PSG | Asset Management

2ND Quarter 2012

ANGLES & PERSPECTIVES

CONTENTS

Cover photo: "The futuristic metropolis of Pudong in Shanghai, China" - Shawn Clover

The Times, They Are A-Changin'

Wayne Waldeck
CEO PSG Asset Management Group

Bob Dylan must have experienced one of his more lucid moments when recording 'The times they are a-changin' in 1964 because today, nearly 50 years later, the lyrics of this hit song are still as true as the day he wrote it. The only constant in today's business environment is, after all, change. We can choose to embrace it or to ignore it, but we cannot escape it. One of the current industry issues that we believe should adapt to change is how we handle rebates.

Continuous change provide a challenge to delivering a relevant service offering

In the financial services industry we are constantly challenged by environmental changes as well as changes we initiate to adapt to prevailing circumstances and to proactively dictate our intended course. A constant barrage of changes in laws and legal matters, in client needs and demands, and in economic realities lead us to question prevailing business models and practices in our endeavours to deliver a relevant service to our clients.

The practice of treating rebates as hidden profits is detrimental to client satisfaction and trust

An example of this is the recent 'Call for contributions: Intermediary services and related remuneration in the insurance sector' document released by the Financial Services Board (FSB). It requests commentary and feedback on a whole range of topics regarding the remuneration of intermediaries, but the one aspect that interested me in particular, was the question of how rebates should be dealt with.

Rebates paid by fund managers to LISPs and other distribution channels have been a part of the industry for many years, and certainly have a role to play. Rebates must, however, be applied for the direct benefit of clients and not treated as a source of hidden profits by the recipients. This practice has been endemic in the industry for many years but we believe that it is high time that it is brought to an end. Platforms should not be allowed to fund their bloated cost structures to the detriment of their clients.

Hidden fees recovered from rebates add to the unhealthy rebate practices

A related 'smoke and mirrors' practice is for platforms to inform clients that they pay no administration fees if they invest in certain funds on a platform. This is often misleading as there still is an admin cost payable - the platform will simply recover the cost from the (often undisclosed) rebate it receives from the fund management company.

Investors should receive the full rebate and be allowed to choose how to use it

A further iteration of this practice is to 'offset' the rebate received only to the maximum amount of the admin fee charged. The excess rebate is then retained by the platform as additional income. Rebates paid on client investments are in essence a 'discount' on the annual management fee charged by the fund managers and we believe it belongs to the client. Since clients pay the full management fee, they should receive the full benefit of the discount. All fees and costs paid and received should be clearly disclosed and they should have a choice as to how they wish to apply the excess rebate or 'discount'.

Some clients may wish to use it to pay for admin expenses or to repurchase units, whereas others might want to use it for a refund into a money market or cash account to pay for trail fees or other charges.

Flexible systems, controlled costs and sustainable business models are essential

Obviously these issues will have serious implications for platform providers, intermediaries and business models across the industry. Systems will have to be flexible to accommodate the changes required, costs will have to be controlled to ensure sustainable business models and intermediaries will have to become more astute in evaluating the needs and requirements of clients and the business practices of suppliers.

So hats off to Bob Dylan, the visionary. The times are indeed 'a-changin' – let's hope and trust it's for the better.

Taking Stock

By Adrian Clayton

Adrian Clayton is the CEO of PSG Asset Managers. Adrian has 17 years of investment experience and continues to co-manage the PSG Balanced Fund, a fund he launched in 1999.

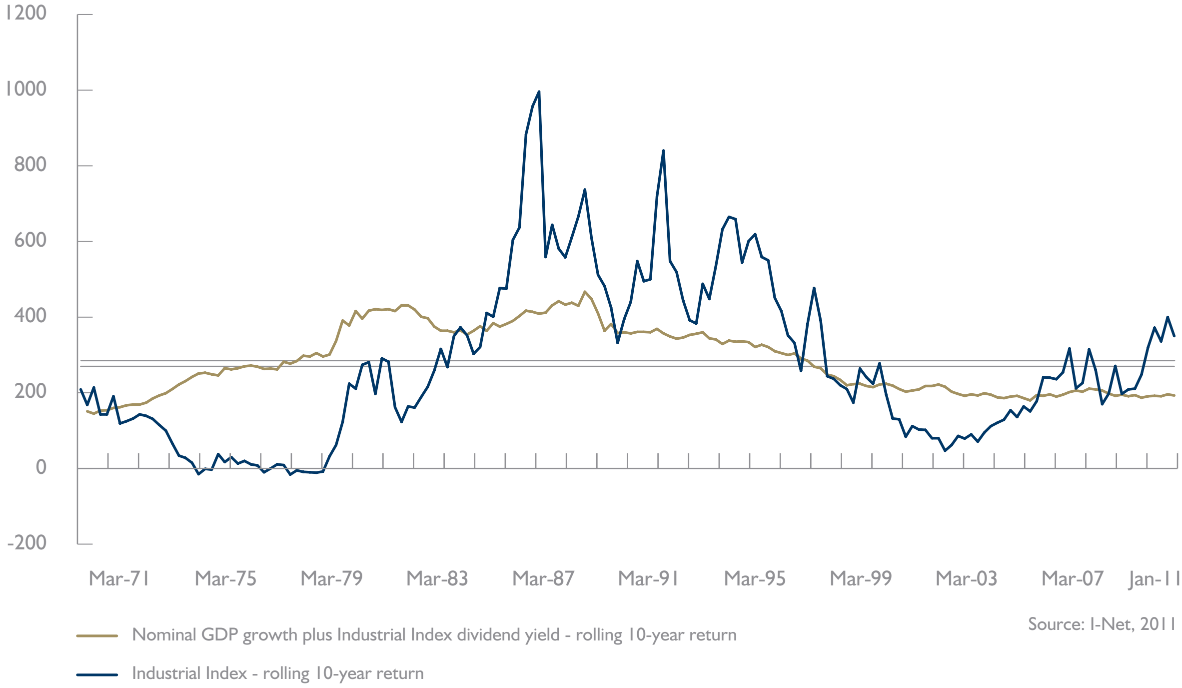
As we enter the new financial year and our second year as the unified investment team, I thought it appropriate to assess the last twelve months with respect to market movements, economic developments and our own operational and investment performance.

A lost decade in the 1st world, but a healthier last year

In the context of the 4.12% annualised total return which investors have received from the S&P 500 Index over the past decade (to the end of March 2012), the 8.54% enjoyed over the last 12 months is more in line with proxy growth estimates often alluded to by investor greats like Warren Buffett. Buffett believes long-term returns should be approximated by adding real GDP (average of 3.3% since 1947) plus inflation (2.9% in 2011) and dividend growth (2%).

The underperformance of developed markets this past decade has been pervasive. The CAC remains moribund 37% below its March 2002 levels, the Nikkei is 8% below its level of 10 years ago and the FTSE a mere 9% higher. Of particular interest is that markets have produced positive returns 7 out of the last 10 years - better than average - but the events of 2008 wrecked any hint of favourable decade return metrics. In stark comparison, gold has returned 9.1 times that of the S&P since 31 March 2002.

Graph 1: Industrial Index versus Nominal GDP growth-plus-dividend yield



Emerging market investors have been richly rewarded

Using South African assets as a proxy for emerging markets we can see that investors with an appetite for these investments were in general richly rewarded this past decade. In South Africa, every asset class has outperformed inflation on an annualised total return basis over the past 10 years, with Property Unit Trusts the stand-out winners at an average 23.7% total return and cash the lowest, but still a healthy 9.1%. The ALSI produced 15.1% on an annualised basis, its best performing sub-sector being Industrials at 20%. Inflation has averaged 5.7% per year over the decade.

Adding to this, the rand has appreciated by 30% against the dollar since the end of March 2002 (the rand/dollar exchange rate was R11.40/$1 on 31 March 2002), creating staggering returns for foreign investors in SA.

With six of nine major sub-indices of the JSE producing rand total returns in excess of 20% over the last 12 months, the local market has yet again been a global stand-out performer.

Erratic and weak global growth has demanded protracted fiscal stimulus

Global economic data picked up in the first quarter of 2012 after a very weak final quarter in 2011. Growth has not been uniform though, with US and Japanese data surprising on the upside whilst very weak numbers have emanated from Europe. Manufacturing activity is contracting in 8 of the 10 Eurozone members where the PMI (Purchasing Managers Index) is conducted. Manufacturing activity, traditionally the power plant of the Chinese economy, has also been very weak and its PMI is at the lowest level since the first quarter of 2009. The effect of all of this is most visible in the severe underperformance of cyclical shares on the JSE and the Resources Index underperformed the Industrial Index by 33% over the past 12 months.

Four years post the 2008 US sub-prime crisis, and central bank and fiscal interventions continue unabated across most of the G20 countries. The US Federal Reserve is involved with 'Operation Twist' where it has allocated $400 billion of funds to drive down long-term interest rates in the US. This incentivises mortgage refinancing (stimulating the beleaguered housing market) and assists large businesses to secure long-term cheap financing.

On the other side of the Atlantic, the Bank of England has been expanding its asset purchase programme by £50 billion to £325 billion and the European Central Bank (ECB) has been actively involved with its Long-Term Refinancing Operations (LTROs). So far □1.019 trillion has been injected into the system by the ECB, which is effectively offering banks cheap funding as the interbank lending market has ceased to operate normally. Banks in Europe have simply been too nervous to lend to each other. The Bank of Japan has been equally active, expanding its repurchases of government bonds to ¥65 trillion from ¥55 trillion.

Financial authorities within emerging markets have also keenly participated in managing their economies in 2012. The central banks of Brazil, Chile, Israel, Thailand and the Philippines have all cut rates and China has reduced the reserve requirements of its banks. All of this has been designed to loosen monetary policy and expand their economies.

South African economy resilient

As financial experiments took place across all corners of the globe in 2011, the South African economy tracked along at an unspectacular but reasonable 3.1% total return for the year.

Households have enjoyed consistently maintained low interest rates and real disposable incomes in SA increased as remuneration levels for SA Government employees rose by 13.7% year-on-year in the 3rd quarter of 2011, compared to only 6.3% in the private sector.

Debt servicing costs have fallen for households from 12% of disposable income during the crisis in 2008, to the current 6.7%, raising confidence and fuelling consumption. Household consumption expenditure rose by 5% in 2011. The SA government assisted GDP growth as government expenditure expanded by 4.5% last year.

Fixed capital formation at 4.4% year-on-year growth in 2011 was also very respectable, driven by Government and the domestic mining industry.

On aggregate, the SA economy produced a relatively well balanced result last year.

We are unashamedly bottom-up stock pickers

Whilst at PSG we are not oblivious to the importance of sound economic policy for creating stability for markets, we do not make economic predictions. Clearly from all the moving parts described above, trying to make consistently accurate forecasts of the future is a hapless task!

Twelve months ago we did not even attempt to gauge how the various economies around the world would perform and, in turn, this had no bearing on our investment decisions. Similarly, we have made no economic predictions for 2012. This is not our process.

That said, understanding macroeconomic policy and its effects on asset class behaviour can assist long-term value investors like us to identify periods of serious market distortion. This could act as another confirmation of what our bottom-up research is telling us.

Our focus this past year, as always, has been heavily geared towards building a deep seated knowledge of the investments we view as appropriate to protect and grow our investors' capital. Working towards assessing the inherent value within individual companies and then owning or selling them is, in our opinion, the only viable and successful strategy to long-term wealth creation.

We presently screen about 3,000 companies around the world and we cover most local companies. As part of our process we conducted at least 60 'deep dives' during the past year. A deep dive is an intense investigation of a company where we believe that there exists a combination of strong management teams, deep and abiding moats (competitive market positions) and which is trading at a significant margin of safety.

It gives us great satisfaction to inform our readers that this investment process continues to reward our investors. This was evidenced by the PSG Flexible and PSG Equity Funds once again winning Raging Bull awards for their outstanding long-term returns. In addition, the PSG Balanced Fund was also again nominated for a Standard & Poors award this year. The fact that no less than three of the core PSG funds were either finalists or winners of awards – all over multiple time periods – speaks volumes for the consistency of the application of our investment process.

Looking ahead

One way for us to assess how easy it will be to generate returns that will try to meet investor expectations in the year ahead is to look at our active stock list, the list of companies we are presently buying across our funds.

Two things stand out on our domestic market stock list. The first is that the number of prospective companies that we view as high conviction buys continues to shrink. There currently are fewer companies trading at levels where we feel that the risk/reward opportunities strongly justify their inclusion at large weightings in our portfolios. The second is that increasing numbers of companies in the domestic market have reached what we have calculated to be their intrinsic values. Graph 1 shows how well local Industrial companies have done relative to the "Buffett Benchmark" and highlights our present valuation concerns.

Where we are finding value domestically is in some of the commodity counters which, whilst not typical compounding stories, have an undervaluation now in stark contrast to the elevated valuations across the SA companies that would traditionally be regarded as compounders.

Abroad, our offshore stock list is fortunately significantly larger than what is available domestically, although frustratingly, the legislated or allowed exposure to these companies is restricted to limits which preclude us seizing sufficient of the opportunities we would like. In general, valuations remain more compelling abroad (particularly in Europe and to a slightly lesser degree the United States) except in the cyclical area where companies remain very cheap.

Although we have a larger pool of options abroad, it is worth noting the extent to which stocks have in general, risen in all markets. Across our offshore active list, our favoured companies are now on average only 12% off their 52-week highs and these selected companies are on average 21% away from what we calculate to be their intrinsic values. This is significantly less than a year ago! While we do not foresee a situation where we will exhaust our options, it is true that the amount of bargains available has declined over the last two years.

Central to our investment thesis is the belief that markets are not perfectly efficient pricing mechanisms. Our job is to direct our energies to those areas where we believe mispricing is most prominent. To do this successfully, we need two critical ingredients; a powerful, intelligent and unifying investment process, and time. Markets move assets through extended periods of over- and under-valuation but, given time, valuations normalise through mean reversion.

We are Positive

In conclusion, at PSG Asset Management we know that we have a robust investment process and a formidable team of investment professionals to implement it. Considering equity returns occur in lumpy, inconsistent spurts, as opposed to being smooth and delivered annually, it is important for investors to ensure that time acts in their favour by being very patient.

Whilst opportunities have reduced domestically, we remain very confident that our portfolios have been carefully constructed from assets where intrinsic values are higher than current prices. Given time, this should ensure that we continue to produce sound returns.

Systems make it possible - EOH makes it happen

By Phillipp Wörz

Philipp obtained a BComm (Hons) Economics from the University of Stellenbosch and is a CFA charterholder. He has been with the business for over five years, is an analyst and serves on the PSG Asset Management Investment Committee.

In the late 18th and early 19th centuries, lifestyles and ways of doing business took a fundamental shift with the arrival of the industrial revolution. Fast forward 200 years and history seems to be repeating itself, just under a different guise.

Information Technology (IT) is the enabler of the current technology revolution or digital age, with its software and networks being the cogs and flywheels of the modern global economy.

A company we have widely held across our client portfolios for a number of years, and one which in our view is one of South Africa's best placed listed entities to benefit from this long term trend, is JSE-listed Enterprise Outsource Holdings (EOH).

What we look for in a company

At PSG Asset Management, our preference when investing is to allocate capital to a high quality company with strong pricing power, which is able to reinvest in its business and earn a high return on capital. This ability stems from the company having a sustainable competitive advantage, or a moat. Furthermore, we require that this company be managed by a competent, interest-aligned management team and that the stock in the company is available for purchase at a sufficient margin of safety.

EOH strongly met all of these criteria when we decided to invest in it a number of years ago. We believe some of the best long-term return opportunities are to be found in the smaller to mid-capitalisation space of the market. At the time, EOH was still a relatively small company, and therefore not sufficiently large for many of our competitors to materially invest in. As Graph 1 however shows, EOH has gone from strength to strength and risen to prominence in a relatively short space of time with its share price up five-fold over the past three years.

Many market participants would rightly ask whether EOH's strong performance is sustainable and continued stock ownership warranted. In what follows we will offer some insight into what attracts us to EOH as a long-term investment opportunity.

The beautiful thing about EOH

The beautiful thing about EOH is that it is a win-win business.

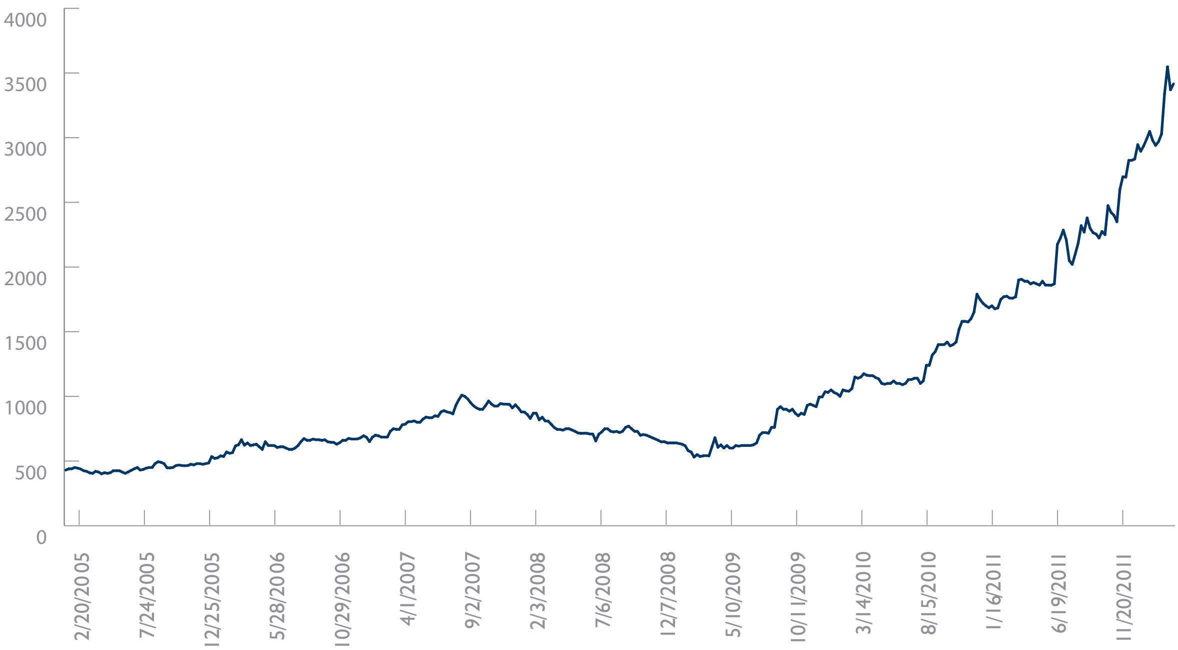
EOH provides the tools (designs, builds and operates IT and business solutions) that assist their clients in running smarter, leaner and more efficient operations. In return, EOH enjoys profitable growth by doing things right first time, by employing the best people and partnering with their clients for life. While this may sound simple, businesses that help other businesses do better will tend to do well in both good and challenging economic times.

Even though the company has grown to a staff complement of around 4,000 people, the company's secret sauce, in our view, lies in the way it has organised itself.

EOH runs a largely decentralised model with a multitude of business units, thus enabling these to become specialists in their respective fields, whilst having incentive mechanisms in place that ensure they work towards one common goal, EOH's overall performance. As EOH increases in size, we believe this will stand the company in good stead and prevent it from losing its entrepreneurial culture and becoming too corporatized.

The same goes for acquisitions. As acquisitive growth is a strategic objective as set out by management and a large historical contributor to the organisation's growth. EOH's ability to integrate acquisitions and extract value is paramount. It is in the enviable situation that it is in fact approached by many potential acquisition targets who would like to be part of a successful group, a la Warren Buffett's Berkshire. EOH then has the ability to leverage these acquisitions by introducing and cross-selling the new product offerings to EOH's existing client base, thereby promoting faster growth. The company has organised itself so it can easily integrate additional acquisitions well into the future. Worth mentioning too is the fact that, so

Graph 1: EOH share price



Source: I-Net, 2011

far, EOH has portrayed great discipline by not overpaying for acquisitions.

The competitive advantages

As mentioned above, one of the characteristics we look for in a company is a sustainable competitive advantage. While there are simpler tasks than describing a competitive advantage for an IT company, we view EOH's competitive advantage to be three-fold:

- **Switching costs** in IT are substantial. As long as EOH provides a quality service and lives up to its 'Right – First Time' mantra, clients have no reason to change IT and outsource providers. Additionally, EOH has an excellent reputation in the industry, thus attracting new clients.
- EOH's Partner for Life philosophy and excellent service creates a hook into the client which allows EOH to **know its clients** intimately, thereby placing EOH in a better position to offer customised solutions that clients need, and price accordingly. It is much easier to sell more to existing clients than to win a new client.
- EOH's **organisational structure**, as described above, makes sense to us, as it makes individual business units more accountable while aligning them with the interests of the group. This organisational make-up differs from the other large IT companies.

A great leadership team

As can be seen in Graph 2 on the opposite page, the company's track record speaks for itself. EOH has delivered a compound annual growth rate in diluted headline earnings per share of 25%, both over a 5- and 10-year period.

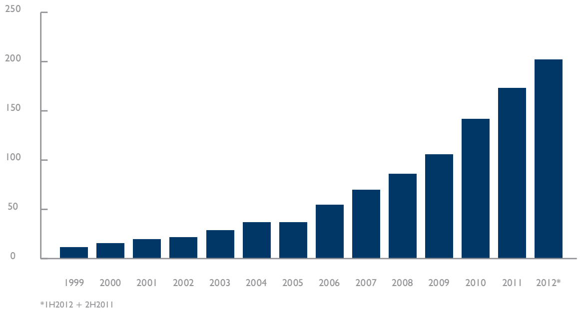
We consider company founder and CEO Asher Bohbot to be one of the top Chief Executives any South African corporate has to offer. He still owns around 7% of the company's shares. The company has strong, competent management – at the top and several layers down – and we are comfortable that management structures have been put in place to take the company well into the future.

Future growth looks promising

Consistent to its long-standing strategy, EOH will grow both organically and via acquisitions. It will do this by organically growing existing clients, winning new clients and by filling out gaps to its service offering via acquisitions, all the while playing higher up the value chain, thereby commanding better pricing and margins. To give some idea as to the size of the market available to EOH, it currently turns over R4 billion in an R80 billion market, or about 5% of the market (Graph 3).

The IT sector is set to grow faster than GDP for some time and IT services are set to be the faster growing components.

Graph 2: EOH - Diluted HEPS



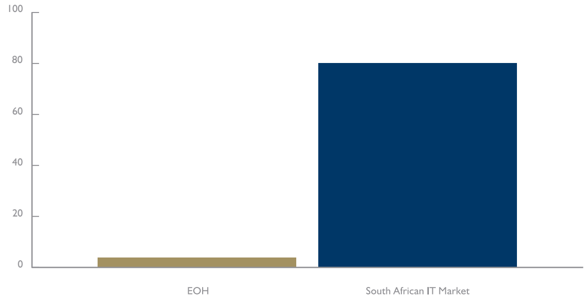
Source: Company reports; PSG Asset Management

In line with the trend of recent years, EOH should continue to grab market share, thus allowing for above industry and healthy bottom line growth.

Still a long-term opportunity

As was seen in Graph 1, EOH has been a phenomenal performer over the years and investing in the firm at its current price is certainly no longer the very contrarian position it once was. EOH's margin of safety has reduced significantly from when we first bought into the share where, according to our calculations at the time, it was trading below its ex-growth value and offering substantial upside to intrinsic value.

Graph 3: Market size



As a new investor would now paying for some growth, the portion of firm value we least like to pay for, we have reduced our conviction levels and position sizes in this holding somewhat. However, according to our work, EOH is still trading at an attractive discount to intrinsic value and – given our conviction in its business model and EOH's enviable positioning as an enabler of the modern economy and a smarter South Africa – we continue to believe EOH will reward shareholders well into the future.

UTC: Global Innovation in Action

By Henno Vermaak

Henno has been an analyst with PSG Asset Management since 2008. He is a qualified actuary and CFA charterholder.

One distinguishing characteristic of the PSG Asset Management investment process is that we do not limit our equity analysts to any specific region. This unconstrained outlook enables us to compare and contrast businesses across geographies and can ultimately reduce portfolio risk when we find attractive investment opportunities outside South Africa.

Once such global opportunity that we hold on behalf of many of our investors is United Technologies Corp (UTC). UTC, an industrial conglomerate listed in New York, is a true blue chip company with a 75 year track record of consecutive dividend payments to shareholders.

Our clients have been invested in UTC since 2008 and will most likely be invested for many years to come. Here is why…

Interesting areas of operation

UTC operates in the global industrial arena in industries that are hardly represented on the JSE. Its businesses can be grouped into two broad categories – commercial and aerospace.

Table 1: UTC's commercial and aerospace businesses

Commercial Businesses	
Company	**Description**
Otis	The world's largest manufacturer of elevators, escalators and moving walkways.
Carrier	The leading heating, ventilating, air-conditioning and refrigeration (HVACR) manufacturer.
UTC Fire & Security	A leading security provider that might be better known for some if its brands which includes Chubb, Supra and Kidde.

Aerospace Businesses	
Company	**Description**
Pratt & Whitney	One of the largest aircraft engine manufacturers of the world.
Hamilton Sundstrand	Producer of multiple control systems used in aircrafts.
Sikorsky	Builder of commercial and military helicopters including the Black Hawk

To expand its product base UTC has recently acquired a company named Goodrich, a competitor in complementary parts and services. UTC's aerospace product base will now include landing gear and braking systems for commercial aircraft.

Attractive shareholder returns

UTC is included in the Dow Jones Industrial Average and is also a constituent of the S&P 500 Index and has an extraordinary track record of delivering value to shareholders, far in excess of the performance of the benchmarks. Including dividends, UTC delivered more than three times the return of the indices over the past 14 years.

Table 2: UTC's returns compared to the S&P 500 and Dow Jones Index (US$) since January 1998

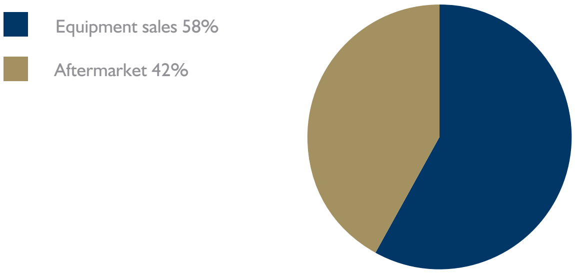
	Total return	Annualised
UTC	487.2%	13.2% p.a.
S&P 500	87.1%	4.5% p.a.
Dow Jones	67.1%	3.7% p.a.

Source: Bloomberg

Recurring revenues

Chart 1: UTC revenue split according to source

Revenue by type



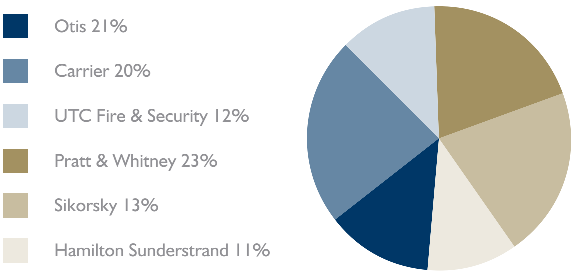
Source: UTC 2011 Annual Report

UTC manufactures, sells and maintains a wide range of quality equipment throughout the world. With every additional piece of equipment that UTC sells, it stands to benefit from an annuity income stream arising from that sale far into the future. As an example, the installation of a new lift or aircraft engine ensures ongoing service-and-parts revenue for decades to come. The beautiful thing about this business is that more than 40% of UTC's revenues come from these ongoing annuity streams.

Emerging market potential

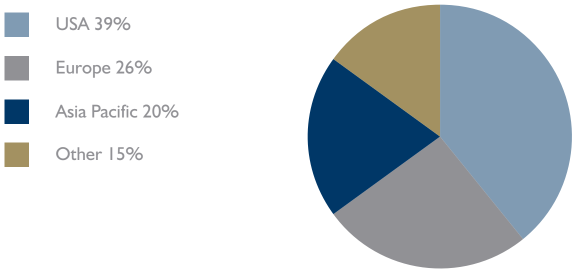
UTC's revenue is earned fairly equally between the commercial and aerospace businesses. The geographical split of the revenue sources shows a balance between the stable annuity revenues of developed markets and the explosive growth in equipment sales to the developing world. Currently, 21% of the revenue is earned from emerging markets and this figure continues to grow each year.

Chart 2: Revenue segmented by business unit



Source: UTC 2011 Annual Report

Chart 3: Revenue segmented by geography



Source: UTC 2011 Annual Report

Competent management team

UTC is managed by a large group of skilled managers and within the different business lines there are a number of candidates in line to succeed the current group executives. Over long periods and through market cycles, management has proven that they can add value to current businesses and expand into growth areas; while rewarding shareholders with growth. Since 1995, earnings and dividends have grown at a compound rate of 13% and 14% per annum respectively on a per share basis.

Group executives focus on using capital efficiently and generating free cash flow. Free cash is used to pay dividends, to buy back shares and to fund acquisitions when opportunities arise. The 2011 purchase of Goodrich is an example of an astute purchase.

The management team also has the ability to roll out the successes of one line of business to other areas. One area of particular success has been the growth and margin expansion delivered within the Carrier business.

Following a number of acquisitions at the turn of the century, management began a focused effort to simplify the business and integrate the different acquisitions into one, efficient company. As a result, operating margins improved from 8% in 2001 to 12% in 2011 and a new target of 14% margins by 2014 has been set.

This same management team that delivered these vast improvements in Carrier has now been given the reins at UTC Fire & Security. UTC Fire & Security is currently where Carrier was a decade ago and we are expecting that the team will successfully implement the lessons they learned at Carrier at UTC Fire & Security.

Secular growth trends

UTC is exposed to two significant global growth drivers: airline travel and urbanisation.

Airline traffic has seen annualised growth of 5% over the past 30 years and is expected to continue growing over the next 20 years at least. The US Federal Aviation Administration expects that traffic on American carriers to double by 2031.

Real growth is also likely to come from emerging markets as more airports are built in new and growing cities. UTC management expects 30,000 new aircraft to be built by major manufacturers, less than half of which will go to the US and EU. UTC's aerospace businesses provide parts to all major aircraft platforms and will benefit further from aftermarket servicing.

The urbanisation trends globally will be a driver of growth for the commercial businesses. Otis is already the number one player in China where a total of around 360,000 new elevators are currently installed on an annual basis. This is 20 times the size of current North American installations. Additionally, each new building also needs HVACR, fire prevention and security systems. These are all areas in which UTC stand to benefit both from new orders as well as from annuity services.

Margin of safety

However highly we regard a company's management and moat, we only invest if shares in the business can be acquired at a margin of safety to our estimate of its intrinsic value. In the case of UTC, we take comfort in the recurring nature of the revenues of the business. It is unlikely that any part of the business will see revenues fall off a cliff as was confirmed during the recent financial crisis.

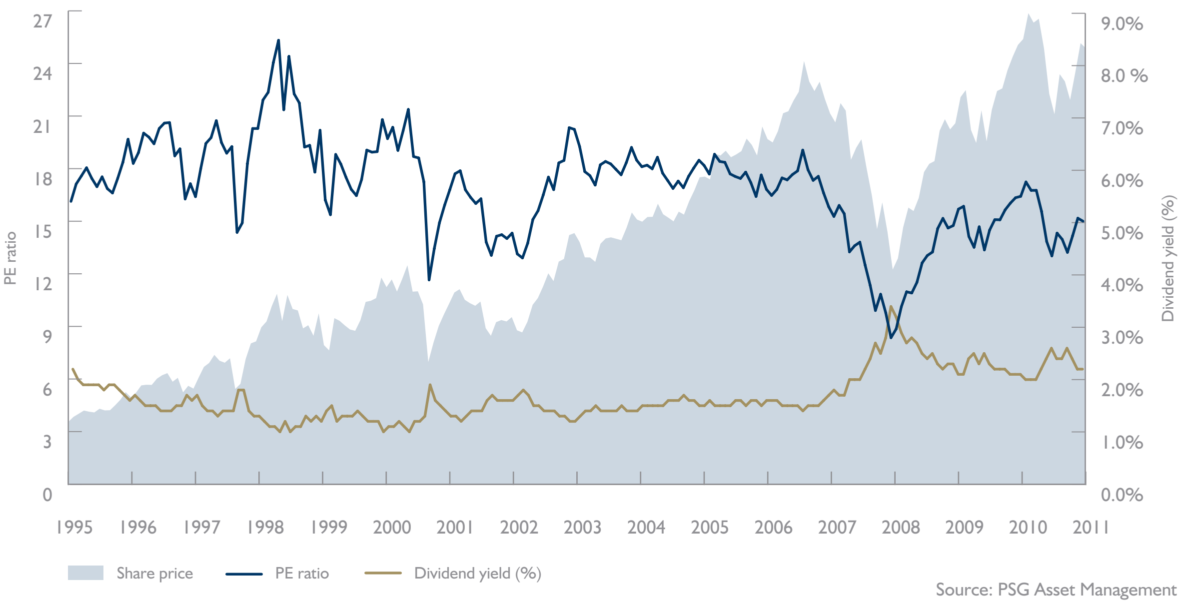
While sales on new equipment and refurbishment orders did see reductions, the spending on the maintenance of current installed equipment actually increased since the credit crunch. Maintenance revenue often earns a higher profit margin than the original equipment sales. This acts as a natural hedge in difficult times.

The current valuation is not particularly demanding on a historic basis. Both the PE ratio as well as the dividend yield is currently more attractive than their long-term averages. Our research suggests that shares in UTC are trading at around 80c in the dollar.

UTC ticks our boxes in terms of the quality of management and a wide and enduring moat. It offers exposure into the growth that emerging markets have to deliver, while benefitting from stable, long-term revenues in the developed world.

UTC remains a holding in our portfolios, and we will happily invest additional capital if the market offers us the kind of opportunity it did in 2008.

Graph 4: UTC: Historic PE ratio and dividend yield



Source: PSG Asset Management

Why PSG Asset Management?

Ross Breedt

Ross is the Executive in charge of sales at PSG Asset Management and a director of various PSG companies. He is responsible for the sale and distribution of the PSG core range of unit trusts. Ross is an unapologetic salesman.

'The numbers are what the numbers are!'

This is a phrase our investment specialists often use and it is particularly applicable in light of the numbers we saw over the past year.

We are very grateful that we can highlight an exceptional year of fund flows into the PSG core range of funds, with net flows for the year to the end of February 2012 in excess of R1.9 billion. This is quite a staggering figure when compared to previous years. It's safe to say this level of net flows is a first in our history.

Since the 'numbers are what the numbers are', the question those who are not yet invested in the PSG funds should be asking themselves is: 'What are all these investors seeing that I am not?'

Five reasons why investors should invest with PSG

In essence, it's the responsibility of the investment specialist to take all the intricate market and fund management information and turn it into a simple and understandable message that the average investor can relate to.

If we, as the sales team, can communicate this message in a way that is well received by the investing community, investors will support our funds and we will experience positive inflows.

Over the past year we have focused on spreading the message of the five simple and proven reasons to invest with PSG.

A highly qualified team of managers with some of the longest track records in the industry

The table shows the years of experience of the managers of the core range of PSG funds. It is notable that the managers have been custodians of these funds for exceptionally long periods of time and all of them have many years of experience in asset management specifically. If one adds up the years, our team has more than 120 years of experience managing investments!

PSG Fund	Manager	Manager inception	Years in the industry
PSG Equity Fund	Shaun le Roux	1 Mar 2002 – 10 years	15 years
PSG Flexible Fund	Jan Mouton	1 Nov 2004 – 7 years	10 years
PSG Balanced Fund	Adrian Clayton & Neels van Schaik	1 Jun 1999 – 13 years	17 years 14 years
PSG Stable Fund	Paul Bosman	1 Sep 2011	8 years
PSG Income Fund	Heinrich Dietzsch & Mark Seymour	1 Sep 2011	32 years 11 years
PSG Money Market Fund	Heinrich Dietzsch & Qanitah Adams	1 Nov 1998 1 Jun 2008	32 years 4 years
PSG Global Equity Fund	Greg Hopkins	1 Jul 2010	12 years

A disciplined and investment philosophy founded in value investing

There are many managers in the industry who claim to be 'value managers', but the proof of whether they live up to this billing lies in whether they truly have a disciplined application of the value philosophy and investment process. This can be measured and observed from fund holdings and performance – particularly at times when markets move into a momentum phase or when there is a significant correction.

The core of our investment philosophy is staying true to the three C's: Consistent, Conservative and Contrarian.

Consistency is about the consistent application of our value-based investment process over long periods of time and across our full range of funds. It also speaks of the consistency of our team members with their lengthy track records.

Conservative reflects our constant focus on avoiding a permanent loss of capital and the unconstrained nature of the portfolios we manage.

Contrarian refers to how we consistently buy when others are selling, how we're not afraid to invest offshore when the majority of investors prefer domestic investments (and the other way around) and how, with our size advantage (which we discuss in more detail later), we can invest in parts of the market that our larger competitors cannot.

These three C's are the spine of our entire investment philosophy.

Using this philosophy as our compass, we tirelessly apply our stock selection process of investing in companies which meet our three M's (see elsewhere in this publication for more on that) in a disciplined way.

The fact that many of our funds have won multiple awards over many years speaks volumes about the validity of our philosophy and execution of our process.

A strong focus on research and a happy team culture

How do you know whether employees are happy and content and are therefore able to focus on what they have to deliver? Just ask about the staff turnover. Over the past eight years we had to bid only one member of our investment team farewell – an analyst who moved back to the actuarial environment he came from.

The number of job applications we receive reflects the strong interest of talented hopefuls to join the PSG Asset Management investment team. One of the biggest attractions of our team is our focus on research. Portfolio managers and analysts alike spend the vast majority of their time – mostly in small teams – researching investment ideas and searching for opportunities. This translates into high conviction investment ideas and, eventually, long-term performance.

Harnessing the advantages of being a smaller asset manager

Contrary to popular belief, there is actually a disadvantage to being 'too big', and a significant advantage to being one of the smaller industry players. As markets move into the territory of offering less value and where momentum pushes returns, having the ability to 'fish' outside the big conglomerates that occupy the JSE All-share Top 40 Index, making sizeable convictions calls on smaller cap stocks and not impacting on liquidity can and does play a huge role in delivering alpha returns. It also reduces the risks of permanent capital loss of buying too expensive stocks (pushed up by momentum).

An alignment of interests between managers and investors

Our portfolio managers are significant shareholders in our company and especially in the funds they manage. This creates a significant alignment of long-term interests between the investor and the manager. If the funds do well, the manager's investment in the fund will grow over time. Furthermore, if the funds do well, the company will do well and the share price of the company will go up over time. Investment decisions are therefore made on a sustainable basis with a focus on ensuring long-term success.

Get onboard

We believe we have a winning formula, and that our consistent long-term returns over time have proven this.

If you are interested in joining the next wave in the South African asset management industry, we urge you to contact us today.

Do not let the following quote be your legacy:

'Opportunity is often difficult to recognise; we usually expect it to beckon us with beepers and billboards.'

William Arthur Ward

Voluntary or compulsory savings for retirement – which is best?

by Tom Blendulf

Tom entered the investment industry in 1995 and joined the PSG team in 2008. He is a Chartered Alternative Investment Analyst Association (CAIA) Charterholder. Tom heads up PSG Asset Management's Technical Investment Centre and is also responsible for products on the platform.

What is the impact of the different tax treatment of products on your investment value?

Most investors assume that they benefit when some or all of their retirement funding premiums are tax deductible. This is partly true, but only if you are subject to a lower marginal tax rate once you have retired.

If investors knew with certainty that they would pay the same tax rate before and after retirement, and if the asset returns were taxed in the same manner in either voluntary (for example a unit trust) or compulsory (for example a retirement annuity or an equity-linked living annuity) retirement products, investors would be indifferent as to which product to invest in. They would have a liquidity benefit if they invest their after-tax money in a voluntary product, and they would be protected from creditors if they invest in a compulsory product.

What impact does compounding tax savings have on fund values?

Under current legislation, compulsory products are exempt from Capital Gains Tax (CGT), Dividend Withholding Tax (DWT) – which replaced the former Secondary Tax on Companies – and Income Tax. The interest you earn is therefore tax free, whereas it's fully taxable at your marginal tax rate in a voluntary product. The purpose of this article is to try and demonstrate the compounding effects of these taxes on the investment value of these two product categories during the saving and income drawdown periods.

We base our analysis on the following assumptions:

1. Both the compulsory and voluntary product investor are taxed at a flat rate of 40% both pre- and post-retirement.
2. Both investors invest R18,000 per year at the start of the savings period (25 years) and increase the premium each year by the same rate as inflation.
3. The compulsory product investor reinvests the tax saving during the saving phase (R30,000 per year in year one).
4. Both investors hold a unit trust portfolio with a 75% equity and 25% Fixed Interest (FI) split at all times in both products.
5. Equity total returns are 15% per year.
6. Any DWT (where applicable) is applied at 15%.
7. The dividend yield is 3% per year.
8. The CGT inclusion rate is 33%.
9. The total return of the FI portion is 9% per year.
10. The FI return is taxed at 40%
11. Inflation is constant at 6% per year.
12. Both investors require an annual income of R360,000 per year, net of tax at retirement. This equates to R600,000 per year gross for the compulsory investor, and R360,000 per year for the voluntary investor as it is already after-tax money. This income increases by inflation each year.

Based on these assumptions, the net after-tax returns are assumed to be:

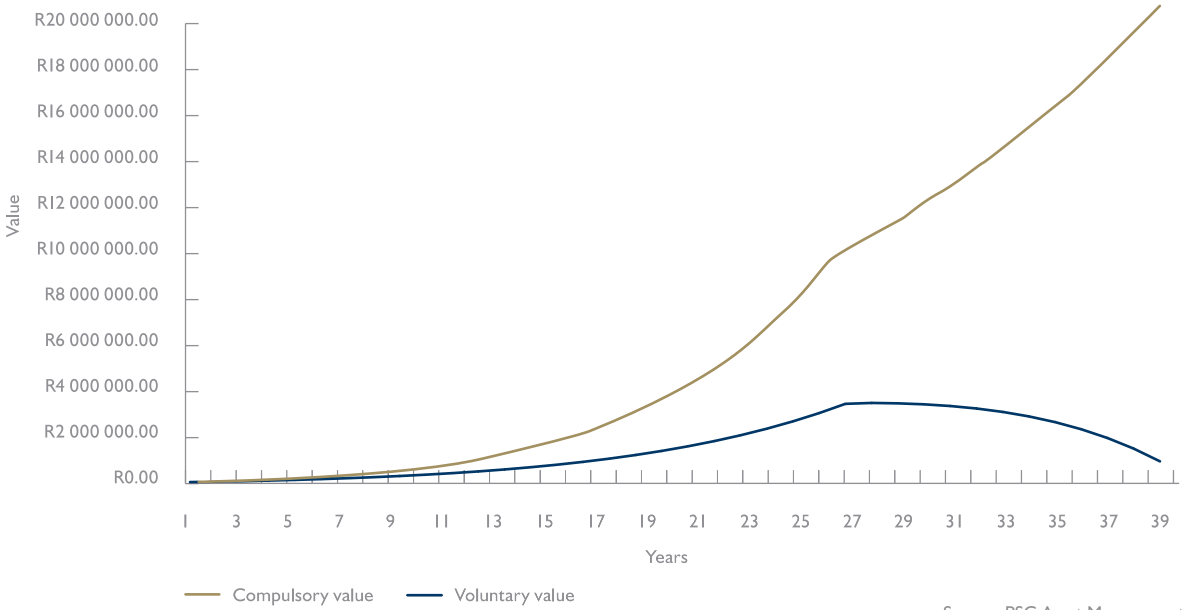
	Compulsory returns	Voluntary returns
75% equity growth at 15%	15% net growth	12.96% net of CGT and DWT
25% fixed interest at 9%	9% net growth	5.4% net of Income Tax
Total return	13.5% per year	11.1% per year

Compounding tax savings has a significant effect on the investment value over the long term

As can be seen from Graph 1, the impact of compounding on fund value differs greatly between voluntary products and tax-exempt compulsory products.

After saving for 25 years, the compulsory product had an investment value of R8,943,718, whereas the value of the

Graph 1: The compounding effect of tax savings on fund value



Source: PSG Asset Management

voluntary product was R3,626,762. This difference is due to the faster growth of the compulsory product tax savings (in relation to voluntary growth) because of tax exemption. When these higher savings are reinvested, it makes a more significant contribution to the overall growth in fund value.

But there's another part to this picture. The compulsory investor was able to draw R600,000 per year after retirement, increasing in relation to inflation into perpetuity. Unfortunately for the voluntary investor, the capital was exhausted after a period of just 14 years, despite only drawing R360,000 per year and generating the same pre-tax returns. The reinvestment of the initial tax saving is offset by the difference in income drawn down, so the outperformance is due only to the difference in tax treatment between the two products.

How can you manage your preparation for retirement in the context of the current tax laws?

1. Take advantage of the current tax deductions when you save for retirement.
2. Take advantage of the tax exemption on the growth of your assets before retirement (via a retirement annuity or RA) and after retirement (via an equity linked living annuity or ELLA) and benefit from the compounding effect of the tax savings on your investment value.
3. Plan ahead to ensure that you have sufficient savings built up at retirement so that you can sustain your lifestyle by taking into account the potential impact of tax on your savings and investment value.
4. Remember that RAs are protected from your creditors. On death the benefit would be paid to your dependants, not your creditors.

NOTES

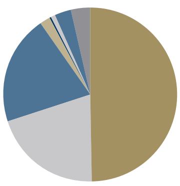
Portfolio Holdings and Performance as at 31 March 2012

PSG Global Equity Fund

Top 10 equities

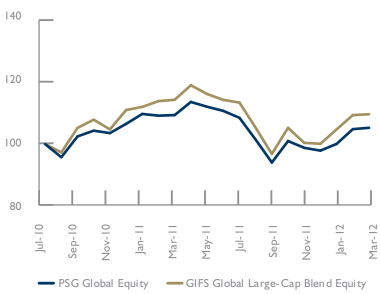
Tesco Plc
Alstom
Berkshire Hathaway Inc
Unilever
Microsoft Corp
Bank of New York Mellon Corp
Imperial Tobacco Plc
Diageo Plc
BP Plc
Heineken Ord

Regional allocation



US	49.8%
UK	20.5%
Europe ex UK	20.3%
Japan	1.9%
China	0.2%
Brazil	1%
Africa	2.8%
Foreign equity	**96.4%**
Cash	**3.6%**
Total	**100.0%**

Performance

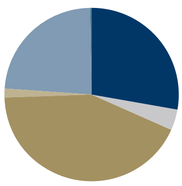


PSG Equity Fund

Top 10 equities

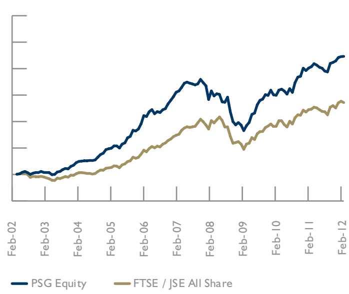
BHP Billiton Plc
Anglo American Plc
Steinhoff International Holdings Limited
Sasol Ltd
Tesco Plc
Tongaat-Hulett Limited
Nampak Limited
Ebay Incorporated
Brimstone Investments Limited
Grindrod Limited

Asset allocation



Resources	28.0%
Financials	3.9%
Industrials	42.7%
Domestic Equity	**74.6%**
Domestic Cash	**1.7%**
Foreign equity	**23.6%**
Foreign cash	**0.1%**
Total	**100%**

Performance

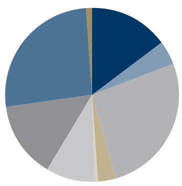


PSG Flexible Fund

Top 10 equities

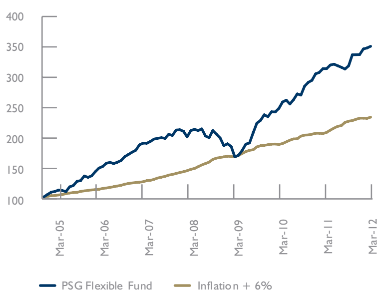
Steinhoff International Holdings Limited
Sasol Ltd
Berkshire Hathaway Inc
Anglo American Plc
Tesco Plc
Capital Shopping Centres Group Plc
EOH Holdings Ltd
ING Group NV
Grindrod Ltd
Eqstra Holdings Ltd

Asset allocation



Resources	15.0%
Financials	4.6%
Industrials	26.5%
Property	3.4%
Domestic equity	**49.5%**
Resources	0.4%
Financials	9.5%
Industrials	14.3%
Foreign equity	**24.2%**
Domestic cash	**26.2%**
Foreign cash	**0.1%**
Total	**100%**

Performance

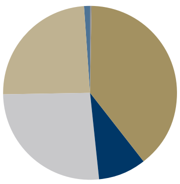


PSG Balanced Fund

Top 10 equities

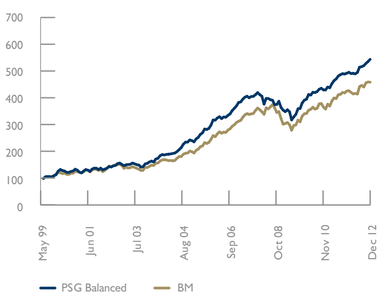
Steinhoff International Holdings Limited
Anglo American Plc
Tesco Plc
Sasol Ltd
Kagiso Media Limited
Microsoft Corp
Reunert Limited
MTN Group Limited
Grindrod Limited
Heineken NV

Asset allocation



Resources	8.5%
Financials	3.7%
Industrials	27.3%
Domestic equity	**39.5%**
Property	**0.3%**
Domestic bonds	**9%**
Domestic cash	**25.9%**
Foreign equity	**24.3%**
Foreign bonds	**-**
Foreign cash	**1.0%**
Total	**100%**

Performance

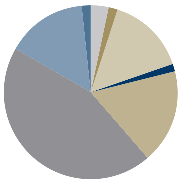


PSG Stable Fund

Top 10 equities

Berkshire Hathaway Inc
Tesco Plc
Steinhoff International Holdings Limited
Capevin Invest Limited
Tongaat-Hulett Limited
ING Group NV
Sasol Ltd
Anglo American Plc
EOH Holdings
Kagiso Media Limited

Asset allocation



Resources	3.6%
Financials	1.6%
Industrials	14.7%
Domestic equity	**19.9%**
Property	**1.4%**
Domestic bonds	**17.6%**
Domestic cash	**44.4%**
Foreign equity	**15.2%**
Foreign cash	**1.5%**
Total	**100%**

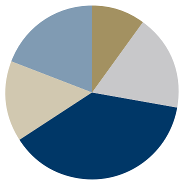
*Performance may only be stated once a fund has a 12-month track record

PSG Income Fund

Top 10 FI assets

Nedbank
Capitec Bank
ABSA
Investec Bank
Standard Bank
Growthpoint
FirstRand
Steinhoff International Holdings Limited
Eqstra Holdings Ltd
JDG Trading

Asset allocation



Listed bonds	10.0%
Promissory notes	17.7%
Floating rate notes	38.1%
NCDs	15.4%
Call and cash	18.8%
Total	**100%**

*Performance may only be stated once a fund has a 12-month track record

Performance to 31 March 2012

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 789 058 417	7.95	56	85	14.72	9	81
FTSE/JSE All Share TR ZAR		7.53			11.27		
Domestic EQ General		9.42			11.36		
PSG Flexible	R 2 059 504 691	11.82	19	64	16.54	7	60
Domestic AA Flexible		10.55			10.44		
PSG Balanced A	R 1 163 782 555	11.62	11	74	12.53	5	64
Domestic AA Pru Variable Equity		8.98			8.69		
PSG Stable ***	R 22 628 663						
Domestic AA Pru Low Equity							
PSG Income***	R 39 587 842						
STeFI Call Deposit ZAR		5.31			5.60		
PSG Money Market A	R 1 795 495 205	5.42	14	25	5.91	14	24
Domestic FI Money Market		5.45			5.95		
PSG Global Equity	$ 27 649 725.50	-4.28	414	557			
MSCI World Free GR USD		1.14			7.39		
GIFS Global Large-Cap Blend Equity		-4.60					
PSG Global Equity Feeder***	R 17 427 583						
Foreign EQ General							
SPECIALIST FUNDS							
PSG Preferred Dividend	R 55 501 627	10.00			7.60		
STeFI Call Deposit ZAR		5.31			5.60		
PSG Optimal Income	R 147 311 945	5.89			5.98		
STeFI Call Deposit ZAR		5.31			5.60		

* 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
25.43	4	77	5.12	39	59	01/03/2002*	19.85	4	34	13.07	53	77
21.29			7.22				15.37					
20.29			5.94							11.58		
27.31	4	53	12.71	1	44	01/11/2004*	18.29	3	20	9.02	26	53
15.83			6.42							7.49		
18.90	2	56	6.79	18	38	1999/06/01	15.26	3	10	6.34	27	56
12.81			6.20							5.93		
						2011/09/13	13.12	38	69	-		
										3.24		
						2011/09/01	6.79	31	56	-		
6.18			7.89							0.29		
6.62	14	23	8.35	11	18	1998/10/31	9.49	4	6	0.36	15	23
6.64			8.36				9.47			0.35		
						2010/07/23	3.21	370	520	-		
20.90			-0.13				7.27					
						2011/05/04	2.48	24	25			
										12.25		
12.24			8.68			2006/11/01	7.06			4.80		
6.18			7.89							0.29		
7.97			7.37			2006/04/10	7.69			1.79		
6.18			7.89							0.29		

Contact Information

PSG Asset Management Unit Trusts

Local Unit Trusts

0800 600 168
utadmin@psgam.co.za

Offshore Unit Trusts

0800 600 168
utoffshoreadmin@psgam.co.za

PSG Asset Management Administration Services

Voluntary Investment Plan
Preservation Funds
Retirement Annuities
Endowments
Living Annuities

General enquiries

0800 117 180
clientservice@psgam.co.za

Technical Investment Centre

0860 0000 27
tic@psgam.co.za

PSG | Asset Management

Cape Town Office

Physical address
First Floor, PSG House
Alphen Park, Constantia Main Road
Constantia, Western Cape

Postal address
Private Bag X3
Constantia, 7848

Switchboard
+27 21 799 8000

GPS co-ordinates
S 34° 00.863´ E 18° 27.387´

Johannesburg Office

Physical address
First Floor, 28 Fricker Road
Illovo, Johannesburg
Gauteng

Postal address
PO Box 41259
Craighall, 2024

Switchboard
+27 11 772 6600

GPS co-ordinates
S 26°129838´ E 28°047602´

Guernsey Office

Address
3rd Floor, NatWest House,
Le Truchot, St Peter Port,
Guernsey, GY1 1WD

Switchboard
+44 1481 711378

Client services
SA Toll Free
0800 600 168