FRIDAY, 22 MARCH 2024

irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

Why returns from giant SA unit trusts may be wildly different in coming years

South African investors and retirement savers who are invested in multi-asset funds should expect the returns delivered by different managers to vary widely in future. The narrow range of returns from different managers over three- and five-year periods will increase greatly as managers take different views on their exposure to offshore equity, to credit and to private equity, Victoria Reuvers, the managing director of Morningstar Investment Managers, said at the recent Investment Forum held in Cape Town and Johannesburg.

There is already more than 13 percentage points between the annual average returns of the top-performing high-equity multi-asset fund (17.1% a year) and the worst performer (3.64% a year) over the three years to the end of January, Morningstar's data shows. Over five years, the difference is around eight percentage points a year. The top-performing fund returned 13.36 % a year and the worst performer just 4.39% a year on average for the past five years. At the Investment Forum, Reuvers discussed the different investment approaches of the managers of high equity multi-asset funds from Coronation, M&G, Prescient and PSG.

	Prescient Balanced	Coronation Balanced Plus	M&G Balanced	PSG Balanced
Local Equity	25%	37%	42%	44%
Offshore Equity	30%	36%	25%	28%
SA Property	5%	3%	2%	4%
SA Bonds	24%	13%	20%	19%
SA Cash	0%	0%	4%	3%
Offshore Bonds	6%	10%	5%	1%
Offshore cash	9%	1%	3%	2%

Four large multi-asset funds' allocations to different asset classes. Source: Morningstar Investment Management

The Prescient and M&G Balanced Funds, for example, have a set or strategic asset allocation to the different asset classes. This can be varied with tactical asset allocation decisions to take advantage of the mispricing of shares, bonds or other securities. Coronation and PSG use the valuations of shares, bond or other securities to decide what to include in their funds and this determines their bottom-up allocation to the different asset classes. The Prescient fund uses passively managed index funds for its asset classes, while the other three funds are actively managed.

Offshore allocations

High equity multi-asset funds are allowed to have up to 75% of the fund in equities and those that comply with regulation 28 of the Pension Funds Act and are suitable for retirement fund investors, must not exceed 45% of the fund in offshore markets. The level to which managers have been maximising the offshore allocation that was increased in 2022 is likely to play an increasing role in differences in fund returns in the future.Reuvers said the Prescient Balanced Fund had the lowest exposure to South African equities (25%) compared to 37% in the Coronation Balanced Plus, 42% in the M&G Balanced Fund and 44% in the PSG Balanced Fund.

Bastian Teichgreeber, the chief investment officer of Prescient Investment Management, said Prescient’s low allocation to local shares had nothing to do with negativity about South Africa and more to do with diversifying away from a bias most investors have towards home-based assets. He says 25% in the very small and concentrated South African equity market is already a "home bias on steroids". Prescient therefore has 30% in offshore equities. The Coronation Balanced Plus Fund has 37% in the South African share market and 36% in the global equity market. Charles de Kock, a portfolio manager at Coronation, said good returns have taken the fund’s offshore exposure through foreign equities, bonds and cash over the 45% limit. The fund will rebalance back to the limits over time. De Kock says the bulk of the fund’s local equity exposure is in global businesses that just happen to be listed in South Africa, so this means the fund has a far higher global bias than the numbers indicate.

More local equity

The PSG Balanced Fund with 44% in local equities is smaller than the Coronation or M&G funds. Justin Floor, the fund’s manager, says the fund is small enough to invest meaningfully in about 100 to 150 local companies, making it possible to invest in some exciting opportunities that larger managers cannot invest in as their holdings in any company’s shares are restricted. Sandile Malinga, the manager of the M&G fund with the second highest exposure to South African equity out of the four managers, says one of the key drivers of returns are valuations, and local equities are cheap relative to global equities.

They have been disappointing as global markets have delivered double-digit returns, but they remain good companies and are very competently managed. While economic growth is low in South Africa, stock markets are not driven by economic factors alone, he said. In Germany, the equity market has almost decoupled from the economy of that country, Malinga said. Use of the AI investment theme The four managers have different views on how artificial intelligence (AI) will affect investments in future. De Kock said AI is a very important new development and not just a fad. But with investors’ money being rushed into AI-related investments, there will be winners and losers, so it is best for managers to diversify across these securities. He warned against getting sucked into buying something on a "crazy" high valuation, as it would end in tears or losses. Tiechgreeber says it is impossible to know which companies will be winners and which ones the losers, so it is best to own them all through an index. In such a diversified portfolio, the underperformance of the losers won't hurt, he said. Malinga says AI has transformed the way active managers view the world as they can analyse billions of pieces of data to inform their investment decisions. Floor said PSG can't predict the outcome of technological change so it prefers to focus on things that do not change – in 10 years' time people will still be drinking beer, for example, so it is easier to invest in a beer company at a reasonable valuation.

Alternative assets

The four balanced fund managers also have very different views on exposure to alternative asset classes including unlisted private equity, credit (listed or unlisted) and infrastructure investments. The exposure to these asset classes is not always reported separately on fund fact sheets – private equity may be bundled with equity exposure, private credit as bond exposure and infrastructure may be included as either bond or equity exposure, depending on how the fund is invested in it. Regulation 28-compliant multi-asset funds can have up to 45% of the fund exposed to infrastructure projects, but funds are taking different views on how much of this allocation to use, if any.

Teichgreeber says the Prescient Balanced fund uses a lot of alternatives to diversify the fund. The fund has 15% in alternatives with 5% in the manager's South African high-linked yield credit, 5% in renewable energy investments and 5% in hedge funds. Alternative assets often trade infrequently making them illiquid or difficult to convert to cash, but Teichgreeber says the fund has 4 000 names in its equity portfolio and is therefore highly liquid. De Kock says while private equity is serious assets class globally, it is difficult to find good players in South Africa and the illiquidity is a problem as most of Coronation's investors can withdraw money within 24 hours.

Both he and Malinga said many alternative assets are only priced once a quarter or once a month, creating the illusion that a fund value is more stable when the price of the underlying investments may have changed. Floor said the world is short of infrastructure and this creates a lot of opportunities for listed companies, like those in the construction sector that are building renewable energy plants. Managers can often access these companies at lower prices than private equity, he said. Malinga said a lot of private equity is just small capitalisation company shares that are have high debt or borrowings. Reuvers said the outcome of managers preferring or shunning different assets classes, and how each asset class performs, will make your choice of manager more important over time.

New24 Business | 20 March 2024

No two-pot retirement system withdrawals already on 1 September

With the two-pot retirement system workers will be able to access a third of their retirement savings before retirement. Although many of the six million who are members of retirement funds are looking forward to dipping into a portion of their retirement savings by 1 September this year when the Two-Pot Retirement System comes into operation, they will not be able to make withdrawals on 1 September already. Deputy commissioner of the Financial Sector Conduct Authority, Astrid Luden, said in an answer to a question at a FSCA conference last week “What we have to manage is the public’s understanding that nobody will be able to pay out on 1 September”. She agreed with the person from the industry who said, in response to a call that retirement funds must do more to increase their members’ financial literacy, that the FSCA and other government agencies, such as Sars, must work with the industry.

Members expect to be paid out on Sunday 1 September

The person pointed out that members of retirement funds expect to be paid out on 1 September, which she also pointed out falls on a Sunday this year. Ludin said that the FSCA invited the industry to submit rule changes to the FSCA already so that their feedback can be received upfront. “We know you can only submit your rule changes by 1 September. We have three months. We must be clear about how this will be rolled out. Things will go wrong and we must manage expectations on the outside.”

The starting date of 1 September 2024 was confirmed as the implementation date for the two-pot retirement system in the Draft Revenue Laws Second Amendment Bill released by National Treasury released to make technical corrections to the Draft Revenue Laws Second Amendment Bill on the same day as the Budget 2024 speech. Managers of retirement funds have until the end of March to comment on the Bill, which is largely aimed at clarifying the existing language and simplify the directives system for administrators as well as Sars to allow for an efficient implementation of the ‘two-pot’ retirement reform.

Retirement fund members will pay tax on withdrawals

Another important aspect for consumers who want to withdraw funds from their retirement savings is that they will pay tax on their withdrawals. According to the 2024 National Treasury Budget Review, contributions to retirement funds will remain tax deductible and tax-free. Finance minister, Enoch Godongwana, reassured retirement fund members that savings accumulated up to the date of implementation will not be affected, except for the initial seed capital amount. “This amount will be the lower of 10% of the fund value on 31 August 2024 or R30 000 and will be transferred from accumulated retirement savings to the savings component to assist fund members who may prefer an immediate withdrawal due to a financial emergency." He said this seeding will be a once-off event. If members choose not to use it, it will still be available in the future. However, members who choose to do pre-retirement withdrawals from the savings component will pay tax at marginal rates as they do for all other income. When taxable income is lower, taxpayers will pay tax at lower rates.

Only one withdrawal per year will be allowed
"Only one withdrawal may take place in a tax year and the minimum withdrawal amount is R2 000. The optimal option is still to preserve retirement savings as long as possible, as the amounts grow at compound rates and can attract lower tax rates," National Treasury said. "Amounts left in the savings component on retirement can be withdrawn and will be taxed according to the retirement lump sum table, which includes a tax-free lump sum of R550 000."
All retirement funds that will be affected by the two-pot system must now amend their fund rules, which must be submitted to and approved by the FSCA. Joon Chong, partner and Nicolette van Vuuren, senior associate at law firm Webber Wentzel, say some of the proposed changes in the Bill signify positive adjustments to the existing system.

"Firstly, it acknowledges and incorporates the new implementation date of 1 September 2024, providing clarity and alignment with the extended timeline advocated by stakeholders. "Additionally, the bill eliminates the necessity for a tax directive when transferring the seeding amount from the vested to the savings components contemplated in the two-pot system." Proposed amendments to definitions They say the proposed amendments to the definitions of the three components exclude maintenance awards. This adjustment ensures consistency with existing tax provisions regarding the tax treatment of maintenance awards under section 7(11) of the Income Tax Act 58 of 1962. The Bill also addresses intra-fund transfers and associated tax directives by proposing that the reallocations of amounts between the three components are not treated as transfers for which tax directives are required.

Consequently, the requirement to obtain a directive for reallocations between the three components has been withdrawn in the Second Amendment Bill. However, Chong and Van Vuuren say while these proposed changes are a step in the right direction to give effect to the two-pot system, the lead time provided still falls short of that which industry stakeholders advocate to overcome the practical challenges associated with the new system, including how it will be implemented for defined benefit funds (DB funds). "The implementation of the two-pot system for DB funds must be carefully undertaken to ensure fairness to all members of each DB fund. Any necessary engagements with the FSCA by DB fund administrators will also require additional lead time from the promulgation date to the implementation date which the Second Amendment Bill does not provide," they warn.

The Citizen | 18 March 2024

What you plan for retirement and what you get is often very different

Why it’s important to look beyond the money when preparing for this life stage.

I find it fascinating to witness the progress of my clients as they move towards their new lives and how they handle the transition from full-time work to retirement.I have had the privilege and honour to walk the path over many years with many of my clients and witnessed how their careers and businesses bloomed, their families matured, and finally, how they transitioned into retirement. For many, it was plain sailing most of the time; for some, however, the challenges of walking away from the life of a business executive were not easy. Frankly, some people find it very hard to let go of corporate life. As consumers, we are used to broadly knowing what to expect if we read the packaging of a new product we buy. What you see is what you get. The label says it all. If only retirement was as easy …

All of us get grilled with financial information. By the time we retire, we have heard over and over that we need capital/assets equaling 16+ times our final annual salary, that drawdown rates should not be more than 4%, that our investments must beat inflation, and the advice goes on and on. Don’t get me wrong, financial stability and accumulating enough capital for retirement are crucial. Without enough capital, retirement is really going to suck and aggravate the issues that I am going to mention in this article even more. However, it is not only about the money. Everyone works with retirement in mind unless they are Warren Buffet. Young people and the more mature of age often refer to “the day I retire”. Some say it with eagerness; others mention it with apprehension. Some say it because they loathe their job, and others think of it in sadness because they love their job. Although timelines may differ, we all realise that we will move away from our daily jobs someday.

What we do not realise is that retirement may look very different from what we planned and expected. Some may love it, and some may hate the new environment … Given my passion for helping clients plan for retirement to ensure they “get it right” and prompted by my own retirement ambitions (someday), I realised there is so much more to retirement than just the figures. By heart and expertise, I am a financial planner first and foremost. Still, after experiencing the challenges so many face before and into retirement, I decided to expand my expertise and explore the area of retirement coaching. I am convinced that by applying the principles of financial planning and retirement coaching, my clients will be much better served because it is not just about the money. Retirement guidance needs so much more. So, what have I learned thus far? Firstly, studying becomes harder as you age! That is one of the facts that we must accept.

But alas, I have also learnt the importance of continued mental development. I don’t want to jump the gun here, but one of the most important factors to ensure a healthy, successful retirement is cognitive stimulation and development while you are retired. An active mind is a healthy mind, and a healthy mind goes a long way to ensuring a healthy body. This does not mean you must now achieve your doctorate in archaeology when you are retired (unless you want to). There are many ways to achieve brain stimulation/development, and some are actually fun!

As usual, I digressed again.

I intend to start a series of articles and booklets backed by recorded webinars to help clients heading towards retirement and in retirement with the challenges they face. I would like to help them create a roadmap to guide them on this treacherous path. Without delving into too much detail, I would like to elaborate on some of the challenges soon-to-be retirees and retirees face:

- What you plan for in retirement and what you experience can look very different. Many people expect sunshine and roses, long walks on beaches every day, or, in short, an extended life-long holiday. The realisation kicks in when the dark side of retirement rears its head.
- Retirement is rated 10th out of 43 measured stressful events. It is important to be aware of these challenges and avoid common pitfalls to prevent stress from taking control.
- Getting the balance right between mental, social, and spiritual aspects will go a long way to setting you on the right retirement path. Without attending to this, the following challenges may occur:
    -
        - You may experience the “honeymoon phase”, where everything seems perfect, and then you realise something is missing one day.
        - Waste the first few years trying to figure out “who am I?”
        - Why doesn’t retirement look and feel like I thought it would?
        - Question your decision to retire.
        - Dwell on the past.
        - Worry about what could have been done differently.
        - Struggle to lead an active lifestyle due to physical ailments (you or your spouse).
        - Feeling robbed due to the loss of a spouse, friend or family member, divorce.
        - Frustration with adult children.
        - Feel unappreciated and rejected.
        - Feel isolated due to declining hearing and vision.
        - Loss of confidence.

    - Anxiety and depression

The above can be managed and, in many cases, overcome by developing certain skills, including:

- Communicate about difficult issues.
- Learn how to say “No!”
- Schedule daily activities, learn new things, meet people, etc.
- Rekindle old passions and forgotten hobbies.
- Explore different work and volunteer options.
- Learn from mistakes, and don’t dwell on the past.
- Letting go of a grudge and being able to forgive.
- Feeling gratitude.
- Developing a “realistic optimism” about life and ageing.

The dark side of retiring

Retiring has its challenges. As we age, the probability of things going wrong with our health increases, and at some point, we may have to deal with one or more of the following. It may not be us, but someone close to us:

- Heart attack, stroke, fractures.
- Macular degeneration (AMD).
- Depression.
- Anxiety, cognitive impairment, mood disorder (these conditions are not considered to be part of normal ageing. 20% of people aged above 55 have mental health disorders).
- Suicide (15 out of 100 000 people over the age of 65 commit suicide in the US).
- Substance abuse.

To prevent and manage the above challenges, we must adopt a practice of **positive psychology that will lead to successful ageing.**

It is important to have more than one lens to see the importance of planning for non-financial aspects. Move from what can go wrong to what can go right. Establish what makes life worth living. Let’s thrive, not only survive. In future articles, I will delve more into the various aspects of how to age successfully and retire well. In my next article, I will elaborate more on the five areas that support successful ageing. These five areas can be referred to as PERMA and are fundamental to successful ageing.

P = positive emotions (we need three positive emotions to counter one negative emotion). In this case, negative trumps positive.

E = engagement (finding flow).

R = relationships (loneliness is two times more lethal than obesity).

M = meaning (being involved in an activity that is larger than oneself).

A = accomplishment (goals infuse our lives with structure).

I have reached my publication space limit and barely scratched the surface. There is so much to deal with on this topic. I look forward to interacting with you further on this subject. You are welcome to email me directly at marius@wealthup.co.za if you wish to join my retirement community, which is not only for retirees but also for people who plan to retire in the next five years or so.

Take care and plan well.

Moneyweb | 14 March 2024

INTERNATIONAL NEWS

UK pension funds snap up real estate at steep discounts

PPF and Border to Coast among schemes hunting in secondary market as peers offload less liquid assets

Some of the UK's biggest pension plans are taking advantage of steep price discounts to snap up real estate and other private assets, as fellow retirement funds put their harder-to-sell holdings on to the market. Funds such as the Pension Protection Fund, the UK's £32bn-in-assets retirement scheme lifeboat, and Border to Coast Pensions Partnership, a £60bn local authority pool, are among those looking for bargains in the secondary market as they try to profit from a wave of selling by some of their peers. The PPF bought part of a property fund at a 35 per cent discount to net assets from a fellow pension fund this year. "We were offered that discount, we didn't try and drive the price down," chief investment officer Barry Kenneth told the Financial Times, adding that the seller had offered that discount to all shareholders in the fund.

The PPF has earmarked up to £350mn to invest in property, including funds being offered for sale on the secondary market. "We are progressing with a couple of managers to take advantage of market dislocations and/or depressed prices," said Kenneth. Portfolios of private assets are being dumped by so-called defined benefit pension schemes — funds offering members a set amount in retirement — as they try to prepare themselves for a buyout by an insurance company. This typically involves offloading illiquid assets that the insurer will not accept as part of the deal. The number of schemes trying to get ready for such deals — last year a record £50bn of bulk annuity deals were agreed — has led to steep discounts on some assets, said investment advisers. That is particularly the case for real estate funds, but it is also seen in private debt and private equity portfolios. "We have been most active in private equity secondaries given the larger opportunity set but continue to consider opportunities across the private credit and infrastructure spaces," Christian Dobson, alternatives portfolio manager at Border to Coast, told the FT. Buying private asset funds, rather than investing directly, had helped diversify Dobson's portfolio, he said. Funds with high-quality assets run by a strongly performing manager may trade at only small discounts to par, while "venture capital and growth equity funds continue to trade at substantial discounts to par, representing greater uncertainty around valuations and future liquidity", said Dobson. While sellers of assets are typically corporate schemes preparing for buyout, many of those hoovering up assets are larger public sector players that are often flush with cash as they are still taking on new members.

"The bigger funds are more nimble and can act quickly," said Chris Roberts, managing director at Dalriada Trustees, a firm of professional trustees. Katie Sims, head of alternative solutions at consultancy WTW, said there were a few big opportunistic buyers in the secondary market putting in bids for some assets at discounts of 30 to 40 per cent. However, interest from pension scheme buyers now appears to be helping narrow some of the price markdowns that had been available. James Lewis, chief investment officer at consultancy Mercer, said there was now less of a mismatch between buyers and sellers, with some UK property funds once again trading at net asset value or, in some cases, even a small premium. "We're seeing that discounts are starting to narrow as values fall, public valuations recover and competition among buyers increases," said WTW's Sims.

Financial Times | 19 February 2024

OUT OF INTEREST NEWS

The choice between a living annuity and a guaranteed life annuity

A guaranteed life annuity generally gives you a higher monthly income than you could sustainably get from the other type of pension — a living annuity.

Question: I am a 70-year-old pensioner and derive my income from a living annuity (from which I draw 2.5% each year) as well as drawdowns from my investment portfolio. I am thinking about converting my living annuity into a guaranteed life annuity, as I hear that the annuity rates are really good. Would you recommend this?

Answer: A guaranteed life annuity is an investment where you buy a series of payments for the rest of your life. This is a great product if you need income security when you retire. The risk of your capital (and income) decreasing if the markets fall has been passed on to the insurance company from which you bought the product. A guaranteed life annuity generally gives you a higher monthly income than you could sustainably get from the other type of pension — a living annuity. One of the reasons for this is that with a living annuity, you need to budget on living to 100, while with a guaranteed life annuity, the insurance company that you bought the product from only needs to budget on you living to your life expectancy age.

So, to summarise, the main reasons for taking out a guaranteed life annuity are:

- You will get a higher monthly income for the rest of your life than you would get from a living annuity;
- The investment risk has been passed on to the company from which you bought the annuity, so you do not have to worry about the stock market falling; and
- Your pension will be paid for the rest of your life, even if you live beyond 100.

If I look at your situation, as you are only drawing 2.5% from your living annuity, you do not need a product that maximises your income. In fact, from a tax perspective, it makes a lot more sense to derive the bulk of your income from your investments, as you will only be paying capital gains tax on that income. In addition, the assets that you are holding in your living annuity do not form part of your estate and will not attract estate duty when you die. I would therefore not recommend that you convert your living annuity into a guaranteed life one.

How to get the best of both worlds

An advantage of a living annuity is that you have a lot of freedom when it comes to choosing the type of investment in which you invest your capital. You can, for example, hold a portfolio of shares or bonds in this annuity. One of the reasons life annuity rates are currently so attractive is that you can get 20-year bonds that offer a yield to maturity of more than 12%. If you invest your retirement capital in one of these bonds, you will effectively be locking in this return for the next 20 years. This will give you a level of income security that is similar to what you are getting from a life annuity but with the advantage of you having a living annuity structure. As you are only drawing 2.5% from the living annuity, the capital value of the investment will grow significantly. Remember that this will be outside of your estate, so no estate duty will be payable on the now much larger retirement fund. As you can see, with a bit of planning you can get the best of both worlds by using a bond portfolio to provide income security for your living annuity.

Daily Maverick | **18 March 2024**

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