Adviser Choice

# Investec Managed Fund

As at 31 March 2011

## Market review

Equity markets performed well during the quarter considering the negative headwinds, which in preceding years would have resulted in sharp falls in risk appetite. Developed markets (4.9%) outperformed the emerging market composite (2.1%), despite a 9% drop in Japanese equities in March and a 6% weaker close over the quarter.

Local equities mimicked global market volatility, recovering January's losses and ending the quarter marginally higher (1.1%). Resource counters performed best, with Sasol, the only oil & gas producer constituent in the index, rising 13.1%. Diversified miners closed 3.2% higher while paper stocks added 15.5% over the period. Platinum stocks lost 10.5%. Both the industrial and financial sectors underperformed the broader market, closing down 0.3% and up 0.7%, respectively. Again, there was substantial dispersion amongst the various sub-sectors, with construction (-25%), food producers (-4.3%) and pharmaceuticals (-11.5%) underperforming, while mobile telecommunication (3.9%), life insurance (6.4%) and industrial metals (14.5%) enjoyed strong returns.

Local bonds traded weaker over the quarter, with the All Bond Index losing 1.6%. The yield curve has continued to steepen, while inflation concerns both globally and at home have been more pervasive. The firm rand has offset gains in oil prices for now, while food prices, rising at producer level, have not been passed on to consumers. Listed property, highly sensitive to the bond market, also gave up some of its 2010 gains, closing 2.2% weaker. Commercial property fundamentals remain under pressure, though highly dissimilar across regions and asset type. A recovery in growth, coupled with a lagged onset of new supply, will lend support to the market over the next year. Cash, as measured by the STeFI, provided a steady 1.4% over the quarter.

## Portfolio review

The final month of the quarter was extraordinary. It is a powerful victory for the bulls that the markets closed flat to slightly higher after an earthquake, a tsunami, nuclear radiation fallout, European debt problems, and wars in a variety of countries in the Middle East and North Africa. Growth is improving, and interest rates in the developed world look likely to be mired around zero for a long time.

The Investec Managed portfolio had a solid quarter. We have shifted the portfolio into more defensive equities as we expect leading indicators to peak shortly in the developed markets. Our exposure to developed market equities outside Japan (at the expense of local equities) worked well over the quarter. Our view is that the problems emanating from the disruption to the Asian supply chain are being underestimated. We still see better value in shares such as Barclays and JP Morgan compared to Standard Bank. European telecoms also look more attractive than our domestic sector. Local South African companies are missing earnings forecasts and are desperate for inflation and a weaker rand. If the rand does not weaken in the next six months, local companies will report poor earnings mid-year.

Debt to disposable income is falling slowly in South Africa, but at a much slower pace than in previous cycles. We do not believe the SA consumer can handle rate increases, particularly with higher oil prices. Oil was showing strength before the outbreak of unrest in the Middle East, and we prefer it to gold. Higher oil will act as a tax on consumption, just as the beleaguered consumer was showing signs of a recovery. Real disposable incomes are being squeezed.

We still like US equities, even though the debt situation in the country and other developed world markets is dire. The US has cheap oil, very cheap gas, a highly flexible labour market, a monetary regime focused on growth, and one of the less constraining banking capital regimes.

Central banks, in our opinion, should not raise interest rates in response to supply side shocks. The European Central Bank seems all set to hike, and whilst this is fine for the German economy, we believe it will increase risk in the peripheral economies. In order to run economies with one monetary policy, the central bank should look at a combined European inflation rate.

## Portfolio activity

Rising bond yields and firmer equity prices have given us the opportunity to lower our equity weighting to the mid 60s. Until the Middle Eastern situation resolves itself, we believe it prudent to have a lower risk weighting. We have topped up the income component in the portfolio by buying high yielding equities. Over 20% of the equity portfolio is in shares with a yield of more than 5%. These companies appear to be much less risky than bonds, and in most cases the yields are superior. Our holding in the gold exchange traded fund remains stable, as it is one of our few uncorrelated assets, and is useful for diversification.

## Portfolio positioning

The portfolio is overweight offshore developed market equities (excluding Japan) and has a neutral weighting in South African equities. We have an overweight position in resource stocks, while we have a neutral weighting in industrials and financials. Our view is that the global financial crisis has pushed back the supply of commodities, and prices are set to continue rising. The market is not pricing in commodity prices remaining at these levels.

The portfolio is underweight local banking shares, which are struggling to show any growth. South African banks are lacking in asset growth relative to emerging market peers and are priced at a premium to the latter. We are also overweight large capitalisation shares relative to mid and small caps in order to benefit from the higher rate of growth in markets outside South Africa. The portfolio has a material weighting in gold and oil. Our holding in financials is predominately in offshore banks. The portfolio has a significant weighting in very high yielding shares. We are underweight emerging markets, with the assumption that inflation will slow once food prices subside. There are many inefficiencies in emerging market economies which contribute to inflation. South Africa has a very expensive and under skilled labour market and sharply rising energy costs. We think the era of strong outperformance by emerging markets is over.

Risks to the portfolio include an upside surprise to the South African growth rate, and downside surprises to the offshore growth rates. We will, however, have a flexible asset allocation.

Collective investment schemes in securities (unit trusts) are generally medium to long term investments. The value of participatory interests (units) may go down as well as up and past performance is not necessarily a guide to the future. Fluctuations or movements in exchange rates may cause the value of underlying international investments to go up or down. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. Forward pricing is used. Quantifiable deductions are the initial fee whilst non-quantifiable deductions included in the net asset value price may comprise brokerage, MST, auditor's fees, bank charges, trustee and custodian fees. Commissions and incentives may be paid and if so, would be included in the overall costs. A schedule of fees and charges and maximum commissions is available on request from the company/scheme. If required, the portfolio manager may borrow up to 10% of the market value of the portfolio to bridge insufficient liquidity. Unit trust prices are calculated on a net asset value basis, which is the total value of all assets in the portfolio including any income accrual and less any permissible deductions from the portfolio. Different classes of units apply to the fund and are subject to different fees and charges. Fund valuations take place at approximately 16h00 SA time each day. Purchase and repurchase requests must be received by the Manager by 16h00 SA time each business day. Performance figures are based on lump sum investment (if applicable). This portfolio may be closed in order to be managed in accordance with the mandate (if applicable). *Inward-listings are shares that are listed on the JSE but regarded by the SA Reserve Bank as foreign investments. A notable example is British American Tobacco (BAT) which used to be held via Remgro and Richemont, both being domestic. BAT was unbundled at the end of October 2008 and inward-listed on the JSE. The presence of inward-listings in the Fund does not therefore mean that the Fund's investment strategy has changed in any way. Please note that with effect from 1 February 2009 the annual management fee on B class units increased by 0.285% (incl. VAT). The risk profile is a measure of volatility, i.e. how the absolute return of the fund varies. Note that there are other risks in the fund, which are not reflected in this rating. **The TER shows the percentage of the average Net Asset Value of the portfolio that was incurred as charges, levies and fees relating to the management of the portfolio. A higher TER ratio does not necessarily imply poor return, nor does a low TER imply a good return. The current TER cannot be regarded as an indication of the future TERs.
A copy of our performance fees FAQ is available at www.investecfunds.co.za. Investec Fund Managers SA Ltd is a member of the Association for Savings & Investment SA.

Out of the Ordinary®

Investec
Asset Management