

Market Commentary – late July 2010

Circulated to Antler investment clients

Pigs, Bears, Black Swans and other animals...



Starting point – The World Cup was effectively faultless – Even Malema managed to keep his mouth shut – Well done South Africa! If you had approached a bookie in 2009 to place a bet on Bafana Bafana beating France in the WC, I am sure you would have made a tidy profit!

What good do we expect to befall our proud nation hereafter? I am unsure, but hear from various clients in the US, UK, Australia and Singapore that the positive coverage our country received from the worldwide media in between matches was pretty much priceless! This can only have opened the eyes of the world to our existence, and lead to more tourism from both a recreational and business point of view in the years to come.

As mentioned in January, returns in 2010 are looking pedestrian to say the least. I have, after much head-scratching, established that a 'Black Swan' is a market term for an entirely unforeseeable event that rocks the market. 2010 has thus far not been short of these:

	1 Jan 10	28 Jul 10	Year to date performance
SA MARKETS			
All Share	27666	28367	2.53%
Financials	19326	21227	9.83%
Industrials	25245	26143	3.56%
Resources	28109	26654	-5.18%
Listed Property	323	363	12.28%
Gold Mining Index	2410	2302	-4.48%
Platinum Index	81	79	-5.67%
EXCHANGE RATES			
R/\$	7.40	7.34	-0.77%
R/€	10.50	9.54	-9.15%
R/£	11.87	11.43	-3.67%
GLOBAL MARKETS			
Dow Jones Industrial	10428	10498	0.67%
US S&P 500 Index	1115	1106	-0.80%
UK FTSE 100 Index	5413	5320	-1.72%
French CAC 40 Index	3936	3670	-6.76%
Hang Seng Index	21886	21091	-3.63%
German DAX Index	5957	6179	3.72%
Japanese Nikkei 225	10546	9753	-7.52%
US Nasdaq Index	2269	2265	-0.20%
MSCI (\$)	1168	1129	-3.35%

- A volcano brings European air travel to a standstill and incidentally brings the Nigerian and Tunisian cut flower markets to their knees.
- Some unknown company, Imperial Crown Trading, somehow gets PROSPECTING rights awarded to themselves by government on an OPERATING mine. The ensuing court cases could determine the future course of South Africa, and will show the world whether SA is a corrupt mess or an effective democracy – clearly we are all hoping for the latter.
- A damaged oil well halves the market capitalisation of one of the largest companies in the world (BP), destroys the fishing and tourism industry in the Gulf of Mexico, while manufacturers of absorbent materials boom as cleanup operations continue.

Economics 101

What are "Austerity Measures"?

In short, it is the practice of avoiding bankruptcy by reducing spending wherever possible. Greece was the first, followed by much of Europe including the UK. A government's spending should closely match its funding by the taxpayer, but this prudent practice was all but abandoned in the recent past, with

governments racking up vast amounts of debt just to fund day to day expenditure, rather than exclusively to fund capital projects.

If we compare this to a company budget: One can understand a company taking on debt to build a factory, buy a truck or purchase trading stock, as these assets will contribute to the profitability of the company in the future. If a company is taking on debt to pay their staff or their electricity bill, they are in serious trouble. What avenues are open in this event? In the case of a company, you downsize, retrench staff, save cash wherever you can – If this fails, you close your doors. A country, on the other hand, has 3 options: Reduce spending drastically through cutting headcount and social benefits, increase revenue by raising taxes, or default on their debt obligations.

Where is the risk?

Each of the above alternatives carry significant risks to economic growth:

1 – Reduce Spending – The unemployment rate climbs, those still employed by government earn less, those who had free or subsidised healthcare, education, pension or disability benefits effectively earn less. Capital projects on new infrastructure is delayed, all of which leads to reductions in the growth rate of the country's GDP. These measures will disproportionately affect the poor.

2 – Increase Taxes – This generally involves increasing the highest marginal rate of tax (From 40% to 50% in the UK), increasing the VAT rate, or increasing the rate of Capital Gains Tax. All of the above result in less cash available for consumer spending, and can result in relocation of people or industries to countries with more favourable tax climates. Net result – reduction in the growth rate of the country's GDP. These measures can be designed to be more equitable, but inevitably disproportionately affect the middle class.

3 – Debt Default – This is simply the refusal by a country to honour its debt obligations. This is generally a last resort as the country will find it almost impossible to find affordable funding for capital projects in the future, and could result in subsequent bankruptcy of their creditors. The risk of debt default has been the main reason driver of European uncertainty amongst the PIGS (Portugal, Italy/Ireland, Greece and Spain).

Why are you telling me this?

Our country, sitting here at the bottom of Africa, unfortunately has Europe as one of its major trading partners, and one of its major sources of foreign investment. Any negative effect on the GDP or 'perceived wealth' of their populations will negatively affect our export outflows and investment inflows, ultimately slowing our own GDP.

So what?

As mentioned before, the developed world has a very large debt they need to repay, and this will take a lifestyle change of some significance. China and India can't be expected to provide an overnight consumerism to replace that of the West. It is going to be a long process. Muted returns are the order of the day, and the JSE is living up to this expectation.

Please remember us when speaking with family members or friends about financial issues. We appreciate all references, and will do our best to assist wherever possible.

Please get in touch if there have been any significant changes to your financial situation that would necessitate a rebalancing of your portfolio.

:::NOTE::: I have recently stumbled upon numerous Risk policies held by clients where they were paying inordinate amounts for outdated Life Cover, Income Protection and 'Dread Disease' insurances. **Please do not neglect this aspect of your financial planning as a Rand saved is a Rand that can be invested!** – Please send me an email or give me a call should you want us to assess your current provisions and the necessity and cost effectiveness thereof!

Kind Regards,



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JSE All Share Index

