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COLLECTIVE INSIGHT

INSIGHT INTO SA INVESTING FROM LEADING PROFESSIONALS

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THE MONEY CONTINUUM

HOW TO THINK DIFFERENTLY ABOUT MONEY AND HOW TO MAXIMISE IT

Inside

By Craig Gradidge

INTRODUCTION

How to advise for a lifetime

A person's financial journey starts at a young age. Traditional perspectives on advising a client along the money continuum may need a rethink in order to be more effective.

I remember my first encounter with money. It was not a good one. I was five years old and my mom had given me a shiny new half cent coin. This was the first time I had held money that was mine.

Two minutes later I was walking up the road to buy my favourite sweets. I remember being happy and doing a little dance while walking to the shop. Somewhere in that dance was a stupid spinning human helicopter manoeuvre. Two seconds later my shiny new coin flew into the thick bush across the road. I remember standing on the side of the road in a state of shock and confusion.

I spent the next hour or so scouring the bush for my coin. I eventually gave up and walked back home defeated, sad, teary and peeved at my own stupidity. Fast forward to May 1998 when I needed to buy a car, and did not have enough coins or money in the bank to pay for it with cash. I went to my bank and walked out with vehicle finance.

Being a black graduate with some work experience counted for little back then and prime plus 1% was the deal, a rate of 19.25%. By September 1998 prime had shot up to 25.5%! My finances were in ruins as a result. Fortunately, rates dropped as fast as they went up, and I was soon able to start on my journey as an investor.

Being a black graduate with some work experience counted for little back then and prime plus **1%** was the deal, a rate of 19.25%.

Being responsible for compiling the *Unit Trusts Handbook* back then, I had a front row seat to all the excitement around small caps and global technology shares. My investments in Didata and Brainwave fell faster than I could blink.

My experiences along the money continuum were not great, but thankfully they were not final either. They helped shape future financial decisions and the mindset I took into those encounters.
But as someone who works in "the industry" I totally missed the fact that my engagement with the industry was disjointed and product-driven.

Things have improved since the late 1970s when I was losing coins, and the late 1990s when I became economically active, but clients' interactions with the industry remain largely disjointed, siloed, product-centred and ineffective in helping them make the necessary trade-offs along the money continuum to their benefit.

Industry stalwart Anne Cabot-Alletzhauser does a deep dive into the money continuum and trade-off debate. She highlights the shortcomings of advisers in assisting clients in managing these financial trade-offs effectively. Financial advisers are best-positioned to pull the disparate parts of the industry together to help clients manage these trade-offs. Our clients and the industry would be better off if this were done more effectively.

Author and academic Deborah James unpacks some of the complex social underpinnings that have and continue to contribute to the debt statistics that we see in South Africa. She unpacks the role of debt in the rapid rise of the black middle class. It provides plenty food for thought for market commentators and advisers who understand the theory of the impact of debt but lack the insight into some of the drivers behind South Africans' behaviours.

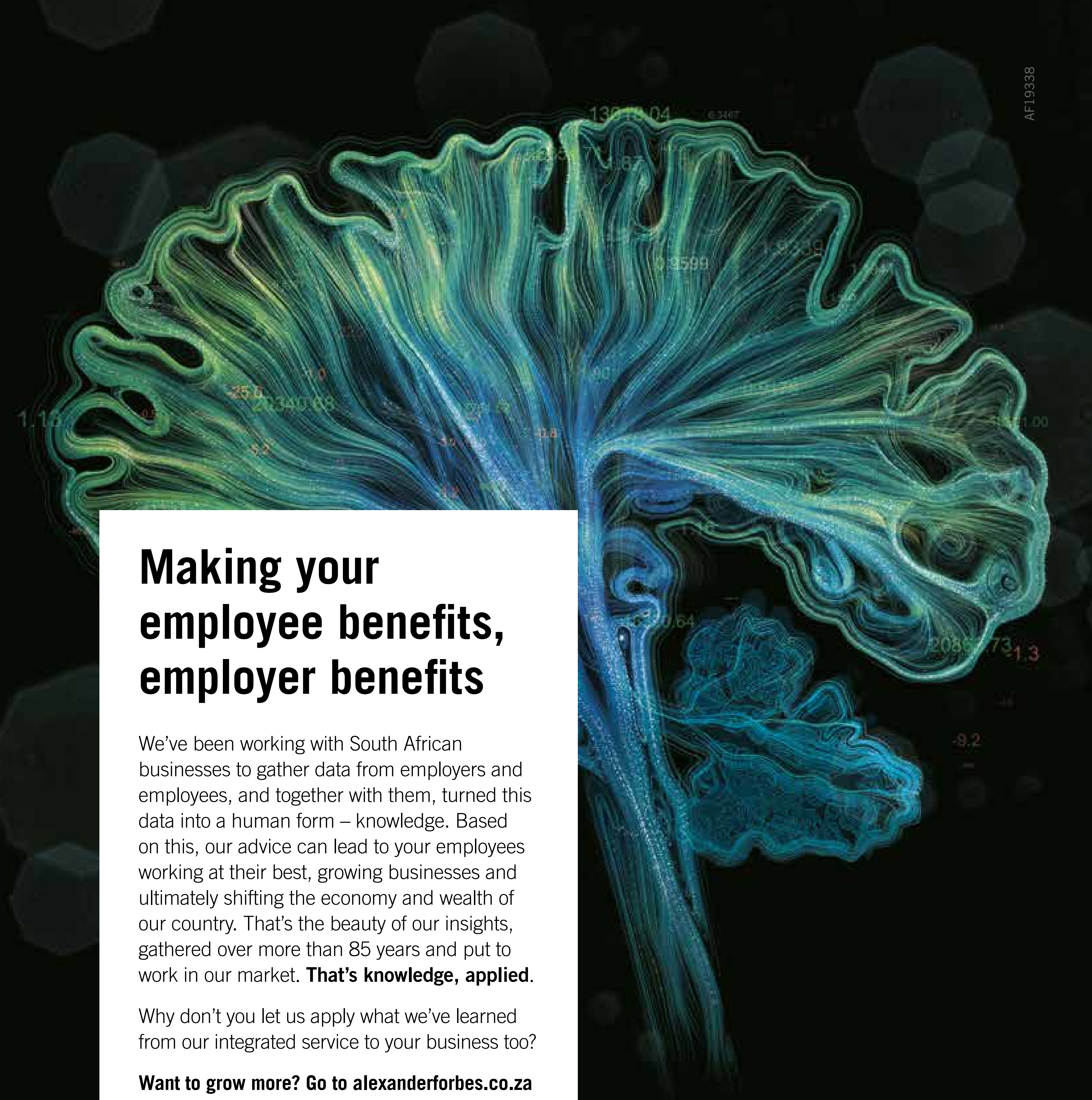
Whether we've accumulated debt through a lack of mindfulness at the tills, poor financial decision-making in managing trade-offs, or as we've risen to middle class status, that debt must be repaid at some point. Sydney Sekese joins in the conversation with a revision of debt and how to deal with it in a practical manner. He explores the different types of debt and shares ideas on dealing with it.

In his article, David Kop explains that when we begin to understand more fully the role that money plays in enhancing our physical, mental and emotional lives we can begin to appreciate that we should perhaps be a bit more circumspect about many of the "rules of thumb" that our industry likes to apply in money matters. In the end, the money continuum is not an abstraction – rather, it is integral to our whole sense of value and self. That means that, as handy as rules of thumb might be, unless we understand the value system of the person making the trade-off decisions, the advice we give may be inadequately thought through.

Wynand Gouws touches a little on the behavioural side of money and takes a deeper dive into the main threat to the value of money, and the best defence against that threat. Inflation is like a cancer which, if left unchecked, has the power to destroy nations. There is an equally powerful counter force in the principle of compounding.

And finally, in his article, Deslin Naidoo does a great job of describing the transition and the unexpected consequences of these changes. It is easy to be aware that we are running out of money when there are fewer notes in our wallet than when there is a lower credit balance on a card. We need to embrace a new "mindfulness" about money as a result. ■

Craig Gradidge is executive director at Gradidge Mahura Investments.



By Anne Cabot-Alletzhauser

FINANCIAL SERVICES

Many pennies for your thoughts

Determining which financial products deliver the biggest bang for a client's buck should be a standard way of giving financial advice.

Money down the toilet

Two years after I bought my first cellphone, I dropped it in the toilet. Bad luck, right? Interestingly, this isn't an uncommon occurrence; research suggests that a fair amount of cellphone owners use their phone in the toilet and dropping phones into the toilet bowl appears to happen with great regularity.

But I thought I would be just fine. Why? Because I had cellphone insurance, of course. Surely, this sort of occurrence was covered. What could go wrong?

It hadn't occurred to me to read the fine print – the print that explained that I wouldn't be covered unless my South African service provider's SIM card was in the phone. And here I was, in an American toilet with a temporary American SIM card in my phone. So, it turns out I wasn't covered, and it cost me close to R18 000 in both replacement value and wasted insurance coverage.

Should I have made better decisions here? Should I have checked my other forms of insurance coverage to see if those policies covered items such as cellphones?

What has occurred to me is that the world of "financial advice" doesn't extend to the mundane issues in our daily lives such as: Is cellphone insurance worth it? Or, which is more cost effective: Leaving my emergency savings in a money market account with a bank or investing it with a money market unit trust? Or whether having a fully paid-up house might provide an even better benefit to having a pension fund?

These are the trade-offs individuals make on a regular basis, often without fully understanding exactly what criteria should underpin those decisions.

The world of financial advice seems to be far more preoccupied with helping you understand the product that advisers would like you to buy than helping you manage the kind of financial trade-off decisions you would have to consider to properly address any of those questions.

Fast forward to last week

I sit on the research committee for the Insurance Sector Education and Training Authority's (Inseta's) training and skills development. The topic on the table is: How do we need to evolve the training and skills development for employees in the insurance sector so that they are relevant for the industry's future?

Because savings vehicles often use insurance licences to pool funds, the pension funds, asset managers and financial advisers are also catered for by Inseta. Intriguingly, the banking industry is covered by a totally different Seta – Bankseta. So presumably, those professionals require a different sort of training.

And therein lies the rub. Because, when you sit down and map out the whole world of financial touchpoints that an individual faces throughout their life, these are actually all part of one continuum of considerations. I'll explain the working of the continuum.

The starting point is an income, whether from a job, from a grant, inheritance, or from an investment. The question every individual (and their family) faces is, how can I best deploy this, so I get the greatest "bang for buck" from that income over time (after having paid for basic needs)?

The **graph** illustrates this: On the right side the trade-off decision is how to use that income to protect the family from any future financial shocks. The left shows the consideration of how to deploy that income so that it can increase one's financial mobility

These are not trivial trade-off decisions. But they can be grappled with if one focuses on weighing out:

- The magnitude of protection required against its cost;
- The timeframe required to accumulate a necessary protection;
- The degree of "risk" one is prepared to take on in investing to accelerate the timeframe or quantum of any funding needs;
- The degree to which a pro-active "investment" would protect against much more costly interventions further down the road.

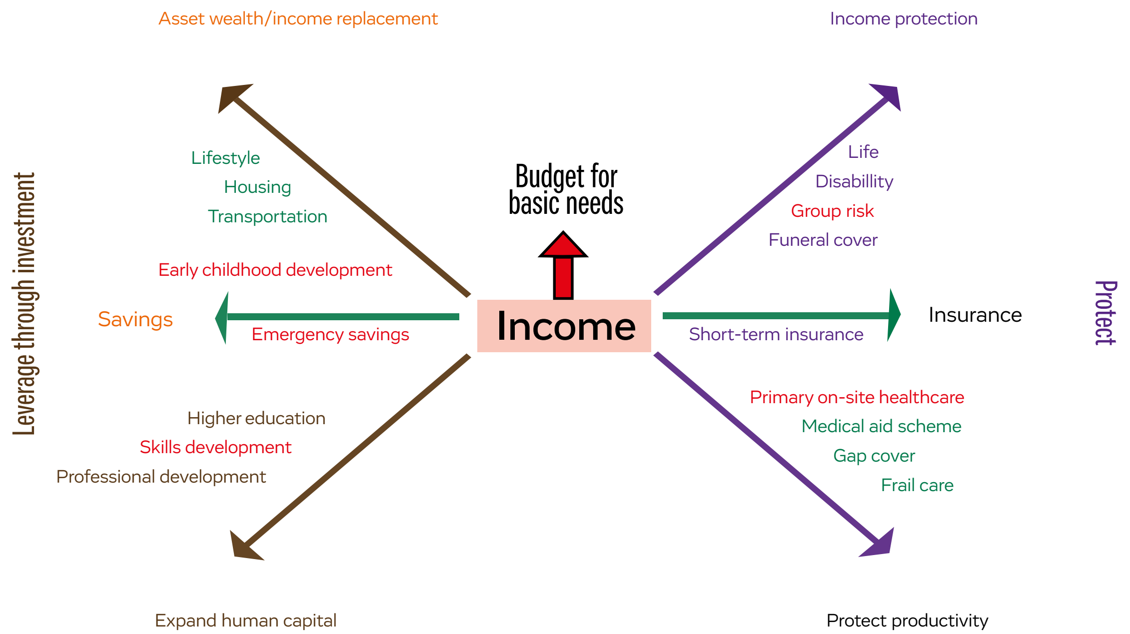
The graph maps out the interplay between these considerations. The left axis represents how one could "leverage" one's income through "investing". In this context we are not just talking about taking on more risk to get higher returns, but how we can also take on risk to accelerate the time it takes to accumulate wealth. "Investing" can also refer to using your income to enhance your skillset, and with it, your earning power.

The right axis represents different forms of protection. Along the top half of that axis are protections that could be considered to minimise the loss of income or wealth accumulation. Along the bottom half of the "protection" axis are strategies that could be considered to minimise the loss of one's earning power or productivity.

Now let's look at a real-life trade-off problem: whether to buy my cellphone insurance. I could simply opt to buy that insurance for R100 per month and know that that R100 only covers very specific conditions that may not always apply – in which case I am on the hook for both the cost of the insurance and the cost of the cellphone. Or I redeploy that same amount into an emergency savings account, calculate how much extra I would need to add to this investment to feel I am adequately prepared for any of these smaller life crises, and feel secure in the knowledge that I would be protected for any event – with no worries about the small print. The concept I have just described is known as "self-insurance".

Now that we've started to think differently about money trade-offs, let's ask a different, but more important question. If I only have the very thinnest of wallets, what decision in each quadrant would likely give me the greatest bang for my buck? Of course, the

IF MY WALLET IS THIN – WHERE DO I GET BEST "BANG FOR BUCK?"



SOURCE: Alexander Forbes

optimal answer will be different for everyone's specific circumstances, but the generic answer here might come as a surprise – and potentially sound quite different to what one gets as financial advice.

- Emergency savings come out on top of any consideration in the savings category – even saving for retirement. Without emergency savings, we have seen that people in financial crisis will simply find a way to access that retirement saving anyway.
- From a healthcare perspective, the best defence is a good offense – which puts primary healthcare in the workplace as the lowest cost defence. Beyond that, we know that with an accident or medical emergency, getting the best possible care during the first 24 hours matters most. That is what would be worth paying for.
- Low-cost risk-coverage doesn't get better than with the group risk that accompanies your employee benefits.
- If you want to increase your earnings potential, your best, low-cost options are to take advantage of any workplace skills development programme – throughout your whole career.
- And finally (here's a surprise one) if you want to invest in enhancing your children's long-term potential, paying for an early childhood development programme has a significantly greater impact than saving for tertiary education.

But here is the crux of the problem: Consider the way the financial services industry currently approaches these concepts: insurance, savings, investments and the issue of "bang-for-buck" financial decisions. Not only do we compartmentalise the marketing of these different financial products but, until now, their marketing was governed by completely different regulatory bodies: the Short-term Insurance Act would govern cellphone insurance, the Pension Funds Act would govern retirement savings, and healthcare would be governed by its own separate regulatory framework. Any adviser wanting to help a consumer wind their way through the decision-making minefield captured by each of these "product silos" would have to pass qualification standards for each product area.

And now – there really is a way forward that recognises current limitations

Fear not, though, for help is at hand in the form of COFI, the Conduct of Financial Institutions Bill.

For the first time this principles-based regulatory framework will shift the focus from the regulatory silos that govern how each sector of financial services (and their attendant products) is regulated in their interactions with the consumer to an outcomes-based framework – where the outcomes and impact to the consumer becomes the primary concern. With this new overarching regulatory framework, financial decision-making advice can begin to explore interconnectedness and interdependencies of all these financial touchpoints.

As such, there will be a huge requirement to completely change the way we teach and train our people to understand these interrelationships.

Imagine if we could get all this right? The impact this could have on enhancing trust in the financial services system and, in turn, dramatically improve people's willingness to plan and save would be significant. Importantly, it could help SA build up a financial services capability that genuinely creates a stable trajectory to wealth and asset accumulation to SA's burgeoning, yet all-important middle class. Policymakers, please take note. ■

Anne Cabot-Alletzhauser is head of the Alexander Forbes Research Institute.

Photo: Gallo/Getty Images

By Deborah James

ECONOMY

Debt and transformation in SA – the dynamics of social upliftment

The surge in South Africa's household debt – whether through banks or informal lenders – contributed to an important change in our social and economic fibre. However, the cost of using credit to become a member of the middle class has complex consequences.

It would be hard to imagine how the burgeoning aspirations for a better life could have been met in the post-apartheid era were it not for the ability to borrow. Had there been no debt – or access to credit, to use the version that sounds more palatable – very little transformation would have occurred in South Africa.*

There would not be nearly as many black people driving decent cars; living in decent homes; and sending their children to good schools and universities. Many in the "new" middle class find themselves expected to educate several children to tertiary level even though they might barely have finished high school themselves. Often the only way to do this is on credit.

An example of this situation is neatly summarised by Jonny Steinberg in his 2008 book *Thin Blue: The Unwritten Rules of Policing South Africa,* when he describes the dilemmas faced by one such member of the new middle class. "To ensure that your children attend a good school, you must buy a house in the suburbs. You have no reserves of cash, no investments, and so your entire house is bought with borrowed cash; the Reserve Bank governor's quarterly decisions on interest rates, which once meant so little that you were barely aware of them, can now destroy your precarious monthly budget overnight."

There may be dissatisfaction with the rate of transformation but, had there been no credit, the sense of grievance would have been greater. The results have often been complex and unforeseen.

People, then, borrow to fulfil their own and their dependants' expectations, but the net result, taken overall, has been levels of debt that many decry as unsustainable. To speak of such borrowing as irrational, as financial advisers and economists often do, is to miss the fact that debt has social underpinnings. People often borrow not to meet immediate material aspirations, but rather to strive for long-term goals like education, housing, or investing in socially valuable and prestigious connections such as marriage.

Shrinking levels of employment for the majority have been accompanied by entry into secure employment for the few: especially in civil service jobs or those involving government tenders. This has exacerbated the levels of dependency on credit. People with jobs are expected to support their relatives who are unemployed and may borrow to meet these expectations.

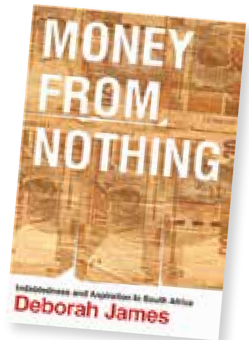
Here, the fulfilling of socially valued norms – like paying for the upkeep and education of members of the extended family – can have negative effects. Debt advisers have recognised, and many of their clients already know, that only by strategically withdrawing from such obligations can a more individually viable middle-class existence become possible.

There are "kind and well-meaning people", says Phumelelo Ndumo, author of a book on the subject, who have been "taken advantage of by those they love". Rather than being a "cash cow", she advises people to partner up in a nuclear family and focus on the future achievements and needs of their own children.

Yet such advice can be difficult to follow since it goes against the grain of valued social norms. Those who were well-served by the new dispensation, finding that they're required to provide security and education for those who benefitted less, have thus found themselves faced with a seemingly insoluble dilemma: To act according to such advice is to undercut the even more forceful value entailed in social expectation and obligation.

Some members of the new middle class, in the grip of the status anxiety and competition, which are well-known in cases of class mobility, spend money on expensive items. "Neighbours compete and feel under pressure to show that they are living in the correct way," one young lecturer told me. "If you take three neighbouring houses in Orange Farm... all the consumer items like DVD players and washing machines are exactly the same as each other."

So, competing for status does not necessarily mean striving for difference: It can



Without access to credit, very little transformation would have occurred in post-apartheid South Africa. This issue is explored in Deborah James' book *Money from Nothing: Indebtedness and Aspiration in South Africa.*

People, then, borrow to fulfil their own and their dependants' expectations, but the net result, taken overall, has been levels of debt that many decry as unsustainable.

Photo: Gallo/Getty Images

be more like "keeping up with the Khumalos" than trying to surpass them. Others will spend money on ceremonies considered socially mandatory like expensive weddings. But many, keen to act more frugally, have become hesitant to marry. Not only lavish ceremonies and receptions, but also bride wealth or *lobola,* are costly and can necessitate debt.

In 2013, the cost in the case of the same young lecturer, given her education, would have been estimated at R50 000, and the wedding itself would have cost around R250 000. While she understands that her parents would want to demand this payment from any prospective son-in-law, this young woman also feels that the huge debt with which he would be saddled to carry forward into the future would make the arrangement unsustainable. She won't be getting married any time soon, she told me.

The formal and the informal: uneven combinations

Policymakers and financial analysts often make incorrect assumptions. For example, they see people as gradually moving from more "traditional" ways of conducting their financial affairs (like investing in savings clubs or stokvels) to more "modern" ones, like saving money in banks. To facilitate more modern (read "rational") behaviour, they advocate the banking of the unbanked.

A group of salaried teachers made a conscious decision to avoid the formal sector and use a savings club, because they felt they had been treated with discourtesy and even criminal neglect by those in that sector: Specifically the notorious retailers that sell appliances on hire purchase, one of whom had wrongly issued a garnishee order on the club's founder for an alleged missed payment, and proved unresponsive to all communications. So, the founders still use the bank to store their money but use the savings club to generate interest.

Likewise, many policymakers view the indebted as victims of nefarious loan sharks (*mashonisas*) and consider that they would be better served by the formal banks. This may have a measure of truth, but there is another side to the story.

Those not in receipt of a regular salary are unable to borrow from the banks: For them, the *mashonisa* represents a preferable (often the only) option for getting hold of money in a hurry, even if they do charge 50% per month. Besides, to see the *mashonisa* as a demonic figure can be a misrepresentation.

Many lenders are also borrowers – and vice versa. Savings clubs or *stokvels* like the one mentioned above, for example, not only encourage members to save money, they also make it compulsory for them to lend that money out at interest (typically, 30% per month), to make it grow.

Ways forward

So, do we advocate the survival of the fittest, sink or swim? Or is the answer the complete avoidance of debt?

Although it is true that there are blurred areas where lenders and borrowers are difficult to distinguish from each other, it is still necessary to decide whether the weaker and more vulnerable in society need more protection than the rich and powerful. If they do, how can such protection be put in place without undermining the stability of the financial system?

The tendency in societies that advocate the free market has increasingly been – often by giving financial advice and attempting to teach self-discipline – to make borrowers carry the can. And this may be necessary, but it can work only if it is combined with other measures. It needs to be accompanied by an attempt to tackle SA's infamous advantage-to-the-creditor culture, by offering debt defaulters a way to start on a new page, and by challenging the general attitude among many lenders (and the magistrates' clerks that enable them to issue garnishee orders with impunity) that anything goes because none of them will ever be called to account.

At the same time, borrowers will need to recognise the social entanglements in which they are caught and start to take the kinds of advice offered by advisers who understand these contexts, even if doing so might put certain social relationships and dependencies at risk. ■

*See *Money from Nothing: Indebtedness and Aspiration in South Africa,* published by Wits University Press (2015).

Deborah James is professor of anthropology at the London School of Economics.

So, do we advocate the survival of the fittest, sink or swim? Or is the answer the complete avoidance of debt?

By Sydney Sekese

PERSONAL FINANCE

How to deal with debt

The reasons for becoming overburdened by debt are complex, but attempting to understand how one has amassed debt is the first step to bringing the situation under control.

Debt is a symptom, not a problem. It is the by-product of something else. Like losing partial vision in one eye, it's the symptom of a greater underlying issue. It's prudent to take a step back and get a better understanding of what debt is.

How do we get ourselves into debt?

Adam Smith argued that most individuals make decisions designed to maximise their personal wellbeing, based on an assumed level-headed evaluation of all the facts. Individuals choose the option that offers the greatest utility (satisfaction) with the least effort. Smith's central belief was that human economic interaction is governed mainly by self-interest.

Some individuals maximise their desire to achieve maximum personal wellbeing (self-interest) at all costs, which leads to a debt burden.

On a controversial level, it was Albert Einstein who coined compound interest as the eighth wonder of the world. He further elaborated that "he who understands it earns it, he who doesn't pays it".

A personal interpretation of Einstein's maxim is that those who are in debt, probably do not understand compound interest.

Those with sound self-interests, probably understand it better.

Nowadays, credit is easily available, and we are continually encouraged to buy unnecessary items. Credit can be sourced from various places including banks, micro lenders, clothing stores and family members. When we can't repay our debts, we often take out bigger, more expensive loans, and the cycle of debt continues.

It is prudent to manage the level of debt we take on to ensure it does not threaten our financial security. If we don't manage our level of debt carefully, we could wind up paying back large amounts of our income to debt throughout our lives.

The trick is to keep our debt down to a manageable proportion of our income. (See **sidebar alongside** that looks at considerations when taking on debt.)

Debt is like a debilitating disease that negatively affects your financial and emotional state of mind. There are several dangers of debt that I wish to highlight:

1. The hidden costs of debt that add up over the period of a loan;
2. If you cannot repay the loan, even if you have paid for many months and years, you will probably have the goods repossessed;
3. If you cannot repay your loans on time, you could be given a bad credit rating, making future borrowing a challenge; and
4. Family loans might have lower or no interest, but they can cause guilt and shame and put strain on relationships.

Understanding debt

Debts arise in two ways. When a person fails to pay a previously agreed sum of money, such as rent or the full purchase price of goods; or when someone claims money from another person as compensation for say, an accident, or defective goods.

For many in debt, the reality of owing so much money is too much to bear, so they simply choose not to. But sometimes, disaster strikes, and people are forced to confront their circumstances head-on. Unfortunate events such as a sudden job loss, an unexpected (and expensive) home repair, or a serious illness can knock one's finances so off track they can barely keep up with their monthly payments.

Is there good and bad debt?

If you use debt as a part of your bigger wealth creation strategy, it will increase your level of creditworthiness. For example, good debt would be when you take out a bond in order to buy a house, because in the long run you will save on rent and you will have an asset that hopefully increases in value over time.

Depending on the purpose, a personal loan could also qualify as a good debt if, for example, it is used to study and improve your future employment and earnings prospects. If this personal loan is for consumption, then it's bad debt.

Let's compare a car with a house in terms of valuation. Car financing would be bad debt because over time the value of your car depreciates. It could become a good debt if it's

HOW TO AVOID DEBT TRAPS

There are some tell-tale signs that consumers could adopt to avoid debt traps:

- Do you spend more money on your friends than you can afford?
- Do you borrow things from friends and not return them?
- Do you sometimes "forget" to pay off personal loans from friends?
- Do you often go out to dinner simply because you don't feel like cooking?
- Whenever you're about to spend money on anything, do you ask yourself if the purchase is a need or a want?
- Do you actively keep your partner in the dark about the household debt situation?
- Do you have a credit card that is maxed out or near its limit?
- Are you being turned down for a loan and/or credit card application?
- Are you regularly using balance transfers between your accounts and refinancing to stay afloat?
- Are you ignoring and avoiding calls from debt collectors?

STEP-BY-STEP CONSIDERATIONS BEFORE TAKING DEBT

There are some items that you need to acquire where debt is the only viable option. In that case, it is wise to take calculated steps to lessen the pain of financial instability. **Herewith some reasonable steps:**

Step 1: Know the full details of the cost of debt.
Step 2: Always consider paying off the debt sooner by using any surplus cash that you may have.
Step 3: Pay off your most expensive debt first.
Step 4: Do not enter into a new debt agreement once you have lessened or cleared your initial debt.

Photo: Gallo/Getty Images

repaid over a short period of time or if the car is used to generate more income.

Bad debt also includes buying groceries on your credit card. You can do that, provided you repay the full outstanding balance on or before the due date. So, in a nutshell, bad debt funds consumption (food, clothing or holidays) while good debt funds the purchase of assets (house, car or education).

How to deal with debt

Unfortunately, the space between realising that you need to pay off debt and getting out of debt can be wrought with hard work and heartache. No matter what kind of debt you're in, paying it off can take years, or even decades.

It starts with accepting that you are in debt and facing the problem head-on.

Sharing your problem with your acquaintances will give you courage to face your debt. They will also be your "watchdogs" to ensure that you keep track of your debt-reduction strategies. Finally, you should resist the temptation to incur any new debt as you make progress with current debt.

Research indicates that South Africa's consumer debt is nearly R1.7tr, which is almost equal to the government's debt of over R2tr.

Research indicates that South Africa's consumer debt is nearly **R1.7tr,** which is almost equal to the government's debt of over **R2tr.**

Consumers should take advantage of the current interest rates which have been relatively low; both in SA and globally.

As part of their budgeting process, consumers should therefore look to put any spare funds or bonuses and salary increases towards eliminating debt. Paying down debt faster could save them significant amounts in repayments over time.

Consumers should begin by creating a debt management strategy that will help them to repay their debts as quickly and effectively as possible.

This means ranking their debts according to how expensive they are as measured by the interest rate being charged on the debt. This can be done by starting with costly short-term debt on credit cards, followed by less expensive debt on cars and homes.

No matter what type of debt you're in, it's important to know there is a way out. It may not happen overnight, but a debt-free future could be yours if you create a plan and stick with it long enough. ■

Sydney Sekese is a senior investment specialist at Old Mutual.

By David Kop

FINANCIAL PLANNING

As a rule of thumb

For those that do not have all their financial goals clearly mapped out, there are some general rules that can help guide the way, but they should not be followed blindly.

a rule of thumb is a generalisation, and in social settings can be useful, as it gives you guidance on how to act in a situation. For example, when looking at a photo on someone else's phone, never ever swipe lest you invade their privacy. (You may be surprised by what you see!)

When it comes to money, however, a rule of thumb should not be considered gospel, but merely a guideline.

Personal economics is about allocating a scare resource (your monthly income) towards needs (things that keep you alive) and wants (things that make you *feel alive*). While it can be tempting to abdicate responsibility and just follow a rule of thumb, the reality is that we would all be better off if we had a plan that not only considered the logical (what you should do) but also the emotional (why I do what I do).

A GENERALISATION

When it comes to money, no two people are alike. We all have different goals, dreams and backgrounds; what's good for the goose is not always good for the gander.

Because we are all unique when it comes to money, blindly following a rule of thumb may be more dangerous than helpful. It either allows for us to absolve ourselves from personal responsibility (not my fault if it doesn't work); may not be achievable in your specific circumstances (which leads to doing nothing rather than starting out failing); or may be implemented without thinking about the bigger plan.

When providing clients with advice around a rule of thumb, financial advisers should be careful to ensure that the advice fits within the client's plan and is not merely given because that is what is done. When the advice is

Blindly following the rule of thumb regarding income replacement at retirement is dangerous because, depending on your retirement vision, your capital needs at retirement are a mix of income and capital-growth assets.

personalised to the client's circumstances, they have a higher chance of implementing the advice.

JUST A FEW EXAMPLES OF WHAT WE 'SHOULD' BE DOING ARE:

DSTV myth

A common budgeting tool is to cut luxuries, and one that comes up first is DSTV subscriptions. In one consultation when doing a client's budget, I had this exact discussion.

"Hey, if you need to free up some money, cut the DSTV." I could see my client immediately became disconnected, and so I probed deeper.

It turns out he was a massive sports fan and had to ensure that he watched his team playing live. So, if he cuts his DSTV, he would go to a venue or a pub to watch the live game and be tempted to spend on food and drink. Although I saw DSTV as a luxury, to him it was his essential entertainment and actually saved him money.

Target 75% of your final salary as a retirement goal

The danger with this rule is that it makes us lazy and disengaged from our retirement planning. Plus, try and target a final salary for a 25-year-old starting out in their career.

It is guaranteed that whatever assumption you'll use, it's going to be wrong. In addition, retirement is about so much more than just replacing your salary. You need to ask what your vision is for your retirement.

When you finally knock off work one day, do you want to buy that Ford Mustang that you never could and take an extended road trip across the country? Or do you want to spend your first year of retirement travelling the world and going on various cruises? Or perhaps you have never considered what this "retirement goal" is all about because you've always assumed your family would take care of you. After all, you've spent most of your life taking care of them.

Blindly following the rule of thumb regarding income replacement at retirement is dangerous because, depending on your retirement vision, your capital needs at retirement are a mix of income and capital-growth assets.

In the absence of a defined plan, the rule of thumb is not bad, but having a plan with defined goals (which will change over time and thus must be reviewed) is the first prize. This means you are not defining your retirement in general, but taking control and engaging in decisions about your life.

A car is not an asset

In the investment definition it is 100% true that a car is not an asset. In the accounting sense, however, it is. Let's look at the scenario of a sales rep who is often on the road.

Yes, a simple car with no frills can get you from point A to point B, but in what state will you arrive? If there is no aircon you can arrive hot and sweaty and make a bad impression. If you are not enjoying your driving experience it can also affect your mood when you arrive at a client and may lead to a less-than-perfect engagement. What about safety (both in terms of an accident and a possible hijacking)?

Buying a car is not a purely economic decision. Neither is it always one of status as we have been taught to believe. There are many emotional and tangible reasons why a person may select one car over the other. But by understanding these needs first, the economic reason could be looked at with a deeper understanding.

Always pay an additional amount into your bond

Again, in general this is great advice. Just paying an extra R100 on a R1m bond can reduce the repayment term from 240 months to 233 months and save you R50 000 in interest charges. However, I have seen cases where this advice was blindly followed. The problem was that the person really could not afford the extra payment and, as such, was racking up credit card debt, which came with a higher interest rate than that of the mortgage bond.

Save at least three months' expenses in an emergency fund

At first call this looks like sound advice. However, the implementation can sometimes be problematic. One needs to consider the opportunity cost of having three months' expenses in an emergency fund, which is usually a low-risk, low-return account.

Some of the things to consider when implementing this rule of thumb is: Do you have an access bond where you have paid in extra and have access to the capital? Do you have a credit card that is only kept for an emergency? Is your disposable income enough that you can cover most emergencies out of your monthly income?

The point here is that this rule of thumb should probably be to have access to an emergency fund that is tailored to your specific circumstances.

When it comes to money, a rule of thumb can be helpful in the absence of a meaningful plan. The danger of just using the rule of thumb is that it does not consider personal circumstances – both financial and emotional.

It also allows us to abdicate responsibility and not to be involved in our own decisions when it comes to money. This would ultimately lead to better outcomes. It can allow us to balance our wants and needs without economically ruining ourselves. ■

David Kop is an executive director at the Financial Planning Institute of Southern Africa.

By Wynand Gouws

INTEREST

How to protect the value of money

Inflation destroys the value of money. It's essential that investors remember the power of compounding interest in order to help battle this erosion.

Money, and beliefs about money, are deeply engrained in each one of us, shaping part of our personalities. Beliefs about money are fashioned from very early on in our lives through our experience, socioeconomic circumstances and education, to name but a few.

Personal views on money range from frugality, as expressed by Benjamin Franklin's "a penny saved is a penny earned", to living the grand life, as expressed by Oscar Wilde: "Anyone who lives within their means suffers from a lack of imagination."

It is important that we know where we are on this continuum between frugality and free spending and how that impacts our relationship with money.

However, while we have different views on money, there are some key concepts that can assist us in better understanding and protecting the value of money. To do so it is important to understand the biggest threat to the value of money and the best way to combat it.

Inflation is enemy #1

Inflation is the general increase in the prices of goods and services over time and it erodes the value of money as time passes.

At an inflation rate of 6%, the buying power of your money will halve in 12 years – that means in 12 years' time your R100 will only be able to buy goods worth R50 in today's prices.

The impact of inflation is clearly illustrated by looking at the cost of fast food, for example, in 1983 compared with today (see infographic).

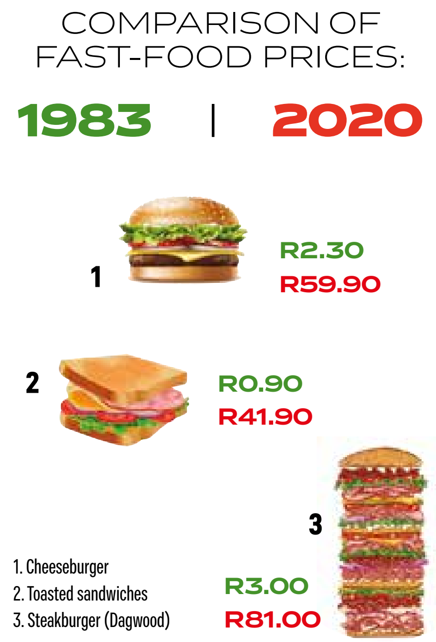
The power of inflation dates back centuries, with the collapse of the Spanish Empire in the 17th century, for example, being largely attributed to rising and uncontrolled inflation. In extreme times, inflation can run completely out of control like it did in Hungary in 1941 where it reached 150 000% a day for some goods, and more than 1 000 000% in recent times in Venezuela and Zimbabwe.

The main challenge for us is that the price of goods and services rises at different rates of inflation. As our lives evolve, our own inflation rates change and, soon enough, we are unable to afford our standard of living.

AN EXAMPLE OF INVESTMENT RETURNS:

Investment	R100 000	R100 000	Difference (rands)	Difference (%)
Return	10%	11%		
Year 1	R110 000	R111 000	R1 000	0.91%
Year 5	R161 051	R168 506	R7 455	4.63%
Year 10	R259 374	R283 942	R24 568	9.47%
Year 20	R672 750	R806 231	R133 481	19.84%
Year 30	R1 744 940	R2 289 230	R544 289	31.19%
Year 50	R11 739 085	R18 456 483	R6 717 397	57.22%

SOURCE: Wynand Gouws



As you go from being a single graduate living in a small apartment to becoming a married parent with children and living in a house, your personal inflation rate can change dramatically. Couple these personal changes with macro changes in the world (such as oil prices), your country (education, medical and food costs) and your own neighbourhood (municipal and security costs) and things can get out of control.

In South Africa we use the consumer price index, or CPI, to measure inflation. It currently sits at around 4% per year, yet electricity tariffs surged almost 12% and education expenses rose 7%.

Employers tend to use the CPI as a benchmark for increasing salaries, which results in employees losing buying power over time as their personal inflation rate is often higher than CPI. This is possibly why Ronald Reagan described inflation as "violent as a mugger, as frightening as an armed robber, and as deadly as a hitman".

How then do we counter the effects of inflation on the value of our money?

Understand the power of compounding

Compounding is often referred to as the eighth wonder of the world and is one of the most important principles in growing the value of your money. Compounding is simply where your returns earn returns.

As an illustration, imagine you invest R100 000 and earn 10% interest (see table). After the first year your investment would grow to R110 000. Subsequently you will earn 10% interest on R110 000 and not only the R100 000 invested. By the end of the tenth year your investment would have grown to R259 374 and you will continue to earn 10% on this amount. Because of compounding you will earn R25 937 in year ten compared with the R10 000 you earned at the end of the first year.

The power of compounding intensifies over time and a small difference in growth can make a huge difference in outcomes.

A 1% increase in return results in a person having as much as 57% more money 50 years later. While 50 years may appear to be a long and unreasonable time, consider that your first retirement contribution at the age of 25 may still be working for you at the age of 85.

The key to fighting the erosive effect of inflation on the value of your money is to invest where you can earn a higher return, and compound that growth over time. While inflation rates will change as you move through various life stages, you need to ensure that you do not interfere with the compounding process. ■

Wynand Gouws is a certified financial planner and a wealth manager at Gradidge-Mahura Investments.

Photo: Shutterstock

By Deslin Naidoo

FINANCIAL MANAGEMENT

The value – and power – of money in a changing world

Although the way we manage our finances is rapidly shifting, understanding the power of your wallet remains key.

What is money? Is it a means of transacting, a store of value, or a measure of value? Is it coins and notes, bank cards, investments or gold?

Money is all of this, connected into a complex financial system consisting of government treasuries, central banks and other financial institutions. Money is the most essential commodity that we use to interact with our world and manage our lives; yet many of us do not know enough about it and for most of the time we do not pay enough attention to it.

As money continues to become more digital, the physical relationship that we once used to manage our finances is rapidly changing. In the past, an emptying wallet was more likely to scare and deter you from overspending than seeing one less digit on your bank balance on a screen.

What is frightening is the new ease of transacting and the seamless ways of doing so: tap and go, QR codes, mobile payments, biometrics; these are all mechanisms that are making it easier to separate you from your money. This, coupled with the onslaught of individualised advertising, direct promotions and simpler means of accessing credit, makes it easier than ever getting you into financial trouble.

Research has shown that personal money management is linked to your attitude towards money. We develop this in many ways – it starts with our general attitude to life, our knowledge of money and general finances, the behaviours learnt from our parents and peers, and most importantly, in my opinion, the effort it takes for you to earn it. Like your physical health, your financial wellbeing requires you to be mindful and disciplined about the decisions that you make with money.

Mindfulness must start at an early age; parenting and our schooling system has a responsibility to prepare learners to independently take charge of their own financial future in an increasingly complex global world. It is imperative that our national curriculum integrates a foundational programme that builds a deep understanding, practical capability and respect for money and the critical role it plays in society.

When I think about my money, it starts with what is in my wallet and ends when it is no longer there, an endless cycle that ebbs and flows with the month. This may sound overly simplified, but our day-to-day lives are largely dictated by this simple cashflow. All of us face the same problem: We have an unlimited set of needs and desires that we need to satisfy with a limited amount of money (some more limited than others). If we truly look at the decisions we make with money, we can break it down quite simply: spend it, save it, or give it to someone else.

> In the past, an emptying wallet was more likely to scare and deter you from overspending than seeing one less digit on your bank balance on a screen.

Photo: Gallo/Getty Images

The two most common themes that you will be exposed to regarding money is about how to save it and how to manage and make decisions about debt. The most powerful decision, however, that you will make daily is how you spend your money, either by consuming goods and services or acquiring assets – resources which can generate a future benefit (such as a house). Consumption is a necessary part of life; we need to eat, clothe ourselves, move from one place to another and communicate. Savings is just a form of deferred consumption or eventually giving money to someone else.

We are all good at spending money, although we spend little time considering the impact that our spending has in shaping the world around us. A piece of the money puzzle that we often overlook is that, with money, the decisions we make are not isolated but integrate into a powerful system of social economics. These economics can drive prosperity or create financial inequality; economics that generate wealth or those that cause markets to collapse. It will amaze you how your wallet, no matter its size, has the power to do all of this.

We influence our world by the things we do with our money. When we buy goods, we are supporting companies and employment, which grow and shrink by these decisions. Our choice to spend our money with entrepreneurs rather than big businesses can build a nation. When we buy foreign goods, money leaves our national system and therefore as a country we become poorer. When we buy counterfeit goods, we are inadvertently supporting crime and possibly even terrorism. The ability to shape a nation and change the world is not just made so much by lofty ideals or votes at an election, but by the way we choose to spend our money.

This is the power of your wallet. Understand money better, be mindful of your decisions in financial matters and unlock your wallet to change our world for the better. ■

Deslin Naidoo, CFA, is the founder of NEBULA SI, a savings and investment start-up integrating traditional finance with artificial intelligence.

By Anne Cabot-Alletzhauser

CLOSING REMARKS

A word from the chairperson

The advisory committee would like to call papers for the next issue of *Collective Insight* and invite readers to the post-publication roundtable discussion.

We want to welcome you to our 56th edition of *Collective Insight* – 17 years and still going strong – and share with you some exciting new developments.

Those of you who may be new to the publication might appreciate a bit of background as to how it was started and how we hope, going forward, to enhance its impact on both the financial services industry and its clients.

In 2003, a small group of investment professionals and academics, in conjunction with *finweek*, identified a clear gap in the market for the introduction of an investment journal that would showcase the best research currently being done on asset management and financial advice in the South African market.

The objective of this publication was to bring together research papers from the academic, consulting and asset management industry in a way that would integrate fundamental investment principles, with best practice reality, and cutting-edge thinking.

Because we felt that the format should be as accessible (but thought-provoking) to both casual readers and professionals or academics in the area of finance, we wanted the publication to provide a forum through which ideas could be introduced, interrogated and, if necessary, challenged.

The trick, then, was to create a journal that the broader investment community and its stakeholders could "own" collectively. As such, *Collective Insight*'s content needed to be totally independent of commercial interests.

We also realised that the quality of this dialogue could be further enhanced by the introduction of an evening roundtable discussion where the various authors of each edition could debate their contributions more fully.

To that end, we are particularly grateful to the CFA Institute of South Africa (the Chartered Financial Analysts' Association), ABSIP (the Association of Black Securities and Investment Professionals), the FPI (the Financial Planning Institute of Southern Africa) and SAFA (the South African Finance Association) for their support in facilitating these evenings (see **sidebar alongside** for the upcoming roundtable dates).

Additionally, we recognised that the publication benefits hugely when we can get contributions to the relevant debates from as wide a range of authors as possible. If you find this of interest, we have posted the details of our next topic here and would welcome any article contributions you feel you would like to make to the discussion (see **sidebar** on contributions).

Thank you for your interest and we look forward to having you join us in these debates. ■

How to contribute to *Collective Insight*

- Contributing authors can determine whether any of the suggested angles under each topic would be of interest to address – or they can elect to introduce their own angle on the specific topic. There is no restriction.
- Contributors should avoid using their contributions as marketing pieces, opinion pieces or investment recommendation pieces.
- An advisory committee selects which contributed articles to include in *Collective Insight*. Selection is on merit and suitability only, and is completely unrelated to any advertising that may appear in the publication.
- Please send any proposed contributions addressed to **Anne Cabot-Alletzhauser at cabota@aforbes.co.za**

Theme for the next issue of *Collective Insight*

The advisory committee is calling for articles on the theme of *Disrupting the world of financial advice* in the forthcoming *Collective Insight*. The deadline for content submission is 6 April 2020. The following topics will be considered:

- How do we get the industry to shift to look through a holistic lens?
- Who is the master: your client or their money?
- What business model or incentive will attract the right skillsets and people into the industry as well as obtain the right commitment from the client?
- How to overcome cultural complexities:
  › Should we consider collective advice for families and collaborative funding solutions?
  › Understanding the pressures of, for example, the black tax. Does it require a different financial planning framework?
- How do we get financial education down to the youth?
- Finding scaling solutions that will get the message to the masses: Will technology provide for what is required? What will that solution look like?

Where to attend the roundtable discussions

You can join us and be part of the conversation as contributing authors in both Johannesburg and Cape Town share their insights and opinions on the topic that is published in this edition of *Collective Insight*. Discussions will take place on **24 February 2020** at **17:00** for **17:30** at the following venues:

Johannesburg: The Auditorium, Alexander Forbes, 115 West Street, Sandton

Cape Town: Flagship Boardroom, FNB Building, 5 Buitengracht Street, Portside

Visit the CFA Society's website at *https://www.cfasociety.org/southafrica/Pages/Home.aspx* and look under the Events page for the roundtable discussion.