Follow this link to view a web version of this message

Dear

July 2017 was a welcome month for the South African investor. After a two year period of no growth in the stock market the JSE finally reached a new record high benefiting all South Africans. An easing of inflationary pressures also allowed the South African Reserve Bank to cut interest rates, reducing cashflow pressure on the South African consumer.

There is nowhere else to start but by looking at the JSE. The month delivered a stellar 7% growth in the JSE All Share Index taking it to a new record high. The last time the stock market was at these levels was in April 2015 from which point investors have had to endure a long period of underperformance and bad news. The growth was largely driven by global investors as they adopted a risk-on approach. There are indications that the world is moving away from investing mainly in US based companies as their valuations have become stretched.

We would caution investors of getting swept up in the euphoria of the momentum. Global investors are fickle by nature and they can just as easily decide not to invest in South African companies and the stock market will lose the recent gains.

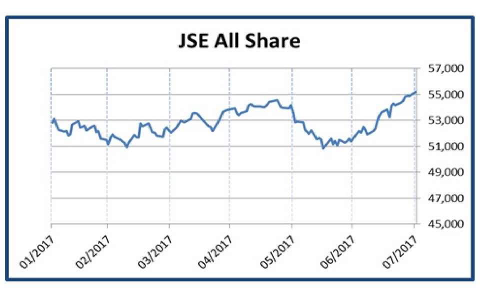
Lower oil prices and a stable Rand have eased the inflationary pressure. Inflation once again surprised on the downside with the reported figure of 5.1% year on year. This is the lowest reported inflation number since November 2015, before the negative impact of “Nenegate” on the Rand. The lower inflation figures allowed the South African Reserve Bank to cut the Repo rate by 0.25%, which in turn forced the major lenders to reduce their lending rates. This is a welcome boost for the South African consumer as their debt repayments should have reduced.

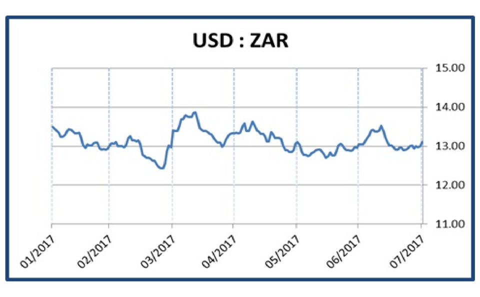
On the political front we are starting to see some signs that, at least at a lower level, corrupt officials are being held accountable for their actions and the looting of the state and the State-Owned Enterprises. It appears in many instances that it is the financial levers that are being pulled in an effort to try get rid of the corruption. The latest example of this is the suspension of the Eskom CFO, Mr Singh. This suspension was as a result of the Development Bank of SA saying that they would recall their R15billion loan to Eskom unless action was taken against Mr Singh.

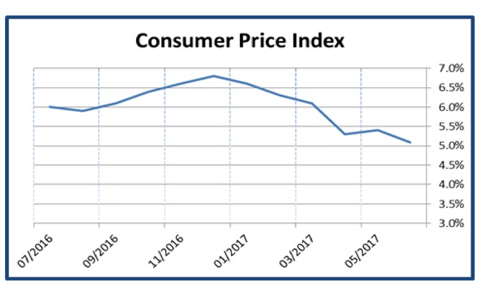
We continue to remain positive that all the efforts of the press will eventually result in everyone being held account. We believe that the tide has turned and the fight against corruption is starting to have positive results. We however, remain very wary of the movements in the governing party and how the balance of the year will pan out in the lead up to their elective conference.

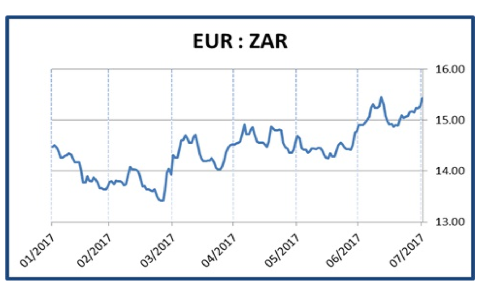
Magwitch Securities

MARKET INFORMATION









FINANCIAL VIEW

RETIREMENT SAVINGS – HOW MUCH IS ENOUGH

One of the questions we get asked most often is how much people should be saving for retirement. In the finance industry we have many rules of thumb which are quick calculations that one can apply. In terms of retirement savings the general rule of thumb is you need accumulated capital of 15 times your final annual salary (pre-tax). In our Financial View this month we unpack how the industry arrived at this number. We also look at what you can do to get there or what you can change if that target is to high.

Why 15 Times?

The 15 times your final annual salary as previously mentioned is a guideline. It is a generic answer that provides a quick solution but the reality is that each person has their own unique requirements that will determine how much retirement savings capital they need. Your retirement savings capital is there to provide you with an income to maintain your lifestyle once retired. The following factors will determine how much you need and you need to consider the following:

1. How much you need to draw a month;
2. How many years you will live in retirement; and
3. How much you want your income to grow each year all contribute to determining your individual needs.

How much income you need to draw

A lot of financial theory deals with net replacement ratios. Simply put the net replacement ratio is how much of your final salary you can replace using accumulated pension / retirement savings. The consensus amongst the financial industry is that you should target a replacement ratio of 75%. This means that for every R10k salary earned before retirement you would need to replace that with R7.5k income from your retirement savings.

The reason you don’t need to replace your full salary after you have retired is that even before retirement you should not be spending your full salary (an example of this is that you won’t need to travel to work and you will no longer be contributing to your retirement fund). People tend to enjoy their greatest asset accumulation phase in the last 10 years before they retire. The reason is that in many instances the kids have moved out of the home, which is hopefully already paid off. With less dependents and less debt there should be more funds directed towards discretionary investments. We often see people ramping up their interaction with financial products very successfully through this phase.

How long you will be drawing income for

In theory your longevity will determine how long you need to draw income. But are you perhaps also providing for a spouse or other relative out of that income, who may outlive you?

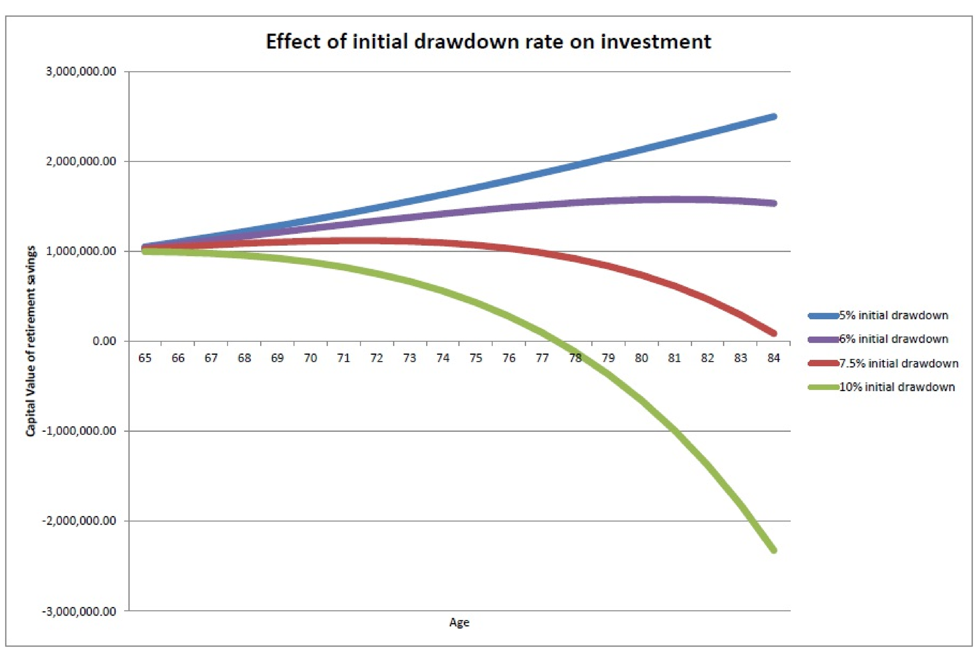
Medical advances have meant that the average person is living longer. The broad financial industry however tends to look at 30 years in retirement. We don’t agree that this is representative of how long most people will live but we do expect a large percentage of retirees to get into their 80’s. We have thus looked at a 20 year period for retirement.

How much you need the income to increase by

Many retirees cannot survive purely because of the erosive effect of inflation. Your income generally needs to increase by inflation each year in retirement. This inflationary increase may however still not keep pace with increases in costs as medical expenses tend to increase at rates above the general inflation rate. Some post-retirement products out there will allow higher amounts of income initially. This may be short sighted as it is not advisable to ignore the damaging effect of inflation.

How different initial drawdown rates impact the investment

If we assume that in your retirement you need to provide yourself an income for 20 years and that your annual requirements will increase by inflation each year we can graph what we expect to happen to your investment over time. We’ve assume post retirement growth of 10% and annual inflation of 6%.



You will note that if you have R1m in capital and take an initial amount of R50 000 p.a (or just under R4.2k p.m) which equates to a 5% drawdown, your capital will not reduce at any point over the 20 years. At higher drawdown rates your capital will be impacted with a 6% drawdown rate meaning that you start to lose value towards the end of the 20 period and will run out of capital after 26 years. At 7.5% drawdown you will exhaust all you capital in 20 years and with a 10% drawdown your capital will only last 12 years.

The 15 times calculation

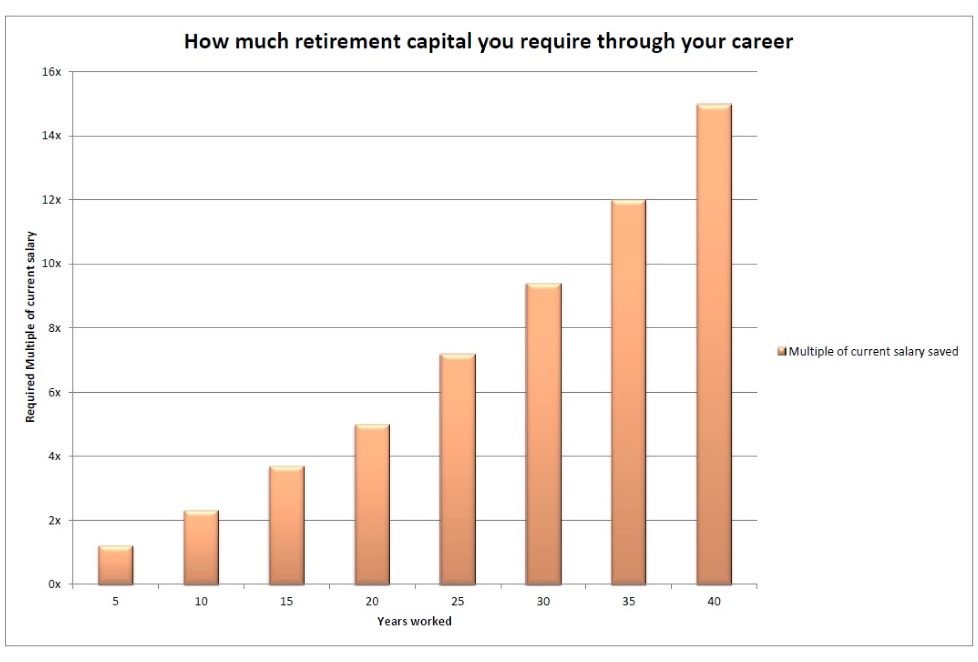
As shown in the graph the ideal initial drawdown rate is a maximum of 5%. General consensus states that you need to replace 75% of your final salary. Putting those two numbers together into a sum gives you the 15 times of your final annual salary.

If you earned R10k per month (R120k per year) you would need R1.8m in retirement capital. If you drew 5% from that it would give you R90 000 (or R7.5k p.m) which would bring you back to the 75% net replacement ratio.

How to get to 15 times

Sanlam recently released the results of their annual BENCHMARK Survey into the retirement industry. They concluded that individuals need to save 15% per year from the start of their working career age 25. They determined this number by using an investment return of 10% per year and salary increases of 6.5% per year.

Sanlam have determined how much you should have saved as you reach each 5 year period in your working career. So in the below chart you would need to have accumulated 9.4 times your annual salary after having worked for 30 years. The annual salary would be that salary that you earn in your 30th year of your career.



We feel that there assumptions may be a little conservative as typically salary increases over your entire career grow by more than inflation. One tends to earn promotions that cause rapid salary increases. The other assumption that we feel is slightly conservative is that Sanlam have used a return assumption that is below the long term average for balanced funds. Most people save for their retirement using balanced funds. We feel that a return assumption of inflation plus 6% may be more appropriate. In which case you will get away with contributing 10% to retirement savings, so long as you do so over a 40 year period.

Where it all goes wrong

There are a number of reasons why so few people reach retirement with sufficient capital. The often quoted number is that only 6% of South Africans have accumulated sufficient capital to enable a comfortable lifestyle in retirement. Or conversely a whopping 94% don’t.

We understand that not everyone has access to financial products but for those that do here are the more common reasons why they don’t have enough at retirement.

- **They start too late**. People often are loath to contribute to retirement savings in the beginning of their career as they are often earning lower salaries and require as much of their income as possible to meet their expenses. The problem that this creates is that those individuals miss out on the power of compounding. Compounding of capital is often referred to as the eighth wonder of the world.
- **They contribute too little**. This has a similar effect as starting late. Many individuals can choose their own level of contribution or how much they are going to put away. If they choose a rate that is low their capital will grow at a slower pace.
- **They access their retirement savings early**. This is probably the biggest factor and definitely the most damaging. Current South African legislation allows one to access pension and provident funds whenever you change jobs. Many people use job changing as an opportunity to access their accumulated retirement savings sending their savings all the way back to zero.

How to catch up

Not everyone is going to be in a position to catch up. Much of the theory relies on the assumption that you have started saving for retirement at the beginning of your career, and contributed at a consistent rate.

Even if you will never get your retirement capital to 15 times of your final salary it is important to still understand the concept of providing income within retirement. The higher your drawdown rate, the quicker you exhaust those savings.

The only way to catch up for missed time is to increase your rate of contribution to your retirement fund. The higher the increase the quicker your retirement capital will grow. SARS has created many very attractive tax allowances to encourage retirement savings. By increasing your contribution rate you often decrease the amount of tax that you pay. This is commonly referred to as SARS contributing towards your retirement.

There are other assets that can be used to boost your retirement savings and will impact on how much retirement capital you need. Property, cash, unit trusts, endowments, tax free savings accounts and other assets could be sold to realise capital at a later point. These assets should be added to your retirement savings to determine if you have saved enough.

We at Magwitch are happy to sit with you and determine how you are going to provide for yourself and your dependents once you are in retirement.

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
- Trust Administration

t: 011 453 3048 f: 011 453 0715 **www.magwitch.co.za**

Magwitch Securities Proprietary Limited is an authorised financial services provider, registered with the Financial Services Board - FSP number 26829