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PCH INSIGHT

PRIVATE CLIENT HOLDINGS

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PRUDENCE VERSUS PERFORMANCE

By Andrew Ratcliffe

Effectively balancing the tension between prudence and investment performance means that wealthy families can have their cake and eat it too!

In a fiduciary context much emphasis is placed on the "prudent man rule" - a process orientated outlook that focuses on how a trustee has behaved and not at how the capital performed. The core of the rule is that a trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, requiring the exercise of reasonable skill, care and caution as part of an overall investment strategy.

Prudence versus returns for families

Outside of the fiduciary context, in the world of private family wealth, legal liabilities are very different and therefore the relevance we place on process versus outcome should also be different.

Whilst wealthy families are being encouraged to elevate process over outcome - believing that sound, prudent procedures will inevitably lead to good investment outcomes - this is not always the case! Many families have developed extremely thoughtful, prudent and inclusive procedures, only to find that their investment returns are far below par. In other words, the "prudent man rule" has been applied, but what about the "prudent investor rule"?

> "A possible explanation is that these families have overlooked the importance of "opportunity costs"."

"Opportunity costs" refers to market price movements that occur between the time when somebody comes up with an investment idea and when they get around to executing it.

In a more typical situation, good investment advice is formulated but degrades over time whilst the family makes its decision and belatedly pick up on the idea.

Family members often believe that they are not doing their job unless they review and discuss every action made at every turn before allowing their advisors to implement it. This ignores the realities of the market place and the relative skills and experience of families and investment professionals.

Families should focus on what they do best, on the many broad issues associated with family cohesion and the critical issues that matter most to the long-term health of the family's capital.

Strategic asset allocation discussions should be agreed to at family level, but tactical, day-to-day, week to week, month to month investment decisions should be in the hands of a capable advisor.

At Private Client Holdings we prefer to manage the affairs of a family in terms of our discretionary mandate ensuring that investment decisions are made on time, but at all times remain mindful of our fiduciary responsibility as trustees where we take due care, skill and caution.

(GreycourtWhite Paper No. 51: Prudence Versus Returns, September 2011)

THE DIRECTOR'S DESK

(Article source: PWC Global Private Banking and Wealth Management Survey June 2011)

Indirect as they may be, the effects of current global trends that are afoot in the wealth management industry need to be recognised and taken into account by local investors. The credit crisis in 2008 also had a dramatic effect on they way things are being done.

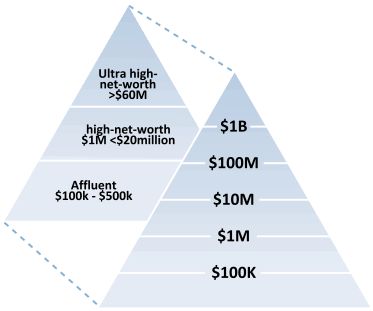
As industry players on a worldwide level adapt to market forces, regulatory change and client expectations, South African investors will feel the knock-on effect and so I thought that I would share with you some of the global trends afoot in the wealth management industry.

> "We are seeing a growing lack of trust in European financial centres"

A recent global survey done by Price Waterhouse on the wealth management and private banking sectors showed an interesting trend regarding the location of firms and that Wealth Management's centre of gravity is shifting from the established financial centres towards emerging markets.

According to this survey, the financial crisis has made clients focus on value, and clients of the traditional financial centres have become more sceptical about the financial markets and the over-sophistication of products that fuelled the credit crisis and accordingly we are seeing a growing lack of trust in European centres.

The survey focuses on the High Net Worth community and includes asset managers, banks, stockbrokers and wealth management firms. Interesting to note is that the highest concentration of their clients' wealth falls within the $1m to $5m range, although clients' investable assets range from $100 000 to over a $1bn as per the wealth pyramid in the graphic below.



Tiers of wealth

The effects of the credit crisis – a summary

The credit crisis in 2008 brought an abrupt end to a fantastic bull market where investment performance fostered complacency by all parties - the wealth managers, the regulators and the clients themselves.

There is nothing like a 55% market crash to focus the mind. Regulators have tightened up considerably to protect the consumer. A positive consequence is the exorcism of inept and unscrupulous advisors, but the challenge for reputable firms is that the increased regulation comes at a considerable operational cost that eats into margins.

Clients have evolved. In general they are smarter, less trusting and demand a better service. They insist that investment products should be simpler, more transparent and deliver value.

Wealth managers must transform their operations, not just by delivering efficiencies and cutting costs, but to meet client expectations of performance and service delivery and to improve the overall quality of the client experience.

What is obvious is that the wealth management industry, its regulations, as well as its clients, have evolved and standing still is no longer an option - the ability to adapt and change is essential in this fast paced industry.

Whilst there is all this talk about a new age for the industry, at Private Client Holdings it remains our philosophy to place clients at the centre of our business model, to provide independent advice and develop a trusted brand. Although we have consistently outperformed our benchmarks, we live in a world of heightened risk and volatility and recognise that when the going gets tough, excellent service and communication is vital.

If you are concerned whether you are still on track with your wealth management strategy please call your wealth manager or myself, and we would gladly meet with you.

Grant Alexander

HAVE YOU HEARD?

WP BRIDGE UNION

We are delighted to be continuing our relationship with the Western Province Bridge Union for another year and looking forward to sponsoring the WPBU annual festival in December.

PCH DRAGON BOAT RACING

The Private Client Holdings Dragon Boat racing team came 11th overall out of 32 teams at the recent annual Rotary charity Dragon Boat regatta, which took place on the 15th of October at Sandvlei - it was a wonderful day out spent taking part in this exciting event for a good cause and a great result from the team!

PCH CYCLING

On Monday the 5th of September 2011 PCH hosted a formal medal ceremony for the 2011 USSA Riders. Well done to everyone who received a medal or leader jersey. The PCH cycling team again participated in the exciting 202km Double Century held near Swellendam. Andrew Ratcliffe was mixing it up with the boys in blue and gray. We are extremely proud of their excelllent performance.

MICKLEFIELD GOLF DAY

Private Client Holdings was delighted to be actively involved with Micklefields' school fundraising golf day which managed to raise almost R50 000 for the schools fundraising programme.

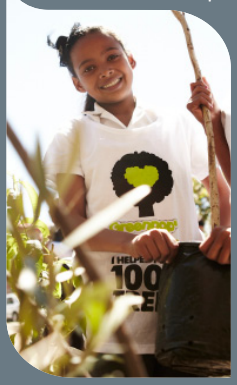
REAP TURNS 10!

The Rural Education Access Programme (REAP), who assists students from poor rural areas across South Africa to access and succeed in tertiary education, turned 10 this year. For more information about the phenomenal work REAP does look at www.reap.org.za

PCH ARE GOING GREEN THIS CHRISTMAS

PCH will again be investing in trees as gifts for our clients this festive season through Greenpop, who plant trees in under-greened areas and provide certificates with GPS coordinates for the tree purchasers.

These make great gifts all year round but particularly in the festive season when people are celebrating the real meaning of giving - and trees improve environments, instil pride of place in communities, absorb carbon emissions, provide shade for children to enjoy and promote biodiversity - the perfect way to round off the year!



NEW CASE LAW RELATING TO TRUSTS

BY MADELEIN MARAIS

> It is vital to ensure that you have your trust affairs in order as they can have far-reaching effects on your family.

An in-depth knowledge of the laws governing trusts is key, as was demonstrated in a recent court case where variations of a trust deed were declared invalid.

A trust deed executed by a founder and trustees of a trust for the benefit of others is akin to a contract for the benefit of a third party, also known as a Stipulatio Alteri.

The law says: The founder and the trustee can change or even cancel an agreement between them before a third party has accepted the benefits conferred on them. But once the beneficiary has accepted those benefits, the trust deed can only be varied with his or her consent.

POTGIETER VERSUS POTGIETER

In the case of Potgieter vs Portgieter, a family trust was established where children A and B were declared as the capital beneficiaries. Subsequently the founder of the trust, the father of A and B, divorced and remarried a woman with two children of her own. These two children, X and Y, were then included as beneficiaries of the trust.

However, children A and B from the first marriage were not consulted on this amendment and did not agree to the changes. And so when the founder of the trust passed away, A and B contested, on the grounds that they had not agreed to the changes - making them invalid.

It was argued from the other side that the amendments were made before beneficiaries A and B had accepted the benefits conferred upon them. However, at the time that the trust was established, beneficiaries A and B were minors and the benefits were therefore accepted on their behalf by their father as their natural guardian.

THE RULING

The courts, including the Supreme Court of Appeal, found in favour of A and B - the amendments were declared invalid and the previous version of the trust deed prevailed.

One must be extremely careful when setting up and amending trust deeds as has been indicated above. Make sure you have all the necessary parties involvement when varying a trust deed otherwise your wishes may not be carried out when you pass on.

QUESTIONING AUSTERITY

If 2010 was the year of discussing austerity, 2011 has been the year of living with it. As the world threatens to dip back into recession, one must look at whether austerity is working, and what happens if it doesn't?

A packed auditorium listened with great interest to Grant Alexander and Jeremy Gardiners' presentations held at the Investec offices on the Foreshore on 17 November 2011 in the 3rd of the Private Client Holdings quarterly seminars.

Alexander reminded us that the state of the economy and our return on investments are not always correlated. What is really important is Valuation. When world news is particularly gloomy it is often the time to invest. Alexander illustrated this by reminding us that equity risk premiums in the USA are at 2.5 standard deviations above the norm. Making equities a relatively cheap investment option.

Gardiner explored investment options in a world where opportunities still exist but are much harder to find. According to Gardiner, solving a debt problem by issuing more debt will only work if such countries manage to raise taxes and cut costs in order to bring down their debt. What has clearly been happening, however, is that by raising taxes and cutting government spending, the economies in some of these disaffected countries have all but ground to a halt, if not collapsed.

Taxpayers across disaffected Europe are starting to question just how much these bank bailouts are actually going to benefit them and Governments will start to be overthrown and replaced as the people voice their discontent.

With this new thinking will come a phase of what is known as 'haircuts'- when a country says to bondholders that they will not receive their full deposits back. We can expect to hear more of the term 'haircut' and to see certain countries eventually capitulating and announcing a rescheduling of their debt. Markets won't like it, but it won't be entirely unexpected and as a result the impact on markets shouldn't be too severe.

Gardiner, with his usual thoroughness and easy manner, provided the audience with an understanding of where the US economy is positioned and the challenges facing President Obama. Also considered was the China factor and its influence on world markets. Gardiner put this all into perspective against our solidly placed Southern African economies.

In summary, whilst obviously financially devastating for investors in countries in the Northern Hemisphere, the policies currently being implemented will allow these countries to move forward sooner than otherwise would have been the case.

WHO TO TALK TO

Our Private Client Holdings experts are available to field your questions. Don't hesitate to contact us on 021 671 1220 should you wish to discuss your bigger picture.

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HAPPY HOLIDAYS!!!

Private Client Holdings wishes you and your family a peaceful festive season and a prosperous new year!

Q&A

For more detailed answers to any of your tax questions we can arrange a consultation for you with the PCH tax team.

When do repairs & maintenance expenses qualify for tax deductions?

This area is the subject of much case law. Briefly, repairs and maintenance are generally deductable in full in the year that the expense was incurred. (Maintenance in terms of s11(a) and repairs in terms of s11(d).) These expenses need to be incurred whilst maintaining, restoring or replacing an asset used in the production of income. Improvements or enhancements to assets are regarded as capital items and are not deductible, but may qualify for special capital allowances.

Must employees tax be withheld from directors bonuses?

Discretionary bonuses allocated to directors based on the performance of company need not have PAYE withheld. However, the previous year sets the base amount on which PAYE needs to be withheld during the following year.

Contact our Financial services division for a more detailed explanation

TEST YOUR SUDUKO SKILL!

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