The Investor

In our 26th year of free service to the South African investing public!

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How to pick market-beating shares

by Richard Cluver

Statistics tell us that in addition to their primary residence, over 200 000 South Africans have at least R1-million invested and of those 50 699 "Super Rich" individuals have over R7.29-million. Furthermore, the average Super Rich South African is comparatively young: barely into their middle age judging from the statistics. So it should be plain that is it possible for quite ordinary people to achieve such sums?

Hopefully I have in previous issues of The Investor so far this year satisfactorily proved that the most commonly-trod path to great wealth over the past century has been the stock exchange. As proof of this argument I have displayed a graph of the ShareFinder Blue Chip Index with a trend line linking its lowest point 27 years ago with its current peak value.

At its lowest point in April 1986 it fell to an index value of 2138. Recently it reached a new peak value of 417 576 on August 28 2012. If you care to calculate it you might thus determine that were you to have bought a basket of shares in April 1986 representing the index at that point and held them unchanged until today, a R100 investment then would now be worth R19 531. That is a compound annual average growth rate of 22.1 percent.

And, of course, had you regularly saved a tenth of your income, accumulating it in a savings account and used the techniques outlined in my books "Footsteps to Fortune", "The Philosophy of Wealth" and "The Simple Secrets of Stock Ex-

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change Success" to choose the most appropriate moments to buy winning shares, you would have vastly increased that growth rate. To illustrate this point, had you applied the simple test of selecting only those companies whose shares have achieved the consistently highest dividend growth over the past decade and, furthermore, whose shares are traded in reasonably high volume, then topping that list would be Capitec Bank which over the past decade has risen in price from 80 cents a share to a recent peak of R228.80. That is a remarkable compound annual average growth rate of 72.1 percent which would have taken a R100 investment then to a current R28 600.

Now it would have been wonderful if you had been able to spot Capitec back then and have risen with it up to the top of a comfortable fortune right now. But the probability is that you would not have spotted it for the simple reason that there was no practical statistical profit record that could have guided you towards highlighting its performance. So let us be a little more realistic and select a company whose shares have been regularly traded in high volume – at least a million shares a day on average – and which has achieved consistently high dividend growth rates over an extended period.

The ShareFinder Quality List displays company performance statistics in green when they are above average which makes it easy to see in the table extract on the right that over the past decade Shoprite Holdings achieved a superior dividend growth rate of 27.47 percent which, in the most recent five-year period accelerated to 31.23 percent annually. Furthermore, as a consequence of this high dividend growth rate the share price grew over the past decade at a compound annual average rate of 37.79 percent. Had you ten years ago put up a graph of the price performance of the share you would have seen that at that stage it was growing at compound 26.9 percent over the previous decade as illustrated by the green trend line in the graph overleaf.

Name	10YrDiv	5YrDiv	10YrGro	IssTrad	DY
Grand Old Favourites					
Group Avg.	22.94	26.35	27.65	18.21	2.6
CAPITEC BANK HL...	35.63	47.39	60.59	8.56	2.0
SHOPRITE HLDGS ...	27.47	31.23	37.79	28.43	1.6
WILSON BAYLY HL...	34.64	35.32	32.85	12.42	2.2
CLICKS GROUP LI...	20.59	27.71	23.95	31.99	0.8
GROWTHPOINT P...	8.59	9.41	18.51	18.29	5.3
BHP BILLITON PLC	23.63	25.48	18.13	13.35	3.1
SABMILLER PLC	13.82	14.51	17.21	7.74	1.9
SASOL LTD	19.15	19.76	12.14	24.85	4.0

Now, let us assume that ten years ago you were earning R200 000 a year and through diligent saving over the past few years had managed to save a lump sum of R50 000. Now you commit yourself to saving a minimum of a tenth of your gross income i.e. R20 000 a year. Furthermore, let us assume that you were a hard worker who was rewarded with annual pay increases of 10 percent which allowed you to set aside ever-increasing sums towards investment in the shares of Shoprit as they reached their lowest point each year.

So, if you follow my table below right, you will note that ten years on you would have accumulated a total of 21 505.62 shares worth, at their peak price on August 30 2012, R172.29 each. That is a total of R3 705 203.

If you care to calculate this process you will see that your investment growth rate from the point you entered the share market with an initial R50 000, would work out at compound 48% from a share that was growing at compound 27.47 percent over the same period. Were you to simultaneously re-invest the dividends received from these investments at an average yield of 2.7 percent yearly you would have grown your capital to a total of R4.65-million in ten years.

Were you, furthermore, to have continued this process for just one more year you would achieve a capital sum which, invested at the Shoprit average dividend yield of 2.7 percent would provide you with an annual dividend income equal to your annual salary which by then, assuming that the annual increments were a constant 10 percent, would equal R519 000. In addition, assuming Shoprit remained the well-managed corporate that it has been for its long past history, you might comfortably assume that its continuing dividend growth rate would offer you year by year a steadily-improving standard of living; one moreover that you would never have afforded if you had simply relied upon a salary growing at 10 percent a year.

Year	Salary growing at 10% a year	Available for investment	Shoprit share price	Buy date	Shares bought
1		50 000.00	6.36	Oct 9 02	7 861.64
2	200 000.00	20 000.00	5.55	May 28 03	3 603.60
3	220 000.00	22 000.00	9.00	Jun 21 04	2 444.44
4	242 000.00	24 200.00	12.51	Jan 21 05	1 934.45
5	266 200.00	26 620.00	19.75	Feb 1 06	1 347.85
6	292 820.00	29 282.00	25.95	Jan 12 07	1 128.40
7	322 102.00	32 210.20	34.20	Feb 11 08	941.82
8	354 312.20	35 431.22	44.36	Mar 9 09	798.72
9	389 743.42	38 974.34	65.70	Jan 11 10	593.22
10	428 717.76	42 871.78	88.90	Jan 24 11	482.25
11	471 589.54	47 158.95	127.72	Jan 30 12	369.24
					21 505.62

So to recap, the way to becoming a ten minute millionaire is:

1) Save a minimum of ten percent of your gross income
2) Create a list of companies whose dividend payouts have increased steadily for the past decade.
3) From this list select all those whose shares are traded daily in volumes in excess of 1-million.
4) Rank the shares that remain in descending order of dividend growth over the past decade.

Now you need to recognise that to keep this calculation simple, I did not add in brokerage costs, but neither did I allow for any interest that his annual savings might have brought in, so it is fair to assume that since interest rates are far higher generally than brokerage ever is, that our investor would have achieved a far greater sum to invest. However this gain might have been reduced by the fact that it is well nigh impossible to always buy shares at the lowest possible price. Nevertheless, the point is obvious, that regular purchases of high-growth shares can quickly enrich people. In this case it is clear that in just a few years a middle-income South African can become a millionaire if he or she makes the right share selection choices and keeps a beady eye upon the market in order to buy at the most auspicious point in that share's annual price cycle.

Of course it is not smart to invest in just one share because you would radically increase the probability of losses should you need to realise cash for some emergency at a time when share prices were exceptionally low, but other than that, there is nothing difficult about getting on the road to riches!

More about this in the next issue of The Investor.

ShareFinder Mobile for R1 400

Its very affordable, quick to use and outstandingly reliable so it is no surprise that the new ShareFinder mobile has become one of the hottest sellers in South Africa because it takes all the guesswork and decision-making out of share market investment.

Designed as an ultra-easy-to-use share market investment system for people on the move, the ShareFinder Mobile combines many of the portfolio-building and monitoring features of the ShareFinder Professional at an extremely affordable price tag. There are:

☻No daily data downloads to worry about
☻No bills to pay for expensive data services
☻No complicated charts to try and understand
☻A portfolio-builder that tailors 10-share portfolios to your personal needs
☻An alert system that tells you when to buy and sell

Conceived with the busy executive in mind; for the kind of person whose only spare time is waiting in airport lounges, the ShareFinder Mobile was designed to operate on a pocket computer. It will, however, function equally well on a standard desk-top computer. With just two or three clicks of a mouse it will tailor a blue chip share portfolio to your personal risk profile, generating portfolios which under practical testing throughout the 2003-2007 bull market have dramatically outstripped the performance of the top-performing unit trusts.

Unlike competing computer programmes which carry extremely costly price tags—sometimes as much as R25 000 — and which are linked to internet data services costing over R2 000 a year, the ShareFinder Mobile is offered as a subscription service costing just **R1 400 a year** and there are no additional costs whatsoever.

It offers you:

1) The tools to help you draw up an investment plan tailored to your personal needs.
2) A systematic portfolio builder that enables you to scientifically minimise risk and maximise capital and income growth rates.
3) A weekly overview of leading world markets accompanied by a graphic commentary of changing trends.
4) A personal portfolio analyser which will keep watch over your investments and suggest periodic changes.
5) An alert system which will signal you by e-mail if emergency action is called for. Shortly we hope to add a facility that will also send you a cell phone SMS so you will be alerted to the need for action wherever you are during the day.

The ShareFinder Mobile system operates from the RCIS servers where your portfolio is subjected to a daily automated analysis. At the end of each week Mobile subscribers receive an e-mailed update that will automatically update the programme.

Having been rigorously beta tested for many months during its final development stages, the ShareFinder Mobile is now ready for you. During the latest 2003-2007 bull market, its top-performing portfolio achieved a compound annual average growth rate of 87.4% . Simultaneously its income-growth portfolio, where dividend growth is more important than share price growth, also significantly outperformed both the Satrix 40 and the unit trust leading Sage Resources fund.

To order it, log onto www.rcis.co.za and go to the order form on the left-hand menu. Next scroll down through our list of products and services and click on the Mobile.

** If you want to use this software to its maximum advantage, it is highly recommended that you read Richard Cluver's books "The Philosophy of Wealth" ISBN No: 0958 3067 61 and "The Simple Secrets of Stock Exchange Success" ISBN No 9780 95830 6775 which can also be ordered from Richard Cluver Investment Services at a cost of R130 including postage.*

Using ShareFinder Effectively

How to trade the world's markets "on-line"

By Richard Cluver

My recent announcement that we are creating a platform that will allow our readers to trade the share markets of the world "on-line" has understandably aroused considerable interest among readers who have been asking how and when they might be able to get started.

Here at RCIS we are involved in a massive re-engineering exercise which will ultimately see the launch of a completely new ShareFinder programme which is currently being re-written from the ground up in the latest computer languages.

Other than the fact that it will be significantly faster to operate and be accessible to current subscribers from any location in the world, our main ShareFinder Professional will not appear particularly different from the current version except for the significant fact that one mouse-click will link you into all of the world's major share markets enabling you to buy and sell shares everywhere. Best of all, the brokerage charges for such transactions will be among the lowest in the world.

This new trading facility is being made possible by an association we have formed with Saxo Bank, probably the world's fastest growing provider of trading facilities to the world investment community.

Denmark-based Saxo Bank, with offices in 35 countries, enables investors to trade shares, foreign exchange, CFDs, exchange traded funds, futures, options and other derivatives on line.

While the new programme will for the next few months still be in the development

ShareFinder Prices

Now you can buy the acclaimed ShareFinder Professional for just R5 000.

You can enjoy the immense power of the Professional with its automatic portfolio building and analysis tools, long-term market outlook projections and greatly-expanded fundamental data tabulations, a comprehensive technical analysis module, 12-month price projections with ongoing accuracy rates included. To this may be added, at R200 a year, access to the ShareFinder Mobile remote access service which offers a daily portfolio analysis that can be viewed on smart phones, laptops and netbooks wherever wi-fi or 3G connectivity is available.

You will need a daily share market prices and volumes feed which costs R1 840 a year (or R150 a month) from InvestorData. You will also need to subscribe at an annual cost of R550 to the ShareFinder Supplemental Data service which keeps the programmes supplied with the detailed balance sheet statistics that enable it to make its quality assessments.

To these may be added the ShareFinder London Stock Exchange database at a cost of R1 100 together with a daily prices and volumes feed from ShareCrazy at £72 annually and supplemental data at R550 a year.

Richard Cluver's Prospects newsletter service which consists of a weekly e-mail column each Friday and a monthly trading analysis costs R500. Pay simultaneously for your Supplemental Data service and you can get both for a total of R950.

Our latest ShareFinder Mobile module for on-the-move investors who cannot spare the time to do detailed daily analysis of their portfolios now costs just R1 400 once a year while those who would like to simply receive the daily ShareFinder trading recommendations by E mail can subscribe for R400 for six months. Double that figure and you can also receive the ShareFinder medium-term investment recommendations. Alternatively you can subscribe to our weekly e-mail service for long-term investors at R300 for 6 months.

Richard Cluver's latest books The Simple Secrets of Share Market Success, The Philosophy of Wealth and Footsteps to Fortune are available from RCIS at R130 each while previously-published works cost R90 a copy.

stage, you can already sign on to the Saxo platform and register for trading by e-mailing Kylie Jerg at XKJE@saxomarkets.co.za who will provide you with an opening window specifically constructed for Richard Cluver Investment Services clients and peopled with the shares that currently feature in our Prospects newsletter portfolio.

Our charges will be significantly lower than are charged by most local and overseas brokerages. Thus, for example, you will be able through RCIS to trade in shares at a brokerage rate of just 0.5 percent, trade EFTs & ETCs for 0.5%, CFDs for 0.25%, bonds for 0.35% and the annual custodian fees will be just 0.3%

Looking to the new ShareFinder module, just as users currently have the facility to analyse and quality-sort shares on both the Johannesburg and London markets, the new ShareFinder will enable users to add as many trading markets as they desire. Thus, as I have already proven possible by trading the JSE from my yacht moored in a bay of a remote Greek island, ShareFinder-users operating from a laptop computer, I-pad or smart phone while sitting in a coffee bar in Sydney or a beach bar in Thailand, will soon be able to trade shares in London, Hong Kong, New York or any other market of their choice.

We are simultaneously working on a new version of a ShareFinder module which has been on beta release to a limited number of users of our ShareFinder Mobile system. Unveiled to readers who attended my recent seminars in Durban, Johannesburg and Cape Town, this programme has been given the working title of the "Phone App" because it has been designed to be viewed and operated from the relatively small screens of smart phones.

Designed for the busy on-the-move investor with little time to devote to the daily health of his portfolio, the Phone App provides an at-a-glance colour-coded view of the current health of the investment markets, a comparative performance graph of the user's investment portfolio, a window on the outlook of the share market and a share-by share analysis individual portfolios highlighting underperformers. Finally it offers suggested high-performance substitutes for the laggards, the optimum date to replace them and the likely optimum buying price.

One more click will allow the user to view ShareFinder analysis graph composites of portfolio underperformers and the suggested replacements to assist the investor to make decisions and, finally another click will take you straight into the appropriate order window of the Saxo platform which will be prepeopled with the ShareFinder recommended buy/sell prices.

Because of its quickness and simplicity of use, initial response to the beta version of this latter programme which has been under test for over a year, has been so favourable that we believe it is likely to become the dominant version in our overall programme offering.

South Africa: Only a matter of time before the bomb explodes

by Moletje Mbeki

I can predict when SA's "Tunisia Day" will arrive. Tunisia Day is when the masses rise against the powers that be, as happened recently in Tunisia. The year will be 2020, give or take a couple of years. The year 2020 is when China estimates that its current minerals-intensive industrialisation phase will be concluded.

For SA, this will mean the African National Congress (ANC) government will have to cut back on social grants, which it uses to placate the black poor and to get their votes. China's current industrialisation phase has forced up the prices of SA's minerals, which has enabled the government to finance social welfare programmes.

The ANC inherited a flawed, complex society it barely understood; its tinkerings with it are turning it into an explosive cocktail. The ANC leaders are like a group of children playing with a hand grenade. One day one of them will figure out how to pull out the pin and everyone will be killed.

A famous African liberation movement, the National Liberation Front of Algeria, after tinkering for 30 years, pulled the grenade pin by cancelling an election in 1991 that was won by the opposition Islamic Salvation Front. In the civil war that ensued, 200 000 people were killed.

The former British prime minister, Margaret Thatcher, once commented that whoever thought that the ANC could rule SA was living in Cloud Cuckoo Land. Why was Thatcher right? In the 16 years of ANC rule, all the symptoms of a government out of its depth have grown worse.

- Life expectancy has declined from 65 years to 53 years since the ANC came to power;
- In 2007, SA became a net food importer for the first time in its history;
- The elimination of agricultural subsidies by the government led to the loss of 600 000 farm workers' jobs and the eviction from the commercial farming sector of about 2,4-million people between 1997 and 2007; and

The ANC stopped controlling the borders, leading to a flood of poor people into SA, which has led to conflicts between SA's poor and foreign African migrants.

What should the ANC have done, or be doing?

The answer is quite straightforward. When they took control of the government in 1994, ANC leaders should have: identified what SA's strengths were; identified what SA's weaknesses were; and decided how to use the strengths to minimise and/or rectify the weaknesses.

A wise government would have persuaded the skilled white and Indian population to devote some of their time — even an hour a week — to train the black and coloured population to raise their skill levels.

What the ANC did instead when it came to power was to identify what its leaders and supporters wanted. It then used SA's strengths to satisfy the short-term consumption demands of its supporters. In essence, this is what is called black economic empowerment (BEE).

BEE promotes a number of extremely negative socioeconomic trends in our country. It promotes a class of politicians dependent on big business and therefore promotes big business's interests in the upper echelons of government. Second, BEE promotes an anti-entrepreneurial culture among the black middle class by legitimising an environment of entitlement. Third, affirmative action, a subset of BEE, promotes incompetence and corruption in the public sector by using ruling party allegiance and connections as the criteria for entry and promotion in the public service, instead of having tough public service entry examinations.

Let’s see where BEE, as we know it today, actually comes from. I first came across the concept of BEE from a company, which no longer exists, called Sankor. Sankor was the industrial division of Sanlam and it invented the concept of BEE.

The first purpose of BEE was to create a buffer group among the black political class that would become an ally of big business in SA. This buffer group would use its newfound power as controllers of the government to protect the assets of big business. The buffer group would also protect the modus operandi of big business and thereby maintain the status quo in which South African business operates. That was the design of the big conglomerates.

Sanlam was soon followed by Anglo American. Sanlam established BEE vehicle Nail; Anglo established Real Africa, Johnnic and so forth. The conglomerates took their marginal assets, and gave them to politically influential black people, with the purpose, in my view, not to transform the economy but to create a black political class that is in alliance with the conglomerates and therefore wants to maintain the status quo of our economy and the way in which it operates.

But what is wrong with protecting SA’s conglomerates?

Well, there are many things wrong with how conglomerates operate and how they have structured our economy.

- The economy has a strong built-in dependence on cheap labour;
- It has a strong built-in dependence on the exploitation of primary resources;
- It is strongly unfavourable to the development of skills in our general population;
- It has a strong bias towards importing technology and economic solutions; and

It promotes inequality between citizens by creating a large, marginalised underclass.

Conglomerates are a vehicle, not for creating development in SA but for exploiting natural resources without creating in-depth, inclusive social and economic development, which is what SA needs. That is what is wrong with protecting conglomerates.

The second problem with the formula of BEE is that it does not create entrepreneurs. You are taking political leaders and politically connected people and giving them assets which, in the first instance, they don’t know how to manage. So you are not adding value. You are faced with the threat of undermining value by taking assets from people who were managing them and giving them to people who cannot manage them. BEE thus creates a class of idle rich ANC politicos.

My quarrel with BEE is that what the conglomerates are doing is developing a new culture in SA — not a culture of entrepreneurship, but an entitlement culture, whereby black people who want to go into business think that they should acquire assets free, and that somebody is there to make them rich, rather than that they should build enterprises from the ground.

But we cannot build black companies if what black entrepreneurs look forward to is the distribution of already existing assets from the conglomerates in return for becoming lobbyists for the conglomerates.

The third worrying trend is that the ANC-controlled state has now internalised the BEE model. We are now seeing the state trying to implement the same model that the conglomerates developed.

What is the state distributing? It is distributing jobs to party faithful and social welfare to the poor. This is a recipe for incompetence and corruption, both of which are endemic in SA. This is what explains the service delivery upheavals that are becoming a normal part of our environment.

So what is the correct road SA should be travelling?

We all accept that a socialist model, along the lines of the Soviet Union, is not workable for SA today. The creation of a state-owned economy is not a formula that is an option for SA or for many parts of the world. Therefore, if we want to develop SA instead of shuffling pre-existing wealth, we have to create new entrepreneurs, and we need to support existing entrepreneurs to diversify into new economic sectors.

Mbeki is the author of Architects of Poverty: Why African Capitalism Needs Changing. This article forms part of a series on transformation supplied by the Centre for Development and Enterprise.

Readers questions

By Richard Cluver

Mr N wrote that both his wife and himself are now over the age of 70 and require a living income of R13 000 a month. In order to provide this they have approximately R3,000,000 invested directly in a portfolio of SharerFinder-selected blue chip shares which have collectively been achieving a growth rate of 35 % p.a.

Representing 18 percent of this portfolio are property shares and they intend increasing this to 30%. However, even at 30% the portfolio will be unable to provide sufficient income to meet their needs and they have accordingly asked whether I consider it wise in their circumstances to draw the balance of their income requirements from the portfolio.

Their obvious hope is that the growth rate of the portfolio will negate their drawings thereby ensuring that they will continue to have sufficient capital to live on for the rest of their expected lives. And there is nothing wrong with the concept. This is precisely how pension funds operate and insurance companies operate annuities. The big question, however, when individuals take on the management of their own annuities, is whether they can be realistic about their rate of withdrawals.

Let's look at a practical example. They plan to move a third of their portfolio into property shares. So let's take as an example Growthpoint, one of the largest and most successful property mutuals which is currently yielding 5.6 percent income, the bulk of which is in the form of interest which is taxable. This would not be a problem for Mr N if this were his entire source of income because the total income of R56 000 a year or R4 666.66 a month would fall within his primary rebate.

The balance of shares, assuming an average dividend yield of 3.4 percent would provide him with R68 000 a year or R5 666.67. If you care to calculate it out you would thus see that his anticipated income would be R10 333.33 a month which implies that in order to reach his required R13 000 a month he would need to sell shares to the value of R2 666.67 a month or R32 000 a year which would erode his capital at a rate of 16 percent a year.

Clearly then, if his portfolio is likely to continue rising at 35% in value, he would still be seeing capital growth of 19 percent a year on the R2-million invested in blue chip shares selected by the ShareFinder programme. Furthermore, his Growthpoint shares would be growing in value at 10.1 percent a year which in total implies that overall Mr N could safely continue with such a plan knowing that even after withdrawing capital at his envisaged rate he would still see his investment capital rising on average by R200 000 a year.

The problem with this assumption, however, is that 35 percent a year is a very high growth rate to rely upon on a long-term basis. It ignores the fact that every few years share markets plunge cyclically and, following such a crash, one would be drawing heavily upon a possibly greatly-reduced capital sum. Furthermore, though Mr N and his wife might be able to get by quite comfortably currently on R13 000 a month, does this figure take into account emergencies, possible future health problems, inflation and so forth. Personally I would not be happy drawing more than 10% of capital each year, but I am very conservative. At that rate Mr N's capital would grow at 25 percent compound leaving him with a far more comfortable margin over time and it would allow for a periodic slow-down in share price growth rates.

The process to follow when seeking to realise capital is to recognise that there are bound to be a few underperformers in your portfolio and in the normal course of events you would be selling these whenever they peak in price in order to switch into shares with higher performance rates. These underperformers represent the group that you need to tap to create income.

Although everyone celebrates when a drop in the interest rate is announced, not everyone, it seems, is benefiting from the decrease. In a recent report released by Rawson Properties, it was revealed that some banks are charging way more than the prime rate set by the Reserve Bank. Sadly, it seems that it is those investing in the lower end of the market and who are truly at the mercy of the banks that are most affected as it appears that the inflated rates are aimed at properties priced between R400 000 and R700 000.

There are instances where buyers of properties in this price bracket are being charged as much as six percent above prime and it is pretty certain that these buyers are unaware of the implications that an inflated bond repayment figure is going to have in the long term.

Bill Rawson, the chairman of Rawson Properties and his financial colleague, Mike van Alphen, describe the interest rates charged by some banks as 'totally unjustifiable' and 'out of all proportion

"Never before in the history of South Africa have banks worked on such flagrantly exaggerated mark-ups. A six percent over prime interest rate equates to a 70 percent mark-up," said Rawson.

Although the banks are quick to point out how many 100 percent bonds are currently being granted, it would seem that some of these bonds come at a price, and that that price is incredibly high. "The amount of deposit a client is putting into the purchase certainly has a bearing on the rate being charged," says Van Alphen.

"We are finding that more 100 percent bonds are being required in the under R1-million purchase price bracket and hence higher interest rates are being charged. The size of the bond rather than the purchase has a bearing on the interest rate. A purchaser buying a property for R2.5-m and only needing a bond of R1,8-million for example, could get a rate of prime minus 1,0 percent, especially if the client has most of his accounts with the bank."

Asked why he believed that some banks were charging higher interest rates, Van Alphen said: "The banks assess their risk and price accordingly. They would look at the client's source of income, employment history, employment industry, the amount of deposit, where the property is situated - if they have a high number of arrear or distressed properties in the area."While it is understandable that banks are business entities and are answerable to their shareholders, one has to wonder how the banks are able to justify these exorbitant rates."The risk needs to be assessed. However, a rate of prime plus 6 percent is just not on as the higher the rate, the less affordable the bond becomes for the client."

It has been widely reported that most of those who are granted 100 percent bonds are first time buyers who, to a large extent, have little or no grasp of the future financial effects an inflated bond repayment figure brings and the true cost of owning their first home.

If, as Rawson says, a six percent above prime figure equates to a 70 percent mark-up, this means that the buyer is in effect paying almost double for his property. One has to ask why, in a country where a large group of people was previously barred from owning property, this has been allowed to happen. Another point that banks should make clear to homeowners who are being charged more is what happens when the interest rate starts to rise. Will the banks then reassess the situation and amend their rates or will the homeowners be forced to pay both the higher interest rate as well as being penalised by the inflated bond rate?

Different banks have different policies and not all are charging higher interest rates. It is highly recommended that all buyers, in all price brackets, shop around and get the best deal available.

By Invitation

Dr Cees Bruggemans
Chief Economist First National Bank

When I was a child, my mother liked 4711 eau de cologne. Never dreamed I would meet up again with 47, now as a reeking game changer in the 2012 US presidential election.

Somebody in California made a video, put it on YouTube, inflamed the entire Islamic world and its fallout should have sunk the US Democratic presidential contender for re-election but didn't.

Someone last month on a koppie outside Marikana gave the signal to charge, someone supposedly fired at the police, and the next thing South African wage negotiations acquired a totally different character from what collective bargaining is supposed to be about.

This list can be expanded. Indeed, it grows daily, with consequences yet to be fully fathomed. In Greece, first the extreme left (impeccable Maoist credentials) gained meteorically but didn't gain a majority. Now the Nazi-wannabee extreme right has jumped in the polls, at a time that both the far left and right have flamed out in Holland (there now barely getting 20% of the vote combined, while Golden Dawn in Greece on its own today wins 22% appreciative noises from voters). Who knows where these extreme wings will take Greece in time when they are again allowed to vote.

The Saudi Royal family also seems to have fallen for a round number, in their case 100. So $100 Brent oil seems to be what we and President Obama are getting (for containing Iran?) even as Fed QE3 should be detonating oil higher. Wrong bet. Never bet against the Fed, but never, never bet against the Royal Saudis (and Obama?).

At home, President Zuma this week seemed to be consolidating his centre-fold hold on power, even as the labour left kept moving further left, going by its favourite minimum wage demands (4500 for all), while labour unrest has spilled over to the transport sector where a strike is now in progress. One wonders what that means for policy down the road? Meanwhile, wildcat strikes seem to be increasing in our mining sector, 12500 seems to have become another popular number locally, output continues to be lost, export volumes sacrificed (even though reaping shock-like rises in precious metal prices).

One would hope the mines have the gumption to sell output forward and lock in these fancy prices, except for two tiny qualifications: stay naked spot for more price-boosting trouble may come, as every siener should have no trouble in seeing; and mining costs are rising at such a pace we need far higher prices than these attractive spots to survive for long.

In the olden days, such labour unrest would have sunk the Rand, supporting mine survival and perhaps even boosting manufacturing prospects (if not eaten away by higher wage demands, prices and profits). But we have never tried this kind of thing before at the peak of multiple global financial crises making key central banks so desperate as to announce UNLIMITED bond buying and liquidity operations, in the process sinking their currencies and sustaining global yield hunger, both serving to prop up the Rand (also assisted by capital inflows as South Africa is about to be included in the Citi global bond index) when our labour troubles should be sinking the Rand like a stone. Where is this leading?

We are getting very long SARB Monetary Policy Statements throwing every known economic statistic plus the kitchen sink at the bewildered public after which there is a Delphic utterance about policy stance. This is so very different from the Fed, which releases a short paragraph exactly stating what to expect next (having prepared the way with multiple hints in various speeches weeks in advance).

The ECB is also getting clearer by the day ("will do whatever it takes; believe me, it will be enough"). Our situation, more Greece-like, apparently doesn't allow such clarity ahead of time or on the day. Are there any bottom lines here? The growth forecast may suffer more than the 0.1% degradation the SARB had in mind this week, lowering its 2012 GDP forecast from 2.7% to 2.6%.

Inflation is in danger of a hiccup from food (just around the corner), and as yet unknown fallout from the change in collective wage bargaining tactics. But would this really push up average wage bills, as the job cutting will presumably match the wage hiking?

Inflation may not get boosted by oil (as the Saudis drill for 100) or by a weak Rand (as the Fed and ECB do whatever it takes to keep markets liquid, Dollar and Euro weak and global investors nervous and in gold and into EM high yielders). That could keep the SARB unchangingly stable in its interest rate stance for the time being. It apparently remains a firm believer in the Euro crisis eventually laying us low, reinforced with US fiscal cliffs, requiring the utmost policy caution and preparedness, ready to do appropriate things at short notice.

Consumer spending could get boosted by those gaining high wage increases and their bigger appetite for unsecured borrowing, but it may be eroded by job losses. Private fixed investment may keep struggling as mining investment may be cut while manufacturing investment prospects look iffy. Many of us may be suffering from sensory overload but short of switching off television, internet, smart phones and no longer believing newspapers (except for the crossword puzzles) there is really very little hope of getting things straight and in focus for very long.

NASA is talking about one-way trips to Mars for some lucky earthlings. I can see why they may have no shortage of volunteers. It must be a quiet, logical kind of place.

Daring central bankers

Interesting how our global collective memory and received wisdom splits down the middle when it comes to what central banks should or shouldn't do.

The one lot wants to be conservative, remembering vividly historic mistakes of being free and easy with money printing, focusing on preventing moral hazard, preferring to maintain a Twiggy monetary diet while waiting for others (governments) do what needs to be done, with societies adjusting accordingly. All reportedly would be well with Mother and Child, if only.

The other lot has the advantage of being in charge of the leading central banks (Fed, ECB, BOE) and has quite a different take on things. It also remembers the past vividly, and mainly what wasn't done on earlier occasions in certain circumstances (not necessarily the same ones the former lot are focused on) that should have been done, and this being another one of those historic occasions where the right things can be done. In this view, rich economies have been mortally wounded by financial excesses and their fallout. Politicians will take a long time to reconcile conflicting views in their respective democratic societies, preventing decisive early action.

With economies in any case on a credit starvation diet because of the damage done and the new regulatory demands coming on top, with institutional change slow in coming where it is most needed (Europe) or where society is forever making up its mind about the preferred answer to its most fundamental existential question (more rugged US individualism or social solidarity?), in the meantime letting markets and economies flounder, central banks should take the lead, offer backstops, buy time.

And thus we are being entertained with unprecedented low interest rates (near zero, seemingly indefinitely) and aggressive expansion of central bank balance sheets (by the trillions in Dollars, Euros, Yen, sterling and Swiss Franc, with EM central banks in any case holding over $8 tril in forex).

And the purpose of it all? At heart it is intended to keep markets amused and occupied. While extra liquidity puts artificial props under asset values, and bolstered sentiment is prepared to push things even higher, wealth effects are at least not negative and are the market natives prepared to stay on the reservation rather than start restless wandering. Not everyone thinks like this, many losing sleep over what could go wrong, punting gold as the non-corruptible safe haven. Still, on balance, these actions buy time for politicians to repair and economies to recuperate, if very slowly.

That's net positive (for now). In a negative sense, such monetary aggression serves to push the currency lower, assisting trade growth in the country doing the pushing but doing so at the expense of growth in the countries facing such unilateral action. The Brazilians are again talking of currency war, and then you know someone is being hurt by the stronger Dollar, but apparently slower growth is making Brazil less attractive to foreign capital inflows, with less lift to their currency than on earlier occasions so what they are really complaining about is only known to them.

As no country likes to lose out on currency support, and one may as well sin as a collectively, many rich countries are taking roughly the same actions as the US and are doing so in close proximity (flying in snow goose formation so to speak, follow the leader everywhere, even over monetary cliffs), limiting the damage from currency shifts (at least initially). Effectively they are together creating a state of suspended currency animation amongst themselves, which stays good for as long as nobody breaks ranks.

The Great Divide here is between such desperate rich housewives and the far more stable Emerging Market damsels who don't have the same problems, who still enjoy growth and yield and who consequently are faced with waves of capital inflows distorting their domestic asset markets, their currencies and their economies if they don't react.

Reacting they do, verbally by shouting abuse at rich QE actions, and practically by buying yet more forex and reinvesting overseas (like in an engine reinjecting lost heat, and seeking yet more turbo at the global centre).

Where is all this leading? When asking a Porsche driver doing 280km per hour on the autobahn, the only answer can be “forward”. And so with global markets, with many holding on to their hats, and with many mumbled prayers as they all follow the leader, for it is known folly to fight Fed, ECB or anyone else with a global printing press. There are many, many, many people fearing the worst. That politicians won’t deliver, that this monetary train can only derail eventually, with spectacular results, with the distant German and many EM hyperinflations and their subsequent political revolutions and even world war coming most graphically to mind.

The central bankers in question apparently see it differently. Simply put, it isn’t even paper money, “it is only virtual money” existing in cyberspace. You can create it, or destroy it, at a whim. If the system needs moral support to keep body and soul together, give them something pleasant to think about. If the money actually starts to connect with real things, first by getting asset bubbles going and then starting up real sector risk taking and spending, neutralize the excess liquidity by withdrawing it.

The cost of the crossover appears to some intimidating, but the cost of becoming paralysed and not doing anything is to the central bank incumbents far worse, for their distant predecessors have been there before.

Is all this without risk? Of course not. Breathing air or crossing the street isn’t without risk either, but if you know what you are doing the risks should be manageable. But that’s the point, according to many: they don’t know what they are messing with!

That remains to be seen. Meanwhile, central bank balance sheets are inflating, in the process putting air into many global asset classes. Governments in all affected jurisdictions get time to be creative, with Europe working on greater governance discipline and integration, eventually reducing their collective risk profile.

It isn’t quite obvious what the US is working on, except winning the next election, and then taking stock (after which more political cycles may be needed as they flame out of the great global stakes). Romney may already have flamed out punting his 47% not quite the right way and does there now loom an inevitable fiscal cliff as a terrible revenge is wrecked on Obama past the post? Time will tell.

Meanwhile China has problems, Japan has, Europe isn’t anywhere close to closure, the Middle East is a huge open sore, the Islamic footprint is humming like an angry beehive, and so around the world. Meanwhile, the Dollar is down (on days the Euro is up), liquidity is sloshing, asset values are higher than they were yesterday, mindless sentiment is perkier than it has been, global repair is proceeding, there is talk of some more growth somewhere, and Bob is your Uncle.

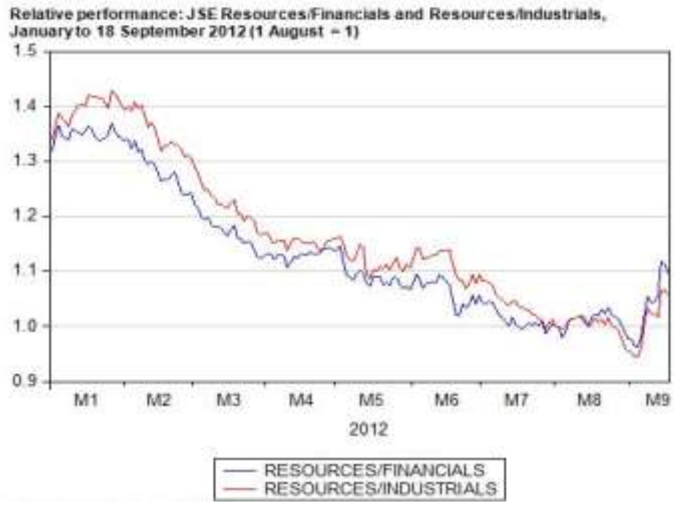
This rally perishing shortly? Perish the thought. There is a lot more push left where the earlier lot came from. Bernanke has at least another 15 months in office (if not more if Obama keeps being favoured by Romney banana skins) and Draghi has got over 7 years left. Mervyn is about to disappear, but don’t think the next Gov will be too different, except in age. And so the end of fiat money has been somewhat postponed while we do crisis repair, collectively try to get into a better frame of mind even while the most hellish weather keeps playing globally.

Stockbroker's views by Brian Kantor Investec Securities

A defining recent feature of the JSE and other stock markets this year has been the very good performance of the defensive stocks, especially those with attractive dividend yields and balance sheets to support growth in dividends.

By contrast, the performance of the cyclical stocks – especially mining companies – has been very poor both absolutely and relatively, when their performance has been compared to the defensives.

We show on the right the relative performance of the Resource, Financial and Industrial Indexes between 1 January and 18 September. As may be seen, in 2012 the Financials and Industrials on average have gained about 30% on the average Resource counter listed on the JSE.

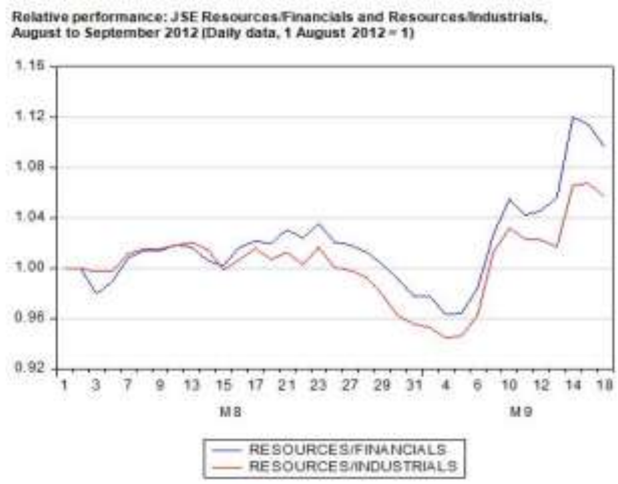


Such outcomes are very understandable in a world of exceptionally low interest rates, coupled as they are with grave doubts about the strength of any global cyclical economic recovery (from which metal and mineral prices and the profits of mining companies would stand to benefit).

This outperformance was reversed on 13 September when Fed chairman Ben Bernanke and the Federal Open Market Committee announced QE3. The Fed plans to inject an additional US$85bn of cash into the US monetary system each month through additional purchases of mortgage backed securities and US government bonds. The intention is to keep interest rates as low as possible for as long as it might take to revive the US economy and employment or at least until 2015.

The question therefore is not whether or not the Fed will achieve its objective of low interest rates. This it will surely do thanks to its freedom to effectively create as much cash as it deems appropriate and also to twist the yield curve accordingly, that is borrow short and lend long if necessary, to hold down long rates relative to short rates (which are close to zero and will surely remain so for some extended time). The question is whether continued low interest rates can stimulate a more robust economic recovery. If they can then the underappreciated cyclical stocks would especially stand to benefit.

The stock markets reacted as if it was truly time for the cyclical stocks. They gained materially against the Financials and Industrials. There also appeared to be some rotation on the JSE away from the Industrials and Financials. Then last Monday these trends were partially reversed as we show on the right.



Our own view, expressed on the day after Bernanke fired his bazooka, was that the promise of a further extended period of low interest rates would continue to make secure dividend yields well above money market rates still appear attractive, given the absence of any assured cyclical recovery. Playing defence, we thought, might remain the best policy in these new circumstances. It seemed clear to us that pumping money into the system would be helpful to asset prices generally – but perhaps not especially helpful to the cyclicals. Still more highly accommodative monetary policy might not, we surmised, provide the quick fix for the global economy. It has not done so to date. The jury will remain out on this for some time we think – or until a global cyclical recovery appears much more likely.

USA Comment

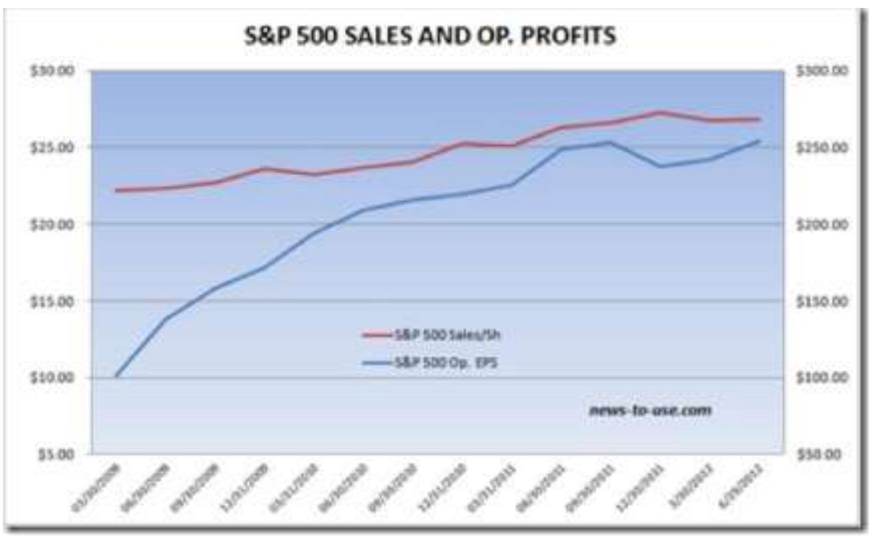
By Denis Ouellet

This is the 4th major intervention from the Fed since 2009, each one *apparently* inflating asset prices without having a definitive impact on the economy other than, most importantly, preventing a lethal debt-deflation spiral.

The chart on the right is used extensively to illustrate the close relationship between QEs and equity prices. Hence our Pavlovian reaction to the FOMC announcement of an open-ended and unlimited money printing program. Virtually every asset class rose, giving credence to Ben Bernanke's attempt to create a stimulating wealth effect.

What if the Fed has it all wrong? Correlation does not imply causation. Could there be another reason for the spectacular rise in equity prices since 2009? Let's try earnings, just in case that intuitive, time-tested, relationship might still be working?

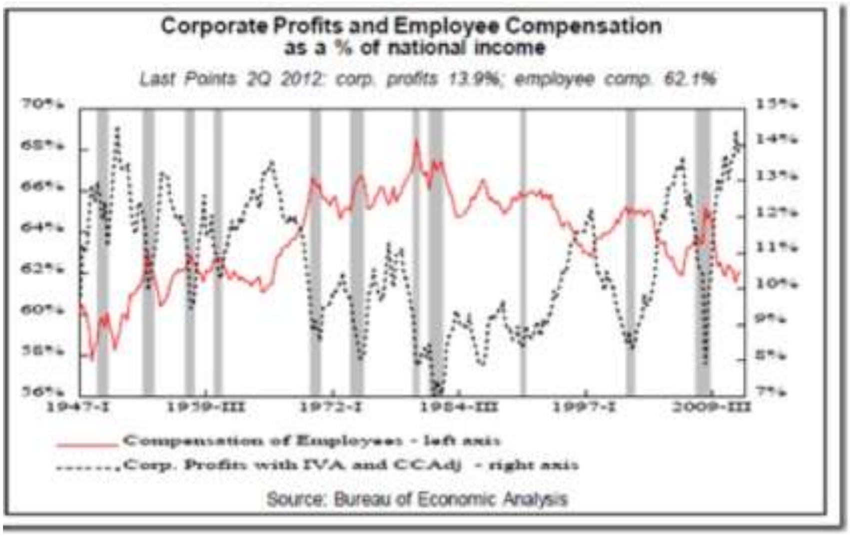
If there were a direct link between QEs and corporate profits, it should be apparent in S&P 500 company revenues. Yet, Index sales have only grown 16.5% during the last 3.5 years, nothing close to the 60% jump in Fed assets. Given that the Fed is now totally focused on growing employment, I doubt that it would take credit for the spectacular jump in profit margins since 2009, since most of it emanated from cost cutting (mostly labour) and rising productivity.



Some recent facts point to weaker earnings ahead:

- Quarterly sales and earnings have peaked in the last 9-12 months.
- Corporate profit margins are at an all-time high. It is therefore dangerous to assume that margins will expand any further. From now on, corporations need to increase sales in order to grow their earnings. Unfortunately, demand is waning.

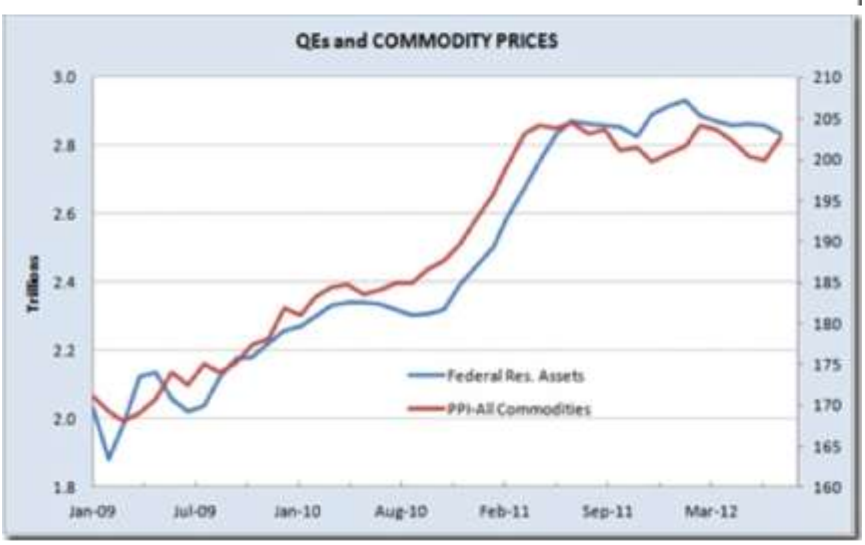
American wages, currently at a 50-year low as a percentage of GDP, are rising very slowly, so slowly that it is hampering consumer spending and the overall economy. At the time of previous QEs, also designed to create a wealth effect, wages were rising at a much faster clip than today. Furthermore, real wages were rising during 2009 and 2010, partly offsetting slow employment growth.



Today, employment growth remains below 1.5% YoY, a rate insufficient to reduce unemployment. Nominal wages are growing 1.2% while inflation is 1.7% and threatens to accelerate, in large part due to the impact that the Fed's actions are having on commodity prices, particularly oil prices.

The US economy got lucky in 2011, when gasoline prices dropped 18% to $3.20/gal. just in time for the back-to-school season and Christmas. It's luck extended into 2012, when the U.S. experienced an extraordinarily warm winter.

Unless something else extraordinary happens soon (SPR releases?), the exact opposite will happen to oil prices. Gasoline has jumped 16% since July, adding to the squeeze just as we enter the most important shopping period of the year (chart right from gasbuddy.com).



The following chart plots the Fed's printing with commodity prices. Unlike the relationship with equity prices, it is difficult to find anything other than excess financial liquidity to explain the spectacular rise in commodity prices. Considering how world economies have been doing lately, why is it that commodity prices have not declined significantly?

The Fed's balance sheet is set to grow another $800 billion by the end of 2013, the same amount it has increased since 2009, a period during which commodity prices jumped 20%.

The Fed wants to grow employment faster, but jobs don't grow out of thin air. Corporations create jobs when they have the means, they see a need, and there is visibility to commit. Needless to say, the last two conditions are far from being met these days. The Fed can't offset negative US politics, the European mess, nor the Chinese slowdown.

Bringing mortgage rates down further might help the slowly recovering housing sector and restart construction employment, but low wages and rising inflation remain a problem that might be perversely aggravated by the very actions the Fed is taking.

Wages are not about to accelerate, but inflation and taxation are problematic. If the American consumer can't spend, who will provide the needed spark?

Higher P/E Ratios to the Rescue?

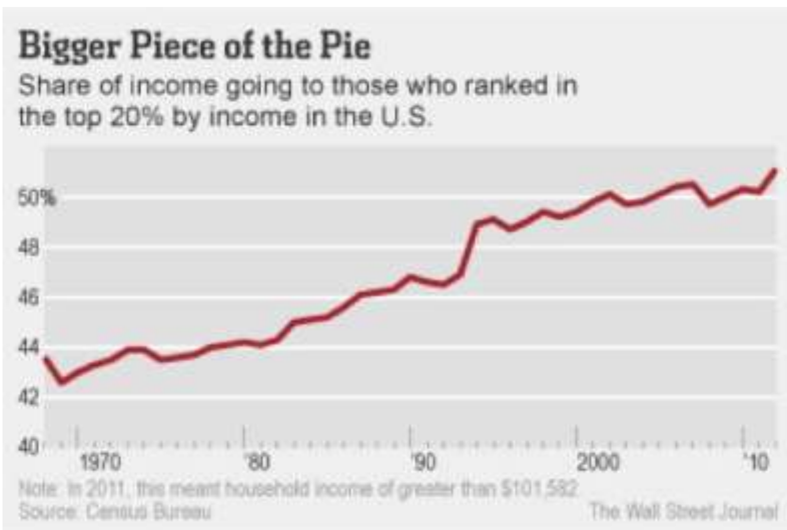
Earnings have stalled, corporations are cutting guidance, and analysts are busy revising their estimates downward. Q3'12 estimates have been cut 8% since March and are now below Q2 earnings, which are themselves coming in much lower than originally expected. Q3 earnings are now seen down YoY.

If so, trailing 12-month EPS peaked last quarter and will decline in Q3. The earnings tailwind has disappeared.

There have been eight periods since 1935 when equities have risen in the face of declining earnings (see Banking [Betting] On Bankers?). *In all cases, inflation declined along with earnings.*

The dependable Rule of 20 says that "Fair trailing P/E = 20 minus inflation." Lower inflation begets higher P/Es. A fair P/E is thus 18.3 at the current 1.7% inflation level, 23% above the current 14.8x P/E, pointing to 1800 as fair value on the S&P 500, based on trailing EPS of $98.69. If this undervaluation is narrowed by the liquidity pumped out by the Fed, could it create enough wealth effect to push US consumers into a spending spree, in spite of negative real labour income growth?

The problem with Bernanke's wealth effect thesis lies with the new reality in America. Income and assets have lately been so significantly redistributed that only a tiny few actually feel a wealth effect from rising equity prices. Here are some sad facts:

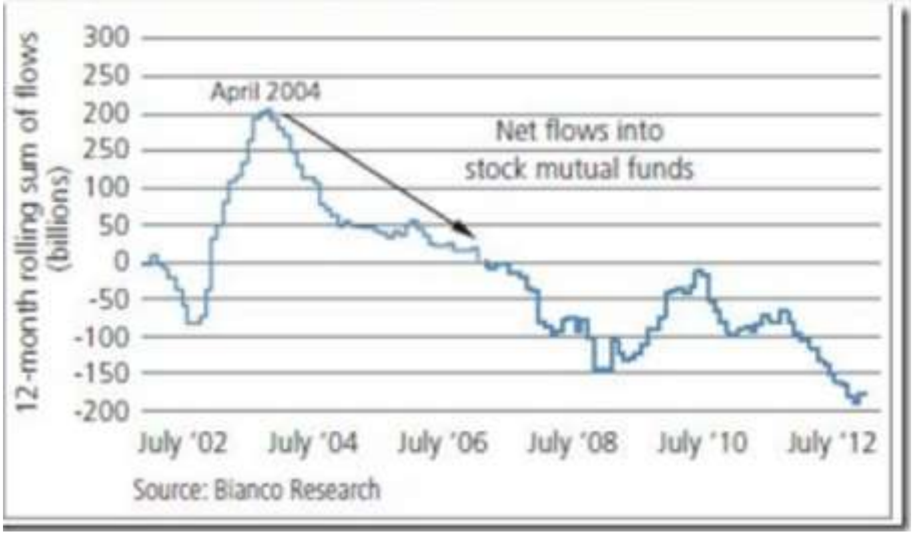


• Last year, the top 20% of households took in 51.1% of all income in 2011, up from 50.2% in 2010 and the highest share since at least 1967, according to the Census Bureau. After the top, each quintile of income earners saw their share of income decrease, with the biggest drop among middle-income earners. The **middle fifth of households took in 14.3% of all income last year**. (WSJ)

• In 2007, the top 20% of income earners had 53% of their financial holdings in stocks (directly and indirectly), down from 59% in 2001. Middle-income earners had 38% of their financial assets in stocks in 2007, down spectacularly from 47% in 2001.

• Stock holdings have obviously declined since 2007:

• US house values remain 30% below their 2006 peak level and now match their 2003 level.



• Total residential mortgage debt has only declined 7.5% since 2008. Some 1.5 million homes are in foreclosure, but 10.8 million homes remain in negative equity.

The "wealthy few" may feel wealthier if stocks advance, but they could nevertheless have much less after-tax income to spend when politicians finally address the looming fiscal cliff nestled within the rapidly growing mountain of debt.

Keep in mind that it is these wealthy people who run American corporations, keeping them lean and mean and flush with cash. They remember how profits literally disappeared in 18 months in 2007-08. They remember how financial markets totally froze in 2008. They see the humongous budget deficits and the debt piling on, and the not-so-distant day of reckoning. They realize that all the Qes in the world can't offset inept and irresponsible politicians on either side of the Atlantic. Yet, they are the ones targeted by the so-called wealth effect!

Call that pushing on a golden string.

Meanwhile, the less affluent, the other 80% – some 250 million people – are little concerned by an eventual wealth effect but highly, directly, and immediately impacted by the side effects of all these QEs, namely rising commodity prices and near-zero interest rates. Consider that:

• 15% of the US population lives in poverty.

• 44% of those 46.2 million poor Americans are in "deep poverty," which is half the level of the poverty line, defined as $22,811 for a family of four.

• More than 45 million Americans are in the food-stamps program, which is 15% of the population, compared with the 7.9% participation from 1970-2000. Food-stamps enrollment has been rising at a rate of 400,000 per month over the past four years. Just last month (August), nearly twice as many people went on the food-stamps program (173,000) than managed to find a new job (96,000).

• More than 11 million Americans are collecting federal disability checks.

• 11.2% of the labour force is out of work, if we include the 7 million people no longer seeking employment. This number (over 17 million workers) is unchanged since 2009.

• Full-time employment remains 1.4 million below its 2009 level. Needless to say, part-timers earn and spend considerably less.

• Most of the 43.5 million American retirees must cope with nominal interest rates, near zero through 2015, when inflation is around 2.0%.

Call that pushing on a chafed string.

Betting on Bankers?

Now that US and European central banks have delivered the financial heroin needed to compensate for inept and irresponsible politicians, should we jump back in equities? Will professional investors drive equities higher?

The risk here is that, much like businesspeople, investors may remain cautious, given the numerous and highly complex difficulties the US and the world are facing. They will also consider that, at the time of previous QE program launches, equity markets were similarly undervalued, but many economic trends were then more positive:

• Earnings were in a strong up-trend on rising margins.
• Oil prices were much lower.
• US real wages were rising (not in 2011).
• The 2011-12 winter was one of the mildest on record in the US.
• Europe was not in recession.
• China was still growing strongly.

Interestingly, the undervaluation of equities, as measured by the Rule of 20, narrowed from 40% to **0%** during QE1, from 23% to **7%** during QE2, and from 19% to **14%** during Operation Twist (see the black line in chart below). The recent rally has narrowed the undervaluation from 27% to **19%**. It would be very surprising if we got near fair value anytime soon. If 10% undervaluation (average of QE2 and OT) is the best we can hope for, the resulting 16.5 P/E (90% of 20 minus 1.7% inflation) brings the S&P 500 to 1625, just about 10% above current levels.
That assumes that inflation stays constant at 1.7% YoY. However, gasoline prices are +7% YoY in September, after rising 1.8% in August.. If they remain unchanged until year-end, gas prices will be +18% YoY. Not only would that considerably disrupt Christmas sales, it would also help raise inflation (gasoline is 5.5% of the CPI, energy is 9.7%). If inflation rises to 2.0%, a 10% undervaluation would get the S&P 500 Index to 1565, a mere 6% above current levels.
If the Fed has it all wrong, simply pushing on golden or chafed strings, and the only effect of QE3 is to boost inflation, only God(ot) knows what will happen.
While the Fed waits for the wealth effect to take effect, the European Central Bank is also waiting for its own Godot, following Draghi's magic with the ECB rules and regulations. Super Mario's "whatever it takes" promise is powerful but not without pitfalls:
• When, if ever, will the eurozone achieve the necessary banking and fiscal unions?
• Will Spain and Italy surrender before it is too late?
• Will ever more austerity finally work?
• When will the debt spiral stop?
• How much longer will the Germans put up with the situation, accepting that the ECB ruins its balance sheet by taking on unlimited risk on behalf of the German taxpayers, risking their fiscal sovereignty to save the "reckless Southerners"?
• How much longer will the hordes of unemployed young Europeans put up with the situation?
Central bankers have indeed delivered. In truth however, they are merely experimenting with totally unproven ways and means, hoping to gain enough time until more responsible politicians emerge. Given the significant risks still facing us until Godot shows up, investors should await more evidence that either earnings will resume their uptrend or some kind of miracle will happen.

Equity holdings should be trimmed to conservative levels. Sustainable income should be favored. Cash earns essentially nothing but is safe for now. Gold remains attractive for many, many obvious reasons.