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Uncertain economic times

Fluctuating exchange rates and uncertainty in local and international stock markets do not predict anything good for South Africa and the world economy.

Current developments are creating anxiety about the safety and growth of investment and retirement savings. Investors are looking for safe opportunities where there is reasonable growth and their capital is safe.

Everything indicates that the uneasiness in the markets is heading for a disaster, but no one knows exactly what will happen. According to some market analysts the world economy may even come to a total standstill, which means that stock exchanges could fall dramatically.

The only ray of light is the US where unemployment has started to decline and the economy is showing moderate growth. There is growth of 2% this year and the Federal Reserve (Fed) is expected to increase interest rates later this year.

All eyes have been on the BRICS countries (Brazil, Russia, India, China and South Africa) which were supposed to be the saviours of the world economy. These economies, however, shrunk or performed poorly. The big problem is that the Chinese economy is no longer driven by industrial growth, but by consumption and the demands of the service sector. This meant that the share prices in China started to decline significantly.

This change in China led to a global oversupply of commodities such as steel and coal and, according to some market analysts, this could last for up to ten years. This has serious implications for South African companies which export commodities.

A sign of the changing economic times is that a weakened rand used to favour South Africa's exports in the past. Today the weak rand has hardly any benefit for exports, owing to the dwindling demand for commodities.

In fact the weakened rand has fuelled inflation and spread poverty. According to Sasfin Securities South Africans have become 6% poorer per annum, measured in terms of dollars over the last twenty years.

The World Bank also has warned that South Africa will have to act urgently to address issues such as labour and the shortage of electricity. This month the National Union of Mineworkers started with a strike – their 30 000 members are directly involved in the delivery of coal to Eskom's power stations.

Only about 8% of South African households have a budget or a financial plan for wealth creation and retirement – according to Unisa's Department of Taxation. It is therefore no surprise that only 17% of people have enough money to retire one day and take care of themselves.

Consumers are living on debt and banks are becoming stricter with regard to lending, because South Africa is in a rising interest rate cycle. There are currently 19 million South Africans with a weakened credit record – according to the National Credit Regulator – which is the highest ever. At the same time, a record number of 10 000 homes are repossessed annually because of non-payment.

The challenge in these difficult economic times is to earn a reasonable return on investments. Consumers are looking for safe investment options where the return is fixed.

This is exactly what Ecsponent's preference shares offer, because the rate of return of all three classes of preference shares are fixed and not linked to the fluctuations of the stock market. The investor knows exactly what will be earned over the next five years. It gives peace of mind and enables the investor to draw up a realistic business plan, budget or income plan.

Why a Pension Fund?

Preserving retirement savings is crucial to ensure financial independence in your old age. Your decisions today will determine whether you will enjoy carefree retirement or be dependent on charity one day.

The question is whether current pension funds perform adequately enough for you to entrust your longstanding contributions to the system?

The State encourages people to save for their retirement by offering tax rebates on retirement funds. They are exempt from income and capital gains tax which provides a great advantage over other options such as investments in unit trusts. Tax deduction (15% of gross income) also applies to annuity contributions.

The main benefit of a pension plan/annuity is that it encourages people to save and in fact forces them to do so. The longer you save, the bigger the advantage of compounded growth (which Albert Einstein called the eighth wonder of the world). Time in the market has a strong positive impact on the growth of a pension. A pension plan can protect you from yourself if you do not have enough discipline to save consistently. It is a blessing for people who would otherwise waste their retirement savings if they were able to put their hands in the piggy bank.

At the same time, however, the State imposes restrictions on what you may do with your pension money once you retire. There are rigid rules which may be in your interest, but could also be very frustrating for some.

The member of a pension fund who takes out an annuity after retirement, may for example only redeem a third of the money. The other two-thirds pays a monthly income and cannot be retrieved again.

Fines of up to 30% of fund value applied before January 2009 if a client discontinued contributions or decided to make the policy paid up. It has since been reduced to about 15% of the fund value, depending on the premium term. This is especially applicable to annuities issued by insurers in a policy where the premiums are discontinued before the end of the term. The prepaid commission (sometimes up to thirty years) is seen as debt which must be paid. It is often regarded as unfair terms of contract which reduce the retirement benefits significantly.

Section 28 of the Pension Fund Act determines the maximum percentages which provident funds/retirement funds may invest in different asset classes. Only 75% may be invested in shares and 15% in offshore investments. However, shares outperform any other asset class as we experienced over the past 25 years. Despite three corrections over this period, the share market delivered returns of consumer inflation plus eight percentage points.

Clearly pension funds are managed very conservatively with returns hardly ever more than 8%. If costs are deducted, the proceeds may be even 5.5%. This is close to inflation which means most pension funds perform poorly.

In the past the life insurance industry charged heavy fees on annuities. It has been reduced in recent years, although initial, annual and fund management costs continue to have a significant impact on fund values.

Many people feel it's their own hard earned money and they would prefer to determine and manage their own financial well-being – especially in light of planned pension legislation which will limit further access to pension fund withdrawals.

The question is whether it will be worthwhile to pay the costs (taxes) due should you withdraw your money from the pension fund system and invest it yourself?

Let us look at the options of a 65 year old pensioner. The first R170 000 will be tax free if the pensioner withdraws annually R300 000 from his pension. If the pensioner falls in a marginal rate of 23%, the after tax return would be 6.9 %– if the pension fund earns a good yield of 9 %.

At Ecsponent the same pensioner would earn an after-tax return of 9% on Class A2 Income. This is also a net rate since no cost is charged by Ecsponent.

The option to invest and control your own pension money is an opportunity to get out of the rigid pension fund system. It liberates you to start on a clean page. There are no penalties, control or hidden costs with Ecsponent and you know where you stand with your retirement.

This is, however, only an option for someone with self-discipline who will manage the investment faithfully to secure that nest egg for the retirement years.