Robert Cowen Investments

Growing families' wealth since 1982

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Newsletter

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The Family Office

You are welcome to pass this newsletter on to friends who may wish to learn more about investment.
To be added to our email, contact alan@rcinv.co.za

"I'm supposed to respect my elders, but now it's getting harder and harder for me to find one."

"Change is inevitable, except from a vending machine." ~ Robert C. Gallagher

RCI MET Flexible Fund – closed August at 389.99, 2.31% up for the month and 2.92% higher than 12 months ago. The JSE Top 40 gained 0.75% for the month and is up 4.31% versus a year ago. Despite this inconsequential 12 months, we are still up 11.52% per annum over the past three years where we ranked 20th out of 76 funds. So why this minimal under performance over the past year? We have been surprised by the strength of the rand over the past six months and were scared of political turmoil in South Africa. Suddenly, with all the shenanigans over Mr. Pravin Gordhan, the rand is weakening.

Continued on next page.

Visit our website: www.rcinv.co.za for back copies of the newsletter, background information, etc.

Please take note:

- Moving offices to Anchor building – 25 Culross Road, (Corner of Main Road), Bryanston around the 14th of October, 2016. This is about 2km from our current offices and is across the road from Didata. We want to be close to Anchor's research teams who can generate good ideas for your investment portfolios.

Possible changes to trust tax: details provided but don't change anything until they are finalised.

What do the rich do that the poor don't? Such gems as: 88% of wealthy read 30 minutes or more each day for education or career reasons vs. 2% of poor.

Is the wild ride in commodities over?

The huge gap developing in American and European pension funds aggravated by lower interest rates.

Financial Statements for Trust Accounts should be available by the end of September – the brokers are taking longer than they promised to provide the tax information.

August's news confirmed our fear of rand weakness and a possible downgrade

As we mentioned last month, our portfolios have been set up to expect rand weakness. Finally, over the past few days, our fears and expectations have come to light. It gives us no joy to be proved right on our pessimism for the country but until reality sets in, we continue to take this line. We expect on-going uncertainty until the issues between President Zuma and Minister Gordhan are resolved.

Got to keep moving.........To Anchor's offices

Just over a year ago we sent you a letter advising that we had sold a stake of our business to Anchor Capital.

Anchor provides back up for Di and Alan. They also give us some great ideas for our local and overseas share portfolios.

Our staff have embraced the learning opportunities afforded them by Anchor and are also contributing to research studies and presentations, whilst we are also able to draw from the pool of research and other market resources offered by Anchor Capital.

The next logical step is to move into their offices so we can maximise the benefit from their excellent local and offshore research. This should enable us to find you even better investments.

So, we are moving to Anchor Capital's offices!! The move will take place on or about 14 October 2016.

Our new address will be: 25 Culross Road (Corner Main), Bryanston, Sandton, 2191, South Africa.

It is not far from where we are now. The offices are really lovely and we look forward to welcoming you to our new "home" once we are there!!

No other details will change – our emails and phone numbers will remain the same. Our postal address remains the box in Saxonwold.

Possible changes to taxation of trusts – don't panic until we tell you to

Our auditors RSM's Neil Hughes has written an explanation of contemplated changes to the taxation of trusts. HOWEVER don't react until the changes, and the timing thereof, has been finalised. Another amnesty has been proposed for people with undeclared offshore assets from 1 October. For this to come into effect requires a new law and they have tried to tack on some changes to trust taxation. However, these changes require considerable thought and response so our guess is that the trust proposals will be dropped from the legislation and the amnesty but might be brought into effect at some stage in the next year. Right now, there is nothing you should do except make yourself aware of the proposal. So, over to Neil:

Trusts and Interest Free Loans

The 2016 Budget Speech contained a proposal to introduce new tax laws targeted at the prevention of estate duty and donations tax avoidance by making use of interest free loans to a trust. National Treasury recently released the Draft Taxation Laws Amendment Bill that contains the measures intended to give effect to the proposal.

Background

A common practice used in conjunction with a family trust is the sale of growth assets by an individual to the trust, with the purchase price remaining outstanding on interest free loan account. The concern is that such a practice results in the avoidance of estate duty and donations tax.

This is achieved by the sale of the assets at market value, therefore not triggering donations tax. As the loan does not bear interest, there is no growth of the loan asset for estate duty purposes. In addition the individual can make an annual donation to the trust which is used to repay part of the loan to the trust. No donations tax arises if the donation to the trust is under the R100 000 annual donations tax exemption.

Proposal

Section 7C has been proposed for introduction into the Income Tax Act. The section is summarised as follows:

1. It will apply in respect of any loan granted on low interest rate or interest free terms to a trust. The loan may be made either directly or indirectly by a natural person, or by a company that is a connected person in relation to that person.
2. If the loan does not bear interest, an amount of deemed interest will be included in the hands of the natural person mentioned above, based on the SARS official rate of interest (currently 8% per annum).
3. If the loan is interest bearing, but at a rate that is lower than the official rate as prescribed by SARS, then the difference between the interest charged and interest determined at the official rate will be included in the income of the natural person mentioned above.
4. If a natural person is subject to income tax as a result of deemed interest that is included in income, they may recover that amount from the trust.
5. If the person does not recover from the trust within a period of three years, the amount of tax incurred as a result of the inclusion in their income, then it will be treated as a donation made by that person.
6. The annual exclusion from donations tax applicable to a natural person, namely against the first R100 000 of donations made, will not apply in respect of a loan contemplated under this section of the Act.

These rules are set to come into operation on 1 March 2017, applying to years of assessment commencing on or after that date.

What does this mean?

The introduction of this new section into the Income Tax Act in its current proposed format will most likely have negative tax consequences. It is common practice for individuals to fund a family trust by way of an interest free loan.

This will now result in a deemed amount being included in the income of the lender, equivalent to a calculated interest charge linked to the SARS official rate. In addition, even though the amount being included in the income of the person is calculated with reference to the official rate, it is not actual “interest”, and therefore there is no relief in the form of the annual interest exemption, currently R23 800 for natural persons under the age of 65.

An individual that falls foul of this new section may think that if they are required to incur income tax on the deemed interest income they will reduce their personal estate. Not so – this is why the new section gives the individual the right to recover the tax from the trust, and to the extent that the individual does not recover the tax from the trust, it will be treated as a donation. That will mean that the individual would also be exposed to the donations tax at the rate of 20% on the donation.

In certain instances, it may be favourable to charge interest on the loan at the SARS prescribed rate. In that event, the individual earns interest income and as a result can make use of the interest exemption. From the perspective of the trust, each case would need to be assessed to determine whether the interest expense incurred can be deducted against other taxable income of the trust.

The trustees also need to assess the ability to repay the loan creditor so as to avoid exposure to donations tax. The proposed section will have far reaching implications and careful consideration must be given to each specific scenario before making any bold decisions.

Neil Hughes
RSM
Tax and Trust Director, Johannesburg

What do the rich do every day that the poor don't do?

Tom Corley, on his website http://www.richhabitsinstitute.com/ outlines a few of the differences between the habits of the rich and the poor. We have chosen some of them:

1. 70% of wealthy eat less than 300 junk food calories per day. 97% of poor people eat more than 300 junk food calories per day. 23% of wealthy gamble. 52% of poor people gamble.
2. 80% of wealthy are focused on accomplishing some single goal. Only 12% of the poor do this.
3. 76% of wealthy exercise aerobically four days a week. 23% of poor do this.
4. 63% of wealthy listen to audio books during commute to work vs. 5% of poor people.
5. 81% of wealthy maintain a to-do list vs. 19% of poor.
6. 63% of wealthy parents make their children read two or more non-fiction books a month vs. 3% of poor.
9. 67% of wealthy write down their goals vs. 17% of poor.
10. 88% of wealthy read 30 minutes or more each day for education or career reasons vs. 2% of poor.
11. 6% of wealthy say what's on their mind vs. 69% of poor.
13. 67% of wealthy watch one hour or less of TV every day vs. 23% of poor.
14. 6% of wealthy watch reality TV vs. 78% of poor.
16. 74% of wealthy teach good daily success habits to their children vs. 1% of poor.
19. 86% of wealthy believe in lifelong educational self-improvement vs. 5% of poor.
20. 86% of wealthy love to read vs. 26% of poor.

Written by Dave Ramsey

Is the wild ride in commodities over?

From Fuller Treacy

Here is the opening of this topical article by Jon Yeomans for The Telegraph
http://www.telegraph.co.uk/business/2016/08/14/is-the-wild-ride-in-commodities-over/

Congratulations if you called the path of commodity prices this year. You're probably also among the 0.0001pc of people who guessed Leicester City would win the Premier League. And of course, you predicted Brexit.

In a topsy-turvy world, metals have shown surprising strength. After cratering in 2015, a basket of major commodities has soared in price this year, from the remarkable 36pc climb of iron ore, to the stellar performance of precious metals, with gold and silver up 25pc and 43pc respectively. Zinc, a mineral used to galvanise other metals to stop them rusting, has chalked up a 41pc rise.

One of the few analysts to call iron ore's recovery was Jason Schenker, of Prestige Economics, who now thinks the metal – used to make steel – will probably extend its rally into the second half, averaging $55 a tonne. Some of the FTSE 100 miners would probably bite your arm off if you offered them iron ore at that price. BHP Billiton, Rio Tinto and Anglo American all produce the metal at far below that level, meaning they can comfortably bank cash at $55 a tonne and get on with paying down debt.

David Fuller's view

We should never forget that the key fundamental variable in commodity prices is always supply. Moreover, supply is notoriously volatile because miners produce all they can when metal prices are high. That window eventually closes because expensive metals inevitably reduce demand. As prices plummet, producers first try to sell even more to maintain revenue. When that becomes counterproductive, marginal producers are forced to reduce supplies and even low-cost producers eventually realise that metal in the ground will be worth more to them if they reduce refined supplies. Demand eventually increases for industrial commodities when prices remain low. As they begin to recover a bull market emerges if commodity producers are slow to increase supplies and GDP growth strengthens.

Pensions and bonds: the problem explained

Editor: the deficit in pension funds just gets bigger and bigger. A lot of the investments in the USA and Europe made to fund pensions are now earning very little interest. Thus the 60% invested in shares has to work twice as hard. The article below, extracted from the Financial Times, touches on some of the problems. What the answers are or what the effects will be (a drop in pensions, paying back in inflated money, working till 70?) are as yet unknown but at some point, the piper will have to be paid.

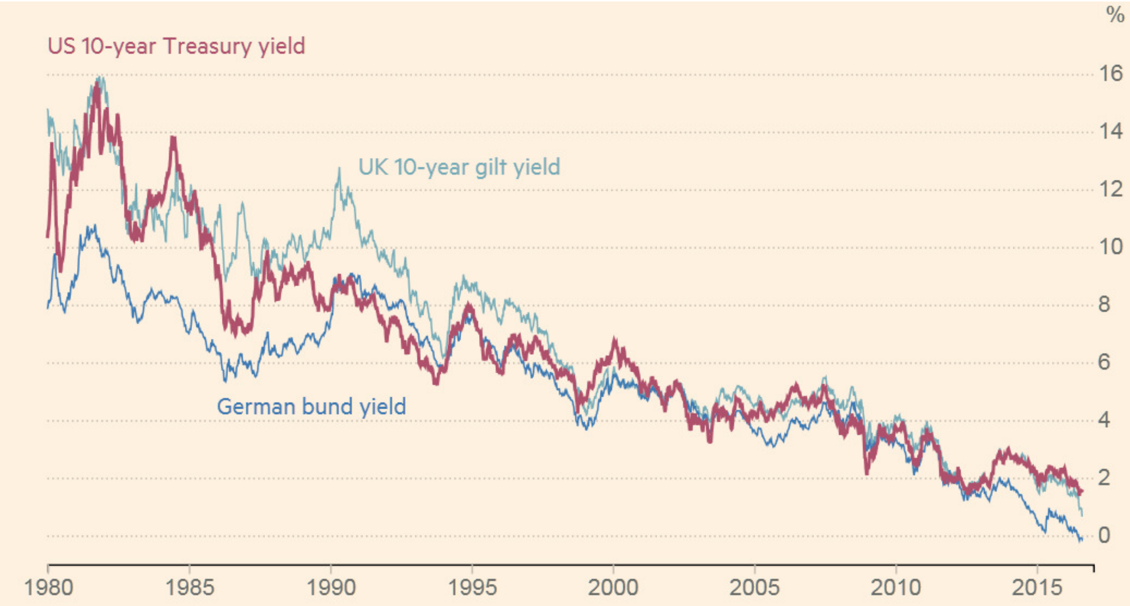
Bond mathematics and the scale of pension deficits

Tuesday, 23 August, 2016 by Joanna S Kao and John Authers

Bond yields have fallen globally since the UK vote on leaving the EU on June 23. This has made even more acute a problem for financing pensions, which has been growing for many years. The problem is greatest for "defined benefit" plans, which have made guarantees to their members about the retirement income they can expect.

For more than three decades, bond yields — which follow interest rates — around the world have decreased. The ten-year US Treasury yield — which was as high as 16 per cent in 1981 — is now just about 1.5 per cent.

Bond yields have fallen for a generation



Source: Thomson Reuters Datastream

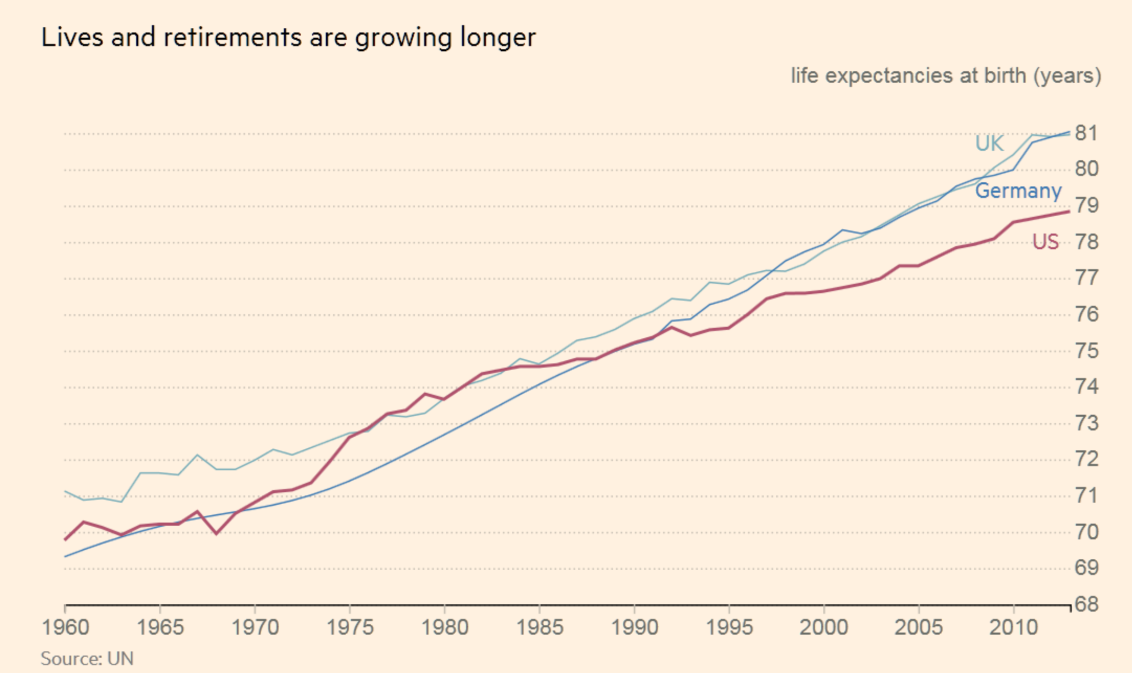
"When US long-term interest rates were nearly 16 per cent, a pension fund wanting an annual payout of $16m would need only to buy $100m worth of bonds. But now with an interest rate of 1.5 per cent, a pension fund would only receive an annual payout of $1.5m from a $100m bond."

This is particularly bad for pension funds, which rely on bonds to fund yearly payouts. To make up for lower interest rates, they have to spend more to get the same annual return.

To continue the simplified example, you would need to invest as much as $1.1bn at 1.5 per cent interest rates to make the same amount you would have made with 16 per cent interest rates and $100m, all other things equal.

Add to that the fact that people are living longer. That means that pension funds must be prepared to pay out for longer and hence their liabilities grow.

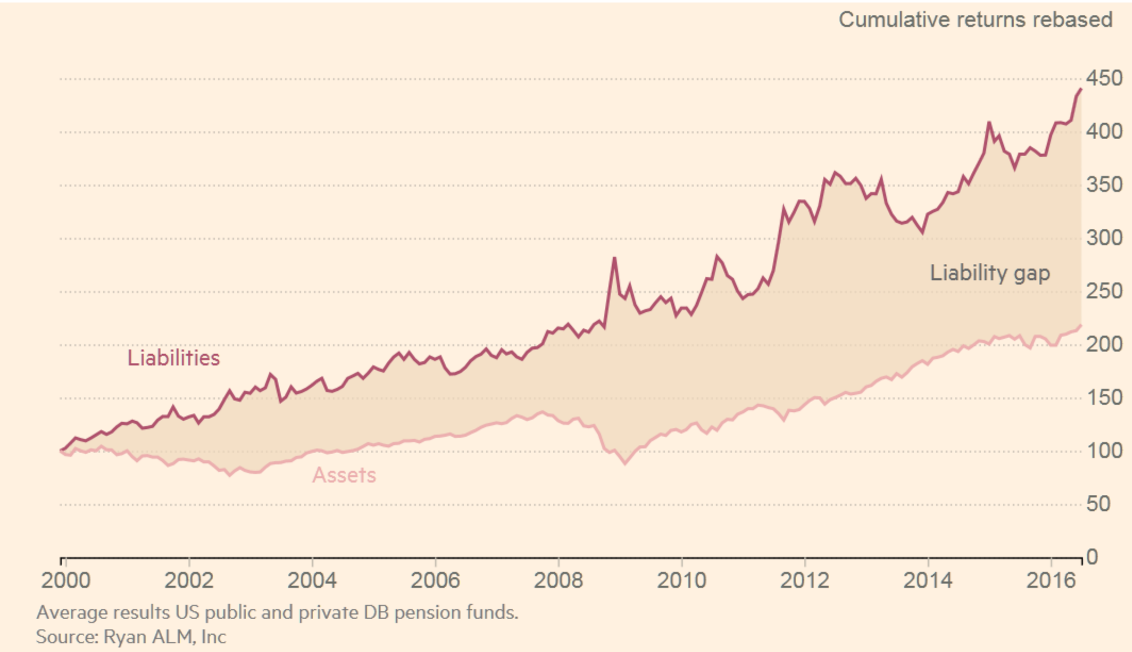
Lives and retirements are growing longer



US life expectancies at birth have increased from under 70 in 1960 to nearly 79 in 2013. Life expectancies in the UK and Germany are even longer.

A further problem for pension funds is that their assets have not grown as fast in recent years, thanks to problems in the stock market. As their liabilities have grown much faster than assets, so their deficits — the gap between the money they have and the money it will take to pay their pensioners — have deepened.

Assets are not growing as fast as liabilities



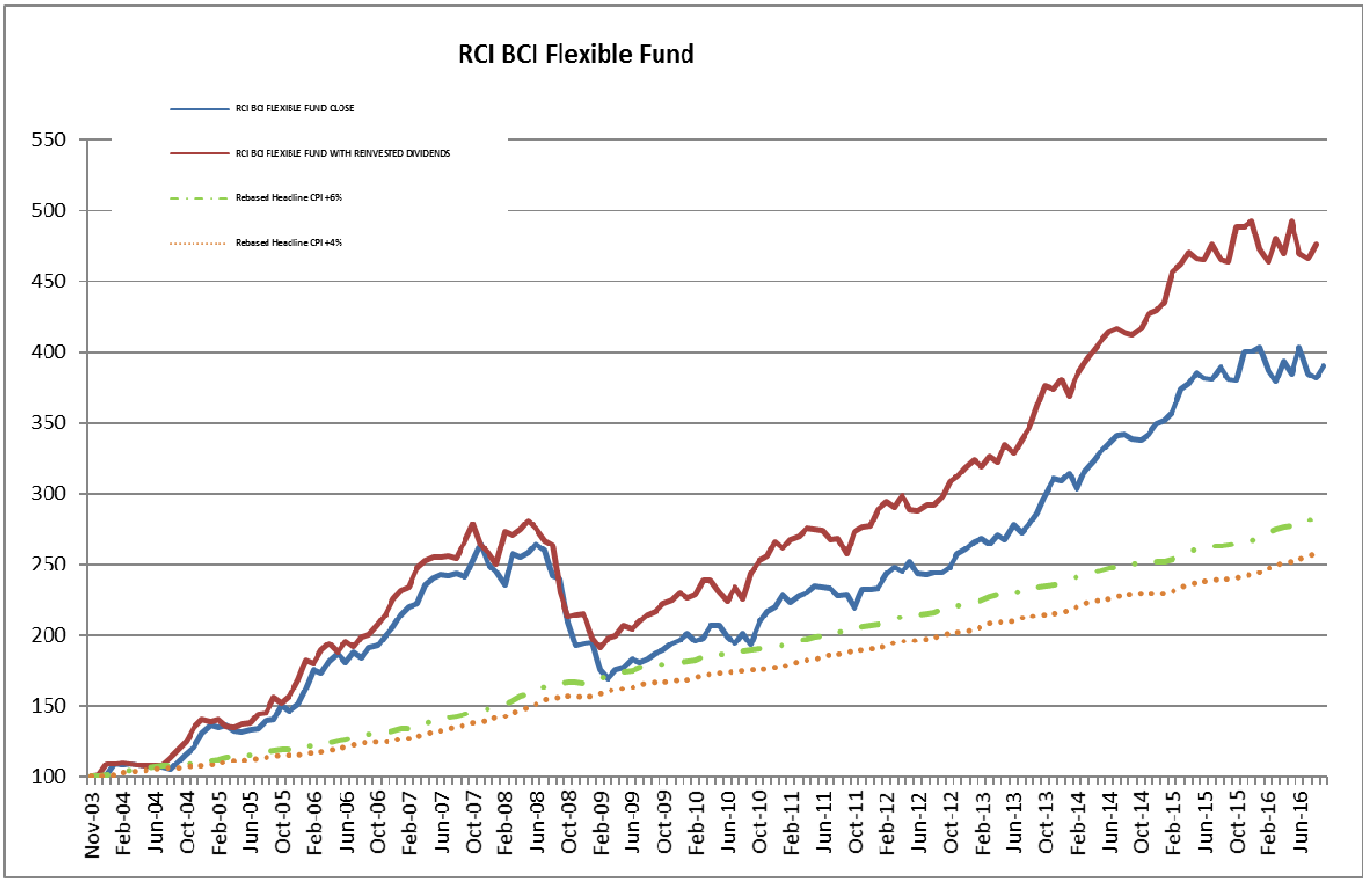
The gap between assets and liabilities is growing.

Let's look at some real numbers. The US public pension deficit is $3.4tn. That's 6 times the size of Apple. Pension deficits sponsored by S&P 1500 companies are lower at $638bn, but still higher than the GDP of many countries, such as Peru or Belgium. The UK public and private pension deficits are smaller, but follow the same pattern.

RCI BCI Flexible Fund – Up 2.92% over 12 months which underperformed the JSE Top 40 which is up 4.31%. Our bet on a weaker rand has not yet paid off, and in the short-term, the rand could get a bit stronger

Please contact Maggie on 011 706 1420 for any help on your unit trusts.

RCI BCI Flexible Fund gained 2.31% for July closing at 389.99c per unit. The JSE top 40 gained 0.75% for August so we outperformed this month. Over a year, the Overall Index is up 4.31% and our fund is up 2.92%. That is a 1.39% underperformance. That is not enough to make us happy. We have set up our portfolio to benefit from a weaker rand which might have a bit of strength in the short-term, now that the downgrade has been avoided and the cash must soon start flowing into South Africa to fund the SA Brews buy out.



Unit trust has flexibility – happy to take small amounts

The unit trust has the flexibility to buy and sell shares and to change weightings more frequently than in an individual portfolio. We are happy to take small amounts into the unit trust (from R1 000 per month or lump sums of R10 000). As you will not pay commission to any agents there is no cost to get in and out of our fund. On selling, the amount you receive back will depend on our performance.

To conclude

The politics of South Africa remains, as ever, uncertain. We have had the municipal elections with the swing to the DA and the EFF. The struggle between President Zuma and Minister Gordhan continues. It is interesting that President Zuma appears to have been muzzled by his own party. When last did you hear him say something?

We have been warning of a downgrade for many years. Now that it is close, people have finally woken up but we fear that we are too close to the edge of the cliff to stop going over the edge. Metal prices have been a little better over the past six months but we do not think they are going to be strong over the next few years. This will place a lot of pressure on the rand and the South African economy, not matter who is in charge.

Our unit trust has about 70% invested in rand hedges. Thus, over the past six months the strong rand has held back our performance. However, we try to look forward three to five years and estimate probabilities of various events occurring. Six months is a coin flip – three years is likely time to get the direction of the markets and the currency correct. So keep your eye on the horizon, not on short term bumps in the road!

We aim to be the best family office in South Africa.

Thank you for being our clients.

Best regards

Di and Alan

"Often we imagine that we will work hard until we arrive at some distant goal, and then we will be happy. This is a delusion. Happiness is the result of a life lived with purpose. Happiness is not an objective. It is the movement of life itself, a process, and an activity. It arises from curiosity and discovery. Seek pleasure and you will quickly discover the shortest path to suffering."

20 Rules for a Knight: A Timeless Guide from 1483 ~ Sir Thomas Lemuel Hawke