20 April 2011

dailyview

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Talking point: Inflation surprises on the upside – but no surprises at the causes

While headline CPI for March was above market expectations of 3.9%, coming in at 4.1%, the reasons behind it were not much of a surprise. March is typically a high survey month, and includes increases coming out of the February Budget speech. Hence there were jumps in alcoholic beverages and tobacco, as well as the jump in education (surveyed annually). The twin bugbears of food and fuel inflation were also present, with petrol prices rising 43c a litre in the month and annual food inflation ticking up to 5.1% from 3.5%.

The good news was that core inflation (which excludes food and fuel inflation) remains steady at 3%, which implies that there are not major capacity constraints in the economy. Given this and the Reserve Bank's recent shift in emphasis to take into account the country's growth needs, one suspects there will be no changes in official interest rates this year. That said, there are some economists calling for a rate hike by September; however we would argue that there would need to be a meaningful closing of the output gap for that scenario to play out.

Market highlights

US equities recovered overnight as traders recouped some of the losses of Monday's trading and focused on corporate earnings and housing numbers.

The JSE bounced back yesterday in line with global equities, as the major sectors staged comebacks after Monday's scares over US sovereign ratings.

The rand tracked the euro against the US dollar, recovering some its losses against the greenback from the previous day. Bonds were firmer, feeding off the stronger currency.

Commodity prices recovered yesterday and the gold price was briefly above US$1500/oz. Commodity markets were lifted by calmer moods following the worsening of the outlook for US sovereign debt by Standard & Poor's on Monday, as well as good flash PMI numbers out of Europe.

Key indicators in a nutshell – Tuesday 19 April 2011

Key indicators	Last price	1 Day	1 Month	1 Quarter	Year to date	1 Year
JSE All Share	**31837.06**	1.43%	3.78%	-1.63%	-0.88%	9.58%
S&P 500	**1312.62**	0.57%	2.61%	2.39%	4.37%	10.11%
Nikkei	**9441.03**	-1.21%	2.54%	-10.57%	-7.70%	-14.96%
Rand/US $	**6.81**	0.42%	2.64%	2.62%	-2.78%	8.45%
Rand/GB Pound	**11.10**	0.05%	2.18%	0.43%	-7.12%	2.08%
US$/Euro	**1.43**	-0.82%	-1.08%	-6.19%	-6.64%	-5.83%
Gold $/oz.	**1495.01**	-0.06%	5.35%	9.10%	5.18%	28.89%

Company results and updates

Altech reported diluted and adjusted HEPS for the year to February of 522c, a decline of 12% on the previous year. A dividend of 356cps was declared, a decline of 5%.

PPC expects its HEPS for the six months to March to decline by between 35% and 40%. The interim results are due out on 17 May.

Investec

Vox Telecom reported a 7% decline in HEPS for the six months to February, to 2.14c.

PBT reported diluted HEPS for the six months to February of 10c, up from its last six month diluted HEPS number (to December 2009) of 3.4c.

Reunert expects to report an increase in normalised EPS for the six months to March of 6% and 12%. The interims are due for release on 17 May.

Datacentrix reported a 13% rise in HEPS for the year to February, to 46.3c.

Tradehold expects to report a headline loss per share of between 9.4c and 10c for the year to February. Tradehold reports on 20 May.

Trematon Capital reported diluted HEPS for the six months to February of 2.4c, down from a previous 17.7c.

Daily ideas

The price of luck: Why betting on the long shots or the high PE companies is expensive

We are all well aware that gamblers are losers on average. If they were not it would not pay the casinos, race courses, bookmakers and lotteries to supply them with gambling opportunities. Nor would governments be able to tax gambling winnings as heavily as they do were not gamblers as eager as they are to gamble on the unfavourable terms they do, made all the more unfavourable by heavy taxes on their winnings.

What is not as clear is why gamblers on average prove so willing to apparently throw away their income. The answer is they enjoy the process, the frisson of perhaps winning big and sometimes doing so. The vast majority of gamblers, perhaps more than 98% of them in SA, are well able to limit their losses to a small proportion of their incomes. On average about 1% of disposable incomes are spent on gambling activity of all kinds in SA.

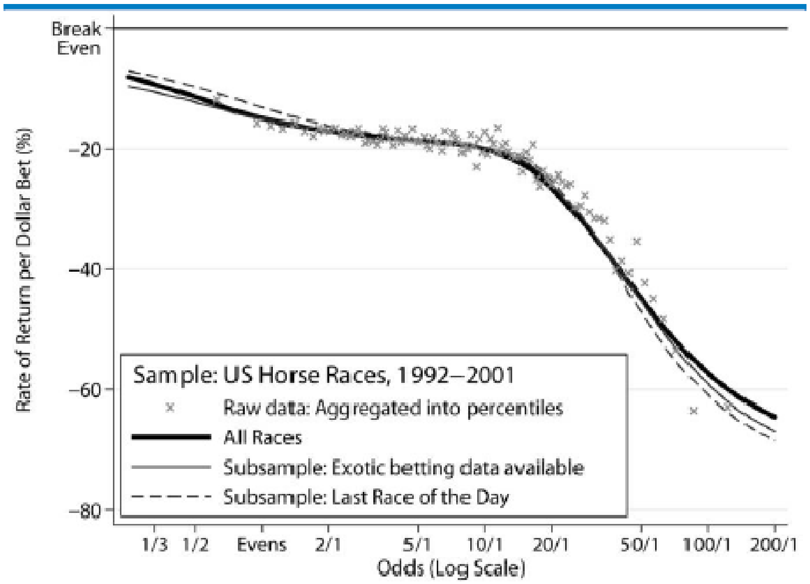
Technically gamblers who trade off expected losses for the pleasures they receive are not risk averse as is conventionally assumed; they are risk loving, playing a game for which the outcomes are not normally distributed around zero. The outcomes are very much skewed to the right hand side of the distribution: many small losses with a small probability of a few big wins.

And so gamblers accept much less than the mathematical odds implied by a normal distribution of outcomes for the opportunity to win big. Or in other words they pay up for the chances they take. It has been established conclusively for US race tracks that the actual odds of a 100-1 outsider winning a race is about 160-1. Researchers with lots of data and computer power at their disposal have calculated the expected betting return from all US horse races run between 1992 and 2001.

These results were shown by Chris Holdsworth in a recent report written for Investec Securities (Long shot bias and the equity market, Investec Securities, 18 April 2011)) that extends the analysis to the equity market in SA.

As shown below the worst bets on the US race courses, in the sense of what you can expect to get back on the basis of historical outcomes, have been on the longest shots. US punters on the races should expect to lose over $60 for every 100 to 1 bet they make. The “fair odds” would have been about 160 to 1, that is 100-1 long shots win only once in 160 attempts not 100.

Figure 1: Expected return is a declining function of odds received in US horse race bets



Source: Reproduced with permission from Snowberg E., Wolfers J. (2010) Explaining the favourite-long shot bias

The explanation for this willingness of gamblers to pay above the theoretical odds for the chance of a big win is surely their taste for risk. They value the small chance of a big win much more than they fear a small (even near certain) loss.

Gamblers who play a lottery, that typically pays out only about 50% of what is taken in, do so for the same reason – for the chance of a really big life changing win. They are in fact risk loving rather than risk averse and pay up accordingly. Government controls over the supply of lottery type games and bookmakers as well as, more recently, online gambling in the US of course prevents the potential gambling competition from improving these especially poor lottery odds or indeed the odds on the race track or the spread at football games.

Holdsworth found that analogous to the results of the gambling research, investors “over pay” for the opportunity to invest in companies listed on the JSE with well above market average PE ratios. The attraction of the high flying companies for risk lovers is that when the companies with high PEs actually grow their earnings even faster than the market expected, as implicit in high trailing multiples, the return can be spectacularly good. And so the risk lovers looking at the far right distribution of potential outcomes drive up valuations and generally overvalue and pay above the theoretical normal distribution odds for the average high PE stock. The ordinary risk averse investor is deterred as much or more so by expected losses as much as they are encouraged by expected returns. This is not necessarily so for the risk lovers.

Holdsworth pursued the analogy of the taste for high PE stocks with the taste for long shots on the race course in the following way

To quote his explanation of the method he used

“........At the beginning of each year from 1994 to 2010 we ranked the constituents of the ALSI by 12m trailing P/E. We then measured the return of each of these stocks over the subsequent 12 months including dividends. We grouped the stocks into deciles based on their P/E within each year. For each year we then had ten equally weighted portfolios based on starting P/E. If our classification is correct then the dispersion of one year returns for the stocks in the high P/E decile should have a much larger tail on the right hand side than that of the low P/E stocks. The top 1% of returns for the high P/E stocks (represented as 0.99 percentile in the chart below) were above 750%. Top 1% of returns for the low P/E portfolio were just under 400%. ....high P/E stocks have a higher propensity for very large returns over one year than low P/E stocks. If this characteristic attracts risk seeking investors, as we think it does, that would imply a lower expected return.

For each year in our sample we measured the return of each decile relative to the average of all the deciles. We then summed up the averages for each decile across the 17 years in the sample. The chart for average returns for each decile is remarkably similar to the horse race chart above .The cost of gambling in the market is high. On average the high P/E portfolio underperformed the average of the deciles by 10% p.a. over the 17 year window. This portfolio would have contained some spectacular winners but their outperformance would have been drowned out by the remaining large number of constituents with sub par performance. The low P/E portfolio, while containing fewer stellar performances, would have outperformed the average of the deciles by just under 4% per annum. Like long shot horses, investors have consistently paid over the odds for high P/E stocks......”

Holdsworth explained that as with gambling it would be sensible for risk lovers in the share market to strictly limit the number of long shots taken and the scale of the investment made in them. Accordingly there also would be no point in holding a number of such stocks. The more diversified the portfolio of very high PE stocks the larger the chance of realising the predicted well below normal returns, if the history of past performance on the JSE is relevant. It would be the equivalent of taking all the tickets in a lottery or raffle where the prize is worth less than the tickets sold.

We would suggest with Holdsworth that investing in high PE stocks it is similar to making a bet where expected losses can be sustained in the hope of a big win. Such action is clearly not for the faint hearted with limited wealth at their disposal.

These results, as with betting odds, should not be regarded as representing market inefficiency or market failure. Rather they represent competitively determined outcomes, given the important presence in the market place of risk loving behaviour.

The risk averse can benefit from these risk loving propensities by betting mostly on the shorter odds favourites that come in the form of the well established blue chips. They have proven track records and whose earnings are not likely to deviate greatly from expectations. These companies will not be expected to shoot the lights out as will be reflected in their average PE rating.

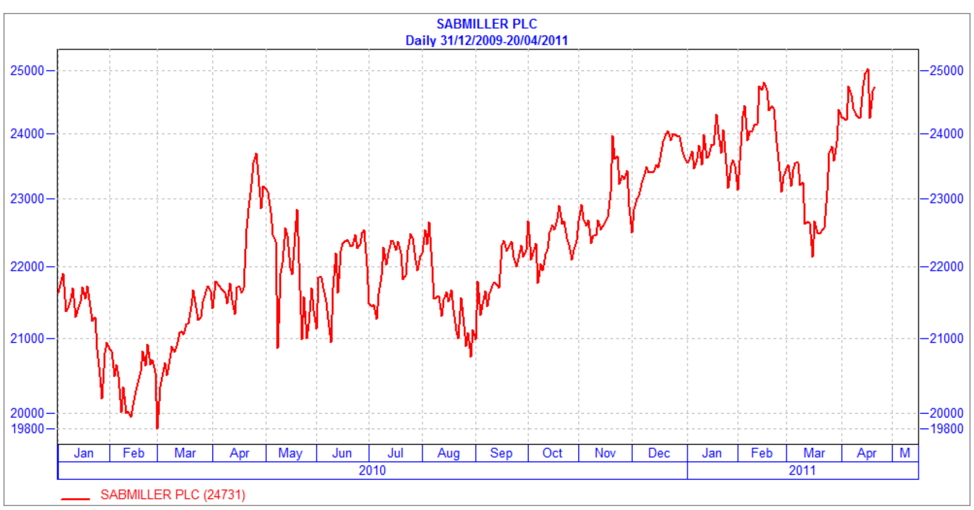
And in the share market, unlike the gambling markets, investors would be playing a positive (after much lower expenses including taxes on winnings) game where the sum of the gains can be realistically expected to exceed the sum of the losses over time. Past performance indicates very clearly as much, as Holdsworth has painstakingly confirmed.

Such advice would not come as a surprise to the typically cautious fund manager or advisor. They might be pleased to know that their experience and intuition is indeed very well supported by past performance on the JSE. ***Brian Kantor***

SABMiller (SAB): A full glass

SABMiller (R247.50; market cap: R410.6bn; forward PE: 16.8x) released a trading update for the full year to March 2011, indicating that its volumes grew by 2% on an organic basis (1H11: 1% growth). At the same time, revenue growth of 5% was achieved on an organic, constant currency basis (1H11: +4%). As in recent periods, growth was principally driven by the groups African and Asian regions – Africa grew volumes by 9% ex Zimbabwe and volumes in Asia were up 10%. Lager volumes in SA were 2% ahead of the prior year and surprisingly were level in the fourth quarter despite the absence of an Easter during that time, while European volumes were 3% lower due to tough economic conditions and steep excise increases in certain countries. US volumes were once again down by 2.5%, and Latin American volumes were level with the prior year.

The group further indicated that its raw material costs on a US dollar per hectolitre basis were marginally lower than the prior year, and hence we expect some margin expansion – in 1H11, EBITA margins expanded by 90bps to 17.3%, with reported EBITA rising 13% (10% in constant currency). Post the 16% adjusted EPS growth that was achieved in 1H11, we think a reasonable earnings expectation is around 185 to 190cps (+16-19% growth), and we expect a further 15% earnings growth in FY12 as organic lager volume growth continues to accelerate due to strengthening macro conditions. SABMiller trades at a **12-month forward PE multiple of around 16.8x** which is a meaningful premium to its global brewing peers and most global consumer staples stocks – this premium can be ascribed to it having a very high proportion of its earnings generated in emerging markets (~80%+), hence presumably a superior growth profile over time. While the rating always appears pretty full, this top-notch company should continue to produce solid results in varying macro conditions which should make it a good long term holding. ***Sean Ashton***



Source: I-Net Bridge

Upcoming dividend dates and corporate actions

Share/security	Last day to trade	Ex-dividend	Record date	Pay date	Description	Per share amount/ result
Nail and Nail N	19 April	20 April	29 April	3 May	Cash dividend	R0.176
Netcare Prefs	19 April	20 April	29 April	3 May	Cash dividend	R3.4161
Oando Oil	19 April	20 April	29 April	31 August	Cap issue	1 OAO for every 4 OAO held
Oando Oil	19 April	20 April	29 April	31 August	Cash dividend	R0.1177702
SBR003	19 April	20 April	29 April	3 May	Interest	R1.41
Sanlam	19 April	20 April	29 April	10 May	Cash Dividend	R1.15
Telemasters	19 April	20 April	29 April	3 May	Cash Dividend	R0.04
Phumelela	28 April	29 April	6 May	9 May	Cash Dividend	R0.25
Vividend	28 April	29 April	6 May	9 May	Interest	R0.0996
Tradehold NPLs	28 April	29 April	6 May	9 May	Rights take up	1 TDHN converts to 1 TDH at R6.26
Zeder	28 April	29 April	6 May	9 May	Cash Dividend	R0.04
Beige NPLs	6 May	9 May	13 May	16 May	Rights take up	1 BEGN converts to 1 BEGP2 at R1 a share
Brimstone	6 May	9 May	13 May	16 May	Cash Dividend	R0.15
Country Bird	6 May	9 May	13 May	16 May	Capital reduction	R0.111
Cipla Medpro	6 May	9 May	13 May	16 May	Cash Dividend	R0.06
Mvela Resources	6 May	9 May	13 May	16 May	Scheme of arrangement	9.5980 NHM per 100 MVL
Afgri	12 May	13 May	20 May	23 May	Cash Dividend	R0.2415
Brait	12 May	13 May	20 May	23 May	Rights issue	3 rights per 1 BAT
CIL	12 May	13 May	20 May	23 May	Consolidation	1 new CIL per 10 old CIL
Simmer and Jack	12 May	13 May	20 May	23 May	Unbundling	47.72727 VIL in addition to every 100 SIM
White Water Resources	12 May	13 May	20 May	23 May	Name change	Goliath Gold (GGM)
UCS	12 May	13 May	20 May	23 May	Unbundling	34.087 BCX and 8.428 Business Connection Group A shares per 100 UCS
JSE	20 May	23 May	27 May	30 May	Cash Dividend	R2.10
Spanjaard	20 May	23 May	27 May	30 May	Cash Dividend	R0.16
Basil Read	27 May	31 May	3 June	6 June	Cash Dividend	R0.30
Capital Shopping	27 May	31 May	3 June	21 June	Cash Dividend	R1.15355
ELB	27 May	31 May	3 June	6 June	Cash Dividend	R0.15
ELB Prefs	27 May	31 May	3 June	6 June	Cash Dividend	R0.06
Brait NPLs	3 June	6 June	10 June	15 June	Rights take up	1 right converts to 1 BAT at R16.50
SBR002	3 June	6 June	10 June	15 June	Interest	R1.45
Freeworld	9 June	10 June	17 June	tbc	Minority offer	R12 per share tendered
JOZI03	9 June	10 June	17 June	21 June	Interest	R14.90
Brait NPLs	17 June	20 June	24 June	27 June	Rights take up	1 right converts to 1 BAT at R16.50
Capitec	17 June	20 June	24 June	27 June	Cash Dividend	R2.05

Source: JSE

Company calendar – 20 April to 27 April

Thursday 21 April	Anglo American AGM Kumba March quarterly production

Source: I-Net, Company updates

Economic calendar – 20 April to 27 April

Date	International	South Africa
Wednesday 20 April	**Japan** – March Trade balance **Germany** – March PPI [08h00] **UK** – MPC minutes [10h30] **UK** – March Public sector finances [10h30] **US** – March Existing home sales [16h00]	
Thursday 21 April	**Germany** – April IFO Business confidence [10h00] **UK** – March Retail sales [10h30] **US –** Initial jobless claims for previous week [14h30] **US** – March Leading indicators [16h00]	
Friday 22 April		**Good Friday – Markets closed**
Monday 25 April	**US** – March New home sales [16h00]	**Easter Monday – Markets closed**
Tuesday 26 April	**US** – February S&P Case Shiller house price index [15h00] **US** – April Consumer confidence [16h00] **US** – FOMC meeting starts	
Wednesday 27 April	**Japan** – March Retail sales **Germany** – April CPI [08h00] **UK** – Q1 GDP advance [10h30] **EMU** – February Industrial new orders [11h00] **US** – March Durable goods [14h30] **US** – FOMC meeting and announcement	**Public holiday – Markets closed**

Sources: Bloomberg, StatsSA

Key market indicators – Tuesday 19 April 2011

Indices	Last price	1 Day	1 Month	1 Quarter	Year to date	1 Year
JSE All Share	**31837.06**	1.43%	3.78%	-1.63%	-0.88%	9.58%
JSE Fini 15	**7989.12**	1.30%	2.82%	-2.95%	-2.23%	-1.48%
JSE Indi 25	**26526.64**	1.79%	5.15%	0.35%	-0.99%	18.31%
JSE Mining	**37205.06**	1.43%	3.14%	-2.85%	0.03%	5.95%
JSE Resi 20	**56505.23**	1.52%	2.36%	-2.70%	0.36%	7.37%
S&P 500	**1312.62**	0.57%	2.61%	2.39%	4.37%	10.11%
DJI	**12266.75**	0.53%	3.44%	3.73%	5.95%	11.33%
NASDAQ	**2744.97**	0.35%	3.83%	0.72%	3.47%	10.63%
Nikkei	**9441.03**	-1.21%	2.54%	-10.57%	-7.70%	-14.96%
Hang Seng	**23520.62**	-1.30%	5.47%	-3.68%	2.11%	7.57%
FTSE 100	**5896.87**	0.46%	3.13%	-1.34%	-1.24%	2.66%
CAC 40	**3908.58**	0.70%	2.58%	-1.71%	2.73%	-1.96%
DAX	**7039.31**	0.18%	5.63%	-0.61%	1.81%	13.89%
ASX-ORD	**4874.30**	-1.44%	3.36%	-1.41%	0.57%	-2.66%
JSE All Share (in US$)	**4676.35**	1.86%	6.52%	0.95%	-3.63%	18.83%
MS EM Index	**1166.41**	0.37%	6.17%	0.45%	1.31%	13.02%
MS World Index	**1324.45**	0.57%	2.90%	1.20%	3.47%	8.36%

Currencies	Last price	1 Day	1 Month	1 Quarter	Year to date	1 Year
Rand/US $	**6.81**	0.42%	2.64%	2.62%	-2.78%	8.45%
Rand/GB Pound	**11.10**	0.05%	2.18%	0.43%	-7.12%	2.08%
Rand/Euro	**9.75**	-0.38%	1.57%	-3.71%	-9.33%	2.22%
Rand/Aus $	**7.17**	-0.15%	-2.76%	-2.97%	-5.79%	-4.49%
Yen/ US $	**82.58**	-0.30%	-2.42%	-0.53%	-1.78%	11.58%
Swiss Franc/US $	**0.90**	-0.36%	0.17%	6.31%	3.93%	18.04%
US $/Euro	**1.43**	-0.82%	-1.08%	-6.19%	-6.64%	-5.83%
US $/GB Pound	**1.63**	-0.39%	-0.55%	-2.14%	-4.36%	-5.92%
US $/Aus $	**1.05**	-0.51%	-5.49%	-5.37%	-2.91%	-12.21%
Nominal Effective Exchange Rate (2000 = 100)	**76.10**	-0.42%	-2.05%	2.33%	6.78%	-2.10%

Commodities	Last price	1 Day	1 Month	1 Quarter	Year to date	1 Year
Gold $/oz.	**1495.01**	-0.06%	5.35%	9.10%	5.18%	28.89%
Platinum/oz.	**1770.5**	-0.51%	2.79%	-3.54%	0.03%	3.12%
Brent Crude $/bbl	**122.42**	0.58%	6.79%	25.19%	29.20%	43.80%

Fixed income	Closing yield %
SA R157	**7.68**
US 2 YEAR	**0.66**
US 10 YEAR	**3.37**
UK 2 YEAR	**0.70**
UK 10 YEAR	**3.57**
EURO 2 YEAR	**1.76**
EURO 10 YEAR	**3.29**

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