**The State of the Nation**

*Changing of the Guard*

Defiant to the bitter end, our beleaguered President Jacob Zuma finally succumbed to the palace revolt after his own party turned against him and his resignation heralded the end of the darkest chapter of the new South Africa. Under Zuma’s leadership South Africa’s image was severely tarnished by the cloud of scandal that followed him. The New York Times summed this up with the headline “Jacob Zuma’s legacy is a weakened South Africa” This legacy includes the looting of state coffers, mismanagement of state owned enterprises and the resultant credit downgrades.

Zuma’s successor Cyril Ramaphosa certainly has his hands full. He walks the tightrope of addressing endemic corruption and restoring investor confidence on the one hand and maintaining unity within the ANC whilst appeasing the aspirations of the masses on the other. He is widely recognized as the best man for the job. His credentials include the role of chief negotiator in CODESA, a prominent role in the organized labour movement and a high profile in the business community.

The initial reaction to the changing of the guard was somewhat euphoric and the State of the Nation address was broadly welcomed by all sectors of the community. With the prospect of the Mining Charter being radically overhauled and the promise of a cabinet reshuffle, expectations are high and sentiment is positive.

Markets were quick to react. The JSE ALSI index rose by 5% between 12 and 16 February. Simultaneously, our currency rose to a three year high level of 11.66 against the US Dollar the day after the so-called Zexit.

*Dealing with Volatility*

Investors do not cope well in uncertain times and the South African political climate is no exception. What we fear most is not risk, but the prospect of loss. Nobel Laureate Daniel Kahneman taught us that people fear loss far more than they relish success. To experience a loss elicits a disproportionately greater pain than the elation caused by the equivalent gain.

Behavioral economists remind us not to extrapolate short term trends or to have knee jerk reactions to unexpected events. The British Pound went into free fall following the announcement of Brexit, but in the ensuing months has steadily clawed back much of the lost ground. Many South Africans believed that the Rand was in a downward spiral from which we would never recover. The same analysts are now predicting increased Rand strength.

The old adage “it’s time in the markets rather than the ability to time markets” is the essential recipe for successful investment outcomes. The reality in the long term is that the performance of financial markets cannot exceed the extent to which the underlying economies grow and businesses are able to increase their earnings.

Therefore, we make our biggest mistakes when we are fearful and we over react to current obstacles. Over time, markets do bounce back if the underlying cause of a sell off is not rational. Conversely, markets do correct after they run too hard. The hidden danger of panic selling is in not knowing when to reinvest. It is easy to miss the boat if you sit on the sidelines, as you may be flat footed by the swiftness of the subsequent recovery.

A currency that is overvalued would tend to discourage the demand for that region’s goods and services. The ensuing decline in trade would leads to a slowdown of the domestic economy and a resultant currency weakness. This is a classic economic cycle. Nothing lasts forever and economic and business cycles are as much a reality as the changing seasons and weather patterns.

The most difficult aspect of volatility is that people sometimes react in the most unpredictable manner. Who would have thought that the election of Donald Trump as the President of the USA would have fueled such positive sentiment on Wall Street?

Volatility will be very much part of our landscape in the year ahead and in the run up to our next elections.

*Managing Risk*

Fundamental to the construction of an investment portfolio is the matching of asset classes to the required investment term. So for example if you need to set aside funds for the payment of provisional tax every six months, you would be best advised to retain your funds in a secure interest bearing account, albeit at a modest return.

However, if you have a 20 year time horizon before you retire, you would embrace volatility risk by selecting appropriate growth investments as the underlying assets of your retirement fund and you should not be deterred by cyclical fluctuations. In this scenario, your volatility risk would be mitigated by new fund inflows and short-term corrections would represent an opportunity to purchase investment units at relatively low prices.

We have alluded in previous Newsletters to the fact that each investor has different time horizons in respect of their different investment objectives. We would typically construct a cash flow model and determine a composite investment strategy that takes cognizance of your situation viewed holistically.

By combining different asset classes, investment destinations and currency exposures, you are able to smooth investment returns, as these all react in different ways to changing economic and political circumstances.

Whilst most investors are concerned about market volatility, many do not appreciate that a far greater risk is that of the erosive effect of inflation. Otherwise stated, the only way to preserve and grow your capital is through appropriate, though not excessive exposure to growth assets such as direct equity or property.

A further mechanism in managing risk is in the process of selecting investment managers. PKF Wealth has a strategic partnership with a research company who assist us, inter alia, with the selection of investment managers. Combining different investment styles can produce a range of outcomes in response to unforeseen events and this has the effect of reducing portfolio volatility.

In the context of the current South African political situation, our best advice is to stay focused on your long term objectives and commit to your selected investment strategy. Even the greatest optimist will realize that there are turbulent waters ahead. More often than not events on the global stage will have a greater effect on your personal wealth than domestic political issues. Our role as your financial adviser is to anchor you in challenging times through the application of our financial planning process.