OUTLOOK FOR 2015

Brace yourselves

It will be hard to find value on the JSE this year, but **Marc Hasenfuss** hasn't lost hope

It would have been a case of looking back in anger (and frustration) for investors on the JSE in 2014. Overall the returns were pedestrian and, in an environment shaken by volatility, not exactly streets ahead of what you could have earned (without incurring nearly as much risk) in a good money market fund.

African Bank, a former market darling, was ushered unceremoniously into curatorship but, thankfully, the list of corporate casualties on the JSE was not long. A number of counters did scurry for business rescue, and there were numerous examples, especially among smaller counters, of desperate capital raising through rights offers or specific share placements.

Still, the clawing for capital by struggling companies should not be taken as a pronouncement on market conditions. After all, the increasing number of strongly performing counters that opted to raise new growth capital via accelerated book builds suggests there are plenty of punters willing to participate in compelling growth scenarios.

Nevertheless, the year ahead looks daunting for investors. Market commentators warn that the equity market does not offer an abundance of value. Perhaps it's worth recalling a recent warning from Remgro chairman Johann Rupert, dubbed "Rupert the Bear" after he predicted the global financial crisis of 2008. At Remgro's AGM in November, he said the credo among top international investors was capital preservation, and suggested that investors had in recent years forgotten about the downside risk in the market(s).

Indeed, the *Financial Mail* writers' stock picks for 2015 appear to lean towards capital protection rather than outright growth.

Lentus Asset Management portfolio manager Nick Norman-Smith reckons 2015 will definitely be a time for investment caution. "Share price values don't look particularly attractive, even if one has to concede that in 2014 the expensive stocks got more expensive and the cheaper stock got cheaper."

Norman-Smith suggests investors "express caution" by having some cash handy. "It's a tough stance because the returns on cash are relatively lowly. But cash does mean being able to take advantage of well-priced opportunities during the year."

Alpha Wealth portfolio manager Keith McLachlan agrees that holding higher levels of cash going into 2015 is important.

He reckons cash-flush investors in the year ahead might have an opportunity to take advantage of attractively priced private placements and IPOs (initial public offerings) as well as snag better value if there are sell-offs in large shares.

The IPO situation is worth monitoring after several successful new listings in 2014, including vehicle tracking and fleet management specialist Cartrack, catalogue retailer and microloans business HomeChoice, asset manager Anchor Capital and day clinic developer Advanced Health. The warm market reception given to these counters could prompt other entrepreneurial ventures to come to market, taking advantage of the paucity of options to buy promising small-cap growth stories at reasonable prices.

McLachlan also advises that investors look to tap into companies that offer asset-specific variables. "Take [franchising specialist] Taste Holdings . . . irrespective of what

WHAT IT MEANS

OUR 2014 PICKS BEAT THE ALSI AGAIN

PROTECT CAPITAL AND KEEP CASH HANDY

"RETAILERS WOULD BE OBVIOUS BENEFICIARIES OF THE LOWER OIL PRICE, BUT THERE MIGHT BE BETTER RETURNS LEVERAGED FROM LOGISTICS AND TRANSPORT COUNTERS

FM PORTFOLIO

2014 price vs 2013 price = annual gain*

CSG Holdings	R1,74 → R2,10	20,7%
Standard Bank	R129 → R143,48	11%
Murray & Roberts	R27 → R21,26	-21,2%
Tiger Brands	R264,80 → R368,06	38,9%
Aspen Pharmacare	R271,84 → R406	49,3%
Bidvest	R266,50 → R303,88	14%
Pinnacle Technology	R23,25 → R12,40	-46,7%
Old Mutual	R33,19 → R34,70	4,5%
Caxton & CTP	R18,50 → R15,10	-18,5%
Vunani/Texton	R9,65 → R9,65	0%
Glencore	R53,49 → R53,88	0,7%
Massmart	R127 → R142,80	12,4%
KAP Industrial	R3,43 → R4,90	42,8%
Sun International	R95,20 → R128,90	35%
AECI	R124,95 → R133,82	7%

ALSI 7,6%

OVERALL FM PERFORMANCE +10%

TOP 40 6%

SOURCE: FM

*dividends not included

happens in the world economy, the success of this company hinges mainly on how successfully it can roll out Dominos Pizza outlets."

He cites low-cost housing developer Calgro M3, Capitec Bank, logistics group Santova and chemicals specialist Rolfes as counters that are "unhinged" from global developments and more dependent on their respective asset-specific variables. "All these companies can create growth, which could result in a rerating of their shares as they continue building their respective track records."

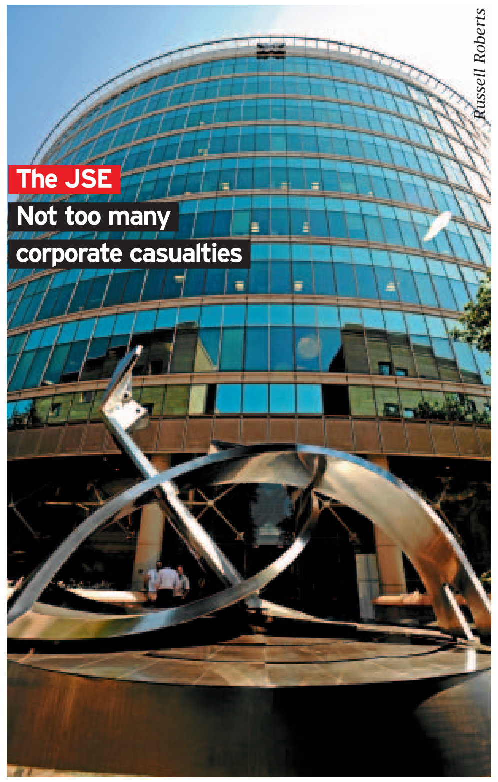
He says investors in 2015 need to back companies with well-reinforced profit margins, high barriers to entry, strong operational cash flows and where management has invested meaningfully in the companies. "In most instances companies with these attributes should not trade on single-digit earnings multiples for prolonged periods. A rerating by the market has to come."

Though the hunt for value in the year ahead looks tough, there were certainly more than a few sweet spots on the JSE in 2014. The perennially popular large-cap stocks — Naspers, Bidvest, Aspen, SABMiller and BAT — again rewarded backers despite the increasingly audible contention that their market ratings were excessively demanding. There were certainly times during the year when the rich ratings on Naspers, Aspen and SABMiller were given a reality check but, overall, the positive sentiment towards these "global" JSE stocks endured.

In addition, investors with an appetite for food stocks could rub their bellies with some satisfaction, while on the whole financial services stocks (led by the banks) performed robustly. Offshore property stocks, helped by a 10% weakening in the rand, were also a popular punt, and some of the alternative rand hedges like Marshall Monteagle, Sabvest and Consolidated Infrastructure received renewed interest.

But pity those punters who factored in a recovery in their favourite commodity stocks. They were left with third-degree wallet burns. After a torrid 2013 there was still little to reinforce the prevailing brittle sentiment towards mining counters, other than a persistent contention that top-quality resources companies should not trade as cheaply. To top it all, the many faithful backers of Sasol went into a value skid during the closing weeks of 2014 as crude oil prices were viciously wound down.

Even the stoic deep-value investors toiled for traction with a good number of poster child turnaround stocks remaining stubbornly static or (as in the cases of Ellies and Chemspec) got much cheaper as market enthusiasm waned.


The JSE
Not too many corporate casualties

Russell Roberts

What was once a lucrative turnaround game is these days compounded by higher energy and inflexible labour costs, as well as the weaker rand exchange rate and, in some instances, economic policy uncertainty from government. In this regard, it's worth noting the increasing number of smaller industrial counters trading at hefty discounts to tangible net asset value (NAV), a sure sign that the market is not expecting an operational uplift in the foreseeable future.

In truth, it's not as if punters were not warned that 2014 would be a more difficult period after several years of blue chip-buoyed market momentum.

In last year's Hot Stocks cover story, market commentators sagely advised investors that stock prices were way too demanding and that locating fair value would be a tricky prospect.

Still, the *Financial Mail*'s small-cap portfolio (see separate story) confirms there were astounding gains to be made for brave(r) investors. In the mid-cap space there were also a number of standout companies. But, quite honestly, at the start of 2014, who would have predicted such strong runs in the share prices of Zeder, Sekunjalo, Astral Foods and Oceana, which have food production as a common denominator?

Of course, investors ultimately have to face up to the rather inconvenient truth that if they had ignored warnings about demanding blue-chip ratings and simply pumped cash into five sector-leading stocks — Aspen, Mr Price, Naspers, FirstRand and Tiger Brands — they would have managed an average annual return of over 40%.

With this in mind it is perhaps a slightly muted boast that for a fifth year in a row the portfolio of stocks selected by the *Financial Mail*'s investment writers beat the all share index (Alsi).

By our calculations the 15-strong *Financial Mail* portfolio managed a return of close to 10%, edging out the 7,6% growth in the Alsi and a 6% gain in the top 40 index.

On a point of order, the *Financial Mail* portfolio's performance takes in straight share price performance and does not work back dividends paid out during the year.

Though there will be a collective sigh of relief at again staying ahead of the market, especially considering we made a rather untimely selection of technology group Pinnacle Holdings (which lost almost half its value during the year), it would be remiss not to admit that the portfolio was dragged up by the sterling performance of a handful of stocks.

Take a bow Aspen (Andile Makholwa), Tiger Brands (Stafford Thomas), KAP Industrial (Razina Munshi) and Sun International (Marc Hasenfuss).

We were also extremely fortunate that our resources expert, Charlotte Matthews, had the foresight to pick Glencore, which did not suffer the same ravages as some of its mining counterparts (Billiton was 23% lower, Implats slumped 38% and Kumba was down a dismal 46%).

Of course, we do acknowledge that after all our intense and lengthy stock-picking deliberations, investors could also have achieved market-beating returns without taking on too much risk by simply backing some of our biggest conglomerates and investment behemoths. Steinhoff International was up 32% for the year, Reinet 25%, Remgro 22% and Bidvest 13%.

In truth, if the *Financial Mail* had been offered a 10% gain at the start of 2014, our merry band of writers probably would have declined to settle for such a modest return. But come October and November, when things started looking a little hairy on the JSE, a 10% gain for the year might have had more than a few takers (especially among the increasingly nervous older hacks).

Trepidation aside, Cannon Asset Management CEO Adrian Saville reckons 2015 should at least be an easier economic environment to navigate than 2014.

He cites much better growth in the US, sluggish but positive growth out of Western Europe and momentum in emerging markets as likely to result in a net gain of around 3,5% in global growth.

"This is good news for SA, as one of the big influencers is world economic growth. All this will be helped by a lower oil price that might keep inflation in the 4,5% range and take pressure off the interest rate cycle. Even with the electricity supply hitches, we should see an environment that is more supportive for local economic growth in 2015, perhaps around 2,5% for the year."

He says if inflation can be contained below 6% and government shows a willingness to set up a supportive economic policy environment, then the oversold rand could strengthen during 2015.

But like most other market commentators, Saville concedes the JSE might be in for a rough patch in 2015. "SA is now among the world's most expensive stock exchanges. At an index level, it's hard to make a case for investing. The JSE's large industrials as a basket don't represent an opportunity, but rather a risk."

Saville is among several market experts canvassed for the Hot Stocks cover story who identified the resources segment as an area of particular interest in 2015.

He argues that resources are at an intriguing juncture for investors looking for value and opportunity in 2015. "Some resources stocks are priced for disaster, perhaps even priced as if the economy were going out of business."

Saville points out that mining conglomerate Anglo American has a nicely diversified portfolio with a management team determined to get the business back into shape. "People are prepared to pay up for [luxury goods business] Richemont, but seem to overlook the fact that Anglo has diamond group De Beers tucked away."

Saville is also fond of small commodity play Pan African Resources. "The assets are superbly operated, and the gold price versus the all-in cost of production is favourable, which makes it an intrinsically profitable business. It ranks as one of the most attractively priced gold assets in the world."

The collapse in the crude oil price threw the market a curve ball in the last few weeks of 2014. While most market attention has homed in on whether JSE energy giant Sasol can be bought at lower levels, it might be more pertinent to mull which stocks might benefit from a prolonged bout of oil price weakness.

Retailers would be obvious beneficiaries of the lower oil price, but there might be better returns leveraged from logistics and transport counters like KAP Industrial, Value Group, Comair and Cargo Carriers.

Plastics packaging counters like Bowler Metcalf — where the crude price determines a sizeable input cost — may also be able to fatten operating margins, while fishing-aligned counters like Oceana, Brimstone and Sekunjalo may significantly reduce their cost of catch. ■

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SMALL CAPS

The year ahead

After the previous year's small cap picks debacle — where our five-strong portfolio slunk down 3% for 2013 — we are relieved to report that our selections for 2014 brought much happier returns.

The *Financial Mail* picked Trans Hex Group, Efficient Group, Santova, Sovereign Food Investments and Torre Industrial — the average return panning out at a rather slick 70% with dividends worked back into the calculation.

The share prices of logistics specialist Santova and industrial conglomerate Torre both more than doubled, while the strong gains at poultry group Sovereign and wealth manager Efficient were not exactly shabby either.

Diamond group Trans Hex was the laggard, dropping slightly over the year, even with the 50c/share special dividend accounted for in the total return equation.

Picking five small caps for 2015 is going to be daunting with the local economy hobbled by high energy costs, power disruptions, labour tensions and a vulnerable rand. There are very few sweet spots that a small cap punter can target without taking on a good deal of risk.

Our small cap portfolio is traditionally compiled separately from the annual hot stocks picks for a good reason. Need we remind readers that the selections are higher risk/higher reward positions that are recommended only as flutters?

A further qualification is that the selection criterion is limited to stocks with market values of less than R1bn.

Our small cap selections for 2015 are:

Value Group. This well-run logistics operation does not enjoy the same market support as Super Group or the cult status of OneLogix. A downbeat interim performance has put a brake on sentiment, causing the share price to dribble down to levels around 430c on the JSE. The second half of the current financial year may not be pretty — even though operations would have been helped by a falling fuel price. But Value has previously shown an ability to re-start profits from a stall, and at current levels the share looks an absolute steal.

Digicore. This vehicle tracking and fleet management specialist has spent quite a few years in the ditch. But recent results showed that prime mover Nick Vlok, who was hauled back from retirement, has gone back to basics. Further improvements in operational cash flow and trading margins could prompt sentiment to swing to positive. With part of Digicore owned by new investment ConvergeNet (to be renamed CQ Capital Partners) the chances of inspired corporate