



Future Focus

March 2025

Welcome to the Autumn Edition of Future Focus – insights on building wealth for your clients

- **Talking point:** South Africa's changing wealth management landscape.
- **Investment centre:** The hidden dimensions of diversification.
- **Manager insights:** The tenuous link between winning industry awards and investment flows.
- **Practice notes:** Income **IN** retirement – a blended approach is most optimal.

STANLIB Multi-Manager Investment Team

Talking point

South Africa's changing wealth management landscape



Key points

- **The South African IFA market has grown considerably. But it is not homogeneous, which allows DFMs to partner with IFAs in several ways as the landscape changes.**
- **This is a ‘win-win’ situation for both parties. The evolution of the wealth management/IFA space is intertwined with the growth and evolution of the DFM space.**

Introduction

In an era of rapid change traditional financial advice models are being challenged, necessitating the re-evaluation of existing practices and creating new ways of thinking. The South African wealth management landscape is undergoing a significant transformation, driven by evolving client needs, technological advancements, and shifting regulatory dynamics. At the heart of this evolution lies the key role of financial advisers, whose segmentation and influence are growing by the day.

Discretionary Fund Managers (DFMs) are fortunate to engage with advisers across the industry. As we navigate this dynamic environment, it becomes increasingly imperative to assess what is shifting the industry landscape. This article aims to provide a lens through which we can examine the current state and future trajectory of wealth management in SA, as well as the role DFMs will play in this evolution.

Current landscape

As one of the largest DFMs in the country, we are fortunate to be able to access high quality research conducted on our industry. According to 1NMG, there are 16 300 financial advisers in South Africa that influence approximately R2 trillion in assets under advice. To put this into perspective, the size of the local CIS (unit trust) industry is currently approximately 2R3.9 trillion. This highlights the immense power and reach of these professionals in shaping the financial futures of South Africans.

Interestingly, the market is split almost evenly between tied advisers (those aligned with specific insurers or banks) and independent financial advisers (IFAs). There are approximately 8 500 tied advisers, that manage a substantial R400 billion, while 7 800 IFAs hold a commanding R1.6 trillion. Although this disparity underscores the growing impact of independent advice, more interesting facts start to emerge when delving deeper into the numbers.



Behind the research

For the purposes of the research, NMG broke down the IFA segment into seven distinct categories, each with its unique characteristics and client base.

- **General practitioners (GPs)**
The largest segment, comprising 3 100 advisers, manages R310 billion in AUA. These advisers cater to a broad range of clients, often providing multi-product solutions at lower asset levels, including risk products.
- **Investment specialists**
With 1 500 advisers and R352 billion in AUA, this segment focuses on investments, catering to clients with assets between R150 million and R250 million.
- **Holistic advisers**
This smaller segment has approximately 500 advisers and R200 billion in AUA, offering sophisticated, comprehensive financial planning, and often serving high-net-worth clients through referrals.
- **Adviser-owned networks**
These comprise approximately 1 700 advisers and R528 billion in AUA, exerting significant influence in the IFA market. They are characterised by lower contestability and fee pressure.

¹ NMG - SA Retail Wealth Report 2024

² Association for Savings and Investment South Africa (ASISA), 4 March 2025

Talking point

South Africa's changing wealth management landscape (cont.)

- **Provider-owned networks**
With 1 200 advisers and R191 billion in AUA, these networks are owned by insurers or product providers.
- **Retail banks**
This segment, with 1 500 advisers, manages a substantial portion of LISP assets, including direct-to-market and savings products.
- **Insurer agency**
With 7 000 advisers, this category represents the affluent agency forces of life insurers.

Opportunity set

DFMs are well placed to play an increasingly important role in the South African wealth management industry. According to NMG, 67% of IFAs interviewed in their research, excluding networks, have already partnered with a DFM. DFMs generally offer a range of services, including portfolio construction, asset allocation, and risk management. As wealth management becomes more complex, advisers are increasingly turning to DFMs to provide specialised investment expertise and support. But given that the needs of each adviser cohort are so unique, there is unfortunately no 'cookie-cutter' approach to success when dealing with IFAs.

...two-thirds already
partnered with DFM

General practitioners (GPs)...network potential

While GPs offer a significant opportunity for growth in the DFM market – given the number of advisers and that most of them are young and growing their books – the sheer volume of advisers and geographical dispersion makes it extremely difficult to provide a comprehensive service offering. GPs are thus generally underserved by the DFM market.

GPs still tend to 'pick funds' when they come across an investment client. It is our view that DFMs, not linked to larger organisations, will struggle to gain traction in this space given limited resources and lack of distribution reach. This presents a great opportunity for DFMs with access to large distribution networks.

Investment specialists...smaller opening

The best opportunity for most DFMs looking to grow their assets is in the investment specialist IFA category – those with assets between R150 - R250 million under advice. These advisers are specialised and focus solely on investments as opposed to broader financial solutions such as risk. But given the rapid growth of DFMs in SA, this opportunity is quickly closing. Most of the DFMs that launched in the past four to five years have built their business cases to 'capture' this market.

Holistic advisers...a saturated market

Holistic advisers – often seen as the 'grail' of advisers in SA – have of late become a difficult segment to penetrate for DFMs. When references by DFMs are made that the adviser market is 'saturated' this is the market often referred to. Besides the limited number of advisers in this segment, of which many also have a Category II Investment license, many have partnered up with DFMs who have had a 'first mover' advantage over the past 10 years. These partnerships are typically based on strong relationships often thought of as 'unbreakable'. As this market starts to mature and succession is on the cards, DFMs without an answer to this succession problem, or at least linked to an adviser network, will struggle to maintain the status quo. We foresee a large shakeup in this market segment over the next five years.

Networks... DFMs continue to grow

The main beneficiaries of IFAs, regardless of the category, looking for succession, security and a 'place to belong' have been and will continue to be the Retail Financial Adviser (RFA) networks – both advice-owned and provider owned. These networks are attractive to advisers leaving insurers and banks as they are positioned as 'independent' but offer some of the security of being part of a larger group or team. We have seen massive growth in assets under advice and management over the past few years into networks, with DFMs linked to them having benefitted handsomely.

...networks hold
the ace



Trends...we need one another

The growth and evolution of the wealth management space is intertwined with the growth and evolution of the DFM space. The two work hand-in-hand and will continue to flourish because of each other, not despite each other.

Besides the impact of DFMs, there are clear trends emerging from the wealth management industry:

- Independent advice: the growing preference for independent advice, particularly among high-net-worth individuals, will continue to drive the growth of the IFA market.
- Technology: this will play an increasingly important role in wealth management, enabling advisers to enhance client engagement, streamline operations, and offer personalised solutions.
- Regulatory changes: evolving regulations will continue to shape the wealth management landscape, impacting adviser practices, product offerings, and client protection.
- Client experience: wealth management firms will need to prioritise client experience, and offer personalised services, transparent communication, and seamless digital interactions.

Conclusion

The South African wealth management landscape is dynamic and clearly evolving. As the market continues to evolve, financial advisers continually need to adapt and innovate to meet the changing needs of their clients. By partnering with a DFM, embracing technology, focusing on client experience, and adhering to evolving regulations, they will be able to navigate the challenges and capitalise on the opportunities presented by this dynamic landscape.

Ultimately, the success of wealth management in South Africa will depend on the ability of advisers to provide trusted, personalised, and value-driven advice that empowers clients to achieve their financial goals.

Leigh Kohler

STANLIB Multi-Manager: Head: DFM

Investment centre

The hidden dimensions of diversification



Key points

- **Diversification of asset managers is crucial to mitigate idiosyncratic risks that traditional diversification methods do not address.**
- **A multi-manager approach enhances portfolio resilience by blending varied managerial perspectives and methods.**
- **True diversification extends beyond asset classes to include the biases, risk tolerances, and decision processes of the people managing the investments.**

Introduction

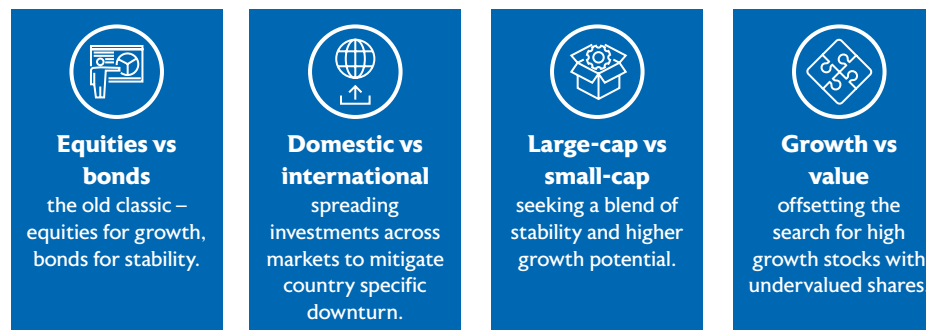
In the world of investments, “diversify” is a drumbeat that echoes from trading floors to retirement seminars, championed as one of the most prudent ways to manage risk. You have likely read countless articles on why it is smart not to put all your eggs in one basket, across stocks, asset classes, industries, and geographies.

But there is a curious paradox. In investment circles, everybody lauds diversification. Yet so many portfolios remain dangerously narrow in one aspect – the people who manage the assets and their decisions. **Diversification of asset managers** is a strategy that is often overlooked but can be as important as diversifying into new markets or currencies. After all, each manager carries their own assumptions, motivations, and blind spots. These ‘idiosyncratic risks’ can compound in ways that traditional measures of diversification do not address. Idiosyncratic risk is tied less to the broader market and more to the specific mindset or methodology of the manager.

Idiosyncratic risk is also referred to as a specific or unsystematic risk

A multi-dimensional approach

When we say “diversify,” what usually comes to mind?



These elements form the cornerstone of traditional portfolio allocation. Yet true diversification is not just about these big buckets, it also lives in the more subtle, often less discussed layers namely the biases, risk tolerances, and decision-making processes of the people making the investment calls.

The ‘human factor’ in portfolio construction

Think of a portfolio manager as you would think of a chef. They each have their signature ingredients (preferred asset classes), cooking style (investment philosophy), and approach to seasoning (risk tolerance). Some might be minimalists, committed to a single elegant strategy, such as pure value or growth. Others might be experimental gastronomists, mixing in unorthodox instruments and derivatives to enhance returns. Each approach may be valid, but also brings very specific, and sometimes unrewarded, risks. Examples may include:

- **Behavioural biases:** confirmation bias, overconfidence, or loss aversion can distort decision-making.
- **Market assumptions:** some managers might build strategies around assumptions (e.g., perpetually low interest rates) that could prove fragile in changing macro environments.

Investment centre

The hidden dimensions of diversification (cont.)

- **Philosophical leanings:** one manager might love momentum plays, another might avoid them outright, yet another might craft a portfolio around sustainable or ESG themes.

Idiosyncratic risk often goes unrewarded

The premise of diversifying across asset classes is to capture different market risk premia. Over the long run you should produce returns from various 'return streams' i.e. shares, bonds, property and so forth. However, idiosyncratic risks from a particular manager's style or biases often do not carry a systematic 'premium' that you can exploit. Instead, those risks can be more akin to quagmires of human error. If a manager, for instance, systematically overestimates earnings growth in cyclical industries, investors will not necessarily be compensated for that risk in the form of higher returns. That is an unrewarded risk you would be better off neutralising.

By diversifying across multiple managers, you effectively spread your exposure to a range of perspectives and methods. While you might end up forgoing the dramatic outperformance of a single star manager whose idiosyncrasies happen to work out brilliantly one year, you are also more insulated from underperformance if those biases backfire.

A choir of voices

Visualise your investment pool as a choir. Each singer (manager) brings a unique voice – soprano, alto, tenor, bass. In a multi-manager setup, it is not about one singer dominating with a show-stopping solo, it is about the harmony that arises from multiple, well-curated voices. When all members have distinct yet complementary vocal ranges and skills, the performance becomes richer, fuller, and less reliant on a single virtuoso.

Similarly, if every manager in your stable is a 'growth at all costs' devotee, that would be like having an entire choir of sopranos. It might be thrilling when hitting a high note in a market that rewards growth, but it can become unbearable when the market turns. Diversifying managers means adding baritones and mezzos, so your total 'portfolio performance' does not collapse when the market decides to favour slower tempos or deeper tonalities.

Investment due diligence

How do you ensure you are bringing genuinely different 'voices' into your investment choir? Start with the same rigour you would use for an asset class:

The foundation of true diversification



Philosophy and process: understand each manager's strategy. Do they rely heavily on quantitative screens, or is their approach more fundamental? How do they react to market volatility?



Performance attribution: look beyond raw performance numbers – examine what is driving returns. Are they picking undervalued shares, chasing momentum, leveraging currency plays, or relying on complex derivatives.



Risk profile: has the manager endured multiple market cycles, or have they only been tested in benign environments? Do they concentrate heavily in certain sectors or themes?



Team and culture: a manager's internal culture can shape how decisions are made, how quickly they adapt, and whether they are prone to group-think.



Correlation analysis: evaluate how the performance of each manager tracks not only with the overall market, but with each other. Two managers might appear different on paper but could still be tethered to similar underlying assumptions.

Operational due diligence

Operational due diligence (ODD) is as crucial as investment due diligence itself. It goes beyond assessing performance or investment philosophy, critically examining the structural integrity that underpins the ability of a manager to consistently deliver their intended strategy. To comprehensively mitigate hidden risks, operational due diligence must rigorously evaluate the quality, depth, and reliability of the manager's operational environment.

Infrastructure of success

Investment centre

The hidden dimensions of diversification (cont.)

- **Systems and technology:** evaluate the robustness, scalability, and security of the technology platforms used. Weak operational systems can lead to trade errors, settlement issues, and significant unintended risks.
- **Risk management:** assess whether managers employ sophisticated, proactive risk monitoring systems. Confirming alignment between stated strategies and actual risk-taking is essential for ensuring transparency and avoiding unexpected losses.
- **Operational resilience and continuity:** confirm managers have robust business continuity plans. Ensuring that managers can maintain investment operations during disruptions helps safeguard your capital during periods of turmoil.
- **Governance and compliance:** thoroughly review the manager's regulatory adherence, ethical standards, compliance structures, and transparency in reporting. Managers who demonstrate strong governance are less likely to experience regulatory penalties or reputational damage.

While ODD may lack the glamour of investment performance analysis, rigorous ODD forms a critical defensive layer, enabling the multi-manager strategy to deliver its value effectively.

Why a multi-manager model works

Beyond blunting idiosyncratic risks, a multi-manager approach offers two additional benefits:

Dynamic flexibility. Having multiple managers means you can more fluidly rebalance capital based on changing markets. For instance, if one manager runs a high-yield bond strategy and another focuses on equities, you can shift allocations as opportunities ebb and flow.

Alignment with goals. Different managers can serve different roles in your overall plan. Some focus on generating stable income while others chase long-term capital growth or alternative strategies. In this sense, you can align managers with the varying objectives you might have for different pockets of capital.

A new way to think about diversification

Far from being an extra or nice-to-have, diversifying managers is central to robust portfolio construction. It acknowledges that no one has perfect foresight or an infallible method. By blending multiple perspectives, you guard against unforced errors tied to a single individual's peculiar way of seeing the world.

Sure, you may get lucky. A lone wolf manager might deliver jaw-dropping returns for a few years. But star power can fade with market shifts, and the unwatched 'idiosyncratic' exposures could become traps. When you build your portfolio with a multi-manager mindset, you are effectively mitigating that single-point-of-failure risk, just like you would do by mixing large capitalisation with small capitalisation shares or domestic shares with international ones.

Conclusion

The bottom line is that diversification extends well beyond merely holding an array of asset classes, industries, or currencies. True diversification includes blending varied managerial approaches to avoid loading up on a single worldview. When building a portfolio, remember that managers, like markets, can harbour hidden risks and biases. By diversifying your managers just as rigorously as you diversify your assets, you create a more nuanced and resilient investment environment – one poised to weather the idiosyncrasies of human nature as effectively as it weathers the storms of market cycles. Each manager comes with their own set of assumptions, philosophies, and biases, and those are as fundamental to a portfolio's risk profile as interest rates or market cycles.

Investing wisely often comes down to anticipating what might go wrong before it does. Apart from just spreading your 'bets' across different asset buckets, remember to also spread them across different minds and methods. In this way, you strengthen the foundation of your investment strategy – reducing your vulnerability to any one person's quirks, no matter how brilliant or compelling they might seem in the moment.

Joao Frasco

STANLIB Multi-Manager: CIO

Manager insights

The tenuous link between winning industry awards and investment flows



Key points

- **Winning awards is great and may boost brand reputation, but surprisingly, on average, award-winning funds saw outflows instead of inflows.**
- **It is more than just awards – investor sentiment, market conditions, and broader industry trends seem to play a far greater role in fund flows than accolades alone.**

Introduction

The asset management industry is filled with award shows each year, from the Profile Data (previously known as the Raging Bull awards) and Morningstar awards, to our very own INN8 Invest Diamond awards. These awards recognise the performance and achievements of asset managers across various categories, time periods and methodologies. Some of these awards, like our Diamond awards, also have a qualitative element to the methodology.

From a commercial perspective, asset managers can capitalise on this success. Awards boost brand reputation and asset managers, large and small, can use this as marketing opportunities. Awards are also beneficial for smaller, less well-known asset managers, who can get crowded out by the size of the industry and are competing with much larger players. Awards may put them on the radars of fund selectors such as multi-managers, discretionary fund managers (DFM's) and advisers.

The question is, do awards result in any measurable outcomes?

For asset managers, success is typically measured by financial performance, which will largely depend on new business flows. Can awards then help to rake in these flows? Winning awards would suggest this is true, based on the idea that these managers have consistently done well in the past (say three to five years) and the accolades from the awards would at least persuade investors to consider investing with them.

Global research

Globally, this topic has also been researched. A study in the United States by ¹Del Guercio & Tkac, 2008, found that Morningstar ratings (not necessarily awards) had a major influence on retail investors. Their findings showed that positive abnormal flows followed rating upgrades, and negative abnormal flows followed rating downgrades.

While awards are mainly backward looking, perhaps investors find comfort in ratings that include both a quantitative and qualitative element. Where qualitative factors such as the experience of the portfolio managers and the repeatability of their investment process may weigh more heavily on an investor's decision to allocate to a specific fund.

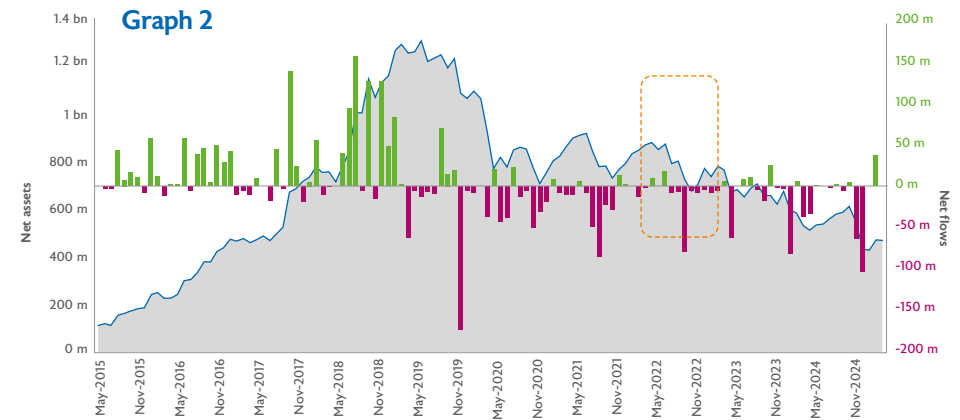
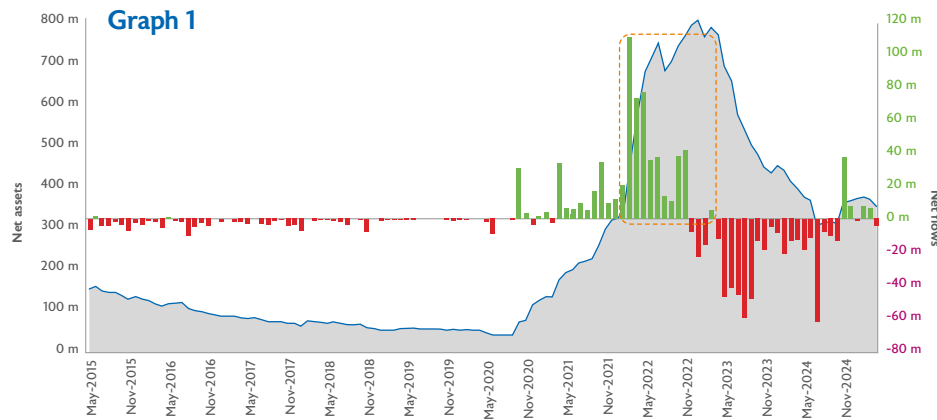
¹ Del Guercio, D., & Tkac, P. 2008. Star power: The effect of Morningstar rating on mutual fund flow.

Manager insights

The tenuous link between winning industry awards and investment flows (cont.)

Example: winner vs non-winner

The graphs that follow show simple examples of the monthly net flows and total assets of a Profile Data trophy winner (graph 1) and a non-winner in 2022. The two funds compared fall within the same category and are relatively small, less well-known asset managers. At first glance, there is a clear spike in flows around the period the asset manager wins (graph 1) and the non-winner (graph 2), after which their flows appear to just trickle along. This is, however, just one example and not conclusive.



Source: Morningstar, INN8 Invest

Statistical testing yielded mixed results

Intuitively, it is easy to assume that when a fund wins an award, it would naturally attract more investments. We tested this statistically using the winners of the Profile Data awards against all other funds to determine whether award winning managers on average received more inflows than those of non-winning managers.

How we conducted the analysis and findings

We examined the winners of the Profile Data awards from 2020 to 2024. These awards are given in three categories:

- Straight performance (based on three years of returns),
- Risk-adjusted performance (over five years), and
- Manager of the Year.

For our analysis, we included South African-domiciled funds and focused on their main retail-fee share class. We also considered both trophy winners and certificate winners, covering 62 unique winners over the period.

Manager insights

The tenuous link between winning industry awards and investment flows (cont.)

We used monthly fund flow data from Morningstar and assumed that the awards took place in February each year. Then, we measured the flows of each fund, as a percentage of assets under management (AUM), over three periods and here are our findings for each period:

- Over 3 months (March - May) and 10 months (March - December), there was no clear evidence that winning an award led to increased fund inflows.
- However, over the 6-month period (March - August), the data showed that on average, award-winning funds experienced a surprising decline in assets under management compared to non-winning funds

Possible reasons for a decline in assets over the 6-month period

- Overall market conditions may have negatively impacted net flows. If the industry was experiencing outflows, even award-winning funds would not be immune, which we discuss more in the next section.
- Performance-based investor behavior – some investors might sell after strong performance, taking profits and reallocating elsewhere.
- Smart investor decisions – many experienced investors know that chasing past winners does not always lead to future gains. Instead of “buying high,” they might wait for a more attractive entry point.

Overall, these results do not conclusively support the idea that winning awards contributes to new business flows.

Sector flows

The table below shows the annual net flows for some of the major ASISA categories over the past ten years.

Category/Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Global EQ General	6.09 bn	8.24 bn	6.17 bn	-1.84 bn	3.31 bn	15.19 bn	24.25 bn	8.07 bn	113.03 m	14.6 bn
Global MA Flexible	3.07 bn	2.38 bn	1.24 bn	-2.49 bn	353.41 m	4.07 bn	4.17 bn	381.92 m	-2.52 bn	-1.97 bn
Global MA High Equity	934.98 m	814.11 m	409.28 m	-387.5 m	-811.21 m	2.09 bn	2.28 bn	1 bn	-3.56 bn	-103.76 m
Global RE General	1.8 bn	541.84 m	-703.74 m	-499.53 m	259.94 m	-761.19 m	-325.32 m	1.02 bn	-926.12 m	-196.79 m
South African EQ General	-3.26 bn	-6.96 bn	-3.55 bn	2.16 bn	-5.44 bn	-5.87 bn	2.24 bn	206.5 m	210.56 m	-773.42 m
South African EQ SA General	4.97 bn	9.92 bn	13.64 bn	8.88 bn	-467.09 m	4.87 bn	13.34 bn	-3.57 bn	2.31 bn	-2.95 bn
South African IB SA Money Market	-7.94 bn	-5.89 bn	-1.61 bn	-10.9 bn	-1.81 bn	15.5 bn	-314.18 m	4.42 bn	1.62 bn	-32.82 bn
South African IB Short Term	-2.54 bn	8.89 bn	30.13 bn	26.62 bn	31.57 bn	40.07 bn	25.65 bn	-26.68 bn	15.05 bn	12.11 bn
South African IB Variable Term	3.44 bn	3.02 bn	2.73 bn	8.32 bn	3.43 bn	17.69 bn	15.12 bn	12.89 bn	-2.09 bn	-528.13 m
South African MA Flexible	6.29 bn	2.23 bn	2.94 bn	3.28 bn	-1.26 bn	-1.33 bn	1.17 bn	6.93 bn	2.77 bn	7.1 bn
South African MA High Equity	51.83 bn	24.8 bn	22.72 bn	14.5 bn	-5.49 bn	-24.1 bn	10.98 bn	16.82 bn	5.54 bn	-10.8 bn
South African MA Income	3.98 bn	7.8 bn	20.52 bn	13.36 bn	63.4 bn	31.37 bn	19.3 bn	24.44 bn	28.19 bn	20.16 bn
South African MA Low Equity	24.92 bn	11.81 bn	-8.71 bn	-6.07 bn	-15.93 bn	-12.22 bn	10.16 bn	-2.27 bn	-12.03 bn	-16.31 bn
South African MA Medium Equity	8.53 bn	4.05 bn	-58.34 bn	268.87 bn	-5.76 bn	-1.51 bn	6.94 bn	3.98 bn	1.25 bn	1.66 bn
South African RE General	2.37 bn	855.23 m	6.64 bn	2.61 bn	-290.52 m	-170.79 m	1.18 bn	-3.2 bn	-2.96 bn	-3.18 bn
TOTAL	108.55 bn	75.99 bn	95.64 bn	57.86 bn	70.53 bn	90.68 bn	144.26 bn	48.47 bn	29.96 bn	-13.35 bn

Source: Morningstar, INN8 Invest

The table only accounts for funds that have been in existence as of 28 February 2024.

Manager insights

The tenuous link between winning industry awards and investment flows (cont.)

The following can be observed:

- In **2020**, the Multi-Asset High Equity, Multi-Asset Low Equity and EQ General categories saw the largest negative flows, whereas the lower risk IB Money Market, IB Short-Term and Multi-Asset Income categories saw the largest inflows. The most plausible reason being investors' flight to safety in the COVID-19 sell-off, switching into lower risk funds.
- In **2021**, the industry saw its largest annual inflows of just more than R144.2 billion, coming off the back of COVID-19, where local equity markets saw a drawdown of more than 20% in March 2020. This detraction was, however, short-lived and investment markets recovered quickly. In 2021, SA equities (FTSE/JSE All Share Index) returned 29.2%.
- In **2022/2023**, the industry experienced big inflows to the Multi-Asset Income category. Over this period, the SARB raised rates from 3.75% to 8.25%. The higher yields on offer made income-focused funds very attractive investment options.
- In **2024**, when the two-pot system came into effect and SA investors were able to access their retirement savings, the industry saw outflows of R 13.5 billion. This was the first time in ten years that the industry experienced outflows. Interestingly, most of the negative flows occurred in the IB SA Money Market category, followed by the Multi-Asset Low Equity and Multi-Asset High Equity categories. For the two multi-asset categories, the outflows made sense, as this would be where most investors would house their retirement savings.

Conclusion

The relationship between industry awards and new business flows in the asset management sector is not as straightforward as it may seem. While awards can enhance brand recognition and provide marketing leverage, our analysis over the past five years does not conclusively support the idea that winning awards directly results in higher fund inflows. In fact, over a six-month period post the award, the data surprisingly suggests that award-winning funds, on average, experienced negative flows.

This counterintuitive result highlights the complexity of investor behaviour. It suggests that broader industry dynamics, market cycles, and investor sentiment play a far more significant role in fund flows than accolades alone. Events such as the COVID-19 pandemic, shifts in monetary policy, and regulatory changes have had more of a profound impact on where investors allocate their capital.

Ultimately, while industry awards serve as valuable recognition tools and can contribute to an asset manager's reputation, they cannot be viewed as a guaranteed driver of new business. Asset managers looking to grow their client base should focus on maintaining strong, consistent investment performance, transparent communication, and a well-articulated investment philosophy and process that resonates with both retail and institutional investors.

Joshua Munnik
STANLIB Multi-Manager
Research Analyst

Practice notes

Income **IN** retirement – a blended approach is most optimal



Key points

- **It is crucial to build up discretionary savings before you retire.**
- **Discretionary investments have several benefits and should be used to supplement your income IN retirement.**
- **It is important to consider all strategies and combinations thereof to optimise your compulsory and voluntary savings IN retirement.**

The day you reach retirement

Retirement planning often involves finding a balance between maintaining a comfortable lifestyle now and securing financial stability when you retire. But life is unpredictable and unexpected expenses can arise. To maintain your desired standard of living, it is crucial to also have discretionary savings.

Making provision for both planned and unplanned discretionary expenses throughout your lifetime is key to balancing your savings. Discretionary savings give you **flexibility** and **liquidity** and should **(1)** provide for unexpected expenses by way of an 'emergency fund' that can be accessed immediately and **(2)**, importantly, provide for income in retirement, so you do not end up with all your savings tied up in a compulsory annuity.

When you retire, at least two-thirds of your retirement fund savings are used to buy a compulsory annuity (pension). The balance becomes part of your existing (discretionary) savings pool.

Discretionary savings - main benefits

- **Flexibility:** allow retirees to access funds as needed without restrictions, offering the freedom to withdraw or invest according to personal circumstances.
- **Tax efficiency:** while contributions to discretionary savings are made from after-tax income, the investment growth may be tax-effective, especially if managed through tax-efficient vehicles.
- **Supplementary income:** an additional income stream, complementing your retirement investments.

- **No contribution limits:** unlike retirement plans, there are no limits on how much one can contribute to discretionary savings plans.
- **Peace of mind:** knowing that you have a financial safety net reduces stress and provides peace of mind.

Before and in retirement...be precise

It is very important to distinguish between **before** and **in** retirement when referring to benefits. For example, despite their flexibility, discretionary investments lack the before retirement tax benefits associated with retirement funds. There is no tax payable on interest, dividends or capital gains while invested in a retirement plan. In addition, discretionary investments do not offer protection from creditors, unlike retirement funds. This can be a concern for those in financial difficulty – typically **before** retirement.

Lastly, investors need to be aware of the 'risks of having access' to capital in their discretionary savings pool **before** retirement if it is earmarked to supplement your income in retirement. As an investor you need to be disciplined enough to not access this capital prior to retirement.

The income, capital and growth conundrum

Compulsory savings

Retirement funds are tax-deferred, meaning that you do not pay tax within the retirement wrapper while your member share grows, but you are taxed when you start drawing an income. If, for example, you are drawing from a living annuity, the income is taxed as ordinary income according to the personal income tax tables. Currently, this ranges from 18% to 45%, depending on the amount of income drawn.

The administrator of the living annuity will deduct the tax upfront and pay it to SARS, depositing the net income amount into your account. Given the tax treatment, drawing large amounts solely from your retirement annuity could push you into a higher tax bracket, as 100% of the income drawn is taxable.

Practice notes

Income **IN** retirement – a blended approach is most optimal (cont.)

Discretionary savings

On the other hand, income from discretionary investments consists of a **capital** portion and a **growth** portion, meaning it is only taxed on a portion of the amount withdrawn, as opposed to income from retirement funds, which is 100% taxable. Discretionary savings – which includes collective investment schemes ('unit trusts'), share portfolios, endowments and money market investments – are all taxed differently. These investments are not subject to the same regulations, allowing you to tailor your investments to your preferences.

- **Capital gains tax (CGT):** only realised capital gains are subject to CGT, and the first R40 000 worth of gains each year is exempt. Beyond that, 40% of your capital gain is included in your taxable income, and you are taxed at your marginal rate.
- **Dividends withholding tax:** if you receive dividends from shares, these are subject to a 20% withholding tax.
- **Endowments:** tax is payable on all interest and capital gains, but at a standard rate of 30% rather than your marginal tax rate. Dividends are taxed at 20%.
- **Interest income:** interest is taxed at your marginal tax rate but the first R23 800 (for individuals under 65) and R34 500 (for individuals over 65) of interest is tax-free.

Finding the optimal combination

It is essential for investors to consider the different tax treatment of retirement funds and discretionary savings. How you use the two savings pools depends on several factors, including withdrawal rates, income needs and liquidity requirements. Ultimately, the best strategy often involves a combination of both savings pools, allowing you to optimise tax efficiency while maintaining liquidity for unforeseen needs. By understanding the trade-offs and aligning your investments with your financial goals, you can create a strategy that supports both your immediate and long-term financial well-being.

Several strategies that can save you taxes in retirement and increase your disposable income, follow alongside.

1. High income earners - disallowed contributions

The reality is that this strategy will not benefit the average salaried employee since their existing contributions will more than likely fall comfortably within the 27.5% deduction and the R350 000 cap. However, higher income earners have the option to invest more than R350 000 in a retirement plan. The decision to invest more than R350 000 is not a simple decision as there is no right or wrong answer.

If you opt to do this, Section 10C of the Income Tax Act provides that any previously disallowed contributions that have not been set off against your lump sum taken at retirement, may then be applied towards exempting annuity income received from compulsory annuities. This in effect, reduces your income tax payable until all disallowed contributions have been used up.

If you think about it slightly differently, when you retire your disallowed contributions allow you to convert a larger amount into discretionary savings, exactly what you want considering the annuity tax dilemma you have **in** retirement.

2. Split your income with your spouse

Splitting your **income** with your spouse can effectively reduce your overall tax liability. Remember a donation made to a spouse is completely exempt from donations tax. By sharing income, you can take advantage of lower tax brackets and exemptions for both individuals. This strategy is particularly beneficial if one spouse is in a higher tax bracket than the other.

3. Plain discretionary savings vehicles

There are various ways to invest – from bank fixed deposits to CISs, model portfolios, exchange traded funds (ETFs) and share portfolios. The appropriate allocation of discretionary investments depends on factors including your individual circumstances, your tolerance for risk and whether you specify financial goals such as saving to supplement the pension you will receive from your compulsory annuity **in** retirement.

Practice notes

Income **IN** retirement – a blended approach is most optimal (cont.)

4. Start early – TFSA

Build up your tax-free savings (TFSA) long before retirement. Tax free savings remain an extremely useful planning mechanism and by starting your tax-free savings long before retirement, you can build up meaningful capital that can be used in retirement to provide tax free income.

Also maximise this benefit between yourself and your spouse or partner to ensure that you get a decent return on this. It is of little use investing in a tax-free savings account in cash or interest-bearing assets (in your bank) as this does not allow your money to grow over time to create meaningful wealth **in** retirement. In starting contributions to tax free savings 14 to 15 years before retirement – it takes roughly 14.5 years to reach the R500 000 lifetime limit – you can accumulate a meaningful amount to provide additional capital, used as tax free income **in** retirement.

However, as there are limits on how much you can save in these vehicles and you cannot replace what you withdraw, it is generally advisable to access other savings and investments first before tapping into your TFSA.

Examples

To demonstrate the actual impact of tax, we show examples of the strategies above. The tax impact will vary based on personal circumstances, e.g. level of income, RA contributions, amount and timing of plain savings, type of pension, dividend yield and timing of realising capital gains.

Example

	Base case	<ul style="list-style-type: none"> R8 million in living annuity in retirement Balance invested in growth 'unit trusts. Pay out dividends. 	<ul style="list-style-type: none"> R8.2 million in living annuity in retirement Balance invested in growth unit trusts. Pay out dividends. Tax free saving account
Pension	10 000 000	8 200 000	8 200 000
Unit trusts		1 800 000	1 000 000
Tax free savings	-	-	800 000
Annuity income	600 000*	552 500**	552 500**
Monthly taxable income	50 000	46 042	46 042
Tax payable	-12 739	-11 314	-11 314
Income after tax	37 261	34 728	34 728
Dividends after DWT	-	2 533#	1 400#
Tax free income (TFSA)	-	-	1 133
Income in retirement	37 261	37 261	37 261
Annual tax payable	152 868	143 328##	139 968##
Annual tax saving	-	9 540	12 900

These are simplistic analysis for illustration purposes only. Medical credits and rebates have not been taken into consideration.

*6% drawdown monthly.

** Approximately 6.74% drawdown monthly.

Approximately 2.1% dividend yield

Includes 20% dividend withholding tax (DWT).

Conclusion

Discretionary income is a powerful tool for shaping your financial future. By understanding the pros and cons of various discretionary investment vehicles and how they can be used to supplement your annuity in retirement, allows you to make informed decisions that lead to greater financial freedom.

The help of an experienced and qualified financial adviser can be invaluable to help you invest your discretionary savings appropriately.

Albert Louw CFP®

STANLIB Multi-Manager: Practice Manager



As neither STANLIB Multi-Manager, a division of STANLIB Asset Management (Pty) Limited ("STANLIB") nor its representatives did a full needs analysis in respect of a particular investor, the investor understands that there may be limitations on the appropriateness of any information in this document with regard to the investor's unique objectives, financial situation and particular needs. The information and content of this document are intended to be for information purposes only and should not be construed as advice. STANLIB does not guarantee the suitability or potential value of any information contained herein. STANLIB does not expressly or by implication propose that the products or services offered in this document are appropriate to the particular investment objectives or needs of any existing or prospective client. Potential investors are advised to seek independent advice from an authorised financial adviser in this regard. STANLIB Asset Management (Pty) Limited is an authorised Financial Services Provider in terms of the Financial Advisory and Intermediary Services Act 37 of 2002 (Licence No. 719).