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Dear

November 2014 was a month where the overextended South African consumer finally found some short-term relief – perhaps an early Christmas present. The oil price has slipped to five year lows off the back of OPEC's decision to refrain from cutting back daily output. The lower oil price has filtered through to the pricing of many items, including the large components within our CPI basket of food and transport. This meant that for the second month in a row inflation remained within the targeted band.

The lower inflation figure has allowed Mr Lesetja Kganyago, the new South African Reserve Bank Governor, to keep the Repo rate unchanged. He did however warn that he expected interest rates to normalise over time. This move was in stark contrast to China who dropped their interest rates to stimulate growth. This was a surprising move for many market participants and resource stocks all jumped on the announcement with the anticipation of greater demand.

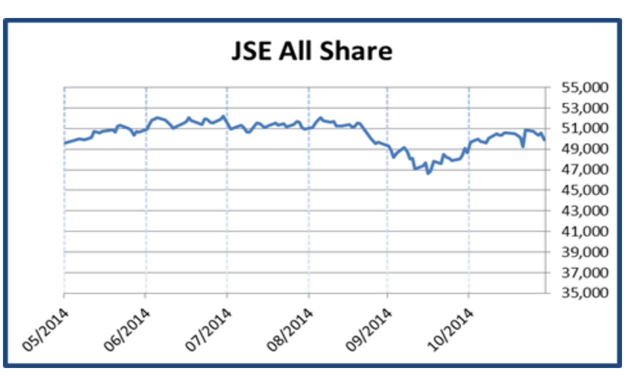
Unfortunately for these resource stocks any anticipated increase in demand has been offset by falling commodity prices as they followed the oil price lower. The resources sector lost in excess of 5% in the month with Sasol showing a massive 17% loss.

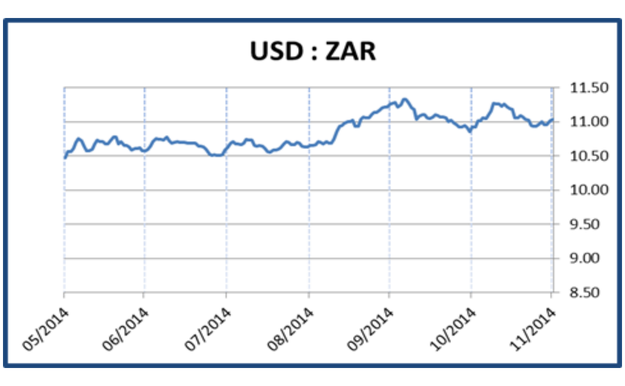
The trade deficit continues to disappoint with a further widening to R21.3bn in October. The South African Revenue Services (SARS) reported a staggering 17.8% increase in imports whilst exports decreased by just under 2%. Going forward imports should be positively impacted by the lower oil price but unfortunately our exports are going to be negatively affected by the lower commodity prices. The Rand was surprisingly stable against a strong US Dollar and increased marginally against the Pub and the Euro. This should be positive for the trade deficit.

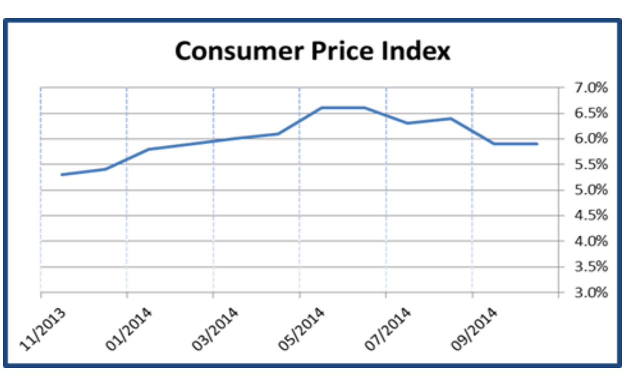
The local economy continues to struggle with structural problems. We thus remain cautious on downside risk to the local markets and the currency.

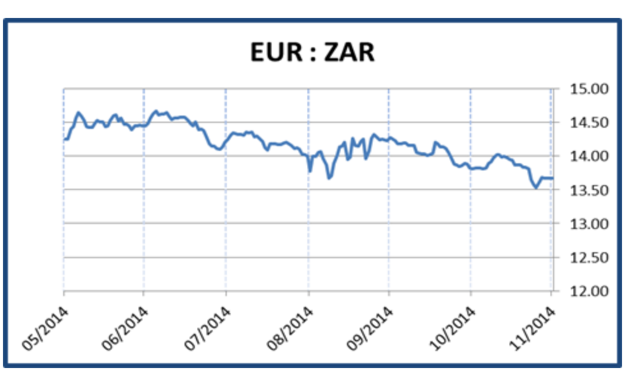
Magwitch Securities

MARKET INFORMATION









FINANCIAL PRODUCT IN FOCUS

DIVIDENDS

In our Financial Product in Focus this month we look at dividends, paying specific attention to those earned on listed investments. Dividends can be defined as a distribution of a portion of a company's earnings, decided by the board of directors, to a class of its shareholders. It is one method for a shareholder to realise a return on their investment, the other is through the eventual sale of the investment.

Why does a company pay a dividend?

The starting point in understanding dividends is to understand the reason that companies make distributions to their shareholders. A dividend is most commonly distributed via a cash distribution to shareholders. When the company pays a dividend they are reducing their cash reserves and reducing the size of their balance sheet so is it in their interest to pay a dividend?

The reason is that the companies' interests need to be aligned with the interests of their shareholders. Shareholders invest in companies in order to enjoy meaningful returns from their investment. Many investors prefer regular income from their investments which dividends will provide. The share price of the company is also determined by demand for that share, the more attractive the share the greater the probability the share price will rise. Because dividends tend to attract investors one would generally see a shareholder in a dividend paying company benefitting from both the dividend and the share price growth. The share price growth will be realised when they eventually sell their investment.

High growth companies that trade on high Price Earnings ratios tend to pay lower dividends as they theoretically feel it would be in shareholders' interests to reinvest their cash reserves into the business to achieve these high growth rates. High dividend payers are thus generally more mature companies that already have dominant market share within their industry. It is why it is often said that dividend paying blue chip shares are less risky than growth shares.

How to measure a dividend?

As companies have different numbers of shares in issue the easiest way to compare dividends is to look at the dividend yield of the individual companies. The dividend yield is a financial ratio calculated on the following basis:

$$Dividend\ Yield = \frac{Annual\ Dividends\ per\ Share}{Price\ per\ Share}$$

The higher the dividend yield, the greater return that the investor is receiving in the form of dividends per year. A ratio in excess of 4% is generally considered to be a high dividend yield within the South African stock market context.

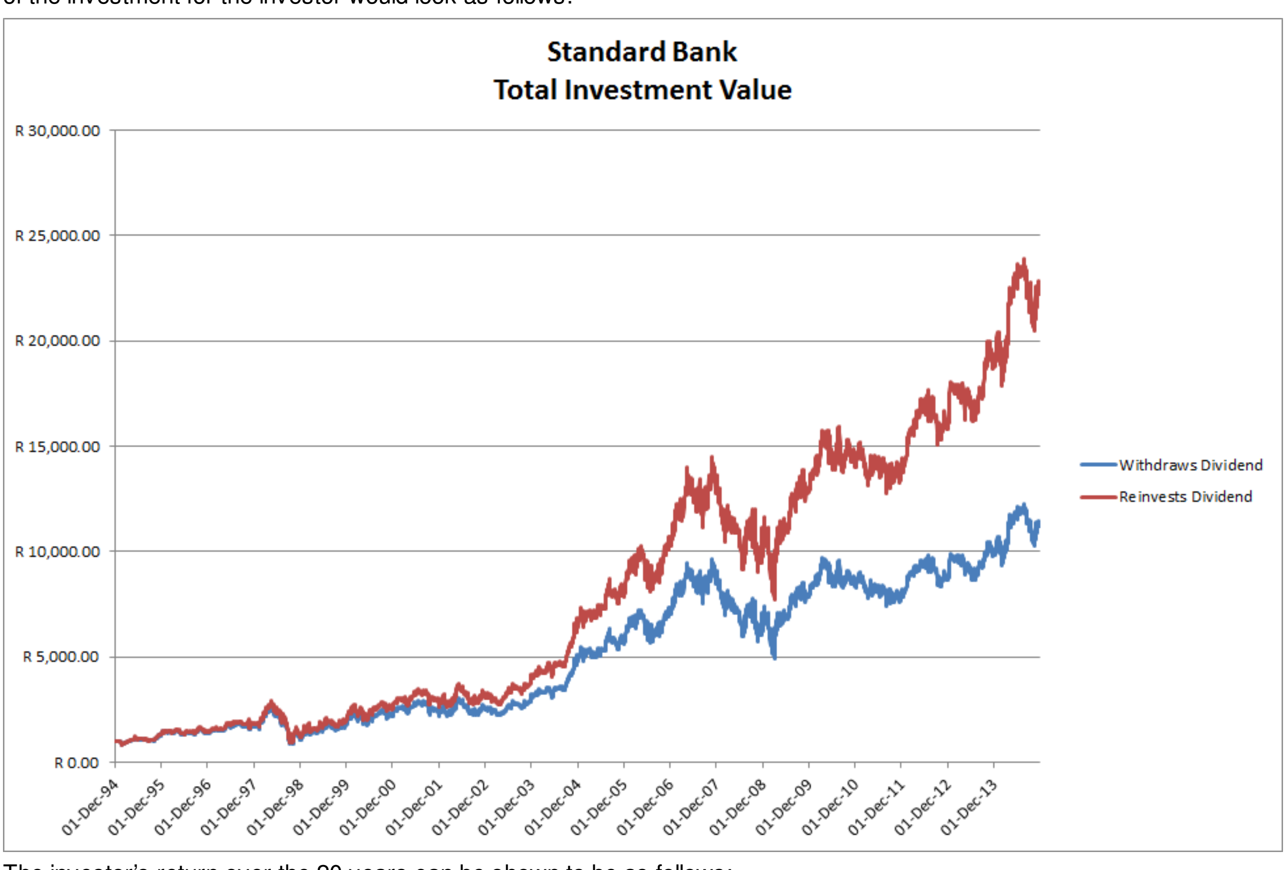
What should the investor do with their dividend?

The investor would need to assess their income requirements when they decide what to do with the dividends that they receive. If they have monthly expenses that need to be covered by their investment then the dividend can be viewed as income from the investment and applied to cover the expenses. If the investor has no immediate requirement, it may be in their interests to reinvest their dividends into the company, purchasing additional shares to generate greater dividends the following year. The compounding effect will ensure that the investor's investment balance will grow quicker, assuming that the share price of the company increases.

In order to demonstrate the two options we will look at how dividends can impact on the returns for an investor.

In the first example we have selected one of South Africa's big 4 banking stocks. The larger banks within South Africa are well established and have a history of paying decent dividends. They do have to continually reinvest back into their business to ensure that they grow their service offering and their geographic footprint but still have the cash flow to declare and grow dividends. The bank's current dividend yield is approximately 4.1%.

In the chart below we look at what would have happened if an investor had invested R1 000 into Standard Bank 20 years ago. The investor has the choice to receive the dividend in cash or to invest it back into the share (for the purposes of this calculation we assume that fractional shares could be held). We have not accounted for taxes on the dividends. The value of the investment for the investor would look as follows:

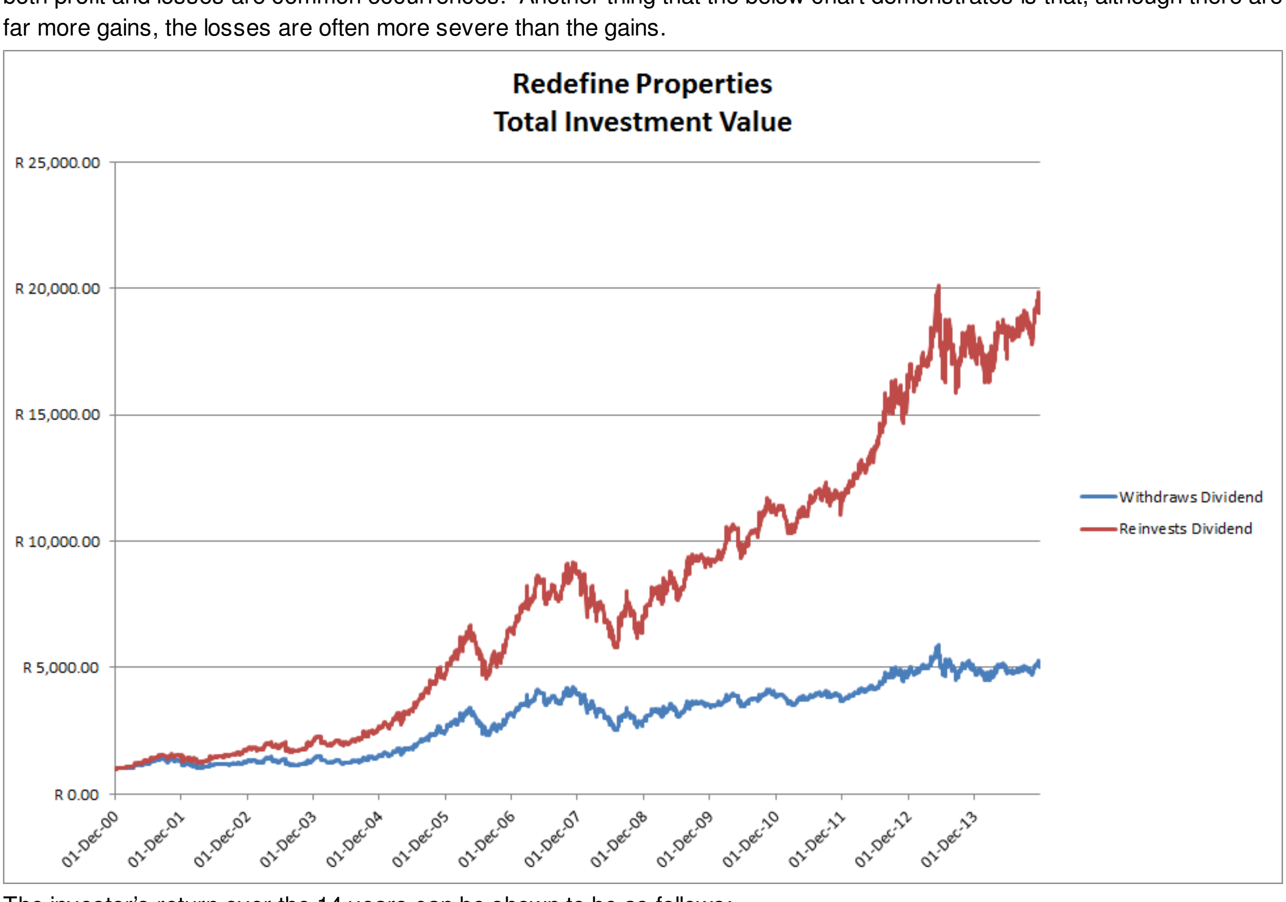


The investor's return over the 20 years can be shown to be as follows:

	Share Price Movement	Withdraws Dividend	Reinvests Dividend
Initial Investment	-R 1,000.00	-R 1,000.00	-R 1,000.00
Closing Investment Value	R 11,164.31	R 11,164.31	R 22,201.96
Dividends Received	R 0.00	R 3,901.22	R 6,163.89
Dividends Reinvested	R 0.00	R 0.00	-R 6,163.89
Return	R 10,164.31	R 14,065.53	R 21,201.96
Return Annualised	12.29%	14.13%	16.50%

Stock market volatility is driven by sentiment around the future share price performance of the listed companies. Volatility is often referred to as the index of fear and greed. Share price is driven by supply and demand and represents how much an investor would be willing to pay for a share of the accumulated and future profits of the company. The future profits of a company cannot be predicted with 100% accuracy and thus news, both good and bad, can affect the investor's estimate of the future profit and ultimately the future share price. When news is perceived to be bad the investor would typically be willing to sell the share whilst another investor may believe that there is value in the share at a lower price and thus the share price moves down to the price that the new investor is happy to pay. When news is perceived to be good then a buyer will be willing to pay a premium to buy into the stock and the seller happy to only sell at a higher price.

Moves are often exaggerated in the short term and if we look at monthly movements in the stock market we can see that both profit and losses are common occurrences. Another thing that the below chart demonstrates is that, although there are far more gains, the losses are often more severe than the gains.



The investor's return over the 14 years can be shown to be as follows:

	Share Price Movement	Withdraws Dividend	Reinvests Dividend
Initial Investment	-R 1,000.00	-R 1,000.00	-R 1,000.00
Closing Investment Value	R 5,153.02	R 5,153.02	R 19,412.00
Dividends Received	R 0.00	R 3,475.91	R 8,482.86
Dividends Reinvested	R 0.00	R 0.00	-R 8,482.86
Return	R 4,153.02	R 7,628.93	R 18,412.00
Return Annualised	10.71%	15.62%	23.13%

The higher dividend yield does magnify the benefit of the dividend as the investor has received an additional average annual return of 4.91%. If they had reinvested the dividend the average annual return would have been a further 7.51% larger. It is important to note that property shares have enjoyed super returns over the last 5 years as artificially low interest rates have kept their debt obligations to a minimum.

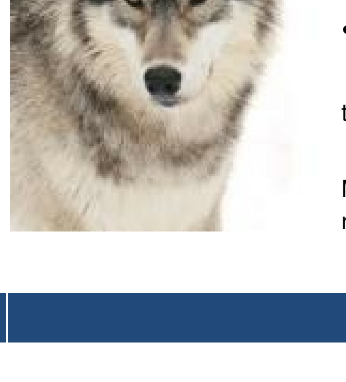
Conclusion

Dividends are a critical component of investing and can allow the investor to use the income generated from the shares to buy more income generating shares. They ensure that the investor can enjoy regular returns from investments without having to wait until the end of the investment to realise a return. In all the examples used the investor received more in dividends than their original investment – meaning that if nothing else they cannot lose money on the investment.

You could look to apply the same principles to your unit trust investments by reinvesting the dividends received and interest earned.

We at Magwitch believe that the large dividend paying blue chip companies are good investments to form the backbone of any investment portfolio. We are happy to advise investors as to the appropriate use of dividends within their portfolio.

ABOUT MAGWITCH



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