



Our Weekly Paid Newsletter

# Richard Cluver Predicts

In our 36th year of service to the investing public of South Africa



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**Recently I have been explaining that, although they are considered to be the least risky investment one can ever make, government bonds nevertheless pose a huge potential risk to the unwary investor who fails to grasp their relationship to the international monetary cycle.**

In a nutshell, unless you are a big financial institution which has absolutely no intention of selling until the bonds you have bought reach their prescribed maturity date, you should only buy bonds when interest rates are at their peak. Failure to adhere to this principal is what bankrupted the Silicon Valley Bank last month and began a domino effect which could threaten many other banks across the world and shake the foundations of the global monetary system.

So it is important to understand that risk is always a relative matter. Which brings me to another low-risk form of investment which can just as easily go wrong if you do not understand timing; Preference Shares.

Little is ever written in the financial press about Pref Shares, short for Preference, because few other than the big institutions ever trade in them. But, bought at the right time, they can offer a very attractive option for those seeking higher than average returns on their investment capital.

Prefs differ from ordinary shares inasmuch as investors who hold them enjoy preference over the holders of ordinary shares in the event that the company which issued them were to be liquidated, in which event the pref shareholders' claims would be settled before the claims of ordinary shareholders were even considered. Furthermore, pref shareholders can expect to be given preferential treatment where profit distributions are concerned, but that fact usually comes at something of a disadvantage because, like bonds, prefs are usually issued at a key interest rate which is usually guaranteed.

Thus, while investors who buy Ordinary shares are normally most interested in participating in the profit-growth of a company and so their primary focus is on items like profit moats which imply that the company they are backing has few competitors and is accordingly not subject to the same pricing constraints as others, those who invest in Prefs usually have different requirements. At heart, then, one might argue that investors who buy Ordinary Shares are in part gamblers who are seeking to make a capital profit in addition to the normal dividend that ordinaries usually offer. And to illustrate this point of gambling, let me go to an extreme and cite one of the great current gambles on offer on the JSE.

I cite the case of Renergen; the Free State company which is drilling into the site of an ancient meteorite strike where wells are yielding methane gas mixed with high concentrations of helium which is in short-supply all over the world.

So here is an explanatory diversion; I have repeatedly stressed to investors that investment should be a lifetime exercise which should ideally begin in childhood with saved birthday and pocket-money forming the foundation of a growth fund which you will keep on building throughout your lifetime. Into it by my definition one should ALWAYS save a minimum of a tenth of one's income.

If you invest such savings wisely, I can guarantee that you will seldom face financial hardship. Indeed, it was such an approach which enabled me to retire in my mid-50s and become an independent writer....because in the fullness of time my savings diligence made a monthly pay check no longer necessary. It provided me

a freedom of lifestyle choice when I was still young enough to enjoy it; which is why I became such a missionary for the cause of disciplined saving and investment.

You should, however, never stop trying to build your investment capital, even in your twilight years, because you never know what fate has in store for you around each corner of life. That said, when you are young you can afford to invest in relatively risky high-growth situations because, what the hell, if you make a mistake – and everyone does make mistakes now and then – you have a long working life ahead of you during which you can re-build those losses; But no longer so in your 50s and 60s and certainly not in your 80s.

My early strategy was to achieve enough capital to guarantee me an income equal to one and a half times my living costs...and that was what allowed me to in turn determine my “early retirement date.” But you should never rest on your laurels. Always remember the golden rule to keep on investing a portion of income until the day you die. Thus, as your surplus of income over expenditure hopefully grows, you should have an ever-increasing sum to regularly invest; but you should never forget that as we age we become increasingly unemployable and so our ability to cope with risk also steadily diminishes as we age. So an understanding of risk is vital if you are to be a successful long-term investor! That is why I so often stress the relationship between risk and investment success. Understanding it is paramount if you hope to succeed.

That said, if you were fortunate to build a large enough capital sum quite early in your life, you might be able to continue taking a greater degree of risk later in life than others who had been less fortunate. Simply stated, if you have been shrewd enough to build a portfolio which delivers many times your living needs, you might then afford to take far greater risk and earn commensurate further riches than someone who needs to make every cent of his retirement capital work for him and thus cannot afford to take any risk whatsoever.

Nevertheless ageing always adds the need to apply a modicum of caution and this can be achieved by a combination of strategies. The tried and tested safe approach is portfolio diversification. Thus it is for example, a no-brainer that if your investment portfolio is spread just five ways and one investment in it proves to be a total loss you would probably still be able to survive because you would have lost just a fifth of your capital. But if everything you have is locked up in a single family business and you have no insurance policies, no retirement annuities and no bank savings account, you could find yourself in something of a pickle if something unforeseen pitched you into insolvency.

So investment diversification is absolutely vital. My rule is to aim for a retirement portfolio consisting of no less than 12 different Blue Chip company shares and from that day onwards one should aim to add at least one new share a year. But, of course, to be able to add investments you obviously need an income surplus....which is why I always stress that portfolio building should be a lifetime exercise.

I have written so extensively in the past about how to select the top Blue Chip growth shares that there is no point here in revising that issue, but at this stage when the world's financial foundations are shaking because central banks have spent the past 30 years playing fast and loose with monetary policy, simple diversification is not enough. Even if you have a well-diversified share portfolio, it will not necessarily be immune to a general investment market collapse....as many of us were made uncomfortably aware during the Covid pandemic when dividend incomes were decimated.

There are many alternative and different ways of adding insurance to your investment portfolio other than simple diversification. Of the latter, the outstanding option is to do what life assurance companies do to guarantee pensioners a constant income stream for life, by including sovereign bonds into the mix. However, if you like the average ageing investor, were also expecting to do for yourself the annuity approach which enables relatively small sums of money to provide relatively large payouts over an extended retirement period, you need to remember your self-managed portfolio is NOT subject to the actuarial averaging system the pension funds depend on.

Let me explain. Pension funds are able, because of their extensive membership numbers, to achieve mortality rate averages. Neither they nor you know with any certainty the likely date of your own death, but if you are an insurance company which has up-to-date social statistics to work from and are blessed with a million members, then you are able with considerable accuracy to project the likely date of death of your

AVERAGE member. Those who live longer within such scenarios are thus subsidised by those who die early. Indeed, if insurance companies know where in the country you were born, from which country your forebears came, whether you were a vegetarian, whether you smoked, what trade or profession you followed, whether married or single etc, their actuaries can build an extremely accurate mortality picture around you and competitively quote a monthly subscription rate that is likely to be a lot lower than you would imagine.

But the do-it-yourself investor logically does not have that averaging advantage and so he needs must try to exquisitely fine tune a blend of growth and income shares and, ideally mix into that some sovereign debt, some property mutuals and, as I said at the start of this column, some little-understood pref shares.

More about that later because this has been a process of introducing you to the spectrum of investment risk, which is why I began with a reference to bonds and pref shares and, at the other end of the spectrum to the example of Renergen; the Free State company which is drilling into the site of an ancient meteorite strike where wells are yielding methane gas mixed with high concentrations of helium which is in short-supply all over the world. Clearly, because nobody can accurately predict when, if ever, this company will begin delivering profits for its investors, Renergen shares are arguably trading at this stage close to the extreme end of risk.

Currently the company is in a development stage and will require massive dollops of investment capital to bring it into profitable production. So presently it must be obvious that there are no profits to distribute and the sole reason investors are buying the shares is that they hope the company will become very profitable in the future and will thus yield both healthy dividends and share price gains.

My following graph tells an important story about how such speculative stories develop, starting with its opening listing on the Johannesburg Stock Exchange on June 9 2015 when, as often with exciting new listings the first trade was at R12.50 and rapidly rose to a closing price of R17 on a total traded volume of 34 433 shares. By June 11 the shares had risen to a peak of R18.05. But for whoever paid the latter price, he was not to see that money again for nearly six years because it was not until February 17 2021 that the price again rose to that level, rising from a closing price of R17.28 the previous day to a peak of R20.49 before retreating once more to R17.78 a fortnight later, regrouping and then beginning a rapid climb to R31.38 by March 30.



The release of good borehole analysis figure in November 2021 then drove the shares to a new peak of R41.91 but within a week the price had fallen back to R28.55. By February 2022 the price was back up at

R42 before falling back again to R35.50 a few weeks later. By June 10 last year the price was back up to R42.12 and since then has been declining steadily to a recent low of R17.50 on March 20 last week.

Clearly then this is a share which traders are speculating on and those who paid R42 a year ago have lost 58 percent of their money. Yet the market well understands that once this company becomes profitable there exists a probability of very big share price profits and a cornucopia of fat dividends in store because the industrial demand for helium far outstrips world supply; But how to invest in a share which shows such price volatility.

Well the Cluver approach is never to commit more than ten percent of my investment capital to such speculative situations....in total. Thus I am likely at most times to have two or three such shares within my personal portfolio but my total cash commitment NEVER exceeds ten percent of my capital. My approach is to apply small sums of spare cash whenever I think I have found such an opportunity – in order to have skin in the game and keep my interest alive. Then I try, using technical analysis tools to anticipate the usually regularly-recurring market bottoms in order buy small additional quantities. So name of the game is establish an initial beach-head and thereafter to try to steadily reduce my overall average buying price.

In the graph which graphically portrays the whole Renergen story, the green trend line represents my current average price of R30.80 which highlights the fact that overall I am standing at a loss but my average cost price is well below what others paid at the height of speculative fever.

The graph also tells the story of how clever public relations drove this share from August 2021 when the shares stood at R16 and the developers were seeking a major capital injection. The purple trend line rising at a compound annual average growth rate of 426 percent was obviously unsustainable and they have been crashing backwards since March 2022.

ShareFinder currently expects these shares to totally collapse in price which would make my current investment look very stupid. So I have identified my next possible entry point at R13 and I would again be a buyer at R9. But why would I be prepared to throw away such money? Well I am satisfied that this is a genuine development company with a real assay value and an outstanding profit future. The problem, however, is there is no way to work out a fair entry price and so all one can do is use the science of technical analysis to aid one.

But in the end all one can do is hope to average in ahead of a one-day investment which will, I hope, significantly sweeten a portfolio in which, as I age, I am steadily pivoting towards sure but not necessarily exciting growth...because I recognize that the time will come when I am unable to manage it but it will nevertheless need to provide for my family in the long term.

# The month ahead:

**New York's SP500:** I correctly predicted the recovery trend was peaking and that the market would today be lower than last Friday. Now I expect to see further declines until April 13 and then gains until early July when I see the next retraction until September.

**Nasdaq:** I correctly predicted a recovery would last until now ahead of weakness until the end of April followed by a modestly-rising trend until early June when I see a declining trend again setting in until the end of August when the next recovery phase should kick in.

**London's Footsie:** I correctly predicted losses which I still see lasting until April 10 within a long-term recovery until the end of the year.

**France's Cac 40:** I correctly predicted the short-term decline until the end of March followed by gains from May 3 to the 25<sup>th</sup> when another three-week retraction is likely to precede gains until November.

**Hong Kong's Hangsen:** I correctly predicted a continuing decline which I still expect to last until early May before the next long recovery begins.

**Japan's Nikkei:** I correctly predicted the protracted decline which was likely to last until early May before the next long but volatile recovery trend begins and is likely to last until late August.

**Australia's All Ordinaries:** The recovery I predicted is now likely to be over ahead of declines to mid-April ahead of gains until June 8 when another five-month decline looks likely.

**JSE Top 40 Index:** I correctly predicted a very brief interim recovery to March 30 followed by losses until mid-May and then modest gains until mid-July. But the overall trend remains down to mid-October.

**ShareFinder JSE Blue Chip Index:** The current brief recovery is a chimera within a year-long trend of weakness which is likely to end in mid-May ahead of a long recovery into the New Year.

**Rand/Dollar:** I correctly predicted the start of a recovery which I expect to last until November.

**Rand/Euro:** I correctly predicted gains which I now expect to last until May 18 followed by weakness until mid-June 4 ahead of a long recovery until next February.

***The Predicts accuracy rate on a running average basis since January 2001 has been 86.94 percent. For the past 12 months it has been 94.75 percent***



# ***Scoring a big tax break from green energy***

**BY GIULIETTA TALEVI WRITING IN BUSINESS DAY**

It's possible: not just R15,000 from your home solar installation, but 125% in tax back on an investment into a new green energy fund

**Investors who mourned the demise of the section 12J tax incentive — which was stopped in June 2021 — now have another, arguably better option for an upfront tax break: a section 12B initiative in renewable energy that 12J stalwart Grovest is offering. The FM spoke to Grovest CEO Jeff Miller.**

**How exactly does the section 12B tax incentive work?**

If you invest R100,000, you will be able to deduct R125,000 from your taxable income in terms of the 12B allowance. Now, it only comes into effect if the monies you've invested in the fund are deployed into assets that start generating electricity in the same tax year. So, deployment is key.

**In other words, it has to happen in the year in which you've invested in it?**

Yes — in order to get the full 125% tax benefit, otherwise you get a proportion of the amount that has been invested. So in our 12B funds, we're doing them in tranches of R200m, and we're confident that we can deploy the full R200m in this tax year so all investors will be able to get the full allowance.

**Is the appeal here more the initial tax break you get, or actually the returns of investing in a renewable energy project?**

I think it's multiples. For one, it's a moderate-risk investment. You enter into these long-term power purchase agreements with contractual monthly cash flows. The second thing is that for the moderate risk, you're getting a very high cash-on-cash return and a high internal rate of return (IRR). And third, the tax incentive makes it that much sweeter.

**Is there a lock-in period for investors? Practically, how many years would you want to have your money in a section 12B fund?**

This is a typical private equity structure where the term is 10 years. But in order to get the tax break, you don't have to be invested for a minimum amount of years like section 12J where you had to be invested for five years. There's no minimum amount of time and our fund makes allowance for investors who want to exit early. It's an 18% IRR and you'd get a very high cash-on-cash return over that period.

**Is that return taxable as per your marginal tax rate?**

There would be two distributions a year from the profits of the sale of electricity, and those distributions would be taxed in the investor's hands at their marginal tax rate. But the tax benefit upfront would shield all taxable income — it could be your salary, it could be capital gains tax, it could be (dividend) income.

**If R100,000 is the minimum, is there a maximum investment amount?**

In 12J, for individuals and trusts the limit was R2.5m, for companies it was R5m, here there's absolutely no maximum.

**Do you already have projects and offtake agreements set up?**

We are consistently building our book and we have a pipeline of approximately R80m currently. We've got people going to sites, getting proposals. We're confident we can deploy the capital raised.

**So the risk at this stage is that you get too much capital, and not enough projects?**

That's why we are doing it in lots of R200m.

**Was it quite easy for you to segue from section 12J investments to this? How long has this taken you to set up?**

12B has been around since 2016 but it hasn't been used in this structure. Knowing that there is a problem with energy in South Africa, we then set up this fund before the February announcement but we did anticipate that there would be some benefits in terms of solar.

**What did you learn from 12J that you'd apply to section 12B investments — things you wouldn't do again or things you would?**

We've learnt how to deal with retail investors; we have R3.5bn under administration. It was a big learning curve in this alternative asset class, and understanding their needs in terms of reporting, returns, risk profiles and so on.

**I'm sure many people might wonder if their money is safe in an investment such as this?**

Grovest has been around for 10 years and we have a meaningful amount of money under administration, which gives us credibility. Also this is a moderate risk investment and it's governed by the FSCA. You get quarterly reports and at the end of the year you get a tax certificate which would tell you how much your share of profits and interest received is.

**What might trip you up? For one thing, it's taking a lot longer to get hold of solar panels thanks to the demand now.**

Logistics and procurement are a big issue at the moment; there's a three-month delay on panels. But we have standing orders, we use large batteries and inverters and we have standing orders for these types of units. The biggest price problem has been the currency.

# AFTER THE BELL

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with Tim Cohen

## Answering Dali Mpofu's pertinent questions

**On Monday, the day of the putative stay-away, South Africa's most high-profile politician-cum-lawyer, Advocate Dali Mpofu, asked the Twitterati two important questions:**

"Dear White Fellow South Africans, THINK VERY CAREFULLY about these questions: 1. Is a safe future for you & your children guaranteed when other people are hungry, desperate & landless? 2. Do you REALLY hate Malema/EFF more than load shedding??".

Very pertinent questions, as you would expect from one of SA's most successful lawyers. I **would like to answer him.**

**The answer to the first question is absolutely "no". The answer to the second question is absolutely "yes".** I didn't even have to THINK VERY CAREFULLY about these answers. They are, at least to me, very obvious.

The reason the answer to the first question is "no" is more or less self-explanatory. **No society survives long-term with extreme levels of inequality.** It's unfair, unreasonable, and unjust. And it's for this reason that though I grumble about South Africa's high levels of tax, I support the government's very intense redistribution efforts. The grumbling is not about that: it's about wastage and corruption and maladministration and cadre deployment and all the other woes about which we are all too familiar.

**As you will know, SA's support for the very poor is well-developed compared to many countries in our middle-income category.** Actually that is a massive understatement. The support net has increased from around three million beneficiaries in 1995 to about 18 million now who currently receive state welfare grants, while a further 11 million get the state's Covid-19 grant, now transformed into a general social relief grant. **That is nearly half the population of the country.**

SA spends about R200-billion a year on the social grant system, and a further R44-billion on the social relief grant, which is at the moment around R350 a month. This is a lot of money for the government, and since it is spread so widely individual payments are modest. But, you know, better that than providing for too small a group.

**And of course, the whole system is placing a huge strain on the tax system.** I'm not raising that as a reason for it to be cut back or reduced. It's just a fact. But what it does do is set limits on how much further it can go without bankrupting the country.

**There are some ten million registered taxpayers in SA, but I think only about 5.2-million actually qualify to pay Personal Income Tax, the largest of SA's tax income categories.** That number is increasing, but not at the same rate as the population as a whole. **This is a receipt for a fiscal car crash,** and you can see that in the gradual increase in SA's debt-to-GDP ratio. Since 2008, the government's debt has risen from about 26% of GDP to about 70%, **an increase that is among the steepest in the world.**

**But the point is that it's not as though the government is unaware of the need to assist poor South Africans;** it's extremely front-of-mind, as it should be. When you are providing some support for half the population, it's hard to argue the problem is being ignored. **As a proportion of GDP, SA's cash transfers are three times larger than the average for the developing world.**



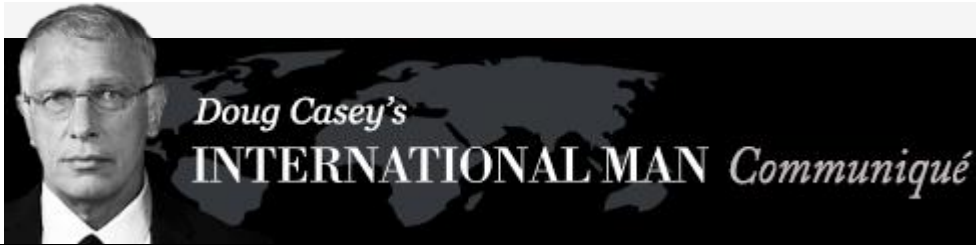
**As for the second question, the consequences of load-shedding pale in significance to the consequences of the Venezuela-esque socialist system I suspect your party, the EFF, would like to implement.** Venezuela went from being the fourth-richest country in the world on a per capita basis to be poorer than it was in 1920 after electing a series of Marxist governments. About 75% of the population now live in poverty, they have participated in the largest mass emigration ever experienced in South America, and of course experienced the hyperinflation and all the other joys that belligerent notionally-Marxist governments impose. Going to school is now a luxury.

By the way, I notice one of your follow-up tweets is brought to us by Karl Marx, "Capitalism contains the seeds of its own eventual destruction". **It's odd how revolutionaries are always predicting capitalism's collapse in the future while Marxist systems actually collapse in the present.**

**In exchange for answering your questions, I have a few for you:** Do you know what it feels like to have to meet payroll every month? Do you know what it feels like if you are running a small business and suddenly you have to lose a day's trading because a political group wants to close the country down to protest about things everybody already knows are problems? Have you experienced that sinking feeling in your stomach when you know the tiny amount you make standing behind the counter of your little store every day is going to be crimped even further because that same political party, well-represented in parliament, wants to make some completely obvious points?

**My guess is that you don't really know how that feels because it doesn't affect you.** It doesn't affect you because you earn tens of thousands of rands every day you appear in court, where you are effectively, and knowingly I suspect, subverting the legal system by presenting spurious legal matters in a transparent effort to prevent a former president from corruption facing charges first brought over a decade ago.

**That is my guess, but by all means, let us know.**



## Here's Why Another Banking Crisis is Unlikely... We'll Get Inflation Instead

By Alex Krainer

**I don't believe we'll have another major banking crisis. In June of 2007, two Bear Stearns hedge funds had large margin calls (over \$400 million), which they were unable to meet. The fallout from that event was limited, and we had plenty of assurances that this was a small hiccup, nothing to worry about, the system was sound, etc. But the system was not sound at all - it was, and still is very fragile and crisis-prone. For example, between 1992 and 2002, more than 65 major financial crises erupted around the world.**

The big one - the Global Financial Crisis of 2008 - happened eight months after the Bear Stearns crisis with the "sudden" failure of Lehman Brothers. But I do not believe that failures of the Silicon Valley Bank and Signature Bank will trigger a cascading avalanche as the Bear Stearns hedge funds triggered 14 years ago. This time, it's different. Recall, back in 2008 the Fed was not able to bail out the banking system without Congressional approval. Treasury Secretary Hank Paulson had to beg for a \$700 billion bailout of "too big to fail" banks literally on his knees. But such prostration is no longer necessary: today the Fed has full discretion to bail out banking institutions as needed. And the need is far greater than it was in 2008: The system is well and truly broken; US banks have accumulated massive losses on their bond investments, and without a bailout they might be forced to sell assets on their books. That would precipitate a crisis much worse than what we experienced in 2008. This is that "seed of doom," which is baked into the fractional reserve banking equation from the get go: the bank failures are only a matter of time.

But in a world where central banks have the facility to "print" infinite amounts of currency to backstop the losses of the corporate and banking system, failed banks can continue to operate, undead for years and perhaps decades. The current crisis will probably be used to consolidate the industry and we might see many small regional banks fail or be absorbed as the monopolists gobble up competition, but a failure of the system will not be allowed.

### **We're in socialism now, baby**

So, if the central banks opt to keep the system afloat – bad debts, losses and all – what we inevitably get is inflation and a gradual collapse of the currency. In a capitalistic free market system, this should not happen: failing banks failed and in a free market, bank runs were a periodic occurrence. But we are no longer operating in that system: a silent banking coup has taken place and it ushered socialism, though only for the too big to fail banks and large corporations. For everyone else, it's still the rugged, cut-throat capitalism.

I grew up in Socialism and much of what I observe today reminds me of my youth. In the former Yugoslavia, we had a bad crisis of stagflation throughout the 1970s and 1980s, but never a banking crisis. I was too young to question how the system worked back then, but it was clear that the central bank was providing all the liquidity needed to keep the system afloat and keep workers employed. But

the price was paid by everyone collectively through inflation which gradually accelerated until the currency became entirely worthless.

### The Fed will print...

I believe that the Federal Reserve will tread the same path. The benefit of choosing that path is that the crisis will unfold gradually. The alternative, allowing the large banks to fail and corporations to go bankrupt, would precipitate a rapid collapse with mass unemployment and disruptions that could unleash social uprisings with a fallout that could be extremely difficult to control.

So the choice for central bankers throughout the developed world is either to allow free markets to operate, or to embrace socialism. It's a choice between a sudden-onset collapse and an unmanageable crisis, or "printing" all the currency needed to paper over the gaping financial holes in the system and having a more gradual and more manageable unravelling. I think no central bank in the world will opt for the free market capitalism at this point.

### Inflation will flare up again

The consequence of that choice will be that the crisis of inflation will continue, inflicting very substantial losses on investors. According to **Stanley Fsieher's** "Modern Hyper- and High Inflation," since 1960, more than two thirds of the world's market economies experienced episodes of inflation of 25% or higher. On average, investors lost 53% of their purchasing power during such episodes. In many cases, the losses were much worse. During the 1970s inflation, US investors lost as much as 65% in real terms.

Inflation causes massive losses in real wealth			
Inflation experience	10-year inflation rate (annualized)	60/40 stock/bond portfolio real return (annualized)	Decline in real portfolio value
USA (1972 – 1982)	9%	-3.5%	-65%
UK (1910 – 1920)	11%	-9.3%	-86%
Japan (1946 – 1956)	23%	3.3%	-52%
Source: Alliance Bernstein, "Deflating inflation – redefining the inflation-resistant portfolio," April 2010.			

In some episodes, like the Weimar Republic 100 years ago, the losses came close to 100%. So what to do? For sure, investors should take bold action to protect their portfolios, and there aren't very many good alternatives.

### How to hedge against inflation?

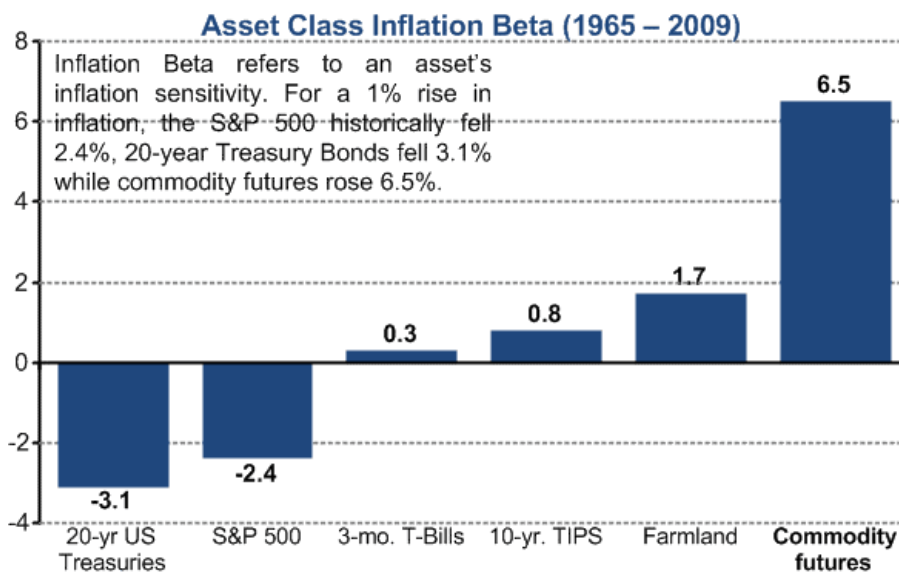
Contrary to popular opinions, stocks on the whole are not a good inflation hedge. Gold and Silver will eventually shine through and should certainly be considered. Farmland is another viable option. Prior to 2021 I would have suggested Bitcoin as well, but it is not a riskless panacea and I think it should only be regarded as one of the assets to include in a broadly diversified portfolio. However, there is one asset class that trumps all others when it comes to inflation hedging...

## The best hedge: commodity futures

As a currency's purchasing power declines, the prices of real stuff that people use in their daily lives will rise, particularly energy, metals and agricultural commodities. This common sense idea is also supported by much empirical evidence.

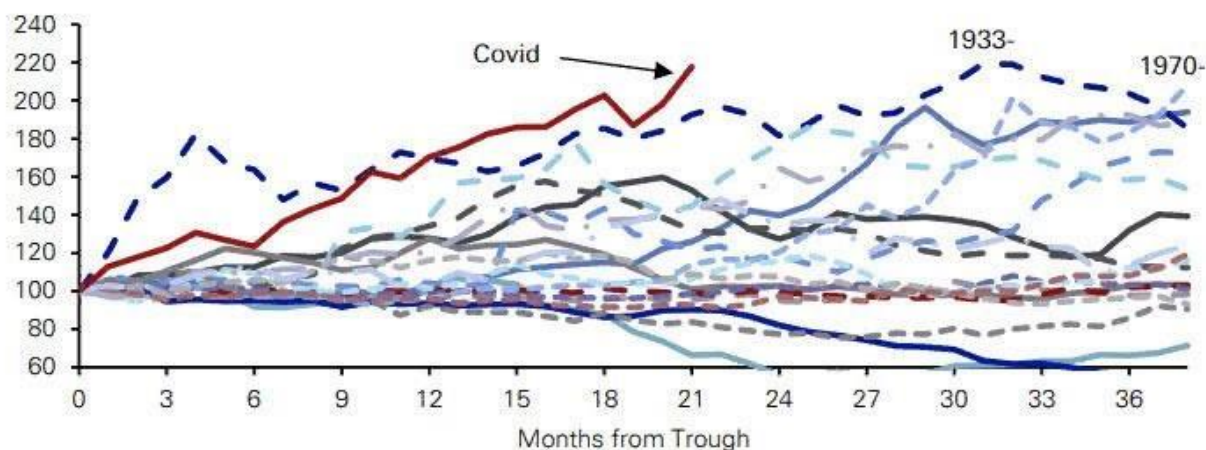
For example, in the paper titled, "Assessing Managed Futures as an Inflation Hedge Within a Multi-Asset Framework," published in the Journal of Wealth Management (April 2011), the authors concluded that, **"Managed futures outperform the other asset classes... No other asset class presents itself as a viable inflation hedge."**

Their finding corroborated an earlier Alliance Bernstein's research which found that "managed futures" (i.e. exposure to commodity futures prices) had the highest inflation beta of all asset classes:



Well, the current crisis of inflation gave us another confirmation for this: as inflationary pressures gradually built up, Goldman Sachs Commodity Index skyrocketed more than 3.5-fold, from 231 in April 2020 to 830 in June 2022. Recent research from Deutsche Bank's **Jim Reid** showed that this **commodities cycle has so far been the strongest on record, eclipsing all of the previous 20 cycles since 1914**, as the following chart shows:

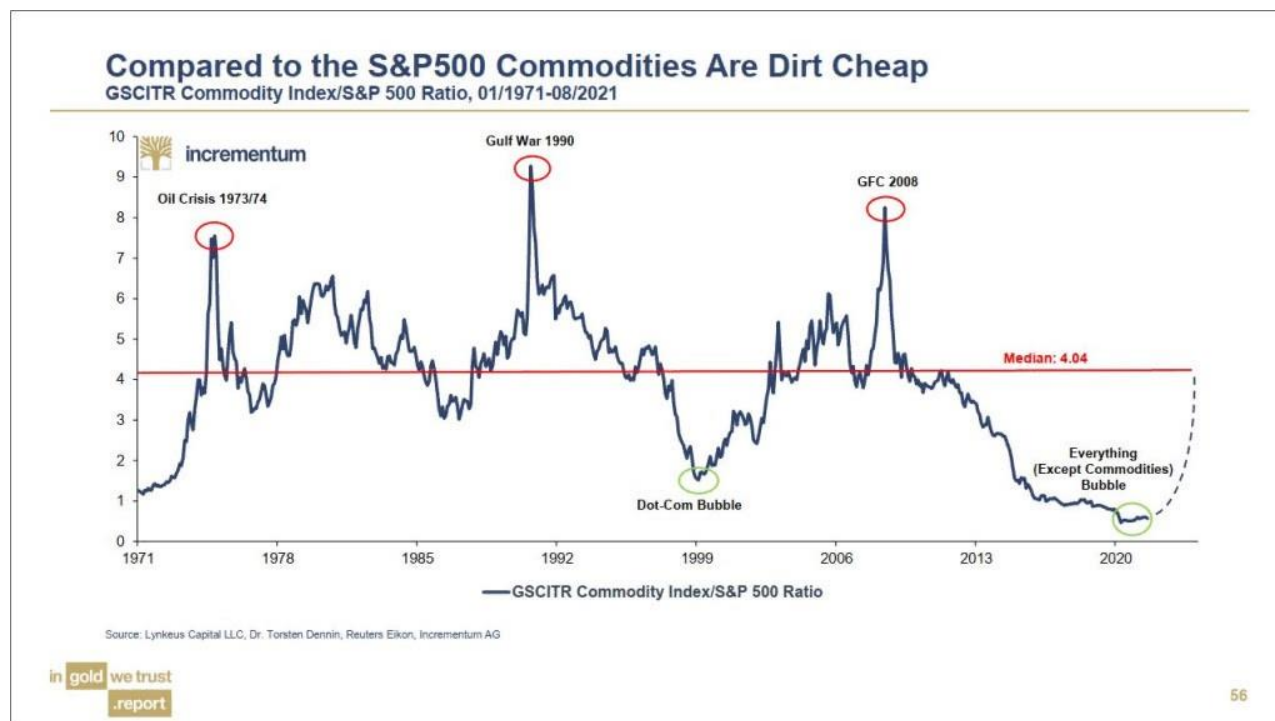
Figure 1: Commodity index recoveries through every US business cycle since 1914



Source : Thomson Reuters Core Commodity CRB Index (with GFD extension), Deutsche Bank

### Commodity futures double up as a portfolio diversifier

Commodity futures provide investors with another benefit: they are the ideal portfolio diversifier. If stocks and bonds prices collapse, they'll take most of the asset classes with them and there will be few escape routes for investors. While commodities could experience sharp corrections in the short term, their down-side is probably very shallow relative to the up-side we could see over the longer term. The chart below shows the historical relationship between commodity prices and equities, and we are still close to the historical all-time lows:



A mere reversion toward "normal" valuation levels may present an attractive investment opportunity in its own right as well as a real means of diversification just when this is most urgently needed. Adding



exposure to commodities like energy, metals and key agricultural commodities should be among the most compelling investment alternatives for the decade of 2020s.

## Markets move in trends

A word of warning is in order: it won't do to simply purchase a commodities ETF and ride the cycle passively may not be the best approach. Commodity prices can be volatile and they tend to be quite sensitive to liquidity conditions on the market. I believe that the best, and perhaps the only sustainable solution to uncertainty of market price fluctuation is trend following, and preferably *systematic* trend following.

Trend following offers investors a number of important advantages, the **first** of which is truth. Namely, trend following is based on the only source of market information that is true, unambiguous and timely: the price of securities itself. Trend followers can ignore all other information which insulates their decision making from biased reporting, flawed data, erroneous analyses and lies.

**Second**, trend following entirely absolves us of the need to be right about the future of markets. The strategy will keep you long through up trends, short during down-trends and it will "change its mind," when market events warrant it, unburdened by beliefs and convictions that could prove mistaken.

**Third**, trend following can greatly enhance investors' versatility and diversification. Because the strategy is only concerned with analyzing security price fluctuations, it can be applied in any market. You can just as easily trade stocks, bonds, currencies or commodities, even if you know little or nothing about those markets. If you think that I exaggerate, I'll confess that during my career I've traded in more than 50 different financial and commodity futures markets and I know next to nothing about most of them. In spite of that I was able to consistently outperform my strategy benchmarks for 13 years straight.

The versatility of systematic trend following could be particularly important in today's market conditions. The ability to diversify from the overinflated traditional asset classes and diversify into commodities like crude oil, copper or silver, or even agricultural commodities like wheat, corn, cotton and coffee could prove decisive.

*Editor's Note: Alex Krainer is a friend of Doug Casey. He's a commodities trader, author, and the creator of **I-System Trend Following**. Alex writes one of the best trend following newsletters on the market, delivering reliable, versatile and effective daily decision support for investors and traders. His book "**Mastering Uncertainty in Commodities Trading**," was rated the #1 book on **Financial Expert UK's** list of "The 5 Best Commodities Books for Investors and Traders" for 2021 and 2022.*

SPECIAL REPORTS

# ***ANTHONY CLARK: It's worth persevering with Renergen***

**The timeline may have been lengthened and the share diluted, but the company could well be a world-class enterprise in the making**

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30 MARCH 2023 - 08:00ANTHONY CLARK



Renergen's Virginia Gas Project in the Free State. Picture: ANTHONY CLARK

This column will, I'm sure, draw heated debate about a share that was at one time a market darling but has over the past months rapidly and unjustifiably turned into a conspiracy theorist's dream and a market pariah.

The stock in question is alternative energy and helium counter Renergen. Some readers will recall my recommendation of the company as far back as the start of 2021 at R12, and at its peak, at the end of March 2022, at R43.90. As I write this column, the stock is trading at R20.50, down 17.3% in the year to date and 47.6% over 12 months.

Many shareholders who went in at higher levels are naturally unhappy, some complaining

vociferously. Check Twitter at any time and you will see the level of angst.

I'm not here to defend either my recommendation or the company. As an independent analyst I was fully aware of the risks in recommending and covering what was a new endeavour in the domestic alternative energy landscape. Many small retail and institutional investors were perhaps not as tolerant as I am, and thought this unique energy project would hum along tickety-boo with no issues. We were all wrong. It was at times challenging — as many pioneering projects are, anywhere, globally.

Having visited the company's site five times over two years, I continue to have faith in the project and believe in its ultimate profitability. Building from scratch and proving a greenfield liquefied natural gas (LNG) and helium deposit in the Free State was never going to be an easy task, nor was it going to follow a scheduled timeline. However, Virginia Phase 1 (VP1) is now fully operational and is a deposit that independent global experts have deemed truly world class.

VP1 has cost about R1bn. It was only modestly over budget; not bad, considering that it was being built during the pandemic and the subsequent supply chain disruption — the plant was constructed in China, then disassembled and later reassembled in the Free State. This resulted in commissioning being delayed by almost a year. It was the root cause of much of the market's displeasure over Renergen.

I recently went to see the final commissioned VP1 production site, together with five institutional investors, who collectively manage nearly R250bn. Some were seeing the site for the first time and remarked on the extreme complexity of what is a pilot plant for the much larger Virginia Phase 2 (VP2).

Phase 1 will produce about 50t of LNG a day and up to 275kg of helium when fully optimised by October. Phase 2, on completion by 2027, should produce up to 800t of LNG a day and 4,500kg of helium. This is the big story; but there are hurdles ahead.

## **Having visited the company's site five times over two years, I continue to have faith in the project and believe in its ultimate profitability**

Renergen has not been without problems. Many have been self-inflicted, as promised timelines for the production of LNG and especially helium were lengthened by technical issues. In hindsight, the provision of timelines has come back to bite the company. I am sure it will be more cautious and reserved with its communication to the wider market about VP2.

Corporate credibility has also been diminished as promised events failed to live up to expectations and the generated hype. A R1bn investment by the Central Energy Fund (CEF) for a 10% stake in Renergen's operating Tetra 4 division, announced in March 2022, has yet to materialise. Management remains optimistic; the market remains unconvinced.

In some quarters the market is also seething at the ongoing equity placements; 10% of Renergen has over the past 12 months been raised from R36 to the recent R24 to fund working capital. This has led to ongoing dilution and a never-ending sea of paper, with a weakening share price having

to absorb ever lower placement prices.

The last issuance at R24 was, however, keenly priced and oversubscribed, with new institutions getting on board. This was a positive signal. Management argues that if it had raised all the requisite funding at the start of the VP1 project it would have placed shares at 800c. Staggering the issuances to when funds were needed has led to an average of R25 gained, and curtailed very hefty dilution. Cold comfort to those who bought in at higher levels, but a reality.

A very recent sell-off of the stock related to the release in early March of the teaser circular for the Nasdaq listing. The IPO and listing are now scheduled for the third quarter of 2023, depending on market conditions. This is not a rights issue, rather a direct placement of up to 67.5-million shares to raise \$150m. On the site visit, one institution extrapolated this price to the rand equivalent of R41.30, or double the then ruling share price.

There was, naturally, incredulity at the stated IPO price range of about \$2.22 a share. What was this financial wizardry? However, a review of similar alternative US energy projects that listed, or have undertaken capital raises, provides grounds for giving a higher valuation to Renergen's assets than what it is now.

Former JSE- and now Nasdaq-listed Montauk, as well as US-domiciled Clean Energy Fuels Corp and North American Helium, already have juicy valuations of earnings before interest, tax, depreciation and amortisation (ebitda). Renergen, on listing, should it attain its IPO valuation, will be at a significantly lower ebitda rating than its peers.

Local investors may become rather excited as the US book build starts to gather momentum midyear. It's not every day that US investors get to buy into a new in-demand commodity at a fat discount to comparable peer counters. Locals may see the IPO pricing as rich; the US market may see it differently. So does that suggest the JSE and Australian Securities Exchange valuations are unreasonably low? Only time will tell.

My crystal ball cannot foretell the future; I just extrapolate the information as I see it. However, I do maintain my course on Renergen and my belief in the stock and its prospects as stated in my original January 2021 stock recommendation.

## **The market has been suffering much Renergen post-traumatic stress. The next few months will be crucial for the company**

VP2 will be a giant project; it's 12 times larger than VP1. The recent update of the capital cost of VP2 puts it at \$1.16bn, or R20bn. It caused the market to wince, but this increase is a function of the weakening rand rather than engineering issues.

The lengthening by a year of the VP2 timeline to production into 2027 has further strained market belief in the stock, and the credibility of the counter in some quarters has been badly tarnished. What raised a market eyebrow was the ebitda range for Renergen in its first full year of LNG and helium production to end-March 2028. That range, in a public document that will be the basis for a legal filing for the Nasdaq, was R5.7bn-R6.2bn. These assumptions were based on conservative prices for LNG and helium of R250 per gigajoule for LNG and \$600 per thousand cubic feet for helium. Both projections are well below current prices. Yes, this ebitda is counterweighted with

\$750m of debt provisioning, but at highly favourable rates and servicing cost of about R1bn a year. That, again, led to a sharp intake of breath when the circular was released. More information will be forthcoming in the Securities & Exchange Commission filing.

However, given a light annual operating cost of R1bn, debt costs will be handsomely covered, leaving about R4bn of ebitda for shareholders.

Renergen's current market valuation is R3bn. The fact that this ebitda number is now in the public domain and authorised by Renergen and its US advisers leads to the semblance of a line in the sand being drawn. It's a confident company that publishes such a number for a US listing unless it believes they are indeed achievable.

The market has been suffering much Renergen post-traumatic stress. The next few months will be crucial for the company. With a great deal of mud being thrown at the counter over the past months, and the resultant share price slide, management now needs to get key corporate deliverable boxes ticked. These will be vital for the rebuilding of confidence and, more importantly, for corporate credibility.

The boxes to be checked, in my order of significance, are: (1) The US International Development Finance Corp, granting \$500m in debt funding; (2) A global bank following suit with a guaranteed \$250m debt facility; (3) The gaining of an underwriter of record for the Nasdaq listing; (4) A successful book build, hopefully at or near the stated US dollar price range, and oversubscribed; (5) A positive US market listing; (6) The CEF getting on board; and (7) The announcement of the tenders and engineering, procurement and construction contracts for the VP2 project. That's a heck of a lot to achieve, but to my mind it needs to be undertaken to rebuild investor confidence.

Much depends on US market conditions. A regional bank crisis in the US hardly helps, but the regulators have quickly stepped in to restore market confidence. Energy, however, remains in global — and especially South African — demand. With South Africa in an energy crisis there is no doubt that a reliable source of ESG-credible energy like LNG will be a sought-after commodity.

On the institutional site visit comments were made that major corporates were clamouring for energy solutions for power as well as transportation. The opportunity for VP2 LNG is significant. Similarly, the surge in demand for helium globally from vast capex within the US semiconductor manufacturing, space delivery and technology sector should result in offtake of Renergen's superior helium deposit.

Much has already been contractually secured by global household names within the sector. The market forgets that a large percentage of LNG and helium has been pre-contracted, derisking the project. Because the price of helium is dollar based, the rand's recent slide will add to Renergen's rand hedge qualities, as more than 50% of ebitda is allied to the gas.

I wrote, back in the day, that Renergen was not a widows-and-orphans stock. It was a stock moving from exploitation to commerciality. That came at a risk and a cost. There have been hiccups along the way, but a successful and operating project is working in the Free State. The concept has been proved. Now VP2 needs to get under way to counter the doubting Thomases.



The coming months may be volatile for Renegen shareholders. There are many fast-moving parts, but achieving just a few of my stated points will immeasurably improve investor confidence as well as the share price.

I don't have all the answers; I am not a cheerleader for Renegen, despite what some on Twitter may think. But I believe, as many do, in the valuable compounds located in the Free State, and that if these are properly exploited, extracted and sold, it just could make Renegen shareholders in the long run a great deal of money.

The English novelist PG Wodehouse wrote in 1924: "If you don't speculate, you can't accumulate." Despite the slings and arrows Renegen has faced over the past months, this rings true. I am holding the line on the stock.