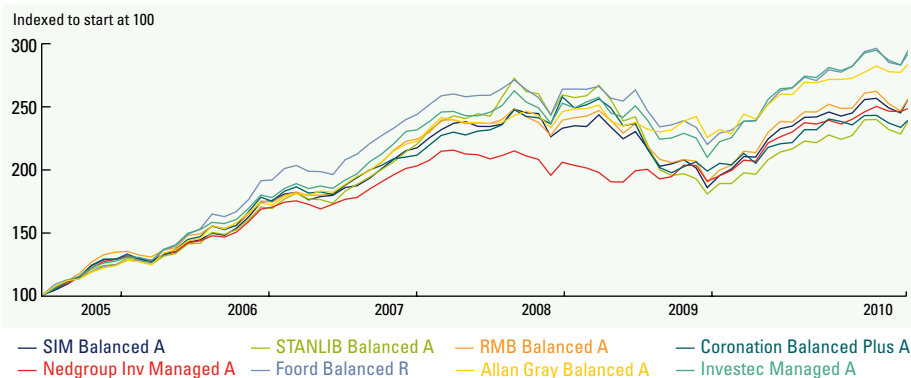


## BALANCED FUNDS

# Flagship vehicles

Investment houses put best brains into popular category

## A BALANCED COMEBACK



Source: Morningstar

**B**ALANCED FUNDS ARE often the flagship of an investment house. It is the fund where they get to bring all their strengths to bear – from stockpicking to asset allocation. The funds are often headed by the most senior investment professionals at the house and have the largest research teams.

The balanced fund category is made up of funds which mix various asset classes – equities, bonds, cash, property and commodities – to try to beat the risk-adjusted returns on any one class. They should be less volatile than a pure equity fund, but are still able to take a fair amount of risk.

The main hurdle is that they may not take on more than 75% exposure to equities. This is still fairly high; investors with less risk appetite should rather look at funds with a lower equity allocation, usually called “stable” to differentiate them from the balanced fund universe.

Balanced funds have grown in popularity as financial advisers and individuals have effectively outsourced the asset allocation decision to fund managers. In the past, portfolios could be built out of building blocks – equity, bond

and cash funds could be combined, with more sophisticated investors even splitting the equity between sector specialist funds. But the volatility of the past decade has convinced many that asset managers are better at the asset allocation than they are.

“I think there’s been a massive swing by both retail and institutional investors to say that asset allocation is a core competency of an asset manager and therefore one should let the asset manager make the decisions,” says **Coronation Fund Managers’** Quinton Ivan.

The trend has also meant fund managers themselves have sharpened up on their asset allocation approach. Ivan says Coronation’s culture encourages a generalist approach with the team expected to have perspectives not just across equity sectors but also across asset classes.

There’s another good reason for one manager to handle allocation as well as the investment within each asset class: they can ensure that consistent views are reflected in both.

For example, **Foord Asset Management** balanced fund manager William Fraser points out that if you have a particular

interest rate view, that should be reflected in both your bond investment strategy and your equity investment strategy. If you expect declining rates, you should be at the longer end of the yield curve at the same time as switching into cyclical consumer-sensitive stocks. With multiple managers and houses managing different asset classes, you are likely to get inconsistent views.

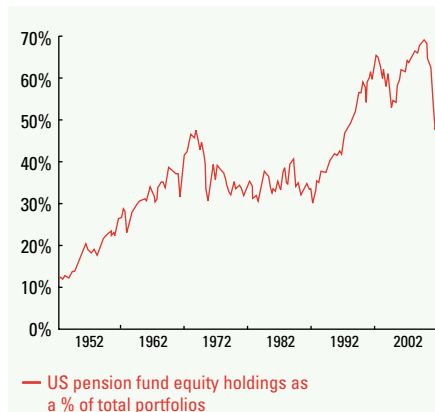
The asset allocation is likely to favour equities as they tend to outperform in the long run, but managers can take quite significant tilts over shorter time periods.

Most South African funds currently have equity allocations of between 50% and 70%, a fairly middling range compared with the last decade.

But **Allan Gray** chief investment officer Ian Liddle also points out that the current culture of high equity allocations is not such a permanent feature – in the US in the 1980s, most pension funds had around 30% allocated to equity, an allocation that seems very low by modern standards. Indeed, Allan Gray itself is at the lower end of the range of equity allocations in the market.

For this month’s Investors Monthly we’ve chosen eight funds to examine from a universe of more than 150 available in SA (including different share classes). The choice was guided by which were the largest funds in the market and which were the best performers, but investors may want to look wider than we have. Our comments on those eight follow. **IM**

## THE GROWTH OF EQUITY



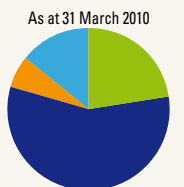
Source: JP Morgan, Allan Gray

**ALLAN GRAY BALANCED A**

Performance		
Period	Cumulative return	Rank (of 7)
1 month (June 2010)	-0,17%	2
Quarter (to end-June 2010)	-0,04%	2
One year (to end-June 2010)	15,62%	7
Three years (to end-June 2010)*	5,34%	1
Five years (to end-June 2010)*	15,39%	1

Fund size (Rm): 36 338,31  
 Total expense ratio: 1,88%  
 Asset allocation:

- Cash 22,74%
- Stock 56,75%
- Bond 6,46%
- Other 14,05%



Source: Morningstar

**T**HE ALLAN GRAY fund is the big hairy gorilla in the market, with almost five times the assets of its nearest competitor. That status has been earned thanks to an impressive long-run performance over which the fund has been top of the group.

The fund is managed by Allan Gray’s chief investment officer, Ian Liddle, and he says it reflects a broadly neutral view of the various asset classes at the moment. “We don’t see enormous valuation gaps between the different asset classes so the fund is fairly balanced,” he says.

With a 56% allocation to equities, the fund looks more conservatively positioned than the rest of the market, but Liddle says it should be seen in a long-run context. He points to data back to the early 1980s that show funds had allocations of as low as 30%, but acknowledges the allocation is low relative to the fund’s 10-year history.

“If we saw the value we would take the fund to its full equity weighting,” he says. Indeed, just a year-and-a-half ago, in the first quarter of 2009, the equity allocation was sitting at 70%. That relatively aggressive positioning allowed the fund to outperform as equity markets recovered from their low in March that year.

The fund now is at its maximum offshore exposure of 20% and is also carrying a fair amount of cash. That is a result of Allan Gray’s value-focused approach. The asset allocation emerges

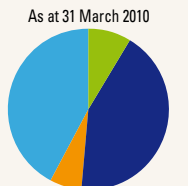
from the search for value – if it can’t be found then a high cash balance is a consequence, rather than a deliberate strategic allocation. **IM**

**CORONATION BALANCED PLUS A**

Performance		
Period	Cumulative return	Rank (of 7)
1 month (June 2010)	-1,29%	4
Quarter (to end-June 2010)	-3,27%	3
One year (to end-June 2010)	18,60%	3
Three years (to end-June 2010)*	5,28%	2
Five years (to end-June 2010)*	15,22%	3

Fund size (Rm): 7 550,03  
 Total expense ratio: 1,49%  
 Asset allocation:

- Cash 8,84%
- Stock 42,58%
- Bond 6,41%
- Other 42,17%



Source: Morningstar

**C**ORONATION’S BALANCED FUND is the second-biggest in the market and has an impressive track record on a long-run view, although there have been bumps along the way. Its approach focuses on looking at companies’ mid-cycle earnings, stripping out the outliers of the moment. That process led the fund out of resources during the resources boom, and out of construction stocks during that boom. In both cases the moves were a little early, but were eventually vindicated. Over the past year, the fund has beaten the peer group by a substantial margin.

Currently, says co-manager Quinton Ivan, the fund has a neutral position in equities, at around 65% of the fund, including global equities. International assets are the best value opportunity, he believes, so the fund has its full 20% allocation to global asset classes. “We have also used the period of rand strength to do that,” says Ivan. “SA has outperformed the [Standard & Poor’s, US index] significantly, so there are a lot of global blue chips that are good value.”

Ivan points as an example to **Microsoft**, which is trading on 10 forward PE (if the cash on its balance sheet is excluded).

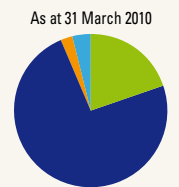
The fund is positioned for a weakening rand in its local portfolio too, with overweight positions in stocks like **MTN** and **Naspers**. It is also overweight banks but underweight resources stocks, to which it is adding on recent weakness. **IM**

**FOORD BALANCED R**

Performance		
Period	Cumulative return	Rank (of 7)
1 month (June 2010)	-0,74%	3
Quarter (to end-June 2010)	-3,67%	4
One year (to end-June 2010)	18,71%	2
Three years (to end-June 2010)*	3,17%	4
Five years (to end-June 2010)*	15,32%	2

Fund size (Rm): 3 332,26  
 Total expense ratio: 1,50%  
 Asset allocation:

- Cash 19,79%
- Stock 73,97%
- Bond 2,49%
- Other 3,75%



Source: Morningstar

**F**OORD ASSET MANAGEMENT has a 20-year track record but is still seen as a boutique operator.

Nevertheless, its balanced fund is one of the largest in the market.

Relative to its peers its weighting in equities is fairly high, an allocation motivated by the house’s top-down view on the interest rate cycle. “Over time interest rates are likely to rise and inflation is likely to rise – so from a preservation of capital point of view you are unlikely to protect your clients in real terms in bonds and cash,” says William Fraser, who manages the fund.

The low interest rates should also translate into higher earnings for companies he says.

Fraser says the fund has lessened its equities exposure in the past few months and is now at about 68% (including foreign equities), and within that the stock selection is quite conservative, avoiding companies with highly geared balance sheets. One of the biggest picks is **BHP Billiton**, with a fairly large exposure to banks, including **RMB** and **Absa** following that up. **Aspen** is also a large

exposure at about 3% of the fund.

Fraser says the international growth profile has been impressive. The fund also has a maximum foreign exposure with more than 20% (if **British American Tobacco** is included). **IM**

**INVESTEC MANAGED A**

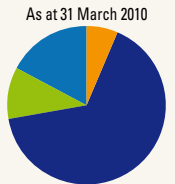
Performance		
Period	Cumulative return	Rank (of 7)
1 month (June 2010)	-1,48%	5
Quarter (to end-June 2010)	-3,89%	5
One year (to end-June 2010)	14,01%	9
Three years (to end-June 2010)*	0,88%	7
Five years (to end-June 2010)*	11,42%	9

Fund size (Rm): 4 364,35

Total expense ratio: 1,11%

Asset allocation:

- Cash 6,65%
- Stock 65,63%
- Bond 10,55%
- Other 17,17%



Source: Morningstar

**T**HE INVESTEC BALANCED fund is unusual in a number of respects.

Where most of its peers are underweight resources, it is overweight. It is underweight in financials, while its peers are overweight. That positioning means its performance is certain to diverge from the average in future.

The long-run performance of the fund is reasonable, but it has had to catch up since it made the wrong call in late 2008. Then the fund switched aggressively into cash as rates began falling, leading to a disappointing quarter.

The fund has been picking up its cash allocation, which reached 13,9% by end-May. It also has a fairly high gold exposure of 8% through the **NewGold ETF**. Fund manager Gail Daniel commented in March that “given the global debt situation, we believe it imprudent not to have exposure to gold”. Gold should outperform if world economies experience inflation.

According to Morningstar’s March figures, the largest equity holding was **Impala Platinum** (5,2% of the fund) but it had been reducing exposure in favour

of **FirstRand** (which was then just under 5,2%), suggesting that the underweight financials is in the process of changing.

The fund’s domestic bond allocation is also relatively high at 11,4%, with much of this made up of corporate bonds in the middle of the curve at three- to five-year maturity points. This will do well if interest rates stay low and the credit-worthiness of corporate SA improves – although those two factors should work against each other. **IM**

**NEDGROUP INV MANAGED A**

Performance		
Period	Cumulative return	Rank (of 7)
1 month (June 2010)	-0,13%	1
Quarter (to end-June 2010)	0,13%	1
One year (to end-June 2010)	19,27%	1
Three years (to end-June 2010)*	5,07%	3
Five years (to end-June 2010)*	12,90%	4

Fund size (Rm): 3 101,74

Total expense ratio: 1,79%

Asset allocation:

- Cash 24,14%
- Stock 51,86%
- Bond 4,84%
- Other 19,16%



Source: Morningstar

**L**IKE ALL NEDGROUP funds, the management is outsourced to a third party – in the case of the balanced fund that is to RE:CM. Performance has been fairly strong, particularly on a one-year view where it is the top of those in our universe.

The fund has been quite conservatively positioned, reflected in the large cash allocation. “We don’t see a lot of value in SA at the moment,” says fund manager Daniel Malan. International markets offer better opportunities, so the fund is near its maximum international asset allocation.

The conservative switch was well timed – it moved into bonds at the short end of the curve a year ago, so falling rates have seen it do well in the past year. It underperformed though in 2007 and 2008 as it took a bet against resources, which it saw as overvalued during the commodities surge of the time. It was

ill-timed – the commodities run continued for a year before collapsing, pulling the fund’s performance back into line with the peer group. The fund is still negative on commodities with exposures only to **Sasol** and a small allocation to gold stocks.

The fund applies a strict value approach, so it’s no surprise to find a big weighting for **Telkom**, while more expensive shares like **Aspen** are absent. Malan says Telkom still has value even if you take the most pessimistic view of the telecom’s management and strategy. **IM**

**RMB BALANCED A**

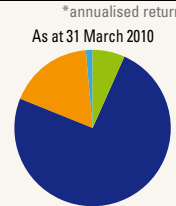
Performance		
Period	Cumulative return	Rank (of 7)
1 month (June 2010)	-2,23%	9
Quarter (to end-June 2010)	-5,40%	9
One year (to end-June 2010)	15,70%	6
Three years (to end-June 2010)*	1,44%	5
Five years (to end-June 2010)*	12,43%	6

Fund size (Rm): 2 582,24

Total expense ratio: 1,46%

Asset allocation:

- Cash 6,82%
- Stock 74,41%
- Bond 17,40%
- Other 1,37%



Source: Morningstar

**R**MB’S BALANCED FUND is largely a mirror of the house’s portfolio fund which emerges from RMB’s investment decision-making process, to which all analysts contribute. The fund is managed by well-known market commentator Wayne McCurrie, who leads the asset allocation team which examines macro-economic variables and expectations to develop an allocation strategy. The asset selection then emerges from different asset class specialist teams.

The equity allocation is handled by three teams – one for each of financials, industrials and resources. They produce a list of top leaders and bottom lagers which is fed into RMB’s optimisation process to calculate target portfolio weights to optimise the risk/return profile.

McCurrie says institutional managers that aim to minimise the overall risk in

the portfolio will likely fall in the middle of the performance rankings, with the outliers likely to be boutique managers which take larger risks in their exposures. Over the past year, though, the fund has outperformed the average in most months.

The equity asset allocation is slightly above the average at 74% (2% is a property debenture that is not truly equity). McCurrie says the house view is slightly bullish on equities relative to the rest of the market, on an optimistic expectation for global growth. Within the equity allocation there is a clear over-weighting for banks, which RMB reckons are going to show a huge earnings recovery as bad debt performance improves. **IM**

At the moment Cruywagen says the approach has highlighted inflation-linked bonds as a clear value opportunity. They now make up about 6% of the portfolio.

Within local equities the value mantra again is important. SIM reckons there is value in resources counters such as diversified miners **BHP Billiton** and **Anglo American**, oil group **Sasol** and paper producer **Mondi**. In financials, Cruywagen likes **Standard Bank** and has smaller exposures to **Absa** and **RMB Holdings**. Banks, he says, offer a better opportunity to benefit from the low interest rate environment than credit retailers.

In the international equities exposure, Cruywagen has a somewhat contrarian preference for European equities. The eurozone's woes have battered share prices, so many stocks now have dividend yields double the US average. Plus the weak euro helps valuations. **IM**

that offer very clear opportunities, that should influence how much is allocated to that class.

The fund is sitting with 58,5% allocated to South African equities, 12% to foreign equities and 14% in cash.

Within the equity allocation, the fund has large exposures to **MTN** and **Vodacom** because of their strong cash flows. Financials are also prevalent with big exposures to **FirstRand** and **Investec**. Swanson was a financials analyst on both buy and sell sides earlier in his career.

Unusually among its peers, the fund has a large exposure to retail counters, including **Massmart**, **Shoprite**, **Spar** and **Woolworths**, all of which have run hard over the past year. Swanson says he likes the retail shares because margins have been growing in the low interest rate environment and management can be flexible in how they structure the businesses.

The fund holds no construction stocks, with the exception of cement manufacturer **PPC** due to its high dividend yield. Swanson expects construction companies are going to find it tough to maintain their business volumes with the World Cup over.

The international exposure is achieved through allocations to the Stanlib high alpha global equity fund and the Stanlib global bond fund. **IM**

**SIM BALANCED A**

Performance		
Period	Cumulative return	Rank (of 7)
1 month (June 2010)	-1,59%	7
Quarter (to end-June 2010)	-4,15%	6
One year (to end-June 2010)	16,85%	4
Three years (to end-June 2010)*	0,96%	6
Five years (to end-June 2010)*	12,85%	5

\*annualised return

Fund size (Rm): 1 145,58  
As at 31 March 2010

Total expense ratio: 1,55%

Asset allocation:

- Cash 12,34%
- Stock 67,68%
- Bond 16,29%
- Other 3,69%

Source: Morningstar

**STANLIB BALANCED A**

Performance		
Period	Cumulative return	Rank (of 7)
1 month (June 2010)	-1,55%	6
Quarter (to end-June 2010)	-4,72%	7
One year (to end-June 2010)	16,43%	5
Three years (to end-June 2010)*	-1,74%	9
Five years (to end-June 2010)*	11,49%	8

\*annualised return

Fund size (Rm): 1 271,57  
As at 31 March 2010

Total expense ratio: 2,03%

Asset allocation:

- Cash 11,87%
- Stock 64,43%
- Bond 8,88%
- Other 14,82%

Source: Morningstar

**FUND MANAGER** Gerhard Cruywagen (who is also Sanlam Investment Management's chief investment officer) shares the view of many colleagues that South African equities offer relatively little value relative to international shares. "The local market we think is fairly priced," he says. The current allocation is 55% to South African equities and 13% to foreign equities. The balanced fund reflects SIM's general value-based approach. "We compare assets to their long-run real returns," he says. Then the fund up-weights asset classes that offer real returns (net of inflation) higher than the historic trend.

**STANLIB ATTEMPTS TO** marry the best of top-down and bottom-up approaches in its balanced fund. A top-down approach is used to decide on which asset classes are likely to outperform, but the decision-making meetings include the various asset class specialists who "push up from the bottom", says one of the fund's managers, Paul Swanson. Swanson is one of Stanlib's longest serving fund managers.

If there are assets in any particular class

Funds data supplied by

**MORNINGSTAR**

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