PSG | Asset Management

4TH Quarter 2012

ANGLES & PERSPECTIVES

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PSG Asset Management moves forward strongly, and more awaits

Mike Smith

COO, PSG Asset Management Group

The last 12 months have been a time of continued strong growth at PSG Asset Management and it is becoming abundantly clear that more and more advisors and investors are starting to take note of where we are and what we are building.

At the end of August this year, the PSG Asset Management Management Company had R22.2 billion in its local collective investments, putting it in the top 15 management companies in South Africa. This is 28% higher than at the same stage of 2011, a significant increase that has thus seen us moving progressively up the ranking tables.

On the investment platform side, the PSG Investment Platform is already just outside the top 10 and has also seen a strong growth in support and take-up. The integration of the Equinox LISP system onto the PSG AMAS LISP platform has been a huge task but has been achieved and our market share is growing at a strong rate.

In the multi-management space, PSG Multi-Management continues to add assets strongly in the retail space and, while it is currently second in size, at the rate at which it is growing we anticipate that it will soon become the leading multi-manager measured by assets under management.

In the institutional space, we have seen a pleasing response and take-up since we began to focus on retirement fund and related business. We have already been awarded mandates on the back of our long and strong retail track record and we foresee that PSG Asset Management is going to grow an increasingly prevalent presence in this space in the coming months and years.

We dedicated our previous edition of this publication to offshore investing and our asset managers continue to believe that there is still an excellent opportunity to acquire quality assets at very attractive valuations offshore.

On the subject of looking abroad, at PSG Asset Management we strive to remain abreast of global developments in the investment management arena. We have been keeping a close eye on regulatory and related developments in areas like the UK and Australia and will ensure that we take the lead in implementing those changes domestically.

Despite much of the gloom and doom that is permeating many local and global markets, PSG Asset Management is growing strongly and we feel confident that as we move forward, we have the people, processes and plans in place to continue on this path.

We have a more diverse collection of articles for you to enjoy this month, with an interesting view from Ruen on the fixed interest environment in which we currently find ourselves. Shaun and Philipp share their equity thoughts and Gavin and Tom provide insights on sustainable income levels that equity-linked living annuities can produce over time.

I hope you enjoy the read and may I take this opportunity, in our last Quarterly Newsletter of 2012, to thank all our supporters for helping us to grow as we have. We are eagerly looking forward to working with you in 2013.

The market yields for nobody

By Ruen Naidu

Ruen Naidu is a co-Fund Manager of the South Easter Fixed Interest Hedge Fund and a member of the PSG Asset Management fixed interest team.

Capital is shifting from developed to emerging markets

The structural shift of capital from the developed market regions to emerging markets remains the key thesis of our strategic view. Given the ongoing deleveraging process taking place in most of the traditional economic powerhouse nations, it is believed that their central banks will continue to maintain exceptionally low policy rates. In addition to easy monetary conditions via low interest rates, major central banks are expected to continue to run unconventional monetary policies for as long as they are in deflation-fighting mode. Deflationary pressures should continue to be exerted on price levels while fiscal policy remains a negative force for growth. Policymakers face the difficult challenge of finding the perfect balance between public debt reduction policies and growth enhancing strategies necessary to alleviate the prevailing high levels of unemployment.

High levels of debt are coupled with low growth

Vast increases in public debt levels can be expected in the wake of a severe economic downturn as government revenues collapse and automatic stabilisers kick in. Couple these natural responses with bank bailouts and we have a recipe for an explosion in government debt-to-GDP levels. What then are the long-run impacts of these increases in government indebtedness? We find it instructive to turn to the work done on this topic by Carmen Reinhart and Kenneth Rogoff. They found that "peacetime debt explosion often reflects underlying political economy dynamics that can persist for very long periods". The chief finding in their analysis was that high levels of debt/GDP are associated with markedly lower growth outcomes.

Fiscal policy in the United States will be dominated by the upcoming "fiscal cliff" which refers to the confluence of $600 billion in expiring spending and tax policies. Lawmakers are required to reach a compromise and extend a portion of the tax cuts and postpone the mandatory cuts to expenditure. Failure to achieve any compromise is expected to result in a 4% reduction in US GDP. In the event that current policies persist, the problem of a large debt load will increase as government spending grows faster than revenues.

In the Eurozone, the Teutonic pressure applied on peripheral economies to enact harsh austerity measures will not help to reduce the debt-burden. It is more likely to increase the risks of a depression that will not serve the government coffers well. Tension between creditor regions in the north and debtor countries on the periphery will persist for as long as the ideological divide remains wide. Social instability is often associated with the enactment of severe austerity. The streets of Madrid and Athens bear testament to this assertion. Markets responded unfavourably to the socialist electoral victories earlier this year. Given these pressures, success in stabilising the debt levels of European sovereign nations will be influenced by the extent to which the social fabric remains intact.

Turning locally, debt-to-GDP in South Africa is expected to stabilise at 39.2% by 2015/16 according to the October 2012 Budget review. Including contingent liabilities arising from parastatal guarantees would bring this number closer to 50%. With negative outlooks by all three major ratings agencies, the risks to this forecast lies on the upside. The ratings agencies cite the reduced fiscal space to respond to downturns in South Africa as one of the reasons for the negative outlook. Reinhart and Rogoff point out that the threshold at which debt levels begin to hamper growth is far lower for emerging market countries than for advanced economies.

Central banks continue to carry the burden of debt

Against the backdrop of hamstrung fiscal policy throughout most regions of economic significance, the heavy lifting falls on the shoulders of the central banks. In September, the Bank of Japan (BOJ), European Central Bank (ECB) and the Federal Reserve (Fed) extended their commitments to monetary accommodation with significant measures. Policy decisions announced by the ECB appear to be a step closer to debt monetisation and mutualisation. Their Outright Monetary

Transaction (OMT) programme will allow them to buy sovereign one-to three-year bonds in countries that request assistance from the ECB. The rationale for such purchases is that monetary policy transmission has been hampered by the existence of "re-denomination risk" or a breakup of the Eurozone common currency, the euro. Negative yields on two-year German bonds in the period before the September policy decisions illustrated this risk. The willingness of investors to accept a negative return in euros suggested to the ECB that the perception of a eurozone breakup was on the rise as these buyers would have been looking for deutsche mark currency appreciation to offset the negative yield in euros. To ensure "unity" of their monetary policy actions, this potential for a eurozone breakup had to be totally dismissed. By including the requirement that a country would have to request assistance and any bond purchases would be subject to conditions, the ECB made an effort to reduce moral hazard by keeping the pressure on the sovereign governments to reduce debt. The manner in which the public responds to conditions dictated by unelected officials in Brussels represents a key risk as the European integration project moves forward. Additionally, Bundesbank objection to these measures introduces potential for discord within the ECB.

The Federal Reserve also introduced aggressive measures to kick-start growth and to fend off deflationary forces. By committing to open-ended balance sheet expansion and tying the amount of intervention to developments in the labour-market, the Fed has doubled down on Ben Bernanke's favoured tool. The extension of the anticipated period of low policy rates to mid-2015 was intended as a form of stimulus since the Fed views communication strategies as a powerful tool under zero lower bound conditions. It is indeed important that the Fed is able to raise rates before their communicated end date because the potential for a fresh recession while still at the zero lower bound could potentially leave the Fed without their most important deflation-fighting tool, interest rates.

Unlike the Fed, the South African Reserve Bank (SARB) does not face the constraint of the zero lower bound with the repo rate at 5%. An examination of recent Monetary Policy Comittee (MPC) statements by the SARB reveals a particularly dovish commitee. The most recent domestic GDP growth estimates were 2.6% for 2012 and 3.4% for 2013. In the September 2011 MPC statement, these forecasts were 3.6% (2012) and 4.4% (2013). Despite these downgrades in their assessment of future growth, they emphasize that the risks lie to the downside. In line with the revised GDP assumptions, the SARB also shaved around 0.7% off their inflation forecasts for 2012 and 2013. While not our base case assumption, the SARB may try to reduce the repo-rate even more if the risks materialise.

There are buying opportunities when there is uncertainty

Based on our assessment of the forces affecting interest rates, we believe that the search for yield will continue to affect South African bond yields favourably. There is the potential for yield curve sell-offs when risk aversion spikes, particularly with the current precarious labour unrest and a widening current account deficit. These episodes should continue to be viewed as buying opportunities, as they have indeed turned out to be in recent times.

Heineken: Arbitraging cheap debt markets

By Philipp 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 six years, is an analyst and serves on the PSG Asset Management Investment Committee.

Is access to cheap finance a competitive advantage?

In its strongest form, a company's moat or sustainable competitive advantage results from its business having a strong hook into the customer and a scale advantage over its competitors.

A strong balance sheet and cheap access to funding would in most instances only be considered a temporary moat. Current economic conditions are however giving companies with strong balance sheets the opportunity to lock in low long-term interest rates, providing an enduring competitive advantage.

Given the uncertainties prevalent in the European economy, one would intuitively expect the rates that companies are able to borrow at in the bond markets to be higher. Graph 1 depicts European Single A corporate bond yields, an index consisting of European blue chip bond yields. Yields have in fact halved since their recent December 2011 peaks.

This situation presents companies that are able to access finance cheaply, as a result of their credit rating and cash flow stability, with interesting opportunities.

Graph 1: European Single A 10-year corporate bond yield

Sources: Bloomberg; PSGAM

Funding share repurchases

As long as a company is able to borrow at a rate that is lower than the sustainable earnings or free cash flow yield of its stock, and the company has favourable prospects not reflected in its stock price, it makes financial sense for the company's management to take advantage of this arbitrage gap and engage in a concept called de-equitization, that is retiring equity (by buying shares) using debt.

We have been attracted to this concept for some time, and in fact hold a number of companies in our portfolios doing just this. While weak economic or industry-specific conditions are keeping the lid on stock prices, it allows smart management teams to permanently reduce the number of shares in issue, thereby growing earnings per share and shareholder value. Graph 2 shows a composite of free cash flow yields of US companies that we own versus 10-year US corporate bond yields.

Funding acquisitions: Heineken

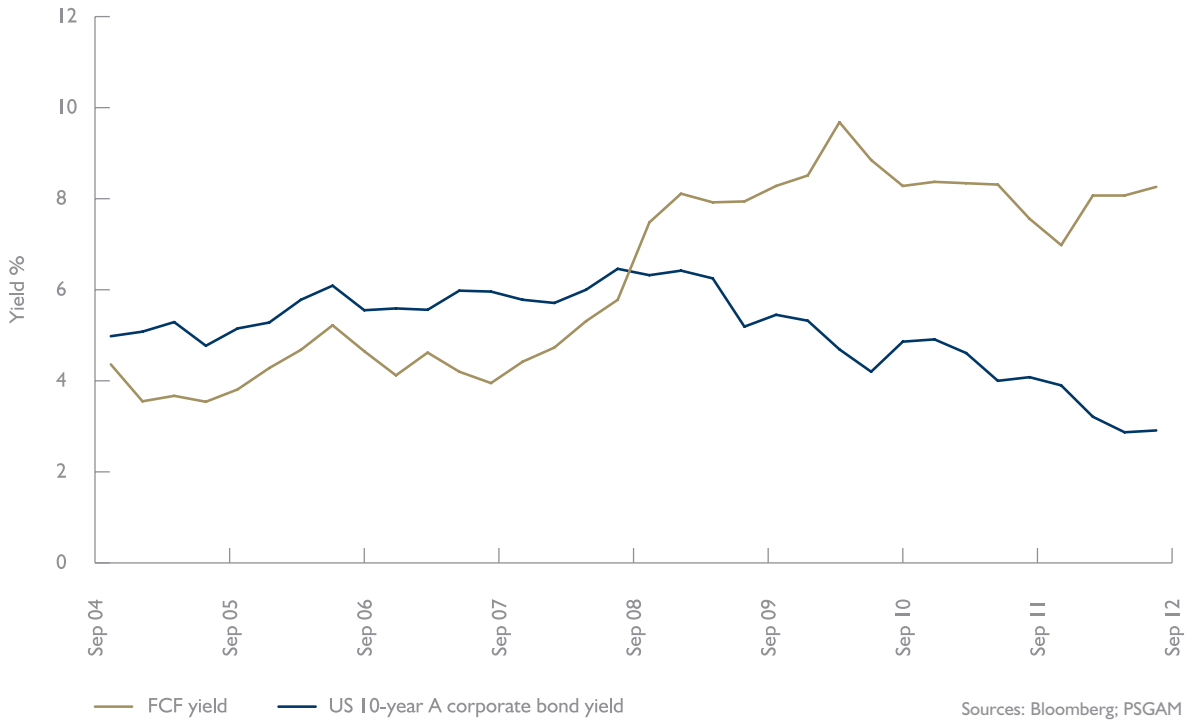
While issuing debt and buying back one's own stock is one way for a company to create long-term shareholder value, another way of taking advantage of cheap financing rates is to grow the business via debt-funded acquisitions.

A company that is using its strong position to benefit from prevailing low interest rates, is global brewing giant Heineken. Weak economic conditions have presented investors with a great buying opportunity as the market in our view has treated Heineken as a European company, tainted by the well-known problems the region faces. However, Heineken, owner of the globe's best premium beer brand, in fact has 51% of sales emanating from emerging markets, with enviable positions in Africa, Asia and Mexico.

To further help cement its position in growing markets, Heineken recently completed the purchase of the portion of Asia Pacific Breweries (APB) it did not already own. APB, owner of brands such as Tiger and Bintang Beer, operates in fast-growing Asian markets and in fact reported operating profit growth of 23% per year between 2007 and 2011. To help finance the deal, Heineken recently raised $3.25 billion at a weighted average term of 10 years and the staggeringly low rate of 2.12%, a great example of borrowing cheaply to invest in growth and strengthen its moat.

While introducing large amounts of debt into a company's books can result in a problematic situation should the company fail to generate sufficient cash flow to service its interest and principal payments, we are comfortable that companies that

Graph 2: Free cash flow yield composite vs US 10-year A corporate bond yield



Sources: Bloomberg; PSGAM

have sustainable moats and stable cash flow profiles, such as Heineken, are making the correct decision in taking advantage of the opportunities that debt markets are offering. Even after Heineken's acquisition of APB, its net debt/EBITDA ratio will merely rise to around 2.8 times, as compared to 1.8 times before the deal.

The emerging market opportunity

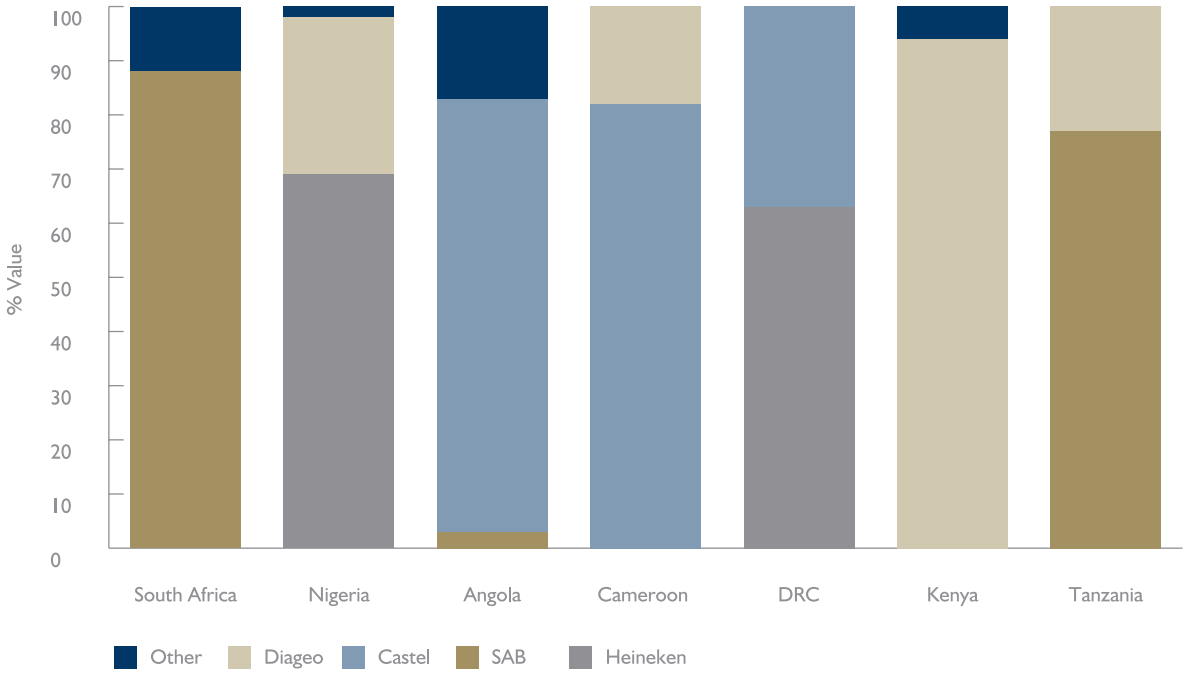
As Heineken generates over half its revenue in emerging markets, we are particularly encouraged by the beer industry in emerging markets, and in Africa especially, being characterised by oligopolistic market structures (see Graph 3), where a limited number of players dominate the market. Also, as Graph 4 shows, Heineken has enviable market shares in some of the major world growth markets.

There is a strong correlation between GDP and beer consumption per capita in Africa. As Graph 5 clearly demonstrates, the runway for beer consumption in countries where Heineken has a dominant position is large. The research house Bernstein estimates that should beer consumption per capita in these lagging markets reach levels comparable to South Africa, beer volumes could rise 6-to 7-fold.

A case of the strong getting stronger

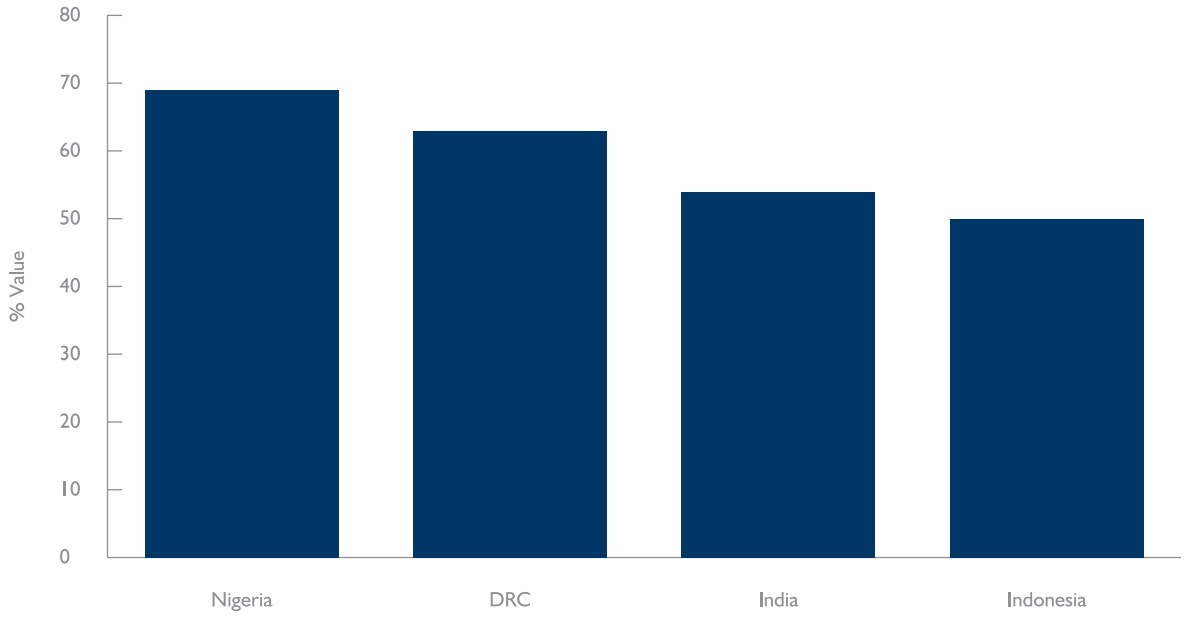
We are of the view that the current environment, where companies are able to tap debt markets for cheap long-term debt, lends itself to strong companies getting even stronger. At PSG Asset Management, we are on the continual lookout for such opportunities.

Graph 3: Key African beer markets - volume share breakdown



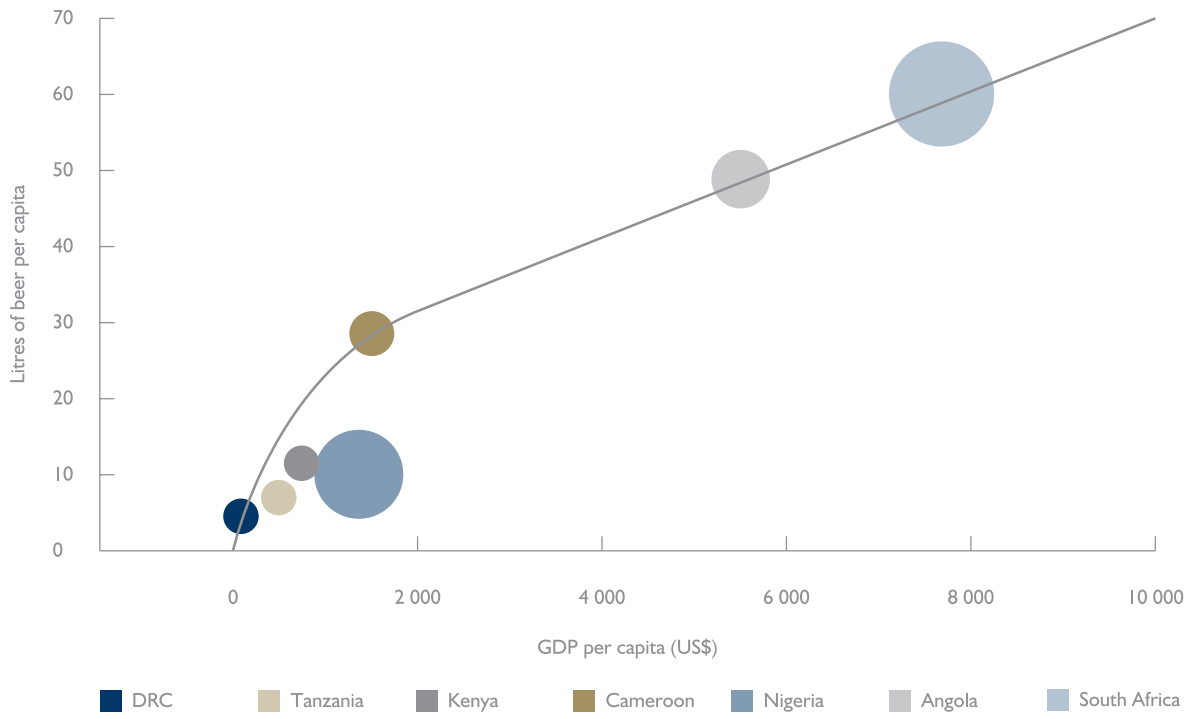
Source: Company reports from PSGAM

Graph 4: Heineken market shares



Sources: Bernstein; Company reports from PSGAM

Graph 5: GDP vs beer consumption per capita in Africa (2010)



Sources: Company reports from PSGAM

Marikana: The implications for investing in the mining sector

By Shaun le Roux

Shaun is a CA(SA) and a CFA charterholder. He has been managing the PSG Equity Fund since 2002.

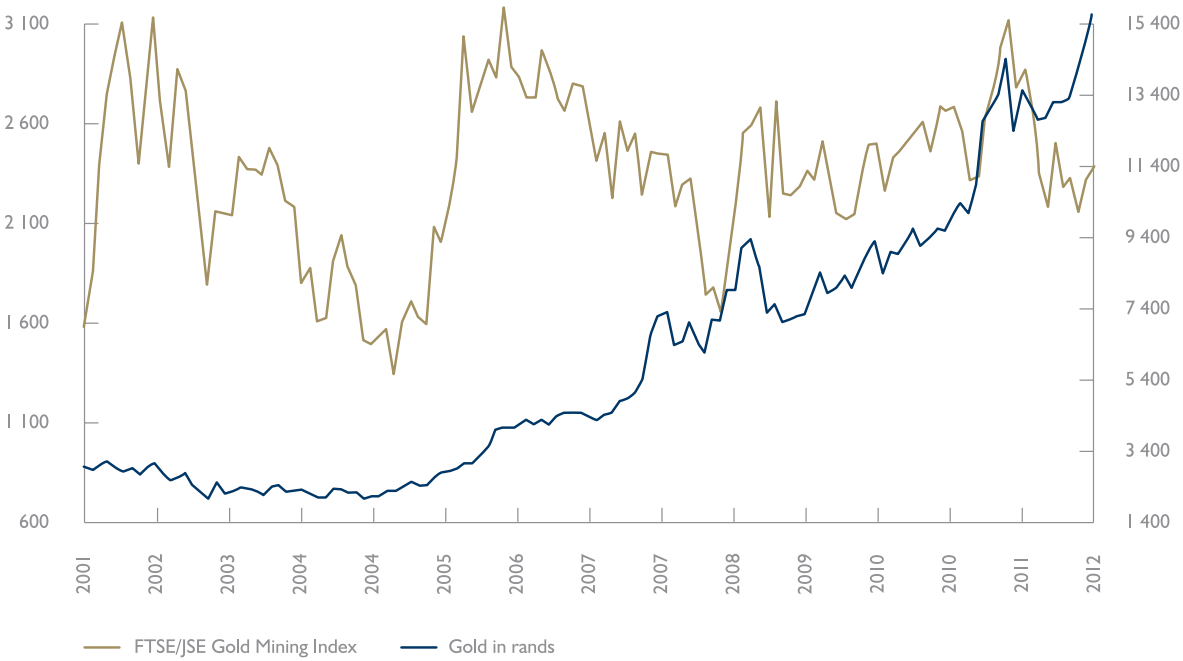
Further margin pressure for an industry that was already in crisis

The tragedy at Marikana was one of South Africa's darkest days. There has been much analysis of the causes and political implications of the events that unfolded and we have little to add. We do note, however, that this event will certainly result in further margin pressure in an already embattled mining industry.

While we prefer to ignore irrelevant market "noise", it is our view that the repercussions from Marikana require attention. This is because the fall-out from the tragic events and the subsequent and inevitable caving to workers' demands has direct consequences. Firstly, Lonmin workers have set a very dangerous precedent of using illegal and unprotected strikes to extract reward; the spill-over into other mines and industrial sectors has been swift. Also, it is clear that labour's demand for a larger slice of the pie will get a sympathetic ear at government level. This has implications for mining companies' ability to keep costs in check and will serve as a cap on profit margins, all things being equal.

Remember this is a sector in our economy that was already struggling. South African mining companies have derived little benefit from the past decade's boom in commodity prices, primarily because they have struggled to keep a lid on rising costs. Graph 1 demonstrates the lack of leverage to rising prices, using the gold mining sector as an example. The rand gold price is more than three times higher than it was when the gold index peaked in 2002. Not only have South African

Graph 1: Gold price in rands versus the FTSE/JSE Gold Mining Index



Sources: PSGAM, I-Net

gold shares failed to benefit from the very powerful bull market in gold of the past decade, but they lost you money over this period!

This lack of leverage to rising prices has been particularly the case for deep level mining industries such as gold and platinum, where above-inflation increases in wages and electricity prices have been eating into profit margins. The benefit of high commodity prices has passed them by, and, given the current political situation and future glide path for electricity prices, the short-term outlook for margins is not rosy.

Cost pressure is an issue for miners around the world

Intense pressure on cash costs is not a South Africa-specific problem - it has been a headache for mining companies in most countries over recent years. It is true that high commodity prices have seen management teams more focused on volume than cost, but keeping a lid on costs has been difficult throughout the global mining industry. Skills shortages and rising wage bills, the rapidly escalating cost of mining infrastructure and equipment, and the sharp rise in fuel and power prices have all kept mining costs running well above consumer price inflation. Graph 2 - courtesy of Anglo American - shows the heavy pressure on the company's cash costs over the past six years.

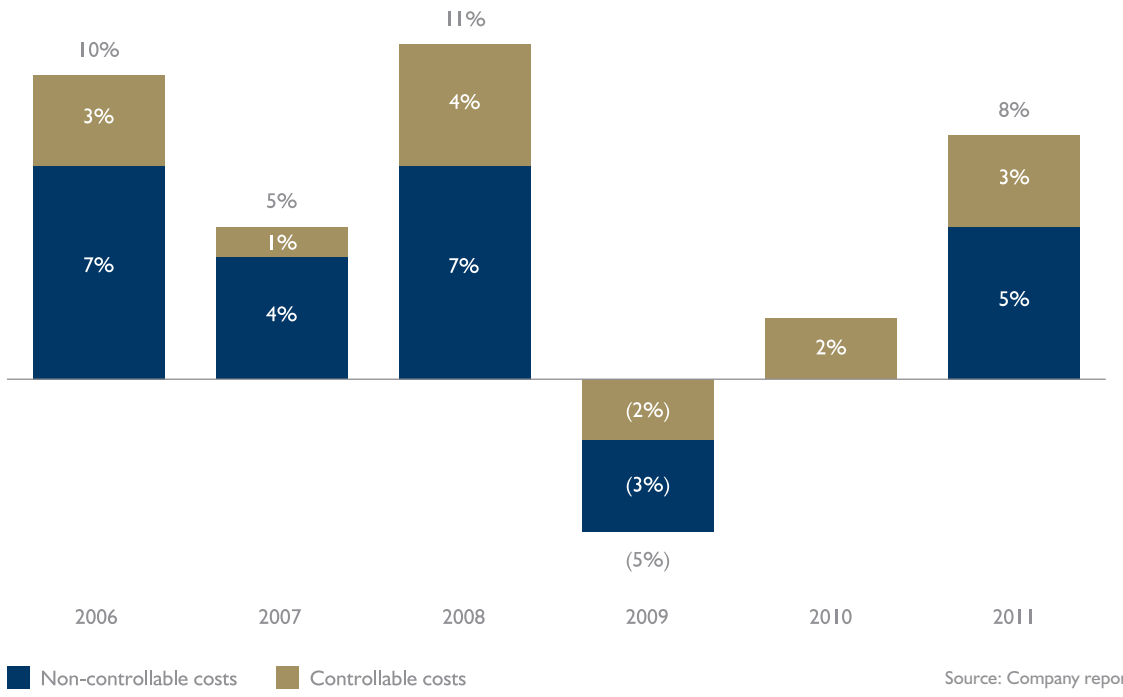
Supply will be cut as high-cost producers exit the market

This year has seen anemic global GDP growth and strong deceleration of growth in China. Industrial commodities have come under pressure, particularly China-dependent steel industry commodities such as iron ore and coal. Declining commodity prices and high cost levels have resulted in analysts taking a knife to future earnings expectations for the resource sector. Fortunately for South African producers, the recent sharp decline in the value of the rand will mitigate some of this pressure on future profits. However, a macro environment of commodity price weakness and stubbornly high cost margins will see high-cost producers being forced to close mines, suspend capital expenditure and in some cases exit the industry. This process of weeding out higher cost production is underway and ultimately favours those that operate at the lower end of the cost curve. This is why we tend to only invest in low-cost producers in an industry where the range of outcomes for future earnings is as wide as it is in the mining sector.

Marikana will accelerate the rationalisation of the SA mining sector

In the long run, commodity prices will likely be underpinned by stubbornly high production costs and declining supply. Let's take the platinum industry as an example: The rapid escalation in labour costs after the re-negotiation of wages post Marikana will cut into already wafer-thin margins. Mines will close, and sadly, jobs lost. With South Africa producing 80% of the world's

Graph 2: Anglo American – Core cash cost movements above consumer price inflation



Source: Company reports.

platinum, as supply is taken out of the market, if demand is relatively stable, the platinum price will rise.

Marikana has injected further cost pressure into an industry on its knees. The domino effect of labour strife into other South African miners is likely to accelerate rationalisation of high cost producers. The outlook for jobs and future investment in the South African mining sector is very negative. Low-cost producers will however ultimately be insulated by rising rand commodity prices and profits will be restored. In mining, the strong will get stronger before the next demand-driven cycle attracts the marginal producers to once again start digging those shafts.

Valuations of resource stocks are attractive but careful stock selection is required

Valuations in the resource sector are generally very attractive but this is an environment in which careful stock selection is vital. Our preference is for low-cost diversified mining companies over single-commodity producers. Diversification across commodities and geographies together with a portfolio of lower-cost higher-quality assets give us a higher level of confidence that a margin of safety is intact. This is especially important when the outlook for commodity prices and the Chinese economy is very unclear. Our highest conviction idea in the JSE mining sector is Anglo American, which we think is very attractively priced relative to its diversified portfolio of higher-quality assets. We would be especially careful of companies that either produce on the high end of the cost curve or have weak balance sheets.

Meet the Manager

Heinrich Dietzsch

Heinrich Dietzsch has more than 30 years of experience managing fixed interest assets. Heinrich is currently the fund manager of the PSG Money Market Fund and the PSG Income Fund.

You manage the PSG Money Market Fund. What is a money market fund and how does it work for the investor?

A money market fund like the PSG Money Market Fund is a collective investment scheme where investors' money is jointly invested. Individual investors therefore benefit from their money working with other investors' money in a group or pool. Money market funds can invest in certain instruments with a maturity of less than 13 months, while the average maturity of the fund's assets may not exceed 120 days.

Money market funds give investors:

- Immediate access to their money.
- The opportunity to diversify their credit risk (exposure to multiple creditors like banks, government paper and corporate paper).
- A yield that is highly correlated to prevailing interest rates.
- A very convenient place to temporarily 'park' money, pending investment in other unit trust funds, share portfolios and investments.
- The comfort of knowing that the capital value of their investment is assured, so it is a very good short-term home for regular income requirements.
- Access to investments that are only issued in the wholesale market.

When you speak of the Fund being able to hold certain instruments. Can you expand on this?

The most prominent instruments held in a money market fund are negotiable certificates of deposit (NCD's), promissory notes, treasury bills (TB's) and floating rate notes (FRN's).

An NCD is a negotiable deposit insued at a fixed rate of interest, which can be bought and sold. It is an instrument that is issued at par and pays interest at an agreed rate at maturity. An NCD is initially bought at face value and has an agreed return. The NCD has a fixed maturity date of between one month and 13 months (the maximum in a money market fund). These are mostly issued by banks.

A promissory note is an instrument that pays a fixed amount at the end of a period, which can vary between 3 and 13 months. It is issued at a discount to its face value, from which the return is determined. These are mostly issued by companies other than banks for financing reasons.

A treasury bill, which is issued by National Treasury, is issued at a discount to face value. The duration is three, six, nine or 12 months. These are auctioned weekly on Fridays.

An FRN is an instrument that pays interest at regular intervals (mostly quarterly or monthly), whereafter upon maturity the capital invested is returned. These typically have a duration of 12 months. The rate at which interest is paid is normally linked to the relevant Johannesburg Interbank Rate (Jibar). Rates are reset after each interest payment.

In addition, the money market fund also holds call deposits at various commercial banks.

Although each of the individual instruments that a fund can hold can have a maximum term of 13 months, the aggregated duration of the holdings in the fund for interest-rate risk may not be more than 90 days. The average aggregated maturity date for capital repayment on the instruments may not be more than 120 days.

I manage the PSG Money Market Fund with my colleague Qanitah Adams. Qanitah has been managing the fund with me for the last five years and is a fantastic partner. We spend our time carefully studying instruments to determine which to invest in and at what weightings. We are required to know these instruments in detail and have developed systems and processes over time that help us to decide which provide the best opportunities for our investors. They also help us to recognise which instruments may be too risky and need to

be avoided. A good money market manager will always be searching for good yield in a prudent way.

Is there a risk, when investing in a money market fund that you won't get your money back over any period?

The Fund invests in various instruments with banks, the state and companies. If, for any particular reason, the issuer defaults on their obligations, then that particular investment will not produce a positive return over the duration of the investment. None of these instruments are marked to market.

You have been in the industry since 1979. What have been the biggest changes you have experienced in money market funds?

The first money market funds were launched in 1997. Before that, the retail investor had very few options. They had to go directly to the banking industry to invest their funds. These were the days of fixed deposits, bankers acceptances, direct NCD's and the like. In the mid-90s, these funds were very simple as they only really held bank paper (NCD's and promissory notes) and treasury bills. For the average retail investor who was not familiar with these products and their workings, they had little choice but to leave their money in current or saving accounts at the bank.

Initially there were only about six money market funds that investors could choose from, but there are now 26. This means that investors have greater choice of funds as well as being able to have professionally managed broader exposure to multiple issuers and durations.

When you are not managing the PSG Money Market Fund what else do you do?

In addition to the PSG Money Market Fund, we at PSG have been awarded a number of segregated mandates for money market portfolios that are tailored for wholesale clients and their needs. We apply the same process across all the funds and portfolios we manage and have always done so.

When I leave the office I really enjoy being active outdoors. I am a long-standing member of the local running club and also do triathlons. I like to holiday in the mountains (I love the Cederberg and Drakensberg) and other wild places where I really enjoy the peace and quiet. During our winter, when it is miserable outside, I might watch some sport on TV like tennis (Wimbledon) and the Tour de France. I also like watching top level athletics – in particular the medium-distance running.

Protect your capital by planning for worst-case scenarios

By Tom Blendulf and Gavin Rabbolini

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.

Gavin is the custodian of research and development on the PSG Investment Platform.

Investigating sustainable income levels using historic monthly real asset class returns

A number of previous studies have indicated that a 5% income drawdown is the maximum level at which a sustainable income can be maintained, while still keeping pace with inflation. We investigated the effect the level of income has on the longevity of the portfolio, and whether we can improve the outcome by increasing the exposure to growth assets in the portfolio to compensate for increased income requirements.

Our study is based on the following assumptions:

- the ongoing advisor fee is 0.50%;
- the administration fee is a net 10 basis points (0.50% less rebates of 0.40%);
- the income requirement increases by inflation each year and the income needs to last 30 years (age 65-95); and
- the fund managers will at least cover their asset management fees in the alpha they generate.

We use the following asset class proxies in an efficient frontier constructed from real monthly returns data backdated to January 1926:

- Local equity - FTSE/JSE TR Index
- Local bonds - ALBI
- Local cash - STeFI Call Deposit Index
- Offshore equity - MSCI World Index
- Offshore bond - MSCI Bond Index
- Offshore cash - US dollar

Scenario 1: 5% income drawdown

Graph 1 shows the average, upside (1 out of 20) and downside (1 out of 20) outcomes for portfolios with different risk levels, given a 5% level of income, where:

- low risk - level 40, ±46% equities;
- medium risk - level 50, ±60% equities; and
- high risk - level 60, ±73% equities.

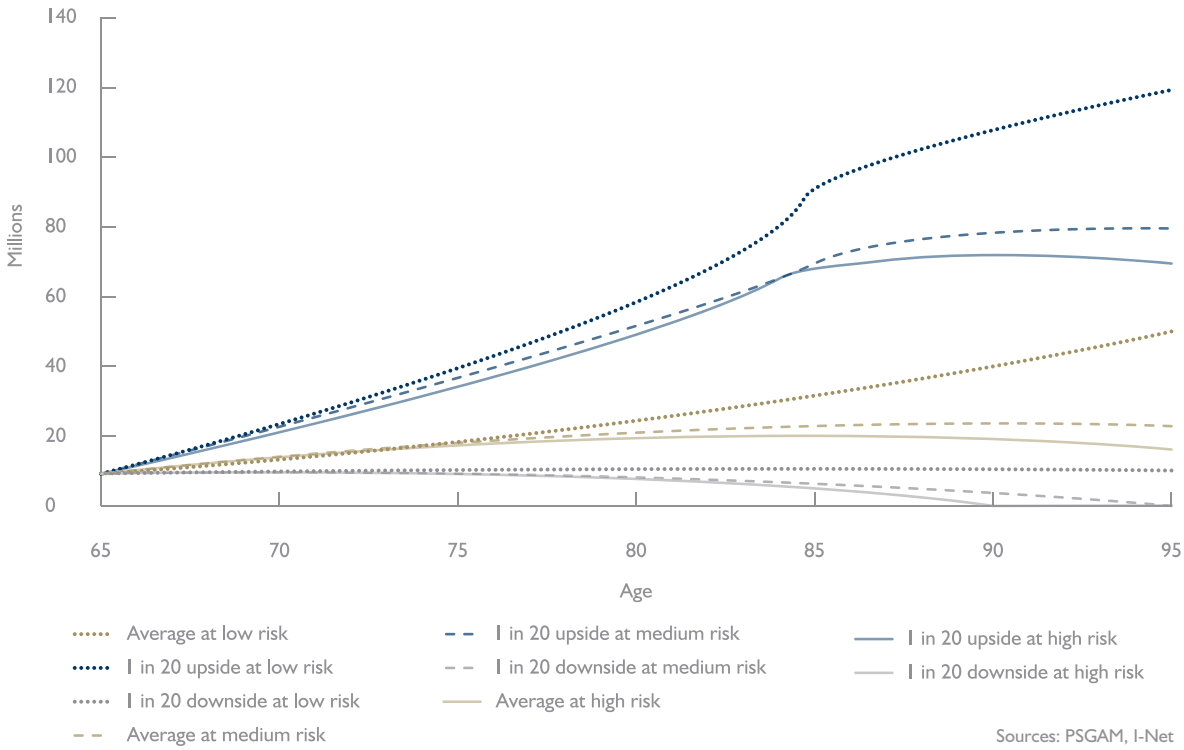
From Graph 1 it is evident that exposure to growth assets are fundamental to a sustainable real income level of 5% per year. The high-risk portfolio was the only portfolio that had a 95% probability of successfully meeting the investor's goals. This proves that financial advisors must educate the typical conservative retirees around the danger of being too conservative in their portfolio choice.

Scenario 2: 6% income drawdown

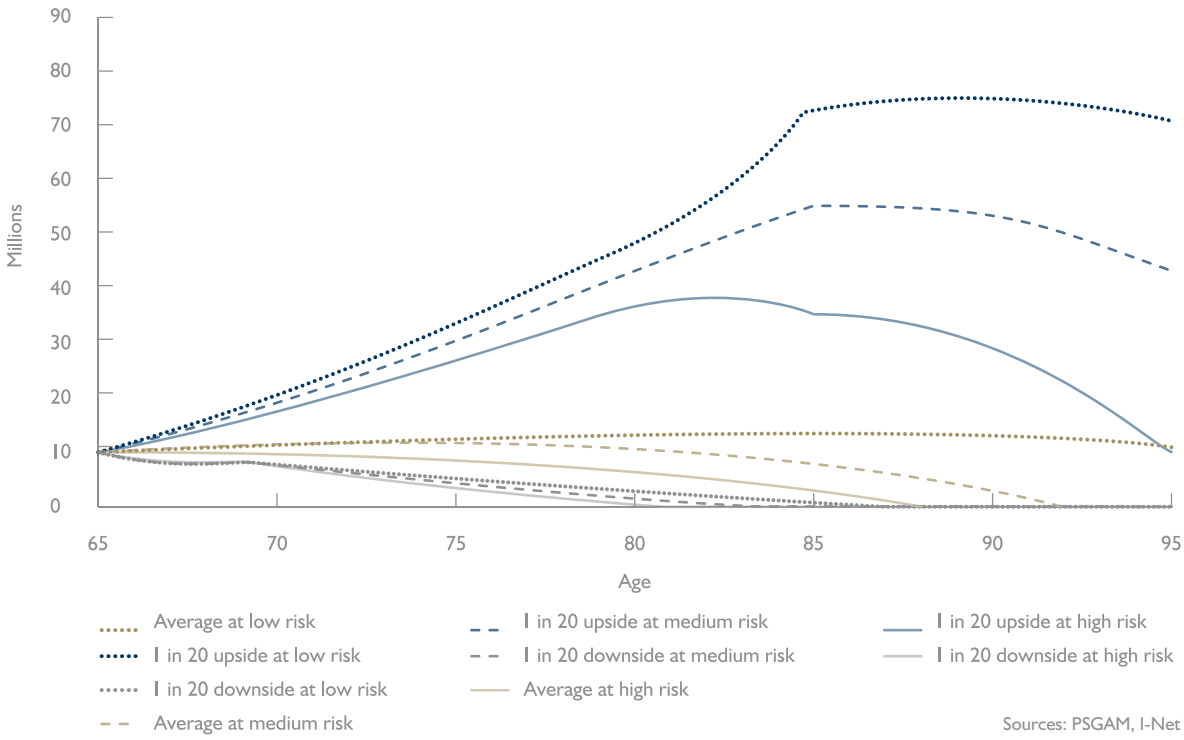
In the next scenario (Graph 2), we investigated the impact of drawing a higher income level. We start with an income level of 6% across the low-, medium- and high-risk portfolios as defined earlier.

Once again, only the high-risk portfolio has a more than 50% probability of achieving the investor's goals. An incremental increase in income of 1% per year can have a significant effect on the outcome over a 30-year term.

Graph 1: Projected outcomes for portfolios with a 5% income drawdown



Graph 2: Projected outcomes for the portfolios with a 6% income drawdown



Scenario 3: 6% income drawdown at a higher risk level

In Graph 3 we tested if we can improve the 6% income investor's chances of meeting their goal by choosing an appropriate risk portfolio. By increasing the risk rating to risk level 74 (±87% equity), we were able to create a portfolio that would meet the goals in almost 95% of the periods tested.

Scenario 4: 8% income drawdown with additional growth assets

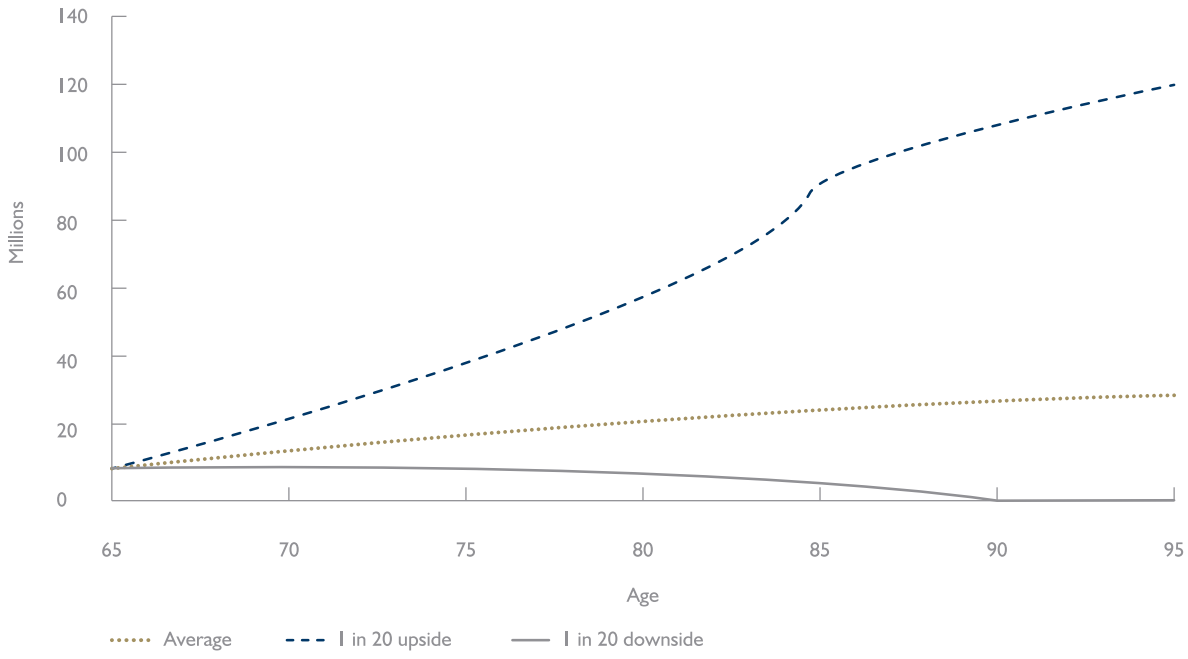
In Graph 4, we moved to an income level of 8% and tested the effect this level of income has on the longevity of the portfolio. (We also added more growth assets to the portfolio to compensate for the higher income level and to see if we can improve the outcome).

The additional growth assets had a beneficial effect. The medium-risk portfolio fails in all market periods tested, and showed a less than 5% probability of meeting the investor's goals. Interestingly, the higher risk portfolio (risk level 74: ± 87% equities) outperformed the medium-risk portfolio in even the worst 5% of market performance over the period tested, with the capital lasting approximately two additional years.

Drawing the right income at the appropriate risk level is essential to successful retirement planning

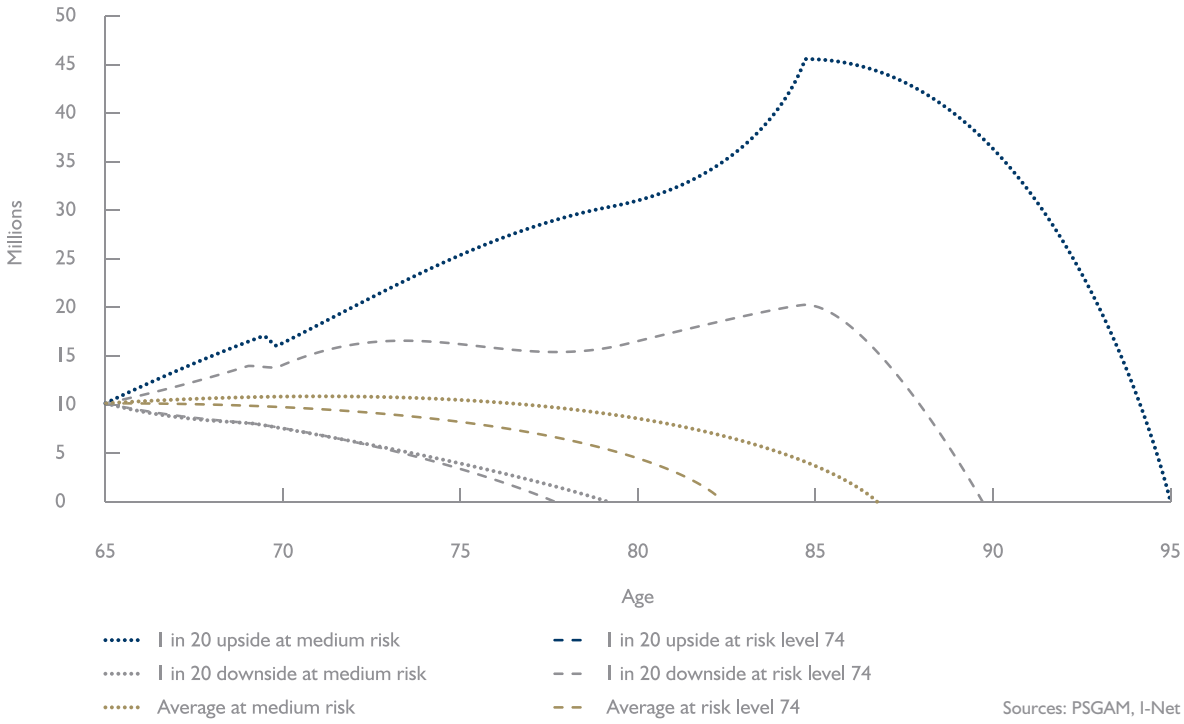
- Drawing more than 5% income in a living annuity is risky if an investor wants to protect the purchasing power of their income. Investors should aim to save 20 times their retirement income requirement for the first year of retirement.
- Matching investors to the appropriate risk portfolio is vital. There is a real investment risk in condemning yourself to guaranteed underperformance by being too conservatively invested. Investors need to be cognisant of the term of the living annuity (approximately 30 years).
- The biggest determination of return on an asset is the price paid for it. Unfortunately, with retirement you do not know if you are investing on the eve of the next severe market downturn, which could reduce capital as income is drawn. Planning for the 5% worst-case scenarios as we have done here is a robust way of ensuring capital will last.

Graph 3: Projected outcomes for the portfolios with a 6% income drawdown at a higher risk level



Sources: PSGAM, I-Net

Graph 4: Projected outcomes for the portfolios with a 8% income drawdown and additional growth assests



Sources: PSGAM, I-Net

NOTES

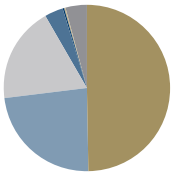
Portfolio holdings and performance as at 30 September 2012

PSG Global Equity Fund

Top 10 equities

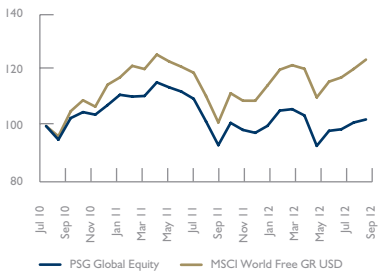
Tesco Plc
Berkshire Hathaway Inc
Alstom
Unilever
Bank of New York Mellon Corp
Microsoft Corp
Heineken Holding NV
Steinhoff International Holdings Ltd
Imperial Tobacco GP Plc
BP Plc

Regional allocation



US	49.9%
Europe ex UK	23.3%
UK	18.5%
Africa	3.7%
South America	0.3%
China	0.2%
Foreign equity	**95.9%**
Cash	**4.1%**
Total	**100%**

Performance

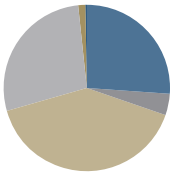


PSG Equity Fund

Top 10 equities

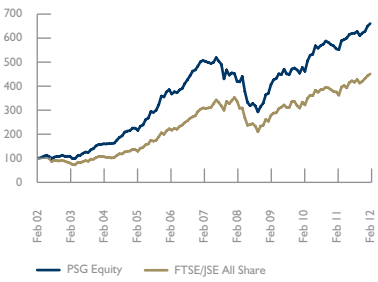
Steinhoff International Holdings Ltd
Sasol Limited
Anglo American Plc
BHP Billiton Plc
Tesco Plc
Nampak Limited
Heineken Holding NV
Berkshire Hathaway Inc
Brimstone Investment Corporation Ltd
Howden African Holdings

Asset allocation



Resources	26.3%
Financials	4%
Industrials	40.3%
Foreign equity	**27.8%**
Domestic cash	**1.5%**
Foreign cash	**0.1%**
Total	**100%**

Performance

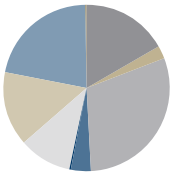


PSG Flexible Fund

Top 10 equities

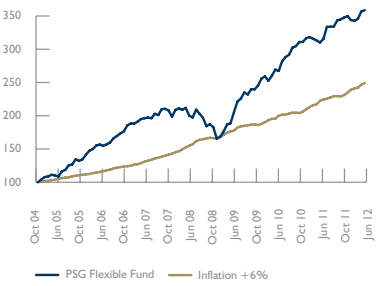
Steinhoff International Holdings Ltd
Sasol Limited
Anglo American Plc
Berkshire Hathaway Inc
Tesco Plc
Capital Shopping Centres Group Plc
Grindrod Limited
EOH Holdings
ING Groep NV
Eqstra Holdings Ltd

Asset allocation



Resources	16.7%
Financials	2.6%
Industrials	30.1%
Property	3.7%
Domestic equity	**53.1%**
Resources	0.4%
Financials	10.2%
Industrials	14.5%
Foreign equity	**25.1%**
Domestic cash	**21.6%**
Foreign cash	**0.2%**
Total	**100%**

Performance

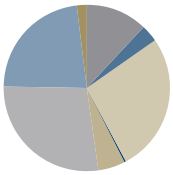


PSG Balanced Fund

Top 10 equities

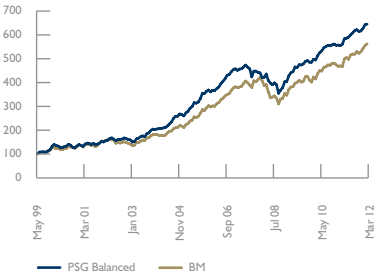
Steinhoff International Holdings Ltd
Sasol Limited
Anglo American Plc
Tesco Plc
EOH Holdings
Microsoft Corp
Kagiso Media Limited
Tongaat-Hulett Limited
Reunert Limited
MTN Group Limited

Asset allocation



Resources	12%
Financials	3.5%
Industrials	26.8%
Domestic equity	**42.3%**
Domestic Property	**0.3%**
Domestic bonds	**5.4%**
Domestic cash	**27.4%**
Foreign equity	**22.9%**
Foreign cash	**1.7%**
Total	**100%**

Performance

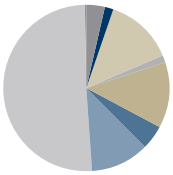


PSG Stable Fund

Top 10 equities

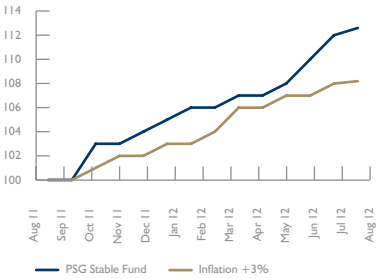
Tesco Plc
Berkshire Hathaway Inc
Sasol Limited
Steinhoff International Holdings Ltd
EOH Holdings Limited
Capevin Investments Limited
Brimstone Investment Corp Ltd
Anglo American Plc
ING Groep NV
Adcorp Holdings Ltd

Asset allocation



Resources	3.8%
Financials	1.7%
Industrials	13.2%
Property	1.3%
Domestic equity	**20%**
Domestic bonds	**13%**
Financials	**4.6%**
Industrials	**11.4%**
Foreign equity	**16%**
Domestic cash	**50.9%**
Foreign cash	**0.1%**
Total	**100%**

Performance

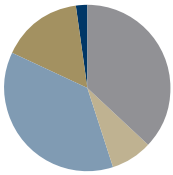


PSG Income Fund

Top 10 FI assets

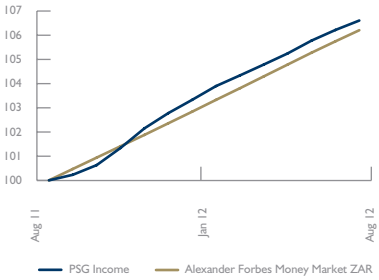
FirstRand
Nedbank
ABSA
Capitec Bank
Standard Bank
Steinhoff International Holdings Limited
Bidvest
Eqstra
Sanlam
Imperial Holdings

Asset allocation



Listed bonds	37%
Promissory notes	8%
Floating rate notes	37%
NCDs	16%
Call and cash	2%
Total	**100%**

Performance



Performance to 30 September 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	R751 731 331	19.64	56	88	14.35	17	80
FTSE/JSE All Share TR ZAR		24.43			13.54		
Domestic EQ General		20.87			11.69		
PSG Flexible	R 2 359 923 138	13.67	44	61	12.76	19	58
Domestic AA Flexible		18.75			11.77		
PSG Balanced A	R1 414 241 307	14.93	42	84	12.15	14	69
Domestic AA Pru Variable Equity		15.21			10.09		
PSG Stable	R26 275 975	12.19	46	67			
CPI+3%		8.00					
PSG Income	R38 106 490	6.36					
Alexander Forbes Money Market		5.70					
PSG Money Market	R2 459 700 869	5.38	18	26	5.52	16	25
Domestic FI Money Market		5.02			5.36		
PSG Global Equity	$28 925 454	9.94	475	570	-0.23	448	517
MSCI World Free GR USD		22.32			8.46		
GIFS Global Large-Cap Blend		14.50			1.98		
PSG Global Equity FF	R24 813 200	9.22	24	24			
MSCI World Free ZAR		22.30					
SPECIALIST FUNDS							
PSG Preferred Dividend	R107 985 025	10.78			5.95		
STeFI Call Deposit ZAR		5.24			5.31		
PSG Optimal Income	R139 544 400	8.18			7.00		
STeFI Call Deposit ZAR		5.24			5.31		

* Manager inception dates
** Annualised (for periods greater than 12 months)
*** Fund Size as at 30 September 2012
All the performance data is net of fees, for a lump sum, includes income, and assumes reinvestment of income on a NAV to NAV basis.
Source: © 2012 Morningstar, Inc. All Rights Reserved.

											VOLATILITY		
	3 Years**			5 Years**			Inception**				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
	15.25	20	78	5.77	33	61	01/03/2002*	19.53	4	32	10.94	38	78
	16.01			6.64				15.30			13.32		
	13.37			5.49				16.03			10.43		
	16.69	7	54	12.27	2	45	01/11/2004*	17.50	3	19	6.99	19	54
	12.20			6.35				14.09			6.75		
	13.17	11	58	6.77	23	40	01/06/1999	15.01	3	10	4.94	22	58
	10.29			6.40				13.56			5.20		
							13/09/2011	12.00	47	66			
								8.00					
							01/09/2011	6.09	48	55			
								5.70					
	6.07	15	25	7.97	12	19	31/10/1998	9.34	4	6	0.24	12	25
	5.97			7.90				9.33			0.37		
							23/07/2010	0.82	441	512			
								10.94					
								5.48					
							04/05/2011	4.48	24	24			
								7.20					
	10.50			8.70			01/11/2006	7.00			4.96		
	5.72			7.51				7.69			0.18		
	6.66			7.30			10/04/2006	7.84			1.51		
	5.72			7.51				7.64			0.18		

NOTES

NOTES

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Retirement Annuities
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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 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 (Pty) Limited is an Authorised Financial Services Provider, Registration Number 1999/014522/07, FSP Number 563. PSG Asset Management Administration Services (Pty) Limited administers the PSG Voluntary Investment Plan. PSG Asset Management Nominees (Pty) Limited is the entity that holds investments in the PSG Voluntary Investment Plan in safe custody for your benefit exclusively. PSG Asset Management Life Limited is an Authorised Financial Services Provider, Registration Number 1999/010087/06, FSP Number 22557. PSG Asset Management Life Limited is the underwriter of the PSG Asset Management Retirement Annuity, PSG Asset Management Preservation Funds, the PSG Asset Management Equity Linked Living Annuity and the PSG Asset Management Endowment Investment.

PSG Fund Management (CI) Limited as Manager of the PSG Global Equity Fund is licensed by the Guernsey Financial Services Commission ("GFSC"). The PSG Global Equity Fund is a Class B open-ended collective investment scheme authorised by the GFSC.

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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.

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