



financial services group

MONTHLY MARKET REPORT DECEMBER 2011

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DECEMBER 2011 COMMENTARY

“Prediction is very difficult, especially about the future.”
Danish Physicist Neils Bohr

As tempting as it is to prognosticate on what 2012 might hold we're going to leave doing so to those braver (more foolhardy?) than us, of which there have been many that have choked our mailboxes over the past month. We'll focus our efforts instead on continually applying our investment philosophy to the portfolios you have entrusted your assets to. The start of a new year is an excellent opportunity to revisit our investment philosophy; particularly for those investors who have joined us over the last few months.

Our Investment Philosophy

When conducting due diligence on other fund managers we are always more impressed by those managers who are able to condense their investment philosophies down to no more than a handful of sentences. We trust we'll be able to meet that criterion here.

NFB AM's philosophy: we are long-term investors who believe that returns are achieved, primarily, through asset allocation.

That's it. Though it does come with two riders:

- Asset allocation is not done through optimization, back-testing, competitor evaluation or predicting the future (forecasts).
- Asset allocation is done on the basis of three key beliefs:
 - That markets are irrational and mean-reverting and
 - That this can be taken advantage of.

Turning jargon into plain English

- The long-term: a period of between 3 and 7 years, portfolio dependent. For an income portfolio to achieve its objectives a shorter time frame can be adopted; for an equity-oriented portfolio more time is needed. Our role is to be obsessively focused on the long-term and to avoid the seductive siren song of short-termism.
- Asset allocation: the allocation of investor's funds within an investment portfolio across cash, fixed interest, property, equity and foreign investments (known as asset classes). In excess of 90% of overall portfolio returns are driven by this decision alone. The remaining 10% is accounted for by selecting one stock over another or one fund manager over another, for example.
- Optimisation: it is possible to mathematically model an optimum portfolio, i.e. the combination of asset classes that provided the greatest level of return for a given level of risk or, conversely, the lowest level of risk for a given level of return, but these models are not without flaws and are often over-used by the investment industry. Note also the use of the past tense in the word 'provided'; for the only period in which an optimization is valid is the period for which it was done.
- Back-testing: it is possible, again through various mathematical/statistical tools, to test a strategy formulated in the present using information from the past, however there is no guarantee that the future is going to look anything like the past. Investing on the basis of back-testing carries with it the assumption that the future is going to look very much like the past which falls foul of our philosophy not to predict the future, see comments below.

Turning jargon into plain English (continued)...

- **Competitor evaluation:** knowing what our competitors are doing in portfolios that are similar to our own is certainly intriguing but isn't terribly useful for investment purposes for two reasons: one, by the time we are made aware of what our competitors are or aren't doing the information is stale and, two, we would have no insight into *why* they made the choices they did.
- **Predicting the future:** it isn't possible to predict the future, basing investment decisions on such forecasts is, well, silly. We base all of our investment decisions only on information that is available to us in the present; focusing largely on information *about* the present.
- **Markets are irrational:** for as long as markets are run, and are participated in, by human beings they will always be subject to the innate irrationality of human emotion, specifically fear (often a time when market prices are at their most depressed, read cheap) and greed (often a time when markets are at their most effervescent, read expensive), which leads us neatly on to our next point.
- **Mean-reverting:** the mean is simply another term for average; the term mean reverting means that when market prices have gone to one extreme or the other they are highly likely to return to their mean. We believe we can take advantage of this to our investor's benefit by buying asset classes when they are cheap, or below the mean, and selling them when they are expensive, or above the mean. Our role here is to be impassioned about market circumstances and to make decisions based on the evidence in front of us, rather than on how the market *feels* about a certain investment.

Our philosophy is the fundamental starting point for any investment decision taken on your behalf; should you have any questions or if you are simply interested in discussing this further please feel free to contact your Financial Advisor or one of the members of our Asset Management team.

All the best for 2012, may it be a blessed year for you and your family.

DECEMBER 2011 DATABANK

	Index Value	Last Month	Year-to-Date	1 Year
SA Repo Rate	5.5%	0.0%	0.0%	0.0%
JSE ALSI	31,985	-2.5%	-0.4%	-0.4%
ALBI	374.1	0.7%	8.8%	8.8%
R157	6.7%	6.8%	7.3%	7.3%
USDZAR	8.1	-0.6%	21.9%	21.9%

All charts and data are sourced from I-Net Bridge.