

INVESTMENT REPORT



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WHITHER THE RAND: R6 OR R12?

By Magnus Heystek—Investment Strategist

Put six economists in a room and ask them what the rand is going to do over time and you are bound to get nine different opinions, goes the old joke. The only problem is that such a forecast is not a trivial matter and can make the difference between huge profits or losses for investors/traders/banks/dealers/travellers/importers/exporters and everyone else whose lives are touched by an indicator which sometime seems to have a mind of its own.

“Rubbish, rubbish, rubbish,” I shouted at the television screen, causing Pebbles the Yorkshire terrier to run scampering to the safety of the kitchen and dearest wife Sue to charge into the study asking what’s wrong. It took a glass or two of Stellenbosch’s finest to calm my nerves after that.

THE GRADUAL DECLINE

Before I continue, dear reader, I must warn you that I am a dyed-in-the-wool rand bear and have been ever since I joined the financial world back in 1980

Those were the days when the rand was one of the strongest currencies in the world, with locals getting \$1.35 for R1. No, that’s not a mistake.

In 1980, South African tourists were roaming the capitals of the world with a very strong currency, spending as if there was no tomorrow, while US and UK tourists bemoaned our strong currency.

And so it was a Monday or two ago while watching Alec Hogg interviewing a local fund manager on the CNBC-Africa- programme about, amongst other things, the “real “ value of the rand.

I nearly fell off my lazy-boy when the said fund manager proclaimed that the rand, on the basis of the so-called purchasing pricing parity theory, should be trading at R6 per share and that over time that’s where the rand is headed.

My reaction to this was almost the same as when the French referee Romain Poite sent off Bismarck du Plessis for a so-called armless tackle against All Black fly-half Dan Carter some two weeks ago.

In this issue

UPCOMING SEMINARS:

JHB SEMINAR: 20 NOV 2013

PTA SEMINAR: 21 NOV 2013

CPT SEMINAR: 28 NOV 2013

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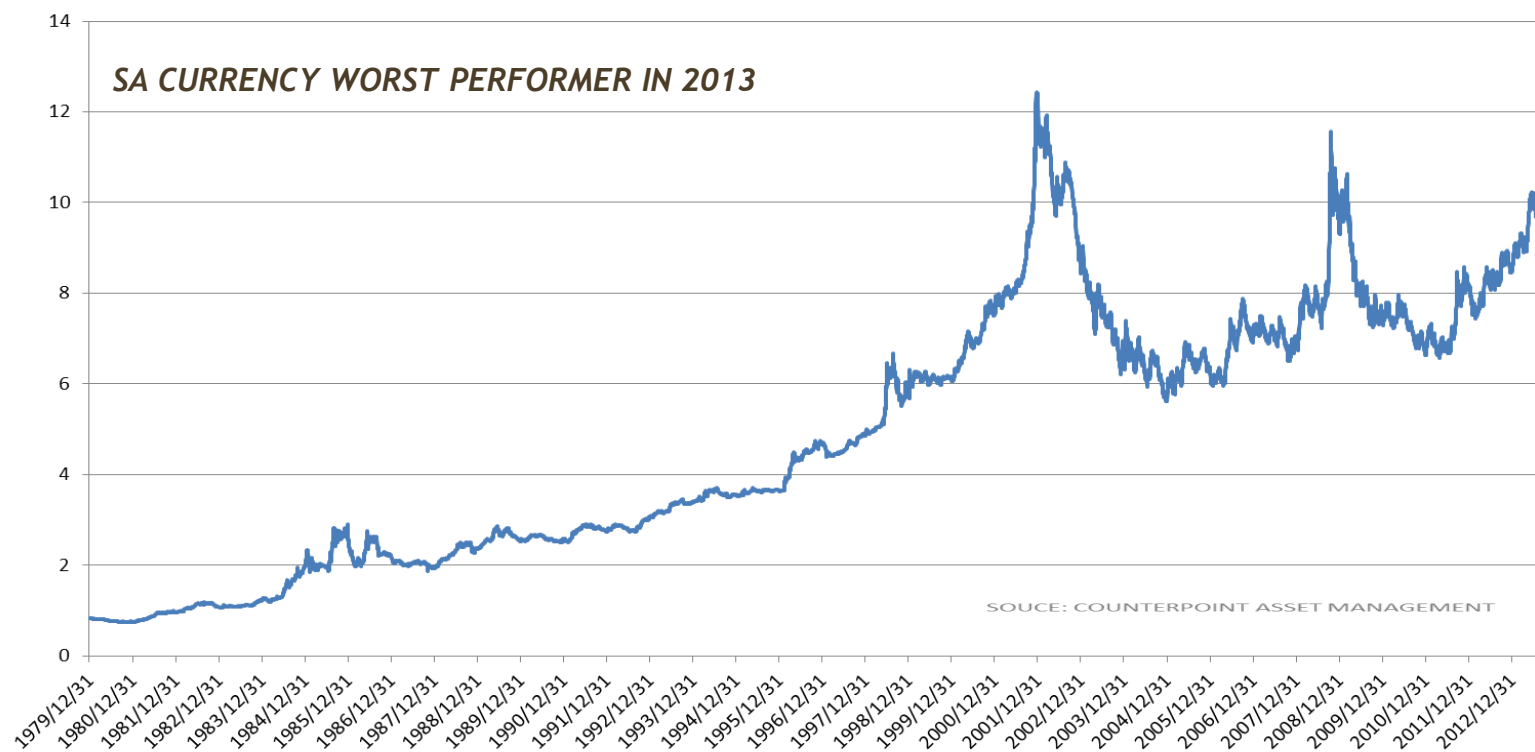
Ever since then, the rand has been a one-way bet, with a brief period of strengthening from its lowest-ever levels of R13.85 against the US dollar in January 2002 to around R6.50 in mid-2007.

But this was after the rand's collapse from R6 to the USD in January 2000 to almost R14 at end 2001, as the land-grabs in Zimbabwe gripped our media-headlines.

I consider that blow-out an aberration of the gradual, 11% per annum decline in the currency over the preceding 20 years.

See the long-term trend of the rand versus the US dollar in the graph below.

ZAR / USD EXCHANGE RATE BLOOMBERG, EXCHANGE RATE SINCE 1980 TILL TODAY



FOREIGN EXCHANGE CONTROLS

For most of those 20 years or so SA investors were prevented from legally investing money offshore. Had they been able to do so, they would have returned on average between 30-40% per annum on their offshore investments - a combination of a rapidly declining currency as well as a major bull market in global equities which began in 1982 and which continued until 2000, albeit with one major interruption in 1987.

Foreign exchange control regulations kept local investors out of this bull market and it was only in 1997 when the doors to foreign investments were opened ever so slightly, first with an allowance of R250 000, then R400 000 in 1999 rising to R500 000 in 2001.

Now the allowance is a total of R5 million per taxpayer per year.

So when the rand collapsed in 2001/2002 there was a rush for the exit door as local investors, fearing a repeat of the Zim land grabs, moved great amounts of money offshore at the worst possible time.

Subsequently the rand recovered a great deal of its losses and equity markets in the developed markets went into a funk after a 17-year bull market.

The result was a whole generation of badly burnt investors who swore never to take money offshore again, that is, until the next rand crisis, in the midst of the global financial crisis of 2008/2009.

From 2009 to 2010 the rand clawed its way back from R11.50 to around R6.50 in mid-2010, as financial markets settled down after the said crisis.

CONFLICTING MESSAGES

For most of 2010 the rand trended sideways in a relatively stable pattern, between R6.50 and R6.80 to the US dollar, and it was at that time that I started recommending some more offshore exposure to my clients.

The same message was broadcast at a series of country-wide seminars. It didn't help my cause much when the co-speaker at these seminars, renowned forecaster Clem Sunter, held the view that the rand could dip below R6 to the US dollar.

COMMODITY CYCLE

My reasons for seeing weakness in the rand were, amongst others, an ending of the commodity super-cycle, downgrades of SA's creditworthiness by the international credit ratings agencies, our weakening economic fundamentals (current account and budget deficits) as well as clear signs by the monetary authorities that it welcomed a weaker currency.

Add to this the non-measureables: the ever-rising tide of corruption, maladministration and gross inefficiency in our country.

(As an aside, I believe the average South African is much too complacent about the state of local government which, by all accounts, is failing at a rapid and very worrying rate. At some stage it starts having an effect on the perceptions of global investors.)

It is now a matter of record that anyone who heeded this advice at the time has enjoyed stellar results with their offshore investments.

Fast-forward to today and my views have not changed, whatever the well-informed and well-educated fund manager on Hogg's show might think. He is, coincidentally, also in the school of deep-value managers whose relative performance has been obliterated over the last two years.

THE RAND GOING FORWARD

Added to the deadly combination of a current account and budget deficit, is the massive unknown surrounding the ending of the US Federal Reserve's policy of quantitative easing (QE) sometime in the near future.

While there is some uncertainty about when this programme will start winding down and at what speed, there is no doubt that it will end.

Already just Bernanke's mention that he might start tapering the monthly bond purchases of \$85 billion per month, has had a major impact on emerging market

currencies, particularly hurting countries with twin deficits like South Africa.

Added to this, in my view, is our gluttony on cheap global credit since 2008.

Our banks now extend more credit for unsecured loans than they do for the purchase of residential property. SA is drowning in debt with almost 50% of all credit active consumers now having an impaired credit history.

TICKING CLOCK

Our country has been a major beneficiary of two global economic windfalls over the last ten years: the rise of China and the commodity super-cycle and the three phases of QE.

Both are over, but here we are, ten years later, with massive consumer debt, record deficits on our current account and national budget, low foreign exchange reserves and a commodity sector not producing much more than we did a decade ago, courtesy of mining rights uncertainty.

If we had to describe the way we have been managing our economy in bar-room-parlance it would be something along the lines of "pissing it up against the wall" (apologies to gentle readers).

The time of reckoning is getting closer all the time. The rand has shown a propensity to blow out from time to time, making it one of the most fragile currencies in the world.

The stars are slowly aligning for yet another volcanic explosion, perhaps sooner than later.

UPCOMING SEMINARS: INVESTMENT OUTLOOK 2014

JOHANNESBURG: INVESTEC

Date: 20 November 2013

Time: 15h30 for 16h00

Venue: INVESTEC OFFICE, 100 Grayston Drive, Sandown, Sandton

RSVP: JHB: +27 11 799 8100 reception@brenthurstwealth.co.za

Presenters: Jeremy Gardiner & Magnus Heystek

PRETORIA: INVESTEC

Date: 21 November 2013

Time: 15h30 for 16h00

Venue: Waterkloof Golf Club, Johann Rissik Drive, Waterkloof, PTA

RSVP: PTA: +27 12 347 8240 yolandi@brenthurstwealth.co.za

Presenters: Jeremy Gardiner & Magnus Heystek

CAPE TOWN: INVESTEC

Date: 28 November 2013

Time: 15h45 for 16h00

Venue: INVESTEC OFFICE 36 Hans Strijdom Avenue Foreshore, Cape Town

RSVP: CPT: +27 21 914 9646 ronelle@brenthurstwealth.co.za

Presenters: Jeremy Gardiner & Magnus Heystek



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