



CREATING WEALTH IN 2012

By Magnus Heystek—Investment Strategist

“The crisis takes a much longer time coming than you think, and then it happens much faster than you would have thought, and that’s exactly the Mexican story. It took forever and then it took a night”.—Rudiger Dornbusch.

For “Mexican” you might as well insert most member countries of the EU in the southern regions, either Greece, Portugal, Italy or perhaps even France.

Keeping up with the unfolding events surrounding Greece, its debts and its continued membership of the EU is not easy. In fact it has become almost impossible not to be confused by the torrent of contradictory news flow coming out of the financial capitals of Europe.

This confusion will continue until, one day, perhaps even soon, a decision is made or is made for it by the markets.

EUROPE HAS THREE MAIN PROBLEMS:

- ⇒ A growing number of its countries are insolvent or close to it. It is increasingly likely that the only way forward is for defaults of some type, to lessen the burden of debt to a level where it can be dealt with and that will allow the countries the possibility of growth, which is the only real answers to the problems they face.
- ⇒ Because of growing fears of multiple defaults (Greece alone will be bad enough) most of the banks in Europe are seen to be insolvent and in need of hundreds of millions of euros of new capital. The interbank market in Europe is a shambles and banks park their cash with the European Central Bank, at a lower rate of return as this is the only institution that they trust. They clearly do not trust each other.
- ⇒ The real problem in Europe is the massive trade imbalances between the peripheral countries and the so-called core countries. Without the ability to adjust currencies, those imbalances will render any debt solution moot, as a country cannot balance its budget while it runs a trade deficit and its citizens and businesses deleverage. There must be balance or there must be a mechanism to achieve balance.

Europe faces a set of choices, none pleasant. They can lend Greece more money on promises to turn things around, which can’t happen because of (1) the very austerity being imposed and (2) the 10% of GDP trade imbalance with the rest of Europe. If they don’t lend the money they face the prospect of an uncontrolled banking collapse, similar to the wave of panic that flooded the world’s financial markets in the wake of the collapse of Lehman Bros. in 2008.



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As well-known financial market commentator John Mauldin says in his latest newsletter “Greece has two choices. They can choose Disaster A, which is to stay in the euro, cutting spending and raising taxes so they can qualify for another bailout; negotiating more defaults, getting further behind on their balance of payments and suffering along with a lack of medicine, energy and other goods that they need. They will be mired in a depression for a generation.

Demonstrations will get ever larger and uglier, as the government has to make even more cuts to deal with decreasing revenues, as 2,5% of their GDP in euros leaves the country each month. There is a run on their banks. Any Greek who can is getting his money out.

Greek voters will then blame, whichever political group was responsible for choosing Disaster A and vote them out, as the opposition calls for Greece to exit the euro, which is of course Disaster B.

These are there only two choices. Whether they opt to go straight to the drachma (Disaster B) is only a matter of timing. They will get there soon enough.”

Who is John Mauldin, you might ask? He is the author of several best-selling books on investments including his latest New York Times bestseller called *The Endgame*.

Mauldin was also a speaker at a Brenthurst Wealth investment seminar in January 2007 where he warned the rather bemused audience, myself included, about the coming collapse of the sub-prime mortgage market in the US.

Sub-prime, we all asked, what is that? Now we all know.

HOW DOES THIS AFFECT SOUTH AFRICA?

South Africa has thus far been spared the crushing austerity affecting many countries in Europe. This is mainly due to three factors: a decade of strongly rising commodity prices, capital inflows from foreigners and, ironically enough, a very low international indebtedness due to our exclusion from global financial markets for most of the 70's, 80's and the early part of the 90's.

South Africa was late to the punch-bowl of global international freebies as result of our pariah status due to apartheid (remember the debt standstill in the mid-80's?)

It would be dangerous to extrapolate these favourable conditions deep into the future, which our politicians are so fond of doing. There are many things to worry about such as our high unemployment rate and little progress in creating employment; inefficiencies in our mining sector and the relatively high proportion of our public budget spent on wages and social grants, which are not adding to our future productive capacity.

Of the 14 million people in SA receiving social grants, more than 12 million are children of between the ages of 6 and 18. From a humane perspective these monthly grants of R230 per child are absolutely essential in feeding poor and starving children. However, the question that it raises is what happens to children when they are released from this safety net when they turn 19, into a job-market with very little job prospects.

Are we not creating a welfare society which might just spawn a generation of hand-out -dependant young people? What kind of political impact can this have in the future when millions of young people have to forfeit their monthly allowance once they reach the age of 18, but instead are given the political vote? These uncomfortable questions need to be asked, as indeed they have been by international ratings agencies Moody's (in November last year) and more recently Fitch.

Both these agencies have put SA's global credit rating on a “watch” which normally is followed by a downgrade. Debt downgrades normally lead to higher costs of borrowing as well as an outflow of capital out a country.

It's ironic that Moody's was the first ratings agency to upgrade SA in 1995 following on the election of a multi-racial government the year before. Then it was hailed as being visionary.

In downgrading SA in November last year Moody's faced a barrage of criticism from politicians, economists and financial columnists.

Like them or hate them, but ratings agencies count ,much more than people think.

In its downgrade Fitch referred to SA's "structural problems", a euphemism for high unemployment, rising wages and social grants, high-level corruption, tender-fraud and growing demands on a shrinking tax base.

As an example of these structural problems one needs to look no further than the auditor-generals' annual report which revealed that a staggering amount of R25 billion of government expenditure could not be "accounted for".

Scarcely a week later central government was forced to step in and take over the chaotic finances of the Limpopo province. Mpumalanga and the Eastern Cape could follow soon.

In a front-page article in Business Day (23rd January) under the headline "Poor Service Delivery killing SA business" the SA Chamber of Commerce and Industry warns poor service delivery are having a serious affect on the companies and hence the economy.

Most glaring service delivery problems were road maintenance, electricity distribution, water and sanitation, parks and public spaces upkeep and solid waste removals.

This report just confirms what other business owners, farmers and entrepreneurs have known all along and have to contend with on a daily basis.

At some point these service problems start having an affect on the overall performance of the country's output and hence the performance of its main barometer of wealth: its stock exchange.

[Read the quotation at the head of this newsletter again.](#)

Our own age of austerity may still lie in wait, especially if a sharp downturn in commodity prices and the demand for these goods result from the worsening conditions in Europe and China abate.

Individual investors and business owners need to batten the hatches down even more in the years to come.

GLOBAL INVESTMENT RETURNS: HOW DID WE DO?

An important feature of 2011 was the underperformance of the emerging markets. According to Allan Gray the MSCI Emerging Market Index returned a negative 18,2% while the FTSE/JSE All share index returned a negative 16% in US dollars.

In rand terms the local equity market was flat, recording no growth. Only the dividends, an average of 2,2% created any wealth.

Contrast this to the average performance figures of the funds used in the creation of our three risk-adjusted client portfolios, which ranged from 8% to as high as 18%.

INVESTMENT PERFORMANCE THROUGH TURBULENT TIMES

	Custom *	1 Month	3 Months	1 Year	3 Years	5 Years
Allan Gray Balanced Fund A	46.27%	0.83%	3.34%	10.74%	12.72%	9.27%
Allan Gray Equity Fund A	66.78%	2.61%	5.71%	11.63%	17.72%	9.29%
Coronation Balanced Plus Fund A	60.43%	2.51%	3.93%	7.03%	16.09%	9.52%
Coronation Top 20 Fund A	88.07%	6.13%	6.56%	8.42%	23.67%	12.62%
Investec Money Market Fund R	18.87%	0.45%	1.33%	5.44%	6.90%	8.35%
Investec Opportunity Fund R	57.58%	1.32%	4.16%	11.17%	15.22%	10.20%
Investec Property Equity Fund A	58.02%	4.89%	6.60%	13.95%	16.75%	13.09%
Investec Value Fund R	87.58%	1.77%	4.41%	2.54%	18.96%	8.31%
STANLIB Balanced Fund A	54.35%	2.96%	4.85%	9.04%	14.67%	6.97%
STANLIB Property Income Fund A	69.91%	5.10%	6.46%	15.60%	19.09%	14.12%

* Custom = Total return % (percentage) 01 April 2009 to 19 January 2012

This was a direct consequence of our well-advertised objective of seeking offshore exposure for our clients. At the beginning of 2011 we hosted a number of seminars countrywide in order to achieve this. We also embarked on a deliberate strategy to increase the offshore exposure within the portfolios we manage on behalf of our clients.

During the course of the year the rand weakened by 22% against the US dollar, at one stage the weakest performance in the world for the year. We foresee further weakness in the years ahead as the structural problems, a slowdown in global growth and more political uncertainty retards economic growth in general and impacts on company profitability on an individual basis.

HOWEVER, THE PRIMARY OBJECTIVE OF ADVISING CLIENTS TO CONSIDER OFFSHORE INVESTMENTS, ESPECIALLY FOR CLIENTS WITH A LONGER TERM HORIZON, IS TO FIND INVESTMENT OPPORTUNITIES NOT AVAILABLE ON THE LOCAL MARKET.

LOCAL INVESTORS ARE LOSING OUT ON FANTASTIC INVESTMENT OPPORTUNITIES, SUCH AS THE INVESTMENT IN GLOBAL TECHNOLOGY COMPANIES, SUCH AS APPLE, SAMSUNG, NOKIA AND IMB, TO NAME JUST A FEW.

The technology sector accounts for a mere 1,2% of the market capitalization while certain highly successful global equity funds such as the Orbis Global Equity Fund, part of the Allan Gray stable, have as much as 33% of its \$10billion fund invested in this sector.

EXCHANGE CONTROLS:

Earlier this year Treasury announced that individual investors can now take out R1 million per person per year for investments abroad without having to obtain tax clearance.

This is in addition to the annual R4 million investment allowance per year, for which tax clearance is still needed, but it forms part of one's annual travel and gift allowance.

PLEASE SPEAK TO ANY ONE OF OUR SEVEN REGISTERED INVESTMENT ADVISORS SHOULD YOU HAVE ANY QUERIES IN THIS REGARD.

This removes an administrative hurdle for many investors whose taxes are not up to date. This money can be moved with very little effort.

WITHHOLDING TAX ON DIVIDENDS:



A number of investors have by now received documents from their respective investment companies, informing them of the introduction of a withholding tax of 10% on dividends declared to them. This only applies to discretionary investments, which have equities contained in them.

This is not a new tax, as some have feared, and merely replaces secondary tax on companies, also at 10%. In terms of the STC dispensation an extra tax was added to companies, after which dividends were declared.

This has now been scrapped to bring it into line with global practice and one would assume that companies would pay the savings in STC over to shareholders in the form of an additional dividends.

These dividends will then be subject to a withholding tax of 10% of the value of the dividend to be deducted by the investment companies before the balance is paid out to investors or added to their portfolios.

Certain classes of shareholders, such as registered charities, will be exempt from paying this tax but application will have to be made to the investment companies in order to qualify for the exemption.

UPCOMING INVESTMENT SEMINARS:



BRENTHURST WEALTH will be commencing its popular series of investment seminars at the end of February at venues in Pretoria, Johannesburg and Cape Town. All clients and their immediate families are welcome to attend free of charge.

We have managed to secure Glyn Owen, a top rated fund manager at Momentum International (previously RMB International) in London for these seminars.

PLEASE BOOK EARLY AS THE TOPIC WILL BE THE UNFOLDING DRAMA IN THE EUROPEAN UNION AND WHAT IMPACT THIS WILL HAVE ON FINANCIAL MARKETS.

GLYN OWEN, INVESTMENT DIRECTOR

Glyn was one of the founders of Momentum's asset management, advisory and investment services business in the UK in 1998. He is now Head of the multi asset team which includes the advisory arm of the UK business, Momentum Global Investment Management Limited. Glyn has over thirty five years of investment experience, most of which has been in the City of London. Prior to working with the FirstRand Group, Glyn was Head of the International Division at Deutsche Morgan Grenfell, where he was responsible for international investments for non-UK institutions. He also spent three years working in the investment industry in Australia.

INVESTMENT PRESENTATION

JHB SEMINAR: TUESDAY 28 FEB	RSVP: CHRISTOFF 011 799 8100	or email christoff@brenthurstwealth.co.za
PTA SEMINAR: THURSDAY 01 MARCH	RSVP: YOLANDI 012 460 0340	or email yolandi@brenthurstwealth.co.za
CPT SEMINAR: WEDNESDAY 07 MARCH	RSVP: SUZEAN 021 914 9646	or email suzean@brenthurstwealth.co.za

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