EFFICIENT GROUP

ECONOMIC COMMENTARY

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YOUR MONTHLY ECONOMIC UPDATE

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For every one to attain financial well-being

THE BIGGEST ASSET MISSING FROM YOUR BALANCE SHEET

Most financial conversations begin too late. They start after money has already been earned. We then debate offshore exposure, fees, tax efficiency, and whether the Johannesburg Stock Exchange can outperform Wall Street. Although these are worthwhile questions, they are concerned with capital that has already accumulated. For most working households, the far larger economic value lies in capital that has not yet been earned.

Strictly speaking, income is not an asset. It is a flow. The asset is human capital: The value of the future income that your health, skills, experience, and productive ability can generate. This distinction does not weaken the argument that your income deserves protection. It makes the argument more accurate.

Consider a 35-year-old earning R60 000 a month. With no salary increase whatsoever, another 30 years of work would generate R21.6 million before tax. This is not a formal present-value calculation; the discounted value would be lower, but it reveals the magnitude involved. For many professionals, future earning capacity is worth far more than their house and investment portfolio combined.

The household's central economic project is, therefore, a gradual conversion of human capital into financial capital. We work, consume less than we earn, and transfer the surplus into pensions, unit trusts, businesses, and properties. As retirement approaches, accumulated financial capital must become large enough to replace the human capital being depleted. Yet, the conversion mechanism is fragile. A household may hold a diversified portfolio, but almost every rand entering it depends on one person, one employer, and one occupation. That is income concentration risk. If a listed company received 90% of its revenue from one customer, investors would demand an explanation. In household finance, we often view the same exposure as normal.

The danger arises when income is interrupted. Expenses are sticky: Bond repayments, groceries, school fees, electricity, and medical aid continue. Contributions stop. Investments may be sold at the wrong time. Debt begins to replace income. What started as a temporary liquidity problem can become a permanent loss of wealth.

Compounding magnifies the damage. Investing R5 000 a month for 20 years at an average annual return of 9% could produce approximately R3.2 million before fees and tax. The first year's R60 000 of contributions could represent about R321 000 of the final amount. Lost income does not only reduce consumption today; it can erase several times that amount from tomorrow's wealth. This is why stability should come before scale. An emergency fund can self-insure a short disruption. Larger risks must either be retained knowingly or transferred. Insurance is not an investment competing for returns. Properly structured, it is a hedge against the forced destruction of a household's balance sheet.

Income protection insurance in South Africa (SA), generally, replaces a part of your monthly earnings when illness or injury prevents you from working. Its quality depends on the waiting period, benefit term, escalation, exclusions, and definition of occupational disability. Disability cover in SA commonly provides a lump sum that can settle debt, fund treatment, or create capital after permanent impairment. It should not automatically be treated as an income replacement for life. Life insurance in SA addresses the permanent disappearance of an earner through death while the family's financial obligations remain. These three protections overlap, but they solve different balance-sheet problems.

Protection can also be excessive. Premiums that crowd out emergency savings and long-term investment undermine the very financial well-being they are meant to preserve. The objective is not maximum insurance; it is proportionate protection against risks that a household cannot absorb itself.

Investors spend enormous energy searching for the next winning share, fund, or property. But, returns only compound for those who can remain invested. Before asking which asset will create the most wealth, perhaps ask the question that comes first: What protects the human capital expected to finance all of the others?

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