BRENTHURST WEALTH MANAGEMENT

INVESTMENT REPORT

BRENTHURST
THE HOME OF WEALTH

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ACTIVELY PROTECTING YOUR RETIREMENT INCOME

Living Annuities

CAPE TOWN
INVESTMENT SEMINAR

DATE: WED 03 NOV 2011
TIME: 15H30 FOR 16H00
VENUE: STANLIB OFFICE
CENTURY BOULEVARD
CENTURY CITY

KEILLEN NDLOVU: STANLIB
- USING PROPERTY AS A SOURCE OF INCOME IN RETIREMENT

MAGNUS HEYSTEK: BRENTHURST
- ARE YOU RETIRING NEXT YEAR?

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Global
Markets
AND SA ECONOMY

Brian Butchart CFP® – Director & Senior Financial Planner, BWM

One of the consequences of retiring from pension, provident, preservation or retirement annuities is that investors will be responsible for investing their own retirement capital, which will hopefully generate an income for the rest of their lives.

This is especially true of investors who have a great deal of their capital tied up in a living annuity where the investment risk and reward is for the account of the investor. This is a daunting task at the best of times and even people who have had years of investment experience tend to get "paralysed" when it comes to managing their own money.

Added to this dilemma is the fact that investment markets have been extremely volatile in recent years. And to top it all one has to include into this concoction the human element – many studies all over the world have illustrated very convincingly that emotional reaction to short term movements in markets, often quite volatile and unpredictable, is one of the biggest reasons why investors fail in their long-term investment objectives. Interestingly, behavioural research has shown that investors react negatively four times worse when markets decline than they would react positively when markets rise.

Living annuities (as opposed to a traditional annuity where an income is purchased for life from a life assurer) has become very popular amongst South African investors in recent years, especially when the amount in question runs into the millions. As opposed to a traditional annuity, the key to a living annuity is the long-term management of the funds within that portfolio. The danger ironically, is that living annuities are not regulated by prudential guidelines. In essence, you can invest your post retirement capital from which your income will be generated into any asset class available to South African investors. This can include offshore investments as well as high risk investments such as specialised funds that invest in emerging companies or resources for example.

At Brenthurst Wealth we have come across many instances where investors have been trying to grow their capital (and hence their future income) as rapidly as possible by investing in high risk funds. In most cases these attempts have been disastrous, particularly over the past few years for example. At the other end of the spectrum we also find certain nervous investors not wanting to take on any risk at all. Instead, they opt to invest their living annuity capital into money market or high income funds, which have no risk attached to the capital at all. Or so these investors might think.

While money market and high income funds seem to offer safety in the short term at least, over the medium to long term money market funds are not ideal as they do not offer the investor any chance of capital growth. Added to this interest rates are at all time lows and inflation running at levels above the average money market return resulting in negative real returns after withdrawals. Not to mention limited or no allowance for any adjustment to your income levels.

In terms of current legislation an investor in a living annuity has to draw an income of between 2.5% and 17.5% (previously between 5% and 20%) of capital. With interest rates as low as they are and the average withdrawal rate between 6% and 8% this means that capital in a money market account earning less than 6% will deplete capital over time. Deduct from these gross returns the cost to the investment house and advisor, anything between 1% and 2% as well as inflation and the investor is left with substantial negative real returns.

This effectively translates into the investor suffering an erosion of capital in real terms. And this is where the big danger lies; a danger many investors cannot see until it is too late.

The major factors affecting living annuities are longevity, income levels, inflation, investment returns and volatility.

LONGEVITY, INCOME LEVELS, INFLATION AND VOLATILITY

Medical technology has extended our lives considerably over the past few decades and on average males aged 55 can expect to live another 22 years and the average woman 27 years.

This effectively means that the longer we live the more capital will be required in order to meet our future income requirements. Selected income levels are therefore vitally important vs the investment strategy selected (conservative, balanced or aggressive)

Table below highlights, using realistic assumptions for market returns and costs, the likelihood that a male (retiring at age 65) will **NOT run out of capital prior to death.**

- Different asset allocation scenarios and withdrawal rate assumptions provide different outcomes.
- Note that withdrawals are increased by the rate of inflation every year in order to maintain the annuitant's lifestyle.
- Inflation is also a very important factor in determining these calculations in order to maintain today's current life style in the future.

PROBABILITY OF NOT RUNNING OUT OF MONEY (%), MALES (AFTER COSTS)

ASSET ALLOCATION / Withdrawal rate	25% EQUITY	50% EQUITY	75% EQUITY
2.5%	99	99	99
4%	93	96	95
6%	68	76	80
8%	47	54	61
10%	35	39	45

Source: Nedgroup Investment Advisors

This illustrates that a male requiring 6% of his initial capital, increasing by inflation, with 50% of his capital invested in equities, will have a 76% chance of not running out of capital.

WHEREAS A MALE REQUIRING 10% WITH A 50% EXPOSURE TO EQUITIES WILL HAVE A 39% CHANCE OF NOT RUNNING OUT OF CAPITAL AND SO ON.

This clearly illustrates that most strategies (25%, 50% or 75% equities) can comfortably accommodate a withdrawal rate of up to 4% per annum and that at 6%, a higher equity exposure improves ones odds to an acceptable level.

For those investors that require income levels of 8% or more, there is limited certainty (especially for females who tend to live longer than their male counterparts), even at maximum equity exposure.

WHAT ARE THE OPTIONS FOR RISK- AVERSE INVESTORS?

Owners of living annuities will have to accept some degree of risk if they want any chance at all of growing capital above their withdrawal levels and ensuring that income levels do not deplete capital over time. A totally risk-free approach is not going to crack it.

Investing in a bull market is always easy. However, it's when financial markets turn and show increased volatility while drawing an income from your portfolio that creates the greatest concern. However, there are a great number of medium risk funds. which are actively managed, with a proven track record that can be considered for nervous investors. Investors do not fully understand what active fund managers do behind the scenes in order to anticipate market downturns in order to preserve as much as possible the historical growth of investors in any particular fund.

Flexible or active fund managers have the ability to switch between asset classes (money market, bonds, property, equities and offshore). This provides greater diversification, reduces volatility and historically in some cases has beaten the returns of the JSE All share and money market returns.

See below the investment returns of some of the funds Brenthurst Wealth has been using in living annuities vs a money market fund and the JSE All share index.

MONTH-END PERFORMANCE DATA (VALUES FOR PERIODS GREATER THAN ONE YEAR ARE ANNUALISED) AS AT 12 OCT 2011

	1 Month	3 Months	1 Year	3 Years	5 Years	10 Years
Fund A	1.47%	1.85%	9.21%	12.35%		
Fund B	2.99%	3.19%	11.96%	14.07%	11.26%	17.36%
Fund C	3.92%	0.94%	7.81%	19.56%	11.92%	25.48%
Fund D	2.30%	3.55%	11.46%	12.31%		
Standard Bank Money Market Fund R	0.43%	1.33%	5.62%	7.71%	8.35%	8.81%
Fund E	1.23%	2.03%	7.97%	14.55%	11.35%	
Fund F	2.65%	0.58%	10.04%	10.52%	8.05%	14.56%
FTSE/JSE All Share index	4.27%	-2.50%	4.54%	14.76%	6.47%	13.78%

All performances shown in the table are percentages calculated using NAV to NAV prices net of fees, including dividends reinvested on payment date. Source: Allan Gray

All of the selected funds have beaten money market as well as the JSE all share substantially with less volatility than the All share index over 1, 3, 5 and 10 years respectively.

At Brenthurst Wealth we emphasize that although living annuities are "low" risk investments, they still need to have some element of risk in order to manage longevity, income levels and inflation for the creation of growth amidst volatility.

However, for those individuals that want peace of mind and do not want the volatility of the markets they can consider converting their living annuity to a traditional annuity. You can opt for an inflation linked annuity which will provide you with an income based on the lump sum and your age. Obviously the younger you are the less income you will start with to ensure that the capital will last, as this needs to provide you with an income until your demise. Increases are based on inflation during the year. Your income keeps up with inflation and is protected against increases in the cost of living, however pension increases can be very low or even 0% if inflation is low or 0% respectively. The other disadvantages of the traditional annuity is that your spouse will receive a reduced income of in most cases 75% of the income you were receiving and on their demise the capital dies with no capital to be left to any heirs.

The reality is that few people retire with enough money to buy an acceptable level of income from a traditional annuity and need the flexibility of a living annuity to grow their capital and income.

However a traditional annuity may suite certain investors. For more information regarding living annuities or traditional annuities, please contact any of our highly qualified financial advisors at Brenthurst Wealth Management.

ALL YOUR QUESTIONS ABOUT LIVING ANNUITIES ANSWERED

A technically-minded potential client of Brenthurst Wealth recently drew up the following questions we needed to answer before he made a decision to place his LA investments with us. We thought the questions were of such good quality and relevance that we are publishing them all, together with our answers, in the hope that they could answer similar questions other investors might have.

1) How does one choose an investment advisor? Do you choose a person or a company? What happens if the person who manages your portfolio is no longer there?

Both. You choose an investment advisor which will have the personal relationship with you but that person needs to have the back-up offered by a larger institution. It is very difficult for one-person investment advisors to offer the varied and complex services demanded by discerning clients today, including investment advice, portfolio structuring, estate and tax planning and offshore investing, to name a few. Furthermore, the investment advisory world is highly regulated today and investment advisors have to spend a great deal of time on regulatory issues.
At Brenthurst Wealth we have a succession plan in place in case an advisor leaves the company or is no longer able to manage client portfolios.

2) Can you change your financial advisor? Is it advisable?

It is very easy to change a financial advisor or advisory company. All it needs is a signed form, which is sent to the investment platform where your money is held, informing them of your decision. It is, however, not advisable to change investment advisors at the drop of the hat. Far better to express your unhappiness with your advisor or the company. Changing advisors is like a divorce and interrupts what should be a lifelong relationship. Rather ask for another advisor within the company than upping and leaving to another company, often at great cost.

3) Type of pension: is it better to go for a living annuity or guaranteed annuity?

As a rule , the larger the amount of money involved the more likely we would be recommending a living annuity than a guaranteed annuity. A well-managed living annuity portfolio should never run out of cash and it leaves capital and/or income for a second generation. In some cases, depending on the individual circumstances, would we recommend a guaranteed annuity.

4) Commission. How much commission will I be paying. Is it standard? Is it negotiable? Is the advisory fee I am paying worth the difference in returns relative to the returns I can achieve by managing my own portfolio?

Both the structuring fee and ongoing fees are totally transparent and negotiable with your intended service provider. The use of commissions have largely fallen away and an upfront fee, either as a percentage of assets or a rand amount will be negotiated between yourself and your service provider/advisor.

As a rule you could expect to pay about R20 000 to R25 000 for a well-thought out and sensible financial plan and thereafter an ongoing advisory fee ranging from 0,5% of fund value to as high as 1,25% per annum. All these fees are deductible from your investment portfolio(s) which removes the need to fund this upfront out of after-tax cash.

We believe that we add substantial value over the lifetime of a client to more than make up for the ongoing fee paid to an advisor/service provider. We have seen some horror stories with clients who tried managing their money themselves. We often joke that “a fool and his/her money should not be locked up in a room together”.

5) Other: what other services do you offer your clients?

At Brenthurst Wealth we offer a range of other services including investment advice and education, portfolio construction, tax advice, estate planning, winding up of estates, to name just a few. We write regular newsletters on the economy and other matters of financial interest as well as a series of investment seminars throughout the year.

ALL YOUR QUESTIONS ABOUT LIVING ANNUITIES ANSWERED CONT.

6) What assurance do I have that you will not be putting my money in risky assets (such as Sharemax)?

The Sharemax -debacle is a very good example of the kind of value we add. After investigating this investment scheme we advised strongly against investing in it and despite the threat of legal action against us, devoted a whole newsletter warning our clients against Sharemax as well as the other property syndication schemes.
All our recommended investments are thoroughly investigated beforehand and must pass a very stringent test by the investment committee before it can be recommended by our financial planners.

7)When my pension is paid out, is it paid out to Brenthurst or transferred to another fund?

We do not accept any money into our accounts and all investment amounts are paid directly across into a dedicated account of the investor at the investment platform that is chosen for the client.

8) Are you interested in being my financial advisor? Why must I choose you?

Difficult question to answer without being biased. We are all passionate about what we do and we believe we have the skills, competence and integrity to look after your investments during your retirement. We take this responsebility very seriously.

9) Type of investments: how would you, in general terms, invest my money today?

While we appreciate that the investment world seems inordinately difficult and fraught with dangers today, are we experienced enough to add that these times will also pass. Having lived and worked through many seemingly intractable financial crisis over a period of 30 years (1987 stock market crash, 1994 dawning of the new SA,1997 Asian crisis, 1998 Long term Capital Management bust, 2001 internet boom/bust, 2007 credit crunch, to name a few.

We create investment portfolios as dispassionately as possible rather focusing on the expected growth rates of the various asset classes going forward. We do like an increased exposure to offshore assets at this stage of the asset class cycle, but prefer local income producing assets in order to fund an income.

10) Is my money managed as a stand-alone portfolio or is it added together with the funds of other investors?

Your money is not pooled together with the assets of other investors. That pooling takes place at fund level but you are the owner of a dedicated number of units in the various funds chosen on your behalf. However, our portfolios are constructed on a very disciplined basis and in terms of an investment formula we have created and applied over many years.

11) How often do you review my investments and how often do you make adjustments?

It depends on many factors but we feel that twice-yearly reassessments of your portfolio is sufficient. However, we do keep contact on a regular basis via telephone, emails, newsletters and also seminars. Technology makes keeping up with you and your portfolio easy and seamless.

However, the funds chosen for our clients are monitored on an ongoing basis behind the scene and discussed by the investment committee and changes made, if necessary. That’s part of the beauty of a living annuity: investment changes do not incur capital gains tax.

12) What type of return can I expect in today's investment climate?

Using guidance from the large investment houses we use, can we suggest the following annual returns going forward:

Cash:	5-7 %	per annum
Local equities:	9-11%	per annum
Local Bonds:	7-9 %	per annum
Offshore bonds:	7-9 %	per annum
Local property:	8-10 %	per annum
Offshore property:	9-11 %	per annum
Offshore equities:	13-15 %	per annum
Offshore cash:	1-3 %	per annum

Living Annuities

"THE ONE INVESTMENT WHERE YOU NEED EXPERT FINANCIAL ADVICE"

UPCOMING INVESTMENT SEMINARS:

SEMINAR DATES	VENUE	PRESENTERS	TOPIC
CPT: 3rd Nov 15h45 for 16h00 JHB: 16TH Nov 15h45 for 16h00 PTA: 22TH Nov 15h45 for 16h00	**CPT: STANLIB OFFICE** Liberty Life, The Estuary, Century Boulevard, Century City **JHB: STANLIB OFFICE** 17 Melrose Boulevard, Melrose Arch **PTA: WATERKLOOF GOLF CLUB** Johann Rissik Drive, Waterkloof	**STANLIB:** Keillen Ndlovu **BRENTHURST WEALTH:** Magnus Heystek	Update on Markets: Global & SA Economy Using Property as a Source of Income in Retirement **BOOK NOW!** JHB: +27 11 799 8100 CPT: +27 21 914 9646 PTA: +27 12 460 0340

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