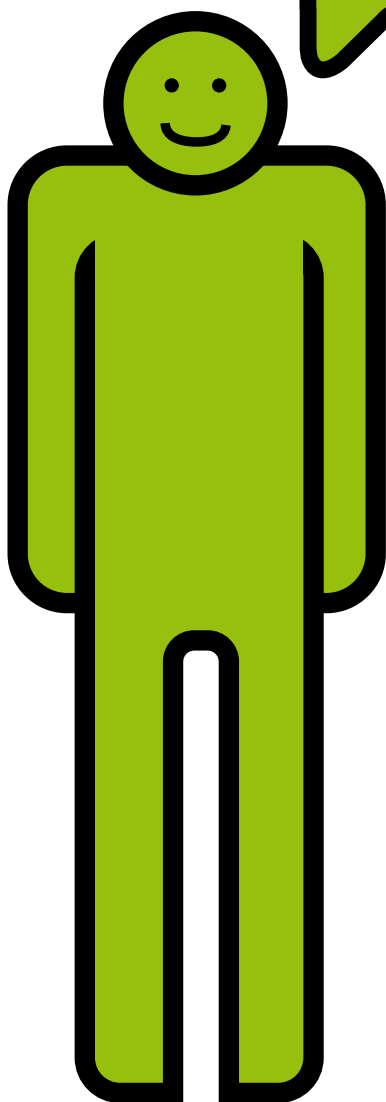


# OMIGSA'S INVESTMENT INSIGHTS

22 AUGUST - 2 SEPTEMBER 2011

Are you  
facing your  
retirement  
**GIANT?**



## INSIDE:

- TAMING THE INFLATION GIANT
- ONE SIZE DOES NOT FIT ALL
- TAKE A NEW LOOK AT EQUITIES
- MULTI-MANAGER FUNDS



**OLD MUTUAL**  
Investment Group

# Taming the inflation GIANT



Pieter Hugo  
Managing Director of Old Mutual Unit Trusts

In my job I have the benefit of seeing what many investors do and I strive to understand what drives their decisions. Two of the biggest challenges they face are making sure:

- their investments produce inflation-beating returns (otherwise they literally move backwards and would've been better off spending the money); and
- they have enough exposure to growth assets in order to provide them with a calculated chance of achieving their investment goals.

Most often an investor's biggest obstacle to achieving both of these objectives is their own aversion to exposing their hard-earned money to the risk of losing any of it over any given period, typically the shorter term.

But it is worthwhile to bear in mind that any form of significant or worthwhile growth requires a bit of a stretch. Whether you are studying for a degree or training for a marathon, you need to step out of your comfort zone and push your limits in order to achieve your goal.

The same goes for investing: to get solid, inflation-beating returns in your portfolio over the long term, you need to take on more volatility risk than you may feel comfortable with. This is because the medium-term picture is likely to be very different to that of the past decade.

Traditionally, investors, such as retirees and those nearing retirement, would reduce equity in their portfolios and increase exposure to investments that offer protection from market volatility and, once retired, they would draw an income from these investments.

Today people generally retire earlier and live longer. The net effect of this is that the time they spend in retirement, living off their investments, is much longer; while the time spent building those investments is shorter due to the reduced time spent earning an income.

So we are faced with a paradox, in that it is now risky to be risk averse: therefore clearly the same recipe used by investors in the past may not deliver the same success as it did in the past, and one needs to consider alternative solutions; these would include investments with a higher exposure to growth assets like equities (shares), which also have the benefit of some inherent inflation protection.

In addition, we need to consider the possibility that the risk of inflation eroding the real (after-inflation) value of these investments is equal to, or may even outweigh, the risk of negative performance in the equity (share) markets – especially if we account for increased longevity.

The general consensus among investment experts is that we are now in a low-return world. It is therefore important to clearly understand that we are going to get less performance across asset classes than we have been accustomed to in the past. This challenge is exacerbated by the prospect of low interest rates coupled with rising inflation. This combination is putting a squeeze on the real returns investors can expect.

Savvy investors should be aware of the nuances of inflation. While government, unions and asset managers all use the official consumer price inflation (CPI) figure as a handy point of reference, the reality for individuals is that there is no such thing as one inflation figure, because we consume different things in different amounts according to our life stage and economic status. Thus each individual has a different, personal inflation “basket”. On page 3 Johann Els, an economist with Old Mutual Investment Group SA (OMIGSA), takes an in-depth look at inflation, with a particular focus on its reality for retirees. In short, despite the fact that most retirees bank on retiring debt free, many forget to plan for the fact that they are faced with a higher inflation rate – which means that they need a higher growth rate in order to sustain their income level.

As you can see, the convergence of low interest rates and high inflation does not bode well for investors who have money saved in bank accounts, or are overexposed to money market and fixed income investments. Not only is the level of interest income they are earning low, but the purchasing power of both their income and capital will be eroded by inflation.

While there is no denying the important role that our money market and fixed income investments play in providing volatility protection, liquidity and income payouts, we should give some serious thought to the implications that inflation and interest rates have on our investment portfolios, and our retirement savings in particular.

If you consider the facts above, it must be clear that if you are heavily invested in the money markets, you should consider alternatives. I'm

not suggesting that you move from a low risk investment into a pure equity fund, but there are many unit trusts that offer combinations of volatility protection, regular income and growth, or simply manage risk better by investing across all asset classes (money market, bonds, property and equity) with targeted outcomes for clients. This means that you will be exposed to more opportunity while being protected from the risk associated with being exposed to only one asset class.

Another important weapon in our investment arsenal is dividend-yielding equity. Dividends play a dual role by helping us overcome the erosive effect of inflation and boosting income – and the best part of this is that dividend income is tax free in the hands of investors. Feroz Basa of Value Equity Investments discusses this in more detail in his article ‘Take a new look at equities’ on page 5.

Our range of asset allocation unit trusts offers the risk benefits of diversification as well as exposure to dividend-yielding equities. Managed by the experienced team at Macro Strategy Investments, these are ‘solution’ funds; this means that they are designed to achieve specific return targets, and some have built-in protection to meet specific risk requirements. In addition, most of them are managed in line with Regulation 28 of the Pension Funds Act, making them ideal to include in a retirement portfolio.

Old Mutual Real Income Fund, aimed at cautious investors, targets inflation + 3% p.a., has become very popular over the past year and now is over R1.5 billion in size, proving that it meets the real needs of many investors who are awake to the twin challenge of the need for protection *and* growth previously outlined.

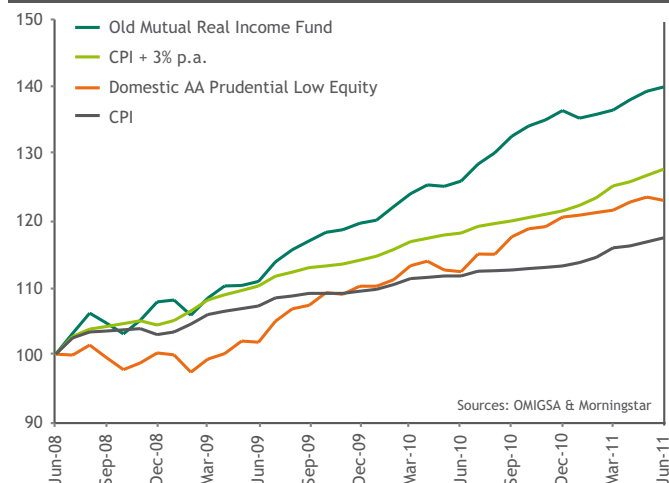
A best-of-all-worlds investment, it offers capital growth and dividend income – through a maximum 35% exposure to equity and property – while income and volatility protection are achieved through expertly selected exposure to fixed-income assets.

Not only does this fund do a good job of delivering on its mandate but, on a relative basis, it has been a regular top-quartile performer in the Domestic-Asset Allocation-Prudential Low Equity category, at lower volatility than its peers.

- Two years: ranks 8/58 funds, returning 12.4% p.a. vs the category average of 10.0% p.a. and CPI of 4.7%
- Three years: ranks 2/51 funds, returning 11.9% p.a. vs the category average of 7.6% p.a. and CPI of 5.5%

- Five years: ranks 3/31 funds, returning 9.6% p.a. vs the category average of 8.4% p.a. and CPI of 6.9%.

**Old Mutual Real Income Fund; CPI + 3%; CPI and Domestic-Asset Allocation-Prudential Low Equity category, three years to 30 June 2011**



For investors who require a more moderate level of income and seek to grow their capital slightly more aggressively, the Old Mutual Stable Growth Fund is a fund to consider, with a target of CPI + 4% p.a., while aiming to avoid losses over rolling 18 months. A choice for investors who do not need an income from their investment and want moderate to high growth over the long term could be the Old Mutual Balanced Fund which targets CPI + 6%.

Please talk to your adviser or broker, and ask them which of Old Mutual’s unit trusts will help you to meet your personal investment goals. Alternatively, visit [www.omut.co.za](http://www.omut.co.za) and plan different investment scenarios with our newly revamped online tools to see how much you should be saving.

But remember, whether you choose from our Classic Investment Collection, a smart selection of funds designed to meet the lifelong needs of most investors, or from our full range of over 40 unit trusts, Old Mutual Unit Trusts has an appropriate solution to help you meet your needs.

Thank you for choosing to invest with us.

# Inflation: one size does not fit all



Johann Els  
Senior Economist

**W**hen it comes to planning for retirement, the length of time to retirement is often an investor's main focus. But, in reality, there are four factors that determine how comfortable your retirement will be: retirement capital, retirement income, capital growth and inflation. Your ability to use any one of these depends on your age and personal circumstances.

If you are young and have a longer time horizon, you can start investing more to accumulate more capital; if you *can* do this, I recommend that you do. However, those of us who are close to or already in retirement, most likely cannot change the value of our retirement capital, nor the monthly income we will require, or that this needs to increase annually in line with inflation.

What few people realise is the significant role that inflation (increasing prices) plays in the retirement equation. And although we have little or no influence over the *level* of inflation, we can plan to invest in appropriate solutions that can help us beat inflation over time. It is easy to say 'beat inflation', but harder to achieve in reality. This is because the official inflation figure is based on averages, and is therefore unlikely to reflect your personal experience of price increases.

So first you need to know what your own inflation rate is before you can reasonably know how and where to invest your money.

## Inflation 101

According to Stats SA, inflation is the process of the continuous and considerable rise in prices *in general*. Put simply, it is the increase in the cost of living measured over a specified period of time and expressed as a percentage. This rise in prices erodes the purchasing power of your income over time, and you are not able to buy the same amount of goods or services with the same amount of money as you could in the past. And, because inflation continues year on year, you need to make sure your investments also outpace inflation on a continuous basis.

In South Africa, we measure the rate of inflation using international best practice via the consumer price index (CPI). This index is used to measure increases in the average price of a 'fixed shopping basket' of consumer goods and services over time, where each item carries a particular weight when it comes to determining the final figure. This basket is developed to be representative of the average South African household. The South African Reserve Bank (SARB) has identified an inflation band of between 3% - 6% as an acceptable yearly increase in the cost of living.

## So, what's in our 'fixed shopping basket'?

The goods and services we find in the 'All Items' basket fall into the 12 categories listed in the table below and include: health (medicines,

doctors, hospitals and medical aid contribution costs); housing; food and non-alcoholic beverages; utilities; transport; alcoholic beverages and tobacco; education; and communication. These items are weighted according to what the Stats SA survey finds as the average national weighting which represents how the average consumer spends his money.

## Inflation: one figure... but we are not all the same

As mentioned, the compilation and calculation of the CPI is governed by averages and, while this may be handy for the authorities to help them govern macroeconomic factors, it is not necessarily a reflection of everyday reality for you and me. This is because none of us is average, and the price increase in your personal basket and mine may differ substantially, because we consume different things in different amounts.

This pattern may be quite pronounced for specific subsets of the population, and is well documented. For example, if you are a pensioner, you will be harder hit by medical costs and food inflation than the average weighting suggests, so any increase in the inflation rate for those specific items is likely to affect you more than it would a younger person.

Consider that as at 30 June 2011, the official inflation figure was 5%, and then have a look at figure 1. It depicts the current weighting per item in the 'All Items' basket, and also indicates their year-on-year (y/y) price increases, i.e. what the cost was in June 2011 relative to the costs in June 2010.

FIGURE 1

	Weight	y/y
All items	100	5.0
Education	2.2	8.6
Food	14.3	7.3
Housing and utilities	22.6	6.8
Actual rentals for housing	3.5	5.9
Water and other services	3.3	9.3
Electricity and other fuels	1.9	19.0
Alcoholic beverages and tobacco	5.6	5.7
Non-alcoholic beverages	1.4	5.6
Health	1.5	5.4
Transport	18.8	5.2
Vehicles	11.3	-0.9
Petrol	3.9	21.4
Miscellaneous goods & services	13.6	4.2
Clothing and footwear	4.1	1.9
Clothing	2.9	2.2
Footwear	1.2	1.0
Household contents and equipment	5.9	1.5
Restaurants & hotels	2.8	1.1
Communication	3.2	-1.2

Source: Stats SA

If you are in the market for a new car you are lucky, but just about everything else has gone up. The figures in red experienced substantial price increases, and the greater proportion of your monthly budget that is spent on these items, the higher your inflation figure is likely to be.

### How this hits your pocket

As an individual, you will be able to identify areas where *your* personal basket will have a different weighting to that of the national average.

If you are still employed, did your after-tax annual increase from your employer compensate you for the actual price increases you have experienced? Or, if you are retired and increased your annual drawdown in line with the official inflation figure, do you have the same amount of cash in your pocket as last year? It is likely you either have had to cut some corners, or perhaps you are just managing to pay your bills. Figure 2 shows the y/y increase in inflation experienced by different demographic profiles to June 2011.

FIGURE 2

Consumer profile	Inflation rate June 2010	Inflation rate June 2011
National inflation figure	4.2%	5.0%
Poor & unemployed (more than half of expenditure: basics such as food, health and utilities)	2.7%	6.5%
Retired couple (half of expenditure: food, health & utilities; then insurance)	4.6%	5.7%
Blue collar worker (big basic expenditure + education + transport costs)	2.9%	6.2%
Average Joe (middle class 2.4 kids)	3.0%	5.9%
Wealthy home owner (luxury goods included in basket diminishes weight of more impactful items, therefore also lessens the gap apparent in the others.)	4.6%	4.7%

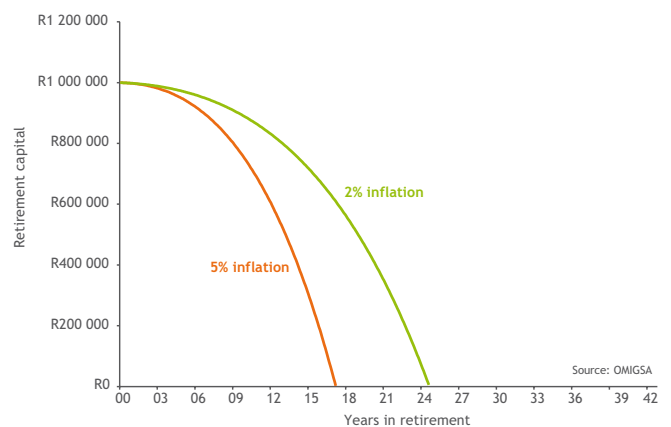
Source: OMIGSA/Stats SA

As you can see, the y/y differences are not negligible and need to be planned for. If you can, find some extra money to invest in an inflation-beating investment to help you keep the inflation monster at bay.

In retirement, if your capital is not growing faster than inflation and you continue to draw the same level of income, and prices keep rising as they do, the purchasing power of your income is diminished. Figure 3 clearly shows that inflation is a real threat. At retirement this investor wants to draw a monthly salary of R5 883 off a R1 million capital base that will grow at a rate of 7% annually, but is subject to two different inflation figures. Obviously the duration of your capital affects the sustainability of your retirement income.

The picture is then quite clear: the level of inflation dramatically impacts your ability to draw an income. As Pieter Hugo points out in his article on page 1, the argument is clear: you need to invest in assets that have the potential to give you a higher return over time... this is true in both the retirement planning phase (accumulation), as well as during retirement (decumulation due to income withdrawals).

FIGURE 3



### Your power lies in the third link in the chain...

Growth. You have no way of beating inflation unless you invest with the sole aim of generating *high real investment returns in your portfolio* over your entire working life, and beyond.

Given that your retirement capital, your income needs and your inflation experience are what they are, and are unlikely to change (unless you are young enough to save more, or have huge expenditure on luxury items which you can cut), the shining light at the end of the tunnel is that you can make a difference where it matters – your level of exposure to growth assets.

### Investing to inflation-proof your portfolio

So, when you select unit trusts to include in your portfolio, a key deciding factor should be by how much they aim to outpace your *personal* inflation figure, and not just the national average. This usually means that you need to be willing to take on additional risk through equity exposure. This need not be outrageous risk; by simply taking on a moderate amount of property and/or equity exposure in different amounts, you really can boost your growth, while still managing your protection and income requirements.

Pieter Hugo refers to some attractive options in his article and I hope that I have convinced you to at least consider inflation-proofing your portfolio for the future.

# Take a new look at equities

Feroz Basa  
Joint Boutique Head of Value Equity Investments



Do you ever wonder why investment experts are always urging long-term investors to include equities in their portfolios, when equity markets are so volatile these days and seem to be very risky? Statistics tell us that most investors are in fact avoiding equities – they prefer to put their savings into money market and low-equity funds after having been scared away by the big market moves we’ve seen in the last couple of years.

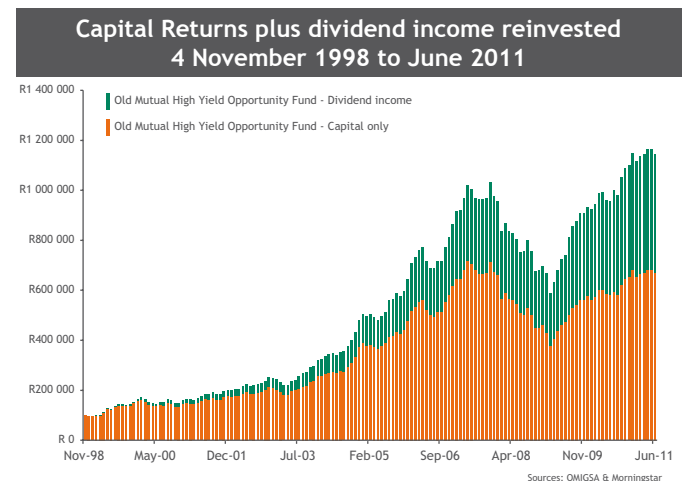
It’s true that the market value of equity investments jumps around a lot from month to month, and it’s extremely hard for investors to ignore a big short-term drop in this value. But what the investment experts know, and what investors aren’t considering, are two important long-term investing principles:

1) the market value will eventually recover, because historically equities have produced positive returns and are the best-performing investments over the long-term; and

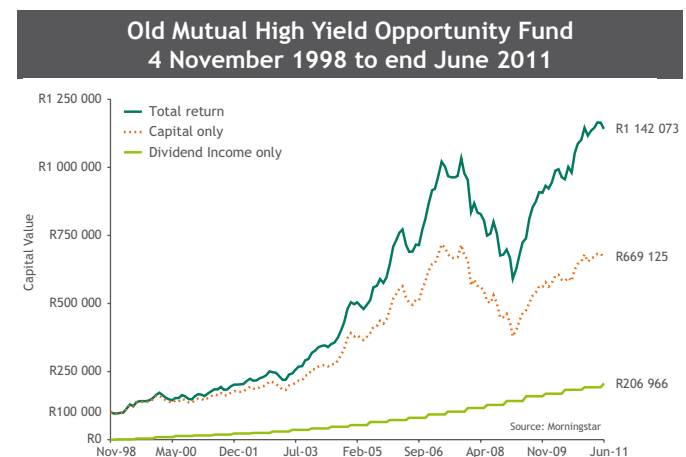
2) the dividends investors receive from their equity investments every six or 12 months provide a steady and growing stream of income that doesn’t change with the market value. Dividends are a very powerful source of returns that investors often forget about in their panic over a fall in equity market values.

But portfolio managers would never overlook the important contribution of dividends to equity returns over time. Feroz Basa, joint portfolio manager of the Old Mutual High Yield Opportunity Fund, and who focuses on achieving high dividend yields in his portfolios, says, “Research shows that dividends have contributed over half of the total returns from the Johannesburg Securities Exchange (JSE) over 25 years. Funds that hold shares of high dividend-paying companies have defensive qualities that help them to perform well in uncertain market conditions. So, as an investor, you should always remember to look at an equity investment for both its dividend returns and its market value – the total return. This reflects the true power of equity investing. Also, this more holistic view can help you to better weather the ups and downs of the markets and, by avoiding panic and sticking with equities, increase your chances of getting inflation-beating returns over the long term.”

The Old Mutual High Yield Opportunity Fund provides an excellent example of the powerful contribution of dividends to total equity returns over time. In the graph below, the value of the fund’s dividend income (shown in green) is reinvested and added to the capital returns (orange) – it clearly represents an ever-growing proportion of total returns over time.



The second graph shows how dividend income from the fund has grown steadily over time (light green line), providing a consistent return. The capital return or market value (dotted line) has also risen strongly over the longer term, but experiences the ups and downs of the equity market. The fund’s total return (dark green line) shows both dividend income and capital returns.



In fact, the graph shows how an investment of R100 000 at the time of the fund's start-up in November 1998 has already paid R206 966 in dividends (through 30 June 2011) - more than double the initial investment! If these dividends were reinvested, then with capital returns, the fund's total return would now be R1 142 073.

By contrast, the same R100 000 invested in an average SA money market fund\*, which does not offer dividend income or the potential for capital growth, would have returned R323 752 in interest income over the same period, while capital would have remained constant. These returns would be further reduced by tax.

The strong returns from equity (represented by the Old Mutual High Yield Opportunity Fund) compare very favourably to money markets, although they are riskier. This makes it easy to see why the investment experts do encourage long-term investors to include equities in their portfolios, and why you should have equity exposure if your risk tolerance allows. As an equity investor, it can certainly help you to weather those unexpected market drops and stay invested for the long term by remembering that your total equity returns are underpinned by steady and growing dividend income over time, regardless of market moves.

So take a new look at equities for the long term. With two sources of returns, you'll like what you see.

\* Source: Morningstar/Average fund return, Domestic Money Market category

## OLD MUTUAL HIGH YIELD OPPORTUNITY FUND

**Risk Rating:** 4/5

**Objective:** The fund aims to deliver a high level of dividend income coupled with long-term capital growth. It does this by investing in fundamentally sound companies that have high dividend yields and good prospects for long-term growth.

**Who should invest?** This fund suits investors seeking a dividend income stream and long-term capital growth. Investors should be able to tolerate equity market volatility.

**Performance:** The Fund is a top-quartile performer in the Domestic-Equity-General category over two, three and 10 years to 30 June 2011.

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# Multi-manager funds: You need to know this



Fred Liebenberg  
Head of Absolute Return and Fixed Income Manager Research at SYm|mETRY

**Find out how** investing with SYm|mETRY Multi-Manager may help you avoid the dangerous limitations of chasing performance.

## Can't see the wood for the trees?

This old saying points out that if you spend too much time looking at individual trees, you will miss out on the experience of the forest, i.e. getting too caught up in the details means you may lose sight of the bigger picture.

The same goes for investing: if you are preoccupied with which unit trust is currently the best performer, you may get distracted from your long-term investment strategy and fall into the expensive trap of switching between funds in an attempt to follow performance.

Not only can this behaviour be costly, but it may negatively impact the overall performance of a portfolio. This is because it takes a lot of time, research and investment expertise to understand an asset management company, and in what market conditions they perform well or may underperform.

## Today's star may be tomorrow's dog...

Even if you buy today's best-performing fund, if the market suddenly shifts, does the portfolio manager have the ability to adjust to the new situation? History indicates that each asset manager responds differently to different stages of the investment cycle.

The table below illustrates this point perfectly, tracking the performance of two asset managers in the Asset Allocation-Flexible category from 1 January 2002 to 31 December 2010.

Calendar year	Best-performing manager	Worst-performing manager
2002		Manager A
2003	Manager A	
2005		Manager A
2006		Manager B
2008	Manager B	
2009	Manager B	Manager A
2010		Manager B

Source: Morningstar

## SYm|mETRY does all the work for you

In South Africa, there are over 900 unit trusts on the market. How do you even begin to go about selecting which unit trusts are best for your clients?

Making the right choice takes experience, expertise and in-depth analysis of an asset manager's philosophy, process and people.

At SYm|mETRY we do all this work for you. Our team spends over 10 000 hours analysing, monitoring and evaluating asset managers. Then

we apply the latest technology available to enhance our research and portfolio construction process.

No single adviser or investor can hope to match that!

Based on our findings we select the best mix of managers to help us achieve a fund's investment objectives. This is not just about who is performing well; it is about selecting managers that complement each other's skills and philosophies. *Optimal manager diversification translates into competitive returns at reduced risk.*

## Complementary managers

Fred Liebenberg, Head of Absolute Return and Fixed Income Manager Research at SYm|mETRY, explains why the right blend of managers is more important than simply chasing performance.

"We aim to combine managers with different investment styles and philosophies that will tend to get their best performance during different times in the market cycle.

"For example, in our Balanced Fund of Funds, Prudential is very focused and does not deviate much from their long-term portfolio structure. This means that they can be quite risky over the short term when markets are weak, but they have the luxury of being able to invest in long-term opportunities that pay handsomely over time. Coronation is a much more active manager, and is constantly changing their portfolio structure to suit current conditions. Through this they are able to manage risk better over the short term, making them an ideal combination with a manager like Prudential."

## SYm|mETRY range of funds

Our solution funds are designed to meet the risk and return requirements of most investors. As asset allocation funds they offer excellent diversification, so the only thing you need to do is determine a client's risk profile, and select the appropriate fund from our range – we take care of the rest.

	SYm mETRY Cautious FoF	SYm mETRY Defensive FoF	SYm mETRY Balanced FoF
<b>Risk Target</b>	No capital loss over 9 months	No capital loss over 12 months	No capital loss over 18 months
<b>Long Term Return Target</b>	Cash+2%	CPI+5%	CPI+7%
<b>Investment Horizon</b>	Over 3 years	Medium term (less than 5 years)	Medium to long term (more than 5 years)
<b>Asset Classes Invested In</b>	Flexible Investment across all asset classes allowing managers freedom to control risk and maximise return. Cautious FoF is limited to max 40% in equity.		
<b>Launch Date</b>	September 2010	June 2001	June 2001

All figures in the publication sourced (unless otherwise stated): Morningstar. Lump sum investments to the end of June 2011, distributions reinvested and NAV-NAV prices used (i.e. initial charges excluded). Income is reinvested on the ex-dividend date. Actual investment performance will differ based on the initial fees applicable, the actual investment date and the date of reinvestment of income. Past performance is not necessarily an indication of future performance. Old Mutual Unit Trusts has been licensed by the JSE Securities Exchange SA to use the FTSE/JSE Top 40 Index name. \*TERs (total expense ratios) are as at 30 June 2011. Contact our Service Centre at 0860 234 234 to obtain copies of the updated fact sheets, or visit [www.omut.co.za](http://www.omut.co.za) and click on "Fund Information & Prices" and select "Fees & Charges". Risk ratings do not take the impact of currency fluctuations into account.

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