

November 2019

# THE STERLING TIMES

Should South African Investors run for the hills?

Are you a Real Investor or a "Make -Believe" Investor?

It's not all doom and gloom

We are a lot more unified than you think

Wow, what wonderful and positive energy our RWC victory brought to South Africa! For a suspended period, we all glowed in the glory of victory achieved, against the odds, by a diverse and committed team.

**L**eadership was key in this victory, as was patience and resilience, all required for successful long-term investing. It has been a tough year, again, for South Africans. We have had to deal with escalating Gender Based Violence issues, further exposures of large-scale corruption, Eskom woes, and the escalation of racial rhetoric from certain political corners. This is a far cry from the glory of the Rainbow Nation of the 1990's.

Depressed property prices, limited business confidence and widespread emigration have resulted. A possible (probable) US recession looms, the Brits go to the polls soon to try to resolve their Brexit mess, and restore their pride.

It is not all doom and gloom. In \$ terms, many global funds have enjoyed strong periods, certain Emerging Markets and global property positions have been buoyed by more accommodating US monetary policy, again, and the Rand has been reasonably stable. The Rand is relatively stable over the past 5 years against the Euro, GBP and the Australian \$.



During all of this, our dedicated wealth managers continue to steer our valued clients through the financial minefield, avoiding pitfalls, product sales, short termism, and potential investment behavioural flaws. It is a tough job (and has been for a few years), but our experience and confidence in dealing with tougher times is a huge advantage. We've seen these periods many times in the past, as have most of our clients. Such is the ebb and flow of markets and investment returns. They are certainly not linear.

It has been a big year for us, with our JHB office move to our new premises, our new younger, better looking and energetic Wealth Managers joining us, and welcoming our new strategic equity partners into the family. We thank our JHB colleagues for all their hard work in ensuring this move was seamless for clients.

Our Counterpoint Asset Management Team continue to both perform and grow assets. This confounds peer group developments. Dr Alex Pestana's Enhanced Income Fund recently went through the R 1 Billion mark in AUM, along with a stellar track record. We have further exciting plans for Counterpoint that will be revealed in more detail, probably early in 2020. Nearly all Counterpoint Funds remain top quartile over meaningful periods, and form a core of our Model Portfolios, which continue to perform and grow. We thank Fundhouse, our independent research partners, for their assistance.



We have included a few pieces of interest for you in this Sterling Times. Firstly, we have a piece by Piet Viljoen, an old friend of Sterling, who discusses our fears as investors of the pending downgrade, and how rational and accurate these are. We then have an interesting issue of behavioural economics raised by Carl Richards, renowned international commentator on all things relating to personal investment emotions. We follow with two politically linked commentaries on varied matters, the developments in SA since the rise to power of our new President, and insight into our actual communities (based on the SA Rugby success at the World Cup) from Melanie Verwoerd.

We wish all our very valued clients a wonderful, safe and fun-filled festive season, and look forward to welcoming you back in 2020, a new decade for us all!

Best wishes



## Graydon Morris

Founding Director  
Sterling Private Wealth



# Should South African Investors run for the hills?

By Piet Viljoen, Founder, RE:CM

**M**any financial commentators are warning of a financial tsunami for South African investors, given the prospects of a credit downgrade. The gist of what many commentators are saying, following the deterioration of the South African economy during Zuma's destructive tenure, is:

1. South Africa faces an imminent rating downgrade by Moody's to junk status;
2. That this is a result of a declining commodity cycle, government corruption and commensurate out-of-control spending, and general lawlessness;
3. Despite this, many economists insist on viewing the state of affairs through rose-tinted glasses;
4. The rand has collapsed over the past 10 years, but Regulation 28 has precluded SA investors from moving enough money offshore to "benefit" from rand weakness;

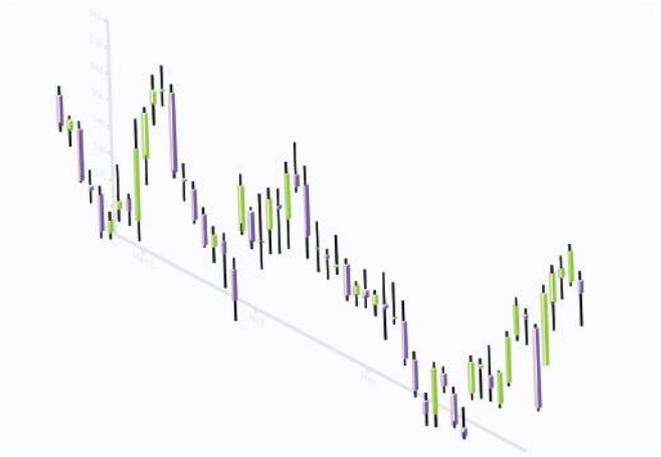


In short, we do not disagree with these views. Where we do differ, is on the investment implications thereof. The main reason for this is that, in our opinion, markets have already priced in much of the downside. After all, markets are a discounting mechanism – market prices are simply a summation of their participants' views. And South African market participants have rarely in history been as negative as they are now.

Moody's remains the last of the big three ratings agencies to have South Africa on an investment grade rating. Currently, our government bonds trade at yields of around 500 basis points (or 5%) over US Treasury yields in US dollar terms. This is higher than the yields Brazil pays on its government bonds. Notably though, Brazil is already rated junk by all the ratings agencies, including Moody's – indeed their rating is two notches below where SA's rating stands today. Looking at interest rates around the world, current SA bond yields imply that we should be rated four notches below investment grade. There is a lot of pessimism baked into this cake already.

Russell Lamberti – an economist whose work we respect – has run the numbers on what happens to markets after downgrades to junk status. He studied the following markets:

Brazil Dec 2015  
Russia Feb 2015  
Croatia Feb 2013  
Hungary Dec 2011  
Uruguay Mar 2002  
Colombia Sep 1999  
Indonesia Dec 1997



After studying market reactions to these downgrades, his conclusions were:

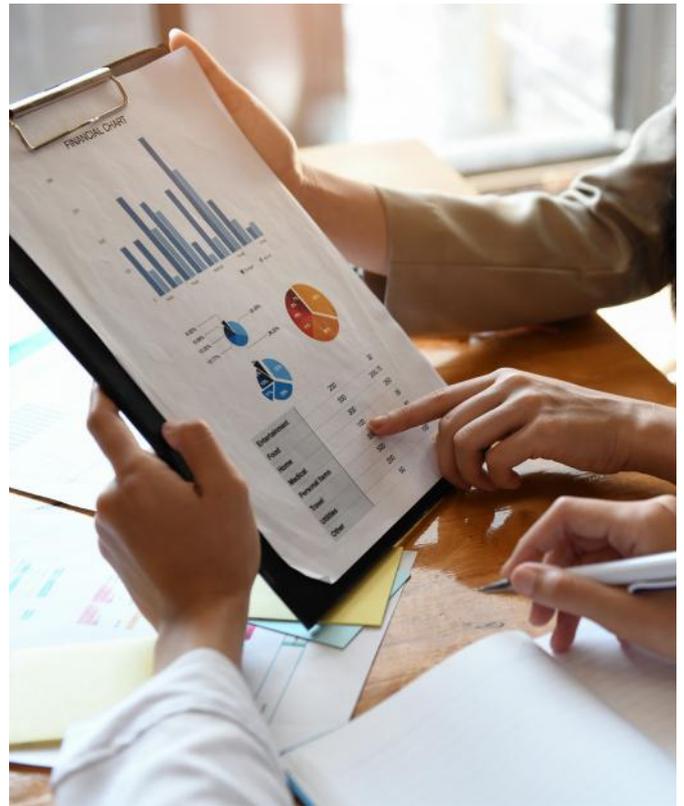
- Much-anticipated downgrades tend to have a minimal negative effect with most of the pain having already taken place before the downgrade;
- After an initial downdraft, bonds, currencies and stocks tended to perform better after downgrades than before downgrades;
- Small-cap value stocks eventually performed especially well;
- Policy rates were lowered;
- Currencies were reasonably stable;

Turning to the rand, we would hesitate to describe its action as “collapsing”, especially if one takes relative interest rates into account. The reality is, if one had started out with R100 five years ago when the Rand was at R10.90, deposited it into a local bank, withdrew it today and bought dollars at the prevailing exchange rate of R14.70, you would have more US dollars than if you had simply converted to US dollars outright in 2014 - and this is with US dollar having been the strongest currency in the world over that time frame. The same applies over ten years. Interest rates have more than compensated local savers for a weakening currency. So, we would suggest that it is quite a stretch to say that the rand has collapsed. A collapse is what happened in Zimbabwe, Venezuela and Argentina. It wipes investors out completely. Over the past decade, taking into consideration the local interest rates you’d have earned over that time frame, investors in the rand have done better or about the same as investors in US dollars, euros, Japanese yen, Australian dollars and British pounds. Surprisingly, SA investors have also done as well as the associated equity markets in constant currency terms, except for the US equity market – which has dramatically outperformed most other markets globally.

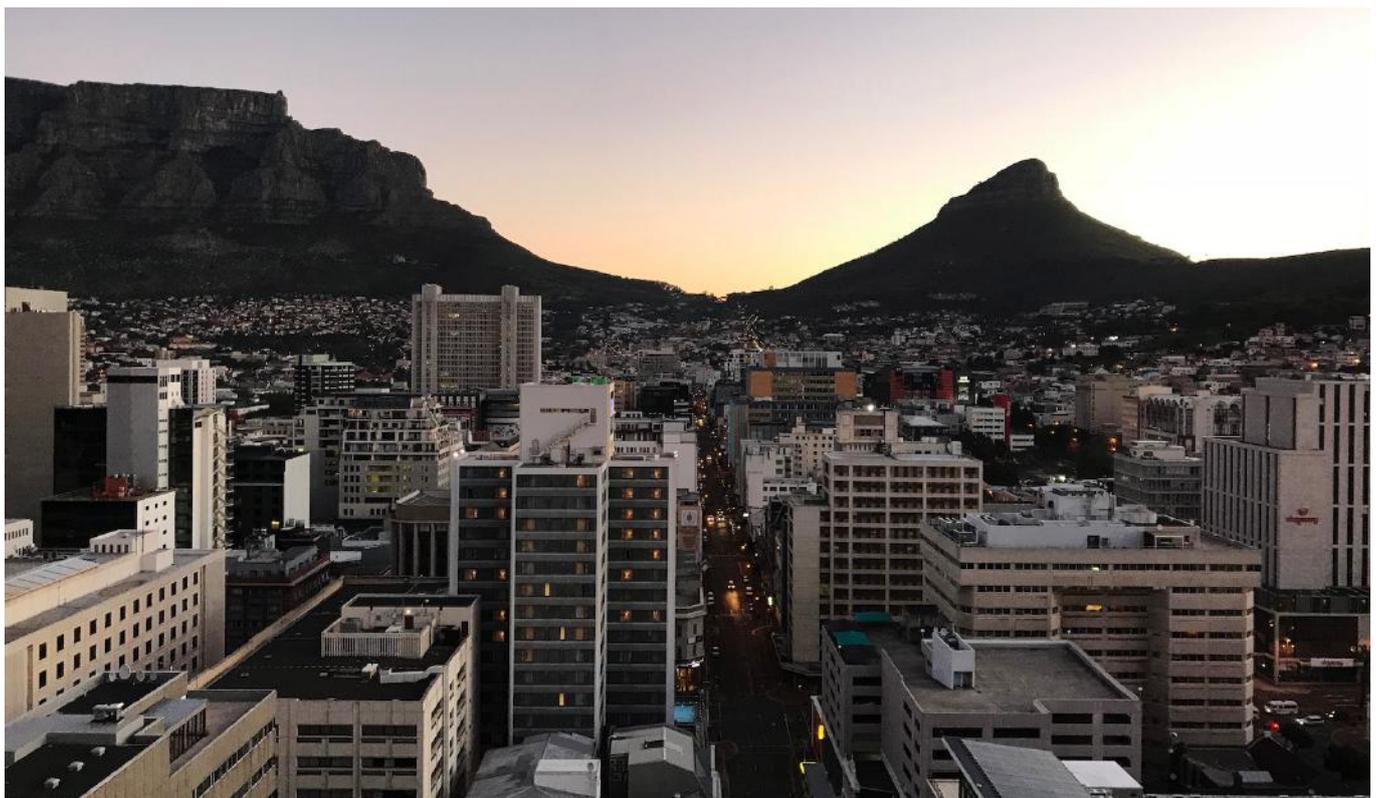
The point is, there are always good investments and poor investments – it’s just not clear a priori which are which. If anything, no one would have guessed that SA investments would have generally held their own given what has transpired here over the past ten years.

To summarise, we agree with a lot of the pessimistic macro views out there, but we think the market is efficient, and has discounted most of these views already. And SA has the ballast of high interest rates and low equity prices to keep us stable, in prospective return terms - just as it has done, in general, over the past 10 years. Referring to selective measurements with the benefit of hindsight adds no value to any investment strategy.

Of course, if South Africa were to go the Zimbabwe/Venezuela route, then all (local) bets are off. Investors with all their money in local investments will face ruin. On the other hand, given current valuation levels, if things were to improve even moderately, local assets will do extremely well.



We think an intelligent investment strategy should recognise that different outcomes are possible, and no one outcome can be guaranteed. A well-diversified portfolio should offer some downside protection if things go from bad to worse, and upside participation if things go from bad to even slightly better. A portfolio built on forecasting one outcome correctly can do very, very well, or very, very poorly. And we all know forecasting is a mug's game. For instance, how many of us thought that the Boks would be in the world cup final when we lost to New Zealand 57 – 0 two years ago?



Investors should also be careful not to completely write off funds governed by Regulation 28. An allocation of 30% offshore is probably inadequate, given the risk investors are facing, but the fact is that in the remaining 70% one can build in strong additional rand hedge protection through the local market. Overall, one can still build a well-balanced portfolio, despite the regulations. We do believe that in future increased prescribed assets are likely, which will make Regulation 28 funds even less attractive, but not unattractive enough to ditch them wholesale. Remember – we have lived through this once before – before 1994 we had 50% prescribed assets here in SA, and fund managers were forced to buy bonds from a totally bankrupt and equally corrupt government. Yet Regulation 28 funds still managed to do okay through that time. The market came up with innovative instruments that helped local investors withstand that government’s worst regulations and policies. Who remembers ELFI bull and bear bonds? If you have no clue of what I’m talking about, ask an old-timer for a lesson on how financial innovation can help investors get around corrupt government policies. Bitcoin anyone?



To put all your eggs in one basket – be that basket local property, offshore cash, offshore equities, Mauritian properties or Japanese biotech - is, in our view, risky and irresponsible. We think a more nuanced view is likely to lead to better portfolio construction and investment outcomes.

# Are you a Real Investor or a “Make -Believe” Investor?

By Carl Richards

Hey, I have a question for you.  
Do you remember being a kid and pretending you could fly?  
I sure do. Now, let me ask you another question. Do you remember jumping off a roof to test that theory?  
No? Ok, good. Me neither. You know why? Because even as kids, we knew what it meant to make-believe.



## Funny how things we know as kids we tend to forget as adults...

For example, a lot of people like to make-believe that they know how to invest. They get some skin in the game, forget they aren't real investors, and the next thing you know, they're doing the financial equivalent of jumping off the roof (with equally predictable results)....

There's a lot riding on whether you are a real investor or a make-believe investor. Not sure which category you fall into? The following breakdown may help:

- 1. Make-Believe investors** think the stuff they hear on the financial pornography networks is real. Real investors know it might be entertaining, like going to the circus, but they would never make a decision because of what they saw there.
- 2. Make-Believe investors** think it makes sense to change their investments based on politics: There's a new president, so act! He doesn't like the Federal Reserve, so trade! He criticized bankers, so buy bank stocks! Real investors know they make changes to their investments based on what happens in their own lives. If their goals change or there is a fundamental change in their financial situation, then they consider an alteration.
- 3. Make-Believe investors** monitor their investments obsessively. The result tends to be poorly thought out, knee jerk reactions to... what else? The financial pornography networks. Real investors know that it takes a long time for a tree to grow, and it will not help to dig it up to see if the roots are still there. The same rule applies to investments.
- 4. Make-Believe investors** talk the talk. You know, investor jargon: alpha, beta, P/E, market cap, time horizon, long this, short that. Beware of this kind of talk. It sounds kind of impressive if you don't listen too closely, but it is also a dead give-away that you're not a real investor. Real investors walk the walk. You know, not so much saying as doing. And the thing they tend to be doing is sticking to their financial plan.

5. **Make-Believe investors** worry endlessly about some far-off part of the world and the impact global politics have on their portfolio. Real investors focus on the things they can control, like saving a bit more next year, keeping their investment costs low, and managing their behaviour by not buying high and selling low.

6. **Make-Believe investors** complain endlessly about volatility in the market and external actions that have a short-term impact on the big bets they have made on individual stocks. Real investors take the long view. Between 1996 and 2016, markets were up more than 180 percent. That included the financial crisis of 2008. Real Investors saw that crisis as a dip; not the end of the world....

Think of this as a kind of litmus test. A six-part quiz to see what kind of investor you are.

Look, there's nothing wrong with playing make-believe. But there is something wrong with acting on it. I'm not telling you to stop using investor jargon and watching the financial news. By all means, watch to your heart's content.

Just don't jump off the roof because you convinced yourself you can fly.



# It's not all doom and gloom

By JP Landman, Political Analyst

"Just do something" is the cry now rising from all over South Africa, a plea to the president and government in general to take some action to break the logjam in which the country finds itself. Confidence is low, growth sluggish, and emigration high. It is useful to replay what has been done, writes **JP Landman**.

**T**he Ramaphosa administration has set itself two tasks: to rebuild the ethical foundations of the state and to revitalise the economy. The two topics are too much to cover in one article, so I will only discuss ethical renewal here.

## Cleaning up and rebuilding ethics

The country first and foremost had to be reclaimed from the forces of state capture. Ramaphosa appointed four commissions of inquiry to help with the clean-up offensive. Two are still in session (the ubiquitous Zondo commission and the Mpati Commission into the Public Investment Corporation or PIC) and two have finished their work. Between these commissions, the four have sparked considerable action – a lot of which we have already forgotten.

## Freeing critical institutions

It is useful to remember that both the erstwhile number one and number two in SARS, Tom Moyane and Jonas Makwakwa, are gone. So is the embarrassing former head of IT at SARS, Mmamathe Makhekhe-Mokhuane, who made such a spectacle of herself on national television that she publicly apologised for it.

That is not all. In the last week of July three SARS executives were suspended. The clean-up continues. The EFF and the Public Protector are fighting a rear-guard action against SARS renewal with old allegations of rogue units and attacks on new SARS Commissioner Edward Kieswetter. He is forging ahead unperturbed and can leave the Public Protector to the courts.



At the National Prosecuting Authority (NPA), the erstwhile top three have also departed. One is fighting her dismissal in court and two have appealed to Parliament not to be fired, which will be an interesting test case for who is in charge in Parliament. The departure of the three has freed the NPA from its era of Zuma capture and it is being rebuilt. The new director, Shamila Batohi, who has experience at the International Criminal Court in The Hague, has returned to South Africa to take up the baton.

Batohi took office in February. In March, a special investigative unit focusing on cases arising from state capture revelations was formed. In May, Batohi brought in well-known corruption buster Hermione Cronjé, who returned to South Africa with valuable international experience to lead the new unit. A senior advocate from the Cape Town Bar, Geoff Budlender, has been appointed as strategic advisor to this unit. Batohi also reappointed Willie Hofmeyr as head of the asset forfeiture unit after he was side-lined three years ago by the Zuma squad.

I wrote in April this year that 2020 will be the year of prosecutions and I explained why at the time. I maintain this view.

Over at the Hawks both the former head and acting head have been fired and replaced by the soft-spoken and highly regarded general Godfrey Lebeya. His influence is showing: two captains and a warrant officer from the Hawks were arrested for bribes. In Durban both the mayor and a councillor have been arrested by the Hawks and have appeared in court (with the usual tweet from Zuma supporting the mayor and her supporters protesting outside the courthouse).

Two senior officials from the Durban Metro were also arrested. A mayor of Newcastle was arrested for an alleged political murder; as was a former mayor of Endumeni for alleged conspiracy to murder. Not bad for an erstwhile Zuma (and current ANC) stronghold.



In the Free State nine civil servants and a director of a company were arrested and charged – one for interfering with the work of the Hawks. In Mpumalanga a former local ANC chief whip was arrested for corruption and fraud. The Hawks are clearly at work.

In Limpopo the VBS report claimed the scalps of five mayors who resigned; a further four were fired and another three were suspended. In the North West three mayors resigned, one was suspended, and three have taken legal advice to try and avoid dismissal. Public opinion counts – especially in the run-up to an election.

At the SAPS a deputy commissioner has been fired and six officers of general or brigadier rank have been charged. As recently as last week seven junior officers were arrested for selling confiscated goods back to hawkers. In a significant ruling in July, one of the "untouchables", former head of crime intelligence Richard Mdluli, was convicted of several charges for offences committed 20 years ago in 1999. The wheels of justice turn slowly, but they turn. (This is what John Block, the former ANC strongman in the Northern Cape and a Zuma acolyte, also discovered – after many legal manoeuvres he is now serving a 15-year jail sentence.)

## The ubiquitous SOEs

The SOEs are still burning cash and their balance sheets are shocking, but on the ethical front a lot has happened.

At Eskom, former big bosses Brian Molefe, Anoj Singh and Matshela Koko are gone. Molefe has also been pursued by Solidarity and must now repay R10m to the Eskom Pension Fund. Lifestyle audits were conducted on 365 Eskom managers, resulting in 44 cases being referred to the Special Investigating Unit. More than 1 000 disciplinary cases were instituted, and 116 employees decided to resign, including 14 senior executives. Of 25 employees who had "business interest in suppliers dealing with Eskom", seven resigned and the rest terminated their interests. Eskom has experienced a serious clean-up.

A year after the notorious Hlaudi Motsoeneng was dismissed from the SABC, three of his erstwhile henchmen are gone too. (The verbose Hlaudi failed with court challenges to regain his job and then went on to fail again in his election efforts to get into Parliament.) In an important self-initiated report published last week, compiled by veteran journalist Joe Thloloe, the broadcaster laid bare political interference in its editorial policy.



Former minister Faith Muthambi complained she was "rubbished" in the report – this could not have happened to a nicer person. Expect further fallout from the Thlolo report. A Zuma-appointed chairman is still in place at the SABC and the corporation wants a mere R3bn to stay afloat, but a clean-up has certainly taken place.

The PIC saga is still ongoing before the Mpati commission, but a new board is already in place, the CEO and two senior executives are gone, and several have been suspended. In an important break with the past, Cabinet reversed the practice of a politician chairing the board. Under new chair Reuel Khoza's experienced leadership and rock-solid integrity, the PIC will, with a little help from the Mpati commission, be cleaned up properly and will head in a new direction.

In his second stint as Minister of Finance, Pravin Gordhan, desperately tried to get rid of the former Zuma acolyte, Dudu Myeni from SAA. She is now gone, as are several former senior executives. Everybody can see how the once-mighty have fallen. For SAA, there is only the small matter of staying afloat.

At Transnet, five executives departed, including the CEO, and eight more have been suspended.

At Denel, the CEO, finance chief and chair are all gone. Both Denel and SAA have new boards. It may not be enough to save them financially, especially Denel, but action has been taken against weak ethics.

## Cabinet

Perhaps the biggest clean-up took place in Cabinet.

Ramaphosa inherited a Cabinet of 36 ministers. There are now 28. At most, five of these can be described as Zuma- or Magashule-supporting and some of them will even deny this. The number of government departments has been reduced from 40 to 35.

For all the publicity that was given to erstwhile Zuma ministers who were appointed chairs of parliamentary committees, the numbers speak for themselves. There are 36 committees in Parliament. Traditionally the Select Committee on Public Finance (Scopa) has an opposition party member as chair. That is the case again in this Parliament. Of the remaining 35 committee chairs, 11 may be regarded as Zuma or Magashule supporters.

Most of these are ministers who were kicked out of Cabinet. From a minister to a chair of a parliamentary committee where every move is watched by opposition parties... and now we are asked to believe that they are paralysing government?

## So what?

Part of Ramaphoria was the belief that the bad guys would lose. That is certainly happening.

- People who were once untouchable have fallen from grace for all to see. Some have even been convicted already. The impunity of the Zuma years is slowly being reversed.
- The process is not over, with the Zondo commission still in session and almost weekly revelations of appalling behaviour.
- Getting convictions in court is very different from revealing things at a commission. Despite this, many people have already fallen on their swords.
- Civil society organisations have helped in this clean-up and this speaks volumes for South Africa's democratic activism.



Afterwards I took a short stroll to my local café as cars were speeding by with our flag flying out of windows and the hooters sounding from every direction. It reminded me of the 1995 victory. Like then, we were proud, and we had reason to be. Funny memes flew around, people hugged each other and cried with joy.

Then Mbuyiseni Ndlozi of the EFF tweeted: "Congratulations to Siya Kolisi... the rest go get your congratulations from Prince Harry." This of course set off a series of very nasty tweets.

## Sigh!

A lot can be said and questioned about this tweet – such as why only Kolisi and not all the other black players – but let's leave that. Ndlozi's tweet raised something that I have been thinking of for a long time.

I don't believe that we are as divided as the politicians (and many match commentators) would like us to think. On a human, person-to-person level I think most South Africans not only want to get on with their lives, but also care deeply about their countrymen and women – irrespective of race.

The celebrations we saw from all corners of our society didn't just suddenly get resurrected when we won the Rugby World Cup. Our desire to be one nation has persisted since 1994, despite a few very hard knocks.



Of course, we have horrible racists in our country (as there are in almost all countries in the world). It also goes without saying that we have inhumane inequalities which are largely along racial lines. These HAVE to be addressed.

However, on a personal level, I believe most South Africans want to get along. Of course, it doesn't suit many politicians and political parties to allow us to live harmoniously. As was the case under apartheid, it is far easier to create fear and hatred than to come up with workable solutions to deal with our inequalities.

The same was true for example in Northern Ireland. For many years after the Good Friday Agreement was signed political parties tried to retain the politics of hatred and division. Ultimately though, the people were fed-up with violence and ignored the politicians, to the point where the politicians and their parliament became largely irrelevant.

Fearmongering politicians in our country could easily suffer the same fate.

Last night I was watching an episode of "Madam Secretary" on TV. At the end Téa Leoni's character gave a beautiful speech which I believe is apt as we contemplate how we can take Saturday's joy and sense of patriotism forward. She said:

"Even more dangerous than nuclear weapons are... hatred. Blind hatred that one group can have for another. I believe nationalism is the existential danger of our time. Nationalism is not the same as patriotism. It is a perversion of patriotism. Nationalism [and racism – my addition] promotes the idea that inclusivity and diversity represent weakness. That the only way to succeed is to give supremacy to one race over all others.

"Patriotism is about building each other up and embracing our diversity as a source of our nation's strength. Our heroes did not die [play] for a race or region. They died [played] for the ideals enshrined in our Constitution. Look where isolationism has got us in the past. Never again can we go back to those dark times when fear and hatred, like a contagion infected our world.



***"We must never lose sight of our common values and our common decency."***

What was highlighted again on Saturday was that most of us share a common identity, common values and common decency. Let's take that forward with us and ignore those politicians who want us to believe otherwise.

# We are a lot more unified than you think

Melanie Verwoerd, Former ANC MP and Ambassador to Ireland

I wasn't going to write about the rugby. After all, what can be possibly be said that has not been said already? Then a day ago, I got a text from a friend. "Please write about how we keep the spirit of RWC 2019 alive?" he pleaded.

This friend of mine has been particularly gloomy about South Africa's future. He is also a big rugby fan. Three days after the final he was still tearing up when talking about the match.

I have to admit I also shed more than a few tears on the day. I thought back to 1995. I was a member of Parliament then. On the day of the opening match in Cape Town, we had a morning session in the National Assembly. Frene Ginwala was in the Speaker's chair. As it got closer to lunch time, it suddenly became apparent that there was not a single man left in the House. In fact, I don't think there was a single man in the precinct. If ever there was a time for the women to launch a coup that would have been it.

In 2007, I was living in Ireland and watched the final with a group of Irish supporters in a pub as South Africa lifted the trophy once again. As was the case this year, the Irish were delighted when we defeated the English.



This year, I was on a plane from Dubai when the match started. Luckily there was live streaming of the match on the plane. (Thank you, Emirates!) Let me tell you, a plane is a FUN place to watch such an important match. People went ballistic – much to the confusion of many of the foreign passengers.

Unfortunately, we landed about 27 minutes into the match. The South Africans sprinted off the plane and once we had cleared customs it was half time. I got home in record time. With almost no cars on the road I was in time to see the second half and Siya Kolisi lifting the Webb Ellis trophy.