galileocapital
Challenging Conventional Wisdom
NEWSLETTER

Monthly Newsletter – May 2017

Note from Theo and Warren: The Value of Advice

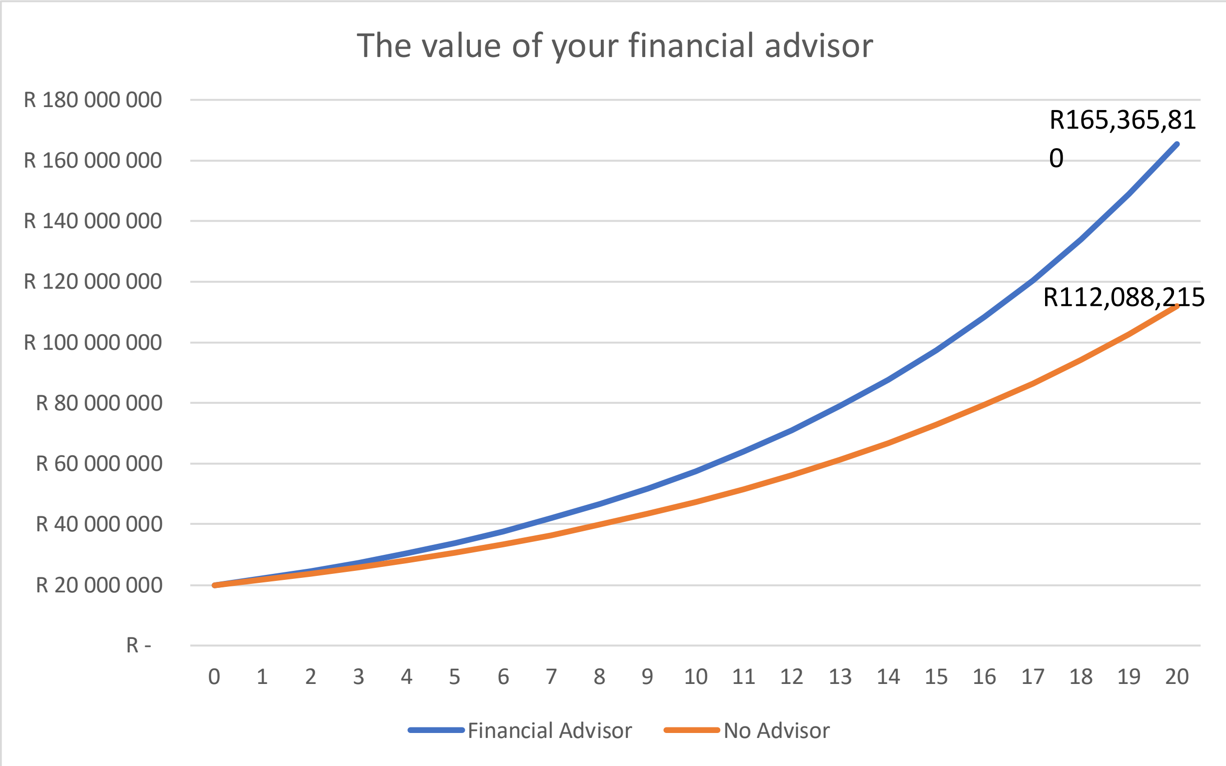
The last three years have been very difficult for investors: the South African stock market has moved sideways, President Zuma is doing his best to destabilise our economy, the rand is see-sawing, and international investments are offering equal uncertainty. In times like these, it becomes increasingly difficult to convince investors to stick to their planned investment strategy, especially when this involves remaining invested in shares while the market is doing nothing.

Vanguard Research published a study in September 2016 that aims to quantify the value of financial advice to investors. We thought it was worth sharing it with you, so that you can see the impact (in rand values) on your investments if you continue to follow your investment strategy – even when markets are not co-operating.

Vanguard found that an effective advisor that uses a disciplined asset allocation strategy with regular rebalancing and ongoing financial "coaching" can add 3% per year to an investor's returns. The study focused on advisors who follow a very clear and rigorous approach to investments, which is exactly our philosophy.

The graphs below show the impact of the value of a good advisor, in rand terms, over time. Two investors each start with R20-million and one investor manages his or her own money, while the other investor uses an effective advisor. The investor who uses a good advisor will have R165-million after 20 years while the person with no advisor will have R112-million.

Of course, these are averages, which means that not all advisors are good enough to add value, and some investors will do better than anyone else with their own money. It is, however, a valuable study as it provides an indication of the benefit of following good advice over prolonged periods of time.



- Theo and Warren

Tax: law changes and the impact on loans to trusts

Section 7C was introduced into the Income Tax Act with an effective date of 1 March 2017. It is an anti-avoidance provision specifically aimed at interest-free or low interest loans that are widely used as an estate planning tool, in order to avoid estate duty and donations tax.

Interest-free loans are typically made to trusts to peg the value of a person's estate. Any capital growth thereby takes place in the trust. Previously no donations tax was payable on the interest-free loan.

In terms of Section 7C, a deemed donation is made where a person (or connected person) makes an interest-free or low interest loan to a trust. The value of the deemed donation is the difference between the official rate of interest (currently 8%) and the actual interest charged. The donation is deemed to be made on the last day of assessment of the trust, typically 28 February.

If you would like to find out more about this law change and the impact on your trust, you are welcome to email: legal@galileocapital.co.za

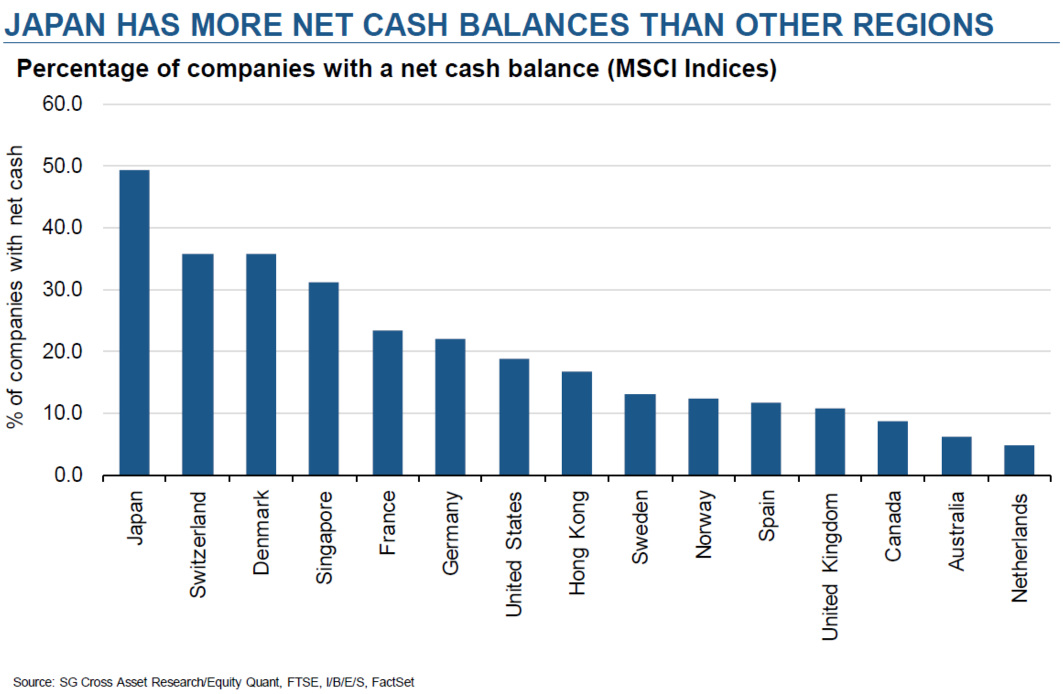
- Galileo Advisory services

Look East, my son …

There is one developed equity market where there are a host of Benjamin Graham style "net current asset value" stocks still available, and over 40% of stocks are trading below NAV.

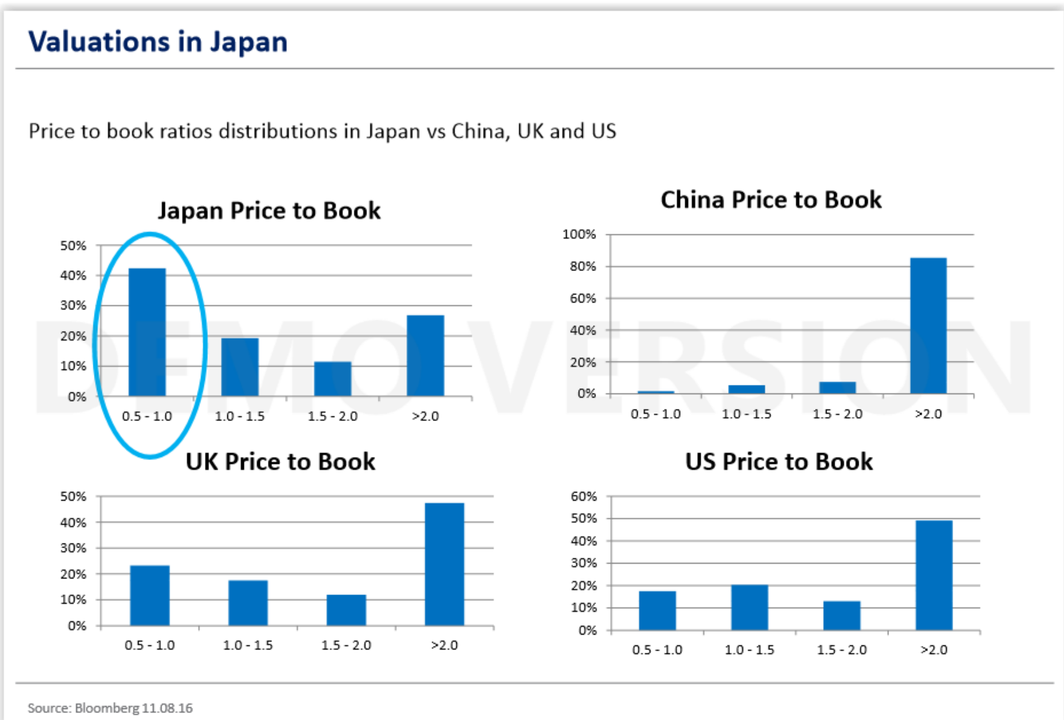
It is a market where a group comprising the central bank, the government's pension fund and that country's own companies are buying (or buying back) stock in size. It is a market where dividends are steadily rising, and seems ridiculously calm compared to the political rodeos going on elsewhere. This market is Japan, and the easiest access available directly on the JSE is provided via the DBXJP.

If North America stands out with high valuations, Japan stands out for low ones. A third of the Japanese stock market has a cash flow yield (EV/Cash from Operations) of more than 15%. No other developed market comes close. Japanese companies also have more net cash than in any other country:



Japanese companies are being nudged to improve capital allocation – that means higher dividends and share buybacks. The average Japanese pay-out ratio is a meagre 25% to 30%, versus, say 65% in the UK, so there is still plenty of room for dividends to rise further. The bottom line is that Japanese balance sheets are the healthiest in the world.

Also backing up the solvent balance sheets are asset-rich holdings:



Japan's not just cheap, we also like the buyers underpinning its markets. John Seagrim of CLSA refers to a new 'High Roller Club' in Japan, actively buying the stock market. Members include the Bank of Japan, Japanese corporates, the Government Pension Investment Fund, and Japanese households.

The BoJ is committed to buying ¥6-trillion in ETFs annually. Corporate Japan is on course to buy back ¥6-trillion in stock this year. The GPIF, the biggest pension fund in the world, is leading the way by raising its equity weight to 25% of assets, which implies it will buy ¥5-trillion in stocks this year. And in the first six months of this year, Japanese households, via NISAs, bought ¥2-trillion, or ¥4-trillion annualised.

In our portfolios domiciled outside of South Africa we make use of currency hedging options against the yen. This is because Japanese equities, much like the JSE, form a pro-cyclical market (when the currency is weak, the market is strong and vice-versa).

Valuations are so low, that we view Japan as attractive for both aggressive and conservative investors alike. Galileo Asset Managers' client portfolios have weightings towards Japanese equities.

**With thanks to Tim Price of Value Partners for material used.*

- Warwick Lucas, chief investment officer, Galileo Asset Managers

6 ways millennials are changing work

While we're busy complaining about how entitled and self-obsessed millennials are, they're busy changing the way we work – right under our noses. Here's what you can expect:

1. They will force companies to be transparent – it's one of the top four qualities they look for in leaders.
2. They will want their work to be meaningful above anything else.
3. They will build collaborative organisations – they like to work in teams to accomplish goals.
4. They will make working from home the norm – but don't be afraid. There's plenty of research to indicate that remote workers work longer hours and are more focused.
5. Work will become a game, rather than a chore – and who doesn't want that? Just look at how gamification is infiltrating all kinds of industries.
6. The old hierarchies will disappear – millennials are all about collaboration and equality.

How to stay well this winter

The cold months are almost upon us, so it's time to start bracing yourself for the inevitable rounds of cold and flu. Here are some ways you can keep yourself healthy:

- Get your flu shot – it will protect you against the most virulent strains of the disease and it won't give you flu. That's a complete fallacy.
- Wash your hands often – it really is the number one way to keep illnesses at bay.

- Avoid colleagues and friends who are not feeling well. Send sick employees home so they don't infect others.
- Eat well – at least five servings of fresh fruit and vegetables daily; more if you can.
- Manage your stress well – some stress is essential; too much takes its toll on us both mentally and physically. Don't allow yourself to become exhausted and run-down, as that will make you more susceptible to illness.
- If you do get sick, take time off to get well. Rest and fluids will sort most viruses out in a couple of days.