FOREWORD

DID YOU KNOW?

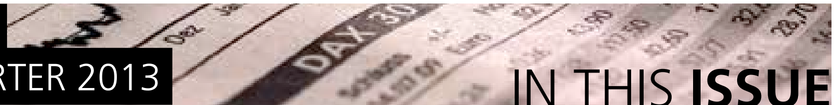
RAND HEDGE SHARES

The Johannesburg Stock Exchange is naturally dominated by companies that are registered in South Africa, have their operations in the country and that derive a large majority of their earnings locally, in rand. There are, however, numerous JSE-listed companies that are dominated by offshore operations or which produce goods or services whose prices are set in international markets in hard currencies, such as the United States dollar. Investing in these companies can provide a "hedge" against rand depreciation.

The shares of listed companies with these characteristics are often referred to as "rand hedge shares" and generally encompass companies that earn a material percentage of their revenues in non-rand currencies and which therefore benefit from a weakening rand. Very few rand hedge shares provide a perfect hedge against rand depreciation and many offer only asymmetric exposure, meaning that the share price moves up and down asymmetrically to rand weakness and rand strength.

There are two broad categories of rand hedge shares: (1) companies that are registered and operate abroad but are also listed on the JSE and (2) major South African exporting companies (including most of the listed mining companies) whose revenues are set in hard currencies. Examples of rand hedge shares include Richemont (a luxury goods retailer traded on the JSE and the Swiss exchange), British American Tobacco (a tobacco company traded on the JSE, London Stock Exchange and New York Stock Exchange), Aspen (a South African pharmaceutical company with substantial operations abroad) and Sasol (the world's top gas- and coal-to-liquids producer, whose share price is closely correlated to the US dollar oil price).

ISSUE 26
2nd QUARTER 2013



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WHEN GOOD NEWS IS BAD NEWS

Benjamin Graham, known as the father of value investing, espoused the use of fundamental analysis to calculate the intrinsic value of companies listed on stock exchanges. Improving economic fundamentals imply growing company earnings and should generally be positive for stock markets. But Graham often spoke about the market's irrational behaviour. In today's world of currency wars and massive monetary stimulus, markets have often contradicted what financial theory might suggest. PAUL CLUER looks at the recent phenomenon of when good news means bad news.

On Wednesday, 19 June 2013, the Chairman of the US Federal Reserve, Ben Bernanke, announced on behalf of the FOMC (Federal Open Market Committee) that the end was in sight for the US's quantitative easing programme that has dominated financial markets for half a decade. The FOMC based its decision on data that shows unequivocally that US economic growth is gaining traction and forecasts for continued growth are positive. By 30 June 2013, US GDP data is expected to have recorded 16 consecutive quarters of growth since Q3 2009, the end of the Global Financial Crisis-induced recession. The FOMC noted that the US labour market has shown "further improvement in recent months" and that the "downside risks to the outlook for the economy and the labour market have diminished since [the northern hemisphere autumn]".

> "MARKETS HAVE BECOME ADDICTED TO THIS COCKTAIL OF STIMULUS AND EASY MONEY"

So, a formal endorsement that the US economic recovery was both sustained and sustainable and that US unemployment was set to decline, spending to rise and house prices to sustainably improve is good news, right? Wrong. Markets in the US and other countries plunged on Thursday and Friday, 20 and 21 June. The Dow Jones in the US lost over 4% and Eurostoxx 50 lost over 7% of its value over the ensuing days. The yield on 10-year US Treasuries hit its highest since March 2012 at 2.36%, up sharply from 1.60% at the start of May. The gold price fell to its lowest level in nearly three years.

Why is this so? Markets were reacting negatively to Fed chairman Ben Bernanke's comment that it would be "appropriate to moderate the monthly pace of purchases later this year" as long as the economy grows as expected. For the time being, the Fed said that it would continue its "QE3" policy of buying assets at a pace of $85 billion a month, and expects to keep interest rates low as long as the unemployment rate remains above 6.5%. But the markets are looking forward to the economic scenario the Fed anticipates, when "the unemployment rate would likely be in the vicinity of 7%, with solid economic growth supporting further job gains." The fear is that this tapering of monetary stimulus would commence in the next few months.

Markets have therefore become addicted to this cocktail of stimulus and easy money and any hint of withdrawal has been met pessimistically by market participants – notwithstanding the fact that US economic fundamentals are improving and that everyone knew that the end of stimulus must eventually come. But as if to prove that bad news can also be good news, on 26 June 2013 markets celebrated the disappointing downward revision of Q1 US GDP growth from 2.4% to a much lower 1.8% (annualised) by igniting a three-day rally as players bet that the Fed would maintain its stimulus just a little bit longer as a result.

ASPEN – THE WINNING FORMULA

Aspen is Africa's largest pharmaceutical manufacturer and the ninth largest generics company in the world. It was founded by the current management team in 1997. The following year Aspen listed on the JSE and today supplies branded and generic pharmaceuticals to more than 150 countries. DANIEL GERDIS puts Aspen under the microscope and reveals its winning formula.

Aspen has been one of the top performing shares in the ALSI40 over the past ten years and has been an important contributor to the absolute returns generated for Foord's client portfolios. Its attraction as a quality company is reflected in its outperformance against other shares listed on the JSE as highlighted by the upward sloping line in Graph A.

Aspen's share price has run hard and the share ostensibly now looks expensive by historic standards with an earnings multiple (PE ratio) of 29 times annual earnings. Clients may question why Foord continues to hold the share in their portfolios.

At Foord, we like to invest in well managed, cash generative businesses that are able to grow earnings on a sustainable basis, whilst also delivering above average returns on equity. While we obviously seek to acquire such businesses at attractive prices, we then tend to remain invested for as long as these criteria hold.

Quality companies are those with management teams that are the best in the industry and whose goals are closely aligned with those of our clients. Aspen ticks both of these boxes. The founders of the business remain in the roles of CEO and deputy CEO today, with more than fifteen years of experience and an exceptional track record. As sizeable shareholders in the business themselves, management's goal of creating long-term value in the business is closely aligned to our own clients' goals, as shareholders.

The importance of a dynamic management team for protecting our clients' capital and generating an acceptable return cannot be understated. Aspen's management has established a track record for superior deal making ability. They have identified a series of value adding opportunities that may otherwise have been overlooked. Applying this winning formula to an established sales platform means that every new product added to Aspen's portfolio further enhances economies of scale.

> **"ASPEN IS ONE OF THE FEW COMPANIES TO HAVE SHOWN ITS DEFENSIVENESS THROUGH THE 2008/2009 RECESSION BY CONTINUING TO GROW EARNINGS WHEN OTHER COMPANIES STRUGGLED."**

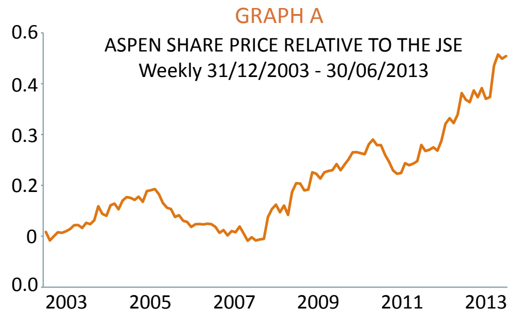
Steady earnings growth over a long period of time is a good indication that a company has a sustainable competitive advantage in its industry. Graph B illustrates Aspen's track record in compounding earnings growth of 26% per annum for the last ten years.

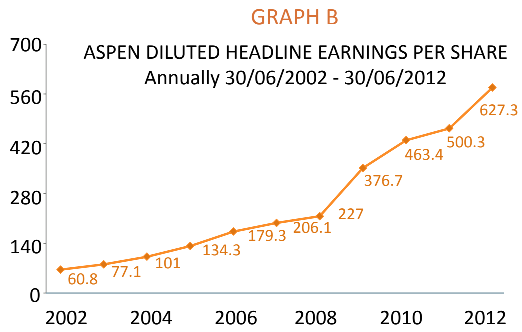
One of Aspen's core assets is its world class manufacturing facility based in Port Elizabeth. The efficiency, scalability and quality of the pharmaceuticals produced enable Aspen's products to be extremely cost competitive. This strength is complemented by Aspen's high quality, motivated sales force that distributes Aspen's products throughout the world, as far as Asia and Latin America. This winning formula has made Aspen a household name and created a brand that is trusted by doctors and pharmacists worldwide. This helps explain why one in four prescriptions dispensed by pharmacists in South Africa is for an Aspen product. As company analysts, we value this market penetration since it cannot be easily imitated by Aspen's competitors.

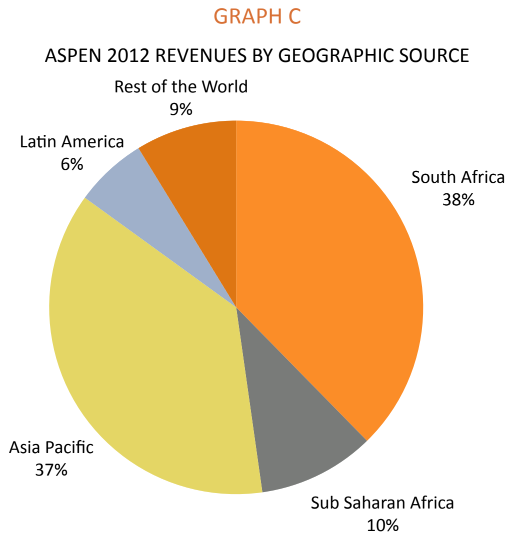
Another quality valued by Foord is for a company to be self-sustaining through strong, consistent cash generation. Pharmaceutical companies are inherently more resilient in recessionary cycles than many other companies. They sell an invaluable product in this era of increasing emphasis on health and wellbeing. Aspen is one of the few companies to have shown its defensiveness through the 2008/2009 recession by continuing to grow earnings when other companies struggled. Furthermore, its strong cash generation gives management valuable optionality when it comes to either returning cash to shareholders or reinvesting in acquisitions that enhance earnings.

There are not many well-diversified, non-commodity rand shares (see *Did You Know?*) listed on the JSE. Aspen has expanded globally to have a presence in over 150 countries, including emerging markets with growing populations and rising per capita income. With more than half of its revenue earned outside of southern Africa, Aspen is diversified geographically which provides useful rand hedge characteristics and reduces investment risk when building an investment (Graph C).

Aspen has many of the characteristics Foord looks for in a quality company and adds useful diversification in a well-balanced portfolio. Therefore despite the past superior returns achieved by an investment in Aspen shares, we maintain our holdings in the company. We have confidence that Aspen's excellent management team has the winning formula to continue delivering exceptional shareholder returns for many years to come.







THE ROLE OF INTERNATIONAL ASSETS IN A PORTFOLIO

With the South African currency's recent weakness, many investors might have rekindled an interest in offshore investing. If investing locally is considered complicated or overwhelming, then those sentiments are likely to be amplified several fold when investing offshore. The opportunity set and the number of products and service providers dwarf the domestic industry. MIKE SOEKOE looks at the role of international assets in an investment portfolio.

Investing offshore should not be a knee-jerk reaction to rand depreciation. While the long-term expectation of the relative strength or weakness of the South African rand is a factor in the decision, it should never be the sole determinant.

The various broad local asset classes (equities, property, bonds and cash) may be combined in a portfolio to produce an optimal return for the level of risk taken. This happens because the returns on the various asset classes might move opposite to one another (that is, they may be negatively correlated). International asset classes may offer similar negative or non-correlation. By including these assets in a portfolio, the portfolio can become more efficient. This means, it will generate a similar return with less variability of that return, or a greater return with the same variability as a "local only" portfolio. Hence, international assets offer the opportunity to better diversify a local portfolio.

Foord has always resisted attempts to define risk as volatility or variability. We consider risk to be the chance of a permanent loss of capital and the risk of being wrong in one's return expectations. These risks are managed by investing in undervalued companies or securities, but also by suitably diversifying a portfolio.

> **"INVESTING OFFSHORE SHOULD NOT BE A KNEE-JERK REACTION TO RAND DEPRECIATION"**

Quantitative research by Darron West of the University of Cape Town shows how much of a fool's errand international investing can be if not executed for the right reasons and with the appropriate long-term view. Darron analysed data since April 2008 (so that it might be compared directly with the Foord Flexible Fund of Funds, which celebrated its fifth anniversary on 31 March 2013). His study shows that there is no fixed allocation to offshore assets that aids a portfolio in achieving a consistent return of CPI+5% with little risk of capital loss over 12 month periods. In fact, the optimal allocation to offshore investments for this period ranges between 0% and 51%, with some variation from month to month.

It is plainly apparent that building passive portfolios that involve a fixed percentage investment to asset classes including foreign assets to generate absolute real returns is a very difficult task indeed, even with perfect hindsight. If anything, this supports the idea that the motivation for investing offshore must be that the future returns are more certain in amount and frequency.

Since the beginning of 2012, the Foord Flexible Fund of Funds has been systematically increasing its exposure to international assets to the present level of some 60%. The systematic nature of this allocation is in stark contrast to the variability of allocations that arise in the passive quants model derived from Darron's research. Nevertheless, this strategic decision has been justified by the fund's recent (and, indeed, aggregate) performance. In fact, the returns of the Foord Flexible Fund over the past 18 months exemplify the role that international assets can and should play in a diversified investment portfolio.

FRESH NEW FACES

We've welcomed a few new faces to the Foord team during the past quarter.

Nick has joined Foord in an institutional client services capacity and will take the lead role in coordinating the client report-back programme. He will act as a liaison between the investment team and institutional clients in reporting on performance, portfolio positioning and the team's investment outlook. For the past five years Nick has been with the Russel Investments group, first in Australia and more recently in SA where his roles included consulting and client relationship management. Prior to this, Nick spent almost ten years with Alexander Forbes and Investment Solutions. Nick holds a BA (Economics and Politics) from UNISA and is a CFA Charter holder.

Wim has joined the Foord investment team as an equity analyst, where he will initially focus on South African companies listed in the retail and food producer sectors. He previously worked as an investment analyst for Peregrine Capital, South Africa's largest hedge fund manager, before joining the group CEO of Peregrine Holdings as an analyst focusing on investment opportunities. Wim holds an LLB degree, with additional subjects in physics and chemistry. He is currently enrolled in the CFA Institute's CFA programme.

A Durban native, **Alexa** chose to pursue her studies at the University of Cape Town. She completed a B.Com in Financial Accounting followed by a B.Com (Hons) in Financial Analysis and Portfolio Management. Alexa joined the Foord performance team in March as a performance and attribution analyst. She will focus on performance measurement calculations and reporting as well as managing the performance composite programme. She is registered in the CFA Institute's CIPM certification (Certificate in Investment Performance Measurement).

MARKETS IN A NUTSHELL

INTERNATIONAL | **SOUTH AFRICA**

EQUITIES

International: Equity markets ended the quarter higher despite declines in June, led once again by a stronger US market – but emerging market bourses lagged when measured in dollars

South Africa: The JSE tracked commodity bourses lower but was flat when measured in rands – commodity shares significantly underperformed the broader market, led by a sell-off in gold shares

BONDS

International: Bond yields rose sharply – as investors sold following a reassessment of the Japanese investment landscape and the Federal Open Market Committee's expected interest rate path

South Africa: SA government bond yields rose in tandem with developed market yields – foreign investors sold large quantities of government debt in June alone, intensifying the sell-off

CURRENCIES

International: The dollar strengthened on a trade weighted basis – as investors switched out of emerging market debt and commodity currencies lost their lustre following weaker Chinese growth forecasts

South Africa: The rand depreciated by 6% against the US dollar – on weak growth prospects, continued labour market strife, twin deficits, global liquidation of emerging market assets and weak Chinese growth expectations

COMMODITIES

Gold lost its shine, falling 24% in the quarter, driven by fund liquidations and broad-based dollar strength as expected stimulus withdrawal dented the metal's appeal as an inflation hedge – while industrial commodity prices also performed poorly, with slower Chinese growth and higher inventory levels weighing on most metals

ECONOMY

International: The initial US Q1 GDP print of 2.4% annualised was subsequently revised lower to 1.8% – as lower government spending (the sequester) and eroding disposable incomes eat into growth

South Africa: SA Q1 GDP growth disappointed, expanding less than 1% on an annualised basis – weak mining and manufacturing sector growth offset by still-robust consumption expenditure

MONETARY AND FISCAL POLICY

International: Interbank liquidity in China worsened significantly – with the People's Bank of China having to force banks to rein in lending practices, especially in the informal and unregulated markets

South Africa: Market expectations for a decrease in the short-term repo rate reversed – with SARB's monetary policy committee warning of currency depreciation-driven inflation risks

FOORD FLEXIBLE FUND OF FUNDS

INVESTMENT RETURNS

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**14.6**	24.2	33.0	5.9
Benchmark	**11.7**	10.7	11.0	3.5

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.
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*	**12.0**	18.7	35.5	7.6
Benchmark	**11.1**	25.0	46.4	9.2

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*	**17.4**	18.1	22.0	2.5
Benchmark	**14.7**	13.1	18.3	1.5

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*	**20.8**	23.3	25.4	2.4
Benchmark	**17.3**	18.1	21.0	-0.2

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 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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