

15 March 2011

"The market can stay irrational longer than you can stay solvent."

John Maynard Keynes

Cannon Asset Managers – The Purest Value Equity Portfolio in South Africa

Greg Flash, of PSG Asset Management, recently published some research (<http://www.psgam.co.za/author/greg-flash/>) on an analysis of the style attributes of the various asset managers in South Africa, using independent research company Morningstar's Style Box™ analysis. Morningstar is able to determine a percentage score for Value, Core and Growth styles for a given portfolio, in this case, the South African Equity Unit Trusts. Their methodology is described in the Appendix. Importantly, they use fund holdings over time to measure style characteristics, and not at a pre-determined point in time. This ensures that consistency of style is represented.

We were particularly intrigued, and flattered, by the results of this research, some of the key points of which we think are worth highlighting:

- The Cannon Equity Fund is by far the most Value orientated on these measures with the highest Value percentage, one of the highest Core percentages and by far the lowest Growth attributes.
- By far, most portfolios (and by inference the market) have the majority of their investments in growth, which confirms our assertion that deep value investing is a minority sport. By definition, the majority of the market has to be in growth stocks, and this is what creates opportunities for us in the value space.
- Given the benchmark constraint in our Core Companies Fund (limited to Top 40 shares) which sits in the Large Cap Sector, we were pleased to see that we have the highest Value and Core allocation, and the lowest Growth Exposure.
- Many funds that ostensibly claim to be value have surprisingly low value attributes, and surprisingly high growth attributes. Bear in mind that that Morningstar sets the weight of each style (value, core and growth) over time to represent approximately one-third of the investable universe, therefore, we observe that to be 'overweight' value in a portfolio, you need to have a greater than 33% allocation to value attributes.
- Given that the market has been rewarding growth over the recent past, with expensive shares getting more expensive, and our unwillingness to style drift, we were pleased to see that we have largely been in line with our benchmarks. However, the implication is quite clear and that is, when value starts re-asserting itself and markets begin to price assets more rationally, our portfolios will be incredibly well-positioned to benefit from this.

Table 1: Morningstar Style Scores for Domestic General Equity Funds

Fund	Sector	Value %	Core %	Growth %
27Four Active Equity A1	General	13	37	50
ABSA General R	General	14	33	53
ABSA Growth FoF	General	19	26	55
ABSA Select Equity	General	16	30	53
Afena Equity A1	General	19	33	48
Allan Gray Equity A	General	16	25	59
Alphen Equity Builder	General	16	30	54
Analytics Managed Equity A	General	24	19	57
Aylett Equity A3	General	21	24	54
BJM Multi Manager Equity B1	General	19	26	55
Cannon Equity A	General	42	49	9
Capstone Active Equity FoF	General	26	38	36
Community Growth Equity	General	17	29	53
Coris Capital General Equity	General	14	42	43
Coronation Equity R	General	14	33	53
Discovery Equity	General	16	37	47
Efficient Equity	General	18	37	45
Efficient General Equity	General	35	28	37
Element Earth Equity A	General	22	31	48
Element Islamic Equity A	General	21	27	52
FG Mercury Equity FoF A1	General	15	32	53
FNB Growth	General	33	31	36
Foord Equity R	General	27	20	53
Gryphon All Share Tracker	General	16	30	54
Harvard House General Equity	General	14	41	46
Hermes Equity A	General	31	22	47
Huysamer Equity A1	General	19	31	50
Imara Equity	General	15	38	48
IndequityTechnical	General	15	21	63
Interneuron Capital Equity	General	19	39	42
Inv Solutions MM Equity A	General	15	35	51
Investec Active Quants A	General	18	21	62
Investec Equity R	General	14	30	55
Kagisa Equity Alpha	General	20	32	48
Kagiso Islamic Equity	General	22	41	37
Lion of Africa General Equity	General	10	29	61
Lynx Opportunities FoF A1	General	21	40	40
Maestro Equity A	General	13	34	52
Marriott Dividend Growth R	General	0	36	64
Metropolitan General Equity	General	19	36	46
Metropolitan Multi-Manager Equity	General	19	45	36
MI-PLAN IP Beta Equity B2	General	18	35	47
Momentum Aggressive Equity FoF B1	General	24	29	47

Momentum Mod Equity FoF B1	General	19	34	47
Momentum Multi Focus FoF	General	20	32	48
Nedgroup InvEquity R	General	18	55	27
Nedgroup Inv Quants Core Eq A	General	24	37	39
Nedgroup Inv Rainmaker A	General	15	38	47
NeF G Equity	General	13	40	46
NFB Equity A2	General	25	30	45
Personal Trust SA Equity	General	19	24	57
Plexus RAFI @Enhanced SA Strategy A	General	18	43	39
Prescient Eqty Active Quant A1	General	14	31	55
Prescient Eqty Quant A1	General	14	29	57
Prudential Equity A	General	19	33	48
PSG Alphen Equity FoF A	General	23	27	50
PSG Equity A	General	17	34	49
PSG Konsult Creator FoF A	General	14	39	47
RMB Equity R	General	22	23	56
Sasfin Equity	General	11	31	59
Sasfin Twenty Ten	General	9	35	56
SIM General Equity R	General	19	42	39
SIM Top Choice Equity A1	General	27	48	24
SMMI Equity Fof A	General	25	25	50
STANLIB Equity R	General	12	32	56
STANLIB Index R	General	15	30	56
STANLIB MM All Stars Eq FoF A	General	16	34	51
STANLIB MM Equity A1	General	19	33	48
STANLIB Nationbuilder A	General	29	35	36
STANLIB SA Equity R	General	12	33	55
STANLIB Shari'a Equity A	General	16	40	44
Stewart Macro Equity FoF A	General	23	31	46
SYmmETRY Equity FoF A	General	25	22	53
Verso LT SA Equity R	General	23	45	32
General Average	General	19	33	48

Table 2: Morningstar Style Scores for Domestic Growth, Value and Large Cap Equity Funds

Fund	Sector	Value %	Core %	Growth %
Cadiz Mastermind A	Value	23	43	34
Dynamic Wealth Value	Value	19	38	43
Investec Value R	Value	12	51	37
Metropolitan High Divident	Value	30	33	37
Nedgroup Inv Value R	Value	14	49	37
Prudential Dividend Maximiser A	Value	26	36	38
RMB Value	Value	23	30	47
SIM Value R	Value	24	48	28
STANLIB Value A	Value	16	34	50
Value Average	Value	21	40	39
Investec Growth R	Growth	14	38	48
Nedgroup Inv Growth R	Growth	22	41	36
RMB Strategic Opportunities R	Growth	33	32	35
SIM Growth R	Growth	18	29	53
STANLIB Growth R	Growth	21	38	41
Growth Average	Growth	22	36	43
ABSA Rand Protector	Large Cap	18	34	49
Cannon Core Companies	Large Cap	16	54	30
Coronation Top 20 A	Large Cap	12	32	56
Kagiso Top 40 Tracker	Large Cap	13	29	58
RMB Top 40 Index	Large Cap	18	16	66
SIM Index R	Large Cap	13	30	57
STANLIB ALSI 40 A	Large Cap	14	29	57
Large Cap Average	Large Cap	15	32	53

Appendix: How Morningstar calculates style:

Style Box™ has become the standard in the industry for depicting the “style” of a fund. Basically, it indicates the average size and style that a fund follows based on the stocks that it holds. In determining a stock’s style, a score is determined by separately measuring a stock’s value and growth characteristics using related but distinct historical and forward-looking variables, each accounting for one half of a stock’s style score. After calculating value and growth scores, they are compared to determine whether value or growth characteristics dominate. If the value-growth scores are not sufficiently different, the stock is designated core/blend. Breakpoints for value, core/blend and growth styles are set so that the average weight of each style over time represents approximately one-third of the investable universe within the capitalization class. In South Africa, Morningstar gathers stock holdings information (usually quarterly and sometimes monthly) for the different funds, and uses this data to calculate their value and growth statistics.

Table 3 Style Factors

Determine a Value Score			Determine a Growth Score			Determine a Style Score	
Factors		Weight (%)	Factors		Weight (%)	Subtract the value score from the growth score	
Forward-Looking	Price to Projected Earnings	50.0	Forward-Looking	Long-Term Projected Earnings Growth	50.0		
Historical	Price to Book	12.5	Historical	Earnings Growth	12.5	Growth Score	0 to 100
	Price to Sales	12.5		Sales Growth	12.5	Value Score	1 to 100
	Price to Cash Flow	12.5		Cash Flow Growth	12.5		
	Dividend Yield	12.5		Book Value Growth	12.5	Style Score	-100 to 100

Source: http://corporate.morningstar.com/us/documents/MethodologyDocuments/FactSheets/MorningstarIndex_FactSheet.pdf