Vickers & Peters

LIFESTYLE AND ASSET PLANNING

"Around the Table with Vickers & Peters Financial Planning"

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Misconceptions surrounding life insurance

On the Table this quarter…

On the surface, life insurance may seem like a simple product. However, there are many elements that must be considered carefully in order to arrive at the appropriate type and amount of cover. Generally, the technical aspects of life insurance are far less difficult for most people to deal with than trying to get a handle on how much cover they need and why. In this article we will briefly examine the misconceptions surrounding life insurance and the realities that they distort.

I absolutely MUST have life insurance regardless of my financial situation.

Persons with no debt or dependents and sizable assets may be better off self-insuring. If you have no debt and medical and funeral costs are covered, then life insurance cover may be optional.

Only breadwinners need life insurance cover.

The cost of replacing the services formerly provided by a deceased partner can be higher than you think, especially when it comes to managing the home and childcare. If there are dependents, this cost could fall out of your budget, meaning an immediate change in lifestyle and spending habits is your only option.

I'm single and don't have any dependents, therefore I don't need any cover.

Even single people need at least enough life insurance to cover the costs of personal debts, medical and funeral bills. If you are uninsured, you may leave a legacy of unpaid expenses for your family or executor to deal with.

I'm better off investing my money than buying life insurance of any kind.

Until you reach the breakeven point of asset accumulation (debt free with enough cash flow to cover family lifestyle), you will need life cover of some sort. Once you have reached the breakeven point, you can consider whether to discontinue (or at least reduce) your life cover. But you take a big chance when you depend solely on your investments in the early years of your life, especially if you have dependents. If you die without cover for them, there may be no other means of provision after the depletion of your current assets.

I only need an amount of life insurance cover equal to twice the amount of my annual salary.

You need an amount of life insurance equal to the amount that is actually required. In addition to medical and funeral bills, you may need to pay off debts such as your home loan and provide an income for your family for several years. A Financial Needs Analysis or Cash Flow Analysis is usually necessary in order to determine the true amount of insurance that must be purchased - the days of computing life cover based only on one's income-earning ability are long gone.

My life insurance through the company retirement fund is sufficient.

For a single person of modest means, employer-paid insurance may well be enough. But if you have a spouse or other dependents, or know that you will need cover upon your death to pay estate duty expenses, then additional cover may be necessary if the policy does not meet the needs of the life assured. One needs to also be aware of whether or not the group benefits offered from your employer are approved or unapproved benefits. If the benefits are approved then the risk benefits are taxable and provisions should be made accordingly.

At least the cost of my premiums will be deductible.

Your contribution to your company pension fund is tax deductible; however, the premiums of a life insurance policy in your personal capacity are not, unless the policy is a company owned policy and meets the conditions set out in terms of Sect 11 (w) of the Income Tax Act.

I should ALWAYS buy term life cover because it's cheaper and invest the difference.

Not necessarily. The cost of term life cover can become prohibitively high in later years; therefore, those who know for certain that they must be covered at death should consider whole of life cover. If structured correctly and the right premium pattern selected, the total premium outlay for a whole of life policy may be less than the total premiums of a term policy.

There is also the risk of non-insurability to consider as you get older. If the term cover has expired and further cover is needed, this could be disastrous for those who may have estate tax issues and need life insurance to pay them. But this risk can be avoided if the correct amount of cover was taken with whole of life cover.

Universal life policies are always superior to stand alone life policies over the long run, because of the long-term growth potential of the investment portion.

Many universal policies contain several layers of fees relating to both the insurance and investment elements present in the policy. Therefore, if the variable subaccounts within the universal policy do not perform well, then the policyholder may well see a lower cash value. In this example, the policyholder would have a poor trade off if a universal life policy was chosen over a standalone policy.

I should always purchase rider benefits when purchasing life cover.

There are different types of rider benefits available for policies that offer this feature. Some people feel that rider benefits are not a viable option and should be avoided. Whether you include rider benefits will depend on your risk tolerance, disposable income and other possible investment objectives.

A Cash Flow Analysis will reveal whether you could come out ahead by investing the additional amount of the rider elsewhere versus including it in the policy. Riders are available to provide additional benefits that help you customize your policy. Rider benefits can be cheaper than stand alone benefits but can reduce if there is a claim on either of the underlying policy benefits.

Conclusion

These are just some of the more prevalent misunderstandings concerning life insurance that the public faces today. The key concept to understand is that you shouldn't leave life insurance out of your budget unless you have enough assets to cover expenses after you're gone. For more information, consult your VPFP financial advisor.

Summary

Why life cover?

- Family protection
- Debt protection
- Key person cover – business contingency
- Buy & Sell cover – shareholders insurance

Market Update

Introduction

The South African investment environment in the third quarter of 2010 was characterized by rand strength driven by continued foreign currency inflows particularly into the domestic bond market (approximately R36bn). This led to the rand strengthening against the US Dollar by 9% during the quarter (7.81 to 6.95). The continued decline in domestic inflation also led to a further 0.5% interest rate cut by the South African Monetary authorities.

The increase in global risk appetite resulted in the domestic and international equity markets performing extremely well (positive returns in excess of 10%) and this in conjunction with positive returns from fixed interest markets resulted in positive quarterly returns for all the VPFP Funds which may be summarized as follows:

Domestic – SA Rand performance

VPFP CPI + 2	4.93%
VPFP CPI + 4	5.43%
VPFP CPI + 6	6.77%

International – US Dollar performance

VPFP International Cautious Fund	4.73%
VPFP International Growth Fund	8.91%

Looking Forward

Your investment team considers the following factors to be the primary drivers of performance given current valuations:

1. **Domestic**

   a. **Equity**

   While the historic Price Earnings Ratio ("PE Ratio") of the JSE All Share Index looks expensive at around 16.5 times, a one year forward PE Ratio of around 12 times (based on current analyst forecasts) looks very attractive particularly if interest rates remain lower for an extended period of time. Accordingly we are diligently monitoring actual earnings announced against forecast earnings as it is our intention to slowly increase equity exposure should improved forecast earnings materialize.

   b. **Fixed Interest and Property**

   While current real yields (yield on fixed rate bonds less the inflation rate) do not look particularly overstretched, we remain concerned about the sustainability of current prices. This is primarily driven by the potential impact of any rand volatility on domestic inflation in conjunction with the continued need for the SA Government to issue new stock to fund capital commitments.

   We have therefore moved underweight property and nominal fixed rate bonds and should the SA Rand weaken materially, we will be moving further into inflation linked bonds.

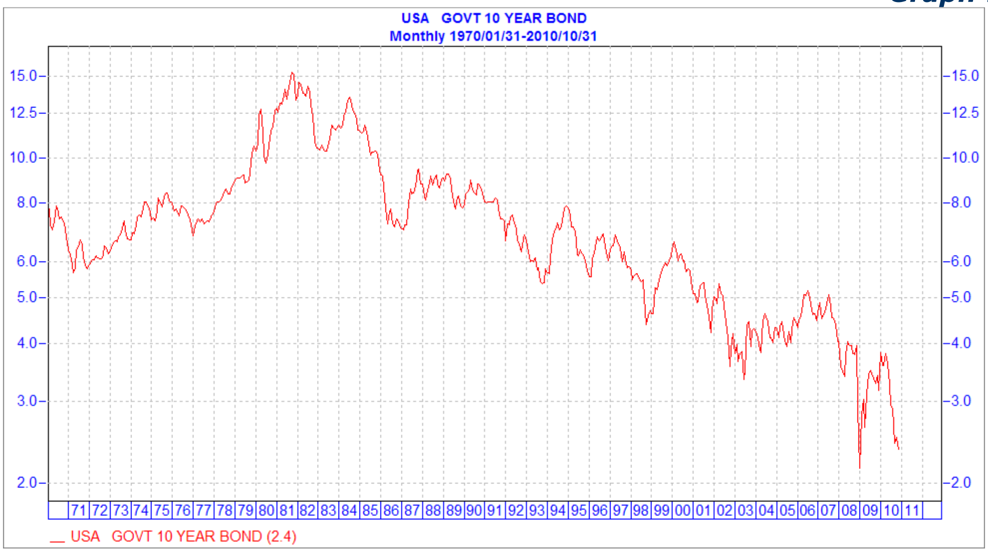
2. **International**

   a. **Equity**

   We continue to look for opportunities to up-weight international equities from our current neutral weighting. We do believe that both developed world multi-national and emerging market growth businesses have the ability to deliver superior returns over the next three years should the current low global interest rate environment persist and the economic environment continue to stabilize.

   b. **Fixed Interest**

Graph 1



It is perhaps this asset class that provides your investment team the greatest concern. **Graph 1** represents the 40 year performance of the US Government 10 year bond. Clearly investors have enjoyed material risk adjusted returns over the period as interest rates declined. Based on the current yield of around 2.5% in comparison to long term prices, we do feel that our current underweight position in this asset class is justified. A strong case can be made that it is going to be increasingly difficult for US Monetary authorities to maintain the current low levels of both long term and short term interest rates.

Conclusion

As alluded to in the last quarterly newsletter, your investment team focuses first on the risk of losing your money and secondly on the ability to make money. Our investment process therefore tends toward reasons why we may be wrong when looking to overweight a risk asset class. It is this "more prudent" approach to money management that we believe allows you, our client, to effectively plan your lifestyle during ever increasing economic volatility.

In the correspondence ahead, we look forward to providing you with increased insights into how we manage money and how we assist in entrenching what we believe to be a prudent approach to money management and (perhaps more importantly) financial planning.

Short Term Insurance Offering

We are delighted to announce that we have formed an association with Hamtern Financial Services, a specialist short term broking business. Hamtern operate from our offices in Rivonia which allows us to work extremely closely with them, and making it convenient for you to see both businesses' in a single visit.

Hamtern's focus is on providing business insurance and risk management solutions to commercial and corporate enterprises, as well as personal insurance solutions. The business related insurance products on offer have been customised by Hamtern and are available exclusively through their brokerage. Similarly, their Personal Asset Care policy is a unique product, rivaling the top end products offered by the banks and national brokers, both in terms of pricing and scope of cover.

We would like to personally introduce our new business partners to you, however should you require their services in the interim, please click on the appropriate e-mail address below.

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Thank you for your ongoing support of VPFP and trust you will give consideration to using the services of Hamtern for all your short term insurance requirements.

Yours sincerely,

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Our services include…

- Pre and Post Retirement Planning
- Local and Global Investments
- Business Assurance – Keyman and Partnership
- Personal and Group Life Assurance
- Employee Benefit Advice and Products
- Tax and Estate Planning

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