

# Old Mutual Capital Growth

QUARTERLY REPORT

Quarter ended 29 February 2012



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Corporate

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The fortunes of the local economy were mixed in 2011. The positive aspect of the year was the discernible, though subdued, economic growth of 2.6%, which was driven by increased consumption, fixed investments and flat interest rates. The negative aspects were: the inflationary environment, which saw headline inflation breach the 6% upper band of the SARB target range; the weakening of the rand; and Government increasing their projections of the budget deficit over the next few years. <a href="#">Read more...</a>	
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# Equity participation coupled with downside risk protection



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After a difficult 2011, equity markets delivered strong performance over the quarter ended 29 February 2012 with the JSE Top 40 delivering a return of 4.1% over the period. The Old Mutual Capital Growth Portfolio, while being focused on protecting investors' capital through a comprehensive quarterly guarantee, still managed to participate in 49% of this return and delivered a (net of fees) return of 2.0% for the quarter. Cash, another asset class offering guaranteed capital protection, only returned 1.4% over this period.

The strength of the Capital Growth Portfolio is most apparent during quarters of negative equity returns. A recent example is the quarter ended 31 August 2011, where the ALSI Top 40 lost 5% of its value. Capital Growth provided full capital protection over this period, delivering a zero return. It is during quarters of strong equity returns that another strength of the portfolio comes to the fore. As highlighted above, Capital Growth allows its investors to participate in equity returns, while protecting against negative returns at the same time. This feature of the portfolio is looked at more closely below.

A detailed review of the behaviour of investment markets over the most recent quarter, together with an explanation of Capital Growth's current positioning in this market, can be found on page 05 of this report. The last section of the report provides more information on how Capital Growth performed historically.

## Enabling positive equity participation

The investment portfolio primarily invests in large capitalisation shares in the local equity market – the FTSE/JSE Top 40. The equity portfolio generally comprises 15-25 shares from the Top 40 Index. The shares are selected quantitatively based on

their expected risk and return characteristics. The portfolio managers only make use of fundamental research to choose between similar stocks with the same risk characteristics and to identify factors for inclusion in their quantitative screening process.

It is this exposure to the local listed equity market that forms the basis of Capital Growth's ability to share in the returns earned by the stock market. This exposure is then managed through two main risk management techniques (dynamic asset allocation and derivative structures) to provide the necessary protection against market downturns.

The practical outworking of this strategy can be seen by comparing Capital Growth's cumulative quarterly returns since its inception in December 2005 to quarterly returns of the Top 40 Index.

Figure 1, shows the cumulative returns earned during positive quarters, negative quarters and overall. Note that quarterly returns were added together, and not compounded.

Figure 1: Capital Growth's participation in equity returns.



While Capital Growth managed to participate in 34% of the returns earned by the Top 40 Index during positive quarters, the portfolio actually did not participate in negative returns at all by earning a positive 2% when the index lost 58% of its value. Overall Capital Growth participated in 56% of the returns earned on equities, all the while completely eliminating quarterly losses.

## Downside risk protection

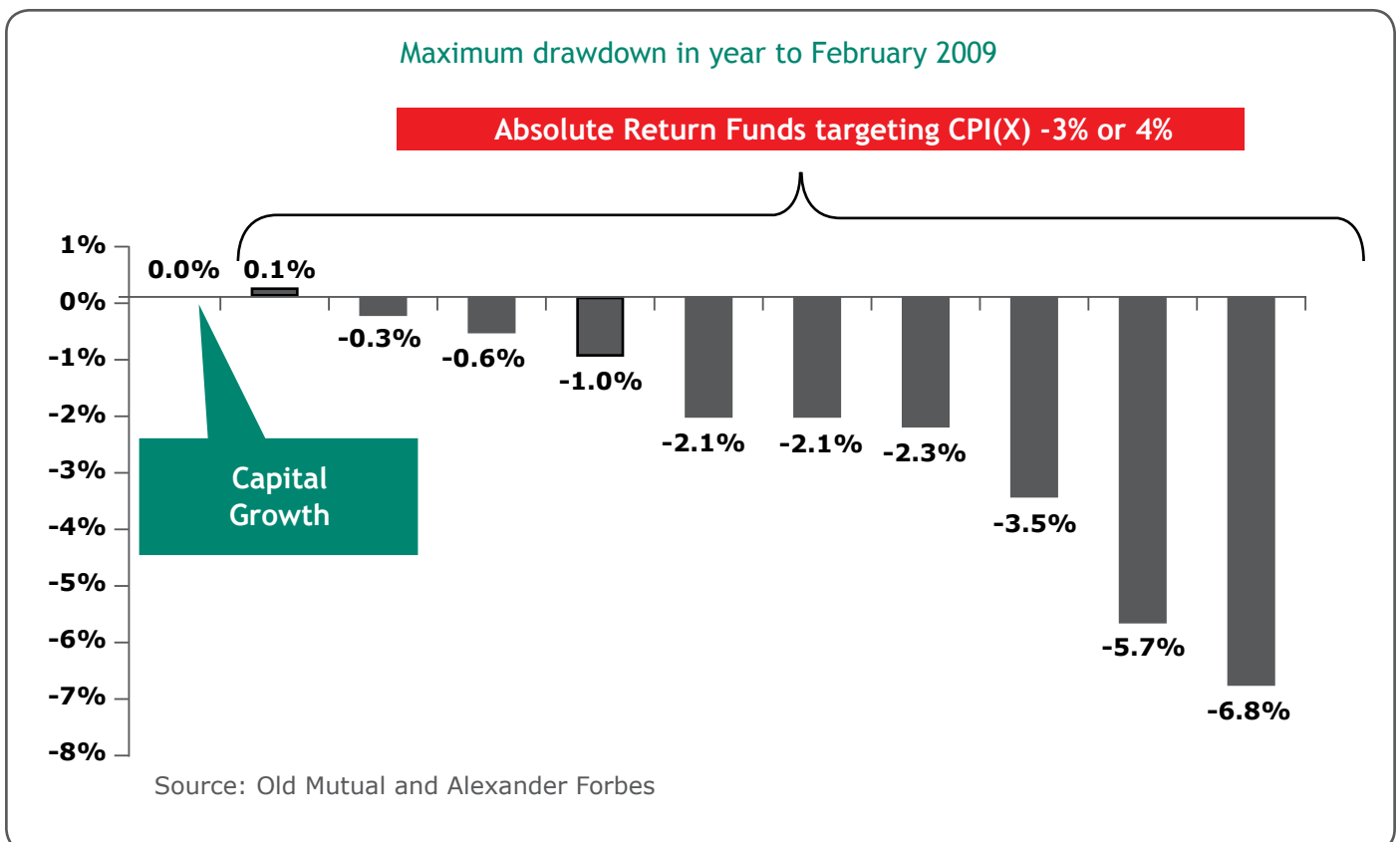
It is evident from figure 1 that Capital Growth has been very effective in protecting its investors from the severe downturns in the equity markets over the most recent four years. It is important to point out that the quarterly capital protection that Capital Growth offers is 100% guaranteed.

There are other investment vehicles that also aim to protect investors' capital. One such vehicle is Absolute Return Funds, which much like Capital Growth, provide downside protection by employing techniques like dynamic asset allocation or the purchasing of derivatives. A major difference between most Absolute Return Funds and Capital Growth is the fact that the former aims to provide capital protection, while Capital Growth guarantees it.

Figure 2, illustrates how most Absolute Returns Funds in the South African market delivered negative returns over the 12 months to February 2009. In contrast to this, Capital Growth provided 100% protection. The maximum drawdown is the worst period of consecutive monthly returns where these are negative. Where no negative returns are delivered, the lowest (positive) monthly return is shown.

Capital Growth's 100% quarterly guarantee is backed by the strength of Old Mutual's balance sheet, which should give its investors peace of mind, knowing that their capital is safely protected, while at the same time being carefully exposed to equity markets in order to deliver the long-term inflation-beating returns that they require.

Figure 2: Maximum drawdown compared to Absolute Return Funds.





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# Investment market review and portfolio positioning

The fortunes of the local economy were mixed in 2011. The positive aspect of the year were the discernible, though subdued, economic growth of 2.6%; which was driven by increased consumption, fixed investments and flat interest rates.

The negative aspects were, the inflationary environment, which saw headline inflation breach the 6% upper band of the SARB target range; the weakening of the rand; and Government increasing their projections of the budget deficit over the next few years.

Headline inflation remained above the 6% upper band in the beginning of 2012, at 6.3% and 6.1% for January and February, respectively. Headline inflation continues to be driven, primarily, by food and energy prices.

Core inflation, which excludes food and energy prices, remained constant, at 4.3% for January and February 2012. OMIGSA's view is that headline inflation is going to continue rising during the year, peak somewhere below 7%, and then gradually drift lower.

The main short-term risk to inflation is a continued surge in oil prices. In terms of the economy in general, the prospects for 2012 are uncertain, as is the case globally.

The main risks to local economic growth are: the Eurozone debt crisis, global economic growth and local inflation. Negative outcomes in the Eurozone will adversely affect the local economy in terms of capital flows and also foreign trade – both volumes and prices. Significant inflationary pressures, locally, may trigger concerns about monetary policy tightening. However, low local interest rates and improvements in fixed-investment growth will limit the downside of these risks.

The local equity market delivered positive returns for the quarter to 29 February 2012. The JSE All Share Total Return Index (ALSI) delivered 4.9% during this period. The JSE Top 40 Total Return Index, the universe from which the OMIGSA Absolute Return boutique picks the stocks for the Capital Growth Portfolio, delivered 4.1% during this period.

In December 2011, the local stock market lost ground as investors continued to react to developments in the Eurozone. In January and February 2012, local markets rebounded in light of positive macro-economic data, e.g. US jobs data that was better than expected and leading indicators suggesting an improvement in China's output.

The local equity performance, broken down at a sector level, shows that financial and industrial sectors delivered strong returns of 12.5% and 5.8% respectively for the 3-month period to 29 February 2012. The resources sector lagged significantly, behind with a return of -0.1% over the period.

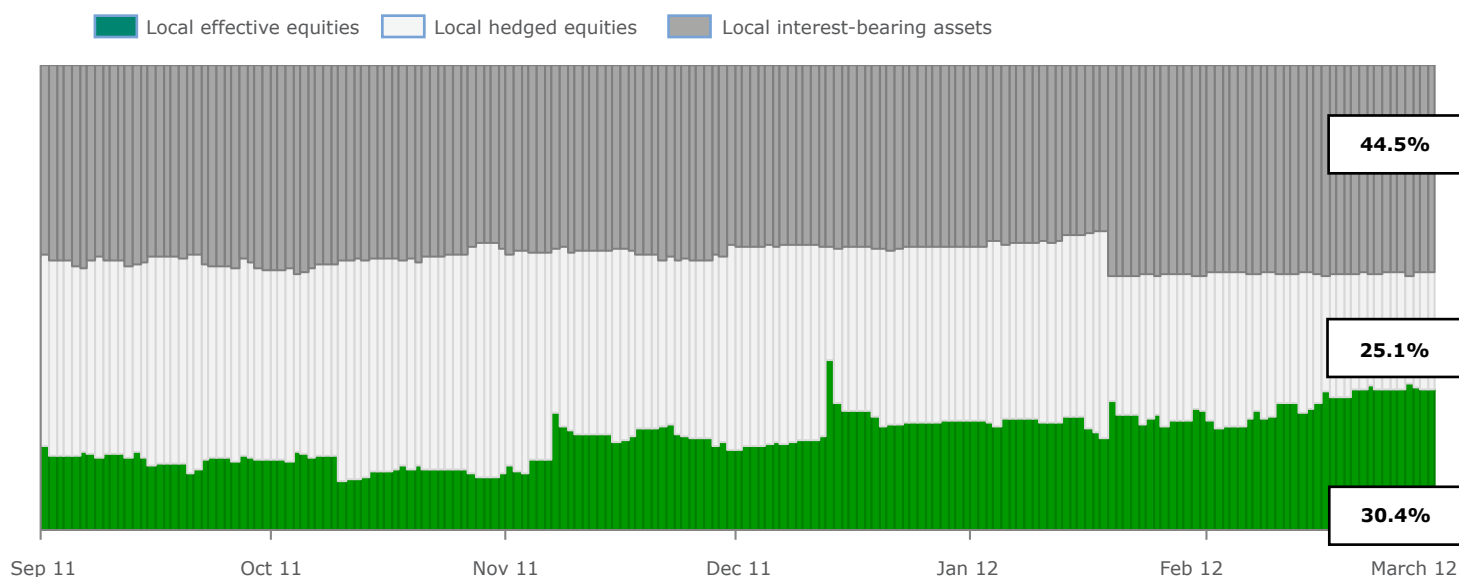


Figure 1: Old Mutual Capital Growth asset allocation.

## Asset allocation

Figure 1, illustrates how the asset allocation for the Capital Growth Portfolio changed during the quarter to 29 February 2012. The quarter-end effective equity exposure of 30.4% indicates the actual exposure to equity markets.

The quarter-end hedged equity exposure, at 25.1%, is the portion of equities that has been completely hedged and is expected to provide a return similar to money market instruments. The remaining interest-bearing asset portion of 44.5% includes call deposits, money market instruments and a small portion of inflation-linked bonds.

## Portfolio positioning

The effective exposure to equities increased over the quarter from 17% to 30% as a result of positive returns in the equity market. Over the quarter, the realised market volatility was much lower than over the previous product quarter, with the 60-day realised volatility decreasing from 27% to 12%. The portfolio managers thus had decreased opportunities to generate additional returns from market volatility during the quarter.

## Top 10 equity holdings

The top 10 holdings that made up the domestic equity portion of the Capital Growth Portfolio as at 29 February 2012, are shown in the table below. The figures shown are expressed as a percentage of the domestic equity portfolio.

Top 10 equity holdings	
Anglo American plc	12.9%
BHP Billiton plc	11.2%
MTN Group	9.9%
SABMiller	9.2%
Naspers	7.00%
Compagnie Fin Richemont	6.5%
Standard Bank SA	5.00%
Sanlam	4.7%
Sasol Ltd	4.5%
Absa	4.4%

# Performance to 29 February 2012

## Monthly returns

The table below shows the returns – net of fees – earned during the quarter to 29 February 2012:

	Dec-11	Jan-12	Feb-12	Quarter	1 Year	3 Years	Since inception
Old Mutual Capital Growth	0.0%	1.3%	0.6%	2.0%	4.3%	7.8%	9.1%
CPI inflation	0.2%	0.6%	0.6%	1.3%	6.1%	5.2%	7.0%
Growth objective	0.5%	0.9%	0.9%	2.3%	10.1%	9.2%	11.0%

The Capital Growth Portfolio delivered a net return of 2.0% over the quarter to 29 February 2012, during a period when the equity market delivered fairly strong, though volatile returns. The Capital Growth returns for longer periods compare favourably against CPI inflation.

The table below provides a detailed record of the historical monthly (net of fees) returns since the inception of Capital Growth in December 2005:

Period	2005	2006	2007	2008	2009	2010	2011	2012
Jan		3.5%	1.3%	0.0%	0.2%	-0.7%	-0.7%	1.3%
Feb		1.0%	1.8%	0.0%	-1.2%	0.0%	0.5%	0.6%
<b>Q1</b>		<b>9.2%</b>	<b>5.1%</b>	<b>0.0%</b>	<b>1.1%</b>	<b>0.0%</b>	<b>1.2%</b>	<b>2.0%</b>
Mar		2.8%	2.6%	0.0%	1.8%	2.7%	0.3%	
Apr		0.6%	0.4%	1.2%	1.0%	0.1%	0.0%	
May		-1.1%	0.8%	0.1%	2.7%	-0.2%	0.2%	
<b>Q2</b>		<b>2.3%</b>	<b>3.8%</b>	<b>1.4%</b>	<b>5.6%</b>	<b>2.6%</b>	<b>0.6%</b>	
Jun		1.0%	0.5%	0.0%	0.0%	0.0%	0.0%	
Jul		-0.6%	0.1%	0.0%	1.6%	0.0%	0.0%	
Aug		2.9%	0.1%	0.0%	1.2%	0.0%	0.0%	
<b>Q3</b>		<b>3.3%</b>	<b>0.7%</b>	<b>0.0%</b>	<b>2.8%</b>	<b>0.0%</b>	<b>0.0%</b>	
Sep		1.7%	2.8%	0.0%	0.0%	1.6%	0.2%	
Oct		1.1%	1.6%	0.0%	1.5%	1.3%	1.9%	
Nov		-1.0%	-0.5%	0.0%	0.6%	1.3%	-0.4%	
<b>Q4</b>		<b>1.8%</b>	<b>3.9%</b>	<b>0.0%</b>	<b>2.1%</b>	<b>4.2%</b>	<b>1.7%</b>	
Dec	4.5%	2.0%	0.0%	2.1%	0.7%	1.4%	0.0%	
<b>Year</b>		<b>17.3%</b>	<b>14.1%</b>	<b>1.4%</b>	<b>12.1%</b>	<b>7.0%</b>	<b>3.5%</b>	

# Key product features

## Portfolio

Capital Growth will primarily invest in large capitalisation shares in the local equity market, the JSE ALSI Top 40, and cash. Apart from this, the portfolio may also hold a combination of money market instruments, local bonds or quoted property. The long-term effective equity exposure of the portfolio is expected to be between 30% and 45%. The portfolio makes use of a combination of derivative instruments and capital-backed risk management techniques to provide efficient capital guarantees to investors.

## Growth objective

To deliver a return of CPI + 4% p.a., net of fees, over any rolling 3-year period.

## Protection objective

The portfolio provides an explicit 100% capital guarantee, net of fees, over the product quarterly periods. The guarantee increases quarterly to lock in the investment growth that is achieved over time. This guarantee ensures that the net return achieved over any product quarter will not be negative. Capital Growth is based on fixed quarterly product dates, starting 1 December, 1 March, 1 June and 1 September each year.

## Costs

An investment management charge of 0.6% p.a. is charged on a monthly basis. This charge covers both the asset management fee and the capital charge. Furthermore, a performance fee is charged on a quarterly basis which is calculated as 10% of the quarterly net outperformance of the target (CPI + 4% p.a.) subject to a maximum of 0.5% per quarter.

## Asset manager

The underlying portfolio is managed by the Absolute Return Boutique, which forms part of the Old Mutual Investment Group of South Africa (OMIGSA).

## Liquidity

At a portfolio level, the product is subject to a net cash-flow daily limit of R100m during the quarter. At the end of the product quarter, the transactions are not subjected to any liquidity constraints.

At a client level, the cumulative disinvestments during the quarter are subjected to a maximum of 10% of the client's value at the beginning of the quarter.

# How to contact us

Find out more about the Old Mutual Capital Growth Portfolio.

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