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

"Don't cling to a mistake just because you spent a lot of time making it." ~ Unknown

RCI MET Flexible Fund – closed June at 384.38c, down 4.64% for the month but still 1.59% higher than 12 months ago. More importantly, it is up 11.91% per annum over the past five years. The JSE Top 40 fell 4.17% for the month and is down 0.36% versus a year ago. Brexit has done some strange and unexpected things to share prices and currencies. All the more reason to stick with the tried and tested formula of buying great shares, when they are cheap and sticking to the plan. See more inside.

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

Please take note:

- Financial Statements for Trust Accounts should be available by the end of August.
- Please cc Michelle@rcinv.co.za on any request for payments. It can take up to 2-3 days for payments (as funds often have to be recalled from PSG). If we have to sell shares first it takes up to 8 days, but the JSE will shorten this by two days from mid-July.

Great advice from teenage singer

South Africa is an "expensive Asia", not a "cheap Europe"

Brexit – all consuming this month

- "Then it occurred to me that I am not powerless at all. There is something big I can do. I can pretend nothing is happening and get on with the ordinary business of living and working." London based columnist, Lucy Kellaway on how to handle Brexit.
- So much noise - not that much action.
- Ross McConnochie, our offshore portfolio manager, unpacks Brexit for you.

Best advice

"The best advice I ever got a as a teenager was to think about your actions because if you are 80 years old looking back, you know if your dad calls you at 8 in the morning and wants to go to breakfast, as a teenager you are like, 'No I want to sleep.' And as an 80 year old looking back, you go to breakfast with your dad. It's just those little decisions like that." ~ Taylor Swift, young American singer at 21. Who says kids are shallow?

http://hollywoodlife.com/2011/08/08/taylor-swift-teen-choice-awards-ultimate-choice/

SA - "an expensive Asia" - great quote

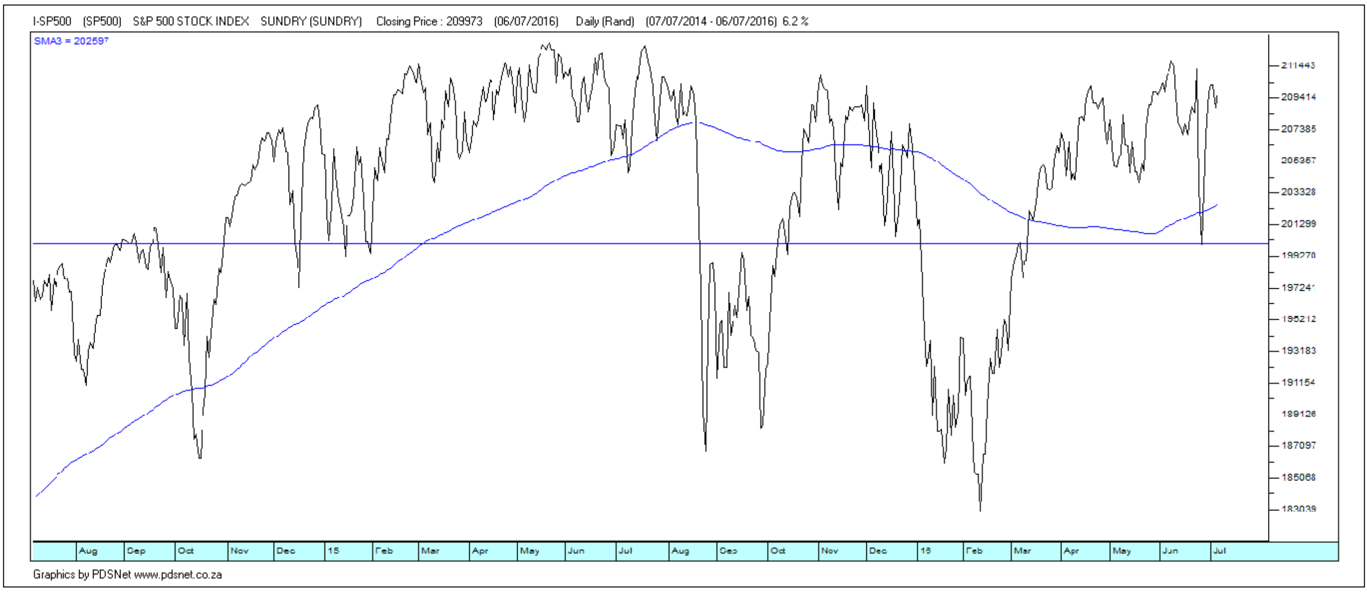
"South Africa has for far too long thought of itself as a cheap Europe, when in reality what it is, is an expensive Asia" Michael Power of Investec. Over ten years ago we quoted him extensively from his presentation of "Chindia" = How China and India stacked up.

Brexit - much ado about nothing for South Africa?

"Then it occurred to me that I am not powerless at all. There is something big I can do. I can pretend nothing is happening and get on with the ordinary business of living and working" London based columnist, Lucy Kellaway on how to handle Brexit.

One can see the effect of the drop in the pound on this graph. It has fallen to its weakest level in over 30 years. However, British shares have risen, as one can see in the following graph. Bear in mind that British companies that export are going to make more money in pounds. If the UK index is measured in dollars, very little has happened. This is covered in the next article.

We are mainly invested offshore in the American SP 500 type shares which took a hit on the unexpected news on the fear that profits for US companies from sales in Europe and the UK would look poor in dollars. Sales to Europe and UK are probably 15% and 5% of their total so a 10% fall in sales in dollar terms would probably drop earnings by about 2% only. The market then shot up so it was a short-lived buying chance but we manage to add some shares to our funds.



Normally, the best thing to do with this type of uncertainty is to ignore it. Usually the hype blows over quite quickly as the world keeps on turning and people have to eat and live. We like to have a lot invested in companies that people 'have to use' such as coffee, booze, cigarettes, pharmaceuticals. When the world returns to a more predictable place, we can then increase holdings in car manufacturers, banks etc.

BREXIT: Positioning offshore portfolios in this new environment

On the 23rd of June the world's fifth largest economy historically voted to leave the EU. The markets displayed increased volatility leading up to the vote as the outcome became increasingly uncertain. The unexpected vote to exit subsequently caused global markets to react (overreact?) negatively. The pound has taken the largest blow reaching a 30 year low against the dollar. The UK has barely grown the last few years and many analysts believe the UK and other EU countries will now enter a recession. There is also the concern that this vote will spark further EU exits by the likes of Spain, Germany and France. How should a portfolio manager position portfolios to deal with this large degree of uncertainty? In this article we explore some of the reactions evident in the market as well as what possible impacts BREXIT will have on the world.

United Kingdom:

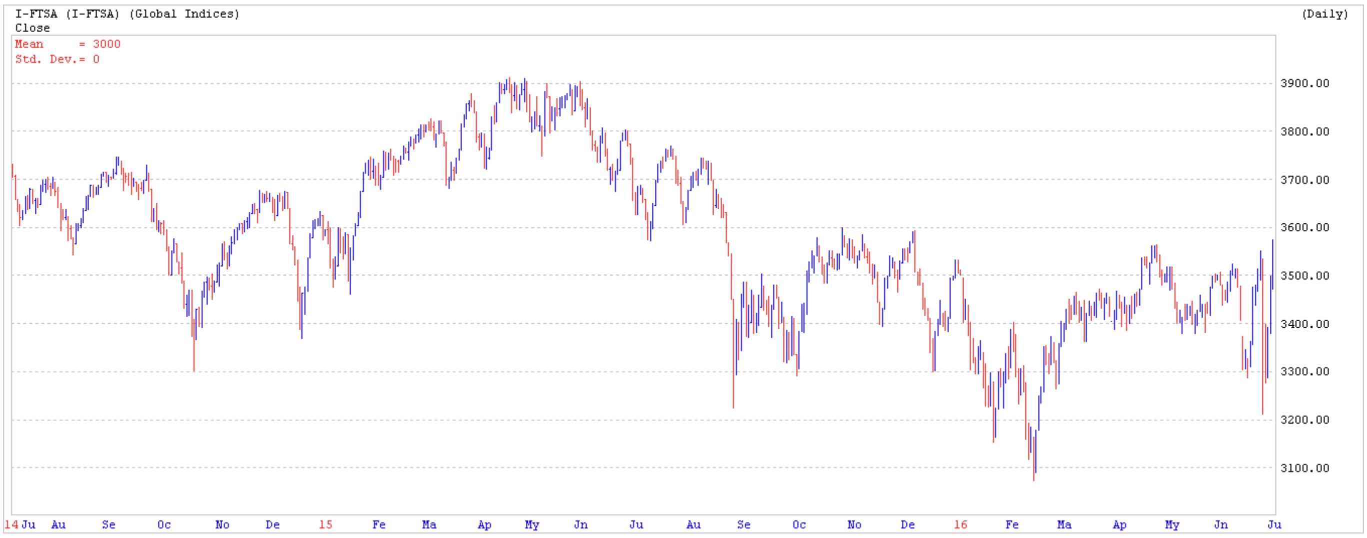
Analysts estimate the repercussions of BREXIT may reduce the UK's 2017 GDP by as much as 1.5% with the longer term impact of about 0.5%. This is mostly caused by less migration, a weaker trade relationship with the EU and damage to investor sentiment. We are still waiting on an announcement on the new Prime minister which should bring a lot of political rhetoric and debate with it. From there we shall see the beginning of the exit proceedings. We expect the cooler heads to prevail and consequently a "BREXIT Lite" type of scenario where the underlying trade relationship between the EU and UK remains fundamentally unchanged.

In the meantime, any new business is likely to be put on hold whilst so much uncertainty exists in the environment. The expected decrease in immigrants and capital flows is also expected to impact the UK property market. The listed property shares have had some of the largest corrections on the stock market. Capital Counties is now trading as much as 40% below its previous high.

The pound dollar relationship:

The pound has weakened to 30 year lows closing at $1.33 for the 30th of June. This is probably a little overdone in the short term but the outlook of any quick correction is unlikely whilst so much uncertainty remains.

The FTSE 350 index:



The FTSE 350 index; the closest indication to the performance of the entire British stock market; fell considerably in the first two days following the result but has since recovered all those losses. The above graph shows the panic the market faced and how much of an overreaction occurred. The banks and insurers experienced the most pain with declines over 20%. This is mostly driven by the fear that some UK property loans may default as well as likely loss in international business relationships. There is also the possibility of moving the financial hub from London elsewhere e.g. to Ireland.

One must remember that although the specific outcomes of the referendum are uncertain, the time frame in which they might occur might be as much as two years from now and therefore companies will go on doing business 'as usual'. Only once the market understands the specifics of the exit can we make estimations on the impact they might have on company specific earnings.

The European markets have also had a tough time of late with German and French markets under pressure following the BREXIT. The possibility has increased that other countries might also demand to pull out of the EU, thus weakening it.

The French CAC40 is in blue and the German DAX is in Black

US Federal Reserve Bank, combating dollar strength:

The time frame for which the American Federal Reserve is expected to increase rates continues to be pushed out as the dwindling global economy lacks motivation to do so. One of the consequences of Brexit has been the fall in the pound and the Euro against the dollar. Therefore, the many US companies which earn a good proportion of profits from the UK and Europe will be under pressure as their earnings will fall when expressed in dollars. The earliest the FED is expected to raise rates has now been pushed to December 2016 due to lower global GDP growth expectations. The US general election is on the 8th of November making it unlikely that the FED makes any changes before then.

The Bank of England:

The Bank of England is also expected to ease monetary policy over the coming months. This is a consequence of the now weaker pound and higher inflation expectations in Britain. The European Union will continue their quantitative easing which should relieve some of the short term effects of BREXIT on their economies.

Trade relationship:

The United Kingdom and the European Union have a substantial trade relationship involving about half of all UK exports. It is likely that one of the implications of revised trade agreements is the establishment of tariffs but it would likely not be impactful enough to be detrimental to their important symbiotic relationship. In any event, the tariffs are expected to be about 4% whereas the pound has fallen by about double that. This should boost UK exports.

European Budget:

Great Britain is the second largest contributor to the European Union budget and the loss of their input would have to be substituted by the other net contributors (Germany, Netherlands, France and Italy). This is especially concerning for the Eastern European countries who would struggle to increase contributions.

Migration:

The UK receives as many as 180,000 migrants per year from greater Europe with about 60,000 from Eastern European countries such as Poland. This constant increase in the work force has helped improve the economy by as much as 0.5% per year without pushing up wage growth or inflation. It is likely that future immigration policy will be more restrictive as to allow only highly skilled workers into the workforce. The low skilled emigrants will have to seek employment elsewhere in Western Europe where they are already struggling with the refugee crisis. This would cause further social and political turmoil in countries such as Germany and France. The repercussions for the low wage sectors such as agriculture, which benefitted hugely from the constant wave of cheap employees, could be significant.

Portfolio positioning:

We have always placed a major focus on investing the majority of our clients' offshore funds in the United States as we believe they are best (or ,more accurately, the 'least worst') positioned in the current global environment. The caveat is any American companies that have major portions of their revenue outside of the USA will likely suffer a decline in dollar earnings if the dollar continues to strengthen. We have tried to mitigate this risk by purchasing a combination of American centric companies as well as defensive Swiss companies such as Nestle and Roche. Defensive UK companies like Reckitt Benckiser, Diageo and Unilever have performed well in sterling terms following Brexit.

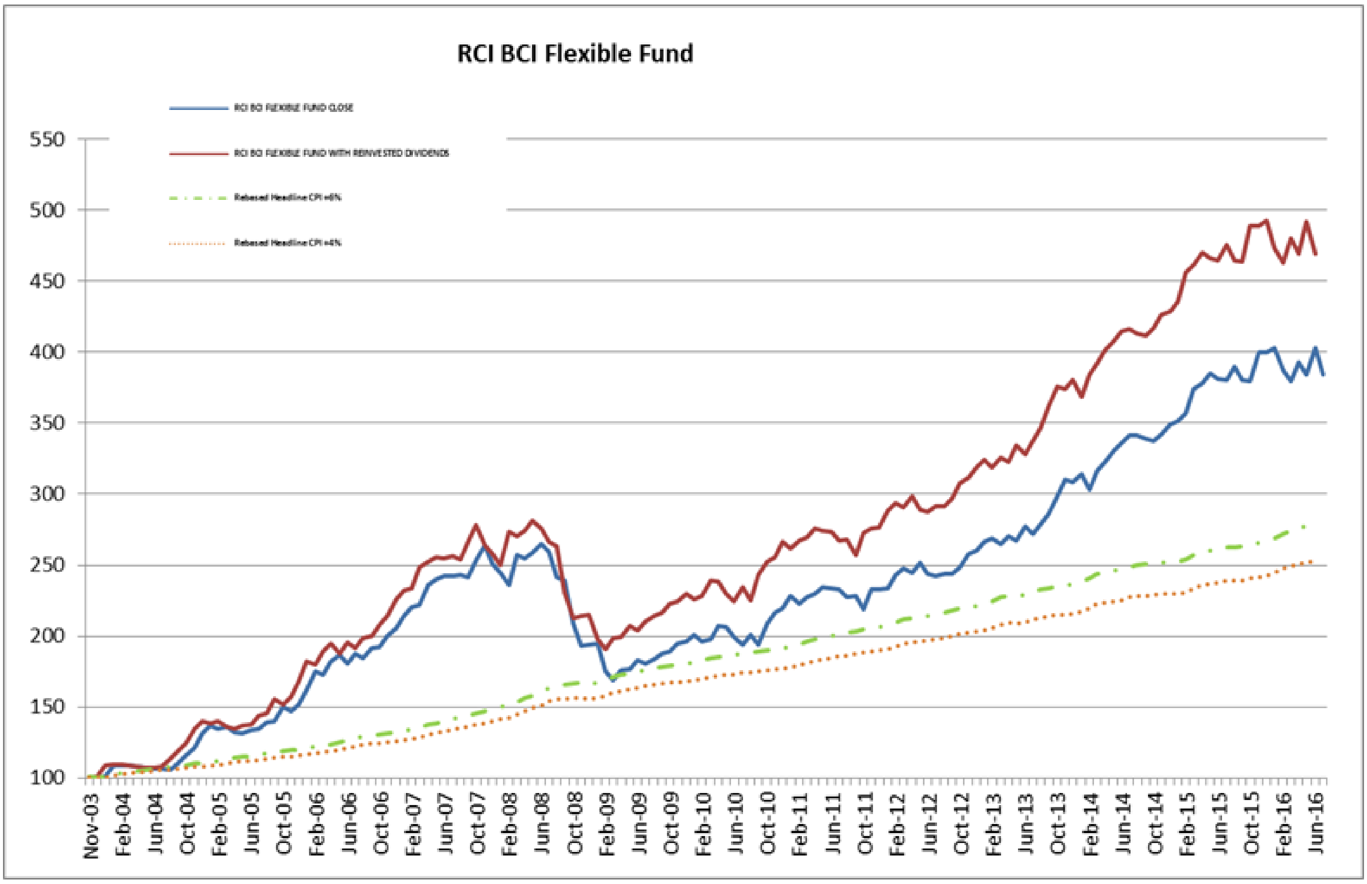
Our portfolios are also highly structured around defensive stocks with excellent worldwide reputations and strong balance sheets. Lately we have focused on the pharmaceuticals sector which is defensive in nature because people still need medication during tough times. We believe global pharmaceuticals and biotechs are offering potential because they have been out of favour due to the US Democratic presidential candidates promising to reduce medical prices. The valuations of these companies have become attractive and, on a three to five year view, we believe now is the time to fully weight this sector in our client portfolios.

The overall outcome of Brexit on the British economy is uncertain but imposing high tariffs should be a lose-lose situation for both the UK and the Eurozone, given their deep interlinkages and co-dependence. Brexit will likely lead to a long period of uncertainty in equity markets as well as larger discount rates in valuations. On a positive note, the significance of the exit is far less impactful on the world today than what it would have been ten years ago as the United States and China combined became the major pulse for the global economy.

RCI BCI Flexible Fund – Our bet on a weaker rand has not yet paid off, and in the short-term, Brexit has caused disruptions

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

RCI BCI Flexible Fund fell 4.62% for May closing at 384.38c per unit. The JSE top 40 fell 4.17% - very similar. Over a year, the Top 40 Index is down 0.36% but our fund is up 1.44%. We are positioned for rand weakness, a drop in the metal prices and potential political problems. Currently, the rand is being relatively strong (possibly influenced by the SA Brews deal and by flows into South African gilts and shares in response to Brexit). In the short-term, the market does unexpected things – it is the long term that counts. Over the past five years, our fund has grown at 11.91% per annum.



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 R1 000 per month or lump sums of R10 000). 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.

To conclude

This month, Brexit is all consuming in the news. Thus we have devoted most of this newsletter to it. As we have said, we think this is mainly the press hyping the issue but this does not mean markets cannot be volatile for the next few months. The solution, as almost always, is to invest in great quality, steady companies – and we have increased your gold holdings just in case the world 'goes to hell'. Keep your eyes on the five year horizon, but avoid tripping on the rocky path!

As Damon Runyan paraphrased the Bible, "The race does not always go to the swiftest nor the fight to the strongest, but that is the way to bet".

We aim to be the best family office in South Africa.

Thank you for being our clients.

Best regards

Di and Alan