PROFICIO
NFB FINANCIAL UPDATE

ISSUE 02 OCTOBER/NOVEMBER 2015

NFB
FINANCIAL SERVICES GROUP

FROM THE CEO's DESK

Well now, we really have had a very turbulent time recently. From economics to politics, on a corporate level as well as in markets, activity and volatility have been the name of the game.

Investors might have read warnings in recent years that our complacency can be our worst enemy. A recent example would include taking a strong rand and the concomitant opportunity to diversify for granted. The problem we now face in remedying this rather obvious omission, is the direction from what could be an overdone selloff, could easily be stronger! Who really knows? Add to this experiences of recent times when the rand experienced similar volatility from which it then recovered and you have real confusion.

What is true is that offshore investments over the last few years have been rewarding given the weaker trending rand, stronger offshore equity markets and the "free ride" which diversification offers. I guess the point is to avoid second guessing the market. It all starts with understanding needs, understanding necessary outcomes and then establishing a risk budget. In simple terms this implies ensuring risk of missing your necessary outcomes on investments is balanced against the likely valuation volatility the chosen portfolio will display. Clearly, the longer money is invested for, the more likely the growth will be best if growth assets like shares and property, either here or abroad, are chosen. Similarly, they are also the most likely to display fairly significant periods of volatility. Equally, taking a more conservative approach will almost always lead to more predictable outcomes, but with a greater risk of underperformance particularly after inflation and tax are factored in!

Equity markets are also all over the show. I feel so sorry for retail Chinese investors who, by the tens of millions have been enticed into a Shanghai Index and even more volatile shares which have performed remarkably over the recent past. What is not always clear to the uninitiated investor is gravity almost always prevails and sky high markets have a habit of returning to earth, often abruptly and often with a nasty bump. What is even more worrying is the fact that the Chinese listed shares are still being underpinned by government-backed funds buying them, and brokers being encouraged to stabilize markets whilst the same shares are available in H shares in Hong Kong at a significant discount!

China's woes are not just having domestic impact. The material losses, the government's use of reserves to underpin the failing economy, the terrible economic stats coming out of China combine to put the Emerging Market (EM) currencies and markets under pressure. They simply don't need our coal, timber, iron ore, platinum and many other goodies, particularly commodities on which the EM's have based their economies.

Another remarkably volatile commodity has been oil. The attached graph shows an extraordinary range in a very short period of time. It appears as if the OPEC members are sorting out their differences and are agreeing strategy which will likely result in a stabilizing of the oil price at higher levels. The oil price has recently risen by almost 27% in ten days. Clearly this leaves some people happy and others very sad! Timing, which we always say is not your friend, in planning long term investment outcomes, is rather more important in these times, particularly when large multinationals are buying or selling millions of barrels in deals!

52WK RANGE
42.23 - 101.25

Source: Bloomberg

Changing tack from matters of markets to developments closer to home - NFB has some very exciting news. A few months back our long time partners in East London listed on the JSE's Alt-X. This was soon followed by us being invited to discuss our inclusion in this listed entity. We concluded a deal on the 1st September and the Group, called NVest Financial Holdings, now includes the East London, Port Elizabeth, Cape Town, Stellenbosch and Johannesburg Advisory businesses, NVest Securities which is a Stock broker, NVest Properties and NFB Asset Management, with a strategy to create a leading, fully integrated advisory and financial services business, capable of delivering cost-efficient world class product, advice and service.

From our client's point of view, nothing changes. We continue to be NFB and offer financial advice and service. What has changed is the Group now has almost R25 billion under management. This will result in cost efficiencies and savings for our clients as product providers recognize the scale and relevance of existing and potential investment flows. Similarly, the stock broking business offers a superb, cost efficient point of access to equities, bonds and derivatives. These will be developed into solutions for our clients in Gauteng, following a very successful introduction into the Eastern Cape business over the last number of years.

It also follows that as an organization grows and the founders get a little older and younger talent is developed, that batons need to be passed on. In both East London and Johannesburg, we have appointed new Managing Directors. Gavin Ramsay and Andrew Duvenage are these new office bearers. I am sure you will join me in congratulating them on these appointments and wishing them well. The "older" team remain in play occupying roles on the listed company's Board and in their historical roles within the advisory businesses.

We would like to thank our many clients, business introducers, institutional partners and product providers as well as our families for the support and loyalty we have hopefully earned and enjoyed in our journey to this important point. We look forward under the leadership of our divisional heads to continuing to deliver advice and service of a high standard and to continuing on a growth path where meeting your needs is our central focus. ■

"NFB Johannesburg has some very exciting news – we are now part of the listed entity, NVest Financial Holdings."

Mike Estment CFP® professional
BA / Chief Executive Officer
NFB Financial Services Group Gauteng

VOLATILITY

CAUSE FOR CONCERN?

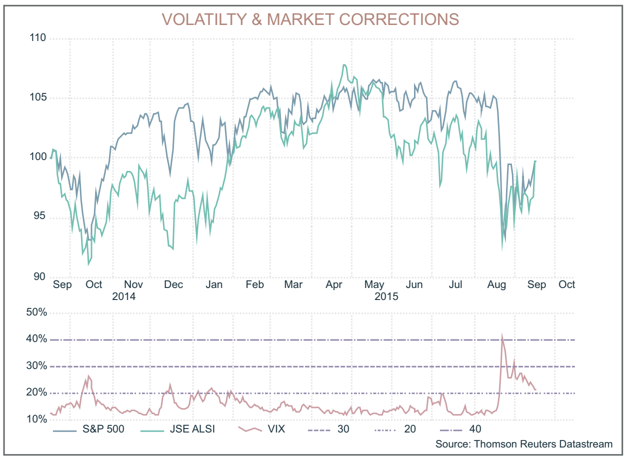
Those with an eye on the markets over the last couple of weeks would have noticed the extreme levels of volatility which will have caused some alarm bells to ring.

The CBOE (Chicago Board Options Exchange) SPX Volatility Index, or VIX, which measures the market's expectation of 30-day volatility on the S&P 500, shot up dramatically to above 40 on Monday 24th August signalling heightened volatility causing investor panic. A move above 20 usually indicates a near-term sign of elevated risk and volatility, while a move above 30 typically signals a stock market correction and extreme volatility.

Refer graph on the right.

The major cause of this spike in volatility and accompanying market correction has been termed China's Black Monday. The recent surge and subsequent plunge in the Shanghai Composite Index on the back of unsustainable Chinese retail investors inflating market prices with borrowed capital has been well documented and

(For interest sake, as well as a sense of comfort, at the peak of the 2008 market crash VIX hit 80 and hovered well above 40 for more than 6 months.)



(Notice the correlation between moves in VIX above 20 and a short term market correction)

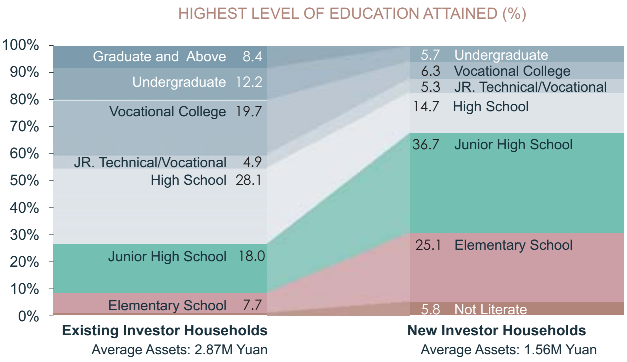
discussed of late. As the bubble began to burst and margin calls were initiated, traders, as they tend to do, panicked which resulted in a vicious cycle of selling and led to a dramatic fall of the Index of over 30% before stabilizing somewhat in early July.

Losses continued through the week of the 24th August with the Shanghai Index falling 8.5% on the 24th alone. This had a contagious effect on global markets, especially in emerging markets (EM) where investors swapped riskier positions for more stable developed market assets in what is known as a 'flight to safety.' Commodity prices were hit especially hard as the weak manufacturing numbers affirmed a slowdown in Chinese growth, having a large negative effect on already weak commodity stocks.

The further knock-on effect from this was a rapid depreciation of emerging market currencies, with the rand particularly vulnerable being one of the most liquid and commodity linked EM currencies.

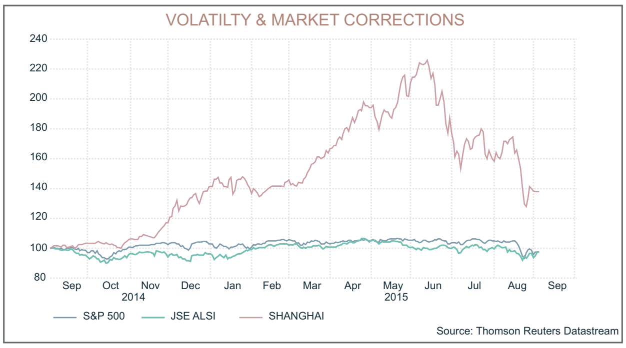
SO WHAT CAUSED THIS CORRECTION?

As previously discussed the rapid growth in the Chinese market has been on the back of deregulation of the country's banking and financial markets. The People's Bank of China had been actively attempting to boost economic growth through several interest rate cuts and a reduction in the cash reserve requirement for banks. This was accompanied by an increase in the amount of retail investors piling into the market with borrowed money. According to Reuters, almost 85% of trades are retail, with 81% of these 200 million traders executing trades at least once a month. Compounded by the 'unsophisticated' nature and inexperience of retail traders, the Chinese market was a breeding ground for irrationality with momentum fuelled by sentiment rather than fundamentals. As the story goes, Joseph Kennedy sold his stocks prior to the 1929 Great Crash after realizing the market was bound to fall as a shoe shine boy shared stock tips with him, similarities can be found in the case of the Chinese investors' level of sophistication. The graphic below, based on a study conducted at the end of 2014 by Professor Li Gan of the Southwestern University of Finance and Economics, illustrates that over two thirds of new equity investors in China have an education level below that of a matric qualification in South Africa. More than 30% didn't even make it to high school.



Source: SWUFE China Household Finance Survey BloombergBriefs.com

In order to comprehend the extraordinary magnitude of the past year we only need to look at the graph below. To give a sense of comparison with both the S&P500 and the JSE ALSI which were relatively flat from September 2014, the Shanghai composite has risen more than 120% and then subsequently fallen 40%.



This is not the first time the Chinese market has behaved irrationally – in 2008 the index rose over 400% in the two years leading up to the Credit Crisis and was then unwound to the effect of 70%.

SHOULD YOU BE CONCERNED?

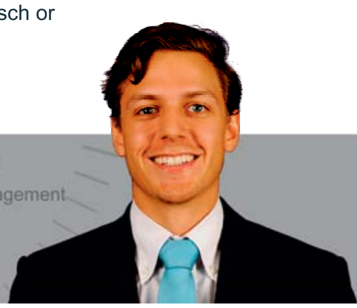
The unprecedented growth China has had over the past couple of decades has led it to become the major trading partner of a large number of nations, including South Africa. Therefore a slowing China will undoubtedly have an effect on both local and global GDP figures as well as markets. However, because the Chinese equity market is so insulated, with only 2% held by foreigners according to CNBC, the effect of stock market contagion is somewhat limited and thus the risk to global asset allocations funds may not be as material as one would initially anticipate.

The fact of the matter is equity markets are volatile and short term drops are to be expected, especially in a world flush with excess liquidity. However, over the long term equities have outperformed other traditional asset classes and you should thus be rewarded for short term volatility with long term excess return. **Investors should always aim to position themselves to be able to SWAN (sleep well at night). Whilst we can all easily get caught up in the hysteria of daily market movements, it's important to take a step back, take a deep breath and rationalize your portfolio in line with your long term views.**

At the end of the day, your NFB advisor is there to correctly position your portfolio and maintain your allocation in line with that of your calculated risk profile. There will always be times where markets are volatile and these times should present opportunity rather than cause for concern.

Should you wish to confirm the correct positioning of your portfolio at this time, please do not hesitate to contact an NFB financial advisor at any one of the NFB offices in Johannesburg, East London, Port Elizabeth, Stellenbosch or Cape Town. ■

> "There will always be times where markets are volatile and these times should present opportunity rather than cause for concern."



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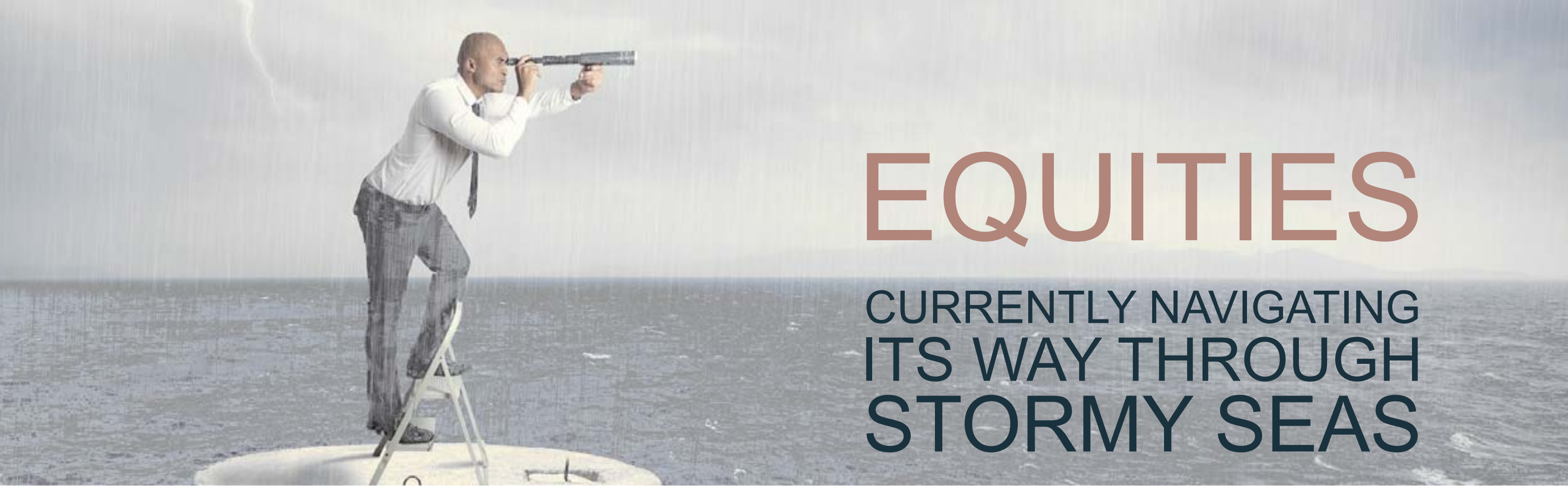


EQUITIES

CURRENTLY NAVIGATING ITS WAY THROUGH STORMY SEAS

The financial markets over the last 12 to 18 months have been challenging for fund managers, advisors and investors as we all find ourselves in a market delivering lower returns than that to which we have become accustomed. Some investors may have experienced a period of little or no growth, while others have had to face the harsh reality of decreasing capital value as their income drawn is greater than the returns currently generated by the underlying investment assets. This is especially tough for investors with no alternative income sources.

We often find the investment manager and advisor reassuring clients that staying invested will pay off over time, as the aim of investing is not to time the market and jump ship, but to stay the course and ride out the storm. One may change coarse slightly and batten down the hatches, but the end goal is to reach the destination port. Investors need to give the markets time to recover from the austerity measures that were needed to mend world economies after the financial crisis. Lower growth rates and lower market returns are to be expected on the way to recovery and rebuilding of the economies that collapsed seven years ago.

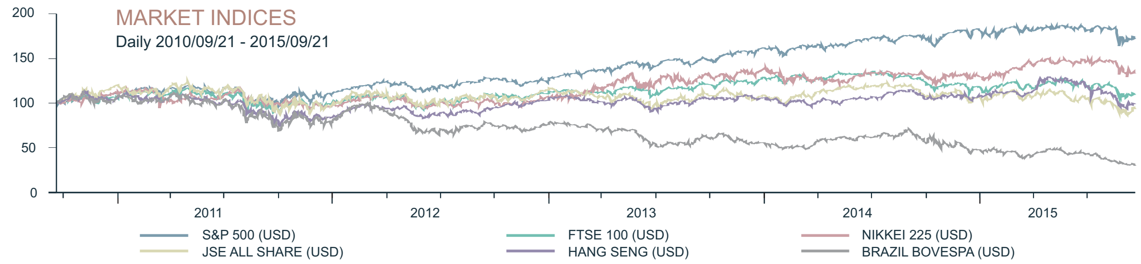
The important thing to remember when coming across uncertain times in the market is the investor's investment objectives as well as the risk profile. Many clients are requesting to go offshore in order to mitigate the negative impact of our weaker currency, low growth and overall loss of confidence in the local economy. Is the offshore market performing any better? The graph below shows that the poor performance in the equity markets is spread world-wide over the short term, and with equities being the asset class we look to for growth, it is clear why portfolio performance is what it is. The growth asset class is taking a knock.

Our local currency volatility and depreciation makes matters even worse as our reliance on imported goods puts further pressure on inflation. As a resource based economy and exporter, the slowdown in China and the world has meant weaker commodity prices which translate to a weaker Rand. Based on historical Price to Earnings ratios and in comparison to the local market, offshore markets seem to be fairly priced and hold more promise over the medium to long term.

However, as can be seen from the previously mentioned graph, offshore markets come with their own challenges as there is both market risk and currency risk. The decision to invest offshore should be taken in context with your current portfolio allocations, as well as your risk profile.

Whichever way one looks at it, the current financial market situation is definitely not for the faint-hearted. There is volatility at present, but this can also be seen as an opportunity. Stormy seas with the wind at your back are often better than a calm sea with no wind at all. Those entering the market should be ready to be in it for the long haul, and those investors already in the market need to look at the initial financial plan drafted with their financial advisor and stick to their plan, changing positions only if there has been a change in personal circumstances with regards to risk profile and financial objectives. If nothing has changed in terms of risk and objectives, the original financial plan towards those long term goals, has already taken into consideration the client's sensitivity to market volatility - so hang on tight, because with equities, the ride can get interesting, and it will not necessarily always be smooth sailing.

For further information on equities and investing offshore, please do not hesitate to contact an NFB financial advisor at any one of the NFB offices in Johannesburg, East London, Port Elizabeth, Stellenbosch or Cape Town.



Source: Thomson Reuters Datastream

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