The Investor

In our 26th year of free service to the South African investing public!

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RCIS launches overseas investment fund

By Richard Cluver

Readers of my Prospects subscription newsletter service have been party for some months to a discussion that I should set up an overseas investment fund for clients who have grown wary of the South African Government's future intentions regarding private investors.

Many who have in the past attempted to invest abroad have had unhappy experiences of excessive fees often coupled with poor investment performance. Seeking a means of overcoming such problems has led us into affiliations with Johannesburg-based Anchor Capital and Saxo Bank which is a global investment organisation with offices in most major world capitals and specialising in online trading and investment across the international financial markets.

As a consequence of this affiliation we are now able to offer full stockbroking and fund management services which will enable both private investors and institutional clients to trade shares and bonds, foreign exchange, CFDs, ETFs, Stocks, Futures, Options and other derivatives. More importantly, we are able to offer all of these services at fees significantly lower than are charged by most local and overseas brokerages.

To explain all this in detail and demonstrate to you how simple it is to use the new trading platform we will together with Saxo Bank be staging workshops starting in Durban on Wednesday August 22 at 6pm for 6.30pm at the Durban Country Club followed by Johannesburg on August 29 at the same starting time in the Macquarie Building, The Place, 1 Sandton Drive and on September 5 in Cape Town at a venue to be announced. Drinks and snacks will be served.

I will also offer a resume of my views on the current market outlook and offer readers a sneak preview of some exciting new ShareFinder software which we hope to release later this year.

You are welcome to attend and to bring along any guests who might be interested. To book your space e-mail richard@rcis.co.za

Current users of our many investment services need not worry that there will be any reduction in

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the services we currently provide. We do, however, envisage a major expansion of the range and scope of our services as a result of our affiliation with Saxo Bank and Anchor Capital.

Heads of agreement were signed at the end of May immediately before my departure overseas for my annual Mediterranean sailing holiday and a significant number of RCIS clients have already signed mandates allowing our dealers to go ahead and buy shares on the London Stock Exchange on their behalf. And readers of The Investor who might be interested to explore this facility can contact Peter Armitage on 011 783 4793 or, alternatively e-mail Peter on parmitage@rcis.co.za.

The mechanics for the development of the new overseas investment portfolio will see myself overseeing share selection and pricing and this will be implemented on the Saxobank platform by Anchor Capital. Anchor Capital is a FSB-registered fund manager and so clients will sign an Anchor Capital mandate.

Initially, the RCIS Offshore Portfolio will concentrate upon London-listed shares but because of Saxo's global reach we hope in the future to be able to "cherry pick" top-performing blue chips from all the world's markets which conform to the ShareFinder selection process. I have already provided our dealers with a model portfolio of London-listed shares and buying has started on behalf of those clients who have already signed up.

The practical effect of this arrangement is that each client has a personal account linked to a bank account of his own choice and he or she has direct access facilities enabling them to access their accounts via the internet to check on their day-to-day progress. Those who wish to operate from an overseas bank account, including those located in tax havens like Jersey or the Isle of Mann, can be assisted to set these up and we can also assist in the transmission of investment capital from South Africa to facilitate such trading accounts.

All monies and investment accounts will be lodged via Saxo's London office, enjoy fidelity protection and be accorded tax haven status. Accounts will be treated confidentially so it will be in your hands to, if you so wish, report to the South African tax authorities.

Our charges will be significantly lower than are charged by most local and overseas brokerages. Thus, for example you will be able through the RCIS/Anchor Capital/Saxo Bank facility to trade in shares at a brokerage rate of just 0.5 percent, trade EFTs & ETCs for 0.5%, CFDs for 0.25%, bonds for 0.35% and the annual custodian fees will be just 0.3%. If you would like to explore these options further, Peter Armitage will be happy to discuss all your local and international requirements.

ShareFinder Prices

Now you can buy the acclaimed ShareFinder Professional for just R5 000.

You can enjoy the immense power of the Professional with its automatic portfolio building and analysis tools, long-term market outlook projections and greatly-expanded fundamental data tabulations, a comprehensive technical analysis module, 12-month price projections with ongoing accuracy rates included. To this may be added, at R200 a year, access to the ShareFinder Mobile remote access service which offers a daily portfolio analysis that can be viewed on smart phones, laptops and netbooks wherever wi-fi or 3G connectivity is available.

You will need a daily share market prices and volumes feed which costs R1 990 a year (or R150 a month) from InvestorData. You will also need to subscribe at an annual cost of R550 to the ShareFinder Supplemental Data service which keeps the programmes supplied with the detailed balance sheet statistics that enable it to make its quality assessments.

To these may be added the ShareFinder London Stock Exchange database at a cost of R1 100 together with a daily prices and volumes feed from ShareCrazy at £72 annually and supplemental data at R550 a year.

Richard Cluver's Prospects newsletter service which consists of a weekly e-mail column each Friday and a monthly trading analysis costs R500. Pay simultaneously for your Supplemental Data service and you can get both for a total of R950.

Our latest ShareFinder Mobile module for on-the-move investors who cannot spare the time to do detailed daily analysis of their portfolios now costs just R1 400 once a year while those who would like to simply receive the daily ShareFinder trading recommendations by E mail can subscribe for R400 for six months. Double that figure and you can also receive the ShareFinder medium-term investment recommendations. Alternatively you can subscribe to our weekly e-mail service for long-term investors at R300 for 6 months.

Richard Cluver's latest books The Simple Secrets of Share Market Success, The Philosophy of Wealth and Footsteps to Fortune are available from RCIS

ShareFinder Mobile for R1 400

Its very affordable, quick to use and outstandingly reliable so it is no surprise that the new ShareFinder mobile has become one of the hottest sellers in South Africa because it takes all the guesswork and decision-making out of share market investment.

Designed as an ultra-easy-to-use share market investment system for people on the move, the ShareFinder Mobile combines many of the portfolio-building and monitoring features of the ShareFinder Professional at an extremely affordable price tag. There are:

- ☻No daily data downloads to worry about
- ☻No bills to pay for expensive data services
- ☻No complicated charts to try and understand
- ☻A portfolio-builder that tailors 10-share portfolios to your personal needs
- ☻An alert system that tells you when to buy and sell

Conceived with the busy executive in mind; for the kind of person whose only spare time is waiting in airport lounges, the ShareFinder Mobile was designed to operate on a pocket computer. It will, however, function equally well on a standard desk-top computer. With just two or three clicks of a mouse it will tailor a blue chip share portfolio to your personal risk profile, generating portfolios which under practical testing throughout the 2003-2007 bull market have dramatically outstripped the performance of the top-performing unit trusts.

Unlike competing computer programmes which carry extremely costly price tags—sometimes as much as R25 000 — and which are linked to internet data services costing over R2 000 a year, the ShareFinder Mobile is offered as a subscription service costing just **R1 400 a year** and there are no additional costs whatsoever.

It offers you:

1) The tools to help you draw up an investment plan tailored to your personal needs.
2) A systematic portfolio builder that enables you to scientifically minimise risk and maximise capital and income growth rates.
3) A weekly overview of leading world markets accompanied by a graphic commentary of changing trends.
4) A personal portfolio analyser which will keep watch over your investments and suggest periodic changes.
5) An alert system which will signal you by e-mail if emergency action is called for. Shortly we hope to add a facility that will also send you a cell phone SMS so you will be alerted to the need for action wherever you are during the day.

The ShareFinder Mobile system operates from the RCIS servers where your portfolio is subjected to a daily automated analysis. At the end of each week Mobile subscribers receive an e-mailed update that will automatically update the programme.

Having been rigorously beta tested for many months during its final development stages, the ShareFinder Mobile is now ready for you. During the latest 2003-2007 bull market, its top-performing portfolio achieved a compound annual average growth rate of 87.4% . Simultaneously its income-growth portfolio, where dividend growth is more important than share price growth, also significantly outperformed both the Satrix 40 and the unit trust leading Sage Resources fund.

To order it, log onto www.rcis.co.za and go to the order form on the left-hand menu. Next scroll down through our list of products and services and click on the Mobile.

** If you want to use this software to its maximum advantage, it is highly recommended that you read Richard Cluver's books "The Philosophy of Wealth" ISBN No: 0958 3067 61 and "The Simple Secrets of Stock Exchange Success" ISBN No 9780 95830 6775 which can also be ordered from Richard Cluver Investment Services at a cost of R130 including postage.*

By Invitation

Dr Cees Bruggemans
Chief Economist First National Bank

Part of the fundamental problem hobbling South African progress these past 65 years is that there has been precious little real competition between opposing ideas.

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There certainly has been opposition, from the suppressed African population following its own brands of nationalism; and from the mainly enlightened English-speaking liberal tradition which intensified in opposition to the apartheid policy championed by Afrikaner Nationalism.

This era was nearly immediately followed by liberal opposition to the redistributive inclinations of African Nationalists, a clash that has deepened with the years (as it did in opposition to apartheid) as the governing inclinations and excesses deepened. But throughout this 65 year period, the real fact of life was that whoever was in power did darn well what they pleased, while opposing ideas were mostly only snapping at heels rather than offering real alternatives.

Apartheid died of its own contradictions as the larger population refused to be contained politically indefinitely, aided by worldwide support in its long struggle. Today, the lack of effectiveness in delivering further real progress of a social-economic nature for large parts of the population is creating a new vacuum which may allow new ideas a chance to find sympathy and a greater following.

This does not deny the importance of historic legacies or cultural affiliation and even some ideological pre-occupations in deciding who's in and who's not. So winning the hearts and minds of a majority of people will have to overcome many hurdles, and is unlikely to be carried by one simple attractive idea. Still, it may be that some new real competition is in the process of germinating. If so, it may be a healthy development, one that may eventually assist in taking the country forward.

When the ANC took power in 1994, its economic philosophy became guided by a number of policy programs, with as main backdrop the ANC charter of 1955. Thus we got the RDP, followed by GEAR, itself overtaken by Asgisa, after which a power struggle gave us new faces and The New Growth path followed shortly thereafter by Vision 2030 from the National Planning Commission. Meanwhile, policy was broadly focused macro-economically on maintaining monetary stability while fiscally shifting the balance in society, with many diverse micro policies further bolstering this redistributing transformative bias, and an growing inclination to greater state intervention in a traditionally mixed economy.

The great pitfall in this approach has been the abandoning of meritocracy in large parts of the public sector in favour of political cadre deployment. One consequence was a steady loss in public sector efficiency and an active restraining of economic development rather than its acceleration, as measured by growth, employment and social upliftment (such as education results and infrastructure maintenance and expansion but also the speed of poverty eradication and urban renewal).

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A successful government has little to fear, but a government falling short on long-term promises eventually encounters new ideas giving it real competition. To date the ideas firing governmental passions have mainly come from within its own ranks, giving us the serial policy programs promising the sky even as growth momentum was mainly carried by favourable global winds but such momentum now progressively wilting, both for global reasons but especially for cumulative domestic failings.

In the National Planning Commission, the government at last did of late find a broad based commonsense offering a new synthesis of ideas best fitted to South African circumstances. But as with the RDP, Gear, Asgisa and the New Growth Path before her, the offering up of ideas isn't the same as getting them fully adopted or effectively implemented. In this regard, the governing party continues to run the risk that the country's failing performance creates scope for new competitors suggesting alternative offerings.

Such competition can be of the lunatic variety, of which there have been various examples over time, but they can ultimately also be of a better commonsense variety. It is for party leaderships, and ultimately the population, to decide which strand of economic philosophy it really wants to try next.

In this regard it was interesting to hear the Democratic Alliance (DA) last week launch its economic offensive in what it terms its Plan for 8% Growth and Jobs. At first brush there may be nothing new here, effectively continuing in a new guise the liberal tradition of past decades. In the main this is probably true. But as the DA refines its message in order to gain greater traction with the larger population, a real competition of ideas may come to the fore which may benefit the country.

It isn't difficult to find fault with the country's present dispensation and its many historic legacies. The main danger may well be a wish list of proposals so long that it loses its effectiveness. The DA obviously wants to promote its main creed just as much as the ANC does, and for that reason it delights its followers by saying all the right things and pushing all their right buttons. But the fact of the matter is that on a now mostly stagnant population of some 50 million and an effective voting public of some 18 million (out of 24 million registered voters), it is probably only about 3 million or so people that count, as much to the ANC as to its opposition.

For these 3 million are the true swing vote of the decade and the future stretching beyond. It is what they want, or perhaps more important, it is what they consider appealing (as in any real life beauty contests) that will matter crucially as to what credo will be in charge of the country, setting its compass. Both ANC and DA may offer comprehensive detailed economic philosophies, plans and policy intentions, but most of it won't matter. Provided they hold or gain power by whatever means achieved, they can thereafter pretty much do or experiment as they see fit for a generation or two, as seen after 1948 as much as after 1994.

It may please some followers to specify exhaustively what all clever things the Party stands for, and what it hopes to achieve. But frankly the great majority of people will likely get lost among so many good intentions, or not understand the claimed linkages (if not confused by a few too many contradictions, deliberate or otherwise). What really connect are simple slogans, and whether one follows through with success or failure.

In democracies such as America, the larger majority of voters have one simple yardstick that is brought to bear ruthlessly every two years for all House Representatives, and every four years for Presidents (with different schedules for Senators and State Governors): have you been good for me economically or have I fallen short? South Africa has many more dimensions in its political makeup than this simple economic one determining its election outcomes, at least so far. But because of the relative lack of economic progress, or at least its slowness, in recent years and the growing impatience among a steadily larger part of the population insisting on more and better conditions now, today, this yardstick may be gaining in importance in decid-

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ing who rules and who may watch from the sidelines. In hearing the DA's take on what ails the country and what needs to be put right, what stands out is DA leader Helen Zille's strategic requirement that the vision needs to be constitutional, market driven and non-racial. Semantics aside (even if politics is a netherworld of semantics), this is effectively the very opposite direction in which the ANC is moving, in whose broader church tinkering with constitutions is apparently considered an accepted pastime, market economies are good for taxing and rubbishing, while in too many instances lip service is paid to non-racial credentials from the past.

This could be the true basis for competition. Its big drawback is that it isn't sexy enough. Instead, it is intellectual, which is perhaps great for debate, but does it sell votes, give power and allow the greater agenda, for either party, to be implemented? The ANC believes in a "better life for all". If it succeeded in making this come true it would probably lengthen its stay in government by another generation or more. But it is the falling down on this score that is opening the wider game for new slogans with greater promise to resonate with the crucial 3 million. Here the political opposition faces a problem in that it has natural drawbacks in not being preferred by many of the 3 million, whether historically, culturally or otherwise.

Track record showing ability to genuinely deliver on simple promises may therefore be crucial. Ignore me as the messenger. Instead, focus on what is delivered. Mussolini is presumably to be remembered for many things, good and evil, but the slogan that stuck was that he made the trains run on time.

For what is Ronald Reagan remembered? Again many things, but what stood out early on is how he fired all air traffic controllers, ending a crippling national strike and set a new course for the nation. Ditto with Maggie Thatcher who confronted the UK mineworkers. Both the ANC and DA will have to decide how they want to be remembered. As the party that kept unemployment high while regularly tripping the lights; or as the party that succeeded in meeting the central needs of the 3 million?

By all means launch profound economic philosophies and the clever comprehensive internally-consistent policy programs to back them up, but do realise that the very clutter of what is unloaded on a fatigued electorate means a loss of focus while non-delivery eventually promises oblivion. That one Clinton advisor back in the early 1990s got it about right, at least for American conditions through the ages. Keep it simple, stupid. It is the economy, stupid. One slogan will do. And then just do it.

Where are my Nikes when I need them?

Domestic downside

There is reason to acknowledge global upside (despite all the crisis concerns) and domestic downside (though allowing for commonsense hope).

The global upside has various contributors. America is reinventing itself economically as new lead sectors come to the fore, though tempered by concern about political disagreement regarding national finances. America is experiencing yet another energy revolution, as natural gas gets hugely boosted by new production techniques (one more Revolution), cheapening the input cost for electricity and other industrial uses.

Also, US manufacturing is being rejuvenated as costs are lowered and new technologies find application, with US producers starting to shift output from China, where costs have risen rapidly, back to American bases which are also favoured by a weaker Dollar.

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Meanwhile US banking and housing seem to have stabilised after five years of major adjustment, with building activity starting to recover slowly from extremely depressed levels (no longer a drag on economic activity but now slowly again turning into a positive). Europe is glacially generating the political will to reform governance structures and effect supply-side reforms, with the ECB backstopping this historic effort (though for some time one will need to allow for possible default among banks and sovereigns wanting to exit).

Despite endless political bickering about peripheral austerity drives, supply reforms and more centralised governance to foster a culture of greater discipline, with electorates nearly everywhere bitterly complaining and objecting, and markets relentlessly enforcing their views, the New Europe is gradually taking shape. The ECB is the commonly held institution most able to buy time for political Europe to painfully slowly create its new structures. ECB President Draghi made news this week when making it clear that the ECB will do whatever it takes to preserve the Euro.

Despite the downside of one or more peripheral sovereigns still exiting the Euro in chaos, potentially triggering massive bankruptcies among European banks, in turn greatly deepening recession with unpredictable global fallout, it would seem that the political vision of a stronger, re-engineered, revitalised Europe remains the key driving force as electorates and markets are taken along, no matter how unwillingly in some respects.

China wasn't pushed into crisis this time, taking timely action to cool off its overheating property market while seeking to shift infrastructure investment and export-led growth to a better balanced domestic growth effort. There is evidence that this is succeeding, with policy again starting to become accommodative enough to ensure a resumption of growth in line with long-term aims.

The strains marking the Middle East, such as the aftermath of the Arab Spring (in Egypt), the civil war in Syria and the containment of Iranian nuclear ambitions, have so far not lead to greater derailment in the region. Instead, there is hope of new workable dispensations taking shape, in Brotherhood-led Egypt, in eventually post-Assad Syria and in curtailed Iran (even though there remains downside potential on all these scores).

Oil prices remain elevated, Brent again over $100, as the global growth slowdown has remained limited, central bank actions worldwide remain supportive (conventionally in EM space and unconventionally in developed rich regions) and concerns remain about oil supply disruptions.

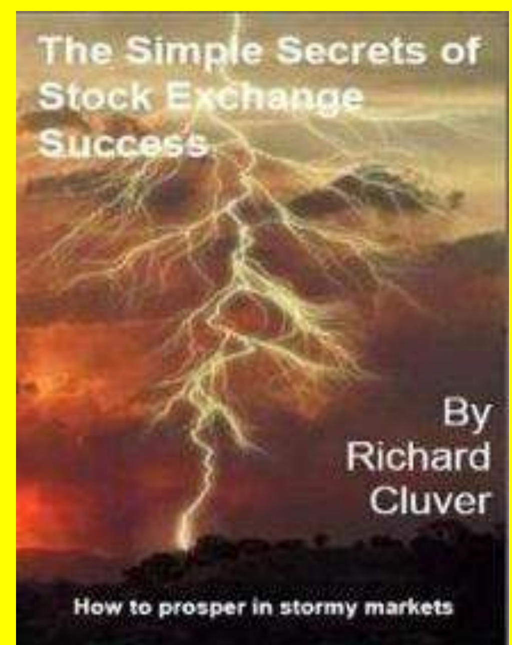
The global growth slowdown has affected large parts of EM space. Yet EM countries have most scope for monetary easing. Many central banks have lowered rates these last few months, even as they are likely to limit their collective easing to only 0.5% or so (South Africa thus being no exception). Meanwhile, the leading central banks keep sending lively signals about taking more unconventional actions to ensure that growth does not falter more as institutional repair and political and economic reinvention proceeds glacially.

Thus we find the US Fed imaginatively considering more QE (bond-buying) options and markets actively playing in on this, with the BoE doing so on a much smaller scale. Meanwhile, ECB President Draghi has indicated that reforming peripherals should not have their sovereign bond premia (over German Bunds) blown out unacceptably by risk-averse markets;"to the extent that the size of the sovereign premia hamper the functioning of the monetary transmission channels, they come within our mandate".

By taking or supporting debt-purchase actions, the ECB would relieve stresses on banks and sovereigns and provide more stimulatory financial conditions for a key region in recession, and thereby the larger world. This is creating an opportunity for the ECB to accommodate initiatives (by whatever technical route) to supplement demand for such bonds, encouraging their premia to subside to more realistic levels, making it possible for European repair to continue.

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 meltdown, 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 lyndy@rcis.co.za with your credit card details or by phoning 031 262 1722*



None of this is supposed to be good news for its own sake. In the midst of big renovations chaos usually reigns until the outline of what is being attempted only slowly comes into view. The US is not collapsing anew but is advancing slowly while finding new lead sectors, backstopped by Fed support (even as dysfunctional politics keeps bickering about state finance options).

Europe is politically reinventing itself and taking time finding new direction and resuming slow growth, it also backstopped by an activist ECB. EM space isn't just watching helplessly as growth momentum is being lost due to uncertainty and the drag effects from European growth loss. There too proactivity can be observed as central banks have entered a new modest easing cycle, mostly having the scope to do so.

Between them, these global actions should keep stabilising global growth performance and eventually see the basis for faster growth re-established even if the repair effort may still take years, especially in Europe. In other words, the prospect isn't only for more downside. If anything, downside is being contained while working on repair and seeing the upside eventually coming back into focus. But that is life generally, even if it doesn't always universally apply.

When we turn the focus on home, we get a somewhat different story. There the past 100 years has always been modest in terms of an average 3.5% growth performance, due to serial peculiarities keeping the growth down even as global luck kept favouring us most of the time. Since 1994, the new political dispensation coupled with a supportive global environment should have favoured a South African breakout from modest growth. Instead, the country took a long time winning the confidence of critical players needed for such an effort, with throughout the danger of alternative revolutionary visions winning out as conventionality supposedly wasn't making headway.

Though successfully traversing the first decade post-1994 on this score, it wasn't done without offering long-term hostages to fortune as meritocracy in the public sector was in important ways sacrificed on greater political altars, supposedly an inevitable price to pay to keep even greater revolutionary demands off the table, yet as deadening in its effect on growth. Winning the World Soccer Cup bid in 2004 and getting an infrastructure wave going accompanied by much consumptive credit binging may have looked like a successful growth effort but eventually wasn't as the fundamentals were far too skewed, with private indebtedness and lacking public sector capacity the main problems.

The recession unleashed by the Anglo-Saxon crisis and key domestic supply shortcomings offered new opportunities for revolutionary demands to change the policy setting in favour of far greater state intervention. The slow-growth revival after the 2009 recession turned out to be yet another dangerous phase offering opportunity for demanding alternative policy settings as the conventional approach supposedly didn't work. Thus we get endless blaming on the Anglo-Saxon financial crisis and since then on the European governance crisis for our own pedestrian economic performance.

Throughout, the political centre of the ruling party has been fighting rearguard actions against demands to throw the ideological policy switch in favour of much greater state intervention, thus to imitate countries which institutionally simply aren't role models for us and who themselves are moving away from their old interim policy settings in favour of more conventional approaches. There has been only very limited public acknowledgement of the own policy mistakes of the past 20 years which have resulted in severe supply side constraints now keeping growth performance well below our modest long-term performance and this mainly for domestic reasons rather entirely for global reasons.

But the weaker we perform, the stronger the call for a switch to less conventional intervention modes, with in our case most uncertain potential to boost performance. But it also creates a political performance vacuum in which other parties gain greater opportunity to offer the electorate alternative options for better economic performance. It isn't in other words all just downside from here onward. Political observers tell us we shouldn't run away with concerns about extreme intervention agendas, the government is trying to offer a long-term infrastructure revival (though hobbled by very real public sector capacity shortcomings), and there doesn't exist a revolutionary monopoly on policy alternatives.

Others are also viewing the policy performance vacuum as an opportunity, in their case as an invitation to think conventionally about our national dilemmas and to offer the electorate an alternative vision.

Things could still get very interesting this decade, as much abroad where repair is proceeding under the watchful eye of central banks, as at home where the vision drought is creating opportunity for multiple breakouts and not only to the downside.

Stockbroker's views

by **Brian Kantor**
Investec Securities

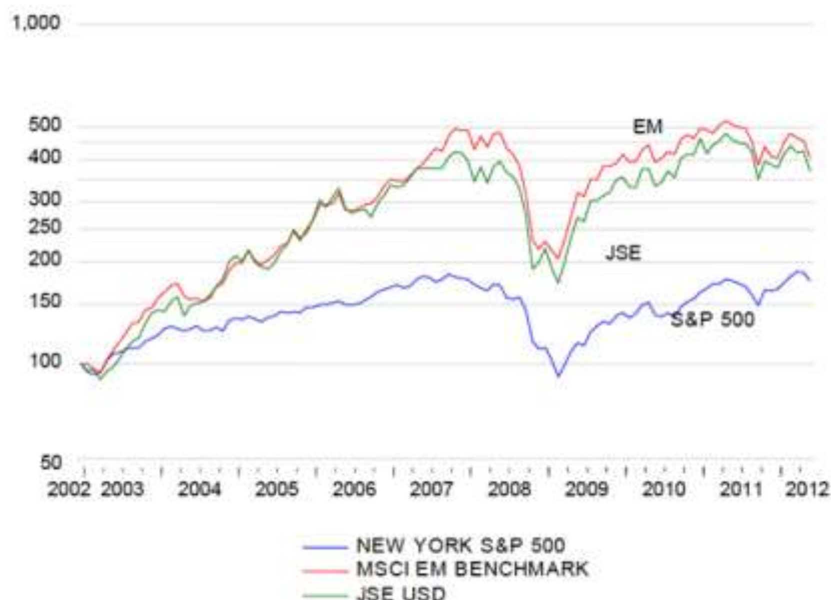
JSE listed companies have an impressive record of generating wealth for their shareholders. We show how they have done so through their excellent management of the capital they have invested.

How well run are companies listed on the JSE and do they create shareholder value? Have they been able to improve their economic performance over the past 18 years since SA became a democracy and SA businesses could freely trade with the world and engage helpfully with global financial markets and also list their shares on the major stock exchanges? How do their returns on capital invested compare to those of companies in other countries? Can shareholders in JSE listed companies hope to benefit from more favourable recognition by global and local investors of the inherent quality of their holdings? How does uncertainty about government economic policies influence risk appetite and market valuations of companies?

Reviewing the recent history of the JSE. Measuring the outstanding returns provided by the JSE for shareholders especially since 2003.

Shareholders in JSE-listed companies have enjoyed outstandingly good returns over the past 10 years. The JSE All Share Index has kept up with the average Emerging Equity Market average (as measured by the Morgan Stanley (MSCI) EM benchmark) and outperformed the S&P 500 by a very large margin as we show below. US$100 invested on the JSE in January 2003 would now have compounded to US$371 by the end of May 2012, including dividends reinvested in the market. The same US$100 invested in the S&P 500 would have grown to US$176, less than half the gains in US dollars realised over the same period by the JSE.

Figure 1: Cumulative returns US$100 invested on 1 January 2003



This outperformance for shareholders by the JSE over the S&P 500 is notable, especially given that the S&P 500 has delivered comparable earnings per index share over the extended period from January 2003 to May 2012. The companies listed on the S&P 500 delivered significantly more accounting earnings per share between 2003 and 2007 than their peers on the JSE or on the average Emerging Equity Market. Their earnings then suffered far more severely from the global financial crisis but have since recovered much more strongly as evidenced by the next chart.

Yet the rating of the S&P 500 in the form of its price-to-earnings ratio has declined markedly relative to the price/earnings multiple attached to the JSE. In other words, S&P listed companies over the past 12 years have done much worse on the valuation front than they have done on the earnings front compared to their rivals for investor attention on the JSE or EM markets.

Earnings can be manipulated. It should be appreciated that the calculation of accounting bottom line earnings differs from company to company and especially from stock exchange to stock exchange. The S&P reports bottom line earnings without any smoothing, while the JSE reports headline earnings that exclude extraordinary items. S&P earnings after 2007 suffered disastrously from bank write-offs of troubled loans of an unprecedented scale. Any comparison of price-to-earnings ratios will be distorted by the extraordinary collapse of S&P earnings in 2007-08.

It will be noticed that the price/earnings multiple on the JSE FINDI is now at an elevated level and that the sector has re-rated very significantly relative to the Resource Index. It is a matter of intense debate amongst South African and offshore fund managers as to whether such a re-rating is justified. The re-rating has been accompanied by net foreign purchases of SA equities and net sales by South African shareholders.

These differences in accounting earnings reported by different companies and the manner in which they are aggregated by the different stock exchanges reinforces the case for using a metric of economic performance much less subject to interpretations and convention. Cash has a similar colour in all accounting treatments and we will report on and compare cash returns on investment generated by JSE listed counters as an alternative to earnings comparisons below.

Before we undertake this analysis of the return on capital delivered by JSE listed companies over the years, an examination of the history of JSE reported earnings over the longer run, from 1970 to the present, provides a very interesting perspective. In the figure on the right we show inflation adjusted real JSE AllShare earnings per share since 1970. These earnings per share are also broken down into earnings per index share reported by Resource Companies and earnings per share for the Financial and Industrial Index. The JSE by market value has been about equally divided between resource and other counters.

As may be seen, JSE real index earnings per share did not recover their 1980 levels, until approximately 2004-05. These earnings per index share were boosted in the mid seventies and early eighties by dramatic increases in the price of gold that began the decade at US$35 per ounce and averaged US$600 in 1980 and 1981. Then, SA mines produced 600 metric tons of gold compared to the less than 200 tons they produce today.

JSE listed companies, particularly resource companies, were hard hit by the deflation of underlying metal and mineral prices that occurred through the mid eighties and nineties as we show in Figure 4.

Financial and Industrial Index earnings per share did not suffer as badly from the commodity price deflation of the nineties, but they also only recovered very strongly from their depressed levels in the past decade. It is surely encouraging for investors in JSE listed companies that real earnings reported today now exceeded their previous pre global recession peak levels. FINDI real earnings, while having recovered from the recession of 2008-09 are still below their previ-

Figure 2: Index earnings per share in US dollars: JSE vs S&P 500

Figure 3: JSE price-to-earnings ratios since 2002

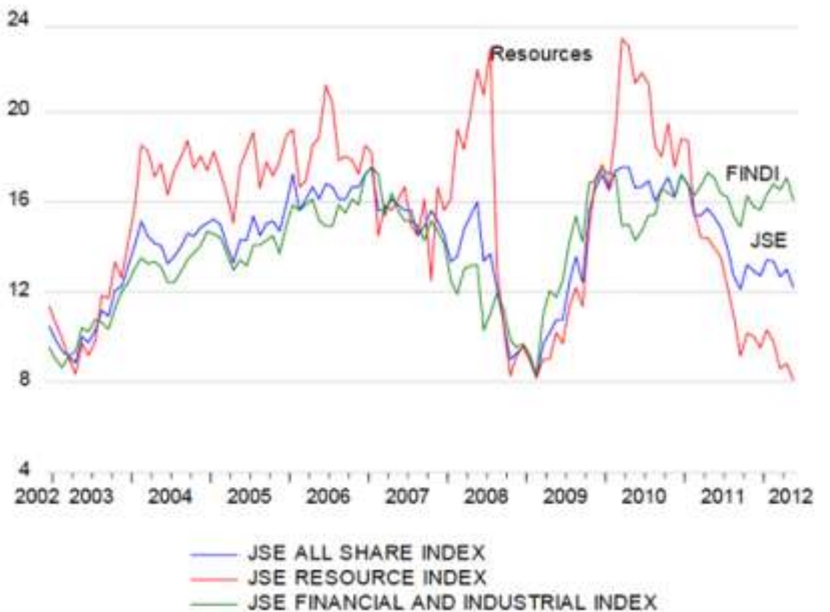
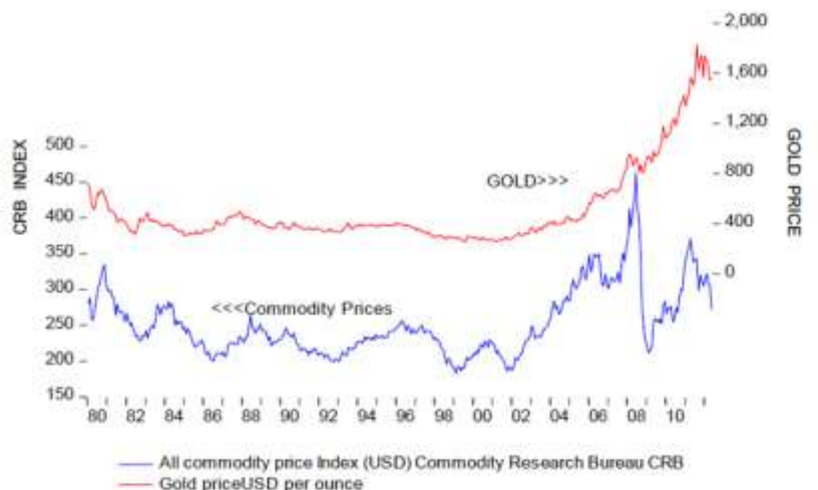
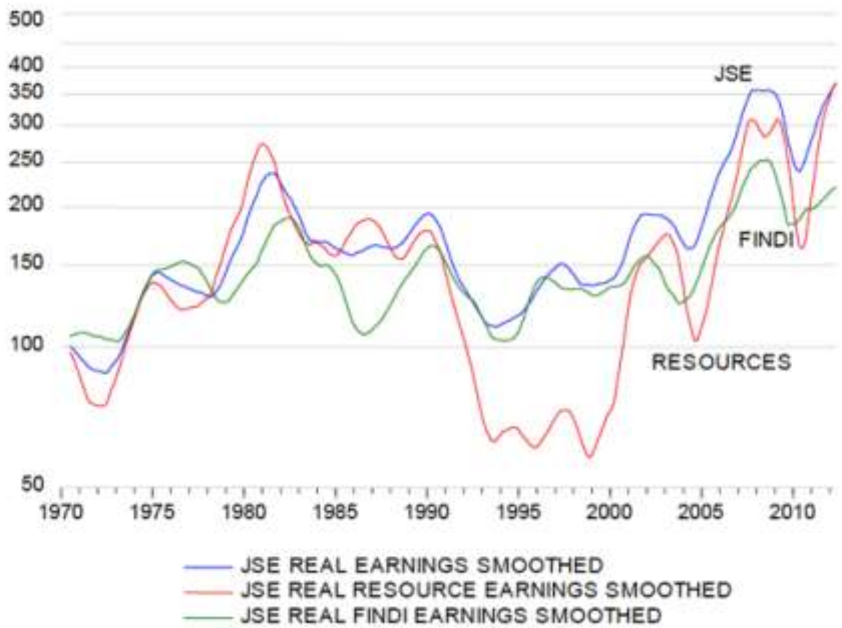


Figure 4: Gold and commodity prices, 1980 to 2012



ous peak real levels.

The benefits of political change for economic freedom and efficiency in SA



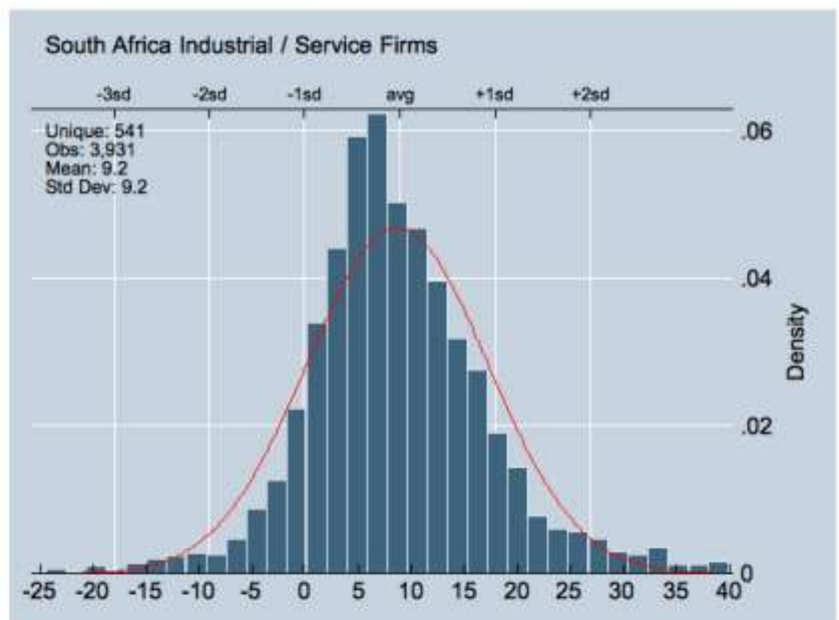
A further factor that made it difficult for SA companies to deliver earnings and returns on capital were the economic sanctions imposed on SA business undertaking global operations and realising potential economies of scale and specialisation only possible with a footprint well beyond the South African economy. Successful SA companies with restricted opportunities to expand their core business activities tended to invest excess cash in acquisitions of unrelated businesses. Their shareholders encouraged them to do so. They were subject to very strict controls on their offshore portfolio investments and had few alternatives to invest in shares other than those listed on the JSE.

An Economic Return on Capital Based Analysis of the JSE

If a company can generate a return on capital that beats the opportunity cost of the capital it employs, it will create shareholder value. The market will in time award the successful company a value that exceeds the value of the cash invested in the company by its management over time. This would clearly be value adding for its shareholders. The strategic imperative for such a firm should be to maintain its profitability and grow. If a company is unable to invest its shareholders capital at least as well as the shareholders could do for themselves by holding shares in other similar companies, it will be destroying shareholder value and should minimise reinvestment. A company that meets its cost of capital is value neutral, and its management team should focus on the hard and exacting chore of improving operating returns instead of growing its asset base.

In general, firms that create shareholder value trade at market values in excess of their book values; firms that destroy shareholder value trade below their book values; and firms that meet their cost of capital trade at their book values. The books of a company will record all the cash invested in the company by its management over time.

The aim of a sound return on capital measure should be to minimise accounting distortions and estimate the underlying economic return on a company's investments. To measure the economic performance of a company and to calculate its (internal) return on capital, we employ CFROI®, which is a real, inflation-adjusted cash flow return on operating assets. Because the measure is real, it is comparable across time and over borders. In other words, a South African company can be compared to itself in different inflationary environments, and to companies in countries with lower inflation. This makes CFROI a very powerful benchmarking and economic return measure.



The opportunity cost of funding the projects undertaken by a company is its real cost of capital. This determines the real return required by investors in the company given the many other alternative uses of their savings open to them. This required return reflects the market's appetite for risk and the company's mixture of debt and equity funding. When the internal rate of return generated by the company exceeds this rate of return, the company will be adding economic value by getting more out of the resources it employs than they cost. The market

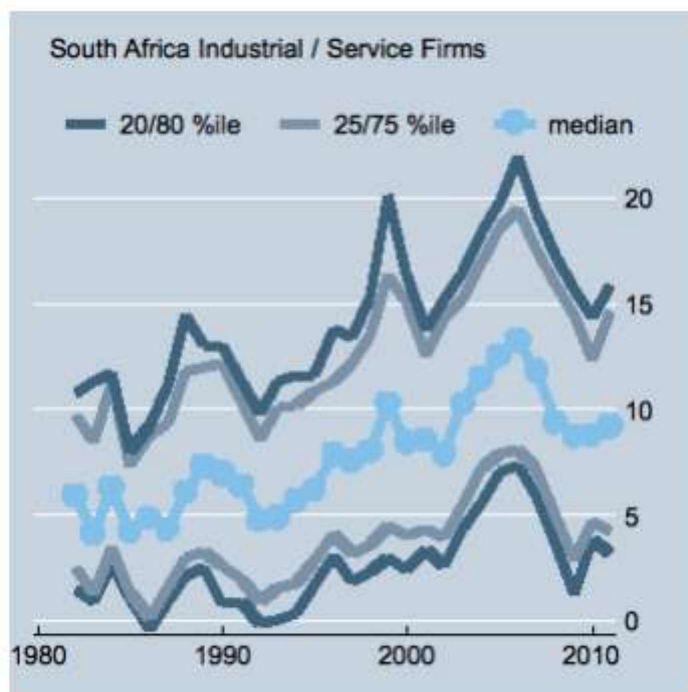
place is very likely to reward such achievements by attaching a higher value to the company to the great advantage of its shareholders.

To answer whether South African companies are value creators, we generated a distribution curve with historical CFROI values dating back to 1982 for publicly listed, non-financial companies. Note that this is a real return – fully adjusted for inflation. The sample includes industrial, service and resource companies. It excludes the financials sector.

The global average CFROI is 6%, which also equates to the long-term real cost of capital. Firms who generate a CFROI of 6% are generally value neutral. The average CFROI for South African companies is an attractive 9.2% with a median of 8.2%. Note the long tail and skew towards value creating returns. Historically, 63% of CFROI values for JSE listed companies were above the global average of 6%, which is an impressive result. 30% of CFROI results were above 12%, which generally gets rewarded with an enterprise value to book multiple of 2. Relative to the rest of the world, listed South African companies are generating impressive economic returns on capital!

What about the evolution of those economic returns? In the next chart, the median CFROI is plotted from 1982. To eliminate outliers, that is companies with exceptionally high or low returns on capital, we show the trends for companies within a band around the median return, excluding the top and bottom 20% of performers. Bands for the 20th and 80th percentiles give an indication of how the range of returns on capital has developed over time. We show that the economic return on capital has improved spectacularly over time, with today's median firm reporting a very healthy CFROI of 10%. Until 1994, the average South African company was sporting a CFROI at or below the global average of 6%.

Figure 7: Time series of South African CFROI - medians and bands about the median



Since 1994, the CFROI has sloped upwards and remained well above 6%. The new South Africa has been a value-creating South Africa! Note that at the peak of the commodity super cycle in 2007-8, the median CFROI was a stunning 13%. The top and bottom quintiles have also sloped upwards, indicating greater value creation for the best firms and less value destruction for the worst firms. Presently, 20% of South African firms are generating economic returns on capital above 15%. 20% of today's companies are generating a value destroying CFROI of 4% or less.

Investors expect higher returns when taking on more risk, so it seems logical to assume that South African investors demand better economic returns on the cash they invest. What is the cost of capital for South African companies and how does it compare to the economic return on capital generated by South African firms?

The market-implied real cost of capital for various countries is measured on a weekly basis by Credit Suisse HOLT.

Figure 8: Real cost of capital for South Africa and the USA

That is the calculation of the required rate of return or discount rate implicit in the observed relationship

between economic performance as measured by HOLT and the market value of a company. Excessive multiples (market/ book value) and market values imply that risk appetite is high and the expected cost of capital (the discount rate) is undemanding. The risk premium is low. When multiples are low and market prices depressed, risk appetite is low and the expected cost of capital high. That is, the market is attaching a high discount rate to expected performance when it values the company. Results of this exercise for the USA and South Africa are shown in plot (Figure 8) on the previous page.

The average real cost of capital as demanded by the market and implied by market prices and cash returns (the implicit real discount rate applied in the share market when it values companies) for the US since 1950 is 6% but since 1991 it declined to about 5%. Note how low it dropped during the Dotcom bubble and how it remained at a risk denying rate of 4% for much of the Noughties. As a rule of thumb, a discount rate below 5% indicates euphoric risk appetite, and a discount rate above 7% indicates a high degree of investor pessimism and bearishness.

Since 1991 the median real cost of capital, the required market returns of investors in JSE listed companies has been 6.1%, which is 110 basis points above the US over this period but still well below the CFROI reported by the majority of South African companies, who are indeed creating value for shareholders. In 20% of the time since 1991, the real cost of capital has been above a risk averse 7% in South Africa and reached 9.4% after Lehman Brothers went bankrupt!

What drives this cost of capital or what may be described as the real return required by investors? Investors don't like uncertainty and prefer transparency in government and corporate policy. If global risk appetite is diminished, then shareholders in all countries will suffer. But those with the least uncertainty when it comes to corporate governance, government policy, inflation, and tax policy will be perceived as safe and suffer less. There are immense benefits to aligning policy with uncertainty reduction. A lower real cost of capital will increase market values, and make marginal investments more attractive. This fuels growth and reinvestment, which create more jobs and tax revenue. A 1% drop in the cost of capital translates into a 20% increase in equity values! The re-rating of South African risk from 2001 until the peak of the super cycle in 2007 is impressive as evidenced by the drop in the cost of capital relative to the US. Improving CFROI, coupled with decreasing cost of capital, leads to remarkable multiple expansion.

We have shown that listed South African firms create value and sport impressive economic returns on capital. Returns have been improving. Over the long run, stock market valuations depend on the economic returns generated in the form of return on cash invested, on the sustainability and improvement of such returns, on reinvestment, and on the risk adjusted returns required by investors that we have also described as the market-implied cost of capital. While companies do all they can to generate shareholder value, government must do all it can to ensure a favourable environment for business activity in SA in order to reduce as far as possible the uncertainty and risk premium demanded by investors. The right business friendly policies are highly value adding for shareholders and very good for the economy. Good policy reduces required returns and increases market values and by so doing encourages firms to grow faster and invest more in machinery and the people they employ. The wrong policies, especially those about which there is considerable uncertainty, is shareholder value destructive and undermines economic development.

South African companies should continue to focus on generating world beating returns on capital while government focuses on minimising the risk premium between South Africa and investor friendly environments such as the US. This positive feedback loop is essential to reinvestment, growth, job creation, skills development and the generation of tax revenue, which would help all of society prosper.

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USA Comment By John Maldin

It seems like the whole world is expecting Ben and Mario to ride in and save the day with yet more stimulus. But to what effect, I wonder. Is a short-term rise in the market a cure for the basic disease of too much debt? And, as today's Outside the Box hilariously points out, it can even make things worse.

Joan McCullough is perhaps my favorite curmudgeon. She writes so freely and with such style and feeling, but she also gives us such exquisite bits of information that no one else seems to find. Today, as I sat in a Denver hotel, I read her and just had to laugh a few times (mostly to keep from crying). She can be a tad hard on sensitive nerves, but we are all adults here, right? Be forewarned, though, that while she may poke at someone you don't like today, tomorrow she may be pointing out the issues with your guy. She is an equal-opportunity skewer.

Today she has Ben and Mario in her sights, and toward the end the poor Department of Labour incurs her wrath, too. On this both Joan and I agree: Europe is going to end in tears. The longer they keep piling up debt, the worse it will be. Their choices are Disaster A and Disaster B. Try to avoid both and you get Super Disaster C.

Joan has been trading and pontificating for longer than most of us have toiled and has forgotten more than I have ever known, assuming she ever forgot anything. She works with East Shore Partners, and God Bless them for giving her free rein to write as she sees fit. The wire-house boys would just die.

But before we hand it over to Joan, here is a quick paragraph from Yanis Varoufakis, writing about Greece. This shows just how absurd things are, and also how pernicious. The Greeks are paying back the ECB on the backs of Greek and other European taxpayers. Just to keep the game going. This is wrong on so many levels.

"On 20th August, the Greek government will have to borrow 3.2 billion from one arm of the Eurozone (from the EFSF) in order to repay another (the ECB). Yet Greece is insolvent. The very idea of an insolvent entity borrowing more from a community, like the Eurozone, in order to repay that same community is obscene.

All it does is to shift the burden from the Central Bank to the taxpayers of Germany, Holland, Austria and Finland. This is not an act of solidarity with Greece. It is an act of irresponsible kicking-the-can-up-a-steep-hill. The simple point I have been trying to drive home for a long while now is that the Eurozone must make a simple decision: Either to give Greece a proper chance of exiting its current death spiral. Or to dump Greece now, before the Greek state loses all its remaining assets and before it gets deeper into debt. And if our Eurozone partners are not prepared to make up their minds (caught up in their own short term concerns and shenanigan s), then Athens must force their hand to decide within the next 23 days. How? By announcing that Greece will NOT be borrowing on 20th August monies it cannot repay under the present scheme of things.

All red is mine

by **Joan McCullough**

… "Such supplementary interventions [by the State], which are justified by urgent reasons touching the common good, *must be as brief as possible,* ***so as to avoid removing permanently from society and business systems the functions which are properly theirs****, and so as to avoid enlarging excessively*

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the sphere of State intervention to the detriment of both economic and civil freedom. " …. [Walter Bagehot]
When that was first posted in this space, I referenced it against the FED's never-ending ZIRP. Because once the State inserts itself too long or too hard, they take over functions that are not their responsibility and **thus expropriate a measure of our economic freedom** . Which stinks.

Given the fact that we are now about the business of waiting for Draghi to show his hand (ahead of an up-coming FOMC meeting no less), perhaps it's time to apply that Papal pearl of wisdom to the LTRO and see how it shapes up.

The time frame is the mid 1850s/60s. Right around the time of the US Civil War. But we are in London. At a firm called Overend, Gurney & Co. Got that? Good. This was a hot, steamin' bank. They had a big business buyin' bills of exchange at a discount. They don't use 'em anymore. But in their day, bills of exchange were the way the commercial markets got business done.

For the Newbies only: I am in France. You are in England. I sell you a cargo of X. You write a bill of exchange (a draft) payable to me on January 10, 1860 drawn on the Bank of Oo-la-la. But I would rather not wait until the 10th of January. Because I have other fish to fry/business to push thru. So I endorse this bill of exchange over (sell) to Overend, Gurney & Co who purchases it from me at a discount. They then sit on it and collect full face value from my French Bank, Oo-la-la, come the 10th of the new year.

So what Overend & Gurney were doing was accommodating international trade thru short-term financing. ***That is the key. Short-term financing.*** They kept things humming along nicely. **This was a function belonging to the free market system. And it worked very nicely until O & G got stupid.**

Right. I gotta' go with the idea that at some point they got a tad over-creative with their financing biz as the tide of the day was changing in that segment. Meanwhile, they had some nice profits, so they decided to invest them in long-term projects. Oh boy. They were short-term financing experts. Now they decide to go long-term investor? Uh-oh.

Well, this tack turned out to be a nightmare. So in order to raise cash, they went public (became a limited liability company which hid certain liabilities) by offering their shares at a big premium. Which got them liquid again.

But before a year was out, wouldn't you know it, but the financial system was under a lot of duress in London. I'll try to make this snappy as it could get quite long.

This is about limited liability companies. Laws were passed in the early 1860s in England to accommodate these entities. All they had to do was scare up 7 or more members and register as a firm. And bingo, they were relieved of a lot of the usual responsibilities such as disclosure. As you can guess, this was abused forthwith by some. In the financing sector in particular. Kinda' like subprime: some of these newly-registered, limited liability entities were willing to lend vs. crappy collateral … and at much higher rates. So there was liquidity but at the end of the day, as always, no stability and that's what eventually brought the house down. A bank run by any other name … is still a bank run!

So, eventually, London got its own "Black Friday" which involved the collapse of stocks such as railroad names in which there had been great speculation. (Think of O &G's "long-term investments"!) Thus began the "Panic of 1866", the catalyst for which was the declaration a day beforehand that Overend & Gurney, WHO HAD RECEIVED A NOTHIN' DONE FROM THE BANK OF ENGLAND IN RESPONSE TO A REQUEST FOR AID… could not meet their obligations. (Remember that long-term investment portfolio? Right. Sayonara.)

Needless to say, Overend & Gurney went down the tubes which was bad enough. But the really bad part was that they took a boatload of other companies … including financials … down the rathole as well.

Aside: Gurney eventually got on its feet. And became part of Barclay's. I just spit my tea out my nose. How funny is that, eh? It survived to go on another 150 years to make headlines in the LIBOR mess.

As the buffs know, O & G was located on Lombard Street. Enter Walter Bagehot. Who wrote **"Lombard Street: A description of the money market"** back in 1873.

From his writings, developed what is known as the Bagehot rule. Which goes something like this: In time

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of crisis, the central bank must nip any panic in the bud. By making abundant loans … but against proper collateral and charging a premium.”...which jibes with our opening quote which offers that the State can indeed step into any weak spot in order to facilitate the market if this action is for the common good. **But they must not overstay lest they impose on our economic and civic freedom.**

So if you ask me, both the FED and the ECB have tread where needed, but both have way overstayed. To the point where they have now become almost a permanent function in the market. And they have also violated Bagehot’s rule in that they have encouraged moral hazard to the extreme. The FED with ZIRP and the ECB with crap collateral and 1%, 3-year loans to deadbeats. Repeatedly. And look poised to continue with the same m.o. NO GOOD ON ANY LEVEL.

Let’s stick with raggin’ on the ECB, shall we? They have inserted themselves so profoundly into the financial mix that they are really no longer behaving like a central bank as they are no longer fostering stability. Rather by taking huge risk on their books like any other run-of-the-mill commercial bank, they are putting the system in jeopardy. Think in any terms you wish; the easiest way to get there is to wonder aloud how they exit this hellhole they have dug even deeper.

In the meanwhile, what is their contribution to solving the problems the Euro system is facing? Right. This morning we touched on this point briefly with this: *… “The only lender to the banks was the ECB. The only lenders to the sovereigns were the banks. The more the sovereigns borrowed, the more the banks loaned them. The more the debt racked up by the sovereigns, the more they are pressed to implement austerity. The more austerity that is enacted, the slower the growth. The slower the growth, the closer to default they creep. Take the visual of a long line of collapsing dominoes. That’s about right.” …*

Do you copy how bollixed up this is? The efforts of the ECB can only have short-term, temporary impact. What they are doing is propping these skanks in the short-term which does nothing in terms of reducing the overall debt. As a matter of fact, it worsens the debt picture. Because I am thinking along these lines, the lines of *extend and pretend*. This variety: a bank gets dough at the LTRO. Pays down some current obligations and makes the next sovereign auction look good because of their heavy participation. These loans from LTRO are 3 years now, don’t forget. So let’s say that after some time passes, this bank has an upcoming obligation. Now what? Where do they get the money to pay that down? Right. They have to sell some of the sovereign debt. To whom? To the very entity who lent them the money to buy it in the first place. And if the timing is anything less than optimum, you can bet your boots that they are selling this stuff at a loss. Noting that the ECB has taken a boatload of the same paper in as collateral. And there appears no end in sight to the madness. Including the lowest blow of all, which puts the ECB right in the same category with the FED: what they are doing has zip to do with the economy. Like the FED, they have forgotten John Q. a long time ago and are acting solely as agents to keep the banks, the sovereigns and by extension, themselves, afloat.

Which brings us around to the final straw, referenced above. The austerity. I can’t figure out what the thinking is here, can you? I mean, which side are we supposed to be rootin’ for?

A. this country does not meet its austerity targets, gets no aid and the economy collapses. Or

B. this country meets its austerity targets, gets aid, but it’s too late because the austerity has already pushed it over the economic cliff.

I believe that Draghi *will* come with a bazooka; he’s in for a nickel already; you know what comes next. But as we know, no matter what he does and I’m sure the effort will be a gangbuster … there is no permanent fix here unless we get fundamental change.

Do the math, Sunshine. Fundamental change can only come about in the event that there is a massive restructuring of all this un-payable debt. In the meantime, they are touchin’ themselves if they think this short-term meddling is gonna’ “stick”.

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