

An impressionistic oil painting of two men smiling. The man on the left is wearing glasses and a blue shirt. The man on the right is wearing a blue and white striped shirt. The background is a warm, textured brown. A solid red vertical bar is on the left side of the image.

AFENA Insights

Quarter ended
June 2010

Business Summary

HISTORY OF AFENA CAPITAL

Afena Capital was established in November 2005 by a team of investment professionals with substantial experience in investment research, portfolio management and business management. We are based in Cape Town, South Africa, and the firm is wholly owned by management and staff.

The Afena Capital partners, Tebogo Naledi, Khaya Gobodo, Khulekani Dlamini and Andrew Joannou, have worked together for approximately nine years at Afena Capital and at Investec Asset Management, where they were previously employed.

The founding partners of Afena Capital established the firm with the long term vision of building a trusted, professionally managed, quality investment management firm, operating across the African continent.

We currently employ 15 full time staff members and manage segregated and pooled portfolios on behalf of institutional and private investors. Our total assets under management at 30 June 2010 stood at just under R11.1 billion.

WHAT DO WE DO

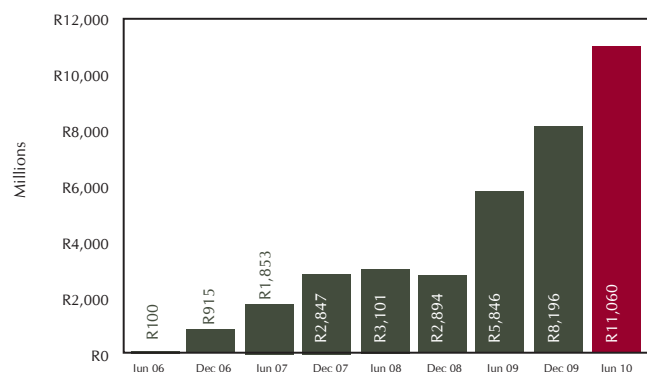
Afena Capital manages domestic specialist equity and balanced portfolios. Our focus is on generating superior long term investment returns and providing quality service for our clients. Our sole business is the professional management of investment portfolios on behalf of third party clients. We do not engage in any other business.

We are absolutely clear on our purpose which is to provide our clients with excellent investment returns in a risk controlled environment. Our core skill lies in active portfolio management, relying on fundamental research underpinned by a clear investment philosophy that focuses on valuation driven long term investing.

The value in our investment process is to be found in our deep fundamental research and our intrinsic valuation based approach to stock selection. This approach requires a long term view on the companies we invest in therefore our investment returns are generated over the long term.

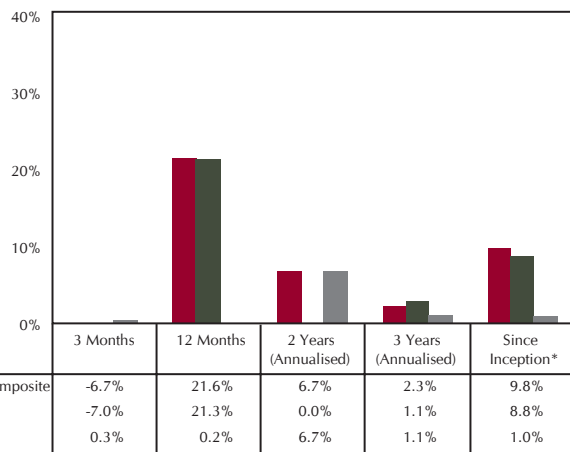
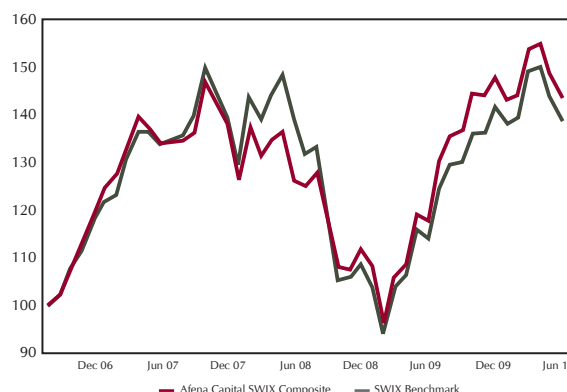
Afena Capital manages segregated portfolios and pooled portfolios which are available to local and international investors.

ASSETS UNDER MANAGEMENT



Source: Afena Capital

INVESTMENT PERFORMANCE



Source: Afena Capital, I-Net

*46 months annualised
Investment performance is presented gross of management fees. Past performance is not necessarily a guide to future returns.

AFENA CAPITAL MANAGEMENT TEAM

Name	Position
Tebogo Naledi	Chief Executive Officer
Gcinikhaya Gobodo	Head of Equities
Khulekani Dlamini	Portfolio Manager
Andrew Joannou	Portfolio Manager
Sandile Sokhela	Head of Institutional Business
Michael Dabrowski	Head of Operations

CONTACT DETAILS

Tel: 021 657 6240
Email: info@afenacapital.com
Web: www.afenacapital.com

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Global Market Review



Sandile Sokhela
Head of Institutional Business

Risk aversion spread like wild fire over the second quarter of 2010, and stock markets proved once again that they are very elusive over the short term.

The second quarter of 2010 proved to be an interesting battle between optimism and pessimism.

Market fundamentals dictate that:

- The direction of share prices is ultimately driven by economic growth;
- Economic growth is driven by income growth and credit availability;
- Credit availability is driven by central bank policy and
- Central bank policy is driven by core inflation.

The market optimists fundamentally believe that the worst is behind us, and better days are ahead. Evidence to this end over the quarter included the following:

- Reported macro economic data was largely positive.
- Earnings upgrades outnumbered earnings downgrades and company earnings continued to surprise on the upside.
- The central bank and other monetary authorities continued to pledge the provision of support and liquidity in the market.

Looking at all the above factors the optimists had reason to believe that this was going to be another positive quarter. Until late April this belief prevailed with the S&P 500 recording the best 12 month run in over 70 years.

The S&P 500 however changed direction and went on to register the worst May in 48 years, declining by 12.3% from its April 23 closing high of 1217.28 to a May 26 closing low of 1067.95. Lipper FMI (previously AMG Data Services) reported the largest weekly net outflow from equity funds and equity ETF's ever recorded in its 20 year history; an outflow of \$16.7 billion during the week ending 26 May. The MSCI rebalancing did not help as a net \$1 billion flowed out of US equities.

The pessimists, or cautious market participants, believed the correction was no surprise. The belief that we are in a structural bear market remained quite resolute. A popular market commentator who belongs in this camp, Richard Russell, made the following observation – "The great primary bull market started in 1980-82 and lasted to 2007. That represents a period of 27 years of generally rising prices, over-consumption and debt building. Most bear markets tend to last one-third to one half as long as the preceding bull market. On that basis, this bear market may have years to go. If, as some claim, the bear market started in 2007, that would mean that the bear market is less than three years old." He further states that, "it's absurd to think that a 27-year bull market can be corrected in less than three years".

He continues and compares today's market to a man who looks healthy, eyes shining, full head of hair, rosy cheeks, broad chest, but he's suffering from cancer of his stomach and his pancreas. In other words, he's a dead man walking.

There are a number of factors that have played in favour of the pessimist. These factors led to the spread of risk aversion and certainly made a big impact on the direction of the market over the second quarter of 2010. These factors are:

1. Sovereign debt issues in Europe
2. A policy induced slow down in China
3. The BP Oil Spill & Goldman Sachs fraud charges

Sovereign Debt Issues

Over the past quarter, concerns continued to grow over European governments' lack of a common position on how to resolve the debt crisis affecting the region. The global investor's concern is that the problem in Europe will not be contained to just the European region and there will be collateral damage, which will halt the global economic recovery.

The Finnish minister Jyrki Katainen recently compared the Greece crisis to the Lehman Brothers collapse saying that the impact the failure of Lehman Brothers had on global markets would be revisited if Greece defaulted. This is despite the fact that claims from Lehman's creditors totalled \$875 billion, much of which may have to be written off. By comparison, Greece has debts totalling nearly €300 billion (\$360 billion). The accuracy of the Finnish minister's statement may be debatable but it is not debatable that such statements added fuel to the fire.

Credit rating agencies did not lend any support either. Greece was downgraded from BB+ from BBB+ (now junk status) by the rating agency Standard & Poors (S&P) who also warned that bondholders could recover as little as 30% of their initial investment if the country restructures its debt. The downgrade marked the first time a Euro member has lost investment grade rating since the currency's 1999 debut. S&P also reduced Portugal's credit rating to A- from A+. There was no escaping the pain as Spain joined the party with Fitch Ratings cutting Spain's credit rating to AA+ from AAA, saying its economic recovery would be more muted than the government forecast.

On the positive side, Greece accepted the bailout from the European Union and International Monetary Fund valued at more than €100 billion (\$120 billion) to prevent default. Furthermore European Policy makers announced a loan package of almost \$1 trillion to contain the regional sovereign debt crisis.

However, the damage over the quarter was already done. The overall impact of the news from the Euro region on global markets overshadowed any positive macro economic news that was released, or any positive earnings numbers that were reported, and we saw major stock market indices close in the red. European indices continued to lag other major global indices as the UK's FTSE 100 Index closed down -14.4%. In the US, the S&P 500 Index closed the quarter down -12.5% lagging the Dow Jones Industrial Index which posted a -10.6% decline, with sentiment largely driven by issues around the sovereign debt crisis.

China Policy Induced Slow down

The Chinese government clearly believes the worst of the global recession and its attendant financial crisis is over. The move to tighten monetary policy, as well as the recent decision to allow the Yuan to gradually appreciate against the greenback clearly shows that the Chinese government believes the worst is behind. The People's Bank of China said in a statement during the quarter that the global economy is "gradually recovering and the upturn in the Chinese economy has become more solid," and that an appreciation of the Yuan will benefit exporters and Chinese employment more than it hurts them. A more flexible currency would also help to curb consumer price gains, asset bubbles and dependence on exports for growth.

While the statement regarding a more flexible currency was seen as positive, market participants attached greater significance to the prospect of a slow down in economic growth in China. The market showed little belief and took little comfort towards the policy induced measures to slow economic growth, exacerbated by heightened tensions in North Korea and the Middle-East which saw the Nikkei Index take a pounding and closing -18.3% over the quarter, lagging most major indices.

Gulf of Mexico: BP Oil Spill

More negative sentiment fuelled the market as another record was broken this quarter with the BP oil disaster becoming the worst American oil spill on record. With everything that is happening around the globe, market participants certainly do not know how all of this will affect oil prices.

Market participants therefore did what they normally do in times of uncertainty; they priced in the worst case scenario and followed the old rule, and that is, when in doubt get out. During the quarter Reuters reported that the net percentage of fund managers who remain overweight in energy stocks plunged to 7 percent in June from 37 percent in May, sighting the BP oil spill as the major driver.

Energy analysts project that losses totaling \$22.6 billion will be incurred by BP, including the cleanup costs, worker compensation, legal fees, and lost revenue. In addition, on 16 June 2010, BP announced it will slash its capital expenditure bill and suspend dividend payments until September 2011 in order to pay for the \$20 billion claims fund imposed upon the company by the United States government.

With the heightened levels of risk aversion, there was only one place to hide. Gold was the winner as it continued to provide a safe haven. The precious metal posted a 10.1% gain in US Dollar terms over the quarter, while other precious metals ended the quarter in negative territory (platinum down 9.7%).

Looking at everything mentioned above, ranging from EU sovereign debt issues to the Chinese slow down in economic growth concerns, pessimism was the clear winner over the quarter. However in an attempt to end this quarterly commentary on a positive note, let me congratulate those who were highly invested in gold – well done.

In closing, the market continues to be elusive over the short-term. We believe that any investment thesis that is predicated on the notion of timing short-term market shocks will prove to be very costly. At Afena Capital, we continue to believe and demonstrate that an understanding of the economic fundamentals of each particular business in the investment universe, and an objective bottom up evaluation process of those fundamentals, is sufficient enough to pick winners and avoid losers over the long-term.

Market Insights



Andrew Joannou
Portfolio Manager

This was a poor quarter for the South African equity market. The FTSE/JSE All Share Index (ALSI) fell by 8.2%, making this the first negative quarter since March 2009. The sell off was pretty broad based with the Resource sector falling 11.9%, the Financial sector generating a negative 7.8% return and the Industrial sector putting in a relatively stodgy performance by being down only 4.5%.

Why the poor performance? What upset the market over the last few months? The answers to such short term questions are always difficult to answer given the complexity of the market and the many variables which impact individual prices. We will however try to explain the key elements which we think led to the short term decline.

Was the market over-valued?

Our investment philosophy is based on valuation. We tend to like under-valued shares and dislike over-valued shares irrespective of the current newsflow or sentiment. It is only correct therefore that we start by checking the market's valuation to see if the recent sell off was merely the market correcting a significant pricing error (pretty much like what happened in the crash of 2008).

The graph below shows our simple long term estimate of the market's price to earnings (PE) ratio based on through the cycle earnings.



Source: I-Net, Afena Capital

It shows that the through the cycle PE (or "normal" PE as we like to call it) did get a little high a few months ago. At the peak (x14.6) it was above the long term average (x11.7), the last 15 years' average (x13.9) and the level that we consider fair (x12.8). The market was therefore slightly over-valued but not to a very large degree.

We would not consider a “normal PE” of x14.6 to be very high or a risky valuation for the market. It is just unattractive and most probably foretells below average long term returns going forward.

The aggregation of our bottom up valuations led to an even less interesting result. At the beginning of the quarter our bottom up estimates, which cover more than 95% of the exchange’s weighted market capitalisation, showed the market to be almost exactly fairly valued.

We would therefore conclude, based on our internal research and valuations, that the market’s valuation was not the key reason for last quarter’s negative return. It was more of a supporting act - a factor that favoured a correction and which lent no support to falling prices, but didn’t cause the decline.

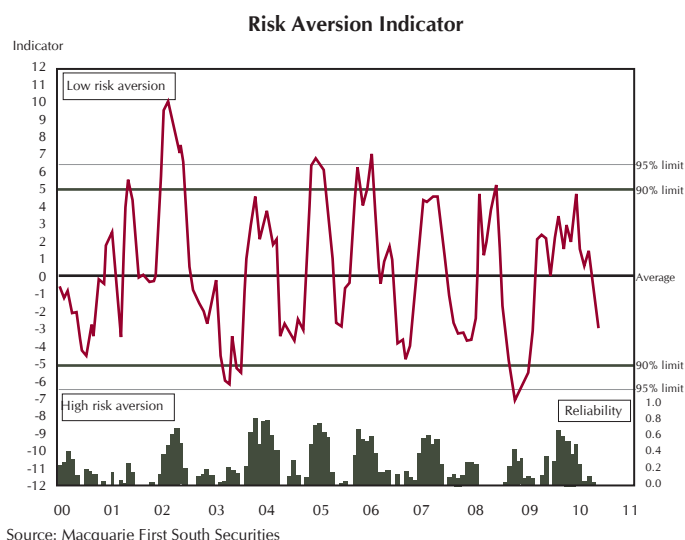
Currently we don’t think much has changed. Valuations are still not high (in fact they must be less risky given the decline), but they are also not yet attractive enough to provide a valuation base i.e. a level at which valuation is so obvious that new investors are incentivised to enter the market.

So if valuation wasn’t the problem, what caused the fall?

Are you worried yet?

Generally when a market move can’t be explained by valuation it can be explained by sentiment. This is the intangible element of price theory which is driven by the unpredictable nature of human emotions and behaviour. When people are worried they become more risk averse and demand a lower price to entice them into the deal. Inversely, when folk are carefree they are more than happy to take a chance and buy something that has significant risk. This is the cycle of fear and greed ... and it is a key driver of the market’s short term performance.

The chart that follows, which we have borrowed from Franco Busetti at Macquarie First South Securities, shows the level of fear in the market.



The chart, which aggregates a number of risk measures, shows that at the beginning of the year the average investor had very low risk aversion i.e. they were willing to take risk. It shows that they were as carefree as before the financial crisis in 2008. This is a fascinating insight since in early 2008 there wasn’t a financial cloud on the horizon and there wasn’t really much to worry about, assuming you believed the general consensus.

At the beginning of 2010 the story was however quite different. The world was still suffering the after effects of the financial crisis, sovereign debt default risk was already on the radar and the risk of a double dip recession was talked about even if the vast majority of investors didn’t subscribe to it. So why was everyone so unworried? Was this imprudent behaviour really warranted? The last three months seem to show that it wasn’t. Instead we have seen risk aversion steadily increase, first moving to the average and then moving quite quickly to above normal.

This move from “show me the money” to “get me the hell out of here” is never good for market prices. As people demand more value to hold onto the same assets, the prices of those assets have to decline to incentivise new buyers. This simple change in sentiment, in our opinion, is therefore what caused last quarter’s poor performance.

What changed people's mood?

Once again this isn't an easy question to answer. We do however think there were a few key stories that caught everyone's attention.

1. The Greek tragedy.
2. China applying the brakes.
3. Increased legislation.

Greece's woes are well known, as are the wider issues in the European Union. We will however highlight the longer term concern which is that fiscal discipline will eventually have to be enacted (not just in Europe but everywhere where imprudent behaviour is currently taking place) and that this will cause a headwind for global growth going forward. Either the governments of the world take their financial medicine or face the risk of being cut off cold turkey and have to deal with the possibility of bankruptcy. From the recent newsflow we do however think the politicians have got the message and have chosen to reduce public spend.

China's policy decisions are less well covered and investor's views are less consistent. The opinions range from "China must slow down to avoid asset bubbles" to "China is a modern economic miracle with nothing to worry about". The recent policy decisions with regard to Chinese property do however seem to suggest that the government is a little concerned. This combined with the recent economic data has made investors slightly more negative. This slight shift in sentiment is magnified in the South African market given our large weight in resource counters and the underlying commodity prices being very dependent on Chinese growth.

The legislation concern has been focused on the financial sector with countries around the world calling for stricter controls and for global banks to have greater capital adequacy requirements. The change in legislation is however not limited to this sector. Policy makers not only want to avoid the liquidity problems of the past but now also want to find new ways to fund their austerity measures. The risk of increased taxation is therefore on the rise, with the proposed Australian resource tax being a very good example of the potential trouble equity investors may face going forward.

Where to from here?

We're not fans of quoting Warren Buffett since it has now become a bit cliché in the financial services industry. The man is however pretty wise and does spout some really good one-liners. We therefore can't avoid using this one to wrap up the article.

"Be fearful when others are greedy. Be greedy when others are fearful."

Warren Buffett

As we sit here today we see a market which is pretty fairly valued and starting to offer better value on a daily basis as it continues to fall. We see a world which has gone from being pretty greedy at the beginning of the year to currently being pretty fearful.

So while we would not advocate that our clients become very bullish on equity (given the so-so valuation of the market as a whole), we would recommend that they think about increasing their equity allocation and start becoming more and more greedy as the markets become more and more fearful.

A Lesson on Investing in Banks

Khaya Gobodo
Head of Equities

At Afena Capital our investment philosophy is predicated on investing in businesses trading below our assessment of intrinsic value. In this assessment, intrinsic value is defined as the value of a business based on the normalised, or sustainable, operating performance the business is expected to deliver through the cycle.

In addition, we pay some attention to the unfolding operating environment and how we expect it to impact the behavior of share prices.

The starting point with valuing any business, including banks, is in understanding the drivers of operating performance. In the case of banks, the simple question is how do banks make money? A simplistic bank income statement that will illuminate the answer to our question looks as follows:

$$\begin{aligned}
 & \text{Net Interest Income} \\
 & + \text{Non Interest Income} \\
 & = \underline{\text{Total Income}} \\
 & - \text{Bad Debts} \\
 & - \text{Operating Expenses} \\
 & - \text{Taxes} \\
 & = \underline{\text{Profit After Tax}}
 \end{aligned}$$

There are therefore a number of important ratios that help in understanding and interpreting bank results:

- Net Interest Margin (NII / Average Interest Bearing Assets)
- Bad Debt Ratio (Bad Debts / Average Interest Bearing Assets)
- Return on Equity (Profit After Tax / Total Equity)

Net Interest Income (NII) is a function of the growth in a bank's lending assets which, in turn, is driven by the demand for debt by retail and corporate clients. An important driver of this demand is the level of economic activity as well as the cost of borrowing i.e. the level of interest rates. The higher economic activity is and the lower interest rates are, the higher the demand for credit. This was the case in South Africa during the years from 2003 to 2008. The importance of **Net Interest Margin (NII Margin)** is that it measures how much income per unit of lending assets the bank is making, and this can easily be compared to history.

NII and NII Margin are but one side of the lending coin. The other is the cost of lending money to people: the inevitable reality that not all will be able to repay their loans. The results are **Bad Debts**. The bad debt ratio measures how significant bad debts are in relation to how much has been lent out to clients. The major driver of bad debts is affordability, which is impacted by growth in income levels and the cost of borrowing (level of interest rates). As income levels fall, as happens in tough economic times, and interest rates rise, the ability of borrowers to repay their loans is significantly impaired. We all witnessed this scenario in the

years post 2008 as the global financial crisis and ensuing recession unfolded.

The other source of a bank's income, **Non-Interest Revenue**, is derived from providing non lending services to clients. This includes a wide range of activities including bank charges, credit card fees and advisory fees to corporate clients, as well as trading and investment income. The higher the activity levels in the economy, the higher the demand from clients for these kinds of bank services.

The final and all encompassing measure of a bank's performance is **Return on Equity (ROE)**. This is because banks are required by law to hold a certain level of equity capital in the balance sheet in relation to the total size of their balance sheet. In simplified terms, banks are required to hold approximately R10 in shareholder equity capital for every R100 in assets. This means one can confidently compare profits to equity capital (Profit After Tax / Equity = Return on Equity) across banks and across time.

Now let's deal with the theory of how to use this information in the **valuation of banks**. Given that the most reliable measure of bank profitability is ROE, we should use a valuation model that uses ROE as one of its important inputs. One such valuation model is called the Warranted Equity Model. What this model determines is how much one should be willing to pay for a company's equity (or book value) for a given ROE. The higher the ROE, the higher the multiple of book value one should be willing to pay. The actual formulation looks as follows:

$$\frac{\text{Price}}{\text{Book}} = \frac{(\text{ROE} - \text{Long Term Growth})}{(\text{Cost of Equity} - \text{Long Term Growth})}$$

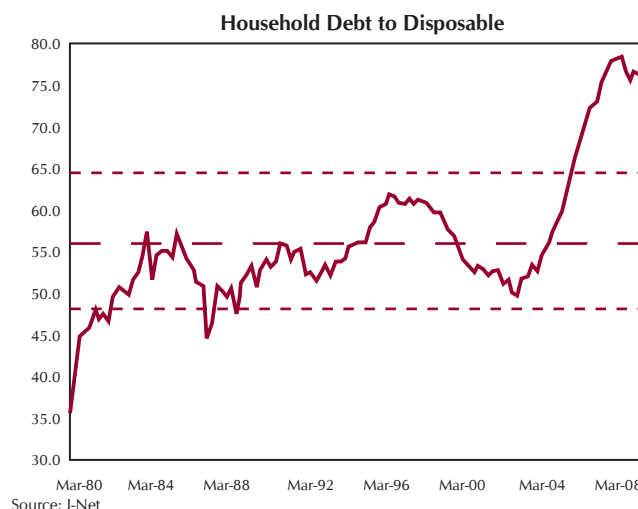
In this formula, we can assume Long Term Growth is equal to nominal GDP and we can assume Cost of Equity is equal to the risk free rate plus a risk premium of 6%. But what ROE should we use in our model? We could use the most recently reported ROE. However this may be too high or too low depending on where we are in the cycle, which highlights the need for an assessment of a sustainable level of profitability through the cycle.

Practical Implementation of Valuation Model: Estimating Normalised ROE

The most efficient way of assessing a sustainable through the cycle

level of profitability is to go through the simple income statement and to establish the normalised sustainable values for each of the key line items.

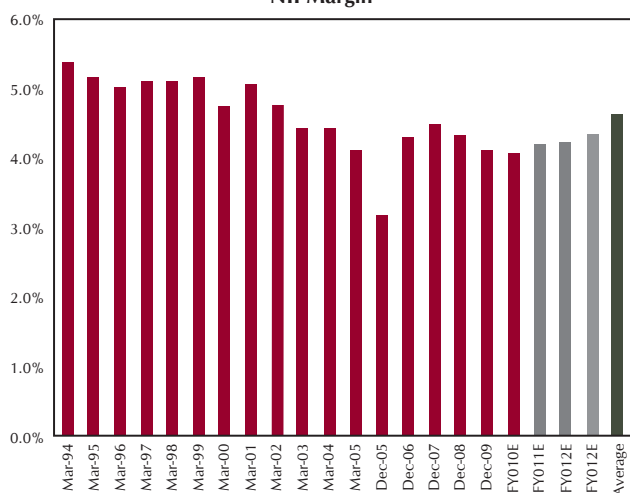
Lending assets is an important starting point because this is one part of determining the level of **Net Interest Income** a bank is likely to earn. We can see from the chart below that household debt to disposable income is very high in relation to history. This suggests that the likelihood of consumers significantly increasing their borrowing from current levels is low, which therefore points to low growth in lending assets going forward.



The chart that follows reflects the **NII Margin** profile of a typical South African bank. One can make two easy observations from this chart: the steady decline in the margin from the mid 1990s, as well as the decline of the last three years. We believe some of the margin the banks lost over the last 15 years has been permanently lost due to increased competition and the arrival of home loan originators. However, we are of the view that the margin lost over the last three years is recoverable as banks re-price their lending products in the wake of higher costs of funding and bad debts.



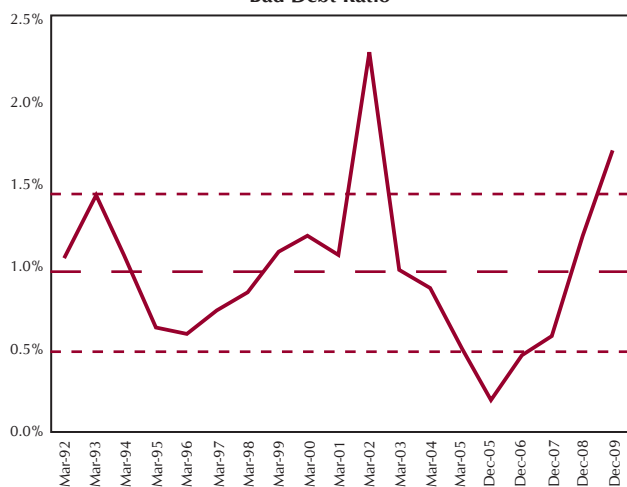
NII Margin



Source: Company Reports

Bad Debts are probably the most influential variable in the change in profitability of a bank through the cycle. The chart below reflects the bad debt profile of a typical SA bank.

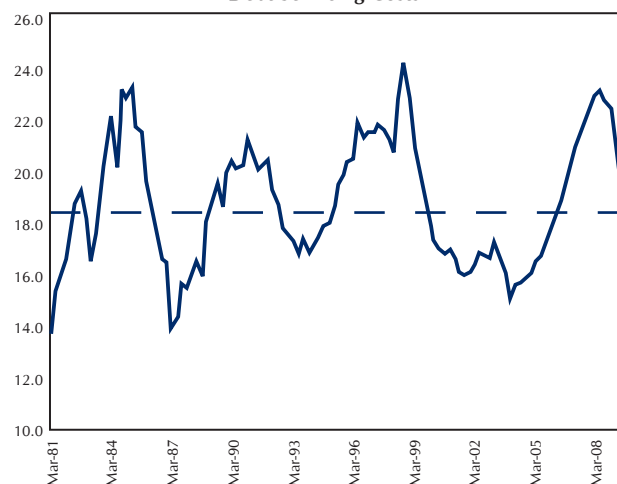
Bad Debt Ratio



Source: Company Reports

As mentioned earlier, Bad Debts are a function of affordability which in turn is impacted by income and interest rate levels. The most recent spike in bad debts was accompanied by a significant increase in interest rates with the prime rate increasing from 10.5% to 15.5% from 2006 to 2008. To make matters worse, we saw a decline in real incomes over this period as a result of the economic recession. The chart below depicts debt servicing costs which are based on disposable income and interest rate levels. The decline in debt servicing costs as the result of the significant decline in interest rates, as well as the improving economy, should result in reported bad debts tending toward historic norms over the next few years.

Debt Servicing Costs

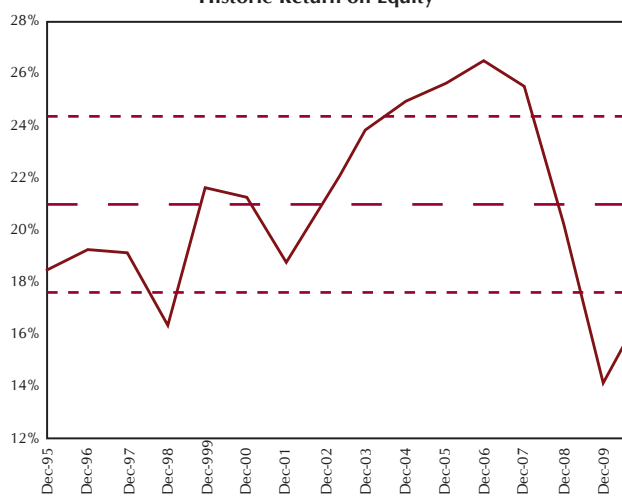


Source: I-Net, Afena Capital

Inputting these normalised assumptions of **Lending Assets**, **NII Margins** and **Bad Debts** in the income statement results in a **normalised ROE** of approximately 20%. Our next task is to compare this computed ROE with history for reasonability. The average ROE generated by South African banks over the last 15 years is approximately 21%, as can be seen in the chart below. It appears therefore that our analysis is consistent with the historic operating performance of banks.



Historic Return on Equity

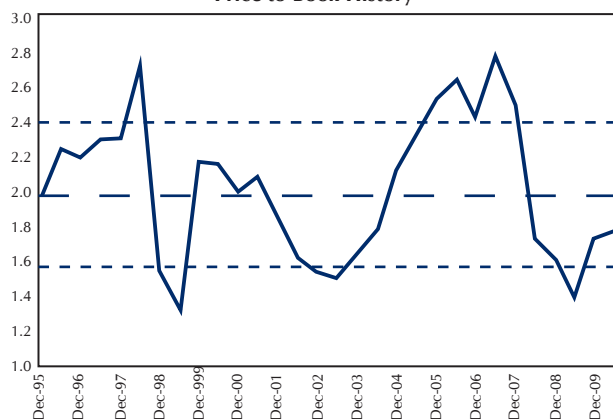


Source: Company Reports

Now the Valuation

We have now established that the normal through the cycle ROE for a typical SA bank is approximately 20% and, using the Warranted Equity formula described above, we calculate a fair Price to Book (or Price to Equity) to pay for this typical bank of about 2.0x. Interestingly this computed fair Price to Book compares favourably with the actual Price to Book history of South African banks over this same period. This significantly improves our confidence in our valuation.

Price to Book History



Source: I-Net, Company Reports

Concluding Remarks

We have just gone through a relatively simple yet amazingly robust approach to the valuation of banks. This approach is predicated on the notion that the most robust valuations are ones based on normalised operating performance. In the case of South African banks this analysis points to a fair Price to Book of approximately 2.0x. Should one find a quality SA bank trading at a Price to Book substantially below 2.0x, in all likelihood one has found a good investment. This is provided there is a reasonable prospect of the bank returning to normal profitability levels within a reasonable period of time.

Meet the Team

Portfolio Manager Profiles



Gcinikhaya Gobodo, Head of Equities

BCom, MSc, CFA, eleven years experience

Khaya is Head of Equities at Afena Capital and a founding partner in the firm. Khaya holds a Bachelor of Commerce (Finance and Economics) degree from the University of the Witwatersrand and a Master of Science in Investment Management with distinction from City University (Cass Business School) in the UK. He is a Chartered Financial Analyst (CFA) charter holder.

At Afena Capital he is responsible for managing the equity investment process, fundamental stock analysis focusing on the financials sector, and portfolio management. Khaya has extensive experience as an analyst covering the financials, industrials and resource sectors of the JSE. His eleven years of investment experience includes time as an equity dealer, where he was responsible for equity execution and asset swap facilitation and execution. He also co-managed a private equity portfolio.

Khaya continues to demonstrate excellence in his role as a portfolio manager, head of equities and as an investment analyst at Afena Capital by performing all duties with distinction. Since the start of the global recession (approximately two years ago) the Afena Capital SWIX relative portfolio which are managed by Khaya have outperformed the benchmark by over 6% annualised, making this composite a top quartile performer over that period. The composite remains well above benchmark over all long-term measurement periods.



Andrew Joannou, Portfolio Manager

BBusSc, CFA, eleven years experience

Andrew is a Portfolio Manager at Afena Capital and a founding partner in the firm. Andrew graduated from the University of Cape Town with a Bachelor of Business Science degree in the special field of Finance. He is a Chartered Financial Analyst (CFA) charter holder.

His eleven years of investment experience include time as a sector head of small and mid cap companies, a portfolio manager of an emerging companies unit trust, and value fund co-portfolio management. At Afena Capital he is responsible for fundamental stock analysis focusing on the resources sector, and equity portfolio management.

Andrew is the portfolio manager of the Afena Capital multi asset portfolios (Managed/Balanced Fund). A display of excellence by Andrew that should earn him a place as one of the best multi asset portfolio managers in the near future is the performance of the Afena Managed Fund which he manages. The Managed Fund has outperformed the peers by over 7% since inception, and has been a consistent first quartile performer since inception. The fund is benchmarked against the median of the domestic prudential variable equity unit trust sector, and competes against 53 well respect fund managers/portfolios.



Khulekani Dlamini, Portfolio Manager

BSc, MSc, ten years experience

Khulekani is a Portfolio Manager at Afena Capital and a founding partner in the firm. Khulekani joined the investment management industry nine years ago. Prior to that, he was a senior Computer Systems Engineer/Consultant for Comverse Network Systems in the US and research analyst at the CSIR. Khulekani Dlamini is no stranger to excellence. He graduated top of his province (Kwa-Zulu Natal) in his matric year. Khulekani holds a Bachelor of Science (cum laude) and a Master of Science in Aeronautical Engineering from the Rensselaer Polytechnic Institute in the USA.

Khulekani is responsible for fundamental stock analysis focusing on the industrials sector, and portfolio management of the FINDI relative portfolios. His ten years of investment experience include extensive stock analysis of the industrials sector and co-portfolio management responsibilities of absolute return portfolios.

Under his portfolio management leadership the FINDI relative portfolios continue to deliver the results promised to clients by generating superior investment returns versus peers and the benchmark. Since the start of the global recession (approximately two years ago) the FINDI portfolios have outperformed by 1.7% (annualised), and remain above benchmark over all long-term measurement periods.

Unpacking the Jargon

Sandile Sokhela
Head of Institutional Business

WHAT IS SYSTEMATIC RISK?	HOW IS THIS USED?
<p>When an investor invests in risky markets (e.g. stock markets), there is a risk that the value of the investment may go down or the investor may lose everything. Some of the risk can be diversified away (not putting all eggs in one basket) and some risk cannot be diversified away. Systematic risk is the risk that cannot be diversified away. It is also referred to as market risk. Systematic risk is the risk that affects the entire market or a segment of the market. This risk is caused by factors that affect a wider number of investment classes though it might affect these classes in different proportions. Systematic risk therefore may not be reduced by investing in different classes of investments as it affects a wider portion of the market.</p>	<p>Market participants use systematic/market risk to compare the risk of specific asset classes relative to the market. Systematic risk is also used when valuing assets and to formulate the return expectation of a particular asset relative to the market. For example, if an investor is taking risk that is equal to market risk, then the investor should, at a minimum, demand returns equal to the market's returns. Therefore systematic risk is associated with aggregated market returns. An investor can use systematic risk to compare the risk that his portfolio faces compared to the market's risk. The market return can then be used to formulate an expectation of the return on the portfolio.</p>
WHAT IS UNSYSTEMATIC RISK?	HOW IS THIS USED?
<p>The risk of price changes due to the unique circumstances of a specific security. Unsystematic risk only affects a specific asset, company or industry, but not the entire market. It is also called diversifiable risk or asset specific risk. This risk can be reduced by investing in different asset classes or different industries. That is called diversification.</p>	<p>An investment manager's understanding of risk that affects or is unique to different asset classes and companies will enable he or she to do sound portfolio management and risk management. This means that the investment manager will be able to diversify the portfolio without compromising the portfolio returns, while lowering the risk of the entire portfolio.</p>
WHAT IS RISK PREMIUM?	HOW IS THIS USED?
<p>There are risky and riskless assets. Risky assets should offer a higher return compared to riskless assets, to compensate for the risk taken. The difference between the return on a riskless asset and the return on a risky asset is called the risk premium. Think of a risk premium as a form of hazard pay for your investments. Just as employees who work relatively dangerous jobs receive hazard pay as compensation for the risks they undertake, risky investments must provide an investor with the potential for larger returns to warrant the risks of the investment.</p>	<p>How risk premium is used is best explained using an example. Suppose a game show participant may choose one of two doors; one that hides R1, 000 and one that hides R0. Further, suppose that the host also allows the contestant to take R500 instead of choosing a door. The two options (choosing between door 1 or door 2, or take R500) have the same expected value of R500 (R0 times 50% plus R 1000 times 50% equals R500 (expected return)), so there is no risk premium for choosing the doors over the guaranteed R500.</p> <p>As illustrated in the example, the risk premium calculation is used for investment decision making purposes. Some investments are worth the risk and some are not. In the example, the risk of choosing a door is not worthwhile. Importantly the risk premium of a specific asset class can be compared through time for investment decision making purposes. If an investment decision taken today has a 5% risk premium and, historically, the same investment decision had a 15% risk premium, it would need to be properly justified from a risk return perspective, simply because it implies a significant change in risk of the underlying investment and a change in return expectation in comparison to historical norms.</p>

Afena Equity Fund

Period ended June 2010



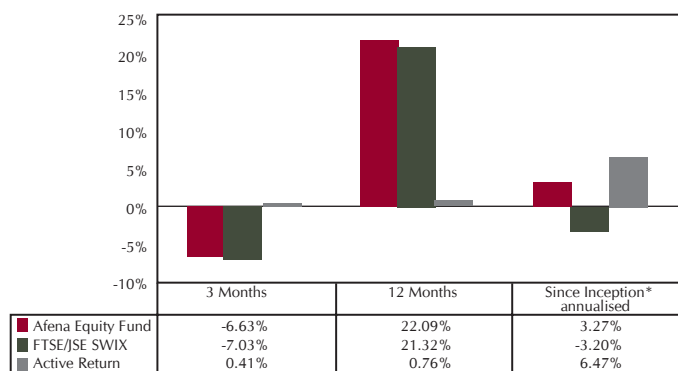
INVESTMENT OBJECTIVE

We believe that through the cycle earnings outcomes are governed by the fundamental economics of a particular business and industry, and that the fundamental economics of any business do not change very often. We therefore focus our attention on valuing companies on the basis of their sustainable through the cycle operating performance. It is our firm belief that we can generate superior returns for our clients by buying companies that are trading significantly below their true worth (intrinsic value) as determined on this basis. The Afena Equity Fund is a general equity fund that aims to provide investors with long-term growth in capital and income. The Fund is actively managed in an investment process that is based on fundamental research and bottom up stock selection. A minimum of 90% of the fund is invested in equities at all times. The Fund is for investors seeking long term capital growth through exposure to the South African equity market.

PORTFOLIO COMMENT

The market has delivered a negative performance of -8% for the second quarter of 2010. It appears this is the result of growing fears regarding sovereign debt issues in Europe and the possibility of slower global growth as Europe tightens its belt. We continue to be cautious regarding the emergence of unexpected risks, including a default by one of the European sovereigns and the impact that would have on the performance of risky assets. As a result, we continue to favour good quality businesses with secure earnings streams, and that are trading at a discount to their intrinsic value. The decline in the market is presenting some interesting buying opportunities, particularly in out of favour cyclical businesses. Should the market fall further from here, we will likely increase our exposure to such businesses.

INVESTMENT PERFORMANCE

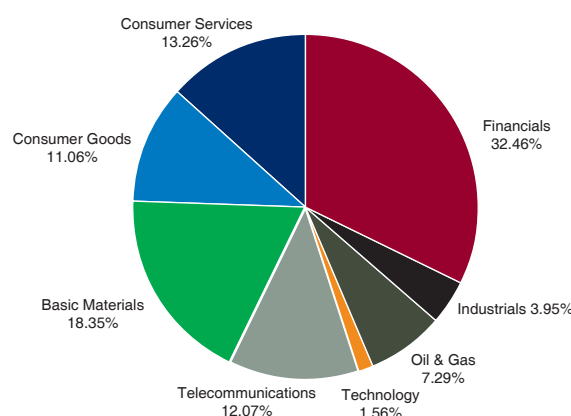


Source: Afena Capital, I-Net

TOP FIVE SHARES

Share Name	% of Fund
MTN	7.3%
SABMiller	7.5%
Anglo American	5.8%
Standard Bank	5.5%
FirstRand	5.4%

SECTOR ALLOCATION



FUND CHARACTERISTICS

Fund Manager	Khaya Gobodo
Fund Classification	Domestic Equity General
Benchmark	FTSE/JSE Shareholder Weighted All Share Index (SWIX)
Fund Size	R109,2 million
Fund Launch	22 May 2008
Income Distribution	Annually (1 April)
Initial Fee	0%
Annual Management Fee	1.0% (excl VAT)
Risk Profile	Moderate to High
Minimum Investment	R1 million (lump sum)
Total Expense Ratio*	2.1% (1 July 2009 to 30 June 2010)

*A Total Expense Ratio (TER) is a measure of a portfolio's assets that are forgone as operating expenses. The current TER disclosed is expressed as a percentage of the average Net Asset Value of the portfolio for the period from 1 July 2009 to 30 June 2010. Included in the TER is the proportion of costs incurred as charges, levies and fees in the management of the portfolio. A higher TER ratio does not necessarily imply a poor return, nor does a low TER imply a good return. The current disclosed TER cannot be regarded as an indication of future TERs. The current disclosed TER is applicable to class A1 units.

Afena Managed Fund

Period ended June 2010



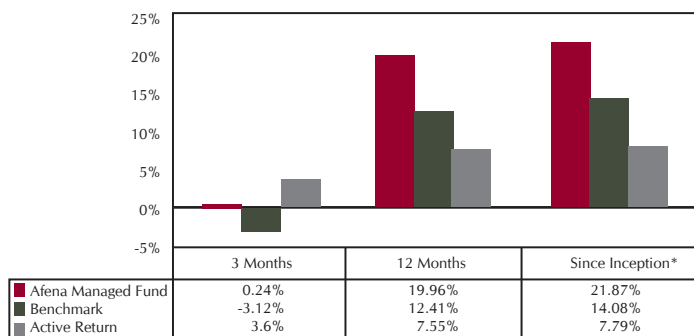
INVESTMENT OBJECTIVE

We believe equities generate the best long term real returns versus bonds and cash. Furthermore, we believe that equity valuation is the best indicator of when to be invested in the equity market or not. Therefore a quality and proven equity valuation competency can be used to construct a multi-asset portfolio with a capital growth priority when equity valuations are favourable; and capital preservation priority when equity valuations are unfavourable, thus generating significant alpha from asset allocation and equity stock picking. The Afena Managed Fund aims to generate equity-like returns, or better, at significantly less risk than the equity market. The Fund is an actively managed domestic multi-asset class fund that invests in equities, bonds, property and cash and has an inflation plus 5% performance target over rolling five year periods. The Afena Managed Fund complies with Annexure A to Regulation 28 of the Pension Funds Act and is therefore suitable for retirement fund investors.

PORTFOLIO COMMENT

Over the last few quarters the fund's portfolio commentary has been subdued and cautious. It mentioned the difficulty we were having in finding new investment ideas and that we were more focused on capital preservation than capital growth. I'm happy to report that this conservative positioning has stood the fund in good stead and helped the Afena Managed Fund to report a small quarterly improvement, even though the South African equity market fell by more than 8%. I'm also happy to record the fund's first anniversary and show a fourteen month performance that is well above inflation (the fund's longer term performance target) and the median of its unit trust peers (the fund's benchmark). While this track record is only fourteen months, it does show a good start and forms a nice base from which to build. Post the decline in the market's level we are becoming more optimistic and are actively looking to increase our equity exposure.

INVESTMENT PERFORMANCE (net of fees)



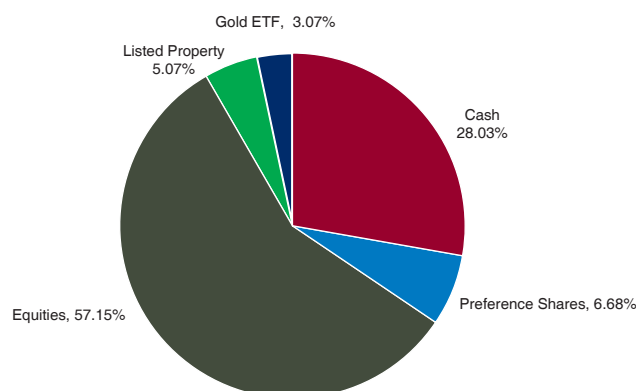
*From 1 May 2009

Source: Afena Capital, I-Net

TOP FIVE SHARES

Share Name	% of Fund
Brait	3.8%
Pan African Resources	3.5%
Sasol	3.5%
Sun International	3.5%
Discovery	3.3%

ASSET ALLOCATION



FUND CHARACTERISTICS

Fund Manager	Andrew Joannou
Fund Classification	Dom. Asset Allocation Prudential Variable Equity
Benchmark	Median of the Domestic Asset Allocation Prudential Variable Equity Sector
Fund Size	R11.2 million
Fund Launch	14 April 2009
Income Distribution	Annually (1 April)
Initial Fee	0%
Annual Management Fee	1.0% (excl VAT)
Risk Profile	Moderate to High
Minimum Investment	R1 million (lump sum)
Total Expense Ratio*	2.4% (1 July 2009 to 30 June 2010)

*A Total Expense Ratio (TER) is a measure of a portfolio's assets that are forgone as operating expenses. The current TER disclosed is expressed as a percentage of the average Net Asset Value of the portfolio for the period from 1 July 2009 to 30 June 2010. Included in the TER is the proportion of costs incurred as charges, levies and fees in the management of the portfolio. A higher TER ratio does not necessarily imply a poor return, nor does a low TER imply a good return. The current disclosed TER cannot be regarded as an indication of future TERs. The current disclosed TER is applicable to class A1 units.

AFENA
CAPITAL

The logo for AFENA CAPITAL features the word "AFENA" in a dark red, serif font on the top line, and "CAPITAL" in a dark green, serif font on the bottom line. A graphic element consisting of two parallel, curved lines in dark green and black swooshes from the right side of the "A" in "AFENA" and extends downwards and to the left, crossing over the "L" in "CAPITAL".

Our Promise

As stewards of our clients' capital, we will act with integrity and honesty at all times.

We will always be consistent with our greatest asset - our investment philosophy and process.

We will run our firm with excellence, professionalism, dedication and innovation and will always respect the individual, be transparent and offer clear reward.

We will be cognisant of the needs and requirements of society and endeavour to play an active role in the upliftment and development of the community.

For further information on Afena Capital or to be added to the distribution list of this newsletter please contact us:

Tel: 021 657 6240

Fax: 021 671 4658

Email: info@afenacapital.com

Afena Capital
PO Box 23883
Claremont, 7735

Website: www.afenacapital.com

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