Robert Cowen Investments

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Newsletter

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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 mike@rcinv.co.za

"The road to success is paved with failure and perseverance." ~ *Anonymous*

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

Highlights of this newsletter are:

The retirement of Alan McConnochie.

Who is your great support team?

How is Trump doing?

Market Outlook by Mike Gresty.

Breaking Futures: are global financial markets still in touch with reality? (Clem Sunter)

Unit trust performance:

RCI BCI Flexible Fund closed July at 351.20c, down 2.58% for the month and up 5.19% for the year to date.

RCI BCI Worldwide Flexible Fund closed July at 124.23c, up 2.58% for the month and up 15.48% for the year to date.

From Di Haiden on retirement of Alan McConnochie

It is with a heavy heart and great sadness that we wish to inform you that Al McConnochie has decided to retire now due to his ill health. I am sure you all know Al has been struggling for some time with his health and has (as he and Churchill put it) kept on 'buggering on'! One of the things we have all admired the most in Al is that as his health has deteriorated he has never once complained – one day I actually said to him how amazing it is that he never complains in spite of this difficult curve ball life has thrown his way; he said, 'What was was, and is the past; this is now and that's just how it is!' – he is one of the bravest people I know!

Al needs no introduction to you and has been an integral part of RCI since he joined in 2004; he has headed up the investment process and assets under management grew substantially under his watchful and guiding eye. Al and I have had a wonderful partnership over the fifteen years and I will be forever grateful for his input, wisdom and insight during both the extremely difficult times and the good times.

A year ago he already started to hand the reins over to Mike Gresty, who we employed specifically to give Al the backup he needed as his health deteriorated. Al has very kindly offered to still be available to Mike if he requires his assistance and guidance. We wish Al all the best and thank him for his enormous contribution to the success of RCI.

Message from Alan McConnochie

I have been writing this newsletter for 15 years, and suddenly, this is my last one. Life does not always work out as planned but I think its been a blast. I wish all of our clients a great future, both financially and otherwise. RCI is left in very competent hands – Di and Mike, with the back up of Anchor. Peter Armitage, the boss of Anchor has been fantastic to me in my hour of need. I am going to try to cut off from shares completely in the faint hope it might delay my deterioration. Thank you everyone! You, the clients, have been fantastic and I thank you for 15 years of a great relationship. May you thrive and prosper!

Who have you got for a support team besides Di and Mike?

On managing portfolios you have:

Eric Lappeman (nine years with RCI) (Eric is a CFA charter holder and has a B.Comm from Monash). He is a portfolio manager on most of Alan's client portfolios but also assists with other portfolios where necessary.

Andrew Lawson (three and a half years with RCI). Andrew has an accounting background, having completed articles at PKF in 2011 and has completed the CFA exams. He is currently completing the practical work experience to obtain the CFA charter (which will be effective at the end of the year). He is also a portfolio manager on some of Di and Alan's client portfolios.

These two specialize in managing portfolios and in communicating with clients.

Gontse Dikeledi (she has a Business Science degree from UCT) has been with us for a year and supports these two, very ably in placing orders, doing reviews etc. In addition, she works with Di on managing a number of portfolios and is being trained as a portfolio manager.

On foreign portfolios you have Ross McConnochie (nine years with RCI). He runs all the high ROCE (return on capital employed) portfolios which produce high returns with low risk and should be essential to your future performance. For some years we have expected foreign portfolios to outperform local portfolios. The performance in rands of these portfolios has greatly outperformed that of local portfolios. "Live in the sun but invest in the shade" has been our advice. For many years into the future we expect foreign portfolios to continue to outperform.

Ross is also a CFA charter holder which followed his B. Business Science from UCT.

We have just employed Marieke de Kock (BA Law Degree, a Post Graduate Certificate in Further Education and Training, as well as a Post Graduate Diploma in Drafting and Interpretation of Contracts) to act as PA to the above team and ensure that all the administration that goes with managing your portfolios is seamless and that all tasks are carried out timeously. She will assume some of Gontse's responsibilities as Gontse becomes more involved in the investment management of the portfolios.

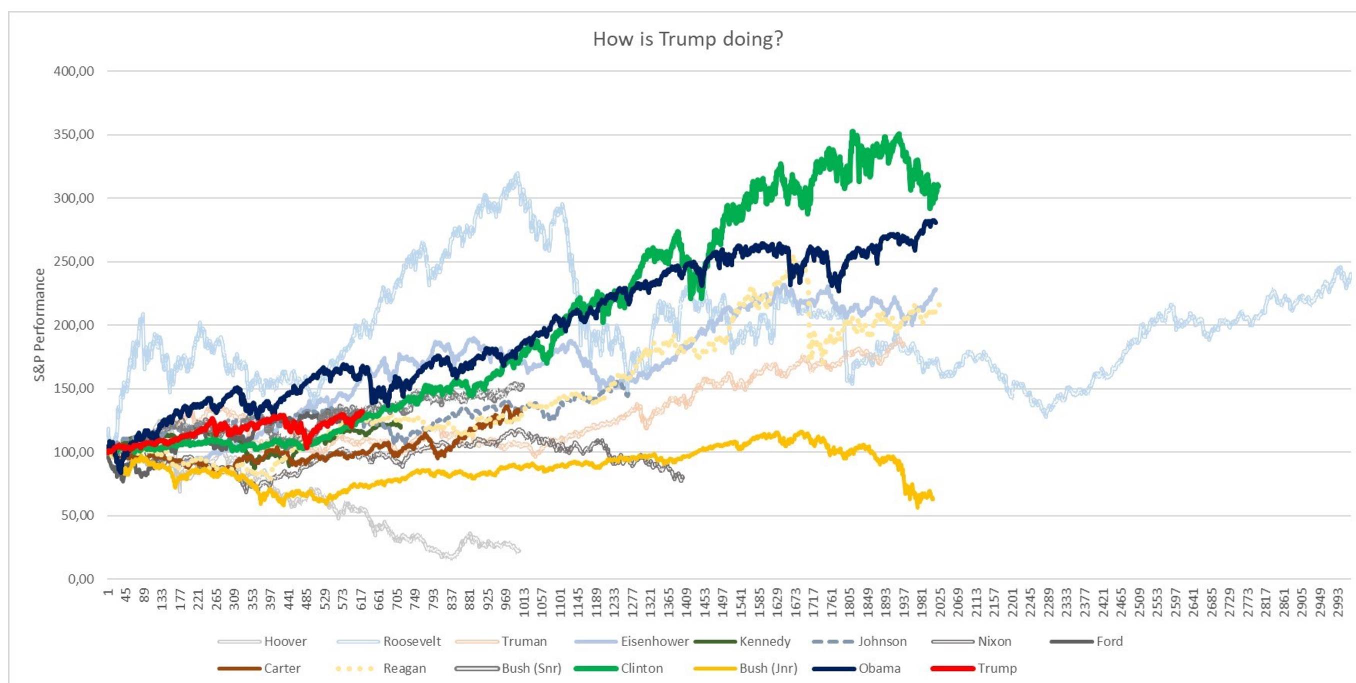
We welcome her to RCI and wish her all the best in her new role. These are very well educated, smart and dedicated people who will serve you well over many years.

Then we have the rest of the RCI team who do all the admin and accounting and are just as important as all of the above in looking after your affairs, but we will concentrate on them in the next newsletter as the above is already information overload!

Now let us get onto business:

How is Trump doing?

Donald Trump has repeatedly boasted about the strong performance of the US equity market since he was elected US President, for which he has claimed full credit. How is his term panning out compared to other US Presidents over the past century? There have been 15 US Presidents over the past 90 years for which there is information on the equity market's performance available. In the chart below, the US equity market's performance during Donald Trump's presidency is the red line.



	Trump	Obama	Bush (Jnr)	Clinton	Bush (Snr)	Reagan	Carter	Ford	Nixon	Johnson	Kennedy	Eisenhower	Truman	Roosevelt	Hoover	Average
Same Period as Trump	31,8%	66,3%	-25,5%	26,3%	30,5%	28,3%	0,6%	NA	-1,6%	25,3%	16,6%	62,9%	8,8%	96,4%	-44,4%	23,0%
First Term	NA	81,4%	-11,8%	72,6%	51,5%	25,6%	31,2%	NA	17,9%	32,1%	NA	77,0%	6,7%	214,4%	-77,4%	43,4%
Full Term (Annualised)	17,6%	20,6%	-8,0%	22,7%	16,3%	15,1%	10,1%	15,9%	-5,6%	11,6%	9,5%	16,2%	12,3%	11,2%	-42,2%	8,2%

Source: Anchor Capital

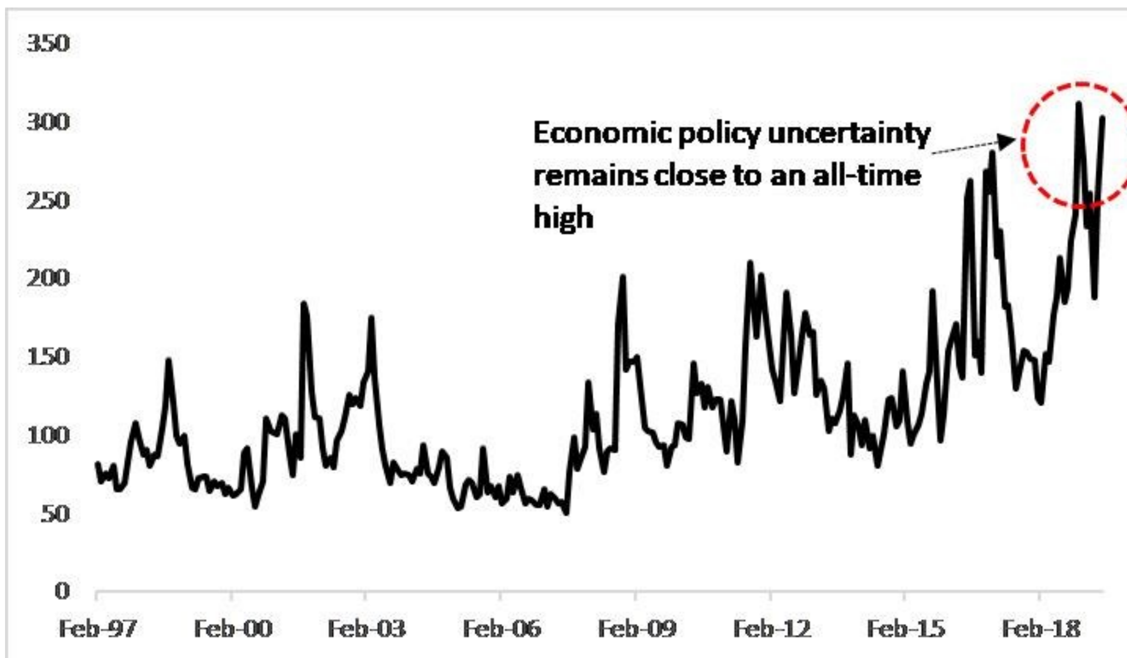
From the above. The American market has increased by 31.8% since Trump took over. This compares with an average of 23% for the last 14 presidents. While this puts Trump in the top half of the class, he is by no means an outlier. The average equity market performance over the full first term of Trump's predecessors was 43%. Presumably, this would be the minimum target from his current 32% - a task made harder by repeatedly escalating the trade war with China?

Market Outlook

International equity markets

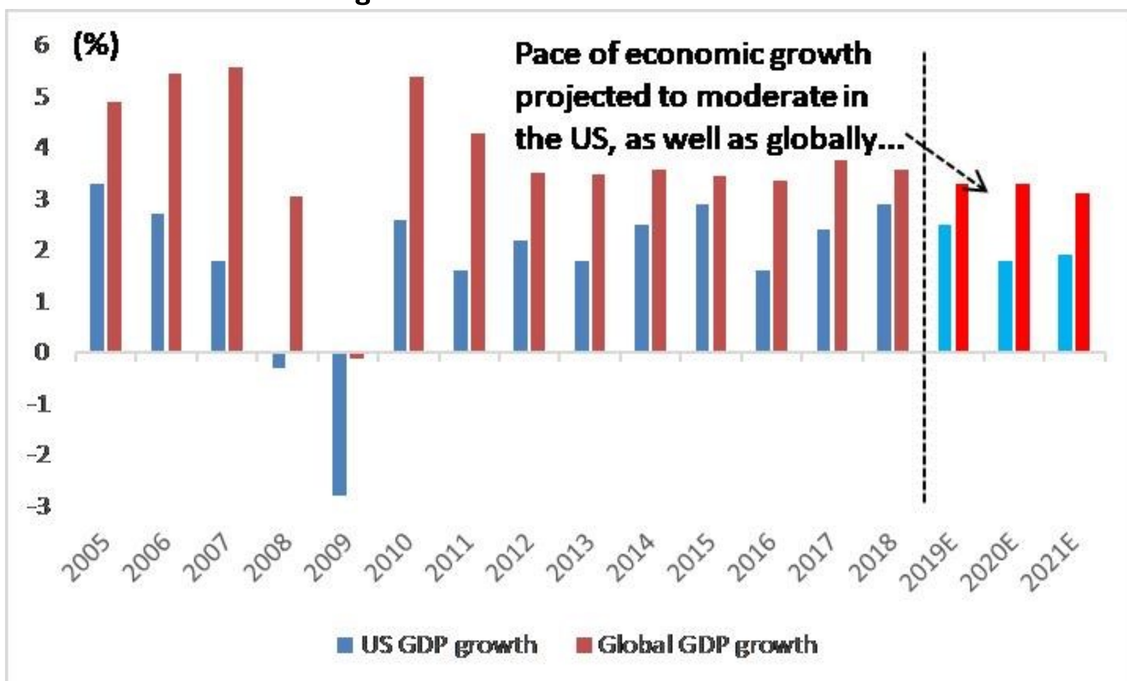
Global trade tensions have dominated global equity markets over the last 12 months and have contributed to a state of elevated economic policy uncertainty for investors.

Economic Policy Uncertainty Index



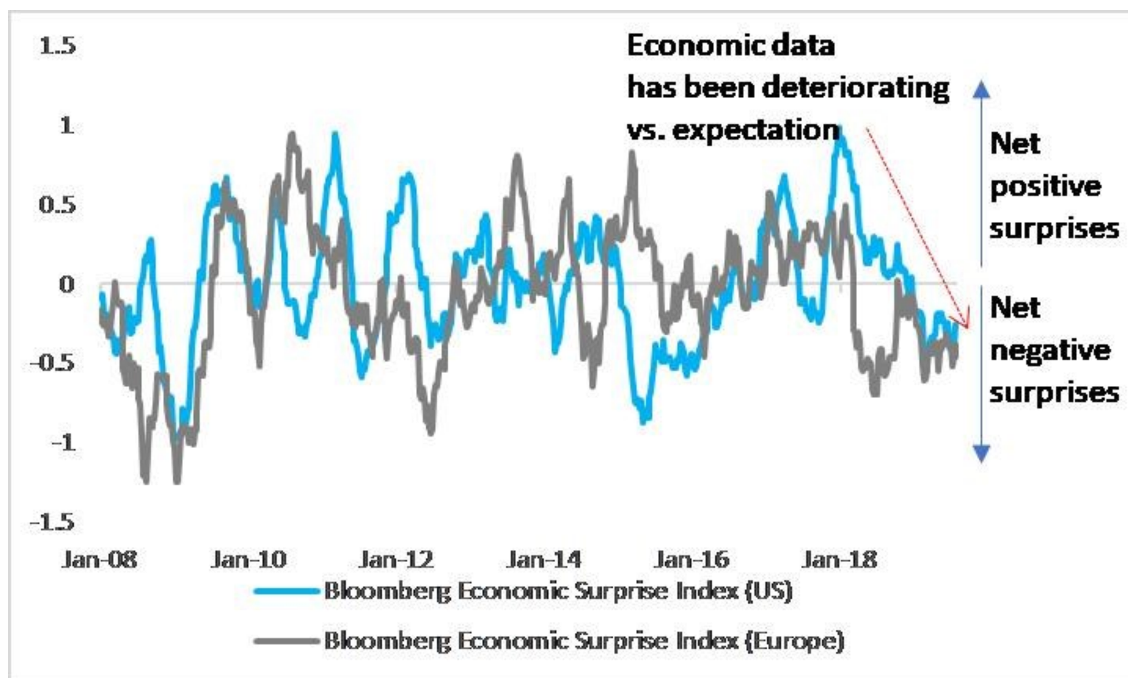
Economic forecasts have been anticipating a moderation in global growth, as the measures that have been employed by the world's leading economies to support growth since the Global Financial Crisis were gradually withdrawn (end of quantitative easing and interest rates beginning to rise), while, in the US, the boost from US President, Donald Trump's, tax cuts was also expected to fade.

Global and US real GDP growth over time



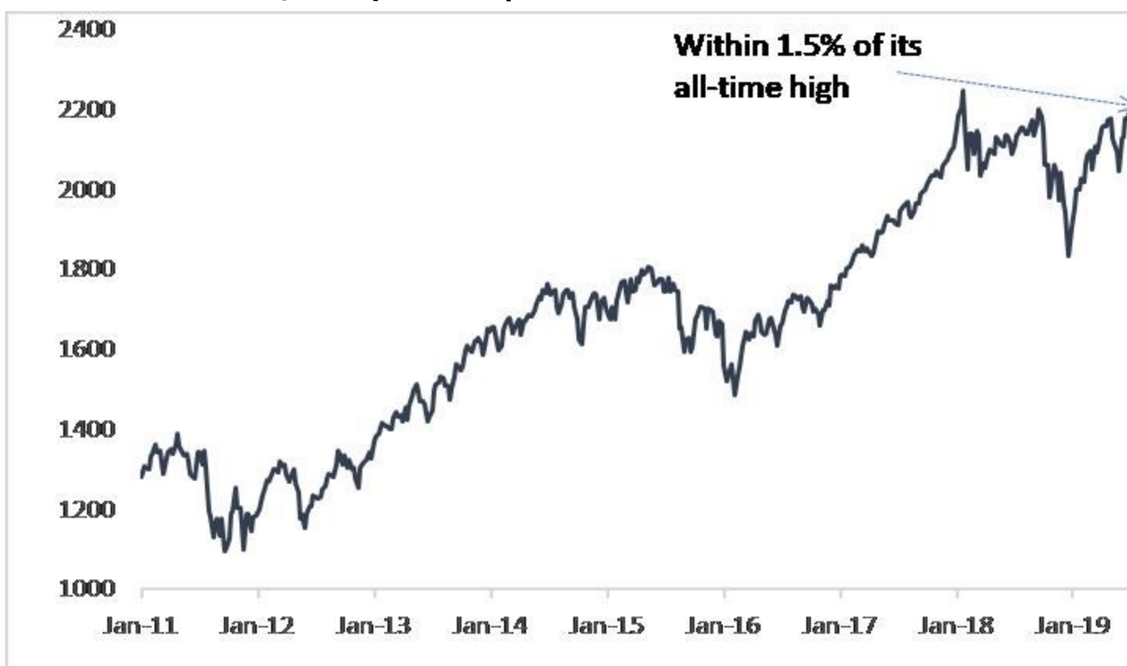
However, the real impact of trade tensions has begun to be felt. After a few years in which economic data was surprisingly positive relative to expectation, even relative to the moderating outlook, economic data have been disappointing in 2019.

Bloomberg economic surprise indices for the US and Eurozone



From an equity market perspective, the response in 2019 so far can best be summed up as "bad news is good news". The sharp correction in the latter months of 2018, which intensified in December, was chiefly driven by concern that rising US interest rates were both bad for asset valuations and risked bringing about the end of the current economic expansion. However, the abrupt U-turn by central banks in the US and elsewhere in the world, which signalled their willingness to resume cutting interest rates in response to signs of economic weakness, has been widely welcomed by equity investors. Investors now expect a continuation of low interest rates and abundant liquidity to support asset valuations for the foreseeable future. So far in 2019, global equities have rebounded strongly from last year's sell-off, and, at the time of writing, have risen by 18% in US dollars since the beginning of the year. This puts global equities within touching distance of the previous peak reached in January 2018.

MSCI World Index, January 2011 to present



So, after the recovery, where do equities stand from a valuation point of view? In the chart below, we show the price of the MSCI World Index as a multiple of its expected earnings over time.

MSCI World Index: Price/forecast earnings

The rally in global equity markets this year has, of course, led to the valuation becoming more demanding than it was at the beginning of the year. Thanks to the fact that companies have continued to grow their earnings though, the valuation of global equities currently remains below the level at which it has been for much of the last 5-years.

To quote a recent tweet from President Trump: *"The Stock Market went up massively from the day I won the Election, all the way up to the day I took office, because of the enthusiasm for the fact that I was going to be President. That big Stock Market increase must be credited to me. If Hillary won – a Big Crash!* "While many professional investors likely dismiss these boasts, it is worth keeping in mind that, having aligned himself with the performance of investment markets in the eyes of the voting public, maintaining a market-friendly policy position is likely to be central to his campaign for re-election in November 2020.

To sum up then, although global growth is set to moderate and valuations are now more stretched than they were at the beginning of the year, actions taken by central bankers and politicians appear set to sustain the long slow equity bull market for the time being. This also needs to be seen in context of the extremely low returns on offer from other asset classes.

South African equities

So far this year, the South African equity market has delivered a total return (price + dividends) of 5.3% in rand and 5.8% in US dollars. While positive, which one could infer is thanks to the SA equity market's tendency to follow international sentiment, the performance has remained well short of that achieved offshore. A particular peculiarity of the SA equity market is that it is comprised of groups of companies for which the underlying drivers of performance have been very different. One needs to consider each of these segments of the SA market to get a proper perspective:

- **Mining shares** - From their lows of early 2016, these cyclical companies have been among the star performers in the SA market. Although some commodities have started to decline in 2019, in line with the slowing global growth outlook, iron ore and platinum group metals have continued to perform strongly. These are commodities to which South African listed miners are more exposed, which has continued to drive positive investment performance in this area of the SA equity market. For now, these companies are generating massive free cash flows, which should support the shares. However, we remain vigilant for signs that the normal cyclical forces are beginning to reverse.

- **Rand hedge/multinationals** – These are companies which are listed in South Africa, but whose fortunes are not linked to any great extent to the South African economy. The include the likes of AB Inbev, British American Tobacco, Naspers, Richemont and BidCorp. Although the exchange rate has not been a significant factor in driving investment performance so far this year, these market heavyweights have generally performed well – the average return from the particular companies mentioned has been 28% so far this year.
- **The domestic "SA-Inc" component** – this group comprises the South African banks, retailers, food producers and various domestic services and industrial companies. Results from this segment of the SA market have been almost universally poor, reflecting the lack of growth in SA's stagnant economy. Share prices of this grouping of shares have been under consistent pressure this year and have been chiefly responsible for the overall market having lagged the performance of global markets this year.

Reflecting back to our outlook for the SA market at the beginning of the year, we made the case that, after the meagre returns from South African equities over the last few years, a stable election, followed by a clear reform agenda being commenced could position SA as an interesting "self-help" investment story in the eyes of international investors. Since then, the depth of SA's economic malaise, as well as just how precarious the position of Eskom is, both from a financial perspective, as well as its ability to reliably meet South Africa's electricity demand, have become more apparent. Furthermore, since the national elections in May, goodwill is rapidly eroding as government continues to dither on meaningful reform, while remaining preoccupied with internal politics. This only serves to intensify our concern that the such an ideologically divided ANC government simply does not have the will to firmly grasp the nettle and adopt necessary but painful (and thus unpopular) reforms.

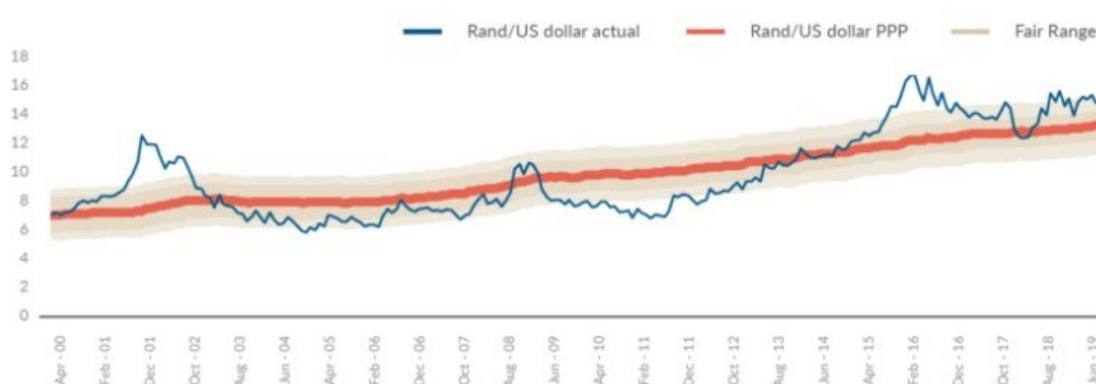
For the SA-Inc shares, the case remains that, off such a depressed base, earnings could rebound strongly if economic growth momentum improves. However, at the moment this is like the investment equivalent of "*Waiting for Godot*"- do we risk sleepwalking through the next 18 months, only to wake up to the realisation that SA's economic backdrop has not improved meaningfully? The opportunity cost would be missing out on the slow grinding bull market offshore.

In summary then, from an investment perspective, we believe South Africa remains a "show me" story. In the event that policymakers do grasp the nettle, confront the populist elements within SA's political ranks and begin in earnest to implement reform, it would be time to reassess. For now, outside of a few stock-specific opportunities locally, we continue to expect superior investment returns will be achieved offshore.

The Rand

The rand has historically proved to be among the most volatile currencies in the world. Unlike many other Emerging Market currencies, it is not pegged to one of the major developed market currencies and is relatively liquid. It has, in a sense, been a proxy of global risk sentiment, which has amplified the range within which it moves. As the chart below shows, although the long-term weakening trend for the rand has been clear, it has diverged widely and for extended periods from our fundamental view of "fair value". This model would put fair value for the rand at around ZAR/USD13.30.

Actual rand/US dollar exchange rate vs rand PPP model



In the short-term, short-term movements will remain dependent on global and domestic developments, the randomness of which make short-term predictions a fool's errand. However, Eskom's financial frailty has dealt a significant blow to SA's financial position and removed what little wiggle room there was to avoid a credit rating downgrade from Moody's (the last hold-out that still rates South Africa's debt "investment grade") at some point over the next year or so. With such risks, we would continue to use any periods of relative strength in the rand as opportunities to diversify further offshore.

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British American Tobacco issued very good results on 1August, so possibly we have seen its nadir. This is a big investment in client portfolios so is important to us. The dividend yield of over 6% in pounds and with growth is very attractive.

Trump Ratchets Up Trade War With New China Tariffs

Fuller Treacey money comment of the day 1 August 2019

This article by Alex Wayne for Bloomberg may be of interest to subscribers. Here is a section:

President Donald Trump abruptly escalated his trade war with China, announcing that he would impose a 10% tariff on $300 billion in Chinese imports that aren't yet subject to U.S. duties.

The new tariff will be imposed beginning Sept. 1, Trump said in a tweet Thursday that broke a tentative trade ceasefire between the world's two biggest economies. The 25% tariff already imposed on $250 billion in Chinese goods will remain in place, he said.

A draft list of $300 billion worth of targets published by the Trump administration in May included a raft of consumer and technology goods, including most of Apple Inc.'s major products such the iPhone, along with toys, footwear and clothing. The final list hasn't yet been released.

"These are the tariffs on many of the consumer goods that were spared in the previous tariff rounds," said Neil Dutta, head of economics at Renaissance Macro Research in New York, in a note. "This is a small hit to growth but will likely be more obvious to consumers. Keep in mind that margins have come in somewhat already, not sure firms can simply eat the cost."

Also from Fuller Treacy comment of the day 1 August 2019 - Indirect effect of the trade war

Samsung alone accounted for a quarter of Vietnam's exports in 2018, although even that might not fully capture the company's effect on the wider economy.

Editor: Why can't South Africa get its act together to pick up some of this export market?

Breaking Futures: are global financial markets still in touch with reality?

Clem Sunter

30 July 2019

We have often invited Mr, Sunter to address our clients, He is always thought provoking. Here is his latest offering:

At the end of May this year, I wrote an article painting three scenarios for the global economy over the next five years.

The first was "Gilded Cage" in which the rich old millions in America, Europe and Japan continued to construct barriers to block the poor young billions in the developing world from migrating to their countries. While this was completely against the spirit of globalisation which entails the free movement of people and goods between nations, the world economy would go on growing, albeit at a much slower rate than last century.

The second scenario was "Bloodbath" in which the US was drawn into a war with Iran, the consequence of which would be millions of Iranians dying as a result of America's military might. There would also be widespread destruction in the Middle East as the war spilt over into neighbouring territories.

The third scenario was "Forked Lightning" in which the markets had another crash similar to 2008. The probabilities that I attached to those three scenarios were 50%, 30% and 20% respectively. The overall message was that a day of reckoning might be fast approaching.

Since I wrote the article, American stock market indices have hit record highs and stock markets elsewhere have generally done pretty well too. So the question to ask is whether this optimism is justified or not. Let me go through the flags that I identified last time as possible game-changers and see how they have developed.

The religious flag

Since May, the UK has been dragged into a potential conflict by detaining an Iranian oil tanker as it moved past Gibraltar. The Iranians have responded by detaining a British vessel going through the Strait of Hormuz. Meanwhile, an American drone has been shot down by the Iranians and sanctions against Iran have been tightened further by the Americans. The oil price has risen slightly, but not leapt over $100 a barrel, as the market believes there is still a chance of peacefully resolving the whole dispute.

Nevertheless, Donald Trump has revealed how far he is prepared to go in the region by saying that America could kill 10 million people in Afghanistan in one week to finish the war there; although it was an option he was not prepared to pursue at the moment. He might say the same thing about Iran at some stage, especially if they start seriously enriching uranium again.

The red flag

There is as yet no resolution to the trade war between the US and China although talks are underway again.

At the same time, there is a belief in Washington that Russia intends to meddle in the US 2020 presidential election as much as it did in the last one. More importantly, the strategic arms limitation agreements are coming to an end with little prospect of renewal. This time Russia probably has smarter nuclear weapons than America which was not the case in the last century. Another arms race could begin.

Across the Pacific, North Korea has recently tested a short-range missile in protest against South Korean military manoeuvres. In other words, the red flag does not appear to be going down any time soon, but the markets believe otherwise.

The grey flag

Nothing has changed in terms of the ageing of the population in Europe, Japan and China leading to a slowdown of economic growth in those countries. In aggregate, they constitute over 40% of the global economy. Of course, this is a long-term flag, which is the reason that the markets ignore it.

The anti-establishment flag

The rise in influence of anti-establishment and populist movements continues apace. Britain now has a leader in Boris Johnson who resembles Trump in his confrontational and bombastic manner. The odds on a no-deal Brexit have risen; and a pamphlet is being prepared by the UK government to give British citizens an idea of what this means for everyday living. The chances of Scotland having another referendum on independence have increased too.

In the US, Trump's tweets about the "squad" in Congress who oppose him and the harsh conditions in Baltimore are being condemned as racist and are further dividing American society ahead of next year's election. It appears to be part of a deliberate campaign strategy on his side to polarise the nation.

Even China is now having problems with young people in Hong Kong demonstrating for democracy.

Again, the markets are dismissing this form of populism as irrelevant. Inequality between the rich and the poor can be shrugged off along with racial tensions. The thinking is that, as long as the economy continues to grow and unemployment/inflation remains low, companies and their shares will do well. Dividends will continue to flow. Yet it is generally accepted that social harmony is a key characteristic of a winning nation and, if that is endangered, it could harm the wellbeing of the private sector as well.

The green flag

The environment is suffering even more than a few months ago. The Amazon forests are being cut down at a record rate; there are huge fires inside the Arctic Circle in Russia and Alaska, the smoke being equivalent to Sweden's annual carbon emissions; and Europe has experienced an all-time high in temperatures causing disruptions in travel and posing a health challenge to old and young alike.

Elsewhere, the area around New Orleans has been flooded again with torrential rains. In contrast, certain Indian cities have run out of water.

Despite the increasing evidence that Mother Nature is getting really angry, the financial gurus have no desire to include any negative features of the environment in the algorithms which they use to predict the market's next move. They are relying on electric cars and renewable energy to sort out of the mess. Technology will always come to the rescue.

The national debt flag

It would seem that within the Gilded Cage, there is still an appetite among central banks to pursue cheap money policies and among governments to run ever-increasing fiscal deficits in order to remain popular with their electorates. Austerity is now a dirty word. We have negative interest rates on some government bonds in Europe which means you pay to hold them.

The Keynesian philosophy of high public spending to avoid the next recession is very much in vogue, as witnessed by Boris Johnson making expensive promises all over the UK and Trump being quite happy to run a one trillion dollar annual deficit in the US federal budget over the next few years.

Thus, the reasonable target of national debt not exceeding 60% of GDP is being breached virtually everywhere in the world, which raises the risk of a default on debt repayments by some country somewhere. Yet, the City of London and Wall Street actively encourage this monetary and fiscal behaviour even if it may ultimately lead to the Forked Lightning scenario. It is good for short-term profits and that is what counts in the markets.

Conclusion

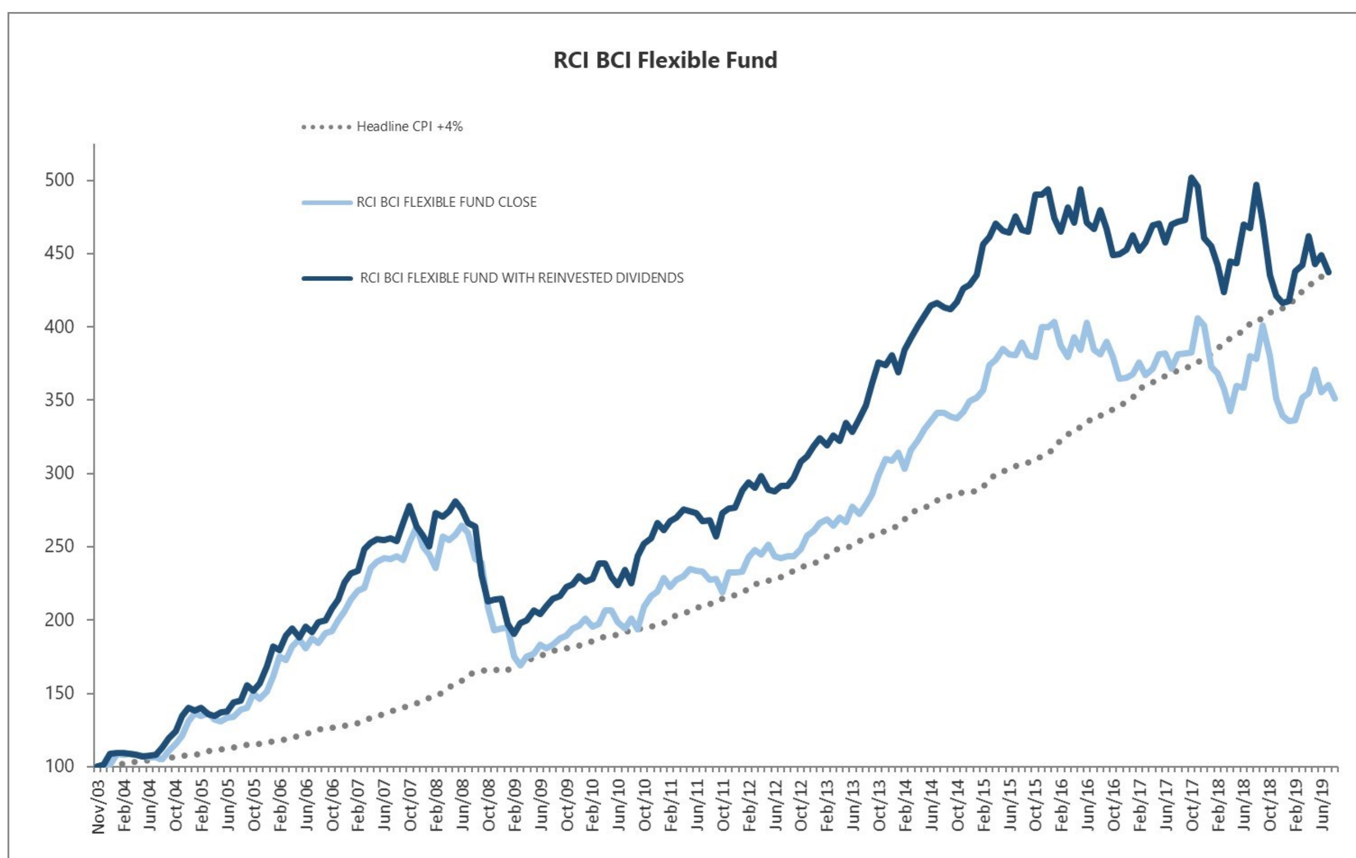
I am not about to change the probabilities that I gave to the three scenarios in May. What I will say is that the events that have happened since then confirm the fairly high probability of 30% attached to Bloodbath and 20% to Forked Lightning. Current markets do not reflect these probabilities. So, like the fox, you must keep your eyes open for surprises and your wits about you to act quickly. In any event, your investment portfolio needs to be sufficiently diversified to weather the storms envisaged in the second and third scenario.

Stock markets are a prime example of crowd-forecasting and foxes always want to be ahead of the crowd!

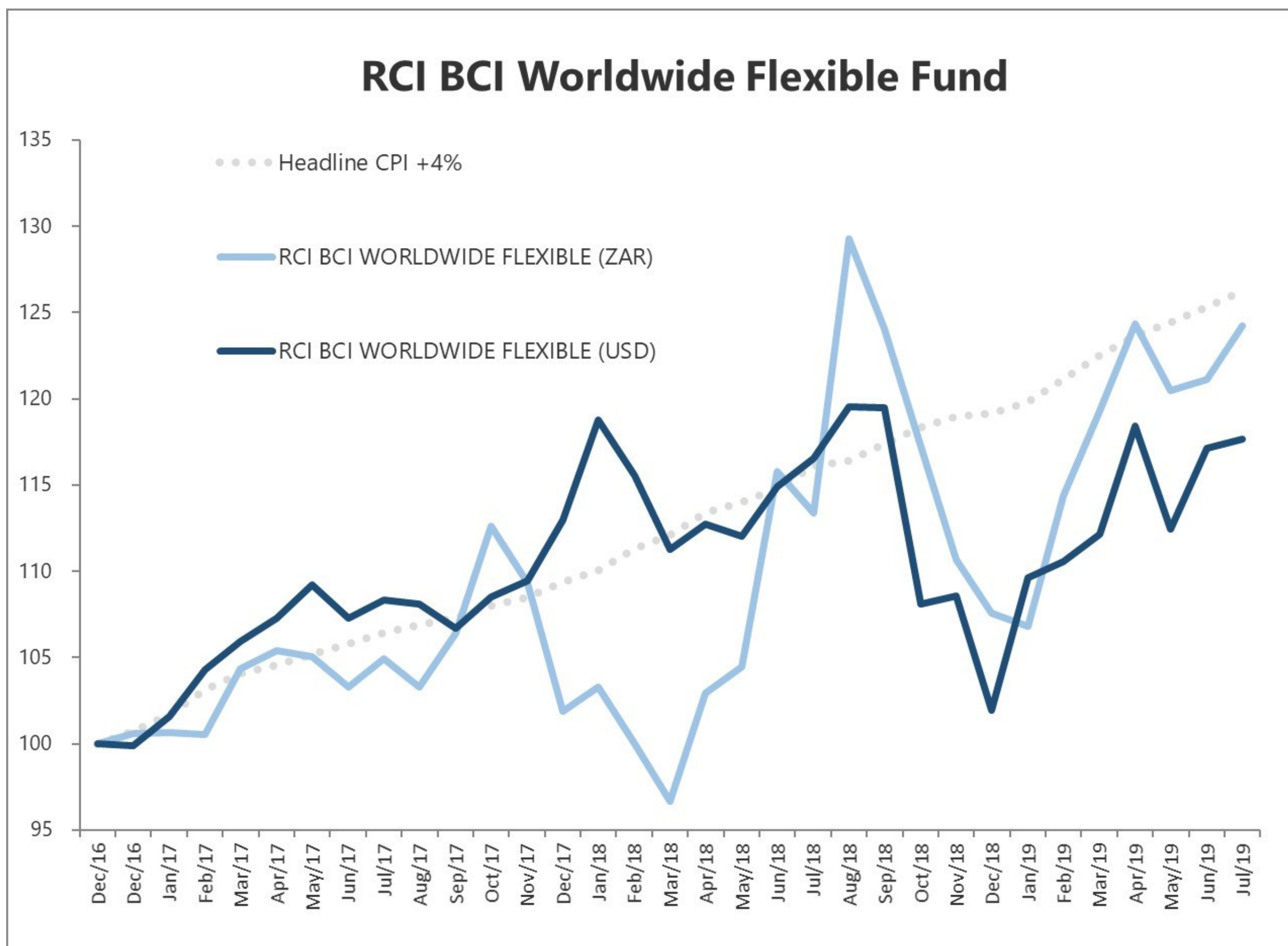
RCI Unit Trusts

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

RCI BCI Flexible Fund closed July at 351.20c, down 2.58% for the month and up 5.19% for the year to date. It was a rollercoaster month for equities. While the US market reached a new high early in the month, trade war fears were re-ignited late in July. The South African equity market was down 3.1% in July. Miners, which had set the pace for much of the first half of 2019, gave up some of their gains, as commodities came under pressure on trade war concerns. On the SA Inc. front, financial shares were also under pressure, as the risks posed by Eskom's debt problems for government finances and, as a consequence, the country's credit rating, became apparent.



RCI BCI Worldwide Flex closed July at 124.23c, up 2.58% for the month and up 15.48% for the year to date. Although the re-escalation of trade tensions between the USD and China late in July did take some of the shine off market performance, US equity markets finished July higher (S&P 500 +1.4%). Better than expected earnings reported by US companies in the quarterly reporting season appears to have been responsible. This helped drag develop market (DM) equities higher (MSCI World +0.5%). However, emerging markets suffered in the face of trade war concerns, with the MSCI Emerging Market Index down 1.2% in July). The rand weakened by 0.6% against the US dollar, which provided a further tailwind for the fund in July.



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.

It's "time in the market, not timing the market" that wins in the end.

To conclude

As we write, investors' nerve is being tested once more. Concerns that escalating US-China confrontation could aggravate already slowing global growth and, if unresolved could ultimately trigger a recession, anti-government protests in Hong Kong and wobbles in Argentina all conspiring to create a "risk-off" sentiment at the moment. At these times the temptation to sell out and head to the side-lines builds. The sharp recovery in markets from their lows in December 2018 was another reminder that efforts to time the market in this way often prove counter-productive - it's "time in the market, not timing the market" that wins in the end.

While we may be in for a bumpy patch, we remain consistent in our approach - seeking to buy great companies today that will do well in 3 to 5 years' time.

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

Best regards

Di, Alan and Mike