INTUITION
14 JULY 2023

Not all is as it seems.

In a recent passing conversation, an acquaintance commented that he had seen what the Rand was against the US Dollar back at the start of 2001, R 7.70 odd. He then went on to say that with the Rand at nearly R20/$ in early June, he should have just held all his money in Dollars under his mattress over the period and he would have been totally satisfied now. I didn't argue with him, but my gut told me he was wrong. To be fair though, it is a widely held perception, no doubt exacerbated by South Africa's recent litany of woes and America's booming tech companies. A client called, anxious about converting a substantial sum to Dollars as the Rand was sliding just after the US Ambassador ranted about Lady R. I told him to do what he was comfortable with, but I suggested that history had proved that acting in haste on the Rand is seldom profitable (without a long subsequent wait). Do not read this as advice to leave all your money in SA Inc companies, by no means. We are actively diversifying into JSE companies that earn hard currency and recommend offshore investments as a means to further diversity of quality, size, and geography, but a financial plan should never be built on fear or perceptions.

Robin Gibson

There is a widely held view that converting currency into US Dollars back in December 2000 (or even further back) and simply holding it in cash in a bank account would have secured the best investment return for South Africans. This is a dangerous perspective, not because I am some sort of raging Rand bull, but rather because I believe it is not built on sound investment analysis and leads to what I would call 'perception' rather than 'informed' decisions. Sadly, perception decisions can erode wealth and not enhance it.

Let me illustrate my point with some calculations. At the beginning of 2001, the Rand was trading at approximately R7.73 for every US Dollar. We all know that at present the Rand is trading at close to R19 per Dollar. It seems like a no-brainer, right? Well not so fast. While it would be great for the Rand to be trading at that 2001 level now, is it a realistic expectation based on the economics? Well, let us consider the comparative inflation rates over the period. US inflation has averaged around 2.4% per annum over the period. South African inflation has averaged 5.37% per annum over the same period.

Economic theory suggests that currencies should devalue/ appreciate based on the inflation rate differential to keep parity of value within each country. If we apply this to the exchange rate at the start of 2001, where should we be

SPEED READ

- **Making investment decisions based on fear, greed, or perception is a very good way to convert your hard-earned cash into someone else's profit.**
- **The idea that offshore investment is a no-brainer can be challenged via statistics. Losing faith in one of history's best-performing stock markets at the peak of pessimism could be going against some of the sagest investors in history who dared to buy unloved stocks when everyone else was fleeing (people like Warren Buffett, George Soros and Sir John Templeton come to mind).**
- **South Africans have experienced blow after blow in recent times. Muted local returns and a weak Rand have led to a perception of any local investment being a failure over any given period.**
- **Long-term investment requires a different mindset: it's much like T20 versus 5-day tests, you cannot successfully bat the same way. Long-term South African investors have still achieved their goals, and they will likely do so again, no matter what the future holds.**

today? Well, the differential is 2.97% per annum and that projects a currency translation rate of R14.85 per US Dollar. The Rand traded at that level as recently as April 2022.

Now we clearly understand that the extreme load-shedding and pro-Russian sentiment has added an enhanced devaluation during 2023, but is there more to this story? We would argue that part of the enhanced devaluation should also be attributed to global economic developments, particularly the high inflation rate in the US at the moment and the strong policy response by the Federal Reserve (i.e. significantly higher interest rates).

> "Surprisingly, the JSE All Share Index has risen from a level of 8,307 at the start of 2001 to roughly 74,500 today. "

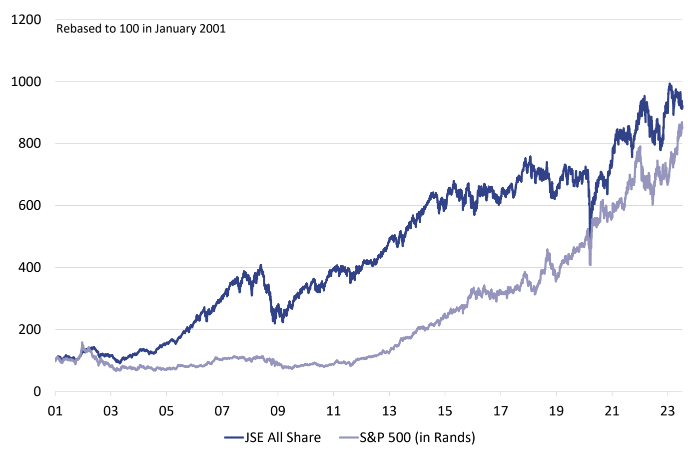
To underline this idea that the Rand is extremely weak only partly because of Government behaviour and loadshedding, let us consider the events of this week. US Inflation was released on Wednesday. It surprised completely to the downside (coming in a full 1% lower than the prior month). What happened to the Rand? (Bear in mind there has been no significant change in politics this week). Well, it has screamed back to under R18 to the dollar, whereas just 4 days ago it closed at R19.44/$. The long and short is that a better outlook for inflation in the US means a better outlook for US interest rates. Lower US interest rates improve the outlook for emerging markets which are likely to enjoy better growth in an easing environment. The Dollar then weakens against most global currencies. Now, if the Rand has declined from R7.73/$ to R14.85/$ due to inflation differentials (a decline of R7.12) and yet now trades at R17.94/$ then the difference of R3.09 reflects the move attributed to sentiment towards South Africa. This is only 30% of the total devaluation, not exciting we would agree, but not quite the narrative that many propose. (And don't forget that the Turkish Lira has devalued by a mammoth 40% this year alone!)

Let's get back to my acquaintance. Had he merely converted his funds to cash in US Dollars and placed it under his mattress, he would have earned a total annualized return of 4.02%. When measured against South African inflation of 5.37% per annum, he would be substantially poorer. He has suffered an effective loss of buying power of 37% (basically turning R100,000 into R73,460 on a comparative basis). Alternatively, what if he had invested in a simple money market account over the period? An investment into 1-year US Treasury Bills would have yielded an annual return of 1.69% over that period. This implies an annualized return of 5.71% per annum, a smidgen higher than local inflation (R100,000 would now be worth R107,765 on equal comparison). Not anything to get excited about yet.

So, how would an investor who remained invested in the JSE over the period have done? (Bear in mind that this period includes the Global Financial Crisis, NeneGate, State Capture, Covid, and the recent Russian invasion, to name just the most obvious challenges.) Surprisingly, the JSE All Share Index has risen from a level of 8,307 at the start of 2001 to roughly 74,500 today. That is a return of 9.8% per annum (equivalent to turning R100,000 into R269,800, again on equal comparison).

No one would argue that had you taken your money out 5 years ago and placed it in the S&P 500, you would have handsomely beaten almost any other local option. However, if you opted to keep your money here for the last 22 ½ years, have you suffered irreparable financial harm? Again, the answer may surprise you. Consider the chart below. R100 would have grown to R917 if invested on the JSE, whereas R100, converted to US Dollars and invested into the S&P 500 and then converted back to Rands at the end would have grown to R868. SA is in front by a whisker. To quote a timeless SA advert, "Not too shabby, Nige!"

SA VS US RETURNS



This chart reflects a common starting point of 100. The dark blue is an investment in the JSE All Share Index, the light blue is the Rand value of an equivalent investment into the S&P500 (i.e. it includes Rand devaluation over the period). Surprisingly, the JSE has performed better over the full period, but less so over the past few years.

In conclusion, my acquaintance was way off the mark, but not alone in his perspective. It is a sound demonstration of that famous saying by the Nobel Laureat, Jose Saramago *"Not everything is as it seems, and not everything that seems is."*

Topic:	TBC
Natal Midlands	
Date:	21st of September 2023
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Our next Insight seminar will take place in September in Howick and Johannesburg. The topic will be announced in due course.

Johannesburg	
Date:	19th of September
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

Cape Town	
Date:	n/a
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

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