BRENTHURST WEALTH MANAGEMENT

INVESTMENT REPORT

BRENTHURST
THE HOME OF WEALTH

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FEBRUARY 2012 • ISSUE 203

"IF YOU THINK THE PRICE OF ADVICE IS HIGH, THEN YOU MUST CONSIDER THE COST OF IGNORANCE."

In this issue

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Global Markets AND SA ECONOMY

By Magnus Heystek—Investment Strategist

The local investment market has undergone substantial change in recent years. In some respects the industry bears almost no relation to an industry that existed a mere ten or fifteen years ago.

Prior to the introduction of the FAIS-Act (Financial Advice and Intermediary Act) of 2002 the investment industry was a veritable free-for-all in terms of qualifications, commission structures, perverse incentives and sleight-of-hand when it came to fees and rebates.

The industry was dominated by the large life assurance companies who promoted their expensive and restricted products such as long-term endowments, back-to-back policies (where one policy was taken out in order to feed another) and geared endowments where loans were extended to investors in order to make even bigger investments.

In a previous life as an investment journalist and editor, particularly at The Star newspaper, I found myself embroiled in many public battles with these insurance companies, particularly Old Mutual, which were still defending their old-style investment products and structures.

Some of our older clients might still recall these battles, which raged in the pages of The Star, Pretoria News and The Cape Argus.

At the time I was of the opinion that the future of the investment industry lay in the growth of unit trusts, previously called mutual funds and today generally referred to as collective investments.

There were only a handful of unit trusts in those days with less than a hundred million rand or so under management for the whole of South Africa when I started life as a financial journalist. By and large, unit trusts were the stepchild of the investment industry, for the simple reason that assurance-type products were far more profitable than unit trusts.

I created my first investment business in 1994 on the basis that clients needed products that were transparent, priced daily on recognized exchanges and offered a range of asset classes in a simple and easy-to-understand format.

This trend was also boosted by the creation of investment platforms, where a range of different unit trust funds, often from competing investment companies, were offered on the same platform with no or very little switching fees between funds.

By the end of last year the assets of this industry had grown to an astounding R1 trillion in assets, which clearly showed what investors preferred. It is noteworthy that the giants of this industry, namely Allan Gray, Coronation, Investec, Stanlib and Nedgroup are mostly companies that did not exist twenty years or so ago.

But it is not only investment companies that were forced to change by this hurricane which was blowing through the financial services industry. Today investment advisors or their firms have to be registered at the Financial Services Board (FSB), be licensed, need to have indemnity insurance and more recently, need to pass very tough financial examinations in order to advise and guide investors through the pitfalls of investment markets, taxation, asset classes and changing legislation, to name just a few of the many variables.

The first round of examinations, which all the 139 000 registered financial advisors in the country have to write and pass by the end of June 2012, is currently under way. Information on this topic is scarce but it seems that between 30 and 40% of advisors will not pass these exams. I am proud to say that all our seven planners have written and passed this examination. There are further examinations in the pipeline, more tailored to specific products in order to enhance the qualification and skill of investment advisors.

All investment advisors also need to have compliance officers, either in-house or outsourced consultants, which report back to the FSB on a quarterly basis on a wide variety of compliance issues. All these steps, while protecting and safeguarding the interests of clients, come at a cost.

The cost pressure on advisory firms has been relentless in recent years, to such an extent that several thousand FSP's have in recent months handed back their licenses, ostensibly due to higher costs and enhanced requirements. This trend is expected to continue and some commentators have openly warned that only the rich would soon be able to afford high quality advice and skilled portfolio management on an ongoing basis.

Many investment firms now require a new client to have a million rand or more in investable funds, which precludes a great number of investors who, ironically need good advice more than those who can afford it.

The fee or commission structure of the investment industry has also changed from an upfront commission to an annual fee, payable as a percentage of assets managed on behalf of a client.

One further development in the investment industry was the total (well, almost) transparency when it comes to costs, fees and performance fees in the collective investment industry. The costs of making investments via the collective industry is now totally transparent as all fund fact sheets include what is known as a Total Expense Ratio (TER). The TER includes all fees in the making of an investment, including fees paid by the fund manager, the investment platform as well as the investment advisor.

FEES CAN VARY FROM PLATFORM TO PLATFORM AND ALSO DEPEND ON THE SIZE OF THE INVESTMENT BUT IN GENERAL A TOTAL TER OF BETWEEN 2 TO 2,8% IS PAYABLE WHICH IS MADE UP OF FUND MANAGER FEES (1,5%) INVESTMENT PLATFORM (0,3 -0,5%) AND THE INVESTMENT ADVISORY FEES (BETWEEN 0,5% TO 1%).

These fees are deducted from investment portfolios and paid over to the advisory firm, either monthly, quarterly or annually by means of a sale of units in order to pay the platform and advisory fees. Fund manager fees are deducted at source and is more difficult to track and trace, but they have always been there.

In addition, fund fees can be influenced by performance fees charged by fund managers and also certain advisory firms. Any investment proposal will be accompanied by a detailed quotation on the fee structure levied on investments. THE FEE STRUCTURE ON ALL BRENTHURST WEALTH PORTFOLIOS HAVE ALWAYS BEEN TOTALLY TRANSPARENT AND ARE TO BE FOUND ON ANY STATEMENT, AS THEY ALWAYS HAVE BEEN.

Investment companies also sometimes charge a structuring fee which is based on the amount and complexity of the work done for a client in order to make an investment. This can be a rand amount or a percentage agreed to upfront with the client.

I might also add that fees in South Africa, especially advisory fees, are substantially lower than in the US and the UK where 1%and even higher is the norm for the advice and management of any investment portfolio.

One direct consequence of the change in remuneration structure from commission (upfront) to ongoing fees has been the business model of advisory firms. An upfront commission fee creates very little or no incentive at all, apart from selling another product, to create and maintain an ongoing relationship with clients.

As no further value can be added there is no need for continuous reviews of the various portfolios. This defect has cost countless investors huge sums of money as their investments were simply dumped into a product or portfolio and forgotten. In some instances investors only found out many years later that the original choice of fund/portfolio was inappropriate, badly performing or the totally wrong portfolio. This was a direct result of the commission-type of incentive that prevailed in the investment industry.

I have always advocated the ongoing advice fee model as more appropriate and advisable in the investment industry. This is also the norm in most countries in the western world.

THE ONGOING FEE-MODEL IS BASED ON THE FOLLOWING:

⇒ Regular and ongoing reviews of a client's portfolio, taking into account changing market conditions, changing legislation. taxation etc.

⇒ A dedicated relationship manager who forms a personal and in-depth relationship with a client and his/her family, fully understanding that client's needs and objectives.

⇒ Often advice is given on matters such as taxation, drawing up of wills, trusts ,key-man insurance and even emigration, to name just a few. This is all taken care of within the agreed annual fee, unless additional work needs to be done specifically.

⇒ A review of the investment performance of the various funds used in the construction of portfolios. Brenthurst Wealth researches and tracks the performance of all the funds used in the creation of the various risk-adjusted investment portfolios.

⇒ It also does research on other funds and products in the market place, often advising clients not to invest in them. Examples include Sharemax, Picvest, Leaderguard, Ovation, Maddoff and many others, all which did not pass the internal screening process at Brenthurst. As I have asked before:" How to you remunerate your advisor for not recommending one of these investment scams."?

⇒ Regular contact and communication. This can take the form of personal meetings, telephone calls, emails, newsletters and even investment seminars.

⇒ Cash-flow forecasts for clients approaching or even already retired.

⇒ A high level of service. A client who does not receive ongoing advice and service can terminate the agreement and appoint another advisor with immediate effect.

This all ensures a high level of service and professionalism to clients. In short, the better the client is serviced and his/her wealth increased, the higher the fee to the advisory firm. It aligns the interest of the client and the advisor best, in my view.

PROFESSIONAL ADVISORY FIRM SPENDS CONSIDERABLE TIME AND EFFORT ON AN ONGOING ANALYSIS AND TRACKING OF INVESTMENT MARKETS, OFTEN IN TIMES OF INCREDIBLY VOLATILITY AND COMPLEXITY. WE REGULARLY ATTEND FUND MANAGER MEETINGS, BOTH HERE AND ABROAD, IN ORDER TO PROVIDE BETTER QUALITY ADVICE TO OUR CLIENTS.

FEE FOCUS:

A recent article in the Sunday Times, has unfortunately created the impression that fees charged within the investment industry are (a) new and (b) excessive.

As an ex-journalist it was particularly irritating that the front-page article simply focused on fees, suggesting that it is possible to make investments without fees. This is unrealistic as all the players in the investment process –funds, platforms and advisors-are free-market enterprises that need to charge fees to remain in business.

Try buying a newspaper or placing an advert in the same newspaper for free. The idea is laughable.
The underlying impression created by articles of this nature is that the investment industry overcharges and the clients are being "ripped off", to use an expression that seems to be used quite widely in all spheres of the business world, especially by crusading journalists. Has anyone ever read an article discussing the advertising rates of newspapers and how they have consistently increased at a very high rate, much higher than inflation?

The investment industry is part of a global industry and talent is not only scarce but also expensive. Many of SA's top fund managers are global players and SA often loses top investment talent to the outside world.

The inflation-beating returns of the funds used by Brenthurst Wealth are and always have been after fees. The fees charged by investment platforms have been reduced significantly in recent years to such an extent that any reduction in fees will endanger the future existence of these enterprises.

FEE FOCUS: CONTINUED

Many platforms also reduce their fees to zero by making use of a rebate system, payable by certain funds managers out of their fees. That leaves the advisory fee as the only remaining area that could attract the attention of cost - conscious investors.

Certain advisory firms with ties to larger companies often ostensibly "reduce" their overt advisory fees from say 0,75% to 0,5% to gain a competitive advantage, but what they do not disclose is that this reduction in fees is compensated for by an additional rebate from the fund that they use, invariably funds which form part of the same group. Examples here include PSG and Absa who, in my experience, deftly conceal this additional payment to advisors extremely well.

So if the fund management company and the investment platform, which was created to enhance the investment experience of the average investor cannot be used to reduce fees, then that leaves the advisory fee.

In this respect we have to agree with one aspect of the article in question, namely, that investment advisors need to add "value" to the lives of their clients. We support this notion as often advisors take a fee and offer very little in return.

AT BRENTHURST WEALTH WE ARE VERY CONFIDENT THAT WE HAVE DEVELOPED A BUSINESS MODEL THAT ADDS IMMENSE VALUE TO OUR EVER-GROWING CLIENT BASE. IF WE CANNOT ADD VALUE TO THE LIVES OF OUR CLIENTS, WE WILL NOT HAVE A BUSINESS. OUR PROFESSIONAL FEE IS FOR THE SERVICE WE PROVIDE TO OUR CLIENTS, WHO UNDERSTANDS AND APPRECIATES THE VALUE WE ADD TO THEIR LIVES.

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