THE STERLING TIMES 6

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STERLING
PRIVATE WEALTH

Inside this issue

Introduction
Graydon Morris

It truly is hard to believe that we have already reached the end of February. By this point, our client facing advisors have met with many of you. These investment report backs have been relatively benign, given the current state of the investment markets. These have included a very strong SA Equity market during 2012, a significantly weaker Rand, coupled with strong local and global listed property markets, and a strong international equity market. These are the results of the financial repression, orchestrated by central bankers, globally. We have stressed to our clients that this is no time for complacency, and that portfolios need to be continually assessed in light of potential continued market risks. We do this in an environment where we appreciate the need over the medium to long term, of earning meaningful real rates of return for investors.

At the time of writing, the ALSI was up 0,8% for the 2013 year to date and 16,8% over the past 12 months. This continued strength has resulted in us advising clients, where appropriate, to continue building global equity exposure positions, where our select fund managers appear to be in a position, from a bottom up perspective, to find more intrinsic value and sustainable earnings, than on the local front. As always, our advice is client specific, and the art of matching allocations, expectations and strategy is what we believe to be a core strength of Sterling Private Wealth.

The budget speech was presented on 27 February 2013. Contrary to popular opinion, this budget produced very little in the way of direct taxation changes. There was much speculation around potential increases to CGT and potentially the top marginal income tax rate. None of these potential changes materialised. It is anticipated, however, that these issues may be addressed in the coming years. We have provided a small piece dealing with the key facets of the budget in this edition.

We have further provided an interesting guest article by Cannon Asset Management dealing with the safety of bonds as an investment over the long term in relation to equities. This article again focuses one's mind on the importance of developing the capability to tolerate short to medium term risk, as defined by capital loss. In the long term of course, all investors carry the risk of a declining real value of capital, in the event they do not take on "growth asset risk". We do not deny that the timing of one's entry into equity markets is critical, but our experience suggests that investors are often more accepting of investing into a trending market, than into a significant correction. This issue makes investment planning a true art, with experience, conviction and a clear and objective mindset being the critical ingredients to success. Our advisors spend many hours debating and discussing client positioning in this light. The graphic below encapsulates this argument.

A select few of our deeply contrarian approved managers have experience periods of performance that has been poor, relative to their peers, and the market as a whole. We have seen this type of divergence in performance before. It is not unique, and will occur again. These managers have not lost client's money. They have merely performed less well than others. This is not atypical of a trending market. We shall not terminate these manager appointments based purely on short term under performance. History shows that such a change is ill advised and irresponsible. Our views in this respect are built on a history of such manager performance swings, dating back over 15-20 years.

Our relationship with Counterpoint Boutique Asset Management continues to grow. The experienced asset management team provides significant backup to our investment thought processes. The team has grown in number, to 7 over the past few months, and the funds under management continue to grow steadily.

Introduction

RE:CM, one of our trusted, select underlying asset manager solutions, turn 10 years old this April. We congratulate them on building a business much admired within the SA industry. We are proud to have been involved with them in a small way since their commencement, approximately 1 year after ours. We have included an interesting piece by one of their analysts in this edition to mark this milestone.

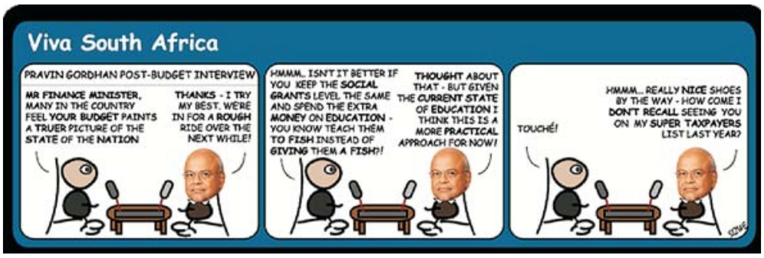
Have a great Easter Break, come the end of March, and thank you again for your support.

Graydon Morris
Founding Director

The Budget Speech
New Tax Rates and Legislation

Budget Speech Highlights

- Personal income tax relief of R7 billion.
- An employment tax incentive targeted to support young workers and those employed in special economic zones.
- Individuals whose taxable income is from one employer and is below R250 000 a year are not required to submit income tax returns.
- Levies on fuel increase by 23c per litre from 3 April 2013.
- From March 2014 an employer's contribution to retirement funds on behalf of an employee will be treated as a taxable fringe benefit in the hands of the employee. Individuals will from that date be allowed to deduct up to 27.5 per cent of the higher of taxable income or employment income for contributions to pension, provident and retirement annuity funds with a maximum annual deduction of R350 000. Contributions above the cap are carried forward to future tax years.
- Streamlining registration with SARS and reducing compliance requirements for the submission of tax returns by businesses.
- Requiring foreign businesses supplying e-books, music and other electronic services in South Africa to register as VAT vendors.
- Several measures are proposed to limit the deduction of interest on specific types of debt to protect the tax base.
- An automated tax clearance system will be implemented this year.
- Policy paper on carbon emissions tax to be published in 2013 with the view of introducing a carbon tax from 2015.



The Rates of Tax in respect of the 2013/2014 Tax Year are set out in the new tax tables, shown below.

Taxable Income (R):	Rates of Tax:
0 – 165,600	18% of taxable income
165,601 – 258,750	R29,808 + 25% of taxable income above R165,600
258,751 – 358,110	R53,096 + 30% of taxable income above R258,750
358,111 – 500,940	R82,904 + 35% of taxable income above R358,110
500,941 – 638,600	R132,894 + 38% of taxable income above R500,940
638,601 and above	R185,205 + 40% of taxable income above R638,600

	Below age 65:	Age 65 and below 75:	Age 75 and over:
Rebates:	R12,080	R6,750	R2,250
Tax Thresholds:	R67,111	R104,611	R117,111

Monthly Medical Aid Tax Credits:	
Principal Member	R242
First Dependent	R242
Each Additional Dependent	R162

Medical Tax Credits:
Effective from 1 March 2012 the capping system was replaced with a medical aid tax credit, bringing in equality for all taxpayers under the age of 65 and improved benefits for lower earners, a move in line with international best practice. The medical aid capping system is also used in the 2013/14 tax year, commencing 01 March 2013. The medical aid tax credit is R242 a month for the first two beneficiaries (including the principal member) and R162 for each additional dependent thereafter.

The interest exemption threshold has been revised and the new exemptions are as follows:

- R23 800 per annum for taxpayers under the age of 65,
- R34 500 per annum for taxpayers aged 65 years and older,

A taxpayer younger than 65 will be able to invest R1 515 183 at 6% per annum without paying tax. Those older than 65 but younger than 75 will be able to invest R2 318 516 at 6% per annum without paying tax. While a taxpayer 75 and older will be able to invest R2 526 850 at 6% per annum without paying tax.

To encourage greater savings, tax-preferred savings and investment accounts are proposed to be introduced by April 2015, as a replacement to the current tax-free interest-income caps as above. This will encourage a new generation of savings products.

All returns accrued within these accounts and any withdrawals would be exempt from tax. The account would have an initial annual contribution limit of R30 000 and a lifetime limit of R500 000, which is to be increased regularly in line with inflation.

Foreign Dividend Exemption

Most foreign dividends received by individuals from foreign companies (shareholding of less than 10 per cent in the foreign company) are taxable at a maximum effective rate of 15 per cent. No deductions are allowed for expenditure to produce foreign dividends.

Are Bonds as Safe as you think?

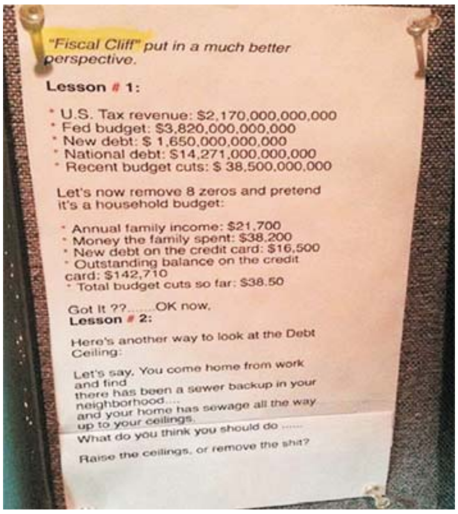
If I asked you which out of Bonds or Equities was the safer investment, you would most likely answer Bonds. This is because bond returns are assumed to be much less volatile than equity returns – an assumption that is well supported by the fact that over the last 50 years, the one year volatility of South African equities is 27.5%, while that of bonds is 10.1%. I have included a brief addendum at the bottom on the mechanics of bonds if you are unsure how they work.

As you can probably guess, we don't agree with the argument that less volatility amounts to lower risk, and that bonds are therefore "safer". Whilst we acknowledge that volatility is uncomfortable, we believe that as long-term investors, the real risk investors should be concerned about is the permanent loss of capital. So how does permanent loss of capital come about?

There are three main risk factors that contribute to permanent loss of capital:

1. The entity behind the security going bankrupt (credit risk);
2. Overpaying for an asset that never regains the price you have paid (valuation risk); and
3. Not being compensated for price inflation because of below inflation returns (inflation risk).

All three risks are of material importance to investors. For instance, given what is happening in the developed economies, credit risk is no longer restricted to corporate bonds, but has spread increasingly to government bonds which can no longer be considered "risk free". Our view on this is well represented in the following picture (I ask your forgiveness for the rather rude and graphic description – but it is effective).


"Fiscal Cliff" put in a much better perspective.

Lesson # 1:

- U.S. Tax revenue: $2,170,000,000,000
- Fed budget: $3,820,000,000,000
- New debt: $ 1,650,000,000,000
- National debt: $14,271,000,000,000
- Recent budget cuts: $ 38,500,000,000

Let's now remove 8 zeros and pretend it's a household budget:

- Annual family income: $21,700
- Money the family spent: $38,200
- New debt on the credit card: $16,500
- Outstanding balance on the credit card: $142,710
- Total budget cuts so far: $38.50

Got It ??.......OK now.
Lesson # 2:

Here's another way to look at the Debt Ceiling:

Let's say, You come home from work and find there has been a sewer backup in your neighborhood.... and your home has sewage all the way up to your ceilings.
What do you think you should do ......

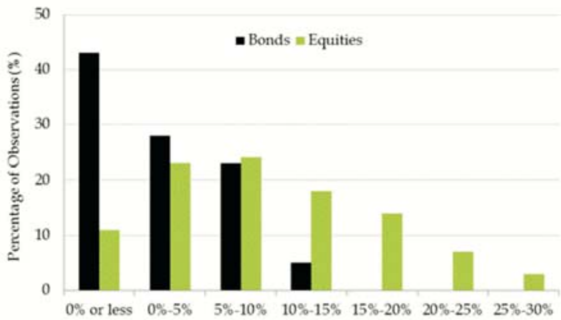
Raise the ceilings, or remove the shit?

What about inflation risk?

Bond investors give much of their attention to Credit and Valuation risk, but tend to ignore inflation risk, which is what we wish to examine here. Using the last 50 years of data for South Africa, we investigated the total returns from bonds (capital and interest) and equities (capital and dividends) above inflation i.e. total real returns. The results are really interesting and somewhat unexpected, as depicted in Chart 1 below.

- Over five year (a meaningful investment period) rolling periods, **bonds have returned a negative real return 43% of the time** (a return less than inflation), while equities have only done so 11% of the time.
- Over this period bonds have returned an annual average real return of 1.5%, while equities have returned a real 9.2% per annum.
- And volatility? Comparing the volatility of these real returns (as opposed to nominal returns) over the same rolling periods, equities are not that much more volatile (7.9% versus 5.3%), and if we turn our attention to 10 year periods, then equity real returns are actually less volatile than that of bonds. So for taking on a little bit more volatility by allocating to equities, investors reduce their chances of negative real returns by about 75 percent, and with significantly better returns.

Chart 1:
Frequency of Five Year Real Returns (1962 – 2012)



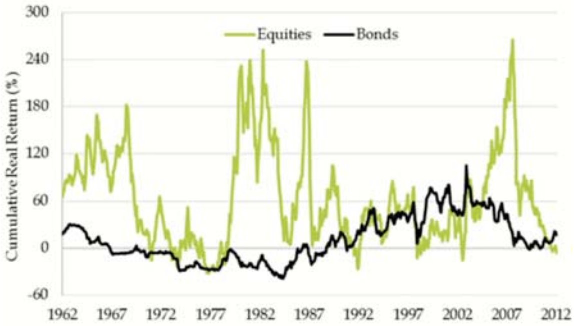
Shorter time frames show a similar picture:

- Over three year rolling periods bonds have returned a negative real return 40% of the time while equities have done so only 22% of the time; and
- Over one year rolling periods, bonds have a negative real return 41% of the time while equities have only done so 33% of the time.

When you examine bonds in this way, they do not appear to be as safe as "conventional wisdom" would indicate.

But before you decide to never own a bond again, there are two further factors to consider. The first is that over this period, while bonds were more likely to give you a negative real return than equities over any given period, any short-term price falls they experience are typically smaller than that of equities. This can be seen in Chart 2 below.

Chart 2:
Rolling Five Year Returns (1962 – 2012)



Second, from the 1960s to the early 1990s, bonds were a poor investment, offering negative real yields (in a setting of rising price inflation), while the 1990s to the late 2000s saw positive real interest rates (and falling inflation) and a strong bond bull market. If the bull market sustains itself and bond yields keep falling despite a stubbornly high inflation rate, then bonds may still experience positive real returns. We don't believe that this is likely or sustainable, but then again, Mr Market is not always rational.

Addendum: Bond Mechanics

A government or a company can borrow money by selling a bond into the market. The issuer (government or company) promises to pay back to the owner of the bond a certain amount at a certain point in the future (maturity date) and a fixed Rand amount of interest every year (the coupon) in the interim. While the coupon and the capital to be paid back at the maturity date are fixed, the actual value of the bond will change if it is traded (bought or sold) before maturity, depending on prevailing interest rates.

If interest rates rise, the traded value of the bond will fall and if interest rates fall the traded value of the bond will rise. This is because the new owner of the bond will want to earn a yield on the bond (interest) in line with prevailing interest rates at that point in time. If the actual coupon is fixed at a Rand amount, then the price of the bond has to change so that the fixed coupon of the bond, as a percentage of the price of the bond, reflects the interest rate that the buyer wishes to earn off the bond.

Investors in bonds therefore do not just earn the yield (coupon), but can also enjoy rising bond prices in a falling interest rate environment and vice versa.

The Price of Value

Johannes Visser, Analyst at RECM

'The market getting more inefficient means longer and bigger deviations from trend line value, greater opportunities to make money and greater career risk in trying to take advantage of them.

90% of what passes for brilliance or incompetence in investing is the ebb and flow of investment style. Since opportunities by style regress, past performance tends to be negatively correlated with future relative performance.'
Jeremy Grantham

Value investing has fallen out of favour. Again. This is evident in the eye-catching media exposure it's receiving and the client pressure value managers (including ourselves) are facing.

Should investors be concerned?

For the following reasons we believe the answer to be an overwhelming 'No':

1 The South African and global stock markets are spectacularly inefficient and have become ever more so. Consequently, the incentive for a value approach has never been stronger.

2 This isn't the first time that value investing has been out of favour. To outperform over a full market cycle value investors often have to accept underperformance in the short term – it comes with the territory. Selling overvalued shares comes naturally to value managers, but often overvalued shares continue to get more expensive. When this happens a value manager's relative performance will suffer, not so much from the companies they're invested in, but because of the companies they chose not to invest in. A good portion of the South African investment universe is now seriously expensive. In all likelihood investors in these securities face a permanent loss of capital at some point in the future.

Section 1: Why markets are inefficient and getting more so, or, the excellent state of (unconstrained) long-term value investing

The continuous formation of bubbles – for example the dotcom bubble in 2000 and the commodity- and global property bubbles in 2007 – provides evidence that mispricing of securities often persists for long periods. Patient investors have been able to take advantage of these mispricings or inefficiencies. In fact, the outperformance of value stocks (long-term investing) over momentum stocks (short-term investing) is the fundamental market anomaly – the most significant evidence that the market is inefficient or that mispricing can persist.

But how is it possible that this market anomaly persists in the face of asset managers who defend their existence with the prerogative of exploiting said inefficiencies?

The answer lies in the somewhat twisted structure and incentives of the financial services industry which, along with some quirks of human nature, prevent investment managers from following and sticking with proven strategies.

1.1 The structure of the financial services industry weakens the ability of investors as a group to arbitrage away inefficiencies

1.1.1 Product segmentation and benchmark tyranny

Asset managers have a strong profit incentive to offer more choice to their clients. Together with a burgeoning consulting industry looking to add another layer of expertise, asset managers have been sliced into increasingly specialised mandates. This growth of narrowly defined funds within each asset class (including, among equity funds, categories such as small cap, large cap, industrial, resources and financial funds) prevents managers of these funds from taking advantage of mispriced securities outside their narrowly defined benchmarks. The increased constraint promotes market inefficiency.

Why would investors allow themselves to be constrained like that? Surely they'd prefer to take advantage of opportunities wherever they can find them as opposed to only in small caps, large caps, financials, industrials, bonds or property – all approaches that are bound to end badly for their investors when those segments of the market are overvalued.

In his book 'Value Investing: Tools and Techniques for Intelligent Investing', James Montier highlights a telling passage by Robert Kirby, a leading fund manager at Capital group in the 1970s:

'Performance measurement is one of those basically good ideas that somehow got totally out of control. In many, many cases, the intense application of performance measurement techniques has actually served to impede the purpose it is supposed to serve – namely, the achievement of a satisfactory rate of return on invested capital. Among the really negative side-effects of the performance measurement movement as it has evolved over the past ten years are: 1. It has fostered the notion that it's possible to evaluate a money management organization over a period of two or three years – whereas money management really takes at least five and probably ten years or more to appraise properly. 2. It has tried to quantify and formulize, in a manner acceptable to the almighty computer, a function that is only partially susceptible to quantitative evaluation and requires a

substantial subjective appraisal to arrive at a meaningful conclusion.'

The negative impact of benchmark tyranny on the side of clients and consultants is reinforced by benchmark hugging on the side of investment managers and is eloquently summarised by Jeremy Grantham when he talks about the concept of career risk.

Grantham says that people get in trouble for being wrong on their own, but not for being wrong as part of a group. So even though investors can only outperform if they take positions that are different from the rest, their safest path is to look pretty much like everyone else. Investment managers have a disincentive to try to outperform.

The same thinking gives rise to statements in the media by portfolio managers such as 'you must be crazy to invest in platinum companies right now'. Or, in the words of a well-known market commentator: 'there's no need to invest in such shares, what's important is buying (momentum) and getting out of the door before everyone else'. Astoundingly, this same market commentator runs a fund with a 'value' label (!).

1.1.2 The investment opportunity set in South Africa is very limited

The size of an investment manager's assets under management relative to the opportunity set matters greatly. Wide flexibility, such as the ability to invest a significant portion of assets offshore or in other asset classes, can be a major advantage, giving one a better chance to own a portfolio of undervalued assets. This is particularly relevant in South Africa with its narrow investment universe and shallow market depth.

The JSE All Share Index comprises only 160 companies. Approximately 68% of the market capitalisation is concentrated in the top 10 stocks (adjusting for free float) and 80% in the top 20. In other words, a limited opportunity set that shrinks rapidly as the asset base of an investment manager grows and their ability to invest in smaller companies diminishes.

Assume, for example, that 3% of an asset manager's portfolio represents a meaningful position and that the maximum practical stake in a company is 20%. This implies that an investment manager with R20 billion in assets under management has 97 stocks to choose from and one with R100 billion only 46. With a limited opportunity set, investors are forced to play a relative value game as opposed to an absolute one. This is where 'investing' in an undervalued stock instead becomes 'speculating' that an expensive stock will become even more expensive – an approach that doesn't protect against the risk of permanent loss of capital, and as such, doesn't qualify as 'investing' in our minds.

In addition, those companies that may be too small to invest in present an attractive investment opportunity. Recent studies suggest that small cap stocks don't outperform large cap stocks over time. However, small caps rotate through periods of greater neglect and demand, which lead to wider valuation swings than in large caps. For example, small caps became very cheap in 2009/10 and were a major investment opportunity for managers small and patient enough to take advantage of them. Spin offs of smaller companies such as Astral, Spar and Adcock Ingram, all of which came out of Tiger Brands, have also created excellent investment opportunities in the past.

1.1.3 Foreign ownership of the South African market has increased considerably

In recent years foreign ownership of the South African market has grown significantly, further limiting opportunities available to South African managers. Today 34% of the South African equity market is foreign owned, approximately double what it was ten years ago.

In recent times, foreign buying has targeted mostly domestic or emerging market focused industrial or consumer shares. The strong buying has contributed to the share prices and valuation multiples of these companies rising to all-time highs.

A good portion of the foreign buying is longer-term institutional investment from companies such as Barclays (in ABSA), ICBC (Standard Bank) and Wal-Mart (Massmart) and is unlikely to reverse any time soon. Another portion, however, is from pension funds that are more prone to reverse when things turn out worse than expected, which they often do when valuations are expensive. It's striking from Tables 1 and 2 that some of the most overvalued shares in the South African market are those that have seen the strongest buying by foreigners and some of the most undervalued shares have seen the strongest selling by foreigners. It's probably fair to say from the evidence that the pattern of buying and selling by foreigners has contributed to a momentum effect in industrial shares such as food and clothing retailers, and a value effect in resources shares such as platinum and steel companies. RE:CM client funds own none of the top 20 foreign-owned shares and four of the ten most foreign-sold shares.

TABLE 1:
Top 20 Foreign-Owned South African Stocks, Exculding Dual Listed Shares (% Free Float)

	Stake bought/sold in the last 3 years	Stake bought/sold in the last 7 years	Foreign ownership at 31 Oct 2012
Massmart	12.9	22.4	81.4
Harmony Gold	3.9	3.8	76.4
Gold Fields	-6.2	0.0	74.0
Truworths	9.9	40.7	65.7
Anglogold Ashanti	-8.0	-0.1	64.1
Clicks	38.8	52.5	58.7
Naspers	1.2	20.0	55.1
MTN	9.0	30.3	52.5
Tiger brands	23.5	21.4	51.6
Life Healthcare	50.1	50.1	50.1
Shoprite	14.4	34.5	49.7
Impala Platinum	-9.2	3.4	49.2
Kumba Iron Ore	5.0	24.5	48.5
Bidvest	23.5	31.0	44.9
Vodacom	31.4	29.3	44.5
Barloworld	17.1	16.7	44.1
Spar	29.8	32.0	43.8
African Rainbow Minerals	-14.9	11.9	42.7
Sanlam	7.7	11.7	42.5
Mr Price	23.8	37.2	42.4
Foschini	7.5	13.2	42.2
Woolworths	24.2	31.1	41.4

Source: McGregor, UBS, RECM analyst

TABLE 2:
Largest Stakes Sold By Foreign Investors in South African Stocks (% of Free Float)

	Stake sold in the last 3 years	Stake bought/sold in the last 7 years
Aspen Pharmacare	-23.7	8.7
Anglo American Platinum	-16.2	-16.3
African Rainbow Minerals	-14.9	11.9
Illovo Sugar	-11.5	12.9
Aveng	-9.9	7.4
Sappi	-9.5	-35.0
Impala Platinum	-9.2	3.4
Sun International	-8.1	-14.1
Anglogold Ashanti	-8.0	-0.1
ArcelorMittal SA	-7.6	-7.8

Source: McGregor, UBS, RECM analyst

1.2 Human nature isn't suited to exploit the value anomaly

Value investing goes against human nature. As a result, too few investors practice value investing for it to stem the tide of momentum investing, especially in late stage bull markets. Let's examine the psychological attributes which make it hard for us humans to be value investors.

1.2.1 Herding

Even when people have high conviction, they often capitulate when faced with an overwhelming majority. People worry about what others think and as a result, they don't act independently. In fact, neuroscientists have found that people feel social pain in exactly the same parts of the brain as real physical pain.

Momentum investing involves going with the crowd and is more consistent with human nature than value investing, which is contrarian and socially painful. In the end, most people simply lack the discipline to stick with value investing for long enough for it to bear fruit.

1.2.2 Short memories

We live in a mean-reverting world, but when anticipating the future people tend to place more weight on their recent experience than the distant past – they tend to extrapolate recent history. The large majority of sell-side firms and professional investors do the same. They don't attempt to estimate intrinsic value which would have to take into consideration long-term history. Instead, they calculate a 'target price' – an estimate of the share price in the near term based on a forecast of earnings in the next year or two.

Failure to account for mean reversion typically culminates in significant over-optimism about the future at the top of a business cycle and excessive conservatism at the bottom. This leads to large fluctuations of share prices around intrinsic value.

1.2.3 Loss aversion

People tend to favour an immediate small gain over a bigger more distant one. They also feel the pain of loss twice as much as they derive pleasure from an equal gain. Investors consequently tend to shun or eventually abandon strategies that involve short-term (relative) losses. For the same reasons investors avoid 'losers' and love 'winners'. They often overpay for quality stocks, or what Howard Marks refers to as 'head-nodders' and overpay for growth or 'story stocks'. For example, if someone mentions shares such as BAT, Shoprite, Mr Price or Capitec, almost everyone nods and says 'great company' or 'great story'. Everyone loves a good story, especially if supported by recent share price performance. Such comfort and excitement sits well with clients too and as a result, value investors are likely to be fired more hastily when they underperform for not holding such shares in their clients' portfolios.

Clients tend to think about asset managers the same way investment managers think about stocks: Buy recent performance. This amplifies the momentum in the market as new client funds are allocated to managers that buy stocks where the recent performance has been good and away from where it has been poor.

1.2.4 Self-preservation and self interest

Buying value stocks even if value is established quantitatively should provide excess returns. In fact, there is a strong case to be made for formula investing both logically and empirically. Formulas can reduce complexity, remove emotion, act quickly, execute long term and reduce fees – all traits of a good investment approach. It makes sense and if enough investors did it, it would significantly dent or eliminate the value anomaly.

There are however a few reasons that formula investing hasn't taken off:

Overconfidence – most asset managers believe they have superior knowledge and will therefore make superior decisions. So they rely on their stock picking skills, which are often based on erroneous rules of thumb and intuition rather than a consistent process with checklists. It doesn't make business sense for active managers who earn active management fees or for their consulting clients. It's hard to sell – most clients like a good story over some rigid quantitative process. It isn't nearly as interesting or as much fun. Most people lack the discipline to stick with it, much like a good investment process.

2 Future relative performance tends to be inversely related to past performance.

The recent underperformance of absolute value managers like ourselves has come not so much from what we owned but from what we chose not to own. To protect investors against a permanent loss of capital we have avoided overvalued shares that have become even more expensive.

Chart 1 illustrates this point. The foreign-bought industrial shares that we discussed earlier, represented by the Industrial Index 25 (INDI25), traded above its long-term price-to-book ratio a year ago. This is an indication that it was overvalued at the time. Since then it has gone even higher. On the other hand, resource shares were trading at a 40% discount to their long-term average a year ago, and have largely been flat to down since then. RE:CM has been reducing exposure to industrials and increasing exposure to resources for its clients over the past year.

Chart 1 accurately reflects our bottom-up views of companies on the JSE as well. As a whole the All Share Index appears to be trading close to intrinsic value, financial shares slightly above intrinsic value, industrial shares appear very expensive and resources shares very attractive.

It is striking that during the past 10 years, these indices were undervalued and expensive at approximately the same times. Today the converse is true with an extremely wide valuation gap between expensive industrial shares and undervalued resource shares.

Chart 1:
ALSI, FINI15, RESI20 and INDI25 Price-to-Book Deviation from Long Term Average

Source: Bloomberg, RE:CM analyst

Consequently, portfolio positioning or stock-picking matters greatly right now.

In the short term, momentum shares may keep outperforming value shares, but longer-term the outlook for value is considerably better. To us it appears that value shares stand to significantly outperform momentum shares in the future. No one knows exactly when prices will reverse but normally it happens too quickly for investors to then adjust their portfolios (and 'be out the door before everyone else'). We therefore believe it is an opportune time for investors to invest with steadfast value managers.

Market performance

investment market performance

period to 31 January 2013	Index	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
South African equity	JSE All Share Index	23.7%	18.3%	11.4%	13.9%	19.90%
South African equity	SWIX	25.4%	19.2%	12.6%	14.2%	20.8
South African fixed interest	SA All Bond Index	13.7%	13.1%	11.1%	9.0%	10.50%
South African property	SA Listed Property Index	31.0%	24.8%	18.9%	18.2%	25.9
South African cash	STefI (3 month NCD's)*	5.3%	5.7%	7.4%	7.8%	8.10%

*Short Term Fixed Interest Index**

investment market performance

period to 31 January 2013	Index	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
international equity	MSCI World (unhedged) Index (USD)	15.9%	10.3%	1.4%	3.1%	8.4%
international fixed interest	Barcalays Capital Global Aggregate (unhedged) Index (USD)	1.7%	4.7%	4.7%	5.9%	5.8%
international property	UBS Global Investors Index "(USD, unhedged, net divs)"	19.8%	17.5%	2.6%	3.4%	11.3%
US dollar	LIBID 7 Day (USD)	0.2%	0.2%	0.6%	1.9%	1.9%
euro	LIBID 7 Day (EUR)	0.2%	0.5%	1.2%	1.8%	2.0%
pound sterling	LIBID 7 Day (GBP)	0.5%	0.6%	1.4%	2.5%	3.0%

breakdown of local share market performance by sector

period to 31 January 2013	% of ALSI	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
Top 40	84.0%	23.5%	17.7%	10.5%	13.5%	19.2%
Mid Cap	14.0%	24.0%	21.7%	17.9%	16.6%	23.8%
Small Cap	3.0%	28.6%	19.3%	11.1%	14.9%	25.6%
oil and gas	4.0%	1.7%	14.9%	5.6%	10.4	n/a
basic materials	28.0%	0.1%	5.9%	0.8%	8.8%	12.5%
industrials	6.0%	28.4%	19.5%	11.9%	13.4%	21.6%
consumer goods	21.0%	49.5%	31.7%	27.5%	24.4%	26.4%
health care	3.0%	52.2%	29.9%	28.7%	20.5%	26.7%
consumer services	10.0%	36.2%	32.0%	27.9%	20.6%	29.4%
telecommunications	7.0%	35.3%	22.4%	11.6%	16.7%	29.6%
financials	21.0%	34.3%	20.7%	14.1%	11.8%	19.3%
technology	0.0%	23.9%	29.8%	21.4%	18.7%	23.4%

The FTSE Group and the Dow Jones Indices have created a new definitive industy classification standard. The Industry Classification Benchmark indices were implemented by the JSEon 1 January 2006

Market performance

breakdown of international market performance by country

period to 31 January 2013	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
United States: S&P 500	14.1%	11.7%	1.7%	2.3%	5.8%
Germany: DAX	20.4%	11.5%	2.6%	4.6%	11.0%
United Kingdom: FTSE 100	10.5%	6.6%	1.3%	1.2%	5.8%
France: CAC	13.2%	-0.1%	-5.2%	-3.9%	2.4%
Japan: Nikkei	26.5%	3.0%	-3.9%	-5.6%	2.9%
Hong Kong: Hang Seng	16.4%	5.7%	0.2%	6.0%	9.9%

all returns are calculated in the respective local currencies and are based on index levels

currency exchange rates

period to 31 January 2013		1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
ZAR/USD	8.9597	-13.1%	-5.3%	-3.5%	-5.4%	-0.5%
ZAR/EUR	12.1921	-16.4%	-4.7%	-1.9%	-7.0%	-2.8%
ZAR/GBP	14.2148	-13.6%	-5.0%	0.9%	-3.8%	-0.1%
ZAR/JPY	0.0978	4.6%	-4.8%	-6.4%	-8.7%	-3.2%
USD/EUR	1.3610	-3.9%	0.6%	1.8%	-1.6%	-2.3%
USD/GBP	1.5870	-0.7%	0.2%	4.6%	1.6%	0.4%
USD/JPY	0.0109	20.2%	0.5%	-2.9%	-3.4%	-2.6%

Market performance

economic indicators

economic growth	%	inflation	%
SA real GDP growth "(3rd quarter '12, annualised q-oq) "	1.2%	SA CPI (y-o-y change for September)	5.7%
US real GDP growth "(4th quarter '12, annualised q-oq) "	-0.1%	US CPI (y-o-y change for September)	1.7%
Euro area real GDP growth "(3rd quarter '12, annualised q-oq)"	-0.3%	Euro area CPI (y-o-y change for October)	2.0%
Japan real GDP growth "(3rd quarter '12, annualised q-oq)"	-3.5%	Japan CPI (y-o-y change for September)	-0.1%
global developed markets real GDP growth "(3rd quarter '12, annualised q-oq)"	0.9%	G7 CPI (y-o-y change for September)	1.7%
interest rates		**commodities**	
SA repo rate	5.00	gold (London PM fix in USD as at 31 October)	1664.75
SA prime overdraft rate	8.50	y-o-y % change	-4.5%
US Fed Funds rate	0.25	platinum (London PM fix in USD as at 31 October)	1672.00
ECB refinancing rate	0.75	y-o-y % change	3.0%
BoJ overnight call rate	0.10	brent crude oil (USD)	115.53
BoE repo rate	0.50	y-o-y % change	4.4%

Market performance

investment market performance

Period to 31 January 2013	Index	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
International Equity	MSCI World (unhedged) Index (USD)	15.9%	10.3%	1.4%	3.1%	8.4%
International Fixed Interest	Barclays Capital Global Aggregate (unhedged) Index (USD)	1.7%	4.7%	4.7%	5.9%	5.8%
International Property	UBS Global Investors Index "(USD, unhedged, net divs)"	19.8%	17.5%	2.6%	3.4%	11.3%
US Dollar	LIBID 7 Day (USD)	0.2%	0.2%	0.6%	1.9%	1.9%
Euro	LIBID 7 Day (EUR)	0.2%	0.5%	1.2%	1.8%	2.0%
Pound Sterling	LIBID 7 Day (GBP)	0.5%	0.6%	1.4%	2.5%	3.0%

breakdown of international market performance by country

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France: CAC	13.2%	-0.1%	-5.2%	-3.9%	2.4%
Japan: Nikkei	26.5%	3.0%	-3.9%	-5.6%	2.9%
Hong Kong: Hang Seng	16.4%	5.7%	0.2%	6.0%	9.9%

STERLING PRIVATE WEALTH

Sterling Private Wealth (Pty) Ltd
Ground Floor, Block B, 19 Impala Road, Chiselhurston
Private Bag X9978, Sandton 2146
t. 2711 883 8828 **f.** + 2711 783 0091
www.sterlingwealth.co.za