Sterling Times

DECEMBER 2023 EDITION

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STERLING
PRIVATE WEALTH

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Introduction by the Managing Director

Graydon Morris

Dear valued clients and friends

We are nearly at the end of 2023, can one believe it, again, another year passing us by?

Someone, stop the clock!

It has been mostly a tough year for South Africans, electricity supply issues escalated, little was done, again, to fight corruption, and convict perpetrators, and major metro centres continue to be managed by bizarre coalition governments with small players dictating terms. We've been through a lot.

What an incredible ray of sunshine, then, was our miraculous defence of the Rugby World Cup.

Was October not just amazing? Three weekends of nail-biting, courageous and fantastic rugby. Our warriors did so much to make us proud, bring a smile to our faces, and make us all feel good to be South African. It was a special time.

I had German visitors at the time of the street parades of the returning World Champions. They attended the parades and later told me how they were in tears at the sheer emotion of the crowd reaction, and the unbridled joy they witnessed.

It has been a volatile year for markets, the Rand has been weak, and many SA businesses have struggled. The silver lining is that most asset prices are now up, recovering well out of 2022, and we are probably soon to be faced with a more relaxed interest rate cycle, locally and globally, as inflation wanes. This should be favourable for growth asset prices, and as Eskom improve supply, coupled with a heightened private sector contribution, outcomes should be more favourable. Toward the end of next year then, the dreaded load shedding should reduce markedly and potentially revive our economy, a much-needed "shot in the arm", hopefully.

Our wealth managers have been hard at work, tweaking portfolios, meeting with clients, and providing highly personalised service. We are, as always, highly indebted to our loyal clients for their long-term support and loyalty.

The relationships we have are key to a mutual understanding of what it takes to succeed and meet one's goals. Our Model Portfolios have shown strong performance for the year, and most client portfolio Reviews have been met with pleasant surprise at how robust investment positions have been.

I thank our Investment Committee and all those who play a part in building optimal outcomes for investors. We launched our Global Flexible Fund in June of this year and this in-house multi-manager, multi-assert solution has got off to a very solid start. This Ireland Domiciled Fund is available to direct global money and provides a tax-effective solution.

We undertook some "above the line" brand building this year, and some of you may have seen our Financial Mail, Daily Maverick and Social Media posts and pages. More of this will continue into the New Year.

We have assembled a few topical and interesting pieces in this end-of-year Sterling Times.

What remains is for me to wish all our valued clients a blessed festive season, safe travels and a wonderful 2024. We look forward to seeing you all then.

We hope you enjoy the read.

Graydon Morris
Managing Director


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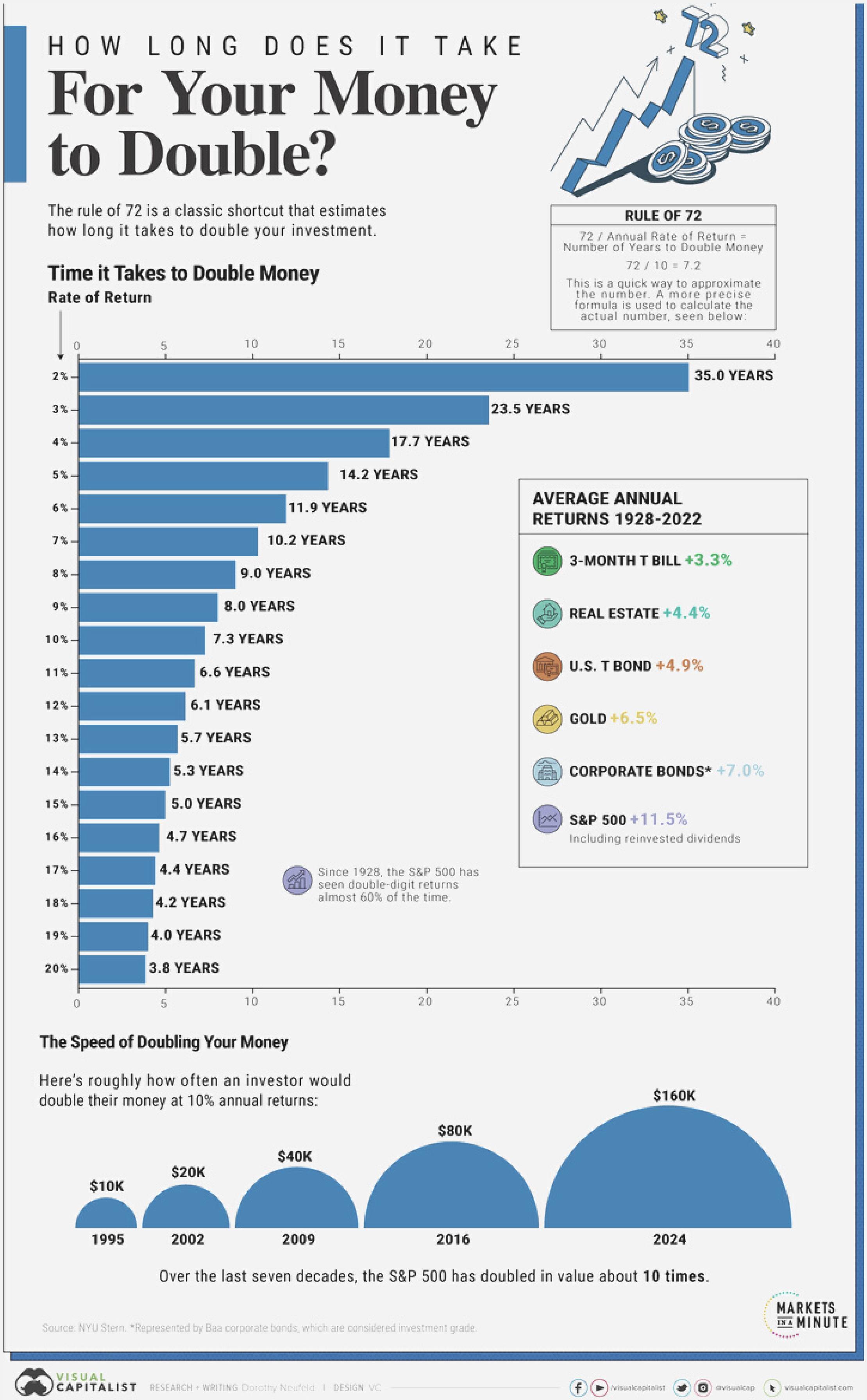
HOW LONG DOES IT TAKE
For Your Money to Double?
72
The rule of 72 is a classic shortcut that estimates how long it takes to double your investment.
RULE OF 72
72 / Annual Rate of Return = Number of Years to Double Money
72 / 10 = 7.2
This is a quick way to approximate the number. A more precise formula is used to calculate the actual number, seen below:
Time it Takes to Double Money
Rate of Return
2% 35.0 YEARS
3% 23.5 YEARS
4% 17.7 YEARS
5% 14.2 YEARS
6% 11.9 YEARS
7% 10.2 YEARS
8% 9.0 YEARS
9% 8.0 YEARS
10% 7.3 YEARS
11% 6.6 YEARS
12% 6.1 YEARS
13% 5.7 YEARS
14% 5.3 YEARS
15% 5.0 YEARS
16% 4.7 YEARS
17% 4.4 YEARS
18% 4.2 YEARS
19% 4.0 YEARS
20% 3.8 YEARS
0 5 10 15 20 25 30 35 40
AVERAGE ANNUAL RETURNS 1928-2022
3-MONTH T BILL +3.3%
REAL ESTATE +4.4%
U.S. T BOND +4.9%
GOLD +6.5%
CORPORATE BONDS* +7.0%
S&P 500 +11.5%
Including reinvested dividends
Since 1928, the S&P 500 has seen double-digit returns almost 60% of the time.
The Speed of Doubling Your Money
Here's roughly how often an investor would double their money at 10% annual returns:
$10K 1995
$20K 2002
$40K 2009
$80K 2016
$160K 2024
Over the last seven decades, the S&P 500 has doubled in value about 10 times.
MARKETS IN A MINUTE
Source: NYU Stern. *Represented by Baa corporate bonds, which are considered investment grade.
VISUAL CAPITALIST
RESEARCH + WRITING Dorothy Neufeld | DESIGN VC
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The Paradox of Past Performance

By Joe Wiggins, UK Investment Analyst

Although we may not like to admit it, the past performance of an asset class or fund is likely to have an overwhelming influence on our decision-making. We may try and mask the hold it has on us, but we are inescapably drawn towards investments with strong recent returns. The more pronounced and persistent the outperformance, the greater the pull. There is probably no more prevalent nor puzzling paradox in investing – in order to enhance our returns, we make decisions based on a measure that is likely to reduce them.

The past performance of an asset is the returns that we are not going to enjoy. They have been (at best) drawn forward from the future – the better the performance before we invest, the worse they will be after. Unusually strong returns are typically the result of unsustainable tailwinds, random doses of good luck and the inescapable swings of market sentiment.

Periods of abnormally strong performance mean that an investment has become more expensive and that it has earned higher returns than it is reasonable to expect on average. Both factors act as a gravitational pull towards future disappointment.

Why do we have such a strong tendency to read the wrong signal from past performance?

- Extrapolation: We seemingly cannot avoid believing that trends of the recent past will persist, even when this view seems to be contrary to any rational analysis.

- Outcome Bias: Whether it be for a stock, fund or asset class, when we witness strong performance we imbue that thing with some inherent goodness (and vice-versa).

- Career Risk: Although performance chasing might objectively appear to be an odd strategy at an aggregate level, for an individual it might be the best way to keep our job or avoid another difficult meeting.

- Instant / Delayed Gratification: We have an ingrained preference for doing things that make us feel better in the moment over waiting for rewards that may occur at some uncertain future point.

The paradox inherent in investors' unhealthy focus on past performance does not mean that we should scour the market for the most egregious laggards, but rather be wary of the influence of high historical returns on our decisions and realistic about its likely consequences. Unusually strong past performance should make us concerned not confident.

Joe Wiggins, UK Investment Analyst

The Silver Lining for Fixed Income Investors

By Lyle Sankar, Head of Fixed Income PSG Asset Management

Fixed income investors find themselves confronting three key factors that are complicating decision-making in the current environment. Money market rates are at a high, but with falling inflation, it seems unlikely that these will be maintained indefinitely. Many consider longer-dated government bonds as a risky choice and are hesitant to invest further out along the yield curve. And lastly, with so much uncertainty locally, some investors are tempted to rather try and take advantage of high yields offshore.

We believe that patient fixed income investors can be well rewarded even in the current uncertain macro environment, with the ability to lock in the prevailing high yields and achieve inflation-beating returns. With bond yields pricing in a significant degree of negative news, investors will need to focus on the most important aspects that will drive returns to enjoy the benefits of the current yield environment.

Money market returns are likely to moderate in the future

Money market rates have played their role to perfection as a safe capital store offering progressively higher yields during the South African Reserve Bank's (SARB's) aggressive rate hiking cycle. But investors should be asking themselves whether the SARB will continue hiking the repo rate given moderating inflation, and with other emerging markets beginning to cut rates. While we don't believe the SARB will cut rates as fast as it hiked and is likely to keep the repo rate ahead of inflation, money market yields are at risk of trending lower. Meanwhile, bond returns should respond positively to a lower repo rate – driving significant relative outperformance of long bonds.

The risk in local government bonds is more manageable than many think

While SA's government debt (forecast to reach 80% in the near term) is not out of line with other emerging markets, low growth projections lead many to question whether government bonds will remain a safe store of capital. However, taking a closer look at the metrics, we don't believe that a debt crisis is likely in the medium term. South Africa has a very well-structured debt profile with only around 12% of long-dated bonds maturing over the next four years.

The SARB has also had a world-class track record since implementing its inflation-targeting mandate and inflation is less likely to exceed target levels on a sustained basis. If a debt crisis is a low-probability scenario and inflation averages 5.0% to 5.5%, investors who buy these government bonds at an average yield of 12% today will earn inflation plus 7.0%, which is on par with long-term equity real returns. Importantly, this is not premised on a high-growth environment in SA. The rate-cutting cycle (and the potential for a slightly better environment) further adds the optionality of capital appreciation to the investment thesis.

Developed market rates offer more risk than reward

US yields are now five times higher than during the Global Financial Crisis (GFC), and thus many investors are wondering if it isn't time to consider offshore fixed income assets. While we do see (and use!) the diversification benefits of offshore assets, we would be cautious of a strong risk appetite for these markets. Investors make a critical call when shifting assets offshore, as we have seen in the past year – both on the valuations of the assets they buy and on the currency risk.

In our view, developed market bonds pose a significant risk of capital losses as key markets (the US, UK and Japan) continue to run budget deficits against substantial debt maturities. The US has approximately 46% of its debt maturing in the next four years. This creates a cocktail of significant bond issuance at a time when yields are five times higher than in recent years, producing a spiral of interest costs. We also don't believe developed market inflation will be contained at the 2% target rate, given that supply-side constraints will take multiple years of investment to resolve. These headwinds are likely to force yields higher, resulting in very poor returns for investors.

Secure the silver lining by ensuring your portfolio is correctly positioned

While money market and offshore rates may currently appear attractive, we believe these areas have to be navigated with care, given the uncertain macro environment. We believe multi-asset income funds are well placed to provide investors with inflation-beating income exposure in a manner that preserves capital and manages short-term volatility. However, in unlocking the opportunities on offer, investors will need to ensure that they partner with an investment manager who can assess the risks and opportunities in the market rationally, and construct robust portfolios that take care to manage the risks and avoid permanent capital losses.

Lyle Sankar,
Head of Fixed Income PSG Asset Management

An Eagle can’t choose to walk. They will die.

Ironically, our choices can be limited by wealth if we live in a hand-to-mouth culture. If someone is expected to pay their way themselves then the “entry ticket” to their community will limit the realistic options they have for what career to pursue.

This makes it harder to make alternative choices if we are in a consumption arms race.

A rule of thumb I use for if there is market dysfunction is if the price isn’t going down over time. Health, Housing, and Education are the obvious examples for me. If the price of those keep going up and they are used as assets/ status symbols (ie we want the price to go up)… that will limit the life choices of the income wealthy.

Income Wealth is earned through a musical chair's process of paying a lot for a limited number of opportunities behind barriers to entry. If you want to earn that, you HAVE TO play by the rules.

The rules usually mean Science, Technology, Maths, and Engineering jobs in a business/money-making context. Not all good ideas are good business ideas, and you can only work on good ideas that don’t make money if (1) you (or a patron) can pay for them, and (2) you don’t need money to fund your own spending (because you have Capital/Support).

The Eagles Nest problem makes it very important that you consider the impact the choices you make have on limiting the choices of the next generation.

By Trevor John, Old Mutual International

A View on Gold

Mark Seymour, NorthStar Asset Management

Warren, I think you're wrong about gold!

Warren Buffett's letters to shareholders are a profound source of valuable insights for anyone learning about investing.

In his 2011 address to shareholders, he highlighted the critical aspect of owning productive assets that can deliver outputs that retain their purchasing power value with minimal ongoing capital investments.

The most crucial hurdle is inflation.

Yes, equity is the asset class best suited to maintaining its purchasing power value, depending on the industry tailwinds, management's skills, and the competitive advantage of its products. In addition, investors only benefit if the company delivers solid earnings per share and the value of its assets is maintained.

Warren is scathing with his views on Gold, where he points out that the metal has limited use and has no productive value. He asserts, "If you own one ounce of gold for an eternity, you will still own one ounce at its end."

Ironically I think this is a true statement which undermines his negative views on Gold. Unlike a productive asset, for example, a brand or a piece of machinery erodes if not maintained, an ounce of Gold will hold its form for eternity without any maintenance.

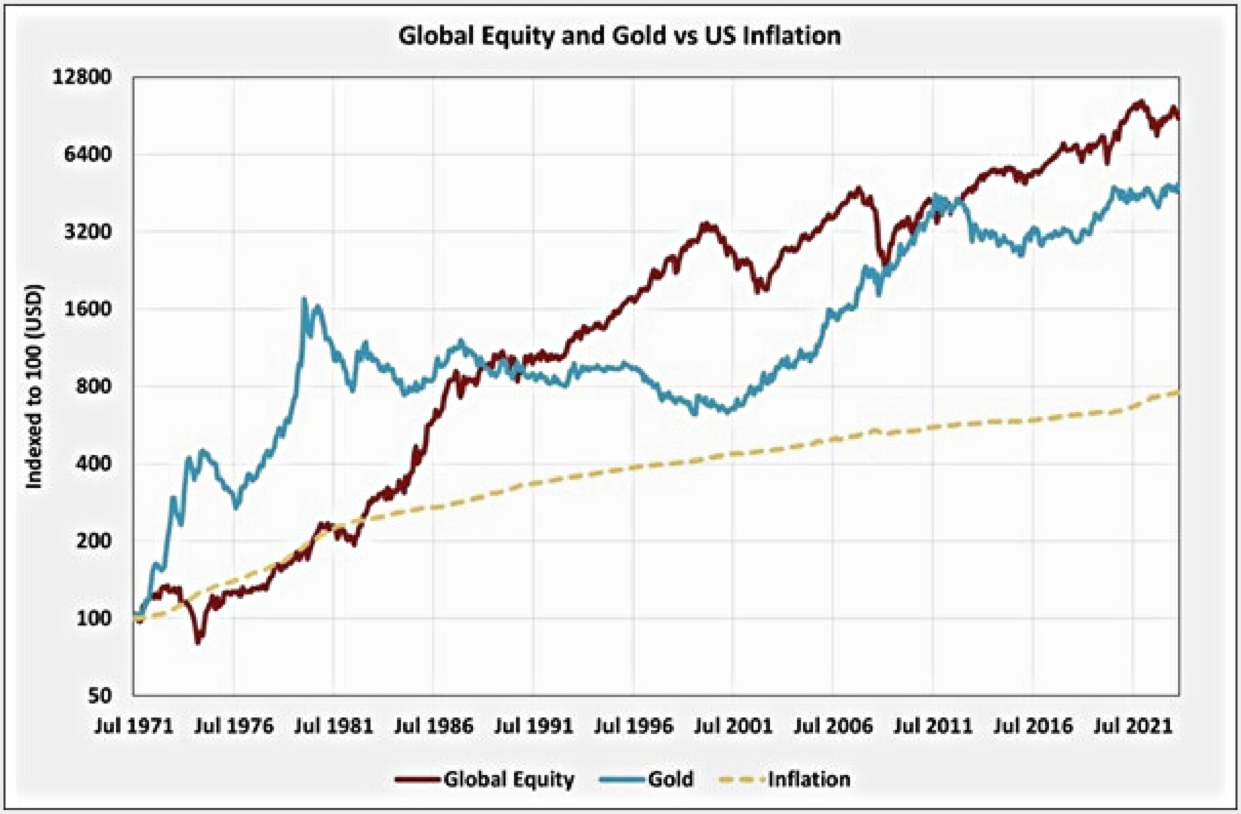
In addition, brands and pieces of machinery are not unique or scarce. Humans can produce an unlimited number of brands or machines, unlike Gold, which is scarce and has a limited supply.

Our understanding of value is further complicated by how we measure it, which in units of monetary value. The main problem is that money itself has infinite supply, which means that not only does a productive asset need to be maintained, but it also needs to produce things at an increasing rate and or price to retain its value.

I would say that a productive asset serves two purposes: 1) it produces useful things or services we consume or need, and 2) for investors, it maintains or grows its value.

On the other hand, Gold has the extraordinary ability to maintain its value, especially during periods of high inflation, a competitive advantage when even companies with extraordinary pricing power begin to fail.

The chart below shows the relative performance of Gold vs the total return of global equities, a stark reminder that gold has maintained its value in real terms and has performed as well as productive assets over time.



By Mark Seymour, NorthStar Asset Management

How to keep your Life Insurance Premiums Affordable

Greg Knowlden,
Sterling Private Wealth - Wealth Manager

Compound interest is amazing. It's great for your investments but brutal for your expenses.

Think of heavy inflation not for 5 years, but 30. Life insurance premiums are probably one of your expenses most linked to the effects of compound interest. There aren't many monthly budget items that consistently increase year on year, by 5% or 15%, and that have a term of 5 or 40 years. Compound interest starts off slow and underwhelming but gathers pace.

There are many examples out there of the power of compounding. An applicable one in this context is 15% per annum over 5 years doubles your money. That applies to investments, but it also applies to life insurance premiums. In this example, your R3,000 per month life insurance premium is R6,000 in 5 years, R12,000 in 10, and in 20 years it will be R48,000 per month.

The above would be considered an aggressive structure but it provides the context. There are so many clients out there who now have this problem. Their policies have had enough time for the compound interest to gather pace. On top of this, their policy structures now turn up the compounding pressure as opposed to stepping on the brakes.

It really puts a person in a tough position:

- You are now probably much older. Age is a huge variable when determining insurance premiums. Trying to find an affordable alternative 20 years after the fact is potentially not a viable option, or is, but so much premium has been wasted by not being cognisant and actioning this upfront.

Below are different premiums for the exact same person and identical benefits, with the only difference being the client's age:

  - 30-year-old = R700
  - 40-year-old= R1190
  - 50-year-old = R2480
  - 60-year-old = R4800

- Your health has possibly deteriorated. It is harder and harder to get favourable medical terms from the insurers (i.e., to be covered for your most likely claims). Should your health have changed for the worse since your existing policy's medical underwriting, then applying with another provider might not be an option (the new provider will offer premium loadings, benefit exclusions, and declinations, all probably in relation to your most likely claim).

- For the above scenarios, you are now potentially stuck on your aggressive and unfavourable compounding path until you claim or are forced to cancel the cover earlier than you intended due to affordability.

So how do you keep your life insurance premiums affordable? The truth is that it's actually very difficult to keep your premiums down over extended periods. I don't believe the industry wants that. The industry likes new business which means new premiums (that applies to automatic cover increases, benefit upgrades, and so on). .

Nonetheless, the below should provide some valuable guidance:

Some truths

- Insurance is an expense and should be treated as such. Contain the expense for your term. Know your long-term compounding path and be comfortable with it or try to exit it soonest. Know what brakes are available too, should the compounding look intolerable in the later years.

- Most policyholders do not put in a claim.

- Most clients do not hold these policies to the grave. One, the compounding gets out of control and makes it unaffordable - you need to plan the policy upfront to hold it for extended periods (i.e., pay more upfront for a less aggressive premium pattern). Two, does it even make financial sense to hold all the built-up cover in the later years?

- Many of these overly complicated money-back schemes and similar ones, do not benefit a considerable amount of their clients and are far more of a long-term commitment than people give credit for. Think of what your premiums will be in the later years to finally receive the dangling carrot (which contains far too many ifs, whats, maybe's). Compound interest on your premiums is guaranteed. Worry about that more and how that impacts you in your 50's, 60's, and beyond.

- The very complicated provider offerings unfortunately only market the best-case scenarios but there are plenty of people getting a raw deal.

- Don't spend to save. Do everything you can to keep that premium down. Do not be sold unnecessarily with all the bells and whistles that are probably offered to you annually.

- This stuff should be simple. Some structures have made the long-term pricing very complicated. The complexity is intentionally baffling.

- Lastly, insurance is extremely important if you need it. Certain scenarios can prove ruinous without it. Structure your premiums in a manner you can bear.

Contain the expense for the term.

Premium Pattern

- Should the need for your cover be only 5 or 15 years, then by all means go with an aggressive premium pattern (Age-rated or similar). Just understand this is the path where the compounding gets out of control with enough time.

    - The more aggressive your premium pattern, the less one locks in the advantage of taking out cover at a younger age. The Age Rated premium pattern does not lock in the benefits of taking out cover at a younger age. Hence, for so many examples, a client can find a similar age-rated replacement with another provider for a similar premium, even though they took the policy out 15 years earlier.

- Should you have a longer term, or possibly might have one (none of us have a crystal ball), consider a fixed 5% premium pattern or similar.

    - In this example, without cover increases, your premium goes up by just 5%. Age Rated in the later years is more like 10%. It makes a stark difference given time.

    - Sometimes the initial cost difference between Age Rated and 5% is not much. Rather consider something like the 5% flat. At some stage, you can forgo the cover increases and then your premium goes up by just 5%. That's building in brakes where other structures are looking to apply gas.

Cover Increases

- Unlike premium patterns, these are voluntary and can be changed/removed within reason, during the life of the policy (your broker might not like that as they are paid for the premium increase involving the extra cover bought every year). Your cover increases are not for free. The insurer bills you for these with your annual premium increase as though you bought the additional cover for the year as a new business at an older age.

    - Your annual premium increase is a combination of the premium pattern option and the cover increase loaded.

- Do all policyholders with cover increases actually need them? I believe the industry quite often sells these incorrectly for self-gain. Consider the below logic.
    - A lot of policyholders are at most risk at the beginning stages of their policy:
        - They're young and haven't built up an asset base (there's no self-insurance).
        - Their dependents are young and have considerable years and expenses ahead of them before independence.
        - Their debt levels are at their highest.
    - A sensible way to take on this expense is to take the more lenient premium pattern upfront, with small cover increases, and look to cancel the cover increases at your earliest opportunity.
        - Then, inflation can chip away at the cover amounts bringing it in line with your reduced need (investments have grown, children are older, and your debt is that much less).
        - Then bank the premium savings through lower premium compounding over the term. Put those savings to work in an investment so the compounding benefits you, in the other direction though.
        - Then hopefully at some stage (60 onwards), you just hold the cover you absolutely need with reasonable compounding - a good strategy for those requiring cover in later years.
- Should you not need the cover, then a policy with good compounding can be offered to your children, etc. who may continue with the premiums.
    - It is scenario-specific, but sometimes it's a great investment for your child to continue with the premiums to receive the lump sum payment.

In summary, ensure you partner with a broker whose interests are aligned with yours to prevent you from being caught in an expensive long-term trap and invest the Rand difference that you shave from your premiums so that you experience the upside of compound interest. It is imperative to balance the need to contain the expense, whilst still insuring yourself appropriately.

Greg Knowlden,
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