Standard

Online Share Trading

Education newsletter

Issue two
16 April 2007

"You need to understand value more than price.

Just because the price of something goes up doesn't necessarily mean the value has gone up."

Robert Kiyosaki
Author of Rich Dad Poor Dad

Free Single Stock Futures road show – open to all

Learn about the exciting world of SSF's from the market leader.

We're hosting an open seminar on the 24th April 2007 in Johannesburg.

To reserve yourself a seat, email us on seminars@standardbank.co.za requesting a seat for the SSF course and please include your name and contact details.

The venue is central and we start at 6.00pm.

Client Courses
These courses are exclusively for Online Share Trading clients and are mostly free. To book for one of these courses log onto Online Share Trading and go to; Help & Education ➔ Face to face classes

Johannesburg
- Understanding Share Instalments (17 Apr)
- Basics of Single Stock Futures explained (18 Apr)
- Half day detailed warrants course (21 Apr)

Cape Town
- A practical guide on how to effectively use the website (24 Apr)
- The Truths of the Market and Trading Skills (25 Apr)

Durban
- Introduction to Fundamental Investing (18 Apr)
- Introduction to technical analysis (21 Apr @ R350)

TALK
From the editor

Issue number two of our newsletter and a big thanks for all the feedback we got after issue one.

This issue sees us growing with new content. A new section on economics and an enlarged review section (we're also going to look at books and podcasts), (for those not sure what a podcast is, we cover that in the review). What we will be doing is rotating content within the section, so this issue has a review of a podcast as well as a book review, the next issue will review a website and a book, and so on.

Once again please send us any feedback, comments and question.

All the best
Simon Pateman Brown
simon.brown@standardbank.co.za
Head of Education - Online Share Trading

INVESTOR
Using PE ratios

Investing is all about numbers; crunching the numbers from the financial statements, watching the share price numbers, working out how many to buy and at what price (another number).

While this is all well and good, numbers in isolation are of no use to us. We actually need to focus on the relationships between the numbers for them to have any value. Now if your head is already starting to swim with the idea of having to dust off your old school math books – worry not, all the ratios you ever likely to need for investing can be found on the Online Share Trading website. So rather then crunching the math yourself, all you've got to do is know where to find them and more importantly what they mean.

So to start with the most popular, and most widely used ratio, the PE ratio. Broken down it stands for Price Earnings ratio, a nice easy name that helps explain what it means. Simply the PE ratio is the share price divided by the annual earnings (earnings per share or EPS).

But before we go further we need to figure out what we mean by EPS. EPS is the total amount that each, and every, share a company has issued earned during the last reporting period. Crucially after all costs have been taken into account. So in its purest form, EPS is all income less all expenses divided by the number of shares.

Taking EPS a step further, as a share holder this is what your slice of the company (your shares) earned for you during the period. However only part of these earnings flow directly to yourself in the form of a dividend (if any is declared). The balance of the earnings accrue to you indirectly in that the company retains them and uses them to grow the business, buy out competitors, upgrade equipment, pay off debt etc. and this increase the value of your stake in the company.

Below is a nice and clear example;

	Company A	Company B
Income	R5million	R12million
Expenses	R4million	R8million
Profit (earnings)	R1million	R4million
# shares	1million	2million
EPS	**100c**	**200c**

So Company A earned 100c per share and Company B earned 200c per share, on the surface company B looks like the better bet. But this is not always the case and this is where the PE ratio comes in because looking at EPS in isolation doesn't tell us the whole picture, the question we need to ask is what price does one pay for those earnings?

AHA you say, this is all starting to make sense.

So the PE ratio is the share price divided by the EPS and what it tells you is how "expensive" a share is by informing you how many years of earnings you're paying to buy the company.

So to continue the above example

	Company A	Company B
EPS	100c	200c
Share price	950c	4400c
PE ratio	**9.5**	**22**

Suddenly the PE exposes Company B as more expensive even considering that it has double the earnings of Company A. The reason why Company B is considered more expensive is because the PE ratio essentially tells us how many years of earnings it will take for those earning to equal the price paid for the stock and as such paid for those earnings (if all earnings were paid out).

So while Company B earns more per share, the higher price paid for those earning makes Company A the "cheaper" option. Put another way Company A will take only 9.5 years for it to pay for itself while company B will take 22 years.

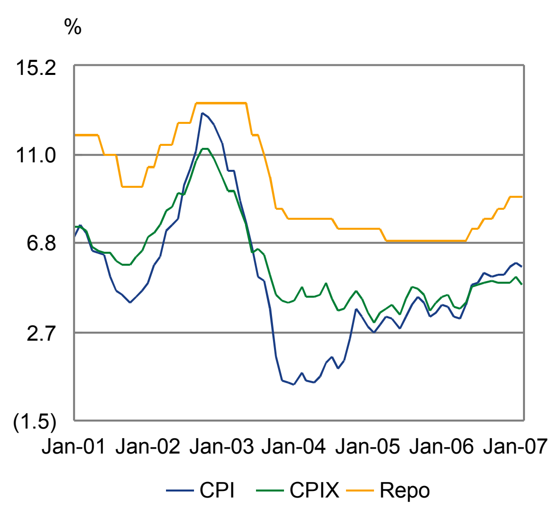
Now some caveats around PE ratios.

- Firstly it is important to compare PE ratios of companies in the same sector, so one can't compare a banks PE with a old miners PE as they are two totally different business's with different risks and as such a different pay off.
- Secondly, while a falling PE may seem like a great buying opportunity check that it isn't as a result of a falling share price that could be a warning that the market expects EPS to drop (this will push the PE back up again).
- Thirdly, high PE's are not always bad as they can indicate a growth stock that is under going a huge growth spurt. In other words owners of the stock are prepared to forgo earnings (and dividends) in favour of growth that will ultimately lead to better earnings and/or dividends. That said income investors would certainly shy away from high PE's looking rather for a high dividend yield.
- A fourth point is that extreme PE's must be treated as a warning. An example would be Amazon.com that was trading up at around US$100 per share in 2000 with no earnings and a PE of more then 1,000. Seven years later the share price is around US$42 and the PE at a still high 62. Certainly the massive PE of the 2000's should have warned investors of the dangers

The last step is where to find the PE ratio on the website and we cover that in the "getting to know the website" section on page 8 of this newsletter.

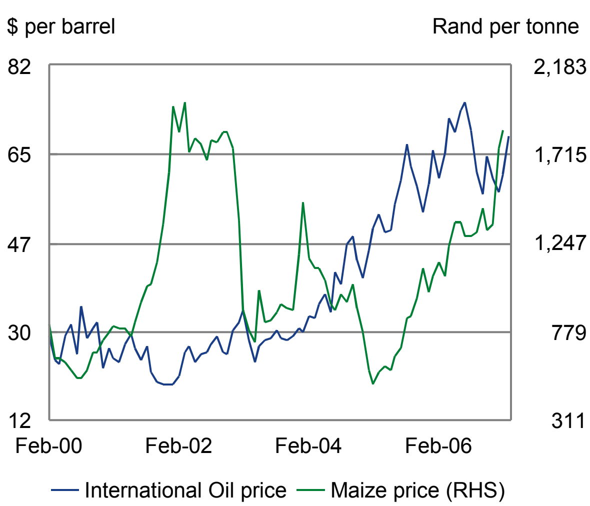
ECONOMICS
What's the MPC?

The South African Reserve Bank (SARB) has three key functions within the economy: formulating and implementing monetary policy; managing government's bank account; and ensuring financial stability. The Monetary Policy Committee (MPC), the monetary decision making body in the SARB, meets every second month to review the country's inflation situation and decide on what the appropriate policy stance should be. The MPC is made up of eight members: the Governor Tito Mboweni, three Deputy Governors and four senior Reserve Bank officials.



In 2000, South Africa adopted an inflation targeting regime in the hope of achieving long term price stability in the economy. A consumer price index (CPI) is an index of the price of a basket of goods and services, while the inflation rate is the annual percentage change in that index. South Africa has a targeted inflation range of 3% - 6% for a CPIX basket, which is CPI excluding mortgage rates. The SARB achieves its price stability mandate by manipulating its official lending rate (repo rate) to commercial banks; through increasing (decreasing) the repo rate, the cost of home loans and vehicle finance increases (decreases), leaving the consumer with less (more) income to spend on other goods.

In 2006, the SARB increased the repo rate four times to 200 basis points (or 2%) due to fears that inflation would be above the target range. Although the SARB acknowledged at the April MPC meeting that the country's inflation outlook has deteriorated since the February meeting, the bank decided to leave the repo rate unchanged at 9% for the second consecutive meeting, due to the recovery of the rand, reduced inflation expectations and reduced demand for durable goods. In the run-up to the June MPC meeting, the SARB will be watching the international oil price, maize prices as well as the demand for consumer credit to determine the next move in interest rates.



Standard Bank does not expect the SARB to hike rates later this year, and remains confident that the next move in interest rates will be down.

Michael Keenan

Consumer Confidence Index

Tuesday last week saw the release of this index at what was a record number. The level of +25 was the highest of the twenty five years that this index has been computed with the previous high being +22 during Q1 of 2006.

So what's this Consumer Confidence Index and more importantly what is it really measuring?

To start with what the index means. In short it measures the economic optimism (or lack of) of consumers and a very positive results like this latest result indicate that even more consumers expect the economy and their personal finances to improve still further.

Now I suppose we have to ask what use it is asking mere consumers these questions when surely we should leave it up to the bright economists of our country. Well the quote below is from the press release and that answers that question perfectly.

"(G)oing by historical precedence, consumers have an excellent track record of predicting the economic cycle.

What households are telling us is that this economic expansion, although nearly eight years old, has hardly run out of breath. Looking at fixed investment prospects and beyond it at net exports, with their solid support for employment growth, and with asset markets remaining on a roll, there is reason for enhanced confidence."

Turning to the methodology, it is actually very simple, 2500 urban South Africans are asked three simple questions;

- Do you expect South Africa's economic performance to deteriorate, remain the same or improve during the next twelve months?

- Do you expect the financial position of your household to deteriorate, remain the same or improve during the next twelve months?
- Do you think the present is the right, neither right nor wrong or the wrong time for people in general to buy durable goods, such a stove, refrigerator, washing machine of furniture?

The index value is then the average of the net balance of the three questions. Put in simple English; the percentage of respondents expecting things to improve or good time to buy less those expecting things to deteriorate or a bad buying time.

On the web http://www.ber.sun.ac.za/

TRADER
Warrants, a starters guide

As a starting point for our equity derivative column let's begin with a refresher on warrants definitions.

What is a warrant?
A warrant is a financial instrument that will pay out an amount of cash (or underlying) at a specified date in the future if the underlying on which it is based (most often a share or an index) is above (in the case of calls) or below (in the case of puts) a predetermined price (that is known as the strike or exercise price).

Before entering a warrant trade it is important to understand the specific terms and conditions of the warrant.

These are set before a warrant is issued and can only change as the result of a corporate action (such as a share split).

Basics of call and put warrants
Standard Bank warrants provide a simple, low cost way to gain exposure to shares listed on the JSE LTD. The two basic types of warrants are "call warrants" and "put warrants". Call warrants allow investors to profit when share price rises. Put warrants allow investors to profit when share price falls.

Call warrants
A call warrant gives the holder the right, but not the obligation, to buy the underlying share for a fixed price known as the "exercise price" at a future date. Taking up this right is known as "exercising the warrant". However, call warrants can be traded without the need to exercise the underlying share, thereby making them ideal as short-term trading instruments.

Put warrants
A put warrant gives the holder the right, but not the obligation, to sell the underlying share to the warrant issuer for the exercise price at a future date.

Strike (exercise) price
The strike price is the level at which underlying security (for example Anglo American PLC) needs to be above (for calls) and below (for puts) in order for the warrant to have a positive value at expiry. This price is set at the outset by the issuer and cannot change (except in the case of a corporate event, for example a share split).

Expiry date
Both call and put warrants have an "expiry date". An "American style" warrant can be exercised at any time up to and including the expiry date. A "European-style" warrant can be exercised only on the expiry date. The terms of issue of a particular warrant will specify the style of exercise.

Conversion ratio
The number of warrants that you need to exercise in order to gain exposure to one unit of the underlying.

By Brett Duncan
Head of Retail Derivatives – Standard Bank

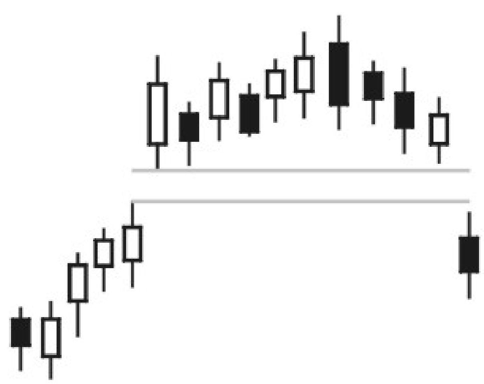
Charts, Island Short-term Pattern

Island Bottom Short-term Pattern
An Island Bottom is a bullish signal indicating a possible reversal of the current downtrend to a new uptrend. This pattern is an indication of

a financial instrument's SHORT-TERM outlook.

The Island Bottom occurs when the price "gaps" below a specific price range for a number of days and then is confirmed when the price "gaps" above the original range.

Island Top Short-term Pattern
An Island Top is a bearish signal indicating a possible reversal of the current uptrend to a new downtrend. This pattern is an indication of a financial instrument's SHORT-TERM outlook.



The Island Top occurs when the price "gaps" above a specific price range for a number of days and then is confirmed when the price "gaps" down below to the original range.

Statistics—Bottoms
Percent of successful formations – 85%
Average rise of successful formations – 34%
Likely decline – 20% Failure rate - 17%
Average time to throwback completion – 9 days

Statistics—Tops
Percent of successful formations – 77%
Average decline of successful formations – 21% Likely decline – 10% Failure rate - 13%
Average time to throwback completion –8 days.

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www.trending123.com/patterns/island_reversal.htm

REVIEW
Podcast – FinWeek

This being our first podcast review we're first going to cover what a podcast is. basically it is downloading audio files off the internet so that you can listen to them in your won time, either listening on your PC or from a portable MP3 player such as an iPod. So it is like listening to your favourite radio show, but when you want to listen – not when they schedule the program.

Further the vast majority of podcasts are free but as this is still a relatively new concept finding them isn't always easy, albeit you'll be surprised at just how much content is out there. The real power comes in using an aggregator (RSS feed) such as iTunes that automatically collects and downloads those podcast that you're interested in so you never miss an episode while not having to lift a finger.

Problems with podcasts in SA is the size of the files that often pass 10mb with some being more then 100mb, so a decent broadband connection is required for downloading. The other problem is lack of MP3 players.

For more info visit more info at ipodder.org or itunes.com with the latter being the best (free) software for managing your podcast downloads.

So onto the FinWeek podcast. This is a relatively new feature from the Media24 stable and so far so good. What they do each week is carry out an interview with the journalist(s) who wrote the cover story of the main cover story. So what we're getting is a little more depth into the week's cover story and it doesn't require you to have read the original article.

Personally I would like to see them expand their coverage to other issues carried in that weeks issue and also more depth in the interview with the journalist. However I get the feeling that they are keeping it light due to concern about losing readers as we could just listen to the podcast. But in truth Finweek should make them compatible and compelling thus increasing rather then reducing both readers and listeners.

My final verdict is that the FinWeek podcast is enjoyable and worth the download. Running time is generally around 7 minutes and file size around 4mb).

More info at
http://www.fin24.co.za/PodCast/display_article.aspx

Book - Trend Following By Michael W. Covel

Covel has made it his mission to increase the exposure of trend following as a trading methodology and I have to declare my bias in that I am a trend trader and as such applaud his mission.

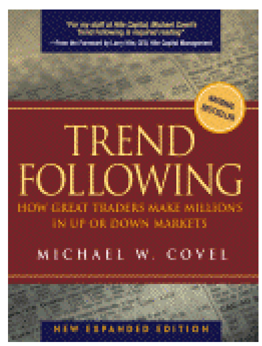
Trend following is basically the idea that when a trend is established all the astute trader needs to do is hope on the bus for superior returns. It is considered a low risk and potentially very high reward trading methodology (considering the recent trend of the Top 40 has returned a couple of hundred percent over the last 4 years).

Of course the trick is defining the trend with moving averages generally considered to be the easiest route.

The book is very much in the tradition of Jack Schwager's Market Wizards. Like Schwager, Covel interviewed a number of great traders and attempted to capture the essence of each trader's approach to trading and as with Market Wizards he succeeds hugely.

It is a very readable and engaging book and Covel really lays out the process of trend following adding lots of examples and backing up his claims with well documented research.

So what are the draw backs of this book? Well in truth a stupid marketing department that added the following comment on the front cover "Covel walks you through the process, one step at a time, in plain English.". This statement is not correct in that the expectation created is that he'll present an end-to-end trend following trading systems - and he doesn't.



That said this does not detract from the book if you bought it for the right reasons - that being wanting to learn about the idea's, concepts and methodologies that feed into trend following. If you're buying the book to be handed a trading system on a plate – this is the wrong book for you. This book aims (and to my mind succeeds) in presenting and proving the case for trend following and presenting some basic tools - then leaving the system design up to the individual.

The author also has a website at
www.michaelcovel.com

HIGHLY RECOMMENDED and available from www.kalahari.net for R185.95 in soft cover.

WEBSITE
Finding PE ratios

In the feature article of this issue we looked at PE ratios and now we'll look at how to find them on the Online Share trading website.

Firstly finding the PE of a share. You need to get yourself to the quote page for the share you're interested in and there are a couple of ways of managing this. If you know the short code then enter it in the top left box and select "live price". If you don't know the short code go to "Find or trade shares ➔ Find or trade a share" and enter the shares name. This will take you to a page showing the share and here you click on "quote" under the action column.

Now that you're on the share quote page scroll down almost to the bottom and you'll see the following.

You'll note that we also include the earnings yield, PE and dividend yield for all the indices (if any) that the share is in.

Share/Index statistics			
Share/Index	Dividend Yield	Earnings Yield	PE
RCH	1.31%	4.34%	23.04
ALSI EX RESI	2.38%	6.47%	15.46
ALL SHARE	2.27%	6.38%	15.67
ALLSINDUST	1.87%	5.92%	16.89
C CONS GOODS	1.85%	5.01%	19.96
FIN AND INDUS	2.13%	6.39%	15.65
INDUSTRIAL 25	1.76%	5.73%	17.45
TOP 40	2.13%	6.36%	15.72

Just below this you'll see the following selection. This gives forward PE ratios (as well as Dividend Per Share (DPS) and EPS) based on the current share price and the forward projected earnings and dividends as produced by INet.

While here on go back to the top and under "Information, tools and links" click on "Company Profile (P)" and on the far right about half way down you'll see a link "Ratio Analysis". Clicking on this will take you to historic ratios including the PE. Here we have final and interim levels and data going back to 1991 (if the share has been listed that long).

As at: 30 Mar 2007	31 Mar 2007	31 Mar 2008	31 Mar 2009
DPS cents	70.0	81.0	94.0
EPS cents	216.0	262.0	297.0
PE	18.70	15.42	13.60
Earnings Yield %	5.35	6.49	7.35
Dividend Yield %	1.73	2.00	2.33

Note: This is what the analysts of the broking community as a whole recommend for this share. This data is collected every week, averaged and redistributed by INET.

If you're looking for the PE ratio of an index you can use the first step as illustrated here. Alternatively go to "Key market statistics ➔ List of indices". This will list all JSE indices and their PE ratios are listed under the stats column.

You will have noticed while hunting out the PE ratio you also kept coming across EPS as discussed in the feature article and dividend yields, the latter we will tackle in another issue.

Free road shows

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

- Cape Town – 18 April
- Durban - 19 April
- Johannesburg – 25 April
- Johannesburg – 03 May
- Durban – 10 May

To book or for more information send us an email to seminars@standardbank.co.za telling us which venue/date and please include your name and contact details. All venues are central and start at 6.00pm.