



Editorial comment

Mike Borland, director, FIRSTGLOBAL GROUP

So much has been said of late in the media about the Euro Crisis, US Debt Crisis and of the most recent stimulus package by the US Federal Reserve Treasury. We will, for this quarter at least, focus on how South Africa ranks against its global competitors, we take a look at Trusts and some important factors to bear in mind in the setting up and running of Trusts, we consider the success of the Living Annuity concept, we

pose the question of Risk profiling and whether investors are mindful of where they stand in this regard, and finally we include a thought provoking article on how much choice (and complexity) we should have in putting together a sound and robustly structured investment portfolio.

Enjoy the read.



Global Competitiveness Report

By Kevin Lings, Economist, Stanlib

South Africa was ranked 52nd out of 144 countries in the 2012/2013 Global Competitiveness Report, released last week. The latest ranking is down from 50th last year, but up from 54th in the prior year. While the latest rankings appear fairly stable at around number 50, South Africa has fallen significantly in the Global Competitiveness rankings over the past number of years. The top five places went to Switzerland, Singapore, Finland, Sweden, and the Netherlands, while last place went to Burundi. The key change at the top of the rankings was that the US fell to 7th place from 5th last year. Interestingly, China is ranked 29th.

South Africa remains an economy of extremes. This is illustrated in the breakdown of the components of the competitiveness ranking on the right. South Africa ranks near the top of the global ratings in a number of factors that mostly relate to the development of the financial sector and financial markets. In contrast, South Africa ranks last in the world in cooperation in labour-employee relations and second last in hiring and firing practices as well as the quality of maths and science education.

These extremes reflect in an economy that is able to compete with the best in the world in some sectors/components, but is ultimately held-back by crucial factors, mainly poor education and labour inflexibility. The main risk for the SA economy is that the factors as the bottom of ranking drag the other, better-ranked, components systematically lower. Instead South Africa urgently needs to find a way to utilise its inherent strengths to create employment. This is clearly going to have to include resolving the major education and labour constraints.

High Rankings

Regulation of securities exchanges	1 st
Strength of auditing and reporting standards	1 st
Efficiency of corporate boards	1 st
Legal rights index	1 st
Soundness of banks	2 nd
Protection of minority shareholders' interests	2 nd
Availability of financial services	2 nd
Financing through local equity market	3 rd
Strength of investor protection	10 th
Reliance of professional management	13 th
Quality of air transport infrastructure	13 th
Quality of management schools	15 th

Low Rankings

Availability of scientists and engineers	122 nd
Burden of government regulation	123 rd
Quality of primary education	132 nd
Life expectancy, years	133 rd
Pay and productivity	134 th
Business costs of crime and violence	134 th
Business impact of HIV/AIDS	135 th
Quality of educational system	140 th
Flexibility of wage determination	140 th
HIV prevalence, % adult pop	141 st
Quality of math and science education	143 rd
Hiring and firing practices	143 rd
Cooperation in labour-employer relations	144 th



The Question of Trusts — To be or not to be?

By Jeffery Wiseman, Head of Fiduciary Services at Momentum Wealth Group Ltd

“SARS to get tough on wealthy South Africans and their Trusts” (Moneywebtax 2 April 2012)

We have become accustomed to hearing announcements and unambiguous messages coming through from Government that they are not comfortable with the use of Trusts for the purpose, inter alia, of avoiding taxes and duties.

SARS has sent a message out that wealthy South Africans and their associated trusts will be a top priority for SARS over the next 5 years and that they should expect substantially more compliance checks and integrated audits.

Apparently offshore accounts in tax havens that are used by individuals to avoid tax will be given priority attention using international cooperation agreements.

In this article we take a look at Trusts and some interesting extracts from local and foreign legislation and case law which provide an indication of what the general thinking is around the use of Trusts. For those clients who already have local or offshore Trusts in place, or who are contemplating their use, this article will hopefully provide some valuable insight. Most of this information is sourced through Jeffery Wiseman who is Head of Fiduciary Services at Momentum Wealth Group Limited.

THE TRUST CONCEPT

Origins in South Africa:

- South Africa early 19th century with the British settlers
- South Africa trust a mixture of English, Roman Dutch and SA law

Trust definition:

The arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument

Trust Property Control Act, 1988

“The essential notion of trust law, from which the further development of the trust form must proceed, is that enjoyment and control should be functionally separate. The duties imposed on trustees, and the standard of care exacted of them, derive from this principle”.

Cameron JA in Land and Agricultural Bank of South Africa v Parker and others

THE CONCEPT OF THE ‘SHAM’

The English Common law position:

If it has any meaning in law, it means acts done or documents executed by the parties to the ‘sham’ which are intended by them to give to third parties or the Court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.

Diplock LJ. Snook v London and West Riding Investments Limited [1967]

The South African position:

Not frequently... the parties to a transaction endeavour to conceal its real character. They call it by a name, or give it a shape, intended not to express but to disguise its true nature. And when a Court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is: not what in form it purports to be.

Innes JA. Zandberg v Van Zyl (1910)

BADENHORST v BADENHORST (2006)

Facts:

- Used trust to accumulate assets outside of personal estates
- Trust assets included properties and interest in estate agency which the wife built up
- Trust granted the husband significant powers:
 - Determine when rights of beneficiaries vest
 - Hire and fire trustees
 - To receive compensation for acting as trustee
- In practice the husband treated trust assets as his own:
 - Seldom consulted with co-trustees
 - Reflected trust assets as his own in a credit application
 - Appropriated trust income for himself

Held:

- Just & equitable for trust assets to be included in the calculation of the divorce settlement

CONCLUSIONS

Trusts enjoy full recognition in SA and remain the estate planning vehicle of choice:

- So long as the functions of trusteeship remain essentially distinct from the beneficial interests, there can be no objection to business trusts.
- The great virtue of the trust form is its flexibility, and the

great advantage of trusts their relative lack of formality in creation and operation.

Aggressive use of the trust form without proper controls frowned upon:

- The core idea of the trust is debased... because the trust form is employed not to separate beneficial interest from control, but to permit everything to remain 'as before', though now on terms that privilege those who enjoy benefit as before while simultaneously continuing to exercise control...
- Where they [the trustees] are also the beneficiaries, the debasement of trust function means all too often that this duty will be violated.

Cameron JA in Land and Agricultural Bank of South Africa v JL Parker and Others

Suggested solution for Master to insist on the appointment of independent trustee in certain circumstances:

- The Master should... ensure that an adequate separation of control from enjoyment is maintained in every trust. This can be achieved by insisting on the appointment of an independent outsider as trustee to every trust in which (a) the trustees are all beneficiaries and (b) the beneficiaries are all related to one another.

In appropriate circumstances, the veneer of the trust should be pierced:

- Where trustees of a family trust, including the founder, act in breach of the duties imposed by the trust deed, and purport on their sole authority to enter into contracts binding the trust, that may provide evidence that the trust form is a veneer that in justice should be pierced in the interests of creditors.

Cameron JA in Land and Agricultural Bank of South Africa v JL Parker and Others

The universal requirement for clients creating trusts is to ensure that the integrity of the structure will stand up to attack:

- The success of the offshore trust industry was been founded, at least in part, upon the expectation of parties that a trust which as properly and lawfully come into existence following the execution of a trust deed will be enforced.
- If the court finds a trust to be a sham, then the trust will be regarded as void and the settlor and trustee will not be able to rely upon the trust deed as representing the true position as to the rights between the parties.
- A successful argument of sham will leave the settlor with absolute beneficial interest in the trust property which is capable of being taxed, inherited or claimed.

South African courts have the tools to make a finding that a trust is a sham and, while they have moved much closer to making a finding of this nature in recent years, they have yet to take the final step.

How to avoid a successful attack on a trust:

- Ensure that the trust is drafted clearly and understandably
- Observe correct formalities of trust management
- Trustees must demonstrate independence – separation of enjoyment and control
- Letter of wishes should not contradict the trust
(Jersey Law, 2011)

Editors Note

Frequently I am asked the question; "is a Trust a good thing?" Or hear the announcement; "I have formed a Trust and am going to transfer my investments/properties into a Trust to protect my assets from creditors."

The answer to the question is "yes and no"— it depends entirely on your situation and what it is that you hope to achieve through the Trust.

There are many reasons why they could serve as a very positive and meaningful planning instrument — it could be the operation of a business Trust, long term estate planning, protection of assets from creditors, management of investments for the benefit of beneficiaries in terms of Will Trusts, the protection of insolvent beneficiaries, tax planning and more — the list goes on and on.

BUT, it should be known that the realization of many of these outcomes is in most cases a very long term process, and we are talking decades.

So the transferor of investments/properties "overnight" into an Intervivos Trust (i.e. one created during the lifetime of an individual as opposed to a Will Trust created in terms of a person's Will) will be faced with a barrage of statutory and common law and judicial precedent which will render his "scheme" a sham and useless for the purpose of protecting his assets from creditors.

It is also clear from a glance at the tax tables that trusts (other than special trusts) are not smiled upon by SARS in every respect — income is taxed at a straight line 40%, Capital Gains are effectively taxed at 26.7% (compared with the personal sliding scale from 0% to 13.3%), and certain exclusions on interest and capital gains enjoyed by natural persons do not apply.

Also bear in mind that the existence of a Trust in one's financial "tool kit" can, and often does import complexity and complication to an otherwise more simple situation — as well as an increased cost implication.

It is therefore imperative that anyone contemplating the use of a Trust should take advice from a professional and qualified source — which source must understand very clearly what the purpose of setting up the Trust is and what the "collateral implications" could be outside of such main purpose. Once established the Trust should be run strictly according to the guidelines referred to above.



Living Annuities - Retirees have cracked the drawdown rate conundrum

By Gareth Stokes, Editor, FAnews

A great deal is written about saving for retirement. The industry mantra is that if you save 15% of your gross salary for 35 years, and never withdraw your accumulated capital when changing jobs, you should retire with enough capital to replace 75% of your final salary. It takes three or more decades of financial discipline to "buy" a reasonable standard of living through your golden years. One of the legacies of 20th Century financial planning is that the goal posts are pegged on the 65-year line... Back then your pension fund trustees would hold your hand – by looking after your accumulated capital – until you needed them most. Retirees would exit their pension or retirement fund and be "on their own" through retirement.

Since the turn of the century financial advisors have realised their clients need help through these difficult years. Improving mortality rates – thanks largely to medical innovation – mean that your clients are living 20-years and longer in retirement. As far as the financial planning game is concerned, the goalposts have shifted way back to the 85-year line (and beyond). Your task has morphed from one of ensuring your client has enough accumulated capital to "buy" a sensible income upon retirement, to advising the client on sensible post-retirement financial strategies. You need to advise your 65 year-plus clients on discretionary investments, annuities and drawdown rates to name a few... Although many believe the most important financial decision on retirement is which type of annuity to buy, a more crucial decision is how much income to draw each year.

MOMENTUM SWINGS IN FAVOUR OF LIVING ANNUITIES

The living annuity is among today's most popular retirement income vehicles, in part because any capital remaining in the annuity at time of death returns to the deceased's estate. A living annuity is described by the Association of Savings and Investments SA (ASISA) as a special type of compulsory purchase annuity that does not guarantee a regular income and where capital preservation is a function of the performance of the underlying investments and the level of income drawdown. There are three factors that contribute to capital preservation in these products, namely the level of income selected, the performance of the selected investment vehicles and the lifespan of the annuitant. There's not much your client can do about the latter, but sensible financial advice is of great value where point one and two are concerned.

The ability to choose income levels and investment vehicles is a double-edged sword. On the plus side, retirees enjoy the transparency and discretion they have over their accumulated capital. On the minus side things can go horribly wrong if discipline is not maintained. It seems the pros outweigh the cons, because by 31 December 2011 South African retirees had tucked away approximately R155.2 billion in 278 000 living annuities. And these financial instruments attracted net inflows of R23.9 billion last year. According to Peter Dempsey, deputy CEO of ASISA, their May 2012 release is the first time that the savings and investment industry has been able to publish

consolidated statistics on the size of South Africa's living annuity book.

In terms of the ASISA Standard on Living Annuities, which came into effect in 2010, member companies must provide a living annuity status report to the ASISA at the end of each year, beginning 2011.

"All 21 member companies that offer living annuities complied with this requirement, providing us with the first ever statistical overview of this saving segment," said Dempsey.

ARE SAVERS GETTING THE DRAWDOWN MESSAGE?

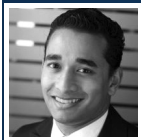
The law regulating living annuities requires that policyholders draw a regular (monthly) income of between 2.5% and 17.5% of the investment value of the policy. This level – also referred to as the drawdown rate – can be changed once per annum on the policy renewal date. In the absence of complete statistics retirement industry stakeholders believed that policyholders were drawing too much income... Individual who draws down too aggressively are at risk of depleting their capital well before death. The good news is that ASISA, thanks to the status reports, is in a position to monitor both the level of income drawn by policyholders as well as the asset composition of living annuity investment portfolios.

The survey showed that, in monetary terms, the average income drawdown level in 2011 was 6.99%. (This is the total value of incomes drawn expressed as a percentage of the total value of the living annuity book). This is encouraging since the industry expected the drawdown rate to be much higher! "While we would like to see an average drawdown rate closer to 5%, at around 7% the risk of policyholders' capital not growing or being completely eroded is much lower than previously thought," said Dempsey. "Asset managers and economists agree that investors can expect [real] returns of between 5% and 10% in the foreseeable future, which will help protect capital provided drawdown rates remain in the same range and policyholders maintain an appropriate asset composition in their portfolios."

Averages do not reflect individual situations. There is no doubt that many living annuity policyholders are drawing down capital in excess of the real return on their invested capital. Dempsey said there were a number of factors that could lead to higher drawdown rates, including early retirement due to ill health (where the policyholder draws down a high level of income due to a low life expectancy), older people opting for a higher drawdown rate (again to maximise income over shorter life expectancy), people who did not save enough for retirement and who could not survive on the income available when a low drawdown rate was selected; and people who opt for a living annuity with the specific aim of withdrawing all their capital over a short period of time, and the beneficiaries of a deceased person.

ANOTHER BIG "THANK YOU" TO FINANCIAL ADVISORS

"We believe that the drawdown rate has dropped significantly in recent years, partly due to the adjustment in the legal rate [in 2007], but also as a result of greater financial advisor intervention," concludes Dempsey. "Policyholders who are assisted by financial advisors generally select lower levels of income as they have a better understanding of the long term implications."



Know what your risk tolerance is

By Imraan Jakoet, Investment Analyst, Glacier by Sanlam

Risk tolerance is an important element of portfolio planning and can largely affect an investor's wealth-building. A general rule is the longer the time horizon, the greater the risk tolerance should be, writes Imraan Jakoet, investment analyst at Glacier by Sanlam.

Not knowing your true risk tolerance can be hazardous to an investor's wealth. Knowing your risk tolerance helps to shape his portfolio of products and the proportion of his investments placed in "risky assets", i.e. equity. This article looks at the factors that affecting risk tolerance and the importance of determining an appropriate risk level.

Most articles seeking to provide financial advice focus on saving for retirement and ensuring that an investor's nest egg grows faster than inflation to last long enough to sustain him in his old age. However, before people reach retirement they would ideally also like to live a full life. To do this they need to reach various financial goals along the way. These could include an overseas holiday, building their dream home or paying school fees.

TIME HORIZON AND FINANCIAL OBLIGATIONS

These goals come on top of usual living expenses and debt repayment. It is important for an investor to realistically estimate how much he'll be able to save for medium-and long-term goals and how much he will need to cover sudden expenses. It's useful to look at money in terms of investment time horizons. This can help determine the amount of risk an investor's money can be exposed to. As a general rule, the longer your time horizon the greater your risk tolerance should be. It is also important to note that premature withdrawal of funds from your savings can jeopardise an investor's chances of reaching his financial goals.

HIGH TOLERANCE

Had an investor's savings, for example, all been invested in the All Share Index in 2008 his risk tolerance would certainly have been put to the test. He would have really suffered had he needed to access his savings in December 2008 and would have been relieved had he stuck it out until the first half of 2011. Only investors with a high risk tolerance would look to be fully invested in equities. By definition investors with a high risk tolerance should invest in equities for longer periods. An emotional investor would possibly have switched much of his equity exposure to the money market in 2008. In hindsight this

Editor's thoughts:

The ASISA Standard on Living Annuities includes guidelines on appropriate income drawdown rates as well as sensible investment compositions to match policyholders' risk / return profiles. Financial advisors need to assist their clients in correctly balancing the income and return decisions to maintain their invested capital.

would have been the worst thing to do at that time.

DIMINISHING VOLATILITY

It is also important not to focus on short term returns, but on the diminishing volatility of returns in the longer term. In general, volatility tends to be much higher in the short term and can often distract investors from their long term objectives. In August 2011 we experienced a period that saw the US stock markets drop suddenly after rating agency S&P downgraded the credit rating of US treasury instruments. Over the following days markets rose strongly as investors capitalise on cheaper share prices and then prices plunged again as fear re-entered the market. What changed between those days, you may be wondering? Not much, really, but that just illustrates the power of investor sentiment and how irrational behaviour can influence your investments.

ABILITY TO TAKE ON RISK

Current net wealth not only affects the amount an investor is able to invest but also the amount of risk he can reasonably take when investing. The more money an investor has, the more he can invest and afford to lose. Including too little risk in a portfolio puts it at risk of growing at a rate below that of inflation.

EMOTIONAL TOLERANCE TO MARKET FLUCTUATIONS

Determining emotional tolerance to losses is probably the most difficult part of the risk assessment exercise. An investor's emotional tolerance is normally determined in the financial planning process via a questionnaire that assesses the amount of losses he would be willing to accept on his investments. The willingness and ability to take on risk should then be compared to determine whether there is a match. An example of a match would be where there is a high willingness and high ability to take on risk. When a mismatch occurs between these two, more investment education will be needed to explain the risks inherent in that. It is vital that the investor should be actively involved in the emotional part of his risk assessment as he is the best judge of his own emotions. If he really is averse to market volatility it is important that this comes out in his risk assessment. It is therefore imperative that he must remain as truthful and objective as possible in order to produce an accurate assessment.

Choice: enough is enough?

Extract from "How Much is Enough" by Arun Abey and Andrew Ford

Imagine what life would be like without your favourite yoghurt; the array of restaurants just around the corner from your office; new books or a DVD on just about any topic; jeans that perfectly fit your body shape; holidays to anywhere; or simply a cup of coffee made just as you like it.

There is an extraordinary range of choices in modern life compared with lifestyles as recent as a hundred – or even fifty – years ago. **Choice, and our ability to exercise it, is an important part of our freedom and enhances our sense of being in control of our destiny.**

It is, however, possible to have 'too much of a good thing'. When we navigate the endless rows of supermarket shelves and contend with dozens of types of breakfast cereals, styles of bread or baby foods, 'healthy' olive oils, soup mixes and pastas, excessive choice may well cause paralysis rather than joy. Without an advanced degree in actuarial science, anyone who has had to choose between different mobile phone plans will know the feeling of confusion and 'missing out' that may result.

On average, Americans now encounter 3000 advertisements for what they can acquire every day. Given such a glut of options, how can we hope to choose wisely?

The paradox that too much choice might be a bad thing has been explored by psychologist Barry Schwartz. He has identified two key consumer types: maximisers and satisficers.

Choice is especially hard for maximisers, who always seek out the best. They spend hours, days, weeks, wading through all possible choices. When they make a selection they often descend into

feelings of regret when something 'better' becomes available.

Maximisers have a particularly hard time with products such as computers. They feel compelled to test everything available and take longer to make decisions. Although objectively they may end up with better results, they are usually less satisfied in the long run. 'They are also less happy with life in general, less optimistic and more depressed', Schwartz tell us.

Maximisers are less able than other people to make any kind of decision at all. Drawing on research undertaken by Sheena Iyengar, Schwartz found that shoppers were ten times as likely to buy jam when only six varieties were on display as when there were twenty-four. Similarly, **when the number of ways in which people could save for retirement went up, the likelihood that they would choose to save at all went down.**

In the world of investment markets, this is a serious issue. For would-be maximisers, given that there are thousands of readily available investment options, and that it is impossible to forecast which will perform best, grief is almost guaranteed.

Satisficers, by contrast, settle for 'good enough'. They stop searching once they have found something that serves their purpose. They suffer less long-term regret than maximisers, waste less time and go home happy.

How will you deal with the extraordinary range of available choices, which can be either a source of disappointment or a contributor to happiness? **You will be happier as a satisficer rather than a maximiser. Satisficers understand what is important and do not waste time on irrelevant trifles and distractions.**

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