AUGUST 2020
VOLUME 17
ISSUE 8

INTUITION

IN THIS EDITION:

HARVARD HOUSE

We understand your need for FINANCIAL INTEGRITY

Empowering offshore knowledge and insight exclusively from the Harvard House Group.

AFTER COVID-19: WILL SA'S ECONOMIC REBOUND BE STRUCTURAL?

Willie Pelser

Those who have studied may well agree that once you leave the textbooks behind, only then do you actually start to learn. Two of my economics mentors, Ulrich Joubert and Nick Barnard, often reminded me as a junior that you only start to understand the economic numbers if you read the Quarterly Bulletin published by the South African Reserve Bank. I must confess that in my early days, I knew each data series code by heart, but that discipline has slipped a little as electronic data feeds have made it easier to download the data. I challenged myself a few weeks ago to read the latest Quarterly Bulletin from cover to cover again. The Bank has done away with its old standard template, and June's cover features the now-boring Covid virus picture hidden behind some charts and a handheld device. But I am digressing.

Why did I spend all that time to read it? Firstly, because I had time. Secondly, because I wanted to honour my mentors, and thirdly ... perhaps read on.

A lot has been said and written about the so-called "lost decade" (2010-2020) or "the Zuma years" or whatever other name you want to call it. I am not going to repeat any comments on that. However, I have asked myself how bad it really was and now, with the impact of Covid and the uncertainty it brings, I want to get a sense of how long it will take to restore SA to its former growth trajectory. Secondly, SA has been waiting for an infrastructure-led recovery since Noah set foot on land again. SORRY, since the FIFA World Cup in 2010. How long is this "waiting" game or will it remain a goalless match?

Gross Value Add – was it added or not?

The following paragraph is the opening gambit of the feature article in the Bulletin:

"The economic recession persisted in the first quarter of 2020, with South Africa's real gross domestic product (GDP) contracting at an annualized rate of 2.0%, following contractions of 0.8% and 1.4% in the preceding two quarters. **The real gross value added (GVA) by both the primary and secondary sectors declined further** in the first quarter of 2020, while real output rebounded in the tertiary sector. The **South African economy was already under pressure before the commencement of the nationwide lockdown** at the end of March, with the level of real GDP 0.1% lower in the first quarter of 2020 than a year earlier." (Emphasis added).

The Bulletin continues with further comments:

- "The real GVA by the primary sector has contracted for eight of the past nine quarters"
- "The further significant contraction of 21.5% in the real GVA by the mining sector in the first quarter of 2020 reflected load-shedding as well as supply-chain disruptions"
- "Following two consecutive quarters of contraction, the real GVA by the manufacturing sector decreased further by 8.5%"
- "The real GVA by the tertiary sector reverted to an increase of 1.3%"

Whilst reading, I asked myself a simple question, "Have the various sectors of our economy added value or not?" In other words, if Mr Economy was an employer, he has to ask himself whether the employees (like Mr Agriculture or Mrs Construction, etc.) added any value to his business.

All economic structures are holistically defined as the Primary, Secondary and Tertiary sectors. These sectors

GVA explained

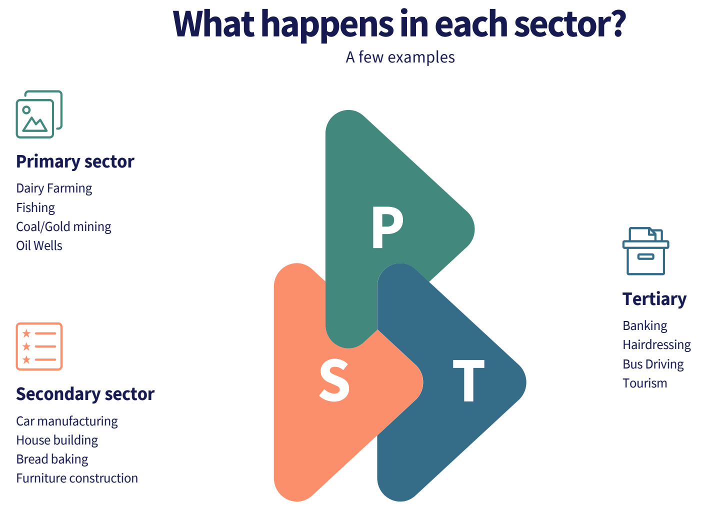
The relationship between GVA and GDP is defined as:

GVA= GDP + Subsidies on products - Taxes on products

In economics, gross value added (GVA) is the measure of the value of goods and services produced in an area, industry or sector of an economy. GVA is a very important measure, because it is used to determine gross domestic product (GDP). GDP is an indicator of the health of a national economy and economic growth. In comparing GVA and GDP, we can say that GVA is a better measure for the economic welfare of the population, because it includes all primary incomes.

Put simply, it is a measure of total output and income in the economy. It provides the value for the amount of goods and services produced in an economy after deducting the cost of inputs and raw materials that have gone into the production of those goods and services.

OVERVIEW OF KEY ECONOMIC SECTORS



produce and sell. It's easiest to think of them as a chain of production, from extracting the raw materials (primary) through manufacturing (secondary) and finally to servicing the end consumers (tertiary). Each sector relies on the others to function properly and efficiently within the economy. Under the three-sector economic theory, every job, in every industry, falls into one or more of these sector types.

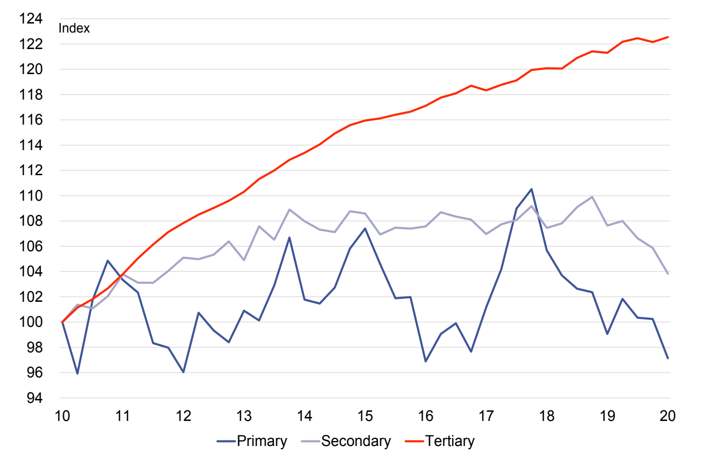
In the chart below, we have rebased the data to 100 as at January 2010 to get an idea of just how poorly our economy has performed. Unfortunately, and as we all suspect, the chart supports the notion that the last decade wasn't a great time in the history of South Africa. If it hadn't been for the tertiary sector, the average annual GDP growth rate would have been closer to 0% or even negative. Mr Economy would have good reason to fire Mr Primary and Mr Secondary, but he can't as the next set of charts will show.

The primary sector consists of Agriculture and Mining. The Agricultural sector is by nature a cyclical industry given the wide array of farming undertaken (livestock, crops, fruit, etc.) and the seasonal fluctuations. On top of the cyclicality, there are external factors such as drought and diseases which can have a major impact on the sector's ability to add value as reflected in the chart. Nonetheless, at least it had grown despite concerns about land distribution.

The growth in Q1 reflected increased production of field crops as well as horticultural and animal products, all on the back of favourable weather conditions during the 2019/20 production season. The expected commercial maize crop of 15.5 million tons for the 2019/20 production season is almost 40% higher than the final crop of 2018/19. At this level, it will be the second largest crop ever, following the record harvest in 2017. This is also well above South Africa's 50-year average maize production of 9.4 million tons.

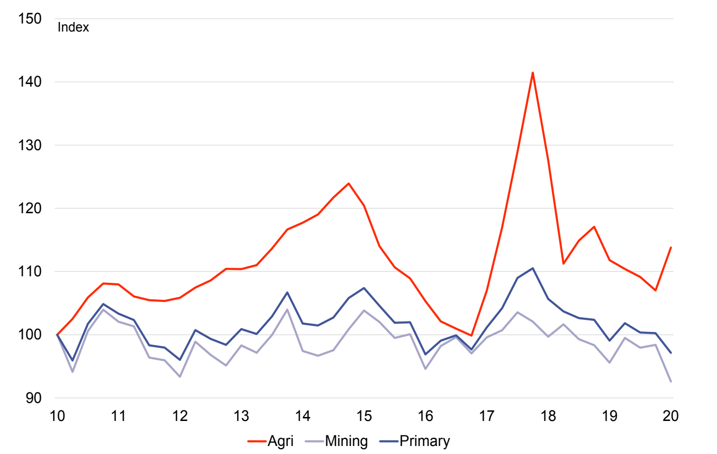
South Africa's economy was founded on mining, but the sector's relative importance has been declining steadily for years. From the end of World War II until the 1970s, the sector's share of real GDP was fairly stable at 20% or more, but it then started to decline as the rest of the economy developed. Nonetheless, mining still accounted for nearly 11% of GDP in 1994, but a subsequent decline of 8% in gross value added by the sector left it accounting for just

REAL GROSS VALUE ADDED: MAIN SECTORS



The last decade wasn't a great time in the history of South Africa. Only the tertiary sector has shown any consistent growth.

PRIMARY SECTOR: REAL VALUE ADD



SA was built on the mining industry, but it's importance to our economy has shrunk significantly.

under 8% of GDP in real terms by 2010. A further decline of 8% in gross value added over the last decade has seen the importance of mining relative to GDP dropping to just 5%.

It would be a mistake, in our view, to narrowly assess mining's contribution to the economy solely by its direct contribution to GDP because the sector generates many important multiplier effects. (The same reasoning is applicable to the agricultural and other secondary sectors.) The Chamber of Mines estimates that, including the downstream impact, the mining sector's contribution to GDP is actually closer to 18%. We think that it is actually quite hard to precisely quantify this, but there is no doubt that the sector has important linkages with both manufacturing and services in all directions: downstream (such as the steel industry), side-stream (such as transportation) and upstream (such as the manufacture of capital equipment for the mining and other sectors).

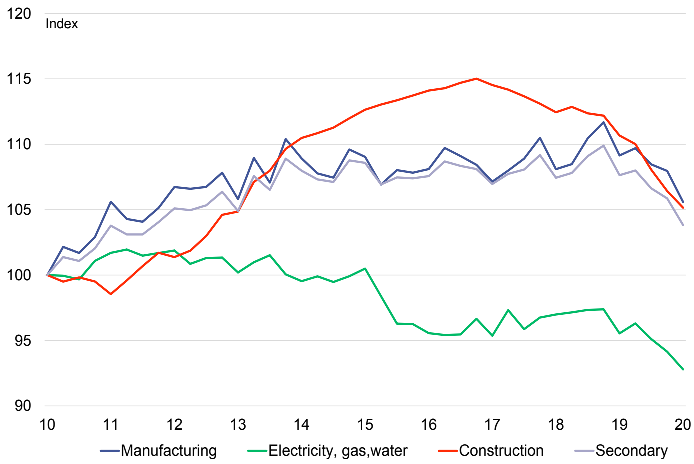
The chart below clearly reflects the drag that Eskom has had on the broader economy. South Africa has experienced sporadic incidents of load-shedding of varying intensity since the end of 2007. We all know that the impact of load shedding on economic activity differs depending on the stages (i.e. Stage 1, 2, 3,4, etc.) and the duration (hours and days). In addition to the electricity, gas and water sector, the real gross value add by the electricity-intensive mining and manufacturing sectors has been most affected, but the agricultural and transport sectors were also affected.

In a previous study, research by the Reserve Bank quantified the impact of load-shedding on our economy. It showed that Q1 2008 was one of the worst as far as the impact on GVA and GDP was concerned. Clients will recall that an announcement in parliament by the then President said, "We will never have load-shedding again." Then came 2014, 2015, 2018 and 2019, and now we face it again. In hindsight, Q3 and Q4 in 2015, and Q1 in 2019 have turned out to be even worse for the economy than Q1 2008.

Of concern is the fact that the electricity, water, gas, manufacturing and mining sectors contracted in a number of other periods as well, even during periods of limited or no load-shedding. Weak value added can be laid at the door of a number of prolonged labour strikes, maintenance and safety stoppages in the mining sector, and weak domestic and global demand. The conclusion from the abovementioned study is that if Eskom remains unreliable (and we do think the ultimate solution is far from being confirmed and implemented) then the above-mentioned sectors will struggle to grow.

The real gross value added in the tertiary sector is cause for jealousy from the rest of the economy. What if maintenance at Eskom had been done in a similar fashion as pre-2008? Could we have generated growth consistently above 5% and jobs along with it? The purpose of this article is not to dwell on the "What-Ifs".

SECONDARY SECTOR: REAL VALUE ADD



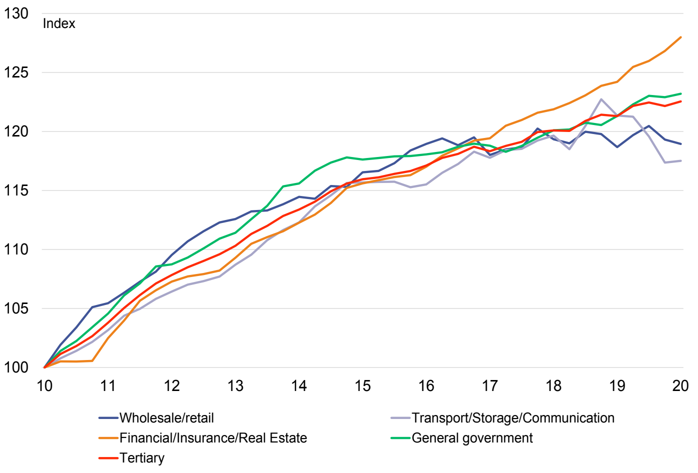
The Electricity (Eskom), gas and water sectors have been in sharp decline since 2015, in turn disrupting all other sectors of the economy.

I refer colloquially to the tertiary sector as that part of the economy that is good at "shifting stuff". In other words, moving goods around via the Transport sector; moving money around via the Financial/Insurance sector; trading (wholesale/retail), and then finally moving cash into people's pockets. Perhaps you will say that this is a cynical view but nonetheless, if these sub-sectors were also faltering, we would all perhaps have a substantially more cynical view on the outcomes.

To put this into perspective, in today's monetary value, the Tertiary Sector comprises 68% of the Gross Value Added in the South African economy. The Primary Sector is only 12% and the Secondary Sector adds the remaining 20%. What is even more scary is that the "Community, Social and Personal" subsector (or alternatively described as general government services) comprises 35% of the Tertiary sector or 24% of South Africa's total gross value added. Employment creation and social grants are the main contributions. This fact is often highlighted by the rating agencies as a key risk for our economy. Again, the purpose of the article is not to dwell on this political component.

In reply to my initial question, this analysis does leave me with the view that the road to recovery will be slow, long and hard, with the odd spike (like a bumper summer crop, or a boost to car manufacturing from a new model) in-between that results in positive growth for a quarter or two. That is how statistics work. If you have a very bad data point and

TERTIARY SECTOR: REAL VALUE ADD



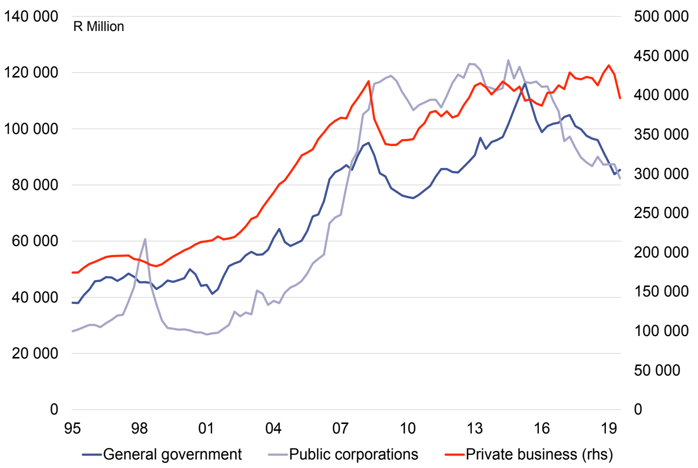
The Tertiary Sector has grown, but it has been supported by an expanding public sector, which is far from optimal for long-term sustainability.

the next one is slightly better, the positive change can be a substantial number. This then begs the question. Is there hope?

Gross fixed investment: the holy grail to our recovery.

Every big growth initiative or policy document in SA over recent decades has referred to the need to invest in infrastructure as a key source of economic upliftment. And for good reason. An economic rule of thumb highlights that gross fixed capital formation (or simply put - investment in infrastructure) should be more than 25% of GDP. Back in 2008, South Africa did this reasonably successfully by building stadiums, improved road infrastructure and the Gautrain – all associated with, and ahead of, the FIFA World Cup. Unfortunately, this has dwindled away to 16% of GDP at last count. The chart reflects this build-up, followed

GROSS FIXED CAPITAL FORMATION



Fixed investment grew strongly ahead of the World Cup, but has since faded away.

by the lack of investment by general government (critical infrastructure of roads, dams, schools, hospitals, etc.) and the public corporations (Eskom, Transnet, SAA, etc.). The private sector has maintained a steady pattern, but it is far from the sharp growth phase of the prior decade.

Almost every year for the past 15 years, various infrastructure plans have been tabled in the annual February Budget, promising spend of approximately R800 billion. While all of these appear compelling in scope and ambition, covering most areas of social and business infrastructure, these infrastructural development plans have not delivered on their promises. The landscape is filled with “carcasses” of “permanently delayed”, “endlessly in early stages of planning”, or “scrapped due to budget constraints”. This can be blamed on changing political priorities and the simple lack of leadership that stems from frequent changes to ministerial positions and Heads of Department.

Consequently, total investment spending by SOEs is at its lowest in 12 years. A study by Standard Bank concluded that the current level of infrastructure investment is insufficient to even maintain our existing infrastructural capacity, leading to a decline in a wide range of critical services, such as water and sanitation. Take the Hospital Crisis, aired by the BBC, as a case in point or the latest Carte Blanche exposé on how PRASA train stations, tracks and electricity infrastructure have been looted in the last 3 months. At a push, trains will only be running in certain areas again in 3-4 years’ time as the infrastructure has to be totally rebuilt. The sleepers were not even left to rest!

Data from the Reserve Bank Bulletin reveals that the level of fixed investment activity in SA is now barely enough to maintain the country’s base of capital stock, let alone expand productive capacity and create job opportunities. It is worrying that the capital stock in our manufacturing sector has declined by 17% since 2008.

Kevin Lings (Chief Economist of Stanlib) added further commentary to the Standard Bank research, highlighting that South Africa does not currently have a sufficiently large savings pool. Our savings are barely enough to cover some basic investment. Consequently, we are forced to look abroad for funding, competing against other countries also trying to rebuild their economies. To win, we need policy certainty, appropriate regulation, improving business confidence and an improvement in the ease of doing business.

Is there hope? Let’s hope.

Hundreds of CEOs, executives, former public-sector leaders, industrialists and experts in banking, law, management consultancy and communications, and health volunteered to mobilise the capabilities of the business sector to respond to the immediate crisis, namely, to restart the country after lockdown, and then develop a fact-based strategy for economic recovery. We know that delivering the promise of 1994, a materially better life for all South Africans, means sustaining high levels of inclusive economic growth. Recently government held its first Sustainable Infrastructure Development Symposium under the title, "Investing in infrastructure for Shared Prosperity; now, next and beyond." This is a welcome development.

Business South Africa said after the Symposium: "We prioritized 12 projects and initiatives, from a list of more than 50, many of which are "shovel ready" and can be launched immediately across 10 high-impact sectors. Public-private partnerships, funded by business, are at the centre of the plan. We also identified 12 policy areas where improvements could increase GDP by over R1-trillion, generate 1.5-million jobs, and increase tax revenues by R100 billion per annum. The 12 policy areas are:

1. Secure and affordable electricity supply,
2. Fast-track the green economy,
3. Implement Transnet's road-to-rail strategy,
4. Ports expansion,
5. Road infrastructure,
6. Full spectrum utilization,
7. e-learning and digital health platforms,
8. e-commerce acceleration,
9. Water infrastructure,
10. Maximize commercial agricultural output,
11. Import replacement focus, and
12. Increased financial inclusion and lower cost of capital.

The 10 high-impact sectors are: small, medium and micro enterprises and township economic development; energy and water; mining; construction; manufacturing; transport; agriculture; financial services; telecommunications; tourism and leisure. To drive such radical economic change fast, our assessment is that we need about R3.4-trillion of funding over three years, of which R2.4-trillion is needed by the public sector."

Business Day (13 July 2020) published an interview with Cas Coovadia (the CEO of BUSA) and I quote: "One often hears the phrase "when you come to a fork in the road, take it". But which of the two roads should one take? We are faced with one of two choices: our trajectory of economic and service decline, where we meander towards a failed state; or decisively choosing a path of recovery and brave reform that creates a more inclusive and totally transformed economy. For me, there is one choice."

For me, there is also only one choice. Despite that choice, my answer to my second question is that this will not be a quick one-year fix. Rather, it could be a number of years before we start to reap the benefits. Success requires brave and decisive leadership committed to: infrastructure, investment, transformation, anti-corruption, public-private partnerships and a capable state. At the time of writing this article, two important first steps in this process were announced:

1. South Africa has just been granted a loan from the IMF for $4,3 billion – the first in our history. Whilst it does not come with specific onerous conditions, the IMF has insisted that government continue to drive reforms, including a smaller state sector, reduced red tape and improved infrastructure.
2. In the Government Gazette dated 24th July 2020, the Government listed over 50 infrastructure projects that will receive priority attention and be fast-tracked through the approval process. These projects span the water, road, energy and housing sectors, amongst others.

Like most South Africans, we remain skeptical of our government, and its ability to deliver. Their track record is not compelling. Nonetheless, our economy and stock market will continue to offer selective investment opportunities, pockets of excellence and real returns. However, we will be watching developments more closely than ever to ascertain whether years of "talk" might finally be translating into some "action." But if ever I can use (or misuse?) Nelson Mandela's book title "Long Walk to Freedom" it is today. My economic book title would be – "SA has a long walk to Economic Freedom."

ASKING THE HARD QUESTIONS

Robin Gibson

A recent series of articles by financial journalists have raised an age-old question of what is the value of my adviser/asset manager in a period where performance has been lacklustre. It's a real question which we are sure clients will ask from time to time. I gave feedback to my son over the weekend on a monetary prize he won from a big financial institution 5 years ago, and which he was obliged to invest with them. They are a household name with solid credentials, but his response was less than complimentary when he heard the value change over 5 years!

1. Reward for perceived value

The concept of reward for perceived value is a common one that probably extends to multiple industries. Who hasn't complained about the fee to an estate agent, a doctor for a failed diagnosis, or an insurance salesman?

Taking this argument into the investment arena, let's consider two other vital cogs in recent investment disappointments, namely the directors and auditors. I am referring to those names associated with companies such as Aspen, Tongaat, Steinhoff and others! Did they deserve their 'wages' given some of the monumental failures?

I don't think there is a correct answer to these questions. As long as human beings are imperfect, systems of reward will also be imperfect. But therein lies the opportunity for innovation - just ask RyanAir or Amazon, for example.

2. Active versus Passive

Passive investing (investing in a low-cost fund that tracks a published index) has grown exponentially in recent times. One of the key success factors has been the ability of computers to interact with trading platforms to significantly reduce tracking error.

What is interesting however, is international trends. It may be too early to draw conclusions, but indications are that as passive funds proliferate and offer ever more complex alternatives, investors are seeking out asset managers to help them navigate through the passive options, and these passive options are increasingly being used in actively managed portfolios. We have also adopted this strategy at Harvard House, both in local and international portfolios, as they are useful tools to gain exposure to selected sectors or industries. This trend is less resource-intensive, especially with regard to analysts and manpower. Consequently, it drives down costs and allows us to reduce the overall cost of investing.

As an interesting aside (and I know the thought may seem ludicrous), have you ever considered the role of the active asset manager in the stock market ecosystem? By way of example, let us eliminate every active asset manager from the equation. How then does a growing company, which is not part of an index (such as Naspers in the 1990s) enter the Index? How does a company such as Steinhoff collapse and leave the index? If everything is passive, there is no relative change? Well, some sort of other mechanism would have to occur or at the ridiculous extreme, Naspers would have to buy a struggling 'Index Component' in order to have access to market exposure. Who would allocate capital to "rising stars" to drive them up the index? If we suddenly lived in a world with only passive investment funds, then returns would become commoditized, which in turn would drive investors to seek outperformance through some other mechanism – in much the same way that Private Equity (investing in unlisted companies) has become vogue in recent times or Hedge Funds have become a new catch phrase.

Passive investing is here to stay and it is a useful tool, and it may cap the fees that asset managers charge in the future. However, we believe active asset management also has its place and is also here to stay.

3. Index Investing

Journalists often write about asset managers failing to beat an index (for example, JSE All Share or Top 40 Index). The industry itself created the benchmarks and set the goal to beat them. This makes us fair game.

What is probably not so clear though is whether this is in the interests of investors. Benchmarks, ranking tables, performance awards – characteristics in so much of daily life – can lead to destructive behaviour from investors. After all, what is actually the point of investing? We believe it is to create a pool of wealth to provide passive income for when you no longer want to sell your services to an 'employer'. No more, no less. To be honest, anything else is probably just greed, and the biggest drivers in human investing behaviour are fear and greed.

So, what is realistic? We believe that over the longer-term an equity portfolio should exceed inflation by 4 to 6% per annum. A property portfolio should exceed inflation by 1 to 2% p.a. Cash will match or fall slightly below inflation. If you plan and save using this framework (and avoid investing in an asset class that only exceeds inflation by 2% over the longer term, or pay fees that effectively decrease your returns to the same or less than inflation), you should achieve your goals. There will definitely be times where you far exceed inflation (2008-2015) in equity and others where you barely beat inflation (2015-2020). However, on balance a return of 4-6% ahead of inflation is consistent over most geographies over the long term.

Here is the actual rub. Generally speaking, the majority of the population save poorly, spend excessively, are too conservatively positioned (and I believe that this has deteriorated further since personal fund selection was introduced into company pension funds), live beyond their means and arrive at retirement with an unrealistic expectation of what their meagre asset base can achieve. In many cases, individuals don't start to seriously think about retirement until their late 40s when the pressure to perform becomes immense. The asset management industry is now expected to produce miraculous results. Furthermore, any interruption to the growth trajectory creates anxiety and a search for alternatives.

Inflation in South Africa (as measured by CPI) averaged 4.83% per annum over the last 10 years. What is incredible is that 25% of the unit trusts listed in the SA General Equity Sector have achieved returns of CPI + 4 to 6% over that period, despite the fact that we are currently in the middle of a crisis. Inflation is seldom reported over longer periods, but in reality, CPI has average 5.6% p.a over the last fifteen years. That implies that a range of 9.6% to 11.6% would be very acceptable for equity returns over that period – and a period that included the GFC, the Zuma Administration and Covid-19. Of the 41 general equity funds that have a fifteen-year track record, 29 of them have met, or exceeded, that range.

I am certain that you, like myself, have read many articles highlighting the power of compounding. Research has proved that, despite the region or market, the compounding of dividends has been a more successful component of portfolio growth than rating change or share price escalation. This remains our emphasis in investing. After all, balance sheet is vanity and income is sanity (with apologies to an oft-used accounting truism.)

What follows are answers to some of the more often asked questions posed to advisers/asset managers:

1. What does it cost me to invest with you?

We try to keep all our fees below 1% per annum. There are instances where this is not possible if the investments are on a legislated platform that attracts fees from a third-party. We don't believe in performance fees. After all, we are incentivized if your portfolio grows as our fees also grow. However, the corollary to this scenario is often overlooked. We do as much work, if not more, in tough times for less income than we do in the good times. Helping you cope with emotion-sapping events like Covid and keeping you invested is not just self-serving as many imply. We still look after clients who have grown wealth with us for almost half a century, through other emotional times. Watching their patience and resolve versus those who pursue the next best thing or better returns at higher cost has demonstrated an indisputable fact - that just like the old fable, the tortoise isn't such a bad competitor.

2. What do you actually do for that money?

At Harvard House, we provide you with a suitably qualified financial planner to help you with the big picture, the tax implications, the planning of your goals and outcomes, to hold your hand in difficult periods and as a point of interaction. In addition, your asset manager invests (not speculates on a short-term share price expectation) in businesses with good management, a sound balance sheet and a sustainable business proposition. Over the course of a number of economic cycles (growth to recession to growth), these portfolio selections should grow their profits ahead of inflation and reward equity investors with a growing dividend. In order to grow returns ahead of boring old cash, these management teams need to take some risk, as do we in selecting them. The art of good asset management is making more good selections than bad ones. (We all have bad ones, sometimes more than one at the same time. If you believe we can avoid all risk, then we have given you a poor understanding of asset management).

We continue to communicate in hard times so that you might understand the dynamics of events as they unfold and why we may continue to believe that holding course is the correct decision. (We know that you may disagree with us, but as the old saying goes, "you can keep all of the people happy some of the time, and some of the people happy all of the time, but NEVER all of the people happy ALL of the time!"). This is in addition to the usual research and analysis that you would expect from an asset manager.

Finally, and possibly less excitingly, we process transactions and withdrawals, pay incomes, produce reports, and adhere to all the regulatory requirements and costs that come with running an asset manager.

"Being an asset manager is like being a Springbok flyhalf. You have to make decisions based on what's in front of you in real time."

3. Why does your performance differ to your peer group?

I remarked to a colleague the other day that being an asset manager is like being a Springbok flyhalf. You have to make decisions based on what's in front of you in real time, whereas every pundit, journalist and spectator can analyse a situation at leisure. The benefit of deciding what is important information and what is not important can c be accurately assessed after the fact. A TV program called "Seconds from Disaster" illustrates my point perfectly.

Asset management is about mandate and philosophy. Many may think it's cut and dried, but it is not. I have experienced two asset managers almost come to blows over differing views on the same shares – make no mistake both had superbly investigated arguments. One mandate or investment philosophy may allow investment into instruments that appear to be the darling of the market, but those invariably turn and as they say, every dog has its day.

I have a good example from my own experience of two clients who are siblings, but with different needs. The brother is still working and is therefore focused on growth. The sister requires a significant income. The tricky part is that the brother is the caretaker of his sister's investments!

In the early to mid-2000's the sister's portfolio had a substantial component in listed property to meet her income requirement. The brother, who did not require income, had substantially less exposure to property. I would have repeated engagements with him because the sister's portfolio was outperforming his. I explained that property was the factor – "shouldn't we have some then" was his reply. I am sure I don't need to explain that the performance of his portfolio in more recent times has exceeded that of his sister.

Sadly, Dan Airley has proved to us in his book Predictably Irrational that we have a flawed decision-making process. We cannot avoid comparison. Yet it is comparison that proves our undoing in the investment arena largely because we pursue historic returns that may or may not be repeated – and often damage us in the process.

We, being Harvard House, have an income-focused approach. Consequently, we have held property when others have shunned it. We are currently underperformers relative to some of our peers, and especially in the face of fears around Covid-19 and the results for landlords. However, while we may be an underperformer in recent times, when we measure ourselves over the longer term and back test on an apples-for-apples basis, we are no worse (or better) than those same competitors when property was our tailwind. In our investing history we have seen the gold boom, the tech boom, the financials boom, the small cap boom, the bitcoin boom, and many others. The list goes on. They flourish and shine for a time, but eventually quality is the sole decider of longevity rather than trend, and the tortoise comes plodding out of the gloom!

4. Why are we better at it than 100 other people who offer a similar product?

It is a great question, but actually a little ingenious. Firstly, if 100 different people can offer the same product (and remain sustainable) then they cannot be accused of not adding value. Secondly, it is the same answer to the question of why can we have so many car brands that do the same thing. Why choose Mercedes over BMW or VW over Toyota? The answer is simple. If your product can deliver most of what the client needs and they want your styling or like your brand or trust your ethics and they perceive value at your price point then you have a future. What does a Porsche Cayenne really give you over a Toyota Fortuner given the price difference? Beyond prestige, it is hard to say, but it is up to the buyer to decide.

For us, we believe our investment philosophy has proved itself over a long time. We believe we offer an excellent midway offering between a Financial Adviser with off-the-shelf products and a bespoke high net-worth offering, with the added benefit of an all-in cost that compares favourably with index products. Most importantly, however, we believe that our integrity is the critical success factor that differentiates us from the pack and has been built up over more than 4 decades of business.

5. What does the future hold? Should I not simply switch to a low index product?

We do not know what the future holds, although many people do believe we should have absolute certainty of foresight. We think people can do a lot worse than buying an index product. We would however warn that not all index products are the same and investors should certainly do some investigation and at least pay a professional (on a time basis) for some insight. We believe wholeheartedly in reducing the cost of investing. Equally, we believe that risk is necessary to achieve your goals – will you take the right risks for your circumstances and goals? We think you should rather consider the following questions and your answer to them:

- Do I know what I am trying to achieve and the time frames to achieve them?
- Does the long-term history of my portfolio asset classes support my objectives and the future of the funds in which I am investing?
- Am I expecting my asset manager to solve an investment problem for me - whether it be insufficient assets, excessive expenditure or unrealistic expectations?

There is a famous financial professional named Morgan Housel of the Collaborative Fund (www.collaborativefund.com) and he writes an amazingly thought-provoking Blog. If you haven't read it, do yourself a favour and have a look. It is world-class. In his Blog of 28 January this year, he quoted from a book by Jim Paul and Brendan Moynihan entitled "What I Learned Losing a Million Dollars". The quote was as follows:

> "The potential for temporary success by pure luck beguiles people into thinking that trading is a lot easier than it is. The potential for even temporary success doesn't exist in any other profession. If you have never trained as a surgeon, the probability of your performing successful brain surgery is zero. If you have never picked up a violin, your chances of playing successful solo violin in front of the New York Philharmonic are zero. It is just that trading has this quirk that allows some people to be successful temporarily without true skill or an edge—and that fools people into mistaking luck for skill."

We remain committed to achieving client goals and delivering quality financial services with integrity and transparency. We haven't always got it right, and the recent past has certainly been more challenging. We continue to assess, analyse and pursue improvement for the benefit of both our clients and ourselves and we are grateful for those clients who choose to join us in the process and place their confidence in us.

ENHANCEMENTS TO PERSONAL INCOME TAX & CHANGES TO 2020 TAX FILING SEASON

Shelly Moreno

SARS has made enhancements to the Personal Income Tax (PIT) system, automating registration and improving their on-line communication channels. This will make it easier for taxpayers to remain compliant and reduce the need for individuals to queue at a SARS branch.

New SARS enhancements to PIT are highlighted below.

- **Automated Registration.** As from 27 March 2020, a taxpayer can now register for personal income tax by SARS auto-registration on the SARS website. This is provided a taxpayer has a valid South African ID number.
- **Notice of Registration Available on eFiling**. A taxpayer can now obtain a Notice of Registration (IT150) on eFiling, which was previously not available on-line. This enables taxpayers to view their registration details are correctly recorded by SARS.
- **Taxpayer Approval for Tax Type Transfer Process**. SARS has made it easier to transfer tax types for an individual on eFiling between taxpayers, tax practitioners and registered representatives. Previously, when requesting a transfer of tax types for an individual, the holding user was required to release the transfer to the requesting user. Now, the approval lies directly with the taxpayer (owner of the PIT), or the registered representative, to transfer the tax type to the requestor. Transfers of tax types for individuals are no longer dependent on the holding user releasing it. However, tax type transfers for companies, trusts or other entities still require the holding user to release the transfer.
- **On-line Appointment System with SARS Consultant.** Previously only tax practitioners could make an appointment with SARS, while the rest of the public were required to queue at a SARS branch. SARS has introduced a new on-line appointment system, called the SARS Branch eBooking System, which is available to all taxpayers, or their representatives, and tax practitioners, provided they already have a tax number.
- **On-line Query System.** Taxpayers who are not on eFiling were previously required to go into a SARS branch to submit supporting documentation. SARS has now introduced a SARS online query system. Taxpayers who are not on eFiling can now submit their supporting documents by completing the online query form on the SARS website. Taxpayers can also submit a payment allocation query using the same process. eFilers are still encouraged to continue using services on their eFiling profiles to upload supporting documents.
- **Streamlined Banking Details Verification Process.** Previously SARS required taxpayers to go into a SARS branch to verify or update their banking details. A taxpayer can now submit supporting documents to verify, add or change their banking details online. This can be done either via eFiling, via the SARS website using the SARS online query system (mainly for taxpayers who are not eFilers), or via email in exceptional circumstances.
- **On-line Tax Directive Application for IRP3(b) and IRP3(c).** Previously pension / provident fund administrators, or employers with an eFiling organization website profile, completed different SARS forms to apply for a tax calculation on a lump sum payable to clients on retirement or resignation. SARS now allows individual taxpayers and tax practitioners to submit the IRP3(b) and IRP3(c) directive application forms via eFiling. These tax directives allow employees tax to be deducted at a fixed percentage / fixed amount. IRP3(b) and IRP3(c) hardcopy applications will no longer be processed.
- **Integrated Email System.** SARS has integrated their email system with their automated case management system, to allow taxpayers, under exceptional circumstances, to send queries via email. This has enabled SARS staff working from home to resolve taxpayer queries.

Changes to the 2020 Tax Season

The 2020 tax year covers the period 1 March 2019 to 29 February 2020. In the past, SARS tax filing season has traditionally opened on 1 July each year.

SARS has introduced three different phases to the 2020 personal income tax filing season, with specified dates for each phase. The first phase focuses on employer filing, the second is on tax file updates, while the third focuses on employee filing.

Phase 1: employer filing (15 april 2020 to 31 may 2020)
There is a renewed focus on third party data providers (e.g. employers, financial institutions, medical schemes and retirement annuity fund administrators) to be fully compliant in terms of their filing and payment obligations. The deadline for the employer annual reconciliation process was 31 May 2020.

SARS uses third party information to pre-populate tax returns. IRP5s, IT3(a)s, medical amounts, local and foreign interest, local and foreign dividends, dividend withholding tax, REIT taxable dividends and local and foreign capital gains and losses will be pre-populated on a taxpayer's income tax return.

Phase 2: tax file updates (1 june 2020 to 31 august 2020)
In this phase, taxpayers need to check that SARS has correctly recorded their personal details, including banking details, postal and physical address, email address and telephone numbers. eFilers will be able to do these checks on eFiling.

If a taxpayer has not yet received their IRP5s, IT3(a)s or other tax certificates (medical, retirement annuity fund or any other third party data relevant to their tax return) during this phase, SARS requires that the taxpayer approach the third party to ensure that they have complied with their submission requirements.

If a taxpayer identifies that there is an error with regards to the third-party data, the taxpayer needs to request the third party to correct the error. The third party is required to resubmit the corrected information to SARS. SARS will pre-populate the taxpayer's return with the corrected information.

Based on third party information submitted, SARS will auto-assess those taxpayers who meet certain criteria regarding their income composite. SARS has stipulated that there is no need for a taxpayer to contact SARS, and that SARS will contact those taxpayers who they have selected for auto-assessment. SARS will contact the taxpayer via SMS in August. The taxpayer will be given the opportunity to either accept or decline the proposed assessment.

If the taxpayer accepts SARS auto-assessment, they do not need to submit an income tax return. If there is any under or over-payment of tax, this will be processed as normal. However, if a taxpayer accepts the auto-assessment, it is important to note that SARS will ultimately hold the taxpayer accountable for the information reflected on the assessment. It is important to check that SARS has correctly reflected any carry forwards from the previous assessment to the auto assessment, the correct amounts have been pre-populated by SARS and nothing has been erroneously omitted from the auto-assessment. For our clients, we will check the auto-assessment carefully and compare the result to our independent calculation, before advising a client whether to accept the auto-assessment or not.

If the taxpayer does not accept the auto-assessment, the taxpayer will be required to submit an income tax return. This return can only be submitted from 1 September 2020.

Similarly, if SARS requires a taxpayer to submit a tax return, they have stipulated that they will notify the taxpayer.

Phase 3: employee filing (1 september 2020 to 31 january 2021)
Taxpayers can submit their income tax returns from 1 September 2020.

If a taxpayer has not accepted the SARS outcome of an auto-assessment, the following deadlines apply:

- Non-provisional taxpayers who choose to submit their tax return by visiting a SARS branch, must file their return by 22 October 2020.
- Non-provisional taxpayers who use eFiling, must file their income tax return by 16 November 2020.
- Provisional taxpayers who use eFiling, must file their income tax return by 31 January 2021.

Should you have any queries about your tax affairs, please feel free to contact our tax department and we will be happy to assist you.

Given the prevailing circumstances, the speed at which conditions are changing, and guidelines from Government on social distancing, our Insight seminars will be postponed until further notice.

Please RSVP to Clare Mitchell on 033 3302164 or clarem@hhgroup.co.za.

Topic:	**N/A**
Natal Midlands	
Date:	N/A
Venue:	Fernhill Hotel Midmar / Tweedie Road (almost opposite entrance to Midmar
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm
Johannesburg	
Date:	N/A
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

CONTACT DETAILS:

For more information on the range of products and services offered by Harvard House Investment Management and its associated companies (including Harvard House, Chartered Accountants), or for any financial advice, please contact the Company at:

HARVARD HOUSE GROUP

3 Harvard Street, Howick, 3290, South Africa

P.O. Box 235, Howick, 3290, South Africa

+27 (0) 33 330 2164

+27 (0) 33 330 2617

@ admin@hhgroup.co.za

W www.hhgroup.co.za