

WHY SO GLOOMY?

BRYANSTON: Over the last few months, I have noticed how private individuals are becoming increasingly gloomy about their investments and the outlook for stock markets in the near future. One can understand how political uncertainty in South Africa and economic woes in Europe can be worrying for anyone. What should rational investors do in this climate and are there good reasons to be balanced in your investment outlook?

POLITICS IN SA IS SCARY RIGHT NOW

I have no insight into SA's political situation, what I do know is that the continuous debate on nationalisation as well as the dismal performance of State Owned Enterprises and the lack of job creation has caused massive harm to our economy. The radical nature of the "debate" around our economic future and the violence of labour disputes has scared away investors from our country at a time when they should have been flocking to us like animals to an oasis in the desert. Just when the world is scrambling for resources, our platinum mines are closing down and the major mining houses are investing in other parts of Africa because we are becoming a scary place for international investors. It seems unthinkable to people who understand economics and economic history that the nationalisation issue is still being debated in South Africa. Surely the numerous failures that we have seen around the world should have settled this debate years ago? Local investors and foreigners looking for growth are loathe to commit their precious capital to a country that might take it away in future. Those companies that are still brave enough to take the plunge get treated with suspicion. Even the bravest investors can be forgiven for looking North of our borders for more stable investor climates. We need foreign capital and trade to grow – we cannot survive in splendid isolation, just ask North Korea.

EUROPE IS NOT MUCH BETTER

If South Africa is looking scary, at least we can see the solutions to our problems. Europe is stuck in a quagmire from which there is no easy exit. It seems to me that it is going to take many years and a lot of sacrifices by ordinary Europeans before the situation will start to improve. One has to unify an area where some nations believe that tax evasion and limited work hours are part of your birthright whilst other groups believe in hard work and the primary importance of the community. I don't believe that the Globe's best and brightest can solve Europe's problems without fundamental social change which is nearly impossible to achieve.

The amount of time that the financial media is dedicating to Europe's problems is a boon for the Americans who are slowly getting their house in order without the world's press tracking their every move. If the economy continues improving, Obama might even keep his job and get the chance to fulfill some of the promises he made before he got elected. If he gets re-elected, I believe that the global economy will benefit as Obama will be more confident, battle hardened and determined to lead the change.

BUT WHY ARE WE ALL SO GLOOMY?

You might wonder if there is a positive aspect to this story for South African investors - I believe there is. Just as everyone is becoming increasingly depressed about our economic prospects; for the first time in nearly five years, South African institutional investors are becoming more positive about our investing future. More interestingly, nearly 80% of them feel like the JSE is fairly valued at these levels. This is according to the Investor Confidence Index published by the Institute of Behavioral

Finance in South Africa. According to their survey of SA's institutional investors, less than 10% of them think the JSE is expensive whilst 79% feel that it is fairly priced. This is not a prediction of the JSE's returns, the fund managers are simply being asked whether they believe the market is cheap or not. They usually make this determination through a rational, logical process i.e. there is not much emotion involved. I believe there is no merit in the forecasts (otherwise known as predictions) of institutional investors but I do believe that most of them are good at determining when something is cheap or not. As a long-term investor, one can derive some comfort from their determination that the market is fair value because it means you can expect the JSE to deliver normal returns from these levels going forward. One of the greatest determinants of investor returns is the initial price you pay for your investment and therefore current valuations are important.

Over the last 112 years, the average return of the JSE has been 7.5% per year above inflation. If inflation remains near 6%, the normal expected returns from the JSE will be 13.5% per year. This is a good return on capital for long-term investors who are not too time sensitive. Given all the things that could keep me awake at night worrying about our stock market returns I derive comfort from the fact that history eventually repeats itself and this time will be no different. Therefore, I am not going to give in to the gloom, I will rather use this opportunity to buy good assets at a fair price. If people increasingly give in to the market depression, there will be opportunities to buy these assets at even better prices, so don't commit all your capital in one purchase, rather phase-in over the next few months.