



## Dear

April 2014 has followed a similar pattern to the Aprils of previous years. The large number of public holidays has impacted all and sundry as they struggle with the stop start nature of the month. It has been reported that South Africa loses in excess of R1bn for every public holiday. Many market participants took advantage of the public holidays to get some well-deserved rest so transaction volumes were low in all markets.

The JSE All Share Index continues to hit new highs and finished the month just off its all-time high. A lot of the larger companies had good economic reports fuelling this growth. The JSE moved up 2.3% in the month of April. With the index trading at an average PE of 17 there is still a concern that a correction or muted returns may take place but analysts are still calling equities as the best asset class to invest in over the next few years.

The Rand had a very stable month against the major currencies and the only significant move was experienced towards the end of the month as the Producer Price Index (PPI) increased significantly to 8.2%. The increase in manufacturing costs is predominantly due to rising costs for labour and utilities. An increase in the Repo rate may be required to manage costs.

During the month reported CPI increased to 6% year on year. March is the month where all the excise duty changes are made. This resulted in a monthly increase of 2% in the price of alcoholic beverages and tobacco as a result of the sins tax increase. Fuel prices continued to increase with another 36c/litre price increase during the month. Annual increases in the price of education were measured during the month and showed an increase of 8.7%, far exceeding overall inflation. CPI is expected to breach and remain above the inflation targeting upper band of 6% for the remainder of the year.

In an update of the platinum strike, it has now entered its 14th week with the last reported figures showing R16bn worth of lost revenue for the large platinum miners. The striking workers are estimated to have lost R7bn in wages which the individual mine worker will not be able to make up. It has been reported in the media that a large percentage of the labour force are leaving the unions and returning to work in order to earn a living.

We do not expect the results of the May election to have any significant effect on the economy or on economic policies. The Governor of the Reserve Bank should continue in the role and we expect to see further rates hikes during the year although they will probably not be dramatic.

Magwitch Securities

## MARKET INFORMATION



## FINANCIAL PRODUCT IN FOCUS

### MONTHLY DEBIT ORDERS AND RAND COST AVERAGING

For our Product in Focus this month we look at the benefits of Rand cost averaging using a monthly debit order. Rand cost averaging is a wealth-building strategy that involves investing a fixed amount at regular intervals over a long period into investments that have fluctuating prices, typically shares or unit trusts.

Rand cost averaging is where one looks at the average purchase price of the total investment over a period of time. The share price of stocks listed on the stock exchange change on a daily basis and Rand cost averaging negates the timing risk on purchase. The amount of money invested on a regular basis remains the same over time, but the number of units purchased varies based on the share price of the underlying shares. When markets are up, you buy fewer shares per Rand invested due to the higher share price. When the markets are down, the situation is reversed and you buy a greater number of shares per Rand invested.

The most common method of Rand cost averaging for South Africans is the use of a monthly bank account debit order. A regular debit order is a fantastic instrument to create discipline for any individual wishing to invest and allows them the ability to prioritise investing and saving over "spending". The money is deducted from their bank account via the debit order each month and they thus become accustomed to not having it as available cash for spending. Too often individuals opt for the alternative investment strategy of waiting to see how much money they have left over at the end of each month, and say that they will invest the balance. The problem very often is that there is no money left over at month end as it has already been spent on short term benefits. Taking away the decision to save each month by automatically investing when the income comes in, removes the temptation to spend it on something else.

Rand cost averaging works well for those who do not have a large amount of money to invest and find themselves managing to save only a small amount at a time. Through regular purchases they are able to grow wealth a bit at a time. It is also a concept to consider for wealthier investors looking to invest lump-sums. With a lump-sum investment the investor would face the risk that in declining financial markets they would lose capital in their investment. Through regular purchases and Rand cost averaging this risk is negated as more units will be bought when the underlying asset becomes cheaper, thus diluting purchases made at the higher price. Regardless of the amount of investment Rand cost averaging remains a long-term strategy and investor should always focus on their long term investment goal and not be distracted by short term volatility.

### Rand Cost Averaging in the Stock Market

In order to demonstrate Rand cost averaging we have analysed what would happen if one was to invest monthly into three of South Africa's largest and best known brands. The three companies all operate in different segments of the market and thus have different factors that influence their share prices.

We have chosen equities as we believe that over the long term an investment in shares will produce real returns that outperform inflation. The three companies are:

#### Standard Bank

Standard Bank has a 151-year history in South Africa and started expanding its brand in the rest of Africa in the early 1990s. Standard Bank is one of South Africa's big four banks. We selected a banking share to demonstrate Rand cost averaging as they are typically less volatile. The income streams of banks are fairly consistent.

#### Anglo American

Anglo American is a general mining company founded in 1917. For many decades Anglo American was South Africa's largest company and had interests in many different industries. We selected a general miner because of the volatility of the share price. The earnings are impacted by many different factors but include commodity pricing and exchange rates.

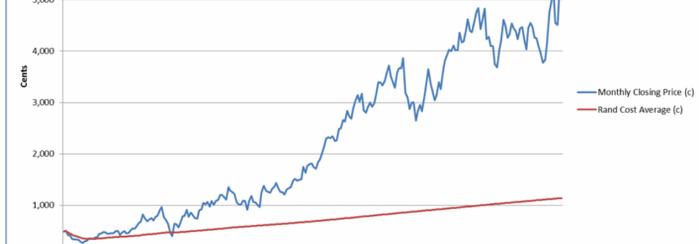
#### Pick n Pay

Pick n Pay is South Africa's second largest supermarket chain and was founded in 1967. They have a presence throughout South Africa. We selected a retail share as their income stream is generally influenced by individuals and their spending capacity.

All three companies are well known brands and most of our readers would be familiar with the brands and their businesses.

In our first example of Rand cost averaging we have looked at the results of monthly investments into these three companies over a period of 20 years. We have assumed that there is no growth in the contribution level, that dividends are not reinvested and that one can purchase fractions of shares.

If one had to put R500 per month into the three companies over a 20 year period the Rand cost averaging can be demonstrated as follows:



As one can see the Rand cost average per share is significantly lower than the current share price. This demonstrates the benefit of the strategy over the long term. All three companies have grown significantly in value over the 20 years and the investor's Rand cost average has been affected only slightly by the rising share prices.

The 20 year investments can be summarised as follows:

	Current Share Price	Rand Cost Average	Total Cost	Market Value	Theoretical Profit
Share	30/04/2014	30/04/2014	30/04/2014	30/04/2014	30/04/2014
SBK	R 138.08	R 33.27	R 120,000.00	R 498,084.94	R 378,084.94
AGL	R 280.50	R 124.87	R 120,000.00	R 269,552.09	R 149,552.09
PIK	R 59.99	R 11.42	R 120,000.00	R 630,286.73	R 510,286.73

On the 20 year charts one can clearly see the huge effect that the financial market crash in 2008 had on listed shares. In order to demonstrate the impact that Rand cost averaging would have on an investor who started investing only just prior to the crash, and continued their investments through the crash, we have redrawn the charts over a 7 year period.

With no change in assumptions and the investor still investing R500 a month the Rand cost average would be as follows:



One can clearly now see the market crash in perspective. Through the continued purchasing of the stocks through, and after, the crash the investor has managed to bring down their Rand cost average of holding per share.

The 7 year investments can be summarised as follows:

	Current Share Price	Rand Cost Average	Total Cost	Market Value	Theoretical Profit
Share	30/04/2014	30/04/2014	30/04/2014	30/04/2014	30/04/2014
SBK	R 138.08	R 101.56	R 42,000.00	R 57,207.75	R 15,207.75
AGL	R 280.50	R 283.29	R 42,000.00	R 41,572.91	- R 427.09
PIK	R 59.99	R 39.02	R 42,000.00	R 64,559.44	R 22,559.44

As one will note the Rand cost average on the Anglo American holding is at present above the current share price resulting in a loss of capital for the investor. If, however the investor had invested the R42 000 as a lump sum 7 years ago (share price R468.04) they would currently have a capital loss of R16 829.07.

Rand cost averaging is a great way of smoothing out the bumps of the market over the long term.

In our assumptions we noted that we did not take the reinvestment of dividends into account. In practice this would bring the Rand cost average down even further as you are purchasing more units in a year with dividend income supplementing your monthly debit orders. This would also substantially increase your theoretical profit. It is a topic that we plan to address in a future newsletter.

If you wish to get more information on Rand cost averaging please do not hesitate to contact us at Magwitch Securities.

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t: 011 453 3048

f: 011 453 0715

www.magwitch.co.za

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