

Glossary of Terms

Active (or tactical) asset allocation

This is when asset managers actively vary their allocation to certain asset classes based on economic and market data, asset class valuations, etc. This should lessen an investor's exposure to declining markets and help preserve capital.

Active stock selection

This is when asset managers actively and tactically vary their stock selections based on economic and market data, and fundamental valuations, etc. This should lessen an investor's exposure to declining markets and help preserve capital.

Alpha generation

Alpha is the returns a portfolio produces in excess of a pre-selected benchmark, on a risk-adjusted basis. Therefore, an alpha generator adds to portfolio returns without adding any additional risk, as measured by volatility or downside volatility. This follows modern portfolio theory in allowing investors to maximize returns while maintaining a certain level of risk. An alpha generator can be any share, including government bonds, foreign stocks, or derivative products such as stock options and futures.

Alternate weighting methodology

A stock index is used to measure the performance of a group of stocks. To do this a weighting method is used, which puts more emphasis (weighting) on stocks that meet specific criteria. In turn, those stocks represent a greater part of the index.

Most major market indices are based on a market cap weighting. Alternate weighting index funds use different weighting methods, such as price weighted, equal weighted, dividend weighted, earnings weighted and revenues weighted indices. There is another school of thought that the various alternative weighting methodologies are simply ways of tilting exposure towards various "factors" such as value or leverage.

Annualised total returns

Annualised return is the weighted average compound growth rate over the period measured.

Asset allocation funds

Also known as balanced or managed funds. A fund manager invests in a spread of assets such as equities, bonds and cash depending on market conditions.

Balanced fund

Also known as an asset allocation or managed funds. A fund manager invests in a spread of assets such as equities, bonds and cash depending on market conditions.

Benchmark cognisant

This is an investment manager who, in the process of evaluating the performance of any investment, compares its performance against an appropriate benchmark. In the financial field, there are dozens of indexes that analysts use to gauge the performance of any given investment including the S&P 500, the Dow Jones, etc.

Bond

A bond is an interest-bearing debt instrument, traditionally issued by governments as part of their budget funding sources, and now also issued by local authorities (municipalities), parastatals (Eskom) and companies. Bonds issued by the central government are often called "gilts". Bond issuers pay interest (called the "coupon") to the bondholder every 6 months. The price/value of a bond has an inverse relationship to the prevailing interest rate, so if the interest rate goes up, the value goes down, and vice versa. Bonds/gilts generally have a lower risk than shares because the holder of a gilt has the security of knowing that the gilt will be repaid in full by government or semi-government authorities at a specific time in the future. An investment in this type of asset should be viewed with a 3 to 6 year horizon.

Call deposits

Call deposits or call deposit accounts allow investors to deposit and withdraw funds in several currencies, which commonly include the U.S. dollar, the euro and the British pound. This flexibility reduces investors' exposure to foreign exchange expenses and currency risk.

Capital appreciation

Capital appreciation is the profit made on an investment, measured by the increase in its market value over the invested amount or cost price. It is also called capital growth.

Capital growth

Capital growth is the profit made on an investment, measured by the increase in its market value over the invested amount or cost price. It is also called capital appreciation.

Capital preservation

This is an investment strategy where the primary goal is to preserve (protect) capital and prevent losses in a portfolio. Preserving capital is a priority for retirees and those approaching retirement, since they may be relying on their investments to generate income to cover their living expenses, and have limited time to recoup losses if markets experience a downturn.

Capital protection

This is a strategy which aims to protect investors against capital losses when the markets go down. It is often referred to as protecting against downside risk (the likelihood of a fund's potential to decline in value if market conditions change).

Capital volatility

Volatility is a measure of 'risk', and refers to the extent to which the price of an investment or capital value fluctuates over a certain period of time. Funds with a high volatility usually offer the potential for higher returns over the longer term than low volatility funds.

Compound rate of return (RoR)

The compounded rate of return is the average yearly (annualised) percentage that the fund has returned since the inception of the fund.

Collective investment scheme (CIS)

Collective investment schemes (also called unit trusts) are portfolios of assets such as equities, bonds, cash and listed property, in which investors can buy units. They allow private investors to pool their money together into a single fund, thus spreading their risk across a range of investments, getting the benefit of professional fund management, and reducing their costs.

Credit instruments

Debt instruments issued by non-sovereign issuers like banks and corporates.

Debenture

A debenture is a medium- to long-term debt instrument used by large companies (or corporates) to borrow money, at a fixed rate of interest.

Debt instrument

A debt instrument (e.g. a bond) is an electronic promise to repay a debt. It is issued by a corporation or government and sold to investors. A bond is an interest-bearing debt instrument, traditionally issued by government as part of their budget funding sources, and now also issued by local authorities (municipalities), parastatals (Eskom) and companies. Bond issuers pay interest to the bondholder every 6 months. The price/value of a bond has an inverse relationship to the prevailing interest rate, so if the interest rate goes up, the value goes down, and vice versa. Bonds generally have a lower risk than shares because the holder has the security of knowing that it will be repaid in full by government at a specific time in the future.

Derivatives

Derivatives are instruments generally used as an instrument to protect against risk (capital losses), but can also be used for speculative purposes. Examples are futures, options and swaps.

Derivative strategies

A derivative strategy employs financial instruments (like futures and options) that are derived from other financial instruments, known as underlying instruments. For example, the Dow Jones Industrial is an indicator of whether the stock market is going up or down. You can 'bet' on the direction of the Dow by selling a 'futures' contract on it. This futures contract is a derivative as it derives from the Dow Index. If you think the market will go up, you will buy the Dow futures contract, and vice versa.

Distributions

The income that is generated from an investment and given to investors through monthly or quarterly distribution pay-outs.

Diversification

This is a strategy designed to reduce risk within a portfolio by combining a variety of investments (or asset classes) such as equities, bonds, cash or property, which are unlikely to all move in the same direction. This is designed to reduce the risk (and protect against capital losses) within a portfolio. Diversification allows for more consistent performance under a wide range of economic conditions as it smoothes out the impact of negative market events. The positive performance of some investments or asset classes should neutralize the negative performance of others.

Dividend income

The investor's share of a company's profits, given to him or her as a part-owner of the company.

Downside protection

This is a strategy which aims to protect investors against capital losses when the markets go down. It is often referred to as protecting against downside risk (the likelihood of a fund's potential to decline in value if market conditions change).

Downside deviation

A measure of downside risk that calculates the volatility on fund returns below a defined minimum. In this case, negative returns i.e. any monthly return below 0%.

Downside risk

The likelihood of a fund's potential to decline in value if market conditions deteriorate.

Duration

A measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years. Rising interest rates mean falling bond prices, while declining interest rates mean rising bond prices.

Dynamic capital protection techniques

These are risk management strategies used to protect one's capital against losses due to the negative effects of market downturns. How we do this in the market allocator fund, is we allocate alternately between equities and fixed-interest instruments (i.e. cash and bonds) as the markets rise and fall. In other words, cash is increased in declining markets and decreased in rising markets.

Equally weighted index

A type of weighting that gives the same weight, or importance, to each stock in an index fund. The smallest companies are given equal weight to the largest companies in an equal-weight index fund or portfolio.

Equities

An equity or share represents an institution/individual's ownership in a listed company and is the vehicle through which they are able to "share" in the profits made by that company. As the company grows, and the expectation of improved profits increases, the market price of the share will increase and this translates into a capital gain for the shareholder. Similarly, negative sentiment about the company will result in the share price falling. Shares/equities are usually considered to have the potential for the highest return of all the investment classes, but with a higher level of risk i.e. share investments have the most volatile returns over the short term. An investment in this type of asset should be viewed with a 7 to 10 year horizon.

Feeder fund

A feeder fund is a South African-based fund that feeds exclusively into its primary foreign-based fund. It allows investors easy access to investing in an offshore fund, eliminating complicated tax and other implications. The shares of the feeder fund represent shares in the primary fund (called a master fund).

Fixed deposits

A fixed deposit or term deposit is an amount of money held at a financial institution for a fixed amount of time. It pays higher interest than a savings account but imposes conditions on the amount, frequency, and/or period of withdrawals.

Fixed-interest investments

Fixed interest funds invest in bonds, fixed-interest and money market instruments. Interest income is a feature of these funds and, in general, capital should remain stable. A fixed-interest investment aims to offer investors a regular income at a set interest rate, which can be fixed over a specified term. If interest rates fall, the fixed-interest investment typically becomes more valuable. Conversely if interest rates rise, the value of the investment will fall.

Fixed-interest securities

A fixed interest security is basically a loan to the government or a company. With most, you get interest payments for as long as you hold the security. The amount of interest you will get (called the coupon) is expressed as a percentage of the nominal value. Since the nominal value is typically R100, if a security has a coupon of 6%, you will get R6 a year interest for each nominal unit (R100) of stock that you have. The interest provides you with a fixed amount at regular intervals. So this is usually a very predictable way of getting an income from your investment.

Floating rate note

This is a debt instrument with a variable interest rate. A floating rate note's interest rate is tied to a benchmark or the prime lending rate. Floaters are mainly issued by financial institutions, corporates and governments. Floaters protect investors against a rise in interest rates. Because interest rates have an inverse relationship with bond prices, a fixed-rate note's market price will initially drop if interest rates increase.

Fund of funds

A "fund of funds" is an investment strategy of holding a portfolio of other investment funds rather than investing directly in stocks, bonds or other securities. This type of investing is often referred to as multi-manager investment.

Investing in a fund of funds may achieve greater diversification. The benefit of diversification is that it can reduce volatility and the overall risk in the portfolio, while maintaining returns.

Fund of hedge funds

A fund of hedge funds is a fund of funds that invests in a portfolio of different hedge funds to provide broad exposure to the hedge fund industry and to diversify the risks associated with a single investment fund.

Fundamental analysis

This is a method of evaluating a share that involves attempting to measure its intrinsic value by examining related economic, financial and other qualitative and quantitative factors. Fundamental analysts attempt to study everything that can affect the share's value, including macroeconomic factors (like the overall economy and industry conditions) and company-specific factors (like financial statements, cash flow and management).

Hedge fund

This is an aggressively managed portfolio of investments that uses advanced investment strategies such as leveraged, long, short and derivative positions in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark). Investments in hedge funds are liquid as they often require investors keep their money in the fund for at least one year.

High conviction bets

High-conviction active management, characterized by a more concentrated, low- turnover investment approach, may improve investment performance as managers are better able to develop a thorough understanding of portfolio companies and factors that influence their long-term business values. The patience to invest in a

company for a longer period of time may also allow ample time for its intrinsic value to be fully reflected in its underlying stock price.

High income portfolio

This is a portfolio that has a primary goal to produce a high level of income by investing in higher-risk asset classes such as equities.

Income funds

Income funds are invested in a variety of interest-bearing assets such as bonds and fixed deposits.

Index

An index is an imaginary portfolio of underlying funds representing a particular market or a portion of it. Stock and bond market indexes are used to construct index mutual funds and exchange-traded funds (ETFs) whose portfolios mirror the components (underlying funds) of the index.

Inflation-linked bonds

Inflation-linked bonds, also called inflation-indexed or real return bonds, enable investors to avoid the adverse side-effects of higher inflation while maintaining the safety of holding bonds. They guarantee a return higher than the rate of inflation if it is held to maturity. Inflation-linked bonds link their capital appreciation, or coupon payments, to inflation rates. Investors seeking safe returns with little to no risk will often hold inflation-linked bonds.

Instruments

Financial instruments can be defined as any asset purchased by an investor. In general, this could be a bond, stock, etc. Money market securities (such as treasury bills, government bonds, etc.) and capital market securities (such as mortgages or long-term bonds) are also referred to as instruments.

An instrument could also be any tool used to implement economic policy. For example, the government may use interest rates as an instrument for implementing monetary policy, and taxes as an instrument for implementing fiscal policy.

Interest bearing instruments

An interest bearing instrument is any asset, such as a corporate or government bond, stock or money market instrument that pays regular, periodic interest to the investor.

Investing in neglected global equities

This is a strategy of selecting shares that trade for less than their intrinsic values. Value investors actively seek stocks that they believe the market has undervalued. They believe the market overreacts to good and bad news, resulting in stock price movements that do not correspond with the company's actual long-term fundamentals. The result is an opportunity for value investors to profit by buying when the price is deflated.

Liquid assets

Liquid assets are shares that can easily be bought or sold.

Liquid instruments

Financial instruments / any asset (bond, stock or money market securities) purchased by an investor that can be easily sold.

Liquidity

The ability to easily turn assets or investments into cash.

LISP (Linked Investment Service Provider)

A Linked Investment Service Provider is a financial institution which packages, distributes and administers a broad range of unit trust based investments. Any investment made through these products gives an investor a single point of entry into a selection of different investments.

A "manager of managers fund"

A "manager of managers fund" is an investment fund that uses an investment strategy of directly selecting different investment managers and gives them the mandate to make investment decisions. The assumption here

is that diversification and balance can be achieved more readily by having a group of specialists, instead of one individual, investing the fund's capital.

Market cap weighted index

A market cap weighted index is created by giving weightings to shares according to the company's size (or capitalisation). The larger the company's market capitalisation, the larger its weighting in the index. In other words, a fund will increase the amount it owns in a particular company as that company's stock price increases. Conversely, as that company's stock price falls, its market capitalisation decreases and the fund will automatically own less of that company.

Market capitalization (or market cap)

Market capitalization (or market cap) is the total value of the issued shares of a publicly listed and traded company. It is calculated by multiplying the share price by the number of ordinary shares in issue. It is used to determine a company's size and value as a listed entity on the South African stock exchange, as opposed to sales or total asset figures.

Maturity date

This refers to the actual date a bond is "cashed out" by the issuer and an investor receives the face value of that bond. Or, this could be the length of time until a fixed income investment returns its original investment at the date mentioned above. For example, someone might say that a bond has "a 5-year maturity."

Money market funds

Also known as cash funds, these allow investors to "park" their money in the short-term. These are highly liquid investments that offer capital preservation with minimum volatility.

Money market instruments

A money market instrument is a low risk, highly liquid, short-term (one year or less) debt instrument, issued by financial institutions or governments, that tend to have lower returns than high-risk investments.

MSCI World (Developed Markets) Index

The MSCI World Index is a stock market index made up of about 1,600 global stocks. It is often used as a common benchmark for 'world' or 'global' stock funds. The index includes a collection of stocks of all the developed markets in the world, as defined by MSCI. The index includes stocks from 23 countries but excludes stocks from emerging and frontier economies.

Multi-asset class funds

Multi-asset class funds invest in a combination of asset classes (such as cash equities, property or bonds). This increases the diversification of an overall portfolio and reduces risk (volatility) compared to holding one class of assets only.

Multi-managed solution

Multi-managed investing combines a range of investment managers with complementary styles, across different asset classes. The risk of the investors' portfolios is reduced as a result, without impacting on the overall long-term returns.

It is based on the premise that no one manager is likely to perform well in all market conditions and all circumstances.

Negative inflation (also called deflation)

A general decline in prices, often caused by a reduction in the supply of money or credit. The opposite of inflation, deflation has the side effect of increased unemployment since there is a lower level of demand in the economy, which can lead to an economic depression.

Net asset value (NAV)

Net asset value (NAV) is the value of a fund's asset less the value of its liabilities per unit.

Optimization techniques

The process of continuously improving the performance of the underlying fund by mirroring the performance of the index.

Optimised income fund

The composition of the underlying funds is determined through the objectives of the fund: minimising the interest rate and equity market risks, the downside volatility and the credit risks while optimising the investment returns and the liquidity of the fund.

Participatory interests

When you buy a unit trust, your money is pooled with that of many other investors. The total value of the pool of invested money in a unit trust fund is split into equal portions called participatory interests or units. When you invest your money in a unit trust, you buy a portion of the participatory interests in the total unit trust portfolio. Participatory interests are therefore the number of units that you have in a particular unit trust portfolio.

Passive investment strategy

This is strategy that employs a passive investment vehicle (such as an index tracker) where the fund copies a particular benchmark, i.e. the fund holds the same underlying funds as the benchmark in exactly the same proportions and puts together a cost-effective product that replicates the performance of this benchmark over time.

Passive investment vehicle (e.g. index tracker)

A style of investing where a fund's portfolio mirrors or replicates a particular market index by investing in all of the underlying funds within that index. Passive investing is the opposite of active investing in which a fund's manager attempts to beat the market with various investing strategies. Also known as "passive investing" or "index investing."

Preference shares

Preference shares rank higher than ordinary shares in terms of dividends and capital, if the company goes into liquidation. They do not have voting rights. Dividends on preference shares are normally a predetermined percentage of the nominal value of the share.

Price to earnings ratio

Price to earnings ratio or p: e ratio is calculated by dividing the price per share by the earnings per share. This ratio provides a better indication of the value of a share, than the market price alone.

Property loan stock (PLS)

A property loan stock is a way for investors to buy shares in commercial, retail or industrial property, listed on the JSE. These property portfolios are managed on behalf of shareholders by professional property managers. Investors buy units and share in the income stream from that property portfolio. However, the modern trend is that PLSs are being replaced by internationally recognised Real Estate Investment Trusts (REITs).

Property unit trusts (PUTs)

Property unit trusts (PUTs) allow investors to buy and sell shares in commercial, retail or industrial property on the JSE. They are listed unit trusts invested in professionally- managed property portfolios that specialise in different sectors of the market – offices, retail or industrial property. The modern trend is that PUTs are being replaced by internationally recognised Real Estate Investment Trusts (REITs).

Pure equity fund

This is a fund that invests primarily in higher-risk asset classes such as equities (stocks or shares) and aims to achieve aggressive capital growth over the long term. This type of fund will experience volatility in the short term.

Rand-hedge protection

A Rand-hedge is a way of maximising returns on your investment in rand terms, through an offshore investment. The rand value of your investment increases if the currency declines (when the rand depreciates, the rand value of your offshore investment appreciates).

Real swaps

A real return swap is a swap that changes the cash flow of an instrument from nominal cash flow (i.e. normal bond or cash instrument) into real (inflation-adjusted) cash flow.

Regulation 28

Regulation 28 of the Pension Funds Act sets out prudent investment limits on certain asset classes in investment funds. It applies specifically to investments in Retirement Annuities and Preservation Funds.

The allowed maximum exposures to certain asset classes is:

75% for equities

25% for property

45% for foreign (offshore) assets.

Regulation 30

Regulation 30 of the Medical Schemes Act sets out restrictions on certain asset classes in investment funds. It dictates that medical schemes may not have exposure to foreign equity, and are limited to 40% exposure to local equity.

Real Estate Investment Trust (REITs)

A financial instrument that sells like a stock on major stock exchanges and invests in real estate directly, either through properties or mortgages. REITs receive special tax considerations and typically offer investors high yields, as well as a highly liquid method of investing in real estate.

Replication strategy

This is a strategy used by index investors that tries to replicate or copy the performance of a specific benchmark, i.e. it will hold exactly the same underlying funds as the benchmark in exactly the same proportions and puts together a cost-effective product that replicates the benchmark over time. An investment vehicle such as index tracker is a good example of a fund that closely tracks the performance of a particular index.

Research-driven investment process

This is a rigorous screening process for sifting through the available universe of asset managers and selecting specific funds on which to perform further, more in-depth research. This allows a more accurate way of valuing shares or funds, and allows a portfolio manager to tailor clients' asset allocation tactically to changing market conditions. This process involves evaluating the macroeconomic environment to quantify the level of risk in the market, and assessing the investment styles of the different asset managers we invest in to identify true skill, which will ensure a repeatable investment process and long-term outperformance.

Rolling returns

These returns show annualised returns for a given number of years. Rolling returns are useful as they can give the returns over holding periods similar to those actually experienced by investors.

For example, a rolling return over 5 years will show you the moving average of returns including the previous 5 years. So if you sold your investment on 1 January 2014 or 1 March 2014, it will include the average performance of the fund 5 years back from these dates (i.e. the 1 January 2014 rolling 5 year return will include the average returns from 1 January 2009 to 1 January 2014; similarly if you sold your investment on 1 March 2014, the rolling return will be a figure that is the average of the funds returns from 1 March 2009 to 1 March 2014).

Sanlam's Pragmatic Value Investment Style

This is a philosophy which enables our fund managers to make rational - not emotional - decisions based on in-depth research. This gives them insight into what an asset is truly worth, not what investors are willing to pay based on greed or fear. We take a more practical (pragmatic) approach and invest in stocks that are, in our opinion, trading below their fair value but which do not strictly qualify as value stocks from a theoretical perspective.

Securities

A general term for shares, bonds, money market instruments and debentures.

Sharpe ratio

The Sharpe ratio measures risk-adjusted performance of an investment or portfolio. It measures the amount of risk associated with the returns generated by the portfolio and indicates whether a portfolio's returns are due to excessive risk or not. The greater a portfolio's Sharpe ratio, the better its risk-adjusted performance has been (i.e. a higher return with a contained risk profile, where the portfolio manager is not taking excessive risk to achieve those returns).

Smart beta equity tracker

Smart beta is a blending of both traditional "active" and "passive" investment strategies, and differs from the traditional market cap-weighted method. Smart beta trackers' main appeal is that they offer investors a chance to get above-average returns without paying excessive fees or taking on too much risk. So they offer some of the advantages of an actively managed portfolio, but without the charges. The goal of smart beta is to boost returns by using a "rules based" approach that puts more weight on other factors, such as valuations, dividends, momentum or volatility to determine which companies to own and how much stock to buy.

Sortino Ratio

The Sortino Ratio is similar to the Sharpe ratio in that it indicates the risk/reward profile of a fund based on past data. The difference is that the Sortino Ratio takes into account harmful volatility by taking into account the standard deviation of negative returns (downside deviation). A large ratio indicates a low probability of a large loss.

Specialist equity fund

This is a fund that invests primarily in higher-risk asset classes such as equities (stocks or shares).

Standard deviation

Standard deviation (also called monthly volatility) is a measure of how much the returns on an investment change from month to month. It is typically used by investors to gauge the amount of expected volatility in an investment.

The S&P South Africa 50 Index

This large cap index represents 90% of equity markets in South Africa.

Tactical (or active) asset allocation

This is when asset managers actively vary their allocation to certain asset classes based on economic and market data, asset class valuations, etc. This should lessen an investor's exposure to declining markets and help preserve capital.

Tax Free Unit Trust

This fund qualifies as a tax free investment according to section 12T of the Income Tax Act, with effect from 1 March 2015. South African individuals qualify for the associated tax benefits namely no tax on dividends, income or capital gains whilst still enjoying all the benefits of a unit trust. Note contributions to tax free investments are limited to R36 000 per tax year, with a lifetime limit of R500 000. Amounts invested in excess of these permissible thresholds are taxable.

Traditional asset classes

The three main traditional asset classes are equities (shares), fixed-income (bonds), cash (money market instruments), listed property and alternatives.

Total Expense Ratio (TER)

This is the total costs associated with managing and operating an investment (excluding administration, financial planning and servicing fees). These costs consist primarily of management fees and additional expenses such as trading fees, legal fees, auditor fees and other operational expenses. The total cost of the fund is divided by the fund's total assets under management to arrive at a percentage amount, which represents the TER.

Ultra Conservative asset allocation band

The ultra-conservative asset allocation band is level with inflation.

Unit trusts

Unit trusts (also called a collective investment scheme) are portfolios of assets such as equities, bonds, cash and listed property, in which investors can buy units. They allow private investors to pool their money together into a single fund, thus spreading their risk across a range of investments, getting the benefit of professional fund management, and reducing their costs.

Upside potential

The amount by which analysts expect the price of a share or asset class to increase.

Value Investing

This is a strategy of selecting shares that trade for less than their intrinsic values. Value investors actively seek stocks that they believe the market has undervalued. They believe the market overreacts to good and bad news, resulting in stock price movements that do not correspond with the company's actual long-term fundamentals. The result is an opportunity for value investors to profit by buying when the price is deflated.

Value stock

A stock that tends to trade at a discount relative to its fundamental intrinsic value (i.e. dividends, earnings, sales, etc.) and is therefore considered to be undervalued.

Common characteristics of such stocks include a high dividend yield, low price-to-book ratio and/or low price-to-earnings ratio; healthy balance sheet; little or no debt.

Volatility

Volatility is a measure of 'risk', and refers to the extent to which the price of an investment or fund fluctuates over a certain period of time. Funds with a high volatility usually offer the potential for higher returns over the longer term than low volatility funds.

Well diversified equity portfolio

A wide variety of equity investments chosen specifically to smooth out risk within the portfolio, as the positive performance of some of the investments neutralises the negative performance of others during the various stages of the market cycle.

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