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You and Your Money

Presenter: Bryan Hirsch **Guest(s):** Vawda, Hansen

Summit TV personal finance expert Bryan Hirsch speaks to Paul Hansen from Stanlib and Fatima Vawda Managing Director of 27Four Investment Managers about investing in 2010 and why retirement savers should be diversifying across asset classes

Bryan Hirsch: Welcome to the first You and Your Money in 2010. I'd like to wish all our listeners a happy, healthy and lucky year. This year we will continue to cover all the different aspects of financial planning and keep you abreast of all the latest changes relating to legislation around investment saving. We had a roller-coaster ride in 2009 so I tried in the festive season to look into my crystal ball to see what we can expect for 2010. There are so many different influences that can affect economies and markets around the world and that includes the possible withdrawal of state programmes around the world, how foreign buying will impact our market, and what the associated dangers are. The opinions of economists and analysts generally differ - I've never seen such discrepancies in forecasts pertaining to currencies, interest rates and the markets. To help us make sense of this I'm delighted to welcome back both Paul Hansen and Fatima Vawda. Paul, did the markets run through too much in 2009 and can we maintain that upward movement?

Paul Hansen: I don't think they did run too far - we're just recouping lost ground. We went from 33,000 points to 18,000 on the JSE and now we are back at 28,000 points so we are still down around 20% from our record high. We've got a lot higher than most people thought we would - but remember we follow the offshore markets. We don't set the trend - they set the trend. They are trading where they were 10 years ago - the offshore developed markets. Not the emerging markets - they're right up where we are. The developed markets are trading at 10 years ago levels so we are following their trend. They've been firm right through December 2009 into January and so have we...

Bryan Hirsch: Our markets certainly you talk about 20% off their high - but the international markets are a lot more than that. I look at the developed markets and there's been an attraction to emerging markets over the last six to nine months...

Paul Hansen: Yes, a lot of money flowing into the emerging markets because that's the hope for growth where the developed markets still have problems with the banking crisis still affecting them to some extent - the lack of credit and so on. The hope for much more growth in the emerging markets is obviously led by China, India, Brazil and the likes - we're a bit behind on the growth side but we are part of that team...

Bryan Hirsch: Fatima, do you share Paul's views? Are you as optimistic as he is?

Fatima Vawda: Going back to a year ago it's unbelievable what we experienced in 2009. A year ago I probably was sitting at this exact same table discussing what 2009's outlook would have been with you - and at that point it was all doom and gloom. Old Mutual was not going to exist any more and a South African bank was probably going to go bust - we were seeing the beginning of the second Great Depression. Since the end of February beginning of March we've seen the biggest rally we've seen in a long time so 2009 has been an unbelievable story. For 2010 I think maybe cautiously optimistic - there's a lot going on that's unprecedented with fiscal stimulus packages globally, quantitative easing, monetary policy, forced interest rates at zero levels. That's really sparked the recovery that we saw beginning in March 2009. As you said in your

introduction the next question that arises is when will the developed markets pull back with the fiscal stimulus? That will really dictate where things go forward...

Bryan Hirsch: We're talking about letters of the alphabet - we talk Vs, Us, Ls and we talk Ws - there is some opinion that we are going to have some major dips coming this year before an increase. Are you a little bit more optimistic? Do you not see that happening?

Fatima Vawda: I'm cautiously optimistic. We've even seen discussions about Ss which is never recovering - no long term recovery. I think we will recover but it's not going to be as quick as people expect - it's going to be a lot slower - but we do expect to see some gains in 2010 but not as aggressive as we saw in 2009...

Bryan Hirsch: Paul if you're faced now as financial advisers are - the clients have got money and they've been in the money markets for a long time and they came out at the wrong time, they're still sitting in cash and interest rates after tax are well below inflation - what would your advice be to them? They want to get into the market and they want to get in long term - would you be suggesting phasing in the money? Would you suggest getting in now? More importantly where do they actually find value because we've had an enormous run?

Paul Hansen: These are difficult questions to answer. We are up 60% from March 2009 and we look expensive at the moment because our earnings have been so poor - we've had the biggest fall in history in South African earnings in 2009 down 28% - so it's all a question of to what extent will earnings recover this year? Will it make the market look reasonable by the end of 2010 if it was sitting at this sort of level? One has to be cautious because we haven't had a pull-back of more than 8% since we started this 60% run 10 months ago in March 2009. Typically you do get pull-backs of at least 10% and maybe even 15% because the offshore markets remain firm. You have to be very careful going into the market cautiously here - and you do that perhaps by going into a conservative fund that has no more than 18% to 20% in equities, 10% in listed property and the rest in fixed interest. With that type of approach if the market keeps running as we would expect over the next few years then you still beat inflation - but if it takes a bit of a pull-back you don't get hurt much...

Bryan Hirsch: Our first caller of the year is Sue. Happy New Year...

Sue: Thank you. I wish you and your panellists the same. What's your view of the upcoming budget regarding tax increases?

Bryan Hirsch: A great question because that could have a major impact. Fatima, you may be a little bit closer to that in terms of what your thoughts are. Paul, we have this investor who has a lump sum and wants to go into the market - would you be suggesting phasing in? If it was your own money and you were a little bit underweight equities would you be ploughing in rather than phasing it in?

Fatima Vawda: Diversification is the key to managing risk so I would say a combination of equities and other asset classes. Where is the value in the other asset classes? Generally one would look at investing in bonds - but bonds are not offering any value at the moment, in fact cash is sitting at the 10 year breakeven level so currently if you invest in cash in South Africa you're going to get 8% to 9% to 10% over 12 months. Yes, the real return is negative - but you are investing in cash at zero risk. I would invest in a combination of cash and equities - the rand is extremely strong at the moment at 7.30 against the dollar so buying offshore is not a bad idea at the moment - and then also if you want to have some exposure to the bond market go for corporate bonds where they're offering a lot more attractive yields than parastatal and government bonds.

Bryan Hirsch: Let's deal with corporate bonds after the break.

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Bryan Hirsch: We have an email from Louis in Port Elizabeth: "How much notice do you as fund managers take of the quarterly beauty parades?" Fatima you talked about diversification, different strategies and corporate bonds - is corporate bond risk not just as great as being in equities?

Fatima Vawda: Absolutely. What you're buying corporate bonds for is equity-like returns - hopefully the risk is not as high as high as equities but it still falls within the same category of risk. It's another diversifier of returns and another means to generate extra returns outside of pure equities. It's a different asset class in a sense - so if equities behave in one way you'd expect corporate bonds to act in another way even though the risk may be equivalent.

Bryan Hirsch: When we started you were both quite optimistic about equities - we have this question about how much should be in equities and how much should go into equities. Paul, you then moved into quite a conservative stance and so did you Fatima - the viewers are now saying they've got this cash and should they be going into the market? I'm saying as a financial adviser yes, if you're underweight equities certainly phase into the equity market. I understand diversification - but the question is should one phase in rather than go in tomorrow or over the next few weeks and buy everything you want if you have one million rand and you want to put it into the market?

Fatima Vawda: There's absolutely no reason why you wouldn't go in all at once. The other asset class that I never spoke about - I'm a huge bull on hedge funds and they're a perfect investment to provide downside protection so you could add a combination of hedge funds to your equities, a bit of cash, a bit of property and a bit of offshore investing as a rand hedge and you've got a combination portfolio. There's absolutely no reason why you should phase in gradually. You could maintain and decrease your cash holding over a small space of time but there is absolutely no reason why you couldn't go with a big bang approach...

Paul Hansen: Remember what Warren Buffett said and that's always keep some powder dry in case of opportunities such as a pull-back of 10% or 15%...

Bryan Hirsch: Paul, before answer the viewer questions we are looking at high price to earnings ratios at the moment - we are talking somewhere in the order of 16 to 18 times which is higher than what our PEs normally trade - so we were down at eight around nine months ago and we are now up which means either PEs have to adjust downwards or the markets have to come down or alternatively the companies have to show better profits and earnings have to rise ...

Paul Hansen: Absolutely. Right now the markets are anticipating much better earnings and that's why it's pricing up like it is anticipating growth of 20% to 25% in the all share over the course of 2010. That's the big unknown - how will it turn out? Will it be better than expected, better than consensus, or worse? That's the unknown. The market currently is saying there's going to be a reasonably good jump in earnings...

Bryan Hirsch: Caller Nkoseli is on the line from Fourways...

Nkoseli: What are the risks associated with the stimulus programmes being withdrawn - the bubble being created by governments internationally?

Bryan Hirsch: Let's just go back to Sue's question about taxation. We've had a fall in tax over the last 15 years with private tax at 14% and company tax at 28% - now there's a feeling where is government going to find the money to fund the deficit in terms of collections? There's a lot of speculation about possible increases in taxation...

Paul Hansen: There is. Although we are short of cash like all countries - except maybe China, India and Brazil - the fact that our economic recovery is so fragile at the moment I think would mitigate against a tax increase because that will put a brake on economic recovery to some extent. We might escape tax increases this time around because of that. Let the recovery pick up a bit of traction - then we can start looking at something like that. At the moment we are in a situation where we can actually afford not to raise taxes because our

government debt as a percentage of the economy is fairly low relative to most other countries - it's around 25% because Trevor Manuel did such a good job over the last 14 years.

Bryan Hirsch: Let's go back to last question we had about states withdrawing support worldwide - there's been enormous bail-outs has this created bubbles?

Fatima Vawda: We've got to go back to the question of what happened in 2008 when Lehman Brothers and Bear Stearns and a lot of the US banks started to go under - there was a definite liquidity squeeze in the market and basically no banks were making prices, and corporates couldn't borrow or lend money. That was a huge problem globally. What the fiscal stimulus basically did was bought back a whole lot of bad mortgage-backed securities in the United States and pumped a lot of liquidity into the market. That was necessary. If you read what Ben Bernanke and Tim Geitner and the US Federal Reserve have said recently - a lot of people are talking about the bad unemployment figures - but had they not done what they did at that time the situation could have been a lot worse. That's why we don't have a Great Depression as expected - we are now talking about a recession - so it hasn't been as bad as it was and that's because of the stimulus packages. It had to be done...

Bryan Hirsch: We have caller Tessa on the line....

Tessa: I want to know what your view is about that offshore markets and investing offshore what asset classes would you suggest?

Bryan Hirsch: The question about a bubble - is there a possibility that a bubble could be pricked in the emerging markets?

Paul Hansen: I don't see any bubble at the moment - not in the valuations of either developed markets or emerging market. It's nowhere near bubble territory. Property is nowhere near bubble territory. Nothing is anywhere near bubble territory at the moment. It's way down on its highs. Valuations are not anywhere near bubble territory...

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Bryan Hirsch: Paul, every quarter out come the "beauty parades" of all the asset managers and how they've done and where they rank. We now have the yearly figures - do you take a lot of notice of that?

Paul Hansen: We have to - because we are to some extent in a horse race in unit trusts and in pension fund management and money management generally because we are always being compared to each other. The results are shown in the newspaper - they're published all over the place - so you have to take note of it. It's taken seriously because it's part of our business...

Bryan Hirsch: We have caller Stan on the line...

Stan: Evening Bryan and the panel. How does one differentiate one asset manager from another?

Bryan Hirsch: I'll put that to the panel. Continuing on Tessa's question - something you alluded to is there great value identified in emerging and offshore markets, and then if there is the question is if you go offshore at 7.30 against the dollar or under 12 to the pound what should your asset allocation be?

Fatima Vawda: Going back to the earlier question about bubbles - what happened with the large outflow of assets from the developed markets was those assets landed up in the emerging markets. As an emerging market we were recipients of in excess of R74 billion worth of offshore assets that came into the South African market alone. The fear with that flow into the emerging markets is that could perhaps, if not managed carefully lead to inflation that could lead perhaps to a bubble so the bubble notion is out there. Coming back to your question on where to invest offshore that's a combination of developed markets - don't write off the developed markets. The developed markets are still driving the recovery globally and a combination of emerging markets. I would prefer equities relative to fixed income globally because of the aggressive fiscal stimulus

packages coming out of government debt - you're going to get absolutely nothing out of treasury, etcetera - so the value is in equities globally.

Bryan Hirsch: Property?

Fatima Vawda: Probably a recovery coming into property maybe in Europe. Property is a scary notion in China at the moment because there is a fear of a housing bubble in China - but property maybe in Europe. Not yet in the US until mortgage prices recover.

Bryan Hirsch: We have Beulah on the line...

Beulah: Yes, I would like to know if we'll see an increase in dividends this year and will companies like Anglo American start to pay again?

Bryan Hirsch: Going back to Sam's question that's for Fatima because she has to select fund managers - what differentiates one fund manager from another?

Fatima Vawda: There's a lot of factors and it's critical one evaluates all of those. The first factor would be the investment process - does the fund manager have a very clear investment process they follow from beginning to end in the way they pick stocks, in the way they research stocks and their ability to construct good portfolios? What sort of risk measures do they use, what sort of team does he work, what's the team base approach? What about the house in which he functions, the brand? What about the operational capacity, what about the risk measures? There's a combination of things that a multi-manager like ourselves would look at when we due diligence fund managers. We score and grade fund managers on those things. It's not only performance because performance says one thing but consistency is critical for long term sustainability.

Bryan Hirsch: Paul, an increase in dividends and in particular Anglo American? Any chance of that dividend coming back this year?

Paul Hansen: A leading question after that collapse last year. I would suspect that we are going to have a really decent increase in dividends this year - maybe not as much as the earnings - but still maybe 10% to 15%. Anglo American should start paying dividends - I would suspect this year they should initiate dividend payments again.

Bryan Hirsch: That's really what people rely on. The question is it doesn't matter what the price of your share is - the dividends remain constant. If you buy the share lower your yield is higher. Today if you look at your portfolio and you're earning good income from your portfolio it doesn't matter what the price of the share is at this point in time if you're looking at the income side...

Paul Hansen: Exactly. If you look at the price of copper up 8% in the last month and the price of platinum up at almost \$1,600 an ounce, the price of palladium jumping despite the stronger rand I think they are going to make quite decent profits this year.

Bryan Hirsch: Fatima, the two leading questions everyone is asking - interest rates and the rand?

Fatima Vawda: The massive inflows we saw in 2009 from developed market investors into the emerging economies led to all that rand strength that we saw - the rand will probably remain strong for the first two quarters of this year with the World Cup coming, and with a lot of offshore assets coming into South Africa it will maintain strength. Towards the end of 2010 it should depreciate back to around the eight level. As the economic outlook improves globally in the developed markets we should see money flow back to those markets. In terms of interest rates I think they've bottomed out in South Africa. We should see interest rates starting to increase probably towards the end of 2010. Inflation will rise as a result of electricity tariffs increasing and that will put pressure on current inflation levels within the target range. There is talk by certain stakeholders within the industry that the SA Reserve Bank should move away from inflation targeting - that won't happen in the near term but I would think we are at the bottom of the interest rate cycle.

Bryan Hirsch: Paul, are you factoring in a change in the rand or interest rates into any of your decisions?

Paul Hansen: The rand is always the toughest call. It's so hard to call that. At the moment the rand's uptrend against those big currencies is still intact so there is some risk it could get stronger - don't wipe that out as it could get stronger than seven. One hopes not of course. So far it's stopped at 7.22 or 7.23 whenever it's got down there - so that's the big area at the moment. As far as interest rates go there is some hope that there could be a cut in March because the rand is so strong therefore inflation could be better than expected but it's a fairly smallish 20% to 30% hope at the moment.

Bryan Hirsch: I'm always asked what I think of the year ahead - there are so many reports that predict the year ahead but if I look back to 2009 and how wrong the majority of investment and financial advisor were in regards to the major crash who would have predicted that, the recovery, the fall in the rand and its current strength? In the short term no one really knows what unexpected events lie in wait and what will affect our best laid plans? Is it going to be a V, W, L or U shaped recovery? I've now heard about an S-shaped recovery but no fund manager can tell for certain because if they really knew then as far as I'm concerned they should either be 100% of the market or 0% of the market in the short term. None of them take such aggressive bets.

Before acting on any advice please consult your investment or financial advisor.

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