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

"Knowledge is like a garden; if it is not cultivated, it cannot be harvested."
~ *African proverb*

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

Want to be a better investor? Then stop staring at your portfolio. Interesting article, with our take on it.

The South African cabinet has been trimmed but is it enough? Compared to other countries our cost to taxpayers remains very high.

Why the long term matters so much: how emerging markets should drive world growth over the next 20 years.

Fuller Treacy: What matters in world markets?

Opt for more Naspers shares or take up NewCo – what is the better choice? Naspers' plans to list NewCo in mid-July (sooner than expected). We explain why we think the better option is to take up the NewCo shares, even though this will trigger a capital gain.

RCI BCI Flexible Fund closed May at 355.34c, down 4.18% for the month and up 5.82% for the year to date.

RCI BCI Worldwide Flex closed May at 120.48c, down 3.10% for the month and up 11.99% for the year to date.

Conclusion: what your fund manager should be doing for you.

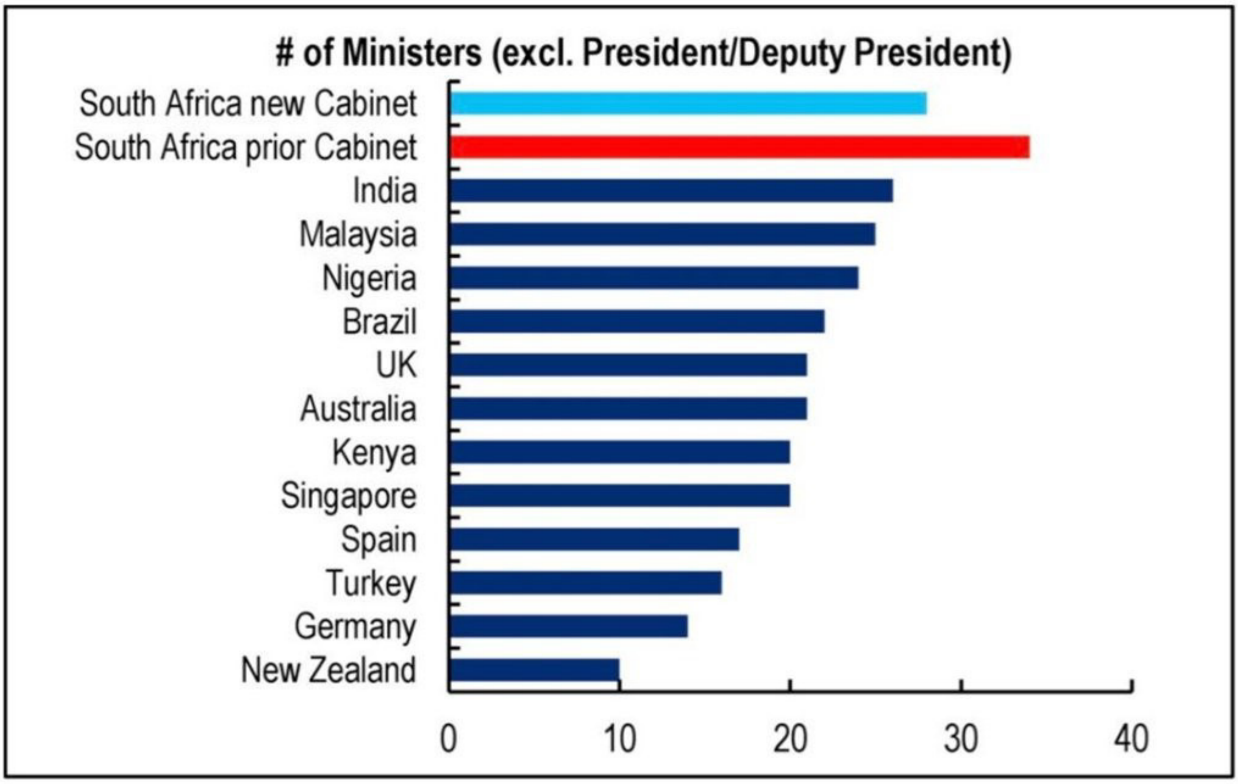
Want to Be a Better Investor? Stop Staring at Your Portfolio

Vitaliy Katsenelson – May 2019 - An extract from his article

You'll have mutual funds and hedge funds whose clients often have the patience of five-year-olds. They are getting in and out of stocks based solely on what they expect them to do in the next month or six months – a rounding error of a time period in the life of a company that lasts decades.

Editor's comment: While we agree that it is silly to buy a poor quality share based on short-term fundamentals, it is also not right to neglect poor short term fundamentals for a good share i.e. it is much better to buy a great share after it has fallen, than after it has risen but Vitaliy's chief point is that if you buy a great share, a few years later, the entry price loses some of its relevance i.e. Was it important that you paid 90c or R1.20 for Standard Bank in 1986? It does not make much difference says Vitaliy as it is now around R200. We say it does: Is it up 222% or only 166%? The most important point is that you bought it, then rode with it, all the way up.

South Africa is still top-heavy in terms of cabinet ministers, but we are improving



Reducing the cabinet, but… (Source Citibank)

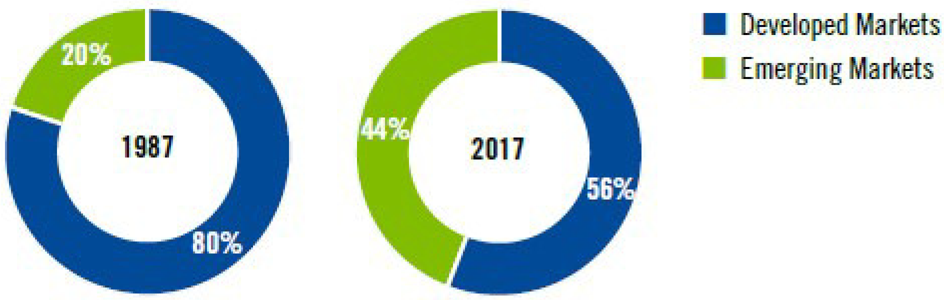
After President Ramaphosa announced his new cabinet the number of ministers dropped but is still well in excess of many other countries in the world. We still have more ministers than India despite our population being about 1/20 of its size. We have significantly more than the UK Australia or Germany. What is also interesting to note is that our number of deputy ministers is huge and excess administration is a waste of taxpayers' money.

Why the Long Term matters so much

Most investors only consider what will occur in the next 12 months. But what if they were to consider the next 30 years? The following graphs show just how much the emerging markets have grown over the past 30 years. In 1987 emerging markets were 20% of the world GDP. By 2017, 30 years later, they were 44% of the world GDP and imagine how much that will be in another 30 years.

EMs INCREASINGLY DRIVING GLOBAL GROWTH

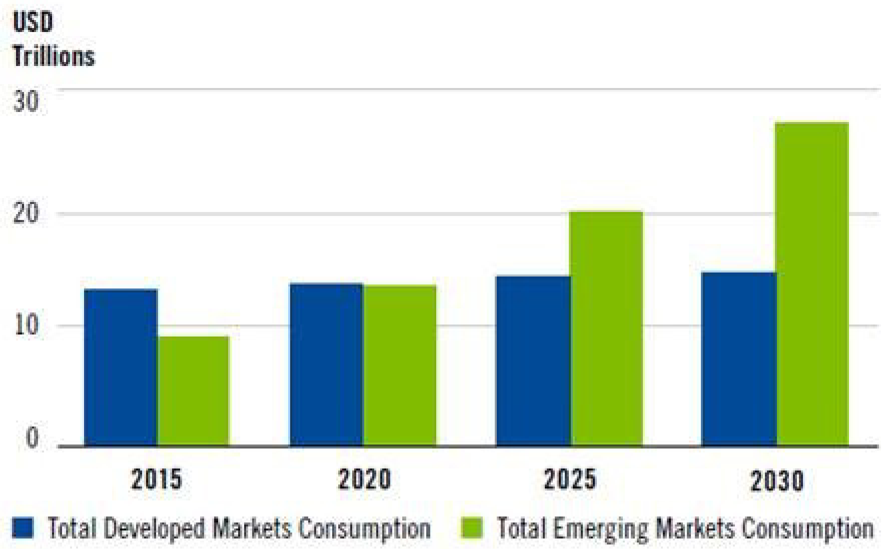
Exhibit 1: Emerging Markets as % of World GDP



Source: International Monetary Fund (IMF), World Economic Outlook as of October 2018.

FAST-GROWING MIDDLE CLASS CONSUMPTION IN EMs IS PROJECTED TO SURPASS DMs

Exhibit 6: Middle Class Consumption



Source: Franklin Templeton Capital Markets Insights Group, Brookings Development, as of June 2018. There is no assurance that any project, estimate or forecast will be realized.

In 2015 total emerging-market consumption was about 9 trillion dollars and developed markets about 12 trillion dollars. Note how the developed markets are expected to increase so little over the next 15 years. Whereas emerging markets should grow from about 9 trillion dollars to almost $30 trillion. Thus it will be very important to invest where the growth is going to be over the next 30 years.

What matters in World markets?

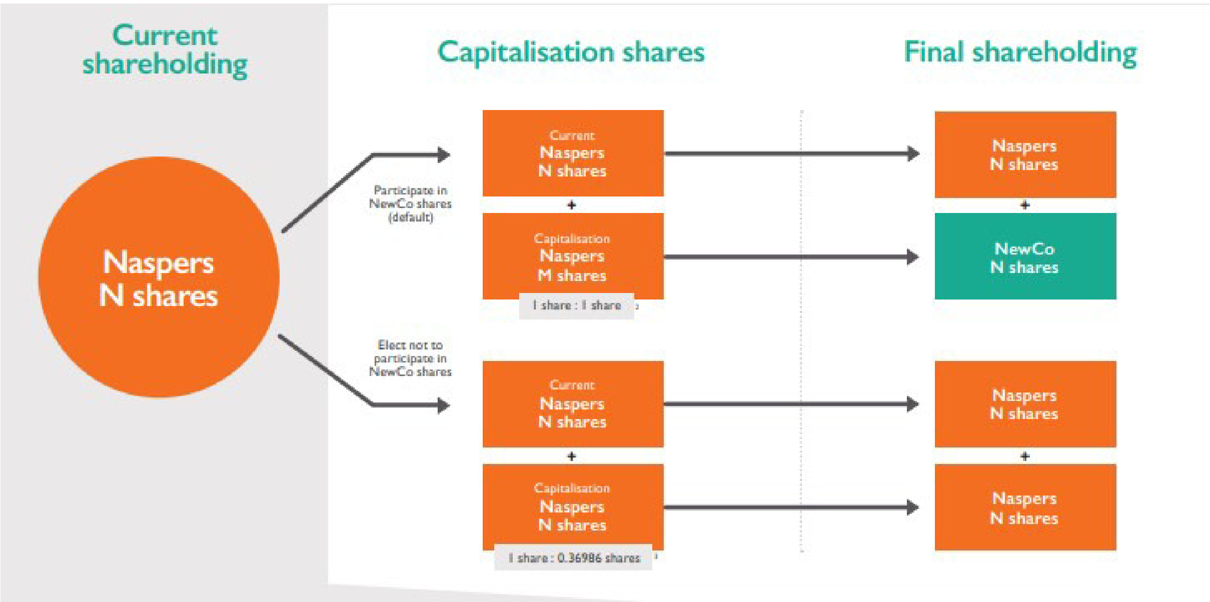
Eoin Treacey from Fuller Treacey Money 24th May 2019: From everything I have witnessed over the years large institutional investors look for three attributes when deciding to invest in markets beyond assets denominated in their domestic currency. These are potential for currency market appreciation, potential for capital market appreciation and yield differentials. I see no reason why investors of all hues shouldn't follow the same rationale. That is the basis for thinking as a globally oriented investor and why this is a Global Strategy Service.

Opt for more Naspers shares or take up NewCo – what is the better choice?

Back in March, Naspers announced that it plans to list a company (still called NewCo) on the Euronext Exchange in Amsterdam, which will hold all of Naspers's non-South African investments. Shortly thereafter, we published an article highlighting the potential sting in the tail for tax-sensitive investors holding Naspers shares in their own names – opting to take up their entitlement of NewCo shares would trigger a capital gain. Naspers has published its circular fleshing out the details of this transaction, which enables us to confirm that such investors will indeed face a Hobson's choice, as well as consider the various options available.

Before we look at the substance of the proposed transaction, it is worth highlighting that RCI, together with Anchor Capital, have devoted much time and resource to determining the best course of action for you, our clients. In this situation, in our opinion, the best course of action for investors would be to take up the NewCo shares, which will result in a capital gains tax liability. However, it is possible to delay this tax liability, while not having to be restricted in the option selected, by transferring your shares into a unit trust, in exchange for units in the unit trust. We have a newly established fund, the Anchor BCI Global Technology Fund which we would suggest using. Once the shares are in the fund, the fund manager will then be responsible for managing the election process, and no CGT would be triggered until units in the fund are sold. The fund will also provide some additional diversification, being invested in a selection of global technology companies, as opposed to the single stock risk of being invested only in Naspers. We are of the opinion that this is the best course of action, but the choice remains yours.

The following is a synopsis of the Naspers transaction, as well as the implications of the different options available to Naspers investors.



Source: Naspers

- Shareholders will have a binary choice, to either receive more Naspers shares or receive NewCo shares, not a combination of the two.
- Shareholders that opt to receive more Naspers shares (*option 2)* will receive 0.36986 additional Naspers share for each share they hold. Shareholders that opt instead to take up their entitlement of NewCo shares (*option 1*) will receive 1 NewCo share for each Naspers share they own.

The maths behind the ratio of additional Naspers shares for those that take this second option means that they will have the same economic split of their exposure to Naspers and NewCo as those that opt to take up NewCo shares.

Tax implications of the two options

Subject to the important disclaimer that investors should seek appropriate tax advice relevant to their own circumstances, the general tax principles explained in the Naspers circular confirm our original understanding for tax sensitive investors holding Naspers shares. In summary, this is as follows:

- The capitalization issues under either alternative will have a zero-base cost. This means they are treated as if you received the shares for nothing.

Option 1 – Elect to receive NewCo shares

For those opting to take up their entitlement of NewCo shares, the conversion of the Naspers "M" ordinary shares is treated by the Receiver of Revenue as a "sale" and is therefore subject to CGT with a zero-base cost. The full value of the NewCo shares received will be treated as a capital gain and will therefore be subject to capital gains tax.

Option 2 – Elect to receive additional Naspers shares

Those opting for additional Naspers shares will not trigger a capital gain on receipt of these shares. However, it is important to note that receipt of further Naspers shares with a zero-base cost will lower the average base cost of those investors' holding of Naspers shares. Investors will, immediately post the receipt of these shares, be in the same net position as before the issue. Capital gains tax (CGT) is not avoided, it is merely deferred to if, and when, the shares are sold.

How should tax-sensitive investors decide between the two options?

To quote Albert Einstein "Compound interest is the eighth wonder of the world. He who understands it, earns it … he who doesn't … pays it".

As a rule, it makes good financial sense to delay the payment of CGT as long as possible. Ignoring trading costs, where investment returns offered by different investment opportunities are identical, the power of compounding means an investor who delays triggering CGT because of switching between investments will end up with a higher net worth than one who switches along the way. Delaying CGT does, of course expose the investor to the risk that CGT rates increase in the future – something that is entirely possible given the fact that SA's CGT rate currently remains below that in many other countries.

Since the exchange ratio for the additional Naspers shares option gives investors the same economic exposure to NewCo as shareholders who opt to take up NewCo shares, it appears on the face of it, more sensible to defer CGT as long as possible by opting for Naspers shares. If only it was as simple as that. The problem arises in that while Naspers and NewCo are ultimately exposed to almost the same investments, the discount at which these companies will trade relative to these investments will likely be different. Should the discounts at which Naspers and NewCo trade at diverge materially, then the argument for delaying the CGT fails.

Currently, Naspers trades at a discount of c. 40% to its underlying value of net assets. As far as the rationale given by Naspers for listing NewCo on Euronext is concerned, it points out: (1) its size will not be a constraint, unlike Naspers currently on the Johannesburg Stock Exchange; (2) it will be eligible for inclusion in more indices, thus attracting passive index-linked buyers; and (3) developed market funds that could not buy Naspers/Tencent before, due to limitations on their mandate, will be able to invest for the first time. As a result of these factors, NewCo, it is hoped, will trade at a lower discount to its net asset value than Naspers has done historically.

As for whether Naspers' rationale will play out in practice and NewCo's discount to underlying net asset value will narrow, it remains to be seen whether Mr. Market agrees once the listing takes place. However, we think the logic is sound and we note that since the plan to create NewCo was announced, Naspers' discount to net assets has narrowed. This implies the market is pricing in an expectation of NewCo's discount narrowing. While the case for NewCo to trade at a smaller discount is compelling, this does not apply to Naspers. In fact, we think there are a number of reasons why, once NewCo is listed, Naspers may trade at a larger discount to its net assets than it did before:

- The creation of NewCo introduces a new investment holding company between Naspers and the underlying investments. This introduces the possibility of a double holding company discount being applied by investors.
- Shifting 27% of Naspers's market capitalisation into NewCo will not reduce Naspers' size in the SA market by enough to prevent its weight in the local index exceeding most investors' single stock exposure limits. In any event, many funds may continue to see Naspers and NewCo as a single entity anyway since they are essentially exposed to the same assets.
- Institutions that do not trigger a capital gain by trading may seek to switch out of Naspers and into NewCo post the listing of NewCo, placing further selling pressure on Naspers.
- A possible lack of appeal of South African assets that remain in Naspers (albeit not very material) and value leakage resulting from existing long-term management incentives linked to Naspers shares.

In short, investors who opt for more Naspers shares to defer the CGT obligation may forgo the one-off opportunity to benefit from any closure of the discount in NewCo. Conversely if the discount at which NewCo trades relative to net asset value narrows very little, one would be better off to defer the CGT by opting for additional Naspers shares. No easy decision it would appear!

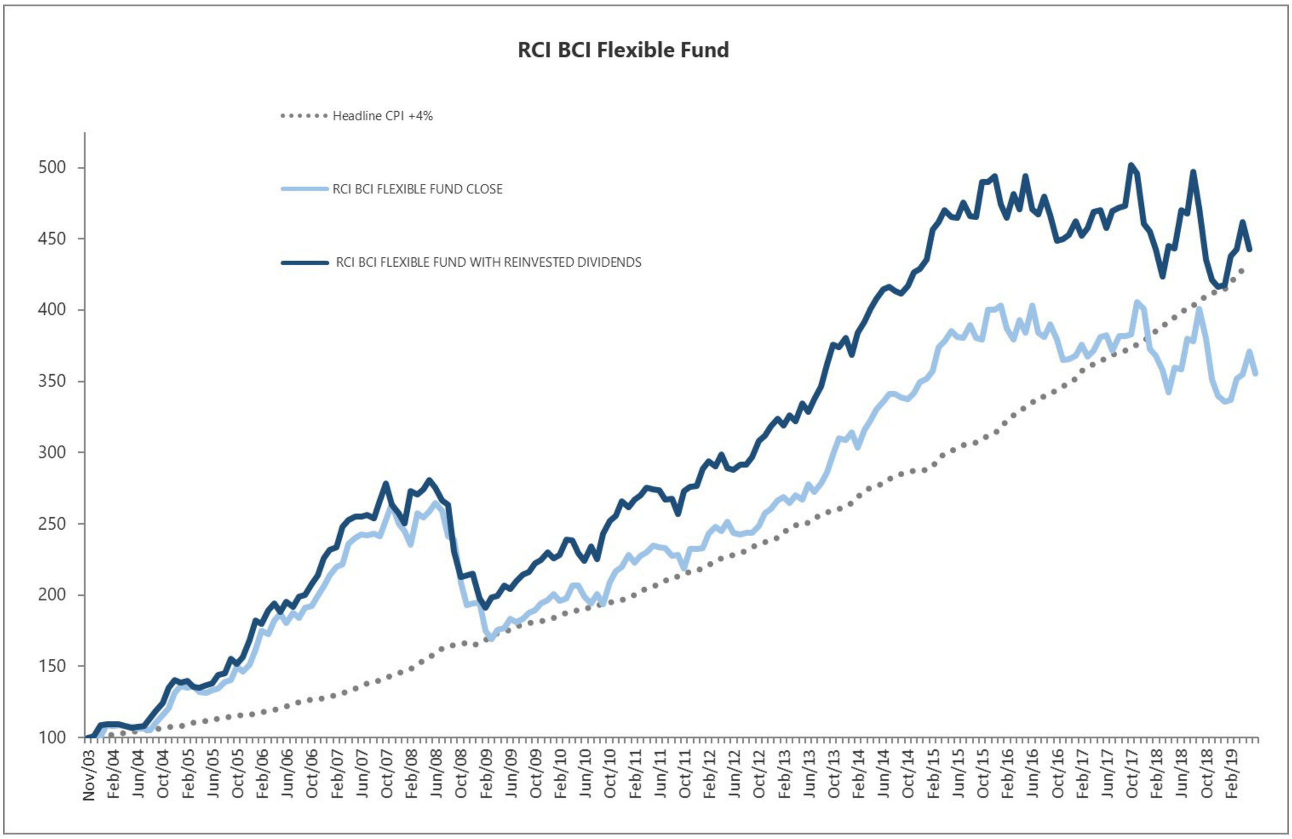
Summing it all up…

In the case of the choice Naspers is offering shareholders, we believe all is not equal. While economically shareholders will have the same exposure to Naspers' net assets initially either way, we think the critical question investors need to ask themselves is what happens to the discount at which Naspers and NewCo trade relative to net assets in the future? While the rationale for NewCo's discount narrowing appears sound, we think at the Naspers level the discount may widen. Those opting to take up additional Naspers shares will likely fail to benefit from the one-off narrowing of the discount anticipated in NewCo. This severely undermines the normal compounding advantage of opting to defer CGT, and our recommendation would be to accept NewCo shares, and pay the relevant CGT.

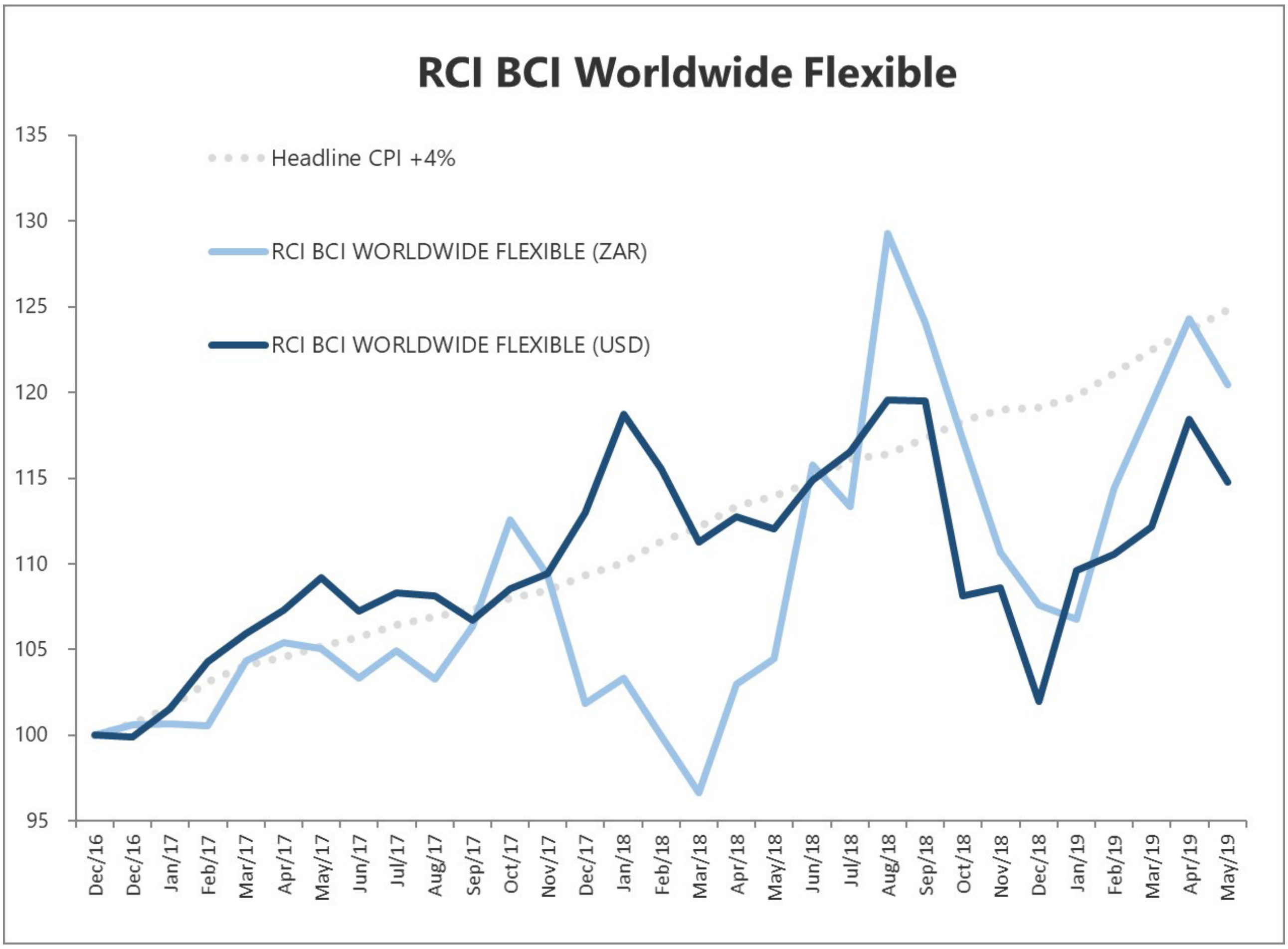
RCI Unit Trusts

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

RCI BCI Flexible Fund closed May at 355.34c, down 4.18 % for the month and up 5.82% for the year to date. Despite South Africa's national election result and subsequent cabinet appointments being judged as largely market-friendly, as so often is the case, these domestic events were overshadowed by global geopolitical developments. The escalation once more in trade tensions between China and the US drove a broad-based correction in May, with the MSCI World Index down 5.7%. A slight depreciation of the Rand against the US Dollar (1.7%) provided some support for rand-hedge shares, but with the FTSE/JSE Capped SWIX Index delivering a total return of -4.8% for the month of May, it was a bruising month nonetheless.



RCI BCI Worldwide Flex closed May at 120.48c, down 3.10% for the month and up 11.99% for the year to date. At least it is keeping much in line with inflation which most South African portfolios have been unable to do.



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.

To conclude

Winter is here! Time to snuggle up warm, hibernate and think about the future.

What are the important goals that the a fund manager should achieve for you?

- Long term growth, at above the inflation rate of portfolio values. Over the past four years, this been hard to achieve in South Africa so it has been important to have plenty of your portfolio invested in offshore shares. By long-term we mean at least five years. The South African market has been flat, even with the help of Naspers which constitutes 20% of the JSE Overall Index, so the investment in overseas shares has been vital. We believe that investing in high ROCE companies is the best way to go for the bulk of your money. It reduces risk and enjoys the benefits of a highly compounding returns on reinvested capital.
- Long-term growth in the cash flow that your portfolio generates i.e. the dividends which you receive need to grow at about the inflation rate.
- Provide the important details required for your tax return. Ensure that future taxation and estate duty will not take too big a chunk of your assets.
- Keep you up-to date on Trust legislation.
- Help you make good use of retirement- and living annuities as well as other taxes advantaged investments.

We hope to be the best family office in the country!

Best regards

Di, Alan and Mike