FORWARD THINKING

ISSUE 2: 4th Quarter 2011

GLOBAL VOLATILITY

The year thus far has been one characterised by uncertainty on many fronts. An initial positive start to the year – both from an economic as well as a market perspective – saw jobs rise in the USA by 650 000 between January and April. The S&P500 index rose strongly (+8.5% to end April) on evidence that the global economic recovery was progressing well. **WILLIAM FRASER** takes a closer look at the international scenario.

The Japan earthquake had widespread consequences in the global supply chain. Supply disruptions specifically in the electronics and motor vehicle manufacturing industries brought negatively impacted markets and economic growth. Employment creation stalled, sentiment turned decidedly negative, liquidity contracted and output barely grew from April onwards. The S&P has subsequently fallen to 1131 (down 17% from April).

The end of Quarter 2 saw renewed focus on peripheral Eurozone debt markets, in particular Ireland, Portugal and more recently, Greece. Greek 10 year government debt is currently yielding 24.5% (vs 2% in Germany). The probability of a technical default by Greece – according to credit default swaps – remains very high. In the USA there was political bickering and grandstanding related to the raising of the debt ceiling. Democrats (favouring higher taxes) and Republicans (favouring further cost cutting) finally conclude a compromise deal just days before the early August deadline. This created additional uncertainty, which had a direct effect on economic activity. Despite August's downgrade of the US sovereign debt rating by Standard & Poors, bond yields fell sharply as investors rushed to buy safe haven assets. A weakening economic outlook compounded the situation.

General market volatility has been extreme since the end of July. The FTSE/JSE All Share Index has fluctuated between 28 500 and 31 500 during this period. The index fluctuated by 1000 points over very short time periods on no less than eight occasions during this time. Global markets have experienced similar volatility. Increased risk aversion in September saw commodity based currencies and emerging market bond yields sell off, while US Treasury prices firmed. The rand depreciated by almost 20%, while the SA 10 year bond yield rose 80 basis points. Foreign investors sold R16bn worth of South African bonds, after accumulating bonds worth R60bn in the preceding four months. Commodity prices fell sharply, driven by liquidations following growth revisions and increased margin calls.

During the year, the allocation to JSE Equities in our portfolios has declined. The market rating (PE) of equity indices and individual companies continue to fall, despite strong earnings reported from resource companies, retailers and banks. Risk aversion remains elevated. It is unlikely to abate significantly in the absence of a material improvement in the European debt crises. Cash has been accumulated and further investment into shares has been done on a very selective basis at cheaper prices.

Equities remain the asset class of choice, particularly in a world where interest rates are anticipated to remain at current low levels and inflation risks are increasing. Quality companies, with strong balance sheets and free cash flow (returned to investors as dividends) will remain an important component of portfolios, best suited to meet real return requirements.

Within the equity component of multi-asset portfolios, a balanced, defensive positioning remains in place. The resource allocation is mostly in diversified miners where earnings are secure despite the recent fall in prices. This is balanced through an allocation to retail shares, focused on discretionary (mostly clothing) and non-discretionary (food) spend. The allocation to non-resource rand-hedges has been increased.

The allocation to SA bonds remains very low and unchanged. The outlook for inflation has deteriorated given the depreciation of the rand and is not fully discounted in current yields. Foreign investors, despite selling bonds in the second half of September, remain long SA government bonds. A further bout of selling is possible should risk aversion rise further.

REDUCE CASH. BUY EQUITIES.

Currently, the Foord International Trust is 65% invested in equities, 29% in cash and 6% in grain and gold ETFs. Cash management is currently 2/3rds in US$ (FIT's reporting and valuation currency) and 1/3rd in Singapore dollars. In our view, the yen seems overvalued and the euro is fragile. **MIKE SOEKOE** unpacks the Foord International Trust.

We continue to avoid longer dated bonds. At these levels, bonds offer very unattractive yields and a high potential for capital erosion. Such risks would be compounded should inflationary fears emerge in eventual response to yet further government debt creation to boost flagging economies.

The overall strategy is to reduce cash and to buy equities on extreme weakness. In this regard, we recognise that the Euroland debt crisis and slow US economic growth will take some time to resolve and will keep markets volatile and depressed in the short term.

The overriding theme within the Foord International Trust is the attractiveness of global multinational companies listed in developed markets but with operations in the faster growing emerging economies. In many cases the dividend yields on these multinationals exceed 3% in USD, with strong balance sheets and rising profits in prospect.

World economic growth for the next few years will only be significant from the non-debt ridden emerging economies whose growth however will be compromised by weak US and European demand. China's growth is expected to continue, with associated demand for industrial commodities. This growth should, however, come in well below historic rates as China seeks to reduce excessive credit growth, given its effects on the housing market and inflation generally, and rebalance the economy gradually away from its capital intensity towards higher consumer demand.

The portfolio includes exposure to only one bank, being the strongly capitalised HSBC which lends less than it takes in deposits, which is fairly unique in the west. The managers still like the defensive sectors of tobacco and drugs, while recognising the former are on higher PE's because of their earnings predictability. We continue to support stocks benefiting from the mainland Asian consumer such as LVMH and Diageo. A recent addition to the fund has been Pepsi.

SHARE FOCUS

CASHING IN ON THE **CHINESE CONSUMER**

LVMH owns market leading brands in soft luxury through Louis Vuitton and in wine and spirits through acquisition of Bulgari. In addition to these flagship brands, LVMH has an extensive portfolio within the segments that allows it to service the different pricing points of the aspiring consumer. **NICK BALKIN** digs a little deeper in to why LVMH remains a core holding in FIT.

Key to the investment case is their strong brand portfolio (which is near impossible to replicate), its long-term track record, strong free cash flows and positive earnings outlook.

One of their future earnings prospects is the rise of the Chinese consumer. As has been highlighted by the latest Chinese five year plan, their authorities intend transitioning from an infrastructure-led economy to a more balanced economy by increasing the contribution from the consumer sector. Like most luxury brands, LVMH has only scratched the surface of the Chinese luxury market. Asia excluding Japan has grown its contribution of LVMH's total revenue from 17% in 2000 to 25% in 2010 and is expected to contribute approximately 40% by 2015. The rapid growth of the Asian economies has accelerated the growth in ultra-wealthy individuals. They will continue to look to the Western luxury brands to flaunt this new wealth.

Besides being in an attractive industry LVMH is very well positioned relative to their peers as their vertically integrated business model allows them to bypass wholesalers. This enhances margins and ensures tight inventory management. Scale also provides significant advantages in distribution and marketing.

Given our long-term investment horizon, the valuation remains attractive for such a well-positioned company and it remains the largest holding in FIT.

FOORD INTERNATIONAL TRUST - COMMON SENSE INVESTING

The traditional definition of diversification is a spread between a variety of investment products in order to reduce the risk of the investment. Diversification is the one free lunch every investor has access to, thus it makes sense to incorporate this strategy within every portfolio. But note that too much diversification reduces return. William Fraser touched on global themes and risk, specifically regarding the US and European austerity measures. Nick and Mike elaborated on the opportunities and risks within the various asset classes and shares. **MARIO SCHOEMAN** explains how the Foord International Trust, since 1997, has delivered Top Quartile returns while protecting investors through common sense investing.

The Foord International Trust (FIT), aims to outperform world equity indices but with significant lower variability of returns. The dual mandate is to produce an annualised return over time in excess of 10% in US$ and to outperform the MSCI (developed markets) world equity index. Integral to this strategy is to maximize the return with minimum risk from a portfolio of international assets, including equities, fixed interest investments and cash.

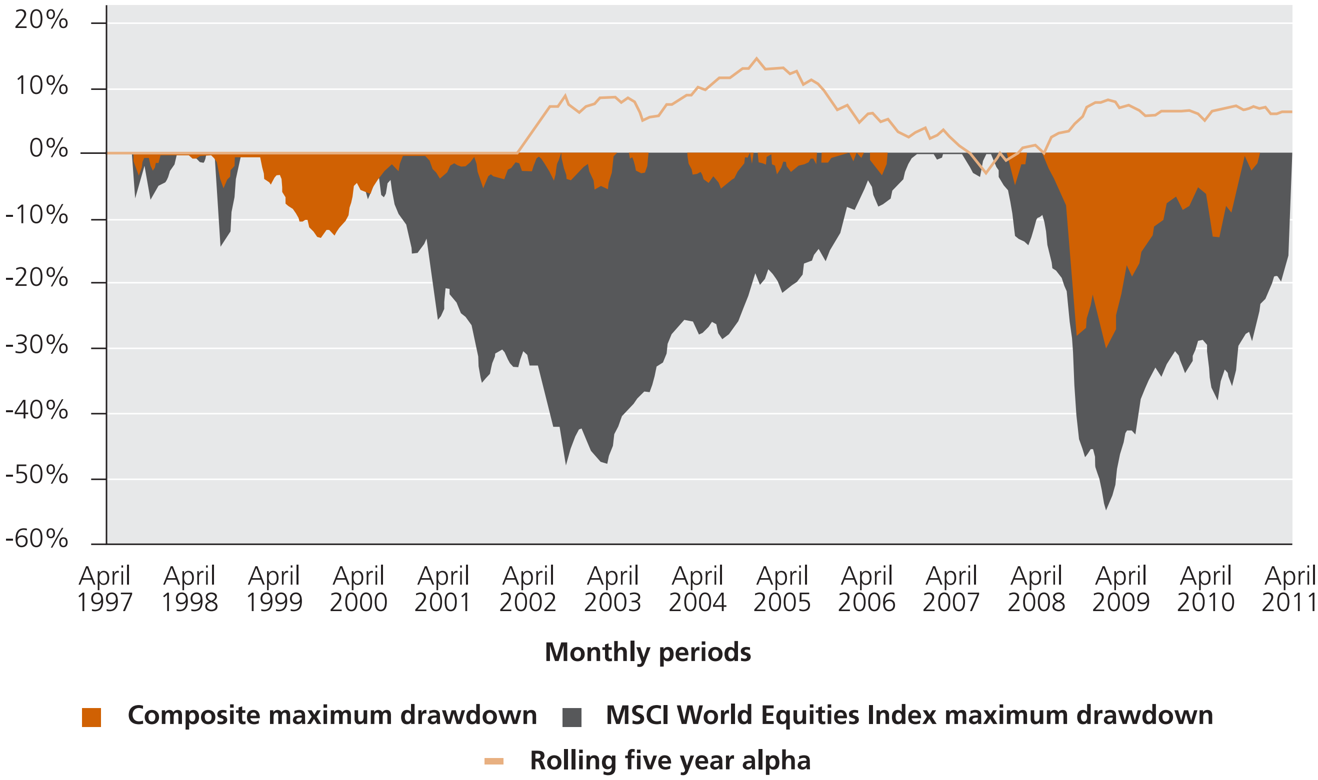
Our philosophy is to identify long-term value and avoid assets with a high risk of loss of capital. We avoid overpaying for assets, as it is easier to achieve a required rate of return when paying a lower price for an investment. We do take a longer-than-normal term approach to investing, and are not benchmark cognizant. Foord employs common sense by evaluating the cheapness or dearness in both absolute and relative terms of the major asset classes and markets. We then determine to what degree we should deviate from our neutral asset allocation percentage (when all asset classes are fairly valued against each other). This neutral position is a function of the returns expected over the long term in different asset classes and their inherent risks of loss.

> “LONG-TERM INVESTMENT THEMES ARE IDENTIFIED AND THEN THE BEST MEANS OF IMPLEMENTING THEM ARE USED, TYPICALLY FAVOURING LARGE, BEST OF BREED COMPANIES BUT OBVIOUSLY VALUATION DEPENDENT. WE EMPHASISE A LOW-RISK APPROACH TO INVESTMENT, HAVING NO DERIVATIVES OR GEARING AT ANY TIME.”
>
> **BRUCE ACKERMAN**

Key to the investment process is risk management, although this is not divorced from our day-to-day management of the portfolio. In constructing a portfolio, we take cognizance of the risks to the view we implement, with particular emphasis on the potential for a negative surprise and the risk to capital values in that scenario. Our approach requires a sufficient margin of safety in prices vs expectations before we allocate money to a particular counter.

Because we focus on long-term investing, we view risk as the loss of capital and not as the volatility of returns. Our management bias is therefore towards absolute return portfolios. Looking at the attached chart we can see that protection of clients’ investment is front of mind as the fund proved to protect investments on the downside. The fund has outperformed its benchmark (a pure equity index) with considerably lower volatility.

FOORD INTERNATIONAL TRUST - SUBSTANTIALLY LOWER DRAW-DOWN RISK



The fund has returned 6.8% p.a. in dollar terms since inception, compared to the MSCI return of 4.3% (including income). Over the last 12 months the fund returned 14.7%. Considering the stellar returns and volatility measurement the fund is rated by Morningstar as a five star fund over five years, 10 years and since inception.

The current asset allocation reflects our view of developed markets vs emerging market shares and matching our macro theme with multi-national companies that have exposure to emerging market consumers.

Our record has shown that the Foord International Trust has gained its performance advantage by judicious stock selection as well as dynamic asset allocation. This is an important quality to have in any diversified portfolio as the Foord International Trust offers lower volatility and substantial international diversification for pre- and post-retirement investors. For non-direct investors, the rand priced Foord International Feeder Fund which invests solely in the Foord International Trust is available.

INVESTMENT RETURNS TO SEPTEMBER 2011

FOORD FLEXIBLE FUND OF FUNDS

INVESTMENT RETURNS

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**7.4**	11.1	13.4	4.2
Benchmark	**12.0**	10.2	10.4	2.9

Benchmark: CPI + 5% per annum, which is applied daily by using the most recently available inflation data and accordingly will be lagged on average by 5 to 6 weeks. Inception date: 1 April 2008

OBJECTIVE

To provide investors with real returns exceeding 5% per annum, measured over rolling three-year periods. The fund will exploit the benefits of global diversification in a portfolio that continually reflects Foord Asset Management's prevailing view on all available asset classes, both in South Africa and abroad. The fund is suitable for investors with a moderate risk profile who require long-term inflation beating total returns, but who do not require a high income yield.

FOORD INTERNATIONAL FEEDER FUND

INVESTMENT RETURNS

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**8.1**	0.8	13.7	9.6
Benchmark	**4.6**	-0.1	11.9	-0.3

Benchmark: The ZAR equivalent of the MSCI World Equities Index (developed markets)
Inception date: 1 March 2006

OBJECTIVE

To provide exposure to a portfolio of international securities constructed with the purpose of maximising return with minimum risk. This is achieved through direct investment into the Foord International Trust, which aims to produce an annualised return over time in excess of 10% in US dollars, thereby expecting to outperform world equity indices. The fund is suitable for South African investors who seek to diversify their portfolios offshore and to hedge against rand depreciation.

FOORD BALANCED FUND

INVESTMENT RETURNS

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**16.7**	10.4	8.4	1.3
Benchmark	**14.4**	9.5	5.7	-0.3

Benchmark: The market value weighted average total return of the Domestic Asset Allocation Prudential Variable Equity unit trust sector, excluding Foord Balanced Fund.
Inception date: 1 September 2002

OBJECTIVE

The steady growth of income and capital, as well as the preservation of real capital (being capital adjusted for the effects of inflation). The fund is managed to comply with the prudential investment limits set for retirement funds in South Africa (Regulation 28 to the Pension Funds Act). The fund is suitable for pension funds, pension fund members, holders of contractual savings products, medium- to long-term investors and those investors who require the asset allocation decision to be made for them, within prudential investment guidelines.

FOORD EQUITY FUND

INVESTMENT RETURNS

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**19.5**	13.5	7.4	-2.6
Benchmark	**16.5**	10.6	3.6	-5.8

Benchmark: Total return of the FTSE/JSE All Share Index
Inception date: 1 September 2002

OBJECTIVE

To earn a higher total rate of return than that of the South African equity market, as represented by the return of the FTSE/JSE All Share Index including income, without assuming greater risk. The fund is suitable for investors who require maximum long-term capital growth and who are able to withstand investment volatility in the short to medium term.

FOORD INTERNATIONAL TRUST

INVESTMENT RETURNS

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**6.8**	3.7	-1.0	-10.2
Benchmark	**3.7**	1.0	-3.8	-16.5

The fund has the following dual benchmarks:
- In excess of 10% annualised in US$ over time
- MSCI World Equity Index (developed markets) total return index

Inception date: 10 March 1997

OBJECTIVE

To maximise return with minimum risk from a portfolio of international assets, including equities, fixed interest investments, commodities and cash. The specific aim is to produce an annualised return over time in excess of 10% in US$, thereby expecting to outperform world equity indices but with significantly lower variability of returns. A flexible asset allocation policy is followed, with a diversified, but focused portfolio of undervalued, high quality investments.

NOTE:
Investment returns for periods greater than 1 year are annualised
* Net of fees and expenses

PLEASE REFER TO THE FACT SHEETS CARRIED ON WWW.FOORD.CO.ZA FOR MORE DETAILED INFORMATION.

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