CLUCASGRAY Investment Management

Newsletter

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Not just another fund...

ClucasGray launched its second unit trust on 1 October 2011. The fund is managed by Peter Clucas and Paul Carter. This unit trust will differ from most others in that it is a high conviction fund and stocks will be limited to a maximum of 20. Share selection will predominantly follow our model portfolio and therefore mostly consist of Top40 companies.

We think that a focused portfolio consisting of high conviction "stock picks" is the best way to generate superior returns over a longer term horizon. Also, we believe it is better to have thorough knowledge of relatively few stocks than obtain market type performance via diversification into a substantial number of shares. In addition a focused fund should result in a more disciplined buy and sell approach.

Why a second unit trust? Bearing in mind that the Future Titans fund is a non-top40 fund, we felt it was necessary and indeed relevant to start a big company investment vehicle. We view the two trusts as complementary investments.

Leading Indicators:

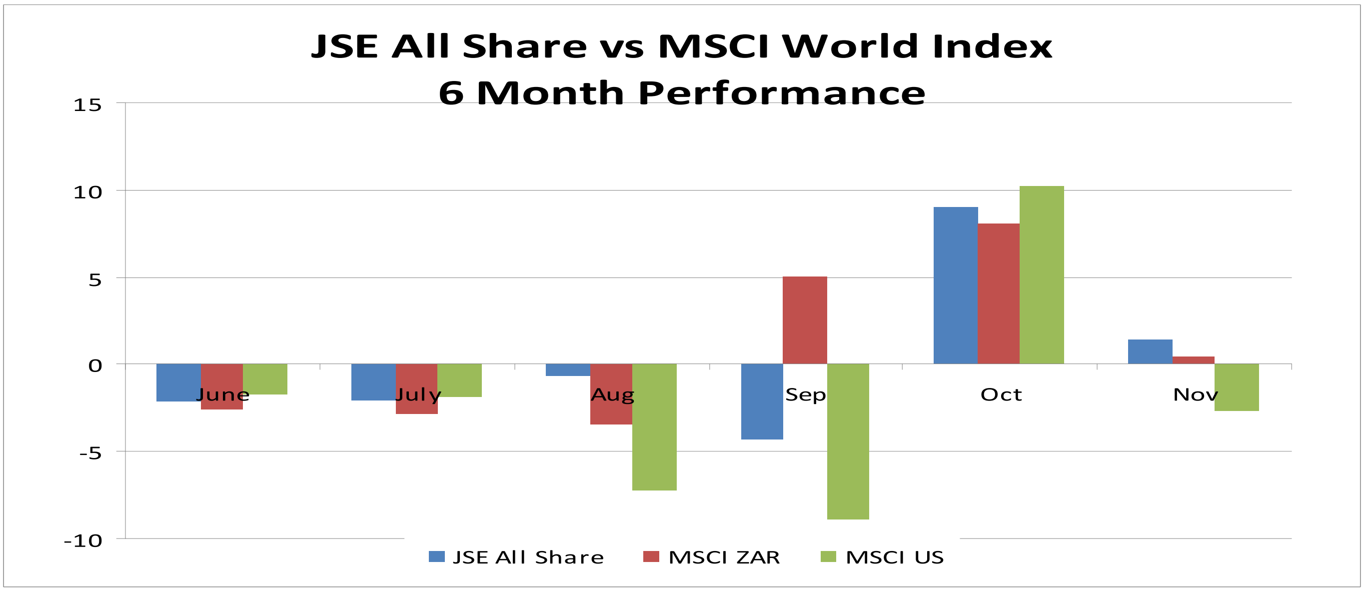
	1mth % ch	3mths % ch	12 mths % ch
JSE	+1	+6	+8
S&P	-1	+6	+14
Nikkei	-6	+2	+6
Oil	+3	-3	+30
Gold	+1	-4	+26
R:$	-2	-16	-14
R:£	+1	-12	-15

The fee structures of both unit trusts is the same and are highly competitive. It is worth remembering the tax advantage of investing in unit trusts notably that all trades are "wrapped" in a zero cost tax structure, and therefore investors' maximum tax burden is limited to capital gains tax on the difference between the entry and exit price.

Above all, we would like to let you all know that you can invest in the equity fund for as little as a R10 000 lump sum or R1000/month. "Trickling" money into the market is a great way of investing as this avoids all the pitfalls associated with trying to time the market. Besides making use of this investment for yourself, we think it represents a superb way of saving for any of your children, grandchildren or staff. Contact us for further details.

The best of a bad bunch?

The second half of 2011 will be remembered as being particularly tricky in equity markets as well as for broader asset allocation decisions. The volatility shown in global markets has been remarkable with the poor months of August, September and November being offset by the strongest October in years.



Although it has been a bumpy ride in the equity market we remain convinced that this asset class has the best potential for growth over the medium term.

- In South Africa, money market rates are offering in the region of 5% per annum. Interest is taxable so in the top income tax bracket the real return is marginally above 3%. With inflation currently running at around 6% per annum (and likely to keep climbing), the money market is yielding negative real returns.
- RSA 10 year bonds are paying interest of 6.9% per annum which is better than the money market but we think the likelihood is that the next move by the reserve bank will be to raise interest rates which would have a negative implication for bond prices.
- How about property then? Generally we like property but right now we think a combination of rising council rates, rampant electricity hikes, higher vacancies and possible interest rate hikes are all conspiring to dampen the outlook.

So we revert back to having a closer look at equities, the asset class which has given investors the best after tax return over the long run. From a bottom up perspective equities both here and abroad are, on the whole, not expensive. The table below gives a breakdown of the JSE and consensus earnings expectations over the next few years. A one year forward price earnings multiple of less than 10x for the All Share certainly stacks up reasonably favourably against history, pointing to a market still offering some upside outside of global shocks.

Sector	Code	FPE0 (x)	FPE1 (x)	FPE2 (x)	EPS0 (c)	EPS1 (c)	EPS2 (c)	*EPSg1 (%)*	*EPSg2 (%)*	FDY1 (%)	FDY2 (%)
SWIX	**J403**	**12.1**	**10.2**	**9.1**	**431**	**508**	**575**	*18*	*13*	**4.1**	**4.7**
ALL SHARE	**J203**	**11.6**	**9.7**	**8.6**	**549**	**659**	**741**	*20*	*13*	**3.8**	**4.3**
Top40 - (Tradeable)	J200	11.9	10.1	9.0	708	833	943	*18*	*13*	4.0	4.6
Mid Cap	J201	12.8	10.7	9.5	184	219	247	*19*	*13*	4.6	5.3
Small Cap	J202	11.4	9.7	8.1	89	105	125	*18*	*19*	4.7	5.4
Findi-ExDual	NSFIXD	13.2	11.3	9.8	311	363	417	*17*	*15*	4.5	5.1
Findi	FINDI	13.4	11.4	9.9	316	371	427	*18*	*15*	4.3	4.9
Findi Dual Listed	FIDUAL	15.2	12.1	10.4	357	448	521	*25*	*16*	2.9	3.5

We sense that given the adverse global economic issues currently at play, investment managers have tended to sit on considerably more cash than normal. In the short term this can be a very good strategy if markets pull back but what if they do not? We are recommending that you have exposure to the market but in a cautious and well thought out manner. Stay with quality, stay with dividend payers and do not pay too much attention to volatility on a daily, weekly or even monthly basis.

The Euro

Whether you flick to the financial channel, pick up a business magazine or read the daily newspaper the future of the Euro and European Union is hitting the headlines. It is an extremely complex topic and as a result every financial commentator has a view.

As we write, European leaders are locked behind doors trying to come up with a comprehensive plan that will not only appease investors but also keep the European population satisfied. The politicians have, in our minds, thus far been too scared to make brave decisions at the risk of upsetting their support base. This strategy has backfired as we have already had five senior changes in leadership within the EU. With every unsatisfactory plan that gets announced the pressure is building, none more so than on Germany. Consider:

- There are growing calls for the ECB to print money, an action that up until now the Germans have strongly opposed.
- There are those that have called to remove weak countries such as Greece, something that may have short term benefits for the Euro but is certainly not a long term solution, not least of which for those countries tossed out.
- There are those that are calling for tough austerity measures and higher taxes—not a recipe for harmony in the country. Admitting that the party is over is not easy!

Germany and France have acknowledged that "unavoidable decisions" need to be made. Our expectation is for a closer fiscal union to come to the fore. If accomplished this body could then look to mechanisms for sorting out the debt of problem countries and could result in much closer monitoring of finances. Recently Goldman Sachs has suggested a two tier structure could be used whereby the EU would stand behind debt equal to the first 60% of GDP but the country is responsible for any debt over this level. Clearly then, bond yields on the first 60% of debt would all trade at very low rates but yields on any debt over that level would vary considerably depending on country dynamics.

Our view is that the prevailing market pricing is suggesting too much optimism of a successful resolution to Europe's woes. We think it is going to take a long time to "fix" this problem (unless a cast iron final plan is enacted) and consequently expect volatility will remain with us for the foreseeable future.

Christmas Stocking

As is customary at this time of year we present our Christmas stocking for 2012. Last years stocking was not our best and to avoid dampening the mood it is probably best to make no further comment - incidentally my wife commented that if I give her one more bad tip she will be hiring a divorce lawyer!

So we put our heads together and have come up with a brand new glitzy set of ideas for 2012.

For my mother-in-law: Sasol (SOL) – Price: R389.13

Petrol keeps going up and to ensure she remains committed to her babysitting duties, I want to hedge out her travelling costs. Sasol has run a bit over the past few months but in this uncertain environment we continue to favour the company as it has a good mix of upside potential (via ongoing volume growth, a recovery in chemicals and a growing gas business) and defensive qualities (via its strong balance sheet, currency hedge and oil price dynamics). Priced now on a forward PE of 9x (in line with its long run average) and forward dividend yield of 4.1% we continue to see upside in the share price.

For my dad: Anglo American (AGL) – Price: R310.50

I figured I owed him this one given his excitement when he heard that Anglo had acquired a further 45% stake in De Beers, taking their stake to 85%, just at a time when the outlook for diamond sales is improving. In addition he is looking forward to a pay day from the $10billion investment in the Minas Rio iron ore project in Brazil scheduled to come on stream late in 2013. Anglo remains pretty convinced albeit the outlook for iron ore seeing demand growth of as much as 40% over the medium to longer term. Added to this it owns 75% of Anglo Platinum, a company that has performed poorly over the past few years but one which we feel is due for better times in the future. All in all we think Anglo is irresistible for the old man!

For my wife: MTN (MTN) – Price R145.38

I do love my wife but the amount of time she spends talking or sms'ing on her cell phone drives me mad! She then wants to go on expensive weekends to enjoy quality time! We like the fact that this hugely cash generative company has started paying shareholders bigger dividends and that while growth in South Africa is slowing this company still has good growth opportunities in Africa. We would have liked to have picked this one up closer to R130, but with good earnings growth and higher dividends ahead surely this counter will satisfy my demanding partner for life!

For my newly married daughter: Cashbuild (CSB) – Price R111.00

I was not that pleased when my daughter fell for a farmer who lives in the middle of nowhere. We made the trip to visit them earlier this year and were struck by the additions being made to the houses in each town we traveled through. The prevalence of Cashbuild stores was also noticeable. This company has a tried and tested formula (191 stores and expanding), strong management, solid earnings growth (we forecast 14% and 12 % over the next two years) and would not be surprised to see the dividend cover reduced as there is over R700m in cash on the balance sheet.

For my youngest daughter: Metrofile (MFL) – Price: R2.41

This is the second time Metrofile features in our stocking but this time around it goes to the apple of my eye. Last time around when we punted it, the company was a genuine small cap share laden with considerably more debt than it had equity. However we banked on things coming right under the stewardship of a solid management team and excellent company fundamentals. Today the company does not have debt issues and is paying a dividend. We are confidently forecasting growth in earnings, cash flow and dividends increasing by 15%pa over the next three years and reckon it is likely that the share can appreciate by at least this amount over the same time period.

For my wild son - Old Mutual (OML) – Price R14.61

Old Mutual could be classed by most investors as dull and boring. The performance of the share over the past decade has been abysmal, rising just 10% odd, whereas its peers in South Africa have mostly doubled. We are hearing the beating of drums calling shareholders to the war room from where a pincer movement is being planned to change the make-up of the board. It has largely been this team that has been responsible for plundering the South African war chest, spilling the cash to far flung campaigns in the US, Bermuda, China and Latin America. On strict instructions my wild son is jetting into the AGM to ask the hard questions and demand action. Importantly though, and notwithstanding management's past squandering of value we see significant upside under an improved management team.

For my responsible son - Nampak (NPK) – Price R22.00

This year I am giving my responsible son Nampak, which under its newish management team has delivered a superb turnaround over the past 3 years. Underperforming operations have been fixed, sold or closed and gearing has been reduced to virtually zero – important from a point of view of sustaining its 5%+ dividend yield. Also, expansion projects are in place both domestically and in the rest of Africa to ensure a continued volume growth trend. In this regard we would note SAB-Miller, Coke-a-Cola, British American Tobacco, Unilever, Procter & Gamble and others all moving at full steam into the African continent. Although Nampak's business in Africa is still small, it is growing rapidly and we do not think this fact has been fully reflected in Nampak's rating. We see earnings growth of 10-15%pa over the next 3 years and reckon it is likely that the share can appreciate by this amount over the same time period.

Our loyal housekeeper: African Bank (ABL) – Price: R34.84

African Bank (ABIL) has also featured in previous stockings and outside of receiving a good dividend over the past year Gracie has not been too charmed with the growth in the share price thanks largely due to the general banking industry malaise. But ABIL is not a conventional bank by any stretch of the imagination and is certainly not beset with unknown write-offs like its high street peers. Ellerines continues to improve and the bank is growing rapidly. I am looking for earnings growth of at least 20% over the next 2 year period, which should provide a solid underpin to a rising share price and growing dividend flow. It should be noted though that due to the strong growth in the loan book and consequent requirement for capital, ABIL's dividend cover will increase. That said though we still anticipate a yield above 5% in the year ahead.

A very Merry Christmas from the team at ClucasGray