Vickers & Peters
LIFESTYLE AND ASSET PLANNING

Around the Table with Vickers & Peters Financial Planning

Issue 27 – July 2013 Quarterly Publication *Compiled by Graeme Holt*

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Managing your Pension drawdown rate

One of the biggest challenges in retirement planning is calculating how much capital is needed to ensure a sustainable lifetime pension.

At present, a retiree has two options when selecting a pension, either a **Living Annuity** or a **Traditional Guaranteed Annuity** can be selected.

Living annuities differ from traditional annuities in that the investor assumes the investment and mortality risk in full. In return the annuitant controls the underlying investment selection, annuity level and the ownership of the asset which will form part of the annuitant's assets, which on death is allocated to his or his nominated beneficiaries.

Because the annuitant assumes the risks, there is no guarantee from the life company that funds will be available to provide an income for life. Selecting a drawdown level that is too high and/or poor investment performance can lead to a reduction in the capital value, reducing the annuity in real terms. However, if managed correctly the Living Annuity can be a valuable asset, providing an income for generations.

Successful retirement planning requires the input of many variables (economic and demographic) which are sometimes difficult to determine and will change over time, which is why planning for retirement needs to be an ongoing process which is retested periodically with your financial advisor. By example, if you are a South African male retiring at age 65, your life expectancy is 15 years. But your potential investment horizon is longer, as you may live longer than the average retiree. The prudent approach would therefore be to plan your affairs to have a sustainable income for at least 25 years.

To mitigate the risk of your Living Annuity being exhausted during your lifetime, VPFP have taken steps to assist clients with managing the income drawdown relative to the investment return by modeling and implementing a retirement strategy that suits your needs. The retirement strategy is a guide to ensure clients pension money lasts the distance and beyond.

Clients can use the table below (endorsed by the Association of Savings and Investments SA (ASISA)) as a general guideline for selecting the appropriate income level to ensure the sustainability of your retirement income. A detailed retirement analysis can be conducted with your VPFP financial advisor to ensure that your unique circumstances are taken into account providing a more accurate "real life" assessment.

Table 1 **Source: ASISA**

Years before your income will start to reduce

Annual income rate selected at inception	Investment return per annum (before inflation & after all fees)				
	2.50%	5.00%	7.50%	10.00%	12.50%
2.50%	21	30	50+	50+	50+
5.00%	11	14	19	33	50+
7.50%	6	8	10	13	22
10.00%	4	5	6	7	9
12.50%	2	3	3	4	5
15.00%	1	1	2	2	2
17.50%	1	1	1	1	1

A **Living Annuity** allows you to set your income level subject to constraints imposed by the authorities. Currently an annuitant may select an income between 2,5% and 17,5% per annum. It is important to note that the table above assumes that you will adjust your percentage income selected over time to maintain the same amount of real income (i.e. allowing for inflation of 6% per annum). Once the number of years in the table above has been reached, your income will start decreasing in the subsequent years.

The often mismanaged variable of living annuities is extrapolating past performance for future performance. Often we see clients increasing their annuity income after a year of good returns believing that next year's performance will be the same or even better - the reality is usually quite different. Market performance does not go up in a straight line and there are periods of volatility and below benchmark performance. To overcome this pitfall of variable returns, a benchmark performance should be used for the full duration of the retirement analysis and your drawdown rate should commensurate this assumption. We are delighted to report that all the VPFP funds have outperformed their benchmark objectives (please see Market Review and Performance on page 8) allowing our financial planners to apply the expected rate of return to their retirement income models with conviction.

Managing retirement income draw downs is not always easy because of the vagaries of life but following a few fundamental steps can make planning for a particular outcome a lot more predictable and life a little easier.

If you would like to review your retirement situation or are aware that your current withdrawal level is too high, please contact your financial planner or client servicing.

Fundamental Checklist for Income clients

Objective: Making your capital last while sustaining your standard of living

- Decide on a level of income high enough to fund an acceptable living standard but low enough to make this living standard sustainable. Implement a realistic retirement strategy.

- Invest in a fund that can limit the variability of returns from year to year and still be able to protect you against the eroding effects of inflation. Choose a fund that produces a reliable yield and a low risk of capital loss month to month. (The VPFP Funds which have benchmarks of +2, +4, +6% above inflation, can assist in developing a sustainable strategy).

- Adequate exposure to growth assets is imperative, especially in the early years of retirement i.e. don't be ultra conservative and get stuck in a money market portfolio. (The VPFP Funds have an optimal asset allocation mandate set relative to each VPFP funds benchmark, so the retiree need not worry about asset allocation decisions or whether or not they are sufficiently exposed to growth assets).

- Your income level will be **unsustainable** if:

    1. The annual income selection is above the annual fund yield.
    2. Long term investment performance is unreliable.
    3. Longevity is not considered in the retirement plan. (Living beyond your life expectancy)

Why the VPFP funds should be your preferred income solution

Following from the previous article "Managing your Pension drawdown rate" I would like to illustrate by way of example why investment performance needs to be reliable, especially for retirees and income dependent clients. One of the fundamentals we pointed out in the article was that clients need to invest in a fund that can limit the variability of returns from year to year and still be able to protect you against the eroding effects of inflation. Clients need to choose a fund that produces a reliable yield and a low risk of capital loss month to month.

Example: a retiree, Mr Z has decided to invest his retirement funding into a Living Annuity. In Mr Z's retirement planning model it was identified that an investment return of CPI +4% is needed to sustain his required level of income for his life expectancy. Mr Z has a choice between selecting Fund A which has a benchmark of CPI +4% with risk of capital loss but with high potential for outperformance **or** Fund B which also has a benchmark of CPI +4% but with a low risk of capital loss and low potential for outperformance.

Assumptions: both Fund A and Fund B have an initial capital investment of R1 000 000.00, a yearly income drawdown rate of 6%, and an annual return of 10% (geometric return). For simplicity we have used one year of variable monthly performance for our series of returns – please see page 4 & 5 for graphic illustration.

The Fund that Mr Z decides to invest in will have different implications for his investment capital. If Mr Z elected Fund A over Fund B, Mr Z will have less capital than in Fund B at the end of year one. Likewise, if Mr Z elected Fund B over Fund A, Mr Z will have more capital than Fund A at the end of year one. The reason for this is the high level of volatility associated with Fund A and the fact that Fund A has negative returns versus the reliable positive monthly returns of Fund B. Although the up months in Fund A were at times a lot higher than in Fund B, Fund A's down months showed capital losses. Fund B had no months of capital losses and therefore the compounding effect of month on month positive returns cannot and will not be matched by Fund A.

If we extrapolate this example over a number of years the disparity in capital value of the two funds continues to widen. In the end this could make the difference between Mr Z retirement plan going the distance of not.

At VPFP we believe in managing assets based on Fund B's investment philosophy –don't lose money. The allure of potentially higher investment returns can be an investor's undoing. Be realistic about your expectations - identify your income need and the required rate of return to sustain your income and invest in a fund with reliable investment returns. The VPFP funds offer clients the full array of target return profiles, from our conservative CPI +2%, to the moderate CPI +4% and aggressive CPI +6%. With the assistance of your financial planner the right fund can be identified for you. Clients can take solace that all three of the VPFP funds have outperformed their benchmarks over 1yr, 2yr, 3yr and 4yr periods with lower volatility than the market.

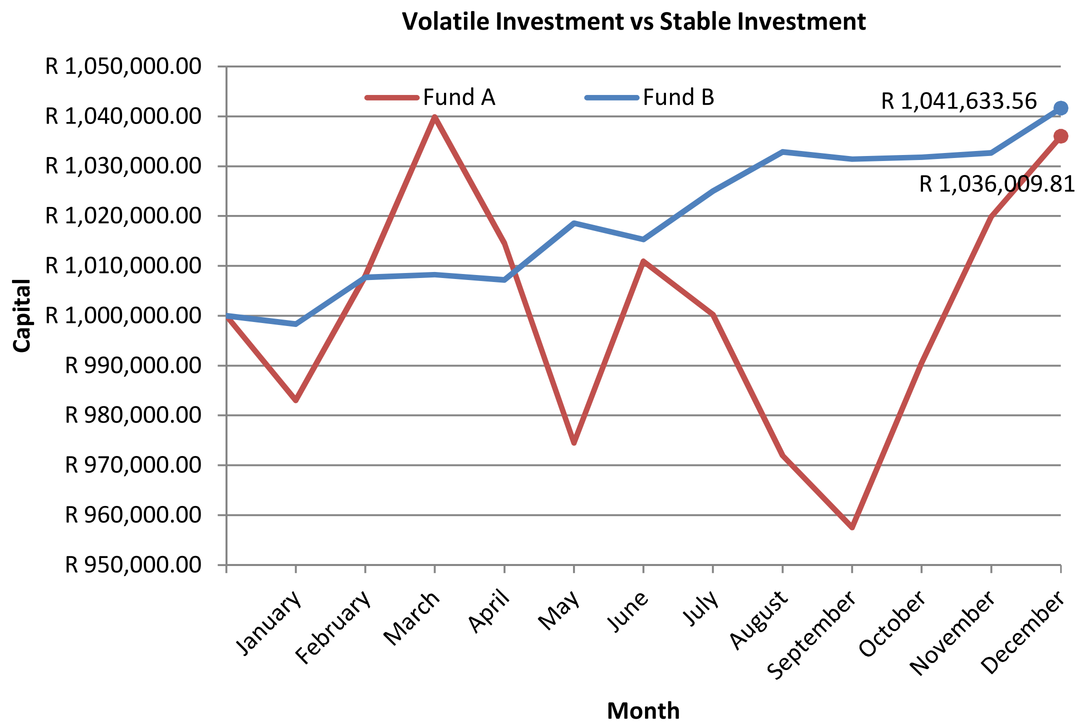
It's interesting to note that given the assumptions for the above example, in order for Mr Z investment capital to increase in line with inflation (6% pa), after income payments, Mr Z would need an annualised return of 13% or alternatively a drop in his income to 3.5% pa.

* The ALSI has returned an annualised 14.28% for investors from March 1967 to Jan 2010 – Glacier Research

Capital	R 1,000,000.00
Annual Income %	6%
Annual Return %	10%

Fund A					
		Invested Capital	variable Monthly return	Monthly income	Capital reinvested
					R 1,000,000.00
January	-1.20%	R 1,000,000.00	R 988,000.00	R 5,000.00	R 983,000.00
February	3.05%	R 983,000.00	R 1,012,981.50	R 5,000.00	R 1,007,981.50
March	3.66%	R 1,007,981.50	R 1,044,873.62	R 5,000.00	R 1,039,873.62
April	-1.96%	R 1,039,873.62	R 1,019,492.10	R 5,000.00	R 1,014,492.10
May	-3.45%	R 1,014,492.10	R 979,492.12	R 5,000.00	R 974,492.12
June	4.25%	R 974,492.12	R 1,015,908.04	R 5,000.00	R 1,010,908.04
July	-0.56%	R 1,010,908.04	R 1,005,246.95	R 5,000.00	R 1,000,246.95
August	-2.33%	R 1,000,246.95	R 976,941.20	R 5,000.00	R 971,941.20
September	-0.97%	R 971,941.20	R 962,513.37	R 5,000.00	R 957,513.37
October	3.97%	R 957,513.37	R 995,526.65	R 5,000.00	R 990,526.65
November	3.47%	R 990,526.65	R 1,024,897.92	R 5,000.00	R 1,019,897.92
December	2.07%	R 1,019,897.92	R 1,041,009.81	R 5,000.00	R 1,036,009.81
Geometric Return	**10.00%**		**Compound Return (Net income)**		3.60%

Fund B					
		Invested Capital	variable Monthly return	Monthly income	Capital reinvested
					R 1,000,000.00
January	0.33%	R 1,000,000.00	R 1,003,300.00	R 5,000.00	R 998,300.00
February	1.44%	R 998,300.00	R 1,012,675.52	R 5,000.00	R 1,007,675.52
March	0.55%	R 1,007,675.52	R 1,013,217.74	R 5,000.00	R 1,008,217.74
April	0.39%	R 1,008,217.74	R 1,012,149.78	R 5,000.00	R 1,007,149.78
May	1.63%	R 1,007,149.78	R 1,023,566.33	R 5,000.00	R 1,018,566.33
June	0.17%	R 1,018,566.33	R 1,020,297.89	R 5,000.00	R 1,015,297.89
July	1.45%	R 1,015,297.89	R 1,030,019.71	R 5,000.00	R 1,025,019.71
August	1.25%	R 1,025,019.71	R 1,037,832.45	R 5,000.00	R 1,032,832.45
September	0.35%	R 1,032,832.45	R 1,036,447.37	R 5,000.00	R 1,031,447.37
October	0.52%	R 1,031,447.37	R 1,036,810.89	R 5,000.00	R 1,031,810.89
November	0.57%	R 1,031,810.89	R 1,037,692.22	R 5,000.00	R 1,032,692.22
December	1.35%	R 1,032,692.22	R 1,046,633.56	R 5,000.00	R 1,041,633.56
Geometric Return	**10.00%**		**Compound Return (Net income)**		4.16%


Volatile Investment vs Stable Investment
Fund A
Fund B
R 1,041,633.56
R 1,036,009.81
R 1,050,000.00
R 1,040,000.00
R 1,030,000.00
R 1,020,000.00
R 1,010,000.00
R 1,000,000.00
R 990,000.00
R 980,000.00
R 970,000.00
R 960,000.00
R 950,000.00
Capital
January
February
March
April
May
June
July
August
September
October
November
December
Month

Flexible Investment Option

At VPFP we are committed to providing you with superior investment solutions and ongoing client service. If you are looking for full liquidity on your investment capital with investment flexibility, then the **Flexible Investment Option (FIO)** is the right choice for you.

The FIO is a voluntary investment (after tax money) that allows single lump sum contributions or regular monthly contributions. There is no lock in terms or conditions, no penalties on withdrawals or if you decide stop your regular (monthly, quarterly, yearly, ad hoc) contributions.

Clients looking for an alternative to holding cash in the bank or sitting in money market accounts can access the VPFP range of funds or a range of both local and offshore unit trusts and shares through the FIO.

Product Features

Flexible investing – a range of underlying investment options make it easy to build a diversified portfolio.

Investment liquidity – you have full access to your capital at all times. No investment restrictions or product terms apply.

Income requirements – you can access a regular income from your investment.

Investment term - There is no investment term that applies to this product. There are no limits for making investments. You may invest once-off or regularly.

Investment minimums - R50 000 for local investments and R1 000 a month for regular investments.

Tax - You may have to pay tax on your investment returns. This includes tax on interest received and realised capital gains. A Capital Gains Tax event happens when units are disposed of. Tax exemptions for individuals apply. The product administrator will give you an IT3(b) certificate that shows the interest and dividend income earned. The administrator will also give you an IT3(c) certificate that shows all realised capital gains. The administrator will withhold DWT on dividends received from South African companies or foreign companies listed on the JSE. Collective investments scheme distributions are also subject to DWT when it includes dividends.

Exemptions – as an individual investor, you can use your annual interest income and Capital Gains Tax exemptions.

Different investor types – the Flexible Investment Option is not only suited to individual investors but also to trusts, companies and close corporations.

If you would like further information please contact your financial advisor or client services.

Market & Fund Performance Update

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Macro Overview

Volatility and uncertainty reigned throughout the second quarter, amid commotion surrounding the continued debate on quantitative easing versus potential tapering.

On 2 May, the ECB cut rates for the first time in 10 months to an all-time low of 0.50% and claimed that it stood ready to move deposit rates from 0.00% into negative territory, thereby continuing to back the stimulus argument.

In the US, fears around possible tapering emerged at the May Federal Open Market Committee (FOMC) meeting when Fed Chairman, Ben Bernanke, stated that the Fed may begin to taper its bond-buying program (QE) in the coming months. At the June FOMC meeting, the Fed kept the target interest rate unchanged at all-time lows and committed to continue purchasing $85 billion a month of agency mortgage-backed securities and longer-term Treasury securities. But at the same time, Bernanke once again announced that the Fed *could* begin tapering their bond purchase program before the end of 2013, depending on a number of key data statistics, namely economic growth, unemployment and inflation. Markets reacted negatively to this news, with most asset classes across the board losing ground.

A number of key points need to be highlighted: US unemployment must reach 7.25% to begin tapering. Unemployment rose to 7.60% in June. It is expected to decrease to 7.50% in July. In addition, the inflation rate needs to increase closer to the Fed's 2.00% target. US inflation came in at 1.40% in June. On 26 June, US Q1 GDP was revised down from an estimated 2.40% to 1.80%. From this perspective, it is unlikely that the Fed will decrease stimulus in the near future. In addition, Fed officials later moved to quell investor panic, commenting that QE would remain in force *unless* economic performance improved and that any tapering of QE would be dependent **on that fact alone** and not on a calendar date specifically. Another important note, Bernanke also reiterated that the interest rate will remain at historically low levels for a considerable time, even after the asset purchase program ends.

The market reaction seems highly emotional and may have been premature. In light of all of the above, it appears that for the time being, the US also remains accommodative.

Although for the most part, economic activity has been improving, the recovery remains subdued. Coupled with continued easing inflation (and fears of deflation), this is likely to encourage central bankers across the globe to remain accommodative for longer.

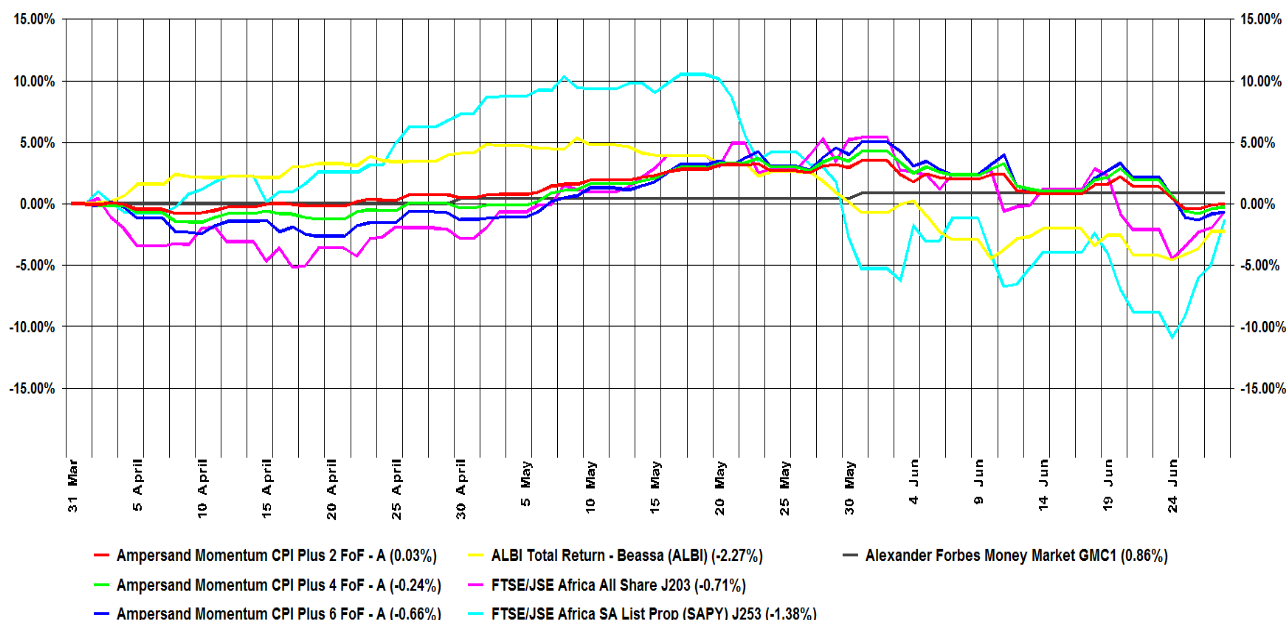
We will keep a sharp eye on upcoming key economic indicators.

Performance – *what added and what detracted?*

Our funds have held up reasonably well in an increasingly volatile and strained environment. With two of the key components of our philosophy being diversification and valuation, it is in an environment such as the one we have recently been experiencing that we are able to see the benefits of our philosophy more clearly.

All local assets, except cash, ended the quarter down. In addition, the majority of global assets took a hammering in local currency terms. The rand, however, lost 8.20% to the

US dollar this quarter, equating to a positive performance in rand terms from our US dollar-based assets. Again reiterating that diversification is paramount.



Position going forward

We have been conservatively positioned for some time in anticipation of increased volatility and as a result we are comfortable with our portfolio positions at this time. We are still in favour of offshore equity and we maintain our overweight offshore position in the local portfolios. We prefer to hold enhanced-yield-type mandates at this time, over pure cash or government bond exposure. We maintain the structural integrity of our portfolios, preferring to err on the side of caution and thus feel no need to make material changes at this time.

It is important to note that fundamentals have not changed. Recent market volatility has been primarily driven by sentiment and emotions. We continue to monitor the situation closely.

VPFP Fund Performance for the Period Ending 28 June 2013

Fund or Benchmark	3 Month	6 Month	1 Year	2 Years	3 Years	4 Years	5 Years	
	Return	Return	Return	Return	Return	Return	Return	Risk
VPFP CPI + 2	**0.03%**	**3.76%**	**12.50%**	**25.91%**	**38.09%**	**52.24%**	**61.16%**	**3.52**
Investment Objective (CPI + 2%)	1.78%	3.82%	7.66%	16.01%	23.70%	32.01%	45.35%	
VPFP CPI + 4	**-0.24%**	**4.12%**	**14.76%**	**26.08%**	**39.33%**	**55.39%**	**56.37%**	**5.35**
Investment Objective (CPI + 4%)	2.28%	4.83%	9.76%	20.58%	31.08%	42.63%	60.10%	
VPFP CPI + 6	**-0.66%**	**3.88%**	**16.31%**	**26.96%**	**42.92%**	**62.60%**	**51.96%**	**8.16**
Investment Objective (CPI + 6%)	2.76%	5.83%	11.86%	25.24%	38.76%	53.87%	76.02%	
JSE All Share Index	**-0.71%**	**0.84%**	**17.41%**	**24.21%**	**50.72%**	**79.50%**	**30.13%**	**17.61**

Inception 12/05/2008 *(CPI Benchmark as at 31 May 2013)*

Source: MoneyMate

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Our services include…

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

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