Standard

Online Share Trading

Education newsletter

Issue # 7
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The individual investor should act consistently as an investor and not as a speculator.

This means that he should be able to justify every purchase he makes and each price he pays by impersonal, objective reasoning that satisfies him that he is getting more than his money's worth for his purchase.

Benjamin Graham

JSE Properties Annual Investor Showcase

Gautang residents are invited to attend the first annual JSE Property Companies Showcase.

The showcase will take place on Wednesday 18th of July 2007in Sandton.

Senior executives of JSE listed companies in the Property sector will present their businesses to you. Thereafter you will be able to meet them face to face. If you are interested in Property, this is a great investment opportunity.

- For more information as to who will be presenting, and to book, log onto the website and you'll see the link under the announcements section.

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 (14 July)
- Introduction to investing (21 July)
- A practical guide on how to effectively use the website (24 July)
- The Truths of the Market and Trading Skills (25 July)

Durban

- Introduction to investing (Mid week) (10 July)

Cape Town

- Introduction to investing (Mid week) (11 July)

TALK
From the editor

I heard Tony Twine (senior economist at Econometrix) on the Moneyweb Power Hour last night talking about what effects the petrol price.

He says that a 10c move in the Rand/US$ moves the petrol price by a modest 2.2c. Yet a US$1.00 move in the oil price moves the petrol price by around 7c.

So the bottom line is that our petrol price is a lot more sensitive to the oil price then it is to the Rand/US$ exchange rate.

Either way, the modest 8c decrease today in the petrol price is welcome, albeit it doesn't exactly save a bunch (unless you burn tons of petrol every month).

That all said, enjoy the latest issue of our educational newsletter and as always we encourage comments and suggestions.

All the best
Simon Brown
Head: Education & Training
Online Share Trading

INVESTOR
Don't sweat the small stuff

In tip No.1 (issue # 5), we explained the importance of realizing when your investments are not performing as you expected them to - but remember to expect short-term fluctuations. As a long-term investor, you shouldn't panic when your investments experience short-term movements. When tracking the activities of your investments, you should look at the big picture. Remember to be confident in the quality of your investments rather than nervous about the inevitable volatility of the short term. Also, don't overemphasize the few cents difference you might save from using a limit versus market order.

Granted, active traders will use these day-to-day and even minute-to-minute fluctuations as a way to make gains. But the gains of a long-term investor come from a completely different market movement - the one that occurs over many years - so keep your focus on developing your overall investment philosophy by educating yourself.

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INVESTOR
Rule of 21

A few weeks ago on the Moneyweb Power Hour, Investing 101 segment (Monday evenings at 18H30), Wayne McCurrie gave his theory on market valuation, "the Rule of 21" that indicates if a market is over, under or fairly valued.

It is a wonderfully simple rule; basically, one adds the one year expected forward inflation rate (CPIx) to the one year forward, overall market's, Price Earnings (PE) ratio. If the answer is around 21, then the market is considered to be **fairly valued**. Much higher (above 24) suggests expensive and much lower (below 18) would be cheap.

So, for the local market, we have CPIx at 6.4% and it is expected to be around 5.8% in a year's time. Then the current All Share Index PE is 15.6 (as at 29 June 2007) and if we assume 15% growth over the next twelve months, that reduces the PE by 15% and gives us a forward PE of 13.3.

Add them together and we have 19.1 and hence according to Wayne's Rule of 21, the South African market is around fair value to slightly cheap.

Wanting to dig a little more I decided to use the values as of today (PE of 15.6 and CPIX at 6.4%) and then we come out at 22, not as cheap as the one year forward value, but still not expensive by the Rule of 21.

Finding the data
So the important issue is how do we find these numbers? The PE of the ALSI Index is easy; log onto the website and on the menu go to ➔ key market statistics ➔ list of indices. On this page we give you the PE of all the JSE indices.

Finding the forward CPIx value is a little trickier. How I get the number is by listening to the Reserve Bank Governors (Tito Mboweni) statement every two months at the conclusion of the two day MPC meeting. At this press conference he gives an indication of what CPIx levels the Reserve Bank expects in the year ahead. If you're not able to listen to the press conference it is online at reservebank.co.za and on the menu, go to ➔ Media releases & statements ➔ Monetary policy statements

An easier but less precise method is to check out our Economic Report, Market forecast. This gives the expected CPIx rate for all of 2008, not ideal as we're looking for the mid year level – but an average for the year is a very good next best. To find this report log onto the website and on the menu ➔ buy and sell ideas ➔ economic reports. The last report was published on 18 June and as such remains current.

What now?
Armed with this information, no investor should rush out and buy indiscriminately; the information merely tells one that overall the market is fairly valued – but investors still need to identify stocks that offer value.

Simon Brown

MARKETS
Primary trend phases

The Bull market

Primary uptrends are usually characterised by three phases.

These three phases of the bull market are psychological phases and do not deal directly with price action, although they are often separated by corrections in a bull market.

Phase 1 bull: Major bull markets start from areas of extreme under-evaluation. The first phase begins with the accumulation stage, which represents informed buying by the most astute investors as all the so-called bad economic news has finally been discounted by the market.
The public is completely disgusted with the market, hates stocks and are totally disillusioned. They are now as "down" in stocks as they had once been enamoured with stocks at the height of the bull market. The market is a hated word and the public are mainly out of the market, if not totally out.

Although business is still depressed, far-sighted investors are willing to pick up shares offered by discouraged and distressed sellers and these investors gradually raise their bids as selling diminishes in volume. It is very hard to buy stocks early in a bull market and stay with those early purchases. The market is like an angry rodeo bull and it will try every trick in the book to get you the investor off its back. You have to decide that "it's a bull market and I am going to buy and accumulate stock at these levels and stay with the bull no matter what!" because the bull wants to advance with as few riders on his back as possible.

Phase 2 bull:
The second stage is where most technical trend-followers begin to participate. This takes place as prices begin to advance more rapidly and business news improves. It is during this phase that the "technical" trader normally is able to reap his best harvest of profits. However, it is very difficult and often nerve wrecking to sit through the first and second phases of a bull market, since the bull will try to "buck you out" time after time. You will be sitting through bearish announcements, secondary corrections, adverse news - any of which will tempt you to get out. However, during the third speculative phase of a bull market it gets easier. As the bull market progresses, confidence gradually builds towards the top third of a bull market. Confidence and greed begins to rise exponentially, leading to this stage in the bull market.

Phase 3 bull:
The third and final phase is characterised by increased public participation as newspapers begin to print increasingly bullish stories; economic news is better than ever and speculative volume increases. The market becomes the topic of conversation as prices advance rapidly, tips abound and there is rampant speculation.
However, there is no value and price earnings are at historic highs. The market boils with activity as the public becomes heavily involved and when everybody is finally drawn in, the market reaches its most dangerous levels with an almost total disregard for risk. Greed and confidence explodes. The market is marching to a different drum. This does not mean that one must sell out, but most certainly stop losses should be in place and should become tighter and tighter as the technical trader reaps his best harvest of profits. There is always a backlash over extreme greed and confidence.
The public has been inculcated with "buy on the dip" philosophy and growth as far as the eye can see, for so long, they cannot even envision a major crushing bear market. No new buying should be made during this volatile and dangerous phase.

No one doubts that in the long term, a secular bull market will run to conclusion as expressed in the three phases of the bull market, which can last for many years.

Note
A gold bull market will end like all bull markets - and that is frantic, emotional and explosive action to the upside.

HOWEVER, gold bull markets are different than other bull markets, in that in its third phase, the gold bull market is propelled by FEAR and this is the strongest emotion of all emotions. Whereas in a general stock bull market the third phase is spurred by GREED. Initially gold will rise as the US dollar falls against most currencies.

Then in the second, and most certainly in the third phase of a gold bull market, gold will rise against all currencies as the fear of inflation and loss of value of all currencies propels gold and the whole world begins buying it as an insurance against falling currencies.

Yoniton Rom

- Yoniton runs our technical analysis courses. See details for our technical analysis offering at the end of the Technical analysis reports article.

USING THE WEBSITE
Technical analysis reports

Online Share trading offers a free daily technical analysis report to our clients. You can either find it online or have it emailed to you as it is published.

But firstly, what is technical analysis? Cambridgefx.com defines it is; “analysis based on market action through chart study, volume, trends, moving averages, patterns, formations and many other technical indicators”.

So basically technical analysis looks at the price and volume of shares and anticipates a possible future direction for the share, index, commodity, etc. Importantly it takes no fundamentals into account.

So back to the report; there is a morning report that comes out just before markets open and it covers the Top40 index and large cap stocks. Then a couple of times a week we also produce a mid-day report focusing on mid cap stocks.

Lastly, every Monday the morning report lists all the current recommendations and how they have preformed since being recommended.

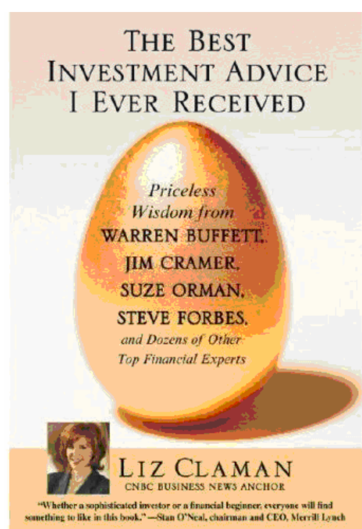
Simon Brown

- You’ll find the report online on the menu at ➔ Buy and sell ideas ➔ tech analysis report.
- If you’d like it emailed to you as it is published send us an email at securities@standardbank.co.za with the subject line "Subscribe Daily Technical Analysis".
- We have an online technical analysis course on the menu at ➔ help and education ➔ Technical analysis.
- We also have face to face classes in major centers. To book, log into Online Share Trading ➔ help and education ➔ face to face classes and look for the Introduction to technical analysis and Advanced/Practical Technical Analysis courses.

REVIEW – Book
The best investment advice I ever received

Liz Claman’s “The best investment advice I ever received”

Liz Claman, a CNBC presenter, should ostensibly have been perfectly placed to author a book titled “The best investment advice I ever received”.. Instead, she asked some 60 people to write a chapter on the best investment advice they had ever received. The book therefore presents a mixed bag, with some excellent advice from well known investors and then some indifferent advice from people we’ve never heard of.



Contributors include some big names but the biggest name, Warren Buffet, produced a disappointing chapter; this was also the only chapter written by Claman herself. However, not all was lost as the chapter contains some telling quotes from the world’s greatest investor.

For me personally the best piece of advice in the book was from Edward J Ludwig (never heard of him) commenting on advice he had received from Peter Lynch: “Don’t invest in anything you don’t understand’. I couldn’t agree more and that includes not understanding the company you're investing in, but equally investing only in products you understand. For instance, don't commit the felony of trading futures when you don't absolutely grasp the product.

Another priceless piece of advice is from Gary Kaminsky illustrates the power of compounding growth. If offered one cent a day doubled every day (1c today, 2c tomorrow, 4c the day after etc.) for a month or alternately R1,000 per day for a month, which would you take. Well the R1,000 per day becomes R30,000 over the one month, which is rather pleasing, but the cent doubling every day becomes an awesome and almost unbelievable +R5,000,000 on day 30 and overall more then R10,000,000 in one month!

The book didn't blow me away and offered little new but it was worth the read for some investing gems and truisms.

Simon Brown

- "Recommended"
- Buy it from Kalahari.net for R243.00 in hardcover (paperback due in December).

JARGON BUSTING
Balance of payments

The combined net position on the capital and current accounts of the country. The current account indicates whether South Africa is spending more foreign currency on imports than it is receiving for its exports, while the capital account shown how much money foreigners are investing in South Africa.

Negative figures are generally bad as it could lead to increased interest rates to try and attract money inflows and/or saving rather then spending by the populace on imported items.

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JARGON BUSTING
Russell 2000 Index

The Russell 2000 Index offers investors access to the small-cap segment of the U.S. equity universe. The Russell 2000 is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set. The Russell 2000 includes the smallest 2000 securities in the Russell 3000.

The weighted-average market capitalization for companies in the Russell 2000 is about US$1billion and the index itself is considered to be the benchmark for all small-cap mutual funds.

- On the web at russell.com

Simon Brown & russell.com

TRADER
Property plus derivatives

Property Plus, the innovative option to leverage into the property loan stocks.

Equity Derivative Securities have been listed on the JSE Securities Exchange for a number of years now, yet they still occupy the trading domain of more sophisticated investors wishing to make use of the varying degrees of gearing they enable to share price movements. A derivative implies exactly what it purports to describe, namely a security with a price that is "derived" from the value of a linked underlying asset. There are active markets in many different types of derivatives, but the underlying theme is always the same. Through trading in derivatives investors are synthetically making use of a bank's balance sheet to attain exposure to shares that they might not have been financially able to with the limited resources available to them. By making markets in equity derivatives, banks lend cash to investors through selling listed options and futures on shares. The investors gear themselves up to subsequent movements in the price of those shares by only having to put up a fraction of the full cost of the actual required investment.

One of the more exciting recent listings are Enhanced Dividend Securities (EDS). EDS are effectively listed deep-in-the-money call options over shares, where the investor pays in a little more than half the value of a particular share and buys the right (but not the obligation) to pay in the other half (the strike price) at or before a prescribed date in the future. The EDS then trades on a 1-for-1 basis with any subsequent share price movements, thus gearing the investor up by a factor of two times the market (he's effectively only paid for half the shares). To hedge itself against price exposure the market maker (a bank) ensures market neutrality by buying the full exposure in the shares (on inception of the trade) and transferring any price risk into the value of the listed EDS. The little bit extra that the investor has paid up front for the first half of the shares is the funding that he is asked to pay on the "loan" of the strike price from the market maker. This funding decays out of the listed value of the EDS on a linear basis over the period of the option, leaving the EDS to trade at exactly the difference between the share price and the strike price on the maturity date (EDS typically last for one year). Importantly, because the bank holds all the shares, it is then able to pass through any dividends to the holder of the EDS, thus bumping up the holder's dividend yield by the same factor of around two times.

Other listed equity-linked products seeing good interest at the moment are Investec's "Property Plus" variable strike warrants over the property loan stock sector. With the rand stabilising following the SARB's recent 50 bps interest rate hike, the rot in the property sector seems to have been stopped, and most pundits agree that extreme longer term value is now evident. Property Plus are options very similar to EDS, with the difference being that instead of actually paying out any distributions to Plus holders (taxable in the hands of investors as classified as interest income and therefore of a revenue nature), the market maker uses those distributions to pay down the strike price that is payable to the bank by the Plus holder. Unlike the EDS, where the funding for the loan of the strike is added to the premium paid for the option, the strike price for the Plus increases over time by the interest factor. The trick is to make sure that the interest distributions paid out by the company outstrip the interest charged on the strike price of the option, thereby engineering the strike price to an ultimate 1c value over time. At this point, the Plus product will trade at a value equal to the underlying share price as the "loan" will have been fully repaid by the company's interest distributions.

Investec currently has over 75 actively traded EDS listed on the JSE (coded as company name "ABC" followed by "IDA, B or C" depending on the most recent tranche – e.g. "AGLIDD"). We also have 5 new Property Plus products covering HYP, GRT, GRY, RDF and SYC (coded as "SYCIVB", the "V" standing for "variable strike option"). Further product information as well as daily product matrices are readily available on our website www.investecwarrants.com.

Richard Swain
Investec Equity Derivatives

ROAD SHOW
Getting started in shares

Online Share Trading is hosting free one and a half hour educational seminars to the public. The seminars are designed to get you started on how to invest in shares and are open to the general public.

By attending one of the seminars, you will learn:

- Investing and returns
- Why invest in the share market
- How to develop an investment strategy
- Understanding the share market
- What determines the share price
- How to make money in the market
- How to choose companies to invest in
- How do you buy shares
- Next steps

Tell your friends and help them get started on the path to creating wealth.

Dates & cities

- Johannesburg – 04 July
- Pretoria – 11 July
- Durban – 12 July
- Cape Town – 17 July
- Johannesburg – 26 July

To book send us an email to seminars@standardbank.co.za telling us which city/date you wish to attend and please include your name and contact details. All venues are central and start at 6.00pm.