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Challenging Conventional Wisdom

NEWSLETTER

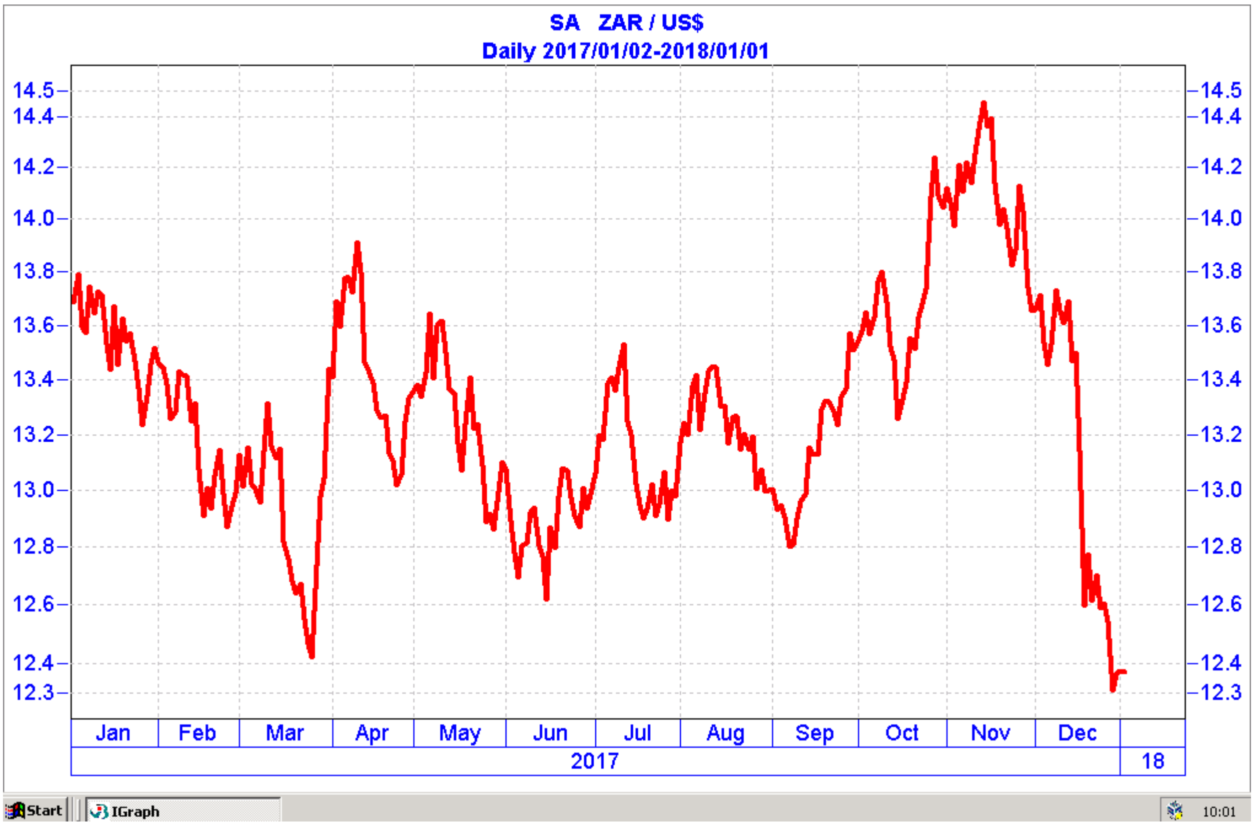
Monthly Newsletter – January 2018

A message from Theo and Warren

2017 was a very difficult year to be a South African. The economic destruction caused by the so-called Zuptas was extensive, and set the country back by at least five years. Under Jacob Zuma's presidency, the South African economy is at least 10% smaller than it should be.

This means that 1.5 million more people should be employed. Capital outflows by South Africans increased dramatically last year and we saw a marked rise in emigration. The impact on stock market investors was camouflaged by Naspers's meteoric year, but the impact on the rand was easy to see.

Fortunately, the ANC's elective conference ended with a Ramaphosa presidency and this was very positive for the rand and the stock market. The graph below shows the rand to dollar exchange rate in 2017: the steep decline in December illustrates the positive reaction to Cyril Ramaphosa's election.



It is worth noting that the stock market increased by 20% in 2017. This includes the collapse of Steinhoff (by 93%) which was comfortably offset by Naspers's rise of 71%. Most investors would not have seen a return of 20% in 2017, as a very significant portion of the growth was generated by Naspers, which accounts for 20% of the JSE.

The average balanced unit trust generated a return of 9.86% in 2017 – a return of 3% higher than inflation in line with long-term expectations.

By the end of the year, the rand had strengthened by 10%, which means the JSE generated a return of 36% when measured in US dollars: this is very respectable when compared to the US market's rise of 22%.

Looking ahead

Predictions are always futile, but we will be watching Ramaphosa's actions in the first six months of this year closely. Ideally, we would like to see a new State President deliver the State of the Nation address, and a new Finance Minister deliver the budget in February. It is not the end of the world if this does not happen, but we will need clarity on critical issues such as the rehabilitation of State Owned Entities.

President Zuma faces a series of very serious legal challenges in 2018 that could derail his remaining term if he is not recalled by the ANC at the start of the year. In summary, if we see firm and speedy action by Ramaphosa at the start of this year, we will see a very strong recovery in investor sentiment. This will cause the rand to strengthen further and the JSE will deliver positive returns.

Inaction by Ramaphosa and a continuance of 'Zumanomics' will lead to further downgrades by ratings agencies, rand weakness and outflows from our investment markets, but the JSE will remain steady as much of the market is priced in US dollars. Investors who have no offshore allocation should consider investing offshore as the strong rand presents a good buying opportunity.

- Theo and Warren

Thoughts on the Rand?

We noted in our last newsletter that the ANC leadership election was a T-junction moment in South Africa's political evolution. If Cyril Ramaphosa won, we expected some recovery in South African assets and the rand, with the caveat that it would take some hard work to recover our credit rating. We noted that if Nkosazana Dlamini-Zuma won, then local markets would look to commodities to do some heavy lifting.

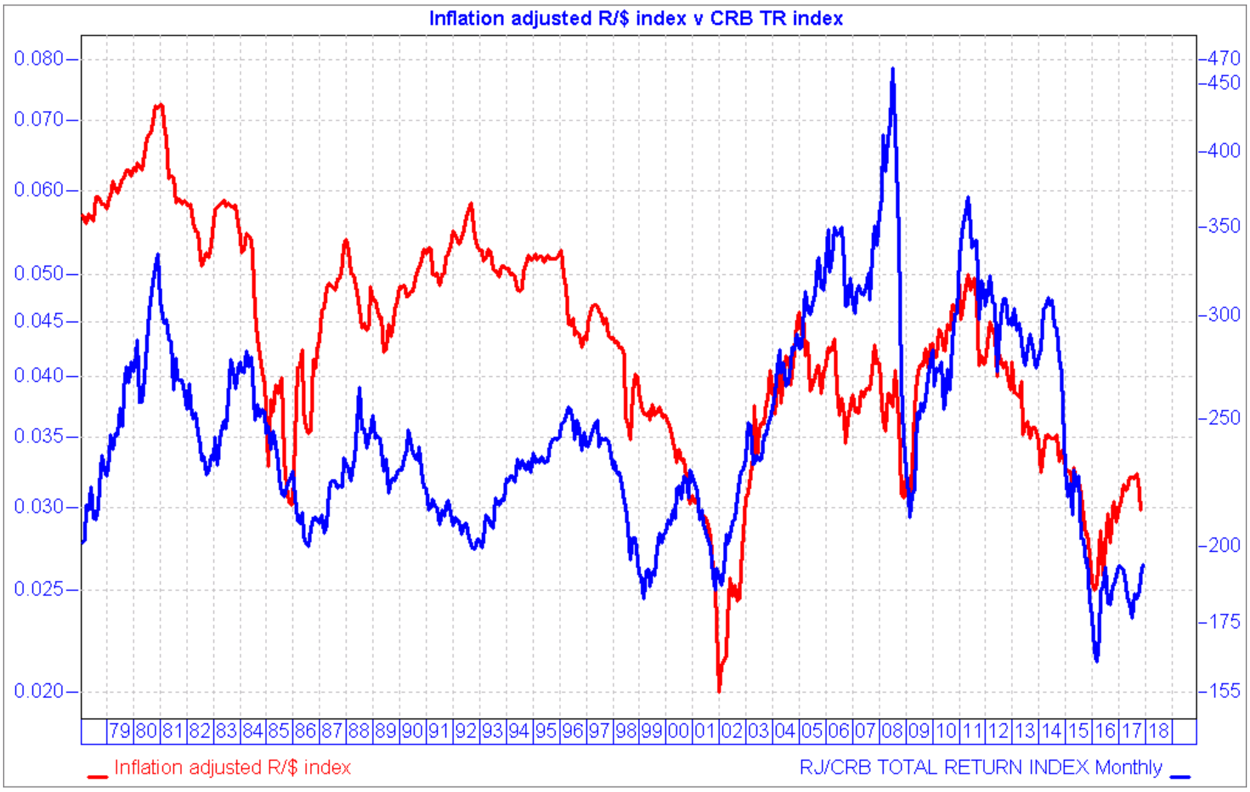
The elective conference came and went. After some furious politicking, a market-friendly candidate won by a fairly small margin, and emigration consultants mourned the loss of their top salesman.

It was easy to look offshore when a kleptocratic elite held an iron grip over South Africa. That said, we would argue that one needs to look beyond a binary stop/go approach to offshore investing. The negative reason was to run from the kleptocracy. The positive reason was to go towards the incredibly wide range of investment options offered in the offshore environment.

The markets have anticipated quite a bit of good news for South Africa with the change in leadership, but some hard work will be required. The ANC needs to clean up its act significantly and undo a great deal of damage, all while maintaining the goodwill of political backers who aren't necessarily that capital-friendly. It's going to take a lot of hard work and deft manoeuvring to dodge the downgrade bullet.

Currencies are incredibly hard to forecast at the best of times. What we do know about the rand forex rate is that the commodity cycle is an incredibly important driver.

This graph, which is a favourite chestnut of ours, shows just how strongly the inflation adjusted R/$ rare tracks the performance of commodities.



This means that there are levers to manage currency risk. After all, a stronger rand is a risk to an investor who commits to heavy offshore exposure. One way to mitigate that risk is to tilt towards other emerging markets that also move in line with commodities. Far be it for us to forecast the commodity cycle, but it does look fairly positive right now, which means it's an important factor to keep in mind.

Risk to both South African and investment markets doesn't follow a simple risk on/risk off cycle. It evolves and changes shape. Being appropriately diversified is an evergreen and relevant risk management strategy. Going offshore is no longer the simple one-way bet on offer when the kleptocrats hold sway, but that doesn't mean it's an avenue that has lost its merits either.

- Warwick Lucas, Chief Investment Officer, Galileo Asset Managers

Give more, smile more

If you want to be happy, you need to up your generosity quotient – that's the word from US sociologists Christian Smith and Hilary Davidson of Notre Dame University. After surveying 2 000 people over five years they discovered that if you give some of your money and time away, you'll be happier.

Smith and Davidson found that Americans who described themselves as "very happy" volunteered an average of 5.8 hours per month, while those who are "unhappy" volunteered just 0.6 hours – just one of the studies that saw Smith and Davidson interviewing and tracking the spending habits and lifestyles of 40 families from different classes and races in 12 states, even accompanying some to the grocery store.

Other findings include lower depression rates among Americans who donate more than 10% of their incomes: 41% say they rarely or never experience depression versus 32% for everyone else.

The researchers found that there isn't just a correlation between generosity and happiness – there's causation. They found nine different causal mechanisms, involving everything from developing a sense of self as generous to being more socially networked to being more physically active. They argue that generosity can actually involve neurochemical changes in the brain.

To reap the happiness benefit, note generosity has to be a practice – something that you do repeatedly. And you can't just cynically give to get happier. You should be generous because you want to – it's part of pursuing the notion of living well, which ultimately leads to greater happiness.

You can read a full interview with Smith and Davidson here.

Working smart, not hard

January is traditionally goal-setting time, and outside of your yearly 'lose weight, stop smoking, drink less' goals, it's also a good time to start your working year as you mean to go on. Here are five ways to be more productive – and less tired – in 2018.

1. Clarify your work or business goals – make them specific, and set a clear and concise time frame that's realistic but still challenging. You want to create a sense of urgency.
2. Cut out excuses and distractions – let this be your year of focus. Turn off notifications and set your own agenda. Remember that your smartphone is there for your convenience, not others'. And set boundaries – work when you're at work, and be away from work when you're home or with family and friends.
3. Know thyself – work with your natural rhythms and inclinations. Do mentally challenging tasks when you're awake and excited and do admin when your energy is low. Create an environment that's conducive to working.
4. Focus on progress, not success – as long as you are working towards your goal, you're on the right track. Just keep making progress.
5. Be consistent – find what works for you and do it consistently and persistently. Create routines that work for you, and that propel you towards your goals and not away from them. At the end of the day review what worked and what didn't, and then tweak and change the next until you create the perfect blend of work, rest, relaxation and connection with others.