PROFICIO
NFB FINANCIAL UPDATE

Volume46 October 2009

FROM THE CEO's DESK

2009 has raced by and the silly season is almost upon us. For some it has been a tough time and for others simply disastrous. The South African economy held up rather well in the face of a global meltdown, but I see signs of belated stress emerging over the last six months or so. What is clear to me, however, is that sticking to one's guns has again paid dividends. Whilst NFB's Asset Management team have reduced the portfolio risk somewhat, we have not exited the market in a state of panic and the somewhat overdone, in my opinion, correction has rewarded the stayers and punished those who capitulated, having almost stayed the journey. Cash is no longer king as dividends on quality equities are now equal to, and in some instances, higher than interest after tax on cash. For those investors in the fortunate position of having more capital than that needed to meet their income needs and with the world starting to realize the longer term inflationary risks attached to the recent and ongoing bail-outs by Central Banks, growth assets are becoming attractive. As noted, the correction appears overdone and Emerging Markets such as SA have motored ahead of their Developed peers, so I am not recommending a headlong dash into aggressive equity. I am concerned, having been stunned by recent institutional meltdowns, markets capitulating and interest rates plummeting, that retired and cautious investors remain confused and that, notwithstanding the terribly low and somewhat negative real return available on cash, they will remain in cash out of fear of loss.

For fear of stating the obvious, markets are cyclical and the factors which influence them need consideration in making wise and timeous changes and decisions. Certainly, there remains a wide range of opinions as to whether or not the world economy is headed into a nice, exciting and sustained V-shaped recovery, implying a steep and durable fix, following the steep and scary drop experienced over the preceding eighteen months. What is more important than this short-term crystal ball gazing exercise is to gather information about previous such events and to compare critical inputs such as interest rates, inflation, equity dividend yields and probable company earnings; investor confidence and government policy. The big investors, i.e. large asset managers and big pension funds, will not be happy to sit on call earning 5 or 6 percent per year, given their mandates from their clients to deliver inflation-beating returns over the medium- to long-term. They will at some point all start sustained investment strategies into growth assets such as property and shares. Once this has happened, given that it typically results in significant gains in the prices of the assets, the private client investor, nervous because of recent poor performance, waits too long and therefore misses out on this run. All too often they eventually get tired of hearing how well their friends or co- employees are doing and buy in at these new highs only to have the market misbehave. Sound familiar? I've been there in decades gone by!

The conclusion the above brings me to is the belief in what NFB offers, as do some of our competitors, i.e. Managed Solutions. We have local and International fund options where the general risk profile is matched to that of our clients, ranging from Cautious or Conservative, to Balanced, to Aggressive Equity. Interestingly, the biggest trend in world investment is towards these solutions, where emotions such as fear of loss or risk aversion are minimized; costs are marginalized as a result of the volume of money being invested and the ease and automation of payments in, out, and the capitalization of income or dividends, makes the option very attractive.

These solutions are intended to allow professional Asset Managers the ability to make subtle changes in asset allocation between asset classes and top fund managers, in different sectors, in an effort to meet and beat the fund's expected returns over the medium term. Great investors such as Berkshire Hathaway's Warren Buffet and others like him, apply these rules rather successfully in their Investment Trust type operations. Avoiding the herd instinct to run or getting too excited and holding on too long are great dangers in the business of investing and are somewhat mitigated by using these professional skills.

Changing tack for a moment, an important amnesty has recently been announced. It can materially benefit those of us who still have domestic residences held in Companies or Close Corporations. The amnesty will allow the transfer of such properties used exclusively for domestic purposes (by the individual shareholder or spouse), into the hands of the natural person without incurring any Transfer Duty, CGT and STC for a period starting January 2010 and ending December 2011. This period of grace is quite long and normally results in potential beneficiaries dragging their heels. I would urge interested or affected clients to act urgently and get the process under way. It offers significant advantages such as the Primary Residence Abatement for CGT purposes which is quite material, doing away with unnecessary accounting or auditing of the dormant Company or CC, and eliminating the cost of the annual return and accompanying fee required by the Companies Act.

Mike Estment, CEO

Breaking News:

It appears that Treasury will be including residential property held in **trusts** in the latest Amendment that we've seen in the Capital and Taxation Laws Amendment Bill. More in this issue.

IN THIS ISSUE

From the CEO's desk

Oh how Cliché. Have we heard it all before?

"To improve is to change; to be perfect is to change often."
~ Winston Churchill

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OH HOW CLICHÉ

HAVE WE HEARD IT ALL BEFORE?

In what has been one of the most volatile and worst economic times since the great depression it is often good to take a step outside the rat race and reflect on what has been. Although not out of the woods yet, we have seen some signs of improvement and markets worldwide have rallied from their recent troughs. By Travis McClure, Independent Financial Advisor - NFB East London

Of course, it is easy to get caught up in the hype and mayhem and it is hard to believe that it has been almost 2 years since the sub prime issues started the rot. It is also 8 years since September 11 and we all thought then that it was the end of the world as we knew it. Life carries on and continues to surprise us and trip us up, and markets and economies will continue to operate. We learn from our mistakes and experiences and often we look back and realise that all it took was a bit of common sense and patience.

It is in times like these that we open the dictionary on common sense and realise that we have heard it all before but, as usual, we did not listen. Sound clichéd? Well of course it does, and now more than ever do we need to take note.

It's not timing, but *time in* the market that counts

JP Morgan calculates that a basket of consumer goods in 1960 costing R1,000 would cost R55,370 at the end of 2008. Although this is over a long period one must remember that a 60 year old investor has a 30 year investment time horizon.

Over this period an investment in:

- **Fixed deposit would have yielded R94,920**
- **Government bonds, R108,500**
- **and Equities, R1,973,590.**

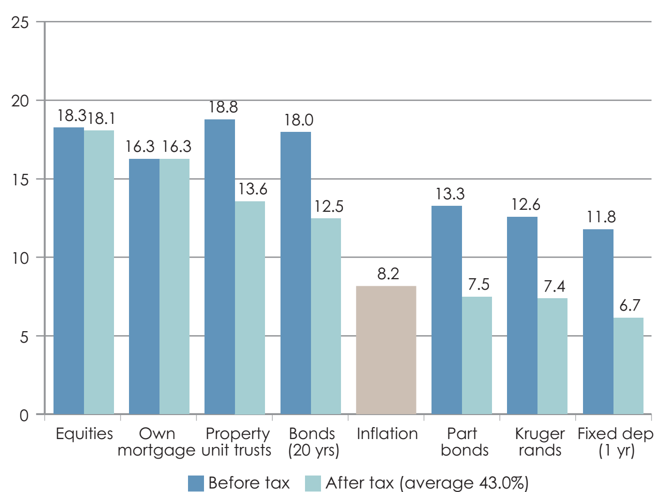
While the compounded wealth in the bank or bonds would have hardly kept ahead of inflation, capital invested into equities produced a far superior result.

It also highlights the importance of cumulative returns on long term wealth preservation against the biggest negative factor, i.e. inflation.

The graph below illustrates the returns from the various asset classes before and after tax vs inflation.

20-year average annual total returns – before and after tax (1989–2008)

Return, %



Source: JP Morgan Chase

Diversify – don't put all your eggs in one basket

The cliché of all clichés: we have all said it, we have all heard it, but not all of us do it. Having a balanced approach protects on the downside, but still allows for upside participation. In the recent

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chaos not many asset classes were spared the devaluation process, but exposure to cash and fixed interest assets, such as bonds, would certainly have saved a portion of your portfolio from the volatility and given some positive returns.

In adversity lies opportunity

Of course, it is easier to point out now but there were huge buying opportunities back in March at the height of the panic. Asset prices were severely depressed and many were well below NAV. Old Mutual who were at R4.50 and is now at R11.50 is one opportunity that comes to mind. The trick is to strip out the noise and look at the inherent value within the asset. Many of us would rather wait to see these asset prices rise before investing, but then you pay a price for this certainty. Those who are only now feeling like things are looking more positive have missed out on a 40% rise, and although the long term outlook is still positive, certainty has pushed the price up and reduced potential returns.

Investors should be providers of scarce capital. Return on capital is typically highest when capital is most scarce. When investors are literally throwing investment funds into a specific area, it drives up prices and drives down potential future returns. The opposite is true, when investment capital dries up, prices come down, but future potential returns are driven up. With the credit crunch and the recent fall-out in the UK property sector, an investment area that has seen just such a drying up of available capital, making for an attractive investment opportunity in adverse conditions.

History repeats itself – Fear and Greed drive markets

2008, along with 1930, ranks as one of the worst years in history for equities. Many felt that they would not see the likes of the great depression again, but the reality is that without Government bailouts many more would be standing in the job line. The lesson here is "never, say never", but the real lesson comes from the fact that the years preceding 1930 also rank as some of the highest returns. The recent gains on both local and international markets have been massive and once again repeat what we know from history.

Markets are forward looking and when panic sets in things get overdone. Market forces will always try and move back towards an equilibrium.

If it is too good to be true - it probably is!

The pyramid schemes that were exposed over the last year have become the next wonder of the world. How can so many intelligent people get caught? The reason comes down to greed and valuations. We have always placed a high premium on risk management, understanding that investing is more than trying to assess the possible returns from an array of opportunities - more often it's analysing, understanding and pricing in the various risks. Risk is not necessarily volatility of a price, but can also include business risk, valuation risk, force of sale risk or liquidity risk. Take the time to asses the risks of your investments and get professional advice.

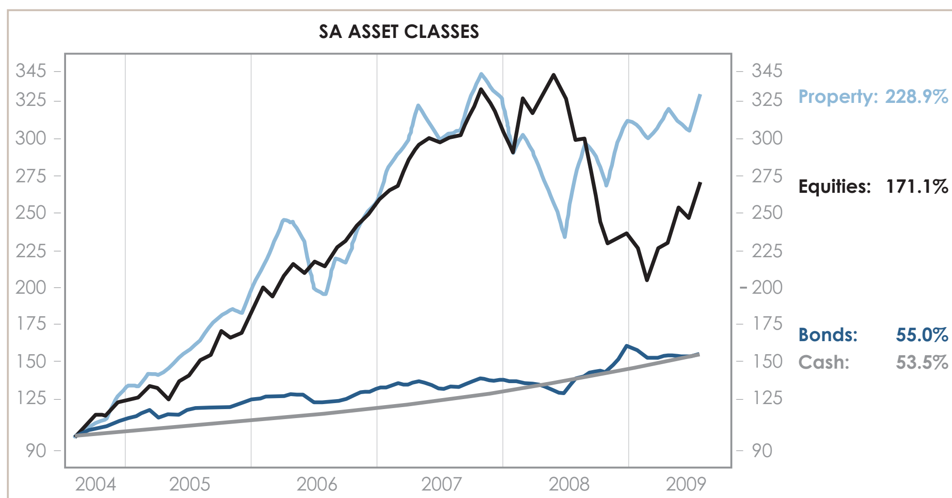
Past performance is no indication of future performance

High returns from our local equity and property markets since 2003 made investing look easy. Returns well into double figure negatives last year would have put pay to that strategy. As would the strategy that negative historic returns will lead to future negative returns. Base investment decisions on current valuations, consistency of performance, risk tolerance and investment time horizons and not the fact that you scored 100 the last time you were at the crease.

My money is safer in the bank and is risk free

Your capital may be safe, although those invested with Lehman Brothers might disagree, but it does not come without risk. As pointed out earlier, cash returns have failed to outperform inflation over time and herein lies the risk.

Because there is no volatility in a cash investment, there is a misconception that shorter term risk free also translates into longer term risk free, i.e. cash with no volatility can and has outperformed the more volatile equities - therefore it can continue to do so over the longer period. This is certainly the case in the last 2 years where Money Market rates have outperformed. But this is not true in the long term, because ultimately an equity investor will demand a higher return than cash because of the additional risk he is taking with capital. He may not achieve this over any shorter period of time, but given a long enough time horizon, he will almost certainly be rewarded with a higher return. The graph below is more indicative of the type of additional returns a long term investor will be hoping to achieve by subjecting their capital to greater volatility. This is why for any investor with a long time horizon, we always say that there is greater risk in not taking the shorter term risk.



If you want the roses you must not mind the thorns

Higher returns come from higher risk investments. Those of us wanting inflation beating returns must accept some volatility.

Stick to your financial plan and don't panic

Should you be correctly risk profiled and your portfolio is managed within the mandate you have given it, your returns over the longer term should meet your expectations. Every so often there are periods where returns from different asset classes are above or below their mean and many investors panic and sell out thereby changing their strategy. Had they stuck to their profile and strategy they would still have received good returns.

So you have heard it all before, the economic jargon, the cheesy sales talk, the logic, and you are probably going to hear it again in the future. We often shrug it off, but we forget how often it holds true.

There is a reason why it is called a "cliché".

References : Sharenet – Seed Investments

“To improve is to change; to be perfect is to change often.”

~ Winston Churchill

The current global financial situation calls for pension and provident funds to challenge their investment strategy. Questions they need to ask are, for example: **are our fund members appropriately invested given their age, proximity to retirement and stage of life cycle?** Unfortunately, many are currently not. Written by Leona Trollip, Divisional Manager Employee Benefits - NFB East London

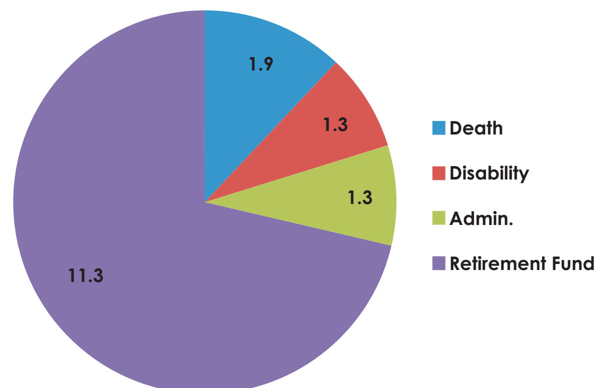
Administrators of pension and provident funds have shifted from defined benefit to defined contribution, dealing, along the way, with the tricky issue of surplus apportionments and improving upon their systems to offer member-directed investment choice at competitive costs. Almost 52% of pension/provident funds surveyed in the 2009 Sanlam Employee Benefit Benchmark offer member-directed investment choice, although of these funds 64% of members rely on the default choice, which for 50% of funds are lifestage mandates.

Whilst lifestage mandates are an improvement on the one investment fund for all, the disadvantage of these types of investment funds is that they assume members will retire at the normal retirement age as stated by the employment contract (generally age 65). However, members may retire from employment early, from age 55, or as late as 70 (with the employer's consent) and find that their total asset allocation in their investment portfolio (including their pension/provident fund) is mismatched with their term to retirement.

Personal financial planning, therefore, is imperative otherwise they might find themselves in the same position as the Brazilian, Jorge Guinle, who said **“the secret to living well is to die without a cent in your pocket. But I miscalculated and the money ran out too early.”** The consensus is that you should be able to retire comfortably provided you save 15% of your gross salary over a 35 year period and preserve your retirement funds throughout. According to the Survey, there has been an improvement in the average contribution rates as the percentage of salary in Pension Funds to actual retirement provision has increased from 10.9% to 11.3%. However, this equates to 8 years less money in retirement according to the Benchmark Survey. Of concern, is that the prevalence of premature withdrawals from retirement funds when changing employment, is still high.

With regard to risk benefits, according to the Survey when compared to 2008, the average death benefits increased from a lump sum of 3.2 to 3.5 x final salary, whilst the average disability benefit remained at 75% of salary per month.

The Survey was across the spectrum of salaried and waged staff, free standing funds and participating employers in umbrella funds. The average total contribution rates to funds indicated the employer contribution increased from 9.5% to 9.9% of salary and employee contributions rates rose from 5.5% to 5.9% of salary (15.8% total contribution). Below is the allocation of contributions:



To assist employers in reviewing the provision of Pension/Provident Funds and Group Risk Schemes, contact Leona Trollip, Divisional Manager Employee Benefits on 043-735200 or ltrollip@nfbel.co.za

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