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STERLING PRIVATE WEALTH

A MEMBER OF THE MERCHANT WEST GROUP

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INTRODUCTORY MESSAGE

Dear valued clients and friends,

As we near the middle of 2023, it is fair to say that the year has been one of great despair and anguish for many of us.

The continued disappointment in our government, on any number of fronts, is a bitter pill to swallow.

Whatever, your political view, it's fair to say that we all await the 2024 elections with the hope of a better future.

Hope, however, is not a strategy.

The ZAR has weakened by -13,5% this year and this has led to a very concerned and fearful mindset for local investors. This is perfectly understandable. We carry elevated emerging market risk, particularly when our leaders appear to be too cosy with the criminal network that is the Russian Government. It is an international embarrassment.

The people of Ukraine remain in our thoughts. It is hard to believe that that unprovoked conflict is now 15 months old. The human cost, on both sides, is too terrible to talk about, and unnecessary.

The risk on rally in large cap US Tech is back. This has led to a renewed and elevated valuation differential between areas of the market, both global and local.

It is a difficult time for investors, one that requires calm heads, steady hands on the wheel, and a lot of experience. It is highly likely that the "sell everything in SA at R 19,80/$, externalise your funds and buy the FAANGS" will turn out to be a winning strategy, 3-5 years out.

Every individual's personal strategy needs to be explored, debated, and thought through. Our highly qualified team is always at hand to assist investors through these troubled times.

We have had a busy year to date. Joanne Baynham and Lisa Kaplan, two of our experienced wealth managers who joined us a few years ago were appointed as Associate Directors recently. Joubert Strydom has taken on the role of Deputy Managing Director to assist further in the management of the business and ensure that we are at the forefront of industry developments.

We are working hard on our business continuity, growing young talent and developing the business skills and enhancing technology, almost monthly.

There are a few insightful pieces in this edition of the Sterling Times that we are sure you will find informative.

Enjoy the read.

Graydon Morris

Managing Director, Sterling Private Wealth

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LESSONS FOR FINANCIAL PLANNING FROM THE WORK OF MARK AURELIUS

By Trevor John, Old Mutual International

Marcus Aurelius, a Roman emperor and Stoic philosopher, has shared valuable insights on life, self-discipline, and resilience in his work, “Meditations.” While not directly related to financial planning, his teachings can be applied to personal finance and long-term financial well-being. Here are 10 lessons from Marcus Aurelius that can be adapted to financial planning:

1. Focus on what you can control:
Marcus Aurelius emphasized the importance of focusing on what is within our control. In financial planning, concentrate on elements such as budgeting, saving, and investing, instead of stressing over external factors like market fluctuations.

2. Practice self-discipline:
Financial success requires discipline in budgeting, spending, and investing. He stressed the importance of self-control and restraint, which can help you achieve your financial goals.

3. Set realistic goals:
Aurelius believed in the importance of setting achievable objectives. In financial planning, set realistic and attainable goals that align with your financial resources and time horizon.

4. Adapt to change:
Life is full of uncertainties, and Aurelius emphasized the importance of adapting to change. In personal finance, be prepared to adjust your financial plan when circumstances change, such as job loss, economic downturns, or unexpected expenses.

5. Seek wisdom and knowledge:
Aurelius valued continuous learning and self-improvement. In financial planning, educate yourself on personal finance topics, investment strategies, and market trends to make informed decisions.

6. Live within your means:
The Stoic philosophy teaches the importance of simplicity and being content with what we have. To achieve financial stability, practice living within your means and avoid excessive consumerism.

7. Embrace long-term thinking:
Marcus Aurelius encouraged a long-term perspective in life. In personal finance, prioritize long-term goals, such as retirement planning and wealth accumulation, instead of focusing solely on short-term gains.

8. Cultivate gratitude:
Aurelius advocated for practicing gratitude and recognizing the value of what we have. By appreciating your financial resources, you can develop a positive mindset, leading to better financial decision-making.

9. Be prepared for setbacks:
Life is unpredictable, and Aurelius emphasized the importance of resilience in the face of adversity. Build an emergency fund and maintain insurance coverage to safeguard your financial well-being during unexpected events.

10. Balance material and non-material wealth:
Aurelius believed in the significance of non-material wealth, such as wisdom, virtues, and inner peace. While working towards financial goals, remember to prioritize personal growth, relationships, and overall well-being.

MARKET NOISE AND JUNK FOOD

By Joe Wiggins, Chief Investment Officer, Fundhouse (UK)

Easy and instant access to information is often framed as a major advantage to present day investors compared to their predecessors, but if anything, we suffer from a profound information disadvantage. The benefit of improved knowledge is easily overwhelmed by the behavioural challenge of dealing with an incessant torrent of noise. Much of what investors consume is little more than investment junk food, tempting us into decisions that feel good in the moment but come with a material long-term cost.

Whether it be an update on why the stock market closed lower today, a vivid description of a new and profound economic theme, or a compelling account of why we are headed for a recession, such communication bears a striking resemblance to the attractions and dangers of junk food. It provides us with a quick fix, is more interesting than the stuff that does us good and can create long-term damage.

Not only is it appealing, but it is also everywhere. Investment junk food is prolific. It is like being in a supermarket with row upon row of cakes and ice cream, with the fruit and vegetables hidden on a shelf in the back corner. Making smart decisions in such an environment is incredibly difficult.

Financial markets are a natural and compelling storybook. A constant stream of heroes, villains, opportunities, threats, failures, and successes. This makes them captivating and intriguing – the perfect setting for creating investment junk food. There is always a new story to tell and sell.

One of the major behavioural problems investors encounter is mistaking the ceaseless action in markets as a call to action in our portfolios. If something is happening in markets, then something should be happening in our portfolios.

For most investors financial markets should be chaotic and fascinating, but our portfolios should be stable and dull.

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The most common defence of the industrial production of investment junk food is that clients demand it, so it must be produced. If we didn't tell them how the stock market performed last month, they would demand to know why. There may be some truth to this, but it is also a vicious circle. Clients want it because they are continually fed it. Perhaps we could try reframing those expectations and talking more about good investment behaviour.

The problem with these fruits and vegetables of the investment communication world, is that they can seem repetitive and dull, much like good, long-term investing. There are two solutions to this – communicating the same messages in different ways (which certain people do exceptionally well). Or by telling people about all the enthralling and emotive things that are happening in financial markets, and then why they should not be doing anything about it.

We can look at the junk food, but just not eat it.

REGIME CHANGE

By Joanne Baynham,
Associate Director, Sterling Private Wealth

Investors tend to be backward looking, assuming that the recent past will be repeated, but as is usually the case, that often turns out to be the wrong strategy.

Having spent over 30 years in markets it seems to me that we are on the cusp of a regime change and what has worked for the last 15 years, is not going to work going forward.

Anyone reading this, might think this is a pretty brave statement to make, but as I will argue in this article, I am of the view that markets have not been normal since the global financial crisis and the world is changing.

Central banks have artificially kept interest rates at virtually zero until the start of 2022, as no matter how much money they printed, inflation remained moribund. So why has that changed and why do I argue the world is moving back to the world we knew pre-2008?

We are going back to an environment where inflation will be higher than we have seen for the last 15 years, due to several factors, starting with deglobalisation. This has come about due to rising geopolitical tensions between the US and China; the Russian invasion of Ukraine and the Russia China alliance pitted against the rest of the world.

COVID also taught companies that “just in time” stock planning does not work in a world where borders suddenly become closed. We have moved to a world of ” just in case” supply chains, one of “friend shoring”, as well as moving factories back home. This will lead to higher costs, as economic theory tells us that countries with competitive advantages should produce goods, not those who do so, purely for political stability.

Environmental, social and governance legislation (ESG), is also going to lead to higher inflation, as the costs to move the world from a carbon world to a zero-carbon world is not free. The legislation enacted in developed worlds has led to a number of “dirty power" companies not being able to gain access to finance, either via loans or additional equity.

A number of banks today are prohibited from lending to oil and coal companies, nor are a number of very large pension funds allowed to invest in the equity of these companies.

As one would expect this has led to these companies not investing in new projects, with the result being that capital expansion projects have been declining for the last couple of years. This is leading to the supply of oil and coal not being efficient to meet demand. In the long run, cleaner energy projects will help meet the demand, but as we transition to net zero, the cost of traditional energy will stay high, and this will be inflationary.

It is not only oil companies that have underinvested, but so too have mining companies, as shareholders are now demanding dividends and share buy backs. This was a result of the last capital expenditures cycle where miners overinvested.

But ESG has created a large demand for base metals and when one extrapolates this demand into the future, the limited new supply coming on stream will be too low to meet the demand. Unlike food, base metals and oil projects are long term projects and when demand is greater than supply, prices need to rise – economics 101.

Lastly, wages are predicted to rise in the future, particularly in developed markets. Deglobalisation has led to countries closing their borders to immigration (Brexit has been a case in point), aging populations are leaving the workforce (thanks to COVID) and there has been a huge shift in work/life balance for the new entrants into the work force (also due to COVID). Add in a growing desire for socialism, thanks to rising Gini coefficients, and politicians will be more pro programs that benefit the worker at the expense of the employer.

All in all, whilst I believe the market is correct in believing inflation has peaked from very high levels, these forces at play that I have just outlined, mean in my opinion that inflation is not moving back to 2% for a very long time.

Coupled with the view that inflation is predicted to stay, at the higher end of central banks targets (for now they are still sticking to 2%, but watch this space), this should mean that interest rates are not going back to zero for a very long time.

If we assume that central banks are targeting a real rate of return of 1.5% on shortterm money and if inflation settles at 3%, then nominal rates of 4.5% become the new normal. This is a world away from the zero to negative yields that we have seen over the last 15 years and has massive implications for investments.

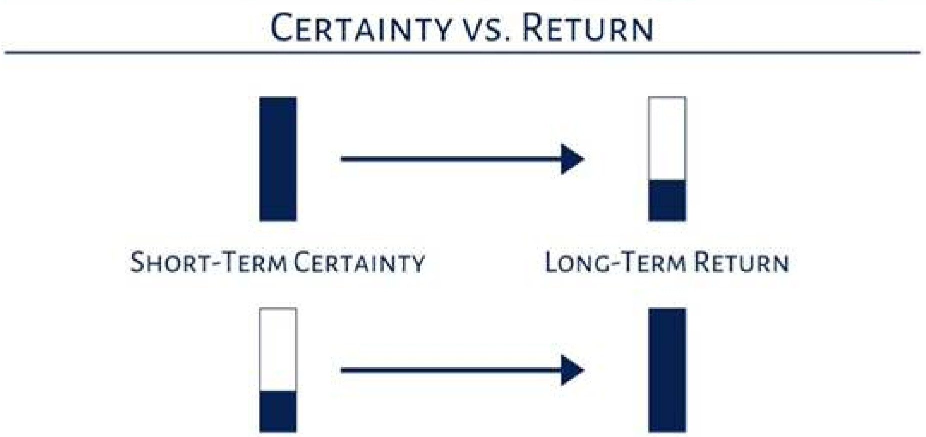
In this new world order, investing in companies with the hope of profits when the cost of capital is over 4%, leads to a much lower discounted cash flow valuation and it makes companies with earnings that are visible in the short term to be a lot more valuable (value companies) .

It also means that Gross Domestic Product growth, whilst in nominal terms could be higher in the next couple of years, as the working population earn more; government spend more on ESG and deglobalisation leads to great capex projects in their home countries.

In a world where growth becomes less scarce, inflation stays sticky and the cost of capital rises, investors will need to invest in the traditional old economy companies.

Given the regime change that we are currently under, short term market movements aside, investors need to start positioning their portfolios towards mining, oil, and value counters. Growth companies, if they can justify their cost of capital, will still have a place, but it is no longer a world where everything will go up. Passive investing could be a lot harder going forward.

I will leave you with the graph courtesy of PSG, in which they argue that the next bull market is not born from the last bull market, but rather as the world changes we get new leadership. No companies stay at the top forever.



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THOUGHTS FROM THE GREAT

By Seth Klarman

"Sometimes the Markets feel like this...

Trading Sardines and Eating Sardines:

The Essence of Speculation

There is the old story about the market craze in sardine trading when the sardines disappeared from their traditional waters in Monterey, California. The commodity traders bid them up and the price of a can of sardines soared.

One day a buyer decided to treat himself to an expensive meal and actually opened a can and
started eating. He immediately became ill and told the seller the sardines were no good. The seller said, "You don't understand. These are not eating sardines, they are trading sardines!"

MESSAGE FROM THE CEO

It is my privilege to have recently attended the prestigious Berkshire Hathaway Annual Shareholders meeting, informally referred to as the “Woodstock for Capitalists”.

As I reflect upon this experience, it strikes me that this is precisely the type of visionary thinking that drives those of us who are privileged to work at Merchant West.

The idea to attend the AGM originated back to a family discussion last year, where we recognized the remarkable milestone of Charlie Munger's 99th birthday, and how this meeting may well be one of his last appearances alongside his esteemed partner, the great Warren Buffet, at the helm of Berkshire Hathaway.

Warren, incidentally, is one of the wealthiest individuals in the world, boasting an estimated net worth of $105 billion. As an aspiring entrepreneur myself, I was eager to learn from these two titans of the industry, who have accrued a wealth of knowledge and experience over their many decades in business. Their exceptional skills and leadership have been demonstrated by their success in growing Berkshire Hathaway, with an astonishing $505 billion in equity on its balance sheet.

This invaluable cash-generating machine, aptly referred to as “free float”, affords them the capital to make further strategic acquisitions. Their second-largest enterprise, a railway company that transports passengers and freight across the Midwest, also thrives under their expert stewardship. These icons of the industry have demonstrated an impressive acumen for investment, with diverse holdings in renewable energy, housing companies, Gillette, Bank of America, Coca Cola, and many others.

Notably, their vast investment portfolio is primarily concentrated in the USA, with each company being led by the same management team that spearheaded the business before they invested in it.

What is the secret sauce that has made these two seemingly unassuming individuals, Warren Buffet and Charlie Munger so successful?

During the two-day shareholder festival, Warren and Charlie answered approximately 60 questions from the floor (see photo attached of 40 000 shareholders).

These questions were impromptu and unscripted. These investment legends were nimble, with a certain sharpness and readiness to the questions that can only come from over 9 decades of experience. My assessment of what makes them great is as follows.

1. Be Curious.
They spend 80% of their time educating themselves by reading and being inquisitive. This provides them with the insight to be able to answer questions about their company, the economy in the USA, Political affairs, matters relating to staff, their families and generally just about life – the takeaway is that we can all upskill ourselves and improve our fortunes by learning every day. Imagine being 99 years old and still having the mental capacity and will to read and to learn!

2. Trust yourself.
During the 65 years that they have run the business they acknowledge that they have made some wrong investments, apart from the great investments. As soon as they realized that their investments were underperforming, they promptly re-evaluated their positions and divested themselves of the unprofitable businesses. Not only did they trust themselves when they were right, but they also trusted themselves when they realized that they made an error and they immediately rectified the error – the takeaway for me here is that we can sometimes go down a road for too long trying to make projects work rather than re-assessing our position, unknowing that we are on the wrong track.

3. Be Prudent.
Never declare a dividend – Berkshire has never declared a dividend apart from a 10 cents dividend which Warren said was declared in 1978, when he went to the bathroom and the board declared the dividend. Warren believes that profits should be retained in the business and should be allocated thoughtfully. Giving profits to shareholders is an indication that the company cannot do better than the shareholders

4. Lifelong Custodianship.
Allow people to manage the businesses which they have been entrusted with and allow them to do this for a very long time. Most of the managers at Berkshire never retire and work till the end.

Many of their managers are in their late eighties. Now imagine the corporate history and knowledge which these individuals possess – like our Sterling clients!

5. Long term Visionary.
Warren maintains strategic long-term perspective in his companies that extends beyond short term fluctuations. He makes decisions that can weather economic cycles, political bouts, and ensure that he can deliver long term value to shareholders. It is easy to succumb to short term "value destructive" decisions that might relieve pressure now, however, exercising patience and discipline to have a long-term vision is critical to growth – the takeaway here is that we at Sterling also have long term visions where we make decisions with a 10+ year time horizon.

6. Luck is involved.
The titans openly acknowledged the extraordinary magnitude of fortune that has graced their remarkable journey. Their incredible luck is evident not only in their successful investments but also in the nurturing environment of their upbringing, which facilitated the flourishing of economic prosperity. The US has seen low interest rates and low inflation, these are the ingredients for a thriving economy. There is a privilege that comes with residing in a developed economy conducive to growth. The US accounts for 25% of the world's income but only 0.25% of the world's population. – The takeaway for us all is to create our own luck. To ensure that we work hard and use our opportunities. SA is replete with opportunity; the onus is on us to seize it.

Braam Viljoen