Richard Cluver Predicts

In our 22nd year of service to the investing public of South Africa

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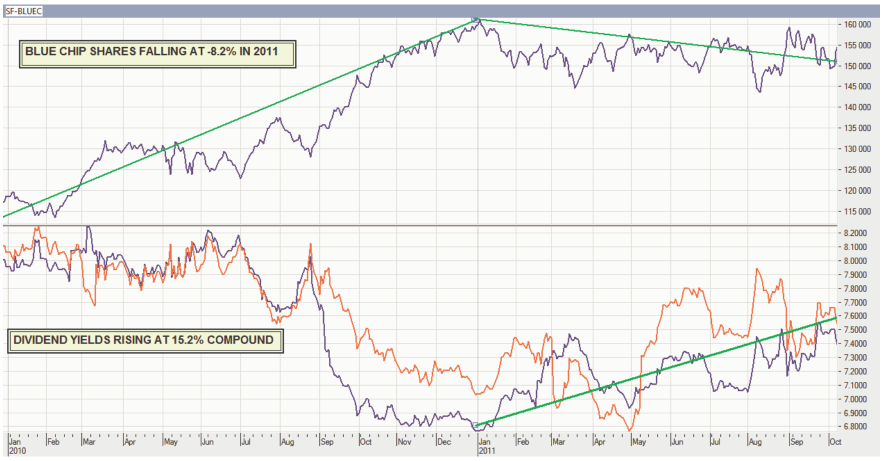
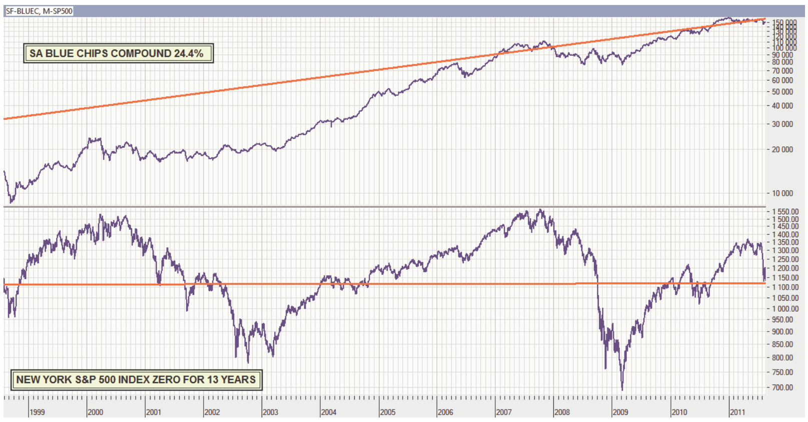
In the October issue of Prospects that went out this week I argued that South African shares, having moved sideways for most of the year, have in the process moved from a relatively overpriced position to fair value.



The graph composite on the right illustrates what has been happening. Blue chip share prices were rising at 51.7% compound for the two years to last December and in the process the average Blue Chip dividend yield (blue graph lower) fell from 6.3% to 3.8% while the average earnings yield (red graph lower) fell from 12.3% to 7%.. However, corporate profits have been rising steadily – on average they rose at 18% over the past year and at a compound average of 24% over the past five years – with the result that the two graph lines have been converging and, from an investment point of view Blue Chips have been growing increasingly attractive.

To illustrate the point, South African bonds have attracted billions of Rands over the past year as nervous investors have sought a safe haven for their money. The result has been that the yield on the R157 long bond has fallen from 7.2% last October to a current 6.7%. Noting that the interest yield on bonds is taxable while dividends are tax free, the implication is that to the marginal taxpayer paying 40% the after tax yield on the R157 today is 4.02% compared with the Blue Chip average dividend yield of 3.8%.

Now of course bonds offer no capital gain potential whereas over the past 25 years Blue Chips have risen in value at a compound annual average rate of 24.4%. One might thus deduce that the total return on the average Blue Chip is currently 3.8% plus 24.4% which equals 28.2% compound. Divide that by the 6.7% yield on the R157 and it is obvious that the price of the flight into safety is a return of only one quarter or, conversely, investors parking their money in bonds are giving away three quarters of their potential gains



Sooner or later then, investors are going to wake up to the fact that they are paying a massive price for safety and they will begin a stampede back into shares and the next big bull market will begin. The only question is when? Furthermore, note the graph on the right which compares the movement of New York's Standard and Poors 500 Index over the past 13 years with that of South African Blue Chips, it is obvious that Developed World markets offer NO growth potential other than to traders who have ridden the market cycles.

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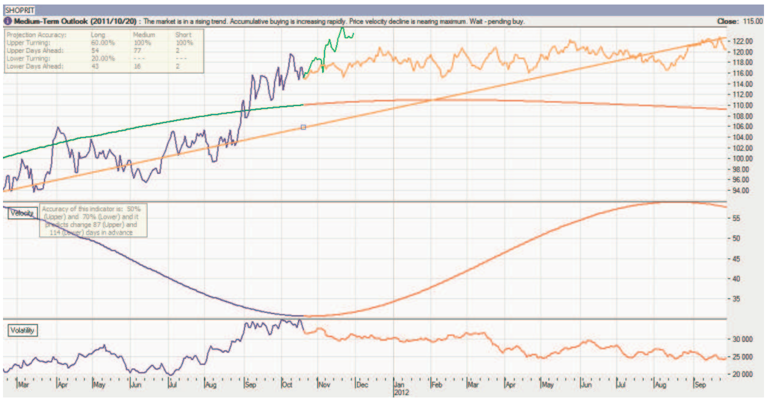
It is, as they say, a no brainer, that when the JSE does take off one must expect it to be rocket-propelled by overseas investors. When will it happen? In this week's Prospects I offered the signs that indicate why I believe the recovery might already have started although I sense some weakness for the next fortnight which will offer readers a good buying opportunity..



Which share to buy today? Shoprit Checkers appear unlikely over the next 12 months to be cheaper than they are today. ShareFinder suggests that from R115 today they will climb to R123 in 12 months time.

The month ahead:

New York's SP500: I correctly observed that sideways trend could last until today before further strength asserts itself. Now I see gains until the first week of November.

London's Footsie: I correctly predicted some weakness before the next strong up-trend which could begin today but is likely to be short-lived.

JSE Industrial Index: I correctly predicted a recovery and I sense it continuing until late next week before a new bout of weakness sets in.

Top40 Index: I correctly forecast a volatile sideways trend and now I look forward to gains until the end of the month.

ShareFinder Blue Chip Index: I correctly forecast weakness which I expect will last until the middle of November.

The Rand: I correctly predicted weakness which I expect to continue until the middle of November.

Golds: I correctly forecast a volatile sideways trend and now I sense weakness until well into November.

Gilts: I wrongly predicted a continuing recovery which I expected to last well into November. However I continue to expect imminent gains lasting at least to mid-November.

The Predicts accuracy rate on a running average basis over the past 407 weeks has been 80.66%.

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