FINANCIAL PARTNERS

VIEWPOINT

www.financial-partners.biz | Vol. 54 | **April 2011**

Newsflash

A new month and the 54th issue of Viewpoint from FP.

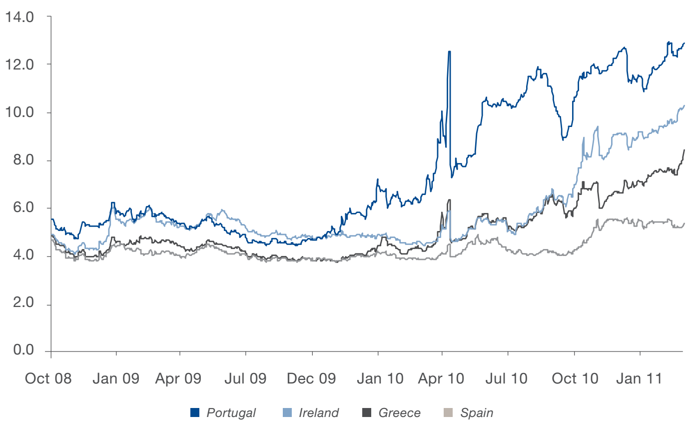
This document will be made available on our website www.financial-partners.biz

Table of Contents

RMB Asset Management International Limited (Registered as a company in England under Reg. No. 3733094 with offices at 5th Floor, 20 Gracechurch Street, London, EC2V 0BG is authorised and regulated by the Financial Services Authority and is a member of the FirstRand Group.

Reflecting on the first quarter of 2011, it is apparent that the market has experienced a remarkable combination of new challenges. On the geopolitical front, Tunisia, Egypt and Libya made headlines, with events in Bahrain enjoying less coverage whilst potentially having a bigger impact on political stability (or lack thereof) in North Africa and the Middle East. The government debt woes of peripheral European countries have been somewhat overlooked during this time, not because they have miraculously been solved, but rather by virtue of being overshadowed by the turmoil in the Arab world, notwithstanding the earthquake and resulting tsunami in Japan. Ever improving economic and corporate news from North America has kept equity markets robust during the quarter, as illustrated by the MSCI World Index's gain of nearly 5%. This return, however, was not delivered in a smooth progression, but via a rather tumultuous ride as the events mentioned above unfolded.

Since news about the geopolitical unrest in Tunisia et al. broke, markets have been moving rapidly and investments have, as anticipated, come under downward pressure. Most importantly, the unrest in North Africa and the Middle East and the real risk that this could spread into the big oil producers (Libya's pre revolution oil production at around 1.6mbbls per day can be readily accommodated by an increase in supply from Saudi Arabia alone) has pushed up the demand for oil. This is essentially a stock piling reaction, to mitigate the risk of a major interruption to supplies. Nevertheless it has pushed the oil price up by c.20% to a level which, if sustained for any length of time, would have a material negative impact on myriad aspects of the economy. To call the Middle Eastern political situation murky is clearly an understatement. It is especially difficult to piece together the extent of unrest in the key oil producer, Saudi Arabia, but there is certainly no longer a zero risk that the House of Saud will face growing unrest and even regime change. The implications for oil supplies and the oil price in this latter event would be huge, and may persist; whoever is in power in oil producing countries will want to ensure a full resumption of production following any curtailment but history shows that in previous situations of dislocation it is invariably very difficult to restore supplies to pre crisis levels.



As anticipated the other big problem area for global markets, the debt crisis in peripheral Europe, has by no means been resolved. Interest rates on Greek, Irish and Portuguese debt have reached record levels (see chart above) and European finance ministers are struggling to prevent a debt default or restructuring in Greece and Ireland. The impact of this crisis on European banks remains a very real concern, while the austerity measures in peripheral Europe may need to be increased even further. The much anticipated March meetings of eurozone leaders took place towards the end of the month, culminating in the announcement of measures to create a new strengthened European Monetary Union (EMU). In Viewpoint's outlook at the start of the year, the EMU was expected to be one of the critical issues for global markets given the extent to which regional events seem to have an ever increasing influence on global sentiment. In the end there were a number of factors that pushed these meetings to the background. One of these was the resignation of the Portuguese Prime Minister (Sócrates) following his coalition's inability to agree to the proposed fiscal tightening that the EMU has set as a requirement. As Jonathan Allum from Mizuho rightly points out, "it is (clearly) not a good idea to have a Prime Minister called Sócrates when you are desperately trying to convince the world that you are not Greece". The good news is that, at least for the moment, it seems as if Spain will not require a bail out based on the recent stability in their 10 year government bond yields.

Markets have also begun to focus on the withdrawal of the Federal Reserve's second round of quantitative easing (QE2). Given the unexpected strength in the US economy in recent months, markets are now expecting that QE2 will end in June, as flagged by the Fed. Given that the Fed has been the major buyer of Treasury bonds through its QE2 programme, there is a risk that bond yields could rise significantly as the year progresses and there are fewer buyers for the mountain of paper that must be issued to finance the fiscal deficit.

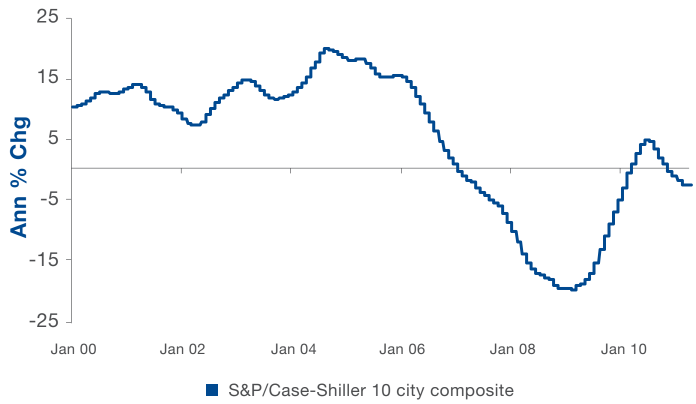
On top of these concerns, investors now have the Japanese earthquake to factor into their thinking. This appears essentially to be a humanitarian rather than an economic disaster. Analysts expect that it will have a relatively short term impact on Japanese activity levels but the rebuilding programme to follow should provide some modest stimulus to spending, as was the case after the Kobe earthquake in 1995. The intrinsic value of the majority of Japanese companies has not declined by as much as the c.19% fall of the Topix index in the first two business days following the disaster would suggest. In the end Japanese stocks shed 7.6% during March, with the Yen only marginally weaker against the US Dollar.

As mentioned in the opening paragraph, equity markets withstood a barrage of major events around the world surprisingly well (especially in March). Global equities

Source: RMB Asset Management / Bloomberg. March 2011.

recovered most of the -6.5% fall they suffered immediately after the Japanese earthquake and ended the month -1.0% lower. Emerging market equities performed particularly well (+5.9%) and exhibited a much stronger rate of recovery following the natural disaster than was the case for developed markets. So far this year it has been a different story, as developed markets have remained ahead of their emerging counterparts in spite of the latter's rally in March. When measured in US Dollar terms, Europe (+7.8%), the United States (+5.8%) and the United Kingdom (+3.4%) all delivered solid results, ahead of Asia ex Japan (+2.7%), emerging markets (+2.1%) and of course Japan, where the Topix is -4.3% lower than at the start of the year.

Bonds did not do anything much during the course of the month with the exception of emerging market bonds (JPMorgan EMBI+) which gained a little over 1%. In the light of inflation expectations slowly rising across the globe, and positive surprises in US economic data, the current yields on government bonds do not offer adequate compensation to holders. The anticipated end of QE2 in June, combined with the factors above, could turn out to be the catalyst for a further sell off in US Treasuries, which in turn could have a detrimental effect on the investment grade corporate bond market. The yield on German bunds (around 3.4% presently) does not compare favourably with the valuation of European equities – the dividend yield on the Eurostoxx 50 of 3.7% looks to provide a better risk / reward profile.



Commodities, with the exception of softs, edged higher during the month. In contrast, property securities around the globe trailed equity markets, with the exception of Europe where the FTSE EPRA/NAREIT index returned 1.7% versus the MSCI Europe ex UK's -2.7% (both in euro terms). House prices in the US remain on a downward trend (as measured by the S&P/Case-Schiller 10 city composite, see chart below), with vacancy rates still between 2 and 3% above their long term average.

Overall, given the evolution of these key uncertainties and risks, we have remained cautious in our approach to building up equity weightings. Our medium term view remains positive but the short term risks have increased and we are in no rush to commit more to equities. We will therefore continue to be patient and wait for buying opportunities to arise; with markets down by 3-5% the correction and consolidation period could continue in the short term. Caution remains our watchword at a time of extreme uncertainty for the global economic and market outlook.

Source: RMB Asset Management / Bloomberg. March 2011

Asset Class Performances

Asset Class/Region	Index	Currency	Mar 2011	YTD 2011
Equities				
United States	S&P 500 NR	USD	0.0	5.8
United Kingdom	FTSE All Share TR	GBP	-0.8	1.0
Continental Europe	MSCI Europe ex UK NR	EUR	-2.7	1.9
Japan	Topix TR	JPY	-7.6	-2.2
Asia Pacific (ex Japan)	MSCI AC Asia Pacific (ex Japan) TR	AUD	4.7	2.7
Global	MSCI World NR	USD	-1.0	4.8
Global Emerging Markets	MSCI World Emerging Markets TR	USD	5.9	2.1
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	-0.1	-0.2
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	1.0	2.1
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	-0.2	0.8
Us High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	0.3	3.9
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	0.4	-0.8
UK Corporate (investment grade)	Merrill Lynch Sterling Non Gilts TR	GBP	0.5	1.0
Euro Government Bonds	Citigroup EMU GBI TR	EUR	-0.7	-1.2
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	-0.3	0.1
Euro High Yield	Merrill Lynch Euro High Yield 3% constrained TR	EUR	-0.3	4.1
Australian Government	JP Morgan Japan Government Bond Index TR	AUD	0.1	-0.6
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	0.6	1.8
Global Government Bonds	JP Morgan Global GBI	USD	0.3	0.5
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	0.5	1.3
Global Convertible Bonds	UBS Global Convertible Bond	USD	0.5	4.4
Global Emerging Market Bonds		USD	1.2	0.7

Source: Bloomberg, March 2011.

Asset Class/Region	Index	Currency	Mar 2011	YTD 2011
Property				
US Property securities	MSCI US REIT TR	USD	-1.6	6.2
UK Property securities	FTSE EPRA/NAREIT United Kingdom TR	GBP	-1.3	5.9
Europe ex UK Property securities	FTSE EPRA/NAREIT Europe ex UK TR	EUR	1.7	3.2
Asia Property securities	FTSE EPRA/NAREIT Asia TR	USD	-3.0	-4.3
Australian Property securities	FTSE EPRA/NAREIT Australia TR	AUD	-0.4	4.5
Global Property securities	FTSE EPRA/NAREIT Global TR	USD	-1.2	3.0
Currencies				
Euro		USD	2.7	5.8
Sterling		USD	-1.5	2.4
Yen		USD	-1.2	-2.1
Australian Dollar		USD	1.6	0.9
Rand		USD	2.7	-2.1
Commodities				
Commodities	RICI TR	USD	2.4	9.7
Agricultural Commodities	RICI Agriculture TR	USD	-1.7	5.4
Oil	ICE Crude Oil CR	USD	2.7	23.2
Gold	Gold index	USD	2.0	2.0
Interest rates	**Last meeting**		**Current rate**	**Change at meeting**
United States	15 March 2011	USD	0.25%	No change
United Kingdom	7 April 2011	GBP	0.50%	No change
Eurozone	7 April 2011	EUR	1.25%	+25bps
Japan	7 April 2011	JPY	0.10%	No change
Australia	1 March 2011	AUD	4.75%	No change
South Africa	24 March 2011	ZAR	5.50%	No change

Source: RMB Asset Management / Bloomberg. March 2011.

Focus: behavioural finance – getting to know the enemy within

Professional investors generally aim to invest on the basis of solid fundamental information. The industry operates on the basis that its assumptions are as objective and defensible as possible. Whilst it is undeniable that the level of sophistication within the institutional investment management universe is at an all time high, with the proliferation of massive computational power allowing market participants to store, analyse and manipulate volumes of data that would have been unthinkable even a couple of decades ago, ultimately the overseeing animal elements – the humans in the system – remain fickle and subject to shortcomings in their behaviour. It is these weaknesses that the study of behavioural finance aims to identify in order to understand their impact on the investment decision making process. Behavioural finance is defined by Martin Sewell of the University of Cambridge as *"the study of the influence of psychology on the behaviour of financial practitioners and the subsequent effect on markets…"* Behavioural finance theory allows investors to be aware of their likely shortcomings and therefore act in a manner that should reduce the influence on their day to day decisions but it also helps explain why and how markets might be inefficient. Below is a short and potted introduction to the vagaries introduced by human behaviour.

In order to first understand what it may mean to have an inefficient market, it is worth defining what it means to have an 'efficient' market. This hypothetical state of the markets is espoused by proponents of the 'Efficient Market Hypothesis' (EMH) as developed by Professor Eugene Fama at The University of Chicago Booth. This hypothesis asserts that markets are 'informationally efficient' i.e. in its 'weak' sense that the market price reflects all available past information and in its 'strong' form that prices reflect all new publicly available information instantly and is even equally reactive to 'insider' information. The core tenets of EMH are compelling for their simplicity and logic, but have long been disputed for a variety of reasons, with one thread of criticism provided by proponents of behavioural finance. This suggests that biases and other human shortcomings prevent EMH from working properly.

Behavioural finance can trace its roots back to the late nineteenth century but it was the twentieth century that saw extensive production of works on the subject by psychologists, philosophers and investment specialists alike. The number of biases and other traits that the human is likely to demonstrate, according to behavioural finance, is lengthy and beyond the scope of this Focus section. Rather below are identified some key shortcomings of the human condition, which successful investors should remain cognisant of and where possible strive to overcome. The first area that behavioural finance manifests itself is in the realm of heuristics. This area of behavioural finance states that people often make decisions based on approximate rules of thumb rather than due to strictly applied logic. There are a number of different Heuristic biases that have been identified by behavioural finance protagonists. The first, **loss aversion**, is premised on the inequality of emotional impact between a gain or a loss. That is, people tend to strongly prefer avoiding losses to experiencing gains. Indeed, this loss aversion is of such a strength that some studies suggest losses are twice as powerful in the mind of the recipient, than gains. A second heuristic, **status quo bias**, is the belief that established behaviour is difficult for the individual to shake off. As a result individuals will tend not to change from established behaviour unless there is a compelling incentive to do so. This assertion is counter to the adaptability required for adherence to EMH. Another heuristic, or rule of thumb, for investors to try to overcome is the so called **gambler's fallacy**; the belief that if deviations from expected behaviour are observed then, future deviations in the opposite direction become more likely. The classic example used by proponents of the fallacy is if a fair coin is tossed repeatedly with a result of tails more often than would be expected on average, a gambler may incorrectly believe that this means that heads is more likely in future tosses i.e. a heads is becoming 'due'. **Self attribution** bias is a rather narcissistic heuristic bias through which people attribute their successes to their (self perceived) skill or qualities, but attribute their failures to exogenous factors they deem to be beyond their control. There is a common human tendency to take credit for success but to deny responsibility for failure and this trait is also demonstrated where humans in aggregate believe themselves to be 'better than average' in areas important to their self-esteem such as driving or leadership qualities. Another heuristic bias which investors exhibit is that of **money illusion**. Under this bias, people tend to think of currency

Source: Bloomberg, www.behaviouralfinance.net. March 2011.

in nominal, rather than real, terms. This means that investors generally underestimate the impact of inflation on returns taking the nominal value of an asset to represent its purchasing power or real value. This effect is markedly present in the housing market as investors attribute all nominal gain in the value of their property to returns without discounting the effect of inflation, which, over a long holding period, can be significant.

A second grouping of behavioural finance traits are explained by framing. These biases may be defined as the mindset that makes up the emotional filters individuals rely on to understand and respond to events. As with heuristics, there are a variety of different framing problems that afflict investors. The first is known as **mental accounting**, which is where people separate out their investments, categorising outcomes for tranches of the portfolio independently rather than the portfolio as a whole. For example, people think of their allocation to cash as their 'short term' assets, equities and bonds as 'longer term' and their property as a 'retirement' pool. This can lead to inefficient allocations from a total portfolio perspective. **Anchoring** is a second form of framing whereby humans rely too heavily on one piece of information when making decisions. That is to say that analysts, for example, may anchor to the most proximate earnings release from a company and then adjust it for their view of future performance rather than calculating earnings from first principles. It is postulated that this is the main cause for analysts over and undershooting at market inflection points.

A third behavioural finance grouping aims to find behavioural explanations for identified market anomalies. The first market anomaly, the **disposition effect**, is related to the tendency of investors to sell shares whose price has increased, whilst continue to hold those that have fallen in value. Investors appear to be less willing to recognise losses whilst being more willing to recognise gains. This is resonant with the loss aversion heuristic introduced above. The **endowment effect** suggests that people place a higher value on a good that they own or have selected compared to an otherwise identical one that they did not. **Herding** describes how individuals in a group have a propensity to act together without concerted effort (or planning) to do so, which suggests that humans will stick with the majority in holding or buying a stock despite growing evidence of a bubble. The final market anomaly is the **sunk-cost fallacy**. This describes the unwillingness of the individual to leave spent resources due to misgivings about 'wastage'. As a result, when money has been spent on an asset many people find it difficult to separate the unalterable sunk cost with future prospects and will therefore hold an investment that has 'cost' them money even if prospects look bleak.

Proponents of behavioural finance do not have it all their own way, however. Critics of this broad and diverse range of observations suggest that this theory understates the rationality of those in the economy; contending that experimentally observed behavior has limited application to 'ideal world' situations. Others note that cognitive theories are models of decision making, not generalized economic behavior, and are only applicable to the sort of once-off decision problems presented in experiments or surveys. Furthermore, traditional economists are also sceptical of the experiments and surveys themselves suggesting risks of systemic biases, strategic behavior and lack of incentive compatibility in lab conditions.

Human nature has, by definition, consequences in all elements of our lives. From the perspective of professional investors the most notable interest will be on the behaviour of fellow participants in investment markets. By being aware of our own likely shortcomings, as well as those of 'the pack', and by surrounding ourselves with other professional investors whose job it is to critique and challenge the motivation behind a decision, we aim to reduce the impact of behavioural elements from investing. Indeed we believe that these potential aberrations from EMH provide opportunities for judicious investors. Irrationality can persist, however, and therefore patient, disciplined investors with a realistic time frame for investing are best placed to take advantage of such mispricing as and when they occur.

Source: RMB Asset Management, March 2011.

Click here for:

Disclaimer:

Simply click on the link of the company that you are interested in. By clicking on any external links provided on this website, you will leave the Financial Partners site and be re-directed to an external organisation's website.

As Financial Partners is not responsible for any content or activities associated with any external website accessed by hypertext links appearing on this website, and as such content has been independently developed by third parties and is outside of our control and subject to change without notice, Financial Partners hereby disclaims any representations, warranties, or guarantees made on external websites.

Further, Financial Partners does not guarantee the correctness or suitability of such information or of any other linked information presented, referenced, or implied. Any hyperlink from this website leading to another website should not be interpreted as an endorsement by Financial Partners of that website, its organisation, or of its products or services.

Financial Partners does not accept responsibility for any loss, harm, or damage, however caused, for information by third party organisations with links appearing on this website. Clicking on any of the following external links constitutes a signature of your consent to the above disclaimer. If you disagree with all, or part of this disclaimer, use of the external links provided below is strictly prohibited.

Important Notes

RMB Asset Management is the trading name for RMB Asset Management International Limited. This document does not constitute an offer or solicitation to any person in any jurisdiction in which it is not authorised or permitted, or to anyone who would be an unlawful recipient, and is only intended for use by original recipients and addressees. The original recipient is solely responsible for any actions in further distributing this document, and should be satisfied in doing so that there is no breach of local legislation or regulation. The information is intended solely for use by our clients or prospective clients, and should not be reproduced or distributed except via original recipients acting as professional intermediaries. This document is not for distribution in the United States.

Prospective investors should inform themselves and if need be take appropriate advice regarding applicable legal, taxation and exchange control regulations in countries of their citizenship, residence or domicile which may be relevant to the acquisition, holding, transfer, redemption or disposal of any investments herein solicited.

Any opinions expressed herein are those at the date this material is issued. Data, models and other statistics are sourced from our own records, unless otherwise stated herein. We believe that the information contained is from reliable sources, but we do not guarantee the relevance, accuracy or completeness thereof. Unless otherwise provided under UK law, RMB Asset Management does not accept liability for irrelevant, inaccurate or incomplete information contained, or for the correctness of opinions expressed.

We caution that the value of investments in discretionary accounts, and the income derived, may fluctuate and an investor may incur losses, including a loss of the principal invested. Past performance is not generally indicative of future performance. Investors whose reference currency differs from that in which the underlying assets are invested may be subject to exchange rate movements that alter the value of their investments.

Our investment mandates in alternative strategies and hedge funds permit us to invest in unregulated funds that may be highly volatile. Although alternative strategies funds will seek to follow a wide diversification policy, these funds may be subject to sudden and/or large falls in value. The illiquid nature of the underlying funds is such that alternative strategies funds deal infrequently and require longer notice periods for redemptions. These Investments are therefore not readily realisable. If an alternative strategies fund fails to perform, it may not be possible to realise the investment without further loss in value. These unregulated funds may engage in the short selling of securities or may use a greater degree of gearing than is permitted for regulated funds (including the ability to borrow for a leverage strategy). A relatively small price movement may result in a disproportionately large movement in the investment value. The purpose of gearing is to achieve higher returns associated with larger investment exposures, but has concomitant exposure to loss if positive performance is not achieved. Reliable information about the value of an investment in an alternative strategies fund may not be available (other than at the fund's infrequent valuation points).

Under our multi-management arrangements, we selectively appoint underlying sub-investment managers and funds to actively manage underlying asset holdings in the pursuit of achieving mandated performance objectives. Annual investment management fees are payable both to the multimanager and the manager of the underlying assets at rates contained in the offering documents of the relevant portfolios (and may involve performance fees where expressly indicated therein).

RMB Asset Management International Limited (Company Registration No. 3733094) and has its registered office at 20 Gracechurch Street, London, EC3V 0BG .

RMB Asset Management International Limited is authorised and regulated by the Financial Services Authority in the United Kingdom, and is an authorised Financial Services Provider pursuant to the Financial Advisory and Intermediary Services Act 37 of 2002 in South Africa.