galileocapital
Challenging Conventional Wisdom

NEWSLETTER

Monthly Newsletter – June 2016

A Note from Theo and Warren

Ratings downgrades

We have consistently avoided the temptation to make predictions about events that relate to investments, as history has proven that people (including the two of us) are really bad at making accurate predictions. That's why the discussions with our clients about the potential ratings downgrades have been so frustrating – we simply don't know if South Africa will be downgraded or not.

To try and gain some perspective on this issue, we decided to find out what happened to other countries after they were downgraded.

First, it takes an average of 76 months (more than six years) to be rated upwards again, ie. to recover the investment grade rating. The fastest country in the last 20 years to regain an investment grade was South Korea and they took 14 months.

The bond markets of the downgraded countries would typically suffer in the 12 months before the downgrading and then actually improve in the subsequent 12 months after the downgrade. The same applies to their currencies: their currencies mostly strengthened in the year after the downgrade.

History might give us some pointers about the consequences for investment markets. Potentially they are not as severe as everyone thinks: the broader economy will suffer sustained harm, but the stock market, bond market and currency might recover from current levels.

This is known as 'buying on rumour and selling on fact'. Very often markets over-emphasise the negative effects of an event and when that event actually happens, the markets realise that the world has not ended.

To be clear, we believe a downgrade would be negative for South Africa's long-term future but we do feel that much of the current fear is over-hyped.

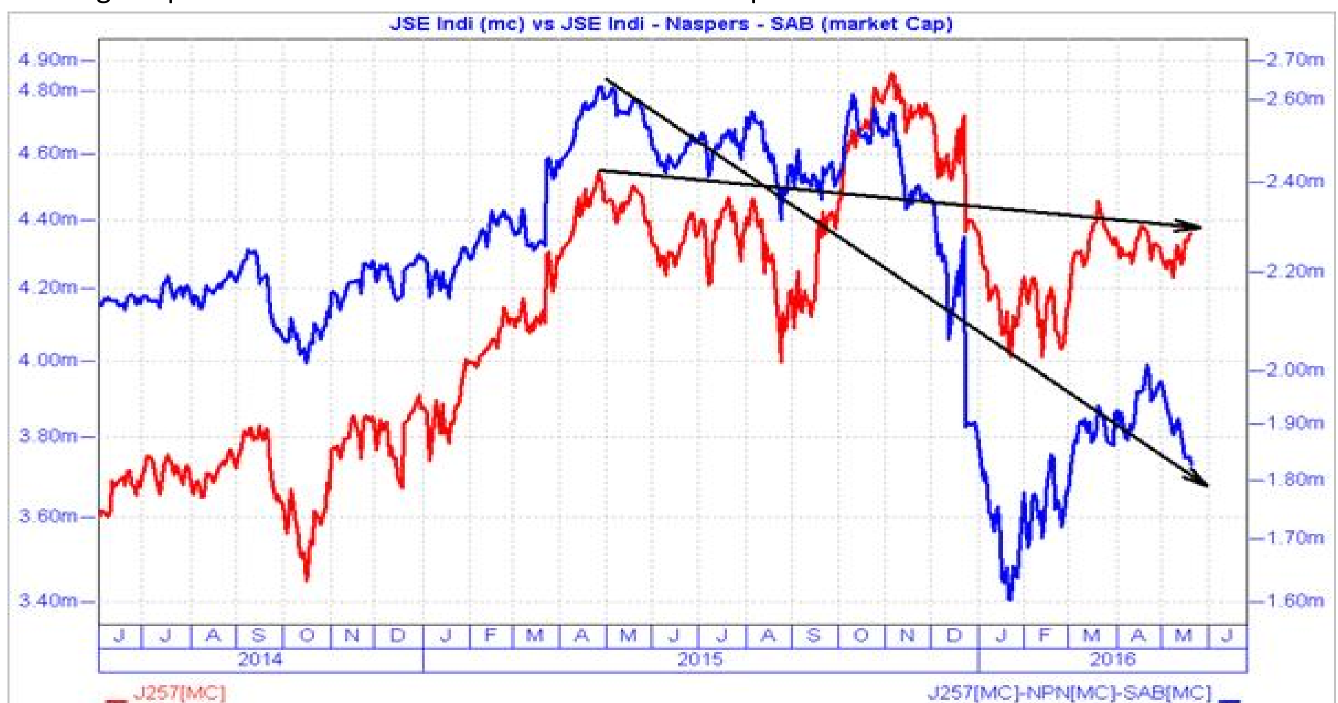
- Theo and Warren

Is your portfolio performing differently than the JSE Index?

If you are looking at your share portfolio or unit trust and wondering why it is not performing like the JSE index at the moment, it is worth considering what the JSE's performance looks like when only two shares are excluded. This is important because many good fund managers have very little money invested in these two companies at the moment – probably for very good reasons.

In the graph above, the JSE All share Index (red line) grew by 3.8% from July 2014 to now, while the All Share excluding Naspers and SAB lost 16.3% in that time. That's a difference of nearly 20,1%!

The difference is even more glaring if we look at only the industrial sector in the graph below. The red line shows the Industrial index since August 2014, it has grown by 18.8% while the industrial sector excluding Naspers and SAB lost 14.5%. This is a monstrous performance difference of 33%.



Many fund managers will have been very concerned about investing in Naspers and SAB in 2014. Naspers is substantially Tencent – a Chinese social media company which had a PE as high as 65x in early 2014. Naspers itself has had an even higher PE – over 100x for the last two years. Naspers is a high growth company, but priced as such. Little wonder value style fund managers weren't invested in the share.

SAB priced at a level above a PE of 25x was showing solid but unspectacular growth – in single digits in hard currencies, with a big footprint in emerging markets (which every man and his dog were hating). Then takeover rumours followed by a bid from Anheuser-Busch in September/October 2015 led to a massive uplift in the share price. Once the bid was confirmed the share started to perform like a pound sterling cash deposit! In the fullness of time, SAB will drop out of the index when Anheuser-Busch pays over for SAB. Until then SAB's presence will dampen volatility in the index.

History of course can be a brutal teacher. Any active portfolio manager who didn't have these stocks in their portfolios will have had to demonstrate considerable skill to match index returns, while any portfolio manager that is a closet indexer is smiling from ear to ear.

These two shares comprise 23% of the All Share. Excluding them demonstrates that the rest of the market experienced a painful episode at the end of 2015. The good news from that, is that it injected some value into the JSE. Buffet always says be greedy when others are fearful. A disappointing market in the short term is a precursor to a better long term investment result.

- Warwick Lucas, Chief Investment Officer

Productivity tips for procrastinators

All of us put things off sometimes – it's human nature. But you can be productive even if you're prone to procrastination.

If you frequently find yourself doing anything other than the thing you are meant to be doing, start by taking a step back and asking yourself why you do this. If you can understand the cause sometimes you can stamp out the behaviour.

Because you should know that procrastination isn't going to make that thing go away. Putting it off will only cause you more stress. Instead, try these simple tools and techniques:

1. Name it – notice and acknowledge your procrastination, but don't beat yourself up.
2. Identify your time sinks – keeping a log for a week can help you to identify where you are wasting time.
3. Get realistic about how long tasks really take – use the stopwatch on your smart phone and time yourself.
4. Reward yourself for productivity – just mini rewards like a cup of tea, a stroll around the office park or a conversation with a colleague.
5. If the job feels too daunting, break it down into smaller steps and tackle each one as an individual task.

6. Consider whether your to-do list needs an overhaul. What can you delegate or ditch entirely?
7. Don’t expect miracles – you will only frighten yourself into inertia. Do a good enough job – don’t set unrealistic expectations for yourself. Don’t expect miracles and you’ll be more likely to make a start.

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