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Crisis with tumbling Rand

South Africa will have to attract more foreign investments to prevent the continued weakening of the rand against the dollar.

Sadly sentiment towards developing countries is dwindling steadily, with the South African business confidence index of RMB / BER dropping in the second quarter of 2015 from 49 to 43.

Investors look at long term growth, which can hardly be envisaged in our country with its lower commodity prices and the ongoing electricity crisis.

Last month, Dr. Janet Yellen, president of the American Federal Reserve Bank, announced US interest rates would not be increased for now. This led to an instant strengthening of the rand against the dollar. This was unfortunately short-lived and unsustainable.

The rand and the currencies of other emerging countries struggle as growth prospects in America improve, resulting in the strength of the dollar.

Therefore, it will be no surprise if the rand plummets to test its lowest level ever against the dollar which was R13.84 on 31 December 2001. According to Rand Merchant Bank there are no obvious resistance levels, which could save the rand from falling so low once again.

Whilst a weaker rand helps South Africa's exports to be more competitive and benefits the manufacturing sector, we are saddled with load shedding which is doing the opposite.

Floris Slabbert - Sales Manager

A hike in the interest rate will help against inflation and the weakening of the rand and may discourage the moving of capital to "safe havens".

Rand hedges like Ecsponent, Richemont and Steinhoff who earn larger portions of their income abroad, benefit from the weakening of the rand and the fact that global growth prospects are substantially better than in South Africa.

Ecsponent has several companies and investments in other Southern African countries. Financing for the investments comes from the countries themselves, but the profits are transferred to the holding company in South Africa. The company's foreign earnings thus strengthen as the rand weakens.

Regards,
Floris

Shares on thin ice

After flourishing for eight years, there are now worrying signs that the JSE might find itself on thin ice with a "hungry bear" in waiting.

Are we on the eve of a healthy correction or is a bear market indeed our destiny?

A bear market arises when the stock market falls by 20%. Last month the JSE dropped by 6%, but it's not close to a bear phase where it could fall by even 5% per day.

Our destiny will be determined by the fluctuation of interest rates in the United States and in South Africa. Higher rates have a negative impact on ordinary share prices. This increases the cost of capital of listed companies, directly affecting their profits and valuations. Therefore Ecsponent raises capital through its listed preference shares, which are not affected by the fluctuation of these markets.

South Africa seems destined to be hit by at least two hikes in the interest rates before the end of the year; from both the USA and South Africa and with serious implications.

The Federal Reserve Bank (Fed) of America's decision last month to keep interest rates at zero, has been widely welcomed. It meant the Fed's rate have been on zero for the past eight years. Economists are, however, warning that this will not continue. They have no doubt that interest rates will be raised by the Fed in September and again in December – the only question being by how much?

When this happens, capital from developing countries such as South Africa will move to America – because assets in the USA would be more attractive to investors. Large amounts leaving our country could shatter our bourse.

In an attempt to prevent this, South Africa will also push up interest rates in the hope of keeping investments here. Foreign investment is crucial for us, especially considering that South Africa no longer appears in the FDI Confidence Index of 25 prestigious countries for investment. This after we had been on the list for the past three years, respectively 11th, 15th and 13th!

If Eskom is allowed to increase the price of electricity by 25.3%, inflation is going to increase and our economy and the exchange will take a knock. The inflation rate (consumer price index) increased in May to 4.6% and can move above the 3 to 6% target range of the Reserve Bank if the National Energy Regulator (Nersa) approves the request by Eskom. This increase can cut a slice of between R10 billion and R16 billion from our economy and decrease the GDP between 0,2 and 0,4 percentage points, according to analysts at Deutsche Bank.

Is a bear market our destiny?

Add to this the debilitating effects of load shedding. Research by the Western Cape Department of Agriculture has shown load shedding decreased agricultural production by 1.54% and the export of agricultural products dropped by 3.12% with the loss of 129 000 jobs.

Another source of concern is the sharp decline of the rand against other currencies. It destabilises the economy and increases inflation (price increases). The solution is to raise interest rates - a vicious circle!

Our first interest rate hike is expected to be announced by the Reserve Bank this month. It could be .25%, followed by similar increases in September and next year in March and May - so a full percentage point within one year. This will increase the repo rate (rate at which banks borrow money from the Reserve Bank) to 6.75% and the prime rate (rate at which banks lend money to customers) to 10.25%.

Furthermore, analysts have cautioned for some time now that share prices in South Africa are overvalued (expensive) and a correction should take place. Overvaluation occurs when share prices rise faster than the companies' earnings/dividends.

The writing is on the wall with the JSE's all-share index falling within two weeks from 55,000 points to just over 51,000 points last month. Twelve of the thirteen trading days closed in the red – an occurrence last experienced 20 years ago. And we have not even been hit yet by the interest rate waves! So where should an investor turn to in these uncertain times? The safe option for new money is cash investments (money market funds and fixed deposits) or to invest in preference shares which provide protection against the volatility of the stock market.

Preference shares, according to Petri Redelinghuys, senior trader at Inkunzi Investments (SakeBurger May 26, 2015) provide protection against a stock market held down by higher interest rates.

Preference shares pay fixed dividends and are often linked to the prime interest rate - as opposed to ordinary shares, where the dividend can vary depending on the company's earnings.

If interest rates rise, the dividend payments on preference shares will also increase.

In Ecsponent's case Class A and B preference shares offer fixed dividends, regardless of what happens in the stock market. Class C is linked to the prime rate and the dividends, which are paid monthly to investors, will increase as the prime rate increases.

Over the past five years general equity funds on the JSE showed an average return of 14.2%. Should we enter a bear market, the picture could weaken dramatically and now might just be the right time to look at preference shares with fixed returns.

Class B of Ecsponent pays a compounded rate of 11.2% per annum, without fluctuations in the stock market or interest rates having any effect on the investment. If you invest for five years, the net rate of return is 14% per year – without paying any costs.

The good news is that Ecsponent stays ahead. Fact is that we get the same average rate which general equity funds achieved on the JSE bull market over the past five years – but without the risks currently posed by the Stock Exchange.