Robert Cowen Investments

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Newsletter

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"I've learnt that people will forget what you said, people will forget what you did but people will never forget how you made them feel." ~ *Maya Angelou* in I know why the caged bird sings

"In the short run, the market is a voting machine but in the long run, it is a weighing machine." ~ *Benjamin Graham*

RCI MET Flexible Fund – closed July at 381.53, up 2.64% for the month. The RCI BCI Flexible Fund is up 3.78% year to date whereas the JSE Top 40 is up 11.32% year to date. Naspers had a big jump this month and contributes 20% to the JSE Top 40 whereas we are limited to hold only 10% in our fund. Furthermore mining, in which we have little as we are not convinced of its longer-term prospects, rose sharply.

RCI BCI World Wide Flex closed at 104.91c. It is up 4.91% since its launch in December 2016.

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

Can you sell out before a crash and buy back in afterwards?

After the large crashes of 2000 and 2008, a friend, Mr. D asked us if it is possible to sell out now to avoid the next crash and to buy back in later. We examine the numbers (before any possible gains tax) to see what the effect would have been to a) sell out 10% before the top and b) buy back in at the bottom and then c) buy back in once the market had risen 10%.

Substantial gains may be made if the crash is large.

Can you still make money if the crash is only a more 'normal' 20%?

We examine all of the scenarios and report back to Mr. D.

Is the world really better than ever?

Steven Wright: 5 of his clever questions.

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

Selling out before the next crash

Can a crash be predicted? What is the effect of selling out at the top and buying at the bottom? Is that possible? What happens if you sell a year too early and buy back only when the market has risen 10% from the bottom? Do you still make money? The 2008 crash was abnormal, being a fall of over 50%. What happens in a normal crash of just 20%? Is it best to sell something or simply sit tight?

Last month, a friend, Mr. D had read that a crash was imminent. He wanted to sell his whole offshore portfolio, go into cash, wait for the crash and then reinvest lower down. We continue to make some points to him:

Do you listen to a prophet of doom? Most people predict 15 of the next two crashes i.e. they are wrong most of the time and much too early. You must work out who to listen to. This is not easy as, historically, most people who have successfully predicted a crash have had a horrible record in predicting the next crash.

The 'prophet of doom' must not be too late with his prediction – or what is the use? This results in them predicting early and often. Many of the people who claim to have predicted a crash in 2008, actually started predicting the crash in 2002! The market often never falls to the level at which they made their first prediction of doom! Furthermore, by sitting in cash for 6 years, they lost out on a huge amount of dividends – probably about 30% on the 2002 level but they normally do not mention that!

They must not be too early in their prediction either or the effect is dissipated. At the moment, a problem is that the US government can carry on printing money for many years and might put the evil day off for a lot longer. In future letters, we will discuss how to decide if you should take money out the market. If you had been scared out of the market two years ago, you would have lost out on a 17% rise in the SP500 (the main American Index)!

From the above graph, it is clear that the 2008 crash was horrific. The peak was about 1500. It collapsed 56%, the worst crash since the Great Depression, yet, less than ten years later, it sits around 2500! So, unless you panicked and sold at the bottom, what was the problem? There is no doubt that if you had sold just before the crash, and bought back at the bottom you would be better off but how did you know when to sell? What happened if you sold two years too early?

Another interesting point is that the growth in the index for the past 20 years is about 8.5% per annum. If the market fell 20% it would reduce this growth to about 7% and if it crashed 40%, the growth rate would drop to about 5.75%.

Let us examine the worst crash in our lifetimes: 2007/2008. What would have happened if you had been able to sell all or part of your portfolio before in happened?

In Scenario I alongside: what would have happened if you had simply held on through all the excitement peak. The fall you experienced was 56%. However, one year later the fall had dissipated to 27% whereas after two years the fall was 16% and, after five years, it had risen by 33% from the peak before the crash.

Scenario 1: hold throughout 2008 crash				
	If measured from peak			
		1 yr after bottom	2 yr after bottom	5 yr after bottom
9/10/2007	1565	1565	1565	1565
9/03/2009	677			
Fall	-56%			
9/03/2010		1140		
Fall		-27%		
9/03/2011			1316	
Fall			-16%	
10/03/2015				2079
Rise				33%

What happened if you had sold at the very peak and bought back at the very bottom? You could have afforded to buy 201% of your portfolio, so you would have made a substantial gain on the subsequent rise.

Scenario 2: Sell a year early buy back at bottom				
	If measured from 1 year before peak			
	1 year earlier	1 yr after bottom	2 yr after bottom	5 yr after bottom
10/10/2006	1364	1364	1364	1364
9/03/2009	677			
Fall	-50%			
buy back in	201%			
9/03/2010		1140		
Fall		-16%		
Value on 201%		2 291		
Gain on 201%		68%		
9/03/2011			1316	
Fall			-4%	
Value on 201%			2 645	
Gain on 201%			94%	
10/03/2015				2079
Rise				52%
Value on 201%				4 179
Gain on 201%				206%

In Scenario 2, we look at what would have happened if you had sold out a year before the peak. The fall, which you so cleverly avoided, would have allowed you to reinvest in 201% of the shares at the bottom. After one year from the bottom, the gain on these cheap new purchases would have been 68%. After two years, the gain was 94% (instead of a fall of 16%) and after five years the gain was 206% (instead of 33% if you had done nothing). NB this ignores capital gains tax!

Ah, but you say, how would you have known to sell at the very top and buy at the very bottom? What would have happened if you sold a year too early? What happens if you only started to buy once the market was up 10% off its bottom?

Scenario 3: sold 1 year early; bought 10% off bottom				
	If measured from 1 year before peak			
	1 year	1 yr after	2 yr after	5 yr after
	earlier	bottom	bottom	bottom
Bottom	677			
10% higher	744.7			
buy back in	183%			
9/03/2010		1140		
Fall		-16%		
Value on 183%		2 086		
Gain on 183%		53%		
9/03/2011			1316	
Fall			-4%	
Value on 183%			2 408	
Gain on 183%			77%	
10/03/2015				2079
Rise				52%
Value on 183%				3 805
Gain on 183%				179%

In Scenario 3, the gain falls from 206% to 179% over five years. Still substantial

In Scenario 3, we examine what happened if you had performed in a more realistic scenario: If you had sold a year too early and only bought back once it was 10% of its bottom. Remember the huge fear about shares in 2009! This would have given you the funds to buy 183% of your shares you previously held. This resulted in you showing a gain of 179% after five years – still substantially better than the 33% of doing nothing *and now you are earning 183% more dividends*!

The crash of 2008 was a 'once in a generation crash' so how big would the benefit have been in the Dotcom crash of 2000?

Now let us look at the effects of the crash that took place in 2000. (The IT crash). This is shown below in scenarios 4-6. Scenario 4 shows that if one had simply held through the crash, your portfolio would have dropped by 47% but after one year the drop would have been only 27%; after two years 20% and after five years 13%.

Scenario 5 shows that if you had sold a year earlier, the decline would have been 41% and if you had then bought back at the very bottom you would have been able to buy back 171% of what you had sold (ignoring capital gains tax). After one year, the gain would have been 43%; two years 51% and five years 65% (compared to the 13% fall if you had done nothing!). Your annual dividend would now be 171% higher!

But, again, how practical is this? What happens if you had sold a year too early? How do you know that the bottom has actually occurred? In Scenario 6 we assume that you would have bought back in only after the market was up 10% from the bottom. You would then have been able to buy 155% of what you sold. After one year, growth would be 30%; after two years 50%; and after five years 136% (compared to a drop of 13% if you had done nothing). So even if you had paid some capital gains, the gain would have been substantial. Your annual dividend would now be 155% higher!

Those two crashes were extreme. What is the effect of a normal crash of 20%?

Then we have a look at the effects of a "normal crash" of just 20%. (Scenarios 7-9). In Scenario 7, if one simply held through the crash, your portfolio would have dipped 20% from 1000 to 800. We then assume growth of 100 points per year so after one year you are still down 10%, after two years you are flat and after five years you are up 30%.

In contrast, if you had sold a year earlier in Scenario 8, you could have bought back 113% of your holdings at the bottom. After one year, you would have been up 13%; two years 26% and up 88% after five years (compared to only 30% if you had done nothing). Dividends would be 13% higher each year.

In Scenario 9, we assume that you would only have bought back after it was 10% off the bottom. In which case, you could have bought 102% of what you had sold. After one year, you would be up 2%; two years 13% and 70% up after five years (compared to the 30% if you had done nothing) and dividends would be up only 2%. We assume that selling had not resulted in capital gains tax. If you would have had to pay tax, this would have decreased this gain.

Scenario 4: hold throughout 2000 crash				
	If measured from peak			
		1 yr after bottom	2 yr after bottom	5 yr after bottom
05/09/2000	1507	1507	1507	1507
11/03/2003	800			
fall	-47%			
15/03/2004		1104		
Fall		-27%		
9/3/2005			1207	
fall			-20%	
13/3/2008				1315
fall				-13%

Scenario 5: Sell a year early buy back at bottom				
	If measured from 1 year before peak			
	1 year earlier	1 yr after bottom	2 yr after bottom	5 yr after bottom
05/09/1999	1364	1364	1364	1364
11/03/2003	800			
Fall	-41%			
buy back in	171%			
15/03/2004		1140		
Fall		-16%		
Value on 171%		1 949		
Gain on 171%		43%		
9/3/2005			1207	
Fall			-20%	
Value on 171%			2063.97	
Gain on 171%			51%	
13/3/2008				1315
Fall				-13%
Value on 171%				2 249
Gain on 171%				65%

Scenario 6: sold 1 year early; bought 10% off bottom				
Bottom	800			
10% higher	880			
buy back in	155%			
9/03/2010		1140		
Fall		-16%		
Value on 155%		1 767		
Gain on 155%		30%		
9/03/2011			1316	
Fall			-20%	
Value on 155%			2 040	
Gain on 155%			50%	
10/03/2015				2079
Fall				-13%
Value on 155%				3 222
Gain on 155%				136%

Scenario 7: hold throughout 20% crash				
	If measured from peak			
		1 yr after bottom	2 yr after bottom	5 yr after bottom
year x	1000	1000	1000	1000
bottom	800			
fall	-20%			
bottom +1yr		900		
Fall		-10%		
Bottom+2 yr			1000	
fall			0%	
Bottom+5 yr				1300
Rise				30%

Scenario 8: Sell a year early buy back at bottom				
	If measured from 1 year before peak			
	1 year earlier	1 yr after bottom	2 yr after bottom	5 yr after bottom
year x-1	900	900	900	900
bottom	800			
Fall	-11%			
buy back in	113%			
Bottom +1yr		900		
Fall		0%		
Value on 113%		1 017		
Gain on 113%		13%		
Bottom +2yr			1000	
Fall			0%	
Value on 113%			1130	
Gain on 113%			26%	
Bottom +5 yrs				1500
Rise				30%
Value on 113%				1 695
Gain on 113%				88%

Scenario 9: sold 1 year early; bought 10% off bottom				
Bottom	800			
10% higher	880			
buy back in	102%			
Bottom + 1yr		900		
Fall		0%		
Value on 102%		918		
Gain on 102%		2%		
Bottom + 2yr			1000	
Fall			0%	
Value on 102%			1 020	
Gain on 102%			13%	
Bottom + 5yr				1500
Rise				30%
Value on 102%				1 530
Gain on 102%				70%

Mr. D, particularly as you are only 58, you need to invest with a very long-term horizon. We think you must assume that with the breakthroughs in medical science you or your wife will live until you are at least 85. Thus, what happens is the short-term should be of very little importance.

In the table above, we show you what would have happened if you had lived through the greatest crash of any living investor's life time. i.e. 2008. A crash of this magnitude is unlikely to recur in our lifetimes. If you had lived off of your income and did not panic and sold at the bottom it would have had little long term effect. The fall from the peak (9/10/2007 – some of our data is weekly only) of the SP500 was 56%. However, if you still held your shares, a year later your drop would have "only" been 27%. After two years the drop was still 16% but after five years you would have been up 33% above the 2007 peak!

What if a commentator had panicked you into selling a year before the peak? In this case you might have sold out at 1364. After the crash, you would have patted yourself on the back saying that you saved yourself a 50% fall. A year after the bottom of the crash you would have saved yourself 16% but after two years you had only saved yourself 4%. Furthermore, you would not have earned any meaningful interest on your cash, nor would you have earned any dividends when it is not invested. Economic conditions remained tough and your prophet of doom probably would have kept you out of the market. If you had not got back into the market, then after 5 years, you would have missed out on the 52% rise on your money (plus dividends) enjoyed by someone who had done nothing. So the question is, are you going to be strong enough to get back into the market?

Now let us examine what would have happened if your prophet of doom had been two years too early. You would have sold at a market level of 1196. When the crash took place you would have been ecstatic having avoided a 43% decline in your shares. After one year, the decline would have reduced to just 5% and after two years you would be forgoing a 10% gain. Five years after the big drop you would be forgoing a 74% gain on your money (plus dividends). Therefore, the question again is: would you have bought back into the market?

Naturally, if your 'wise-man' had talked you out of the market even earlier, the reduction in the decline would have been less and you would have had to get back in early to have benefitted.

We can see why Peter Lynch (who wrote many years before the big crash), felt that staying fully invested was the right thing to do as he had only experienced 'normal' 20% or less crashes. However, if you had managed to get your timing right in the last two BIG crashes, AND THEN BOUGHT BACK you would have made substantially more money. We are not saying it is easy, or even likely that you will get it right, but we will examine this possibility in future letters.

We will also examine in future letters the steps you could take to mitigate the damage of a drop. e.g. you could create a stop loss policy at say, 12% below the running portfolio value or you could decide to hedge with futures and guarantees. You might decide to sell, say, 30% and increase you cash position by 5% every six months thereafter. Such strategies will be examined. We will also take a look at selling the most expensive shares and replacing them with cheaper shares.

Is the world really better than ever?

From: Fuller Treacy Money comment of the day 28 July 2017

"Thanks to a subscriber for this article from The Guardian which may be of interest. Here is a section:

The loose but growing collection of pundits, academics and thinktank operatives who endorse this stubbornly cheerful, handbasket-free account of our situation have occasionally been labelled "the New Optimists", a name intended to evoke the rebellious scepticism of the New Atheists led by Richard Dawkins, Daniel Dennett and Sam Harris. And from their perspective, our prevailing mood of despair is irrational, and frankly a bit self-indulgent. They argue that it says more about us than it does about how things really are – illustrating a certain tendency toward collective self-flagellation, and an unwillingness to believe in the power of human ingenuity.

And that it is best explained as the result of various psychological biases that served a purpose on the prehistoric savannah – but now, in a media-saturated era, constantly mislead us.

“Once upon a time, it was of great survival value to be worried about everything that could go wrong,” says Johan Norberg, a Swedish historian and self-declared New Optimist whose book Progress: Ten Reasons to Look Forward to the Future was published just before Trump won the presidency last year. This is what makes bad news especially compelling: in our evolutionary past, it was a very good thing that your attention could be easily seized by negative information, since it might well indicate an imminent risk to your own survival. (The cave-dweller who always assumed there was a lion behind the next rock would usually be wrong – but he’d be much more likely to survive and reproduce than one who always assumed the opposite.) But that was all before newspapers, television and the internet: in these hyper-connected times, our addiction to bad news just leads us to vacuum up depressing or enraging stories from across the globe, whether they threaten us or not, and therefore to conclude that things are much worse than they are.

Really good news, on the other hand, can be a lot harder to spot – partly because it tends to occur gradually. Max Roser, an Oxford economist who spreads the New Optimist gospel via his Twitter feed, pointed out recently that a newspaper could legitimately have run the headline “NUMBER OF PEOPLE IN EXTREME POVERTY FELL BY 137,000 SINCE YESTERDAY” every day for the last 25 years. But none would have done so, because predictable daily events, by definition, aren’t newsworthy. And you’ll rarely see a headline about a bad event that failed to occur. But surely any judicious assessment of our situation ought to take into account all the wars, pandemics and natural disasters that might hypothetically have happened but didn’t?”

Steven Wright-isms

If you're not familiar with the work of Steven Wright, he's the famous erudite (and comic) scientist, who once said: "I woke up one morning, and all of my stuff had been stolen and replaced by exact duplicates."

His mind sees things differently than most of us do... here are some of his gems: *(editor: we have only included the last six)*

30 - The sooner you fall behind, the more time you'll have to catch up.

31 - The colder the x-ray table, the more of your body is required to be on it.

32 - Everyone has a photographic memory; some just don't have film.

33 - If at first you don't succeed, skydiving is not for you.

34 - OK, so what's the speed of dark?

And the all-time favourite -

35 - If your car could travel at the speed of light, would your headlights work?

RCI BCI Flexible Fund

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

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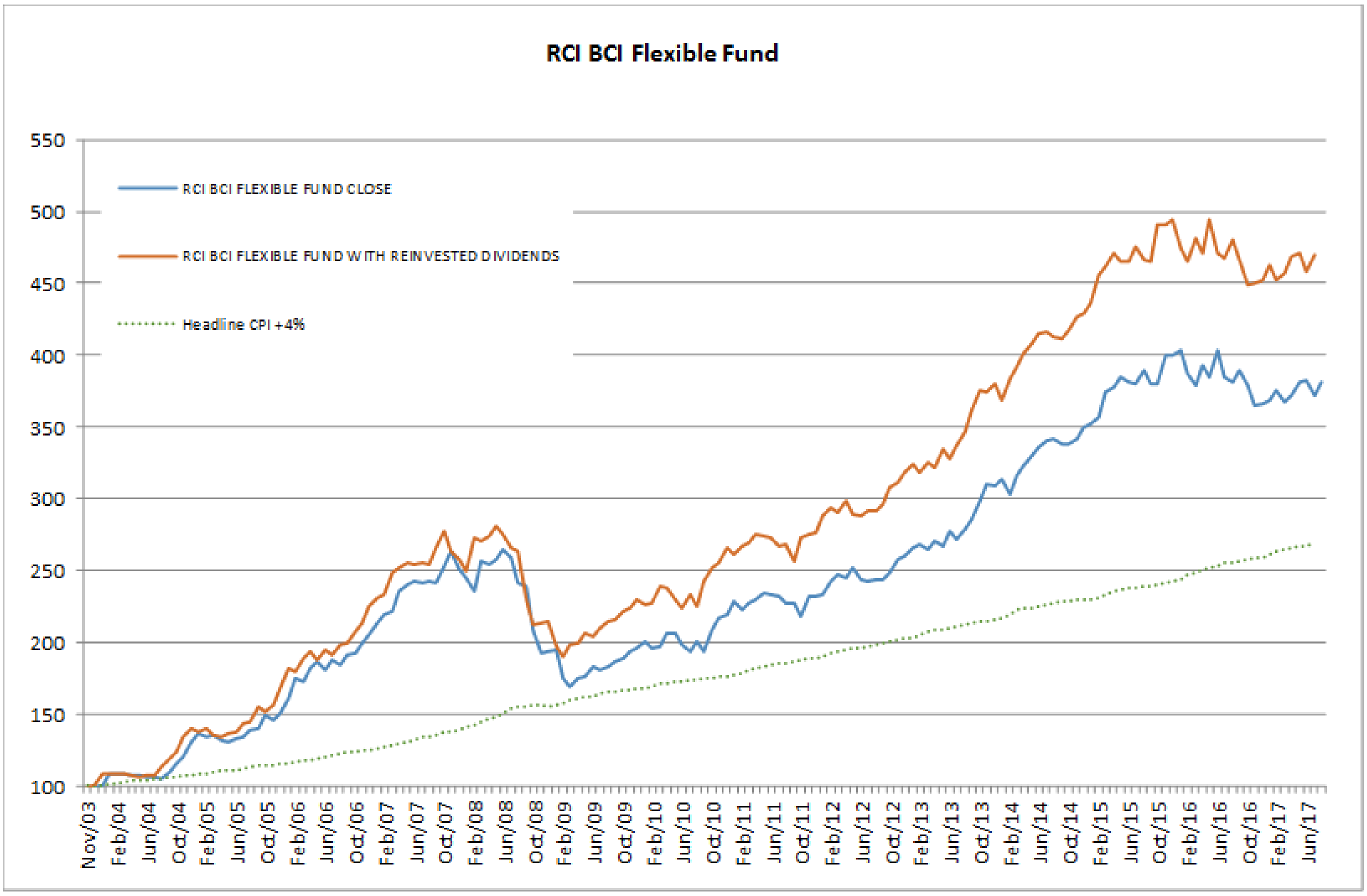
RCI BCI Flexible Fund
RCI BCI FLEXIBLE FUND CLOSE
RCI BCI FLEXIBLE FUND WITH REINVESTED DIVIDENDS
Headline CPI +4%
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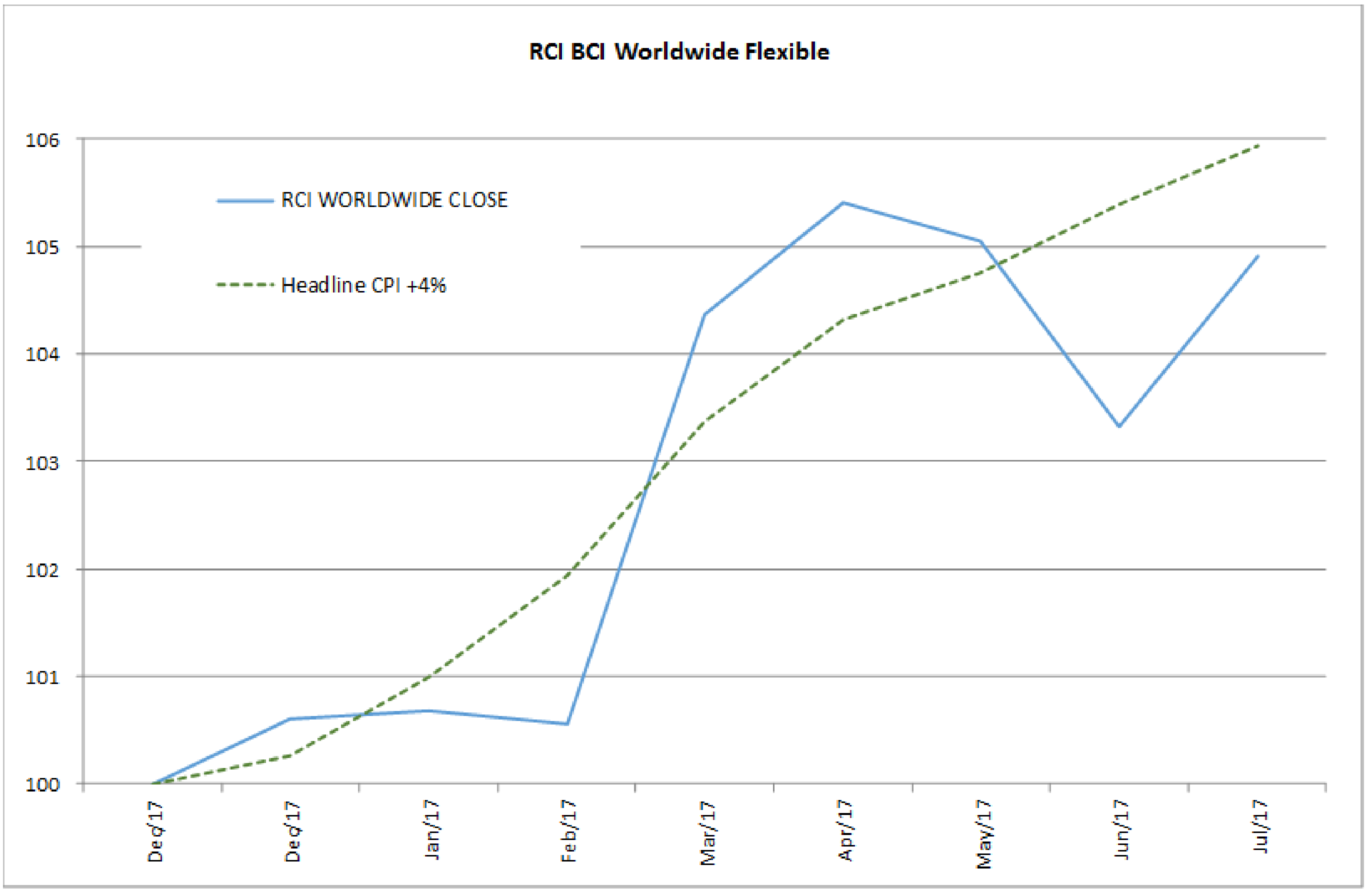
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Unit trust has flexibility – happy to take small amounts

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 R25 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

August is going to be an interesting month in South African politics. Will there be a secret ballot against President Zuma? Our best guess is that he is going nowhere until after the December ANC conference. We continue to expect South Africa to be downgraded (probably in June 2018 but it could be sooner) where after the rand should fall and our investment strategy should bear fruit.

We have continued our answer to Mr. 'D' about his question on offshore investments and what to do about fears of crashes in offshore markets. We have examined the effect of selling out at the very top and repurchasing at the very bottom. Then we examined the more likely scenario of selling a year too early and buying back once the market has risen 10% from its bottom. These scenarios provide some interesting numbers if the crash is in excess of 40% but are not as beneficial if the crash is only a more 'normal' 20%!

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

Thank you for being our clients.

Best regards

Di and Alan