News and Review

Volume Six – April 2017

Dear Investor

We would like to remind you that it is your responsibility as an investor to ensure all your details held by IFM are current and up to date. This includes your FICA documentation. If any of your details have changed since opening your account, please do inform us immediately. If you are not sure if any of your details are incorrect or if you have any outstanding FICA documentation, we would like to urge you to call us on 0861 11 60 75 or email us on admin@itransactfm.co.za in order to confirm. In accordance with the Act, all investor accounts are frozen where we do not hold the required FICA documentation.

1.1 Analysis of the Portfolios

As part of the regulations that govern financial institutions, a manager must publish on its website each calendar quarter a general investor report that details an analysis of the portfolio with reference to the extent to which it has, or has not, adhered to its policy objective. We can report that for the quarter ending 31 March 2017, the following two portfolios have adhered to their respective policy objectives:

- **IFM Technical Fund** with the objective of being a general domestic equity fund where investment decisions are based on technical analysis.
- **IFM Balanced Value Fund of Funds** with the objectives of prudential asset allocation and being a medium equity fund to secure balance between capital growth and income.

Summary of analysis of the respective portfolios for this quarter:

PORTFOLIO	IFM TECHNICAL FUND
January 2017	• No changes to the portfolio.
February 2017	• No changes to the portfolio.
March 2017	• Decreased holding of the following shares: - Anheuser-Busch - Aspen Pharmacare Holdings - British American Tobacco PLC - Old Mutual PLC - Steinhoff International Holdings N.V.

	• Increased holding of Schroder European Real Estate Investment Trust PLC. • The following securities were added to the portfolio: - Achor Group Limited - Anglo American PLC - Assore Ltd. - Nictus - Rolfes Holdings - Sasol.

PORTFOLIO	IFM BALANCED FUND OF FUNDS
January 2017	• Increased holding of: - Allan Gray Money Market Fund - Momentum Bond ABIL Retention Fund (A) - STANLIB Bond Fund A Class - STANLIB Bond ABIL Retention Fund - Momentum Bond Fund (A). • Decreased holding of: - Stanlib Bond Fund A Class - Stanlib Global Bond Feeder Fund – Class B3.
February 2017	• Increased holding of Allan Gray Money Market Fund. • Decreased holding of STANLIB Global Bond Feeder Fund – Class B3 & Old Mutual Global Bond Feeder Fund A.
March 2017	• Increased holding of Allan Gray Money Market Fund and Foord Equity Fund Class B1. • Decreased holding of the IFM Technical Fund and Foord Equity Fund Class B1.

1.2 Enquiries regarding your investments

Please direct your enquiries as follows:

- All administrative enquiries, for example a request of statement or balance of investment, redemption request, update of contact details, enquiries regarding FICA or assistance required to log onto the IBrowse system is handled by Itransact Fund Managers. The telephone number is 086 111 60 75, and the email is admin@itransactfm.co.za.
- All investment specific or portfolio enquiries are handled by Heiden Grimaud Asset Management. The telephone number for the fund is 0861 378 378, and the email is investments@heidengrimaud.co.za.

1.3 News from the Fund Manager's Office

Credit ratings and its effect on South Africa

The South African financial markets have experienced turbulent times in recent weeks. Actions taken by President Zuma to recall the then finance minister, Pravin Gordhan, from an international trip, the reshuffle of the cabinet and a subsequent downgrade of our country's credit rating made headlines on a daily basis. However, in our local funds we have seen positive movement over this time period, which can be seen from the table below.

	IFM Technical Fund	IFM Balanced Value FoF
Pravin Gordon is recalled	Increased in value with +1,92%	Increased in value with +2,62%
JZ reshuffles his cabinet	Increased in value with +2,60%	Increased in value with +4,21%
S&P downgrade SA debt	Increased in value with +4,27%	Increased in value with +6,47%

You may wonder how the units in the funds could show a positive increase in an environment where the country rating went down. Let's first look at credit ratings and what they are.

1. What is a credit rating?

A credit rating is a relative opinion about credit risk, and measures the *presumed creditworthiness* of an individual, company or nation, such as South Africa. In simpler terms, it basically indicates what the willingness and capacity will be for the individual, company or nation to repay their debt (loans) in full and on time.

A credit rating is a single grade and this grading system plays a role in financial markets. A credit rating is not investment advice per se', but rather a factor that investors and financial institutions take into consideration when making decisions on where to invest. The impact of this credit risk information on bond and equity prices is not always clear or easy to predict, but keeping close track of changes in the creditworthiness often pays off for investors.

2. Credit rating agencies

Credit rating agencies assign credit ratings for issuers of different types of debt obligations. For their analysis they use both public and private information, based on several aspects, such as qualitative and financial. This information is then used to forecast credit performance opinions with a series of macro-economic and credit conditions, including stress situations.

The main rating agencies are Moody's, Fitch and Standard & Poor's (S&P) and are collectively referred to as the 'big three'. Moody's was the first main credit rating agency and started in 1909. Standard & Poor's established soon after Moody's in 1916 with Fitch following in 1924. Numerous studies over the years show that these big three rating agencies often provide new information to the markets in addition to what is already publicly available. The role of these agencies has become increasingly important - pension funds are for instance sometimes only allowed to invest in investment grade rated debt (debt above a certain credit rating).

Each credit rating agency uses their own method in the measurement of creditworthiness and use a specific credit rating scale to announce its ratings opinions about default probability.

S&P and Fitch use both the ranking scale: AAA, AA, A, and BBB for investment grade categories and BB, B, CCC, CC, C, and D for speculative grade rankings which reflect a higher default probability. Moody's long-term rating scale for investment grade is: Aaa, Aa, A, Baa and for speculative grade: Ba, B, Caa, Ca, and C.

Often the rating agencies add modifiers to the ratings to classify and rank ratings within every group category. To modify the ratings Fitch and S&P use pluses and minuses, whereas Moody's generally uses numerical adjustments 1-3, where 1 indicates that a credit lies in the higher end of the rating category, 2 implies mid-range of the rating category, and 3 implies the lower bound of the rating category.

The agencies also announce Credit Watch (S&P), Rating Watch (Fitch) or Watch List (Moody's). A 'watch' means that a rating has been placed under review until further data about the event causing the change in credit perception have been obtained, without necessarily changing the rating after obtaining the missing information.

Investors and regulators desire some level of stability and do not want rating changes to reflect small changes in financial conditions. Therefore, agencies filter out temporary credit risk components. This way rating changes reflect only long-term structural components, and agencies avoid excessive rating reversals, bearing the cost of some delay in relation to the financial market pricing of securities.

South Africa was, until now, rated by S&P at BBB-, with a negative outlook, the lowest possible *investment-grade* rating. The rating of South Africa is now BB+ - below investment grade (also commonly known as junk status). As a result of this downgrade, we will notice an outflow of investment funds from bonds and equities as many local and international investment funds are mandated to place their money in investment-grade jurisdictions only.

A ratings downgrade will lead to lower access to credit and, potentially, an interest rate increase, which would affect many South Africans because they would be paying more to borrow money.
Higher interest rates increase the cost of families paying for loans from banks, financing things like

home-loans and vehicle finance. The rand could also decrease further in value, causing a rise in the price of imported goods.

This brings us to our original question. If the rating of South Africa was downgraded, why has the value of the units in the funds increased?

The fund manager has had the view that the value of the rand will fall over time. He has positioned both funds by buying quality shares, many being rand hedge shares. A hedge in the context of financial markets offers protection against a future change in the value of an underlying item, for example, the value of the rand. On a market capitalization basis, around 70% of the value of the JSE is now in rand hedge stocks. This is because of the dominance of a number of large cap counters such as Naspers and British American Tobacco that are effectively international companies.

The portfolios have not, however, only been structured to include shares because it is rand-hedged. We look at each share on an individual basis. We consider the range of the business model of the organisation, the quality of management, the industry dynamics, regulation, and the supply and demand dynamics. The currency is a part of that, particularly its impact on returns generated offshore. Remember that in economies doing badly, there are always still companies doing well. It is important to buy those select companies that have a competitive advantage and can produce returns. Furthermore, and very importantly, we look at investments over the long-term.

You might feel that South Africa is currently in a messy situation as a result of recent changes. But there is always a silver lining. Our current portfolios are well diversified, with a substantial exposure to offshore assets. Many of the companies in which rand-hedge shares are held, have operations outside of South Africa and so earn revenues in other currencies. Commodities are also generally priced in US dollars, so a weakening domestic currency means higher revenues *in rand terms*.

We are still of the opinion that the rand can weaken further. We base this view on the current political instability, especially towards businesses and foreign investment. Direct foreign investment has already shown a considerable decline in recent months, and this will further decline now that the country has been downgraded to junk status. Any deficit on the balance of payments (which includes the trade deficit) must be financed by foreign capital inflows, mostly into our bond and equity markets. These inflows will certainly decline and without capital inflows, the rand must take the full blow as our currency reserves are not large enough to shore up the currency. Foreign investors are already showing losses on their investments in South Africa (in foreign currency terms) because of the weakening rand. At some stage they will decide to cut their losses and run, resulting in a significant outflow.

We always say to our investors to spread their risk and not put all their 'eggs in one basket'. If you are seriously thinking of diversifying into a larger offshore investment, remember that South Africans have an offshore investment allowance of R10 million per registered taxpayer per year. This can be taken out of South Africa and be invested offshore. Should you, or any member of your family, consider such an investment, kindly contact our business executive, Carin Henderson (Tel. 0861 378 378), to set up a discussion to look at your and your family's specific requirements.

The Heiden Grimaud Global Fund, which is a Guernsey domiciled fund, denominated in euro's, offers investors a convenient way to further their offshore exposure to developed financial markets as part of their overall investment strategy, with maximum capital appreciation as their primary goal. Investments are made in global equities listed on recognized exchanges around the world, typically those in the developed markets of the US, Europe, UK and Asia. For example, some of the global company shares which were held by this fund are shares such as Apple Inc., Amazon Inc., Deutche Bank, Ten Cent Hldgs, Barclays Plc KBC Group NV, Samsung Electronics, Johnson & Johnson, Ford Motor Corp and Steinhoff Int NV.

Yours in investments.