



BAUER LAWRENCE & ASSOCIATES

Independent Global Wealth Management

Incorporating Bauer Reuvers & Associates CK1999/003433/23
Lawrence Family Trust IT939/06

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“REALITY CHECK”

In the current environment of declining investments values and excessive bad news, it is naturally difficult not to become pessimistic. Most importantly however, not one of our clients has suffered losses that will affect their required cash flows, nor medium to longer term overall financial positions. We remain convinced that, as in the past, this negative cycle will pass sooner than generally expected.

Without a doubt, it is possible to pick a statistic here and a data point there, and make a case that this is 1929 all over again. In reality, however, the differences dwarf the similarities. The world of today, unlike that of 1929, is marked by a high degree of free trade and global cooperation, global institutions that allow for a global response (non existent in 1929), and governments that respond more appropriately. It is widely accepted that government responses in 1929 were inappropriate, and exacerbated the situation.

Per the latest World Bank report of 31 January 2009, overall global growth is expected to average 0.5% in 2009, picking up to 3% by late 2010. Output in developed economies is expected to contract by 2% overall, comparable to the 1974-75 and 1980-82 periods. In emerging economies, growth is expected to slow from an average 6.25% in 2008, to 3.25% in 2009, but remaining at or above growth rates during previous global slowdowns. On the more positive side, the commodity boom has ended, resulting in a 60% decline in oil prices, and declining food prices. Inflation pressures in emerging markets are expected to subside to an average 5.75% in 2009, down from 9.5% in 2008, allowing interest rates to fall, and boosting economic activity. On an overall basis these are not disastrous economic conditions.

Considering equity markets, there are currently excellent medium-term investment opportunities, with the current panicky market offering the chance to take discounted investment positions that will deliver handsomely in due course. Patience will however be required, and short-term return disappointment is possible.

Perhaps it is useful to appreciate that that the fair value of a company, namely the calculated present value of its expected future profits, is only marginally influenced by its short-term profit prospects. Interestingly, if one assumes that a company's profits will decline considerably to 30% of normal (year one of the recession), and then 70% of normal (year two of the recession), and that profits only recover to normal pre-recession levels in year 4, the calculated fair value of that company only declines by approximately 6-7%. This is significantly less than the negative market adjustments of 30-60% over the last year applied to many excellent companies. The majority of the fluctuation in the listed market value of a company's shares in the short term is driven by market sentiment (emotion), rather than factual assessment, providing significant opportunity for the astute, patient investor.

The last similar severe recession was the global recession of 1974-75, caused by a ten-fold rise in oil prices. Predictions for the global economy going forward were dire during that period. The JSE declined 18.9% in 1975, and declined 10.9% in 1976, to be followed (surprisingly) by an excellent +21.6% (1977), +37.2% (1978), +94.4% (1979), and +40.9% (1980).

Bull markets, almost always start in recessions, and certainly most of the awful economic data is already well known and more than factored into share prices. This, combined with the fact that equity markets tend to bottom 6-12 months in advance of the trough in economic conditions, ensures that positive surprises will follow when least expected. We have no doubt that shares continue to remain the best option for growing wealth in the medium to long term, especially from current levels.

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