FUTURE FOCUS

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EXPLORE

INN8 INVEST

WELCOME TO FUTURE FOCUS

SUMMER EDITION

Insights on building wealth for your clients.

In this edition of Future Focus we highlight the importance of patience when markets are down – do not panic. We weigh in on the yield misinterpretation - the importance of making ‘like for like ‘ comparisons when selecting an income solution. We also discuss the main corporate activity and people movements over the last year, and end off with the impact of CGT when you decide on the way to invest offshore.

Navigation

We hope you find relevant insights in the Summer Edition of the **INN8 invest DFM Future Focus.**

INN8 INVEST

TALKING POINT

Never panic...focus on your goals

Leigh Kohler
DFM Head: INN8 Invest

Key Points:

- Market volatility is inevitable. It is the nature of the markets to move up and down over the short term.
- One way to deal with volatility is to avoid it altogether. This means staying invested and not paying attention to short-term fluctuations.
- Be focused and always revert to your game plan – the time horizon(s) you have put into practice to meet your goals.

Volatility is normal

Financial markets have experienced extreme market volatility in 2022. Volatile markets are usually characterised by wide price fluctuations and heavy trading – much like the ocean's waves. Like the open ocean, the market is constantly churning and the degree of market volatility varies from small ripples to rolling waves.

Despite the negative connotations, volatility is normal and happens over time. It is not necessarily a cause for panic and is something that needs to be considered when investing with specific goal(s) in mind.

> Volatility simply refers to a change in prices

Do not panic

It might sound counterintuitive but during periods of market volatility, the correct course of action might be to take no action. Yes, that is correct – do not look at your investment statement. On the whole, this is difficult to do because volatility can leave investors feeling vulnerable and concerned that they have to react. It means that investors who jump ship after a 'big wave' may break the cardinal rule of investing by 'selling low.'

This relates to an old Wall Street saying that financial markets are driven by two powerful emotions – greed and fear. Succumbing to these emotions can have a profound and detrimental effect on investment outcomes, as too often investors enter (on greed) or exit (on fear) the market at precisely the wrong time.

Consider this – if you own a home and its value went down this year, would you panic and sell? Most likely, you would not. You bought your house knowing that you would live there for a while and thus, its day-to-day price movement is not that important. The chances are that the value of your home will rise over time and that is what you should focus on.

Be disciplined and stay invested

There might be many investors who have made money by seemingly timing the market correctly – in other words, predicting market movements and selling or buying shares accordingly – but it is likely that this was due more to luck than skill. For the average investor it is not only difficult to foresee market upswings and downswings, but also challenging to make decisions that are not marked by emotion.

> It is about time in the market and not timing the market

We know that markets do not move up in a straight line and that volatility is inherent in equities as an asset class. Checking a portfolio too frequently can make investors more susceptible to loss aversion, since the probability of seeing a loss in a short time period is much greater than over longer time periods. As a result, investors that frequently check their portfolios tend to take a less than optimal amount of risk. True long-term investors are more willing to allocate towards risky assets because they do not care about the short-term ups and downs.

TALKING POINT

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Your time horizon – 'what it says on the tin'

The period over which you need to invest in order to meet your investment goals should influence your willingness to take on more or less risk. It is a component that can help to align investment goals with risk tolerance and ultimately, the portfolio you consider investing in. You therefore need to ensure that your money is invested in line with your investment goal(s) and not necessarily in the best performing asset class over the recent past.

Conclusion

We all know that acting on emotion can lead to irrational decisions – and difficult lessons. However, if you develop a sound investment game plan and stick to it, you are more likely be in a better position to pursue financial goals. A game plan can help remove emotion from the equation, enable investors to make the most of potential market opportunities; and help preserve assets during periods of volatility.

> A goal without a plan is just a wish

Investors who are not saving for a goal and/or do not have the discipline to remain invested during the time spent saving for a goal, are more likely to realise the waves of volatility that occur in their period of investing. In contrast, investors with clearly defined goals, that are able to shift their focus on the potential of meeting their needs and requirements, have the luxury of realising infrequent negative market returns. There is unfortunately no assurance that an investment strategy will be successful but investing with a clear plan provides a higher probability of meeting your goals/needs.

Income funds and effective yields – mind the pitfalls

Malcolm Holmes
Head of Portfolio Management (SA): INN8 Invest

Key Points:

- As appealing as it might seem, relying solely on the quoted yield of a fund to make investment decisions is flawed and has many pitfalls.
- It is important to equalise all factors. Focus and check whether the quoted yield is gross or net, a running yield or an effective yield; and ensure the date chosen for the comparison between two funds is the same.

It has become popular for income-oriented funds to publish their current yield. In fact, it is common among multi asset income, interest bearing short term and money market funds in the South African collective investment scheme industry. We are not sure why the practice arose but suspect it originated from investors wanting to get a sense of how the yield would compare to a fixed deposit or other products offered by banks.

Naturally, as the practice became more prevalent, the yield was used by advisers to compare and recommend different funds. By using the quoted yield as the primary decision point, it made it easier to select between a range of seemingly indifferent funds. Unfortunately, we think this practice is flawed.

No regulatory requirement to publish the yield but you must publish your calculation

Not only is it a measure that is calculated and quoted in different ways by different providers, but it is also a point estimate that ignores the impact of on-going active management, and when looking back, very seldom equals the return that was ultimately generated.

1 PITFALL 1 – CALCULATION OF FUND YIELDS

As simple as it may seem to say that the calculated yield that is quoted gross of fund fees, will be higher than a yield quoted net of fund fees, this is often not understood or is hidden deeply in the disclaimers and missed in a cursory glance. The reality is that there are many ways to calculate the yield on a fund – gross of fees or net just being one – and an overreliance on this one number can therefore result in poor decision making. In calculating the yield, many providers simply do so according to the ASISA standards – taking only the interest paid by the instruments in the fund over the previous seven trading days and annualising that. Clearly, this calculation would generate a different outcome if the period was extended to 14 days.

Other providers calculate the running yield on all the instruments in the fund and publish the weighted average running yield. Finally, some providers calculate the running yield and then convert it to an annual effective yield. That is, they adjust the yield to give effect to the reinvestment of quarterly coupons over the course of the next 12 months.

Different methodologies to calculate the yield

An effective yield is by definition higher than a running yield – assuming positive interest rates – and hence the two are not worthy of comparison.

2 PITFALL 2 – POINT IN TIME ESTIMATE

What happens if the fund manager changes the underlying holdings/ instruments in the fund, selling an instrument with a low yield and buying an instrument with a higher yield? That would render the previous quote outdated. And it also highlights that the current quote is a snapshot based on the current fund. Many things can change, including the fund manager's

Income funds and effective yields – mind the pitfalls

active management, or the general level of interest rates in the economy, as determined by the Monetary Policy Committee of the South African Reserve Bank (SARB). This action is likely to impact the yield of a fund going forward. When things change, so does the yield. Comparing the yield on a fund today with another at say the beginning of 2022, when interest rates were 2.5% lower, is flawed and hopefully illustrates an obvious, but often overlooked pitfall in using yield to compare funds.

3

PITFALL 3 – YIELD DOES NOT EQUAL EXPECTED RETURN

In a stable interest rate environment, one could be forgiven for thinking that the yield quoted by a fund is the return that you will receive from that fund over the next 12 months. But it is not, and this is not a stable interest rate environment. Yield is only one component of total return, the other being the capital component. Let us take two funds, both quoting an 8% yield today. Fund A holds only floating rate notes and Fund B holds a diversified basket of floating and fixed rate interest instruments, including longer-dated fixed rate bonds.

All else being equal, if market interest rates subsequently rise and push up the yields to maturity of longer dated bonds (known as a parallel shift in the yield curve), then Fund B will likely underperform Fund A – and the 8% yield quote – as longer-dated fixed rate bond prices will fall as yields to maturity rise.

Yield ≠ expected return

The opposite is true as interest rates fall. So, post the yield quote comparison, funds positioned differently will perform differently with the obvious conclusion that the yield quoted cannot be relied upon to forecast the expected return of a fund. Simple changes in interest rates or the holdings in a fund, or any other unforeseen events imply the yield quoted today is very seldom the return enjoyed by the investor over the next 12 months.

Conclusion

We have highlighted the main pitfalls associated with income funds and effective yields. Conducting in-depth research and equalising all factors could help, but you would still need a solid understanding of the fund's strategy and positioning before getting a true sense of the return potential of the fund.

What to focus on? Check whether the quoted yield is gross or net, a running yield or an effective yield and ensure the date chosen for the comparison between two funds is the same. Then ensure you have a good understanding of how the funds are managed before offering advice on the basis of the yields quoted by different funds.

MANAGER INSIGHTS

People shaping the past...and the future

Jennifer Henry

Head of Strategic Investments & Manager Research: INN8 Invest

Key Points:

- 2022 was an eventful year in terms of corporate activity. Kagiso changed its name to Camissa, Sanlam and Absa formally combined their investment businesses and Momentum Metropolitan Holdings is likely to acquire RMI Investment Managers, subject to regulatory approval.
- Aluwani Capital Partners is now one of the largest majority black-owned fund managers.
- Lastly, several senior appointments across the local industry – including a new CIO at the PIC, women taking up senior roles, and Mahesh Cooper rejoining Allan Gray.

Annually, we share a round-up of the main corporate activity and people moves in the local asset management industry – business repositioning, shareholding structures, mergers and acquisitions, and senior staff movements.

We have observed changes at the CIO or CEO level of several asset managers with some key female hires. At the same time, we have unfortunately said farewell to several industry stalwarts – individuals who have, over the years, played major roles as mentors and ambassadors in the asset management industry – Alwyn van der Merwe at Sanlam Private Wealth and Helen Conradie at Satrix. Also, Rob Formby the COO at Allan Gray, who will pursue other opportunities.

The main corporate happenings

Name change to Camissa Asset Management

In February 2022 Kagiso Asset Management (KAM) announced they had changed their name to Camissa Asset Management as part of a corporate restructuring. Camissa is an indigenous Khoisan word describing the area around Table Bay, which is known as the City Bowl today. It means 'the place of sweet waters' and is derived from the fountains, springs and streams originally found around Table Mountain.

The restructuring sees founding shareholder, Kagiso Tiso Holdings (KTH) sell its 50.1% stake in the business to a combination of KAM management and staff (74%) and Sinayo Capital (26%).

The business is now **30% OWNED BY BLACK WOMEN** via Sinayo Capital and the Martha Molobi Women's Trust.

Momentum Metropolitan Holdings to acquire RMI Investment Managers' equity stake in asset managers

Earlier this year, Rand Merchant Investment Holdings (RMIH) announced its intention to unbundle their largest shareholding in Discovery and Momentum Metropolitan, along with plans to swap its JSE listing with OUTsurance. The corporate action is also expected to see Momentum Metropolitan Holdings (MMH) acquire RMI Investment Managers – pending regulatory approval. The nine affiliate asset managers that RMI has equity stakes in are Granate, Perpetua, Sentio, Truffle, Northstar, Visio, Sefikile, Ethos and Polarstar. We have investments or allocations with Granate, Truffle and Visio.

Our discussions with these managers have shown that they do not foresee any change to investment processes, since RMI played a support and oversight role to their businesses, which they expect to continue under Momentum.

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Sanlam Investments merges with Absa Asset Management

Sanlam and Absa formally combined their investment businesses. In October 2021, the two companies announced that they were joining forces to create an asset management firm. The new company will be born out of marrying Sanlam Investments and Absa Investments – which comprised Absa Asset Management, Absa Alternative Asset Management, Absa Fund Managers and Absa Multi-Management – and will have assets of more than R1 trillion. e.

Aluwani Capital Partners – now one of the largest majority black-owned fund managers

Aluwani acquired an additional 40% stake in the business from Momentum Metropolitan Holdings and another 20% from BEE partners. Aluwani is now majority owned by founding members and staff. With the exception of the five founders, Aluwani allocated 16% of the equity to staff and has brought in two black shareholders, Vulindela Holdings and Temo Capital, with (unspecified) minority holdings.

Senior management and investment team changes

Public Investment Corporation – new CIO

KABELO RIKHOTSO, previously an executive and fund manager at Visio Capital, took up the role of Chief Investment Officer at the Public Investment Corporation (PIC), the largest 'fund manager' in South Africa. Kabelo joined Visio in July 2020 and prior to that was the founder CEO and Executive Director of Royal Investment Managers for approximately four years.

Satrix – new CEO

FIKILE MBHOKOTA, a former GEPF executive, has been appointed CEO at Satrix following Helena Conradie's retirement at the end of last year.

New CEO for Alexforbes Investments

ANN LEEPILE joined Alexforbes Investments from Absa Asset Management as CEO. Ann has 20 years' experience in the investments industry.

Allan Gray – Mahesh Cooper rejoined the firm as COO

MAHESH spent nearly 14 years at Allan Gray between 2003 and 2017, starting as a business analyst in the institutional client servicing team and rising to the role of executive director. He also headed up the institutional clients team for more than a decade. In 2018 he took up a position as COO at Perpetua Investment Managers and set up Fintech company, Pirate Code.

Momentum Metropolitan – CIO joined Eskom retirement funds

The Eskom Pension and Provident Fund (EPPF) appointed SONJA SAUNDERSON as Chief Investment Officer. Sonja joined the EPPF from Momentum Metropolitan Holdings where she served as the Group's Chief Investment Officer for seven years.

Ashburton – new CEO

MDUDUZI NDLOVU has taken over the role of Chief Executive Officer at Ashburton Investments. The previous CEO, Sizwe Nxedlana, stepped down having been in charge since October 2019. Mduduzi is the co-founder of Argon Asset Management and joins from BlueAlpha Investment Management.

Mergence Investment Managers – new MD

SHOLTO DOLAMO has joined Mergence as the Managing Director. He has more than 15 years' experience in the financial services industry and joins from the Public Investment Corporation where he worked in several senior roles since 2015.

Vunani Fund Managers – CEO parts ways with the business

SNOWY MASAKALE, the Chief Executive Officer left Vunani for personal reasons. Snowy joined the firm in September 2019 and assumed the role of CEO in March 2020.

Sanlam Private Wealth – Head of Equities promoted to CIO

DAVID LERCHE will take over as CIO from Alwyn van der Merwe who will retire at the end of March 2023.

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M&G Investments – senior portfolio manager departs

In April 2022, M&G Investments announced that MARC BECKENSTRATER, co-manager of the M&G (South Africa) Global Funds range and co-head of Systematic Investment Strategies left the business. Marc was previously CIO of the South African business from 2009 until July 2016.

Differential Capital – new co-CIO

SAM HOULIE replaced Naeem Badat as co-CIO. Sam has 26 years' investment experience and has worked for several local asset management firms over the years.

Old Mutual Investment Group – key portfolio manager resigns

SALIEGH SALAAM resigned from his role as a portfolio manager for the Shari'ah funds and relocated to the USA.

Foord Asset Management – new senior appointees

Foord appointed RASHAAD TAYOB and FARZANA BAYAT in August to develop the manager's fixed income offering, covering South African and global income and bond funds.

Investing offshore – CGT depends heavily on the way in which you choose to invest

Albert Louw CFP®

DFM Practice Manager: INN8 Invest

Key Points:

- Capital Gains Tax (CGT) is only payable if the value of your investment has grown, and you decide to sell a portion of or all your investments
- No CGT is payable on compulsory savings – only on discretionary money
- It is important to also focus on the CGT differences when you invest in a rand or foreign-denominated fund. In a rand-denominated fund you also pay CGT on currency gains (i.e., rand depreciation).

Recap on when you are liable for CGT

Capital Gains Tax was introduced to the South African Income Tax Act, 1962 ('the Act') in October 2001 and is applicable to capital gains made after that date. The Act sets out the basis for taxing the capital gains arising from the disposal of an asset.

Key facts about CGT for investors

1. CGT is ONLY payable if the price of the investment (e.g a local or foreign collective investment scheme) has risen since the date of investment. This increase in value is known as a capital gain and only becomes relevant when/if you decide to sell – a portion of or all – your investments. Thus, you decide when you become liable for CGT.

2. It is important to note that individual taxpayers enjoy an annual capital gain exclusion of R40 000. You therefore ONLY pay CGT on the amount above the R40 000 threshold.

3. Currently, ONLY 40% of the net capital gain and not the total gain, is included in your annual income. This makes the maximum CGT rate 18% for individuals that pay the maximum 45% marginal tax rate.

4. Retirement funds – pension, preservation, and provident funds – retirement annuities and living annuities are all tax efficient products and CGT is not payable on investment growth. These are typically referred to as compulsory or non-discretionary savings.

Rand vs foreign-denominated funds

When contemplating an investment offshore, before deciding on the vehicle and/or type of portfolio that will meet your requirements, you need to decide whether you want to invest in:

- A rand-denominated fund; or
- Directly in a foreign-denominated fund by using your foreign investment allowance.

CGT on currency gains

If you invest directly in foreign currency with a foreign manager or through an offshore platform using your foreign allowance, you do not pay tax on currency movement while you are invested. When you sell assets bought in a foreign currency, the foreign capital gain or loss is first calculated and then translated into rands using either the average exchange rate – available on the SARS website – or the exchange rate on the date of sale. On the flip side, you are liable for CGT on the currency gains* if invested in a rand-denominated portfolio.

*Based on the assumption that the rand will depreciate against other global currencies such as the US dollar over time.

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PRACTICE NOTES

Investing offshore – CGT depends heavily on the way in which you choose to invest

An example

John decided to invest R1 million of his discretionary savings in a foreign-denominated fund (no tax clearance certificate required) and another R1 million in a rand-denominated fund. He does not want to go through the formal process of obtaining a tax clearance certificate. What does this mean in terms of CGT when he sells out of both funds/portfolios five years later?

Assumption: On the day of investing, the R/$ exchange rate was R14/$, which depreciated to R18/$ on the date of selling all his units. Also, the equity market posted positive returns over the five-year period.

Rand-denominated CIS	Foreign-denominated CIS
• You invested $71 429 in an equity fund when the spot rate was equal to R14/$	• You invested $71 429 in an equity fund when the spot rate was equal to R14/$
• Five years later, you sell all your units for $100 000 at a spot rate of R18/$	• Five years later, you sell all your units for $100 000 at a spot rate of R18/$
• The result is a capital gain of **R800 000** (R1800 000 – R1 000 000)	• The result is a capital gain of **R514 278** (R1800 000 – R1 285 722#) #$71 429*R18/$
	• The currency fluctuation of the initial investment is disregarded for CGT purposes.

In this example, the foreign-denominated fund resulted in John saving R44 230# in income tax when selling his two equity investments after five years.

#Assume you are taxed at a marginal tax rate of 45% [(R800 000-R514 278) - R40 000 (annual exclusion) x 40% inclusion rate]

Conclusion

The decision which investment vehicle/fund to consider when investing offshore is not a simple one. A significant issue to consider when a fund is selected, is the impact of CGT. It is important to show the client the difference in the CGT calculations between rand and foreign- denominated funds.

INN8 Invest DFM is not a tax professional. Please seek the appropriate assistance/advice from a qualified financial or tax advise.

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