Robert Cowen Investments
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Newsletter

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The Family Office

You are welcome to pass this newsletter on to friends who may wish to learn more about investment.
To be added to our email, contact alan@rcinv.co.za

"They told me I was gullible, and I believed them."

"I had amnesia once – or twice."

RCI MET Flexible Fund – closed January at 387.28, 3.96% down for the month but 8.46% higher than 12 months ago. The JSE Top 40 fell 3.78% for the month but down 2.32% versus a year ago. See more inside.

Visit our website: www.rcinv.co.za for back copies of the newsletter, background information, etc.

Trying to time the market – how David Granville got it so wrong.

Global markets are down $6 trillion in 2016. What is causing it?

How the drop in the rand keeps our mines going – which prevents and even bigger fall in the currency.

Is a drop in country credit rating already discounted?

What to do?

Decide how much you want onshore and offshore.

How much in rand hedges?

Examine your cash levels.

Buy quality shares that people 'have' to buy the products of, such as booze, cigarettes and pharmaceuticals.

Buy shares where the dividend (after tax) approaches the rate you can get from the bank.

Keep your courage close at hand, you will need it to buy bargains.

Movember- a report back from our dealing room.

What has changed over five years?

What was the oil price? See how commodity prices have collapsed.

Trying to time the market

From Fuller Treacy Money letter on the folly of trying to time markets (9th Jan 2016)

Here is the latter section of this informative, sensible column by Barry Ritholtz for Bloomberg

http://www.bloombergview.com/articles/2016-01-07/be-smart-don-t-try-to-time-this-stock-market

I bring up Granville for obvious reasons: The anniversary of his terrible market call coincides with the unnerving plunge in Chinese markets. For those of you who may be unfamiliar with the whole story -- spoiler alert! -- here is the coda to Granville's market-timing recommendation. As the chart below shows, 1981 was just about the start of the greatest bull market the world has ever seen, rising 1,447 percent during the next 20 years. Granville, who died in 2013, never managed to admit his error or reverse himself; he ended up being consigned to the dustbin of history, his track record in tatters. Mark Hulbert, who tracks the performance of investment newsletters, noted in 2005 that Granville's letter was at the bottom of the "rankings for performance over the past 25 years - having produced average losses of more than 20 percent per year on an annualized basis." Ouch.

I bring up Granville today as a reminder of the many risks we undertake when we 1) try to time markets; 2) take ourselves too seriously; and 3) refuse to acknowledge our fallibility.

It's the last of those three that has been most resonant this week. Some perennial bears have been declaring vindication for their great market insight -- this despite having missed the better part of a 250 percent rally since this bull market began.

My colleague Ben Carlson makes several astute observations about this, perhaps the most important being that "your favorite pundit isn't going to be able to help you make it through the next bear market." A close second is that "the majority of the people who have been scaring investors by predicting a bear market every single month for the past seven years will be the last ones to put their money to work when one actually hits."

The bottom line is this: The relentless rising trend for markets has been broken, and whether it is going to recover anytime soon is unknowable. Your best bet is to have a plan, stick to it and keep your own counsel.

Oh, and don't try to be a Granville. It's a career-ender.

David Fuller's view

No one can predict the future. However, we can make some strategic educated guesses in stock markets, by being interested in market history, by paying attention to market valuations, by being disciplined investors, by understanding crowd psychology, by paying attention to the trend of governance in markets of interest and most of all, in my opinion, by observing markets via price charts and using a practical, factual common sense approach to what I have called Behavioural Technical Analysis throughout my career.

Choppy markets - rand fall saves miners

Since the end of November, markets have been very difficult. This applies to most world markets whereas South Africa had, at least, the firing of a finance minister to blame as well as the threat of being downgraded. In fact, our interest rates and currency are already behaving as if we HAVE been downgraded. It is notable that our government bond rates are now trading at higher yields than those of Russia and Brazil who have already been downgraded. Thus, it might be best to simply get the downgrade out of the way, and a few months later rates should improve, rather than everybody fearing it happening. This is not to say that the markets will not react negatively if South Africa is downgraded, but we do think those excesses should be short-lived.

Weirdly, one may view President Zuma as having done the miners a favour. Mines sell their output in US dollars and we were fast approaching the point where the falling mineral prices were getting to be lower than our costs. Mines can only sell at below production cost until their cash piles run out, then they are forced to borrow (from which sucker?), raise capital (in this market?) or close. When they close then the country stops earning foreign currency and we can no longer afford our imports – then the rand would really collapse!

A falling currency means that the rand sale price of metals rises and South Africa can afford to continue to produce for longer. Chinese demand for metals has waned so our mines are in fierce competition with Australian and South American mines to not be the highest cost producers. We estimate that there is about a 25% oversupply of minerals being mined so about 20% of production is likely to go insolvent, more if China slows rapidly. We just don't want it to be the South African mines that close.

Big drop in stock markets in 2016

The following graph shows how world markets have dropped $6 trillion this year. Partly, this is due to negative interest rates in Europe and Japan and the fear that the US may have to follow to negative rates in the next few years. We take the view that the thing that most fear seldom happens and the US government will take big steps to prevent this. As only 13% of US trade is with outsiders (and half of this with Canada and Mexico), the US is still very much 'an island'.

Obviously one does not want to catch a falling knife but once the market bottoms, or values become irresistible, we will turn buyers. Mainly, we want shares that have products people 'have to buy' such as booze, cigarettes and pharmaceuticals.

What is scaring world markets?

Some oil producing countries such as Saudi Arabia and Norway were, a few years ago, making a fortune and investing some of the proceeds through sovereign wealth funds. These funds bought fortunes' worth of shares in world stock markets. Suddenly the stream of cash has dried up and they can no longer buy. Simply, not having these large buyers to absorb normal selling is enough to make markets fall. In fact, as some of these large oil producing countries' budgets go into deficit, they may even be forced to sell some of their shares. This can cause the markets to tank. Over a longer period of time, the consumers of petrol slowly save money when filling up their tanks and slowly get richer. Then they can finally afford to buy shares. However, there is a hiatus period when the sellers sell but the buyers are not yet ready to buy. This causes a plunge in share prices, as we are currently experiencing.

We have mentioned the threat of negative rates which is linked to the threat of deflation. If things are getting cheaper, why buy them now? If you wait, they will get cheaper. Demand falls into a death spiral and profits collapse. We have learned over many, many years that these fears are very unlikely to materialise. So start to nibble when the value becomes irresistible. This may be simple but it's NOT EASY. We say, only half tongue in cheek, that we know when it is time to buy – when our stomachs wake us up at 3 o' clock, three nights in a row, worrying about the markets. How to reverse fear and greed is one of the oldest questions in investment literature.

When to start nibbling?

As wealth slowly builds, people will start to wonder how they can earn more than the very low interest rates offered by banks and they will be tempted to buy "safe" shares where dividend yields are much higher. However, if those share prices are falling, most investors will stand back until they finish falling! At some point, the yields get high enough and some brave chap takes the plunge. The shares start going up and the whole herd follows his lead. It is a bit like the wildebeest migration in the Serengeti, and just as brainless in a way. Nobody knows when the market will turn. The only thing we do know is when the shares offer good historical value and excellent dividend yields.

Is it a safe company?

Then we must try to ascertain if the company will be able to maintain its dividend, even if economic circumstances deteriorate further. If we are sure that we are looking to invest in a "safe" company, one can slowly start easing our toes into the water. If we are going to earn a lot more in dividends than we will from the bank, does it matter if the price goes down a little further first before turning up? No, not if we have a three to five year investment horizon. If however, we are short-term traders who may be forced to sell if the prices drop further, then there would be danger in taking the plunge too soon. If we invest in a company which is not "safe" that has highly erratic earnings, we may do ourselves substantial damage by buying too early.

Above is the share price over the past ten years of Johnson& Johnson, the huge US pharmaceutical company which sells pharma, baby soaps, etc. Next year, people are going to use roughly the same amount of their products as they will this year. Does it matter now that the share price plunged from $70 to $50 in 2008? The important thing was that it steadily grew its dividend, then sooner or later the price would start to move up again.

Similarly, in a South African context look at the graph of Standard Bank which we have chosen because it has hardly changed its nature over the past 30 years. It has risen from about R1 to R110, having touched R176 during 2015. Thus it has fallen by 37% in recent months. Nobody knows when it will turn up again, but history shows that a sharp fall led to great performance over the next few years. In 1998 it fell 55%. Does it matter whether you got in 30% from its peak, or 40% or 50%? Does it matter whether you paid R20 or R17 or R15? No. What matters today is that you bought it then, so when it rose over 5 times in the next 16 years, you made a lot of money. If you buy now you earn a 5% yield after tax! You are being paid handsomely to be patient. Thus nibbling after a large fall, usually turns out to be a very good thing to do.

So, keep your courage in your handbag. You are going to need it soon to buy near the bottom!

The first decision is how much offshore versus onshore.

Second decision is the level of cash in each portfolio.

Thirdly, how many rand hedges to own.

Fourth, the underlying value of each share.

Fifth the level of dividend income.

These are the issues occupying our thoughts.

The Movember Mavericks by Vass Vasselou

The month of November has come and gone, and so has our attempt at sprouting whiskers (according to Alan McConnochie). At times throughout the month of November it felt like a rodent had fallen asleep on our upper lip however, the brave men of RCI persevered and managed to raise an impressive R11 750. An immensely satisfying effort from the three stooges, an effort well worth attempting to be a Tom Selleck impersonator for the month.

Although the Mo's are gone for the year, the global contributions to the Movember Foundation will hopefully be long lasting. Altogether, R720 437 410 was raised worldwide, an indication as to the efforts put forth to raise awareness and support for this fantastic cause.

From the side of RCI and in particular Vass, Eric and Byron we would like to say a massive thank you to the wonderful clients that so generously donated to the Foundation, your generosity is hugely appreciated.

NOW AND THEN

How the world has changed in the past five years

	2010	2015 or latest	Change
The cost of commodities			
Brent oil (US$ per bbl)	95	38	-60%
Iron Ore (US$ per tonne)	167	39	-77%
Gold (US$/t oz.)	1,421	1,063	-25%
UN Food Price Index	225	157	-30%
Cocoa (US$/mT)	3,035	3,369	11%
Lithium prices (US$/metric ton)	5,180	6,600	27%
The cost of capital			
10-year US Treasury yield	3.29%	2.22%	-107 bps
10-year German bund rate	2.96%	0.61%	-235 bps
30-year US Treasury yield	4.33%	2.95%	-138 bps
VC investments, US (US$ bn)	24	47	100%
BBB Corporate bond yield	6.6%	5.1%	-144 bps
The cost of technology			
Global smartphone penetration	18.6%	74.6%	56 p.p.
Top 1% of mobile data users as a % of total use	52%	18%	-34 p.p.
Monthly active Facebook users (in bn)	0.6	1.6	161%
Hours of video uploaded to YouTube/min	24	400	16.67x
Cellular phone and network equipment price index	1.9	0.8	-58%
The cost of labour			
Minimum wage in the UK (£/hr)	5.9	6.7	13%
Average wages in China, (000s of CNY)	37.1	57.3	54%
Industrial robots sold (000s)	121	229	89%
Japan female labour participation rate	60%	65%	5 p.p.
An era of abundance			
LED lamp price (US$/klm)	50	11	-78%
Solar PV c-Si electricity cost (US$/MWh)	211	133	-37%
Li-ion battery prices (US$/g)	1.0	0.4	-60%
Cost of sequencing a genome (US$)	46,774	1,363	-97%
Oil supply (million barrels per day)	87	97	11%
Article count on Wikipedia (millions)	17	37	116%
Seeking growth			
EMs one year forward GDP growth projection	6.5%	4.5%	-2 p.p.
Number of dresses sold per minute on Ebay	6	90	15x
Alibaba's Singles Day revenues (US$ bn)	0.14	14.3	102.14x
Airbnb guests (000s, over the summer)	47	17,000	361.7x
Corporate colour			
World Market Capitalisation (US$ tn)	52.0	62.8	21%
Energy as a % of MSCI world index	11%	6%	-5 p.p.
Capex (GS global coverage, US$ tn)	1.79	2.17	21%
Global M&A deals announced above US$10bn	21	83	295%
Biggest company by market cap	Petrochina	Apple	
Some things don't change...			
Africa as a % of global trade	3.2%	3.1%	0 p.p.
Life expectancy	70.27	70.91	1%
Speed of a 747 Jumbo jet (km/h)	988	988	0%
Sq. mt of luxury property that $1mn can buy in London	23	21	-9%
Japan GDP per capita (000s of yen)	3,767	3,835	2%
...while others do			
Top of the English Premier League	Manchester United	Leicester City	
Bitcoin (in US$)	0.3	453.6	1511.97x
Temperature in Tokyo in December (Celsius)	4.4	12	173%
Top Grossing Movie	Toy Story III	Not out yet	
Beijing Air pollution (PM2.5 concentration in $\mu g/m^3$)	104.0	70.4	-32%
Superbowl Champions	Packers	Patriots	
Fuel efficiency of a Ford F150 (MPG)	17	22	29%
China's military expenditure as a % of the US	18%	35%	18 p.p.

Notes: VC Investments to 2015Q3, phone &network equipment index 1987=100, UK minimum wage for ages 21+, Japan female participation for ages 25-54, annual avg given for Beijing air pollution (levels reached 300+ on red alert day earlier this month) and Chinese military expenditure as % of US for 2010 & 2014.

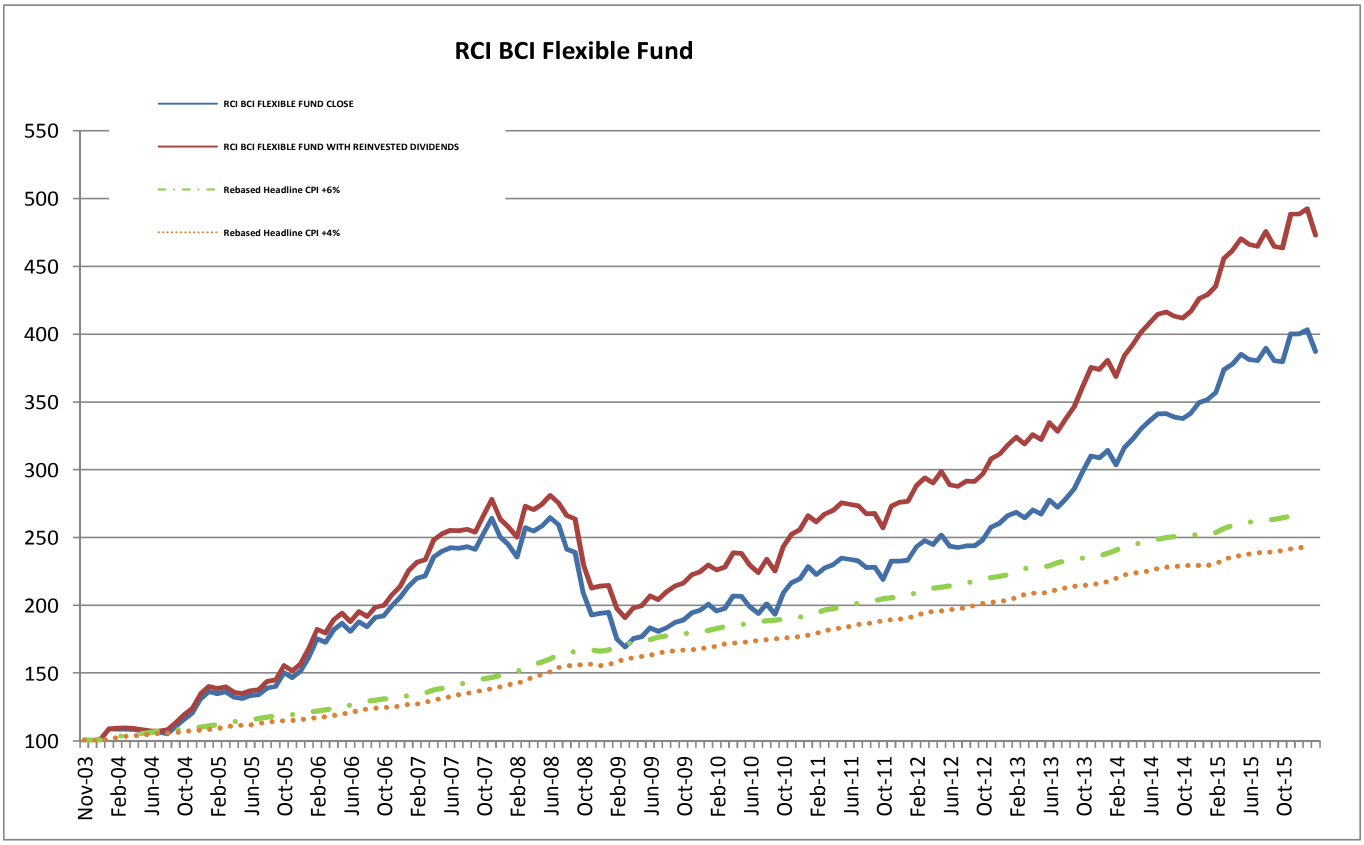
Sources: Goldman Sachs Global Investment Research, Bloomberg, USGS, PricewaterhouseCoopers, LLP/National Venture Capital Association, MoneyTree, Thomson Reuters, Cisco, Company data, news sources, Federal Reserve, ONS, IFR, OECD, US DOE, National Human Genome Research Institute, IEA, Wikipedia, IMF, Factset, WTO, World Bank, Knight Frank, US State Department, SIPRI.

RCI BCI Flexible Fund – Up 8.46% over 12 months - in position 11/84 of flexible funds

Please contact Maggie on 011 706 1420 for any help on your unit trusts.

RCI BCI Flexible Fund dropped 3.96% for January closing at 387.28c per unit. The JSE top 40 fell similarly (-3.79%) for January but is down 2.32% over 12 months whereas your fund is up 8.46% We are outperforming because we have no mining or Sasol shares and we also have 25% in offshore investments.

It has almost doubled over five years.



Unit trust has flexibility – happy to take small amounts

The unit trust has the flexibility to buy and sell shares and to change weightings more frequently than in an individual portfolio. We are happy to take small amounts into the unit trust (from R500 per month or lump sums of R3000). As you will not pay commission to any agents there is no cost to get in and out of our fund. On selling, the amount you receive back will depend on our performance.

Collective Investment Schemes in Securities (Unit Trusts) are generally medium to long term investments. The value of participatory interests (units) may go down as well as up and past performance is not necessarily a guide to the future. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. A schedule of fees and charges and maximum commissions is available on request from the company/scheme. Commission and incentives may be paid and if so, would be included in the overall costs. The portfolio is registered under the license of Boutique Collective Investments, a member of the Association for Savings & Investment SA. Forward pricing is used. More details are contained in a fact sheet that is available on request.

To conclude

The stock market has endless cycles of fear and greed. Currently fear has the upper hand. So how to buy when others are feeling fearful is one of the most difficult questions to answer. What if this time we are wrong and the world continues to crash? Firstly, the world can only end once and history shows that optimism, near a bottom, vastly outperforms pessimism.

Secondly, we advise that the bulk of your investments (both locally and overseas) be in shares with high and growing dividend yields. Nestlé pays over 3% yet putting your cash into a bank in Switzerland results in a negative return. Nestlé has survived two world wars and many economic cycles. It is spread over about 100 countries. It sells baby food, chocolate and coffee. People are going to buy their products this year, and next! Its risk of total failure is negligible.

Similarly, Standard Bank has never cut its dividend in over 45 years, it is unlikely to start now. It will pay you three dividends over the next 13 months totalling about 7.6% AFTER TAX. Just how badly can you do, measured in rand terms?

This is the point where new investors and advisors die of fright and are paralyzed to act but now is a time when experienced investors know is close to a bottom. Sure, of course we might be wrong, this time it might well be different but that is not the way to bet. And if we are wrong, you will still be earning wonderful dividends and, we bet, that your shares will fall less than the market and you will be able to swap at the bottom into shares that have fallen even more.

So, HOU MOED, keep courage. The sun will rise in the morning and things will over-react upwards again. Bet with the percentages, one can seldom predict a turning point (no one seems to get it right twice in row, so the first time was mainly luck). Rather, wait till shares are giving great value and slowly ease into them.

Best Regards

Di and Alan