




FROM THE CEO'S DESK



Wow! It's Friday the 13th. This fact, to the superstitious, might be alarming, but to me, of greater concern is, it is Friday the 13th, November, 2009, and I wonder where the year has gone. It's almost time to gather my management team around, do a review of the year past, plan for 2010, and push the guys, as always we do, to achieve great things in the year ahead.

Thanks to our team and client base, we have continued to grow the business. Our East London colleagues have bedded down a merger of their business with the Eastern Cape division of Sasfin, in what has surely been a tough time for mergers of this sort, and the Johannesburg business has continued to grow in both assets under management as well as in the critical area of human capital. We have gained a few new directors, a few new advisors, and importantly, have strengthened our already expert administration.

2009 has also been a blur as a result of some rather sublime movements in markets, currencies and in other varied ways. The Gautrain is now a reality. The naysayers must also be blushing as all 10 of the stadiums promised fast approach completion, well inside the agreed deadlines. On this note, I was privileged, along with Gavin Ramsay from NFB East London, to tour the Cape Town stadium earlier this week. What an unbelievable landmark this is. Seating 68,000 people and with no grain of sand on the pitch more than 5mm from perfectly flat (or at the correct draining angle!) it is a marvelous icon to all entering Cape Town. This may only be eclipsed by the Durban stadium and the Gauteng Calabash which are truly works of art. Although frightfully expensive, they will have viewers (billions by the way) in awe. Our tour of the stadium was followed by a truly uplifting presentation over dinner, with Gary Bailey giving us stats and forecasts of visitor numbers, accommodation and transport updates, as well as a reasonably certain warning that given the unbelievable increase in people to be fed, accommodated, moved and entertained, we had better think about the shortages forecast by Woolies, Checkers and the food industry at large. Perishables in the centres where people will stay or view the games will be in short supply, and the retailers are making plans and adverts to deal with this certainty.

Of interest, he mentioned 30,000 confirmed British visitors. He went on to say that this was one of 31 countries from which visitors would arrive! He added that should England make the quarter- and semi-finals that this number stood to go up by 10,000 more.

The world, recovering from a near fatal economic meltdown, has rallied over the last eight months. Whether this is sustainable, I will not hazard a guess, but the crisis certainly has hastened the ascendance of a new Global Financial Order. This does not predict the permanent decline and eventual collapse of the West as a financial powerhouse, it simply says that the East and other emergent areas of the globe are here to stay, and will probably deliver more predictable and sustainable returns for risk taken over decades to come. Of note, the GDP of these large emerging markets is expected to eclipse the established US, UK and Euro-zone markets over the next two decades, and on top of this it is these same markets which have the trade surpluses and which are investing significantly in infrastructure and capacity, whilst the West licks its wounds and funds bank executives profit shares and the recapitalization of bankrupt institutions.

It is all very well predicting the rise of a new order. What is most important to us at NFB is to understand these markets, and distill a range of products and portfolios which will give us safe and cost efficient access to them. Already our Asset Management team are busy with the necessary due diligence work to sanction a few alternative entry points.

Investment management for professionals or the investor themselves is not for sissies. It requires quite some preparation, loads of patience, thorough and ongoing attention being paid to an ever changing economic, technical, legal and geopolitical landscape. We continue to strive to deliver this to you - our clients.

Personally, markets continue to worry me as they seem to have corrected on no clear results. If this is true and if company earnings and Christmas hype doesn't happen, I'm afraid the setback many have forecast will be a reality. 2010 will help, but I would not be betting the farm on the JSE right now. The rand is also behaving strangely. We understand its strength due to the portfolio flows coming into our market, but the local unit seems too good to be true and I am certainly recommending that investors either start, or continue taking advantage of this strength if they wish to take up more foreign investment. The Christmas gift the Minister of Finance gave us in the doubling of the foreign allowance is a gift horse. Use it if appropriate!

I would in conclusion like to wish all of our readers a Happy Christmas, a safe and prosperous New Year and good holidays, as we've all earned them this year!

Mike Estment, CEO

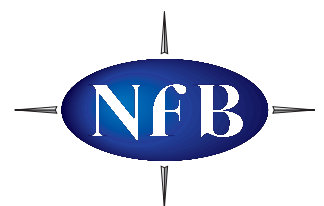


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The great offshore debate – is offshore investing worthwhile?

Paper Versus Gold



financial services group



THE GREAT OFFSHORE DEBATE IS OFFSHORE INVESTING WORTHWHILE?

Many investors have had bad experiences with regards to offshore investing and quite rightly question whether offshore investing is a worthwhile exercise. With the newly appointed Finance Minister, Pravin Gordhan, recently increasing individuals' offshore allowances to R4 million, NFB is of the opinion that investors need to clearly define what their objectives are in order to answer this question. By Andrew Duvenage, Director/Financial Advisor and Jeremy Diviani, Financial Advisor - NFB Gauteng

Newly appointed Finance Minister, Pravin Gordhan, recently increased individuals' offshore allowance to R4,000,000. This means that investors who had previously taken their full allowance offshore now have an opportunity to increase their offshore holdings. However, given the recent turmoil in global markets, many investors are questioning whether this is a worthwhile option. A number of fundamental issues are causing this confusion, and we felt that now would be a particularly good time to share our thoughts on them.

1) The rand continues to be relatively strong

The rand has shown remarkable resilience against major currencies over the last 18 months, but one needs to understand the source of the rand's strength before making a judgement on the long term sustainability of its current levels. While the issue is far more complex than the scope of this article, some of the issues that are worth noting include:

- The JSE has attracted as much as R70 billion from foreign investors in the last 6 months. These flows are often referred to as "hot flows" of money. These inflows could be ascribed to the so called carry trade, where foreign investors borrow money at very low interest rates (as is the case globally at present), and invest the funds in markets with the potential for greater yields and returns. During the same period though, South Africa has seen very little foreign fixed investment. The risk that lies here is that should sentiment towards emerging markets change, or global interest rates move up, the flows of hot money could easily leave the JSE causing destabilisation of the currency.

- While inflows have been seen into stocks listed on the JSE, outflows have been muted as a result of very low dividend

declarations over the last year. These JSE listed stocks have significant foreign ownership and thus the lower levels of dividends equate to lower outflows from South Africa. This has had a positive effect on the currency, but when dividends move back to normalised levels, the downward pressure on the rand that this causes could well return.

- SA currently enjoys a trade surplus meaning our earnings from exports exceed the cost of imports. On the surface this looks like a good thing, but on further investigation one will see that this has resulted from decreased imports (which are a sign of decreased internal demand) as opposed to increased exports. This is a sign of economic weakness as opposed to strength. As our economy recovers this too will change and downward pressure on the rand will return.

- Finally, it is important to realise that there are two sides to any trade. This relative trade concept really focuses on the concept that it may not be that the rand is strong, but rather that the dollar, euro and pound are relatively weak. SA was sheltered from the global crisis to an extent, and thus the fallout has not been felt as clearly here. Once developed world economies recover, one may well find that the major currencies rally strongly.

2) The Dollar is finished!

Virtually anywhere one looks, one hears about the demise of the dollar. The oil barons no longer want oil denominated in dollars, the Indians are buying gold, and the Chinese are unhappy. The US has printed money and as a result the dollar is extinct! (we have even seen video clips showing that the US Dollar was to be scrapped in February this year and be replaced by the "Americano" – a hybrid Central American currency).



We would be the first to admit that the dollar is under pressure, and it is likely to stay this way for the medium term. However, the view that the dollar is dead and that one should be getting rid of any dollar denominated assets one owns is premature. There are a few issues that need to be considered before any drastic moves are decided on:

- The US remains the largest economy in the world with its consumer accounting for around 30% of global demand. If the dollar fell apart, the ability of the US to buy goods would be compromised and this would be catastrophic for the world economy. China and India as well as European countries and the Middle East would be severely compromised if the dollar collapsed.
- China and India hold massive amounts of US treasuries (in effect US dollars). These reserves back their economies. Should the dollar collapse, so would their reserves. It is simply not in their interests to let the dollar fall apart.
- What are the alternatives? While commentators may highlight the deficiencies of the US and the dollar, one has to consider the alternative options. Both the euro and the pound have significant structural issues that make them far from a guaranteed alternative:
- The euro has to deal with massively divergent economies in different states of decline and recovery with a single monetary policy. The so called PIGS countries (Portugal, Ireland/Italy, Greece and Spain) have very different challenges to the likes of France and Germany. The single monetary unit and policy could have a very negative effect on these countries as they would much prefer depreciation in the euro as this will assist their tourism and export based economies. Significant strengthening in the euro could be catastrophic for their economies and this could be massively negative to the Euro-zone. Add to this the as of yet unresolved Eastern European Banking issues, and one gets the sense that while the euro may seem like a safer bet than the dollar in the short term, it still faces challenges and is by no means a one way bet.
- The pound as a currency also faces challenges. Its position in the global pecking order is being challenged and the relevance of its currency in a global context going forward is in question. The UK also needs to deal with aging infrastructure and a funding issue with the National Health Service. Furthermore, the UK's reliance on the financial sector (which has been badly effected in the last 2 years) and property sector (which has also been decimated) and its decreasing output on the industrial and export front will put pressure on its economy from a global perspective in the future, and this is bound to have an effect on its currency. Finally, whilst commentators point to the US's excessive monetary printing, consider that the UK's current government debt exceeds its GDP.

3) Is Gold the answer?

One needs to look no further than the headlines to see that gold is running like crazy at the time of print. One of the traditional arguments against gold has always been that it doesn't pay interest or a dividend, but in the current low (or in some cases zero) interest rate environment this argument doesn't hold water. Add to this the inflation clouds that loom on the distant horizon. The theory is that while inflation is not an issue at present, there may be only one or two ingredients that are missing in global economics before inflation comes back into play. We are all aware that central banks have been printing money. The reason that this has not caused inflationary pressure is that this money has been used to repair banks' balance sheets as opposed to being injected into the broader economy. Once this happens and the velocity with which this money moves increases (known as the multiplier effect), inflation will return. And with the dollar apparently in decline, significant uncertainty associated with other major currencies, and inflation in the distance, is gold not the answer? In our view the answer is both yes and no.

- Gold certainly has a role to play in a portfolio, but we would caution anyone who wants to make a wholesale change into the yellow metal.
- While the lack of interest and dividend is a non-issue at this point

in time, when global interest rates rise (and they will), this will be an area to consider in the future.

■ Speculation and volatility are two issues that are extremely concerning in this space. Our fear is that with so much uncertainty in global markets, it is entirely possible that the price of gold is being artificially inflated by speculators. The concern is that many of these players could effectively cause a bubble, which could result in long term investors who have adopted gold as a strategy getting caught if the bubble bursts. If one looks back in the history books, the period of 1979 to 1984 is what is of concern. From 1979, gold increased from \$120 to around \$750 per ounce, and then dramatically fell back below \$250. The speed at which gold is currently appreciating is alarmingly similar to the 1979 run and NFB would caution that a heavily overweight position in gold is a high risk strategy and may not be as defensive as people would like to believe. Whilst gold can be argued to be a hedge against global inflation and/or developed country currency depreciation, it is also – and fundamentally so – a commodity. Commodity prices are notoriously difficult to forecast and consequently exceptionally volatile.

4) Is offshore investing a worthwhile exercise in the first place?

Many investors have had bad experiences with regards to offshore investing and quite rightly question whether offshore investing is a worthwhile exercise. NFB is of the opinion that investors need to clearly define what their objectives are in order to answer this question. There are a few issues to consider:

- Is it appropriate that the investor is exclusively exposed to a single currency, and just one market? NFB is firmly of the view that offshore diversification is exactly that – **a diversification strategy**. NFB believes that offshore exposure should be used to mitigate the risk associated with South Africa. These risks include economic, political and social factors which may influence the long term prospects of the country. This is not to say that we are pessimistic about the prospects of the country, but rather we believe that it is a prudent strategy to create assets that are largely uncorrelated to South Africa's fortunes. Just think of Iceland in terms of the recent crisis and one can get the point – a first world country whose banking system and economy was absolutely obliterated by a specific crisis. If one lived in Iceland and were not diversified, the investor would have lost everything.
- Very importantly though, NFB believes that this exposure should be determined by the size of the portfolio. NFB does not advocate that clients take all of their assets offshore.

“ NFB believes that as a rule of thumb, exposure of between 15% and 40% to offshore assets should be considered. ”

- Finally, in most cases, NFB sees offshore exposure as a **long term strategic investment**, and as such the risk profile of these assets must be carefully considered. Generally NFB advocates that these assets err on the **conservative side of the risk spectrum**.

With all these issues in play, the question that remains is “in what does one invest”? While there is no stock standard answer to this, NFB would suggest that diversification be the core principle behind offshore investment at present. With all the uncertainty that the world faces, we believe that strategies that do not focus on diversification run the risk of being speculative plays, and investors need to consider whether this is in line with their reasons for investing offshore in the first place. **Diversification would be achieved by investing in dynamically managed solutions that invest across currencies, asset classes and geographic regions.** ⊕



PAPER VERSUS GOLD

What is the significance of gold really? It is people's perceptions of gold's value which determines gold's price significance. Written by Duncan Wilson, Financial Advisor - NFB Port Elizabeth



Gold has seen a prolific rise in its value of late, amid global financial concerns and the resultant devaluation of fiat paper currencies. Gold is seen by bankers as a store of value and its recent appreciation reflects fiat paper currency weakness (most notably the Dollar), gold's strength and the significance of gold's role in Global Financial Reserves. A multitude of countries have shown that they would prefer to hold more gold in a vault, where they can see it and the value of which is not dependant on another country's level of debt nor ability to print money.

Gold is notoriously difficult to produce and incurs extensive costs, time and associated environmental damage. There are 160 000 metric tonnes above the earth's surface today, 50% of which is used for investment purposes. The remainder is kept in family safes or worn on the extremities.

Just last week, the Indians bought 200 tonnes of the yellow stuff. This purchase, which has led the way for smaller Asian countries, represents 6.5% of the Indian Reserves. More importantly, many argue this to be a new phase in the battle between paper and gold.

Since 1971, when President Nixon ended the convertibility of the dollar into gold under the Bretton Woods system, most countries have been net sellers of gold and net purchasers of the dollar. It has recently become clear that a number of countries have effectively reversed this position and decided that they have more Dollars than they actually would like to hold. Outside of the Indian Government, the Chinese views on this are of particular importance to gold, due to the size of their foreign reserve holdings, the value of which is

derived primarily from the Dollar.

Gold is viewed as a **fiat commodity currency**. Its attractiveness is relative to the value of a collective of fiat currencies, issued by central banks. A more realistic way to think of the value of gold is not as an intrinsically valuable commodity (such as silver, copper and zinc etc.), but to view its value as a set of intrinsically invaluable paper currencies. What is the significance of gold really? It is the significance of people's perceptions of its value, that determines gold's price significance.

Complexities aside, there is a strong story for gold as fiscal incontinence threatens price stability of global currencies. The medication for this crisis until now has been the doubling of the Fed's balance sheet and the tripling of the Bank of England's balance sheet. This process has a fancy name - quantitative easing - which essentially refers to the around the clock running of the printing presses.

The immediate concern for most developed countries is deflation in the short term. Inflation should be of far greater concern looking ahead, with enlarged global balance sheets and future fiscal deficits. Despite gold being intrinsically invaluable, it is very difficult to rapidly increase the supply of it. Unlike gold, money can be printed at a very low marginal cost, the supply of which can be compared to opening and closing a tap.

Gold is enjoying a long and healthy run, and it may well continue. The argument remains as to the sustainability of the gold price when its' true value is inherently derived from intrinsically invaluable paper and the market's perception thereof. ⊕



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Contact us:

Johannesburg Office: NFB House 108 Albertyn Avenue Wierda Valley 2192, P O Box 32462 Braamfontein 2017, Tel: (011) 895-8000 Fax: (011) 784-8831

East London Office: NFB House 42 Beach Road Nahoon East London 5241, P O Box 8132 Nahoon 5210, Tel: (043) 735-2000 Fax: (043) 735-2001

Port Elizabeth Office: 110 Park Drive Central Port Elizabeth 6001, P O Box 12018 Centrahil 6001, Tel: (041) 582-3990 Fax: (041) 586-0053

E-mail: nfb@nfb.co.za **Web:** www.nfb.co.za