PSG | Asset Management

4TH Quarter 2011

ANGLES & PERSPECTIVES

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A word from the CEO

Welcome to our first quarterly newsletter.

The PSG Group has a long record of generating value for its shareholders. We have achieved this over a long period by investing in entrepreneurial businesses that are managed by passionate, knowledgeable individuals and then supporting these businesses to achieve their objectives.

During 2010 it became increasingly apparent that many of the companies that now form part of PSG Asset Management were working closely together and that the time had come to refocus and formally streamline these businesses into one entity. This merger of a number of PSG-owned companies therefore formed PSG Asset Management Holdings in March 2011. The business consists of an asset manager (PSG Asset Management) and an investment platform (PSG Asset Management Administration Services).

The integration of the asset management teams under the leadership of PSG Asset Management CEO Adrian Clayton and CIO Jan Mouton has been very successful. This wasn't surprising considering the significant historical overlap of philosophies among the different fund managers within the team. The new team consists of a group of highly qualified and talented individuals with extensive industry experience. They work within a formalised and structured investment process and we are confident that investor returns will continue to exceed expectations.

Assets under management have continued to grow with net flows of more than R1.4 billion since the teams merged. We have revised our offering of funds available to investors with the launch of the PSG Stable Fund and PSG Income Fund and now offer a comprehensive range of funds that cover the complete risk-return spectrum. A major contribution to the increased flows (aside from the stellar consistent performance of our core range of funds) has been the focussed approach of the specialist sales team under the leadership of Ross Breedt.

At PSG Asset Management we focus on building long-term, mutually beneficial business relationships with advisors by understanding their businesses and how we can add value to their practices. PSG Asset Management aims to become a serious contender in the overcrowded asset management market.

The integration of the investment platforms continues at a steady pace due mainly to the sterling work being done by our COO Mike Smith, Head of the Life Company Niel de Bruin, and Head of the LISP, Lizé Visser who joined us after the merger to focus on the distribution and strategy of the platform offering.

As part of this process, PSG Asset Management acquired the business of EFS Investment Solutions that operated under the Equinox and Intervest brands and combined our existing linked life licence as well as a new LISP licence to form the core of PSG Asset Management Administration Services (PSG AMAS). The aim of PSG AMAS is to provide financial advisors and their clients with a broad range of investment alternatives, offering flexibility and functionality while maintaining cost effectiveness.

As we move towards the end of 2011, we reflect on a watershed year for PSG within the investment and administration space and we look forward to 2012, to build on the solid foundation that we established with your valued support. Thank you.

Wayne Waldeck
CEO PSG Asset Management Group

Are equities a default asset class simply because interest rates are low?

by Adrian Clayton

Adrian Clayton is the CEO of PSG Asset Managers. With a Business Science qualification from UCT, an MBL from UNISA and more than 15 years experience managing investments, Adrian is one of the PSG Asset Management stalwarts. Adrian has contributed to the PSG Angle since May 1999 and his thoughts on stocks, local and global markets, relative asset allocations and currency views have made him one of the most rounded members of our team. When not managing portfolios, Adrian enjoys his beloved surf board and riding up the mountains on his mountain bike.

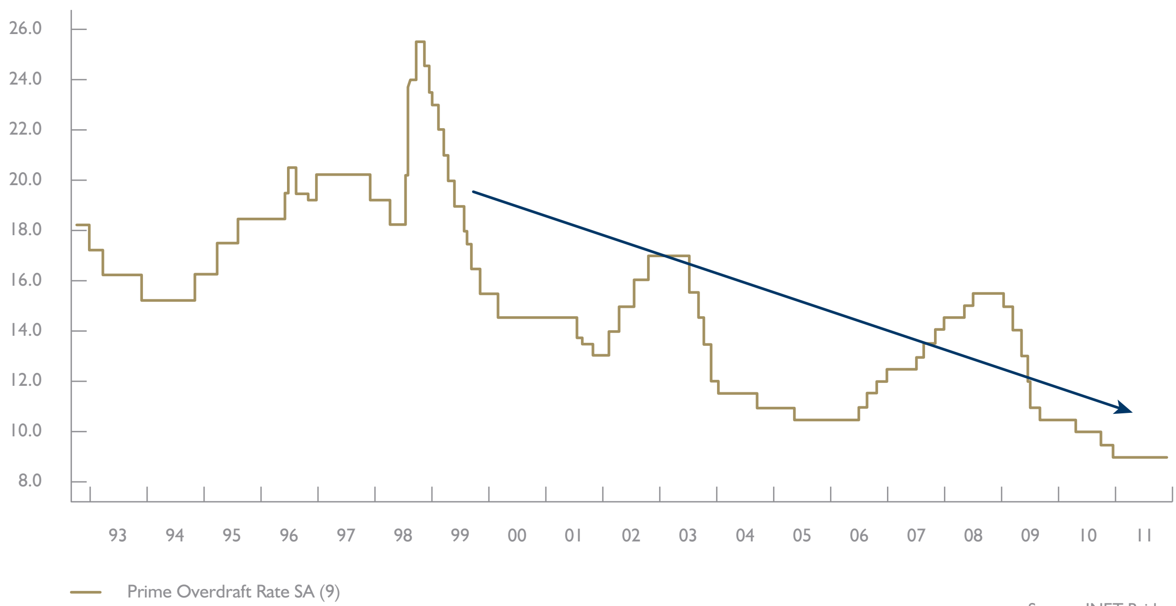
Even though we are bottom-up managers, we don't ignore global trends

As bottom-up managers, we focus on researching companies at an operational level. This does not mean that we completely ignore global economic trends. We believe it is important to be aware of what is happening in the wider world so that we are not shortsighted and do not just dive into a particular company or asset class. Below is a brief description of two important themes that concern us and that we believe justify caution when you invest locally.

Are current low interest rates sustainable?

Our first concern is whether current low domestic interest rates are sustainable. The South African Prime Overdraft Rate, currently at 9%, is at the lowest level in 20 years, and is in fact, at precisely half the level it was 18 years ago. We understand that South Africa's interest rates have migrated lower as global inflation has reduced. This is most observable when looking at the Organisation for Economic Co-Operation and Development (OECD) inflation, which collapsed from 8% in 1990 to its current 3%. (The OECD is an economic organisation of 34 countries founded in 1961 to stimulate

Graph 1: Long-term inflation rates decreasing but four significant interest rate increases



Source: INET Bridge

and develop economic progress and trade. Most OECD countries are developed countries.) In spite of lower inflation, there have been significant interest rate increases at times.

A closer inspection of the period under review will reveal that although the trend in South African inflation and interest rates has been a lowering one, within this longer-term cycle there have been four significant interest rate rising 'mini-cycles'. The average change in interest rates over these four shorter cycles was slightly more than 40% and the largest gains took place during the latest rising cycle, from the middle of 2006 to the end of 2008. During this time, the South African Prime Overdraft Rate increased from 10% to 16%, a rate of change of 60%.

Why are interest rates remaining so low?

This is happening because global interest rates are being priced off rock-bottom US rates. These look like they will be kept low for as long as possible while the economy staggers. It is however important to realise that this works well in an environment where lenders are happy to 'sponsor' the US with cheap funding. Asian economies are actively trying to find new markets (and develop their own market) for Asian goods. They are doing this to reduce the close link that exists between US consumption of Asian goods and Asia's funding of this consumption by acting as a financier.

At some point, the cost of funding risky behaviour rises

This is what we have seen in Greece and to a lesser extent in Italy. It is possible that the market might demand the same from other large indebted countries. With this in mind, it concerns us that market participants have become increasingly complacent with domestic interest rates. The last rate cycle clearly shows that interest rates in South Africa can move higher rapidly and with larger than anticipated increases.

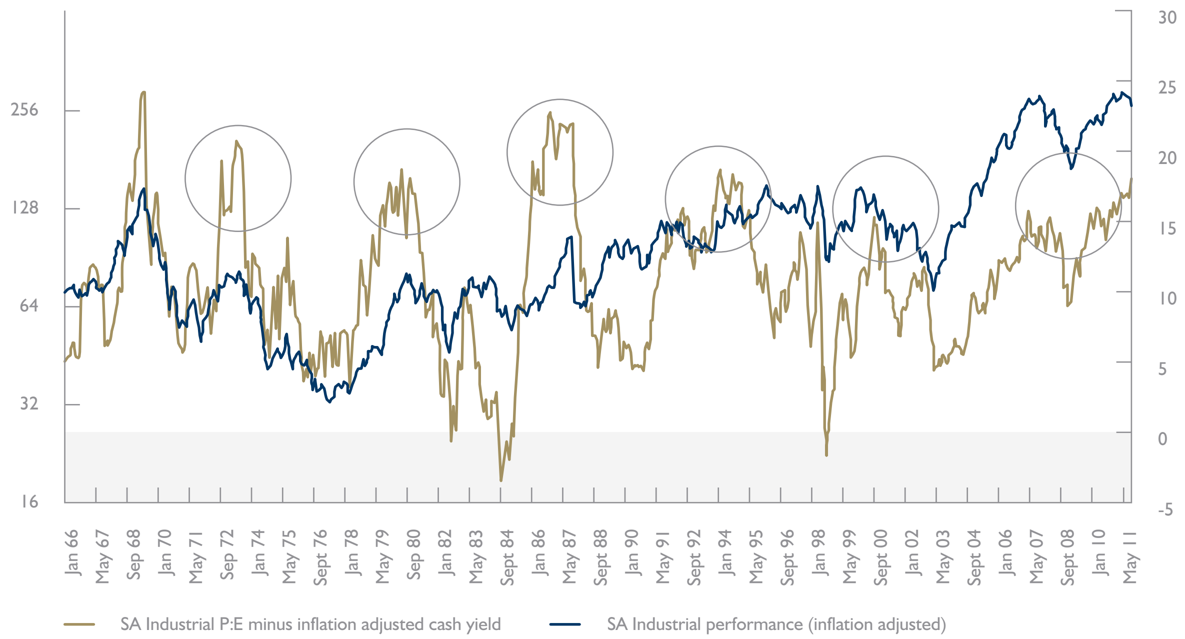
Many quality local companies are no longer particularly cheap

Our second concern is tied to our first concern. We think the market is being driven into a narrow space as investors search for earnings consistency in an uncertain world. This has led to a willingness to pay higher than normal ratings (P:Es) for quality companies. The primary hunting ground is domestic consumer stocks and locally-listed multinational companies with large emerging market exposures. In a desperate need to find 'E', less prudence is attached to establishing an appropriate level for 'P'!

How are industrials priced relative to cash?

In capturing the two concerns raised above, we have attempted to look at the relative rating of cash versus industrials on the FTSE/JSE in a simple way. We have taken the P:E of the domestic JSE Industrial Index and subtracted cash yields over

Graph 2: Seven periods when industrials have been expensive relative to cash



Source: PSG Asset Management

time from it. Against this, we have mapped the performance of the JSE Industrial Index adjusted for inflation. The purpose of the exercise is to look at periods when the Industrial Index is at extreme valuation points relative to cash and to then assess the subsequent returns from these levels.

When industrials are expensive relative to cash, the chance of negative real returns increases

In the graph, we have circled six periods since the 1960s when industrials have been priced as high relative to cash, as they are at present. When this has occurred historically, the probability of receiving negative real returns in the three years following these rating spikes is greater than 65%.

Overpaying for industrials is unrewarding – irrespective of interest rates

We have no idea when interest rates will rise to stop the trend of paying-up for quality companies. What we do know (and have demonstrated) is that overpaying for the quality area of the JSE (the Industrial Index), in previous similar cycles has been unrewarding. The idea that cash might be a 'safer' asset class than many local equities is not palatable to many investors while cash yields are equal to inflation rate levels. In fact, the argument many market commentators express is that present low interest rates make equities a 'default' (go-to) asset class.

At PSG Asset Management we would rather argue that companies should be priced relative to realistically priced interest rates, especially considering our view that equities are very long-term investments.

What kind of companies do we invest in?

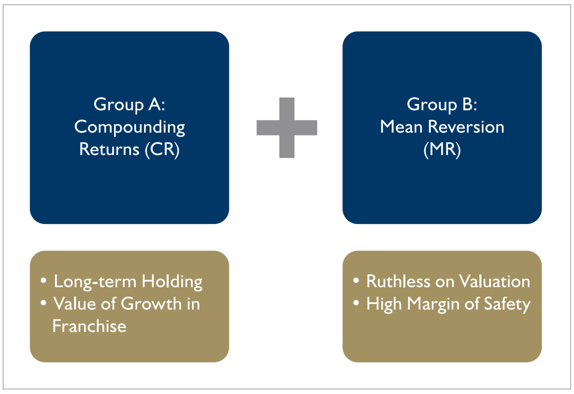
by Greg Hopkins

Greg graduated from University of Cape Town in 1993, and qualified as a Chartered Accountant after completing his articles at Ernst Young in 1996. He joined Merrill Lynch Investment Managers (now Blackrock) in London in 1997. On his return to SA in 2006, Greg joined Sanlam Investment Management, where he worked on the Best Ideas Fund product until 2009. Greg joined the PSG Asset Management team in 2010. Greg is Head of Global Equities and manages the PSG Global Equity Fund.

An investment process should provide a constant, disciplined, step-by-step way of discovering strong investment ideas. It should be repeatable and applied consistently over time, irrespective of the mandate of an individual fund.

Our investment process has been refined and developed to produce ideas that we have conviction in. It forces us to ask the right questions and interrogate many aspects of an investment idea to ensure that we are able to determine the most precise risk reward outcome of each idea.

Figure 1: How we view investments



At PSG Asset Management, we typically split our investments into two categories

Group A: High compound returns (Compounding Returns or CR)

Shares that fall into Group A as depicted in Figure 1 are typically long-term holdings where the underlying business compounds at a high rate of return.

Group B: Reversion to a long-term mean (Mean Reversion or MR)

Shares that fall into Group B are companies whose underlying margins, returns on capital or valuations will show a tendency to revert to a long-term average; put differently, properties of mean reversion. The long-term average rate of return on underlying capital in these companies tends to be significantly lower than for Group A companies.

How our analysis differs based on which Group or type of company we are analysing

Group A company analysis

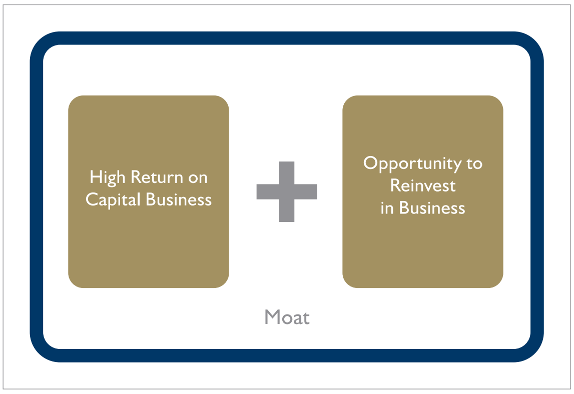
Group A companies need to have a strong moat (or competitive advantage) relative to their peers to protect their high returns on capital. We therefore spend a significant amount of time and effort evaluating the strength of a company's moat before we determine the attractiveness of their shares.

We assess management teams on their ability to protect the moat and their skill in re-investing the capital they generate from the high returns back into the business to generate growth, as shown in Figure 2. For a patient investor, these high rates of underlying returns should create compound growth and decent share price returns over time.

We like to hold these high compounding companies over many years because we believe that the value of steady growth is often underestimated.

We use a matrix, (shown in Figure 3) based on the strength of a company's moat (and returns on capital) and future potential growth rates, to estimate the potential value of the growth franchise.

Figure 2: Estimating potential growth



After our calculations, we arrive at a multiplier that ranges from 1x (in other words, no value, top left position in matrix) up to 3x (bottom right) the underlying 'ex growth' or bond-like value.

This shows that a company with sustainable returns on capital of 3x its underlying cost of capital and a long-term growth rate in the highest category will be worth 3x a similar company with little or no growth and returns similar to its cost of capital. We would expect this value to emerge through time.

Given the well-documented industry shortcomings in forecasting the future, we use the above matrix for scenario planning and a 'what if' analysis. In practice we would like to buy our compounding return stocks when there is no future growth priced into the current share price.

Assessing when to exit these holdings is not a perfect science. We share more insights on how we decide when to exit these holdings in the next article.

Group B company analysis

When analysing these types of companies we focus on margin of safety and are very mindful of the risk of deploying capital in value traps. These are stocks that on the face of things look cheap but, similar to a slow puncture, continue to go down as business conditions deflate.

Knowing when to exit these mean reversion types of companies is key. In assessing these investment ideas, we often use the word 'scrubbed' to describe whether the margin of safety and subsequent risk reward profile is adequate to compensate investors for the large range of potential outcomes. European stock markets have recently provided an opportunity for the contrarian investor to find stocks that have been significantly 'scrubbed'.

Recent examples of potentially undervalued compounding return stocks

Tesco, Unilever, Diageo and Heineken are examples of solid compounding return stocks where we believe there are opportunities from a reversion to a long-term valuation. A common investment strategy across our funds is to find companies with great assets, where management have taken their eye off the ball, and on which the market has given up. New management teams are then typically installed who cut away at the surplus fat, re-invigorate the company's strategy, and move the company back onto a sustainable growth path. Both Tesco and Unilever have relatively new management teams that have hit the ground running. Indeed one would be hard pressed to find a better chief executive officer anywhere than the boss of Unilever, Paul Pollman.

Figure 3: Our growth matrix

Growth Multiplier

← Strength of Moat →

Growth					
	1.01	.5	2.02	.5	3.0
Below Market	1.01	.1	1.21	.2	1.2
Market Rate	1.01	.3	1.5	1.61	.7
Above Market	1.02	.0	2.52	.8	3.0

As we move down the rows in Figure 3, the assessment of growth improves and value is added exponentially to a business. Indeed, it increases at a faster rate for companies with higher returns on capital (in other words, better assets).

Unilever's new management team have gone back to basics. They have taken out a layer of costs that had been added to the business over many years and re-invested the savings into innovation-driven research and development. For example, you may have noticed a range of new product launches from the company over the Rugby World Cup.

Charlie Munger, the irascible partner of Warren Buffett often talks about catching an investment wave – "when a surfer gets up and catches a wave and just stays there, he can go a long, long time".

And so it is in the world of consumer goods when a management team kick starts an innovation cycle from which success creates success. The wave goes on for a long time as economies of scale kick in and higher growth rates provide more money for innovation that drives higher growth rates in the future. We hope we might ride the Unilever wave for many years to come.

These two categories are not mutually exclusive from an analysis point of view

In conclusion we apply our investment process to all investment ideas to ensure that we remove any subjectivity and bias from our investment decisions. While we analyse categories of companies in slightly nuanced ways, the Holy Grail is of course to find long-term compounding return companies that the market has given up on, and where there is an additional opportunity from mean reversion in valuation.

When do you sell a good company?

by Paul Bosman

Paul Bosman joined PSG in 2004 when he began working for PSG Capital as an equity analyst. In November 2004 he joined the PSG Tanzanite team as an equity analyst. Upon the incorporation of PSG Tanzanite into PSG Asset Management, Paul continued as an equity analyst, specialising in both local and offshore listed companies. On 1 September 2011 Paul became a Portfolio Manager at PSG Asset Management and is responsible for the management of the PSG Stable Fund.

One of the rules scholars of value investing recite is that you should exit an investment when it reaches fair value. In contrast to this, many experienced investors will tell you that the most important lesson they have learnt is that you should never sell a good company.

We are careful to balance our quantitative assumptions with qualitative facts

As most of our clients know, we religiously demand a margin of safety when investing. Put differently, we only hold companies that are trading below fair value. We clearly view ourselves as value investors. However, we have realised that one of the biggest traps for value investors is the error of grossly underestimating the fair value of a good company. If you assume that an able and energetic management team running a company with very strong economic fundamentals is going to grow the company profits at a pedestrian rate, you are sacrificing logic for the sake of conservatism. If we define risk as the opportunity cost incurred by prematurely exiting a company that will compound for many years to come, we are probably being more reckless than conservative. Our quantitative assumptions should not be contradictory to the qualitative facts.

The fair value of a company is not an exact number, it is an estimate

It is important to be fair towards the company in the assumptions you make when valuing the business. For example, a company that generates consistent free cash flow deserves a lower discount rate than a company that delivers very volatile cash flows.

1. How consistent are profits?

In Graph 1 we have plotted Famous Brands as an example of a consistent profit generator and how this contrasts with a less predictable company like Anglo American Platinum. Due to the higher level of conviction we have in future profits from Famous Brands we would use a lower discount rate, in other words a smaller risk premium, when we value Famous Brands.

2. Profit growth rate depends on return on capital, competitive position and management

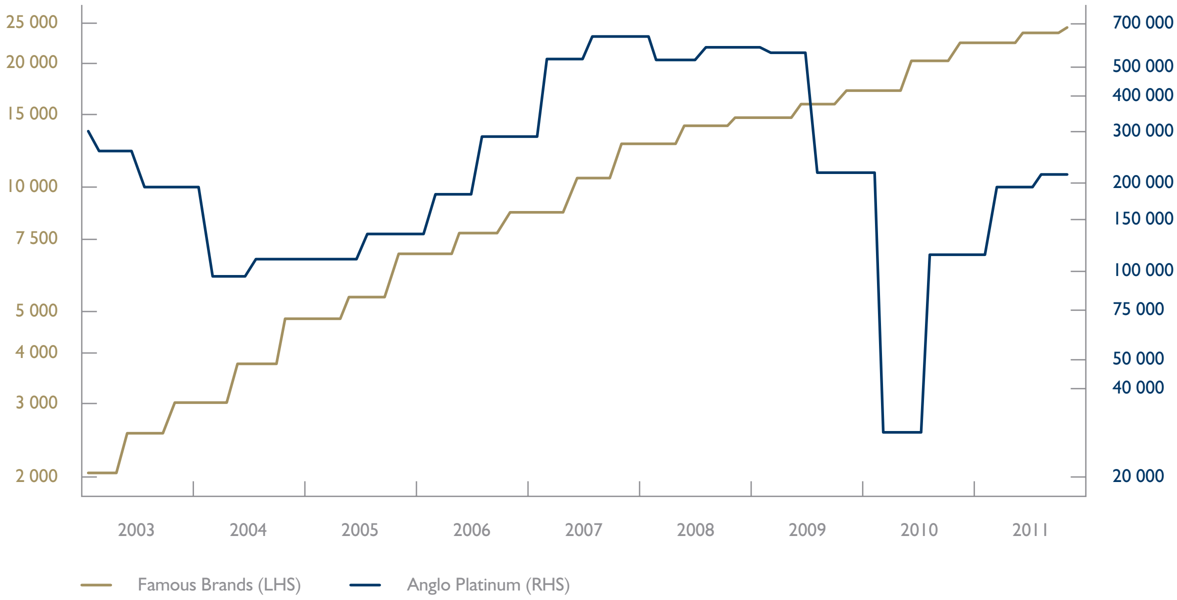
Another key decision when we value a company is the profit growth rate we assume. What determines a company's ability to grow?

We would argue that a key driver is the level of return a company can generate on its capital. Companies with high returns on capital can generate meaningful organic growth by reinvesting free cash into existing and new opportunities. A second determinant of a company's profit growth rate is the ability and willingness of management to harness a strong competitive position. To judge this ability one would have to look at the management team's track record. We would also consider the management team's incentives and would ideally prefer them to have a meaningful percentage of their net worth invested in company stock. Where the financial interests of management and shareholders are aligned we feel more confident in assuming stronger profit growth. Our growth assumptions therefore need to be a function of a company's moat, or return on capital, and the strength of the management team.

Famous Brands currently generates a high return on equity of 35%. The management team has certainly proven themselves over the last decade and with directors owning 40% of the Group, their interests are aligned with those of other shareholders. We are therefore comfortable to assume an above average growth rate when we value Famous Brands.

3. How much profit can be distributed to shareholders without detracting from profit growth?

Graph 1: Famous brands generates more consistent earnings per share than Anglo American Platinum



Source: Inet

A third vital assumption is the percentage of profits that a company can distribute to shareholders whilst still maintaining its profit growth rate. Companies that continuously need to reinvest significant amounts of capital into their operations would, over time, pay a smaller portion of profits to shareholders as dividends than a company that can grow organically with little reinvestment. When you assume above average profit growth accompanied by large distributable cash flows, the resulting intrinsic value could be a surprisingly large number. Large enough to stop us from selling a good company simply because it is trading on a high P:E ratio.

Famous Brands currently trades on a P:E ratio of 17.5 and the share price has appreciated at a compound rate of 48% per annum over the last decade. Compared to the 12.9 P:E ratio of the JSE All Share Index the company certainly does not seem optically cheap. Famous Brands, however, generates high returns on capital and has a management team with an exceptional track record. In addition, this business is not very capital intensive and currently distributes 65% of profits, while continuing to grow at an above average rate.

We combine qualitative factors in our fair value estimate before we decide to sell a good company

We combine these qualitative factors in our fair value estimate which yields a value of around R55 per share. This is 25% above the current share price, which implies that Famous Brands still trades at a 20% discount to our estimate of fair value. The margin of safety is not as wide as at many other companies we hold in our portfolios, so it does not currently appear among our larger holdings. However, we continue to hold the company on behalf of our clients.

We will sell Famous Brands if the share price exceeds our estimate of fair value, but if it never does we will not make the mistake of selling this good company.

Meet the Manager: PSG Flexible Fund

Jan Mouton obtained an M.Phil Finance (2002) from the University of Cambridge and also holds a B.Acc cum laude (1996) and Hons B.Acc (1997) from the University of Stellenbosch. He qualified as a Chartered Accountant (South Africa) in 2000. He completed his articles with PricewaterhouseCoopers in 2000. After a further six months at PricewaterhouseCoopers in Amsterdam, he read an M.Phil Finance at the University of Cambridge on a Cambridge Commonwealth Trust Scholarship. On 1 July 2002 he joined PSG and his responsibilities included managing the Tanzanite Capital Limited Hedge Fund and assisting the corporate finance team in making investment decisions. He has managed the PSG Flexible Fund since 1 November 2004.

Jan is the Chief Investment Officer at PSG Asset Management.

What is 'success' for investors in the PSG Flexible Fund?

We aim to give our clients high returns but at lower levels of risk.

Over the past five years, we have achieved this goal. The Fund not only outperformed its benchmark of inflation plus 6%, but also outperformed the FTSE/JSE All Share Index, while exposing investors to much lower levels of risk.

How do you construct the Fund's holdings?

We have a flexible asset allocation mandate, which means that equity exposure can vary between 0% to 100% and we may invest up to 25% directly offshore. Historically, the equity portion in this fund has varied between 60% and 100% with an average equity exposure under my seven years of managing the Fund of 75%.

Asset allocation is done based on opportunity. If we can find many undervalued shares, we have a higher equity exposure and lower cash exposure.

We are constantly on the lookout for businesses that meet our investment criteria of having a moat, good management and are trading at a margin of safety. A business with a moat is one that has some form of sustainable competitive advantage. Microsoft has a strong moat with its Windows Operating System which, despite there being free alternative competitors like Linux, still has a market share of over 90% of the PC operating system market.

Berkshire Hathaway is the epitome of a business managed by individuals with proven track records that has honest and transparent financial reporting.

A business offers a margin of safety when its share price is at a discount to our evaluation of its intrinsic value.

If we can find many businesses that have the 3 M's above, the equity portion of the Fund will be high. If there are fewer opportunities, we will patiently wait in cash.

In spite of the significant volatility in equity markets since 2008, the Fund has performed very well relative to the ALSI and its peers. Why is this?

Essentially, there are two reasons why the Fund performed well.

Firstly, the Fund's flexible mandate allowed us to be positioned defensively in April 2008 – and on occasions since then too – when we felt that many stocks were expensive and the margins of safety were just not there. Consequently, we were able to substantially protect the interests of our investors by holding relatively high levels of cash heading into periods when the market fell. This cash was then employed as the prices of these businesses came down and we acquired shares in high quality businesses that we always wanted to own at very attractive valuations.

Secondly, stock picking has been very beneficial for investors.

Our investment process has identified companies that we felt met our investment criteria and would deliver exceptional returns over time. These companies have gone on to deliver excellent returns. We are constantly on the lookout for high quality businesses trading at attractive valuations. We will acquire shares in these companies and then patiently wait for the shares to re-rate.

We buy when there is fear and panic. At the end of July this year, the Fund was 70% invested in equities. As equity markets tumbled during August and September, we increased our equity holdings to 80%. We are long-term investors that select equities when they are undervalued. Notable, for example, is the weighted average price:earnings ratio (P:E) of the equities in the Fund: At the end of September 2011, the P:E of the equities in the Fund was 9.1 times, lower than the ALSI which was then 12.2 times. The previous time the P:E of the Fund was this low, was in October 2008 during the financial crisis. At the end of September the price-to-book ratio of the Fund was also at its lowest since October 2008. These are attractive valuations at which to increase exposure to equities.

We look for businesses whose management's interests are strongly aligned with those of shareholders (and invariably are shareholders themselves) or for companies where a strategic investor has a significant shareholding.

A consistent feature of the PSG Flexible Fund is that it invests in companies where management or another strategic investor has a large shareholding. At the end of September this year, 23 out of the 37 companies in which the Fund was invested had management as a large shareholder or another strategic investor. We have a preference for these companies because it ensures that the interests of management are aligned with those of shareholders. A manager who is also a large shareholder will be more inclined to take long-term, value-enhancing decisions even though short-term profitability may be sacrificed. These managers will also generally avoid corporate extravagance and other wasteful expenditure. In our view, the fact that we have invested the money entrusted to us in companies where management think like shareholders not only reduces the risk of the investment, but also bodes well for long-term capital growth.

What should investors do in the face of fears about a continuing European recession and market volatility?

We don't take macro views. For example, we don't invest based on what is happening in Europe, or in any other industry, sector or geographic area in general. We look from the bottom up for quality companies trading at attractive valuations.

For example, in August and September this year a lot of this macro news went around and consequently the share price of many European banks were hit very hard. Our research at the time indicated that the share price of ING Group was significantly mispriced. The ING Group is an Amsterdam-listed bank with truly globally-diversified earnings. Macro fears regarding the exposure of European banks to certain sovereigns like Portugal, Ireland, Italy, Greece and Spain (the PIIGS) meant that the banks were, across the board, sold down very hard. We concluded that ING's exposure to the PIIGS was manageable and, having considered their business and sources of earnings, we felt that the share's price was trading at a more than 50% discount to its intrinsic value. Consequently, we more than doubled the Fund's holding in ING Group at the time.

Fear creates mispricing and opportunities. Investors in the PSG Flexible fund should know that we use times of fear to acquire quality assets cheaply. Over time, the prices of these shares are expected to normalise and this will mean solid returns for the Fund's investors.

You completed an M.Phil in Finance at the University of Cambridge. What was one thing that you learned there that you still use this day?

Academic theory with regard to the valuation of shares is incomplete without taking into account behavioural finance. Market participants tend to become too optimistic and too pessimistic at times and this drives share prices too high or too low for periods. This creates opportunities for contrarian investors and in the seven years that I have managed the PSG Flexible Fund we have frequently taken advantage of these emotional overreactions in markets – and our investors have benefited.

What do you do at the end of the day when you leave the office?

My daughter, Kate, loves me chasing her around the couch. If I can do this with the Bloomberg channel on in the background it is great! Sometimes it has to be Tellytubbies. On weekends I try to spend time with my family and we like to get away from Cape Town to Stellenbosch, my father's farm near Barrydale or to the beach at Onrus.

PSG Asset Management LISP: How we make complexity more manageable

by Lizé Visser

Lizé obtained a BComm (1994) from the University of Johannesburg. She joined the industry in 1994 at RMB Unit Trusts. Lizé has held senior management positions at RMB Unit Trusts, Plexus Asset Management, Absa Investments and Investec Asset Management where her duties have always been to focus on the distribution strategy, delivery and support thereof. She joined PSG Asset Management in March 2011 as Head of the LISP. Her responsibilities included managing client services, marketing and sales distribution.

A linked investment service provider or LISP should be like a paint store where advisors are able to use primary colours to blend a unique colour for each of their clients. In other words, a LISP should be able to cater for all investor needs.

Investors' core investment needs are income, growth and capital protection. In addition, advisors' core needs are investment choice, ease of use and cost efficiency to fulfil their clients' investment needs. In the recent market turmoil, choice has become crucial. For many investors, capital protection and managing the cost of meeting their investment needs has become as important as achieving good returns.

Making the complexity of choices more manageable without reducing choice, ensuring efficiency and cost control is a LISP's key challenge.

Currently the LISP industry is divided into limited LISPs and open LISPs

A limited LISP offers a selected and limited range of asset managers, and a limited number of investment instruments from which to choose. Most offer only unit trusts, but there are a few that also offer share portfolios. Specialist advisors often view limited LISPs as a 'semi-tied' solution. An open LISP on the other hand is (as the name suggests), open to a wider range of asset managers offering a broad range of investment instruments and tax wrappers.

What is a well-managed LISP? And what is a sustainable model?

We believe that a focused delivery strategy and a flexible administration system that can 'plug and play' with any advisor's business will make a LISP a successful business.

The primary element of a LISP is its administrative platform. The supporting system provides the engine for the administration. Many large LISPs are constrained by the flexibility of their systems. Today, systems need to be more flexible to administer both simple and complex solutions, without compromising on accuracy and efficiency.

The LISP business model is an enterprise that is based on economies of scale. The sustainability of a LISP is therefore directly related to assets under administration. Specialist technical teams are critical for the success of the business. They are required to support the delivery strategy and provide technical support.

What about the alternatives to a LISP?

Many investors believe that investing directly with an asset manager saves an additional layer of administration (and cost). But these costs are mostly discounted due to the economies of scale and distribution that large LISPs offer – which gives investors significant discounts. A LISP also offers the benefit of aggregation or consolidation, without which it can be challenging to maintain a portfolio view and to avoid duplication and undermining the composition of the overall portfolio. Advisors and investors have one relationship and one point of contact, which reduces their administrative burden.

What should an investor and advisor be looking for in a LISP?

The benefit of a LISP is only optimised when an investor's whole portfolio is included on the LISP. This means it is important to offer a range of tax wrappers. Advisors should be looking for a LISP that builds delivery around their advice process. Trust is critical because the relationship between advisors and their clients is a fiduciary one. PSG Asset Management provides transparency, simplicity, and a range of tax wrappers and discretionary investments. We offer a total expense ratio, single unit prices, and structured portfolios. We look at advisor investment licences and administer assets according to these licences.

Systems are key to delivery and a LISP should provide systems that will deliver even greater efficiencies to an advisor's practice and respond quickly and effectively to market changes and clients' needs.

We have developed a calculator to help advisors comply with Regulation 28

We are helping advisors with the challenges of monitoring investment limits in the context of the recent changes to Regulation 28.

PSG Asset Management offers retirement annuities, a pension preservation fund and a provident preservation fund, all of which have to comply with Regulation 28. We use a life licence to provide these products and the LISP to administer a range of underlying unit trusts and alternative instruments. This provides advisors and investors with the same transparent pricing as a discretionary investor in the LISP itself.

We prefer to focus on the portfolio mandate limits, because a manager can change the asset allocation at any time. Because of the mandate though, the manager may not breach the Regulation 28 limits. To this end, we offer a calculator to help advisors understand the impact and potential impact of combining different underlying investments in a portfolio and to help advisors monitor compliance with the revised Regulation 28 investment limits.

Can LISPs make investing simple? Do they need to make investing simple?

Yes and no. A successful LISP is a business that can meet advisor needs irrespective of how simple or sophisticated these might be. PSG Asset Management offers both, and we help advisors with tools that can illustrate a range of investor outcomes (or stories as we refer to them) to investors. We therefore believe we should play a leading role in creating a range of understandable stories or investor outcomes that are credible and compelling for each investment need. In this way, we offer a way to blend products or 'tax wrappers' (usually a complex challenge) AND a simple and transparent fee structure that is clear and easy to understand. We don't charge initial fees and our annual administration charge is an easy to understand flat rate.

We believe a LISP should be an efficient enabler for advisors

At PSG Asset Management, we are passionate about the value of advice. We believe that our role is to focus on offering both simple and sophisticated solutions for a range of income, growth and protection needs. We should neither limit nor prescribe the available investment options. We should rather equip advisors with the tools to blend long-term solutions to meet their clients' wealth creation and wealth preservation needs – and in so doing reduce the risk of investors undermining their potential by being caught up in the latest hype and market noise and chopping and changing their portfolio.

We are focused on the future and remain committed to helping advisors blend the different asset managers and investment instruments to optimise each solution for their clients. We won't reduce choice, but we will focus on making the complexity of the investment advisory process more manageable for advisors.

The PSG Asset Management Technical Investment Centre

What we offer advisors:

- Portfolio analysis and quantitative research. We provide the quantitative support via Morningstar and the Plan. We also offer multi-manager support and investment consulting.
- A quick turnaround on technical investment proposals.
- Insights and input on a wide range of investment products and instruments that include unit trusts, compulsory tax wrappers, shares, and segregated and structured instruments.
- Technical support on tax, compliance and legal queries.

Why our Technical Investment Centre provides a compelling resource for advisors:

- We provide insights on investment industry issues and regulatory updates in the form of a flexible 'on-tap' service when and how advisors require this.
- There is no limitation on the extent to which we can provide access to portfolios, shares, and structured investment solutions – which enables advisors to blend and model portfolios according to their investment licenses.
- The Centre offers efficient access to expertise from a pool of highly skilled resources:

  Tomas Blendulf
  Chartered Alternative Investment Analyst
  Annemie Nieman
  LLB (Cum Laude), PDFP: Legal Advisor
  Greg Flash
  BSc Eng, MSc Eng: Portfolio Manager

Ultimately, we aim to free-up advisors' time so that they can focus on managing their clients.

Treasury's proposal to replace Illas with Riddas on hold

by Annemie Nieman

Annemie obtained an LLB (Cum Laude) and Post-graduate Diploma in Financial Planning from the University of the Free State in 2004 and 2010 respectively. She completed her articles with Pagdens Inc. in Port Elizabeth during 2006 and practiced as commercial attorney with the same firm for three years. She jointed PSG Konsult as trainee financial planner in April 2009. During April 2011 she relocated to Johannesburg and was appointed as Legal Advisor with PSG Konsult and PSG Asset Management from May 2011.

Regulatory and tax issues must be resolved before Riddas can officially replace Illas

In its Draft Taxation Laws Amendment Bill, released in June this year, Treasury proposed replacing investment-linked living annuities (Illas) with more accessible and less restrictive retirement income drawdown accounts (Riddas) from 1 March 2012. However, Treasury's Chief Director of Legal Tax Design recently said that there are regulatory and tax issues to address before the proposal can be implemented. The proposals have now been excluded from the Taxation Laws Amendment Bill 19 of 2011, published in late October, and it is unlikely that the replacement will take place on the date initially planned. Treasury's decision to make the replacement seems to remain unchanged though. Time will tell whether Treasury will, pending the regulatory and tax issues resolutions, apply some of the less restrictive characteristics of Riddas (such as withdrawal percentages and options available to nominees) to Illas.

Treasury believes increased competition will lower costs

One of the main reasons for Treasury's proposal is to lower costs. Currently, Illas can only be sold under a life assurance licence and are marketed mainly by linked-investment service providers (LISPs) that are owned by life assurers or have obtained a life assurance licence. Treasury believes that more competition will lower costs and proposes that more providers should be allowed to market Riddas. Treasury has therefore proposed that retirement funds, collective investment schemes (unit trust management companies and providers of exchange traded funds) and banks be allowed to market Riddas.

Effective investment administration and reputable providers are still essential

We welcome Treasury's proposal, but advisors and their clients are well advised to take into account how effectively their investments are administered and how reputable the provider is; not only cost. PSG Asset Management offers an attractive platform to any retiree. We are backed by the PSG name and all the positive attributes that this provides, including a solid reputation and financial strength. We also offer a competitive flat rate fee structure that is further reduced by rebates paid by the selected funds.

Removing the minimum drawdown will give investors more flexibility

The proposed changes also relate to withdrawal percentages. At present, the drawdown level that the recipient chooses must be set between 2.5% and 17.5%. This forces the recipient to make minimum withdrawals even in circumstances where a smaller or no income is needed. Treasury proposes removing the minimum 2.5% drawdown level, allowing more flexibility. Someone who inherits a Ridda and doesn't require an income from the Ridda can, for example, choose not to make any withdrawals against the account. This allows for optimal capital growth until they need an income. The maximum drawdown level of 17.5% will remain unchanged.

Transfer on death will in future offer a combination of a lump sum and annuity payout

The current legislation states that the investment may be paid to a nominee either as an annuity or as a lump sum on the death of the recipient. As a result, nominees often find themselves in a difficult situation. For example, the nominee may only require a small lump sum amount, but then have to suffer 'unnecessary' taxes because they have to commute the full investment. On the flipside, if nominees choose to continue with an annuity, they are often in a position where they are unable to settle certain immediate debts. Treasury indicated that no good reason exists to deny a combination of both a lump sum and annuity. This proposal will enable advisors to formulate plans that are tailor-made to suit their clients' specific needs.

Government also wants to encourage the combining of Illas because it will be cost-effective and less likely to result in the capital value of the assets falling below an effective R75 000 (which results in a commutation to cash). There is currently no clear guidance from SARS as to how the combining of Illas should be treated and there is no consensus in the industry either. Service providers therefore handle these differently and unintentionally deter investors rather than encourage them to combine their Illas. We would therefore welcome uniform rules.

We hope the proposed changes will be implemented soon to enable investors to benefit from the less restrictive and more flexible provisions. We will keep you updated on any developments.

PSG Asset Management Core Fund Range

FUND TYPE	FUND NAME	OBJECTIVE	RISK
Equity	PSG Equity Fund	The Fund aims to provide outstanding capital growth and to deliver consistent upper quartile returns within an acceptable risk profile.	High
Global Equity	PSG Global Equity Fund PSG Global Equity Feeder Fund	The Fund aims to outperform the average of the world's equity markets, as represented by the MSCI Daily Total Return Net World USD.	High
Flexible	PSG Flexible Fund	The Fund aims to achieve superior medium- to long-term capital growth through exposure to selected sectors of the equity market, and/or the gilt market and/or the money market.	Moderate to High
Prudential	PSG Balanced Fund	The primary objective of the Fund is to provide long-term capital growth and a reasonable level of income.	Moderate
Stable	PSG Stable Fund	The Fund seeks to generate a performance return of CPI+4% over a rolling two-year period, while aiming to achieve capital appreciation with low volatility and low correlation to equity markets through all market cycles.	Moderate to Low
Income	PSG Income Fund	The Fund aims to maximise income while achieving long-term capital appreciation as interest rate cycles allow.	Low
Money Market	PSG Money Market Fund	The Fund aims to obtain a high level of income that is consistent with capital preservation and liquidity.	Negligible

PSG Asset Management Investment Administration Platform

PRODUCT	DESCRIPTION
PSG Voluntary Investment Plan	PSG Asset Management offers investors a wide range of collective investment funds and optional portfolios. You may switch between these portfolios easily and at no cost at almost any point during the investment period. You can invest a lump sum, with or without recurring investments, as well as ad hoc amounts at any time. You may also withdraw your capital whenever you reach your financial goal.
PSG Endowment Investment	An endowment investment is a product suited for providing medium- to long-term savings or capital accumulation. It is ideal if you require a tax-efficient forced savings product to accumulate funds for a specific purpose and is also well suited to those who have a high average tax rate due to the lower tax applicable to interest and capital gains. An endowment has a minimum statutory five-year investment period that provides a further incentive to save and gives you the option of taking regular tax-free income once your investment has matured.
PSG Asset Management Retirement Annuity Fund	A retirement annuity is the ideal product to accumulate wealth for your retirement. A portion of the contributions that you pay into a retirement annuity is tax deductible, thus enhancing your current financial position.
PSG Asset Management Preservation Pension Fund	A pension or provident preservation funds is used to preserve and grow your retirement investment prior to your retirement. It will preserve the savings set aside for your retirement once you have withdrawn from an employer's pension or provident funds.
PSG Asset Management Living Annuity Fund	A living annuity provides you with income during your retirement. A living annuity has the safety of being a highly regulated product, and it enables individuals to choose from a flexible range of underlying investments that is appropriate for their individual needs.

Performance to 30 September 2011

FUND PERFORMANCE

		1 Year			2 Years**			
Fund	Fund Size	Return	Sector Rank	Sector Count	Return	Sector Rank	Sector Count	
CORE FUNDS								
PSG Equity A	R 663,967,753.00	9.30	3	85	13.11	12	84	
FTSE/JSE All Share TR ZAR		3.60			12.02			
Domestic EQ General		3.21			9.80			
PSG Flexible	R 1,475,154,870.00	11.86	5	59	18.23	3	57	
Domestic AA Flexible		5.19			9.06			
PSG Balanced A	R 1,045,270,399.00	9.44	4	65	12.30	2	57	
Domestic AA Pru Variable Equity		5.20			7.91			
PSG Stable ***	R 14,606,146.67							
Domestic AA Pru Low Equity								
PSG Income***	R 18,221,927.53							
STeFI Call Deposit ZAR								
PSG Money Market A	R 1,711,812,021.00	5.66	14	22	6.41	12	22	
Domestic FI Money Market		5.70			6.44			
PSG Global Equity	$ 26,928,563.00	-9.46	401	631				
MSCI World Free GR USD		-3.84						
GIFS Global Large-Cap Blend Equity		-9.17						
PSG Global Equity Feeder***	R 27,744,246.00							
Foreign EQ General								
SPECIALIST FUNDS								
PSG Equity Builder	R 29,079,088.00	3.74	38	85	9.88	47	84	
FTSE/JSE All Share TR ZAR		3.60			12.02			
Domestic EQ General		3.21			9.80			
PSG Preferred Dividend	R 62,810,313.00	1.33			10.37			
STeFI Call Deposit ZAR		5.38			5.95			
PSG Optimal Income	R 143,975,824.00	5.84			5.91			
STeFI Call Deposit ZAR		5.38			5.95			

* Manager inception dates
** Annualised
*** Performance data may only be published after 12 months
All the performance data is net of fees, for a lump sum, includes income, and assumes reinvestment of income on a NAV to BAV basis.

3 Years**			5 Years**			Inception**				VOLATILITY 3 Years**		
Return	Sector Rank	Sector Count	Return	Sector Rank	Sector Count	Inception Date	Return	Sector Rank	Sector Count	Std. Dev.	Sector Reverse Rank	Sector Count
13.55	8	78	7.22	37	59	01/03/2002*	19.52	3	38	16.89	61	78
10.56			8.77				14.39			18.31		
9.05			8.00				15.53			14.74		
15.81	3	51	13.22	3	39	01/11/2004*	18.06	3	18	12.27	36	51
8.42			7.90				13.62			9.15		
11.12	5	51	8.05	16	39	01/06/1999	15.02	3	10	9.42	33	51
7.80			7.56				13.43			7.39		
						01/09/2011	2.76					
							0.40					
-			-			01/09/2011	0.62					
							0.42					
7.71	14	22	8.68	10	19	31/10/1998	9.66	5	7	0.62	14	22
7.72			8.67				9.63			0.61		
						23/07/2010	-6.27	417	626			
							2.23					
							-1.53					
						03/05/2011	-6.28	18	26			
							-0.69					
						05/01/2009	11.97	54	80			
							15.14					
							13.38					
9.59						01/11/2006	6.25			6.53		
7.16							8.20			0.57		
7.67			8.21			10/04/2006	7.78			2.63		
7.16			8.19				8.09			0.57		

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PSG Asset Management Administration Services

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Retirement Annuities
Endowments
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All references to "PSG Asset Management", "PSG" or "we" shall be deemed, unless otherwise stated, to include PSG Asset Management (Pty) Ltd, PSG Collective Investments Limited, PSG Asset Management Administration Services Ltd, PSG Absolute Investments (Pty) Ltd and PSG Asset Management Group Services (Pty) Ltd, all being subsidiaries of PSG Asset Management Holdings (Pty) Ltd, a wholly owned subsidiary of PSG Konsult Limited. PSG Konsult Limited is a juristic representative of PSG Konsult Financial Planning, an Authorised Financial Services Provider, FSP 728.

PSG Asset Management Administration Services Limited is an Authorised Financial Services Provider, Registration Number 1999/010087/06, FSP Number 22557. PSG Asset Management Administration Services Limited administers the PSG Voluntary Investment Plan and is the underwriter of the PSG Retirement Annuity, PSG Equity Linked Living Annuity, PSG Preservation Fund and PSG Endowment Investment. PSG Wealth Nominees (Pty) Ltd is the entity that holds investments in the PSG Voluntary Investment Plan in safe custody for your benefit exclusively.

Collective Investments Schemes are generally medium to long-term investments. The value of participatory interests may go down as well as up and past performance is not a guide to future performance. Collective Investment Schemes are traded at ruling prices and can engage in borrowing and scrip lending. A schedule of fees and charges and maximum commissions is available on request from PSG Collective Investments Limited. Commission and incentives may be paid and if so, are included in the overall costs. Forward pricing is used. The Portfolios may be capped at any time in order for them to be managed in accordance with their mandate. Different classes of units apply to some portfolios and are subject to different fees and charges. PSG Collective Investments Limited is a member of the Association for Savings and Investments South Africa (ASISA).

Conflict of Interest: PSG Asset Management (Pty) Ltd will earn fees at the Funds' level in addition to fees earned at the underlying fund level where a discounted charge will apply. All discounts negotiated are re-invested in the Fund for the benefit of the unit holder. Neither PSG Collective Investments Limited nor PSG Asset Management (Pty) Ltd retains any portion of such discount for their own account. The Fund Manager may use the brokerage services of a related party, Online Securities Ltd, trading as PSG Online.

PSG | Asset Management

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