TUESDAY, 27 OCTOBER 2020

irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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Is Regulation 28 due a major overhaul?

The ongoing trend of companies delisting from the JSE could force National Treasury to make amendments to Regulation 28, whether they wish to or not. Regulation 28 was introduced under the Pension Funds Act to prevent asset managers from taking excessive risk with South Africa's retirement savings. The regulation, last amended in 2011, limits the maximum capital allocations that retirement savers can make to various asset classes such as bonds, equities and real estate, with additional sub limits for alternative investments and the percentage of a portfolio that may be held offshore, among others.

Where did all the listed companies go?

Asset managers are concerned that the universe of list able opportunities from which they can 'fill' their domestic equity allocation, has contracted massively over the years. A few days ago, on 19 October 2020, African Oxygen (Afrox) became the latest JSE-listed firm to announce it had been bought out by an US/German company and would subsequently delist from both the South African and Namibian bourses. Afrox is one of more than 250 firms to have exited the JSE since the early 2000s. Todd Micklethwaite, Head of Strategy & Impact at Sanlam Investments, told attendees at a webinar, held 4 September 2020, that opportunities in private markets substantially outweigh those in listed markets.

"The number of listings on the JSE has halved since 1994, while the capital committed to the private equity industry has grown around 10% over the past decade," he said. His observation explains why there is increasing pressure to lift the regulatory caps on alternative asset classes and allow greater portions of retirement savings to flow to private equity and venture capital opportunities, among other private market asset classes. Such a relaxation would have positive implications for the broader economy as it shrugs off the impact of COVID-19. Tanya van Lill, CEO of the Southern African Venture Capital and Private Equity Association (SAVCA), suggested that a relaxation of the regulatory cap for alternative assets could be a game changer for the country's hard-hit small and medium enterprises (SMEs).

Saving the economy, creating jobs

In a SAVCA media statement, issued 21 October 2020, the association stated that a simple amendment to Regulation 28 could support the country's economic recovery by allowing more investment into the SME-focused private equity class. They argue that capital unlocked in this way would be more beneficial to struggling firms than government's COVID-19 loan scheme because SMEs were keen to de-risk rather than take on more credit. The regulation currently allows for a maximum of 15% of retirement savings to be allocated to alternative investments, with a sub limit of 10% for private equity. SAVCA proposes the following simple changes:

First, that hedge funds and private equity be separated into independent asset classes, each with their own caps. “This would enable investment decision makers to model the asset classes independently in their portfolio construction process, so as to properly accommodate the risk and return characteristics of each,” said Lill. And second, to gradually increase the private equity cap from 10% to 15%, perhaps by 1% each year. “Increasing the private equity cap would allow a pension fund to take a larger exposure to the entire asset class, enabling a higher degree of diversification, and improving the overall financial security of pension fund savers,” she said.

Driving social outcomes with impact investing

There is also a growing contingent of asset managers who are supportive of changes to Regulation 28 as an alternative to the prescribed asset concept. Dawie de Villiers, CEO at Alexander Forbes, said it made sense to “shift the investment model to one that is driven by investing in attractive opportunities with higher economic and social benefits”. De Villiers was presenting during a ‘Partnering for better financial well-being outcomes’ discussion, held early-August. His views were backed up by Janina Slawski, Head of Investment Consulting at the firm, who offered impact investing as a workable alternative to prescribed assets.

Impact investing is designed to give market-related investment returns that have an underlying positive impact on the community and infrastructure into which it invests. The challenge with impact investing is that most qualifying investment opportunities are in unlisted and illiquid private markets. “Current limits in Regulation 28 do allow investments into unlisted assets; but not at a huge level because of liquidity concerns in the defined contribution fund environment,” said Slawski. “The discussion is thus focused on whether the regulatory limits should be increased and whether infrastructure should be included as a new asset class in the regulation”.

Attractive returns from private markets

During a September presentation titled ‘The investment case for private markets’, Micklethwaite observed that there were “a broad range of private market asset classes with inherent characteristics which offered investors the opportunity for attractive returns, on both an absolute and risk-adjusted basis”. He added that the market for unlisted assets was substantial and, that where such assets were incorporated in retirement funds, they had generally proved beneficial.

Micklethwaite presented a compelling argument for increased exposure to private markets, comparing a diversified Regulation 28 compliant portfolio that contained only listed assets, to one that included a 20% allocation to private markets. “We can demonstrate, purely based on historical performance, that there is an investment case for considering private markets,” he said. The caveat is to balance the liquidity associated with such investments with fund members’ needs.

FA News | 26 October 2020

A simple Reg 28 amendment could fuel SA's economic recovery

Considerably more investment could be directed towards SMEs.

Covid-19 and the ensuing national lockdown has had a dramatic effect on all spheres of South African society, but small and medium-sized enterprises (SMEs) – especially those in the service sector – have been particularly hard hit. These SMEs, however, are also the fastest creators of new jobs, and could underpin the country's much-needed economic recovery. A recent McKinsey report reveals that South African SMEs represent more than 98% of businesses, employ between 50% and 60% of the country's workforce across all sectors and are responsible for a quarter of private sector job growth. Stimulus of SMEs is therefore the most effective mechanism to drive a recovery of the estimated two million jobs that have been lost through the Covid-19 crisis thus far.

More specifically, however, a simple amendment to Regulation 28 – a regulation in terms of the Pension Funds Act that specifies ceilings for exposures to different asset classes – could support this recovery by enabling considerably more investment to be directed towards SMEs. Private equity and venture capital are major sources of funding for SMEs, but the sector is currently unable to mobilise the level of investment required and, as a result, 763 companies and close corporations were liquidated in the first six months of 2020. This is because the asset class is consolidated in the same bucket of alternative investments as hedge funds, which is capped at 15% of compliant funds' assets under management. Within that, private equity is capped at 10% and any one fund to a maximum of 2.5%.

As the private equity sector has grown over time, and investor awareness has increased, this consolidation no longer makes sense. The 'alternative investments' category was introduced into Regulation 28 in 2011 after pressure from institutional investors for more diversification options. Subsequently, however, investors have built up capacity to engage with the asset class and today model the risk/return characteristics of hedge funds and private equity quite differently. While the Covid-19 crisis has highlighted the need to amend this regulation, it does not need to be overhauled. This is a relatively simple measure that can be quick to implement. As we saw in 2011, Regulation 28 can be easily amended, and the quicker this is done, the sooner the economy will start feeling the benefits.

The Southern African Venture Capital and Private Equity Association (Savca) has prepared a positioning paper which outlines two proposed amendments to Regulation 28:

1. Separate hedge funds and private equity into independent asset classes, each with their own caps. This would enable investment decision-makers to model the asset classes independently in their portfolio construction process, so as to properly accommodate the risk/return characteristics of each, thereby evaluating risk-adjusted real returns.
2. Gradually increase the private equity cap from 10% to 15%. This step can be phased, allowing the industry and investors to scale up capacity in tandem, possibly by one percentage point each year. A

gradual approach is also low-risk as unintended consequences can come to light before full implementation.

Increasing the private equity cap would effectively allow a pension fund to take a larger exposure to the entire asset class, enabling a higher degree of diversification. This offers positive public benefits by improving the overall financial security of pension fund savers in the long run. We believe that the private equity cap should be raised by expanding exposure at a gradual rate, as pension funds will need to develop the skills to analyse the asset class and the supply side may need to increase capacity. Such amendments to Regulation 28 would also allow for much-needed economic stimulus following the low rate of loan approvals from the government's R500-billion bank loan guarantee scheme.

While this initiative was aimed at providing relief to businesses affected by Covid-19, companies' balance sheets are under immense pressure and businesses are therefore looking to de-risk rather than take on more debt. This is where equity and smart capital can play a fundamental role in supporting economic recovery and growth. Amendments to Regulation 28 could see much-needed capital being invested to where it is needed.

Moneyweb | 23 October 2020

Lockdown looms for SA expat pensions

South Africans who have recently financially emigrated, but still have retirement and pension funds in South Africa, have until 1 March 2021 to transfer out their funds, or face the prospect of having them effectively locked for three years. That's the net effect of recent changes promulgated in the draft Taxation Laws Amendment Bill on 31 July 2020, which will make it even harder for people to take their funds out of the country. Currently, expats can withdraw their retirement funds before their retirement age as long as they have financially emigrated from South Africa. From 1 March 2021, however, they will need to prove they have been a non-tax resident of South African for at least three consecutive tax years.

Leah Mannie, a pensions specialist at Sovereign Trust (SA) Limited, an international trust and structuring company, said expats should be worried about leaving their retirement provisions behind in South Africa. Apart from an uncertain economic future, SA-based funds are more difficult to manage, and forced investment into prescribed assets could affect their hard-saved monies. "The real and ever-present worry is that South African based retirement and pension funds will be forced to apportion a fixed percentage of their funds into government infrastructure projects and into bailing out state-owned enterprises," said Mannie. "Those who have left South Africa should examine their options for their retirement funds left behind, if they have not done so already."

What this means is that prospective expats, particularly those retired or close to retirement, should consider funding an overseas account in lieu of contributions to an SA-based retirement annuity or pension. “While they would not get the tax advantages of local retirement annuities, this would at least leave the expat with accessible funds to settle them in their new country of residence,” said Mannie. Typically, an investor would house their foreign investment in an overseas discretionary trust, then draw on the funds once they had completed their relocation.

Another option would be to look at establishing an overseas retirement plan while still living in South Africa, and fund the plan with after-tax funds while pursuing one’s emigration through the normal channels. The overseas retirement plan route is more popular due to the ease of establishment, lesser cost and clear rationale for funding. These overseas retirement plans are typically set up in stable and well-regulated jurisdictions such as Guernsey or the Isle of Man. “Retirement planning is never a ‘one size fits all’ situation: it all depends on the specific circumstances and retirement goals of each person. But forward planning pays off, especially at this time,” said Mannie.

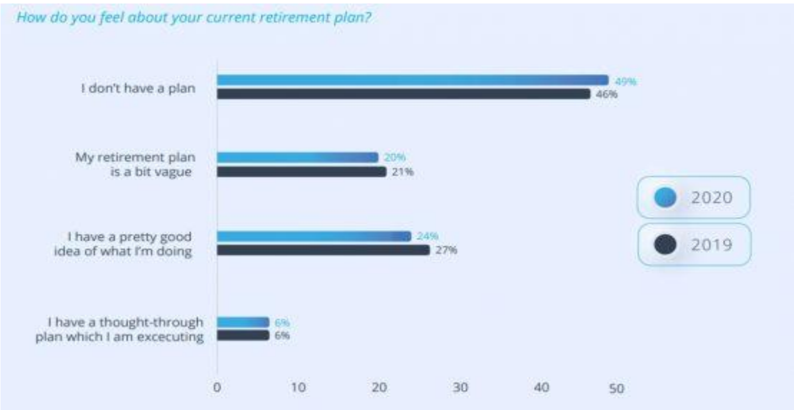
FA News | 26 October 2020

Half of South Africans are unprepared for retirement

Technically, 49% have no pension plan – and women are less prepared than men.

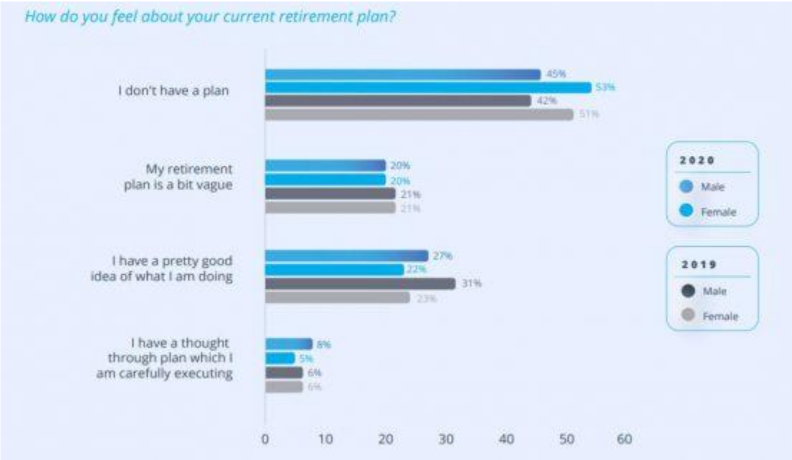
South Africa is sitting on a ticking retirement timebomb, with National Treasury saying that in 2019 only 6% of the country’s population was on track to retire comfortably. Chris Eddy, head of investments at 10X Investments – which released its third annual Retirement Reality Report on Wednesday – said the Covid-19 pandemic has highlighted the urgency needed to tackle the retirement savings crisis. The report is based on findings of the 2020 Brand Atlas Survey, which tracks and measures the lifestyles of the 15.1 million economically active South Africans living in households with a monthly income of more than R8 000 (through online surveys). The report revealed that South Africans do not retire with dignity and there is seemingly little sign of improvement, as 49% of people surveyed said they don’t have a retirement plan; last year it was 46%.

How South Africans are saving



Source: 10X Investments Retirement Reality Report 2020

Women are the worst when it comes to saving, with 53% saying they don’t have a retirement plan.



Source: 10X Investments Retirement Reality Report 2020

The key reasons

The report states that many South Africans will face a bleak reality after their working lives come to an end. “A frightening number of people have not formally planned how they will fund their retirement. Of those who have, few are monitoring their progress. “Most don’t know whether or not they are on track to meet their goal to be able to support themselves in retirement, never mind in any comfort.” Another reason for South Africans not saving for their retirement is because there is simply not enough money to live a decent life *and* save. “Some of this is down to economic hardship. It is simply impossible to save without a minimum level of income,” according to the report.

“This year more than half of the survey’s respondents indicated severe financial stress.” Beyond that, it is not just an income issue, because people in low-, medium- and high-income brackets are equally worried about making ends meet in retirement. The report indicates that it is rather a savings problem that is rooted in the widespread lack of retirement planning. “[Of those] who do have retirement saving plans, dangerously few are monitoring their progress. Most don’t know whether or not they are on track to meet their goal to be able to support themselves in retirement, never mind in any comfort.”

The last hope

Eddy said the silver lining is not obvious, as the data paints a picture of the population sailing blindly into a worsening crisis. The coronavirus pandemic might however have helped drive the message home, with Eddy saying that there is a possibility that some lessons may have been learned as sudden lifestyle downgrades became a reality for many. “If there is to be a positive from our state of economic and financial disaster, perhaps it is the increased awareness of our vulnerability to life’s unexpected broadsides,” he said. He said that the glimpse into the future of what poverty feels like for many may finally convince people that they cannot afford to ignore planning for retirement.

Moneyweb | 22 October 2020

Positioning SA for a green recovery

Sustainable finance may not yet be as mainstream locally as it is globally, but it is gathering momentum.

Following the devastating impact which the Covid-19 pandemic has had on South Africa and the world, governments, corporates, and citizens collaborate to focus on a green economic recovery. This is a result of the pandemic being inextricably intertwined with global environmental issues such as biodiversity loss, climate change, air and water pollution. The South African government is subscribing to a green recovery as the blueprint for rebuilding and growing the economy with sustainability, resilience and inclusion as key priorities.

The President articulated the direction of the recovery plan titled "South African Economic Reconstruction and Recovery Plan" in the joint sitting of Parliament on Thursday, October 15, 2020. Whilst it is crucially important to focus on the implementation of the eight-point plan, a green recovery directive is sound thinking. In assessing the above point, the Presidential Economic Advisory Council released briefing notes in October 2020, and it is poised in pointing out what used to be a choice is now mandatory. Those countries not adapting to a green transition will find themselves behind and excluded. They will be behind on the innovation curve, the cost curve and thus be laggards. Thus, the question is not whether, but how.

Regulatory commitment

As a signatory to the 2015 Paris Climate Agreement, South Africa has a commitment to reduce greenhouse gas emissions by 2030. Considering this, we recognise that South African specific climate change risks and social concerns are as important as governance concerns. The materiality of ESG risks matter. Regulation 28 promotes responsible investing of pension fund assets by specifically requiring the need to consider environmental, social and governance (ESG) factors. Regulation 28 is cognisant of risk and aligned with the long-term investment time horizons of pension fund investors. Evolution in regulatory environments around the world are a key sign that the importance of ESG integration and measurement of impact in an investment process is growing. There are definite positive effects it can have on both pension funds and societies. Sustainable finance may not yet be as mainstream locally as it is globally, but it is gathering momentum.

Accessing opportunity

Green finance for an investor:

Green finance investments can find expression through impact investments or specific thematic investments. The Global Impact Investing Network defined impact investments as 'investments made into companies, organisations and funds with the intention to generate measurable social and environmental impact alongside a financial return. Examples include commercially viable impact investments, but can extend to infrastructure and renewable energy contributing toward positive impact. A recent global development has shown that several providers of investment products have begun creating products in the public markets that are linked to making a positive public impact.

In South Africa, the green bond market exists as a niche. Recently, a Sustainable Development Goal (SDG) bond instrument was successful in funding R2 billion of sustainable finance in Africa. In June 2020, the JSE also launched a sustainability segment, as a platform to raise capital. The long-term goal is for capital markets to have worthy niche ideas become the mainstream. Products can be developed with specific reference to the 17 United Nations Sustainable Development Goals. According to the Impact Management Project, a forum for building global consensus on impact measurement, an enterprise's intention around impact, positive or negative, intentional or not, can be classified into those who:

- act to avoid harm
- benefit stakeholders
- contribute to solutions

Thematic investing can also extend to include environmental or social imperatives by virtue of a specific theme that is being explored. For example, a fund with a social theme can be found in microfinance, urban regeneration, property and social infrastructure. Environmental themes are another example and can be explored through water and waste management as well as renewable energy. Allocations to these investments under Regulation 28 brings diversification to traditional listed investments.

It also plays a pivotal role in enabling environmentally appropriate social development, fostering economic opportunities in the green economy. "In sourcing viable investment opportunities, there are also ESG considerations to be made. The investment research and ratings of asset managers, or investee companies that provide developmental assets and sustainability themed investments (clean energy, education, health, transportation, low-cost housing, and other social infrastructure) must be considered strongly."

Supportive governance frameworks

The economic recovery plan requires the contribution of robust governance frameworks in listed and unlisted investments. Listed shareholders who have concerns around ESG issues have power and can vote, attend annual general meetings or write shareholder letters to the management to raise these issues. Listed bonds currently do not have this avenue for recourse and more stewardship effort by the industry is needed to level the playing field. "Where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the Principles for Responsible Investment (PRI), the Code for Responsible Investing in South Africa's (CRISA) principles and other codes and standards applicable to institutional investors."

Raising transparency is of paramount importance to citizens and investors alike. An institutional investor should be transparent about the content of its policies, how they are implemented and how the Code for Responsible Investing in South Africa principles are applied to enable stakeholders to make informed decisions. Green finance, as an avenue for investment, brings differentiation to the South African market. It allows pension fund investors to access compelling return profile at acceptable levels of risk, while acting in the best interests of the society and environment within which we operate.

Moneyweb | 25 October 2020

INTERNATIONAL NEWS

Secure Act aims to boost the appeal of annuities in retirement plans

Guaranteed income in old age makes sense but stumbling blocks remain for sponsors and workers

Adviser Joe DeNoyior believes the promise of a guaranteed income for life can be a game-changer for employees investing in 401(k) retirement accounts. Yet the product best-positioned for the task — the annuity — comes with challenges that make it a tough fit for such defined contribution (DC) retirement plans. It is not just that an annuity can be costly and operationally complex; the product is also legendary for its jargon. Focused on mixing insurance with investments to guarantee returns, the annuity boasts contrasting features such as “death benefits” and “lifetime income riders”.

“It is hard for advisers to talk about annuities to the retirement plan, and it’s tough to talk about them with consumers,” says Mr DeNoyior, president of the Washington Financial Group at Hub International and among this year’s FT 401 advisers. Yet the tide may now be turning in favour of annuities, especially when it comes to adding them to DC plans and individual retirement accounts (IRAs). Annuities have strong growth potential in these markets, which represent 62 per cent of the US’s $32.3tn in retirement assets — or just above $20tn — as of December 2019, according to the Investment Company Institute. Enter the Secure (Setting Every Community Up for Retirement Enhancement) Act.

It is a bipartisan law approved by Congress last year that offers improved immunities to employers offering annuities in workplace savings programmes. The Secure Act protects plan sponsors from the liabilities when selecting approved annuity providers if an annuity insurer subsequently cannot meet its obligations. The hope is that plan sponsors will gain more confidence in offering such annuities with these risks removed.Experts agree that the act is a big step forward for providing guaranteed income in retirement accounts — but they also acknowledge it is no “flip-of-the-switch” moment. Indeed, for annuities to be distributed widely in DC plans, a co-ordinated effort is needed from advisers, employers, retirement plan recordkeepers and annuity providers.

And the checklist for this group is exhaustive, encompassing everything from creating a fluid way to transport the products to different employer savings programmes to educating consumers about how annuities work. Barbara Delaney, a principal at Hub affiliate StoneStreet Renaissance, says the industry must help develop record-keeping platforms that allow annuities to be transferred efficiently between different employer-sponsored plans, as well as from an employer's DC plan to an individual retirement account (IRA).Currently, a company could offer an annuity to employees via their workplace retirement record-keeping platform but then it would be unable to move it to another recordkeeper's system, says Ms Delaney, an adviser listed in the FT 401 whose firms advise plan sponsors.

The deficiency means the annuity's promise of lifetime income for employees would end prematurely when either a worker leaves a job, or a company switches plan recordkeepers. For adviser Chad Wilson, co-founder of Fiduciary Plan Advisors at Hightower, the problem ranks among the top barriers preventing annuities from growing more deeply into the retirement market. It sits alongside obstacles such as the high cost of annuities and liability issues — which the Secure Act seeks to address, says Mr Wilson, whose company advises retirement plans. "The lack of portability means it is impractical for a plan sponsor to change recordkeepers, even if they have concerns about the financial health of the annuity provider," notes Mr Wilson, who is also listed among this year's FT 401 advisers.

"This rigidity is a strong deterrent to including annuities in a retirement fund." Meanwhile, if employees are invested in more liquid mutual funds, such record-keeping changes are seamless, giving them an operational edge, experts say. "You don't want your employees buying a product and then losing the guarantee" if the company changes retirement recordkeepers, says Mike Harris, the senior education adviser at the Alliance for Lifetime Income. "It is not fair."The Alliance for Lifetime Income, a non-profit backed by a coalition of financial services groups, is working on eliminating this barrier through education, as well as raising awareness about the benefits of annuities and helping ensure there is financial assistance available on using the products properly, Mr Harris says. Part of the public outreach is eliminating the jargon that makes annuities confusing.

Ms Delaney says: "Plan sponsors don't know the difference between terms such as 'in plan' or 'out of plan.' They want money guaranteed. We have to be careful with lingo in this business. "Todd Colburn, a wealth management adviser with the Northwestern Mutual Wealth Management Company, and among this year's FT 401 advisers, concurs. "This is the biggest challenge," Mr Colburn says. "It's difficult enough to effectively communicate and educate employees as to how much they should save . . . and how to invest. This is such a specialised topic that it warrants its own forum" for communication, he adds.

Financial Times | 22 October 2020

60% of Retirement Savers Who Made This Financial Decision Regret It

Short-term financial relief comes at a long-term cost.

According to a report from advisory firm Edelman Financial Engines, 60% of retirement savers who've borrowed money from their 401(k) regret the decision to tap those retirement funds. As well, 80% of borrowers say they didn't understand the implications of the loan prior to accessing the cash. Those implications include a likely reduction in take-home pay, along with missed contributions and lost earnings over time. If you're considering a 401(k) loan, minimize the post-transaction regret by estimating the full costs and consequences of the transaction -- before you act. Here's how to do it.

Quantifying taxes and interest on your 401(k) loan

According to a recent Vanguard study, the median 401(k) balance is roughly $22,000. Let's assume your balance is in line with this median and you want to borrow $20,000 of it. That loan amount is possible, but only in 2020 -- coronavirus relief efforts temporarily raised the maximum 401(k) loan amount from 50% of your balance to 100%. First, ask your administrator what fees you'll be charged for taking out the loan. These may include one-time loan origination fees and annual loan maintenance fees. Then, dive into the costs of repayment. A common interest rate on these loans is the prime rate plus 1%, which would be 4.25% currently. 401(k) loans normally must be repaid within five years with after-tax dollars.

Using an online loan calculator, you can estimate that a loan balance of $20,000 paid back over five years at 4.25% requires monthly repayments of $371. As well, the total interest cost on this loan is $2,235. Note that those interest charges go into your own 401(k), so you could argue that they don't actually cost you anything. You'll then use the monthly repayment amount to understand how the loan will affect your take-home pay. Before the loan, you were contributing some amount of pre-tax dollars to your 401(k), which lowers your federal and state income taxes.

After the loan, you have swapped the pre-tax contributions for after-tax repayments. That change lowers your net pay unless your repayment amount is less than what you were contributing prior to the loan. Review the details of your paystub or use a paycheck calculator to quantify the change. For context, an average worker earning $50,000 annually and contributing 7% prior to the loan might see a monthly income reduction of about $135, or more if there are state income taxes. The difference is comprised of higher federal taxes of $56 and a $79 increase in 401(k) payments.

Quantifying lost earnings on your 401(k) loan

Understandably, you might view the modest reduction in your take-home pay as a reasonable cost for accessing the cash you need. But a look at how your loan affects your 401(k) balance over time is far more startling. The table below estimates what your retirement savings balance will be after 30 years, with a loan and without one.

Date	Balance Assuming No Loan	Balance Assuming $20,000 Loan in 2021
January 2020	$22,000	$22,000
January 2021	$27,209	$7,209
January 2022	$32,794	$12,328
January 2023	$38,784	$17,817
January 2024	$45,206	$23,702
January 2025	$52,093	$30,013
January 2050	$534,794	$408,378

Table data source: Author calculations

The saver who doesn't borrow is contributing $292 monthly with an annual growth rate of 7% to amass about $535,000 by 2050. The borrower enjoys the same annual growth rate and starting contributions but takes out a $20,000 loan at the end of 2020. The loan is repaid over five years at $371 monthly. Once the loan is paid back, the contributions return to the pre-loan level of $292. As you can see, the ending balance for the borrower is roughly $126,000 lower -- a high price to pay for a $20,000 loan. Also, if this borrower wanted to catch up after repaying the loan, he or she would have to increase those monthly contributions to about $450 to reach that $535,000 balance by 2050.

You can test out these numbers, and project your own, using the SEC's compound interest calculator. You might wonder, too, if you can minimize the long-term reduction in your balance by continuing contributions while you are repaying. Most likely, the answer is no. 401(k) plans don't normally allow you to make new contributions until the loan has been fully repaid.

A word on defaulting

If you don't repay your 401(k) loan according to the terms, the IRS can deem it an "early withdrawal" rather than a loan. Early withdrawals are subject to income tax and, usually, a 10% penalty. (In 2020 only, the 10% penalty is waived for those affected by the coronavirus pandemic.) Beyond those extra costs, defaulting means you never fully restore the funds to your account, which can be disastrous to your savings growth.

The loan of last resorts

A 401(k) loan could get you out of a jam today, but it often creates new problems for you tomorrow -- namely, a meager savings balance at retirement. If you must take the loan, do it with full knowledge and acceptance of the consequences. Estimate the effect on your take-home pay during the repayment phase as well as the contributions you'll need to make after repayment to reach your savings goals. That doesn't guarantee you won't later regret your decision to borrow, but at least you'll know what's needed to get you back on track.

The Motley Fool | 24 October 2020

OUT OF INTEREST

Wealth tax among Mboweni's options to fund SA's budget

Budget-gap forecasts jumped even before the coronavirus struck.

Finance Minister Tito Mboweni will have to find money to help the nation's economy recover from its longest recession in three decades and bail out state companies in a budget that's projected to record the biggest shortfall since 1914. Mboweni will present the government's revised spending framework for the next three years on Wednesday, four months after a supplementary budget that was unveiled to reallocate funds to help pay for a R500 billion stimulus package announced by President Cyril Ramaphosa.

A lockdown that was imposed to curb the spread of the coronavirus sent tax collections plummeting and even forced the ruling African National Congress to end its long-held resistance to borrowing from the International Monetary Fund. With a budget gap that's forecast to reach 16% of gross domestic product this year, according to the median estimate of 23 economists in a Bloomberg survey, the minister may now be forced to lay the groundwork for tax increases next year.

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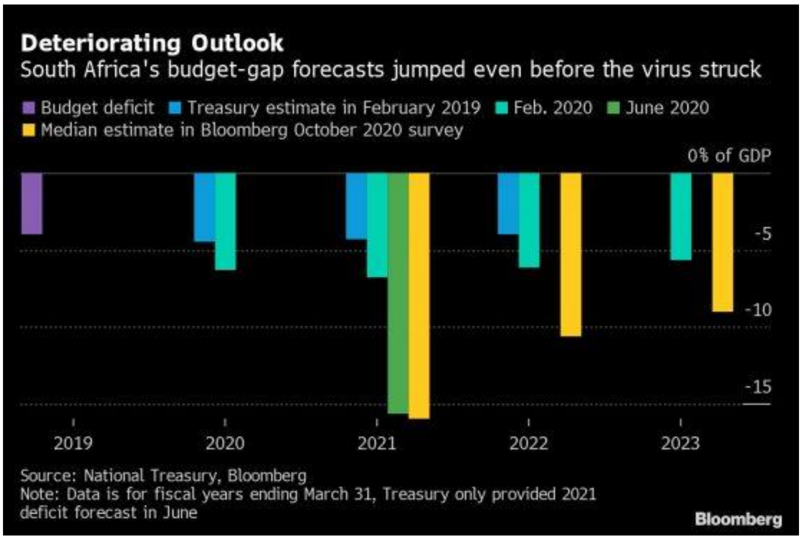

The Treasury discussed the possibility of a wealth tax earlier this year and 30% of respondents in a Bloomberg survey see Mboweni signalling his intention to institute such a levy in February, even as South Africa's ratio of tax revenue to gross domestic product is 26% compared to a global average of 15%. An advisory panel appointed by Ramaphosa said hikes to the fuel levy and estate taxes should be considered, as should a three-year "solidarity tax" that would boost income tax for higher earners. "The Ministry of Finance finds itself in a very precarious position," said Nazrien Kader, head of tax at Old Mutual.

"It can't do one thing: it has got to increase taxes, contain costs and stimulate economic growth to close that budget deficit." The cabinet has backed Mboweni's plan to target a primary budget surplus by 2023-24 and this week's budget announcement is expected to outline plans to cut government spending by 230 billion rand over the next two years. However, austerity could hinder the recovery of an economy that's expected to contract by 8.5% this year, according to a separate Bloomberg survey. It could also face opposition, including from labor groups aligned to the ANC.

Plans to reduce the public-sector wage bill, which has climbed by 40% over the last 12 years, have stalled and the Treasury has warned a bid by unions to compel the state to honor a salary deal would lump the country with 37.8 billion rand of additional debt. The minister also faces pressure to find money to bail out South African Airways, arms manufacturer Denel SOC Ltd. and the Land and Agricultural Development Bank of South Africa. The "government and the finance ministry are going to have an avalanche of requests in the coming months," said Mike Schussler, chief economist at Johannesburg-based Economists.co.za.

What Bloomberg's economist says…
"Finance Minister Tito Mboweni has tied himself to the mast with an ambitious plan to drastically cut expenditure and move toward debt stabilisation by 2023-24. We think the scale and pace of his envisioned consolidation is unlikely to materialise or put debt back on a sustainable path. Instead, it risks plunging the country into an even deeper crisis. A more credible strategy in our view, is big stimulus now, accelerated reform, and a credible commitment to cut expenditure when the recovery has gathered pace."

Moneyweb | 27 October 2020

Understanding the benefits – and risks – of alternative investments

To grow, preserve and diversify wealth.

While a relatively small amount of the wealth of high-net-worth Africans is invested in alternative investment vehicles such as private equity, there is a high degree of interest in private equity and venture capital investments. More investors are seeking exposure to alternative investment vehicles to grow, preserve and diversify their wealth. Alternative investments are defined as investments that do not fall into one of the traditional asset classes such as shares, bonds and cash. Prominent sub-alternative asset classes include venture capital, private equity, hedge funds, structured products, private debt and direct property. There are also the more esoteric sub-alternative asset classes like art or exotic cars. Previously, alternative investments were considered too onerous to access, high-risk or complex for many investors, but now they have become more mainstream and are accepted as an attractive means to diversify a portfolio and typically generate better inflation-beating returns than traditional public market investments.

How alternatives are considered to add value in a portfolio

A key and fundamental element of investment management is creating a well-balanced, diversified portfolio. Ultimately, diversification works to safeguard investors' portfolios against volatility in certain sectors to allow for a more consistent overall portfolio performance. Different industries and sectors do not perform at the same time or at the same rate. When applying a diversification strategy to diversify your portfolio, you are less likely to experience major drops, because as some sectors encounter tough times, others may be thriving. Alternative investments cover a broad range of sectors and sit on the upper end of the risk spectrum but often achieve higher returns than more conventional asset classes. The expected return of an entire portfolio – constructed of traditional asset classes – increases when adding the higher-yielding return of alternatives, which is uncorrelated to the rest of the portfolio.

Types of alternative investments

- **Hedge funds**

Hedge funds have evolved from an institutional type of investment instrument to become more mainstream. As of around three years ago, there became a construct of a Retail Investor Hedge Fund (RIHF) investment vehicle that is governed by the Financial Sector Conduct Authority, and most of these are tradeable daily and offered by reputable financial services providers. While hedge funds may have been portrayed as high risk, high return, get-rich-quick schemes in the past, the genesis of hedge fund investments was not to create high alpha instruments, but to act as a portfolio stabiliser and diversifier in that they provide a hedge against other asset classes. As the environment was not regulated initially, the positions hedge fund managers would take were aggressive and somewhat irresponsible. However, regulators stepped in to understand these alternative investment vehicles, limit positions of this nature and create a more controlled and predictable return environment.

- **Section 12J**

Section12J is a tax incentive that was introduced by government in 2008 to drive the South African SMME economy by linking seekers of capital (entrepreneurs) with providers of capital (investors). The aim is to stimulate entrepreneurship by incentivising holders of private capital by way of tax dispensation to invest in opportunities outside of formal financial markets. The logic is that the investor has direct input in the business by way of assisting with mentorship, craft, and access to different markets.

The underlying asset class of Section 12J is private equity or venture capital and legislation governing the act has been tightened over time and regulatory requirements have become more stringent to ensure investors are remaining within the spirit of what S12J is trying to achieve. While started in 2008, S12J only took real form and shape over the last five years and is a near R10 billion industry as it stands. It offers an opportunity for clients in that it gives access to a part of the economy that is difficult to access but can be lucrative in terms of returns generated.

- **Private equity and venture capital**

Private equity provides an opportunity to make investments into real, physical businesses with a long, proven track record while venture capitalists invest in smaller and medium-sized companies that are in early development phase. In the past, this asset class – especially in South Africa – has typically been limited to institutional investors such as pension funds. Now, individual investors can use private equity or venture capital to invest in the real economy. As with any investment, there are associated risks. The asset class does not sit on a formal, listed exchange, so the granularity of information regarding the investment is subjective, and less regular.

There may be a lack of visibility of price points for a business, and few indicators of true value. Pricing is driven by an audit process and the ultimate sign of value is determined when an investor buys or sells. This differs to the domain of traditional public market asset classes, where thousands of opinions eventually arrive at a single pricing point. However, the beauty of private equity is that the fund manager would typically own a significant stake in the underlying business, which creates alignment between the investor and fund manager. While the ability to unearth growth and real value is much harder to come by in this space, private equity managers can find investment opportunities that are more controllable from a day-to-day management perspective. **Full Report*****: https://www.moneyweb.co.za/investing/understanding-the-benefits-and-risks-of-alternative-investments/***

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