



**PetroSA**

# PetroSA Retirement Fund

## INVESTMENT CHOICE

### MAIN ASSET CLASSES

The assets in which the Fund invests the money are equities, bonds and cash. These asset classes are available both in South Africa and offshore.

One cannot explain all the intricacies of these asset classes, but the following provides an overview.

#### Equities (or shares)

When an investor owns the equity (or shares) of a company, he/she effectively owns part of that company. Equity prices are sometimes affected by market sentiment. Sometimes investors are negative towards the market and even if the company in which they have invested is doing well, it may still fall in value.

Equities can be bought and sold on stock exchanges throughout the world. The South African stock exchange is called the JSE (Johannesburg Stock Exchange). The two main features of equities (compared to bonds and cash) are:

- Historically, over the long term (10 years and longer), equities have been the asset class that provided the highest investment return; and
- Equities have had the highest volatility (or highest risk of reducing in value), especially over shorter measurement periods.

This makes sense – logically investors should look to be rewarded by higher investment returns for taking on more risk.

#### Bonds

The Government (and some large companies like Transnet, Telkom, ESKOM and SASOL) are regular borrowers of money. So, they issue bonds that invite investors (like the asset managers of the Retirement Fund) to lend them money. The bond will set out the interest the borrower will pay, and the date on which the loan will be repaid.

The market value (price) of a bond at any point in time depends on interest rates and, importantly, that price can decrease. By way of example, let's say the Retirement Fund owns a bond that is worth R1 million, which is currently earning 8% per annum. If interest rates now increase to 10% per annum, the market value of the bond will fall because no investor will be prepared to pay R1 million to earn an 8% return when they now can earn 10% elsewhere!

The extent to which the price of a bond falls (rises) if interest rates rise (fall) depends on the period before the loan is repaid. If the repayment of the loan is a long way off, the investor will look for a much lower price because he/she needs to be compensated for the difference between 10% and 8% for a longer period.

Government bonds and other large corporate bonds can be bought and sold easily on the Bond Exchange of South Africa (BESA) and other world markets.

Over the long term, bonds are expected to provide a lower investment return than equities, but a higher return than cash. Bonds are less volatile (or risky) than equities.

## Cash and near cash investments

Such an investment is like a bank savings account or a 30-day fixed deposit. Government bonds that have a term of less than 12 months before the loan is repaid are regarded as “near cash” investments. Such investments are also called “money-market instruments”.

Because such investments have a very short term (i.e. less than 12 months) they are much less affected by changes in interest rates than bonds and are the least risky of the three asset classes described above.

Cash and “near cash” are expected to provide the lowest return of all the asset classes over the long-term.

It is important to emphasize that investing in cash is not entirely risk free. In certain market conditions the bank or institution where the money is invested may default, for example African Bank Ltd, which was placed into curatorship in 2014.

## International investments

Investments in equities, bonds and cash can be made either in South Africa or internationally.

The main additional factors introduced by international investment are: -

- The investor can be exposed to the companies that are the best in the world at their business.
- The South African equity market is very small (it represents less than 1% of the total world stock market capitalization). By investing internationally, the Fund is exposed to a much wider opportunity set of investments.
- The Fund is exposed to currency changes. Say, \$1 currently costs R12 and the Fund invests R12 million in the USA (i.e. \$1 million). If the Rand now “weakens” so that \$1 now costs R14, the Fund will profit since its \$1 million investment is now worth R14 million. Obviously if the Rand “strengthens” to say R5, then the Fund’s R12 million investments will reduce to R5 million and the Fund will make a loss.
- There is different investment risk in different countries. For example, the US stock market has historically been less risky than the South African stock market.

It is important to highlight that the primary benefit from investing internationally is the diversification across different economies. Such diversification gives them greater protection should investment returns in South Africa be poor in relation to other economies. However, it is also important to note that every economy goes through “highs” and “lows”, and it will not always be true that it is better to invest in the developed economies.

## KEY INVESTMENT RISKS MEMBERS FACE

Member's retirement benefits depend on two factors:

- How much money the member and the employer contribute monthly for retirement; and
- Most importantly, the investment returns earned on these contributions.

**Thus, the member carries the risk of whether the investment returns earned on their retirement saving contributions will be sufficient to provide them with a reasonable income at retirement.**

Members are exposed to two main investment risks, namely:

### Inflation risk

This refers to the risk that the money that members and the PetroSA set aside monthly for their retirement saving does not earn sufficient investment returns to provide reasonable retirement benefits.

For an average employee with a full career, a member needs investment returns to be something like **4.5% per annum higher than price inflation** (after allowing for investment manager fees and investment-related charges) to provide for reasonable retirement benefits. (As highlighted previously the purpose of the Fund is to provide an employee with 35 years' service, an average contribution rate of 15% of salary and an average career progression with a capital value of some 9 to 10 times annual salary at retirement, although such capital sum is not guaranteed.)

**As a general rule, the further the member is from retirement, the more they are exposed to inflation risk.**

Some people are concerned that there is a risk of *deflation* in some economies, and even in the South African economy. Deflation happens when the loss of investor confidence is so great that people defer buying assets, because they expect that prices will fall even further. The economy will have to slow down, and asset prices will have to fall low enough until people start to feel confident to invest at the cheaper levels. In these circumstances, bonds and cash are the asset classes that will probably give the most protection to an investor.

### Capital risk

This is the risk members' face when their investment horizon becomes rather short – the key risk is that when they receive their benefit the market is at a low point.

Capital risk generally becomes more acute as one approach retirement. The following examples highlight the nature of "Capital risk" and whether this risk applies to a member or not:

- A member will be retiring shortly. At that time, they intend securing a *pension annuity*. The initial pension they will receive will depend critically on the amount of their retirement savings at retirement. In this example they face "Capital risk" (and have a short investment horizon) because they do not want their retirement savings (and consequently their initial pension) reduced by investment losses.
- A member is 20 years' from retirement and will be resigning soon. They intend preserving their resignation benefit for their retirement. In this case they have a long investment horizon and do not face Capital risk.
- A member is 20 years' from retirement and will be resigning soon. They intend using their resignation benefit to pay off their house bond. In this case they face Capital risk because if the market goes down sharply, they will have less to repay their house bond.

**Since it is expected that most members will elect a pension annuity at retirement, as a general rule, the closer a member is to their retirement age, the more they are exposed to "Capital risk".**

## THE LIFE STAGE MODEL

The Fund's default investment strategy is the life stage model. The life stage model consists of three portfolios, namely the Market-Linked Portfolio, the Stable Portfolio and the Money-Market Portfolio.

- Member's money will automatically be invested according to the Life Stage model unless they make a positive choice to invest their money in another way (i.e. one or more of the "own choice" portfolios).
- The model assumes that the major determinant of whether they wish to manage their inflation risk or capital risk is *the period until their retirement*.

The model *does not take into account the possibility* that they may be planning to resign soon and intend spending their resignation benefit.

The diagram below shows the life stage model – the next sections explain the:

- Market- Linked Portfolio
- Stable Portfolio
- Money-Market Portfolio
- How members transition from the Market-Linked to the Stable Portfolio and then to the Money-Market Portfolio; and
- Key assumptions underlying the default Life Stage Model

### The Market-Linked Portfolio

The Market-Linked Portfolio has been designed to deal mainly with **inflation risk**. According to the life stage model your money will be invested exclusively in the Market-linked Portfolio until 10 years before your assumed retirement age.

This means that members money will be invested 100% in the Market-linked Portfolio up to age 55.

The Market-Linked Portfolio has an investment objective to deliver an investment return that is 5% p.a. (net of tax and investment management fees) higher than the consumer price inflation rate over any 7-year period, *although this return is not guaranteed*.

The assets of this portfolio are invested mainly in a mix of shares and bonds (local and offshore). As such, it is exposed to the performance of these markets, and the return you earn from this portfolio over a period may be positive or negative depending on market conditions.

A detailed fact sheet on the Market Portfolio is set out at the end of this guide.

### The Stable Portfolio

The Stable Portfolio has been designed to deal mainly with capital risk a member faces. According to the life stage model their money will be invested fully in the Stable Portfolio from age 60 onwards. Then from age 63 part of your money will be invested in the Money Market Portfolio and at age 64 their money will be invested fully in the Money Market Portfolio (The transition between the Market-Linked; Stable and Money Market Portfolio is explained below).

The investment objective of the Stable Portfolio is to earn a real return (after deducting retirement fund tax and management expenses) relative to price inflation of 3% p.a. over any rolling 3-year period, with a focus on short-term protection of capital. **However, this level of return and protection of capital is not guaranteed.**

This portfolio aims to achieve sustainable positive returns, with protection against capital loss. It is suitable for members of the Fund who are within five years of retirement, and who want to protect their capital. It is also suitable for any younger members who might prefer “smoother” returns.

The Stable Portfolio can be termed an “absolute return” portfolio. However, this is a very broad category, and there are many different strategies which investment managers use to try to achieve absolute returns (or positive returns). Some of these strategies can be very complex.

A detailed fact sheet on the Stable Portfolio is set out at the end of this guide.

## The Money Market Portfolio

The Money Market Portfolio is invested 100% in SA money-market instruments.

The prime objective of the Money Market portfolio is to preserve the Rand value of members’ retirement savings at all times and to increase it with the interest earned on the underlying money-market instruments. Importantly this portfolio does not provide such a guarantee.

It is expected that over the long-term this portfolio will achieve an after tax return of some 1% per annum above inflation over 12-month periods.

*This portfolio is designed for those members wanting complete protection against "final payment risk". However, it gives limited protection against "inflation risk".*

A detailed fact sheet on the Money Market Portfolio is set out at the end of this guide.

## Transitioning between the Market-Linked, Stable and Money Market Portfolios

According to the life stage model, the money you have invested in the Market-Linked Portfolio will be transitioned in 5 more or less equal instalments starting at the end of the month following the member’s 56th birthday. This means that by the end of the month in which they turn 60 their accumulated savings will be fully invested in the Stable Portfolio until they reach age 63.

From age 63 onwards, 50% of their accumulated savings contributions will be transferred to the Money Market Portfolio. At age 64, 100% of their money will be invested in the Money Market Portfolio until their retirement.

Their future monthly retirement saving contributions will be allocated in the same way as their accumulated savings.

The following table explains this transition in more detail.

Month-end following birthday	Allocation of existing savings as well as future contributions		
	Market-linked	Stable	Money Market
<b>55 and younger</b>	100%	0%	0%
<b>56</b>	80%	20%	0%
<b>57</b>	60%	40%	0%
<b>58</b>	40%	60%	0%
<b>59</b>	20%	80%	0%
<b>60</b>	0%	100%	0%
<b>61</b>	0%	100%	0%
<b>62</b>	0%	100%	0%
<b>63</b>	0%	50%	50%
<b>64</b>	0%	0%	100%

## Important assumptions of the Life Stage Model

The life stage model is based on a number of important assumptions, namely:

- The life stage model assumes that the member will retire at age 65 in terms of the rules of the PetroSA Retirement Fund.

For example, if they intend to retire at age 55, they may wish to consider transitioning their retirement savings in the Stable Portfolio from age 45 onwards (as opposed to age 55 as would be the case with the life stage model). Importantly, they would need to indicate this choice by sending in an Investment Choice Option Form.

- The member's money will automatically be invested according to the life stage model unless they make a positive choice to invest your money in another way (i.e. their choice of one or more of the own-choice portfolios).

The model assumes that the major determinant of whether a member wishes to manage your inflation risk or capital risk is *the period until their retirement*.

The model does not take into account that they may be planning to resign soon and intend spending their resignation benefit.

The model is also based on an "average risk appetite". To the extent that their risk appetite is more conservative or aggressive than average, the life stage model may not be appropriate.

# OWN CHOICE PORTFOLIOS

## What individual investment choice is

- It is the administrative ability to give members the choice as to the type of assets they would like to invest in;
- It acknowledges the fact that individual members have different needs; and
- It is saying that a single one-size fits all strategy may not be appropriate for all members.

## The legal basis of individual investment choice

The extent of member's **own choice** is as follows:

They may choose to invest in any of the portfolios listed below, in any proportion they want at any age. If they make such a choice they will **not be automatically transitioned** from their current portfolio to the Stable Portfolio and Money Market Portfolio from their transition birthday. In other words, **they will be opting out of the default Life Stage model.**

They will need to inform the Fund of this election (they need to complete an Investment Choice Option Form).

They should be careful in using an own choice portfolio in an attempt to "time the market". There is strong evidence that professional investment managers are not able to time the market correctly on a consistent basis.

## Portfolios available

The Portfolios available to members if they want to opt out of the default Life Stage Model, or if they elect to invest their money in any of, or combination of, the:

You may elect to invest your money in any of, or combination of, the:

- Market-Linked Portfolio,
- Stable Portfolio,
- Money Market Portfolio,
- Shari"ah Portfolio

## Range of choice they have

A member may make a separate election of how they want to invest their Member Individual Account and how they would like to invest their on-going retirement saving contributions. For example, they may elect to invest their Member Individual Account in the Market-Linked Portfolio and their on-going retirement saving contributions in the Stable Portfolio.

## Investment switching

### What switching is

If a member makes a voluntary choice to change part or all of his/her retirement Fund investment from one portfolio to another, this is a switch. It is voluntary and **requires their specific instruction.**

### Restrictions applicable on switching between the portfolios

There are no restrictions on how members can allocate their money between the portfolios. For example, they can invest their future contributions differently from their accumulated retirement savings.

### When members can switch

They can switch monthly.

### What members must do

They will need to complete a switching form. These forms are available from the Human Capital Department.

### To whom instruction must be sent

The completed switching form must be sent to Alexander Forbes by following the instructions on the switch form. **It is their responsibility to ensure that Alexander Forbes receives this form.**

### The deadlines applicable

Members have the facility to switch on a monthly basis. They must inform the Fund by the 10<sup>th</sup> of the month if they want a switch to be implemented on the first day of the next month.

### After the instruction is made

The benefit administrator, Alexander Forbes, will issue an instruction to the investment administrator, Sygnia, for the transfer of money between the investment managers, and will amend their Fund record to allocate their retirement savings to their new portfolios.

### How members will know whether their instruction have been carried out

After the switch the benefit administrator will send a confirmation to them to confirm the switches that have been carried out. The switching transaction is also available to them on the Alexander Forbes online Facility.

### The cost of switching

In each financial year they will be entitled to **one free switch**.

They will be charged for **any additional switch** in the 12-month period. This fee will be deducted from their retirement savings at the time of the switch.

### Investment penalties applicable if members switch

There are no penalties on switching out of any of the portfolios. However, on switching out they will receive the market value of their investment in the portfolio at the date of the switch. (Bear in mind that the market value may be less at the switching date than the total amount invested, if the stock-market is at a low point).

### Opting back into the Life Stage portfolios

If a member **at any time** makes a positive election to invest differently from the Life Stage portfolio, then in future they will always need to advise the Fund if they want to switch portfolios in future.

They always have the option to return to being a Life Stage member, but they will have to advise the Fund in writing.



## COMMON MISTAKES

Although it may be attractive to construct their own portfolio, it is worth pointing out the following two common mistakes members make with own choice portfolios.

### Choose an investment strategy that is too conservative

The South African and international experience is that when faced with investment choice, members often choose a portfolio that is too “conservative” relative to the risks they face. This error can have materially negative financial consequences on the value of retirement benefits.

For example, if a 25-year old member decides to invest their retirement savings in the Money Market portfolio over their entire working life (i.e. for 35 to 40 years), they could end-up with a pension some **20% less** than had they invested more appropriately according to the life stage model.

So, if they are thing and/or they are not concerned about their “Capital risk”, they should invest primarily to manage their inflation risk (as the life stage model aims to do automatically).

### Trying to “time the market”

Experience shows that many members **believe that they can “time” the share market**. This means they try to get out at the top of the share market and buy back in at the bottom of the share market (i.e. they aim to get both decisions right).

The reality is that the vast majority of **expert** investment managers cannot time the market effectively. Expressed another way, it is very difficult to choose the right time to invest or disinvest. Usually this can only be done with hindsight.

The evidence to date shows that retirement Fund members who try to time the market **almost always get it wrong**. In fact the evidence shows that members expose more money to the equity market when it has gone up sharply (possibly the worst time to do so) and avoid the share market after a sharp fall (typically the best time to get back into the share market).

If they can consistently time the market correctly, they are almost certainly in the wrong job!

# FACT SHEET: MARKET-LINKED PORTFOLIO

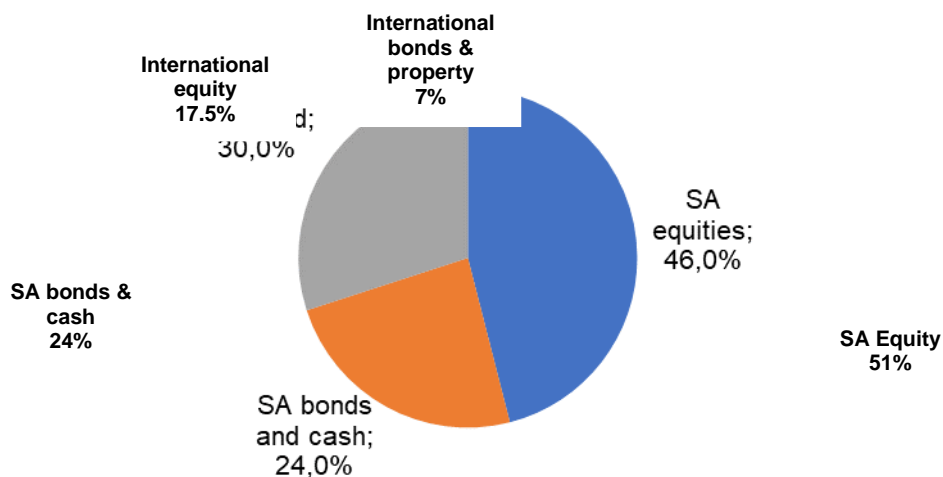
## Investment objective

The investment objective of the Market-linked Portfolio is to achieve a real return (after deducting retirement fund tax and management expenses) relative to SA price inflation of 5% p.a. over any 7-year period. Please note that this level of return is not guaranteed.

*This portfolio is available both in the Life Stage Portfolios and the Own Choice Portfolios.*

## Asset allocation

The strategic asset allocation of the Portfolio is shown in the chart below:



Thus, the portfolio has approximately 67% strategic allocation to equities and 33% strategic allocation to property, bonds and cash.

The actual allocation of the Portfolio will vary around this strategic asset allocation. It is important to highlight that the split between SA and international investments will depend on market conditions.

## Performance characteristics

This portfolio does not provide any performance guarantees. It aims to deliver a good return relative to inflation. It has a long-term investment horizon and one should not measure its performance over periods of less than 5 years.

Part of the SA and international equity component is managed according to the value style.

The performance of this portfolio may thus at times be **significantly different from that of the average retirement fund** – it should generally deliver somewhat better performance in weak markets, but under-performance in strong markets. There are however no guarantees of this.

## Investment managers

The investments are split between a variety of different Specialist Asset Managers. They are:

- Allan Gray, Coronation, ABAX (SA Equity Managers)
- Ninety One, Coronation and Futuregrowth (SA Bond Managers)
- A global balanced portfolio comprising a range of highly rated global equity, bond and property managers (administered by Sygnia Life)

## Costs

The following charges apply to this portfolio:

- Investment management fees: The member pays the investment manager fees (the fees are deducted from the investment return credited to them).
- Investment-related charges: These include transaction-related costs incurred by the investment managers such as brokerage (deducted from the investment return credited to members).

# FACT SHEET: STABLE PORTFOLIO

## Investment objective

The overall investment objective of the Stable Portfolio is to earn a real return (after deducting management expenses) relative to price inflation of 3% p.a. over any rolling 3-year period, with a focus on short-term protection of capital.

**However, this level of return and protection of capital is not guaranteed.**

This portfolio is available in both the Life Stage Portfolio and the own choice portfolio.

## Asset Allocation

The portfolio is invested in equities (typically up to 40%), bonds and cash. The allocation between these asset classes is highly variable and depends on the managers' view of current market conditions at a given time.

## Performance Characteristics

The Stable Portfolio is invested in the Ninety One Cautious Managed Portfolio, Coronation Inflation Plus, and Allan Gray Global Stable Portfolio.

Members can expect that this portfolio should produce consistent positive returns that are targeted to beat inflation over 3 years. It is possible that in any given month the return could be negative. However, the negative return is not likely to be material, and it is unlikely that there will be a negative return over any 12-month period.

It is important to understand that whilst negative returns over a 12-month period are unlikely, **they are not impossible**.

In summary, over periods of 3 to 5 years members can expect:

- a low probability of capital losses, and
- a high probability of returns above inflation.

## Investment Manager

The Stable Portfolio is invested in the Ninety One Cautious Managed Portfolio, Coronation Inflation Plus, and Allan Gray Global Stable Portfolio.

## Costs

The following charges apply to this portfolio:

- Investment management fees: The member pays a *pro-rata* share of the investment manager fees (the fees are deducted from the investment return credited to the member).
- Investment-related charges: These include transaction-related costs incurred by the investment managers such as brokerage (deducted from the investment return credited to members).

# FACT SHEET: MONEY MARKET PORTFOLIO

## Investment objective

The investment objective of the Money Market Portfolio is to achieve maximum security of capital. People who have a very short investment horizon, or who expect deflationary conditions, would invest in this portfolio.

*This portfolio is available both in the Life Stage portfolios and the Own Choice portfolios.*

## Asset Allocation

The portfolio is invested 100% in SA money market instruments.

## Performance Characteristics

This portfolio aims to protect capital, but without guarantees. However, of all the Fund's portfolios it is the **closest** to providing the highest degree of capital security in all economic conditions. Over the long term it is expected to achieve a real return (after deducting retirement fund tax and management expenses) relative to SA price inflation of 1% p.a. over any rolling 12-month period.

## Investment managers

The investment manager for this portfolio is Ninety One Asset Management.

## Costs

The following charges apply to this portfolio:

- Investment management fees: The member pays the investment manager fees (the fees are deducted from the investment return credited to members).
- Investment-related charges: These include transaction-related costs incurred by the investment managers such as brokerage (deducted from the investment return credited to members).

# FACT SHEET: SHARI'AH PORTFOLIO

## Investment objective

The investment objective of the 27four Shari'ah Multi-Managed Balanced Fund aims to deliver a real return of 4% (after deducting management expenses) in excess of SA price inflation over any rolling 5-year period. This investment return *is not guaranteed* and will depend on market returns and investment manager skill.

*This portfolio does not form part of the Life Stage Portfolios.*

## Asset Allocation

The 27four Shari'ah Multi-Managed Balanced Fund has a maximum equity allocation of 60% to shares (local and offshore) with the balance of assets invested in sukuk ("Islamic bonds"), murabaha contracts (short-term sale-repurchase agreements which aims to deliver a cash-type return) and commodities (gold and platinum ETF).

## Performance Characteristics

The assets of the 27four Shari'ah Multi-Managed Balanced Fund are invested in a mix of Shari'ah compliant shares (local and offshore) and local "Islamic bonds". The Fund has a lower weighting to equities and a higher weighting to fixed income assets than the PetroSA Retirement Fund's Market-linked Portfolio. This means that the Shari'ah Portfolio should provide a somewhat greater cushion against negative returns in the equity markets in the short term than the Market-linked Portfolio.

*This portfolio is exposed to the performance of markets, and the return you earn from this option over shorter periods may be positive or negative depending on market conditions.*

## Investment manager

The manager is 27four Investment Managers (an authorised financial services provider) as the multi-manager responsible for the construction of the Fund's Shari'ah compliant investment portfolio. All investments meet Shari'ah principles as interpreted and laid down by the 27four Shari'ah Supervisory Board. The investment process ensures adherence to Shari'ah principles which the 27four Shari'ah Supervisory Board monitors closely on a regular basis. The specific investment product is the **27four Shari'ah Multi-Managed Balanced Fund**.

## Multi-Manager Investment process

27four combines different asset managers for each asset class, each manager with a different set of skills. The portfolio is therefore diversified by investing in a combination of Shari'ah compliant equity fund managers locally and internationally, Sukuks ("Islamic bonds") and direct physical exposure to gold bullion.

## Costs

The following charges apply to the Shari'ah Portfolio:

- Investment management fees and multi-manager fees. The member pays these fees, which are deducted from the investment return credited to them.
- Investment-related charges: These include transaction-related costs incurred by the investment managers such as brokerage (deducted from the investment return credited to members).