ROBERT COWEN INVESTMENTS

SEPTEMBER 2023 NEWSLETTER

20 September 2023

HIGHLIGHTS OF THIS NEWSLETTER ARE:

- Tax efficiency in investing - *by Sandy van der Zanden*
- Update on what we have been doing in the offshore funds – *by Ross McConnochie*
- Update on what we have been doing in the local fund – *by Mike Gresty*
- Seasonality in the US equity markets
- Intriguing developments
  - Electric vehicle sales struggling to gain momentum in South Africa
  - Mexico becomes the USA's biggest trading partner – and the associated benefits
  - Rising oil prices set to ignite a resurgence in inflation
  - Nvidia is not the only company struggling to keep up with demand for its products

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Important notice for clients with Nedbank Corporate Saver bank account at RCI

Very important notice for all clients who hold a Nedbank Corporate Saver bank account at RCI. The branch code for all Nedbank Corporate Saver accounts will change with immediate effect **from 720026 to 198765** (universal code) for all deposits and debit orders. Should the universal branch code not be used going forward, these transactions will be unsuccessful.

2023 income tax return filing dates

Please take note of the dates below for filing the 2023 income tax returns - these dates distinguish between non-provisional taxpayers and provisional taxpayers.

Income tax return filing dates

Here are the dates and criteria for the 2023 Filing Season:

- Individual taxpayers (non-provisional): **7 July 2023 @ 20:00 to 23 October 2023**
- Provisional taxpayers: **7 July 2023 @ 20:00 to 24 January 2024**

"You only have to get things right a few times. 12 investment decisions in my career have made all the difference." Warren Buffett

"Successful contrarian investing requires us to live with discomfort, for being wrong and alone. But bargains do not exist in the absence of fear." – Rob Arnott

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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 keiran@rcinv.co.za or 011 591 0666

*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.

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.

We aim to be the best family office in South Africa.

Thank you for being our clients.

Di, Mike & The RCI Team

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TAX EFFICIENCY IN INVESTING

BY SANDY VAN DER ZANDEN
(WEALTH MANAGEMENT, ANCHOR CAPITAL)

Does tax matter?

In South Africa (SA), tax rates have increased for several years. Personal tax rates have increased, and even structures such as trusts and companies are now heavily taxed.

Figure 1: SA effective tax rates

Company dividends	41.6%
Trusts	45.0%
Individuals (maximum)	45.0%

Source: Anchor, SARS

Companies, trusts and individuals pay almost half of all declared income to tax. An individual at the maximum income bracket pays ZAc45 in tax for every rand earned. Now, more than ever, tax efficiency makes a material difference to your overall investment return. In fact, any tax saving is equivalent to an increased investment return. So, just how much difference can tax efficiency make?

As an example, we will run two simple R1mn cash portfolios side-by-side. The one portfolio is invested in an individual's hands, in a simple interest-bearing bank account or money market fund. The second portfolio is also invested in a money market fund but with one crucial difference – it is housed within a retirement annuity (RA). Assume a 30% average tax rate for the individual with the interest exemption already fully utilised. The growth inside the RA is tax-free. Let us assume a return of 6% p.a. on the investment. So, what is the difference?

In the individual's hands, the 6% p.a. return is reduced by tax to become only a 4.2% after-tax return. The RA earns the full 6%. After one year, the tax saving equals an enhanced return of R18,182 inside the RA. After two years, the saving is R39,690. If you track the two portfolios over five years, the RA outperforms the direct investment by R115,625. That sort of number is nothing to scoff at. It equates to 9.4% more in your pocket at the end of five years.

Figure 2: After-tax returns

Investment term (years)	Direct investment	Retirement annuity	Enhanced return
1	R1,042,818	R1,061,000	R18,182
2	R1,087,469	R1,127,159	R39,690
3	R1,134,032	R1,196,680	R62,648
4	R1,182,589	R1,270,489	R87,900
5	R1,233,225	R1,348,850	R115,625

Source: Anchor, SARS

Are there restrictions on my money?

One of the main concerns around structuring investments is the restrictions on your capital – exit penalties, access to capital, increased costs and inadequate reporting are often noted (quite rightly) as investor concerns.

RAs, in particular, have been the focus of many of these queries. Restrictions on access to capital before age 55 and limits on underlying investment flexibility should be clearly understood when housing investments inside an RA. The proposed two-pot retirement system (effective 1 March 2024) does allow for early withdrawals from retirement funds, including RAs. Still, we note that any withdrawals will be limited, as the aim of the new system is to strike a balance between maximising retirement savings and minimising early withdrawals.

Tell me about the fees

As the adage goes, "nothing is for nothing". Structures have associated fees, and the effects must be assessed against potential tax savings. Structures such as endowments and RAs have been under intense scrutiny by modern investors. New-generation products such as modern endowments have done a lot to address the concerns around fees – with exit penalties removed, capital liquidity created through the issue of multiple policies (not applicable to RAs), and drastically reduced fees. These structures now merit a place in an overall investment portfolio.

What about estate duty?

South African (SA) taxpayers with assets above the R3.5mn exemption are subject to estate duty (death taxes) at a flat rate of 20%. The rate then increases to 25% for any assets above R30mn. It is important to realise that your beneficiaries will only receive their inheritance after your estate has settled its bill with the South African Revenue Service (SARS). Without proper planning, your estate could be handing the tax man up to one-fifth of all your assets. As daunting as this may seem, there are tools available for estate planning purposes.

A simple and zero-cost method of reducing estate duty is to leave assets to your surviving spouse. Any assets left to your spouse are currently exempt from estate duty, and this preserves the R3.5mn tax exemption, which can be used later in your spouse's estate. This means that on death, your spouse will benefit from a full R7mn estate duty exemption (R3.5mn exemption x 2).

Do you have any assets held offshore? Beware of offshore death taxes such as situs tax. This is a tax levied for assets held offshore, such as property and equities. The threshold before this tax applies differs from country to country. For example, the UK allows the first GBP325,000 free of inheritance tax. The balance above this exemption is taxed at a flat rate of 40%. In the US, the first US$60,000 is exempt and the subsequent balance is taxed on a sliding scale up to a maximum of 40%. For those with US assets, the 40% situs tax is applied from assets of about US$1,060,000 This is double SA estate duty.

Again, there are tools available to address this issue. For example, investing within an offshore insurance wrapper has the advantage of not attracting situs tax, even while holding the same underlying taxable assets. That is a 40% boost to your heirs on your death. Beneficiary nominations on these structures will assist further by avoiding the executor's fees (another 4% saving).

Which structure is the right one?

For simple investing, often, a single structure may be appropriate. More complex portfolios may require several structures, including trusts, companies, endowments, RAs, etc.

An important note around any investment structuring is to update your will as required. There may even be a need for two wills – one for local assets and one for offshore assets. Specialist advice should always be sought as required. It is essential for any structures to correctly reference any affected assets and take cognisance of applicable legislation and taxes in the relevant jurisdictions.

Who should I be talking to?

Ideally, your accountant, legal counsel (where applicable) and wealth manager should be aware of any structural changes to your portfolio.

In summary

It is every taxpayer's right to structure their affairs and investments in the most tax-effective manner possible. Tax is never the sole consideration but instead forms part of the overall investment plan. Smart tax planning is just good investment sense and will affect your returns over the long term.

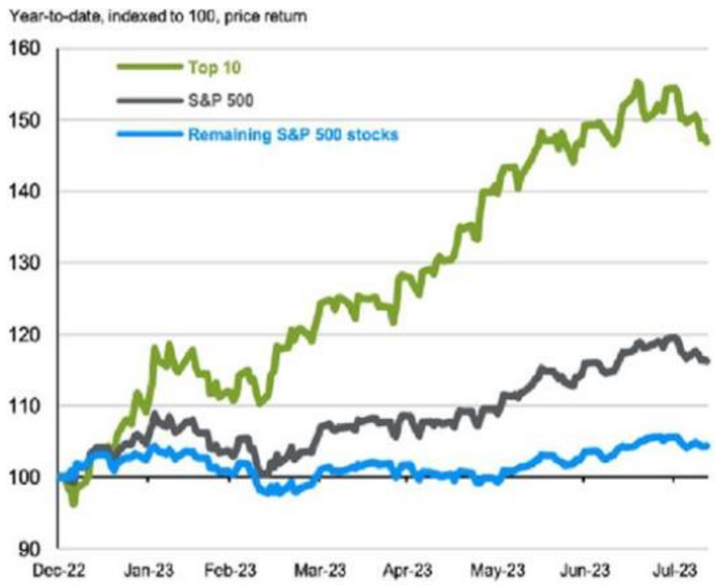
WHAT HAVE WE BEEN DOING IN THE OFFSHORE FUNDS?

RCI BCI WORLDWIDE FLEXIBLE FUND

August began with a major pullback in global markets but significantly recovered towards the end of the month to close a little over 2% down. Developed Markets are still up 16% for the year to date well ahead of what was expected at the beginning of the year due to recession fears. Interest rates remain high in the USA and are expected to increase further as strong economic data and stubborn inflation remains the main concern for the Fed. With it we have seen a strong dollar and rising oil prices.

The S&P 500

We have shown a variant of the below graph in previous commentaries, but this particular graph splits the Year-to-Date performance of the top 10 shares in the S&P500 from the rest of the members. What is clear is that the American market has been hugely driven by these ten megacap businesses which have collectively grown about 50% since the start of the year, leading to overall S&P 500 growth of about 18% for the year to date. This implies that the remaining S&P 500 shares have only grown around 5% for the year to date.



Source: Morgan Stanley

The S&P 500 performance has been significantly influenced by the ten largest companies.

Below we tabulate the valuation of each of the top 10 companies in the S&P 500 by Forward Price Earnings Ratio (FPE) and Forward Price to Sales (FP/S). Only United Health, Exxon and Meta have P/E ratios less than the market. Only Amazon, Berkshire, Exxon and United Health have P/S ratios less than the market. Therefore, there is a lot of optimism around earnings growth for these top 10 shares relative to the rest of the S&P 500 but there are definitely pockets of excellence and mispricing appearing in the rest of the market.

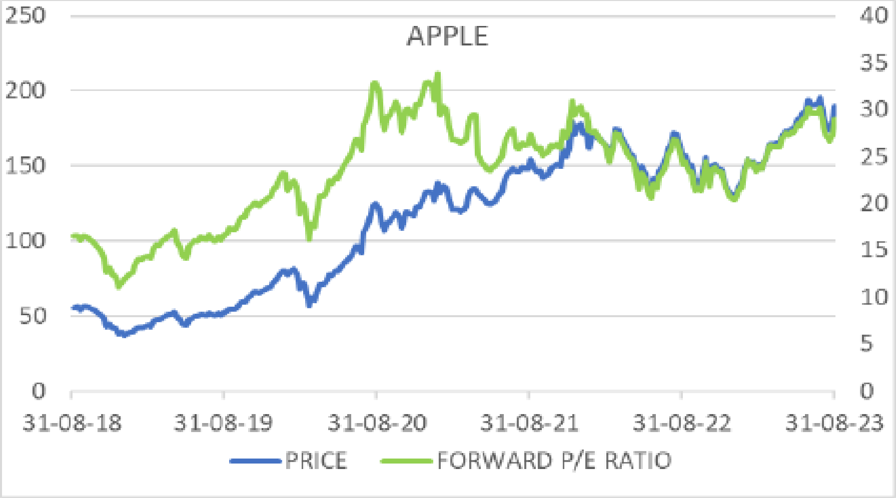
Name	FORWARD PE RATIO	FORWARD PRICE TO SALES
ALPHABET	20.5	6.3
AMAZON	34.0	2.4
APPLE	28.9	7.4
BERKSHIRE	21.5	2.2
EXXON MOBIL	13.7	1.3
META	18.2	5.4
MICROSOFT CORP	29.1	10.4
NVIDIA CORP	34.0	16.7
TESLA INC	56.4	7.0
UNITED HEALTH	17.3	1.2
S&P500	**19.1**	**2.5**
WORLD INDEX	17.1	2.0

Most the top performers this year have been tech shares that have caught the artificial intelligence wave

WHAT HAVE WE BEEN DOING IN THE OFFSHORE FUNDS?

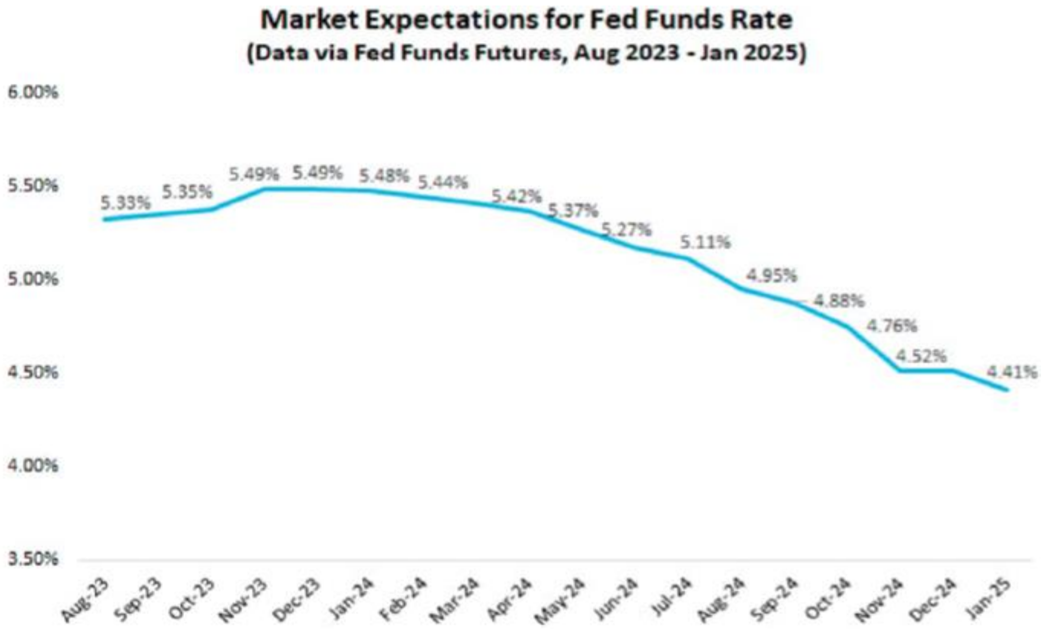
BY THE RCI INVESTMENT TEAM (CONT.)

Apple is the largest US company and represents over 7% of the S&P 500 by market cap and has had a fantastic year thus far. If we examine its valuation relative to history, we can deduce that the valuation is expensive at the moment. The blue line in the following graph is the price graph and the green line is the forward Price/Earnings ratio (FPE). With a P/E of around 30x the shares are trading at their upper range relative to history. This would be justified if the earnings growth was expected to accelerate but it has actually slowed this year following very strong performance during COVID-19 lockdowns when consumers spent stimulus cheques on new tech as they weren't able to purchase experiences and services at the time. High PEs in general are also not justified at the moment as interest rates are high relative to history and thus investments in bonds and money markets have become attractive. Therefore, equities would need to be a lot cheaper than current levels to attract flows away from those investments.



In order for investors to justify investing in Apple at the current valuation they would have to believe that interest rates are going to fall over the coming months, making equities more attractive again. In other words, although bonds and money markets are attractive right now, they will be less so in the coming months as rates fall and hence they would rather stick to a high quality equity investment such as Apple.

The below graph is market's expectation for rates over the coming months:



Source: Charlie Bilello and Creative Planning

The market expects the Fed funds rate to peak very soon and then be cut almost immediately. They believe inflation has come under control and that any economic slowdown would lead to monetary stimulus and thus rate cuts. However, this forecast has been wrong in the last several months as the Fed has continued to hike rates to the surprise of the market. The Fed has made it clear that they are not finished hiking yet and still have an inflation target of 2% to achieve. It is likely that we are somewhere close to peak rates but it's possible that the Fed decides

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to hold them at elevated levels for much longer than expected, which would imply a bad outcome for equities as investors can stay in bonds and money market investments for the time being. We remain invested in equities but are very cognizant of valuations and are thus actively seeking out opportunities in the "S&P:490" and beyond.

Our top 10 positions:

	PE in one years time	PEG Ratio (FWD PE/'23-25 Growth)	EPS Growth 2022-2023E Growth	2023-2024E Growth	2024-2025E Growth
ALPHABET INC-CL C	20.49	1.01	30%	18%	23%
AMAZON.COM INC	34.00	1.18	381%	26%	31%
BOSTON SCIENTIFIC	24.84	2.09	17%	12%	12%
FORTINET	36.42	1.93	27%	16%	22%
INTUIT INC	33.10	2.27	20%	15%	14%
KWEB CHINA INTERNET ETF					
MERCADOLIBRE INC	54.63	1.27	109%	45%	41%
MICROSOFT CORP	29.14	2.02	5%	14%	15%
MONCLER SPA	24.54	2.01	7%	13%	11%
VISA	25.47	1.82	16%	13%	15%
HARMONIC PE	**29.15**				
d PE/'23-25 Growth in EPS)		**1.61**			
Annual EPS Growth Rate (HARMONIC MEAN)			**14%**	**16%**	**17%**
S&P500 - FWD PE and EPS Growth	**19.14**		**-2%**	**10%**	**10%**

Main changes this month

- **Sold Airbnb –** Airbnb has performed very strongly this year and we thus took the opportunity to take profits on the position as the short-term upside potential became limited.
- **Sold Disney** – We have taken the decision to sell our Disney position in the fund after holding it for many years. We have waited patiently for an improvement in the business but have been constantly disappointed. There are several issues that we have been looking at that have not shown improvement that have caused us to finally sell**:**
    - **Culture:** The company is struggling with its identity as its support of "Woke policies" has been hugely detrimental to its broader audience. There needs to be far more change in upper management and the overall company direction for us to regain confidence in their future.
    - **Content Spend:** Disney's spending on content has destroyed its free cash flow as it tries desperately to compete with Netflix and other streaming sites. It is likely to slowdown in the coming year as the writing strike forces it to pause on new projects but if they don't rein in spending, profitability will continue to suffer.
    - **Parks:** Ticket prices have now been increased to levels that exclude a large portion of the population and now have a negative impact on foot traffic, hence there is likely negative growth from this division going forward.
    - **Brand Exhaustion:** In the past their Marvel and Star Wars movies produced unbelievable revenue, but these brands have been overworked and are no longer as profitable. The company desperately needs a new franchise.
    - **Debt Level:** Following the Fox purchase several years ago, the debt levels remain very high relative to current EBITDA. The company has prioritised content spend instead of debt payback which has become a problem during a rising rate environment.

We will of course keep Disney on our watchlist and if we see a decent turn around in the above we might decide to reinvest.

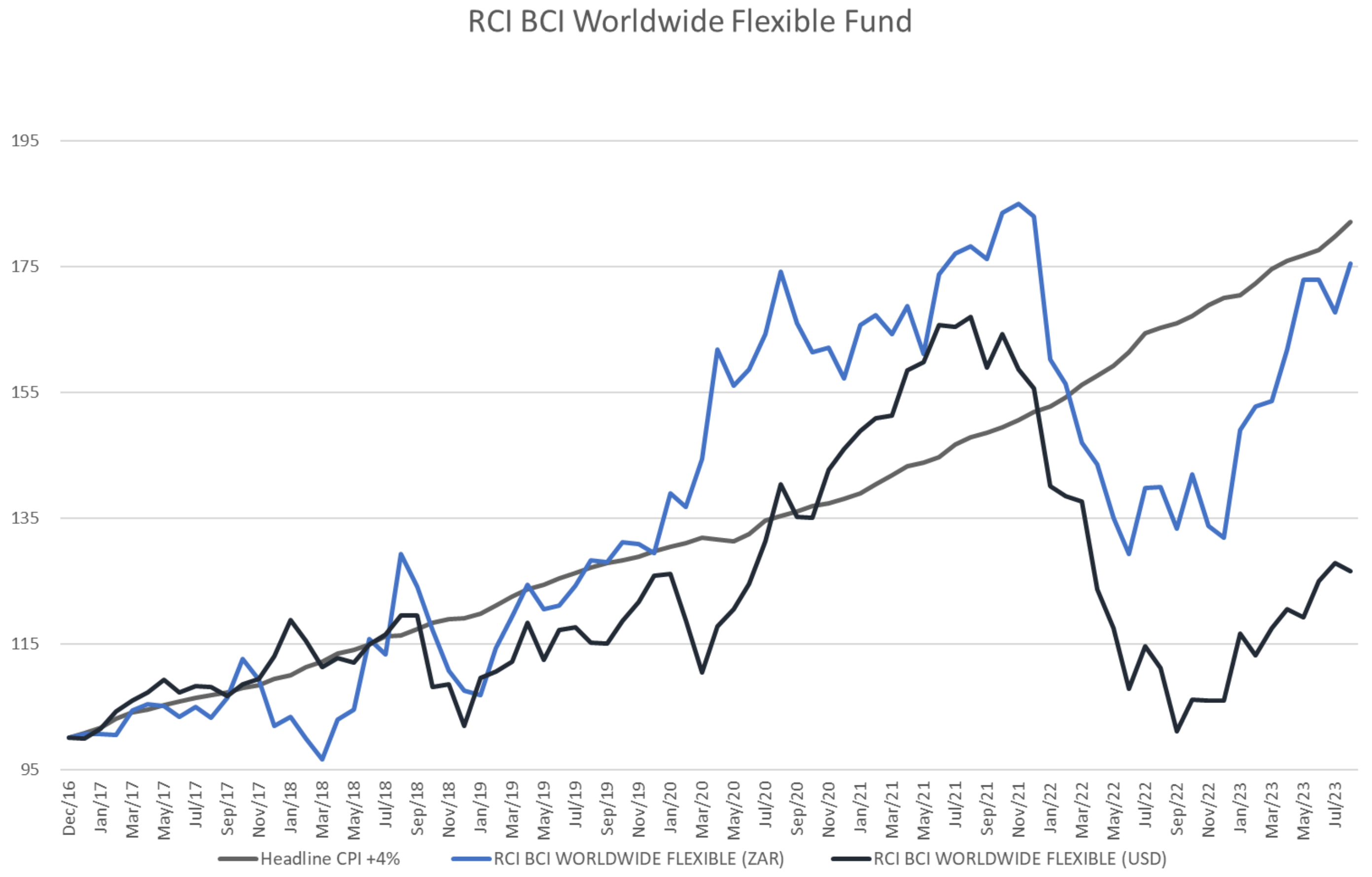
Performance in Rand

	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%	6.4%	-5.8%	-1.4%	**-27.9%**
2023	13.0%	2.5%	0.6%	5.3%	6.9%	0.0%	-3.0%	4.7%					**33.2%**

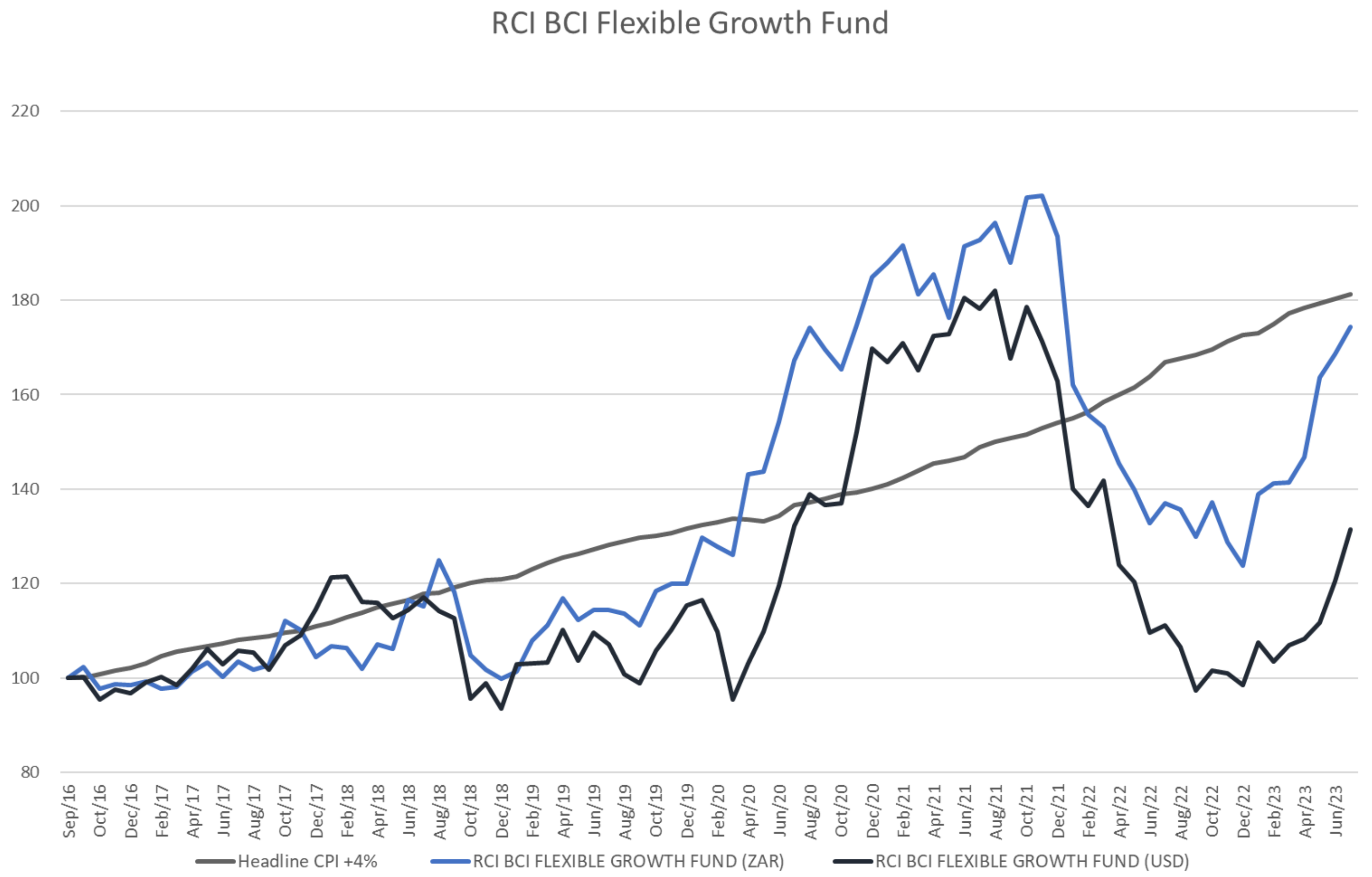
RCI OFFSHORE UNIT TRUSTS

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

RCI BCI Worldwide Flexible Fund closed August at 175.56c, up 4.68% for the month and up 25.47% for the last 12 months.



RCI BCI Flexible Growth Fund closed August at 167.23c, down -0.56% for the month and up 23.25% for the last 12 months.



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WHAT HAVE WE BEEN DOING IN THE LOCAL FUND?

ANCHOR BCI SA EQUITY FUND

BY THE ANCHOR BCI SA EQUITY TEAM

While questionable whether one waste too much time worrying about seasonal market patterns, August conformed with the historic observation that it has proved to be a relatively weak month for global equities (MSCI World -2.3% MoM, but still up a solid 16.6% YTD). A key headwind for risk assets in August was rising yields on government bonds, as this increases the cost of capital for equities and thus reduces the valuation that can be justified. Despite the bulk of equity returns YTD coming from a handful of US-domiciled mega-cap technology and chip companies, these held up relatively well in August, as did energy shares in sympathy with rising oil prices. Unsurprisingly, more rate-sensitive sectors (real estate, consumer staples and utilities for example) underperformed. It was also a particularly tough month for smaller growth companies that are not yet profitable. The more “risk off” tone was clearly evident in Emerging Markets (EM), which meaningfully underperformed DM (MSCI EM Index -6.1% MoM). Chinese equities were notable laggards in response to a raft of data pointing to weak economic activity, while the market’s hope for a strong policy response continues to go unanswered. This Chinese economic weakness weighed on commodity prices through August (Bloomberg Industrial Metals Index -5.1% MoM).

In common with other Emerging Markets, South African equities had a very tough August (FTSE/JSE Capped SWIX Index -4.8% MoM), leaving local equities only marginally in positive territory YTD (+2.8% YTD). Mining stocks (particularly PGM miners) were the biggest drag on the market (-9% MoM), as China’s disappointing news weighed on commodities. Naspers and Prosus (-8.2% MoM) were also dragged lower by their key investment – Tencent (-7.3% MoM). The rand weakened 5.4% vs. the US dollar, which provided a tailwind for several of SA’s rand hedges – British American Tobacco (+4.9% MoM) and AB Inbev (+5.5% MoM) for example. Financial stocks also fared relatively well, as the general message from their latest results reported through the month was a reassuring one. Local education companies (Curro, Stadio and ADvTECH) were a particular bright spot, as their solid double-digit earnings growth proved that they have put COVID headwinds behind them and continue to benefit from deteriorating public education provision.

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 July, the top 15 holdings in the fund, making up 68% of the equity exposure, were as follows:

- Naspers
- Absa
- Prosus
- British American Tobacco
- Bidcorp
- Standard Bank
- Investec
- Afrimat
- Advtech
- Richemont
- AECI
- Anglo American
- Shoprite
- Sasol
- Coronation

Main changes in the month

There were no major changes to the fund’s positioning during August. We exited the remaining gold exposure as we struggled to make the case for material upside in gold in the face of potentially higher for longer interest rates. We took advantage of price weakness to initiate small positions in **MultiChoice** and **African Rainbow Minerals**. We also added to our holding in one of our favourite smaller capitalisation shares on weakness – **Invicta**.

Performance

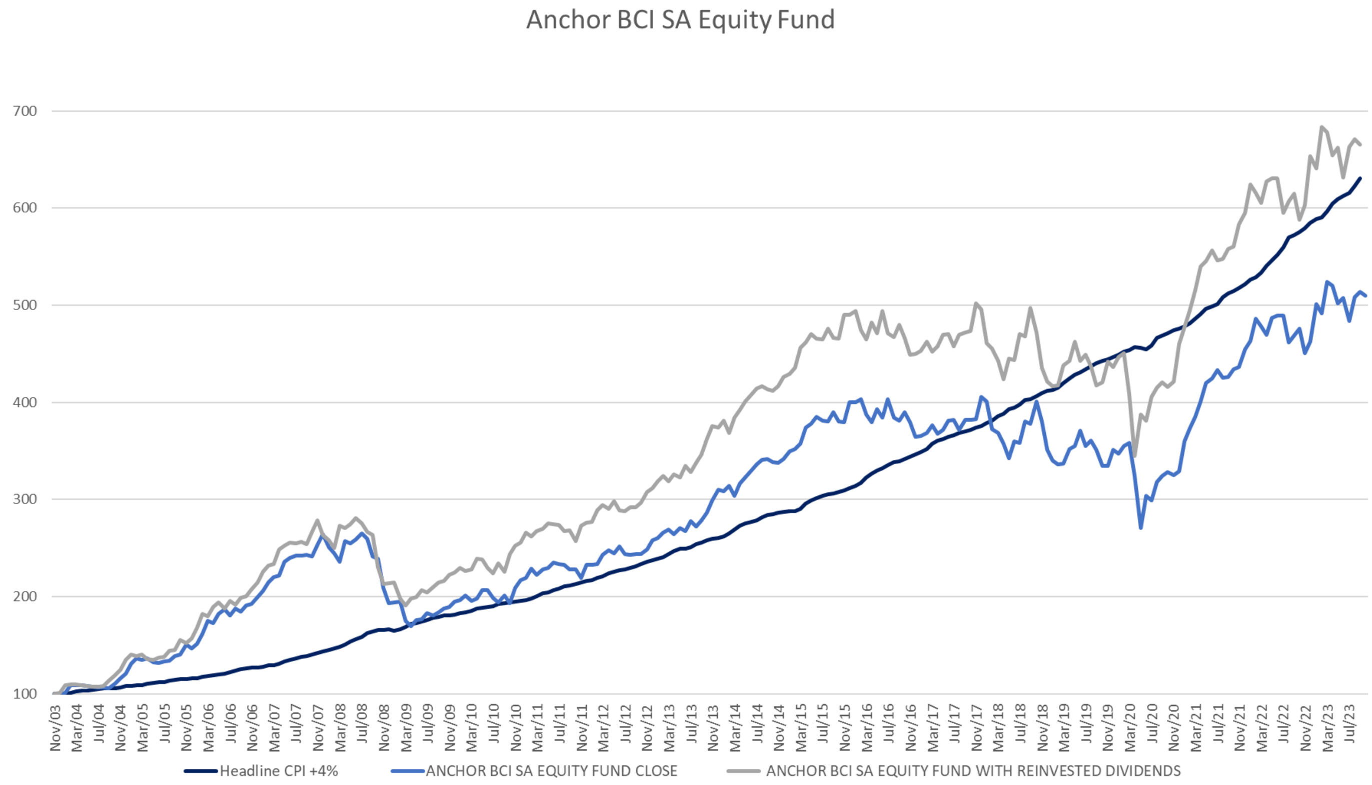
While being careful to remember that relative returns in a long-only fund do not in themselves put food on the table, it was none-the-less pleasing that the Anchor BCI SA Equity Fund ended August down just 0.68%, comfortably outperforming the market for the month and creating some clear daylight in relative performance YTD. While our quality orientation paid off, ensuring the fund avoided the worst of the damage in the mining space, we were also well positioned among rand hedges and SA Financials. It was particularly gratifying that our patience was finally rewarded in the SA education stocks, to which the fund has a healthy exposure.

WHAT HAVE WE BEEN DOING IN THE LOCAL FUND?

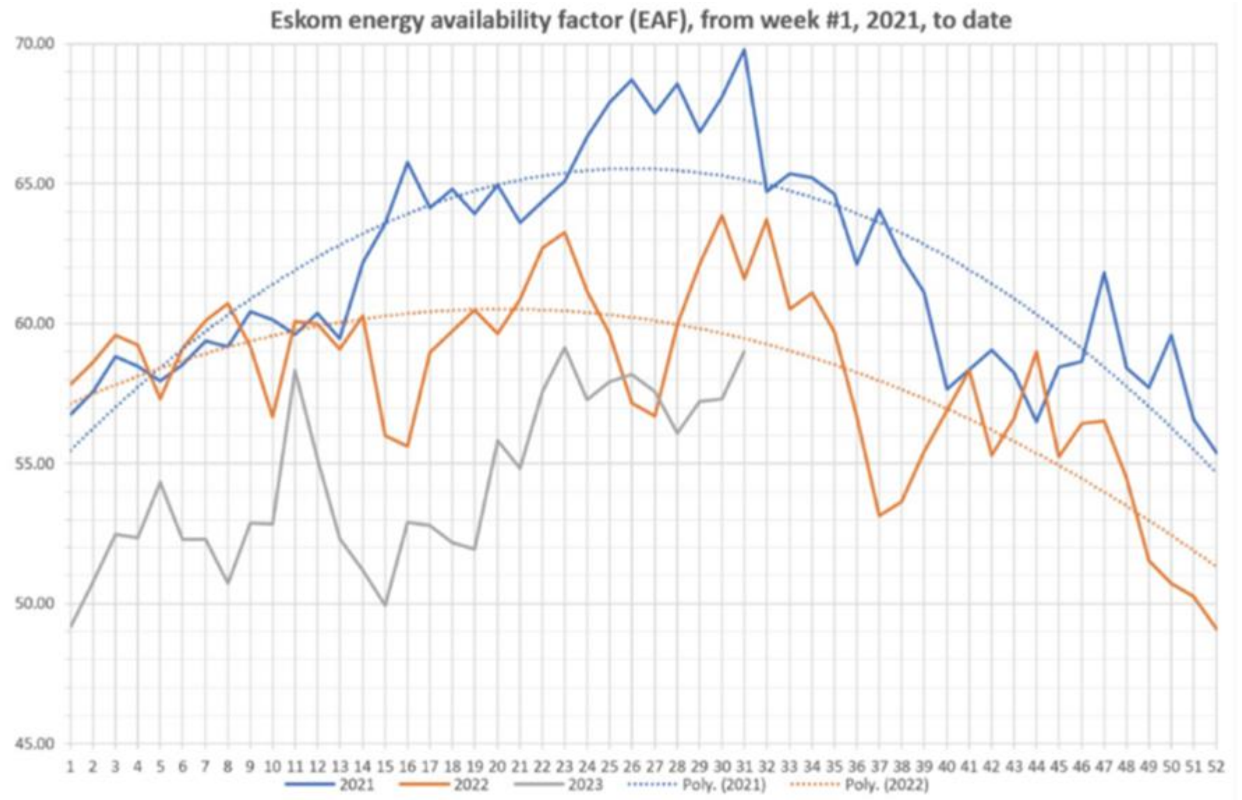
BY THE ANCHOR BCI SA EQUITY INVESTMENT TEAM (CONT.)

The Family Office

The Anchor BCI SA Equity Fund closed August at 114.28, down -0.7% for the month and up 7.12% for the last 12 months.



Note: The performance history above uses that of the RCI BCI Flexible Fund until 30 September 2022, the date of its amalgamation with the Anchor BCI SA Equity Fund.

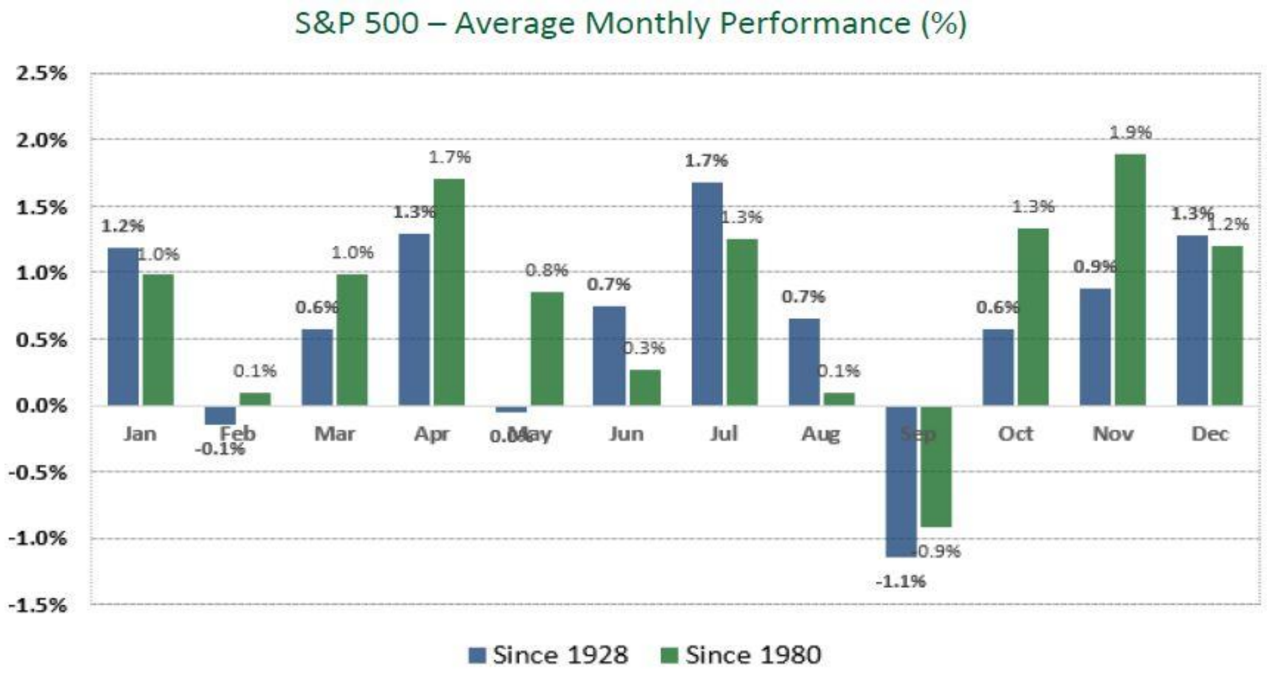


Source: Eskom

The above shows how devastating load shedding has been in SA this year. Energy availability factor (EAF) is a measure of Eskom power stations' combined performance. The grey line shows Eskom's EAF this year, which is below that of 2022. During 2022, the EAF was below the EAF for most of 2021. This is a trend that South Africans hope reverses soon. It is expected that SA's electricity deficit will peak in 2023.

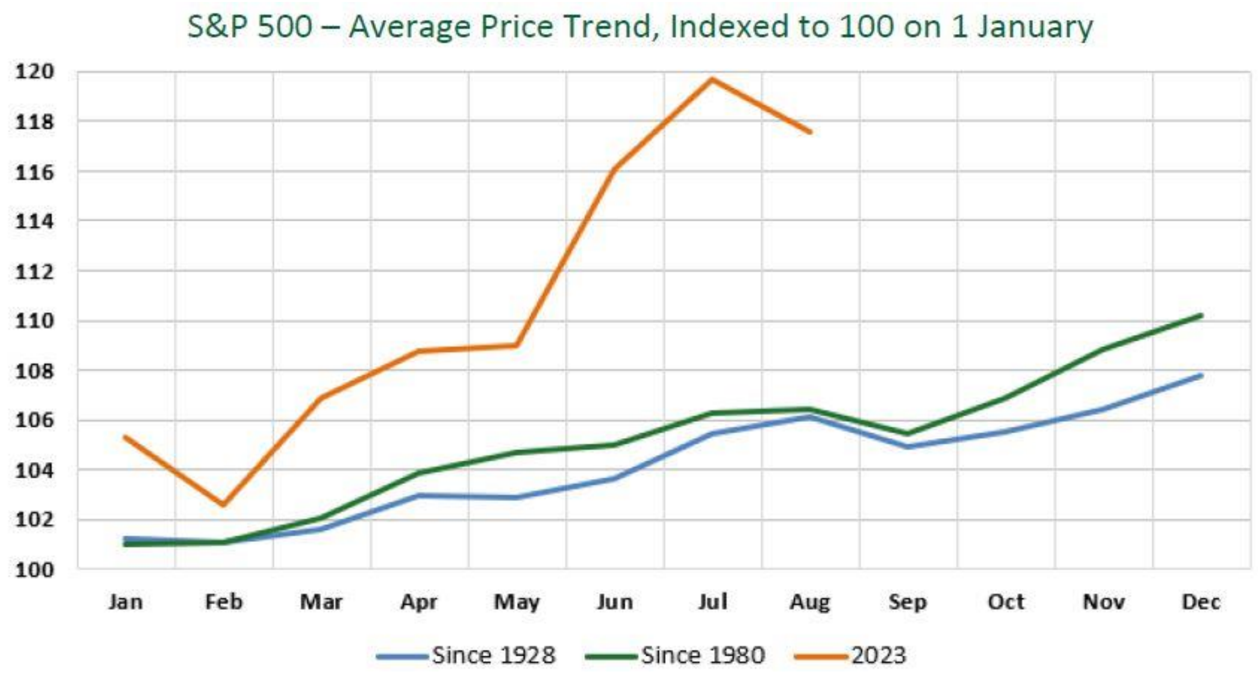
SEASONALITY IN THE US EQUITY MARKETS

There is a general perception of seasonal patterns in the stock market:



Source: Stonehage Fleming

The above chart reflects the average monthly performance over different extended periods. It is striking how similar the monthly levels over the two periods are. It has 'forecasted' the recent weak August. Both series reflect a strong last quarter for the year. Let's see if the historical trend continues into the back of the year.



Source: Stonehage Fleming

The above chart also reflects how similar the historic stock market trends through the year have been going back almost 100 years. Whilst the current performance (orange line) is much stronger (off a depressed 2022 base), the monthly trends remain quite similar.

The Family Office

Electric vehicle sales struggling to gain momentum in South Africa

There were 501 electric vehicles (EVs) sold in SA in the first half of 2023. This was equivalent to the total number of EVs sold in 2022. There are now approximately 1,000 EVs in SA. The market shares are as follows: BMW 51%, Volvo 20%, Mini Cooper 12%, Mercedes 8%, Audi 3%, Jaguar 2% and Porsche 1%.

The new Volvo EX30 EV has been allocated 500 units for SA in 2024 of which, 150 have already been pre-ordered. The SA EV market is expected to shift around in the coming years off the current low sales base. An interesting space to watch!

Mexico becomes the USA's biggest trading partner – and the associated benefits

The biggest US trading partner is no longer China but Mexico. Mexico made up 15% of US imports in July and China 14.6%. Industrial parks are filling up fast. Nationwide, vacancies fell to 2.1% last year. This due to aggressive US near-shoring activity to bring trade closer to its borders. Mexico is a massive beneficiary of this and on top of resurgent exports, Mexico boasts the world's strongest currency this year and one of the best-performing stock markets. Foreign direct investment is already up more than 40% in 2023, even before Tesla Inc. starts building a proposed $5 billion factory. Not since the signing of the North American Free Trade Agreement in the 1990s has the country held the kind of allure for investors that it has right now.

Rising oil prices set to ignite a resurgence in inflation

Source: Trading Economics

Central banks tend to ignore oil prices when setting interest rates due to its high volatility. However, the recent strong run in oil prices to above $90 a barrel will lead to a slight resurgence in inflation. Americans (like most of us) do not like high gasoline prices. The Biden administration's approval rating when it comes to the economy is 36% and with the next US presidential election a year away, the US is likely to do all it can politically to increase oil production.

Nvidia is not the only company struggling to keep up with demand for its products

Novo Nordisk launched its weight-loss injection Wegovy in Britain, its 2nd debut in just over a month, as the drug maker seeks to expand as it struggled to keep up with soaring demand.

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