INVESTMENT STRATEGY

The **CAPE PENINSULA UNIVERSITY OF TECHNOLOGY RETIREMENT FUND** is a defined contribution retirement fund. The long-term investment performance of a defined contribution retirement fund affects the size of your retirement benefits. The Trustees understand that a key area in which the Fund needs to succeed is to provide members with appropriate investment portfolios and to provide sufficient and appropriate information for members to make informed decisions.

The starting point of any investment strategy is to define the purpose of the Fund. Put another way, the Trustees have tried to answer the question – “Why does the Fund exist?” The Trustees have answered this question as follows:

“The Fund exists to target reasonable retirement benefits for members. A reasonable retirement benefit for an in-service member with 35 years service at retirement and an average career progression is a capital sum of some 12 to 13 times pensionable salary at retirement. The Fund must also provide a reasonable (but appropriately limited) choice of investment vehicles to those members who require more control over their retirement fund investments and who prefer to take responsibility for their own investment decisions.”

The reasonable retirement benefit is a <u>target</u> that cannot be guaranteed. The target is based on the assumptions that 20.725% of the member’s pensionable salary will be set aside as retirement savings, that the investments will earn at least 4.5% per annum in excess of inflation <u>over the long term</u>, and that the member will retire at age 65.

The Fund’s investment strategy is detailed in its Investment Policy Statement. This section covers the following:

- Investment philosophy the Trustees have adopted
- Investment objectives for the portfolios
- Investment Approach
- Approach adopted by the Fund
- How the Fund chose the investment managers

Disclaimers

Investment is a complex area and every attempt has been made to simplify this for ease of understanding. This may result in some areas being covered in relatively little detail. Readers should note that:

- Past investment performance is not necessarily a guide to future investment performance. The statistics shown in the guide are based on past performance;
- The information contained in this guide does not constitute advice by either the Board of Trustees, nor its advisors; and
- Members may need to seek expert financial advice before making an investment decision.

INVESTMENT PHILOSOPHY

- Primarily the Trustees have adopted a *long-term time horizon* in formulating the Fund's investment strategy. This means that the overall success of the strategy will be measured over periods of at least 7 years.

- The *main risks* carried by members of the Fund are:

    - *Inflation risk* - this is the risk that the Fund does not earn a sufficient return to be able to provide a reasonable retirement benefit. The Fund will therefore measure its success by comparing its return relative to inflation over periods of 7 years.
    - *Loss of capital* - it is important that members are provided with an increasing degree of capital security for the 7-year period leading up to retirement age.

- The Trustees have assumed that the most appropriate indicator of investment risk is the time to retirement of the member. Younger members are assumed to place priority on management of inflation risk and older members on protection against loss of capital close to retirement.

- To this end the Fund has established 3 separate default portfolios. Younger members will be allocated a portfolio that has the potential to earn returns sufficiently higher than inflation to achieve a reasonable retirement benefit, and older members will be allocated a portfolio that offers a degree of capital protection close to retirement.

- The Fund's investments must be conducted in a manner that is honest, transparent and ethical.

INVESTMENT OBJECTIVES

The investment strategy has the following two objectives:

- To achieve close alignment between the **purpose** of the Fund and the **investment strategy**; and
- Greater focus on short-term protection of your retirement savings in the event that markets deliver negative investment returns.

These objectives are achieved in two ways:

- By allocating the investments of the Fund between different asset classes (such as shares, bonds, cash), and allocating the assets to more than one investment manager that adopt different investment styles (such as value, growth, momentum); and
- Adopting a conservative strategy for the life stage model.

Important note:

The Trustees considered a possible alternative answer to the question on why the Fund exists. The alternative answer is that the Fund exists as a **tax efficient savings vehicle** allowing members to invest at wholesale investment fees instead of retail fees. If this was the purpose of the Fund, it would need to provide a very wide range of investment options. The Trustees believe that most members simply want reasonable retirement benefits, and only very few members would make use of such wide investment choice. The Trustees therefore **do not** regard this objective as the main purpose of the Fund.

INVESTMENT APPROACH

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

There are various approaches to investing in equities:

- 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%.

- A 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% p.a. over the long term.

- The **value investing approach**. 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/she 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/she 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/she 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/she will lose your money.

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

- The **earnings revision** approach. Under this investment approach, the manager looks to invest in companies where expected future profits are being revised upwards (which is different to the value investing or market manager approach).

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. 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/she 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).

APPROACH ADOPTED BY THE CPUT RETIREMENT FUND

There are two important features in the investment approach adopted by the Fund, namely:

- The Fund has appointed three asset managers for the Long-term growth portfolio; and
- Two of these managers follow the value style of investing and the third manager follows an earnings revision approach.

Three asset managers

The Trustees decided to use three asset managers for the Long-term growth portfolio instead of just one. The Long-term growth portfolio is the "default" portfolio into which all of the savings of members under age 58 will be invested.

The Trustees are of the view that splitting the assets in this way will reduce the risk of a single manager's poor investment decision impacting on a member's retirement savings.

Use of the value style for equities

Two of the three asset managers for the default Long-term growth portfolio follow the value style of investing.

This decision has very important consequences:

- Your Retirement Fund may under-perform the average retirement fund significantly in a period where the markets are delivering very good investment returns, particularly when such measurement is done over a short period (e.g. 3 years)
- On the other hand, the Fund is likely to provide you with greater protection of your money when investment markets are weak. In these times your Retirement Fund is likely (but not certain) to do better than the average retirement fund.

Over time the Trustees believe such an approach is consistent with the purpose of the Fund, which is to provide reasonable retirement benefits for long-serving members.

In essence the investment approach adopted by the Trustees means that they take a longer-term view of investments with a greater focus on protecting your capital. Importantly this means Trustees (and the members) will need to have the **patience and courage** to stay with a more conservative investment strategy in times when there is a speculative bull-market. **This is much more difficult than most people think!**

Shari'ah investments

It is important to note that the Shari'ah investment restrictions (exclusion of certain economic sectors such as conventional financial services companies, gambling, alcohol, pork and tobacco) may result in the Shari'ah compliant equity funds in the portfolios performing less well than funds with similar investment objectives which are not subject to these restrictions. This will occur during periods when the excluded sectors do extremely well. Having said that, Shari'ah investors in fact have benefited from these characteristic exclusions and the favouring of sectors that have proved resilient in the current economic climate.

There is a strong argument to support the notion that Shari'ah investing is not about sacrificing returns but is a viable investment approach suitable for many different investors. Whilst the behaviour of individual Shari'ah portfolios is no different to conventional portfolios in that some will outperform and others will underperform, recently Islamic indices have highlighted that the Shari'ah compliant low-debt, non-financial, social-ethical approach works well in market downturns.

HOW THE FUND CHOSE THE ASSET MANAGERS

The Trustees first surveyed several asset managers, insurance companies and consultants to understand the different investment strategies that can be followed to achieve the stated purpose of the Fund. The critical step was to choose the actual managers who are most appropriate, given the purpose of the Fund. The Trustees applied many criteria in choosing the managers, but the main ones were:

- *Business ethics* – the Trustees wanted to ensure that the interests of the asset manager are aligned with the interests of the Fund.
- *Investment philosophy* – the Trustees were looking for a clearly defined investment philosophy, with evidence that this philosophy is working for its investors.
- *Quality of people employed* – the Trustees were interested in how the manager’s business is structured to bring out the best in their investment professionals.
- *Investment process* – the Trustees wanted to know how investment decisions are made, how they manage their risks and how the investment decisions are implemented.
- *Performance* – the Trustees were interested in **expected future** performance (largely based on the qualitative factors mentioned above such as investment philosophy, process and quality of people), rather than past performance. Past performance was used as a guide to understanding how the managers use their investment skills, so that they could understand whether they are likely to continue their past successes or failures into the future
- *Black economic empowerment* – the investment manager must have a clear and cohesive strategy on black economic empowerment and employment equity and must be able to demonstrate success in implementation.
- *Alignment of interests* – the Trustees assessed whether the interests of the clients and the investment manager aligned and if the investment management fees appear to be competitive.
- *Regulation 28 principles* – the Trustees were interested in how the investment manager incorporates Environmental, Social and Governance considerations when making investment decisions.

Due to the fact that the Fund is not yet large enough to allow the trustees to construct “customised” portfolios with the asset managers for each of the Fund’s investment channels, the trustees are generally limited to the “pooled” offerings (or even unit trust offerings) of the selected asset managers that offer the best “fit” to the trustees’ requirements.

INVESTMENT MANAGERS

The Fund's investment managers are:

- For the Long-term Growth Portfolio: Allan Gray Limited, Ninety One SA Pty Limited and Coronation Asset Management (Pty) Limited.
- For the Medium-term Protection Portfolio: Coronation Asset Management (Pty) Limited and Allan Gray Limited
- For the Shari'ah Portfolio: 27Four Investment Managers
- For the *Money Market Portfolio*: Ninety One

Allan Gray Limited

Allan Gray Limited is the largest privately held asset management firm in South Africa. They have a very strong long term track record for SA equities

Allan Gray is a strong believer in the investment approach advocated by Ben Graham.

Ninety One SA Pty Limited

Ninety One is a large, listed asset manager with a global presence and a good track record of managing balanced portfolios. Mr Chris Freund and Mr Hannes van den Berg are the strategy leaders for the Balanced Fund.

Ninety One have an excellent SA bond and money market team and an outstanding long term track record. The bond team works closely with the Ninety One global bond team, giving it a good understanding of international bond market trends.

Coronation Asset Management

Coronation Asset Management also have a very good long term track record for the SA equity asset class. Coronation describe themselves as "*a long-term, valuation-driven investment house, focused on bottom up stock picking*".

27Four Investment Managers

27Four Investment Managers is a multi-manager investment firm where they pick the underlying investment managers for their portfolios, and one of their key competencies is Shari'ah compliant portfolios.