BRENTHURST WEALTH MANAGEMENT

INVESTMENT REPORT

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THE POWER OF LONG-TERM INVESTING

By Magnus Heystek—Investment Strategist

A look back at the forecasts made for the expected performance of investment markets in 2012 this time last year shows up the folly, once again, of using "forecasts" to determine and shape investment strategies.

At the beginning of 2012 the headlines were full of gloom and doom.

Global economic activity was tepid at best while the heat and noise surrounding the expected collapse of the European monetary union following on the near-certainty of a Greece withdrawal was reaching boiling point almost on a daily basis. This continued for most of the year dragging down markets to cyclical lows in June.

And as the year sped towards its ending, headline grabbing Greece and Spain was quietly replaced by equally doom-laden forecast surrounding the so-called fiscal cliff" in the USA.

The cumulative effect of this was that a great number of potential investors were kept on the side lines in cash while an even greater number of investors fled equity markets into cash at precisely the wrong time. They missed out on one of the best rallies in markets for a long time.

Banking giant Citigroup, for instance, put the certainty of a Greece withdrawal from the EU at 90% at one stage around the middle of last year. Greece, Spain and later on in the year Italy dominated financial media headlines, creating a sense of impending doom for risk-taking investors in equity, currency and commodity markets.

A January 5, 2013 analysis of 2012 forecasts on the Bloomberg website **("Almost all of Wall Street got 2012 Market Calls Wrong")** illustrates the dangers of relying too much on banner-headline forecasting.

For instance, hedge fund manager John Paulson (he manages $19billion in assets) lost a fortune for his clients banking on the collapse of Europe 2012.

Banking giant Citigroup put the odds of Greece pulling out of the EU at 75% and Morgan Stanley forecast a down year for global equity markets.

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Global Markets AND SA ECONOMY

Goldman Sachs chief executive Lloyd C. Blankfein, however, early on the year warned that the biggest risk for investors was being too pessimistic on markets, advising an increased exposure to equities in an era of negative global interest rates.

And then there are the perennial bears such as economist Nouriel Roubini—who have been forecasting a collapse of the global financial system for many years now.

In hindsight the ill-timed advice shows that even the largest banks and most successful investors failed to anticipate how government actions would influence markets.

Unprecedented central bank stimulus in the US and Europe sparked a 16% gain in the S&P 500 which included dividends for calendar 2012, investors who bought Greek bonds in May reported a windfall of 78% while investors in US government bonds, which was described as "dangerous" by legendary investor Warren Buffett, provided a 2,2% return.

The market value of global equities increased by $6,5 trillion last year as the MSCI-All Country World Index returned 17% including dividends.

Some of the best returns were earned in European countries at the centre of the crisis swirling around Greece, Spain and the future of the European Monetary Union. The German stock market was up 29% last year, for example.

It would appear as if fund managers, bankers and economists alike underestimated the political will of European leaders to keep the EU intact along with the determination of the US Federal Reserve to spend almost unlimited monetary firepower in an effort to keep interest rates low, increase employment rate and get economic activity to pick up speed.

South African equity markets too had a very good year with the average rate up 22% for the year on average, while certain sectors such as property was up a staggering 37%.

The resource sector, mainly as a result of declining global commodity prices and the events surrounding Marikana, was the only sector to record a negative return year last year.

SO WHY THEN ARE MARKETS RISING AGAINST SUCH A NEGATIVE MACRO ECONOMIC BACKDROP?

This surely is the one question uppermost in the minds of the investing public, especially those new to the market.

One of the most common mistakes the "average" investor - if there is such a mythical animal - makes is to try and find a correlation of media headlines and market behaviour.

If the news is bad the markets must fall, and if the news is good the markets must rise. This seems the investment mantra of many uninformed people who follow the market on a day-to-day basis.

A recent study by Deutsche Bank tried to debunk the myth that markets should be following the news. In fact, there is a very low correlation between market behaviour and global macro events.

At BRENTHURST WEALTH are we used to this phenomenon and one we are often called up to explain: the market is not the economy.
History shows that periods of low and even negative growth rates are often the best times for making equity investments.

Despite the continuing debt crisis in the developed world, which still dominates the media headlines, global companies are still enjoying record levels of profitability.

In the US, for instance, company profits currently represent 12% of the GDP. The same is happening at European companies: profit margins have increased since 2008 and by end 2011 (the latest figures available) have returned to 2005 levels.

Apart from 2006 and 2007 higher margins have not been recorded since 1981. It is only Spanish, Portuguese and Greek companies that have been significantly affected by the broader macro-economic situation.

Many large US and European companies have become truly global and have diversified their earnings and profits across multinational boundaries.

The same has happened in South Africa. Despite the fall-out of the financial crisis since 2007/2008 company profits, with the exception of companies in the mining sector, have been rising steadily and are currently at record levels. It is also notable that, in contrast with previous economic downturns, there has been no major company liquidation of note. Companies generally have survived the downturn far better than individuals.

The general level of interest rates also plays a major role in asset allocation. South African interest yields after tax for almost all levels of taxpayers are currently negative in real terms .

Interest rates in most parts of the developed world have been negative or close to zero for almost three years now; a result of the policy actions by the world's central bankers generally described as quantitative easing (QE).

Many investment analysts now deem dividend-paying global companies the best asset class for the foreseeable future; a far better alternative to cash or even bonds, which are now considered to be risky.

Mark Mobius, director in charge of emerging markets at Franklin Templeton, one of the global fund houses used by **Brenthurst Wealth**, was bullish of prospects at the beginning of last year. Events have proved him right and he has not changed his stance for the year ahead.

"Global markets will have a fantastic year in 2013", he said on Bloomberg TV on January 7 this year. The reason?: global money supply is starting to increase all over the world and it needs to find a home. He is particularly bullish on his outlook for frontier markets-countries in Africa such as Nigeria and Ghana, Thailand, Venezuela, Colombia and others.

THE NON-FORECAST FORECAST

IF FORECASTS, THEN, ARE SO NOTORIOUSLY INACCURATE, WHY THEN DOES THE MEDIA SPEND SO MUCH TIME ON REPORTING THEM?

First, the beginning of the year is normally a quiet time for websites, newspapers, radio and other forms of media. Many media-savvy investment companies use this paucity of other forms of financial news to gain some handy media exposure.

Second, gloomy forecasting also makes for intense reading: the gloomier the headline the more exposure it gets and the more it is read, but this is not the way to make investment decisions.

I have in my research files a number of articles which appeared in the local financial magazine Finweek in March and April 2009.

In the April 2 2009 edition of Finweek seasoned journalist Vic De Klerk wrote the following (in the wake of the 34% decline of the JSE from September 2008): *"It makes no sense to save in equities any more. Those close to or at retirement won't recover their losses of the past two years in their lifetimes"*.

In fact, April 2009 presented the <u>best</u> opportunity to invest in the local (and global) equity markets in a generation; most definitely the best since October 1987 when the JSE dropped by 22% on ONE DAY.

Since then the JSE All share index has risen by 123% in just over three years while most balanced funds, the funds predominantly used in the creation of our portfolios, have doubled over the same time.

This example is not used to embarrass De Klerk or the publication (OK, just a little), but is rather used as an example how emotions can override rational thinking at times.

Therefore, our forecast for 2013 is much the same as last year: we do not know what will happen in investment markets this year, but we do know that on a basis of probability and past history growth portfolios are once again likely to outperform cash as an asset class.

This is done by seeking out and allocating our clients' funds to the best fund managers in the various sectors we have identified for growth. It also means that we reallocate funds from badly performing or underperforming funds to other funds, especially within legal structures, which do not attract adverse tax implications. More about this in our next newsletter.

Our investors were well rewarded last year for assuming risk (relative to the risk-free return of cash). Cash investors, on the other hand, have for the third year in a row seen the purchasing value of their investment decline in real terms.

THE BRENTHURST INVESTMENT PHILOSOPHY:

If we do not ascribe much value to "forecasts" and "predictions', what then is used in our investment methodology, for surely there should be one?

In short this methodology is based on a pragmatic value investment philosophy which hinges on the following:

(a) investing for the long-term
(b) ignoring the short term wobbles and noise
(c) ensuring your money is placed in the hands of the best fund managers in the business.

For noise and wobbles there will always be and we forewarn our clients of this fact. One of the many determinants to being a successful investor is to ignore the short term noise emanating from what is generally called the market.

WE REMAIN COMMITTED TO THE BELIEF THAT OVER TIME A WELL-CONSTRUCTED AND BALANCED PORTFOLIO, CONSISTING OF EQUITIES, BONDS AND PROPERTY, BOTH LOCAL AND GLOBAL, WILL OUTPERFORM CASH AND CREATE LONG-TERM WEALTH FOR OUR INVESTORS.

This is done by creating and managing bespoke risk adjusted portfolios for our clients on an individual basis selecting listed funds from a "menu" of three categories of funds.

Here are the funds we use in the creation of our investment portfolios within the range of investment products, which include discretionary investments, preservation funds (pension and provident) living annuities as well as endowments policies.

CONSERVATIVE FUNDS

Graph showing total return (%) from 18 Dec 2012 to 04 Jan 2013.

	Custom*	1 Month	3 Months	1 Year	3 Years	5 Years
Allan Gray Stable Fund A	0.59%	-0.16%	0.41%	6.54%	8.22%	8.59%
Coronation Balanced Defensive Fund A	1.32%	1.82%	4.30%	17.46%	13.51%	11.95%
Coronation Strategic Income Fund A	0.26%	0.76%	2.37%	11.87%	11.25%	10.29%
Investec Absolute Income Fund A	0.23%	0.51%	1.45%	7.00%	7.14%	8.51%
Investec Cautious Managed Fund A	0.91%	1.16%	3.34%	11.10%	9.24%	8.48%
Investec High Income Fund R	0.34%	0.65%	1.83%	7.80%	7.94%	8.92%
Investec Opportunity Income Fund A	0.12%	0.67%	1.60%	9.35%	9.07%	9.63%
MET Cautious Portfolio	1.64%	2.07%	3.01%	12.66%	8.77%	
MET Enhanced Income Portfolio	0.26%	0.21%	1.26%	5.82%	6.52%	
Nedgroup Investments Positive Return	1.25%	1.54%	3.65%	6.58%	6.15%	7.69%
Nedgroup Investments Stable Fund A	1.11%	1.25%	3.31%	14.93%	12.85%	11.48%
Prudential Inflation Plus Fund A	1.19%	2.26%	4.37%	20.04%	14.43%	10.90%
STANLIB Balanced Cautious Fund A	1.02%	1.41%	3.25%	14.40%	11.76%	
STANLIB Income Fund R	0.32%	0.60%	1.46%	7.36%	8.24%	9.18%

BALANCED FUNDS

Graph showing total return (%) from 18 Dec 2012 to 04 Jan 2013.

	Custom*	1 Month	3 Months	1 Year	3 Years	5 Years
Allan Gray Balanced Fund A	2.81%	3.05%	4.79%	14.63%	12.86%	9.82%
Coronation Balanced Plus Fund A	2.65%	3.08%	6.82%	21.42%	14.97%	11.15%
Coronation Capital Plus Fund A	2.15%	3.32%	5.48%	17.05%	12.95%	10.71%
Foord Balanced Fund R	2.16%	3.14%	6.66%	22.17%	16.35%	11.20%
Investec Diversified Income Fund A	0.26%	0.00%	1.40%	8.77%	9.63%	
Investec Managed Fund R	1.72%	1.87%	4.69%	20.51%	13.48%	8.09%
Investec Opportunity Fund R	1.42%	1.85%	5.58%	19.58%	14.53%	11.43%
MET Balanced Plus Fund A1	3.25%	4.28%				
STANLIB Aggressive Income Fund A	-0.40%	0.68%	2.11%	18.06%	14.52%	11.40%
STANLIB Balanced Fund A	2.73%	3.42%	7.03%	22.88%	15.87%	6.31%

AGGRESSIVE FUNDS

Graph showing total return (%) from 18 Dec 2012 to 04 Jan 2013.

	Custom*	1 Month	3 Months	1 Year	3 Years	5 Years
Allan Gray Equity Fund A	2.87%	4.28%	7.14%	17.73%	15.74%	9.85%
Coronation Top 20 Fund A	3.98%	6.55%	10.16%	26.91%	18.35%	14.87%
Foord Equity Fund R	3.18%	5.44%	10.29%	29.90%	21.83%	13.31%
Investec Emerging Companies Fund R	2.52%	5.10%	11.40%	40.00%	24.27%	8.32%
Investec Growth Fund R	3.54%	7.61%	13.04%	27.26%	16.18%	7.70%
Investec Property Equity Fund A	-1.75%	-0.20%	2.42%	35.15%	22.92%	14.66%
Investec Value Fund R	3.36%	6.01%	8.12%	1.66%	8.48%	7.46%
MET Value Fund	4.13%	5.79%	10.75%	24.77%	13.82%	8.50%
Momentum Small Mid-Cap Fund A	2.06%	4.75%	5.99%	27.07%	23.17%	12.71%
Nedgroup Investments Entrepreneur	1.83%	3.27%	6.67%	40.34%	26.83%	11.76%
Nedgroup Investments Rainmaker Fund A	3.50%	5.23%	8.20%	19.01%	15.22%	9.34%
Nedgroup Investments Value Fund R	3.31%	6.65%	9.81%	25.87%	17.67%	14.37%
STANLIB Property Income Fund A	-1.99%	-0.28%	2.22%	32.98%	23.11%	15.56%
STANLIB Value Fund A	2.87%	6.55%	8.22%	19.44%	14.20%	5.93%

Managing client wealth can only be done if you have a complement of 8 highly qualified investment advisors, all registered with the Financial Services Board and most of them having qualified as Certified Financial Planners® at the Financial Planning Institute.

To this end we were also one of the first five financial planning practices in South Africa to be awarded with the accolade of Professional Business Practice® by the Financial Planning Institute (FPI).

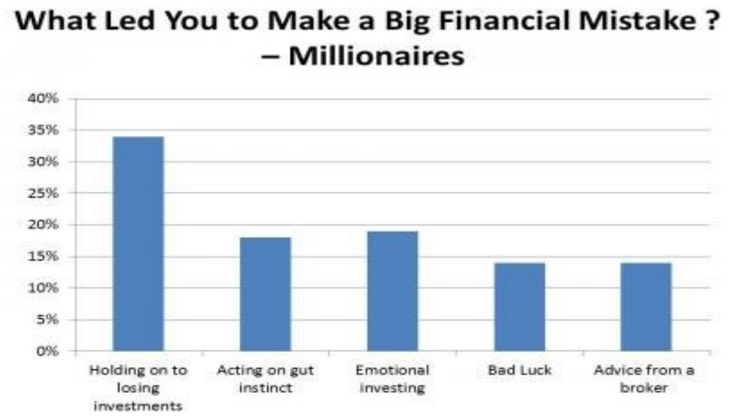
This recognition is only made to companies who have the requisite number of qualified financial professionals, a nationwide footprint and the ability to offer holistic financial services across the whole spectrum as demanded by our clients.

Finally, we would like to wish all our clients and their families a very happy, healthy and prosperous new year for 2013.

MILLIONAIRES: FEAR OF LOSING MONEY LEADS TO LOSSES

WHAT'S THE MOST COMMON INVESTING MISTAKE REPORTED BY MILLIONAIRES?

Here's a hint: It has to do with a fear of losing money.



Millionaires attribute their big financial losses to a host of factors, but the most commonly cited pitfall is holding on to losing investments, according to the latest monthly survey from Millionaire Corner, a USA-based website.

Investing mistakes are common to 56 % of millionaires, according to the December 2012 survey. Of these mistake makers, 31 % blame the losses on their failure to sell a bad investment in a timely matter. Other factors, such as bad advice from a broker or investing based on fear of greed, were cited by less than 20 percent of Millionaires, who have investable assets of $1 million up to $5 million.

More than 60 %of millionaires admitting to a financial mistake reported losing $20,000 or more. Why do millionaires – generally a sophisticated & hands-on group of investors – hold on to an investment that's clearly losing value?

A common human bias called loss aversion is likely at play, according to the website Contrarian-Investor.com: "It would be safe to say that loss aversion is ingrained in our genetic code. No one likes to take a loss and this often leads us to hold onto poor investments and bad companies. Rather than just cutting our losses we frequently delude ourselves by making up reasons why we think out investment will bounce back even though we know deep down inside that it probably won't."

Some millionaires appear to have learned the folly of loss aversion. When asked what they could have done to avoid their mistake, 11 percent cited "cutting my losses" and 24 percent of Millionaires indicated "researching industry and market trends." **Another 22 percent of millionaires indicated working with a financial professional may have helped them make better buying and selling decisions.**

The lesson seems lost on an even greater share of millionaires. More than one-third attribute their losses to "economic events beyond my control" and 48 % of Millionaires indicate "there was nothing I could have done" to avoid making a big financial mistake.

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