Galileo Quarterly Newsletter

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GENERAL NEWS

IS SOUTH AFRICA THE NEXT ZIMBABWE?

We are all bombarded daily with the horrific news coming from Zimbabwe and the obvious failure of Thabo Mbeki's "Quiet Diplomacy" policy on Mad Bob. As advisors, we are often asked whether SA is the next Zimbabwe. We recently came across some interesting research from JP Landman who is the political analyst for BOE. As we have seen in the past these political commentators are often wrong when providing insights into the political situation in SA and therefore we tend to be sceptical of any information we receive from them. This research captured our interest because it used some economic measures to analyse where we are at present and (perhaps) where we are going. We have summarised JP Landman's main argument in the paragraphs below.

Why is the national mood so glum?
Three main factors are driving the national state of depression: politics, economic headwinds and Eskom. Landman argues that Eskom is the straw that finally broke the camel's back as it raised "all the subliminal fears that (whites) have about (black) governance. He goes on to say that SA had a similar crises in the mid-1970's when the whole country was without power for 18 hours and Eskom had to increase tariffs by 75% to fix the problem.

Can Eskom be fixed?
Yes, the Eskom crisis was caused by a lack of investment and maintenance. This is no longer the case; last year Government invested R17.7 billion and will invest a further R46 billion this year in Eskom. By 2012 it will have invested a total of R360 billion on Eskom which should alleviate the long term issues with Eskom. But there will be four years of interruptions until 2012. This is happening all over the economy with Transnet and the roads being the other major beneficiaries. "In total SA invests 7% of GDP and spends 4.6% on social security" That means we invest more in the economy than we spend, especially as private enterprise invests more than double what Government invests.

Are we the next Zimbabwe?
His answer is definitely “no” and he uses a measure called “per capita income” as a justification. Per capita income measures the average income per person in South Africa. He argues that this has risen by 26% in the 14 years since democracy in SA and if our economy only grows at 4% p.a. for the next 7 years, per capita income will rise by another 26%. He contrasts this with Zimbabwe where per capita income has been declining every year since 1999. He argues that whenever per capita income declines consistently you see major political and economic unrest in a country. During the “golden days” in Zimbabwe after Mugabe came into power they invested heavily in education and health with money that they did not have. This resulted in 10 great years of political stability and peace. However the overspending came home to roost as the economy started to slow and people started earning less every year. There was no opportunity for civil debate to raise concerns about the economic troubles that have subsequently crippled the country.

In SA the government started with extreme fiscal discipline for the first 12 years of democracy. Very little was invested in infrastructure until the country achieved economic stability however, the country has stepped up investments in infrastructure dramatically over the last 3 years. The benefit of this strategy is that the country can afford the massive investments that are now being made and we are seeing the positive spin offs of this in the rising average income of the average South African. This is vital because it means the average population are able to spend increasing amounts on goods and services on a sustainable basis, which is extremely positive for sustained economic growth.

There will be short term pain and continued “messiness”
Inflation and rising interest rates will continue to challenge us in the next year or two but they will then subside, which will be hugely positive for our economic growth. Several decades ago, the economist Prof. De Kiewiet wrote that SA only progresses through “political disasters and economic windfalls.” Landman argues that Polokwane and rising incomes set the stage for great progress for SA. He says that things will continue to be “messy” and if we can adjust to this messiness we will be able to capitalise on the opportunities that abound in the country.

“AVERAGING” IS A FOUR LETTER WORD IN INSURANCE - DOES IT AFFECT YOU?

Averaging is the process where an insurance company assesses what percentage of your claim they will pay out in the event that they feel that you are underinsured. This usually happens when you claim for stolen items that form part of your household contents such as audio visual equipment, computers, appliances and clothes. If the insurer feels that you are underinsured you will only receive a portion of the value of your claim. This often leads to intense aggravation where you feel ripped off. Averaging also applies to items such as your physical building if you own your home or office. How can you be protected against averaging?

This is an example of how averaging works with household contents. If you have household contents that in reality are worth R800,000 but you only take insurance to cover for R400,000 then the insurer assumes that you are self-insuring half of your household contents. In the event that you have a burglary where R400,000 worth of goods are stolen, the insurer will only pay out R200,000 of your claim. The rationale from the insurer is that you are your own insurer for 50% of the value of your goods and therefore they will only pay out 50% of your claim. This methodology is not intuitive and could be confusing to the uninitiated, it certainly pays you to understand how they work so that you do not find yourself in a poor financial position after a burglary.

In a recent survey, insurers found that most South Africans tend to underinsure their household contents. People who had household contents insurance of R400,000 were only being paid back an average of R192,000 for their claims due to underinsurance. The situation with physical buildings is even worse. People who claimed for the replacement of buildings valued up to R1.5m only received R678,900 for their building.

This problem can easily be prevented by ensuring that your items are insured at the correct value. As an example your premium for household contents valued at R400,000 would be R320 per month and if you doubled the value to R800,000 your premium would increase to R490 per month. Naturally, the actual premiums would vary according to your area and security etc. However the principles are the same for all of us. If you would like to ensure that you are correctly covered please contact us and we will gladly assist you.

WEALTH MANAGEMENT CLIENTS

After re-reading the newsletters we wrote in January and April this year; we have to say that we have nothing new to say about the markets. The volatility will continue and the portfolios are still holding up well despite the economic headwinds facing the country. We still feel that the portfolios will remain flat for the calendar year. Our clients that have been with us for two or more years are all comfortably up on their initial investments, whilst our newer clients may see some small losses (2% - 6%) on their portfolios. This is certainly normal for these market conditions and we are very confident that the portfolios are well positioned to generate great growth again once the markets stabilise. This is the type of year that will test our newer clients as they may get nervous during periods of volatility but our “older hands” are typically calm and relaxed as they have seen this all before.

GALILEO CAPITAL NEWS

GALILEO CAPITAL SIGNS A JOINT VENTURE WITH MONEYWEB

We are very pleased to announce that we recently signed an agreement with Moneyweb to launch a new financial planning business called Moneyweb Wealth. The business will be managed by Galileo Capital and will use the same planning processes and methodologies that we have used for our clients since 2005. This new business will have no impact on our existing clients, however, we wanted to share the news with you so that you are not surprised if you read about us in the press. We are hopeful that this new venture will allow us to continuously improve the service we offer you. We expect the business to launch to the public in August or September this year.