Dear

The month of April is always a very disjointed month with the large number of public holidays but for those invested in the equity market enjoyed what was the most part consistent movements in one direction – up! A significant increase in the oil price had a positive impact on the prices of other commodities causing the resources index to increase by 8%.

The JSE Alsi finished the month just off its record high, in spite of poor global economic data. There is once again a disconnect between the performance of the economy and the valuations within the market. The PE ratio of the JSE Alsi is currently at a level last seen in 1969, although this is influenced by the large weighting Naspers has within the index.

CPI increased marginally to 4% mainly as a result of a fuel price increase. Food prices were lower than expected which provided some benefit to the consumer. A number of the items within the basket of goods are only measured once a year, and that took place during the month. The biggest increase occurred in education with annual education inflation now at 9.3%. Education inflation has averaged 4% higher than than CPI for the last 7 years. Old Mutual estimates that if a child starts Grade R this year, a complete education – including primary school, high school and three years of university – will cost just under R1 million for public school tuition, or R2,2 million for private school tuition (in nominal terms).

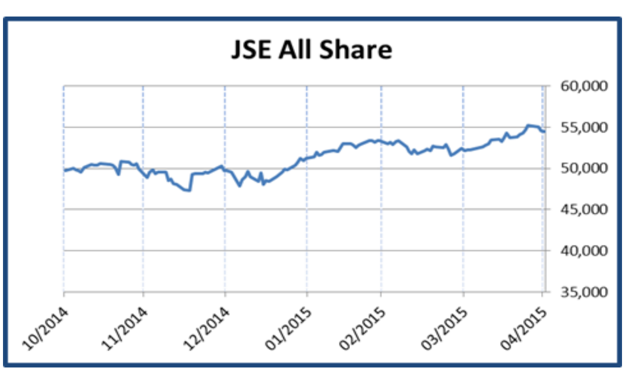
South Africa's balance of trade was positive for the second time within the last 12 months. This was driven by increased exports in precious metals and stones. A large driver of exports is sales to our neighbouring countries and if those sales were excluded then the reported figure would have been a sizeable deficit. The cumulative trade deficit is R5.4bn lower than the previous year.

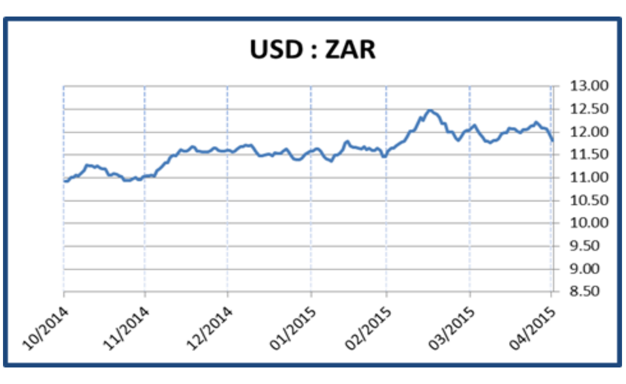
In the US the quarterly reported GDP of 0.2% underperformed against expectations and caused the Dollar to lose some ground against other major currencies. Dollar weakness would help soften the blow of fuel price increases in the future.

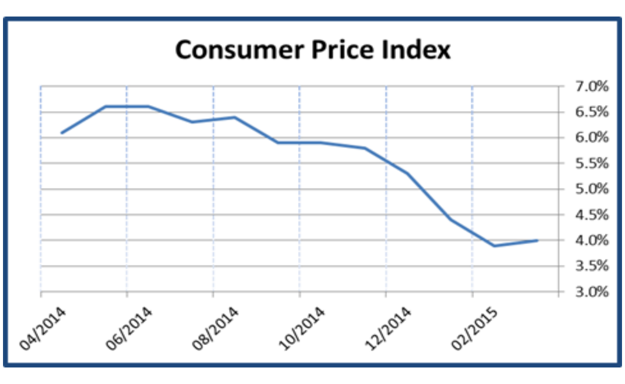
With the current economic data we continue to advise on a cautious approach. Don't be greedy and maintain a diversified portfolio.

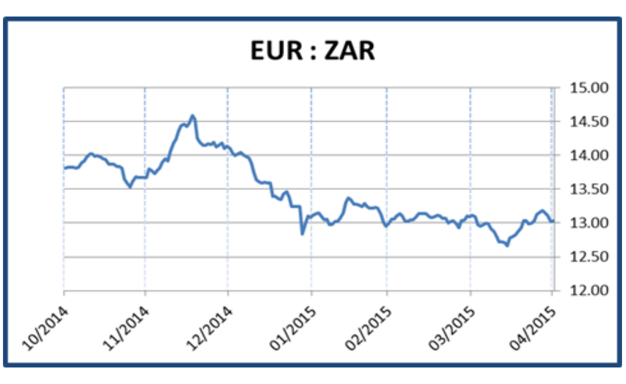
Magwitch Securities

MARKET INFORMATION









FINANCIAL PRODUCT IN FOCUS

COMPULSORY AND VOLUNTARY ANNUITIES AFTER RETIREMENT

In our financial product in focus this month we look at what options you have when you finally retire and access your accumulated retirement savings. Individuals can save for their retirement either through an employer provided retirement fund, which may be a pension fund or a provident fund, or through the use of a retirement annuity fund held in their own name. We have looked at each of these products in previous articles and focused on accumulating as large a balance across all retirement savings products as possible. When you stop working, you need to decide on what to do with your accumulated retirement savings.

Compulsory Annuities – Pension and Retirement Annuity Funds

When an individual retires from a pension fund or retirement annuity fund they are allowed to receive up to one third of the total retirement benefit as a cash lump sum. The balance of at least two thirds of the total retirement benefit value must be used to buy a compulsory annuity/pension, which will provide you with regular income during retirement.

Voluntary Annuities – Provident Funds

When an individual retires from a provident fund they are allowed to receive their entire retirement benefit as a cash lump sum. They are not compelled by law to purchase a pension but if they would like to receive a regular pension they can buy a voluntary annuity/pension from a long term insurer.

In our opinion the individual should seek advice on the most tax efficient structure when determining the amount to withdraw as a cash lump sum and how much as an annuity.

There are two main classes of annuities that you can purchase, and they are classified as follows:
• Conventional life annuities
• Living annuities

Life Annuities

The life annuity is a product where you transfer the balance of your retirement benefit to a life insurance company and in return they will pay you a monthly income for the rest of your life. The value of the monthly income is determined by a number of factors:
• Amount transferred to the life insurer – The higher the amount transferred the higher the amount that will be received on a monthly basis
• The age of the individual – You will be swopping your lump sum for a month income for the rest of your life. If you have a shorter life expectancy then the insurer has to pay out more per month.
• Interest rates – As the product is a guaranteed monthly payment the insurer will use interest bearing investments like government bonds to provide for annuity payments.

The insurer takes responsibility for market fluctuations as they have to pay the contractual amount to the individual and this cannot be changed even if the insurer suffers capital losses in their own business. For the individual the biggest risk is the risk of inflation eating away at the buying power of your income. There is a secondary risk of default by the insurer (so one needs to use a reputable insurer).

As the income is paid until death the insurer has a risk that the individual lives beyond their normal life expectancy. This will mean that the insurer is paying out far more than they received on the inception of the agreement. The individual has the inverse risk. If the individual passes earlier than their life expectancy the investment dies with them unless they have put certain structures in place, all of which carry a cost.

Once you have purchased a life annuity you cannot change it later on so it is very important that an informed decision has been made when selecting the life annuity option. There are many different life annuity options:

Level Annuity

Under a level annuity you receive the same amount of monthly income for the full term of the annuity. This structure will give you the highest initial monthly income however your spending power will be eroded by inflation over time.

Escalating Annuity

In an escalating annuity the monthly income will increase annually based on a predetermined agreement. The increase can be linked to inflation or be a fixed percentage. The first month's income will be far lower than the level annuity as the insurer only has a fixed amount to invest (the amount transferred in). The higher the increase rate, the lower the starting price to allow for all the increases to occur until the end of the predicted life expectancy. In this case if you pass away early in the contact, the insurer will benefit.

Enhanced Annuity (Impaired Life Annuity)

These annuities pay a higher amount to people who can prove that they may have a shorter-than-average life expectancy because of health conditions or unhealthy lifestyles eg smoking, alcoholism or suffering from some illness. The insurer can increase the monthly income that they are paying as they assume that they will be paying the annuity for a shorter period.

Joint Life Annuity

This is an annuity that carries over on to the life of the surviving spouse. You normally have the option to elect what percentage of the original pension the survivor should receive. The life insurer will look at the life expectancy of both owners and apply the assumptions on the one that is expected to life longer.

Capital-back Annuity

The capital value of your annuity is guaranteed through the purchase of a life policy. Part of the monthly income is then used to pay the life assurance premiums. Life assurance premiums can be very expensive as one ages so it would mean that you would receive less on a monthly basis.

Guaranteed Life Annuity

The monthly income is guaranteed not only for the life of the individual but also for a fixed number of years. If the individual passed prior to the expiry of the guaranteed term then the monthly income will be paid to a nominated beneficiary for the balance of the guaranteed term.

With Profit Annuity

A with profit annuity is similar to an escalating annuity but the annual escalations are determined by market fluctuations. What happens in practice is that the increases are "smoothed" meaning that excess performance in good years is held back for years when investment performance is not so good. The individual is thus adding investment risk to their monthly income without any say (or knowledge) on where the money is invested. This is seen as a negative when compared with living annuities.

Living Annuities

Similar to the life annuity you use your retirement savings benefit to buy an annuity from a life insurer. The difference with the living annuity is that you get to manage how much income you receive from the investment each year. This income taken can range between 2.5% and 17.5% per annum of the capital value, to suit both your income needs and tax position.

You are able to select the underlying investments of the living annuity using an appropriate structure to try meet your investment goals. You are however exposed to market risk and any negative market fluctuations can result in a loss of capital, depending on the equity exposure.

Unlike a life annuity, a living annuity does not die with you but the balance in the fund can be left to your beneficiaries. This is countered by the risk that your capital may run out before your pass. It is with this in mind that one needs to carefully determine the appropriate monthly income taken to ensure that your investment outlives you.

It is always possible to switch from a living annuity to a life annuity at any stage as long as you still have a capital balance that can be transferred. It is not possible to switch the other way round as in the life annuity the capital balance has been converted to a monthly income.

If you are not well the living annuity will be the best option as the full capital will be transferred to your beneficiaries.

Conclusion

It is important to seek appropriate advice when retiring as the choice of which annuity to use can only be done with reference to the individual's financial position and their income requirements and the needs of their dependents.

With a living annuity you have flexibility and choice of income and underlying investments but this comes at increased risk. With a life annuity you have guaranteed income but no flexibility and often leave nothing for your dependents.

In the current environment of artificially low interest rates we prefer to use living annuities. As one can switch from a living annuity to a life annuity at any time in the future one can always change if there is an opportunity to lock income in at higher interest rates. We would also consider switching if the individual is of good health and has a good chance that they would outlive their life expectancy as this would mean more income over the long term.

If you are considering retirement, or already in retirement, contact Magwitch to determine the best structure for you.

ABOUT MAGWITCH

Magwitch Securities is a Financial Services Broker offering the following products as a comprehensive financial solution to both individuals and businesses:

- Employee Benefits
- Medical Aid
- Risk Benefits
- Short Term Insurance
- Retirement Planning
- Investment Planning
- Estate Planning
- Foreign Exchange
- Money Market
- Investments
- Treasury Management

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