Robert Cowen Investments

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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

"Trump may equal volatility but volatility does not equal risk."
~ Vitaliy Katsenelson

RCI MET Flexible Fund – closed February at 367.34, down 2.32% for the month, compared to the JSE Top 40 which was down 3.91%. The RCI BCI Flexible Fund is 1.85% lower than 12 months ago whereas the JSE Top 40 was up 0.75% versus a year ago. Our fund is more comparable to the FINDU 30 Index which was down 1.7% over the year.

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

Warren Buffett on widespread fear being your friend and personal fear being your enemy for investors.

US Economy: no recession in sight.

RA's can now be calculated at 27.5% of taxable income (i.e. including interest and 40% of capital gains). It is worth adding some to your policy whenever market weakness occurs.

If only you had invested in BATS rather than smoking a pack a day. The enormous, and ongoing, effect of diverting smoke into shares.

"The rise of the useless class" a thought provoking article on what the future will look like and how we will have to cope with the "unworking class" as machines render the skills of many workers redundant.

The Conclusion: The tax on dividends rose by ONE THIRD from 15% to 20% so it is important to try to save tax by smart planning, the use of RA's etc. We remind you to talk to us about rearranging your loans to trusts etc.

Warren Buffet on FEAR

"During such scary periods, you should never forget two things: First, widespread fear is your *friend* as an investor, because it serves up bargain purchases. Second, *personal* fear is your enemy. It will also be unwarranted. Investors who avoid high and unnecessary costs and simply sit for an extended period with a collection of large, conservatively-financed American businesses will almost certainly do well."

Warren Buffett Berkshire Hathaway 2016 Annual report

US Economy: No recession in sight Policy uncertainty enormous

(From Fuller Treacy Money Comment of the day 4th March 2017)

This report by Torsten Slok for Deutsche Bank. Here is a section:

1. The fact that the Fed wants to raise rates three times this year tells us that they are worried about the economy moving towards overheating
2. The economy is already at full employment, confirmed by anecdotes of higher minimum wages and labor shortages across industries
3. Average hourly earnings have trended higher since 2014
4. US may be reversing on the "strong dollar" policy to boost US exports
5. Import prices are trending higher
6. Producer prices are trending higher
7. Breakeven inflation expectations are trending higher
8. Lower corporate taxes will boost growth and hence also inflation
9. Increased infrastructure spending will lift growth and hence also inflation
10. Lower household taxes will raise growth and hence also inflation

All variables in the Fed's model of inflation point to higher inflation in 2017:

Inflation = F(Inflation expectations, unemployment rate, oil prices, import prices

RCI Comment: The American economy is heating up and inflation might begin but there seems no threat of a recession in the immediate future.

RA's: This tax season is over but contribute on market weakness for Feb 2018. N.B. RA calculations are now calculated at 27.5% including capital gains and interest

Last month, Eric Lappeman advised you to take advantage of your RA situation. We wish to clarify a few things:

You can now deduct 27.5% (with a limit of R350 000) of your taxable income.

Taxable income includes:

- Salary
- Annuities
- 40% of your (capital gains less R40 000)
- Interest (less your interest allowance of R23 800 for those under 65 and R 34 500 for those over 65)

The RA's of 30 years ago were a big rip off! The salesman got commission of about 15%. Today, the salesman gets very little. We take no commission for sales.

We do take 0.5% as the financial advisor for RA's invested in unit trusts. The underlying unit trust manager usually charges about 1% (sometimes they add a performance fee when performance exceeds their benchmark) and a fee of 0.25% goes to the unit trust administrator. The insurance company administering the RA charges about 0.35% to our clients.

Thus the total annual fee is normally about 2.1% plus VAT.

Now look at the benefits –

1. You save tax on the initial amount you invest in an RA at your marginal tax rate - say 30%. It is important to realise that you are saving your marginal tax rate not your average tax rate.
2. All dividends are tax free. If the portfolio earns 3% in dividends, then at the new 20% DWT, you are saving 0.6% per annum!
3. There is no tax on capital gains.
4. When you draw the money out you can take up to 1/3 upfront (you must be over 55) of which the first R500 000 is tax free over your life time. Most people who retired ten years ago only got R310 000 tax free and are not aware that they can get another R190 000 out tax free. Then, similarly, there is some more money in the 18% tax bracket that you can draw down as part of your 1/3.
5. The remainder (the Living Annuity) is repaid to you annually at a rate chosen by you of between 2.5% and 17.5% so you can choose how much to draw annually.
6. No RA (or when converted to a Living Annuity) is included in your estate for estate duty purposes. Thus you save 20% if your assets exceed R3.5m.
7. You can leave it to your surviving spouse who can leave it to your children.

Example: Alan is trying to build his RA up to say R6m. When he retires he can then cash in the first R1m at low tax rates and then draw 2.5% on the remaining R5m = R125 000 per year which at 65 will mean zero tax payable. So the bottom line is that he can save 45% tax on his contributions but pay no tax when he finally draws it out. Such a pity that one can only put in R350 000 per year!

Very Important suggestion – Move some capital gains and interest income into your spouse's name – then even if they have no salary or annuity income, they too can contribute to an RA.

If you need any advice on RA's, please speak to your financial advisor.

If only you had invested in BATS rather than smoking a pack a day

How much profit has gone up in smoke?

Ross McConnochie, February 2017

British American Tobacco listed on the Johannesburg Stock Exchange in October 2008. Previously, it was part of Remgro. It has been a strong market performer ever since. It has grown over three times from R274 to over R811 a share and has had an average dividend yield of 3.5% over the period.

What if instead of smoking a pack a day you had invested that money into BATS shares? Well we have done the exercise for you and the results are amazing.

<u>Here are a couple of stats:</u>

Since listing BATS has been listed on the stock market for just over eight years. That is about 3040 days.

If you smoked a pack a day you would have smoked over 60,000 cigarettes!

A pack of cigarettes costs about R42 today and we have made a loose estimate of inflation and sin tax of about 7% per year. [Although this number could be higher but the principle remains the same]

It would have cost you about R100,000 to smoke all those cigarettes over this time.

If you had rather saved your money every month and bought BATS shares instead you would have a portfolio worth about R200,000 today. But you also would have received a healthy dividend each year. So if you had reinvested those dividends into buying more shares, you would have shares worth around R225,000 today.

A R225,000 portfolio of BATS shares should produce a dividend of 3.7% before tax over the next year. That is about R6700 (after deducting the increased 20% Dividend Withholdings Tax). BATS has also grown its dividend by about 12% per year since its listing in South Africa. So you would now own a share that is likely to continue to produce a growing revenue stream and also enjoy capital appreciation.

Even if you stopped adding to the portfolio but continued to just reinvest the dividends, you are looking for your current R225 000 to grow to a million rand of shares in about ten years' time (if it continued to grow at similar rates to the past). At that stage it could be paying out R30,000 a year in dividends to you. This exercise shows the value of investing from a young age and the power of compounding and, of course, the excessive amount one can spend on smoking over the long run. We will not touch on the health issues! Let's stick to investing!

Please note: We have excluded trading fees in the above calculation and have made a simplifying assumption that it would be possible to purchase partial shares when in reality this is not the case. The exercise is simply to show the big picture of a lifestyle of smoking vs investing.

The Rise of the Useless Class

(From Fuller Treacy Money Comment of the day 4 March 2017)

Here is the opening of a brief excerpt from this fascinating new book, *Homo Deus*, by Yuval Noah Harari, published by Harper Collins

http://ideas.ted.com/the-rise-of-the-useless-class/?utm_source=pocket&utm_medium=email&utm_campaign=pockethits

Historian Yuval Noah Harari makes a bracing prediction: just as mass industrialization created the working class, the AI revolution will create a new unworking class.

The most important question in 21st-century economics may well be: What should we do with all the superfluous people, once we have highly intelligent non-conscious algorithms that can do almost everything better than humans?

This is not an entirely new question. People have long feared that mechanization might cause mass unemployment. This never happened, because as old professions became obsolete, new professions evolved, and there was always something humans could do better than machines. Yet this is not a law of nature, and nothing guarantees it will continue to be like that in the future. The idea that humans will always have a unique ability beyond the reach of non-conscious algorithms is just wishful thinking. The current scientific answer to this pipe dream can be summarized in three simple principles:

1. Organisms are algorithms. Every animal - including Homo sapiens - is an assemblage of organic algorithms shaped by natural selection over millions of years of evolution.

2. Algorithmic calculations are not affected by the materials from which the calculator is built. Whether an abacus is made of wood, iron or plastic, two beads plus two beads equals four beads.

3. Hence, there is no reason to think that organic algorithms can do things that non-organic algorithms will never be able to replicate or surpass. As long as the calculations remain valid, what does it matter whether the algorithms are manifested in carbon or silicon?

True, at present there are numerous things that organic algorithms do better than non-organic ones, and experts have repeatedly declared that some things will "for ever" remain beyond the reach of non-organic algorithms. But it turns out that "for ever" often means no more than a decade or two. Until a short time ago, facial recognition was a favorite example of something that babies accomplish easily but which escaped even the most powerful computers. Today, facial-recognition programs are able to identify people far more efficiently and quickly than humans can. In 2004, professor Frank Levy from MIT and professor Richard Murnane from Harvard published research on the job market, listing those professions most likely to undergo automation. Truck driving was given as an example of a job that could not possibly be automated in the foreseeable future. A mere 10 years later, Google and Tesla can not only imagine this, but are actually making it happen.

In fact, as time goes by, it becomes easier and easier to replace humans with computer algorithms, not merely because the algorithms are getting smarter, but also because humans are professionalizing. Ancient hunter-gatherers mastered a very wide variety of skills in order to survive, which is why it would be immensely difficult to design a robotic hunter-gatherer. Such a robot would have to know how to prepare spear points from flint stones, find edible mushrooms in a forest, track down a mammoth, coordinate a charge with a dozen other hunters and use medicinal herbs to bandage any wounds. However, a taxi driver or a cardiologist specializes in a much narrower niche than a hunter-gatherer, which makes it easier to replace them with AI. AI is nowhere near human-like existence, but 99 percent of human qualities and abilities are simply redundant for the performance of most modern jobs. For AI to squeeze humans out of the job market it need only outperform us in the specific abilities a particular profession demands.

<u>David Fuller's view</u>

I have mentioned Yuval Noah Harari and *Homo Deus* before, as have several subscribers, and the excerpt above from *ideas.ted.com* was provided by Mrs Fuller. I have yet to finish reading *Homo Deus*, given all of life's distractions, but it is the most interesting book that I have ever read.

One does not have to agree with everything that Yuval Noah Harari says, and I imagine that some people may even be offended by *Homo Deus*. Nevertheless it is very intelligently written and it challenges perceptions while making us think. That is an invaluable gift.

RCI BCI Flexible Fund

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

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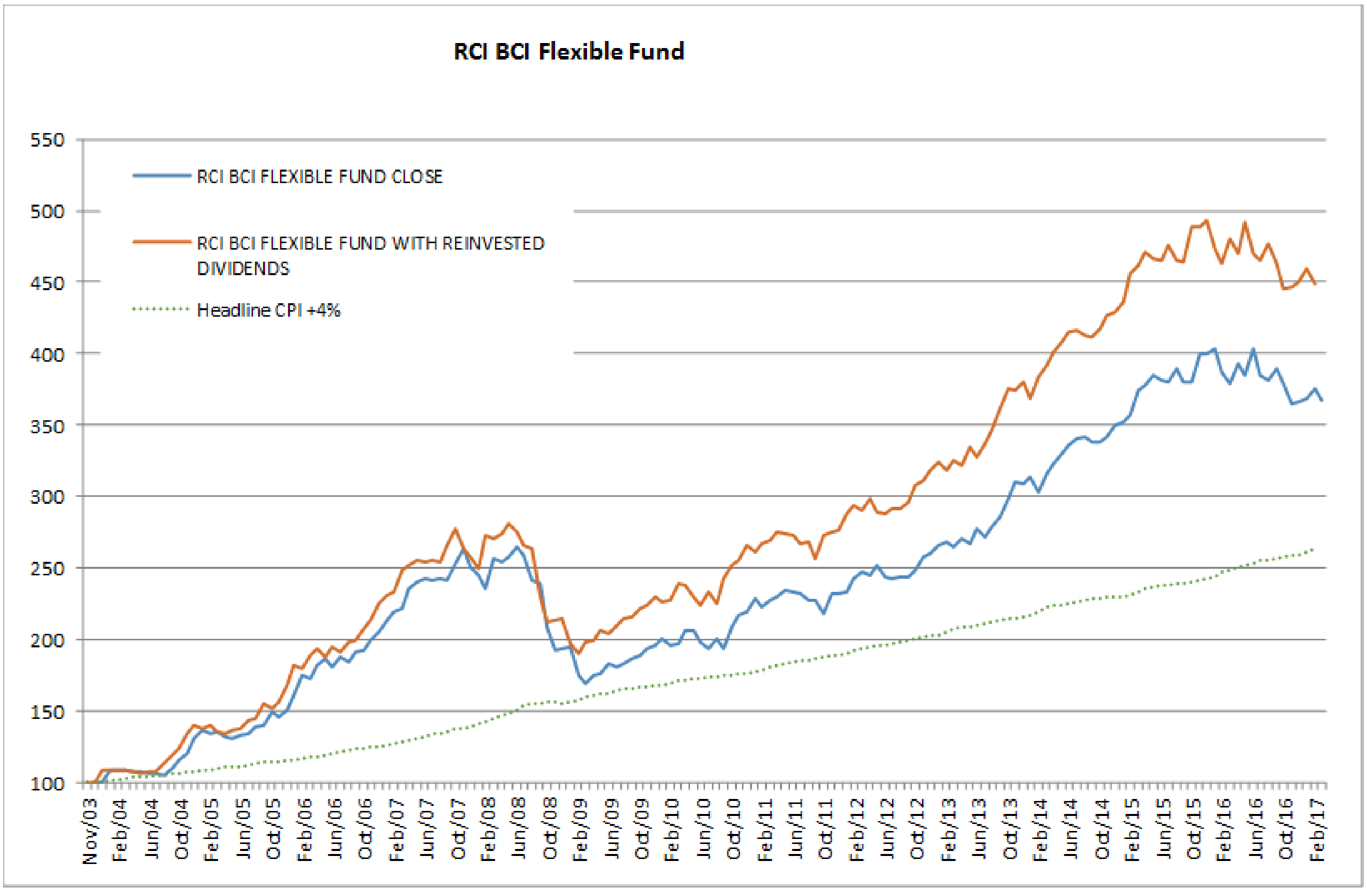
We have set up our portfolio to benefit from a weaker rand which might have a bit of strength in the short-term. We are investing for the long-term in companies that should enjoy reliable growth in earnings and dividends. Sooner or later, this should be translated into good share price growth.



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.

Collective Investment Schemes in Securities (Unit Trusts) are generally medium to long term investments. The value of participatory interests (units) may go down as well as up and past performance is not necessarily a guide to the future. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. A schedule of fees and charges and maximum commissions is available on request from the company/scheme. Commission and incentives may be paid and if so, would be included in the overall costs. The portfolio is registered under the license of Boutique Collective Investments, a member of the Association for Savings & Investment SA. Forward pricing is used. More details are contained in a fact sheet that is available on request.

To conclude

Investors need a long-term time horizon. The important issue is to get a great long-term return in both income and capital while being invested in shares with relatively low risk. Along the way, it is vital that you take advantage of proper tax and financial planning. If you earn a 10% return but end up paying 18% in capital gains tax and 20% in Estate Duty, this is not a good as earning 8% after all taxes.

Passing on tax savings to your spouse or to your children can significantly reduce the tax they will pay. Thus it is vital that the advice you receive on your affairs is appropriate. Take into account normal tax, capital gains tax, estate duty, local trusts and foreign trusts as well as donations between spouses and shifting income between spouses.

Very few of our clients earn more than R1.5m of taxable income per annum as most are retired. For those earning over R1,5m the Budget increased the tax rate from 41% to 45%. However, all clients are affected by the increase in Dividend Withholding Tax from 15% to 20%. This is a ONE THIRD increase in the tax rate – which is massive. It is vital that you combat this by reducing tax in other ways, e.g. using RA's.

The Budget did not implement the change that donations between spouses will no longer be tax free. Of course there is still a risk that this will be implemented at some stage in the future.

Loans to Trusts will now attract donations tax. So if your loan is R3m then apply the 8% rate – R240 000. Deduct the R100 000 donation you can make tax free every year = R140 000 and apply donations tax at 20% =R28 000 is your bill. Discuss with us how you can reduce this e.g. by donating some to a spouse, moving assets which do not benefit from capital growth out of the trust etc.

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

Thank you for being our clients.

Best regards

Di and Alan