FOREWORD

DID YOU KNOW?

35 YEARS OF INVESTMENT STEWARDSHIP

For many investors, Foord Asset Management is perceived as a relatively new kid on the block in the investment industry. Few investors know that Foord & Meintjes, as the company was originally known, was founded by Dave Foord and Liston Meintjes in October 1981.

This means that Foord Asset Management recently celebrated 35 years of investment stewardship — the enduring vision of its founders. Thank you to those investors who joined us in celebration at the Meet the Team events held in Durban, Johannesburg and Cape Town in November 2016.

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THE YEAR IN REVIEW

2016 was a tumultuous year for many of us in South Africa and around the world. In this article, NICK CURTIN describes some of the major events and market outcomes of the past year and gives them some historical perspective.

Populist nationalism arrived in force in 2016 with the "out" Brexit vote, the Bernie Sanders campaign, the Donald Trump election win, the impeachment of Brazilian President Rousseff and the frustration of government-sponsored Italian constitutional reform. We also saw a strong reversal in the fortunes of several emerging markets after a number of torrid years.

> THE CONTINUED SEARCH FOR YIELD AND SPECULATIVE ACTIVITY LED TO GENERALLY BUOYANT MARKETS.

The continued search for yield and speculative activity — pursuant to large Chinese economic stimulus and a potentially massive US fiscal expansion under Trump — led to generally buoyant markets. The MSCI All Country World Index gained 7.9%, with emerging markets rising most on strong gains by the Brazilian and Russian bourses. US equities gained 10.9%, largely due to a rally in the US industrials sector.

Commodities mostly advanced, especially oil, gas and iron ore, which all posted high double-digit gains. Related emerging market currencies including the rand, Brazilian real and Canadian dollar gained against hard currencies. But the US dollar was understandably stronger against the euro, pound and yen given the relative economic performance of these markets and nascent hawkishness by the US Federal Reserve.

It is quite possible that 2016 saw the inflection point in a multi-decade fall in interest rates. Indeed, by mid-year, $11 trillion of developed market government debt was trading at negative yields. Even corporates began issuing debt at negative yields. However, yields on US Treasuries and the dollar surged after Trump's election on expectations of higher US economic growth, inflation and US interest rates. The nature of global trade is also likely to look very different in future as Trump ushers in a new protectionist era.

South Africa see-sawed between the fortuitously benign global environment for emerging markets on the one hand and the risk-drenched domestic political environment on the other. The FTSE/JSE All Share Index eked out a 2.6% annual return, weighed down by the cohort of large rand hedge counters as the rand improved. Bonds (+15.5%) delivered a reasonable return and listed property (-20.4%) disappointed. Cash proved to be a safe hiding place amidst the turmoil.

Bill Bryson's *One Summer: America, 1927* recounts the era-defining events bridging the Roaring Twenties and the looming Great Depression. That short season held the first non-stop trans-Atlantic flight (Charles Lindbergh), the first "talking movie" (The Jazz Singer), the original Ponzi scheme (Charles Ponzi's postal coupon "business"), the advent of television, the birth of the shopping mall, the Great Mississippi Flood and Babe Ruth's phenomenal 60 home-run season. Bryson also offers fascinating insight into President Coolidge who somewhat lazily restored confidence in the White House after the scandals of his predecessor — an unexpectedly comforting facet of the book for a South African reader in 2017.

Though an astonishing number of important things happened in 1927 that affected events in subsequent decades, so too might events of 2016 prove to be epoch defining. Mostly notably, the turning point in the trajectory of interest rates could be the single biggest driver of return outcomes in the coming years.

So a lot happened in 2016 and in 1927. But a lot has happened in other years too. In fact, the more one thinks about it, the more striking it is how normal a cluster of abnormal events actually is.

THE YEAR AHEAD

At the Meet the Team investor functions in November, MIKE SOEKOE discussed Foord's outlook for investment markets in 2017. Mike's presentation focused on capital preservation, as well as the effect of uncertainty and extreme volatility on investors' decisions. This article is an overview of his presentation.

Foord's forward-looking investment process means the investment team works to best understand the future path of the global economy and its implications for investment markets. Portfolio managers then position the investment portfolios after the team has conducted detailed investment research. Looking back at the presentations of the previous year, we noted that the forecast volatility did indeed transpire, and then some. Who would have believed a year ago that Brexit could happen, or that Donald Trump could be elected?

The team's projections were mostly vindicated by developments in 2016, except for the timing and magnitude of two key forecasts: that US interest rate increases would gradually resume and that the rand would weaken. In the event, the US Federal Reserve increased interest rates only once and the rand was subjected to violent swings, but by November 2016 it was little changed over the course of the year. However, we remain confident that these events will nevertheless play out in the not-too-distant future.

The presentation first focused on the US, the world's biggest economy and generally the harbinger of global economic activity. The financial press reported fully on the uncertainty and turmoil introduced by the US president-elect and the markets were under-standably jittery immediately after the election.

However, at the time of writing, US stock markets and the dollar have strengthened, while the bond market has weakened, as market participants digested Trump's expensive expansionary policies. These include a proposed $500 billion infrastructure programme, the aggressive cutting of corporate taxes and penalising US companies that access cheaper labour abroad only to sell goods and services back to the US.

We have for some time forecast steady growth from the US. Now, if Trump's promises are fulfilled (and there are big question marks about his commitment and ability to do so), we envisage that US economic growth will accelerate in 2017, introducing inflationary pressures and more quickly rising interest rates, thus sustaining dollar strength. On the other hand, if actioned, Trump's protectionist plans to nullify global free trade agreements would be negative for global GDP, especially in the event of a Sino-American trade war.

European prospects, in contrast, are less rosy than those of the US, but equally uncertain. Brexit and rising populism have shaken Europe. With elections in Holland, France and Germany this year and a belligerent Russia to the east, geopolitical risks are rising in the EU. We expect muted growth and sustained weakness from the euro and pound in the year ahead as central bank stimulus persists.

The world's second largest economy, China, is set to continue its growth trajectory, but at a slower pace than in past years as its economic base expands. With $3 trillion in foreign currency reserves, the Chinese authorities have both the will and the means to hold its growth path steady and to withstand any economic shocks. We continue to expect the Chinese economy to normalise in favour of the consumer and away from infrastructure-led growth.

Expectations for South Africa were downbeat: 2017 growth will unlikely exceed 0.5% and prospects for net job creation are dire given private sector jobs losses and the continued public sector jobs freeze (as government attempts to control public spending while ratings downgrades loom). Business and consumer confidence is also depressed as a result of continued policy uncertainty, non-existent fixed investment and the over-indebted consumer being unlikely to achieve wage increases exceeding inflation.

Also, South Africa runs a structural deficit on its current account (we import more than we export, including dividends and interest payments to foreign investors) and, on the fiscal account, government annually spends more than it collects in taxes. These twin deficits underpin a gloomy forecast for the currency, sovereign credit ratings and bond yields.

Given that global share markets, notably in the US, are at or near all-time highs and that geopolitical risks are elevated in all markets, Foord's portfolio managers are understandably cautious.

Investment strategies vary by mandate and investment market but generally include:

- Raising cash levels above normal weights to protect portfolios and to take advantage of market dislocations
- Within prudential mandates, a full weight to foreign assets to diversify SA-specific risks
- Preference for global equities, with investment in companies with excellent management teams, attractive business models, sound balance sheets and stable cash flows
- Within South African equities, preference for rand hedge counters
- A low to nil weight in government bonds given the risk of rising yields
- Holding some gold bullion as a hedge against severe market stress.

	WHAT WE SAID	WHAT HAPPENED	WHAT WE ANTICIPATE
USA	• Moderate growth • 5% unemployment -> wage growth • Consumer spending tailwinds • Modest rate hikes	• US economy is growing • Real wage growth recorded • Spending accelerated • Only one rate hike in 12 months	• Growth may accelerate • Nominal wage growth to pick up • Inflation to rise • Fed to resume interest rate normalisation • Stronger dollar
EU	• Modest growth • Weak euro and cheaper energy to boost exports	• Recovery gaining traction • Exports grew less than anticipated	• Limited economic growth • Geopolitical risks • Weaker euro vs US dollar
CHINA	• Economic transition to take time; gently slowing growth • Expect broad policy easing	• Transition is continuing; growth slowed to 6.7% • Significant government support for infrastructure and housing	• Growth to gently slow • Government to use fiscal stimulus when needed • Modest currency depreciation
RSA	• Slower SA growth • Rand remains vulnerable	• Growth has slowed • Volatile rand marginally stronger	• Growth to stall • Policy uncertainty • Rand remains vulnerable

THE FIRST RULE OF INVESTING: CAPITAL PRESERVATION

In last quarter's *Foreword* (Issue 39), Paul Cluer addressed the issue of lower future returns, noting that "for now, Foord's portfolio managers are in capital preservation mode." SIHLE LUKHELE takes a closer look at this concept and what it means for investor portfolios.

Benjamin Graham, the father of value investing, defined an investment operation as "one which, upon thorough analysis, promises *safety of principal*[1] and an adequate return." Graham's concept of safety of principal could easily have been expressed as "capital preservation," one of the hallmarks of Foord's investment philosophy.

The importance of capital preservation in especially uncertain times cannot be overemphasised. At Foord, we define investment risk not as volatility, but as the likelihood of permanent, real capital loss — loss from which recovery is impossible or very highly improbable. Permanent loss of capital is the flipside of capital preservation and is one of the key risks we manage.

We have found that avoiding losers is as important to building a superior, long-term track record as picking winning investments. This is well illustrated by a simple example. Consider an investment whose price declines to R50 after it was purchased for R100 (a 50% loss). The price of that asset must double (a 100% gain) merely to nominally break even. The greater the fall in price, the more significant the required return must be just to reach an overall return of nil.

In addition, the time required to recover nominal losses is often correlated to the capital value decline of the asset — capital recovery in real terms may never occur. It follows that it is far more sensible to embrace the higher probability of preserving capital with a defensive disposition from the outset.

Few people would dispute that the present global economic environment is fraught with uncertainty, with most asset classes at or near historical highs and trillions of dollars of sovereign bonds trading at negative yields. The South African economy faces structural headwinds, and political risk remains elevated. Investment risks associated with this uncertainty are high and rising, making the focus on real capital preservation more imperative.

So what does it mean to be "in capital preservation mode"? Firstly, cash levels in equity and multi-asset portfolios are well above their long-term averages. Additional cash in the portfolio serves to provide an income yield when the prospects of return from other asset classes are limited; to buffer the portfolio against potential declines; and to provide liquidity to buy quality investments if asset prices fall significantly.

Secondly, overall equity (especially SA-equity) allocations are below their long-term averages as portfolio managers mitigate the risk of portfolio loss in the event the market falls dramatically. Within equities, the fund managers prefer quality companies that derive some or all of their earnings outside of South Africa (rand hedge shares), given the risks in this market and to its currency.

Thirdly, in the current cycle, holdings of government bonds are low given the risk of rising global and local yields, which work inversely to bond prices. Then, portfolio managers will typically have a full weight in foreign assets to diversify the risks of investment in South Africa. Finally, portfolio managers will often hold a meaningful position in gold bullion (via ETFs) as the metal usually acts as an uncorrelated, safe-haven investment during periods of market dislocation.

Liquidating one's entire portfolio is an extreme strategy as the very real risks of loss may never eventuate. Therefore, portfolio managers maintain some exposure to growth assets, notably quality companies, to manage the risk of being wrong in their overall risk assessment.

[1] Author's emphasis

CONSOLIDATION OF OFFSHORE SERVICE PROVIDERS

Foord Asset Management employs different administrators in various jurisdictions to support its offshore investment funds. PAUL CLUER reports on the 2017 initiative to consolidate these service providers.

Foord established the Foord International Trust in 1997 in the well-regulated jurisdiction of Guernsey. In March this year, that fund will celebrate its milestone 20-year track record. In 2012 the group established an investment research office and the Foord Global Equity Fund in the busy global financial centre of Singapore. Foord's Singapore office now employs 10 staff members.

In *Foreword* Issue 25 (1st Quarter 2013) we reported on the establishment of Foord Sicav in Luxembourg, Europe's leading cross-border funds market. The strategies of the Foord International Trust and Foord Global Equity Fund were mirrored in two UCITS-compliant sub-funds of Foord Sicav. Unlike the Guernsey and Singapore funds, these UCITS portfolios are eligible for distribution in all EU markets although for the time being only registered for distribution in Luxembourg, the UK and Switzerland.

The unintended consequence of these developments was that common investors in all three offshore jurisdictions must interface with three different service providers and there is no consolidated investor reporting. We have, therefore, for some time sought a partner capable of jointly administering all four funds across the three jurisdictions.

After extensive due diligence, Foord's executive team approved the consolidation of all service providers. The Royal Bank of Canada (RBC) is expected to go live on 1 July 2017 as the single custodian bank, transfer agent and fund administrator to all of Foord's offshore funds. We chose RBC for its position as Canada's largest bank and a top-ten service provider in Luxembourg, as well as for its operations in Guernsey and Singapore.

> WE LOOK FORWARD TO INTRODUCING THE SINGLE INTERFACE FOR INVESTORS IN ALL FUNDS, CONSOLIDATED REPORTING AND BEST-OF-BREED SERVICE.

We look forward to introducing the single interface for investors in all funds, consolidated reporting and best-of-breed service from this leading custodian bank.

MULTIPLE-COUNSELLOR UPDATE

Foord's multiple-counsellor system allocates the management of each portfolio to two or more portfolio managers. The firm annually reviews the optimality of the manager complement, taking into account the skill set available and capacity of individual managers. William Fraser will now co-manage multi-asset portfolios with Dave Foord, Dane Schrauwen and Daryll Owen, although Dane Schrauwen will be enjoying a well-deserved sabbatical in the first half of 2017. Dave Foord joins the SA equity manager mix of Dane Schrauwen, Nicholas Balkin and Brian Davey.

MARKETS IN A NUTSHELL

INTERNATIONAL / SOUTH AFRICA

EQUITIES

International: A sentiment-driven rally propelled US stocks higher in anticipation of faster earnings growth under a Trump presidency – but healthcare stocks and Chinese companies fared less well

South Africa: SA equities declined ahead of the US Federal Reserve's only interest rate increase of the year – gold and platinum miners fell most after precious metals prices retreated from mid-year highs

BONDS

International: US long bonds sold off as yields rose sharply on rising inflation expectations and rate hike expectations – compounded by hawkish Federal Reserve statements on the number of rate increases expected in 2017

South Africa: The All Bond Index advanced modestly but was the best performing major asset class for the year as yields fell from January's highs – cash returns beat inflation, while returns on the equity market rose marginally

CURRENCIES

International: The dollar strengthened meaningfully against developed market currencies – Trump policy proposals are expected to boost growth and inflation, and prompt some offshore profit repatriation by US corporations

South Africa: The rand ended the quarter barely changed against the US dollar but improved materially against the euro and sterling – the rand was one of the best performing currencies in 2016, gaining 12.6% against the US dollar

COMMODITIES

Gold sold off as bond yields rose sharply and the dollar strengthened – oil prices rose in response to the proposed production cuts announced by OPEC and non-OPEC countries

ECONOMY

International: In a "vote for change," Republican nominee Donald Trump upset poll-leader Hillary Clinton to clinch the US presidential election – subsequent nominations for key government positions portend a radical change in US trade policy, with China in the crosshairs

South Africa: Tight fiscal and monetary policies constrained domestic output – analysis of manufacturing and consumer spending data suggests that fourth quarter GDP barely advanced from the third quarter's already-depressed expansion

MONETARY AND FISCAL POLICY

International: The US Federal Reserve finally, and unsurprisingly, raised the benchmark federal funds rate by 25 bps to 0.75% – the latest FOMC minutes reveal much uncertainty about fiscal policy measures and the likely effect of faster US growth, jobs creation and inflation on future interest rate increases

South Africa: The SA Reserve Bank kept interest rates unchanged, with monetary policy downward revisions unlikely in the near future – inflation breached the 6% inflation band upper limit, but is expected to be temporary in the absence of any currency shocks

FUND OBJECTIVE

FOORD FLEXIBLE FUND OF FUNDS

Inception date: 1 April 2008

The fund aims to provide investors with a net-of-fee return of 5% per annum above the annual change in the South African Consumer Price Index, measured over rolling three year periods. Exploiting the benefits of global diversification, the portfolio continually reflects Foord's prevailing best investment view on all available asset classes in South Africa and around the world.

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	13.4	8.3	-4.4	-2.1
Benchmark	11.3	10.9	11.7	1.9

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.

FOORD BALANCED FUND

Inception date: 1 September 2002

The fund aims to achieve the steady growth of income and capital as well as the preservation of real capital (capital is adjusted for inflation). The portfolio is managed to comply with the statutory investment limits set for retirement funds in South Africa (Regulation 28).

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	15.2	5.9	-1.0	-1.7
Benchmark	13.2	6.1	1.7	-1.6

Benchmark: The market value weighted average total return of the South African Multi Asset High Equity unit trust sector, excluding Foord Balanced Fund.

FOORD CONSERVATIVE FUND

Inception date: 2 January 2014

The fund aims to provide investors with a net-of-fee return of 4% per annum above the annual change in the South African Consumer Price Index, measured over rolling three-year periods. The portfolio is managed to comply with the statutory investment limits set for retirement funds in South Africa (Regulation 28).

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	6.0	6.0	0.3	-1.4
Benchmark	9.9	9.9	10.7	1.7

Benchmark: CPI + 4% 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.

FOORD EQUITY FUND

Inception date: 1 September 2002

The fund aims 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.

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	18.1	5.9	2.2	-2.5
Benchmark	15.6	6.2	2.6	-2.1

Benchmark: Total return of the FTSE/JSE All Share Index

FOORD INTERNATIONAL FEEDER FUND

CLOSED TO NEW INVESTMENT

Inception date: 1 March 2006

The fund aims to achieve long-term inflation-beating US$ returns over rolling five-year periods by way of investment in listed securities on global exchanges — including equities, exchange traded funds, UCITS and other UCIs, convertible bonds, interest-bearing securities and warrants as well as cash deposits.

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	12.1	9.6	-12.0	-3.0
Benchmark	9.6	10.6	-9.5	0.7

Benchmark: US inflation in ZAR

FOORD GLOBAL EQUITY FEEDER FUND

CLOSED TO NEW INVESTMENT

Inception date: 2 May 2014

The fund aims to provide investors with exposure to a diversified mix of global equity and equity-related securities. This is achieved through direct investment into the Foord Global Equity Fund, which aims to produce a higher total rate of return than the MSCI All Country World Index, without assuming greater risk.

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	8.7	-	-11.0	-3.8
Benchmark	13.4	-	-5.1	0.4

Benchmark: ZAR equivalent of the MSCI All Country World Equity Index.

NOTE: Investment returns for periods greater than one year are annualised | * Class R, Net of fees and expenses | A MEMBER OF THE ASSOCIATION FOR SAVINGS & INVESTMENT SA

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