RichardCluverPredicts

In our 33rd year of service to the investing public

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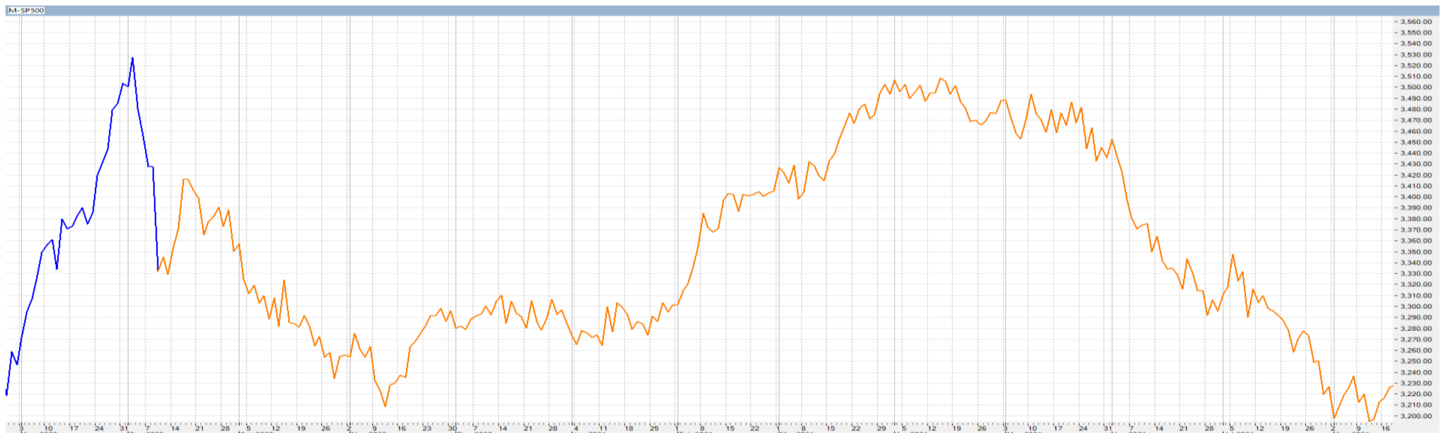
Tesla shares closed down 21.06 percent on Tuesday, making it the worst one-day Wall Street loss on record, decreasing the market valuation by $82 billion to $307.7 billion. Tesla founder Elon Musk lost $16-billion in the rout.

The share price history of Pretoria-born electric vehicle manufacturer Elon Musk's Tesla – pictured on the right - has over the past year arguably been the most dramatic example of the crazy times we are living through, but it underscores the fact that we are living in completely unchartered investment territory where every investment adviser is flying by the seat of his pants.

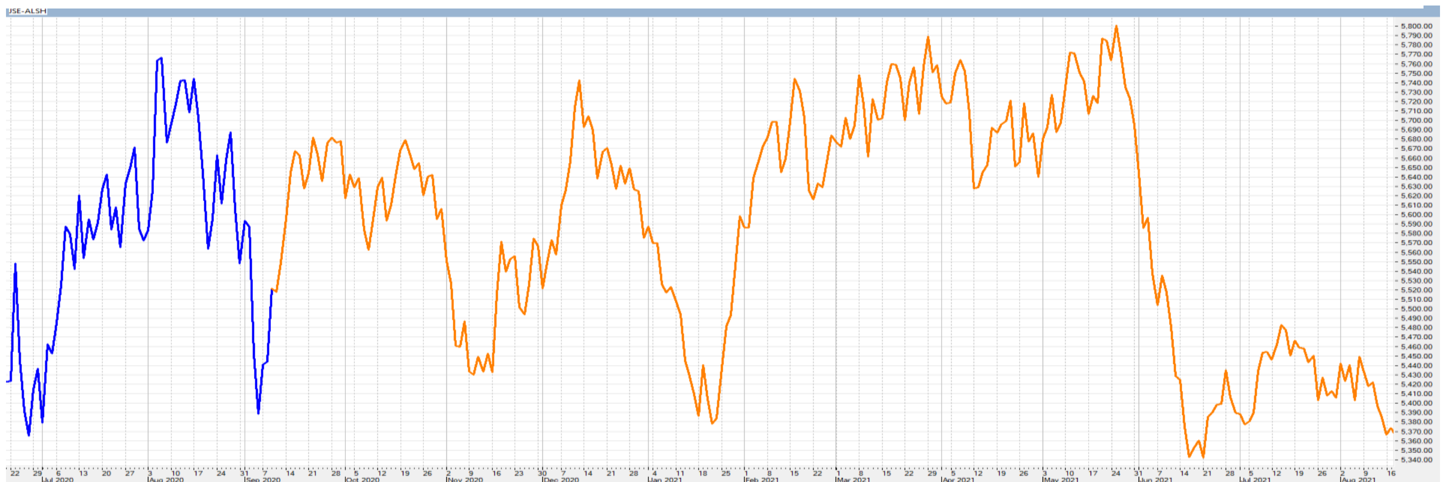
Fortunes have been lost by many who sold shares at the bottom after markets plunged in March only to see them recover once more in the weeks that followed when central banks began printing money on a scale that has never witnessed before.

To date the US Federal Reserve, to quote just one example, has printed over three trillion extra dollars – that's 15 times the normal increase of US M2 money supply – and while the American government has been pouring similarly unprecedented levels of temporary relief grants into the pockets of people who have lost their jobs, the recession is biting there nearly as badly as it has in South Africa where our already cash-strapped government simply lacks the resources to assist on anything like the American scale.

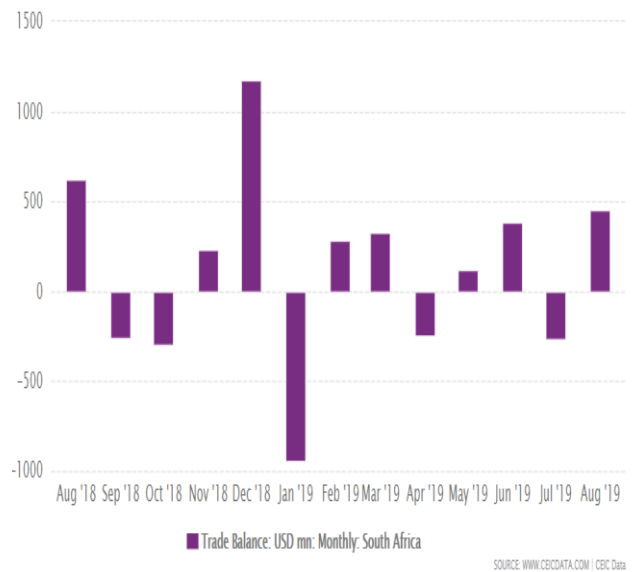
Happily, for us at ShareFinder International, our artificial-intelligence-driven market projections have proven to be astoundingly accurate throughout this time of deep uncertainty. For those of you who read my book **The Crash of 2020** you will doubtless remember that the software predicted both the February and September market declines with near-perfect precision and, as the chart below makes clear, it continues to provide guidance that Wall Street's most widely-used market indicator, the S&P500 Index, will continue its predicted decline until the second week of November before recovering once more until mid-April when it will go into a second decline through to next August:



Given the massive uncertainties surrounding our own South African economy and the arguably even more uncertain political environment that investors have to contend with, it should surprise nobody that ShareFinder senses a similar pattern of decline and recovery for the JSE All Share Index albeit with considerably heightened volatility:



It is, however, time to remind readers of the significant difference between our "Developing" economy and that of the so called First World economies such as the USA. Where the leading nations can rely upon a very broad spectrum of income drivers, countries like South Africa are reliant upon their exports of mineral and agricultural products to fund their vitally important balance of trade with the rest of the world. Thus, as the graph on the right clearly indicates, for the first time in many years, our trade balance has been positive for eight of the past 13 months.



Now you need to understand that if you are a country which exports manufactured goods, your only pricing problem is having to contend with competitive pricing. To a great extent, such countries are able to build in profitable margins into their exports which in turn benefit ALL of their people and enable them to build up significant reserves of wealth over the years.

In contrast, exporters of raw materials like South Africa are hostage to an international marketplace within which we are obliged to compete with many other producers. However, when prices swing in our favour as has recently been the case with commodities like iron ore that has nearly trebled and platinum that has nearly doubled, the money comes flooding in. The green trend line in my graph on the right indicates that, measured in Rands, the price of platinum was until recently rising at compound 307 percent a year.

Over time the benefits of these profits tend to be spread around as the mining companies spend their profits into the communities around them in the shape of better wages and welfare projects and in capital projects such as additional shafts and the like. So, of course, the entire country eventually begins to benefit.

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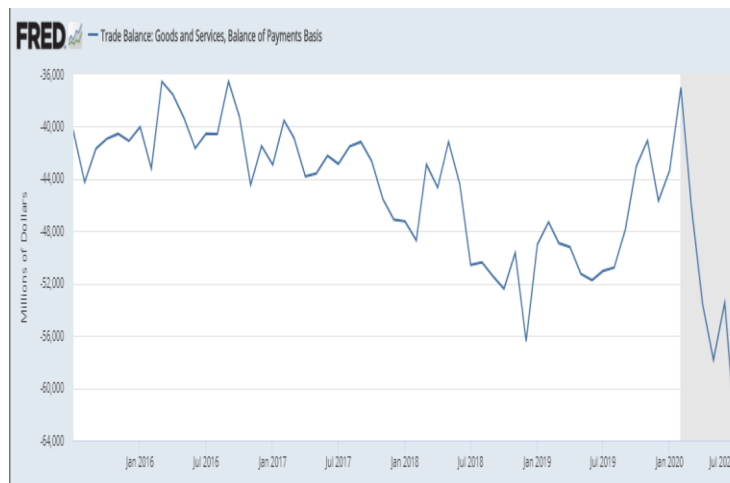
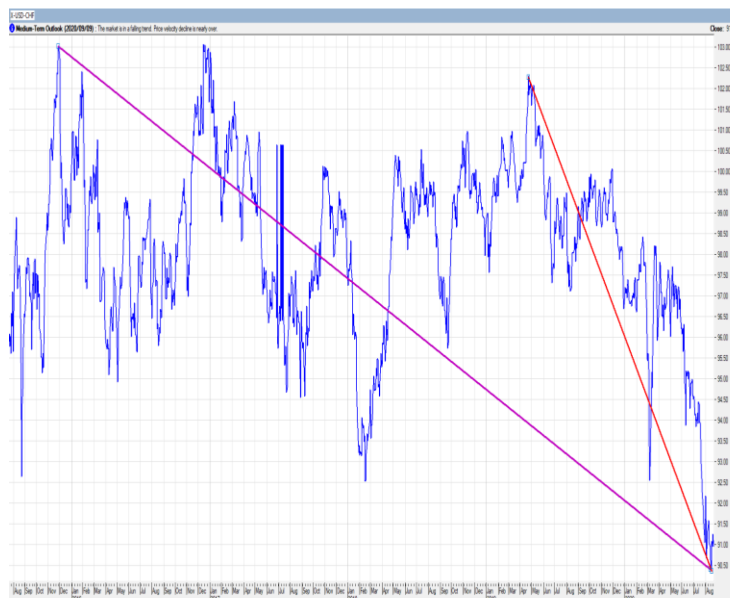
Secondary manufacturers, service providers and retailers all feel the benefit and, of course, our share market begins to rise significantly in relation to countries where their balance of payments is in the red.



So it might be timely to point out to all those investment advisers who have been urging South Africans to send as much as possible of their money offshore and, more particularly, to the USA, to note that the American balance of trade has been negative continuously since the 1970s and, as the graph on the right indicates, it has recently been growing rapidly worse. Over time US citizens have grown poorer and, as any visitor who has had to travel on their commuter trains can attest, their infrastructure has become quite dilapidated.



In fact, the only real reason why Wall Street share prices have boomed is because the US Federal Reserve has been printing money like there is no tomorrow…which is the probable truth. Why then, you might ask, has the US Dollar not reflected a similar decline? Quite simply, two thirds of all the money in circulation in the world is represented by US Dollars which are recognized as the world's reserve currency. Thus, a few billion or so extra going into circulation is like emptying your garden hose into the ocean in order to try and raise the level. Nevertheless, in recent years the Fed has been in an orgy of printing money and the effect is beginning to show. As my last graph indicates, relative to the Swiss Franc the US Dollar has been losing value over the past five years at an annual rate of 2.7 percent as indicated by the mauve trend line.

More ominously for the average American, however, my red trend line indicates that the three trillion dollars of new money created by the Fed recently HAS been raising the level of the ocean. The dollar has been falling since last April at compound 8.9 percent. At that rate the international buying power of the Dollar will HALVE every eight years.

So, something to ponder, do you really want to invest in the USA?

Do enjoy your weekend!

The months ahead:

New York's SP500: As I correctly predicted the peaking of this market. This week's shock is, however, likely to be reversed in the short-term until around the 16th but then it's down once more until mid-November.

London's Footsie: I correctly predicted a brief recovery until mid-October ahead of a run-down until late January.

Germany's Dax: My prediction that the Dax would continue recovering until the second week of October ahead of a slide down to December, remains on track.

France's Cac 40: I correctly predicted a brief two to three-week recovery which I now see ending around the 23rd. Thereafter it is down-hill to the end of October when a brief upward spike is likely before the down-trend continues to the end of November.

Hong Kong's Hangsen: I correctly predicted a continuation of the overall declining trend that began on August 25 and is likely to continue until the end of this month. Thereafter I see 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 now probably over and I see a recovery until the 22nd ahead of a volatile declining trend until mid-December and then gains until mid-March.

Australia's All Ordinaries: I correctly predicted a recovery which should be over by the 17th ahead of declines until at least the end of October before a volatile recovery trend begins.

JSE Industrial Index: I correctly predicted a fortnight of gains until September 23 ahead of 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 the month ending around September 28 followed by volatile declines until mid-November when another upsurge is likely until mid-December ahead of the next down-trend until early-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 a recovery which is likely to last until late October before a long decline well into the new year.

Gold Bullion: I correctly predicted a recovery which is likely to continue well into 2021.

The Rand/US Dollar: I correctly predicted a short period of weakness that should be over by the 14th followed by gains until the second week of November when a fresh phase of weakness is likely until mid-February.

The Rand/Euro: I correctly predicted brief gains which I expect to be over by the 18th when weakness is likely to resume until mid-December and then further gains until mid-February.

The Predicts accuracy rate on a running average basis since January 2002 has been 85.92%. For the past 12 months it has been 95.05%.

The claim that SA's economy has declined by 51% is a misrepresentation of the facts

By Imraan Valodia; reprinted from The Daily Maverick

South Africa's Gross Domestic Product has not halved as reported by several publications and commentators. Statistics South Africa (StatsSA) released the eagerly awaited Gross Domestic Product (GDP) estimate for the second quarter of 2020 on Tuesday. In its own summary report, and in numerous press reports, the following is said: "South Africa's gross domestic product (GDP) decreased by 51% in the second quarter of 2020 owing to the impact of Covid-19 lockdown restrictions since the end of March 2020.

Based on this report, a number of publications and commentators reported that South Africa's GDP has halved as a result of Covid-19 (see this, for example).

So, let's put some facts on the table before getting into the technical issues. We can safely say the following:

1. Covid-19 and the associated lockdown has had a devastating impact on the economy and the recovery process will be very tough.
2. While the impact across the globe has been uneven, South Africa is not alone, and is one of many countries where the impact has been severe.
3. The real number to focus on is the fall in the GDP between the first quarter of 2020 and the second quarter of 2020. Our lockdown was announced on 23 March and began on 26 March 2020 so, give or take a few days, the first quarter is pre-Covid-19, and the second quarter is post-Covid-19 and the lockdown period. In truth, the effect of Covid-19 began much earlier, with people changing travel plans, shortages of some personal protective equipment (PPE) and so on but, for simplicity, let's ignore the effects prior to the announcement of the lockdown.
4. South Africa's GDP in the second quarter, compared to the first quarter, did not fall by 51%. It fell by 16.4%.
5. While it is technically correct to say that, on an annualised, seasonally adjusted basis, GDP in the second quarter fell by 51%, in our current context, this is a highly misleading statistic. StatsSA should have published the report with the following health warning: "Before quoting this report, please take the time to understand the concept of an annualised quarterly GDP estimate. Oh, and please do think for a minute."

So, how do we make sense of all of this?

In a normal world, for most economic data, including GDP data, we like to have the data annualised. This is mainly because annualised data allows us to compare data that is collected over different periods of time. This is clearly the case for GDP data.

StatsSA reports our quarterly GDP data on an annualised basis, as it did with the data released on 8 September 2020. In essence, the annualised data assumes that the quarterly trend of GDP would grow or shrink as if that rate of change is sustained over a period of 12 months. Since GDP growth compounds on itself, the calculation is a little more complex than multiplying by four (because we have four quarters). The data is then adjusted for seasonal patterns – hence, the annualised seasonally adjusted GDP growth rate. Ordinarily, from one quarter to the next, GDP data does not fluctuate dramatically, so the annualised data is a useful approach, and we can compare GDP growth rates in this annualised fashion.

However, in instances where the quarterly data may fluctuate in a dramatic fashion, as has been the case with the Covid-19 and the lockdown, this calculation, to annualise the estimate, is highly misleading, because it assumes that the economic effects of a lockdown will continue as it did for the second quarter, for four consecutive quarters. As Stuart Theobald has very usefully pointed out, the 51% fall is a result of compounding the quarterly 16.4% fall (in other words, -16.4 x -16.4 x -16.4 x -16.4). We know for certain that, while the third quarter data will not be good news, it will not be a fall of 16.4%, since the lockdown has eased.

Moreover, since we will now be calculating the change between quarter three and quarter two, our comparator will not be quarter one data, but quarter two data, which is lower than quarter one data.

If you think this is all academic, think about what you would say if the quarter one and quarter two data were inverted – that is, if the economy grew in the same manner, rather than declined. The quarter on quarter growth rate would be about 20%, but the annualised growth rate would be over 100%! Correctly, if this were to occur and President Cyril Ramaphosa were to claim to be our economic messiah, we would accuse him of manipulating the facts. What is good for the goose must be good for the gander – the claim that South Africa's economy has declined by 51% is a misrepresentation of the facts.

Of course, this is not in any way to suggest that we are not in a parlous economic state. Our economy has shrunk by 16.4% between March and June 2020 – that is a massive fall in GDP. Covid-19 and the lockdown has had a devastating impact on our economy. As a nation, over the period, we have lost R512-billion! It will take many years to recover from this. But anyone who tells you that our economy has halved is misleading the public. The best estimates we have suggest that GDP for 2020, compared to 2019, will fall somewhere between 8% (the SA Reserve Bank estimate) and 10.4% (Intellidex's estimate). Certainly not 51%! **DM/MC**

*Imraan Valodia is the Dean, Faculty of Commerce, Law and Management and Director of the Southern Centre for Inequality Studies, University of the Witwatersrand.***Offshore is medium term**

Offshore not always best!

Reprinted from Daily Maverick

Informed investors who have followed a phased approach of investing surplus capital offshore have enjoyed significant additional growth to their investment portfolios and overall wealth. However, not all investors who invested offshore during this time have had the same experience. In light of the severe current pessimism in South Africa, it is prudent to remind investors of some of the key pitfalls of offshore investing.

SA equities and the rand have outperformed global markets and currencies for long periods in the past 20 years. Indeed, there have been lengthy periods where the local equity market significantly outperformed the S&P 500 in dollars on a rolling 10-year basis.

While the historic differences are volatile for sure, this is also true when investing more broadly in emerging markets. For that assumed risk, at one point, you could have been compensated with a differential in excess of 360%.

Further, there were times when a 10-year investment in the S&P 500 yielded a negative return, while having held the JSE All Share Index (ALSI) was markedly positive. In particular, the period following the technology bubble in 1999 and 2000 resulted in negative returns for the S&P 500 over the following 10-year period. There was a similar picture for the MSCI World Index (ACWI) compared with the South African equity market in US dollars.

The expected global economic recovery, China (and most of Asia) coming through Covid relatively well, very low interest rates, expected US dollar weakness and stronger commodity prices may be tailwinds for emerging markets (EM).

Within EM equities, the TOP 40 index in SA is at its cheapest level in 10 years relative to Emerging Market peers after foreign investors have sold $4.5-billion of SA stocks year to date. However, the South African market is cheap for reasons familiar to all of us. The intention of this article is not to make a strong investment case for South African assets relative to offshore assets, but rather to highlight that emotionally externalising assets can potentially be detrimental to investors.

Predicting future returns is very hard, and at Stonehage Fleming, we prefer to spend more time on factors we can control, such as basic risk diversification principles and understanding what we invest in, to minimise any permanent loss of capital.

When investing offshore, investors need to remember the most important principles — be careful of following the herd, stay away from investing capital that might be required in the short to medium term and watch out for investing for the wrong reasons.

When investing offshore, it is essential to do so with capital that is surplus to sustaining your desired standard of living (and likely business interests) in the medium term – say five to seven years (being cognisant of the investor's unique circumstances).

It can be very painful to externalise assets for the wrong reason and when everyone is panicking, only to return the assets once the markets have calmed and the rand has strengthened again. It is also important to invest offshore for the right reasons.

The primary reasons to invest offshore have received much airtime, but are worth revisiting:

1. Diversification of risk; to improve risk-adjusted returns in the long term via accessing different types of assets; and
2. A broader and improved opportunity set.

The rand is a structurally weak currency and should continue to weaken in the long term. However, this should only be an ancillary benefit from offshore investing, as the rand can (also) strengthen and remain strong for long periods.

A practical example: an investor who invested one lump sum offshore in 2001/2 when the rand was very weak, had to wait about 10 years for the rand to get to those levels again, all while South African equities performed very well during this honeymoon period of our democracy. If the investment was made with capital required during this period — and/or for the wrong reason, such as to (only) benefit from the weaker rand trend — then the investment could have resulted in a very unpleasant loss of capital and opportunity. However, if the investment was made with long-term surplus capital, invested for the right reasons and invested following a phased approach rather than investing one lump sum, the same investment turned out very well in the long term. **BM/DM**

Why modern monetary theory is such a dangerous drug

BUSINESS DAY SANDY MCGREGOR

Modern monetary theory is a new term for an old idea. Its proponents argue a state that issues fiat money does not have to resort to taxation and borrowing to pay its bills. It can fund itself simply by printing money.

While there are numerous historical examples of unfunded fiscal spending being followed by hyperinflation and economic collapse, the modern supporters of what would previously have been regarded as economic heresy say this time it is different.

Central banks in the US, Europe and Japan have been applying the precepts of modern monetary theory for the past decade, and in responding to the Covid-19 crisis have abandoned any sense of traditional financial prudence. The US Federal Reserve has been the most aggressive, increasing its balance sheet from $4-trillion to $7-trillion over the three months since the market meltdown in March.

Most of this new money has been used to fund an exploding federal fiscal deficit. The balance sheets of the Fed, European Central Bank and Bank of Japan have collectively increased by $6.3-trillion this year. Modern monetary theory has arrived almost by accident. Its longer-term unintended consequences pose a grave risk to the financial stability of the global economy.

For centuries a golden rule of public finance has been that a state should live within its means. Fiscal spending should not exceed sustainable tax revenues and prudent borrowing. The wisdom of this precept was confirmed when governments tried to sustain economic growth by Keynesian deficit spending into the recession triggered by the first oil price shock in 1973. The consequence was damaging inflation, which was only brought under control in the early 1980s when the Fed raised dollar interest rates to levels that caused a serious recession. After this bad experience financial prudence again became the guiding principle of public finance.

In recent years in many countries political leadership has become increasingly restive about the constraint on government spending imposed by what have generally been regarded as prudent targets for fiscal deficits and the appropriate stock of government debt relative to GDP. This is not restricted to the political left, which usually favours increased expenditures.

In the US the Republican party has pushed through tax cuts, and in the UK prime minister Boris Johnson has abandoned Margaret Thatcher's legacy of fiscal conservatism. Usually the justification offered is pressing need, for example to combat climate change, meet the growing cost of health care as the population ages, renovate ageing infrastructure and address poverty. The argument against has been that however desirable, they are unaffordable.

Our immediate problem is a paucity of domestic savings

The present orgy of spending financed by printing money sets an alarming precedent. It seems to give the lie to the idea that public spending must not exceed available resources. Politics is like water. It flows downhill by the easiest path. The rapidly developing habit of using central banks to finance governments will be difficult to break. Modern monetary theory is a dangerous drug to which political elites can easily become addicted.

The developed economies of the northern hemisphere can pursue imprudent fiscal policies because in the current deflationary environment they can get away with it, at least in the short term. They have large, diverse and robust economies.

In the case of Europe and Japan they have external surpluses, so are less vulnerable to capital flight. The US enjoys the inordinate privilege of the dollar being the world's reserve currency. Even though these nations are probably creating serious problems for the future, they have the freedom to be irresponsible without immediate adverse consequences. The same does not apply to emerging markets such as SA.

Our immediate problem is a paucity of domestic savings. In recent years we have been trapped in economic stagnation. There is widespread agreement that escaping from this unhappy situation will require increased investment by productive enterprises. Our fiscal deficit has grown so large it is now consuming all our national savings, and even on the most optimistic projections threatens to crowd the private sector out of domestic capital markets for years.

Foreigners who invest in emerging markets are particularly neurotic about governments that are unconventionally imprudent. They wish to avoid investing in a country that will become the next Zimbabwe, Venezuela or Argentina. Among the warning signals that would prompt instant capital flight is funding the government through the central bank by printing money. If SA started doing this an exodus of capital would make financing the fiscal deficit more difficult and expensive. Even the dollar has weakened 8% after the Fed's creation of money earlier this year. The rand would be much more vulnerable.

There is a lot of foreign money in SA, including about R500bn in government bonds, the owners of which could panic. The rand would weaken with inflationary consequences, which would force the Reserve Bank to increase interest rates. While there would be immediate short-term costs, even more damaging would be the

long-term consequences of exclusion from international capital markets. Who in their right mind would invest in a country adopting the policies that bankrupted Zimbabwe?

While funding SA's fiscal deficit is a formidable challenge, we lack the freedom to copy developed economies and print the money. To do so would make matters even worse. Modern monetary theory is not for us.

• *McGregor is a portfolio manager at Allan Gray.*

GRAY MAGUIRE: Like it or not, Mantashe will be unable to stop the shift to renewable energy

The minister's indifference and Eskom's bungling are paving the way for municipalities to turn electricity consumers into electricity prosumers.

Last month saw the outcome of a five-year struggle between the City of Cape Town and the department of mineral resources & energy to allow the city to procure electricity directly from independent power producers. Frustratingly for the city, the court failed to pronounce on the merits of the application and simply referred the matter back to the parties to resolve.

Given the clear lack of interest by mineral resources and energy minister Gwede Mantashe to allow such power procurement processes to go forward, the judgment in effect puts the city, and by extension all municipalities in the country, in limbo. What will it take for the courts to recognise that municipalities simply cannot rely on Eskom's overpriced and unreliable power in the future?

I can't help but feel that after years of deliberate obfuscation to avoid breaking Eskom's stranglehold on electricity generation, just desserts are coming to the line for the department. The march of history is afoot, and neither by hook nor by crook is there a way to avoid the inevitability of renewable energy's advantages over Eskom's dirty, expensive and unreliable fleet.

The reality is that at less than R1/kWh for small-scale solar it simply does not make sense to keep paying municipalities the R1.5/kWh to R1.80/kWh average asking price for Eskom power. Wise municipalities saw this coming some years back and the small-scale embedded generation (SSEG) guidelines were developed to provide a system that would keep electricity users from migrating off-grid entirely. Little surprise then that the market for distributed solar grew from 3MW in 2010 to 200MW in 2016, with only the Integrated Resource Plan (IRP) 2019 update cap of 500MW per annum holding it in check.

Even there Eskom's bungling has paved the way for the demise of its monopoly. Due to Mantashe's deprioritisation of a rapid rollout renewable component of the IRP there was little choice but for the approved policy to forego an annual limit on the allocation of distributed generation between 2019 and 2022, stating that the allocation would be determined by the extent of the short-term capacity and energy gap. The IRP estimates that up to 6,000MW could be added to the grid by embedded generation over this four-year period alone.

It doesn't take a crystal ball to see only two likely outcomes. Residents and businesses could opt for cheaper, cleaner and more reliable own-generation solar power and kiss municipal supply goodbye altogether. Or municipalities pull out the stops and develop their own mechanisms for financing and installing rooftop solar and turn electricity consumers into electricity prosumers.

At 25% of average national municipal revenue (second only to grants and subsidies at 28.4%), electricity sales form a critical pillar of financial sustainability for municipalities. Allowing the first outcome would be a national disaster, so the only viable outcome is the second option.

At this point, 41 SA municipalities have published SSEG regulations, more than half of them in the Western Cape. A 2018 study by green economy powerhouse GreenCape found that opportunities in the national green energy sector have the potential to generate 7,000 to 8,000 new direct jobs per annum. It states that rooftop solar PV now has a total annual available market of R5bn and total available market of R75bn by 2035.

Better yet, effective structuring of SSEG tariffs have resulted in findings such as the study into “the impact of residential rooftop solar PV on municipal finances: An analysis of Stellenbosch” reflecting a maximum reduction in total electricity revenue of only 2.4%.

How ironic that Mantashe will meet a renewable energy destiny on the road he took to avoid it.

• *Maguire holds a master's degree in global change studies from Wits and has developed green economy solutions for the private sector, NGOs and the state for more than a decade.*

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