Robert Cowen Investments

Growing families' wealth since 1982

Authorised Financial Services Provider FSB Licence No. 701

Newsletter

end April 2017

10 May 2017

Contact us:

Alan McConnochie

+27 11 591 0551

083 378 3463

alan@rcinv.co.za

Di Haiden

+27 11 591 0572

083 308 7928

di@rcinv.co.za

"I am not a product of my circumstances; I am a product of my decisions.

~ *Steven Covey*

RCI MET Flexible Fund – closed April at 381.11, up 2.58% for the month, compared to the JSE Top 40 which was up 4.22%. The RCI BCI Flexible Fund is 0.27% lower than 12 months ago whereas the JSE Top 40 was up 1.29% versus a year ago. Excluding dividends, over five years our fund is up 59% and the JSE Top 40 is up 60%. (By 9 May it had risen another 6c to 387.85c).

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

When Pravin Gordhan was fired the rand did not immediately weaken too much. Later in April, the iron ore price fell rapidly, and, unsurprisingly, so did the rand. Usually, the correlation is not as immediate but we believe it is the key factor.

This caused our portfolios to increase as they are full of rand hedges that do well if the rand weakens and our offshore portfolios are boosted by any drop in the rand.

The true effect of the "downgrade" has not yet been felt as only when Moody's downgrades South African bonds will international bond funds be forced to sell between R112bn and R240 billion of our bonds. This could take weeks or months. Some economists believe it will be put off until December 2017 or even June 2018. We think a lot will depend on the iron ore price (SA's largest export) and the price of the other metals which South Africa exports.

Share indices remain expensive relative to history – with the exception of financials. Some of these comparisons are being distorted by the growth in the importance of rand hedges such as Naspers, British American Tobacco and Richemont.

The make up of the Top 40 Index. Do you realise that our top five shares are all off-shore shares and make up 46% of our Index. Naspers alone is 19% and Richemont 9%. Thus a fall in the rand is, perversely, good for the JSE!

Short Term rand strength vs Long term rand weakness – What to do?

What happens to your Facebook account or other cyber accounts when you pass on? Who will have access to them – a family member or a hacker? We give you a few pointers on what you should do to ensure that the accounts are smoothly closed.

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

An important chart we should all be watching – the iron ore price

At the end of March, President Zuma fired Pravin Gordhan as Finance Minister, creating panic, but of course, the world did not end. We pointed out that the rand was strong. It was probably held up by the strength in the price of our largest export viz. iron ore. Iron ore was up from $40 at the end of 2015 to $90 because of strong Chinese demand and problems in Australian delivery caused by hurricanes. Now, a month later, the delivery from Australia has resumed and the price has collapsed back to $60. Interestingly, the rand has fallen quite a bit over the past month (signified by the rise in the graph below).

There seems, unsurprisingly, to be some inverse correlation between the two graphs.

The other shoe must fall: although SA suffered a "downgrade", the full effect has not yet been felt as Moodys must still downgrade us. When this happens, it is estimated that between R120bn and R210bn of our government gilts (bonds) will have to be sold as most international hedge funds are not allowed to own gilts which are not of investment grade. This is likely to cause the rand to weaken to between R14 and R15. When might this occur? Within a few weeks say the pessimists. In December say the moderates but by June 2018 say the optimists – nobody is saying it won't happen.

Should this occur, our mines will start to make money and more tax will then be paid – provided that metal prices stay high. This sounds so easy BUT what happens when you want to buy a new car or import a vital heart medicine? The price will then jump. This is the reason why we have invested so much of your funds offshore or in rand hedges. Sadly, we believe that the metal cycle will take many years to turn up (currently we are simply experiencing a bounce along the bottom) and that the Government is going to remain ineffective. Thus, we believe that the rand will weaken considerably over the next five years.

Because we have invested in so many rand hedges, the value of portfolios experienced a nice little fillip in April.

Shares remain expensive relative to history, with the exception of financials. The increase of the importance in offshore shares, such as Naspers, is distorting the value of the history.

April JSE Index Data

By Ross McConnochie

With the exception of the Financial Index -all Indices appear expensive at this point. The Industrial Index is greatly distorted by Naspers as it has risen to 20% of the Top 40 Index (and even more of the Industrial Index) so that Naspers' high current PE makes the Index appear even more expensive.

Valuations relative to history (this article was written for Mr. Ahmed, a long term reader)

Below is the current and long term average data for Price Earnings Ratio (P/E), Earnings Yield (EY) and Dividend Yield (DY) for all the major JSE indices.

Index	Price	Price Earnings Ratio				Earnings Yield		Dividend Yield			
	Current	Current	*Cheap*	10 Year Average	*Expensive*	Current	10 Year Average	Current	*Cheap*	10 Year Average	*Expensive*
JSE All Share	53.817	**20.16**	*12.99*	16.26	*19.53*	**4.96**	6.44	**2.73**	*3.44*	2.87	*2.29*
JSE Top 40	47.072	**20.49**	*13.20*	16.47	*19.74*	**4.88**	6.36	**2.63**	*3.35*	2.75	*2.15*
JSE Midcap	76.554	**17.09**	*11.36*	15.10	*18.84*	**5.85**	7.00	**3.19**	*4.14*	3.48	*2.83*
JSE Financials & Industrials	75.142	**22.68**	*13.98*	17.39	*20.80*	**4.41**	6.03	**2.61**	*3.29*	2.76	*2.23*
JSE Financials	15.047	**11.96**	*10.06*	12.62	*15.17*	**8.36**	8.34	**4.55**	*5.00*	4.10	*3.19*
JSE Industrials	72.395	**31.85**	*15.33*	20.07	*24.81*	**3.14**	5.27	**1.91**	*2.65*	2.25	*1.86*
JSE Resources	32.347	**15.92**	*10.82*	15.80	*20.78*	**6.28**	7.01	**2.72**	*4.29*	3.04	*1.79*

* [Cheap and Expensive are represented by -1 and +1 Standard Deviations from the mean]

Source: Timbukone

- PE ratio is Price/Earnings. A high PE ratio relative to history would imply the index is more expensive than the long term average. At the moment, the JSE All Share is trading at a PE of about 20.1 while its long term average was around 16.2 for the last ten years.
- The PE tends to move between one standard deviation below the average (where it could be considered cheap) and one standard deviation above the average (where it could be considered expensive). At the moment, the PE of the All Share and the Industrial Index is trading above what could be considered expensive, relative to history. However, one must be cognizant of future earnings expectations, especially from large weighted sectors like mining that can have very erratic earnings. Also, Naspers now makes up almost 20% of the index and its large PE is thus very influential compared to history (more detail on following page).
- You will notice that only the Financials Index is trading below its long-term average PE. All the others are considerably higher than the ten-year average. In fact, most indices are trading at PEs above one standard deviation from their mean (average). **This implies that they are currently expensive.**
- Midcaps are trading above their ten-year PE but are not trading in expensive territory.
- The earnings yield is just the reciprocal of the PE ratio: (1/PE) or Earnings/Price. It thus portrays the same information as the PE but only now an index would be expensive relative to history if its yield is lower than the long-term average. We only include this because some people find it easier to think in yields rather than in PE terms.
- On a dividend yield basis, the All Share is not too expensive as it is above its historical level.

- We have also included when the market was cheap and expensive relative to history but, in contrast to the PE, you should consider the market to be cheap when its yield is above one standard deviation from the mean or expensive when its yield is below one standard deviation from the mean. The JSE All Share is currently trading at 2.7% dividend yield, which is slightly better value than history of what would be considered expensive (2.29%) but just below the average of 2.75%. So the question to be asked is, do we have average prospects as a country? On the negative side we have a poor political outlook, low resource prices and a loss of confidence.

Here are the largest 20 shares that makes up the first half of the JSE Top 40 Index.

						Price	Price Earnings		Earnings Yield		Dividend Yield	
	Code	Name	Industry	Top 40 Weight	Accumulative Top 40 Weight	Current	Current	10 Year Average	Current	10 Year Average	Current	10 Year Average
1	NPN	**Naspers**	Consumer Services	19%	19%	253.86	92.59	51.09	1.08	2.80	0.17	0.57
2	CFR	**Richemont**	Consumer Goods	10%	28%	11.21	35.34	24.34	2.83	4.61	1.45	1.06
3	BIL	**Billton**	Basic Materials	8%	37%	20.31	31.75	8.76	3.15	7.73	2.90	3.19
4	AGL	**Anglo American**	Basic Materials	5%	42%	19.19	8.90	20.17	11.24	7.42	-	2.35
5	BTI	**British American**	Consumer Goods	4%	46%	90.09	22.03	18.06	4.54	5.80	2.63	3.54
6	MTN	**MTN**	Telecommunications	4%	50%	12.65	-163.90	8.05	-0.61	5.95	4.53	3.76
7	SOL	**Sasol**	Basic Materials	4%	54%	41.00	12.72	10.71	7.86	10.12	2.82	3.42
8	SBK	**Standard Bank**	Financials	3%	57%	14.84	10.30	11.65	9.71	8.95	4.32	3.74
9	SNH	**Steinhoff**	Consumer Goods	3%	60%	6.81	16.26	11.04	6.15	10.65	2.19	0.66
10	OML	**Old Mutual**	Financials	3%	63%	3.37	11.35	9.66	8.81	8.86	2.45	3.58
11	FSR	**Firstrand**	Financials	3%	66%	4.99	11.72	12.01	8.53	8.73	3.92	3.76
12	MNP	**Mondi**	Basic Materials	2%	68%	34.70	15.70	24.96	6.37	6.76	1.91	3.03
13	SLM	**Sanlam**	Financials	2%	70%	7.09	14.39	13.70	6.95	8.16	3.02	3.70
14	REM	**Remgro**	Industrials	2%	73%	22.18	17.06	15.85	5.86	6.61	1.73	1.90
15	APN	**Aspen**	Health Care	2%	74%	27.72	24.94	24.39	4.01	4.51	0.76	0.10
16	BID	**Bidcorp**	Consumer Services	2%	76%	28.31	25.25	17.70	3.96	3.19	0.95	0.66
17	SHP	**Shoprite**	Consumer Services	2%	78%	20.98	21.83	21.29	4.58	4.88	1.89	2.24
18	VOD	**Vodacom**	Telecommunications	1%	79%	15.12	17.12	14.67	5.84	6.92	4.47	4.58
19	GRT	**Growthpoint**	Financials	1%	80%	2.56	14.16	13.90	7.06	4.52	7.39	4.98
20	WHL	**Woolworths**	Consumer Services	1%	82%	7.25	16.31	18.15	6.13	5.97	3.58	3.33

Source: Timbukone

- This exercise shows you just how unequally weighted our stock market is.
- Naspers makes up the bulk of the Top 40 Index at 19%. Therefore, the performance of Naspers (and subsequently Tencent) is a large driving force behind our stock market's movement.
- Richemont is the second largest at 10% of the index.
- The largest 10 shares make up 63% of the JSE Top 40, and the largest 20 contribute a massive 82% of the index. Therefore, you would only need to buy the above 20 shares in the same proportions in order to quite closely replicate the top 40 performance.
- As the Indices are expensive relative to history, the constituents must be expensive too. Again you will notice that it is mostly the financials that are trading below their ten year average PEs.
- Naspers has a whopping PE of 92 which is high relative to other companies and to its own history but one must remember that the majority of Naspers comes from a 34% ownership in Tencent (one of the top ten largest company in the world) and because its isn't a majority shareholder it cannot consolidate Tencent's earnings on its own financial statements. So the only earnings that Naspers reflects come from majority owned assets like Media24, MailRU, etc. Therefore, PE is not a meaningful metric to use in this case but one must be aware that because Naspers makes up such a large part of our index and has such a large PE ratio it causes our stock market to have a high PE ratio. So in a nutshell our market's PE ratio is not as high as it currently reflects.

- Of the above shares approximately 15 earn meaningful revenue outside of South Africa. Most of which are currencies like the pound or euro. Consequently, there is a large skew to rand hedge shares in our Top 40 index. This is the reason why our market rises when we have weakness in the rand.

Short Term rand strength vs Long term rand weakness – What to do?

Conditions for sending additional funds offshore.

By Ross McConnochie

The rand has seen considerable strength over the past year – Red channel below:

Pravin Gordhan was fired over the weekend of the 25th of March and the rand weakened immediately from around R12.40 (its strongest level in years) to R13.90 within in two weeks. This was a weakening of the rand by 12%.

We have also had two different ratings agencies downgrade our country's debt to junk status. We have had large scale demonstrations as well as political turmoil between the various South African parties and in particular the infighting within the ANC. Yet despite all this the rand has strengthened again as if nothing has happened.

The rand has recovered to R13.04 as of 25 April 2017. This is a dramatic improvement of over 6% in a very short space of time. So why has the rand had such a strong 14 months? And why did the junk status and firing of Gordhan have such a trivial and fleeting effect on the rand? The reason for this strength can be explained by combination of macro forces:

Investment flows from the developed world to emerging markets:

Global investment managers are currently in the process of moving their investments from the expensive developed markets such as the US (where bond yields are currently close to zero or in some countries below zero) to countries that can provide an impressive yield like South Africa. Once the flows begin to trend then they can continue for a long period until global forces go the other way. At the moment for any foreign investor South Africa is looking very attractive because you can invest here and earn a high yield and then as long as the international flows are moving into the country the exchange rate will be favourable. In fact any offshore investor that has been in our bonds over the past year has made a lot of money. Foreigners actually bought R1.6bn of our bonds last week bringing the total for the year to over R35 billion. So they haven't really batted an eyelid.

Bond ratings:

The recent credit downgrades were relating to our government debt in dollars not our local government debt (in rands to South Africans). We would need our local denominated debt to be downgraded to junk from investment grade for there to be a massive selling of our bonds in the international arena. This is estimated to only occur in about early 2018. A full junk status is expected to create a forced selling of about R296 billion worth of local bonds if all investors who invest in, or track this fund are forced to sell by mandate. Wayne McCurrie believes this figure to be closer to R100 billion however, this is still an enormous amount of selling that is really only expected in about a years' time. So we could easily see further buying of our bonds in the meantime.

Higher commodity prices:

South Africa being a commodity driven economy improves with increased resource prices. If mineral prices continue to remain around these levels we shall see improved earnings in our mining sector which entices offshore investment into our mines and the longer term, bigger picture ability to earn taxes (All of which trickles down in the economy). So whilst commodities are at these levels we should continue to see flow into South Africa.

Weaker USD:

Commodity prices tend to increase during periods of USD weakness. The USD has traded weaker against the euro of late due to favourable election results indicating political stability in Europe. This would result in a twofold improvement to emerging markets and in our case a strong rand, firstly because the dollar has weakened and increased commodity prices as a consequence of that weakness. However because we expect that Trump will implement tax repatriation holidays for US companies it is highly likely we shall see a period of strength in the dollar post those reforms. Therefore the dollar could continue to weaken in the short term giving opportunity to invest offshore at these levels.

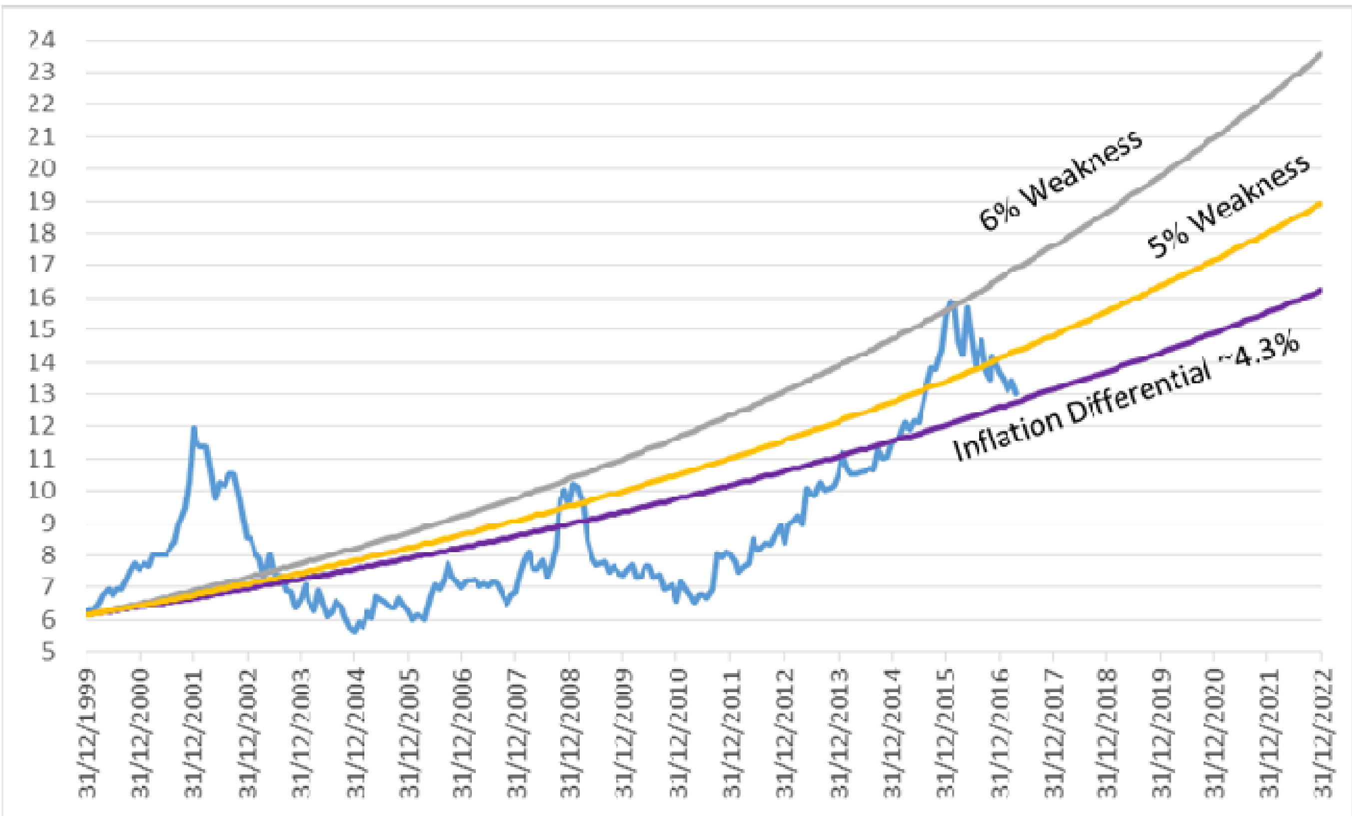
Improved global growth prospects:

The global economy is picking up and market participants are optimistic about global growth. This is complemented by increased possibility of tax reforms in the USA (announced but still to be implemented) and low cost of oil/ energy across the globe. Improved growth prospects also lead to increased demand for commodities, further strengthening the rand.

Conclusion:

Therefore whilst emerging markets remain in favour and our local bonds remain investment grade we should continue to see strength in the rand in the short term.

This is the relationship between the rand and the dollar since December 1999:



The long term average weakness in the rand has been about 6%. In recent years this accelerated to about 9% per year and the rand **peaked** against the dollar at the end of 2015. The recent strength in the rand has realistically brought the rand back to average levels relative to history. It is therefore quite possible that we continue to see strength in the rand causing the relationship to break below economic parity indicated by the purple line. This is the theoretical value of what the rand should be versus the dollar over the long run. So if history is anything to go by if it is below this purple line then the rand is probably too strong and will likely weaken and rise to the long term average levels of weakness as indicated by the grey and yellow lines. Therefore we may very well see the rand reach R12 by the end of the year before it turns back up. Anything can happen in the short run whilst the long run weakness in more predictable.

In the long run we expect the rand to continue on its long term path of weakness. This is mainly driven by long term issues in our South African economy (further downgrades, political instability, increased inflation, increased interest rates, low growth, unemployment etc.).

We should take this strength in the rand as an opportunity to increase our offshore investments where we would rather achieve reliable long term growth and high dependable dividends [in dollars]. However, it must be stressed that the USA is considered expensive at the moment and we would thus suggest a trickling out of rands into dollars. The benefit of this is the possibility of sending money offshore at better rates in the future as well as the possibility of lower prices on the US stock market. We could thus send money in tranches over the next several months every time the rand gets meaningfully stronger and further below that purple line above.

Where there is a Will……. But what happens to your cyber account?

By Christine Ulyate of RCI

It is very important to make a will. Dying without one, creates much hardship for those left behind and often your assets end up going to unintended people!

In modern times, we all normally have at least one 'cyber account' such as Facebook, twitter or simply "buying on-line" to make our lives easier. Do not ignore these and hope they will one day disappear into cyber dust. Cyber criminals love 'dormant' accounts:

Dormant accounts are a honeypot for hackers. That's because they know their criminal activity will go unnoticed. And they're right. Amazon sellers didn't realize something was wrong until customer complaints started rolling in – but by then it was too late. (From an article on Blue Lance's website. Blue Lance is a global provider of Cyber Governance solutions in America).

So how does one protect our cyber assets when we are no longer here?

The simplest way is to include in your will, a" champion" of all your cyber assets. Preferably include all your cyber asset accounts and passwords and instructions as to what the champion is to do with these accounts. If you are not comfortable with leaving cyber account details, still appoint a champion to take care of the accounts and list them. This will make it easier for the person to prove to the cyber account managers that they are indeed acting on your behalf and are not some "scamster" trying to access your account illegally.

Most of the social media sites do have guidelines on what to do with accounts of deceased users.

Facebook: Facebook announced Thursday a policy that allows you to designate a "legacy contact," who'll be allowed to "pin a post on your Timeline" after your death, such as a funeral announcement. The contact won't be able to log in as you or read your private messages, but will be allowed to respond to new friend requests, update your cover and profile photos, archive your Facebook posts and photos.

Before, the Facebook profiles of the deceased could only be "memorialized," deleted or left unchanged after friends or family reported the deaths. Memorializing the profile involves freezing the account, which then no longer appears in searches or public notifications like birthdays, and can be viewed only by the user's friends.

Here's how to designate your legacy contact: go to Security and click on "Legacy Contact," where you'll be able to select one of your Facebook friends. You'll also be given the option to send them a pre-written message (which you can edit) that provides information about the policy. Otherwise, the contact will be notified only when your death has been reported to Facebook, and your account is memorialized. (http://time.com/3706807/facebook-death-legacy/)

Twitter: In the event of the death of a Twitter user, we can work with a person authorized to act on behalf of the estate, or with a verified immediate family member of the deceased to have an account deactivated.

For more details on Twitter or Instagram, please contact Christine@rcinv.co.za

Most social media and online shopping portals advise what would happen to the account in the case of a member being deceased. Check your terms and conditions with each account and/or contact them to find out what their policy is in this regard.

After that, decide who should be in control of this part of your will and how you would like the social media accounts to be handled.

Having your memory live might be considered "a wonderful thing", however none of us want our memory to be abused by ruthless cyber criminals!!

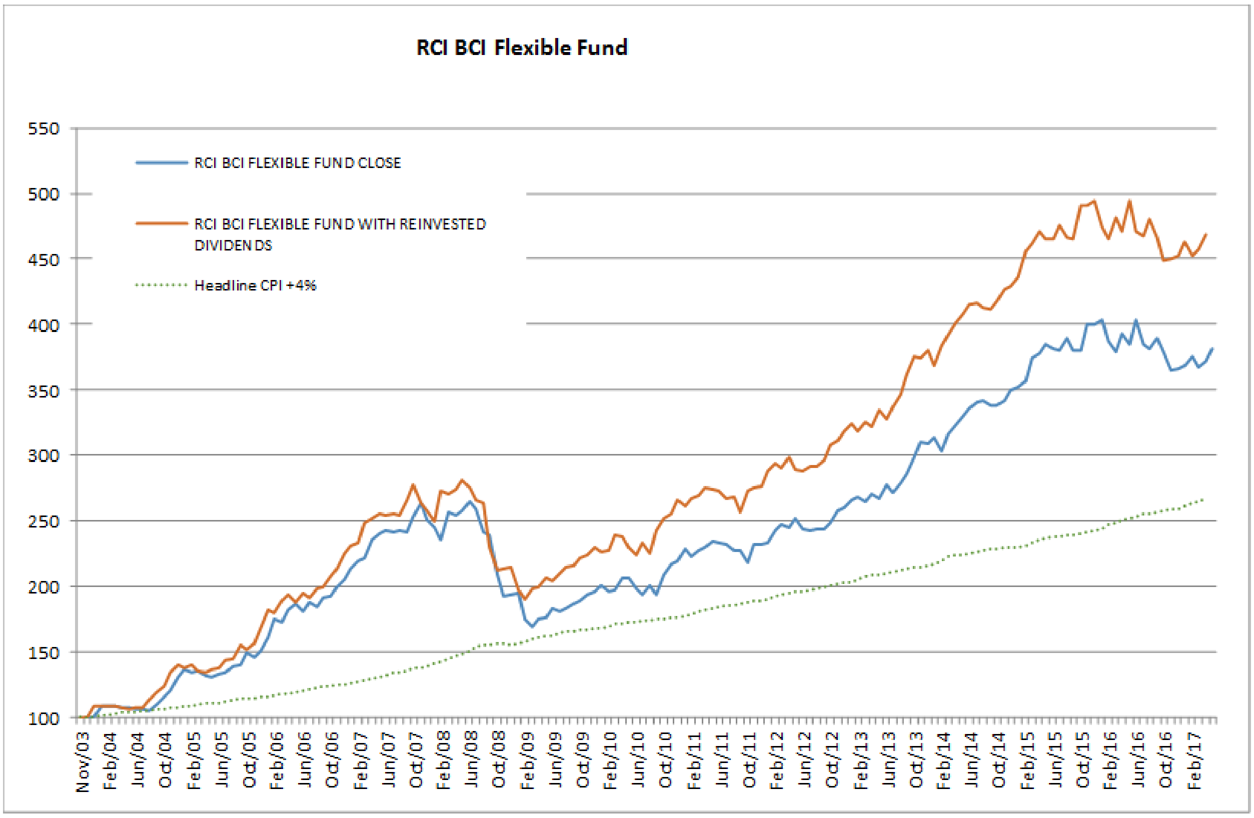
For assistance with wills, please contact **Kate Trollip** (kate@rcinv.co.za).

RCI BCI Flexible Fund

Please contact Maggie on 011 591 0578 for any help on your unit trusts.

RCI BCI Flexible Fund closed April at 381.11, up 2.58% for the month, compared to the JSE Top 40 which was up 4.22%. The RCI BCI Flexible Fund is 0.27% lower than 12 months ago whereas the JSE Top 40 was up 1.29% versus a year ago. Excluding dividends, over five years our fund is up 59% and the JSE Top 40 is up 60%. By 9 May it had risen another 6c to 387.85c

We are investing for the long-term in companies that should enjoy reliable growth in earnings and dividends. Sooner or later, this should be translated into good share price growth.



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.

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

April was a good month for our clients' portfolios as the rand weakened and the numerous rand hedges, in which we have invested. improved in value.

We have been at pains to point out that the excellent performance of 2010 to 2015 was because we felt the rand was going to weaken and that rand hedge and offshore shares were likely to be good, while mining shares were likely to be poor.

We did not change our strategy but in 2016, the rand strengthened and metal prices jumped! Thus, our portfolios were not set up to perform. Firstly, it is often difficult to change a portfolio too radically simply to take advantage of short term trends. What happens if you sell, buy into the new trend and the market then goes back to the old trend? You lose out!

Also, many portfolios have tax consequences to bear in mind. Secondly, mining shares jumped so rapidly that if you missed the first month, you missed most of the rally and we doubt that the long-term bear market in metal prices is going to conclusively turn around for many years. Thirdly – the rand. Our expectation of a weakening rand was suddenly rewarded in the first week in April. Therefore, we still have not changed our strategy – over the longer term we continue to expect metal prices to be under pressure and the rand to weaken.

As we said last month: "Please remain calm, things are never normally as bad (or as good) as the press makes out at the extremes. Most things settle down after a few months if they are pushed too far from the trend-line. Guessing the short-term moves of market is speculating whereas working out the long-term direction of the trend line, and altering one's balance at extremes, is investing. The rand is not even above R14 to the dollar. It is not nearly as extreme as the R16 to the dollar at the beginning of 2016."

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

Thank you for being our clients.

Best regards

Di and Alan