THE STERLING TIMES 1

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STERLING
PRIVATE WEALTH

Inside this issue

Welcome by
Graydon Morris

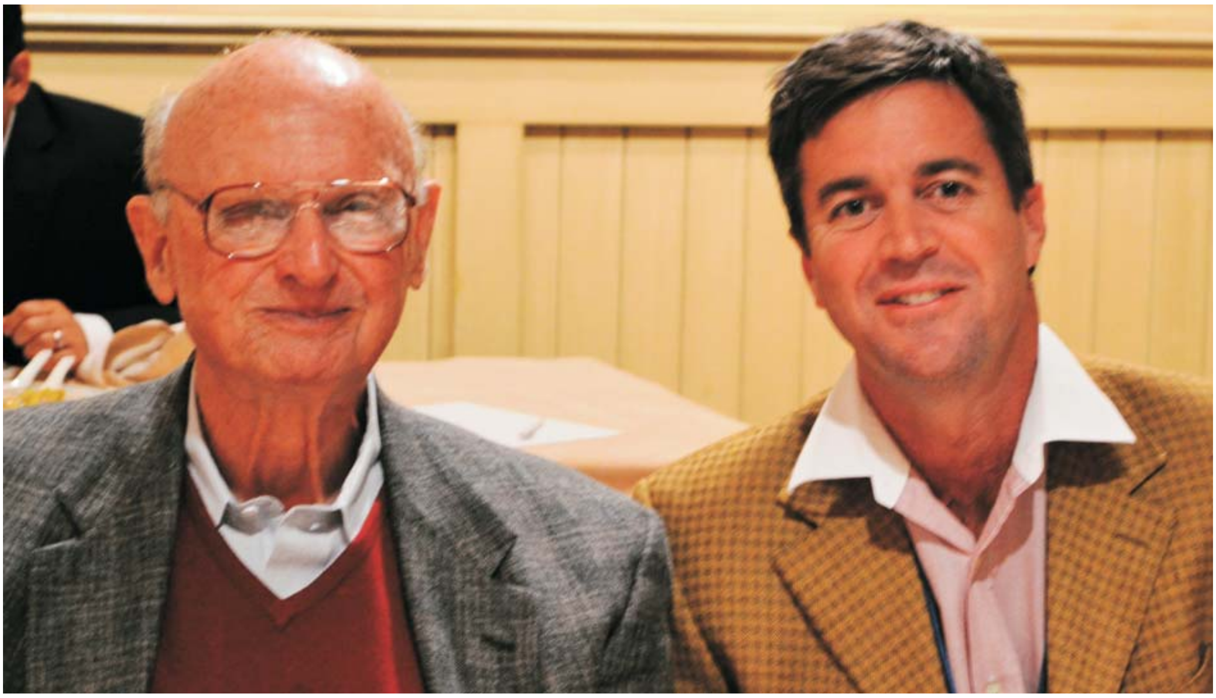
Welcome to you all, clients and friends of Sterling Private Wealth, to the first edition of the Sterling Times. This publication will be produced three times per annum, at the end of January, July and November each year. We shall aim to keep you updated in terms of developments in our business, market and investment conditions, as well as technical input from a variety of our business partners, in terms of general wealth management issues. We trust you find our regular communication informative and thought provoking.

A high degree of personal interaction has always been a hallmark of our business, since our establishment in 2002. We aim to continue and enhance this interaction. Many of you would already have read our first two electronic newsletters, at end May and end June 2011. These will be produced regularly in the 9 months when the Sterling Times is not published. This communication, too, will provide condensed, and hopefully useful snippets of advice. During the course of the first few editions, we shall be introducing you to the Team, and familiarizing you with the personalities in the Sterling Family.

We thank each and everyone one of you, in this our tenth year, for the support and faith you have shown in our business, allowing it to grow and flourish. We are acutely aware of our tremendously important role as custodians of your family wealth and investments, and it is indeed a great privilege for us to assist you in planning your investment lives.

RA Panel Advisory Reportback

Graydon Morris



During the course of early May, I had the wonderful privilege of attending the Research Affiliates Annual Advisory Panel held in Laguna Beach, California. Around 50 attendees congregate annually at this forum to discuss and debate issues around the global investment landscape.

The luminaries in attendance include Nobel Laureate for Economics, Harry Markowitz, pictured here with Graydon Morris, Burton Malkiel, Princeton Professor and author of a Random Walk Down Wall Street, John Mauldin, Investment Scribe, and Rob Arnott, Founder of Research Affiliates. Brief CV's of each of these high profile investment specialists, are provided at the end of the summary of the Panel Advisory Discussions, below:

The 3-D Hurricane and the New Normal

Research Affiliates 2011 Advisory Panel Summary

The 2011 Advisory Panel meeting focused on two important topics: Debt, Deficit, and Demographics and the New Normal. These two concepts are interconnected, and they bode ill for the future of developed nations— while they point to a potentially bright one for emerging markets. But for rapidly aging developed markets with rapidly mounting deficits and debts, the results are sobering. In this summary, we present the critical insights from the AP presentations.

The 3-D Hurricane as the Driver for the New Normal

Debt, deficit, and demographics—the 3-D hurricane is heading to the shores of all developed economies. It threatens to derail the lukewarm economic recovery and to alter forever the heretofore path of robust growth for the developed world. In a sense, debt, deficit, and demographics will reset the world to a "New Normal"—an extended period of lower economic and return expectations.

Numerous high quality Advisory Panel speakers highlighted their views on the matters addressed below. These included: Ramin Toloui (PIMCO), James Bianco (Bianco Research), Lacy Hunt (Hoisington Investment Management), Burt Malkiel (Princeton University), Harry Markowitz (UC San Diego), John Cochrane (University of Chicago), Richard Roll (UCLA), Keith Ambachtsheer (KPA Advisory Services and University of Toronto) and Research Affiliates' Rob Arnott, Denis Chaves, and Omid Shakernia.

An Executive Summary of the Discussions over the three days is provided for your perusal.

Emerging economies with healthy government and household balance sheets, responsible fiscal policies, and young labor forces, will be the drivers for global growth and will compete with their developed counterparts for economic and political leadership. More importantly, the emerging economies will demand their fair share in the consumption of resources and goods. That competition for resources and goods will lead to higher prices at a time when developed countries are less able to further finance their consumption. As Ramin Toloui pointed out, finance plays a critical role in the real economy. Shocks to financing for the developed economies—whether through high interest rates due to poor sovereign credit risk or through the crowding out effect from government deficit financing— would have long-term effects on economic growth and the unemployment rate. By comparison, emerging countries have low debt-to-GDP ratios. Specifically, the Asian EM countries generally maintain trade surpluses and, therefore, also act as suppliers of global capital to the debt-laden developed economies. These healthier balance sheets, over time, mean that emerging economies would represent lower credit risk than many of their developed counterparts. The trend of declining credit spread for EM debt has been occurring for many years. Toloui argued that in the New Normal, emerging countries will not only converge with the developed countries, but in fact are likely to overtake many of them in short order. Toloui further asserted that the capital markets have not fully comprehended this pending reversal of fortune between the developed and developing economies. Rob Arnott's research on debt fundamentals for global countries also illustrated this point. Emerging economies currently are assessed higher credit spreads versus developed economies although they often have significantly better underlying collateral quality and debt capacity. This reflects an irrational bias on the part of investors, and Arnott suggested that it is not unfathomable that a re-pricing of developed market sovereign credit risk is forthcoming for even the most stalwart of the developed economies—Germany and the United States.

When Deficit becomes Odious Debt

Arnott and Lacy Hunt each explored the effects of deficit- driven stimulus programs. Both found that short-term growth, financed by deficit spending, rarely translates into sustained growth. The argument is that government- directed investments are often zero or even negative net present value (NPV) projects. From their perspective, government stimulus programmes are more about creating make-work jobs than valuable investment in infrastructure and education, which would drive future growth. The short-term increase in economic activities does not translate into future increase in production of valuable goods and services. In a true Keynesian sense, government recessionary expenditure aims purely to smooth temporary shocks; it cannot substitute for private sector investments which are necessary to drive long-term growth. Insofar that the government stimulus is financed by more debt, it necessarily translates into higher future tax burdens on the private sector, which then drains future private sector consumption and investments. By backward induction, a higher future tax burden decreases expected (after-tax) return on investments, which then reduces private sector investments today. Crowding out future and current private sector activities by the public sector growth today bodes ominously for future growth.

Indeed, under standard economic theory, the government either borrows to invest for future growth and therefore drive future tax revenue (funding higher education, subsidizing research and development, or building basic infrastructure, etc.), or it borrows to shift future consumption to the present in an attempt to ameliorate shocks to the economy. In reality, deficits have a tendency to become ever-increasing debt. We have been all too willing to believe the story that future growth driven by indomitable American ingenuity will deliver them from their debt. Unfortunately, unless another decade-long period of explosive technology innovation is in the cards for the UAS, they may have just now hit a wall:

The debt-to-GDP ratios for many developed countries have become untenable; additional borrowing capacity is small. What has driven this inevitable march toward self-destruction? In hindsight, the policy of persistent deficit spending seems utterly irrational and short-sighted.

However, one might argue that this outcome is exactly rational in the context of baby boom demographics prevalent in the developed countries. Deficit spending gives an instant and immediate boost to GDP, which can feel like prosperity and good government stewardship. The natural conflict between the future non-taxpayers and the future taxpayers means that Boomers, who have controlled the elections and politics, have rationally chosen a path of more consumption today at the expense of the future generations. Whether deficit spending truly has any significant impact on subsequent growth is rather irrelevant to the discussion; voters and politicians alike would simply misread the regression results and assume more consumption today will drive more growth tomorrow. In other words, and as scientific as one can put it—the Boomers have screwed Generation X.

The great deleveraging, which has been proposed as the only responsible course of action for the developed countries after the global financial crisis, never materialized and calls for fiscal austerity have largely fallen on deaf ears. As Arnott repeatedly pointed out, the Boomers around the world have written into law rich benefits for themselves, which have to be financed by tax dollars from future generations. Adding insult to injury, they have also pre-spent future tax revenues through massive deficit spending today. The combined weight of the explicit debt and implicit government-guaranteed obligations (such as state pensions and healthcare benefits) has begun to stress most of the developed economies and is already crushing some.

What Exactly Did QE2 Accomplish?

Mounting debts—whether implicit or explicit—are a long-term issue that Boomers are passing to the next generation. In the shorter term, many observers have focused on the recent U.S. government monetary intervention (namely, QE2). It is important that we understand exactly what resulted from the Fed's quantitative easing program. It is not entirely accurate or useful to equate quantitative easing to the printing of money. The Fed bought long-term Treasury securities from banks and issued interest-bearing reserves in return. As John Cochrane explained, when reserves pay interest, they are no different than T-bills; both are short-term government securities paying similar interest rates. Cochrane suggested that the appropriate way to think about QE2 is to recognize that the U.S. government simply refinanced its long-term bonds with short-term bills. If not for all the media hoopla, it has been an otherwise rather unspectacular shift in financing arrangement. No money was printed in the sense that the monetary base did not expand. Arguably, liquidity in the marketplace did not improve materially as banks do not appear to have reduced their government debt holdings in favor of other investments. Perhaps QE2 has had an impact on the interest rate? The evidence here is rather mixed. Hunt argued that long rates moved higher due to increased inflation expectation, while Cochrane presents evidence that Treasury yields experienced only a brief and temporary shock before recovering back to their old trend.

Both Jim Bianco and Hunt observed various indicators of increased speculation in the financial market (mostly from increases in speculative positions reported by commodities traders). They argued that the large excess reserve balances held by the banks allowed banks and their related investment arms to engage in greater risk taking. Bianco and Hunt hypothesized that banks used their low-yielding reserves as collateral to engage in financial speculation (instead of making loans). They claim these speculative activities seem to have resulted in higher commodity and stock prices. Certainly, both found ample evidence of Federal Reserve Chairman Ben S. Bernanke taking credit for the strong stock market performance as a result of the Fed's easing policy.

Changing Demographics

As the USA prepares for retiring Boomers (and the debt and deficits associated with them), it will also need to prepare for changing demographics—specifically, the adverse effects driven by the dramatic decline in the support ratio associated with an aging population. It is projected that the support ratio in developed markets will decline from 3.5 working age adults per retiree to below 2:1 by 2050. In comparison, in 1970, the support ratio was 5.3:1. Arnott's research showed that by 2025, at the height of Boomer retirement cycle in the United States, there will be 10 new retirees for each new entrant into the workforce. Not only does the future appear unenviably poor in aggregate, it also appears predictably unproductive.

People consume goods and services which are produced by workers. A sharp decline in the U.S. and developed country workforce means that Americans, and their European and Japanese counterparts, must either reduce consumption drastically or increase reliance on imports from emerging countries. Thus, the trade deficit between developed countries and the emerging countries must continue to widen aggressively or the standard of living for developed countries must decline precipitously. However, the only way for most developed countries to maintain (and increase) their trade deficit against the emerging countries is to borrow heavily from the emerging countries. If the PIIGS are any indication of what is to come, the balance sheet, and ultimately the credit rating, of the developed economies simply would not allow further aggressive borrowing.

Burt Malkiel observed that, empirically, demographic shifts have had little impact on markets. However, Malkiel conceded that the analysis could change dramatically at debt-to-GDP ratios above 90%. The linkage between demographics and debt cannot be overemphasized. Demographic shifts are generally considered to be non-risk events, in that they can be fully anticipated ahead of time. Economies with rational agents, saving, consumption, and investment decisions would allow individuals to largely manage the (adverse) effects of (unfavorable) demographic shifts. Boomers should have anticipated the untenable support ratios when they retire. They were supposed to save aggressively during their working years (and therefore delay pre-retirement consumption) and then convert their large and plentiful retirement assets into retirement consumption, particularly paying up for imported goods. Specifically, Boomers should have anticipated the weakening of their home currencies as their economies run greater trade deficits against the younger EM economies. Boomers should also have anticipated a significant rise in the cost of domestic services, which cannot be effectively imported from foreign labor markets.

When 3-D is Really 1-D

Deficit spending, by itself, is not particularly worrisome. That is, borrowing today to invest for the future and/or borrowing to smooth temporary consumption shocks represent rational and intelligent choices. The danger occurs when chronic deficit spending compounds into high debt-to-GDP ratios. Aging demographics, while a headwind against future growth, can also be thoughtfully managed. Serious problems arise when countries have become so indebted that they are unable to raise more debt to bail out retirees who have, by and large, under-saved. Even high debt can be paid down if borrowed money were deployed toward investing for the future, which would result in greater innovation and productivity; technological advances can sustain future growth and consumption even in the face of a declining work force. However, if the borrowed money were largely consumed to provide current prosperity rather than invested for future prosperity, then the mounting debt will be our ugly legacy to the future generations.

More stimulus packages will not stop it. Blaming the Chinese for lending the USA too much money will not stop it. Pretending that the storm isn't coming will most assuredly not stop it.

We wish we had a better weather forecast for you.

Keith Ambachtsheer founded KPA Advisory Services in 1985, where he serves as President. Through it, he provides strategic advice to a global clientele in person and through the monthly Ambachtsheer Letter. He is the author of three best-selling books, and has been a regular contributor to industry publications since the 1970s. He is Publisher and Editor of the Rotman International Journal of Pension Management. In 1991, Keith co-founded CEM Benchmarking which benchmarks the organizational performance of some 400 major pension funds around the world. More recently, he played a major role in founding the Rotman International Centre for Pension Management at the University of Toronto, where he was appointed Director. He also serves as Adjunct Professor of Finance at the Rotman School. He has won major awards, including the CFA Institute Award for Professional Excellence in 2011 for "exemplary achievement, excellence of practice, and true leadership," and the EBRI Lillywhite Award in 2010, given in recognition of outstanding lifetime contributions to Americans' economic security. In 2009, Keith was awarded the James Vertin Award from the Research Foundation of CFA Institute for his contributions "of enduring value" to investment theory and practice.

Burton Malkiel, the Chemical Bank Chairman's Professor of Economics at Princeton University, is the author of the widely read investment book A Random Walk Down Wall Street. He has long held professorships in economics at Princeton University, where he was also Chairman of the Economics Department. He was Dean of the Yale School of Management and William S. Beinecke Professor of Management Studies there from 1981 through 1987. He is a past appointee to the Council of Economic Advisors. In addition, he is a past president of the American Finance Association. He currently serves on the board of the Vanguard Group and serves on the investment committees of the American Philosophical Society and Active Investment Advisors. He is the author or co-editor of eight other books, the most recent of which are The Random Walk Guide to Investing: 10 Rules for Financial Success and Global Bargain Hunting: An Investor's Guide to Profits in Emerging Markets, with J. P. Mei. He holds a BA and MBA degree from Harvard and a Ph.D. degree from Princeton University.

RA Panel Advisory Reportback

Harry Markowitz, the co-winner of the 1990 Nobel Laureate in Economics, has applied computer and mathematical techniques to various practical decision-making areas. In his 1952 article and 1959 book, he presented what is now referred to as "Modern Portfolio Theory." MPT has become a standard topic in college courses and texts on investments, and is widely used by institutional investors for asset allocation, risk control, and attribution analysis. In other areas, Harry developed "sparse matrix" techniques for solving very large mathematical optimization problems. These techniques are now standard in production software for optimization programs. He also designed and supervised the development of the SIMSCRIPT programming language. SIMSCRIPT has been widely used for programming computer simulations of systems like factories, transportation systems, and communication networks. In 1989, he received the John von Neumann Award from the Operations Research Society of America for his work in portfolio theory, sparse matrix techniques, and SIMSCRIPT.

Richard Roll is the Japan Alumni Chair in International Finance at the UCLA Anderson School. He also is a Principal of Compensation Valuation, Inc., Factor Advisors, Inc., and several other financial firms. Roll's business experience also includes three years with the Boeing Company in the early 1960s where he worked on the Minuteman missile and the Saturn moon rocket. During 1985–87 he was a Vice President of Goldman, Sachs & Co., where he founded and directed the mortgage securities research group. Richard has a Ph.D. from the University of Chicago. Subsequently, he joined the faculty at Carnegie-Mellon University, The European Institute for Advanced Study of Management in Brussels, and the French business school, Hautes Etudes Commerciales, near Paris. He joined the UCLA faculty in 1976. He has published two books and 100 articles in peer-reviewed journals on a variety of financial topics. His 1968 doctoral thesis won the Irving Fisher Prize as the best American dissertation in economics. He has won the Financial Analysts Journal's Graham and Dodd Award for financial writing (three times) and the Leo Melamed Award for the best financial research by an American business school professor. He is past President of the American Finance Association and is a Fellow of the Econometric Society. He is currently or has been an Associate Editor of 11 different journals in finance and economics.

Jack Treynor is President of Treynor Capital Management. Previously General Partner and Chief Investment Officer of Treynor-Arbit Associates, he was for many years editor of the Financial Analysts Journal. In addition to his book The Financial Reality of Pension Funding under ERISA with William Priest and Patrick Regan, he is the author of more than 70 papers published in the Harvard Business Review, the Financial Analysts Journal, the Journal of Business, the Journal of Finance, the Journal of Investment Management, and others. He is the author of Treynor on Institutional Investing (Wiley, 2007), a collection of his work. He has taught the investments course at Columbia and the University of Southern California and lectured in many foreign countries. At various times he has been a general partner or director of certain investment companies. He serves on the advisory boards of the Financial Analysts Journal and the Journal of Investment Management. Along with William Sharpe, Robert Merton, Harry Markowitz, and others, he is a Distinguished Fellow for the Institute for Quantitative Research in Finance. He majored in mathematics at Haverford College, wrote cases for a year after graduating (with Distinction) from Harvard Business School, and devoted a sabbatical year to the study of economics at MIT.

Regulation 28 Update

James Guimaraens Director, Sterling Private Wealth

New Asset Allocation Parameters for Retirement Funds

In February 2011 Regulation 28 of the Pension Funds Act was amended, specifically the asset allocation parameters that are permissable and how these should be applied to individual retirement funds.

Regulation 28 has always included the maximum investment limits for different asset classes, but the asset allocation bands could be adhered to at fund level, and not necessarily at individual member level. The current asset allocation limits are a maximum of 75% in equities, 25% in offshore holdings, and 25% in property investments.

Then and Now

As an example, before the February 2011 amendment, Allan Gray had to ensure that their overall total Retirement Annuity Fund holdings did not exceed 20% in offshore holdings. Due to the poor returns of offshore funds, and the relatively conservative nature of many investors, the substantial number of investors holding less than 20% in their individual investment accounts meant that there was "surplus" offshore allocation that could be used by other investors. Therefore, you could hold up to 100% of your retirement annuity in an offshore portfolio if you wished.

The February 2011 amendment increased offshore exposure to 25%, along with various other adjustments to investment parameters that are not relevant for the purposes of this article. The biggest change was the unexpected amendment that asset allocation compliance must now apply at individual investment account level, and not as an average across the entire retirement fund.

The previous regulations allowed considerable flexibility for investors to manage their retirement funds as part of a holistic investment strategy. Going forward, both current and new investment accounts will be required to comply with the asset allocation limits at investment account level.

Implications

This therefore has serious and far-reaching implications for investors who currently have funds that exceed the maximums, and for investors who would have in the future wanted to exceed certain asset allocation maximums. Offshore allocation is the main issue, as many investors desired a high global allocation as part of their long-term investment allocation.

Any existing investments that exceed the maximums (with offshore being the most obvious issue) must be brought back within the maximums as soon as any portfolio changes are made. Therefore, for an investor with a substantial offshore exposure over 25%, any switch or amendment to the investment will require a simultaneous reduction in offshore exposure. Unless you can make allowance for this by increasing offshore holdings elsewhere in your portfolio, in practise this means that you cannot make any changes to either asset allocation or fund manager selection if you wish to retain your offshore exposure. Given that the Rand remains strong, global equities remain one of the few asset classes offering relative value, and certain investors have a meaningful portion of their wealth in formal retirement funds, this creates an undesirable situation. You may have to reduce the very asset class that has underperformed, but is expected to outperform going forward.

Regulation 28 Update

Solution

For existing retirement fund investors, the solution is to ensure that before making any changes to your investments you fully understand the resulting implications of having to comply with Regulation 28. Note that Living Annuities currently do not fall under Regulation 28, and are therefore not affected.

Market performance

investment market performance

period to 30 June 2011	Index	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
International Equity	JMSCI World (unhedged) Index (USD)	30.5%	0.5%	2.3%	5.4%	4.0%
International Fixed Interest	Barclays Capital Global Aggregate (unhedged) Index (USD)	10.5%	6.0%	7.1%	6.2%	7.4%
International Property	UBS Global Investors Index (USD, unhedged, net divs)	39.0%	2.6%	0.7%	7.7%	10.9%
US Dollar	LIBID 7 Day (USD)	0.2%	0.6%	2.2%	2.5%	2.3%
Euro	LIBID 7 Day (EUR)	0.7%	1.2%	2.2%	2.2%	2.5%
Pound Sterling	LIBID 7 Day (GBP)	0.6%	1.2%	2.9%	3.4%	3.6%

breakdown of international market performance by country

period to 30 June 2011	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
United States: S&P 500	28.1%	1.0%	0.8%	2.1%	0.8%
Germany: DAX	23.6%	4.7%	5.4%	8.9%	2.0%
United Kingdom: FTSE 100	20.9%	1.9%	0.4%	4.2%	0.5%
France: CAC	15.7%	-3.5%	-4.3%	0.9%	-2.7%
Japan: Nikkei	4.6%	-10.0%	-8.7%	-2.7%	-2.7%
Hong Kong: Hang Seng	11.3%	0.4%	6.6%	9.0%	5.6%

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

Market performance

investment market performance

period to 30 June 2011	Index	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
South African Equity	JSE All Share Index	24.6%	4.5%	11.5%	21.1%	16.70%
South African Equity	SWIX	24.4%	7.5%	12.4%	21.5%	n/a
South African fixed interest	SA All Bond Index	11.3%	13.4%	8.9%	9.7%	10.40%
South African property	SA Listed Property Index	20.5%	26.6%	19.0%	25.4%	n/a
South African cash	STefI (3 month NCD's)*	5.9%	8.0%	8.6%	8.2%	9.00%

**Short Term Fixed Interest Index*

breakdown of local share market performance by sector

period to 30 June 2011	% of ALSI	1yr	3yrs pa	5yrs pa	7yrs pa	10 yrs pa
Top 40	84.0%	25.7%	2.5%	10.7%	20.6%	15.8%
Mid Cap	14.0%	19.1%	20.8%	17.0%	24.1%	22.4%
Small Cap	2.0%	18.8%	11.3%	13.4%	23.0%	23.8%
Oil and Gas	5.0%	33.7%	-5.1%	8.7%	n/a	n/a
basic materials	37.0%	20.4%	-7.6%	7.4%	16.7%	19.3%
industrials	6.0%	17.9%	8.0%	10.8%	20.0%	16.6%
consumer goods	15.0%	31.6%	23.4%	20.3%	26.6%	16.3%
health care	2.0%	19.3%	34.4%	16.3%	23.1%	20.9%
consumer services	9.0%	34.1%	30.0%	21.2%	26.6%	24.6%
telecommunications	7.0%	45.6%	7.4%	21.1%	25.1%	24.6%
financials	19.0%	17.3%	14.7%	7.9%	16.7%	12.5%
technology	0.0%	31.6%	22.2%	17.7%	20.8%	0.2%

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.

Investing for Growing Income Streams

The piece below, is a guest article by Mark Seymour of PSG Alphen Asset Management. The notes highlight the importance of investing for growing income. This forms the basis of our advice process for clients looking for tax-effective, growing income in their retirement years, based in ZAR. The PT High Yield Growth Fund continues to achieve this goal for such clients. We have provided, as an insert, the detailed income distribution history of the fund, since inception in 2003, compared to cash and a preference share alternative.

Initial Investment R100 000

Income Received per year

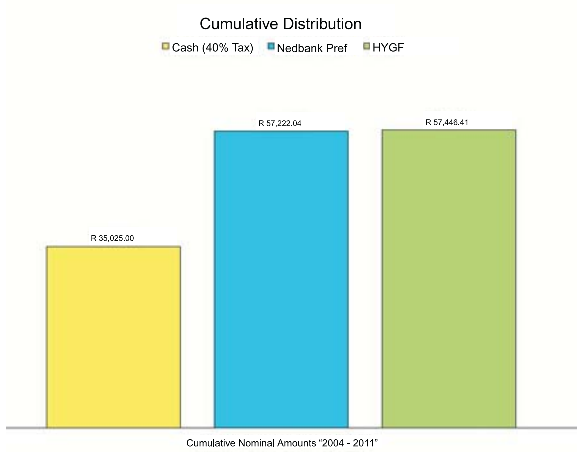
	Nedbank Pref	HYGF	Cash (40% Tax)
2004	R 8,435.31	R 4,591.73	R 4,675.00
2005	R 7,363.00	R 6,941.53	R 4,275.00
2006	R 7,083.05	R 8,170.78	R 4,600.00
2007	R 8,149.15	R 9,461.74	R 5,800.00
2008	R 9,558.32	R 8,955.23	R 6,975.00
2009	R 9,619.26	R 10,198.13	R 4,925.00
2010	R 7,013.95	R 9,127.26	R 3,775.00
	R 57,222.04	R 57,446.40	R 35,025.00

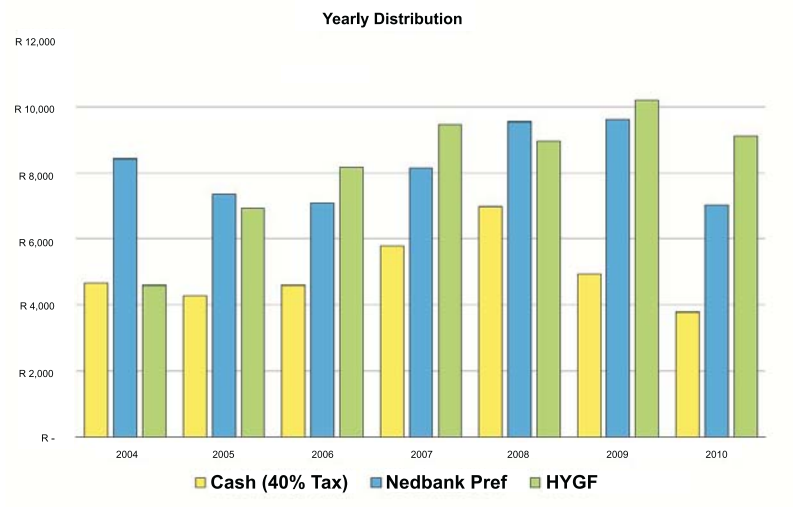
Capital Value at Year End

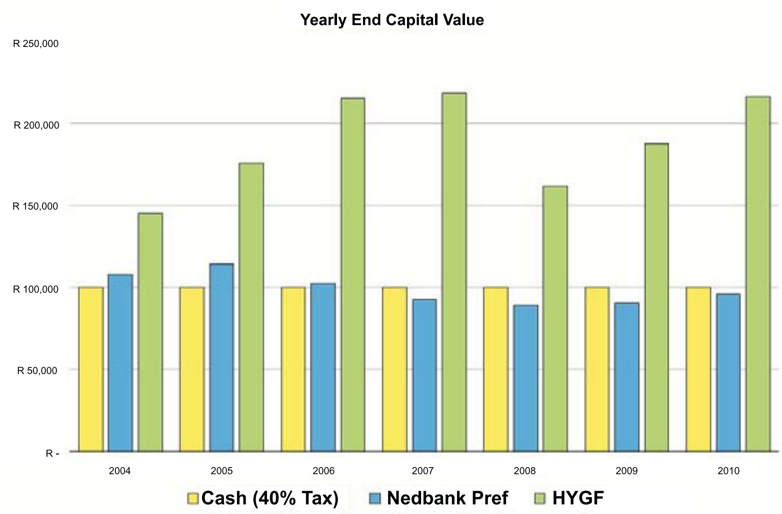
	Nedbank Pref	HYGF	Cash (40% Tax)
2004	R 107,623.32	R 144,842.37	R 100,000.00
2005	R 114,349.78	R 175,735.86	R 100,000.00
2006	R 102,242.15	R 215,268.50	R 100,000.00
2007	R 92,376.68	R 218,529.00	R 100,000.00
2008	R 88,789.24	R 161,670.65	R 100,000.00
2009	R 90,134.53	R 187,620.53	R 100,000.00
2010	R 95,964.13	R 187,620.53	R 100,000.00

	Nedbank Preference Shares	High Yield Growt Fund	Cash (After Tax)
Price on 31 December 2003	11.15	1.14	1
Quantity Purchased	8,968.61	87,588.91	100,000.00
2004			
Cumulative Income per unit	R 0.94	0.00524	0.04675
Total Income Received	R 8,435.31	R 4,591.73	R 4,675.00
Share price at year end	R 12.00	1.6537	1
Value of investment at year end	R 107,623.32	R 144,842.37	R 100,000
Capital Performance	7.60%	44.80%	0%
Income Yield (based on year end capital value)	8.40%	4.60%	4.70%
Total return for the year	16.10%	49.40%	4.70%
2005			
Cumulative Income per unit	R 0.82	0.0793	0.04275
Total Income Received	R 7,363.00	R 6,941.53	R 4,275.00
Share price at year end	12.75	2.0064	1
Value of investment at year end	R 114,349.78	R 175,735.86	R 100,000
Capital Performance	6.30%	21.30%	0%
Income Yield (based on year end capital value)	6.80%	4.80%	4.30%
Total return for the year	13.10%	26.10%	4.30%
2006			
Cumulative Income per unit	R 0.79	0.0933	0.046
Total Income Received	R 7,083.05	R 8,170.78	R 4,600.00
Share price at year end	11.40	2.4577	1
Value of investment at year end	R 102,242.15	R 215,268.50	R 100,000
Capital Performance	-10.60%	22.50%	0%
Income Yield (based on year end capital value)	6.20%	4.60%	4.60%
Total return for the year	-4.40%	27.10%	4.60%
2007			
Cumulative Income per unit	R 0.91	0.108	0.058
Total Income Received	R 8,419.15	R 9,461.74	R 5,800.00
Share price at year end	10.30	2.4949	1
Value of investment at year end	R 92,376.68	R 218,529.00	R 100,000
Capital Performance	-9.60%	1.50%	0%
Income Yield (based on year end capital value)	8.00%	4.40%	5.80%
Total return for the year	-1.70%	5.90%	5.80%
2008			
Cumulative Income per unit	R 1.07	0.102	0.06975
Total Income Received	R 9,558.32	R 8,955.23	R 6,975.00
Share price at year end	9.90	1.8458	1
Value of investment at year end	R 88,789.24	R 161,670.65	R 100,000
Capital Performance	-3.90%	-26.00%	0%
Income Yield (based on year end capital value)	10.30%	4.10%	7.00%
Total return for the year	6.50%	-21.90%	7.00%
2009			
Cumulative Income per unit	R 1.07	0.116	0.04925
Total Income Received	R 9,619.26	R 10,198.13	R 4,925.00
Share price at year end	10.05	2.1421	1
Value of investment at year end	R 90,134.53	R 187,620.53	R 100,000
Capital Performance	1.50%	16.10%	0%
Income Yield (based on year end capital value)	10.80%	6.30%	4.90%
Total return for the year	12.30%	22.40%	4.90%
2010			
Cumulative Income per unit	R 0.78	0.104	0.03775
Total Income Received	R 7,013.95	R 9,127.26	R 3,775.00
Share price at year end	10.70	2.4677	1
Value of investment at year end	R 95,964.13	R 216,144.74	R 100,000
Capital Performance	6.50%	15.20%	0%
Income Yield (based on year end capital value)	7.80%	4.90%	3.80%
Total return for the year	14.20%	20.10%	3.80%
Annualised Total Return (2004-2010)	7.70%	16.50%	5%

Investing for Growing Income Streams







Investing for Growing Income Streams

"Every time we choose safety, we reinforce fear." Cheri Huber

When markets tumble, it's easy to understand the appeal of cash. The beguiling task is to know when to switch out of equities and into cash. What usually happens is that the fear of losing capital causes us to erroneously exit the market too early, resulting in an increasing exposure to cash as markets rise. Unfortunately cash makes for a very poor medium to long-term investment.

When comparing investments, we invariably only consider characteristics such as total return and volatility which doesn't tell the whole story. Over the short-term, equity prices can be very volatile yet the income generated by this investment can be very steady. Conversely, the capital value of cash is extremely stable over all periods, yet the income generated by cash can halve in value over short periods. Looking at capital performance and income generating ability in isolation can therefore be a very useful exercise in comparing investments (see figure 1 and 2 below).

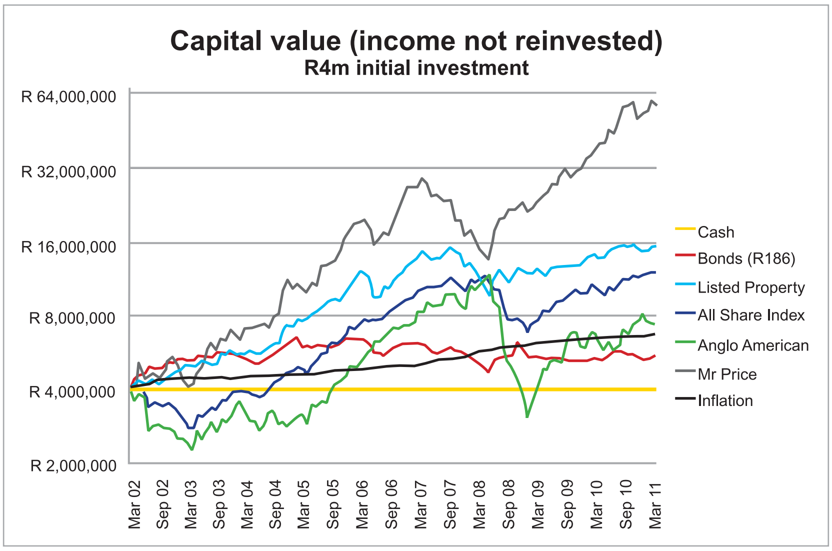


Figure 1. Capital growth with no income reinvestments
Source: I-Net Bridge and PSG Asset Management

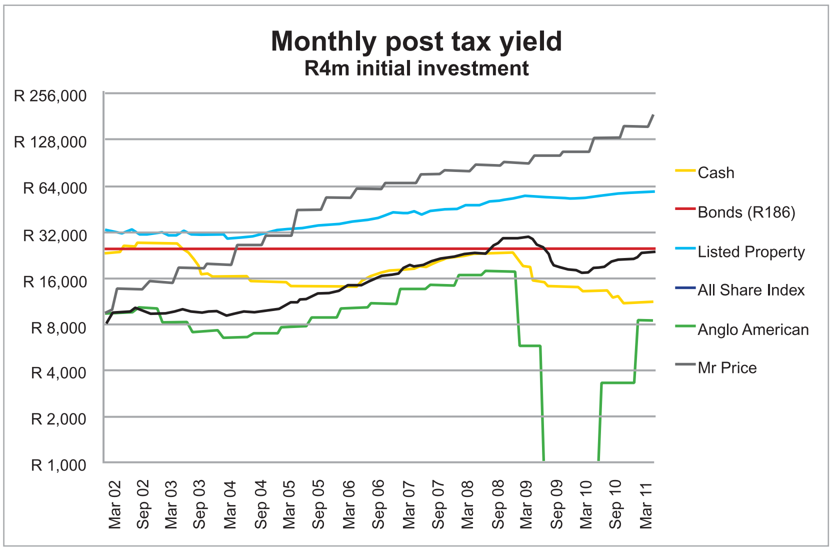


Figure 2. Monthly post tax yield (40% marginal tax rate) for an initial investment of R4m
Source: I-Net Bridge and PSG Asset Management

The information represented in the graphs above is summarised in the table below.

Investment	Initial Capital	Final Capital	Annualised Capital Growth	Initial Monthly Income	Latest Monthly Income	Annualised income growth
Cash	R4.00m	R4.00m	0%	R 23,000	R 11,000	-7.70%
Bonds (R186)	R4.00m	R5.42m	3.40%	R 24,332	R 24,332	0%
Listed Property	R4.00m	R15.42m	15.60%	R 32,020	R 57,465	6.60%
All Share Index	R4.00m	R11.83m	12.60%	R 8,535	R 24,440	12.20%
Anglo American	R4.00m	R7.25m	6.70%	R 9,448	R 8,354	-1.30%
Mr Price	R4.00m	R56.90m	33.60%	R 9,630	R 186,667	38.20%
Inflation	R4.00m	R6.70m				5.80%

Table 1. Capital and income returns for the period 31 March 2002 to 30 April 2011

The above graphs and tables highlight the relative unattractiveness of cash and bond investments for those income investors seeking to grow their capital and to grow their income in excess of inflation (negative real growth highlighted in red). It is true that cash offers a high initial monthly income for the same initial investment, however, the income is linked to interest rates which have fluctuated between 13.5% and 5.5%, translating into a 59% drop in yield through the cycles in recent years. In addition all the other assets have grown their income to levels higher than the current yield on cash for the same initial investment (baring Anglo American which cut its dividend in July 2009 and has yet to raise dividends to the level last seen in 2002).

Although cash is a fantastic investment for short spells during market crashes, switching to cash at the correct time is close to an impossible task to achieve, yields fluctuate by a wide margin through the cycle and the capital portion has no ability to grow. On the other hand, equity has the potential to grow its capital and yield components allowing investors to enjoy an income stream which is quite stable, grows in excess of inflation and at the same time enjoy real capital growth.

Time to rebalance portfolios?

Dear valued clients and friends,

I thought this may be of interest. It is an interview going back to 2007. We are comfortable that the approach contained therein brought our clients safely through the crisis of May 2008-February 2009, arguably still playing itself out! Consistency in one's planning approach is key, and I am sure you will be in a position to confirm our continued, consistent advice process.

Posted: 2007-08-02 23:57
Presenter: Lindsay Williams
Guest(s): Graydon Morris

Classic Business Day asks if it's time to rebalance investment portfolios. Graydon Morris from Sterling Private Wealth says that depends on the wealth planning process

LINDSAY WILLIAMS: A quick update on the markets - the Dow Jones is up 65 points at the moment at 13,426, the European markets closed relatively strongly about 0.8% for the FTSE and the Dax, and about 0.5% for the Paris Cac - but the markets themselves have been so volatile in the last few days. I'm really looking forward to some financial advisor or somebody coming to me and saying: "This is the end of the bull market. After four-and-a-half years it's all over - never mind long-term investing, just get out of everything and come back in a couple of years." But of course you don't get that sort of thing - and history dictates that if you're a long-term investor and you buy into these dips you're going to do well in the long term. Let's have a chat now with Graydon Morris, executive director at Sterling Private Wealth. We are going to talk about investing for the long term. Graydon, as I said it would be nice for someone to actually break the mould and say goodbye to the markets - but of course that's not the case, and we should be putting in a plan for the long term shouldn't we?

GRAYDON MORRIS: Absolutely. Obviously equity exposure forms a very important part of the long term strategy - because as you know 100 years of data will show you that's the most effective way to outperform inflation. So, yes, one could become concerned about the market levels - and perhaps you know to take some profit off the table - but to completely exit would probably be foolish.

LINDSAY WILLIAMS: You get all these lovely little cute sayings coming out of investment advisors and fund managers during these sorts of times. One is: "Those who fail to plan, plan to fail." It may sound corny - but of course it's true. What sort of plan should we be putting in place now? Let's say for example that one had become part of the investment community in the last week, and had looked at the markets and said: "No, I don't want to come in now." What sort of plan would you then suggest for that person in order to benefit in the long term?

GRAYDON MORRIS: The importance of planning is that you've got a reference point - something that you can go back to, and understand why you're positioned in the way in which you are positioned. You highlight people moving into the investment markets in the last week or two or month - or whatever the case may be - but that's the reality with people who might be retiring today, who've sold businesses, who've sold properties, or inherited sums - so it is a reality that people are needing to strategise looking forward, not looking in the rearview mirror. Of course the most appropriate way to do that is to establish what your risk tolerance levels are, what your income requirements are, your liquidity requirements and what your real rate of return above inflation objectives or requirements are - and then to put together a strategic asset allocation to understand exactly why one would allocate a certain portion of the assets to equity markets, to bond markets, to cash markets, to property markets to hedge fund markets both locally and internationally. You do that to achieve a desired real rate of return with the least possible risk - and you look at correlations between those asset classes. You need to document that - you need to understand what the ranges are that one can tolerate. Failure to do so in a significant bear market will force investors to panic and sell at the bottom - but if you have say a strategic equity allocation of 40% as a retiree in one portfolio - and perhaps tactical bands between 35% and 45%. If you document that you can refer to it - it gives you a source of reference. It's critical.

Time to rebalance portfolios?

LINDSAY WILLIAMS: The type of person that invests in an equity market - which is one that over the decades has proved to achieve the best returns - is a specific type of investor though. For example if you had come into the market a year ago and panicked out of it this week by the time the market starts to recover you would have lost out quite a bit I would imagine? What usually happens is you don't get back in again - and before you know it you are buying in at a higher price. One must recognise that a certain type of investor must go for equities - is that true?

GRAYDON MORRIS: There are very few investors around the world who would not have exposure to the equity market - the only investors worldwide who wouldn't have exposure to equity markets are those who quite frankly don't need to take any risk because their asset base is just so significant in size that a cash return would provide for them, and three, four or five generations. The reality is those types of investors who can afford not to take any risk on equity markets are quite prepared to take the risk - because their investment horizon is so lengthy. They understand the markets, they're generally procured significant wealth in their lifetime through business activities so they're very comfortable to do so. If you look at the World Wealth Report that's published every year and you look at what the asset allocation exposure is of high net worth individuals and ultra-high net worth individuals you will see that the average equity holding there is between 35% and 40% which you may consider to be on the low side - but consider that there are significant property holdings there, there's certain private equity holdings which are not considered to be pure equity plays, etcetera. There are very few investors who would have zero equity exposure.

LINDSAY WILLIAMS: Sure. What about adding to those positions? Are these the sort of environments - that we've seen in the last week - that we should be taking advantage of? In other words we've seen almost 10% down on the JSE - during that 10% sell-off should we be adding to oppositions?

GRAYDON MORRIS: I think you'll probably find the contrary has been appearing quite frankly. Rather than analyse what's happened in the last week or two or three if you look over the last year or two perhaps certain investors who retired within the last two, three, four or five years might have strategically decided that the 40% equity position for them was appropriate. If they haven't re-balanced their portfolio's they're holding significantly more equity than that so they have been selling off. To what extent that's caused a pull-back in the market in the last two weeks - I think it's highly unlikely that's had any impact. That's probably largely driven by foreign positions not South African retirees or investors, etcetera - but I think you've seen the converse occur in the last year or two, where those who've gained significantly have been taking money off the table. Bear in mind of course that cash returns at present are fairly attractive in real terms - if you structure your cash as effectively as you can from a tax perspective it's providing you a significant real return with very little risk. Further to that in a rising interest rate environment - traditionally that's not a wonderful time to be in the equity market, so tactical re-balancing in terms of a reduction of equity would probably be the position most investors are taking.

LINDSAY WILLIAMS: What should we be doing? What's your message here?

GRAYDON MORRIS: The message is not to panic. When you have a two week or in fact a six month sell-off quite frankly if you have a plan - if you have strategised exactly what your position should be in the equity market - you're very comfortable for the market to sell-off, and then increase your position back to your stated objective, and by the same token to re-balance on the other side as I've suggested. So there's certainly no reason for panic - it's been a wonderful period. Do investors who have a twenty year horizon still need equity exposure? Absolutely. Should they expect volatility? Absolutely. Should they plan? Yes, it will assist decision-making going forward.

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