FOREWORD

ISSUE 10
2ND QUARTER 2009

DID YOU KNOW?

THE MAGIC OF QUANTITATIVE EASING

When required, central banks will lower interest rates to stimulate their economies. But central banks don't have this option when rates are at or close to zero (as they are currently in most developed economies).

At such times they may use an extreme monetary policy process with the fancy name of "quantitative easing." The basic process is that the central bank will create money electronically in its own accounts to purchase government or other bank debt. Because of the fractional reserve banking system, this disproportionately increases the total money in circulation. The expectation is that, combined with the lower interest rate environment, this will jump-start demand for goods and services, thereby providing a stimulus to the economy.

So there you have it - at times central banks can create money out of thin air as they seek to boost the economy by managing money supply.

IN THIS ISSUE

TURBULENT TIMES A TEST OF INVESTOR RESOLVE

CHRIS GREYLING CHAIRMAN: FOORD UNIT TRUSTS

Over the past two years we have been working to create an informative, interesting and visually appealing mouthpiece that serves to inform without being overly demanding. These pages remain committed to the perspective you expect from Foord, but have been redesigned to ensure a fresher look and flowing read.

One of the changes we introduced was to reduce the fund specific disclosures carried in the newsletter. This information is contained in much more detail in our monthly fund fact sheets and fund overviews, which can be accessed directly from our website www.foord.co.za. To subscribe to receive the fact sheets by automated e-mail service, please contact Arlene or Nadia by email on unittrusts@foord.co.za.

Economic data for the first quarter shows that the SA economy contracted by its widest margin for decades. The country is therefore technically in its first recession since 1992. While commodity prices improved, the SA share market rose during the quarter and interest rates were reduced by a further 2%, our outlook for the SA economy remains negative.

The contraction in formal employment, deteriorating competitiveness of the SA manufacturing sector and poor earnings growth in the resource sector should test investor resolve. Foord therefore continues to remain cautious about the prospects for recovery in SA equities and accordingly our portfolios remain conservatively positioned.

In this Foreword, Darron West takes a closer look at the objectives of flexible funds (see *Flexible Funds - Their Place in the Sun*). Our own Foord Flexible Fund of Funds was a long time in development but is a product of which we are justifiably proud. As a fund of funds listed in the Worldwide Flexible sector, we are able to include foreign assets via the Foord International Trust that exceed 20% when appropriate (most other flexible funds in the industry are limited to 20% exposures).

We also pause to put some longer-term perspective on the recent declines in the local equity market (see *Equities - Long-term Returns)*. Investors who have been invested in shares (or equity biased asset allocation funds) for the past two decades up to and through the recent "crash" have been invested in the best performing asset class in South Africa for the last half century, earning real returns of 9% per annum over this time.

This quarter we also introduce a new face at Foord Unit Trusts and profile a rising star in our Equities team. See who's doing what in *What's New*. While we're in the throes of winter, the good news is that the days are now getting longer. The year really is slipping by quickly. Keep well until next quarter.

Chris Greyling

> "WE REMAIN CAUTIOUS ABOUT THE PROSPECTS FOR RECOVERY"

IN A NUTSHELL

BRUCE ACKERMAN AND WILLIAM FRASER

PORTFOLIO MANAGERS

BRUCE ACKERMAN and **WILLIAM FRASER** summarise the market movements over the past quarter.

	INTERNATIONAL	SOUTH AFRICA
EQUITIES	Equity markets typically registered their best quarterly performance in a decade - coordinated aggressive fiscal and monetary policies successfully bolstered the banking system	Equities staged dramatic turnaround after poor Q1 returns - as a result of increased demand from investors (prematurely) seeking growth and recovery opportunities
BONDS	Bond yields rose (especially US) on vastly increased issuance to fund unprecedentedly large (in peace time) budget deficits - but corporate bond yields fell, reflecting reduced default fears	Bond yields were flat for the quarter - but should drift higher longer-term on persistent inflation fears and increased government borrowing
CURRENCIES	Dollar weakened as its continued reserve currency role questioned in Asia and on unsustainable US government debt levels - pound and resource currencies gained	The rand appreciated by 20% against the US dollar on increased risk appetite and potential corporate activity involving SA companies - despite the election of a more socialist inclined cabinet
COMMODITIES	Commodity prices rose sharply - with short-term demand from China and inventory rebuild in developed markets offsetting poor longer-term global growth prospects	
ECONOMY	Economic indicators showed economies deteriorating less rapidly (despite two US car company bankruptcies) and even recovering in some cases - unclear if this will prove to be a short lived inventory "bounce"	Q1 data shows SA economy to have contracted by the widest margin since the early 80's confirming the first recession in over a decade - but some respite experienced from increased government spending
MONETARY POLICY	Growth-friendly policy rates held close to zero - but longer maturities' yields subject to issuance and longer-term inflation concerns if economic stimulation measures not reversed timeously	Short-term interest rates reduced by a further 2% to 7.5% on poor growth outlook and consumer recession - despite inflation remaining well above the upper band of the 3% - 6% inflation target

WHAT'S NEW

NICHOLAS BALKIN

Nicholas was employed in 2005 as part of an initiative to mentor young investment talent under a longer-term succession plan. While we anticipated some natural attrition in the ranks, we also had high expectations that some of the analysts would progress to become fund managers in their own right - and Nick has stepped up to the plate.

NICK BALKIN
ANALYST AND FUND MANAGER

Nicholas has been a rising star on our Equities team over the past four years. He is the Foord analyst responsible for the financial, media and retail sectors of the JSE. Last year, he was promoted to fund manager on a small but important long-short equity fund and he has excelled in the role. As a result, Nick was recently given responsibility as back-up fund manager for certain other mandates as well as for a large value fund mandate which exceeds R1 billion in size.

Nick's development is a pleasant affirmation of the decision five years ago to introduce young talent into the experienced mix of Foord's investment team. We are excited about Nick's future contribution. In the spirit of this success, the company will continually seek to introduce fresh talent to the team.

NADIA THOMS

Foord Unit Trusts welcomes Nadia Thoms to the fold. Nadia joins Arlene Thompson in the client services area for unit trust clients. Nadia recently relocated to the Cape after nearly two decades in Johannesburg, where she worked in portfolio administration and tax for private client fund manager, Melville Douglas. Please don't hesitate to give Nadia or Arlene a phone call should you have any queries on your investments with Foord Unit Trusts.

WISE WORDS

"I believe the most important variable in valuing any asset is the risk-free interest rate over the term of the investment. **THOSE WHO CAN ANTICIPATE THE CHANGE TO THE COST OF MONEY WILL HAVE THE OPPORTUNITY TO BE GREAT INVESTORS.**"

Dave Foord

EQUITIES – LONG-TERM RETURNS

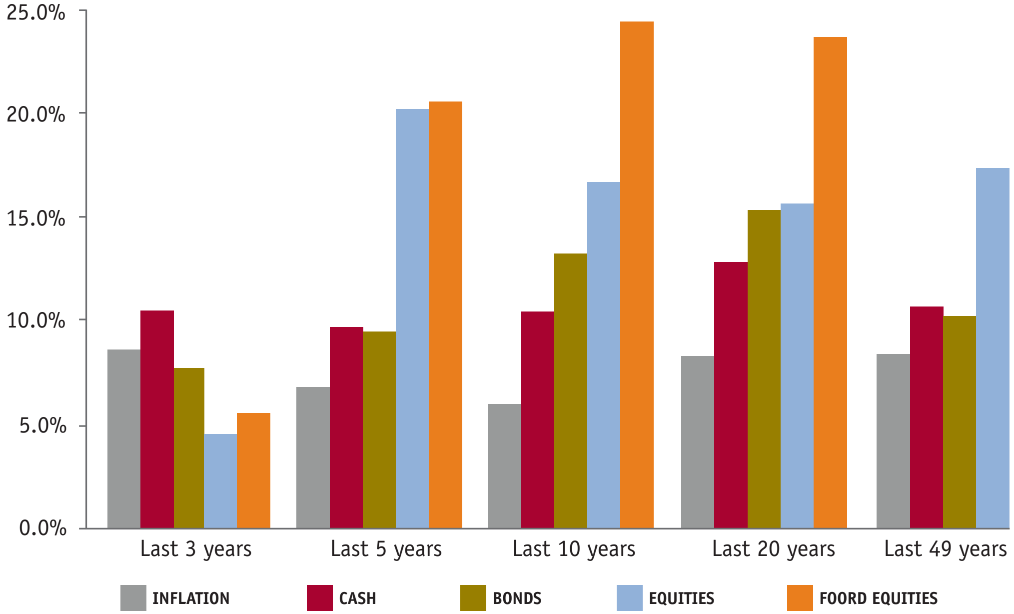
PAUL CLUER MD: FOORD UNIT TRUSTS

Despite its recent gains, by the end of June the South African equity market was still 31% off its mid-May 2008 high (33% in dollar terms). The magnitude of the loss and subsequent lack of firm direction should not deter new entrants to the equity markets nor cause existing investors to question continued investment in equities. **PAUL CLUER** explains.

A review of the longer-term returns to various asset classes provides some perspective on the recent declines. In South Africa, market return data preceding 1960 is somewhat unreliable. Nevertheless, we have nearly half a century of credible data from which to draw conclusions.

The graph below shows that over periods of five years or more ending 30 June 2009, equities have been the best performing asset class on a total return basis. Over three years, share returns have disappointed as a result of the current global recession. However, we have often said that investors in the share market should have time horizons of at least five years. It is still possible to sustain negative returns after inflation over five year periods but historical data shows that the frequency of such occurrences is low.

Bonds have shown some solid returns over the last 10 to 20 years, particularly as bond yields have declined and South Africa's risk rating has improved. However, individuals are taxed on bond coupons and the after-tax return is appreciably lower, as it is for cash returns. Predictably, pre-tax cash returns (using 3 month NCD yields) have maintained their margin of safety over inflation which has remained in the 6% to 8% bracket over the periods shown.



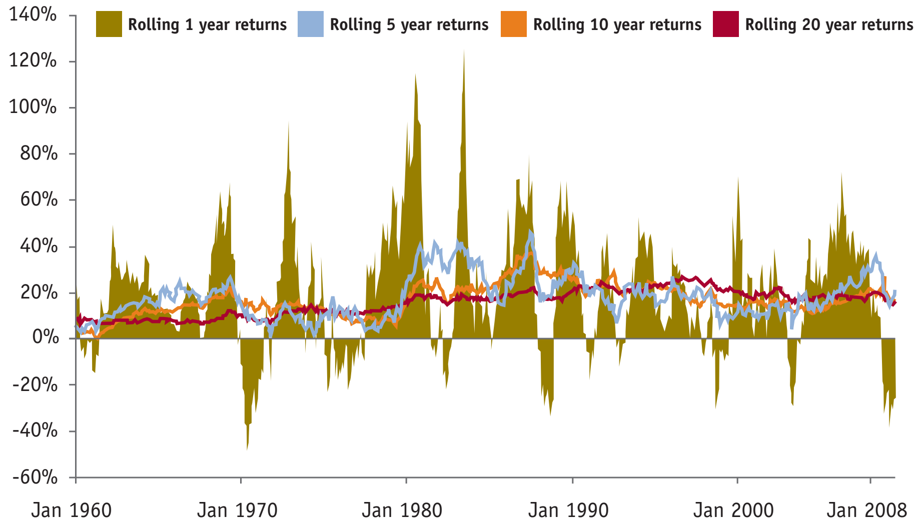
"IN MOST INSTANCES IT IS NOT THE MAGNITUDE OF THE LONG-TERM RETURNS ON EQUITIES THAT DETERS INVESTORS, BUT RATHER THE SHORT-TERM VOLATILITY OF THOSE RETURNS."

Investors with a material weighting to equities and a long exposure to the markets would have gained as a result of their strategy. An overly conservative strategy would have achieved after-tax returns that are only marginally higher than inflation.

Compounding these superior returns results in an exponential increase in the present value of an investment made in 1960. R10,000 invested in the SA share market would be worth over R29 million today. By comparison, goods and services then costing R10,000 would cost R560,000 today, while an investment in cash would be worth R1.5 million before tax.

In most instances, it is not the magnitude of the long-term returns on equities that deters investors, but rather the short-term volatility of those returns. The graph below shows the rolling one year returns on the local share market since 1960. For the most part, it reflects net positive returns although the data is punctuated by some material short-term declines (1970, 1976, 1988, 1998, 2003 and 2008/09).

One can see from the data that extending one's investment horizon to 5, 10 or 20 years results in a much smoother return profile (blue, orange and red lines). The minimum annualized return over any single 20 year period commencing after 1960 is 14.9% with the maximum return being 26.5%, during a period when inflation was just over 8%.



THE LESSONS FROM THIS SIMPLE ANALYSIS ARE TO:

- Extend your investment horizon well beyond the foreseeable future
- Maintain a healthy weighting to growth assets such as shares to beat inflation on an after-tax basis
- Ride out short-term volatility (recall that prices fluctuate far more widely than values)

FLEXIBLE FUNDS – THEIR PLACE IN THE SUN

DARRON WEST BUSINESS ANALYST

It is generally true that most investors are simply seeking real returns over periods of 3 to 5 years. If this is so, the preferred (and simplest) choice for most investors should be a quality flexible fund that has a robust real return objective. **DARRON WEST** puts the flexible fund under the microscope.

Many balanced or multi-asset class portfolios operate under certain mandate constraints (most notably, the Prudential Investment Guidelines of Regulation 28 to the Pension Funds Act). Yet many argue that such constraints limit the ability of a good fund manager to generate returns and to manage risk. The flexible fund is a logical extension of the balanced fund. But it is an unconstrained version offering the benefits of the fund manager's best investment view across all asset classes including shares, listed property, bonds, cash and offshore opportunities.

The objective of a flexible fund should be to earn an appreciable real return over the medium-term. A fund manager aims to achieve this objective by utilising all available asset classes to actively manage the risk of loss in the portfolio while capturing the upside potential in the underlying investments.

As we've said so often before, risk management is not about measuring a number; it's about the investment and portfolio construction methodology employed that produces those risk numbers. The beauty of an unconstrained flexible fund is that the fund manager has the freedom to implement decisions in the absence of artificial (and in most cases arbitrary) constraints.

A good flexible fund is likely to prevail over a portfolio of specialist funds because fads will not be followed, the fund will be properly diversified and the investment universe will not be constrained by a specialist mandate. Certainly, there may be times when specialist and sector funds will outperform even a good flexible fund. However, over the medium-to long-term, we argue that such outperformance is unlikely to be consistent.

> **"THE OBJECTIVE OF A FLEXIBLE FUND SHOULD BE TO EARN AN APPRECIABLE REAL RETURN OVER THE MEDIUM-TERM."**

It is also worthwhile noting that most flexible funds (in fact all funds listed in the "Domestic Asset Allocation Flexible" unit trust sector) are not as flexible as they may seem. These funds have a hidden constraint in that they may not invest more than 20% of the portfolio offshore - and in this regard are no more flexible than the average balanced fund.

At Foord, we believe that a fund which reflects our best investment view must, of necessity, be unconstrained in respect of offshore investments too. Accordingly, we designed the Foord Flexible Fund of Funds product to utilise the Foord International Trust for offshore exposures that can exceed 20% when appropriate. The fund is therefore listed in the less populous (but in our view most appropriate) "Worldwide Flexible" unit trust sector.

FOORD FLEXIBLE FUND OF FUNDS

INVESTMENT RETURNS

	3 Months %	1 Year %	Since Inception %
Foord*	1.7	-6.2	**-8.4**
Benchmark	4.4	14.4	**15.9**

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

	3 Months %	1 Year %	3 Years %	Since Inception %
Foord*	-10.9	-18.5	2.7	**7.0**
Benchmark	-3.5	-32.2	-7.6	**-2.4**

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

	3 Months %	1 Year %	3 Years %	Since Inception %
Foord*	4.2	-7.1	6.4	**17.0**
Benchmark	7.4	-5.4	6.5	**14.4**

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

	3 Months %	1 Year %	3 Years %	Since Inception %
Foord*	10.9	-12.6	5.2	**19.0**
Benchmark	8.6	-24.9	4.2	**16.3**

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.

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.