by Richard Cluver

Events in Cyprus have once again shaken the investment world with a sharp reminder that the world economic crisis has not gone away: that nothing has actually been solved and government debt levels continue to rise to unsustainable levels as central bank governors everywhere apply the only, largely ineffective, tool they have at their disposal: printing money.

Gradually, however, awareness is growing among the financially-savvy that what we are witness to is the end of an economic era. The world is waiting for a new John Maynard Keynes to gallop onto the stage on a white horse and save the day with some brilliant new economic theory.

The fact is, however, that it is not a new economic theory that is needed but rather a new dispensation that curbs the controlling hands of the politicians and ushers in a new Belle Epoque like the one that reigned in Europe from the 1870s and ended with the First World War. The "Beautiful Era" which is what the name translates into, was a period characterised by optimism, peace in Europe, new technology and scientific discoveries which allowed the arts to flourish and gave rise to a golden age of creativity.

To understand what needs to be done requires an appreciation of why the world's current system is not able to function as effectively as it could because of a hangover of the political experiments that characterised the 20th century: most notably the failed extrapolation of democracy's fundamental tenant that all men are equal before the law into bills of human rights that are enforceable by citizens against the state.

It is a laudable Bill of Rights that argues that all people are entitled to food and sustenance together with a home provided with water, electricity and sanitation but it is demonstrably unworkable to extrapolate that sentiment into a fundamental expectation that the state shall somehow provide such things for all of its citizens within a given period of time. South Africa set out to do just that and prides itself on the fact that since our transition to democracy in 1994 the State has been able to build 1.5-million homes. What is not recognised in that statement is the fact that after 19 years of laudable effort there are now more homeless people than there were before the project began.

Another of our exercises in futility was to recognise that everyone has the right to employment and then, since the State patently cannot directly create jobs for all the unemployed, to substitute a "social wage" in the form of the dole which 19-years on is now consuming six out of every ten taxpayers' Rands and while the cost to the State is rising unsustainably, there are now countless more unemployed people than there were in 1994.

The problem is that once instituted, it is nearly impossible to imagine the State ending the dole. Notwithstanding its current overwhelming parliamentary majority, it is a racing certainty that were the State to try to end or even rein back its monthly payments to nearly half our population the very least result would lead in very little time to the overthrow of the ANC.

Now while it is undoubtedly true that nations that have provided the dole for lengthy periods have created an underclass that no longer understands the meaning of proper employment, there can be little doubt that the vast majority of unemployed people would like nothing more than gainful employment. And countless studies have illustrated that by far the most cost effective means of creating jobs for everyone is to nurture a business-friendly government.

The problem in South Africa, and we are by no means unique in grappling with the political hangovers from a radically different past, is that we are diverting so much money towards appeasing the unemployed that resources that might otherwise have provided the seed capital for entrepreneurship are simply unavailable or too expensive. Ironically, however, we live in an era in which money is arguably cheaper than it has ever been because central banks have been manipulating borrowing rates in a vain

attempt to stimulate the planet out of the deepest recession since the Great Depression of the 1930s.

Unfortunately, in South Africa's case, our interest rates are being held at impossibly high levels; something we are obliged to do because only by offering abnormally high rates are we able to counter foreign investors natural reluctance to lend money to a country whose sovereign rating is well below that of the world's leading nations. And why do we need to stimulate overseas investors to send their money here? Well simply because as a nation we continue to spend far more on our imports than we earn from our exports.

And what are we importing. Well while it is true that we are importing machinery with which to build two massive coal-powered generating stations that will significantly add to the planet's global warming problems, we also import millions of Rands worth of clothing, electronics and other consumer commodities which we could very well manufacture ourselves if we did not institute minimum wage restraints which guarantee that local manufacturers cannot compete with their counterparts in Asia. Sadly, though clothing workers would be happy to work for less on the basis that any job is better than no job at all, clothing companies are closing. Currently 237 factories that are unable to comply with the Government's minimum wage legislation face closure threatening to put 14 000 workers out of work.

Since 1994 200 000 jobs have been lost in the clothing and textile industry and 500 000 mining workers have lost their jobs. Hundreds of thousands more have lost their jobs in a wide swathe of industries that flourished in South Africa before the ANC government ended the tariff barriers that previously protected them from cheap foreign imports.

Infinitely compounding the problem in terms of lost employment potential, soon after they came to power the ANC government inexplicably closed dozens of technical and agricultural colleges, and artisan apprentice systems, which might have turned millions of low and unskilled blacks into electricians, plumbers and welders.

Furthermore, immediately after assuming power, the ANC government launched a voluntary retrenchment programme for teachers – which some of the best teachers took before leaving the profession – and closed down teaching colleges. Often these teaching and technical colleges were in rural areas where they were a crucial pillar of the local economy, and their closures blighted their localities. The subsequent collapse of our education system has been well documented with its degeneration to the stage that it is now rated by the World Economic Forum as 140th out of the worst 144 schooling systems in the world. It is hard to get much worse than that!

Is there a solution for South Africa's problems which also offers solutions for economic-chaos-gripped Greece, Cyprus, Spain, Ireland and a host of other countries which have so far failed to grasp the new realities of a globalised planet? Yes there is. It requires the simple recognition that the internet with its ability to move information right around the planet in split seconds – and here read money movement as well – together with the globalisation of world trade has severely limited the powers of governments to dictate economic policy.

Times was when by tweaking interest rates the central banks of countries could stimulate or slow their economies, but since the 1990s when the US Federal Reserve began printing money in a largely successful bid to cover up the cracks of the then Asian and Mexican monetary crises, followed on by merchant banks' uncontrolled use of derivatives which enormously multiplied the amount of money and virtual money sloshing about the planet in tidal wave proportions, the efforts of individual central banks were dwarfed into insignificance. This view is no better proved than by the story of George Soros who has become known as the man who broke the bank of England.

Here a quick history lesson is necessary. In 1979 in preparation for the creation of the European Monetary Union the then member nations progressively did away with exchange controls and awarded each country a fixed exchange rate with fluctuation bands within which each was obliged to adhere. The system appeared to work for over a decade but in late 1992 hedge fund manager George Soros realised

that Britain's weak economy and high unemployment rate would not allow it to remain for long in its allotted fluctuation band and began betting against the pound. At first Britain tried to defend its exchange rate using up its reserves to buy in 15-billion pounds. But Soros and his imitators continued selling the pound and on September 16 – which was to become known in financial circles as "Black Wednesday" – the Bank of England announced a 2 percent rise in interest rates from 10 to 12 percent in an attempt to make the pound more attractive to bond investors. A few hours later the rate was raised again to 15 percent. But traders kept selling pounds in huge quantities and by late the same day the then Chancellor of the Exchequer was obliged to announce that Britain was to leave the ERM and that interest rates would return to the original 10 percent.

In the aftermath the Pound sank in value by 15 percent against the German Mark and 25 percent against the US Dollar and in the process Soros' Quantum Fund raked in a two-billion pound profit. More importantly that event signalled to central bankers everywhere that the days of fixed currency parities were over and that their ability to influence the value of their currencies was also effectively over.

Which raises the question as to why South Africa South Africa persists against world best practice to uphold artificially high interest rates in order to achieve a continued inflow of short-term investment capital which in turn makes the Rand artificially strong which in turn encourages the self same imports that are the cause our balance of trade problems. Furthermore our high borrowing costs discourage local manufacturers from entrepreneurial activity and make it impossible, when coupled with an artificially strong rand, for exporters to compete in the outside world.

Why, furthermore, do we persist with minimum wage restraints which also make it impossible for local manufacturers to both create jobs, replace imported goods with locally manufactured goods and similarly reduce our balance of trade problems?

We have either to recognise that if we want to artificially control the wages that employers must pay and thus render them uncompetitive in the world marketplace, then then we must simultaneously apply import tariff protections to those industries products or otherwise accept that these businesses will be obliged to close with the consequent loss of jobs. We cant have it both ways

These are just some of the unintended consequences that arise when governments interfere with the free market system. South Africa today is almost a laboratory exercise illustrating all the wrongs that arise when misguided politicians set about changing the natural order of things without the ability to recognise all the likely consequences. All of which takes me back to my original statement that it is time for a new dispensation that curbs the controlling hands of the politicians and ushers in a new Belle Epoque: wishful thinking perhaps to expect the political class to step aside when, demonstrably, election to political office offers status, power and wealth. The world cannot for much longer continue papering over the cracks when our distorted global economic situation is stretching to breaking point. It would be better that mankind find an orderly way of retreating from over-regulation lest total collapse leads to chaos.

THE 10-Minute Millionaire

The richest person on the planet

In the previous issue I explained how, by drawing a simple trend line linking as many graph turning points as possible on a logarithmic graph of the ShareFinder Blue Chip Index one could achieve an effective guide to the best buying opportunities.

And of course the same approach applies to any share you might be interested in buying. I offer a copy of such a graph above. Whenever the index fell below the trend line that would offer a buying opportunity and we thus determined that buying opportunities happened approximately once every 20 months.

In order to determine an effective investment strategy for someone who was earning R120 000 a year in 1986 and saving 10 percent, I created the table below. I also increased our investor's income by a fixed annual amount of 7%. The monthly savings were then accumulated until each time the index fell to its lowest point below the trend line as noted in the "Buy Date" column and the money was used to buy the index at whatever value it stood on such dates.

If you consider the table below you will see that over the 25 years we made 15 buys and, overall, invested a total sum of R544 314.50 which enabled us to buy a total of 8 720 units which at the end of the period of observation were in total valued at R1 357.61 each.

Thus we might calculate that the total value of this investment grew to total R11 830 198. At the time of writing the average dividend yield of the ShareFinder Blue Chips was 3.2% which implies that such an investment would provide an annual income of R378 566 which would be equal to 80% of our investor's annual salary at the current time.

Now it is important to note at this stage that I would not normally recommend that one attempt to buy the ShareFinder Blue Chip index as a whole. I created this latter exercise in order to illustrate the effectiveness of using a regression line overlain on a logarithmic graph as a super simple buying guide and used the ShareFinder Blue Chip Index as a proxy for the individual shares which one would normally buy using the Super Simple Rules I have previously outlined.

Salary	**Saved**	**Buy Date**	**Price**	**Units Bought**	**Value**
120000	12000	Jun 1986	6.7	1791.04	
132000	22000	Feb 1988	10.62	2071.56	
141240	62381	Jul 1991	34.91	1786.91	

		2			
151127	17631	Sept 1993	41.6	423.82	
211963	90773	Sept 1998	69.25	1310.79	
226800	22680	Sept 1999	119.16	190.33	
242676	14156	April 2000	145.36	97.39	
259663	36786	Sept 2001	134.11	274.30	
277840	13892	March 2002	133.279	103.83	
297290	29730	March 2003	156.294	189.44	
318100	31810	March 2004	231.213	137.63	
340366	36873	April 2005	392.3	93.99	
364192	42490	June 2006	532.54	79.79	
416963	81370	July 2008	661.67	122.98	
446150	29743	March 2009	638.213	46.61	
477380	544314.5			8720.4	11 830 198

One could, however, use a market tracker unit trust like the Satrix 40 which is similar. But do note that if you were to opt for this approach, the Satrix has grown at a far more modest compound annual rate of 10.1 percent since its inception ten years ago. Indeed, the best unit trust performer over the past decade has been the Sanlam Industrial Fund which has achieved compound 14.02 percent which is in turn a tiny fraction of the 24.6% compound annual average growth rate achieved by the Blue Chip Index throughout the past 25 years. So I would strongly urge everyone to rather employ my Super Simple Rules to select a share portfolio which will both offer you the safety of spreading your money over a series of high quality shares, and the advantage of a very high capital growth rate over an extended period.

That said, however, buying the Blue Chip index would have done very well for our investor. I have shown that by investing a tenth of your income over 25 years you can create enough to retire on. Furthermore, if you were to decide after 25 years that you had accumulated enough money to retire, you could stop at that point and, noting that share dividends are taxed at a far lower rate than other forms of income, you would by this means enjoy an income greater than you would by continuing to work and drawing a taxable salary.

More importantly, assuming our dedicated hypothetical saver had started work and started saving at the age of

20, he would at this stage be a mere stripling of 45. With the advantage of such a tax-reduced income he would be liberated to start a second career without having to worry about the constraints of working for an income. Furthermore, since the money would have been invested in shares, it could be expected to continue growing year by year and more than adequately compensating for the erosion of inflation.

To illustrate this latter point, I have created another table to show what would have happened to the capital if it had remained invested in the Blue Chip Index for the next 25 years.

Year	**Compounding at 24.6%**	**Dividend at 4%**
26	11 830 198	473 208
27	14 740 427	589 617
28	18 366 572	734 663
29	22 884 748	915 390
30	28 514 396	1 140 576
31	35 528 938	1 421 158
32	44 269 057	1 770 762
33	55 159 245	2 206 370
34	68 728 419	2 749 137
35	85 635 610	3 425 424
36	106 701 970	4 268 079
37	132 950 654	5 318 026
38	165 656 515	6 626 261
39	206 408 018	8 256 321
40	257 184 390	10 287 376
41	320 451 750	12 818 070
42	399 282 881	15 971 315
43	497 506 470	19 900 259
44	619 893 061	24 795 722
45	772 386 754	30 895 470
46	962 393 896	38 495 756
47	1 199 142 795	47 965 712
48	1 494 131 922	59 765 277
49	1 861 688 375	74 467 535
50	2 319 663 715	92 786 549

So you can see that by the time our investor had reached the age of 70 in year 50 of the investment scheme he would be worth R2.3-billion and be enjoying an annual income of R92.7-million…..I rest my case.

Finally, however, you might wonder what would have happened if you applied the same compounding effect to our Super Simple Portfolio? At 57.6% compound it would have grown to an unimaginable R652-trillion making you by far the richest person on this planet. But do realise that we have extrapolated the startling growth achieved by this portfolio over two years. In reality it would have slowed over time to something closer to the Blue Chip Index rate.

Continue reading on the next page below…

By Invitation – Dr Cees Bruggemans

Our real household income is stuck in low gear, with unsecured lending also throttling back gradually, between them constraining real spending and job gains.

Business remains deeply concerned about labour force unrest, high cost increases, an uncertain political and tax regime outlook and lingering global crisis risks yet to be resolved satisfactorily, with the Italian political prospect yet to be clarified.

With our macro policies fully extended, as much fiscally (restraining the budget deficit through trimmed spending) as monetary (SARB signalling Rand and labour risks implying inflation upside), and global conditions not favourable for another commodity price boom soon, fresh steroid injections for the economy seem unlikely.

Given all that, we are at 2%-2.5% really stuck in the slow lane, by our own and fellow EM 6% growth standards.

SARB noticeably admits to downside risk to its growth forecasts due to possible overseas growth disappointment also catching us, but probably increasingly also reflecting domestic doubts (concern about labour output losses and electricity interruption). One wonders about impact of anxiety on business confidence and the balance sheet conservatism and defensiveness this may invite.

Most policymakers and analysts, however, keep to sunnier views, whether it is next year's growth prospects (always higher than the present) or what will follow well laid plans longer term (even though there is a long history of disappointment).

The government has now nailed its colours fully to the National Development Plan mast (2012), as it also successively did to the RDP (1994), GEAR (1996), Asgisa (2006) and the New Growth Path (2010).

These were all grandiose plans, Big Picture stuff and Blue Sky thinking, aimed to get the economy off its low growth trajectory and breaking the structural logjams.

Yet the economy simply meandered onward all these years, not doing too much in slow global years, catching spirit in global commodity supercycle eras, reinforced by soccer-based infrastructure booms and further credit-leveraged by speculative private binges, laid low by global crisis-cum-recession setbacks but pulled along again by global rescue efforts.

The only real policy contribution made throughout these decades was the retention of macro discipline (as opposed to adventuresome throwing of the rudder as so desperately demanded by many), after 1998 rigidly following a non-intervention policy regarding the Rand (allowing capital flows and economic conditions to set realistic Rand terms and preventing disruptive imbalances from accumulating) and providing anti-cyclical fiscal and monetary support during crisis conditions.

Throughout, the economy had to fall back on its own wits, its quality assets and the people manning them, accumulated with great effort during our 150 year drive to economic maturity, to keep producing, consuming, planning, scheming and expanding while adjusting to bureaucratic burdens, disruptive technical and social changes and higher labour and infrastructure costs.

Strife there has been throughout among the political Alliance partners, and today isn't any different. Cosatu position papers express deep suspicion about the ultimate intentions with the National Development Plan, admitting disappointment that a more radical labour agenda isn't making more progress.

But then it isn't as if the labour scene is devoid of action. With half Cosatu members reportedly believing that nothing can be achieved except through violence, with new unions making their mark (violently), and ever more workers discovering they can cut out the middleman by directly confronting employers (often violently, with survivors handsomely rewarded and non-survivors cut loose), there is no shortage of revolutionary fervour.

This is the true mark of 2013 as it was of 2012, with foreign rating agencies and investors suspiciously watching and some employers with difficulty having to sustain operations while still managing wage bills at a time when windfalls appear absent from our national menu.

Still, it can be done, and is daily as we keep growing, but it keeps the pace excruciatingly slow and prevents structural change (reducing unemployment).

Meanwhile there is something new to celebrate and focus the national energy as we play host to the BRIC countries with new initiatives potentially on view.

There is possibly much in play here.

As the smallest BRIC member, with an economy 1/20 China's and a population 1/25 India's and foreign reserves 1/100 the combined BRIC firepower, but with ambitious infrastructure wish lists exceeding 100% of GDP, yet experiencing a major saving shortfall of over R220bn of GDP annually (as per our current account deficit of 6.5%), we have much to be humble about.

Yet all this insignificant smallness also creates its own opportunities, especially as we supposedly are the richest endowed commodity country in the world (85% of which represented by platinum deposits yet to be mined).

One can see some useful leverage here.

There is presumably collateral galore in our rich mining deposits. These and greater Africa's commodity riches could be the real draw card for some of the resource poor foreign visitors, while Africa's large and growing population steadily gaining real income is yet another consumer market of the future, as well as adding critical mass to the other BRICs in global political forums.

And not forgetting our rich construction contracts to be had, which for the suppliers would be strategic exporting by another name.

Meanwhile, our BRIC partners could make our lives so much easier by playing IMF-without-the-strings when we need it most (as during a sudden-stop capital reversal) and by playing a generous World-Bank-equivalent for our many infrastructure ambitions supplementing other sources.

For the one purpose we need a safety net sharing foreign reserves in an emergency pool (and $5 trill of BRIC reserves should comfortably protect us during all imaginable eventualities, unlike our own rather limited $50bn forex reserves).

The same pool of money could easily provide some seed capital for a BRIC infrastructure development bank, it in turn leveraging up in global financial markets (but primarily China's, basically an export-financing facility by another name), with its likely triple-A rating ensuring attractive terms.

Indeed, one can see a potential wave of construction contracts, especially if these can be undertaken on the back of China's mammoth expansion efforts, thinking high-speed passenger trains (Durban?), fleets of nuclear power stations (despite a cheaper gas fracking revolution probably shortly) and possibly state-of-the-art oil refineries and steel mills.

Would all such projects be strategically needed? Would it amount to mortgaging the nation's limited foreign leverage potential? And who would benefit most?

As to our awkward labour scene, one should think deep and long. Perhaps the inconvenience may blow over but meanwhile it is for employers to ensure sustainable operations while mostly being price takers rather than price makers in their final product markets.

That doesn't allow much scope for generosity and puts jobs at risk.

Continue reading on the next page below…

Is there an investment bubble on the JSE?

By *Andrew Dittberner who is a Senior Investment Manager at Cannon Asset Managers*

It may beat the previous decade's construction and resource bubbles.

Using Cyclically Adjusted Price Earnings (CAPE) ratios, Cannon Asset Managers notes that some equities are massively overvalued, and an investment bubble has formed in Large Cap Industrials and cash retailers, while others sectors of the market have become very keenly priced. This bubble is larger than the construction bubble of the mid 2000s, and the resource bubble of 2007 to 2008.

The CAPE ratio uses a seven-year earnings number to get the "DNA" or through-the-cycle earnings of a share, sector or market, as opposed to last year's earnings (which can be very volatile and driven by near-term economic conditions) when valuing a business. Using CAPE ratios is a far more sensible way of valuing an investment than any method based on just one year's worth of earnings.

We have divided the domestic equity market into five quintiles according to their CAPE ratio, with Quintile 1 being the attractive stocks (low CAPE = Value stocks), and Quintile 5 the expensive stocks (high CAPE = Growth stocks). There are some outliers on the low and high side, hence binning the data into quintiles makes for more sensible analysis in understanding valuations.

The following graph shows the dispersion of valuations between stocks in South Africa. The black line (Quintile 5) represents the lowest CAPE ratio (the most expensive 20% of stocks on the JSE), while the green line (Quintile 1) represent the highest CAPE ratio (the most-attractively priced 20% of stocks). The remainder of the market – 60% of shares – lies between the two lines in terms of valuation.

Chart 1: CAPE Valuation Dispersions on the JSE ALSI (160 shares)

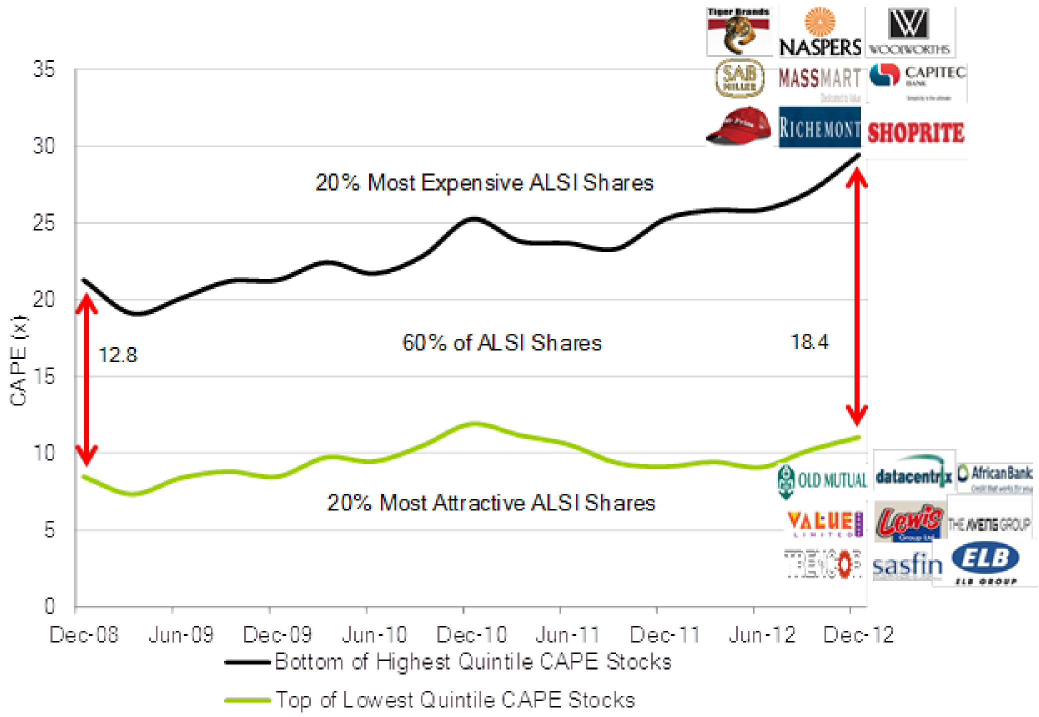
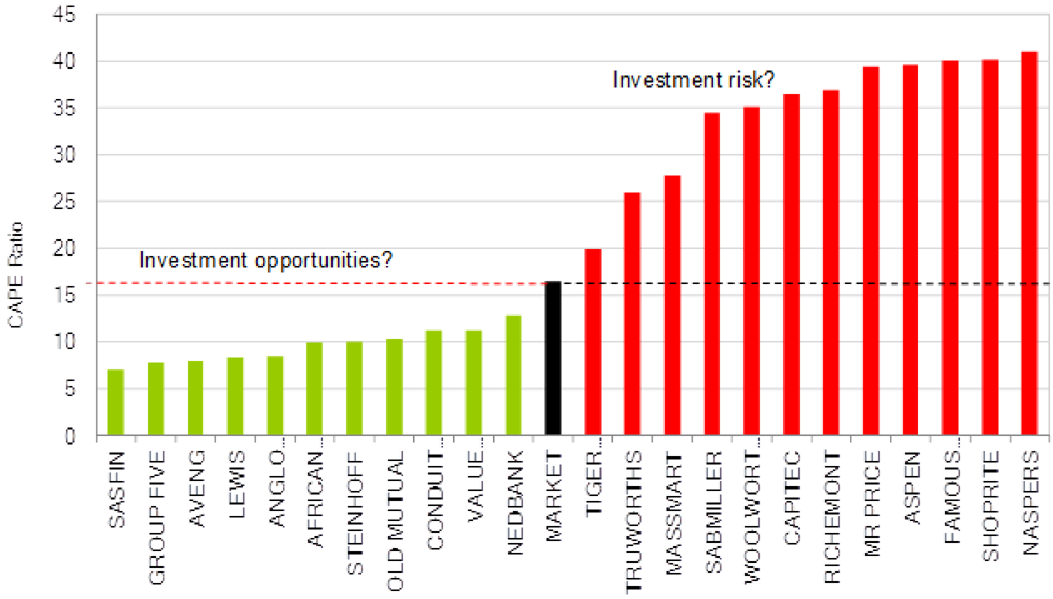


Chart 1 of the CAPE valuation dispersions on the ALSI shows the bubble-like run up of expensive stocks in the last two years. It should come as no surprise that it is mostly resource stocks that make up Quintile 1. The valuation dispersion between Quintile 1 and 5 is currently in excess of 18.4 times.

The rising valuation gap shows that growth stocks have become a staggering 40% more expensive relative to value stocks in the last four years. The lower quintiles look very attractive with CAPEs in the early double-digits, but with Quintile 5 starting at a CAPE ratio of almost 30 times, alarm bells should be ringing.

These expensive growth stocks represent clear investment risk, while the value stocks represent clear investment opportunity. Chart 2 shows just how expensive some of current highflyers are.

Chart 2: Selected Stock Valuations



While many of the bubble-like stocks are indeed great businesses, they are incredibly expensive. And it’s always easy to find reasons to buy expensive stocks at any stage, but don’t be fooled by their growth prospects. Remember construction stocks in 2007, when stratospheric valuations were well “justified” by their growth prospects, to only be decimated when the bubble burst. At the height of that bubble, Aveng was on a CAPE of 44 times, Group 5 at 39 times, Murray and Roberts a whopping 58 times and WBHO 54 times. Among the largest 40 stocks on the JSE (Chart 3), the valuation dispersion is even more immense, having nearly doubled to an off the chart 22.2 in the recent past. Large Cap Growth shares have essentially become a staggering 90% more expensive relative to Value shares.

Chart 3: CAPE Valuation Dispersions on the JSE Top 40

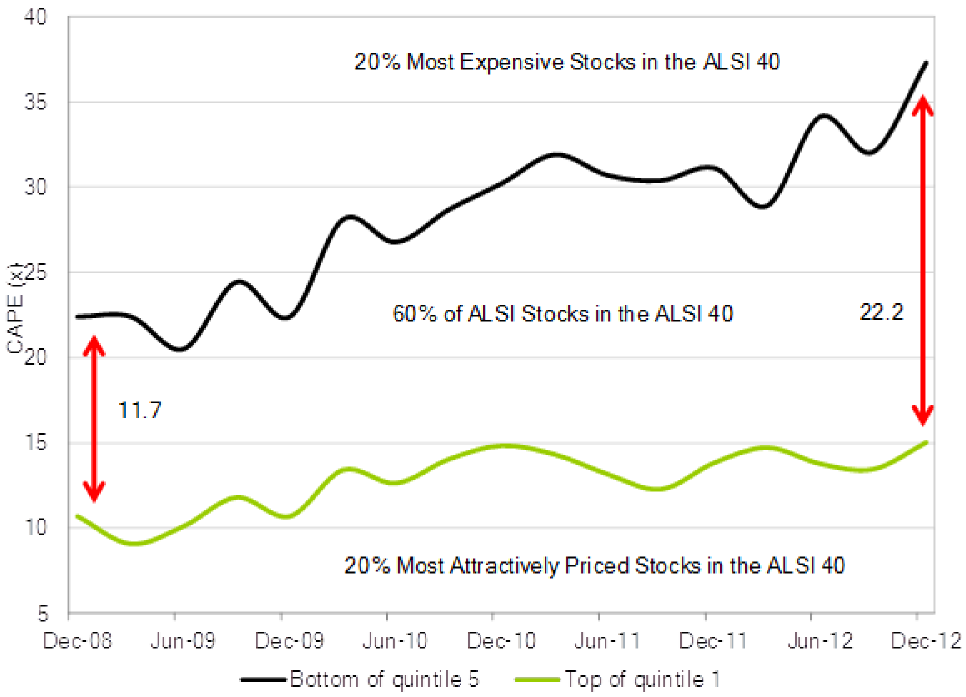


Chart 3 above has just eight stocks per quintile, being the Top 40. We know that resources have been under enormous price pressure recently, and financials have performed reasonably but are fairly priced generally. Therefore, this chart points to the dangerously elevated multiples within large industrials. Despite the overwhelming value in the resources sector, investors still need to exercise caution in terms of the specific counters purchased and to what extent.

Across different time frames and in various markets around the world, history has demonstrated consistently that anything above a CAPE ratio of 16 times is expensive. The market as a whole currently is on a CAPE ratio of 16.2 times, "fairly" priced. However, this aggregate is comprised of highly expensive stocks, as well as stocks that are very attractively priced.

Consider that the fair CAPE ratio for equities is 16 times, and the more expensive counters within the Top 40 are more than double this. Table 2 shows the CAPE ratio for Quintiles 1 and 5 of the Top 40 stocks. It shows the stark difference in valuations across the quintiles.

Table 2: Quintile 1 (cheapest stocks) vs Quintile 5 (most expensive stocks) of the Top 40

Q

Quintile 1	CAPE (x)
ANGLO AMERICAN PLC	8.2
STEINHOFF INTERNATIONAL	9.6
OLD MUTUAL PLC	10.4
IMPALA PLATINUM	10.4
INVESTEC LTD	10.5
SASOL LTD	10.7
ABSA GROUP LTD	11
STANDARD BANK GROUP LTD	11.3
Quintile 5	CAPE (x)

MEDI-CLINIC CORPORATION LTD	31.3
SABMILLER PLC	34.8
WOOLWORTHS HOLDINGS LTD	35.7
RICHEMONT SECURITIES AG	35.9
MR PRICE GROUP LTD	37
ASPEN PHARMACARE HOLDINGS	39.2
SHOPRITE HOLDINGS LTD	40.9
NASPERS LTD N	41.2

The multiples on the expensive stocks are not sustainable, given that they will need to maintain very high levels of earnings growth to justify such valuations. As some of these companies' earnings begin to disappoint investors, they will suffer the risk of investor selloffs. Large caps are expensive as an aggregate therefore you want to avoid the Quintile 5 stocks in general.

One interesting aside to the above is that whilst the price action of these stocks has pushed the JSE to new highs, they have also masked some of the tremendous value opportunities that are available in other areas of the market at the moment.

It should be noted that the CAPE ratio is just one valuation tool that Cannon Asset Managers uses. In looking for balanced evidence of value in a stock we assess ratios such as PE, price:book, DY, forward PE and price:sales, and not just the CAPE ratio.

However, using CAPE ratios it is evident that a considerable gap exists between expensive stocks and those more modestly priced. Investors can utilise this gap to their advantage.

New York Viewpoint

by Gary D. Halbert

Continue reading on the next page below…

On Friday, the US Labour Department reported that the Consumer Price Index (CPI) jumped an unexpected 0.7% in February. This was above pre-report estimates and was the highest monthly reading since 2009. We should be very concerned, right? Let's take a closer look.

Upon further examination, we find that if we subtract food and energy from the CPI, the cost index rose only 0.2% last month. It turns out that most of the big increase in the CPI last month was due to the sharp rise in gasoline prices. The experts tell us that due to the volatile nature of oil and gasoline prices, we shouldn't include energy in the CPI. Ditto for food prices which can also be quite volatile.

I have always argued to the contrary, that food and energy prices do indeed need to be considered in the CPI. Think pocketbook: if gas prices rise $1.00 per gallon, and you have to fill up once a week, and it takes 20 gallons to fill up your car, then you have $20 less to spend on something else that week, or $80 less per month. Not good for the economy.

Some others disagree with me, arguing that you spend the same amount each month, and that if you spend more on gas, then you spend less on other things, but the overall economy gets the same amount of money from you one way or the other. Both points are valid.

But if you are trying to measure the true inflation rate, I maintain that food and energy should be included. Apparently the government agrees with me since they continue to report the headline Index including food and energy, and secondarily report what the Index was without food and energy.

The real question is whether or not the Consumer Price Index is really indicative of the actual inflation rate. I will argue that it is *not* a very good indicator with, or without, food and energy. At the very least, the CPI is controversial.

Why the CPI is So Controversial

The Consumer Price Index (CPI) is produced by the US Department of Labour's Bureau of Labour Statistics (BLS). It is the most widely watched and used measure of the US inflation rate. For years, there has been controversy about whether the CPI overstates or understates inflation, how it is measured and whether it is an appropriate proxy for inflation.

Originally, the CPI was determined by comparing price changes in a fixed basket of goods and services. Determined as such, the CPI was a cost of goods index (COGI). Over time, however, the US Congress embraced the view that the CPI should reflect changes in the cost to maintain a constant standard of living. Consequently, the CPI has been moving toward a cost of living index (COLI).

Over the years, the methodology used to calculate the CPI has also undergone numerous revisions. According to the BLS, the changes removed "biases" that caused the CPI to overstate the inflation rate. The new methodology takes into account changes in the quality of goods and "substitution." Substitution is the change in purchases by consumers in response to price changes, and this alters the relative weighting of the goods in the basket. **The overall result tends to be a lower CPI**.

Critics view the methodological changes and the switch from a COGI to a COLI focus as a purposeful manipulation that allows the government to report a *lower* CPI. Most critics prefer that the CPI be calculated using the original methodology based on a basket of goods with fixed quantities and qualities. Doing so can result in a significantly higher inflation reading.

On Friday, the BLS reported that the CPI rose only 2.0% over the last 12 months. Economists using different methodologies (including the original methodologies) estimate that the real US inflation rate over that same period was anywhere between **5%** and **8%.** That's a huge difference!

If Inflation is 2%, Why Are Prices Up So Much?

I read a good article last week from TIME Business & Money columnist Michael Sivy. He pointed out that his printer ran out of ink recently, and he was "shocked" to find that the same printer cartridge had gone up in price by **25%** in less than a year.

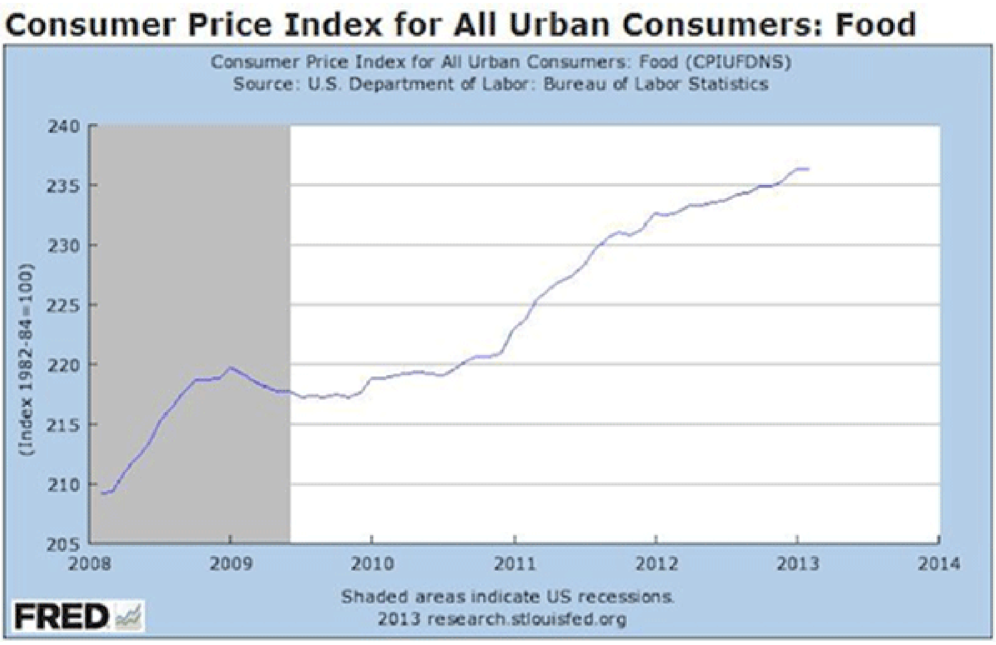
While the government's CPI has averaged only 2% since the end of the Great Recession in early 2009, many basic commodities have soared since then. Gold was $930 an ounce when the recession ended, and today it's just over $1,600. That's an increase of 70% in four years, or an annualized rate of over 14%.

Of course, that's just one commodity. How about a broader measure? The Reuters CRB Commodity Index, which tracks the prices of energy, coffee, cocoa, copper, cotton, etc. is up 38% over four years, or 8.6% at a compound annual rate.

The price of gasoline has gone up from $2.60 a gallon when the recession ended to around $3.70 today nationally. That's a 41% increase in four years, or an annualized rate of 9%. Taxes have gone up almost as much. Federal, state and local income taxes have risen 35% over four years, an annualized rate of 7.8%.

Then there's the so-called ***"Big Mac Index"*** that was popularized by *The Economist* some years ago. McDonald's hamburgers are available in many countries and their prices reflect the cost of food, fuel and basic labour. The price of a Big Mac, therefore, can be yet another indicator of inflation in a particular country. Since the recession ended, the cost of a Big Mac in the US has risen from an average of $3.57 to $4.37, or 5.2% a year.

As the main grocery shopper (and cook) in our family, I am reminded several times a week how food prices continue to go higher. Take a look at this chart from the St Louis Fed.



And while we're on the subject of food, have you noticed how many manufacturers reduce the size of the containers and/or packages so as to reduce the enclosed amount – but still charge the same price as before? I know I'm not the only one!

Severe Drought Led to Higher Food Prices

Forecasters lay much of the blame for higher food prices on the drought that swept through much of the US last year, and is continuing this year. Last year's severe weather put nearly 80% of the continental United States in drought conditions – the worst in 50 years. Particularly hard hit areas include the Midwest states of Illinois, Iowa, Minnesota, Nebraska, Kansas, as well as Oklahoma, Texas, Arkansas and many parts of Colorado and California.

The drought damaged key crops like corn, wheat and soybeans while driving up commodity prices and forcing farmers to scramble to find feed for livestock. Farmers and ranchers have had to cut back on the number of livestock and poultry in order to limit their own costs, which created a shortage of beef, chicken and pork.

Although conditions have improved in some areas, roughly 61% of the country still suffers from drought, which remains at its worst levels in more than a decade, according to the US Drought Monitor.

On a personal note, we are fortunate to live on beautiful Lake Travis, just outside Austin. Lake Travis is a Corps of Engineers man-made lake, and it supplies water for hundreds of thousands of area residents and countless businesses in Central Texas. As such, the lake level varies significantly, depending on the amount of rainfall we receive each year.

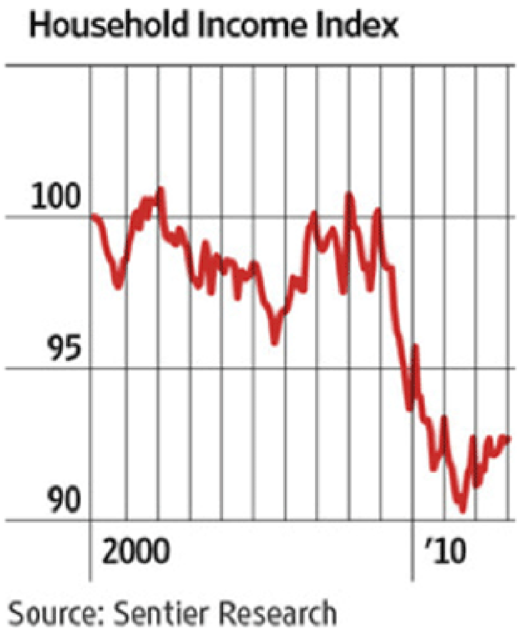
The drought in Central Texas is in its third year. Lake Travis, which is 65 miles long and over 200 feet deep in places, is now only **40% full** (or 60% empty). As the water level falls, we have to push our dock out further and further to keep it in the water. A trip down to the dock is over 125 steps (one way)!

So How Is the CPI at Only 2%? It's Not.

As we've seen above, the prices of many things that consumers buy on a regular basis have risen much faster than the CPI. So how can the CPI be at only 2%? And how could it have averaged just 2% since the end of the Great Recession four years ago?

Some argue that it's because wages are down, and with the economy so weak, workers can't demand higher pay to make up for their increased cost of living. Indeed, that's one of the factors causing the decline in real after-tax household income.

Real median annual household income in January of this year was $51,584 – or 92.7% of the level in January 2000. Incomes inched up early in 2012 but have been treading water since May, according to the **Household Income Index.** While household income ticked up slightly in the past year, it remains well below the $54,008 level seen at the start of the recovery roughly four years ago.



These are all factors influencing the economic recovery (or lack thereof) and thus the inflation rate. But they don't explain why the headline Consumer Price Index has hovered around 2% for the last four years, or why other inflation measurements are in the 5%-8% range. How can this be?

Quite simply because it's a government report that's been frequently manipulated over the last 35 years. Whether by design (my bet) or coincidence, these revisions have served to reduce the official inflation rate.

Also, keep in mind that our government has a record $16.7 trillion in debt it is paying interest on. If interest rates rise, it costs Uncle Sam more money. If inflation rises, interest rates follow. Obviously, the government has incentives to manipulate the official inflation rate lower than it really is.

The bottom line is that there is no absolute and objective gauge of inflation. Any particular measure is simply one way of making the calculation, based on a host of assumptions. We do know with certainty that a number of the costs that American households face are going up considerably faster than the CPI.

Finally, the fact that real world inflation is higher than the CPI poses challenges for investors. Investors should calculate their total required return net of the effect of inflation. As the inflation rate increases, higher returns must be earned in order to obtain a desired real rate of return.

Those who believe that inflation is only 2%, when it may be 5-8%, may be making investment decisions that are almost guaranteed to erode the purchasing power of their money over time. This is especially true with low-yielding investments such as CDs, Treasuries, etc.

Obama’s Olive Branch – “Chained CPI”?

Before we leave the subject of CPI, I think it’s important to discuss something going on right now in the budget negotiations in Washington. Over the shrill opposition of liberal Democrats, Obama has verbally offered to change the way cost of living increases are calculated for Social Security and other entitlements. Instead of the CPI now used, he said he might consider using something called the ***“chained CPI.”***

In a nutshell, chained CPI is a measure of inflation that seeks to account for substitution by consumers when prices rise. While the current CPI measure uses substitution to a small extent, chained CPI assumes that when prices rise, consumers will resort to entirely different products, rather than just seeking a cheaper brand. For example, if beef prices rise, chained CPI would assume that consumers might opt for chicken to save money.

The end result is that chained CPI is generally *lower* than the current CPI used for measuring inflation. As I noted above, the

CPI for the past 12 months was measured at 2.0%. The chained CPI for the same period was 1.8%.

If we switch to chained CPI for entitlement cost of living increases, which remains to be seen, it would mean that benefits would rise at a slower rate. Alan Greenspan recommended moving to chained CPI for Social Security back in his day at the Fed, but it went nowhere.

Liberal Democrats oppose the switch to chained CPI and demagogue it as a “war on seniors,” while Republicans feel it’s a way to save Social Security as we know it. Democrats prefer eliminating the cap on salary subject to Social Security taxation (read: increase taxes) to using chained CPI, which they view as a cut in benefits. It seems that only in a politician’s mind can a slower rate of increasing benefits be called a “cut.”

It’s still too early to tell how the current chained CPI debate will play out. This is one of those issues that hits both old and young. If chained CPI is used, then entitlement benefit increases will be lower. If it is not, then future Social Security taxes may well have to be higher. Either way, somebody’s got to pay, and it might end up being a little from both.

Hoping you stay ahead of inflation,

Gary D. Halbert

Company Reports

HYPROP 2013/03/28
reported an increase in its distribution for the year to December of 6.8%, to 409c per unit.

ACCENT 2013/03/28
reported HEPS of 6.01c for the six months to December, from a previous 6.05c.

METROFILE 2013/03/28
grew its HEPS for the six months to December by 18.8%, to 12c. An interim dividend of 4.5cps was declared.

SANTAM 2013/03/28
reported diluted HEPS of 984c for the year to December, down from the previous year's 1202c. A final dividend of 410cps was declared, an increase of 15.5%.

INTERWASTE 2013/03/25
reported HEPS of 3.89c for the year to December, from a previous loss per share of 1.48c.

SECUREDATA 2013/03/25
reported adjusted EPS on continued operations for the six months to January of 0.5c, down from a previous 1.9c.

VUNANI 2013/03/25
narrowed its headline loss per share for the year to December to 11.2c, from a previous 28c.

ANDULELA 2013/03/25
expects to report a headline loss per share of between 0.06c and 0.12c for the year to December.

BATS 2013/03/25
reports that the following documents are
being mailed to its shareholders (as applicable) today, Monday 25 March 2013. Those
documents with a web?link shown will also available to be viewed or downloaded on the
British American Tobacco website as indicated:

(1) Annual Report and Accounts 2012 www.bat.com/annualreport
(2) Performance Summary 2012 www.bat.com/AGM
(3) Notice of Annual General Meeting 2013 www.bat.com/AGM
(4) Proxy Form
(5) Proxy Form – South Africa
(6) Voting Instruction Form – South Africa

HYPROP 2013/03/25
Unitholders are advised that Hyprop and Sycom Property Fund ("Sycom"), through its manager Sycom Property Fund Managers Limited, are engaged in discussions regarding Hyprop's investment in Sycom. Any agreement resulting from these discussions would involve the current litigation being withdrawn on the basis of a mutually acceptable settlement being reached. In light of the above, unitholders are advised to exercise caution in dealing in their Hyprop units until a further announcement is made.

PALLINGHURST 2013/03/22
reported a loss per share of 6 US cents for the year to December, from a previous 15 US cents.

MASONITE 2013/03/22
reported HEPS of 446c for the year to December, from 138c in the previous year.

ORION 2013/03/22
reported diluted HEPS of 0.16c for the six months to December, up from zero in the previous comparable period.

SECUREDATA 2013/03/22

expects to report adjusted EPS of between 0.31c and 0.69c for the six months to January, down from the 1.9c reported in the prior comparable period. Results are due out today.

ADCOCK 2013/03/22
Ingram has received an unsolicited letter from Bidvest stating its intention to make an offer to acquire 60% of its shares by way of a scheme of arrangement. Adcock has constituted an independent committee to consider the offer.

PURPLE 2013/03/22
expects its HEPS for the six months to December to be 0.15c, from 0.74c at the interim stage last year. Results are due out on 2 April.

ISA 2013/03/20
expects to report HEPS of between 4.5c and 5.9c for the year to end February, down from the previous year’s 7c. Results are due out on 24 May.

RBA 2013/03/20
reported a headline loss per share of 0.88c for the year to December, from the previous year’s HEPS of 2.16c.

REMGRO 2013/03/20
reported a 35.1% decline in HEPS for the six months to December, to 334.4c. Excluding the effects of the refinancing of Mediclinic, HEPS would have risen 18.6% to 611.2c. An interim dividend of 145cps was declared, up 15.1%. Intrinsic NAV per share at 31 December was R182.54, up 19.6% on the intrinsic NAV at 30 June.

STEINHOFF 2013/03/06
reported a 5% increase in HEPS for the six months to December, to 173c.

STANBANK 2013/03/06
results for the year ended 31 December 2012 have
been audited by the group’s external auditors KPMG
Inc. and PricewaterhouseCoopers Inc. Their unmodified
audit report is available for inspection at the company’s
registered office.

AFGRI 2013/03/06
expects to report a decline in HEPS of between 12% and 18% for the six months to December. Results are out on 13 March.

BSI STEEL 2013/03/06
expects its HEPS for the year to March to decline by at least 20%.

BUILDMAX 2013/03/06
expects to report HEPS of between 20c and 25c for the year to February, up from a restated 5.5c in the previous year. Results are due out on 17 May.

MMIHLDGS 2013/03/06
reported core HEPS of 94c for the six months to December, an increase of 16%. The interim dividend was increased by the same percentage, to 51cps.

RMBH 2013/03/06
reported a 26% increase in normalised EPS for the six months to December, to 168.7c. A dividend of 66cps was declared, up 27% on the similar period in 2011.

MTN-GROUP 2013/03/06
reported diluted HEPS of 1082.4c for the year to December, an increase of 2.1%. A final dividend of 503cps was

declared, while subscriber numbers rose by 15.1% to 189.3m.

RMBH 2013/03/06
RMBH continued to build on the strong base of the previous year and produced excellent results for the six months to 31 December 2012. RMBH achieved normalised earnings per share of 168.7 cents (R2.4 billion), an increase of 26% on the previous period. This outcome was driven by excellent results from FirstRand which continued to benefit from strong
performances in all franchises. The interim dividend of 66.0 cents per share increased 27% compared to the comparative period.

PINNACLE 2013/03/06
Shareholders are advised that the Company is pursuing the possibility of issuing a corporate bond in the initial amount of approximately R250 000 000, depending on market conditions. The proceeds of the bond will be used to replace the existing short term funding of the rapidly expanding finance lease book in Centrafin (Pty) Ltd, the Company's financial services subsidiary, and to fund future growth of that book. The term of the bond is expected to be a maximum of three years.

FIRSTRAND 2013/03/05
reported diluted normalised EPS of 128c for the half year to December, an increase of 25%. An interim dividend of 55cps was declared, also an increase of 25%.

CAPITEC 2013/03/05
expects its HEPS for the year to end February to increase by between 32% and 36%. Results are due out on 27 March.

MERAFE 2013/03/05
saw its HEPS for the six months to December fall to 5c from 6c previously.

CAPEVIN 2013/03/05
grew its HEPS for the six months to December by 16.1% to 29.6c. An interim dividend of 10cps was declared, up 6.4% on the similar period last year.

PETMIN 2013/03/05
reported a 16% decline in EPS on continuing operations for the six months to December, to 5.22c.

AFROX 2013/03/01
reported HEPS of 91c for the year to December, just below the previous year's 91.6c. A final dividend of 18cps, bringing the total for the year to 45cps, unchanged from 2011.

LITHA 2013/02/28
reported diluted HEPS for the year to December of 4.9c, down from a previous 22.1c.

HYPROP 2013/02/28
has declared a total distribution for the year of 409 cents per combined unit, an increase of 6,8% on the previous year and in line with forecast.

The final distribution of 211 cents per combined unit reflects growth of 4,5%, compared with the corresponding period in 2011. Distributable earnings in the second half of 2011 included a once-off benefit amounting to 3,7 cents, which impacted relative growth in the second half of 2012. Excluding the once-off benefit, second half growth in 2012 was 6,4%.

MASSMART 2013/02/28
reported HEPS (before Walmart transaction costs and forex moves) for the 26 weeks to 23 December 2012 by

5.3%, to 424c. A final dividend of 275cps was declared.

LIBERTY 2013/02/28
grew its BEE normalised HEPS for the year to December by 38.8% to 1328.3c. Dividends totalling 528cps were declared for the period, up 10% on 2011.

CLICKS 2013/02/28
The Company announces that an agreement has been entered into in relation to the purchase of its shares by a subsidiary company during its closed period. The closed period will commence on 28 February 2013 and is anticipated to end on 25 April 2013, when the Clicks Group interim results are scheduled to be published. The maximum aggregate consideration payable for the shares to be repurchased is R50 million.

The mandate in the agreement is for an irrevocable, non-discretionary programme to purchase the Company's shares. Any purchase will be effected within certain pre-set parameters within the limits of the programme and the Listings Requirements of the JSE Limited.

BATS 2013/02/28
BAT delivered strong profit growth in 2012, achieved through good pricing and an outstanding improvement in operating margin, partially offset by adverse exchange rate movements. Despite the difficult trading conditions in many parts of the world, particularly southern Europe, these results demonstrate the Company is in excellent shape and we remain confident that our strategy will continue
to deliver superior shareholder returns.

BATS 2013/02/28
grew its adjusted diluted EPS by 7%, to 207.5p. Dividends also grew by 7%, to 134.9p a share.

CAPITAL 2013/02/28
grew its dividend for the year to December by 1% to 1.5p a share. Underlying EPS was 1.8p, up from 1.4p previously.

MMIHLDGS 2013/02/27
Trading statement in terms of the JSE Listings Requirements

MMI will be releasing interim results for the six months ended 31 December 2012 on 6 March 2013.

Shareholders are advised that the group`s statutory diluted earnings per share and diluted headline earnings per share are expected to be between 85 and 100 cents per share for the six month period, an increase of between 60 and 80 percent on the comparative results. Diluted core headline earnings will be between 90 and 100 cents per share, an increase of between 10 and 20 percent.

Core headline earnings are a measure of performance used by MMI in addition to earnings and headline earnings. Core headline earnings are regarded by the directors of MMI as an appropriate measure of longer-term operational performance, given that items of both a once-off and an inherently volatile nature are eliminated. These include changes to the valuation basis, investment variances, fair value movements on shareholder assets, secondary tax on companies and the amortisation of any intangible assets recognised due to business combinations.

The financial information on which this trading statement is based has not been reviewed or audited by MMI`s external auditors.

GROWPNT 2013/02/27
reported a 7.2% rise in distribution for the six months to December, to 72.7c a linked unit.

INTU 2013/02/27
(formerly Capital Shopping Centres) reported underlying EPS of 16.1p for the year to December, from 16.5p previously.

GRANPRADE 2013/02/27
reported adjusted HEPS of 15.86c for the six months to December, an increase of 12.3%.

MMI 2013/02/27
expects to report diluted core HEPS of between 90c and 100c for the six months to December, an increase of 10% to 20%.

GRINDROD 2013/02/27
posted HEPS of 121.9c for the year to December, an increase of 22%. A final dividend of 15.4cps was declared.

IMPERIAL 2013/02/27
core EPS for the six months to December grew 15% to 872c, while it increased its interim dividend by 27% to 380cps.

DIGICORE 2013/02/27
HEPS for the six months to December fell by 55% to 4.5c.

LITHA 2013/02/27
says it is considering a proposal to delist the company as part of a BEE transaction currently being considered. In addition, Litha says it expects its HEPS for the year to December to fall by between 60% and 80%. The company is due to report tomorrow.

I hope you enjoyed this post

Richard Cluver
Richard Cluver Investment Services