Robert Cowen Investments

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Newsletter

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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

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

"Happiness is the meaning and the purpose of life, the whole aim and end of human existence." ~ *Aristotle*

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

What a difference a month makes! In April, the rand fell 5% as 'Ramaphoria' hit its limits but the portfolios and the unit trusts rose some 5% to 7% as they have invested in so many rand hedges.

A reader asks why we love Naspers and British American Tobacco? We set out our estimates of what they should be valued at in five years and you will see why we can't resist them!

What country is thought to be greatest threat to world peace? An interesting graph of the fears of different countries!

Macquarie's Global Economic and Market Outlook "Bracing for higher US rates".

The coal price is flying – we have added some Exxaro to our local unit trust.

Mike Gresty, our new CIO, joins us on 1 June 2018.

A reader asks, "Why do you keep going on and on about Naspers and BAT?"

Let us answer with a quote from Warren Buffet from Three lectures to Notre Dame -1991:

> *"You don't need very many good ideas. If we get one good idea a year, that would be terrific. And, if you negotiate with me, you'd get me down to one every two or three years. That's all you need. You do not have to keep hitting home runs. That's one of the nice things about this business. If you make one decision on something like that, it takes care of a lot"*

Naspers and BATS have been great performers for us in the past and will be again in the future. We are trying to buy shares that will deliver a return of at least 15% per annum. Naspers' chief holding is in Ten Cent which has a high ROCE of over 29% and is expected to grow EPS by over 20% per annum.

In the following table, which we have based on a report from a 'renowned' analyst who expects the price to rise 69% over the next year to 510000, we have rather tried to look at what might happen over 5 years.

		Naspers	**RCI's rough calculations**					
Row		**Year end March**						
		2017	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
1		**1**	**1**	**1**	**1**	**2**	**2**	**2**
2	EPS (US c)	3.99	6.86	10.07	13.86	16.632	19.9584	23.95008
3	EPS growth		72%	47%	38%	20%	20%	20%
4	Approx. Rand earnings							
5	Rand / dollar	13	13	12.5	12.5	12.5	12.5	12.5
6	App. Rand EPS	51.87	89.18	126	173	208	249	299
7	PE (analysts methodology)		35.5	24.2	17.6			20
8	Current price		301933					598752
9	Analysts expectations			510000				
10				69%				
11	5% weaker rand							
12	Rand / dollar			13.13	13.78	14.47	15.19	15.95
13	EPS							382
14	PE							20
15	Rand price		301933					764176
16								
17	15% growth		301933	347223	399306	459202	528083	607295
	1 = analyst's expectations							
	2 = RCI guess							

The dividends are so paltry that we have ignored them! In row 1 we show the dollar earnings to 2020 as forecast by the analysts (72%, 47% and 38%) but thereafter we drop the growth rate to 20% as nothing grows to the sky and we prefer to be pleasantly surprised, not disappointed! So in 5 years time, 2023, we are hoping for EPS of US 23.95. Using the current exchange rate of about 12.50 this should equate to about R299 (row 6). If Naspers is growing still at 20% per annum it will deserve a PE of at least 20 so we get a share price of R598752 in row 8 which is almost double the current share price. If our 15% growth target is to be achieved, the price must double over 5 years. (Shown in line 17.)

However, we expect the rand to weaken (or the dollar to strengthen) by 5% per annum (approximately our inflation differential) reflected in line 17. This should increase Naspers' Rand EPS to R382 as per line 18 and result in a share price of R764 176 per line 15 at a PE of 20. That is growth of 153% over 5 years, Of course, the price might be more (or less) than this in 5 years but we are trying to build in a 'big margin of safety' so as long as it is worth more than R 607 295 (our 15% target) we will be happy.

British American Tobacco

We are going to cop out of the argument about whether it is moral or not to invest in tobacco. Driving cars kills people too. The point we are making is that now should be a great time to buy this share. In the graph below we show the share price since after its reorganisation in 2009. The grey line is the PE ratio which averages about 20% per year. Bear in mind that this share grows earnings at about 7% per annum in pounds, and pays a fantastic and growing dividend, in pounds, of some 6%. It is clear that the share normally trades on a PE of around 20. If it goes back to a PE of 20 from its current level, you will make a huge capital gain and a great dividend.

Why is tobacco a great industry to invest in?

Tobacco companies are not allowed to advertise. Costs are minimal. No new competition will dare to enter the market!

American's first put a health warning on tobacco packs over 50 years ago, 'Dinosaurs take a long time to die'. Over the next hundred years, we expect smoking to SLOWLY decrease. The number of smokers in the USA has halved in over 50 years but profits have risen? Why? People are addicted to smoking so smokers buy cigarettes no matter the price!

Discouraging smoking made smoking a 'rebellious' thing to do. This appeals to many people.

The number of First World smokers is dropping but the Developing World is increasing the cigarettes sold. Sixty years ago my parents' gardener could not afford cigarettes so had to roll his own from Boxer tobacco. So, a lot of cigarette smoking (as opposed to alternatives) is taking place. Ok the population has grown from about 20 million to 60 million in South Africa. Think of the markets in China and India, and the rest of the Far East, and South America.

British American Tobacco						
	2018	**2019**	**2020**	**2021**	**2022**	**2023**
EPS (based to 100)	100	107	114.49	122.50	131.08	140.26
PE	10	12	14	16	18	18
Share price based to 100	100	128.4	160.3	196.0	235.9	252.5
Add dividend	6	6.42	6.87	7.35	7.86	8.42
Total return	106	135	167	203	244	261
If rand weakens 5% p.a.	111	142	176	214	256	274

The table above reflects a gain of about 161% over five years or 174% if the rand weakens by 5% p.a.

What country is thought to be greatest threat to world peace?

The map shows the results of a 2013 (pre-Trump) WIN/Gallup International survey asking people which country they felt was the greatest threat to world peace. The USA and Canada feared Iran. Most of the rest of the world feared the USA. India feared Pakistan.

Global Economic and Market Outlook - Bracing for Higher US Rates…

Desk strategy from Macquarie 7th May 2018

This publication has been prepared by Sales and Trading personnel at Macquarie and is not a product of the Macquarie Research Department.

2017 saw the best "synchronised" growth since 2010, with global GDP increasing by 3½% in the year to Q4, well above the long-run average of 2¾%. Historically growth rarely stays at such elevated levels for long, and so it has been in this cycle, with the pace of expansion moderating in recent months. However, while the growth bears have been quick to jump on the latest "slowdown scare" as a sign that the improvement was an aberration**, our reading of recent data suggests that the downdraft may already be coming to an end, with growth likely to remain above average over the course of 2018.**

- We expect global GDP to expand by 3% in the year to Q4 2018, with a similar pace of expansion in 2019.

While markets rightly remain nervous about the possibility of a global trade war, with President Trump's negotiating style likely to continue to drive volatility ahead of midterm elections, **we think the greater risk lies in a repricing of the US yield curve as the ghost of secular stagnation is finally put to rest.**

- According to the best indicator (the employment cost index) US private sector wages growth is back in the "normal range" and picking up, while core PCE inflation (3m/3m saar) is already above the Fed's 2% target.

- With US growth likely to rebound in Q2, **this suggests that the Fed has fallen behind the curve**. We feel that over coming months the market will begin to move toward our expectation of another 3 Fed hikes this year, followed by a further 3 or 4 next year.

- **While the 3 to 3.1% level for 10 year yields provides a formidable technical barrier, we expect it to be breached sometime in the next month or two, effectively signalling an end to the 38 year bond bull market.**

The impending reset in US interest rates is likely to drive further volatility across asset classes as investors debate whether higher rates will crash the economy, or whether the long tail of the crisis is finally passing. We are firmly in the "normalisation" camp, however, it is likely that it will take some time for the market to become comfortable with a return to something more like the "old normal" interest rate structure in the US.

In the near term, as 10-year yields hover below 3%, the equity market is likely to remain nervous. And while the risk is that the initial decisive break above 3% will see a significant correction, **we feel that the stellar earnings results have not been reflected in US equity pricing, and should provide a support once the initial shock subsides (forward PEs suggest that the S&P 500 is not terribly expensive).**

The spread between US and European interest rates has finally found a level that looks to be sufficient to support the dollar. However, while the Greenback is likely to continue its move higher once the US 10-year breaches 3.05%, we think the rally will be relatively short lived, with the slump resuming toward the end of the year as the ECB comes into sharper focus.

War on coal making the world's top mine owners a lot richer

Fuller Treacy Money Comment of the day: 5th May 2018

Some of the more significant declines are occurring in China, the top mine operator, and financing for new supplies is drying up. That's creating a windfall for the producers who remain.

"It's a perverse consequence" of policies intended to combat climate change, said Julian Treger, co-founder of activist investor Audley Capital Advisors LLP. "It's going to be very difficult for funders to provide capital to bring new coal assets online. We have a very interesting supply and demand picture being set up."

Anglo American, which not long ago wanted to unload its coal assets, has seen income from the business triple since 2015 to become the mining company's most profitable commodity. Last year, Glencore reported earnings from the fuel more than doubled, while BHP Billiton said it surged sixfold.

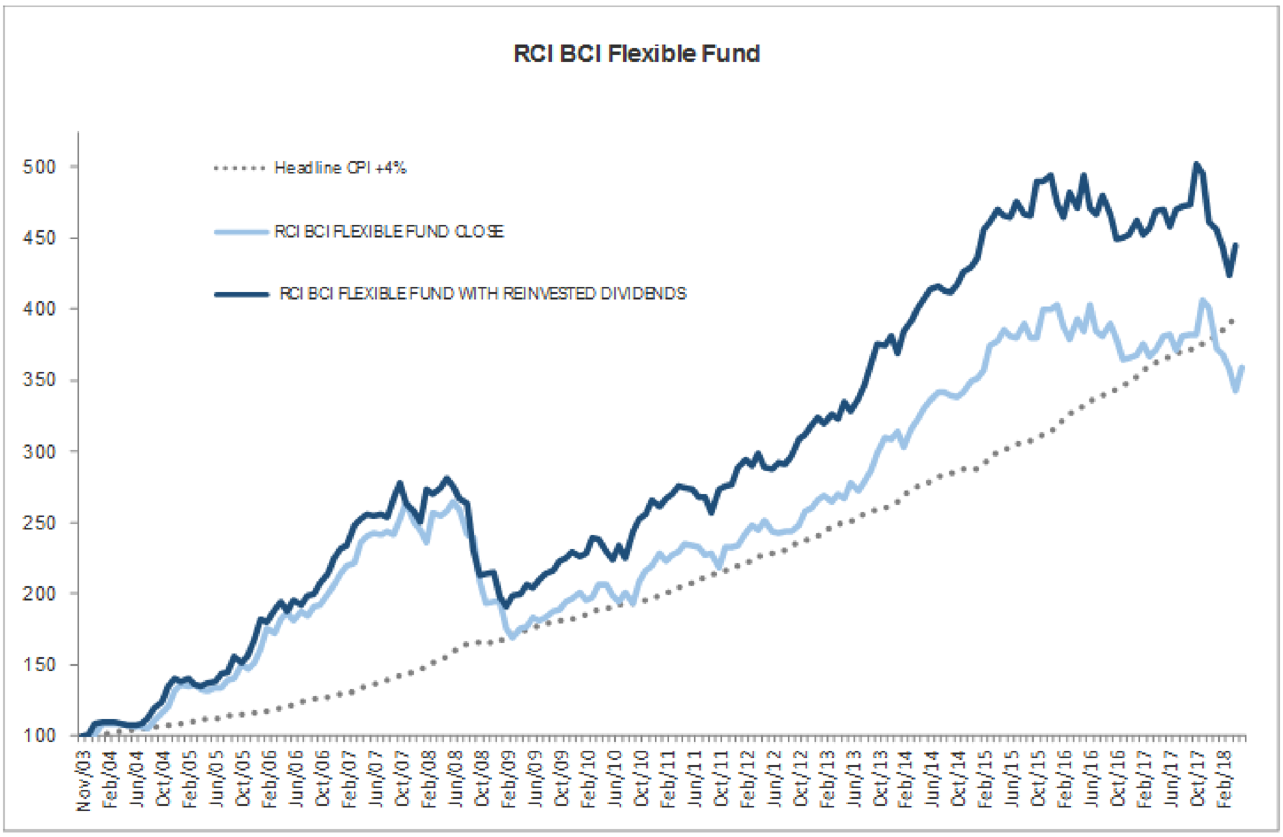
While global coal use and mine output has been dropping, production failed to keep pace with demand in 2016 for the first time in seven years, data compiled by BP Plc show. As supplies continue to drop, the amount available for export is shrinking. BMO Capital Markets says the 1 billion-metric-ton seaborne market will have a small deficit by 2021 and expand to 15 million tons in 2022.

Editor: We have been buying a bit of Exxaro in our local unit trust – still waiting for the price to take off.

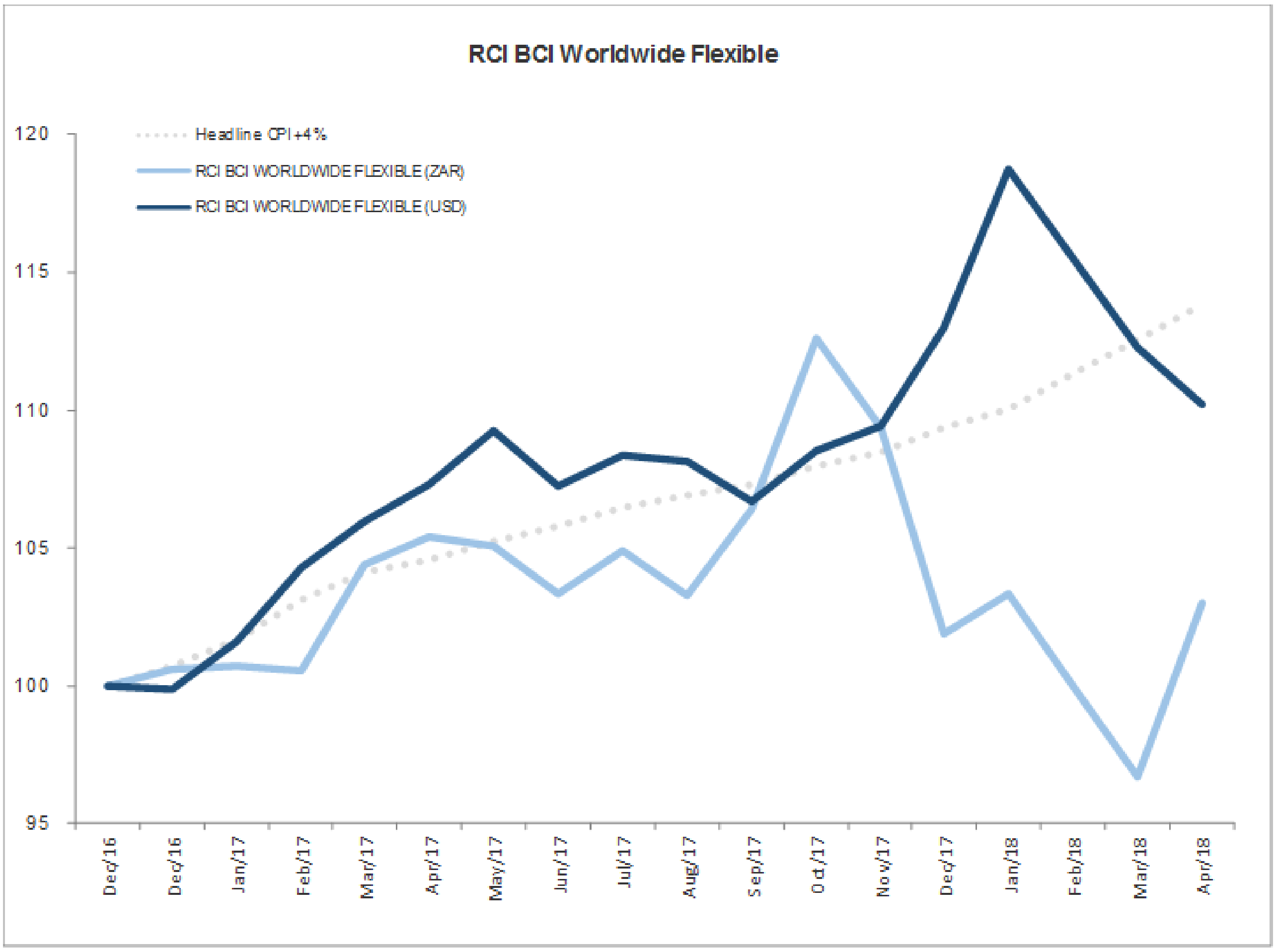
RCI Unit Trusts

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

RCI BCI Flexible Fund closed April at 359.64, up4.94% for the month.



RCI BCI World Wide Flex closed April at 102.97, up 6.8% for the month. The investments are mainly in foreign companies with very high ROCE (return on capital employed) which has normally resulted in fantastic returns with low risk investments.



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.

Our new CIO – Mike Gresty

Just a reminder that Mike, our new Chief Investment Officer, joins us on 1 June 2018. As we have sung his praises in previous communication with you, we will not repeat the long list of accolades here, but will be organising a couple of functions during the month for you to meet him in person. We look forward to him joining us and assisting Alan and the team in the investment process.

To conclude

How are we trying to invest? We want to put most of your money into great companies with very high Return on Capital Employed that should enable us to aim for returns of above 10% per annum. We aim for 15% per annum but sometimes things go wrong. In this letter we have shown why we expect Naspers and British American Tobacco to grow by over 15% per year for the next five years, with additional growth if the rand is weak over this period.

During April, the rand fell 5%. Possibly, the market overdid the reaction to the succession of Mr. Ramaphosa to President so the rand has given up some of its gain as South Africa faces many problems which will take some time to overcome e.g. Eskom. SAA etc. The threat of a trade war from Mr Donald Trump brought foreign markets down to earth for a while. American companies showed even higher growth than expected for the first quarter of 2018 which, together with the drop in tax rates, has helped restore the PE ratio to more acceptable levels. The information coming out of the USA indicates that a recession before the latter half of 2019 is unlikely so markets may be high, but are not outrageous considering the low alternative interest rates. We look forward to a good rest of the year!

Thank you for being our clients.

Best regards

Di and Alan