



Dear

April 2016 was another great month for the South African economy, the markets and the currency. Over the past two months we have seen a dramatic improvement in sentiment as positive court rulings indicate that the country appears to be moving forward and resolving some of the political old issues.

The US Fed kept their interest rates unchanged during the month and this has encouraged investors to once again move into emerging markets. This risk on, risk off approach has been a continued theme for the last two years as global investors try to obtain an inflation beating return at the lowest perceived risk. The majority of the world's economies have reported growth that is significantly lower than their long term averages, with the one major exception being the US. Large global investors are concerned that the risk of recession in other economies is too high so they are trying to avoid these markets and invest in the US. The low nominal rates in the US mean that an investment there would lose money in real terms. Whenever there is an indication that the interest rates will rise money flows out of emerging markets and back to the US. Conversely when it appears that rates will not increase investors move the money out of the US and back into higher yielding assets.

The flow into the emerging markets caused the Rand to continue its recovery strengthening by 3% during the month. The Rand finished the month at a five month high against the Dollar, matching the levels last seen in December when the Finance Minister reshuffling took place.

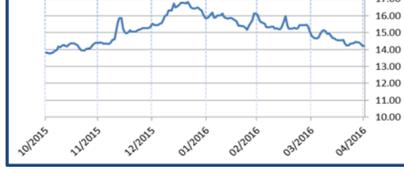
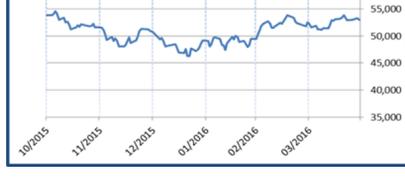
The JSE All Share index was marginally higher in the month, led by further recoveries in the Resources sector. The Resources sector has now recovered 38% since the start of the calendar year but is still down more than 20% over the past twelve months.

Inflation reduced to 6.3% but remains above the monetary policy targeted bracket of 3-6%. Food was the biggest driver of inflation during the month as the effects of the weak Rand and the drought continue to pile pressure on the consumer at the tills.

The petrol price is going up at midnight with a 12c per litre increase across all grades of petrol. Remember to fill up on your way home.

Magwitch Securities

MARKET INFORMATION



FINANCIAL PRODUCT IN FOCUS

PURCHASING POWER PARITY AND THE BIG MAC INDEX

The Rand was one of the better performing currencies during the past month, recovering some of the losses incurred over the last three years. The value of your currency is like a share price and sentiment would affect how the world values your currency. Given the volatility in the currency many investors and businesses want to know where to from here.

Forecasting currency movements over the short term is almost impossible as there are a number of factors which affect the exchange rate. Ongoing events, many of which are unpredictable, can have a bearing on the sentiment and the risks of a specific country which by extension affect its currency. The Rand is one of the more actively traded currencies in the world with speculators causing excessive moves in both directions as they try make profit on the volatile currency.

Whilst impossible to forecast over the short term things tend to revert to the mean average over time and in this month's product in focus we look at how the Rand may still be undervalued, even after the recovery since "Nenegate".

Exchanges rates will naturally change over time as inflation impacts the value of the currency. As an emerging market economy South Africa tends to have a higher inflation rates than developed economies and as such the Rand should naturally weaken against the currencies of the developed countries.

Purchasing Power Parity is an economic theory that assumes that a basket of goods should cost approximately the same amount after accounting for the exchange rate differences, inflation, interest rates and earnings differential. The theory is used to calculate the relative values of two different currencies.

Often the simple things work the best and the best demonstration of the concept just compares relative prices of burgers around the world.

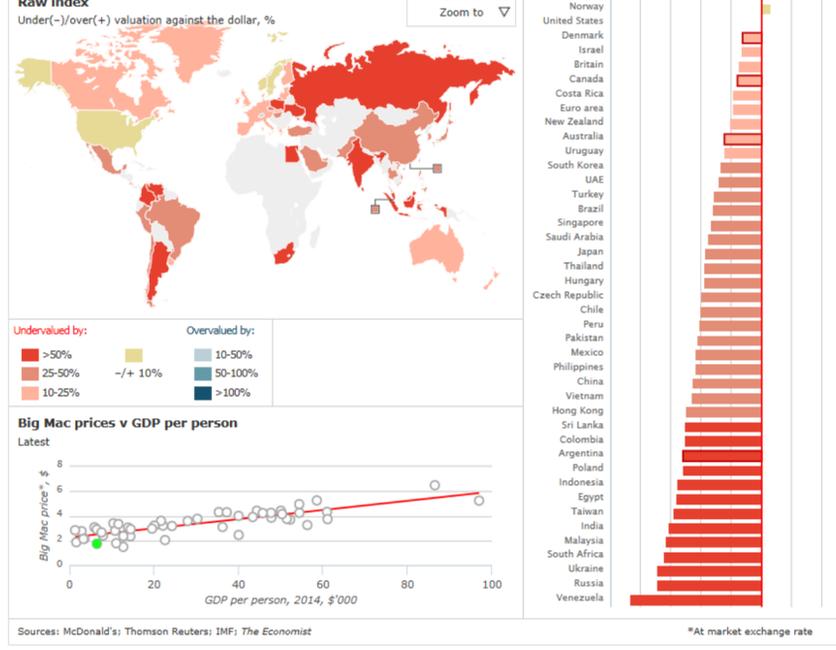
The Big Mac Index

The Big Mac Index was introduced by *The Economist* in 1986 as a semi-humorous demonstration of Purchasing Power Parity. *The Economist* has updated the index on an annual basis ever since and state that it "is a lighthearted guide to whether currencies are at their correct level".

The Big Mac Index Compares the converted Dollar price for a Big Mac burger, the best-selling burger of global fast-food chain McDonalds, across 44 different countries. The Big Mac was selected as the standard unit of measurement as the burger has to meet exacting standards across the world so a Big Mac should be pretty consistent wherever you may purchase one. The raw materials of the burger are however sourced locally and are the biggest drivers of the burger's selling price. The Big Mac has to be priced at a competitive price in the local currency otherwise sales would be low.

The index is updated every year and the 2016 results are available on *The Economist's* website for viewing.

In January 2016 the price of a Big Mac in the United States was \$4.93 whilst in South Africa it was R28.00. This meant that if a traveller from the US was to have purchased a Big Mac in South Africa they would only have paid \$1.77 (using exchange rate of 15.81). The Big Mac Index would thus indicate that the Rand is undervalued by 64% and should be trading at exchange rate of R5.68/\$1. According to the Big Mac Index the Rand is the fourth most undervalued currency in January 2016.



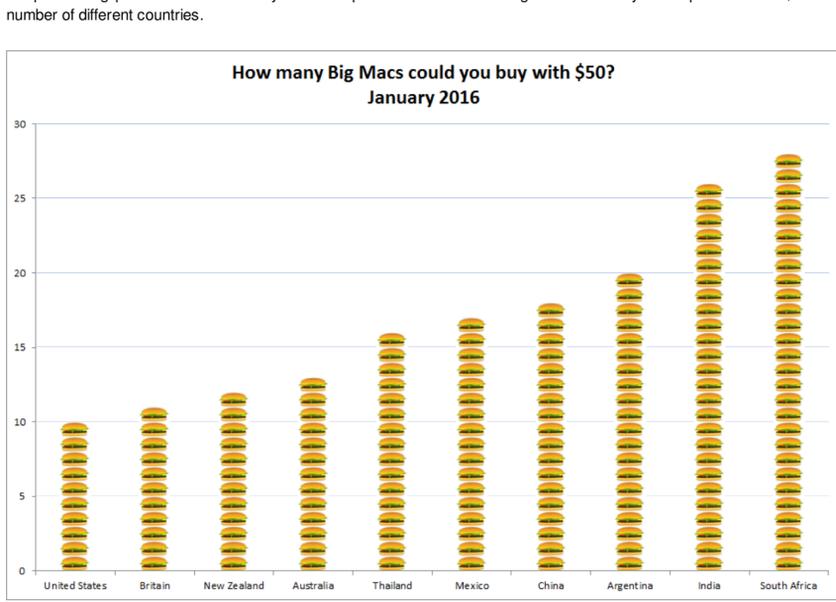
The Big Mac index has come under some criticism in the past as being too simple and ignoring certain country specific factors. The general argument is that a large component of any burger is not the raw materials but the labour cost of operating the fast-food outlet. In 2011 *The Economist* created an adjusted index which takes into account the GDP per person. South Africa is represented by the green dot in the above image. One can see that the price of the burger tends to rise as the GDP per person increases.

The adjusted index is a better indicator of relative currency weakness and can offer vastly different results. The full table of South African Big Macs since their inclusion within the index demonstrates that.

Year	Big Mac price in United States	Big Mac price in South Africa	Ruling Exchange Rate January	Implied Big Mac price in South Africa	Raw Index		Adjusted Index	
					Over / (under) valuation	Implied Exchange Rate	Over / (under) valuation	Implied Exchange Rate
2000	\$2.51	R 9.00	6.72	\$1.34	-46.61%	3.59		
2001	\$2.54	R 9.70	8.13	\$1.19	-53.15%	3.81		
2002	\$2.49	R 9.70	10.90	\$0.89	-64.26%	3.90		
2003	\$2.71	R 13.95	7.56	\$1.85	-31.73%	5.16		
2004	\$2.90	R 12.40	6.66	\$1.86	-35.86%	4.27		
2005	\$3.06	R 13.95	6.65	\$2.10	-31.37%	4.56		
2006	\$3.15	R 13.95	6.08	\$2.29	-27.30%	4.42		
2007	\$3.22	R 15.50	7.11	\$2.18	-32.30%	4.81		
2008	\$3.57	R 16.95	7.56	\$2.24	-37.25%	4.74		
2009	\$3.57	R 17.95	8.28	\$2.17	-39.22%	5.03		
2010	\$3.58	R 17.95	7.30	\$2.46	-31.28%	5.02		
2011	\$4.07	R 19.45	6.77	\$2.87	-29.48%	4.77	23.80%	8.38
2012	\$4.20	R 19.95	8.13	\$2.45	-41.67%	4.74	-4.20%	7.79
2013	\$4.37	R 20.90	9.08	\$2.30	-47.37%	4.78	-17.20%	7.52
2014	\$4.62	R 23.50	10.88	\$2.16	-53.25%	5.09	-23.60%	8.31
2015	\$4.79	R 25.50	11.48	\$2.22	-53.65%	5.32	-23.60%	8.77
2016	\$4.93	R 28.00	15.81	\$1.77	-64.10%	5.68	-39.30%	9.60

The adjusted index indicates that the Rand should be trading R10/\$1. Most market commentators come out with a realistic exchange just slightly higher than that but all agree that they cannot forecast that one event that will cause a rerating and a significant strengthening of the Rand.

We are not sure if the Big Mac index has ever been used by an American planning their holidays but if they are interested in the purchasing power of their currency we have plotted the number of Big Macs that they could purchase for \$50 in a number of different countries.



And if South Africa didn't already have compelling arguments in favour of it being a tourist destination.

Conclusion

As we have previously mentioned the exchange rate can be very hard to predict. All indications are that the Rand remains undervalued but then it was undervalued prior to the last 4 years of currency weakness (part of which is due to Dollar strength).

The best way to manage your currency exposure is to understand the impact that any currency move may have on your investments or your trade.

Local investors generally have sizeable currency stakes through offshore holdings and Rand hedge shares within their retirement savings. Fortunately many asset managers make use of derivative products to reduce the currency exposure and the volatility associated therewith.

For those that are either buying or selling Rand due to cross border trade it is important that you always deal at the best price possible. Magwitch make use of professional experts in the field to ensure that your main concern only ever has to be on your business, not on how much you may end up paying or receiving for goods or services.

ABOUT MAGWITCH

Magwitch Securities is a Financial Services Broker offering the following products as a comprehensive financial solution to both individuals and businesses:



- Employee Benefits
- Retirement Planning
- Money Market
- Medical Aid
- Investment Planning
- Investments
- Short Term Insurance
- Foreign Exchange
- Treasury Management
- Trust Administration

t: 011 453 3048 f: 011 453 0715 www.magwitch.co.za

Magwitch Securities Proprietary Limited is an authorised financial services provider, registered with the Financial Services Board - FSP number 26829

Disclaimer: Although every effort has been made to ensure the accuracy of the content of this newsletter, Magwitch Securities (Pty) Ltd accepts no liability in respect of any errors or omissions contained herein. The contents of this newsletter cannot be construed as financial advice and does not confer any rights whatsoever, enforceable against any party and does not replace any legal contract or policy which may be subject to terms and conditions.