BRENTHURST WEALTH MANAGEMENT

INVESTMENT REPORT

BRENTHURST
THE HOME OF WEALTH

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Global Markets AND SA ECONOMY

SA CLOSER TO TIPPING POINT

By Magnus Heystek—Investment Strategist

In the late nineties and early part of the 21st century South African investors rushed to take their money offshore out of fear of a collapse in the local currency. Offshore investing was only legalized in 1997 and when the rand soon thereafter dropped from R7 to almost R14 to the US dollar in 2001/2002 it looked like this fear was not misplaced. At it's worst the rand peaked at R13,85 against the US dollar and R20 to the pound sterling in 2001. This led to a rush of investors taking money offshore at precisely the wrong time.

It is a matter of record that the rand recovered most of these losses since then, leading many investors to resist any advice that includes investing offshore.

Over the last eighteen months or so we have been advising our clients to increase their offshore asset exposure which, by and large, has been very good advice. At the beginning of 2011 the rand was trading at under R6,70 to the US dollar, which we considered an excellent time for clients to move money offshore.

By the end of last year the rand touched R8,50 to the US dollar and since then seems to have established a new trading range of between R7,70 and R8,20. On a pure currency basis investors have already made some very nice profits.

Our clients have also responded in great numbers and are showing a far more mature and long-term approach to offshore investing, thereby creating wealth not impacted by localized developments.

WE CONTINUE TO RECOMMEND AN INCREASE OFFSHORE EXPOSURE, MAINLY FOR TWO REASONS AT PRESENT:

FIRST, valuations of local investments, particularly equities and to a lesser extent property are considered to be very stretched, with certain sectors showing signs of being in bubble territory, particularly retailers. More on this a little later on in this newsletter.

SECOND, the question needs to be asked: for how long can the local equity market continue to operate normally within a society that is drowning in a sea of corruption, administrative collapse and a state of general lawlessness?

It is this question that is tending to occupy our minds and research as we try and protect and grow the wealth of our client base.

It is also in this context that the lead-article of the Business Day of Tuesday 8th May 2012 needs to be considered.

We quote certain parts of the leader, headlined **"Lining pockets as the state collapses".** It makes for some sobering reading indeed.

"The office of the auditor-general has been ringing increasingly urgent alarm bells over the state of management of SA's public finances, particularly at municipal level, for years, but the message has now taken on a note of helplessness and despair that is truly disturbing.

A picture is emerging of a public administration that is in a state of collapse across great swathes of the country and—even worse—of a political leadership that is so preoccupied with securing its own position and access to state resources that its either deaf to the warnings or indifferent to consequences of failing to act.

Further on: "*The real problems come when governance is so poor that there is nothing to audit—where records are not kept, minutes of meetings and decisions are never made, employees are not qualified to do their jobs and it is not clear who is responsible for anything.*"

Such an environment of zero accountability is ripe for corruption and this is precisely the outcome that has resulted. It is no exaggeration to say that there are entire towns, and critical state departments, that are now in the hands of organized crime syndicates, masquerading as public servants. Their sole aim is to loot, and creating a climate of general administrative chaos is an excellent smokescreen.

There is no getting away from the fact that the ANC cadre deployment policy bears much responsibility for this horrific state of affairs. People who are given jobs because of their political clout rather than their skills, qualification or even potential to learn are difficult to get rid of when they mess up or steal, for precisely the reason they were bumped to the top of the short list in the first place."

Hard words indeed, but it doesn't differ much from the warning recently made by Public Protector Thuli Madonsella who warned that SA had "reached a tipping point" with corruption now endemic to both the public and private sectors thereby threatening to "distort the economy" and derail the economy".

If the economy is indeed "derailed" then would it not take long for such a derailment to have an effect on the long-term wealth of each and every South African, be it their businesses, shares, properties, pension or provident funds. It is not likely to be an overnight, front-page shattering derailment, but rather a long and slow strangulation of growth, optimism and wealth. Such as the period we already find ourselves in…

LOCAL OUTPERFORMANCE COMING TO AN END

A combination of a stronger rand and an inflow of money into developing countries, especially those resource-rich countries, produced a period of outperformance of SA investments compared to global equity investments over the last ten years or so. This period seems to have come to an end and is expected to do so for the foreseeable future, especially if the slowdown in China and India gain traction.

A number of local fund managers have in recent months moved substantial portions of their allowable funds into offshore markets, seeing more long-term value in especially the developed markets of the world. They include Allan Gray, Coronation and Investec.

In a recent research note John Biccard, who has been running the very successful Investec Value Fund for more than 12 years (and to which a great number of clients of Brenthurst Wealth has exposure) warns that many sectors of the SA local equity market are currently totally over-valued.

"We believe the 'risk on' rally that has occurred over the last six months is not the beginning of a major bull market, but is just another rally prompted by central bank intervention. As with the rally of 2010 and 2011 we expect this rally to peter out.

As relevant as these macro-economic worries are, that lack of attractive valuations in the SA equity market are of greater concern. Careful stock selection is therefore crucial to protect investors against the possibility of sustained capital losses. We maintain our position, avoiding overvalued 'defensive' stocks and remaining overweight rand-hedge laggards.

We believe the recent market trends have resulted in extremes in relative pricing performance. A good example of these extremes is the resource sector that has significantly lagged the broader market. In our experience such extremes end when over-valued shares collapse and, cheap out-of-favour stocks attract investor attention again.

VALUATIONS MORE IMPORTANT THAN MACRO FACTORS

While macroeconomic concerns are relevant, valuations are more important. The JSE All share index is close to an all-time high and is trading on 13 X earnings—a relatively high price earnings ratio (PE) by historical standards. SA has been one of the best performing markets over the last ten years and is now trading at record-high valuations relative to global equities. The upside for SA equities is low and a defensive positioning is warranted.

Usually, defensive shares are to be found in the stable goods sectors. At this juncture, it is believed that these stocks might not prove to be defensive as they have led the market up over the last few years and now trade at very high multiples. Shoprite, for example, is trading at a PE of 27 X earnings, Massmart on 30 X and SAB on 20 X earnings.

Given these very high valuations and the fact that they are owned by foreign investors (who are marginal buyers on our market and can sell at a moment's notice) it is believed that these shares are more vulnerable than most.

Given the strength of the rand and the weakness of the developed market over the last decade, it is therefore not unexpected that fund managers are finding significant value in a number of stocks listed in the US, Europe and Japan.

In contrast to the JSE these markets offer many stocks trading at single digit PE's, discounts to book value and half the price they traded at ten years ago.

OFFSHORE PORTFOLIO

AS MANY INVESTORS ARE AWARE WE HAVE SET UP OUR OWN OFFSHORE FUND, THE BRENTHURST WEALTH GLOBAL BALANCED FUND, JUST OVER A YEAR AGO AS A SOLUTION TO OUR CLIENTS WANTING TO HAVE A DIVERSIFIED INTERNATIONAL PORTFOLIO. THE PORTFOLIO IS HOUSED ON THE MOMENTUM WEALTH INTERNATIONAL PLATFORM AND IS REGISTERED IN GUERNSEY.

The fund is managed by the highly successful Glyn Owen in conjunction with the local investment committee consisting of Brian Butchart, Johan Burger and myself.

After a slow start, as can be expected from a new fund due to the cost structure hurdle inherent such a set-up, the fund is now handsomely outperforming its benchmark.

In addition, we include specialist funds in our offshore recommendations, especially into asset classes and industries that are not available to investors on the local market. A good example of this strategy is technology and biotechnology funds, both which have substantially outperformed the local investment markets.

WE FURTHERMORE ALSO TRY AND EXPOSE CLIENTS TO OTHER PARTS OF THE WORLD, SUCH AS FAST-GROWING INDIA AND CHINA AS WELL AS GLOBAL GOLD AND ENERGY FUNDS FOR FURTHER DIVERSIFICATION. LOCAL INVESTORS CAN NOW INVEST R1M OFFSHORE WITHOUT ANY TAX CLEARANCE WHILE A FURTHER R4 MILLION PER YEAR CAN BE INVESTED BY MAKING USE OF THE PREREQUISITE FOREIGN INVESTMENT ALLOWANCE. **Speak to any of our seven registered investment planners about investing offshore.**

OFFSHORE INVESTMENT RETURNS (ZAR) *MONTHLY & ANNUAL AVERAGE RETURNS*

INSTRUMENT	6 months	1 year	3 years
FTSE/JSE All Share index	5.2	5.2	17.0
Franklin Biotechnology Discovery Fund	23.2	36.0	21.7
Franklin Technology Fund	3.9	17.0	18.9
Templeton Global Balanced Fund	1.4	11.0	6.8
Franklin U.S. Equity Fund	8.3	20.1	11.4
Investec Asian Equity Fund	2.5	5.0	12.2
Investec Global Franchise Fund	8.7	23.0	15.4
Investec Global Gold Fund	-16.7	-7.6	5.8
Brenthurst Global Balanced Fund	6.0	21.0	NA

FOREIGN CURRENCY:

We are now in a position to assist our clients in buying foreign currency using wholesale channels. This can save our clients, whether they are importing or exporting, or simply sending money abroad, up to 4c per rand when buying US dollars, pounds or euro's. All our foreign currency transactions are conducted via **Esmerie Loots (012 460-0340), esmerie@brenthurstwealth.co.za** at our Pretoria office. Please do not hesitate to contact her for a quotation when buying or selling currency.

INVESTMENT SEMINARS: UPDATE ON INVESTMENT MARKETS

- MAGNUS HEYSTEK: DIRECTOR, INVESTMENT STRATEGIST, BRENTHURST WEALTH
- PAUL HANSEN: DIRECTOR, GROUP ADVISORY SERVICES, INVESTMENTS AT STANLIB
- KEVIN LINGS: CHIEF ECONOMIST OF STANLIB

UPCOMING SEMINARS: JUNE 2012 BOOK NOW

PRETORIA SEMINAR:		**05 JUNE 2012**	*PAUL HANSEN & MAGNUS HEYSTEK*
DATE:	TUESDAY, **05 JUNE**	**16:00 - 17:45**	
VENUE:	WATERKLOOF GOLF CLUB, JOHANN RISSIK DRIVE, WATERKLOOF		
RSVP:	**+27 12 460 0340**	yolandi@brenthurstwealth.co.za	
JOHANNESBURG SEMINAR:		**06 JUNE 2012**	*KEVIN LINGS & MAGNUS HEYSTEK*
DATE:	WEDNESDAY, **06 JUNE**	**16:00 - 17:45**	
VENUE:	17 MELROSE BOULEVARD, MELROSE ARCH		
RSVP:	**+27 11 799 8100**	reception@brenthurstwealth.co.za	
CAPE TOWN SEMINAR:		**11 JULY 2012**	*PAUL HANSEN & MAGNUS HEYSTEK*
DATE:	WEDNESDAY, **11 JULY**	**16:00 - 17:45**	
VENUE:	LIBERTY LIFE, THE ESTUARY,CENTURY BOULEVARD, CENTURY CITY		
RSVP:	**+27 21 914 9646**	suzean@brenthurstwealth.co.za	

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