

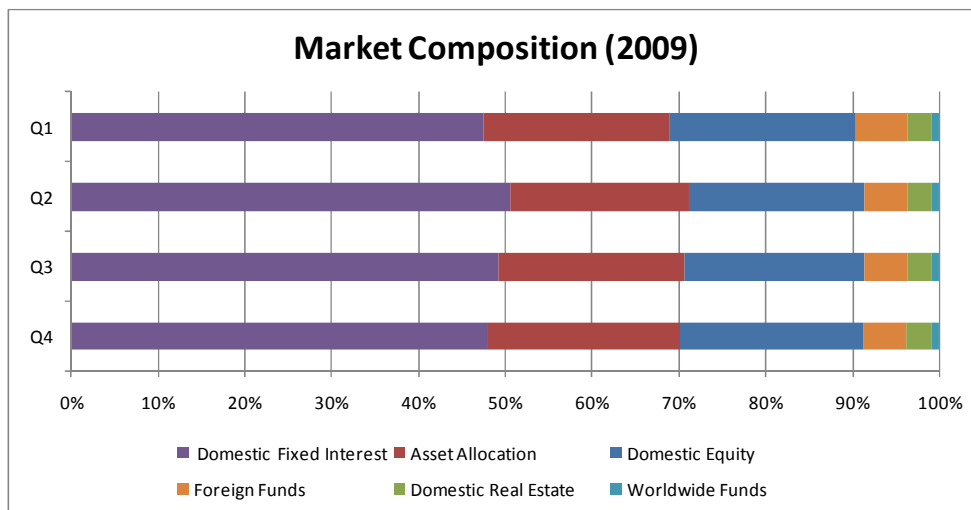
05 March 2010

VOLUME 574

What asset allocation calls have investors made?

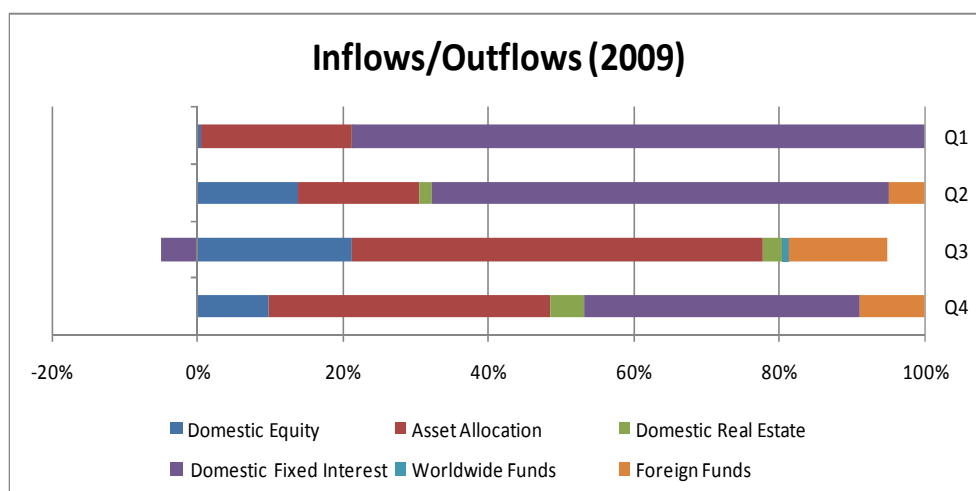
WRITTEN BY: Rushil Jaga, Glacier Research

The most recent (Q4 2009) statistics released by the Association of Savings and Investment South Africa (ASISA) revealed that the overall market split between major fund classifications has not changed much during the past 4 quarters. The majority of assets continue to reside within the fixed interest space, with asset allocation funds gaining in popularity, predominantly in the prudential low equity (5%), prudential variable equity (9%) and targeted absolute and real return space (5%). The total assets under management in collective investment schemes at the end of December 2009 was R786bn.



Source: ASISA

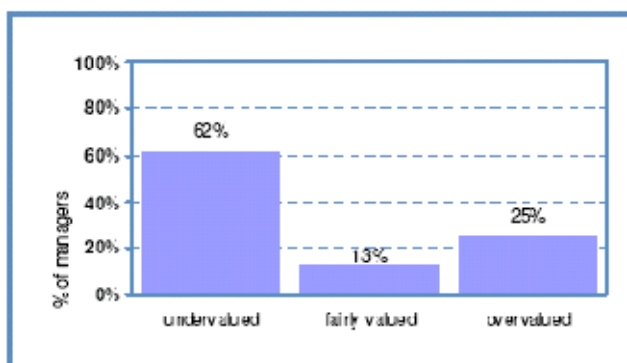
While the overall composition of the market has not changed much, a completely different story emerges upon further examination of the quarterly net flows into various sectors. The flows indicate that investors have been quite erratic in allocating money during the past four quarters. This begs the question - have investors managed to get their asset allocation calls correct over the past 4 quarters?



Source: ASISA

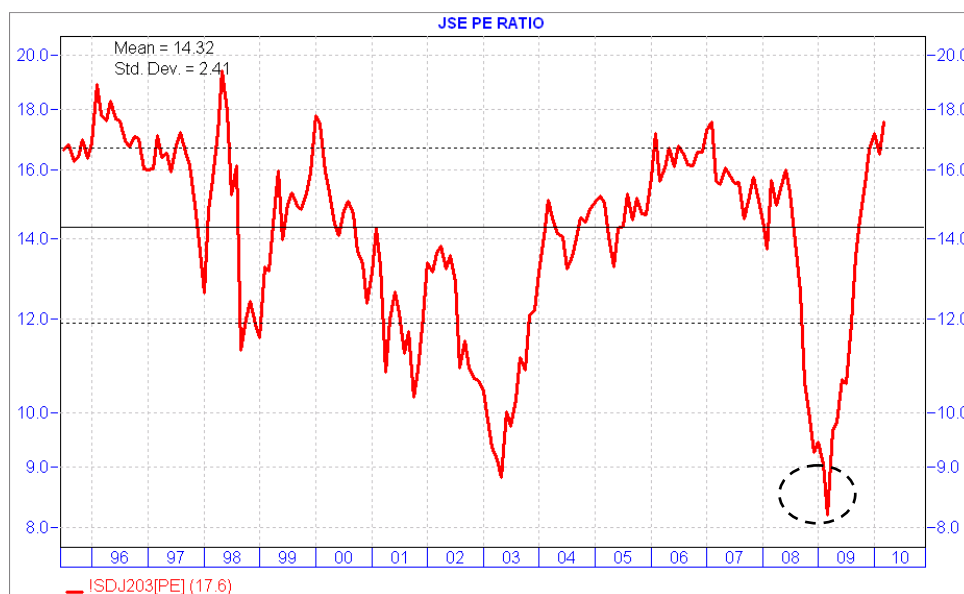
During Q1 2009 unit trust funds attracted net flows of R22.7bn. Fixed interest funds attracted an overwhelming majority (79%) of these flows, most of which went to Money Market funds. Understandably investors were still reeling from the massive correction in the All Share Index, as it slumped to 17 814 points in November 2008, from an astronomical high of 33 232 in May 2008. Investors who climbed into cash at the beginning of January 2009 were well rewarded during the quarter as the All Share index continued to disappoint returning -5.32% for the quarter, while cash returned a more compelling 2.7% over the same period. At this stage the market was pricing in doom and gloom, but what were the experts saying regarding the state of the markets? According to the Glacier Bull and Bear report (which surveys eight large asset managers quarterly) the majority of managers felt the All Share Index was undervalued during Q1 2009.

Which general valuation condition best describes the current SA equity market?



Source: Glacier Bull & Bear Report, Q1 2009

In addition, the price-earnings ratio of the All Share Index was more than two standard deviations from its long term mean. However, most investors continued to plough money into the more conservative asset classes.



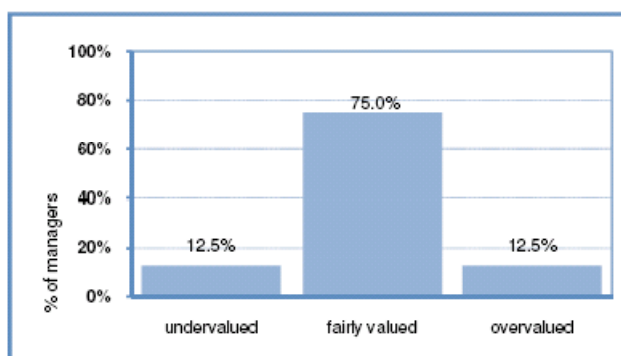
Source: INET

Risk appetite resumed promptly during Q2 and Q3 with the rally during March sparking investor interest once again. Flows into equities constituted 14% and 23% in Q2 and Q3 respectively. But this was perhaps a little too late as the market recovered rather quickly from its March lows rallying as much as 21.68% by the end of Q2 and 37.47% by the end of Q3. It is quite clear from looking at the flows that most investors missed a substantial part of this equity market rally. Interestingly, flows into fixed interest investments went from an inflow of 63% in Q2 to an outflow of 6% during Q3. Notably, asset allocation funds also benefited from the

increase in investor risk appetite, attracting 63% of net inflows during Q3 (with the majority of flows going to the riskier prudential variable equity category).

What is in store for the rest of 2010? Be cognisant of risks involved when allocating funds into various asset classes. We have seen a huge rally in equities, so much so that the majority of the eight managers we surveyed during Q1 2010 seem to think that the market is now perhaps fairly valued.

Which general valuation condition best describes the current SA equity market?



Source: Glacier Bull & Bear Report, Q1 2010

We have also seen the SARB reduce interest rates by 500bps, with some commentators forecasting that this is the end of the interest rate cutting cycle. Risks to the bond market include an increase in supply from both government and state-owned enterprises and a potentially higher inflationary environment stemming from Eskom's approved tariff increases of 25% per annum for the next 3 years. Rand depreciation is also a factor that could derail CPI's bid to remain within the inflation target band. The consensus from the latest Bull and Bear Report is that bonds are likely to return between 7% and 9% over the next 12 months. Cash returns are likely to be relatively muted due to lower interest rates, even more so, on an after tax basis. The risk here is that returns will not keep pace with inflation. Little consensus was shown in terms of property returns with 4/8 managers expecting property to deliver returns between 9% and 11% over the next 12 months. The key risk here is higher vacancy levels. On the other hand distribution growth is usually relatively stable as tenants are contractually bound by rental escalation clauses. In order to alleviate some of the risks presented by these asset classes, ensure that you maintain a fully diversified portfolio and do not over expose yourself by investing in a single asset class.