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Motswedi

A Well of Knowledge

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Financial Markets Recovery

By Oupa Rangaka

The banking crisis, followed by news that the United States was in recession, led to markets around the world to fall by more than 50% in some cases. From the peak in June to December 2008, the JSE All Share index followed the rest of the world equity markets lower and fell -27.84%.

All of these occurrences (banking crisis, news of a recession and the sharp fall in the market) caused panic among many trustees of the retirement funds. Some trustees started pulling assets out of the equities markets and investing in cash. Others changed their cash flow strategies to redirect new investments into cash.

However, some stuck to their funds' strategic long term asset allocation and didn't temper with asset managers' mandates.

Whatever intervention measure that trustees would have taken, the likelihood is high that it was taken late in the cycle when the market had already fallen significantly and about to bottom. The danger of this kind of reaction is that it is often ill-timed from both exiting the market when it falls as well as going back into the market when it's about to turn. The result is usually prolonged periods of underperformance due to the inherent delays in implementing trustees' investments decisions.

Table 1 (left) shows that the All Share Index has since recovered most of the losses it suffered since the market peak in June 2008. International markets have also recovered their losses although to a lesser extent than the domestic markets. In addition, if one had a strategic asset allocation of 60%, 20%, 5%, 10% and 5% in domestic Equities, Bonds, Cash, offshore Equities and Bonds respectively, and never tempered with it throughout the market cycle, they would have achieved a return of approximately 1.25% over the 18 months to December 2009.

Historically, bull markets happen more frequently than bear markets. Their gains also tend to surpass losses suffered in the preceding bear market.

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	6 months to Dec 08	6 months to Jun 09	12 months to Jun 09	12 months to Dec 09	18 months to Dec 09	Weighted average return (18 months to Dec 09)	Weight
JSE All Share Index	-27.84%	4.09%	-24.88%	32.10%	-4.65%	-2.79%	60%
All Bond Index	25.35%	-4.86%	19.25%	-1.00%	24.11%	4.82%	20%
Cash (STeFT)	5.95%	5.07%	11.22%	9.10%	15.62%	0.78%	5%
MSCI World Index (R)	-19.10%	-13.50%	-30.02%	1.61%	-17.80%	-1.78%	10%
MSCI World Index (S)	-33.52%	6.79%	-29.01%	30.79%	-13.05%	0.00%	
Citi Group World Gov Bond Index (R)	30.19%	-20.25%	3.83%	-19.88%	4.31%	0.22%	5%
						1.25%	100%

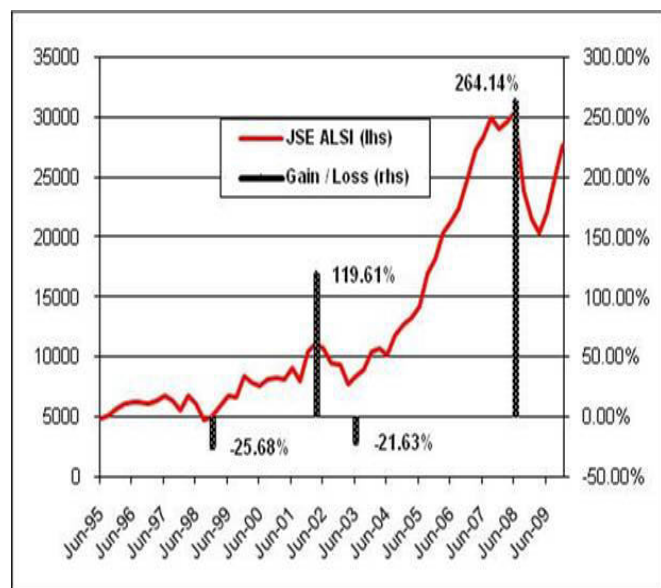
Table 1: Market returns of various asset classes over various periods. Source: Inet Bridge

Financial Markets Recovery

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However, there may be short periods within a bull market trend where the market falls, but the losses are usually short lived and insignificant.

Chart 1 (below) highlights bull and bear market periods from June 1995 to December 2009. From April until December 1998 the market fell by 25.68% and the subsequent bull market, which started in January 1999



and ended in March 2002, achieved gains of 119.61%. Similarly, the bear market, which started in July 2002 and ended in June 2003, lost -21.63%, while the subsequent bull market achieved returns of 264.14% and lasted for five years up to June 2008.

One cannot over emphasise the importance of funds to remain as close as possible to their strategic asset allocation. Any deviation should be negligible and for tactical asset allocation reasons only. Trustees should always be mindful that a fund's strategic asset allocation is informed by the asset and liability study of the fund, which also includes members' risk profiling.

Finally, bull and bear markets are a common phenomenon in financial markets and they should not be the cause for panic.

Chart 1: JSE All Share index, Bull and Bear markets.
Source: Inet Bridge

Q&A Relating to Investments

Q: As a member of a retirement fund, do the trustees of my retirement fund have different investment strategies for my contributions, my current fund value, and my additional voluntary contributions?

A: Where trustees have decided on a single investment strategy, it will mean that all fund assets – which include current fund values, new contributions and additional voluntary contributions – will be invested in accordance with that strategy. It will also mean that all fund asset categories mentioned will receive the same investment returns, split proportionately.

Q: In order to protect my benefit from market fluctuations, why are the trustees not investing my benefits in a bank account?

A: Nothing prevents the trustees from investing 100% of the fund's assets in banks. The trustees are, however,

committed to providing investment returns over the medium to long term periods such as five to 10 years plus which are geared to exceed the inflation rate. This is to ensure that members' expectations of enhanced benefits are met.

An investment in a bank has proven over many years of research that it will never outperform inflation over the periods mentioned above, and for this reason, trustees are encouraged to invest not only in banks .

With the introduction of alternative investment options, trustees often transfer the benefits of members who are close to reaching their normal retirement ages into a bank investment vehicle that is meant to protect the benefits until retiring members access them.

Making the Call on Where to Invest

By Johan Botha



As members enjoy the upswing that their investments have had over the last couple of months during which nearly all, if not all their previous losses have improved, it is the trustees of their funds who should be commended for persevering with the investment strategies which they believed would best satisfy members' expectations.

Trustees know that there are times such as in 2008 when their investment decisions were not popular, but they knew that things usually change for the better. Members will find that historically when they add the good and the bad investment performance years together, it's the good years that would have won thus provided them with returns exceeding the inflation rate.

Managing millions (sometimes billions) worth of assets, operating within the confines of mandates and restrictions, as well as being expected by members to at least predict when the markets are going to crash or grow (something that no-one has ever been able to control), are ongoing pressures that impact on the decisions taken by trustees.

In this article, we shed light on the role of the trustees when making the call regarding investments.

On investing members' benefits, trustees are expected to:

- Draw up an investment strategy on which the investment decisions will be based;

- Ensure that the contributions and current assets in the fund are invested with an asset manager in accordance with the rules of the fund;
- Evaluate investment managers and the products and services on offer;
- Select the investment product (or products) that they believe will be best suited for the current membership of the fund;
- Ensure that the investments provide adequate (above inflation) returns; and
- Manage the investment managers to ensure that they stay within the investment mandate.

The trustees must also be aware of a number of factors when selecting an investment manager and the actual investment product (or products) where the contributions and assets will be invested. Grant Robertson outlines these factors in his book, "Investment Management for South African Retirement Funds":

- Cost – What management fees are charged to manage the product and how does it compare with other products;
- Pricing – How frequently are prices available and does this suit the trustees' needs;
- Termination conditions – What are the conditions for terminating the product (this is important for guaranteed and structured products);
- Minimum period – What is the minimum investment period;
- Performance restrictions – Is the performance limited in any way (e.g. structured products can 'cap' upside performance);
- Liquidity – How easy is it to convert to cash if the need arises;
- Minimum investment – Most products have a minimum level of investment in Rand terms;
- Communication – What feedback is given to the fund on the performance of the product;
- Switching restrictions – What restrictions apply to the product for member investment choice;
- Risks – Various risks may exist in the product or underlying investment. These need to be examined in some detail; and
- Administration – Is the fund's administrator capable of administering the product adequately.

Making the Call on Where to Invest

The Role of the Fund Consultant

The consultant is involved in all the aspects of managing a retirement fund – whether it be monitoring the administration function (contributions, claims, transfers etc), the selection of a risk underwriter for the risk benefits provided for in terms of the rules of the fund, or the appointment of an investment manager.

The consultant's duty is to provide the trustees with the following information:

- **Where to find the best investments products**
The consultant is best placed to know who the providers are and how to contact them.
- **What the different products are**
The consultant can provide the board of trustees with information relevant to a specific company, its product and the specification of the product.

- **Which products might be best suited for members' needs**

Based on experience established over a number of years, the consultant will be able to give the trustees an indication of which products or product combinations will be best suited for members' needs.

- **How to better the current products**

The consultant will be able to introduce the trustees to additional or newly launched or alternative products or services that can enhance the current status of members' benefits.

At the end of the day, however, the final decision on the appointment of investment managers and the selection of products lies with the trustees and not the consultant. Once the trustees make the decision, the consultant is given the task to ensure that the decision is implemented.

Allocation of Investment Returns

By Stephen Walker

There are two basic approaches to allocating investment returns in a Defined Contribution retirement fund: either to smooth investment returns or to allocate actual investment returns to members' retirement savings.

Smoothing of Investment Returns:

The traditional treatment of investment returns was to smooth investment returns. The trustees, with professional advice, would declare fund interest annually once the fund had been audited and reviewed. Investment returns would be held back during years of good performance to be able to make better declarations during years of poor investment performance. As far as possible, negative fund interest rates would be avoided. Such retained amounts would be held in a reserve, referred to as a Smoothing or Investment Reserve Account.

Legislative changes in 2001 entitled members leaving a retirement fund to receive a share of such a reserve. As the value of the reserve is only known when the fund is audited and assessed, this led to administrative problems: either members must be paid a rough estimate on exit, or be paid an additional "agterskot" share of the

reserve (which often proves a costly exercise) or both.

A member would only know the true value of their retirement savings once a year due to the need to wait six months or more for financial statements and for a financial review to be completed.

Allocating Actual Returns:

Instead of smoothing investment returns, most funds have moved to allocating actual returns. These rates can be positive or negative, exposing members' retirement savings more directly to the volatility of investment markets. Therefore, there is a need for member education to understand that returns should be assessed over the long-term.

Investment returns are usually expressed on either a monthly or daily basis, enabling members to be informed of their value in a fund on a more regular basis.

Removing smoothing of investment returns also allows the trustees to have more than one investment strategy, e.g. introducing a more conservative strategy for older members.

Control of Fund Assets

NBC looks into the role of trustees and the participating employer as well as the expectations of members

By Khomotso Rapetsoa

Practice and experience show that members regard their retirement funds as savings vehicles. In this context, members generally expect that their fund values would realize positive growth and not depreciate.

This line of thinking was demonstrated by the recent market crash and the resultant drop in members' fund values. Some members were dissatisfied with the negative returns and lodged complaints with the office of the Pension Funds Adjudicator. While trustees tried hard, they experienced difficulty in explaining the situation to the members.

The Pension Funds Act of 1956 (the Act) states that every registered fund must have a board of management (trustees) in place. Half of the trustees are appointed by the participating employer and half of them are elected by the members of the fund.

The members, trustees and participating employers are therefore the main stakeholders in retirement funds. The members represent shareholders and trustees manage the daily aspects of the fund while the employer's

role is to deduct and pay contributions to the fund in order to ensure the fund's liquidity to pay claims, its sustainability and continued existence.

The Act requires trustees to direct, control and oversee the daily operational responsibilities of the fund in terms of the applicable laws and the fund's rules. It is the responsibility of trustees to ensure the good governance of their fund.

To ensure good governance, trustees should make certain that the benefits provided for in terms of the rules of the fund are realized. Trustees are required to act in the best interest of the members at all times.

Trustees are generally responsible for the investment of fund assets. It is common cause that a sound investment strategy and platform will yield positive results and ensure the ability of the fund to meet the payment obligations of all accruing benefits.

To this end, trustees should make certain that the investment mandates define their expectations and benchmarks clearly.

Re-Arranging Home Loan Payments

By Jose Da Fonseca

Many South Africans are experiencing financial strain in the global recession and are finding it difficult to service their debt.

Cash-strapped retirement fund members with home loans that wish to re-arrange their repayments must make certain that when they discuss the options available to them with their credit provider they understand the implications of any amendments to the repayment amount and/or term.

One option for members, after consultation with the credit provider and only if agreed to by the credit provider, is to request that the repayment amount currently being paid be reduced to a lesser amount.

Members need to understand that a reduction in their existing repayment amount will result in the original repayment term being extended and the capital repayment amount (the total amount paid at the end of the term) being more.

Any reductions to a repayment amount, however, should be a temporary measure and members should revert to the original repayment amount as soon as possible.

Members are also encouraged to increase their repayment amount when they are able to do so.

View from the Market



Magda Wierzycka,
Chief Executive Officer,
Sygnia Group

This first issue of Motswedi for 2010 reflects on investment returns and focuses on market recovery. For industry perspective on the current market trends, NBC approached Magda Wierzycka, Chief Executive Officer of Sygnia Group, for her input.

Q: Is the market recovery sustainable, what are your views?

A: Going into 2010, global equity markets are a sentiment-driven rollercoaster with daily news flow setting the pace. Unfortunately the recovery in share prices does not reflect the relevant underlying company valuations, nor the economic fundamentals.

The panic selling of 2008 and early 2009 has been replaced by a massive buying spree largely fuelled by excess cheap money made available by governments worldwide. Hence, the equity markets have run well ahead of economic fundamentals.

The developed countries, in particular, face many problems, from high unemployment to unprecedented levels of debt. The true recovery is going to be bumpy and slow.

Everyone's hopes are thus pinned on emerging economies and specifically on China, India and Latin America as the drivers of growth going into the next decade. Those countries are industrialising at a rapid rate and are hungry for commodities. That is hugely positive for a commodity driven economy such as

South Africa and will dictate global sentiment towards our equity markets.

In the short term, we are bound to experience significant volatility in the South African equity and currency markets with some significant short term losses still ahead of us. In the long term, however, a high equity allocation strategy remains appropriate for long term wealth accumulation.

Q: What elements could have negative and positive impacts on the market going forward?

A: South Africa's equity market is at the mercy of global sentiment. Hence, any downward pressure on global markets, such as the Greece crisis, US banking regulations or China withdrawing stimulus measures, will translate into a "sell-off" of perceived riskier countries and currencies.

Monitoring global events is thus key to understanding our own markets. We also face numerous domestic risks, including a runaway budget deficit, high inflation, electricity shortages and any potential move away from current monetary and currency policies. However, provided infrastructure problems are resolved, South Africa is well positioned to benefit from the growth of China and other emerging economies.

Q: What stance is advised for investors or retirement funds at this uncertain time?

A: In uncertain times it is key to focus on long term sensible investment strategies appropriate to one's risk and liability profile, and to ride out the daily storms. This is neither the time for panic, nor for any fundamental change. If one's strategy is sensible to begin with, no change is required. If not, any changes should be made immediately but implemented slowly.

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