INVESTMENT APPROACH

The Fund will invest a significant proportion of its assets in South African and international equities.

There are broadly three approaches to investing in equities, namely:

- One can simply hold a basket of shares that mirrors the FTSE/JSE All Share Index (or the MSCI World Index for international equities) – this is called **passive investing**.

  For example, with this approach if the share market goes up by 15%, the Fund's investments will also go up by 15%. On the other hand if the share market goes down by 20%, the Fund's investments will also go down by 20%.

- The most common investment approach adopted in South Africa is to be what we call a **market manager**. In this case an investment manager tries to out-perform the FTSE/JSE All Share Index. This means they will buy more of the shares that they think will do better than the index (and consequently hold less shares in companies that they think will do worse than the index).

  In reality a market manager tends to take relatively small "positions" away from the index and so will perform rather similarly to the index. The best market managers aim to beat the index by about 2% to 3% p.a. over the long term.

- The third investment approach is that of a **value manager**. A value manager believes that the market either becomes too optimistic or too pessimistic about a particular share.

  Value managers believe that over-pessimism gives them the opportunity to buy shares in good companies at a cheaper price than the company is really worth. Value shares are most often good companies that have gone out of favour with the market.

  The advantage a value manager has is that he is buying shares that are already cheaply priced by the market. *This means that if the market goes down sharply, these shares generally will not fall as much as the rest of the market.*

  If the value manager is right about the company he has bought, the market will eventually find this out. In this case the share price will go up sharply and the value manager will make a tidy profit.

  The main difficulty with a value manager is that it may take the market a long time to work out that the shares he is holding are in fact good companies. This most commonly happens when the market becomes over-excited about an idea (e.g. small South African financial services companies in 1998 and US internet shares in 1999.)

  During such a "speculative" bull-market a value manager could under-perform a market manager significantly, but it is unlikely that he will lose your money.

  When the stock market bubble eventually deflates, the value manager will protect your capital much better than a market manager or a passive manager.

Copyright@2009 CPUT Retirement Fund: Cape Peninsula University of Technology – Revised Feb 2018

More about value managers

Value managers do two things differently than most other managers, namely:

- They invest with a long term investment horizon (which is consistent with the philosophy of the Fund); and

- They focus on buying very good, but out of favour shares, which they can buy at cheap prices relative to the true worth of the Company. In this way they are contrarians.

This investment approach that was developed in the early 1930's by Ben Graham and is the approach that has the best track record by far of delivering superior investment returns. Warren Buffett, the world's most successful investment manager, was a student of Ben Graham and applies the Graham approach to investment.

This approach takes the view that market sentiment and human behaviour result in the price of companies deviating from their long term intrinsic value. Another way of looking at this is that the intrinsic value of a business generally changes more slowly than its price.

This means that from time to time some companies become very cheap relative to their true value and sometimes they become very expensive. The cheap companies (but still good companies) are often those that have fallen out of favour with the market temporarily and these are the shares the valuation manager will buy.

The expensive companies (which may also be good companies) are those that are in fashion and strongly liked by the market, but the valuation manager will not buy these shares because he assesses them to be too expensive.

Whilst this “buying bargains” is a sensible strategy, the difficulty is that excessive market sentiment may result in such managers under-performing the index significantly, especially over short measurement periods (i.e. periods of less than 5 years).

Copyright@2009 CPUT Retirement Fund: Cape Peninsula University of Technology – Revised Feb 2018