Politicians around the world are known to exchange popular promises for votes ahead of elections, and often once constituents have drawn their crosses, these are not fulfilled. South Africa is facing a general election in May and promising statements and announcements by political parties must be read and heard with a pinch of salt. This is an unfortunate situation as the country is desperately in need of strong leadership to steer economic and political policy.

President Ramaphosa’s State of the Nation Address (SONA) created a good balance between the ruling parties’ agenda and strong economic policy. However, the positive sentiment did not come through as strongly in the subsequent 2019 Budget presentation by finance minister Tito Mboweni.

While many investors, including corporates, are taking a wait-and-see approach to investing, the JSE has strung together three consecutive positive trading months since the start of the year. It still has some way to go before it reaches the same levels recorded in late 2017 and early 2018. However, the positive change may lure investors back to the market, which leads to the next question: “where should one invest?”

Combining investments and politics, the conversation is naturally steered in the direction of the ANC’s election manifesto which indicated the intention to prescribe local pension fund money to invest in struggling state-owned enterprises, such as Eskom and SAA.

Calendar of upcoming events

Tuesday & Wednesday 19 – 20 March
Third Party Risk Management Conference
Ecsponent CEO, Terence Gregory, is one of the presenters at this conference and will focus on the risks and mitigation strategies for supply chain management.

The Ecsponent Group’s Pretoria office has relocated
From 4 March the office’s physical and registered address is: 1st Floor, The Wedge, 43 Garsfontein Road, Pretoria

Our phone and fax numbers remain the same. Similarly, our general email address and individual emails of team members will remain unchanged:

t: 087 8080100
f: 086 4323459
e: info@ecsponent.com

Our new premises provide our teams the ability to share one space and collaborate freely to continue to grow our business. It is also big enough to allow us to grow our teams in the areas where our business is expanding. Your support is one of the key reasons why we have grown over the years and we look forward to seeing you at our new address.
It failed to deliver an economic plan in support of the positive State of the Nation Address, delivered by President Cyril Ramaphosa during the opening of parliament earlier this year.

We needed a credible plan to boost growth, considering that over the past ten years the South African economy has grown on average by only 1.7% per year. This rate is low, compared to most other middle-income countries, and far from the targets set by the National Development Plan (NDP). The NDP targeted 5% annual growth and the creation of 500 000 jobs per year. Today this is totally unrealistic and even the ANC has decided to scale this down to only 275 000 job opportunities per year.

A year ago, President Ramaphosa predicted that a growth rate of 3% was achievable. It has since changed to 1.7% and was later adjusted to a dismal growth of 1.5%.

One consequence of this lower than expected growth rate is that the budget deficit is increasing. The budget deficit for 2018/2019 will be 0.2% higher than the 4% predicted in the medium-term budget. This will rise to 4.5% the following year and the debt-to-GDP ratio will rise to 60.2% in 2023/2024.

This will be the first time since 1994 that the debt to GDP breaches the 60% level. For the past ten years South Africa’s debt has been growing year by year. If there were any efforts at all to stabilise the debt, they were not successful. Our country is already spending over R1 billion per day just on interest.

The poor growth performance is affected by several factors, including the slowing down of the global economy, which compromised South Africa’s ability to increase export earnings.

Another contributing factor is state owned-enterprises (SOE) receiving ongoing bailouts. While the Minister stated that the government will not provide further guarantees for the debt of SOEs, billions were allocated to the restructuring of Eskom. This is in addition to the guarantees government issued in respect of their debt in the past.

A turnaround plan of the SOE’s could decrease the pressure from rating agencies and also reduce the interest rate on government debt. South Africa does not have the resources to sustain the SOE sector indefinitely and the government must admit that the current structure of the state as the sole shareholder, is something of the past. On the whole these agencies have proved that they were not able to change or adapt to a new financial era.

Moody’s is scheduled to issue updated ratings in March. If South Africa is downgraded to sub-investment grade, billions of rand of bonds will flow out of South Africa. This is because the Citi World Government Bond Index does not allow asset managers to invest in junk status countries.

Moody’s responded to Minister Mboweni’s speech by saying it “highlights the government’s limited fiscal flexibility amid a challenging economic environment.”

To boost economic growth and create jobs, we need a fundamental change in our economic policy. The government should rather support the private sector, as they are the ones who visibly create employment and growth. The growth enhancing reforms in President Cyril Ramaphosa’s economic recovery plan is losing momentum and it is unlikely that this will alter the country’s growth projections significantly.

Knocking the term “white monopoly capital” and referring to “business champions” or “heroes” last year, was an effort by Ramaphosa to link up with the private sector. However, as long as no meaningful action is taken, the fiscus will deteriorate. You must do what is required in a capitalist environment and be frank with the unions so that they can deal with it.

Was enough said in the budget to motivate the private sector to invest again in South Africa? Definitely not. There are too many uncertainties, like land expropriation, and everyone is waiting to see what is going to happen with the election and if South Africa will be downgraded by Moody’s.
What qualifies as a suitable investment?

In the world of investment there is no one size fits all. A prudent advisor will recommend a plan based and built around your own personal circumstances and needs. “Investment suitability” is key.

There are no short cuts. Advisors worth their salt design a tailor-made investment strategy for each individual. These strategies are essential and form the core of your investment process and a sound financial plan.

What does “suitability” mean and how is it measured?

The Suitability Rule (Sections 8(1) (a), (b) and (c) of the FAIS General Code of Conduct) requires that all financial advisors have a duty to ensure their recommendations fit the unique circumstances of the client.

Suitability is not only a case of someone being a cautious, balanced or aggressive investor. There is far more to the full meaning of suitability with regard to investments.

It is the degree to which the product or service offered, matches the client’s financial situation and the level of risk tolerance. Any financial planning must be aligned with the client’s financial personality as well as his/her needs and objectives.

Each investor is different and the circumstances of each need to be identified through initial discussions and using risk profiling tools. The discussions must be fruitful and tools visual so that clients clearly see the degree to which they want to expose their capital to risk and what the possible rewards are.

Bear in mind that both attitude to risk and capacity for loss may be changed temporarily by die nature of vulnerability. An investor might suffer illness, divorce or retrenchment and it might become necessary to delay initial investment decisions for a period of time, or even change them to adapt to new developments.

The investment advice must be suitable to the client’s position at that point in time. Being a vulnerable client is not necessarily a permanent state of affairs. As the circumstances change, the financial advice must be adjusted accordingly.

Vulnerabilities may emerge over time and can change the risk profile of the client. A loyal and prudent advisor will be understanding and mindful and overcome biases.

Complicating the matter is that very low risk investments can be as damaging to an investor’s portfolio as very risky investments.

Interestingly enough is that the rule does not cover losses. Just because an investment is suitable, does not mean it is advisable or that it will be profitable. Suitability does not automatically imply risk-free. Similarly, unsuccessful investments are not necessarily unsuitable. No one can categorically predict the rise and fall of the market, and that is why financial loss may also occur from suitable investments.

Risky investments might have greater returns, but you could also lose your full investment. The reality is that most clients have financial needs which are impossible to address. At present projection rates, more than 94% of South Africans will not have enough capital to retire. Such clients actually require an unrealistic investment, but with regard to risk it is absolutely unsuitable.

Suitability Rule

The Suitability Rule merely requires that a financial advisor has a reasonable basis for recommending an investment or strategy. The advisor must know all the facts about the investment and why it would suit the investor perfectly at that point in time.

Hence, the sale of an annuity (funds only accessible at age 55) to a young client who needs reasonable access to money, would be unsuitable and could constitute fraud or investment negligence. Likewise, the advice to put money into risky investments, could be unsuitable for a conservative investor.

The suitability rule is also violated if the financial advisor does not fully understand the product which is recommended. An advisor must undertake sufficient due diligence to understand the potential risks with the recommended strategy or products. Ignorance is no excuse.

How is suitability ensured?

A risk profiling exercise is done to assess the investor’s • emotional tolerance to risk • financial capacity to risk • perception of risk • needs • ideal asset allocation; and • the expectation of returns.

This helps to create a plan that will attempt to meet the needs of the client, taking into consideration their views, insecurities and appetite for risk. Such a plan will provide the ideal asset allocation for investments, matching their goals which include cash flow, risk management and proper estate planning.

The essence of the plan is based on the principles of Treating Clients Fairly (regulatory framework set by the Financial Sector Conduct Authority) which place the clients at the centre and delivers a fair outcome for them.

Also required, are diversification principles across asset types, like property and equity, as well as diversification within asset types, like foreign and domestic equity. Additionally, diversification like small cap, medium cap or large cap equities.

This plan must be set out in clear documentation with a “reasons why” report documenting why the particular strategy is recommended and how it addresses the client’s investment objectives and preferences.

Providing suitable advice is one of the key outcomes of the FAIS Act. Section 16 of the Act specifically requires that a code of conduct must be drafted to ensure that clients will be able to make informed decisions, and that their needs regarding financial products are satisfied appropriately and suitably satisfied.
In its election manifesto, the ANC indicated the intention to prescribe to local asset managers to invest in struggling state-owned enterprises, such as Eskom and SAA. The prescribed assets policy will enable government to access ordinary South Africans’ savings and pensions. This will significantly weaken pension fund returns.

This move is nothing more than a form of taxation or redistribution of wealth to get even more money for government spending. This means that pension fund members have to face the music and compensate for government corruption with their hard-earned retirement money.

Golden years may be cold years
Retirement savings are not just about how much you invest. What is critical is how your retirement capital is managed. For most South Africans, their retirement fund is their biggest, if not their only, investment, and any irresponsible investment decisions will be reflected in their old age.

As it is the vast majority of South Africans are not able to retire independently. It is estimated that only about 6% will be able to do so. If the government succeeds with their latest plan, the percentage will decrease even further. People will be discouraged from saving for their retirement and could lose faith in pension funds.

Financial sins in retirement
Many people will react by withdrawing their maximum monthly amount from their pension funds or similar retirement funds if the fund managers are obliged to make poor investments. It contradicts the golden rule that you should stay invested as long as possible to enjoy the benefit of compound interest/growth.

Compound growth is known as the eighth wonder of the world and influences long-term investment (such as a pension fund) significantly.

Withdrawals, without reinvesting again, negatively affects the pension fund’s value upon retirement and are the reason why so many people do not enjoy the real effect of compound interest.

Old but not cold
Our life expectancy is much longer today than it was several years ago. Half of men who are currently 60 years old, will reach the age of 85. Women aged 70 today could live up to the age of 93. Long lives require substantial investment to be self-sustaining. Many retirees underestimate their life expectancy and believe their funds are adequate, only to be disappointed later.

South Africa is not unique. Worldwide, life expectancy is rising. The growing ageing population, as well as the financial need of most retirees, mean that the pool of people who are dependent on a state pension will only grow - which will become a major challenge for the government.

Government can no longer care
The guaranteed pensions of the past, no longer exist. You need to look after your own interests today and make sure your funds are adequate. Have you saved enough capital to survive when you retire?

How does the state manage its own pension fund?
The State Pension Monitoring and Promotion Association says the fund (the largest in the country with 1.27 million active members and 450,322 pensioners) has an estimated long-term financing deficit of R469 billion. The cash inflow in the 2018 financial year could not fully cover the disbursement of fund benefits. The last actuarial valuation was in March 2016 and the fund is silent on why the valuations have not been settled in time.

The fund made high-profile investments such as Steinhoff and the bankrupt VBS Mutual Bank, and Eskom, Denel, Sanral and the bankrupt Isibaya projects were funded at will.

Retirement must be planned and purchased
Retirement can only be purchased and provided for when you are younger and still generating an income. A safe rate for retirement provision is 25 times the income you want as a retiree.

If you want to receive a pension income of R200 000 per year as income, you need to invest 25 x R200 000 = R5 000 000.

Road to retirement not easy
Remember that the road to retirement is not always easy. It is accompanied by many sacrifices, but the destination will ultimately make it worthwhile.

The consequences of our decisions are usually only experienced later. That is why it is so important from the outset to plan, make wise decisions and adjust if the tide or regime changes.