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Protect Yourself from a Steadily Devaluing Rand by Investing in UK Commercial Property

During a webinar (web seminar) hosted by Scott Picken (founder and chairman of *International Property Solutions*) and Ryan Pinnick (professional trainer, speaker and coach) in February 2014 Picken, mentioned three very important facts:

- During 2013 the Rand's total value loss against the US Dollar was 24.08%
- Over the last 30 years the compounded loss of wealth in South Africa has averaged 29.5% per year
- The Rand has devalued by more than 6% year on year against the US Dollar for over 30 years

A significant contribution to the webinar was also made by James Paynter, a local market analyst. His opinion is well-respected in the investment community, and he is especially known for his ability to predict the value of the Rand relative to major currencies with over 80% accuracy.

Paynter discussed his methodology and presented some statistics based on his research:

There are two key drivers of the value of the Rand:

- Fundamentals – that determine long term trends, and
- Mass Sentiment – that determines intermediate trends

Within the **fundamentals** there are two influential elements:

- Productivity (that has fallen from 31% in 1981 to 19% currently, relative to that of South Africa's trading partners)
- Labour cost (that has risen from 37% in 1981 to 147% currently, relative to trading partners)

Against this backdrop of falling productivity and rising labour costs the Rand has had to devalue by 5-6% per year in order for our exports to remain competitive. Neither of these fundamentals appears likely to improve in the foreseeable future.

Regarding the impact of **mass sentiment**:

- Only 6.1% of the value traded against the Rand is attributable to actual goods and services (i.e. elements influenced by productivity and labour costs)
- The remaining 93.9% of trading is driven by market sentiment and speculative investment

- 64.1% of the speculative investment (and disinvestment) affecting the value of the Rand is in the hands of non-residents
- These foreign investors tend to be very fickle and react to risks, and perceived risks, by moving money in and out of developing countries like South Africa

Paynter also commented that,

> *"The charts of financial markets (like the Rand) are not a chart of financial data, but of the mass human sentiment in that market, and these emotions create patterns which repeat themselves – and are therefore predictable, just like weather patterns." and,*

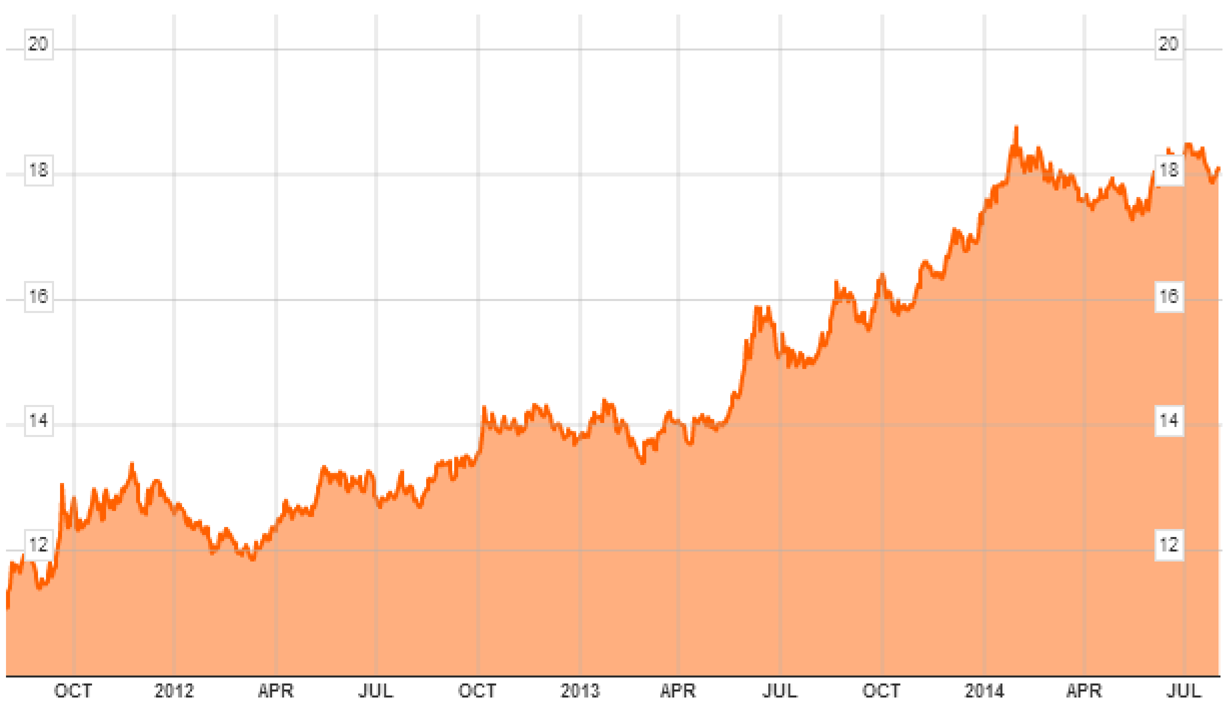
> *"Analysing past weather patterns helps us predict future weather, so analysing past patterns of sentiment helps us predict future movements."*

With this in mind, then, the past behaviour of the Rand is indicating a steady decline in value relative to major international currencies going forward. This will continually erode the real value of locally-held wealth.

Since the webinar was held, the Rand rallied slightly and then fell back to much the same level (R18.04 at closing on 11 February and R18.08 at closing on 31 July). This type of fluctuation is completely normal in currency markets – it is the long term trends that are most important from an investment perspective.

Two factors lend credence to Paynter's point of view and predictions:

1. The performance of the Rand relative to the Pound over the last three years has shown a steady decline, as illustrated by the graph below.



* Source – www.bloomberg.com

2. In the last few days, some positive news has emerged regarding the state of the UK economy:

- In the July 2014 update to its *World Economic Outlook*, the *International Monetary Fund* (IMF) stated that the British economy is now growing faster than that of all other major developed countries. Britain's economy is expected to grow faster than those of the USA, Germany, France and Canada. The IMF is forecasting UK economic growth at 3.2% for 2014 and 2.7% in 2015.

- On 1 August, *The Telegraph* reported that the British economy has now bounced back to pre-financial crisis levels, according to figures released by the UK *Office for National Statistics* (ONS).

Senior government officials reacted to this news with positive statements, for example:

- Prime Minister David Cameron said that the news was a "credit" to the hard work of the British people.
- Chancellor of the Exchequer, George Osborne, described the news as a "major milestone" for the country.
- Nick Clegg, Deputy Prime Minister said: " Today is a big day for Britain - the rescue has worked: our economy is now larger than it was before the crash."

All of this bodes well for the value of the Pound and the currency is widely expected to strengthen in the near future. Of course, a strengthening Pound means a weaker Rand in relative terms – even if the Rand does not devalue against other international currencies, although this is likely to happen as well.

It is important for South African investors to hedge against this risk. UK commercial property, especially in the secondary market, offers exceptionally good value for South Africans wishing to place capital offshore. Not only are property prices and rentals likely to rise significantly in the near future; but a devaluing Rand will actually add substantially to the wealth of locally-based investors that participate in the UK commercial property market.

However, as the UK economy recovers and the pound strengthens it will become progressively more expensive for foreign investors to enter the sector. An increase in demand driven by the expanding economy will also push prices up, making it harder to find quality commercial property deals that offer good value going forward.

Investing sooner rather than later remains the best strategy.