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

"You can't plough a field by turning it over in your mind."
~ Gordon B. Hinckley

"You can do anything, but not everything."
~ David Allen

RCI MET Flexible Fund – closed January at 376.06, up 2.20% for the month. It is 2.42% lower than 12 months ago whereas the JSE Top 40 was up 4.23% versus a year ago. However, our fund is more comparable to the FNDI 30 Index which was down 2.7% for the year. We hope that this is the bottom of the market as we have seen growth of 2% in 2017.

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

The markets turned up in January.

Time to make an increased RA contribution. During this tax year to the end of February 2017, the amount that may be contributed was increased from 15% to 27.5% (maximum R350 000). For those earning a salary or drawing on a living annuity, substantial savings may be made.

It has been speculated that donations between spouses will no longer be tax free after the budget. In addition, from 1 March, loans to trust will attract some donations tax so talk to us if you need to re-arrange your affairs.

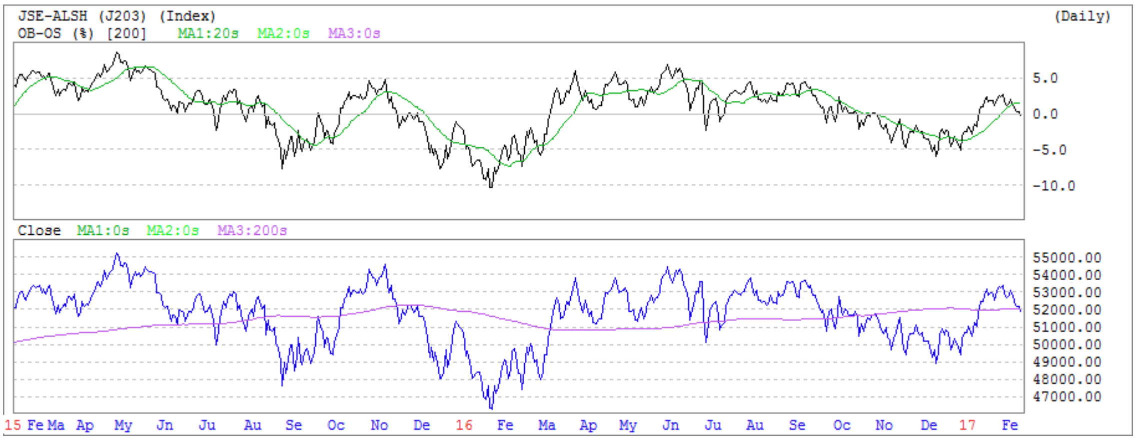
Nick Dennis, of Anchor, wrote an interesting article on why short-term underperformance is not necessarily a reason to change strategy. Sometimes risky behaviour is rewarded but when things go wrong, risky behaviour was not a clever strategy to follow.

The markets turn up in January

The JSE turned strongly in January, however, it is back at the same levels as two years ago.

The bottom of the graph shows the JSE Allshare Index price and its 200 day moving average.

The top of the graph shows the overbought ratio of this index, the 20- day moving average of which turned up on 29 December. Note that the oversold ratio fell to almost -6% at its bottom in December.



We will invest very little money in mining shares until a mining boom is firmly underway because mining shares are inherently risky. Statistics from the last century (see our newsletter of April 2016) show that when a metal cycle peaks out (2012), it normally takes 20 years for the next boom to start! Thus, the odds are that last year was a blip on the radar in the big picture. Mining shares are likely to battle for ten years. This does not mean they will not have a periodic upswing, as in early-2016, but the danger remains that they might give up most of their gains.

So, if we invest so little in mining, how is non-mining doing? Below is the graph of the Financial and Industrial Top 20. It too turned up on 29 December but it's oversold ratio had reached 9.5% below its moving average.

What happens in the short-term is not nearly as important as what happens in the long-term.

Two years of sideways performance disappear in the blink of an eye. What were you doing two years ago? The long -term is what counts!

This graph shows you what happened over the past 10 years. Did you notice that it includes the financial crisis of 2008? Now, you can hardly notice it on the graph! So the graph shows two down years to start with and then steady growth for the next 6 years. Clients were not sanguine at the beginning of 2009 and neither are they now, but these two past years of lower performance should lay the foundation for some good years ahead.

Take advantage of the changes in limits to RA (retirement annuity) contributions. You must act before the end of Feb. It applies to drawings from living annuities too!

NB! Contributing up to 27.5% of your taxable income to your retirement funds can save you substantial tax.

By Eric Lappeman

This time, each year – ahead of the tax year-end in February – we remind clients to take advantage of ways to reduce their tax. This includes both capital gains tax (by taking advantage of your R40,000 capital gains exemption) as well as by contributing more to your retirement annuity fund (RA) – the limits of which increased in this tax year.

1. ***Realise some capital gain for the year to get as close as possible to your R40,000 exemption.***
2. ***Contribute more to your RA and so reduce your taxable income for the year.***

In March 2016, the amount you can contribute to your retirement funds was **increased from 15% to 27.5% of your total taxable income but capped at a maximum of R350,000 per tax year**.

In return for saving your funds for the long term, you can deduct the amount contributed from your taxable income for the year. You will therefore reduce your tax payable. These savings/rebates can then be contributed to next year's RA or to your existing share portfolio or spent on yourself. The point is that the savings are better in your hands than in the hands of the taxman!

If you earned R1,200,000 from salary or from a living annuity you could contribute 27.5% or R330,000 to your RA and reduce your taxable income for the year to R870,000 and save R135,300 in tax!

So, what are the important benefits to note about your retirement annuity?

1. ***Your contributions, up to the lower of 27.5% or the limit of R350,000, are fully tax deductible.***
2. ***All growth inside the RA, including interest income, dividend income and capital growth, is tax free.***
3. ***You can invest up to 25% of your RA offshore. 25% must be invested in property, gilts or shares.***
4. ***Any retirement products fall outside of your estate, therefore are not subject to 20% estate duty on death.***

* Note: Although you are saving up to 41% tax on the contributions, these contributions are locked in until you turn 55, except in very specific circumstances **– so don't invest money you will need before then**!

Once you turn 55 or retire, you can withdraw the first 1/3rd, as cash. The first R500 000 is tax free. This is a life-time limit but note that most people who retired 1 March 2014 only utilized their maximum of the time which was R310 000, so many people have an extra R190 000 which they can use tax free. Thereafter, a sliding tax scale applies to the amount withdrawn but normally we do not recommend withdrawing more than about R1 million. The remainder will be converted to a living annuity on which you will be forced to draw between 2.5% and 17.5% per year. This drawing is fully taxable. So at worst, if you are already paying the top tax rate, you will delay your tax but in most cases, when you draw it out you will be paying a lower tax rate than you saved when putting it in.

Normally, when you start drawing on your annuity, you should be earning less (if any) other income and therefore benefit from withdrawing the funds at a lower average tax rate than you saved when you made the contribution. Assuming you build your RA up to R4,500,000 when you turn 65, taking the first R500,000 out tax free leaves R4,000,000 to convert to a living annuity. Drawing 2.5% per year would amount to R100,000. The tax threshold for those over the age of 65 is R116,150 which means you wouldn't have to pay a cent of tax!

So you are getting a double tax benefit:

1. ***Pay less tax now due to the contributions, essentially deferring the tax.***
2. ***Paying tax at a lower rate when withdrawing funds in the future.***

Some of you may already have existing retirement funds (employers, pensions or provident funds) but they have probably deducted a maximum of 15% which means you can supplement in February with lump sum top ups to 27.5% of your total earnings once you have a clear picture of your total taxable income for the year. Others may be without an existing RA in place, in which case you can open one and make a lump sum contribution. Either way, if you haven't reached the 27.5% limit (capped at R350,000), you have until the end of February to take advantage of 'topping' up the balance!

* Note: while you can only invest up to 27.5% tax free each year, there is no penalty for exceeding this limit. It will just carry over to the next tax year. But it can only carry over for one year – so don't put in way too much!

In the example below, there are four scenarios with different sources of income and how you can reduce that tax payable, in some cases, substantially.

	Scenario 1	*Scenario 2*	*Scenario 3*	*Scenario 4*
Living Annuity Gross Income	300,000	500,000	-	-
Salary (including bonuses)	300,000	-	600,000	1,400,000
Rental Income (after costs)	100,000	200,000	500,000	-
Total taxable Income	700,000	700,000	1,100,000	1,400,000
Tax Payable per tax scales	**206,457**	**206,457**	**370,431**	**493,431**
Effective tax rate	*29%*	*29%*	*34%*	*35%*
Less effective tax paid already in living annuity (if applicable)	(63,280)	(129,960)	-	-
Additional tax to be paid	*143,177*	*76,497*	*370,431*	*493,431*
Contributing 27.5% of total taxable income to RA	192,500	192,500	302,500	350,000
Reduced taxable income	507,500	507,500	797,500	1,050,000
Tax payable per tax scales	**132,660**	**132,660**	**246,406**	**349,931**
Tax savings on contributions to RA	**73,797**	**73,797**	**124,025**	**143,500**
% saving on the contribution	*38%*	*38%*	*41%*	*41%*
Net tax payable	**132,660**	**132,660**	**246,406**	**349,931**
less tax already paid by both living annuities	(63,280)	(129,960)	-	-
Balance of tax due to be paid	69,380	2,700	246,406	349,931

* Note: although it was originally proposed that SARS should allow you to use Capital Gains to calculate the 27.5%, when it was finalized, Capital Gains could not be included.

Scenario 1:

This scenario details three sources of income (pre-tax living annuity drawings, salary and rental income after costs). This amounts to taxable income of R700,000 and tax payable to R206,457. The tax on the living annuity drawings would already have been deducted by the service provider (although probably at a lower rate than it should be because they may be unaware of your other income). So, R63,280 should be deducted from the tax payable. This leaves additional tax payable of R143,177.

Now, if you contribute 27.5% of the total taxable income, or R192,500 to your RA, you can reduce your taxable income to R507,500, on which R132,600 tax is payable rather than the R206,457. This is a tax saving of R73,797! So, instead of paying SARS an additional R143,177 in tax, you would only have to pay an additional R69,380 (R132,660 –R63,280). **That means that the R73,797 stays in your pocket rather than going to SARS.**

Put another way, you are **able to contribute R192,500 towards your RA for R118,703 (net of the tax saving).**

Scenarios 2, 3 and 4 are similar to the above but with different amounts and sources of taxable income. The concept and methodology still remains though. You will notice that in scenario 4 the total taxable income amount to R1,400,000, at which point 27.5% amount to R385,000 but the contribution is capped at R350,000 so that person would save about R143,500 in tax.

Conclusion

It makes sense to contribute to your RA each year to reduce your taxable income and hence tax payable. Furthermore, the benefits of tax free growth inside, as well as the later benefits of withdrawing the funds at a lower average tax rate upon retirement, make it all the more worthwhile.

If you haven't made full use of your 27.5% (maximum of R350,000) allowance, then you have until the end of February to take advantage of 'topping' it up. However, please be realistic – make the payment by 25 February as there is a bit of paper work to complete on any new RA.

If you have any queries regarding opening an RA, or contributing to an existing one with RCI contact Christine Hall at christine@rcinv.co.za or 011 591 0569 or Eric Lappeman at eric@rcinv.co.za or 011 591 0573. We will require all the necessary documentation as well as your total taxable income for the year by **20 February 2017**.

A reminder from Nick Dennis that although riskier strategies may show the best short term results, they are not the best way to invest. End December 2016

By Nick Dennis who runs the **Anchor Global Equity Fund**

"A prime element in risk creation is a belief that risk is low, perhaps even gone altogether. That belief drives up prices and leads to the embrace of risky actions despite the lowness of prospective returns." ~ Howard Marks, The Most Important Thing

Keeping up with the Joneses

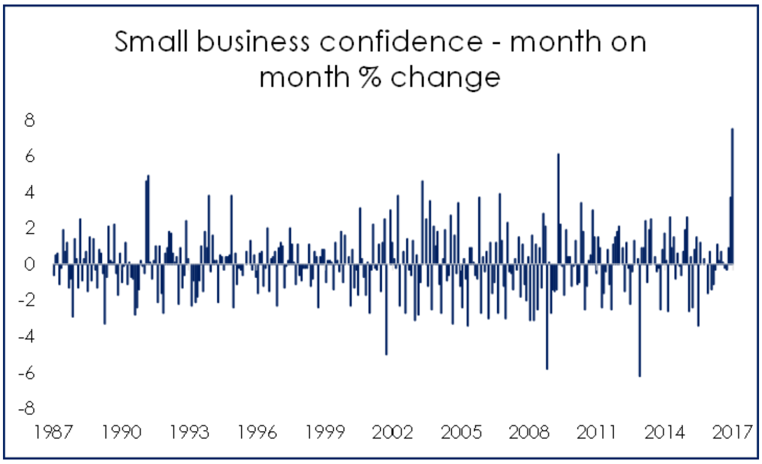
One evening, two couples decide to go out on a dinner date. They order two Ubers. The Joneses climb into the first car, which appears to be held together by duct tape and prayer. The one-star rated driver has bloodshot eyes and reeks of alcohol. "Step on it!" says Mr Jones, "We need to get there before the Smiths!" The Joneses' car narrowly misses several pedestrians and an oncoming truck. They arrive two minutes ahead of the Smiths and celebrate their victory with fist pumps and high fives.

After dinner, Mr Jones tries his luck at the roulette table. He says to everyone within earshot, "I maxed out our credit cards, re-mortgaged the house, took out all our savings…and put it all on red! And…I won!" Mrs Jones looks at her husband and says with tears in her eyes, "Oh Mr Jones, how tremendously clever you are! My husband, the genius!"

Animal Spirits return

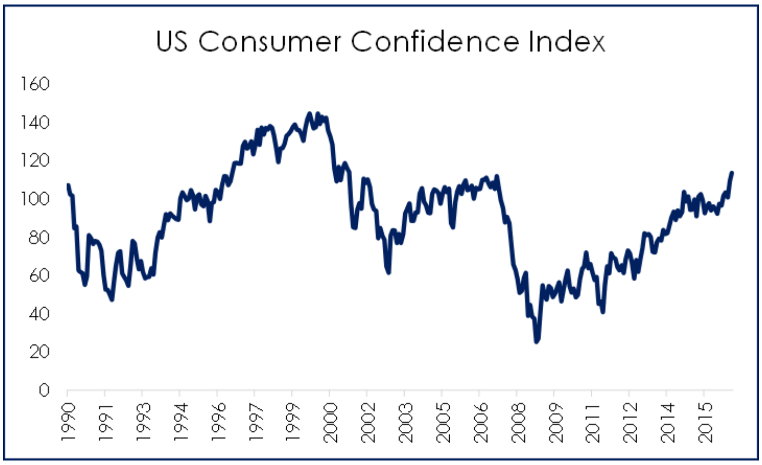
In the last Bits & Pieces, I suggested Animal Spirits could make a comeback following Trump's election win (https://medium.com/@nickdennis10/bits-and-pieces-volume-25-animal-spirits-e7d00e768ac4#.511bk4d05). They've done that, and then some. The combination of improving economic data (bolstered by record low interest rates) and Trump's pro-business agenda has had an intoxicating effect.

Small business confidence has skyrocketed, with the biggest month-on-month move in the survey's history.



Source: Bloomberg

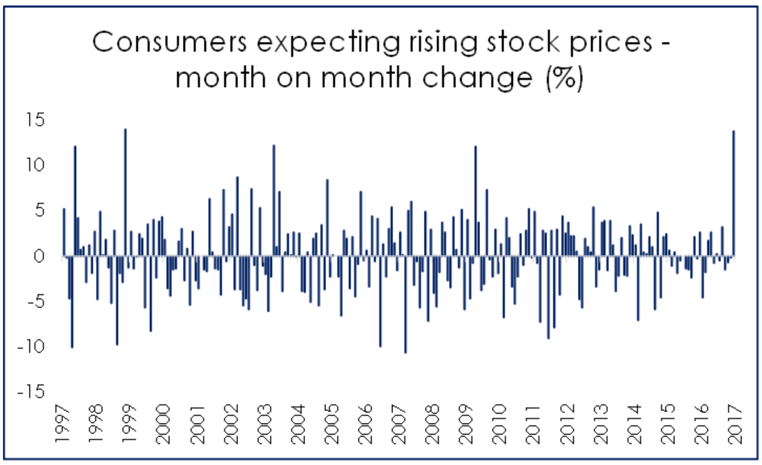
Consumers are also feeling optimistic, with confidence reaching pre-crisis levels.



Source: Bloomberg

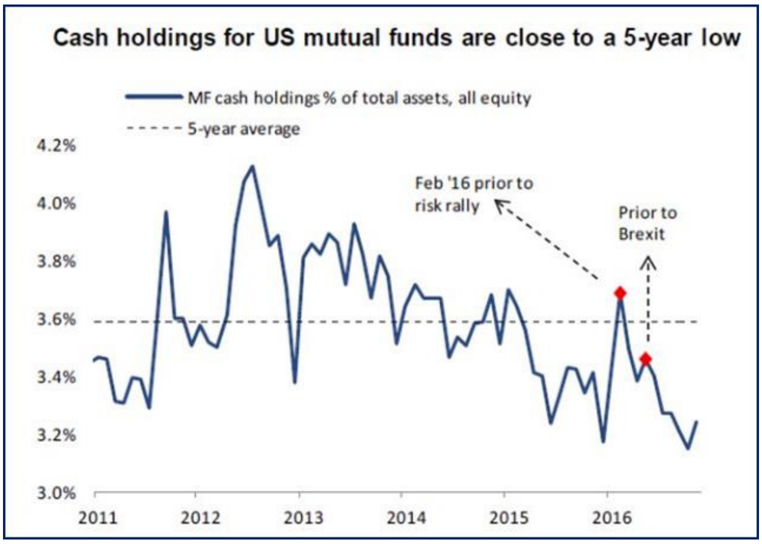
Equities have responded in kind, with cyclical sectors rallying hardest. Last quarter, companies with the **lowest** return on equity outperformed those with the highest return on equity by 4%. Companies with the **slowest** sales growth outperformed the fastest growers by 8% over the same period (http://blog.gavekalcapital.com/?p=12540).

Investor sentiment has improved dramatically. The percentage of US households expecting stock prices to rise has seen its biggest month on month jump since the late 90s.



Source: Bloomberg

This bullishness is also reflected in reduced cash holdings for US mutual funds.



Source: Deutsche Bank

As a result, valuations have become fairly expensive. According to investment bank Jefferies, the Russell 2000 Value Index (US Small Cap Value shares) is trading on its **highest PE multiple in history**.

The Paradox of Risk

Now that the dust has settled on the uncertainty of 2016 (China hard landing, Brexit, US election etc.), it stands to reason that markets are ready to fly in 2017, doesn't it?

Unfortunately, it doesn't.

To the extent improving conditions are already anticipated, they are likely to be reflected in shares prices. If Trump's policies are enacted and the market's growth expectations are met (with significant hurdles to both assumptions), the payoff is likely to be modest. On the contrary, markets are priced for future disappointment if said policies are not effective or have a delayed impact.

Second order effects will also come into play. As growth and inflation expectations rise, so do interest rates. Auto, mortgage and other financing becomes more expensive, effectively reducing demand. The stronger dollar also acts as a brake on growth.

The paradox: when investment risk appears low, it is usually high. And vice versa.

This is **not** a call to sell everything and head for the hills. I remain a long term bull on equities. But I am saying that **investment risk has risen and investors should prepare accordingly**. Those with a well-constructed, long term financial plan and the right temperament are already ahead of the game.

At times like this, the best performing strategies are frequently those that assume the greatest risk. The Joneses' actions appear more rewarding than the Smiths', but will ultimately lead to disaster.

In every possible respect, no good can come from trying to keep up with the Joneses.

We don't worry about the Joneses and our strategy remains unchanged: to own best of breed businesses that grow shareholder value, regardless of the environment.

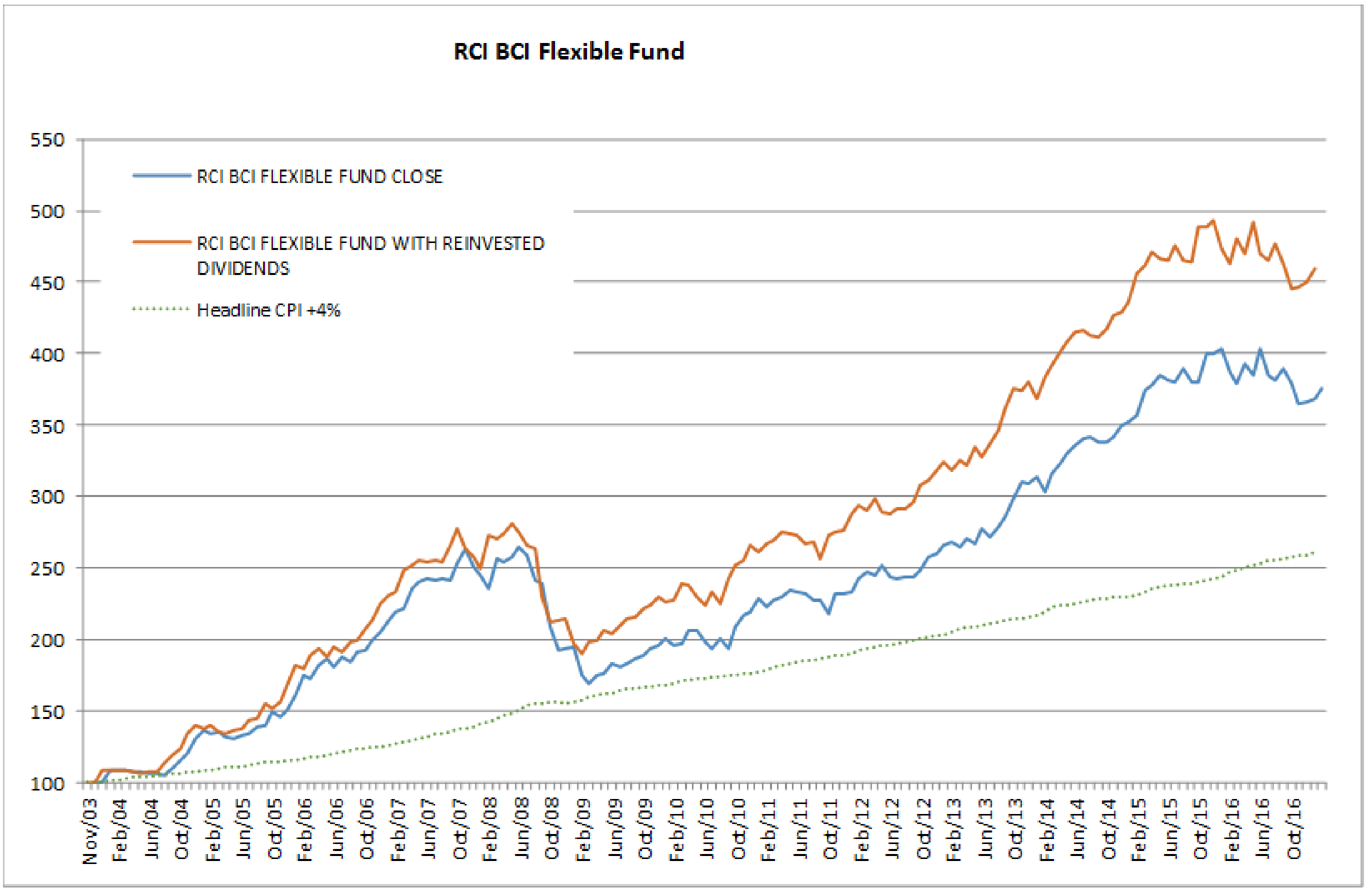
For more Bits & Pieces, please see: https://medium.com/@nickdennis10

RCI BCI Flexible Fund - a better month: up 2%

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

RCI BCI Flexible Fund rose 2.20% for January closing at 376.06c per unit. Over a year, the Overall Index is up 4.23% and our fund is down 2.42%. However, our fund is probably more comparable to the FNDI 30 Index which was down 2.7% for the year (before costs). We hope that this is the bottom of the market as we have seen growth of 2% in 2017.

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

2017 has started with a bang!

We are working flat out on ways to reduce your tax - e.g. utilising the higher RA allowance of 27.5% and also looking at the tax implication of loans to trusts on which SARS wants to charge you donations tax from 1 March 2017.

We need to discuss with you how to re-arrange your affairs. **There is also a risk that donations between spouses will no longer be tax free,** so some changes might be needed before the Budget Speech at the end of February where many of the tax changes are announced.

Our chief long-term goal is to grow your money in a manner where your investments are safe and the income therefrom is reliable. Of course, in shares, there will always be short-term price volatility. Ignore that, avoid long-terms losses and investing in risky sectors. When you look at the growth in your portfolios over the past ten years, the returns have been spectacular, without adopting much risk!

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

Thank you for being our clients.

Best regards

Di and Alan