



April 2014

# FINANCIAL MATURITY

## Quarterly newsletter

2014 started with a bang – the South African repo rate was hiked by 50 basis points, the first change since July 2012, the Federal Reserve has a new chairwoman, Russia threatened to invade parts of Ukraine, and strikes in the mining sector reared its head again, to name but a few. Between all that, missing planes and celebrity court cases, it is time to glance back over the last three months and see what the rest of the year has in store for us.

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### Market Overview

Global markets experienced a turbulent time during the first quarter of 2014, plagued by the thoughts of the Federal Reserve Bank's decision to taper its quantitative easing by \$10 billion per month in 2014 as well as negative sentiment towards emerging markets and the general uncertainty of what lay ahead for quarter one of 2014. If someone of importance had sneezed, investors would have hit the sell button!

During January a "sneeze" materialized - tapering started in January but it was already priced in after it was announced in December, China started showing signs of a slowdown, which in turn affected emerging markets as investors reduced their exposure - and the markets tumbled. February saw investors realising that it was just a sneeze as they hurried to buy back emerging market assets in order to make the most of the great buying opportunity that had presented itself. The markets recouped their losses and have not looked back since.

**Welcome to Warwick Wealth's quarterly newsletter, *Financial Maturity* - our tool to keep our clients informed and up to date with market summaries, fund updates and other news.**

**We have exciting things in store for the rest of the year – Our head of Fixed Interest, *Sidney McKinnon*, has been appointed as the General Manager of the asset management part of the business. *Sidney* and his team will focus on expanding the retail product offering, thus increasing the benefits we provide to our clients.**

**We hope you enjoy this edition of *Financial Maturity*.**

*Adrian*

There was no front runner for the world markets in quarter one. Developed and emerging markets were equally affected and both had their winners and their losers.

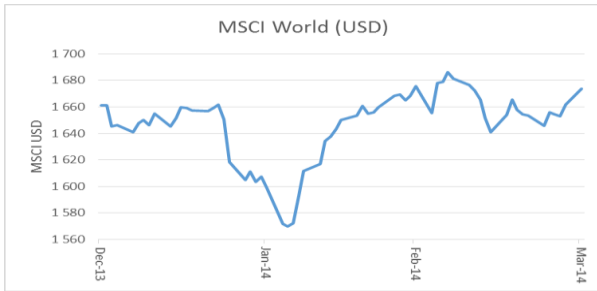
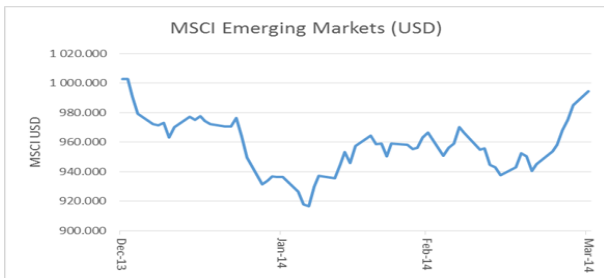


Figure 1 and 2: The MSCI World Index (above) and the MSCI Emerging Market Index (below) both show a decline in January and a correction in February. The effect was that the quarter ended quite “flat”.

Source: MSCI, Warwick Invest



Locally, the **South African markets** followed the pattern shown by the rest of the world – losses in January that were recouped in February followed by a relatively flat performance in March. After a very volatile 2013 for most world markets, it is a relief to see that this behaviour is not continuing to the same extent – there are signs of markets stabilising as investors learn to price in most of the market risk and volatility that can be expected as conditions move back to “normal”. The movement of the All Share Index (J203), the S&P 500 and the FTSE 100 can be seen below:

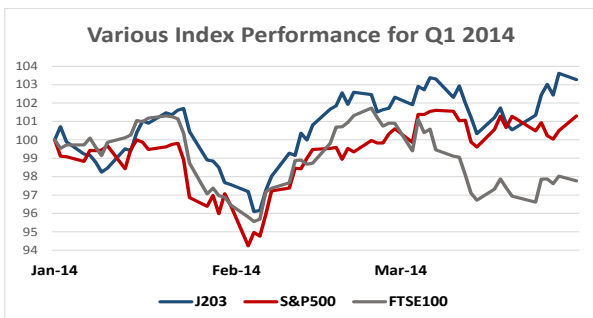


Figure 3: Quarterly performance (based to 100) of the JSE All Share Index (J203) along with the S&P 500 and the FTSE 100 index performances.

Source: McGregor BFA, Warwick Invest

**Emerging market (EM)** currencies were not immune to the volatility experienced throughout the quarter. Most were battered during the start of the quarter, spiraling out of control against the stronger currencies. The South African Rand hit a low of R11.30 to the dollar, over 7% weaker compared to the year’s opening exchange rate. The Turkish Lira weakened by over 8% to the US Dollar by the 4<sup>th</sup> week in January. Interest rate hikes were implemented almost immediately, with Turkey raising their interest rates by 4% in one sitting. South Africa took a more cautious approach raising the repo rate by 50 basispoints to 5.5% with the view of consistent measured interest hikes throughout 2014. This appears to have stabilised the currencies, at least in the short term. The strengthening of both currencies towards the end of the quarter caused them to end at levels only slightly weaker than what they started the year with.

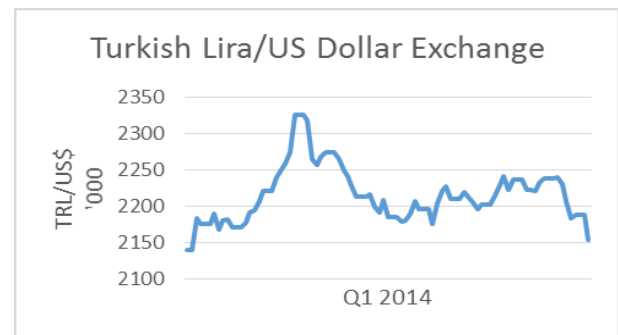


Figure 4: The initial weakening of the Turkish Lira and the subsequent stabilisation can be seen over the duration of the quarter.

Source: fxtop.com, Warwick Invest

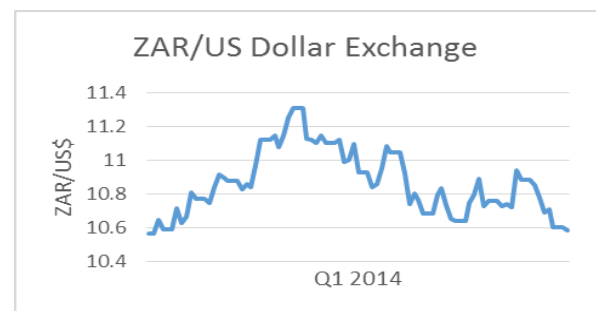


Figure 5: The initial weakening of the South African rand and the subsequent stabilisation can be seen over the duration of the quarter.

Source: fxtop.com, Warwick Invest



Negative sentiment towards emerging markets grew from late 2013 with foreign investment leaving as quickly as it had flowed in previously. Both developed and emerging markets suffered dramatic downturns in their economies as uncertainty loomed and investors followed the negative sentiment. February saw the emerging markets recoup most of their losses as investors saw a great buying opportunity from January's fall. The markets took a dip at the end of February on the back of the news that Russia was moving in to seize land in Crimea, a Ukrainian state, against Ukraine's will. Talk of sanctions and rumours of a renewed cold war between Russia and the US cooled the positive outlook on all economies and fueled nervous investor sentiment. The heated stand-off subdued and became dormant, resulting in a quiet confidence in the markets - the MSCI Emerging Market Index (USD) gained 6.07% from mid-March to the end of the month. A weary eye will still be cast on this situation and will be kept in the back of the investor's mind.

**Developed markets** did not escape the January volatility and also suffered a large dip in their respective markets.

The UK FTSE 100 Index performed negatively for the quarter, declining 2.2% year to date. European giants Germany and France were up at quarter end, the DAX and CAC returning 0.04% and 2.18% respectively. The S&P 500 returned 1.3% for the year so far.

**Asian markets** had a slow start to 2014 - the Chinese Shanghai Composite Index and the Japanese Nikkei were considerably weaker after quarter one, falling by 8.56% and 9.87%. This was largely based on the slowdown in China's annual growth and Japan possessing the firms that produced the second-lowest return on equity amongst developed markets. There have been talks of a Chinese stimulus injection into the economy and there has been strategising by Japan's Shinzu Abe to steer the Japanese economy out of deflation and realign the corporate structures for better growth. ■

## Tracking the South African Rand

South Africans are quite used to seeing our currency yo-yo up and down – we've seen it happen more than once over the past two decades.



Figure 6: The ZAR/USD exchange rate since 1994.

Source: fxtop.com, Warwick Invest

In 2013, the rand weakened by over 20%. That is a substantial loss of value and will of course impact many factors of the economy. Where do we go from here?

We must remember that South Africa is not viewed in isolation but rather as an emerging market. Whatever factors affect emerging markets as a group will have an effect on our economy. Ben Bernanke's announcement in May last year about tapering caused a huge sell-off of emerging market assets, resulting in a drop in most EM currencies. The ZAR depreciated by more than 12% in May.

We feel that global markets in general have since learned to price risks better and are better managing their uncertainty. Markets have taken tapering in their stride and the overreaction we saw in May last year is now a thing of the past. The rand ended the first quarter of 2014 on a similar level than where it started. Over the same period last year, the rand weakened 8.92%.

Will the rand see another 20% depreciation in 2014? Probably not. The path to global market recovery is still a long one, and the elevated returns due to unnatural and unsustainable high liquidity and low interest rates seen over the last few years will most likely not be the norm going forward. ■



**Warwick MET Managed Fund**

Few changes were effected in the Warwick MET Managed Fund over the last three months. We sold our holding in Acucap Properties as well as The Foshini Group (together less than three percent of the portfolio) and we bought small holdings in Adcock Ingram and African Bank.

Our cash holding was reduced and our fixed interest holding increased through our position in the Warwick MET Enhanced Income Fund – although both earn interest, the yield on fixed interest instruments are higher and more beneficial for our clients.

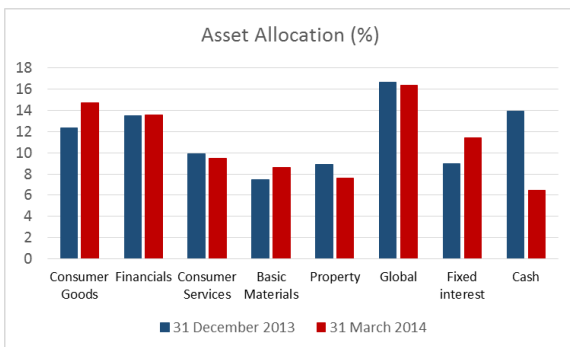


Figure 7: Changes in the asset allocation of the Warwick MET Managed Fund for the year to date – it is clear that no major changes were made (not all categories are shown here).

Source: MetCI, Warwick Invest

We rebalanced the portfolio in 2013 to be more in line with our house view. This restructuring was done with long term performance in mind.

In 2013 we decreased our property exposure and increased our exposure to both fixed interest and global assets. Our flagship fund continues to show an upward trend, as can be seen in the six-month graph from September to March. Record high levels have been reached during the month of March and the fund returned 2.33% in the month.

The Warwick MET Managed Fund returned 14% over the last year and a cumulative return of almost 35% over the past 24 months. The upward trend in the fund can be seen in the following graph:

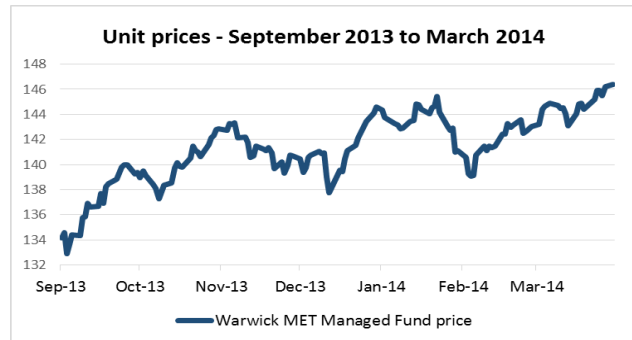


Figure 8: Unit prices for the fund shows an upward trend over the last six months. A dip in January similar to that of global markets was experienced.

Source: MetCI, Warwick Invest

**Warwick MET Managed Fund of Funds**

Over the last quarter, a few minor changes in the underlying asset allocation of the Warwick MET Managed Fund of Funds occurred – our property and bond exposure decreased slightly while equity and cash exposures edged up slightly. The asset allocation as at the end of March 2014 can be seen below:

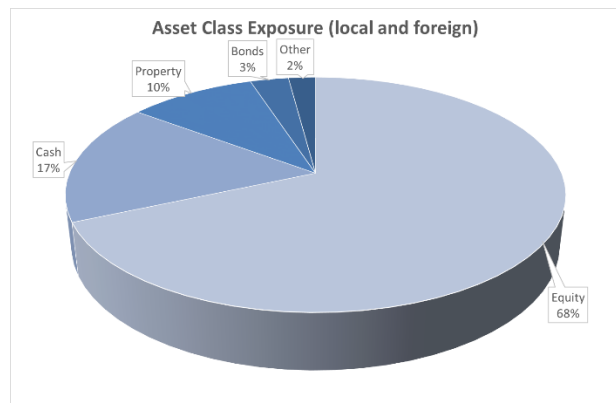


Figure 9: The asset allocation for the Warwick MET Managed Fund of Funds as at the end of March.

Source: Met CI, Warwick Invest

We replaced the two fixed income funds that we previously held, the Momentum Income Plus Fund and the Coronation Strategic Income Fund, with the recently launched Warwick MET Enhanced Income





Fund. We are also replacing the Sasfin MET Equity Fund with the Momentum Value Fund in April.

This Momentum fund follows an unconstrained approach to investing and has a good long term track record. A fund that follows a contrarian investment style should have a low correlation to the rest of the funds that we hold, and thus lower the overall volatility of the fund.

The exposure to different asset managers, asset allocations and investment styles has served the Warwick MET Managed Fund of Funds well over the past year since launching last April.

In the graph below, the lower volatility of the Fund of Funds relative to the JSE All Share Index over the last three months is clearly visible – the magnitude of the upwards movements and downward movements of the fund is less than that of the All Share Index.

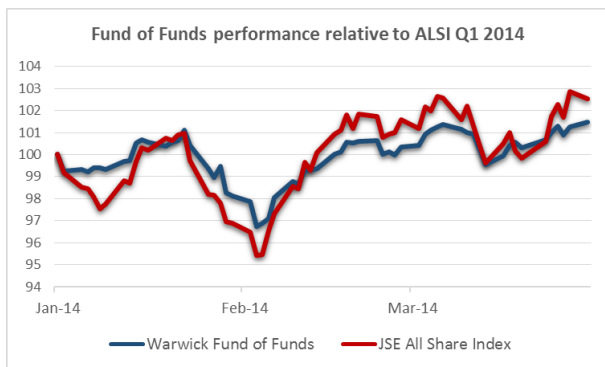


Figure 10: Lower volatility of the Warwick MET Fund of Funds can be seen when comparing the fund to the return of the JSE All Share Index over the past three months.

Source: McGregor BFA, MetCI, Warwick Invest

The Warwick MET Managed Fund of Funds returned 14.66% between inception (2 April 2013) and the end of March 2014. ■

**The Warwick MET Enhanced Income Fund**

The Warwick MET Enhanced Income Fund completed the first quarter of the year well within keeping with its objective of delivering high levels of income whilst ensuring stability in the capital that is invested. Despite huge market volatility, the fund produced positive returns during the month of January, placing it in the top quartile for its designated unit trust category. A weaker currency, higher inflation expectations and an interest rate hike could not detract from the performance gained.

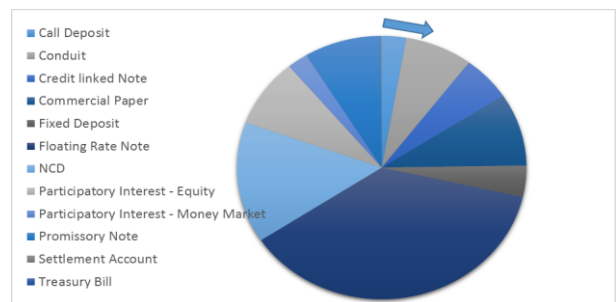


Figure 11: Fund structure as at the end of March 2014.

Source: Warwick Invest

<u>Investment Instruments</u>	<u>Weight</u>
Call Deposit	2.73%
Conduit	7.58%
Credit linked Note	5.53%
Commercial Paper	8.92%
Fixed Deposit	3.83%
Floating Rate Note	37.12%
NCD	14.86%
Participatory Interest - Equity	8.40%
Participatory Interest - Money Market	2.30%
Promissory Note	8.65%
Settlement Account	0.08%
Treasury Bill	0.00%

Table 1: Fund structure as at the end of March 2014 (percentages).

Source: Warwick Invest



The Fund continues to be well positioned to yield returns in excess of those delivered by vanilla cash investments while maintaining the necessary liquidity.

During the latter part of the quarter, investments were made largely into floating rate notes and carefully selected credit instruments that provide the necessary protection, should there be further increases in interest rates as anticipated over the coming year.

We continue to evaluate opportunities within the broader investment universe of the fund and will participate as long as we can ensure that we remain within the liquidity constraints and risk parameters defined.

**Glossary:**

***Floating Rate Notes (FRN)** are medium/long term debt instruments that pay a variable interest rate. The final interest rate payable by FRN is composed of a reference rate (floating part, tied to a certain money-market index like JIBAR) and a spread (fixed part, payable on top of the reference rate). The floating part of the note is typically being periodically adjusted on a quarterly basis.*

***Negotiable Certificates of Deposit (NCD)** are investments normally issued and guaranteed by a bank and can usually be sold in a highly liquid secondary market, but they cannot be cashed in before maturity. NCD's usually pay coupon interest on a six monthly basis. ■*

**Warwick International Balanced Fund**

We are three months into 2014 and so far it has really been a year that will not be forgotten easily. No economy, developed or emerging, could escape the market madness that saw both dramatic losses

and gains across all markets. Some economies are still left to make up for what has been lost and others are already in positive territory for the year.

Asian markets suffered a large drop in January and are yet to find their way out - the Nikkei (Developed Market) and the Shanghai Composite Index (Emerging Market) both suffered significant losses.

Global market conditions seem to have stabilised, with the exception of Russia's land grab escapade with the Ukraine over Crimea, which has caused a lot of concern amongst world markets. Sanctions have been implemented against Russia and they have been warned against any use of military force by the US. Markets watch with baited breath to see if the US will get involved. Negotiations are still ongoing and investor confidence has been on the rise since the initial incident. Markets have begun to pick up after the initial negative knee-jerk reaction and we expect this to continue.

With all this in mind, we have been watching the markets carefully and reduced our Asian exposure to a minimum at the beginning of the quarter. This reduced our equity exposure and increased our holdings in cash. Cash as an asset class reduces the risk to violent fluctuations in the equity market while giving us the opportunity to be ready to "buy in" should an opportunity present itself. The current general consensus in the industry is to hold a little more cash than normal for the exact reasons listed above.

We are constantly researching potential FSB approved funds in which to invest that will complement the funds already held within the Warwick International Balanced Fund portfolio and that will keep the Warwick International Balanced Fund in line with the Warwick ethos. ■



## Beneficiary nominations

### **Silma Hamdulay, MD of Warwick Trust, shares a few tips to consider when nominating beneficiaries for a death benefit from a policy.**

When nominating a beneficiary on your policies, consider the following:

- Death benefits to a nominated beneficiary are not tied up in your estate and will be processed and paid out immediately by the relevant financial institution. The proceeds of the policy fall outside of your estate and therefore do not accrue executor's commission, nor can it be claimed by the Executors to settle estate debt.

There are, however, important changing circumstances and factors to consider when making the decision to nominate any one person:

- Marriage or divorces  
These are life changing events which would warrant changes to beneficiary nominations on a policy. As these actions do not automatically replace beneficiaries, the life insured must take effort to attend to the changes of the policy document with the relevant insurers and by signing the pertinent paperwork.
- Nominations of beneficiaries who are not residents or have immigrated.  
The likelihood of these beneficiaries wanting payment to their overseas bank

account creates the administrative process of having to comply with Exchange Control Regulations. This prolongs payment until such time as strict requirements have been complied with, and a clearance is issued by regulators.

- Insolvent or incapable beneficiaries.  
In the instance of a mentally incapacitated or insolvent beneficiary, payment must be facilitated through the curator or trustee appointed by the court, as the beneficiary is unable to directly accept the benefit.
- Payments to minor beneficiaries nominated.  
The funds cannot be paid to a minor, and must be paid to the natural or legal guardian or the Guardians Fund. In the instance of payment to guardians, there is a potential risk of the funds not being suitably invested to the benefit of the minor. To protect the minor beneficiary, a testator may, in his Will, stipulate a Trust to be created and to be administered for the benefit of the minor.

The value of a life policy, despite nominating a beneficiary, is included in the calculation of Estate Duty, which is the tax due to the South African Revenue Services on your death. ■

# FINANCIAL MATURITY

Quarterly newsletter

April 2014

## The power of your cell phone

Gone are the days where your cellular phone was just that – a phone. We can now do just about anything with our smart phones.

Warwick Cover has harnessed the power of the “app” era and will soon be launching a smart phone application that will allow its insurance policy holders the ability to have numerous insurance and lifestyle benefits available at their fingertips.

Soon, policyholders will be able to manage their policy, seek assistance with any emergency, report and monitor a motor claim as well as store valuable data on their Warwick Wealth application.

A screen shot of the application is noted below.



For more information please contact Roy or his team on 0800 50 50 50. ■



Warwick Wealth Presentation Video  
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