FOREWORD

DID YOU KNOW?

Fragile FIVE

Not to be confused with Enid Blyton's Famous Five, the "Fragile Five" may roll off the tongue just as easily but the subject matter is no children's story.

Coined in August 2013, the phrase has gained traction globally. It refers to the five emerging market economies most reliant on foreign capital inflows, of which South Africa is one. The other four are Brazil, Indonesia, India and Turkey. Together, they represent around seven percent of the world's economy.

The Fragile Five benefitted from easy money brought about by quantitative easing. But reduced foreign investment, declining exports and ailing economic growth have resulted in current account deficits across the five, sending alarm bells ringing among investors. This, coupled with elections this year in four of the five fragile economies, creates even more jitters, and makes for a thrilling storyline.

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FOORD'S NEW CONSERVATIVE FUND

Foord seldom adds new funds to its fund range and is very selective in the timing of fund launches. Adding a new fund to the range is done only after careful consideration. It is a rare event and thus a big deal. PAUL CLUER introduces the new Foord Conservative Fund.

Readers familiar with the Foord approach to investing will know that the company's primary objective is to deliver inflation-beating long-term returns to investors. The absolute return focus in the way Foord manages money means that the firm has avoided specialist products and funds. The result has been a focused unit trust fund range suitable for long-term contractual and discretionary savings.

We have recognised that investors who expect a significant capital drawdown within a three- to five-year period but who would like to maintain some diversified exposure to growth assets, are not particularly well catered for. Similarly, some long-term investors might have very specific reasons for wanting a diversified growth portfolio that provides a lower level of short-term volatility than one might expect from a traditional high equity balanced portfolio.

On 2 January 2014, the Foord Conservative Fund was launched. Similar to the Foord Balanced Fund, the fund is an asset allocation fund that will be managed to comply with the prudential requirements of the Pension Funds Act in South Africa. However, whereas the Foord Balanced Fund has a maximum exposure to equities (both domestic and foreign) of 75% of the fund, the Foord Conservative Fund will be artificially constrained to a maximum equity exposure of 60% – a substantial additional restriction.

In defining the word "conservative," the Oxford English Dictionary includes the entry, "purposefully low for the sake of caution." The word is also a derivative of the verb "to conserve," which implies preservation. The fund's name thus appropriately describes the portfolio's lower equity weighting, more cautious positioning and greater emphasis on short-term capital preservation than the other Foord Unit Trusts' portfolios.

> "THE FUND IS ONLY APPROPRIATE FOR CONSERVATIVE INVESTORS WHO ARE RETIRED OR CLOSE TO RETIREMENT AND WHOSE TIME HORIZON DOES NOT EXCEED THREE TO FIVE YEARS."

The benchmark of the fund is the annual change in the South African Consumer Price Index (CPI) plus 4% per annum, which is lower than the benchmark of the Foord Flexible Fund (CPI+5%). The Conservative Fund's constraints (60% maximum equity and 25% maximum offshore), mean that achieving inflation-beating returns will be more challenging than in the Flexible Fund. As such, we expect the Foord Flexible Fund (but also the Foord Balanced Fund and the Foord Equity Fund) to outperform the Conservative Fund over most periods, particularly periods longer than three years.

Taking all of the above into account and given the fund's *maximum* 60% equity investment restriction (the fund's exposures will typically be lower), the fund is only appropriate for conservative investors who are retired or close to retirement and whose time horizon does not exceed three to five years. Such investors might be happy to trade away potentially higher long-term returns for lower levels of investment volatility and risk of short-term loss than those provided by a less conservative fund.

Importantly, for investors with investment horizons longer than three to five years, the unconstrained Foord Flexible Fund (for discretionary assets) and the Foord Balanced Fund (for retirement fund assets) remain the appropriate investment vehicles.

THE YEAR AHEAD

In November 2013, MIKE SOEKOE took the podium at the Foord client functions to discuss the year that was and the outlook for investment markets in 2014. For those readers who were unable to attend, we set out below a synopsis of this presentation.

The most important message is that GDP growth forecasts for the developed regions of the world indicate that the synchronised, but fledgling, global growth experienced in 2013 will build into 2014 and 2015. The indicators for the USA, Europe and Japan are all positive.

In the USA, housing market gains and improved corporate spending (on plant and equipment) should help expand 2013's GDP growth of 2.8% to around 3.5% for 2014. The concomitant and all-important increase in consumer confidence will further compound such growth. In Europe, financial indicators reveal that the bloc's economy, as a whole, has finally troughed. The latest figures show marginal GDP growth for the second half of last year. Manufacturing data shows a healthy upward production trend, which we expect will continue its correlation with growth of Europe's most important export markets, the USA and China. Japan emerged from years in the doldrums with a solid 2.2% growth in 2013. The Japanese central bank has adopted a strategy of devaluing the yen to improve export competitiveness, which will help stimulate that economy further.

The world's second largest economy, China, is expected to deliver GDP growth of between 7.5% and 8% in the coming year. Government infrastructure spend, but increasingly also consumer consumption by an increasingly aspirant population, should drive economic growth. More than 20 million Chinese are being urbanised annually, where jobs are plentiful and the demand for quality clothing, jewellery, household appliances and motor vehicles appears limitless.

> **"GDP GROWTH FORECASTS FOR THE DEVELOPED REGIONS OF THE WORLD INDICATE THAT THE SYNCHRONISED, BUT FLEDGLING, GLOBAL GROWTH EXPERIENCED IN 2013 WILL BUILD INTO 2014 AND 2015."**

This global economic growth should inspire increased confidence and corporate spending (a necessary facet of global economic recovery that has to date been lagging). Corporates around the world with trillions of dollars on their balance sheets are currently earning negative real interest rates on cash as they wait for the economy to improve. Recent global surveys on company intentions, however, indicate increased planned capital expenditure and increased staff hiring. This is very positive for global growth and markets.

But we must also consider quantitative easing. Because the global economy is indeed recovering, the US Federal Reserve will reduce the levels of liquidity it pumps into the US economy. The Fed has already started tapering its stimulus programme to achieve normalised liquidity conditions, possibly by December 2014. A return to normalisation is evidenced by rising long-term interest rates (US government bonds are currently trading at 3.0%, up from a low of 1.5% just one year ago). All indications are that long-term rates will continue to rise this year.

This will not be the case (in 2014 at any rate) for short-term interest rates, which in the developed economies are close to 0%. Central bankers, including the US Fed, will want to ensure that economic growth remains sustained and strong, that inflation remains low, and that employment creation continues before it increases the short-term rate. Cash interest rates will thus remain below inflation rates for the course of 2014.

A key factor in Foord's asset allocation deliberations is the value of the rand. The currency weakened against most developed market currencies by approximately 20% in 2013. Yet, we still believe the rand is vulnerable to further weakness. South Africa is one of the "Fragile Five" economies (see *Did You Know?*) that exhibit especially high "twin deficits." These two deficits are the government's fiscal deficit and the trade deficit (imports exceed exports). In recent years the country relied on foreign investors buying its equities and bonds. The resulting inflows neutralised the trade deficit. However, as the home economies of these foreign investors improve, South African equities and bonds will become less attractive. The absence (or reversal) of such flows and the high deficits will leave the rand vulnerable.

The result of the above considerations is that equities, notably foreign equities, remain the most attractive asset class for 2014. After inflation, cash will deliver a negative return. Bonds, if our assumptions are correct and yields rise, could cause capital loss. However, equities, in an environment where the global economies are recovering and the borrowing costs are very low, should offer inflation-beating returns, even off a high base.

Foord's unit trust portfolios are thus positioned to benefit from investment in quality companies with strong balance sheets, good cash flows, proven management teams and attractive relative dividend yields. Furthermore, because of the weak rand, the portfolios will have adequate exposure to foreign assets, especially equities. This is evidenced from the asset allocation in our best investment view fund, the Foord Flexible Fund, which is almost 90% invested in equities, of which more than half is offshore. The fund has no government bond exposure and low cash levels.

HIGH CONVICTION
THE MIND OF THE FUND MANAGER

Active managers must earn their fees by providing returns that outperform their benchmarks over time. Failing to do so suggests that investors would have been better off by investing passively, such as buying an index or exchange traded fund. NICK CURTIN explores the concept of conviction behind the value proposition of active fund managers.

Active fund managers need to outperform passive strategies by at least the margin of their [higher] fees to justify their existence. Calendar years of underperformance are expected as the manager seeks to outperform over longer cycles. Underperforming passive strategies in the long term shows that the manager has failed to deliver his mandate. Worse still, where a manager purports to take active positions, and generates returns that merely match the benchmark, fees are being paid for this "closet indexation."

To justify the fee, an active manager must have conviction as to the positions taken in the fund that differ from those in a passive strategy. Fund managers who harbour arbitrary convictions should be avoided. In our view, conviction arises as a result of thorough, rigorous analysis and an intimacy with the investment circumstances that can only come with experience.

But conviction as what? While it seems obvious that the fund manager should be convinced of the upside potential inherent in a particular position in a portfolio, they should hold even more conviction regarding the extent of downside risk. It is the avoidance of permanent loss of capital that is the first tenet of successful investing. The degree of conviction is weighed up carefully against he risk of being wrong (because investing is a rospective practice dealing with inherent uncertainty). ne of the ways of managing the risk of being wrong y diversification. A higher degree of conviction requires less diversification – but not no-diversification, because no one has perfect foresight.

But caveat emptor: not all convictions are what they seem. Darwin asserted, "ignorance more frequently begets confidence than does knowledge." Overconfidence, which is distinct from conviction, is dangerous. The Dunning-Kruger effect describes the condition whereby certain unskilled individuals mistakenly judge their abilities much higher than is accurate. Applying the effect to investing, there is a risk that unskilled fund managers and investors make poor decisions and reach incorrect conclusions, but their very lack of skill makes it impossible for them to realise their mistakes.

The ability to determine when and why you are wrong is fundamental to successful investing. We believe that good investors should be introspective and perhaps even somewhat masochistic, constantly assessing decision matrices and their success or failure. If anything, successful investors exhibit behaviour that is the very antithesis of the Dunning-Kruger effect.

> **TO JUSTIFY THE FEE, AN ACTIVE MANAGER MUST HAVE CONVICTION AS TO THE POSITIONS TAKEN IN THE FUND THAT DIFFER FROM THOSE IN A PASSIVE STRATEGY.**

At Foord Asset Management, investment professionals are obsessed with risk: the risk of loss, the risk of being wrong, the risk of failing to meet return expectations. Well-founded conviction is essential to the positive differentiation of returns from the market (and, indeed, to active fund management as a profession). The rigour of the investment process and the constant assessment of portfolio positions, combined with more than 30 years of experience and success in the investment markets, are essential parts of the enigma that is sustainable superior investment returns.

MARIO
ON THE MOVE

Mario Schoeman chose to relocate to Cape Town from the beginning of 2014. He made the decision with his family for personal reasons and Foord has supported him in his move from Gauteng. He continues his work from Foord's Cape Town office. Mario's move created a vacancy in servicing financial advisors in Johannesburg and Pretoria. We have, however, secured an experienced individual to continue Mario's work in the region and will be profiling her in a future edition of *Foreword*.

A MIGHTY FINE CENTENARIAN

An investor with Foord from the age of 69, Louis Rabinovitz celebrated his 100th birthday recently. We salute a fine man on reaching such a milestone, as well as his very recent retirement as an accountant at Broll Property Group.

FOORD INTERNATIONAL BENCHMARK

It is a little-known fact that the Foord International Trust (FIT) started its life in 1997 as a global equity fund. The fund's name was the Foord & Meintjes International Equity Trust and the benchmark was the MSCI World Equities Index (developed markets). In the late 1990s, the fund changed its orientation to become a flexible fund incorporating all asset classes. The decision was made because the tech boom had resulted in extreme valuations in equity markets and the managers began to find better value for investors in global bond markets.

From this time, FIT had a dual objective: to achieve in excess of 10% per annum in US dollars over time and thereby expecting to outperform the MSCI index, but with lower variability. Foord continued to report performance against the MSCI World Equities Index.

The advent of the Foord Global Equity Fund in 2012 re-introduced a dedicated global equity fund. The fund is benchmarked against the MSCI All Country World Equities Index. Given this development, we felt that it was useful to report FIT's performance against its primary objective, being the 10% per annum in US dollars over time. The Foord International Feeder Fund is now reported against that same objective, but measured in rands.

MARKETS IN A NUTSHELL

INTERNATIONAL

EQUITIES

Eased by the renewed commitments to accommodative monetary policy, global equity markets rose – with developed markets (+8.1%) outperforming emerging markets (+1.9%)

BONDS

The US 10-year yield moved up from 2.6% to 3.0% over the quarter following the Fed's taper announcement – improving global macro data and strong equity markets also undermined demand for bonds

CURRENCIES

The US dollar was flat on a trade-weighted basis while slightly positive for the year – weakness against the euro (-4.2%) was offset by strength against the yen (+21.9%)

SOUTH AFRICA

The FTSE/JSE All Share Index rose 5.5% to 46,256 as of 31 December 2013 – financials (+6.9%) and industrial shares (+6.7%) outperformed resources (+2.1%), despite the weaker rand

SA bonds ended the quarter flat (+0.1%) and were the worst performing asset class for the year with a return of 0.6% – foreign buying of SA bonds amounted to R25.7bn for 2013 compared to R93.5bn in 2012

The rand depreciated by 4.4% over the quarter and 19.2% for the year against the US dollar – with continued labour market strife, twin deficits and asset rotation contributing to the rand's sell-off

COMMODITIES

Commodity prices were mixed with crude oil prices slightly up (+1.5%) on renewed tension in Libya and Sudan – but gold fell 9.3% over the quarter with tepid inflation in the US and Europe and the Fed's taper decision weighing on bullion

ECONOMY

Revised annualised Q3 US GDP growth was 4.1%, the biggest quarterly increase since Q4 2011 – while employment continued to improve with the unemployment rate reaching a five-year low of 7%

SA's current account deficit widened to 6.8% of GDP in Q3, mainly because of trade balance deterioration – as petrol prices rose, the rand depreciated, import volumes surged and prolonged strikes curbed exports

MONETARY AND FISCAL POLICY

The US Federal Reserve finally announced the tapering of its monthly bond purchases from January 2014 – but simultaneously eased investor anxiety by committing to prolonged accommodative monetary policy

Consumer inflation decelerated over the quarter from 6.4% year-on-year to 5.3%, while factory-gate price increases also eased – positive for continued easy monetary policy

FOORD FLEXIBLE FUND OF FUNDS

INVESTMENT RETURNS

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**16.2**	25.2	35.0	6.9
Benchmark	**11.5**	10.9	10.6	2.1

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.

FOORD INTERNATIONAL FEEDER FUND

INVESTMENT RETURNS

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**13.1**	24.6	40.9	7.0
Benchmark	**17.3**	27.1	32.3	7.1

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

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*	**17.8**	17.6	22.0	4.6
Benchmark	**15.1**	13.9	21.2	4.3

Benchmark: The market value weighted average total return of the South African Multi Asset High 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*	**21.6**	21.4	27.8	6.3
Benchmark	**18.2**	16.4	21.5	5.5

Benchmark: Total return of the FTSE/JSE All Share IndexInception 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 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.