INTUITION

(n: immediate insight; receive knowledge by direct perception)

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MAY 2013 VOLUME 10 ISSUE 5

HARVARD HOUSE GROUP

INTUITION
Market Insight from the Harvard House Group

REACHING NEW HIGHS: A TECHNICAL PERSPECTIVE

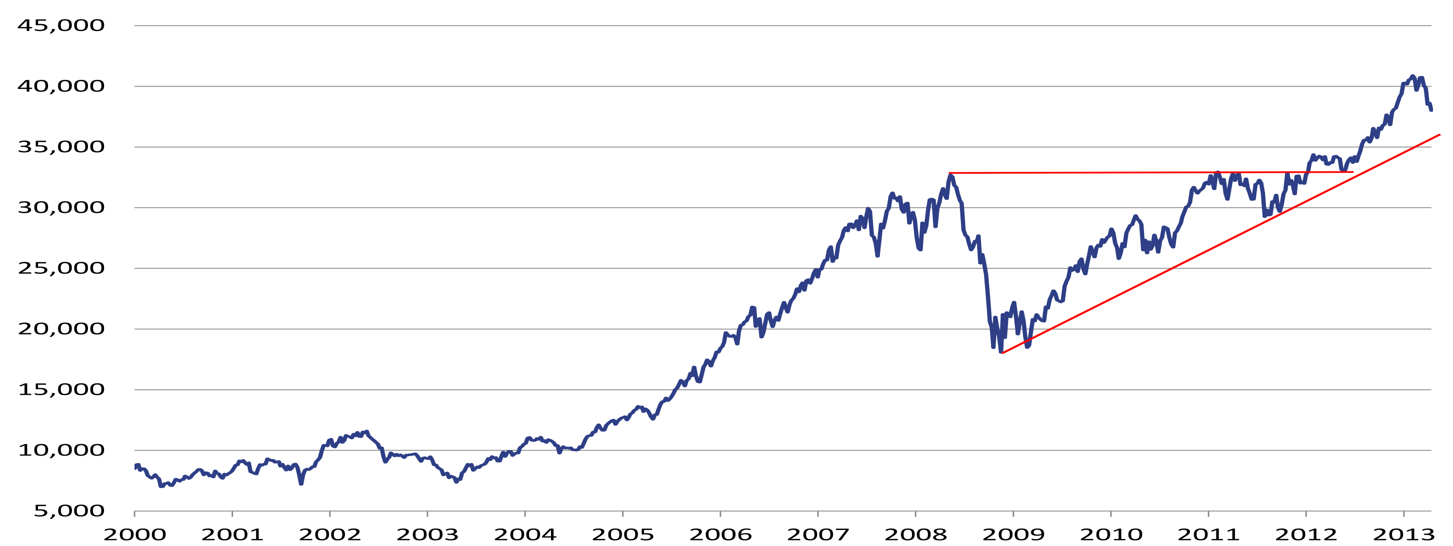
Michael Porter

We cautioned last month in Intuition that markets had run ahead of themselves. After 10 months of almost relentless gains, our market was long overdue for a period of consolidation. It was only a question of what would cause the consolidation to take place. In the end, it was weakness across commodity prices, coupled with weaker Chinese and US economic statistics, that proved to be the catalyst for the current sell off in our market.

There is no need to revisit our outlook for this year. Despite the current weakness, we remain firm believers that this year will see positive equity returns, and that those returns will beat comparable returns from bonds and cash. We still maintain that global growth is accelerating (albeit a little patchy), and that will fuel a steady switch from bonds and cash into shares. But as we have done on occasion in the past, we thought it might be instructive to glance at a few charts to put current trends into perspective. A picture says a thousand words, so the saying goes, and in the case of markets, they bring daily movements into sharp perspective. The charts that follow cover the JSE and its three major sub-sectors, foreign markets, currencies, and commodities. In each case, the data starts in January 2000, so as to provide a fair historical perspective on current levels.

The first chart below shows the JSE All Share Index. When we showed this chart fifteen months ago, the blue line was just breaking up above the horizontal red line for the first time. Having broken through its previous highs, we cautioned that the market could go much higher, despite the overall prevalence of bad news. So it proved to be. Markets did indeed rally hard over the second half of last year, pushing the JSE to record highs day after day. As the charts on the next page show, this was mainly thanks to Industrial and Financial shares – mining shares had their moments but on balance they remain weak. Over the past few weeks, markets have fallen just less than 10% - a significant move in such a short space of time. But corrections always tend to be short and sharp – glance at the chart below for confirmation. We believe the current weakness brings valuations back into line and removes some of the froth that had formed. That is a welcome development. From a technical perspective, the market could fall to a level of 36,000 without breaking the uptrend that was started at the trough of the Financial Crisis. That implies weakness of a further 5%. At the end of the day, all of our investors know that nothing goes up in a straight line. A little ebb and flow is quite normal, and frankly, should be expected.

JSE ALL SHARE INDEX



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RESOURCES

Much has been written about the poor performance of the mining related shares on the market. Labour issues and relentless cost increases have taken their toll on profitability. The latest bout of weakness has resulted in share prices falling to 40 month lows.

FTSE/JSE BASIC MATERIALS INDEX

FINANCIALS

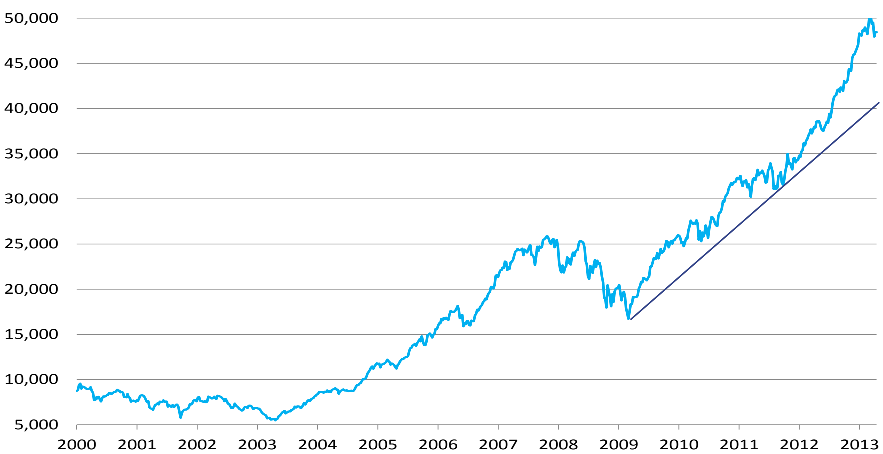
In 2011, Financials spent the year consolidating, after the recovery off the lows in 2009. In 2012, share prices rallied hard, off a well-established level of resistance. That rally has seen the Index eclipse its previous high, and make fresh highs. Financial shares have not reacted much to the recent weakness owing, in our opinion, to their attractive dividend yields.

FTSE/JSE FINANCIALS INDEX

INDUSTRIALS

We have commented before on the strength of Industrials, but this chart says so much. This index has surged ever since the lows reached at the trough of the Financial Crisis. There has hardly been a pause for breath. The Index is looking frothy at the moment, especially in light of a weaker economy. But Industrials offer a more certain outlook, and consequently remain in favour for the time being.

FTSE/JSE INDUSTRIAL INDEX



SA LISTED PROPERTY

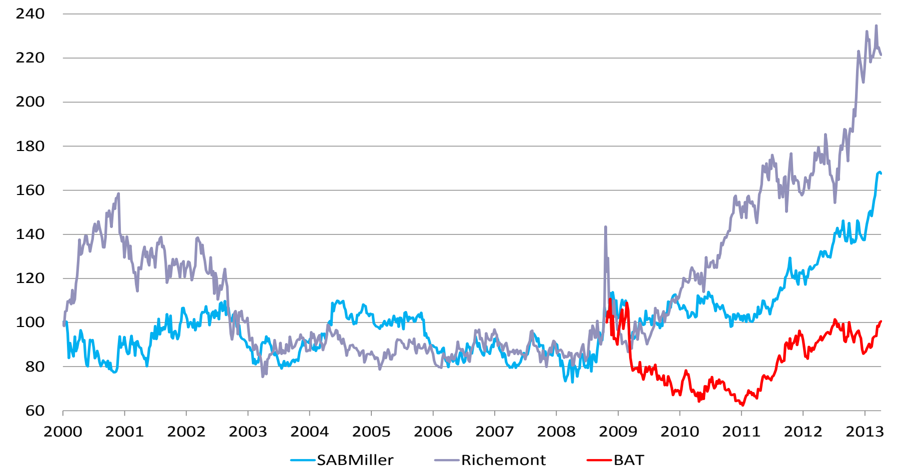
Low interest rates and the global search for income have been favourable tailwinds for listed property in recent years. The sector suffered a sell-off in 2006 when interest rates were raised unexpectedly, and again in the Financial Crisis. But the sector has recovered well and rallied hard last year. The Index looks overbought but the income yield remains attractive.

SA LISTED PROPERTY

GOOD PERFORMERS

The chart may surprise many, but it shows how some of our large, foreign focused shares have performed relative to the JSE as a whole. From 2000 until 2008, SABMiller and Richemont actually performed worse than the market. Since then, both have performed admirably, with the honours going to Richemont. Surprisingly, BAT has only kept pace with the market. It has not outperformed it at all. (Note that BAT was only listed in late 2008.)

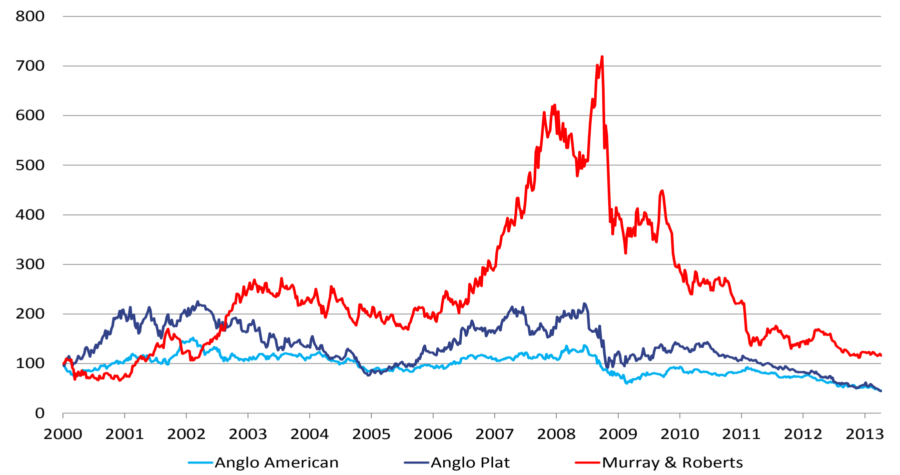
SELECTED SHARES RELATIVE TO ALL SHARE



POOR PERFORMERS

At the opposite end of the scale, this chart shows three poor performers. The red line is Murray & Roberts – which performed significantly better than the market ahead of the World Cup, only to plummet back to earth. The other lines represent Anglo American and Anglo Platinum. Both have been serial under-performers for some time. Let us hope that Anglo's new CEO, Mark Cutifani, can turn the sinking ship around.

SELECTED SHARES RELATIVE TO ALL SHARE



US MARKET

In line with the steady economic recovery taking place in that economy, American markets have been good performers, especially in recent months. The S&P 500 has recently reached fresh highs, and is poised to break higher through a well-established, multi-year resistance level. If US stocks push higher from here, we would expect a substantial rally, which would benefit other global stock markets too.

US S&P 500 INDEX

UK MARKET

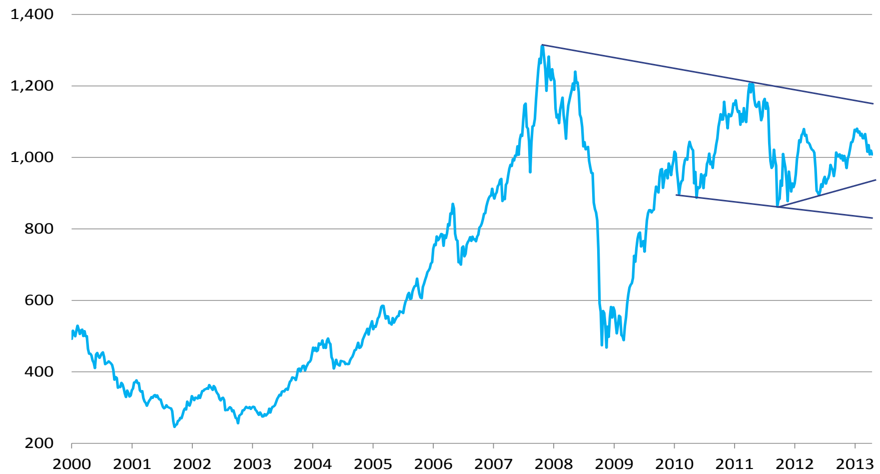
The UK has also been pushing higher, despite the weak economy there, but has yet to reach new highs. The high reached at the height of the Dotcom Bubble still stands, some thirteen years ago. The trend is higher, and the weaker pound might well prove a boon to ailing British industry. Given that the UK market has a heavy exposure to global mining, it is not surprising that this index has lagged its US peer.

UK FTSE 100 INDEX

EMERGING MARKETS

2000 to 2008 was the decade of emerging markets. They outperformed developed markets hand over fist. However, recently this trend appears to be waning. China's stock market is well of its highs, and other BRIC countries are equally unexciting. At the same time, traditional western markets are lifting their heads. Despite the long term growth appeal, we expect developed markets to fare better than emerging markets for the next 12 months.

MSCI EMERGING MARKETS INDEX



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RAND VS US DOLLAR

The Rand was hit by a cocktail of negative influences in 2012 which saw it weaken from R8/US Dollar to a current rate over R9/ US Dollar. Whilst the last ten years has been one of declining peaks – in other words, the blowouts are becoming less severe – the long term trend is a gradual weakening against the US currency.

RAND / US DOLLAR EXCHANGE RATE

RAND VS BRITISH POUND

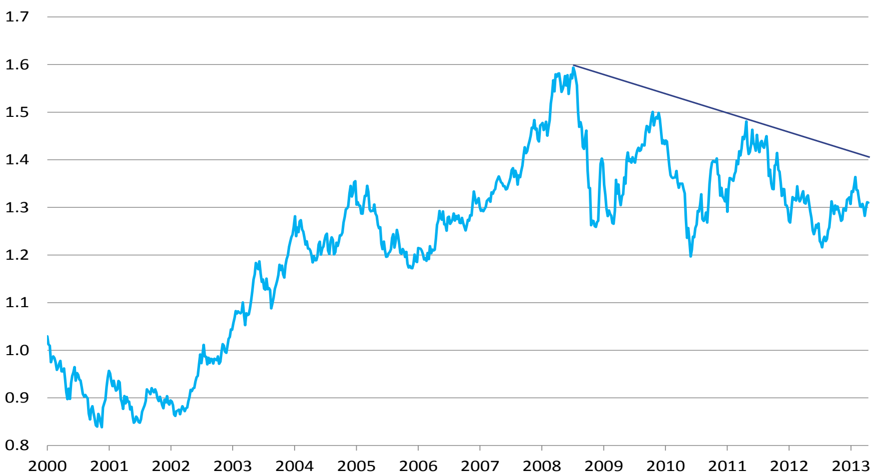
Relative to the UK Pound, the trend is more interesting. The Rand has traded within a very broad range over the last thirteen years, peaking at R18/Pound, before recovering to a level of approximately R10.50/Pound – on two occasions. At present we appear to be heading back towards the top end of the range, but the time period over which that is reached remains uncertain.

RAND / UK POUND EXCHANGE RATE

US DOLLAR VS EURO

This chart looks at the world's two dominant currencies – the US Dollar and the Euro. Contrary to conventional wisdom, the US Dollar has been in a weakening trend against the Euro. The US Dollar has been stronger over the past six months, but there is nothing to indicate that the trend that has been in place for the past five years is about to change.

US DOLLAR / EURO EXCHANGE RATE



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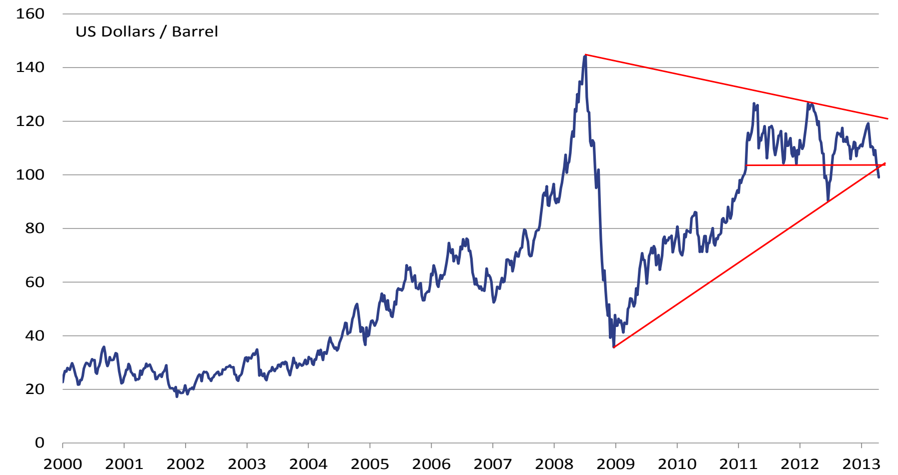
OIL

Having tried to come to terms with the potential for oil prices at $200/barrel back in 2008, recent shale gas discoveries and a weaker global economy are putting downward pressure on the current oil price. Prices have broken below $100/barrel again, which will give relief to ailing motorists the world over. At current prices, our petrol prices could fall between 60c and 70c a litre next month.

BRENT OIL PRICE



GOLD

After a period of consolidation, gold has broken down decisively and is in free fall at the moment. The trigger was the comment that Cyprus may have to sell some of its gold reserves to fund its recent bailout. If so, this could set a precedent for other European countries – some of which have substantial gold holdings. We remain long term bulls, but recent weakness adds enormous pressure to our already stricken local mining industry.

GOLD PRICE

PLATINUM

Platinum prices have drifted sideways for years, owing to weak demand. Supply is being cut – most of our major platinum miners are cutting production and closing shafts. The price needs to rise well above $2000 per ounce on a sustainable basis for our mines to return to profitability. The Rand platinum price looks slightly more encouraging, but still falls far short of levels required to improve the outlook.

PLATINUM PRICE

INSIGHT SEMINARS: KZN MIDLANDS & JOHANNESBURG

Natal Midlands: Following on from our seminar on shale gas, we thought it might be interesting to extend the debate to sustainable or socially responsible investing. We have written about this before, but investors and companies alike are under pressure to promote good governance and sustainability. Come and learn what it is all about.

Johannesburg: We have written about offshore investing in Intuition. Despite the recent rand movements, we still think there is a good case to be made for diversifying offshore. This seminar will delve into that topic in more detail.

Space is limited, especially in Natal, so please book to avoid disappointment.

	Natal Midlands	Johannesburg
Topic:	Sustainable Investing: Theory vs Practice	Offshore investing: a simple, practical alternative
Date:	28th of May 2013	15th May 2013
Venue:	Fernhill Hotel Midmar / Tweedie Road (almost opp entrance to Midmar)	JP Morgan Auditorium, Cnr Fricker and Hurlingham Roads, Illovo, JHB
Time:	5.30pm for 6pm	5.30pm for 6pm
RSVP:	Annalie Robins on 033 330 2164 or annalier@hhgroup.co.za	

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