BRENTHURST WEALTH MANAGEMENT

INVESTMENT REPORT

BRENTHURST
THE HOME OF WEALTH

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In this issue

Global Markets AND SA ECONOMY

SPECIAL REPORT ON THE RAND

THE RAND : LOOKING IN THE WRONG PLACES

By Magnus Heystek—Investment Strategist

IN response to many queries from our clients have we drawn up this special report, trying to explain the exceptional volatility and downward pressure on the rand exchange rate in recent days and weeks.

For the record: last week the culmination of a number factors contributed to pushing down the local currency to four year lows against its major peers, including the US dollar, the euro and the British pound.

The rand has now dropped by more than 50% against the US dollar, the euro as well as the British pound since mid-2011. Last week's decline was the third largest decline in the rand since 1994, declining from R9,60 to R10,28 against in the greenback in less than three days.

South Africa's media reporting on the issue focused on the outsize wage demands by trade unions, especially in the gold and platinum sector as the main driver behind the sharply weaker rand.

This, in our view, is a classic case of "car park economics", which is explained by means of the following story.

Have you ever heard the expression 'car park-economics'? Let me explain by means of a short story.

A policeman patrolling a car park late at night finds a drunk on his hands and knees underneath a lamp-pole.

"What are you doing," he asks. "I'm looking for my car keys," he replies.

The policeman starts helping the drunk, but after a while he says: "I cannot see any keys. Are you sure you lost them here?" To which the drunk replied; "I lost them somewhere else", pointing at his car parked a distance away in the dark, "but there is no light there."

In the USA the term car park economics is often used when an explanation is offered for an economic event which, superficially might appear reasonable but in fact is not. Sometimes it is plain wrong, but it is very hard to alter the public perception once the first, incorrect, causality has been printed, tweeted and broadcast to the whole world.

Such is the superficial nature of our modern communication that very few stop and question the glib, easy-sounding explanation. We are all looking for an explanation where there is some light.

In the past two weeks or so we have, again, witnessed a prime example of car park economics: **"Rand weakens on wage demands by miners".**

It would seem to me that one media outlet concluded that the rand started weakening due to the outrageous mining wage demands and almost everyone followed suit.

Speak to any member of the public and the same reason is given. What follows, logically, is that should the issue of the wage demands be settled, the rand will calm down and perhaps even strengthen.

Outrageous wage demands are nothing new in the South African context and it is part of the annual or bi-annual posturing between labour and employers.

Investors too, especially foreign ones, are equally aware of this dynamic and should by now be immune to it.

In fact, the current weakness of the rand is the culmination of a number of inter-related global and local economic forces that started blowing, ever so gently some two years ago, and is now picking up speed and under certain circumstances can turn into a full-blown tornado.

Two years ago when the rand was trading in a range between R6,50 and R6,80 against the USD we at Brenthurst formulated a viewpoint that the rand strength was of a short-term nature and that a weaker rand could be expected. We hosted countrywide seminars on this issue and several of our newsletters, all still on our website, is testimony to the view that we took.

Even Pravin Gordhan, our minister of finance, is on record as saying that the rand was too strong at that time.

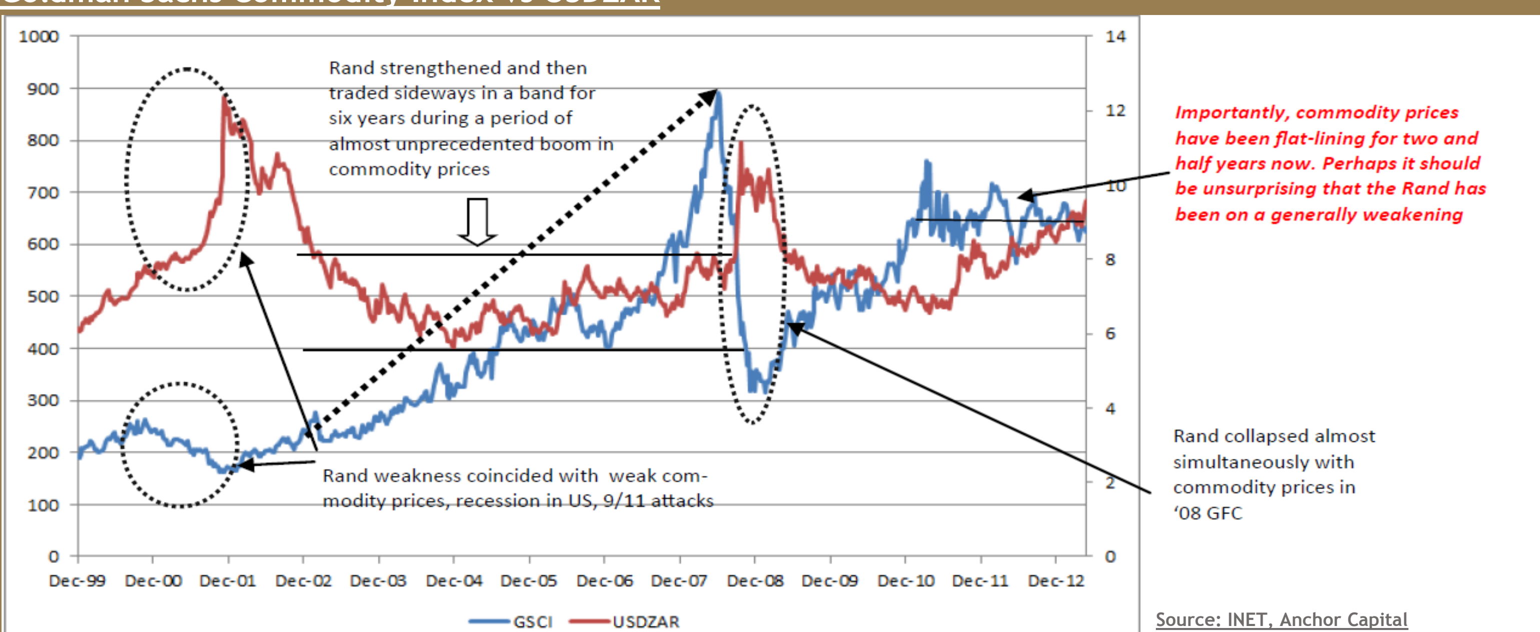
Since then the rand has dropped by almost 44% against the US dollar and more than 50% against the euro in response to credit downgrades, lower economic growth and uncertainty about certain key political viewpoints on the economy.

During this time the country experienced a record-inflow of foreign money, mostly in search of the juicy yields which our government bonds were paying. Last year the inflow was R180 billion or so.

This inflow could not stem the weakening rand which indicated, at least to me, that more money was flowing out somewhere else. In short, our foreign account has become like a leaking bucket: more was flowing out in the many holes than what was flowing in at the top.

SO WHAT IS CAUSING THE CURRENT RUN ON THE RAND? THE FOLLOWING FACTORS ARE ALL LINING UP WHICH, ALREADY CAUSING A BIT OF A GALE:

Goldman Sachs Commodity Index vs USDZAR



Source: INET, Anchor Capital

SO WHAT IS CAUSING THE CURRENT RUN ON THE RAND?

➢The end of the commodity super cycle. Last month two large financial institutions, Citibank and Credit Suisse, published detailed reports on the commodity super cycle, both saying the cycle is dead and buried.

➢US Dollar strength. The USD moves in very large and pronounced cycles. I follow the ICE dollar index (code DXY on the New York stock exchange) which measures the USD against its six major trading partners. Since July 2011 this index has moved from 73 to its current level at 84 – a major move for the dollar.

➢SA leading economic indicators turning down. Earlier this week the SARB published its leading economic indicators, most of which had turned down in the first quarter of the year.

➢Deficit on the current account of the balance of payments. The slowdown in export volumes and a drop in prices of our major export products is causing havoc with the balance of payments and last year the country recorded its largest deficit on record.

➢Last week Treasury reported to Parliament that the budget deficit would average 6,5% of GDP over the next three years. This report, which attracted very little news analysis, points to a much higher deficit than was forecast in the budget, less than three months ago.

➢Outflow of foreign money from the local bond market. This, in my view, is the single most important indicator when it comes to the outlook for the rand. The rand has been propped up by the billions of foreign currency flowing into our bond market.

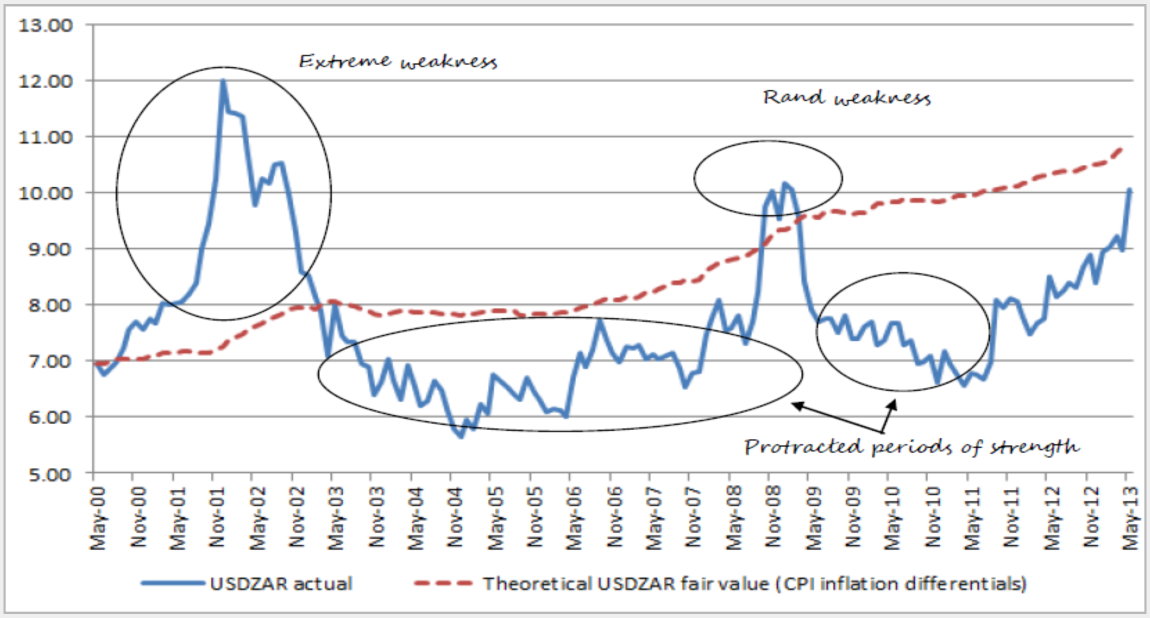
Any return of this money back to home base, which could happen if global interest rates normalise, could be disastrous for the rand. Then the current strong gale would turn into a force - 10 hurricane.

Smart investors can turn such a scenario into their advantage and profit by buying rand-hedge investments or taking some money abroad. There are a number of excellent offshore funds and ETF's on the local market.
As Ian Liddle. Chief executive of Allan Gray said on this website two weeks ago: invest at least 25% of your pension offshore. I think this number should be higher.

OFFSHORE INVESTING:

Over the last three years Brenthurst Wealth has assisted many clients in taking money offshore. The results so far have been very encouraging. Should you wish to take more money offshore please do not hesitate to contact any of our qualified investment advisors.

Rand / $ exchange rate and theoretical PPP value
– using May 2000 as a starting point



Source: INET Bridge, Anchor Capital calculations

UPCOMING SEMINARS:

PRETORIA SEMINAR:

Date: 04 JUNE 2013
Time: 16h00 to 17h45
Venue: Waterkloof Golf Club, Johann Rissik Drive, Waterkloof, PTA
RSVP: +27 12 347-8240 yolandi@brenthurstwealth.co.za
Presenters: Magnus Heystek **BRENTHURST,** Paul Hansen & Melissa Dyer **STANLIB**

JOHANNESBURG SEMINAR:

Date: 05 JUNE 2013
Time: 16h00 to 17h45
Venue: Stanlib JHB Office: Melrose Arch
RSVP: +27 11 799 8100 reception@brenthurstwealth.co.za
Presenters: Magnus Heystek **BRENTHURST**
Melissa Dyer and Keillen Ndlovu **STANLIB**

CAPE TOWN SEMINAR:

Date: 11 JUNE 2013
Time: 16h00 to 17h45
Venue: Liberty Life, The Estuary Century Boulevard Century City
RSVP: +27 21 914 9646 ronelle@brenthurstwealth.co.za
Presenters: Magnus Heystek **BRENTHURST**
Keillen Ndlovu and Paul Hansen **STANLIB**

STOCK MARKETS ARE AT RECORD LEVELS.

THE RAND HAS NOW DROPPED BY MORE THAN 50% AGAINST THE US DOLLAR.

LISTEN TO TOP FUND MANAGERS DISCUSS THIS ISSUE

BOOK NOW FOR ~ UPCOMING SEMINARS

INVESTMENT STRATEGIST:

MAGNUS HEYSTEK
magnus@heystek.co.za
+27 83 692 8635

INVESTMENT ADVISORS:

BRIAN BUTCHART CFP ®
brian@brenthurstwealth.co.za
+27 82 335 5117

JOHAN BURGER CFP ®
johan@brenthurstwealth.co.za
+27 82 732 8655

RENEE EAGAR CFP ®
renee@brenthurstwealth.co.za
+27 83 233 9373

SONIA DU PLESSIS CFP ®
sonia@brenthurstwealth.co.za
+27 83 260 4055

INVESTMENT ADVISORS:

MAGNUS L. HEYSTEK CFP ®
magnus1@brenthurstwealth.co.za
+27 72 071 5567

JANA GOUSSARD CFP ®
jana@brenthurstwealth.co.za
+27 82 443 3868

RICHUS NEL ACCA
richus@brenthurstwealth.co.za
+27 78 260 4013

TAX & ACCOUNTING:

GAVIN BUTCHART
gavinb@brenthurstwealth.co.za

MARKETING:

SUE HEYSTEK
sue@brenthurstwealth.co.za

RECEPTION JHB:

ANTJE MOUTON

CLIENT SERVICES (JHB /CPT/PTA):

SUZEAN HAUMANN
suzean@brenthurstwealth.co.za

ESMERIE LOOTS
esmerie@brenthurstwealth.co.za

CHRISTOFF POTGIETER
christoff@brenthurstwealth.co.za

YOLANDI BURGER
yolandi@brenthurstwealth.co.za

CELESTE PHAKHATI
celeste@brenthurstwealth.co.za

ALLIE SIKHOSANA
allie@brenthurstwealth.co.za

ERNA MARÉ
erna@brenthurstwealth.co.za

RONELLE STIPP
ronelle@brenthurstwealth.co.za

ROZANNE HEYSTEK POTGIETER
rozanne@brenthurstwealth.co.za

BRENTHURST WEALTH MANAGEMENT (PTY) LTD

JOHANNESBURG: Building 3 Prism Business Park | Cnr Fourways Boulevard & William Nicol Fourways | Gauteng | South Africa
Tel: +27 (0) 11 799 8100 | Fax: +27 (0) 11 799 8101 PO Box 10150 Fourways East | 2055 Gauteng South Africa

PRETORIA: 494A Lois Avenue Erasmuskloof X3| Pretoria | SA
Tel: +27 (0) 12 347 8240 | Fax: +27 (0) 12 346 0601 Postal Address: PO Box 32593 |Waverley | Pretoria | 0135 | South Africa

CAPE TOWN: Tyger Waterfront I Waterfront Terraces Block 2 I Waterfront Road I Carl Cronje Drive I Bellville| W Cape
Tel: +27 (0) 21 914 9646 | Fax: +27 (0) 21 914 6515 Postnet suite 275 P/Bag X22 |Tygervalley |7536|Cape Town SA