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Dear

August 2017 was a good month for the South African investor. Amidst all the political noise and intrigue we had what was for the most part a positive month.

The JSE continued to climb to new record highs improving in the month by 2.4%. A large contributor to this performance was the resources sector, buoyed by improving commodity prices. Equities are now the leading asset class year to date with equity investors enjoying 2017 returns that are more than double that of cash and close to 70% higher than returns from bonds and property. After dismal equity returns in 2015 and 2016 the current equity returns have been a suitable reward for the patient investor.

The consumer is slightly better off at the tills these days with inflation continuing its downward trajectory. The reported CPI figure dropped to 4.6% year on year, which was widely expected. A stable currency has helped with lower fuel prices helping to lower inflation. With inflation firmly within the targeted band of 3 – 6% many economists are predicting another interest rate cut with some calling it as early as at the September MPC meeting.

As mentioned the currency has been relatively stable as global sentiment is currently positive towards emerging markets. The Rand finished the month marginally up against the major trading currencies.

The end of August saw the close of the SARS voluntary disclosure programme that allowed South African citizens to report and account for offshore assets that were previously undisclosed to the local authorities. We hope that those Gupta family members who are South African citizens managed to get their disclosure of foreign earnings and assets in on time. During the South African Communists Party 14th party conference in July Professor Ivor Chipkin of Wits University told the delegates that they have calculated that the Guptas have taken more than R40 billion from various State Owned Enterprises contracts, including a large amount for locomotives purchased by Transnet – that cannot fit our railway tracks. Imagine how those funds could have benefited the country.

August also saw our president, Jacob Zuma, survive the 8th motion of no-confidence in his presidency. What set this one apart was that the motion was voted on using a secret ballot. Despite the heads of the ruling party insisting that all their members of parliament follow the party's instructions there will still at least 30 ANC members of parliament that voted for the removal of the president. We still remain very wary of how the rest of the year is going to play out in the lead up to the ANC elective conference in December.

Just one final thought. Despite all our noted problems in South Africa we may be better off than some of the other countries of the world. This was clearly demonstrated in the final week of the month when North Korea decided to do a ballistic missile test (or demonstration) and launched one missile that went clear over Japan into the North Pacific Ocean. Is this a sign of things to come in the Northern Hemisphere?

Magwitch Securities

MARKET INFORMATION

FINANCIAL VIEW

STAYING THE COURSE WHEN INVESTING IN EQUITIES

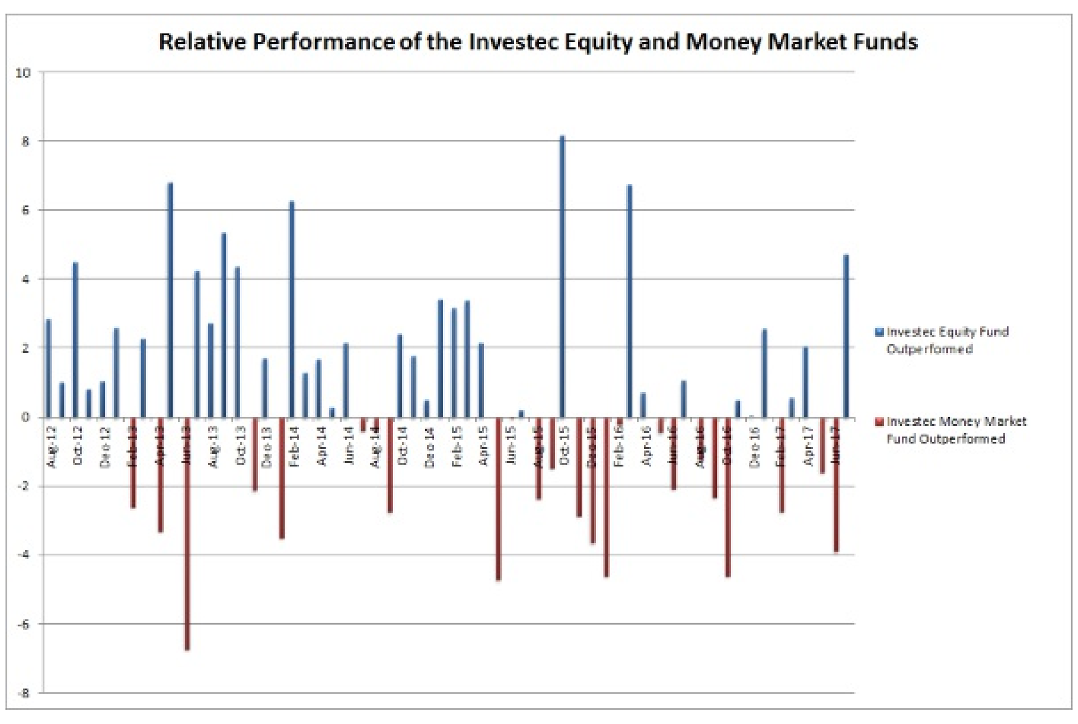
Everyone knows the general theory of risk and return. In order to generate a higher return one has to be prepared to accept a higher risk. This is definitely true when it comes to investing and can be proved by looking at the longer term returns of two of the major asset classes. On the conservative side of the risk spectrum you have cash investments which would typically give you a before tax return that just exceeds inflation. On the opposite end of the risk spectrum you have equity investments that should give a real return of 7%pa in excess of inflation over the long term. In essence you get the additional return because you are prepared to accept the additional risk.

The risk of the equity investment is obviously that you can lose a big portion of your money over the shorter term, this is defined and measured by the volatility in the share price of the equity. Equity returns do not come in a straight line and there will be good times and bad times as share prices are driven by investor sentiment and they go up and, more importantly, also come down. Many investors wish to enjoy the returns of the stock market but cannot stomach the volatility that comes with it so whenever the market comes off slightly they move their investments into cash. For our financial view this month we demonstrate why it is better to stay the course when investing in equities.

The stock market is very volatile and we see daily losses almost as often as we see daily gains. In fact in this last month where the JSE moved to record highs we had only 12 positive days against 10 negative days. Similarly if we look at the last 12 months we have had 6 positive months and 6 negative months. An equity investor needs to accept that they will experience months where the value of their investments comes off and months where the value of their investment will increase. Investors will also experience stock market crashes but they will also see their investments recover. A good example of this is the historic returns of the S&P500 which is an US index consisting of the 500 largest companies. Since the end of the Second World War the S&P500 has experienced 27 market crashes and corrections however it is up 11 000% over that period of time (that isn't a typing error). The patient investor often has the best return hence the saying, "It is about time in the market, not timing the market."

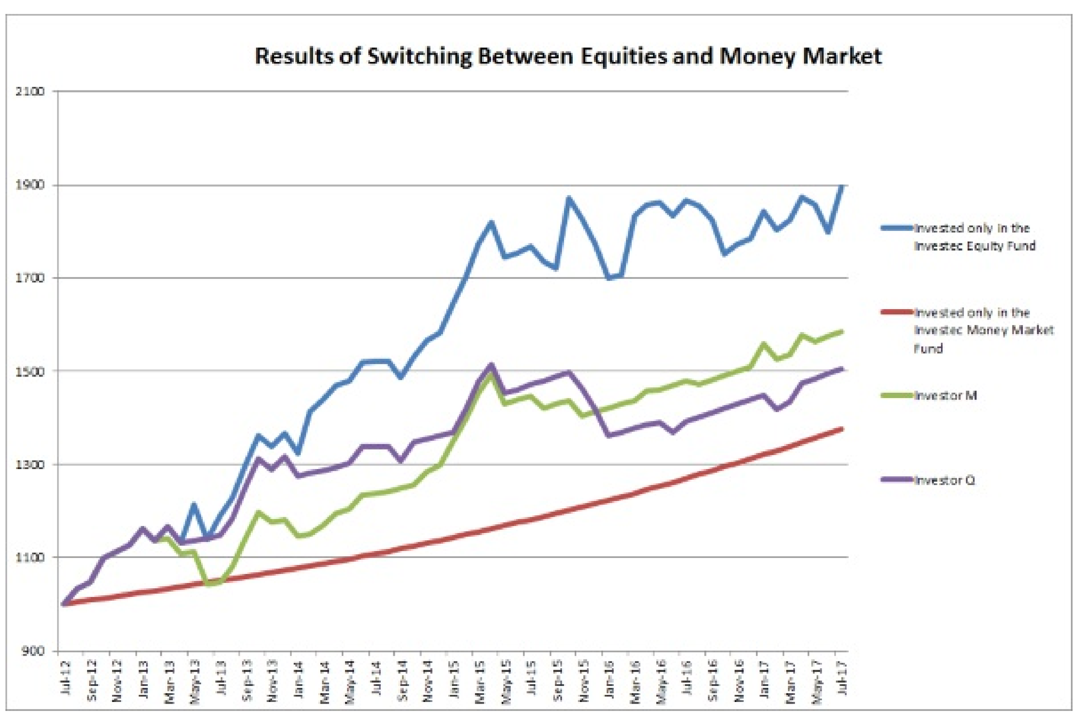
In order to demonstrate how it is better to sometimes just sit and do nothing in volatile times we have looked at the monthly returns for two Investec unit trusts, the Investec Equity Fund and the Investec Money Market Fund. Both funds have been in existence for over 20 years and both are highly decorated funds when it comes to market awards.

We have plotted the relative returns of the two funds over the last 5 years and what you would note is that there isn't a clear pattern, although the equity fund tended to outperform more consistently in the first half of the period.



The biggest problem with moving to the "safe haven" of cash after a period of underperformance by equities is that you often miss out on the best months when the stock market rebounds. Have a look at the 3 biggest periods of outperformance in the last half of the period. October 2015, March 2016 and July 2017 all followed at least 2 negative months.

With the above information on the monthly returns of the two funds lets assume that there are two anxious investors (Investor M – "Monthly" & Investor Q – "Quarterly") who use past returns as guidance and will switch between the Equity Fund and Money Market Fund based on recent performance. Investor M looks at the relative returns for the month and ensures that their investment in the next month is allocated to the fund that performed best. Investor Q looks at the relative returns for the quarter and ensures that their investment in the next quarter is allocated to the fund that performed best. By switching between the funds the investors would have experienced the following growth in their portfolio (all investments rebased to R1 000).



As one can see the best return would have been obtained by remaining in the Investec Equity Fund. Investor M has outperformed Investor Q because Investor M managed to miss a large part of the losses that the Equity Fund experienced in the last quarter of 2015 whereas Investor Q was fully invested in the Equity Fund. Both Investors missed the rebound that then occurred in the first quarter of 2016.

The only way that moving from equities to cash would have given a better performance is if the investor had remained in equities until October 2015 and then switched out to cash but what are the chances of someone switching the investment after a positive run. Investment decisions are generally based on the confidence of the investor and decisions to sell are generally only made after losses.

How to stay the course

The best advice to any investors is to always remember their original goal. Investments are normally structured with an envisioned time frame and objective. If you can focus on that objective the short term volatility should not be a distraction. If it assists you write down the investment's objective when you first enter into the investment – this will help you refer back to it later.

You need to understand that the asset classes that deliver the highest returns do come with the highest risk and volatility. Appreciate that short term volatility will happen but will not impact your investment return in the long term.

Lastly if you are looking to invest over a shorter time frame or need to have a high degree of capital protection then equities might not be the most appropriate asset class to utilise.

ABOUT MAGWITCH

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