

Market Commentary – early September 2008



PHOTO: MICHAEL LLEWELLYN

Circulated to Antler investment clients

There remains an extreme shortage of good news in the economic world, so let me start by paying attention to the little that there has been. The oil price has declined from well above \$160 per barrel to just under \$114. We in SA are about to experience the first drop in the price of fuel in what seems like a lifetime. Interest rates were held at 15.5% (Prime) in August. ICASA was beaten in court and Mugabe was heckled mercilessly in the opening of the Zimbabwean Parliament. Small blessings but blessings nonetheless!

Since my last newsletter dated 24 June 2008, we have seen a 'reversal in fortunes' that should serve as a reminder as to why we should not react to short-term market movements. Resources, the star performers up to the middle of the year, have fallen by 25.7% in the last 2 months. Had you been born in July 2008, you would believe that Listed Property and Financials were marvelous things! Had you gotten it right, you could be up around 51% year to date – Had you gotten it wrong, on the other hand, you could be down 66.5%. We are all blessed with the benefit of hindsight, but I retain my view that a balanced strategy is the correct one – **Buy & Hold!**

	1 Jan	31 Aug	Year to date (%)	Change since last letter (%)
SA MARKETS				
All Share	28958	27702	-4.34	-9.10
Financials	22654	18677	-17.55	12.38
Industrials	29824	26053	-12.64	5.32
Resources	30448	31566	3.67	-25.7
Listed Property	354	306	-13.49	20.59
Gold Mining Index	2309	1794	-22.30	-18.39
Platinum Index	99	94	-4.98	-35.11
EXCHANGE RATES				
R/\$	6.81	7.69	12.91	-4.16
R/€	9.97	11.29	13.23	-10.54
R/£	13.64	13.96	2.35	-13.03
GLOBAL MARKETS				
Dow Jones Industrial	13265	11544	-12.98	-2.27
US S&P 500 Index	1468	1283	-12.64	-2.42
UK FTSE 100 Index	6457	5637	-12.70	0.04
French CAC 40 Index	5614	4483	-20.15	0.20
Hang Seng Index	27813	20972	-24.59	-8.31
German DAX Index	8067	6422	-20.39	-1.78
Japanese Nikkei 225	15654	12768	-18.43	-8.53
US Nasdaq Index	2652	2368	-10.77	0.00
MSCI (\$)	1589	1345	-15.35	-5.65

Economics 101

How can a fund manager be proud of his/her performance when my return has been negative for the past months?

The role of a fund manager is to manage money within a mandate. When indexes are falling, the fund manager can be compared to a man running in the rain to catch a bus. His mandate precludes him from carrying an umbrella. If he runs cleverly making use of the available shelter, he will avoid getting as wet as others, but at best will get somewhat damp as the destination is more important than his suit. At the same time, he can't sit under cover for too long or he will never get to his destination.

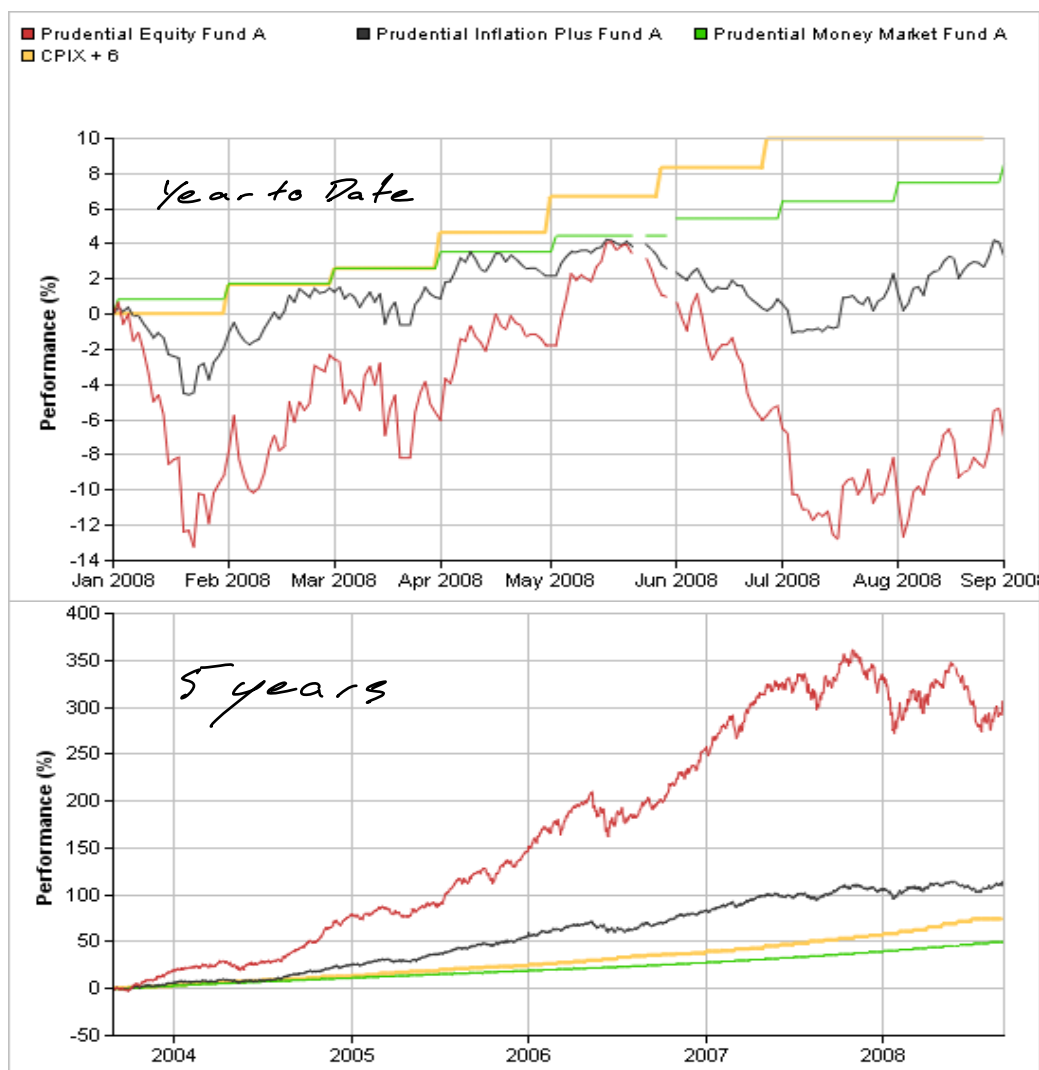
The point

There is a saying in our industry 'nobody wants to catch a falling piano' – That said, the equity managers we use are unfortunately tied down under said piano. The best they can hope for is that their valuations of their holdings allowed a margin of safety when compared to the overall market. My due diligence on the fund managers is conducted to achieve an understanding of their

objectives and processes in constructing their portfolios. Every fund manager Antler uses that contains an equity component has a single common trait – They hate losing money, but will stick to their ongoing valuation of each stock they hold regardless of short-term market fluctuation. There is no speculation/gambling taking place with your funds.

What does my risk profile have to do with all of this?

Should you have a long term to retirement, you can afford to take a significant amount of risk in the quest for superior returns over the long term. Should you be approaching retirement or in retirement, we must be more conservative but at the same time give you a good chance of meeting your income objectives and achieving capital growth above inflation over the medium and long term. To this end, we have mixed assets of varying risk and return expectations to meet your objectives.



What do inflation rates have to do with all of this?

Assume you are drawing from your investment at 6% per annum. CPIX is currently sitting at 13%. This means that in nominal terms your portfolio needs to 'produce' an average of 19% per year to prevent you from going backwards in real terms. The table and graphs show a real example of the volatility one must accept when real returns are needed (Returns above inflation). For the below, whether you are pre or post-retirement, we will assume that your target performance is Inflation + 6% per annum.

I have used 3 funds managed by Prudential Portfolio Managers in this example to show you the varying performance and volatility of funds run by the same group of people depending on their mandate. The Money Market (GREEN) has managed to stay ahead of Inflation, but has provided an almost negligible real return, despite being very stable – this means that with a target of CPIX + 6% (YELLOW) you are falling behind over both the short and long term.

The Prudential Inflation Plus fund (BLACK) is much more conservatively managed than the equity fund, but has managed to remain comfortably ahead of CPIX + 6% over 5 years, despite being 7% behind the target thus far this year.

The Prudential Equity Fund is a pure equity fund, and as such will almost inevitably provide the best return of the three over any rolling 5-year period. The fund is extremely volatile and as such provides no certainty of return over the short-term. This fund is currently 15% behind the target year to date.

Month-End performance data (values for periods greater than one year are annualised) as at 01 Sep 2008						
	Year to Date	1 Month	3 Months	1 Year	3 Years	5 Years
Prudential Equity Fund A	-7.02%	4.03%	-7.94%	-6.10%	22.52%	31.89%
Prudential Inflation Plus Fund A	3.31%	2.13%	0.68%	6.00%	13.69%	16.23%
Prudential Money Market Fund A	8.56%	1.00%	3.91%	12.07%	8.93%	8.61%
CPIX + 6%	9.95%	0.00%	3.08%	15.75%	12.88%	11.81%

So What?

By mixing assets with different risk characteristics we can find a balance between volatility and return expectations. As can be clearly seen from the above, it is unreasonable to compare your portfolio to a money market only in the bad times, and compare it to a pure equity fund only in the good times.

How do I do it?

This has been the starting point in firstly placing and thereafter monitoring your portfolio. It is for exactly this reason that we need to be kept abreast of any major changes in your financial situation. The balance is often self-maintained in that as the market moves, your equity/property/bonds/cash components fluctuate. Should you believe that we have misread your risk profile or investment objectives, please let us know.

Changes at Antler

Eugene Taljaard CFP™ has joined Antler as a specialist Employee Benefits Consultant as of 1 July 2008. He brings with him 35-odd years of Financial Services experience and is available to you should you want an opinion or an impartial review on your group benefits. In the short time he has been at Antler he has managed to add significantly to the business, and we believe his appointment has been and will remain a fortuitous and mutually beneficial one.

As usual, please feel free to contact my office should you want to discuss/review any aspect of your investment holdings.

Once again, please remember us for the following services:

- Your/Your company group risk portfolio (Life insurance; disability cover; dread disease cover)
- Group Retirement Funds
- Further investment and retirement planning needs
- Fiduciary services (Wills and trusts)
- Offshore investment services
- Tax affairs and returns
- Short term insurance needs

If you are happy with our service, please keep us in mind when discussing financial affairs with family, friends and colleagues – all referrals are acted on immediately, and will be dealt with to the best of our ability.

Until next time.

Kind Regards,



Anton C Muller CFP™

Antler Financial Services (Pty) Ltd

FSP License No: 27476

Tel: 011 886 7171

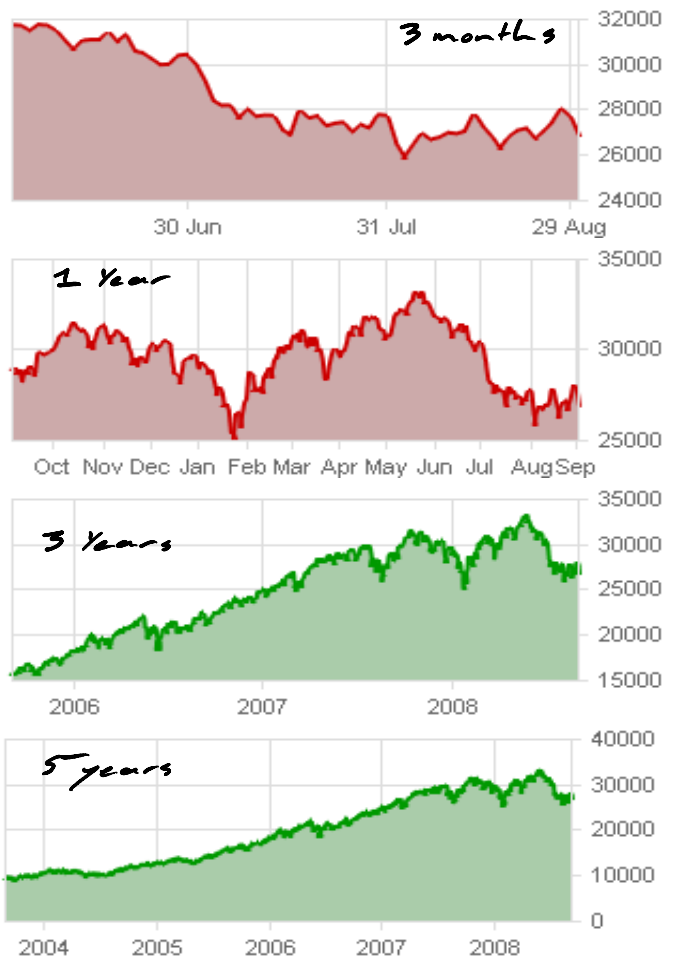
Fax: 086 515 7554

Cell: 082 880 8080

Email: anton@antlerfin.co.za

Website: www.antlerfin.co.za

All Share Index



Rand/Dollar Exchange Rate



Take the emotion out of your investment decisions

If the current market turbulence makes you a nervous investor, remember that a disciplined approach to investment creates long-term wealth. You cannot control the markets, but you can temper your reaction to them. We suggest that you:

- Have an investment objective
- Stick to it
- Always take a long-term view
- Educate yourself as much as possible about your investments

Emotions affect our financial decisions

Investor behaviour, rather than market performance, often dictates returns. But investor behaviour is not always rational. Emotions affect the financial and investment decisions that are made everyday. Fear of loss leads investors to sell investments in a panic, and fear of missing out makes investors invest in haste, regardless of the fundamental value or their long-term objectives.

In the early half of the year we experienced sharp price corrections in the equity market. The South African collective investment industry statistics show that instead of seeing this as a buying opportunity, investors withdrew a net R6.7bn from equity and real estate unit trusts, while R9bn flowed into money market unit trusts. Investors sought the perceived 'safety' of fixed interest funds, investing a further R2.4bn into this sector. In the quarter to the end of June 2008, R1.4bn again flowed out of equity funds. It is not clear whether this was sensible or not, and will not be until we have the benefit of hindsight, but is illustrative of the typical response to falling prices.

It is wise to remember that share prices are often driven high above their intrinsic value before crashing under their own weight. Sometimes it takes a turbulent period of sharp increases and declines before the markets re-establish their connection to economic and commercial fundamentals. The same is also true on the downside.

Stay the course

Studies have shown that investors are particularly bad at picking the right times to buy or sell. Selling shares that are rising in price, while buying those that are falling is rational, but difficult to implement. Investors are usually more comfortable buying shares when prices are high and rising, and selling when prices are low and falling.

Sticking to an investment strategy helps take the emotion out of your decision-making because your long-term strategy should not change when markets turn volatile. One of the worst things you can do when the market falls is take your money out of the market. This short-term strategy locks in losses and erases any hope of future gains. Changes in your personal circumstances and risk profile should encourage you to rethink your investment strategy, not short-term market fluctuations.

Attractive opportunities arise from going against the crowd

The need to conform leads to similar behaviour among people. An investor may feel it makes sense to change his/her opinion when a large majority of people are changing their views. This explains fads and fashions. Investors contribute to the very market forces that lead to inflated or deflated prices. This creates both a danger and an opportunity from an investment perspective. Unpopular shares tend to outperform more popular shares over the long term. It is thus more rewarding to stop and think than to instinctively do what others are doing. Attractive investment opportunities arise from going against the fearful or greedy crowd.

Allan Gray has a long-term valuation-based investment philosophy

Allan Gray's investment objective is to concentrate on fundamental value. In the short term, share prices are affected by market psychology. Over the long term, we believe share prices are determined by the economic progress of the underlying business. Through discipline and patience we are able to exploit the opportunities this presents. This approach is long term in nature – the investment horizon normally being four years or more. This allows sufficient time for undervalued assets to return to fair value as the market recognises its irrational pessimism.

It is difficult to own unpopular shares that continue to fall in price in sympathy with unfavourable short-term prospects and even more difficult to buy more of them. This is however, when we get most excited as we know we are able to accumulate shares that are being sold at prices that will deliver exceptional future returns.

Commentary by Johan de Lange, Director, Allan Gray Investor Services

Allan Gray Limited is an authorised Financial Services Provider.

Behavioural finance uses psychology-based theories to explain how rational individuals fail to make rational investment decisions.

There are a number of theories that explain stockmarket anomalies and market behaviour. For example:

- **Anchoring** is when we use historical reference points to 'anchor' decisions. Investors tend to use past and most recent information to relate to future prices, making the mistake of ignoring longer-term information.
- **Regret aversion** explains how we fool ourselves to justify poor past decisions. Investors often avoid new information or concoct logical arguments to maintain their beliefs and justify past decisions. The cost of procrastination and the price of fooling oneself are equally high.
- **Overconfidence** explains why confidence in a little knowledge is dangerous. Investors often base decisions on a flawed or inadequate intellectual framework and believe they have the knowledge or expertise to predict the future. This leads to poor investment decisions based on speculative thought.
- **Herd behaviour** encourages us to conform. Investors are often swayed by what other investors are doing rather than using a rational, considered framework for decision making.