EXECUTIVE SUMMARY

Thursday, 6 February 2020

INVESTEC ASSET MANAGEMENT

Michael Power – Strategist

2020 Foresight: What on earth will the earth look like in 2030?

Having identified five overarching macro influences we see as shaping the 2020s – namely technological advancement, climate change, demographics, debt and the rise of a China-centred Asia - we view them all in detail through five micro lenses – politics, economics, geopolitics and geo-economics, financial markets, and tech from the individual perspective. From this exercise, we see three broad scenarios for the 2020s arising: Redux, Fraying at the Edges and Brave New World.

Learning outcomes:

Arising from these scenarios, we identify the likely winners and – just as importantly – the possible losers in the universe of investment opportunities, specifically in Asia. This will facilitate the adviser’s ability to make appropriate long-term investment decisions for their clients.

STANLIB

Kevin Lings – Chief Economist

Economic overview

Trade dispute between the US and China hurts world trade in 2019

Global trade started to weaken in November 2018 and has trended weaker for the past twelve months. This time-frame corresponds to President Trump’s decision to escalate the trade dispute between the United States and China. The weakness in global trade has also undermined world industrial production, especially manufacturing activity, as well as business confidence.

Given that world exports represent around 30% of world GDP, the global trade data suggests that a very significant component of the world economy is currently experiencing a meaningful slowdown in economic activity. If the weakness in world exports is sustained or exacerbated, it could pull the world economy into a more pronounced slowdown during 2020, with little policy option available within the major economies to reflate global growth.

South African economy is struggling to grow, hurt by electricity outages and weak business confidence

In the third quarter of 2019, an economic policy document was released by the South African National Treasury setting out a roadmap of key reforms and policy priorities necessary for South Africa.

The document focuses on both short-term initiatives as well as long term reforms that aim to improve the immediate growth outlook, but also lay the foundation for long-term sustainable growth. Under these circumstances, the key focus is on whether the government has the political will and institutional capacity to implement the key policy components put forward by the Minister of Finance.

Closing the gap between South Africa's current trend growth rate of around 0.5% and a modest target of 3% on a sustained basis is going to require a significantly larger effort than is currently evident, including the co-ordination of economic policy across key government departments.

SANLAM UK

Pieter Fourie – Fund Manager and Head of Global Equities

Mistaking momentum investing for quality investing

A question facing quality investors is whether large parts of the index are un-investable if you adhere to a strict valuation discipline.

A major challenge facing quality investors is that they're paying a record premium for the safety of strong balance sheets and reliable profitability, evidenced by the widening premium between the MSCI World Quality Index and the main World Index over the past seven years. We remain in an environment where slowing economic growth and pressure on margins make it tougher for companies to deliver on earnings expectations. However, it's pleasing to see that those businesses that can deliver, are being rewarded via increasing share prices.

Over the past three years, growth stocks and in particular, the universe of names from which we determine our portfolio, have traded at above-average and in some cases, extreme valuation levels. Growth stocks have recently reached 15-year-high valuation levels, and as a result, collectively the margin of safety has reduced for the names in our universe.

Since the start of our global high quality strategy, our insistence on investing in businesses that embody the quality criteria we require for inclusion in the portfolio has never changed. However, when faced with valuations at the top of their historic range, we must be steadfast in our willingness to never overpay. We continue to invest in companies with strong free cash flow generation, high operating margins, and balance sheet efficiency.

In the context of this strategy, quality investing means never straying from the key attributes a business must exemplify, while endeavouring to never compromise the valuation discipline on which our philosophy is centred.

SANLAM INVESTMENTS

Nersan Naidoo – Chief Executive

Technology trends and investing: Disruption or opportunity?

The impacts of technology can be thought of either from the perspective of disruption or opportunity. A good example of disruption would be photo industry giant, Kodak, filing for bankruptcy in 2012 after being disrupted by digital photography. The focus of this presentation is more on the opportunities technology presents for investing.

Moore's Law famously tells us that the number of transistors on a microchip will double every two years. Said differently, microprocessors will grow at an exponential rate.

The rapid increase in processing power combined with the decline in the cost of storage has resulted in our ability to store and process massive amounts of data, commonly referred to as 'big data'. In 2017, IBM noted in a study that 90% of the data in the world had been created in the prior two years alone. Today terms like brontobytes (10^{27}) and geopbyte (10^{30}) are commonly used, and companies that have mastered big data have outstripped their competitors and created tremendous investment opportunities. Think about Amazon that traded in the late 90's for $US 10 and is today trading around $US 2000 a share.

Advances in medical and food technology are also having profound effects on us. Gene therapy technologies have opened the door for cures to be found for dread diseases. Food technology, like Beyond Meat's meat-free burger, are delivering on healthier food options. Food and medical technologies are accelerating longer life expectancies. Longer life expectancy means that we may need to think fundamentally differently about our goals, retirement or otherwise, and how we invest for these goals. These future-focused companies also create fantastic investment opportunities, with Beyond Meat posting phenomenal returns of 202% in 2019 (since its May IPO).

There can be no doubt that technology is changing the world. Cryptocurrencies, digital tokens, artificial intelligence and deep learning will all have a material impact on how we think about our investment needs as well as the investment opportunities available to us. It is most important to remember one of the fundamental rules of investing – diversification. Investors shouldn't fall into the trap of investing everything into Amazon, Beyond Meat, Bitcoin or the next big thing. Instead try to introduce diversified baskets of these assets or asset classes slowly into your portfolio using a sound portfolio construction philosophy. In other words, stay clear of the new 60:40 portfolio – 60% Tesla, 40% Bitcoin!

PRUDENTIAL INVESTMENT MANAGERS

Pieter Hugo – Head of Retail Business

Challenging Conventional Retirement Thinking

After five years of underperformance by local equity and listed property assets, investors have experienced very disappointing returns, and have been moving increasingly into the perceived safety of cash, based on the recent superior performance of cash (with less risk).

However, we would argue that this situation of having insufficient equity exposure is actually inherently more risky for investors, especially those building their retirement savings. Investors are trying to solve the wrong problem - preserving their existing savings - when they should be focusing on having enough money at retirement. Switching to cash can cost investors many years' worth of foregone returns.

We know that over the long term, equity and listed property have delivered far higher returns than cash. When equities outperform, they tend to do so quickly and with no obvious trigger, meaning that many investors sitting on the sidelines miss out on significant parts of the returns on offer. They switch back too late to enjoy the market's full gains.

Currently, there are a number of valuation measures telling us that, from this point forward, local equities are very likely to produce above-average returns over the next three to five years; history says they are likely to be much improved after such a unprecedently long period of underperformance.

In order to solve the problem of retiring with inadequate savings, investors should not be de-risking their portfolios in tough times, nor should they even be de-risking as they approach retirement age. One of the major drawbacks of the latter approach is that it limits the investment's growth potential *exactly at the time* when the retirement capital is typically at its highest-ever value. "Safe" assets will not deliver sufficient inflation-beating returns to last throughout retirement. Rather, maintaining the equity exposure similar to that of a typical balanced fund should give the investor an extra decade's worth of retirement savings to live on.

Friday, 7 February 2020

Round Robbin Sessions

ALLAN GRAY

Duncan Artus – Director and Portfolio Manager

“What value will I add to my clients’ portfolios by adding global exposure / equities?”

The correct allocation between local and offshore assets is one of the most debated topics in the local savings industry. We have tried to look at it from a fund manager’s view.

It is important to note that South Africa makes up about 1% of the world and it makes little sense to have all your savings in one small market. The ALSI has been a poor performer over the recent past but over the very long term it has impressively held its own versus global markets.

But small emerging markets are by their very nature riskier and protecting against a tail risk such as events in Venezuela is important for capital preservation in real terms. In addition, the ability to gain access to sectors which have low or no representation on the ALSI provides not only more opportunity but also diversification benefits.

The ALSI is a very concentrated index and most of the large shares have a reliance on the Chinese economy. This results in local investors being significantly exposed to Chinese country risk including their elevated and rapidly growing debt obligations.

In our experience many investors destroy value over time by switching between local and offshore at the wrong time and we believe advisers can add value by encouraging the right behaviour both for themselves and clients.

CORONATION FUND MANAGERS

Peter Kempen - Head of Retail Distribution

The impact of the decision to de-risk

Subsequent to an anomalous period of low returns from growth assets, investors have de-risked their retirement portfolios in favour of cash and income assets. The concern is that such a move results in insufficient growth asset exposure within investors’ portfolios which sets them up for disappointing returns over the long-term, and ultimately leads to unfavourable retirement outcomes. In our presentation we outline the impact of the decision to de-risk as well as the potential outcomes for those investors that stay the course. Ultimately there are four conclusions that are made:

- If retirement portfolios are invested in balanced funds that achieve their inflation linked investment objectives, the recovery of capital may take some years, but they are certain to provide a better long-term outcome than moving to cash and income assets at this juncture.
- Judicious exposure to growth assets remains a cornerstone of balanced portfolios that are required to provide income over long time horizons.
- The downside within retirement portfolios needs to be managed as there are significant risks to long-term real capital when large drawdowns are experienced in a portfolio that provides a regular income, especially if these drawdowns occur in the early years of retirement.
- Drawdown rates from retirement portfolios need to be realistic and managed to reflect the reality of capital movements in the underlying investment portfolio.

Ultimately investors are best served by investing in a diversified portfolio that includes sufficient exposure to growth assets, and that is aligned to their investment risk profile as well as their individual investment objectives.

PSG ASSET MANAGEMENT

Gustav Schulenburg – Assistant Portfolio Manager and Equity Analyst

Are equities still a relevant asset class?

Often, investors need to be reminded that behind every stock is a company. We believe that those companies remain relevant and often present good investment opportunities, provided that these are acquired at a reasonable price.

The cycle will always play a part when investing, especially over the short term. How investors navigate those cycles will often influence an investor's return and investment experience. Poor decisions, especially during times of fear and uncertainty can lead to inferior long-term outcomes for any investor.

At PSG Asset Management we always remain aware of the cycle, but we do not try to time inflection points in a cycle: we prefer to look for good opportunities that are priced below their intrinsic value, and then to hold these for the long term.

We are comfortable constructing portfolios that could look different to that of the index or our peers. We aim to find the best opportunities for clients, and those are often in less popular parts of the market.

Currently valuations in sections of local and global markets are at extremes. Although these stocks/sectors remain popular and arguably good companies, we don't believe that it is prudent to allocate client capital to these companies at current valuations.

Our portfolios remain well diversified to ensure that, over appropriate time periods, we don't expose clients to excessive risk.

Over the short term, our funds have underperformed, and we are cognisant of that. We do not follow market momentum or invest in what is currently popular. We therefore expect our performance to be lumpy, since markets can often diverge from fair value for extended periods of time. However, we remain confident that our portfolios remain well-managed and should outperform over the longer term.

SATRIX

Kingsley Williams – Chief Investment Officer

The Satrix Balanced Index Fund

In an increasingly uncertain world, how do we even begin to have any confidence in investing on our clients' behalf, particularly when there are so many options out there? Investing by its very nature, can be an unnerving endeavour.

In the high-equity balanced fund space, most investors have entrusted their savings to the largest 10 funds, which - over the last five years - hasn't been a bad place to be. However, with increased scrutiny on costs and ensuring your clients are truly diversified, the Satrix Balanced Index Fund offers a compelling proposition.

When diversifying, we have to go beyond simply putting eggs in different baskets… we need to make sure those baskets are also uncorrelated. This applies to blending high equity balanced funds, as much as it applies to the design of an equity strategy within these funds. The Satrix Balanced Index Fund has multiple benefits of i) being highly cost effective, ii) providing greater certainty of what you're investing in, and iii) being differentiated, thereby helping you to remove risk and uncertainty from your clients' portfolios. The Satrix Balanced Index Fund is a large fund with assets in excess of R5bn, so it is able to comfortably absorb flows with minimal impact on transaction costs and total investment charge.