
Lessons Learned in a 'Zero Beta' Market

Stuff I Wish Somebody Told Me

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Overview

1. Nothing Goes Up Forever
2. Flat Market for Over Five Years
3. What I Would Have Liked To Know
 - What has Worked
 - What to Avoid
4. Liquidity
5. Quality

Nothing Goes Up Forever



Photographer: Dean Hutton/Bloomberg

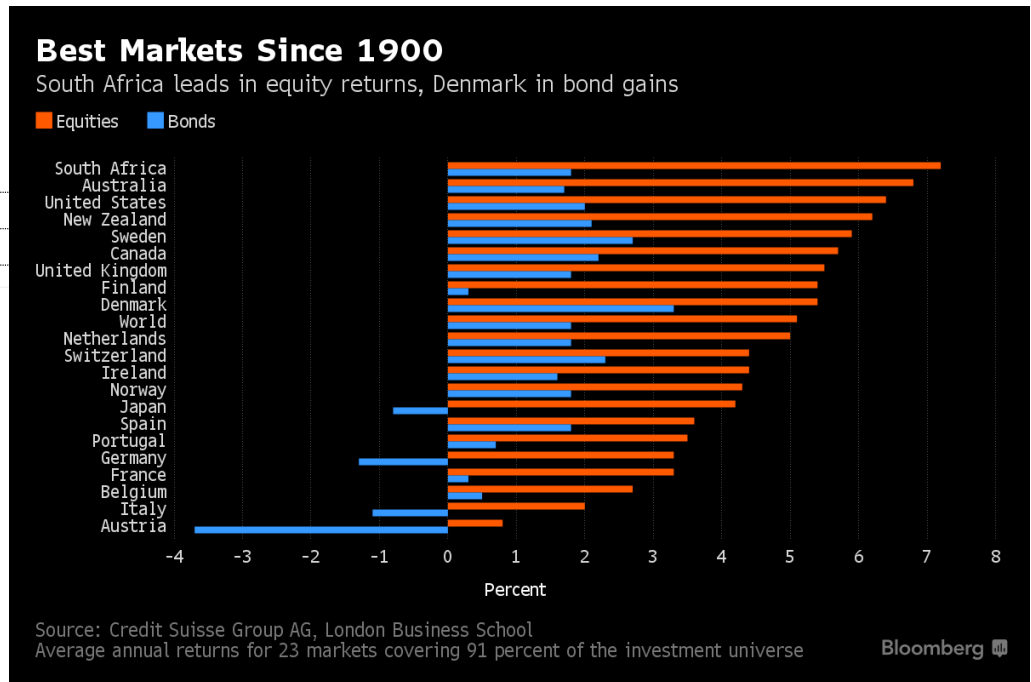
Markets

Top Equity Returns Since 1900 Start With South Africa

By [Selcuk Gokoluk](#)

23 February 2017, 13:56 GMT+2 *Corrected 24 February 2017,*

- ▶ Nation leads commodity-producing nations at top of list
- ▶ Australia, U.S., Canada also outperform rest of world



Source: <https://www.bloomberg.com/news/articles/2017-02-23/list-of-top-equity-returns-since-1900-starts-with-south-africa>

Before 2014

Strong Banking System

Limited External
Financing Issues

+/- 12% CAGR ZAR returns

Innovative Companies

Strong Corporate Management

No Property Bubble

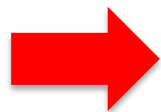
Flat Market for Over Five Years

EditDementor published on TradingView.com, January 27, 2020 11:04:48 UTC
JSE_DLY:J203, M 55799.71 ▼ -1461.33 (-2.55%) O:57308.67 H:59104.61 L:55774.58 C:55799.71



TradingView

Marginal Market Gains; Flat GDP growth



**Market Up +25% over 5 years
(negative in real terms)**

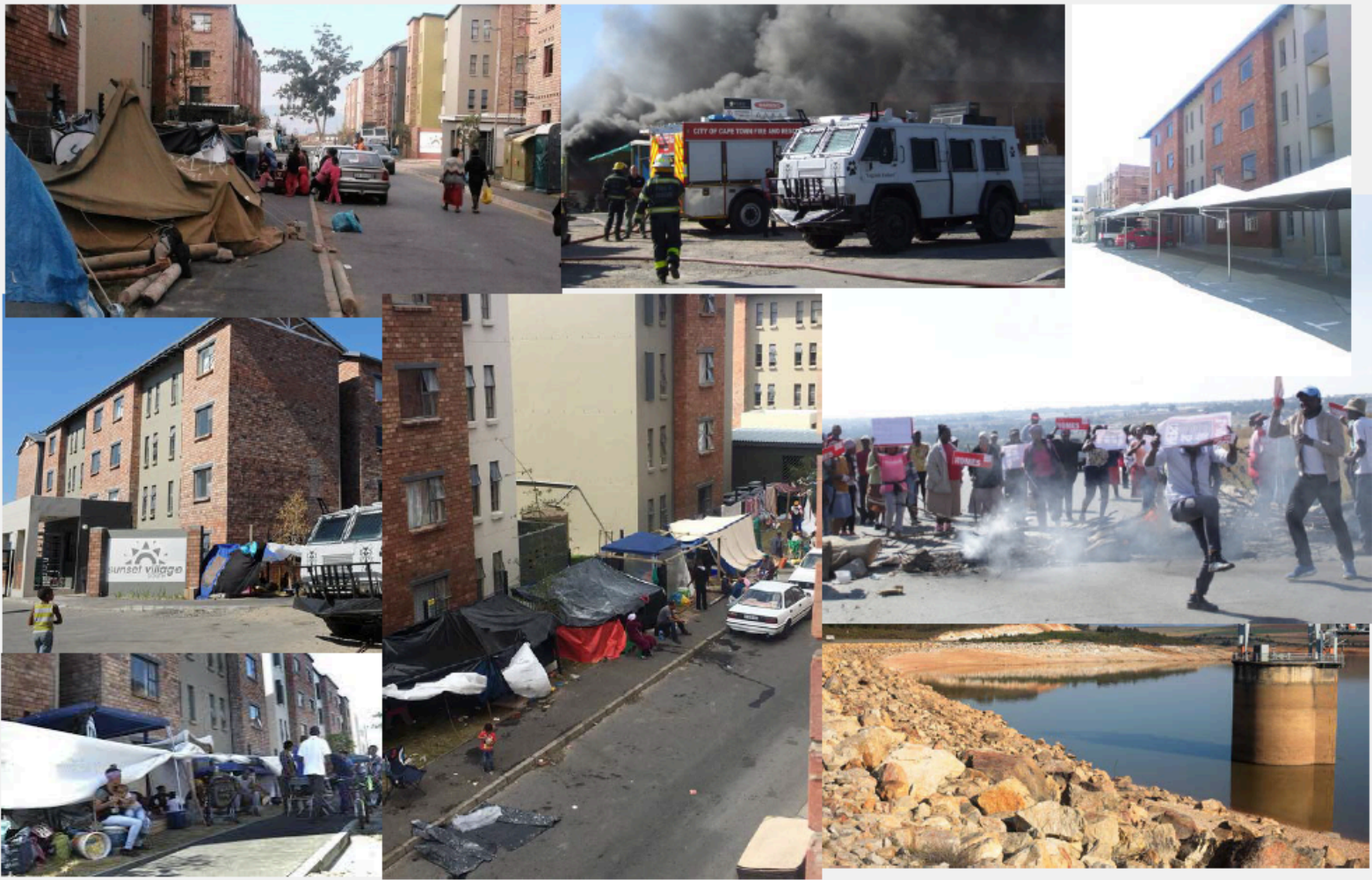


GDP growth (0-1.9%)



**Strong USD (terrible for
EM's)**

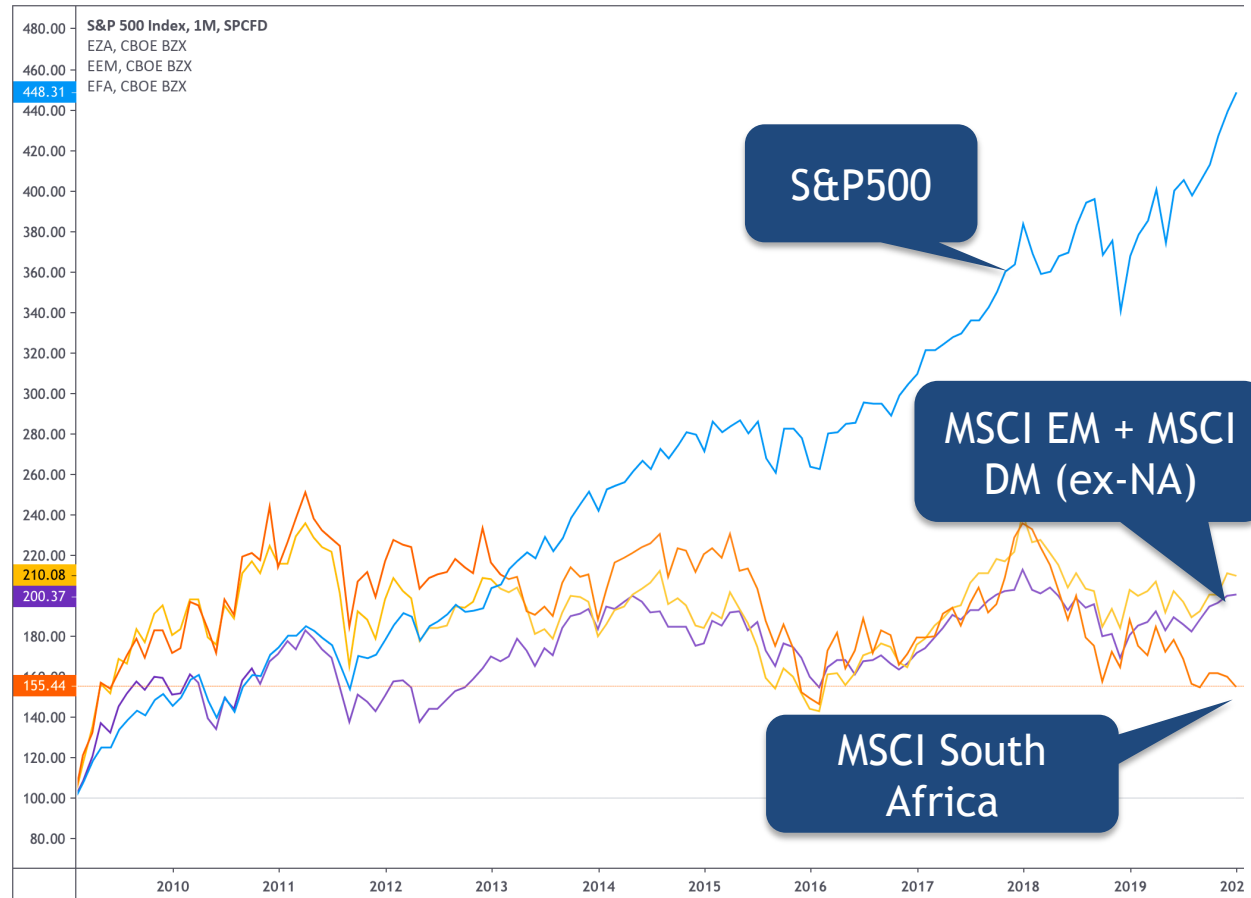
Conditions On The Ground



Nothing Goes Up Forever??

- Strong currency (US\$)
- QE Tailwinds
- Earnings and Margins at Cycle Peaks
- High Valuations

Indexed Returns Since GFC Low in 2009



I'm a Stock-Picker and I Don't Care About Macro!

What Would I Have Liked To Know

What Would I Have Liked to Know?

- After Strong Historic Performance: Risks are to the Downside
- Macro important - pricing strengths usually first to go
- Value Chain Analysis Important (what happens to Ox Peckers if Rhino's Get Killed)
- B2B feel it first, Consumer Lags Towards Middle of Cycle
- “Story” Stocks Often Had a Skeleton
 - Roll-ups (PE backed roll-ups / Share currency underpinned)
 - Frauds (Promotional CEOs, perverse incentives, accounting manipulation)
- Mid and Small Caps will Decline in Value (50-80%)

What Has Worked

What Has Worked

- Niche Lenders with disruptive cost structures
- Subscription business models - opex-based product rather than capex
- Special situations
 - pre-announcement: Business P/E characteristics
 - Leverageable earnings
 - Lazy balance sheets
 - post-announcement: merger arb, activist activity
- Offshore Growth Markets
- Investment Holding Company discounts
 - Wait for catalysts
 - Usually new management / activist

What To Avoid

What to Avoid

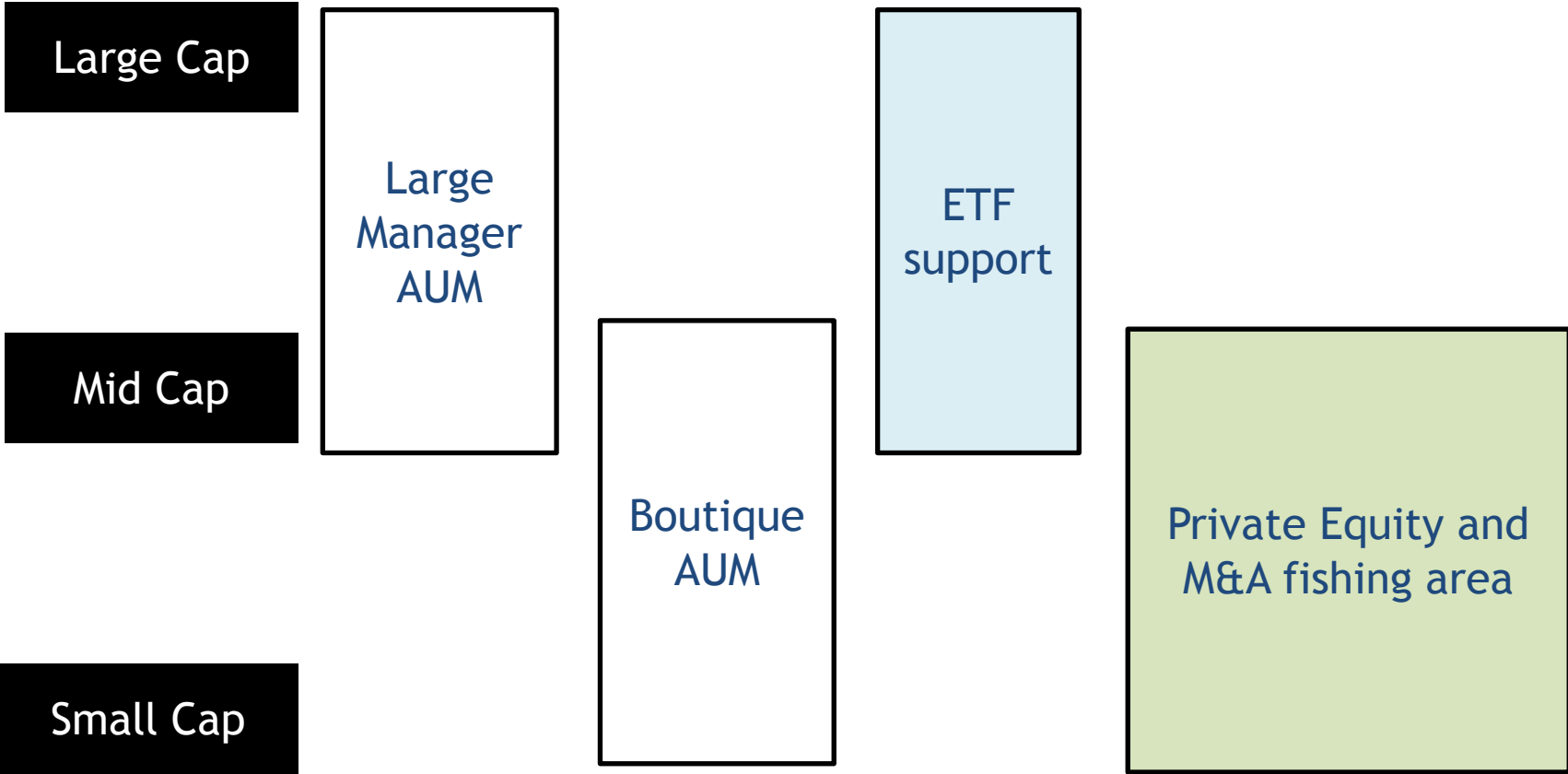
- Debt-laden companies
 - Had strong growth record and record margins → “just one last deal”
 - High refinancing costs (severe dilution or equity wipe-out)
- Recent big-ticket M&A (most likely overpaid)
 - New geographies
 - Adjacent markets
- Property and home-market exposure
- Capex products vs. flow products

Liquidity

Handling Liquidity

- Liquidity Conundrum
 - Funds facing redemptions or anticipating liquidity squeeze - small caps sold first
 - Creates Market Cap Multiple Gap
- Expect 50%-80% declines
- Wait until debt markets start to open up
 - P/E firms start to move in (80%-100% premiums)
 - Good merger arbitrage opportunities (15%-20%) IRRs - low risk

Liquidity



Quality

“Quality”

- High ROIC / High Margin / Strong Brand
 - How much due to strong conditions?
 - High GP margins - will reduce to keep market share
 - Usually operative leverage drops earnings