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Challenging Conventional Wisdom

NEWSLETTER

Monthly Newsletter – August 2017

Note from Theo and Warren

The JSE had a strong recovery in July with the index breaching 55 000 again for the first time in years. We are not forecasting a sustained recovery yet, but this might be recognition by investors that the JSE is once again offering good value.
It is important to remember that many of the largest companies on the JSE are not solely focused on the South African economy. In fact, the majority of them are international businesses with limited exposure to South Africa. This means that a recovery in the JSE is not necessarily a vote of confidence in the country, although there are some signs that foreign investors see value in our resources sector again, and that they may be discounting the actions of the current Cabinet Minister in charge.

The political backlash against the 'Zuptas' is gathering momentum and corporate South Africa seems to have finally found its voice. We are hopeful that this trend will continue to gather pace with more people carrying the can for their part in corruption within all levels of government.

- Theo and Warren

Passive vs active in global ETFs

In 2015, Warren Buffett shocked the audience at Berkshire Hathaway's shareholders' meeting in Omaha by admitting defeat in the battle over stock performance.

For decades, he had beaten the market by carefully buying quality companies at a discount and holding for the long term. But since his investment company has grown so large, he threw in the towel and decided it was better to invest in index funds like Jack Bogle's gigantic Vanguard S&P 500 Index Fund. He reiterated the virtues of passive investing in his 2017 annual report to shareholders, called Jack Bogle a hero.

Buffett also has a USD1-million bet with an asset manager over whether a group of hedge funds would beat an S&P 500 Index fund over 10 years. Buffett looks set to comfortably win the bet on 31 December.
Vanguard's revolutionary idea was a low-cost index fund that kept fees low and returns higher – as much as 0.5% higher annually over time. That concept has drawn in more than 20 million investors since its founding in 1975. Vanguard's assets have tripled in a decade, rising by USD1-trillion to USD4.2-trillion in just the last five years, and costs have fallen from 0.68% to 0.13% on average since 1975.

It's one of the competitive edges that ETFs (exchange traded funds) have – the bigger they get, the more costs come down. Vanguard isn't alone either – Ishares, State Street, Schwab and others all have fiercely competitive cost and product offerings.

That would suggest at first blush that passive ETFs have wiped the floor with active managers. But what about Buffett's own investment company? In recent history, Berkshire Hathaway stock has continued to outperform the S&P 500 Index, even when you include dividends.

One group of funds has done even better than S&P Index funds: as much as Bogle gets underneath the skin of active managers, it is 'smart beta' or 'alternative index' funds that get under Bogle's skin! And for good reason.

A traditional S&P 500 Index weighs stocks by market capitalisation. The bigger the company, the bigger the weight in the index. That's why the top 10 stocks account for 18% of the S&P 500. Smart beta funds are like index funds in that they are passive, but they are based on 'alternative' indexes. It turns out the index upon which a passive strategy is based makes all the difference.

You can construct an index using all sorts of other criteria: fundamentals, momentum or even by tracking companies buying back their own stock. Let's look at a very simple 'alternative' index strategy. Instead of weighting the S&P 500 stocks by market capitalisation, take the same 500 stocks and weight them equally — and rebalance them at the end of every quarter. With this approach, the top 10 stocks will account for a mere 2% of the index. This simple strategy has outperformed the traditional market-cap-weighted indexes by over 2% a year since 1967 - a massive difference if compounded over time.

This is why our offshore portfolios are blends. We use passive indexing, with plenty of geographic diversification, but we also use themes such as value, stock buybacks, dividend growth, size and trend-following.

- Warwick Lucas, chief investment officer, Galileo Asset Managers

Meetings – they can be healthier

Meetings are seen as a kind of necessary evil – they've become something of a habit. And in many cases, people are very busy having meetings rather than getting anything done. Here's how to make your meetings smarter, more productive, and even healthier.

1. **Count the cost.** In the US, a study by Microsoft, America Online and Salary.com concluded that the average worker worked only about 1.5 hours a day, and the rest of their time was wasted, with unproductive meetings being at the top of the list of time wasters. Think about the hourly cost of each person assembled around the meeting table – are you getting the best bang for your buck from them right now?

2. **Keep them short.** Instead of booking an hour as a standard – book half an hour or even 20 minutes. It'll induce a sense of urgency.

3. **No agenda, no meeting.** An agenda gives you a goal – and don't forget to allocate tasks as they are decided upon. A task without someone taking responsibility isn't going to move even an inch towards completion.

4. **Smart snacks.** If you are having a long meeting, some snacks are a good idea: people can't focus if they haven't eaten. But remember that many people are trying to avoid

sugar or carbs, and these foods can also cause fatigue. Aim for lean protein and plenty of fresh fruit and vegetable, with water readily available in addition to any other beverages.

5. **Take a break.** A smoke/bathroom/phone checking break is a good idea every 45 minutes or so, or people's eyes begin to glaze over.

6. **Take it outside.** If it's practical, consider a walking meeting – a bit of fresh air and movement gets people's creative juices flowing. Just pre-warn your colleagues so that no one has to totter along in their stilettoes.