FOREWORD

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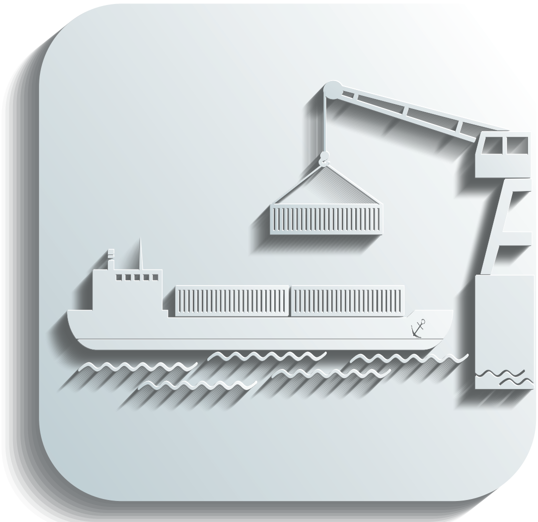
# DID YOU KNOW?

# TWIN DEFICITS

A country is said to have a "twin deficit" when its trade (or current) account and fiscal budget are both in a negative position.

The trade account is in deficit when a country's imports exceed its exports. The fiscal budget is in deficit when the government spends more on goods and services than it collects in taxes and other revenues.

As one can imagine, South Africa's twin deficit is precarious indeed. An economy that buys more than it sells and simultaneously spends more than it earns is hardly an attractive investment destination. These circumstances, combined with an inauspicious downgrade of South Africa's sovereign credit rating in June, make for gloomy local prospects.



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# FOORD GLOBAL EQUITY FUND MARKS ITS 2ND ANNIVERSARY

**Foord Global Equity Fund (FGEF), the Singapore domiciled unit trust managed by Foord Singapore, recently marked its second anniversary. PRAKASH DESAI takes a closer look at the fund and prospects for investors.**

Foord owns a 17-year track record of successful investing in global markets and three decades of top ranking investment returns in South Africa. This proven Foord experience underpins Foord Singapore's ability to construct, in the Foord Global Equity Fund, a diversified, high conviction, low risk portfolio of quality shares.

The fund's objective is different to that of the Foord International Fund, which has a conservative, absolute return mandate. Investors should be aware that FGEF's return profile will likely exhibit significantly more volatility over shorter periods. We both expect and welcome this volatility as an opportunity to invest in great companies at excellent prices. The fact that we do not view volatility as a risk has set us apart from the competition for three decades.

Foord's investment process can best be described as forward-looking and dynamic. The Singapore team employs both "top-down" and "bottom-up" metrics to construct the portfolio through a value-driven, common-sense investing approach. The top-down aspect involves analysing a range of economic variables, geopolitical factors, macro themes, market valuation and sentiment. From a bottom-up perspective, our analysts conduct rigorous fundamental research to ensure that the companies we buy will deliver superior earnings growth over the long term.

The fund is managed by Dave Foord and Foord Singapore Chief Investment Officer, Vincent Ee. The multiple counsellor approach mitigates key man risk while allowing each individual portfolio manager to build concentrated portfolios of his best ideas. In common with Foord's experience in South Africa, having a small but experienced team of managers and analysts dispenses with the need for cumbersome committees, and thus portfolio decisions are implemented swiftly.

FGEF is a global fund. The investment team can thus research all geographies for companies that offer prospects for sustainable earnings growth and portfolio diversification. Diversification can reduce risk. The Foord approach has always emphasised the importance of balance in the portfolio, while never "betting the farm" on a particular company, sector or theme. It also stresses the need to actively manage the risk that we are wrong.

Over the past few years, global equity markets have surged. FGEF has underperformed its benchmark during this bull phase, with the "rising tide" lifting even lower quality stocks. This does not alarm us as our experience in SA shows that our equity portfolios tend to underperform in strong bull markets.

I have mentioned that the investment process is forward looking. Therefore, the portfolio includes both large and medium capitalisation companies that we expect will re-rate significantly over the medium term. Warren Buffett said that "the stock market serves as a relocation centre at which money is moved from the active to the patient." With much of the market now focused on the very short term, we believe that investors focusing on earnings growth three to five years out will ultimately be rewarded most handsomely.

Given its very different investment objective, the FGEF portfolio exhibits significantly disparate holdings to its Foord International sister fund. For example, only one of the respective top-five shareholdings is common. We are confident that FGEF comprises the optimum balance to ensure that the fund is poised for superior returns in the coming years.

- FGEF is now available for direct investment by South African investors with lump sums of US$10,000 or more.
- A domestic rand-priced feeder fund is available. See www.foord.co.za for more information.

# WOOLWORTHS A LONG-TERM STORY

**In a low growth environment, few companies offer the prospect of attractive, stable growth underpinned by quality earnings. WIM MURRAY sheds some light on why Foord believes Woolworths is a sound long-term investment.**

The first Woolworths store opened in Cape Town in October 1931 in the midst of the Great Depression. Notwithstanding this difficult start, the company subsequently flourished, offering quality, value-for-money products to its customers.

We've written in this newsletter before about how Foord favours quality companies. For us, quality companies are those select companies with good business models, a sustainable competitive advantage and the ability to grow their earnings faster than the market taken as a whole. We focus on understanding how past earnings growth was achieved and then assess the probability of such a performance being repeated in future taking into account a variety of future scenarios.

In an ever changing world, company management plays an important role when evaluating an investment opportunity. This is because decisions made today will impact future performance. As investment analysts we therefore spend a lot of time assessing the quality of the executive teams in the companies we analyse.

In our view, Woolworths has a good management team lead by its CEO, Ian Moir. Ian was appointed in 2010 after four years of underperformance by the group (see Graph 1, orange line between 2007 and 2010). The graph also shows how Moir subsequently created shareholder value by implementing long-term strategies and building on the platform left by Simon Susman, the previous CEO. This platform has allowed the implementation of greater operational efficiencies and improvements in the supply chain, which resulted in margin uplift and greater profitability.

Today, Woolworths offers the highest return on equity among its retail peers. This, coupled with strong cash generation, has allowed the group to grow the business while also returning a significant portion of earnings to shareholders in the form of a growing dividend stream.

> **COMPANY MANAGEMENT PLAYS AN IMPORTANT ROLE WHEN EVALUATING AN INVESTMENT OPPORTUNITY.**

In order to gain a greater understanding of how Woolworths has been able to achieve these returns, it is useful to take a closer look at the group's two main divisions, Woolworths Clothing and Woolworths Food.

Woolworths Clothing represents a strong consumer brand that offers quality products at attractive prices. Because a large portion of Woolworths' clothing range comprises essential items, fashion risk is reduced and this results in smaller merchandise write-downs. During difficult economic times, value for money is foremost in consumers' minds and Woolworths remains well positioned in this area.

The Woolworths Food division has developed around a strong private label brand built on product innovation and quality. This allows the company to achieve market-leading margins and a high return on invested capital. Future growth remains promising as Woolworths aims to capture a larger portion of the consumer's shopping basket, while also rolling out new stores.

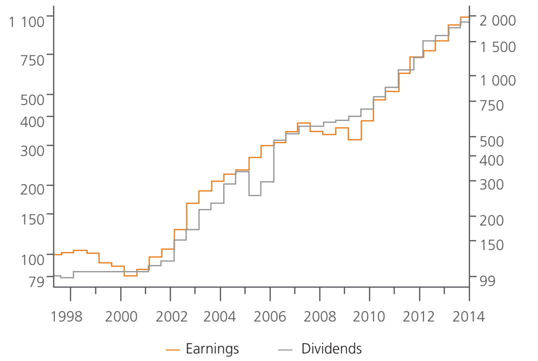
The group's target market across all divisions is the more affluent customer. This market has proven to be more resilient in the current economic climate with depressed consumer spending amongst the less well-to-do. Future growth from this segment is also expected to exceed the market as consumers continue to shift up the LSM curve.

The recently announced David Jones acquisition is an interesting development, with the potential to provide the group with significant international exposure. We took the view that a detailed understanding of David Jones and the Australian retail environment would be essential in conducting a probability analysis of the potential benefits and risks associated with such a large transaction. Given the materiality of the proposed acquisition, we took the opportunity to visit David Jones stores in Australia, talking to market participants and competitors.

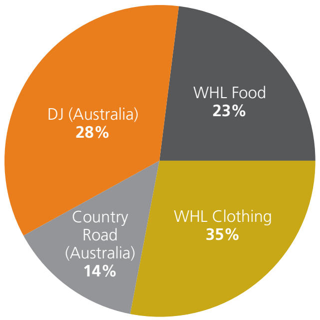
While we believe the deal will add value to Woolworths' shareholders, we are cognisant of the complexity introduced and will continue to monitor developments closely. However, from a portfolio construction perspective, the David Jones acquisition adds additional benefits as greater earnings diversification provides investors with an attractive currency hedge against a weakening rand (see Graph 2).

Graph 3 highlights Woolworths' historic share price outperformance of the FTSE/JSE All Share Index. The upward sloping trajectory from mid-2008 indicates that the counter has outperformed the index. Although the share has underperformed the market over the course of the last year as the consumer sector as a whole has come under pressure, the company has an excellent management team and is well positioned to grow its market share in the more resilient upper income consumer segment. We believe that Woolworths remains a solid long-term investment and the counter continues to have a place within our diversified investment portfolios.

**GRAPH 1:**
Woolworths earnings and dividends from 1998 to 2014




**GRAPH 2:**
Projected Woolworths 2015 operating profit including the David Jones deal




**GRAPH 3:**
Woolworths share price relative to the FTSE/JSE All Share Index

# INTELLIGENT INVESTING REQUIRES INTROSPECTION

**"The Intelligent Investor" is a seminal text on value investing written by Benjamin Graham (Warren Buffett's mentor) in 1949. Its content has been applied and debated for the last six decades. PAUL CLUER looks at what it takes to be an intelligent investor.**

The nub of Benjamin Graham's investment thesis is that investing should be a rational, analytical process involving a keen assessment of risk and the proverbial "margin of safety." Graham said, "You are neither right nor wrong because the crowd disagrees with you. You are right because your data and reasoning are right."

Graham's approach is profoundly rational, but it is not devoid of any psychological or behavioural elements. One of Graham's basic precepts is the determination of where an investor fits on the spectrum between "defensive" and "enterprising." Graham distinguishes the two investor groups by the amount of intelligent effort they are willing to expend on investment research, not by the amount of risk they are willing to take.

Defensive investors aim to reduce investment effort, annoyance and decision frequency. By contrast, enterprising investors are more willing (or indeed more able) to devote time and care to the selection of securities. Note how Graham does not describe defensive investors as "risk averse," nor are enterprising investors described as "risk taking."

The ancient Greek aphorism "know thyself" is a Delphic maxim that was inscribed in the forecourt of the Temple of Apollo at Delphi. This seems an appropriate point of departure for any investor. Intelligent investing need not involve a high degree of financial education, and it need not require a full time preoccupation with the investment markets. Intelligent investing first requires a pragmatic, honest assessment of one's investment objectives and the time available (and effort required) to attain them. As noted above,

> **"INTELLIGENT INVESTING IS A DELIBERATE, THOUGHTFUL PROCESS, REGARDLESS OF THE INVESTOR'S LEVEL OF SKILL OR EXPERIENCE."**

Graham suggests that investors classify themselves as defensive or enterprising. Dave Foord, in his book *Time in the Markets*, advises investors to "set investment objectives that are realistic, within their budget and within their intellectual and emotional range."

This aspect of investing requires a degree of introspection as to an investor's response to different scenarios. Indeed, much evidence exists of how investors sell equities for cash during periods of market weakness, and buy equities at the peaks of market strength. In neither case is the decision correct or rational. Investing is often an effort in crowd control, and a myriad of psychological biases affecting an investor's decision-making have been identified and studied.

Being an intelligent investor means understanding why you are investing. It means understanding the role and objective of your investments. It means appreciating the time horizon realistically necessary to achieve those outcomes. Those tenets form the basis of subsequent successful investment decision-making. They guide the reasoning for selecting a particular kind of investment or fund manager. They provide a framework for forming suitable expectations and managing those expectations appropriately. They compel an investor to reflect carefully on his or her reaction to circumstances, and they are the bedrock of consistency in such responses.

Intelligent investing is a deliberate, thoughtful process, regardless of the investor's level of skill or experience. It is not a process devoid of emotion, but one that embraces an understanding of emotion and how best to manage such emotion rationally. The maxims are universally applicable, whether to a professional fund manager or to the man or woman in the street.

# FOORD IN BRIEF

## FAREWELL, DONNETTA


**DONNETTA MCKINLEY**
PERFORMANCE ANALYST

Last quarter we said farewell to **Donnetta McKinley**, who retired after 19 years with Foord. Donnetta was Foord's performance analyst, having joined the company from Allan Gray back in 1995. She has taken the opportunity of early retirement following the matriculation of the last of her three children and will likely spend a significant amount of time each year in her home country, Ireland.

Donnetta's responsibilities included, among others: ensuring the accuracy and completeness of the performance record for each mandate, grouping of mandates into performance composites, facilitating prompt responses to consulting actuary surveys, and completing quarterly reports for all institutional mandates. During her nearly two decades at the firm, Donnetta presided over the move from a paper-based performance record to an electronic system that tracks over one thousand performance streams and benchmarks.

## WE WELCOME TWO NEW FACES

Foord recently welcomed **Irina Gavrilova** into the investment team as an equity analyst. Irina has eight years' investment experience gained at SBG Securities and JPMorgan Chase. She was ranked first in the Financial Mail's annual "Ranking the Analysts" awards in the Construction and Building Materials category on two occasions. She holds an honours degree in investment management from the University of Johannesburg and is a CFA charter holder.


**IRINA GAVRILOVA**
EQUITY ANALYST


**ANTHONY ROGERS**
FINANCIAL MANAGER

**Anthony Rogers** joined Foord in a financial management role in April this year. Anthony is a chartered accountant, having completed his articles with KPMG Inc at the end of 2013 where he worked in the financial services division. He is currently completing his Masters of Commerce in Financial and Risk Management at the University of Cape Town. We look forward to his contribution.

# MARKETS IN A NUTSHELL

## INTERNATIONAL / SOUTH AFRICA

### EQUITIES

**International:** Global equity markets continued to grind higher – emerging markets (+6.7%) outperformed developed markets (+5.1%) on expectations of improving EM economic growth and corporate earnings

**South Africa:** The local bourse rose 7.2% reaching an all-time high of 51,322 towards quarter-end – led by industrials (+9.1%) and financials (+7.8%) while resource counters (+2.9%) lagged

### BONDS

**International:** US Treasury yields declined – as capital flowed back into the US safe haven markets following increased geopolitical tensions

**South Africa:** The All Bond Index (+2.5%) advanced – SA attracted record foreign inflows as tension in Ukraine/Russia and Iraq escalated

### CURRENCIES

**International:** The British pound has been very resilient on improving economic fundamentals in the UK – European stimulus should see the euro weaken relative to the US dollar

**South Africa:** The rand depreciated by 0.9% against the US dollar and 3.6% against the British pound – but appeared to have shrugged off negative ratings reviews by rating agencies S&P and Fitch Ratings

### COMMODITIES

Brent crude rallied as Russia cut gas supplies to Ukraine and conflict in Iraq heightened concerns over supply risks – while the gold price rose latterly as US inflation surprised to the upside

### ECONOMY

**International:** The US economy contracted in the first quarter of 2014 mainly due to very poor weather conditions, but continued to add jobs – while the Chinese economy grew at 7.4%, marginally down from the previous quarter

**South Africa:** The economy contracted 0.6% in the first quarter of this year with the mining sector acting as a significant drag – however, economic weakness was broad-based with the consumer sector remaining stressed as inflation and interest rates rose

### MONETARY AND FISCAL POLICY

**International:** The European Central Bank maintained its easing bias by cutting key interest rates and announcing further stimulus – it became the first major central bank to put negative deposit rates into effect

**South Africa:** Nhlanhla Nene replaced Pravin Gordhan as Minister of Finance in SA's fifth democratic administration – with the country facing the risk of further ratings downgrades, fiscal policy continuity is expected

## FUND OBJECTIVE

### FOORD CONSERVATIVE FUND

Inception date: 1 January 2014

The fund seeks 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 limits set for retirement funds in South Africa (Regulation 28 to the Pension Funds Act). The fund is appropriate for conservative investors who are close to, or typically in, retirement and whose time horizon does not exceed three to five years.

Regulation prohibits performance reporting for periods less than one year.

Benchmark: CPI + 4% per annum.

### FOORD BALANCED FUND

Inception date: 1 September 2002

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. The fund is suitable for pension funds, pension fund members and holders of contractual savings products.

| | Since Inception % | 3 Years % | 1 Year % | 3 Months % |
|---|---|---|---|---|
| Foord* | **17.6** | 19.4 | 19.9 | 4.5 |
| Benchmark | **15.2** | 16.1 | 20.7 | 4.8 |

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

### FOORD FLEXIBLE FUND

Inception date: 1 April 2008

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.

| | Since Inception % | 3 Years % | 1 Year % | 3 Months % |
|---|---|---|---|---|
| Foord* | **15.7** | 26.3 | 21.6 | 3.6 |
| Benchmark | **11.7** | 11.3 | 11.4 | 3.8 |

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 EQUITY FUND

Inception date: 1 September 2002

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.

| | Since Inception % | 3 Years % | 1 Year % | 3 Months % |
|---|---|---|---|---|
| Foord* | **21.7** | 25.5 | 32.3 | 6.9 |
| Benchmark | **18.5** | 21.6 | 32.7 | 7.2 |

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

### FOORD INTERNATIONAL FEEDER FUND

Inception date: 1 March 2006

To provide exposure to a portfolio of international assets including equities, fixed interest, commodities and cash. This is achieved through direct investment into the Foord International Fund, 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.

| | Since Inception % | 3 Years % | 1 Year % | 3 Months % |
|---|---|---|---|---|
| Foord* | **12.7** | 24.2 | 17.9 | 3.2 |
| Benchmark | **17.4** | 27.7 | 16.8 | 3.0 |

Benchmark: The ZAR equivalent of 10% per annum in US dollars

### FOORD GLOBAL EQUITY FEEDER FUND

Inception date: 2 May 2014

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.

Regulation prohibits performance reporting for periods less than one year.

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

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



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