WEALTH

Summer 2019

OLD MUTUAL WEALTH JOURNEY

I can't believe that this is our last newsletter for the year. 2019 has had its fair share of turbulence. Although there have been patches of smooth sailing, headwinds have generally outnumbered tailwinds during the year.

In these uncertain times, investors can easily lose perspective on the importance of maintaining a long-term outlook, and we all know the damage a hasty response can wreak on a well-crafted investment plan. Yet, it is important to remember that challenging times can present unique opportunities. At Old Mutual Wealth, we remain focused on leveraging such opportunities for our clients' long-term benefit.

We believe that it is crucial to firmly subscribe to the following three principles during challenging times: 1) remember that time out of the market is costly, therefore staying invested in growth assets is better than holding cash; 2) chasing performance is not a good strategy as past performance is not an indicator of future performance; and 3) making decisions to disinvest based on market noise is not advisable. Long-term investing and a diversified investment solution are essential to grow your personal wealth.

On a positive note, now is the time to take stock of your personal achievements and successes as well as to reflect on the goals you did not accomplish, and what you need to do differently in 2020. Most importantly, you should now be planning your well-deserved break, quality time with loved ones and quiet time for yourself.

I thank you for your continued support and the confidence that you have placed in us. We are committed to ensuring that our strong, skilled investment teams, robust business processes and risk-aware approach to managing your money will provide you with peace of mind as we navigate these challenging times. We wish you all the best as you embark on your journey into 2020. Have a wonderful break and be safe on the roads when travelling.

KERRIN LAND

CEO, OLD MUTUAL WEALTH

GLOBAL ASSET ALLOCATION TO DIVERSIFY FOR INVESTMENT SUCCESS

South Africa accounts for less than 1% of the sum total of investible opportunities in the world. Looking at the recent performance of the Johannesburg Stock Exchange, local investors seeking long-term capital growth would be wise to look offshore, without delay. There is a big world of investment opportunities out there and the most effective asset allocation justifies careful consideration.

When it comes to asset allocation, there are many factors that make some sectors and geographies relatively more appealing for investors. Panic and greed are never good reasons to invest offshore; a move that should rather not be attempted without credible advice. Effective portfolio diversification is about risk management. The principle is intuitive, but the implementation can be quite a balancing act – all too often, investors either find themselves with too much concentration, or settle for average performance because of too much diversification. The investment portfolio management structure can also make a material difference in terms of tax and/or estate duty.

GLOBAL EQUITY EXPOSURE IS KEY

South African investors who want to grow their assets have to ensure that their portfolios have sufficient exposure to global equities. Although a number of multi-national businesses are listed on the local bourse, the choice is significantly smaller than what is available in the global market. Offshore investments enable investors to diversify their portfolios across geographies, sectors, companies and currencies. Different asset classes, industries and sectors or geographies don't often perform in sync and should be rising and falling at different times. Effective portfolio diversification will therefore minimise the risk specific to particular industries, companies and even geographies, lowering a portfolio's volatility and smoothing returns as a whole.

EMERGING MARKET OPPORTUNITIES

Considering the various global geographies and sectors currently showing value, emerging markets will be driving global economic growth for the foreseeable future, with China and India leading the charge. Since corporate earnings ultimately drive equity investment returns, and economic growth drives corporate earnings in the long term, emerging markets will play a significant role in driving global equity investment returns. Emerging market consumers present an attractive market for

the long term, with personal consumption expenditure likely to increase considerably over the next two decades, be it expenditure on basics such as food, education and healthcare, or the consumption of fashion, luxury goods and entertainment or travel experiences.

The world's economic centre of gravity is shifting south and east, yet the global equity market remains firmly centred in the north and west. South African investors overweight in domestic stocks and underweight in global stocks, and global market participants overweight in the United States, have very limited exposure to the world's long-term growth drivers, namely emerging markets.

KEEP TAX IMPLICATIONS TOP OF MIND

If long-term capital growth is an investor's key objective and assuming favourable valuations (bearing in mind that valuations can change quickly), broad emerging market sectors such as information technology, healthcare and consumption are rich in opportunity. Offshore investing can entail quite complex tax implications, so it is crucial that investors structure their investments with a focus on tax and estate planning. Since South African tax residents are taxed on world-wide income, investors need to consider structures that legitimately minimise their tax liability and the administrative burden of filing tax returns.

Wealth can only truly be protected and grown through coherent investment structuring and management – no amount of investment outperformance or cost savings can ever compensate for the damage done by poor planning and structuring, which is why you need the guidance of a financial planner.

CHRIS POTGIETER

HEAD OF OLD MUTUAL WEALTH PRIVATE CLIENT SECURITIES

DUAL CITIZENSHIP PROVES AN ATTRACTIVE OPTION FOR INVESTORS

In the spirit of diversification and globalisation and a world of increasing uncertainty, many high-net-worth South Africans are acquiring an alternative citizenship as a way of protecting their freedom and expanding investment horizons.

YOUR OPTIONS

Residency by investment: With this option, one is a resident of the country with a possibility of becoming a citizen at some future date, which may range anything between 5 and 20 years.

Citizenship by investment: Suitable for those who want a second passport immediately, be it for travel, tax or business reasons.

High-net-worth individuals can acquire a second citizenship very quickly by investing or donating a predetermined amount to the government. South Africans who seek this option are generally entrepreneurs or professionals who want to grow or diversify their businesses or career opportunities. A second passport will allow them to grow and preserve their capital while also accomplishing their financial goals.

SPEAK TO A PROFESSIONAL

It's easy to make a mistake in choosing between residency or citizenship by investment. If you consider investing in dual citizenship, speak to your financial planner to ensure you make the right decision for your future wealth.

HINDSIGHT IS 2020 VISION

Although the future is uncertain, with hindsight everything is obvious. Therefore, building your investment case on exactly what takes place in the future can be risky. A properly diversified investment portfolio, ignoring the noise and sticking to your plan will lead to investment success over the long term.

I will be paying close attention to the following in 2020:

1. Budget 2020

The October 2019 mini-Budget revealed that the pace of borrowing is increasing due to a weak economy and the Eskom bail-outs. High interest rates are increasing Government's interest bill and crowding out other spending areas. The February 2020 Budget is expected to contain some measures to limit the increase in government borrowing, but will it be enough?

2. Long-awaited economic recovery

Economists only expect growth of between 1% and 1.5% in 2020, but this would represent a substantial increase from around 0.5% in 2019. The bigger question is whether Government will push ahead with reforms to make it easier and cheaper to do business in South Africa, and also how quickly these reforms will gain traction.

A common refrain among a surprisingly broad front of South Africans is that confidence among CEOs, investors and ordinary folks alike will only pick up once there are prosecutions of those involved in state capture. This might be overstating things, but there is no doubt that it is a key step to restoring trust between Government and South Africans.

3. Rate cuts

One thing that will help local growth is lower interest rates. The SA Reserve Bank's repo rate at 6.5% is much higher than inflation of around 4%. This amounts to a 'real' interest rate of more than 2%. It's important to note that you and I don't borrow at the repo rate, but the prime rate, which is even higher. The official reason for the high interest rates is to get South Africans to permanently lower expectations of future inflation to around 4.5%, the mid-point of the 3% to 6% target range. In other words, if we all expect inflation to be 4.5%, we will behave accordingly and this will influence actual inflation. However, the Bank is also worried about a sudden outflow of capital if foreign investors lose faith in South Africa, leading to a weaker rand and higher inflation.

4. Global markets – steady as she goes

Global equity prices increased significantly in 2019 (around 20% at the time of writing in mid-November) following a negative return in 2018. A similarly strong return is unlikely in 2020, but that does not mean it's time to cash in. The underlying environment for global equities – steady but unexciting economic growth, low inflation and low interest rates – remains very supportive. Global markets also don't seem expensive.

2020 is election year in the US. If President Trump escalates rather than scales back his trade battle with China, markets will react negatively. Keep in mind that past predictions of how the market will respond to the election outcome have proven wrong.

5. Local market rebound

It's no secret that the local equity market has struggled, delivering returns barely beating inflation over the past five years. With hindsight, it would have been better to sit in cash over this period. But we only know that now.

While hardly a catastrophic collapse, it is well below the average historic annual returns from local equities of about 7% above inflation. However, the average return is always made up of lean years and fat years, and one often has to sit through the former to enjoy the latter. Nobody can pinpoint when exactly things will turn. The disappointing performance of the JSE is a combination of local and global factors, since the local market is roughly half local and half global in terms of where the listed companies earn their revenues. Better local growth should help the domestically focused companies in 2020, but the globally focused companies will still need solid growth abroad. Importantly, irrespective of what happens locally in terms of politics and economics, the JSE is unlikely to rally if global markets fall. Conversely, we don't need a strong local economic recovery since positive global sentiment lifts the JSE along with it.

The simple message is to remain invested and stay on track to achieve your goals.

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