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Inside this issue

02 Our 10th Year End
Graydon Morris

04 Qualifying as a Certified Financial Planner
Mishka Gamiet

05 Women and financial planning
Lesley Hohne

06 Do Active Managers add value?
Greg Flash

07 Demographics and Investment Issues

10 Retirement Fund Reform

12 Market Performance

Our 10th Year End

Graydon Morris

Would you believe our first 10 years in business have flown by so extremely quickly? The years to seem to pass us by so much quicker as we all age somewhat.....What a year 2012 has been! Perhaps we should take a few minutes to reflect on what we have seen in the past 10 and half months......

- We have most recently seen President Barack Obama re-elected for a second term;
- London hosted the Olympics with tremendous success during August, with our swimmers and rowers and Bert le Clos delivering much pride and entertainment respectively;
- A US Ambassador was tragically killed in Libya in September;
- Spain has recently accepted a 100 Billion Euro (over 1 trillion Rand) bailout;
- Vladimir Putin has re-emerged as Russian President;
- Whitney Houston passed away prematurely at age 48;
- The Facebook IPO made bankers wealthy at the expense of unsuspecting and potentially greedy investors;
- A luxury cruise ship ran aground in Italy, resulting in a large loss of life;
- The ALSI has risen by 16.9%, as of 15 November, year to date.

We have experienced so much change and the landscape looks so very different to that which we awoke to at the beginning of the year. In fact, very much the same can be said of the last 10 years.

In 2002, when we opened our doors for business, no one (or very few of us) had heard of Julius Malema (fortunately he does seem to be retreating into the shadows);
Saddam Hussein was in hiding, as was Osama bin Laden;
Muammar Gaddafi ruled Northern Africa with an iron fist (ultimately, of course, all three of these named stalwarts' met with less than glamorous ends);
Brett Kebble was a revered mining tycoon;
Thabo Mbeki was the president of the Republic; although he was recalled in 2007. He was consistent through his term in denying that HIV caused AIDS and as a result, many died unnecessarily;
Shabir Shaik was not yet terminally ill;
One of our close and trusted asset management partners, RECM, had not yet commenced operations, Piet Viljoen still managed the Investec Opportunity Fund;
The ipod had been launched only on 1 November 2001, the iphone and ipad were still just a dream to Steve Jobs;
The ZAR/Dollar was R 10.09, and interestingly, the US$/Euro exchange rate was broadly at parity;
The JSE ALSI was at 10 000 points;
The Apple share price was $ 8.80.

The examples we have provided above are clear evidence of why we try to focus the minds and the thinking of our clients to be truly long term. The world is in a continuous state of flux. Technological innovation, start-ups, whether they are asset management related or not, abounds, and need to be assessed for validity.

It really has been a tremendous journey for all of the staff and management of our business. We are understandably proud of what Sterling Private Wealth has become, but wish to ensure you all that we shall not rest and reflect, but rather seek to explore, probe, discover and improve. We remain unashamedly conservative in our advice, strategies and fund manager selection. We firmly believe that the avoidance of permanent capital impairment, and the consistency of one's returns, is a critical investment strategy. This allows compounding to be truly effective. Since human beings began investing, they have been searching for a magic formula or a recipe for instant wealth. As we well know, this Holy Grail does not exist, and in the absence of such a miracle, we should be guided by the following basic principles, which we would propose as a fundamental philosophy of life: Be Prepared, Be Disciplined, Be Patient and Be Decisive.

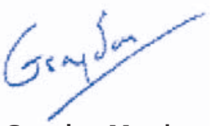
It may seem very clichéd, but we truly cannot survive without the support, loyalty and trust of our valued clients. We live by the mantra that says that Trust and integrity take years and years to develop, yet can be destroyed in a heartbeat. This issue is at the core of our thinking in any business decision we take. We are nothing without this Trust. We hope and pray that this guiding principle carries us through the next decade, that we may sit in front of you in 2022, and thank you all for the continued journey.

My partners and I believe ourselves to be truly blessed to be in a position, on a daily basis, to interact with the passionate, intelligent and focussed personalities, who form the core of our client base. This interaction assists in keeping us broad-minded and exposed to many differing life views. I quote Harvey Finestone when he said: "I notice that when all a man's information is confined to the field in which he is working, the work is never as good as it ought to be. Man has to get perspective, and he can get it from books, or from people, but preferably from both".

As a result of our 10th year celebration, and on behalf of each of our valued clients, we shall be making a contribution towards the education of a young lady, due to study at the UOFS next year. This young lady will be studying medicine. Her plight was highlighted by Prof Jonathan Jansen, the outspoken educator and activist, in an article he penned in The Times Newspaper on 1 November this year. We have attached this article for your reference.

We have included varied and diverse articles for your perusal in this, our 5th Sterling Times edition. This includes a short piece by each of our lady CFP's in the office! We do hope you enjoy the read, and celebrate the festive season with your families in a fun-filled and joyous manner. We look forward to seeing you all again soon.

Best wishes



Graydon Morris
Founding Director

Girl's journey from horror to triumph

JONATHAN JANSEN

AN EDUCATED GUESS

'MY FATHER murdered my mother in front of us, my little brother and I; he beat her to death with everything he could find."

The Grade 12 girl sitting in front of me took some time to complete the sentence as she covered her face with her hands and tears ran through her fingers.

It happened every weekend, the ritual beatings of a mother whom her daughter absolutely adored; the little girl would bear testimony to this brutality and wonder why her mother did not leave. In the harsh life of an informal settlement, her options were limited. When asked whether they wanted their father released from prison where he served time for the murder, the children agreed; they needed the one parent still alive.

Thembi Letsoara (not her real name) was just starting to emerge from an earlier tragedy in which she was brutally raped by her cousin. Nobody would believe her, until days later the doctors would confirm the sexual assault. By this time, the evidence was thin since she had bathed and cleaned up the mess.

The boy's father was the only person working and gave money to the grandmother with whom Thembi was staying; there was an agreement that they would not pursue matters for that would risk the only source of income available to the extended family.

"For a long time I did not trust male figures, not even my father. I slept with my mother."

The young woman cries again as she recalls being raped.

Her sole support through this dreadfully painful period of her life was her mother.

"She encouraged me, she loved me, she supported me."

Now the mother was dead.

It is almost impossible to match this smart, beautiful and well-poised young woman with the two tragedies I had just heard about.

It is even more improbable that her Grade 12 examination results, before these National Senior Certificate finals, include 92% in the mathematics third paper, 94% in the main mathematics paper, and 90% in life sciences.

Having spent only three years, Grades 10 to 12, at one of the top public girls' schools in the country, the young woman overcame poverty, hardship and unspeakable trauma to become a top academic performer.

"She is guaranteed an A aggregate matric," swears the principal.

Her break came when a famous boys' school invited two children from every disadvantaged school in the area to become part of an academy in which promising learners were given high-quality lessons.

From this large group, two students were sent to that boys' school, and two to the adjacent girls' school. She made it, and took every opportunity to excel not only in academics, but also in senior netball.

'I would tell my mother: I am stronger than I have ever been'

There is something I have yet to understand: why most young people, when faced with incredible hardship, give up on life, but a few stand firm and triumph. This thing called resilience fascinates me. Her report card speaks of "her tenacious spirit" and "her determination and zealous attitude" and "going the extra mile to produce work of a high standard".

But the report also speaks of her humility, her grace, and a "respectful, quiet and unassuming nature".

"What is it about you that keeps you going?" I ask.

"My mom, she was my best friend and she was very strong."

And then she mentions the principal of the academy; this amazing man makes sure that people and the system do not fail her again.

"She wants to study medicine," he tells me, and will need financial assistance and guidance.

"Why medicine?" I ask her.

"Like my mother," she says, "I always wanted to make a difference in people's lives. I wanted to make my mother proud."

It is clear to me that this is not the kind of medical graduate who will jet off to Europe after a state-subsidised education. She will plough back right here.

"If your mother were here, what would you say to her?"

She does not need to think.

"I would say thank you for raising me, for supporting me, for believing in me."

And then my final question: "What is the one thing you would want your mother to know about you today?"

With a soft, confident voice: "I am now stronger than I have ever been."

Anyone who wishes to contribute to the university education of this matriculant should contact me on jj@ufs.ac.za for further information.

HOPE IN A SEA OF HOPELESSNESS: Our news is full of stories of young girls being raped, or children who have seen their parents murdered. Yet even stories that begin that grimly can have a happy ending Picture: LEBOHANG MASHILOANE

Qualifying as a CFP

Mishka Gamiet

Mishka Gamiet, who joined Sterling Private Wealth in the second half of 2010, recently qualified as a CFP. We are sure that you will join us in congratulating her and wishing her well in her continuous journey and development as a wealth manager. We are very proud of Mishka and asked her to provide this brief overview of her journey thus far.

Qualifying as a Certified Financial Planner - A milestone in my career

The Journey

Soon after joining Sterling Private Wealth, I realised that wealth management would grant me an ideal opportunity to use my financial and academic background to work in an environment where I could help improve the structuring of an individual's financial situation. This prospect served as a huge motivator with regard to my choice of studies. In supporting and working with the team at SPW over the past 2 years, I witnessed, and have firsthand experience pertaining to the benefits of strategic financial planning to advance the financial position of our clients. It's been a rewarding career in many respects, and I'm pleased with my decision and choice of career having completed my diploma and becoming a certified financial planner (CFP).

There are various "financial adviser" courses available, I however recognized that the CFP certification would act as a key differentiator and would equip me abundantly in my role as a financial professional, allowing me to produce quality advice, providing additional value to our clients.

The road to becoming a CFP was challenging yet incredibly rewarding. The many months of, late nights, public holidays and weekends studying were well worth the sacrifice and it felt surprisingly effortless, and at the same time captivating and extraordinarily pleasing.

I found the final CFP certification module particularly relevant to my experiences as a financial adviser by researching a husband and wife duo who found themselves in financial difficulty as a direct result of the global financial crisis. A high level of personal gearing, as well as questionable advice from their former adviser, resulted in a forecast of doom and gloom for this young couple. SPW is providing me with an opportunity where I am now in a position to make a valuable contribution to clients who have allowed emotional decision-making and product proliferation by financial services companies to cause them financial distress, helping to restructure their investments and significantly improve their financial situation.

Bringing peace-of-mind to a client is an incredibly rewarding experience and I thoroughly enjoy empowering and educating them and along the way, simply improving their financial destiny.

Historically each year, the CFP programme typically has a 50% success or pass rate, which was again evident with my intake group. I feel truly blessed and honoured that I successfully completed the course.

The Future

As a CFP professional with newfound knowledge and expertise, I will endeavour to promote competent and ethical financial planning providing sound advice with constant value adds and look forward to making a positive impact on the success of Sterling Private Wealth and its clients.

Women and financial planning

Lesley Hohne

Even in today's society where men and women both provide for their families, we find that relatively few women are intimately involved with the financial planning of their families. Although women are often tasked with monthly budgets and the running of the family – shopping, schools, bills – they are seldom involved with either their long term retirement planning or even their more immediate risk planning.

The idea of a life-time partnership is a good thing but the reality is, for whatever reason, many couples separate. There exists overwhelming evidence that one of the fundamental reasons for failed relationships are"financial issues". Involving both parties in the long term financial planning should be high up on the agenda of couples seeking a long term relationship.

A joint financial plan creates an ideal opportunity to focus short term hardships into long term successes. It provides both parties with additional areas of opportunity and, importantly provides joint responsibility for the future growth of their partnership and family.

It is true that today's women are financially sophisticated and realise the importance of standing financially on their own two feet, yet many are reluctant to be involved in financial planning? Relying on a spouse to provide for their financial needs or trying to live happily ever after on the proceeds of someone's pension fund is not the fairytale you want to be a part of. You will need at least 70% of your final income increasing every year by the rate of inflation to maintain your pre-retirement lifestyle. This means that you will need to be a member of a typical retirement fund for at least 30 years.

Most working couples are used to receiving two incomes. Retirement provision by one spouse only will result in a significant drop in income at retirement and, of course, a commensurate drop in lifestyle.

Single Mothers

A high proportion of women in SA are single, whether due to divorce, being widowed or by choice. It is important that women rely on their own financial planning and be intimately involved with their partner's planning.

Single mothers usually end up with the financial responsibility for looking after the children and extracting money from their ex-spouse or partner. This can often be a bitter, acrimonious and hard fought process. Yet it is vital that single mothers have a plan in place to ensure that their financial future is secure. It is often extremely difficult to do future planning when month to month financial survival is paramount, but setting goals and achieving small financial victories can change attitudes and assist in personal growth.

Medical expenses

If trends continue, science tells us that you will live eight to 10 years longer than your spouse, if he is your age. It is therefore even more incumbent on you to ensure that you are involved in every stage of financial planning, as you will require independence.

The aging process is not always kind. As you get older you are more likely to have major health-related expenses. We see healthcare spend as the third highest cost of a family's budget, after accommodation and travel. If the trend continues, healthcare may even become the second highest cost. Medical aids need to keep pace with this and we have found that many older people have been forced to reduce the benefits on their medical aids as they have become unaffordable. Given the responsibility of family and children all your life, in many cases providing non-stop emotional and caring support, perhaps you owe it to yourself to enjoy a comfortable and financially carefree retirement.

Do Active Managers add value?

Greg Flash

According to our understanding of science, the universe that we live in continues to expand outwards at high speed. Similarly the financial universe continues to expand - maybe not at light speed, but definitely fast enough to make it difficult to keep up with the new types of securities, instruments and strategies that become available. For the average investor, even those with competent financial advisors, they need to constantly increase their understanding of how their savings are and can be invested.

One relatively new type of security that continues to become more popular is the Exchange Traded Fund (ETF). ETFs are securities that aim to passively track a specified index. According to one of the largest purveyors of ETFs, iShares(http://sg.ishares.com/understand_etfs/basics/growth_etfs.htm), the first ETF was launched in 1993 and now the assets invested in ETFs is greater than US$ 1.5 trillion! To put this into perspective, Bloomberg reported (http://www.bloomberg.com/news/2012-08-06/etfs-poised-to-exceed-trade-in-s-p-500-as-spiders-beat-apple-1-.html) that the daily trade in ETFs that track the S&P500 index is close to overtaking the total daily trade in the stocks that make up the S&P500 index. This shows the popularity of passive ETFs, particularly offshore. Note that not all ETFs are passive trackers of indices; there are a growing number of specialised or smart ETFs focussing on specific metrics.

The two main reasons for the growth in ETFs (the passive tracking kind) are cost and performance. Investors have become more and more frustrated with active managers that charge large fees and fail to outperform their benchmarks. Passive index tracker ETFs are far cheaper and although they don't outperform the index that they track they come quite close. The problem with investing in ETFs is that all one is getting is beta and no alpha. Beta is the not a measure of performance, but rather a measure of risk. Hence an ETF gives close to 100% of the risk of the index that it is tracking. Alpha is a measure of performance (out or under) relative to some index or benchmark and is determined by the skill and luck of the manager that one is invested with. The increased ETF use is an indication of what investors think of active managers.

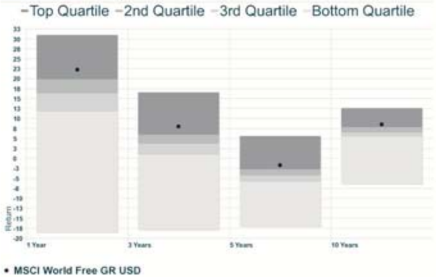


Figure 1 Historical performances of funds in the Global Large Cap Blend, Large Cap Value and Large Cap Growth sectors versus the MSCI World index. Data Source: Morningstar

Figure 1 shows the historical performance of global equity managers versus the MSCI World index. This chart depicts the range of performance of global equity managers in Morningstar's Large Cap Blend, Large Cap Value and Large Cap Growth sectors. It also highlights the four quartiles of performance. What is important to notice is that the performance of the MSCI World index is within the top quartile of funds; hence less than 25% of funds have outperformed this index. What is also very concerning is the large range of returns. It is distressing and amazing that there are funds that have produced an annualised -5% return for ten years. There is survivorship bias here; hence the picture would look worse if the funds that no longer exist were included.

Figure 2 depicts a similar example but rather looking at South African equity funds in the General, Growth, Value and Large Cap sectors versus the JSE All Share Index.

Figure 2 Historical performances of funds in the General, Growth, Value and Large Cap Equity sectors in South Africa versus the JSE All Share Index. Data Source: Morningstar

Here in South Africa, equity funds have fared better against their index (JSE All Share). Over ten years, more than half of the funds have outperformed the ALSI. Over shorter periods, less so, however in all cases, except over three years, top quartile funds have outperformed the index. The range of funds is still large over 5 years and less, but less than global equity funds.

So it would seem that the average South African equity manager is producing more positive alpha versus the market as compared to global equity managers. Therefore the pressure is on the active managers to continue to produce consistent positive alpha. If they don't, ETF growth in South Africa is sure to accelerate. Lastly, we at PSG Multi-Management focus on investing with active managers and spend all our time ensuring that we pick the best managers with the highest likelihood of producing positive alpha.

Greg Flash
PSG Asset Management

Demographics and Investment Issues

As investors, it often pays to take a big-picture view. Warren Buffett once attributed his initial investment success to the fact that he had “bought into the demographics” in America. By this he meant that he had invested in companies, such as Gillette and Coca Cola, which were likely to benefit from the increased size of the “baby boom” generation as it grew to adulthood.

Demographics relates to the study of population structures, of which age is one of the elements. Numerous academic studies have examined the effect of population ages on economics and on financial markets, with the effect of the ageing baby boomers being a popular choice of topic.

Earlier this year, Robert Arnott and Denis Chaves published a study which went beyond just the baby-boom generation (those born between 1946 and 1964). They examined the economic effect of population age-group structures, in virtually every country in the world, over the past 60 years. They then extrapolated these effects, predicting economic, stock market and bond market performance over the next ten years. The results make interesting reading, not least of all for investors.

The rationale behind the study

As Arnott and Chaves point out, demography is one of those rare social sciences in which forecasts have surprisingly little uncertainty. For example, today’s 40-year-olds will be next year’s 41-year-olds; we can count them, we know their likely mortality rate, and the probable rate of immigration and emigration for this age-group.

If we look ten years into the future, there will be a degree of uncertainty regarding the number of people under 10 and over 70 years of age, as this will depend largely on developments in medical science. However, there will be surprisingly little uncertainty in the number of people aged 10 to 70, barring war, pestilence, or other catastrophes.

In any country the economic effects of age groups, and more particularly of the percentage of the overall population to be found in certain age groups, is also well known by now. This is due to the curiosity of economists and the countless economic studies they have carried out.

Of course, population age is not the only determinant of economic performance; for example, factors such as infrastructure, the percentage of educated people, and the levels of education attained will also play a part. If one assumes though that previous levels of any economic driver plus historical growth in these levels are likely to persist into the future, it should be possible to come up with some interesting and arguably valid economic predictions.

Why age matters

The writer F. Scott Fitzgerald famously observed that “youth is wasted on the young.” This may be the case, but as Arnott and Chaves discovered we are largely dependent on the young for our economic success. Based on previous academic research, the two researchers made certain discoveries regarding age and economic performance:

1. Productivity varies significantly across age groups. As a large age group makes its way into the workforce, then into the more productive stage of its life, and subsequently into retirement, total per capita output first increases and then decreases. In the demography literature, this effect is known as a demographic dividend.
2. Anecdotal evidence suggests that most entrepreneurs, inventors, and innovators are young adults. For instance, Nobel Prizes are usually awarded to older scientists and researchers for contributions made years earlier, when they were much younger. Kanazawa (2003) found that the productivity of scientists, musicians, and painters peaks between 30 and 40—the only exception is authors, whose productivity tends to peak between 40 and 50. Therefore, we would also expect to identify a higher increase in productivity across all age groups—and thus in total per capita output in countries with a relatively higher share of younger age groups.
3. Another reason that young adults have more impact on GDP growth than do middle-aged and older adults is even simpler. When growth rates in output are being considered as opposed to simple output, the effects that are identified should show a peak at ages considerably earlier than pre-retirement. A worker’s contribution to total output is likely to peak when she has more experience, but her contribution to growth in total output is highest when she is in the process of acquiring that experience.
4. For each of us, the biggest jump in our contribution to GDP occurs as we transition from non-working adolescents into gainfully employed 20-somethings. Another, often smaller, jump in our contribution to GDP occurs as we mature

into our 30s. By our 40s, the evidence of real wages would suggest that most of us are at, or approaching, our peak contribution to GDP, with a falling contribution to GDP in our 50s and 60s. Either way, we would expect per capita GDP growth to be strongest in populations dominated by young adults and in populations in which the young-adult population is growing quickly. This circumstance is indeed the case for most emerging economies and is assuredly not the case for most developed economies.

5 Various age cohorts trade with each other. During baby booms, consumption is relatively higher and savings relatively lower, effectively pushing up returns on both shares and bonds; during population busts, (i.e. periods of negative population growth) the opposite effect dominates. Moreover, people shift their investments from shares to bonds as they approach retirement. Young adults, often in the process of starting a family, will rarely be major contributors to the quest for savings, investments, and capital accumulation.

6 As they look past their own and their children's immediate needs to their eventual retirements, people begin to invest—first in shares, then in bonds. As they slide into retirement, they begin to sell assets in order to buy goods and services that they no longer produce – either directly through their own investments, or indirectly, through their pension benefits. They tend to liquidate their riskiest assets (stocks) before their less risky assets (bonds).

Methodology

In order to test their assumptions, Arnott and Chaves studied the relationship between age groups and GDP growth, and age groups and stock market and bond market returns. Age groups were considered because, as mentioned previously, productivity differs between different age groups. In short, the size of the working age cadre (generally, people aged 20–60) as a percentage of the total population was important: If the working-age cadre is growing faster than the broad population, that should boost GDP growth; if slower, then GDP growth should face a headwind.

To measure GDP growth and market returns, Arnott and Chaves adopted the following approach:

- Because total economic growth in any particular country could be misleading, they considered "real, per capita, PPP adjusted GDP growth" instead. As they explain, in a country with 3 percent population growth, 3 percent GDP growth means no growth at all for the average citizen—hence, their reliance on per capita data. The same logic holds for 10 percent per capita GDP growth in a country with 10 percent inflation— thus, their focus on real (i.e. not inflated) per capita GDP growth.
- Second, Arnott and Chaves measured share and bond returns as excess returns relative to domestic cash returns, rather than as simple annualized returns. They did so for two simple reasons. In the first place, share and bond excess returns over cash can be fairly compared around the world (for reasons too complicated to explore!) In addition, by looking at excess returns over domestic cash, they "crudely, but reasonably effectively, stripped out inflation differences: Cash yields rarely differ from domestic rates of inflation by more than a couple of percentage points."
- Finally, the PPP (purchasing power parity) adjustment creates a fairer global comparison, by emphasizing the domestic purchasing power of the average citizen for the consumption basket that matters for each country.
- This sounds complicated, but can be explained as follows: If you want to translate South African per capita GDP into US dollars, you could use the exchange rate between the two countries. However, this approach can cause inaccuracies. To avoid these, the PPP adjustment takes into account the relative costs and inflation rates of the two countries instead.

Findings

Arnott and Chaves tested the relationship between demographics and both economic growth and market returns, by looking back at 60 years of economic and market history. They then projected these findings forward for a further ten years. Their major discoveries confirmed the findings of prior research, namely that:
Children are not immediately helpful to GDP. They do not contribute to it, nor do they help stock and bond market returns in any meaningful way; their parents are likely disinvesting to pay their support.
Young adults are the driving force in GDP growth; they are the sources of innovation and entrepreneurial spirit. But they are not yet investing; they are overspending against their future human capital.
Middle-aged adults are the engine for capital market returns; they are in their prime for income, savings, and investments.
And senior citizens contribute to neither GDP growth nor stock and bond market returns; they disinvest to buy goods and services that they no longer produce.

Winners and losers – the next 10 years

All of the figures quoted refer to expected excess average annual returns, compared to averages actually achieved over the past 60 years. In the case of GDP growth, the implied forecasts are bleak, with rare exceptions that include India and most African countries, given their large working-age cohorts and very small number of senior citizens. (Excess annual per capita GDP growth in SA is expected to average between 0% and 0.4%, compared to neighbours Namibia, Botswana and Zimbabwe which could achieve greater than 0.9% above previous averages. Things don't look great for Australia, at worse than -1.8% per year).

Bonds exhibit the opposite results: Most of the ageing world has a fast-rising roster of middle-aged potential savers, leading to positive predictions for bonds, whereas Africa presents mostly negative forecasts owing to a large number of younger borrowers relative to older savers.

The most interesting and extreme cases concern shares. Japan, Finland, and Sweden have a dangerous combination of very low birth rates and an exploding number of retirees, giving them a strong demographic headwind. The results for Canada, the United States, and central Europe are mixed, with slightly negative or positive projections, depending on the measure used.

Stock market returns look positive for South Africa, which is forecast to match Russia, India and China by achieving average annual excess returns of between 4% and 9% per year. Brazil could be the star of the BRICs, with abnormal returns exceeding 9% per annum. Singapore is also expected to achieve similar results. Only Botswana of our neighbours is expected to match our performance, while things look less positive for the USA and the Aussies with forecasts of between 0% and 4%, and even worse for the UK at between 0% and -1%. The European periphery—including Ireland, Portugal, Spain, and Greece—has slightly better forecasts for stock and bond returns, showing that there is hope for those countries despite their recent troubles.

Conclusions

Like all forecasts, these are not set in stone. If the rate of technological growth outstrips historical averages, for instance, the above-mentioned projections could look very different. However, all other things being equal it looks as though investors could do a lot worse over the next ten years than to invest in the JSE. The main danger might be that politics and related labour unrest put a dampener on things. If you're looking at bonds, however, a fund based on a mix of the developed countries should be a better bet.

Retirement Fund Reform

National Treasury recently released three new papers for discussion-one on **Incentivising non-retirement savings-Paper D**, one on **Improving tax incentives for retirement savings, Paper E**, and one on **Preservation, portability and governance for retirement funds-Paper C**.

It is not possible in this brief publication to summarise all three papers, but it is important to realize that the bulk of the proposals in the papers are positive.

The Fifth Paper (Paper E) in Treasury's Discussion Documents concerning the restructuring of retirement provision in the country deals with tax incentives for retirement savings.

This paper starts from the presumption that there is no evidence that retirement fund contributions need greater tax deduction limits in order to encourage retirement provision. The fundamental issue that comes out of Treasury's research is that employers see the need to provide retirement funds and this element of the system seems to work well. The authors of the paper are quite correct that the tax regime is very complex and it would be advantageous to streamline the system. One of the policy drivers is that the system permits higher income employees to make much greater tax exempt contributions than Treasury see as necessary to maintain a reasonable standard of retirement. This also enables employees to postpone tax by diverting amounts of income to pension or provident funds which will be taxed later after the retirement date.

The key capping provisions that were set out in the 2012 budget are very much endorsed in the report - that employees should be permitted a deduction in respect of employer and employee contributions to all types of retirement fund equal to 22,5% of the greater of employment or taxable income subject to a cap of R250 000 and in respect of employees who are aged 45 and above that number would be 27,5% of employment or taxable income capped at R300 000. The minimum monetary deduction of R20 000 would apply to allow low income earners to contribute in excess of the above percentage limits. The Paper proposes that this tax regime should be effective from 1 March 2014.

The paper discusses the scenario where an employer provides employees with risk benefits by purchasing insurance policies outside of the retirement fund (so called unapproved risk benefits) as against the position of arranging such benefits through the retirement fund (approved risk benefits). (For those readers interested the table looking at the efficiency of approved versus unapproved arrangements is set out in Table 7 on page 22 of the Paper). The important part in this regard is the move to tax the contributions to a retirement fund on the basis of a fringe benefit allocated to employees, and permit a deduction in respect of these contributions, to try and retain the tax efficiency of providing approved as opposed to unapproved risk benefits.

But it is this logic, which is driving what I think is probably the most important policy aspect of the paper, to move away from allowing the present position where an employee cannot get a deduction in respect of contributions made to a provident fund. In other words, Treasury would like to only provide for a tax deduction on contributions where pension fund and retirement annuity fund holders have to annuitise two thirds of their retirement benefits when they retire, and not allow the position where a provident fund member can take a full lump sum. But the outcome of this is that Treasury will be looking for a uniform retirement contribution model so that provident funds get brought into the same tax structure (allowing a deduction for contribution by employers; taxed as a fringe benefit subject to the capped deduction in the hands of the employee) as the quid pro quo for taking away the provident fund's ability to give a total lump sum at retirement.

There is a lengthy discussion in the paper dealing with defined benefit schemes, but these are of limited significance in the South African market today, as most employers, in order to avoid the accounting issues, have moved their employees towards defined contribution funds. Furthermore, the Treasury would like to simplify the provision of retirement income to not be based on 'taxable income' as defined but to move towards being based purely on the definition of 'remuneration'.

Some of the salient points put forward for discussion in respect of the above, are the following:

- The proposed changes are only set to become law from **1 March 2014**.

- From this date, all employer contributions to a pension, provident or retirement annuity fund will be taxed in the employee's hands as a fringe benefit. The employee, or individual taxpayer if he/she is contributing directly to a retirement annuity, will then be allowed a maximum tax deduction against this fringe benefit of up to 22.5% of their taxable income, [the exact definition of this still has to be finalized], if they are under 45, and 27.5% if they are 45 and over.

- The above will be subject to an overall annual rand capping deductible limit of R250 000 for taxpayers under 45 and R300 000 for taxpayers 45 and older.

- This means that the majority of individuals contributing to a retirement annuity will be unaffected-it is only if they are contributing more than R25 000 per month to a RA [or R20 833 if they are under 45] that the capping will apply. In fact, some individuals might be better off-for example, currently an individual earning R1m per annum is restricted to deductible contributions to a RA of **R150 000** [15% of R1m, assuming all income is non-retirement funding], while after the changes he/she will be able to contribute 22.5% of R1m, or **R225 000**, [or 27.5% if he/she is 45 or over].

- For those investors who are contributing more than the capped amount of R300 000 per annum or R25 000 per month, things are not that serious. The non-deductible contributions will be carried forward, and if not deductible prior to retirement, will be deductible on retirement. They will either be deductible against the lump sum, and increase the tax free amount available, [as is the current position], or if they exceed the lump sum, or if no lump sum is taken, **then the new proposal is that they will be allowed to be set off against any compulsory annuity taken, until they are used up in full**. This allows the client to still obtain benefit from the contributions, even if they are above the capping.

New SARS Retirement Fund Practice Note, RF 1/2012

- This Retirement Fund Practice Note replaces Retirement Fund Practice Note RF 1/2011, with effect from the date of the publication of this note.

- This note has the following interesting paragraph confirming **translocation of benefits to a preserver**:

Translocation of benefits

A member exiting their former occupational fund can access a portion of their benefit in cash before transferring to the pension preservation fund or provident preservation fund.

Such a transfer is tax-neutral **and does not preclude the member from accessing a further once-off withdrawal benefit in the pension preservation fund or provident preservation fund**."

This note confirms the principle that a member withdrawing from a pension/provident fund can take a portion of their benefit in cash, and transfer the remainder to the preservation fund. **They then will still have access to a once-off withdrawal benefit from their preservation fund.**

Market performance

investment market performance

period to 31 October 2012	Index	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
South African equity	JSE All Share Index	18.6%	15.4%	6.5%	15.6%	18.20%
South African equity	SWIX	21.8%	16.8%	7.7%	16.2%	19.5
South African fixed interest	SA All Bond Index	13.2%	12.5%	10.1%	9.3%	11.00%
South African property	SA Listed Property Index	28.3%	22.5%	13.2%	19.4%	26.4
South African cash	STefI (3 month NCD's)*	5.4%	5.9%	7.7%	7.8%	8.30%

*Short Term Fixed Interest Index**

investment market performance

period to 31 October 2012	Index	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
international equity	MSCI World (unhedged) Index (USD)	9.4%	7.9%	-2.9%	3.4%	7.2%
international fixed interest	Barcalays Capital Global Aggregate (unhedged) Index (USD)	3.4%	4.8%	5.8%	6.3%	6.5%
international property	UBS Global Investors Index "(USD, unhedged, net divs)"	16.1%	15.9%	-2.1%	4.2%	11.0%
US dollar	LIBID 7 Day (USD)	0.2%	0.2%	0.8%	2.1%	2.0%
euro	LIBID 7 Day (EUR)	0.4%	0.5%	1.4%	1.9%	2.0%
pound sterling	LIBID 7 Day (GBP)	0.6%	0.6%	1.6%	2.6%	3.1%

breakdown of local share market performance by sector

period to 31 October 2012	% of ALSI	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
Top 40	83.0%	17.4%	14.8%	5.9%	15.0%	17.3%
Mid Cap	14.0%	24.7%	18.5%	11.4%	19.2%	23.4%
Small Cap	3.0%	25.2%	16.1%	4.4%	16.0%	25.0%
oil and gas	4.0%	8.3%	12.0%	6.1%	n/a	n/a
basic materials	29.0%	-1.4%	5.0%	-1.7%	11.3%	11.9%
industrials	6.0%	30.1%	14.9%	5.7%	14.9%	20.3%
consumer goods	19.0%	25.9%	26.5%	19.4%	23.4%	22.6%
health care	3.0%	49.8%	29.5%	22.1%	21.9%	24.4%
consumer services	11.0%	44.1%	31.3%	20.5%	24.1%	30.1%
telecommunications	7.0%	18.0%	15.0%	6.9%	18.1%	30.0%
financials	20.0%	31.1%	17.5%	6.1%	13.3%	17.7%
technology	0.0%	40.6%	31.8%	17.3%	22.7%	23.2%

The FTSE Group and the Dow Jones Indices have created a new definitive industy classification standard. The Industry Classification Benchmark indices were implemented by the JSEon 1 January 2006

Market performance

breakdown of international market performance by country

period to 31 October 2012	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa	
United States: S&P 500	12.7%	10.9%	-1.8%	2.3%	4.8%	
Germany: DAX	18.2%	10.3%	-2.0%	5.7%	8.7%	
United Kingdom: FTSE 100	4.3%	4.7%	-3.0%	1.2%	3.7%	
France: CAC	5.7%	-1.7%	-10.1%	-3.6%	0.9%	
Japan: Nikkei	-0.7%	-3.8%	-11.8%	-5.8%	0.3%	
Hong Kong: Hang Seng	8.9%	-0.2%	-7.1%	6.0%	8.6%	

all returns are calculated in the respective local currencies and are based on index levels

currency exchange rates

period to 31 October 2012		1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
ZAR/USD	8.6684	-8.3%	-3.4%	-5.5%	-3.6%	1.4%
ZAR/EUR	11.2416	-2.0%	0.7%	-3.5%	-4.7%	-1.3%
ZAR/GBP	13.9857	-8.6%	-2.9%	-0.6%	-2.3%	1.1%
ZAR/JPY	0.1086	-6.5%	-7.1%	-12.3%	-8.6%	-2.8%
USD/EUR	1.2964	6.9%	4.3%	2.2%	-1.1%	-2.7%
USD/GBP	1.6134	-0.3%	0.6%	5.2%	1.3%	-0.3%
USD/JPY	0.0125	2.0%	-3.9%	-7.1%	-5.2%	-4.2%

Market performance

economic indicators

economic growth	%	inflation	%
SA real GDP growth "(2nd quarter '12, annualised q-oq) "	3.2%	SA CPI (y-o-y change for September)	5.5%
US real GDP growth "(3rd quarter '12, annualised q-oq) "	2.0%	US CPI (y-o-y change for September)	2.0%
Euro area real GDP growth "(2nd quarter '12, annualised q-oq)"	-0.7%	Euro area CPI (y-o-y change for October)	2.5%
Japan real GDP growth "(2nd quarter '12, annualised q-oq)"	0.7%	Japan CPI (y-o-y change for September)	-0.3%
global developed markets real GDP growth "(2nd quarter '12, annualised q-oq)"	0.4%	G7 CPI (y-o-y change for September)	1.7%
interest rates		**commodities**	
SA repo rate	5.00	gold (London PM fix in USD as at 31 October)	1719.00
SA prime overdraft rate	8.50	y-o-y % change	-0.2%
US Fed Funds rate	0.25	platinum (London PM fix in USD as at 31 October)	1570.00
ECB refinancing rate	0.75	y-o-y % change	-2.2%
BoJ overnight call rate	0.10	brent crude oil (USD)	110.21
BoE repo rate	0.50	y-o-y % change	1.3%

Market performance

investment market performance

period to 30 June 2011	Index	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
International Equity	MSCI World (unhedged) Index (USD)	30.5%	0.5%	2.3%	5.4%	4.0%
International Fixed	Barclays Capital Global	10.5%	6.0%	7.1%	6.2%	7.4%
Interest	Aggregate (unhedged) Index (USD)					
International Property	UBS Global Investors Index "(USD, unhedged, net divs)"	39.0%	2.6%	0.7%	7.7%	10.9%
US Dollar	LIBID 7 Day (USD)	0.2%	0.6%	2.2%	2.5%	2.3%
Euro	LIBID 7 Day (EUR)	0.7%	1.2%	2.2%	2.2%	2.5%
Pound Sterling	LIBID 7 Day (GBP)	0.6%	1.2%	2.9%	3.4%	3.6%

breakdown of international market performance by country

period to 30 June 2011		1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
United States: S&P 500		28.1%	1.0%	0.8%	2.1%	0.8%
Germany: DAX		23.6%	4.7%	5.4%	8.9%	2.0%
United Kingdom: FTSE 100		20.9%	1.9%	0.4%	4.2%	0.5%
France: CAC		15.7%	-3.5%	-4.3%	0.9%	-2.7%
Japan: Nikkei		4.6%	-10.0%	-8.7%	-2.7%	-2.7%
Hong Kong: Hang Seng		11.3%	0.4%	6.6%	9.0%	5.6%

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