

Monthly Newsletter – September 2016

A Note from Theo and Warren

Offshore investing update

The possible outcomes from here are either very positive or very negative – quite similar to what happened with Nenegate. This means that the rand will either strengthen significantly or weaken even more. Unfortunately we cannot predict the outcome and believe the odds of a speedy resolution are probably the same as a coin toss.

In situations like this where the outcome is so unclear, we believe that you need to exercise caution in making big financial decisions. You need to maintain a focus on the long term so that you avoid material investment mistakes.

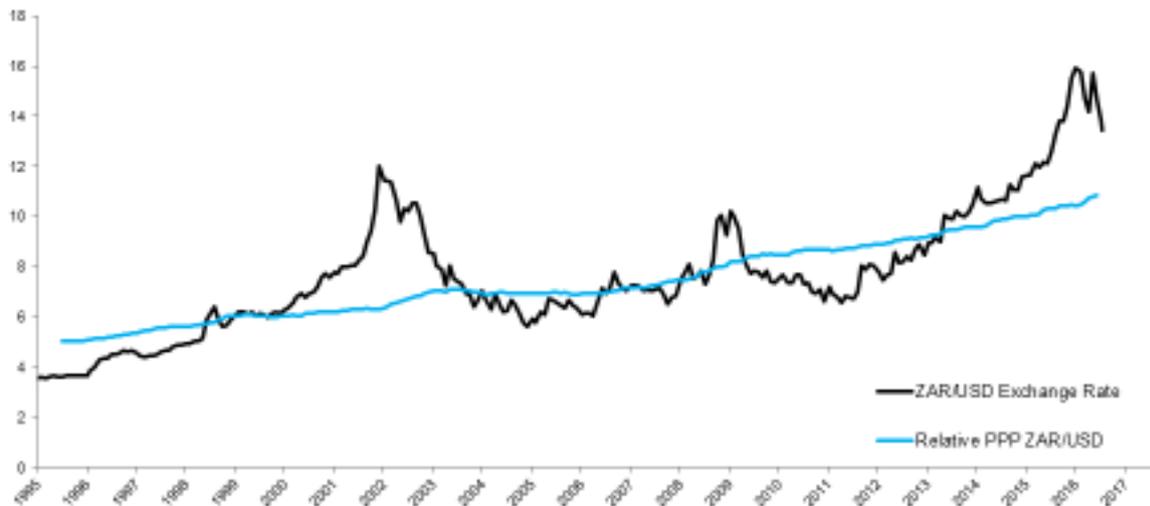
This too shall pass

The graph below from Credo Wealth illustrates the cyclical nature of the rand very well. The black line shows the rand/dollar exchange rate since 1995 while the blue line shows the approximate 'value' of the rand as measured by Purchasing Power Parity (PPP).

The simplest example of PPP is the Big Mac Index which shows the price of a Big Mac burger in every country where McDonalds operates. When a Big Mac (or Starbucks coffee) is much cheaper in SA than in the USA, we know that the rand is cheap. The PPP calculation in the graph below aims to provide a more comprehensive comparison of a currency's value.

The PPP (blue line) shows that the rand is still very cheap and so there is still scope for it to strengthen more, possibly below R11 to the US dollar.

Relative Purchasing Power Parity – ZAR/USD



Source: Credo, Datastream

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When making an investment decision, considering the relative value of the rand can be a useful anchor in your decision-making process. It's certainly not a perfect solution, but many people sent money out in late December 2015 and early 2016, which was not a good time for the rand. It would have been better to send money out in batches so that they could have averaged the weak exchange rate against a stronger rate a few months later.

The current situation with Gordhan might cause sustained weakness but it would not be wise to predict a sustained one-way collapse of the rand. Political events can turn positive as quickly as they have turned negative.

Invest offshore for the right reasons

This is the ideal time to determine the correct offshore allocation for your portfolio. If you decide to invest overseas, it should be for the right reasons. You should be trying to diversify your asset base as a way of reducing your investment risk.

It is not certain that you will achieve much better growth by investing overseas in the next few years. International markets are not cheap, and many developed economies are in deep distress. More importantly, they have poor demographics with ageing populations and negative interest rates.

This does not mean you should avoid international markets, just be prepared for a low growth environment. You need to be patient and realistic with your growth expectations. If you are structurally under-invested overseas then continue investing offshore, but send your money out in batches over a period of time to minimise the impact of volatility in the exchange rate.

- Theo and Warren

Portfolio pointers

Deutsche Japan ETF

Japan offers a numbers of attractions. Its economy is mature, as are its demographics, but the market spent a long, long time travelling southward in the bear market that started in the late 1980s and continued through to the late noughties.

In such markets tremendous value can become available. In addition, the huge quantitative easing pursued by the Bank of Japan (BoJ) is very equity supportive. Its equities are massively discounted relative to its bond markets. The BoJ is determinedly trying to devalue the yen/dollar and with the help of the noises coming out of the Fed, they may succeed – somewhat.

Before you let that worry you, bear in mind that, being an export economy, the Nikkei is pro-cyclical, ie. when the currency weakens, equities strengthen. For our offshore clients we have the option of using the Wisdomtree dollar hedged ETF, which allows us to fix our yen value back into USD if we wish.

Consolidated Infrastructure Limited

This is one of our small cap interests. They're involved in exposure to electricity distribution infrastructure in both SA and the rest of Africa despite justified worries about our political environment: more and more substation explosions are sending a clear message – even if Eskom generation is stable, distribution is not!

New dynamic service-delivery oriented management at large metros is grounds for interest too. Short-term earnings from “Rest of Africa” may be constrained by the recovery in the rand/dollar, but that's no spoiler for us. A rights offer for the acquisition of Conlog (at an attractive price, we believe) has depressed the share price, and may offer entry points.

- By *Warwick Lucas*

5 ways to handle diversity

Diversity is a big topic in the workplace in South Africa. Harnessed correctly it's an enormous asset to a company.

That doesn't always mean that managers know how to work with diversity however. They worry that it could cause divisions or strife, and don't always have the sensitivity and emotional intelligence to successfully manage a diverse team.

But diversity brings many advantages. At senior management level it brings a wealth of knowledge, experience and different perspectives, which can be invaluable for innovation, problem solving, insight and creativity. Fostering a working environment that embraces differences means your company will have a greater chance of being ready, able and flexible to embrace changes in your business sector and be ahead of the game.

Here's how to do diversity well:

1. Communicate well: have crystal clear, easy-to-understand policies, health and safety information and a company ethos that everyone is aware of and is easy to interpret. Check for any ambiguities and any misunderstandings, and ensure your internal

communication uses ordinary, everyday language.

2. Be clear about what people are accountable for and ensure everyone is treated equally.
3. Arrange relationship building exercises to enable a culture that recognises people as individuals rather than stereotypes or caricatures.
4. Educate yourself on differences your employees might have: different religions have different taboos. People with various disabilities require different office spaces. Be aware and sensitive around those differences and treat them with respect.
5. Think about ways to foster dialogue around diversity. Allow team members to explain what it's like to be their age, their culture, or living with an impairment of some kind. Lack of understanding is often at the root of discrimination.