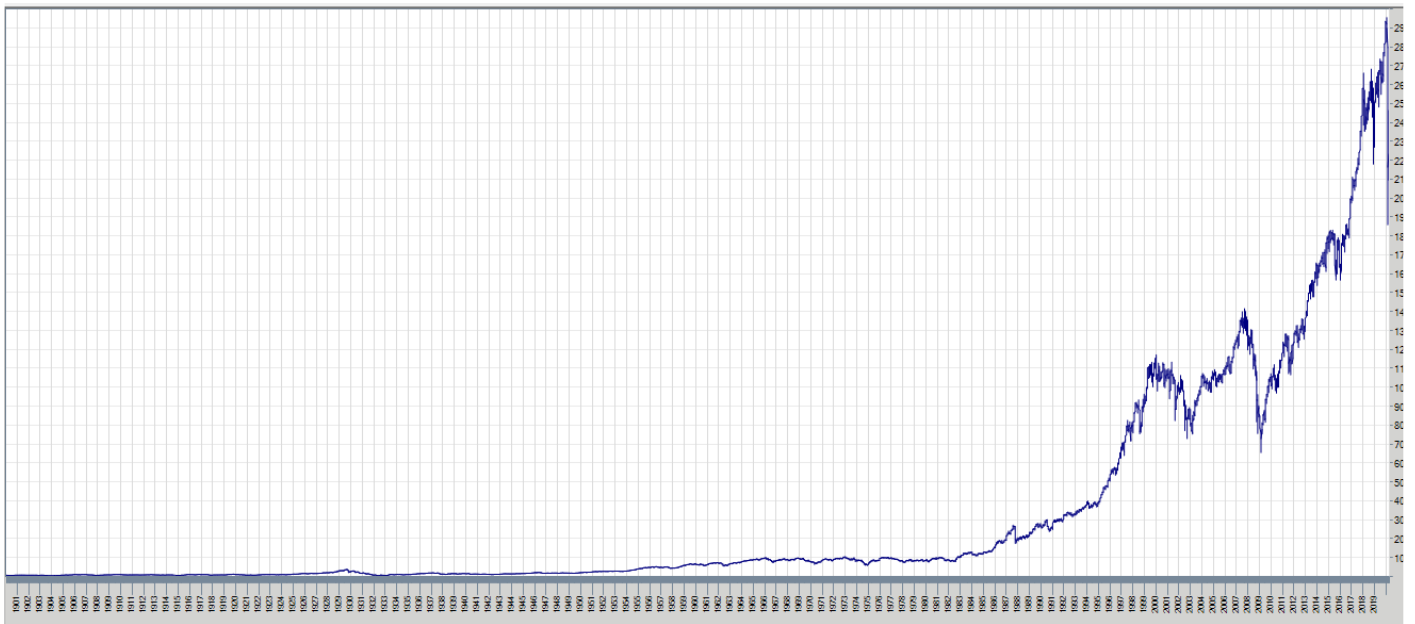




Much on my mind this week have been the dire warnings of increasingly worried economists all over the world about the long-term damage being inflicted upon national economies by protracted lock-downs.

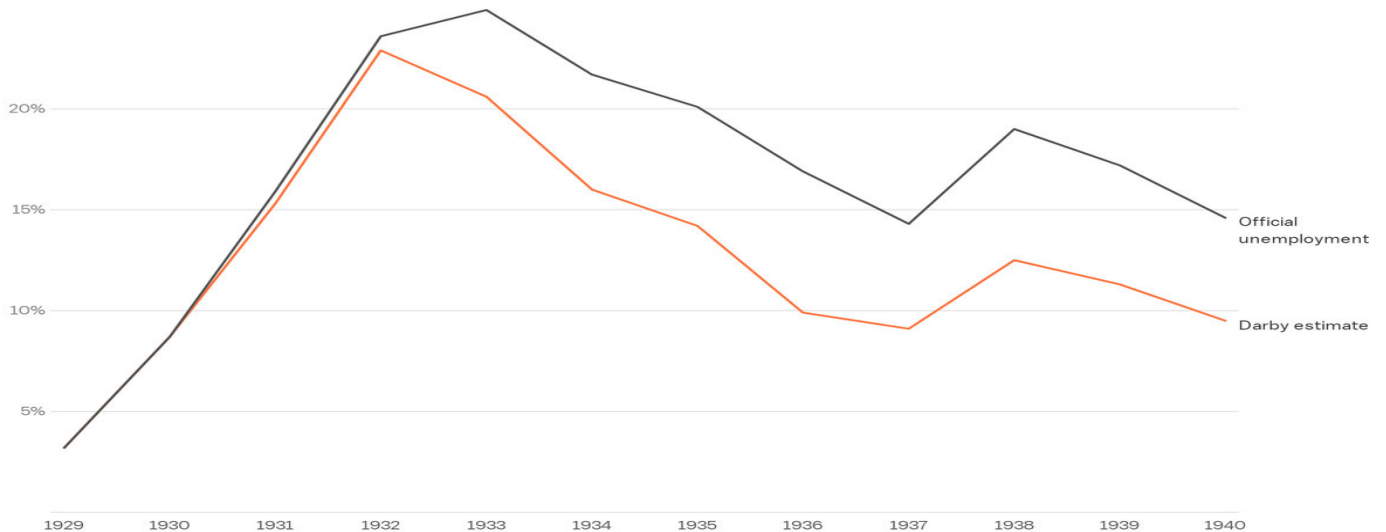
So, I think investors should carefully study the following graph from ShareFinder 6 which tracks Wall Street's Dow Jones Industrial Index since the year 1900. See if you can spot the worst-ever global economic disaster in contemporary history, the Great Depression which officially lasted from 1929 to 1940 but from a share market perspective in fact lasted until mid-1949? The scale is too great for you to really see the Depression but those with sharp eyes will detect a slight upward bump a quarter of the way across the graph from the left. But you need sharp eyes to actually notice the worst event in 120 years of share market history....and that is the important point I wanted to make.



The events of the Great Depression have been much visited lately because many fear that if our governments are not careful in their response, the aftermath of the Crash of 2020 will be worse. Indeed, the Bank of England yesterday warned exactly that. So here is a brief history of the Depression courtesy of Vox News:

The most striking thing about the American economy in the 1930s is that the Depression went on and on and on. There are a few different ways you could look at this, but probably the simplest is to consider the unemployment rate. Here's a chart showing joblessness calculated in two ways. One is the official unemployment rate from Stanley Lebergott of the Bureau of Labor Statistics, the other line is a more optimistic model constructed years later by economist Michael Darby, who argues that the official statistics of the day improperly classified people with unemployment relief jobs as not working. The Lebergott-Darby gap of roughly 5 percentage points makes a difference, but either way, it's a long depression.

Estimates of US unemployment rate in the Great Depression



Source: Robert Margo, 1993

Vox

Tim Ryan Williams/Vox

Even using Darby's numbers, the unemployment rate never got low during President Franklin D. Roosevelt's New Deal programs. After getting steadily worse under President Herbert Hoover in the early 1930s, the economy got better under Roosevelt, which is why he won re-election overwhelmingly in 1936. But things were still really bad during the New Deal's best moments.

Then it got worse, because in 1937, the US stopped making progress and fell into a new recession within the depression. Policymakers corrected some of the errors that led to the 1937 recession (more on that later), and the unemployment rate started falling again.

But even by 1940, the labor market was still in shambles. It's only the extraordinary events surrounding World War II that really brought the Depression to an end. And that resolution shows us two things.

One is that if politicians had been willing to try more drastic things earlier, they may have been able to earlier generate the rapid recovery that took place in 1940. The other is that if war hadn't broken out, the very modest and unsteady pace of recovery that was happening under Roosevelt might have just continued for years more. Nothing about the nature of an economy guarantees that it will "bounce back" from bad news.

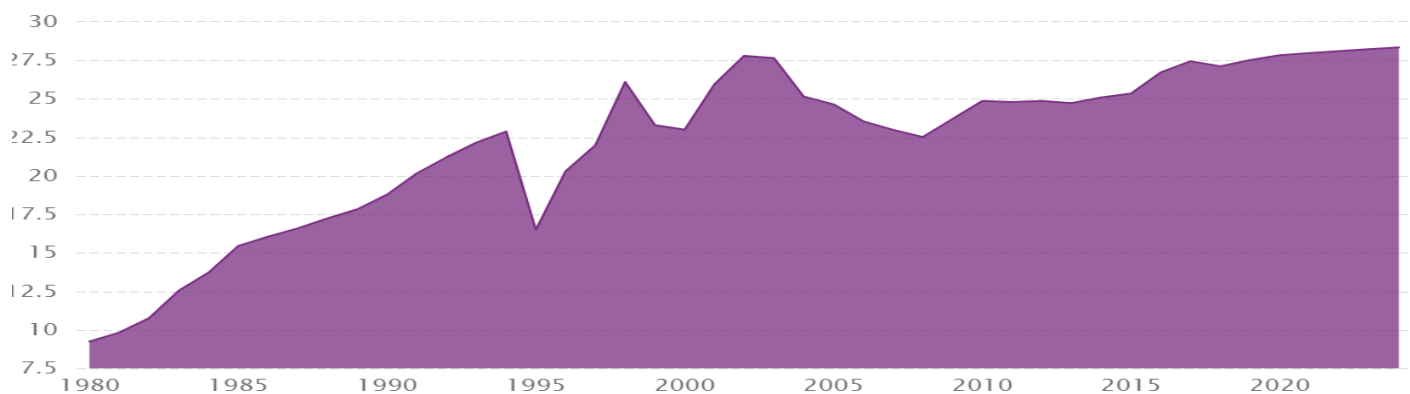
It is an important observation to take to heart, particularly by South Africa's Soviet-styled National Command Council which has been visiting one of the most draconian lock-downs in the world with, many now observe, a power-driven frenzy of control measures that are frequently devoid of public-health-based reality.

If you have any doubt of this, just consider the tobacco sales ban which has fuelled a massive prohibition style boom for the illegal cigarette industry or, the fact that the motor manufacturing industry has been re-opened when the motoring public has practically no need for new cars. This latter is economic madness as is the extraordinary argument for keeping on-line traders shut down.

Ironically too, there seems to be growing evidence that smokers are internationally enjoying a better than average immunity to the virus. Citing France as an example where 25 percent of the public are smokers but only 5 percent of virus victims are smokers. The command council either does not know how smokers are faring locally or they are failing to inform us.

Be that as it may, it is important to note that, measured by the unemployment rate which peaked in the USA at 24.9 percent in 1933 whereas it has averaged 5.9 percent for the past decade, South Africa has had worse than Great Depression levels of unemployment throughout the past decade having at best achieved 21.5 percent in 2012 and is currently sitting at 29.1...and that number excludes those who have given up looking for work.

The ANC has to take full responsibility for its mismanagement of the economy that resulted in this crisis such that the unemployment rate has risen by 50 percent under its administration as the following graph illustrates.



Meanwhile, as business and human rights organisations are reportedly mobilising for a legal challenge to the Government's right to have set up the National Command Council in the hope of curbing the draconian powers its members have taken, civil society is clearly growing increasingly alarmed at the daily reports of abuse of power by police and the armed forces, exemplified by a man being beaten to death for consuming alcohol in his own garden, at a mother being flung into a police van when she rescued her toddler which had run onto a Cape beach and of a motorist jailed when a road block found a cooler bag containing alcohol in the boot of his car.

Worse, the preening self-satisfaction of Command Councillors who appear to condone these actions and warn that they will have no hesitation in imposing harsher lockdowns if the public continues to flout their edicts smacks, at best, of a Nanny State. History has taught us that dictators, having tasted power, have seldom willingly relinquished it.

We need to be very fearful that the very people whose misguided policies drove the South African economy into the ground even before Covid-19 administered the coup-de-gras, now believe they should be allowed to dictate to society how it should rescue itself from this crisis. That is the stuff that so often in the past has inspired revolution!

At the core of the Great Depression was poverty. Yet money did not disappear. People hoarded it because they were fearful of where the next dollar/Pound/Franc etc would come from. In South Africa there is a real shortage of money because the ANC Government squandered it and continues to do so on massively-inflated wage bills for non-productive public servants leading us as a nation into such severe debt levels that all the major ratings agencies have “junked” us. It accordingly lacks the monetary ammunition to initiate Hoover Dam type infrastructure projects which could get the economy moving again.

There is, however, still capital within our society resting in private citizen’s savings accounts, pension funds and the like. Private enterprise similarly sits on large cash piles but in a moribund economy where a stagnant growth rate and a sovereign debt contaminated Rand renders the private sector fearful of investing locally, the consequence has been one of the world’s worst unemployment rates.

Meanwhile the ANC, on the face of it, continues to regard the private business sector as “the enemy” and, as is clearly being demonstrated right now, by keeping it locked down and unable to viably operate, those precious last stores of capital are being consumed.

If it continues much longer, it will be well nigh impossible to lift the South African economy out of depression. This is not just Richard Cluver saying this. A nationally-respected team of actuaries, Nick Hudson, CEO at Sana Partners, and Peter Castleden, a fellow of the Actuarial Society of South Africa warned this week that the current lock-down could cause nearly 30 times more deaths than Covid-19.

In a letter to the presidency they pleaded that, *“We present our data and analysis to you with an urgent appeal: to revise the current approach to lockdown. Using commercially tested actuarial principles, we have been able to estimate the impact of the lockdown’s economic contraction on South Africans’ mortality, or the ‘life-years lost’.”*

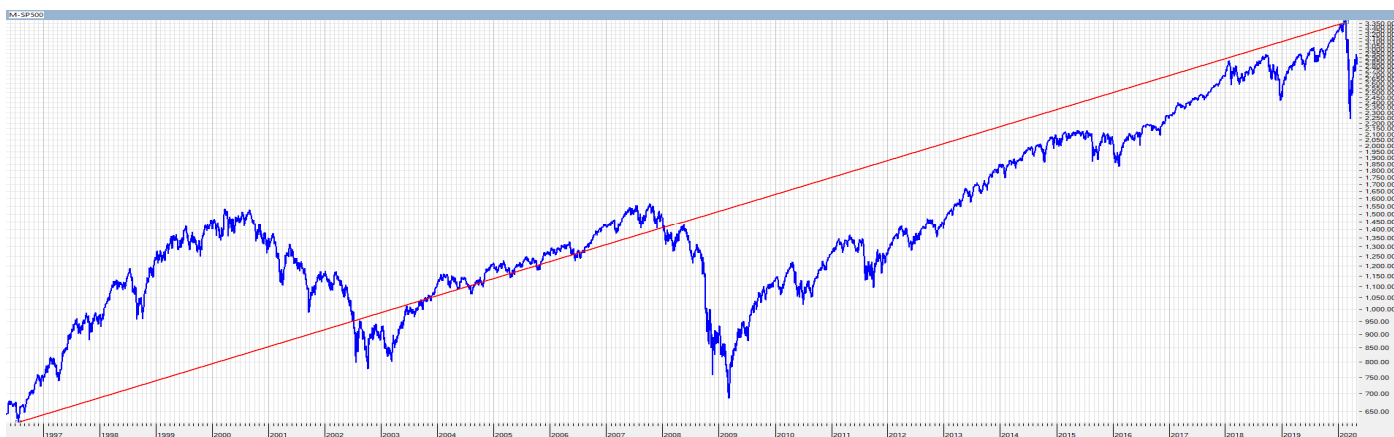
“This equates to three orders of magnitude higher than the life-years that could plausibly be saved by the lockdown. The data also takes into account the reduction of life expectancy as a result of the economic damage and/or hardships caused by the lockdown, on the same set of demographics in society.”

I trust the National Command Council is listening! Already the townships are burning and desperate people have taken to rioting in the streets. Barely a kilometre from my home a mob stoned cars in the centre of Pinetown this week!

However, I write this column primarily for long-term share market investors and, here I need to stress the words long-term for whom I initially drew attention to the long-term Dow Jones Industrial Index graph because the fundamental message is that over time the index always rises. More importantly, since I have from the start of writing this column back in 1986 constantly urged readers to invest in Blue Chip shares, I can put that graph into perspective by offering you my next graph which covers the entire period of this column during which Blue Chip portfolios rose at a compound annual rate of 19.3 percent:

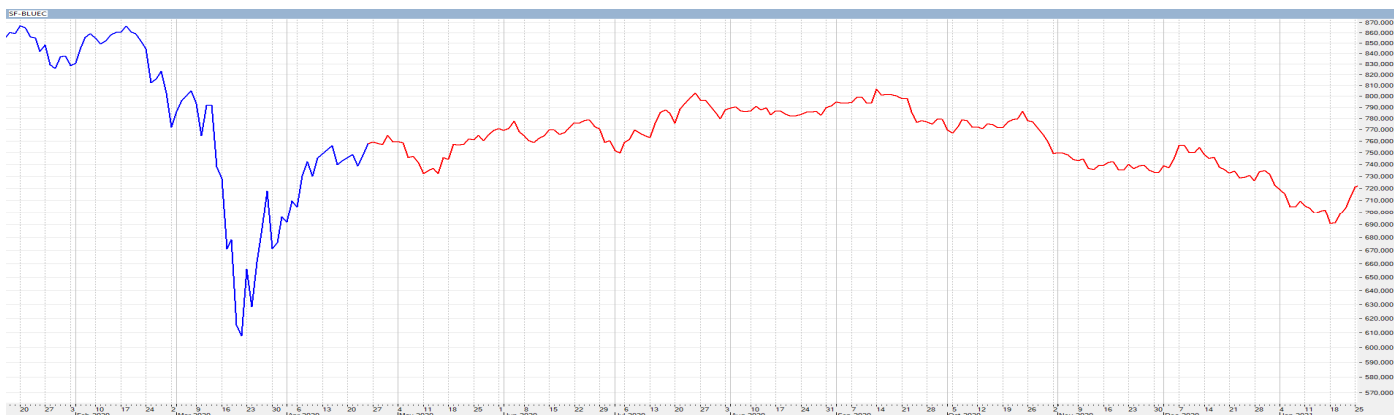


Furthermore, since the continual comment I have recently heard from the popular investment analysts is that one should endeavour to place as much as possible of one's money offshore, my next graph illustrates the performance of the Wall Street's most representative market index, the Standard and Poors 500 which, if you cared to measure that line, has offered investors a compound annual average growth rate of 7.4 percent.



So local Blue Chips have done 260 percent better since 1987! Sometimes the "experts" need to do their homework!

The most important message, however, is that even if your portfolio appears decimated currently, in time the current damage will be barely distinguishable on a long-term graph. So above all, do not sell now. My next graph illustrates that, just as ShareFinder predicted they would, almost two thirds of the losses incurred during the February-March crash have already been restored. Furthermore, the September to January decline which ShareFinder had long predicted, has had much of the bite taken out of it by the February crash:



Have a good weekend!

The month ahead:

New York's SP500: I correctly predicted that last week's brief weakness would soon be over and we should now look forward to volatile gains until the end of September when the next sharp phase of weakness is likely. That view remains unchanged.

London's Footsie: I correctly predicted the recovery which I still see lasting until the end of May followed by a downhill phase until early July and then another recovery until early October ahead of the next big down-turn.

Hong Kong's Hangsen: I correctly predicted the start of a long recovery until the end of December when the next down-turn is likely. In the short-term I still see declines until mid-May.

Japan's Nikkei: I correctly predicted it was likely to be downhill until around May 11 before the next up-surge until the first week of June and then down-hill again until August before a recovery until late September.

Australia's All Ordinaries: I correctly predicted a worsening situation with the down-trend continuing until mid-August before it briefly recovers with further down-hill trending thereafter until year-end. I correctly also predicted this week's brief recovery which is now over.

JSE Industrial Index: I correctly predicted a modest recovery which I saw lasting until about May 5. It is most likely to peak today, fall until May 12 and then recover until May 18 before going into a decline until early July.

Top 40 Index: I correctly predicted a brief recovery followed by a decline which I now see lasting until the end of June followed by a recovery until the first week of August.

ShareFinder Blue Chip Index: I correctly predicted the beginning of a more modest phase of recovery which I now see lasting until late July though interim volatility must be expected including weakness in the new week. From July 27 it is likely to be downhill again.

Gold shares: I correctly predicted declines which I expect to last well into 2021.

Gold Bullion: I correctly predicted weakness lasting until mid-June before a long recovery begins and is likely to continue well into 2021.

The Rand/US Dollar: I correctly predicted modest gains until the third week of May and I still hold that view.

The Rand/Euro: I correctly predicted a volatile recovery which I still see lasting until mid-June followed by weakness until mid-July followed by gains until late October.

The Predicts accuracy rate on a running average basis over the past 744 weeks has been 85.71%. For the past 12 months it has been 96.54%.

Richard Cluver

Can PSG afford to cut Capitec loose?

By MARC HASENFUSS

Reprinted from Business Live Premium

Speculation is rife that the company's most successful asset — Capitec — is back on the unbundling block

Investment house PSG Group has, over the decades, undergone numerous transformation exercises that founder Jannie Mouton would clearly define as "Project Growth". "Project Internal Focus" and "Project Unlock Value".

Older readers may remember that 2002's "Project Unlock Value" (in)famously involved unbundling PSG's stake in Capitec Bank — a decision almost instantly rued by Mouton and his brains trust.

The Stellenbosch-based investment company wasted little time in strenuously reacquiring and rebuilding an influential Capitec stake – a development that has been both a blessing and a curse, especially over the past few years.

No new project is being bandied about now, at least officially. But PSG is, significantly, trading under cautionary, which means something is afoot. With numerous references to the large discount (25% at the time of going to press) that the PSG share price offers to the sum-of-the-parts (SOTP) value and the portfolio's heavy value bias towards the stake in Capitec, investors can safely assume "Project Unlock Value, Part Two" is under way.

There is some conjecture that a sure way to unlock value is for PSG to consider unbundling, or partially unbundling, its stake in Capitec.

CEO Piet Mouton is obviously not giving much away. He tells the FM: "What can I tell you ... there are myriad opportunities [for] unlocking value." But he does stress that the value-unlock considerations have been in the works for a while: "I have this year so far written about five executive strategy proposals to the board."

He says the first followed the successful conclusion of agribusiness subsidiary Zeder's sale of its stake in Pioneer Foods to PepsiCo. This deal, via a special dividend from Zeder, will pump R1.7bn into PSG.

Another proposal was drafted in February, when the economy started to creak rather ominously, and there have been other proposals triggered by the Covid-19 pandemic.

Opportune Investments CEO Chris Logan thinks PSG might be too concerned about the various discounts which have opened up dramatically at the group (and Zeder).

"They missed the point that discounts will open up dramatically when a country is downgraded to junk, capital and talent leave and growth is negative," he says. He suggests PSG should rather buy back shares at Zeder, where there is both a 50% discount and cash, and, more importantly, that it should follow fellow investment company Remgro's recent lead in aligning executive incentives with shareholder value.

But after canvassing some investors after PSG's results presentation, the FM concludes that first prize would be some form of unbundling effort with Capitec.

Significantly, one slide in the presentation pack asked: "Is PSG Group just a Capitec proxy?"

Capitec, valued at R32bn, accounts for a whopping 67% of PSG's SOTP. This holding has fairly recently been as high as almost 80% of the SOTP. The proxy point is clearly valid.

But Mouton argues that a 10-year performance to the end of February 2020 gives a better contextualisation of Capitec's contribution to its parent.

Sure, a 10-year compound annual growth rate on a PSG per-share basis, excluding dividends, puts Capitec comfortably in the lead, with a dashing 34%. But PSG's other assets returned a decent 16% — well ahead of the 7% returned by the JSE all share index.

Mouton's conclusion is: "Capitec has contributed significantly to our success. However, our other assets have also materially outperformed the JSE over the last 10 years."

The FM maintains that PSG would be better served by at least unbundling a portion of its Capitec holding — perhaps reducing the stake to a portfolio holding of 10%.

That would give the portfolio better balance, and allow PSG to bring promising smaller investments like retirement village developer Evergreen, power management specialist Energy Partners, Southern African fast-moving consumer goods distributor CA Sales and distance learning business Optimi (the old FutureLearn) to the fore.

In addition, R1.7bn of cash from Zeder could potentially make a "needle-moving" investment if PSG's portfolio, after a Capitec unbundling, carried a value of between R15bn and R25bn (rather than a figure of closer to R50bn).

The one serious drawback of a Capitec unbundling, complete or partial, would be a serious reduction of dividends, despite the bank skipping the latest payout after following Reserve Bank guidance to cope with possible lingering Covid-19 fallout.

Dividends from Capitec, which have underpinned PSG's generous discount policy, have just about tripled since 2015, to R621m in 2019.

Aside from the Capitec triumph (which Mouton reckons is the most successful business started in SA over the past 20 years) there are several other reasons for PSG's discount to SOTP.

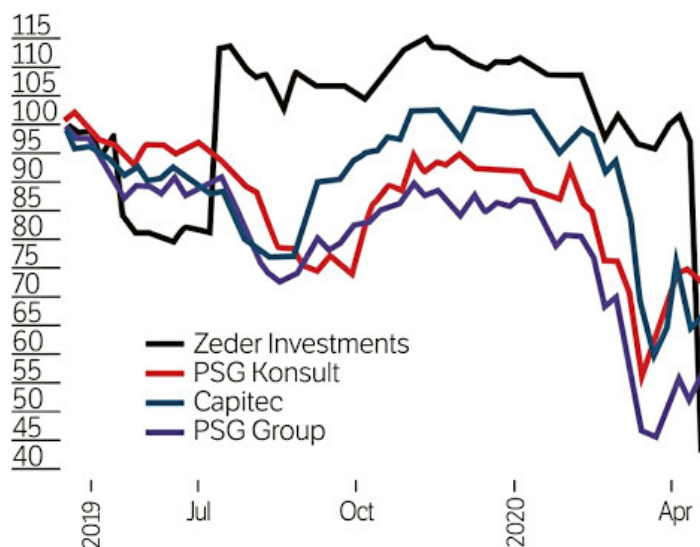
Mouton argues that investment holding companies have generally fallen out of favour and that there are too many listed entry points into PSG (which really means investors can construct — or customise — their own portfolio).

Another factor, Mouton concedes, is that PSG has struggled to get meaningful traction with its early-stage investments nursery, PSG Alpha (though this did initially house the highly successful private education venture Curro).

Mouton stresses that it is PSG's intention to "unlock the discount as far as reasonably possible when opportune".

SUM OF THE PARTS

Capitec Bank Holdings vs PSG Konsult vs Zeder Investments vs PSG Group – weekly
Based to 100



Source: Infront

Share buybacks, however, are unlikely to form part of this strategy.

It would probably be a bridge too far for PSG to pitch a buyout offer to minority shareholders in 60.6%-owned financial services subsidiary PSG Konsult, which holds a market value of over R10bn. PSG Konsult would also seem an unlikely candidate for unbundling.

But PSG's private education interests Curro (schools) and Stadio (tertiary institutions), both 55% owned, could make for some intriguing speculation.

There is definitely an advantage to keeping both companies listed, with capital raising via rights issues not exactly a remote possibility considering the long-term expansion plans for these businesses.

But Curro's market capitalisation of R4bn and Stadio's of less than R1bn might tempt PSG to pitch buyout offers.

This would assume a longer-term plan to consolidate all PSG's private education interests, including unlisted Optimi, under one structure.

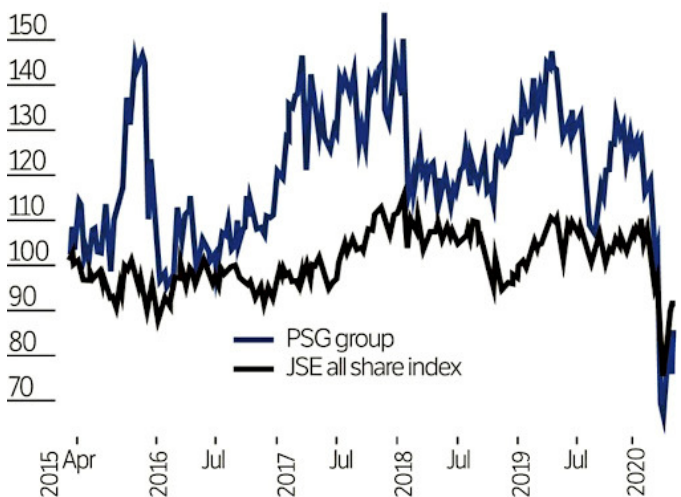
Ultimately, though, any real resurgence in value in any of PSG's companies depends on factors entirely outside of the company's control. Which is presumably why Mouton spent much of last week's results presentation arguing for an "urgent" return to economic activity.

"No-one wants to make unpopular statements and become targets on social media by those who will also later be the first to claim what should have been done. This is not our style," said Mouton.

But, he said, "we believe SA should act much faster in lifting restrictions to rejuvenate the economy".

STRUGGLING

PSG vs All share index – daily
Based to 100



Source: Infront



Capitec
HOLD

Target price: **R1,210.90**
Potential upside: **30.5%**
* Based on analysts' consensus forecast

Reprinted from Business Maverick

Saturday evenings aren't normally the ideal time for tuning into a multi-hour investor conference, especially after being cooped up all week working from home due to the Covid-19 pandemic. But mere minutes into the live-streamed Berkshire Hathaway Inc. annual shareholder meeting, it was clear that something much more meaningful was unfolding.

Warren Buffett, sitting on a stage in an empty Omaha arena, began with a history lesson like no other — a vivid walk through the other moments in America's past that tested its resiliency, but never broke it. At 89 years old, he's lived through many of them.

The current crisis "is creating a huge amount of anxiety and changing people's psyche and causing them to somewhat lose their bearings, understandably," the chairman and CEO of Berkshire told his virtual listeners, while peering out where some 40,000 of them would normally be sitting. "The American magic has always prevailed and it will do so again."

While his unwavering confidence in the U.S. economy is hardly a new theme in Buffett's lectures, they're not normally so moving. Like many of those watching, he was in need of a haircut and acknowledged it, adding that he had grown used to wearing sweat suits — as opposed to the real suit and tie he donned on Saturday. It was a humanizing moment. Watching Buffett was like watching Dr. Anthony Fauci or New York Governor Andrew Cuomo, the two government leaders whose comforting words and realism have probably stuck with Americans most during the pandemic and helped to create a sense of hope and community.

Even so, going into the event, it wasn't quite so clear that Buffett still believed in his mantra, "America's best days lie ahead." He had been notably quiet in recent weeks, and Berkshire was selling stock and shunning acquisitions, a bearish signal for a company where the ethos is to buy when others are panicking. After all, Buffett once wrote:

Every decade or so, dark clouds will fill the economic skies, and they will briefly rain gold. When downpours of that sort occur, it's imperative that we rush outdoors carrying washtubs, not teaspoons. And that we will do.

Berkshire has done neither, even with \$137 billion of cash just sitting there. As such, some say his optimistic outlook doesn't align with his actions of late. But Buffett explained that the panic hasn't hit the stock and credit markets to the extent it did during the 2008 financial crisis — or not for as long, thanks to the extraordinary measures taken by the Federal Reserve. His investing during that time "was not designed to make a statement, it was designed to take advantage of what we thought were very attractive terms," he said. He's not finding as many enticing investments now, partly because of those Fed actions, which removed the need for many companies to seek a lifeline from a deep-pocketed savior like Buffett.

The complicated public-health aspect of this downturn also makes it impossible to predict how long it will carry on or how much worse it will get before it gets better. "The cash position isn't that huge when I look at worst-case possibilities," Buffett said Saturday.

There are also some industries that may be permanently altered by the coronavirus, such as airlines, Buffett said. Berkshire was a top-three shareholder in American Airlines Group Inc., Delta Air Lines Inc., Southwest Airlines Co. and United Airlines Holdings Inc. as recently as early April. Buffett has since decided to completely exit those positions: "The world changed for airlines and we wish them well."

Even though Buffett is still a believer in the long-term prospects of the U.S. economy as a whole, his 180-degree turn on the airline industry shows that he sees the virus changing at least some consumer behavior for good. That will affect future deal making. One of Buffett's biggest takeovers was Precision Castparts, a supplier of airplane engine parts, which he bought for \$37 billion in 2016. It was also his last major transaction.

As fascinating as Buffett's commentary was, the Q&A wasn't the same without his usual sidekick, Charlie Munger, who is known for his quips and comically curt responses compared to Buffett's monologues. Munger, Berkshire's longtime vice chairman, is 96 years old and lives in California. Though he is in good health, Buffett said, it didn't make sense to have him travel to Omaha — a reminder of both their ages, even if they are as sharp as ever.

Instead of Munger, Buffett was joined by Greg Abel, who oversees all non-insurance operations under the Berkshire umbrella and is Buffett's likely successor. "When I talk to Greg, sometimes I wonder, am I talking to Warren?" Lawrence Cunningham, a professor at George Washington University Law School and author of books on Berkshire, said during the meeting pre-show. It may be a while before others see him that way. While Abel answered some questions Saturday, he mostly deferred to Buffett and stuck to high-level corporate-speak.

Buffett, who recently joked that his age puts him "[in the urgent zone.](#)" did have a message for whoever does replace him: "I will bet on America the rest of my life, and I hope my successors at Berkshire do."

He closed the evening with a smile and a laugh: "We'll see you next year and we'll fill this place!" Let's hope. But if it turns out that this virtual event was the Oracle's last time as the master of ceremonies, it will stand as a fascinating and beautiful sermon that will be remembered.

Dangerous Half Truths

By Willem H. Buiter

Modern Monetary Theory (MMT) offers a dangerous half-truth that has become particularly seductive now that governments are desperate for tools with which to keep their economies afloat.

In a recent [statement](#) by MMT proponent [Stephanie Kelton](#) to the *Financial Times*, referring to the United Kingdom's current Conservative government, argues that, "They're going to have massive deficits. And it's fine."

The problem is that while this assessment is correct for now, it won't necessarily be correct in the future. Indeed, we should anticipate that the year following the end of the Covid-19 lockdown could be when MMT falls flat on its face – starting, perhaps, with a burst of inflation in the UK. But, even barring that specific outcome, policymakers are flirting with disaster if they accept MMT's main message, which can be paraphrased as: "Deficit, schmeficit. Just boost public spending or cut taxes, then monetise the resulting imbalance."

To be sure, some parts of MMT make sense. The theory views the treasury (or finance ministry) and the central bank as components of a single unit called the state. The treasury is the beneficial owner of the central bank (or, put another way, the central bank is the treasury's liquidity window), which implies that central-bank independence is an illusion, especially when it comes to its fiscal and quasi-fiscal operations.

MMT holds, correctly, that because the state can print currency or create commercial bank deposits with the central bank, it can issue base money at will. And because the monetary base is irredeemable, it is not in any meaningful sense a liability (even though it is certainly viewed as an asset by the holder). As long as the non-monetary debt issued by the state is denominated in domestic currency, sovereign default is a choice, not a matter of necessity, because debt servicing can always be funded (by creating money).

But if sovereign default is a choice, there are circumstances in which it might be chosen. If the deficit that needs to be monetised is large enough, and if the interest on the public debt accounts for a significant part of that deficit, the monetary financing required to maintain sovereign solvency might result in a politically unacceptable rate of inflation. In that case, the sovereign might opt for the “lesser evil”: defaulting on its domestic-currency-denominated debt.

To get to the heart of the matter, forget about issues such as bond financing, and focus directly on how the state funds the deficit by creating money. Assume that public spending and tax revenues are fixed in real (inflation-adjusted) terms. The resulting real deficit will be equal to the increment in the real stock of base money that the private sector must be willing to absorb each period.

There are two “regimes” for base-money demand. The first is where many of the advanced economies now find themselves: in a liquidity trap at the effective lower bound (ELB) for the nominal policy rate. At the prevailing near-zero risk-free short-term nominal interest rate, the effective demand for real-money balances is infinitely elastic. In this case, it is proper for fiscal authorities to follow a simple dictum: when in doubt, shovel it out. “[Helicopter money](#)” – monetised increases in public spending or tax cuts – is an appropriate policy response under such extraordinary conditions. So long as interest rates are stuck at the ELB, cash disbursements will not be inflationary.

Yet one must remember that domestic or foreign developments affecting financial markets or the real economy can quickly eject a country from its ELB perch, landing it in what economists would call a normal monetary regime, where the policy rate is above the ELB. With Japan stuck at or near the ELB for the past 20 years, the concept of “normal” may require some rethinking. Nonetheless, it would be reckless to design policies on the assumption that the neutral interest rate (the interest rate that would prevail with the economy at full employment and inflation on target) will hover near zero for the foreseeable future.

In this second, normal scenario, there still would be no inflationary threat so long as the economy has excess capacity (idle resources). But when demand for the monetary base is constrained by interest rates and the level of economic activity (measured, say, by income or consumption), the unbridled monetisation of state deficits would eventually exhaust what slack there is, putting upward pressure on the rate of inflation.

At this point, no one can know whether the Covid-9 pandemic will have lasting effects on supply relative to demand. Although weak investment and strong precautionary saving are likely to depress neutral and market interest rates while the pandemic persists, we should be prepared for when social distancing becomes a thing of the past and supply chains are at least partly restored. Governments will have to adjust their fiscal position and its financing accordingly. MMT thus ignores the level of demand for base money at its peril.

Willem H. Buiter, a former chief economist at Citigroup, is a visiting professor at Columbia University.

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