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Moderate budget

The budget for 2015/16, announced by the Minister of Finance, Mr. Nhlanhla Nene, last Wednesday, proposed increases in personal income tax, the fuel levy, the electricity levy, property transfer duties and the Road Accident Fund levy. Not to speak of the bad news for "sinners" with heavy taxes on cigarettes and alcohol!

Yet it was moderate in many respects and will NOT have a major impact on Ecsponent's companies and subsidiaries.

The dividend tax of 15% remains as it was. It is a relief that it was not raised by 1% as predicted by many economists. It is positive for Ecsponent's investors, as we have been obliged to deduct 15% withholding tax on dividend payments. Since this has not been raised our investors will not be receiving lower returns.

The tax rate for companies remains unchanged at 28% and the budget will not have a negative impact on the profitability of our subsidiaries and companies.

What has gone up, is the maximum marginal rate for individuals, but only by 1% and will now be 41%. It is the first time in twenty years that personal income tax has been increased, and indeed many of our investors will pay higher taxes.

And as from April 1st the general fuel levy will be rising by 30.5 cents per litre – no April Fool's Joke! An additional increase of 50c per litre in the Road Accident Fund levy, will bring the total fuel levy increase to 80.5 cents a litre.

Investors will, no doubt, be concerned about the expected economic growth of 2% in 2015. This is extremely low and will put a lot of pressure on the Treasury. The best way to address this, would be initiatives which unite South Africans to promote effective growth and combat corruption and unemployment.

Kind regards,

Floris

Floris Slabbert Sales Manager

Beware of costs!

The cost of a fund manager can weaken the return of equity investments to the extent that the investor lands up with little or no growth in his or her portfolio.

Yet there is the emotional confidence of investors that their fund managers "will beat the market" – which would make their fees worthwhile.

Unfortunately this is usually not the case. Research has shown that most fund managers do not outperform the market average and the fees they charge, can have a significant impact on the growth of an investment portfolio, especially if there is a downswing in the stock market.

Fund managers will tell you they buy low and sell high. There are however only two parties where only one can buy low. And this one is not necessarily your fund manager.

A recent example is a well-known asset manager who has 65 fund managers. When African Bank collapsed, they were with 22% the largest shareholder in the bank. Even when the red lights were flickering, the asset manager continued investing in the bank.

Fund managers make mistakes. Why must investors pay high fees when the All Share Index often beats the returns of their individual selections?

It would of course be difficult for a fund manager to justify fees when funds are invested in the All Share Index – so there are vested interests that prevail.

Almost ten years ago, Rob Rusconi, an independent actuary, shocked the market with his research about the impact of fund managers' fees on investments. He showed how bad the actual returns of pension funds were.

Rusconi's finding - that 1% cost per year over a period of forty years reduces the investor's return by 30% - caught the market off guard. There is always talk of compounded growth but what about compounded costs?

Many fund managers are compensated on the basis of the percentage of funds under their management. The more they manage, the greater the reward. This could motivate them to obtain more funds, rather than to show good returns.

There is a wide variety of investment funds and Rusconi believes many of them are deliberately made to appear complicated to justify charges or hide facts.

The funds have certain benchmarks, for example inflation +3%, and fund managers are compensated if returns beat the benchmark. They choose the measure which suits them best and in a bull market, the measure of inflation + 3% is easily beaten - which means big bonuses. As if that were not enough, investment houses receive super profits if the benchmarks are exceeded.

If the fund manager fails to reach the benchmark in the given period, the investor is also the one at the losing end. In an attempt to save the day, the manager will chop and change the investments and if his efforts fail to reach the benchmark, it is the investor who will suffer major losses.

Commission to a broker is often seen as the major culprit when it comes to investment costs. Yet, according to Rusconi this represents only 35% of the total cost of retirement plans. In reality, 13% constitutes upfront costs for infrastructure and 16% for marketing, distribution, etc. The ongoing costs consist of 9% for profits, 3% tax, 14% maintenance costs and 10% for investment costs and guarantees. It seems the finger is deliberately shown to the adviser to deflect attention from the real cost picture.

There is the ethical question of whether trustees neglect their fiduciary responsibility by not questioning the actions of fund managers and specifically how cost is recovered and how bonuses are allocated.

A devastated investor recently approached Ecsponent about his investment of R500 000 at a well-known commercial bank. After seven months the investment was standing at R499 237. He was upset because the expected growth was supposed to strengthen his retirement. He would have to work for a longer period if this did not happen.

An analysis of his investment statement showed that an initial cost of R7 500 (1.5%) was deducted by the financial advisor. Further registration and initial costs reduced his initial investment amount to R491 552.

The product guaranteed the capital less the cost. So not R500 000, but only R491 552! The investor didn't realise this.

Monthly management fees of R212, R242 advice costs, as well as R120 for the financial advisor were paid. So a total monthly cost of R574!

An analysis of the fact sheet of the product in question showed a performance bonus was also paid to the fund manager. This was 25% of the proceeds if the benchmark of Consumer Price Index (CPI) + 2% was beaten – which is very low as most of the other benchmark starts at CPI + 3%.

The CPI for the past five years averaged at 5.3% per year. This meant a bonus was paid to the fund manager if the fund outperformed 7.3%. In January, the inflation rate fell to 4.4% - which meant the fund just needed to do better than 6.4% to earn a bonus.

Ironically this means a fund manager benefits by being "compensated for the fall in inflation" without any additional work being done.

The fact sheet showed the fund returned an average yield of 7.82% per year over the last five years. If the average inflation was subtracted, it meant the fund only showed a return of 2.6% per year above inflation. Subtract the cost and it is clear the investor is the loser!

Had he decided to invest the R500 000 seven months ago in Ecsponent's Class B shares, at a rate of 11.2% per year, his capital would have stood at R532 655.

Ecsponent offers investors 100% capital allocation from day one and pays good and reliable returns – especially in the long term. We honor accountability to our clients, and treat our clients fairly at all times.