Standard

Online Share Trading

Education newsletter

Issue # 3
4th May 2007

I think you have to learn that there's a company behind every stock, and that there's only one real reason why stocks go up.

Companies go from doing poorly to doing well or small companies grow to large companies.

Peter Lynch

Getting started in shares
Free road show – open to all

We offer a free 90 minute presentation "Getting Started in Shares", open to all who are interested in learning more about investing on the JSE.

Dates & cities

- Durban – 10 May
- Cape Town – 17 May
- Johannesburg – 24 May
- Pretoria – 31 May

To book or for more information send us an email to seminars@standardbank.co.za telling us which city & date and please include your name and contact details. We will reply with venue details. All venues are central and the start time is 6.00pm.

Client courses for the next two weeks

These courses are exclusively for Online Share Trading clients and are free (except for the Technical Analysis courses). To book for one of these courses log onto Online Share Trading and go to; Help & Education ➔ Face to face classes

Johannesburg

- Introduction to technical analysis (05 May)
- Introduction to Fundamental Investing (09 May)
- Introduction to investing (12 May)
- A practical guide on how to effectively use the website (15 May)
- The Truths of the Market and Trading Skills (16 May)

Durban

- Introduction to technical analysis (12 May)
- Introduction to investing (19 May)

Cape Town

- Advanced/Practical Technical Analysis (19 May)

TALK
From the editor

Welcome to issue three of the Online Share Trading newsletter. As I write this, a report is out from Unisa's Bureau of Market Research (BMR) showing that the economy could be as much as 9% larger than official estimates (reported in Business Report 02 May), more fodder for the bulls?

The last issue of our newsletter generated a couple of questions that are worth answering here.

Firstly people have been asking if they can forward this newsletter to friends, etc. – absolutely.

Secondly we've been asked if the newsletter is online and also for the back issues. Well all previous (and the current issue) are online. The day after we email it out you will find the current issue on the Online Share Trading website. Log in, on the menu go to Help and Education ➔ Newsletter. You'll find all the back issues as well as the current issue.

All the best
Simon Brown

INVESTOR
Un-bundling - what, how & why?

After the recent announcement from Tiger Brands (short code - TBS) that it was looking to dispose of its health care business, Adcock Ingram, we're going to have a look at the two common options used by companies when disposing of a major asset in the form of a company.

What Tiger Brands is essentially planning to do is either, sell Adcock Ingram or list it on the JSE and un-bundle it to current Tiger Brands shareholders.

Option one would be for Tiger Brands to sell Adcock Ingram to a third party, then the profits from the sale will most likely be returned to share holders, either via a special dividend or alternatively via a share buy back. That said, the parent company may keep the profits from the sale and use it to pay off debts or acquire new assets, equipment, etc.

The un-bundling option is for Tiger Brands to simultaneously list Adcock Ingram on the JSE and then give those new Adcock Ingram shares to Tiger Brands share holders. What this entails is all holders of Tiger Brands shares will receive Adcock Ingram shares in a set ratio per number of Tiger Brands held, and Adcock Ingram will then start to trade on the JSE as an independent company. For example for every 100 Tiger Brands you "may" receive 25 Adcock Ingram.

This latter process is the more popular and certainly this is what Tiger Brands has done in the past, with for example Spar (SPP).

Another similar local example is Barlow World (BAW), they are planning to un-bundle PPC to share holders. The difference with PPC is that it is already listed on the JSE but Barlow World owns 72% of the listed PPC stocks and they will be returning this 72% to share holders of Barlow World in the ratio of 1 PPC for every 5 Barlow World held. So if you hold 100 Barlow World you will receive 20 PPC.

That said if the un-bundling route is taken there are a couple of issues that need to be remembered.

Firstly, even while the intention to dispose of a business may have been announced there will be a final and formal announcement (via SENS) that will specify a date for the un-bundling to happen – called a last day to trade (LDT). Holders of Tiger Brands (or whichever share is un-bundling) at the close of trade on that LDT date will be entitled to receive the new un-bundled shares.

The announcement will also state how many of the new shares (Adcock Ingram) one will get for every holding company's share (Tiger Brands) one owns.

Secondly, the shares received will technically be free to share holders of the parent company, but naturally the market will place a value on them and importantly the un-bundling parent company can expect to see its share price fall by roughly the same amount as the new company starts trading on the JSE.

Historically un-bundling helps create value and after a while (generally weeks or months) the two shares will have a joint value greater then the value of the parent stock before un-bundling. The logic here is multifold. Investors may be especially interested in the new un-bundled companies industry and rate it higher then the parent company conglomerate; the ability to freely trade the new un-bundled shares could create demand and push the price higher; the new "owners" may embark on a different (preferred?) strategy and so on.

A last point before we move on, why do companies go the disposal route? Generally it is because the company being disposed is no longer core to the parent companies business or because the "smaller" company has grown to a stage whereby it is almost as big (or in some cases such as PPC, actually bigger) then the parent company. A last point is that this is the business model of some listed companies. They take in small companies and foster them into large(r) companies before un-bundling them.

Effect on derivatives

For those trading derivative products things are pretty much the same.

If holding a Single Stock Future (SSF) you will get a new contract in the un-bundled company for every hundred shares due to you because of your contract holdings in the parent company (remembering that every contract is equal to 100 shares). So if you have 5 contracts (equal to 500 shares) and the ratio is 1 new un-bundled share for ever 5 parent company shares you will receive one contract for the new un-bundled company (in other words 100 new shares equaling one contract). The exchange will also make adjustments to the parent companies initial margin requirements to bring it into line with the new share price.

NOTE: if the new un-bundled shares due to the holders of an SSF is not a round 100 (a full SSF contract) then a number of options are possible and not all fully benefit the client. In that case we will take guidance from the JSE and inform clients holding the effected SSF's as to the possible out comes.

With warrants one of two things generally happens. You will receive warrants in the new un-bundled company is the same ratio that the un-bundling is happening. Once again the un-bundling ratio will be applied to the warrants.

Alternatively the issuer may decide to go the basket route (this is the less popular route). What happens here is that instead of the warrant underlying just being Tiger Brands it will now be a basket comprising Tiger Brands and Adcock Ingram and the strike price will be referenced against the share price of both companies.

Installment holders of Tiger Brands and/or Barlow World will also receive the allotment of new installments or shares in exactly the same ratio as if they held the underlying share (assuming Tiger Brands goes the un-bundling route with Adcock Ingram). So once again if the ratio is one new un-bundled share for every five parent company you get one new share installment in the unbundled company for every share installments held by the parent company. Note that some issuers will issue the new un-bundled shares directly while others will give you new installments in the new un-bundled company. Check with the issuer which route they will be taking.

Investment strategy

As a final thought, hunting out shares that have the potential to un-bundle can be a very rewarding investment strategy. Some very profitable examples in the last few years have been; Tiger Brands (Spar), Tongaat (Hulett Aluminium – announced but not yet happened), Iscor (Kumba), Kumba (Exxaro Resources) and Barlow World (PPC – announced and expected mid year) to name but a few. The challenge is to identify the potential companies well before the announcement is made as much of the markets response happens at the time of the initial announcement.

Simon Brown

ECONOMICS
BRIC's – say what?

BRIC's is an acronym for the economies of Brazil, Russia, India and China combined. The general consensus is that the term was first prominently used in a Goldman Sachs report from 2003, which speculated that by 2050 these four economies would be wealthier than most of the current major economic powers.

The BRIC thesis proposes that China and India will become the world's dominant suppliers of manufactured goods and services, respectively, while Brazil and Russia will become similarly dominant as suppliers of raw materials. It's important to note that the Goldman Sachs thesis isn't that these countries are a political alliance (like the European Union) or a formal trading association - but they have the potential to form a powerful economic bloc. BRIC is now also used as a more generic marketing term to refer to these four emerging economies.

Due to lower labour and production costs, many companies also cite BRIC as a source of foreign expansion opportunity.

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TRADER - derivatives
Benefits of warrants

Standard Bank warrants are traded on the JSE Ltd. This means that you can buy and sell warrants with the security of knowing that you are trading on a regulated exchange via a registered stockbroker.

The South African warrant market is regulated by the Financial Services Board (FSB), under the Stock Exchange Control Act (SECA). You can trade profitably by buying and selling warrants on the JSE Ltd, as you can with shares, but with significantly lower costs. Since Standard Bank warrants are much cheaper than the underlying shares, both brokerage and interest costs are lower.

Through the use of put warrants, which give investors the ability to go "short" of the market you can make a profit when a share falls in value. Standard Bank warrants are a leveraged share investment. Since Standard Bank warrants are considerably cheaper than the shares and capture 100 percent of the price movement of the shares, the warrants are an effective way to leverage your investment.

Using call warrants as an example, "leverage" means that for a given increase in the share price, warrant holders will potentially make a greater profit as a percentage of capital invested. Conversely, for a given decrease in the share price, holders will be exposed to a greater potential loss for a decrease in the share price as a percentage of capital invested. However, you are never obliged to pay anything more than the initial price of the warrant, so the maximum amount you can lose is limited to the price paid for the warrant.

Comparing a Share Trade to a warrant Trade

Assume that stock of XYZ, a leading company is priced at R100 per share. You believe the stock is likely to appreciate by R10. You want to profit from this anticipated price increase by taking exposure to 1 000 shares.

Alternative 1 – Buy the underlying share
Buy XYZ shares: purchase 1 000 shares at R100 each. With brokerage and UST, your entry cost will be R101,160.66

Projected Costs: Share purchase		
Projected share price:	R	100,000.00
Brokerage @ 0.7%:	R	700.00
UST @ 0.25%:	R	250.00
STRATE:	R	10.93
Investor protection levy:	R	0.20
VAT @ 14%:	R	99.53
Total cash required:	**R**	**101,060.66**
Total brokerage and costs:	**R**	**1,060.66**
Percentage brokerage:		**1.06%**

Alternative 2 – Buy call warrants listed over XYZ
Buy XYZ call warrants: let's assume they are Standard Bank Call Warrants trading over XYZ shares. The warrants are currently priced at R1 each, and your warrant broker informs you that the warrant currently has a delta (This gives relative change in the price of a warrant for a 1-cent change in the underlying) of 0,50 and a conversion ratio of 10 for 1; that is, you need 10 warrants to exercise into one share.

Therefore to gain exposure to 1 000 shares, you purchase 20 000 XYZ call warrants at R1.

To get this figure you divide the delta (0,5) by the cover ratio (10) to get 0,05.

You then divide the number of shares you wish to get exposure to (1 000) by this number (0,05) to get to the 20 000 XYZ calls needed to gain exposure to 1 000 shares .

Therefore for each R1 share price increase, the warrant price is likely to increase by 5 cents. This figure is attained by multiplying the share price move (R1)* by the delta of the warrant (0,5 or 50%) and dividing this number by the conversion ratio of (10)*. The reason for dividing by the conversion ratio is that you need 10 warrants to gain exposure to one share.

Projected Costs: Warrant purchase		
Projected share price:	R	20,000.00
Brokerage @ flat **R50**:	R	50.00
UST @ 0.25%:	R	50.00
STRATE:	R	10.93
Investor protection levy:	R	0.04
VAT @ 14%:	R	8.53
Total cash required:	**R**	**20,119.50**
Total brokerage and costs:	**R**	**119.50**
Percentage brokerage:		**0.60%**

If the stock has increased in price by R10 from R100 to R110 then given the delta of the warrant, you would expect the Standard Bank call warrant to have increased in value by approximately R1 from a price of R1 to R2.

** Note that this is true for the day of purchase, however, over time all warrants will gradually decline in value, due to time decay. While very small over one day, over several months time decay may have a significant impact on the value of the warrant.*

The table below compares the two alternatives. In this example, the profit from trading the warrant is more than double the profit that you would have realized on the share trade, on a capital outlay that is one fifth of the size.

Summary of profit & loss for a R10 move in XYZ share	Investing in 1,000 XYZ shares at R100 each	Investing in 20,000 XY warrants at R1 each
Purchase price	-R100,000.00	-R20,000.00
Trading costs	-R1,060.66	-R119.50
Sale price	R110,000.00	R30,000.00
Brokerage & costs	-R890.46	-R69.50
Profit	**R8,048.88**	**R9,811.00**
Return	**8.05%**	**49.05%**

** Note: In the above example the transaction cost involved gaining exposure to an equivalent amount of the underlying via the warrants is less than 1/10th of directly purchasing the underlying. This is due to lower brokerage and UST fees, which are charged as a percentage of the total transaction.*

By Brett Duncan
Head of Retail Derivatives – Standard Bank

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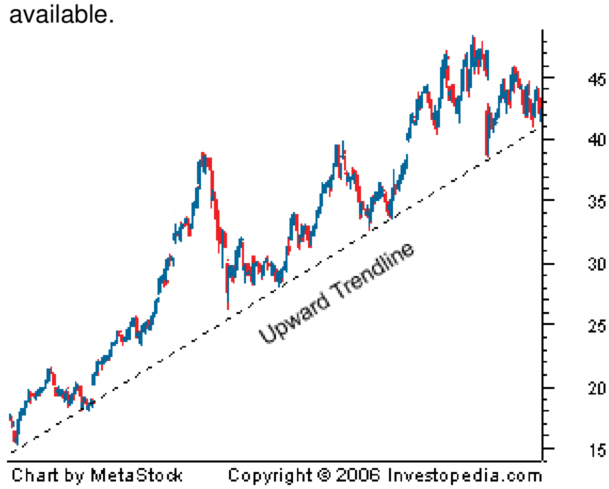
TRADER – technical analysis Basic concepts of a trend

Prices move in trends because of an imbalance between supply and demand. When the supply of a stock is greater than the demand the trend will be down as there are more sellers than buyers; when demand exceeds supply the trend will be up as buyers bid up the price; and if the forces of supply and demand are nearly equal, the market will move sideways in what is called a "trading range". Eventually, new information will enter the market and the market will begin to trend again either up or down depending on whether the new information is taken as positive or negative.

A major aspect of technical analysis revolves around identifying and reading trendlines based on the theory that prices trend. The concept of trend is absolutely essential to the technical approach to market analysis. Most chart technicians find trendlines to be one of the most valuable tools available.



Rarely is there an important change in price trend that is not accompanied by a penetration of a trendline on the daily bar chart. However, trendlines are often penetrated prematurely and considerable judgement must be exercised in deciding where to place a trendline and in determining when a valid penetration has occurred.

Another precaution is to consider a penetration of a trendline during the trading session as tentative until confirmed by the close. However, no matter what procedure is followed, the possibility of a false penetration cannot be ruled out, and trendlines must sometimes be revised. A very good example is the classic "fan" formation in which two false penetrations in succession are followed by a third penetration that is valid and meaningful.

All the tools used by the chartist - support and resistance levels, price patterns, moving averages, trendlines etc. - have the sole purpose of helping to measure the trend of the market for the purpose of participating in that trend. We often hear expressions such as "the trend is your friend," and "never buck the trend." The ability of prices to cling extremely close to a straight line is one of the most extraordinary characteristics of chart movements. Another important characteristic is that when a stock is found to be following a given trend line, it is more likely to continue moving along that line, than not to.

It is perhaps obvious that the longer a stock has been moving along a given trend or within a given channel, the stronger that trend is likely to be. For this reason, trendlines on longer range charts such as weekly or monthly bar charts are usually more reliable than trendlines that form on intraday or daily bar charts.

Even when stocks break away from an established trendline and signal a true shift in direction, they have a tendency to return to it. This magnetic attraction of the old trend is called a "pull-back" effect and is common to trendlines. (This phenomenon will also often be found after breakouts of support and resistance congestion areas, patterns etc.).

Prices move in a series of peaks and troughs and the direction of these peaks and troughs determine the trend. The appropriate names for peaks and troughs are also known as resistance levels and support levels respectively.

Yonatan Rom
The Winning Edge
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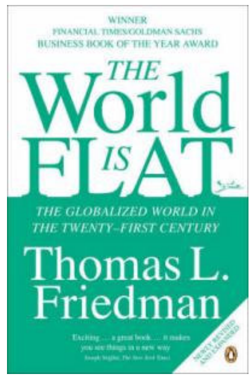
REVIEW – book
The World is Flat

The World is Flat: A Brief History of the Twenty-first Century by Thomas Friedman

The first question is if this is an investment book? Directly it is not, but the subject matter will have direct impact on how business happens in the newly proposed flat world, and importantly how individuals, companies and countries will have to adapt.

Also before we go any further one has to note that Friedman is very pro-globalisation and the latter half of this book is geared towards how the US will survive this new flattened world. He is also a twice weekly op-ed foreign affairs columnist for the New York Times and a three times winner of the Pulitzer Prize. So while his credentials may be of a particular slant his pedigree is not is out of the top draw.



The main tenant of the book is that the planet has under gone three major periods of globalisation. First it was countries globalising (colonies, trade etc.), then it was companies globalising (global markets, sweat shops, etc.) and now in the final stage it is the individual globalising (out sourcing, collaboration, etc.). This third stage was fired off by the collapse of communism, the dot-com bubble resulting in over investment in fibre optic telecommunications (now resulting in cheap global telecommunications), and the out-sourcing of engineers enlisted to fix the Y2K issue.

This allows distant countries such as India, China and Russia to enter markets that would normally been geographically restricted and as Friedman comments “When the world is flat, you can innovate without having to emigrate”.

So now thanks to cheap bandwidth a McDonalds drive through in the US can have the order taker sitting in a call centre in India, at a cheaper cost and improved efficiencies to McDonalds. Further some 400,000 Americans have their taxes done by Indians in Bangalore. Bang – suddenly things are very different for practically everybody.

Overall the argument Friedman makes for the new flat world is compelling and we’re seeing it all around us (Online Share Trading is indeed an example). He further suggests that it becomes self fulfilling in that as India gets better as one of only three global research centres for Microsoft – so it will attract more talent and better talent.

In fact Friedman paints a worrying picture for America as he shows that their intellectual dominance is waning as India, China and Russia produce more (and in many cases as good) engineers, programmers, etc. Further whereas talent tended to gravitate towards the US they now no longer need to in a flat world, the net result is the US is losing its edge, and this could spell trouble for the world's largest economy.

This all said Friedman does spend a large art of the latter part of the book addressing how the USA can adapt (and thrive) in the new flat world, and certainly he is of the view that the USA will adapt and thrive.

Friedman also looks at the ten things he says have had the biggest impact and scattered through out the book are examples that illustrate his points.

He also makes some interesting points about the sort of jobs that can not be out sourced; namely geographically bound jobs such as nurses, mechanics and shelf packers.

Overall a recommended read albeit it is a bit long winded towards the end.

Friedman has a website at www.thomaslfriedman.com

Buy from Kalahari.net for R130.00

Simon Brown

REVIEW – website Kitco.com

Kitco.com started life as a simple gold price website; then when the gold price finally started moving upwards its popularity grew and it expanded to both other commodities and to other commodity related content.

Kitco.com supplies users with the gold price across the different time zones/currencies, in chart format (dating back as far as 1833 for gold and 1792 for silver!) as well as a multitude of other metals and even the Gold Lease Rate (this is the rate at which traders pay to borrow gold).

These days they also have news, press releases, analysis (technical and fundamental) and while they don't produce any content themselves they are an excellent source of info for anybody interested in commodities in general and gold in particular. In fact the website is so full of content these days that it's almost like a one stop shop for anything gold related.

One of the more popular features is the KCast, a small (and free) program that when installed puts the latest gold price on your windows task bar so that gold bugs are constantly up-to-date with moves in the price.

My personal favourite is the 24 hour gold chart that shows you gold's price across the different markets/time zones during the global trading day.

In short this website is a must for those gold bulls (and any bears still lurking out there) and is equally useful for other commodity traders and investors. A last point is that this is not a website that'll ever win any design awards, but that's not a worry as we're visiting for content, not how it looks.

Simon Brown

JARGON BUSTING Balance sheet

A list of all balances taken from a company's ledger after incomes and expenses have been offset to arrive at a profit or loss. These balances are combined in carefully prescribed ways. The objective of the balance sheet is to give a snapshot of the company at a precise moment in time. This shows where the company obtained its money (liabilities) and how it has allocated that money (assets) so as to generate profits. Obviously, the sources of money must be totally accounted for in assets of one sort or another and therefore the "two sides" of the balance sheet must always balance.

Online Share Trading