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PCH INSIGHT

PRIVATE CLIENT HOLDINGS

Nurturing Wealth for 25 yrs

WHAT'S IN THIS ISSUE?

Offshore investing maximising opportunity, minimising taxation

> "It is not necessarily only the solution that an investor selects that is important. It is also deciding on which vehicle you pick to implement that solution."

The offshore investment universe offers a massive amount of products, asset classes and service providers - making the decision of where and how to invest offshore an overwhelming one for many South African investors.

Mark MacSymon, a Wealth Manager at Private Client Holdings and a finalist in the 2015 Financial Planner of the Year Awards, advises that offshore investing offers a myriad of benefits, not least of which is potentially better investment opportunities, improved portfolio diversification and a hedge against Rand weakness.

"Offshore markets provide a much broader universe of shares, bonds and funds – for example the Saxo platform alone gives us access to over 19000 stocks listed in 19 countries across the globe – making the task of finding valuable and attractive investment opportunities so much easier," says MacSymon.

However an investor needs to consider what solutions are available. Whether to invest directly using a segregated portfolio or consider a multi-manager unit trust portfolio or similar wrap vehicle? And each of these offer different restrictions and tax benefits. MacSymon explains that the use of an offshore segregated portfolio using a combination of ETF's (low cost, market / industry trackers) and offshore listed shares provides excellent access to attractive offshore opportunities. This allows SA investors to gain access to the world's top global brands and corporate titans, as well as gain access to sectors and markets not well represented by the JSE, such as biotech and technology stocks.

Depending on the investor's risk profile another good opportunity is the use of a multi-manager unit trust portfolio. By blending the investment styles of 'best of breed' asset managers with proven track records, a wealth manager can control the risk and return attributes of various portfolio solutions. Institutionally diversified portfolios spread asset manager risk so that portfolio returns are not driven by the style, strategy and philosophy of only one asset management house.

Offshore investment vehicles

MacSymon says that there are several effective offshore vehicles which PCH can recommend to investors that are looking to invest offshore.

International retirement and savings plans, also known as Retirement Annuity Trust Schemes, provide an effective vehicle for building long-term tax-efficient wealth offshore. Retirement Annuity Trust Schemes fall under Guernsey pension legislation and for Guernsey Income Tax purposes are exempt from income tax. In addition to the tax saving benefits, Retirement Annuity Trusts offer a flexible and cost-effective solution for building wealth offshore and are particularly useful for effective wealth transfer to future generations. The PCH Offshore Segregated Portfolio, which invests in some of the world's best global brands, can be positioned as the underlying investment solution within a Retirement Annuity Trust.

Alternatively the use of a sinking fund or an endowment wrapper can ensure tax on interest and capital gains tax is pegged at a level lower than what an investor might pay in his / her own marginal capacity. For instance, investors who pay tax at 41% for every additional rand earned would prefer to pay 30% tax on interest. Similarly, capital gains tax can be pegged at 9.99% using an endowment or sinking fund structure, which compares favourably relative to the maximum effective rate of 13.67% investors would pay if capital gains were to be taxed in their personal capacity. Sinking funds or endowment wrappers also have compelling estate planning benefits which should not be ignored.

When it comes to accessing offshore investments MacSymon advises that investors wanting direct offshore exposure, given the plethora of international choice, should consider the offshore offerings of local fund managers that they have come to know and trust.

The Directors Desk

After 25 years in the industry Grant Alexander contemplates why offshore opportunities are too good to miss.

The proceeds from the extraordinary commodity boom have not serviced debt levels – instead the windfall went into a consumption splurge and we have nothing to show for it other than the twin deficits. The Budget Deficit means that we spend more than we collect in taxes and the Current Account Deficit implies that we buy more than we sell with our global trading partners.

Foreign investors presently fund this imbalance and if there is an exodus of foreign capital, the Rand will weaken and in spite of our sluggish growth, interest rates will be increased. This is very bad news for the bond markets and the JSE.

Market commentators are fixated on the timing of the increase in interest rates by the US Federal government and the impact that it would have on emerging markets (EM) and SA in particular. The rates lift off could cause a sell down in EM markets, but it will merely be the trigger, not the cause. US interest rate moves will affect sentiment in the short term but over the long term EM risk assets – equities, bonds and currencies – are driven by their own fundamentals. In fact over the past 15 years, interest rates in SA have been negatively correlated to the US Fed. This is largely because the US increases interest rates when the global economy is booming. The strong global economy encourages flows into emerging markets and automatically strengthens EM currencies.

However, during global meltdowns, the US government cuts rates, foreign investors exit risky markets and EM currencies depreciate as a consequence. EMs are then forced to increase rates to protect their currency.

Many of the meltdowns are in fact caused by deteriorating fundamental structures in emerging markets (electricity supplies, labour strikes etc.) Accordingly, the main driver of foreign capital flows into EM's has been linked to the return on capital i.e. growth and company profitability. Recently foreign flows have continued in spite of deteriorating fundamentals and SA has arguably become addicted to free money released from the US, ECB, Japanese and Chinese stimulus and Quantitative Easing programmes.

> "The huge inflows lead to complacency amongst companies and the government, incentivising consumption as opposed to capital investment."

In SA at the moment productivity is poor, with wage increases and difficult labour relations leading to reduced profit margins and a reduction in the return on capital. PCH's global research partners, BCA Research, state that poor productivity growth and ensuing low profitability points towards further currency depreciation. Company profit margins are squeezed and it is only a weaker currency the can help boost export competitiveness.

So, how do these issues inform PCH's tactical positioning?

> "At PCH we have maximised offshore investments to mitigate against further rand weakness and to take advantage of better investment opportunities."

We are underweight in bonds due to the risk of yield spikes following currency weakness. We are cautious with SA equities and have bought multi-national companies with global footprints and Rand hedge qualities. We have rotated into cheaper resources companies, albeit too early as they have continued to get cheaper, but are expected to enjoy earnings upgrades as the cycle bottoms out. Avior Research are positive on Chinese economic growth prospects with lower growth rates off a higher base resulting in a surging economy.

Our offshore universe has some excellent investment opportunities, in spite of the search for yield resulting in expensive asset classes. Zero interest rates have resulted in a search for yield which has shrunk bonds to very low and expensive yields. Low interest rates have resulted in low discount rates which are used to value companies which in turn results in expensive valuations of share prices.

In our view

1. It is too soon to de-risk our global equity portfolios as there remains a flood of Quantitative Easing and credit, potential defaults will be supported by the relentless quest for yield.
2. European equities still have an upside in spite of recent out-performance. The forward earnings could surprise on the upside, especially relative to US companies who face the headwind of a strong dollar compromising global sales. The price to book multiples of European companies are trading at a substantial discount to the MSCI world index.
3. The "no vote" in Greece will cause volatility in European equities, but a Greek exit from the euro is not a systemic risk and will not cause contagion with other Mediterranean countries.

There are two outcomes that will be particularly poor for euro unity – the first is if Greece is allowed to stay in the EU with an easier austerity package and the second is if Greece were to exit the EU, print Drachmas, and then survive hyper-inflation and prosper with a weaker currency. Both scenarios will embolden the Euroskeptics and political expediency could result in other nations – Portugal, Spain and Italy – following suit. We believe that there is a low probability of either of these scenarios playing out.

Grant

Grant Alexander

Judge Dennis Davis head of the Davis Tax Commission.

Is SA heading towards a tax revolt or is it not as bad as some think?

Have taxpayers been pushed too far?

There is growing concern at the apparent waste of taxpayers' contributions through highly controversial government spending and South Africans are becoming more belligerent about tax. Some commentators have speculated that South African taxpayers are on the precipice of a taxpayer's revolt. Will a higher tax burden be the straw that breaks the camel's back?

Last year a trillion Rand was collected by treasury in the form of taxes but the ever increasing government expense burden means that additional funding is required. Many taxpayers question where this will come from and whether they will be squeezed even more.

The Davis Commission has been established and charged with finding the solution which least impedes growth. Key to addressing the deficit problem is an increase in GDP, while simultaneously cutting costs.

An increase in VAT is not likely as it would result in a decrease in GDP and an increase in inflation. There is however scope to address the effective rate of corporate taxes, with many industries paying an effective tax rate well below 28%.

According to Judge Dennis Davis, based on a study conducted by the World Bank, SA has one of the best VAT collection and tax and transfer systems in the world. Much of the tax collected goes toward addressing the inequality inherited from apartheid and although some taxpayers see little benefit, were these systems to collapse the whole economy would be affected, leaving SA in a far more volatile position.

The resulting increase in poverty, social unrest and serious political instability is an outcome we can ill afford.

HAVE YOU HEARD?

PCH Sponsored ITU Triathlon

PCH once again sponsored a triathlon team in this year's ITU triathlon series held in Cape Town. The athletes competing in our kit did us proud and performed outstandingly in their various categories – well done to you all!

Cheetah Outreach Trust Golf Day

Director of PCH Financial Services, Jeremy Burman and Wealth Manager, Bryan Leach were delighted to support this year's Cheetah Outreach Trust Golf Day and enjoyed a wonderful day out on the De Zalze Golf Course helping the trust in their endeavour to promote the survival of the Southern African cheetah. For more information visit www.cheetah.co.za.

Empowerment through Education Golf Day

PCH recently took part in the Empowerment through Education Golf Day – which was a huge success with over a hundred people participating in the event. Empowerment though Education (www.e-t-e.org) continues on their mission to sponsor the complete education of selected children from both Masakhane Creche in Masiphumelele and Green Curtains Pre-Primary School in Ocean View.

PCH's new REAP student

PCH is continuing our relationship with the Rural Education Access Project (REAP) and this year we are assisting Lizette Philander to complete her BComm in accounting at UWC. Last year's student, Brandon Draaier, has joined the PCH tax team on a part time basis while he completes his tax credits.

Greenpop Eco-Hub and Nursery

PCH is supporting Greenpop in establishing an eco-hub nursery and education centre in Woodstock. This green hub will allow Greenpop to share information on the importance of trees, of growing our own food, and of taking care of our environment.

Hello Mr Greg Minaar

Friends of PCH, Emma Gray and her boyfriend Sean, were lucky enough to meet 2 time World Downhill MTB Champion Greg Minnaar in Switzerland.

Private Client Holdings Collective Investment Scheme

PCH have been managing multi-manager solutions for our clients since 2003. Over the last few months we have been preparing our business to evolve our multi-manager offerings into Collective Investment Schemes. These are more effective administrative and tax-friendly vehicles that will benefit our clients' current investment portfolios.

From a multi-manager point of view, a Collective Investment Scheme structure enables the multi-manager to change underlying fund managers that are either not performing or where fund mandates or managers have changed to the extent that it no longer serves our clients' best interests. The implementation of these changes will not realise capital gains and as the funds grow there will be greater leverage to negotiate tighter fees which will benefit long term performance. Access to previously excluded investment opportunities such as index trackers, exchange traded funds and segregated mandates would be another benefit, as well as more active asset management decisions and the implementation thereof.

For more information on the PCH CIS offering:
Please contact Grant Alexander on: +27 21 671 1220

Mark MacSymon Financial Planner of the Year finalist

PCH Wealth Manager, Mark MacSymon, was runner up in the 2015 FPI Financial Planner of the Year Awards – Awards which represent the highest accolade a professional financial planner can obtain in South Africa.

MacSymon explains that being selected as a finalist affirms that the financial advice and investment philosophy which PCH dispenses to clients is of the highest standards and that the company's strategy, business, operations, people and client management standards are excellent. "It is a validation of the tremendous amount of hard work, dedication and commitment to our clients that the team at Private Client Holdings has embraced over the years."

Exciting new look and feel for the PCH website

We are excited to announce that we have launched our refreshed PCH website. The new, less text-heavy site has up to the minute market indicators and JSE indicators, as well as all our fact sheets and performance indicators. In addition to this, the easy-to-navigate site houses interesting and informative articles and an archive of our newsletter and our monthly market review. Our new blog section is also regularly updated and makes for an interesting read. Visit **www.privateclient.co.za.**

WHO TO TALK TO

Our Private Client Holdings experts are available to field your questions. Don't hesitate to contact us for wealth management advice.

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