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

"The way you train reflects the way you fight. People say I'm not going to train too hard, I'm going to do this in training, but when it's time to fight I'm going to step up. There is no step up. You're just going to do what you did every day."

~ *Georges St. Pierre*

"Right, as the world goes, is only in question between equals in power, while the strong do what they can and the weak suffer what they must."

~ *Thucydides, History of the Peloponnesian War (circa 400 BC)*

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

In June, the rand fell further and the portfolios and unit trusts leaped in value. It is sad that we are investing to benefit from poor performance from South Africa. May the politicians get their acts together and get South Africa back on a growth path! If fact we will be glad of small mercies – this letter is delayed because of internet outages and we have had to huddle under blankets during the power outage. Roll on summer!

The RCI Flexible Fund had a great month and closed June at 380.07c, up 6.07% for the month. The JSE Top 40 was up by 0.6% for the month. Our unit trust came third in its category of over 80 funds.

The RCI BCI World Wide Fund closed June at 115.76c, up 9.7% for the month. We came first in the class and were well rewarded as one should expect with a weakening rand. See graphs later in this letter.

On the 1st of June, our new **Chief Investment Officer, Mike Gresty,** joined us. He writes his first article for you on page 2. One of the reasons why we employed him is his thorough knowledge of investment theory, which shines through. He discusses the reasons to be in the market over the medium term.

Investing offshore – surprisingly little difference if you take rands out overtime or when the rand is strong – just don't do it when the rand has collapsed . From an interesting article in the Sunday Times.

'Guns, Germs and Steel' How civilization spread across the world. Jared Diamond wrote an excellent book. It is summarised here.

What does Anchor think of the American Bond Rate? Slightly expensive – meaning rates should rise more. Interesting meter makes their point.

What a difference just a few days can make

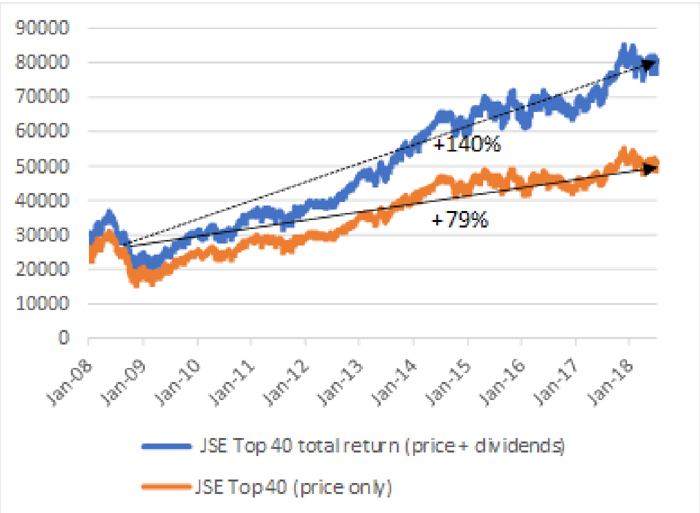
By Mike Gresty, our new Chief Investment Officer

One of the many reasons we employed Mike is his thorough understanding of investment theory, as you will see in the article he has written below:

Wow – can you believe we are past 2018's half way mark already? When you think of the optimism with which we started the year (positive political change in the air as Cyril Ramaphosa replaced Jacob Zuma as President, healthy global growth in prospect and the rand at its strongest levels in months to name a few), who would have expected we would end the first half with the equity market in negative territory? Indeed, the All Share finished the first half with a total return (price change + dividends) of -1.7%. Consider too that, with only 11 shares out of the top 40 South African listed shares managing positive return so far this year, there were few places to hide from the tough market conditions so far this year.

After a period like this, it is not surprising that one begins to question the wisdom of being invested in equities. However, six months is not an appropriate period to assess the performance of shares, particularly South African shares. With this in mind, I thought it would be a good opportunity to take stock of how the score card looks for various asset classes over a longer period.

As it happens, ten years ago, we were in the midst of the Global Financial Crisis. Since then, equities have delivered a total return of 140%, although investors' nerves were severely tested initially (equity markets only bottomed 8 months later, in March 2009).



In the table below, we show the annual return from various asset classes one could have chosen over the last 10 years. In the dark days of 2008, many investors fled the equity market, promising themselves never to return. History shows that this was the wrong decision. If the difference in annual returns between equities and the other asset classes does not appear that great, keep in mind (1) these are pre-tax returns and much of the return from cash, bonds and property is in the form of taxable interest; and (2) the power of compounding – a couple of percentage points makes a significant difference over the long-term.

	2 years	3 years	5 years	10 years
All Share	8,2%	6,8%	11,1%	9,9%
Resources	20,3%	12,4%	8,9%	-0,4%
Financials	6,5%	3,3%	11,7%	14,8%
Industrials	4,7%	5,7%	12,0%	16,8%
Listed Property	-3,7%	1,0%	6,6%	15,7%
All Bond	9,1%	7,8%	7,4%	9,8%
Cash	7,5%	7,3%	6,7%	6,9%
Headline CPI	4,6%	5,2%	5,4%	5,4%

While the idea of equities outperforming other asset classes over the long-term is hardly a revelation, it remains difficult to resist the temptation in times of particular uncertainty to head to the sidelines for a while, with the expectation that one can always reinvest when things settle down and the future looks clearer. This feeling is entirely understandable – we would all love to be able to time the market perfectly and avoid the bad patches. What I really wanted to do in this article was to see what trying to time the market over the last 10 years would have meant for returns.

For the record, over the last 10 years, there have been 2502 days on which the SA equity market was open. Interestingly, it rose on 53% of those days – far closer to 50% : 50% than one might assume considering the return achieved over this entire period. In the table below, we show how returns would have been impacted by a market timing strategy that resulted in an investor being out of the market for just 2, 5 and 10 of the best and worst days each year from a market performance perspective (note that we have excluded the trading cost of actually trying to do this!).

	Avoiding the worst days of performance			missing the best days of performance		
Fully invested total return	140%	140%	140%	140%	140%	140%
	2 worst days	5 worst days	10 worst days	2 best days	5 best days	10 best days
2009	15%	38%	57%	-16%	-35%	-63%
2010	7%	16%	29%	-8%	-17%	-29%
2011	6%	13%	22%	-6%	-12%	-22%
2012	7%	16%	28%	-8%	-19%	-31%
2013	7%	15%	24%	-5%	-11%	-20%
2014	5%	11%	18%	-5%	-11%	-20%
2015	7%	14%	24%	-8%	-15%	-25%
2016	7%	17%	30%	-7%	-16%	-29%
2017	5%	10%	18%	-5%	-10%	-19%
2018	5%	12%	21%	-7%	-14%	-23%
Impact of market timing	71%	161%	271%	-74%	-161%	-281%
Total return over 10 years	**211%**	**300%**	**410%**	**66%**	**-21%**	**-141%**
% of days out of the market	0,8%	2,0%	4,0%	0,8%	2,0%	4,0%

It goes without saying that returns would be greatly enhanced if one could successfully avoid only the worst days each year. What may be surprising, however, is how much of the market's overall performance is driven by just a few days of positive performance each year. Should one's efforts to time the market result in missing out on just a few of the best performing days each year, you can see how quickly the respectable 10-year return from being fully invested throughout turns into a loss.

What about avoiding the worst days if this also means missing the best ones? Our shading shows how this would have worked out (green: a positive net result and red: a negative one). Undoubtedly, there have been some years when it would have worked out ok. However, note that there are more instances where it proved to be a losing strategy than a winning one and don't forget, this is before trading costs.

While the supernatural ability of knowing ahead of time where the market's landmines lie in wait each year would be tremendously helpful, the problem is we don't have it! The damage done to returns by watching from the sidelines on just a few days of outperformance is significant. Effort is likely better spent on identifying the right companies in which to invest at acceptable prices and allowing time to smooth out the bumps in the road.

The benefits of offshore investment

In the Sunday Times, 17 June 2018:

Many people, including leading local managers of offshore funds, claim the rand is the biggest factor influencing returns from offshore investments. But Allan Gray research shows this isn't in fact true.

The manager tested the outcome of investing R12000 a year in an investment tracking the FTSE World Index for 22 years to the end of last year using three different strategies. The three strategies were investing R1000 monthly, investing a R12000 lump sum at the best time from a currency perspective each year, and investing at the worst time each year.

The best outcome was for the fictitious investor with perfect foresight who invested when the currency was strongest. After 22 years the investor had $119288. Investing R1000 a month regularly, however, yielded only 7% less or $111471.

Picking the worst time each year to invest for 22 years had the worst outcome of $103849 - a 15% difference compared to the best outcome you would get if you knew how to time the currency and invested when the rand was strongest."

Editors comment: We have been suggesting for years that clients should take their money offshore: "Live in the sun; invest in the shade". It is interesting that the benefits of taking money offshore at the best time was hardly superior to the average time. It is clear that it is best not to take your money offshore when the rand is at its weakest. It is interesting that in 2018, the rand has weakened rapidly over the past few months. Suddenly, the performance of off-shore portfolios is great when measured in rand terms.

Guns, Germs and Steel

Alan has been reading the book "Guns, Germs and Steel" which explains the spread of civilization from Asia across to Europe and why it failed to spread down America or Africa. The author, although American, was based in New Guinea for a long time Alan sent some comments to an Australian friend who sent back this short summary by Australian author, Mark Avery, which we think you will find interesting.

"In his book, 'Guns, Germs and Steel,' Jared Diamond explains many things. One of those things is why the Australian Aborigines (and other peoples) did not "develop" in the way Western civilisation has. Hopefully I can paraphrase parts of his book accurately enough to give you a hint of an answer. To get a good answer, read his book.

With apologies to Jared:

Eurasia had opportunities other places didn't:

(1) Eurasia had domesticable animals that could supply people with meat, milk and cheese, and with skins. There were sheep, cattle, pig and goats, and all could be bred in captivity.

- South America had just the llama and alpaca, virtually the same species.
- North America: none.
- Africa. You can't domesticate zebra, antelope, buffalo, elephants etc or breed them in captivity.
- Australia: none. You can't milk a kangaroo or echidna.

(2) Eurasia had horses, donkeys and bullocks that allowed people to

i) plow land, which allowed greater crop productivity.

ii) Those animals allowed them to transport goods and people over long distances.

(iii) That prompted the people to create roads and bridges, which gave them military advantages, and allowed them to exchange innovations with other Eurasian regions.

- In Africa, you can't saddle a springbok.
- In Australia, you can't harness a koala, or plow a paddock with a wombat.
- In the Americas, you can't saddle a Bison or harness a tapir.

(3) Eurasia had access to the plant flax, which is good for making clothes. That helped create a huge textile industry and it gave them opportunities for trade. The other regions didn't have that plant, and had to make do with animal skins.

(5) Europe also had another big advantage: It went from East to West, which meant the climate didn't vary too much. That meant that crops could be grown in large tracts of Europe. Whereas, The Americas went North South, so the few crops that could grow, like maize, could only be grown at certain latitudes. The rest of the continent struggled.

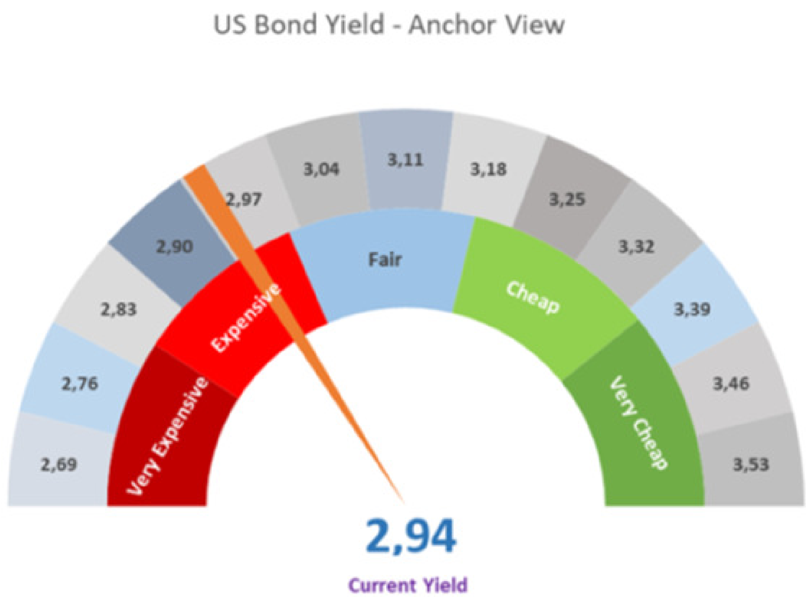
Africa also had variations in climate from north to south: crops and animals that flourished in one area never reached other areas where they could have flourished, because they could not survive the intervening environment.

Although Australia is East West (and North South) most of it is desert. Even if it had not been desert, it still could not make use of the East West advantage for the reasons already given: it didn't have the domesticable animals or the resultant infrastructure to develop like the Eurasian nations.

(6) The opportunity to trade was a huge advantage for any developing nation. This is not in Jared's book (to my memory): but I imagine that not only did Eurasia have its roads, they also had plenty of developing neighbours, and that encouraged boat building. With trade by boat, nations could share ideas and innovations, and get goods they didn't have by trading goods they did have. The result: all nations would flourish. I don't think that North America, Africa Australia had those same advantages.

In short, Eurasia had significant advantages over places like Africa, The Americas, and Australia. If those regions had had the animals and East/West farming land that Eurasia has, and Eurasia had not been given those advantages, the situation would be reversed.

Thank you, Jared Diamond. And you have my apologies for the bits I got wrong."



RCI Unit Trusts

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

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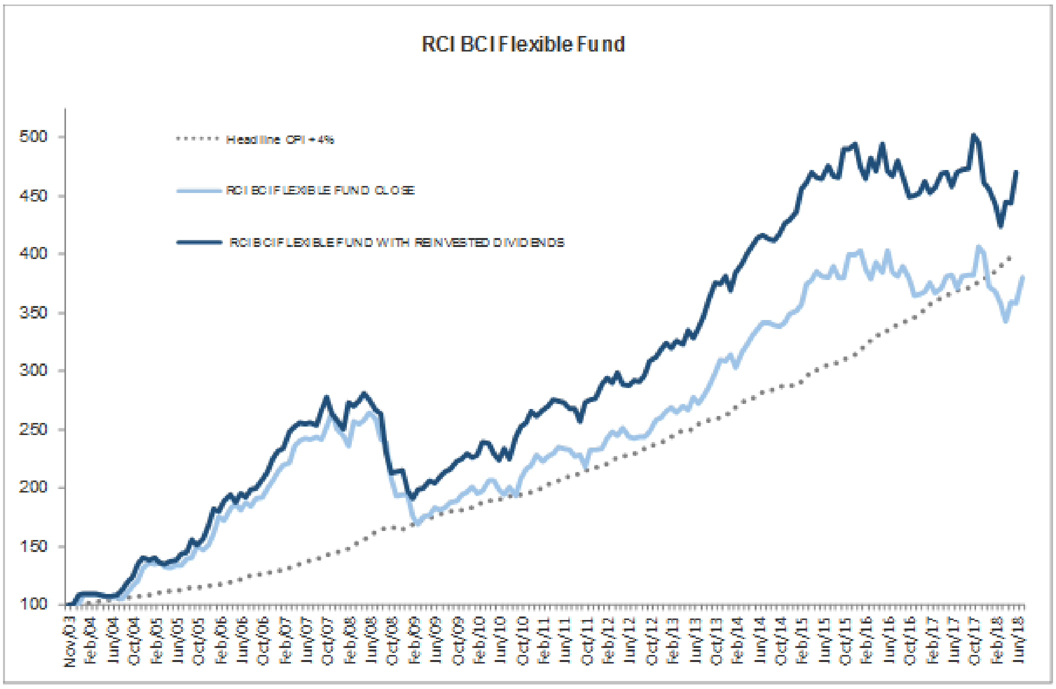
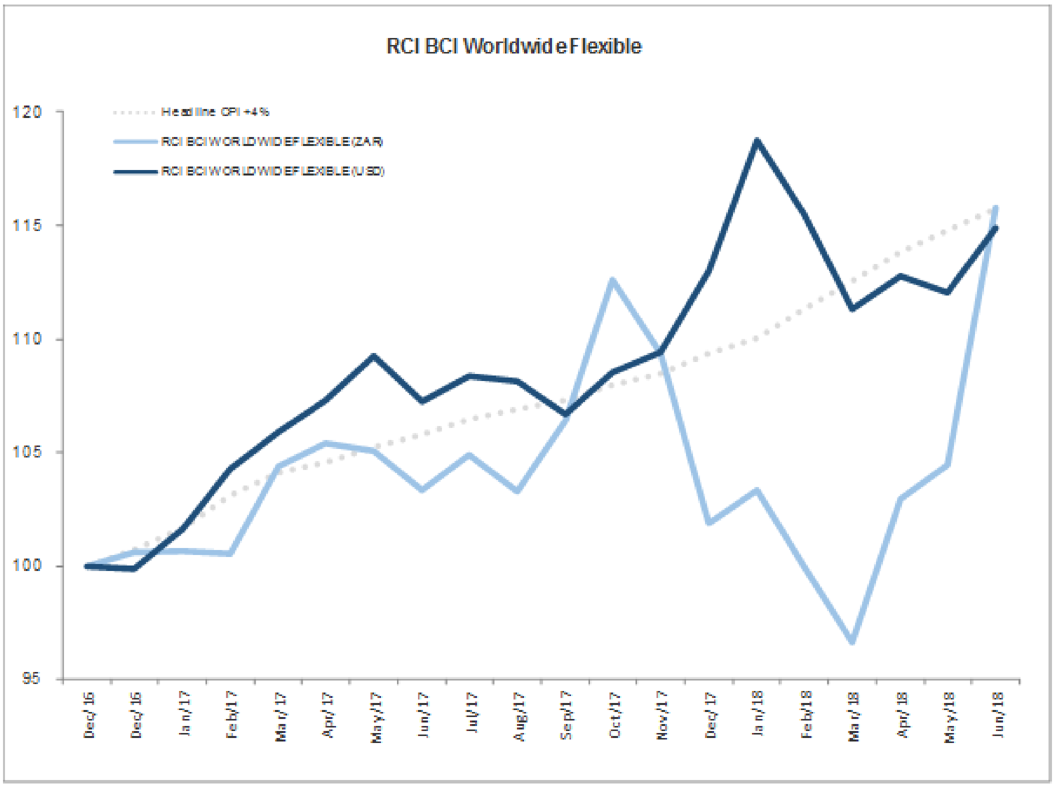


RCI BCI Worldwide Flex closed June at 115.76c, up 9.7% for the month. In contrast, the JSE Top 40 was only up by 0.6% during June. The investments in the fund are mainly in foreign companies with very high ROCE (return on capital employed) which have normally resulted in fantastic returns with low risk investments. The performance in dollars remains good (which is what we focus on) so the weaker rand has resulted in good growth when measured in rands. It came first in its category.



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

During June, as we had feared, the rand continued to weaken and our market is back to the levels of late October, before Mr. Ramaphosa won the ANC election. What has changed in this period is that Donald Trump has threatened to start a trade war with China so emerging markets are no longer in fashion and Americans have been disinvesting from them. If the trade war intensifies, demand for South Africa's minerals from China may drop off, with a resultant price cut and a weaker rand. This is why we have tried to set up your investments with an offshore slant.

We hope you enjoyed the first article by Mike. We think he will be a great long-term asset for the company and great for portfolio values!

Thank you for being our clients.

Best regards

Di and Alan