FOREWORD

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CHAIRMAN OF THE FEDERAL RESERVE, JANET YELLEN. Image source: Huffington Post

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DID YOU KNOW?

TAPERING

Quantitative easing (QE) is a process in which a central bank buys financial assets (such as bonds) from commercial banks, thereby increasing money supply and lowering interest rates. The US Federal Reserve (the Fed) has been using this policy since the financial crisis of 2008-9 in order to stimulate the US economy. Consequently, interest rates have been artificially low for some time. But QE cannot simply stop – that would be like popping a balloon instead of deflating it slowly. Tapering is the process of progressively slowing the purchases of financial assets, thus normalising interest rates from current low levels. The new Fed chair, Janet Yellen, announced at the end of March that the tapering process would conclude towards the end of 2014.

FOORD INTERNATIONAL TRUST LONG-TERM PEDIGREE

Foord has successfully managed diversified long-term portfolios (balanced funds) for South African investors since the early 1980s. When exchange controls were lifted in the late 1990s, we launched the Foord International Trust (FIT) to house the foreign component of our investors' balanced portfolios and allow individual investors to invest directly in offshore markets. Today, FIT is one of only a handful of funds in its category that has a successful track record in excess of seventeen years has been managed by the same portfolio management team according to a consistent investment philosophy and holds the coveted 5-Star Morningstar rating. NICK CURTIN unpacks this quality fund.

Given Foord's strong focus on generating inflation beating returns, we have long felt that a significant exposure to foreign assets should be an essential component of any investor's overall portfolio. Because South Africa has a structurally higher rate of inflation than most of our developed market counterparts, over time our currency should depreciate at least to the same extent as this inflation differential. This provides a very attractive long-term "inflation hedge" for South African investors with a CPI-plus investment objective. Indeed this has been the case over FIT's seventeen-year history.

In addition, FIT also provides South African investors with access to investment themes, sectors and geographies that simply do not exist in the South African economy. By way of example, one of our core investment themes is the rise of the middle-class consumer in the emerging markets of the Asia Pacific. This is a difficult investment theme to capture if limited to South African assets only. However, in FIT, we can invest our investors' capital in our very best international share ideas. Companies such as Nestlé, Johnson & Johnson, Vodafone and LVMH all provide attractive exposure to this particular investment theme (amongst others).

> **OUR UNAPOLOGETIC OBSESSION WITH CAPITAL PRESERVATION MEANS THAT WE STAY FIRMLY ROOTED IN THE QUALITY CAMP.**

One of FIT's most important differentiating features is the focus on only the highest quality investment opportunities. This is by design - FIT is managed to a relatively conservative investment mandate. FIT's opportunity set comprises companies mostly listed in the developed markets with quality earnings, strong balance sheets and high quality management teams. The best regulatory, legal and corporate governance environments are also non-negotiable. This focus on quality has paid off handsomely for investors over the long-term as attested by its category–leading performance history.

However, FIT's absolute return objective (10% in USD per annum) and long-term focus mean there will be short time periods where the portfolio underperforms a sharply rising equity market index. As a multi-asset class portfolio, FIT has had an average equity exposure of approximately 60% over its history. Importantly, this allocation is flexible and has been as low as 40% and as high as 85%. The flexible asset allocation approach has been crucial to FIT's ability to meet its absolute return objective over time. Also, when equity markets are led higher by low quality, cyclical (and riskier) shares, our focus on quality companies can lead to short-term periods of underperformance (relative to index). On these occasions, our unapologetic obsession with capital preservation means that we stay firmly rooted in the quality camp. It is also during these occasions that we typically accumulate positions in our highest conviction, best quality, long-term investment ideas.

In the long-term, this investment philosophy will continue to handsomely reward investors.

REQUIEM FOR A DREAM

THE REDEMPTION OF THE *FOORD COMPASS DEBENTURES*

> **FOR MANY, THE FOORD COMPASS DEBENTURES WERE THAT DREAM INVESTMENT**

Foord Compass Variable Rate Debentures were redeemed in full on 31 March 2014. They were subsequently delisted from the exchange operated by the JSE Limited. Foord Compass Chairman DARRON WEST gives an explanation for its demise and pays tribute to the fund's outstanding performance record.

Since inception just over 12 years ago, the Foord Compass debentures provided investors with an annualised total return of 18.5%, of which 12.8% was paid as income. Incredibly, the annualised total return exceeded the exacting long-term benchmark of inflation plus 10% by almost 3% per annum. What makes these returns all the more extraordinary is that they were generated during a period blighted by some of the most challenging years in the South African (and, indeed, global) investment markets.

Over the same period, even the FTSE/JSE All Share Index could not match the performance of the Foord Compass debentures. South African equities enjoyed an annualised total return of only 16.6%, which included a dividend yield of approximately 3% per annum.

The hallmarks of an investment in the Foord Compass debentures were twofold. First, an investor was reasonably assured of a relatively stable and still appreciable income stream (made all the more significant in a period of very low interest rates across the globe). Second, the Foord Compass debenture demonstrated the benefits of a largely unconstrained investment mandate given to a skilled manager.

The income yield on the debenture's net attributable asset value (NAAV) (which of itself increased over time) was never less than 10%, and at times exceeded 16%. Indeed, the debenture trust deed provided that 90% of all realised trading profits and investment income had to be paid to debenture holders. Combined with the obvious need to make the quantum of this payment substantial, the fulfillment of this requirement meant that the fund manager had to be all the more attentive to the portfolio. As such, and as is common to the management of all portfolios by Foord Asset Management, the risk of loss was monitored assiduously.

Except for the need to provide a meaningful income stream (which was never an objective to be taken lightly), the investment mandate underpinning the Foord Compass debentures was unconstrained as to asset class, geography or any other attribute. It truly represented the investment manager's very best investment view. It also meant that there was so much more for which the company and the investment manager could be held to account. Shortcomings in performance could never be blamed on a mandate, or constraints, or a benchmark. However, Foord Compass's track record vindicated the notion that a skilled fund manager can indeed do better for investors when unshackled.

That the debenture was listed not only afforded investors the discretion to add to or realise their investment, but also forced a high degree of transparency and the associated and imperative governance structures and protocols, giving even greater assurance for investors. With the bright lights of a public listing always on, there was no scope for the fund manager to simply close the fund or defer income payments during periods of market difficulty.

In many respects, the Foord Compass debenture was the perfect investment. However, and most regretfully, references to it are in the past tense. On 31 March 2014, all of the debentures were redeemed for cash, and the proceeds paid to a saddened corps of debenture holders. The decision to redeem the debentures followed amendments to the Income Tax Act which would have had the effect of taxing in the hands of Foord Compass the amounts of interest paid to debenture holders. Furthermore, these amendments also would have forced dividends tax to be withheld from the income distributions to debenture holders. The nub of this would have been that debenture returns would have been reduced by as much as almost 39%.

Before the amendments, Foord Compass was allowed a tax deduction for the debenture income payments, so enabling the return to be passed to debenture holders before taxation. The debenture holders would have paid (and, indeed, did pay) the tax themselves. Certainly, tax-exempt investors such as retirement funds had a particular appreciation for the receipt of regular, significant and untaxed income stream.

However, the National Treasury and the South African Revenue Service have sought to put a stop to all similar structures. In doing so, the authorities have deprived investors of a very meaningful means of building long-term savings. One wonders whether this is an instance of cutting off one's nose to spite one's face.

In the confusing plethora that is the investment landscape, a truly excellent opportunity is a rare ideal so difficult to find, and even more difficult to sustain. For many, the Foord Compass debentures were that dream investment, both discovered and enduring. But instead of lauding the proven exemplary long-term performance of an investment, we find ourselves eulogising it, which makes the pity so much greater.

THE NATIONAL BUDGET
HOW IT AFFECTS YOUR SAVINGS

Minister Pravin Gordhan's budget speech on 26 February 2014 was roundly regarded as necessarily conservative. The Minister tabled some proposals relating particularly to saving for retirement to encourage citizens to save sufficiently and so lower the risk of burdening the state. PAUL CLUER takes a closer look at the Miniser's proposals.

The first proposal is to increase the amount of the tax free lump sum paid out of retirement funds. Upon retirement, retirement fund members typically face the option of withdrawing a lump sum from their accumulated savings, and the balance is usually annuitised to provide an income during retirement. The amount of the tax-free portion of the lump sum was increased from R315 000 to R500 000. Although this seems an appreciable increase, these levels have not been subject to frequent adjustment, so much of the proposed increase serves to account for the effects of inflation. That said, investors at or close to retirement might be prompted to reassess the tax effects of their actions (or intended actions) at retirement so as to ensure optimal benefit.

The minister also noted that agreement had been reached with the Association of Savings and Investment of South Africa (ASISA) on the future means of reducing the level of charges for retirement products. Foord has long bemoaned the high costs of these products, and so the initiative is welcomed. However, sight should not be lost of the tax effects of such retirement savings products over the long term: Foord has previously analysed and criticised the taxation of annuities arising from such retirement funds, and how these might reduce the ultimate benefit to investors relative to after-tax discretionary savings.

The other proposal of interest to investors is the broadening of the tax-efficient means to save. Historically, savings that have attracted any kind of tax advantage have been limited to contributions to pension, provident and retirement annuity funds. Investments into other, often discretionary, products have been made on an after-tax basis. However, the Minister proposed that "legislation to allow for tax-exempt savings accounts will proceed this year, to encourage household savings." Although the minister offered no further clarification in his speech, the People's Guide to the Budget notes that the proposed tax exemption will extend to the interest, dividends and capital gains arising from tax-preferred savings accounts", but only to the extent of R30 000 of investment per individual per annum. The details of tax-preferred savings accounts will be provided over the course of the next twelve months, but they are likely to include "investments in bank deposits, collective investment schemes [unit trusts], exchange traded funds and retail savings bonds" offered by "banks, asset managers, life insurers and brokers". Amongst Foord investors, it is trite that the minimisation of costs and taxes is a sure way of increasing one's returns. To the extent that the proposed tax-exempt savings accounts offer even a small basis for reducing tax friction, investors might be well advised to consider making use of them when further clarity is provided by the authorities.

The Minister also made reference to the pending introduction by Treasury of a "new top-up retail savings bond" this year. As with any other form of investment, investors would be well advised to seek counsel on the appropriateness of this form of investment in their aggregate portfolios.

The nub of the budget proposals is that efforts are being made to encourage and incentivise citizens to save. While the government's focus remains firmly on offering maximum benefit to middle and low-income earners, all investors should be mindful of how the relevant budget proposals might affect them positively.

FOORD IN BRIEF

WELCOME
ADELE JANKOWITZ

Adele joins Foord's business development team as regional head of retail business in Gauteng. She has enjoyed a long and successful career in retail investments having spent the last ten and half years at Allan Gray in Johannesburg and four years prior to that with Investec Asset Management in Cape Town.

Today, as a Foord business development team member, she will continue to build relationships and share our investment philosophy, approach and formidable long-term track record within the financial advisor market.

> "I am honoured to have been given the opportunity to be part of this respected asset manager and wonderful success story."

ADELE JANKOWITZ

REGIONAL HEAD:
RETAIL INVESTMENTS (GAUTENG)

CHANGE OF MINUMUM LUMP SUMS

During the quarter, Foord Unit Trusts increased the minimum lump sum amount for first-time investors from R20 000 to R50 000. We believe that this higher minimum should remain accessible to most investors. The minimum top-up amount of R1 000 for existing investors has not changed.

An alternative to making a lump sum deposit is to invest by recurring debit order. The strategy of investing at regular, discrete intervals is known as rand cost averaging. It is widely endorsed because it lowers the risk of investing an entire lump sum at market peaks and suffering loss. The minimum recurring debit order amount remains R1 000 per month.

MARKETS IN A NUTSHELL

INTERNATIONAL

EQUITIES

Global equity markets (+0.6%) were little changed – developed markets (+1.4%) continued to outperform emerging markets (-0.4%) despite shifting sentiment late in the quarter

BONDS

The US 10-year yield initially declined on safe haven buying – but latterly drifted higher after Janet Yellen indicated that US interest rates could rise sooner than previously anticipated

CURRENCIES

Fragile emerging market currencies fell sharply in January as the Fed's "tapering" continued – but rebounded after reaching oversold levels

SOUTH AFRICA

EQUITIES

The JSE rose 4.3% to reach a record high on 28 March 2014 – led by resource (+10.6%) and financial shares (+6.1%) while industrial counters (+0.8%) lagged

BONDS

SA bonds (+0.9%) underperformed both equities and cash (+1.3%) over the quarter – with foreign selling of SA bonds amounting to R6.3-bn over this period

CURRENCIES

The rand's slide stabilised – the currency only declined 0.4% against the dollar on tighter monetary bias, February's unexpected trade surplus and net repatriation of foreign currency

COMMODITIES

Commodity prices were mixed with crude oil prices (Brent) falling despite tensions in Crimea while the gold price rose on emerging market demand following currency volatility – the iron ore and copper price declined sharply on indications of further slowing of the Chinese economy

ECONOMY

Fourth quarter US GDP growth was reported at 2.6% (annualised) following 4.1% third quarter growth, while the unemployment rate declined to a 5-year low – the Chinese reported a surprisingly high 7.7% GDP growth in Q4 2013 despite serious headwinds

The trade balance unexpectedly swung into surplus in February due to seasonal factors and reduced imports – but prolonged strikes in the platinum industry should be negative for the current account

MONETARY AND FISCAL POLICY

Central banks in embattled emerging markets including Brazil, Turkey, India and Russia abruptly hiked rates – in a bid to stop capital haemorrhaging as investors fled to safe haven markets

SARB hiked rates by 0.5% in the quarter but left interest rates unchanged at its March meeting – but implied continued modest tightening bias with inflation risks to the upside

OBJECTIVE | **INVESTMENT RETURNS**

FOORD CONSERVATIVE FUND

Inception date: 1 January 2014

The fund seeks 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 limits set for retirement funds in South Africa (Regulation 28 to the Pension Funds Act). The fund is appropriate for conservative investors who are close to, or typically in, retirement and whose time horizon does not exceed three to five years.

Regulation prohibits performance reporting for periods less than one year.

FOORD BALANCED FUND

Inception date: 1 September 2002

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. The fund is suitable for pension funds, pension fund members and holders of contractual savings products.

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**17.6**	18.0	17.6	1.8
Benchmark	**15.1**	14.5	16.9	2.7

Benchmark: The market value weighted average total return of the South African Multi Asset High Equity unit trust sector, excluding Foord Balanced Fund.

FOORD FLEXIBLE FUND

Inception date: 1 April 2008

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.

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**15.7**	25.2	24.2	1.4
Benchmark	**11.5**	11.1	11.1	2.6

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 EQUITY FUND

Inception date: 1 September 2002

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.

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**21.5**	23.1	26.7	4.0
Benchmark	**18.2**	17.6	23.6	4.3

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

FOORD INTERNATIONAL FEEDER FUND

Inception date: 1 March 2006

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 Fund, 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.

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**12.6**	23.0	22.9	-0.4
Benchmark	**17.6**	27.4	25.8	2.0

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

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.