PROFICIO

NFB FINANCIAL UPDATE

NFB PRIVATE WEALTH MANAGEMENT

FROM THE CEO's DESK

Reflecting on South Africa as a tiny component of what really goes on in the world, whilst recognising our passionate desire for it to be a safe place for us, our children and grandchildren to live, love and prosper safely, has had me pause and reflect on our reality.

We live in a place with several radically conflicted interests and factions. Most, if not all of the readers of this journal belong to a part of our nation who are educated, are employed or are reasonably wealthy and enjoy access to world class service and infrastructure. So many of the vital constituents in “World Class” exist in South Africa in abundance. From 'gees' in the Ayoba Nation, to resources, technology, world class infrastructure, the best logistics on the continent, great banks, financial markets, brilliant people who are recognised here, but even more abroad, and the list goes on. However, we seem trapped in a place where world class is frowned upon. We also find ourselves at a place where massive corporations, professional firms, notably major accounting firms, have been less than ethical and have cost investors, pension funds and pensioners and the country at large. The cost is more than just money. It is belief, and is hot on the heels of massive theft and corruption, previously the reserve of corrupt ministers and civil servants!

The big issue is that the globe has become remarkably small. Investors and funds will go where they see safe, predictable and stable markets. Not scared to take on market risk, they do shun markets and regimes who think that they alone can make the rules. These markets must protect the sovereignty of property, respect the rule of law, offer competitive returns and be prepared to understand the competition. Global flows favour only what suit their needs. Typically, these are real returns, technology and efficiency, stability of regulation and very quick and easy access to mobility of capital, particularly in volatile markets.

A few conversations that seem to be taking place rather regularly in good old SA include:

- Prescribed Assets being re-introduced.
- The excellence of companies like Discovery Health getting criticised for their dominance in a market where the State suggest NHI is the way to go.
- Expropriation of “property”.
- “Ramaphoria” becoming a fleeting memory. Perhaps even becoming Rama-pausia!

We need to take a look at these singularly and severally.

Prescribed assets refer to an environment where pensions and institutional funds are forced to invest a material proportion of available capital into Government and Parastatal bonds. This is typical of situations where funding from external sources dry up either due to country specific issues, or a so-called risk-off market where developed country money managers withdraw funds from emerging markets, favouring their home currencies and markets. This last happened in the apartheid era where South Africa was unable to raise funds from major countries and fund managers. I recall at its worst, pension funds (notably the Government Pension Fund or GEPF) and others being obliged to place up to 40% of reserves into these bonds. Clearly this serves to negatively impact flows into private companies, listed shares and global opportunities. This is likely to cap returns and endanger pensioners in years to come. It is also true that this isn't a sector avoided by investors. Currently, balanced funds might have an allocation of between 30-40% into non-equity investment, including cash, property and bonds. Also, in tough times, when markets are negative and volatile, bonds offer fairly predictable returns, notably in the form of income paid semi-annually.

Excellence being blamed for dominance. Recent media noted the Health Market Enquiry, led by former Chief Justice Ngcobo suggesting Discovery's dominance being unhealthy and suppressing competition. Why on earth is there no regard for their arguably world leading technology, efficiency and innovation? Perhaps the government would have Discovery stop innovating, training and developing talent, opening a new bank, etc. This sounds like telling someone to climb into a bucket and then pick it up! Perhaps it is similar to the Western Cape being run efficiently, clearly an embarrassment to opposition leaders in other centres and provinces where graft, mismanagement and corruption dominate the news.

Expropriation is a really worrisome idea. Whilst farmers think it's about farms, flat and home owners think it's about their homes - it is really much more. Property rights are enshrined in the

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Any strength in the Rand represents an opportunity to consider offshore alternatives, adding diversification to portfolios. This is not forecasting - it simply makes sense.

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DO NOT PUT ALL YOUR EGGS IN ONE BASKET

We have heard the idiom “Don't put all your eggs in one basket”. The meaning is simple: we should not make everything depend on one thing. This is very true for eggs and more relevant for our hard-earned cash. Our investments and financial well-being should not be concentrated into one area. Investments should be put into different investment baskets.

It is tempting to put substantial portions of our wealth into one investment type that we are convinced will yield good returns – but what if we are wrong? Without a crystal ball we could lose our entire investment. Spreading our hard earned cash into different investment baskets will help guard against a major loss. This principle is called diversification.

Diversification is a time-honed investment rule. Stories abound about people losing significant portions of their investments due to concentration in one area. Diversification also assists investors to avoid excessive correlation - the tendency of certain asset classes or investment baskets to move in tandem.

We invest to generate returns, but there is always an element of risk. Here is how we can reduce that risk by diversification:
1. Different asset classes
2. Different holdings within asset classes
3. Different jurisdictions

DIFFERENT ASSET CLASSES

An asset class is a collection of securities, manifesting comparable traits and which go through similar market fluctuations. There are four core classes of assets generally considered:
- Shares or equities
- Fixed income or bonds
- Money market or cash equivalents
- Real estate or property

The above asset classes differ in risk factors, taxation, return profile, liquidity, tenures and market volatility. Having all four asset classes represented in your financial portfolio is highly recommended, not only to prevent investment disaster, but also to take advantage of the different strengths of each class.

A basic understanding of the above various asset classes helps to build a well-diversified portfolio that will be positioned in such a manner so that the overall portfolio risk is reduced and the portfolio's performance is not heavily affected by the inferior performance of any single asset class.

DIFFERENT HOLDINGS WITHIN ASSET CLASSES

After spreading your investment funds between shares, bonds, cash and property, you need to diversify further within each of these classes. Therefore, you should choose a range of shares, a range of bonds with differing maturity dates, and different cash and property investments for your portfolio.

Let's say you have a portfolio of only mining stocks...if it is publicly announced that mine employees are going on an indefinite strike, and that all mines will be closed, the share prices of mining shares will drop. Your share portfolio will experience a noticeable drop in value.

If, however, you counterbalanced the mining industry shares with a couple of retail shares, only a part of your portfolio would be affected. In fact, there is a good chance that the retail share prices would climb, as investors consider retail a stable and a defensive share.

Diversification by industry is relevant also to fixed income and property. This may include balancing your fixed income allocation between corporate and government bonds, short and/or long duration bonds as well. Property allocation should include consideration of retail, commercial and residential space.

The considerations should not only be limited to balancing across different industry sectors, but also include volatility and risk inherent to the individual holdings. Appropriate allocation should be made between high risk and low risk or stable securities.

Higher risk companies may be defined by their share price volatility and can be profitable investments. However, depending on your risk profile, the high-risk proportion of your portfolio should be balanced with investments in companies that have the potential for slower, more stable growth and less risk of capital loss.

A good example of this is that, Blue Chip companies with little or no debt and steady revenue streams tend to be considered lower risk and more likely to pay regular dividends. Also, long duration bonds are considered to be higher in risk than short duration bonds.

DIFFERENT JURISDICTIONS

The other form of diversification that investors should consider is global diversification, which is diversifying one's portfolio into different countries and jurisdictions.

Some investors, instead of spreading the wealth around, put their money in places that are familiar - usually their own country. This a very well-known phenomenon called “home bias”. Allocating assets only to your home country is being short-sighted. This bias does not only expose the portfolio to geopolitical and currency risks, but also the opportunity cost of price trends that are often favorable in the global space.

It is rare to find any single domestic market that has consistently performed among the top global stock markets. It is nearly impossible to predict which market will be a top performer in any given year; it makes sense to hold a portfolio that's diversified across a number of countries. Moreover, the independent movement of global markets, which react to factors such as different domestic monetary and fiscal policy cycles, has historically provided considerable diversification benefits when held in combination with domestic instruments.

Global diversification will also give investor's access to industries and shares not available in domestic markets. Research has shown, albeit diminishing, there is a low correlation between countries. Given this lower correlation of returns across countries, it is reasonable to expect that international returns can be quite different from domestic returns and it is this low correlation that produces the large diversification benefit of investing internationally.

IN CONCLUSION

Diversification is not a magic bullet. Having a diversified portfolio doesn't mean you'll never lose money; there may be extreme and pervasive circumstances like the 2008-9 financial crisis. However, diversification will soften the blow of these extreme and pervasive circumstances. It also doesn't mean complete protection from short-term dips and does not guarantee that if one investment goes down another investment will go up - it is not a seesaw. However, diversification remains essential.

Investors should guard against diversifying their portfolios too much. For instance, the notion that the more asset classes you own - shares, bonds, cash of all sorts and property - the safer you are, does not hold true. Studies have shown that beyond a certain point, adding new asset classes doesn't help much.

The right mix of assets for you and your goals should be based on your risk tolerance, cash flow needs, investing experience and time horizon, among other factors. And you should revisit your allocation periodically, if there is a change in your circumstances or whenever your goals or objectives change.

Asset allocation and appropriate diversification requires a long-term view, and it shouldn't be unduly influenced by short-term considerations. This is an investment strategy for the long haul that requires patience and discipline.

Whether the market is bullish or bearish, maintaining a well-diversified portfolio is essential to any successful long-term investment strategy.

Should you require assistance in diversifying your portfolio please contact one of our Private Wealth Managers. ■

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FROM THE **CEO's** DESK

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Constitution. The ANC having replaced Zuma, inadvertently had the EFF left short of a call to action. They swiftly adopted EWC, forcing the governing party to respond. An undertaking was made to investigate the concept and as a result of a vacuum in clear communication, the public are left to draw their own conclusions.

Rama-phoria is real; we are genuinely in better hands, but the future remains fluid and our president and his team need to win an election, carefully managing the confusing landscape which is political SA. We forget the alternative, just a few votes away just six or so months back. Next year is likely to remain volatile with those darned short-sighted politicians making promises to rather naïve constituents, who will tick boxes and then recriminate in hindsight. In this respect South Africa is no different to dozens of other countries!

Will Cyril succeed? Is he the right guy? Will he get a clear mandate next election? When will the big shake-up come? Is there room for a ratings agency up or downgrade? Why hasn't a big slowdown or reversal of theft been reflected in the budget? How long does 10 years of grand theft take to reverse?
Loads of questions. Many varied answers. I suppose it depends on your interest or perhaps faction! Our country remains a special place. Full of potential, it never fails to come back from the brink.

A reminder that we suggested any strength in the Rand represents an opportunity to consider offshore alternatives, adding diversification to portfolios. This is not forecasting - it simply makes sense.

Since our last publication, NFB has been awarded a very special award. Awarded by Intellidex, we were recognized by our clients and institutional partners as the Wealth Management Boutique of the Year. I would like to thank our team around the country, the management and boards of the subsidiary businesses and that of the listed business. We are also supported by the country's leading product providers and many other service providers. I like to describe NFB as a Rolls Royce supplier. Importantly, you, our clients allow us to live up to our promise of delivering on the motor plan!

We are both proud, and thankful, and look forward to continuing the refinement of our service and advice to you. ■

FACTORS THAT **YOUNG PROFESSIONALS** SHOULD CONSIDER WHEN **CHANGING JOBS**

Young professionals in the job market continue to change jobs as they look for greener pastures and better income prospects. This might be linked to the millennial generation continuously seeking instant gratification. My younger brother in the IT industry entered the job market 3 years ago and has changed jobs 4 times already.

THINGS TO CONSIDER PRIOR TO MOVING TO A NEW JOB

You need to consult your financial advisor to assist you with the preservation of your Provident and/or Pension fund into a Preservation Fund. The funds are preserved for its original purpose of retirement savings. Your financial advisor will assist you with the completion of forms and facilitation of the transfer of the Pension and/or Provident fund into a Preservation fund that will suit your investment objectives. The transfer has no tax consequences, unless you wish to make a pre-retirement withdrawal. The tax on this withdrawal is calculated as follows:

TAXABLE INCOME FROM LUMP SUM BENEFIT	RATE OF TAX
R0 - R25,000	0%
R25.001 - R660,000	R0 plus 18% of amount over R25,000
R660,001 - R990,000	R114,300 plus 27% of amount over R660,000
R990,001 plus	R203,400 plus 36% of amount over R990,000

Pre and post retirement lump sump benefits are aggregated with effect from 1 March 2009

THINGS TO CONSIDER PRIOR TO STARTING A NEW JOB

Does the Company offer any of the following:

- Medical aid
- Pension and/or Provident Fund Benefits
- Risk Benefits – which includes Life cover (including spousal and/or child benefit), Disability Income protection and dreaded disease.

If the company doesn't offer the above benefits, it becomes the individual's responsibility to set up these benefits at their own cost with the consultation of your financial advisor. The advisor should do a complete Financial Needs Analysis (FNA) to determine your current financial position in the event of death, disability, dreaded disease and retirement. The following would be considered: current assets and liabilities; income and living expenses; and responsibility to dependants. The outcome of the FNA will determine the amounts that need to be saved for retirement and the appropriate cover that should be implemented. The FNA should be done on a regular basis as your circumstances change.

Medical aid – our medical aid consultants can offer advice on a range of medical aid schemes and gap cover products available in the market.

Pension and provident funds – the advisor can assist you to set up a range of retirement savings vehicles like a retirement annuity (RA) and Tax-Free Saving Account (TFSA).

RA - Contributions made to an RA are tax deductible to a maximum of 27.5% of the greater of taxable income or remuneration, but limited to R350,000 per annum. The fund selection must comply with the Regulation 28 of the Pension Fund Act.

TFSA – Contributions into the TFSA are limited to R33,000 per annum and R500,000 per life time. It doesn't have to comply with the regulation 28 compliance of the Pension Fund Act, therefore this can be used to increase ones foreign and equity exposure.

With both the RA and TFSA account you don't need the employer/employee relationship. The asset allocations of these portfolios will be set up according to your risk profile, market conditions and investment objectives.

Risk Benefits – The outcomes of the FNA will determine how much cover should be taken up. The continuation of group benefits from previous employers can be an option, should this option be available. Young professionals need to make sure that they protect their biggest asset in their working life which is their ability to generate an income and to protect themselves against adverse situations, like disability and dreaded disease. They will not be young forever and one day they will need to live off their savings to maintain their standards of living which is why retirement savings are so important. Continuous consultation with your financial advisor is of utmost importance, as and when your lifestyle changes. ■

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