



# GLOBAL BRIEF

Second Quarter 2013



## Editorial Comment

Mike Borland, director, FIRSTGLOBAL GROUP

It has been more than 4 years since the collapse of Lehman Brothers heralding the harshest economic blow the world has experienced in nearly a century.

The world has never been through all the quantitative easing that we're now witnessing and this has clearly had a positive influence in stimulating some life back into the US and Global economy. The suggested tapering off of quantitative easing has had its negative effects on sentiment but Bernanke's assurances that this (tapering) will be highly dependent on growth, jobs, and inflation data behaving.

If the economic indicators remain good (as they have been), then tapering should be seen as a positive and a much needed component of the Global

healing process.

Locally we have seen new market highs followed by some more recent and somewhat harsh volatility, coupled with a sharp decline in the Rand. Those investors who have adhered to the simple and common sense basics of sensible investing will be smiling.

In this edition, we look at the Rand's volatility, consider an interesting look ahead to predicted personal wealth in SA, we share some lessons of time on investing, and finally we quote some sage words of advice from Warren Buffet.

Enjoy the read.

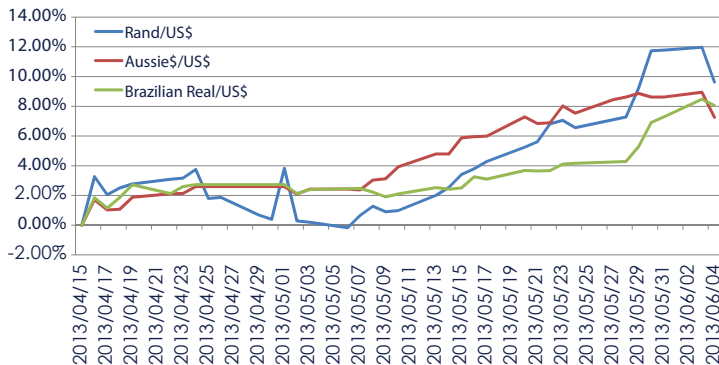


## The Volatile Rand

Philip Lidgey, Chief Investment Officer, Odyssey Capital Managers (Pty) Ltd

The Rand experienced a precipitous decline over the last week with a combination of factors culminating in a steep selloff in emerging market currencies, exacerbated by rising South African-specific risks. The Rand has, historically, been a volatile currency, with the currency depreciating by more than 20% against the US Dollar on at least six occasions during the last 15 years. These large exchange rate movements are in response to interruptions or disruptions in the flow of capital to and from South Africa. The South African currency market regularly transacts over \$15bn worth of rands every trading day, with three quarters of trade being conducted between third parties without a direct connection to South African trade or finance, according to the Reserve Bank. Last week's sell-off, is widely believed it to be in response to rising labour tensions and the lack of substance in comments made by President Zuma in

his media address last Thursday. However, the reality is that emerging markets experienced a strong outflow of funds in May sending a number of emerging and commodity-rich currencies down sharply against the Dollar, albeit not to the same extent as the rand.



The graph above indicates that there was a broad sell-off of commodity currencies in May, exacerbated by a weak first quarter South African GDP figure published on the 28th of May, which correlates with the sharp depreciation in the Rand on that date. The weaker than expected GDP growth figure coupled with emerging/commodity currency disaffection with international investors, culminated to send the currency from R8.60/US\$ on May 28 to an intra-day low of R10.25/US\$ three days later.

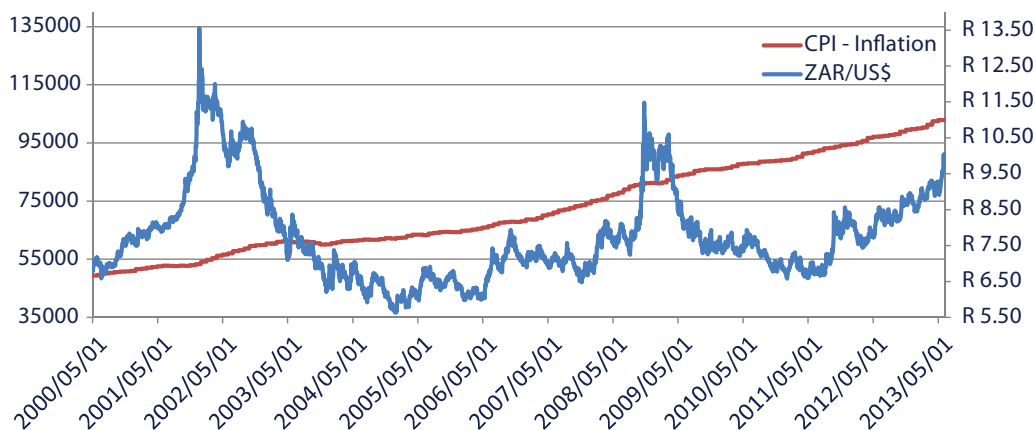
There are a number of factors that have given rise to the sudden fall in emerging and commodity currencies. The most notable reasons for the change in sentiment seems to emanate from slowing growth in China evidenced by the slowdown in GDP growth over the last quarter and a seemingly strengthening US economy. Since China published a weaker than expected GDP figure on the 15th of April (starting point for the graph above), countries that rely on China to drive demand and price growth for commodities have experienced a substantial depreciation of their currencies through the second half of April and particularly in May. The projected slowdown in China coupled with the Australian Reserve Bank cutting rates by 0.25% at the beginning of May, have sent the Aussie Dollar down nearly 9% against the greenback since April 15th.

The causation between rising commodity demand/prices and appreciating commodity currencies boils down to, effectively, a liquidity boost for those countries, resulting in a strong currency, low inflation, strong consumer spending and robust GDP growth.

The onset of the above factors boosts international demand for local investments, thus strengthening the exchange rate further. Australia has benefited immensely from China's infrastructure binge over the last decade resulting in a commodity "supercycle" that led to the above factors, and in particular, a strong appreciation of the Australian Dollar relative to the US Dollar over the period.

Recent Fed meetings have sparked concerns of the Fed tapering-off its asset purchases in the near future in light of a strengthening economy underpinned by improving labour markets, house prices and sentiment in the world's largest economy. The increased potential of this occurring has led to a sizeable rally in the Dollar and a sell-off in the US treasury market over the course of May, sending bond yields to their highest levels in over a year. Stimulative monetary policy in the developed world has depressed bond yields in traditional "safe haven" markets like the US, resulting in investors transferring funds into riskier emerging debt markets in search of higher yields. Thus, rising US Treasury yields could well be signalling the end of the search for yield as the spread between US Treasuries and emerging market debt has narrowed enough for foreign investors to start looking back to the US for guaranteed Dollar-denominated coupons. The last week of May saw emerging market debt funds record their first weekly fund outflow in a year, totaling \$200m or 0.1% of assets under management. Emerging market equity funds experienced their biggest outflow in 18 months during the same week, as \$2.9bn or 0.3% of assets under management were withdrawn.

### Rand/US\$ & Purchasing Power Parity Implied Inflation



The most useful long-term predictor of a currency's fair value is purchasing power parity; which looks at inflation differentials between two countries when determining the direction and approximate level a currency exchange rate should trade at in the long-term. Therefore, if one currency has inflation of 5% and another has inflation of 10%, it amounts to a 5% inflation differential and one would expect 5% annual depreciation in the currency of the latter. The

aspect of the model that keeps the majority of economists in the dark about the level of a currency at a certain date is that the correction to that level and the timing are never known for certain. In South Africa's case, the inflation differential with the US has averaged around 3.5%. If purchasing power parity is used on the Rand/US\$ exchange rate of R7/US\$ in May 2000, it indicates that fair value for the rand today is around R10.80/US\$.

Foreign investors' search for yield coupled with robust commodity demand over the last five years has largely allowed the SA economy to paint over the country-specific cracks that have formed. Large financial account inflows over the last 5 years have funded the country's widening current account deficit, which has increased dramatically over the last year. However, as foreign investors pull their money out of emerging markets, they do so in order of risk. Thus, with South African-specific risk factors such as high unemployment, rising government debt, high inflation, a rising budget and trade deficit as well as a heightened potential labour unrest over the rest of 2013, foreign investors are more likely to pull their money out of South African assets at a higher pace than other "less risky" emerging markets, such as

Brazil. This has led to the Rand declining faster over May compared to the Aussie Dollar and Brazilian Real as well as a number of smaller emerging markets. The factors discussed above explain a large part of the rand's depreciation over the last two months; however, South African-specific risks have compounded the situation and led to a sell-off in excess of its peers. In the short-term, we expect the volatility in the exchange rate to continue in light of stagnant/falling commodity prices emanating from China attempting to remodel its economy into a local consumer-driven market from one reliant on big government infrastructure projects, an improving US economy resulting in rising US treasury yields, rising South African inflation and potentially tumultuous upcoming wage negotiations in the mining sector.

## South African household wealth to rocket by 2020

Glacier by Sanlam

*Editorial Comment: This article was placed in a circular sent out by Glacier for readers' interest and is not intended to reflect Sanlam or Glacier's views.*

**Gross household wealth, including non-profit institutions serving households (NPISH), among South Africans is set for a steady rise and is expected to almost triple to R20 trillion, new research reveals. As of 2012, gross household wealth in South Africa stood at R7.8 trillion, while an average household's wealth was R670 000.**

But according to projections by CoreData Research, based on data from the South African Reserve Bank on gross household wealth and gross household debt, an average household's wealth is estimated to increase to R1 080 000 by 2020.

Saving among South African households has been on a slow upward trend from a difficult financial period during which most households were spending beyond their means. However, the savings landscape of South African households is looking considerably different for 2015 and 2020. Income levels are on the rise, according to CoreData's calculations and by 2020, an average salary is expected to more than double to R1 683 300 from R72 000 in 2011.

In the next eight years, people will be moving into higher bands of wealth, creating a pool of disposable income that can be saved or invested; meanwhile saving will also become more feasible for those who haven't been able to put money aside in the past. The level of wealth among South Africans aged 31-45 (accumulators) and 46-60 (pre-retirees)

in particular is set to increase dramatically by 2015 and by 2020 and the appetite for short and long-term savings products, securities investments and mortgages will grow as a result.

- CoreData forecasts an average growth of 12.5 per cent in household wealth over the next eight years. By 2020, more people will have some level of disposable income to save or invest.
- In 2011, individuals between the ages of 31-45 (accumulators) gathered a pot of savings that includes pension, stokvels and insurance contributions worth R385 billion.
- Total accumulated savings by South African pre-retirees alone was R720 billion in 2011. By 2020, this pot of wealth will grow to R1.5 trillion. While people aged 31-45 will have gathered a pot of savings worth R541 billion in 2015 and by 2020, this same age group will have saved R945 billion.
- The increase in the savings pot of South Africans under 30 (incubators) by 2015 is R20 billion. By 2020, incubators will have saved R100 billion. These first-time investors may look to savings products such as tax-exempt short- and medium-term savings products that will be introduced by the South African Treasury in 2015.
- Currently pension funds and long-term insurance are the highest portion of gross household wealth, followed by non-financial assets such as property, then other financial assets including securities and assets with monetary institutions.
- By 2020, interest in pension funds and insurance should remain the highest portion of gross household wealth.
- However, the portion of wealth in financial assets

such as securities will become larger, implying investors will take more of an interest in securities investments over the next few years.

- As with savings, the liabilities of households are also

shifting and secured debt is estimated to form the majority of gross household debt by 2020 suggesting that the appetite for mortgages is likely to pick up in the next seven years.

## Extract from “Learning from the Lessons of Time”

Legg Mason, Global Asset Management

### The issues that worry investors today aren't new

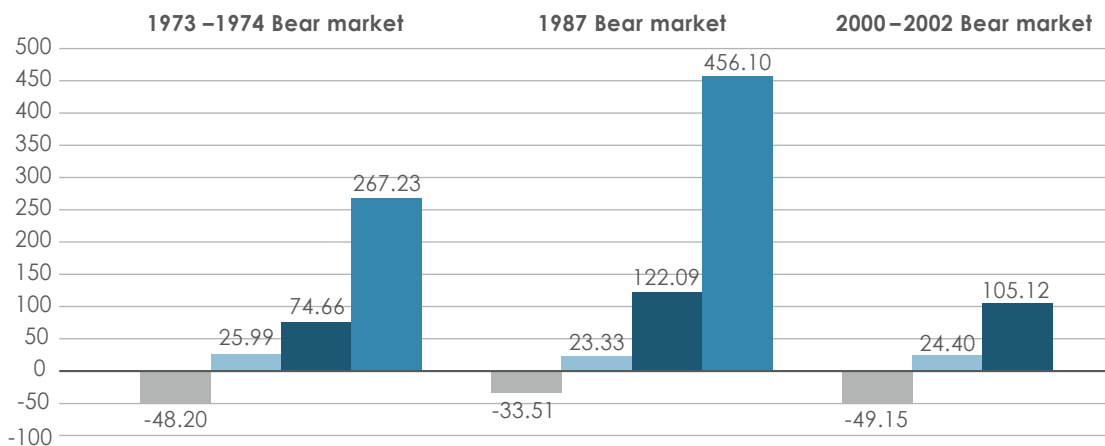
Staying focused despite the day-to-day distractions of the market is never easy, especially during periods of great economic uncertainty. However, investors who seek the guidance of a trusted financial advisor and remain committed to their investment plans, even when it's tempting to head to the sidelines, are better positioned to realize their short- and long-term goals.

### A few “history lessons” to consider:

For every bear, there's a bull... and for every bull, there's a bear

The chart below shows how dramatically the stock market (as represented by the S&P 500) bounced back from its lowest point during three bear markets over the last few decades. Of course, investors during these periods couldn't possibly have known their investment would grow so dramatically... but they could have remained fully invested, confident in the knowledge that markets recover over time.

### Cumulative total returns of the S&P 500 (%)



Source: Standard & Poor's, a division of The McGraw-Hill Companies, Inc. and GPW (Legg Mason internal system). Past performance is no guarantee of future results.

This chart is for illustrative purposes only and is not indicative of performance of any specific investment. All investments involve risks, including loss of principal. Please note that an investor cannot invest directly in an index. This chart illustrates the historical performance of the Standard & Poor's 500 Index (S&P 500) before and after the bear market bottoms of 10/3/74, 12/4/87 and 10/9/02. Cumulative total returns include reinvestment of dividends and capital gains. The S&P 500 Index is an unmanaged index of 500 stocks that is generally a representation of the performance of larger companies in the U.S.

### Don't let emotions drive your decisions

Emotions can lead to irrational decision making and impulsive decisions that compromise the realization of stated goals. Before you react impulsively, make a list of your concerns, revisit your goals and review your strategy. If your goals and/or priorities have changed, or if you believe your strategy is no longer appropriate given the economic environment, contact your financial advisor. When there is fear and uncertainty in the air, when there is scary news that

makes you question what you should do, that's when it's most important to talk to your advisor. He or she can provide the perspective you need to understand the situation at hand and how it relates to your individual goals and strategy.

### Understand your tolerance for risk

Risk is part of investing. You can limit it, you can defend against it, but you can't eliminate it. The important thing is to have a well-informed under-

standing of how much risk you can tolerate by working closely with your financial advisor. By having a well-informed understanding of your tolerance for risk, your financial advisor can construct a long-term investment strategy suited to your needs.

**Be diversified**

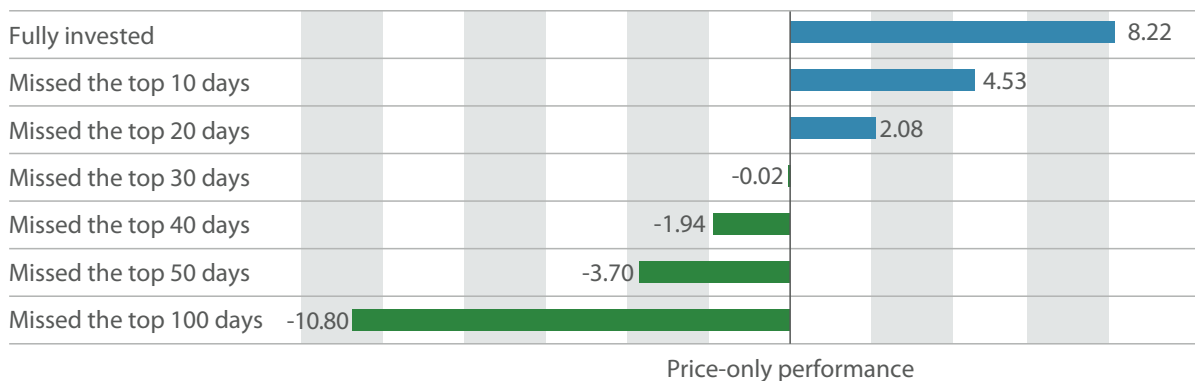
Despite the best efforts of investment professionals, it's virtually impossible to guess in advance which asset class will have the best return in any given year. Spreading your investment dollars between different

asset classes is an important tool to manage investment risk, especially during periods of market volatility.

**Stay invested**

Investors who stay the course have historically been rewarded for their patience. When you look at market performance over decades rather than just a year or two, you find that while it may contract, it also expands — with the gains often concentrated in a handful of trading days.

**Market returns: S&P 500 Index from 12/31/92 - 12/31/12**



Sources: FactSet, as of 12/31/12.

All investments involve risks, including loss of principal. The chart provided is for illustrative purposes only and represents an unmanaged index in which investors cannot directly invest. Past performance is no guarantee of future results. This chart is for illustrative purposes only and is not indicative of past or future performance of any specific investment.

**Work closely with a trusted financial advisor**

A trusted financial advisor works with you to identify your goals, needs and aspirations to align your short- and long-term goals with your own risk tolerance. A financial advisor also offers much-needed perspective by helping to identify the consequences of

impulsive and irrational decisions. Most importantly, your financial advisor, backed by the resources of his/her own firm, helps you achieve your goals by providing valuable insight and guidance on economic issues, the markets, specific investments and strategies.

**Extract from The Tao of Warren Buffett**

Quotations and Interpretations, Mary Buffett and David Clark

**“We never look back. We just figure there is so much to look forward to that there is no sense thinking of what we might have done. It just doesn't make any difference. You can only live life forward.”**

Warren has never had much use for regrets in life, business, and investments. In the world of investments there is always some investment that you missed, some stock going up that you don't own. If you sold a stock and it then continued going up, you could spend months kicking yourself. If you didn't sell and the price of shares tanked, you could spend years kicking yourself and everyone else. The same thing applies with business decisions – if you make a hundred decisions and ten turn out bad, you could

end up obsessing over your mistakes to the point that you neglect the new decisions that need to be made.

In the investment world, each day brings a new batch of opportunities in an endless procession. You need not focus on your mistakes any more than is necessary to learn their lessons. What you need to do is apply the lessons learned to the problems of today. In the investment game you will make countless errors of omission, none of which will hurt you. It is the errors made in taking action that you have to watch out for, and they are found on the road ahead.





## FG Asset Management | Investment Update

by Klaas Venter, Chief Investment Officer, and Adri Viljoen, Investment Analyst



**The FG IP JUPITER Income Fund of Funds** returned 2.55% year to date and 8.08% over the last 12 months, outperforming the benchmark STeFI Composite Index as well as the average of the SA Multi Asset Income category over both periods. The South African Reserve Bank kept interest rates unchanged at both the March and May meetings. Despite a deteriorating local inflation outlook, in part due to a weaker currency, growth remains sluggish and well below potential, therefore putting the SARB in a difficult spot. Markets were pricing in the possibility of a rate cut before the May meeting, but the sharp weakening of the rand saw expectations turn around, with markets now expecting rate hikes over the next 12 months. Global and local bond yields have moved sharply higher since the US Federal Reserve announced that it might start tapering its bond purchases in the next few months. The higher bond yields contributed to a selloff in listed property securities as well, which was down 11% in May. The Coronation and Prudential funds, the only two underlying funds with mandated offshore exposure continued to benefit from rand weakness, while the Atlantic Fund lagged due to the fund's 10% exposure to listed property securities.

**The FG IP VENUS Cautious Fund of Funds** returned 3.56% year to date and 11.78% over the last 12 months, lagging peer performance by a small margin. The fund has remained conservatively positioned with lower exposure to local risk assets as well as global assets than its peers. Risk-adjusted performance has been satisfactory. In order to increase exposure to offshore assets, we invested in a new fund, the Coronation Optimum Growth Fund during the period under review. This fund has a fully flexible mandate to invest in the best opportunities worldwide. The fund currently has close to 85% invested in offshore assets, with the majority in equities. The fund has contributed positively to performance, returning 8.55% since we first invested at the end of March. Exposure to offshore assets has increased from 5% in March to 12% at time of writing. Emerging market assets, both bonds and equities, have come under severe selling pressure since the last meeting of the US Federal Reserve and we believe that developed market equities offer better investment opportunities at present. Despite negative returns from the bond and property sectors, all three income funds returned in excess of 1% during the period under review.

**The FG IP SATURN Flexible Fund of Funds** returned 6.5% year to date and 18.2% over the last 12 months,

outperforming the benchmark peer group over both periods. The fund performance has been in the top half of peer performance over the last 6 months as well as 1, 3 and 5 years. The fund is at its maximum 25% offshore asset allowance and the rand weakness has contributed to the performance. The Coronation fund, with more than 30% of its assets invested offshore, was the best performing underlying fund, returning in excess of 3% during the period. The local equity market reached a new all-time high at the end of May, before selling pressure saw local equities down 4% during the first two weeks of June. Dispersion amongst sectors was high; with the media sector (Naspers) returning 20% while gold mining shares declined by 20%. We are in the process of replacing the ABSA Balanced Fund with the ABSA Absolute Fund which is offering us the opportunity to introduce "boutique" manager funds with higher risk profiles to the fund. The first boutique manager added towards the end of the period was the 36One Flexible Opportunity Fund.

**The FG IP MERCURY Equity Fund of Funds** are close to unchanged (-0.12%) year to date and returned 14.7% over the last twelve months, somewhat behind the JSE All Share Index return. Three of the top ten shares by market cap had double digit returns over the last 3 months. All three are industrial, rand hedge shares. MTN and SAB, the other two industrial shares also recorded positive performance, while the rest of the top ten shares, all financials and resource shares, declined over the period. The index tracker funds did not manage to outperform the index, while all three active managers managed outperformance. All new inflows in the Mercury fund was invested in the 36One fund during the review period, increasing the allocation from 4.6% to 8.4% and contributing positively to performance as the fund returned 3.9%, the best performing underlying fund. The resource sector was the worst performing sector, despite the rand weakness and declined close to 10% over the last three months and the Nedgroup Mining and Resources fund as well as the SIM Rafi Fund declined as a result. Companies in the unsecured lending sector were sold down aggressively after African Bank released poor results. The SIM Dividend Fund performed poorly as a result, down 6% over the period.

**The FG INTERNATIONAL Flexible Fund of Funds** continued to benefit from further rand weakness, brought about by both local and global factors. The local currency broke through the R10/\$ at the end of May, a four-year low for the rand. The fund has

returned 23% year to date and a handsome 37% over the last 12 months measured in rand terms. Global equities gained in excess of 1% (US Dollar terms) during the review period, outperforming emerging peers and property securities which declined during the review period. The FGAM Global Growth fund outperformed the FGAM Global Cautious and Investec Global Strategic Managed funds as a result, gaining 1.4% during the last 3 months, while the other two funds were unchanged

in US Dollar terms. Global bond exposure was reduced during the period in both FGAM funds as the risk of capital losses became too high and the proceeds is kept in cash over the short term, to be deployed into global equity funds when opportunities arise. The International fund has close to 50% exposure to global equities, with the balance invested in cash and listed property securities and selective bonds through the Investec Strategic Managed fund.

#### Performance and quartile rankings in sector for periods until 15 June 2013

Index	Year to date	6 Months	1 Year	3 Years*	5 Years*
<b>FG IP Jupiter Income FoF</b>	<b>2,55%</b>	<b>2,70%</b>	<b>8,08%</b>	<b>8,17%</b>	<b>8,83%</b>
Atlantic Enhanced Income Fund	1,92%	2,05%	6,84%	7,36%	8,47%
Cadiz Absolute Yield Fund	2,93%	3,12%	8,72%	9,21%	10,53%
Coronation Strategic Income Fund	2,97%	3,13%	9,97%	10,42%	10,93%
Prudential Enhanced Income Fund	2,67%	2,61%	9,53%	9,59%	not started
SIM Active Income Fund	2,58%	2,83%	6,86%	7,61%	9,79%
SA Multi Asset Income Category Average	1,90%	2,09%	6,82%	7,39%	8,62%
<b>FG IP Venus Cautious FoF</b>	<b>3,56%</b>	<b>3,91%</b>	<b>11,78%</b>	<b>11,27%</b>	<b>9,64%</b>
Coronation Optimum Growth Fund	25,22%	22,99%	40,41%	21,57%	9,54%
Coronation Top 20 Fund	7,10%	9,00%	25,90%	18,74%	15,75%
Investec Diversified Income Fund	3,35%	3,17%	7,70%	9,02%	Not Started
Nedgroup Flexible Income Fund	2,85%	2,91%	7,21%	8,61%	8,75%
Nedgroup Opportunity Fund	2,54%	3,53%	16,15%	14,53%	8,55%
Nedgroup Value Fund	-2,34%	-0,87%	11,16%	13,88%	13,05%
Prudential Enhanced SA Tracker Fund	6,39%	4,32%	25,66%	22,33%	23,88%
SIM Active Income Fund	2,58%	2,83%	6,86%	7,61%	9,79%
SA Multi Asset Low Equity Category Average	5,22%	5,33%	13,86%	10,66%	9,21%
<b>FG IP Saturn Flexible FoF</b>	<b>6,49%</b>	<b>6,86%</b>	<b>18,23%</b>	<b>14,15%</b>	<b>10,17%</b>
ABSA Absolute Fund	3,45%	3,63%	14,21%	12,61%	10,64%
Absa Balanced Fund	4,15%	4,88%	14,50%	11,55%	9,16%
Coronation Market Plus Fund	11,90%	12,29%	27,94%	19,06%	14,54%
Investec Opportunity Fund	5,83%	5,73%	17,89%	15,24%	11,09%
Prescient Balanced Quantplus Fund	2,51%	3,40%	11,33%	9,15%	8,11%
SA Multi Asset Medium Equity Category Average	5,27%	5,66%	15,61%	11,70%	8,79%
<b>FG IP Mercury Equity FoF</b>	<b>-0,12%</b>	<b>1,74%</b>	<b>14,69%</b>	<b>16,17%</b>	<b>9,04%</b>
36One MET Equity Fund	12,96%	14,77%	Not Started	Not Started	Not Started
Coronation Top 20 Fund	7,10%	9,00%	25,90%	18,74%	15,75%
Nedgroup Investments Entrepreneur Fund	9,60%	10,24%	28,48%	27,01%	14,28%
Nedgroup Investments Mining and Resources Fund	-3,00%	-1,38%	1,50%	4,83%	-1,04%
SIM Dividend + Index Fund	-5,55%	-3,27%	8,14%	Not Started	Not Started
SIM Equally Weighted Top 40 Fund	-2,44%	-0,60%	13,71%	Not Started	Not Started
SIM Rafi 40 Index Fund	0,27%	2,21%	15,66%	Not Started	Not Started
SA Equity General Category Average	3,19%	4,86%	17,01%	14,42%	8,96%
<b>FG IP International Flexible FoF</b>	<b>23,25%</b>	<b>23,12%</b>	<b>37,38%</b>	<b>15,79%</b>	<b>4,94%</b>
*Data longer than 12 months are annualised	1st quartile	2nd quartile	3rd quartile	4th quartile	

## FG IP International Flexible FoF

Fund	Formation Date	Manager	Size (R)	Benchmark
FG IP International Fund of Funds	10/2007	FGAM Investment Committee	R142 mn	55% MSCI AC World (USD), 33% JP Morgan Global Bond Index (USD), 7% FTSE EPRA/NAREIT Global Index (USD), 5% Stefi Call Index (ZAR)
FGAM Global Growth Fund	05/2006	FGAM Investment Committee	\$30.9mn	70% MSCI AC World, 15% Citigroup WorldBIG, 10% FTSE EPRA/NAREIT Developed, 5% LIBOR USD 7-Day
FGAM Global Cautious Fund	05/2006	FGAM Investment Committee	\$27.4mn	25% MSCI AC World, 50% Citigroup WorldBIG, 10% FTSE EPRA/NAREIT Developed, 10% LIBOR USD 7-Day, 5% LIBOR EUR 7-Day
Investec Global Strategic Managed Fund	02/1995	Philip Saunders	\$506mn	60% MSCI AC World NR, 40% Citi WGBI

## Quarterly Performance of general indices

Index	Asset Class	2Q 2011	3Q 2012	4Q 2012	1Q 2013	Year to date 2013*
STEFI Composite Index	Local Cash	1,39%	1,36%	1,30%	1,25%	2,31%
Beassa ALBI Total Return	Local Bonds	5,20%	4,99%	2,62%	0,91%	-1,11%
JP Morgan World Govt Bond index (USD)	Global Bonds	0,92%	2,99%	0,45%	-2,80%	-2,51%
FTSE/JSE Africa All Share (Total Return)	Local shares	0,98%	7,26%	10,34%	2,48%	4,13%
FTSE/JSE Africa Swix Top 40 (Total Return)	Local shares	1,24%	7,55%	10,87%	0,86%	2,11%
FTSE/JSE Africa Small Cap (Total Return)	Local shares	1,81%	6,23%	7,99%	8,13%	9,47%
MSCI AC World (USD)	Global Shares	-6,36%	6,13%	4,63%	5,98%	6,86%
FTSE/JSE SA Listed Property (Total Return)	Local Property	10,31%	10,98%	2,75%	9,14%	5,88%
US Dollar/South African Rand (+ weaker, - stronger)	Exchange Rate	6,79%	1,59%	2,16%	8,71%	17,08%

\*(Data up to 15 June 2013)

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