Plexus Wealth

12 October 2020

Dear Valued Client

As the end of 2020 comes into focus, we still live in an uncertain world. When we look back at the original three week and then five week lockdowns, it seems a long time ago. It is unbelievable how long the lockdown endured, and that entire sectors of the economy remained closed for over four months. This has left our economy with significant challenges.

Interest rates have, for all intents and purposes, halved. This affects the valuations of stocks and bonds. The uncertainty has led to a level of hysteria, which has ebbed and flowed in South Africa over the decades. In recent weeks we have been encouraged by political anti-corruption action, while the opening of the economy starts reversing the negative trend.

RETIREMENT FUNDS AND STRATEGIES

This quarter's article summarises a view on the current discussion in the media regarding retirement funds, and possible strategies in reaction to this.

While the main principles are covered, it is not possible to include all the details. All cases have unique characteristics that should be analysed individually.

Going back in history, prior to 1988, prescribed assets meant pension funds had to invest a large portion of assets in government and Eskom / Transnet type bonds.

Recently, we have seen a fear of a return to such a policy or law, especially given the government's large budget deficit and high cost of servicing the debt. However, the ANC's proposals do not automatically become government policy. Government will need to consult with all stakeholders, including business, labour, community, government and ASISA, before amending Regulation 28. This is the law that governs what asset classes are allowed in pension funds, retirement annuities (RAs) and preservation funds (it does not apply to Living Annuities).

The ANC's document, "*Reconstruction, Growth and Transformation: Building a New Inclusive Economy*", outlines its vision for the post-COVID economy. The paper proposes amending Regulation 28 to allow (please note, not force) pension funds to invest directly in infrastructure assets and development finance institutions such as the Development Bank of South Africa (DBSA) and Industrial Development Corporation (IDC). This paper is not final and is still far from being government policy and law, however it is possible, and such investments might be attractive at the right risk / return ratio.

Retirement annuities (RA) and emigration

In addition, there are proposals to change the rules on what one can do with an RA on emigration. The proposals include that you need to be a non-tax resident for three years before you can take all your funds from an RA / preservation fund. Currently, you can cash in an RA or preservation fund if you emigrate through the South African Reserve Bank (SARB).

This change forms part of the combining of the principles of tax residence and the concept of 'financial emigration' through the SARB. Combining is positive, as it will remove much confusion and align with other countries. However, it also creates a risk that SA residents can declare themselves a non-tax resident, cash in all their retirement funds and then 'change their mind' shortly thereafter. They then return to SA, having accessed retirement funds for which a tax deduction had been allowed. We can thus see a reasonable thought process behind these proposals.

It is also sometimes expensive to cash in these funds on emigration, as you reach the 36% lump sum tax bracket for amounts over R1.05m. A figure of 36% is a very large hit to take on your capital when alternatives could be explored.

Once you have converted an RA into a Living Annuity, you can take up to 17.5% per annum. However, Regulation 28 no longer applies, so you could invest all the funds in offshore unit trusts. Your assets could thus be matched to your new place of ordinary residence, and your only remaining risk would be a rule that did not allow you to move the income from SA to your country of residence. This is unlikely to be an issue at the under R1m a year level. Clients who intend to use the investment allowance for amounts over R1m are advised not to assume this will be available forever.

TAX AND EXPATS

There is also confusion in the media about expats being taxed in SA if they do not 'financially emigrate.' If this applies to your family, please contact us. We have links to top tax consultants, as well as attorneys who can draft foreign wills, offshore life insurance policies that can replace local ones, and investment structures that can house investments moving offshore. If you genuinely live outside SA, have your home and family there, and you have a right to live there, it is unlikely that these rules will apply to you. Rather, they are aimed at people who live in SA but work offshore for limited stints.

The bottom line is that we can work around the various proposals, even if they do become law. We need to think carefully and have a plan. We can assist in an integrated and holistic manner, as we have been assisting many clients with emigration.

GOOD RUN EXPECTED

When the current extreme SA pessimism is over, we think the rand and stock market are going to have a very good run, like in the early 2000s. We are positioned for this and are not getting caught in the technology bubble that is developing on US markets.

At some point the US markets will be too expensive and the big funds will take profit and look for better value elsewhere. We therefore think there will be investment flows to the emerging markets from the large offshore funds.

Locally, funds have moved into government bonds yielding 11%, instead of property or equity (shares) for example. We think if offshore funds, looking for yield to enhance their -0.5% bond yields, move into SA bonds, it would push yields down (a very small portion of their fund is a large amount for our market). Investors will then move back into the equity and property market. All this will take some time to unwind, but there will be a big run in SA equities and property when it finally comes.

We have also consistently advised of the need to diversify offshore, but not to do this at any cost or exchange rate. When the time is right, we will advise you. We have spent time further refining our offshore offerings. The choice now caters for all needs, and we can advise on leading share portfolios, a range of top unit trusts, property portfolios, and structured products that come with capital guarantees while still maintaining exposure to the upside potential of the share market. We think it is important to include this final asset class in many of our client portfolios and your advisors will be talking to you about it.

CHANGES TO PLEXUS WEALTH FUNDS

We recently sent you an email detailing decisive action to implement changes to our Plexus Wealth Balanced and Conservative Fund. We are very positive about the change to Marriott and the prospects for returns going forward.

Our main challenge is that we need to give the portfolios and funds time to recover. For example, we expect significantly reduced dividends on banking and property company shares on average, as they retain profits to protect their businesses.

We need to continue to work together to forge plans to minimise the sale of investment units, a theme that has been a consistent base for our investment methodology.

Thank you for your continued support as we navigate through our uncertain world. Our team of advisors is available for your needs.

The Team at Plexus Wealth

BOOK A MEETING

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