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The Home of Retirement Funds

ETF Investment Insights

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Investment Seminars
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Agenda

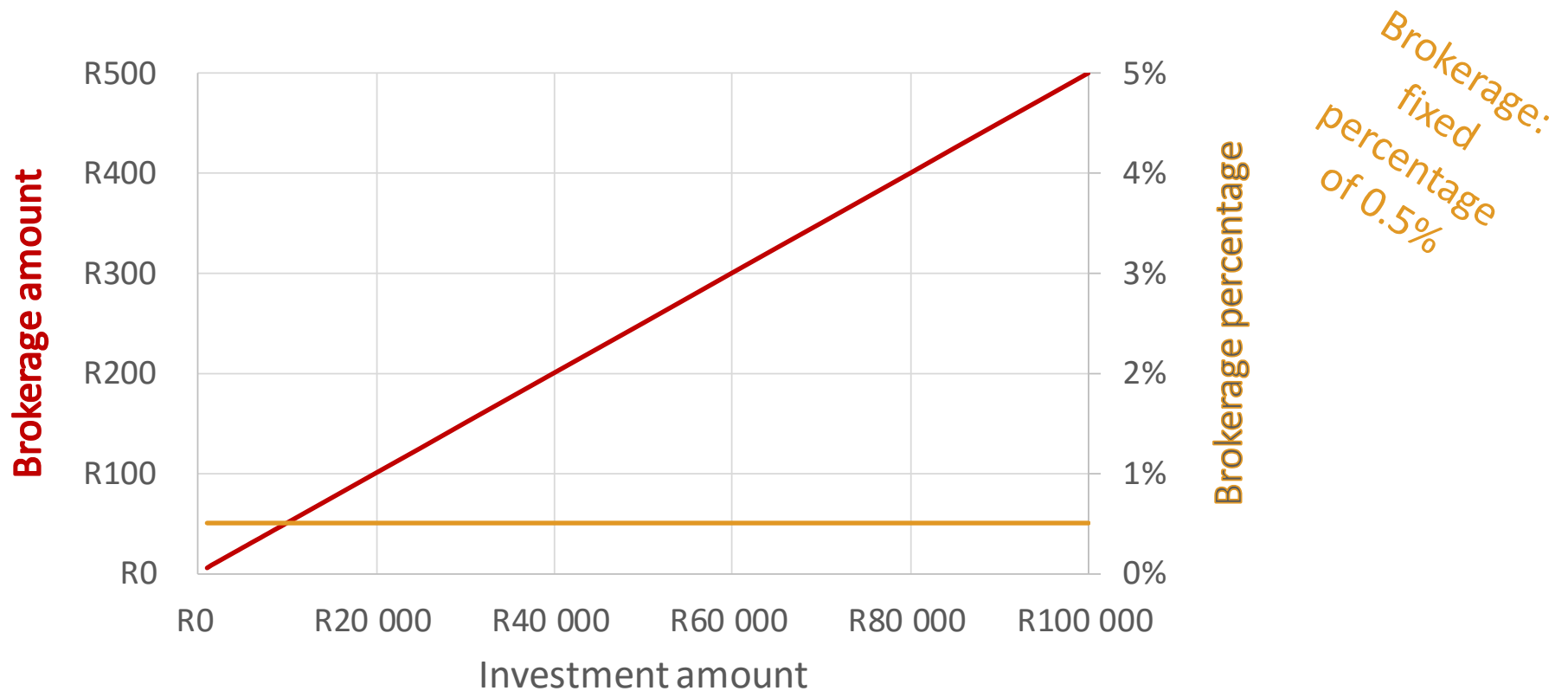
- Understanding the impact of **costs**
 - **Transaction** costs
 - **Administration** charges
 - Total Expense Ratio (**TER**)
- Understanding the impact of **tax**
 - **Discretionary** investments
 - **Tax free** investments
 - **Retirement** Annuities
- **“Where do I start?”**

Understanding the impact of costs

Transaction costs

- Costs incurred **every time** you buy or sell
- Can be a fixed **percentage** or a fixed **rand** amount
- Examples:
 - Brokerage of **0.5%**

Understanding the impact of costs



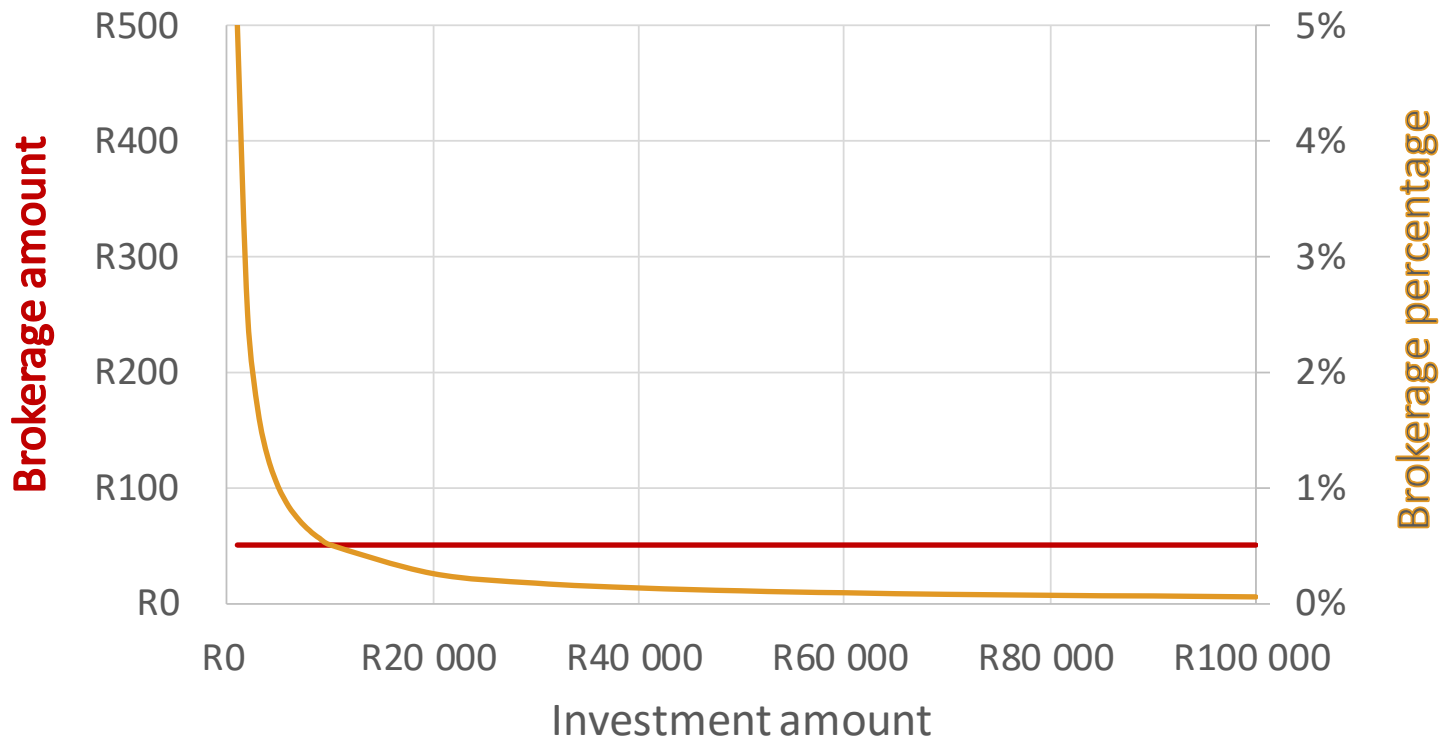
Understanding the impact of costs

Transaction costs

- Costs incurred **every time** you buy or sell
- Can be a fixed **percentage** or a fixed **rand** amount
- Examples:
 - Brokerage of **0.5%**
 - The **bigger** the investment amount, the **bigger** the brokerage amount
 - Best suited for **small** investment amounts and **frequent** investments
 - Brokerage of **R50**

Understanding the impact of costs

Brokerage:
fixed cost
of R50



Understanding the impact of costs

Transaction costs

- Costs incurred **every time** you buy or sell
- Can be a fixed **percentage** or a fixed **rand** amount
- Examples:
 - Brokerage of **0.5%**
 - The **bigger** the investment amount, the **bigger** the brokerage amount
 - Best suited for **small** investment amounts and **frequent** investments
 - Brokerage of **R50**
 - The **bigger** the investment amount, the **bigger** the brokerage %
 - Best suited for **large** investment amounts and **lump sum** investments

Understanding the impact of costs

Administration charges

- **Annual** fee, typically payable on a monthly or quarterly basis, **throughout the year**
- Can be a fixed **percentage** of your total investment amount or a fixed **rand** amount
- Impact as for brokerage – **BUT** you **cannot add** the two **together** to get a **total cost**

Understanding the impact of costs

Transaction costs and Administration charges combined

▪ Lump sum example:

- Invest R12,000 at 0.5% brokerage and 0.5% admin fee p.a.
- Brokerage: 0.5% of R12,000 = R60
- Admin fee payable quarterly, total of R60*:
 - Q1: $R12,000 * 0.5\% / 4 = R15.00$
 - Q2: $R12,000 * 0.5\% / 4 = R15.00$
 - Q3: $R12,000 * 0.5\% / 4 = R15.00$
 - Q4: $R12,000 * 0.5\% / 4 = R15.00$
- Total for brokerage + admin = R120
- Percentage of investment amount = 1%

* Assume no growth in investment

Understanding the impact of costs

Transaction costs and Administration charges combined

▪ Debit order example:

- Invest R1,000 p.m. at 0.5% brokerage and 0.5% admin fee p.a.
- Brokerage: $12 \times 0.5\%$ of R1,000 = R60
- Admin fee payable quarterly, total of R37.50*:
 - Q1: $R3,000 \times 0.5\% / 4 = R3.75$
 - Q2: $R6,000 \times 0.5\% / 4 = R7.50$
 - Q3: $R9,000 \times 0.5\% / 4 = R11.25$
 - Q4: $R12,000 \times 0.5\% / 4 = R15.00$
- Total for brokerage + admin = R97.50
- Percentage of investment amount = 0.81%

* Assume no growth in investment

Understanding the impact of costs

Total Expense Ratio (TER)

- This is **not** a “cash flow expense”
 - You do not pay for it **directly**
 - You effectively “pay for it” through **lower performance**
- Assume an investment **return** before costs of **10%**
 - If the **TER = 0.5%**, your investment will only return **9.5%**
 - If the **TER = 1.5%**, your investment will only return **8.5%**
 - The **higher** the TER, the **lower** your investment return
- **Active** management attempts to give you more “**alpha**” than the **TER impact**, but this is **seldom the case***

* 85% of active managers fail to beat the index – SPIVA Report, S&P Dow Jones

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Understanding the impact of costs

What is included in the **TER**?

- **Fixed** costs
 - Trustee fee; audit fee; regulatory charges; licensing fees, etc.
 - The **smaller** the fund, the **bigger** this is **as a %** of fund size
- **Variable** costs
 - **Manco** fee (issuing company) – relatively small, and standard
 - **Asset management** fee – varies significantly according to investment style, incl. active vs. index-tracking
 - **Performance** fee – can be **significant**, especially if the “hurdle” is inappropriate
- **Trading** costs – varies significantly according to level of activity; **often excluded**

Understanding the impact of costs

Comparative Total Expense Ratios (TERs)

- Average TER for **actively** managed unit trusts
1.52% per annum
- Average TER for Exchanged Traded Products (ETPs)
0.33% per annum

Just remember that the TER does NOT include all costs!

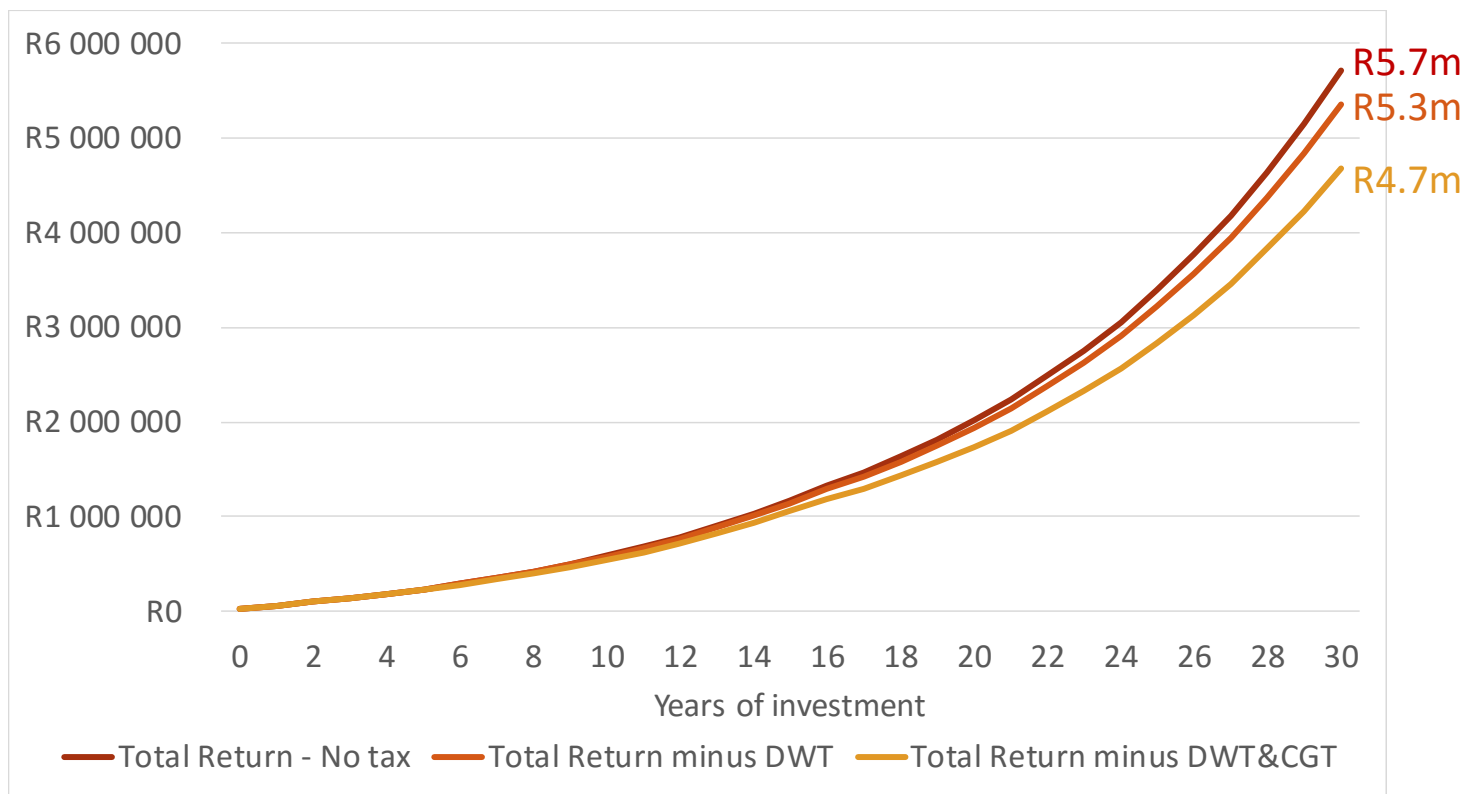
Understanding the impact of tax

Discretionary investments

- All contributions are made with after-tax money
- All distributions are taxable
 - Dividend Withholding Tax (DWT) of 15%
- All growth is taxable
 - Capital Gains Tax (CGT) of up to 16.7%
- BUT there are no constraints on how much, where and what you can invest in

Understanding the impact of tax

Assumption: invest R30,000 per year up to R500,000



Discretionary investments

- Dividends (DWT)
 - Reduces total return by **6.4%** after 30 years
- Capital gains (CGT)
 - Reduces total return by a further **11.6%** after 30 years
- Total reduction of **18.0%**

Note: Based on total return of 11% (9% capital gain and 2% dividend yield)

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Understanding the impact of tax

Tax free investments

- **ALL proceeds** are tax free:
 - Dividends
 - Interest
 - Capital gains!
- The **full benefit** only comes after years of **compounding**
- Although you are **allowed to withdraw** from a tax free account, you are “**robbing your future self**” by doing so
- **BUT** there is an annual and lifetime limit on how much you can invest

Understanding the impact of tax

Assumption: invest R30,000 per year up to R500,000



Tax free investments

- No DWT payable
 - Save 6.4% after 30 years
- No CGT payable
 - Save another 11.6% after 30 years
- Total tax free benefit of 18.0% after 30 years

± R1million!

Note: Based on total return of 11% (9% capital gain and 2% dividend yield)

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Understanding the impact of tax

Retirement Annuities

- **Tax deduction upfront** (contributions are tax deductible)
 - If your tax rate is **18%**, you **save R90,000** in tax on **R500k**
- **ALL growth** is tax free:
 - Dividends
 - Interest
 - Capital gains
- **BUT** the **proceeds are taxable** at your income tax rate
- Unless you pay less than **18%** tax in retirement, you are **better off in a tax free** investment!

“Where do I start?”

- **Tax Free Investment**
 - **Contribute** the **maximum** allowance – currently **R30,000 p.a.**
 - **Resist** the **temptation** to **withdraw early** – this is not an emergency savings fund!
- **Retirement Annuity**
 - **Contribute** the **maximum** tax deductible allowance – currently **27.5% of your gross taxable income**
 - Use the tax **savings to fund** your tax free investment
- **Discretionary Investment**
 - Invest **whatever remains** – the more the better!

Question time



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