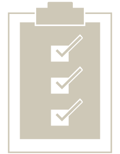
INVESTMENT RESEARCH AND STRATEGY REPORT

SUMMER 2016

PSG Wealth



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Introduction

Welcome to the special 2016 edition of the *PSG Wealth Investment Research and Strategy Report*. In an effort to add more value to your PSG Wealth experience, our research division has looked at a variety of factors which could influence your wealth in this New Year.

At PSG we believe that wealth is personal. To really make it count, wealth management should be shaped to the individual. For that reason our publication is interactive – you do not need to scroll through the whole document to get to the section you want to read, but you can simply click on the link to each article on the table of contents page. At the end of each article you also have the choice to click on **back**, for the previous article, **next**, for the following article and **table of content** if you would rather like to jump to another piece that piqued your interest. We will focus on an array of topics every season, but in this special edition we attempt to look forward to what you could do to grow your wealth in 2016.

What to expect from our special edition

In this edition, Franco Pretorius, Head of Direct Security Research, showcases our research on which stocks to watch this year. Henko Roos and Johan Pyper, senior analysts in our multi-management team, take a look at offshore and domestic unit trusts respectively. While a new edition to our team, Jinine Botha, an investment writer, spoke to some experts on how the demographics of the wealthy around the world will be changing in 2016 and beyond. I have given my own insights into prevailing economic and financial market conditions, as well as how our funds are positioned to ride out the waves in 2016.

In addition to all the content above, we have a special report in which we speak about, amongst others, the increasing interest rate cycle and China's slowing growth to our predictions for 2016.

A new feature

From this year we will ask you to take part in a small survey or poll question each quarter. The results from each previous quarter's question will be discussed in the next edition of the report.

Please follow this link to take part in our first poll regarding performance expectations for commodities in 2016.

We value your feedback

We hope you enjoy the read, and the new format of our seasonal research report. Please feel free to send us any feedback you might have – we always look forward to hearing from you.

Regards,

Adriaan.

Adriaan Pask
Chief investment officer
PSG Wealth

PSG Wealth

Special report

SPECIAL EDITION

Predictions for 2016

The year 2015 was an eventful one in the markets, with events in countries such as Greece, Russia, and China reminding investors how quickly seemingly calm seas can turn choppy and how swiftly currencies can stumble.

On the domestic front, the rand weakened significantly to R16/$ after President Jacob Zuma replaced former Finance Minister Nhlanhla Nene with a relatively politically unknown candidate, David van Rooyen. In addition, two rating agencies downgraded South Africa's sovereign credit rating.

There were, however, a myriad of highlights for PSG Wealth in 2015. These include a Morningstar award nomination for our multi-management team, another solid result in the Intellidex Wealth Manager of the Year competition, the expansion of our investment research capabilities, and the launch of our new, consolidated online viewing and transactional platform, which offers access to a client's entire PSG portfolio via a single log-in.

National Treasury also introduced tax free savings accounts last year, and PSG Wealth launched our own Tax Free Investment Plan. This development in the domestic savings landscape sends a very positive message from policy makers, showing that they are actively adopting a solution-focused mind-set around the need to create a savings culture in South Africa. This was a small but significant step forward.

In 2016, we expect that the usual economic players will continue to dominate the global and domestic marketplace. These include the world's largest economy, the US, and South Africa's largest trading partner, China.

US rate hikes indicate an increasingly healthy US economy

On the face of it, the US economy looks healthy. Unemployment, which peaked at 10% of the workforce in 2009, was down to about 5% by the end of last year and economic growth for 2015 was expected to come in at a relatively solid 3%. The Chair of the US Federal Reserve (Fed), Janet Yellen, obviously feels that the economy is strengthening sufficiently to cope with higher borrowing costs, as evidenced by the 0.25% interest rate hike announced in December.

Historically, initial US interest rate hikes have been followed closely by more hikes. In 2009 for example, rates rose by two percentage points in just twelve months. Although Fed increases will affect asset class returns in 2016, the longer-term story remains positive in that these Fed hikes stem from an increasingly healthy US economy, which is good news for the global economy.

2015 in review - quarter 1**

- Grade 12 disappoint with 2.4% lower pass rate of 75.8%
- Paris under siege in extremist hostage drama, leaving several civilians dead
- The Swiss National Bank shocks world markets by removing the Swiss franc/euro peg
- EFF members escorted out of parliament during Zuma's state of the nation address
- SA budget day - Among othe tax raised, Nene increases total fuel tax by 80.5c/l
- EU start talks on third bailout for Greece valued at R471.6bn to R786.2bn
- Italy's 10-year bond hits the lowest yield since Bloomberg started collecting data

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Special report

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PSG 2015 in review

PSG and Industry highlights 2015

- Enhancements made to PSG Insure and PSG Wealth platforms
- PSG unified its web front end with a single sign-on login functionality
- PSG upped its marketing substantially
- Launched Real Time Buying and Booked Media banner ads
- Among the many languages in the firm we have also added French after our Mauritian acquisition
- We produced record profits with high inflows of new business and added clients across the firm
- Growth of the team and added functionality in Bryanston with key appointments like equity research, investment writers
- At PSG Group's 20th anniversary in November, founding member Jannie Mouton said the now R60 billion group delivered compounded growth of 54% a year to shareholders
- Introduced the PSG Wealth Local and Offshore Portfolios
- Introduction of the Retail Distribution Review
- Financial Sector Regulation Bill tabled in Parliament
- 2015 is also the year in which tax-free savings accounts entered the SA landscape and both our active and passive managers now offer this option to our clients

China's economic performance for 2016 is both uncertain and a great concern

The Chinese economic growth train that powered ahead for almost three decades slowed down significantly in 2015. At 6.9%, GDP growth last year was at its lowest since 2009. Many leading economists were at one stage predicting that China was on the brink of a recession. However, despite the lowered infrastructure spend, Chinese economic growth remained reasonably strong during the country's continued transition towards becoming a consumer-led economy.

Although many professional economists and investors maintain that obtaining accurate economic information about China is close to impossible, there is no doubt that there were a few hiccups in 2015. In one instance, regulators allowed investors to borrow heavily to trade on the stock market. This created a substantial bubble, which duly burst (leading to the biggest one-day loss ever on the Chinese stock market) and prompted the government's arguably misguided and unsuccessful effort to prop up the falling market.

The central bank then took the unexpected step of devaluing the yuan to boost exports, leading to further speculation that China's economy was in worse shape than the supposed 7% growth rate implied.

2015 in review - quarter 2**

- Switzerland becomes the first country ever to sell its 10-year bond at a negative yield
- Foreigners buy R14.1 billion of SA notes (net) on the JSE in the first half of April, the biggest two-week inflow ever
- JSE raced to all-time high in April, before it corrected by nearly 14% and bottomed out on 24 August
- Minister of police Nathi Nhleko releases report stating features like fire pool and kraal at Zuma's Nkandla home are all security features and Zuma doesn't need to pay back the money for these upgrades
- The UK reports negative inflation for the first time since 1960
- The Dow Jones and Nasdaq stumble as the IMF cuts US growth forecast to 2.5% from 3.1%
- Reports show 9% of 2013/14 South African state expenses was interest on debt
- Greece defaults on its $1.7bn IMF payment

Special report

A further indicator that all was not well on the Chinese economic front came from the global fall in demand for commodities. In November, the cost of shipping commodities fell to a record low as Chinese demand for iron ore and coal slowed. The huge construction and mining equipment manufacturer, Caterpillar, also posted its 35th consecutive month of falling sales last November, confirming a worldwide slump in construction and mining activity. This slump can largely be attributed to China, which cut back heavily on commodity imports and construction activity.

The prediction is that China's growth rate for 2016 will be 6.5%, but the actual figure is anyone's guess. China's performance during the rest of this year is not only uncertain, but of real concern to the global economy. What is a lot more certain is that Chinese demand for South African commodities will be well below the levels seen in 2013 and 2014. Worse still, the fall in demand seen in 2015 is likely to worsen in 2016 as China introduces structural reforms and looks to move its economy towards services and away from a reliance on manufacturing and infrastructure spend.

We are optimistic but cautious about Europe's moderate recovery

Europe has finally exceeded the GDP levels achieved before the financial crisis, even though this feat took twice as long as in the US. A belated quantitative easing (QE) programme has aided the process, weakening the euro during 2015 and boosting exports. Prospects for 2016 look mildly positive, with the economic tailwind produced by the QE programme set to blow throughout the year. European equity valuations remain generally attractive and the generous stance on QE programmes should underpin a moderate recovery in the Eurozone. Investment risk remains material and, although we are optimistic about return potential over the medium to longer term, we proceed with caution when selecting investments in the Eurozone.

Economic recovery in the UK since the financial crisis is still stable

The UK performed relatively well in 2015, with growth of around 2.5% and rock-bottom inflation. Economists predict that this will continue in 2016. Low levels of government investment and low labour productivity are material concerns, but these are largely priced into existing growth forecasts. Similar to the US, UK economic recovery has been reasonably stable since the financial crisis and we expect this trend to continue at a moderate pace in 2016.

2015 in review - quarter 3**

- Greece repays €4.2bn to ECB after receiving temporary funding
- MPC surprises with a 25 bps interest rate hike, taking the repo rate to 6%
- Chinese stocks plunge more than 8% - their biggest 1-day loss ever
- China orchestrates the biggest devaluation of its yuan since 1994
- Chinese manufacturing slows down - Caixin China Manufacturing PMI falls to a 77-month low
- SA GDP contracts by 1.3% annualised in Q2
- ANC denies any involvement in the Hitachi scandal after the Tokyo-based company agreed to pay $19m in fines
- The ALSI40 surges after AB InBev starts courting SABMiller

Special report

South Africa's outlook for 2016 looks dire, but the market has already priced in bad news

Although there are a few export-driven positives, South Africa faces a host of economic challenges in 2016 that could derail the economy. The weaker demand for commodities and falling commodity prices will reduce profits in the mining industry and cut government tax revenues. While the weak rand is beneficial for exports, it makes imports more costly. This is not good news for a country that will import substantially more than it exports in 2016. It will also put upward pressure on the inflation rate.

Inflation expectations are therefore rapidly increasing, and managing inflation will be an enormous challenge for the South African Reserve Bank's Monetary Policy Committee (MPC) this year. The committee seems well aware of the fact that the economy is struggling and that most of the inflation is supply-side inflation. Hiking rates may do little to decrease supply-side inflation, and demand-side inflation is already under pressure.

Subsequently, we expect the impending rate hikes to be more successful in getting real rates in sustainably positive territory than in substantially lowering inflation. Nonetheless, the hikes are probably needed to normalise monetary policy going forward.

The South African forward rate curve (FRA) is pricing in a total rate hike of 0.75% over the next two MPC meetings. Cash is also starting to offer value, with a three-month fixed deposit currently expected to yield close to 8% in nine months' time.

Since domestic economic conditions are under pressure, these hikes will undoubtedly be extremely unpopular. To make matters worse, manufacturing Purchasing Managers' Index (PMI) numbers are signalling an increasing likelihood of a local economic recession. The South African manufacturing PMI was recently revised downwards from a weak 48.10 to a dismal 43.30.

The outlook for our economy is not great. That said, market sentiment is very low and the market is pricing in a lot of bad news already. This does provide investors with opportunities if some bad sentiments do not materialise. More realistically speaking, prices seem to be compensating investors for the prevailing risks.

2015 in review - quarter 4**

- FeesMustFall protest starts at South African universities
- SA Business confidence falls to 22-year low
- AB InBev agrees to buy SABMiller for R1.4 trillion
- China GDP grows by 6.9%, the worst since 2009
- SARB increases interest rates for the second time in 2015 - repo rate 6.25%
- Abenomics ends deflation in Japan and raises expectations
- Japan's Nikkei gains 11% in 2015
- Two ratings agencies downgrade the country's sovereign credit rating
- Rand drops to R16/$ low after Zuma replaces Nahlanhla Nene with unknown David van Rooyen
- FED hikes U.S. interest rates after eight years
- Brent Oil slides to $36 a barrel – an 11-year low.

**Sources: Reuters, Bloomberg, CNBC, Finweek, Sharenet, trading economics, BDLive

Special report

SPECIAL EDITION

Our product positioning in light of the state of the local and global economy

In light of the above, our local equity positioning remains as follows:

- underweight interest rate-sensitive stocks and asset classes
- underweight companies whose earnings rely heavily on domestic drivers
- overweight multi-national, rand hedge stocks with low non-emerging market exposure
- underweight companies that are heavily reliant on improving commodity spot prices, like resources firms
- overweight companies with strong balance sheets and healthy cash flows
- overweight firms that are expanding their operating margins and gaining market share

With regards to property, we remain of the view that the interest rate cycle will affect domestic economic strength, affordability and sentiment. In addition, other income-generating assets with positive correlations to interest rates will become increasingly attractive, placing further downward pressure on listed property.

Where we are required by mandate to hold listed property, we prefer to hold shares with the following characteristics:

- low price-to-book ratios
- low levels of debt/gearing and strong credit ratings
- a globally diversified portfolio, or shares that generate earnings abroad (such as New Europe Property Investments plc, Rockcastle, New Frontier, Capco, Intuprop, MAS, Sirius, Redefine International and Investec Australia)
- utilisation of structures that offer superior liquidity, such as Real Estate Investment Trusts (REITs)
- superior distribution growth track records

We maintain our view that offshore equities remain attractive on a relative basis. We are cautiously optimistic about developed market equity returns and remain overweight this asset class.

We are, however, underweight offshore fixed interest as we believe that most of these asset classes do not sufficiently compensate investors for the inherent risks. We expect the Fed rate and bond yields to normalise rapidly during the course of the year.

Conclusion

Considering all of this, it is likely that 2016 could be another rollercoaster year. However, our products are designed to weather these storms and we believe there are still opportunities that can deliver favourable results for our investors over the long term.

Special report

SPECIAL EDITION

Expectations for 2016

- MPC reverts back to 0.50% rate hikes on the back of accelerating inflation.
- Organisation of the Petroleum Exporting Countries (OPEC) meets before their current scheduled meeting date in June to discuss lower prevailing oil prices and their pricing strategy for 2016.
- The rand strengthens against other major currencies. On our assessment of purchasing power parity, the rand is currently oversold.
- Commodity prices move lower and bottom in 2016. As smaller producers are flushed from the industry, decreased supply improve the outlook for supply/demand dynamics in 2017.
- Growth underperforms value as expensive stocks lose momentum.
- South Africa fails to avoid a recession. Leading indicators point toward much tougher economic conditions for local manufacturers.
- Inflation nears the 8% level as the pass-through effects of a weaker currency take effect.
- Prime rates move above 11% as the MPC attempts to combat higher inflation.
- The full-term budget informs us that everyone will be subject to higher taxes through higher income taxes, company taxes and VAT.
- Investors lose money in the perceived safety of offshore bonds as yields normalise.
- The World Bank revises their global growth outlook upwards for 2017 and onwards.
- European Central Bank (ECB) stimulus is more favourable than generally expected, as the ECB does whatever it takes to kick-start the Eurozone's economy.
- China makes the most of a buyers' market in commodities and strengthens ties with Saudi Arabia and Iran.
- The S&P 500 surprises with stronger-than-expected returns as the US economy marches on.
- Japan continues to struggle regardless of current stimulus measures. More fundamental changes

Economic commentary

South Africa

Although there are a few export-driven positives, South Africa faces a host of economic challenges in 2016. When it comes to the domestic economy, it appears that there is not an optimistic economist in sight. Falling commodity prices, the worst drought in 20 years, the weakening rand, electricity supply problems, the country's huge budget deficit and credit rating downgrades are just some of the reasons economists describe the glass as half empty.

Inflation expectations are also rapidly increasing, and managing inflation will be an enormous challenge for the South African Reserve Bank's Monetary Policy Committee (MPC) this year. The committee seems well aware of the fact that the economy is struggling and that most of the inflation is supply-side inflation. Hiking rates may do little to decrease supply-side inflation, and demand side is already under pressure.

Subsequently, we expect that the coming rate hikes will be more successful in getting real rates in sustainably positive territory, than they will be at substantially lowering inflation. Nonetheless, the hikes are probably needed to normalise monetary policy going forward.

As at 31 December 2015

	2015											
	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mch	Feb	Jan
Repo	6.25%	6.25%	6.00%	6.00%	6.00%	6.00%	5.75%	5.75%	5.75%	5.75%	5.75%	5.75%
Prime	9.75%	9.75%	9.50%	9.50%	9.50%	9.50%	9.25%	9.25%	9.25%	9.25%	9.25%	9.25%
FRA 9x12	8.17%	7.2%	7.0%	7.1%	7.0%	7.0%	6.9%	7.0%	6.8%	6.8%	6.5%	6.0%
Inflation	5.2%	4.8%	4.7%	4.6%	5.0%	5.0%	4.7%	4.6%	4.0%	4.0%	3.9%	4.4%
ISM Index	46.7%	50.0%	52.0%	52.0%	46.4%	46.4%	46.4%	50.3%	49.1%	49.1%	49.5%	48.2%
Unemployment	*			25.5%			25.0%			26.4%		
GDP Growth (Y/Y)	*			1.0%			1.2%			2.1%		
Current Account (% of GDP)	*			-6.8%			-3.1%			-4.8%		

Source: INET, Stats SA, SARB
* as on 2 February 2016

The South African forward rate curve (FRA) is pricing in a total rate hike of 0.75% over the next two MPC meetings. Cash is starting to offer value, with a 3-month fixed deposit currently expected to yield close to 8% in 9 months' time.

Rate hikes will undoubtedly be extremely unpopular as domestic economic conditions are under pressure. To make matters worse, manufacturing Purchasing Managers' Indices (PMIs) are signalling the increasing likelihood of a local economic recession.

PSG Wealth

Economic commentary

Developing economy manufacturing PMIs

Country	Last	Previous	Change	Highest	Lowest
South Korea	50.70	49.10	1.60	52.60	45.70
Austria	50.60	51.40	-0.80	54.30	46.90
Greece	50.20	48.10	2.10	51.30	30.20
Singapore	49.50	49.20	0.30	51.90	48.30
Hungary	49.10	55.80	-6.70	58.30	37.63
India	49.10	50.30	-1.20	55.00	48.50
Russia	48.70	50.10	-1.40	53.20	47.60
China	48.20	48.60	-0.40	52.30	47.20
Egypt	48.20	45.00	3.20	52.50	37.10
Indonesia	47.80	46.90	0.90	58.50	46.40
Canada	47.50	48.60	-1.10	56.30	47.50
Norway	46.80	47.50	-0.70	64.60	34.80
Hong Kong	46.40	46.60	-0.20	53.30	44.40
Brazil	45.60	43.80	1.80	53.20	43.80
South Africa	43.30	48.10	-4.80	64.20	34.20

Large Economies

Members of the EU

BRICS countries

Source: Trading economics

The South African manufacturing PMI was recently revised downwards from a weak 48.10 to a dismal 43.30.

The bad news, therefore, is that the outlook for the economy is not great. That said, market sentiment is very low and pricing in a lot of bad news already. This does provide investors with opportunities, especially when all the negative sentiment does not materialise. More realistically, however, prices generally seem to be compensating investors for the prevailing risks.

Economic commentary

Global

Globally, we expect weak emerging market growth to continue alongside lower (but stable) growth in developed economies.

The World Bank forecasts that the world economy will grow by 2.9% in 2016, adjusted downwards from 3.3% in June 2015. This is largely on the back of lower growth forecasts in emerging markets.

The deterioration in emerging markets has weighted in global economic growth being under 3% for five consecutive years. We expect this trend to continue into 2016.

We expect the American Federal Reserve (Fed) to remain on centre stage as policy normalisation continues. Interest rates are also expected to normalise over time. Since the Fed finalised their bond repurchase programme, the logical next monetary policy decision would be to hike rates.

However, as the Fed has mentioned on numerous occasions, its decisions will be 'data dependent'. Data that indicates the health of the American economy – such as inflation returning to the 2% target, relative rates, a growing labour market and the state of capital markets – all remain important considerations.

The European Union is largely set for a recovery in an expansive monetary policy climate.

In general, we expect emerging markets to continue to struggle in the interim as commodity prices remain low over the short-term.

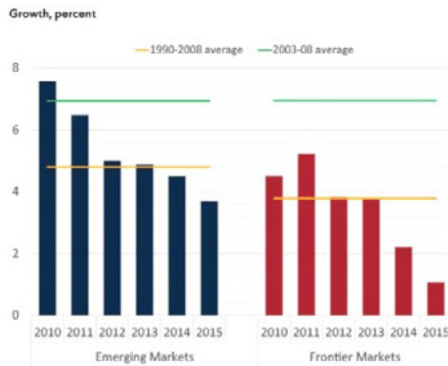
The Underwelming World Economy

GDP growth is stuck in low gear, seven years after the global recession

Source: World Bank Group; Bloomberg

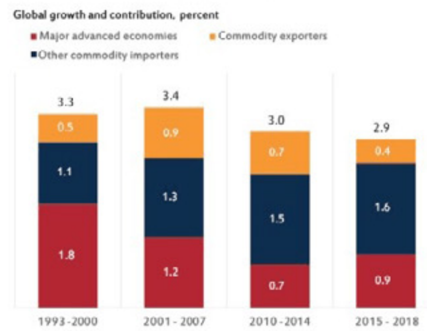
Economic commentary

HOW BAD WAS GROWTH IN 2015?



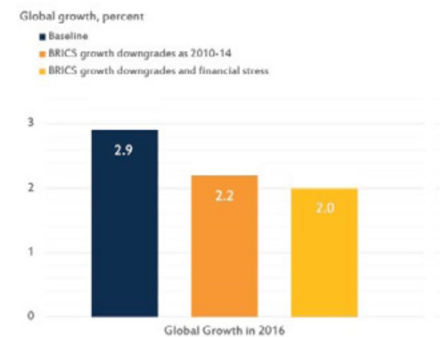
GROWTH SLOWDOWN

HOW ARE CONTRIBUTIONS TO GLOBAL GROWTH EVOLVING?



GROWTH CONTRIBUTIONS

HOW COULD BRICS WEAKNESS AFFECT GLOBAL GROWTH IN 2016?



SPILLOVERS

Source: World Bank Global Economic Prospects Report January 2016

How bad was economic growth in 2015?

Growth rates in emerging markets and, in particular frontier markets in 2015 were the lowest of the post-crisis period and well below historical averages.

Global growth fell short of 2015-expectations, slowing to 2.4 percent from 2.6 percent in 2014.

Going forward, global growth is projected to edge up, but at a slower pace than envisioned in the June 2015, reaching 2.9 percent in 2016 and 3.1 percent in 2017-18.

How are contributions to global growth evolving?

The contributions to global growth from major advanced economies are increasing.

Amid low commodity prices, the contribution to growth from commodity exports is declining substantially.

Going forward, global growth should pick up at an appreciably slower pace than previously envisioned.

How could BRICS weakness affect global growth in 2016?

Risks to the global growth outlook remain tilted to the downside.

Risks to growth has become increasingly centered in emerging and develepoing economies.

A combination of continued weak growth in BRICS and rising financial stress could considerably reduce global growth.

Financial market review

Domestic assets

Domestic equities experienced a slow, but moderate quarter despite a poor showing during December, with the FTSE/JSE All Share Index (ALSI) generating a 1.21% return. The full year return ended on a mere 1.85%.

From all the main sectors, industrials was the only positive one for the quarter, with a 6.10% return. This compares very favourably with the 19.23% loss generated by the resources sector over the same period. Financials delivered a 4.05% loss over the quarter, following the 2.15% loss the preceding quarter.

If one takes a long-term view, the ALSI generated an annualised return of 11.57% over the last five years.

Industrials, which gained 29.04% over the same period, have been the main driver of returns. Unfortunately, the resources sector was a significant enemy of returns over the last quarter, recording an 11.11% annualised loss over the same five-year period.

Listed property experienced healthy returns over the last five years, narrowly underperforming the broader ALSI by only 11 basis points. We previously cautioned that this asset class was somewhat overheated and, as a result, our lightened weightings where appropriate. This decision paid dividend in December, as the sector retracted by 6.67%. We still feel that the sector remains overvalued with significant headwinds that could restrict further domestic earnings expansion. Despite this we are starting to see some value in selected counters.

We generally expect emerging markets to continue to struggle over the short-term as commodity prices remain low. As recoveries in larger economies start to take place, we expect the Purchasing Managers' Indices (PMI) in emerging markets to signal improved growth, and perhaps the potential for higher spot prices on the back of increased demand. However, it's worth noting that more than 40% of the earnings of JSE-listed companies are generated abroad, and often in developed markets. Although the macro-economic outlook for emerging markets look grim at the moment, careful stock picking may yield very different results to what the local macro-economic variables may suggest.

Global assets

Global equity returns generally reflect what we have noted in our economic commentary, with developed markets outperforming emerging markets.

The S&P 500 generated a gain of 6.45% in the previous quarter and the FTSE 100 a gain of 1.73%. The Hang Seng recovered by 5.12% in the fourth quarter, after a 20.59% loss during the third quarter of 2015. The Euro Stoxx Index gained 6.04% during the last quarter, following the 9.45% loss during the preceding quarter.

The German Dax was up 10.55% over the quarter, following the 10.13% loss during the preceding quarter. The Japanese price-weighted Nikkei recovered 9.46% after a 14.07% loss in the third quarter.

Over the long-term, the US generated a strong five-year return, with the S&P 500 up by an annualised 12.50%. Despite extensive controversy regarding monetary support to the rest of the Eurozone, the German Dax also generated strong returns of 12.04% per annum over the last five years.

Financial market review

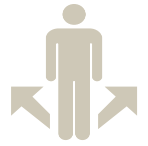
Market indicators (as at 31 December 2015)

Index	Quarter-end value	1M	3M	6M	1Y	3Y	5Y
ALSI	50 693.76	-1.77%	1.21%	-2.15%	1.85%	9.72%	11.57%
Industrials	79 304.20	-0.27%	6.10%	5.94%	12.53%	22.97%	29.04%
Resources	13 774.25	-3.89%	-19.23%	-35.57%	-39.98%	-17.12%	-11.11
Financials	40 954.85	-6.53%	-4.05%	-6.11%	-0.05%	13.11%	17.84%
Listed property	608.57	-6.41%	-5.59%	-1.28%	2.39%	7.78%	11.46%
ALBI	462.07	-6.67%	-6.43	-5.40%	-3.93%	2.16%	6.88%
VIX	18.21	12.90%	-25.67%	-0.11%	-5.16%	0.35%	0.52%
S&P 500	2 043.94	-1.75%	6.45%	-0.93%	-0.73	14.44%	12.50%
Euro Stoxx	3 287.98	-6.23%	6.04%	-3.98%	4.50%	8.39%	3.55%
Nikkei	19 033.71	3.61%	9.46%	-5.94%	9.07%	27.70%	17.22%
Hang Seng	21 914.40	-0.37%	5.12%	-16.52%	-7.16%	-1.09%	-0.97%
Dax	979.19	-4.88%	10.55%	-0.64%	11.33%	15.16%	12.04%
MSCI world	1 694.40	-0.67%	2.98%	-4.77%	-2.59%	8.86%	6.47%
MSCI world ex US	1 725.48	-1.76%	-0.04%	-8.96%	-6.91%	1.95%	0.35%
FTSE 100	6 356.09	-0.08%	1.73	-9.00%	-5.45%	2.59%	1.55%

Sources: I-Net, JP. Morgan
*Performance reported in base currency. Returns of periods exceeding one year have been annualised

PSG Wealth

Tactical asset allocation preferences



Domestic assets

Despite the recent pullback in markets, domestic equities remain slightly overvalued relative to its historic yield. There certainly remains some expensive pockets in the market, and investors should expect continued volatility at current levels. Good stock pickers should be able to find value in selected shares, although some patience is likely required before material gains are realised. Nimble investors will benefit from more frequent opportunities created by increased volatility.

We are increasingly cognisant of the fact that there are some value traps on the local exchange - some counters are trading at very low price to earnings multiples, but the earnings are in a cyclical decline. We feel that risks are abound for the inexperienced investor, and that a fair assessment of macro-economic factors are becoming increasingly important.

In addition, as local economic strength is waning, we look at corporate balance sheets and debt structures that will be able to weather the storms. We expect smaller businesses, and businesses with low cash balances, and low cash flows to struggle in prevailing economic conditions.

In light of the above commentary our positioning with regards to domestic equity remains as follows:

- Underweight in interest rate sensitive stocks and asset classes;
- Underweight in companies whose earnings rely heavily on domestic drivers;
- Overweight in multi-national, rand hedge stocks with low non-emerging market exposure;
- Underweight in companies that are heavily reliant on improving commodity spot prices, like resources firms;
- Overweight in companies with strong balance sheets and healthy cash flows; and
- Overweight in firms that are expanding operating margins and gaining market share.

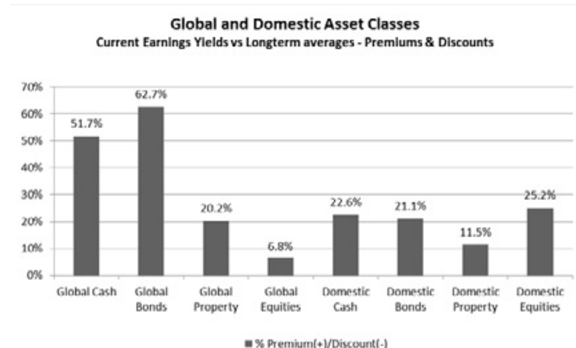
With regards to property investments we remain of the view that the interest rate cycle will impact domestic economic strength, affordability and sentiment. In addition, other income-generating assets with positive correlations to interest rates will become increasingly attractive, placing further downward pressure on listed property.

Rate hikes are set to present headwinds for capital growth in the property sector. Broadly speaking, we expect property yields to normalise on the back of capital value pressure.

Selected property shares are experiencing growing yields, which may present some opportunities, but exposure to broad-based property exposure is ill-advised at this stage.

Where we are mandated to hold listed property, we prefer to hold counters with the following characteristics:

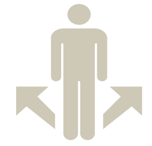
- Low price-to-book values;
- Low levels of debt/gearing and strong credit ratings;
- Globally diversified portfolios, or counters that generate earnings abroad (like New Europe Property Investments plc, Rockcastle, New Frontier, Capco, Intuprop, Mas, Sirius, Redefine International and Investec Australia);
- Utilisation of structures that offer superior liquidity, like ReITS; and
- Superior distribution growth track records.



Despite a large surge in yields, domestic bonds remain generally overvalued. The asset class's yield reduced its premium (relative to its historic average) from 28.3% overvalued at the end of September 2015, to 21.1% as at the end of December. The increase in yields have improved its valuation and created selected opportunities, but it still remains generally overbought.

PSG Wealth

Tactical asset allocation preferences



Domestic cash may be the asset class with the least risk, but has up until recently offered very little investment potential. The gross real yield on money market assets is near zero, and on an after-cost-after-tax basis, there has been very little to be excited about in this asset class. We do however expect this to change quite drastically over the coming months, as rate hikes ensue at an increasing pace.

The South African forward rate curve (FRA) is pricing in a total of 0.75% of rate hikes over the next two Monetary Policy Committee (MPC) meetings. Cash is starting to offer value, with a 3-month fixed deposit currently expected to yield close to 8% in nine months' time.

We expect cash to play an increasingly important role in our portfolios over the coming months.

Global assets

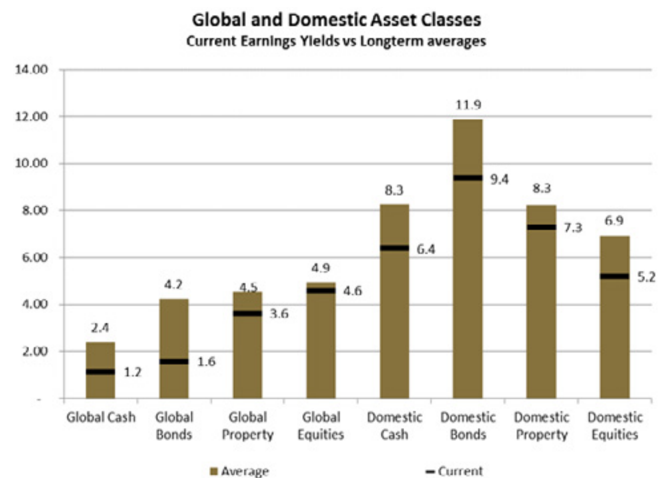
Global equity valuations gives a mixed picture. Developed economy forward price-earnings (P/E) ratios seem to indicate that developed market equities may be fair-valued to slightly overvalued, while forward P/E ratios for developing economies appear undervalued. That said, strong economic recoveries in developed countries like the US and UK should support further medium-term earnings growth. Whilst poor economic growth in developing economies are not supportive of any positive outlook on earnings at this stage.

The one forewarning to this assessment is that weaker emerging market currencies have made developing market assets more appealing to foreign investors, which may underpin some demand. Therefore, currency movements are likely to be one of the largest factors to influence the level of success of these markets over the short-term.

From a valuation perspective, global-listed property is currently a more risk-efficient investment than global bonds. Global cash yields, although increasing, remains unattractive. Still investors should be very cautious in this segment of the market. Extreme property price fluctuations in structures with high leverage or limited liquidity can hold severe capital consequences for investors.

Valuations on global bonds remain severely stretched on the back of unchartered monetary policy stimulus and the subsequent capital flows to credit instruments. In the US, nominal and real 10-year treasury yields have been falling for the past 30 years, leaving both real and nominal yields historically low. Federal Open Market Committee (FOMC) research supports the view that current yields should increase by roughly 3% to normalise.

Global cash remains unattractive apart from its liquidity and nominal capital protection properties. For investors seeking offshore diversification, equities offer the best value over an investment horizon that would be suitable for an offshore investment.

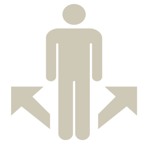


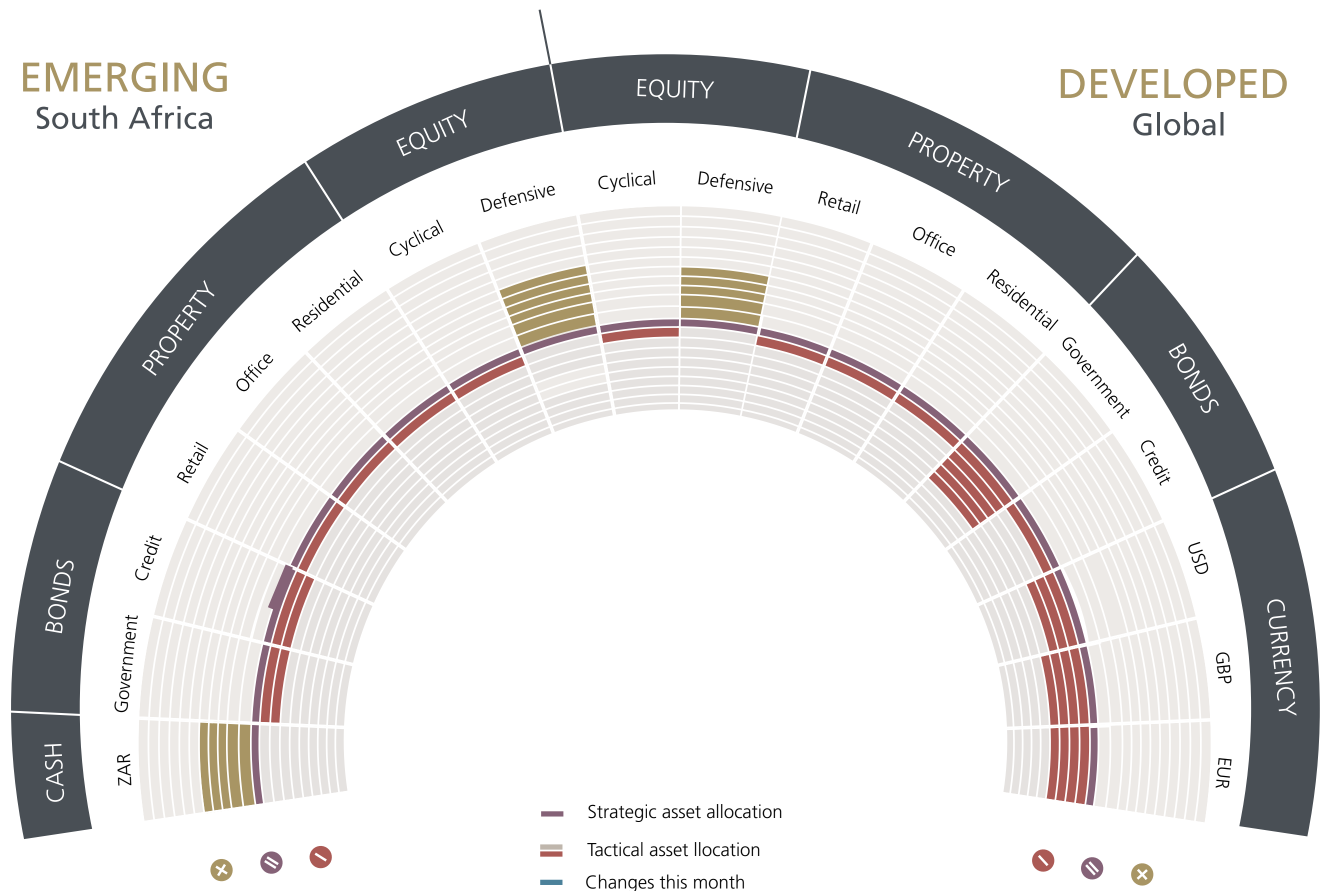
We remain of the view that offshore equities remain attractive on a relative basis. We are cautiously optimistic about defensive developed market equity returns and remain overweight in this asset class.

We are however underweight in offshore fixed interest, as we believe that most of these asset classes do not sufficiently compensate investors for the inherent risks. We expect the Fed rate and bonds yields to normalise rapidly during the course of the year. Please see our prediction for 2016 as further reading.

PSG Wealth

Tactical asset allocation preferences





Overweight:
Tactical recommendation to hold more of the asset class than specified in the strategic asset allocation

Neutral:
Tactical recommendation to hold the asset class in line with its weight in the strategic asset allocation

Underweight:
Tactical recommendation to hold less of the asset class than specified in the strategic asset allocation

Domestic unit trust positioning

PSG Wealth Solutions: 2015 results and current positioning of the domestic Fund of Funds (FoF)

The year 2015 had a very promising start, but the FTSE/JSE All Share Index started to drift lower from 27 April 2015 to the end of the calendar year, with a disappointing total return of only 5.1%.

There were a few pockets of excellence, such as the Industrial Index (with a total return of 16.3%) and the Listed Property Index, with a total return of 8.0%. In contrast, the Financial Index delivered a mediocre total return of only 3.9%, the Basic Materials Index delivered a downright poor total return of -20.7% and the more concentrated Mining Index performed even worse with a negative return of -35.9%.

The best performance for South African investors came from their investments in offshore assets such as offshore equities, property and bonds. Measured in South African rand, the MSCI World Index delivered a total return of 31.3% and the J.P. Global Bond Index delivered a total return of 32.4%. The rand, however, weakened by 35.0% against the US dollar, which was more than the rand return of the two offshore indices. In other words, the two offshore indices measured in dollar terms delivered negative return for 2015.

The good returns from the Industrial Index are due to the very strong rand hedge properties of some industrial companies that earn their income in US dollars.

PSG Wealth Enhanced Interest Fund

The management of the fund is allocated to five of the most respected short-dated fixed interest managers in South Africa, namely Atlantic, Nedgroup Inv Core Income, Prescient Yield Quant Plus, PSG Asset Management and STANLIB.

The fund delivered a total return of 6.8% compared to the 6.4% of the benchmark. All of the underlying managers delivered satisfactory returns in 2015.

Name	1 year to 2015/11/30	Rank
PSG Wealth Enhanced Interest D	6.81%	12
Atlantic*	7.31%	
STANLIB*	7.10%	
PSG AM*	7.06%	
Nedgroup Inv Core Income B	6.88%	11
Prescient Yield QuantPlus A1	6.81%	13
SA IB money market sector	6.35%	28
*Segregated accounts (before accounting manager fees)		

Positioning of the PSG Wealth Enhanced Interest fund according to the type of instruments

PSG Wealth Enhanced Interest Fund	
Instrument type	%
Cash & call	3.0
Commercial paper	4.5
Coupon certificates of deposit	3.5
Fixed deposits	1.7
Fixed interest bonds	5.2
Floating rate securities	50.4
Negotiable certificates of deposit	28.4
Promissory notes	2.7
Treasury bills	0.6
Portfolio total	100.00%

PSG Wealth

Domestic unit trust positioning

Positioning of the PSG Wealth Enhanced Interest fund according to credit ratings

PSG Wealth Enhanced Interest Fund w	
Credit rating	%
Cash	0.8
AAA	7.8
AA+	2.4
AA	58.7
AA-	3.1
A+	16.8
A	4.2
A-	3.4
BBB+	1.8
BBB	0.0
BBB-	0.0
Other	1.2
Portfolio total	100.00%

The assets in the fund consist of domestic short-dated instruments of investment grade quality.

Rising interest rates do not influence these instruments negatively, but allow the fund to benefit very quickly. The fund has a modified duration of 29.6% or 108.4 days.

Although the fund cannot benefit directly from a weaker rand, it will benefit indirectly from higher interest rates due to the pressure of the weaker rand on the inflation rate.

We expect that the fund managers will utilise rising interest rates effectively to deliver above-benchmark returns in 2016.

PSG Wealth Income FoF

The management of the fund is allocated to four managers, namely Coronation Strategic Income, Prescient Income Provider, Prudential Enhanced Income Fund and PSG Diversified Income Fund.

The fund delivered a total return of 7.1% compared to the 7.16% of the benchmark. All of the underlying managers except Coronation Strategic Income and Prudential Enhanced Income delivered satisfactory returns in 2015. The unexpectedly strong rise in interest rates in December 2015 influenced their performance negatively.

Name	1 year to 2015/11/30	Rank
PSG Wealth Income FoF D	7.10%	20
Prescient Income Provider A1	9.28%	5
PSG Diversified Income	7.78%	13
Coronation Strategic Income	6.69%	27
Prudential Enhanced Income A	6.69%	27
STeFI 12 month NCD ZAR	7.16%	

The largest exposure of the fund is 38.7% to cash and money market instruments. These assets have virtually no volatility, their yields increase with rising interest rates and they increase the manager's ability to participate in new opportunities when they arise.

The second-largest exposure of the fund is the 31.9% holding in domestic bonds with a duration of between one and seven years. However, these bonds consist mainly of floating rate bonds where the yields adjust every three months to be in line with market rates. This allows the fund to participate in higher yields than those offered by money market rates, without a significant increase in price volatility.

The rest of the exposure consists mainly of an 11.3% holding in long bonds, which offer attractive long-term yields, and a 9.9% exposure to global assets to benefit from offshore diversification. The fund also has a 2.4% exposure to real estate to benefit from its ability to produce inflation-beating returns, and a 2.9% exposure to inflation-linked bonds to benefit directly from rising inflation.

Domestic unit trust positioning

Look-through positioning

PSG Wealth Income FoF	
Asset allocation	%
Foreign equities	1.4
Foreign property	1.6
Foreign bonds	6.4
Foreign other	0.0
Foreign cash	0.5
Domestic equities	1.5
Domestic property	2.4
Domestic preference shares	1.3
Domestic ILBs	2.9
Domestic bonds 7+ years	11.3
Domestic bonds 3-7 years	12.4
Domestic bonds 1-3 years	19.5
Domestic cash and money market	38.7
Portfolio total	100.00%

We do not expect the current weaker performance of Coronation and Prudential to continue, but rather that the managers will adjust the portfolios to benefit from higher interest rates and return to above-benchmark returns.

PSG Wealth Preserver FoF

The management of the fund is divided between five of the most respected conservative asset managers, namely Coronation Balanced Defensive, Investec Cautious Managed, Nedgroup Inv Stable, Prudential Inflation Plus and PSG Stable. The fund delivered a total return of 9.7% compared to the 7.9% of the benchmark.

All of the underlying managers except PSG Stable delivered satisfactory returns in 2015. The PSG Stable Fund has a lower exposure to industrial shares with strong rand hedge properties due to the current high valuations of these companies.

Name	1 year to 2015/11/30	Rank
PSG Wealth Preserver FoF D	9.70%	25
Investec Cautious Managed A	11.60%	4
Nedgroup Inv Stable A	11.40%	5
Prudential Inflation Plus A	8.70%	42
Coronation Bal Defensive A	8.10%	50
PSG Stable	7.00%	74
CPIX +3%	7.90%	
SA MA low equity sector	7.60%	108

The largest exposure of the fund is the 32.3% holding in equities, which consists of a 15.6% holding in domestic equities and a 16.7% holding in foreign equities. This is lower than the fund's maximum limit of 40%, and reflects both the defensive positioning of the managers and the view that equities have the highest return potential of all asset classes over the medium to long term.

The second-largest exposure of the fund is its 28.4% holding in cash and money market instruments. These assets have virtually no volatility, their yields increase with rising interest rates and they increase the manager's ability to participate in new opportunities when they arise.

The third-largest exposure is the 13.2% holding in primarily short-dated bonds. These bonds consist mainly of floating rate bonds that participate in higher yields than money market rates, without a significant increase in volatility.

The rest of the exposure consists of a 10.1% exposure to long-dated bonds, to participate in higher yields; a 6.4% exposure to global non-equity assets (which brings total offshore exposure to 23.1%); 5.8% exposure to inflation-linked bonds, to benefit from rising inflation; and a 3.4% holding in real estate to benefit from its ability to produce inflation-beating returns.

The PSG Wealth Preserver FoF is a well-diversified fund, positioned to lower volatility, benefit from higher interest rates and protects against higher inflation.

PSG Wealth

Domestic unit trust positioning

Look-through positioning

PSG Wealth Preserver FoF	
Asset allocation	%
Foreign equities	16.7
Foreign property	0.5
Foreign bonds	1.4
Foreign other	2.8
Foreign cash	1.7
Domestic equities	15.6
Domestic property	3.4
Domestic preference shares	0.5
Domestic ILBs	5.8
Domestic bonds 7+ years	10.1
Domestic bonds 3-7 years	4.4
Domestic bonds 1-3 years	8.8
Domestic cash and money market	28.4
Portfolio total	100.00%

PSG Wealth Moderate FoF

The assets are divided between six moderate fund managers, namely Coronation Balanced Plus Fund, Foord Balanced Fund, Investec Opportunity Fund, Prudential Balanced Fund, PSG Balanced Fund and SIM Balanced Fund

The fund delivered a total return of 8.4% compared to the 7.7% of the benchmark. All of the underlying managers except SIM Balanced and PSG Balanced delivered satisfactory returns in 2015.

The SIM Balanced Fund had a currency hedging structure in the fund to lower its effective offshore expose in anticipation of a stronger rand on the back of an oversold position and higher interest rates.

The PSG Balanced Fund has a lower exposure to industrial shares with strong rand hedge properties due to the current high valuations of these companies.

Name	1 year to 2015/11/30	Rank
PSG Wealth Moderate FoF D	8.40%	61
Investec Opportunity	14.20%	10
Foord Balanced R	9.10%	49
Prudential Balanced A	8.40%	62
Coronation Balanced Plus A	8.10%	71
SIM Balanced R	5.40%	100
PSG Balanced A	5.00%	104
SA MA high equity sector	7.70%	129

The largest exposure of the fund is the 62.1% holding in equities, which consist of a 38.9% holding in domestic equities and a 23.3% holding in foreign equities. This is lower than the maximum limit of 75% of the fund and reflects the defensive positioning of the managers.

The domestic equities are divided mainly between industrials (23.2%), financials (9.2%) and resources (6.0%).

The second-largest exposure of the fund is an 18.0% holding in cash and money market instruments. These assets have virtually no volatility, their yields increase with rising interest rates and they increase the manager's ability to participate in new opportunities when they arise.

The rest of the exposure consists mainly of an 11.9% holding in bonds, a 4.0% holding in property and a 2.8% exposure to global non-equity assets (which brings total offshore exposure to 26.1%).

Domestic unit trust positioning

Look-through positioning

PSG Wealth Moderate FoF	
Asset allocation	%
Foreign equities	23.3
Foreign property	0.9
Foreign bonds	0.5
Foreign other	0.0
Foreign cash	1.4
Domestic equities	38.9
Domestic property	4.0
Domestic preference shares	0.2
Domestic ILBs	1.2
Domestic bonds 7+ years	7.5
Domestic bonds 3-7 years	2.5
Domestic bonds 1-3 years	1.9
Domestic cash and money market	17.9
Portfolio total	100.00%

The 10 shares with the largest exposures in the fund are all blue chip companies with very broad investor bases that consist of both local and international investors.

We do not expect the current weaker performance of SIM Balanced and PSG Balanced to continue, but rather that the managers will adjust the portfolios to protect against volatility, benefit from rising interest rates and return to above-benchmark returns.

Top 10 holdings

PSG Wealth Moderate FoF	
Top 10 holdings	%
British American Tobacco plc	3.2
Steinhoff International Ltd	2.5
Sasol Ltd	1.6
Old Mutual plc	1.6
Naspers Ltd	1.5
SAB Miller plc	1.3
CF Richemont SA	1.3
Standard Bank	1.2
NewGold ETF	1.0
FirstRand	0.8
Total	16.0%

PSG Wealth Creator FoF

The assets of the PSG Wealth Creator FoF are also divided between five highly respected general equity managers, namely Coronation Equity Fund, Investec Equity Fund, Old Mutual Investors' Fund Prudential Equity Fund and PSG Equity Fund.

The fund delivered a total return of 1.5% compared to the 1.0% of the benchmark. All of the underlying managers except PSG Equity delivered satisfactory returns in 2015. The PSG Equity Fund had an above-average exposure to resources companies early in 2015, and a lower exposure to industrial shares with strong rand hedge properties due to the current high valuations of these companies.

Domestic unit trust positioning

Name	1 year to 2015/11/30	Rank
PSG Wealth Creator FoF D	1.50%	97
Investec Equity R	14.30%	6
Old Mutual Investors R	6.60%	47
Coronation Equity R	4.70%	71
Prudential Equity A	4.20%	76
PSG Equity A	-6.40%	138
SA EQ general sector	1.00%	135

The largest exposure of the fund is the 95.2% holding in equities, which consists of an 86.9% holding in domestic equities and a 8.2% holding in foreign equities. This is well above the minimum exposure of 75% to equities, which the fund has to maintain at all times.

The 86.9% exposure to domestic equities are divided between industrials (51.0%), financials (21.9%) and resources (13.6%).

The rest of the exposure consists mainly of a 2.5% holding in property and a 2.0% holding in cash and money market instruments.

The limited total offshore exposure of 8.3% is due to the lack of any offshore exposure in the portfolios of the underlying managers.

PSG Wealth Creator FoF	
Asset allocation	%
Foreign equities	8.2
Foreign property	0.0
Foreign bonds	0.0
Foreign other	0.1
Foreign cash	0.0
Domestic equities	86.9
Domestic property	2.5
Domestic preference shares	0.2
Domestic ILBs	0.0
Domestic bonds 7+ years	0.0
Domestic bonds 3-7 years	0.0
Domestic bonds 1-3 years	0.0
Domestic cash and money market	2.0
Portfolio total	100.00%

The 10 shares with the largest exposures in the fund are blue chip companies with very broad investor bases that consist of both local and international investors.

Top 10 holdings

PSG Wealth Creator FoF	
Top 10 holdings	%
Naspers Ltd	7.9
Old Mutual plc	5.5
Steinhoff International Ltd	5.3
British American Tobacco plc	4.6
CF Richemont SA	2.0
Anglo American plc	1.7
FirstRand	1.6
Imperial Holdings	1.5
Sasol Ltd	1.3
Investec	1.3
Total	16.0%

Domestic unit trust positioning

Higher inflation and interest rates in 2016 may result in lower equity returns, but we are convinced that the fund will deliver above-average returns over the long-term.

Conclusion

Developed countries lowered interest rates to the lowest levels in recent history to save the world economy from a severe recession. This flooded the financial system with a mountain of cash that found parking places for which it was not intended.

We have seen the first interest rate hike in the US, and current indications are that it will continue to raise rates gradually in 2016.

The non-equity exposure in all our FOFs are primarily holdings in cash, money market instruments and short-dated bonds. These assets earn interest directly from current low yields and will benefit from rising short-term rates. Although some higher yields are available through longer-dated bonds, these bonds are still at high valuations. However, these assets will become more and more attractive as long rates rise.

The equity exposure in our multi-asset portfolios (Preserver FoF and Moderate FoF) is well diversified in terms of domestic equity sectors and offshore equities, which have benefited from the weaker rand. The offshore exposures of these two funds are very close to the maximum exposures allowed.

The PSG Wealth Creator FoF does not have the same level of offshore exposure as the previous two funds. This is simply a function of the limited number of funds with large offshore exposures in the investment universe of the fund. However, South African blue chip companies have large rand-hedge components due to the fact that they derive a large portion of their income from foreign countries.

Investors in the PSG Wealth Solutions can be assured that their investments are in the hands of the best asset managers available to us. Through their research and insight all our funds are well diversified and conservatively positioned to withstand the current uncertainties and coinciding volatility of financial markets.

Offshore mutual fund positioning

'Past performance is no guide of future performance'

Any new investor will likely see or hear this disclaimer within minutes of starting their investment journey. Whether through a fund fact sheet, financial instrument brochure or fund manager advertisement. One would need to look far and wide to find a person working in the investment management industry who does not agree with this statement.

However, when talking to investors it seems this is the most well-known… but ultimately most ignored rule in the market. Even if investors agree with the logic of the 'random walk' argument about security prices (i.e. prices follow a random pattern that cannot be predicted), in practice they tend to extrapolate recent history into the future (termed Recency-bias in behavioural finance) when making portfolio decisions. Recency-bias is evident when one sees the attention that funds and securities receive, which recently delivered above-average performance.

Given the enormous range of options available to investors, one can understand investors' need for a way of screening (and ultimately picking from) the thousands of options available. Just in South Africa there are over 1 400 collective investment schemes (CIS) available and over 200 000 open-ended funds globally. Quantitative analysis, which focuses on a fund's performance history, provides an easy way to rank funds and thus investors tend to base their investment decisions mostly on this aspect.

However, a plethora of studies have found that a manager's past performance is an inferior predictor of the future ability to outperform. A simple analysis of South African General Equity funds highlights that four out of the top five funds based on five-year performance ending 2010, subsequently delivered bottom-half performance in the next five years (see Table 1). Over shorter periods the trend continues (see Table 2) as the best performing fund based on one-year performance ending December 2014 delivered fourth quartile performance in 2015. Out of the top five funds in 2014, three delivered bottom-half performance in 2015.

Out of the 38 funds ranked in the first quartile on 31 December 2014, 60% delivered non-top quartile returns during 2015.

Out of the 16 funds ranked in the first quartile on 31 December 2010, 44% delivered returns below the category average over the next five years.

Quantitative analysis of past performance plays an important part in the manager selection process, but it should not be used as the sole basis for investment decisions. The question then remains, if past performance

Table 1: 5 year returns

ASISA South African EQ General				
	5 years ending December 2010		5 years ending December 2015	
Fund	Rank (out of 63)	Quartile	Rank (out of 100)	Quartile
Fund 1	1	1	67	3
Fund 2	2	1	56	3
Fund 3	3	1	26	2
Fund 4	4	1	66	3
Fund 5	5	1	73	3

Source: Morningstar Direct

Offshore mutual fund positioning

Table 2: 1 year returns

ASISA South African EQ General				
	1 year ending December 2014		1 year ending December 2015	
Fund	Rank (out of 148)	Quartile	Rank (out of 167)	Quartile
Fund 1	1	1	131	4
Fund 2	2	1	1	1
Fund 3	3	1	93	3
Fund 4	4	1	63	2
Fund 5	5	1	92	3

Source: Morningstar Direct

is not an accurate predictor of the future, how should investors approach manager selection?

In the following section, we will provide a broad framework for manager selection and highlight the importance of qualitative analysis (predominantly in the form of manager due diligence).

Manager selection

Evaluating an investment manager is a complex and detailed process that encompasses a great deal more than analysing investment returns. Manager selection involves a broad set of qualitative and quantitative considerations to determine whether a manager displays skill, and the likelihood that the manager will continue to display skill in the future. The manager search and selection process has three broad components: defining the universe, a quantitative analysis of the manager's performance track record and a qualitative analysis of the manager's investment process.

Offshore mutual fund positioning

Table 3: Components of manager selection

Key aspects	Key questions
Universe Defining the universe • Suitability • Style • Active vs passive	 What is a feasible set of managers that fits the portfolio need? Which managers are suitable for the investment mandate? Which managers have the appropriate style? Which managers fit the active vs. passive decision?
Quantitative analysis • Attribution • Capture ratio • Drawdown • Forecast objective • Causal factors • Consistency of returns	 Which manager 'best' fits the portfolio need (processes)? What has the manager's return distribution been? Has the manager displayed skill? How does the manager perform in 'up' markets versus 'down' markets? Does the return distribution exhibit large drawdowns? What is the most suitable number of funds per universe to give the best chance to deliver consistent above-average performance for each solution? Which factors do we believe are good indicators of above-average future returns? Which manager's return profile indicates that return was based on skill, and not luck?
Qualitative analysis Investment due diligence • Philosophy • Process • People • Portfolio Operational due diligence • Process and procedure • Management company • Investment vehicle • Terms (fees etc.) Monitoring	 Which manager 'best' fits the portfolio need (infrastructure and firm)? Is the manager expected to continue to generate this return distribution? What market inefficiency does the manager seek to exploit? Is the investment process capable of exploiting this inefficiency? Do the investment personnel possess the expertise and experience necessary to effectively implement the investment process? Is portfolio construction consistent with the stated investment process? Is the manager's track record accurate, and does it fully reflect risks? Is the back office strong, safeguarding assets and able to issue accurate reports in a timely manner? Is the firm profitable, with a healthy culture, and likely to remain in business? Is the firm committed to delivering performance over gathering assets? Is the vehicle suitable for portfolio needs? Are the terms acceptable and appropriate for the strategy and vehicle? Does the manager continue to be the 'best' fit for the portfolio need?

Source: Institute, CFA. CIPM® Principles Curriculum 2015. Wiley Global Finance, 2014-10-20.

Offshore mutual fund positioning

In conducting investment manager due diligences, the focus is on understanding how the investment results were achieved and on assessing the likelihood that the investment process that generated these returns will produce superior, or at least satisfactory, investment results going forward. Due diligence also entails an evaluation of a firm's integrity, operations and personnel. As such, due diligence involves both quantitative and qualitative analysis.

Defining the manager universe

The first difficulty in manager selection is using the correct universe of funds to select from. PSG Wealth's multi-management team has clearly defined universes for each of the solutions out of which we select our underlying funds. Our local unit trust universes are based on ASISA classifications.

For our global funds, defining a universe is considerably more challenging. No product provider has an accurate classification system which correctly classifies global funds within clearly defined categories. With reference to South Africa, the majority of global funds (US mutual funds specifically) are not available for sale to South African investors. For this reason our multi-management division has developed an in-house fund screening system which provides custom, investable and clearly defined universes that fit into our global mandates. This process has assisted us in taking advantage of our ability to invest in non-South African based global managers, resulting in excellent performance during 2015.

Qualitative analysis – key concepts

The key objective in manager selection is identifying skill. Therefore, one of the main focus points is determining whether past performance was due to luck or skill, and then deciding whether the manager will be able to continue to display skill in the future. To achieve this objective one needs a detailed understanding of a manager's investment philosophy and process. Specifically, one needs to understand what market inefficiency the manager seeks to exploit, whether the investment process is capable of exploiting this inefficiency and if the investment personnel possess the expertise and experience necessary to effectively implement the investment process. This level of understanding is achieved by conducting a detailed investment and operational due diligence.

Not understanding a manager's investment approach will likely lead to investors making decisions based on short-term underperformance, which may be due to a market environment that is unfavourable to the manager's process. This lack of understanding is one of the key causes of 'fund performance chasing' (selling short-term underperformers and replacing them with short-term outperformers). This has been proven in multiple studies to detract from investor returns.

Conclusion

The evaluation of an investment manager is part science and part art. Quantitative analysis assists in identifying consistency of returns and provides data for judging whether a manager displayed skill. However, relying solely on past performance will likely only lead to underperformance. Combining quantitative work with a comprehensive due diligence process, focused on understanding the manager's approach to investments and the market inefficiency the process is trying to identify, is key to successfully picking managers.

PSG Wealth's multi-management division has a documented manager selection process with consistent results over relevant periods in both local and offshore categories. With regards to our global mandate, the latest performance data highlights the results of using a detailed, consistent manager selection process. These processes have ensured great results, with the PSG Wealth Global Creator Feeder Fund delivering the tenth highest return out of all 1 400+ South African domiciled CISs for 2015.

> [the PSG Wealth Global Creator Feeder Fund delivered the 10th highest return out of 1400 domestic CIS's]

Offshore mutual fund positioning

Global funds - performance and positioning

1 year performance to 31 December 2015		
Fund name	%	Rank
PSG Wealth Global Creator FoF D (USD)	1.3	32
BM: GIFS Global Large-Cap Blend Equity (USD)	-3.0	136
PSG Wealth Global Creator FF D (ZAR)	36.3	4
ASISA Global EQ General (ZAR)	29.1	37
PSG Wealth Global Moderate FoF D (USD)	-4.5	69
BM: GIFS USD Flexible Allocation (USD)	-4.4	111
PSG Wealth Global Moderate FF D (ZAR)	28.9	10
ASISA Global Multi Asset Flexible (ZAR)	27.7	19

The PSG Wealth Global Creator FoF had a strong 12 months ending December 2015, with each of the underlying managers contributing positively to alpha. It is interesting to note that the Investec Global Franchise fund, which at the end of 2014 was significantly underperforming, has subsequently managed top quartile performance over 2015, delivering 8.2% in USD.

The PSG Wealth Global Moderate FoF had a difficult 12 months, with performance hampered by exposure to emerging markets, deep value European equities and specific positions within the Basic Materials sector.

Look-through positioning of the PSG Wealth Global Creator FoF

PSG Wealth Global Creator FoF		
Asset Allocation	Current %	Previous Quarter
Foreign Equities	**94.8**	**93.8**
Basic materials	3.1	3.3
Communication services	1.9	2.8
Consumer cyclical	12.2	11.0
Consumer defensive	13.6	14.2
Healthcare	17.0	16.3
Industrials	11.0	11.4
Technology	16.8	15.2
Energy	3.5	4.1
Financial services	14.7	14.7
Utilities	0.9	0.9
Foreign property	**-**	**0.6**
Foreign bonds	**-**	**-**
Foreign other	**-**	**0.1**
Foreign cash	**5.2**	**5.9**
Domestic Assets	**-**	**-**
Portfolio Total	100%	100%

The underlying managers within the PSG Wealth Global Moderate FoF have found some better buying opportunities given the market correction at the end of 2015, and we saw them starting to reduce cash and buy equities over the fourth quarter of 2015. Offshore cash decreased by 2.5% and offshore equities increased by 2.6%. The underlying managers reduced exposure to the Consumer Cyclical (-2.1%), Consumer Defensive (-1.3%) and Basic Materials (-1.3%) sectors and significantly increased exposure to the Financial (+5%) and Industrial (+3.5) sectors.

Offshore mutual fund positioning

Look-through positioning of the PSG Wealth Global Creator FoF

PSG Wealth Global Creator FoF		
Asset Allocation	Current %	Previous Quarter
Foreign Equities	**94.8**	**93.8**
Basic materials	3.1	3.3
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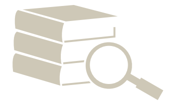
Industrials	11.0	11.4
Technology	16.8	15.2
Energy	3.5	4.1
Financial services	14.7	14.7
Utilities	0.9	0.9
Foreign property	**-**	**0.6**
Foreign bonds	**-**	**-**
Foreign other	**-**	**0.1**
Foreign cash	**5.2**	**5.9**
Domestic Assets	**-**	**-**
Portfolio Total	100%	100%

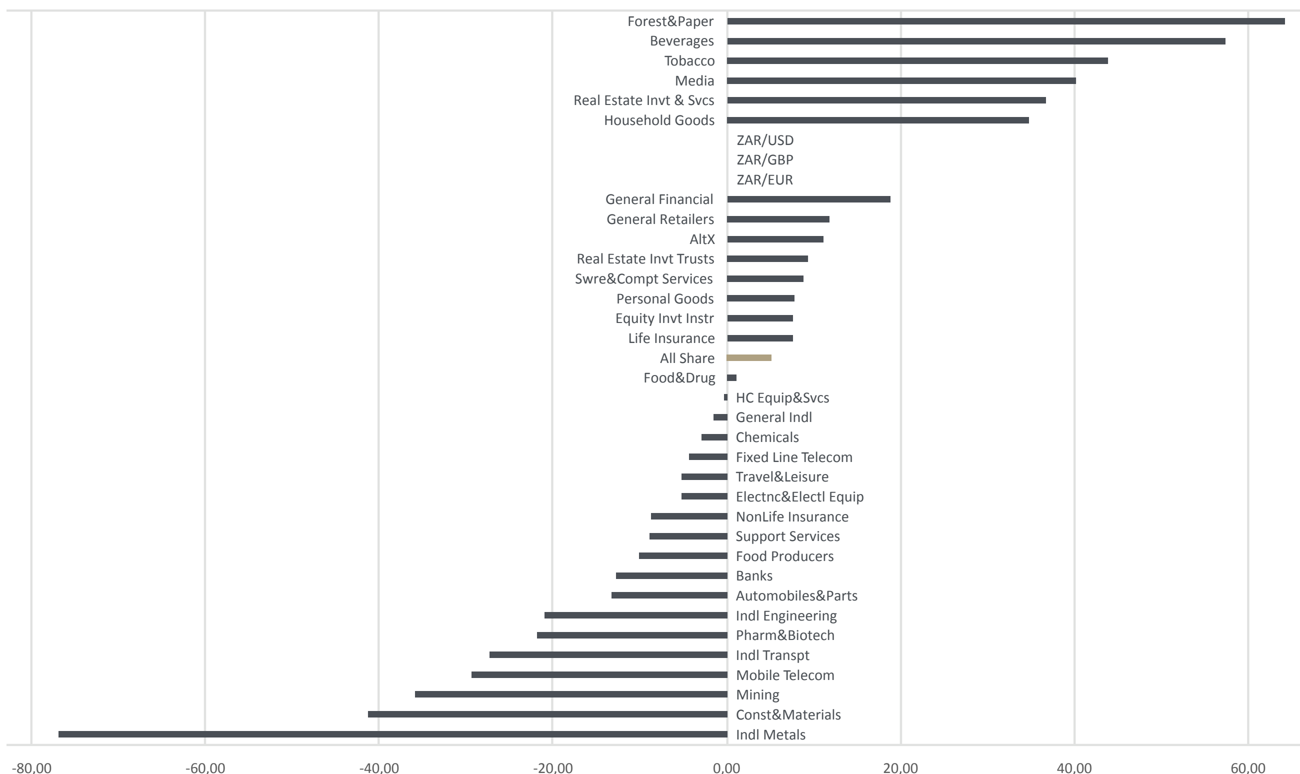
Over the last quarter, exposure to equities was increased by 1%. The underlying managers reduced exposure to offshore property (-0.6%) as well as the Communication Services (-0.9%), Consumer Defensive (-0.6%) and Energy (-0.6%) sectors, and significantly increased exposure to the Technology (+1.6%) and Consumer Cyclical (+1.2%) sectors.

PSG Wealth

Equity research



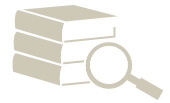
Investment returns in 2015 – or the lack thereof – was mainly due to the way in which you were positioned in the event of a weaker local currency. The rand, in line with other emerging market currencies, experienced one of its worst sell-offs in recent history against the US dollar. The decline was precipitated by lower-than-expected data on economic activity in China, which translated into a steep decline in commodity prices, a convergence in growth rates between industrialised nations and emerging markets, and a tightening of monetary policy in the US. Locally, these negative economic fundamentals were exacerbated by a flip-flop between finance ministers, which contributed to a spectacular rollercoaster ride for the rand.

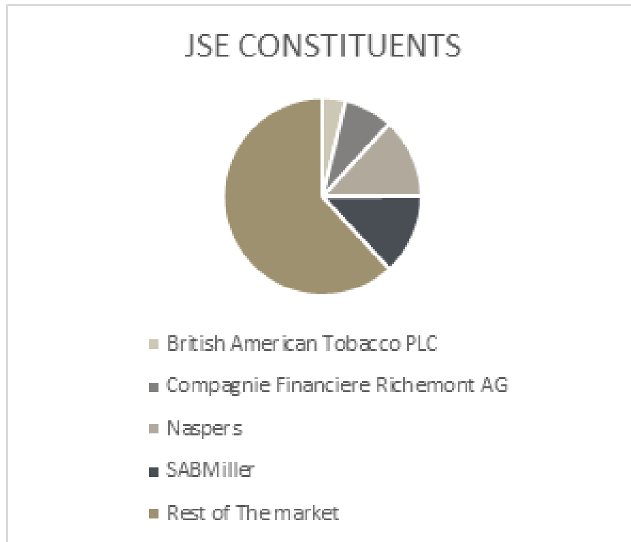


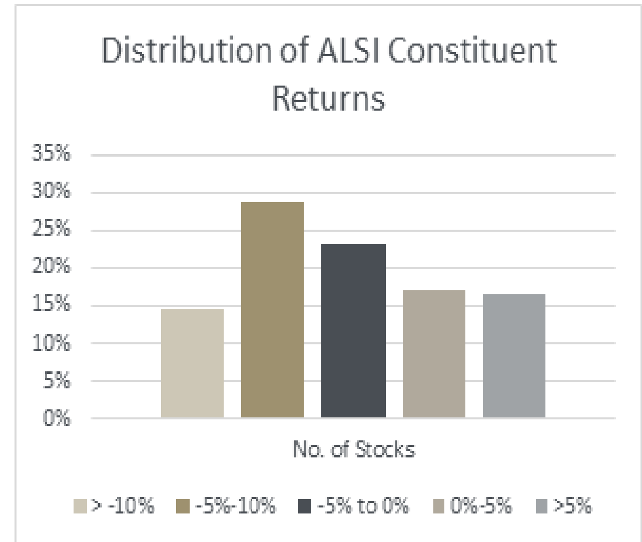
Source: PSG Wealth, Morningstar

Despite this volatility, the performance of the equity market remained resilient, with the FTSE/JSE All Share Index (ALSI) returning a muted 5% total return. The positive performance of the ALSI was heavily influenced by rand hedge counters, which benefited from the significant weakening of the rand. SAB Miller, Richemont, Naspers (with its large stake in Tencent) and British American Tobacco contributed 38% towards the index value. These companies also derived the majority of their earnings outside of South Africa. Drilling down into the performance of the ALSI's underlying constituents provides a different perspective of what happened during the year. While the median counter (share) declined by 3.5% during the review period, total sector returns ranged from a decline of 77% to an improvement of 64%. Eighty-four percent of the ALSI constituents underperformed compared to the average, highlighting the impact that heavyweight rand hedge counters had on total returns. Without these counters 2015 would have been a dreadful year.

Equity research







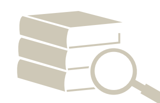
Source: PSG Wealth; Morningstar

All indications demonstrate that 2016 could be another tough year for local companies – with weaker-than-expected economic growth, higher inflation, higher interest rates and a lower forecast of consumer spending. The rand is likely to remain vulnerable to further depreciation, which could be worsened by a weaker economy, low commodity prices and an increasing risk of losing its investment status – which could result in an abrupt tightening in credit. This could be further compounded by the performance of the US dollar, which is expected to strengthen. The problem is that it is difficult to predict – and impossible to control – variables such as commodity prices and exchange rates, which will have a significant impact on valuations.

As such, 2016 is expected to be a year of transition, where uncertainty is likely to dominate the macro-economic and investing landscape. Despite all this uncertainty, local investors are not without options. An investor may not be able to control market returns or economic fundamentals, but does have an influence over the quality of their investment portfolio and the prices they are prepared to pay for the risk they assume. Investors can also diversify their assets across a range of asset classes and international markets to further reduce their portfolio risk. In addition, we believe that having concentrated positions in the right sector will be just as important going forward as it was in 2015. Combined with a realistic long-term perspective, this should ensure that investment strategies are most likely to succeed.

Accordingly, we have decided to start the year off with a sector review and our preferred positioning per sector.

Equity research



Comparative analysis and themes 2016

BANKS

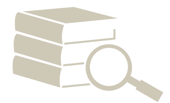
Code	Price (cps)	Actual ROE (%)	Quality rating (%)	P/E*	PEG (P/E) %	P/NAV	Div yield (%)
BGA	13 355	17	58	7.9	72	1.3	7.3
CPI	51 289	26	65	19.8	104	4.6	1.9
FSR	3 940	26	68	9.9	82	2.4	5.3
NED	17 455	16	58	7.7	64	1.1	6.3
SBK	10 614	16	58	7.5	67	1.1	6.0

Banks seems to be oversold, declining by 13% in 2015 and continuing their decline into the current year. Trading conditions are likely to remain depressed, with a weak macro-environment impacting on non-interest income and credit growth. An improvement in non-performing loans (NPL), which was an important driver of earnings the last couple of years, is also at a cyclical low and is unlikely to help earnings growth. In addition, regulations to hold more liquid assets will also be a drag on return-on-equity (ROE) going forward. Domestic banks also appear vulnerable to the possibility of a sovereign credit downgrade. We would, however, recommend exposure to this sector as a significant amount of negativity is already reflected in valuations. While FirstRand remains the premier stock in the sector, with ROEs well ahead of the sector, Standard Bank and Nedbank are our preferred investments, based on valuations, trading on price-to-net-asset-values (P/NAV) of 1.1 times and dividend yields of around 6%.

RETAILERS

Code	Price (cps)	Actual ROE (%)	Op margin (%)	Cash/ HEPS	Interest cover	Quality rating (%)	P/E*	PEG (P/E) (%)	P/NAV	Div yield (%)
CSB	28 106	34	6.0	1.3	No debt	93	17.7	111	5.1	2.5
HSP	5 690	22	17.6	1.1	55.6	85	11.2	86	2.4	5.0
LEW	5 122	14	18.4	0.6	8.2	50	5.7	57	0.8	10.1
MRP	18 800	57	17.1	0.9	No debt	100	18.4	108	8.6	3.3
MSM	9 395	21	4.0	0.7	9.1	75	16.1	85	3.6	4.5
TFG	11 386	25	17.5	0.4	12.4	70	11.4	82	2.8	5.5
TRU	8 633	37	21.1	0.8	No debt	85	13.8	87	5.0	4.7
WHL	9 395	31	11.1	1.0	4.7	90	20.9	130	6.1	2.6

Equity research



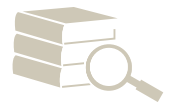
While general retailers appear attractive on a price-to-earnings (P/E) basis in a historical context, trading conditions are likely to deteriorate. Low employment rates and a decline in income growth, combined with more stringent lending criteria and higher interest rates, could likely erode consumers' disposable income. This situation will be exasperated if government decides to raise taxes or cut its spending. Our preferred exposure to this sector would be through an investment in a recent underperformer, Massmart. Massmart is a high-quality retailer with leading market brands in its stable. The group boasts a consistently high ROE and traditionally healthy cash generation. In the current economic climate, earnings growth will be highly dependent on improved efficiencies and the group's ability to maintain market share in a competitive market. Operating margins are currently on a very low base, and difficult market conditions in the short term are likely to hamper a recovery in margins toward their long-term average. The group's strong cash trading profile warrants a premium for defensiveness and the continued association with Wal-Mart and its African expansion is positive for its medium- to long-term growth. While Truworths, Lewis and Foschini also appear to offer good value, we remain concerned of the impact that new credit regulations will have on the credit sales growth of these counters.

FOOD AND DRUG RETAILERS

Code	Price (cps)	Actual ROE (%)	Op margin (%)	Cash/ HEPS	Interest cover	Quality rating (%)	P/E*	PEG (P/E) (%)	P/NAV	Div yield (%)
CLS	8 629	59	6.3	1.1	24.3	93	21.5	154	11.5	2.7
PIK	6 075	31	1.8	1.5	20.7	85	28.8	131	8.7	2.0
SHP	13 143	24	5.6	1.4	31.9	93	16.3	116	3.6	2.9
SPP	17 259	60	3.2	1.7	16.8	85	17.9	119	11.1	3.7

Food retailers traditionally produce relatively stable earnings, but their operations are not immune to a weak point in the economic cycle. In addition, higher input costs and increased competition are likely to supress margins in the medium term. While the sector deserves a premium for its defensive attributes, we feel this is fairly reflected in current valuations. We do not feel that this sector currently holds significant value.

Equity research



Healthcare

Code	Price (cps)	Actual ROE (%)	Op margin (%)	Cash/ HEPS	Interest cover	Quality rating (%)	P/E*	PEG (P/E) (%)	P/NAV	Div yield (%)
LHC	3 328	38	23.7	1.3	8.0	90	18.0	138	8.4	4.6
MDC	11 685	10	16.1	1.3	6.1	75	24.3	203	2.5	1.0
NTC	3 277	29	11.5	0.7	12.9	85	16.7	104	4.5	2.8

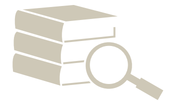
Investments in hospital groups are normally lower-risk investments due to the industry's defensive nature and high barriers to entry. However, uncertainties resulting from regulatory changes could impact this sector negatively. Government have proposed fundamental changes to South Africa's healthcare system. If these changes are implemented, healthcare funding for the public sector is likely to be prioritised, putting the earnings of private hospitals at risk. All three the big listed players have diversified their operations geographically to address the impact that this might have. In this sector, Mediclinic has the most attractive spread of operations, with strong established operations in South Africa, Switzerland, the UK and the UAE. The company also has a high proportion of hard currency revenue, which might be attractive to investors seeking currency diversification.

General industrials and transportation

Code	Price (cps)	Actual ROE (%)	Op margin (%)	Cash/ HEPS	Interest cover	Quality rating (%)	P/E*	PEG (P/E) (%)	P/NAV	Div yield (%)
BAW	5 736	9	6.4	(0.4)	3.4	58	6.7	84	0.6	6.0
BVT	31 520	19	4.6	1.0	8.4	68	16.0	123	2.8	2.9
GND	1 056	5	4.4	1.5	No debt	75	9.8	61	0.4	3.2
IPL	10 895	18	5.3	1.6	4.7	83	6.7	51	1.1	7.3
MPT	4 083	15	8.7	1.0	6.2	73	13.0	118	1.9	2.4
NPK	2 180	15	10.5	(1.0)	6.5	50	10.0	84	1.6	6.1
OLG	325	14	9.1	0.4	5.3	68	9.4	59	1.2	4.3
SPG	3 641	20	7.8	1.0	11.2	63	12.6	97	2.0	-

This sector is prone to several macro-economic factors including interest rates, vehicle sales and exchange rate movements. These factors are difficult to predict, but have a significant influence on its profitability. We believe that a material amount of pessimism is already reflected in this sector's valuations. Our preferred exposure to this sector would be through Imperial, which seems attractively priced, trading on a 10% premium to its net-asset-value (NAV) and a historical P/E ratio of less than seven times, while also offering an attractive dividend yield. The group's continued focus to grow its non-vehicle and foreign operations should negate, to a certain extent, the cyclical impact from lower expected South African new vehicle sales and poor trading from Associated Motor Holdings.

Equity research



Construction

Code	Price (cps)	Actual ROE (%)	Op margin (%)	Cash/ HEPS	Interest cover	Quality rating (%)	P/E*	PEG (P/E) (%)	P/NAV	Div yield (%)
GRF	1 914	7	1.7	1.8	No debt	70	6.8	46	0.6	2.9
MUR	776	15	3.6	(0.0)	15.2	40	4.2	52	0.5	6.4
PPC	1 481	31	18.0	1.5	2.8	80	10.4	65	3.1	3.8
RBX	1 526	12	8.4	0.6	38.9	83	6.8	61	0.8	4.7
WBO	11 241	18	2.6	3.3	No debt	85	9.3	62	1.5	3.3

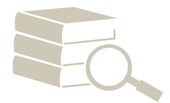
The construction sector is currently challenged by weak pricing power due to overcapacity and poor demand due to the weak mining sector. This should improve going forward, given the significant restructuring completed across the industry, especially relating to civil engineering divisions. In this restrained environment, construction companies have focused their attention on lower margin building contracts and cross border contracts, with a specific preference for Australia. So, while the short-term outlook is expected to remain depressed, marginally higher order books and an improvement in operating margins off a very depressed base should support earnings growth. Our preferred exposure to this sector is through WBHO, which seems attractive on a P/E ratio of below 10 times, while earnings are at a cyclical low.

Chemicals

Code	Price (cps)	Actual ROE (%)	Op margin (%)	Cash/ HEPS	Interest cover	Quality rating (%)	P/E*	PEG (P/E) (%)	P/NAV	Div yield (%)
AFE	8 564	13	8.4	1.5	9.4	73	10.7	107	1.2	4.1
AFX	1 300	4	7.2	3.5	34.8	83	12.1	55	1.2	1.6
OMN	13 050	15	9.5	0.1	11.0	68	10.3	94	1.3	3.7
SOL	41 502	17	25.1	1.4	48.6	100	8.7	72	1.4	4.5

Companies in the chemical sector remain influenced by a number of external factors, which have a significant impact on their profitability. Predominant factors like the oil price and exchange rate movements are not under the control of management. We believe the low current oil price has created an attractive opportunity to invest in Sasol. The group's management has been proactive in reducing costs while improving operating efficiencies, which should to a certain extend negate the impact of the weaker oil price on earnings. We feel that the group remains a sound investment with its long-term drivers intact, given its diverse portfolio of operations and the potential inherent in its gas-to-liquid and coal-to-liquid ventures. CO2 tax remains a risk, but will not have a short-term impact on the group's earnings. Trading on a historic P/E ratio of below 10 times and a 30% premium to its NAV, we feel the share offers value. The share offers an attractive historic dividend yield of 4.5%, but this is likely to come under pressure if the weak operating environment persists.

Equity research

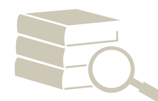


Telecoms

Code	Price (cps)	Actual ROE (%)	Op margin (%)	Cash/ HEPS	Interest cover	Quality rating (%)	P/E*	PEG (P/E) (%)	P/NAV	Div yield (%)
MTN	12 542	27	29.9	1.1	15.8	100	7.8	52	1.7	10.2
TKG	5 884	13	10.1	0.3	12.3	53	11.1	111	1.2	3.7
VOD	14 603	59	25.0	1.1	13.9	100	16.5	127	10.4	5.4

The telecoms sectors is attractive to many investors despite subdued earnings growth, because the high pay-out ratio policy underpins attractive dividends yields. In the local market, mobile voice penetration is saturated but growth in data remains strong given the lack of infrastructure on the continent. The impact of lower interconnect rates going forward should reduce as mobile operators have already absorbed a material portion of the lower local mobile termination rates and further reductions will have a significantly smaller impact on the result. Growth for the sector is likely to be dependent on clear differentiation through service and value in an increasingly competitive and regulated environment. Growth in international markets will depend on increasing coverage and enhancing market penetration through network quality, distribution reach, meaningful products and competitive value. MTN seems to offer the best value in this sector, but its recent Nigerian fine justifies a discount given the elevated geo-political risk attached to the countries where it operates. Its Nigerian unit was recently fined R65 billion by the Nigerian Communication Commission for not timeously disconnecting unregistered SIM cards. MTN's current valuation fully reflects the proposed fine. The group has instituted management changes while negotiating with the regulators in Nigeria regarding a reduction in the fine. The share price is likely to benefit from any reduction. Despite MTN's apparent value, we will likely not invest in its counters until further clarity is received on these negotiations.

Equity research



Rand hedge

Code	Price (cps)	Actual ROE (%)	Op margin (%)	Cash/ HEPS	Interest cover	Quality rating (%)	P/E*	PEG (P/E) (%)	P/NAV	Div yield (%)
CFR	10 791	9	23.5	1.0	87.4	75	19.9	142	2.5	2.2
NPN	206 000	11	7.5	0.9	2.4	58	66.5	-	7.0	0.2
SAB	93 380	18	21.5	1.0	8.1	80	30.5	305	4.4	1.8
BTI	84 857	91	38.7	0.9	13.0	100	21.2	265	12.9	3.2

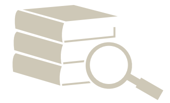
Given the importance of currency movements on the returns of investments in the past year, we expect that our exposure to these stocks will remain critical to our performance in the year ahead.

British American Tobacco is an excellent company with a well balanced portfolio of brands that cover all major price points, together with a geographic diversity that mitigates country-specific risks for shareholders. In addition, BAT offers a product that has traditionally demonstrated resilience in times of economic uncertainties. The group boasts a strong balance sheet with good margins, consistently high ROEs and healthy cash generation. We also believe that the group has pricing power to improve margins even further. Trading on a historical P/E of 21 times we feel the share is attractive, given its reasonable valuation and its rand hedge characteristics. The share is also underpinned by a solid dividend yield of 3.2%. Our preferred exposure to BAT is through Reinet. Reinet is an investment trust with 70% of its intrinsic value attributed to its investment in BAT. Reinet currently trades at a 30% discount to the intrinsic value of its investments as we feel that it is a cheaper entry point into BAT.

Given the evolving nature of many of Naspers's holdings, gauging sustainable growth accurately remains challenging, as high growth has already been priced into Tencent (listed on the Hang Seng), which is reflected in its historical P/E ratios of around 40 times. The group's other ecommerce businesses are also increasing their revenue strongly, but it is not contributing to earnings yet due to its high development spend. The group's investment in Tencent (listed on the Hang Seng) alone is worth around 224500c per NPN share. We also estimate that the investment in the Mail.ru group is worth approximately 5423c per NPN share. The performance of these two investments (which are separately listed), together with a stable exchange rate remain key inputs in the valuation of this company. We do not feel that the market is currently ascribing significant value to this group's other ecommerce operations despite the significant increase in scale of the operations over the last couple of years. This might lead to an increase in our valuation if these investments are successful. They are, however, not currently materially successful relative to the value of Tencent. Naspers offers exposure to a diversified portfolio of more mature cash-generative operations and high growth potential primarily through its internet investments in emerging markets.

Richemont is a high-quality company with a strong position in the luxury goods market that is unlikely to be eroded. This group has recently experienced challenges in its wholesale channel, but this should to some extent be mitigated by the continued expansion of its retail base, where management has more control over distribution. Earnings are on a high base and growth is expected to be more challenging. With the majority of its costs denominated in Swiss francs, any further appreciation in the franc is also likely to erode the group's margins. When valuing the company on a Euro basis one should keep the lower interest rates in that territory in mind. In addition, South African shareholders should be reminded that the share price will remain a function of exchange rate movements to a large extent. We consider the share as a viable investment option given its reasonable valuation and its hard currency exposure.

Equity research



Travel and leisure

Code	Price (cps)	Actual ROE (%)	Op margin (%)	Cash/ HEPS	Interest cover	Quality rating (%)	P/E*	PEG (P/E) (%)	P/NAV	Div yield (%)
CLH	14 500	27	35.3	0.9	43.2	100	17.7	118	4.5	3.2
FBR	12 162	37	20.6	1.0	No debt	100	23.3	146	8.4	3.2
SUI	8 531	38	20.6	1.6	3.8	90	10.7	67	3.4	3.3
SUR	3 185	18	25.8	0.9	No debt	100	18.4	132	3.7	4.1
TSH	2 236	29	29.0	1.0	4.8	90	12.1	80	2.8	4.1

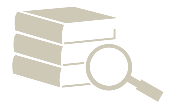
Within the travel and leisure sector we prefer gaming stocks, with both Tsogo Sun and Sun International screening well for value. Gaming shares have not been strong performers, as deteriorating economic conditions placed pressure on both casino and room revenues. Furthermore, the new visa regulations in South Africa impacted the number of foreigners entering the country. We prefer Sun International for gaming stocks. The group has an attractive portfolio of operations spread across all the economic centres in the country and is also establishing a foothold in other emerging countries. The group has a solid track record, boasting good margins, exceptionally high ROEs and strong cash generation, which can be attributed to the defensive nature of its operations. The group's earnings should improve in the medium term when its global operations and new initiatives mature; when the benefits of its recent restructuring flows through and when gaming revenue improves. The Menlyn Maine project is an exciting growth prospect for this group, providing exposure in a key economic zone with limited gaming competition. The group is also concluding a deal to merge its operations with Peermont. While all this corporate activity is thrilling, it has placed the group's balance sheet under strain. Investors should be mindful of its high level of gearing, low interest cover as well as the complex regulatory environment in which it operates. We do, however, feel the share offers good value trading on a historic P/E of 11 times.

Food producers

Code	Price (cps)	Actual ROE (%)	Op margin (%)	Cash/ HEPS	Interest cover	Quality rating (%)	P/E*	PEG (P/E) (%)	P/NAV	Div yield (%)
AVI	7 467	31	17.0	0.9	32.9	100	17.2	156	6.5	4.4
PFG	14 813	24	11.5	0.8	20.9	93	18.6	116	4.0	2.2
RCL	1 366	10	6.6	0.8	4.8	65	11.4	95	1.1	2.7
TBS	29 500	27	12.0	0.8	9.5	90	16.1	107	4.3	3.2

The earnings of food producers are traditionally resilient, given the defensive product offering. Profitability in this sector should, however, be impacted by subdued volume growth given weak economic expansion. Companies in this sector generally aim to sustain profitability through manufacturing efficiencies and improvements in supply-chain infrastructure. We do not feel that the sector presents attractive buying opportunities as current ratings do not reflect the increasingly competitive operating environment.

Equity research



Mining

Code	Price (cps)	Actual ROE (%)	Op margin (%)	Cash/ HEPS	Interest cover	Quality rating (%)	P/E*	PEG (P/E) (%)	P/NAV
AGL	5 421	9	16.7	1.5	17.7	90	4.5	32	0.2
ARI	3 965	7	10.2	0.5	17.9	75	7.9	52	0.3
ASR	6 151	17	(6.9)	0.8	No debt	85	4.9	61	0.5
BIL	15 568	10	26.6	1.2	19.3	90	14.0	67	1.0
EXX	4 238	16	17.1	1.2	27.3	90	6.8	76	0.4
GLN	1 875	9	3.0	0.5	4.7	50	16.3	108	0.5
KIO	3 135	52	40.8	1.3	44.6	100	1.4	24	0.5

Mining companies definitely hold more value given the slaughter that share prices experienced during 2015. We do, however, believe that a recovery in this sector remains contingent on higher commodity prices, which in turn are influenced by the supply/demand cycle. A significant improvement in global economic growth and, in particular, Chinese growth is not expected in the short term, which translates into weak demand. Excess supply is also expected to linger until substantial production cuts are announced and higher cost production facilities are rationalised. This should keep improved prices and valuations at bay in the short-term, despite the positive impact of the weaker rand.

Conclusion

It is worth highlighting that approximately half of ALSI revenues are based offshore and that the weak local currency could lead to earnings surprises, which should flow through to share prices. The skill is going to be to choose investments that are more likely to remain resilient given challenging trading conditions. We believe a core portfolio with investments in Nedbank, Massmart, Imperial, WBHO, Sasol, Mediclinic, Reinet, Naspers and Richemont offers a good mix of domestic value and international growth investments. While investors remain very sceptical on the domestic macro-economic front, we believe that much of the deterioration in macro-economic fundamentals are already priced in. The chosen portfolio also has a high weighting in quality global growth stocks which should bolster performance from further currency depreciation. A major contributor to future returns are, however going to be the strength of your resolve in the face of higher volatility.

*Rolling PE: The P/Es provided by PSG Wealth will differ from those in other publications as we use a more accurate rolling P/E. The rolling P/E formula calculates the EPS the company earned for the last 12 months up to the current date. It is, therefore, always comparable with its peers, notwithstanding different year-ends.

For updated values and additional information refer to the 'Value Investor' and 'Quality Investor' on the PSG website.

Fixed income

The governor of the South African Reserve Bank (SARB), Lesetja Kganyago remained true to his initial commitment in 2015 - to remain ahead of the curve and implement small incremental increases in official short-term interest rates ahead of imminent policy normalisation by the American Federal Reserve (Fed).

The domestic position

This brought the domestic prime rate to 9.75% by year end. We endorsed a 60/40 probability of a 25 basis point (bp) rate hike at the November meeting and four out of six members voted for rates to increase. Despite the increase the governor pointed out that monetary policy although pre-emptive, was still accommodative.

Concerns regarding the currency, drought and impact of Eskom tariff hikes on inflationary expectations, outweighed worries over the weak growth outlook and rising unemployment levels. In this regard, we believe that the authorities acted appropriately and their actions will reinforce confidence in the SARB's independence and the currency. PSG Wealth's outlook on long bond yields are less negative now, compared to prior expectations of unchanged rates. We do however expect a rally in the near term.

Nevertheless, we still think yields will rise over the next 12 months due to a plethora of negative headwinds discussed in this report. We anticipate further that SARB will increase short-term interest rates with a minimum of 125bp over the next 18 months. Which could push the prime rate to 11% by the first quarter of 2017. The likelihood of 50bp increments will also increase as the base rate moves higher over the next year.

Despite the rand having reached a new all-time low against major currencies in the past few months, the pass through effects have been relatively muted. The continued weakness of the oil price and a delay in Eskom's additional tariff increase have kept consumer price index (CPI) inflation at lower levels than initially forecasted. Nevertheless, the recent weakness in the rand and the effect of the drought on food prices is yet to be felt. The probability of further significant petrol price reductions have also receded.

The correlation between metal prices and the rand predicts further downside despite the fact that the currency appears cheap on a Purchasing Power Parity (PPP) basis. We expect the American dollar to strengthen on par with the euro, while exhibiting considerable volatility with a trading range of between R13.00 to R18.00.

We see inflation breaching 6% in January this year, averaging above 6% during the rest of 2016 and potentially rising further in 2017. Despite the Monetary Policy Committee's (MPC) balanced statement, upside risks to inflationary expectations remains their core concern. With a repo rate of 6.25% this would imply a less accommodative monetary stance, which we believe is appropriate given the headwinds facing emerging markets and commodity-based currencies in the year ahead.

Given the warning tone inherit in the MPC's statement and the corresponding action by its members, we continue to see a bear flattener over the next twelve months. A bear flattener often occurs when the government raises interest rates in the short term. Increasing interest rates drives short-term bond prices down, increasing their yields rapidly in the short term, relative to long-term securities. We would therefore continue to avoid the short area of the curve in favour of cash. A barbell of longer dated bonds and cash would be the preferred risk/reward trade-off, given the authorities willingness to act on inflation in preference of short-term growth. However, upside risks across the entire curve are prevalent and cash is still likely to outperform all bonds over the short- and long-term.

Looking at emerging markets

Emerging markets have enjoyed an elevated status over the past decade, but they are beginning to lose their lustre as interest rates in developed markets begin to turn at a very gradual and shallow pace. Appetite for assets in economies that exhibit strong growth prospects and adhere to political reform, will remain on the menu. South Africa does not rate highly in either of these categories and in the absence thereof, the positive carry argument is beginning to wear thin. Sound economic fundamentals and a commitment to good governance

Fixed income

and policy making, will be of much greater importance than merely being the 'least ugly' amongst peers. In this regard absolute, and not relative attractiveness, is becoming more critical.

With gross debt/GDP ratios pencilled in to reach 49.4% over the medium-term, the psychologically inhibiting 50% level is just a heartbeat away. This reality will not be lost on rating agencies who are waiting in the wings at the prospect of any deviation from the promised road map. Brand-SA no longer has any place for a margin of error. In this regard it is telling to examine South Africa's current standing in comparison to a country like Russia, who has been afforded junk status.

Based on our 2016 forecasts, the Taylor-rule describes an average 10.5% target prime rate from the current 9.75%, with 100bps upside on average to 11.5% in 2017. The targets are based on a forecasted average CPI north of 6%. Our conservative forecast for prime to reach 10.75% by the end of 2016 is below the figure described by the rule. Given the poor growth outlook for the year ahead it's unlikely to overshoot drastically.

Our analysis of the Alexander Forbes Large Universe survey reveals that private fund manager's exposure to domestic fixed income for the third quarter of 2015 has risen from 12.8% to 13.0%. This is more than double the all-time low of 6% reached in the fourth quarter of 2008. The margin between cash minus fixed income has shrunk to 1.7%, well below the highs of 11.9% in the fourth quarter of 2008 at the start of the global credit crisis. The safety net has reduced significantly and warrants a more cautious stance. Based on the above, our sectoral recommendations and modified durations are tabled below.

Table 3: Sectoral recommendations vs benchmarks

	Recommended		Benchmarks	
Sector	3-month %	12-month %	ALBI %	Avgas fund %
Cash	60	50	0	53
1-3	0	0	6	2
3-7	10	20	17	9
7-12	20	10	26	15
12+	10	20	51	21
Modified duration:				
Incl cash	3.0	3.3	7.0	3.3
Excl cash	7.0	6.4	7.0	6.8

	3-month	12-month
1-3	ES18	ES18
3-7	R204, HWAY20	R204, HWAY20
7-12	R186, ES26	ES23, R2023
12+	R2044, R2030, R2037	R2030, R2037, R2032

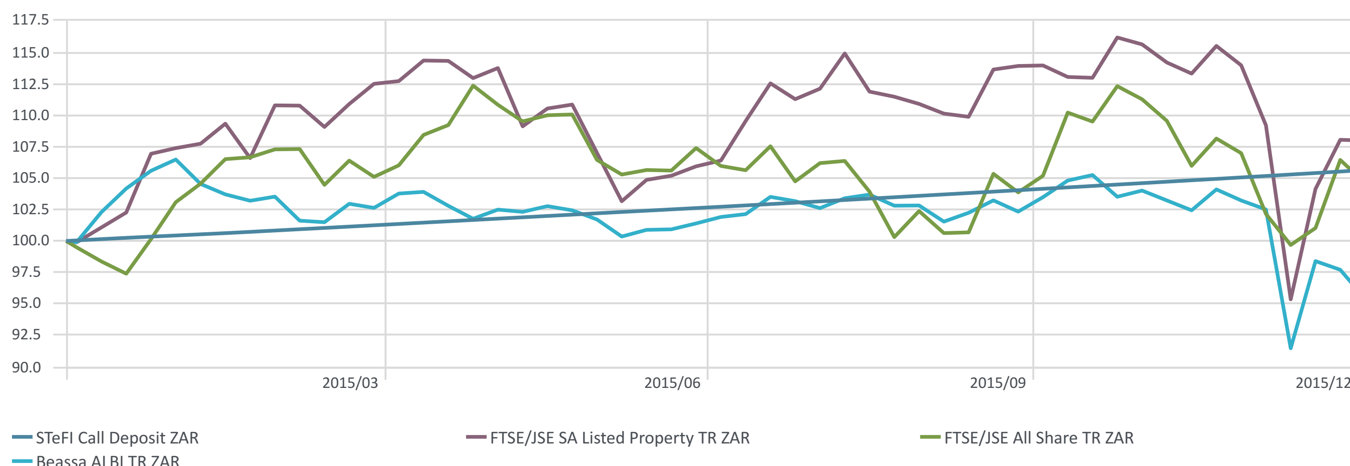
Source: PSG Wealth

Property commentary

The last quarter of 2015 was packed with unprecedented local events which negatively impacted markets across the board, particularly local property shares. The quarter kicked off fairly positive, but the month of December just proved how quickly the tide can turn. The month of December brought with it a string of bad economic news which included a downgrade on South Africa's credit rating and the unexpected replacement of Finance Minister Nhlanhla Nene with the less than familiar ANC-cadre, David van Rooyen. Both these consecutive events created a massive sell-off in the local currency and bond markets. Capital markets were not very forgiving either as domestic financials and -listed property received the most punishment.

December alone saw the SA Listed Property Index (SAPI) fall by 6.12%, the All Bond Index (ALBI) by 6.67%, and the FTSE/JSE All Share Index by 1.72% respectively. Despite the sell-off in December, the SA Listed Property sector still managed to grow by a healthy 8% for the year, outperforming both equities (5.13%) and bonds (-3.93%).

Investment growth



Reporting season

The results season came to a close during November, with the last few companies in the domestic property sector reporting their results. Redefine, Octodec, Arrowhead and Dipula reported their full-year results for the periods ending in August and September 2015.

Company	Market cap in rands	Reporting period	DPS growth	NAV growth
Redefine	52 028 180 000	Full year	7.3%	4.6%
Octodec	6 055 720 000	Full year	7.7%	12.5%
Arrowhead (A and B combined units)	8 333 740 000	Full year	12.8%	26.7%
Dipula-A	2 102 660 000	Full year	5%	14.5%
Dipula-B	2 236 860 000	Full year	9.5%	14.5%

Source: Catalyst Fund Managers, Company Financial Results

Property commentary

Corporate activity

The final quarter of 2015 featured another big takeover in the listed property space with Fortress Income Fund acquiring listed industrial player, Capital Property Fund which also delisted in November. The deal makes Fortress one of the biggest listed property companies in the country with a total market capitalisation (cap) north of R50 billion at the time of the announcement. This will also book its spot in various global indices, including the MSCI Emerging Markets Index and our local JSE Top 40 Index. Joining big players such as Growthpoint, Redefine, Capital & Counties and Intu. The new merged entity is set to attract fresh demand from global institutions in 2016.

Specialised REIT, Stor-age, successfully listed on the main board of the JSE in November with a market cap of R1.4 billion. This listing adds a new dimension to the local listed property sector with Stor-age being the only listed storage REIT available on the JSE. This brings the total property listings on the JSE to six for 2015 after listings from counters such as New Frontier Properties, Lodestone REIT, Indluplace Properties, Balwin Properties and Green Flash Properties debuted in 2015.

Best performers

The local listed property sector was characterised by a large divergence in returns over the year. The gap between the best performer (Fortress Income-B +103%) and the worst performer (Freedom Properties -68%) represented a spread of 171%.

The top 10 best performing listed property companies were dominated by rand-hedged stocks representing six out of the top 10. Fortress Income Fund B-Shares were the front runner again for the second year in a row as the best performing listed property stock on the JSE. The company continues to deliver favourable results consistently beating estimates. Freedom property was the worst performer over the period losing more than 60% of its value.

Top 10 listed property shares for the year:

Rank	Company	Total return for the year
1	Fortress Income-B	103.29%
2	NEPI	61.97%
3	Capital & Counties	55.67%
4	Hospitality-B	49.6%
5	Rockcastle	49.45%
6	Sirius	46.95%
7	Lodestone	44.44%
8	Resilient	43.26%
9	Tradehold	42.33%
10	Atleaf	38.22%

PSG Wealth property portfolio

For the month of December the PSG Wealth Property Portfolio fell by 3.01%. Despite the negative return, the portfolio still managed to comfortably outperforming its benchmark, the JSE SA Listed Property Index (SAPI), which returned a negative 6.12% over the same period.

London-focused property company, Capital & Counties Properties, was the strongest contributor to the portfolio with the share price up 7.62%, followed by the Romanian-based New European Property Investments which returned 6.79%. The returns over the period can almost all be attributed to the weakening of the rand against the pound and euro of 6.01% and 11.4% respectively over the period. This is clearly seen as its London-listed counterparts remained fairly flat over the same period.

Locally we saw property shares falling across the board with those trading at expensive premiums dropping the most. Blue chip mall owner Hyprop Investments which traded at a 34% premium to its Net Tangible Asset Value (NTAV) at the beginning of December topped the list for the worst performer over the month, falling a massive 14.2%. Fortress Income Fund B-shares which traded at a 205% premium to NTAV at the beginning of December, wasn't far behind returning a negative 13.7%.

Property commentary

Global listed properties

The FTSE EPRAN / NAREIT Developed Rental Index recorded a net total USD return of 0.93% in December. The best performing listed real estate market (in USD currency) was Australia, which recorded a return of 4.20% for December.

Concerns about emerging markets continue to weigh heavily on capital markets, as the emerging economy economic slowdown impacted property sectors. Catalyst reports that despite limited supply and low vacancy rates the Japanese office market continued to underperform. Singapore was the worst performing global developed real estate market for 2015 with a USD return of minus 13.55%.

Direct real estate prices in the US have now doubled from their 2009 position. During 2015 US REITs shifted from being the biggest net acquirers of real estate to being the largest net sellers.

Region	Dec 2015 Return % (USD)	Dec 2015 Return % (Rand)	YTD Return % (USD)	YTD Return % (Rand)
Global Investors Index (NTR)	0.93%	7.80%	0.97%	35.32%
North America	1.43%	8.33%	1.81%	36.45%
Europe	-0.97%	5.78%	6.32%	42.48%
Asia ex Australia	1.39%	8.30%	-4.25%	28.32%
Australia	3.36%	10.40%	2.25%	37.03%
Sa Listed Property Index	-12.11%	-6.13%	-19.42%	7.99%

Source: Catalyst Fund Managers, FTSE/EPRA NARBT, Bloomberg, I-Net Bridge

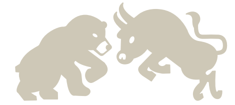
Positioning

We remain of the view that the interest rate cycle will impact domestic economic strength, affordability and sentiment. In addition, other income-generating assets with positive correlations to interest rates will become increasingly attractive, placing further downward pressure on listed property.

Where we are required by mandate to hold listed property, we prefer to hold counters with the following characteristics:

- Low price-to-book values;
- Low levels of debt/gearing and strong credit ratings;
- Globally diversified portfolios, or counters that generate earnings abroad (like New Europe Property Investments plc, Rockcastle, New Frontier, Capco, Intuprop, Mas, Sirius, Redefine International and Investec Australia);
- Utilization of structures that offer superior liquidity, like ReITS; and
- Superior distribution growth track records.

Preference shares



The Preference Share Market Index generated a loss of 1.0% (total return) during the last quarter of 2015. This follows the marginal gain of 0.7% during the third quarter. The total return for the year came in at 2.6% for the year. The poor performance was largely attributed to weaker South African equities and a softer rand. Although yields expressed as a percentage of prime are generally below the prime rate, effective yields are currently above prime at 9.75%. This is due to lower market prices.

Some markets capitalisations are well below R1 billion, and some trading volumes remain very low in absolute terms.

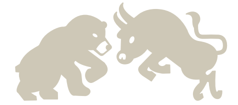
Domestic reference shares characteristics

1/8/2016	Standard	ABSA	FirstRand	Nedbank	Inv Ltd	Inv Bank	Inv Pref	Capitec	Sasfin
Value	SBPP	ABSP	FSRP	NBKP	INPR	INLP	INPPR	CPIP	SFNP
Price (R)	83.00	738.99	82.00	9.00	76.10	83.00	82.50	85.50	74.00
Yield as % of prime	77.00	70.00	75.56	83.33	77.78	83.33	95.00	83.33	82.50
Dividends	Non-cum	Non-cum	Non-cum	Non-cum	Non-cum	Non-cum	Non-cum	Non-cum	Non-cum
Accrued dividends	R0.60	R4.08	R0.57	R0.08	R2.25	R2.41	R2.74	R0.26	R0.04
Clean price	R82.40	R734.91	R81.43	R8.92	R73.85	R80.59	R79.76	R85.24	R73.96
Liquidity	SBPP	ABSP	FSRP	NBKP	INPR	INLP	INPPR	CPIP	SFNP
Market cap (Rm)	4 398	3 654	3 690	3 226	2 452	1 282	188	196	141
Avg monthly trade (Rm)	63.32	36.21	43.15	36.81	30.67	15.24	4.22	5.72	2.70
% of market cap traded monthly	1.44	0.99	1.17	1.14	1.25	1.19	2.24	2.91	1.92
Yield as a % of prime	93.45	95.25	92.79	93.43	105.31	103.40	119.11	97.76	111.55
Effective yield	8.88	9.05	8.82	8.88	10.00	9.82	11.32	9.29	10.60

Source: Grinrod Asset Management

PSG Wealth

Preference shares

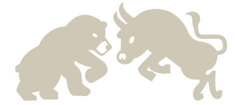


Domestic reference shares characteristics

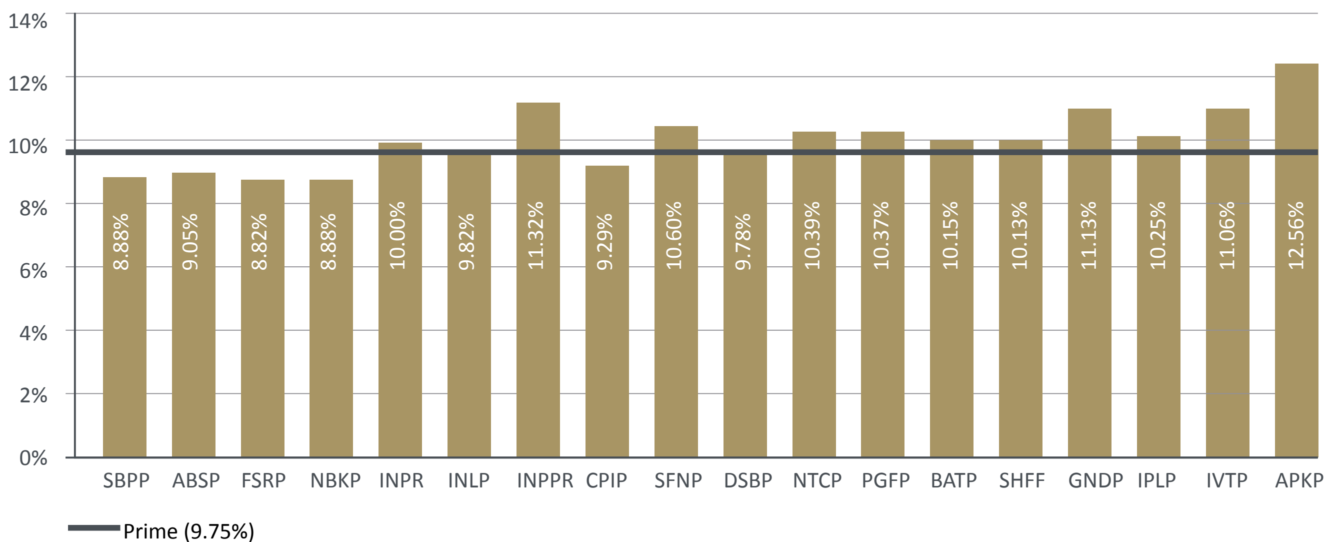
1/8/2016	Discovery	Netcare	PSG	Brait	Steinhoff	Grinrod	Imperial	Invicta	Astrapark
Value	DSBP	NTCP	PGFP	BATP	SHFF	GNDP	IPLP	IVTP	APKP
Price	97.50	78.50	76.61	100.00	81.00	75.50	76.75	90.00	67.49
Yield as % of prime	100.00	82.50	83.33	104.00	82.50	88.00	82.50	102.00	88.89
Dividends	Non-cum	Cum	Cum	Cum	Cum	Cum	Cum	Cum	Cum
Accrued dividends	0.41	3.05	0.26	2.64	3.65	0.36	0.25	2.40	0.27
Clean price	97.09	75.45	76.35	97.36	77.35	75.14	76.50	87.60	67.22
Liquidity	DSBP	NTCP	PGFP	BATP	SHFF	GNDP	IPLP	IVTP	APKP
Market cap (Rm)	780	510	1 334	2 000	1 215	559	348	675	101
Avg monthly trade (Rm)	11.29	12.35	14.07	21.98	12.59	7.53	8.17	18.23	2.40
% of market cap traded monthly	1.45	2.42	1.05	1.10	1.04	1.32	2.34	2.70	2.37
Yield as a % of prime	102.99	109.34	109.15	106.82	106.66	117.11	107.84	116.84	132.24
Effective yield	9.78	10.39	10.37	10.15	10.13	11.13	10.25	11.06	12.56

Source: Grinrod Asset Management

Preference shares



Effective yield



Banking preferences and Basel III

Basel III capital adequacy requirements stipulate that banks must hold specified minimum amounts of capital in their tier 1 common equity, as set out by the South African Reserve Bank (SARB). The existing preference share listing documents currently do not satisfy the requirements under Basel III, but SARB has allowed a 'grandfathering' period during which the preference shares allocated towards tier 1 capital will be reduced by 10% per annum (currently 70%).

It remains to be seen whether the bank will elect to repurchase their preference shares in the open market, or incentivise investors to accommodate any changes to the legal risks in the listing documents.

Current risks for preferences shares

Although preferences shares can be seen as a suitable income-generating investment for some high net worth investors - and although prime-linked yields are set to increase as interest rates increase - we feel that there are some significant capital risks in this asset class.

With the domestic economy struggling, further downgrades to any South African sovereign ratings, local banks or state-owned enterprises that are guaranteed by the South African government, become increasingly likely. If this happens, large international institutional investors and passive investment funds may be compelled to exit these markets. This will drive yields higher and will put capital values of preference shares under pressure.

In addition, liquidity is an investment characteristic that we do not easily sacrifice, as it often places an investor in the position of price taker, when fundamental asset values are skewed disproportionally to what can be obtained in the open market.

PSG Wealth

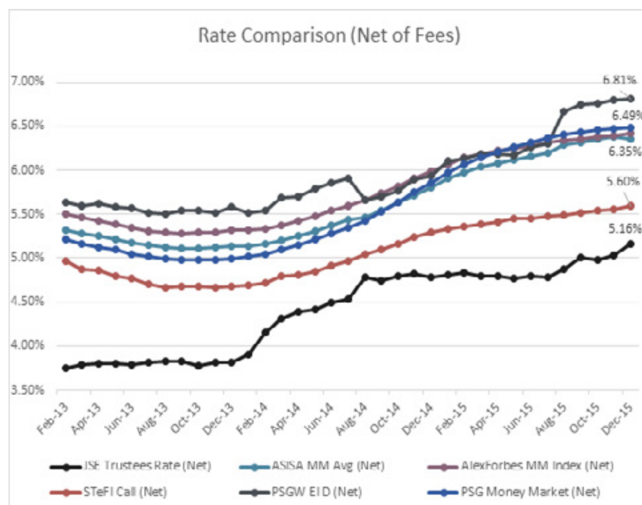
Cash management options

The effective after-cost yields for both the PSG Wealth Enhanced Interest Fund (6.81%) and the PSG Money Market Fund (6.49%) are currently well above SteFI call rates (5.60%). These numbers are also higher than the average yield of the ASISA Money Market Fund peer group (6.35%).

Both these options invest only in investment grade instruments and are Regulation 28 compliant. The PSG Money Market Fund retains a slightly shorter duration as required by its fund classification and mandate. The PSG Wealth Enhanced Interest Fund's mandate maintains a slightly higher duration profile to enhanced yield.

The JSE Trustees rate (net 5.16%) offers a reasonable yield for investors who wish to keep cash in their stockbroking accounts in order to act swiftly if, and when, equity investment opportunities present themselves.

The South African forward rate curve (FRA) is pricing in a total of 0.75% of rate hikes over the next two Monetary Policy Committee (MPC) meetings. The last of which is to be concluded on 17 March. Cash is starting to offer value – a 3-month fixed deposit is currently expected to yield close to 8% in nine months' time.



Source: PSG Wealth Investment Research and Strategy division, Morningstar, JSE, Investec.

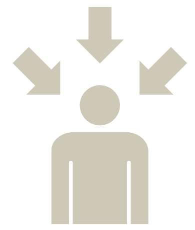
A note on interest rates

Managing inflation will be an enormous challenge for the Monetary Policy Committee (MPC) this year, especially with inflation expectations rapidly increasing. The committee seems well aware of the fact that the economy is struggling and that most of the inflation is supply-side inflation. Hiking rates may do little to decrease supply-side inflation, and demand side is already under pressure.

Subsequently, we expect that the coming rate hikes will be more successful in getting real rates in sustainably positive territory, than it will be at substantially lowering inflation. None the less, these hikes are probably needed in order to normalise monetary policy going forward.

Entering a rising interest rate cycle, does however, offer exciting possibilities with higher returns on cash.

In a highly volatile share market, perhaps having some safe cash investments, like the PSG Wealth Enhanced Interest Fund and the PSG Money Market Fund, could improve portfolio performance and diversification.



Theme spotlight

While the number of white South Africans are expected to decline over the next decade, many experts believe that wealth will be fuelled by a growth in the African and Indian millionaires in the country. Andrew Amoils, the Head of Research at New World Wealth (NWW) a South African research agency, says that in the 14 years from 2000 till 2014, the number of High Net Wealth Individuals (HNWI) in Africa increased by 145%, compared to the worldwide HNWI growth rate of 73% during the same period.

Creating wealth in 2016 and beyond

Research conducted by NWW found that in 2015, the numbers of South African millionaires declined by 5% from 49,000 to 46,800. According to Amoils, this was mainly due to the depreciation of the rand. NWW defines a millionaire as an individual with net assets of over US$1 million.

Amoils says they also expect a negative millionaire-growth in South Africa in 2016, due to an exodus of wealthy people out of the country.

"We expect large numbers of wealthy South Africans to move to the UK, Canada, Australia, Mauritius, Cyprus, Israel and the USA in 2016," he commented. "But we have a relative positive outlook of the growth of millionaires in the country beyond 2016."

NWW expects the numbers of millionaires in South Africa to reach 72,000 people by 2025.

"We do however, expect the number of wealthy white South Africans to decline, so growth will be fuelled by strong growth in African and Indian millionaires in the country."

Wealth and distribution relative to world

According to their data, white South Africans currently account for 68% of South African millionaires, but NWW expects this percentage to decline to less than 30% by 2025.

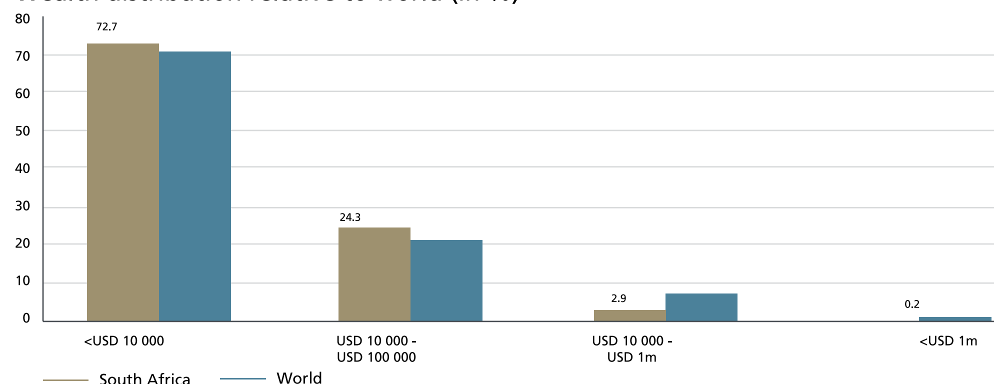
In Africa the amount of HNWI are expected to rise by 45% over the next 10 years, reaching approximately 234,000 by 2024.

While negative growth is expected for some of Africa's economic powerhouses like South Africa and Nigeria, NWW expects strong growth in a number of key sectors in Mozambique.

"We believe key sectors in Mozambique like real estate, construction, financial services, oil and gas will aid in this growth. A stable government and strong ownership rights will also help their prospects," said Amoils.

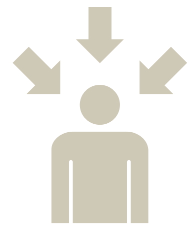
NWW expects South African media and healthcare companies to do well in 2016.

Wealth distribution relative to world (in %)



Source: Credit Suisse Research 2015 Global Wealth Report

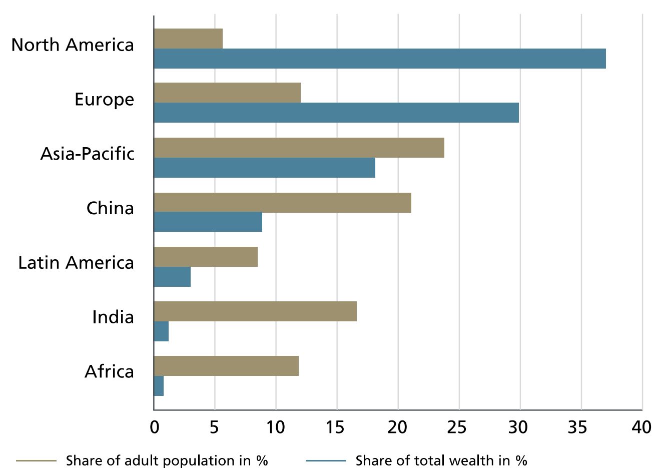
Theme spotlight



"Good growth in the tech sector is also possible." This research group further expects that there will be poor spending on luxury goods in 2016 in South Africa.

"Luxury cars and watches should sell well, but we expect luxury clothing and accessories brands such as Prada and/or Gucci to sell badly in 2016."

Wealth and population by region, 2015



Source: Credit Suisse Research 2015 Global Wealth Report

Wealth defined

According to the 2015 Global Wealth Report by Credit Suisse Research, net worth or "wealth" is defined as the value of financial assets plus real assets (principally housing) owned by households, less their debts. This corresponds to the balance sheet that a household might draw up, listing the items which are owned and their net value if sold. Private pension fund assets are included, but not entitlements to state pensions. Human capital is excluded altogether, along with assets and debts owned by the state (which cannot easily be assigned to individuals).

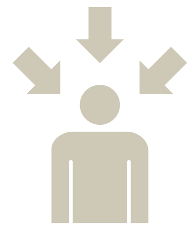
Trends in the number of millionaires

Growth in the number of millionaires is often taken as a sign of the health of an economy and reflects its ability to generate wealth at the top end. Credit Suisse estimates that the number of dollar millionaires worldwide grew from 13.7 million at the turn of the century to 36.1 million in 2014, but fell back in 2015 to 33.7 million due to exchange rate effects. The rise of 146% since 2000 reflects population growth and the fact that inflation progressively lowers the bar for membership of the millionaire club.

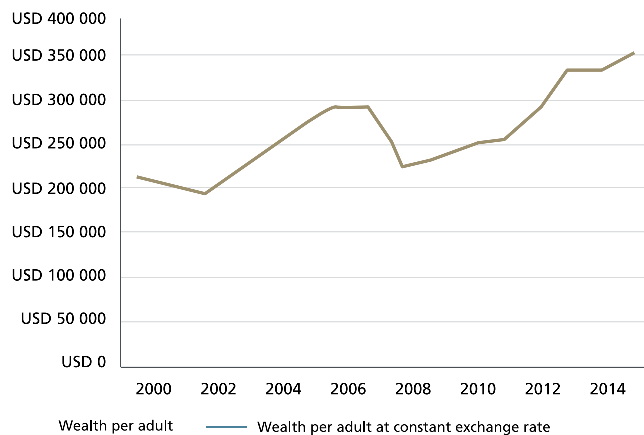
Nevertheless, according to their research the number of millionaires has still grown significantly after discounting for these factors. The number of dollar millionaires dipped during the financial crisis. However, unlike the trend in median wealth, the number of millionaires recovered quickly after 2008 and new records were set every year from 2011 until 2014. Millionaire numbers within each region trended upwards until 2007. Membership in North America and Asia-Pacific grew at about half the world pace, while in Europe and Africa it grew faster than average. Millionaires became five times more common in India and spectacular growth was seen in China, where the number rose more than tenfold. According to Credit Suisse, these regional patterns have diverged in more recent times.

"Millionaire totals have continued to rise in North America and China. Another interesting contrast is between China, Africa and India, which all began the millennium with millionaire numbers between 30,000 and 45,000. Numbers in all regions have since grown significantly faster than the global average, by a factor of four in Africa to 126,000, and by a factor of six in India to 185,000. However, these growth records appear almost anaemic in comparison to China, which is now host to 1.3 million millionaires, ten times the number in the whole of Africa."

Theme spotlight



Wealth per adult over time



Source: Credit Suisse Research 2015 Global Wealth Report

Wealth in the U.S.

According to research conducted by Credit Suisse, the United States continued adding to global wealth in 2015 at an impressive rate, with solid growth also evident in China. In 2015 there were more than 15, 6 million dollar millionaires in the U.S.

The report states that: "The US economy and its financial markets continued to perform well in 2014–2015, leading to a seventh successive year of rising wealth.

Average wealth was USD 209,000 at the turn of the century and rose fairly steadily until 2006, before falling as a result of the financial crisis. Wealth per adult has now fully recovered and is 21% above the 2006 level."

"The USA has by far the greatest number of members of the top 1% global wealth group and currently accounts for 46% of the world's millionaires. The number of UHNW individuals with wealth above USD 50 million is six times that of the next country, China."

Wealth in China

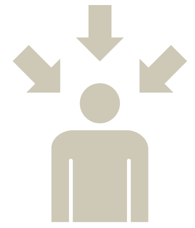
In 2015 China had over one million millionaires and more residents with wealth above USD 50 million than any country, except the United States. Research conducted by Credit Suisse found that wealth per adult in China has grown strongly since 2000, quadrupling from USD 5,670 to USD 22,513 in 2015.

"The global financial crisis caused a major setback, with wealth falling by almost 20%. However, wealth soon recovered to its pre-crisis level and although it grew slowly from 2010 to 2012, it was 12% above its 2012 level by mid-2015. Recently, forecasts of GDP growth have been revised downwards and the stock market is unsettled. The consequences for the economy over the next few years are difficult to predict, but there will certainly be implications not only for the Chinese but for households around the world."

Elsewhere in the world, local currency wealth gains were offset by depreciation against the US dollar, so that world wealth in 2015 declined overall by USD 12.4 trillion.

According to Credit Suisse, an amount of USD 68,800 is required to be a member of the top 10% of global wealth holders, and USD 759,900 to belong to the top 1%.

The report found that while the bottom half of adults collectively own less than 1% of total wealth, the richest decile holds 87.7% of assets, and the top percentile alone accounts for half of total household wealth.



Theme spotlight

Wealth in 5 years' time - 2020

Credit Suisse found that despite the slowing momentum in recent years, they expect that wealth growth will pick up by the end of the decade, reaching USD 345 trillion by mid-2020, 38% higher than in 2015. "The number of millionaires will grow to 49.3 million adults, while the middle segment of wealth holders will exceed 1.3 billion adults, 40.3% of whom will be from China."

Another opportunity for investment firms lies in members of the Generation Y who are now starting to settle down and planning financially for their futures. The oldest members of "Generation Y" turned 35 in 2015. According to experts this is the biggest demographic opportunity since the post-war boom. "Generation Y turned out terrified of financial risk, but eager to pay for professional expertise. They're getting married, having kids, thinking about the future," an economist told Bankrate.com.

Building wealth in 2016 and beyond

The PSG investment research and strategy division found that PSG Wealth has managed to grow the amount of client millionaires by roughly 75% over the last three years. According to the Chief Investment Officer at PSG Wealth, Adriaan Pask, this means we have been able to grow the number of client millionaires by about 20% per annum over the last three consecutive years.

"PSG Wealth has a proven ability to assist clients to help grow their long term wealth. We have done so despite challenging market conditions and a general decline in wealth in our industry."

He adds that market challenges will come and go. "The best investors can do is to trust wealth managers with proven abilities which assist them to navigate around these challenges successfully."

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