

News and Review

Volume Eight – October 2017

Dear Investor

As we are entering the final quarter of the year, we hope to have all investor details updated and in accordance with the Act. Legislation that governs all investment actions stipulates that the records of investors are correct and up to date. If any of your details, such as your contact number, email address (where possible) and address 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.

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 30 September 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.

Herewith a summary of the analysis of the respective portfolios for this quarter:

Portfolio	Analysis
IFM Technical Fund	<p>JULY:</p> <ul style="list-style-type: none"> • Decreased holding of Nictus and Steinhoff International Holdings N.V. Added holding of African Rainbow Minerals. Increased holding of Anchor Group Limited, British American Tobacco PLC and Compagnie Financiere Richemont SA. <p>AUGUST:</p> <ul style="list-style-type: none"> • Increased holding of Anchor Group Limited and British American Tobacco PLC and Naspers. Decreased holding of Steinhoff International Holdings N.V. <p>SEPTEMBER:</p> <ul style="list-style-type: none"> • Added Novus Holdings. Decreased holding of Nictus.

Portfolio	Analysis
IFM Balanced Value Fund of Funds	<p>JULY:</p> <ul style="list-style-type: none"> Increased holding of Allan Gray Money Market Fund. Decreased holding of IFM Technical Fund. Increased holding of Stanlib Bond Fund A Class, Stanlib Bond Abil Retention Fund and Momentum Bond Fund (A). <p>AUGUST:</p> <ul style="list-style-type: none"> Increased holding of Allan Gray Money Market Fund. Decreased holding of Foord Equity Fund Class B1. <p>SEPTEMBER:</p> <ul style="list-style-type: none"> Increased holding of Foord Equity Fund Class B1 slightly again and Allan Gray Money Market Fund.

1.2 Enquiries regarding your investments

Should you have any enquiries regarding your investments, please direct it 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



Is Naspers the most important share on the JSE?

Naspers Limited, the holding company for the group of companies which operate in the electronic and print media industries, has been in the financial news on a daily basis in recent weeks. As we hold shares in Naspers in both our portfolios, in this edition of the newsletter we want to focus on this company and the influence of its share price on the overall performance of the JSE.

The Group, which was founded in 1915, provides television subscription and internet services, as well as publishing newspapers, magazines and books in more than 120 countries. It is also one of the largest investors in technology in the world and has sizeable investments in Tencent, Mail.ru, MakeMyTrip Limited and Flipkart. The company has its primary listing on the Johannesburg Stock Exchange (JSE) and has an ADR (American Depository Receipt) listing on the London Stock Exchange.

1. Background to Share Indices

Share indices are used in all equity markets as a measure of the value of the share market as a whole, with declining indices commonly labelled as a *bear* market, and rising indices known as a *bull* market. The factors determining exactly which shares are eligible to contribute to an index are specified precisely by the regulatory body governing each exchange. The inclusion criteria

are mainly based on three factors, namely market capitalization, share liquidity and business type. Most stock exchanges, including the JSE, have a single index that measures the overall price performance of all equities listed on that exchange (The All Share Index), as well as indices that measures the performance of various business sectors within the overall market.

2. The JSE Top 40

The JSE is often defined by its most prominent index – the JSE Top 40. Many market watchers view this as a barometer for the wider market. According to Mark Randall, the manager of indices and valuations at the JSE, the Top 40 is designed for the South African investor and aims to reflect the 40 companies, ranked by market capitalization, or market cap, of the local market. The market cap of a company is the number of shares outstanding times the current share price.

The first criteria to be included in the Top 40 is that the company must be listed on the All Share Index. This index is reviewed in March and September annually and qualifying firms must meet the eligibility criteria.

Broadly speaking, the rules include:

- The company must be listed on the main board of the JSE.
- The firm must trade 0.5% of its investable market capitalization on the JSE each month.
- At least 15% of the company's global issued shares must be available to trade.
- Foreign firms must have a minimum of 1% of their total issued share capital held in South Africa.

Once the All Share is selected, it is used to select the Top 40. The latter is reviewed quarterly and ranks companies on free float adjusted market capitalization rather than gross market capitalization. The free float adjustment excludes numerous types of shareholdings that are deemed to be not freely available, such as director holdings, strategic holdings, holdings subject to a lock-in clause and holdings on a foreign share register.

Glencore is a top five company in terms of market capitalization, putting it near the top of the All Share Index, and Large Cap Index for that matter. However, only about 3% of its shares are held in South Africa, and this three percent is the fraction used to calculate its total market capitalization.

Using this investable market capitalization measure can create distortions. For example, in the Top 40, Anglo American ranks fourth in terms of weighting because of its high local share ownership. But when compared with all companies listed on the stock exchange, it is the 13th largest in terms of market capitalization. British American Tobacco has a small weighting and so does AB InBev, even though SABMiller used to appear on the Top 40 with a weighting of 13%.

3. The Naspers Share

Naspers accounts for about 20% of the Top 40. In an environment where, until recently, mining stocks have defined the character of the local market, the JSE has been dancing to a different tune, one that is increasingly played by the Naspers piper. It is fair to say that the fortunes of the JSE are significantly more dependent on the number of youngsters playing video games in China than on the value of mineral resources extracted from South African soil — or any other local activity for that matter.

The Top 40 index attributes most of its growth to Naspers. As a result of its 34% stake in Tencent, the biggest gaming company in the world, Naspers's stocks continue to grow as they track the Tencent share price. The company has recorded a capital gain of 27% since the beginning of the year.

For quite some time, the JSE All Share Index has been characterized by its high level of internationalization. A number of major multinational companies that make most of their money outside South Africa are listed on the exchange, and so the performance of the JSE is more often driven by global developments than by domestic ones.

Naspers qualifies as a very good example. This share is the only modern stock and with its holding in Tencent, it has followed a considerable price increase. Its market capitalization has increased and resulted in the rise in Naspers' weighting in the TOP 40 index. The share price is rising much faster than the rest of the market, driven by the share being gobbled up by institutional funds in ever increasing amounts.

To say that the Top 40 has become far riskier due to its reduction in weighting diversity is an understatement. In fact, it is downright dangerous. Being priced to perfection, all that is needed is some hiccup with an earnings miss and the share will be severely punished by investors, which will obviously have an outsized negative effect on the JSE. This herding of large money into a few larger cap counters is a classic phenomenon near great market tops in most worldwide stock markets. It is clearly a problem when the largest shares making up more than 50% of the weighting of the top 40, that are doing the heavy lifting, are priced to perfection or overpriced due to herding. The risk becomes concentrated to just say 10 shares as opposed to being distributed among 40 shares. The manifestation of this herding also brings along the change of the JSE upwards or downwards, as a result of movement on the Naspers share alone – being the share with the largest weighting on the exchange.

Even with the growth of a share like Naspers and other listings such as Richemont (up by 25%) and British American Tobacco (up by 15%) on the exchange as a whole, there is a disconnect between the performance of the JSE and other exchanges: those elsewhere are experiencing growth, but the JSE has been flat.

Political events are partly to blame, for example, the recent release of the new mining charter has hurt local mining stocks. Another factor to consider is that the larger market cap shares on the exchange are from old industries.

However, the rise of Naspers, coinciding as it has with the sustained bear market for commodity stocks, has seen a material shift in the character of the JSE. One only has to glance at the portfolios of South Africa's highest profile equity unit trusts to confirm that. The Naspers share is the largest holding in many equity funds, including the funds managed by boutique managers. This is a clear indication that there is a fairly broad consensus amongst asset managers about the importance of the share. Given its current prominence, one has to believe that whatever happens to Naspers will materially affect the overall market.

Yours in investments.