Standard

Online Share Trading

Education newsletter

Issue # 8
17th July 2007

Only buy something that you'd be perfectly happy to hold if the market shut down for 10 years.

Warren Buffett

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 –26 July
- Pretoria – 02 August
- Johannesburg – 07 August
- Durban – 16 August
- Johannesburg – 23 August

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.

Client courses for the next few 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 investing (21 July)
- A practical guide on how to effectively use the website (24 July)
- AltX investor Showcase - Meet the CEO's (25 July)
- The Truths of the Market and Trading Skills (25 July)

Cape Town

- Introduction to investing (18 August)

TALK
From the editor

As I write this the All Share Index has been trading just below the 30,000 level after breaching it a few times on Friday (the 13th!).

The significance of this (aside from the magic of round numbers) is the very impressive return that our local market has returned year-to-date. The All Share Index started 2007 at 24,915, so now at just below 30,000 the six month return has been 20.4%! Adding to this is that 20,000 was only breached in March 2006 while 10,000 was breached for the first time in December 2001! Amazing!

I want to comment on an article from the last edition of this newsletter, the "Rule of 21" article. A number of readers used the rule on an individual stocks and got some seriously wild results. BUT the bottom line is that this "Rule of 21" works on the stock market as a whole – not individual stocks. Having determined if a market is offering value you then hunt out preferred investments.

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

ECONOMICS
Purchasing managers Index (PMI)

What is it?
The Purchasing Managers Index (PMI) is derived from a survey of purchasing managers in the manufacturing industry and, along with production data, provides us with an indication of economic activity in the manufacturing sector. Unlike manufacturing production, which is lagged by two months, PMI is released on the first working day after the survey month, and therefore acts as a leading indicator for economic activity in the manufacturing sector.

How is it calculated?
Purchasing managers are surveyed monthly to comment on whether business conditions in nine manufacturing sub-sectors have improved, remained constant, or deteriorated. Each response is processed into an index and the PMI is collated by summing the weighted responses of five sub-indices. The nine questions for comment are as follows; the first five are used in calculating PMI, with their weights in brackets:

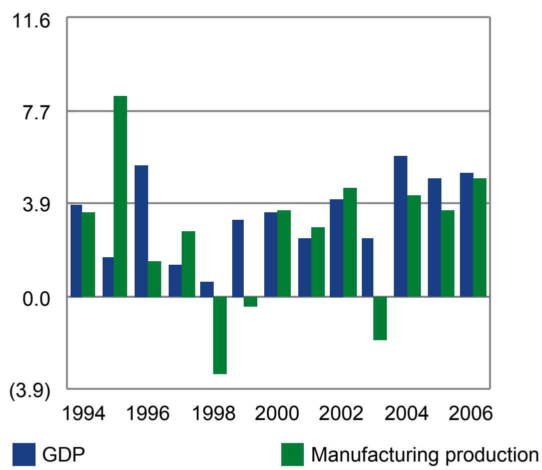
- ***New sales orders (0.3)***: The level of new sales, or requests for products, received within a month, whether fulfilled or not;
- ***Business activity (0.25):*** The level of production output in that month measured either by production volumes, person-hours, sales volumes or any other non-monetary measure;
- ***Employment (0.2):*** The level of overall employment including temporary and contractual workers;
- ***Supplier deliveries (0.15):*** Measures how readily available inputs for running the business are relative to the previous month;
- ***Inventories (0.1):*** The level of materials and goods used in normal business activity and yet to be included in production or to be sold as a finished product;
- ***Backlog of sales orders:*** The level of sales orders that have been received but not yet fulfilled;
- ***Purchasing commitments:*** An undertaking to purchase inputs for the production process;
- ***Prices:*** The change in the price paid for goods and services purchased for conducting business; and
- ***Expected business conditions:*** Expectations of current and future business conditions.

What does it mean?
An increase in new sales orders and business activity may increase PMI more than an increase in employment and supplier deliveries because of the weights. Given the methodology employed, PMI can range between 0 and 100, where zero signifies a recession in the manufacturing sector and one-hundred a booming industry. Fifty is the critical level in the index, where a value below is indicative of deteriorating conditions in the manufacturing sector, and a value above, of buoyant economic activity (Figure 2, over page).

Why does PMI matter?
Manufacturing makes up 16% of South Africa's Gross Domestic Product (GDP), the second-largest industry in the economy, and its performance acts as a leading indicator of activity in the broader economy. Thus, if the manufacturing sector experiences protracted growth, it is highly likely that the broader economy will contract (Figure 1, over page). In addition to overall PMI, the prices component provides key insight into pipeline consumer inflationary pressures. As discussed in the May newsletter on CPI, producers pass higher input costs onto

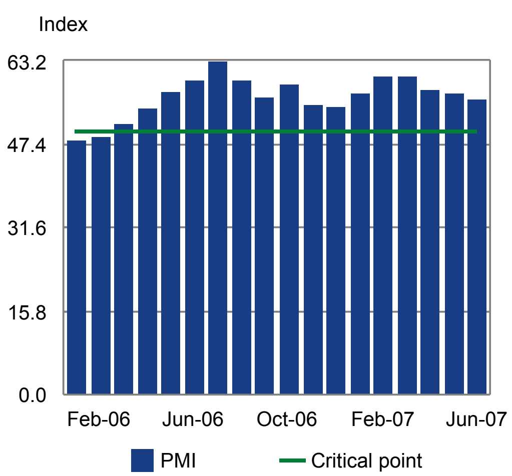
consumers, thus fuelling CPI. Higher consumer inflation, in turn, has consequences for monetary policy (see April newsletter). Therefore, PMI data give us an indication of how well the economy is likely to perform and, along with PPI, of future consumer inflationary pressures.

Figure 1: Manufacturing production and GDP



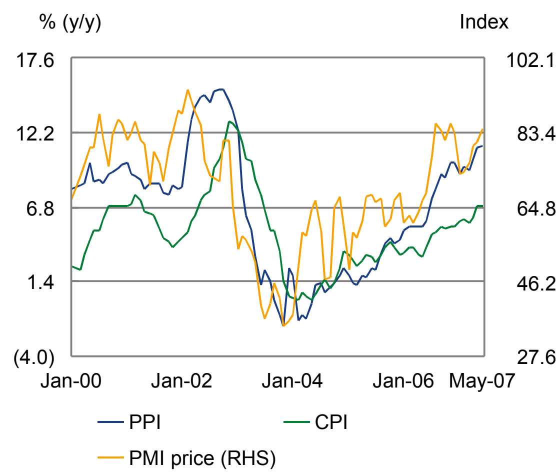
well as domestic and global monetary tightening have resulted in PMI printing softer over the past three months (Figure 2). June's PMI reading declined to 56.0, driven by moderation across the board but mainly by a deceleration in business activity and inventories. New sales orders moderated on the back of rand strength in May and June, resulting in a decline in the backlog of sales orders as production capacity freed up. Surprisingly, employment increased.

Figure 2: PMI



The price component continued its upward trend on the back of a reacceleration in the international price of oil, as well as buoyant commodity prices. The persistent increase in the price component of PMI indicates that there are higher pipeline inflationary pressures for consumers, which creates concerns of further monetary tightening in the coming months (Figure 3). Standard Bank is of the view that the SARB will hike interest rates by yet another 50 bps at the August MPC meeting.

Figure 3: PMI price component and inflation indicators



Purchasing managers' expectations appear to have softened, partially influenced by the June 50 bps interest rates hike, as evidenced by moderating inventories, purchasing commitments and general business climate expectations data in June.

Although PMI is moderating, all the components remain above the critical 50 level, indicating that the industry is still growing, just slower. In light of PMI moderating in the last three months, it is interesting to note that manufacturing production data surprisingly rebounded significantly to the upside in May (Actual: 6.6% y/y; Expected: 3.4% y/y; Previous: 3.8% y/y) after pointing to a moderation in growth since March. June's PMI data indicates that this buoyant manufacturing data many just be a temporary blip and that the sector may contract moderately over the medium term. The next PMI data will be released on August 1, 2007 on the Bureau of Economic Research website (ber.sun.ac.za).

Ayanda Olifant
Analyst
Standard Bank CIB: Global Markets Research

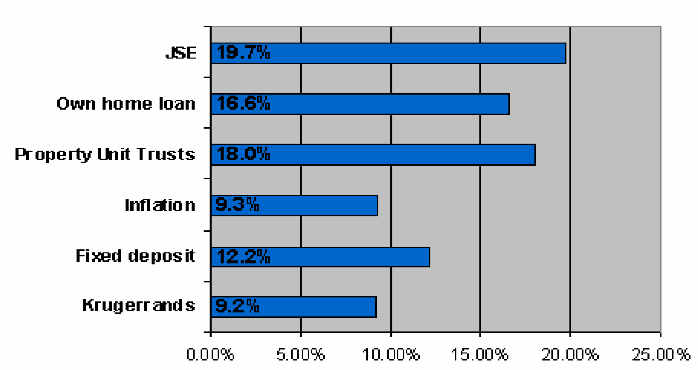
INVESTOR
Why invest in the stock market?

It's a good question and the answer is often something along the lines of: *Because we want to be rich*. Well sure, but are we investing in the right place to create wealth?

The graphic above covers a twenty-year period of the average annual JSE return. Importantly, the period 1985 – 2005 covers;

- The end of the 80's Bull Run;
- The crash of 1987;
- Emerging market crisis of 1998;
- Dot.com boom of late 90's;
- The bear market of 2002-2003; and
- The first half of the current bull market.

This twenty-year period covers the entire range of market conditions and gives us a fair reflection of market returns.



20-year annual average return 1985-2005
(Source - JP Morgan)

What clearly stands out is that over the long term the stock market outperforms all other asset classes – and this is why we choose to invest in the stock market rather than in granny's jam business.

But before the gold bugs and/or residential property owners shoot me down, yes there have been periods when other asset classes out perform the stock market. Heck, during the bear market of 2002-2003, cash in the bank produced better returns than the stock market.

But the point is that over the long term (20 years), stock markets outperform other asset classes. During shorter periods different asset classes may have their day in the sun (residential property 2002-2005, gold 2002-2006 and so on), but stock markets win in the long run.

Another important feature we need to take into account is the inflation rate over this twenty-year period. Inflation averages 9.3% and the market returned 19.7% – 2.1 times ahead of inflation. So if inflation were to drop in the next twenty years and average, say 5%, we should expect the market return over the next twenty years to also drop to around 11% per year compounded.

In conclusion; stocks markets, as a whole, outperform other asset classes over the long term.

Simon Brown

INVESTOR
Don't overemphasize the P/E ratio

Investors often place too much importance on the P/E ratio. Because it is one key tool among many, using only this ratio to make buy or sell decisions is dangerous and ill-advised. The P/E ratio must be interpreted within a context, and it should be used in conjunction with other analytical processes. So, a low P/E ratio doesn't necessarily mean a security is undervalued, nor does a high P/E ratio necessarily mean a company is overvalued.

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JARGON BUSTING
What is the PE Ratio?

The market price of a share divided by its earnings. It expresses the number of years' earnings (at the current rate) which a buyer is prepared to pay for a share.

If the earnings per share are 10 cents and the price 100 cents, then the price earnings ration is 10:1. The ratio is, in fact, the reciprocal/inverse of the earnings yield. This ratio is also referred to as the PE ratio, the P/E ratio and the multiple.

Online Share Trading

- On the web – we covered the PE ratio in detail in issue 2 on the educational newsletter. To find it log onto the website and on the menu ➔ help and education ➔ educational newsletter and download/open issue 2.

USING THE WEBSITE
Finding PE Ratios

On our website, we quote the current price:earnings (PE) ratio for all listed stocks as well as their historic PE going back to 1991 (assuming the company was listed back then). We also quote the PE ratio going forward (*I-Net* consensus) and the PE ratio for all indices.

Share PE – current
On the quotes page of any listed share, we list the current PE ratio as well as the PE ratio of all indices in which the stock is represented.

The example for Standard Bank (take from the website) is below.

Share/Index statistics			
Share/Index	Dividend Yield	Earnings Yield	PE
SBK	2.96%	7.74%	12.92
ALSI EX RESI	2.45%	6.4%	15.62
ALL SHARE	2.19%	5.99%	16.69
BANKS	3.17%	7.71%	12.97
FINANCIALS	3.53%	7.58%	13.19
FINANCIAL 15	3.38%	7.49%	13.35
FIN AND INDUS	2.21%	6.28%	15.92
TOP 40	2.04%	5.92%	16.89

Share PE – forward
Just below the image on the shares quotes page, we offer the *I-Net* consensus forecast for companies' PE going three years forward. However, a few issues about this feature. Firstly, this is the forward PE ratio using the current share price. In other words, we use the analysis's consensus divided into the current price, hence the forward PE assumes *earnings growth* but *a static share price*.

Secondly, one needs to understand what *I-Net* consensus is. *I-Net* is an independent company that calculates an average from brokers' analysis's on companies' future expectations; I-Net then distributes the average.

As at: 6 Jul 2007	31 Dec 2007	31 Dec 2008	31 Dec 2009
DPS cents	376.1	444.0	522.0
EPS cents	929.6	1,094.8	1,289.1
PE	10.92	9.27	7.87
Earnings Yield %	9.16	10.79	12.70
Dividend Yield %	3.71	4.37	5.14
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.			

Share PE – historic
From the quotes page as above, on the top right on the screen – click on Company Profile (P) and then on this page, check on the right-hand navigation menu scrolling down to Ratio Analysis. This page gives you the PE ratio for every listed company at interim and final results stage for every period going back to 1991 (if listed back then).

Index PE – current
On the website menu ➔ Key market statistics ➔ list of indices. Here you will find all the different JSE indices and next to each index we list today's price action and then the three key ratios for each index; dividend yield (DY), Earnings Yield (EY) and Price Earnings Ratio (PE ratio).

You can also click on the code under the heading Index Shares and this will give you the complete list of all stocks making up the index.

Simon Brown

REVIEW – website
CANSLIM.net

I stumbled across this website (canslim.net) while looking for alternative long-term investment strategies; CANSLIM perfectly fitted the bill. While I haven't yet applied the strategy locally, I certainly like the concept, and see no reason why South African investors couldn't apply it, or at least adapt it, to their current strategy.

CANSLIM is a formula created by William J. O'Neil, the founder of *Investor's Business Daily* and author of *How to Make Money in Stocks - A Winning System in Good Times or Bad.*

CANSLIM is an anagram; the seven letters of the word make up the investment strategy:

- C = Current quarterly earnings per share.
- A = Annual earnings per share.
- N = New product/management/price high.
- S = Supply/Demand: Small Cap + Volume
- L = Leader
- I = Institutional Sponsorship
- M = Market Direction

Whilst neither new nor inventive, CANSLIM is a solid enough methodology for selecting profitable stocks. The website covers the CANSLIM investment concept in detail.

Much of the website is also about selling products around the CANSLIM concept and searching for US stocks that meet the CANSLIM requirements and this won't be of much use to local investors. But this in no way detracts from the over strategy concept and as such is highly recommended.

Simon Brown

REVIEW – Podcast Trade interviews

Trader Interviews, conversations with top traders – podcast - traderinterviews.com

This is a great podcasting website, in fact, one of the best for traders. It features a weekly, half hour, interview with a different trader each week as they discuss how they trade, what they use to trade, the time frames, types of charts and so on.

The traders interviewed trade everything; from stocks, to futures, to soft and hard commodities, and everything in-between. One week intra-day swing traders are interviewed and the next a trend-based trader who considers a ten-week trade to be short term. Basically anybody can be interviewed, the only criteria is that they are a trader and even more importantly – that they are successful.
But as always what's really interesting is not what they trade, but how they trade it as the actually asset being traded is never really the issue, rather it is how one designs the trading system.

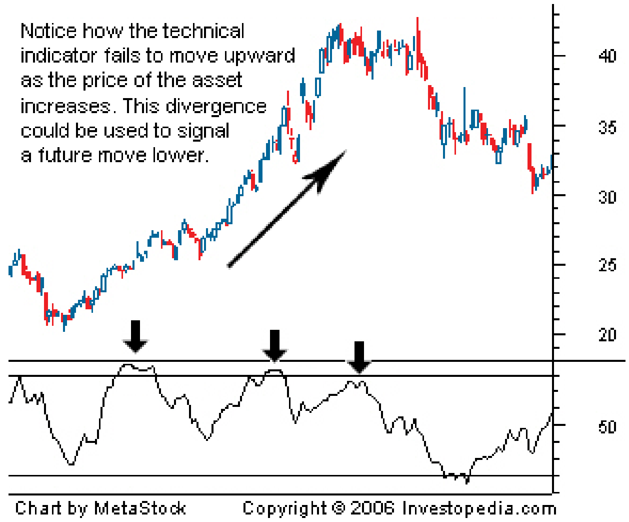
So bottom line, this site has something for every trader and it is must listen for those wanting to improve their trading.

Find it at traderinterviews.com

Simon Brown

TRADER Divergence

A situation in which the price of an asset and an indicator, index or other related asset move in opposite directions. In technical analysis traders make transaction decisions by identifying situations of divergence, where the price of a stock and a set of relevant indicators, such as the money flow index (MFI), are moving in opposite directions.



In technical analysis, divergence is considered either positive or negative, both of which are signals of major shifts in the direction of the price. Positive divergence occurs when the price of a security makes a new low while the indicator starts to climb upward. Negative divergence happens when the price of the security makes a new high, but the indicator fails to do the same and instead closes lower than the previous high.

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➔ On the web

- We offer face to face classes in Technical analysis as well as an online training feature.
    - On the menu ➔ help and education ➔ face to face classes OR Technical analysis.
- We also have a daily technical analysis report we send out and load onto the website. On the menu ➔ buy and sell ideas ➔ technical analysis reports.