FOREWORD

ISSUE 27
3rd QUARTER 2013

DID YOU KNOW? COAL LIQUEFACTION

Coal liquefaction is the generic name for the family of processes used to convert coal to liquid fuel (CTL). The CTL process thus allows coal to be used as an alternative to oil. Coal liquefaction is therefore ideal for countries that are heavily reliant on oil imports but which have large domestic coal reserves.

Coal is affordable and available worldwide via a well-supplied international market. Coal-derived fuels are sulphur-free, low in particulates, and low in nitrogen oxides, which means they are preferred to most oil-based equivalents. Coal liquids can therefore be used for transport, cooking, stationary power generation, and in the chemicals industry.

IN THIS ISSUE

UNDERSTANDING DISTRIBUTIONS

All South African unit trusts distribute their income at least once per year. Foord's unit trusts distribute biannually at the end of August and February. Investors should therefore have received their distribution statements during the quarter. DIANE BEHR explains the reasons for distributions and looks at the potential changes in store.

In terms of South African income tax legislation, collective investment schemes (unit trusts) must distribute their income to investors at least annually to avoid the unit trusts themselves being taxed. As a result of the distribution, income is not taxed in the trust but is rather taxed in the hands of the unit trust investors at their respective marginal tax rates. As the tax rate for trusts (including unit trusts) is 40%, the maximum sliding scale rate applicable to individual investors, a distribution of income is always more tax efficient than paying income tax in the unit trust fund.

The amount of the distribution varies from fund to fund, period to period and year to year. It depends on the level of interest and dividends earned in each fund over the six-month period and the level of expenses incurred by the fund. All things being equal, funds with higher income and lower expenses have greater distributions. Funds that invest in interest securities generally have higher distributions than those that invest in equity securities, as dividend yields are generally lower than taxable interest yields. Distributions are also typically higher during economic cycles when interest rates are high.

Investors in the Foord International Feeder Fund and the Foord Flexible Fund of Funds may have noticed that these funds did not make any distributions for the six months ended 31 August 2013. The reason for the nil distribution was that the expenses in these portfolios exceeded the income available for distribution (interest and dividends). Both these portfolios are heavily invested in Foord's international unit trusts: the Foord International Feeder Fund exclusively so, while the Foord Flexible Fund of Funds had approximately 60% invested offshore at the distribution date. These international unit trusts are structured as roll-up funds, meaning that they do not make any income distributions (the income portion of the total return is "rolled up" into the unit price). These international funds are not separately taxable in their home jurisdictions and accordingly retaining the income in these funds is the most tax efficient result for investors.

The implication for the South African portfolios of investing in the international roll-up funds is that the local funds receive the benefit of this income as a market value gain, and not as income that must be distributed. As a result, their income yield is lower than might otherwise be the case. After deducting expenses that can be elevated as a result of performance fees, the distribution can be zero. This does not mean value has been lost. Rather, the income element is built into the unit price, which investors enjoy as a market value gain. Tax on these gains is deferred until investors dispose of their units, in which case a potential taxable capital gain may arise. All things being equal, a low to zero income distribution is most tax efficient.

The 2013 Taxation Laws Amendment Bill has been issued for public comment by National Treasury. Amongst other matters, the bill proposes changes to the Income Tax Act to accommodate hedge fund strategies within the collective investment scheme framework. The proposals include amendments to ensure a complete exemption from tax (income tax and capital gains tax) at the unit trust level. The implication is that South African unit trusts could, in the near future, be structured as roll-up funds without any tax penalties. The proposals, if enacted, would entrench unit trusts as the premier discretionary savings vehicle in South Africa, combining maximum flexibility, transparency and tax efficiency. Roll-up funds making nil distributions would become the de facto norm in South Africa.

SASOL SOUTH AFRICA'S ENERGY GIANT

Sasol is South Africa's largest integrated energy, petrochemicals and chemicals company. The share has had a material weight in Foord's portfolios over the past decade as a result of its unique investment qualities. MIKE TOWNSHEND takes a closer look at this JSE-listed giant.

South Africa does not have any significant oil reserves of its own. As a result, the country's single largest import item is oil and related products. This heavy dependence on oil imports has a major impact on South Africa's balance of payments. Sasol was established in 1950 as a strategic asset to reduce South Africa's dependence on oil imports by investing in fuel liquefaction technology (see *Did You Know?*). The company was privatised and listed on the JSE in 1979.

Sasol commenced producing coal-derived fuels in 1955 and operates the world's only commercial coal liquefaction industry. Roughly 20% of all fuel sold in South Africa, and more than 50% of that sold in the inland regions, is converted from coal using Sasol's proprietary coal-to-liquids (CTL) technology. The other 80% of fuel retailed in the country is either imported as a finished product or refined from crude oil imported by one of the other five refineries.

From an investment perspective, Sasol is a highly cash generative and profitable business. The company has experienced operating profit margins averaging over 20% for the last decade. The high return on capital coupled with a business model protected by the company's proprietary technology and significant barriers to entry have made the company an attractive investment proposition.

Sasol's management is now embarking on an international expansion strategy to capitalise on the company's unique expertise in converting coal and gas into a range of petrochemical products. Two large projects in particular should provide significant new earnings growth opportunities. The projects, to be constructed in Lake Charles, in Louisiana in the USA, are expected to result in a massive capital expenditure outlay of approximately $20 billion (see Graph 1 depicting Sasol's rising capital maintenance and expansion programme).

To put this capital budget into perspective, it's useful noting that Sasol's current market capitalisation amounts to approximately $30 billion. If these projects are not ultimately approved, Sasol is expected to distribute much of the company's expected cash stockpile as a dividend to shareholders.

> **SASOL IS A HIGHLY CASH GENERATIVE AND PROFITABLE BUSINESS.**

The domestic fuel price is based primarily on a global dollar denominated oil price that is then converted into rands. This means Sasol benefits directly from a weaker rand; for every 1% weakening of the rand, Sasol's earnings improve by approximately 2%. This attractive rand hedge quality is an important investment consideration when building a diversified and balanced investment portfolio.

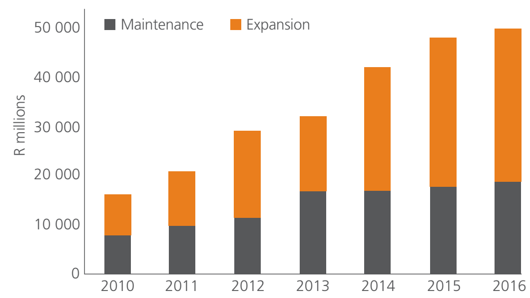
As with most investments, Sasol does not come without risks. Sasol is one of the largest polluters in the country. Investors therefore need to consider the environmental, social and governance (ESG) consequences resulting from owning shares in Sasol. One response would be to simply avoid owning the share, but we feel this is an overly simplistic strategy that does little to influence an acceptable environmental outcome. An alternative strategy is to use shareholder influence to exert pressure on the board and management to exercise better care of the environment when driving Sasol's business strategy. Aside from the ESG factors, the pending introduction of carbon taxes in South Africa could have a material impact on the company's earnings and this should be factored into earnings forecasts and valuations of the share.

Another main risk is Sasol's earnings exposure to volatile commodity prices, notably oil. The oil price has been extremely volatile over the past decade, having scaled prices as high as $145 per barrel in June 2008, then falling to $38 at the height of the financial crisis before recovering to its current price of around $110 per barrel. Graph 2 shows the very close correlation of Sasol's share price to the rand price of Brent Crude oil. While oil price volatility does introduce earnings risk to Sasol, it also provides South African investors with a unique opportunity to invest in a quality company that provides a hedge to the oil price and thus, indirectly, an inflation hedge given the contribution of the fuel price to domestic inflation rates.

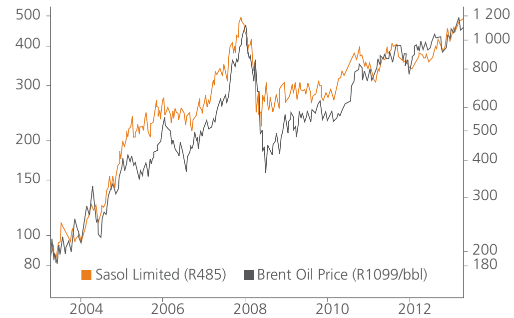
On a 9-times historic price earnings (PE) ratio and a 4% dividend yield, the current valuation of the share is undemanding. As shown in Graph 3, Sasol's PE ratio relative to that of the FTSE/JSE All Share Index is currently close to 30-year lows, meaning that the share is very attractive relative to the market as a whole.

In summary, what does Sasol provide as an investment case to Foord clients? Firstly, it is a quality company with an attractive, defensible business model based on proprietary technology that provides investors with good rand hedge properties. Secondly, it has a sound balance sheet that, together with its strong cash generation, allows the company to fund its major international growth projects. Thirdly, valuations remain undemanding despite the share price having outperformed the market by 20% year-to-date.

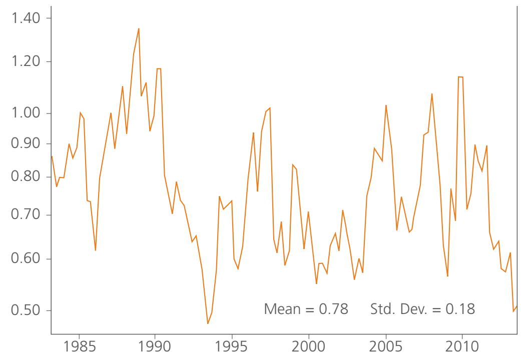
GRAPH 1: Sasol's past and planned capital expenditure



GRAPH 2: Sasol share price compared to the rand price of Brent Crude oil



GRAPH 3: Sasol PE ratio relative to the FTSE/JSE All Share Index PE ratio



UPDATE FOORD GLOBAL EQUITY FUND

Carolyn Levin reported on the establishment of an office in Singapore and the launch of the Foord Global Equity Fund in *Foreword Issue 22* (2[ND] Quarter 2012). PRAKASH DESAI, Chief Operating Officer of Foord Singapore, provides an update on recent developments in Singapore.

The Foord Global Equity Fund was launched on 1 June 2012 under a restricted regulatory approval category in terms of which only accredited and institutional investors could subscribe for units. Singapore regulations prescribe relatively high net asset/personal income thresholds to qualify for investment in this category. Entities such as corporations and trusts (including family trusts) must have net assets exceeding S$10 million (R80 million) while individuals require net personal assets exceeding S$2 million (R16 million) or personal income in the preceding 12 months of not less than S$300,000 (R2.4 million) to qualify.

These thresholds effectively placed the fund out of reach for most of Foord's South African retail investors. Nevertheless, Foord was able to use the fund for its institutional mandates where the inclusion of global equities was both permitted and appropriate in terms of the investment strategy.

In addition, Foord planned the launch of a feeder fund into the new Singapore fund. However, one month after the launch of the Foord Global Equity Fund, South African collective investment scheme regulations were amended, which restricted this outcome. Under the revised regulations, the Singapore fund would be required to have an unrestricted retail status to qualify as the master fund of a South African feeder fund.

Singapore regulations require fund managers to hold a Capital Markets Services (CMS) licence for fund managers to serve all classes of investors, including retail investors.

> **"WE HAVE APPLIED TO HAVE THE FOORD GLOBAL EQUITY FUND REGISTERED FOR DISTRIBUTION IN SOUTH AFRICA."**

The Monetary Authority of Singapore (MAS) that regulates the financial services industry, typically reserves this licence for global companies that have a demonstrable track record of at least five years and assets under management in Singapore exceeding S$1 billion (R8 billion).

Foord Asset Management (Singapore) Pte. Ltd (Foord Singapore) submitted a lengthy and detailed application for a CMS licence. After several months of engagement with the MAS, Foord Singapore was issued its CMS licence in late May 2013. Immediately thereafter, Foord Singapore filed an application to register a prospectus that is appropriate for distribution to retail investors. The prospectus was registered with the MAS on 10 June 2013.

The retail status of the fund means that investors are no longer required to meet the net asset/personal income thresholds set out above. However, Foord Singapore has set the initial investment amount at US$250,000 and subsequent investment amount at US$10,000 per account. These relatively high minimums were set to enable the company to manage the number of individual investments made into the fund.

Foord Unit Trusts has submitted an application for a rand-priced South African feeder fund into the Singapore fund. The minimum investment amount will be set at the much lower threshold that applies to its SA unit trust suite (currently R20,000).

MEET FOORD'S NEW DEPUTY CIO

DARYLL OWEN
DEPUTY CHIEF INVESTMENT OFFICER

Foord Asset Management has made an important addition to its investment team by recruiting Daryll Owen as Deputy Chief Investment Officer. PAUL CLUER explains the rationale for the new position.

The role of the Deputy Chief Investment Officer (Deputy CIO) is a new position and was created with Daryll's appointment. The objective is to add operational capacity to the office of the Chief Investment Officer without affecting the portfolio management arrangements in place for client portfolios or the relationship of the portfolio managers with the CIO.

Daryll's mandate as Deputy CIO will be to assist Dave Foord as CIO with many of the people and process management responsibilities demanded of the CIO. The position of Deputy CIO will bring additional rigour to processes already in place at Foord. Daryll will manage the South African investment research efforts, including responsibility for the SA head of research and the analyst team, as well as supervision of the securities dealing team. He will assist with staff recruitment and evaluations of staff in these roles. Daryll will also be involved in coordinating the investment strategy setting process and will add capacity to the investment research function, client reporting and report-backs and due diligence engagements.

As CIO, Dave Foord will remain responsible for the investment team at Foord Asset Management. The investment research team and securities dealing team will report to the CIO through the Deputy CIO, while the portfolio managers will continue to report directly to Dave Foord.

The support of a dedicated deputy will free Dave from many of the most time-consuming operational and people management aspects of the CIO's responsibilities. This will allow him to spend more time on the management of the local and international portfolios and on the development and training of the non-SA investment team based in Singapore. Given that most of Foord's SA mandates include a material allocation to Foord's foreign portfolios, having a strong team abroad is especially important.

> **"THE POSITION OF DEPUTY CIO WILL BRING ADDITIONAL RIGOUR TO PROCESSES ALREADY IN PLACE AT FOORD."**

Daryll joins Foord from Nedbank Private Wealth (previously called BoE Private Clients) where he was Chief Investment Officer since 2001, having joined that firm in 1996. He has 27 years' experience in portfolio and private client management. Daryll's long experience in the markets and intimate knowledge of the role of the CIO puts him in good stead to add immediate value to the team and to Foord's client base.

MARKETS IN A NUTSHELL

INTERNATIONAL

EQUITIES

Global equity markets performed well over the quarter with developed markets (+8.3%) outperforming emerging markets (+5.9%) as measured in dollars – the NASDAQ put on an extraordinary 10.8% while the S&P ended the quarter up 4.7%

BONDS

The US 10-year benchmark yield almost breached 3% as investors anticipated a scaling-back of the Fed's stimulus programme – but soon retreated after the Fed decided against tapering

CURRENCIES

The US dollar weakened on a trade weighted basis as a result of budget uncertainty and a stronger Euro – which responded to partial stabilisation of Eurozone economies and the "no taper" announcement

COMMODITIES

Commodity prices were generally firmer with base metals in particular responding to stronger macro indicators from China – while the easing of tensions built around the Syrian conflict saw crude oil prices rebound 6.9% over the quarter

ECONOMY

US GDP growth picked up to 2.5% as the unemployment rate fell to 7.3% – Chinese GDP growth slowed to 7.5% from 7.7% previously, but the Chinese government committed to a minimum 7% growth target

MONETARY AND FISCAL POLICY

The US Federal Reserve defied consensus expectations to taper its monthly stimulus programme – citing the weak growth environment and focus on employment as the key policy measure

SOUTH AFRICA

EQUITIES

The FTSE/JSE All Share Index gained 11.2% in rand terms with the JSE near its all-time high at the end of the quarter – driven by a strong rebound in resource shares (+19.7%) while industrials (+11.3%) and financials (+6.9%) also gained

BONDS

SA government bond yields initially rose and then declined on significant foreign buying (R19.6bn) – with the net result that the All Bond Index ended the quarter up by 1.9%

CURRENCIES

The rand depreciated by 1.6% against the US dollar on continued weak fundamentals – compounding the 6% decline in the second quarter and taking the year-to-date decline to 16.2% against the US dollar

ECONOMY

The current account deficit widened to 6.5% of GDP in the second quarter from 5.8% the previous quarter – with insufficient foreign portfolio inflows, this resulted in a net loss of foreign exchange reserves

MONETARY AND FISCAL POLICY

The MPC kept rates on hold at 5% despite an increase in inflation to 6.4% in August – the Reserve Bank now expects inflation to average 5.8% in 2014 (up from 5.5%)

FOORD FLEXIBLE FUND OF FUNDS

INVESTMENT RETURNS

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**15.5**	25.0	33.4	8.2
Benchmark	**11.6**	10.7	11.5	2.4

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 and who require long-term inflation beating total returns.

FOORD INTERNATIONAL FEEDER FUND

INVESTMENT RETURNS

	Since Inception %	3 Years %	1 Year %	3 Months %
Foord*	**12.6**	21.8	36.0	7.2
Benchmark	**12.0**	27.0	46.6	8.7

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*	**17.8**	17.9	23.8	7.7
Benchmark	**15.1**	13.9	21.5	7.5

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*	**21.5**	22.6	31.3	12.0
Benchmark	**18.1**	17.8	27.0	12.5

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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