

Mr Uncertainty

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By definition our future implies copious amounts of uncertainty. The uncertainty principle (and probability) is one of the foundations in quantum physics. It basically says that not all properties of a quantum particle can be measured with unlimited accuracy.

Our macro world and South Africa in particular is uncertain. Consider the influx of immigrants into Europe and a turbulent election process in the United States. Nothing can really make our future more certain – there is no remedy for uncertainty. Generations have always had to deal with degrees of uncertainty, right? And at times when things seem to be certain, it isn't...

The first quarter of 2016 has been a real roller coaster ride in many respects. Think financial markets, the Rand and politics. Thanks to the shenanigans of our dear president and his government, the mainstream media has had no shortage of attention grabbing headlines. It was interesting to follow the popular opinion that seems to suggest that Zuma's demise would somehow resolve all of South Africa's ills overnight. Of course nothing could be further from the truth. So, given the current investment environment (where uncertainty appears to be the only certainty), what are key truths?

1. We know for sure that the best determinant of future investment returns is the price you pay at inception. Many know the story of the businessman who elaborated on his acumen and success... and clearly stated that he did not make his profit when he sold anything, but when he bought it! The moral of the story: always insist on discount.
2. We know for sure that the true worth of a business or company doesn't fluctuate wildly on a daily, weekly or monthly basis, though the share price that are traded on a stock exchange may do so. Why would a large company like Remgro, or Berkshire Hathaway (that have been in business for decades), be worth a different price from one day to the next? Isn't it based on sentiment and/or future expectations? Strangely, property investors don't receive an investment statement each month and hence they aren't reminded about how much their asset is worth. But does it really matter? Shouldn't all investors rather focus on the investment income and its ability to escalate over time, i.e. rising rental distributions and dividends that beat inflation?
3. We know for sure that we don't know where the South African stock market might move to in the short term. The JSE at circa 53,000 points (and despite delivering dismal returns over the previous 12 months) appears as a whole relatively expensive – the price to earnings ratio (a measure of how expensive, or cheap an investment is) on the FTSE/JSE All Share Index is currently above its long term average.

Amidst severe market volatility (a cousin of Mr Uncertainty), it is always important to have a long-term view. Legendary value investor Benjamin Graham described financial markets – a voting machine: *"In the short run the stock market is a voting machine, but in the long run it is a weighing machine."* What Graham meant, was that in the near term asset prices are determined by investors whose decisions (to buy, or sell) are largely driven by their emotion. Some investors decide at any point that they either like or dislike an investment. This is an emotional response usually motivated by their interpretation of news flow and the impact this has on expectations and sentiment. Graham's student, Mr Warren

Buffet stated it otherwise: *"The stock market is a device for transferring money from the impatient to the patient."*

Grexit, the Brexit and more....

"Zumit" could certainly be added to it. As the media keeps on generating taglines and headlines, investors are continually distracted by events that they have no control over – and in the process they keep on delaying sound investment decisions. So what if South Africa hits junk status? Based on the flood of stories, Grexit and Brexit must be BIG news. Take note however that government maladministration (in various degrees) repeats itself across the globe. Further, it is interesting to note that Greece is not even 2% of the entire EU economy. The question is probably to what extent does Greece's problems and Britain leaving the EU affects our financial affairs? We may consider this fact odd; however, what happens in Greece doesn't change our financial goals. It is out of our control. Yes, there may even be a financial correction, but whatever the outcome, we need to remember that our financial plan should have some flexibility to accommodate unexpected events. Maybe Greece will leave the Euro (or, maybe they won't), but please don't worry whether it will hurt a good plan and well-diversified investment portfolio.

Ignore the noise and look at the facts

So what is it that we consider when we manage your investments?

- We ignore short term sentiment (either positive or negative) that masks the real fundamental issues. Sentiment is what we refer to as noise;
- We stick to companies that have excellent management teams with a proven track record of successfully having negotiated good and bad times;
- We take our cue from what the smart money is doing – and it has been going offshore: Today more than 60% of profits generated by the top 40 companies listed on the JSE are generated outside of South Africa. This trend is gaining momentum with the likes of Truworths, Woolworths, Mediclinic, Spar and several property companies having invested their shareholders' funds abroad;
- With global and local economic growth prospects subdued for 2016 plus stubbornly high government expenditure, we are of the opinion that Treasury will battle to balance the books and we therefore expect the rating agencies to downgrade South Africa to junk by year-end. This will be negative for interest-sensitive companies such as the banks, but companies with international exposure will protect your capital in such a scenario.

Take heart, we'll survive a downgrade

Contrary to what you may think, there actually is life after a financial downgrade. While the currency, bonds and some JSE sectors (especially the banks, retailers and property) will be penalised, some of the downgrade is most probably already reflected in our asset prices. Also, because we can see the trouble coming, we can take pro-active action (with reference to the abovementioned).

The gist is that you and I don't have control over these external influences. Our focus should rather be to manage our capital within the parameters that the current reality demands of us. If you happened to be around during PW Botha's Rubicon speech in 1985, you'll know that we have been through worse. South Africans survived that round and I assure you we can survive a downgrade.