

Contact us:

Alan McConnochie

+27 11 706 1420

083 378 3463

alan@rcinv.co.za

Di Haiden

+27 11 706 1420

083 308 7928

di@rcinv.co.za



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

“If voting made any difference, they wouldn't let us do it.” ~ Mark Twain

RCI MET Flexible Fund – closed April at 403.09, 4.87% up for the month and 6.17% higher than 12 months ago. The JSE Top 40 gained 3.23% for the month and is up 3.65% versus a year ago. We do not think we have outperformed enough but our portfolio is set up to benefit from a weaker rand. There could first be a bit of strength in the rand over the next few months as the downgrade has been deferred and the money must start pouring in to fund the SA Brews deal. 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-June.

The downgrade is deferred – what does it mean to you?

Surviving the rocky investment road ahead. What car or off-road vehicle should you be driving to make sure you finish the race? What should your investment strategy be to survive the pot holes present in the world economy?

An Australian looks at China. Why is it important? Because the Chinese are utilising half of the world's metal supply and South Africa's exports depend on Chinese demand.

Weakening emerging market currencies. SA lagged this, then caught up spectacularly in early 2016 but is now showing strength in the past two months.

US home prices continue to rise – a boring but very important indicator.

Conflict in the South China Seas – USA and China increasingly square off.

Putting off the downgrade

We held back this letter to await the decision of the rating agency at 18:00 last Friday. As we expected, they have delayed a downgrade but it was by no means a cut and dried decision. We have been warning for at least three years that South Africa was facing a downgrade. We could see the cliff looming in the distance but South Africa was doing nothing about fixing the problem.

Now, the country has woken up just two meters from the edge of the cliff and thrown the valiant Minister Gordhan into the fray. His feet are slipping in the dust as he tries to hold us back. For now he has succeeded, helped by a sudden spurt in metal prices. The price of almost all our mineral exports collapsed in 2015 but has suddenly recovered in 2016. These prices could easily drop again as they were boosted by a sudden demand rise in China which may not persist.

Thus the rating agencies have effectively delayed the decision a further six months. No real skin off their noses if they only do it then! However, it makes a huge difference to South Africa as it normally takes about six years to get your rating back once you lose it.

What effect will a ratings downgrade have? As usual, it is complicated, but it cannot be good for the rand, interest rates or investments. We are not like most countries due to our strange history. Firstly, only about 10% of our government bonds are held by foreigners, many of whom will be forced by their fund rules to sell. How much will interest rates then rise? Nobody knows, most of the rise is usually anticipated.

How much will the rand weaken? Well, as the downgrade is deferred the rand should strengthen. By how much? Nobody knows but we would be surprised if it strengthens more than 5% from its current level of just above R15 to the dollar. However, currencies often get a life of their own as they seem to overshoot when people trade with the trend.

Next, SA Breweries is being bought out by AB Inbev. Last week South African permission was granted for the deal. A few outstanding permissions are required from the rest of the world but at best guess, they should be forthcoming by the end of July or mid-August. AB Inbev will have to send a big chunk of cash to pay the SA shareholders the GBP44 they have offered. Will they send a whole lot of it now, before the rand can strengthen too much? What about the effect of Brexit? If the Brexit deal is passed, the GBP is likely to fall. In contrast, if Britain votes "no" on 23 June, as they are expected to do, the GBP could get stronger. So AB Inbev have many variables to work with but at some point in the next few months, there will be an enormous inflow into South Africa.

Cashing in your SABrews (and paying a hefty capital gains tax) leaves one with a choice of spending the money - a bit like selling the family silver to fund everyday consumption or buying another offshore share, like AB Inbev. There is another option we are examining for clients with large capital gains: to switch it into our unit trust and delay the capital gain until you finally sell the unit trust.

As usual, life is complicated and there are many moving parts to consider. This is why we try to keep our eyes on the heavens - to work out what will transpire over three to five years. Trying to guess the next six months is just too hard! With a five year horizon, it should make a very small difference if we get downgraded in December 2016 or in June 2017. At this point, we feel that the timing depends on the metal prices - is the current recovery sustainable? We think it unlikely but much dependent on Chinese government policy.

The clients for whom we took more money offshore, gained over 20% in rand in the tax year ending February 2016. The short-term timing is to them, largely irrelevant.

Surviving the rocky investment road ahead

By Vitaliy Katsenelson, CFA / Institutional Investor Magazine

He used a useful analogy of which type of car to use on a rocky road which should be translated into investment strategy for the future

Time for an All-Terrain Investment Portfolio. (<http://imausa.com/time-terrain-investment-portfolio/>)

We reproduce the first two paragraphs:

As investors today we feel something like a traveler preparing to drive across an unknown continent. A look in the rearview mirror tells us we should pick a race car, and if the road continues to be as it has been, then our trip may be fast and uneventful. But what if the road that lies ahead is rocky, full of holes and maybe even strewn with giant boulders?

A sports car will not get past the first potholes. What we need is a four-wheel-drive, all-terrain vehicle. This monster will not have the speed or the sex appeal of the shiny red convertible, but it will complete the journey. Its position at the finish line will depend entirely on one unknown — the road ahead. If it is a smooth, unbroken route, then our Land Cruiser will be left in the dust by the Ferraris and Maseratis. It will complete the journey; it just won't be the first to cross the finish line. But if my prediction is correct, you're going to be mighty glad to be in the ATV — you might even end up at the head of the pack.

An Australian's view on China - Fuller Treacy Money, 17 May 2016

In Friday's audio, you speculated about possible reasons for China's tightening of social conditions. The following report from an Australian reporter in China, leaves me with little doubt. Xi has already shown his cards. If the country is opaque today, the future will be more so. If governance is everything, China will be a laggard.

My first assessment was that more centralization and tougher social conditions in China would delay economic growth but I now think the opposite is just as likely.

The need for economic reform has been obvious but progress has been slow. Debt has increased, excess capacity remains a serious problem while attempts to influence stock markets were ham-fisted. The failure of the bureaucracy is evident but implementing tough economic policies in the face of public resistance has been difficult. The existence of the country's strongest unions in the infrastructure and heavy industry sectors, seems to have made change impossible.

In the West we are seeing how democratically elected governments are being taken over by populists whose promises are unrealistic and mostly damaging to their economies. In Australia we are at day nine in an eight week election campaign where the economically conservative government, which is acutely aware of the nation's unsustainable path, is struggling to sell a moderate budget which sees debt continuing to increase while depending also on continuing world economic growth and financial stability.

Premier Xi has no intention of allowing China to go down that same path. He can see the country's problems as clearly as we can but the system has failed.

I can easily see Xi blaming bureaucrats and weak leadership in the provinces. The scene is being set for a major purge. A second cultural revolution. Xi can see what the markets are saying and he could use his power to implement tough economic policies. There will be significant short term social pain and major economic risks but a strong turnaround in the economy is likely to emerge. China could regain its position as an economic powerhouse.

The period of turmoil will see China’s markets collapse. This will be a black swan event. Knock-on effects around the world will be serious but, as is often the case, will be another good long term buying opportunity.

Eoin Treacy's view

Thank you for sharing your perspective and this article highlighting the increasingly leftist leanings of Communist Party rhetoric. Most forward looking societies prize bettering oneself through pursuing education and China is no different. Therefore regardless of how you dress it up in idealism, relegating the most educated people in society to its lowliest echelons can only be considered a retrograde step.

Weakening emerging market currencies

Efficient select put out this article on 26 May 2016. With the decision by the rating agencies not to downgrade SA yesterday, the rand has strengthened a few percent to about 15.13.

[In this] chart we review a group of emerging market currencies relative to the US dollar over the past 5 years. As we can see, this group of currencies have weakened in aggregate relative to dollar over the period. The Indian Rupee and the Turkish Lira have been the best performing currencies with the Brazilian Real and Russian Ruble the worst performers in this group, respectively. When we shift our attention to the South African Rand, we notice a rapid depreciation, highlighted in the blue circle below. As we know, this occurred on the back of a spike in negative political activity during the fourth quarter of 2015. Overall the deterioration in economic fundamentals and negative global investor sentiment towards South Africa has resulted in the currency effectively weakening further, now trading in line with the Ruble and the Real – relative to the US dollar.

Author: Joel Andrews

Source: FactSet



U.S. new homes sales hit eight-year high, point to firming economy

From The Fuller Tracey comment of the day, 26 May 2016

This article (<http://www.reuters.com/article/us-usa-economy-housing-idUSKCN0YF1VI>) from Reuters may be of interest to subscribers. Here is a section:

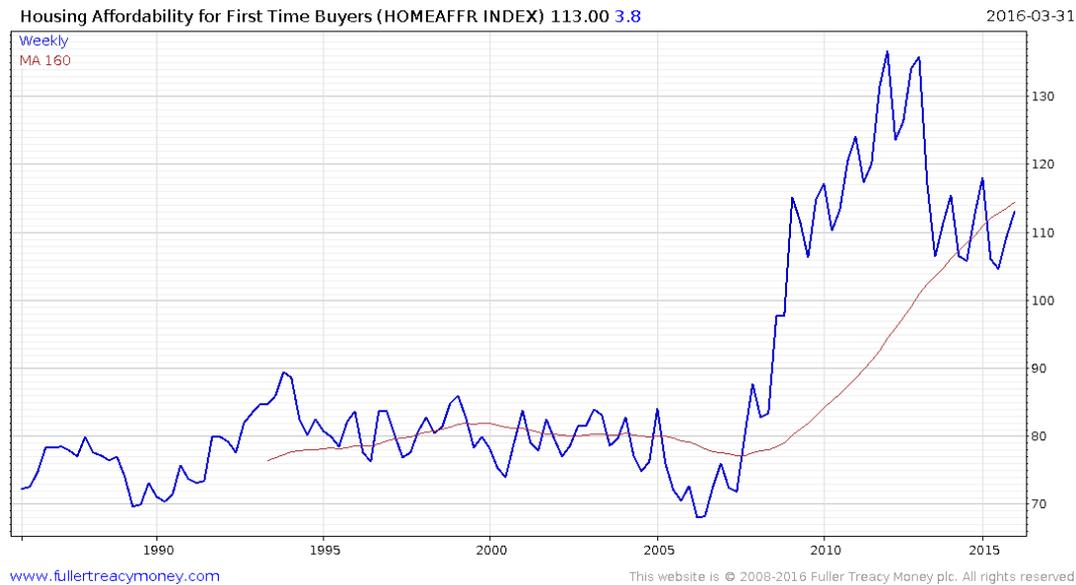
New U.S. single-family home sales recorded their biggest gain in 24 years in April, touching a more than eight-year high as purchases increased broadly, a sign of growing confidence in the economy's prospects.

Tuesday's report from the Commerce Department, which also showed a surge in new home prices to a record high, offered further evidence of a pick-up in economic growth that could allow the Federal Reserve to raise interest rates soon.

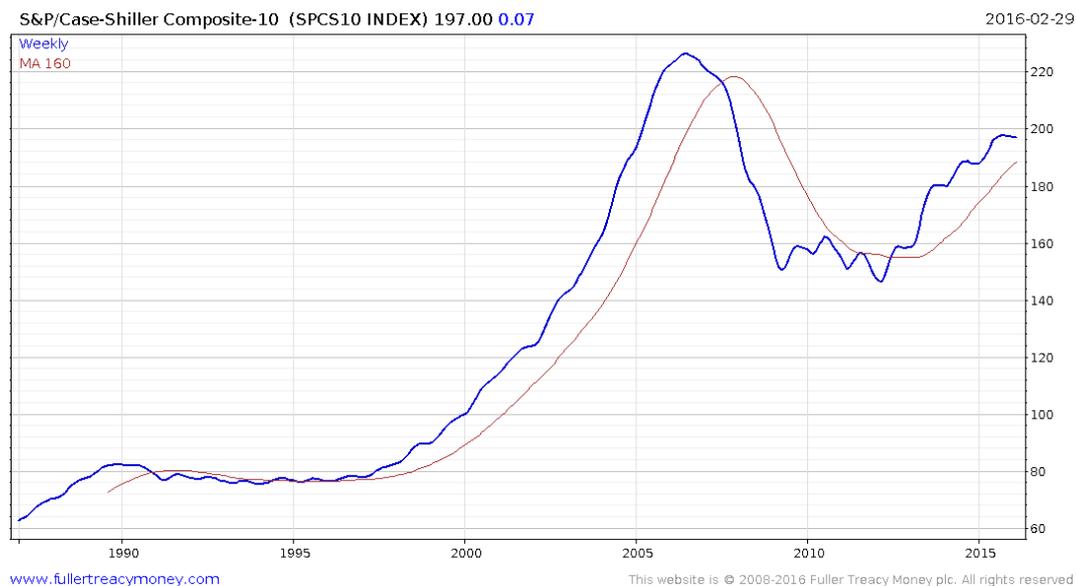
"Consumers are taking the leap and buying the biggest of big ticket items of their lives and this speaks to confidence. The Federal Reserve can raise rates at their June meeting without fear the economy is going to slow," said Chris Rupkey, chief economist at MUFG Union Bank in New York.

Eoin Treacy's view

Home affordability has contracted since its peak in 2012 but is not back to where the previous norm was in the decades prior to the housing boom and subsequent bust. The role of ultra-low interest rates in bolstering affordability is seldom discussed and yet it represents a significant influence not least because wage growth did not improve until very recently.



The S&P/Case-Shiller Composite 10 has rallied by a third since 2012 and homes in desirable locations took out their historic peaks more than a year ago.



Editor: we have long been of the opinion that house prices in America are a vital part of the economic puzzle – if they are rising and unemployment falling, we continue to believe in an improving US economy.

Conflict in the South China Seas - USA and China increasingly square off

From the Outsider 20 May 2016 (<https://www.outsiderclub.com/we-really-are-going-to-war-with-china/1948>) on escalating tensions in the South China Sea

“There is no doubt that China's one-party, communist government leans on its rivalry with the United States to solidify public support, distract from domestic issues, and further its global agenda.

It is equally obvious that the U.S. government does the exact same thing.

The problem is, beneath all the propaganda, there's a legitimate confrontation brewing. And the nexus of that conflict is the South China Sea, where tensions continue to spiral out of control.

Clearly, neither China or the United States are truly interested in de-escalation. And the relationship between the two countries is only getting worse.

The [South China Seas] area is important for three reasons:

- It has resources, including fish, natural gas, oil, and minerals.
- It is a massive shipping corridor, as half the world's seaborne cargo passes through.
- It's a valuable buffer for China's defense.

Recently, China has advanced its claim by creating more artificial islands. In just two years, China has expanded these islands by 2,000 acres. It's also outfitting them with harbors, airstrips, military barracks, and even drilling for oil.

... China is boosting military spending and modernizing its forces to counter all military resistance to its objectives, including that of the United States.

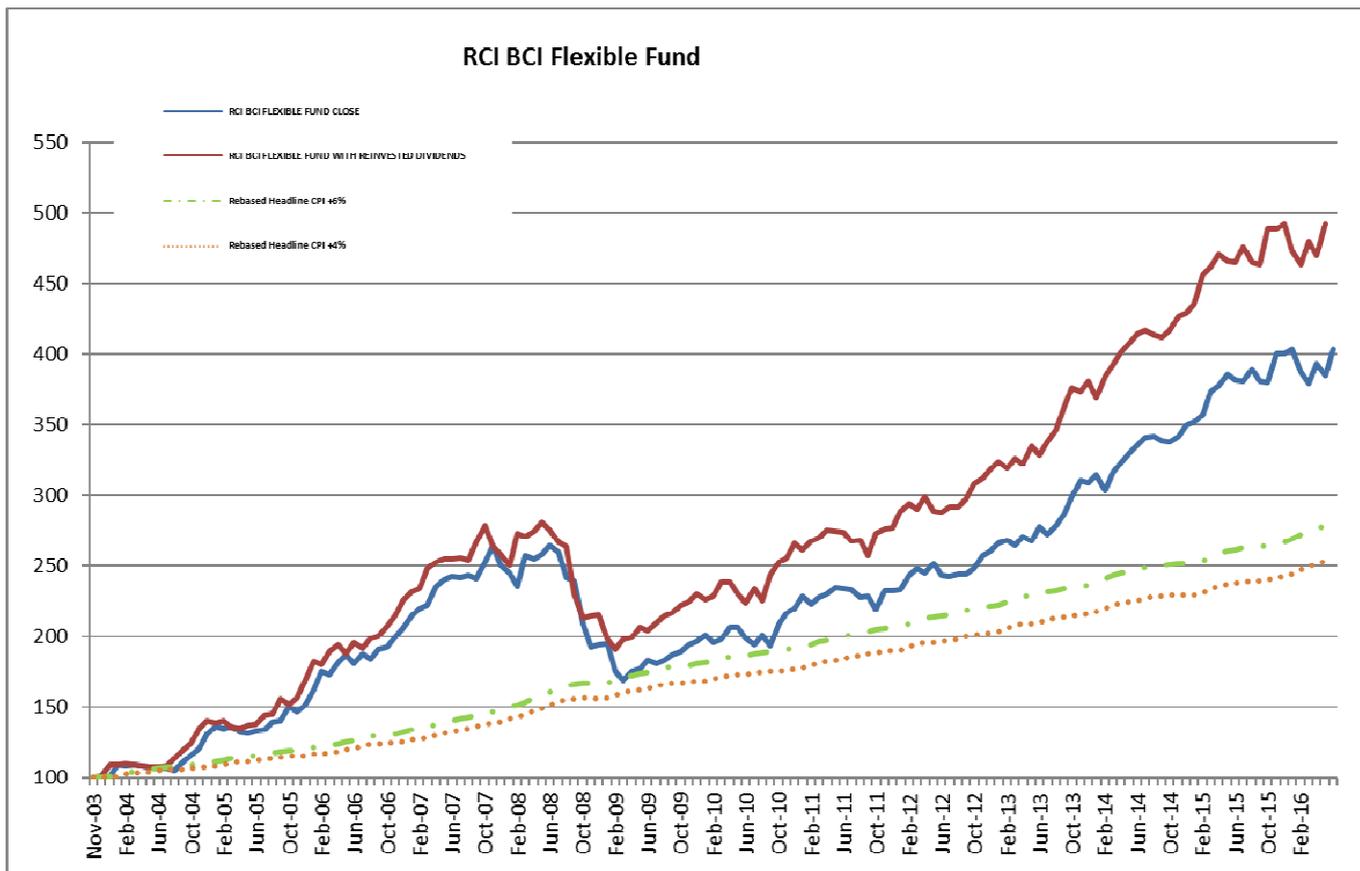
The Chinese navy will likely comprise more than 400 ships by 2030. And the country's air force has expanded to 3,010 operational aircraft. That's still roughly one-fifth the size of the 13,717 aircraft across the four services (including the U.S. Marine Corps), which is enough to mount a serious defense.”

Editor: So by 2030, the Chinese navy should be strong enough to chance a confrontation with the US Navy, at least in the area around China. Obviously, much can be done to avert this but we plan long term!

RCI BCI Flexible Fund – Up 6.17% over 12 months which beats the JSE overall which rose 3.65%. Our bet on a weaker rand has not yet paid off, and in the short-term, the rand could get a bit stronger

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

RCI BCI Flexible Fund gained 4.87% for May closing at 403.09c per unit. The JSE top 40 gained 3.23% for May so we outperformed this month. Over a year, the Overall Index is up 3.65% but our fund is up 6.17%. That is over a 2.5% outperformance. That is not enough to make us happy. We have set up our portfolio to benefit from a weaker rand which might have a bit of strength in the short-term, now that the downgrade has been avoided and the cash must soon start flowing into South Africa to fund the SA Brews buy out .



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.

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

Avoiding a downgrade, at least for another six months, should help prevent the rand weakening sharply. Metal prices have been better than expected in the past few months so much will depend on if the strong demand persists.

Unfortunately, we think it is too early for the metals boom to return and we are planning for a tough few years for miners and the rand.

The municipal elections are looming ever closer which is why we put it that wonderful quote from Mark Twain “If voting made any difference, they wouldn’t let us do it.”

For those people who enjoy the classic “Game of Thrones” on TV, we say “winter is coming”. Winter is indeed here both metaphorically and outside the window. However, winter, as always, passes.

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

Thank you for being our clients.

Best regards

Di and Alan