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In this edition

STERLING PRIVATE WEALTH

MERCHANT WEST

A message from our managing director

By Graydon Morris, Sterling Private Wealth

We write this to you in the middle of our 5 week lockdown, unsure of whether this period will be extended or not. By the time you receive this Sterling Times we should know what the president's plans are. I am sure that you, like us, are very proud of the Presidential leadership that has been evident during this global crisis. South Africa appears to have responded well and on a co-ordinated basis.

Our office is functioning very well from its now decentralised locations. Our staff are safe, happy, and optimistic that we can all overcome this virus together. We hope that all our clients remain safe, healthy and resilient. We look forward to seeing you all again in person in due course.

It has been quite a first quarter; the fastest ever 30% drop in the S&P 500, the unfolding of Covid-19, the Downgrade by Moodys, Oil at nearly 20 US$ a Barrel, the decimation of the Sasol share price and a significantly weaker Rand. Emerging markets have been massively out of favour, and we have been punished accordingly.

We have tried to continually communicate with you all via mails, notes and messages during these troubled times. Our message is consistent - do not panic or make any irrational decisions. **This is a major economic development** - we are not clear on how it will play out - but we have seen many such crisis before. *"This time it is different"* are amongst the most damaging words in investment speak.

Our calm, thoughtful and unemotional views are hopefully providing comfort to you all as markets gyrate wildly and asset prices display significant volatility.

In this Sterling Times edition we introduce you to Marteen Michau of Fidelis Vox with a piece on the importance of an up to date Will. Fidelis Vox are a new Fiduciary Partner of ours; a business we co-founded to provide the highest level of professionalism and service that we possibly can in this area.

It is our opinion that Marteen is one of the most respected Fiduciary practitioners in the country and we are proud of our new association. Please speak to us should you require an introduction to Marteen and her team.

We have also presented a few thoughts from Trevor John, an investment blogger we follow in the UK. Some of his thoughts may interest and resonate with you.

We also share an article dealing with getting back to the basics of planning and thoughts during this unique Covid-19 time.

We are indeed living in a chilling and scary time now. This reality makes it mighty hard not to be tempted to bail out. Although the decision is always yours, our *strong* recommendation is *don't do it*! I know you've heard it before, but it's true. Centuries of experience demonstrates that **those who bail, fail; those who stay, succeed.**

Dr Alex Pestana, our resident Fixed Interest and Economic strategist at Counterpoint introduces a fascinating piece on debt, bonds and borrowings. This is delivered with Alex's typical high level of insight and deep global knowledge.

And finally, James Guimaraens, a Sterling Director, provides guidance on dealing with family financial matters during this time of crisis.

We share the parable on the following page that may provide a message you can identify with.

We hope you enjoy the read.

Graydon Morris

Managing Director

King Solomon, for reasons unknown, decided to send the servant who loved him most on an impossible quest. King Solomon told this servant that he wanted a ring that would cheer him up when he was feeling down and would calm him down when he was too excited. King Solomon gave his servant one year to find the ring.

The servant thought nothing of the mission. Whatever King Solomon desired, he was honoured to procure and serve. So, off the servant went on his mission. The servant travelled all over the world, looking for the powerful ring that could control the strongest of emotions. The servant walked into every jewellery shop he could find, from the fanciest and richest of the stores in Paris to the smallest and humblest of jewellery shops in the middle of nowhere towns. Every shop owner sent the servant away laughing or insulted – jewellery shops were no place for magic!

As the servant's deadline was coming to an end, he was feeling disheartened. But he didn't give up. Any time he saw a jewellery shop, he'd go in to inquire whether they had a ring that could calm and humble our proud moments and cheer us up in the darkest of hours. But even with the pressing deadline, there was no luck.

Finally, the day arrived when the servant had to return to King Solomon. As the servant approached the palace, he saw one last and tiny jewellery shop. With nothing to lose, the servant walked into the shop, "King Solomon desires a ring that will lift his moods in times of sorrow and soothe the elated moments." Mostly expecting yet another jeweller maker to laugh in his face, the servant asked, "Do you have such a ring?"

The jeweller, without any hint of contempt or sarcasm, thought for a minute and responded, "Yes, I do. Please wait here." The jeweller went to the back of the shop where the servant couldn't see him. The servant could hear the jeweller banging and working away.

When the jeweller finally came out, the ring was wrapped in such a way that the servant had no idea what the ring looked like. As the servant was out of time and had nothing else to present to King Solomon, off he ran to the palace.

At the palace, King Solomon was waiting for his loyal servant. King Solomon was feeling smug. He knew the servant would come back empty-handed because he had sent the servant on an impossible mission.

When the servant arrived with a small box in hand, King Solomon was surprised. He opened the box and upon seeing the ring, he began to cry. While he was sure he had sent his servant on an impossible mission, his servant did indeed find a ring that humbled him in his moment of smugness and would certainly cheer him up in dark moments to come.

I'm sure you are wondering what made the ring so special. Inscribed in the ring were the words, gam ze yavo: "This too shall pass."

The need for a will

By Marteen Michau, Founder of Fidelis Vox, Proud Fiduciary Partner to Sterling Private Wealth

Estate planning need not be an exercise to only be undertaken if you are wealthy and lie awake at night worrying about protection of your assets. The basics of estate planning should be done by every person, and that includes signing a Will and planning for the cash needs of your family immediately after your death.

Without a Will, there is no nomination of an executor by you, with the result that nominations of an executor would have to be obtained from your closest family members after your death before it can be lodged with the Master of the High Court, causing possible delays. Without a Will you have not directed that an appointed executor does not have to provide security as such to the Master of the High Court, which may mean that the Master's Office could demand of such a person to first take out a bond of security with high premiums to provide security to the Master of the High Court; again unnecessary delays and costs.

The assets in your estate will be subject to executor's fees. The maximum tariff that an executor may charge to administer and wind up your estate is 3.5% of the gross value of the assets in your estate, including the value of the proceeds of the above policies payable to your estate. You can nominate an executor in your Will and place on record in the Will that the nominated executor has agreed to charge a discounted executor's fee at a reduced rate. Some executors are willing to negotiate such discounted fees.

Why your Will could be out of date

Changes in circumstances or changes in legislation can cause your Will to be out of date, with the effect that the consequences thereof are not what you intended it to be.

"If you do not **sign a Will**, your estate will **devolve** in terms of the rules of **intestate succession.** This could mean that someone who you would have liked to bequeath a specific asset to, **will not inherit that asset from you."**

If your circumstances have changed as follows, you should (in general) reconsider your Will:

▪ Change in your marital status: if you were divorced more than three months ago and still bequeath assets to your (now ex) spouse in your Will, he/she will inherit those benefits even if you would rather exclude him/her as heir;

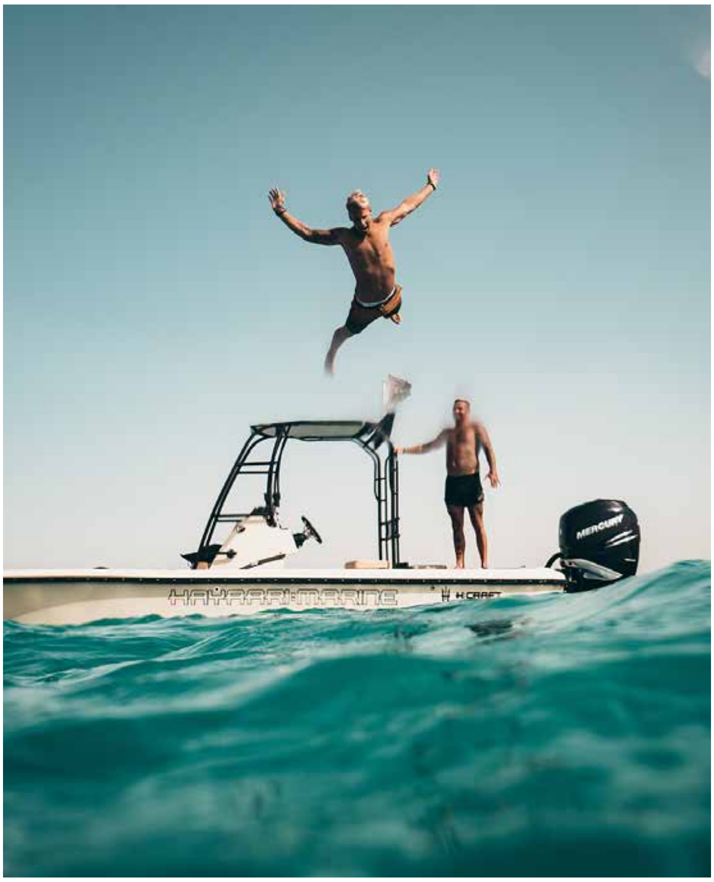
▪ Death of an heir: if you failed to name an alternative heir in the event of an heir being predeceased, the benefits could devolve on the deceased heir's estate to devolve in terms thereof;

▪ You created a Trust after your current Will was signed: you can now bequeath assets to this Trust instead of to a testamentary trust, thereby eliminating the creation of another structure with duplication of costs. Trustees succeeding you (of such a new trust) can be nominated in your Will, if you are empowered to do so in the trust deed. Loans owing to you by such a trust can be bequeathed to the trust in your Will, thereby the trust assets do not have to be used to repay the loan to your estate;

▪ Children becoming of majority age: children over the age of 18 can inherit and hold assets in their own name, eliminating the need for trust structures for minors;

▪ Children now living or working abroad: children who live or work abroad and who have not formally emigrated (as per the current situation), could be unable to externalize an inheritance from you to the country where they now live, because of restrictions in terms of exchange control regulations in South Africa.

▪ Acquisition of assets not covered in the Will: assets acquired after the date of signature of your last Will, will not be covered specifically in your Will and might devolve as part of the residue of your estate to your residuary heirs and not to the specific persons you would like to benefit therefrom.



▪ Acquisition of foreign assets: Foreign assets acquired after the date of signature of your last Will, could be more efficiently administered in terms of a foreign Will depending on the jurisdiction where it is and the type of asset, than being covered in terms of your South African Will. Probate may also be necessary to be able to transfer these assets to your heirs, and the process of applying for probate may be delayed with one Will dealing with your worldwide assets and your executor having to obtain sealed copies of lodged documents from the Master of the High Court in South Africa.

▪ You had a joint Will with a predeceased spouse: you should consider signing a new Will as the original joint Will (which is your valid Will) would have been lodged with the Master of the High Court and is not in your possession any more, and furthermore you might want to now deal with inherited assets in a different way.

Does your **Will** need **updating?**

Your last Will and Testament is one of the most important documents to have in place. Your Will should be regularly reviewed and updated for changes in your circumstances or when legislation changes. Below is a checklist to assist you to ascertain whether you should relook at your Will or update it:

1. Is the date of signature on your Will more than five years ago?

If so, you should update your Will. Personal circumstances change over the course of a few years.

2. Do you have loan liabilities to for instance a trust, the payment of which you have to provide for from your estate?

In the event of there not being enough liquidity in your estate or even not enough assets available in your SA estate to repay these loans with, there are various other ways to provide for the repayment of these loans, which you should consider.

3. Do you have Wills that deal separately with your South African and non-South African assets?

The administrative process of a deceased estate is simpler and easier if Wills dealing with assets in different jurisdictions are separated. SA legal terms used in Wills are often different to those used in other countries where you have assets, and may cause interpretation issues with additional cost and time implications. Some jurisdictions have forced heirship rules instead of our wide powers of testamentary disposition. Bequests of immovable properties situated in such countries may as a result hereof not devolve in terms of the directions in your Will to the heirs you bequeath it to, but in terms of these rules to other persons. If your worldwide Will drafted in SA is in Afrikaans and you have foreign assets, it may cause further delays and costs, as a translation of that Will may be needed to deal with the foreign assets.

4. If your answer to question 3 is yes, does the Will that deals with the respective assets in and outside SA clearly state that it deals only with those assets, and even more importantly, that it only revokes Wills dealing with the respective assets situated in the particular jurisdiction?

If not, one Will may unintentionally give rise to the provisions of another Will being in conflict with the other or even worse, the one Will can revoke the other resulting in you potentially dying intestate in respect of certain assets.

5.Have you established the cash requirements in your estate?

Cash shortfalls may delay the winding up of your estate, and/or may cause some of your assets to be sold. Cash shortfalls may be as a result of outstanding liabilities in your estate, including bonds over fixed property, claims against your estate, debts, medical, last illness and funeral expenses, executor's fees, estate duty and capital gains tax on death, and cash bequests in your current Will.

6. Have you negotiated the executors' fees with your nominated executor and have you included the agreed fees in your Will?

The maximum legal tariff is 3.5 % plus VAT of the gross value of the assets administered by the executor. A further 6% plus VAT may be charged on income collected by the executor after your death. You can agree on a discounted fee with your nominated executor and ask the drafter of your Will to place it on record in the Will.

7. Have you nominated guardians, failing the biological parents, to your minor children in your Will?

The nomination of guardians serves as an indication of your wishes in this regard. A conversation should be had with the nominated persons to ensure that they are aware hereof and agree hereto. Nominations in your Will and that of your spouse should be the same persons.

8. Do you direct that bequests to minor children (below 18 years of age) be handed to their legal guardians or kept in trust until majority age?

If not, the bequests to minors may be paid into the Guardians Fund and will be kept under their control until the heirs are majors..

9. Do you exempt the nominated executor as well as the trustee(s) of a trust created in your Will from the requirement to provide security to the Master of the High Court?

If not, the Master may require them to furnish security, which may prove expensive and may cause them to not accept appointment as such. Possible delays may be the consequence hereof.

10. Have you considered the consequences of your marital regime on your death (if married)?

A marriage in community of property may mean that you can only dispose of a half share of the assets in your communal estate in your Will. The accrual system being applicable to your marriage may have unintended consequences, including that your spouse firstly receive the accrual claim proceeds, which may have the effect that bequest to other persons are reduced.

11. Have you dealt with loan assets in your Will?

You can bequeath loan assets in your Will to the persons owing you the loan amounts and thereby cancelling the loans, with the effect that these persons do not have to repay the loan amounts to your estate on your death.

12. Have you considered the effect of US or UK situs assets and the potential liability for inheritance taxes in the US and the UK at your death?

Cash shortfalls may delay the winding up of your estate, and/or may cause some of your assets to be sold. Cash shortfalls may be as a result of outstanding liabilities in your estate, including bonds over fixed property, claims against your estate, debts, medical, last illness and funeral expenses, executor's fees, estate duty and capital gains tax on death, and cash bequests in your current Will.

13. Do you maintain your parents or provide towards their maintenance or medical expenses?

You should consider how these expenses will be paid when you are not there to do so. Your parents can be maintained from a testamentary trust or as a condition to a bequest in your Will.

14. Do you have a maintenance liability towards a previous spouse or to children in terms of a divorce order?

Depending on whether the liability carries on after your death, you should provide for the payment thereof in terms of your Will to avoid your estate having to make monthly payments for years to come, as your executor will then not be able to finalize the estate.

15. Do you have bank accounts in overseas jurisdictions? If yes, are you the only bank account holder or do you hold the bank account jointly with someone else?

If you hold a bank account in joint tenancy with your spouse, the bank will on receipt of your death certificate, remove your name off the account and the account will carry on in the name of your spouse. No probate will be required in the overseas jurisdiction (eliminating the associated costs) to transfer the bank account to your spouse in this way.

16. Do you own business interests? If yes, have you provided for continuity in the business?

You can enter into a buy and sell agreement with a life policy associated therewith to provide the liquidity to your business partner to buy your share of the business, providing liquidity to your estate. Otherwise you should provide for succession in your business in terms of a shareholders' agreement or a bequest in your Will.

17. Have you nominated beneficiaries for the proceeds of life assurance and/or pensions benefits?

Proceeds will pay out to nominated beneficiaries outside of your estate, and will not be subject to executors' fees, providing beneficiaries with liquidity at an earlier stage without having to wait for the administration process.

> the basics of estate planning should be done by ***every single person,*** and that includes signing a Will

How robust is your financial plan?

By Graydon Morris, Managing Director, Sterling Private Wealth

Dealing with COVID -19

At midnight on 26 March 2020, we began an unprecedented lock down in our country's history. The coronavirus (COVID-19) outbreak which started in Wuhan, China has brought back unpleasant memories of the SARS outbreak in 2002 and the MERS outbreak in 2012, both of which had resulted in investor stress, anxiety and fear. Most of the concerns centred around whether their investments can withstand the short-term market fluctuations and volatility as well as not knowing how long this uncertainty would last. Global and local equity and credit markets have sold off significantly; the S&P experienced the fastest 30% fall in its history. Think about that!

In South Africa and elsewhere globally, the authorities have implemented measures to minimise the spread of COVID-19 in their respective countries and help stem the global spread of the virus. These include putting in place controls on the entry of visitors into many developed and affected nations.

As retail investors, we should also have robust measures to safeguard our savings and assets that are able to withstand short-term shocks and volatility. Doing so will go a long way in preventing any adverse knee-jerk reactions and impulsive investment decisions. It gives us a peace of mind so we can avoid giving in to unnecessary panic and sleepless nights.

Here are six tips to manage your finances during these times of uncertainty.

"The secret of change is to focus all of your energy, not on fighting the old, but on building the new"

\- Socrates

6 tips to manage your finances

1 Have a sound financial plan

Having a proper financial plan in place will give us a better understanding of our financial resources such as our money flows and where our investments stand in the risk-reward continuum. A comprehensive financial plan covers the areas of managing budgets, insurance, investment, retirement and estate planning. When these areas are well covered in a sound financial plan, we have greater clarity on how each financial decision affects another and we can adapt more easily to life changes, while keeping our life goals intact.

2 Ensure you have positive cashflow & emergency funds

The foundation of financial well-being is to maintain a positive cashflow which can be invested in suitable instruments to make our money work harder. To do this, it is always prudent to set up a realistic budget which indicates your money inflows and outflows. Having at least three to six months emergency funds in cash helps to ensure that you have enough liquidity to tide you and your dependants during financially challenging times. Doing so will give you some peace of mind even if you may suffer from temporary setbacks like losing a job or are unable to make a living because you are in lock down. Many of our retired portfolio clients will have many years of income requirements allocated to cash and other fixed interest positions. This prevents the forced sale of any growth or highly volatile assets.

3 Get insurance cover

Insurance is a means to cushion against financial loss due to specified events. Top of the list is a suitable medical aid and gap cover, if necessary. Other healthcare related insurance includes critical illness and income disability cover.

4 Diversification

A basic rule for retail investors is not to put all eggs in one basket. Thus, an investment plan should not be reduced to a single stock or investment strategy that is over-concentrated on single securities or single-country assets. It is prudent to diversify your assets and ensure a good mix of investments that carry different levels of risks, depending on your risk profile and financial needs. It is wise to seek the guidance of a professional financial adviser who can also help to do portfolio rebalancing when required. Once you have your optimal asset allocation in place, you will be able to sleep peacefully even during times of uncertainty because you know that your risk exposure will be taken care of. A sound and diversified portfolio will be able to weather the ups and downs of market uncertainty such as the one we are experiencing due to COVID-19.

5 Use Rand-cost averaging

Adopting the strategy of Rand-cost averaging helps investors to avoid the pitfalls of timing the market. It involves regularly buying a fixed Rand amount of an investment, regardless of the unit price or the share price. By doing so, you buy more shares or units when prices are low and fewer when prices are high. So over time, you will have a lower average entry price.

This helps investors to stay invested even during tough times since they keep getting a lower average price.

6 Invest for the long-term

We cannot be sure how long the COVID-19 outbreak will last and how it will impact the markets. However, history tells us that financial markets have bounced back time and time again, and we expect this to be no different.

Already the global and local markets have bounced significantly off their lows. Many of our investors have taken this depressed opportunity to buy potentially undervalued assets. The local listed property market has fallen by around 50%. This is a dramatic fall from grace for a once loved and revered asset class. This, again, shows the danger of relying on a single sector to provide either returns, or income into retirement.

A few thoughts from Trevor John

Taken from a UK based Investment Blog

The most potent investment force is time. Our working lives are short. If providing for ourselves when we can't use our hands anymore is our only goal, that is still focused on consumption. It is still hand-to-mouth. Just our younger hand and our older mouth. The key difference between saving and investment is that saving is putting money aside for something, while investment is putting money to work. Compounding means the work that money does has a greater and greater impact. Consumption means the impact stops as it is swallowed. Once we liberate our hands from our mouth, the game changes. We shift from being consumers to being custodians.

We see based on what we have seen, and what we want to see. Businesses don't give a pre-set return or guarantee the Capital will survive. Over the long term, return is based on adding demonstrable and recognised value. What you do matters. Over the short term, price is based on what investors have seen, what they worry about, and what they want to see. Over the very long term, the US Stock Market (e.g. S&P500) has generated nominal returns of roughly 7% (with several dramatic falls). Stock pickers normally would want more. How much more? The more aggressive the model, the less the distant future appears to matter. If you want stocks that will return 20%, you'll see stocks that will return 20%. Financial Modelling raises more questions than answers. Still worth doing, but with a pinch of salt. At 20%, the maths means anything 5-10 years out becomes a significantly smaller, almost negligible, part of the decision-making process. That is dangerous. It's no surprise prices are all over the place when our eyes are only on the next 5 years. This too will pass. Ensuring a Future matters.

If something is free, you are not the client. You are the product. The same is true with the Stock Market. You don't "play" the Stock Market. It is not a game. It is true that Traders can trade anything with a pulse with no regard to what it refers to. The "fundamentals are free", because the product is the other people who are trading. If you are "playing", you are playing against some of the most sophisticated and resourced poker players alive. Investing is different. There, the fundamentals matter. You are buying a slice of ownership in an underlying business. You can't get played if you have a long-term horizon. Then what matters is the quality of the offering, culture, management, and people in delivering their problem solving. What matters is the strength of the company to endure through difficult times. To emerge. In a dynamic world where they have to respond to a changing environment. You don't have to respond. You can sit on your hands. The "Investor Behaviour Penalty" is a well-studied phenomenon where the average investor underperforms the thing they are invested in, by second guessing and buying in and selling out at the wrong times. Sometimes, the best thing to do is nothing.

Hut Taxes were used by the British Colonies to force people out of subsistence lifestyles after the Anglo-Somebody wars. In South Africa, this led to the Bambatha Rebellion in 1906, which galvanised the post-war identity of the Zulu people. If you need to pay taxes, you need money to pay it. This means problem solving needs to have a number put on it. One way to think of a Universal Basic Income is as a "Reverse Hut Tax".

It allows people to reinvest in the basics. To have sufficient money to have parcels of time where they don't have to think about money. To rebuild a base, that allows them to survive periods when a hand-to-mouth, pass-the-parcel, economy is not functional. To build basic competencies (that get outsourced when you are just one link in a fragile value creation chain. We can be seduced by specialisation. Just doing the one thing we are good at. That is fine, until it isn't. Winters aren't a surprise. Creative Destruction requires periods of unlearning and rebuilding. Without endurance and resilience, creativity can have no roots to draw sustenance from.

Bottom-up Stock Picking is equivalent to seeing people as individuals and communities rather than abstract prejudices. It's easier to simplify people and businesses into races, nations, and asset classes. It's lazy. A bottom-up stock picker has a universe of thousands of public businesses from around the world to choose from. For most, you can afford to put them in the "Too Hard Pile". You don't have to have an opinion on everything, and you can admit ignorance on the vast majority of hard questions. You can gradually build an opinion on the endurance, resilience, and creativity of enough businesses to allow a margin of error. The first question is always, "what if I am wrong?". Fundamental Investing isn't about predicting the future. It is about creating an environment for sustainable growth in a world that is complex, ambiguous, and random. The key is time. You buy yourself time through consistent investing in strength, flexibility, and control. The peaks and troughs become the inevitable and predictable chapters in a much longer story of staying alive, and making a contribution to the conversation.

Hans Rosling divided the world up into 4 income levels which he argued were more useful than the traditional Developed-Developing perspective. I am interested in the transitions. How does someone get from Level 1 to Level 2 ($2), 2 to 3 ($8), and 3 to 4 ($32). A challenge we face is that the first step of building a business is finding a community (with money) with a problem you know how to solve. Money attracts problem solving through supply and demand. 1 Billion of us consume more than $32 a day, and most of the money will be directed at solving our problems. Putting cash in the hands of the billion people who consume less than $2/day will suddenly make solving that set of problems a bigger priority. The best decision maker of what problems need solving would be the person with the problem. The best provider of a solution is likely someone who has recently had the same problem. Not someone projecting their Level 4 "competence" onto a world they know little about.

When you snap the connection between consumption and finance, the game changes completely. You don't have to rein anything in. Consumption becomes a rounding error. More than 99% of Warren Buffett's fortune was made after the age of 50. His financial planning has absolutely nothing to do with financing his lifestyle. He sorted that out long ago. For years, it was all about reinvestment. That was Adam Smith's real magic word. Not Profit. Reinvestment. That shifts the Rich from living a life of Conspicuous Consumption because every dollar you consume is a dollar you fire.

Debt, Government debt, potential default and the ZAR

By Dr Alex Pestana, Head of Fixed Interest, Counterpoint Asset Management, 17 March 2020

Lessons for South Africa from Lebanon and Argentina

Amidst the market turmoil last week, Lebanon announced that it was defaulting on its debt for the first time in its history. After several weeks of political debates around potentially defaulting on its hard currency debt, prime minister Diab announced on Sunday the 8th March that the Lebanese authorities would not be repaying 1.2 billion USD of debt due on the 9th March 2020.

Debt is a marvellous device, vital to the functioning of the global economy if effectively deployed. Here's how it works: At a cost called interest, people called lenders make sums of money available to borrowers, which allows them to consume straightaway not only what they need, but also what could be prudently delayed until affordable. There is the annoying inconvenience of having to pay back the money, together with the interest of course, at some predetermined time in the future. But tomorrow is tomorrow, mañana and all that, the party is underway and everyone is itching to dance. All the while, the future creeps up with a nagging relentlessness, or is destined to for the next five billion years, when the sun will turn into a red giant star and its outer layers will expand out to the orbit of Mars, engulfing our planet in the process. So, one fine day the pay-back date arrives.

What happens if debtors cannot pay back the money on the allotted date, if they default? Ah, therein lies the rub. In Victorian times, debtors were thrown into prison. Charles Dickens's novel Little Dorritt is centred around life in the Marshalsea, London's notorious debtors' prison. In some Arab states, debt is still criminalised to this very day. In financial markets today, caveat emptor applies. The dispenser of loans beware; the lender takes the risk. Of course, lenders have ways and means of extracting their cold cash from reluctant payers. They can turn nasty on debtors who do not pay. Some of their methods are none too salubrious. Threats, baseball bats, guns, heavies, hitmen, torture and other horrors have been visited on reluctant debtors, some of which, at times, work. But at the end of a day, you cannot squeeze water from stone. If the money has been squandered, it's just not there for all the baseball bat waiving.

> ***"Annual income twenty pounds, annual expenditure nineteen [pounds] nineteen [shillings] and six [pence], result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery."*** - Charles Dickens in David Copperfield

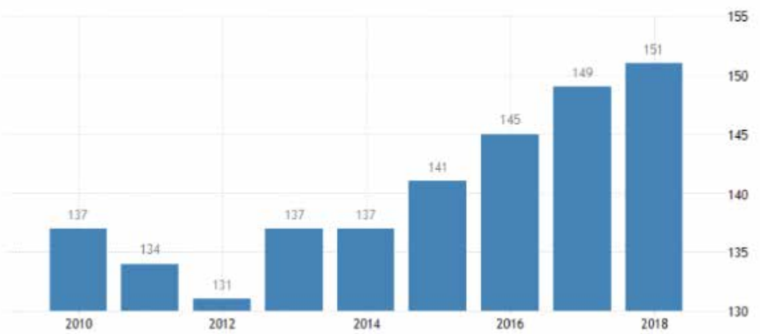
The way not to lose money is not to lend it out in the first place. Or if you do, take care. Spread your lending and ensure that the interest rate compensates you for the degree of default risk. This is bizarrely why the weakest borrowers, those who need debt most, pay more for it - if they can get it.

At the level of nations, the same principles apply as to individuals. There are debtor and lender nations, as well as the baseball bat equivalent of enforcing payments. Debt repayment used to be enforced by gunboat diplomacy. For example, during the Venezuelan crisis of 1902-1903, European powers imposed a naval blockade against Venezuela in order to get it to pay its foreign debt. An armada of warships menacing around their ports can be a persuasive sight to reluctant payers. The global landscape is seemingly gentler today. Countries raise money on international bond markets, which is a community of professional investors across the world who lend money, including to sovereign states, in exchange for bonds. Bonds are essentially legally enforceable notes issued by borrowers, promising to pay the money back at the end of a period, typically years, together with periodic interest payments called coupons, typically every six months. In bond markets, borrowers get the money, lenders get pieces of paper and hope not to bother their lawyers once the debt falls due. But lenders still hold a big stick. Essentially, when a country runs out of money, It typically defaults by missing a coupon payment, or not paying back a maturing bond. [E.g. South Africa did not pay out its debt obligations for four months in 1985]. This triggers a legal process, but lenders to defaulters invariably lose money. The debt of the defaulting country is usually restructured, and lenders get whatever the restructured value of the debt is deemed to be when the process settles. An economic crisis follows, usually followed by a political crisis, as faith in the government collapses.

That does not mean that the defaulter goes without punishment. The problem is that the defaulting country still needs money. It needs foreign reserves to keep its economy afloat (to import oil, say). Alas, owing to the default, the international bond markets close ranks on the defaulting country. Credit lines freeze up. The defaulter is now in a desperate situation, with limited options. A defaulting sovereign might approach a power such as China, which might lend to the troubled country subject to certain conditions, usually in the form of trade deals or concessions. The defaulter may also approach the IMF, which is a punitive option. When approached for funds, the IMF sends in a team of people and effectively takes over the finances of the country. Money is disbursed according to a checklist system. It's called 'attached conditionality' in the trade. Austerity rules. Toe the line, comply, be good and do as you're told by the IMF, and you'll get money paid out from their programme. Else you don't. That's a rather precarious situation for the debtor nation to find itself, for it may be ordered to cut down drastically on its civil service or social grants, say, which could wreak havoc with political stability. Understand that, and you understand why protests flare-up against the IMF across the globe from time to time. Not that it's the IMF's fault, no. They're only there to help.

How did Lebanon land up in this situation? It took on too much debt.

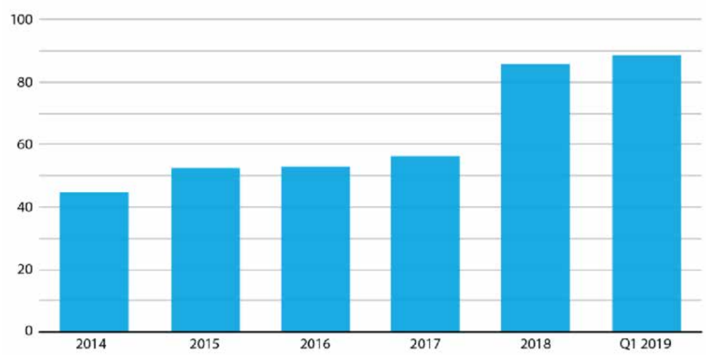
Chart 1: Lebanon: Debt/GDP (Source: Ministry of Finance, Republic of Lebanon)



Lebanon's debt rose to over 150% of the size of its economy in 2018. Interest payments on its debt as a percentage of government revenue inflated to 45.7% in 2017, clearly an untenable situation. Something had to give, and it did. They failed to pay. Falling on their sword were investors in Lebanese bonds. Faced with negative interest rates in large swathes of the developed world, they were prepared to chase yield at any risk wherever they could find it across the globe. Their ventures led them to the spicy sub-investment bond markets, also known as junk bond markets in the trade, which comprise exotic locations such as Lebanon. In just over two years, the price of the Lebanese 15y USD bond fell from 100 to below 25, a drop of 75% in value. An investment in an index of safe-haven US treasuries, the debt of the US government, would have returned 20% over the same period.

Argentina is another case in point. Unlike Lebanon, Argentina has been a periodic defaulter on the world stage since the first of its nine defaults in 1827. It has a history of debt crises, including three times in the 21st century. Two of these credit events occurred between the year 2000 and 2017. Yet the bond market, as though afflicted by a short memory or dazzled by the higher dangled yield, was there anew for Argentina in 2017. Despite a rapidly worsening debt situation, in June 2017 Argentina was able to raise 2.25 billion of USD debt at 7,125% interest, the principal to be paid back in 2117. In other words, three years ago, Argentina managed to float a 100-year USD bond in the markets, the principal to be paid back a century hence.

Chart 2: Argentina: Public Debt to GDP (Source: Argentina Economy Ministry). An alarming deterioration.



In August 2019, just over two years later, Argentina defaulted. It began re-structuring its towering debts, as before. The price of their bonds collapsed once again (see Chart 3)

Chart 3: Argentina 100y USD bond, price. (Source: Bloomberg).

Most alarming was the action of the Argentinian peso against the US dollar. A mere five years ago, in March 2015, a dollar bought around 8 Argentinian pesos.

Today, a US dollar buys 63 pesos. The Argentinian currency has depreciated by over 85% in five years.

Chart 4: Argentina Peso versus US Dollar. (Source: Bloomberg).

In the case of both Lebanon and Argentina, a rapid accumulation of debt got them into trouble. Which raises the question: What is the situation in South Africa?

South Africa's debt-to-GDP has been rising at a vertiginous pace since 2008, when the ratio reached a low of around 25%. The latest figures released by the South Africa national treasury during the February 2020 budget speech make for rather disconcerting reading.

Chart 5: South Africa – Debt/GDP and Debt-Servicing costs (Source: SA National Treasury, February 2020). On an unsustainable path?

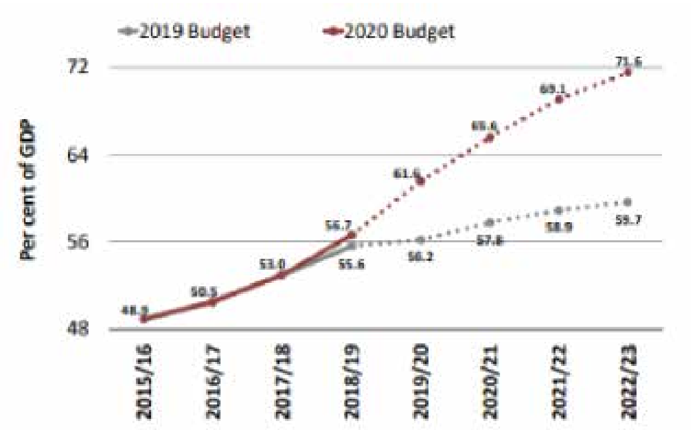


Figure 1.1 Gross debt-to-GDP outlook

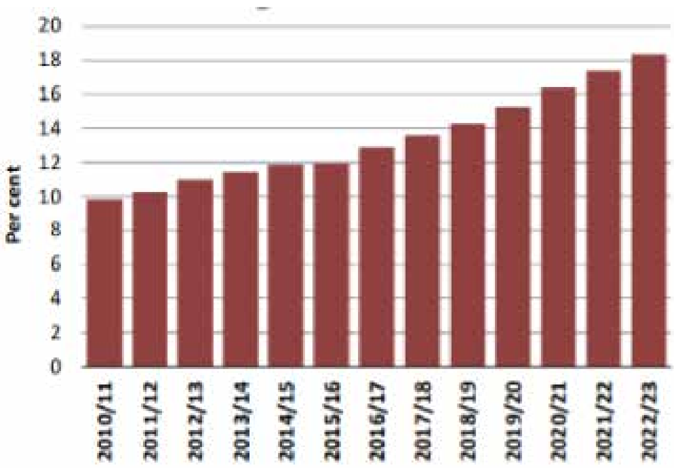


Figure 1.2 Debt service costs as proportion of main budget revenue

The forecast gross debt/GDP profile, which in previous budgets rose to an inflection point a few years into the future, after which it was projected to turn downwards, no longer does so. It is now projected to rise monotonically over the forecast window. Debt servicing costs are projected to rise to over 18% of the main budget revenue by 2022/3. This means that of every rand expected to be raised in taxes in that fiscal year, 18 cents will go into paying off interest, crowding out other forms of expenditure. Government realises that stabilisation of the debt burden is crucial and is relying on negotiations with unions etc. to moderate wage increases, as well as on natural attrition and voluntary retirement to bring down its costs.

What the government really needs is a strong economy to lift it out of its debt spiral, in fact a sustained GDP growth rate of close to 3% is needed to bail it out of its malaise. This seems quite unlikely at present, as economic problems will be compounded by the nefarious effects of the COVID-19 virus this year. In fact, South Africa will likely experience a full-blown recession in 2020.

> ***"Neither a borrower nor a lender be For loan oft loses both itself and friend."***
>
> - William Shakespeare in Hamlet Act-I Scene III

Economic forecasters we follow are downgrading SA 2020 GDP growth to zero and even into negative territory. A weakening economy makes it more likely that parastatals will call in their government guarantees, placing a greater burden on the fiscus.

If economic growth fails to materialise, higher taxes are implicated, further dampening growth. Projecting the situation a few years into the future, the Moody's debt downgrade will be a fait accompli, yesterday's concern. South Africa will be a sub-investment grade destination, proscribed to investment grade investors. When money proves hard to find, the IMF lies benignly in wait, China too. At that point, the ZAR (rand) at around 16/US dollar might seem a distant bargain. Steep ZAR depreciation might lead to higher inflation, placing hardship on the populace, 18 million of which receive social grants that might have to be cut. That is a recipe for social upheaval. It is imperative that the hard medicine be taken now, and that government proceed with more stringent savings and lose no time in implementing the necessary reforms.

Chart 6: The ZAR and the Argentinian Peso vs. the US Dollar (5 years, March 2016 to March 2020). (Source: Bloomberg).

.Alex Pestana is head of Fixed Interest and an Investment Strategist at Counterpoint Asset Management (CPAM). Views reflected are his own and should not necessarily be attributed to CPAM.

> ***"It is the mark of an educated mind to be able to entertain a thought without accepting it"***

Lockdown - Managing financial consequences of family finances

By James Guimaraens, Director, Sterling Private Wealth

It's inevitable that, as the severe financial consequences of the economic lockdown reverberate through the economy (locally and globally), so our clients will be confronted with the implications within their own immediate community. Family and friends will face cashflow problems, and in many cases existential threats to their livelihoods.

Money, family and religion. The three biggest contributors to relationship challenges within our family and social groups. Appropriately handled, and you will be blessed with a harmonious existence. Inappropriately managed, and we see the results in fractured and acrimonious relationships, often with permanent consequences. We hope that our observations and suggestions assist our clients in establishing a framework within which to tackle the first two intertwined issues – money problems and family relationships.

"Now is the time to provide leadership to your family"

Leadership - Rise to the occasion

Now is the time to provide leadership to your family. When times are tough and uncertainty abounds, your family looks to you for leadership and guidance. And just like in your business career, leadership doesn't necessarily mean your decisions will be liked. Making tough choices is far more difficult but more enduring, than the easy route, which often ends badly.

We spend the majority of our time guiding our clients on subjective issues beyond the elementary aspects of portfolio management. Money is without doubt the greatest source of family conflict. Furthermore, relationships between siblings deteriorate as the years pass. Any jealousies, inequalities or perceived unfairness, manifests itself in fractious relationships right through until those siblings reach retirement age.

Loans to family - where to start

Any financial assistance to family or friends is a highly emotional and subjective situation. Start the process by trying to be as objective as possible. When you are approached for a loan, or you identify that there may a need in the near future, apply basic common-sense criteria:

Critical or Lifestyle? Paying the school fees for three months, purchasing groceries, assisting with medical aid; these are essential items, for which you have a certain obligation. Loaning a large lump sum towards a home renovation or new car is not essential. It's a lifestyle-driven need.

Cashflow or Lump Sum? Rather assist with monthly contributions than a once-off lump sum. Lump sums are easily spent. Monthly financial assistance provides essential cashflow assistance, whilst limiting the ultimate size of the loan.

Loan or Donation? Be realistic about whether you expect the money to be repaid - the intention may be there, but on reflection the warning signs indicated repayment was probably unlikely.

Managing expectations

Conflict arises when there is a difference in expectations. The son perceives that his parents are wealthy and therefore any loan should be on an altruistic basis to "help him out". The parents expect the loan to be repaid with interest to keep things fair. The months pass, and the situation becomes untenable. The son is under financial pressure and doesn't prioritise his family finances appropriately. His siblings resent the financial assistance and the lack of priority to repay. The parents are caught between the emotional need to assist their son, and the realisation he won't be able to repay the money.

> ***"Communication is critical in managing the situation pro-actively."***

1 **Opportunity Cost** - The funds you utilise for a loan have an opportunity cost, which is not limited to the return you are earning within your portfolio, but also the implications for your own liquidity.

▪ A large lump sum withdrawal requires your portfolio to be restructured to ensure you have access to liquidity after the withdrawal. This reduces your opportunity for long-term returns as and when markets and currencies provide investing opportunities. You no longer have the liquidity to take advantage.

2 **Communication –** Ensure that the family member realises that your assistance comes with an opportunity cost, which affects everyone in the family. Therefore, the borrower should propose the amount and the terms under which they wish to borrow the money, and this should be communicated in writing (e-mail) to you.

▪ Committing requirements in writing requires more intensive personal reflection and consideration. It also reduces the dominance of subjective or emotional issues and distils the issue down to numbers.

▪ A written request provides you, the funder, with time to reflect on the request, debate it with your spouse and any appropriate trusted third party, and to then reply with sensitivity, but on counter-terms that are acceptable to you.

3 **Worst Case Scenario –** Manage your own tolerance for risk or uncertainty and the related anxiety it will cause both you and your spouse.

▪ Assuming the funds cannot be repaid, would you still make the loan?
▪ Will you enforce the loan obligation if the family member passes away?
▪ What happens if they unexpectedly divorce?
▪ Can your portfolio tolerate the financial implications if you have to accept there will be no repayment?

4 **Consistency –** Formal communication between the parties provides you with time to reflect on historical issues and financial assistance to other family members. Consistency, fairness, but cognisant of differing circumstances, will ensure the final decision is defendable and reasonable. Future family relationships depend on this.

Financial resposibility and reflection

Hard-earned money is not easily spent. Borrowed money is. When you buy a car using your own cash, you will negotiate everything. Every R1,000 saved has meaning. Purchase a car with finance and all you focus on is the monthly repayment. Buy a large house with a large bond and the focus is on the monthly repayments. It's easy. But try selling your home to a cash buyer! They will haggle on everything, because every Rand saved makes a difference.

We live in a world of immediate gratification, convenience, and materialism. Borrowing money to grow a business is productive. Borrowing money to fund a lavish home or car will have consequences when financial challenges arise. All of us will be confronting the harsh economic reality of the current global lockdown and the severe economic ramifications. It will affect friends, family, and colleagues. But in many cases, the financial hardships are exacerbated by profligate spending funded by debt. And there must be a price to pay. Companies with conservative balance sheets have been sharply criticised over the past few years. Why sit on cash? Pay it out, borrow, buy back shares. They will reap the benefits of a conservative approach, just as businesses with highly geared balance sheets will now face their reckoning. This surely also applies to individuals.

Assist your family because you must and because you want to. But be wary of supporting a lavish lifestyle funded by debt. If the importance of financial prudence is not learnt now, it never will be.

In closing, you are the best custodians of your family's future inheritance. It can be an onerous responsibility for you when others require assistance. We are here to support you and your families during these tough times. We provide you with that third-party source of objective guidance and advice. We understand the subjective issues, we know your families and most importantly we know you. And we will combine our objective experience and professional knowledge with the subjective sensitivity required to assist you in navigating what will undoubtedly be testing times for our clients and their families over the forthcoming months.