BRENTHURST WEALTH MANAGEMENT

# INVESTMENT REPORT

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# SUPERSTAR FUND MANAGERS LOSE THEIR LUSTRE

By Magnus Heystek—Investment Strategist

Look past the marketing hype at performance.

The investment industry spends a lot of time, energy and money on promoting their super-star fund managers.

When a fund manager wins a Raging Bull or Morningstar- award the marketing goes into overdrive: press releases, advertisements and invites to seminars just to mention a few of the tactics employed to get the good news out to the market. For it knows: many investment advisors and also the investing public react positively to such news, even at the risk of investing in yesterday's top performer.

A classic example was in 1999, when the small-cap sector in SA had a sterling run - I think the index rose by 100% in one year. RMB ran huge billboards on the M1-motorway in Johannesburg advertising this fact.

I had to persuade many people not to put their money in that asset class after such a run. The next year the fund lost 50% or more as the small-cap sector came down to earth with a bump.

Over a drink with someone from RMB I asked why they followed this aggressive approach. His reply: everyone else was doing it.

Sometime last year there was a Sanlam (JSE:SLM)-billboard next to the M2-highway, just past the Centurion turn-off, which invited investors to invest with "The best fund manager in the world." I actually stopped to take a photograph of the said billboard, which was promoting Kokkie Kooyman's Global Best Ideas Fund.

What neither the billboard nor the marketing said, was that the "Best Ideas Fund" was the winner in a very small sector, but which nevertheless still lost money over a certain period of time. This fund just lost less than the other funds in that sector....

Even today, over a three-year period investors still have not made much money with this fund.

On the RSG Geldsake call-in programme, I had to warn many listeners to make absolutely sure that they knew what they were investing in and not to rely purely on some marketing claims, when it came to the Best Ideas Fund.

But, it's when a star-performing fund manager who previously achieved some cult-like status in the marketplace starts under-performing that it creates all kinds of problems for the fund companies concerned.

## In this issue



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Global Markets AND SA ECONOMY

In SA there are currently a number of such star fund managers who are going through a torrid time as far as their performance, both relative and actual, is concerned. It is also no coincidence that almost all of them follow the so-called 'value investing'-style, popularised by Warren Buffett.

The three funds and their managers that I have been tracking and analysing are the Investec Value Fund (John Biccard), the RE:CM Flexible Equity Fund (Piet Viljoen) and Cannon MET Equity Fund (Dr Adrian Saville).

Over the past two years, as the local equity market rose to ever higher levels, the performance of these three funds have lagged the market, in the case of Biccard and Viljoen quite badly.

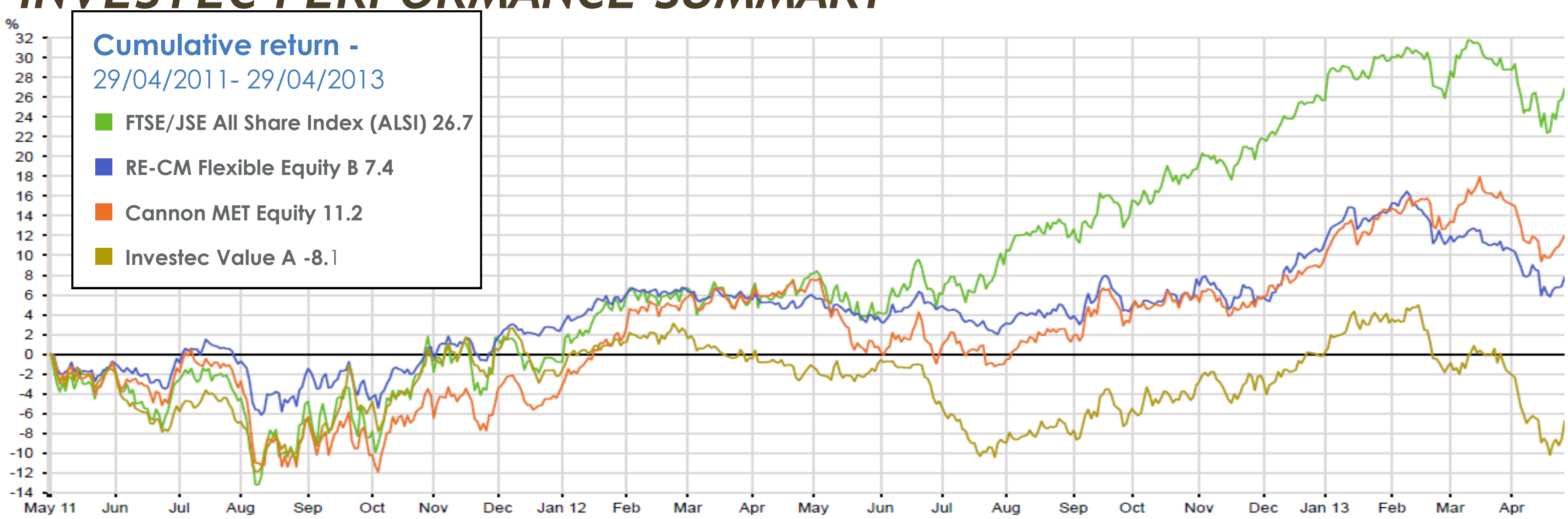
In all three cases it seems as if the fund managers have taken an outsized contrarian bet on the market. A year ago Biccard had almost 31% of his then R8bn fund in local gold shares. This has since been reduced to just under 20% - still an outsized bet on gold shares rocketing against of background of a soaring gold price, rising global inflation and a much weaker currency.

Viljoen on the other hand has been very negative, almost disdainful, of other fund managers who were making money hand-over fist in the retail sector, warning of a "possible permanent loss of capital." RE:CM has also been very negative on the listed property sector for some time. It's no secret that listed property was the best performing asset class again last year and even in the first quarter of this year.

Dr Saville has also been searching and investing in under-valued and neglected shares, a strategy that has yet to produce the expected performance he has hoped for.

As can be seen from the accompanying table, these funds have under-performed the benchmark JSE (JSE:JSE) All-Share index by a substantial and painful margin.

## *INVESTEC PERFORMANCE SUMMARY*




It is also no coincidence that all three of these funds have experienced substantial outflows as investors and/or their advisors capitulate and switch into another fund or asset class.

In the post-Fais (Financial Advisory and Intermediary Services Act) era this kind of development poses considerable difficulties for investment advisors who are being paid by their clients to 'look after' their investments.

Do you hang on for the 'long term', whatever that might be, or do you take pro-active steps and switch your clients out of a badly-performing fund into something else with much less deviation from the average returns.

What period of under-performance is acceptable? Is it six months, a year or two years? And what level of underperformance is acceptable before you as an investment advisor start looking for alternatives?

**THE INVESTEC VALUE FUND WAS USED BY BRENTHURST WEALTH AS ONE OF ITS CORNERSTONE FUNDS SINCE INCEPTION.**

**HOWEVER, OVER THE LAST SIX MONTHS, WE`VE BEEN AGGRESSIVELY REVIEWING OUR POSITION BY DECREASING OR REMOVING OUR CLIENT`S MONEY OUT OF THE INVESTEC VALUE FUND AND SWITCHING IT EITHER TO THE MET BALANCED, MET VALUE FUND OR ALTERNATIVE FUNDS, AS DISCUSSED WITH THEIR FINANCIAL PLANNER.**

What cannot be done is to ignore the elephant in the room and hope it goes away. That's when an advisor risks the wrath of the Fais-legislation which imposes a duty of care and responsibility on each and every advisor who has a client in a badly performing fund. And speaking of badly performing funds, the other day I was chatting to someone who had a considerable amount of money in the Marriott Property Income Fund.

It is a well-known fact in the investment circles that Dr Simon Pearse, who has been running this fund for almost ten years, has been notoriously negative on listed property as an asset class, at one stage some years ago having 50% of his fund in cash, thereby missing the bull-run in listed property.

Why, I asked him, do you still have so much money in this fund as it happens to be the worst property fund in the country?

"I am a rugby supporter and every Saturday afternoon I see their advert on the jerseys of the referees of the game I am watching. Surely they must good?"

I battled with this logic for a while but then I showed him the underperformance of this fund versus other funds in that sector. Over a five-year period the Stanlib Property Income fund fund returned 23,5% pa versus 13.9% for Marriott, over three the returns were 24.4% and 14.3% p.a. respectively and over one year 41.2% versus 22% for Marriott. He rushed off to have a "chat" with his Old Mutual plc (JSE:OML) advisor…..

I then had a look at the Morningstar -performance tables dated April 24 2013 and looked at the performance of this fund going back ten years. I saw something I have never seen in 30 years in the investment business: a fund that is stone last in the rankings for almost each and every period measured over that period of time.

Monthly and annual average returns (%) - dates to 29/04/2013

| Instrument | 1 month | 6 months | 1 year | 3 years annualised | 5 years annualised /*Since launch* annualised* |
|---|---|---|---|---|---|
| FTSE/JSE All Share Index (ALSI) | -1.5 | 7.3 | 17.8 | 14.2 | 8.2 |
| RE-CM Flexible Equity B | -3.0 | 1.9 | 1.8 | 6.5 | 8.8 |
| Cannon MET Equity | -3.6 | 5.4 | 4.7 | 7.3 | 4.2 |
| Investec Value A | -6.6 | -3.6 | -6.4 | 3.4 | 6.5 |

# SPECIAL REPORT BRENTHURST GLOBAL BALANCED FUND

## BY GLYN OWEN, FUND MANAGER

Last week's meeting of the Federal Reserve will be seen to be critical in the evolution of the current market cycle: it pointed to the beginning of the end of ultra- loose monetary policy in the US.

Bernanke indicated that if the US economy continues to make steady progress, unemployment declines further and inflation remains low, the Fed will begin to moderate its monthly rate of asset purchases later this year & end its purchases around the middle of 2014.

The market has taken this to mean that asset purchases will begin to taper in September and the programme will end in June 2014. Investors have taken fright and markets have fallen significantly across the World, with bond yields rising sharply and those assets that have become heavily dependent on excess liquidity, such as gold and emerging markets, falling especially rapidly.

Following the Fed's more hawkish stance than anticipated we can now say with more confidence that the 32-year bull market in bonds is over.
The move down in yields on 10 year US Treasuries to around 1.5% in the past year has clearly been driven by Fed action rather than economic fundamentals or valuations.

We now face the prospect of a withdrawal of liquidity and the strong likelihood that short term interest rates will rise within investors' short to medium term time horizon, i.e. over the next two years (whereas since 2008 the prospect of rate hikes has been very distant).

This must mean that interest rates on bonds will rise further, particularly during the period of uncertainty in coming months until the market knows the exact timing and scale of the Fed's tapering.

It also means greater volatility in markets as the Fed's tapering actions are short-term data dependent.
The better the news is on the economy, the more likely it is that bond markets will fall and the more pressure will be put on risk assets. Under these circumstances the most interest rate sensitive asset classes will be hardest hit, as well as those assets which have become dependent on excess liquidity.

Emerging market bonds and currencies have already sold off but further falls seem likely, especially in light of the negative news flow from key emerging market economies.

Precious metals and commodities are also likely to remain under pressure as the cost of carry increases.

However, it is important to remember that the news that would cause the Fed to rein in ultra loose policy, namely stronger economic growth, will ultimately be good for corporate profits and equity markets.

Furthermore, there is something of a backstop for equity markets in that if growth disappoints the Fed will reaccelerate asset purchases. The Fed's policy is not predetermined: tapering will not be an automatic process but will depend on economic data and the evolution of the outlook. The Fed also stressed that its policy action is akin to easing the foot off the accelerator rather than braking. It is slowing the pace of asset purchases and will not be shrinking its portfolio, and it emphasised that the tapering of QE will not have an impact on the Fed Funds rate: it continues to expect short-term interest rates to remain at current levels (i.e. effectively zero) until 2015 and any increases thereafter will be gradual. We therefore see the falls in equity markets, especially in developed markets, as a buying opportunity whereas bond markets are vulnerable to further weakness. Ten-year US Treasury yields were 4% in 2010 and could easily go back there within the next couple of years.

We have for some time seen no value in safe haven government bonds and have no meaningful exposure in the Brenthurst Global Balanced. Our fixed income exposure has been almost entirely in corporate debt and we have avoided particularly expensive areas such as emerging market debt, which has been fuelled primarily by liquidity flows.

We have also been anticipating an end to QE and earlier this year shortened the duration of our fixed income portfolios considerably (for example, by buying floating rate securities such as loans) so we are well protected from the interest rate rises we are now seeing in bond markets. In equities we have taken profits in the past three months following sharp rises in markets since mid- 2012 and are holding higher than usual levels of cash.

We are now taking action to reduce further the duration of our bond holdings by selling high grade corporate debt, where spreads have already narrowed substantially and future performance will be heavily dependent on moves in government bond yields. We anticipate using our currently high cash levels to add to equity positions during this period of weakness, focusing most likely on developed markets.

We do not envisage the favourable environment for the corporate sector changing for the foreseeable future while valuations are returning to attractive levels as markets fall.

**THE BRENTHURST GLOBAL BALANCED FUND HAS RECORDED A 16,9% IN USD IN THE YEAR TO END MAY 2013, OUTPERFORMING ITS BENCHMARK SUBSTANTIALLY.**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