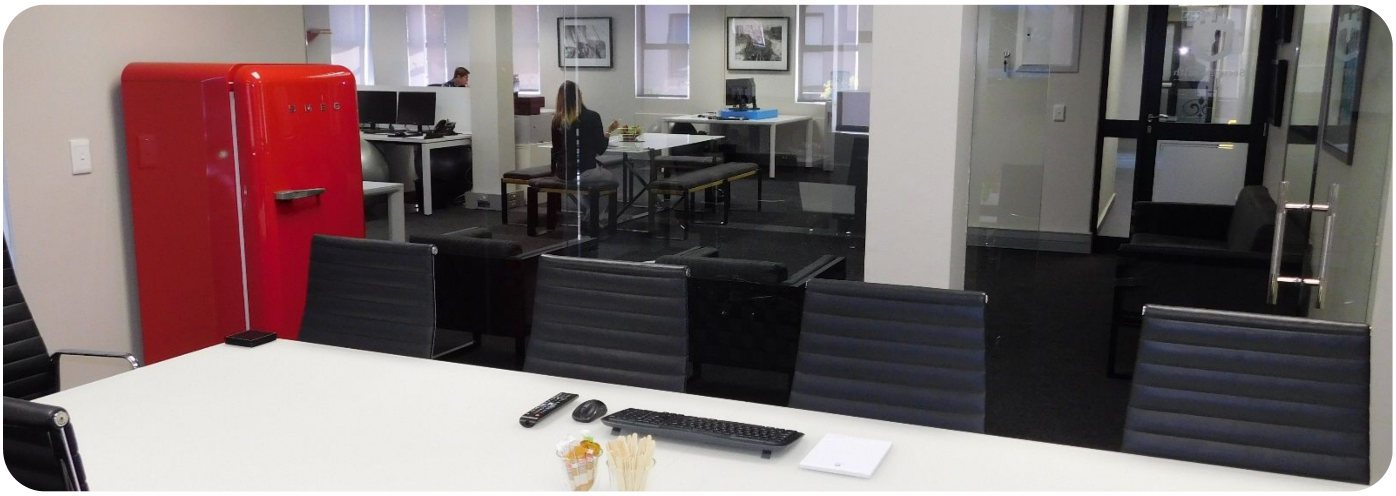


SecureWealth
Lead. Don't Follow.

Quarterly Commentary June 2017

"Good judgement comes from experience, and a lot of that comes from bad judgement." – Will Rogers

Markets at a glance:

1. **South Africa:** Fell into a technical recession for the first time since 2009.
2. **South African Rand:** The Rand appreciated 2.80% against the USD this past quarter.
3. **JSE/FTSE:** The JSE All Share was down 0.50% over the past 3 months.
4. **Allan Gray**: Our top holdings rebounded. It certainly does not feel like it, but they have been some of the best performers in the last quarter. We feel our positions bottomed in late March – and we are hoping to have a wind on our backs for the rest of the year.
5. **Coronation Fund Managers**: The aggressive Coronation Global Emerging Markets Fund had another excellent quarter. The more conservative strategy, which has a large weighting in USD cash, was up a very respectable 2.50%.
6. **Franklin Templeton**: We stripped out much of the risk in our USD portfolios due to extreme American valuations and also in light of margin debt on the New York Stock Exchange hitting all-time highs.
7. **Investec and ABSA Stockbrokers:** All our Investec portfolios are overweight emerging market technology shares. And our ABSA and Investec portfolios are also overweight USD and GBP cash – some patience is needed before we see these portfolios start performing.

South African Rand - Allan Gray/Orbis Global Optimal Fund of Funds

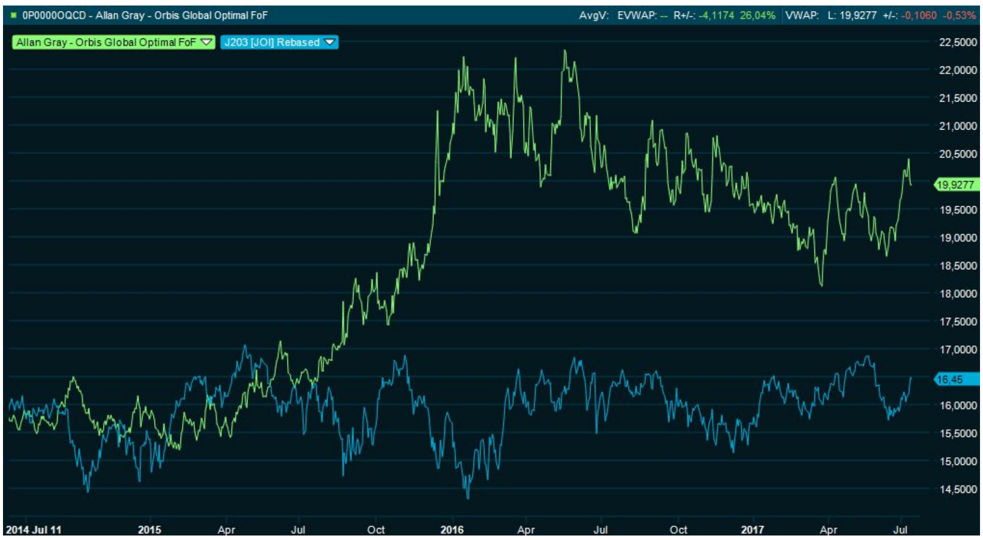
The behaviour of the SA Rand **(ZAR)** versus overseas currencies has a huge effect on the performance of your portfolio and on our business.

Our largest holding – Global Optimal Fund of Funds – is a conservative offshore strategy comprising of USD61% and EUR39%. After being the best performing fund in the country in 2015, it has struggled the last 12 months. However, we are all judging this strategy on its short term performance. But if one takes the time to look out a little further – it actually produces stellar returns. With very little risk!

The fund is up USD4.7% year to date and up USD7.9% over the past year. If Allan Gray can repeat that first half performance of USD4.7% over the next 6 months – that would equate to almost a USD10% return this year. That would be a very acceptable result!

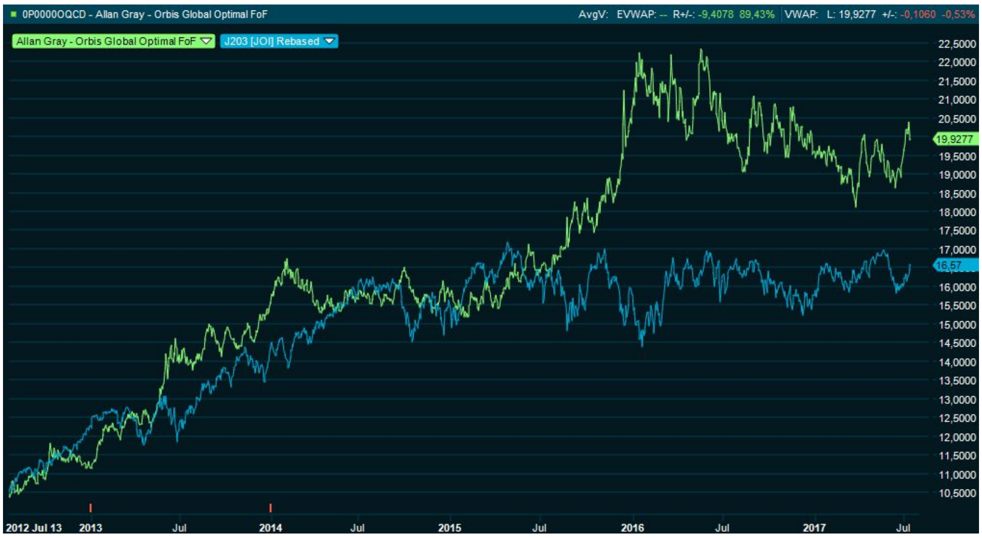
Furthermore, please study the returns of this low risk fund below versus the JSE All Share (high risk) over a 3 and 5 year period. The fund is in green:

<u>3 Year</u>



Courtesy INET Bridge

5 Year



Courtesy INET Bridge

It has outperformed the All-Share and yet almost everyone, including ourselves, only look at the last year and incorrectly assume that it has not performed at all. This is a classic case of the hare and the tortoise.

Right now, our main concerns are valuations in America and the record margin debt underpinning those steep valuations. At some stage those concerns are going to come to the boil – and we believe that the conservative Global Optimal Fund of Funds is perfectly positioned to benefit from this.

Lastly, we only focus on the Rand, but the Rand is rallying in sympathy with all other emerging market currencies at the moment. In the following paragraph, we allude to the fact that (unlike other emerging markets) South Africa, above our other challenges, has fallen into a recession. We believe that at some stage the Rand is going to decouple from other emerging market currencies in better performing economies.

South Africa

We learned in early June that South Africa is officially in a technical recession. We believe it is going to take massive and unpopular restructuring to solve South Africa's major challenges - not just a change in leadership.

We are doubtful the present or future ANC leadership will be willing to grasp the nettle and take the tough decisions necessary to restructure the economy, root out corruption and get the economy growing again (which is the only way to begin to solve the deep-rooted challenges we face at the moment).

This is the first time since the Great Financial Crisis in 2009 that South African has experienced a recession. A technical recession is when an economy suffers two consecutive quarters of negative economic growth. It simply implies that economic activity in a country is declining. The country's GDP, which is a measure of the value of all goods and services produced within a country's borders, fell by 0.7% in the first quarter of 2017 compared to the previous quarter. This followed a decline of 0.3% in the fourth quarter of last year.

In the last quarterly commentary we suggested that South Africa may be headed for a perfect storm. This latest economic information is just more confirmation that Africa's most industrialised economy is walking a tightrope at the moment.

This is particularly worrying because the country is desperate for strong economic growth to counter the massive unemployment, inequality and poverty dilemmas it is facing. The youth unemployment rate (for individuals aged *15-24*) recently rose to 38.6% and 58% of people aged between *15 and 34* are unemployed. Unemployment among graduates remains at 7.3% and the expanded unemployment rate was 36.4%. These figures are not only alarming - they are frightening!

Falling into a recession is only going to add more pressure on already indebted consumers, and aggravate the unemployment crisis. And ultimately, the currency should bear the brunt of the unique challenges we face, unless the government acts bravely and decisively.

High Conviction Investment Proposal: Emerging Market Technology Shares

Notwithstanding our concerns RE valuations and margin debt in America, the one sector we are extremely bullish or confident in (and in which we are prepared to ignore any short term volatility) are emerging market technology shares. We feel they are completely undervalued relative to their American peers, taking into account the enormous growth potential in their domestic markets and regions. This space represents one of the most compelling investment opportunities over the next decade in our opinion.

A **$10 000** investment in the following American technology shares yielded the following results over the past 5-10 years:

1. Amazon - **$141 500.00** – a 30% per annum return over 10 years.
2. Google - **$35 538.00** – 13.50% per annum over 10 years.
3. Facebook - **$39 493.00** – a 31.50% return per annum over the 5 years since it listed.

And a **$10 000** investment in Tencent (the largest Chinese technology company) over 10 years has grown to **$380 000** (or a 44% compounded annual return).

Asia comprises more than 4.4 billion people (60% of the world population) living in 49 different states. Asia is also the fastest growing economic region and the largest continental economy by GDP in the world. The potential of this **highly techno-literate region** is mind boggling.

The Chinese Internet Evolution

The Chinese internet sector has seen tremendous growth over the past few years. In 2014, China's e-commerce market size actually surpasses that of the US! Only 52% of China's population are Internet users compared to 88% in the US. We thus believe there is vast capacity for growth in the Chinese internet sector.

Here are a few statistics that underpin our recommendation:

1. Total potential internet population in China – 721 million (versus 287 million in the US)
2. E-commerce market size in 2016 – $749 billion in China (versus $394 billion in the US)
3. 2015-2016 online sales growth – China's sales online grew 26.2% (versus 15.1% in the US).
4. Asia is home to more technology firms than the States.
5. These tech firms have massive emerging markets in Asia and India to sell to, whereas Western markets are far more mature.

And these are the following 10 technology companies we are considering to make up our high conviction technology portfolio. It is astonishing that we assume only American companies are the leading tech companies in the world. Look at some of the simple stats below:

1. **Samsung**: One of the largest multinational conglomerate tech companies in the world – revenue of $350 billion and close to 500 000 employees.
2. **Alibaba:** The world's largest retailer, having surpassed Walmart in April 2016.
3. **Netease:** Chinese online gamer - largest holding in the Allan Gray/Orbis Global Emerging Market Fund.
4. **Taiwan Semi-Conductor:** World's largest dedicated and independent semiconductor foundry.
5. **BYD**: Sold a total of 506 189 passenger cars in China in 2015 and is the best-selling global electric vehicle brand. More electric cars are sold in China than in the rest of the world combined. Also one of the largest battery manufacturers in the world. Warren Buffet bought 10% of the company in 2008.
6. **Hon Hai Precision Industries/Foxconn:** The world's largest contract electronics manufacturer and the world's third largest tech company by revenue.
7. **Baidu**: The Google of China.

8. **JD.com:** One of the two largest online retailers in China by transaction volume and revenue with 237 million active customer accounts.
9. **Infosys:** The second-largest Indian IT services company.
10. **China Mobile:** Presently the world's largest mobile telecommunications company by market capitalization.

We will be producing a comprehensive presentation for you covering valuation metrics and estate duty challenges/solutions about owning these shares on a foreign stock exchange. International Inheritance Tax and Probate issues only apply to individual tax payers, Companies and trusts can take advantage of the above recommendations without any challenges. We will be using Investec's asset swap capabilities.

Furthermore, we will reduce our R1 million minimum premium for private stock market portfolios to R250 000, to accommodate as many clients as possible wanting to participate in the above recommendation.

I look forward to chatting to you shortly about the opportunity above.

Kind Regards

Mike Carruthers

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