Our Weekly Paid Newsletter

# Richard Cluver Predicts

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

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**Forgive me if I lapse this week into the fields of mumbo-jumbo and superstition, but one of the things experience has taught me is not to take for granted are those momentary sparks of intuition which, like the countryman who claimed always to know when to gather in his sheep because bad weather was coming, sometimes something goes ping in my mind. And this week I had a ping moment!**

*How did that old farmer know, when the skies were clear and Met had said nothing? Well he had an arthritic toe which gave him pain whenever the weather was likely to turn….and experience had taught him to trust his toe rather than the white-coated scientists.*

I don’t have an arthritic toe but I have been investing in the share market since I was a teenager and over all that time some reliable instincts tend to develop. So, though in that time I have also developed some very powerful computerized tools to guide my thinking, I have also learned to trust those light-bulb moments when something in my brain goes ping.

Thus instinctively, though US Federal Reserve officialdom was this week seriously trying to dissuade the markets from thinking that the end of monetary austerity was nigh, that thing that goes ping tells me the moment might have in fact arrived. Simultaneously the summation of the 36 years of mathematical research we have poured into the development of the ShareFinder computer system was also suggesting – note the purple (short-term) line in the projection graph below of USA 30-year T Bonds – that interest rates are likely to react again upwards between now and Christmas, the ping thing in my head says that it is going to be down-hill from there.

So. while I am not discounting the probability of a few more brief upward spikes, but the end of high global interest rates is, I believe, now in sight. That also means a coming stock-exchange lift off, so please pay attention to the more reliable red, medium-term, projection which senses that US long bond yields will begin falling in earnest from late January and so, while paying attention to the black support line I have drawn into the graph, ShareFinder’s AI system is suggesting that while recovery is likely, it could be a very long time before the world ever goes back to the kind of low-interest rate regime that we have become used to over the past 30 years.

Indeed, I believe we will never again in my lifetime see T bond yields plunge as low as their March 9 2020 yield of 0.96 percent which happened at a time when the official US inflation rate was 1.5 percent. That, readers will remember, was the time when the world first woke up to the chilling fact that hospitals in Italy were being overwhelmed by people who were chocking to death in the grip of Covid 19. It was also the culmination of 30 years of US Federal Reserve monetary manipulation which had reduced the Dollar to an ultra-cheap commodity.

Note that at that sorry time in our history, the sum of those foregoing two numbers implied that by March 2020 the US Government was effectively paying borrowers a subsidy of 0.54 percent to take money off their hands. Global markets were absolutely saturated with dollars and borrowers were having to be bribed to borrow more!

The current projection, given that the official US inflation rate is today 3.8 percent and that 30-year T bonds could be bought at the lowest yield this week of 4.7 percent, is that the real T Bond yield in international markets is now 0.9 percent. Effectively the real cost of money has thus risen 267 percent since its low and that rise it has plunged the whole world into effective recession. Thus, if you wonder why wars are breaking out, consider that ordinary folk everywhere have very short fuses.

Now, if you care to consider my next graph which plots the performance of the Wall Street- representative Standard and Poors 500 share index over the past 15 years, the green median line I have created suggests that the average annual capital gain of a US share portfolio was thus 13.2 percent.

Subtract the current 3.8 percent inflation rate and you can thus conclude that in real terms an average US portfolio has been enriching investors at an annual 9.4 percent. Add in an average dividend of 3.3 percent and one gets a REAL average Total Return of 12.7 percent. That means that shares are VERY cheap!

That's an exceptionally good investment return to lock into at this point in history. It guarantees wealth to everyone smart enough to take advantage and, given that I have just shown you that the REAL cost of borrowed money in the US right now is 0.9 percent, you don't have to be a genius to recognize that at this stage in history a share market investment could make you very rich in a remarkably short time! And that is before my ping moment which suggests that a share market boom might soon begin as US bond yields start to track backwards! So quick gains could be due in the New Year.

Even without a share market recovery, a 12.7 percent yield means that your investment capital will DOUBLE in 5.7 years. In absolute terms, i.e. if you ignore inflation, then your dollar worth will double in little more than four years.

So what does the same calculation suggest here in South Africa where the average dividend yield is now a remarkable 6.8 percent, official inflation is 5.4 percent and the yield on an RSA long bond is 10.4 percent? Given, as we ruefully know, that ANC fiscal mismanagement means we have to pay top dollar when we try to borrow in international markets, the effect of buying a bond locally is a REAL return of 5 percent which is simultaneously the REAL cost of money in South Africa. So, let's consider the long-term performance of the JSE All Share index in the next graph.

Here we can generate a long term growth rate mean (green line) rising annually at 7.8 percent to which you need to add the JSE average dividend yield of 6.8 percent to determine that your annual Total Return from such an investment would be an extraordinary 14.6 percent. Compared with a Wall Street average investment, the JSE average thus offers a real return after inflation 15 percent better. That is the benefit you could get by keeping your money onshore. It's a much higher return because the cause of the differential with the Wall Street average is that foreign investors currently perceive that all South African investments might soon go up in smoke because of the ANC's poor fiscal management.

But you can do even better if you choose a Blue Chip South African portfolio; one which comes with the bonus of being less risky than average. My next graph depicts the annual performance of the Prospects Portfolio which I maintain on behalf of readers of my Prospects monthly newsletter. Since its inception in January 2011 it has to-date delivered a compound average growth rate of 15 percent as highlighted by the green mean line in my next graph.

| Year | Dividend | Value |
|---|---|---|
| 0 | 221,436.58 | 5,295,815.50 |
| 1 | 286,193.13 | 5,816,978.57 |
| 2 | 369,886.97 | 6,402,443.01 |
| 3 | 478,056.11 | 7,060,142.36 |
| 4 | 617,858.05 | 7,798,988.99 |
| 5 | 798,543.45 | 8,628,994.90 |
| 6 | 1,032,068.18 | 9,561,407.38 |
| 7 | 1,333,884.50 | 10,608,861.38 |
| 8 | 1,723,963.49 | 11,785,550.81 |
| 9 | 2,228,116.53 | 13,107,420.78 |

The portfolio also delivers an average dividend of 4.6 percent currently which means that investors who follow my monthly-recommended changes are getting a Total Return of 19.6 percent currently which, after deducting the 5.4 percent official inflation rate, means a REAL figure of 14.2 percent.

At 19.6 percent your Rand value will likely double in 3.67 years and its real buying power likely double in five!

How extensive is the risk South Africa is facing? Given that our expected coming debt to GDP ratio of 77 percent is well below that of nations like the US whose equivalent ratio is 121.6 percent and Japan's 263 percent, things do not at first glance look that bad. The problem is that we are not budgeting to narrow that debt and so markets view SA with suspicion and refuse to invest here.

To change that perspective we need to change one major item. Set at R646.4-billion in 2023/24, the cost of paying public servants is the single largest component of government expenditure and it is gobbling up 30 percent of our total government expenditure of R2.26-trillion in the current fiscal year.

It is crowding out spending on capital projects - which, it is widely understood - is the best means of stimulating economic growth and creating jobs. Since civil servants represent just two percent of the population, around a third of our taxes are being used to benefit just two out of every 100 South Africans.

Furthermore, most ordinary civil servants are not getting that benefit as is made clear by the fact that since 2013 the number of public servants with annual earnings of more than R1-million has increased from just more than 10,000 to over 55,000 in 2023/24. Those, one can probably safely assume, are the 'Cadre Deployment' contingent; people who are distinguished more by ANC loyalty than by professional ability who are occupying the top posts and are the principal reasons why practically ALL Government-owned institutions are in deep financial trouble.

Of the rest, and by the rest I mean State employees doing the real work such as teachers, nurses and policemen who earn between R350 000 and R600 000, these who have not seen the same mouth-watering increases which is why strike season is upon us now. Nevertheless they are FAR better paid than those in the private sector!

So, at the heart of our economic problems is the fact that Government is simply not spending money where it really makes a difference in the lives of all of us, but rather on a connected few fat cats who very likely waste it on items with fancy labels. That's why most of us now understand the urgency of replacing the ANC with a growth-orientated coalition in the New Year. If that happens, the bonus for local investors would be that the probability of a global investment market recovery could be massively amplified here in South Africa.

Clearly, if we want to end our current acute financial anxiety – and hopefully improve the employment outlook of ALL South Africans, we need to make every vote count in next year's election!

# The month ahead:

**New York's SP500:** I correctly predicted a recovery to late February. And in the short-term I continue to expect a short-term dip from November 13 and another in early January.

**Nasdaq:** Ditto the Nasdaq where I correctly foresaw the start of an up-surge which I still expect to last until the 10th/16th of November followed by a retreat until December and then surge again to the end of January.

**London's Footsie:** I correctly predicted a decline until the end of November with a brief recovery from November 27 until Christmas ahead of a cruel January after which a volatile market will likely bump along the bottom all year.

**France's Cac 40:** I have so far been correct in predicting an overall decline until early April.

**Hong Kong's Hangsen**: I correctly foresaw the start of what I expect to be a recovery which I initially expected to last until December 8th ahead of a long decline to the end of March. I am now fine-tuning that peak to November 28.

**Japan's Nikkei:** I continue to see a long-term weakening trend which began last June and which I still expect to last until next June. Within that I am expecting a brief recovery from November 27 to the end of December.

**Australia's All Ordinaries:** I have correctly identified Sydney as the one positive market in a bleak international scene with gains beginning early in November and lasting to mid-June.

**JSE Top 40 Index:** I correctly predicted the start of gains which I still see lasting until mid-February followed by fresh weakness until June.

**ShareFinder JSE Blue Chip Index:** I correctly identified the start of modest gains likely lasting until mid-November. That has now passed and I see the declines I predicted lasting until mid-January when fresh gains should follow until mid-March within an overall rising trend for most of the New Year.

**Rand/Dollar:** I correctly predicted the start of long-term gains which I saw lasting long into the New Year. Within that I see brief weakness until year-end.

**Rand/Euro:** Ditto the Euro. I correctly predicted the start of a long recovery which I still see lasting until early March.

***The Predicts accuracy rate on a running average basis since January 2001 has been 87.04 percent. For the past 12 months it has been 91.12 percent.***

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# SA's public service may not be "bloated". But the wage bill is

**By Tim Cohen**

Way back in 1986, US President Ronald Reagan - not my favourite president TBH - memorably said, "**The nine most terrifying words in the English language are: "I'm from the government, and I'm here to help**." I actually don't agree with this statement, but I do know where he is coming from. Reagan said this in an era of an ever-expanding government, which was putting pressure on public finances while noticeably not substantially improving the lives of Americans.

**What country does that remind you of?**

In the wake of the mini-budget last week, we are at last getting some more detailed stats about the SA public-sector wage bill. There is one important distinction right from the start: **the public service is not necessarily bloated, although there is an argument to be made supporting this point. What is** indisputably distended in my mind is its wage bill.

**Here are the highlights of the statistics:**

- The number of public servants earning above R1 million per year has grown from just over 10 000 in 2013/14 to more than 55 000 in 2023/24.
- SA spends more on its public servants, as a proportion of total government expenditure, than Australia, Canada, the US, Denmark, Sweden, and Norway.
- Almost half the public servants in SA will earn between the annual ranges of R350,001 and R600,000 in 2023/24.

**But interestingly, although SA pays more than most OECD countries, it still has fewer public servants in relation to that budget than, say, Denmark.** With those stats, it's easy to work out what has been going on here: senior people in government departments have been promoting each other willy-nilly.

The result is that SA is getting the worst of both worlds: an out-of-control wage bill and a government without the ground forces necessary to deliver services more effectively. **The brass has been absorbing the biggest slice of the increases.**

The slice we are talking about here is not insignificant: total remuneration costs are set to rise from R646.4-billion in 2023/24 to R720.3-billion in 2026/27.

**How does all this happen?** You know partly it's because government is government. The incentive systems are misplaced because performance measurement is loopy, where it exists, and more often, it just

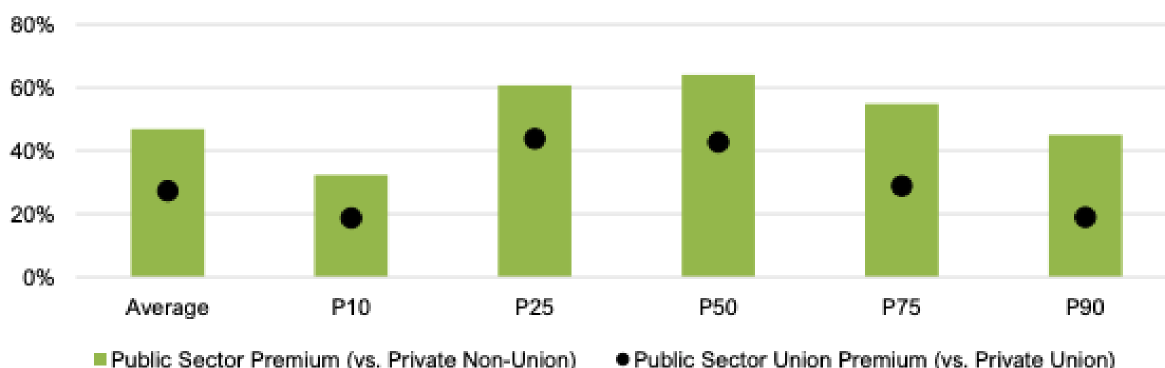
doesn’t exist. Did you know, by the way, that government departments are required by law to develop and institute performance management systems?

**The other really crazy thing about the public service is that in most countries, people go into the public service out of a desire to serve the public.** There is a morally laudable aspect to the job. This is why there is usually a premium paid to people who choose to work in the private sector. In the private sector, you may very well be helping humanity, you probably are in some way, but your immediate responsibility is to the business and its shareholders.

**But this doesn’t apply in SA**. At the beginning of last year, a host of well-known developmental economists, led by Ricardo Hausmann, published a paper on the South African economy over the past decade through the United Nations University World Institute for Development Economics Research.

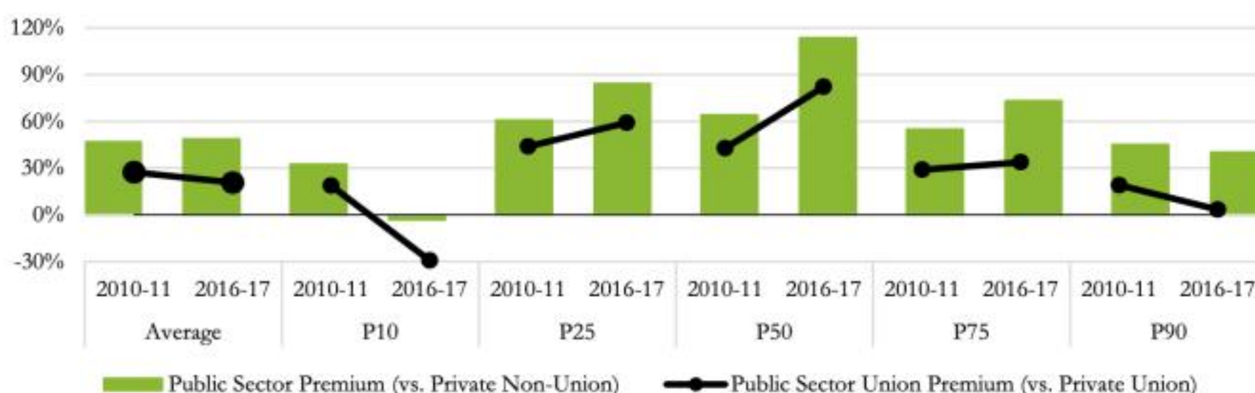
What it found was that government salaries in all but the lowest and highest categories have gradually been outpacing private sector salaries. This is happening to the extent that now **state employees in the 50th percentile get paid 110% more than their private-sector counterparts.** I am not making this up.

Figure 11: Public sector wage premium: premium relative to non-union formal private workers, controlling by worker characteristics (2010–11)




On average, the premium paid to public sector employees, the research found, is about 25% compared to their counterparts in the public sector, controlled for job type. And there is something even more weird; the premium paid to public servants compared to non-union private sector employees is even higher; around 40%. (I presume that is because if you are comparing public servants to non-union private sector employees, you are comparing people largely in professional jobs. But it's still pretty incredible.)

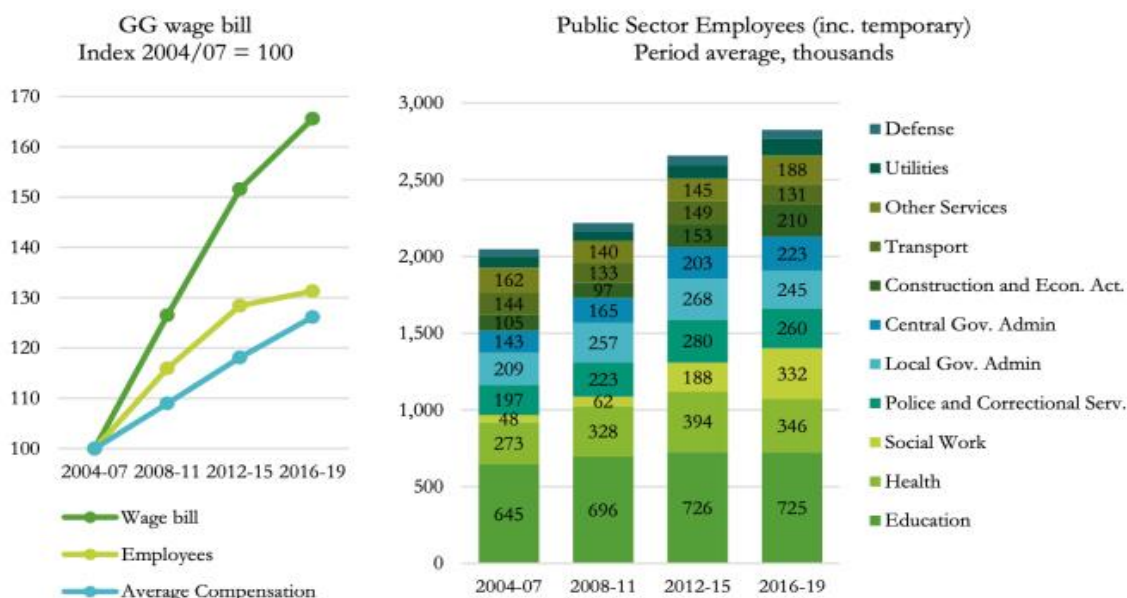
Figure 11: Public sector wage premium: premium relative to non-union formal private workers, controlling by worker characteristics



So, is the public service “bloated”? **Some of my colleagues believe that it's unquestionably not bloated**; some of the areas of greatest need are teachers and nurses, and there are real shortages of both. The numbers above do provide some support for this notion.

But, it is also true that the total number of public servants has been increasing really fast. **The cost of the public service has exploded, but its total head-count number has also increased sharply, by 30% between 2007 and 2019.** And in this number, there are some very strange things: the absolute number of nurses plummeted, but the number of social workers grew substantially. There are now almost as many social workers employed by government as nurses.

Figure 10: Public sector wage bill




Source: authors' elaboration based on SARB, Post-Apartheid Labour Market Survey (Statistics South Africa) data.

**The picture you get from all these numbers is simple: the whole process is completely lacking in any rational planning or preconception.** It's just a mess and is compounded by government buckling at the slightest threat from public sector trade unions in all years other than the two Covid years, arguably the time they should have lent a hand.

The economists and other notables who recently signed the letter demanding SA take on more debt claimed they were doing so to prevent widespread hunger. But it turns out that **by far the majority of SA’s new debt will be going not to poor people struggling to put food on the table, but some of the most pampered employees in the country, the favoured 2%: public servants.**

Happy investing

Tim Cohen