BRENTHURST WEALTH MANAGEMENT

INVESTMENT REPORT

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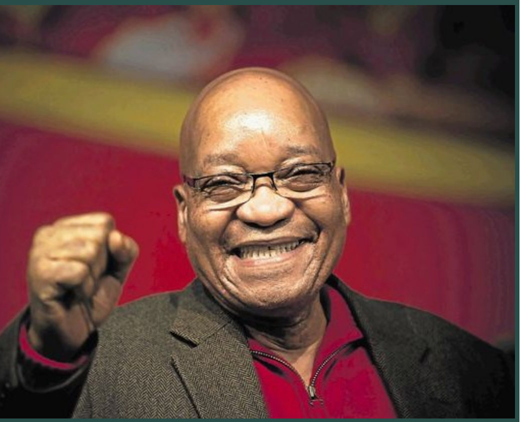

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UPCOMING SEMINARS:

JHB SEMINAR: 04 SEP 2013
PTA SEMINAR: 09 SEP 2013
CPT SEMINAR: 18 SEP 2013

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Global Markets AND SA ECONOMY

JACOB ZUMA, THE ECONOMIST

By Magnus Heystek—Investment Strategist

Listen to the collective groan after being told 'we're doing well.'

Who will ever forget the sight of 'Comical Ali' being interviewed on CNN, BBC and almost every other television station in Baghdad during the 2003 Iraq War, furiously denying that Saddam Hussein was losing the war while, in the background and very visible to television viewers around the world, American tanks and troops were streaming into the city in clear sight of the cameras.

Comical Ali's real name was Muhammad Saeed al-Sahhaf and for a brief period was the minister of information under the rule of Saddam Hussein.

He is best known for his grandiose and grossly unrealistic propaganda broadcasts during the Iraq War, extolling the invincibility of the Iraq Army while they were being slaughtered by the invading western alliance troops. To the last he continued his charade until he himself was arrested.

He, however, was one the few Iraqi ministers who kept his head and today, according to Wikipedia, lives in Saudi Arabia.

A vision of someone similar in total denial came to mind while I was reading a Sapa report on President Jacob Zama's views on the SA economy sometime last week.

"I think there is leadership in the country, very clear leadership. There is certainty on policy; there is certainty on economic policy. I would not accept there is no certainty," he told the National Assembly, responding to a question by Democratic Alliance parliamentary leader Lindiwe Mazibuko.

Mazibuko raised several questions about the government's handling of the economy, including the fact that, according to several reports, that SA's platinum industry could decline by 60% in coming years.

Zuma dismissed these questions, adding that negative headlines (about the economy) were largely to blame for the negative news expressed by the political opposition.

"Generally, people are saying we are doing well. I have just come back from Japan. They are full of praises of South Africa … key investors. So it is not like a perception that is thrown around that investors are worried, not at all."

He said that the economy was well-balanced and aimed at dealing with the country's specific challenges, including imbalances created by its apartheid past.

To which he added: "Therefore, I confirm the policies of the ruling party are absolutely correct; no-one could argue against them. Whoever argues against them does not understand the South African sentiment."

So there you have it, boys and girls, the economy is being run superbly, there are no questions being asked about the government's handling of it and there is no need to panic.

I am sure there must have been a collective groan in the offices of economists, investment analysts and especially credit rating agencies around the country and the world as he was making these comments. If that is what the rest of the cabinet and indeed government are thinking, then we are really deeper in the pooh than we realise.

My first thought was who was the 'they' President Zuma was referring to? Because 'they' certainly have not been buying our bonds and equities in the last couple of weeks and most certainly not been putting down their hard-cash in any committed, significant way the last number of years.

Much of the inflows have been portfolio flows and as we are now learning, it can also flow out at the touch of a button. This week, Moneyweb reported that foreign direct investment (FDI) flows into South Africa decreased by 24% between 2011 and 2012. Angola and Mozambique got more direct investments than their regional economic giant.

The lack of clarity on SA's mining and resource policies for many years now has meant that most of the benefits from the commodity super-cycle have passed us by. Huge investments have flowing to Australia, Canada and Chili, to name just a few commodity-rich countries, which have benefitted far more than SA.

It doesn't help much to keep on proclaiming, as Deputy President Kgalema Montlanthe, said this week on Radio 702:

"South Africa has the largest reserves of minerals, metals and other resources in the world,", while government policies are scaring off foreign investors.

Without foreign investors much of these resources will remain where they are—deep underground.

An interesting little historical tit-bit illustrates the adversarial relationship that seems to indicate that the government of the day has always been keen to get its finger into the resources-pie.

I recently joined the historical Kimberley Club, erstwhile home of Cecil John Rhodes, and still today one of the most historical buildings in SA. There is a framed front page of the Colesberg Advertiser, dated July 16 1867 in the men's bathroom.

The lead article that day concerns the discovery of diamonds by two prospectors, named only as Messrs Hond and Mons, on the farm De Kalk in the Colesberg- area. According to the report the first thing these two gentlemen did when they discovered the diamonds—the first reported find in SA—was to determine what position the government of the day would take with regards to the claim. It was only after clarity was obtained about this issue that the diamond rush could really start in Southern Africa.

It's amazing what history lessons one can learn from dealing with a very temporaneous dilemma…..

THE GREAT UNWIND

Most emerging market counties are potentially exposed to a global retreat of capital back to developed countries, dubbed as the Great Unwind. Some say it has already started, as is evidenced by the sharp drop in EM currencies, including the Australian dollar, Brazilian real and SA rand in recent weeks.

In fact, many consider the SA economy to be extremely exposed to the Great Unwind—the withdrawal of foreign capital from our shores as the cheap money that flooded into our bond and equity markets over the last five years—starts going 'home'. We had a taste of things to come last week when our bond and equity markets were slammed by the sudden reversal of foreign capital.

Research compiled by Dr Alex Pestana from Counterpoint Asset Management, a new boutique asset manager in SA, reveals that SA, together with Brazil, Mexico, Turkey and Ukraine, are the five countries most exposed to a sudden withdrawal of foreign capital.

And is it any coincidence, I asked myself when reading the data, that two of those countries, namely Brazil and Turkey are currently been gripped by massive and largely unexpected social unrest? I also seem to recall that not long ago these countries were touted as the rising economic stars of the future….

EM METRICS – VULNERABILITY TO EMOUTFLOWS

	Capital Inflows		Original Sin				Balance of Payments position			Domestic Credit	
	Surge of Portfolio Flows (% GDP)	Portfolio inflows (share of total)	ST Ext debt (% of total ext debt)	ST Ext debt (% of FX reserves)	Total external debt (% FX Reserves)	Fgn holdings of gov't bonds (% FX reserves)	Basic balance (= Curr. Acc + net FDI), % of GDP	Change in CAD (+ve number is better)	Change in primary budget balance (+ve number is better)	Excess credit (Credit YoY - Nom GDP YoY)	Loan-deposit ratio
	2Q09-4Q12	2Q09-4Q12	4Q12	4Q12	Latest	Latest	4Q12	2Q09-4Q12	2009-12	Latest	Latest
MOST EXPOSED											
Brazil	7%	43%	7%	9%	122%	33%	0.6%	-1.2%	-0.1%	8.2%	1.6
Mexico	10%	62%	21%	45%	217%	46%	-2.0%	0.6%	0.9%	8.3%	1.1
S. Africa	11%	73%	20%	63%	312%	86%	-6.2%	-0.3%	1.2%	0.1%	1.1
Turkey	10%	65%	30%	103%	343%	63%	-4.9%	-2.8%	2.4%	9.2%	0.8
Ukraine	5%	27%	25%	147%	596%	0%	-4.6%	-3.9%	2.2%	1.0%	1.6
BORDERLINE											
Argentina	0%	22%	27%	87%	326%	17%	2.5%	-3.1%	-1.1%	0.0%	0.9
Hungary	5%	22%	11%	55%	482%	55%	3.4%	7.0%	1.8%	-5.1%	1.3
Indonesia	5%	44%	18%	17%	97%	32%	-0.8%	-3.4%	0.0%	13.6%	0.9
Poland	16%	63%	11%	44%	379%	64%	-2.7%	1.6%	4.3%	0.3%	1.0
MODERATELY EXPOSED											
Chile	12%	28%	16%	31%	195%	1%	-0.1%	-1.4%	5.0%	4.0%	1.2
Colombia	4%	25%	13%	27%	210%	6%	1.3%	-0.3%	3.0%	11.7%	1.0
Czech Rep.	9%	46%	26%	71%	272%	22%	2.4%	0.2%	1.1%	4.4%	0.8
India	5%	47%	24%	35%	144%	3%	-4.5%	-2.9%	1.5%	2.5%	0.8
Korea	13%	92%	31%	40%	130%	17%	2.1%	1.2%	1.9%	3.5%	0.9
Malaysia			48%	37%	78%	38%	3.8%	-11.0%	1.9%	8.2%	0.8
Thailand	8%	51%	43%	33%	78%	12%	-0.2%	-3.6%	1.6%	9.0%	1.1
LEAST EXPOSED											
China	2%	13%	73%	16%	22%	1%	4.7%	-5.1%	1.2%	5.3%	0.7
Israel	1%	4%	38%	47%	123%	2%	2.9%	-2.7%	0.2%	0.0%	0.9
Peru	2%	9%	16%	13%	82%	12%	2.6%	-0.9%	3.9%	7.7%	1.0
Russia	1%	12%	13%	17%	147%	3%	3.7%	-0.2%	6.8%	9.8%	1.4

Source: Haver Analytics, various national sources, Morgan Stanley Research; We also employ a credit rating average so as to anchor the level of countries in the rankings; We mimic Indonesia's inflows for the missing values for Malaysian portfolio flows. Countries listed alphabetically within exposure groups. FX reserves exclude gold.

The implications of a global reversal of foreign capital from developing to developed countries cannot be lightly dismissed. I have previously written that almost without fail, crisis in developing countries have been caused by a rising US dollar.

<u>According to Dr. Pestana the following scenario could unfold:</u>

- ⇒ EM assets that have been driven by liquidity flows rather than fundamentals will sell off. EM bonds and listed property fall into that category.
- ⇒ Money to flow out of SA risk assets supported purely by search-for-yield dynamics.
- ⇒ ZAR to remain under pressure; interest rate cut totally priced out of mark and in fact, rate hike factored in..
- ⇒ Expensive defensive shares could relatively de-rate in such a scenario.
- ⇒ Policy rates will need to rises to stop the haemorrhaging of capital out of EM.

Warren Buffet is often quoted as saying that when the tide goes out everyone will see who has been swimming naked. I have a sneaking suspicion that SA has been skinny dipping……

UPCOMING SEMINARS: CREATING GLOBAL WEALTH

BRENTHURST WEALTH & FRANKLIN TEMPLETON INVITE YOU TO OUR UPCOMING SEMINARS:

JOHANNESBURG:

Date: 04 SEPTEMBER 2013
Time: 16h00 to 17h45
Venue: Bryanston Country Club, 63 Bryanston Drive,Bryanston,JHB, Gauteng
RSVP: JHB +27 11 799 8100 reception@brenthurstwealth.co.za
Presenters: Evan McCulloch (Biotech PM) I Nic Steyn I Magnus Heystek

PRETORIA:

Date: 09 SEPTEMBER 2013
Time: 16h00 to 17h45
Venue: Waterkloof Golf Club, Johann Rissik Drive, Waterkloof, PTA
RSVP: PTA +27 12 347-8240 yolandi@brenthurstwealth.co.za
Presenters: Evan McCulloch (Biotech PM) I Nic Steyn I Magnus Heystek

CAPE TOWN:

Date: 18 SEPTEMBER 2013
Time: 16h00 to 17h45
Venue: 15 on Orange Hotel, cnr Grey's Pass & Orange Street, CPT
RSVP: CPT +27 21 914 9646 ronelle@brenthurstwealth.co.za
Presenters: Evan McCulloch (Biotech PM) I Nic Steyn I Magnus Heystek

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