NFB FINANCIAL SERVICES GROUP

PROFICIO

NFB FINANCIAL UPDATE

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FROM THE CEO's DESK

It is not often that we promote our own propositions at NFB and it is most unusual for me to start an article in this way, however, given the excellent results of late (the last few years!), I would like to note some worthwhile facts.

Firstly, the propositions I am particularly referring to are the domestic Cautious and Balanced Fund of Funds propositions. The second point is that we notice, depending on which information one refers to, including industry specialists and various financial publications, differences in the reported performances of various top performing funds! We are addressing this with these various publications as accurate, consistent and relevant information is owed to the recipients of this information.

The third, probably the most important fact, is that these returns are not 'one day wonders'.

Our Asset Management business has a few core beliefs and important attributes. It does not forecast, it has to deliver a solution that is cost effective, and must allow our advisors to understand exactly what is on offer and to be kept appraised of all decisions and that business must be receptive to both compliment and criticism. Finally, it needs to deliver consistently good results, sensitive to the very clear mandate afforded it. Many funds available have done fabulously, sometimes having taken bets which, had they gone wrong, could have dealt investors a telling blow. NFB Asset Management is close to us and is ever mindful that we need to address various investment needs (income, growth, local and offshore exposure).

NFB's advisory team, in doing so, blend in additional different risks including being too aggressive, too conservative, too focused, unnecessarily diverse, vulnerability to unnecessary tax or estate duty.

So back to the results I wanted to crow about. Our Cautious Fund of Funds is first quartile over all meaningful reporting periods to the end of July and our Balanced Fund of Funds is first quartile over the 1 and 3-year periods and is second quartile over the 5-year period. These results are tabulated below. For completeness: the first quartile represents the top 25% of funds in that sector, the second quartile the next best 25%.

	1-Year	3-Years	5-Years
Cautious Fund of Funds	1st	1st	1st
Balanced Fund of Funds	1st	1st	2nd

Source: Morningstar, 31 July 2016.

Moving on to matters more general. Local developments continue to excite, frustrate and remain in flux. What a turn of events in the most recent elections. The remarkable municipal election results, including the capture of Gauteng, Pretoria and Port Elizabeth, has created a possibility for more examples of delivery of service, a duty seemingly of little interest in recent years to local authorities!

There is an equal chance that corruption and largesse which have permeated local and national government will be curtailed before it becomes too late! These examples, no matter how small, are crucial, as the behaviour set by the top echelon becomes the norm. Hopefully, we have our own version of Rudi Giuliano's Broken Window Pane approach about to happen…. The brave action by the Tshwane (Pretoria) mayor in reversing the purchase of a dozen luxury cars, the banning of the blue light brigade, and the recent firing of the CEO of Pikitup all serve to give us hope.

My friend, Herman Mashaba's efforts to privatise Pikitup, have been disturbed by the rather unique alliance partner, the EFF, blocking this, apparently not because they differ that Pikitup need to do just that in terms of service delivery, but on the grounds of political issues. Whilst this might be frustrating, it is what democracy is all about, and these new alliances have the potential to work. Certainly, in areas which need the most help in our new democracy, getting public servants on track will make for a safer and more stable South Africa.

Looking further afield, we have seen a fair amount of volatility in local and global markets, currencies and bonds. It appears as if the USA has moved into a slow interest rate raising phase, but with capacity for delays. Given the accommodative approach in Europe, the UK, parts of the developed East, there appears to be a "Risk On" approach, meaning that Emerging Markets (Ems) are enjoying flows into their deposits, bonds and equity. When you consider how quickly things change, this apparent attraction can reverse from one day to the next. Consider also that traders love volatility and, it could be argued, fuel this volatility as it results in trade and revenue!

I guess whenever one puts pen to paper in this way, it is reasonable to expect the question "so what?" The critical issue is the appropriate allocation of capital into durable and appropriate assets. In my

continued on page 3...

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THE EPIDEMIC THAT WILL KILL YOUR **INVESTMENT**

We are going through some interesting times and I was tempted to discuss the hot topics of the moment – the US elections, Brexit, Zumagate, or the looming possibility of a downgrade to junk status and what these will do to your investment. But all these recent events prove, is that whatever you think will happen, it will most likely be the opposite, as well as ten other things you could never have imagined, much less predicted.

The reason why these events are important to your investments is because they affect financial markets and therefore your returns. They represent opportunities or catastrophes, depending on whether your investment was prepared for them or not. So we follow them, discuss them and read about them daily, and everyone hopes for the same thing – that they will anticipate what is to come and somehow be better prepared. And these are the things your wealth managers, stock brokers and fund managers focus on to try and ensure that years from now, we have done our best to avoid the speed bumps and grow your investment.

And that is exactly what they are – speed bumps – even though at the time they may feel more like falling off a cliff. The table below shows returns of the JSE All Share Index over 30 years and as you can see, when the going is good, it far exceeds times like the present where markets are hovering around some invisible ceiling and not returning very much. A similar pattern can be seen in the S&P 500 MSCI Emerging Markets Indices, among others.

FTSE/JSE Date	ALL SHARE 1 year % change
1997	9.53%
1998-1999	-12.82%
2000	70.82%
2001	0.35%
2002	32.61%
2003	-8.31%
2004-2008	148.97%
2009	-23.24%
2010 - 2011	51.83%
2012	1.96%
2013-2015	58.99%
2016	5.13%

So other than just hang in there at times like these, what can you do? You invest your monthly debit order, often knowing that it probably isn't enough, but hoping that in the future you'll take care of it. The truth is if you want to have more, the best way to ensure that is very simple – you need to save more. Most people think "if I can just pay off that debt" or "if I can just make more money...then I will be able to invest more". The truth is, the number of people reaching retirement age and being unable to retire due to not having saved enough, far outweighs the number of those who are unable to retire due to some market event that caused a loss of some of their capital or poor returns on their investments.

We speak so much about markets, politics and fees, but debt, budget, savings – these are quite often the elephant in the room. When it comes to how you are (or aren't) coping on a month-to-month basis, to talk about it, even with your financial advisor, is considered taboo or embarrassing.

This point was made in an article I read recently, called "The Secret Shame of Middle-Class Americans" written by an American journalist named Nael Gabler. In the article, he speaks of financial impotence and references Brad Klontz, a financial psychologist, who states "you are more likely to hear from your buddy that he is on Viagra, than that he has credit-card problems". And this is the problem – nobody wants to discuss or face up to problems with debt.

Gabler refers to a Federal Reserve Board survey where participants were asked how they would pay for a $400 emergency and 47 percent of respondents claimed that they would need to borrow or sell something, or would not be able to come up with the $400 at all. This means they have no liquid savings and no available credit to pay for the emergency.

He states: "I know what it is like to have to juggle creditors to make it through a week... I know what it is like to be down to my last $5 – literally – while I wait for a paycheck to arrive, and I know what it is like to subsist for days on a diet of eggs… to tell my daughter that I didn't know if I would be able to pay for her wedding; it all depended on whether something good happened… You wouldn't know any of that to look at me… I am nowhere near rich, but I have typically made a solid middle- or even, at times, upper-middle-class income… and you certainly wouldn't know it to talk to me, because the last thing I would ever do – until now – is admit to financial insecurity".

This brings home an important point that all over the world, people battle financially to get through the month, even those in respectable jobs, earning relatively good incomes and with the education that should have given them the tools to manage money. Even these people worry when the bills arrive and unforeseen expenses crop up, and it all comes down to one problem – instant gratification. Paying for what I want today with tomorrow's money. Credit is waved in our faces daily and it's just too easy to take it.

The graph below paints a picture of a thousand words. South African Debt to Income over the last 47 years – while there has been a small improvement in recent years – is still alarmingly high.

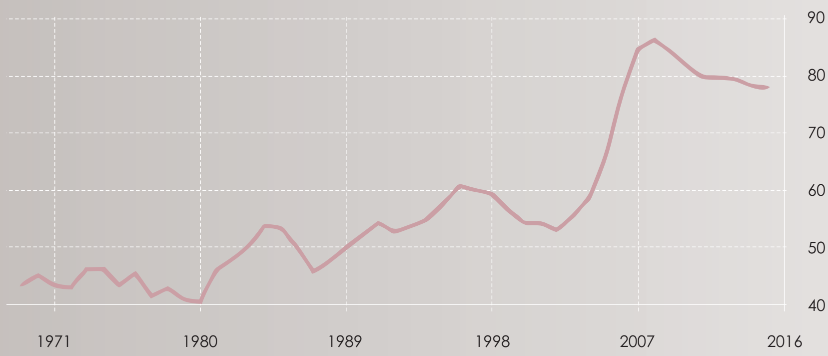
More concerning is that according to World Bank data, South Africans are the biggest borrowers in the world, with 86% of the population in debt. So technically speaking, even if you have nothing, you can count yourself in the top 14% of South Africans in terms of net worth. If you have debt, but you are managing to make payments, you can also count yourself better off than 10.3 million South Africans, according to the National Credit Regulator. So there comes a time when you have to put things in perspective. Acting CEO of the South African Savings Institute, Gerald Mwandiambira says: "South Africans tend to say they are too poor to save. However, when you look at their consumption numbers, those are not consumption numbers of a poor country, those are consumption numbers of a country that has great throughflow of money".

What's happening in South Africa is that saving and investing is an afterthought when it should rather be non-negotiable, something that is paid before the general "consumption" of goods and services. Spending should happen after that, and be dependent on that, and not the other way around.

In summary, the one point I would like to emphasize is that poor returns, while something we work daily to avoid, are not the reason why people don't have savings, or aren't retiring when they would like to or as handsomely as they aimed to. And they certainly are not a reason to hold back from investing too much. The problem is that no one is saving or investing enough. We need to stop spending tomorrow's income before we have even earned it and focus on providing for tomorrow, today.

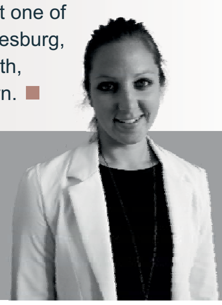
If you would like assistance in getting started on your saving and investment path today, please do not hesitate to contact an NFB Private Wealth Manager at one of our NFB offices in Johannesburg, East London, Port Elizabeth, Stellenbosch or Cape Town. ■

SOUTH AFRICA HOUSEHOLDS DEBT TO INCOME



www.tradingeconomics.com | South African Reserve Bank

" We need to stop spending tomorrow's income before we have even earned it and focus on providing for tomorrow, today. "



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FROM THE CEO's DESK

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last editorial, I suggested that given recent developments, and given the rand's recovery from the "Nene Brink", clients should consider offshore as attractive. This has in the last few months switched from excellent, to ordinary, and back to excellent in concept.

When asked about timing such a decision, I react with a question, this being: "what would you do if the rand collapsed to R20/$, and how would this make you and your family feel?"

We also think that investments can be tactical or strategic. I think this concept is worth ventilating in an article, and I will attempt this in a subsequent editorial.

Growth in the world is not easy to spot. Long term, as always, we think that growth assets will prevail. Understanding why something makes sense, sticking to your guns and remaining mindful of any major changes in your needs or circumstances and communicating these to your advisors are good ideas.

We are fast approaching the year end. The smell in Johannesburg of Jasmine blossoms announces spring. We have other special features in the other cities and towns where we are privileged to offer our advice. Please take note of these where you are. Life is fleeting and it is far too easy to focus on the challenges, ignoring the special things that are easy to take for granted. After all, making money and then having it work for you is for a purpose. A balanced approach, like our funds mentioned in this article, is a good idea!

The various points raised in the editorial are not intended as advice. Please discuss these and other thoughts or needs with an NFB advisor to ensure the correct fit into your portfolio. ■

" Understanding why something makes sense, sticking to your guns and remaining mindful of any major changes in your needs or circumstances and communicating these to your advisors are good ideas. "

IS YOUR BEHAVIOUR COSTING YOU MONEY?

Portfolio theory and finance models assume that investors are rational beings making decisions based on perfect information. In practice, however, things are somewhat different. Realistically speaking, investors being human, are programmed to certain biases that lead them to embrace the very fate that they wish to avoid. Biases stemming from faulty reasoning are termed "Cognitive Biases", while those based on impulsive feelings or intuition are termed "Emotional Biases".

Studies reveal that untrained and unguided individuals are likely to buckle under the stress invoked by falling prices of a bear market by selling out when the prices are low. On the other hand, they are prone to being overly confident of the momentum of a bull market, buying at the higher prices in the belief that the best is yet to come. As far as the individual is concerned, they are making the best decision under each given circumstance.

Research has shown that the innate fight-or-flight response when faced with perceived danger does not serve humans well in the investment world. So how do advisors handle clients who want to take over the reins when they perceive danger to be real and imminent? How do advisors speak sense and rationality to the client's bias?

COGNITIVE BIASES INCLUDE:

- **Confirmation bias –** seeking out information that reinforces your beliefs, like googling your symptoms to confirm that you are suffering from what you indeed suspect;
- **Framing bias –** making a decision based on how attractively the facts are presented. i.e. "If we operate on the eye, there is a 25% chance of him going blind" vs "If we operate on the eye, there is a 75% chance of his vison being restored".

Cognitive biases are best solved through moderating the bias by reducing or eliminating it. This can be achieved by providing more information, or looking at the information from a different angle as well as giving advice that clarifies certain facts for the client. The financial advisor can then continue with the portfolio constructed to address the financial goals of the client as if the bias does not exist.

EMOTIONAL BIASES INCLUDE:

- **Regret -** of past action that led to an adverse result;
- **Denial -** failure to acknowledge realities that makes us feel bad;
- **Loss aversion -** losses are viewed as worse than gains of equal quantity.

The emotional biases are often harder to correct. The individual displaying the emotional bias may wish to act differently, but will find it very difficult to do so. Pointing out the bias to the client may cause them to become defensive and may lead to them justifying the bias. The remaining solution is for the advisor to adapt to the bias by adjusting their advice in order to avoid losing the client altogether. It will be very difficult to convince a client to invest their retirement savings in a Regulation 28 compliant share portfolio if the client's family lost all their wealth in a stock market crash, which in turn led to the client's family suffering a downgrade in lifestyle and strained family relations due to that financial loss. That damage will be hard to undo in two or three client meetings. The best action would be for the advisor to construct a portfolio leaning towards other asset classes and to introduce a sprinkling of shares in the form of an index tracking unit trust structure for capital growth.

It is therefore advisable to work with a financial advisor to curb biases, and help reach financial goals through rationally informed decision making.

Should you have any queries with regards your financial decisions, please do not hesitate to contact an NFB Private Wealth Manager at one of our NFB offices in Johannesburg, East London, Port Elizabeth, Stellenbosch or Cape Town. ■

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