3rd Quarter 2013

# ANGLES & PERSPECTIVES

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# SIMPLICITY IS OFTEN UNDERRATED

By Greg Hopkins

*Greg is a CA (SA) and a CFA Charterholder. Greg is PSG Asset Management's Chief investment Officer.*

We at PSG Asset Management admire simple ideas or products that have been stripped bare of noise and complexity through much iteration. The interface of the Apple iPhone is a great example – a very simple user experience that covers extreme enabling though complex technology. We wonder about the time and brainpower that must have gone into making that 'simple' product.

The investment process at an asset management house should be no different. It should have a simple philosophy, a simple checklist to execute on that philosophy, and a simple risk framework to measure the integrity of that process. Of course, behind this interface are years of cumulative experience, reading, thinking and learning from past mistakes.

The cornerstone of this is the quest for rational thinking, which is arguably the simplest way to achieve long-term risk-adjusted returns in our industry.

### We believe in having a simple philosophy

Let's apply this test to PSG Asset Management. We believe that we have a straightforward philosophy – we don't want to lose money. To this end:

- We demand that investments clear a high bar before we consider them in our funds.
- We have a long-term approach, which is the bedrock of our philosophy.
- We look for an uncomplicated asymmetry in our ideas – little downside and sufficient upside to compensate for the risks (known and unknown) that may exist.
- We choose to have an absolute approach, rather than buying the best of a bad bunch or because they happen to be in the index.
- We use a simple checklist that we call our 3 Ms (Moat, Management and Margin of Safety) to evaluate equity investments.
- We keep our risk framework reasonably simple: we look to buy instruments when valuations are low and to diversify our investments over a range of companies, geographies and currencies.
- We strive to offer a few high quality products, which reduces complexity and allows us to focus our attention on research.

### The attractiveness of simple investment ideas is not a new trend

Some of the most successful investors of the past believed that an investment idea should be elegant in its simplicity. Michael Steinhardt, an investor who some argue as being one of the most successful over the last 40 years, once told a summer intern that they should be able in two minutes to describe the four basic things that they were looking for in an investment. His investment approach was a simple one and has been described as 'variant perception'. He was looking for the greatest difference between market perceptions (usually captured in the valuation of a stock) and what the analyst thought was more likely to happen.

### In this edition

In this edition, Shaun le Roux writes about a variant perception in the global stock markets when he compares the high valuations in a basket of South African equities to one of our large offshore holdings, Microsoft. We also extend a warm welcome to two new joiners at PSG Asset Management. Nicolette Wulfsohn, our new equity analyst, writes about a simple valuation methodology that produces compelling investment results. We also meet our new Head of Fixed Income, Ian Scott in our 'Meet the Manager' segment. Ian also writes about looking for a straightforward asymmetry in the fixed income markets.

We trust you will enjoy the read and find out articles insightful.

# ARE BONDS LEADING THE CHARGE TO THE NEW NORMAL?

By Ian Scott

*Ian Scott joined Sasol Oil as a forex trader in 1996, trading crude oil and petroleum products, foreign exchange exposures, and hedging various market risks. In 1999 he joined SCMB Asset Management as a money market dealer. He was also involved in the portfolio management of various cash funds. In 2003 he moved from the money market desk to join the capital market desk of the fixed interest team and in 2007 he was promoted to senior portfolio manager. Ian joined PSG Asset Management in June 2013 as Head of Fixed Income.*

*It never matters, until it matters and then it matters too much.*

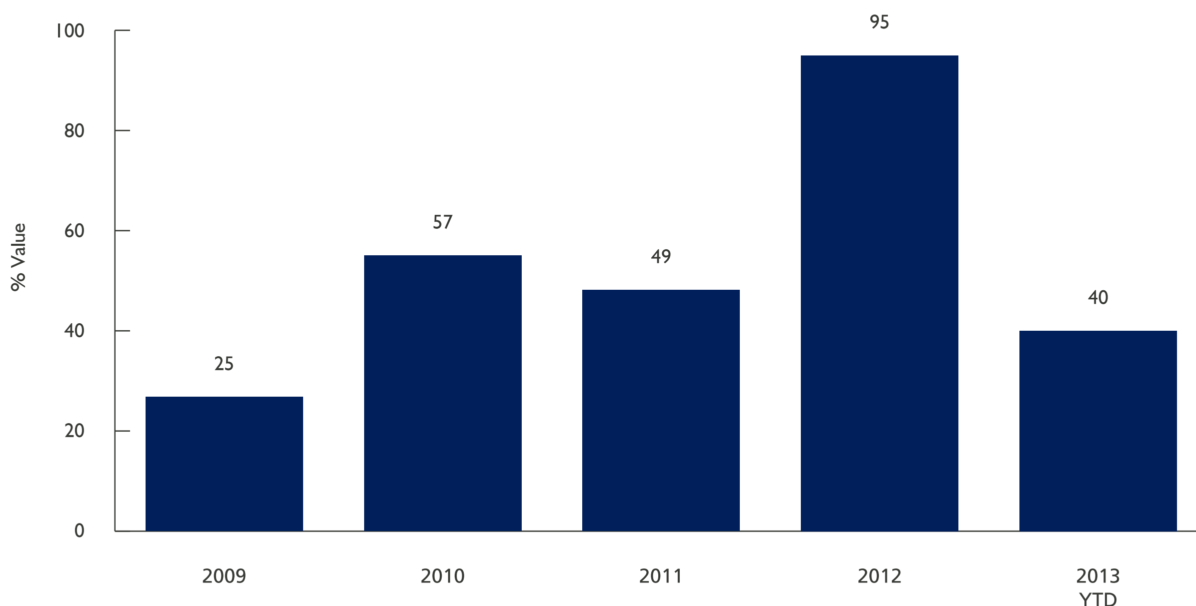
### The race to lower yields

It has been a multi-decade bull market in global bond yields, ever since Alan Greenspan assumed the chairmanship of the US Federal Reserve in 1987. The policy method was to anchor inflation and cut interest rates to support global markets. Even when inflation escalated, real policy rates were kept low to support markets. When the Chinese cheap labour disinflationary forces spread through the world, rates were lowered further. The financial crisis of 2008 spiked market rates to multi-decade highs, prompting global monetary policy action. Developed market central banks reduced rates to multi-decade lows and further added stimulus to markets and the banking system through various forms of quantitative easing and money creation methods.

### After 2008, the search for higher yields was in full swing

Firstly government, utility and corporate investment grade yields were bought to expensive levels, and when there was no margin left in these markets, the hunt for yield turned to emerging market assets. South Africa was a beneficiary of this

Graph 1: Foreign purchases of South African bonds




Source: JSE

global search for higher risk, higher yielding assets. The country looked attractive as an investment destination due to the following reasons:

1. We have a stable banking system (no subprime assets).
2. The rand is a liquid currency.
3. Bond and swap markets are liquid.
4. For an emerging market, South Africa's politics were quite stable.

All of the above created a perfect storm scenario for a significant rally in bond yields to lower levels as long as global central banks added cash to the financial system. Every year since 2009 the foreign participation in the local bond market increased and in 2012 the pinnacle was reached when approximately R95 billion worth of bonds was purchased by foreigners (see Graph 1). This was a relief to the monetary authorities, as the inflows financed the bulk of South Africa's current account deficit as well as the increased budget deficit that government had to fund in the debt markets.

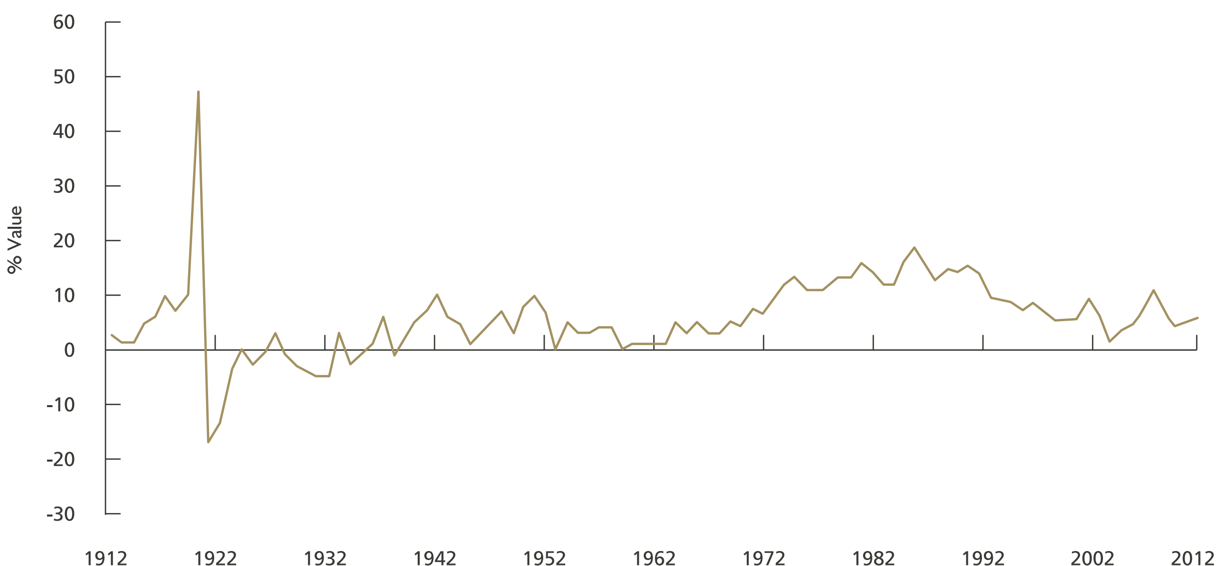
**Then the world was turned on its head.**

US Federal Reserve Chairman Ben Bernanke announced in a statement that the US Federal Reserve would start to reduce the monetary stimulus it was adding to the market. The reasons were that the macro economic data in the US was starting to show a sustained improvement and that further stimulus can be withdrawn in an orderly manner. Unfortunately, bond markets did not re-price in an orderly fashion, and since May 2013, bond markets have been in a bearish mode. The US bond market was the catalyst of this trend reversal, with the 10-year treasury selling off from a low of 1.6% to 3.0%, a high so far in 2013.
Since most bond markets follow the trend in the US treasury market, few bond markets were left untouched. Locally, the South African 10-year bond traded from a low yield of 5.6% to a high of over 8.0%. The so-called risk-off trade was back in full swing, where money raced out of riskier emerging markets back into developed market safe havens. The real problem for South Africa was the negative impact of the sell-off in the rand, rather than only the bond market.

**The weakened rand and its impact on inflation**

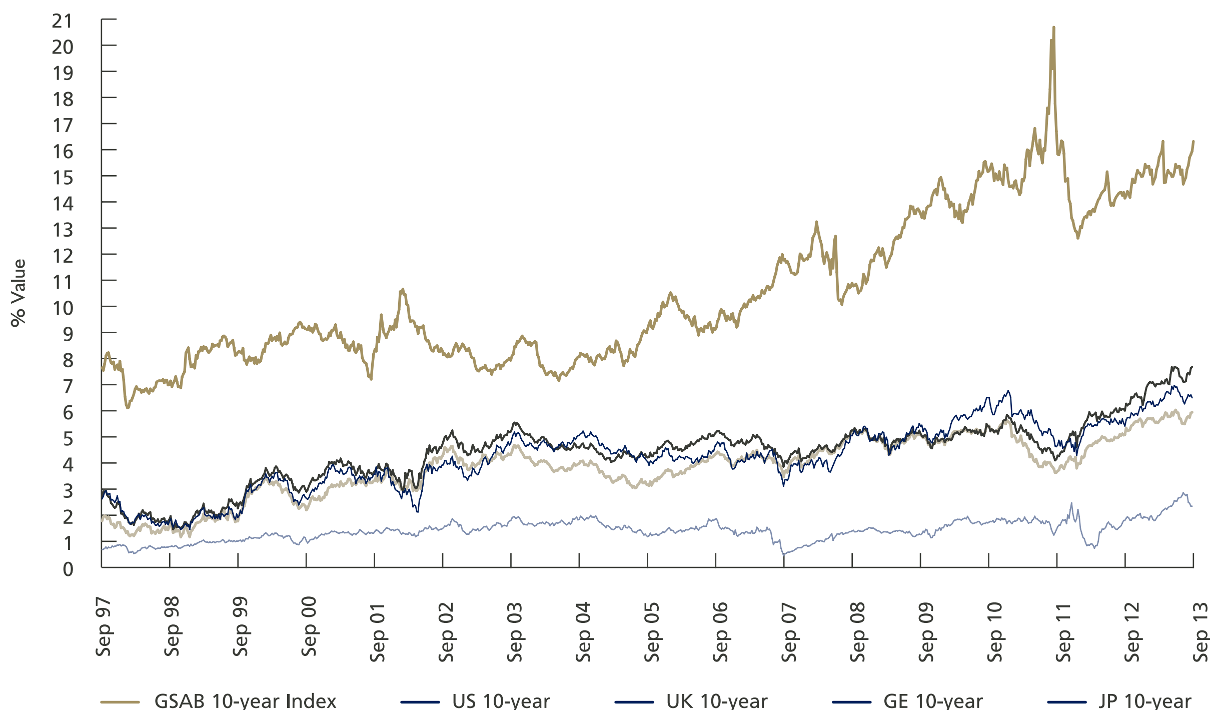
The depreciation in the rand against the major currencies has a much wider impact on the economy than just higher bond yields affecting the cost of capital in the economy. The South African economy is very much leveraged to the rand due to our high consumer base, our current infrastructure spend, and the effect on commodity input prices. The major concern for the monetary authorities is obviously the secondary inflation effect that the weakening in the rand will have on the economy, especially on the consumer. Although we have seen various spikes in inflation over time, it is interesting to note that consumer inflation in South Africa has averaged around 6.0% annually since 1912, when inflation was first measured. Since the introduction of inflation targeting in the year 2000, consumer inflation has averaged 5.8% annually (see Graph 2). Not all is lost on the inflation front and we are typically entering a period of elevated inflation.

Graph 2: Inflation in South Africa




Source: JSE

Graph 3: Nominal 10-year bond yields




Source: Bloomberg

### What is the 'new normal' and how do we get there?

Markets love new catch phrases. All that the new normal means in interest rate markets is: Where is the new neutral level for interest rates after the financial crisis? This is a not an easy question to answer, since economic theory would dictate that neutral rates are the sum of consumer inflation and real GDP growth. For the US that would mean 2.0% inflation plus 2.0% real GDP growth equals a 4.0% Federal funds rate (now at 0.25%). Currently, the more relevant question is: Can the US economy still grow sustainably if interest rates had to rise from 0.25% to 4.0% over the next few years? We must remember that the monetary authorities created money and cut interest rates in 2008 and 2009 to support the housing market and banking system from the subprime crises. In the current rising interest rate environment, can the housing market and employment creation capacity hold up? Only time will tell.

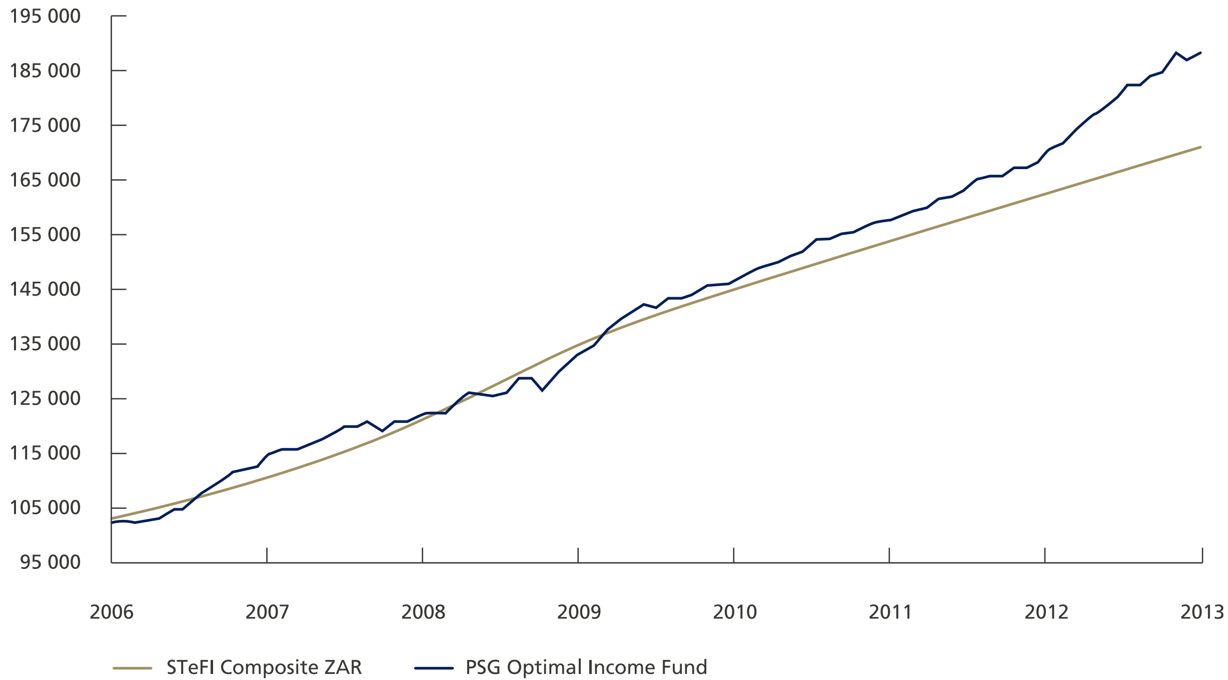
### What the new normal will mean for emerging markets like South Africa

South African long bond yields will not be immune to higher US bond yields, as we have witnessed over the last few months of 2013. South African bond yields trade at a premium to US bond yields and that premium will in all likeliness remain or even widen as yields rise in developed bond markets and their returns become more attractive on an inflation-adjusted basis (see Graph 3). Fundamentally, South Africa finds itself in a difficult position by being in the unenviable group of countries currently running both budget and current account deficits. To further exacerbate the problem, the rand is one of the most liquid and traded emerging market currencies. In other words, in a risk-off scenario the rand is sold more than many other emerging market currencies of similar quality. On the back of a weaker rand, higher bond yields will follow. Unfortunately the unwinding of the current dual deficit situation is not a short-term solution, which means the volatility in the rand and bond market will be with us over the medium term.

### Finding value in the fixed income market

If the outlook for long-dated bonds over the medium term is not particularly bullish, other areas of the yield curve present good value. The front end of the yield curve is currently steep given that the market's expectations for inflation have risen, while short rates remain anchored by the South African Reserve Bank. This provides a significant yield pick-up opportunity for income funds. These funds are more conservatively positioned than typical bond funds and are therefore not exposed to the current sell-off in long bonds. In addition, these funds are typically more diversified than many money market funds. As a result, they should provide an inflation-type return at an acceptable level of risk.

Graph 4: The PSG Optimal Income Fund compared to its benchmark




Source: Morningstar Direct

For the less risk averse, conservative investor with a medium-term horizon, the combination of income fund assets blended with a conservative low equity holding will be attractive. The outlook for income assets as well as equities remains positive over the medium term. In this space, flexible income funds would be a solution over a medium-term horizon. The low equity asset allocation funds should yield a positive real return at an acceptable risk level.

**In summary**

The good times in bond markets over the last few years are over for the foreseeable future. There are as always pockets of value to be found in the market. We believe income funds are the place to be for the conservative investor over the medium term. Multi asset class funds will be the appropriate solution for less risk averse investors.

The bond tide is moving out, and we can clearly see who has been swimming naked.

# EXPLORING THE NOTION OF A DEFENSIVE EQUITY INVESTMENT

By Shaun le Roux

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

### Defensives: The best of a bad bunch

We have been somewhat bemused by commentary emanating from a number of South African fund managers that they are worried about the levels of the stock market. Yet they are holding on to their Naspers, SAB Miller, Richemont, or British American Tobacco (BAT) shares because these are 'defensive' or the 'best of a bad bunch'.

### The poster children of the strong run on the JSE

These four stocks all exemplify the strong run on the JSE in recent years. The share prices of Naspers and Richemont are both more than 80% higher than they were a year ago. It is also true that these stocks (with the exception of Richemont) outperformed the JSE during the global financial crisis in the second half of 2008. However, it is worth pointing out that all four of these stocks are now significantly more expensive than they were at the onset of the crisis. In addition, their relative performance was boosted by a sizeable devaluation in the rand during the market meltdown as these companies all produce most of their profits outside South Africa.

### Equities, by their nature, are risky investments

Unpredictable economic cycles have a significant impact on future profits and investor sentiment is fickle. As a result, equities trade at earnings yields above bond yields and hence should produce higher long-term returns. In recent times, bond yields have been at multi-decade lows. It is also noticeable that in recent years the market has attached a very low risk premium to stocks in which there is most confidence for future growth. In essence, in the world of very low yields on cash and bonds, high quality equities have become quasi-bonds. As a result, the likes of Naspers, SAB Miller, Richemont and BAT trade at the higher end of their long-term valuation ranges (as shown in Table 1). With the growth outlook for profits in emerging markets likely deteriorating relative to recent years, we regard these stocks as expensive stocks on cyclically high earnings. Accordingly, we do not view these four stocks as defensive and we do not own them in our portfolios. They are, however, the types of businesses we like to own at the right price and they have done well for us in the past.

| Trailing P:E ratios (As at 10 September 2013) | |
|---|---|
| SAB Miller | 20.6 |
| Naspers | 41.0 |
| BAT | 15.4 |
| Richemont | 20.6 |
| PSG Equity Fund | 12.6 |
| FTSE/JSE All Share | 18.1 |

Sources: Bloomberg, I-Net, PSG Asset Management

Our investment process sees us putting risk first whenever we review a stock as an investment opportunity. This means we only like to invest where we are confident that clients will not incur a permanent capital loss and where we expect the investment to generate returns above our hurdle rate. The hurdle rate we set takes into account the long-term risk of investing in equities and the quality of the business.

### We believe that an asymmetrical opportunity is a defensive equity investment

We actively seek out what we refer to as asymmetrical opportunities. These are investment ideas where expectations are low, the downside or bear case is effectively priced in, and any improvement in outlook or sentiment is to our benefit.

### An example of a stock that we think provides an asymmetrical pay-off is Microsoft

The share is widely held across our funds. Until recently, the Microsoft share price was at the exact same levels as in 2003, a decade ago. Understandably, there are many frustrated shareholders and their frustration has been compounded by Microsoft's distinct lack of success in the big growth areas of search and consumer devices. Throw in a declining PC market and the outlook becomes very bearish. This view is clearly widespread, which is why Microsoft trades on less than 12 times earnings, despite the fact that they grew their profits by 10% per year over the decade.

Comparing today's valuation with ten years ago, when Microsoft was trading on almost 30 times earnings, goes a long way towards explaining why the share price has performed so poorly. This needs to be remembered if you are viewing today's 20 to 30 PE stocks as being 'defensive'.

Graph 1 compares the P:E ratios of the basket of South African-listed industrial blue chips (Naspers, SAB Miller, BAT and Richemont) to Microsoft and the inverted US 10-year bond yield – as bond yields move lower, PE ratios rise. It should be clear that the blue chips are on average the most expensive they have been over the past decade, while Microsoft is inexpensive on this basis.

**Microsoft owns some of the world's most powerful and valuable enterprise software products**

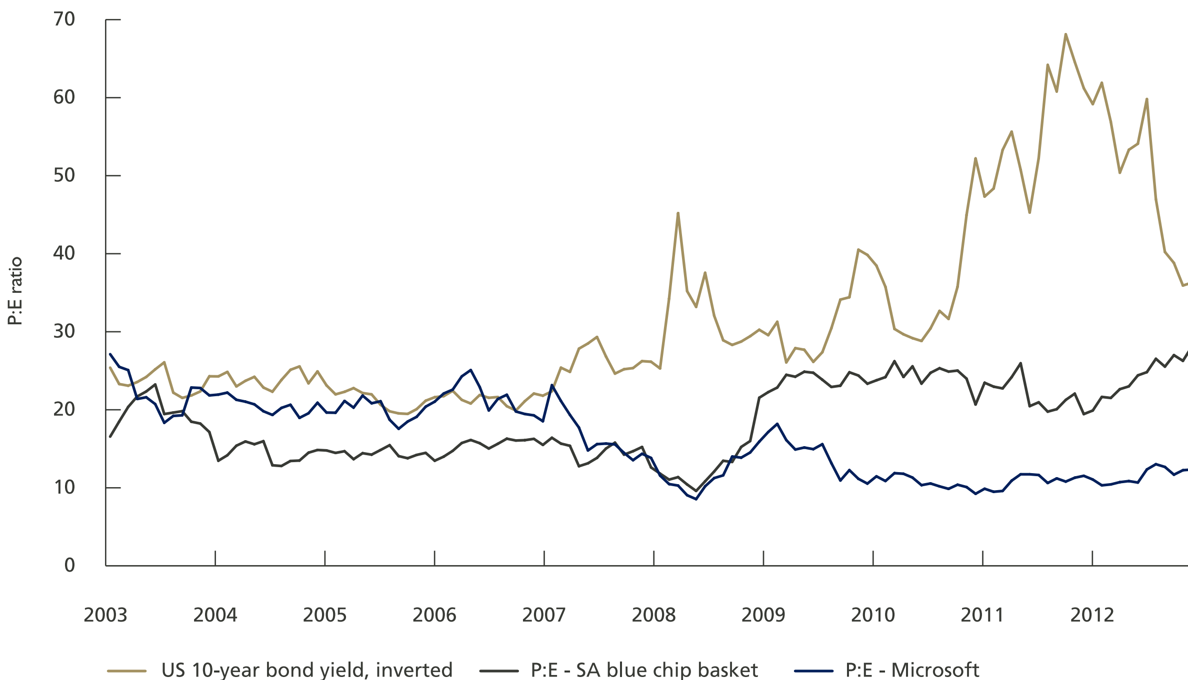
These include Office, Windows and their server and tools division. This is the essence of our investment case. Microsoft's enterprise business, which we estimate generates 90% of their profit, is growing and has a very strong positioning in a cloud-based IT ecosystem. All of the focus and criticism is directed at their consumer and devices businesses, which are less relevant in our investment thesis. When we derive an estimated fair value for the enterprise division, we effectively get the consumer business and the $70 billion of cash on the balance sheet for free. This means that we don't have to take an explicit view on future success in consumer devices or the decline of the PC in the home. Anything other than repeated failures and significant cash burn results in good upside for shareholders.

**We view Microsoft at current share prices as a defensive opportunity**

We see little room for downside, we are buying a high quality franchise at a very good price, and we have effectively bought a free option on future success in the consumer (or other) arenas. The valuation is underpinned by very strong cash flow generation and the company currently yields 4.4% (dividends and share buybacks), which compares very favourably to bond yields.

For us a defensive equity investment is a stock that will provide attractive future returns with limited downside. We think the market still provides such opportunities but careful selection is required. We do not consider expensive higher quality stocks to be defensive.

Graph 1: Comparing P:E ratios of a South African industrial blue chip basket and Microsoft with US 10-year bond yields (inverted)




Sources: Bloomberg, PSG Asset Management

# VALUATION TOOLS: PRICE-TO-BOOK RATIO

By Nicolette Wulfsohn

*Nicolette Wulfsohn (B Bus Sci (UCT) and CA(SA)) joined PSG Asset Management as an equity analyst in 2013 from another large and respected South African asset manager. Before her investment career, she worked at Woolworths in a variety of financial roles. Nicolette has completed the exams for the CFA qualification and awaits her investiture as a CFA Charterholder.*

**The price-to-book ratio compares the share price to the equity book value**

There are a myriad of valuation tools and formulae available that investors can use to estimate the value of potential investments. One of these is the price-to-book (P:B) ratio, which compares the price of an individual share to the equity book value as recorded in the company's latest balance sheet.

You may think that the historic book value of a company bears little relevance to what the share trades at on the JSE. However, in this article we will explain this relationship and for what types of companies it is useful to use the P:B ratio for valuation.

**What is a company's book value?**

The equity book value of a company is the accumulated investment that the management have had at their disposal to invest in that company. It is made up of the original share proceeds and accumulated profits less dividends paid out each year. The value we would place on the business is determined by how management have invested the retained profits, that is, what they invest in.

**What returns are generated from the book value?**

The relationship between the share price and equity book value of a share is dependent on the returns that a company can generate from the invested capital.

It is therefore essential to look at the P:B ratio in conjunction with the return on equity.

In a simplified example, company A have invested all their capital in vacant land. No income is generated on the land and a reasonable investor would be prepared to pay the same price as the management of company A, which signifies a P:B ratio of 1.

The management of company B have constructed a building that they lease out and generate rental returns. These rentals grow over time and provide an income stream return for which an investor may be willing to pay more than just the original building cost. In this case, company B is likely to be valued at a P:B ratio greater than 1.

Some people may say that the book value of equity is a historic number rather than a reflection of the current value of the assets and liabilities on the balance sheet, and therefore dismiss its use. We would however argue that it is still relevant when used in conjunction with return on equity, which is calculated on the same basis.

**When is it relevant to use the P:B ratio for valuing a company?**

P:B valuation is relevant for capital intensive companies where capital management is key to running a successful business, such as infrastructure or manufacturing companies and banks. The P:B ratio is generally not appropriate for valuing capital light businesses such as retailers, or businesses where the value is derived from intellectual property that is not reflected on the balance sheet.

Another key consideration when using a P:B ratio for valuation is to understand the company's ability to grow the book value over time, primarily through earnings. The company's track record as well as future prospects are taken into account.

One example of where we have used the P:B ratio as our key valuation technique is in our investment in Grindrod, a logistics infrastructure company. At the time of our investment in mid-2011, Grindrod was trading at a P:B ratio of 1. We believed that due to weakness in the shipping market, returns were cyclically depressed and would recover over time. In addition, the company had made significant investments in port infrastructure, the benefits of which were not yet reflected in the share price.

The investment has worked well, with the share price up 70% from R14 to R24* since we made the investment. Despite returns still being below our longer-term expectations, the outlook has improved and the P:B ratio has increased from 1 to 1.3 times, accounting for 30% of the share price increase.

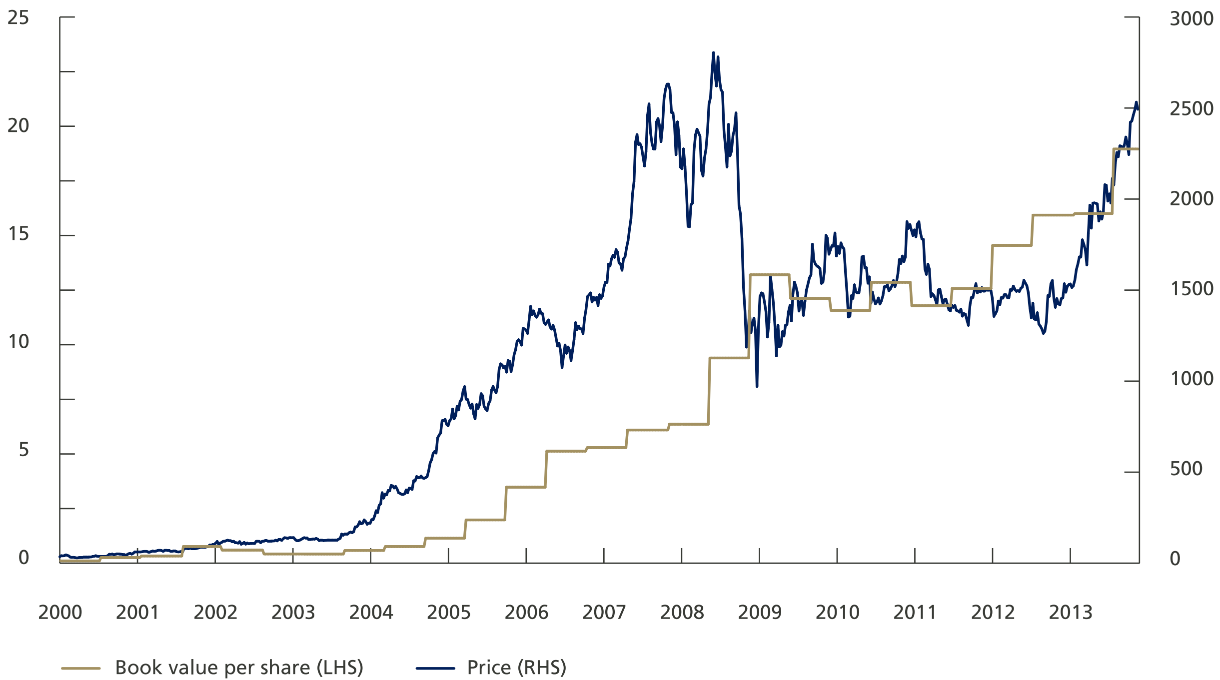
*Grindrod's closing share price as at 23 September 2013: R24.60

The book value per share has grown 40% over this time and has driven the balance of the share price increase, as shown in Graph 1.

**Know how to use the P:B ratio for valuations**

The P:B ratio is one of the valuation techniques we use for identifying investment opportunities in the market. We use this ratio in conjunction with the returns generated on equity and the ability to grow the book value of the equity. It is best used when analysing capital intensive businesses.

Graph 1: Grindrod book value per share and price




Source: Bloomberg

# MEET THE MANAGER

Ian Scott

*Ian Scott joined Sasol Oil as a forex trader in 1996, trading crude oil and petroleum products, foreign exchange exposures, and hedging various market risks. In 1999 he joined SCMB Asset Management as a money market dealer. He was also involved in the portfolio management of various cash funds. In 2003 he moved from the money market desk to join the capital market desk of the fixed interest team and in 2007 he was promoted to senior portfolio manager. Ian joined PSG Asset Management in June 2013 as Head of Fixed Income.*

**You have come to PSG Asset Management from a highly respected company that is very well known for its expertise in managing fixed income products. What attracted you to PSG Asset Management? Was it just the location?**

Coming to Cape Town was not on my agenda for 2013, yet here I am. On a serious note though – I think what happened to me was natural career progression. Fund managers often start their careers at one of the big companies and progress to smaller, focused players. We have seen it happen in the equity space and now it is happening more frequently in the fixed income space too. I was in the right space in my life to make this career change and accept this challenge given to me by PSG Asset Management.

**Tell us a little about your background and experience.**

I have always loved markets. I started my career in the forex markets at Sasol Oil. From there I moved on to the Liberty and Standard Bank stables, which evolved into Stanlib and the start of my asset management career path. I started out on the money market side of the fixed income team and later moved on the income to the bond side. The team was very successful, winning a number of investment awards and growing fixed income assets significantly from a small base over the decade. I had a great time in that team and gained lots of experience and many insights, which I felt I could in part replicate at PSG, and with our smaller asset base, the opportunity set is much greater.

**At PSG Asset Management you are now working with a smaller team than you were part of in the past. How are you dealing with the adjustment?**

As much as people like to say bigger is better, that is not always the case in the fund management industry. I like the smaller team idea – the team dynamics are so different. Smaller teams are much more dynamic, and ideas and suggestions from every team member are important and taken seriously. Decision making is a lot more nimble than in large teams. I find that there is more time for idea generation and thought processes than in large teams. The administration involved in running a wide variety of funds overwhelms the thought generation process in larger teams. My view has always been to decide where you want to play on the investment risk curve and do it well, instead of being everything to everyone.

**How are you fitting in with the equity team? Do your teams work in isolation or how are you organised?**

There really is an integrated process here at PSG Asset Management between the equity and fixed income teams. I think the days when equities and fixed income were separate investment teams are over. I enjoy the interaction and discussions with the equity team. I think to research a company from the equity and debt side leads to a much clearer picture on the investment decision. In the investment world that we live in, we are two sides of the same coin. The same companies that we research and invest in from an equity perspective are the ones we also find coming to the debt capital markets to do term debt funding. I can see that this will only increase over time as we move into the Basel 3 world of banking regulations.

**These are certainly some interesting times to be managing fixed income assets. Are we experiencing 'abnormal markets'? What are some of the risks out there for investors in these assets and, on the other hand, where are you and your team finding opportunities?**

It is never a dull day in fixed income markets, because they are sentiment-driven markets and many global macro events influence their behaviour. We have been in abnormal fixed income markets for the last few years if you think of the amount of money global central banks have 'printed', which has led to generationally low global interest rates. Surely there must be risks around when so much money has been created and we know that this stimulus has to be withdrawn at some point in time. The risk for me at the moment sits in the long

bond yields of developed markets, especially the US. We have had a taste this year of what happens to bond yields when the US Federal Reserve starts to prepare the market for the first withdrawal of the stimulus. We believe that, even in this more bearish scenario for long bonds, there are good opportunities in fixed income markets. We still like the income fund space, where investors can earn yields in excess of cash yields on an interest rate risk level that is similar to cash funds. We also like the space where there is a synergy between short- and medium-dated fixed income with a low equity allocation in the fund.

**Looking forward, what do you feel are some of the key drivers and inflection points that investors should be mindful of over the next few years?**

It is very important in the current world that we live in to discard all the 'noise news' that we see and hear daily. A key driver for our market will be the trend in global rates, especially what happens in the US Treasury market. Global markets are driven by the actions of various countries' monetary authorities, so it's important to listen how central bankers view their countries and the world. Secondly, the view on emerging markets is important. As much as we think we are isolated here in South Africa, we are not. South Africa will follow the global trend of emerging markets to some degree. We are part of the BRICS group (Brazil, Russia, Indian and China) and will be judged as such.

**Tell us a bit more about how the two PSG income-oriented funds aim to meet investors' specific investor needs.**

Income funds are for investors who are seeking a high level of income over the medium to longer term. PSG Asset Management's two income-orientated funds seek to provide risk solutions to various income-seeking investors. Firstly, the PSG Income Fund is for conservative investors that are looking for a higher return than money market funds but at a similar risk level. The PSG Optimal Income Fund is for less risk averse investors who are looking for a higher return than vanilla income funds through the low exposure to high quality equities. For longer-term investors looking for above inflation returns with a high level of income, the PSG Stable Fund would be the solution to their requirements.

**You are currently living in Newlands, Cape Town, which some would argue is the wettest part of South Africa. How are you and your family enjoying the Cape?**

I have no doubt that Newlands is the rain factory of Cape Town. When my wife arrived, she asked if the sun ever shines in Cape Town (she's been a Joburger her whole life). We are so used to the sunny weather of Joburg, so this is a period of adjusting to the Cape Town winter weather. We do enjoy the beauty and general quality of life of Cape Town and try to get out as much as we can to see the sights. We as a family love walking the different trails on Table Mountain. I am indeed enjoying the lifestyle of Cape Town, but I'm still not supporting the Stormers.

# IT'S BEEN A GOOD PAST SIX MONTHS AT PSG ASSET MANAGEMENT

By Anet Ahern

*Anet Ahern has over 25 years' experience in investment and business management. After starting her career at Allan Gray in 1986, where she fulfilled various roles in trading and investment management, she worked as a portfolio manager at Syfrets, and later BoE Asset Management, where she was CIO and CEO. She also spent six years at Sanlam, where she was the CEO of Sanlam Multi Manager International, with assets totalling R100 billion in local and global mandates. Anet joined PSG Asset Management as CEO in 2013.*

*It seems as if my first six months at PSG Asset Management have gone by in the blink of an eye. I'd like to use this opportunity to reflect on milestones we have reached as a company during this time.*

**Size matters… in more than one way**

Size in asset management is a hotly debated issue. Smaller asset managers can be more nimble, as alpha-generating capacity is a limited resource. However, if the funds under management are not of an appropriate size, it becomes harder for smaller companies to get the opportunity to demonstrate that very ability. Many clients have a minimum fund size below which they simply will not even consider investing in a fund, no matter how good performance is. They want the comfort that other investors are also of the conviction that past performance can be repeated, and that the company has a good chance of being around for the long haul. Smaller managers may also find it tougher to attract and retain talent. This means that for a smaller asset manager, managing this capacity to perform, together with the need to reach a critical mass to give clients comfort, is a perpetual juggling act.

At PSG Asset Management we are very pleased with the growth in our assets, which recently surpassed the R12 billion mark. This means we are still able to find more opportunities for our clients to invest in when compared to large asset managers, but we are big enough to be noticed. In addition, on a fund level, we now have five funds larger than R1 billion, three funds larger than R2 billion and one that is over R3 billion in size.

**Our team is growing**

*Fixed income*

Ian Scott has joined us from Stanlib to head up the division. We have also employed a new credit analyst, Tyron Green, and a quantitative analyst, Angelo Joseph. We are very excited by the prospects in this part of the market, both in the income and lower risk multi asset space. We do however believe that the easy times in the credit markets are over and that we have to have a clear-cut and disciplined process to avoid the pitfalls and temptations of yield pick-ups. We are seeing growing interest in our PSG Income Fund, as well as our PSG Stable Fund, which has a large component of fixed income assets.

*Equities*

Nicolette Wulfsohn joined us from Prudential as an equity analyst. This brings the investment team to a strong 13, with over 120 years of equity experience among them. Our fixed income team has almost 50 years of combined experience

*Sales*

Charles Lombard joined us from Nedgroup to head up our retail sales efforts, and we also strengthened our national presence with Chris Rogerson and Jolene Bauermeister in the north. Gavin Rabbolini, Bernard Wessels and Alex Dearman cover the other bases in the retail space, with Andrew Tunstall continuing to look after the institutional market.

**Fund anniversaries**

Our PSG Money Market, PSG Equity and PSG Balanced funds have all been around for more than ten years, with the PSG Flexible Fund being almost ten years old. Our PSG Stable and PSG Income funds have just passed the two-year mark. In most cases, the same fund manager and team have managed these funds since inception, something we are very proud of.

**A new and improved look**

Our offices have undergone a revamp. We have specifically aimed at making our offices a lighter, brighter place to work and receive guests. If you have not had a chance to visit us, please drop by – we would love to show you around.

We have also standardised, automated and updated our fund factsheets so that it is even easier for you to compare our funds and so that we are able to publish them sooner. We have added a summary of all our funds to our website homepage. This shows that we have a comprehensive yet focused range of funds that should cater to most investors' needs.

**The proof is in the pudding**

All of the above is great to know, but what really matters is whether we are doing a good job looking after our clients' money. In this regard, I am very pleased with the performance rankings of our funds. Even more so, I am proud of the fact that, on the whole, we took less risk than other managers to achieve our returns. It is worthwhile reiterating our approach to risk, which is that the potential for our clients to lose capital is a concern for us. We therefore take this risk into account in every investment decision we make and we are not fazed by managing portfolios that look very different to the market indices and our peers.

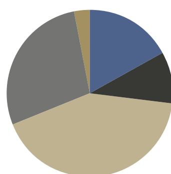
# PORTFOLIO HOLDINGS AS AT 30 SEPTEMBER 2013

## PSG Equity Fund

### Top 10 equities

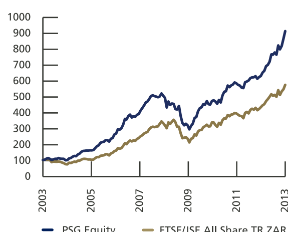
Steinhoff International Holdings Ltd
Anglo American Plc
Microsoft Corporation
Sasol Ltd
Capitec Bank Holdings Ltd
Adcorp Holdings Ltd
Walgreen Co
Super Group Ltd
Exxaro Resources Ltd
EOH Holdings Ltd

### Asset allocation



| | |
|---|---|
| Resources | 17.0% |
| Financials | 10.0% |
| Industrials | 42.0% |
| Foreign equity | 28.0% |
| Domestic cash | 3.0% |
| **Total** | **100%** |

### Performance

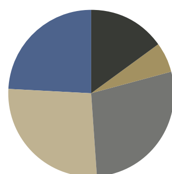



## PSG Flexible Fund

### Top 10 equities

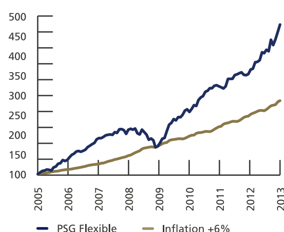
Steinhoff International Holdings Ltd
Anglo American Plc
Berkshire Hathaway Inc
Sasol Limited
Tesco Plc
EOH Holdings
Super Group Ltd
Capitec Bank Holdings Ltd
ING Groep NV
Eqstra Holdings Ltd

### Asset allocation



| | |
|---|---|
| Resources | 15.0% |
| Financials | 6.0% |
| Industrials | 28.0% |
| **Domestic equity** | **49.0%** |
| **Foreign equity** | **27.0%** |
| Domestic cash | 24.0% |
| **Total** | **100%** |

### Performance

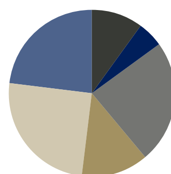



## PSG Balanced Fund

### Top 10 equities

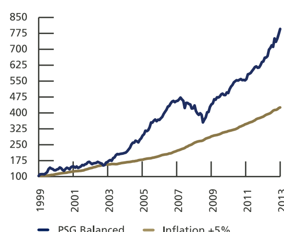
Steinhoff International Holdings Ltd
Anglo American Plc
Super Group Ltd
Berkshire Hathaway Inc
Tesco Plc
Sasol Ltd
EOH Holdings Ltd
Capitec Bank Holdings Ltd
Adcorp Holdings Ltd
Microsoft Corporation

### Asset allocation



| | |
|---|---|
| Resources | 10.0% |
| Financials | 5.0% |
| Industrials | 24.0% |
| **Domestic equity** | **39.0%** |
| **Domestic bonds** | **13.0%** |
| **Domestic cash** | **25.0%** |
| **Foreign equity** | **23.0%** |
| **Total** | **100%** |

### Performance

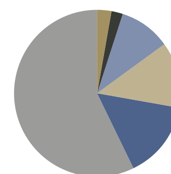



## PSG Stable Fund

### Top 10 equities

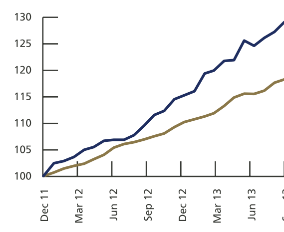
Steinhoff International Holdings Ltd
Berkshire Hathaway Inc
Tesco Plc
Target Corp
Microsoft Corporation
Anglo American Plc
Super Group Ltd
Capitec Bank Holdings Ltd
Adcorp Holdings Ltd
Sasol Ltd

### Asset allocation



| | |
|---|---|
| Resources | 3.0% |
| Financials | 2.0% |
| Industrials | 10.0% |
| **Domestic equity** | **15.0%** |
| **Domestic bonds** | **13.0%** |
| **Foreign equity** | **15.0%** |
| **Domestic cash** | **57.0%** |
| **Total** | **100%** |

### Performance

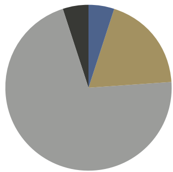


## PSG Optimal Income Fund

### Top 10 equities and bonds

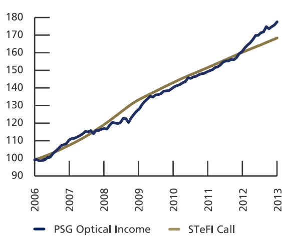
Steinhoff International Holdings Ltd
Super Group Ltd
Berkshire Hathaway Inc
Capitec Bank Holdings Ltd
Heineken Holding NV
Transnet Soc Ltd
Capitec Bank
Bidvestco Ltd
Toyota Financial Serv. (South Africa)
Firstrand Bank Ltd

### Asset allocation



| Asset | % |
|---|---|
| Local Equity | 5.0% |
| Local Cash | 19.0% |
| Local Bonds | 71.0% |
| Offshore Equity | 5.0% |
| **Total** | **100%** |

### Performance

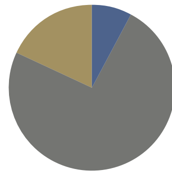



## PSG Income Fund

### Top 10 FI assets

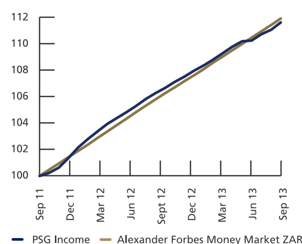
Nedbank
Capitec Bank
Transnet Soc Ltd
Firstrand Bank Ltd
Toyota Financial Services
Eqstra Corporation
Barloworld Ltd
Absa Bank Ltd
Sappi Southern Africa
Landbank

### Asset allocation



| Asset | % |
|---|---|
| Fixed rate notes | 8.0% |
| Floating rate notes | 74.0% |
| Cash and NCDs | 18.0% |
| **Total** | **100%** |

### Performance

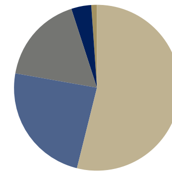



## PSG Global Equity Fund

### Top 10 equities

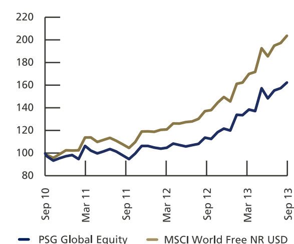
Berkshire Hathaway Inc
Microsoft Corporation
Tesco Plc
Steinhoff International Holdings Ltd
Anglo American Plc
International Business Machines Corp
Alstom
Cisco Systems Inc
JP Morgan Chase & Co
Heineken Holding NV

### Regional allocation



| Region | % |
|---|---|
| US | 54.0% |
| Europe | 24.0% |
| UK | 17.0% |
| Africa | 4.0% |
| China | 1.0% |
| **Total** | **100%** |

### Performance



# PERFORMANCE TO 30 SEPTEMBER 2013

FUND PERFORMANCE

| | | 1 Year | | | 2 Years** | | |
|---|---|---|---|---|---|---|---|
| Fund | Fund Size*** | Return | Sector Rank | Sector Count | Return | Sector Rank | Sector Count |
| **LOCAL FUNDS** | | | | | | | |
| PSG Equity A | R 1 116 775 801 | 37.87 | 1 | 114 | 28.43 | 10 | 103 |
| FTSE/JSE All Share TR ZAR | | 26.97 | | | 25.69 | | |
| (ASISA) South African EQ General | | 22.71 | | | 21.27 | | |
| PSG Flexible | R 3 413 942 791 | 30.25 | 6 | 69 | 21.68 | 25 | 66 |
| PSG Flexible BM: CPI +6% | | 12.43 | | | 11.71 | | |
| (ASISA) South African MA Flexible | | 18.92 | | | 18.42 | | |
| PSG Balanced A | R 2 202 010 626 | 24.07 | 15 | 104 | 19.42 | 28 | 94 |
| PSG Balanced BM: CPI +5% | | 11.41 | | | 10.70 | | |
| (ASISA) South African MA High Equity | | 18.87 | | | 17.32 | | |
| PSG Stable | R 982 417 217 | 14.86 | 28 | 89 | 13.52 | 33 | 79 |
| CPI+3% | | 9.40 | | | 8.69 | | |
| PSG Optimal Income | R 188 900 952 | 9.04 | 2 | 55 | 8.60 | 8 | 46 |
| STeFI Call Deposit ZAR | | 4.68 | | | 4.96 | | |
| PSG Income | R 107 375 596 | 4.61 | 26 | 26 | 5.49 | 21 | 24 |
| Alexander Forbes Money Market | | 4.68 | | | 4.96 | | |
| PSG Money Market | R 2 611 817 864 | 4.98 | 23 | 26 | 5.18 | 24 | 26 |
| (ASISA) South African IB Money Market | | 4.69 | | | 5.08 | | |
| PSG Global Equity Feeder Fund | R 55 400 296 | 39.87 | 18 | 24 | 23.60 | 20 | 22 |
| MSCI World Free ZAR | | 47.46 | | | 36.06 | | |
| **OFFSHORE FUNDS** | | | | | | | |
| PSG Global Equity | $ 30 146 477 | 18.17 | 234 | 528 | 13.98 | 335 | 487 |
| MSCI World Free NR USD | | 20.21 | | | 20.90 | | |
| GIFS Global Large-Cap Blend | | 17.00 | | | 15.74 | | |

* Manager inception dates
** Annualised (for periods greater than 12 months)
*** Fund Size as at 30 September 2013
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: © 2013 Morningstar, Inc. All Rights Reserved.

| 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 |
| | | | | | | | | | | | | |
| 21.71 | 6 | 91 | 19.28 | 5 | 84 | 01/03/2002* | 21.01 | 4 | 42 | 9.88 | 46 | 91 |
| 17.85 | | | 16.38 | | | | 16.26 | | | 11.79 | | |
| 15.00 | | | 14.16 | | | | 17.59 | | | 9.19 | | |
| 18.31 | 14 | 62 | 18.12 | 6 | 55 | 01/11/2004* | 18.86 | 3 | 17 | 7.69 | 38 | 62 |
| 11.60 | | | 11.34 | | | | 12.25 | | | 2.52 | | |
| 13.72 | | | 12.34 | | | | 15.40 | | | 5.77 | | |
| 15.99 | 18 | 79 | 14.37 | 8 | 62 | 1999/06/01 | 15.62 | 4 | 13 | 5.61 | 20 | 79 |
| 10.58 | | | 10.32 | | | | 10.65 | | | 1.16 | | |
| 12.99 | | | 11.55 | | | | 13.87 | | | 5.72 | | |
| | | | | | | 2011/09/13 | 13.50 | 35 | 78 | | | |
| | | | | | | | 8.70 | | | | | |
| 7.68 | 15 | 41 | 8.04 | 20 | 33 | 2006/04/10 | 8.00 | 14 | 23 | 1.79 | 27 | 41 |
| 5.10 | | | 6.27 | | | | 7.24 | | | 0.11 | | |
| | | | | | | 2011/09/01 | 5.38 | 20 | 22 | | | |
| | | | | | | | 4.97 | | | | | |
| 5.34 | 19 | 25 | 6.69 | 14 | 23 | 1998/10/31 | 9.05 | 4 | 6 | 0.11 | 14 | 25 |
| 5.29 | | | 6.66 | | | | 9.04 | | | 0.27 | | |
| | | | | | | 2011/05/04 | 17.93 | 20 | 21 | | | |
| | | | | | | | 28.09 | | | | | |
| | | | | | | | | | | | | |
| 5.56 | 305 | 444 | | | | 2010/07/23 | 6.20 | 351 | 440 | 14.07 | 90 | 444 |
| 11.82 | | | | | | | 8.80 | | | 14.31 | | |
| 6.76 | | | | | | | 8.96 | | | - | | |

# CONTACT INFORMATION

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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.

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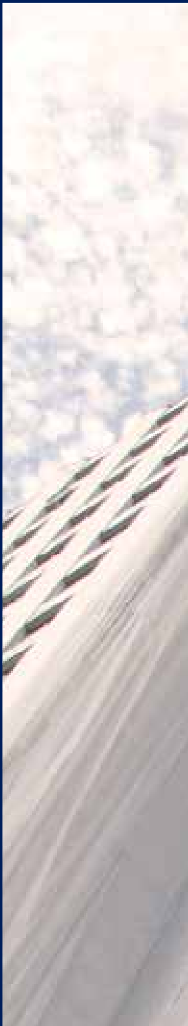


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