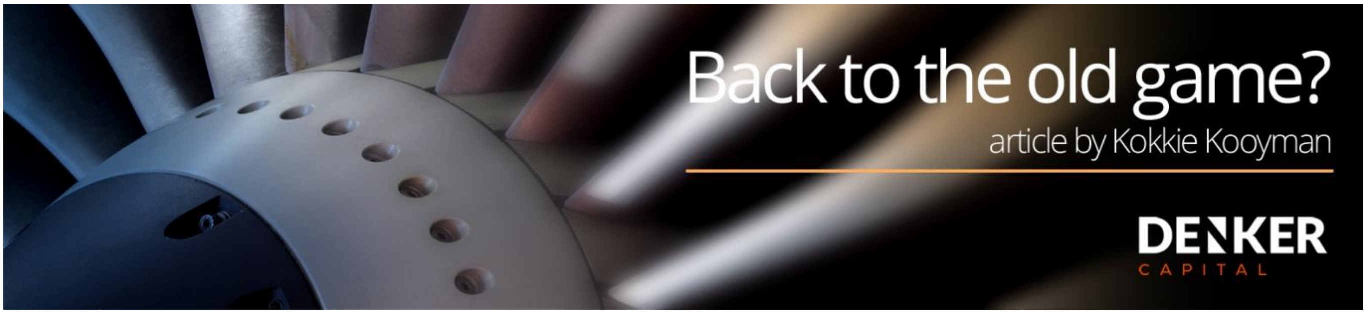

Back to the old game?

Warren Buffett often warns that it takes 20 years to build a reputation, but 5 minutes to destroy it. The reckless appointment of David van Rooyen destroyed the reputation that South Africa still had and brought its sovereign debt rating closer to junk bond status.

Funding a growing debt burden with an increasing budget deficit with junk status rated government (and bank) bonds would be very costly. Even now, the higher cost of debt in 2016 post the events last week may push South Africa into a recession whilst at the same time the weak rand will push up the cost of living significantly and lead to increased unemployment.

How much does the appointment of Pravin Gordhan 4 days later reverse the risk of going over the cliff? He has the credentials, and his speech (Monday, 14 Dec 2015) inspired confidence (fiscal discipline, do what it takes to avoid downgrade to junk bond status, state owned enterprises will have toe the line, etc.).

He has two sticks he can use inside the cabinet, namely junk debt status risk and "this is unacceptable; I resign".

But, based on the ANC news conference today (Tuesday, 15 Dec 2015) it seemed as if the lessons haven't been learnt; arrogance continues to prevail. Pravin Gordhan faces an uphill battle and the odds are stacked against him:

- The same president and cabinet remain in place,
- Based on President Zuma's 9 Dec speech, they subscribe to an economic philosophy that has failed over and over again wherever tried (read a summary of this speech by Rian Malan here),
- The same vested interests at SAA and other parastatal feeding troughs remain in place,
- Along with a high and increasing debt burden, he also inherits:
    - Currency induced higher inflation levels,
    - A recession in 2016 exacerbated by a serious drought,
    - Low commodity prices in a low growth world.

What to expect

- Very unlikely that the rand will strengthen much from here,
    - All previous large rand declines resulted from external factors, and hence subsequently the rand usually strengthened, except in 1984. The 1984/5 post PW Botha's Rubicon speech fall was self-inflicted and the rand did not reverse its course until news leaked out that the apartheid government had initiated talks with Nelson Mandela.

- Higher price levels in 2016,
- Higher taxes are a certainty, although the appointment of Gordhan reduces the risk of a much higher capital gains tax, but then, he will have very little room in which to move.

My main concern is Zuma's speech on Wednesday, 9 Dec 2015. Essentially he said three things:

- Africa is still enslaved by Western values. *Denouncing values associated with it such as fiscal discipline?*
- Those who criticise are in the pockets of the enemy. *Categorising those who criticise him as enemies of Africanism.*
- We must go back to the principle where the price of a product is **not** determined by the market forces of supply and demand, but by the cost of labour used to produce it. *Very idealistic, but history is littered with states who believed this and delivered misery to all but their rulers.*

Based on this speech it would seem that:

- fiscal discipline has been scrapped?
- real interests are abolished?
- any regard for rating agencies or western capitalism rejected?
- we seem to have shifted to the Robert Mugabe ideology?

If correct, this makes one worried about how long Pravin Gordhan can last…

Potential Positives to look out for

- Higher commodity prices (possible at some stage in 2016).
- An acceleration of the #Zumamustfall campaign. The powers that stood up to the president and forced the removal of Van Rooyen as finance minister will have caused a breach in the ANC. The battle has begun; today's press conference however, shows the Zuma-loyalists still seem in control.

Denker Capital

Life might change, but it does go on. Experience has taught us that in uncertain environments such as we live in at the moment (both local and global) it is best to be invested in well-capitalised, high quality, cash generative companies with good managements. We've been following emerging markets for more than 20 years and are always amazed at how good managements overcome tough and even corrupt environments. The severe market falls last week presented a good opportunity to increase holdings at marked down prices. For instance, the **SIM Value Fund** increase its holdings in Firstrand which gained 20% at one stage on Monday.

And then in terms of global investments we must point out the excellent performance of the **SIM Global Equity Income Fund** (top decile over past 3 years). A low risk USD fund for investors seeking to flee risk and turbulence. You won't find many opportunities in the world giving a low-risk dividend yield exceeding 3.8%. The focus on high quality, low risk companies has worked very well for Douw and his team.

It has outperformed most of its peers in its first three years. In the past three years Douw has been careful to do so responsibly and eschewed most risks (e.g. no exposure to banks despite the high dividend yields). For those who want a growing low risk steady cash dividend yield offshore this fund is very attractive.

On the other end of the scale the **Sanlam Global Financial** and **SIM Global Emerging Market Funds** represent exceptionally good value (we have not seen these valuation levels since 2002). The past 27 years have taught me to focus on quality and be patient.

Both funds are invested in a line-up of companies that have long track records of growing shareholder value despite often tough and volatile circumstances. The events this week show how quickly bad news can become good news. Hence we invest in quality when expectations are low and valuations are attractive. The re-rating potential in both these funds is significant on any good news in 2016. But in the meantime we know that shareholder value keeps growing.

The **Nedgroup Investments Financials Fund** has outperformed its benchmark and peers over every period over the past 10 years, delivering a compound return exceeding 15% (measured after last weeks' significant fall). The fund has been positioned for a weak rand and poor economic growth and SA bank valuations are now back to 2002, 2008 and 2011 lows.

The **Sanlam Global Best Ideas Fund** has had a tough time but Douw and Pierre have stabilised it. It has very little emerging market or resources exposure. Along with other value funds, it has underperformed the growth driven indices, but that we know from experience that this will turn based on the quality and valuations of the companies in the fund.

It is a pity, that as we did in 2008, we end 2015 on a depressed note. But 2009 was a good year, in fact an excellent year. When markets fall, opportunities do present themselves for the patient investor.

Our sincere and very best wishes for 2016.

Kokkie Kooyman
15 December 2015