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Dear

July 2015 saw the Rand hitting a 14 year low against the US Dollar and the Pound. This has been driven by the continued weakness of commodity prices and also improving economic data out of the US leading to many market commentators predicting a US interest rate hike at the Federal Reserve's next meeting in September. A rate hike in the US would increase the appeal of a cash investment in developed economies, which in turn requires a divestment from emerging economies. JP Morgan have stated that there is a 55% chance of a rate hike occurring at the next meeting.

South Africa moved earlier and local interest rates were hiked by 0.25% during the month. The Reserve Bank Governor indicated that there is a concern about the likely inflation trajectory, highlighting that the Rand remains vulnerable. The increased repo rate should apply pressure on inflation in the short term and provide a greater return for investors in the South African market.

The other big event in the month was the ongoing "Grexit" saga. Greece finally agreed to a bailout deal that will allow them to remain as part of the European Union. This may not be the end of this story though as many agreed items contained in the bailout deal contradict the wishes of the Greek population. Earlier in the month Greece held a referendum where the population voted against the austerity measures that were later agreed to.

The South African stock market was volatile during the month but ultimately ended flat. The temporary resolution of the Greek crisis had led to a strong rally in global markets in the first half of the month. South Africa however was unfortunately influenced by reduced commodity demand and this caused our commodity heavy stock market to come off during the second half. Global commodity demand is driven by China and they are currently experiencing a stock market crash. Elevated corporate valuations created a gap between stock market prices and the intrinsic fair value of those entities. In the months of June and July these prices have reverted back to more reasonable levels. The Shanghai Composite Index has lost 30% since its peak in mid-June.

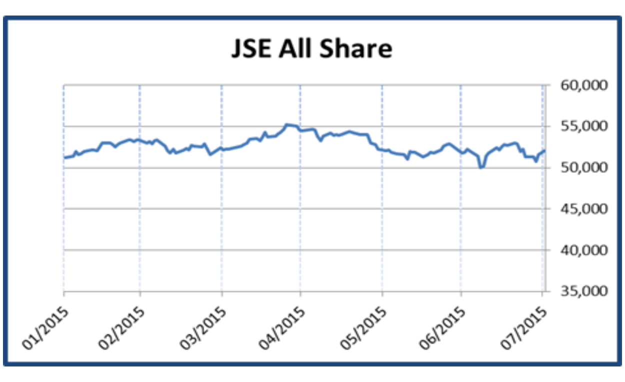
Locally inflation surprised with a lower than anticipated figure of 4.7%. This was driven by a reduction in the prices within the food and non-alcoholic beverages sector. There have been increases in the maize price and they will filter through into various food prices causing inflation to increase over the next few months.

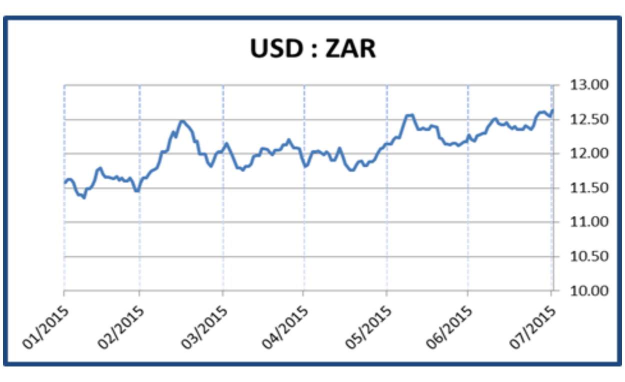
Another positive was the balance of trade where a surplus was reported for the second consecutive month, driven by increased exports of vehicles and a reduction in the oil price for imports.

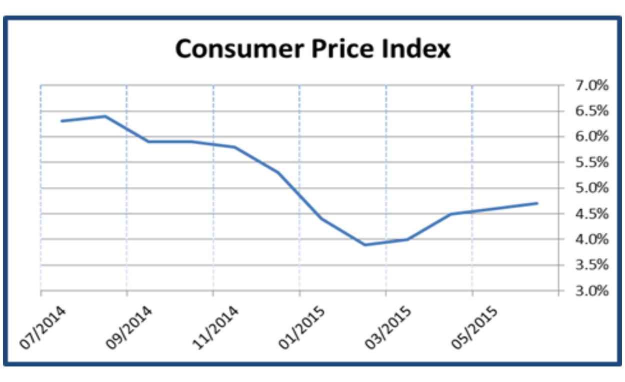
With the reduced valuations in the local stock market it does appear that there are a few more opportunities for the astute investor.

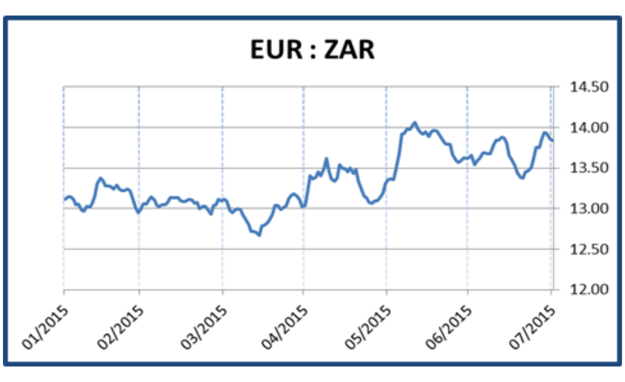
Magwitch Securities

MARKET INFORMATION









FINANCIAL PRODUCT IN FOCUS

BALANCED FUNDS

In our financial product in focus this month we look at "Multi Asset High Equity" funds, generally known as balanced funds. The reason that they are termed as "balanced funds" is that they have a mandate to invest in a number of different asset classes resulting in a balance between growth and protection.

These funds are ideal for the investor who wishes to use an investment professional to make the asset allocation decision. The asset manager is able to increase and decrease exposure to riskier growth assets throughout the investment cycle in order to take advantage of market movements. In this article we will look at how this benefits the investor, especially in times of excessive market volatility.

Balanced funds are currently the most popular investment choice for investors owning unit trusts. The assets within the retail high equity sector have grown by 68% over the last 2 years whilst the entire unit trust industry has grown by 30% over the same period. The high equity sector now accounts for 26% of all investments.

The huge inflow of investment into the balanced funds space is driven by two factors:

Retirement industry

The retirement industry is collectively the biggest investor in South Africa. One just needs to look at the large skyscrapers in Johannesburg and Sandton to see some of the physical assets held by the retirement funds. These physical assets however are dwarfed by the retirement industry's investment into shares of listed and unlisted companies.

In order to limit the risk of loss within retirement savings Regulation 28 of the Pension Funds Act was implemented in 2011, imposing prudential investment guidelines for retirement funds. Certain regulation 28 limits are identical to the category criteria for a unit trust to be considered a high equity unit trust.

Investment companies generally receive their fees as a percentage of assets under their management. In order to grow their assets under management and maximise their revenue they need to be able to attract investment from the largest investors, which as mentioned previously is the retirement industry. The majority of investment companies thus have regulation 28 compliant funds and this is evidenced by the very large high equity unit trust sector.

Regulation 28 aims to protect investors from over exposure to high risk asset classes as well as forcing the creation of a well-diversified portfolio. The limits are applied at asset class level as well as at individual issuer level. An example of this would be that regulation 28 applies no limit on cash holding so a fund can be invested wholly into cash. The fund is however limited to not holding more than 25% in any individual bank. This diversification spreads the investment risk and has often been referred to as the only free lunch within investing.

The regulation 28 limit on growth assets can be demonstrated as follows:

Asset Class	Regulation 28 Limit
Equities (Local and Offshore)	75%
Property (Local and Offshore)	25%
Offshore investments	25%*

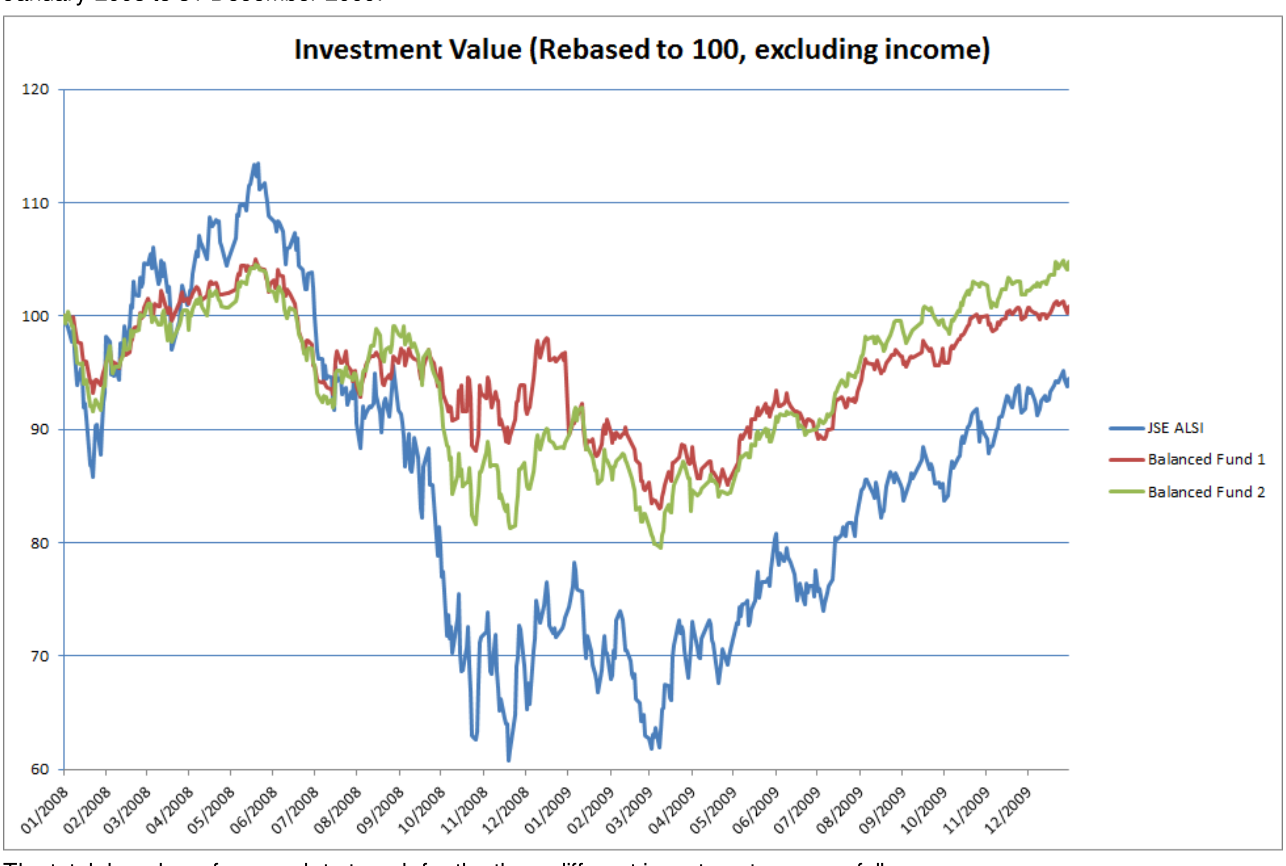
*Offshore investments are measured as the sum of all non-South African investments within the fund. It includes investments into cash, bonds and other asset classes.

Risk Aversion

As balanced funds are limited in their allocation to growth assets they also have to have holdings in conservative assets. These investments into bonds and cash reduce the risk of the fund as these asset classes have lower risk of capital loss.

In order to demonstrate how a more conservative allocation protects against downside risk one can look at what happened during the 2008 Global Financial Crisis ("GFC"). The GFC was the worst market crash since the Great Depression and whilst South Africa's financial stocks were not guilty of the same practices as their foreign counterparts we still had a huge knock on into our resources dominated index as commodity demand all but dried up.

We have plotted the performance of two of the largest balanced funds against the JSE All Share Index for the period from 1 January 2008 to 31 December 2009:



The total drawdown from peak to trough for the three different investments was as follows:

Investment	Return for 2008	Drawdown from Peak to Trough
JSE ALSI	-27%	-46%
Balanced Fund 1	-3%	-21%
Balanced Fund 2	-11%	-24%

So while an investment into the JSE would have lost you almost half your money the balanced funds would have lost less than a quarter.

Balanced fund managers acknowledge that they will underperform in a positive market due to their cash and bond holdings. They state however that their long term performance is always delivered through outperformance when the market comes off.

With equity valuations being at high levels many asset managers have increased their cash holdings within their balanced funds.

Conclusion

With current market valuations we believe that many investors need an element of protection within their portfolio. Balanced funds offer this protection however not all balanced funds are the same and the asset allocation will invariably be different from one asset manager to the next.

The high equity sector has 139 different funds ranging in size, investment style and investment experience. Magwitch do a huge amount of analysis amongst this sector and have a preferred fund list that we utilise determined by the due diligence work that we do. Where you are looking to reduce or diversify your risk come speak to us about an investment strategy that suits you.

ABOUT MAGWITCH

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- Estate Planning
- Foreign Exchange
- Money Market
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