



FROM THE CEO'S DESK

As I write this I am in Canberra, the home turf of the ACT Brumbies, and I now understand the meaning of patriotism. I am here to celebrate my very good friend Ron Parker's 50th Birthday. Just in case any of you wondered if we were "just having a look" - we are not! Now, back to patriotism. South Africans need to rediscover the term. I have spent the last three days being bombarded with an overdose of crazy Aussie patriotism, ranging from the achievements and failures of their athletes, notably in the pools of Beijing, to the general acceptance that they are far superior to those just miles away across the Tasman, who surprisingly, haven't yet earned a single medal. SA and Aussie enjoy many similarities and culturally, whilst they irritate us, we come out of similar pods. They, however, enjoy a wonderful sense of national pride and let others know it! We could do with an injection of the same stuff back home.

Recently, I was privileged to be invited to a half-day tour of the Gautrain project. Starting with the Government engineer in charge of the project, who was one of the most enthusiastic and positive people I have met, we progressed from the Mushroom Farm entrance to the actual underground works. The project, from concept to execution, to quality of staff and the use of innovative, cutting edge mining and tunnelling technology, is world class. It is something to behold and is in absolute contrast to the many, almost uniformly negative newspaper billboard headlines which reflect doom and gloom. We continue to miss what is going on out there. I have made it my business to read up on and witness the infrastructure spend and then see the reality. Whilst it is clearly a pain in the butt to have to travel on roads still peppered with potholes and cut up to accept the Neotel fixed lines, the big picture is pretty interesting. We are rebuilding infrastructure in a way few countries are and I see a little Dubai being created.

This very positive backdrop does not detract from our very real concern about markets and the local currency, neither of which is out of the woods, and it is probably appropriate to engage in careful thought before making any significant calls when making any form of aggressive investment, locally or offshore. Similarly, we recommend taking advantage of the rand's relative strength when this is possible and the recent rally it enjoyed represented a great opportunity to top up either foreign allowances, or even asset swapped exposure to globally diversified portfolios.

On a similar tack to my opening comments, I thought a reference to a talk I recently enjoyed was appropriate. The inimitable JP Landman, husband of the renowned Carte Blanche presenter, Ruda, entertained a distinguished group of Investment Market Specialists, in Cape Town last week. He spoke of a few important issues, not the least of which, was the significant increases in infrastructure spend by government. This, he argued, was as a result of the positive growth achieved by SA in recent years, and which inevitably would lead to greater employment, less crime and the prospect of sustained, above trend growth, which becomes a positive virtuous process. He also spoke of the need to resuscitate South Africa's social conscience. This responsibility of the people, business and the public sector, had been given a positive boost by the initiation of projects by Media Group, Prime Media with Crimestop, the newspaper City Press, First National Bank who, together with an NGO and offshore donor funds have started what I believe is a R300 million fund, and various others. This is all good stuff, and will positively impact on decision makers here and abroad. The most important catalyst in the development of a positive self- image, critical in getting overseas businesses and people to want a part of the SA action, is the population beginning to understand its special place in the world order. South Africa needs to grab itself back from the tiny minority of criminals, interspersed between government, the private sector and members of our various communities. Just look at the incredible changes in Income Tax collections. Pravin Gordhan and his team have embraced a challenge, and delivered a setup which is fair, yet unrelenting in its search for compliance. They have changed the landscape from one, some years ago, which almost supported tax avoidance, to one today, which has everyone frowning on those who choose to operate outside of the law.

Things can change, and must, if we are to win this fight for the right to stay and prosper and be safe in the country we all own.

Lastly, I am sure you will all join me in thanking Madiba for his awesome contribution to the miracle which has been our country's story over the last 14 years, and wishing him a Happy Birthday!

Mike Estment, CEO

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DRASTIC TIMES CALL FOR SENSIBLE MEASURES

Local and global markets are all, with a few precious exceptions, negative for the year with a seemingly unending stream of bad news continuing to add fuel to the fire. Is there light at the end of the tunnel, asks Stephen Katzenellenbogen, Independent Financial Advisor – NFB Johannesburg.

It was not so long ago, that when meeting with our family and friends we would happily describe our most recent investment triumphs. Everyone had their 'you cannot go wrong' investments, be they in the form of a specific share, sector or trading strategy. More recently, this topic of discussion now only elicits a grunt or a look of dismay. This reaction is a function of the current times in that nobody, including the professionals, can accurately forecast what the short-term investment horizon holds for us and is further a function of the recent brutal past.

The current extreme volatility and uncertainty in the market has not been seen since the 80's. Local and global markets are all, with a few precious exceptions, negative for the year with a seemingly unending stream of bad news continuing to add fuel to the fire. In addition, global political uncertainty and instability are contributing another set of unknowns to the equation. As South Africans we also tend to have some unique concerns, and although these have no direct bearing on our investments, they do play a part in our thought processes.



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What does this mean for our investments and investments strategy?

Many an investment strategy has been formulated around the premise of investing by constructing a well-diversified portfolio suitable to your risk tolerance. Unfortunately, many a portfolio has been unduly tilted to more risky (volatile) assets during the recent bull market. Another common attribute of a falling market is the presence of investors waiting on the sidelines to only enter at the last stages, buying the markets at their highs, and then capitulating at the almost inevitable loss, which only pushes prices further down.

There are 2 types of investors who need to be considered during these contentious times:

■ There are those individuals who have enjoyed the positive upswing since early 2003 and whose portfolios have managed to build up some 'fat'. Even if the market has come off a bit, these investors needn't have too much room for concern because they should still be in substantial positive territory. When an investor in such a position asks why their investment is down from 6 months ago it can indicate one of two things:

- Greed or
- Unsuitable asset allocation [risk profile].

■ There are of course individuals who are only investing now, and as such, face some gloomy prospects, or do they? There is no denying the fact that the volatility and uncertainty spoken of above is not going to go away next week, next month or even next quarter, but a depressed environment most definitely does provide some interesting opportunities.

There are a few points above that have been either alluded to or directly mentioned, that deserve further discussion and analysis.

Investor Psychology

Investor psychology suggests that the typical investor buys an asset at its peak and then sells somewhere along its decline. What this then leads to is, of course, disappointment with the outcome perhaps being an aversion to taking another 'chance'. This investor may forever sit on the sidelines and watch the market go through its ebb and flow whilst they enjoy a very pedestrian and probably negative [after tax and inflation] return with cash in the bank.

It would be a very interesting exercise to do a risk-profile, which indicates an investor's possible portfolio allocation, during positive and negative markets. Experience has illustrated that investors will always score higher, in terms of their risk profile, during upward markets and lower during negative markets. This could be paralleled to betting on a sports team when they are winning and stopping when they are losing. This is, of course, not necessarily a bad strategy, although how you cope with mixed form and a return to winning ways is critical.

Getting back to the investor who is only entering the market now: they are faced with the mental wall of investing into a falling market with bleak short-term prospects. As mentioned above, when markets are off their highs, we are presented with assets showing a lot more value than they were perhaps offering one, two or even three years ago. The other side of this debate to consider, is that just because you are buying something cheaper than it has been for a while does not mean that it will not get even cheaper. Through the use of an investment strategy called 'phasing-in' we are able to take advantage of both sides of the arguments. The basic premise of phasing-in is, assuming a lump sum investment, to start off with your investment in a money market fund and to then allocate this to the investment over a 1-24 month time period. Should the market continue its decline from your inception date you will then be continuously buying units at a cheaper price, averaging down your unit cost and reducing your short-term loss, thus enhancing

your potential future return. If the markets should increase from day one you do stand to lose a bit of the upside, but you have the all important 'sleep-easy' factor. If, however, the markets take a bigger than expected downswing early on in the phase-in you could accelerate your investment to take advantage of the even cheaper unit cost. Mathematically, phasing-in a lump sum investment does not hold too much virtue after three and more years of having the investment. However, it definitely does help protect you from short-term negativity. The other option to average out your unit costs, is to have a monthly premium for some of your investments which in essence has the same virtues of phasing-in lump-sums, although over a much longer time frame.

Asset Allocation

Probably the most important yet trickiest part of managing your portfolio is having the correct asset allocation. The asset allocation is the proportion the various asset classes - cash, bonds, property and equity - are allocated in your portfolio. As discussed earlier, different market conditions may entice you into having an asset allocation that is inappropriate to your objectives, which could then lead to disappointment and drastic measures which are usually never in your best interests. As hard as it is you need to ignore the 'noise' around you and concentrate on exactly what it is you need from your investments. You need to be realistic around which investments are necessary for income and possibly liquidity, and those that can be put aside for long-term growth. It is not wrong to allocate these different types of assets with different asset allocations based on their intentions.

Another consideration around asset allocation is the product that holds the investments. Different products have different tax consequences; for example, there is no tax within a living annuity and your gross return is the same as your net return. This gives, for example, a money market fund a very different profile in a discretionary investment than in a retirement investment.

Currently, with interest rates being higher than they have been for around five years, it may be a temptation to switch your retirement assets into a money market fund. Depending if and how much income you are taking, this may or may not be the way forward. However, the aforementioned would only suffice as a short-term solution as you need to have around 30% of your portfolio or specific asset in equity if you want to beat inflation over any meaningful time period.

Sensible Measures

With markets looking bleak, local and international inflation reaching multi year highs accompanied by higher interest rates, there are a few fundamental principles we can adopt to ensure we get through what is in essence a normal, although severe, market cycle relatively unscathed:

- Do not be too conservative or too aggressive because you may end up unhappy
- If you are unsure, rather ease in than taking on an asset that is too risky for your profile or personality
- Keep your head - avoid making emotionally-fueled decisions
- Think about the long-term consequences of your short-term decisions
- If you invest on your own, stick to what you really understand
- Consider paying off debt in a high interest rate environment
- We are in a professional market - use a professional to advise you

Should you have any questions, comments or observations your NFB Financial Advisor would be thrilled to discuss these with you. ○



Homo Economicus or Homo Sapien?

For an investor seeking a comfortable retirement, the romance is not in the journey, but solely in the destination. Written by Philip Bartlett, **Independent Financial Advisor** - NFB East London

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The Efficient Market Hypothesis has been the central proposition of finance since the 1950's. In a nutshell, the assumption is that investors are always rational, and value assets accordingly. It is deemed that irrational behaviour is random and subject to elimination by rational market arbitrageurs. It asserts that asset prices reflect the unbiased collective beliefs of all rational investors.

The Behavioural Finance approach on the contrary, believes the market over the short-term to be affected by irrational sentiment, postulating that people are strongly steered by emotion when assessing value. Hence pricing is imperfect; giving rise to unsystematic biases that can move prices away from fundamental values. Behavioural Finance sees the investor as complex, often irrational, unpredictable and contradictory, and although the rational side of the investor is recognised, it is proposed that inefficiencies in the market can be attributed to the likes of greed, fear, overconfidence, and investor noise. The conclusion is that market returns, or lack thereof, are in the short-term linked to investors' behaviour as opposed to market performance.

Decision-making is fundamentally based on the way the investor perceives and organises information, the way they feel when they register the information and the social environment in which the decision is made. With so many contributing factors it is no wonder the outcome is subject to bias.

Consider the impact of the representative bias where the investor, in a bid to cut to the chase, focuses on a small data set, matches it up to previous experiences, and hence either writes it off as a bad idea or takes it on as if being fully informed. Or in an attempt to research the

position turns to the most available information source, Google or "Bob", and hence falls foul of the availability bias, failing to question the objectivity of facts.

Advertisers play to these weaknesses, framing facts in wording specifically catering for our propensity to associate credibility with a product or tweaking our inherent regret aversion button by implying inaction leads to missed opportunities.

Then there is the way we as investors see money: compartmentalising it into money earned or unexpected windfalls; the fore being subject to lock and key and the latter to the whims of something red and fast or bright and bold.

Rainy day funds, fun funds, sentimental funds and the likes all fall foul of mental accounting mixed with an unwarranted faith in one's own intuitive reasoning or judgment.

Ultimately the cold and detached investor will be the most successful.

Investing legend Warren Buffett is a prolific advocate of common-sense investing, being quoted as saying "investing is simple, but not easy", referring of course to the sea of emotions that one needs to detach from.

My advice is simple: plot your course carefully, man the tiller and hold your line. For an investor seeking a comfortable retirement, the romance is not in the journey, but solely in the destination.

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