INVESTMENT REPORT

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THE POWER
OF INDEPENDENT ADVICE

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IN SEARCH OF GLOBAL WEALTH

By Magnus Heystek - Investment Strategist

FOR the past three years and more, we at Brenthurst Wealth have been recommending greater offshore exposure to our clients. We have been doing this by means of direct offshore investments for discretionary investments or the use of asset swaps within investment portfolios that place restrictions on direct investments, such as retirement annuities, pension and provident funds, preservation funds as well as living annuities.

Several newsletters and seminars over this period of time have highlighted the reasons for such a recommendation. These included, amongst others:

- Credit ratings downgrades
- Weaker economic growth in SA
- Political uncertainty
- Problems at Eskom
- Diversification
- Access to investments not available to local investors

At first we had to overcome a lot of resistance amongst our clients to consider offshore investing, as previous periods of rand weakness, in 2001 and then 2008, were both followed by periods of a sharp retracement of the rand from oversold positions.

Since its low of R6.50 against the US dollar in mid-2010 the rand has now declined by as much as 80% against the US dollar over this period, almost in a straight line.

Although there is always the possibility of the rand strengthening in the future again—something that needs to be monitored on an ongoing basis - we do not foresee such a scenario in the near future, considering the global macro dynamics currently playing out around the world.

There is, furthermore, the possibility of further and perhaps substantial weakness in the local currency against the US dollar in particular. It is not inconceivable that the rand could decline to R20 against the US dollar over the next five years.

This is not a prediction but a sober assessment of the headwinds facing most emerging market currencies, especially those that are trying to deal with high and rising current account and budget deficits. South Africa suffers from both these deficits and in addition, like other commodity-producing countries such as Australia, Brazil, Chili and even Canada, is it currently suffering from the effects of the dramatic collapse in the commodity cycle.

This has impacted on the price and volumes of the country's major exporting commodities, which has contributed to the deficit on the balance of payments.

RISING US INTEREST RATES

A much larger problem looms in the next few months if and when the US starts normalizing its interest rates, which is expected to happen either in June or September this year.

US interest rates have been artificially lowered by means of the programme of quantitative easing (QE1,QE2 and QE3), which has been operational since the aftermath of the Great Financial Crisis of 2008.

More than $4 trillion was literally printed by the US Federal Reserve in order to reduce interest rates in the US in order to stimulate economic growth. A great deal of that money flowed around the world, much of it into the financial markets of emerging markets, including South Africa, in search of higher yields than that available in the US market.

Over this period of time foreign holdings of the SA equity and bond markets rose substantially and by estimate now accounts for about 40% of all the equity investment on the JSE and as high as 60% of the local bond market.

The big question that now overhangs the market is what will happen to our equity, bond and currency markets, if and when US interest rates start normalizing and global capital starts flowing back to the US.

Many top-rated economic commentators, including the highly-rated John Mauldin, who recently visited SA for the 10th time or so, warns that a normalization of global interest rates could severely damage emerging markets, particularly South Africa, Turkey and Indonesia.

These are all three emerging market countries with low foreign exchange reserves, high and rising current account deficits as well as high budget deficits.

SUCCESSFUL BWM STRATEGY

Our strategy of increasing the foreign investment exposure of our clients over the past number of years has been very successful, as can be seen from the accompanying table.

Although the returns of the JSE over the past three years has been a very good 69%, it does not compare very well to the returns on the other offshore funds we have been using. These figures clearly illustrate that our investment strategy has produced excellent returns, particularly in specialist sectors such as biotechnology (+303%) and health care (+177%) over the same period of time.

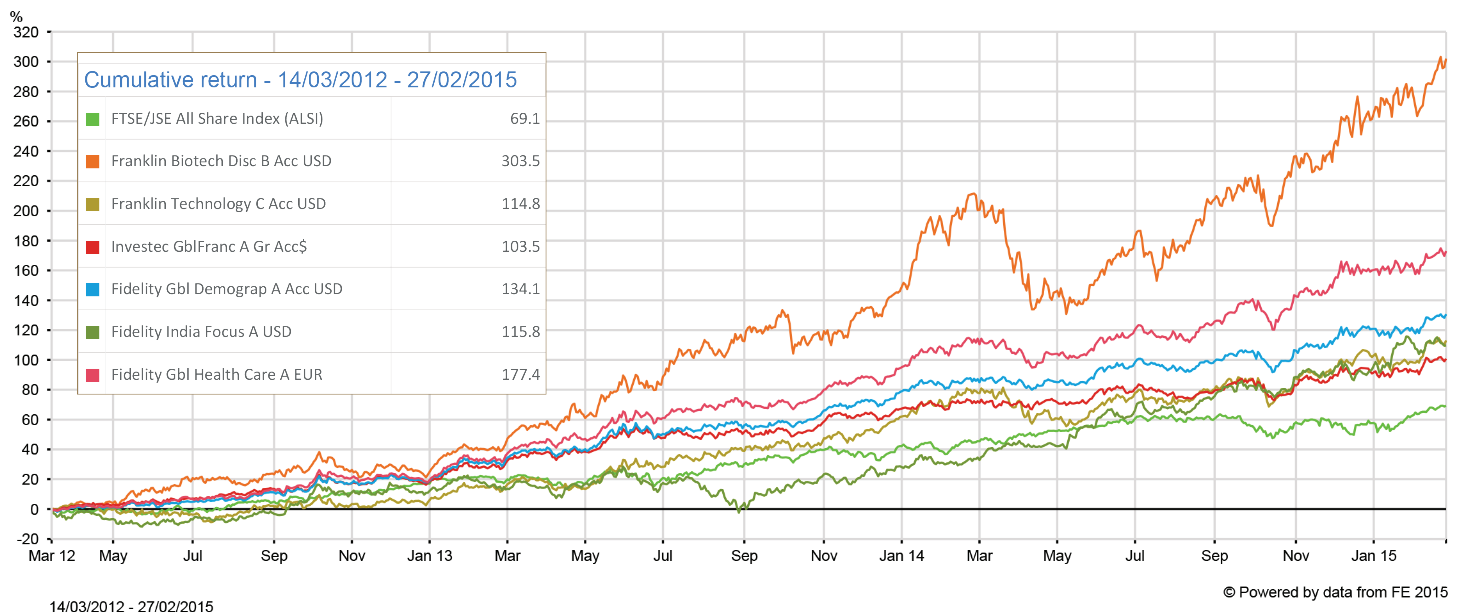
Some of our early investors into biotechnology funds in 2011 have made returns of over 400%. Despite these returns we still feel confident the biotech sector will continue to perform well, albeit with a slightly higher degree of volatility.

Recent research suggests that the biotechnology sector has the potential to become the biggest industry in the world in the next ten to twenty years at the rate it is growing now.

As far as we are aware we are one of the very few investment advisory companies in South Africa who have been recommending biotechnology as an investment to our clients. Other sectors we find particularly compelling include the health care sector, demography funds as well as a country specific investment, namely India.

A future newsletter will discuss India in greater detail, but the country has been making substantial strides in unlocking its economic growth rate (8% expected for the next year) as well as other business-friendly initiatives.

PERFORMANCE SUMMARY 14/03/2012 - 27/02/2015



2015 BUDGET

An unexpected bonus in this year's Budget was the announcement, tucked away on page 154 of the Budget Review with no mention in the main Budget speech, that the offshore investment allowance is to be increased from R4million per qualifying taxpayer per year to R10MILLION PER YEAR. Qualifying means that the taxpayer's affairs must be in order and up to date. This is in addition to the R1m general allowance which can be used without any tax clearance.

The effect of this announcement is that exchange controls, for all practical purposes, has been abolished for most South Africans apart from the super-rich. This is a welcome development and offers South Africans further opportunities to globalize their personal wealth.

We still feel that many South Africans still have too much of their personal wealth exposed to one country, especially when one considers that economic growth is likely to be suppressed to around 2% per annum for the foreseeable future as a result of Eskom's generating troubles.

Load shedding is now a part of normal day life in South Africa while the possibility of a general collapse of the electrical grid, cannot be discounted.

The consequences of such a development are too ghastly to contemplate and will cause massive damage to local financial markets, the currency as well as growth prospects.

Most top investment companies are warning that the growth prospects on the JSE over the next five to ten years are not particularly exciting, warning that returns would, at best average between 7 and 10% per annum going forward. This is a drastic lowering of the investment returns of almost 15-18% per annum over the last ten years.

In contrast, offshore investment returns are forecast to offer returns going forward between 10 and 14% per annum, perhaps even more, depending on the behaviour of the local currency.

It is therefore of utmost importance that investors consider exposing a greater proportion of their investment portfolios to offshore investments. Almost all the investment companies we deal with have recommended an overweight exposure to offshore equities. Only recently the Allan Gray Equity fund changed its investment mandate to allow it invest up to 25% of the fund—the largest equity fund in the country—in offshore equities as well as further 5% into African equities.

The message is clear: SA equities have had a very good run over the last ten years but the market is now considered to be very expensive and similar increases in the future are not to be expected.

All our investment advisors at our offices countrywide have been briefed to make suitable suggestions during reviews of portfolios. These changes to your portfolios are aimed at increasing your returns while reducing your overall risk.

BUDGET OVERVIEW

The 2015/16 Budget was tabled in Parliament on the 24th February 2015. No major announcements were made, apart from the increase in the foreign investment allowance. Please find herewith a summary of the Budget, courtesy of Old Mutual.

BUDGET SPEECH 2015

CHALLENGING TIMES, RESPONSIBLE CHOICES

This circular only includes budget changes and proposals which are relevant to the financial planning environment.

1. PERSONAL INCOME TAX

The Minister proposed that the personal income tax rates increase by one percentage point from the second bracket upwards. This would result in increased tax for tax payers earning more than R181 900 a year. However, tax brackets, rebates and medical scheme contribution credits will be adjusted for inflation, as in previous years. The net effect is that there will be tax relief for income levels below about R450 000 a year, while those with higher incomes will pay more in tax.

The rate of tax for trusts (other than special trusts) has also increased from 40% to 41%.

The table below illustrates the adjusted tax rates applicable to individual taxpayers and special trusts for the 2015/2016 tax year:

TAX RATES FOR NATURAL PERSONS AND SPECIAL TRUSTS 2015/2016 TAX YEAR	
TAXABLE INCOME	**RATE OF TAX**
R0 - R181 900	18% of each R1
R181 901 - R284 100	R32 742 + 26% of the amount above R181 900
R284 101 - R393 200	R59 314 + 31% of the amount above R284 100
R393 201 - R550 100	R93 135 + 36% of the amount above R393 200
R550 101 - R701 300	R149 619 + 39% of the amount above R550 100
R701 301 and above	R208 587 + 41% of the amount above R701 300

TAX REBATES		
	2014/2015 Tax Year	**2015/2016 Tax Year**
Primary rebate	R12 726	R13 257
Secondary rebate (Age 65 to below 75)	R7 110	R7 407
Tertiary rebate (Age 75 and over)	R2 367	R2 466

TAX THRESHOLDS		
	2014/2015 Tax Year	**2015/2016 Tax Year**
Below age 65	R70 700	R73 650
Age 65 to below 75	R110 200	R114 800
Age 75 and over	R123 350	R128 500

This means that a taxpayer younger than 65 and earning a taxable income of R73 650 or less per annum, or a taxpayer 65 and older but younger than 75 and earning a taxable income of R114 800 or less per annum, or a taxpayer of 75 years and older and earning a taxable income of R128 500 or less per annum, will not pay any income tax in the 2015/2016 tax year.

The examples demonstrate the impact of the proposed changes on individuals younger than 65:

TAX IMPACT FOR INDIVIDUALS YOUNGER THAN 65				
Taxable income (R)	2014/15 rates (R)	Proposed 2015/16 rates (R)	Tax change (R)	% change
150 000	14 274	13 743	-531	-3.7%
200 000	25 056	24 191	-865	-3.5%
250 000	37 556	37 191	-365	-1.0%
300 000	51 421	50 986	-435	-0.8%
400 000	82 549	82 326	-223	-0.3%
500 000	117 549	118 326	777	0.7%
750 000	213 246	215 297	2 051	1.0%
1 000 000	313 246	317 797	4 551	1.5%

2. CAPITAL GAINS TAX (CGT)

As a result of the increase to the marginal tax rates, the highest effective capital gains tax rates increase as follows:

- **Individuals and Special Trusts: from 13.32% to 13.65%, and**
- **Trusts: from 26.64% to 27.31%**

Due to there being no change to the companies' tax rate, the maximum effective rate for companies remains unchanged at 18.65%.

3. INTEREST EXEMPTION

The interest exemption threshold has not been changed as a result of the tax-free investment vehicles that will be introduced on 1st March 2015 (see point 7 below for further detail).

The exemption amounts therefore remain as follows:

- **R23 800 p.a. for taxpayers under the age of 65,**
- **R34 500 p.a. for taxpayers aged 65 and older.**

It is expected that these amounts will remain unchanged in the future.

4. TAXATION: SMALL BUSINESSES

Following recommendations of the Davis Committee, further relief was proposed for small businesses. These are businesses where one of the requirements is that the business has a gross income of less than R20 million in a financial year.

The tax rates for SMALL BUSINESSES for financial years ending: 1 April 2015 and 31 March 2016

TAX TABLE APPLICABLE TO SMALL BUSINESS CORPORATIONS	
TAXABLE INCOME (R)	Rate of Tax (R)
R0 – R73 650	0% of taxable income
R73 651 – R365 000	7% of taxable income above **R73 650**
R365 001 – R550 000	R20 395 + 21% of taxable income above **R365 000**
R550 001 and above	R59 245 + 28% of taxable income above **R550 000**

The above committee proposed more generous relief for micro businesses. These are businesses that generate turnover of less than R1 million in a financial year.

The tax rates for MICRO BUSINESSES for financial years ending: 1 April 2015 and 31 March 2016

TAX TABLE APPLICABLE FOR TURNOVER OF MICRO BUSINESSES	
Taxable Income (R)	Rate of Tax (R)
R0 - R335 000	0% of taxable turnover
R335 001 - R500 000	1% of the taxable turnover above **R335 000**
R500 001 - R750 000	R1 650 + 2% of the taxable turnover above **R500 000**
R750 001 - R1 000 000	R6 650 + 3% of the taxable turnover above **R750 000**

To complement this relief, SARS is establishing small business desks in its revenue offices to assist in complying with tax requirements.

5. TRANSFER DUTY

There has also been a change to the rates of transfer duty for property transferred as from 1 March 2015. The new rates are as follows:

RATE OF TRANSFER DUTY	
Taxable Income (R)	Rate of Tax (R)
R0 - R750 000	0% of property value
R750 001 - R1 250 000	3% of property value above **R750 000**
R1 250 001 - R1 750 000	R15 000 + 6% of property value above **R1 250 000**
R1 750 001 - R2 250 000	R45 000 + 8% of property value above R1 750 000
R2 250 001	R85 000 + 11% of property value above **R2 250 000**

** There is a difference in the rates published in the "People's Guide" and the contents of the Minister's speech. The table above reflects the rates indicated by the Minister in his speech, as well as in the National Treasury Budget Review document.*

6. MEDICAL TAX CREDITS

With effect from 1 March 2015, the initial tax credit (for contributions to medical schemes) for all tax payers is R270, and for a taxpayer and his or her first dependent is R540. An additional credit of R181 is afforded to each additional dependent.

For taxpayers younger than the age of 65 **(who are not disabled or who have any disabled dependents)** an additional tax credit will be given of an amount equal to 25% of the aggregate of:

- **the amount by which their contribution exceeds four times their tax credit (for contributions), plus**
- **their out of pocket expenses that exceeds 7.5% of their taxable income (excluding any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit).**

For taxpayers 65 years of age or older, or **who are disabled or who have any disabled dependents,** an additional tax credit will be given of an amount equal to the aggregate of:

- **33.3% of the amount by which their contribution exceeds three times their tax credit (for contributions), plus**
- **33.3% of their out of pocket expenses.**

It is proposed that the additional tax credit afforded to employees who are 65 years and older with respect to their contributions to medical schemes may also be accounted for in the monthly PAYE calculations. It is likewise proposed that this facility will also be afforded to over 65 year old provisional tax payers.

7. TAX-FREE INVESTMENTS

As from 1 March 2015, section 12T of the Income Tax Act will introduce a tax-free investment savings instrument to the South African investment market place for individuals:

- **Contributions are subjected to an annual limit of R30 000 and a lifetime limit of R500 000.**
- **Investment returns, growth and payouts in respect thereof will be tax free.**
- **The South African Revenue Services (SARS) will levy a penalty of 40% on all contributions which exceed the above limits.**
- **Customers can disinvest at any time from their tax-free savings.**

8. RETIREMENT

FLEXIBLE RETIREMENT DATES

Currently only members of retirement annuity and preservation funds may, subject to fund rules, elect to retire from the fund at any time once they reach the age of 55, whereas members of pension and provident funds must access their retirement benefits upon reaching "normal retirement age" defined in the fund's rules.

With effect from 1 March 2015, members of pension and provident funds will be able to elect, at any time after reaching normal retirement age, when they want to access their retirement benefits and trigger the accrual thereof for tax purposes (and fund rules must be amended to allow for this).

9. "SIN TAXES" AND LEVIES

The following increases are proposed:

- **Tax on a packet of 20 cigarettes increases 82c**
- **Tax on a 340ml can of beer increases by 7c**
- **Tax on a 750ml bottle of wine increases by 15c**
- **Tax on a 750ml bottle of spirits increases by R3,77**

Government proposes to increase the general fuel levy and Road Accident Fund levy by 30.5c/l and 50c/l respectively with effect from 1 April 2015. This results in a total increase of 80.5c/l.

Government is considering increasing the electricity levy by 2 cents per kWh as a temporary measure until carbon tax is introduced.

10. RETIREMENT REFORM DELAY

The most important change introduced by the 2014 Taxation Laws Amendment Act was the delay in the implementation of the retirement reforms by a year. This delay has the result that the following changes will only be implemented on 1 March 2016:

- **The fringe benefit taxation of employer contributions to pension and provident funds.**
- **The simplified and improved contribution deduction regime for retirement fund members.**
- **Making provident funds subject to the pension fund annuitisation regime, subject to the protection of vested rights.**
- **The increase to the amount below which retirees can take their entire benefit from retirement funds as a lump sum, from R75 000 to R150 000.**

11. DISABILITY INCOME REPLACEMENT POLICIES

With effect from 1 March 2015, the premiums of all income replacement policies will be non-deductible and the policy benefits will be tax free. This also means that the benefits being paid to existing disability claimants will change from being taxable to tax free as from 1 March 2015.

12. EXCHANGE CONTROL CHANGES

The exchange control manual is being simplified and will be completed in 2015. The following threshold changes will take effect from 1 April 2015:

- **South African residents' foreign capital allowance will increase from R4 million to R10 million per calendar year or upon emigration, or R20 million per family unit.**
- **The subcategories under the individual single discretionary allowance are removed and the annual R1 million allowances may be used for any legal purpose abroad.**

These dispensations are subject to the statutory requirements of the Reserve Bank and SARS. Further administrative details will be communicated by the Reserve Bank.

13. FINANCIAL SECTOR REFORM

The 2015 Budget reiterated Government's commitment to the reforms set out in the 2011 publication "A safer financial sector to service South Africa better".

These broad themes were:

- **Strengthening financial stability.**
- **Improving how financial services firms conduct their business and treat customers (market conduct).**
- **Expanding the reach of financial services to all (financial inclusion).**

In order to achieve these outcomes, National Treasury intends to introduce a "twin peaks" model of financial regulation. In a nutshell this involves separating prudential regulation and market conduct regulation.

The Treating Customers Fairly, Retirement Reform and the Retail Distribution Review initiatives all fall under the market conduct theme.

14. OTHER PROPOSALS

ESTATE DUTY

National Treasury is concerned that some individuals are transferring assets into retirement annuity funds for the purposes of avoiding estate duty, rather than for retirement provision purposes.

To eliminate the potential to avoid estate duty, Government proposes that an amount equal to the non-deductible contributions to retirement funds be included in the dutiable estate when a retirement fundmember passes away.

Withdrawal from retirement annuity funds by non-residents Currently, a South African resident who is a member of a retirement annuity fund and emigrates is allowed to withdraw their full benefit as a lump sum. This concession is not afforded to non-resident members of retirement annuity funds who return to their home countries. It is proposed that this mismatch will be reviewed.

CONCLUSION

Minister Nene faced a tough task for his first budget: an increasing deficit, dwindling tax revenues and economic headwinds. International rating agencies expected something to be done. In response, the Minister has reaffirmed the state's commitment to tightening its belt and proposed to increase tax revenues, mainly through the mechanism of adjusting the personal tax tables. Rian Le Roux, the Old Mutual Investment Group's Chief Economist predicted this course of action when he said the following:

"Fiscal consolidation provides the backbone for SA maintaining its investment grade rating, with fiscal slippage being a key contributor to recent downgrades. Ultimately, raising taxes to ensure the reduction of our deficit is a small price to pay for the alternative, which is the risk of being downgraded to junk status, a slump in the rand, surging inflation and higher interest rates."
As the heading of this note indicates, the 2015 Budget acknowledged the challenging times we face and proposed the responsible choices that we need to make.

Please note that the information provided in this circular is based on proposals made in the national budget speech delivered on the 25th of February 2015 in parliament. Until the proposals have formally been promulgated in legislation it will only be viewed as proposals.

Compiled by: Retail Affluent Legal & Product Legal | Date: 26 February 2015

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They are highly qualified to give advice on all investment matters.

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