INVESTMENT REPORT

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BRENTHURST
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THE POWER
OF INDEPENDENT ADVICE

IN THIS ISSUE

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SLEEPWALKING
INTO A FINANCIAL COLLAPSE

By Magnus Heystek - Investment Strategist

The South African economy is speeding headlong into a financial crisis, the result of a **"PERFECT STORM"** that is gathering on the horizon, which could wreak serious havoc on employment, the value of the rand as well as government revenues.

Yet, in the face of this approaching economic precipice, we have a government seemingly unaware or, worse, unconcerned, with the flashing amber lights that are warning of great financial instability, rising unemployment and low-intensity social uprising in many parts of the country in the form of service delivery protests.

The collapsing levels of service deliveries, which has long been a part of daily existence in many country towns, have now moved to SA's largest metropolitan area, the Johannesburg-Pretoria axis.

What was considered unthinkable even weeks ago is now set to become a feature of daily life for consumers and business people alike in many parts of the country, including Johannesburg and Pretoria.

Government appears totally unconcerned about these fast-moving events and are seemingly more concerned with protecting president Jacob Zuma from further revelations and allegations about possible fraudulent involvement in the tainted arms deal.

The leaders of other emerging market economies, president Narendra Modi from India in particular, have been travelling the world stage emphasizing the radical and structural changes India is making to its economy in order to make it more attractive to foreign investments.

The further decline of the rand in recent weeks has highlighted SA's vulnerability to the rising US dollar in particular. The rand has dropped by more than 10% in less than three months and is set to decline further, perhaps even dramatically, so in the weeks and months ahead.

Brenthurst Wealth Management (PTY) LTD FSP No. 7833

A rand closer to R12 to the US dollar by the end of the year is now a real possibility and this weakness will result in higher petrol prices, higher food inflation and everything else that is imported.

Looking out further into the future and one can foresee a resurgent US dollar on the back on rising US economic growth and an end to the programme of quantitative easing, whereby billions of dollars were pumped into world markets with a substantial portion of that money finding its way into emerging markets, including South Africa.

This so called "carry-trade", whereby money is borrowed at virtually no cost and investing in high yielding investments in SA, has now ended.

The rand is effectively defenseless in the face of this onslaught as it has very little foreign exchange reserves while its export earnings are also under pressure as a result of the slowdown in mining exports as well as a slowdown in demand from China in particular.

The US dollar has in recent weeks risen dramatically against a basket of foreign currencies and has depressed the price of gold, oil and other commodities on global markets.

The timing of the end of QE could not have come at worse time for the SA economy. Economic growth has slowed down dramatically, from a forecast of 2,8% at the beginning of the year, to an estimated 1,4% at best for 2014. This halving of the economic growth rate is bound to have repercussions for government revenue, already under pressure as a result of the slowdown in retail sales and mining exports.

The new finance minister Nonhla Nene has warned in recent weeks that an increase in taxes is under consideration by Treasury and could include an increase in VAT, capital gains taxes and other taxes in order to plug the fiscal holes that are leaking all over.

To make matters worse the country has recently lost its Reserve bank governor, Gill Marcus, who will not be extending her contract for another five years, adding another layer of insecurity to the already-fragile economic and monetary mix.

HEREWITH A SUMMARY OF SOME OF THE ECONOMIC FACTORS CURRENTLY AT PLAY.

ECONOMIC GROWTH

In many respects the SA economy surprised on the upside in the wake of the great financial crisis of 2008/2009. It recorded an economic growth rate in excess of 3% in both 2010 and 2011, was driven by amongst other factors, a massive surge in retail sales in the back of the boom in unsecured lending and higher-than-inflation salary increase for government workers.

Growth in 2011 was just above 2% and has since then declined substantially. In the first quarter of 2014 the growth was -0,6% while the second quarter was +0,6%.

The sudden collapse of African Bank in August this year has signalled, in our view, the end of the boom in unsecured lending, which perversely has boosted economic growth for SA's retail sector for a very long time.

There is also no prospects for a sudden increase in the growth rate above 3%, as Eskom's well-known problems have placed a cap on electricity generation for years to come.

Add to that now a potential serious shortage of water supply to SA's economic heartland, Gauteng, one can now understand why business confidence has dropped to 15 year lows, according to the Bureau for Economic Research at the University of Stellenbosch.

This lack of confidence, low economic growth and rising levels of unemployment are creating a vicious circle leading to higher crime, amongst other factors.

SOUTH AFRICA
LIVING ABOVE ITS MEANS

The ever-increasing deficit on the balance of payments, in August is at a new high of 6,2% of the Gross Domestic Product (GDP), is mainly funded by inflows of short-term foreign money into our equity market and bond markets.

This deficit is now one of the highest in the emerging market world, particularly amongst those five countries deemed to be economically fragile by the international financial community. The other countries which are in the same boat include Turkey, India, Indonesia and Brazil.

SA now needs an inflow of R200 billion every quarter to finance this deficit, much of it fleeting and "hot global money" in search of high yields.

History shows that this hot money does not stick around when an economic crisis starts. It flows out very suddenly and without warning, leading to great volatility and weakness in the currency. Spare a thought for importers/exporters who have to plan in such a scenario.

The ending of the QE-programme is expected to accelerate flows of capital back to the United States over the next couple of years, the full financial extent which cannot be speculated on.

In a worse-case scenario the rand can collapse to R13-R14 to the US dollar, local bond rates can shoot up to 10% and above and the repo-rate will have to be adjusted upwards by more than 300 basis points to offer some kind of a lifeline to the beleaguered currency.

The rand has further been weakened by the uncertainty created by the announcement of the SA/Russian "nuclear deal". Have we or have we not signed up to buy 8 nuclear reactors from Russian at a total estimated cost of R1 trillion or not? The investment community and the public at large are not getting straight answers from government in response to endless questions in this regard.

Not many years ago it was the most competitive (and largest, economically) country in Africa, but has since been overtaken by Mauritius and even Botswana.

Many smaller and even larger towns across the country, with the exception of the Western Cape perhaps, have become dysfunctional in most areas of water provision, road works, maintenance of infrastructure and sewerage.

It is not being alarmist or unpatriotic to say that many smaller towns have in many respects collapsed when compared to the situation ten or even twenty years ago.

FISCAL POLICIES
UNDER PRESSURE

It is understandable that governments increase their spending in times of economic crisis in order to offset lower expenditure by the private sector. This is called the Keynesian approach to economic management and this is what has happened over the past four years.

In 2010 the government debt was under 30% of GDP but has since steadily climbed to an estimated 46% in the current fiscal year. We will have greater clarity when the mid-term budget is released later in October.

Government has also reached its limits in terms of guarantees it supplies to parastatals such as Eskom, SAA, Transnet and other struggling state-owned entities. In terms of these guarantees government has to provide financial guarantees to lenders of capital (banks and other financial organisations), who make short-term loans to them.

Without these guarantees many such parastatals will cease to operate. Add to this dangerous mix the fact that many municipalities are bankrupt and are owed hundreds of billions of rands by individuals, companies and even the state themselves.

In all, not a financially attractive picture, and there has been very little forthcoming from government, which instills some confidence that the situation will turnaround soon.

The recent World Economic Forum reported that SA's global competitiveness has slipped back even further and now stands at 59th in the world (out of 144 countries).

ECONOMIC SCENARIO
AND YOUR INVESTMENTS

If the scenario is so bleak why then is the JHB Stock Exchange doing so well?

This is a question often posed when the above scenario is outlined to clients of Brenthurst Wealth.

The primary reason is that large listed companies have, over the last decade or more, diversified their business operations and hence income streams away from South Africa into other, better managed counties.

This diversification has taken place in two ways. One has been to seek a listing in London (Old Mutual, Investec, BHP Billiton, SAB Miller etc.) which has been very public, but has attracted a degree of criticism back home.

The other has been much more low-key, such as Shoprite for example, which intends to open 700 stores in Nigeria over the next couple of years. Almost every other company on the JSE, which can has sought better fortunes elsewhere, to such an extent that it is now calculated that more than 70% of all revenues earned by JSE listed companies is now earned outside of South Africa.

Many companies (Murray and Roberts, Redefine etc.) have publically stated that they are not seeking new ventures in SA as the labour situation has become too uncertain and unstable to make long-term investments.

Businesses and enterprises directly linked to local conditions have experienced massive drops in economic value, both in local terms but more particularly in US dollar terms. A prime example are the platinum which has dropped in value by more than 40% this year alone. The same can be said for most local producers.

OFFSHORE INVESTING
OUR RECOMMENDATION?

To a certain extent this question has become an academic one. Until recently many, if not most, local investors have been reluctant to commit themselves to offshore investments. Fortunately, this decision was made on behalf of the investors themselves, who via local companies on the JSE, have gained vital offshore diversification, thereby protecting their personal wealth.

Investors who stuck to a policy of not exposing themselves to foreign diversification have witnessed a dramatic destruction of global wealth.

Asset classes that fall in this category include local residential property, farms, cash and money markets and bond funds. In global terms such investors have lost between 60% and 70% in global value in just over 5 years!

From a peak of R6,50 in September 2011 the rand has dropped by more than 73% against the US dollar and by similar percentages against the Euro and British pound.

As an investment company we have been recommending greater offshore exposure for more than four years. In the winter of 2011 we held several seminars countrywide espousing this view and recommended greater offshore exposure.

This advice, regrettably was met with a great deal of scepticism and resistance. Fortunately for those early investors who took the plunge, especially in respect of certain specialist funds such as biotechnology, technology and health care funds, the returns have been spectacular, in excess of 300% over less than four years.

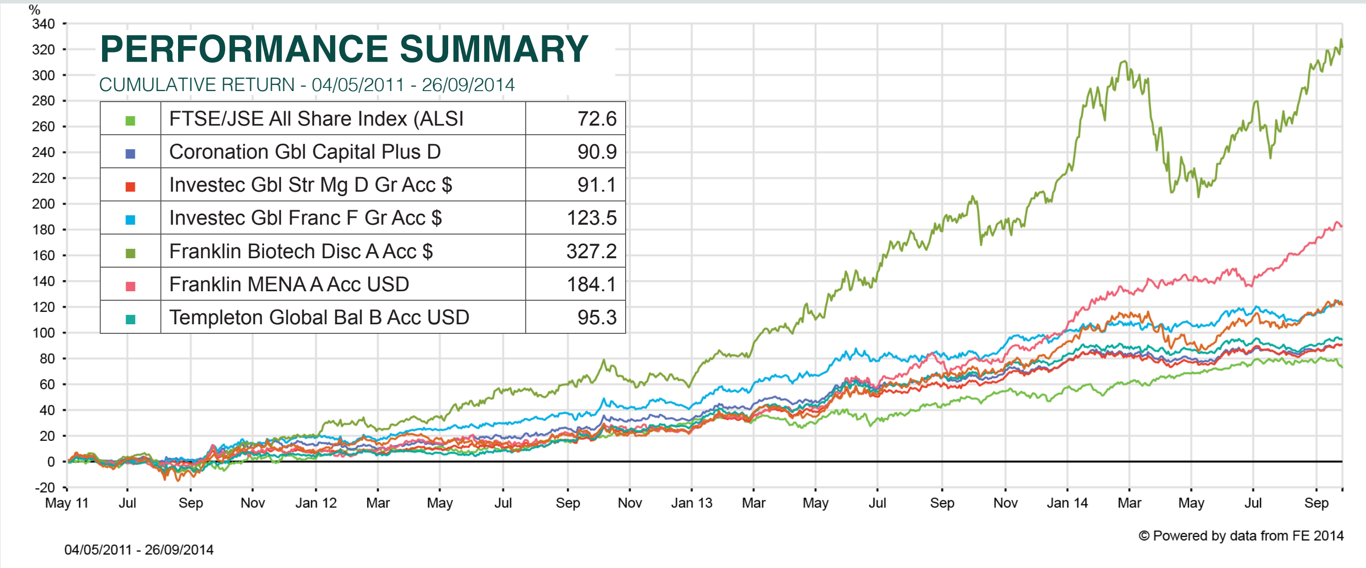
The following table reflects the kind of funds we have been recommending consistently and the returns earned over the past 3 years (see below).

We remain committed to offering this kind of advice as we still feel that global opportunities are offering much greater potential rewards to investors.

Most of our investors and particularly new investors are still way too exposed to SA Inc. in the form of residential property, commercial property, cash and money market accounts. These and other investments offer no protection against further declines in the currency.

We might sound like stuck records at times, but our mandate is to offer our clients the best advice in order to protect and grow their capital.

The harsh reality is that South Africa is facing serious economic headwinds right now. We again urge our clients to consider more offshore diversification in their respective portfolios.



At BRENTHURST WEALTH we make use of a range of the top investment houses in the world in order to create investment portfolios for our clients. These chosen funds are not static and we add and deduct funds from time to time depending on market conditions and performance.

As one can see the decision to invest offshore has been the correct one. The investment returns have outperformed an investment on the JSE by a substantial margin. Even an investment in global balanced funds have given similar and in some cases better returns than higher risk pure equity funds on the JSE.

OFFSHORE DIVERSIFICATION
CAN TAKE PLACE IN THE FORM OF:

1. **Direct offshore investments by means of the R1million annual discretionary allowance (no income tax or SARB clearance needed).**
2. **Direct offshore investment by means of the R4million annual investment allowance for which SARS and SARB clearance is required.**
3. **Offshore asset swaps. Internal changes to local discretionary and living annuity portfolios (up to 100% of asset values).**
4. **Offshore asset swaps. Internal changes to retirement annuity and preservation funds (up to 25% of asset values, depending of asset swap capacity).**
5. **Direct offshore investments do not have to be repatriated back to SA while asset swaps are only redeemable in rands and in South Africa.**

PLEASE DO NOT HESITATE TO CONSULT WITH YOUR DEDICATED FINANCIAL ADVISOR TO DISCUSS YOUR INVESTMENT REQUIREMENTS.

INVESTMENT SEMINAR
CREATING GLOBAL WEALTH

This year has seen the developed world healing, while the economic slump in emerging markets is worsening. Equities everywhere are still powering ahead, seemingly oblivious to economic reality. The South African economy, like its emerging market peers, is suffering, but while the rand has taken the pain, equity markets are at all-time highs? Join JEREMY GARDINER (INVESTEC) and MAGNUS HEYSTEK (BRENTHURST) as they navigate the challenges investors face in this volatile world.

PRETORIA: 10 NOVEMBER 2014
TIME: 15h30 for 16h00
VENUE: Villa Sterne Boutique Hotel, 212 Johann Rissik Drive, Waterkloof Ridge
RSVP: +27 12 347 8240 magda@brenthurstwealth.co.za

JOHANNESBURG: 11 NOVEMBER 2014
TIME: 15h30 for 16h00
VENUE: INVESTEC OFFICE, 100 Grayston Drive, Sandown, Sandton
RSVP: +27 11 799 8100 reception@brenthurstwealth.co.za

CAPE TOWN: 20 NOVEMBER 2014
TIME: 15h45 for 16h00
VENUE: INVESTEC OFFICE, 36 Hans Strijdom Avenue, Foreshore
RSVP: +27 21 914 9646 ronelle@brenthurstwealth.co.za

JEREMY GARDINER - INVESTEC

Jeremy Gardiner is a director at Investec Asset Management. In addition, he is a regular voice in the media, at conferences and to the investment related world at large, responsible for communicating Investec Asset Management's views on current affairs, economics and investment markets.

In his position as a director of Investec Asset Management, Jeremy is inundated with information from the world's top analysts, on everything from politics to petrol. Jeremy's challenge is consolidating all this information and bringing it to you in an understandable format that you will find interesting and informative.

With the company since 1991 and a director of the company since 1999, he is also one of the longest standing members of the global executive management team. Jeremy also served on the board of Western Province/Stormers rugby from 2003 to 2005, a period in which their performance was particularly poor! Although he studied accounting at the University of Cape Town and Economics at the University of Witwatersrand, Jeremy is neither an accountant nor an economist, but uses these skills to demystify what the accountants and economists are saying.

BRENTHURST WEALTH
CERTIFIED FINANCIAL PLANNERS:

Brenthurst Wealth Management (PTY) Ltd is a registered financial services provider and is a fully-fledged financial and investment services company with offices in Johannesburg, Pretoria and Cape Town.

All our Financial Planners are CFP® Professionals and members of the Financial Planning Institute of Southern Africa. They are highly qualified to give advice on all investment matters.

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"THE FINE ART OF MANAGING INVESTMENTS REQUIRES CONSISTENCY, PATIENCE AND THE CRITICAL ABILITY TO PERCEIVE A LONG-TERM APPROACH TO THE CREATION OF WEALTH AND MOST IMPORTANTLY, THE POWER OF GOOD SOUND INVESTMENT ADVICE."

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