



## Monthly Commentary – September 2010

### South Africa, Africa and overseas acquisitions

Africa is the flavour of the month:

- Wal-Mart intends to buy Massmart.
- HSBC intends to acquire 70% of Nedbank.
- A recent survey <sup>(1)</sup> of 700 of Europe's leading investors shows that over 60% intend to invest in Africa within the next five years.

We wonder how much thought has gone into this, and whether it's mainly an indication of evaporating opportunities in these companies' home markets. When the JSE deregulated in the nineties, many major American and European stockbrokers arrived here fairly promptly with large cheque books, to acquire local stockbrokers. In nearly all cases, it remains unclear who, if anyone, has benefited. As asset managers, it is not clear to us that the standard of sell-side research has improved. Further, the JSE is recognised as the best regulated securities exchange in the world, and that is entirely due to its magnificent, 100% home-grown management.

The history of some recent (partial) acquisitions is checkered. Standard Bank said as much when describing the benefits of its relationship with its Chinese shareholder as "disappointing". We are not aware of anything too thrilling to have arisen from Barclays' stake in ABSA. (In the next English – South African rugby test match, will the greater banking entity inadvertently end up being the sponsor of both teams?). We have observed in these monthly commentaries that in most cases of mergers or acquisitions, much is said about "synergies" (the most over-used word in corporate finance?) for both parties and their shareholders. Old Mutual's acquisition of Skandia does not seem to have amounted to much; far less its misadventures in America (as described in last month's commentary). Cross border transactions really are more difficult to implement than the involved parties tend to allow themselves to believe. We have also previously discussed the litany of failures by South African retailers in Australia.

We trust that BHP Billiton's planned purchase of Potash in Canada does not become a pyrrhic victory.

But why the fascination with Africa (especially ex-South Africa) now? Has governance improved? Has regulation improved? Have currencies stabilized? Has war and famine vanished? Are water and electricity supplies more assured? We think the answer in all cases is no; hence our suspicion that the voracious appetite has to do with fashion and with diminishing domestic opportunities.

### Buzzwords

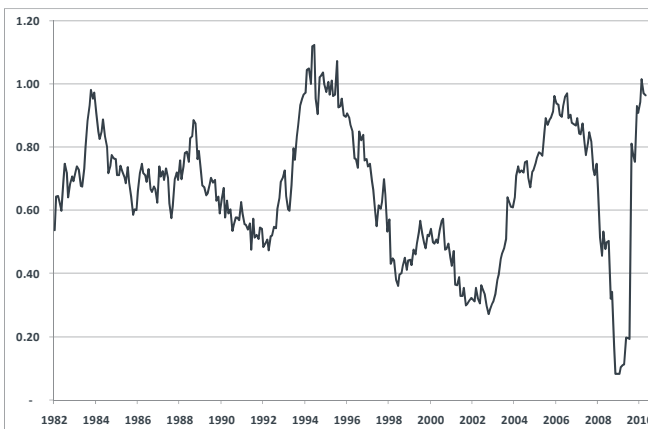
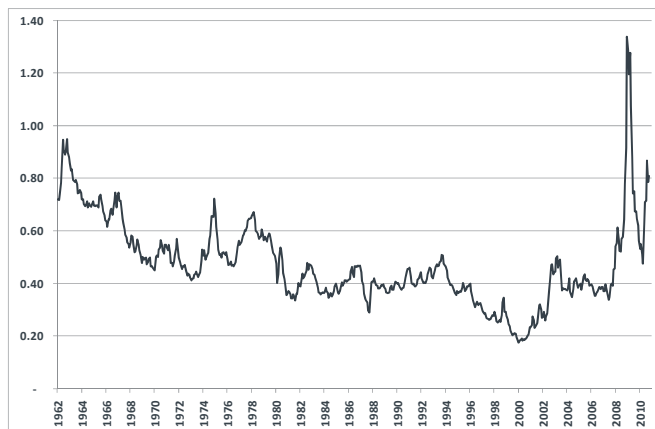
We have learnt to be wary when an investment theme is crowned with a new name or acronym. All too often, this marks the beginning of the end. To cite just a few examples which have ended in tears: Nifty Fifty, RDP, WC2010 (basically meaning construction shares), Y2K, Asian Tigers and Arctic Tiger. Even though the Asian Tigers had already collapsed by the time the Celtic Tiger came along, the Irish seemed quite pleased with their new moniker. As we stand, the Irish stock exchange is down 76% from its 2007 high.

### China

Netcare is in hot water for allegedly procuring kidneys from Brazilians and implanting them into Israelis in its South African hospitals. In China as much as 65% of transplanted organs still come from death row prisoners. More from China: "Banks around the world are flocking to China because of its fast-growing economy. But their financial performance there so far isn't pretty. Profits in China for banks based in other countries fell sharply last year. In contrast, Chinese banks posted double-digit percentage gains in after-tax profits. The report underscores the obstacles confronting non-Chinese banks as they try to establish or rev up operations in the world's second-largest economy". <sup>(2)</sup>



## Stretched valuations



The chart on the left is the ratio between the S&P500 dividend yield and the yield to maturity of US 10 year government bonds since 1962. The chart on the right is the PE relative between South African and US equities since 1982. The level of the former points to future outperformance of US equities over US bonds while the level on the latter suggests future outperformance of US equities over South African equities. In both cases, then, valuation suggests a reversal of the past few years' experience: something to which markets are highly prone, especially when the investing public has widely embraced a continuation of the norm.

## Bond trivia

Bonds had a strong quarter ended September 2010, returning 8.04%. In the nine months year to date, the ALBI has returned 14.11%. These seem like great returns, but they don't scratch at the surface of the record books. We discard all bond data prior to late 1989 (due to prescribed assets and monetary policy that was anything but independent). Since then, this period's rolling three month return ranks only 35<sup>th</sup> out of 247 and the rolling 9 months rank only 96<sup>th</sup> out of 241. Adjusted for inflation, these rankings improve only slightly, to 28<sup>th</sup> and 72<sup>nd</sup> respectively. Nevertheless, we expect near term returns to abate. Over the past number of months we have written about our strong expectation for bonds to beat cash. This has come to pass and is also now likely to abate somewhat.

## Rowan Williams-Short

CIO - Orthogonal Investments

- (1) Terrapinn Survey, September 2010.
- (2) KPMG Report, September 2010.