FOREWORD

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DID YOU KNOW? REAL RETURNS

Inflation erodes the purchasing power of money over time. When investing for the long term, particularly for a life event such as retirement, the most important element of an investment return is the return achieved after adjusting for inflation. It is this element of return that increases your wealth and your purchasing power – provided it is positive and not negative.

In financial jargon, returns presented after adjusting for inflation are referred to as "real returns." The calculation of the real return is most accurately achieved by means of an arithmetic calculation. For the vast majority of scenarios, one can determine the real return by simply subtracting the rate of inflation from the actual return achieved (also known as the "nominal return").

For example, the Foord Balanced Fund has delivered an annualised return of 17.0% per annum over the three years to 30 June 2012. Inflation over this period amounted to 4.8% per annum (using latest figures). The fund could be said to have delivered a real return of 12.2% per annum over this period.

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SINGAPORE

Fifteen years after its first foray into the global sphere in Guernsey, Foord launched its second foreign domiciled unit trust on 1 June in Singapore. CAROLYN LEVIN, managing director of Foord (Singapore), explains the strategy and the rationale behind the move.

Foord first managed a global investment portfolio when it opened the Foord International Trust in Guernsey in 1997. That decision was motivated by South Africa's relaxation of its complete exchange control regime, allowing institutional investors access to foreign assets via the asset swap mechanism. Rather than appoint sub-managers for the foreign asset component of the portfolio, Dave Foord (joined at the time by Bruce Ackerman) believed Foord could do things better by applying the same investment philosophy and approach that had worked so successfully in South Africa. This was not mere bravado on their part, as the success of the Foord International Trust (FIT) has proved.

FIT has by necessity been a very cautiously managed, conservative portfolio. This is due to its "one size fits all" status as the sole foreign asset component of all Foord's South African portfolios that have an international element. This conservative approach has met the needs of portfolios but has left an opportunity for a more aggressively positioned foreign portfolio. Moreover, unit trust legislation in South Africa has limited the inclusion of foreign unit trusts (such as FIT) to 20% of portfolio. From 1 July, the regulators have allowed 20% per fund up to an aggregate limit of 80% of portfolio. Funds like the Foord Balanced Fund therefore may not invest more than 20% into FIT but are permitted to invest 25% offshore (in two or more foreign unit trusts).

The changing regulatory environment and opportunity for a more aggressively styled global portfolio led us to conceive an international equity portfolio, namely the Foord Global Equity Fund. We chose to domicile the fund in Singapore which is challenging its regional rival Hong Kong for supremacy as Asia's financial services hub. The domicile also hints at the investment universe of the new fund. Unlike FIT, it will not routinely restrict itself to shares listed in developed markets. While we like the governance structures associated with a developed market listing, there are undoubtedly some attractive investment opportunities in developing markets. The Foord Global Equity Fund will be far more active in this space than FIT has been.

While the fund builds an investment and operations track record in Singapore, the regulator in that market has requested that the fund remain closed to direct retail investors. We are, however, able to implement a South African feeder fund structure (similar to the Foord International Feeder Fund). We expect our applications for the approval of the feeder fund to be approved soon. Watch this space and our website for further developments.

WHAT WE REALLY NEED FROM RETIREMENT REFORM

National Treasury is going to address retirement funding comprehensively. They are entirely justified in doing so: our country's savings rate is poor, the costs of retirement savings products are high and far too many people retire incapable of supporting themselves, thereby burdening their families and the state. PAUL CLUER, writing with DARRON WEST of the University of Cape Town, unpacks the real issues.

There is little doubt that encouraging saving for retirement, reducing the deleterious effects of costs and charges on wealth accumulation, and making retirees more self-sufficient are worthy and necessary objectives. However, facilitating retirement saving is a battle against human nature more than anything else; most people cannot or will not look to the long term, and as such retirement saving is a "grudge purchase." Governments the world over have opted to address this challenge by dangling the tax incentive carrot, since everyone appreciates paying less tax.

Historically, various tax incentives have been in place to encourage saving for retirement, not the least of which are the tax deductions available for contributions to retirement products, and the apparently benign taxation of retirement lump sums. Conventional wisdom dictates that people should invest in retirement products and that their annuities in retirement will be subject to a lower rate of tax (because of a lower absolute income, higher deductible medical expenses and higher tax exemptions and rebates). In this way, an investor apparently obtains a government subsidy of sorts during the wealth accumulation phase.

Interestingly (and perhaps a little disconcertingly), the analyses in support of saving in vehicles like a retirement annuity (RA) tend to stop at retirement age. Hence, they illustrate the purported wealth accumulation benefits of RA's, but they fail to examine the after tax cash flows arising from that wealth after retirement. The taxman does not give away anything for free. It goes without saying that where savings are subsidised (by way of tax deductions and tax exemptions on income), the resultant wealth at retirement will be higher than in an equivalent non-subsidised option. But what of the tax effects thereafter? Stated simply, the annuity resulting from an RA is fully taxable, but only the income and capital gains from a discretionary investment are taxed. This differential can work in an astute investor's favour.

It is true that by saving in a retirement vehicle and reinvesting the tax savings, investors are effectively enhancing their investments by their marginal tax rates. It is also true that retirement funds are not currently subject to any tax on interest and dividends, unlike individuals. However, it is also true that retirement funds have limited investment discretion, notably the maximum of 75% invested in equity.

The key determinant of after tax income in retirement is not the tax deductibility of contributions to an RA. When one models the long-term effects on wealth accumulation and the resultant after tax income stream arising in retirement, the major determinants affecting

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that after tax income are the age at which one commences saving (younger investors have an advantage when investing on a discretionary basis), the additional returns (alpha) earned on an investment portfolio (higher alphas favour discretionary investments as capital builds up), the taxable yield on that portfolio and the costs of the product (higher taxable yields favour RA's, as such income is shielded from tax in the RA).

The simple fact is that retirement products are not a panacea for all. Certainly, the scare tactics are justified when used against older investors who have not accumulated much of a retirement nest egg. In that instance, given the short accumulation period and the likely high marginal tax rates on such individuals, an investment in an RA might be appropriate.

However, an investor (younger or even middle-aged) capable of selecting a fund manager who can consistently provide benchmark-beating returns (ie alpha) enjoys all the benefits of discretionary investing (including considerable flexibility as to investment type and geography) even where contributions are made on an after tax basis. At worst, such an investor is indifferent towards RA's, regardless of the purported tax benefits. Of course, factoring product costs into this model serves only to reduce the apparent attractiveness of the RA even further; indeed, this is an aspect about which National Treasury is acutely aware.

There is no short cut to procuring financial security in retirement. However, it is evident that financial planning cannot stop at the retirement stage without due consideration of the after tax consequences of deriving an income in retirement. Investors considering products on the basis of their purported pre-retirement tax benefits must make precise and detailed enquiries as to the post-retirement ramifications, and they must question whether or not an investment in such a product really is in their best interests.

Commitment to a retirement savings vehicle is a leap of faith. Possible future increases in tax rates on wealthy investors could prejudice investors in retirement products by taxing the future annuities at tax rates that exceed the rates at which deductions were afforded to the contributions. This, combined with the limited investment discretion of retirement products (and as a consequence, the limitations on expected returns), should make any investor pause (or at least do some careful calculations on post-retirement after tax cash flows).

What we really need from retirement reform is particular consideration to tax incentives post-retirement. If the trap is in the taxation of annuities, perhaps National Treasury would be well advised to consider tax incentives that look beyond merely the accumulation of savings and that treat annuitised retirement income more benignly too. Only when the taxation of annuities, which is at the root of any indifference an informed investor should have towards RA's, is made significantly more attractive will RA's become a proverbial "slam dunk" investment option.

ARE YOU ADDICTED TO RISK AVERSION?

> "A PRIME EXAMPLE OF THE ADDICTION TO RISK AVERSION IS THE USE OF SO-CALLED "STABLE" OR LOW-EQUITY PORTFOLIOS AS LONG-TERM INVESTMENT VEHICLES."

The investment management industry, and indeed the average investor, is preoccupied with short-term performance. Funds are ranked by performance, judged monthly or quarterly, and awards are based on performance over relatively short time horizons. Assets often flow from funds that have under-performed over the short term to those that have outperformed over the same measurement period. MIKE SOEKOE introduces the concept of addiction to risk aversion.

There is also compelling evidence that investors chasing returns often do so to their prejudice by switching to riskier asset classes when these are fully priced or expensive, and by switching from such asset classes when they are cheap or offer value. It has been observed that equity funds experience net inflows near the end of bull markets (and money market funds experience concomitant outflows). Money market funds experience inflows at the bottom of bear markets, precisely when the opportunity to invest in the riskier asset class is most favourable.

Perversely, it would appear that investors might perceive less risk in an asset that has moved up, and more risk in an asset that has declined in price. These observations are not just examples of bad timing. To us, they demonstrate that investors don't properly understand the concept of investment risk.

Too few investors perceive risk as the chance that invested capital will be lost permanently. Too many investors see risk in the short-term volatility or variability of returns – measured in days, weeks and months. This disconnect results in behaviour that we classify as an addiction to risk aversion.

Because it is difficult to value a company, share prices tend to be especially volatile. This is particularly true in times of economic uncertainty. Furthermore, investors may have sustained losses over the short term during periods of market weakness. It is in these circumstances that addiction to risk aversion manifests most acutely. Strangely, risk aversion usually relates only to share markets, even though other asset classes such as bonds at times carry a very high risk of loss.

A prime example of the addiction to risk aversion is the use of so-called "stable" or low-equity portfolios as long-term investment vehicles. Funds in this category are typically restricted to no more than 40% exposure to shares with the balance invested in bonds, cash and listed property. This equity ceiling brings down the volatility of returns but also severely curbs one's ability to earn long-term inflation-beating or real returns (see *Did You Know?*).

Stable funds are most appropriate for investors who have a time horizon not exceeding two, possibly three years. If the bulk of your retirement capital is invested in a low-equity portfolio when you realistically expect to live longer than five years, you're probably addicted to risk aversion.

END OF AN ERA

After more than 30 years in business, it's no wonder Foord loses some valuable members of the team to retirement. In this edition of Foreword, PAUL CLUER says farewell to CHRIS GREYLING, independent Chairman of Foord Unit Trusts but welcomes some new faces to the Foord family.

It seems that too often these days Foord says "adieu" to one or other long-serving member of the team. When valued employees and directors retire from Foord it is less an indictment on our staff turnover than an endorsement of the company's ability to attract and retain talented individuals for the very long term.

Chris Greyling retires from the Foord Unit Trusts board this August on the company's ten-year anniversary. His journey with Foord started in 1997 when he became a private client of Foord Asset Management. In 2003 he joined Foord as Chief Executive Officer and was instrumental in assisting Dave and the other directors in implementing policies that have resulted in the growth and prominence that Foord enjoys today.

Chris has been particularly active in Foord's retail growth. He was appointed to the board of Foord Unit Trusts in 2003 and became non-executive Chairman in 2005. Chris's involvement in growing the business from its infancy to what is today a successful retail investment business with more than R14 billion under management cannot be overstated.

Chris has displayed thoughtful and considerate leadership during his tenure at Foord. A stickler for correct and proper governance, he has nevertheless always stressed the importance of doing the right thing over simply doing things right. For me, this simple lesson will be a lasting legacy of Chris's mentorship over the past eight years.

NEW FACES

Over the past few months we have welcomed some new staff members to Foord. **PRAVARSHAN MURUGASEN** and **DANIEL GERDIS** have joined the investment team as equity analysts. **DIANE BEHR** was appointed as compliance and operations manager. All three new staff members are chartered accountants and have brought an excellent mix of skills and experience to Foord.

PRAVARSHAN MURUGASEN
EQUITY ANALYST

DANIEL GERDIS
EQUITY ANALYST

DIANE BEHR
COMPLIANCE AND OPERATIONS MANAGER

MARKETS IN A NUTSHELL

INTERNATIONAL

EQUITIES

Equity markets contracted sharply in response to weaker economic data out of China and the US – despite a month-end rally on hopes of broader fiscal consolidation following an EU summit that promised increased bank supervision

BONDS

Bond yields mostly declined on continued safe-haven demand – but the funding costs of nations affected by the Euro crisis have risen rapidly

CURRENCIES

The US dollar strengthened – as investors reallocated capital to treasuries away from both emerging markets and European shares and bonds

COMMODITIES

Precious and industrial metals prices (barring gold) weakened significantly and Brent crude fell by 25% – but soft commodity prices (corn and wheat in particular) rose significantly in June given a worsening crop outlook in the USA and Russia

ECONOMY

US employment creation stalled following robust growth in Q1 – driven by seasonal lay-offs and a cautious outlook from businesses leading into the November US presidential cycle

MONETARY AND FISCAL POLICY

China commenced relaxing monetary conditions following weaker-than-expected growth – reducing both short-term interest rates as well as the reserve requirement, reducing the amount of capital banks have to put aside from depositors

SOUTH AFRICA

EQUITIES

The FTSE/JSE All Share Index ended the quarter 1% higher, but tracked emerging market bourses lower when measured in US dollars – as commodity companies fell on declining mining output and the sharp decline in commodity prices

BONDS

Bond yields continued to trend lower as inflation prospects improved – but also on foreign tracker fund demand following approval for SA's inclusion in the Citigroup World Government Bond Index from October

CURRENCIES

The rand depreciated during the quarter – with increased risk aversion and lower commodity prices weighing on the currency

ECONOMY

Economic growth continues to disappoint, especially the mining sector following protracted strikes in the platinum industry – but manufacturing, government spend and household consumption remained relatively buoyant and fixed investment continues to recover

MONETARY AND FISCAL POLICY

Domestic interest rates remained low and should endure for an extended period – owing to the moderating inflation outlook and deteriorating domestic growth

FOORD FLEXIBLE FUND OF FUNDS

INVESTMENT RETURNS

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**10.7**	19.7	24.7	2.7
Benchmark	**11.9**	10.2	11.4	3.3

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*	**8.7**	10.5	19.9	4.1
Benchmark	**6.4**	13.6	14.8	1.1

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*	**17.0**	17.0	16.5	2.0
Benchmark	**14.3**	12.7	9.6	0.5

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*	**20.3**	23.3	19.1	0.4
Benchmark	**16.9**	18.3	9.2	1.0

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.