ROBERT COWEN INVESTMENTS

NEWSLETTER – END SEPTEMBER 2022

14 October 2022

The Family Office

HIGHLIGHTS OF THIS NEWSLETTER ARE:

- Family Office Learning Corner – Phishing & Scammers!
- Merger announcement of RCI Flexible Fund with Anchor SA Equity Fund
- USD/ZAR exchange rate, bond investing & loadshedding
- Active vs passive investing
- What have we been doing in the offshore funds – *by the RCI Investment Team*
  - Macro factors continue to whipsaw equities
- What have we been doing in the local fund – *by the RCI Investment Team*
  - Hawkish Fed, UK fiscal policy & China's zero-covid policy induce another challenging month
- Charts for the month
  - US GDP growth, inflation and interest rates
- Latest Research from Anchor Capital
  - WHILE AUGUST INFLATION SLOWS, SARB KEEPS APACE WITH GLOBAL CENTRAL BANKS ON TIGHTENING RATES

Due to the current economic environment, we have increased the cash positions inside our client accounts to provide sufficient liquidity to meet drawings over the next 12 months so that we are not forced sellers in a downturn. For investors concerned about equity exposure in the current environment, we suggest some context by considering the following aspects/questions:

- *Are you likely to want to withdraw money from your offshore portfolio in the next 3 years? Do you need the money? If you don't, it is almost always the right thing to stay invested.*
- *What are equities as a proportion of your net asset value? Don't generally consider down-weighting equities if it is less than 50%.*
- *Is a compound 8-10% USD return for the risk portion of your portfolio a target you are comfortable with, and are you prepared to have up and down years in the pursuit of this long-term objective?*

The market is presenting opportunities to invest in top quality companies at more reasonable valuations that do not come around often. RCI aims to take advantage of this as, on a 3 to 5 year view, there is potential for great returns for those who can stomach the current volatility in equity markets.

If you have any questions about your portfolios, please feel free to reach out to one of our team members. We are always happy to help.

Note: *If any of our clients wish to be added to the Anchor research and news mailing list, kindly let us know and we will gladly add you.*

*If you know of anybody who would like their financial affairs looked at, please do not hesitate to send them our contact details and we will ensure we get back to them with a proposal plan. They can contact us at eric@rcinv.co.za or 082 561 3124.

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

Di, Mike & The RCI Team

PS: Please feel free to pass this newsletter on to friends and family who may wish to learn more about investing. To be added to our mailing list, contact eric@rcinv.co.za

Robert Cowen Investments
Growing families' wealth since 1982

IMPORTANT NOTE ON PHISHING & SCAMMERS

Dear Clients,

As we hurtle into Spring and enjoy the first hint of colour on the jacaranda trees, we have a few interesting facts that we would like to share with you from our "Family Office Corner".

The SCAMMERS are very active at the moment. PLEASE TAKE CARE. The following points are worth noting:

- Scams are frequent, and coming in many forms now – SMS / phone calls / Emails
- The SMS may, for instance, notify you of a parcel to be delivered to you with a small amount due for taxes or delivery / an unpaid account with a link into a payment site / an unpaid debit order from a legitimate company like Netflix or DSTV. Contact the company directly. Double check please.
- The phone call may claim to be from your own bank, supposedly the Fraud Department suggesting they have picked up fraudulent activity on your account. Do not fall for this. Phone the Fraud Department yourself.
- The email may contain a link requesting personal information. Do not use any link in the email. Type the address into your browser. If it looks suspicious it probably is!
- **NEVER disclose your Account Details, PIN number, USER Name or Password over the phone or on an email. Contact your Personal Banker or the Fraud Department of your Bank immediately.**
- Do NOT assume that someone is legitimate without checking. Unfortunately, we have had a couple of clients fall foul of a couple of these scams recently, where hundreds of thousands have been siphoned out of bank accounts! It can become an expensive error. Please be alert. The fraudsters will go to endless lengths to persuade you that they are legitimate. Make a phone call FIRST to someone you trust.
- Remember we are always here to help you!!
- **Please share this with all your family members.**

IMPORTANT NOTICE ON THE STATUS OF OUR LOCAL UNIT TRUST

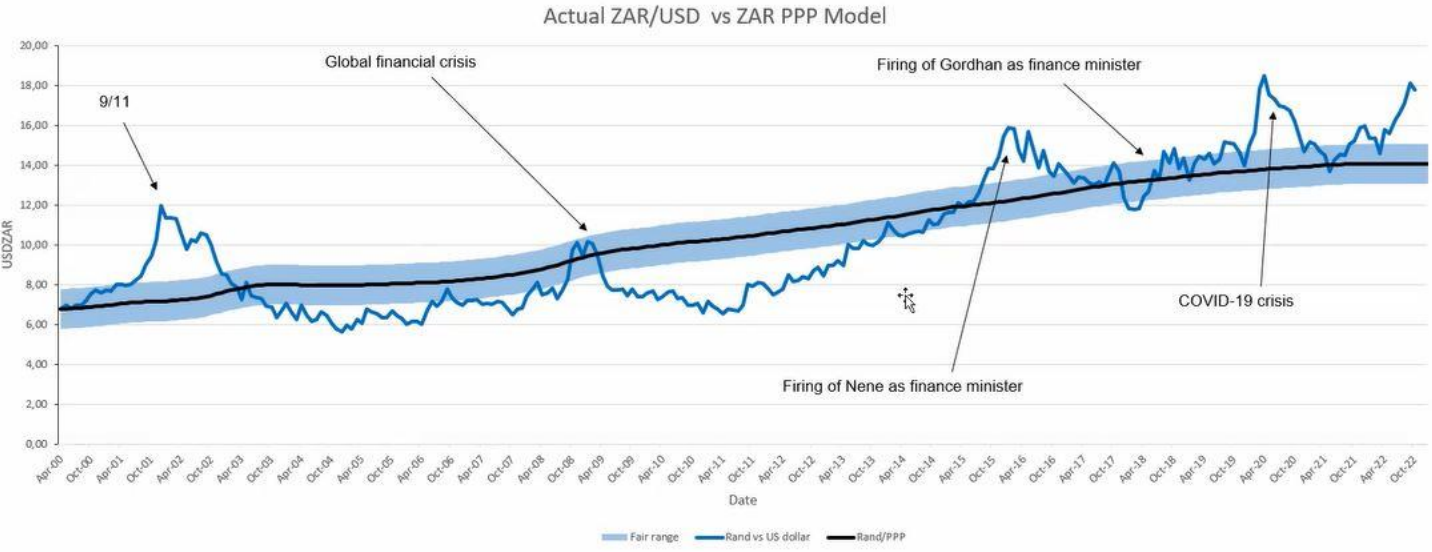
RCI BCI FLEXIBLE FUND MERGED WITH ANCHOR SA BCI EQUITY FUND

For those that have been invested in the RCI BCI Flexible Fund, it is with nostalgia that we note that, effective 30 September 2022, this fund has come to an end. The RCI BCI Flexible Fund was established in November 2003 and, after almost 20 years, it is with rather heavy hearts that we say goodbye to the fund. The fund has been merged with the Anchor SA BCI Equity Fund, and going forward you will see this reflected on your statement. The main reasons for merging the funds were firstly, both funds followed a very similar investment approach, were invested exclusively in JSE listed equities, and were both managed by Mike Gresty, our CIO. Secondly, from a scale perspective, the merged fund is materially bigger than what the RCI BCI Flexible Fund was, and so investors will benefit from a reduced effective cost. We have full confidence that with Mike still running the Anchor BCI SA Equity Fund investors will have a virtually identical outcome, and we as RCI remain close to the investment and management of the fund.

USD/ZAR EXCHANGE RATE, BOND INVESTING & LOADSHEDDING

USD/ZAR exchange rate

As of the time of writing, the exchange rate is at R18.22 to the US dollar. As South African investors, the importance of international diversification of our assets to protect us from sudden unexpected adverse events locally has been a key part of our wealth preservation strategy. We are all aware of the most severe issues facing South Africa, but by virtue of being an emerging market, our currency is often a victim of events that are unfolding in financial markets internationally, even though, unfair as it may seem, the direct impact on SA might be limited. Over the last few months, US Fed policy, the UK's economic woes, Europe's dire situation and China's rapidly slowing growth have meant that capital has sought after a home that is the most secure, i.e. the US dollar. This flight to safety, provides another example why we generally believe it best to have a sufficient portion of your portfolio in US dollar-denominated assets, or in companies that generate an adequate amount of their earnings in US dollars. This is not to suggest that events in South Africa have not played any part in the rand's recent moves – there is little doubt that persistent load shedding and, very recently, the strike by Transnet workers, have also done their part to lean on the rand. Times like these again highlight the importance of international diversification and why we need to capitalize on those periods when all appears well in the world and the rand is relatively strong to diversify.

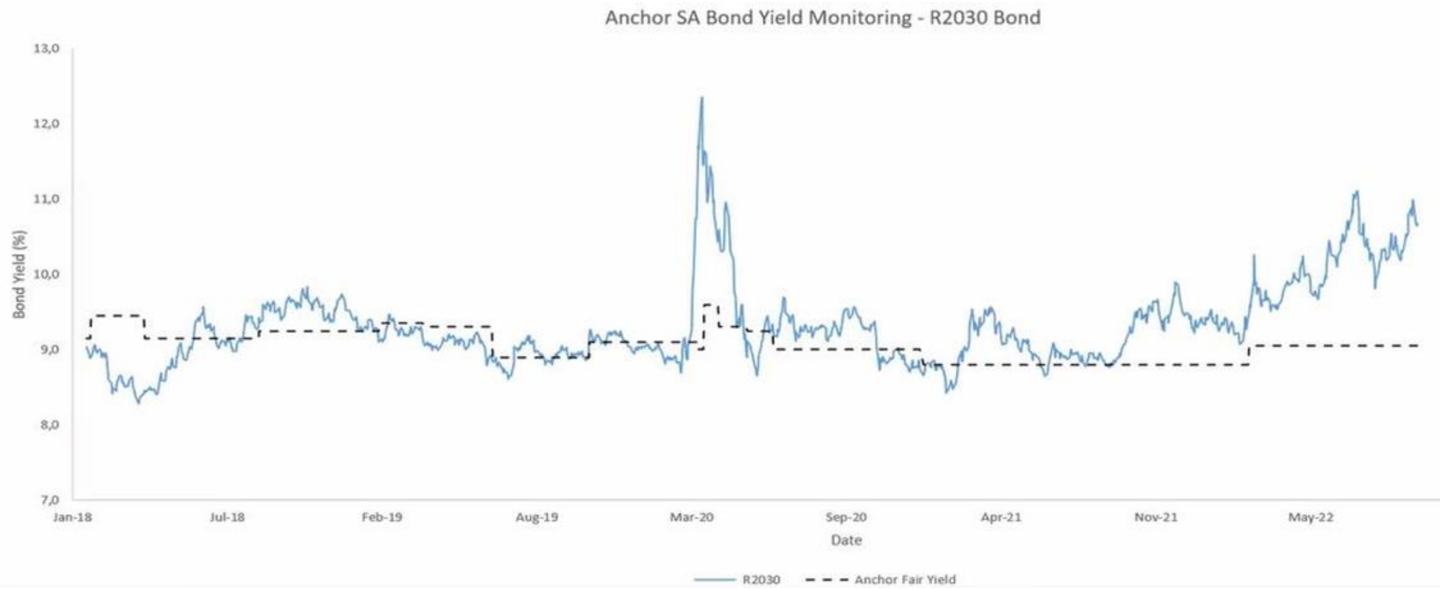


The above graph shows Anchor's model of the fair value of the ZAR/USD exchange rate according to purchasing power parity (PPP). Looking back through time, it is clear that the rand has acted as a barometer for risk, either domestically or globally and has tended to weaken well outside of its fair value band during times of stress. For now, we are living through one of these high risk periods and the chart suggests this is probably not an ideal time to be taking money offshore. The good news is history also shows this too will pass!

Bond investing

After more than a decade of artificially low interest rates in developed economies, the phrase "TINA", or There Is No Alternative, became synonymous with building a portfolio. In simple terms, there is no alternative to investing in equities because the potential return one could earn from other investment options was almost non-existent. However, the recent significant rise in interest rates has meant that bonds are starting to again appear as a real alternative to equities in one's portfolio. A very important factor to consider when you own bonds is that an increase in interest rates is a significant headwind to your fixed income return. For example, if an investor purchased a 2-year bond paying 2.5% per year and interest rates for 2-year bonds jumped to 5%, the investor is locked in at 2.5%. For better or worse, investors holding fixed-income products receive their fixed rate regardless of where interest rates move in the market. With this in mind, the best time to be a buyer of bonds is at the top of the interest rate hiking cycle. Once rates start to decrease, your fixed income return is locked in at a higher rate and the return on the principal will be positive if you wish to sell out of the bond position.

USD/ZAR EXCHANGE RATE, BOND INVESTING & LOADSHEDDING (CONTINUED)



The above graph shows what Anchor believes the fair yield should be for the 10-year government bond (the black dotted line - around 9%) versus the yield currently offered (around 11.3%). We surmise that we are starting to near the end of the interest rate hiking cycle. In which case, bonds, particularly the higher yielding SA government bonds, start to look very attractive.

Loadshedding

Here we switch tune to the loadshedding crisis in South Africa and highlight some facts/stats of the ugly reality:

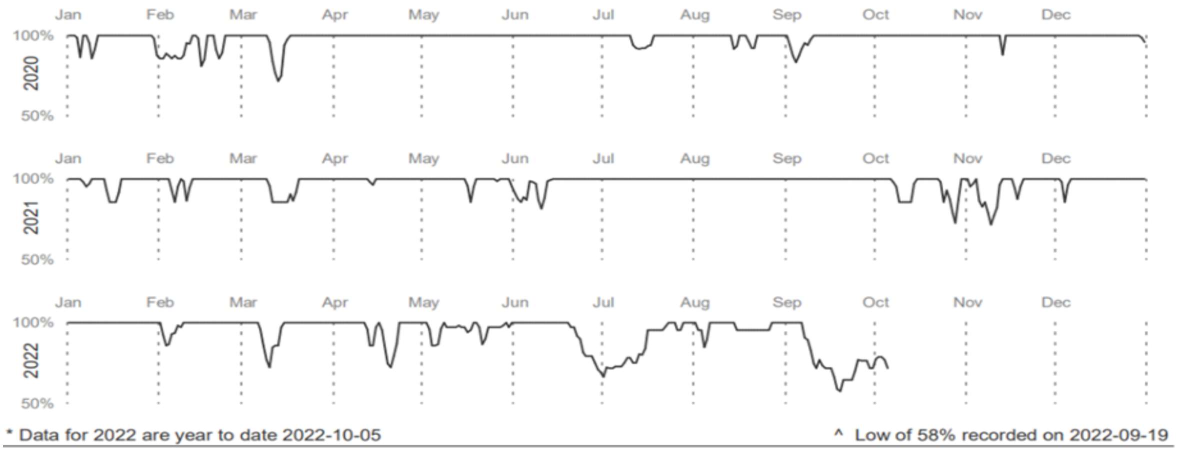
- 6 October 2022 marked the first time in history that rolling blackouts continued for 30 consecutive days.
- The phone app, EskomSePush had its biggest day ever, of 2.5 million unique users on 17 September 2022.
- As of 5 October 2022, SA has experienced loadshedding on 129 calendar days.
- This, however, does not reflect the total number of hours that South Africans have experienced loadshedding. The intensity (stages) have been far higher this year than in previous years. As such, the average household has experienced 459 hours of loadshedding, more than the last 8 years combined.
- In the first 6 months of the year, Eskom had cut 90% of the electricity it had cut during the whole of 2021.

Chart 1: Number of calendar days on which rolling blackouts occurred

Chart 2: Number of hours the average consumer was disconnected from the grid

The graph on the following page shows the percentage of hours that South African households have had electricity over the last 3 years. Clearly, 2022 has been devastating, and on the domestic front, and we think has been among the most significant SA-specific influences behind USD/ZAR weakness.

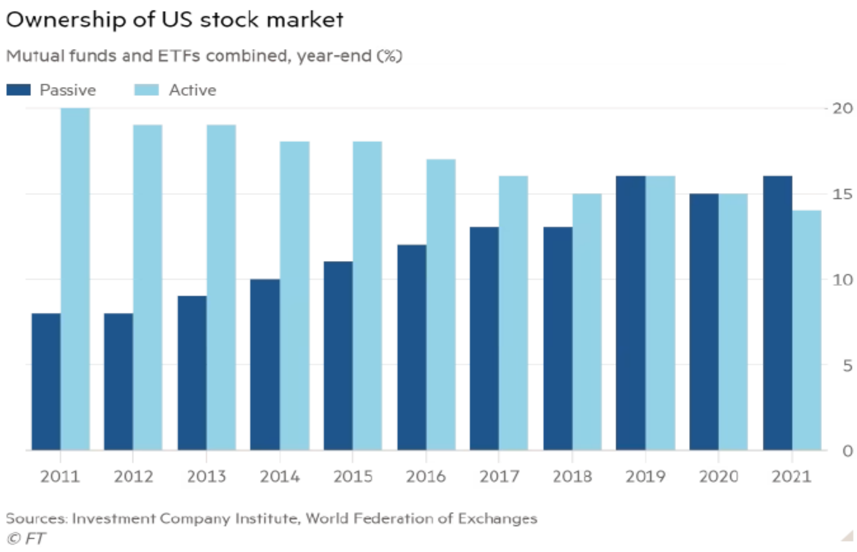
USD/ZAR EXCHANGE RATE, BOND INVESTING & LOADSHEDDING (CONTINUED)



Some of the economic costs due to prolonged loadshedding that are not fully quantifiable include:

- **Hundreds of thousands of jobs** that have been lost due to load-shedding and the jobs that could have been created in its absence.
- The **export of capital** that has been used to supplement the impacts of load-shedding.
- The **loss of confidence** in the democratic government by its citizens.
- The **loss of industry talent and skilled labour** to mass emigration.

HOW WILL PASSIVE INVESTING FARE DURING TURBULENT MARKETS?



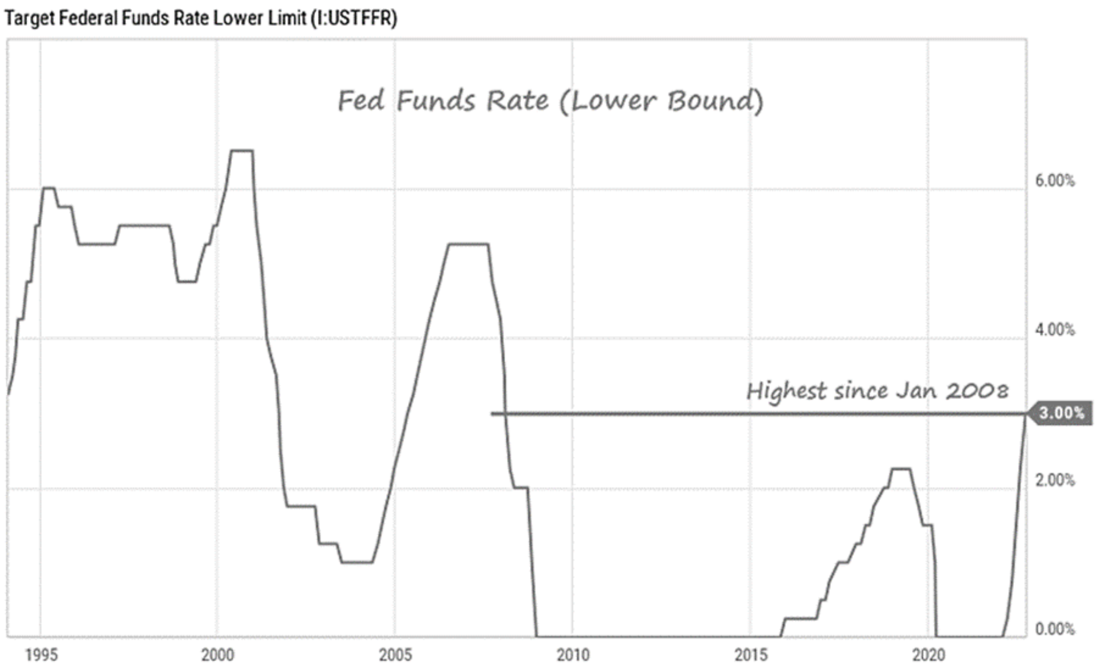
Active managers have historically had a tough time beating their benchmarks. This has led to the rise of passive investing through ETFs and mutual funds since the 2008 crisis. Yet, this year may prove to be an exception with nearly half of large-cap managers outperforming their indexes. We watch with interest to see if the current market environment leads to a reversal of the massive migration to passive investing. Yahoo Finance daily newsletter makes a very interesting point regarding stock picking vs passive investing during challenging times such that we currently find ourselves in. "Avoid both overvalued stocks and those of slow-growth companies". It may also pay to own dividend yielding stocks and to diversify. And it's worth noting that if we do have a repeat of 1966-1982 (US equity indices were flat for 16 years), stock picking becomes more important versus passive investing and index funds."

This point is particularly relevant in South Africa where there is a general lack of top-down conviction. By the same token, in a rising interest rate environment, share fundamentals become more important and the market differentiates between stocks more than in an environment of low interest rates. In this current dynamic, more value is placed on active managers who can differentiate themselves from the benchmark. For RCI, we are focusing on ensuring that we use the broad-based decline in share prices to upgrade our portfolios, buy adding shares we have liked fundamentally but had to wait patiently for the valuation to become attractive.

WHAT HAVE WE BEEN DOING IN THE OFFSHORE FUNDS?

RCI BCI WORLDWIDE FLEXIBLE FUND – Macro factors continue to whipsaw equities

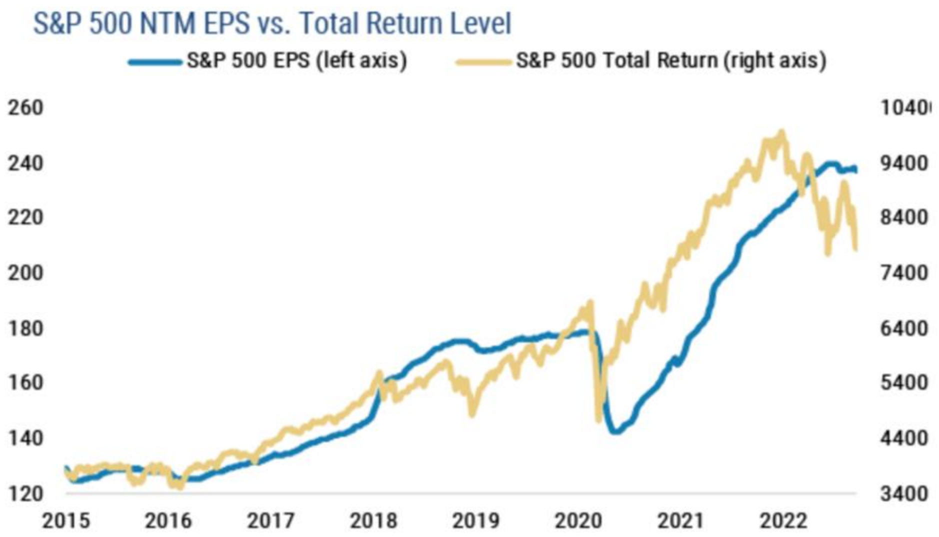
The Fed's narrative of bringing inflation under control at any cost has caused major selling in September as the market is now convinced it will lead to a hard landing in 2023/2024 and a subsequent recession. We are now at a federal funds rate of 3%, which is the highest level since 2008, with expectations that it will rise to over 4.5% in the coming year. From there, the market expects the Fed will need to cut rates as the economy will likely be suffering at the time.



Rates are reaching levels not seen since the Global Financial Crisis (GFC)

The market has been whipsawed up and down over the last several months as it moves from euphoria to depression depending on the changing narrative. As at the end of September the market fell back into bear market territory, over 27% down from the all-time-high. There is a bit of a chicken and egg situation with news headlines and poor market conditions. The more the market falls, the more bad news is in the headlines and history has shown it is always the best time to invest when the world feels the most uncertain.

Earnings expectations for 2023 is another issue that is causing market distress. The blue line in the following chart is the analyst consensus earnings per share (EPS) expectation for the S&P 500 over the next 12 months. The market is concerned that it hasn't turned down enough considering the potential expected economic hardships for 2023/2024.

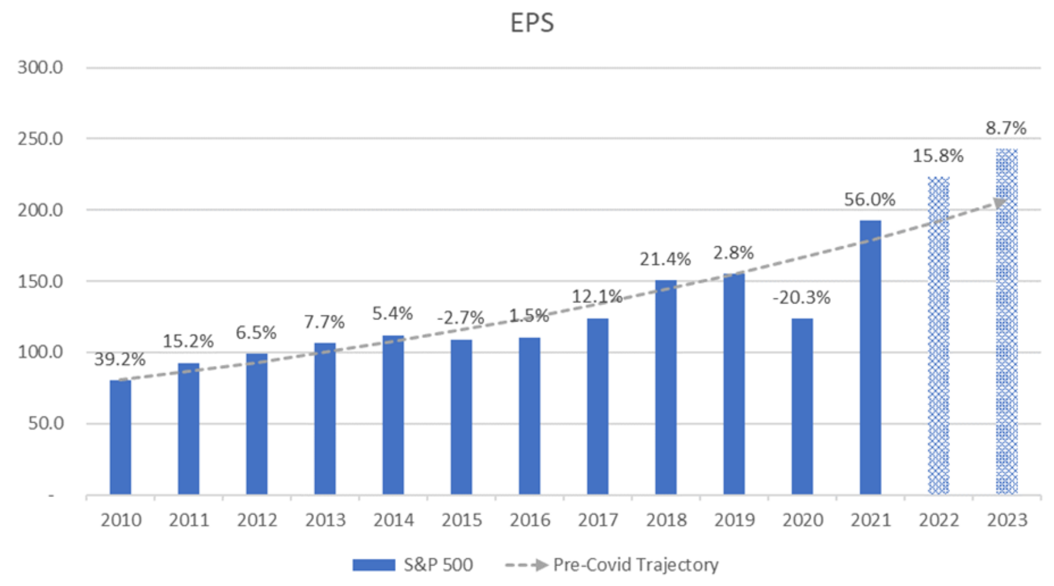


Expected EPS For the next twelve months in blue. S&P 500 price in yellow.

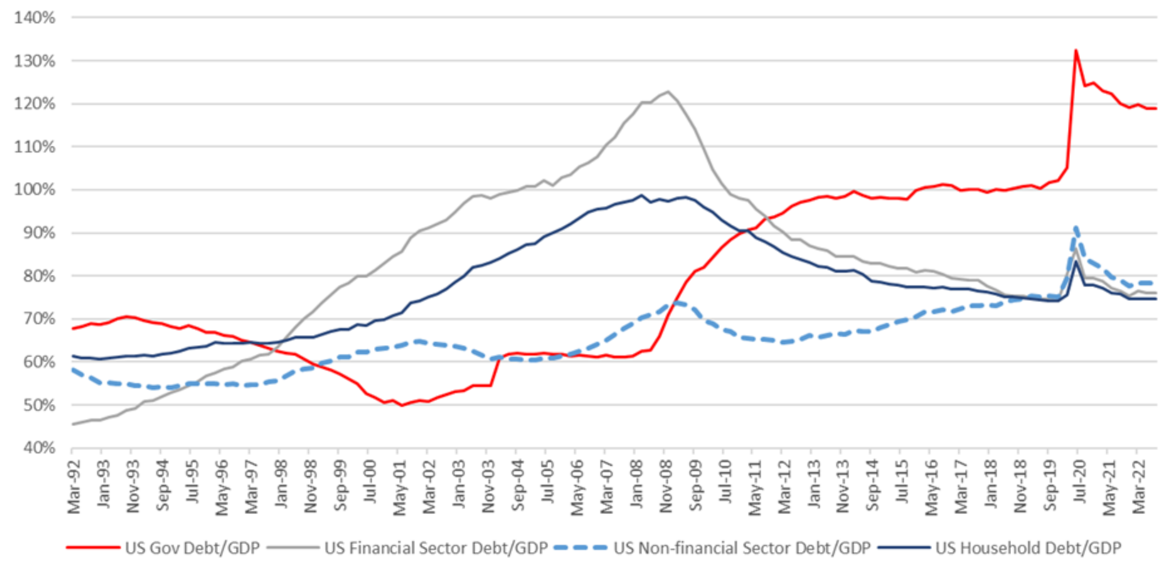
WHAT HAVE WE BEEN DOING IN THE OFFSHORE FUNDS?

BY THE RCI INVESTMENT TEAM (CONTINUED)

It does look like American companies over-earned the last 2 years and need a cool off period to come back to the long-term trajectory:



But one must not be too pessimistic as the average American household is in a far greater position than they were prior to the GFC. This is highlighted by the US household debt/GDP which is shown by the solid dark blue line below.



Various debt levels relative to GDP

US Corporates are more indebted than during the GFC as a function of taking on cheap debt to buy back shares. As the cost of debt increases companies will no longer be buying back shares at the same rate as the past, which will lead to EPS growth rate going forward. When we pick companies for our portfolio, we are very conscious of debt levels and the extent that buybacks were an influence on EPS in the past.

The real concern is the debt levels of the US Government, which expanded significantly following the Covid stimulus packages. These levels will need to be brought under control over the next couple of decades as there has to be a repercussion for printing all that money.

When we look at our watchlist of high-quality shares, the average pullback is about 37% down versus the S&P 500 which is down about 25%. We believe our universe of shares has already taken most of its pain and are currently trading at attractive valuations. Of course, prices can always get cheaper in the short term but high-quality companies like Alphabet, Amazon and Microsoft have already fallen over 35%, pricing in quite a lot of bad news next year.

So, if we look past next year and the expected slowdown period and try and ignore the current noise in the headlines, we can deduce that this is an opportunity to add to our positions in these high-quality businesses.

Portfolio Strategy

The focus of the portfolio continues to be direct investment in high quality offshore equities that are world leaders in their industries, with emphasis on businesses with high Return on Capital Employed combined with excellent free cash flow generation. We tend to ignore whether or not a company pays a dividend but usually prefer those businesses that reinvest earnings in their internal operations. We also tend not to chase short-term investment narratives and themes that could be trending in the market, as we would not want to reduce the quality of the portfolio for the sake of following the flavour of the month.

	PE in one years time	PEG Ratio ('22 PE/'22-24 Growth)	EPS Growth		
			2021-2022E Growth	2022-2023E Growth	2023-2024E Growth
AMAZON.COM INC	39.74	0.42	-56%	134%	61%
BOSTON SCIENTIFIC	20.25	1.61	8%	11%	14%
DISNEY	18.26	0.61	62%	39%	21%
GLENCORE	4.76	-0.18	119%	-32%	-20%
ALPHABET INC-CL C	15.44	0.97	10%	17%	15%
KWEB CHINA INTERNET ETF					
MICROSOFT CORP	21.89	1.82	19%	7%	17%
NETFLIX	21.28	1.75	-6%	7%	18%
PAY PAL	18.84	0.94	-14%	21%	19%
VISA	21.04	1.37	26%	14%	17%
Median PE	**20.25**				
PEG Ratio (Forward PE/'22-24 Growth in EPS)		**0.97**			
Annual EPS Growth Rate (Median)			**10%**	**14%**	**17%**

Note: KWEB China ETF earnings growth figures have been excluded from the above as it is not a share but rather an ETF where the data is not available.

Our top 10 positions are expected to grow earnings per share by about 14-17% per year for the next two years. Our companies are trading at higher valuations (20x earnings versus the S&P 500's 15x) but they deserve to do so as they are higher quality and are growing earnings at a higher rate than the market as a whole.

Main changes during the month

- **There were no outright sales or purchases during September.**

Performance

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2017	-	-	-	-	5.1%	-1.6%	1.5%	-1.8%	3.2%	5.8%	-2.9%	-6.8%	**1.9%**
2018	1.4%	-3.2%	-3.6%	6.8%	1.4%	10.8%	-2.1%	14.1%	-4.1%	-7.3%	-3.8%	-2.8%	**5.6%**
2019	-0.7%	7.1%	4.3%	4.0%	-2.9%	0.5%	2.6%	3.3%	-0.3%	2.5%	-0.3%	-1.1%	**20.3%**
2020	7.3%	-1.5%	5.6%	10.2%	-1.9%	1.7%	3.5%	6.0%	-4.7%	-2.8%	0.4%	-3.0%	**21.5%**
2021	5.4%	1.0%	-1.9%	2.7%	-4.5%	7.9%	1.8%	0.7%	-1.2%	4.2%	0.8%	-1.2%	**16.3%**
2022	-12.4%	-2.5%	-6.0%	-2.4%	-5.9%	-4.3%	8.2%	0.0%	-4.7%				**-27.1%**

The fund was down 4.7% in ZAR terms (-9.7% in USD) for the month. The ZAR weakened 5.3% against the USD for the month which added to the ZAR performance.

For the 2022 year thus far, the fund is down 27% in Rands or 35% in USD terms, with the rand having weakened 11% against the dollar. The MSCI Developed Markets Index has fallen 26% in USD for the same period.

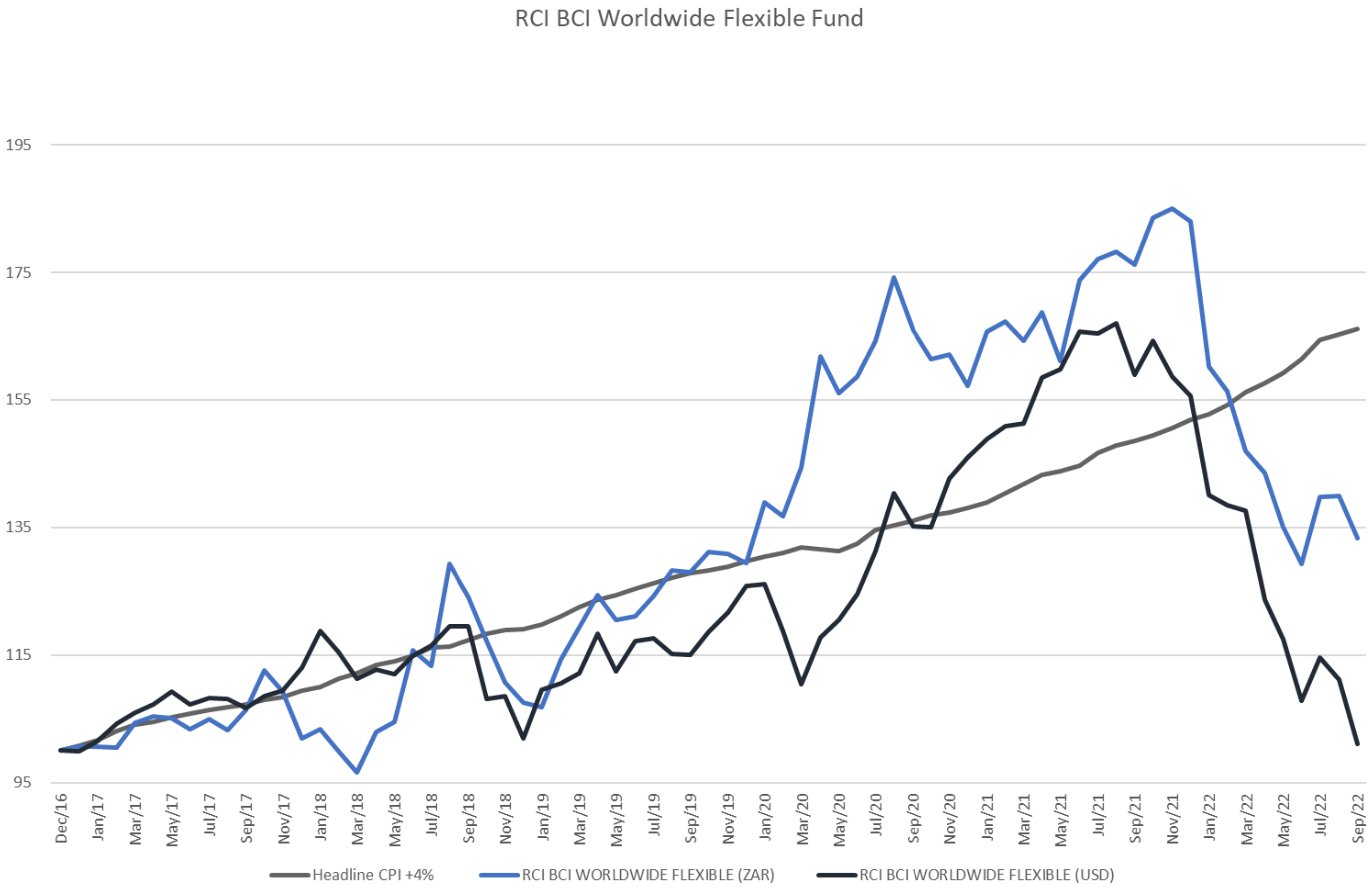
For the 2021 year, the fund closed up 16.3% in Rands or 7% in USD terms, with the rand having weakened 8.1% against the dollar. The MSCI Developed Markets Index has risen 20% in USD for the year.

RCI OFFSHORE UNIT TRUSTS

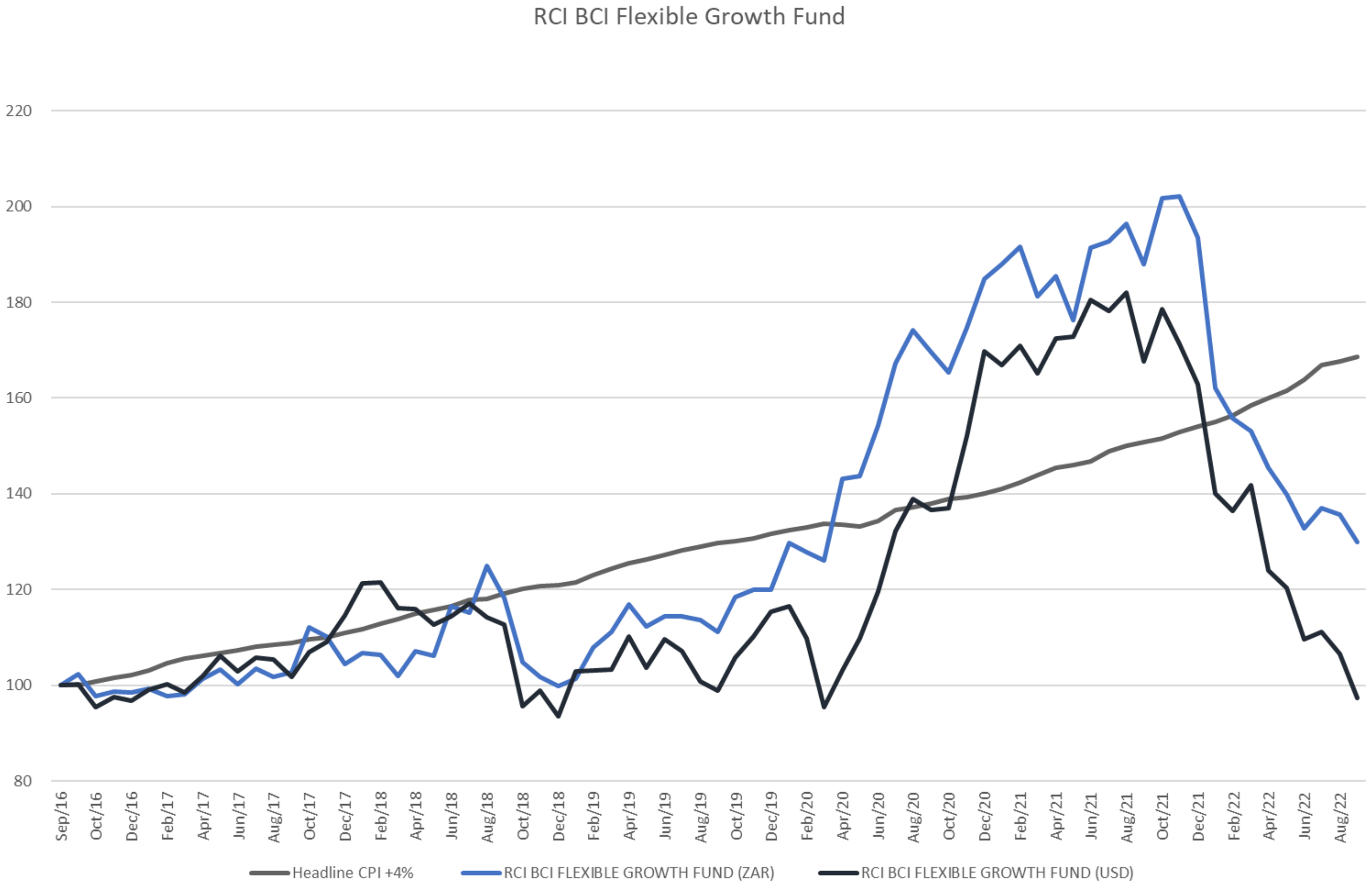
"In the short run, the market is a voting machine, but in the long run it is a weighing machine." – Benjamin Graham

The Family Office

RCI BCI Worldwide Flexible Fund closed August at 133.39c, down 4.67% for the month and down 24.28% for the last 12 months.



RCI BCI Growth Fund closed August at 129.88c, down 4.27% for the month and down 30.89% for the last 12 months.



Robert Cowen Investments
Growing families' wealth since 1982

WHAT HAVE WE BEEN DOING IN THE LOCAL FUND?

RCI BCI FLEXIBLE FUND – Hawkish Fed, UK fiscal policy & China's zero-covid policy induce another challenging month

The Family Office

BY THE RCI INVESTMENT TEAM

Having got off to a fairly resilient start to September, global equities were then derailed by a succession of negative macro developments. September ended up seeing global markets suffer their worst month in what has already been a painful year (MSCI World -9.3% MoM). The initial leg lower followed a worse-than-expected US inflation print, which torpedoed any remaining hopes of an imminent dovish pivot from the Fed. Although the subsequent 75bp rate hike by the Fed was in line with market expectations, the message from Fed members that accompanied this rate announcement was even more hawkish than expected, giving the impression the Fed would accept a hard landing if necessary to bring inflation back under control. Already fragile sentiment was then dealt a further blow as markets reacted to the new UK chancellor's proposed unfunded spending plans contained in his mini-budget. The Economist suggested that, when this mini-budget is compared with an infamously unpopular Conservative government budget from a decade ago, dubbed at the time an "omnishambles", it made the omnishambles budget look like a triumph for the ages. EM equites provided no sanctuary for investors either, faring even worse (MSCI EM -12% MoM), with Chinese equites the epicentre of this pain – a consistent theme this year. Brazil was the other side of the EM performance coin, being the only major exchange in positive territory for September (+0.5% MoM).

Although SA equities did not avoid the carnage offshore in September, the silver lining of sorts is that, in relative terms at least, they outperformed global peers (FTSE/JSE Capped SWIX -3.8% MoM). Mining shares generally provided the support, being the only cohort to grind out a positive return (+2% MoM). JSE companies with UK exposure came under significant pressure post the mini-budget discussed above. This countered the natural tailwind one would have expected from rand depreciation (rand fell 5.3% against the USD in September). Shares geared towards the domestic economy were a sea of red in September, in sympathy with global risk sentiment, but persistent loadshedding did not help the outlook for SA's economic activity. While rand weakness and the ongoing share buyback may have been responsible for relative outperformance of Naspers (-6.7% MoM) and Prosus (-11.8% MoM) relative to Tencent (-18.5% MoM), these market heavyweights continue to weigh on the domestic performance in September.

The focus of the portfolio is on investing in domestically listed companies that have an investment case that insulates them from SA's difficult economic situation (strong multinational franchise, rand hedge, dominant local platform, or clear local expansion strategy for example); high confidence in improving Return on Capital Employed and excellent cash flow generation. Of those companies that pay a dividend we prefer businesses with a dependable and solid payment history.

At the end of September, the top 15 holdings in the fund, making up 62% of the equity exposure, were as follows:

- Prosus
- Naspers
- Bidcorp
- Afrimat
- Advtech
- Glencore
- Absa
- Investec
- MTN
- Transaction Capital
- AECI
- Coronation
- MAS Real Estate
- Anglo American
- Bidvest

WHAT HAVE WE BEEN DOING IN THE LOCAL FUND?

BY THE RCI INVESTMENT TEAM

Main changes in the month

In September, we took profits on a large portion of the **Grindrod Shipping** position, judging that limited further upside to the offer price meant risks were more skewed to the downside, should the buyout not proceed. We also took some profits on **Thungela**. We started a position in **Capitec**, judging the vicious sell-off in response to slightly underwhelming interim results to be excessive. We started a position in **Stadio** – a potential multi-year compounder. We also acquired a position in **Telkom** in anticipation of a potential offer from MTN in the short-term.

Performance

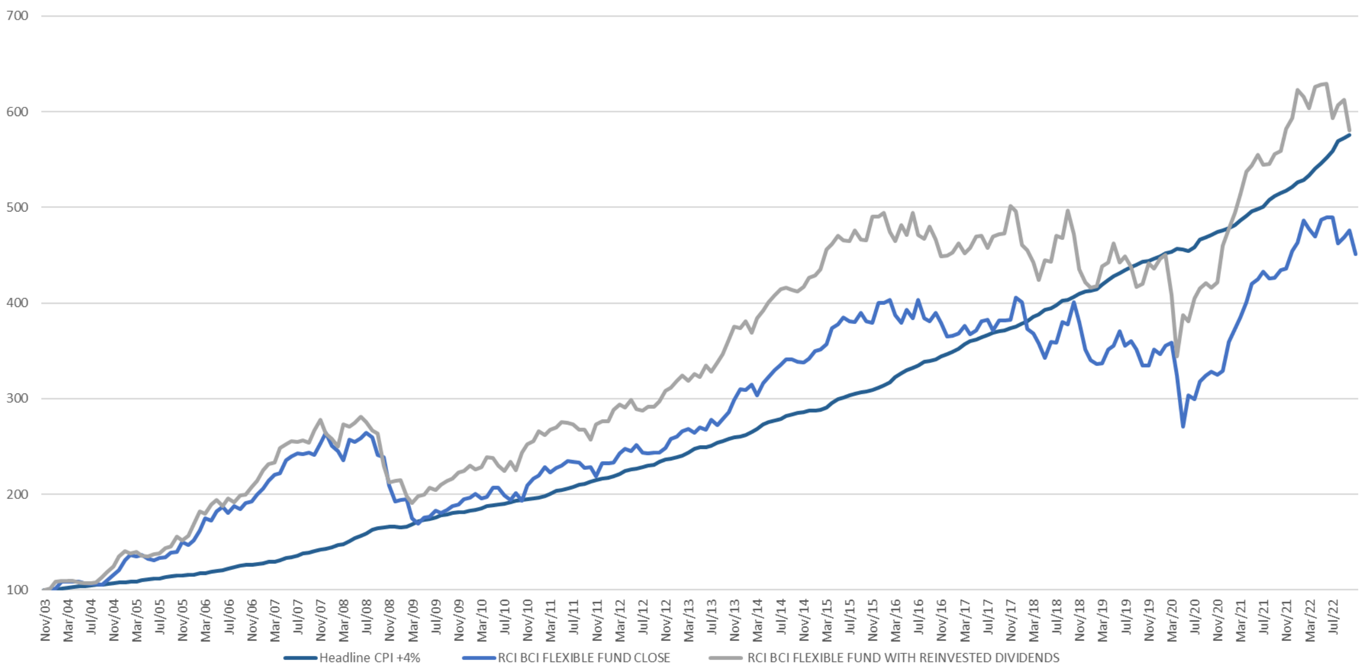
The RCI BCI Flexible Fund had a difficult month, declining by 5.2%. The fund's rand hedge positions with exposure to the UK came under considerable pressure, although we think the defensive nature of their activities suggest this was an overreaction by investors.

The RCI Flexible Fund investment team

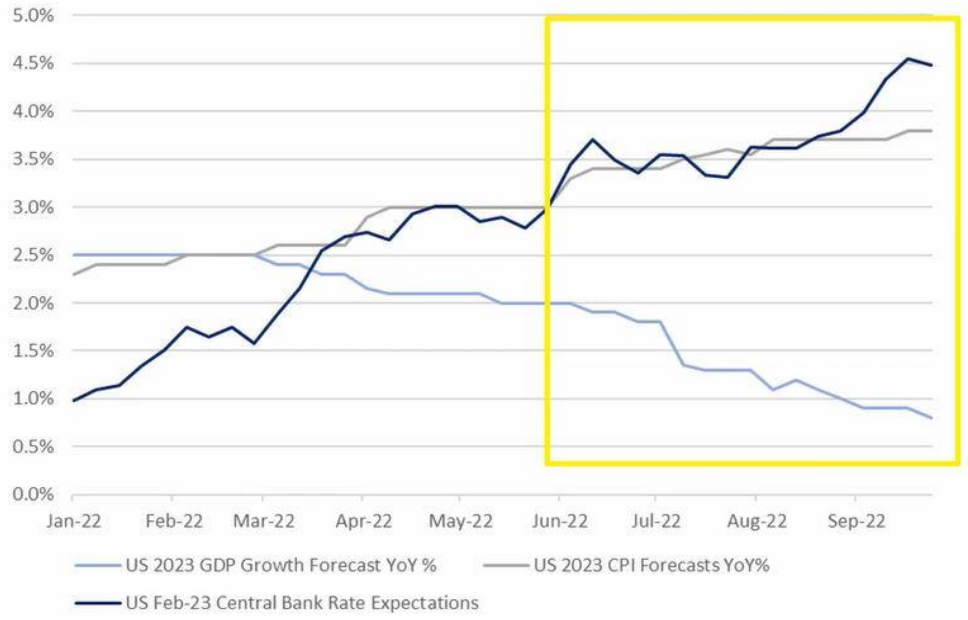
- **Mike Gresty**
- **Di Haiden**
- **Eric Lappeman**
- **Andrew Lawson**
- **Ross McConnochie**
- **Gontse Dikeledi**
- **Keiran Witthuhn**

RCI BCI Flexible Fund closed August at 450.92c, down 5.17% for the month and up 3.35% for the last 12 months. The fund is ranked 7th out of 60 funds in its category over the last 3 years.

RCI BCI Flexible Fund

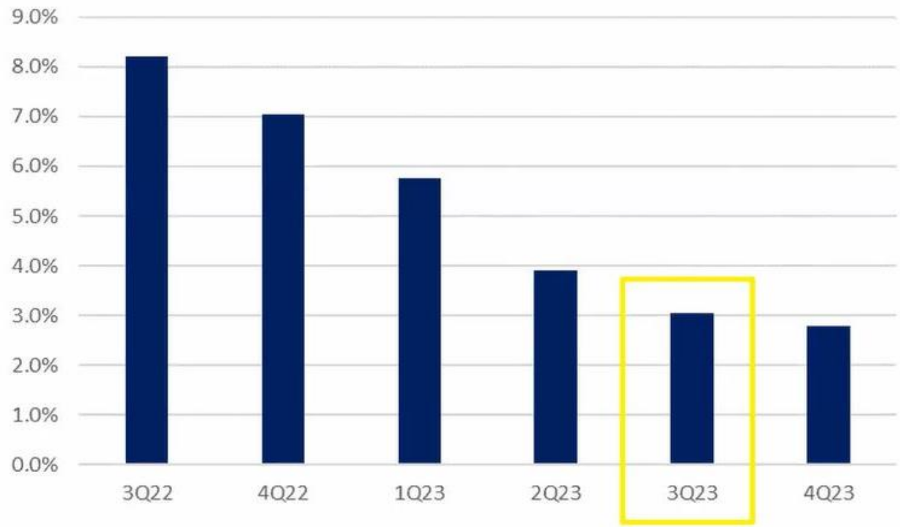


Collective Investment Schemes in Securities (Unit trusts) are generally medium to long term investments. The value of participatory interests (units) may go down as well as up, and past performance is not necessarily a guide to the future. Unit trusts are traded at ruling prices and can engage in borrowing 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 upon request.



2022 evolution of US GDP growth, inflation and interest rate forecasts for 2023 (year average)

Economists have spent most of 2022 recalibrating their expectations for higher inflation, less growth and higher central bank rates. In January 2022, expectations for average US growth throughout 2023, was 2.5%. Now that number has fallen to less than 1% currently. 2023 average inflation forecasts in January were 2.3%, now that estimate sits at 3.8% currently. Finally, expectations for what the federal funds rate will be at the end of February 2023 have increased from 1% in January, to 4.5% currently. This year has specifically shown that in an environment of rising rates (and weak economic prospects), investors experience plenty of pain, regardless of whether you are positioned in equities or fixed income. The dark blue line in the graph above shows that since the middle of August, the market has increased its short-term expectations for rates significantly. This precipitated the painful third leg of 2022's sell-off in risk assets. It is tough to know how close we are to the point of peak pessimism, but what we do know is that a lot of negativity has been priced into the assets we invest in.



US quarterly inflation forecasts

We believe that the inflation data out of the US will be the primary driver of returns over at least the next 6 months. As shown above, US inflation is likely to be more under control by this time next year, with the current forecasts looking for inflation at around 3%. This is largely a consequence of this year's US hiking cycle, which has seen the Federal Reserve hiking interest rates at its fastest rate in 35 years. The Fed has hiked 2.36% in just 6 months.

All of this has played its part in the US dollar being at its strongest level since May 2002. It also briefly touched on its strongest levels ever against the pound. The dramatic impact of currencies on returns this year is best shown from the perspective of a US dollar investor who has been invested in British sterling bonds. Year-to-date (end of September) he/she would have lost 46%.