SecureWealth
Lead. Don't Follow.

Quarterly Commentary September 2015

Brief Overview

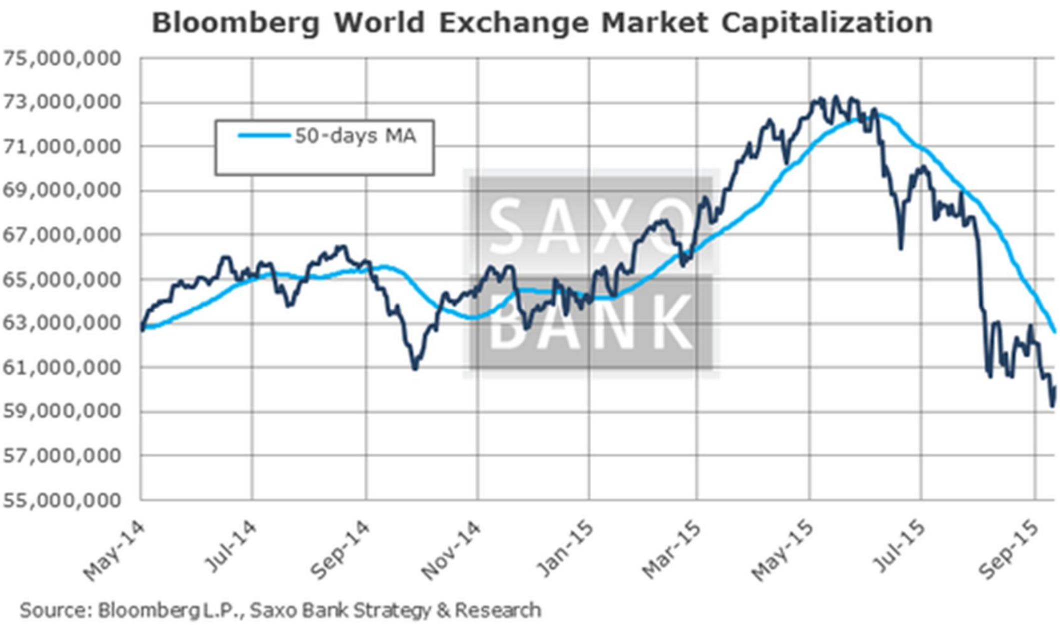
- Global Markets: Global markets have endured their worst quarter in 4 years, losing USD13 trillion in value.
- China: China devalued their currency, the Yuan, by 1.9% on August 11.
- JSE: The JSE All Share lost 2.87% for the quarter and is up 3.39% for the year.
- Dow Jones Industrial Average: The DJIA is down approximately 10% since hitting a peak on May 19 this year.
- Emerging Market Currencies: Most EM currencies plummeted this past quarter against the USD – the worst performers included the Brazilian Real and the South African Rand. The Rand was down 12.79% for the quarter, and is now down 17.23% for the year against the USD.
- Volkswagen: Having been caught in a diesel emissions scandal, Volkswagen shares collapsed 43% in two days after having already lost 38% since their peak. The auto manufacturer now faces massive legal action by governments, environmental agencies and consumers who are claiming misrepresentation.
- Federal Reserve of America: In one of the most widely watched Monetary Policy meetings to date, on September 17th the Federal Reserve failed to raise interest rates yet again. This supports our opinion that they won't be raising rates anytime soon unless the market truly forces them, and furthermore that they are now starting to lose credibility.
- Franklin Templeton: Our Franklin Templeton book had a tough quarter in which we decided to reduce risk in favour of USD cash and a conservative Global Bond strategy. We are finding that producing USD returns in these markets without taking undue risk is extremely difficult and we maintain that capital preservation for our clients is paramount.
- SABMiller: The top two brewers in the world, AB InBev and SABMiller, have agreed in principle to merge, resulting in a 26% increase of SABMiller's share price. SABMiller is our third largest holding with Allan Gray.

- **Allan Gray**: We had a very good quarter – we are geared for softer markets and a weaker Rand and this quarter the markets obliged.
- **Coronation Portfolio Managers**: Our cautious option has held its head above water, whereas our aggressive strategy has struggled.

Global Markets

After the third quarter, the scoreboard for Global Markets was not pretty. From their respective 2015 highs in USD terms, the S&P 500 of America was down 9%, the SENSEX of India was down 13%, the FTSE of Great Britain was down 14%, the NIKKEI of Japan was down 14%, the CAC of France was down 15%, the Hang Seng of Hong Kong was down 26% and the Shanghai Index of China was down 40%.

Below is a chart confirming the drop in market capitalisation since the peak in May. This drop coincides with a slowdown in China, as well as a stuttering American economy.



China

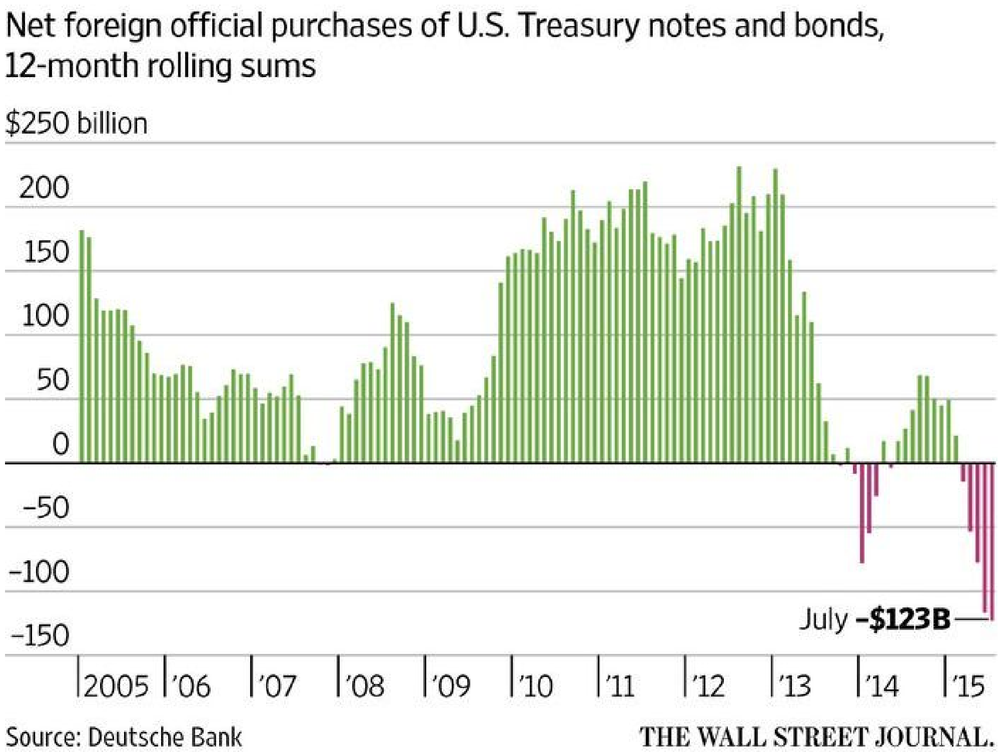
The Chinese devaluation of their currency by 1.9% caught everyone by surprise. The Yuan is pegged to the USD, thus it does not trade freely like the South African Rand. The actual devaluation of 1.9% was not the problem in our opinion. Other currencies – including the Australian Dollar, ZAR, Canadian Dollar and the Euro – have lost a lot more ground against the USD over the past 12-18 months.

The ramifications of the devaluation are the on-going concern:

1. Why did they devalue? *The economy might be much weaker than they have being telling us.*
2. Are they going to devalue again? *The Yuan was only devalued by 1.9% - other Emerging Market currencies have seen devaluations upward of 20%. There is a very good chance they will have to devalue again going forward.*
3. How much is it costing the Chinese to hold the peg against the US Dollar? *It costs billions of dollars each month to manage a currency peg.*
4. Where are the Chinese raising the funds to defend the peg? *Partly from their US Treasury reserves. China has been selling record amounts of US Treasuries – a long term negative for interest rates in America.*

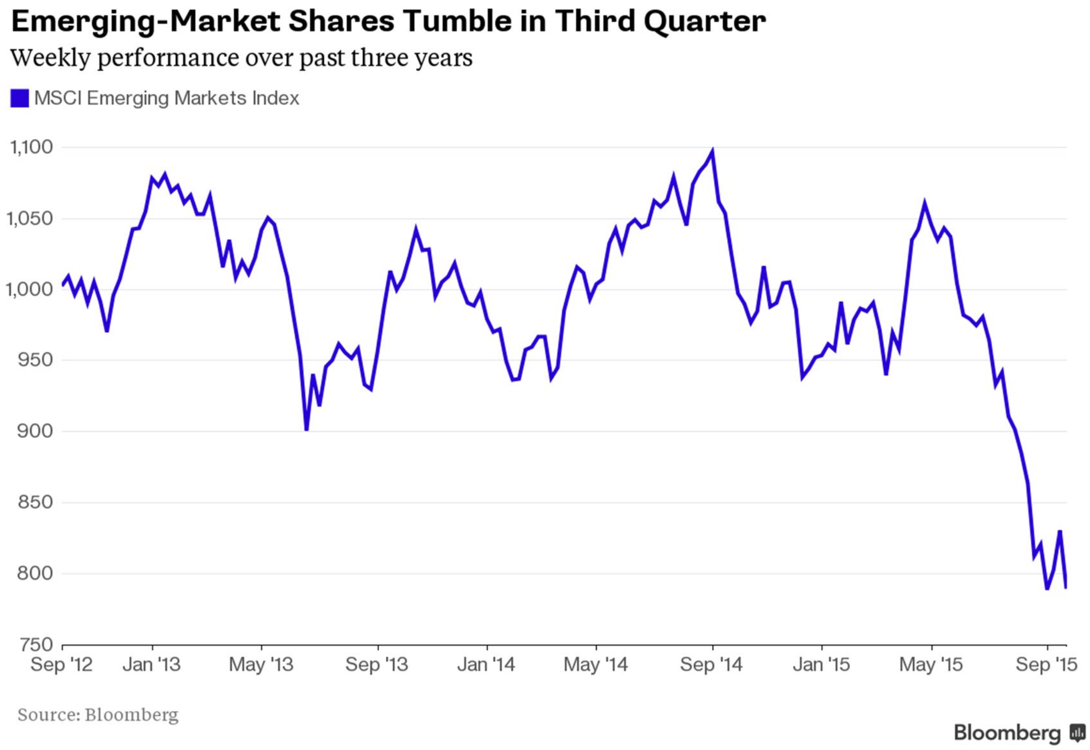
We note above that the Chinese are going to need funds to defend the currency peg and to offset a weakening economy. The chart on the next page clearly illustrates that China, and other countries, have been selling US Treasuries for only the second time in years. This is generally a negative for interest rates in America – and maybe this is the catalyst that forces the Federal Reserve to start raising interest rates.

It is no secret we are bullish on China, as well as the cheaper markets within the Emerging Market universe. Markets however have a nasty habit of making one look foolish. We are either wrong on China – or early. When the news of the devaluation broke we moved quickly to defend our clients' USD portfolios.



The China Enterprises Index now trades at an average price-to-earnings (PE) ratio of 6.52 – down from 30 plus in 2008. Whilst the PE Ratio is only one measure of many valuation metrics that we use in our industry, what it does tell us is that certain Chinese shares are ridiculously cheap.

Whilst the chart on the next page looks alarming, we see a massive opportunity brewing in Global Emerging Markets. We are in good company – Dr Michael Hasenstab of Franklin Templeton who is regarded as one of the best Bond managers in the world – came out this week saying he feels certain Emerging Markets offer a multi-decade opportunity at the moment. We feel exactly the same – our challenge is to take advantage of those opportunities, *whilst avoiding a major blowout*.



We are thus not giving up on the opportunity to invest in some of the cheapest markets in the world, with the highest growth rates to boot. Despite the on-going concerns regarding China, we still see China as a fantastic opportunity – *just like it was an excellent opportunity to invest in America in the middle of their crisis in 2008.*

Allan Gray

As mentioned, we had a very good quarter for our South African clients. Only one fund from Coronation has disappointed. It is not Coronations fault – we choose where to invest within a suite of funds from Coronation. We are therefore responsible! This particular strategy is invested in the cheapest regions in the world – namely Brazil, China and India. It will recover, but it is going to take some time.

The Rand plummeted on the Chinese devaluation and this benefited our local portfolios. Additionally, considering the steep equity valuations specifically in America and Developed Markets, we deemed it prudent to reduce risk on almost all our local portfolios (if the client, investment mandate and product allowed us to).

We still believe the most attractive place to be invested is overseas, and specifically the cheaper Emerging Markets. The Rand, however, is deeply oversold and we expect it to rebound at some stage. Now, if we believe the Rand is going to rebound, why would we not be bringing some of your money to SA and banking the profits?

The answer is a simple one. We do not have a viable investment alternative here in SA to invest your money. Shares, Bonds and Property are all overvalued in SA in our opinion. If either one of those asset classes offered compelling value, we would consider taking advantage of the fall in the Rand and would repatriate a portion of your capital to SA.

South Africa

One of the most effective ways of ascertaining how a country's economy is doing is demand for electricity. It stands to reason that higher demand can accurately portray the health of an economy. South African electricity demand has declined up to 10% year on year according to local energy expert Chris Yelland – by contrast, China has had an increase in electricity demand of 3.8% year on year.

Obviously the rolling blackouts are playing their part, but it is very difficult to have confidence in an economy with declining electricity demand. We are thus still extremely concerned about South Africa, and we believe a buoyant stock market is covering up a lot of cracks.

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Below is some excellent work courtesy of Charlie Bilello of Pension Partners, LLC. What the chart illustrates is that South Africa is only -4.8% (local currency) from its all-time highs – achieved a mere 6 months ago. It is the best performer out of every country listed in this specific survey. Have a look at the figures for some of the other markets and how many months ago they made their highs.

Global Equity Indices				
Country	Index	Months From All-Time Closing High	% Below All-Time High
United States	S&P 500 INDEX	5	-7.1%
United Kingdom	FTSE 100 INDEX	5	-10.9%
Germany	DAX INDEX	6	-20.0%
South Africa	**FTSE/JSE AFRICA TOP40 IX**	**6**	**-4.8%**
India	S&P BSE SENSEX INDEX	8	-9.3%
Canada	S&P/TSX COMPOSITE INDEX	13	-12.8%
South Korea	KOSPI INDEX	54	-10.7%
Brazil	BRAZIL IBOVESPA INDEX	90	-35.1%
Spain	IBEX 35 INDEX	96	-36.6%
China	SHANGHAI SE COMPOSITE	97	-49.9%
Australia	S&P/ASX 200 INDEX	97	-24.3%
Switzerland	SWISS MARKET INDEX	102	-8.1%
Italy	FTSE MIB INDEX	190	-55.7%
Taiwan	TAIWAN TAIEX INDEX	312	-32.8%
Japan	NIKKEI 225	314	-53.3%

Source: Pensions Partners LLC

Are South Africa's prospects that much better than all the other countries listed?

We are absolutely astounded that investors are still incredibly confident in our market when it seems every piece of data highlights – to us anyway – that there are far better opportunities in beaten down global markets offering much better value than South Africa.

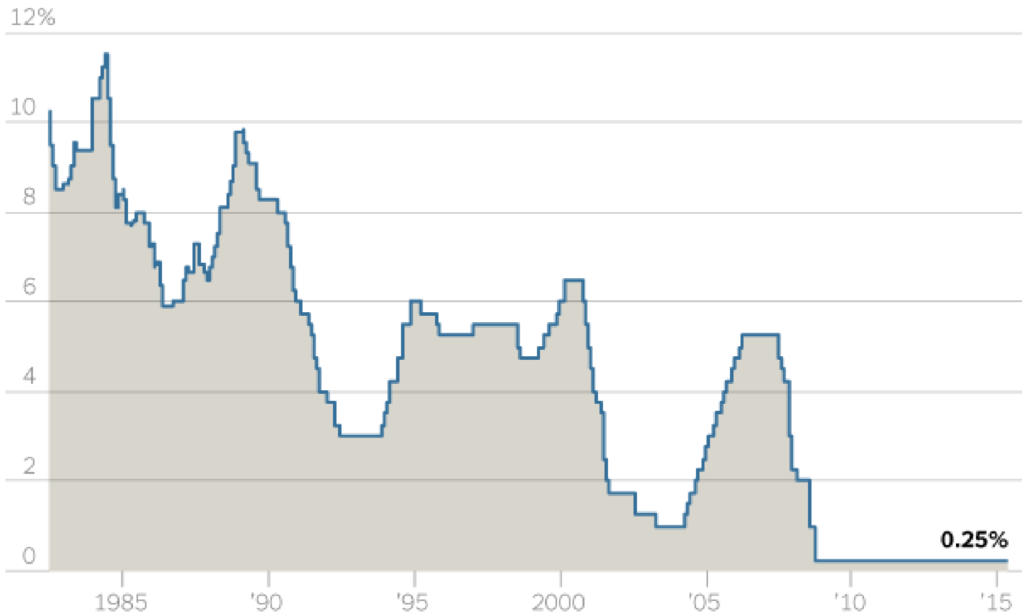
We know it sounds boring and repetitive, but we are going to continue to hold a strong offshore bias, and a cautious approach to South Africa.

Franklin Templeton

Managing portfolios overseas in a strong dollar and negative USD interest rate environment (with your responsibility denominated in USD) is incredibly difficult at the moment.

Interest rates in America are at unprecedented lows – lower than any date we could source dating back to 1800 when Thomas Jefferson was elected the 3rd President of the United States of America. It bears noting that electricity was not even around at this time!

If one studies the graph below, clients can quite clearly see that it was easy for us to produce USD returns when interest rates were 4, 5, or 6%. Looking at the rate now, you are getting a negative return in USD by sitting in cash.



Source: Bloomberg

When we take on the responsibility of looking after your money – we focus on two goals:

1. Capital preservation – that is our primary responsibility
2. And producing an acceptable return is secondary

With those two goals in mind, developments in this last quarter forced us back to our primary responsibility on your behalf. We could throw caution to the wind, ignore the latest market developments and pray that we do not have another 2008 crisis around the corner, but if we do have another crisis – Developed Markets now have limited ammunition on hand and the market knows this!

As long as I have a say, we will always react to a serious market development – we felt that China and Asia had bottomed after a 5 year consolidation period and we were wrong. It is frustrating for you, and it is equally frustrating for us. The only ray of sunshine right now is that your portfolio is worth more in GBP Sterling, Euros, Canadian Dollars, ZAR and Australian Dollars.

Our Franklin Templeton portfolios are down on average USD2% this year. If one looks at the negative returns this year, we have done a reasonable job in preserving our client's capital. Not only are we are extremely confident that we can recover these losses, but we believe we will be able to produce an acceptable USD return when the market affords us the opportunity.

Our strategy is simple: If China and select Emerging Markets get significantly cheaper in a global sell off by the end of the year, we will reinstate our positions at a very decent discount. Alternatively, we will begin Dollar/Rand Cost Averaging, thus buying into our preferred markets on a monthly basis over a 12-18 month period. That way our clients still get access to the cheapest markets in the world, but we smooth out the risk.

We thank you for your continued support.

Kind Regards

Mike Carruthers