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## EVEN A LITTLE EQUITY IS BETTER THAN NONE

Ultimately, the aim of investing is to grow your money, outpace inflation and have enough savings in order to retire comfortably.

But this is not so easy as it might sound; the heydays are over and the global investment landscape is not as lush as it used to be. For us at Macro Strategy Investments (MSI), this is evidenced by the themes of:

- Low interest rates
- Low returns
- Rising inflation

### The challenges

So what does this all mean when selecting investments to include in your portfolio? Where can you find value and growth?

#### Rising inflation and low interest rates

It is understandable to be nervous after the gut-wrenching roller-coaster ride offered by investment markets over the past few years, but the attempt to preserve and protect your savings by investing in the money markets and in pure income funds is actually putting your long-term prospects at risk.

This is because the combination of low interest rates and rising inflation threatens to erode the returns from money markets and many fixed income investments – this holds true even if the South African Reserve Bank (SARB) does decide to hike rates by 50 basis points (bps) between November 2011 and February 2012, as we anticipate it will.

In order to achieve decent real returns and offset the erosive factor of inflation, if your portfolio is very conservatively positioned, you may be wise to consider taking on more risk by investing in equity. The benefit of doing this via an asset allocation fund is that you will also enjoy the risk management benefits of diversification and the flexibility of the portfolio manager to move between asset classes.

#### Low returns

The real (after-inflation) returns on local equity averaged 7% per annum over the last 80 years, and more than 11% over the last decade. For the next medium term (± five years), we expect real returns from all asset classes to be generally lower than they have been historically, averaging closer to 6% for equities, and 1.5% for cash.

This means that in order to maintain the same level of return as enjoyed previously, you probably need to accept a little more risk and increase equity exposure, and not only that – it must be the right equity exposure.

#### A fund to consider

For risk-averse retired investors, and those approaching retirement, we still stand by a fund we have recommended before. Old Mutual

Real Income Fund aims to offer investors a steady income stream and protection against volatility, and capital growth and protection against inflation.

Its objective is to outperform inflation over the medium term (CPI + 3% before fees) and protect capital over 12 months.

#### Old Mutual Real Income Fund\*

In May 2011, the Old Mutual Real Income Fund tipped the **R1.5 billion** assets under management (AUM) mark, just five months after breaking the R1 billion barrier in January.

- Top quartile over one, three and five years
- It ranks second out of 28 funds over three years
- Over three years the fund returned 10.8% vs the sector average of 7.3% and inflation of 6.3%

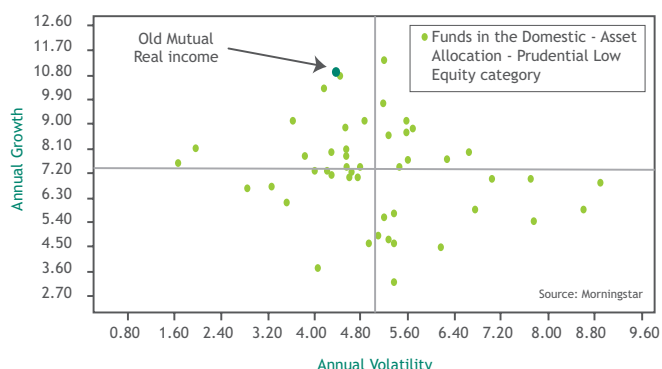
\*All figures to 30 April 2011

#### Expert fund management

As it is an asset allocation fund, we can use the full spectrum of local asset classes, plus our combined 150+ years of experience and our wealth of economic data, to make informed investment decisions when structuring the portfolio. And, as market conditions change, we can reallocate the asset structure in order to achieve the fund's investment aims and offer investors the best of three worlds (see "winning combination" overleaf).

As this is a lower-risk fund we are limited to 35% equity exposure, which is 5% less than our competitor funds in the Domestic-Asset Allocation-Prudential-Low Equity category that allows 40% equity exposure. This means that this fund is less volatile than its competitors, yet Figure 1 shows that the sacrifice of 5% equity has in no way compromised its ability to deliver excellent returns in spite of lower volatility. In addition, when it comes to selecting the fixed income assets, we can call on the expertise of Futuregrowth Asset Management, OMIGSA's fixed income specialists.

**Figure 1: Old Mutual Real Income Fund risk/return vs competitors over three years to 30 April 2011**



## A winning combination

### Income

Income is paid quarterly and is comprised of interest income – derived from fixed income assets – and tax-free dividend income paid by high-yielding equities.

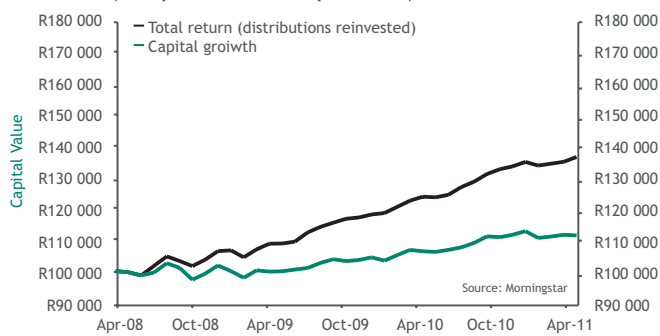
### Capital growth and protection

Inflation-linked bonds, property and equities offer growth potential which will protect capital from inflation.

### Growth and risk

The equity exposure means it will be more volatile than a money market or an income fund. However, we offset this by carefully selecting the equity component in order to reduce bear market risk. Active asset allocation also plays an important role in limiting risk, as we have the option to move freely into less risky assets should it be appropriate.

Figure 2: Old Mutual Real Income Fund three years (30 April 2008 - 30 April 2011)



## In summary

This fund competes well against other top performers in its category (refer figure 1) both in terms of returns and risk management and, unlike its closest competitors, offers the added advantage of an income focus.

If you can, it is definitely time to increase your equity exposure!

This unit trust is available direct from Old Mutual Unit Trusts, via Max and Fairbairn Capital, as well as from most major LISPs.

## Important note

*This fund is for risk-averse investors or it can serve as volatility protection in a well-diversified investment portfolio and, while it is expected that the fund will continue to outperform cash in the medium term, its absolute level of return will not necessarily be as high as in the past in a lower return world. Additionally, the limited exposure to equity in the fund means that funds with higher equity, e.g. balanced funds, will outperform it when the markets run.*

# Market Commentary

Equity, bond and listed property markets broadly posted solid gains, both globally and locally, in April. The FTSE/JSE All Share Index (ALSI) gained 2.2%. The All Bond Index (ALBI) returned 2.3% as higher yields attracted investors, with foreigners buying R16 billion of local bonds after having been net sellers in the previous quarter, and the FTSE/JSE Listed Property Index gained 3.7%. Strength in the rand, particularly against the US dollar, reduced the return from offshore investments.

Commodity prices were mostly firmer as the dollar weakened, with gold and oil posting strong gains. The European Central Bank (ECB) became the first major developed economy central bank to raise rates on inflation fears from rising commodity prices. However, markets are likely to continue enjoying policy support for some time as the other major central banks are not expected to follow the ECB, while unemployment remains high and growth remains fairly muted.

## Fund performance and commentary

### Old Mutual Flexible Fund and Optimised Aggressive Fund

The funds benefited from higher asset prices during the month, although returns from international markets were diluted by the strength of the rand. Over 12 months, the funds have delivered returns of 12.8% – a strong real growth in capital. We retain our view that equities will deliver the best real returns going forward, and do not see good alternatives in the quest for real returns. However, we are “nervous bulls” as the continued grind higher in the market is reliant on the continued growth in the world economy leading through to higher earnings. Therefore, we have put in place some protection strategies, which will help preserve capital if markets fall.

### Old Mutual Balanced Fund and Optimised Balanced Fund

The funds benefited from their exposure to growth assets, as both equities and listed property enjoyed strong returns. We continue to prefer offshore equity to local equity based on valuations and maintain an overweight position in offshore equity. The funds also benefited from exposure to gold in April as the metal continued on to new highs. The pace of the rise in gold has been quite sharp, and we will be taking some profits into strength. We continue to favour growth assets over fixed income assets.

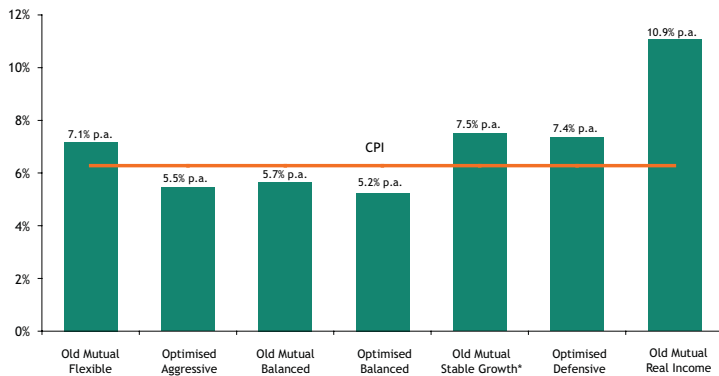
### Old Mutual Stable Growth Fund and Optimised Defensive Fund

The funds have a return target of inflation + 4%. Our long-run modelling suggests that they need to hold 30% in equity to deliver this. Clearly, when we think returns from equity will be good, we will hold 40% (the maximum allowed in the Domestic-Asset Allocation-Prudential Low Equity unit trust category), and when we expect poor returns we will hold less. Looking forward, we think equities will deliver the best real return, but the risk of that return has increased. Therefore, while we currently hold more than 30% in physical shares, we have put in place a protective structure, which means that the effective equity exposure is 30%. This means we participate in more of the upside, while being somewhat protected from the downside of equity markets.

### Old Mutual Real Income Fund

The fund benefited from the increased risk appetite during the month, and the 12-month return was a very respectable 10.4%. However, we are now maintaining a more cautious position than previously as we think returns will be more subdued. For instance, the fund's equity weight has fallen to 12%. Additionally, it no longer owns any resources shares, having sold out the Sasol position when the oil price spiked over US\$120 a barrel. The remaining equity positions were primarily chosen for their high dividend potential, rather than an expectation of large capital gains.

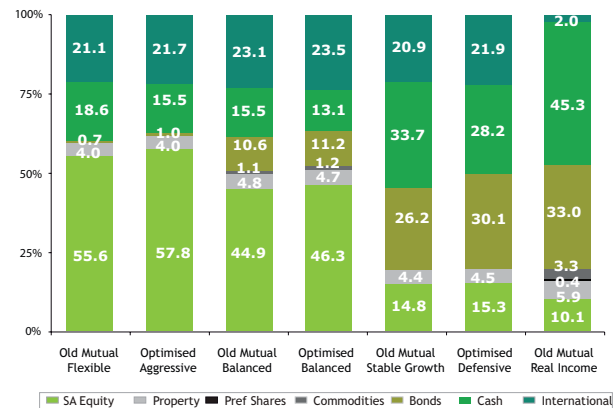
3-year performance to 30 April 2011



\* The Old Mutual Stable Growth Fund does not have a 3-year track record yet.

Sources: Morningstar and OMIGSA

Asset analysis as at 30 April 2011



Sources: Morningstar and OMIGSA

Performance to 30 April 2011	1 year	3 years (p.a.)	5 years (p.a.)	Description	TER
Old Mutual Flexible Fund	12.7%	7.1%	10.0%	CPI + 8% p.a. over rolling 3 years Flexible Category	2.52%*
Optimised Aggressive Fund	10.7%	5.5%	9.0%		
Target	13.2%	14.3%	15.1%		
UT Peer Average	11.5%	5.9%	8.7%	CPI + 6% p.a. over rolling 3 years Prudential Variable Equity Category	2.46%*
Old Mutual Balanced Fund	11.5%	5.7%	9.0%		
Optimised Balanced Fund	9.9%	5.2%	8.2%		
Target	11.2%	12.3%	13.1%	CPI + 4% p.a. over rolling 3 years Prudential Low Equity Category	2.22%*
UT Peer Average	9.1%	5.8%	8.3%		
Old Mutual Stable Growth Fund	8.1%	7.5%	#N/A		
Optimised Defensive Fund	8.1%	7.4%	8.5%	CPI + 3% p.a. over rolling 3 years	1.38%
Target	9.2%	10.3%	11.1%		
UT Peer Average	7.8%	6.8%	7.7%		
Old Mutual Real Income Fund	10.2%	10.9%	9.1%		
Target	8.2%	9.3%	10.1%		
<b>CPI</b>	<b>5.2%</b>	<b>6.3%</b>	<b>7.1%</b>		

\*TER as at 31 March 2011

Sources: Morningstar and OMIGSA

For more information, visit [www.omigsa.com/msi](http://www.omigsa.com/msi)

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\* These are the A-class fund Total Expense Ratios (TERs). The portfolio performance is calculated on a NAV-NAV basis and does not take any initial fees into account. 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. Lump sum basis. Performances are in ZAR and as at 28 February 2011.

Sources: Morningstar and OMIGSA. Unit trusts are generally medium- to long-term investments. Past performance is no indication of future growth. Shorter term fluctuations can occur as your investment moves in line with the markets. Fluctuations or movements in exchange rates may cause the value of underlying international investments to go up or down. Unit trusts can engage in borrowing and scrip lending. The fund's TER reflects the percentage of the average Net Asset Value of the portfolio that was incurred as charges, levies and fees related to the management of the portfolio. A higher TER does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs. A schedule of fees, charges and maximum commissions is available from the company. You may sell your investment at the ruling price of the day (calculated at 15h00 on a forward pricing basis). Certain funds may be capped to be managed in accordance with their mandates. Different classes of units apply to these portfolios and are subject to different fees and charges. Old Mutual is a member of the Association for Savings and Investment SA.