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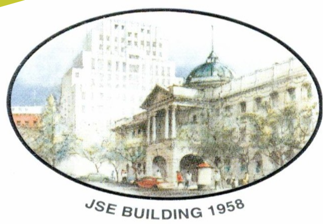

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Dave Pohl & Associates
Registered Financial Planner

post — Dave Pohl & Associates, P O Box 465, Lanseria, 1748
office — Unit B Three Seasons Office Park, 7 Spring road Rivonia
email — dave@davepohl.co.za
web — www.davepohl.co.za
phone — 011 807 1052
cell — 083 653 6255
fax — 011 807 3815
FSP — 12436
assist — Matthew Pohl, matt@davepohl.co.za
assist — Richard pohl, richard@davepohl.co.za
assist — Estelle Earl, estelle@davepohl.co.za

Risky Business

Having a good understanding of your risk tolerance is crucial to any successful advisor/client relationship. As investment advisors we usually explore things like age, size of investment portfolio, expected retirement date and future earnings and financial obligations to gauge your risk tolerance. These quantifiable aspects can tell us a lot about your ability to take investment risk, but what about your willingness?

The importance and complexity of your willingness to take risk is one of the many differentiating factors between managing investment portfolios for large institutions and managing them for individual investors. Because most investment products and programmes are developed by institutions for institutions they fail to address this "human side" of risk tolerance. Personality typing is a new tool that is helping investment advisors better understand an individual investor's willingness to take risk and behavioural tendencies. Read on to learn more about what personality typing is, how it can help you gauge risk tolerance, and how it can give you insight into your decision-making tendencies.

Before we discuss the process of personality typing, it is important to understand that individual investors are unique and cannot always be perfectly placed into a specific personality type or category. However, personality typing can help facilitate discussions with investors about risk tolerance and can give you insight into investment strategies that may fit your psychological profile. (Just because you're willing to accept a risk, it doesn't mean you always should. Risk tolerance only tells half the story.)

The Process

The first step in personality typing is to understand your personal background. Interviewing investors about their life experiences, inherited behavioural traits, career paths and their current investment portfolio can tell a lot about their willingness to take risk and whether or not they have a tendency to make emotional decisions regarding their investments. Once a good understanding of their background is established, they can usually be placed into a broad investor personality type.

There are four main personality types: *cautious, methodical, spontaneous, and individualist*. They are categorised below by willingness to take risk.

Lower Willingness to Take Risk

Cautious

Cautious investors make decisions based primarily on feelings and are very sensitive to investment losses. Fear drives their investment decision making process. They have trouble making proactive decisions regarding their investments and do not trust the advice of others. For this reason, their portfolios usually have low turnover and mostly include safe investments.

Methodical

Methodical investors follow a disciplined, mechanical investing strategy. They make investment decisions based on hard facts and have the tendency to nitpick about small details. They rely heavily on investment research and are not emotional about their investment decisions. They tend to be disciplined investors which can cause them to have a lower risk tolerance.

Higher Willingness to Take Risk

Spontaneous

Spontaneous investors make investment decisions based on feelings and make them frequently. They are always second guessing themselves and the advice of others, and often chase investment fads. For this reason, their investment portfolios usually exhibit high portfolio turnover and may include riskier investments.

Individualist

Individualist investors make decisions based on hard facts and do not second guess their investments often. They exercise independent thinking and put a great deal of trust in their investment research. For this reason, they are usually less risk averse than others. Individualist investors are usually self-made and hard working.

Professional Advice Is Critical

Investors who use advisors express a higher degree of satisfaction and success. Specifically, investors who use advisors…

- Are more likely to have a financial plan (82 percent versus 51 percent of unadvised investors)
- Are more satisfied with their financial situation (78 percent versus 67 percent)
- Are more than 50 percent more likely (34 percent versus 22 percent) to say they're doing a very good job managing their investments
- Have a better mix of investments (81 percent describe their mix of investments as good or better, versus 68 percent of unadvised investors)
- Are less likely to go more than 18 months without rebalancing (13 percent versus 20 percent)

Of the investors surveyed, 60 percent said they have a primary financial advisor. Men are significantly less likely than women to say they have a primary investment advisor—50 percent of male investors say they have a primary financial advisor versus 70 percent of women.

Arriving at Total Risk Tolerance

Your personality type and *willingness* to take risk can be used in conjunction with information regarding your *ability* to take risk to better judge your total risk tolerance. Occasionally, your willingness will vary greatly from your ability to take risk. When this occurs, further education about capital markets and investment risk may be required to resolve the issue. As you will see in the side column (left), investors who use financial advisors, experience a higher degree of satisfaction and success. It may well be that an objective third party, in the form of your advisor, provides the unemotional advice you require.

Conclusion

When dealing with individual investors, building a truly customized investment portfolio involves a good understanding of both your ability and willingness to take risk. Most generic investment programmes and financial products do not properly address your willingness to take risk. The growing acceptance of behavioural finance makes it crucial to use new tools like personality typing to help them better understand your risk tolerance. Although self diagnosis may not always be healthy, personality typing can also be used as a tool to give you insight into your own investment biases and willingness to take risk.

What is the difference between risk tolerance and risk capacity?

Risk tolerance and risk capacity are two concepts that need to be understood clearly before making investment decisions. Together, the two help to determine the amount of risk that should be taken in a portfolio of investments.

Risk Tolerance

Risk tolerance is the amount of risk that an investor is comfortable taking, or the degree of uncertainty that an investor is able to handle. Risk tolerance often varies with age, income and financial goals. It can be determined by many methods, including questionnaires designed to reveal the level at which an investor can invest, but still be able to sleep at night.

Risk Capacity

Risk capacity, unlike tolerance, is the amount of risk that the investor "must" take in order to reach financial goals. The rate of return necessary to reach these goals can be estimated by examining time frames and income requirements. Then, rate of return information can be used to help the investor decide upon the types of investments to engage in and, the level of risk to take on.

Income targets must first be calculated in order to decide the amount of risk that may be required.

Balance of Risk

The problem many investors face is that their risk tolerance and risk capacity are not the same. When the amount of necessary risk exceeds the level the investor is comfortable taking, a shortfall most often will occur when it comes to reaching future goals. On the other hand, when risk tolerance is higher than necessary, undue risk may be taken by the individual. Such investors sometimes are sometimes referred to as risk lovers.

Taking the time to understand your personal risk situation may require self-discovery on your part, along with some financial planning. While attaining your financial goals is possible, reason and judgment can be clouded when personal feelings are left unchecked. Therefore, working with a professional is helpful, if not critical.

Til death do us part

This article explains everything you ever needed to know about the Accrual System.

How it works and how it affects your testamentary planning.

South Africa's legal system has in the past few decades progressed in leaps and bounds in attempting to ensure equality between the sexes before the law. Until the introduction of the Accrual System into our marriage law, the legal position of married women in South Africa was one which would make even the most ardent modern chauvinist blush.

Marriage law — the South African perspective

The legal position prevailing in most legal jurisdictions, even as recently as the last century, can be seen from the comment by an eminent American law professor who, writing in 1917, commented that "husband and wife are one and that one is the husband". In South Africa, prior to 1984, our law usually left a prospective bride (particularly one intending to be a full-time mother and caregiver) with a difficult choice to make between the available marital regimes.

In the absence of an antenuptial agreement, the common law position then prevailing was that which had existed for centuries: upon marriage the spouses' estates became one (called "community of property"), over which the husband had sole control in terms of his so-called "marital power". Our law's wedding gift to the bride was to effectively bestow on her the legal capacity of a child. A betrothed couple could avoid this regime from applying to their union by entering into an antenuptial agreement prior to tying the knot.

By excluding "community of property" in the contract, their estates would remain separate thus giving the wife full legal capacity and complete control over her estate. An intending bride was thus often caught between "the devil" (community marriage with little legal power over the joint estate and diminished legal status) and the "deep blue sea" (marriage out of COP – full legal capacity over her separate estate but having no claim against her husband's assets upon his death or their divorce).

The introduction of "the Accrual System"

In 1984, the Matrimonial Property Act was passed, dragging our marital law somewhat belatedly into the 20th century. For marriages in community of property, the Act abolished the husband's "marital" power over his wife and their joint estate. A system of joint (and equal) administration over the community assets was introduced for all such marriages (even for "in community" marriages entered into prior to 1984). The Act also gave spouses who chose to marry out of community of property another option: the "Accrual System".

What is the Accrual System?

The Accrual System, based on the German model, has been described as one of "deferred sharing of profits". It automatically applies to all marriages out of community of property after 1 November 1984, unless specifically excluded by antenuptial contract. With the Accrual System, during the marriage the spouses are fully independent and there is a complete separation of property.

On dissolution of the marriage either by death or divorce, the gains made during the marriage are shared. The Accrual System thus recognises that marriage is a partnership but assets acquired before the marriage are not shared.

How does the Accrual System work?

Each spouse declares a "commencement" value for his or her estate. On dissolution of the marriage each spouse's estate is again valued. The spouse whose estate shows the smaller gain is given a claim against the spouse whose estate shows the greater gain, for an amount equal to one-half of the difference between the two gains or "accruals".

The "commencement" values are adjusted for inflation and the "dissolution" values exclude certain assets like inheritances (see Accrual ex-

A brief history of marriage in South Africa

Ever wondered how we got to where we are in our contemporary view of marriage and the rights of women therein? You may be surprised by how far we have come!

585 AD Church Synod of Macon resolves that women are human beings with immortal souls, who might not be sold and traded (not strictly applicable to S.A *per se* but an indication of the general thinking in Europe at the time.)

Pre-1652 Roman-Dutch law

Upon marriage, spouses' estates are combined and are administered by the husband. Upon divorce, estate split equally (unless "guilty" party ordered to forfeit). Antenuptial contracts allowed couples to amend this structure.

1652 Dutch settlers bring Roman-Dutch law of marriage and divorce to the Cape.

1935 Age of marriage raised from 14 to 18 years for boys and from 12 to 16 years for girls.

1949 Prohibition of Mixed Marriages Act passed—marriage between whites and non-whites outlawed.

1953 The first dent in husband's marital power. Wife married in COP now protected against sale of her immovable property by husband. Also allowed control over her own earnings and to open banking accounts unassisted.

1970 Marriage age for girls decreased to 15 years (this remains the marriage age for girls today). Also requirement of banns and marriage licenses abolished.

1979 Main ground of divorce changed from “guilt” to “irretrievable breakdown”.

1984 Husband’s marital power over wife and joint estate abolished, replaced by “joint administration”. Accrual system introduced for marriages out of COP. New laws do not apply to black people.

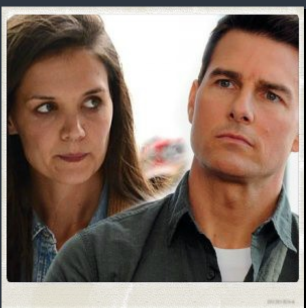
1985 Mixed Marriages Act scrapped. Inter-racial marriages now legal again

1988 1984 law reforms extended to “black” civil marriages.

1992 Domicile Act allows married woman to acquire her own legal domicile. Previously she automatically acquired domicile of husband.

1993 Husband’s legal status as “head of the household” is abolished.

1994 Husband’s status as sole guardian of a married couple’s children removed. Now husband and wife both guardians



Celebrity pre-nups

Attorneys say some recent celebrity prenups include:

- Limiting the wife's weight to 120 pounds or she must relinquish $100,000 of her separate property
- No mother-in-law sleepovers.
- Only one football game per Sunday
- Requiring a husband to pay $10,000 each time he is rude to his wife's parents.

ample below). As the example shows, it’s not always the “wealthier” spouse overall (i.e. the husband above) who has to pay the Accrual claim on dissolution!

The Accrual System effectively ensures that spouses share equally in the wealth they create during the marriage.

What happens if a spouse dies?

While most people think of an Accrual claim in the context of a divorce, probably the most common way in which a marriage is dissolved is by death of one (or tragically both) of the spouses.

On death of a spouse, the Accrual claim is calculated and depending on their respective gains, could result in either (i) a claim being lodged by the surviving spouse against the estate of the deceased spouse (if the survivor shows the smaller gain) or alternatively, (ii) the survivor might be required to make payment into the deceased spouse’s estate (if the latter shows the smaller gain). Some antenuptial contracts provide that if the survivor has the greater accrual, then the deceased spouse’s estate’s accrual claim is forfeited.

How does the Accrual claim affect one’s testamentary planning?

The possible impact of an accrual claim upon death of either of the spouses is an important issue commonly overlooked in one’s testamentary planning. The rule is that the Accrual claim is calculated and takes effect before applying the deceased spouse’s Will.

The Accrual claim, if it is due to the surviving spouse, constitutes a claim against the deceased estate which ranks in preference behind that of other creditors but ahead of heirs. In other words, the Accrual claim due to a surviving spouse must be paid before any other heirs such as children, parents and other can inherit.

Where married couples leave their entire estates to one another in their Wills, the effect of the Accrual claim is academic — whatever the result of the calculation, the deceased spouse’s estate ends up in the hands of the survivor.

Planning for the Accrual claim

By properly planning for one’s death, one can ensure that the effects of an accrual claim are dealt with—an antenuptial contract and Will can ensure there are no unintended problems, and a life assurance policy can ensure that there is enough cash available to meet any possible Accrual claim.

Accrual Example

A simple example illustrates how this works

- Husband enters marriage with a net estate worth R2,000,000, wife with R500,000.
- Upon husband’s death his estate is worth R2,500,000 and wife’s R2,000,000.
- Gains (ignore inflation) = husband R500,000 and wife R1,500,000
- Difference between gains = R1,500,000 – R500,000= R1,000,000
- Wife has gained more, therefore husband can claim one-half of the difference of R1,000,000 from wife = R500 000.

The husband would have a claim against the wife’s estate for R500,000 which would be due to him before the heirs in terms of the wife’s Will (eg children from a previous marriage) receive their inheritances

What about the kids?

There are some particular dangers in overlooking an Accrual claim where (step)/children are also heirs…..

Example 1
A husband dies and, having intended to leave his estate in equal shares to his wife and a child from his previous marriage, made provision for this in his Will. If he hadn’t allowed for his wife’s accrual claim against his estate, she will receive, in addition to her accrual claim, half of the balance too—potentially more than was intended, leaving the child less.

Example 2
A wife dies leaving her estate to her children from her previous marriage, having thought that her husband had sufficient assets of his own. However, she overlooked her Accrual claim against her husband’s estate and he would have to pay the amount of the claim into the estate to be inherited by his stepchildren.

Understanding Euro Crisis Jargon

Eurobonds

Eurobonds are being suggested as a way to tie the finances of the eurozone's 17 countries more closely. A eurobond would be a bond -- or debt which investors buy in return for yield -- backed by all the countries of the bloc. The idea remains under discussion, although it has been rejected by the eurozone's two most powerful leaders, German Chancellor Angela Merkel and then-French President Nicolas Sarkozy earlier this year. Francois Hollande, Sarkozy's successor, has been more favorable to the idea.