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ECONOMIC AND MARKET OVERVIEW

Global

Despite the dim message from current economic data, particularly in Europe, and the recent inversion of the short end of the US Treasury curve, global growth is likely to reaccelerate in the second half of 2019, according to a recent report from BCA Research.

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Their analysis of global indicators shows that leading industrial, sentiment and even some trade indicators have troughed. Credit growth, a key lubricant of growth momentum in the globally relevant sectors of China's economy, is no longer decelerating, and is poised to boost global trade in the second half of the year.

Speaking of global trade: China's chief trade negotiator, Vice-Premier Liu He, heads to Washington again in April for the latest round of talks aimed at bringing an end to the tariff battle between the world's largest economies that has had a negative impact on sentiment across the global economy. Liu met US Trade Representative Robert Lighthizer and Treasury Secretary Steven Mnuchin in Beijing at the end of March. But despite a growing belief that the sides may be getting closer to reaching a deal to end the trade friction, they remain far apart on core issues such as market access, an enforcement mechanism and the protection of intellectual property rights in China. A lack of a resolution around these matters may still upset the global growth apple cart towards the end of the year.

Under the assumption that a trade war is averted, Europe will stand to benefit from it, as well as from meaningful easing in financial conditions. The latter follows a softening in global growth paired with the US Federal Reserve's adoption of a more patient stance to interest rate adjustments, which have prompted global central banks to assume a more dovish tone. With interest and inflation rates at very low levels, unemployment rates in Europe and the United States continue to fall. This trend could well support global economic activity into 2020, with inflationary pressure (especially in the US) only rearing its head then. The current soft patch in markets could make way for a rally in growth assets in the second half of the year as fears of a pending recession dissipate.

South Africa

The South African Reserve Bank's Monetary Policy Committee (MPC) met at the end of March and took a unanimous decision to keep the repo rate unchanged at 6.75% (with the prime rate still at 10.25%). What was of interest is that their quarterly projection model (QPM) still implied one interest rate hike (of 0.25%) before the end of the year whereas many commentators are proposing significant interest rate reductions in order to kickstart our local economy. At the very least, one increase is far less than the four implied increases from the MPC statement of November last year.

In his statement, Governor Lesetja Kganyago noted that, although inflation has generally surprised on the downside in recent months, the sharp increase in electricity, water, and fuel prices will tend to push inflation higher over the coming months. At the same time, the increased electricity constraints have resulted in a downward revision to SA growth in 2019, with risk to the downside. Once again, the Bank acknowledged the weakness in the domestic economy is largely unrelated to interest rates. While the longer-term risks to the SA inflation forecast are still somewhat to the upside, the Bank can afford to keep rates on hold for an extended period while it watches international and local developments, including the path of international interest rates.

The **fuel price** has now **risen** by more than R2 per litre over the last two months

The fuel price has now risen by more than R2 per litre over the last two months, adding pressure to South Africans' wallets. While consumer spending has been the key underpin to SA's economic growth in recent years, a few factors have dampened the outlook for consumer activity in 2019. These include the ongoing weakness in domestic economic activity, a further slowdown in wage growth as the private sector continues to cut costs, and dwindling bonus payments as corporate earnings take strain. There are also hikes in electricity tariffs awarded to Eskom which come into effect in April. Hopefully, after the National Election on 8 May, sentiment will start to recover, resulting in some economic improvement.

Lastly, Moody's gave the South African government a breather as it skipped the review of both its credit rating as well as the outlook for the rating at the end of March. The next update is in November which allows government and businesses to continue their efforts in boosting South Africa's low levels of economic growth – the credit rating agency's biggest area of concern.

Market Performance

South African equities managed a fourth consecutive month of positive returns with the FTSE/JSE All Share Index rising by 1.6%. These positive returns were however not widely based as two thirds of companies that make up the Index registered negative returns. Kumba Iron Ore lead the charge as it ended the month 20% higher, closely followed by British American Tobacco which added more than 18%. Aspen Pharmacare had a dismal month and shed around a third of its market capitalisation in March. The weaker rand (down 3% against the US dollar) weighed on the performance of local banks, insurance firms and retailers – most of them ended the month in the red.

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South African bond yields traded in a relatively narrow range during the month as investors appeared reluctant to take aggressive positions before Moody's credit rating announcement. Domestic bonds ended the month stronger (up 1.3%), in line with global markets and ignoring the weakening rand. The listed property sector continues its dismal run, underperforming all other domestic asset classes over one and 12 months as oversupply and weak domestic growth has curtailed pricing power.

Equity markets around the world saw another increase in March as the MSCI World Index (measured in US dollars) ended 1.3% higher. It's just about back at the levels it reached before markets sold off in the fourth quarter of 2018. Emerging market equities still trail their developed counterparts over most meaningful periods under ten years. The possibility of further US interest rate increases towards next year could dampen global investors' appetite to allocate capital to companies exposed to developing markets.

South African Multi-Asset High Equity Funds delivered an average of 5.8% to investors during the last 12 months with their low equity counterparts ending 6.7% higher.

MARKET INDICES [1] **(All returns in Rand)**	**31 March 2019**		
	3 months	12 months	5 years
SA equities (JSE All Share Index)	8.0%	5.0%	6.5%
SA property (SAPY)	1.5%	-5.7%	5.6%
SA bonds (SA All Bond Index)	3.8%	3.5%	8.3%
SA cash (STeFI)	1.8%	7.3%	7.0%
Global developed equities (MSCI World Index)	12.9%	27.4%	14.4%
Emerging market equities (MSCI Emerging Market Index)	10.2%	13.3%	10.8%
Global bonds (Barclays Global Aggregate)	2.5%	21.2%	7.6%
Rand/dollar [2]	0.3%	21.7%	6.5%
Rand/sterling	2.6%	13.1%	1.4%
Rand/euro	-1.5%	11.1%	2.2%
Average South African Multi-Asset High Equity Fund	5.8%	5.8%	5.5%
Average South African Multi-Asset Low Equity Fund	4.0%	6.7%	6.3%

1 Source: Factset
2. A negative number implies fewer rands are being paid per US dollar, so it implies a strengthening of the rand.
3. A sincere thank you to Dawid Krige of Cederberg Capital who brought this book to our attention.

Commentary – Turning one into one hundred

"Few things are harder to put up with than the annoyance of a good example."

- Mark Twain, Puddin'head Wilson

The idea is simple: find the **best stocks** you can and let them **sit** for **10 years**

Peter Lynch, arguably one of the world's most renowned investors, popularised the concept of a "bagger". For example, a five bagger is a share that goes up five times, a ten bagger has gone up ten times and so on. Christopher Mayer co-opted this terminology in his wonderful "100 Baggers: Stocks That Return 100-To-1 and How to Find Them" [3] .

In this book, the author analysed 365 stocks during the period 1962 to 2014 that went up at least one hundred times. He looked for characteristics that were shared across these companies and came up with the following list:

- These companies tended to be owner-operated.
- They had high returns on capital.
- Starting valuations tended to be reasonable.
- They tended to start small rather than tiny (median market cap USD500 million, which would be much higher today).
- It typically took 26 years for them to rise 100x (that's compounding at a little over 19% per annum).
- They all had a long runway for rapid growth.

Most investment managers can identify most of these characteristics, therefore improving their odds at finding these amazing compounders. It's the conviction to not sell when times are tough that will set investors apart. It's the principle of the "coffee can" portfolio.

It all began with Robert Kirby, then a portfolio manager at Capital Group, one of the world's largest investment management firms. He first wrote about the coffee can idea in the fall of 1984 in the Journal of Portfolio Management. "The coffee can portfolio concept harkens back to the Old West, when people put their valuable possessions in a coffee can and kept it under the mattress," Kirby wrote. "The success of the program depended entirely on the wisdom and foresight used to select the objects to be placed in the coffee can to begin with."

The idea is simple: find the best stocks you can and let them sit for 10 years. You incur practically no costs with such a portfolio. And it is certainly easy to manage. The biggest benefit, though, is a bit more subtle and meaningful. It works because it keeps your worst instincts from hurting you. In his paper, Kirby told the story about how his idea came about.

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"The coffee can idea first occurred to me in the 1950s," Kirby wrote. Back then, he worked for a big firm that counselled individuals on their investments. He had a client he worked with for 10 years whose husband died suddenly. She inherited his stock portfolio, which she moved to Kirby's care. "Looking at the portfolio," Kirby wrote, "I was amused to find that [her husband] had been secretly piggybacking our recommendations for his wife's portfolio. Then I looked at the size of the estate. I was also shocked. The husband had applied a small twist of his own to our advice: He paid no attention whatsoever to the sale recommendations. He simply put about $5,000 in every purchase recommendation. Then he would toss the certificate in his safe-deposit box and forget it. In doing this, a wonderful thing happened. Yes, it meant his portfolio had a number of broken stocks that came to be worth $2,000 or so. Small positions. But he also had a few holdings that ended up worth $100,000 each. The kicker, though, was this: he had one jumbo position of $800,000 that alone was bigger than the total value of his wife's portfolio." As Kirby wrote, "[It] came from a small commitment in a company called Haloid; this later turned out to be a zillion shares of Xerox."

That is an inspiring tale, a triumph of lethargy and sloth. It shows clearly how the coffee can portfolio is designed to protect you against yourself – the obsession with checking stock prices, the frenetic buying and selling, the hand-wringing over the economy and bad news. It forces you to extend your time horizon. You don't put anything in your coffee can you don't think is a good 10-year bet.

When considering investment managers to look after your savings, it may be a good idea to check their philosophy on the coffee can portfolio. They may not be able to consistently find the one hundred baggers, but if they find enough potential five, ten and twenty baggers, and hold on to them, you could end up a very satisfied investor.

The **US dollar** continued to weaken against most other currencies