



Monthly Commentary – May 2010

Politicians and markets

Hot on the heels of Australia's startling disincentive to mining companies, we now have the following statement from Angela Merkel, the German Chancellor, and we wonder whether it will end in a new version of "Angela's Ashes"ⁱ:

"In some ways it's a battle of the politicians against the markets. That's how I do see it. But I'm determined to win this battle."

Maybe the Chancellor should heed George Soros'sⁱⁱ famous observation in 1992, after politicians, led by Prime Minister John Major and Chancellor Norman Lamont, tried desperately to prop up sterling by raising interest rates from 10% to 12% and then to 15% in one day, and by spending billions of pounds buying sterling, before capitulating and withdrawing the currency from the ERM. Soros allegedly commented that he had not bet against the pound, but against politicians.

Xstrataⁱⁱⁱ CE Mick Davis (ex Eskom, incidentally) has suspended AUD1.2bn of expenditure with immediate effect. These projects would have created 3,250 new jobs which are now at risk. This results from Xstrata's review of planned investment into its Australian operations as a result of the Australian Government's proposed Resource Super Profits Tax ("RSPT"). The review includes projects comprising total investment of AUD22bn and the potential to create 14,725 new jobs. For now, Prime Minister Kevin Rudd, who is still unable to provide a satisfactory definition of "super profits" remains stubbornly committed to the crazy new tax.

At home, the ANCYL's quixotic proposal, in which the private sector might own just 5% of new mining projects, while providing all the expertise, is laughable. If the ANCYL would be so kind as to inform us which listed company might take them up on this offer, we would then know the best share in the world to sell short.

Beware of awards!

It is said that asset managers should be worried about winning industry awards, such as the various annual awards handed out in the unit trust industry. This stems from some classic examples of winning funds going on to perform abysmally in the following year. In this vein, we were amused by the following:

"The UK Debt Management Office (DMO) has been voted the most impressive sovereign funding team and DMO chief Robert Stheeman as most impressive sovereign funding official, said EuroWeek. The top award comes as the DMO sold a record £227.6 billion worth of Gilts in FY 2009/10. Hopefully, Stheeman should have better luck than the recipient of last year's award for most impressive sovereign funding official, who was Spyros Papanicolaou, who is now the ex-chief of the Greek Public Debt Management Agency."^{iv}

Rating Agencies

Back to one of our pet peeves, the useless rating agencies. To quote from the FT^v: "Equity markets thrive without ratings. The notion that bond markets need them exposes a dream of taming risk with false precision."

Dogs and Darlings

Quite often, a market darling underperforms a market "dog". The former is invariably regarded as a great company; well managed and with bright growth prospects. The latter is viewed as suffering dull management and having limited growth prospects. The problem is that these notions easily become exaggerated in the shares' respective ratings. A topical case is



within the Mobile Telecommunications sector: Vodacom's total returns have exceeded those of MTN by 30% since Vodacom was unbundled from Telkom exactly a year ago.

Some company news during May:

Investec (held) reported final results to March 2010. Headline earnings per share were down 3% to 40.2 pence per share but, encouragingly, the dividend was up 23% to 16 pps, with dividend cover reducing from 3.2x to 2.5x. Pre-tax operating profit was flat, with performance in 2H10 better than 1H10, in all divisions except the investment bank. Particularly encouraging was a strong showing from the Capital Markets division with earnings in this division being driven by strong principal and dealing revenue. The sustainability of this revenue stream is a concern for us, however, as is the weaker performance from the Private Banking operations.

African Bank (not held) reported results for the half year. There was a departure from the norm in that the core banking business was weaker than previous reporting periods, whereas the Elleries retail business showed a much improved performance. The group RoE was below the group cost of capital but the bank still reported a very healthy 44% RoE. One reason we do not hold ABIL shares on your behalf is that last year we became aware of a private placement by ABIL of an Inflation Linked Bond (ILB). In our view, the real rate at which this was placed was extremely high. So, we were not too surprised to see the sharply higher cost of capital. Of interest, (in the bank) was the decline in income yield from 39.1% to 36% and an increase in gearing, from 6.8x to 7.7x. We note also that the cash holdings increased significantly, from R1.4bn to R5.1bn, resulting in a drag on the return on assets.

Telkom (not held) announced the resignation of CEO Reuben September on 4th June 2010. The market served up one of its more sardonic assessments, by promptly lifting Telkom's share price by over 2% on a flat day for the market overall.

Vodacom (held) released final results to March 2010. Off a virtually unchanged subscriber base, revenue was up 6% and headline earnings were up 22%. CAPEX was down 4% - a pleasing sign from a mature business.

Rowan Williams-Short

CIO - Orthogonal Investments

ⁱ Angela's Ashes is an excellent novel by Frank McCourt. It describes the absolutely grim experiences of an impoverished Irish family during the Great Depression and World War II.

ⁱⁱ George Soros became known as the man who broke the Bank of England, after he made a reported \$1bn profit during the 1992 Black Wednesday UK currency crisis, by short selling sterling.

ⁱⁱⁱ Source: Xstrata

^{iv} With thanks to Tim Price of PFP in London for alerting us to this.

^v FT, 4 June 2010