

# The Investor<sup>®</sup>

In our 30th year of service to the South African Investing Public!

## **Financial security means never again having to worry**

**by Richard Cluver**

**Financial security means never again having to worry about how you are going to pay the household bills at the end of the month and never again having to worry about the financial implications of a family crisis. It also offers you the freedom to take a break whenever you please; to travel or be able to implement projects you have dreamed of all of your life. But most of it buys you peace of mind.**

For most people the concept of such wealth is a seemingly impossible dream. Judging by the latest official statistics, the average South African is totally enslaved by debt, spending up to 82.3 percent of their disposable income on paying off debt. Furthermore nearly half of credit-active consumers are three or more months behind on debt repayments.

Clearly then, we as a nation need to make it an urgent national priority to rid ourselves of debt and dedicate ourselves to the concept of growing wealth and the most effective means of achieving this objective is via stock exchange investment: by regularly saving a portion of your monthly income and dedicating it towards the step-by-step acquisition of a Blue Chip share portfolio.

So let us begin by considering the stock market options of the beginner investor, noting that over the past ten years the average growth rate of Blue Chip shares was 34.4% a year. On average, furthermore such shares have yielded a dividend return of 3.4% making for a total return of 37.8% which, since dividends are taxed at just 20% compared with the 45% marginal tax rate for South African individuals, means that the investor in blue chip shares is achieving an after-tax return nearly eight times greater than he would receive from a sovereign bond like the RSA 186.

If you care to do the maths, you would thus determine that were you a young person just starting out in your first job with something like a 40-year working expectancy ahead of you and you were able to invest R50 000 in such a portfolio, and furthermore, other than re-investing the annual dividend income, were you never to

save another cent, you could expect to have at retirement an investment portfolio worth something of the order of R21-billion. That sum would provide you with a monthly income of R47 369-million.

From this it is clear that long before your normal retirement age, you would have reached a level of wealth that would have opened up a multitude of life options of which the very least might have been early retirement.

Such incredible wealth numbers are hard to believe given the common—dare I say cynical—experience of people who have tried to grow their savings using instruments such as unit trusts and life assurance policies which are the normal resource of ordinary folk. The sombre fact is that unit trusts have on average been dismal investment performers. Whereas over the past ten years the average Blue Chip share has risen by compound 34.6% annually, the average gain achieved by all the unit trusts that have been in business for ten or more years has been a pitiful 7.64% annually. The graph below illustrates the difference between the two averages on a percentage annual change basis over the past decade.



Just why unit trusts perform so badly for the people who invest in them can be partially explained by the fact that they are customarily bought through investment advisers who collect commissions on each transaction. Furthermore the companies that manage unit trusts also collect management fees in addition to the normal transactional taxes and brokerage associated with the buying of the underlying securities.

So what would be the result for our young investor if he were to have put his initial R50 000 into an average unit trust and held it unchanged for the next 40 years? Well, again assuming he had re-invested all his dividend income, he would have achieved an effective compound growth rate of 11.1% and over the next 40 years this would have grown his original capital to a total of R3.37-million.

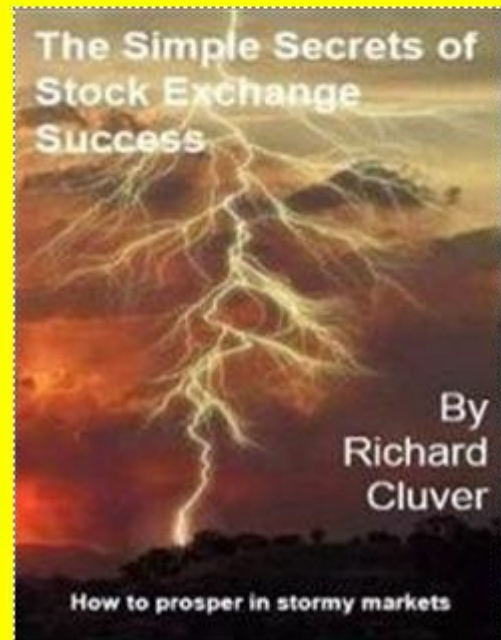
Can it really be possible that two different investments can yield such a dramatically different outcome: on one hand R21-billion and on the other just R3.37-million? Well what readers need to take to heart is that the real secret of growing great wealth is

the power of compound interest and that is why just a small difference in the returns you are able to achieve when you invest your hard-earned savings will in the end make a dramatic difference to whether you end your days disgustingly wealthy or in genteel poverty.

I will be away overseas next month so there will be no issue of The Investor; but in subsequent issues I plan to take up this theme to explain a simple approach to choosing top-performing shares!

## A new book by Richard Cluver

A new 225-page new Richard Cluver book entitled "**The Simple Secrets of Stock Exchange Success**" has just been released. Detailing comparisons between the monetary events that sparked the Great Depression of 1929 to 1940 and the current global melt-down, Richard Cluver's latest work explains how to survive and grow rich in stormy markets. It is priced at R130 and can be ordered by E-Mailing [Support@rcis.co.za](mailto:Support@rcis.co.za) with your credit card details or by phoning 031 9400 012



# Politics is damaging our economy

by Cees Bruggemans

**To talk of THE economy today is a complete misnomer. There are in fact three. The daily nuts-and-bolts one, the political one and select exporters.**

**And don't confuse the one with the others.**

The SA political economy is a raving disaster. The nuts-and-bolts are struggling, indeed going down on the goods side but carried by services. When it

comes to corporate results, select counters do well, others are losing growth momentum and yet others are severely struggling. To simply say we will do better in 2017 than in 2016 is somewhat ingenious if the underlying reasons for such mild optimism are usually not explained.

Besides base effects in agriculture, having hit bottom supposedly last year, the next part of the journey can only be up. Except why doesn't it feel

like that, with the political economy apparently working overtime to give us as little confidence as possible?

What remains is hope, but that isn't a strategy, I keep on being told. Iron ore keeps surprising at over \$90/ton in March. We should by now have seen a serious clawback which keeps receding. Apparently global supply has

been disciplined enough to keep the price bouncing back from its \$30-40 lows of early last year. At some point, supply will re-engage, but physically

this takes time, besides which all the major miners may be quite conservative by now in expecting price reversals, thereby underwriting the delay.

Even so, these prices are supportive for the producers concerned, and also help our balance of payments where the current account deficit keeps slowly

eroding, also assisted by a slow domestic economy and suppressed import demand.

Our political economy appears every month to throw up another disaster. The social grants undoubtedly will get paid every month going forward (at

least every thinking South Africa cannot conceive of it not happening and inviting the whirlwind), but opening the Sassa can has again suggested at

best incompetence and at worst corruption on an unprecedented scale, at the expense of the poor and the taxpayers.

The retracted Commonwealth Games hosting bid, and what it cost in thrown away money (over R100 million, and this money denied to SA sport) is just the

next episode of public wastage.

Observing corporate results announcements, many are being accompanied by asides regarding a lack of certainty, an increase in unease, a lack of

political confidence, all of it projected into the future. While some companies try to dress up their ultimate views with hopeful remarks, the results and body language tell enough. There is a growing unease,

which potentially could still last a considerable time.

Meanwhile the nuts-and-bolts economy tells its own story. The motor trade decline of the past three years may be bottoming out in year on year growth

data (the replacement cycle stabilising) but households remain negative even if buying more second-hand (still a sign of stress).

Mining should hold up, but not everything is iron ore, and the stats for the past decade is anything but encouraging, as is government policy in this

sector. The veneer of hope remains thin.

Retail kicked off 2017 very poorly in January, seemingly continuing the decline of December. There are positives, such as falling inflation this year

boosting real income, and oil prices stabilising, but against that we have the tax stripping by the finance minister.

Confidence remains the key in the private sector, and it is stuck deeply in negative territory. RMB/BER business confidence surveys still only report

a 40 level in 1Q17, meaning 6-out-10 business managers giving the thumbs down. It keeps manufacturing stressful, despite positive purchasing manager index readings, also not helped by a steadily firming Rand now at 12.68:\$

stripping away the trade support of last year.

It isn't as if the SA economy can't perform better. But with politics and public sector working at variance with the private sector, and the household

sector steadily losing its real income edge, the general lack of confidence keeps us back from bigger commitments, and the economy near stagnation

level. We remain in waiting mode for something better to turn up rather than making our own luck.

**Books to guide your investment**

<b>The Philosophy of Wealth</b> How to identify the long-term share market winners R130	
<b>Footsteps To Fortune</b> How to identify medium-term investment shares and effectively time the market R130	
<b>Investment Without Tears</b> Richard Cluver's original best-seller: how to get started on the share market R130	
<b>How To Make A Million</b> A step-by-step guide to the creation of investment wealth R130	
<b>300 Ways To Make Your Money Grow</b> 300 Investment growth solutions R130	
<b>Making Money With the Mutuals</b> How to win as a unit trust investor R130	

# The global picture is slowly mending

by Cees Bruggemans

**The temptation in today's uncertain world is to draw up a long list of risks to assess the state of the future. All risks being obvious, though not necessarily equal in stature. That way, though, one might miss the forest for the trees.**

It may pay to take a hard look at what has floored us in recent years, and to project these forces forward. And then still ask a few things about

looming risks as yet not felt. In my view, it is a remarkable short list that floored us in the post-financial crisis world. In other words I ignore 2007-2009, and start with 2010.

And as far as I can ascertain, there were three nutcrackers operational: Agricultural drought. The ending of the commodity supercycle. And the policy choices of Zuma and his elites.

The consequences were easy to identify. Plunging farm income and higher household inflation, creating a headwind for the economy. A falloff in mining income, similarly creating headwind for

the economy. And an underperforming public sector not pulling its full weight, while the preferred political policies caused private business

confidence to tank in unprecedented fashion, in ways that had never happened since WW2, causing a sharp slowdown in growth momentum.

The good news is that the multiple droughts of recent years are presumably cyclical. This season's maize output promises to be nearly twice last

year's. The global mining cycle is more complex, with its Chinese features first offering a terrific windfall to commodity producers followed by a terrific

bust. The Chinese industrialisation effort based on exportation will probably not be repeated on anywhere near a comparable scale. And the world

commodity producers have by now adjusted to this wrenching change.

The ironic news for SA is that not having fully geared up for the commodity supercycle due to incompetent policy interferences, our adjustment to the

bust wasn't as wrenching either compared to others. Small mercies. Any way, that's behind us. What isn't behind us, but looming bigger every day, is the ideological policy choices of government and its consequences.

One observes ordinary people carrying on with life, and telling institutionalised stories that all might be well (as no other message sells), but in

average boardrooms they are a lot more hard nosed than that. There has been a steady outward migration for greener pastures in what is called geographic diversification. It doesn't look yet at an end.

It would be different if we could see ourselves as one nation. But daily, some politicians take clear joy out of emphasizing how different we all are.

That is not a platform for building healthy confidence and risk-taking.

The real challenges and choices here still lie ahead in future political cycles. So far it isn't obvious that the larger population wants a change in policy direction. That carries its own consequences.

As to other known and unknown unknowns still ahead, it is difficult to get too uptight. America is a big rich country, in which political checks and

balances operate and nobody really gets the chance to do his nut. Trump has now been checked twice, by the courts on migration, and by the Republican

Congress on healthcare. Losing too many battles is not recommendable. It tarnishes the reputation, and makes more important battles lose stature. Tax

reform hopes have driven financial markets higher. If that were to falter, of which some signs, all future progress will be more difficult.

But in the end America is rich and will carry on. Its politics will mainly decide distribution aspects, whether to favour the rich over the poor or the other way.

One aspect could set the world back and do more damage than imagined. The wrong trade reforms could do real damage everywhere. But for now it remains difficult to read. Europe has bigger structural challenges than America. The quick conclusion is to expect the worst, and the region to fall apart. I am not convinced that is the will of the majority. But it may take a while shaping.

China has its structural challenges, and OPEC lives in a world of its own, one in which walls are thought to do the job. But American frackers became

the world swing suppliers some years ago, and it will be messy to unwind these controlled oil market shares. The world should benefit.

Two long-term realities concern me. One is climate change over which we may have less control than imagined. The other is global demographics, in the

way climate change, war, growing population pressure and economic failure sets in motion unprecedented population migrations.

The last few decades may only have seen the start of something infinitely more ugly. It is that which should concentrate minds, not about which

politician and elite should feed next.

# Angst in America: Aimless Men

By John Mauldin

**Angst is “a feeling of anxiety, apprehension, or insecurity.” Many of us feel it acutely right now – and that’s new. Angst isn’t a temporary, individual thing anymore. Now we all feel it together – or at least most of us do – and it’s not at all temporary. Millions can remember feeling no other way.**

There’s a general sense in much of the developed world that we’re headed for more difficult times. Deficits increase, unemployment rises, and the benefits of the future – or at least the future that is already here (to paraphrase William Gibson) – have been unevenly distributed throughout society. It is not just in voting patterns that you can recognize the sense of malaise. You can see it in the economic numbers and in a lot of the psychological/sociological research.

Angst manifests differently in different countries. Consider Japan:

Recent research by the Japanese government showed that about 30% of single women and 15% of single men aged between 20 and 29 admitted to having fallen in love with a meme or character in a game – higher than the 24% of those women and 11% of men who admitted to falling in love with a pop star or actor.

The development of the multimillion-pound virtual romance industry in Japan reflects the existence of a growing number of people who don’t have a real-life partner, said Yamada. There is even a slang term, “*moe*”, for those who fall in love with fictional computer characters, while dating sims allow users to adjust the mood and character of online partners and are aimed at women as much as men. A whole subculture, including hotel rooms where a guest can take their console partner for a romantic break, has been springing up in [Japan](#) over the past six or seven years. ([The Guardian](#))

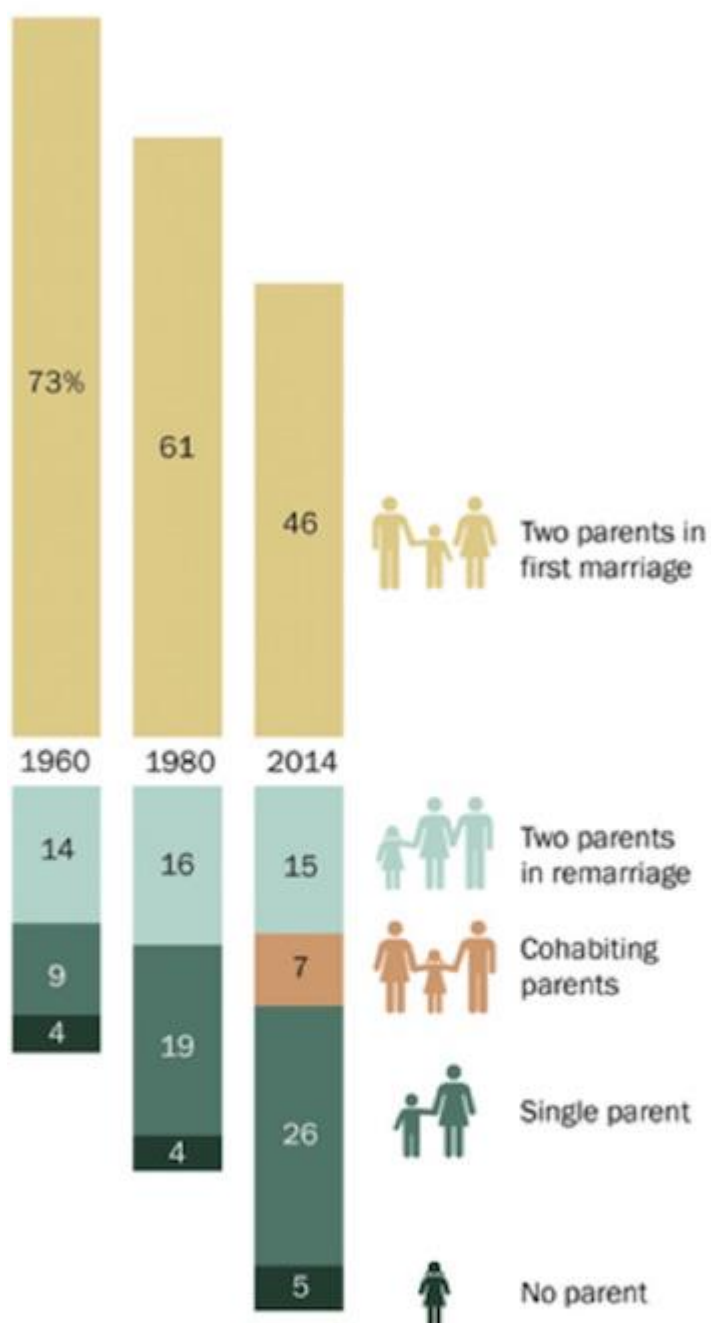
Is it any wonder that there is a dearth of babies in Japan? It’s hard to get pregnant when a computer avatar is your companion. Young British women are literally 20 times more likely to have a pregnancy out of wedlock than young Japanese women. The cultural oddity of *moe* partially explains that fact.

While researching this topic I came across literally scores of similarly disconcerting statistics. For instance, the difference between the income and employment status of young males who grew up in two-parent versus one-parent homes is staggering, especially when you realize how fast the number of single-parent homes – generally, though not always, led by the mother – is rising. Less than half of US children live in a traditional family setting, according to Pew Research.



## For children, growing diversity in family living arrangements

*% of children living with ...*



Note: Based on children under 18. Data regarding cohabitation are not available for 1960 and 1980; in those years, children with cohabiting parents are included in "one parent." For 2014, the total share of children living with two married parents is 62% after rounding. Figures do not add up to 100% due to rounding.

Source: Pew Research Center analysis of 1960 and 1980 decennial census and 2014 American Community Survey (IPUMS)

PEW RESEARCH CENTER

This week I want to look at what causes it and think about what we can do to ease it. I don't know how many letters this dive will take. I may break away for other topics and then come back to the topic of angst. The one thing I know, based on my own experiences with family, friends, and business associates and the feedback I get from readers, is that we have a big problem.

In his first inaugural address, Franklin D. Roosevelt famously said, "The only thing we have to fear is fear itself." In 1933 that wasn't even close to true. They had plenty to fear: The US was already in the throes of a depression that would only get worse, and war clouds were forming across the Atlantic and Pacific.

Roosevelt didn't have all the right answers, but he did one thing very well: He gave people hope. My generation heard from our parents, even decades later, how FDR helped pulled them through those hard times.

Of course, he had an important advantage today's leaders lack: Television, talk radio, and the internet weren't constantly reminding everyone how terrible things were. We didn't know or care about the intimate details of our leader's lives. Today, I am not sure even FDR himself could do what he did back then. Conditions are different now.

It is become increasingly clear to everyone that we are breaking ourselves up into tribes based on how we consume news. We consume our news from people who are generally ensconced in the same ideological bubble we are, which only reinforces our concerns and anxieties. If you think Donald Trump and Paul Ryan are taking us in the wrong direction, there are plenty of people who will agree with you and tell you so. If you think the people opposing them don't understand and are distorting the truth, there are plenty of sources that will confirm your thinking. And both sides talk/shout over the other.

We have always had polarization among our news sources (even back in colonial times), but it has never been so ubiquitous before, or so extreme; and the news has never been so readily accessible, so that numerous "tribes" can live in the same physical neighbourhood yet hear different versions and interpretations of the problems and directions in our country and the world. We no longer all listen to Walter Cronkite on the radio or TV or read the local newspaper for our news. There is no unifying national experience, just a disjointed series of intra- and intertribal interactions. (This is not just a US problem, but I'm going to be citing mostly US data.)

### **Labour Market Limits**

It's no wonder that so much of our angst is job-related. Some people don't have jobs at all while many others don't like the jobs they have. The millions of unemployed, underemployed, or unhappily employed touch all of us in some way.

If our nation's work rate today were back up to its start-of-the-century high, well over 10 million more Americans would currently have paying jobs. And that employment shortfall makes a real difference to the growth of the economy. There are only two ways to grow the economy: You either have to grow the number of people working, or you have to increase their productivity. If you remove 10 million American workers from the labour force, not only are they not producing anything, the vast majority of them are obviously consuming the fruits of the labor of those who are employed.

As we will see, the number of people dropping out of the labour force is increasing, and if that trend is not turned around, the hope that we will get back to 3% GDP growth is simply wishful thinking. Couple that trend with reduced productivity and we will be lucky to see even 2% growth for the rest of the decade. If we have a recession, we will end up with a lower GDP than we have today. Think about that, and then plug it into federal budget projections.

Meanwhile, employers feel a different kind of angst. Many either can't find qualified workers or their workers require constant attention and extensive training to be productive. Neither side of the labour-management divide is happy with the arrangements. Everybody is apprehensive about the future. The common complaint from businessmen is not that they need more capital and the ability to borrow money from banks, but that they need more good workers in order to attract more good customers.

This widespread dissatisfaction among employers, employees, and those who aren't working is one big reason Donald Trump is now president. He paid attention to a large group of voters that others ignored, spoke to their anxieties, and won the White House. It was not simply working-class white males that he appealed to; that is far too simplistic an analysis. It was also their bosses, spouses, parents, and friends. A huge swath of the country was experiencing a yawning disconnect between the reality of their daily lives and the supposedly growing economy touted by politicians and media pundits. We focus on the anxiety of the white working-class male, but I challenge you to find me an identity group (however you want to define it) that isn't anxious and concerned that things aren't heading in the right direction.

American culture used to be known for its optimism, its can-do spirit. That quality hasn't vanished, but it has surely lost some of its lustre this century. You can see it fading in the statistics about the number of new business start-ups, which is now less than the number of businesses closing down. And that trend has been in place for almost a decade. The hope that the situation was temporary probably let people tolerate much worse conditions than they should have. But you can only look on the bright side so long before you get tired of waiting.

The change in direction that began at about the turn of the century is described clearly in Nicholas Eberstadt's biting essay in *Commentary* magazine entitled "[Our Miserable 21st Century](#)."

I will quote from that essay several times in this letter. If you take the time to read it, you should also read the pushback from my friend John Tamny, published in *Forbes* a few days ago, titled "[Nicholas Eberstadt, Election 2016, and Self-Flagellation by the Elites](#)."

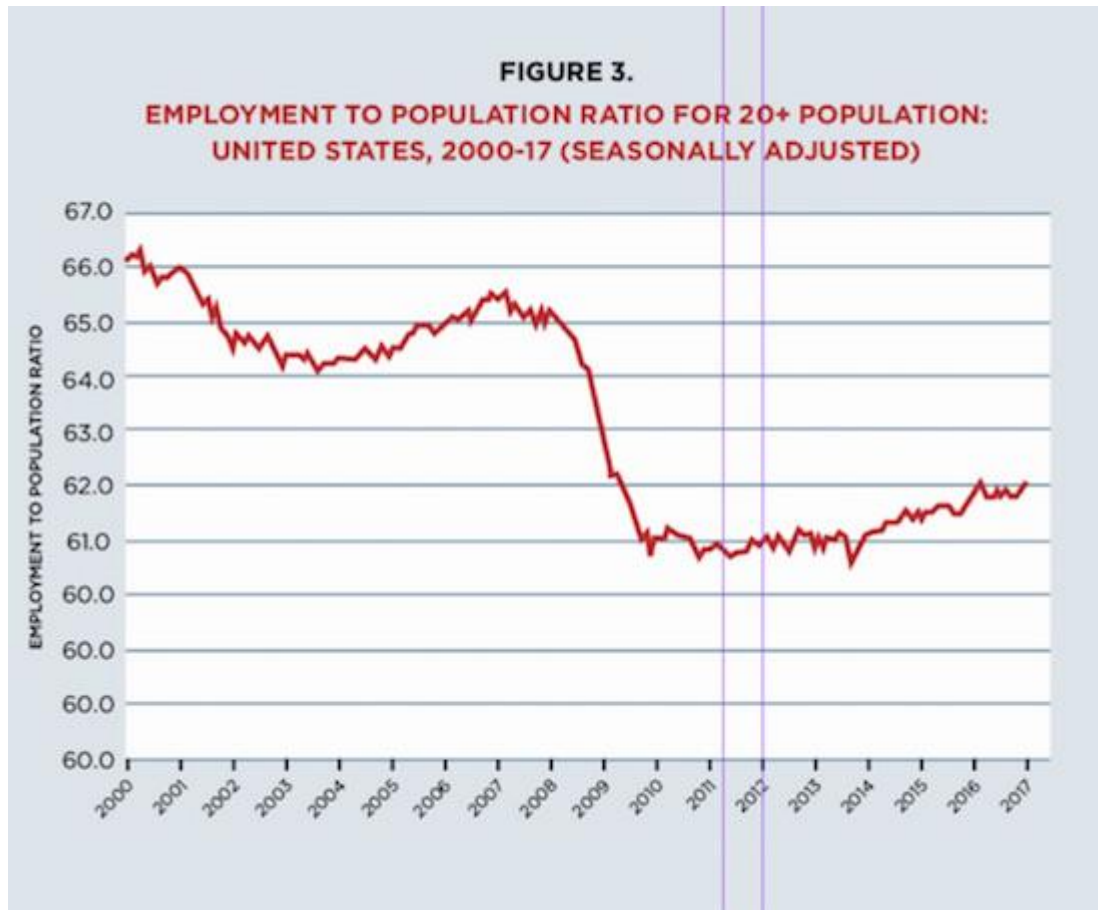
### **Men Without Work**

One problem is data-related. The "labour force" from which we calculate unemployment statistics necessarily includes only those people who are either working or who wish to be working. It ignores the retired, those in school, the disabled, nonworking spouses, as well as those who are not interested in working.

That's always been the case, of course, but the percentages vary. Even a 1% variance in the size of the labour force represents millions of people in a nation as large as the US. So the data got even murkier as the Baby Boomers approached retirement age. The oldest of that very large cohort turned 65 in 2010. Some

probably retired early for various reasons. Others worked or will work well beyond the theoretical retirement age of 65, either voluntarily or not.

Regardless, it is definitely the case that a smaller percentage of the adult population is working now than in the past. The percentage declined in the early-2000s recession and never fully recovered before plunging in 2008–2010. We see only a very slight upturn after the recession ended.



The problem is particularly acute for men, though it affects women as well. Recently I read a marvellous book called *Men Without Work: America's Invisible Crisis* by Nicholas Eberstadt, who wrote the essay in *Commentary*. The book is fairly short, and I highly recommend it. Eberstadt, who is a researcher at the American Enterprise institute, is very concerned with the large number of men in their prime who simply aren't working. This isn't a new development, nor is it restricted to men, but it is becoming more obvious. (At some point I will do a full review of the book.)

When Federal Reserve officials gathered last week to raise interest rates, they reviewed the data that says the economy is near "full employment." That notion is laughable to millions of regular Americans. We all know, or at least observe, plenty of working-age males who *could* be working but are not. They don't appear in the stats as unemployed unless they are "actively looking" for work. Or they may count as "employed" because they spent an hour or two doing odd jobs that month. But for all practical purposes they're unemployed, and someone else is supporting them.

Eberstadt digs into the data and estimates that for every unemployed American male between ages 25–55, there are three more who are neither working nor looking for work. The number of those males presently in the labour force is down almost 4

percent since 2000. That's about 5 million men who, for whatever reason, have dropped out of the labour force.

Here's another and possibly even more startling number. Between 2000 and 2015, the total paid hours of work by all American workers rose 4 percent. The prior 15-year period saw a 35-percent increase in work hours. That's bad enough, but it gets worse. In that same 2000–2015 period, the adult civilian population grew almost 18 percent.

With the population growing far faster than the total number of work hours, it shouldn't be surprising that so many people aren't working. And maybe they should be –you could surely argue that the work hours will appear if these people get busy and demonstrate their worth. In some cases that's likely true, but the full picture is more nuanced. The downturn in labour force participation is a trend that has been going on among working-age men for over 60 years, and recently (and somewhat alarmingly) we have seen the same negative trend in working-age women. Let's look at a few charts from the FRED database of the St. Louis Federal Reserve Bank.

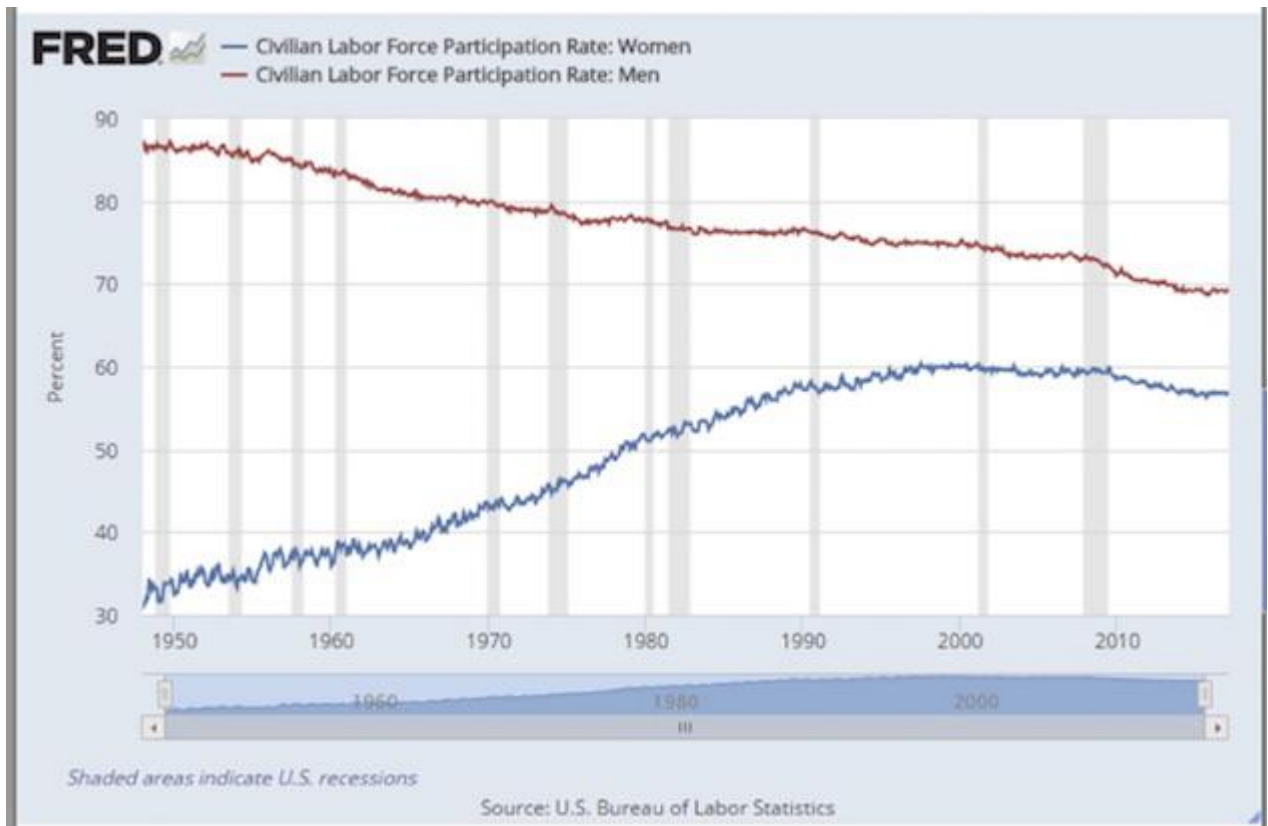
This first chart shows the overall civilian labour force participation rate, which grew from the mid-'60s right up until the beginning of the century.



But that chart is misleading. It looks like things were just fine up until 2000, but that's not the case. The next two charts show what really happened. The first chart is the male labor force participation rate. There is a bit of a statistical illusion in the way the data is framed, but let there be no mistake: The drop-off has been significant.



The next chart shows the labour force participation rate for both men and women. Note that the participation rate for women doubled in the 50 years up till 2000, while for men it went from almost 90% (87.4% to be precise) to just below 70% today. And that falloff has been steady throughout the entire period. This is not a recent phenomenon, although the downturn has worsened significantly since 2000. Notice that the participation rate since 2000 among women has been dropping at roughly the same rate as for men, at least in the last 6–7 years.



## How Does It Start?

The progression from childhood to working adulthood used to be fairly standard. In an idealized form, which now seems almost mythological, it went something like this.

You grow up seeing at least one parent go off to work every day. You know from an early age that this is normal and necessary to support the family. When you reach your preteens, you get a starter job of some kind – paper route, mowing lawns, babysitting, etc. Maybe you get a regular job after school or in the summer. You finish high school and gain some independence from your parents by going to college or into the military, or by getting a full-time job, which may involve learning a trade. After a few years of saving your money, you're ready for marriage and the purchase of a starter home. Then you live happily ever after. The End.

That sequence, to the extent it ever existed, is pretty rare now. The majority of children grow up in broken homes, see parents hop from job to job with little satisfaction, and in some areas grow up surrounded by crime and welfare dependence. Overcoming that kind of start to get on a positive path is hard. People still understand that education is critical, but it's also more expensive than ever. Young adults take on student debt only to find the wonderful career they imagined isn't so easy to come by.

Then there's a second category. These are people who may grow up in stable surroundings, make all the right moves, get a good education, and start a rewarding career, only to run into a buzzsaw recession like we had in 2007–2010. They get laid off, burn through their savings, spend months or years looking for work, and eventually give up in despair. Then families break up, people move back in with parents, addictions form, and everything gets worse from there. And if such people do finally get another job, it comes with lower pay and fewer benefits.

On this topic, here are some quotes from “Our Miserable 21<sup>st</sup> Century.”

A short but electrifying [2015 paper](#) by Anne Case and Nobel economics laureate Angus Deaton talked about a mortality trend that had gone almost unnoticed until then: rising death rates for middle-aged US whites. By Case and Deaton’s reckoning, death rates rose somewhat slightly over the 1999–2013 period for all non-Hispanic white men and women 45–54 years of age – but they rose sharply for those with high-school degrees or less, and for this less-educated grouping most of the rise in death rates was accounted for by suicides, chronic liver cirrhosis, and poisonings (including drug overdoses)....

All this sounds a little too close for comfort to the story of modern Russia, with its devastating vodka- and drug-binging health setbacks. Yes: It can happen here, and it has. Welcome to our new America....

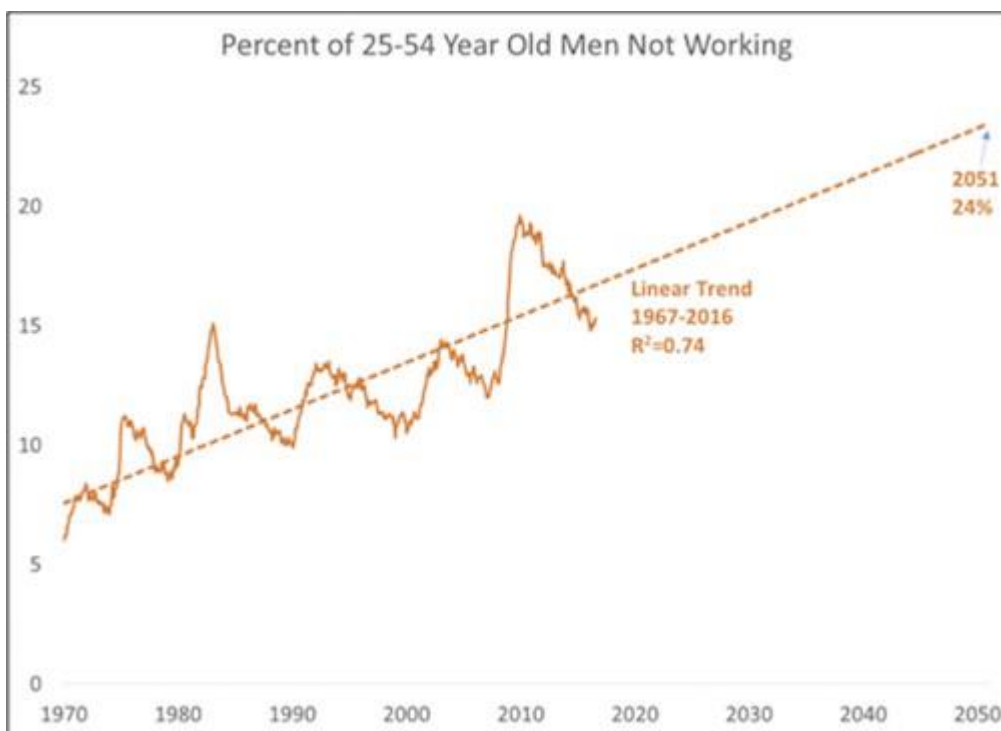
By 2013, according to a [2015 report](#) by the Drug Enforcement Administration, more Americans died from drug overdoses (largely but not wholly opioid abuse) than from either traffic fatalities or guns....

In [Dreamland](#), his harrowing and magisterial account of modern America’s opioid explosion, the journalist Sam Quinones notes in passing that “in one three-month period” just a few years ago, according to the Ohio Department of Health, “fully 11 percent of all Ohioans were prescribed opiates....”

[N]early half of all prime working-age male labour-force dropouts – an army now totalling roughly 7 million men – currently take pain medication on a daily basis.

### The Big Question: Why?

Again, both men and women are dropping out of the labour force at higher rates, but Eberstadt shows it is more common for men to do so. The trend is getting worse, too.





Larry Summers shared the above trend chart in his *Men Without Work* book review. You can see that the trend goes back way before NAFTA and factory automation were big factors. The percentage spikes higher in each recession then falls back, but in a series of “higher lows.” I generally hesitate to extrapolate this far into the future, but after six economic cycles with the same effect, I think it’s fair to call this a persistent pattern.

If the trend since 1970 does continue, nearly a quarter of all men aged 25–54 will be voluntarily jobless by mid-century. We should all hope the pattern does *not* persist, because I can’t imagine this scenario being good for anyone. Large numbers of unoccupied young males are rarely beneficial to social order.

But that outcome is totally possible. Let’s go back to what I was writing a few weeks ago. When six million truckers and taxi drivers are put out of work starting in 2025 (but will surely be out of the driver’s seat by 2040), along with most auto-industry repair and maintenance workers who now repair gasoline and diesel engines, and the auto insurance business too has been decimated, it is not hard to imagine a world in which 20%+ of the population is not part of the labour force. (And that’s just one industry.)

Set aside the future, though. We have millions of unoccupied working-age males right now. What are they doing all day? Survey data suggests they spend much of their time staring at screens, either TV or video games. They watch a lot of pornography. On average, they are in front of a screen for 2000 hours a year, about what most people spend working a full-time job. Many live with relatives or couch-surf between friends’ homes. They say they’ll look for a job when conditions improve, but that’s always tomorrow. They just drift.

I can’t find hard data, but I suspect this group works more than the surveys indicate. Much of the work happens off the books as they try to preserve government benefits or avoid child support payments. Nevertheless, they surely don’t have stable careers. Why not? What are the barriers? Here are a few, in no particular order.

Education: Many of the aimless males barely made it through high school and aren’t ready for college. Maybe they could get ready, but that would take money and dedication few of them have, especially after they are 30 years old. This limits their options to manual labour, low-end service work, or even less positive options.

Now, it’s easy for someone like me to say these men should swallow their pride and buckle down at whatever kind of work they can get. Yes, they should. But it’s one thing to work in the salt mines when you know you’re on your way to something better, and quite another when you know it’s the end of your road and you’ll never do better. That’s got to be discouraging. Given a choice between jobs like that and playing video games, it’s no wonder so many choose the virtual life.

Safety Nets: Our well-intentioned social programs can create a disincentive for people to work. That’s not always the case; sometimes people fall on hard times and need a temporary hand up, and society benefits by making them productive again. We need to do a better job of creating the right incentives and avoiding the wrong ones.

This also goes for disability benefits. You’ve seen the statistics on how many people suddenly acquired debilitating medical conditions during the Great Recession. To my non-physician mind, it seems like distinguishing between genuine disabilities and

fraudulent ones would be simple. Apparently it's not. Here again, we need to consider incentives and deliver the right ones. Eberstadt notes (again quoting from "Our Miserable 21<sup>st</sup> Century"):

By the way: Of the entire un-working prime-age male Anglo population in 2013, nearly three-fifths (57 percent) were reportedly collecting disability benefits from one or more government disability program in 2013. Disability checks and means-tested benefits cannot support a lavish lifestyle. But they can offer a permanent alternative to paid employment, and for growing numbers of American men, they do.

The rise of these programs has coincided with the death of work for larger and larger numbers of American men not yet of retirement age. We cannot say that these programs caused the death of work for millions upon millions of younger men: What is incontrovertible, however, is that they have financed it – just as Medicaid inadvertently helped finance America's immense and increasing appetite for opioids in our new century.

Addictions: A startlingly high number of men without work take prescription pain medicines. Others use alcohol or other drugs. I'm sure many really are in pain, especially older men who worked on assembly lines or did other hard labour. Physical pain plus the discouragement of being unemployed plus happiness-inducing substances is a toxic and sometimes deadly combination. Quoting again from "Our Miserable 21<sup>st</sup> Century":

You may now wish to ask: What share of prime-working-age men these days are enrolled in Medicaid? According to the Census Bureau's SIPP survey (Survey of Income and Program Participation), as of 2013, over one-fifth (21 percent) of all civilian men between 25 and 55 years of age were Medicaid beneficiaries. For prime-age people not in the labor force, the share was over half (53 percent). And for un-working Anglos (non-Hispanic white men not in the labor force) of prime working age, the share enrolled in Medicaid was 48 percent.

If you qualify for Medicaid, then for your \$3 co-pay you can get a prescription for OxyContin. The street value of that prescription is theoretically around \$10,000. It's just the most expensive street drug available. All you have to do is find a doctor willing to write that prescription, which is evidently not that hard to do. (Some 20 years ago, I was prescribed OxyContin in Mexico as a sleep aid (from a very reputable doctor), because I wanted something different from what I'd been taking. One pill knocked me for a loop for 24 hours, putting me into a very strange, mind-altering situation. I threw that bottle away and can't imagine how anyone can function normally taking that drug. It should be banned.)

The addictions don't simply harm the men themselves. They lead to broken homes, unwanted pregnancies, domestic violence, lost job opportunities, criminal records, and more. Eventually you get whole communities riddled with dysfunctional, addicted people. It becomes very hard for anyone to escape the cycle.

Crime: I am not talking about an increase in crime, because overall US crime is actually in a real downtrend and has been for some time. The actual, often overlooked, problem is the large number of people with criminal records. Obviously, we shouldn't ignore crimes, but we've developed a system that punishes people long after their formal sentence has been served. Many jobs are simply off limits to people with a felony or drug offense on their record, and easily accessible databases mean

more employers do background checks now. In Texas, as in many states, you can't get a simple apartment lease if you have a felony conviction or, in many areas, just a felony charge. Many potential employers simply never follow up if they see that criminal record. And we are talking about a significant part of our population. While there may be "only" 1.5 million men in prison today, that population turns over and has accumulated to startling proportions. Eberstadt sizes up the problem in "Our Miserable 21<sup>st</sup> Century":

We have to use rough estimates here, rather than precise official numbers, because the government does not collect any data at all on the size or socioeconomic circumstances of this [felony convict] population of 20 million, and never has. Amazing as this may sound and scandalous though it may be, America has, at least to date, effectively banished this huge group – a group roughly twice the total size of our illegal-immigrant population and an adult population larger than that in any state but California—to a near-total and seemingly unending statistical invisibility. Our ex-cons are, so to speak, statistical outcasts who live in a darkness our polity does not care enough to illuminate – beyond the scope or interest of public policy, unless and until they next run afoul of the law.

Think about what this approach does. Even if a man has every intention of reforming his life, he probably can't do so unless he gets a steady job. That won't happen unless some employer overlooks his background and gives him a chance. The alternative is to drop out of the labour force and drift, creating and participating in all the other disorderly conditions we've outlined.

### **Elusive Solutions**

As you can see, "men without work" is a tough problem. It's as much sociological as economic, but it has a serious economic impact. Our moribund economy will have a hard enough time supporting millions of Baby Boomers who lack sufficient retirement savings (that's a topic for another letter). Adding millions of nonworking young and middle-aged men to the dependency pool doesn't help.

Technological solutions may not come to our rescue this time. If anything, technology is aggravating the problem by making it cost-effective for machines to do entry-level work that once needed humans. And while technology does create jobs, it is not creating entry-level jobs that don't need education and training.

I started this letter talking about Franklin Roosevelt. He faced a similar problem when the Great Depression put millions of able-bodied men out of work. One response was national service programs like the Civilian Conservation Corps. I'm not sure something like that is feasible now. But doing nothing is not feasible, either.

# Stock market indices: Swix in the mix

by Brian Kantor

**The very large weighting of Naspers in leading indices like the JSE Swix and the JSE All Share Index has major implications for active and passive investors alike. Investors need to be aware of what this means for the risk attached to their portfolios.**

The original reason for constructing a stock exchange index was simple: to provide a statistic that summarised the price performance of the average company listed on a widely followed stock exchange. The calculation of such an average or index is supposed to represent the general direction of the equity market.

The most famous and oldest of the indices that tracks share prices on the New York Stock Exchange, the Dow Jones Industrial Average (DJIA), simply aggregates the US dollar share prices of the 30 largest US companies. The higher the prices of the individual shares included, the higher the DJIA and vice versa. The S&P 500 was introduced later and has become the most important of the global indices. In contrast with the DJIA, the S&P 500 tracks the market value of the 500 largest companies listed on the New York stock exchanges. The share price moves of the largest companies carry the most weight in the index and move the index proportionately.

Indices that attempt to summarise equity market performance, however, have much more than simply an informative role. They are also widely used to measure the ability of fund managers who actively manage their share portfolios and compete with other managers for assets to manage. Relative, as well as absolute price performance and returns, matter to both fund managers and their clients.

The performance (total returns in the form of price changes plus dividend income) of the funds they manage are not only compared to those of their rivals, but also to some relevant equity index. The ability to generate returns ahead of the benchmarks – the returns (theoretically) generated by the index (positive or negative) – becomes their measure of success or failure. Conventional wisdom now dictates that index-beating returns, beating the market (after fees), is the only reason for active management. We will show why this is incorrect.

## **A passive approach**

Because of the difficulty that the average equity fund manager faces in trying to perform better than the index, there has been a large move to so-called passive equity investment strategies. Investors simply track some index by dividing their equity portfolios in exactly the same proportions (weights) as the shares included in the index.

Index tracking funds (under the banner of the so-called exchange traded funds or ETFs) have been created in large numbers by different fund management houses to facilitate such an investment strategy. This process generates no more or less than index-equivalent returns for the investor. The advantage for the investor is that since

no knowledge or experience of the market place is needed – only a suitably programmed computer – the fees charged for the service (usually measured as a percentage of the assets under management) can be far lower than the fees typically paid for actively managed portfolios. These latter fees are charged to cover the higher costs of active managers, for example the salaries of the stock pickers and their analysts, as well as the trading and marketing costs incurred by the firms.

The ETFs and their originators and managers are therefore taking full advantage of highly efficient and competitive equity markets, without contributing to the process of price discovery. It is this efficiency in processing information about companies and the economic and political forces that will influence their future profitability (and their current value) that makes the share market so difficult to beat. Such information comes without expense for the passive investor.

Another expensive responsibility incurred by active shareholders is the surveillance of the managers of the companies in which they invest client wealth. This responsibility and the accompanying costs are largely avoided by passive investors. Good corporate governance demands that shareholders cast their votes on corporate actions by exercising proper diligence, which has a cost. Engaging actively with company managers is essential for active investors but not for index trackers.

The index trackers are free riders on the investment bus, paid for by others. The proportion of funds that would have to be actively managed to make for a well-informed, efficient marketplace and to keep the investment bus rolling cannot be known with any degree of certainty. If all investors simply followed rather than led, the market would be full of valuation anomalies, from which only a few active investors could become fabulously wealthy by exploiting the valuation gaps.

### **The relevance of risk**

Prospects like these are what encourage active investors to take risks. Think of hedge fund managers who take large risks in exchange for prospectively (not always realised) large returns. They also add helpful liquidity to the market that facilitates trading activity by risk averse investors. It is the expected distribution of returns, the small chances of a big win on the markets and the potential to achieve long run returns sustained well above average market returns that explains some of the preference for active managers. A select few of these (though we never know which few) will always beat the market by a large and sustainable margin.

This raises an all-important issue. Investment decisions and the make-up of investment portfolios are not determined only by prospective returns. The risk attached to such prospective returns is at least as relevant for the average wealth owner saving for retirement or a rainy day. This is the risk that the portfolio can lose as well as gain value. Stock market indices and the ETFs that track them can be more or less risky, depending on their character and composition. An essential requirement of a low-risk equity portfolio, actively or passively managed, is that it should be well diversified against risks that individual companies are exposed to.

This is achieved by spreading the portfolio among a large number of shares, none of which should account for a large proportion of the portfolio. The threats to the value of a share of a company that comes from adverse circumstances beyond the control of all company managers – i.e war, revolution, taxation, expropriation, regulation, inflation and financial crises – can only be mitigated by diversifying the wealth

owners' total portfolio across different asset classes, such as bonds, cash or real assets – or different jurisdictions. Index-tracking ETFs can simulate a particular equity market or well traded sector of it. But designing an optimal, risk-aware total portfolio – how much equity or other risks a wealth owner should assume – calls for more complicated considerations.

An important consideration for any investor tracking some equity market index is the issue of how well diversified the index being tracked is. A further consideration is which equity markets should be tracked given their very different risk profiles and how they are constructed.

The S&P 500 is very clearly well diversified against US company specific risks. The JSE All Share Index, by contrast, is not well diversified, nor is the JSE Top 40 Index nor the JSE Shareholder Weighted Index (Swix), which has largely superseded the other JSE indices as the benchmark for measuring the performance of SA equity managers. The Swix is weighted by the shares of the company registered by the JSE itself, as opposed to shares registered for transfer on other exchanges where the company may also have a primary or secondary listing. The larger the value of the shares registered by the JSE (Strate), the larger the weight that company will be allocated in the Swix. It should be understood as a measure of the proportion of the shares registered for transfer in SA, not necessarily of the share of the company owned by South Africans.

### **How diversified is your index?**

The largest company currently included in the S&P 500 Index is Apple, with an S&P 500 Index weighting of only about 3%. The largest 100 of the S&P 500 account for about 60% of the index. In strong contrast, the largest company included in the market capitalisation-weighted JSE All Share Index in November 2016 was Naspers, with a weight of 17.14% in the Index. The next largest company included was British American Tobacco, with a much smaller weight of 4.31% followed by Sasol with 4.08%. The largest 10 companies included in the All Share Index now account for as much as 42.6% of its weighting – it's clearly a much less diversified index than the S&P 500. Until its recent takeover, SABMiller was accorded a large weight in the All Share Index and the other leading indices. It is no longer represented and its new owner, AB Inbev, while already listed on the JSE, at the time of writing had still to make an appearance in the indices. The weights in the Swix have become similarly

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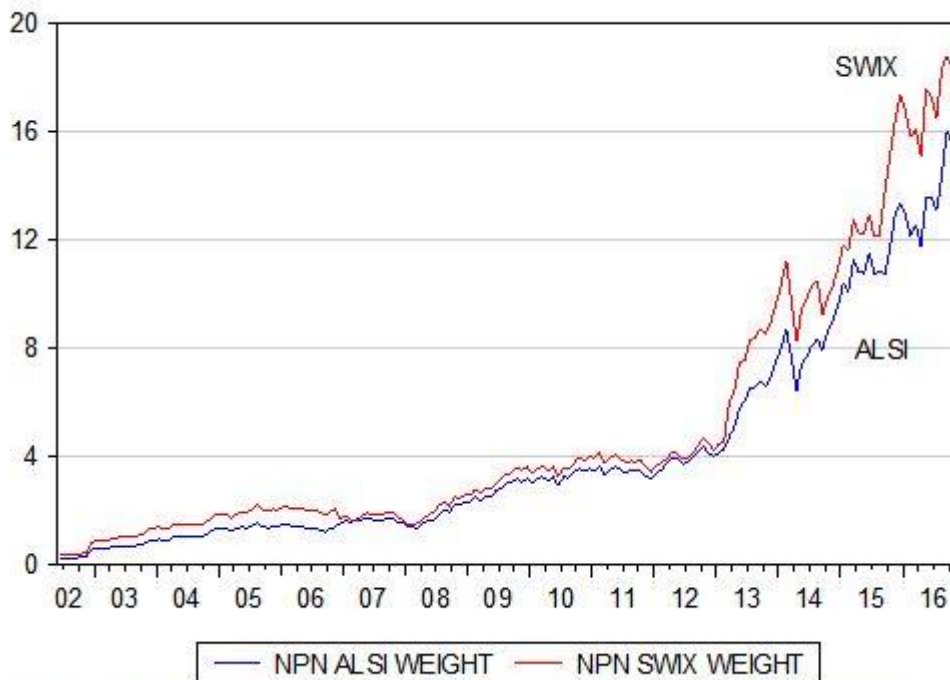
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lopsided as we show below in figure 1. The weight of Naspers in the Swix is now even larger than that accorded to it in the All Share Index.

**Figure 1: The share of Naspers (NPN) in the JSE Swix and All Share Index (2002-2016)**



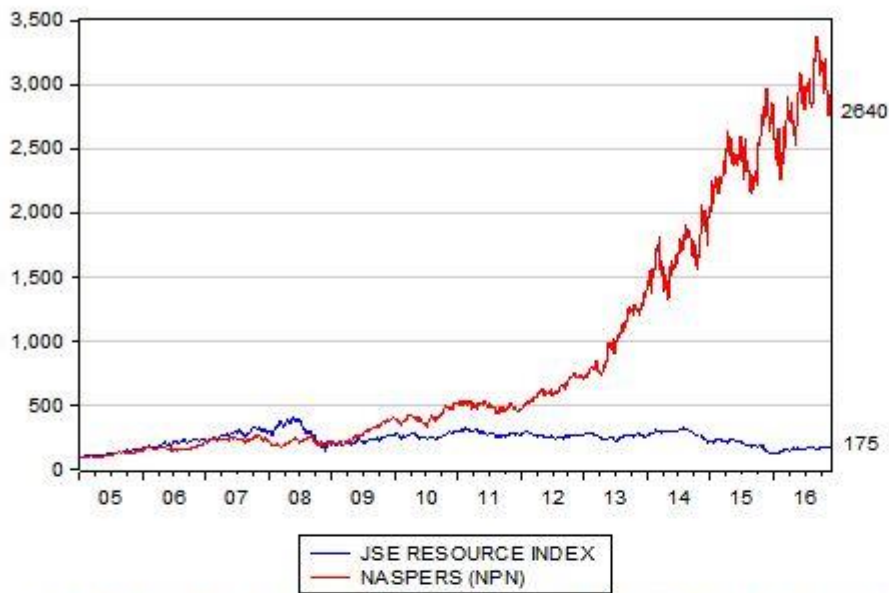
Source: Bloomberg, Investec Securities and Investec Wealth & Investment

The weight of Naspers in the JSE indices has risen automatically with the extraordinary and persistent increases in its share price. Naspers shares are also all registered on the JSE, though foreign investors hold a large proportion of the company. As important for increasing the weight of Naspers in the indices has been the near stagnant value of resource companies that once had a very large weight on the JSE, but whose valuations have increased very little over the same period.

### **From mining to media**

In figure 2 we compare the Naspers share price with that of the JSE Resources Index. The Naspers share price has increased 26.4 times since June 2002 while the JSE Resources Index has not even doubled over the same period. In figure 3 we show consequently how the weight of resources in the JSE All Share Index has declined from over 40% in 2008 to about 15% today, a lower weighting than Naspers on its own. The Swix reveals a very similar pattern, according a very high weight and importance to the Naspers share price moves and much less importance to resource companies in the direction the index takes (and so any ETF that tracks the JSE All Share Index or Swix).

**Figure 2: The JSE Resource Index and the Naspers (NPN) share price (2002=100)**



Source: Bloomberg, Investec Securities and Investec Wealth & Investment

**Figure 3: Resources weightings in JSE All Share Index and Swix versus Naspers (2002-2016)**



Source: Bloomberg, Investec Securities and Investec Wealth & Investment

It is the rising Naspers share price and its growing and larger weight in the Swix that has made the latter the best performing of the local indices over the past 14 years. The differences in performance are significant. R100 invested in the Swix in 2002 with dividends reinvested (before fees and taxes) would have grown to R864 by November 2016. The same investment in the JSE Top 40 would only have realised R645, with the All Share Index and an equally weighted index of the 40 top



companies performing somewhat better. Not only did the Swix deliver higher returns, but it did so with less volatility than the other indices, thanks to Naspers (see figures 4 and 5 below).

Clearly, choosing the right index to represent and track the JSE and measure the performance of active managers is an important decision for investors or their advisers to make. All indices are not alike and some can be expected to deliver returns with much greater risk or volatility than others.

The major JSE indices that might be used to deliver market equivalent returns by some tracker fund or others are not suitable for diversifying the specific company or sector risks that investors tracking the index will be exposed to. Naspers carries far too much weight and therefore exposes index-tracking investors to much more danger than would be appropriate for any risk averse portfolio. The same criticism could have been made of the composition of the JSE indices in 2008: they were too exposed to the specific risks that faced resource companies. Investing over 40% of an equity portfolio in resource stocks – with their well known dependence on highly unpredictable metal prices – is not something a risk averse investor would want. The same argument could be made of a current exposure to Naspers: investing up to 20% of a portfolio in one company would be regarded as highly unwise.

Wise and risk averse active managers presumably would not have allocated 40% of their portfolios to resource companies in 2008. And, they would have been much more likely to have outperformed the indices over the subsequent eight to nine years as resource valuations fell away. They would also have done even better with a larger-than-index weight in Naspers. But the risk conscious fund manager would have had to become ever more cautious about exposure to Naspers after 2013, when its weight in the index began to exceed 10%. Prudence would suggest that no more than 10% of any equity portfolio should be invested in any one company.

Given this, along with the current 18% plus weight of Naspers in the leading SA indices, active managers are therefore much more likely to underperform the index when Naspers is outpacing other stocks, as has been the case until recently. Conversely, they would outperform should Naspers lag behind the other stocks included in the index. The case for or against active management in SA should not have to depend on the fortunes of one company.

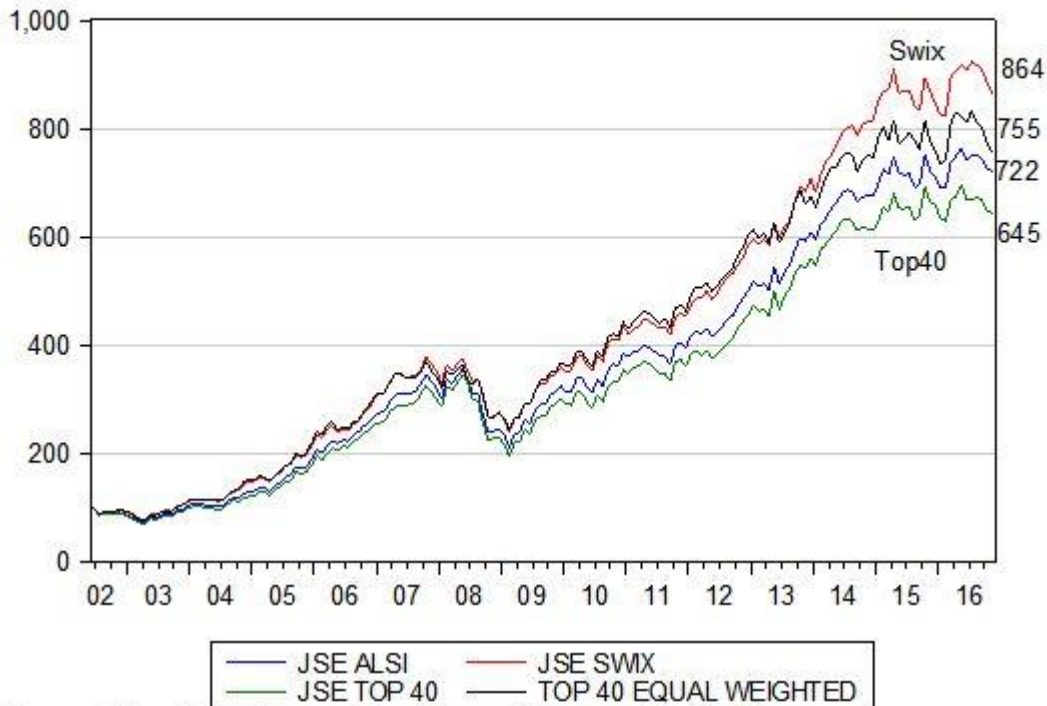
Judging the performance of a fund manager in South Africa by reference to a very poorly diversified Index like the JSE All Share Index or Swix would not be an appropriate exercise. Realised returns should always be compared to the risks that were taken to achieve those returns. The task of the active manager is not simply to aim at the highest returns for their clients, they should also be managing risk.

Recognising the risk tolerance of their clients and allocating assets and planning savings accordingly is a large part of a fund manager's duties. This is even more important when the market (index) carries identifiable and unjustifiable risk as the JSE indices have done and continue to do. Even when the active investor has not beaten the market, the advice offered can be very valuable.

There is incidentally no risk when calculating past performance. Risks apply only to expected performance – not to known past performance. Investing in an index tracker is not a decision that can be made passively because such advice is not

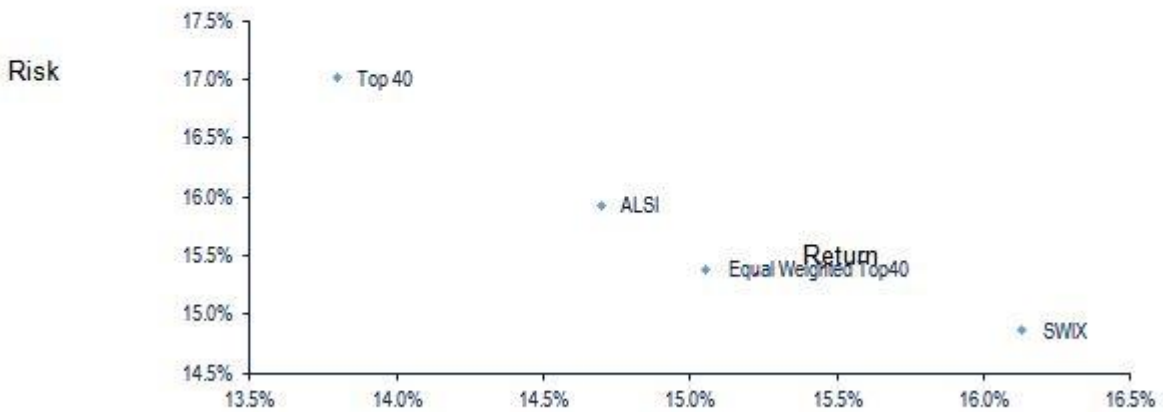
easily provided by a robot and is worth paying extra for, or ignored at the investor's peril.

**Figure 4: JSE Index total returns, June 2002 to November 2016**



Source: Bloomberg, Investec Securities and Investec Wealth & Investment

**Figure 5: Index annual average risk and returns (2002-2016)**



Source: Bloomberg, Investec Securities and Investec Wealth & Investment

Note: I am indebted to Chris Holdsworth of Investec Securities who painstakingly undertook all the Index and return calculations that are used and represented in this report. All the indices used in the study are dynamic ones representing the indices and the sector and share weights in them, as they occurred over time.