

Galileo Quarterly Newsletter



July 2009

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GENERAL NEWS

HOW BAD WAS 2008 FOR YOUR RETIREMENT PLANS?

Alarming market losses caused many investors to rethink their plans for retirement. Some have decided to postpone retirement, others plan to go back to work whilst many retirees have reduced their expenses in an effort to preserve their precious capital. All of us are now faced with the question of what to do next to ensure that we do not erode our capital further and how to recover the losses from last year.

Lessons from 2008 and the first months of 2009

Now that the dust has started to settle after the dramatic market movements of the last 18 months, we can look back to figure out what happened to our investments and try to determine how to go forward. One important lesson was the benefit of diversified portfolios in minimising but not preventing losses. In South Africa, well diversified investors (like our clients) saved themselves from 50% of the losses experienced by investors who only invested in the stock market. Internationally the situation was even more grave, our clients saved themselves 70% of the losses that share investors experienced.

Investment managers were all surprised that most asset classes lost money simultaneously during the worst months of the crash. Classic investment theory dictates that the asset classes move at different times; so when shares fall, bonds should rise etc. The worst months of the market showed that when the tide goes out all ships fall. In addition to the simultaneous movement of asset classes, investors were completely surprised by the magnitude of losses on the markets. This combination of events placed significant stress on our clients' portfolios. We were however very relieved that the shock absorbers that were built into the portfolios performed well in such difficult times.

With the benefit of early hindsight we need to question whether it is appropriate to change our investment philosophy to compensate for very rare market events (called Black Swans by Nassim Taleb) or if the consistent implementation of our philosophy will reap benefits for our clients over the long term. Early indications are, that our clients remain on track despite the events of last year however, they will need to remain invested and stick to the plans that were developed for them. Whilst we plan for market losses we cannot predict when they will happen and how long the portfolios will take to recover. We are convinced that the portfolios

will recover and will enable our clients to meet their long term objectives as set out in their Financial Plans. As a business, we still believe that diversified portfolios with a long term focus will generate the expected returns despite the poor economic environment.

New, low-cost investments

In difficult years we have seen the performance benefit of reduced investment costs. Over the last six months, we have been working very closely with one of our investment managers, Xchange Solutions, (part of Nedbank Group) to introduce lower cost, index based investments. We are pleased to announce that they will be launching these new funds in August and will offer our clients a significant cost saving. For our clients at Old Mutual, Sanlam and Investec; the investment fees will reduce by as much as 40% per year. This is a significant saving and will have a big impact on investment performance over the longer term. If you would like to know more, please contact your advisor.

How much to draw from your investment?

We have long believed that you should not draw more than 8% per year from your capital if you would like to ensure that you can increase your drawings to match inflation. Last year showed us that those clients who drew 8% per year may have ended up drawing 10% after the market drop. This amount is high but sustainable over the short term as we believe that the market value of these portfolios will increase again so that our clients only draw 8% again in future. Those clients who started their retirement by drawing 10% or more would have been drawing at least 12% last year which is unsustainable over the medium term and could erode their capital even after the market has recovered.

WHAT IS HAPPENING IN THE GLOBAL ECONOMY?

News about the global economy seems confusing and even contradictory at the moment. As an example, on the front page of the Business Day, June 11, we see two headlines, "*Oil at \$71 high mark on market rebound. Fresh signs of a global recovery spur bourses, commodity prices*" and on the same page, "*Manufacturing production falls a record 21.6% in April*". These types of headlines along with the stories that are being written, make it very difficult for all of us to know what is really happening. Our first comment is that you need to differentiate the noise from the news. Journalists are paid to get you to read their papers so they write dramatic headlines and articles that are often close to hysterical in tone. The economic news being reported is often historical as economic information is usually 90 to 180 days old. Our suggestion is that you ignore what is written as stock markets generally look forward. They try to anticipate what the economy is going to do in future and are not too concerned about history. To paraphrase Warren Buffett, the fact the US economy is in a shambles does not help him to predict where the US stock market is going to go.

Our sense of events is that the world is starting to stabilise but the effects of the economic downturn are felt at different times depending on the industry and country involved. As an illustration, we saw the construction industry in Dubai take a knock very early in the downturn whilst the banks in South Africa have only started downgrading their earnings in the last three months. This does not mean the crises is getting worse in SA now, it is just the way that the effects of the crises pan out over time.

No one can predict when the global economy will start recovering however we know that it will happen as a widespread event over a number of different industries and countries.

SHORT TERM INSURANCE - PAY ATTENTION AT CAR ACCIDENTS

Here is advice from the ombudsman for short-term insurance, Brian Martin, on what to do if you are involved in a bumper-bashing.

“The most important thing to do is to check for injuries. If anyone is seriously injured, the police must be informed and no one may leave the scene before they have arrived. If no one has been seriously hurt, then the accident must be reported by all parties involved within 24 hours.”

It is very important to note that one should never discuss the merits of the accident with other parties. What this means is that even if you believe you caused the accident, you should never admit to it. The reason for this is that you may prejudice the rights of your insurer to recover from other parties after they have settled your claim. Only a legally trained person can, in any event, make an informed decision on how the blame should be apportioned.”

“Next, make sure you obtain the relevant contact details of all the parties involved in the accident. It is also important to get contact details from eyewitnesses, because this will help to determine blame and might also assist if there is a criminal prosecution. Also, get the full details of the insurance policies of all parties involved. Cellular phones with cameras have proven useful tools in recording important information at the scene of an accident. If your phone is equipped with such a camera, take a number of photos of the scene as well as any damage to each of the vehicles involved.”

We have pamphlets that you can keep in your car that will provide you with a guideline on what steps to follow after an accident. We find that people become unsettled after an accident and struggle to think clearly in the moment so it helps to have written guidelines that you can follow. If you would like a pamphlet please contact Lezanie on 011 502 8800.

GALILEO COMPANY NEWS

ANOTHER ADDITION TO THE GALILEO FAMILY

We are very pleased to announce that Lezanie Kieser is engaged to be married to Johan Barnard. We wish them all the very best for their wedding in November!

EXPANDING AGAIN

We are in the process of increasing our short term insurance business through an agreement with Am I Insured, where we will be taking over their clients over the next six months. This means we will be employing a new staff member shortly and increasing our operational capacity which is good news for all our clients.