The Sixteen Secrets of Stock Market Success

A Dream come true…

CDW Oosthuizen

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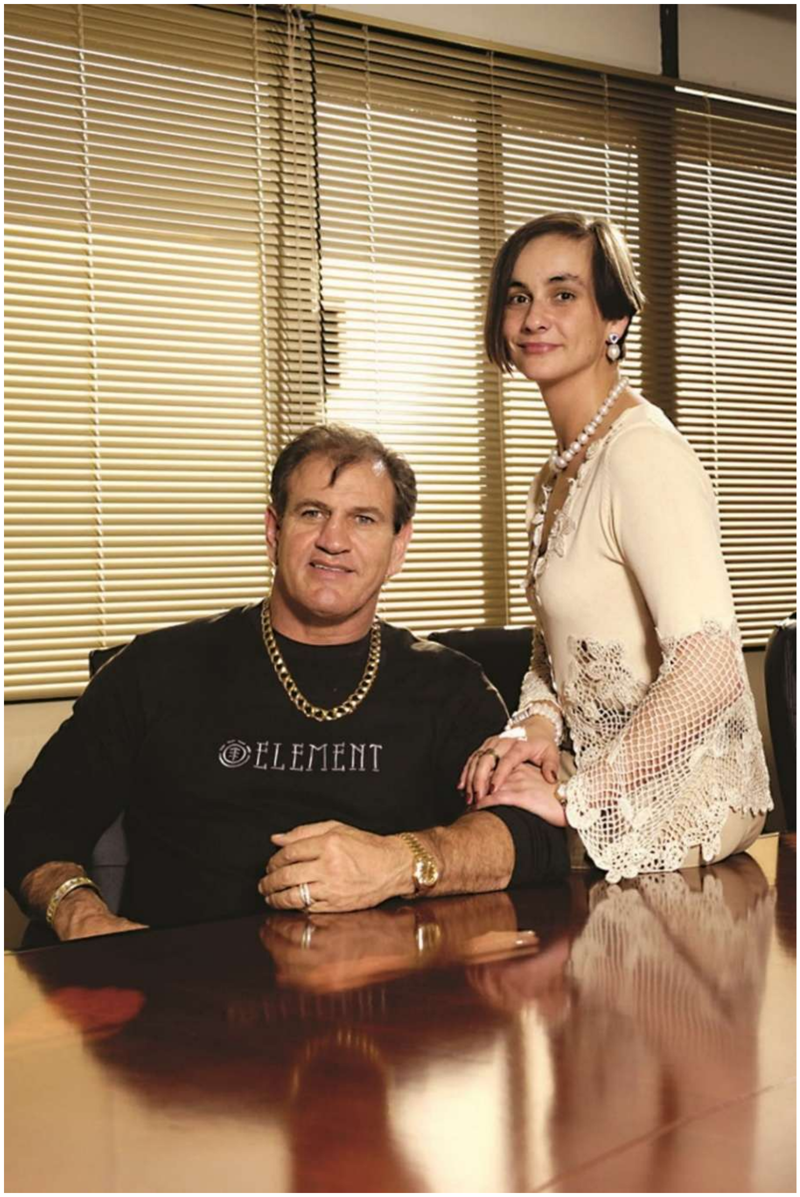
ACKNOWLEDGMENTS

I wish to thank my wife, the same Karien for her unstinting support in my efforts to achieve financial independence. Also, my teacher deserves a lot of credit (MAY THE FORCE BE WITH YOU). Finally, my colleagues at work, the people working close to me on a day-to-day basis. Thank you for your positive contribution to my world of goals and dreams…

Also, thank people like Napoleon Hill, who through his book, "Think and Grow Rich", kept me motivated in my darkest times…



Christo & Karien Oosthuizen

FOREWORD

It was a Friday evening at the airport in Los Angeles, with crowds of people pushing and shoving against me in the ticket office line, others rushing through boarding gates to get to their international destinations – the businessmen doing final work on their presentations, the long-absent family members who couldn't wait to get back home, and the newly-wed couples going on honeymoon… In my mind it was quiet, my thoughts rising above this everyday hustle and bustle… Is this the dividing line between the "rich and famous" and the poor? Is this how society separates you from the desirable lives of the rich, as if you don't belong there, are not part thereof? It was there and then that I made a promise to myself: I WILL return. I WILL visit Los Angeles again, but THEN, I won't be poor!

This was what I promised myself, firmly believing that through FAITH and a POSITIVE ATTITUDE *anything* is possible. Then a hostess startled me, interrupted my thought pattern, and directed me to counter 36. I booked my return flight to South Africa on the 11 pm flight connecting through London and made my way to the security checkpoint. Turning around and looking back at this life I so much wanted, for the last time as a poor person. "I'll see you again, but in much better circumstances…" I thought - then I was off.

I had come to Los Angeles to take up a career in computers. Computers had always fascinated me and I had managed to get a diploma in hardware maintenance. Somehow, America just seemed to offer more opportunities than South Africa, especially in the computer field. A Friend of mine had got me a job with a company in Los Angeles called "Your Image" which specialized in software that could change and improve photographic images – warts could be removed, receding hairlines restored and unwanted crows feet smoothed out. My job was to maintain and fix computers and support the software, but the company in many ways represented the American focus on the image.

Everything in Los Angeles was about what you looked like and if you couldn't fix your image with botox or a tummy tuck, well then, we at "Your Image" could fix anything and make you look wonderful. They were selling a part of the "American Dream".
I had been working in LA for three-and-half years, gaining experience and learning how the Americans did business. Then the blow fell. I was just six months away from being eligible for a Green Card when I received news that my visa had been denied. What a setback! I was forced to give up my job and return to South Africa. I had no choice. The authorities were just not interested in my problem. So I found myself boarding a plane for the land of sunshine and braaivleis.

I was a reluctant traveler. My dreams had been abruptly and unceremoniously terminated. Everything I had been working towards for the last three-and-half years was down the toilet. I was furious, disappointed, and depressed. It was like finding yourself on down the canvass in a boxing match. Now I would have to start again from scratch with nothing. I would arrive back in my home country penniless and I would have to rely on my relatives for support. I felt it was the story of life. I was always trying to get somewhere – then WHAM! I was zeroed again - usually by something that was outside my control. But the strange thing about adversity is that, if you have the right attitude, it makes you stronger.

My parents were divorced when I was young and my mother was left with six children to provide for. My father could not pay maintenance because he was unemployed and my mother tried desperately to make money by selling subscriptions to a record club – but she was not very good at it. Then one day when I was about 12, I came home from school and found that there was only dry bread in the house for me to eat. I decided that we could not go on like this – so I went out to try and sell one of my mother's record club subscriptions – and I succeeded! I found that I had a natural ability for sales. Pretty soon I was the second-best salesman in the company even though they did not know my name! All the deals had to be put through my mother because I was too young to be working. I came home from school each day and went out to sell. My mother insisted that I stay in school until I was 16 but I was always keen to leave.

At 16, I joined the South African Railways with a standard 8 pass. For four years I worked away shoveling coal on those old steam trains, but my early experience of selling had convinced me that I would not work for the railways forever. So after four years, qualifying as a stoker, I moved on to other things.

As a youngster, my father had taught us, boys, how to box. I had a flare for it and I just hated to lose. I ended up boxing for Western Transvaal and made it into the semi-finals of the South African middleweight division. From boxing, I learned determination and persistence. I learned to pick myself up after I had been knocked down.

And now, here I was with my hopes for a career in America in tatters. I was heading back to my home and my family. I had nowhere else to go. On the final leg to SA, I was woken by an air hostess switching the lights on. I tried to shift myself out of the uncomfortable position I had fallen asleep in. I opened my window blind, only to realize that we were over Africa and that we would be landing in about two hours. In the back of my head was an accusing, by now nauseating voice reminding me again – you don't have a life! Where to now? Where do you start? How do you begin to pick the pieces of your life back up? As breakfast was being served, I looked around at the other passengers, noticing that they looked glad to be back, excited to see their families. They were all absorbed in thought, paging through files, doing calculations…

Then, as if a switch went on inside my head, I realized: it's THEM! THEY are the ones with plans and goals. They are the business people who enriched their lives with this trip! And then I thought, "I was born with the same talents they have. What was I doing wrong? How could they be successful, and not me? I kept on looking at them as the announcement came that we had to fasten our seatbelts. I was trying to see inside their heads, and stared at them from behind as we disembarked, wishing that I could trade places with them - ANY ONE of them …

Two hours later, after collecting my luggage, I was welcomed by my family with friendly "hello's". I was glad to know that there were still people who cared about me, but I could not rid my mind of that irritating voice. I knew that not a single person in my welcoming party would understand my problems. Nor were they in the position to give me the advice that I urgently needed now, more than ever.

Later on that autumn evening, at my brother's house, he brought up that dreaded question that I had been running away from for too long. I understood that I had to face my future, but his words still cut like a sharp razor: "Where to from here? What do you have planned?" I had no choice but to admit to him that I was stuck in a deep, dark pit, and it seemed as if there was no getting out. I shared my fears with him, and the emotions I had experienced throughout my flight. His answer hit me like a bucket of ice water, "I'm sure that, if I talked to our Director, he would be able to fit you in somewhere as handyman or artisan's assistant." I realized that he had not listened to what I had been saying.

It suddenly dawned on me that he was – like most people – "just getting by". He had no real ambition, and he was stuck in what I later came to call "The Salary Treadmill". Every month he got his salary but realized that he had spent all of it before the month had even begun. He had credit cards to pay, an Edgars account, school fees, mortgage bonds, and a host of other monthly expenses. By the time all of that was paid there was nothing left. And so he just had to go on working for a boss to keep on paying the minimums on his cards and paying for his family. The one thing that terrified him more than anything else was to lose his job because, without that, he would have nothing.

So he was on The Salary Treadmill – round and round and round. And every payday he realized that he could not begin saving because he was up to his eyeballs in debt – but he planned to start saving in a few months.

But every month it was the same story – round and round and round – a never-ending cycle of working and paying, working and paying – never managing to save the capital necessary to break out of his situation. He was "making a living" rather than a "life" – and would probably continue doing that for the rest of his days. And he was offering me a "job" even more menial than his! I just couldn't bear the thought! It was the most depressing prospect I had ever faced.

But, work is work, and in the end, I had to provide for my children, so a week later I reported for duty, looking and feeling extremely awkward in my blue overalls. But people are strange creatures, they adapt much more quickly than we would like to admit, and I somehow came to accept this low-income "comfort" life that I was leading. Temporarily, that is.

For three months, I managed to control that devilish voice in the back of my head, to silence it, to suppress it… Until IT could be silenced no more…

The turning point came on a cold winter's morning. And when it came, it ripped my spirit right out of my body. My spirit was standing next to me, and seemed to be "talking in different tongues". It was asking, "Is *this* what you want from life? Is *this* where you want to be? Is *this* how you wish to use your talents? Do you want to *KILL* the awareness that you awoke in yourself in the Los Angeles airport? Are you not even going to *ATTEMPT* to climb the ladder of success?" This was IT – this inner voice. I had, by now, come to know and experience it as a sixth sense – to <u>listen</u> to it, to always be <u>aware</u> of it. I felt that there was a good reason for it to be there. I knew then that I had to listen to it, even though, at the time, I seldom really understood what it was saying. But now, eventually, I ***was*** listening. I ***did*** understand. And I turned my frustrations into action.

Since I began working again, I had been wracking my brains for a way to break out of my situation – anything to break out of my personal "salary treadmill". I tried to think of any way that I could make money - the kind of money that would ultimately enable me to go back to America as a rich man – and my mind went back to an earlier time before I went to America. It was a time when I had worked as a salesman for a company in Johannesburg called "Progressive Systems College". They specialized in selling a training course and software to help people to make money in the share market. I recalled the CEO of that company saying to us again and again,

"There are only two ways to make money in this life – you can work for it, or you can make your money work for you – and nobody has ever become rich by working for a salary!" Then he would say, "So you have to have some capital to invest and that means you have to budget and save"

And then he would say,

"Nobody cares about your money except you! I don't care about your money. I care about <u>***my***</u> money – <u>***you***</u> care about your money. So you should learn how to manage it effectively for yourself. Anyone you pay to do that for you will probably do a bad job - because they will get their commission whether you make money or not. They just don't care!"

These ideas made a deep impression on me at the time. I tried to remember as much as I could about that course and the share market. What had I learned? Where could I learn more? Surely there must be a way to make money out of the share market and the business of helping other people to do the same. I was deeply inspired by this thought. I felt intuitive that this of all things would satisfy that inner discontent that had been nagging me since I left America.

Then one morning, I found myself in front of a restaurant in Hatfield, a suburb of Pretoria. On entering, a friendly Greek man welcomed me and introduced himself as Peter, the owner. Everything in life happens for a reason, and, although I did not know it then, Peter ended up playing a vital role in my personal growth. After lunch, and a nice, casual conversation with Peter, I had the strongest feeling that 'I was there for a reason' and I knew that somehow, I had to seize the moment – but how?

Peter walked me to the door and we parted with a handshake. When I turned around, it was as if *everything* suddenly fell into place. Right in front of me was a board advertising furnished office space in big, black, bold letters. The second floor of the Saambou Building – it felt as if I was drawn there. I knew that's where I had to go.

The receptionist asked me to have a seat while she called the manager. I was paging through a Finance Week when I heard a greeting. I looked up to see a beautiful woman with long dark hair. She was wearing a red mini-skirt with a white blouse and silk stockings – and she had the most amazing legs I had ever seen! We introduced ourselves. Her name was Karien. She invited me to her office to discuss my requirements.

She was very businesslike - office size, how many telephone lines, what furniture was required, how often would I want to make use of the boardroom, and so on. She explained to me how the structure worked. Then she handed me the quote… I felt sure that she must have noticed that I nearly fell off my chair - and that I was lying when I walked away saying casually "I'll call you back", otherwise she wouldn't have offered to contact me should something smaller became available.

Within the same week, a nice corner office had become available, and I again went to Hatfield to meet with Karien. Even though it was less than half of the original amount quoted, I had to admit to Karien that I could not afford it as I had a mere R300 in my pocket. That did not seem to bother her. What I did not know at that stage, was that Karien also relied strongly on her sixth sense, and what she had suggested meant sticking her neck out for me. She was risking her position for me – a stranger with no money, that she had only just met!

It turned out that Karien's employer was visiting his business in Argentina, and would only return in a month. Karien suggested that I occupy the offices immediately, without any upfront payment, with the agreement that my deposit, as well as the rental, will be paid in full after three weeks.

Without hesitation, I grabbed this opportunity, and immediately signed the rental agreement. Karien showed me to my new offices and made sure that I was comfortable with all equipment and charges. Then she excused herself and closed the door behind her...

Now alone, I was suddenly back in Los Angeles… My current circumstances flashed in front of my eyes, and I thought about this unexpected opportunity to make my dreams a reality. I sat in my chair, rocking forward and backward, forward and backward, realizing that THIS, this was the opportunity that I had wished for and that from now on, it was all up to me – to make it a success. I thought, "If I mess this up I will not have anybody to blame but myself". I saw this as my *first step* in the financial world - my ONLY chance. I realized that such an opportunity would never come again.

I spent the afternoon in my office putting together my ideas for teaching ordinary people how to make money from the share market. And this was quite difficult because at the time I had never before bought a share in my life! But I had to have something to sell. I knew that if I just had a product, I would be able to sell it – I knew selling from my childhood. I had sold for Progressive Systems College and I had been successful in selling time share – so I was confident of my ability to sell. But putting that product together was a very big challenge because I knew very little about the share market at that time.

As I stood up I felt I had to share this wonderful news with my brother. I felt about 10 feet tall when I locked MY office door behind me.

Now it was time to "face the family". Both my father and brother are strong believers in 'job security', and would rather work for a boss on a small salary, than venture into the unknown or risk losing their small salaries. Furthermore, I was boarding at my brother's house, and was starting to wonder if he was going to kick me out when I resigned… Still, the thought of Monday, to start working on this dream of mine gave me butterflies and unknown courage.

That weekend was the longest I have EVER experienced. I spent hours on the Internet, researching all possible info I could get on the JSE and how it could make you financially independent in five to ten years. FINALLY, it was Monday. I was tall and proud to be back in my office. But I had no idea how I was going to make money. I only knew that I wanted it to have something to do with making money on the share market.

MONDAY

One by one my neighbors from the office block came to introduce themselves. All of them looked so positive and happy, even though the footprints of experience in the business world were visible on their faces. I again realized how important it was to succeed, not only for me but also to prove my family wrong.

Then Dirk Bezuidenhout walked into my office. He had a small office down the corridor and what he told me was like manna from heaven. He had a computer system that used moving averages and overbought/oversold to predict prices on the share market. When I said that this was exactly what I was looking for he agreed to show me the system the following morning.

TUESDAY

The next day I rushed in to see what he had. It was very primitive and did not even offer "buy" and "sell" signals – but for me, it was enough! We decided to call it "Time Series Analysis and Forecasting" or TSA&F for short and we priced it at R3800. Now I had a product all I had to do was to sell it – but I needed someone to sell it to. I looked around the office. There were some telephone directories. I chose the Middleburg/Witbank directory and began to phone people like doctors, lawyers, and engineers; because I remembered from my time at Progressive Systems College that they were always a good market for investment products. It took me ten calls before I managed to get one person to see me. And by the end of the day, I had made three appointments for the next day.

WEDNESDAY

I arrived at my first appointment wearing my suit and full of hope – only to find that he wasn't there and wasn't expected back. What a blow! He had me stood up. But I had two other appointments. I knew that I just had to make a sale on my second appointment – and I did. I walked out with a cheque for R3800! It was a fortune! What a feeling! At that moment I knew in my soul that I was going to succeed.

And so it continued. I worked the telephone book for opportunities to set up presentations in the mornings, went out selling in the afternoons and evenings, and then back to the office to complete all the paperwork and catch up on my administration. I dedicated 200 % of everything I had to my business success… Karien would sometimes find me asleep on the board room table because I had been there all night.

I managed to pay the rent and the deposit by the end of that month and the next month I made more than R40 000 worth of sales. In the third month, I began recruiting and training salespeople to go and sell for me.

After a year, Karien joined me as my administrative assistant and proved that she was both hard-working and efficient. She knew how to do all that back-office stuff which left me free to sell and train salesmen. After two years we decided that the TSA&F system was not suitable for our needs so together we designed and wrote the first version of ***Share Trackin*** in Lotus 123!

As soon as I had some spare cash I began investing in the share market. I was desperate to get "my money working for me". My first trade was for R1200. I was lucky, because, at that time, I still knew very little about the share market – but I stuck to my basic principles and I made a profit of R300 after my dealing costs! That gave me R1500. I added another R700 which I had spare at the end of the month and went back into the market with R2200. I continued building that portfolio whenever I had some spare cash. I will not tell you what my net worth is now, but I can say that within 6 years I had reached that magic point of financial independence

I have always been mad about cars so in 1998 I traded my old Fiat Uno in on a brand new BMW M3. In 2000 I moved up to an M5 and then in 2002 I bought a Porsche GT2. Next came a Ferrari 360 Modena, a Mercedes SL65, a Lamborghini Murcielago, and finally the Lamborghini LP640. In 2007 I bought a Lockheed Jetstar II – which can carry up to 11 people. And in 2009 I finally launched my yacht. It had taken me five years to build and cost R47 million, but it was quite exquisite!

I was the oldest of six children, a stoker on the railways from Boksburg, who left school at 16 with standard 8, but I made my dreams come true. My message to you is that you can do the same. With vision and dedication, you can achieve financial independence. In this book, I have concentrated all my ideas and experience on the share market into one place.
By downloading this book, YOU have decided to take action. You have decided to break out of your salary treadmill, and to share in the dream of financial independence! You have taken your first step. The first rule, as with anything in life, is discipline and perseverance. Creating unique investment routines, and STICK to THEM!

The stock market is the key. Only there can you catch hold of the coat-tails of the smartest business managers in South Africa – and ride the wave with them. You cannot be a director of Pick 'n Pay, Anglo American, Sasol, or Standard Bank – but you can benefit directly from their amazing skills and growth. It just takes a telephone call! Remember, no fortune in the world has been made without direct involvement in the stock market – and nobody cares about your money except you! So you need to take control of your financial life and begin to share in the dream!

Through the SIXTEEN simple ideas explained in this book, I want to place you in the position to look AFTER YOUR OWN MONEY, because who will look after your money better than you? Remember that you will still not be a qualified broker, but your knowledge will be firmly grounded on tried and tested strategies, enabling you to choose the best shares and to time your transactions for the best profit.

To you, who have read this and felt the same burning desire in your heart to achieve wealth, always remember the following words:

There are NO limitations to the mind, except those that we acknowledge!
Both riches and poverty are the offspring of thought...

Christo Oosthuizen

Christo an Karien presenting the Investor’s Choice prize of R1 Million to the winner of the 2008 Guts & Glory Competition, Mr and Mrs Pepler

Christo and Karien standing next to Christo’s Ferari 599GTB. The Ferrari boasts a V12 motor which propels the car to 100km/h from a standing start in 3,4 seconds and has a top speed op 330 km/h. It cost R4,5 million.

Christo’s Lamborghini Murchalago LP640, a V12 which accelaerates from 0 – 100km/h in 3,2 seconds, has a top speed of 335 km/h, and cost R4m. It is standing next to his Lockheed Jeststar II which can carry 13 passengers and 2 crew, one stop to Europe, at a cost of R20 Million.

One of Christo’s two custom Harley Davidsons. This one has a 1750cc engine and accelerates from 0 – 100 km/h in 3,5 seconds with a top speed of 220 km/h. It cost R450 000.

Christo an Karien's Luxury Yacht which took them five years to build and cost R46 million. It is powered by twin turbo 1050 horsepower diesel engines with ZF gearboxes. It is 90 foot long and weighs 130 tons. It carries 28 000 litre of diesel.

The lounge/dining room in the yacht fitted out in the utmost luxury.The boat has four en-suite bedrooms, a gym and a movie theatre. No expense has been spared.

The Sixteen Secrets of Stock Market Success

Secret No 1

"Set a concrete, achievable goal"

Achieving wealth is mostly a question of belief – belief in yourself and your goal. If you do not believe that you can – no, that you ***will*** – become wealthy, then you certainly will not. And that belief has to be based on a concrete, detailed and believable plan. It must not be some kind of self-delusion or "positive thinking" mumbo-jumbo. It must be real.

Firstly, let us define your goal. You would probably say, "The goal is to become rich" – but exactly what does that mean? Have you bothered to put a number to that or is it just a shapeless dream? It helps to visualize your dreams. Let's say, for instance, that your dream was a motorcar – picture what color the seats would be; leather or material; imagine air-conditioning, CD player, radio, GPS, and so on. With a financial goal, it must be numbers – solid concrete rands and dollars that you can believe in.

I think that the best way to define financial independence is:

That point where the return on your investments is equal to your monthly salary

Only at that point will you be truly *independent* of the need to work. It is a very clear and easy definition that will also serve as a concrete goal that you can work towards.

To make it real, you need to understand and believe in the numbers – just as you understood and believed in the color of your dream motor car. You need to believe that you can become wealthy by saving and investing. What are the numbers? They are an analysis of your salary, your savings, and the return on those savings that will ultimately add up to your wealth. You can do this exercise manually or, if you have a computer with a spreadsheet like Excel, you can do it much more quickly.

Begin with your salary. Assume that you will save 10% of your gross monthly income and that you will invest that saving into the share market to make a return of at least 30% per annum. Is such a return realistic? Yes, provided you spend some time each day studying how the market works and how you can benefit from it. The shares in the JSE Top 40 index have doubled every 4,5 years for the past 30 years – and those are the most conservative investments in the JSE. With a little attention, you should be able to do far better.

You can make the assumption that your salary will increase more-or-less in line with inflation, and because we have defined your goal in terms of your salary the exact inflation rate that you choose does not matter – because, as your salary increases, so will your savings - by the same percentage – the inflation rate (for those who are new to economics, inflation is easily defined as the amount you paid for your groceries last year compared to what you are paying for the same goods this year).

So create a spreadsheet with columns for the month/year, your salary, your savings, the return you will make on your savings, and hence the total value of your capital. For example…

Assumptions

Starting capital	R20,000
Annual Increase	10%
Salary	R10,000
Savings %	10%
Return	30%

Year	Month	Salary	Saved	Interest	Capital
1	1	R 10,000	R 1,000	R 500	R 21,500
	2	R 10,000	R 1,000	R 538	R 23,038
	3	R 10,000	R 1,000	R 576	R 24,613
	4	R 10,000	R 1,000	R 615	R 26,229
	5	R 10,000	R 1,000	R 656	R 27,884
	6	R 10,000	R 1,000	R 697	R 29,582
	7	R 10,000	R 1,000	R 740	R 31,321
	8	R 10,000	R 1,000	R 783	R 33,104
	9	R 10,000	R 1,000	R 828	R 34,932
	10	R 10,000	R 1,000	R 873	R 36,805
	11	R 10,000	R 1,000	R 920	R 38,725
	12	R 10,000	R 1,000	R 968	R 40,693
2	1	R 11,000	R 1,100	R 1,017	R 42,811
	2	R 11,000	R 1,100	R 1,070	R 44,981
	3	R 11,000	R 1,100	R 1,125	R 47,205
	4	R 11,000	R 1,100	R 1,180	R 49,486
	5	R 11,000	R 1,100	R 1,237	R 51,823
	6	R 11,000	R 1,100	R 1,296	R 54,218
	7	R 11,000	R 1,100	R 1,355	R 56,674
	8	R 11,000	R 1,100	R 1,417	R 59,191
	9	R 11,000	R 1,100	R 1,480	R 61,770
	10	R 11,000	R 1,100	R 1,544	R 64,415
	11	R 11,000	R 1,100	R 1,610	R 67,125
	12	R 11,000	R 1,100	R 1,678	R 69,903
3	1	R 12,100	R 1,210	R 1,748	R 72,861
	2	R 12,100	R 1,210	R 1,822	R 75,892
	3	R 12,100	R 1,210	R 1,897	R 79,000
	4	R 12,100	R 1,210	R 1,975	R 82,185
	5	R 12,100	R 1,210	R 2,055	R 85,449
	6	R 12,100	R 1,210	R 2,136	R 88,795
	7	R 12,100	R 1,210	R 2,220	R 92,225
	8	R 12,100	R 1,210	R 2,306	R 95,741
	9	R 12,100	R 1,210	R 2,394	R 99,344
	10	R 12,100	R 1,210	R 2,484	R 103,038

Here you can see that the spreadsheet is designed to:

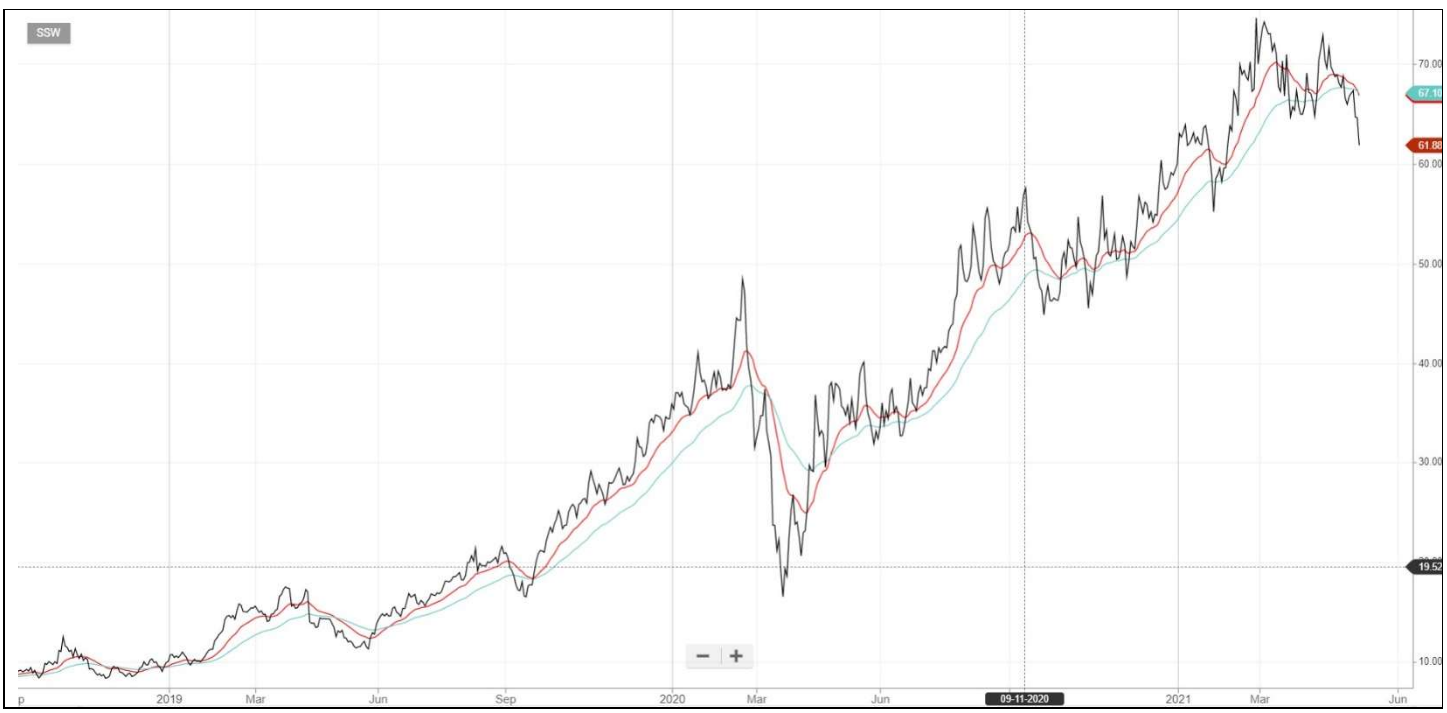
1. Automatically increase your salary by the inflation rate each year (annual increase)
2. Allow for a saving of 10% of your gross salary every month, and
3. To calculate the return on your invested capital at the rate of 30% per annum (or 30% /12 months).

If you extend this spreadsheet you will discover that using these assumptions you will achieve "financial independence" (defined as the point where your income from investments is more than your salary) in 9 years and 9 months starting from the month when you started saving and investing. Financial independence will come sooner if you increase:

1. Your savings rate,
2. The return which you think you can make, or
3. The capital which you have at the start.

But are these assumptions reasonable? Only you know what your financial circumstances are…

With proper budgeting (discussed in the next section) you will probably find that you can easily save 10% of your gross monthly salary. Your ability to control your spending depends on your belief in yourself. If you believe that you can get a decent return on your savings then it becomes worthwhile to save. People mostly don't save because they just don't realize the kind of returns they could make. It is not uncommon for high-quality investments to double their price in a year or so. Consider the following chart of SSW's share price, for instance:



In July 2018 you could buy SSW for just R7.20 per share. Today they are trading for RR67.00 each and they have been as high as R76.65. This means that if you had bought R10000 worth of them in 2018 @ R7.20 and just held on to them, your shares would be worth R106 466. today – a massive gain of 1064%, in less than Three Years! And I believe that the demand for Palladium and Platinum and will continue to increase and Sibanye will still do well into the future.

To expect to make 30% per annum or more on your capital is not unrealistic, provided you are well-informed and knowledgeable about the market. But this sort of return is only possible if you take control of your financial affairs and educate yourself in the workings of the share market and investment. While you are allowing other people to manage your money, your returns will always be mediocre – and could quite easily turn negative. Ask yourself, who is more concerned about your returns – other people or yourself?

I strongly urge you to build a spreadsheet like an example above. Or you could visit my website at http://www.sharetrackin.com/fica.asp. Apply your figures and make them into your specific target for achieving your goal of financial independence. Then, as each month and year passes, you will have the great motivation of watching your goal coming closer and closer – like watching the score in a game of cricket.

Secret No. 2

"Choose to be rich"

Most people do not manage their money effectively. They live from day to day and hope that the future will somehow take care of itself. They have a dream about becoming rich but take no steps to ensure that this dream becomes a reality. They do not save, and they borrow money from their future to finance a more lavish lifestyle NOW. This approach to money ***always*** comes unstuck in the end. Sooner or later something unexpected happens and those who have high debt levels and no savings find that they do not have the cash to get through it. Their situation is pitiable – but they only have themselves to blame.

So the first step towards becoming a wealthy person is to take control of your financial affairs. Remember,

"Nobody cares about your money except you!"

I do not care about your money. I care about my money. *You* should care about *your* own money.

Only by reaching out and taking responsibility for your money can you achieve financial independence. You have to ***choose to be rich.*** Most people do not realize that becoming rich is a conscious, deliberate choice – a decision that you make. And the opposite is also true. Being financially irresponsible is also a choice – but usually not conscious or deliberate. Usually, the decision to remain poor is unconscious and results from apathy or a lack of belief in yourself. So you can choose to be "consciously rich" or "unconsciously poor" and directionless. Whichever you choose will have enormous consequences in your life.

If you are "unconsciously poor" now, you can become "consciously rich". All you need is a plan and the patience and self-discipline to put it into effect. Never, never forget the "power of thought….!"

Unless you have a rich uncle who is going to die and leave you a fortune, there are only two ways to make money in this life – you can work for it or you can get your money to work for you.

And nobody has ever become rich by working for a salary!

In the history of man, this has never happened - because your boss will never pay you more than <u>just enough</u> to keep you doing what you do. He would be a bad businessman if he did. So your salary will never do more than ***just*** keep up with your immediate needs. It will ***never*** make you rich. To become rich you need to get your money working for you.

That means that you must have a plan:

1. Get out of debt;
2. Begin saving the capital base that will give you an income - ultimately enabling you to retire.

Such a plan begins with BUDGETING and there are two important points to remember about budgeting:

1. It must be done daily. It is difficult to remember everything that happened the day before yesterday - what you spent on what. You will find that if you leave it until tomorrow, you will tend to lose track – and then lose interest. Do it every day!
2. Budgeting is about the future – not the past. So there is no need for you to keep invoices and slips from shopping, or to get involved in tedious exercises to allocate expenses and so on.

3. You begin with your balance today and then work forwards into the future. The past has already happened and is no longer relevant.

You need to have a clear plan for how much money you are going to spend every day – until your next payday. You need to eliminate all your unnecessary spending so that you only spend what you have to. The best way to do that is to divide your money up into four sections:

a. Your normal monthly expenses (rent, child maintenance, phone account, etc.);
b. What you will spend every day on food and other consumables;
c. What you expect to spend on other more major items (such as petrol and entertainment) before your next pay-day; and
d. What you will save or use to pay off debt (same thing).

Follow these simple steps as soon as you have been paid:

1. Pay your normal monthly expenses to get them out of the way (item ”a” above). This should include the minimums on your credit cards and other accounts that you may have.
2. Calculate how many days there are until your next payday. If you are like most people on a salary, then you probably get paid around the 25th of each month – so, for example, if it’s a 30-day month, you will have 5 days until the end of this month and 25 days at next month. A total of 30 days until your next payday. If you are doing this exercise mid-month, then, obviously, there will be less;
3. Daily Allowance - work out how much money you need each day for food and other consumables. If you are a family man, then your wife will have to be involved in this. She will know what she needs to buy food and cleaning materials etc. daily. This is not just an estimate – it is also a goal, a target. Once the budget is in place then she must stick to this limit and even try to save some money from it.
4. Multiply the number of days left until your next payday (item 2. above) by your daily allowance (item 3. above).
5. Subtract this figure (item 4 above) from what you have left after paying your normal monthly expenses (item 1 above);
6. And from what is left after that, subtract what you expect to spend on other major items (item “c” above).
7. What is left after that is available for paying any unexpected expense and for paying off debt or saving. Remember that paying off debt is more effective than saving, because after a debt is settled, you will save on interest as well, and instead of paying it to your creditors, you add it to your savings.

If you have a computer with a spreadsheet program like Excel then this exercise is very quick and easy. Create a column for each day until your next payday. Consider the example of Joe Citizen and his wife, who have agreed that their daily allowance should be R250. Their budget spreadsheet should look something like this…

	Thu 26	Fri 27	Sat 28	Sun 29	Mon 30
Opening Balance	(5 045)				
Salary	16 000				
Balance	10 955	9 267	8 857	7 727	7 727
Days left	30	29	28	27	26
Daily allowance	7 500	7 250	7 000	6 750	6 500
Petrol	1 500	1 200	1 200	1 200	1 200
Maintenance	1 200	0	0	0	0
Credit Card minimum	500	500	500	500	500
Pocket money	200	200	0	0	0
Vet expense	500	500	500	500	500
Birthday – Fred	500	500	500	0	0
Entertainment	1 200	1 200	1 200	800	800
Books – Marcie	300	300	300	300	300
Total expenses	13 400	11 650	11 200	10 050	9 800
Month-end overdraft	(2 445)	(2 383)	(2 343)	(2 323)	(2 073)
Saving	3 100	62	40	20	250

Let us go through this budget, day by day.

On Thursday 26th, Joe Citizen had just been paid and had 30 days to go until his next payday. This means that each day that passes they (Joe and his wife) can reduce the number of days left to the next payday and the amount allowed for daily expenses falls by R250. Joe's salary of R16 000 wiped out his overdraft of R5 045 and left him with a positive account balance of R10 955. He and his wife worked out what money they would need to get through the month. His wife and he agreed that she needed roughly R250 per day to meet their food and consumables expenses – so this meant that they needed to set aside R7 500 (R250 X 30 days) for "Daily Allowance".

Beyond this, they expected to have to spend R1500 on petrol, R1200 on maintenance to Joe's ex-wife, R500 to pay the minimum on Joe's credit card, R200 for pocket money for their two children, R500 to get the cat neutered, R500 for their son, Fred's, birthday present, and R300 for college books for their daughter, Marcie. They also allowed R1200 for entertainment to enable them to take the family out on Fred's birthday, and for other possible entertainment (a film and popcorn) for the family during the month.

With all these expenses allowed for, they budgeted to pay out a total of R13 400 during the month – R2 445 less than Joe's net salary of R16000. This means that they budgeted to reduce Joe's overdraft by that amount at the end of the month.

On Friday 27th Joe sat down and accessed his bank account through the Internet. His balance was R9 267 – which meant that he and his wife had spent R1688 the previous day. Joe worked out that this amount was made up of the maintenance of R1 200, R300 worth of petrol for the car, and Joe's wife had spent R188 at the local supermarket. As you can see, the maintenance and the petrol came out of (and eliminated) amounts that had already been budgeted for, and Joe's wife spent R62 less than the R250 daily allowance. This saving was immediately reflected in a further reduced overdraft balance expected at the end of the month (R2445).

Saturday 28th is the day that the children get their pocket money, and Joe's wife spends R210 at the supermarket. This means that the family makes a saving of R40 on the day – which again reduces the expected end-of-month overdraft.

Sunday 29th is Fred's birthday, so the family pays R450 for a present for him and R400 to go out for supper. In addition, Joe's wife spends R280 on food and cleaning materials. So a total of R1130 is spent, but because Fred's present was R50 cheaper than the R500 that was budgeted for, it's a saving of R50 which more than covered the over-spending of R30 at the supermarket. The net result is that the family saved R20 on the day.

On Monday 30th Joe's wife does not go to the supermarket and the family spends no money at all. The result is a saving of the full R250 daily allowance.

Budgeting is like keeping score at a game of cricket. If nobody kept score, cricket (or any sport) would be completely uninteresting. Nobody would watch. Needless to say, over the past four days, Joe and his family saved an additional R384 – good for them!

It is keeping the score that makes the game so exciting!

Budgeting is like keeping the score of your life. Without it, that R50 that you spent on a whim in the supermarket does not matter. With it, that decision to spend that R50 in the supermarket becomes a serious matter. Questions are asked like "Do we need it?" Everyone in the family is motivated to stay inside the budget. Everyone is proud of the achievement of an extra saving. And with these extra savings, everyone can ultimately be rewarded!

Once you have a good budget working which your family understands and accepts, you can begin to pay off your debt. You should aim to get rid of all your debt except for the bond on your property if you have one. Once out of debt, you can begin to build a "capital base", and make your money work for you. That is the first step towards becoming rich. You need to do three things to get rich:

1. Spend less than you bring in by keeping a simple, effective budget;
2. Have the patience to wait while your debt is eliminated and your wealth accumulates; and
3. Make your capital base grow by effective investment in quality blue-chip shares.

If you cannot do these three things, then you will never become rich. If you can, then you will certainly become rich – it is merely a matter of time. Believe in "deursettingsvermoe", and …that Golden Virtue – Patience!

Secret No. 3

"Great investments are always bought – and never sold"

The financial world is inundated with a multitude of investment products aimed at the unwary consumer. As soon as you have a regular income, or have saved a little money, the salesmen or "guru" will descend on you, usually in the guise of a "financial advisor" or a "planner" and try to sell you their products. These products are inevitably institutional, particularly unit trusts and endowment or investment insurance policies of various sorts (including retirement annuities). Let us consider these two institutional investment products in more detail:

Investment Insurance: There are now a wide variety of investment insurance products available and the insurance companies have been inventive in re-packaging their offerings to make them more appealing to overcome consumer objections. But the truth of the matter is that endowment or investment insurance (including the retirement annuity) is almost always a terrible investment by virtually any measure.

I am not referring to term insurance here. Term insurance is the insurance you take on your car or your household possessions; it is your life policy or your disability policy – designed to protect you against risks that you cannot afford to take yourself. It is the original business of insurance companies. Investment insurance, on the other hand, is a type of long-term investment and should be seen and evaluated as such.

My attitude to term insurance is that you should have it only to the extent that you cannot afford to self-insure. For example, you may be able to afford the first R20 000 of a medical emergency, but not more than that, then a hospital insurance plan whereby you pay the first R20 000 and are insured for all expenses thereafter is better for you than a full medical aid which would be much, much more expensive.

As far as investment (or endowment) insurance is concerned, all insurance companies worldwide work in more or less the same way. They gather small amounts of money from hundreds of thousands or even millions of people every month. They pool those funds and invest them mostly on the stock exchange. There they can make 40%, 50%, or more, and when you turn 65 (or whatever age is specified in your policy) they give you back the money that you gave them, plus maybe 12% per annum (if you are lucky) – and with the difference they pay their salesmen fat commissions, their directors' nice bonuses, and their shareholder's handsome dividends.

It is better to buy the shares of the insurance company that is trying to sell you the policy than to buy the policy itself. In my experience, the shares of insurance companies offer a return that is generally several hundred percent better than any of their policies over the same time. In other words, it was better to be Donny Gordon's partner than his client (Gordon was the founder and chairman of Liberty Life).

I know of a person who bought R1000 worth of Liberty shares when they were first offered to the public by Gordon. Today those shares are worth more than R10 million – excluding dividends! I don't know of any insurance policy offered by any insurance company anywhere that has given a return anywhere near that – and I don't know anyone who has become rich by buying endowment insurance (although I know some salesmen who have become very rich by selling it!).

Consider Liberty Life. It went from being worth R1.49 per share in February 1985 to R145.50 per share in April 2016 – ***excluding dividends***! Has your endowment policy or retirement annuity done that??

And investment insurance policies have one other major disadvantage – once you have "bought" into them it is almost impossible to get out of them without paying huge penalties. In other words, if they are an investment, they are a very illiquid investment that is very difficult to get rid of.

Unit Trusts: roughly four out of five unit trusts throughout the world under-perform the indexes of the markets in which they participate. For me, this fact is a severe indictment.

There are many reasons for this poor performance, not least of which is the fact that they have to meet statutory requirements for holding cash (5% of their portfolio in South Africa). Another is their sheer size which restricts them to buying only the so-called "institutional stocks" which are the most heavily traded of the blue-chip shares on the JSE. But none of these reasons offer much comfort to the investor - and the enduring question must be,

"Why should you pay somebody to have the virtual certainty of under-performing an average?"

This you could do for yourself without paying anyone! After all, if you accept that the index is a mathematically correct average of the market, then, theoretically, if you chose your shares completely at random, they should perform in line with that index over time. That must be true because the index is an average of the shares that you are selecting from!

The unit trust industry, observing this consistent under-performance has resorted to setting up the so-called "index funds" which are unit trusts that exactly mirror the make-up of the index. That way they can at least be sure to perform in line with it!

But from my perspective both insurance companies and unit trusts (whatever their type) are essentially middlemen who stand between you and the share market, skimming off or losing the lion's share of your performance. The JSE is the engine of growth in the South African economy. That is where the wealth is being made. What you don't need is a whole lot of middlemen standing between you and that engine, skimming off your profits.

If you study the share market you will see that over the years there have been several truly great investment opportunities. These were opportunities to make several hundred percent on your capital in a relatively short time. For example, the listing of Capitec on the JSE. The initial public offer of shares was over-subscribed more than 100 times by excited investors. The smart investors knew a winner when they saw one. And Capitec did not need to send out any commission-only salesmen to sell their shares to achieve this. This underscores a very important truth…

“Great investments are ***always*** bought – they are ***never*** sold”

Look at the performance of Capitec Bank, for instance:

Capitec listed on the JSE on 4th January 2006 @ R28.50 a share and rose to 1594.00 on 14th May 2021 (When this snapshot was taken). If you had invested R10 000 (±350 shares), when it was listed in 2006, your money would have grown to R557 900.00 (5 579%), to date.

So what does this tell you? It tells you that when there is an exceptional investment opportunity in the market the “smart money” will probably smell it out long before you ever hear about it. You don’t see these same smart investors lining up to buy unit trusts or insurance policies. If they were such great investments they would all have been snapped up long ago. So the fact is…if a company has to send out a salesman to sell you an investment then you don’t want it – by definition!

<u>Secret No. 4</u>

“Be organized, efficient and disciplined”

Once you have paid off your debt and you begin to build a capital base of savings, you should focus your mind on learning as much as you can about investment in general and the share market in particular. Think of it as starting your own business at home in your spare time. The same things that will make you successful in business will make you successful in the share market. Be organized, efficient and disciplined.

You need to spend about 45 minutes a day concentrating on your goal of becoming financially independent. I suggest that the early morning is the best time for this. That is your “control” time when everyone else is asleep and the phone does not ring. No one will interrupt you. The share market is closed and for a while, you can have the same information as any investment analyst or stock broker anywhere in the country. Think about this…

In time, you will make more money in the 45 minutes you spend studying the markets and your financial goals than you do in the rest of your day put together – more or less irrespective of what your profession is.

I am always amused by people who say they do not have time to study the markets. How can you not have time to make money?! What are you doing at your work if it is not trying to make money? This attitude is foolish in the extreme. The time you spend studying the markets is the most important time of your entire day – and you should treat it as such.

But your time is limited and valuable.

The share markets of the world produce more information in a single day than the average person could absorb in a lifetime. The amount of information available is truly daunting and your problem will be to find ways to sift through it all and to pick out the important ideas that can make money for you. You will need to learn to narrow the field down in such a way that your time is spent ***profitably.***

In the share market, <u>time</u> is your most important resource – not money – because how you spend your time will determine how you spend your money.

So how should you allocate your time? Your priority is to search for interesting-looking shares which might have the potential to be good investments. This search can be done in five primary ways:

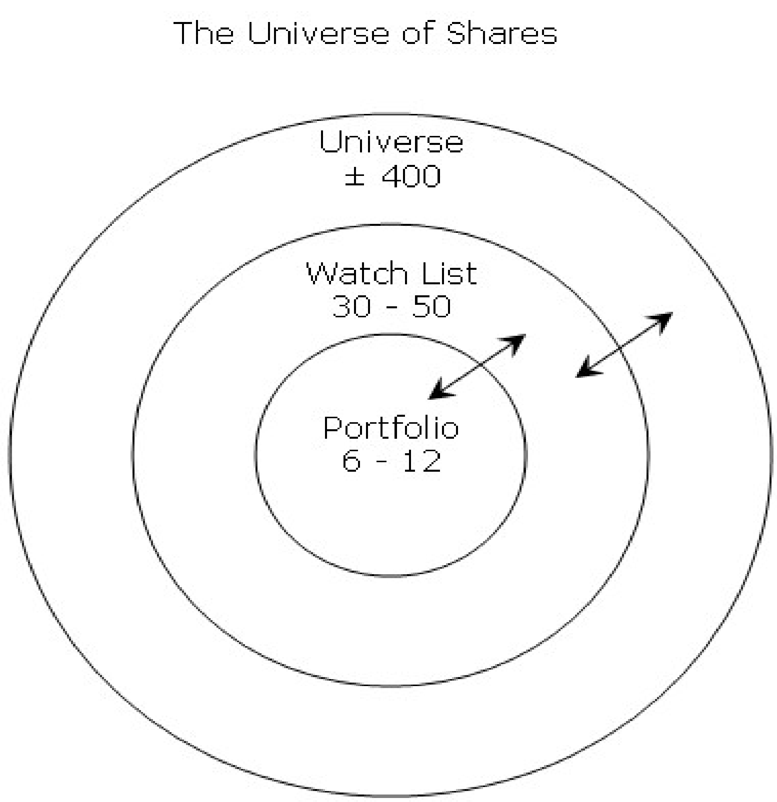
1. Through the financial media. You should read all the articles about listed companies in your daily business newspaper. You should listen to one of the daily radio programs on the stock market, and especially when they are interviewing the CEO of different companies. You should watch CNBC Africa channel 410 television when they have transmissions of the Investment Analysts Society meetings. These meetings are given by listed companies to report their financial results. All these sources will throw up a steady stream of shares which might have the potential to be profitable.
2. Listen to your friends and business associates. Often one of your friends or acquaintances will have the inside track on a particular company or industry. This type of information can be very valuable. You should question such people closely if you think they are a good source of information and keep their contact details. Beware of “tips”, however, because they can often be dangerous. The secret is to confirm the tip by doing your homework. Ask yourself this, “Would I have bought this share even if I did not get the tip?” if the answer is yes then you can proceed with caution, but if the answer is no, you should probably avoid the share.

3. Financial analysis can often throw up interesting-looking investment ideas. By keeping track of the financial year-ends of companies and then researching in advance what you think they might report in their results you can sometimes get in before the rest of the market is aware of an under-priced share.
4. Technical analysis can also throw up some interesting opportunities. Most charting packages have well-developed scan facilities which enable the user to search for shares that conform to specific criteria. By narrowing down the field in this way you can create a shortlist of potentially profitable ideas.
5. Economic analysis. If you study the economies of the world and their inter-relationships you can often see which industries are likely to benefit from broad trends in commodities, currencies, technologies, and other areas of particular growth or unexpected developments. All major changes in the economic environment carry the profit potential. The problem is to determine exactly how you can invest to exploit them. Begin with an analysis of the world economy. Move on to how this impacts South Africa and then which industries will benefit. From there move down to the specific companies in that sector and finally to the exact timing of your move.

For the private investor, shares fall into three broad categories:

1. The "universe" of shares that are listed and traded on the JSE
2. From this universe, a "watch list" of shares may become potential profitable investments.
3. A portfolio of shares that will be bought and held in your portfolio.

Consider the following diagram:



All three groups are dynamic. Shares are being listed and de-listed all the time. Companies are merged or taken over by other companies – so the composition of the universe of listed shares is always changing.

From this list, you are going to select perhaps 6 or 8 shares to buy and hold. This means that you are probably looking for the top 2% of opportunities in the market. With that in mind, your watch list should only contain those shares which you believe could fall into that category of the top 2% of opportunities. As soon as you think that they do not, then you should drop them. So shares move in and out of the universe of shares, in and out of your watch list, and in or out of your portfolio.

To decide which shares to include in your watch list and then into your portfolio, you need to develop a series of criteria. These are like "tests" which a share must pass before you will include it.

Size might be an important criterion. Perhaps you want to be invested only in blue-chip shares with a long track record of profits rather than secondary shares or penny stocks. To determine which category a particular share falls into you need to consider its market capitalization and perhaps whether it is in the Alsi40 index, the mid-cap index, or the small-cap.

The next criteria might be the volume traded. You do not want to be in shares that are very "thinly traded" because then you might not be able to get out of them when you want to. You should look for shares that have a good quantity of shares traded each day. That way you can be sure that you can sell out on your stops if necessary. Here is a typical bar chart that shows the volume traded as a histogram:

You can see the volume histogram at the bottom – and notice how the volume increased as the "smart money" bought heavily into the share at the lowest point in the cycle.

Then you might formulate a criterion based on the company's profit track record. Perhaps you would like to invest only in companies which have increased profits by an average of 15% per annum for the past three years. This type of information can be obtained from your handbook or the company's website.

You can formulate criteria based on the company's exposure to union activity or the strength of the rand. Criteria can be technical, such as looking for shares that are oversold to a certain level. There are many criteria that you could impose on shares before you include them into your watch list or your portfolio. But you need to begin by developing such criteria, applying them, and testing them.

Secret No. 5

"Never buy investments that you know little or nothing about"

The decision to invest is usually both emotional and personal. And it is reasonable to assume that, whatever investment you are making, is important in the context of your current financial position. In other words, the amount involved is significant for you – either because it is a substantial proportion of your total net worth or because it has been difficult and perhaps even painful to accumulate the money that you are going to invest. Either way, its loss would represent a material calamity in your life.

And yet, despite its importance, it is amazing to me how little time and effort most investors are prepared to put into ensuring that:

1. Their capital is well-placed
2. The risk they are taking is proportional to the potential for return; and
3. That they minimize that risk by learning as much as possible about the investment vehicle they have chosen.

Rather than do their investigation, however, most investors show an amazing willingness to accept the arbitrary advice of those who they perceive as "experts". And anyone who shows the slightest knowledge of investment (like someone you met at a braai) is instantly promoted into that "expert" category.

I have come to think that this strange reluctance of investors to get "down and dirty" with their stock market investments has something to do with the intangible and abstract nature of those investments. For example, they demonstrate no such squeamishness with tangible investments like property.

Consider, would you buy a house that you had never seen? Of course not. And yet investors make substantial purchases of equities every day without even a basic understanding of what they are buying. Similarly, you would not buy a house on a tip from a friend or the recommendation of an estate agent – without going to look at the property yourself. And yet, people regularly invest millions of rands in the stock market without knowing who the managing director of the company is, or even what the share's highest and lowest price was last year.

So my recommendation to you is that, if you want to buy shares, you should do your homework first. The information is readily available. Most of it can be obtained from the internet or your local newspaper and more can be obtained directly from the company itself. And, as with a property, there is nothing to beat an actual visit - to see what exactly it is that you are buying.

Begin with the Stock Exchange Handbook. This is a book which is produced three times a year – every four months (available from all leading bookstores). It carries a wealth of useful data about every company listed on the share market, including abbreviated financial information over the past three or four years. It gives the contact details for the company including its phone numbers and web address. When you come across a listed company that interests you, this book will give you an initial idea of what the company does and how it has been doing it.

You need to get and read a daily business newspaper. There are two options in South Africa - The Business Day and The Business Report (which is a supplement to The Star and several other regional papers). You need to read all the articles about individual companies and the economies of the world. Read anything to do with major commodities like gold, platinum, oil, coal, and chrome. These prices are critical to the South African economy and many listed companies. Try to learn about the individual markets. For example, what are the factors which impact the coal industry and the international price of coal? Learn about the different types of coal and the costs of transporting coal to Europe and about our major competitors in the coal industry – like Australia. Or think about the price of palladium and its uses in manufacturing. Who buys it? Who produces it?

What is the current supply and demand position? Make it your business to be well-informed on these subjects. Here is the chart of the palladium price since 1998:

When you find an article about a listed company does a little research of your own. Firstly, look up the share in your Stock Exchange Handbook. Find out its "nature of business" and see who the directors are. Look at its volatility (its "beta" rating) and see whether its profits are rising or falling. Look at the financial ratios and see whether the debt: equity (D: E) is rising or falling.

If you like what you see, Google the company to see what other articles have been written about it recently. This will bring you up to speed on what is going on with it. Is there an imminent takeover or merger? Has there been any bad news or an announcement by the board? And so on.

You should also visit the company's website and read through everything carefully. There you will find its most recent financial statements. You should compare this to what you see in your handbook to get a better understanding of where the handbook figures come from and what is left out.

Create a file for each share that you become interested in. In that file put a copy of its most recent financial statements and any recent articles about it. If it is a commodity share add articles on the current situation of that commodity.

You need to take the attitude of a detective. Dig, scratch, and find out everything that you can about the company. Watch its share price closely and look at the volume traded every day. Gradually, you will get a very good feel for the company and the market action surrounding its share price. After a time you will see that it is at an opportune moment to buy.

Most of us have a lifetime of experience in dealing with people and assessing business. Through our work, we have developed a good sense of how a business should be run and how it should treat its customers.

This knowledge and experience are invaluable because it enables us to evaluate potential investments. So the next step is to set up a visit to the company that interests you.

If you contact a company and say that you are an investor and that you would like to come and talk to the Chief Executive Officer or one of the directors, they will normally be happy to arrange it. Remember, they do not know how much you want to invest. You could be a big institutional fund manager. You may not get to see the CEO himself, but if he is not available, then usually one of the other directors will assist you – which is sometimes better because the CEO is more used to dealing with the public and can be very guarded and cautious. He may not give you very much which is useful to work with.

Before you go to this meeting make sure that you have read and studied everything available to the public. You do not want to be asking the CEO questions which can easily be answered from the company's website. You must tell the CEO that you are ***not*** a journalist and that what he tells you will not appear in the press – you are just an interested potential investor. This should make him less guarded and more willing to disclose important information. After all, this company is – or at least should be – his passion.

And passion is what you are looking for. The best profits in the share market are made because of the passion of the people running the business. If they are genuinely excited about what they are doing then they will likely do it extremely well. The CEO and his directors must be the kind of people who can inspire their staff with a shared vision and make them passionate about the business. And that, of course, is why you have to visit the company – because you cannot read passion off a balance sheet. You have to go there and look into the CEO's eyes.

Often the CEO will arrange for you to have a tour of their facilities – the factory floor, the work shop, or the mine shaft. Such a tour can give you an invaluable insight into the business, especially if you are permitted to talk to the staff that you meet. Then you can ask them questions like, "Do you enjoy working here?" and "What do you think of your CEO?" and so on. You get a feel for how efficiently or otherwise the company operates. You can gauge their excitement and passion for the business. Little details can be indicative of how the organization as a whole runs. Ask yourself how you would run it if you were the CEO.

The best time to visit the company is after the end of their financial year, but before their financial statements are published. During this "window" of about 2 or 3 months, the directors of the company usually have a very good idea of how the company did, but the investing public is still ignorant. The CEO should not divulge how the company did, but you should at least be able to get a very good indication. Remember, the whole purpose of visiting the company is to try to get a better feel for its business than other investors have. You are looking for an edge.

Be sure to obtain the personal phone number of the CEO or the Director that sees you so that you can phone him later with any other questions which may occur to you. He will be your future contact in the business. For that reason, it is always good policy to send him an e-mail to thank him for his time and attention.

Your objective is to get to know all the companies listed on the JSE over time. Take a pride in having a good working knowledge at least of all the major companies and their inter-relationships.

Secret No. 6

"Use an effective and intelligent stop-loss strategy"

Perhaps the greatest problem which investors have in the market is to retain their objectivity. We all experience two powerful emotions which tend to keep us poor – our fear and greed. Of these two, fear is the worst because it paralyzes the mind. When we are losing money we feel pain and anguish which prevents us from assessing the situation clinically and taking the necessary remedial action. One of the ways to combat this is to use an effective stop-loss strategy.

In its simplest form, a stop-loss strategy is a mechanical system for selling an investment when it has fallen by a certain amount from its highest point since being bought. So, for example, if you buy a share for 1000c you might consider putting in place a "stop" to sell it if it falls by 10%. Thus your stop would be set at 900c. Alternatively, if the share goes up then you maintain the stop 10% below the highest price that it has reached since you bought. Thus when the share reached 1700c your stop would be set 10% or 170c lower at 1530c. Then, after making this high at 1700c, if the share began to fall you would sell out at 1530c – assuming you had not already sold for other reasons. In this way, a stop strategy works like a ratchet in that it can only move upwards and not downwards. It is a way to lock in your profits as your investment rises while cutting your losses should the share begin to fall.

A stop-loss strategy, like the moving average, takes advantage of the fact that the share market tends to move in broad sweeping trends. The stop will get you out if the direction of the trend changes unexpectedly – provided, of course, that you have the self-discipline to act on it. It is a sober truth that.

"Being successful in the share market is not so much
about making money, as it is about not losing it!"

If you have some experience of investing you will immediately know that this type of stop would have saved you plenty of money had you implemented it rigidly. Think of it this way…

The share market tends to go up over the long term – perhaps by as much as 15% per annum on average. Consider the JSE overall index since 2003 – a period which includes the 2008 crash and the 2020 Covid-19 adjustments:

This steady growth over the years reflects the ***inflation rate and the real growth*** of the economy – since most of the companies involved in creating that growth are listed on the stock exchange. The JSE overall index is an actuarially weighted average of that market and while it may have the occasional down year it generally moves upwards. This means that, if you buy shares, your statistical probability of buying a winner is already higher than that of choosing a loser – ***and you can apply a stop-loss strategy!***

Imagine if you could apply a stop strategy when playing roulette at the casino. Then, every time you won, you would double your money and every time you lost you would only lose 10%. This cannot be done on the roulette table, but it can be done in the stock market. If you have a strict stop strategy then your winners could make 100%, 200%, or more for you while your losers would only cost you 10% - or let us say 15% including your dealing costs. And, unlike the roulette wheel, the odds of choosing a winner are actually in your favor on the stock market – even if you choose your shares at random because the market on average goes up.

A simple percentage stop is the easiest to implement, but it does not take into account some of the complications of the market and your risk exposure. The first problem is that it does not take into account the fact that shares fall by the amount of a dividend on the ex-div date. If you are holding a share when it goes ex-div then you will need to adjust your stops down by the amount of the dividend or you could find yourself kicked out of the share for no good reason – especially if you allow your broker to execute your stops.

Other problems are more subtle. For example, it makes sense to adjust your stop for the degree of exposure that you have to the particular share or investment. This is rather more complicated. This requires you to make decisions about the number of shares that you want to have in your "ideal" portfolio. Opinions differ on this point. You must spread your risk by owning more than one share – but the question is, "How many?" Each additional share reduces your risk – but by less and less as you add successive shares. However, each additional share spreads your available time for investment analysis more thinly. So there is a trade-off. Studies in the United States have demonstrated that if you have 14 shares in your portfolio then the reduction in risk achieved by adding the 15th share is negligible. So probably the most sensible compromise is somewhere between 5 and 15 different shares.

Let us assume, for this discussion that you decide that, ideally, you would hold 8 shares in your portfolio. By dividing your capital available for investment by 8 we can arrive at an approximation for how much you would invest in each of these 8 shares assuming that they were of equal investment merit. So, for example, if you have R800 000 to invest and you would ideally have 8 shares in your portfolio then if all your investments were of equal merit, you would put R100 000 into each of those shares.

But, of course, we all know that all investments are not of equal merit. You may be tempted by an extremely attractive investment idea which you are very positive about putting in R200 000. This doubles your exposure to that share and so doubles your risk if you are wrong and it does not perform as you expect. I suggest that because of that you should cut your normal stop-loss percentage in half. So if you normally use a 10% stop then, where you have double your normal exposure you reduce that to 5%. That way, your increased exposure is offset by a tighter stop.

The problem with this idea is that as the market value of your portfolio changes every day and so does the average value you would put into each of your 8 shares. This means that you must continuously adjust the percentage stops on each share that you hold to reflect your changing exposures.

I have found it useful to maintain my stop strategy in an Excel spreadsheet of my portfolio in which I update daily. I have built formulae that re-calculate my stops as the market prices of my shares change. I also put in adjustments for dividends on the ex-div dates and so on. Many possible adjustments can be made to your stops. Indeed, there are many different approaches to setting stops aside from a simple percentage. For example, some technicians feel that it makes more sense to establish stops in line with specific support and resistance levels in the share's chart.

However you choose to do it, one thing is clear – it is better to have a simple percentage stop than to have no stop at all. And the most advanced stop strategy is of no value unless you implement it strictly. It's like that seatbelt in your car. It does not matter what brand of seatbelt you have – so long as it is buckled up when you have your accident!

I began this discussion with the idea that a stop strategy helps to overcome emotion in the market – specifically the emotion of fear. If implemented strictly, it will force you to admit your mistakes when you make them - and then act on this admission.

What is important about stop-loss is to set your stops before you buy – not afterward when you are in trouble. Psychologically, you will be out of position once a share that you own has fallen. The fear will already be upon you and your opportunity for objective thought will be gone. You must do it when you are at your most positive – which is just before you buy. Later will be too late.

And I have found it useful to value my shares at their stop-loss levels in my mind. This minimizes the pain of selling out when they reach their stops. Returning to our original example, if you buy a share for 1000c and your stop is at 900c then you should think of that share as being worth only 900c from the moment you have bought it. This means that the very act of buying a share is the act of taking an immediate loss (equivalent to your stop). The point is that cash is a risk-free asset (at least in the short-term), whereas shares are a risky investment. I am suggesting that you should pay for this risk up-front at the time of purchase. That way you will be well-positioned psychologically to sell when they reach their stops.

More conservative investors and particularly institutional fund managers might scorn the idea of a stop strategy, but the question you need to ask yourself is, "How much are you prepared to lose?" For example, are you prepared to lose as much as 50% of an investment? This seems nonsensical since a 50% loss means that you must then make 100% to get back to where you started from, without taking into account inflation and the opportunity cost of your money. If you are unwilling to take a 50% loss then we have at least established that you must have a stop strategy – because how else can you avoid such a loss? The next question is what percentage you are willing to accept. I do not like to lose more than 15% on any stock market investment – ever. And that includes my dealing costs. So my stops are never set more than about 12% out.

I say again, imagine if you could go to Monte Casino's roulette wheel and apply a 15% stop! Yet in the JSE you have a market where the odds are already in your favor and you can apply a stop. The only thing stopping you from making money in the share market is your ignorance.

Secret No. 7

"Maintain an objective mental posture"

Many years ago, William O'Neill, editor of *The Investor's Daily* – the only serious competitor to *The Wall Street Journal* in America, suggested that "mental posture" was the key to separating those people who make money in the share market from those who do not. Mental posture is defined as the investor's emotional response to the share market and more especially to the shares that he/she holds.

The emotions of fear and greed, mentioned in the previous section, on stops are primary, but there are many others - such as a pang of guilt, shame, elation, and ebullience. These emotions interfere with our ability to make sensible decisions timeously. They cause us to become impulsive and to either abandon or ignore our careful research. And we have no escape from our emotions. The best we can do is to recognize them when they are in play and to adjust our trading strategy accordingly. Mechanical systems such as a well-developed stop-strategy or a trading strategy of "buy' and 'sell' signals will help provide if we have the self-discipline to act on them.

Your emotional response to your money can overwhelm your reason and cause you to act incorrectly – or, worse, not to act at all. For example, if you have bought a share and it has fallen you will be caught in emotional turmoil. Your reason will tell you that you need to sell the share to avoid further losses and protect the bulk of your capital, while your emotions will rebel against selling because the very act of selling and taking a loss is a clear acknowledgment of failure.

Such feelings are closely tied up with your self-image and even your personal history of success and failure. If you have low self-esteem, you may regard a loss in the share market as the continuation of a pattern of failures reaching back into your childhood. This is incorrect and irrational, but the willingness to face up to failure is a key problem in the share market, especially among beginners. If you are not comfortable with facing up to your mistakes you will find the share market a very uncomfortable place because even the smartest investors make mistakes regularly – that is the nature of markets. As one investor put it, "You need to develop a taste for egg on your face."

Professional investors understand that investment is not about certainties. It is always a matter of probabilities – which means that there will be regular failures. The critical issue is whether the successes outnumber the failures or not. But if you have insufficient confidence to cope emotionally with making mistakes in the market then you should not participate. Because there will always be bad selections and bad timing decisions. The secret is to cut your losses when you make a mistake and to move on as quickly as possible.

Similarly, there will be innumerable missed opportunities in the market. Every week several shares in the market move up strongly and most of the time you will not be in a position to benefit from them. Consider the "Weekly Top Ten Up" section on the price page of most newspapers. This shows the 10 shares which went up by the most in percentage terms over the past week. These are opportunities to make substantial capital gains that you missed. Mostly, when reading this list of "winners" you will not experience any strong emotions. It does not bother you that there are ten shares that you completely missed.

But if you have recently sold one of those shares you will almost certainly experience a strong emotional reaction – even if you made a good profit on the sale. You will feel inclined to "kick yourself" for selling too soon. You will feel somehow cheated by "fate". These feelings might even motivate you to buy the share again, especially if it continues to rise. You will not feel these feelings about the other nine shares in the "Weekly Top Ten Up" list. You will have no emotional response to them at all. This difference points up your loss of objectivity

We all tend to "marry" our favorite shares – shares from which we have made money in the past. Equally, we "divorce" shares that have lost money for us. Professional investors only distinguish between shares which they are watching, shares which they currently hold, and the rest. Once they sell a share it joins the universe of shares which they no longer find interesting enough to watch closely – unless they think that it might offer another opportunity for profit soon.

Professionals understand and accept that most of the opportunities for profit in the share market will pass them by. They also understand and accept that out of ten share selections they will almost certainly have three or four failures. They anticipate this and so have a stop strategy in place and operational. Beginners, by contrast, cannot countenance failure. They do not want to accept that they might have bought the wrong share or timed their transaction wrongly – or both. And this unwillingness to accept the possibility of failure prevents them from even having a stop strategy. They find it difficult to anticipate and prepare for the possibility of failure – and they are completely unprepared to deal with failure itself.

So what can you do to improve your "mental posture"? What can be done to prevent emotion from becoming a major determinant of important investment decisions? One tip is to "keep your counsel". Do not tell other people where you are investing. Keep the investment side of your life secret. And do not encourage other people to buy what you are buying. We all look for confirmation of our ideas. If we think that ABC Ltd is a good buy we seek approval for our idea from other people. The best type of approval occurs when we can convince them sufficiently to cause them to buy the share as well. That is validation, or vice versa if that share loses money they will blame you for a weak decision, and we feel that they then share our risk. They are a fellow traveler and we are not alone.

These are strong feelings and difficult to suppress. If we are optimistic we want others to share our optimism. We look forward to getting the credit and accolades for our investment acumen. Unfortunately, such "grand-standing" has a devastating effect on our mental posture. Now we have to worry about other people as well as ourselves. We are not the only ones that will lose because we have convinced someone near and dear to us to invest as well. And our reputation is at stake. We are in danger of losing credibility and being seen as a fool. These unnecessary additional pressures make it, for example, much harder to execute a stop when it is reached. Your feelings of loss will be escalated to real anguish if you have caused others to lose. So keep your ideas close to your chest.

You should also be perceptive of your emotional ability to handle the size of funds that you have in the market. If you have more money in the market or in a particular trading idea than what you can cope with emotionally you will lose your objectivity. Normally, this shows itself by your failure to execute your stops when they are triggered. There is no easy way to determine how much money is beyond your emotional threshold except trial and error. Selling out on stop is always a little painful even for the seasoned investor, but is it so painful that you cannot execute?

The best approach is to begin small and build up. The mistakes that you make with twenty thousand rands are the same as the mistakes you make with two hundred thousand or even two million – they are just far less painful! So learn about investment with "small" money and then let your portfolio grow as your confidence and experience grow – and your ability to control and manage your emotions improves.

The strange thing that you will notice is that once you do execute your stop, suddenly all the pressure is gone. You are no longer invested and there can be no further denial of the true position. You cannot go on kidding yourself that you have not lost the money. Selling has clarified everything. The mental paralysis disappears.

Secret No. 8

"Understand some basic economics"

The social science of economics has developed enormously over the past 70 years. From the simple *laissez-faire* economics of the early part of the last century to the development of Keynesian economics and then the innovations of Milton Friedman and the advent of Monetarism have changed the way that economies are managed by central banks throughout the world.

Central banks have the dual role of ensuring the stability of a country's currency while ensuring adequate growth in the economy. These two objectives are mutually exclusive in that economic growth tends to spawn inflation thus eroding currency stability, while efforts to control inflation normally involve a reduction of the money supply and this usually means economic contraction. So central banks are always in one of three modes –

1. Expansionary – where interest rates are falling to stimulate growth.
2. Holding – where interest rates are held steady because there is a temporary balance between growth and the control of inflation
4. Contractionary – where interest rates are rising to get inflation back under control

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Which of these three modes is in play, or expected to be in play, at any point in time determines the progress of the economy and hence the share market. The problem is that monetary policies like changing interest rates generally take about 9 months to feed through to the economy. So the Monetary Policy Committee (MPC) is always trying to see what the position is likely to be in the future and to take remedial action now to counter it. Protracted periods of high-interest rates generally result in a recession and vice versa, but they are not the only cause of recessions.

The business cycle is a loosely defined "cycle" of booms and busts that the economy goes through. These occur because, in the good times, consumers and businesses tend to borrow too much - which leads to excessive demand and inflation. When the central bank increases interest rates demand falls off (after about nine months) and inflation is reduced. So the central bank alternately puts its foot on the brakes or the accelerator, always trying to second-guess the state of the economy 9 months ahead.

Interest is the price of money. It is the cost of borrowing and so money can be "expensive" or "cheap". The central bank makes money more expensive by increasing interest rates and by mopping up surplus cash in the economy using so-called "open market operations". Rising interest rates mean that banks lend less and consumers and businesses borrow less and the economy slows down – and vice versa.

Inflation is not necessarily caused by excessive demand, especially in the long term. Rather it is caused by excessive growth in the money supply a growth that is beyond the ***real*** growth of the economy. The money supply, as represented by M3, is a symbol of the goods and services in the economy at any point in time. If that supply of money grows more quickly than the economy then, over the long term, the result must be more money chasing the same amount of goods services - and so the price of everything must go up.

And over the long term, there is only one organization that can create money and that is the government. So, they create the money and spend it, while the rand in your pocket goes down. In other words, in the long term, inflation is a subtle, undisclosed form of taxation.

The idea is not a new one. It was invented by the Romans more than 2000 years ago. In those days Rome used gold coins for their currency. Periodically they would call all the coins in the realm in on the pretext of re-minting them with the new Caesar's image. So each citizen would hand in his coins and get a receipt.

The coins would be put in a big pot and melted down. Then 20% of lead was added. Once re-minted the new coins would be handed out to the citizens who handed them in and when this was done there would be 20% left in the bottom of the pot. This was then used to finance the next Punic war.

In those days they called it "debasement". Today we call it inflation – but it is essentially the same thing. With our "fiat" currencies today which are not backed by gold it is very easy for the government to create more money – and to spend it. That is what is happening in Zimbabwe. If the government does this then the value of the rand in your pocket falls in terms of its purchasing power. And that is a form of taxation.

Since the 1980s and the work of Milton Friedman, central banks worldwide have moved away from inflationary policies and have strived to minimize inflation. This harmed the price of gold which fell from a high of around $850 to a low of $200. Since then the excess of jewelry demand over the supply of newly-mined gold has resulted in a steady rise in the gold price - and more recently the melt-down of the world financial system has seen some investors worldwide buy gold as a "haven"

You need to assess the position of the economy before you invest. Are we entering a recession or are we nearly at the end of a recession? Is the boom about to come to an end or will it last another year? Remember, that the share market generally anticipates changes in the economy by about 9 months. This means that, when interest rates begin falling, investors are already looking for the next economic recovery even though the economy is still in the teeth of a recession and all is doom and gloom. Similarly, when interest rates begin to go up investors anticipate a slow down in 9 months and begin selling their shares.

It is also important to understand the broad workings of the Balance of Payments (BoP) and how it fits into this picture. The Balance of payments records South Africa's financial relationship with the rest of the world. It is divided into two parts:

1. The Capital Account shows the flows of capital in and out of the country. So overseas investments into South Africa plus the repatriation of capital by South Africans minus overseas disinvestments from South Africa plus the investments made by South Africans off-shore. The capital account is affected by the level of South African interest rates relative to those available overseas and by the overseas perception of political risk in the country. If local interest rates are high relative to what is available overseas then capital will tend to flow into the country and vice versa. Being an "emerging" economy we are generally perceived as being much riskier than that of a first-world economy likened to that of Australia – and if there is uncertainty about the political future then that also tends to make foreign investors nervous about putting their money here. If capital is flowing into the country then the rand will tend to be strong and vice versa.
2. The Current Account shows the value of South African exports less its imports. Imports and exports are affected by the strength of the rand. If the rand is very strong against the currencies of our major trading partners, then the price of our exports will be more expensive on world markets while imports into this country will become cheaper for South Africans – with the result that the current account will tend to slip into deficit. The opposite is also true.

During boom periods people tend to buy more expensive imported goods leading to a current account deficit and vice versa – so sometimes the central bank will increase interest rates to "cool" the economy down and so reduce imports to help the current account. Equally, the central bank might keep rates high in South Africa to attract foreign capital and so keep the rand strong. A strong rand means less imported inflation (in the form of higher prices for oil and other imports).

You need to study the relationship between the rand, the level of interest rates, the inflation rate, the business cycle and the balance of payments. Together these factors will have a significant impact on the share market

Secret No. 9

“Develop a consistent opinion on important world indicators”

Companies exist within the context of the South African economy which, in turn, exists within the context of the world economy. Listed companies are constantly influenced, directly or indirectly, by changes in international economics. The shifts in the directions of a multitude of currencies, commodities, and stock markets together with political developments and central bank policies will have a direct impact on their profitability. If you want to be a successful share market investor you need to begin developing an awareness of the complex and dynamic matrix of indicators that make up the world of international finance.

Begin by studying the rand against the currencies of our major trading partners – particularly against the US dollar and the Euro. Key to this understanding is the idea that the rand (like any currency) is a direct reflection of how this country is perceived economically. The currency of a country is similar to the shares of a company. If a company is doing well then its shares will rise. If a country is perceived as stable and growing strongly then it will attract foreign capital and its currency will be strong. Is our economy seen by overseas investors as strong or weak? Is it growing in real terms or not? And, more importantly, “What is the degree of risk – both to the rand’s stability and politically to the country?” Consider the following chart of the rand against the dollar:

When the ANC took power, the economy grew and the international perception of our political stability has been improved steadily. This, combined with the fact that Trevor Manual and Tito Mboweni have managed to pay down the deficit on the Reserve Bank’s forward book in the currency markets has enabled the rand to stabilize.

In fact, in the 19 years from 1997 to July 2004 the rand was one of the stronger currencies in the world due to the conservative economic policies of the ANC up to that point. As you can see, since July 2011, the rand has been falling rapidly against the US dollar. This is partly because of the “risk-off” investment approach of international investors following the sub-prime crisis, but it is also because of the bad economic policies implemented by Jacob Zuma’s government. And the fall of the rand accelerated sharply after Zuma axed the Finance Minister in 2016.

Constructing an accurate and objective opinion of the complex politico-economic patterns within South Africa is extremely difficult. For a start, you must have a well-informed view of where the rand is likely to go next, and to do this you need to have an idea of what is likely to happen politically. Will the current monetary policy conservatism continue to prevail or will a new era of looser monetary management result from increased labor union influence over the government? Will Pravin Ghordan be able to hold things together? We all know that the government is under the influence of the unions who want inflation targeting to be abandoned.

And the strength of the rand is partly predicted by the strength of the US dollar and other currencies so you need to consider the economies of our key trading partners. For example, do you think that America is headed into a great depression similar to that of the 1930s? Or do you think that the various central bank stimulation packages and the sharp drop in interest rates worldwide will hasten the recovery of the world economy? This is an extremely difficult question and we will return to it later in this book.

South Africa is very dependent on raw materials exports. And those exports are bought by the major Western and Eastern countries. If they go into recession or depression it seems unlikely that we can escape unscathed. The platinum industry is linked directly to the motor industries of the world and, with the sharp decline in the demand for motor cars, the demand for auto catalysts has fallen. The platinum price fell from $2200 to less than $800 putting extreme pressure on shares like Angloplats. Consider the chart of the platinum price:

But what of the impending shift to electrically powered motor cars and the advent of fuel cells? Batteries and fuel cells depend on platinum group metals - so does that mean that platinum is the oil of the future? If so, then was Angloplats at less than one-third of its peak price a good buy?

And what of gold? The gold price held up very well during 2008 and 2009. Are investors moving out of various paper assets into gold because they fear a resurgence of world inflation as all the vast stimulation packages of various central banks work their way through the system? Gold's role as a hedge against inflation has been less apparent in recent decades, but the global economic melt-down of 2008/09 has seen a definite flight to hard assets such as gold. If the gold price is strong then this should have an impact on the strength of the rand since it is one of our major exports. Here is a chart of the dollar price of gold since 1995:

If the world economy is moving into recession and perhaps even depression then what type of industries here in South Africa will be the least affected? Probably the retail grocery stores like Pick 'n Pay and Shoprite because even in a recession people have to eat. They might buy cheaper food, and you might see a switching down from more expensive stores like Woolworths Food to Pick 'n Pay or Checkers (which is part of the Shoprite group), but they have to go to a supermarket and spend some money. Look at the chart of Shoprite:

As you can see here Shoprite went from 540c in May 2003 to 28190c by August 2018. That is a more than a Fifty Two fold return, excluding dividends in just over Fifteen years!

Companies that sell big-ticket items like motor vehicles, white goods, and furniture will probably suffer. Interest rates have already fallen quite sharply and may fall further. The effect of this has a gathering impact on the economy. Each month that passes with lower rates puts more and more money into the hands of consumers and households. They may repay debt for a while, but sooner or later they will begin to spend again as they feel they can afford to.

The mining sector depends on the strength of the rand and the price of commodities. This makes it a very volatile sector. Most commodity prices are not set in South Africa – not even the gold price. The fortunes of the mining industry are based on the world economy and the cycles of the various base and precious metals. The rand can also be very volatile as overseas investors react to good and bad news about emerging markets. Any time that there is a major scare and a consequent "flight to quality" you can expect all emerging market currencies to drop and the rand will be among them (although generally one of the strongest). But the mining industry, because it sells most of its production overseas is a "rand hedge" sector. If the rand weakens the rand hedge shares get more rands for the foreign currency which they earn. So they make a gain on the currency every time the rand weakens and vice versa. Sometimes it is suggested that the government deliberately allows the rand to weaken to maintain the profitability of the mines and so keep hundreds of thousands of mine employees in work.

Some sectors move in advance of the business cycle and some lag behind it. The classic example of a "leading" sector is the paper and packaging sector. The argument is that when the recession ends then manufacturers have to order more packaging materials before they can make more products – so the suppliers of those packaging materials should move before the rest of the market.

A typical "lagging" sector would be something like the construction industry. In this industry the contracts for major building projects usually take years to complete so long after the recession in full swing they will still be benefiting from long-term building projects. When you see the cranes begin to disappear off the horizon and the building sector finally enters the recession the next upswing is probably not too far off.

Secret No. 10

"Understand and exploit group investor behavior patterns"

There is some debate amongst investors as to whether or not there are patterns in the share market and the price movements of shares. Adherents of the "Random Walk Theory" maintain that the prices of shares (and other instruments) are essentially random and that there is no ***dependence*** between today's price for a share and yesterday's or tomorrow's.

If share prices are random then all forms of analysis are a waste of time since, by definition, a random series cannot be predicted. This, in turn, would mean that all the research departments of large stockbroking firms and other financial institutions around the world are wasting their time.

Let us examine this idea in more detail. Imagine that you are considering Standard Bank's shares on the JSE. Consider the chart of those shares over the last 20 years:

Do you think that the share (shown above), could move from a price of around R125 per share to R1 tomorrow? And then to R1000 the next day? No, Standard Bank shares have only moved by more than 5% in a single trading day on perhaps twenty or thirty occasions since they were listed. But a random series could move in exactly that radical fashion. So, Standard Bank shares do not fluctuate at random.

The fact of the matter is that a share's price today is largely determined by the price that it closed at yesterday because investors and traders consider that most recently traded price when they are deciding what to bid or offer for the share today. Common sense indicates that share prices generally do not move at random. And if shares do not move at random, then their movements **must** contain patterns. All we need to do is to find the mathematical tools that will isolate and identify those patterns so that we can use them to help us predict which way the share price is likely to move in the future.

The development and use of such mathematical tools are known as "technical analysis" or "charting" and it is a very powerful tool in the hands of the astute investor.

The first question we need to ask in technical analysis is,

"If there are patterns in a share's price, where do they come from?"

The answer is that they derive from the behavioral patterns of investors – ***as a group***. Individual investors often get into and out of the share market for entirely personal reasons. Perhaps they need to sell shares to finance the purchase of a house or for some other reason which is entirely unrelated to the share itself or the state of the market. But, as a group, they are influenced by sentiment and their inherent behavioral characteristics. For this reason, it is worthwhile to try to identify and understand the behavioral characteristic that each particular technical indicator is exploiting.

For example, the simple moving average works because shares and other data streams in the market tend to move in broad sweeping trends broken by periods of uncertainty which are characterized by "sideways" movement. The moving average exploits the market's broad sweeping trends but does not work well during sideways markets. So the next question is,

"Why do markets move in trends?" – or more precisely - "What human behavioral characteristic causes markets to move in trends?"

The answer to this question is that people have great difficulty in adjusting their perception of the value of an asset quickly. From childhood, we are infused with the idea that assets retain their value – or at least that they lose value only very slowly. If I told you that your house was worth nothing you would have a great deal of difficulty accepting that – even if I was right. The most traumatic experience you can have is to right off a motor car – because what was worth R200 000 a few moments ago is now a heap of useless scrap metal.

Suppose that you were holding a share that was trading in the market for R20. Would you sell it tomorrow for R1? No! Nor would anyone be stupid enough to offer you R1. But if the share was over-priced at R20 you might quite easily accept R19 for it tomorrow. And, if you were still holding it the day after, you might accept R18 for it. And, in fact, over time it might eventually reach R1. But it would ***never*** do so in one day. It would take weeks and months to fall so far. And this means that, mathematically, the share price ***must*** break down through its moving average and you will always have time to sell. Consider this chart:

Here you can see the clear “buy” and “sell” signals given by a simple 70-day moving average.

So the moving average works because people have difficulty in adjusting their perceptions of value quickly. This causes the market to move in broad sweeping trends most of the time - and to the extent that it does the moving average will work – and to the extent that it doesn’t, it won’t.

Thus we can see the human behavioral characteristic underlying this simple technical analysis tool. It is not always easy to perceive the interactive characteristic which underlies an indicator, but it is certainly worth the effort because it improves our feel for the indicator and its reliability.

So technical analysis is essentially a social science – like economics or psychology. It is the study of group investor behavior through the prices that people are prepared to pay for a share at any point in time and the number of shares that they are prepared to trade at that price. And, like all social sciences, it tends towards statistics and probability. No psychologist would come to conclusions based on an experiment involving a single subject – because that subject might be schizophrenic or psychotic. The reliability of the psychologist’s findings increases directly with the size of the sample that he tests.

So what is the size of the sample in technical analysis? It is the volume traded. The more heavily traded a share is the more reliable it becomes technically. Thinly traded shares are unreliable because a single large investor getting into or out of the share can throw your indicators all over the place. But in a heavily traded stock, the activities of the individual are lost in the overall direction of the trend.

So you will find that indexes are more technically reliable than individual shares and currencies are probably the most technically reliable because of the enormous volumes traded.

Secret No. 11

"Know the type of market you are in"

Markets go through cycles. This idea is very old – almost as old as markets themselves. There have always been booms and busts. As markets rise, more and more people get sucked into the excitement, and share prices gradually lose contact with their underlying fundamentals. Price-to-earnings ratios become more and more fantastic. So-called "experts" and "gurus" pop out of the woodwork to explain why this cycle will be different; this cycle will continue upwards indefinitely. But sooner or later, one way or another, every bull market gives way to a bear market (and vice versa). Consider this great truth…

Nothing in the share market moves in a straight line.

And for the investor, this understanding is very important. Also important is the understanding that there are many different lengths of a cycle, from the minute-to-minute cycles during intra-day trading, up to the "grand super cycle" which is reckoned to have a length of approximately 54 years. Underlying these cycles is the business cycle of the economy. The economies of the world alternate between borrowing from the future and living at a higher level and then repaying these borrowings and living at a lower level. These cycles are well-known to investors and are generally anticipated by the markets at least nine months in advance.

Against this backdrop, it has been well established that approximately 70% to 80% of a share's move is caused by the movements of the market as a whole. In other words, most shares move in the direction of the underlying trend. Relatively few (30% or less) buck the trend. So, if you are planning to buy some shares, try to make sure that you are in a rising market because that fact alone will greatly improve your probability of making money. And, with the enormous advances in communications technology, all the markets of the world tend to move together – led by Wall Street

So establishing exactly what type of market the world is in should occupy the lion's share of your time and analysis. And this analysis should begin with the Standard & Poors 500 index (S&P). This index is a weighted average of the 500 largest companies trading on the New York Stock Exchange (NYSE). It is the most reliable and accurate indication of what is happening on the NYSE and what is likely to happen in the rest of the world, including South Africa. Look at the chart of the S&P500 over the past 40 years:

Obviously, like all markets, it does not move in a straight line but has many fluctuations from week to week. To establish the underlying trend I recommend that you watch the **slope** of a 200-day simple moving average. While this average is upward-sloped you can be fairly certain that the NYSE and the stock markets of the world are in a bull trend. When it flattens out and begins to fall then you should take your money out of the markets because the high probability is that we are headed into a bear trend. It is difficult, if not impossible, to know how long a bear market will last – although inevitably many so-called "experts" will try. The best approach is simply to stay liquid and watch the markets fall until the 300-day once again flattens out and then begins to rise.

You can see that the 200-day moving average delineates the bull and bear trends in the S&P500 index. On the left-hand side, the chart begins with the great bull market of 1995 to 2000. Then in 2000, with the 9/11 disaster in New York, the market began a bear trend that lasted until the middle of 2003. After that, there was a bull market stimulated by very low-interest rates in America which continued until the sub-prime crisis which started in August 2007. The 300-day moving average fell until March 2009 and then the market entered a protracted bull market which continued until about May 2016. You will notice that in August 2011, the index fell heavily and remained down until November – a period of three months. It broke down through the 200-day moving average – but the moving average itself continued to rise – indicating that the bull trend was still in tact. That is the benefit of using the slope of a long-dated moving average. It keeps you invested during even the most protracted corrections. Finally, you will note that in 2016, the 200-day moving average began to fall again – indicating the existence of a new bear trend.

So your first step is to consider the slope of the 200-day moving average of the S&P.

Once you have satisfied yourself with what type of long-term trend the market is in, you should turn your attention to the South African market. While we are certainly influenced by what happens in America and the rest of the world, some factors separate us from those markets. We are an emerging market that is heavily dependent on exports of precious metals and other raw materials (like gold, platinum, coal, and chrome). We have exchange controls that prevent us from being involved in the world market and protect us against things like sub-prime collapse. Our institutions (pension funds, unit trusts, and insurance companies) are forced to buy South African shares and their enormous cash flows tend to underpin the JSE.

To evaluate whether we are following the world markets, consider the average earnings yield (EY) of the JSE. Historically, the average EY falls to as little as 6% or less during a major bull market and rises to as high as 11% or 12% when the market is very low. All the major bear trends and market crashes on the JSE have begun from an EY of around 11% or 12%. This is important information because if you see that the average EY is at these levels you should think twice before investing – and vice versa. In fact, when the markets are very high you should move more and more into cash. It is fun and exciting to play the final stages of a great bull market, but you should do so with a smaller and smaller percentage of your available capital as the market goes higher.

And this brings up an important point –

The further up the cycle you are the closer you are to the top - and hence the greater your risk. The lowest risk part of the cycle is at the bottom – but that is also the place where the ***perceived*** risk is at its greatest. What I am saying is that when the market falls for a long period, investors, the financial press and analysts become extremely negative – so at the bottom of the cycle, the perception of risk is very high, but the actual risk is very low. I am fond of saying,

If you don't feel the market risk in an investment,
you are probably not going to make money

You have to be a contrarian. You have to be right when the market on average is wrong. Then you will make money. As Warren Buffett says, "Be greedy when others are fearful and fearful when others are greedy."

Secret No. 12

"Risk is your friend – not your enemy"

In this life, nothing worthwhile can be achieved without taking a risk of some sort. Think of all the really big achievements in your life and you will realize that each one of them involved taking a major risk. When you were about 12 months old, one day, you stood up on your back legs and began to walk. Hopefully, your mother was there to catch you when you fell. If not, you probably fell flat on your face – but imagine if you had never taken that risk. You would still be crawling around on the floor! Risk should not be avoided because without risk there can be no growth.

The same is true of investments. The general rule is that

Risk and return should rise together

In other words, the more risky an investment is, the higher the potential return should be. Investors need to be paid more for taking greater risks - or put differently - if two investments have the same risk, then the one with the highest return is better because it allows you to get a better return for taking the same risk.

The most secure investment of all (i.e. the least risky) is gold – not gold shares but gold coins (like Krugerrands) or gold ETF's. And, of course, because it is the least risky investment, gold has a zero return. The only benefit of holding gold is that it protects you from the general weakness of paper investments, and especially the inflation of paper currencies.

So gold coins do not pay any interest, dividends, or rent and they do not add 10% to their weight each year. They simply retain their value in purchasing power terms, irrespective of what happens to the world and what happens to paper currencies and other paper assets. If there was a third world war destroying civilization as we know it, your Krugerrands would still buy you the same number of chickens (albeit mutated) afterward as they had done before - and as they did 3000 years ago in Egypt. The purchasing power of gold simply does not change.

What does change however is the value of currencies measured against gold? So when you see a report on the TV that says the gold price went up or went down in US dollars, the truth is that gold did not move - what changed was the value of the dollar against gold.

This means that, when paper currencies like the US dollar are stable, the demand for gold will tend to drop – and vice versa. In the 1990's the Bank of England sold 400 tons of gold at prices below $300 per ounce – and they bought US treasury bills with the proceeds - precisely because T-bills were paying a return of around 5% - while, of course, the gold paid no return at all. Gordon Brown, who was then Chancellor of the Exchequer, was congratulated for this money-making decision. Some years later around 2008, when the sub-prime melt-down was in progress and investors were losing their faith in the financial paper of all types, the gold price rose steadily to record highs above $1000. Then suddenly the fact that Brown had sold half of Britain's gold reserves at under $300 per ounce began to look very foolish indeed!

In my opinion, South Africans should always have some of their portfolios in gold, even in normal times. I recommend about 10% of their total net worth. I make this recommendation because South Africa is substantially a third-world country and still has significant political risk. The potential for the rand to be debased is real and so you need an asset in your portfolio that will hold its value irrespective of what government is in power and what it decides to do. Consider the case of Zimbabwe. Gold coins have been completely immune to the hyper-inflation in that country and the eventual collapse of its currency.

So all investments carry risk – some more than others and the risk is very difficult to measure. Two types of risk exist for all equity shares listed on the stock market – fundamental and technical.

The fundamental risk is the risk that the company will not be profitable in the future – for whatever reason. Perhaps management will make bad decisions that jeopardize its growth potential – or that the industry which it is in will experience a significant downturn. This type of risk can best be evaluated by studying the company's financial statements, reading about its industry, and meeting and talking to its senior management.

A key concern in assessing fundamental risk is the amount of gearing which the company has incurred. Essentially, companies derive their finance from two primary sources – from their shareholders and outsiders (like the banks). Funds borrowed from outsiders normally carry an interest burden and that can become a problem. There are two fairly simple ways to assess the level of gearing in a company:

1. The debt: equity ratio measures the amount of money that outsiders have in the business for every rand of funds that the shareholders have. In general, it is unhealthy for this ratio to get worse than one-to-one. In other words, to the point where the banks have more money in the business than the shareholders.
2. The second method is the interest cover ratio – which looks at the amount of interest the company is paying as a percentage of its profit. If a company is paying out more than one-third of its pre-tax profit in interest, it is very "highly geared". Such a company may be threatened by a sudden increase in interest rates which can cause it to become squeezed between a rising interest rate bill and falling sales.

A lack of liquidity can also pose a significant risk. This occurs where the company is profitable, but where most of its money is tied up in working capital (stock and debtors) or committed to fixed assets. Such a company might find itself with insufficient cash to meet its daily expenses.

The new Companies Act (71 of 2008), which came into effect in May 2011, understands these two areas of risk and insists on a "solvency and liquidity test" to measure the company's solvency and its ability to pay debts before any dividend can be declared or any share buy-back approved.

This raises the issue of working capital. How much money is tied up in the day-to-day running of the business? Working capital is usually given by the formula – stock plus debtors minus creditors. So take a look at the company's management ratios to see how quickly it is turning its stock over and how many days it takes, on average, to collect its debts. Worsening ratios in these areas indicate poor management and this implies significant fundamental risk.

The technical risk exists in the volatility of the company's share price. The more volatile the price pattern, the more difficult it becomes to predict and the riskier it is. The most risk-free chart is a straight line. The more the chart departs from that, the riskier it becomes. And nothing in the share market moves in a straight line. The longer a share moves in one direction the more likely a change of direction becomes. The overall trend can be bullish, but within that bull market, you should expect regular corrections and vice versa.

Technical risk is measured by "beta" which is reported for each listed company in the Handbook. The beta of a share is its volatility relative to the average volatility of the entire market. The market has a beta of one and a share that has a beta of 1,5 will move 50% further than the market in either direction. So if the market goes up by 10% then such a share will go up by 15% and so on. Conversely, a share with a beta of 0,5 will move only half as much as the market. The more volatile a share is the more potential there is to buy it at the bottom and sell it at the top, but the more possibility there is of making a capital loss.

Moving away from the share market, you will often see large institutions like insurance companies advertising "risk-free" investments. Unfortunately, they are not talking about gold coins. They are talking about investment products where your capital is supposedly "guaranteed" by the organization selling it. In my experience, such risk-free investments are, inevitably, also return-free after inflation and taxation have been taken into account. In other words, to beat inflation after tax as a private investor you will have to take some risk. The secret is to use your knowledge, experience, and expertise to reduce that risk to an acceptable level.

In thinking about what level of risk you are willing to take you should consider the risk posed by inflation. Remaining in cash or near-cash may feel comfortable and secure, but over time the purchasing power of your cash will diminish. In other words, if you are not prepared to take some form of risk you will find that you can never reach financial independence as I defined it earlier because the moment you stop working for a salary, your capital will begin to diminish in real terms.

It's a little bit like what I used to say to my girlfriends when I was younger:

"If you never take any risks, nothing exciting will ever happen to you!"

Secret No. 13

"Exploit the market's over-reactions"

In the share market, as I have said before, you can only make money when you are right and the market, on average, is wrong. You have to be a contrarian or a maverick. And this implies that you need to do your homework rather than relying on that of others, or just moving with the crowd. You must not allow the emotional behavior of the mass of investors to influence you. Equally, you must not be influenced by the many so-called "experts" who regularly give their opinions on the internet, radio, or TV.

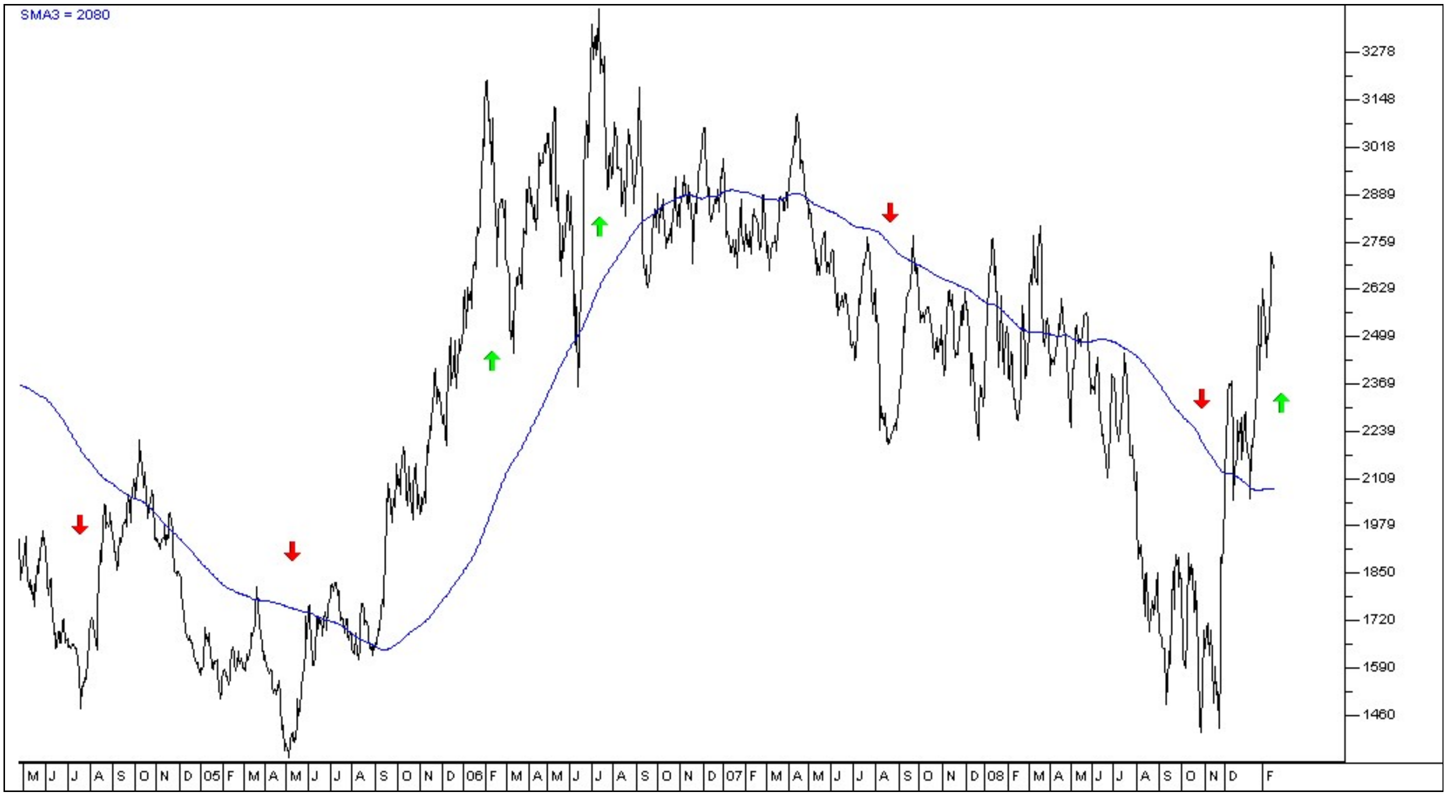
You must also have sufficient self-confidence to act on your contrarian understandings, because, when it is the right moment to buy, every market commentator and investment "expert" will tell you that you are wrong. Going against the prevailing market opinion takes enormous courage and feels very risky. But once you have done it a few times you will realize as I have said earlier, that unless you can ***feel*** risk you are probably not going to make very much money.

Probably the best way to be a contrarian is through technical analysis or charting as it is known. Technical analysis is a social science. It is the study of group investor behavior as reflected in price and volume patterns. In other words, each technical indicator is based on a generalized behavioral characteristic of investors as a group – which can often be identified. So, for example, the moving average works because of investors' general inability to change their perceptions of value quickly. The slowness of their response to new information causes the price to move in broad sweeping trends. That is why the moving average works – it exploits the inability of investors to adjust quickly to the changed value of a share, either on the upside or the downside and so shares tend to move in one direction for extended periods.

One of the most pervasive and convincing behavioral characteristics of people, especially in groups, is their tendency to over-react to new situations. People always allow their emotions to get the better of them. Things are never just "good" – they are always "excellent" or "fantastic", and they are never just "bad" but "terrible" or "disastrous". This tendency to over-react causes share prices and entire markets to move well above and below their true values. And that allows the astute technical analyst to exploit the resulting extremes of price.

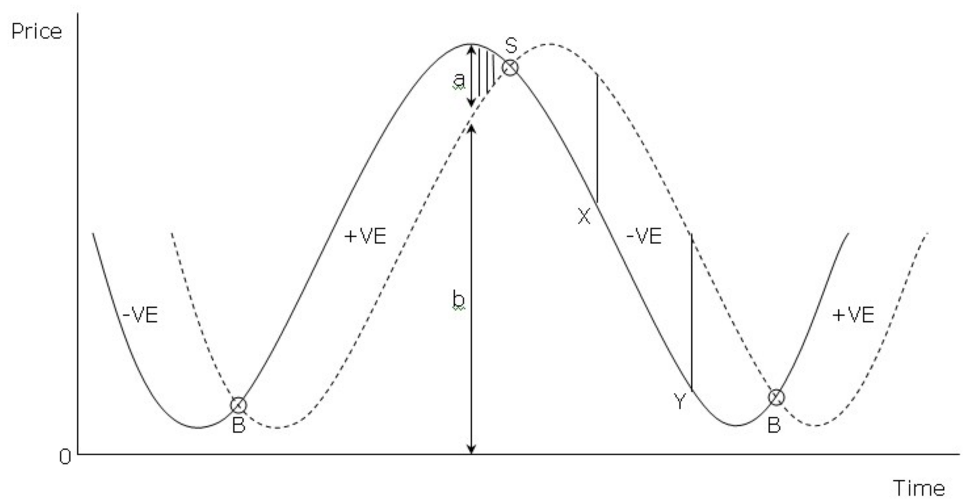
The overbought/oversold indicator is a fine way to identify and measure the over-reactions of the market.

Technical analysts, studying the moving average, very quickly realized that the best time to buy and sell was usually not at the traditional moving average (MA) cross-over signals, but rather where the "gap" between the MA and the price was at its greatest. Consider the following chart of the JSE gold index over 5 years with a 200-day MA…



On this chart, you can see that the best times to buy (the red arrows) and to sell (the green arrows) were at points where the price chart was furthest away from its 200-day MA. This simple observation led to the development of the overbought/oversold indicator (OB/OS).

Look at the following diagram…



Overbought / Oversold

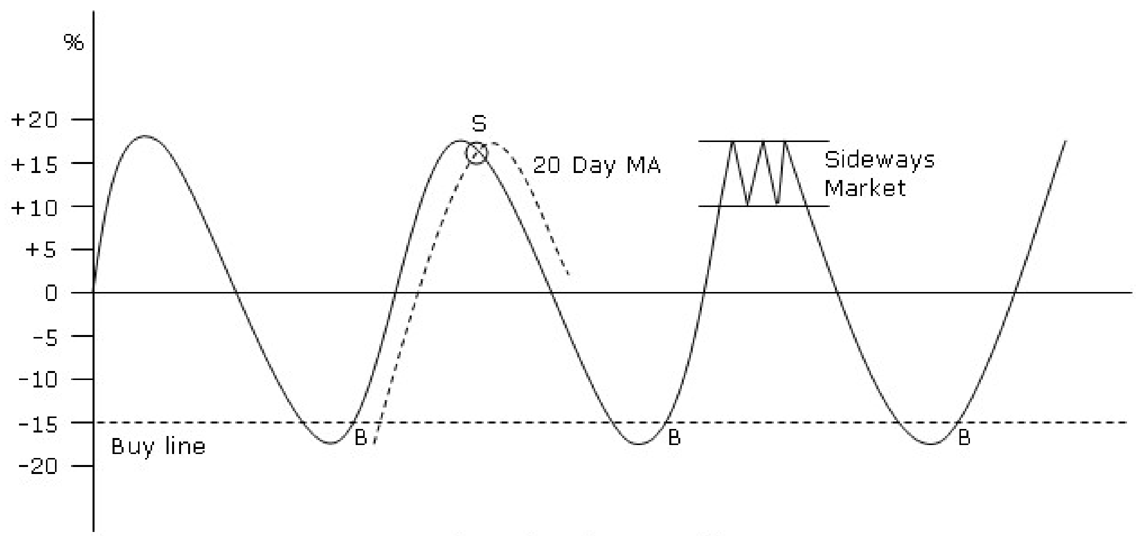
The chart shows a share price (the solid line) with a MA (the dashed line) superimposed. The "buy" and "sell" signals have been marked with "B" and "S". Look at the vertical line which is broken into that part which is between the price line and the MA ("a") and that part which is between to X-axis and the MA ("b"). To calculate the OB/OS you must express the distance "a" as a percentage of the distance "b" (which is the MA). Thus:

$$\text{OB/OS} = \frac{\text{Price - MA}}{\text{MA}} \times \begin{matrix}100\\100\end{matrix}$$

You will notice that, as this vertical line is moving closer and closer to the MA sell signal, the gap between the price line and the MA becomes shorter and shorter, until, at the sell signal, it is zero. And then on the far side of the sell signal, it is negative because now the price is below the MA so Price minus MA will be negative.

Examining the whole chart you will see that the OB/OS will be negative at the start then reach zero at the first "buy" signal, then become positive when the moving average is below the price line, then zero again at the "sell" signal and then positive again and so on.

Mathematicians call this an oscillator – because it oscillates above and below zero. Now consider this oscillator:



Overbought / Oversold

One way of thinking about this chart is that the MA line has been pulled straight to make the zero line and the price line is now oscillating above and below it. So the moving average buy and sell signals will be wherever the OB/OS crosses the zero line. But, as we have discussed earlier, the best place to buy is usually where the price is furthest away from the MA below it and the best place to sell is where it is furthest away above it.

But what have we have achieved by re-drawing this chart as an OB/OS oscillator? Our problem is to find the best place to buy the share. Have we not simply re-arranged the figures into a different form - without really solving this problem?

What we have achieved is that we have reduced our problem to an *oscillator*. This means that we can now begin to apply the concepts of statistics and probability. For example, we can study a particular share's OB/OS chart over the past twenty years and see that it has never been wrong to buy the share when it fell below -15%. We can draw a "Buy Line" at the -15% level.

But, of course, in the technical analysis, we need a cross-over to give us a clear signal – and here we have two cross-over points – one where the OB/OS crosses down through the -15% buy line and one where it crosses back up again. But the best buy signal is given when it crosses back up because the price will be lower there than where it crossed down.

To understand this you need to go back and look again at the first diagram. You will see that there are two vertical lines marked "X" and "Y". These two lines help to illustrate the point. The first line ("X") is equivalent to the point where the OB/OS crosses down through the -15% buy line, and the second vertical line ("Y") is equivalent to where it crosses back up again. And you can see immediately that the share's price is lower at "Y" than at "X".

The OB/OS can remain below your buy line for a considerable time, and the whole time that it is there, the share's price will be falling. We only become interested when it turns up and begins moving back towards the zero-line (which is the next moving average buy signal). So you can see that in the lower diagram we have three OB/OS "buy" signals, each given when the OB/OS breaks up through the -15% buy line and marked with a "B".

Then you might say, "Well, let us put on a +15% 'sell line' and then we will have this stock market thing wrapped up!"

But there is a great difference between buying and selling. Most beginners think that buying and selling are just two sides of the same coin – the same thing, just the opposite way around. Professional investors understand, however, that there is a great difference between buying and selling - and it is this:

When you buy you can optimize in two dimensions. You can optimize in terms of ***which*** *share you choose to buy and in terms of* ***when*** *you choose to buy it. But when you sell, you can only optimize in the time dimension. You can only sell the shares that you have. You cannot choose which share you want to sell!*

Whereas you can look through the whole share market searching for shares that are below -15% to buy them, there is no point in searching for shares that are above +15% to sell them because the high probability is that you do not have them!

For this reason, the OB/OS is primarily a buying technique. It is designed to get you into the market at the right price. Most investors do not realize that you make your money from an investment when you buy – not when you sell. Because if you buy at the wrong price – you're dead!

So you buy when the OB/OS breaks up through its buy line. But there are some methods that you can apply to the OB/OS that will help you with your "sell" decision. Firstly, you can put a 20-day moving average *of the OB/OS* onto the chart and that will give you a classical moving average sell signal when the OB/OS breaks down through its MA.

Also, you should be on the lookout for the "sideways" market. At the top of the trend, the smartest and the most stupid money are in the market at the same time and they have diametrically opposite views of what will happen next. They cause the market to move around like a cat on hot bricks. Do not get involved in that uncertainty – recognize it for what it is and take your money someplace else. Remember, the OB/OS is an oscillator. It must return to -15% and you will get another opportunity to buy – if not this share then another.

Now let us stop for a moment and consider what exactly it is that we are measuring with the OB/OS.

Well, the OB/OS measures the rapid departure of the price line ***away*** from its moving average. That departure must be rapid or else the moving average will move down with the price and there will be no significant deviation. So what human behavioral characteristic would lead to such a rapid departure of the price away from its moving average?

You might say "panic" and you would be close to the truth. The OB/OS measures the ***over-reactions*** of the market – both on the upside and the downside. And what could be more human than to over-react? We all do it all the time and investors, in particular, are prone to fits of wild enthusiasm and utter despondency.

So the OB/OS measures the over-reactions of the marketplace. This means that we can go back over the past 30 years or more on a particular share and see that it has the *propensity* to over-react to the -15% level. That is an enormously powerful understanding. We can study the share and discover that it has spent only 2% of its time below our -15% buy line. I put it to you that your statistical probability of being wrong in buying at such a level is extremely low – and you have one great satisfaction. You are not buying it at +15% - but somebody did! Otherwise, the chart does not go there! And you are doing <u>much</u> better than him.

Can you see that by using the OB/OS you will be "bending the odds in your favor" – so that investing on the stock market becomes like playing a roulette wheel where the odds are stacked maybe 60% or 70% in your favor? Would you play such a wheel? Of course, you would! Because, even though you know you are going to lose 30% or 40% of the time, you also know that the laws of probability are working in your favor and you must ultimately win.

Remember:

Investment is not about certainties – it is about probabilities

It is about using your knowledge, understanding, and experience to bend the odds in your favor.

Secret No. 14

"Listen to your inner tutor"

The problem that many serious investors have with the market is that they think that they can get to the point where they can understand it sufficiently well to come up with a fool-proof strategy that will always make money for them. They are looking for a profitable "buy" and "sell" strategy. This type of investor is typically male and professional – usually qualified in the sciences (an engineer, doctor, or mathematician). Typically also, they begin an intensive search for a technical solution to the problem of the market, investigating thousands of formulae that might offer the best method of deriving "buy" and "sell" signals which work consistently.

If you are one of these people, then I can save you a great deal of time and effort. There is no such shortcut. Making money in the markets is more of an art than a science. It subsists in acquiring a ***feel*** for markets and economies rather than the reductionist approach of trying to fit them into some set of mathematical formulae. This highly unscientific suggestion is not likely to go down well with the "rational" investor who is seeking a scientific solution. But I have traveled the route of "searching for the magic powder" and I can say, with a fair degree of certainty now, that it does not exist.

So what is the answer? To get to that, we need to understand a bit more about how the human mind works. Many years ago, I participated in an experiment in the psychology department of a university. The experiment was designed to establish how quickly people could understand new concepts. The technique was very simple. The experimenter showed the subject a card with a seven-digit number/letter combination on it and then asked the subject to guess whether the card conformed to a particular concept – or not. Since the subject did not know what the concept was his first attempt was a guess. The experimenter gave him feedback as to whether he/she had got it right or wrong – and then showed the subject a second card. Again the subject guessed and was again given feedback. Card after card was shown to the subject who guessed whether or not the card belonged to the concept and got immediate feedback.

The concept could be something very simple such as "The number '7' is present except where the letter 'Q' is present". Eventually, after seeing many cards and guessing many times with feedback, the subject would grasp what the concept was. And we measured how many cards it took for him to grasp the concept and we tried with different concepts – some more complex and some simple. We also tried many different subjects to get a good spread of capability.

But I noticed something very interesting. I noticed that, especially with the more complex concepts, and especially with the more intelligent subjects, they began to get a 70% or 80% "hit-rate" long before they could tell me what the concept was. And when I asked them how they knew that a particular card belonged to the concept and another did not they replied, "That one ***feels*** right – and that one ***feels*** wrong."

I found this intensely interesting. It implies that the subject was processing the data subconsciously and finding an answer well before his/her conscious mind had seen what the answer was. I then realized that, whereas the conscious mind could never even remember fifty-seven-digit number/letter combinations, the sub-conscious mind not only could remember them but it also performed a rapid correlation of the data to find a pattern. Once this pattern was found, it was thrust forward into the conscious mind in the form of a ***feeling.***

The subconscious mind is the most powerful pattern-recognition computer known to man. It is far more powerful than the most powerful computers ever constructed. The conscious mind is relatively impotent by comparison.

The stock markets and economies of the world produce more information in a single day than the average person could absorb consciously in an entire lifetime. The only way we have any hope of processing so much information is with the subconscious mind. If you look at enough charts of shares, commodities, indexes, and currencies you will begin to develop a ***feel*** for them which can be surprisingly accurate.

Of course, women have known about this for centuries! They call it “women's intuition”. I am sure that you have had that experience of sitting in a room with your wife or girlfriend when a stranger walks in. He may not stay for very long and he may not even say anything, but when he walks out the lady with you will say, “I don’t like that man”. You will protest that she does not know anything about him and what she has said is entirely illogical and yet in time, her intuition will be proved to right.

What has happened is that she has absorbed, at a subconscious level, thousands of tiny details about the stranger – details of body posture, facial expression, intonation, dress, and many other aspects. She has then done a rapid subconscious correlation of this material with everyone she has ever met in her entire life and found a match – which she did not like. Only the result of this analysis enters the conscious mind and so she is entirely unable to “explain” her feeling in any rational way – but she is right! Chess masters will also acknowledge that they often reach a point in their analysis where the conscious mind can take them no further and where they rely on their highly-developed sub-conscious “feel” for the position in making their decision.

So what I am saying is that you need to become sensitive to your feelings about the share market and to separate them from your emotions of fear and greed. And part of that process is to feed the subconscious mind with as much information as you can lay your hands on. Read many articles, listen to many interviews with the CEOs of listed companies, study many websites and consider many charts - even though you know you will not remember them consciously – they will affect your evaluation and your ***feel*** for what is going on around you. The subconscious mind’s ability to handle detail is virtually unlimited.

What I am saying is that you should listen to your “inner tutor” – which is the direct derivation of the word “intuition”. Your inner tutor will provide you with the “tuition” that you need to comprehend the markets.

Secret No. 15

“Gold – the unique investment”

The South African investor needs to have a good understanding of gold. Even if you never intend to buy gold shares, gold is a major export for South Africa, and for that reason its price directly affects the international perception of the rand. More than 40% of the world’s known underground reserves of gold are located here in South Africa. And gold is unique as a commodity in that it has almost no uses industrially. Its value is derived from its relative scarcity and the simple fact that people regard it as valuable. It is held by central banks around the world as a hedge against the debasement of paper currencies.

To get an idea of its relative scarcity, it is an interesting fact that all the gold that has ever been mined since the dawn of civilization would not fill a cube 27 meters on aside. It is highly prized by certain nations – particularly the Indians who use it as part of their wedding preparations and are very clever at buying and hoarding it. Central banks around the world together hold about 28 000 tons of gold with the largest quantity being held in Fort Knox in America (approximately 800 tons). From time to time central banks sell off large quantities of gold, thus depressing the price, but sooner or later they re-acquire these reserves. As I mentioned earlier, the British government, on the advice of the then Chancellor of the Exchequer, Gordon Brown, liquidated 200 tons of gold at prices below $300 per ounce in the early 2000’s – much to their regret. Consider the dollar price of gold over the past 40 years:

The significant rise in the gold price until July 2011 and again in August 2020, reflects the significant fall in the dollar and the rising indebtedness of the American economy.

The gold in South Africa is in “conglomerate form” which means that it is in a “reef” about 20cm thick, which was once the bottom of a great sea. The reef contains the remains of mollusks and other small sea creatures that lived millions of years ago and whose shells are now part of the reef. The reef breaks the surface just south of Johannesburg and tilts downwards towards the south at an angle of about 20 degrees. It is similar to a cracked plate, broken in places by the faulting of the rock.

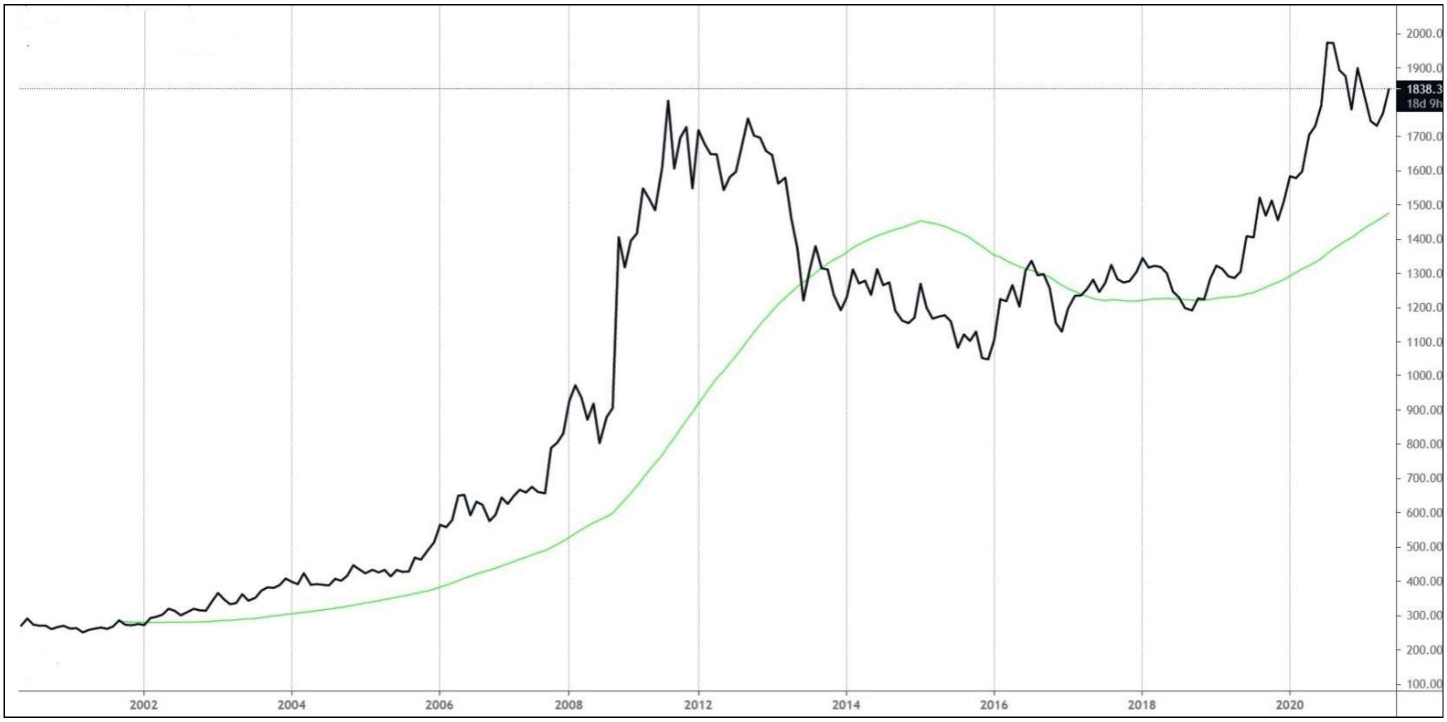
Initially, when gold was first discovered on the reef it was close to the surface, but as more and more of the reef has been mined operations have had to go deeper and deeper until now ultra-deep level mines are mining more than 1000 meters below sea level from Gauteng. At these great depths, pressure and temperature are a constant problem and some mines pump crushed ice down to the bottom of the mine shaft to keep it cool enough for men to work. And the pressure at these depths can cause the rock to burst and "flow" in ways that make it very difficult to mine safely. The deeper the mine, generally the higher the grade, but the more expensive it becomes to extract.

In the 1930's it was widely thought that the South African gold mining industry was dying because the cost of extraction was rising to the point where mining was no longer profitable. However the invention of a technique called "heap leaching" greatly improved the process of extracting the gold from ore and gave the mining industry a new lease of life. In 1970 South Africa mined over 1000 tons of gold and was by far the world's largest producer, but since then, as the mines have been forced to work deeper and deeper, gold production has been declining. Today South Africa produces less than 200 tons per annum and is now the sixth-largest producer in the world. It is possible that in the future new technologies such as robotics and visual reality will be perfected which will enable us to mine at much greater depths economically and give the mines a further lease of life.

The price of gold is a key factor. If the price is high then it becomes profitable to mine the more marginal areas of a mine – and vice versa. The gold price is a result of supply and demand. The demand for gold is mainly from jewelry and its role as a reserve asset held by individuals and central banks. The purchasing power of gold has been almost constant throughout recorded history. As I mentioned earlier, one ounce of gold will buy roughly the same number of chickens today that it would have bought you 5000 years ago in Egypt. This incredible constancy in its value has made gold the ultimate secure store of value.

But as an investment, gold has a significant disadvantage in that it does not give any return. It does not pay dividends, interest, or rent and it does not add 10% to its weight every year. So, in times of currency instability gold provides the safest place to keep your money, but when currencies are more stable it may be better to be invested in other securities which offer a return. Indeed, a long period of currency stability is what persuaded Gordon Brown to sell half of Britain's gold reserves 9 years ago and invest the proceeds in US T-Bills where he could earn about 5%. Today he looks like a fool for doing this, but at the time many central banks were doing the same.

In South Africa, the best way to own gold is to buy gold coins or gold ETFs. Your reasons for doing this would be that you expect the rand to fall against the US dollar or the gold price to go up in US dollar terms – or both. In 2007, when it became apparent that Jacob Zuma would probably be the next president of South Africa and the split in the ANC became clear, it was reasonable to expect that the rand would fall in the medium to long term. This idea was based on the assumption that Trevor Manual and Tito Mboweni would sooner or later be replaced by officials who were less concerned about maintaining the stability of the rand and more concerned with stimulating growth. At the same time, it was becoming increasingly likely that the gold price in US dollars would climb. Thus investment in gold seemed indicated. Later, when the sub-prime crisis began to gain momentum, stock markets around the world began to fall, and finally, when Zuma fired the Minister of Finance, Krugerrands offered an excellent hedge against the turmoil. Consider the long-term chart of the krugerrand:



In the period around January 2000 Krugerrands could be bought for $286.10 per one-ounce coin. By August 2011, just eleven years later the same coin was selling for $2000. During that period the rand weakened dramatically, which increased the price of Krugerrands.

However, because Krugerrands pay no income of any sort and are just a way to stabilize the value of your money, they probably should not be held indefinitely as a substantial proportion of your portfolio. I recommend that all South Africans should hold at least 10% of their savings in Krugerrands all the time, and more in times of potential political instability when the rand is likely to decline against other currencies. Certainly, it has been my observation that South African investors do not take sufficient advantage of this excellent "resting place" for their money during bear trends. Krugerrands can be bought through several coin dealers throughout South Africa. Most of these dealers will hold the coins in their safe-keeping or you can keep them in a safe deposit box at your local bank. Buying gold ETFs has the advantage that there is no need to have a safety deposit box, but the disadvantage is that ETFs cannot be taken to London or Tokyo and sold there and sold there as easily as they can be here.

The other important advantage of Krugerrands against other investments is that do not have your name on them – nor is any record kept of your purchase of them. They can be bought and sold in any country in the world and they can easily be moved from one place to another since they are coins and highly transportable.

They were first produced in South Africa in the 1960s and there have been more than 50 million coins minted. They are available in halves, quarters, and tenths. They are very strong and virtually impossible to "sweat" for their gold content. Accordingly, they have become accepted as legal tender almost anywhere in the world at the going price of gold.

Secret No. 16

"The grand super-cycle"

Context is very important in the share market. Most investors lack the experience to see the current markets in their proper historical context and so they miss the point of what is going on around them. For example, did you know that in 1970 one US dollar bought 300 Japanese yen – and yet today it buys less than 100 yen? That fact, and the explanation for it, is very important to our understanding of what is going on in world markets. Look at the chart of the dollar against the yen over the past 40 years:

In this chart, you can see that despite substantial Japanese government intervention, the yen is inexorably strengthening against the dollar over the long term. It is making a series of lower highs and lower lows. Sooner or later the low of 76.3 yen to the dollar will be broken and the dollar will be in free-fall. That will cause the gold price to rise in dollars.

The problem is that people do not generally live long enough to remember what happened 50 or 70 years ago – and they do not study that history sufficiently. In this section, I will try to give you my perspective of where we are. And that must begin with an understanding of the Russian economist, Nikolai Kondratiev, and his important observation.

Kondratiev noticed a long cycle of commodity prices and wrote a paper about it in the late 1920's – predicting the 1929 crash. What he said was that approximately every 54 years there would be a major collapse of commodity prices and he traced this cycle back about 300 years. Economists, working at the London School of Economics, have subsequently traced this cycle back over 3000 years. It appears that every 54 years or so commodity prices fall sharply because of an "economic depression". The level of economic activity falls so sharply that the demand for commodities collapses leading to a sharp fall in prices.

There has been much speculation about what exactly causes this drop-off in economic activity, but in my view, it is excessive debt.

When people, organizations, and governments borrow money they are always borrowing it from the future – which inevitably means that, somewhere in the future, there will be less money. When the debt is incurred there is more money than usual, standards of living are very high and boom conditions exist in the economy. Conversely, when the debt has to be repaid there is less money than usual and living standards drop off sharply – what we today call a recession or depression. And when economic activity is very low commodity prices fall – manifesting as a Kondratiev wave.

But why every 54 years? I believe that this is equivalent to the economically active life span of the average man. A man becomes economically active in his early twenties and remains economically active until his late seventies. For this reason, by 1987 there were very few economically active people who had direct, personal, and adult experience of the 1929 crash and the great depression. I recall that my father (born in 1915) would never take on any debt. He refused to have an overdraft, credit card, or accounts with trade stores. His philosophy was, "If we cannot afford to buy it for cash, then we do without". As his generation passed out of the economy there was more and more inclination to take on debt.

By the late 1970s, the personal memory of the great depression was fading. New people were in power, running governments and corporations. The old guard, that could remember the great depression and the consequences of excessive debt, were mostly gone. The stage was thus set for a new build-up of debt levels. By 1987 that debt had reached massive levels and the time was right for the next Kondratiev wave. The cycle had been 58 years - longer than usual - but people were living longer and technology had stretched the cycle out a bit.

To understand what happened next, we need to consider the work of the economist John Maynard Keynes who wrote a very important and influential book ("The General Theory of Employment, Interest, and Money") in the mid-1930s, in the middle of the great depression. Keynes argued that the American government had taken exactly the wrong approach after the 1929 crash. At a time when millions of dollars had been wiped off the value of shares in the stock market, the Federal Reserve Bank had applied a tight monetary policy – leading to the collapse of many banks and a severe shrinking of the money supply. This approach he argued had caused the great depression of the 1930s and that what they should have done was to pump money into the economy to compensate for the wipe-out of wealth following the crash.

By the 1970s, Keynesian economics was taught at all universities, and among the students was Alan Greenspan - soon to be the Federal Reserve Bank Chairman. When Wall Street collapsed in October 1987, the Republicans, then under Ronald Reagan, were expecting to fight for re-election in 1988 and the last thing that they wanted was to contest the election with a collapsed stock market and an economy in depression. So Greenspan and Reagan, using Keynesian economics, persuaded the G7 (the 7 largest countries in the world) to pump vast quantities of money into the world economy to compensate for the wealth which had been wiped off share values. The method was very successful. So successful that, 18 months later, Wall Street made a new all-time high, and analysts began talking about the 1987 "correction" instead of the 1987 "crash".

1987 set the tone for all stock market crashes. For the next 25 years, Alan Greenspan and his successors (Bernanke and Yellen) responded to stock market crashes in the same way, by arranging to pump vast quantities of money into the world economy. But over those 25 years, the level of debt grew enormously. Whereas the US budget deficit had been about $3,5 trillion in 1987 it is now over $27 trillion and rising quickly. The normal 54-year debt-clean-out cycle had been cleverly prevented, but the size of the problem has become astronomical. When the sub-prime crisis brought markets down in 2007 and 2008 no amount of government stimulation or rescue finance seemed to make the slightest difference. The markets just continued to collapse.

In 1987, immediately after the crash, there was much talk about Kondratiev. His name was all over the financial media, but as Alan Greenspan and the G7 worked their economic magic, his name rapidly faded into obscurity and by the end of 1988 he had been largely discredited and returned to his place as an eccentric Russian economist who had once published an interesting paper.

For the Kondratiev Wave to occur, people must first forget all about Kondratiev.

So in 2009, with the S&P 500 index down some 56% and all methods of government monetary intervention exhausted, the world waited in trepidation to see where exactly the bear trend would end.

That led to the implementation of what is now known as "quantitative easing" – which means the "printing" of money by central banks. The sub-prime collapse had caused central banks to run out of cash – and so they just created more – which they then pumped into the world economy to try and stimulate growth. They have produced more than 12 trillion US dollars in this way – and monthly quantitative easing continues in Europe. By 2016 it seemed as if this massive and unprecedented monetary policy stimulation of the world economy was finally working and the US economy was shakily clawing its way back from the recession.

In 1929, with the last Kondratiev wave, Wall Street fell to just 11% of its peak value. But there is a possibility that this bear trend will be bigger, much bigger – because the debt problem has been allowed to grow to much greater heights.

Do not be fooled by a short-term rally on the S&P. Bear trend rallies are always very strong, but the S&P will need to go to at least 2130 before we can safely say that a new bull market may have emerged. It is also true that bear market bottoms are very seldom "V" bottoms (as would be the case if the current rally became the new bull trend). They are more commonly "saucer" bottoms that drift out sideways over an extended period.

In 1929 the center of world economic power shifted from London to New York. In 2016 it may be moving from New York to Beijing. The Chinese economy grows by about 6% per annum while all the economies of the West are barely growing at all. Indeed, America has been in trouble for decades. The strength of the Chinese economy has kept the world economy afloat through much of the sub-prime crisis. Only recently has it begun to slow, but it still has one of the highest growth rates in the world.

The dollar has been falling against the Japanese yen for forty years. The wealth has been leaking out of America at an alarming rate. Like a rich man who has fallen on hard times, America has been living off her credit rating (which is now coming to an end); she has a taste for expensive imported goods which she can no longer afford and she has a strong aversion to hard work. She has been sustaining herself by printing money – which must ultimately result in the debasement of her currency.

The average American school-leaver does not seem to be a patch on his German or Chinese counterpart. And the country has a surprisingly high level of functional illiteracy. The savings rate in America is low. In my opinion, their productivity rate has only been sustained by the fact that most of the world's computers were located in America and so the productivity benefits of the internet were mostly felt in America. But those times are rapidly coming to an end as the Japanese, the Chinese and the Europeans upgrade their infrastructures. America is the largest consumer of DVD recorders and yet not a single one is made inside the country.

When considering this you need to understand that South Africa may be particularly well-placed to weather whatever happens. Our exchange control regulations have prevented South African banks from participating in

the sub-prime crisis. Furthermore, our institutions are prevented from investing off-shore which means that they are forced to spend their very considerable cash flows in the local market. Also, our gold reserves tend to insulate us against the vagaries of world markets. Gold has remained strong as investors worldwide buy gold to protect themselves against turbulence. We also have a strong agricultural sector that has enjoyed many years of bumper crops much of which was sold into the high-priced international food markets. The current El Nino phenomenon will pass and we will again lead Africa in food production. Notably, in recent years the JSE has been consistently out-performing Wall Street. I expect that trend to continue.
So there are two distinct possibilities from here. Either:

1 The massive stimulation of the US and other western economies will work and the world will avoid a deflationary depression; – or
2. These policies will eventually fail and the world economy will slide into a long depression.

I believe that the balance of probabilities favors the success of the central banks in avoiding and postponing the depression. If I am right then it means that all that money that has been pumped into the world economy will gradually begin to be felt. Consumers and businesses will slowly become more confident and begin spending again. As they do that it will encourage yet more people and companies to spend and so on in an upward spiral. However, that upward spiral must eventually come to an end, and then we will face a bear trend which will probably make the 1929 collapse of the stock market look like a Sunday school picnic.

The smart investors are signaling that they don't quite believe that the recovery in the US economy will be sustained. Only time will tell which of these scenarios is correct.

But one thing is sure, the Kondratiev wave, long-delayed and with its author forgotten, will eventually hit home – and when it does, South Africa may well be about the best place to be. For those with an awareness of the markets, the rewards will be substantial.