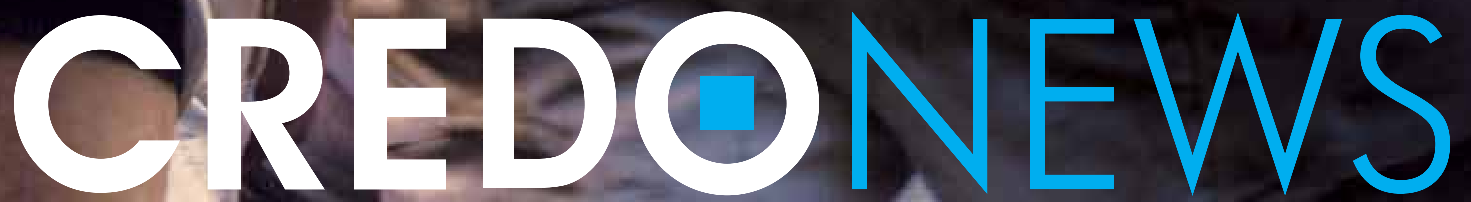


Issue 20 | Rugby World Cup 2015


## Rugby, robo-advisors and Credo
***Alan Noik***
*Page 4*

## A Currency World Cup
***Deon Gouws***
*Page 6*

## Shale: victim of its own success?
***Jarrod Cahn***
*Page 12*

Don't just give it away - let HMRC help you! - *Page 5*

In conversation with Bob Skinstad - *Page 8*

Tax Goes Global - *Page 22*

...and more

# *"The Rugby World Cup returns to Britain 24 years after Australia first raised the Webb Ellis Cup"*

# From strength to strength

As a real rugby fan it is with great anticipation that I await the 18th September when the grandest rugby circus, namely, the Rugby World Cup, returns to Britain 24 years after Australia first raised the Webb Ellis Cup, having triumphed over their hosts, England, at Twickenham.

My excitement in being able to experience this wonderful spectacle is exceeded only by the enjoyment I get from seeing Credo go from strength to strength, and being part of our fantastic team.

It is interesting that the world may only bear witness to the major sporting championships every 4 years – the frequency of the rugby, cricket, and football World Cups. Likewise with the greatest sporting event of all, the Olympic Games. Hence Olympians and other champions are provided a minimum of 4 years to train, practice, learn, and improve. It is of note that the truly great Olympic performances are not judged over the span of a single Games, but many – an even longer period.

If only the world of financial services would take such a long term view. If only clients, and in particular private clients, would allow investment professionals the luxury of 4 year cycles over which to measure and judge performance. While the daily noise of the financial and, increasingly, lay press is difficult to ignore, the truly great investors are those able to overcome a short term obsession with noise and instead focus on long term performance.

As an illustration, consider the performance of our very own Best Ideas Portfolio: since the last Rugby World Cup final on 23rd October 2011 it has enjoyed a total return of approximately 55% and 52% in pounds sterling and US dollar, respectively.

We strongly believe that all investors, as hard as it may be, should try to take a longer term view of their investments and the performance thereof. In my humble opinion, investing – to use a metaphor from a different sport – is a marathon, not a sprint.

Just like picking the winners of major sporting events, it remains extremely difficult to accurately pick winners in the financial markets, particularly over the short term. Nevertheless, in both instances

## dedication, hard work, persistence, and intelligence are essential features of the exceptional.

This is where Credo's edge lies, and the performance of our Best Ideas Portfolio over the past 4 years is testament to that. As far as rugby goes, I believe that the New Zealand All Blacks exhibit these self-same characteristics, and they would certainly be my pick as likely winners.

As our client base grows, our AuM grows with it. This enables us to continue investing in both our people and our infrastructure, resulting in the continuous upgrading of Credo's capacity and capability. Like the returning champions, the All Blacks, our sights are set on the long term, and we hope that you, our clients, will join us in reaping the benefits of this virtuous circle of investment and growth. ■

Alan Noik - *MD* | @AlanNoik_Credo

# Rugby, robo-advisors and Credo

Nothing beats a good creation myth. With the Rugby World Cup kicking off this month, avid fans may be familiar with the tale of Rugby schoolboy William Webb Ellis, who "with a fine disregard for the rules of football as played in his time, first took the ball in his arms and ran with it". Though the story is unsubstantiated, William's legacy lives on: at the end of the tournament the victors will raise the Webb Ellis Cup. What the young William did in the early 1800s was to disrupt the sport of football.

Fast-forward 200 years and, with the advent of the so called robo-advisor, we are now witnessing the disruption of our very own industry. Per Wikipedia, robo-advisors are "a class of financial advisor that provides portfolio management online with minimal human intervention". Although at Credo we are aware of the inroads being made by robo-advisors, we do not feel that our business model and the way we currently interact with our clients is materially threatened.

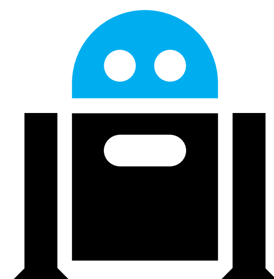
Indeed, there are many soft factors which the "robo" model will simply miss: family dynamics, client emotions, looking after beneficiaries and special circumstances, to name but a few. Part of what we love is developing long standing, close, personal relationships with our clients. For more than 16 years we have successfully developed these relationships by providing a very high level of client service together with transparent, meaningful reporting and steady investment returns.

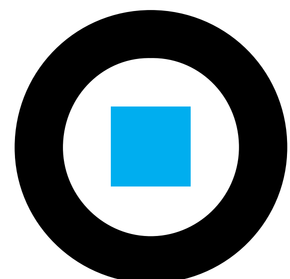
The FT recently reported that 80% of advisors in the United States are concerned about the robo-advisor.

## As part of the minority, are we being ignorant or arrogant?

We are far from complacent. This year alone we are investing more than £750,000 into new client portfolio modelling and reporting infrastructure. In addition, we continue to invest significantly in our investment team and our support staff. All this is to ensure our clients' experience with Credo remains a fruitful and prosperous one.

Although we are not adventurous enough to disrupt our own industry, we do believe we are tackling the important issues head on and look forward to developing close relationships with our clients for the next 200 years.





Stephen Davis - *Director*



# Don't just give it away - let HMRC help you!

Although successive governments have done their best to erode the benefits to be had from contributing to pension funds, recent Chancellors of the Exchequer have aided the charitable sector by extending tax relief available to UK taxpayers who donate to charities.

Whether you believe "charity begins at home" or prefer "no one has ever become poor by giving", there are many ways HMRC encourages your contribution, in addition to the Gift Aid reclaimed by the charity.

At a basic level, for those who habitually donate items to charity shops, you can receive an annual certificate detailing the proceeds generated, which should be noted on your tax return in order to obtain higher rate tax relief.

More substantially, for those bequeathing 10% of the value of their estate above the Nil Inheritance Tax rate band to charity, the rate of IHT on the residue falls from 40% to 36%. For example, assuming an estate of £3million and a Nil rate band on second death of £658,000 (the current level), by leaving £234,200 to charity, the net cost to the beneficiaries of your estate is only £56,208 after tax.

The question then arises as to which charity to leave the money to. For some, the decision may be self-evident, others may prefer a longer term legacy. But setting up a charitable trust is complicated, expensive and may not be appropriate unless the amount involved is above £1million.

Prism the Gift Fund is a recently established charitable trust, which has been set up to provide the flexibility of a charitable trust to those less wealthy than the super-rich, whereby you or your beneficiaries can determine which charities to benefit over the longer term. Their solution is cost effective and takes away all the hassle and compliance issues surrounding establishing and managing a trust.

The Prism solution is just as effective for charitable giving whilst you are alive. In addition, for those fortunate enough to be a UK tax resident but not domiciled in the UK:

**If you have an offshore asset, pregnant with gain, you can gift this to a charitable trust and benefit from full UK tax relief on the gift,** without suffering capital gains tax or having incurred a remittance. The trust will receive Gift Aid on the current value of the asset.

Prism does not manage the monies in the charitable trust and appoints an authorised wealth manager of your choice to do so – presumably Credo Wealth!

Please seek appropriate tax advice, when considering the suggestions made in this article.

Deon Gouws - *CIO* | @DeonGouws_Credo

# A Currency World Cup

Clients often ask about Credo's approach to currency management within our various portfolio solutions. This is a valid and important question, given that all clients will specify a base currency as part of the firm's account opening procedures for purposes of valuing portfolios and measuring investment performance.

Having said that, our investments are typically not limited to a client's base currency (especially for large, diversified portfolios). Provided that clients have a longer term view as well as sufficient risk capacity to stomach shorter term fluctuations, our approach is generally to invest in a basket of leading developed market currencies.

But which currencies do we tend to focus on? And to what extent do our portfolios reflect the pecking order of the world's most important currencies in terms of global trading value (i.e. dollar, euro, yen and pound sterling, in that order – essentially reflecting the relative size of the economy in each of those areas)?

In response to the last question, most clients will be well aware that the bulk of Credo's portfolios are exposed to a combination of the dollar and the pound, with a much smaller percentage in euro assets and even less yen exposure (if any).

There are a few reasons for this. Firstly, the majority of leading international companies are headquartered and/or listed in either the USA or the United Kingdom (even if they have operations and service markets across the globe). Of course, Europe also houses a number of important companies and groups – which we selectively invest in – but in the last few years, we have been very cautious to increase our exposure to the area, given the much-publicised structural issues related to a monetary union considered by many to be unsustainable (not to mention an economy which in places has appeared moribund).

**Given the recent excitement surrounding a possible Grexit and the consequent weakness in the euro, being underweight in this currency has proved a value-adding position.**

The bottom line from a Credo perspective is that we believe a basket of securities exposed mostly to dollars and pounds is likely to provide sufficient currency diversification benefits for the purposes of most of our clients over time, even though it might appear to create additional volatility in the shorter term. The last eighteen months have been a good example of the latter, with the dollar strengthening against the pound from a level of approximately 1.70 to as low as 1.50 (only to weaken somewhat in the last few months). This has led to a situation where the majority of portfolios denominated in dollars have shown muted returns over most of this period (even though there may have been good price gains as well as income in the form of, for example, dividends denominated in "home" currencies such as the pound).

Given Credo's approach to currency management, we thought it would be useful to look at a slightly longer time frame… and in the context of this newsletter's Rugby World Cup theme, we decided to focus on the period of (nearly) four years since the previous tournament. We also thought it might be interesting to consider all the currencies of the different nations taking part in this year's tournament (bearing in mind that some share a currency, such as England, Scotland, and Wales as far as the pound is concerned and France, Italy, and Ireland with respect to the euro).

The results for the 3 years and 9 months since the day of the 2011 Final, up until the time of writing, are as follows (with the movements in all the other currencies expressed relative to the base, being the pound, i.e. the currency of this year's host nation):

| | | 23-Oct-11 | 23-Jul-15 | Change |
|---|---|---|---|---|
| **Argentina** | Peso | 6.63 | 14.25 | -53.5% |
| **Japan** | Yen | 121.41 | 192.99 | -37.1% |
| **South Africa** | Rand | 12.83 | 19.40 | -33.8% |
| **Uruguay** | Peso | 30.95 | 43.16 | -28.3% |
| **Australia** | Dollar | 1.54 | 2.11 | -26.9% |
| **Georgia** | Lari | 2.65 | 3.52 | -24.8% |
| **Canada** | Dollar | 1.61 | 2.02 | -20.6% |
| **France/Italy/Ire** | Euro | 1.15 | 1.42 | -19.0% |
| **Tonga** | Pa'anga | 2.71 | 3.31 | -18.3% |
| **Fiji** | Dollar | 2.82 | 3.32 | -15.2% |
| **New Zealand** | Dollar | 1.99 | 2.34 | -15.0% |
| **Romania** | Leu | 5.00 | 5.63 | -11.1% |
| **Samoa** | Tala | 3.76 | 4.05 | -7.1% |
| **USA** | Dollar | 1.58 | 1.56 | 1.6% |

The first and arguably most important conclusion from this table, is how consistent the pound and the dollar have been relative to each other over the full period (in fact, the dollar is the only currency that has actually gained against the pound, albeit ever so slightly). It would perhaps be an overstatement to suggest that this vindicates the Credo approach as set out above, but it is a comforting reminder of the diversification benefits offered by a basket of assets denominated in these two leading currencies.

Focusing on some of the weaker performers in this Currency World Cup, the dramatic effect of a devaluation in Argentina in January 2014, as well as Japan's implementation of Abenomics in 2013 are clear to see.

As far as the rand is concerned, come October the Springboks will hope to do better than their national currency has done since the previous tournament (3rd weakest out of all the participating nations). Having said that, one should bear in mind that the rand's decline has been of a very similar order of magnitude to other "commodity currencies", such as the Australian dollar and the Georgian lari. Yes, the rand may have done slightly worse than the others, and one can postulate any number of reasons for that, but most commentators agree that the main reason for the drop in value relates to the softening commodity cycle (which ultimately relates to the real economy in China).

New Zealand, on the other hand, will not only have the most highly rated team going into this year's Rugby World Cup (as they usually do), but their currency has also been one of the best performers since the previous tournament.

But who would have guessed the winner of the Currency World Cup (outside of the two "main" currencies already discussed i.e. the pound and the dollar)? As the table shows, the answer is Samoa – a country so small that were its entire population to fly to London in October, Twickenham could accommodate all of them in two sittings. The country may be small, but the strength of their currency can be ascribed to an agriculturally led economy with little or no resources exposure and, crucially, strict fiscal discipline.

In closing, I'd like to return to the two main currencies. Call me a cynic, but I do not expect the USA team to line up on the field and sing "Star Spangled Banner" come Cup final day on 31st October this year. But I am prepared to place a small bet (denominated in pounds, of course) that England will be there… the host nation's rugby team has been on an upward curve nearly as strong as their currency over the past few years. Swing Low, Sweet Chariot.

# In conversation with Bob Skinstad

Since the South African team's first success at the 1995 Rugby World Cup, there have been a total of 7 different individuals who have captained the Springboks on 10 or more occasions. Bob Skinstad was one of them, and to this day he has the distinction of having been the youngest ever Springbok captain to lead the national team.

Skinstad played a total of 42 tests (12 as captain) and scored 11 tries for the Springboks. After terminating his contract with SA Rugby in January 2004, he moved to the UK for 3 years, only to make a dramatic comeback as part of the Rugby World Cup winning South African squad in 2007.

Bob was always known as a fast and adventurous loose forward who played rugby with style and swagger (not to mention his ever-present cheeky smile). Had it not been for a series of leg injuries in the latter part of his career, he would no doubt have gone on to play many more tests and score more beautiful tries.

Today, Skinstad juggles a successful career as businessman, television commentator, and keynote speaker. He is also involved in a number of charities.

Bob is married to Debbie, and they and their four young children live in Cape Town.

Deon Gouws and Ed Fincham recently conducted an interview with Bob to ask about his approach to money and investments. What follows is a selection of questions and answers.

1. Do you manage your own financial affairs?
   It's actually a combination. Between my wife and I, we make a lot of the decisions ourselves (my wife has a Business Science degree, specialising in Tax). I am also a client of two boutique investment companies as well as an accountancy firm in Cape Town. We generally review our affairs on a quarterly basis and decide what to do in order to optimise our tax and investment structure.

2. What is your typical choice of investment?
   I try and split it up three ways. Firstly, I invest in a selection of funds. I also invest directly in the stock market, based mostly on my advisors' recommendations.

The remainder, which I consider to be more risk orientated capital, I invest in business ventures. To give an example, I invested in a hospitality business which, at the time, ran one country pub. It has since grown to a collection of country pubs as well as an outside catering business.

### 3. What has been your worst investment?

I made the mistake of investing in a golf and lifestyle resort, where I bought a plot at the height of the property boom. Since then, I've struggled to recoup my initial investment (the place probably lost about two thirds of its value in the first couple of years after I bought). Fortunately, it is attached to a wonderful golf course, arguably my favourite course anywhere, so at least I can go there sometimes and enjoy my unprofitable "investment".

### 4. What's the most extravagant thing you've ever bought?

I'm not really that way inclined, but I suppose property. I bought a holiday home once which I sold about five years ago. In hindsight, it was a lucky escape and I certainly wouldn't buy one again – I'd much rather pay the yearly fee to rent out someone else's.

### 5. Do you support any charities?

I do support a number of charities, and I actually also started one myself – the Put Foot Foundation – which provides school shoes for children in South Africa and neighbouring countries. One way in which we fundraise is through car rallies, where part of the money raised for each vehicle goes towards a school which is earmarked on the route. The foundation has expanded so we now run a Put Foot rally across the US as well.

### 6. What is the biggest lesson you've learnt about money?

I've been incredibly lucky: I played rugby through the late semi-professional stage into being one of the first professionally contracted players in 1995. I always looked up to other players and tried to model myself on some of them. I found that the most successful rugby players have been the guys who completed their degrees and were working in parallel to rugby. A number of those guys have gone on to be very successful in their own financial world. They taught me very early on about the importance of saving, and how money looks after itself if you look after it. I've always been quite frugal: I try to save as much as possible so I can leave a legacy and don't have to worry too much as I approach retirement.

### 7. Tell us a bit more about the move to professionalism.

At the time that Francois Pienaar and the 1995 World Cup squad were negotiating with Louis Luyt for the first round of proper contracts, I was only 19 and studying at Stellenbosch University where I played first team rugby. I also ended up captaining SA under 19, following which I was actually the first ever officially contracted junior player in South Africa. While the World Cup players were still busy negotiating, they started signing up some of the younger players first. I guess it was easier for them to contract us, as we were a lower cost base at the time.

### 8. Do you have a money weakness?

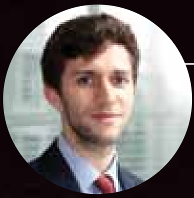
Fishing gear and fishing trips are my passion. My wife can't believe her eyes at the cost of the some of the equipment, but I always tell her that it's very, very vital!

### 9. How do you view offshore investing?

A small percentage of my portfolio is offshore, though I am looking to increase that. I will probably spend some more time working in overseas broadcasting in future, at which point I will be far more ready to leave money in certain offshore investments. I look at it being a much larger part of my portfolio going forward.

### 10. And finally, if you won the lottery, what would you do?

I'd try and repay any remaining debts and look for some steady, safe, overseas investment haven. Then I'd take a sabbatical with my family – take a couple of months off and improve my surfing. I don't want to be the guy who gets to 60 and says well now let's go on a family holiday and my kids are already in their 20s, and are quite happy to go on their own. I'd rather go now while I'm still the centre of their lives, so that I've got something to reflect on and laugh about when I'm too old to be enjoying it with them. ■



Ed Fincham - *Investment Analyst*

# Past, not prologue

No one wants to be struck by lightning, but suppose today is your unlucky day. For now, let us assume that lightning strikes at random and every day the chance of being struck is the same, say, 5%. Given this, what is the most likely day to be struck by the *next* bolt of lightning?

To those unfamiliar with the mathematics of probability, the intuitive answer may be "every day has the same chance". Seductive, but wrong. Rather the most likely day is tomorrow (a 5% chance). To illustrate this point, take the chance that the *next* strike will not be tomorrow but the day after. Such an outcome requires two criteria: no strike tomorrow (a probability of 100% – 5% = 0.95%) and a strike the following day (5%), giving a combined probability of 4.75%. So with each passing day the odds decrease. Lightning strikes are an example of what is known as a Poisson process, named after the French mathematician Siméon Denis Poisson.

In a Poisson process, events occur continuously, randomly, and independently of one another; every moment the die are cast, but with no memory of what came before. Unfortunately, the human mind is all too often bewildered by randomness: research by the likes of Kahneman and Tversky indicates that we are cognitively ill-equipped to deal with probability. For instance, faced with an unfavourable diagnosis with an 83% survival rate, we would struggle to think of ourselves as 17% dead as the mathematics of expected value require. Unfortunately, probability is often entirely counterintuitive; as the statistician William Feller has remarked,

"to the untrained eye, randomness appears as a regularity or tendency to cluster".

Nowhere is this insight more valuable than markets. Though it may smack of heresy, in an uncertain world, track records matter less than you might think. It goes without saying that the future is unknown but, paradoxically, the same can be said of the past: how are we to judge performance without knowledge of all the other possible outcomes? To illustrate this, suppose we are continually drawing balls from an urn containing red and black balls. An Urn Manager may celebrate her success, having drawn 19 black balls and only 1 red ball in the last 20 draws. Yet our Urn Manager knows nothing about the distribution of the balls beyond her historical record, which is asymmetric: her knowledge of the presence of black balls dramatically improves as she finds each one, but her knowledge of the presence of red balls, having found fewer, increases much slower. Likewise, when selecting investments, the fetishism of past performance can prove a dangerous illusion: without knowledge of the underlying distribution, it is impossible to discern skill from fortune.

However, knowledge of a probability distribution alone is no panacea. The consolation of statistics is based on a simple premise: the more information you have, the more confidence you can have of the outcome. But if the distribution of outcomes is random, statistics may deceive rather than aid us. It has never been easier to mine data – scouring for patterns, anomalies, and opportunity – but if the data is random we are merely tilting at windmills. Nassim Nicholas Taleb illustrates the problem of interpreting past data in the form of a humorous reductio:

*What is the most likely day to be struck by the next bolt of lightning?*

I have just completed a thorough statistical examination of the life of President Bush. For 55 years, close to 16,000 observations, he did not die once. I can hence pronounce him as immortal, with a high degree of statistical significance.

Such an argument is patent nonsense, and exposes the fallacy of an untempered enthusiasm for statistics.

Without an underlying logic – be it in the form of a behavioural or risk-based rationale – any "strategy" plucked from historical data could prove utterly spurious.

Faced with an exceptional track record, it is all too easy to be blinkered by induction; comforted by the illusion that, to paraphrase Hume, instances of which we have had no experience will resemble those of which we have had experience. Unfortunately, the past is not prologue, and randomness may often dress in the borrowed robes of order. Like President Bush, we may claim immortality, only to have our pride checked by the next lightning bolt. ■

Jarrod Cahn - *Director*

# Shale: victim of its

When the oil price declined from $115 to $80 from July to November last year, market participants remained fairly complacent, expecting OPEC (in the guise of Saudi Arabia) to re-balance the production quotas at the forthcoming OPEC meeting. However, in a fairly unprecedented manner, the "swing producer" Saudis decided not to cut capacity, and left their supply quota at 30 million barrels per day. The market was caught unawares, and thus continued the oil rollercoaster to lows of around $46.59 before recovering somewhat during Q1 2015. It has since settled around $50 for Brent and $44 for West Texas Intermediate (WTI).

## As the most heavily traded commodity in the world, the collapse in the oil price has been one of the most keenly watched moves.

Its dramatic decline has significant ramifications for all market participants; from the oil dependent countries like Venezuela, Norway, and Russia to the individual consumers who feel the benefit of price deflation in the supermarkets and at the petrol pump.

So why did OPEC not cut production at the meeting on 27th November? The official line was "to protect market share". Clearly the oversupply has partially come from non-OPEC members on the conventional side, but without doubt the biggest culprit has been the rise of non-conventional supply, through shale oil operators in the US.

The emergence of the shale oil industry has been one of the greatest technological and scientific achievements of the last decade. Indeed, the US' success in shale exploration has propelled it towards oil independence. Shale exports have flowed into other markets, such as Asia, which has historically been serviced by OPEC members.

Fracking involves a technique of drilling wells into shale rock formations found deep underground. The process includes drilling a vertical well for about 10,000 feet, then continuing with a horizontal well for another 10,000 feet. Once secured, small charges are let off in the well, creating fractures in the shale formation. Next thousands of gallons of water, mixed with a cocktail of toxins and sand, are pushed down the well at very high pressure. This forces the small fractures to expand, allowing the trapped oil or gas to flow before being extracted to the surface. The process is far from natural, and comes replete with major environmental issues. Particularly, the water used becomes contaminated with toxins, and may leak into nearby formations or the water system supplying nearby communities. Despite its benefits, fracking remains a controversial technology.

Today, shale contributes approximately 4/5th of every new barrel of oil that is produced in the US. The expediency of shale production has changed the playing field. In response, OPEC, a cartel dominated by Saudi Arabia, has proved adroit in trying to stem the torrent of shale hitting the market. Although not ostensibly, it has calculated that the cost of producing shale oil is on average around $60 per barrel (WTI). In driving the price of WTI below this, to levels of around $44 today, the belief is that the shale operators will be forced to close shop.

While the fracking industry has been hugely successful, there are certain weaknesses the low oil price may expose. Firstly, the costs of extracting unconventional oil are high. Although there is little pricing transparency, data across the three main basins in the US suggests costs vary from as high as $120 to as low as $40. Clearly

# own success?

the larger, more technologically advanced players who bought land cheaply will be able to produce at lower cost. However, with WTI oil now trading around $44,

it is difficult to see how the majority of these suppliers will produce at a profit.

Secondly, the production rates of shale producers is very different to conventional wells. While a conventional producer enjoys depletion rates of approximately 5% per annum, a shale producer suffers a depletion rate closer to 65-70% in year one, 35% in year two, 15% in year three, and then 10% thereafter. By the end of year three, producers have lost almost 80% of total production. So to keep production rates high, shale producers must continuously drill new wells. Failure to do so will result in rapidly diminishing production.

The fracking boom has been predominantly funded by debt. Since 2011 over $650bn of high yield debt has been issued. In 2014 Oil and Gas accounted for nearly 45% of issuances. This is partly due to low funding costs (between 5% and 6% in 2013) but costs have since risen to 8-12%. Accordingly, it appears that investors' risk appetites have diminished somewhat and, while the viability of the fracking business model continues to be tested, traditional money managers may be far more reluctant to support the debt funding that the industry so heavily relies on.

The last piece of the shale puzzle revolves around "hedging strategies". Many operators will look to hedge their production against future oil prices. This guarantees them a certain return, and alleviates much of the price risk. Most operators operate on a 1-2 year hedging strategy. When oil prices were stable at $100, operators were more flexible in terms of their hedging strategies and in fact, as prices have started to drop, some producers have actually lifted their hedges. Whether or not the operators have continued to lock in their hedges at higher prices or are operating unhedged, will determine the viability and profitability of these businesses. With 1 year WTI futures at around $51, it begs the question as to how unhedged business will turn a profit.

Perhaps the best indicator of how the shale industry has coped with the dramatic slide in oil prices is the Baker Hughes Rig Count. This takes into account the number of onshore rigs that are in operation in the US and Canada, and is published weekly. In October 2014 the rig count peaked at 1609 before reaching a nadir of 628 at the end of June 2015. This represents a 60% drop in operational rigs in less than a year. Interestingly, in the last few weeks the rig count actually increased 6% to 664 (as of 6th August 2015).

To date, the shale industry has remained resilient. The industry will argue that with all the slack in the system at present, costs have fallen significantly, not least thanks to ever-improving technology. For example, multi-pad well drilling, movable rigs, and better data enables operators to produce at a much lower marginal cost. An alternative explanation is that while these companies have all cut capital expenditure, much of this year's production was already paid for – and hedged – such that the drop off in supply was never going to materialise until the next year's hedging and drilling cycle began. Given that the price of oil dropped in July 2014, and the rig count lagged by about four to six months, we will probably only see the real depletion rates in production and hedging programs start running off towards the end of this year and into 2016. Uncertainty abounds but, as yet, the economics are not stacked in shale's favour. ■

Gareth Crosland - *Senior Relationship Manager*

# Hangars are not only

The CFA Institute recently announced that nearly 160,000 candidates from 174 countries had registered for the Level I, II and III CFA exams. This year's exams, administered worldwide on 6th June, have drawn in an additional 10,000 registrations compared to last year. Regionally, Asia Pacific continues to be the largest source of candidates, accounting for over 40% of the total. For those of us with ties to Europe and Africa: EMEA (which includes Europe, the Middle East, and Africa), accounts for approximately 20% of worldwide candidates.

History suggests that more than half of candidates are likely to fail, so one is bound to ask why so many flock to the various test centres around the world for a day – a Saturday no less – of pain and torment.

First awarded in 1963, the Chartered Financial Analyst® designation (CFA) has become the most respected and recognized investment designation in the world. Some argue that with pass rates less than 50% and the sheer complexity of what candidates have to study, a premium is now associated with the qualification, possibly surpassing the much more established Masters of Business Administration (MBA), which has its origins in the 19th century. With the rapid increase in the number of candidates registering for the CFA exams each year, some, however, question the exclusivity of the qualification. Yet there are surprisingly only approximately 123,000 charterholders worldwide, including Bill Gross, previously of PIMCO fame, and Sir John Marks Templeton, who founded the Templeton Mutual Funds.

Having recently written Level III of the CFA Program in London, one of the largest exam centres in Europe if not the world, the numbers of registered candidates mentioned do not surprise me. Writing an exam in what can only be described as a hangar better suited for stowing an Airbus A380, with row upon row of desks meticulously laid out, drives home the point that this qualification has become the gold standard of the global investment community and is highly sought after.

Apart from providing a strong foundation of advanced investment analysis and real-world portfolio management skills, pairing academic theory with current practice, the CFA Program curriculum focuses heavily on investment ethics and each candidate is held accountable to the Code of Ethics & Standards of Professional Conduct. Throughout all three examinations levels of the program, the principle that client interests come first is sacrosanct and the need to maintain the integrity of the investment profession and capital markets in general is stressed ad nauseam.

Credo, always keen to invest in its people, currently has five staff members, all part of the Investment Team, who have passed all three levels of examinations on the CFA Program, including our Chief Investment Officer, Deon Gouws. As Benjamin Franklin once wrote,

# for A380s...

*"an investment in knowledge pays the best interest."*

Whilst the knowledge gained from the three six-hours of exams across the various levels in itself does not guarantee that our team are or will be great long-term investors, what the CFA Program gives one is a very broad yet detailed knowledge of finance, accounting, and economics. This provides the necessary foundation to better understand businesses and their related securities, which is a prerequisite for making a sound investment. It should also instill confidence in clients that the ethical environment insisted upon by the CFA Code of Ethics & Standards of Professional Conduct permeates throughout the organisation. At Credo, a client's interests comes above all else and we take our fiduciary duty to our clients extremely seriously.

As Credo strives to increase its assets under management, the investment team is likely to expand further. Given our preference for experienced professionals who are suitably qualified, there may yet be some growth left in the CFA qualification. ■

*History suggests that more than half of candidates are likely to fail...*

Ainsley To - *Research Analyst* | @AinsleyTo_Credo

# The Rehabilitated Macrophobe

## *"In the long run, we are all dead" John Maynard Keynes*

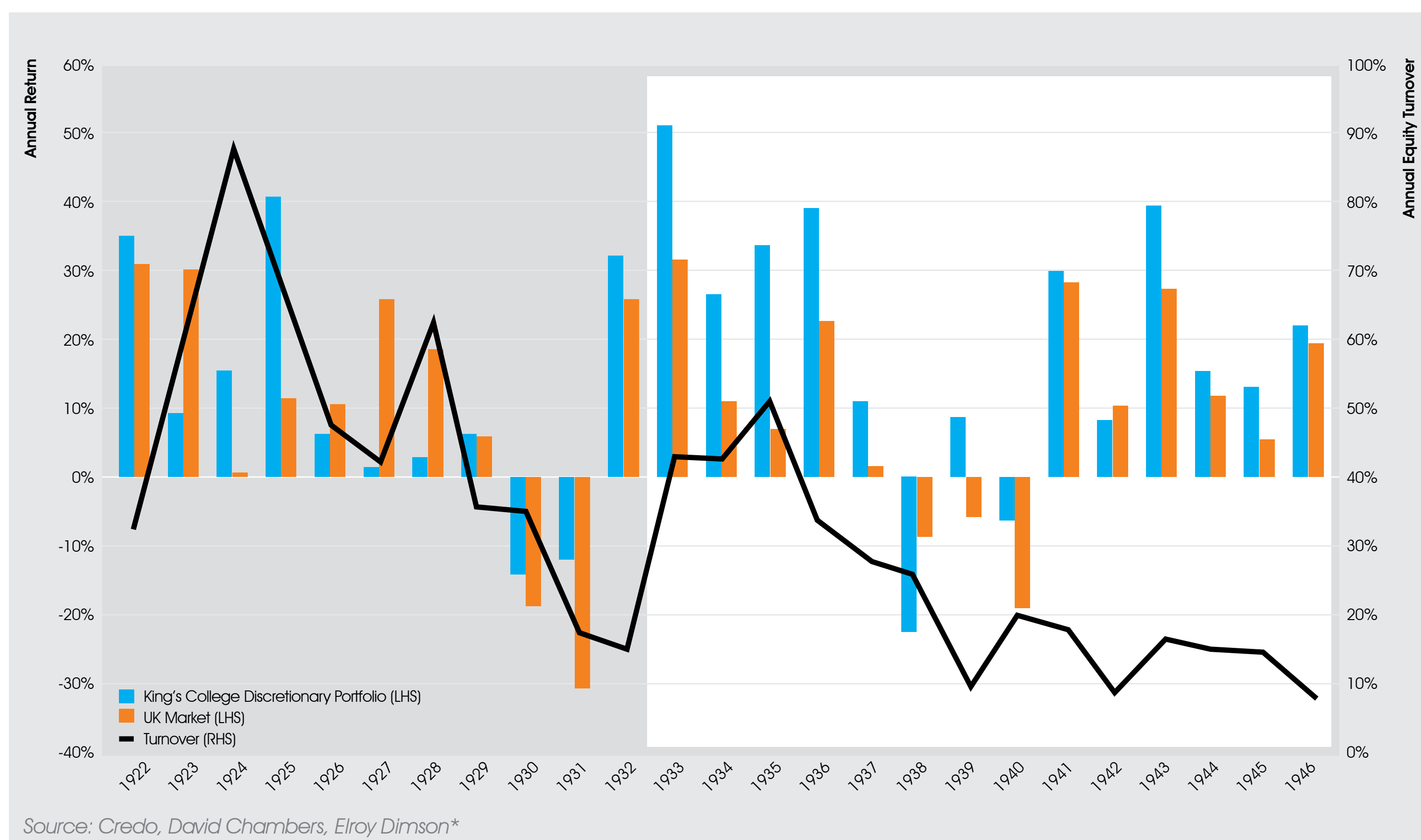
Whilst his famous words were in the context of promoting counter cyclical fiscal policy, many investors have taken this Keynes quote to heart and embraced it as a pillar of their investment philosophy. With ETF assets now eclipsing hedge fund AuM ($3trillion+), investors have taken it upon themselves to venture into the world of "Macro tourism" and short term market timing. If you have recently traded anything based purely on what your crystal ball has told you about Crude Oil, Grexit, the US dollar, or the exact date of Fed rate hikes, then yes, you fall into this category.

Although the financial media may be partly to blame, many investors are equally guilty of succumbing to the aptly named condition of "Macrophobia": the fear of waiting. If you feel intense discomfort when confronted with any situation that involves patience or having to wait for something (in an investor's case, the phenomenon known as compound interest), you are likely to be a Macrophobe. And you're not alone – any human being dealing with uncertain outcomes feels compelled to act (see my previous article: Investor Existentialism), including many of the brightest minds in our history.

Keynes ran the endowment for King's College at the University of Cambridge from 1921 to his death in 1946. And whilst many have documented his stellar track record, the period encompasses a distinct shift in investment philosophy, or what investment analysts call Style Drift.

As a great macroeconomist, Keynes began investing the endowment with a top down macro philosophy or, in his own words, using the "credit cycle theory of investment". Yet with all his monetary and economic indicators, this approach yielded mixed results for Keynes. Up to 1932 he only marginally beat the UK equity market. Despite being in the most informed of investment circles with a substantial industry network (from his days at Eton, Cambridge and the Treasury), his macro forecasting didn't translate into sound predictions of the direction of financial markets. He went through a torrid period in the late 1920s during which he lagged the UK market for three consecutive years and culminated in him bearing the brunt of the crash in late 1929.

Whether it was caused by these investment experiences or other factors (the publication of Graham and Dodd's Security Analysis, perhaps?), history saw a significant change in Keynes' investment philosophy between 1932 and 1934. Reflecting on his investment record for King's he wrote "We have not proved able to take much advantage of a general systematic movement out of and into ordinary shares as a whole at different phases of the trade cycle... Credit cycling means in practice selling market leaders on a falling market and buying them on a rising one and, allowing for expenses and loss of interest, it needs phenomenal skill to make much out of it". Having conceded that the markets could indeed remain irrational longer than he would remain solvent, he released his portfolio from the shackles of short term macro forecasting to become what would today be described as a buy & hold investor.



*Source: Credo, David Chambers, Elroy Dimson**

| | Keynes' Average Annual Return | Average Return for UK Stocks | Years in cumulative drawdown vs UK Stocks | Max Drawdown vs UK Stocks | Average Annual Turnover |
|---|---|---|---|---|---|
| 1920-1932 (Keynes the market timer) | 11.44% | 10.24% | 6 out of 11 | -53.39% | 46% |
| **1932-1946 (Keynes the buy & hold investor)** | **19.53%** | **10.47%** | **0 out of 12** | **0.00%** | **24%** |

*Table 1. "When the facts change, I change my mind. What do you do, sir?"*

Analysing portfolio activity in the two periods highlights the change in approach – average annual turnover was almost halved and there was a significant difference to how he reacted to bear markets. As the UK market fell with Wall Street in October 1929, Keynes "the market timer" dramatically sold out of equities (selling ~20% of his portfolio). Yet when the Federal Reserve tightened in 1937, sparking the second large decline of the depression era, the newly reformed buy & hold investor resisted Macrophobia and continued to hold his equity exposure (he even added to positions). Whilst this hurt him in the short term, his portfolio rebounded much faster than the market in the subsequent year. The difference in performance of the two approaches can be seen in Table 1. Post his renaissance he beat the UK market 12 out of 14 years and was never behind on a rolling 3 year or 5 year basis.

All asset classes that provide long term returns on capital will experience volatility - that's why they call it a risk premium. Ascertaining the economic reason driving the movement in financial assets is difficult enough in hindsight, let alone before the fact. The best investment lesson from one of the greatest macroeconomists that ever lived is to avoid the short term macro noise and focus on the long term. And if in the long run we're all dead, you're better off not wasting your finite time listening to talking heads and masochistically overtrading your nest egg.

*(*) D, Chambers and E. Dimson, "Keynes The Stock Market Investor" (2012)*

Ben Newton - *Investment Manager*

# Selective Opportunities

As speculation mounts over prospective interest rate rises in the UK and the US, many investors may suffer a natural aversion to fixed income securities since, historically, government securities have exhibited a negative correlation to rate rises. However, within the corporate credit market, this relationship is less robust. In particular, higher yielding securities tend to outperform over these periods as returns are driven by the fundamental strength of the company.

From a total return perspective, we continue to find opportunistic investments within the asset class that look very attractive to maturity.

Though there may be volatility along the journey, our fundamental research gives us confidence in the credit quality of the underlying company.

This enables us to find investments that we are confident will outperform cash alternatives over the duration of the investment.

A pertinent example of this is the recent issue of a sterling hybrid bond by Sainsbury's which has a coupon of 6.5% and a call in 5 years' time. Whilst the coupon is discretionary, Sainsbury's cannot pay any dividends until this cumulative interest is paid, thus we don't envisage any deferral. Whilst the bond is termed a perpetual, the coupon resets every 5 years and on the first call date in 2020 there is a punitive additional step of 5% above the current spread, which means at the current low interest rate levels the bonds coupon would reset at 11.5%. As a result we believe this is very likely to be called in normal market conditions. Credo started purchasing the bond immediately after its IPO and continues to be a buyer of the bond at current levels, with a yield to call of approximately 6.0%.

Sainsbury's is the UK's second largest supermarket with a market capitalisation of £5bn and is a component of the FTSE 100 Index. Despite market pressure, Sainsbury's has showed greater resilience than its peers, has reacted quickly to the current environment, and, in our view, is adequately positioned. We

# in Fixed Income

are confident Sainsbury's will be able to repay or refinance the note in 5 years' time.

A recent US dollar investment that Credo purchased for discretionary and advisory clients is the senior investment grade bond issuance from Bill Ackman's listed hedge fund, Pershing Square Holdings (PSH). We are recommending this investment grade issue as we believe there is a high level of security and, for a 7 year bond, a relatively attractive yield of 5.5%. Extensive research has given up an in-depth understanding of the strategy and structure, having participated, on behalf of a select number of stockbroking clients, in the October 2014 equity initial public offering of $6bn of permanent capital for the strategy, listed on Euronext Amsterdam. PSH is activist in nature; building up large positions in US large capitalisation stocks, with the intention of facilitating a change in strategy or management. In total, the strategy has $19bn assets under management, concentrated in 8 to 12 stocks. The strategy has been defensive in nature and, while the historical return is not necessarily reflective of the future performance, this provides investors with a certain degree of comfort.

In the fixed income arena, one must remain nimble. Nevertheless, we believe opportunities remain to put to work. We continue to expect a hike in interest rates but expect the rise to be gradual, so as not to unsettle the market or the economy, and unlikely to return to historic levels. Therefore, we believe the total return prospects of our fixed income selection remains attractive with the investment horizon of their maturities, and are given comfort by the steady stream of annual income while we remain comfortable with underlying corporate fundamentals.

We focus our mindset on the opportunity to fix a rate over the maturity of the investment, irrespective of market movements, especially given the cash rate alternative.

For further information or more comprehensive research on these selective investment opportunities in fixed income please contact your Relationship Manager. ■

SJ du Preez - *MD, South Africa*

# Growth in Credo's South African Operations

The Rugby World Cup (RWC) 2015 kicks off on Friday 18th September with hosts England taking on Fiji. The real RWC only starts the next day when the South African Springboks take on Japan… now you know where my loyalties lie!

A common misperception about the RWC is that it is merely a competition between 20 nations divided into 4 pools. Rather, what we shall be watching is the result of numerous countries competing over several years for one of 20 berths. In fact, by the end of the RWC 2015, 92 teams will have competed for the honour of lifting the Webb Ellis Cup. This stands in stark contrast to the inaugural RWC, played in 1987, when only 16 countries competed. This equates to a growth in participating countries of 475% over the period!

It is also interesting to note the growth in some other areas concerning the RWC. For example, the estimated television audience has swelled to unbelievable heights: from 300 million in 1987 to 3.9 billion in the last tournament – a growth of 1,200%!

While Credo's South African operations can't claim a large television audience, our South African team has also experienced rapid expansion. In 2013 Credo's operations in South Africa were comprised of only two members, but have since grown by 250% to seven. Today we have a new head office in Johannesburg with five people, an office in Cape Town, and a representative in Port Elizabeth servicing the Eastern Cape. We will continue to invest in resources in order to provide our clients with exceptional service.

The benefit for our South African clients is that we have people on the ground with a wealth of experience in offshore investing, dealing with wealth platforms, financial intermediaries, and private clients. Many South Africans feel that their money gets lost in the big wide world of offshore investment markets; that they become just a number, and timely information is hard to come by. At Credo, our aim is to provide each client with the relevant information and advice concerning their investments. In addition, we provide our clients with access to MyCredo, our online reporting tool, where they can keep an eye on their investments. For those South African clients who need to use MyCredo for more than just keeping track of their investments, we also offer specialist training.

Our South African clients are provided with the means to invest or trade in international markets with simple, easy-to-understand solutions, while keeping in contact with a local representative of Credo.

It may be prudent to remind our clients that while we are here to provide you with exceptional service, we are supported by a team of around 55 highly qualified individuals in London. Furthermore, your assets are being managed (or your trades executed) by our London-based team of investment professionals and dealers. We do not manage your assets from South Africa, but we do want to deliver you with timely, relevant information and advice to ensure a seamless and gratifying client experience.

Please allow me this opportunity to thank you, our clients, for your continued support and for trusting Credo to preserve and grow your assets. You may rest assured that even though your assets are managed from our head office situated in the RWC 2015 host nation, you will be looked after by the Springbok team in South Africa.

*Source of RWC statistics: www.rugbyfootballhistory.com*

Debra Chalmers - *Legal and Compliance Director*

# Tax Goes Global

Ronald Reagan once joked that the government's view of the economy can be summed up in a simple phrase: "if it moves, tax it". As the world becomes increasingly globalised and individuals move both their assets and themselves abroad, his words have become eerily prescient. In February of last year, representatives of the G20 endorsed the Common Reporting Standard (CRS) for automatic exchange of tax information. This latest mandate will require governments to obtain detailed account information from their financial institutions and exchange that information automatically with other jurisdictions on an annual basis.

Now that it is easier for all taxpayers to make, hold, and manage investments through financial institutions outside their countries of residence,

offshore tax evasion is an even more serious problem for jurisdictions all over the world.

Countries have a shared interest in maintaining the integrity of their tax systems. Cooperation between tax administrations is seen as critical in the fight against tax evasion and in protecting the integrity of these tax systems. A key aspect of that cooperation is the exchange of information.

The CRS provides for annual automatic exchange of financial account information between governments, including balances, interest, dividends, and sales proceeds from financial assets, reported by financial institutions and covering accounts held by individuals and entities. It sets out the financial account information to be exchanged, the financial institutions that are required to report, the different types of accounts and the taxpayers covered, as well as common due diligence procedures to be followed by financial institutions.

The adoption of the CRS comes on the heels of the US Foreign Account Tax Compliance Act (more commonly known as "FATCA") which countries and financial institutions have already begun to implement. The CRS is aimed at achieving a similar result on a much wider scale. Along with 60 other countries, the UK has signed as an early adopter of the CRS regime and the intended first information exchange date has been set as September 2017. While we anticipate that this will have a minimal impact on our clients, should you think that it may affect you please discuss your situation with your Relationship Manager. ■

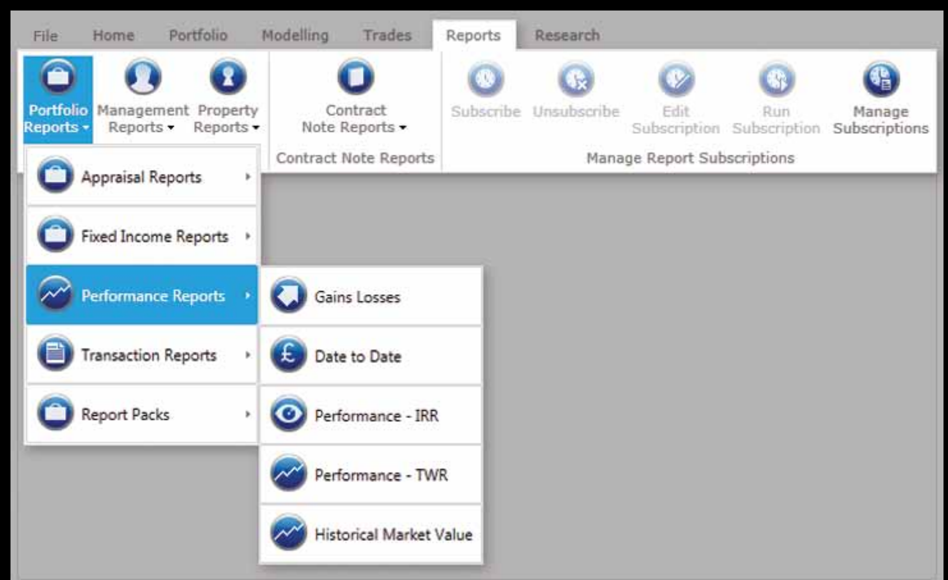
# MYCREDO Performance Measurement

When the Rugby World Cup kicked off in 1987, the game of rugby was still an amateur sport and far from the scientific, professional empire it has become. The dawn of professional rugby has seen various evolving measures from sport psychology, bio-kinetics, physiotherapists, dieticians, and technology to measure and improve performance.

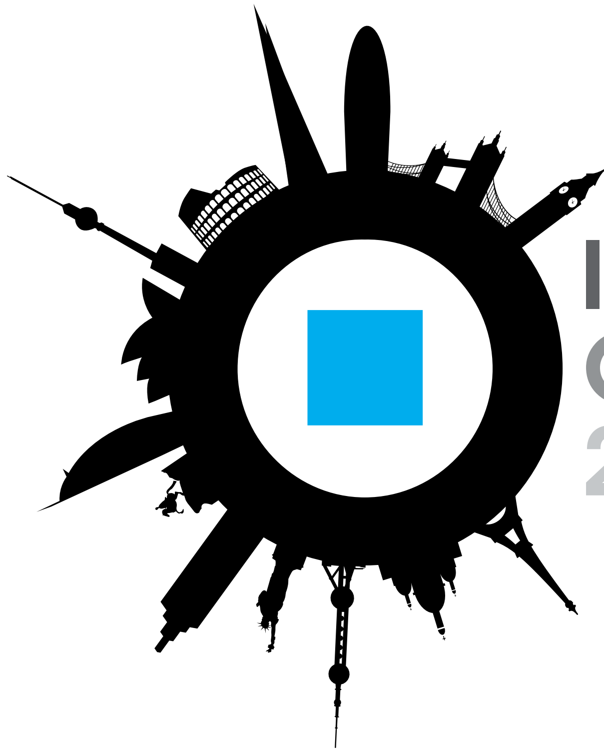
Just as each player is analysed and performance is measured on an individual player basis, MyCredo employs state of the art performance measurement tools to analyse and measure each account's performance.

A choice of detailed technical reporting or a simple one pager is available:

## Detailed reporting



INTERNATIONAL
CONFERENCE



# INTERNATIONAL CONFERENCE 2015

On Thursday 11th June 2015, Credo Wealth held its second biannual International Client Conference (the first having been held earlier this year in South Africa) at the Royal College of Physicians (RCP) in Regent's Park, located just down the road from our London offices. A fitting venue, some might say, given the trust patients place in the hands of their physicians. Likewise, at Credo, our primary objective is to earn our clients' trust through the protection and enhancement of their wealth.

The evening began in the RCP's renowned garden, where the wine and canapés flowed. Our CEO, **Roy Ettlinger, opened with an overview of Credo's history,** highlighting the continued growth in assets under management, which now stands at approximately £1.7bn (a growth of around 25% since January 2014). Boasting new offices in three major locations (London, Johannesburg, and Cape Town) and over 70 skilled staff, Credo is primed to continue this expansion and we encourage clients to visit us whenever they find themselves near our offices.

Oil has been a major talking point in recent months, with the oil price having largely halved since June 2014. Credo's Director and Senior Portfolio Manager, **Jarrod Cahn, provided an all-encompassing, insightful perspective on the global oil market** covering the major developments and implications. With global oil demand remaining relatively constant, Jarrod noted this is clearly a supply-side shock and outlined both the political and economic elements at play. Evidently, there are large uncertainties regarding the future of the oil price, and Jarrod was able to explain the implications at client portfolio level.

Reading news headlines daily can be a daunting activity, but Credo's CIO, Deon Gouws, can discern the signal from the noise. **This year's keynote address was delivered by Deon as he looked back over certain headlines in the previous 12 months, including the Ebola scare, QE uncertainties, inflation, and Greece, to name a few.** Pursuant to Credo's long-term and prudent approach to investment management, Deon encouraged the audience to have an investment plan, remain optimistic about the long-term, and simply to keep calm and carry on.

The conference ended with a Q&A session followed by more drinks and canapés – a relaxed environment for further conversation. A successful event all-in-all and we look forward to welcoming you back next year.

Ed Fincham - *Investment Analyst*

# Running on empty...

The race had hardly begun, but already I was stood next to a giant testicle. Stood as I was, shivering in the cold, overcast morning I begun to question my sanity. The medley of costumes surrounding me served only to make the experience more surreal.

This fantastic team provides a supportive, listening ear as well as information on the latest research into the debilitating condition.

Six months earlier, from the comfort of my sofa, I had decided on a whim that I should do a marathon, and where better to begin than with the world's number one: London. I signed up in a flurry, for a moment disregarding my general lack of fitness. Opting to run for a charity, I chose MS-UK, which supports those living with multiple sclerosis.

I am proud to have supported such a worthy cause.

When it comes to marathons, luckily, at Credo, I was in good company. Our very own Chief Investment Officer, Deon Gouws, can only be described as a veteran, having run 76 marathons in his time, including 31 of the forebodingly named "ultra-marathons". So as the race approached, not only were my concerns assuaged by the wealth of advice I received, but also my colleagues were exceptionally generous. The vast majority of the £1,025 raised for MS-UK came from Credo.

# New starters on the Credo Team

## London Squad

### John Verkroost
*Equity Analyst*

A lawyer by training, John qualified as a solicitor with Freshfields Bruckhaus Deringer. Later, while working at Orbis, he transferred to the investment team. In his spare time John enjoys flying helicopters.

### Tony Thompson
*Business Support Analyst*

Tony has 4 years of experience in financial services, mainly working with execution-only brokers. Prior to joining Credo, Tony worked as a business support analyst at Selftrade. An enthusiast about IT's potential to transform financial services, Tony recently gained his ITIL Certification. He is also interested in graphic design and, of course, football.

### Emma Cooper
*Project Assistant*

Emma started her career at Barclays Wealth, working on numerous projects in both the Channel Islands and Scotland. Later, she worked with Interactive Investor, an online stockbroker, to help them remodel their dealing, settlement, and custody business. Outside of the office, Emma is a passionate chef, and has studied at a Scottish culinary institute.

## South African Squad

### Brendan Capstick
*Relationship Manager*

Brendan is based in our Port Elizabeth office, and holds a Bachelor of Commerce degree in Economics from the Nelson Mandela Metropolitan University. Prior to joining Credo he worked in business development at Old Mutual Wealth. He is currently studying towards the CFA qualification. Outside of the office, he is a keen rugby and golf fan.

### Quinton Coetzee
*Software Developer*

Originally from Boksburg, South Africa, Quinton moved to the UK just over 4 years ago. A committed Software Developer, after a long day's coding he likes to go home and code some more, and is currently designing a number of independent games. He joins Credo with over 10 years of experience. Prior to moving to the UK, Quinton played international paintball for South Africa.

### Lauren Monk
*Private Client Services*

Lauren read Psychology at the University of East Anglia and, prior to her realisation that she wanted to work in financial services, was going to become a clinical psychologist. She is a keen reader, and enjoys travelling and spending time with her friends and family.

### Gary Wilson
*Compliance Assistant*

Originally from Manchester, Gary has a Master's Degree in Law from the University of Liverpool. He moved to London two years ago to work as a Compliance Consultant for CCL, based in the City. In his spare time he enjoys cooking, reading, and travelling to explore new places.

### Caron Mackenzie
*Relationship Manager*

With over 18 years as a Business Development Manager, Caron brings a wealth of experience to Credo's South African operations. Prior to joining Credo she spent 10 years working at Allan Gray. Outside of the office, she is more than occupied with her two sons – aged 12 and 14 – and enjoys reading, travelling, and catching up with friends.

CREDO
WEALTH

**Important Notice:** This newsletter has been approved for the purposes of section 21 of the Financial Services and Markets Act 2000 by Credo Capital plc (reg. no. 3681529, registered office at 8-12 York Gate, 100 Marylebone Road, NW1 5DX), which is part of the Credo Group ("Credo"). Credo Capital plc is authorised and regulated by the Financial Conduct Authority in the United Kingdom and is a member of the London Stock Exchange. The content of this newsletter does not constitute an offer, solicitation to invest nor does it constitute advice or a personal recommendation. The different investments referred to herein have their own specific risks and recipients must consider their own attitude to risk, financial circumstances and financial objectives before deciding whether any particular investment is suitable for them and should seek advice from their financial adviser before investing. Recipients should be aware that past performance is no guide to future performance. Investments may go up or down in value, returns are not guaranteed and original amounts invested may not be returned. The value of any investment may fluctuate due to changes in tax rates and/or the rates of exchange if different to the currency in which you measure your wealth. Credo Capital plc, its associated companies and/or any of their employees may have positions in the investments referred to in this newsletter and may have provided advice or other services in relation to such investments. Credo has used all reasonable efforts to ensure the accuracy of the information provided, but makes no representation or warranty, express or implied, as to the accuracy or completeness thereof, or of opinions or forecasts contained herein and expressly disclaims any liability relating to, or resulting from, the use hereof. This applies in particular to any taxation consequences you may suffer as a result of any investment opportunity referred to herein, or as a result of any future projections, estimates or statements about future prospects of any investment opportunity described herein and to the extent to which any tax efficient investments are referred to herein or the tax consequences of any investment are mentioned, these are given for information purposes only and should not be relied upon as Credo does not provide tax advice. You should accordingly take your own tax advice before making any such investment. A non-UK resident making an investment must comply with any foreign regulation/legislation relating to the investment and must warrant that he/she will not breach the local securities or financial services laws or other regulations in such foreign jurisdiction. No part of the information may be copied, photocopied or distributed without Credo Capital plc's prior written consent.

*Paolo Bona / Shutterstock.com*