Robert Cowen Investments

Growing families' wealth since 1982

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Newsletter

end October 2016

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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

"Only a life lived for others is a life worthwhile."

~ Albert Einstein

RCI MET Flexible Fund – closed October at 364.84, down3.81% for the month and 8.36% lower than 12 months ago. The JSE Top 40 was down 3.10% for the month and is down 8.89% versus a year ago. Despite this poor 12 months, we are still up 10.68% per annum over the past ten years. Why are we underperforming in recent months? Because we have been expecting the rand to weaken with the threat of a downgrade drawing ever nearer. Guessing the short term requires luck. Take the last week or two when the news varied from Mr. Gordhan being charged, then charges dropped, then President Zuma being under pressure. Nobody knows the outcome in the short term. We are looking at a three to five year outlook and working out where the market is likely to be. That is the way we invest and we try to put most of your investments into shares that pay consistent and growing dividends.

When we are feeling the pressure, we have the experience of thirty years to draw upon – re-examine your assumptions, change them if necessary, and stick with the plan. Normally the temptation to change plans comes close to the turning point.

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

Please take note:

- We have moved offices to Anchor building at 25 Culross Road, (Corner of Main Road) Bryanston. We tried to keep our old phone number but it did not work out so our new number is 011 591 0585 and Samantha should answer.

What we are doing about our investment strategy? Tough times never last, tough people do!

Who will win the US election?

Changes to the taxation of a loan or credit advanced to a trust have been released: Deemed donations tax on interest at 8% from 1 March 2017.

Tough times never last, tough people do!

2016 has been a challenging year for world markets. It is years like this where market gyrations can test not only our investment portfolios but also our internal fortitude. Sticking with our core strategy and having confidence in our calls when volatility means they might see ups and downs makes it all the more challenging for everybody. Financial and geopolitical crises, slow economic growth and unprecedented levels of central bank intervention have led to increased uncertainty in world markets this year (both from an equity and currency point of view). The fact remains, markets don't like uncertainty… yet it also presents us with great opportunities if we can see through the noise of it all.

In terms of world markets, what with the possibility of Donald 'Trumping' Hillary at the polls (who would have thought – although we should learnt our lesson from Brexit), the possibility of a rate hike in the US in December, more quantitative easing out of the EU and Japan, a recovery in commodity prices and yet China continues to slow down, one might find it difficult to make sense of it all. The truth is, this is not the first time we are experiencing uncertainty. In general the world finds solutions to its problems and keeps working through them (albeit a rocky ride sometimes). Simply put, we do not have control over these external factors. Although one should be able to rationalize and come to some form of conclusion with all of this information, this year has reiterated to us that in fact, sometimes the least expected outcome occurs. Thus one should invest on the balance of probabilities – not stake everything on one outcome.

Closer to home, we wake up each morning wondering what else 'JZ' has in store for us and whether or not today is that day that marks the first step towards a stronger, more inclusive, optimistic outlook for SA. While we wish to remain optimistic about the prospects for our beloved country, we cannot help but realize we have managed to get ourselves into a right mess. The damage that has been brought upon us by captured state owned enterprises, greedy politicians and a corrupt government will likely remain deeply rooted in the system for a while to come and this indicates a very long, winding road to recovery for SA.

At the end of the day the prevailing environment requires us to constantly reconsider our investment stance – in particular those investment opportunities that offer growth potential and more importantly those that offer downside protection. We are entering a period of lower economic growth and hence great returns (as in the past) will likely be more difficult to come by going forward.

So what is our chosen strategy going forward at RCI?

Much of the same but with a few minor changes. Ultimately we need to be able to stick with our chosen strategies long enough to see the benefits – even through the inevitable market fluctuations.

1. Invest in top quality companies that can weather the storm.
2. Start building positions in resource companies – with the proviso that the outlook for China, and thus for metal prices, could deteriorate at any time so one might need to reverse this decision on short notice.
3. Remain focused on investing in the US.
4. Rely on a steady stream on income.
5. Start building some rand strength plays into the portfolios – so far our call on the rand, for weakness this year, has been wrong. Fundamentally speaking we still expect weakness over the medium to long term. Our inflation rate is 6% and the US is less than 1%, so we should see 5% depreciation of our currency each year against the US dollar. Over five years this amounts to 22%. That being said, this is very unlikely to occur in a straight line. We have seen the rand strengthen 13.2% so far this year against the dollar and 28.1% against the pound. This has had an adverse effect on the performance of rand hedge shares such as British American Tobacco. The short-term trend may be stronger, within a longer-term trend of weakness. Predicting the short-term trend is almost impossible so sticking with the long-term trend is usually the only reasonable, if painful, way to go.

In summary, the world we live in is constantly changing and we, as your asset manager, are constantly looking for new and better investments for you. Our goal continues to be that of growing your wealth in real terms over the medium to long term. It is important that we look through all the short term noise and focus on the 'bigger picture'. We are aware of the macro factors that could continue to affect the performance of the portfolios but our investment strategy should not be swayed by these shorter term events.

Ultimately, we are here for you night and day. It is never an inconvenient time for a call, should you wish to chat about any concerns.

As Winston Churchill once said: 'KBO – Keep Buggering On'. The world has made it through many low growth periods before and it will find a way of doing it again. The worst possible idea is to change strategies at a fundamental turning point just as your strategy is about to bear fruit.

Over the past ten years (even with the past two years of tepid performance) we have averaged 12% p.a. growth for clients. Some years it was well in excess, some years well below. The issue is to have a plan, constantly re-examine if it is still suitable, and then stick with it.

Who will win the U.S. Election?

The best website that has been referred to us is: http://projects.fivethirtyeight.com/2016-election-forecast/

It forecasts a 65% chance of Hillary Clinton winning. So that is the probability we are placing on her victory.

Changes to the taxation of trusts - 7C

Mr Michael Honiball, a director with Werksmans Attorneys has advised us that the changes proposed by section 7C are in final draft. Relevant extracts from Michael Honiball's letter are:

"In terms of 7C, the difference between interest at the official rate of interest and the interest actually incurred by the trust on the loan would constitute a deemed donation by the natural person. The official rate of interest currently stands at 8% for Rand denominated loans.

This deemed donation would constitute a donation at the end of each year of assessment of the trust. The natural person would, however, be entitled to reduce this deemed annual donation with his/her annual R100 000 donations tax exemption.

Section 7C(5) further provides various instances in which section 7C would not find application to low-interest or interest-free loans advanced to trusts"

Please note that in respect of the above extracts, this is advice that is of a general nature which we have received from Michael Honiball.

While the following paragraphs should not be taken as tax advice without proper consultation and without taking each person's and trust's individual tax position into account, we interpret the gist of it to be:

From 1 March 2017:

If a person, or a company connected to that person, provides a loan to a trust, the difference between the interest rate charged and the official rate (currently 8%) will attract donations tax at 20% but one may deduct the annual R100 000 donation exemption.

So for example, if Mr A advanced an interest free loan of R5m to a trust then he will have to pay donations tax on 8% less the annual R100 000 donation tax exemption. So R5m x 8%= R400 000 less the R100 000 annual donation = R300 000 taxable donation.

Donations tax is payable at 20%. Therefore on R300 0000 = R60 000 donations tax will have to be paid.

Total tax payable before restructuring R60 000

It remains to be seen how one might restructure one's affairs with repayments - a few months remain to assess what changes should be made to family structures.

Thus it MIGHT be possible for Mr A to donate half of his loan to his wife (there is no donations tax on donations between spouses) then his tax position becomes

8% on R2 500 000 =	R200 000	
Less his annual donations tax exemption	R100 000	
Taxable donation	R100 000	
Donations tax at 20%	R20 000	
Assuming his wife has no other taxable income,		
8% on R2 500 000 =	R200 000	
Less her annual donations tax exemption	R100 000	
Taxable donation	R100 000	
Donations tax at 20%	R20 000	
Total tax paid by Mr and Mrs A	**R40 000**	**(after restructuring)**
Potential saving by restructuring	**R20 000**	

How much loan can a beneficiary make to a trust before any donations tax becomes payable?

If you lend the trust R1 250 000 then the deemed 8% = R100 000

Above that you will have to look at paying donations tax of 20% on the deemed 8% on the excess.

We will consult with the tax attorneys, put on our thinking caps and revert to you about how your family's affairs might need to be restructured.

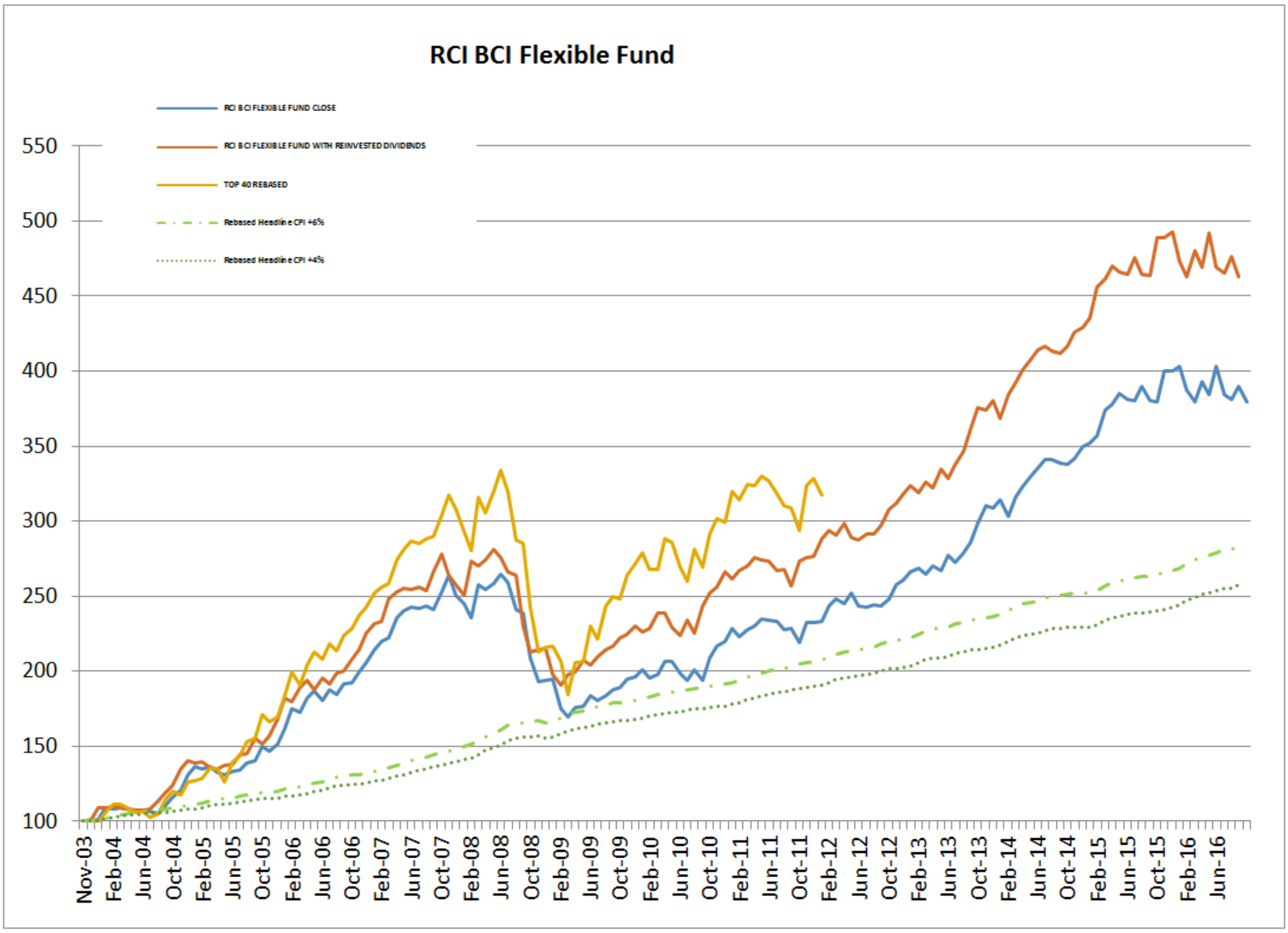
Report back on Alan's trip to the USA

Thus far, Alan has only received a preliminary report from Sacramento who are world experts on FXTAS. They confirm he has FXTAS but believe it is atypical in that it is mild and that it might have been brought on, or aggravated by, infection. Thus, if the effect of the infection wears off, Alan's balance may improve somewhat. They are hopeful of a new drug trial they are starting shortly. If it works they will send Alan some of the drugs to try.

RCI BCI Flexible Fund – down 8.36% over 12 months is in line with the performance of the JSE Top 40 which is down 8.89%. Our bet on a weaker rand has not yet paid off, and in the short-term, the rand could do anything, but in the medium term, we fear a downgrade with possible weakening of the currency

Please contact Maggie on 011 591 0578 for any help on your unit trusts.

RCI BCI Flexible Fund fell 3.81% for October closing at 364.84c per unit. The JSE top 40 fell 3.10% for October so we underperformed this month. Over a year, the Overall Index is down 8.98% and our fund is down 8.36%. This makes un unhappy. We have set up our portfolio to benefit from a weaker rand which has so far not occurred. The threat of a downgrade remains with Minister Gordhan being threatened / unthreatened continuously. If a down grade does not occur, the rand might get 5% stronger in the short-term but if it happens, the rand could easily fall ten percent. We believe that a downgrade is likely within the next 14 months.



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

Life is seldom easy and the easy times don't last too long. That is what we are here for – to plan how to get through the tough times. We re-examine our strategy continuously and try to trim the sails according to the change in the wind.

It is prudent to keep an eye on the medium term goal and steer towards that far off continent. For instance, there is no point steering with the wind when you are trying to get to America.

Then we should take into account the man-made waves, primarily that of taxation. Part of being a family office is to know the overall plan of the family, to help them steer towards that "far off continent", no matter the intermediate direction of the tempest. To invest in safe, regular income-producers is vital to the family fortunes which should be properly spread geographically to overcome the short-tem fluctuations caused by local politics.

What is the best spread of investments to safeguard your children and grandchildren?

Another of our aims is to ensure that proper financial records are maintained and then to minimise the effects of taxation and estate duty through the adroit use of trusts and financial planning.

The latest 7C tax amendments have necessitated a review of the whole plan, to see how we can best go forward into the unknown.

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

Thank you for being our clients.

Best regards

Di and Alan