RichardCluverPredicts

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Increasingly, local investment advisers are advocating for placing as much as possible of your money offshore and, in the short-term, it is hard to fault them.

Although I have long pointed to the significant outperformance of local shares over the long term, South Africans have demonstrably lost confidence in a government that is so wrapped up in its own internal ideological struggle that it appears unable to initiate the growth strategies that could lift us out of our debt trap.

As so explicitly argued this week by Stephen Van Coller, the CEO who is leading the charge to save troubled JSE-listed EOH by ridding it of debt as quickly as possible, there are all too many examples of bankrupted companies which failed to take speedy action to rein in debt. And South Africa Inc is no different!

Pointing to the most recent example of Edcon, Van Coller wrote: "*Edcon is a recent example — the shareholders refused to sell the Jet business when it was worth a lot of money. They could have reduced the debt while Edcon still had some equity value. But the debt, compounding at 14%, in euros, meant Edcon could not grow faster than that due to a tough environment. The rest is history.*

Whether or not South Africa Inc has already fallen over the debt cliff very much depends upon the eye of the beholder but the fact that eight percent of our wealthiest citizens left the country before Covid 19 locked our borders tells you that significant numbers have already lost hope that this country can resuscitate itself. And the current trend of JSE Blue Chips, which are declining at a time when overseas markets are making new highs, seems to suggest that the leavers were right.

But there is an alternative view. President Cyril Ramaphosa seems to have resoundingly won the first really decisive battle of his current term at a time when JSE Blue Chips are the cheapest they have been for decades. Those who choose to be fully invested at this time are, depending upon your viewpoint' either desperately foolish or possessed of a superior insight that will see them enormously rewarded in the future. With the average Blue Chip dividend yield standing at 4.9 percent, down from a recent 5.3 percent, such devaluation has not been seen since the dark days of the Rubicon speech when South Africa had long since lost the regard of the world community, was seemingly being outgunned in the border war and many justifiably believed that all of Southern Africa might soon be engulfed by soviet communism. As my Blue-Chip Index graph illustrates, optimism is fading once more!

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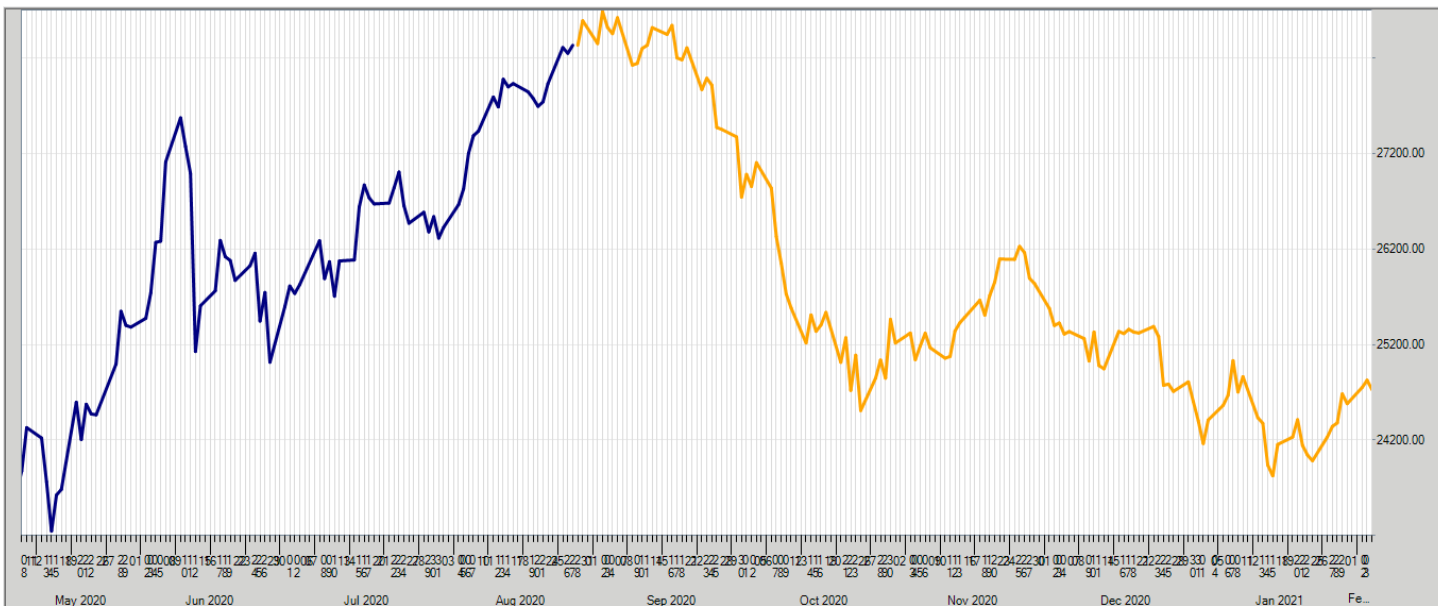
At the same time Wall Street's S&P500 Index – illustrated on the right with a red trend line rising at a compound annual average rate of 116.2 percent - is highlighting unbounded investor optimism at the same time as US cities are burning and unemployment rates equal those of the Great Depression. That share markets appear to have become completely detached from reality is the consequence both of new share markets Apps which have handed back market dominance to retail investors and, far more importantly, a flood of new money that has been manufactured by the world's central banks to counteract a looming economic depression. To date the amount of money circulating in the world has doubled since the start of the year and the US Federal Reserve has just telegraphed that it intends keeping the cost of money at negative real rates for the long term. As most will appreciate, it would require an expectation of ongoing interest rate increase to reverse the trend of Wall Street shares in the medium to long term…but it can be easily spooked at these levels as yesterday's moves illustrate.

US Blue Chips are at a dividend yield average of 3.1 percent which is arguably very expensive and many commentators believe that a sharp retraction was overdue, particularly since the front runner in the presidential election, Joe Biden, is widely believed to stand for significant future tax increases to support a Democratic platform of Welfare State spending. Furthermore, ShareFinder's projection of the Dow Jones Industrial Index continues to project that such a retraction is increasingly likely as my following graph illustrates:



The graph suggests that Wall Street actually peaked yesterday but the sell-off is likely a short-term event with further gains now likely until about September 16 when the next plunge is due and likely to last through to October 26 before retracing until November 25, and then resuming its decline until January 15.

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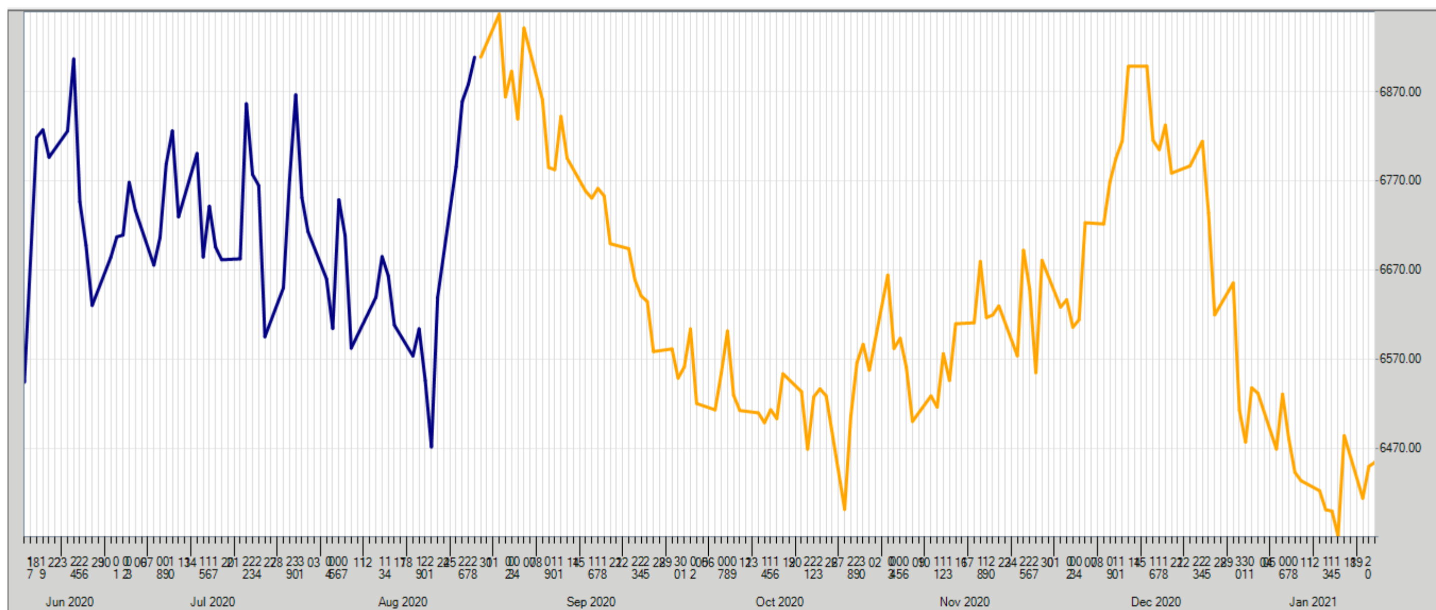
In theory this should be ShareFinder's most accurate ever prediction since it is based upon 120 years of Dow data but the magnitude of the move has changed significantly in recent months once the heat was taken out of it by the February decline.

The latter was long forecast as just the fore-runner to the September/October crash which prompted my book "The Crash of 2020". Now September/October is seen as significant but not as severe as the February event.

ShareFinder predicts that the Wall Street share price decline will be echoed locally with approximately the same dates for the decline getting under way on about September 7 to bottom around October 27 with the second decline beginning around December 15 exactly a month later as the following graph suggests:



That is why I have been urging investors to set some money aside to be able to take advantage if a market decline sets in.

I think a decline of both markets, as elsewhere in the world, is highly likely but the magnitude of that move could massively depend upon political events over the next few weeks. To negate that potential downward pressure locally we would need to see three categories of events:

1) On the political front President Ramaphosa has been able to win executive support for his war on corruption. But it will only achieve traction if the public is provided with practical proof that this is more than a war of words. There have been rumors circulating recently that some high-profile arrests are imminent. What is now needed is to pick the low-hanging fruit.

2) South African GDP shrank an annualized 2% in the three months to March of 2020, following a 1.4% contraction in the previous period and compared with market expectations of a 3.8% decline. It was the steepest contraction since the first quarter of 2019, amid the initial effects of the global pandemic on domestic activity even before the implementation of the nationwide lockdown on March 27th. On an annual basis, however we achieved growth of 0.9 percent. Now we need to provide economists with practical evidence that the Ramaphosa growth plan can at least achieve two percent year on year for a recovery to be believable.

3) So, the ball is now squarely in Ramaphosa's court like it has seldom been before for any president! We need to get started immediately on such a growth plan and the best way to do so is to end our dependence upon an intermittent Eskom. The private sector has indicated that it can fix our supply shortages in the short-term by allowing own-generation power to be fed into the grid and in the long term a solar-led renewable energy programme could comprehensively plug the remaining gaps at NO cost to the fiscus.

Longer term, if suitable guarantees can be provided that the annual price escalation rate will not be anything like Eskom's predicted 25 percent annual rate, Ramaphosa could kick-start us back into realistic growth if he were able to announce the completion of the current ongoing sub-division of the Eskom and, more importantly, that the disaster-prone generation division would in future be competing against private sector power suppliers to feed an independent grid.

South Africa's previously very successful post-war industrialization was made largely possible because of cheap electricity and, given our abundance of sunlight, solar power backed by battery storage could do that again!

Another easily-achieved growth initiative that would be cash positive for the fiscus would be the long-promised radio frequency spectrum auction.

Couple that - if Ramaphosa has truly gained political ascendancy over the Soviet-trained adherents of the resoundingly disproven concept that a central command economy can triumph over the proven efficiency off private capitalism – he could demonstrate that by announcing that ALL but a tiny few State Owned Enterprises are to be closed down if they cannot be sold to private enterprise before the end of this year. Admittedly this might be one bridge too far, but he would clearly enjoy electoral support for such a move and, furthermore, with the fiscus in Great Depression mode, Government has no option but to engage in drastic cost-cutting. Closing the tax-guzzling SOEs would, after all, surely be more palatable to the ANC and its tripartite partners than pruning the civil service.

Currently we face one of the worst fiscal deficits in the world and the mid-term budget next month will lay that out in stark relief. The President thus has just over a month to turn back the tide. He started well last weekend. We should all pray that he can maintain the momentum.

Do enjoy your weekend!

The months ahead:

New York's SP500: As I correctly predicted the market continued rising. Yesterday's shock is likely to be reversed in the short-term but the market peak is now very close.

London's Footsie: I correctly predicted a brief recovery but it could not prevail over Wall Street. Nevertheless, I now see gains until mid-October ahead of a run-down until late January.

Germany's Dax: I wrongly predicted the Dax would continue recovering until the second week of October ahead of a slide down to December. Nevertheless, once the Wall Street effect has been overcome, I continue to see a brief recovery until early-October ahead of the renewed slide to the end of November when a four-month recovery is likely.

France's Cac 40: Within an overall declining trend that began in early June and should last until the end of November, I still anticipate a brief two to three-week recovery.

Hong Kong's Hangsen: Within an overall declining trend that began on August 25 and is likely to continue until the end of this month, pressure is continuing to build up for a recovery until the end of December ahead of a volatile weakening first half of the new year.

Japan's Nikkei: The down-hill phase I anticipated is still likely to last until the end of November ahead of a likely four-month recovery.

Australia's All Ordinaries: Though the short-term gains I expected were delayed by global market weakness, I still anticipate an imminent fortnight of gains within an overall falling market that should see declines until at least the end of October.

JSE Industrial Index: I correctly predicted another brief decline and then a fortnight of gains within an extremely volatile declining phase until mid January.

JSE Top 40 Index: I correctly predicted a decline until early September followed by a recovery for most of September ahead of the next down-trend until mid-November when I expect the first foundation to be laid of a double-bottom base with the second in mid-January ahead of gains until May.

ShareFinder JSE Blue Chip Index: I correctly predicted a continuation of the volatile decline which began in early June and is likely to continue until mid-January.

JSE Gold shares: I correctly predicted that the down-turn which began in July would last until the first week of September followed by a recovery which has now begun and is likely to last until late October before a long decline well into the new year.

Gold Bullion: I correctly predicted a month-long, interim decline followed by a recovery which is now under way and is likely to continue well into 2021.

The Rand/US Dollar: I correctly predicted the start of a short period of weakness that should last until the second week of September ahead of very volatile gains until the end early November.

The Rand/Euro: I correctly predicted gains which I continue to see lasting until early November followed by weakness until mid-December and then further gains well into the new-year.

The Predicts accuracy rate on a running average basis since January 2002 has been 85.9%. For the past 12 months it has been 95.05%.

STEPHEN VAN COLLER: Stealing from SA's future

Re-printed from Investors Monthly

As CEO of a company in crisis, I know what happens. So I ask you, Mr President, please fix SA's debt today

As companies around the world struggle with Covid-19, I can't help but draw parallels between managing a company in crisis, and a country in crisis. Strictly speaking, financial systems are a zero-sum game and so you have only a few levers to pull when faced with a crisis.

I read with interest that Sasol, for many years a stalwart of the economy (and the Industrial Development Corp's balance sheet), made a R91bn loss for the year. This is larger than the International Monetary Fund's loan to SA. But it was not the size of the loss that was eye-catching, nor the fact that it effectively takes around R30bn from SA Revenue Service coffers, thus reducing SA's ability to repay its growing debt. Rather, it was Sasol's response to fixing the problem that was noteworthy.

It wasn't dissimilar to how the new management at Tongaat and EOH (where I am CEO) looked to solve their inherited problems: through asset sales and partnerships to swiftly reduce debt to manageable levels.

These were decisions not well received by all — EOH sold some of its software businesses, while Tongaat elected to sell its starch business.

However, the stark reality is that interest on debt doesn't stop accumulating just because of a crisis. In fact, it usually gets worse as the rates at which you borrow tend to rise.

You only have to look at our government's predicament. Not only have foreign and local borrowing spreads moved out considerably, the number of willing government bond buyers has dropped. This is why the Reserve Bank had to create liquidity in the bond market by buying back bonds.

The problem is that the more you borrow, the more interest you pay later. It's like selling the future proceeds of a business by taking cash today and paying interest tomorrow.

You cannot engage and communicate enough with stakeholders during a time of uncertainty. I saw this first-hand. In 2017 and 2018, the banks lent EOH more than R3bn which was used for a number of things, including paying existing shareholders (some of whom were the previous management) dividends of around R600m. The grossly unfair consequence is that the current employees must work extra hard to repay the interest and debt back to the banks while not being able to reap their just rewards. It means the business is unable to properly invest in the future until the debt is normalised.

Through restructuring and asset sales, EOH has reduced its debt from R4.1bn in August 2018 to R2.5bn in July 2020. This has been a monumental task. Sasol, too, faces this journey, but it has at least already identified $4bn of potential sales. The speed of these decisions by Sasol is the first important step towards solving its crisis.

I have learnt many lessons while operating in a crisis. First, don't borrow more long-term money. Second, the three Cs — communicate, communicate, communicate. You cannot engage and communicate enough with stakeholders during a time of uncertainty. Don't let anyone assume what is going on: keep them updated and ensure you are consistently addressing their concerns.

Third, be proactive and increase the pace of decision-making. Don't wait until you see the enemy peppering your defenses — by then it is too late. After all, "the worst decision is no decision — you can always change a bad decision".

Fourth, have a clear vision that you can articulate so everyone is going in the same direction.

Last, you need to build resilience to make the organisation as efficient as possible. You can't waste resources. Interest payments in a crisis is a waste of resources as it eats time and effort while you pay down the debt.

Unfortunately, the truth is that there is always hardship before change and recovery — many at EOH can attest to this. They have forgone salary increases and bonuses and taken pay cuts, and some, sadly, were retrenched. But debt must be managed swiftly and decisively since interest compounds at an alarming rate. This is a story we have seen play out time and time again.

Edcon is a recent example — the shareholders refused to sell the Jet business when it was worth a lot of money. They could have reduced the debt while Edcon still had some equity value. But the debt, compounding at 14%, in euros, meant Edcon could not grow faster than that due to a tough environment. The rest is history.

My request to President Cyril Ramaphosa is simple: please do not mortgage the future of our children by packing on the debt. This is a real crisis and we need to keep SA's economy afloat so we can invest in the future by creating jobs for our young people.

Now is the time to critically review your asset and cost base. Sell, or find partners for assets that are underperforming but still have value, like power stations, airlines and pipelines. That way, we can increase internal capability and reduce debt, thus allowing us to invest in growth.

Please, Mr President, can you focus on reducing SA's debt burden — you will save our children's future rather than selling it for our generation's benefit. Now is the time for radical economic transformation — and that needs radical and accountable leadership.

Trade of the Month: Famous Brands

BY ANTHONY CLARK

Deciding on these two eatery brand counters as the trade of the month is like deciding which of your two children is the naughtier.

The one that has done the least wrong in the past couple of years is Spur Corp.

Its been steady, if dull. Its year-to-date performance shows the share price is down 44% — placing the counter on a modest market cap of R1.4bn. The only real nasty incident was the hangover from a social media spat at one restaurant in 2017 that hit sales badly.

Its larger sector sibling, Famous Brands, has had a torrid time, but lately has started to behave better.

The hangover from the acquisition of UK-based Gourmet Burger Kitchen (GBK) for R2.1bn in 2016, just after the Brexit vote, has caused much indigestion and a gut-wrenching slide in the share price. Year to date Famous Brands is down 46%, giving the counter a market value of R4.4bn.

Both Famous Brands and Spur have had to deal with the deteriorating consumer spending appetite within the domestic fast-food sector.

The data released by Stats SA in its monthly food and beverage report has detailed weak performance for the past three years. The lockdown and the closure of quick-service restaurant (QSR) and casual dining establishments meant sales in April, May and June fell off a cliff. April sector sales fell 93%. They recovered by 125% in May but were still 85% below March trading levels. This just highlights how Covid-19 and the government regulations on trading slammed the fast-food sector.

After regulations eased in June and July, some normality has returned. However, some chains remain closed as trading will be uneconomic for them, given the demands of social distancing and the ban on the sale of alcohol.

Both counters have had voluntary trading updates recently. Both highlighted what the market had assumed in terms of trading and expectations for earnings for the forthcoming reporting period. They were dire.

The sector also now has to adjust to a new dynamic — that of increasing home delivery and the fickle nature of consumers. That has put pressure on the vast estate of stores that both businesses have, which are now operating materially below capacity. Some offset from rising delivery services has occurred, but the large fixed asset nature of the brands hangs as a heavy cost anchor.

The pandemic has resulted in a shift in dining trends. Famous Brands stated recently that its leading QSR brands, such as Steers and Debonairs, were faring materially better than its more upmarket signature brands. Its signature sit-down eatery brands such as Tashas and Mugg & Bean have been hit harder by the social distancing requirements that have curtailed venue revenue, an inability to serve alcohol and abridged operating hours thanks to the nighttime curfew.

Much the same has occurred at Spur — where its mainly sit-down chains such as the Spur Steakhouse chain, Hussar Grill and Panarottis — have not had the flexibility that some of Famous Brands' takeaway QSR chains have had.

Spur is more a destination, eat and drink business and does not have the same level of QSR as Famous Brands. QSR is likely to fare better than traditional sit-down brands for the remainder of this year.

On top of this, both counters have had to cope and adjust to the increased cost of operating in a Covid-regulated trading environment.

Famous Brands has an added headache with its struggling GBK unit in the UK. On the flip side, both businesses have African and Middle East businesses, which have traded materially better than domestic operations.

In reviewing the respective trading updates, IM prefers Famous Brands. The stock is sharply higher than its Covid sell-off low of R23, and the market seemed pleased with the fact that trading over the lockdown was slightly better than anticipated. More importantly, the debacle of GBK — most notably the restructuring and associated write-offs — seems to be cresting.

The market was concerned that Famous Brands would need a rights issue to help its balance sheet. Management has dismissed such a call and the price perked up in June and July.

Spur Corp, in its recent update, detailed that its earnings for the year to June will be down at least 40%. On a relative May and June trading basis from its mainly SA-based operations, it was hard hit. It was also announced that longtime CEO Pierre van Tonder was relinquishing his post at the end of the year. That leadership uncertainty and whether continuity will occur in operations may also add to the lack of enthusiasm for Spur Corp.

In truth, both Famous Brands and Spur operate in a sector we do not find an appealing investment destination right now.

However, on a relative basis given what we detailed here; we believe Famous Brands' recovery from its recent lows will on a relative basis outperform Spur Corp.

We thus rate Famous Brands a relative BUY and Spur Corp a relative SELL.