FOREWORD

ISSUE 47 3rd QUARTER 2018

IN THIS ISSUE

DID YOU KNOW? EMERGING MARKETS

The Financial Times reports that the term *emerging markets* was originally coined in 1981 by World Bank economist Antoine Van Agtmael. Despite its quarter-century use in the economic lexicon, there is still no universal definition.

Economists and financial data providers classify about 25 countries as developed markets because they exhibit qualities of high per capita incomes, efficient and effective financial institutions, open capital markets and unrestricted capital flows. All other countries are developing markets, which include the subsets of frontier markets and emerging markets.

Emerging markets are low-to-middle income per capita markets showing promise of becoming developed. The term was for years synonymous with the Asian Tiger economies (see *Foreword* Issue 23) until Goldman Sachs coined the term BRICs (Brazil, Russia, India and China), to which South Africa belatedly claimed membership as the 'S'.

Given its dominance of global indices, Morgan Stanley Capital International (MSCI) is now the de facto arbiter of emerging market classification. The MSCI Emerging Markets index comprises 24 countries, including Asian Tigers Korea and Taiwan and all five BRICS.

EMERGING MARKETS – EMERGING TURMOIL

Investors typically seek out emerging market investments for the prospect of higher returns, but this is often accompanied by greater risk. Foord Singapore portfolio manager GUY SHIRTLIFF takes a closer look at the emerging turmoil in emerging markets.

The development of emerging market economies (see *Did You Know?*) is seldom smooth and often plagued by political instability, corruption, infrastructure bottlenecks and currency volatility. Investors consequently demand much higher returns than those available in developed markets to compensate for these uncertainties. In periods of crisis or liquidity tightness, the required returns rise further, forcing down asset prices.

> EMERGING MARKET CONTAGION RISK HAS SPREAD TO OTHER VULNERABLE TWIN DEFICIT NATIONS SUCH AS SOUTH AFRICA, BRAZIL AND INDONESIA.

The unprecedented central bank stimulus unleashed after the 2008/2009 global financial crisis suppressed global yields and drove up asset prices (see *A Global Markets Temperature Gauge*). The liquidity pumped into the global system was needed to stabilise market turmoil but had unintended consequences. Low-risk investors such as the burgeoning pensioner population, were pushed down the risk curve into riskier assets such as equities and emerging market investments.

The flood of new money allowed emerging markets' governments to fund their development aspirations and cover deep budget deficits for a decade. But unfortunately for emerging markets, the trend is starting to reverse. US Federal Reserve monetary policy is now more hawkish, favouring higher interest rates and stimulus withdrawal. As the federal funds rate rises, so does the attractiveness of investing in US dollar cash and the hurdle rate for indebted emerging economies. It is no coincidence that recent emerging market woes are strongly correlated with US policy tightening.

Twin deficit nations, running trade and budget deficits, are in the vanguard. Debt-to-GDP ratios and the cost of funding future deficits are rising sharply in these markets as investors demand a greater risk premium for growing default risk. Argentina and Turkey are prime examples of the downward spiral of lost investor confidence and their currencies have now plunged against the US dollar. Emerging market contagion risk has spread to other vulnerable twin deficit nations such as South Africa, Brazil and Indonesia.

Trump's antagonistic America First policy and disruption of the liberal world order is compounding emerging market anxiety. Sanctions, trade wars and rising oil prices detract from much needed global growth. And a global growth shock would be disastrous for countries with stretched national balance sheets. These fears are now beginning to manifest in troubled emerging markets faced with much higher financing costs.

China is the world's second largest economy and is the largest emerging market. President Xi's ambition to establish China as a global superpower offers hope by suggesting that China could fill the leadership void left by a retreating US. But for now, China's own debt issues and prospects of a prolonged economic war with the US mean it is not immune to recent emerging market sentiment.

A GLOBAL MARKETS TEMPERATURE GAUGE

Foord has always advocated the importance of staying invested through cycles for the long term. But as the market cycle progresses, risks rise. In this article, portfolio manager NICHOLAS BALKIN takes a temperature gauge of global markets.

We've all heard that it is time in the markets that counts, not timing the market. But as we know, market cycles do exist. They are very difficult to predict accurately, but they can and should be assessed in broad terms. We can do this because we know that they are driven by interest rate cycles and business cycles, which affect earnings.

Assessing the stage of the market cycle allows us to build conviction in the direction of the most important variables in the global economy. In turn, these variables are key to our forecasts for economic growth and the earnings and income streams we can reasonably expect from different asset classes. It also clarifies the key risks that we need to be managing.

We look at four simple factors to gauge the temperature of global markets and inform our assessment of the stage of the market cycle. I have already mentioned two — interest rates and earnings. Money available for the market and confidence levels are the other factors. We will look at each in turn.

An assessment of the money available for the markets includes an analysis of the aggregate money flow into and out of global markets. Quite simply, lots of money flowing into markets implies structural support for market price levels because we would expect there to be more buying than selling. The opposite results when liquidity is withdrawn.

In the ten years since the 2008/2009 global financial crisis, central banks have injected unprecedented liquidity (money) into global markets. Extremely supportive monetary policy in all corners of the globe resulted in $2.5 trillion per year flowing into capital markets. Most of this money landed up in financial assets and not the real economy.

MARKET CYCLES ARE VERY DIFFICULT TO PREDICT ACCURATELY, BUT THEY CAN AND SHOULD BE ASSESSED IN BROAD TERMS.

The US Federal Reserve is now reversing the flow of dollars as quantitative easing ends. The ECB is about to begin its own reversal and the Bank of Japan should soon follow. So, we are in the midst of a reversal in money for the market after a decade of excess liquidity. In the years ahead, there will be less money for the markets. What does this mean for portfolio positioning?

The second factor, the interest rate cycle, is simply the cost of borrowing. Economic expansions usually end with rising interest rates. Since 2008, central bank policy was focused on avoiding a deflationary depression and interest rates were reduced to zero. Low interest rates support companies to grow earnings (through cheap borrowing and by spurring consumption in the broader economy).

Interest rates also have a direct, positive impact on valuations via the discount rate — as the discount rate falls, the current value of future income streams of all assets goes up. The developed world, led by the US, is now firmly into a rising interest rate cycle. So, interest rates, like money for the markets, is another indicator of the late stage of the market cycle.

Confidence is the third factor. This is where we assess the markets' animal spirits, so to speak. Because fear and greed drive markets, gauging confidence is important in judging the market cycle. By almost any metric, confidence is comfortably above pre-crisis levels. This is not surprising after one of the longest bull markets in history, combined with global economic growth, especially in the US. Confidence levels are high, but where do they go from here? In our view, it is more likely that they will decline rather than rise further.

Finally, we assess earnings. In the fullness of time, company earnings drive share prices. And like the first three temperature gauges, earnings appear to be nearing cyclical highs, particularly in the ever-important US economy. Years of monetary stimulus, robust economic growth and late-cycle fiscal stimulus from the Trump government have caused US company earnings to surge well above pre-crisis levels. For now, rising earnings support market valuations but there is little room for error.

So, we have four amber warning lights flashing when we filter the current market cycle through our mnemonic MICE trap. This supports our cautious and defensive investment strategy. But readers will take note that our balanced portfolios still hold 60% in equities, despite our worries for the late stage of the market cycle — because investing in quality companies through these cycles is the most important driver of long-term return outcomes.

FORWARD PRICING – WHAT DOES IT MEAN?

The unit trust industry is not immune to technical jargon. Compliance Officer FAIEKA SLEMMING explains the forward pricing disclosures in simple English.

Let's start by looking at an excerpt from the standard terms and conditions which can be found in the small print on all Foord fact sheets: "Unit trust prices are calculated on a net asset value basis, which is the total value of all assets in the portfolio including any income accruals and less any permissible deductions from the portfolio. Forward pricing is used. Prices are determined at 15h00 each business day and are published daily on www.foord.co.za and in national newspapers. The cut-off time for instruction is 14h00 each business day."

WHAT DOES THIS MEAN?

Unit trusts are priced once each business day at the time listed in the unit trust scheme's deed. Foord's unit trusts are priced at 3pm. This is a common industry pricing time as it allows platform and other institutional investors to download prices for downstream pricing of their investments and reporting to their investors.

Forward pricing is the practice of calculating the price only after the cut-off time for transactions, meaning that investors do not know the price when giving an investment instruction — an essential practice to avoid price manipulation. Foord's cut-off time is 2pm for processing at the forward price calculated an hour later. Valid instructions received after this cut-off time are processed at the forward 3pm price on the next business day.

Because the price is struck after the cut-off time, it is not possible to know in advance how many units will be received for an invested rand lumpsum. Neither can we know what the redemption value will be for a given number of units until after the price is calculated.

FORWARD PRICING IS THE PRACTICE OF CALCULATING THE PRICE ONLY AFTER THE CUT-OFF TIME FOR TRANSACTIONS.

The **net asset value** is the market value of the fund's investments at 3pm, plus accrued income and less a provision for allowed expenses. The price is calculated by dividing the net asset value by the number of units in issue that day.

Accrued income is income such as interest and dividends that are earned but not yet received. Legislation restricts costs that may be deducted from the portfolio assets. The only **permissible deductions** are: the manager's service charge; levies and taxes; fees payable to auditors, custodians and trustees; and bank charges and costs incurred in settling investment transactions such as broker fees, market settlement charges and related taxes. These costs are included in the TERs (total expense ratios) published in the monthly factsheets.

The **number of units in issue** fluctuates daily. When an investor purchases Foord unit trusts, units are created, while units are cancelled when an investor redeems units. The number of units created or cancelled is based on the price per unit calculated on the transaction day at the forward price.

The daily A class prices of Foord unit trusts are published on our website www.foord.co.za and in national newspapers.

FOORD IN BRIEF

Prakash Desai joined Foord Singapore as Chief Executive Officer on a five-year plan in late 2012, not long after the Foord Global Equity Fund was launched. He was instrumental in establishing Foord's global footprint, having achieved several significant administrative milestones during his short executive tenure. He afforded us an extra year's grace and this month Prakash retires from an executive role. He will, pleasingly, continue to add value to the respective boards as a non-executive director.

One of Prakash's key responsibilities was to source and mentor a successor. Agnes Cai was his excellent choice in 2014. We are pleased to announce that the Monetary Authority of Singapore has approved her to succeed Prakash as CEO on 1 October 2018.

We welcomed Debbie Yang in September to succeed Agnes as compliance and operations manager. Debbie joins us from RBC Singapore and holds a Bachelor of Accounting and Finance from the University of London.

On the home front, we welcome investment analyst Pravarshan Murugasen back to Foord after a sabbatical to complete his MBA at Oxford University. Finally, Irfaan Abbas joins Foord's trainee analyst programme. He completed a Bachelor of Business Science (Hons) degree and Post-graduate Diploma in Accounting at UCT, before qualifying as a chartered accountant after his traineeship at PWC.

MEET THE TEAM

Foord's annual Meet the Team roadshow will take place between 12 and 16 November in Durban, Johannesburg and Cape Town. This has become a popular event and provides investors with the opportunity to meet members of the Foord executive, investment and unit trust teams. Qualifying investors who reside in these regional centres will have received invitations already. However, investors who reside outside these major centres and would like to attend one of these events can contact Arlene Thompson on unittrusts@foord.co.za or 021 532 6969.

MARKETS IN A NUTSHELL

WORLD / SOUTH AFRICA

EQUITIES

World: World equity markets advanced, led by US bourses — but emerging markets were lower on additional US tariffs on Chinese goods and heavy new tariffs on Turkish steel and aluminium

South Africa: The FTSE/JSE Capped All Share Index declined, with mixed performance from the rand hedge counters as stock specific factors offset the weaker rand — but SA Inc. counters were mostly sharply lower

BONDS

World: Developed market bond yields were higher, with the US 10-year yield surpassing 3.0% — the Fed's tone has become noticeably more hawkish

South Africa: SA bonds were lower as yields spiked on the emerging markets sell-off — but the All Bond Index eked out a positive total return

CURRENCIES

World: Dollar strength persisted — but emerging market currencies nosedived after the US tariffs on Turkish goods and Argentina's IMF bailout

South Africa: The rand weakened sharply against the US dollar on emerging market contagion risk — compounded by trade war escalation

COMMODITIES

Commodity prices were broadly lower on US dollar strength and the negative trade outlook — but the oil price surged on supply concerns given disruptions in Venezuela, new US sanctions on Iran and Russia and OPEC's refusal to ramp up production

ECONOMY

World: The global economic expansion continued, driven by robust US economic activity where unemployment has been below 4% for the longest period in 18 years — the cycle is now undoubtedly in its late stages

South Africa: Data confirmed a technical recession with 2nd Quarter GDP contracting 0.7% (q-on-q) after Q1's -2.6% — mostly due to very weak consumption, steep agriculture declines and a dearth of fixed investment

MONETARY AND FISCAL POLICY

World: The Fed again raised the federal funds target rate and started with the slow process of winding down its balance sheet — the European Central Bank is about to conclude its own stimulus

South Africa: SARB kept interest rates unchanged despite the sharply higher fuel price and interest rate increases in peer economies Turkey and Russia — although its tone is less accommodative

FUND OBJECTIVE

FOORD FLEXIBLE FUND OF FUNDS

ZA — Inception date: 1 April 2008

The fund seeks 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. It aims to achieve this objective by exploiting 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.

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**12.3**	7.1	2.1	2.1
Benchmark	**11.1**	10.4	10.2	2.5

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

ZA — Inception date: 1 September 2002

The fund aims to grow retirement fund savings by meaningful, inflation-beating margins over the long term. The fund is managed to comply with the prudential investment limits set for South African retirement funds (Regulation 28 to the Pension Funds Act).

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**14.1**	4.7	1.2	0.3
Benchmark	**12.5**	6.2	3.7	0.3

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

ZA — 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*	**6.4**	5.8	4.0	1.2
Benchmark	**9.6**	9.4	9.1	2.3

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

ZA — 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*	**15.9**	0.2	-6.9	-2.2
Benchmark	**14.9**	7.1	4.6	-1.0

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

FOORD INTERNATIONAL FUND

LUX — USD — Inception date: 1 August 2014

The fund aims to achieve meaningful inflation-beating US$ returns over rolling five-year periods from a conservatively managed portfolio of global equities, warrants, exchange traded funds, UCITS and other UCIs, interest bearing securities and cash instruments reflecting Foord's prevailing best investment view.

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord***	**6.6**	5.9	-1.2	0.6
Benchmark	**2.1**	2.0	2.2	0.4

Benchmark: US inflation

FOORD GLOBAL EQUITY FUND

SG — USD — Inception date: 1 June 2012

The fund aims to achieve optimum risk adjusted total return by investing primarily in a diversified portfolio of global equities. Without assuming greater risk, it seeks to achieve a higher total rate of return than the MSCI All Country World Net Total Return Index.

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord**	**7.5**	11.3	1.8	0.1
Benchmark	**11.6**	13.4	9.8	4.3

Benchmark: MSCI All Country World Equity Index.

NOTE: Investment returns for periods greater than one year are annualised
* Class A, Net of fees and expenses | ** Class B, Net of fees and expenses | *** Class R, Net of fees and expenses

FOORD ASSET MANAGEMENT | Tel: 021 532 6988 | Email: info@foord.co.za | www.foord.co.za