BRENTHURST WEALTH MANAGEMENT

INVESTMENT REPORT

BRENTHURST
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CLEM SUNTER HAS A RETHINK

...*“what will the rand do in the near future?”*

In this issue

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Global Markets AND SA ECONOMY

By Magnus Heystek—Investment Strategist

ABOUT a year ago Brenthurst Wealth held a series of seminars countrywide together with the well-known Clem Sunter, scenario-planner and author of many best-selling books on South Africa.

It is always worth listening to Clem as he is very entertaining, well- informed and abreast of the mega-trends shaping the fortunes of this country.

At one of the seminars a client asked him the following question: “What do you think the rand will do in the near future,” to which Clem answered: “I think it will strengthen to below R6 to the US dollar”.

At the time I expressed a different view and strongly advised our clients to make use of the strong rand to increase their offshore exposure. These views were also expressed in several newsletters and subsequent seminars as well.

Brenthurst Wealth even embarked on an advertising campaign to this effect, to such an extent that we were accused of being “negative” about the country.

We recommended this strategy for a number of reasons, including diversification, making use of the strong rand (in our view) and also looking for better investment prospects elsewhere in the developed world.

Last week the rand was trading at levels around R8,80/70 meaning that those investors who were fortunate enough to buy US dollars in order to make their offshore investments at around R6,70-R7,00 to the US dollar, have enjoyed a very nice run.

From a purely rand perspective this advice was very beneficial to our clients, even considering the fact that global equity markets dropped sharply in the third quarter of last year, resulting in short-term losses (in US dollars) in some of the funds we recommended. More about this in our next newsletter.

We were pleased on behalf of our clients that we took advantage of the strong rand and moved a portion of their local assets into offshore funds. Nothing pleases us more than to recommend a certain investment strategy and then to see it unfold as we expected (or hoped) as foreseen. This certainly was the case with our offshore strategy for most of the past twelve to fifteen months.

We are once again forced to consider the outlook for the local currency against the backdrop of several negative developments in recent weeks. These include, naturally, the horrific shooting of 34 miners at Marikana in the Northwest Province, the broadening miners’ strike for higher wages and working conditions as well as other, also negative economic developments, which, while not featuring as prominently on the front pages of the newspapers, are perhaps more damaging to the immediate outlook for our volatile currency.

I am referring to the massive deficit on the current account of the balance of payments announced last week by the SA Reserve Bank. The deficit is the difference between what we as country import and export and at the end of August 2012 was a jaw-dropping R200 billion or 6,4% of gross domestic product. This is the largest trade deficit ever recorded and is currently, in my view, the single most important economic indicator to look out for in the months ahead.

The deficit is not new and has been funded over many years by inflows into, initially our equity market and more recently our bond markets. Inflows have averaged about R40b per month for the last year or so.

As far as Sunter is concerned, he has changed his optimistic outlook on South Africa and its prospects in a very dramatic manner. At our seminars last year he gave a 5-10% probability of SA becoming a failed state.

Last week, in a report on News24 he wrote the following:

"Just over a year ago, Chantell Ilbury and I were giving a 70% probability to South Africa staying in the Premier League, 30% to a peaceful decline into the Second Division and zero to a Failed State. With the tabling of the Secrecy Bill, we changed to 50% for Premier League, 40% for Second Division and 10% for Failed State. Gagging the media would remove an essential pillar of democracy, precipitate a massive increase in corruption and terminate our brand of being a model for the rest of Africa to follow. Accordingly, we went more negative.

With the Marikana tragedy ushering in a period of industrial turmoil which, aggravated by the lack of service delivery, can escalate into a full-blown South African version of the Arab Spring, we have revised the probability yet again. While we are keeping Premier League at 50%, we now have amended the chances of a peaceful versus violent, anarchic decline from 40:10 to 50:50 and therefore accord the Second Division and Failed State scenarios each a 25% probability.

We have been saying for several months that South Africa shares the same characteristics as those existing in all Arab countries that have experienced or are experiencing a popular uprising: an abnormally high youth unemployment rate; combined with active social networks; combined with a growing alienation towards the state by young people. All these uprisings were triggered by a random event and maybe in our case it was Marikana. One senses a change in mood among the workers in this country. They no longer trust authority whether that authority is exercised by employers, the unions or the government. If that deep distrust and anger continues and merges with the total desperation felt by the unemployed, then we have a recipe for a revolution which nobody in authority will be able to control.

Hence, it would be foolish for Chantell and myself to continue backing peaceful decline into Third World status as our favourite downside scenario. Events of the past few weeks have shown how quickly the wheels can come off when the mood turns ugly. However, we are at pains to emphasise that the incidents so far are relatively isolated and we are still a long way from the violence that engulfed Libya and is destroying Syria.

The whole point about scenarios is to recognize when the chandelier in the ballroom is beginning to tremble. The way we are programmed is to stick our heads in the sand and go on enjoying the party until the lights go out. Like everyone else, neither Chantell nor I wish to raise the probability of a terrible outcome. But the flags say otherwise and the purpose of flags is to take emotion out of our judgment on the probabilities of desirable and undesirable futures.

We are still holding the odds at 50:50 on Premier League versus Second Division and Failed State. We still maintain that the country is at a tipping point where it can tip either way. What we are saying, though, is that the penalty for not tipping in the right direction has just become a lot more extreme. Have we as a people got a sense of crisis to remedy the situation? You decide.

As for Chantell and I as two seasoned scenario planners, we sense a perfect storm approaching which could blow us over the edge of the cliff. All around the world, inequality is increasing as technology drives a stake through traditional job creation and human greed ensures the rich get richer. South Africa just started higher up on the inequality scale. We need a new economic accord which gets rid of the waste, inefficiency and corruption. We cannot afford it anymore. We need to tighten anti-monopoly legislation to create the space for millions of new small enterprises. We need to return to a stable industrial relations climate by creating greater wage parity, better living conditions for workers and a greater sense of common purpose.

*All this can only be achieved by setting up an Economic Codesa to come up with a new economic blueprint involving measurable outcomes for all the parties concerned - and to which they are held accountable by each other.
We are in a state of emergency. Collectively, we have to resolve it."*

CONCLUSION

AT BRENTHURST WEALTH WE CONTINUE TO RECOMMEND OFFSHORE DIVERSIFICATION FOR EXACTLY THE SAME REASON WE DID SO 12 TO 18 MONTHS AGO, NAMELY FURTHER RAND WEAKNESS, GLOBAL INVESTMENT OPPORTUNITIES AS WELL AS A HEDGE AGAINST POLITICAL UNCERTAINTY IN SOUTH AFRICA.

THE RECENT DOWNGRADES OF SA DEBT AND CURRENCY BY RATINGS AGENCIES MOODY'S AND STANDARD & POOR'S IS A FURTHER WARNING TO LOCAL INVESTORS THAT FOREIGN INVESTORS ARE TAKING A DIM VIEW OF ECONOMIC AND POLITICAL DEVELOPMENTS IN SA. ANOTHER DOWNGRADE BY ANY ONE OF THESE AGENCIES COULD JEOPARDIZE SA'S INCLUSION IN CITIGROUP'S WORLD BOND INDEX AND LEAD TO A MASSIVE WITHDRAWAL OF CAPITAL FROM OUR MARKETS. SUCH AN OUTCOME COULD SERIOUSLY WEAKEN LOCAL INVESTMENT MARKETS, ESPECIALLY THE BOND AND CURRENCY MARKETS.

BRENTHURST RECEIVES TOP HONOURS

The Financial Planning Institute (FPI) has recently introduced the FPI Approved Professional Practice™ brand which makes it easier for consumers to identify financial planning practices that adhere to the highest standard of professionalism.

The Approved Professional Practice™ accolade is only bestowed upon a practice once certain rigorous criteria have been met, which includes amongst others that at least 60% of the planners are Certified Financial Planners™ and at least one CFP™ professional is a key individual.

Brenthurst Wealth Management (Pty) Limited is therefore proud to announce that we have recently been awarded top honours by the Financial Planning Institute of South Africa (FPI) as an Approved Professional Practice (APP), of which we are one of only five financial planning companies countrywide to have been given this accolade. Kindly refer to the following link: **http://www.fpi.co.za**

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