

Market Commentary – early January 2010

Circulated to Antler investment clients



A new year and a new decade to confuse us all...

Starting point – We at Antler wish you and your families a prosperous, healthy and (hopefully) wealthy new year!

I am proud to announce the new Antler website was launched a few months back, and the bugs have now been ironed out. I am going to be posting the most interesting articles and general information that may cross my desk onto the site periodically, and ask that you please visit it from time to time to see if anything appeals to you – click the link to have a look if you have not already www.antlerfin.co.za – I have already made a major effort to gather good content.

What has fundamentally changed in the investment world in the last decade? Well, from a local perspective, we have instant access to information on what is going on everywhere else in the world – This has led to what I call the “3.30 pm phenomenon” where our SA daily market movements have frequently either accelerated madly or reversed at or around 3.30pm as the US markets open. 2009 has proven to me that South Africa really is an international investment destination and foreigners truly have the power to make or break our local markets.

	1 Jan 09	1 Jan 10	2009 final
SA MARKETS			performance
All Share	21509	27666	28.63 %
Financials	15779	19326	22.48 %
Industrials	21496	25245	17.44 %
Resources	21199	28109	32.60 %
Listed Property	310	323	4.19 %
Gold Mining Index	2250	2410	7.11 %
Platinum Index	53	81	52.83 %
EXCHANGE RATES			
R/\$	9.53	7.40	-22.35 %
R/€	13.16	10.50	-20.21 %
R/£	13.73	11.87	-13.55 %
GLOBAL MARKETS			
Dow Jones Industrial	8776	10428	18.82 %
US S&P 500 Index	903	1115	23.48 %
UK FTSE 100 Index	4434	5413	22.08 %
French CAC 40 Index	3218	3936	22.31 %
Hang Seng Index	14387	21886	52.12 %
German DAX Index	4810	5957	23.85 %
Japanese Nikkei 225	8860	10546	19.03 %
US Nasdaq Index	1577	2269	43.88 %
MSCI (\$) (\$)	920	1168	29.96 %

Economics 101

What is the “Carry trade”?

In short, it is the practice of borrowing money where interest rates are low, and investing it wherever expected returns are greater than the cost of the interest on the loan. In the current environment where most of the developed world is sitting with interest rates at close to 0%, this practice has grown dramatically. It seems like a true ‘no brainer’ as an American to borrow cash in the US at 2%, and invest in a South African government bond to earn 8%. This type of investment is unwelcome in the destination/receiving country, as it is ‘flighty’ and seldom long term in nature, rendering it disruptive to the economy.

Where is the risk?

There are 3 significant risks:

- 1 – Sovereign risk – The country defaults on its debt repayments (Bonds), leaving the investor with nothing but a loan to pay off (This was narrowly avoided by Dubai late last year before Abu Dhabi provided a ‘bridging loan’).
- 2 – Political risk – The country bans or tightens foreign capital flows, making it more expensive or difficult to get your money out of the investment (Brazil mooted imposing a 2% tax on capital in/outflows late last year as a means of preventing these disruptive cash flows).

3 – Exchange Rate risk – Looking at the volatility of emerging market currencies over the past years, it is feasible that your entire gain could be wiped out by a depreciation of the destination currency. In the example above, a 6% weakening of the Rand would wipe out all profits.

These risks are continually weighed against the potential profits, and it has surprised me how fast the capital does flow when there is any change in the perceived risk, either positive or negative. Hence another recent buzz phrase: “flight to safety”.

Why are you telling me this?

South Africa, with relatively high interest rates and relative (apparent) political and economic stability, has become a favoured destination for this type of investment. It has created what I believe to be an artificial demand for the Rand, resulting in the Rand being overvalued against major world currencies. I also believe that some of the larger and more liquid shares on the JSE such as Anglo American have become a target of these cash flows. This has pushed their share prices ahead of the general market.

So what?

Should another country become more appealing to some of these investors, they will start to sell their shares and bonds, weakening the Rand prices of these assets. They will then sell Rands to buy the next currency, thereby weakening the Rand. This will in turn encourage other foreign investors to do the same, resulting in even more volatility. It is very likely the developed world will start increasing interest rates this year, and there is still some potential for SA to reduce rates – this will result in some capital leaving SA.

The point?

Expect Rand weakness to come fast, and to be accompanied by a significant fall in the share price of some of our largest companies. Expect these companies' share prices to recover quickly thereafter as the weaker Rand leads to enhanced local profits, thereby attracting the carry trade all over again in an endless cycle.

So what are you telling me?

Expect volatility – it is a fruitless exercise trying to time it. We will all lose money in the markets and make it back again. We live in a truly global environment and are powerless to do anything to prevent this.

I repeat my concern that returns will be anything but spectacular in 2010 as world liquidity is reined in. I am expecting inflation-beating returns in 2010, but do not believe we will be looking at a bull market of any historic significance.

Please remember us when speaking with family members or friends about financial issues. We appreciate all references, and will do our best to assist wherever possible.

Please get in touch if there have been any significant changes to your financial situation that would necessitate a rebalancing of your portfolio.

All the best for 2010, let's hope our dear Bafana Bafana put on a decent show in the FIFA World Cup, and we can hold our heads high as the hosts of what I am sure will be an amazing world class event!

Kind Regards,



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JSE All Share Index

