



WEALTH MANAGEMENT

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Introduction

This year seems to have flown by at incredible speed and on reflection it certainly has been an eventful year. Quite a roller coaster ride on the markets but the important thing is we won the Rugby World Cup. I can't help but wonder, when we look back in 10 years time, will it have had the same impact on bringing South Africans together and creating a more optimistic mood as it did in 1995. The local and international markets got off to a good start but then things started to change. The second half of the year has been incredibly volatile. Higher interest rates in the United States started to take their toll. In July a number of large corporate transactions were called off as the cost of capital made the deals unattractive. This was soon followed by the Sub Prime market crisis which has dominated the year since August. The housing market collapse in the United States has triggered concerns of a recession and Ben Bernanke was forced to start cutting interest rates to avoid a recession. What were the Americans thinking giving 120% housing loans on already inflated house prices to people who should not have qualified for loans in the first place. Honestly how can you lend money to people with no job, income or assets?

Global

The US Dollar has been very weak and is not expected to recover until the middle of 2008. Brazil, Russia, India, China and the Middle East have been the driver of Global Growth while the United States and Europe have been slowing. Interest rates in the UK and Europe are expected to be reduced next year which will help boost those economies and help strengthen the US Dollar. The Pound and Euro are in over bought positions currently and should give back some of their gains to the dollar late next year.

On a positive note a strong demand for commodities has been driving the out performance of emerging markets over developed markets. Emerging markets have all had a very strong year and have largely been unaffected by the sub prime market crisis. The East has had a good year and the million dollar question is whether China, India and the Middle East have managed to decouple from the United States. The jury is still out on this one.

Most economists believe the Rand will come under pressure next year and now is a good time to move some money offshore. The outlook for global equities is positive for next year as most developed countries expect interest rates to decrease, while emerging markets should remain robust. We can also expect increased volatility which will create opportunities if correctly managed.

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Record high Oil price which flirted with 100\$ a barrel and higher food prices have been driving inflation higher. At time of writing interest rates have just moved up another half a percent taking the prime lending rate to 14.5%. Inflation is expected to peak early in the first quarter of next year. Rising prices and slowing growth are a central banker's worst nightmare (its called Stagflation) I sincerely hope that we have now reached the top of the interest rate cycle as the last two interest rate hikes are not yet reflecting in the data. The lead indicator is usually new car sales as the figures are already out for November and show a significant decline year on year. I can imagine that Cosatu and other unions will also be applying pressure to the government not to increase rates further as there members will be some of the worst effected. As I mentioned high energy prices and high food prices are the main factors influencing inflation. This means that low income earners have almost double the inflation rate that high income earners have. This is due to low income earners spending most of there income on food and transport.

Economic growth is expected to slow next year as higher interest rates take effect. This will hit the consumer sector the worst. Capacity constraints in the electricity sector will also dampen productivity and growth.

There is also the political factor as who will be our next president. This could also have an affect on the Rand as when it became clear that Zuma was in the lead foreigners became net sellers of South African securities. These foreign investors have been funding our current account deficit. Should capital flows decrease it will put pressure on the Rand.

Tighter monetary policy has resulted in negative earning revisions in respect of interest sensitive stocks. We are seeing that earnings upgrades and down grades are highly skewed according to the economic outlook for the different sectors.

Credit consumer shares such as furniture and clothing retailers are experiencing negative earnings revisions, while positive earning revisions for mining companies (except Gold), construction companies, some banks, mobile telecommunications and food retails are very encouraging. The forecast for earnings growth on the JSE for 2008 is 19% which is positive.

I think we can expect slower but, inflation beating returns for 2008.

On a more positive note China and India's economies are scrambling for resources and commodities on the African Continent. If we (Africans) can get the Chinese and Indians to rebuild Africa's decaying infrastructure and employ our people, the continent will receive a much needed boost. Growth in Sub Saharan Africa is already at an all time high although it is off a low base.

Zimbabwe has to be very close to complete collapse; surely 2008 will see the end of the Mugabe era. When this does happen the whole investment climate in sub-Saharan Africa will change.

The Standard bank deal is the largest foreign direct investment to date and signifies the biggest offshore investment in their history. The Industrial and Commercial Bank of China (ICBC) is the biggest bank in the world and it is a huge vote of confidence in South Africa and the continent. The spin offs for Standard Bank are enormous. Standard bank has a large banking footprint in Africa, South America and Russia all of which are resource rich regions. All future deal flow the Chinese do in these regions will surely flow through Standard Bank.

This deal also signals what could be the start of the much needed flow of foreign direct investment from India and China into South Africa.

Volatility

I firmly believe that we are moving into an extended period of increase volatility which may scare some people more than others depending on their risk profile. Volatility also creates opportunity for increase profits and returns if managed correctly. Irrespective of your risk profile volatility can work in your favour. Many savvy investors see periods of high interest rates and increase volatility as the best time to buy quality assets at discounted prices. What you do require is some patience as it might take some time for the value to be extracted in these undervalued assets.

A good example would be our Banks, clothing and furniture retailers. Some of these stocks are incredibly cheap at present but they are good well run companies that are currently out of favour as their earnings expectations are lower for the immediate future. When Interest rates start to reduce they will come back into favour and those investors that bought when no one wanted to buy these stocks will make very handsome returns.

The best known contrarian investor is Warren Buffet. One of my favourite quotes of his is *"When the market is fearful be greedy and when the market is greedy be fearful"*

Another opportunity will be property as some people will not be able to maintain bond payments and will be forced to sell their properties. This will pose buying opportunities in the property market.

There is actually less risk of buying quality assets at discounted prices than when these asset classes are performing well.

Retirement annuities

Don't forget that in the New Year we will need to check your retirement annuity contributions and deductions to see if you can top up before the 20th of February to get the full tax benefit for the 2008 tax year. You can get tax benefits on bonuses, dividends, rental and other non retirement funding sources of income.

In Conclusion

I would like to thank you all for your support in 2007 and look forward to working with you in 2008. I wish you and your families all the best for the New Year and the festive season.

I have been researching new investment opportunities locally and offshore that will cater for all risk profiles and have defined and added some new services for 2008.

The new web site is in the final stages of completion and will be up by the middle of January. Please feel free to visit it at absolutwm.co.za.

As always there is never enough time in the day and if I didn't get to see you before the end of the year I will definitely be in contact early in the New Year.

Ok enough babbling from me. I recently read an article on Volatility that was written by one of the fund managers at Stanlib and I thought it would be appropriate to include it in this news letter.

Take care, and travel safe

Best regards,

Michael Westcott

Don't be scared of volatile equity markets

We have seen impressive returns from the South African equity market over the past four years. The FTSE/JSE All Share Index (representing all the shares listed on the JSE Securities Exchange) achieved a 327% (40.71% annualised) total return (including dividends) between the end of April 2003 and the end of July 2007.

One of the few certainties about equity investments, though, is that periods of intense volatility will be experienced, and strong gains be followed by at least some losses. (Volatility is the amount of up-and-down movement of a security's price over a period of time.)

Although history shows that profits outweigh losses and the net long-term position is normally positive, short-term pain can often block out the memory of past gains.

Therefore, many investors bail out at a loss during periods of sharp market declines.

History confirms these behavioural patterns, but we only need to go back nine years to see them at work in South Africa

Back in 1998, 70% of investment flows were into equities. Then came the market corrections in 1998 and late 2001, igniting the fear of further loss.

By 2003 only 25% of investment flows went into equities. The situation was even worse in 2004 when bonds and cash accounted for 80% of flows.

The fearful investors of 2003 and 2004, however, missed out on much of the 327% equity market, bull-run between April 2003 and July 2007.

What should a sensible investor make of all this?

Investors should not be scared of volatile equity markets. Despite periods of intense volatility, the long term trend on the JSE Securities Exchange has always been positive for the patient few.

The key is to focus on average returns, over long-term periods, within a well diversified portfolio.

The rationale for diversification is to reduce the overall volatility of a portfolio. This means that the volatility of the overall portfolio will be lower compared to the average volatility of each underlying asset class within the portfolio.

A number of techniques can be employed to diversify an investment portfolio. Some of these techniques are highlighted below.

Allocate your investments into a mixture of asset class

History has shown that not all asset classes will perform well at the same time. By including cash, bonds, property and equities in your portfolio, the positive performance of some investments will neutralise the negative performance of other investments.

Invest in more than one type of equity

Investing in both value shares as well as growth shares can further reduce the volatility within a portfolio. Value shares are normally undervalued, or relatively cheap compared to their fair market value. Value investors choose these shares for their potential to return to their true value at some point in the future. Value shares tend to do well when the market is slowing down. Growth-style investors select shares that have the potential to grow their earnings faster than the market. Growth shares tend to do well when markets are rising.

Invest across regions

No single country will be home to all the best investment returns in the world. Local investors often overlook markets abroad as a means of diversifying their portfolios. Offshore markets provide access to investments and industries that are not available to local investors and the prospects for managing risk are greater. A portfolio that is diversified across regions will have a greater growth potential over the long term.