributions made that were not allowed as a deduction or exemption at the date of death will constitute property in the estate for estate duty purposes. This was one of the primary reasons people used to set up a trust and we know how popular those were before legislation changed.



2. THE GROWTH WITHIN RETIREMENT FUNDS IS TAX FREE

While this has been the case for a few years now, we still find many people are unaware of this fact. There is no tax on any form of growth within the investment, which means no income tax on interest earned, no dividend withholding tax (DWT) and no capital gains tax (CGT) are levied in the investment before retirement.

This is a tremendous bonus and can negate, or considerably reduce, the impact of income tax being levied on income drawn after retirement.

(Note: If funds are invested in a unit trust or share portfolio, your investment is subject to DWT on dividends and possibly income tax on interest.) In addition, you may be liable for CGT on withdrawals.

3. YOU CAN REDUCE YOUR TAXABLE INCOME

If you contribute to a retirement annuity, your taxable income is reduced and if you have already paid income tax, you may well qualify for a sizeable tax rebate.

If you earned taxable income of R1 200 000 p.a. for the 2018/19 tax year, you will be paying 41% tax on every rand earned above R708 310 (amounting to an annual tax liability of R394 973.90) and you may well have paid the tax due in the form of PAYE.

You could contribute R330 000 (27.5% of taxable income/ remuneration to a maximum of R350 000) in a single contribution to a retirement annuity before the end of the tax year. This will reduce your taxable income to R870 000, resulting in an annual tax liability of R259 673.90.

In the example above, this will lead to a decrease of your tax liability in the amount of R135 300, which means the investment of R330 000 actually costs you R194 700, whilst the fund value is R330 000 plus any growth. That is equivalent to an effective boost of almost 70% on your investment if the tax savings are taken into account. It is possible to do this every year.

(Note: The annual cap of 27.5% of taxable income/remuneration limited to a maximum of R350 000 covers the total contributions to all pension, provident and retirement annuity funds. You can contribute more, but the annual tax relief is limited to these perimeters.)

4. RETIREMENT ANNUITIES CAN ALSO ACCOMMODATE LUMP SUM CONTRIBUTIONS

The beauty of this is that you always get some tax relief if you make a large lump sum contribution, either immediately or in the future. If you contribute more than your allowable tax relief on in any one year, the portion 'disallowed' as a deduction can be used in the future. In a sense one can get rollover relief each year while the large 'disallowed' portion is whittled down each year.

What is more, if you haven't had the benefit of tax relief on a portion in the build-up to retirement, you can draw that amount tax free as a lump sum at retirement, or as income in retirement.

(Note: Even though your immediate tax relief may be capped based upon the above limits, all of the growth on the large lump sum contribution is free of tax.)

5. THERE IS AN EXCEPTION TO THE 'ONE-THIRD RULE' WHEN CASHING IN YOUR RETIREMENT ANNUITY

The general rule is that, upon retirement, you would be allowed to take a maximum of one-third as a lump sum in cash and you would have to purchase a pension with the remaining two thirds. The exception to the rule is if the total value of your investments in any retirement annuity fund is less than R247 500. In this case you may take the full amount in such fund in cash on retirement.

This presents an amazing opportunity for clients who may have retired prior to a certain date, and a professional planner will be able to guide you on saving a considerable amount of tax. A client who retired prior to October 2007 and has not received any lump sums from retirement funds after this date, for example, could benefit by up to R225 000 in tax savings (accumulatively) by making use of the tax deduction for contributions, whilst still being able to commute the full fund value as a lump sum on retirement, if managed correctly. This example would apply to a client with a marginal tax rate of 45%.

(Note: It is important to seek professional advice with regard to all of the above and to note that this article is based upon current legislation.)

SUMMARY:

There are many opportunities arising from legislative changes and we are able to continuously add value by looking at the opportunities (and threats) and incorporating them into our client's retirement plans.

These opportunities and value-adds are not limited to the retirement landscape only.

NASPERS'S BALANCE SHEET REMAINS STRONG

PAUL STEVEN
PRIVATE CLIENT SECURITIES, OLD MUTUAL WEALTH

Media and internet giant Naspers posted strong results for the half-year to September 2018.

Trading profit rose by 34% to US$2bn as all classifieds businesses were profitable and ecommerce continues to improve. Acquisitions in the period totalled over US$700 million as Naspers said it continued to invest in existing and new businesses in classifieds, payments and food-delivery verticals.

The payments business is fast approaching profitability, particularly gaining scale in India. While Tencent continues to underpin growth, Naspers is becoming less reliant on Tencent's contribution. This is evidenced by the fact that the group's headline earnings rose 39%, outstripping the 24% growth generated by Tencent. In the interim period, Naspers announced its intention to list the video-entertainment business on the JSE as MultiChoice Group. The listing is expected to take place later this month. The net result of the listing of MultiChoice Group is that 100% of Naspers revenues and profits will come from online businesses.

Naspers's balance sheet remains strong, with healthy cash flows driven by Tencent's dividend and the proceeds of the Flipkart sale. Management reiterated that they are ready to take advantage of opportunities to acquire good businesses at good prices in the current market and economic climate.

THE HEALTH BENEFITS OF SKIPPING

IT'S AN INEXPENSIVE PIECE OF EXERCISE EQUIPMENT TO BUY, IS SO SMALL THAT YOU CAN TAKE IT WITH YOU ANYWHERE, AND BEST OF ALL, IT BURNS MORE CALORIES THAN YOU MIGHT THINK.

Here are a few of the health benefits of skipping:

Improves cardiovascular fitness. Your heart is a muscle and gets stronger with exercise. In general, exercise helps lower your blood pressure, which in turns helps lower your risk of cardiovascular disease.

Burns calories. According to the Mayo Clinic, a person weighing around 73kg can burn as many as 861 calories in an hour of skipping. That's more calories burned than running at an 8km per hour pace, doing stationary rowing, or doing high impact aerobics for the same amount of time.

Builds muscular strength. Skipping is an all-body workout, working the calves, quads, hamstrings, glutes, abdominals, forearms, and the deltoid muscles at the top of the shoulder.

Strengthens agility and hand-eye coordination. Skipping is a great exercise to do because it requires balance, core strength, cardiovascular fitness, coordination and timing.

Helps build strong bones. A study in the American Journal of Health Promotion monitored 60 participants jumping 10 times a day, twice a day. After a period of four months, they found that jumping provided greater bone-building benefits than running or jogging.

A FEW THINGS TO KEEP IN MIND

If you're new to skipping, here are a few tips:

Make sure you **maintain a good posture** while skipping. Tighten your core, keep your upper body stable, and keep your elbows close to the side of your body.

Start slowly and build up to a good pace. Start skipping slowly at a low intensity for periods of around 2-5 minutes before taking a break. If you can, to keep your heart rate up, jog on the spot slowly while taking your break. Gradually increase your skipping periods to 10-15 minutes as you get used to the activity and start to feel stronger. You can also play around with alternating minutes of low intensity with a few bouts at a higher intensity. If possible, try to skip three or four times a week.

Skipping is a high impact activity and can be quite tough on your knees if you overdo it or if you don't **wear the correct shoes.** Try to wear aerobic or cross-training shoes with support at the ball of your foot for maximum comfort.

Ensure that your skipping rope is the correct length for your height. Ideally, the handles of your skipping rope should reach your armpits.

If you're new to exercise or if you have a pre-existing health condition, speak to your doctor before starting a new exercise regime.

Source: www.healthinsite.net

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LIFESTYLE **EVENTS**

SA CHEESE FESTIVAL 2019 – STELLENBOSCH

Experience the popular South African Cheese Festival and discover the biggest variety of local and international cheeses, explore exciting taste combinations, and buy the finest local produce.

Dates: 26 - 28 April 2019
Time: Starts at 10:00
Venue: Sandringham Road, off R304, Stellenbosch Area

THE AUTUMN GARDEN SHOW – JOHANNESBURG

The Gardener and Die Tuinier magazines present the second year of The Autumn Garden Show. It is an opportunity to take part in a herb tour, walk through the spiral labyrinth garden, taste heirloom tomatoes and purchase plants, crafts and gardening equipment and accessories. (Tickets should be booked – www.webtickets.co.za)

Dates: 5 – 7 April 2019
Time: 09h00 to 17h00
Venue: The Herb Farm, 264 Summit Road, Blue Hills, Midrand, Johannesburg

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