



CLUCASGRAY AM

ASSET MANAGEMENT
A juristic representative of ClucasGray (Pty) Ltd
An Authorised Financial Services Provider, FSP 21117



“Laugh, and the world laughs with you; weep, and you weep alone.”

Ella Wheeler Wilcox, 1918

December is typically a time for reflection, rest and relaxation. Reflection on any year just passed can bring with it mixed emotions – none more so than any reflection on 2019. It has indeed been a peculiar year for South Africans – we celebrated our 6th democratic elections, the Springboks won the Rugby World Cup, and whilst there has been significant progress on the political and policy front, a number of obvious calamities have overshadowed any perception of progress. It has been a year that promised much, yet domestically has failed to quite deliver.

We are on the cusp of the Festive Season, so it is not our intention to dwell too much on the negativity that seems to pervade many parts of society. There have however been a few developments over the last few weeks, which are worthy of mention.

The decision by the Competition Commission to instruct MTN and Vodacom to cut mobile data prices by up to 50% is an extraordinary demonstration of regulatory overreach to disrupt the market economy. Whilst we all as consumers may welcome any relief on prices, the implications of these decisions are far reaching, and at odds with the free market economy and the ideals of capitalism. The perception of high data prices has brought competition in the form of Telkom Mobile and CellC, and despite aggressive pricing to grow their market share, both are floundering. The capital invested by the leading operators has resulted in a higher quality offering which appeals to consumers – the foundations of capitalism is that capital invested requires a return commensurate with the risk undertaken.

With the market still reeling from the adverse implications of the above, the medical schemes regulator announced plans which are intended to scrap low cost health care schemes, thereby excluding hundreds of thousands of families from private medical services. The rationale is that these schemes are at odds with governments plan for universal healthcare. Whilst they may have an argument, the reality is yet again the free market has been tampered with – the concept of willing buyer, willing seller simply ignored.

As if concerned that the above 2 announcements were not enough to dampen the festive spirit, Eskom has seemingly trumped them all. No words – suffice to say Stage 6 loadshedding has sent the national mood spiralling.

101 years ago, Ms Wilcox penned the above quote. It is a quote that resonates with us all – a message we attempt to pass on to our children, one we should all strive to live by. Sadly, with the Eskom developments, the nation weeps collectively.

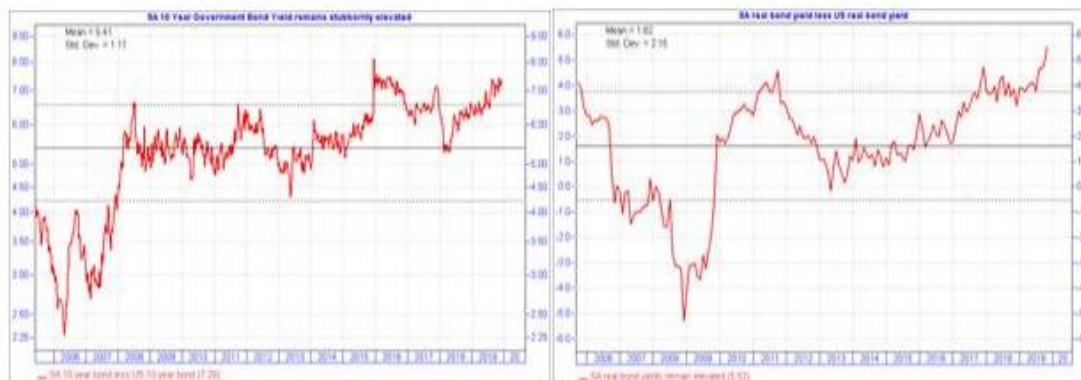
We are all well versed in the challenges facing South Africa, and whilst many of us despair, we do believe there are solutions to many of the issues. Tough decisions are needed, some requiring an ideological shift in thinking – if there is any silver lining in the clouds, it is that crises force practical solutions – the time for ideological debate is over.

What does it all mean?

The history of South Africa is littered with numerous periods of distress – political, social and economic alike. Perspective in the eye of any storm is never easy, and an attempt to sugar coat recent developments will, and should, be met with appropriate scorn.

It is a well-worn market cliché that opportunities frequently present themselves in periods of distress. At ClucasGray Asset Management we continue to diligently apply our robust investment process to objectively analyse underlying assets and asset classes, looking for those whose current valuations are not aligned to our assessment of their prospects.

In the September 2019 quarterly we wrote extensively about the benefit enjoyed by savers, and the pain inflicted on consumers, of the high interest rate environment in South Africa. The chart below shows the elevated bond yields in South Africa relative to the US – demonstrative of an extremely conservative monetary policy adopted by the SARB. The chart on the right is more startling – given the significant fall in SA inflation, and the elevated yields, the real yield differential between South Africa and the US has reached levels unprecedented in the last 15 years.



Source: Iress

Indeed, as articulated in the September 2019 quarterly, with local government bonds offering 5% real yields, they are an appealing asset class. Equity too, as evidenced by select dividend yields remaining elevated, looks attractive – however the short term prospects for earnings growth are clearly clouded by the economic backdrop. The interplay between ratings and earnings, at the heart of our investment process, will remain of paramount importance. We continue to hold the view that numerous companies are inappropriately valued, given their ability to deliver earnings growth, albeit modest, over the next few years. We expect patience to be well rewarded.

The ClucasGray Asset Management portfolios have had an interesting year. A number of key holdings have enjoyed the benefit of some or other corporate action – these include Clover, Zeder, Remgro and more recently Metrofile. To some extent this has been a vindication of the investment process – we have been able to identify good assets at attractive prices. However, the performance of the Platinum sector in 2019 has been nothing short of spectacular, their returns dwarfing those of the overall market – sadly it is not a sector to which we have been directly exposed.

ClucasGray Equity Prescient Fund & ClucasGray Equilibrium Prescient Fund

The last quarter has been a better one for investors in the ClucasGray Equity Prescient Fund (+6%) and the ClucasGray Equilibrium Prescient Fund (+4%). Over the quarter a number of holdings have performed well – Metrofile gained over 50%, Astral was up over 20%, Anglo American, Exxaro, Remgro and Bidvest all gained over 10%. Both Bidvest and Remgro were added opportunistically over the last few months when they were trading at levels we deemed to be very attractive. Investors will recall that Clover was delisted towards the end of September – fortuitously there were a number of good companies trading at very attractive prices, so the Clover proceeds could be constructively allocated.

One disappointment in the month was the SARB once again refusing to use monetary policy to stimulate economic activity. The rest of the world has embraced lower interest rates as

activity has stalled, yet South Africa continues to operate under the yoke of restrictive high real interest rates. We remain hopeful that in due course interest rates could prove a catalyst for an improved economic backdrop for companies to operate within.

Conclusion

Who knows what 2020 has in store for investors – as has become the increasing norm in modern markets, the investment backdrop is likely to remain incredibly noisy, often resulting in seismic fluctuations in asset prices. It is how investors react to these that will define them, and we strive to be nimble to position our portfolios to take advantage of any material dislocations in asset prices.

We would like to take the opportunity to thank you for your interest in, and support of, ClucasGray Asset Management over the years. May you have an enjoyable and relaxing Festive Season, and here's wishing you everything of the best for 2020 – may it be a year we yet again learn to laugh, whilst the world laughs with us.

Safe travels,

Andrew, Grant & Nikki