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News Letter November 2022

The Rand and the Economy

In September, the rand broke through R18 to the US dollar for the first time since the COVID-19 crisis. The rand's recent slump is less about the rand and more about what is finding favour with the world's investors: the US dollar. Nearly every major currency has lost ground against the greenback this year. Even the so-called hard currencies have cracked under pressure. In July, the euro breached parity with the dollar for the first time in 20 years, while, in September, the British pound reached an all-time low perilously close to dollar parity. The rand is in good company at least.

The reason for Dollar strength

What's behind this dollar strength? The answer is rate hikes and risk aversion. With the US economy in relatively good shape, the US Federal Reserve has raised interest rates faster than any other advanced economy to combat inflation. Investors have also sought out the dollar's safe-haven appeal amidst rising geopolitical tension and market turmoil. The combination of increasingly attractive yields and perceived safety has caused an irresistible pull towards the mighty dollar.

Why this bad for SA economy

Dollar strength is negative for emerging economies for two main reasons. Firstly, most commodities are priced in dollars, so vital imports become more expensive — countries can inadvertently import inflation along with their wheat and fuel. Secondly, many emerging market governments borrow in dollars, so their borrowing costs increase when the dollar strengthens — crowding out other government spending. South Africa has also suffered the knock-on effect of rising food and energy costs. However, its position as one of the world's largest exporters of commodities, such as platinum group metals, has helped to offset imported inflation.

The SA Reserve

Fortunately for us, South Africa's debt is mostly rand-denominated. While the Fed is fighting inflation, emerging market central banks must fight the twin perils of inflation and dollar strength. They can only do this by also rapidly raising interest rates, even if this tips their economies into recession before the US. The SA Reserve Bank has therefore had no option but to follow the Fed's lead in aggressively

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hiking the local repo rate. Countries such as South Africa, with structurally higher inflation and interest rates, should experience steady currency depreciation over time. This in turn fuels inflationary pressures, which we must manage if we are to meet our primary investment objective of achieving meaningful inflation-beating returns for our investors over time.

Investment strategy to follow?

New investors: Both SA markets and US markets has pulled back significantly which means a buying opportunity for new investors. Having said that: there could still be a further downside to markets as the high inflation and ever-increasing interest rates could be with us for a while longer. Therefore, markets should be approached with caution. A balanced investing strategy of not more than 50% in equities should be followed, with the other 50% in bonds and cash. It is important to keep/put one foot in the equities space as markets can change overnight. It is impossible to time the market and one should, therefore have some equities exposure.

Investors already in the market: The best course of action when markets are down is to do nothing. Markets will turn and in the long-term you will be better off. Do not try to play the "timing market" game as you will not be able to win it. Rather be patient and wait. Selling off equities for cash now, will only mean that you will be cashing in on your negative growth.

In conclusion

Markets go up and markets go down. We are now in a bear market (down market). In bear markets we have plan for the up-side: do your due diligence, understand your investment goals and your own risk profile and implement your plan.

Happy investing