# FOREWORD

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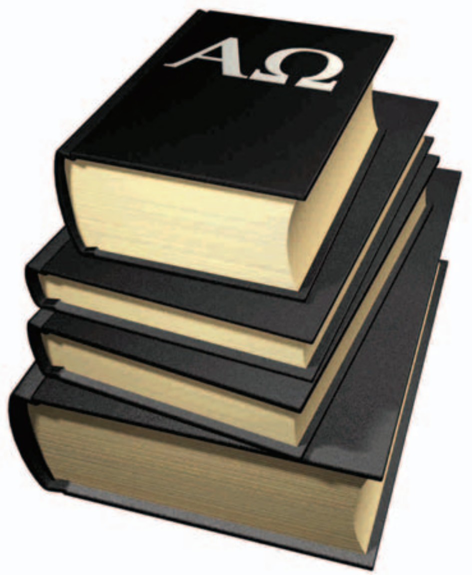
## DID YOU KNOW?

# ALPHA

Alpha is most famously recognised as the first letter of the Greek and NATO phonetic alphabets. In investment parlance, “alpha” typically refers to the value that a portfolio manager adds to (or subtracts from) the market return. Often, the return of the portfolio’s benchmark is simply subtracted from the fund’s return to estimate the “alpha” that has been achieved. This simple approach is understood by all and is widely used.

More technically, financial theory teaches that alpha refers to the risk adjusted performance of a fund or security. When alpha is negative, the investment has returned less than what was implied by its risk profile. Conversely, positive alpha means that the investment has delivered returns in excess of expected reward for the assumed risk. Financial theory works in theory but not necessarily in practice. We therefore suggest investors adopt the simpler explanation for alpha.






# MULTIPLE-COUNSELLOR

## PROCESS EXTENDED TO BALANCED PORTFOLIOS

We have reported on Foord’s multiple-counsellor investment process in past issues of *Foreword*. In summary, the process involves splitting an investment portfolio into two or more parts. Each part is then managed by a separate fund manager. The process allows the individual managers to focus on their best ideas in a concentrated portfolio of investments with the objective of diversifying key-man risks at Foord and investment risks in the portfolio.

Foord first implemented the process in December 2009 for equity-only mandates, including the Foord Equity Fund unit trust. In December 2010, a third manager was added to the mix. We are pleased to report that following the success of the programme, the process has been extended to almost all mandates, including balanced fund mandates (mandates that include exposure to equities, bonds, listed property and cash). From 1 January 2012, Dane Schrauwen and William Fraser have participated as managers in all balanced mandates, including the Foord Balanced Fund unit trust. Almost all Foord’s portfolios now have more than one manager assigned to them via the multiple-counsellor process.

# FOORD EQUITY FUND

## TAKES THE PERFORMANCE SPOTLIGHT

The Foord unit trust funds continue to perform well relative to their benchmarks and within their sectors. The Foord Equity Fund specifically has performed extremely well. The fund delivered double-digit alpha (*see Did You Know?*) by outperforming the benchmark FTSE/JSE All Share Index by a massive 12.4% after fees over the year to March 2012. The latest Morningstar® rankings place the fund first over one-, two- and three-year periods (out of 77 funds). The fund achieved this not as a result of taking any big “bets” but by having a balanced weighting to most industries, while taking into account Foord’s economic outlook.

The fund benefited from a lower allocation to the resource sector, which underperformed the overall market by 20% over the last 12 months. Platinum shares in particular had a tough year. SA consumer shares, however, performed especially well. The sector benefited from improving economic conditions, rising real incomes and additional employment creation (with continued social support from government). Bank shares also performed well on the back of improved global sentiment around banking shares and improved earnings of SA banks as bad debt provisions continued to reverse. Non-resource rand hedges contributed positively to total returns over the last 12 months.

See fact sheets carried on www.foord.co.za for more information on fund composition and returns.

# BUDGET 2012 -
## WHAT IT MEANS TO YOU

**February's Budget Speech by the Minister of Finance contained a number of surprise announcements. PAUL CLUER highlights two surprises that affect Foord investors in direct or unit trust portfolios.**

Dividend Withholding Tax (DWT) was mooted by National Treasury some years ago as a replacement tax for Secondary Tax on Companies (STC). STC was a tax at 10% on the company declaring dividends rather than a tax on the shareholder entitled to receive dividends. DWT was introduced to follow international practice of taxing the shareholder rather than the company. The burden of withholding and paying over the tax to SARS however remains with the company declaring the dividend.

The surprise move from the Minister was the last minute increase from the widely reported 10% to 15% of the dividend declared. The higher 15% rate is in line with international norms. More importantly, it all but closes the arbitrage gap for individuals earning income in their own hands (taxed at a 40% maximum rate) compared to individuals earning income via a company and then declaring the after tax income to themselves as a dividend (income is taxed at 28% and the after tax income taxed again at 15%).

Certain categories of shareholders will be exempt from the tax. These include companies, unit trust portfolios and retirement funds. Such entities will receive the dividends without having any withholding tax deducted but must sign exemption forms and provide these to the collection agents. Unit trust funds will receive dividends on listed shares gross of the tax, but will withhold 15% of the dividend portion of their annual distributions paid to investors who are not exempt from DWT. Foord Unit Trusts' first distribution under DWT laws will take place at the end of August 2012. Exemption forms are available from Foord.

The second surprise worth mentioning is the increased inclusion rate applicable to capital gains tax. Since 2001, capital gains have been included in taxpayers' gross incomes and taxed at their marginal rates. The inclusion rates have been 25% for individuals and 50% for companies and trusts. From 1 March 2012, National Treasury has increased these rates to 33.3% and 66.7% respectively. This means that for any individual making taxable capital gains, one third of the gain is brought into taxable income and taxed at the taxpayer's marginal rate. The increased rates do not change the reporting obligation of Foord to report the full capital gains made by investors. Investors must however be cognisant of the increased tax burden associated with selling investments for profit.

# SAVE REGULARLY
## BUT DON'T FEAR LUMP SUM INVESTMENT

**Investors often ask whether it is better to invest a single lump sum amount at a specific point in time or to contribute a regular amount to an investment over time. MARIO SCHOEMAN, using statistical analysis provided by DARRON WEST of the University of Cape Town, shows that both strategies have merit.**

Investing a lump sum involves an element of market timing. Market timing is a well-researched topic with most studies concluding that the average investor is a shocking timer of the market. Buying into an investment or asset class when it is expensive (after it has risen in price) and selling when it is cheap (after the price has declined) is an unbelievably common practice.

These studies imply that one should never invest a lump sum for fear of getting the timing wrong. The alternative strategy is one of making regular investments over a period of time, often called "rand cost averaging". The term describes the practice of investing irrespective of whether the market is up or down – and so converging your investment to a better average price.

To answer the question of lump sum vs. regular investment, we asked Darron West to analyse the returns achieved when investing lump sums or equivalent regular contributions. Darron used monthly total return data for the JSE going back to January 1960 – a period exceeding 50 years. The analysis clearly showed that the longer your investment horizon, the less you need to concern yourself with market timing[1]. Lump sum investing is therefore fraught with fewer dangers the longer your intended investment horizon.

The results of our analysis of a rand cost averaging strategy using past JSE returns are even more profound. Over investment horizons shorter than five years, the average return earned by a regular investor is statistically significantly higher than that earned by a lump sum investor. However, the additional benefit of investing regularly declines as the investment period approaches 20 years[2]. This is consistent with the earlier observation that investors are relatively indifferent to market timing with long investment horizons. It is also consistent with the notion that price volatility should have little bearing on the perspective of a long-term investor.

We draw two clear conclusions. Firstly, regular contributions to an investment offer the prospect of somewhat higher average returns over the shorter term as advantage is taken the market's vagaries and the associated timing benefits. This benefit reduces as the investment horizon increases. Secondly, if you have a lump sum to invest for the long term, your timing has less effect that you may initially believe, especially when investing into an actively managed and diversified general equity fund or multi-asset class fund.

[1] Over all one-year investment periods, the highest return earned is 123%, and the lowest return is -47% with an average of 21%. Stretching the investment horizon to five years, the maximum and minimum annualised returns contract to 46% and 1% respectively, while the average remains relatively constant at 18%. Over all 20-year investment horizons, the maximum annualised return is 26% per annum, the minimum is 15% per annum and the average is 19% per annum.

[2] The additional benefit of investing regularly declines from almost 6% per annum. over one-year investment horizons to just over 1% per annum over four-year investment horizons. Beyond that, the improvement in average returns amounts to just 0.5% per annum (although this increment, compounded over 20 years, results in a 10% increase in wealth at the end of the investment horizon).

# STOCK SELECTION
# KEY TO FUTURE INVESTMENT RETURNS

**Many studies have proved that over the long term listed share markets generally outperform other asset classes. An investment strategy constructed solely around this principle, however, is a dangerous gamble. In fact, investors working from the assumption that broader equity markets will always outperform in the long term run the risk of significant loss of capital. Equity analyst ANDREW COULTAS explains.**

The past three decades have been characterised by unprecedented world economic growth – this growth has supported a positive earnings trajectory for many companies. In addition, equity markets have been collectively buoyed by falling inflation, falling interest rates and higher P/E multiples (a measure of how much investors are prepared to pay for a future stream of earnings). They say that a rising tide lifts all ships. Similarly, most listed shares benefitted from these effects.

However, the past does not easily extrapolate into the future, which is intrinsically uncertain. Looking forward, there is a low probability of the previous decades' earnings trend repeating itself across the broader equity market. Lower world economic growth, financial turmoil in Europe and rising commodity costs are some of the headwinds faced by companies.

That is not to say that equities as an asset class are a poor investment. Rather, it is apparent that not all shares will deliver similar returns. In the future paradigm, there will be clear winners and losers. The market will ultimately reward companies that deliver on their strategies and objectives and penalise those that fail to do so. Stock picking – successfully picking the winners while avoiding the losers – will be the strategy that delivers the best returns.

Government bond yields are currently at historic lows. After the US housing bubble burst in 2008, the US mortgage agency debt market is quite rightfully no longer considered safe. The European crisis has stripped all of the periphery's sovereign debt of their previous status as a safe haven. As a result, there is a shortage of traditionally "safe" assets as an alternative to government bonds of AAA-rated governments. The result has been a flight to safety into the bond markets of the world's largest economies. Compounded with massive injections of liquidity by central banks, the consequence has been that yields on US Treasuries have fallen to all-time lows.

> "STOCK PICKING
>
> – SUCCESSFULLY PICKING THE WINNERS WHILE AVOIDING THE LOSERS – WILL BE THE STRATEGY THAT DELIVERS THE BEST RETURNS."

Normally, low bond yields imply a benign inflationary outlook. In the current environment, however, they point to an imbalance between supply and demand. As a result, the risk of inflation cannot be ignored despite what the bond yields seem to be indicating. In the near term, inflationary pressures are being driven by input cost pressures, with specific reference to those linked to commodities. Investing into the bond and cash markets thus also comes with a significant risk of loss of real capital.

So what is the best investment strategy when the broader equity, bond and cash markets all carry material risk of loss in real terms? In Foord's view, the strategy to negotiating the current environment lies in building portfolios that have an equity bias to protect against rising inflation, but most importantly, the equity component of the portfolio has to be carefully selected. In this environment, stock selection is critical to achieving inflation-beating returns. A strategy of simply buying the market as a whole is unlikely to achieve this goal.

Shares that are attractively priced and that exhibit a growing dividend stream are very important in our equity selection criteria. We look for quality companies with pricing power that will provide a hedge against inflation. Investing in quality companies at reasonable valuations with a margin of safety reduces the downside risk. A growing dividend provides a stream of income for reinvestment.

Many multinational companies have very strong balance sheets and stable, sustainable cash flows to support their dividend yields. With pricing power, earnings growth potential and dividend yields superior to the 10-year US Treasury note, certain equities remain an attractive proposition. The key is picking the right ones.

# MARKETS IN A NUTSHELL

## INTERNATIONAL

### EQUITIES

Improving US economic data and the ECB's Long-term Refinancing Operations (LTRO) implemented in late December eased market tensions – equity markets rallied with cyclical and consumer discretionary shares outperforming

### BONDS

US Treasury and UK gilt yields rose substantially and US Treasuries posted their worst quarterly result in two years – as revived risk appetite pushed US share markets close to four-year highs

### CURRENCIES

The US dollar weakened against emerging market currencies as capital flows shifted to those markets – while the Bank of Japan and the Brazilian Central Bank intervened to weaken their rising currencies

### COMMODITIES

Commodity prices rose over the quarter, but fell latterly on news China had downgraded its growth targets – but fears of Iranian nuclear weapons combined with associated international trade sanctions drove oil prices to near term highs

### ECONOMY

US disposable income growth increased more than previously estimated and US employment creation gathered pace – with unseasonably warm weather in the USA supporting economic activity

### MONETARY AND FISCAL POLICY

The US Federal Reserve pledged to maintain ultra-low rates until at least 2014 to help the economic recovery – but has recently given indications that a new round of monetary stimulus, dubbed QE3, is unlikely

## SOUTH AFRICA

### EQUITIES

The FTSE/JSE All Share Index tracked global equity markets higher, rising 6% over the quarter – SA industrial companies outperformed the index on improved construction sector sentiment and solid results posted by companies in the consumer sector

### BONDS

Long bond yields fell as bond prices tracked the stronger rand higher, benefitting from a surprisingly low current account deficit – yields seemingly unaffected by S&P's outlook downgrade at this stage

### CURRENCIES

The rand appreciated over the quarter, buoyed by improving emerging markets sentiment – following the successful implementation of LTRO in Europe and renewed capital flows to emerging economies

### ECONOMY

Economic growth in SA continued at a modest pace – higher growth rates in the consumer and government sectors were offset by slow rates of growth in manufacturing, agriculture and mining

### MONETARY AND FISCAL POLICY

The South African Reserve Bank has maintained the repo rate at 5.5% for 16 consecutive months – but warns that inflation risks are to the upside

## FOORD FLEXIBLE FUND OF FUNDS

### INVESTMENT RETURNS

| | Since Inception % | 3 Years % | 1 Year % | 3 Months % |
|---|---|---|---|---|
| Foord* | **10.6** | 19.4 | 22.6 | 8.0 |
| Benchmark | **11.7** | 10.6 | 11.3 | 2.3 |

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* | **8.3** | 4.9 | 15.5 | 0.6 |
| Benchmark | **6.5** | 12.3 | 14.2 | 5.8 |

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 assets including equities, fixed interest, commodities and cash. 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* | **17.2** | 17.8 | 15.0 | 6.1 |
| Benchmark | **14.6** | 14.1 | 9.5 | 4.4 |

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

| | Since Inception % | 3 Years % | 1 Year % | 3 Months % |
|---|---|---|---|---|
| Foord* | **20.9** | 27.5 | 19.9 | 10.8 |
| Benchmark | **17.3** | 21.3 | 7.5 | 6.0 |

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.**