2017 Corporate Report • Commodity Nationalism • Risky Behaviour
• Questions & Answers
• Bitcoin explained
Personal Trust

is a client-focused Trust and Investment Management company that is dedicated to servicing the individual requirements of its clients – a professional investment service with a personal touch.

We offer a full range of financial services, providing our clients with the convenience and comfort of having their business affairs conducted under one roof. Our services include:

- Investment & Portfolio Management
- Retirement Planning
- Offshore Financial Services
- Tax Services
- Money Market
- Wills
- Estate Planning

Personal Trust has been in successful operation for more than 35 years, and has offices in Cape Town (Rondebosch and Noordhoek), Somerset West, Knysna, Port Elizabeth and the UK.

For more information, please contact Belinda Danks on 021 689 8975
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Three months ago Kevin Anderson became the first South African since Kevin Currin to reach a tennis Grand Slam final – and the first since Cliff Drysdale in 1965 to participate in the US Open Final. Somehow it gave us a satisfied, positive feeling.

However, there are negatives which we cannot ignore. The scandal associated with KPMG, an international auditing firm, came as something of a surprise because, due to the nature of their business (ensuring the integrity of other businesses’ financial processes) it was presumed that their own integrity was paramount. Not so. Auditing irregularities have been exposed with regard to certain companies, and in particular Eskom. It has resulted in KPMG losing auditing contracts. Thando Gobe, in his Managing Director’s Corporate Report, explains why Personal Trust is ending its association with KPMG.

To date, there has been no time limit on auditing firms’ contracts with companies. What is heartening is that, in the UK and the EU, audit rotation has been enforced whereby mandatory re-tendering is required every 10 years. The Independent Regulatory Board for Auditors (IRBA) in South Africa will enforce mandatory audit firm rotation in 2023. This means that no relationship can extend beyond 10 years.

Two other companies have been in the headlines for the wrong reasons. McKinsey is a multinational management consultancy which allegedly partnered Trillian (Trillian Capital Partners) in winning contracts with South African state-owned entities (SOEs), particularly Eskom. Anti-graft group, Corruption Watch, is convinced that anti-corruption laws have been broken in both the US and South Africa, and it is pursuing these contradictions with the US authorities under the Foreign Corrupt Practices Act.

A pause for time to play with numbers. The two matches that the Springboks played against the All Blacks resulted in losses of 0-57 and 24-25. Apart from a loss by one point in the second game, what did the Springboks achieve? The All Blacks scored 32 fewer points and the ’Boks scored 24 more. A turn-around of 56 points! A remarkable achievement and one that had the doomsayers eating their words. It was with confidence that the ’Boks departed on their end-of-year tour – however, the 3-38 defeat to Ireland underlines the yo-yo nature of the team’s performance. ”There is something rotten in the state of South African rugby.”

The Public Investment Corporation (PIC) is the largest piggy bank in the country, managing the huge Government Employees Pension Fund. With R1.9 trillion under management, it invests in most of the top JSE companies and is also the biggest holder of Bonds issued by SOEs.

At present CEO Daniel Matjila is safe-guarding the PIC’s funds but there have been signs in recent weeks that looters have these funds in their sights. There have been dubious allegations against Matjila made with the intention of having him removed from his post. It is of extreme importance that checks and balances are put in place to protect the Government Pension money. In particular, it is vital that the PIC discloses its unlisted portfolio.

At last action has been taken at the SABC – but is it necessarily the right action? New Board chairman, Bongumusa Makhathini, and his deputy, Febe Potgieter-Gqubule, have close ties with Zuma family members.

Deputy President Cyril Ramaphosa has welcomed the news that a new Board has been appointed at SAA; support also came from Business Unity South Africa (BUSA). Businessman Johannes Bhekmuzi Magwaza and Businesswoman Nolitha Fakude have been appointed as Chairman and Deputy Chairman. Their experience will be invaluable as they try to turn around the ailing carrier’s fortunes.

Despite widespread expectation of a cut of 25 basis points, Reserve Bank Governor, Lesetja Kganyago, and the Monetary Policy Committee, elected to keep interest rates on hold. Apart from uncertainties in the economy, the Committee was concerned about the potential 20% electricity increase that Eskom is seeking, plus likely pressure on the rand due to looming US interest rate hikes.

In his Medium-term Budget speech, Finance Minister Malusi Gigaba stumped Parliament with a plethora of facts and figures – painting a negative picture of the country’s finances. However, it was in a way heartening that he should admit: ”Recent years have seen several worrying developments with regard to state-owned companies, with governance failures, corruption, operational inefficiency and the need for government bailouts. As the shareholder we are tired of being dragged into crises by those we employ to govern and manage state-owned companies. This must end”. At last an honest admission of the problems we face.

I have kept the best to last. Recession! What recession? My wife and I have recently been to Natal to attend our eldest grandson’s Old Boy Blazer Presentation at his final matric year function. During our five days’ stay we spent two days north of Durban and we were amazed by the development that has taken, and is taking, place in terms of industrial and residential growth from Umlangana Rocks almost continually up to Ballito. The necessary infrastructure is keeping up with the development and certainly that area of our country is in positive mode. And that is a good note on which to end.

Ed.

P.S. As a result of my plea for Chess opponents, I have found one – Conrad Hendrick, Manager of Personal Trust’s Noordhoek Branch!
Introduction

It is November, and that means yet another year is almost behind us. This year, our 37th, was particularly emotional for us at Personal Trust as we had to face up to the tragic loss of our dear Jeni Williams. Jeni epitomised what it means to be a ‘PT person’ – committed and passionate about delivering a truly personal and professional service to all her clients.

Notwithstanding the deep sense of loss, Andy Calmeyer’s department (the A-Team) had to see to it that clients continued to be looked after. I am pleased to report that we have now been able to strengthen the team by welcoming Paul Roux and Rene Pienaar.

A big thank you must go to all the members of the A-Team for rolling up their sleeves to minimise the negative impact on client service. Thank you also to the affected clients who remained patient with us throughout this transition.

2017 Focus Areas

At the beginning of each year, our management team gets together to agree on plans for the year. This year we agreed on four focus areas which we felt would help us improve as a business. These areas are:

- **Information Systems**: We are acutely aware of the ever-increasing client need for improved access to reporting and other information.

- **Simplification**: Working in an industry with ever-increasing regulatory requirements and paperwork, we feel that simplifying our processes where possible will give our staff more time to spend with clients. This will enhance our competitive advantage.

- **Importance of Personal Brand**: For us, reputation is key. It is what drives our business as we do not invest heavily in marketing campaigns. We let our service do the talking, and our personal brands should complement this.

- **Internal service levels**: Our view is that excellent service to internal clients (between various departments) will lead to excellent service levels to the end client. This is especially important in our business as we seek to provide a holistic solution with many services under one roof.

I am pleased to report that we have made good progress in these focus areas. And while these are all areas in which we need constantly to improve, I am confident that the business and clients will see tangible improvement in these areas over the next few months.

Developing an inter-generational business

Most of our clients appreciate the fact that, while we are not a big corporate, there is sufficient depth at Personal Trust to allow clients to plan for a smooth transition to the next generation. Succession planning, for us, is important and thus I am pleased to report that 2017 saw the addition of two staff members to the Associate Director group.

The first is Dave Edgar who is an experienced Trust Officer and has been working closely with Keith Andrews for the last ten years. The second is Mark Huxter, an investment professional with over 25 years’ experience. Mark joined Personal Trust in 2015 from FNB Securities and is responsible for a number of our equity portfolios.

The invitation to join this group is well deserved for both of them, and it is pleasing to see the way in which they continue to add value to Personal Trust and our clients. I would like to wish them both all the best for the future.

KPMG

Most of you will be aware of the developments at KPMG South Africa and the various investigations into their conduct, some of which are still ongoing.

When we launched a subsidiary company to administer our Unit Trust funds in 2006 – Personal Trust Management Company (Pty) Ltd – it was an FSB requirement that we appoint one of the big four auditing firms as auditors to this subsidiary company. We selected KPMG as auditors to the Manco.

The service from KPMG has been of a very good standard, and there has been no question about the integrity of the work. However, the Personal Trust Board felt it appropriate to review our ongoing relationship with KPMG and, in light of the developments and the ongoing associated risks, it was decided to terminate the relationship with KPMG.

Conclusion

I would like to take this opportunity to thank the Directors and Staff of Personal Trust for all their hard work and dedication throughout the year.

On behalf of the Board, I would also like to extend sincere appreciation to you, our clients, for your ongoing support. It is indeed a pleasure – and it is most rewarding – to be of service to you.

To all those planning to be on the road over the festive break, do take care and travel safely.
COMMODITY NATIONALISM: SHOULD INVESTORS BE SURPRISED?

Mark Huxter, Associate Director and Fund Manager, discusses globalisation, nationalism and the markets.

It cannot be denied that the surge in prosperity delivered by globalisation has been unprecedented. Numerous people feel disenfranchised due to globalisation, with rapidly changing economic structures which offer less and less security and threaten large-scale social-cultural changes. The desire for the popularising movements such as BREXIT and Catalanon independence is a craving for like-minded peoples to band together to weather the developing storm of the migration of marginalised peoples and the perceived threat of the “Fourth Industrial Revolution” to job security.

One needs to be cognisant, given this political-social behaviour and ongoing trend, of the mindset of ‘city states’ of the past. The timing of Commodity Nationalism should not be a surprise; it is not unique to South Africa but rather a global development. For example, it is seen from Rio Tinto in Indonesia and Anglo American in South Africa, to Western Australia – where gold miners have warned the state government that an increase in gold royalties would not only result in massive job losses, but could also jeopardise the future of the sector as less money will be put towards exploration. In South Africa, one needs to see the Chamber of Mines’ response to the third iteration of the Mining Charter etc.

The threat to diversified miners globally, given the long lead times and massive CAPEX required to bring a mine into production, should be of concern to investors. This prevalent trend further underlines the disconnection of the world of politics (chaos, uncertainty) from the world of financial markets (calm, certainty). With markets, perhaps a little too elevated (valuation-wise) and volatility very low, I believe that many investors should look through the hurricanes of ‘fake news’ and populist trends and develop a solid appetite for good, long-term investment themes.

Given this background, Central Banks such as the FED become increasingly important players in the current climate. It is therefore instructive to reference the recession of 1937-38, which is sometimes called ‘the recession within the Depression’. It came at a time when the recovery from the Great Depression was far from complete; sovereign nations were deeply anti-free trade; globalisation and the unemployment rate was still high. Familiar? It is important to avoid the mistakes of the past.

The recession of 1937-38 occurred long ago, but it does have valid policy lessons for today. It suggests that, in a weak recovery, a preemptive monetary strike against inflation (which was very low at the time, as it is today) can produce a devastating recession.

The speed of Fed rate rises is an ongoing question that casts doubt on the path of the US Dollar and the extent of remaining upside to the US equity market cycle. The severe hurricanes, Harvey in Houston and Irma in Florida and the West Indies, will have a negative effect on consumer spending and GDP growth near-term and heighten inflationary expectations, which is likely to accelerate the pace of Fed rate increases next year. This adds to reflationary pressures and motivation for concentrated rate rises next year.

Why is this important given that South Africa’s equity risk premium is among the most expensive of Emerging Market valuations? Equity investors get an earnings yield that is 2.9% below the 10-year bond yield. While earnings should grow now that the country is out of recession, the issues around Central Bank independence and political scandals will prevent the bond yield from falling from its current yield of 8.82%, especially if the expected sub-investment grade rating materialises on Rand denominated debt.

South African policy makers have consistently misinterpreted the current structural decline as just a cyclical phenomenon. The evidence is that 10 years later, the economy tells a different story; growth still has not returned to its pre-crisis level.

Globally the political risk premium is too low or absent. The world does not need an isolationist United States or a dictatorship in China. Alas, it may get both. In South Africa, politics and the fiscal accounts will be the Rating Agencies’ focus in the November review and the use of PIC funds to bail out State-owned entities (SOEs) would be seen in a very negative light.

While I accept that financial markets are being too complacent and in denial about the political pitfalls, should geopolitical events concern investors, given the evidence on Page 68 Pure geopolitical risks clearly should not be relevant to long-term thematic investors.

The Global yield curve shape is consistent with our overweight stance on equities (especially offshore) versus bonds. History suggests that equities almost always outperform bonds and cash, outside of recessions. If global growth remains strong over the next 12 months, as we expect, equities are likely to climb to new highs, but note that absolute returns on a balanced portfolio will likely be low, as Government bonds are vulnerable to total return losses.

Bonds also traditionally perform poorly in times of rising inflation. In the last 10 years, Central Banks have been busy buying up bonds to boost the global economy and increase lending. This has further accentuated the move higher for bond prices and many economists now believe the market has become distorted. On balance, we expect a significant increase in credit spreads in the course of next year.

Thematic investing requires a fundamental understanding of the impact of long-term economic, political, and social trends on regions and sectors, which reveals investable opportunities. A very different approach to passive investing.

To highlight the effectiveness of a thematic approach, look no further than European family businesses which tend to be ‘old’. research shows that the average age of a quoted family business in Europe is 82 years, compared to just over 30 years in the emerging world. Why? The drivers of this outperformance by family businesses appear to be a focus on long-term revenue growth and an emphasis on innovation financed by organic cash flows i.e. a long-term investment horizon and no share buybacks etc.

Thematic drivers such as demographics and politics (‘angry societies’) transform economies and drive investment trends i.e. Commodity Nationalism. From an investment perspective, driven by a thematic approach, commodities are an alternate real asset class. They have a distinctly different correlation profile and link to the economic cycle, inflation, interest rates and the US dollar. They respond more to cyclical supply/demand dynamics and their returns tend to be weakly or negatively correlated with stock and bond returns, which helps reduce overall portfolio volatility.

The impact in the long term of strongly rising demand for resources on the environment will further restrict supply, as policy makers may
face renewed demands and competition from billions of consumers who still lack access to basic needs such as energy, food, and water.

At the important Chinese Communist Party Congress in October, as many economists expected, the Party focused on limiting the rise in debt and preventing asset price bubbles at the cost of slower growth. This in turn will pressure commodity prices and heighten the anxiety of commodity producing nations, resulting in negative responses as tax revenues collapse and GDP remains delayed.

South African politicians continually ignore advice advocating ‘normal’ structural reforms to improve the long-term sustainability of the government budget. The beneficial effect of structural reforms on an economy is far more difficult to monitor for voters. First, the policy effect takes more time to materialise than the effect of straightforward fiscal consolidation. Secondly, it is less certain, since it depends on behavioural responses of individuals to these reforms.

For example, raising the official BBBEE equity percentage might raise future employment, but equally it might be more likely to also trigger increased unemployment, with early retirement being taken by those that are fearful of the long-term economic effects on sector sustainability and pensions. We must also consider the response of providers of scarce capital when linked to policies as espoused by the 3rd mining Charter.

It is important to note that the removal of barriers to entry or of other barriers can be seen equivalent to a transfer of wealth from current to future generations. The reverse of this argument might also explain why the ANC is keen on implementing barriers such as BBEEE, Charters etc. as opposed to focusing on the removal of barriers and implementing structural reforms. Often motivated by populist interests, these barriers are installed as they are viewed as an easy way to relax the budget constraint of the current generation by extracting wealth from future generations (task fees must fall).

The warning signs of populism are flashing at elevated levels, with Business Day reporting on 30 August that Finance Minister Malusi Gigaba has told Cosatu’s central executive committee that he “…cannot guarantee that government will not make use of the PIC’s funds to capitalise state-owned companies and other projects…” Expect mining houses/commodity producers in South Africa to shy away and curtail further investment till Commodity Nationalism dies a natural death or the current South African leaders abandon their driving ‘philosophy’ based on narrowly defined national and self-interest.

In conclusion, to succeed we need vision to hasten the decoupling of the nanny administrative state to free resources to leverage South Africa onto the high road. The new “Freedom Charter” needs to evolve into a forward-looking, living document that embraces the disruptive realities of the ‘new tech economy’. It is Chinese growth and inflation, together with the direction and speed of Fed rate policy and Trump’s fiscal and trade policies, that are the most important influences on global markets in the short term, both developed and emerging.

The only way to create economic growth is to create an environment fertile to investment and ditch commodity nationalism. The business models of an Amazon, Airbnb, Uber, robotics, contract workers, artificial intelligence, horizontal drilling and driverless cars are just a few examples of companies and technologies that are cutting costs and depressing prices and wages – yes – but potentially offering real, sustainable job opportunities and growth. Finally, Investors should psychologically be prepared for an extended duration of asset price returns that are a shadow of the returns earned over the last 30 years.
Risky Behaviour

Paul Roux, Trust Officer and Certified Financial Planner®, explains the negative effect our own behaviour can have on our investment performance.

“You get recessions, you have stock market declines. If you don’t understand that’s going to happen, then you’re not ready, you won’t do well in the markets.” Peter Lynch

It has been strongly recommended countless times by successful investors that if we want to become wealthier, we need to take on an element of risk when we are investing our money. Market risk is simply the possibility that we, as investors, may experience short-term losses due to factors that affect the overall performance of financial markets. Higher exposure to this type of risk can set us up for higher investment returns over a long-term period. Obviously, these returns are never guaranteed and herein lies the risk. We as investors would like to achieve the highest returns while being exposed to the least amount of risk. In other words, we love the path of least resistance and would prefer avoiding any uncertainty especially when it comes to our money!

Our investment timeframe will have a direct bearing on the amount of financial markets. Higher exposure to this type of risk can set us up for higher investment returns over a long-term period. Obviously, these returns are never guaranteed and herein lies the risk. We as investors would like to achieve the highest returns while being exposed to the least amount of risk. In other words, we love the path of least resistance and would prefer avoiding any uncertainty especially when it comes to our money!

Our natural tendency to sell is when we have already witnessed the price fall in value and want to offload the non-performing shares in our portfolio at a cheaper price, with acceptable long-term growth prospects. Opportunities to buy many quality shares at discounted prices can arise very quickly in a volatile market. A good solid company in your portfolio with great long-term growth potential, run by a solid management team at a cheaper price, is an easy win to the intelligent investor. As the price of these shares appreciates over time, the reward investors receive can be realised when they have more of these shares than they did before, growing the value of the portfolio. The main ingredient to this whole process is patience!

The reality we create for ourselves can be quite different. It’s not uncommon for us to choose shares that have already appreciated in value, as this is seen as a winning share that is doing well. Unfortunately, it’s now more expensive than it was, and potentially overpriced.

The same goes for the selling of shares and moving to cash. The best time to sell a share is when it is trading at its highest value. Our natural tendency to sell is when we have already witnessed the fall in value and want to offload the non-performing shares in our

Behaviour Gap

Carl Richards, Certified Financial Planner®, columnist for the Morningstar Advisor, and author of two current books on Investing has been instrumental in bringing investor behaviour to light and coined the term, “Behaviour Gap”. Simply put, his argument is that investors are the greatest threat to their own investments and end up with diminished returns from their own behaviour.

The real issue is not that market risk is intrinsically bad, but rather we are bad at managing it. Dr Daniel Crosby, in his book The Laws of Wealth: Psychology and the secret to investing success, discusses the sad paradox we as investors face around risky assets. He explains that although “we must invest in risk assets if we are to survive, we are psychologically ill-equipped to invest in risk assets.”

In other words, we are awful at dealing with volatility. Volatility can be associated with severe highs and lows and linked directly to the ‘loss’ of capital over short-term periods. To the average investor volatility demonstrates uncertainty and uncertainty creates fear. Even well-seasoned investors can attest to the fact that they have their limits when it comes to uncertainty over longer than normal periods. Even now, the South African equity market has just moved sideways over the last three years giving investors nothing to show for it. Our natural desire to preserve our capital in uncertain times and when markets are volatile can result in us making decisions that in hindsight we may regret.

Volatility

Intelligent investors view volatility as an opportunity, but let’s be honest, volatility is seen more as a ten-letter swear word than an opportunity creator. One of the greatest investors of our time, namely Warren Buffett, has stated that volatility should rather be seen as ‘our friend’ because it creates buying opportunities in the market. One of the first fundamental truths I learnt about investing was the concept or notion of buying low and selling high. Asset managers are always on the hunt for good quality shares that are either undervalued or at a fair price, with acceptable long-term growth prospects. Opportunities to buy many quality shares at discounted prices can arise very quickly in a volatile market. A good solid company in your portfolio with great long-term growth potential, run by a solid management team at a cheaper price, is an easy win to the intelligent investor. As the price of these shares appreciates over time, the reward investors receive can be realised when they have more of these shares than they did before, growing the value of the portfolio. The main ingredient to this whole process is patience!

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portfolios. Unfortunately, it may already be too late. An important point to remember is that a loss is only realised when we actually sell. A paper loss on our monthly or quarterly statement is not an actual loss until we pull the trigger and sell the shares. Remember that volatility is temporary, but an actual loss is forever.

The image below provides great insight into our emotional state around each phase of the market cycle and reiterates the reality we create for ourselves.

**THE CYCLE OF MARKET EMOTIONS**

Taking responsibility for our financial wellbeing is very important, but making decisions such as liquidating current positions during volatile market periods can go against the responsible behaviour we are trying to uphold. Our efforts at minimising these risks are increasing our probability of those risks materialising, resulting in what we are trying to avoid in the first place, namely the loss of our capital.

Delbar Research House in the United States have released the “2017 Quantitative Analysis on Investor Behaviour”. Their 2016 report states that while the gap between the return of the average equity investor and the market represented by the S&P 500 has reduced over time, investors staying the course and holding their position in the S&P 500 earned almost double than their counterparts who did not. You can purchase their latest report on their website (http://www.delbar.com/QAIB/Index).

**Market Noise and Loss-Aversion**

Daniel Khaneman, winner of the Nobel prize for Economics, in his book, Thinking Fast and Slow, discusses how our brains interpret information and he applies this to behavioural economics. He and Amos Tversky created and developed what is known today as ‘Prospect Theory’, which states that people make decisions based on the potential value of losses and gains rather than the final outcome. Their findings reveal that people are on average doubly affected by market losses as opposed to market gains.

Daniel Khaneman further suggests that individual investors can save time and agony by reducing the frequency of checking their investments’ progress. Observing daily and even monthly portfolio performance can be highly stressful if the performance is not meeting our expectations. Today, more than ever, we are subjected to information from every angle in the form of news, fake news, people’s opinions and market commentary. It shapes our consciousness and our thought process, directly affecting our mood and inevitably leading to decisions that we could regret later on. Removing this noise is crucial for our sanity to prevail and for us to make healthier decisions. A trusted financial advisor will help us remove the noise and remind us of what is important and relevant.

**Reducing the Behavioural Gap**

All investors, even those with years of experience, need to be kept reminded about the fundamentals of investing. Jumping in and out of the market at the supposedly right time is undeniably a powerful temptation, but we can’t afford to become influenced emotionally and need to remain objective in our approach. A paradigm shift needs to occur in how we think about investing and what we perceive volatility to be. Emotion confuses issues, clouds judgement and has the potential of diminishing our investment returns. Often the best financial advice doesn’t make a whole lot of sense at the time because our emotional state is telling us a different path to take.

Ben Carlson, in his book published by Bloomberg press, A Wealth of Common Sense, recommends six courses of action to follow throughout our investment career:

1. Think and act for the Long-Term
2. Ignore the Noise
3. Buy Low, Sell High
4. Keep your emotions in check
5. Don’t put all your eggs in one basket
6. Stay the course

The above courses of action are not new. These simple principles are what identify successful investors. Our avoidance of market risk during volatile periods can be one of the riskiest decisions we make if we are long-term investors. Our responsibility to seek objective sound financial advice especially around uncertain, volatile times is crucial for our investment strategy to be a success. A financial advisor can provide the right coaching today so we are mentally and emotionally prepared for what is to come tomorrow.
Questions that clients ask

Grieg Phillips, Junior Trust Officer, answers some of the questions that are frequently asked.

Q

Ratings Agencies are obviously relevant/governed institutions which grade industries, financial entities etc. Who are they? Are they national e.g. American or are they international financial organisations? What gives them their power and authority?

A

A credit rating agency is a company that assigns credit scores to companies and governments. They rate a debtor’s ability to pay back debt by making timely interest payments, and they assess the likelihood of a default. They are independent institutions situated all over the world. The three most recognised agencies (the ‘Big 3’ — Standard & Poor’s, Moody’s and Fitch) are based in the USA. They provide their services to countries and financial companies across the globe. One can see them as a group of credit bureaus that determine credit scores for governments and entities.

Ratings agencies have no actual regulatory power or authority. They simply offer an educated opinion on the probability of a firm or government defaulting on their debt repayments. This opinion is based on rigorous analysis and research. They try to help prospective investors make a more ‘educated’ decision about how much risk they are prepared to take. The ‘Big 3’ are highly respectable companies who have a significant influence on international investors the world over. The ratings agencies do, however, have the power to influence ETFs (Exchange Traded Funds) and index weightings. This would occur if a company had its credit rating downgraded; this would in certain cases force an index to rebalance with an alternative company of a higher credit rating.

The IRBA is the Independent Regulatory Board for Auditors. What are its powers? Is it an international body to which the South African entity is subordinate or is there an autonomous IRBA (SA)? Is there any way in which the Board can be ‘captured’?

A

The IRBA is an autonomous body established in South Africa. It is the statutory body mandated by the Audit Professions Act to regulate the audit profession. Its responsibilities include the monitoring of audit firms with respect to auditing and ethical standards; investigating and taking action against audit firms for breaches of improper conduct; as well as enhancing public confidence in the profession.

It has the power to de-register and/or to impose fines on unethically behaving audit firms. The IRBA also has the power to institute disciplinary action against any registered auditors who may be guilty of misconduct.

The executive members of the Regulator’s Board are appointed by the Minister of Finance. A portion of the Board must include registered auditors. One would certainly like to believe that they cannot be ‘captured’, but in practice whenever human beings are involved there is a possibility that someone may be susceptible to undue influence by the one who has appointed them. It’s not beyond the realms of reality that it could happen, although highly unlikely.

Q

I know it has been said that when the US increases the rate of the world catches a cold. In what way do the US interest rate increases or decreases affect the rand, the JSE and our own repo rate?

A

One cannot ignore the fact that, in these modern times, countries across the globe are all interconnected due to globalisation.

Thus, even relatively small changes in US economic variables have a significant bearing on currencies, bonds, shares and other financial assets. Economic uncertainty can often lead to a sudden ‘flight to quality’ away from the more liquid currency of emerging market countries such as South Africa.

Rising government bond yields available in developed countries often result in a reversal of carry trades. The carry trade is a strategy where investors borrow money in low (±2.30%) interest currencies (like the USD) and invest them into high (±8.40%) interest-bearing currencies, such as the rand. This can be a lucrative investment strategy until market conditions change (such as US rates rising substantially), and then it becomes a race-to-the-door to unwind rand positions at any cost. This in turn further weakens the rand, requiring even more aggressive selling to exit, and so on.

An increase in the Federal Reserve’s (Fed) interest rate will increase the gap between US capital markets and South Africa’s capital markets, thereby making South African assets relatively less attractive than US assets. This is turn can lead to a sell-off of local assets in favour of foreign (developed market) assets. In practice, JSE shares, South African government bonds and local property should all (in theory) devalue against the US dollar-based assets.

The rand should also depreciate against the US dollar, as a direct result of the outflow of foreign investors’ rand assets, which will increase the supply of the rand. A weakening of the rand in addition should support (increase) the price of rand-hedge shares listed on the JSE, for example: Richmont, BHP Billiton, British American Tobacco etc.

South Africa’s repurchase (repo) rate may be affected by the Fed increasing their interest rates. This is in the event that an increase in the Fed’s rate has an adverse effect on the rand (weaker), thereby impacting negatively on South Africa’s inflation rate. This is because the primary mandate of the South African Reserve Bank (SARB) is inflation targeting; they strive to keep South Africa’s CPI between 3% and 6%.

The IRBA is an autonomous body established in South Africa. It is the statutory body mandated by the Audit Professions Act to regulate the audit profession. Its responsibilities include the monitoring of audit firms with respect to auditing and ethical standards; investigating and taking action against audit firms for breaches of improper conduct; as well as enhancing public confidence in the profession.

It has the power to de-register and/or to impose fines on unethically behaving audit firms. The IRBA also has the power to institute disciplinary action against any registered auditors who may be guilty of misconduct.

The executive members of the Regulator’s Board are appointed by the Minister of Finance. A portion of the Board must include registered auditors. One would certainly like to believe that they cannot be ‘captured’, but in practice whenever human beings are involved there is a possibility that someone may be susceptible to undue influence by the one who has appointed them. It’s not beyond the realms of reality that it could happen, although highly unlikely.

I know it has been said that when the US increases the rate of the world catches a cold. In what way do the US interest rate increases or decreases affect the rand, the JSE and our own repo rate?

One cannot ignore the fact that, in these modern times, countries across the globe are all interconnected due to globalisation.

Thus, even relatively small changes in US economic variables have a significant bearing on currencies, bonds, shares and other financial assets. Economic uncertainty can often lead to a sudden ‘flight to quality’ away from the more liquid currency of emerging market countries such as South Africa.

Rising government bond yields available in developed countries often result in a reversal of carry trades. The carry trade is a strategy where investors borrow money in low (±2.30%) interest currencies (like the USD) and invest them into high (±8.40%) interest-bearing currencies, such as the rand. This can be a lucrative investment strategy until market conditions change (such as US rates rising substantially), and then it becomes a race-to-the-door to unwind rand positions at any cost. This in turn further weakens the rand, requiring even more aggressive selling to exit, and so on.

An increase in the Federal Reserve’s (Fed) interest rate will increase the gap between US capital markets and South Africa’s capital markets, thereby making South African assets relatively less attractive than US assets. This is turn can lead to a sell-off of local assets in favour of foreign (developed market) assets. In practice, JSE shares, South African government bonds and local property should all (in theory) devalue against the US dollar-based assets.

The rand should also depreciate against the US dollar, as a direct result of the outflow of foreign investors’ rand assets, which will increase the supply of the rand. A weakening of the rand in addition should support (increase) the price of rand-hedge shares listed on the JSE, for example: Richmont, BHP Billiton, British American Tobacco etc.

South Africa’s repurchase (repo) rate may be affected by the Fed increasing their interest rates. This is in the event that an increase in the Fed’s rate has an adverse effect on the rand (weaker), thereby impacting negatively on South Africa’s inflation rate. This is because the primary mandate of the South African Reserve Bank (SARB) is inflation targeting; they strive to keep South Africa’s CPI between 3% and 6%.
Bitcoins a product that has recently been in the media spotlight and the talking point around many a Sunday afternoon braai. In our last edition of Personal Opinions, in the ‘Questions that clients ask’, Greig Phillips wrote briefly about crypto-currencies. We felt the increased interest warranted a more in-depth explanation on the topic of crypto-currencies, Bitcoin in particular. This article attempts to give a neutral explanation of Bitcoin (a form of crypto-currency) and is not an investment recommendation.

Before being able to understand the concept of Bitcoin, we need to explore its origins. It aimed to solve the problem of trust, or the lack thereof, in transactions with unrelated parties from across the world. The Byzantine Generals’ Problem, more commonly known as the Two Generals’ Problem, is a famous thought experiment which illustrates this point quite well. It is a story of two armies (A1 & A2), and is explained as follows: each army is led by a general, preparing to attack a fortified city (B). The armies are encamped near the city, each in its own valley. A third valley separates the two hills, and the only way for the two generals to communicate is by sending messengers through the valley. Unfortunately, the valley is occupied by the city’s defenders and there is a chance that any messenger sent through the valley will be captured.

The two generals not only need to communicate regarding the time of attack, but the first general must know that his counterpart has received his message. Because acknowledgement of message receipt can be lost as easily as the original message, an infinite series of messages might be required before confirmation is achieved. This scenario can be applied to a monetary transaction. If I affirm that I have paid money in exchange for a service, how do you know if I am telling the truth – unless you have proof?

Until now, a trusted third-party (Visa, PayPal or banks) was the only solution. The invention of Blockchain technology removes the need for a third party to verify the transaction. Blockchain is the technology on which Bitcoin rests. The Blockchain is an immutable public ledger where transactions are recorded transparently for everyone to see in real time and are confirmed anonymously. Once information is entered, it cannot be altered. This property of immutability and a publicly available ledger is what makes Bitcoin and other crypto-currencies unique. Bitcoin uses the Blockchain technology to allow for peer-to-peer transactions without the need for a trusted third party, resulting in much faster transactions, both locally and internationally – as well as removing the fee charged by third parties. Bitcoin is created by Bitcoin miners. The miners form the essential task of confirming all the previous Bitcoin transactions, and critically providing security to the ledger. In turn, they are rewarded with Bitcoin. Unlike traditional currencies where central banks can manipulate currency supply at their discretion, Bitcoin is based on a simple system of mathematical principles that control the supply of Bitcoin. The lack of central control has attracted liberals who are sceptical of governments debasing their currency value by printing more currency – Zimbabwe is a case in point. These are some of the reasons why Bitcoin has begun to build up steam as the new medium for transactions.

Having defined Bitcoin, the industry is still in debate over Bitcoin’s formal classification – there is uncertainty as to whether it should be classed as a currency or a commodity. Regardless of its formal classification, investors are rushing to claim their share of exorbitant returns. The ‘fear of missing out’ syndrome has set in. A recent survey shows that over 50% of Bitcoin holders are buying not on fundamental beliefs, but on speculation – the hope that someone will be willing to pay me more for my Bitcoin tomorrow than what it was bought for today. This creates a very volatile market and, in saying this, a very risky investment. With each piece of positive or negative news the market responds, resulting in large price movements.

Although Bitcoin’s future is uncertain, the fact that numerous big names in the financial industry have pledged their support for the system and the fact that the price of Bitcoin has surpassed $6,000 means it cannot be ignored. Bitcoin does, however, have a number of large threats to its survival. Regulatory and institutional risks are two of the major uncertainties for Bitcoin holders. The risk that governments over-regulate or that banking institutions push back to hold their territory will both be threats to Bitcoin’s survival.

At this point, without a definitive view on the world’s most dominant crypto-currency, the topic will remain a popular talking point. Only time will tell whether crypto-currencies will be fully embraced and adopted by the general public across the globe or disappear into the abyss. However, if it does survive, Bitcoin has the potential to fundamentally change the way people transact with one another in the future.
Section 7C – Impact of the recent repo rate change

Gavin Ashwell, Associate Director and Trust Officer, discusses the effect the repo rate reduction will have on loans to Trusts

On 1 March 2017 Section 7C was introduced into the South African Tax Act, in an effort to reduce the transfer of wealth through the use of low interest or interest-free loans, advances or credit. Under Section 7C, an annual and ongoing donation is triggered whenever interest-free loans, advances or credit with low rates (or interest free) are made to a Trust – by either a natural person or a company that is a “connected person” in relation to the natural person who advances the loan or credit to the Trust.

The tax is calculated at a rate of 20% on the difference between the actual interest charged on the loan, advance or credit and the interest that would have been paid by the Trust had interest been charged at the “official rate” of interest as defined in the Act. For a debt denominated in Rand, the official rate is equal to the SA repo rate plus 100 basis points.

The reduction in the repo rate earlier this year from 7% to 6.75% means that the official rate has decreased from 8% to 7.75% from 21 July 2017.

The relevance and importance of this change is that, if you have a Rand-denominated loan, you may need to:
- Do a pro-rata calculation if the loan to the Trust is subject to Section 7C of the Income Tax Act
- Review any interest rate on loans if these were fixed rather than linked to the official rate before 21 July 2017.

In summary, a decrease in the repo rate will reduce the donations tax liability under Section 7C and an increase in the repo rate will increase the liability under Section 7C. Calculations will be pro-rata based on the prevailing official rate during the period in question.

As an aside to the above, Personal Trust are in the process of reviewing our clients’ Trust Deeds and making recommendations to amend the Trust Deed to ensure it does not fall foul of Section 7C.

Kindly contact your Trust Officer should you have any questions regarding Section 7C and the impact thereof on loans to Trusts.

SNIPPETS

Malibuyez Tom, Trust Officer, advises us of the new requirements for Tax Clearance applications, and elaborates on ‘retiring’ and ‘withdrawing’ from a fund.

- The South African Revenue Service has increased the requirements for investors applying for a Tax Clearance for foreign investments when they have exceeded their R1 million a year discretionary allowance to include:
  - Material demonstrating the source of capital
  - Statements of assets and liabilities for the previous three tax years
  - Tax returns for the previous three tax years.

For an example, please visit www.sars.gov.za and type ‘supporting documents for foreign investment allowance’ into the search function.

- When reaching retirement, you need to be aware of the following before ‘retiring’ or ‘withdrawing’ from a retirement fund:
  - Ask SARS to provide you with a tax estimate before submitting an instruction to a fund. Remember that once an instruction has been sent to a fund it cannot be reversed.
  - Consult a tax practitioner and/or a financial advisor.
  - Understand your options. If you have not taken previous lump sums and are over the age of 55 years, in most cases you will be better off retiring from your preservation fund rather than taking a withdrawal.

- Check if you have excess retirement fund contributions that you may be able to use. Your excess contributions can reduce your taxable lump sum amount.

- A decrease in the repo rate will reduce the donations tax liability, while an increase will increase it under Section 7c, for individuals with an existing loan to a trust. The calculations will be pro-rata, based on the prevailing official rate during the period in question.

- The best way to ensure that someone does not inherit from you is to get him/her to witness your Will.

- In terms of the Wills Act, a witness to the Will cannot also be a beneficiary, i.e. that individual cannot inherit. It is important to review your Will regularly and also to ensure that your nominated beneficiaries have not signed as witnesses.

- Tax Submission Deadlines:
  - 2nd Period 2018 Provisional Tax Submission – 28 February 2018
  - Income Tax 2017 E-Filing Submission – 31 January 2018
Many will be sad to hear that Rose McCrorie, a ‘household name’ for countless Personal Trust clients, will be retiring from Personal Trust at the end of December. Rose has served Personal Trust tirelessly for 20 years. Some may remember her for her friendly and efficient welcome as the company receptionist, a position she held for 10 years until her retirement from full-time work at the end of 2007. We were then delighted to welcome her back on a part-time basis as a Client Service ambassador for a further 10 years. Rose’s passion for Personal Trust, her knowledge of our client base and her care and empathy for our clients is evident from the enthusiasm and the commitment she has shown to the business during her tenure.

Rose’s role has required the very special qualities of kindness, compassion, patience, empathy and above all, a sense of humour. Over the years, Rose has brought joy to many clients and we are tremendously grateful to her for delivering ‘the personal touch’ on a daily basis.

We will miss her presence in the office but we know that this is not goodbye. Rose is a client of Personal Trust, and we look forward to seeing her at our various future events. Now that Rose will have more time available to her she is looking forward to spending time travelling with her husband, Tom, as well as turning her hand to gardening and cooking.

Also retiring from Personal Trust is another loyal employee of the company - Vivienne Vokwana.

Vivienne has been part of the dedicated team welcoming clients to the Personal Trust Rondebosch offices for more than 20 years. During that time, Viv has become synonymous with “The Personal Touch” service that we love her for, with her warm and generous spirit. During her service to Personal Trust and its clients in her role as cleaner and catering support, Viv has always had a willing smile to greet clients, and a ready chat for those who regularly visit our offices.

Vivienne will be sorely missed in her planned retirement. “Sithi ndlela ntle. Sohlala sikukhumbula”.

Rose McCrorie and Vivienne Vokwana retire
How long have you been with Personal Trust and what made you apply to join the company?

I joined in September 2016, so I have been with the company for just over a year.

Being a lawn bowler, I had been aware of Personal Trust for some time and, when Johann van der Westhuizen from the Knysna office contacted me regarding a position with them, I jumped at the opportunity.

What was your first impression of the company?

My first impression was formed even before I started working at Personal Trust. I have always admired the way Personal Trust goes about doing their business and the way they treat people in general. Once I started working for them, I became even more impressed! Friendly, honest and a true people-orientated company. The impression that most people in the Garden Route have of the company is similar to mine and the credit for this must surely go to Johann and his team!

What department do you work in and what is your role in Personal Trust?

You will find me at the Knysna office working under the guidance of Johann van der Westhuizen. I am responsible for marketing in the area, servicing existing clients and introducing new clients to our Personal Trust family. My main focus is to grow business in the area from Sedgefield and all the way West to Still Bay. In time it is planned that I open a satellite office in George to improve overall client experience.

Tell us about yourself

I am married to a stunning, beautiful lady named Caryn. We have three little boys, Jarko aged 6, Rico aged 8 and Dian aged 12. I love life, am optimistic by nature and compete against myself in all areas of life. I have strong Christian beliefs and my family is my main priority. I believe that each day is a new opportunity to make a difference. I will always try to make time for people and enjoy listening to their stories. I like telling jokes and most of the time laugh at them the hardest! Trust, commitment and love are the three most important things in all areas of my life. I try to be a good husband and a good father. I hope being good at one makes me better at the other! What I do in life, echoes in eternity!

What are your interests – music, art, books, films, garden, sport?

Wow! I have a couple of them — I think most people that know me will tell you that I am a true sport fanatic! I love all kinds of sport and have played most sporting codes. Today I play bowls and really enjoy playing and competing in this not so well-known sport. I like reading, especially autobiographies. Anything that is life inspiring is of interest for me. Spending time with my boys, doing my best to teach them about life, will always be interesting. I don’t always have weekends free but, when I do, I love watching movies with Caryn.

In one sentence how would you describe yourself?

I would like to say that I am a committed, honest and caring person who enjoys making others smile and having a positive influence on people.
Captains’ Invitational

Johann van der Westhuizen, Director based at Personal Trust’s Knysna office, elaborates on Pezula’s Inaugural Captains’ Invitational

Pezula Golf Club hosted the Inaugural Captains’ Invitational Championship on 11 September this year, and Personal Trust was privileged to be the first sponsor for this prestigious event through the introduction of our client, Liz Keller (Lady Captain of Pezula Golf Club).

Personal Trust entered a team in this championship and we would like to thank Ian Collier and Ian Dicey for joining me and Prof Stadler on the Team Personal Trust. The team from St Francis Links won the Ladies’ Captain event whilst Zwartenbosch Golf Club won the Men’s event. The prize-giving was rounded off with a delicious steak and boerie braai.

The day was such a great success that Pezula Golf Club plan this to be an annual event on the Knysna Golfing calendar, and to extend it to include clubs from further afield. Next year, Pezula will be hosting a two-day event with the Men’s and Ladies’ teams taking on not only the Pezula Golf Course but also Simola.
Readers of our newsletter are reminded that any comments, opinions and recommendations relating to investment products are made in good faith and with full attention to accuracy. However, market conditions are subject to constant fluctuations locally and globally. We advise, at all times, that investments be made only after consultation with us, and after individual circumstances have been thoroughly considered.