# Currency fluctuations:

## *Launching The Credo Sirloin Index*

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A couple of weeks ago, two colleagues and I travelled to South Africa on a week-long roadshow.  As it happened, this was the time that the rand seemed to go into free-fall on a daily basis – which clearly led to a number of interesting discussions about the future of the currency.

Upon returning to London, I went through all my receipts from the trip and put together a travel claim.  Amongst other things, I paid for six meals (for all three of us) while we were out there.  Most of these were light lunches or relatively modest dinners, but I also paid for some lovely steaks at HQ in Cape Town (not to mention a wonderfully drinkable bottle of Cederberg Merlot/Shiraz, as recommended by our very knowledgeable waiter on the night).  In total, these six meals set me back the grand sum of £158.67 at the prevailing rand/sterling exchange rate (at the time of writing some ten days later, the total equates to £147.03). It's probably fair to say that just the one dinner (steak for three and a decent bottle of wine, plus tip) would cost in excess of £150 in one of London's upmarket restaurants such as Hawksmoor or Goodman – which helps to put the value of the six meals we had in South Africa in some perspective.

I guess the above is just my own crude attempt to reconstruct a Big Mac Index (the Credo Sirloin Index?) (specifically for those of us who do not typically frequent the hallowed halls of McDonalds).  But it's probably also worth noting that when the actual Big Mac Index was in fact updated by The Economist magazine earlier this year, it was suggested that the rand (at 9.03 to the dollar / 14.20 to the pound at the time) was already significantly undervalued.

The Big Mac Index uses the theory of purchasing-power parity (PPP), according to which prices and exchange rates should ultimately adjust in order to ensure that identical baskets of goods cost the same across countries. The index refers only to the price of one Big Mac hamburger and relies on the ▶

efforts of McDonalds to produce identical products from the same ingredients around the world.

Even though it has to be conceded that the Big Mac Index is a rather blunt instrument, one should also acknowledge that its relative success in explaining currency movements over the years has been rather uncanny – which is probably why the measure has already survived more than a quarter of a century. In the past few months, for example, the rapid slide in value of the Brazilian real and the Australian dollar have in fact once again approximated the relative overvaluation as per the January update to the index.

Unfortunately the Big Mac Index has never really seemed to work particularly well in the case of the South African rand. One can postulate a number of explanations for this, but I would suggest that one of the main reasons why eating out (whether at HQ or McDonalds) has always been cheaper in South Africa than anywhere in the developed world, simply relates to the tremendous gulf in real estate values (and by implication restaurant rents).

Having said this, how does one reconcile the fact that the rand continues to slide from levels which could be argued to be somewhat undervalued already? This is clearly a vexed question and the truth is that no-one really knows the full answer. But there are obviously a number of contributing factors, only some of which relate to economic fundamentals, with others boiling down to swings in sentiment (political and otherwise).

This is why I always give the same answer when someone asks my views about the future of the rand. Honestly, why should I (or anyone else, for that matter) have any idea? How many people do you know who have been able to successfully predict the big moves in the rand since the New South Africa dawned two decades ago?

I would therefore put the question back to anyone who asks for an opinion about the currency: what are your views regarding the political stability of the country in the medium to longer term?

If you remain bullish about South Africa's prospects, there is reason to believe that the rand is likely to start appreciating again at some point, as it can be illustrated that the rand is now relatively undervalued based on a selection of fundamentals (the Credo Sirloin Index being only one of them). If however, you are one of the political skeptics (and assuming you have money to invest) you probably owe it to yourself and your loved ones to continue diversifying as far as currency exposure is concerned.

Over the past year, my colleagues and I have been involved in numerous conversations with clients who indicated that they were very keen to invest offshore, but would only do so "as soon as the rand returns to a certain level". And of course, we all know what the currency has done in the meantime…

Suffice it to say that the different exchange rates at the time of many of these conversations over the past twelve months will now look very attractive to those who never actually pulled the trigger. Fretting about opportunity profits foregone can be very painful indeed.

It is often said that diversification is the only free lunch in the world of investing and we would argue that this principle extends to one's currency exposure as well. Against this background, our advice to South African investors will always be the same: utilise any periods of relative rand strengthening in order to add to your offshore exposure.

We cannot guarantee that you will find a steak (or a hamburger!) which compares favorably to those in one of Cape Town's better restaurants, but it may be the only way to ensure that the price of eating out does not give you indigestion when you next travel overseas. ■

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