



THE POWER
OF INDEPENDENT ADVICE

IN THIS ISSUE

“It’s very nice and dandy to tell people to “remain invested for the long term” when it’s not your money.”

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CAUTION ...INVESTMENT SPEED BUMPS AHEAD

By Magnus Heystek, Investment Strategist & Director Brenthurst Wealth Management

THE SA retirement industry loves to scare people about how poorly they will be off in their retirement years. They love throwing around those oft’ quoted statistics that only 6% of the population can afford to retire “comfortably”, whatever that means.

For a start that 6% number is inaccurate and applies to developed countries such as Australia or Canada, and not to South Africa. Even a superficial analysis of SA’s demographics (55 million people), people employed (16 million) and number of people paying income taxes (6 million), will reveal that the number is closer to 3% of the population.

But even that much lower number is currently under threat, partly caused by the retirement industry itself, aided and abetted by the prescriptive (and restrictive) investment guidelines imposed upon savers by virtue of Regulation 28 of the Pensions Act.

Reg28, as it is referred to in the investment industry, are guidelines determined by National Treasury, which have been influenced by the heavy-hand of exchange controls over many years. In short, Reg28 has limited the percentage that fund managers or individual investors are allowed to expose to offshore assets within their pre-retirement funding years.

Reg28 has been forcing local asset managers and investment advisors into limiting the amount of money that can be invested offshore for their clients. And as anyone in the investment industry knows, offshore markets have been producing annual returns at double and in the case of the USA treble the rates earned on the local stock market.

In fact, the local market has battled to even beat the local inflation rate over all periods up to five years. Yet, one reads very little about this exploding time-bomb in the mainstream media, who either is not aware of it (they should be) or they prefer, like the rest of the investment industry, to believe that “*Alles sal regkom. Moenie worry nie..*”

But for how long can the asset management industry and its thousands of advisors ignore this elephant in the room?

Every year for the past four to five years I’ve watched the investment giants such as Old Mutual, Coronation, Sanlam, Allan Gray and others trot out that hackneyed appeal for investors to “stay invested”, that “cash is trash” and that over the long term equities will beat inflation.

Well, we are now in year 5 where cash has beaten equities, and not only by a slim margin, but by a massive one.

Take for example, the following forecast made for the Johannesburg Stock Exchange (JSE) by Peter Brooke, Head of Old Mutual Investment’s Head of Macro Solutions in the FA News Magazine of November 2017: “*The sell off in local assets have made them cheaper and the better valuations means higher future expected returns.*”

For instance, we have increased our expected returns for the local property and local bonds by half a percent. We are also looking at SA assets that have priced in the bad news, including listed property and selected equities such as Absa,” he was quoted as saying.

For the record, the JSE overall index declined by 4% year on year during 2018 while listed property lost almost a quarter of its value.

The Old Mutual Investors fund, its largest multi-asset manager, which Brookes runs, lost 8% year on year while cash returned 8%, making it the fourth year in a row for cash to better the return of multi-asset local funds.

A year later we have the same Brooke with the following on Network 24 on December 24, 2018:

“Now is not the time to sell your local assets for cash or to take it offshore. We see Wall Street as overvalued and have been bringing some of our cash back to invest in SA.”

One can find the same sentiment and comments from virtually all SA’s large asset managers and they all have the same optimistic forecasts about the local equity market. The sad reality is that the JSE has hardly beaten the inflation rate over 1- 5 years now while all three categories for retirement funds (low-, medium- and high equity) are under water against inflation over 1-5 years.

OLD MUTUAL VERSUS CASH OVER YEARS

Currency: ZAR



One gets the impression that so much money is flowing out of these asset managers that they are desperately beseeching their clients not to withdraw more money or take it offshore. This in our view is not good advice.

It is hard to comprehend that this news does not feature in the mainstream financial press and one needs to almost question why. Is it a misplaced sense of loyalty or are there other, more telling reasons for this one-sided approach. Advertising revenues perhaps?

CAUTION SUGGESTED:

However, a more in-depth analysis of SA's precarious economic and financial situation suggests that the rose-tinted forecasts of the investment giants need to be approached with a great deal of circumspection.

There is, in fact, a very strong argument for remaining in cash or funds with a high cash content than falling for the lure that the next great upturn is just around the corner. These large asset managers will never advocate a move to cash, for one simple reason: fees. The fees on multi-asset funds are up to four times that of cash funds.

A switch to cash will lead to a significant reduction in fees, bonuses and even promotion. Careers are built and made on multi-asset funds, never cash funds.

Long-standing clients of Brenthurst are aware that we been recommending a great deal of caution with regards to local investment funds.

Our two local fund of funds - THE BRENTHURST CAUTIOUS AND BRENTHURST BALANCED FUNDS OF FUNDS - have very high exposures to cash and bonds. We simply do not see a sudden improvement in the outlook for the local equity market and in fact, remain very negative in the short term.

We equally have been externalizing a great deal of clients' money over the past five years, in some cases with spectacular results. We still see better investment prospects for capital than in the local market.

It's very nice and dandy to tell people to "remain invested for the long term" when it's not your money. Many investors cannot afford a prolonged period of non-performance as we have experienced over the past 5 years.

JSE VERSUS THE REST OF THE WORLD

The JSE has been one of the worst-performing stock markets in the world over the past 5 to 7 years.



An investment in a global index has produced returns more than double of the JSE while the returns on the S&P500 has returned treble that of the JSE. The JSE has also been underperforming against the MSCI Emerging Market index, an index which it has beaten consistently over many decades

In fact, the JSE has become something of an economic backwater over the past ten years, directly as a result of the economic mismanagement of the economy by the ANC under Jacob Zuma.

If one has to believe the local asset management industry, ours is the best place in the world to invest your money, which we know is simply not the case. That's why we are sometimes astounded at the optimistic forecasts by the SA asset management industry.

Our independent analysis of local economic conditions remains at odds with the hopelessly optimistic forecasts of many of our large asset management companies.

HERE ARE SOME OF THE ISSUES WHICH WE FIND CENTRAL TO OUR NEGATIVE OUTLOOK ON THE JSE:

- Foreign money has been flowing out of the JSE equity and bond market consistently since 2014 and the total outflow (according to the end January 2019 figures) is now close to R500 billion.

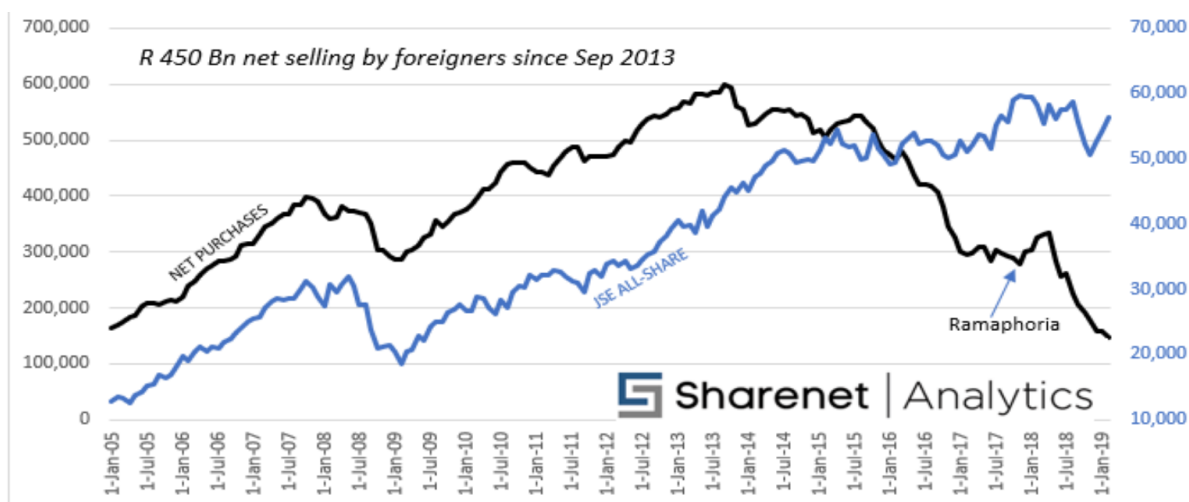
This selling started in 2014 and continued relentlessly, apart for a small uptick around Ramaphoria (October/November 2017) and has even accelerated in recent months. This is due to a general emerging market sell-off and rising global interest rates.

But perhaps more than that, it's the direct result of bad and often illogical policy decisions as well the poor management of the economy.

This massive capital flight has been a major headwind for the JSE and further declines lie ahead, unless there is a dramatic turnaround in the flow of capital. Based on the experience of the last four years, this does not seem likely in the near future, especially not with the uncertainty created by the general election on May 8th 2019.

OUTFLOW OF CAPITAL FROM SOUTH AFRICA

NET FOREIGN PURCHASES OF SA SHARES & GOVERNMENT BONDS (Rm)



- Company profits are under extreme pressure. According to Thompson Reuters more than 70% of listed Top 40 companies have disappointed on the downside to analysts expectations over the past 12 months.
- The Bureau for Economic Research at the University of Stellenbosch University has estimated that the financial costs of State Capture could be as high as R1,5 trillion, while growth over this period could have been 30 to 50% higher, with about R500 bn more in tax revenue and 2,5 million more jobs. The optimistic forecasts emanating from the asset management industry seems to deliberately ignore these dire statistics.
- The issue of expropriation without compensation (EWC) might have moved away from the front pages of the media for a while, but it will come back very soon in the run up to the election. It is hard to accurately measure the damage EWC is doing to the economy, but just one indicator - applications for new mortgages - has declined by 16% in the third quarter of 2018.
- A possible Moody's downgrade. International ratings agency Moody's is the only agency still having an investment grade rating on SA's credit and foreign debt. Any further downgrade to sub-investment grade - known as junk- will lead to a massive outflow of money from the SA equity and bond market and weaken the currency even more.
- In addition, the ANC in its election manifesto has signalled its intent to reintroduce some form of prescribed asset requirements for the retirement industry. This will come as another blow for retirement fund members who have already seen their retirement dreams dashed by 10 years of economic mismanagement by the ANC under Jacob Zuma.
- All these and more (state of SOE's, Eskom and municipalities etc.) seem to be totally ignored by our optimistic forecasters trying to paint a rosy picture, fearful of losing funds under their management.

CONCLUSION:

There's no point beating around the bush or trying to pretend that the negative and destructive trends concerning SA's investment markets are not happening or that they will miraculously arise out of their slumber. Residential property has not beaten inflation over almost 11 years now while listed securities has shown the same trend over 5 years now. The only two asset classes that have consistently beaten inflation has been cash in the form of High Income funds and offshore assets. That still remains our major investment recommendations to protect your retirement capital.

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