



### Editorial comment

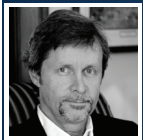
Mike Borland, director, FIRSTGLOBAL GROUP

This year we celebrate the 10th Anniversary of the Firstglobal Group and my, what a dynamic time it has been!! The financial world continues to provide a bumpy ride, and politics has become a major determining factor in what unfolds in the Euro-area over the coming months and weeks.

But there is always positive news and pockets of exceptional performance in our diverse world - Goldman Sachs says that South Korea, Mexico, Indonesia and Turkey are growing faster than any others in the Emerging Markets' space and that these,

along with Brazil, Russia, India and China will be among the 10 biggest contributors to global growth over the next decade.

In this celebratory issue of Global Brief, John Swart takes us back through 30 years of progress in the investment arena and revisits the "Firstglobal story", and Investec's Rene Grobler provides great perspective to what investors are faced with and what we need to consider during these times of challenge and opportunity.



### The changing landscape of the Investment industry in South Africa

By Dr John Swart, director, FIRSTGLOBAL GROUP

This year, the FIRSTGLOBAL Group celebrates its 10th birthday. This event presents an ideal opportunity to reflect how much, and in some instances how radically, the industry has changed.

#### • Brief historical overview

Prior to the mid nineties, investment options for private individuals and families were in the main, limited broadly to four categories:

Firstly, banks dominated this space with their array of investment products including savings accounts and fixed deposits.

Secondly, fixed interest instruments such as term deposits and Government bonds ("gilts") were bought in addition to bank products as a simple, safe and predictable investment. The Post Office and Building Societies such as UNITED, ALLIED, NBS, SA PERM and SAAMBOU were all household names.

Thirdly, investing directly in the stock exchange, for the more sophisticated investor or unsophisticated "hobby" investor, was always available through stockbrokers albeit in a market far less sophisticated than it is today and selecting from shares far fewer than available today.

Lastly, Life Assurance companies offered long term investment products such as retirement annuities and endowment policies where the minimum term was 10 years. The minimum term for endowment policies was only reduced to 5 years in 1993 after the abolishment of the 6th schedule of the Income Tax Act. These were aggressively sold (to a large extent by tied insurance sales agents) and the options offered by different

companies varied very little between instruments, investment processes and costs. Investment portfolios within endowment policies were, generally speaking, mainly invested in shares, bonds and cash with limited transparency and very high costs. Life assurance policies and retirement annuities were also the first investment products that offered monthly debit order facilities.

Gradually we saw the emergence of collective equity investments or Unit Trusts as they are known today. The first official fund in SA was the SAGE fund which began trading in June 1965. Due to the lack of proper accounting systems, slow marketing and adverse markets, this investment vehicle never really gained momentum until the late eighties and early nineties. By 1993, there were 7 registered funds and these hardly represented any market share of private investor monies. Then a number of events took place that revolutionized the way people invested.

The 6th Schedule of the Income Tax Act was abolished in 1993 which, amongst other things, broke the dominance that Life Assurance companies enjoyed in managing personal investments.

Private banks aggressively entered the arena as contenders in the management of private client funds around the mid nineties. These banks, and in particular Syfrets (later bought by BOE Bank, later bought by Nedcor), UAL (later bought by Nedcor), Investec and RMB Bank competed in taking market share away from Life assurance companies. Apart from specialized securities portfolio management services to the high end of the market, they then embarked on creating structured products which combined the use of conventional

investment instruments with derivatives and in some cases, capital guarantees for the general private client investment market. They were also amongst the first institutions to establish dedicated unit trust management companies and/or divisions. Around 1994, the first Linked Investment Services Provider ("LISP") entered the market, then known as TMA which was later taken over by Investec. The LISP functionality was arguably the single biggest turning point in the way private investors could invest and gave rise to a surge in the Unit trust industry and growth of new funds – simply because they could be combined in a number of ways on a single platform account and marketed through more efficient portals.

In South Africa, the unit trust industry has exploded from the 7 in 1993 to 947 funds at the end of 2011 with a combined value of just over one Trillion rand under management. Growth in collective investments has been a global phenomenon and logically for the following reasons: The pooling of resources and skills, technological advancements, cost effectiveness, flexibility, liquidity, daily pricing and transparency of underlying securities.

In 1997, we saw the first relaxation in Exchange control and private individuals were officially allowed to invest up to R200 000 (legally) outside of South Africa. While this was a small token and first gesture towards broadening SA investor horizons, the biggest impact was adding a world of other investment opportunities to those of the South African investor. By the turn of the century, there were over 30 000 investment funds globally accessible by South Africans – not to mention the vast array of banking and stock market instruments!

#### • Professionalisation of the Financial Services Industry

The financial planning arena was, up until the late eighties and nineties, largely serviced by sales agents where sales were largely product and volume driven rather than advice and solution driven by professionally trained and qualified advisers. Training and qualifications were, until the early eighties, "in-house" within Banks and Life Offices as there were no recognized formal programmes and qualifications open to the industry.

Recognising the need to improve the levels of professionalism, the Financial Planning Institute of Southern Africa (FPI) as it is now known, was formed in 1981 as a non profit professional body to improve levels of professionalism.

Today the FPI and a number of Universities and other reputable educational Institutions run diploma, degree and post graduate courses which have together contributed hugely towards the development of our industry as a vitally important and highly professionalized one.

#### • Regulation of the Financial Services Industry

In 2002, the Financial Advisory and Intermediary Services Bill (FAIS) was promulgated. Due to a number of failed investment schemes that South Africans have sadly become overexposed to, coupled with low levels of expertise and education (with some practitioners), and unprofessional and unethical behavior, Government was prompted to establish a more regularized environment.

FAIS has been phased into this industry and this process is still in progress whereby, amongst other things, all Financial Services

Providers, from all sectors of financial services, have to apply for a license to trade in their particular fields of service. Currently, all representatives and practice managers (Key Individuals) are being forced to write certain exams before stipulated due dates in order to retain their licenses.

The South African Financial Services industry was largely modeled on the UK and Australian industries which have gone before us in regularising their industries and like them, it has become clear that this regularisation has resulted in a large percentage of so called Financial Advisors leaving the industry. The South African process is still underway but early indications are that the number of advisors has already shrunk to about 30% of the number prior to 2002.

Whilst FAIS has posed a number of challenges and increased the cost and time commitment required to manage a professional practice, there have been some very positive outcomes for both consumers and practitioners in the financial services arena.

#### • The FIRSTGLOBAL story

The idea of a national network of investment advisors, was conceived on a farm in the Limpopo on 3 December 2001.

The problem identified was that smaller independent firms lacked the resources and competitive cost structures enjoyed by banks. The solution was simple: Find and convince a number of the top independent professional financial advisor firms in South Africa to combine forces and develop a strategy to build on the collective skills and resources of each other. Creating a national "footprint" was key and hence identifying firms in Pretoria, Johannesburg, Durban and Cape Town was considered sensible. The common denominator required was the focus of each of these firms to deliver financial planning and investment services of the highest quality to high net worth individuals and retain the level of consistency in personal service and long term client relationships that the larger institutions could never offer their clients. We realized that we had to combine the values, skills and experience of selected principals to create an entity that would offer collective intellectual input, enhanced efficiency, better service levels, lower costs and ultimately competitive investment solutions – with the flexibility to tailor to clients' unique objectives and needs – to our collective client base.

The first practices to commit to this venture were, Sirius Capital in Pretoria (now FIRSTGLOBAL Capital), Borland Financial Services in Durban, Finlex in Johannesburg and First Global Investment Managers in Cape Town – from which the FIRSTGLOBAL name was adopted.

And so the FIRSTGLOBAL Group was born in March 2002.

The group expanded shortly afterwards with the inclusion of Harcourt and Martens in Richards Bay, Investhouse in Pretoria and FIRSTGLOBAL Investment Counsel and Bear Vision in Johannesburg.

Over the past ten years, the FIRSTGLOBAL Group has emerged as one of the top five independent investment advice and management firms in South Africa. Member offices (shareholders of the Group) have thrived as a result of the synergies between skills, experience and systems. Individual members can reflect on ten of the best professional years of

their careers, a time over which personal and professional development has taken place and deep friendships have been forged.

A milestone that merits specific mention is the formation of FG Asset Management in 2004. In this group company, FIRSTGLOBAL embarked on the construction of multi-manager portfolio's locally and offshore to harness the skills and years of experience within the group and through outside consultants, to offer a choice of investment fund "building blocks" with specific objectives and applications which in turn enable us to construct customized and optimal investment solutions for our clients.

Today the group manages over R3.5 Billion in these funds alone. Alongside these solutions, the group offers cash management services at competitive institutional rates, private stock

portfolios and access to structured investment products underwritten by a selection of financial institutions in SA and abroad.

In this, the celebratory issue of GLOBAL BRIEF, the members and advisors in FIRSTGLOBAL wish to extend their heartfelt thanks to each and every CLIENT that has been part of our history and helped to make us what we are today.

We are forever mindful of the dynamic and challenging environment in which we live and operate and are committed to ensuring that we are at all times "ahead of the curve" and equipped with the knowledge, products and expertise to serve your best interests in the years that lie ahead. As we enter the next decade, we look forward to working with you and to continuing to add real value to your financial wellbeing.



## Viewpoint: We are Living in Extraordinary times

By René Grobler, Sales Director, Investec Asset Management

*René Grobler, Sales Director and Head of Investec Asset Management's retail division discusses why investors need to consider several factors before investing in today's uncertain world.*

### We are living in extraordinary times

Investors are now used to hearing about the 'new normal' - a world characterised by sluggish growth, increased volatility, low interest rates and sticky inflation. Investing in such an environment has become increasingly difficult and although investors have recognised this change, they have not necessarily altered their investment decisions accordingly.

In the first decade of this century it did not really matter in which asset class in South Africa you invested your money. Most asset classes provided a very good return, while balanced portfolios delivered almost double-digit returns year-in and year-out. As can be seen in figure 1, over an annualised ten year period every single asset class comfortably outperformed inflation, which ultimately remains the most important investment consideration.

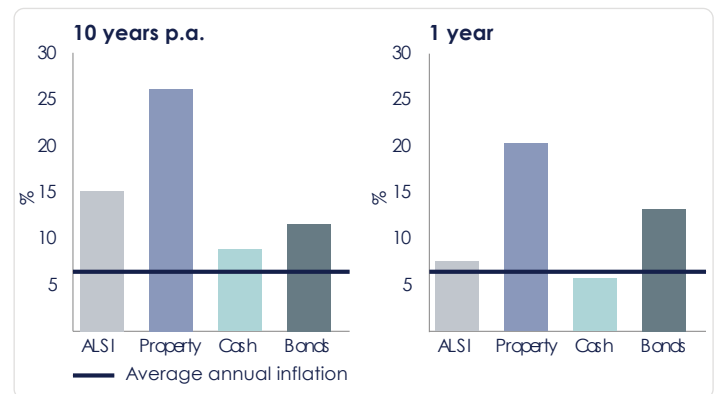
Over the last year the picture changed rather dramatically – all asset classes were down substantially compared to the annualised ten year returns of the previous decade, with only property and bonds meaningfully outperforming inflation. Furthermore, inflation, which had been on a downward trend for years, is also refusing to budge. Unfortunately, this is the shape of things to come. Flexibility and diversification in portfolio construction will become increasingly important to capture opportunities that exist in this new world of investing.

### Factors to consider before investing in today's uncertain world

While you may want your savings to be secure, you also need them to grow so as to at least keep up with inflation. The problem now facing investors is that the less "risky" your investments are, such as money market investments, the less likely you will be to achieve the returns that you require to grow

your investment savings. The challenge is to balance the security of your assets with the required growth.

Figure 1. The world has changed



Source: Morningstar to 31 March 2012. The STeFI Composite represents Cash, ALBI represents Bonds, FTSE/JSE SA Listed Property represents Property, FTSE/JSE ALSI represents Equity.

Although an evaluation of individual circumstances is necessary, we have set out a few key investment themes below that we believe investors should bear in mind when considering their portfolios in this uncertain world. These considerations could affect your decisions and help determine your required investment returns.

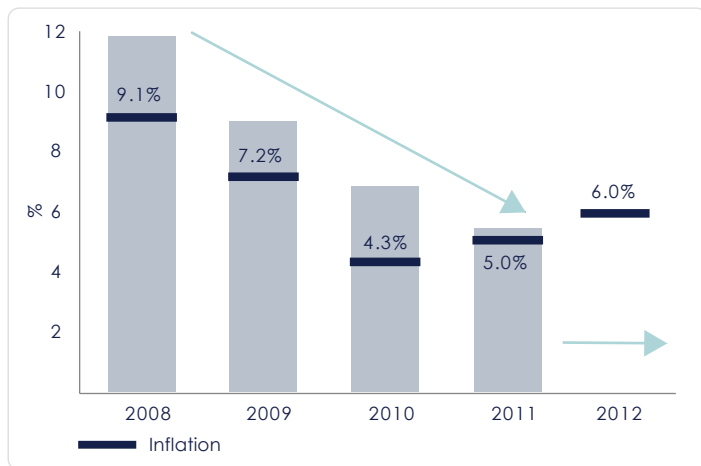
### 1. Time to get real!

In our February 2012 Viewpoint - Broadening the search for income in a low interest rate environment, we discussed the global paradigm shift. Around the world, South Africa included, central bankers are now biased towards stimulating growth and job creation by maintaining historically low interest rates, at the expense of living with higher inflation.

As can be seen in figure 2, money market returns have declined from nearly 12% in 2008 to current levels of around 5.5%.

Inflation is expected to stay near the top end of the inflation band (6%) until at least the end of 2012, meaning 'lazy' money left on call is a sure way to erode hard earned savings.

Figure 2: Average SA money market fund returns



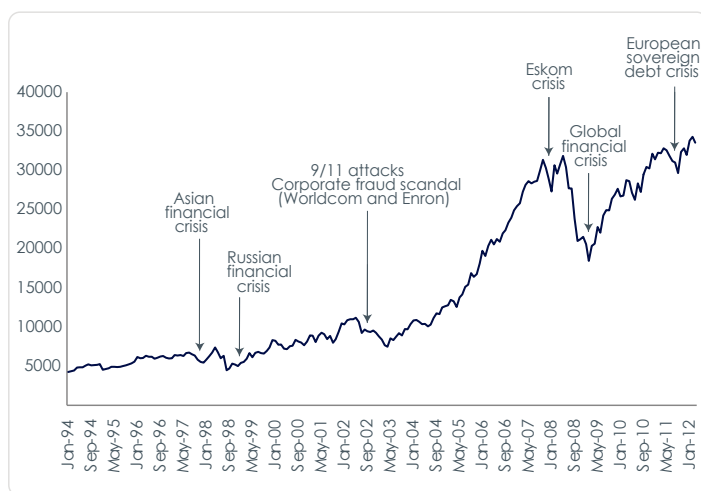
Source: Morningstar, in rands, bid-bid, gross income reinvested to 31 December 2011.

## 2. Expect more market volatility

Legendary investor Benjamin Graham characterised the stock market as a manic-depressive business partner, someone "who lets his enthusiasm or fears run away with him." Over the past few years, the market's wild swings between euphoria and despair have confirmed Graham's statement (see figure 3). Whether or not Europe resolves its banking crisis, the United States its deficits or China its cooling economy, South African investors should be prepared for potentially more volatility and muted returns going forward.

The past few years have provided a good demonstration of the futility of trying to invest based on the headlines. Given the market's increasingly more violent swings and the uncertainty that exists in the market, investors' concerns intensify when watching their portfolio's irrational performance. If there is one thing we should have learned over the past few years is that investing on the basis of speculation or fear is a loser's game, incompatible with building wealth over the long term.

Figure 3. Euphoria and despair in the FTSE/JSE All Share Index



Source: I-Net Bridge. Monthly returns from 1 January 1994 to 31 March 2012.

## 3. Longer life spans and more active retirement lifestyles

Thanks to medical advances and healthier lifestyles, many retirees lead active lives that include travel, second homes and expensive hobbies. The challenge is to save enough money now to enjoy your after-work years to the fullest.

Many financial planners suggest that households should plan to retire on 75% of their income at retirement. New research suggests an entirely different approach. Megan Butler, Research Actuary at Alexander Forbes and lecturer at the University of the Witwatersrand, considered the income and expenditure profiles of almost 3000 South African households and found that contrary to popular belief, South African retirees do not necessarily lead a more frugal lifestyle compared with their younger counterparts.

In South Africa, the amount with which an investor should preferably retire is typically measured by a replacement ratio, which gives the income in the year after retirement as a percentage of the income in the year before retirement. Most prospective retirees use targets of between 70% and 79%. The research found that, for an income replacement ratio target of 79% (gross of tax) only half of couples would find the target sufficient to avoid a consumption drop at retirement. These results have important implications for individuals, retirement funds and financial planners.

### Where to from here?

#### 1. You have to broaden your horizons

Following a decade of double-digit returns and against a backdrop of low growth, low interest rates and rising inflation threatening to erode returns, many investors are struggling to adapt and are questioning where to find real returns.

It is imperative to adopt a wider perspective in this market environment. Not only do you need to diversify more thoroughly; you also require flexibility. To make the most of your investments you will have to balance the risks and make choices that may look uncertain over the short term, but which pay off over the course of your working life.

Over the past decade, the best opportunity for South African investors was to invest in South African equities. Managers now need to work harder to pick quality domestic assets to deliver good returns. A decade ago South African equities were valued at nearly half that of global stocks. Currently, we are trading on similar valuations to the US, German and Japanese markets, where attractive investment opportunities now exist. Looking ahead at global equity markets, equity valuations continue to be very reasonable by historic standards.

#### 2. Time in the market is crucial

During the market volatility of the past few years, many investors saw dramatic falls in their portfolios. No one can predict what the market will do in the future, so don't let short-term volatility drive your long-term investment planning. Investors can act emotionally and as a result may sell out at or near the stock market bottom. Successful market timing during a decline is extremely difficult because it requires two near-perfect actions: getting out and then getting back in, both at the right time.

The opportunity cost can be substantial if you wait until you feel confident in the market. You could miss the best days by staying on the side lines. The main factor working against market timing

is that market gains often come in quick bursts and if you miss enough of them, you could lose all of the long-term advantages of owning shares.

Figure 4 illustrates the opportunity cost facing investors. If you had invested R100 000 over the past 15 years to March 2012 in the South African FTSE/JSE All Share Index, your investment would have grown to R526 836. However, if you had decided to get out of the market during volatile periods in these 15 years and as a result missed the market's best 10 days (that is 10 out of 3765 trading days) your investment would have only grown to only R289 513.

Figure 4. Staying the course



Source: I-Net Bridge. FTSE/JSE All Share daily returns from 1 April 1997 to 31 March 2012 (3765 data points). Initial investment R100 000. Indices are gross of fees.

Table 1. Consistency outperforms over time (%)

	Avg. Money Market Fund	Avg. Bond Fund	Avg. Real Estate Fund	Avg. General Equity Fund	Avg. Foreign Bond Fund	Avg. Foreign Equity Fund	Investec Opportunity Fund
2002	11.2	15.4	16.5	-1.5	-17.2	-38.3	8.8
2003	11.8	16.9	32.5	19.6	-12.9	-2.0	25.8
2004	7.7	14.1	34.2	38.9	-7.1	-2.2	36.1
2005	6.9	10.4	42.5	37.9	5.6	23.3	29.6
2006	7.3	5.5	25.8	37.1	16.5	31.0	26.3
2007	9.5	4.0	21.4	17.2	5.6	6.2	14.5
2008	11.9	16.1	-4.5	-23.1	34.8	-23	-5.4
2009	9.1	-0.1	12.5	25.9	-11.2	5.2	20.9
2010	6.9	14.7	24.1	18.1	-6.9	-2.5	11.7
2011	5.5	8.5	7.6	3.2	27.3	11.5	11.4
Return - 10 years p.a.	8.7	10.4	20.5	15.7	2.1	-1.1	17.4
Volatility - 10 years p.a.	0.6	6.1	14.0	14.7	16.1	16.0	9.6

Source: Morningstar to 31 December 2011, based in Rands. Returns are calculated on a bid-to-bid basis, net of fees, with gross income reinvested. All returns are based on the respective average ASISA SA Unit Trust sectors and are net of fees.

#As measured by standard deviation

### 3. Getting your asset mix correct will be crucial

Investors often tend to invest in the best performing asset class, fund, strategy or manager based on recent outperformance. Chasing outperformance can lead to poor investment decisions, especially in volatile markets.

- **Past performance is not an indicator of future performance.**

Table 1 illustrates the annual average return of the best and worst performing unit trust sectors in each of the asset classes over the last 10 years. As can be seen, not one asset class has consistently outperformed every year and most asset classes have at some point been the worst performing asset class in a year. By chopping and changing investments, investors often manage to buy at the high and sell at the low – a fatal error that can erode valuable savings.

As can be seen from table 1, international equity has been the worst performing asset class over the last 10 years, but as detailed earlier, many market professionals agree that international equities are looking particularly attractive as company balance sheets are in good shape and valuations are reasonable, given that the economic uncertainties are largely priced in.

- **It's a "risky business"**

Given the uncertain markets, investors need to take cognisance not only of expected returns but equally important, of the risks (for example volatility) associated with the specific investment.

Looking at table 1 below, an investor may infer that property is the consistent outperformer over the last 10 years. However, when looking at the associated risk of the investment, an investor needs to question whether it is appropriate to invest

100% of a portfolio in property. This is especially true considering the structural re-rating this asset class has experienced. Investors and financial advisers alike need to ensure that they allocate to investments that appropriately match their risk and investment return requirements.

#### • Diversify across asset classes

The basics of investing is not just a strategic decision on where to invest and how to choose the best funds but more importantly, one of asset allocation. Given the market volatility and current challenging environment, analysing and determining which asset classes to invest in becomes increasingly more difficult for an investor.

Over the last few years the increasing trend has been to outsource the asset allocation decisions to professional managers instead of an individual investor trying to get the correct allocation across asset classes. During this time, asset allocation funds have taken 66% of the South African unit trust industry net flows (ASISA statistics to 31 December 2011). Last year saw the largest net flows into asset allocation funds (R29.4bn) that the industry has experienced in the last ten years.

While asset allocation funds seem to be the answer, investors need to be aware that there are different investment philosophies when managing multi-asset funds, as well as different risk profiles associated with these strategies.

The South African unit trust universe has a variety of asset allocation funds from which to choose, including low, medium, variable, high and flexible equity funds. The funds in the different sectors vary in the amount of equity that they are permitted to hold and hence their risk profiles differ. Funds in the

low equity sector can allocate up to a maximum of 40% in equities and offer conservative investors limited exposure to equity markets, while still offering growth opportunities as well as capital preservation.

**Editors Note:** The FGAM Venus Cautious Fund of Funds falls into this category. Marginally further up the risk curve is the FGAM Saturn Flexible Fund of Fund in the Prudential Medium Equity sector, that can invest up to 75% in equities. The more equity a fund holds, the higher the associated risk.

#### Investing in today's uncertain world

Being able to pick and choose the correct asset class takes time and research and the cost of getting it wrong is considerable. Although investors could invest directly in the different asset classes, much of the benefit can be derived from allocating between asset classes and consistently evaluating the trade-off between risk (volatility) and return. Referring back to table 1, asset allocation funds, such as the FGAM Saturn Flexible Fund of Funds, might not be the star performer in any given year, however it delivers consistent performance at a moderate level of risk and therefore such a fund is a sensible, consistent investment for the medium to long term.

Investors need to consider investing in a portfolio that takes an active approach to asset allocation. Such a portfolio should seek to balance the opportunity for wealth accumulation against the risk of capital loss in the various asset classes, whilst diversifying risk in a disciplined repeatable manner that allows investors to benefit from the advantage of a multi-asset portfolio.

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