Robert Cowen Investments
Growing families' wealth since 1982
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Newsletter

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The Family Office

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To be added to our email, contact eric@rcinv.co.za

"The stock market is designed to transfer money from the active to the patient." ~ Warren Buffett

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

Highlights of this newsletter are:

- A month in markets - March 2020
- Market Crash Perspectives
- Stocks that actually rose during Q1 - by Eric Lappeman
- Moody's Downgrade: The Implications for investing in SA - by Nolan Wapenaar
- Charts/Memes of the month - March 2020
- Meet the RCI team - Monthly RCI staff profile - Maggie da Silva
- RCI Unit Trusts
- RCI - 'The Family Wealth Office' - What we offer

A few interesting articles to read when you are done with this month's newsletter:

Why Flattening the Curve is Overrated
I Became a Disciplined Investor Over 40 Years. The Virus Broke Me in 40 Days

* Note: For all those clients who wish to be added to the Anchor research and news mailing list, kindly let us know and we will gladly add you.

A Month in Markets - March 2020

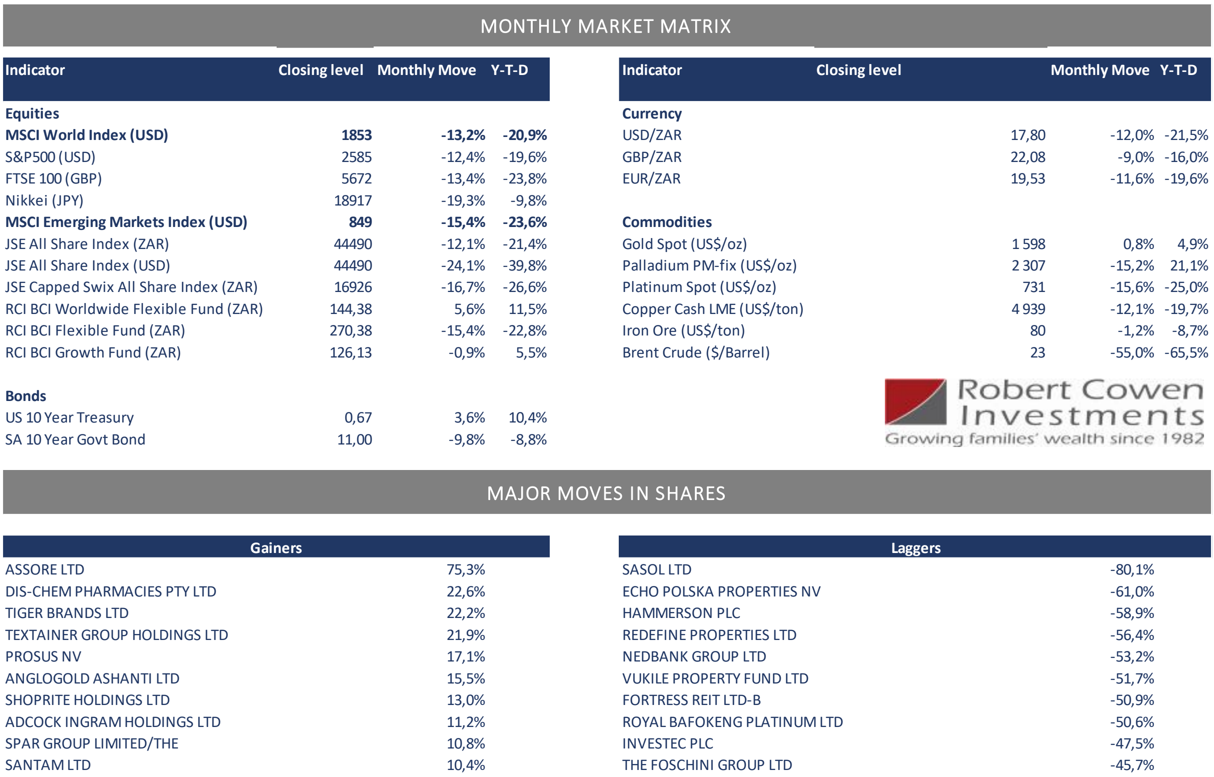
Over the last two months the mood in the market has shifted from complacency, to denial, to despair, followed by hype.

We started the year with high equity valuations, alongside bullish growth forecasts and optimistic earnings estimates. This complacency was replaced by denial when the COVID-19 virus began to spread across the globe, with market participants initially shrugging off the news.

However, when the penny finally dropped in early March, we witnessed the markets gripped by despair as we experienced the most rapid equity market correction seen since the Great Depression, with the S&P500 dropping 19.6%, while the JSE All Share declined 12.1% in ZAR. This is despite seeing hope return in the last two weeks of trading, as equity markets recovered some heavy losses due to the US administration successfully passing an impressive $2.2trillion fiscal stimulus package and the US Federal Reserve cutting interest rates to 0%. The rand also gave up major ground to the US dollar, closing at R17.80 (depreciating 12% in March), as Moody's downgrade of SA's debt to junk compounded the risk-off tone. This helped the RCI Worldwide Flexible Fund to close up 5.6% for the month, compared to a drop of 12.1% in the JSE All Share.

On the commodity front, we witnessed a second month of gains in gold (now up 4.9% for the year to date) and, unfortunately, another drop in oil of 55% (now down 65.5% for the year).

Individual share moves reflect the extreme volatility witnessed in March. Gold shares enjoyed a good month on the back of a move to haven assets. On the other hand, Sasol (down 80%) and JSE REITs experienced a terrible month (down 53% in aggregate).



MONTHLY MARKET MATRIX

Indicator	Closing level	Monthly Move	Y-T-D
Equities			
MSCI World Index (USD)	**1853**	**-13,2%**	**-20,9%**
S&P500 (USD)	2585	-12,4%	-19,6%
FTSE 100 (GBP)	5672	-13,4%	-23,8%
Nikkei (JPY)	18917	-19,3%	-9,8%
MSCI Emerging Markets Index (USD)	**849**	**-15,4%**	**-23,6%**
JSE All Share Index (ZAR)	44490	-12,1%	-21,4%
JSE All Share Index (USD)	44490	-24,1%	-39,8%
JSE Capped Swix All Share Index (ZAR)	16926	-16,7%	-26,6%
RCI BCI Worldwide Flexible Fund (ZAR)	144,38	5,6%	11,5%
RCI BCI Flexible Fund (ZAR)	270,38	-15,4%	-22,8%
RCI BCI Growth Fund (ZAR)	126,13	-0,9%	5,5%
Bonds			
US 10 Year Treasury	0,67	3,6%	10,4%
SA 10 Year Govt Bond	11,00	-9,8%	-8,8%

Indicator	Closing level	Monthly Move	Y-T-D
Currency			
USD/ZAR	17,80	-12,0%	-21,5%
GBP/ZAR	22,08	-9,0%	-16,0%
EUR/ZAR	19,53	-11,6%	-19,6%
Commodities			
Gold Spot (US$/oz)	1 598	0,8%	4,9%
Palladium PM-fix (US$/oz)	2 307	-15,2%	21,1%
Platinum Spot (US$/oz)	731	-15,6%	-25,0%
Copper Cash LME (US$/ton)	4 939	-12,1%	-19,7%
Iron Ore (US$/ton)	80	-1,2%	-8,7%
Brent Crude ($/Barrel)	23	-55,0%	-65,5%

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MAJOR MOVES IN SHARES

Gainers		Laggers	
ASSORE LTD	75,3%	SASOL LTD	-80,1%
DIS-CHEM PHARMACIES PTY LTD	22,6%	ECHO POLSKA PROPERTIES NV	-61,0%
TIGER BRANDS LTD	22,2%	HAMMERSON PLC	-58,9%
TEXTAINER GROUP HOLDINGS LTD	21,9%	REDEFINE PROPERTIES LTD	-56,4%
PROSUS NV	17,1%	NEDBANK GROUP LTD	-53,2%
ANGLOGOLD ASHANTI LTD	15,5%	VUKILE PROPERTY FUND LTD	-51,7%
SHOPRITE HOLDINGS LTD	13,0%	FORTRESS REIT LTD-B	-50,9%
ADCOCK INGRAM HOLDINGS LTD	11,2%	ROYAL BAFOKENG PLATINUM LTD	-50,6%
SPAR GROUP LIMITED/THE	10,8%	INVESTEC PLC	-47,5%
SANTAM LTD	10,4%	THE FOSCHINI GROUP LTD	-45,7%

Market Crash Perspectives

"If it only gets back to 80% or 90% of the peak, I swear I will sell everything." (Unknown)

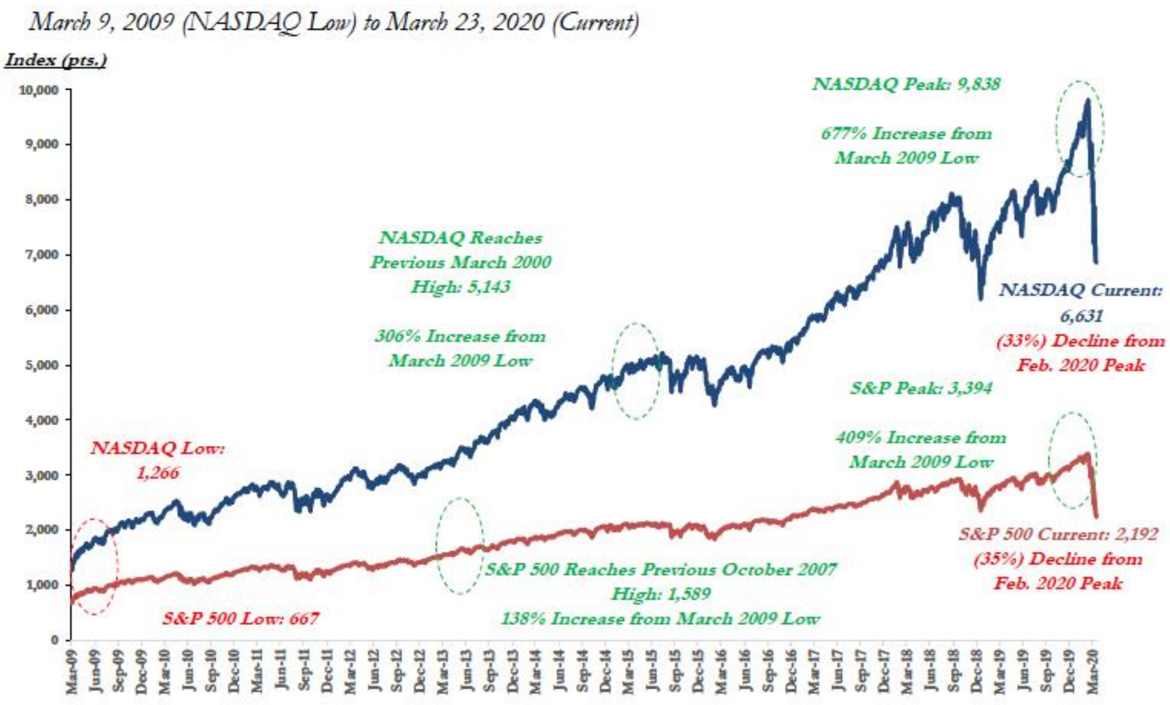
In our previous newsletter, we wrote that stocks have historically provided long-term returns far better than bonds or cash, but we also mentioned that there is a price to pay for those returns. That price is coping with the short-term market swings which frustrate even the most seasoned investors. Unfortunately, some of these swings can be severe – amidst corrections from time to time, history suggests investors can expect to weather market crashes at least once or twice in a lifetime. After reading a lot of research, we thought it best to put this market fall into some perspective for investors.

Key takeaways are as follows:

- The 11-year bull market, which had seen a 677% rise in the Nasdaq and 409% rise in the S&P500 from March 2009 to its peak on 19th February 2020, officially ended in March 2020.
- The S&P500 and Nasdaq declined 35% and 33% respectively in a single month, driven by the global COVID-19 pandemic, the steepest decline to down >30% of any market crash in history.
- The markets have weathered prior pandemics reasonably well, but the depth of their immediate reaction to the severe economic disruption caused by COVID-19 lockdowns is unprecedented.
- Past market crashes of comparable magnitude point to a lengthy recovery time, especially if the time to reach ultimate bottom is extended, and almost certainly to economic recession. On average, it takes about 3.1 times as long to recover from the trough of the crash than it takes to reach the bottom from the peak.
- We are likely to experience multiple false rallies on the way to the bottom. Both the 1929 and 2000 crashes, each of which lasted three years from start to finish, experienced five separate rallies of 20% from successive midway dips before reaching the ultimate bottom.
- While valuations appear to have declined significantly, analysts have not yet had time to revise their forecasts to fully capture the likely impact of the unprecedented actions being taken by governments to “flatten the curve”. The likely further significant downward revisions in earnings forecasts could place further downward pressure on prices and multiples. That, however, depends on how long the shutdown lasts, and on how low interest rates will go.
- 80% of stock market crashes of >20% are followed by economic recession within a year. Normally, when equity markets crash, investors grow concerned that they are worth less, stop spending and hoard cash. Businesses anticipating lower revenues and profits get conservative, reduce work forces, push out capex, defer acquisitions and, all of a sudden, business activity declines significantly.
- Thus far, there is an unprecedented level of stimulus worldwide. The US has announced unlimited monetary liquidity support (QE) and has cut interest rates to a record low of 0%. The dollar index is now also at its highest level since the Dotcom Bubble in 2001.

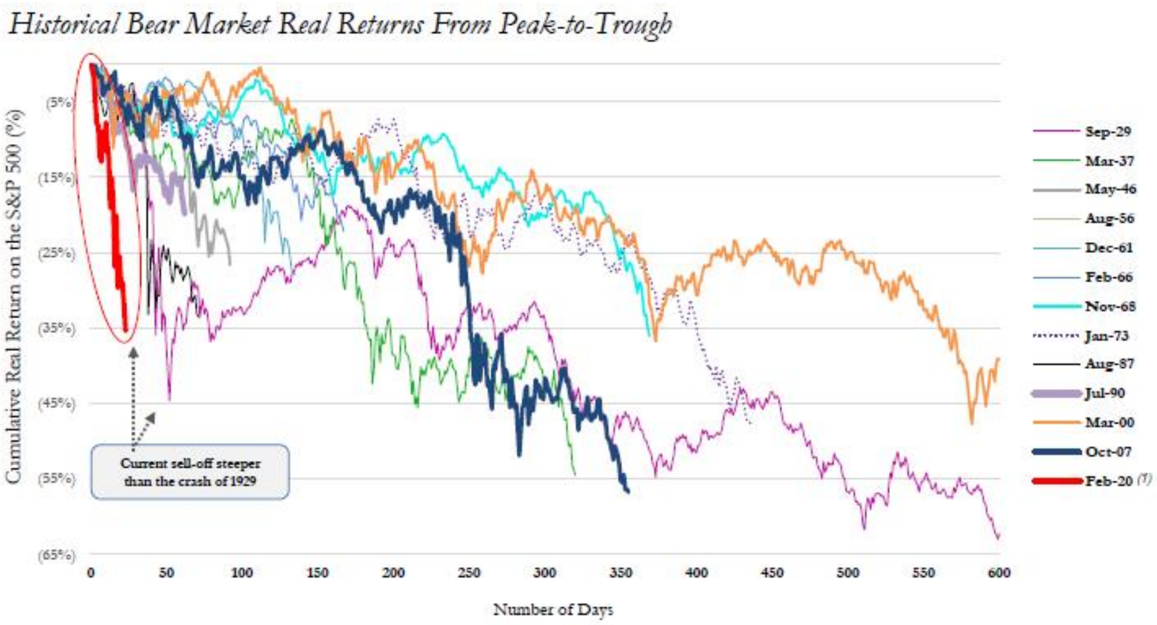
And now for the charts...

Figure 1: End of Historic 11-Year Bull Market



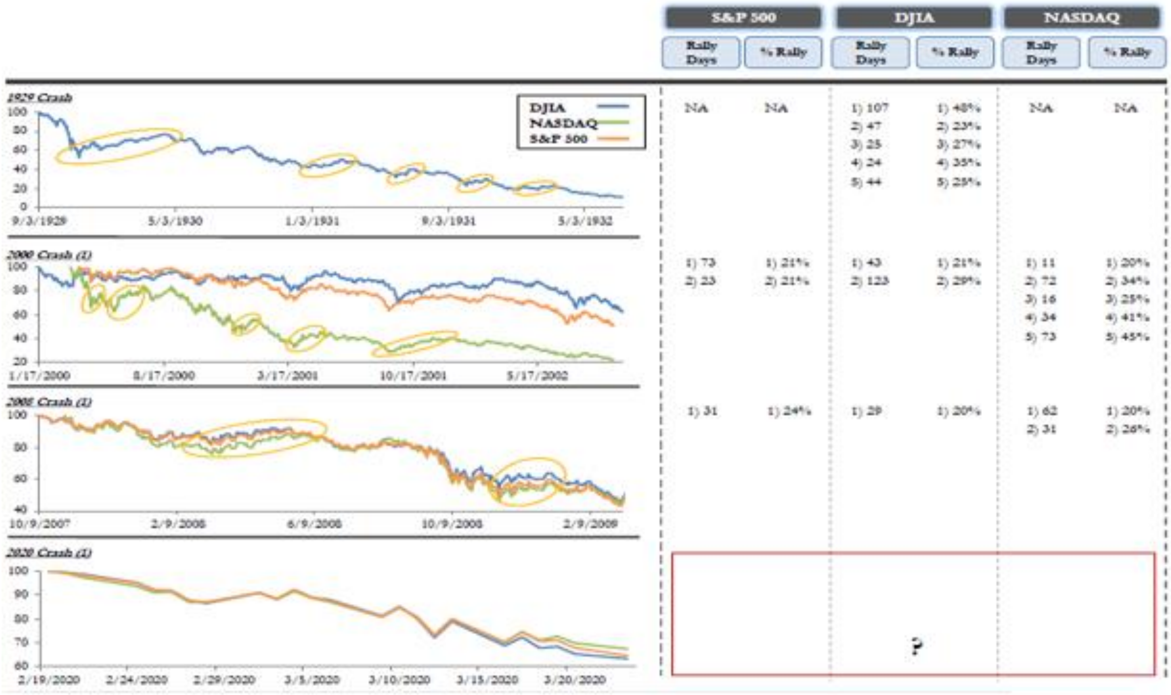
Source: Capital IQ

Figure 2: Market Events in Historical Context



Source: Capital IQ

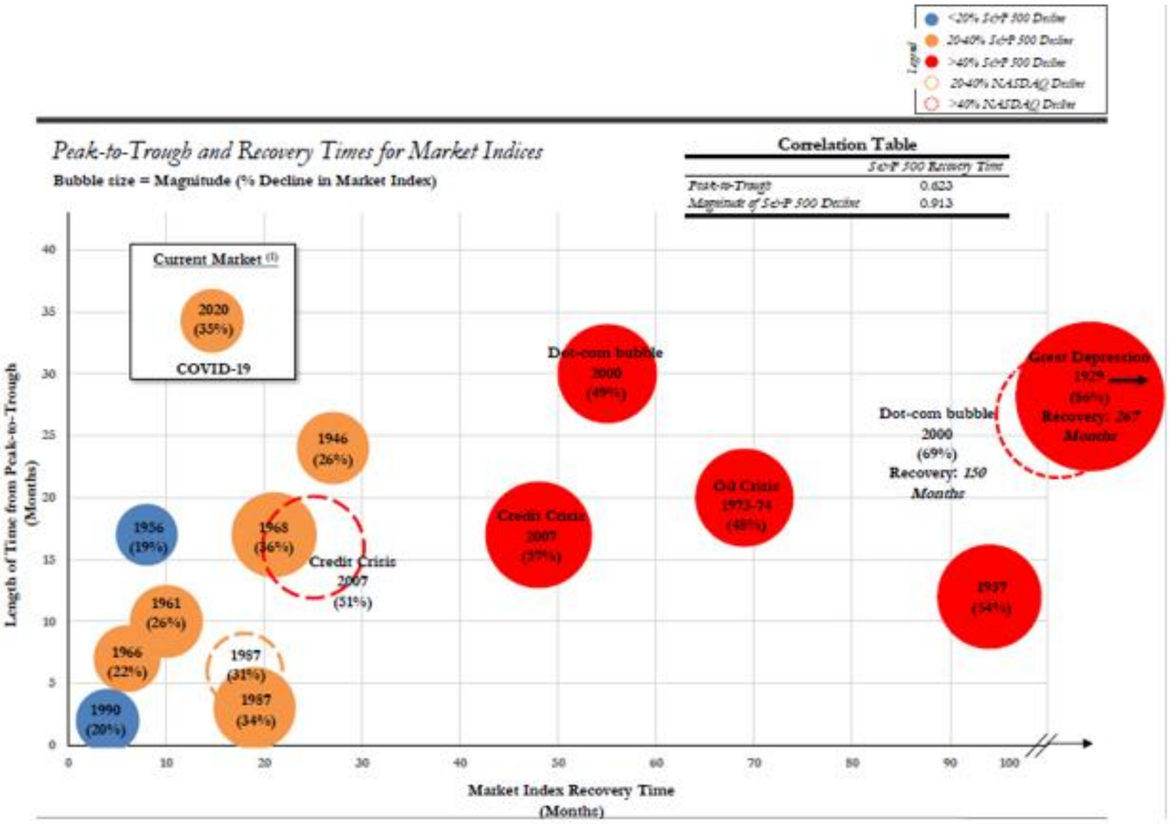
Figure 3: Expect Multiple False Rallies On The Way To The Bottom



	S&P 500		DJIA		NASDAQ	
	Rally Days	% Rally	Rally Days	% Rally	Rally Days	% Rally
1929 Crash	NA	NA	1) 107 2) 47 3) 25 4) 24 5) 44	1) 48% 2) 23% 3) 27% 4) 35% 5) 25%	NA	NA
2000 Crash (1)	1) 73 2) 23	1) 21% 2) 21%	1) 43 2) 123	1) 21% 2) 29%	1) 11 2) 72 3) 16 4) 34 5) 73	1) 20% 2) 34% 3) 25% 4) 41% 5) 45%
2008 Crash (1)	1) 31	1) 24%	1) 29	1) 20%	1) 62 2) 31	1) 20% 2) 26%
2020 Crash (1)			?			

Source: Capital IQ

Figure 4: Past Cycles Indicate Magnitude & Time from Peak-to-Trough Are Factors in Time to Recovery

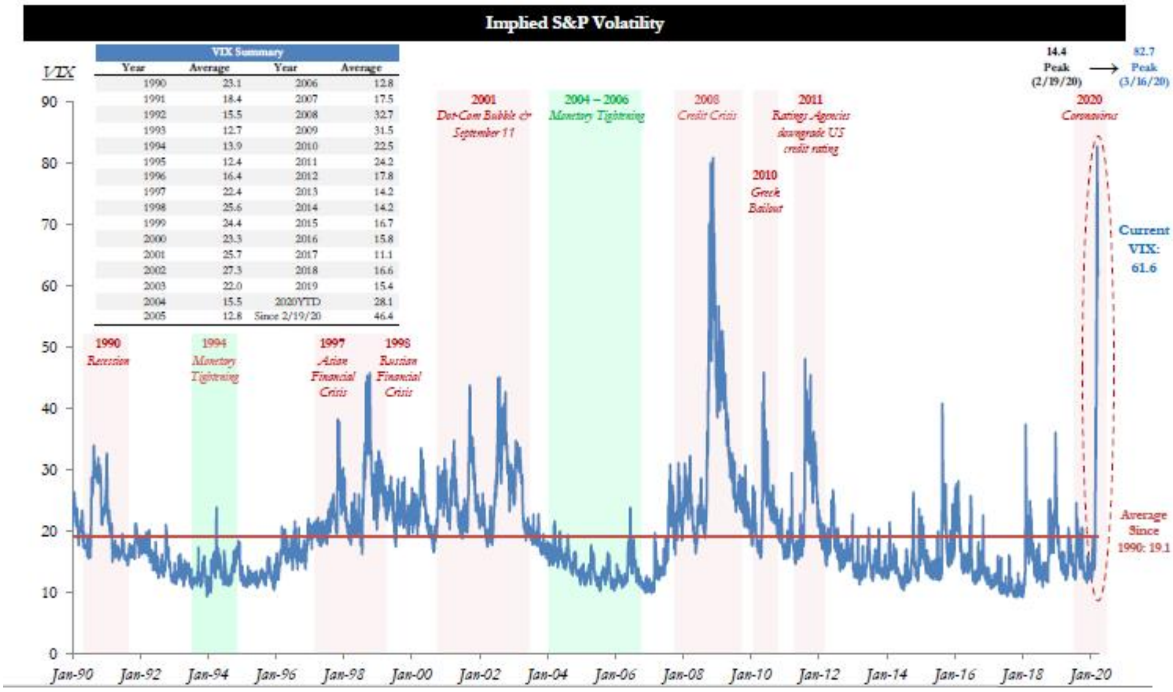


Correlation Table

	S&P 500 Recovery Time
Peak-to-Trough	0.623
Magnitude of S&P 500 Decline	0.913

Source: Robert Schiller, Irrational Exuberance and Reuters

Figure 5: Severe Recent Volatility: Highest in VIX History

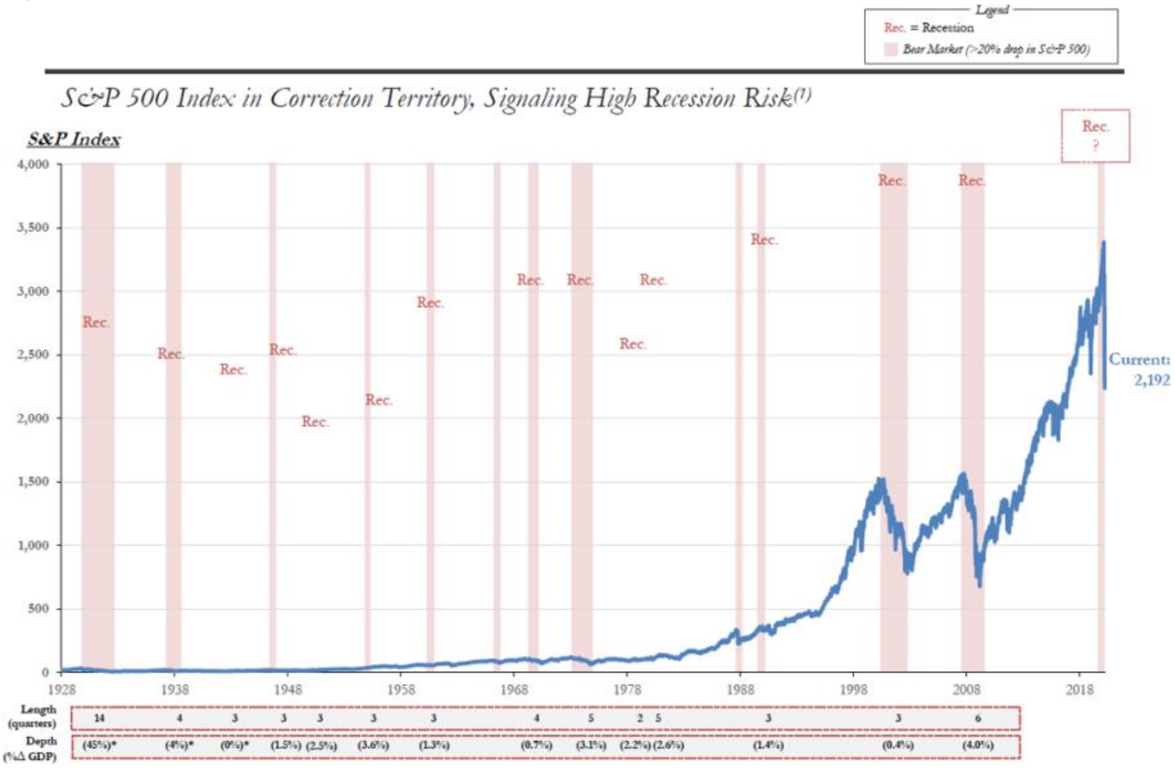


VIX Summary

Year	Average	Year	Average
1990	23.1	2006	12.8
1991	18.4	2007	17.5
1992	15.5	2008	32.7
1993	12.7	2009	31.5
1994	13.9	2010	22.5
1995	12.4	2011	24.2
1996	16.4	2012	17.8
1997	22.4	2013	14.2
1998	25.6	2014	14.2
1999	24.4	2015	16.7
2000	23.3	2016	15.8
2001	25.7	2017	11.1
2002	27.3	2018	16.6
2003	22.0	2019	15.4
2004	15.5	2020YTD	28.1
2005	12.8	Since 2/19/20	46.4

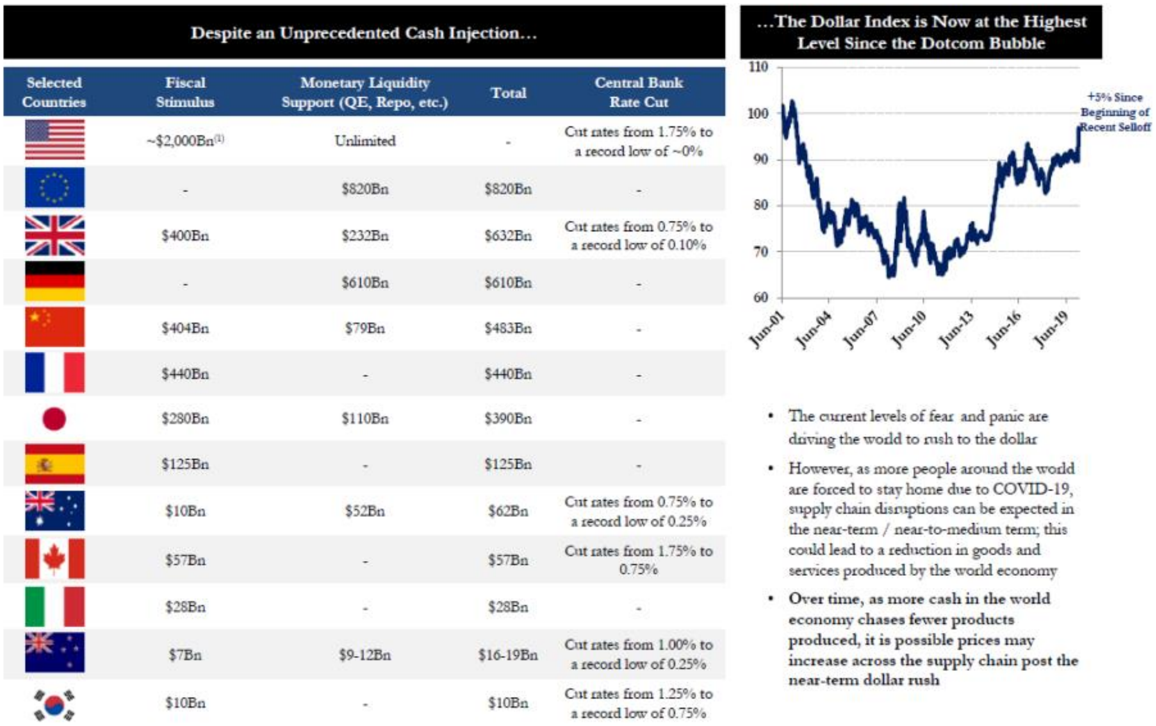
Source: Federal Reserve and Capital IQ

Figure 6: 80% of Prior Crashes Have Led to Economic Recessions



Source: Capital IQ and National Bureau of Economic Research

Figure 7: Record amounts of stimulus are being added



Despite an Unprecedented Cash Injection…

Selected Countries	Fiscal Stimulus	Monetary Liquidity Support (QE, Repo, etc.)	Total	Central Bank Rate Cut
🇺🇸	~$2,000Bn[1]	Unlimited	-	Cut rates from 1.75% to a record low of ~0%
🇪🇺	-	$820Bn	$820Bn	-
🇬🇧	$400Bn	$232Bn	$632Bn	Cut rates from 0.75% to a record low of 0.10%
🇩🇪	-	$610Bn	$610Bn	-
🇨🇳	$404Bn	$79Bn	$483Bn	-
🇫🇷	$440Bn	-	$440Bn	-
🇯🇵	$280Bn	$110Bn	$390Bn	-
🇪🇸	$125Bn	-	$125Bn	-
🇦🇺	$10Bn	$52Bn	$62Bn	Cut rates from 0.75% to a record low of 0.25%
🇨🇦	$57Bn	-	$57Bn	Cut rates from 1.75% to 0.75%
🇮🇹	$28Bn	-	$28Bn	-
🇳🇿	$7Bn	$9-12Bn	$16-19Bn	Cut rates from 1.00% to a record low of 0.25%
🇰🇷	$10Bn	-	$10Bn	Cut rates from 1.25% to a record low of 0.75%

…The Dollar Index is Now at the Highest Level Since the Dotcom Bubble

- The current levels of fear and panic are driving the world to rush to the dollar
- However, as more people around the world are forced to stay home due to COVID-19, supply chain disruptions can be expected in the near-term / near-to-medium term; this could lead to a reduction in goods and services produced by the world economy
- Over time, as more cash in the world economy chases fewer products produced, it is possible prices may increase across the supply chain post the near-term dollar rush

What strikes us as different this time is how quickly tens, if not hundreds of millions of individuals and major industries have made huge changes to their daily habits and workflows. These changes will ripple through the global economy. Government officials, recognizing that we were way too slow to respond to this virus and not at all equipped to handle a spike of infections, have now determined that extreme measures, such as closing schools, cancelling sporting and entertainment events, and ultimately issuing "shelter in place" orders are necessary to flatten the growth curve of COVID-19 infections, thus allowing more time to develop and produce tests, build hospital bed, ICU and ventilator capacity so we don't overwhelm the health care system, until vaccines become available.

The world is making a conscious choice to shut itself down for weeks, if not longer, to minimize deaths and try to prevent the horrible triage decisions about who will survive, as is taking place in Italy. When you consider the collateral damage to small businesses, gig workers, restaurants, hotels, airlines, and other affected industries such as oil companies (following the related 2020 crash in oil prices) and all their employees, a recession seems inescapable. In this case, the only question is how long and how deep.

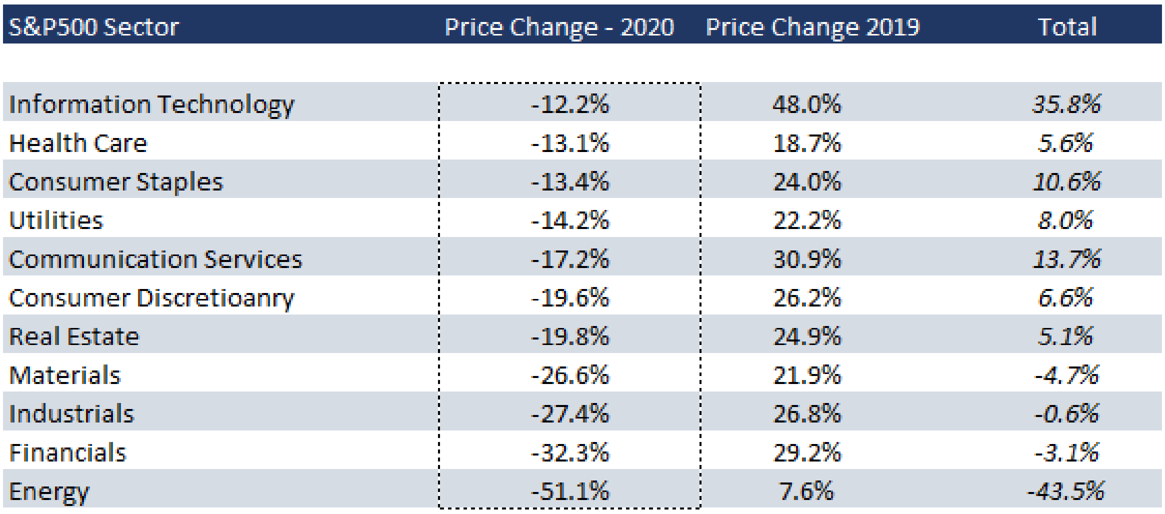
Stocks that actually rose during Q1

By Eric Lappeman

At various times in March, we saw days in which virtually all shares fell sharply. This indiscriminate selling is often explained by cases where investors have borrowed to invest in the market and become forced sellers in a falling market – as buyers step back, these forced sellers sell what they can with little regard for the company's fundamentals. As a result, during crashes (although this is my first), there are major opportunities that present themselves. As the Dalai Lama once said, *'I choose to be optimistic, it feels better'*.

Even during a brutal first quarter for stocks, there were some winners as COVID-19 quickly changed the way people live and work around the world. In fact, most of the companies we mention below are in the business of facilitating remote work, entertainment and commerce. Others were pharmaceutical companies, which present opportunities for treatments of the novel coronavirus.

Here's how the 11 sectors of the S&P500 performed during the first quarter (excluding dividends):



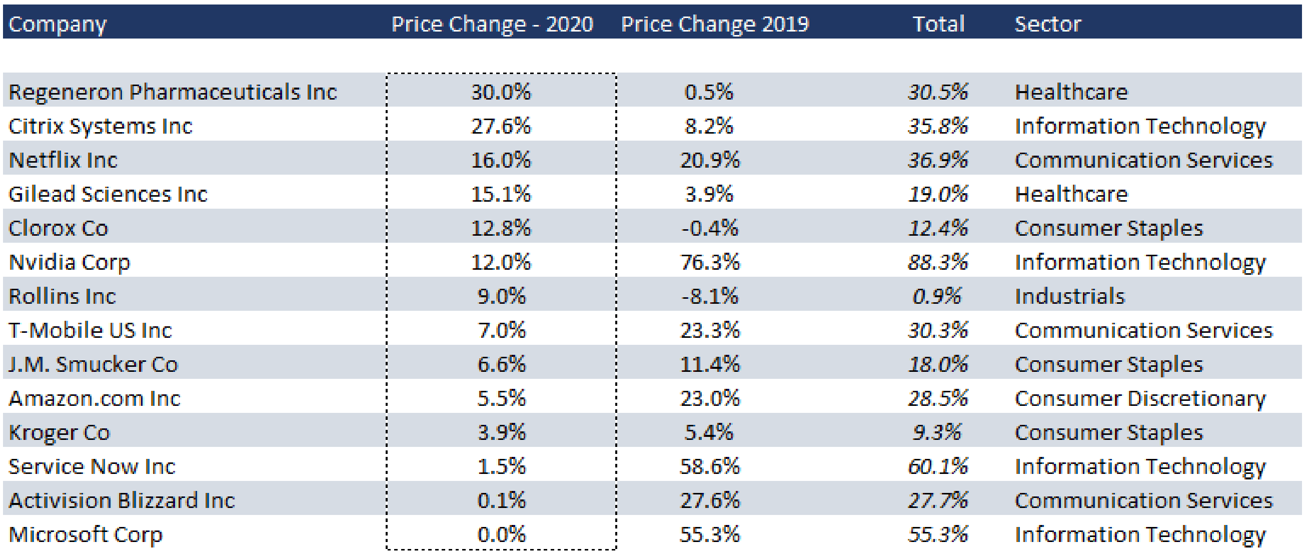
S&P500 Sector	Price Change - 2020	Price Change 2019	Total
Information Technology	-12.2%	48.0%	*35.8%*
Health Care	-13.1%	18.7%	*5.6%*
Consumer Staples	-13.4%	24.0%	*10.6%*
Utilities	-14.2%	22.2%	*8.0%*
Communication Services	-17.2%	30.9%	*13.7%*
Consumer Discretioanry	-19.6%	26.2%	*6.6%*
Real Estate	-19.8%	24.9%	*5.1%*
Materials	-26.6%	21.9%	*-4.7%*
Industrials	-27.4%	26.8%	*-0.6%*
Financials	-32.3%	29.2%	*-3.1%*
Energy	-51.1%	7.6%	*-43.5%*

Source: FactSet

The information-technology sector continued to be the best performing sector, despite having been a big outperformer last year. For reference (seen in the table on page 2), the Dow Jones Industrial Average had its worst quarter since 1987 (that was the year I was born), and the S&P500 index sank 20% for its worst performance since the fourth quarter of 2008 (and this includes a 16% rally in the last 8 days of March).

While one should be careful not to generalise too much, as business models differ across the technology sector, the global response to the COVID-19 pandemic has been a boon for many technology companies. For many of them, the pandemic is likely to accelerate by years the adoption of their services relative to what would have happened otherwise. What remains to be seen, of course is, once we come out the other side, will our behaviour be forever changed by this new immersion in technology or will we revert to the way things were before? Facebook, for example, is seeing more users turning to its service for information about coronavirus, as well as communicate with friends (who had heard of "houseparty" before this lock down?), while Amazon plans to hire 100,000 more workers to deal with the surge in orders.

Here are 15 of the top 30 S&P500 stocks that rose during the first quarter:



Company	Price Change - 2020	Price Change 2019	Total	Sector
Regeneron Pharmaceuticals Inc	30.0%	0.5%	*30.5%*	Healthcare
Citrix Systems Inc	27.6%	8.2%	*35.8%*	Information Technology
Netflix Inc	16.0%	20.9%	*36.9%*	Communication Services
Gilead Sciences Inc	15.1%	3.9%	*19.0%*	Healthcare
Clorox Co	12.8%	-0.4%	*12.4%*	Consumer Staples
Nvidia Corp	12.0%	76.3%	*88.3%*	Information Technology
Rollins Inc	9.0%	-8.1%	*0.9%*	Industrials
T-Mobile US Inc	7.0%	23.3%	*30.3%*	Communication Services
J.M. Smucker Co	6.6%	11.4%	*18.0%*	Consumer Staples
Amazon.com Inc	5.5%	23.0%	*28.5%*	Consumer Discretionary
Kroger Co	3.9%	5.4%	*9.3%*	Consumer Staples
Service Now Inc	1.5%	58.6%	*60.1%*	Information Technology
Activision Blizzard Inc	0.1%	27.6%	*27.7%*	Communication Services
Microsoft Corp	0.0%	55.3%	*55.3%*	Information Technology

If one uses a liberal definition for what could be classified as a ‘tech company’, they make up more than a third of the list. Listed ‘tech’ companies that are not included in the S&P500 technology sector included Amazon, Netflix and Activision Blizzard, yet one could easily argue that they too could be considered part of this sector.

Of the stocks out there, technology stocks seem especially well positioned today, even though many have been punished by the recent sell-off (albeit to a lesser extent than other sectors). At RCI, we are hard at work looking for the best risk-reward scenarios going forward. Some of the characteristics we are focused on are:

1. *Does the company have the balance sheet to weather the crisis?*
2. *Beyond the crisis, does the company have favourable long-term prospects?*
3. *Might the current crisis benefit demand for this company's products in some way?*

With these criteria in mind, below are a few top tech stocks that we are keeping a close eye on at current prices, with a view to hold for the long term:

Microsoft

Software and cloud behemoth Microsoft has proved to be one of the best stocks to own over the past five years, and nothing has changed under the current narrative. Its Azure cloud infrastructure as a service offering has surged 64% in the last year. In addition to this, its other services, including its software development platform GitHub and the video game platform Xbox, have allowed it to transition to high profit margin annuity-like revenues. It currently holds $134billion in cash and only has about $70billion worth of debt. The current stay-at-home narrative will likely see its hardware and video game business poised for a new stage of growth later this year (Xbox live memberships have seen a solid tick up since the beginning of the year as kids, and adults, stay at home to game). The current crisis is also spurring a surge in the use of certain Microsoft products, such as the Teams video conferencing software (it saw a surge of 37% in Teams usage during the first week of the lockdown alone).

Teladoc

Even before the coronavirus outbreak, Teladoc Health was delivering solid results that had us place the stock on our watchlist as we became excited about its future potential. The virtual healthcare services company grew revenue by 27% year over year in the last quarter and has been accepted by a growing number of insurers who see telehealth as a convenient and cost-effective alternative to the standard doctor's office visit. Some of Teladoc's other metrics also pique our interest; subscription-access fees climbed 24% year over year and fees from digital office visits grew 47%, while paid memberships in the US, its largest market, grew 61%. The company's presence is more established than its rivals and it is seeing strong momentum across the global health marketplace. The current health crisis has highlighted the benefits of telehealth. Last month, Teladoc reported that virtual medical visits surged 50% over the prior week. The company is not cheap, using convention metrics. However, with $517million of cash and no debt, it is in a position to capitalise strongly on this crisis. Society has been given a front-row seat and is seeing first hand why telemedicine is the way of the future. I fully expect that the global pandemic will be the catalyst that makes telehealth a part of everyday life for many people from now on.

Netflix

While its shares haven't been immune to the recent stock market slump, Netflix has been defying gravity lately. The stock is up 16% for the first quarter, while the market is down 19.6%. Investors likely see the streaming platform as a safe bet for continued growth as people around the world prioritize at-home entertainment during the lockdown, when the reality is that Netflix might remain an attractive business during any economic downturn, since consumers are likely to find room in their budgets for its relatively small monthly fee, even if incomes decline. From an investment standpoint, the company reported on its recorded subscribers last quarter, adding 28 million new subscribers despite the challenges of price increases and new competition. Their cost base of content is fixed and hence each new subscriber increases margins nicely. The rise in prices also supercharged earnings growth this quarter (three times the level of two years ago). The shutdown should also help to boost cash generation, as it is forced to reduce spend on new content (although Netflix argues it has a great pipeline of new content ready for release over the next few months). Although debt levels are of some concern - it sits with $14billion of debt - just $1.2billion of this is due within the next three years, and a further $2.4billion is due within the next six years.

Netflix was already a strong growth business before COVID-19 efforts put a premium on at-home entertainment. Admittedly, you are less likely to get great value purchasing shares at current levels, but then again, Warren Buffet once said, *'It's better to own a fantastic business at a fair price than a fair business at a fantastic price'.*

Moody's Downgrade: The Implications For Investing In SA

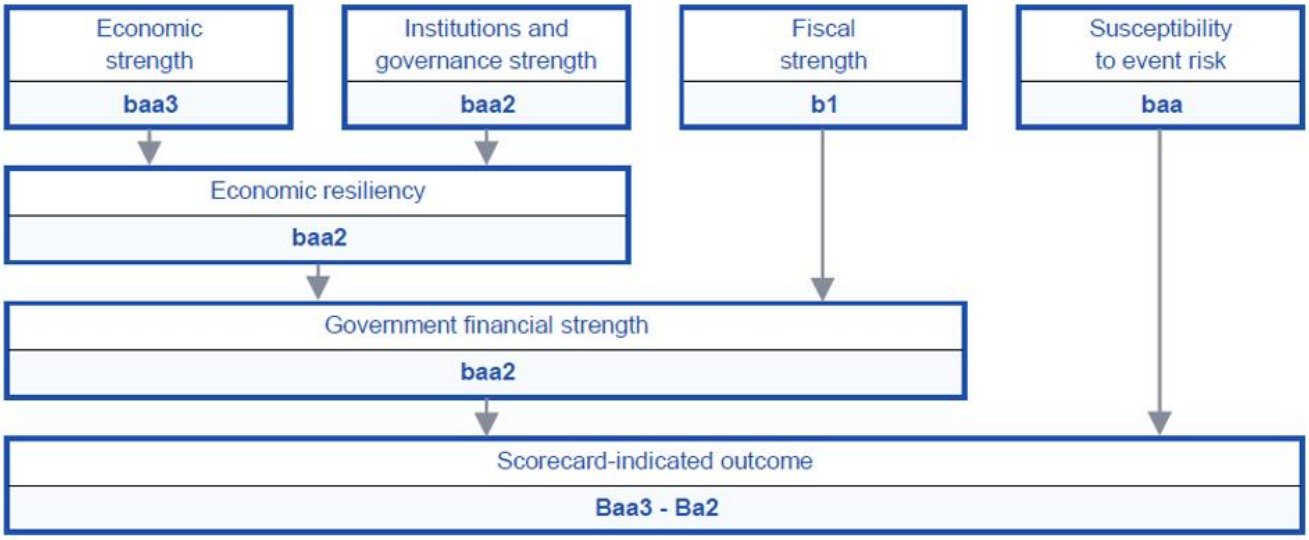
By Nolan Wapenaar

Moody's has downgraded South Africa (SA) to Ba1 with a negative outlook (from Baa3). SA is now junk-rated by all major rating agencies. Losing our last investment-grade rating will mean being booted out of the World Government Bond Index (WGBI), with potentially R80bn to R120bn of bonds that are likely to be sold by foreigners. We expect that this will create further selling pressure on local bonds and the rand for a short period, while the oversupply of bonds is absorbed by other market participants.

Moody's

The statement from Moody's was direct and pinpointed its concerns. There were no surprises and we are all aware of the issues facing the country. Moody's has four pillars to its rating process of sovereigns, and Figure 1 below shows how each of these pillars are scored.

Figure 1: SA's credit profile determined by four factors


Economic strength
baa3
Institutions and governance strength
baa2
Fiscal strength
b1
Susceptibility to event risk
baa
Economic resiliency
baa2
Government financial strength
baa2
Scorecard-indicated outcome
Baa3 - Ba2

Source: Moody's Investor Service

In this regard, we highlight that SA scores a weak investment grade on pretty much everything highlighted in Figure 1 and is pulled down by its fiscal strength. Indeed, SA's fiscal strength is so poor that it drags everything else down to junk status. We can also see that SA is now rated Ba1, which is in the middle of the Moody's rating band. Unless things get worse, we should stabilise at this rating, notwithstanding the negative outlook.

Junk status was all about our fiscal weakness. As per the Moody's rating action, "*Debt-to-GDP increased by 10 percentage points (ppts) over 2014-18 and will rise by a further 22 ppts over 2019-23 under Moody's baseline projections. Over that timeframe, Moody's expects primary deficits to persist. The fiscal deficit will widen in fiscal 2020 to around 8.5% of GDP, as revenue declines this year, only narrowing very gradually thereafter. Fiscal strains from interest payments and support to state-owned enterprises (SOEs) will continue.*"

We, along with several other market commentators, think that Moody's is underestimating the impact COVID-19 will have on the SA economy. The lockdown and associated economic pain are more likely to see a deficit of about 10% in 2020. Moody's acknowledges that its estimates might be conservative and, hence, have maintained a negative outlook on the rating.

In arriving at its numbers, Moody's is looking at SA government debt and then adding to that the liabilities for guarantees that have been given for SOEs. Moody's does not believe that SAA or Eskom are viable going concerns and therefore adds their debt to that of the government. Such is the price of continuous bailouts. So, in part, Eskom has sunk us.

We maintain our view that the competing interests at Eskom are hampering a structural turnaround. Instead of absorbing the Eskom losses, the Public Investment Corporation (PIC) should rather be investing in a new electricity generation company and head-hunting staff from Eskom to work for the new company. This has the benefit of increasing electricity supply and providing job security for some of the excess 16,000 employees at Eskom which government has acknowledged. At this stage, the rating agencies are already adding Eskom's debt to that of the government, so government might as well take on the excess debt and be done with it. Instead, we are still waiting around for the company to be split into three parts while the country's economy continues to suffer.

Per Moody's, "*Moreover, a strategy to stabilise electricity production has been slow to emerge and has yet to prove its effectiveness. Moody's assumes that while power supply will become more reliable, the restoration of full capacity will take some years to complete.*" Basically, Moody's thinks that government is faffing about with minor issues and that, as it stands, we are going to remain in the dark for a while. We note that in his State of the Nation Address, President Cyril Ramaphosa made bold announcements for the private production of electricity. However, while these changes would materially improve our economy, they are now being bogged down in bureaucracy and SA is losing jobs while all efforts are made to maintain the unsustainable and failing monopoly of Eskom. Competing interests are indeed hampering a structural change.

We see massive pressure for monetary stimulus in SA. There is pressure for interest rate cuts and some political parties are even calling for additional stimulus measures in the form of quantitative easing (QE). Yet Moody's is honest and correct in its assessment that *"The SARB may further cut interest rates this year, but monetary policy easing will not address structural economic issues and will at best prevent a deeper contraction."* Our problems are policy and structural and monetary policy cannot overcome these. There is also a point where further rate cuts will do more harm than good.

Instead, Moody's says, *"Structural issues such as labour market rigidities and uncertainty over property rights generated by the planned land reform remain unaddressed."* Basically, the playing field is tilted too far in favour of labour and this prevents businesses from creating employment. We need more flexibility in the labour markets.

Expanding on the Moody's statement, we note that expropriation without compensation (EWC), which has been a rallying cry for socialist parties, is a problem. No one is investing for a long-term future in SA, while EWC and uncertainty over property rights hang over the country. Instead, cash and jobs are leaving our shores. The plan is already impoverishing people and costing jobs. We need a social compact between government, business and civil society as a basis for long-term economic development and growth and it needs to address those concerns that Moody's has identified. Currently these concerns are not being addressed.

Moody's sees our consolidated debt levels growing to just over 90% of GDP by 2023. This is very stark for a country that had debt below 40% just more than a decade ago. We note that emerging countries generally run into trouble when their debt levels reach about 100% of GDP. That is the point where the decision between printing money (Zimbabwe style) or going to the IMF (Ghana style) needs to be made. The Moody's report serves to highlight that the runway for current policies is getting shorter and that the time for difficult decisions has arrived.

The Moody's rating action and associated releases have shone an uncomfortable spotlight on the structural challenges and policy issues that have led to the downgrade. They do, however, point out some of our positives as well. We have a strong and independent judiciary. Our banks and financial institutions are of high quality, while the SA Reserve Bank is also seen as a positive. We have a large and diversified economy which is positive, as is our society which is considered to be relatively open. We tend to look at the negatives and focus on those, however, considering the balanced view, we conclude that all is not lost and that a resilient society can overcome this. The risk of a government funding crisis is still considered low because we have a stable and dependable domestic market.

Through the COVID-19 crisis, we have seen politicians put aside their differences and working together to respond to a grave danger. The fiscal cliff that is approaching is far more dangerous and risks more people dying than COVID-19. Our hope is that we can work together to recover from the economic tragedy that has befallen us. However, for as long as government policies are spawned from their distrust of the private sector and an attempt to control it, we will see job losses and increasing poverty. Without a relationship of trust between government, labour and business, there is no future.

Financial markets

Our role is to assess all of this and what it means for investment. We are at a difficult point in time, trying to assess the risk premiums that have been priced in from the COVID-19 crisis and then to establish how that changes with the Moody's downgrade.

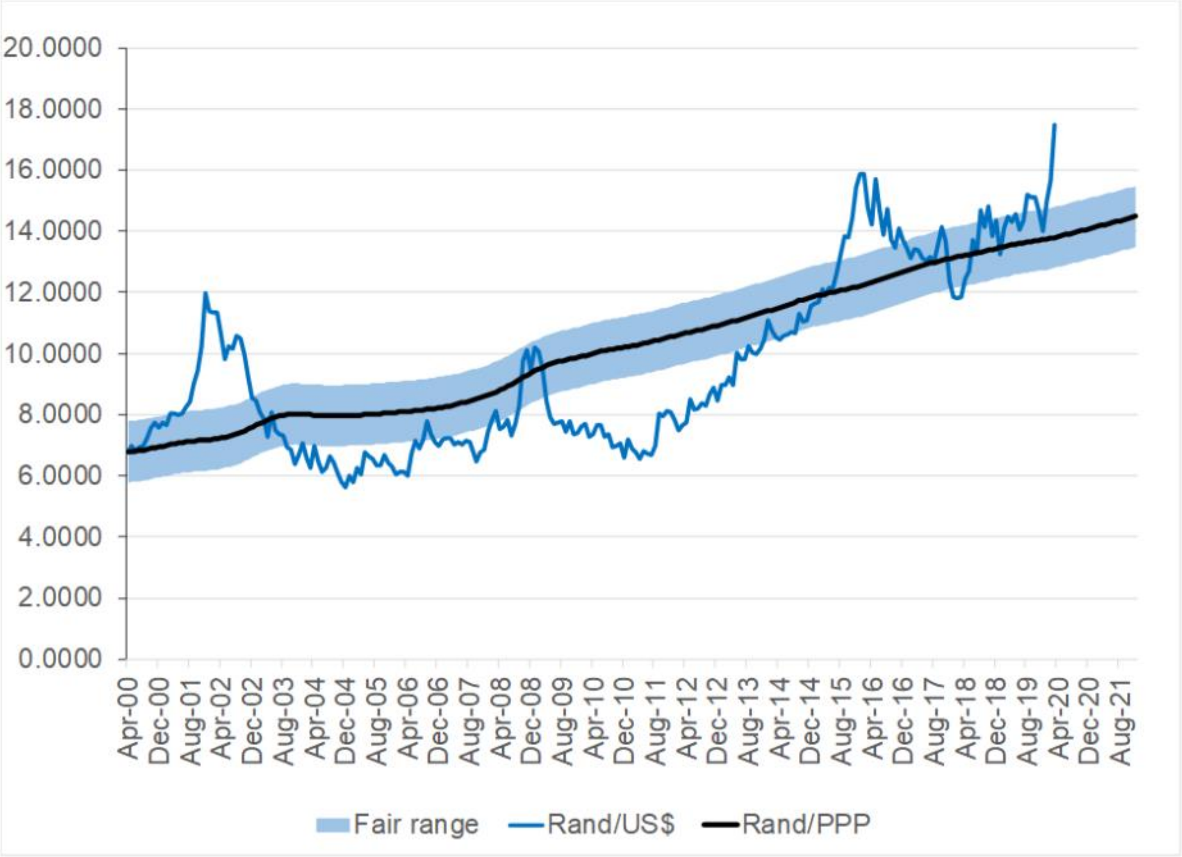
As countries slide down the slope towards a weaker credit quality, their domestic bond yields also increase. The absolute rate on SA long-term bonds is about 13% as a result of the COVID-19 crisis. This is in-line with the historic yields on Nigerian and Kenyan domestic debt. We believe that SA bonds remain a better-quality credit and we therefore see some scope for our bonds to recover over time. Obviously, a steeper yield curve is warranted as future risks are greater.

We also know that as the country's fiscal situation deteriorates, the real yield tends to increase to levels that are above those suggested by fundamental models. SA's long-term inflation target is 4.5%, while fundamental models suggest that the SA 10-year bond should yield about 8%. This is a real yield of c. 3.5%. In our view, the deterioration in SA probably aligns with real yields of about 5% to 7%. That would imply that a bond yield of around 9.5% to 11.5% is reasonable. This, in turn, aligns nicely with being just a little stronger than Nigerian and Kenyan debt.

The likely excess foreign selling of local bonds will push yields slightly higher in the short term, with a recovery in the next six- to nine- months as the overhang of supply is cleared. We also think that the risk-on environment after COVID-19 will push yields to the bottom-end of our range. There is probably about a 13% upside to bonds from the closing prices on Friday (27 March). While investors wait for that to play out, they are earning attractive interest income of CPI + 7%.

We subscribe to the purchasing power parity (PPP) model for the rand. The rand closed at R17.63/$1 on Friday and we believe that the knee-jerk reaction and foreign selling of bonds might push this a little weaker in the near term. Over time, however, we expect this to recover towards its PPP level. Current SA government policies are not likely to materially increase inflation and therefore, we have confidence that the rand should recover once the COVID-19 crisis passes. We think that the recovery will be driven by short-term carry trades, which can result in the snap back being quite fast when it does arrive.

Figure 2: Actual rand/US$ vs rand PPP model

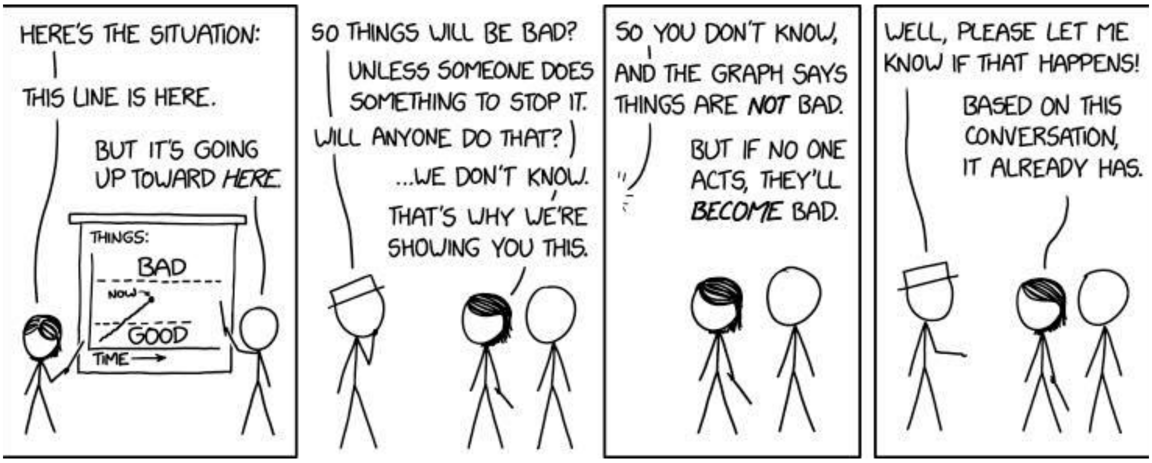


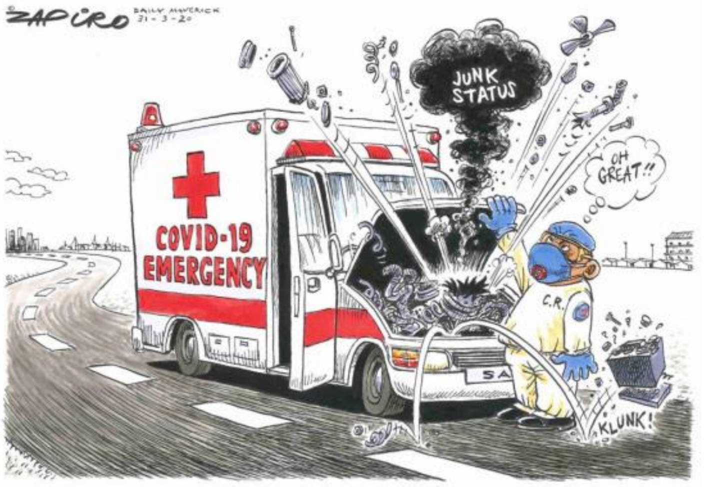
Source: Anchor, Thomson Reuters

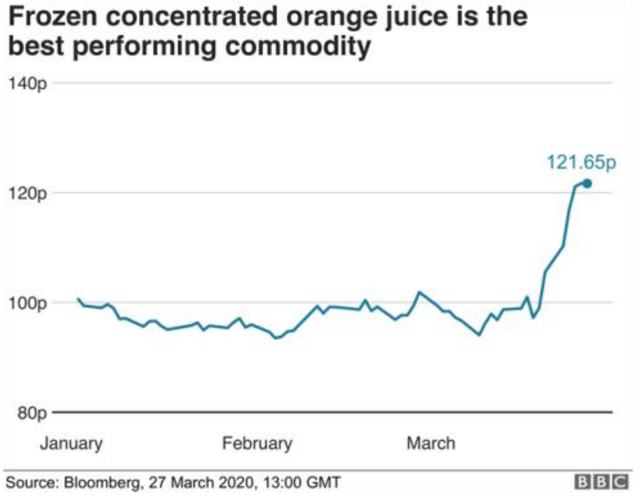
The Moody's report is more problematic for equities. It highlights the difficulties of the domestic operating environment. While we hope that policymakers take note of this, we do not expect the situation to change in the near term. The most likely scenario is a continuation of job losses and current difficult operating conditions. The higher real yield demanded by bondholders will make the cost of capital higher, while the size of government will continue to crowd out the private sector. The saving grace for domestic equities is that COVID-19 has made them very cheap and we therefore think that there will be good opportunities for a bounce in equities. Some quality companies will continue to grow in this difficult operating environment but, structurally, domestically focused equities will have a tougher uphill battle on their hands. Our approach is to avoid those companies that will face long-term structural damage from current events and to rather focus on companies that should emerge in reasonable shape after the current crisis subsides – some of these are trading at valuations seen only once in a decade. Companies that generate offshore revenue are an easier call. But we are approaching the scenario with caution and the facts are changing continually. It can take some time for the market to stabilise and investors who deploy new capital into equities must be able to stomach further potential downside.

'Charts/Memes' of the month – March 2020

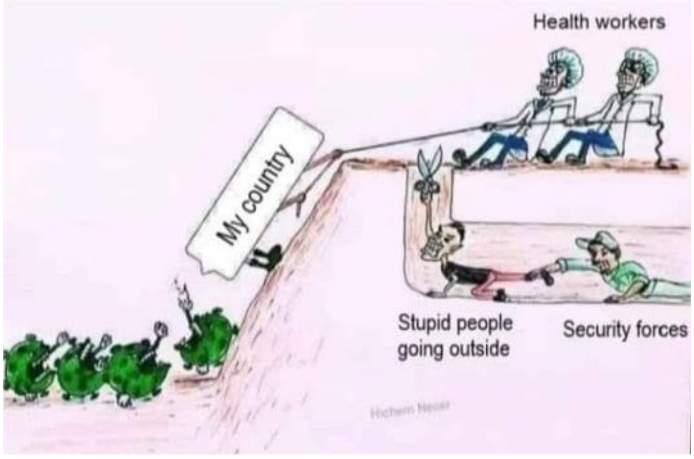
A great visual representation of the COVID-19 virus and its spread since inception.
https://ourworldindata.org/coronavirus#trajectories-since-the-5th-confirmed-death


HERE'S THE SITUATION:
THIS LINE IS HERE.
BUT IT'S GOING UP TOWARD HERE.
THINGS:
BAD
NOW
GOOD
TIME
SO THINGS WILL BE BAD?
UNLESS SOMEONE DOES SOMETHING TO STOP IT.
WILL ANYONE DO THAT?
...WE DON'T KNOW.
THAT'S WHY WE'RE SHOWING YOU THIS.
SO YOU DON'T KNOW, AND THE GRAPH SAYS THINGS ARE NOT BAD.
BUT IF NO ONE ACTS, THEY'LL BECOME BAD.
WELL, PLEASE LET ME KNOW IF THAT HAPPENS!
BASED ON THIS CONVERSATION, IT ALREADY HAS.


ZAPIRO
DAILY MAVERICK 31-3-20
JUNK STATUS
OH GREAT!!
COVID-19 EMERGENCY
C.R.
SA
KLUNK!


Frozen concentrated orange juice is the best performing commodity

Source: Bloomberg, 27 March 2020, 13:00 GMT



You'll think you've die
and gone to heaven
Tolerancia Extra

Monthly RCI Staff Profile – Maggie da Silva

Rejoined Robert Cowen Investments in October 2013.

Maggie was at Wits for 2 years, doing BA in languages, but did not finish as she was too eager to earn money.

Maggie speaks 4 languages and studied French as well, which is rather rusty due to lack of practice.

Maggie has Diplomas in Training and Development.

Maggie does all the administration for the local and offshore unit trusts.

Before joining RCI, Maggie worked at Stannic Fleet Management as a Trainer and was with the Hospitality Training Board. She then moved to Mozambique and was Administrator at the American International School of Mozambique for 8 years. When she returned to South Africa, she joined Brolaz South Africa in the training department, before moving over to its Project Management Division.

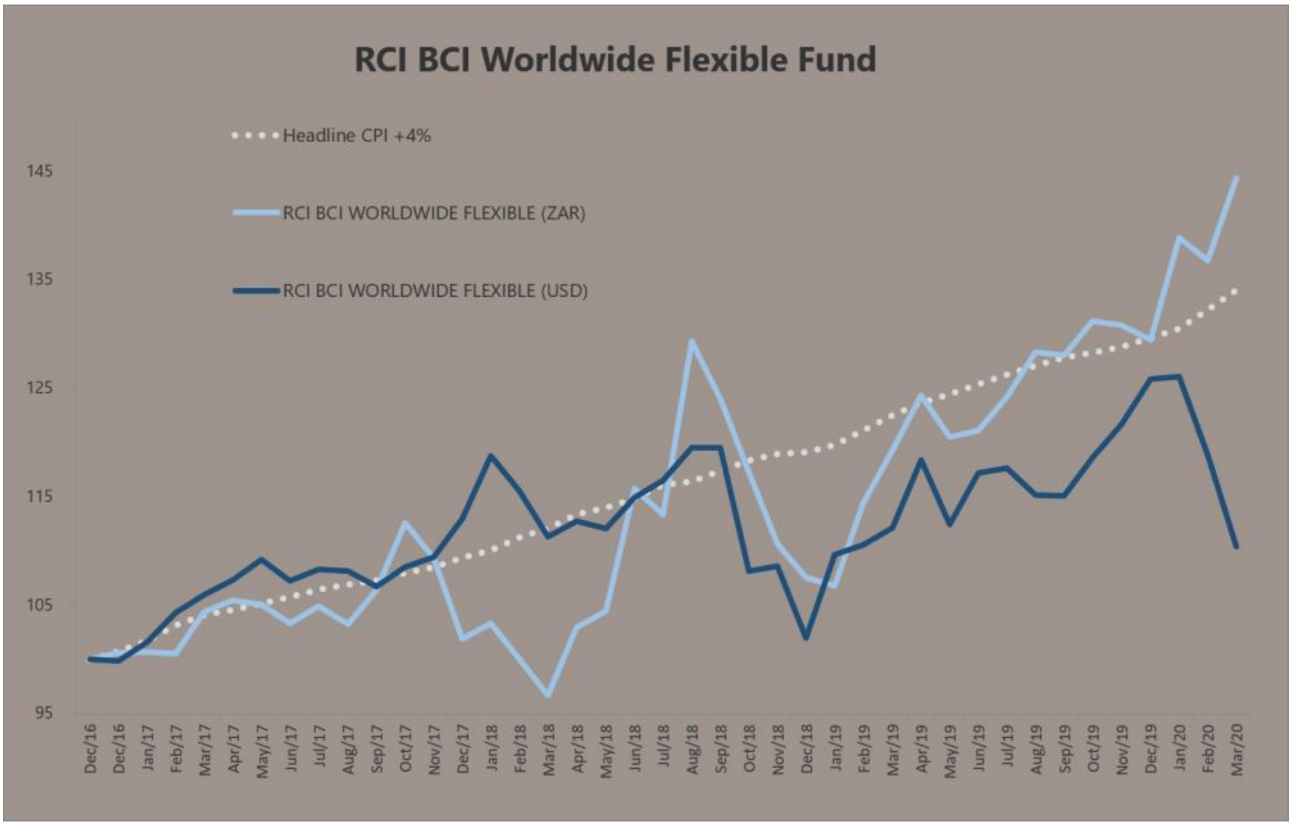
Maggie is from Ballito and her two children still live there. She is the proud gran of 3 beautiful grandchildren.

Her hobbies include reading, archery, gardening, sketching and she is addicted to Sudoku. She enjoys a round of golf every now and then. She has a good camera with which she enjoys taking the occasional pics, but is by no means a fundi.

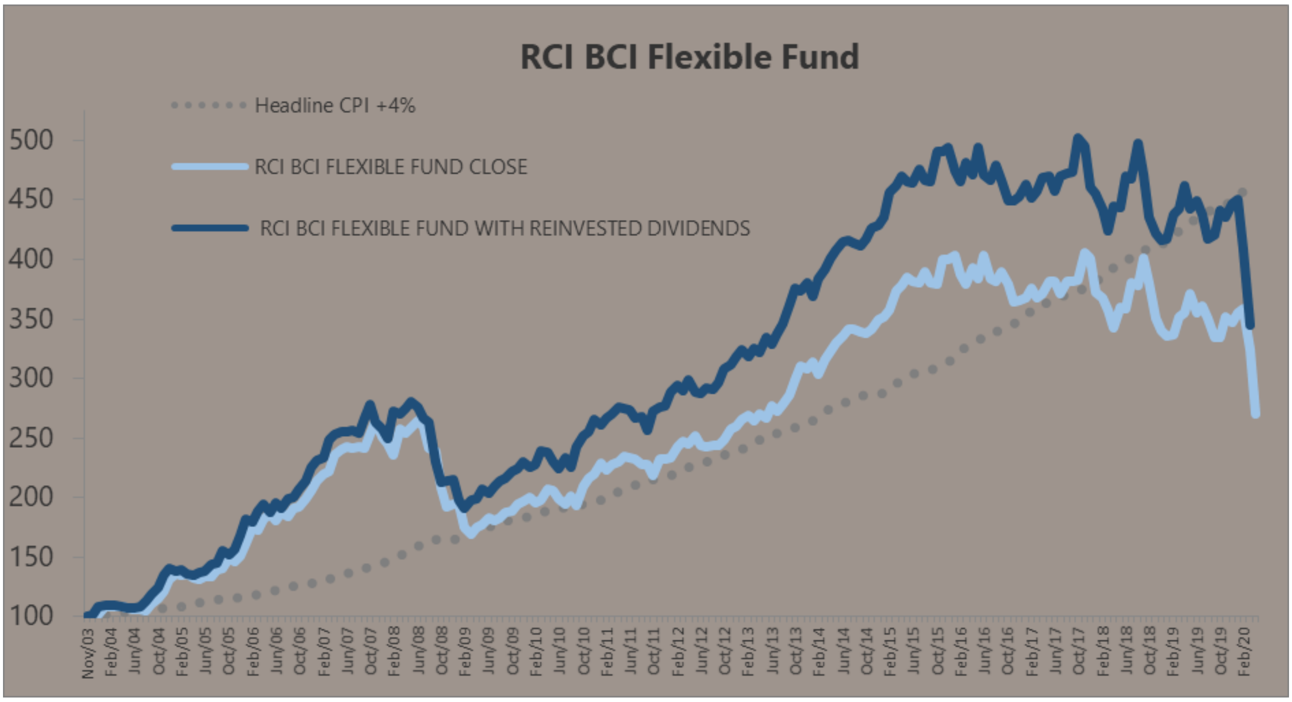
RCI Unit Trusts

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

RCI BCI Worldwide Flex closed March at 144.38c, up 5.58% for the month and up 20.99% for the last 12 months. It is **ranked 2nd out of 76 funds in its category for the last year, and 2nd over a rolling two-year period.**



RCI BCI Flexible Fund closed March at 270.38c, down 15.42% for the month and down 21.87% for the last 12 months.



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

March was a month of extreme volatility on global markets. In this newsletter, we give some context to the current market crash. Markets have already entered correction territory, then bear territory, followed by crash territory and then back to correction territory as we witnessed a late rally during the last two weeks of trade. History dictates that we might see many short-term rallies on the way to the bottom and we will likely see the world enter a recession. That said, we have also witnessed very swift and unprecedented levels of central bank interventions to support people through this crisis. There is a wall of liquidity waiting to enter shares and record low interest rates also remain supportive of our long-term love of equities.

Our client portfolios are very well positioned, with plenty offshore exposure as the rand weakens, and about 20-25% in cash as we wait patiently for some great investment opportunities to emerge. We highlight how resilient the technology sector has been amid the chaos. We also shine light on a few companies that have posted positive returns this year.

Nolan Wapenaar gives us a summary of the downgrade and the impacts it will have on us as investors. The downgrade will mean being booted out of the World Government Bond Index (WGBI), with potentially R80bn to R120bn of bonds that are likely to be sold by foreigners. We expect that this will create further selling pressure on local bonds and the rand for a short period.

We also urge all investors to remain calm and keep a cool head. We are excited that a lot of our favourite companies are now cheaper today than they were a month ago. We continue to keep a look out for companies on our watchlist that should be able to generate our clients' solid returns from current levels.

We hope to continue assisting you, our clients, by being the best Family Office we can be!

Best regards

Di, Mike and Eric

RCI - “The Family Wealth Office”

What we offer

FINANCIAL NEEDS ANALYSIS OF YOUR FAMILY’S ENTIRE ASSET BASE

- Evaluate existing asset base and asset allocation
- Evaluation of current investment structures (retirement, endowment, company, trust etc)
- Establishment of future goals/objectives/risk appetite

RECOMMENDATION OF CHANGES TO EXISTING ASSET BASE AND ASSET ALLOCATION

- Suggested restructuring (per proposal)
    - Local/offshore split
    - Trusts; local and offshore
    - Companies
    - Insurance
- Estate planning
    - Calculating existing estate duty and capital gains tax
    - Assisting in reducing estate duty and capital gains tax
    - Reviewing trust deeds
    - Reviewing existing wills

INVESTING CLIENT FUNDS

- Bespoke local/offshore share portfolios
- Retirement funds
- Unit trusts (local/offshore)

ONGOING FULL CASH MANAGEMENT SYSTEM

- Fully managed transactional banking accounts for clients
- Third party payment functionality - debit orders and ad-hoc payments
- Transferring of funds offshore

FIDUCIARY SERVICES

- Trustees on more than 80 trusts
- Trust administration
- Trust accounting
- Tax compliance
- Assisting in applying for foreign tax clearances
- Legal compliance; drafting of resolutions, contracts and assisting with legal opinions

Robert Cowen
Investments
Growing families’ wealth since 1982