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PREPARING FOR THE NEXT BULL MARKET?

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In our previous newsletter (dated 5th March 2009) we suggested that conditions in the battered global economy were stabilizing. Two months later, and while real economic conditions remain torrid, we are seeing the first signs that the global economy is starting to find some footing underneath.

Global unemployment is still rising around the globe, trade has slumped even further and manufacturing output in many major industrialized countries remain comatose. US GDP contracted by 6% in the first quarter of this year and bad news still dominates news headlines. Yet, the first shoots of spring are there for those willing to look for them.

It often surprises investors, especially those new to investing, that contrarian investors are looking for precisely these end-of-times newspaper and TV-headlines to move money back into the discarded stock markets. Sir John Templeton, legendary founder of the investment company that bears his, often said that times of utmost despair are the best times to make long-term investments.

And quite often history shows that the sharper the fall and the more dramatic the headlines, the more dramatic the eventual recovery.

Now we have distinct signs of a global economic recovery: they are far and few between and hard to find, but they are there.

Since March 6th the Dow Jones has recovered by almost 30%, while most other financial markets have made substantial gains. Volatility is down to almost normal levels, banks are starting to lend to each other (but not to the public yet) and the utter fear and panic which prevailed from September 08 through to early March 09 seems to have abated.

Is this just a bear-market rally or is it the start of a new bull market?

The answer depends on your interpretation of the rapid and sometimes confusing flow of information. The ability to see some order unfolding in all the financial chaos around often separates the truly great fund managers from those who prefer to hide their mediocrity by sticking to mainstream commentary.

For a while the doomsayers of the global economy—Nouriel Roubini, Peter Schiff and Nassim Taleb, amongst others—have been correct.

They have achieved cult-status on a global scale, but ultimately they will be wrong. They will write their books, make their speeches, collect consulting fees but in the end the Great Caravan of Life moves on.

During a career of more than 30 years (and being a student of economic history) have I seen many such doom-merchants peddling their wares.

I can think of many: Harry Schultz, Clive Roffey, Fred Crooks, Dr.Frederick Richebacher and many, many others. Very few have a successful long-term forecasting track record. Like a broken timepiece they will be right twice a day. Or as some cynical friend always says, they remind him of someone who has predicted two of the last 17 recessions (!)

Their stock-in-trade is fear. They prey on one of the most innermost fears of the human condition: **economic and financial catastrophe.** They become the darling of the media who love the controversy and fear they generate. Who in SA still remembers the indomitable Fred Crooks, the sugar-cane farmer who managed to convince MNet's Carte Blanche that the end of the world was nigh? That was back in May of 1997 and his forecasting methodology : some bizarre theory that events on earth are determined by the bombardment from space of the pulsating energy emanating from stars. I am not making this up.

His predictions were viewed by M-Net literally weeks before the Asian Crisis blew up in July 1997. Naturally he became the darling of the media while the second screening of "the World According to Fred Crooks" by Carte Blanche, caused panic in the local stock market, with investors heading for the hills. If memory serves me well, I seem to remember that the JSE All-share index at the time was around 7 000 when this all happened. Ten years later the market went above 33 000—a fourfold increase in value.

What these "respected" commentators grossly underestimate is **the incredible tenacity and creativity of human beings to survive and to prosper despite seemingly desperate odds.** Take the miracle revival of Japan and Germany after the Second World War as an example.

Countries and economies go through times of "creative destruction" as the foremost Austrian economist Peter Schumpeter used to describe it. I would humbly suggest that the global economy is going through such a period right now.

And out of this will emerge, I believe, a re-born economic order and a new cycle of wealth creation. Ultimately not because of massive government intervention or regulations, but because of the "invisible hand of the market place" as Adam Smith described it many centuries ago in his book "The Wealth of Nations". Add to that the flame of economic self-preservation that burns in the heart of most individuals that walk this earth.

Pardon my being a positive but I cannot but cannot succumb to the theory that we are heading for the Second Great Depression. After a period of prolonged economic growth have we entered a normal and some would say, necessary period of adjustment (recession) in order to eliminate all the inefficiencies that built up in the good times.

The Great Depression was, in the view of many, a normal recession that was made worse by bad decisions by the US government. It raised interest rates and introduced trade protection; precisely the opposite that was needed.

THIS TIME AROUND GOVERNMENTS ARE DOING THE RIGHT THING. The US is also very fortunate to have someone such as Dr Ben Bernanke as head of the US Federal Reserve. After all, he wrote his doctoral thesis on the causes of the Great Depression and he is doing everything in his powers to avoid making the same mistakes again.

TOP FUND MANAGERS TURN BULLISH

Several of the world's top fund managers have in recent weeks and days called the bottom of the cycle. They include former perma-bears STEVE LEUTHOLTZ and JEREMY GRANTHAM, both highly respected analysts who cannot be accused of brave-heart foolishness.

Leutholtz, for instance, closed his short-only Grizzly Bear Fund (which made 74% in $ last year shorting the US market) earlier this and started a long-only equities fund.

Grantham from GMO Fund Managers has been bearish for 10 years and has recently suggested that "market valuations are compelling".

MARK MOBIUS from Templeton Asset Management as also stuck his neck out calling for a recovery in emerging markets, including South Africa, and finally WARREN BUFFETT, who over the weekend at his annual shareholders meeting in Omaha, Nebraka, suggested that the "WORST MAY BE OVER."

EVEN LOWER INTEREST RATES ON THE WAY?

South Africa has been much slower than most other industrialized countries in cutting interest rates in order to keep the economy moving forward.

For some reason SA's political leaders kept on believing and stating that SA will escape the worse of the economic slowdown.

This delusional view has now given way to reality, especially after the news that SA's retail sales dropped by 4,5% (year on year) in the first quarter of this year. Inflation was yesterday's battle; the battle now is to get consumers to start spending.

Last week Thursday it took the Reserve Bank just two hours to announce another 100 basis points cut in the repo-rate to 8,5%, now down 350 points since December last year and back to the level it was in mid-June 2007, taking prime lending rates down with it.

Reserve Bank governor Tito Mboweni was in a frank mood about the economy, warning that further pain lies ahead. At the same time he also acknowledged that SA was already in its first full-blown recession in 17 years.

Depending on the severity of the down of the downturn can further interest rate cuts be expected to soften the economic blow. Interest rates can be down by another 200-250 basis points by the end of the year. It is clear to some that the Reserve Bank has now capitulated against its formerly steadfast fight against inflation, and has now embarked on major pump-priming of the economy.

This poses a major dilemma for investors who have been hiding in the relative safety of money-market investments. Over the last twelve months or so money market instruments, and to a lesser extent bonds, have been a shelter from the storm. The scenario is rapidly changing and at current levels of interest rates investors are barely breaking even on a pre-tax basis.

On an after-tax basis investors are losing up to 40% of the real value of their investments. At some time common sense will kick in and those investors will need to look for alternatives to protect the purchasing power of their money.

Where will retail investors go?

In previous periods of interest rate cutting retail investors went flocking to the residential property market. Money was freely available from the banks and the National Credit Act was not in place then. Reserve Bank statistics clearly show a very strong correlation between declining interest rates and the uptake of mortgage finance to purchase more property. This time around this is not happening, due mainly to the unwillingness of the banks to dispense with money as freely as before as well as the tighter credit preconditions are required by the NCA.

It would seem as if the South African long-time love affair with residential property is over, for the time being at least.

Many households will, no doubt, use the lower interest rates to repair badly damaged personal balance sheets and repay debt, but many will use it to spend on themselves, seeing that they cannot get themselves deeper into debt, as was the norm in previous economic cycles.

The extra available cash for ordinary South Africans is likely to boost consumption expenditure on essential and semi-durable items. Expect expenditure on food, clothing and the little luxuries in life to increase, perhaps dramatically. And therein lies an investment opportunity that we at Brenthurst Wealth intend to exploit for the benefit of our clients.

It has not gone unnoticed that shrewd fund managers have in recent weeks increased their exposure to stocks that are set to benefit from this expected trend. These counters include Foschini, Truworths, MTN, Pick n Pay, Shoprite and even Spur, to name a few.

CHINA LEADING THE WAY?

A vitally important piece of information was perhaps missed by the local market when it was announced that Taiwan has given permission for Chinese mainland companies to take significant stakes in Taiwanese companies. On Wednesday of last week the Taiwan stock market had its largest single gain in 17 years on the news that China Mobile has taken a majority stake in a Taiwanese telecoms company in a deal worth $540 million.

The Chinese government has also embarked on its own major stimulus of its economy, with more than $150 billion earmarked, to boost consumer expenditure and other measures to keep the economic growth high and sustainable. Local investors are served a continuous, minute-by-minute diet of economic news emanating from London and New York, courtesy of CNBC and Bloomberg. However, coverage on developments in mainland China is very scant and superficial, thereby creating a vacuum that could cause investors to see the truly big picture.

Rapidly-growing China has overtaken Germany as the third biggest economy and could soon overtake Japan as the second-largest economy.

Increasingly, events in China and other fast-growing companies in the East, are having more of an impact on global economic conditions that in the West, where growth has slowed down and ageing populations are putting a lid on the pace of economic expansion.

Investment guru Jim Rogers, who ran the Quantum-hedge fund with George Soros and retired a multi-millionaire at the age of 37, has now, at the age of 66 settled in Singapore and is teaching his two young kids Mandarin, in order to take advantage of this generational move of economic power from the West to the East.

SA UNDER JACOB ZUMA

The general election has come and gone and Jacob Zuma will be SA's third ANC-president.

The currency markets, always an indicator of how the global investment community perceives SA's economic futures, has surprisingly strengthened. In fact, over the last two months the rand has firmed by almost 25% against its three major trading partners. Two months or so ago there was talk of the rand at R12,50 to the US dollar. Last week it was at R8,50. What gives? Is it the fact that the ANC did not get a two-thirds majority in Parliament wsor were there some other factors at work?

Nobody really knows what happens in the massive global currency market. Is it the return of the so-called carry trade (where investors borrow money in low-interest rate countries and invest in countries with higher interest rates, such as SA, or is money flowing in from abroad to fund the possible buy-out of Vodacom by UK phone company Vodaphone?

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