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WEEKLY REPORT

OVERBERG MARKET REPORT

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Global Report

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Is a retirement annuity really the best way to save for retirement?

There are various ways to build up one's wealth and plan for retirement. Two common South African strategies involve investing in a retirement annuity (RA) and investing in a discretionary investment (DI). The prevailing view amongst many financial advisors within the industry seems to be that an RA is the preferable route because of the tax efficiencies it allows whilst saving towards retirement age. This is indeed an advantage, however there are other important factors to consider, the impact of which may significantly outweigh this tax benefit.

At Overberg Asset Management, we have access to a one-of-a-kind, industry-leading calculator that can forecast the impact of the above (and many other) factors, thus assisting to answer the critical question above. It can show that, depending on your personal financial circumstances - and perhaps contrary to popular opinion - a discretionary investment can potentially be a significantly more beneficial investment strategy over the course of one's lifetime. When assessing the options, it is necessary to gain an understanding of the two investment structures and the inherent pros and cons of each.

What is a retirement annuity?

A retirement annuity is an official retirement savings vehicle that is governed by the regulations of the Pensions Fund Act 24 of 1956. These regulations place certain restrictions on both the asset allocation decision (Regulation 28) and the extent to which one can access funds. The earliest one may access a portion of the investment is at the retirement age of 55. No withdrawals are permissible until retirement age (with a few exceptions). Both the pre- and post-retirement scenarios should be reviewed.

Key considerations of an RA pre-retirement:

- The contributions made to an RA are tax deductible, subject to a maximum limit of the lesser of R350,000 or 27.5% of the greater of one's remuneration or taxable income.
- Both the income and capital gains earned within the RA are not taxable.
- Upon emigration, access to the investment sum can only be obtained after demonstrating to SARS that one has been a tax resident of another jurisdiction for 3 consecutive years (a 3-year waiting period).
- Regulation 28: This regulation effectively places limits on one's asset allocation decision, which is the primary determinant of future potential returns. It stipulates that no more than 75% of one's capital can be invested in equities. Additionally, as of February 2022, the maximum exposure towards offshore assets is limited to 45%. This significantly inhibits the extent to which one can be exposed to a far greater investment universe and potentially

superior investment opportunities. It also limits the degree of geographical diversification which can be achieved in one's portfolio.

Key considerations of an RA at and post-retirement:

- When one has reached retirement age or when one wants to access the funds in an RA at a later stage, the RA must be matured. At maturity, one is only able to access a maximum of 1/3 of the value of the capital sum as a lump sum withdrawal and the remainder must, in terms of regulations, be used to purchase an annuity. Alternatively, if no lump sum is withdrawn, then the full investment amount must be used to purchase an annuity. This can either be a living annuity or a life/guaranteed annuity or a combination of both. A living annuity is more common and lasts until the investment is depleted, which is considered below.
- The exception to the above is that the full amount of the capital sum can only be withdrawn if the investment is lower than the *de minimis* value, currently R247,500
- A lump sum withdrawal may be taxable. Currently, accumulated withdrawals of R500,000 or lower are not taxable (subject to certain exceptions), however larger sums are taxed according to a specific tax table and the tax payable thereon may be considerable.
- An income of between 2.5% and 17.5% of the investment sum must be withdrawn annually. This sum can be paid monthly, quarterly, or annually. The drawdown rate one selects is an important decision as this can only be changed once a year at the policy anniversary date. These restrictions may create difficulties should one's financial needs change during the year.
- The annuity income is subject to tax and is taxed as normal income at one's marginal tax rate. For individuals that fall into the higher tax brackets, this may equate to a significant tax burden over the course of one's retirement.
- The annuity income will be paid in South Africa in Rands.
- You may only access all the funds in your investment if the capital sum is below a certain level, currently R125,000, and this withdrawal may be subject to tax.

It is therefore critical for investors to note that when investing in an RA, they are also effectively committing to enter an annuity contract at retirement. The tax burden both at, and following retirement, can be substantial. These are also regulated investment vehicles and are therefore subject to regulatory changes from time to time, which may or may not be favourable to investors.

What is a discretionary investment?

A discretionary investment (DI) refers to an investment using "after-tax" money. The underlying investment vehicles can be unit trusts, share portfolios, offshore products etc. As the name suggests, an investor can use their discretion to invest their funds with almost no restrictions and according to their risk profile, investment strategy and financial goals.

Key considerations of a DI:

- Unlimited contributions and withdrawals at any time. However, contributions are not tax deductible.

- Dividends and interest earned are taxable, the annual interest exemption would however apply (local interest earned: currently R23,800 for persons under 65 and R34,500 for those over 65).
- Capital gains tax (CGT) will be levied upon capital growth when equities/investments are sold (for switches and withdrawals). The current annual CGT exclusion of R40,000 would be applicable.
- There are no restrictions on offshore exposure and investors can utilize their annual discretionary allowance of R1 million and/or annual foreign investment allowance of R10 million (subject to tax clearance) to fully invest offshore.
- Upon emigration, there is no waiting period for funds to be sent offshore (subject to tax clearance). Offshore funds can be accessed immediately.
- Offshore investments do not have to be repatriated to South Africa.
- No restrictions on the asset allocation decision and investors can gain a greater degree of exposure to potentially more attractive global investment opportunities.
- An offshore investment in hard currency serves as a Rand hedge. Over the last 10 years, the Rand has depreciated by approx. almost 7% against the US Dollar and approx. 4% against the British Pound per annum. The effect of such exchange rate movements can therefore have a very compelling effect on the Rand returns that South African investors can achieve over the long-term.

How should investors choose what is best for them?

To ascertain how to best invest for your retirement, it is recommended that you seek advice from professionals. However, blanket advice where your personal circumstances and financial position are not fully understood and assessed may potentially result in an inferior investment outcome for you.

When comparing whether an RA or DI will be more beneficial for you, the following two key factors (amongst others) should be analysed:

1. **The impact of potential returns on the investment**: An RA is subject to investing restrictions in terms of Regulation 28. These associated limitations may potentially result in lower returns over the course of the investment. It is important to remember that the investment horizon for one's retirement is a very long-term time frame. Even a small differential in returns may have a sizable impact over time given the effects of compound growth.

2. **The tax implications both at and after retirement**: A lump sum withdrawal from an RA of more than R500,000 will be subject to tax. Additionally, the subsequent annuity income received is taxed as income at one's marginal tax rate. This is, therefore, a crucial consideration for individuals in higher personal income tax brackets. The quantum of this tax burden can be so substantial that it can negate much of the tax benefit gained from an RA during pre-retirement years.

Fortunately, Overberg Asset Management has access to various one-of-a-kind calculators, one of which will facilitate forecasting whether a RA or DI will be more beneficial for you. The results are extremely comprehensive and can cater for all applicable taxes, costs, investment returns etc. The results will show the full breakdown of forecasted annual cashflows and the tax implications over the full investment period. It is important to consider various scenarios when using the calculator, and these scenarios can be determined instantaneously.

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Contact Overberg Asset Management to book a free consultation with one of our Wealth Managers to benefit from this highly specialised financial offering. This offer is available to all Overberg Asset Management clients or prospective clients looking to invest R1 million or more either locally or offshore.

Local Report

Gielie Fourie

Small was beautiful in 2022.

INTRODUCTION: Small was beautiful in 2022. Stocks with smaller market capitalisations performed surprisingly well. Likewise smaller stock exchanges also did surprisingly well relative to the bigger stock exchanges. The Davids of the stock markets sometimes manage to beat the mighty Goliaths. During quarter 4 2022 (Q4 2022) stock markets started to recover. European markets were at the vanguard of the recovery. At least two stock markets have reached all-time highs last week. The outlook for global markets has greatly improved compared to this time last year.

2022 was one of the worst years for the stock market in the last 80 years. Financial asset prices were rattled by the highest inflation and the sharpest increase in interest rates in over 40 years, strict Covid restrictions in the world's second largest economy, the biggest war in Europe since WWII and an energy supply shock that rivals 1973. The all-important 10-year US Treasury bond yield, against which all financial assets are priced, reached a peak of 4.23% in October 2022 compared with 1.49% at the start of the year but by the end of December had stabilised at 3.88%. The US dollar index fell 7.7% in Q4 2022. A weaker dollar helped to shore-up global liquidity, to the benefit of global financial markets.

BIG AND SMALL STOCK EXCHANGES: Big stock exchanges suffered in 2022. In the US the Dow Jones was down 8.77%. In 2019, 2020, and 2021, the S&P 500 was up more than 31%, 18%, and 28% respectively. In 2022 the S&P 500 was down 19.34%. The Nasdaq 100 was up 160% between 2019 and 2021. In 2022 it was down a whopping 32.87%. In the East it was red ink all over the markets. The Nikkei 225 was down 10.92%, the Shanghai Composite was down 15.13%, the CSI 300 was down 21.63%, the Shenzhen was down 21.92% and Hongkong was down 15.46%. Australia's ASX 200 was down 5.45%. In Europe, the German Dax 40 was down 13.09%, in France the CAC 40 was down 9.5% and in Russia the MOEX was down 44.09%. The STOXX Europe 600 index was down 12.9%. This index is a wide-ranging European index. It has 600 components representing large, mid, and small capitalization companies among 17 European countries.

Some smaller exchanges in emerging markets outperformed the bigger exchanges of the developed markets. The Indonesian Jakarta Exchange (the JCI) was up 2.78%, and in Greece the Athens General Exchange was up 3.88%. In Turkey, the small Borsa Istanbul 100 (BIST100) index was up by a massive 172.99%. The Johannesburg Stock Exchange (JSE) was up a mere 0.90% in 2022, or 3.6% including dividends. In the UK, the benchmark FTSE 100 was slightly up at 0.91%, the same as the JSE. The JSE and the FTSE are both down by the same percentage but bear in mind that the ZAR dropped by 2.7% against the GBP in 2022. Even taking that into account the small JSE performed well against the much bigger FTSE exchange. The JSE and the FTSEs near identical performance in 2022, continued into 2023. Last week the FTSE 100 hit a record high, surpassing its all-time high of 7,903.50, hit in May

2018. The JSE did the same – it hit a new all-time high of 80,129 yesterday, 23 January 2023. Not too bad if you remember that it was below 40,000 just three years ago, in March 2020.

THE WINNERS: There was money to be made within the JSE Top 40. Eight stocks – Nedbank, ARM, Absa, Woolworths, Investec, Glencore, Exxaro, and Mediclinic were up over 20% in the year. Some smaller stocks and micro capitalisation stocks did much better. The share prices of six JSE-listed companies more than doubled in 2022, with four of these more than tripling. There are small and microcap companies on this list, including Stefanutti Stocks (R300 million market cap, up 259% last year) and MC Mining (previously Coal of Africa; R1.3billion market cap, up 205% in 2022). Shares of very thinly traded Deutsche Konsum Reit (real estate investment trust) were up 485%. Grindrod (market cap of nearly R7 billion) was up 106% last year. We sold out of Grindrod and banked the profit for our clients. Investment holding group HCI (market capitalisation of R13 billion) was up 105%. Finally, Thungela Resources (market capitalisation of R35 billion) was up 224%.

THE LOSERS: On the opposite end, the biggest losses were recorded by small and microcap companies. Steinhoff, Murray & Roberts, and Nampak all endured disastrous years, with declines more than 70%. Over a dozen listed shares saw their share prices more than halve during the year. Four of these are microcaps. It is no longer appropriate for these companies to be listed. Smaller Jasco (market capitalisation R48 million), Labat (market capitalisation R60 million) and Kibo Energy (R91million) saw their shares down 58%, 65.5% and 50%, respectively. Finbond, with a market capitalisation of half a billion rand, saw its shares down by 66.7% in 2022. Brikor shot the lights out, just like Bitcoin, and was referred to as Brikcoin. Then it crashed, just like Bitcoin. It moved from 20c to R2.00 and then returned to 20c. Brikor saw a 63.6% drop in its share price during 2022.

BOTTOM LINE: In the Chinese horoscope, 2023 is the Year of the Rabbit or, more specifically, the Year of the Water Rabbit. The rabbit is believed to be the luckiest of the 12 animals to be born under and considered a gentle animal that thinks before acting. The Year of the Rabbit represents peaceful and patient energy. Perhaps 2023 will be our lucky year. Contact one of our consultants to assist you. Like the “wabbit” they think before acting, they are peaceful and patient. Having a financial advisor at your side to build your portfolio with the correct planning processes ensures you can weather market crashes and reach your long-term objectives.

Sources: MoneyWeb, Financial Mail, Business Day.