



Robert Cowen Investments (Pty) Ltd.
Growing Families' Wealth Since 1982

NEWSLETTER - END JANUARY 2012

7 FEBRUARY 2012

On gold versus paper money: "If you don't trust gold, do you trust the logic of taking a pine tree, worth \$4,000-\$5,000, cutting it up, turning it into pulp, putting some ink on it and then calling it one billion dollars?" ~ *Kenneth J. Gerbino*

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RCI Flexible Managed unit trust - jumped 5.47% (to 243.11c) in line with the 5.99% jump in the JSE Top 40 . This performance includes a distribution of 2.83c on 3 January. Thus we have had a very strong start to 2012 .

VISIT OUR WEBSITE: www.rcinv.co.za for back copies of the newsletter, background information etc.

A month ago we said that the historically cheap valuations and reasonable earnings prospects justified a 10% to 15% increase in the JSE Overall for 2012. Well, with 6% already in the bag after just one month, what should we do now? Resource shares have moved up sharply but the reality is, they have only got back to where they were a year ago despite substantially higher earnings and much stronger balance sheets so although in the short term the move might be too much, too fast, Resource shares are still cheap unless China falls off a cliff.

Despite the jump, the JSE performed very poorly compared with other Emerging Markets – most managed 11% to 21% in US dollars for January but we have been leading the way recently so some catch up was expected. This is good as we are most likely to move up in tandem with Emerging Markets and the US's SP500 (up 4%).

Does the Wizard of Id live in Johannesburg? The answer to our pothole problem?

Report back from visit to London fund managers: cautious optimism for a moderate increase in markets. As usual there is a wide range of views from a collapse in China to sustained strong metal demand from China; a slow steady improvement in the US to the upswing running out of steam quickly. Europe to muddle through (but with a high risk of a political impasse)

Does the new dividend tax affect you? Minimal change to your pocket but it will make shares look about 5% cheaper by historical standards.

PERSONAL SERVICE

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RCI Flexible Unit Trust

In order to view / obtain RCI Flexible unit trust statements, unit holders may register on Metropolitan's website www.metropolitan.co.za.

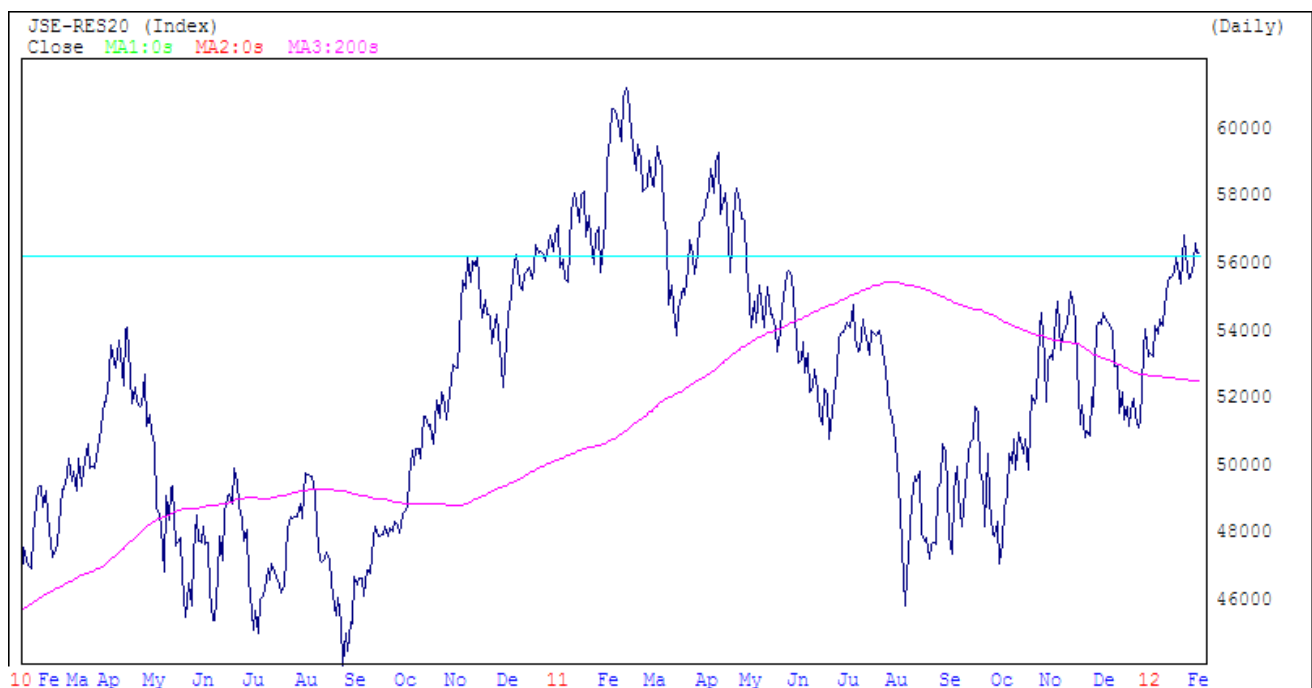
To obtain an access user manual, please contact Kate Trollip on 011 486 0576 or by e-mail on kate@rcinv.co.za

After a rise of just 3.97% in 2011, our unit trust rose more than that in the first month of 2012. What a way to start! Taking into account the distribution of 2.83c our fund rose 5.47%, much in line with the JSE's gain of 5.99%. Fortunately we had no hedge in place and had cut our cash holding to 7% so we benefitted from most of the gain.

Last month we wrote: *During 2011, our cash, gold and hedging positions helped us but the volatility in trend often resulted in one having to be very careful that the gain on the hedge when the market fell did not disappear when the market snapped back up again. Currently we are of the view that improving economic data from America and continued demand from China is going to outweigh the negative news from Europe (which should have been largely discounted by now) so we expect some improvement in share prices over the next six months. The big mining shares are cheap, the retailers are expensive and banks are somewhere in between.*

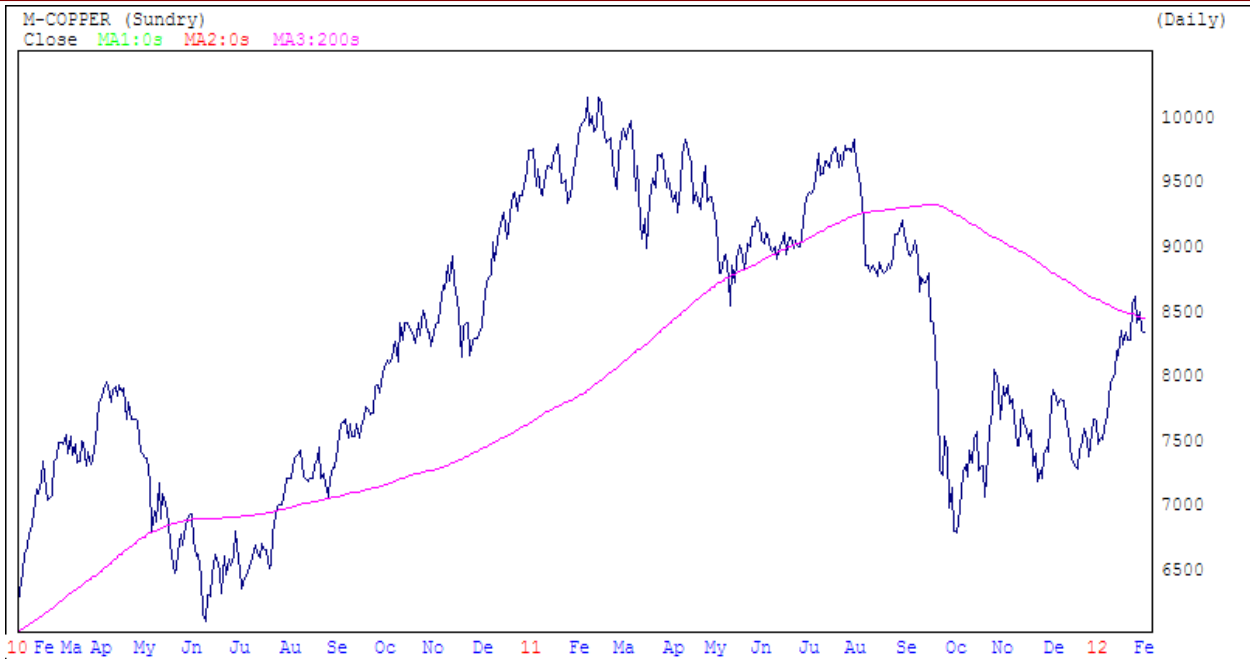
The question now is whether it has risen by too much, too fast in the short term so a correction might take place in which case we should lighten a little, or does one concentrate on the good value offered by the mining shares, the good results due over the next six weeks and the improving sentiment in world markets and decide that this is a long overdue improvement? Resource shares may have jumped in January but they are only back where they started a year ago! We are hoping for the latter but are wary of a correction which might result from any sign of bad news from Europe.

Resources shares – back where they were a year ago, despite an 8% jump in January



Metal prices bounced off their lows reached in October, helping to justify a recovery in resource share prices

The copper price in US \$ – a bellwether for most metals – strong rise in January



The platinum price in rands – despite the stronger currency, the mines are earning more than in December.



Unit trust has flexibility – happy to take small amounts

The unit trust has the flexibility to buy and sell shares and to change weightings more frequently than in an individual portfolio. We are happy to take small amounts into the unit trust (from R500 upward). As you will not pay commission to any agents there is no cost to get in and out of our fund. On selling, the amount you receive back will depend on our performance.

Collective Investment Schemes in Securities (Unit trusts) are generally medium to long term investments. The value of participatory interests (units) may go down as well as up and past performance is not necessarily a guide to the future. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. A schedule of fees and charges and maximum commissions is available on request from the company/scheme. Commission and incentives may be paid and if so, would be included in the overall costs. The portfolio is registered under the license of Metropolitan Collective Investments, a member of the Association for Savings & Investment SA. Forward pricing is used. More details are contained in a fact sheet that is available on request.

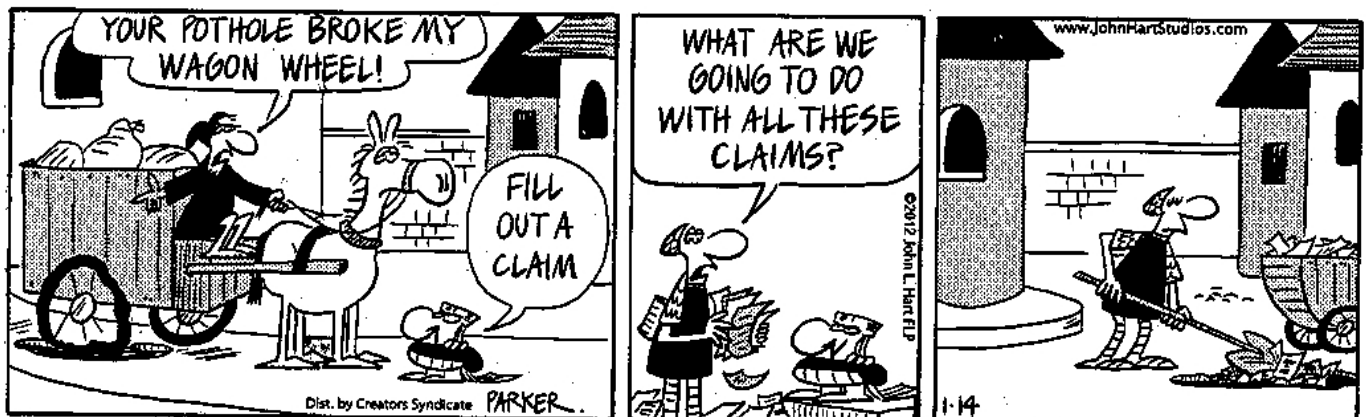
Great performance from JSE in January but it lagged other Emerging markets

The JSE Top 40 rose 5.9% in January but due to the 3.5% increase in the rand against the dollar, the dollar return was 9.5%. Sounds wonderful, is wonderful but when you look around the locker room, the envy factor sets in: The MSCI Emerging market gained 11.4%, India rose 21%, Turkey 19%, Brazil 18%, Russia 15%, Korea 12% and China 11%. The SA MSCI rose just 7.8%. However, to be fair, one must realise that SA has been leading the way in the last few months so there was a bit of catch up taking place.

Does the Wizard of ID live in Johannesburg?

This cartoon came from a European newspaper but it is just so applicable to Johannesburg after all the rain and the non-response of our mayor!

WIZARD of ID



Report back from visit to London fund managers

Whenever one visits ten London fund managers, one is likely to come away with twenty different opinions. This time was no exception with a very diverse set of views.

The consensus view was mildly optimistic, at least for the first six months but with the proviso that bad news from Europe could derail the upswing.

The USA: The optimists feel that economic activity was better than expected for the last quarter of 2011; housing prices and unemployment could be bottoming; and with the election looming at the end of 2012 no real action will be taken so a steady, if muted, improvement in the economy and markets should be expected. Large US companies such as Apple, Microsoft, Coke, Yum (KFC) have strong balance sheets and their world-wide sales are improving rapidly. So with household and company balance sheets improving, all that remains to be fixed is government debt, which is a long term problem that will not be addressed until well after the election. The most likely outcome is higher inflation which should cause people to buy more shares. In the meantime, interest rates will remain low for a few years so provided Europe is settled, US investors are likely to look for better yields in emerging markets.

The pessimists argue that the turnaround is mainly due to lower inventories and without further stimulation from the government, which is unlikely, will rapidly run out of steam. In the longer term, US profit margins for major companies are too high so might correct.

Europe: The optimists believe that European governments have shown that they are prepared to do what is necessary to keep the system going and we should have seen the worst. The economies can now grow very slowly off a low base but it will take years to work through the problems. Greece, and possibly Portugal, may have an orderly withdrawal from the EU arranged for them. Even the optimists stress that there is a chance of things not working out and Europe getting worse before it gets better.

The pessimists argue that the risks of Greece defaulting, triggering problems within all the other PIIGS is still very high and with the best will in the world, the Germans and French may not be able to prevent a collapse in the Euro. They argue that this would retard world growth for years.

The UK: London is seen as a 'separate economy' from the rest of the UK. London housing prices remain very high due to the significant number of Arab buyers who only occupy their expensive London properties during the three hottest months in the Middle East. The rest of the UK 'might get worse before it gets better'. Of course London streets are chock-a-block with shoppers talking strange languages and clutching shopping bags from Harrods and Hamleys. Restaurants and theatres are full, making one question, "what recession"? Outside of London, people are feeling the pinch of job losses, a drop in house prices and a loss of confidence. UK commercial properties might be close to a bottom. Yields in carefully chosen properties are holding up well and offer a better return than cash. Fund managers remain concerned that further problems in Europe would have a knock on effect on the UK as Europe remains a very significant contributor to trade and tourism.

China – now the diversification of views becomes extreme.

The ultra-pessimists are enough to scare any South African or Australian whose countries rely on exports to China. One emerging fund manager lost 5% by mid January when markets rose 5% because he believes China's economy will shortly collapse so he had shorted resource companies, commodities and Australian dollars, resulting in a big loss. (Impressively he recovered almost all of this loss by month-end).

One school of thought believes in a sudden collapse in China within a year or two. They point to increasing bank lending which is rapidly becoming unsustainable, the property bubble and overspending on wasteful infrastructure that will stand unused. *(Our comment: China has successfully worked through these problems, but the scale is getting bigger)*. They believe in a collapse in the Chinese economy and a massive drop in demand for metals in particular. *(In the longer term risks of a problem in China are rising but we don't see why it should reach a tipping point in the next two years or so. In the words of St. Augustine, "Make me chaste oh Lord – but not just yet")*.

The moderately pessimistic point to a slowdown in the Chinese economy and a re-orientation of further stimulus away from infrastructure spend (bad for resource demand) towards consumer stimulation. When one tries to pin them down on whether this means that metal demand will simply grow slower at say 4% or whether demand will actually fall, say, 20% they get a bit vague.

The China optimists point out that all that is happening is that growth is falling from 10% to 8% and, so what if it is only 6% considering the massively increased size of the base. The Chinese government is changing at the end of 2012 so they are likely to stimulate the economy again later in the year to go out on a high. This stimulation is most likely to have a large infrastructure component again. They point out that China's exports have remained very strong; they have huge cash piles and sufficient economic growth to continue stimulating for some years so resource demand will remain strong.

We at RCI will hope for the optimistic situation in China but plan for the possibility of the moderately pessimistic scenario. We do not see the disaster scenario occurring within the next few years but we will have to watch for the long term effects of the one child policy and a natural slowing of the growth rate as the economy continues to grow. At some point, infrastructure spending must slow but it is debatable whether this is in five or ten or fifteen years. The level of bank credit growth is also very worrying for the long term but the Chinese government has proved in the past that it is capable of dealing with excesses in the system. What is so important for South Africa and Australia is that China, which is absorbing about 50% of all world commodities at present, should continue to grow albeit at a slower rate until the USA and Europe finally get back on a growth path with a higher demand for commodities.

So in conclusion about the consensus view of overseas markets: The shares are cheap but growth is patchy and slow. It is hard to see what will be the catalyst for a lot of money to go into the share market. Thus a muted upward year is justified but the upswing could run out of steam in the second half of the year or be derailed by events in Europe. The longer term is murkier with optimists and pessimists clearly divided but we did not find one person who does not expect higher inflation.

Our conclusion: there is definitely some good value in overseas shares, provided that earnings do not decline a lot further. Dividend yields are often significantly higher than interest payable on cash deposits. However, one might have to wait quite a while for a catalyst to trigger a decent upward movement in shares so one should preferably invest in companies paying high and growing dividends with a good part of their sales being made to emerging markets. Don't be too aggressive, there are still risks out there and patience is likely to be rewarded with better buying opportunities on market shocks.

The Withholding Tax on Dividends is effective from 1 April. Does this affect you?

The short answer for you as an individual – you used to get R1 in dividends now you will get out 99c. The cost to the company of the dividend will remain 110c. So in table 1, under the old STC (secondary tax on companies), if a company paid you 100c it had to pay 10c in STC so its total cost was 110c. Now it will declare a dividend of 110c, deduct 10% i.e. 11c withholding tax which it pays across to SARS leaving 99c to be paid across to you.

Table 1

Old: STC	
Dividend Declared	100
Add STC @ 10%	10
Cost to Company	110
New Dividend Withholdings Tax	
Dividend Declared (cost to company)	110
Dividend Tax of 10%	11
Net Dividend received by shareholder	99

The new withholding tax will make companies seem better value – but it is all smoke and mirrors. Although the total cost to the company of the dividend remains 110c, the accounting treatment is different. The tax is no longer paid by the company (it is deducted off the higher dividend) so the after tax earnings per share rise by the R10 tax previously paid on the dividend. If a company's dividend policy is to pay out half of its earnings after normal tax, then under the old STC regime, it would have to earn 200c after tax to enable it to pay out 100c per share. Then it would pay 10c STC which gets added to tax paid so drops the post tax earnings per share to 190c. If the share price is R10 (1000c) then the Price Earnings ('PE') ratio is 5.26 (1000/1.90) and the dividend yield is 10% (100/ 1000).

Under withholding tax, despite the fact that the dividend you finally receive drops from 100c to 99c, the magic of accounting increases the earnings by 5.3% to 200c (as the company no longer pays the dividend tax), thus dropping the PE to 5.0. Compared to history, the company will appear 5% cheaper than it should.

Similarly, the dividend yield improves to 11% (110c on R10) despite the fact that your pocket will be 1c lighter. Thus compared to history it will suddenly seem 10% cheaper!

Table 2

Old: Current PE and DY			New: Withholding tax improves PE			Diff%
	DPS	EPS		DPS	EPS	
Pre-tax Earnings		278	Pre-tax Earnings		278	
Tax @ 28%		78	Tax @ 28%		78	
Earnings before STC		200	Dividend Declared (cost to company)	110	200	
Dividend Declared (50% payout)	100		Div withholding tax at 10%	11	-	
STC Tax at 10%	10	10	Post Tax earning per share		200	5.3%
Post Tax earning per share		190	Net Dividend for Distribution	99		
Dividend Cost to Company	110		Dividend Declared	110		
Dividend Declared	100		Share Price	1000	1,000	
Share Price	1000	1,000	Dividend Yield	11.0%		10.0%
Dividend Yield	10.0%		PE Ratio		5.00	-5.0%
PE Ratio		5.26				

Why have they done this? To standardise our tax system with international norms. Foreigners were always moaning because they could not claim the STC as tax paid on their dividends and in some cases were paying double tax on the dividends.

This positively affects your offshore dividend income. The old tax system regarded dividends earned on foreign shares as fully taxable in an individual's hands i.e. at 40% if you were in the top tax bracket (ignoring the laughable little allowance of the first few thousand being tax free). From now on, in terms of the double taxation treaties you will end up paying only the 10% withholding tax that the foreign government deducts at source.

If a company pays a dividend to another company – no withholding tax

Interestingly, if a company pays a dividend to another company then it does not deduct the withholding tax. Only when the second company pays a dividend to an individual, will they then deduct the withholding tax. Thus there will be a temporary loss of dividend income to SARS. As usual with taxation there are a number of special cases e.g. for specifically designated small businesses, rules for carrying forward old STC credits etc.

To conclude

2012 has started off with a bang. Most people made almost as much money in January as they did in all of 2011. That is the way markets move – in unpredictable fits and starts. If one was not fairly fully invested on 1 January, you would have missed out on a substantial gain. That is why we try to follow a strategy of buying when shares are fundamentally cheap. If they are paying a good dividend yield then you are being rewarded for your patience until suddenly the market jumps up to another level and capital gains occur. Sooner or later, economies work through their problems and share prices start to move up – provided the shares are bought at reasonable valuations. It was always so!

Thank you for being our clients. May the rest of 2012 continue how it has begun.

Best Regards

Rob, Di and Alan

P.S. You are welcome to pass this newsletter on to friends who may wish to learn more about investment. To be added to our email, contact alan@rcinv.co.za

Annexure A REALITY CHECK: 6% better than average historical value. Good growth in earnings expected in Feb and March will make it even cheaper.

Table 1: Valuation & sentiment indicators		31 January 2012					
Valuation indicators	TOP40	FIN 15	RES 20	IND 25	BANKS	Mid Cap	Small Cap
Current PE ratio (x)	13.26	12.20	10.31	18.87	12.94	14.45	13.18
10 year average (x)	14.05	12.19	15.52	14.93	10.57	12.50	13.24
% below / above(-) ave	6%	0%	34%	-26%	-22%	-16%	0%
10 year cheap level	11.63	9.29	11.69	12.34	8.41	10.48	8.76
10 year expensive level	16.47	15.09	19.35	17.52	12.73	14.52	17.72
Comment	6% below ave	at ave	13% better than cheap	7% worse than expen.	2% worse than exp	at exp	at ave
Current Div Yield %	2.62	3.66	2.23	2.61	3.53	3.43	3.34
10 year average DY%	2.85	4.01	2.53	2.22	3.81	3.66	4.22
% below (-)/ above ave	-8%	-9%	-12%	18%	-7%	-6%	-21%
10 year cheap level	3.53	4.98	3.39	2.66	4.53	4.29	5.31
10 year expensive level	2.17	3.04	1.67	1.78	3.09	3.03	3.13
Comment	8% worse than ave.	9% worse than ave.	12% worse than ave.	2% from cheap	7% worse than ave	6% worse than ave	7% from exp
* Mining earnings and div's fluctuate wildly so ratios based on expected results must also be considered.							
* Most results are released in Feb and August causing PE's to drop and Div Yields to rise if results are positive							
Sentiment indicator							
% above/ below (-) 200 day moving ave	7% Up	10% Up	6% Up	7% Up	11% Up	8% Up	7% Up

An explanation of Table 1 - Still good value despite January price jump

Absolute Value: (P/E) (N.B. Lower PE's = better value) The ten year average PE (Price/ Earnings ratio) for the JSE Top 40 index is 14.05x whereas over 16.47x is expensive. After last month's big price jump, the PE of 13.26 is now just 6% better than average (compared to 11% last month). However, strong growth in earnings from results due in February and March are going to improve it further to well below average.

(DY valuation) (Higher div's = better value) The dividend yield (DY) of the Top 40 has averaged 2.85%, is expensive below 2.17% but is cheap above 3.53%. So at 2.62% it is 8% worse than the historical average. High forecast dividend growth for the next 12 months should return it to well above average.

Sentiment level: (we measure whether the market has run too fast by what percentage the Index is above its long term (200 day) moving average). Above 20%, it is usually a time to exercise caution. So now, at 7%, it is close to half way to being overbought

Underlying Indices: We then split out the underlying indices. From a value viewpoint, the PE of the Resources Index is 13% better than cheap (but last month this was 34%)! So Resources had a great January rising by 8% but they are only back to the levels of a year ago. Industrials, mid-caps and banks are at historically expensive PE levels so good results are required to restore value. Dividends are 6% to 10% worse than average but good growth should fix this. Small caps are an anomaly, probably due to the small sample size distorting history. From a sentiment measure all indices turned up sharply and are 6% to 12% above their moving averages – another 10% up will cause us to get nervous about a pull back .

Indices performance to 31 January 2012							
Index	Prices	One Month %	Y-T-D %	12 Month Rolling %	OB/OS	Current historical PE ratio	Div Yield%
International							
DJI	12,633	3.40	3.40	6.23	5.56%		
NASDAQ	2,814	8.01	8.01	4.21	5.93%		
SP500	1,312	4.36	4.36	2.04	4.58%		
FTSE100	5,682	1.96	1.96	(3.09)	1.84%		
AUSTRALIA	4,325	5.21	5.21	(10.82)	-1.97%	(1.92)	
HANG SENG	20,390	10.61	10.61	(13.04)	-0.40%	0.34	
Local							
TOP40	30,176	5.99	5.99	7.22	6.84%	13.26	2.62
FIN 15	8,910	6.54	6.54	10.42	10.26%	12.20	3.66
RES 20	55,538	8.30	8.30	(0.90)	5.81%	10.31	2.23
IND 25	29,759	3.47	3.47	15.95	6.95%	18.87	2.61
JSE-Banks	44,382	7.78	7.78	10.55	10.61%	12.94	3.53
JSE-Midcap	45,629	3.94	3.94	10.40	7.93%	14.45	3.43
JSE-Small Cap	34,244	3.92	3.92	5.56	6.91%	13.18	3.34
Gilt rate R207 (2020)	7.68	(3.09)	(3.09)	(10.65)			
Currencies							
Rand/US\$	7.82	(3.08)	(3.08)	9.38			
Rand/Euro	10.21	(2.39)	(2.39)	3.93			
Rand/Aus\$	8.32	1.37	1.37	16.56			
Rand/GBP	12.33	(1.65)	(1.65)	7.46			
RCI Unit Trust							
RCI Flexible (ZAR c) (Performance includes divs paid)	243.11	5.47	5.47	11.50	5.64%		
RCI Off-shore Funds							
RCI Fund (ZAR)	1,233.80	(0.95)	(0.95)	4.69			
RCI Fund (\$)	157.71	2.20	2.20	(4.30)			

