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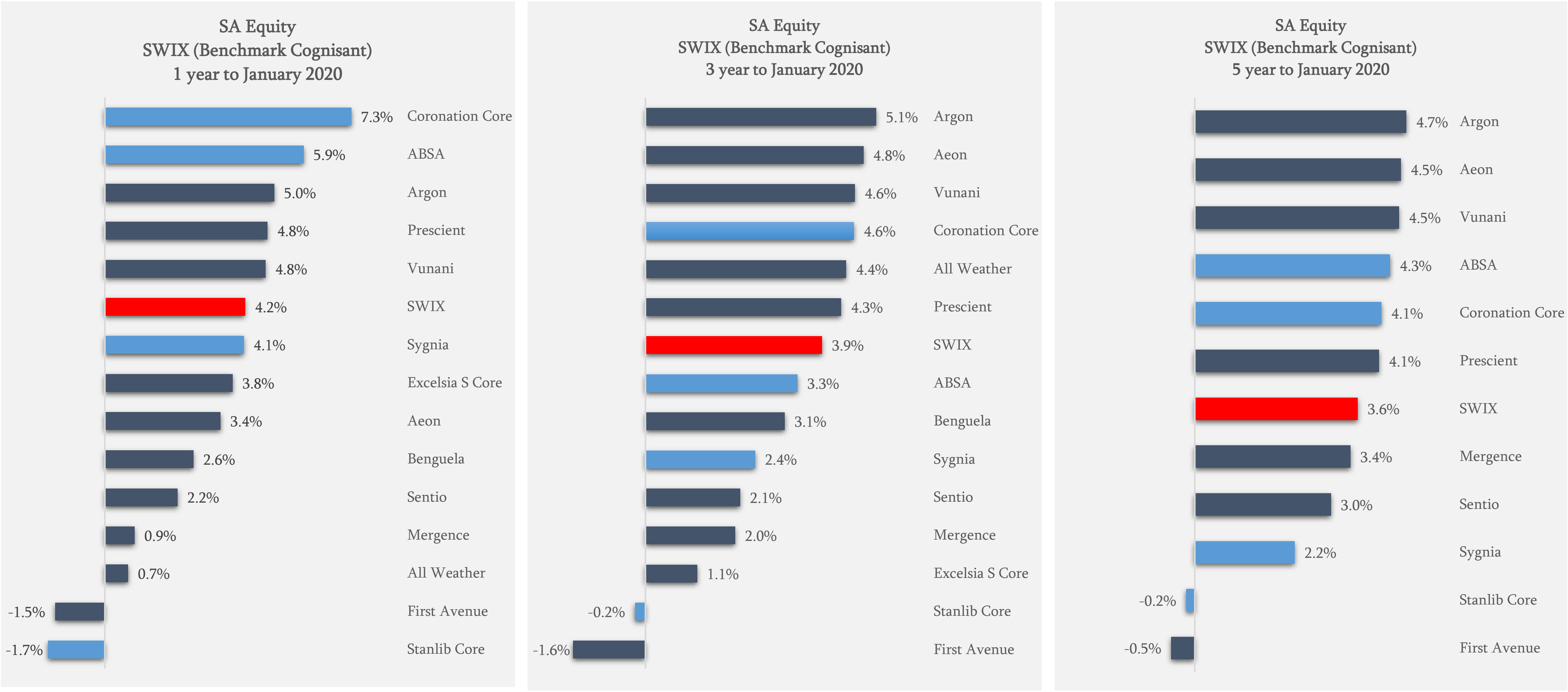
EMERGING MANAGER STRATEGISTS

South Africa Equity and Bond Survey

January 2020

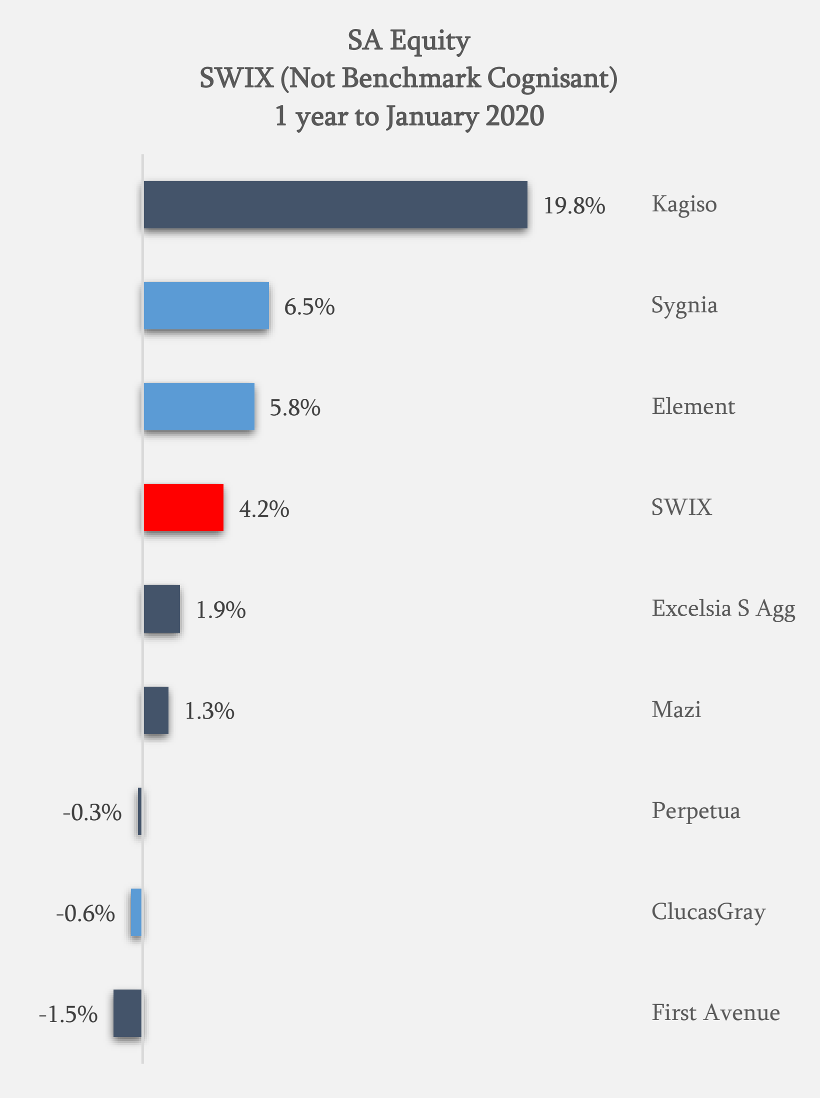
“Reshaping the SA Asset Management Industry”

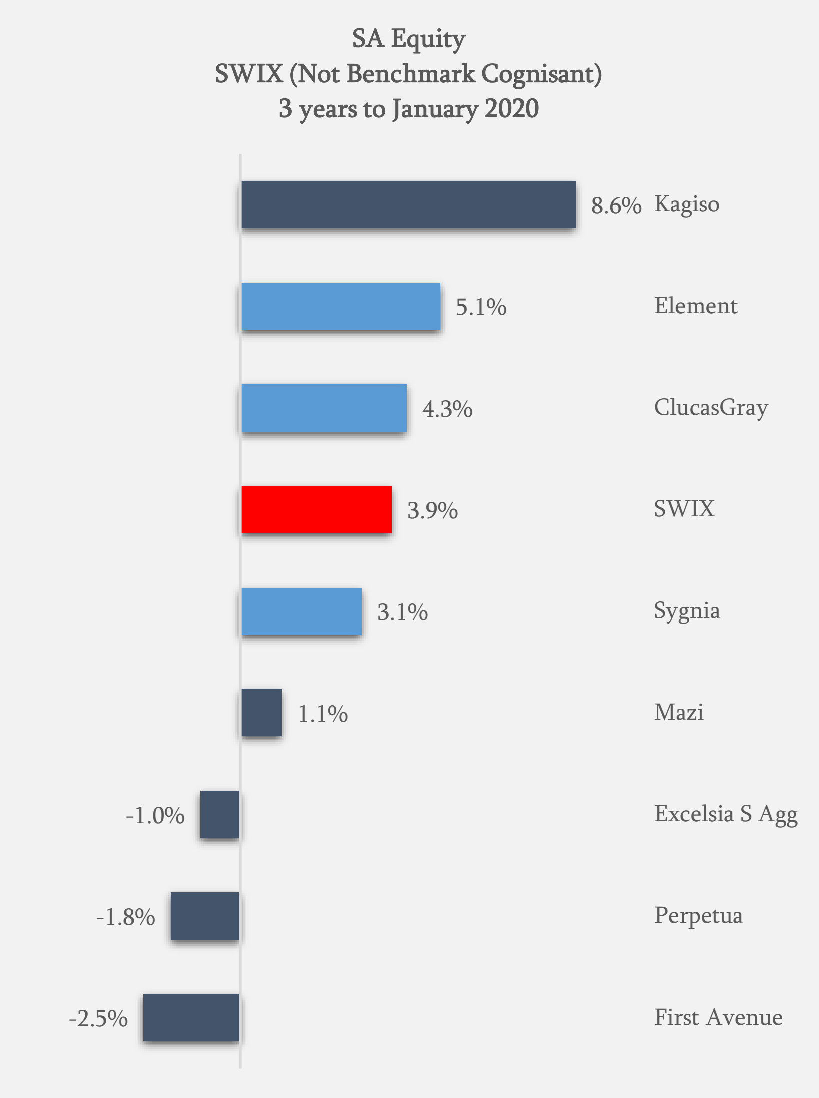
SA Equity - SWIX (Benchmark Cognisant)

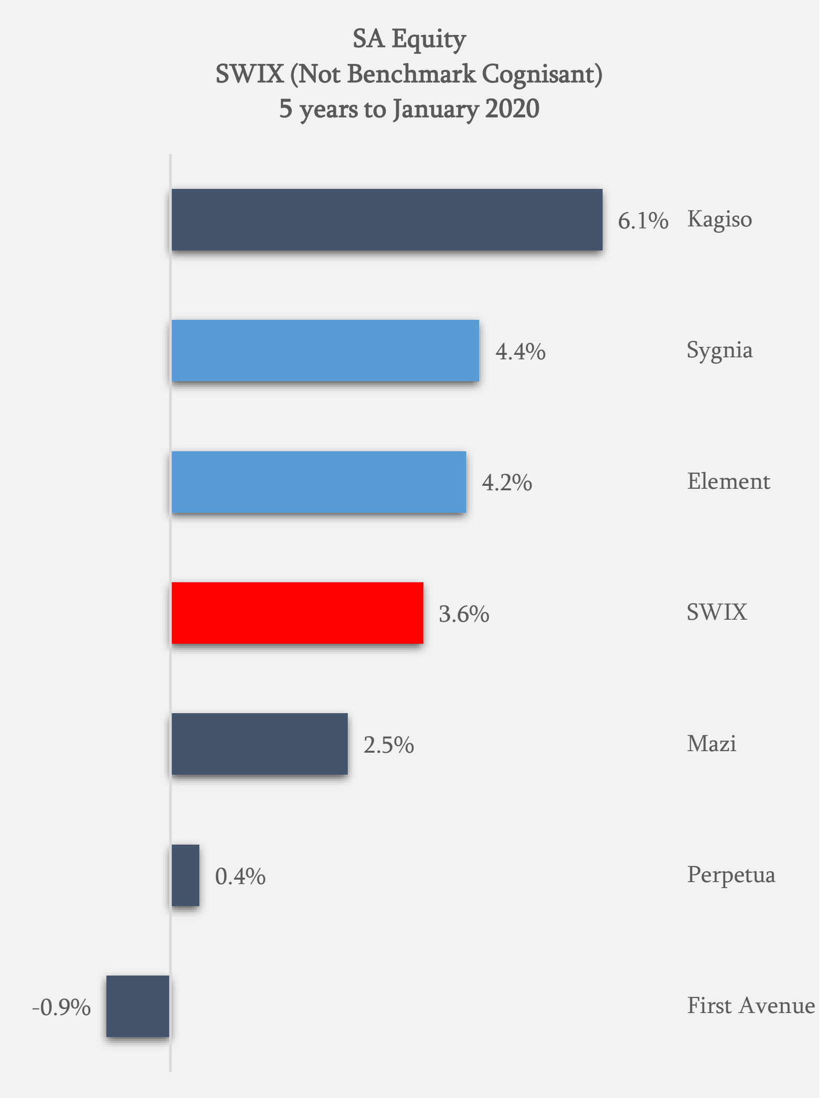


Source: Motswedi Research, Alexander Forbes Manager Watch

SA Equity - SWIX (Not Benchmark Cognisant)







Source: Motswedi Research, Alexander Forbes Manager Watch

SA Equity - Capped SWIX (Benchmark Cognisant)

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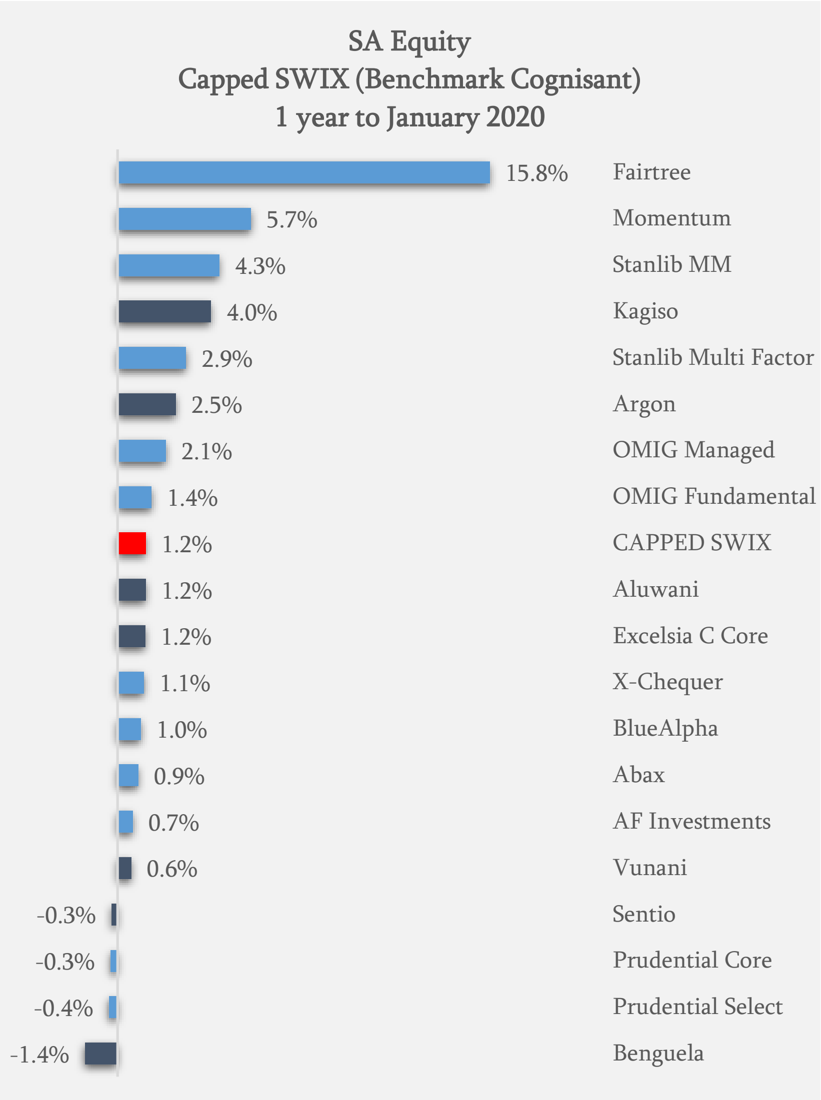
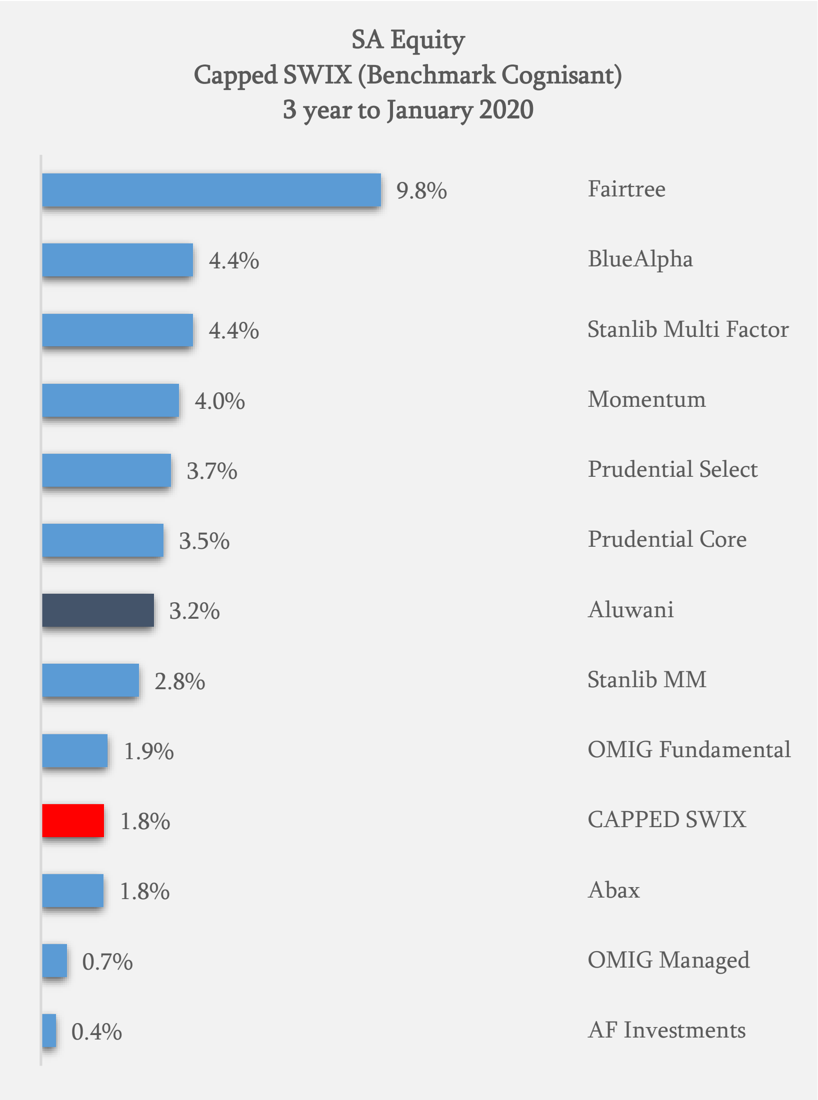
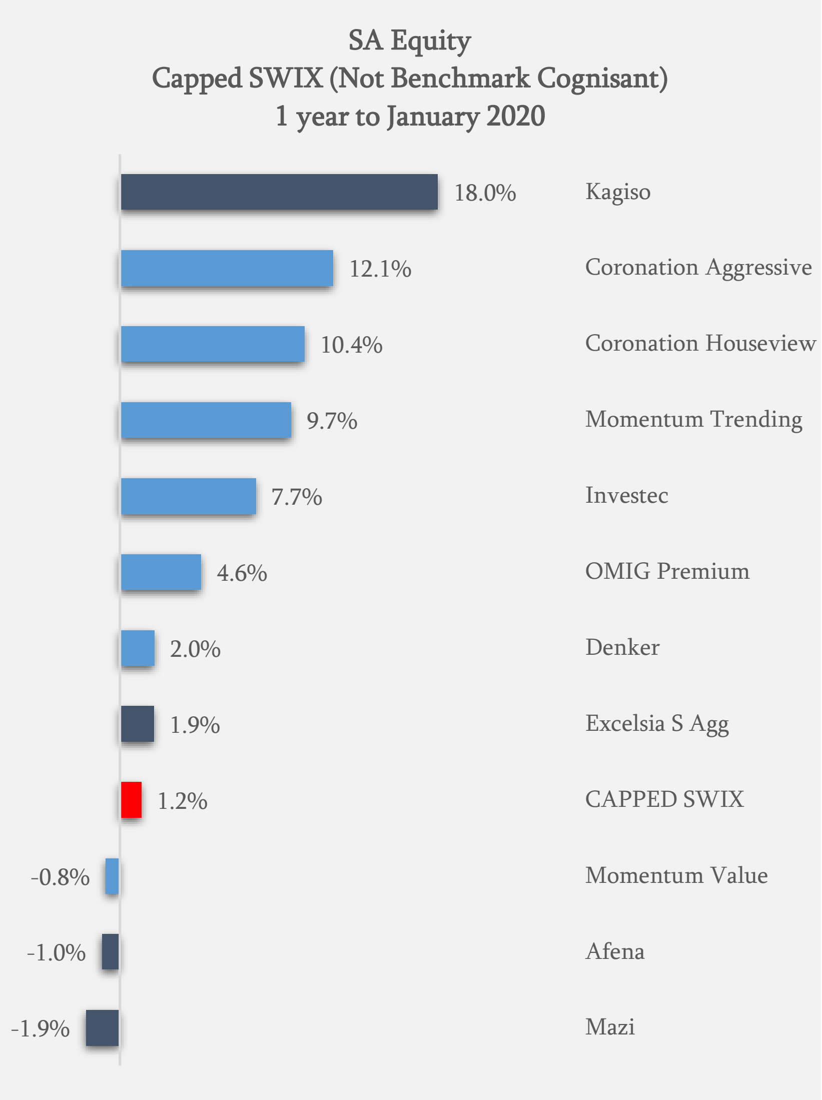
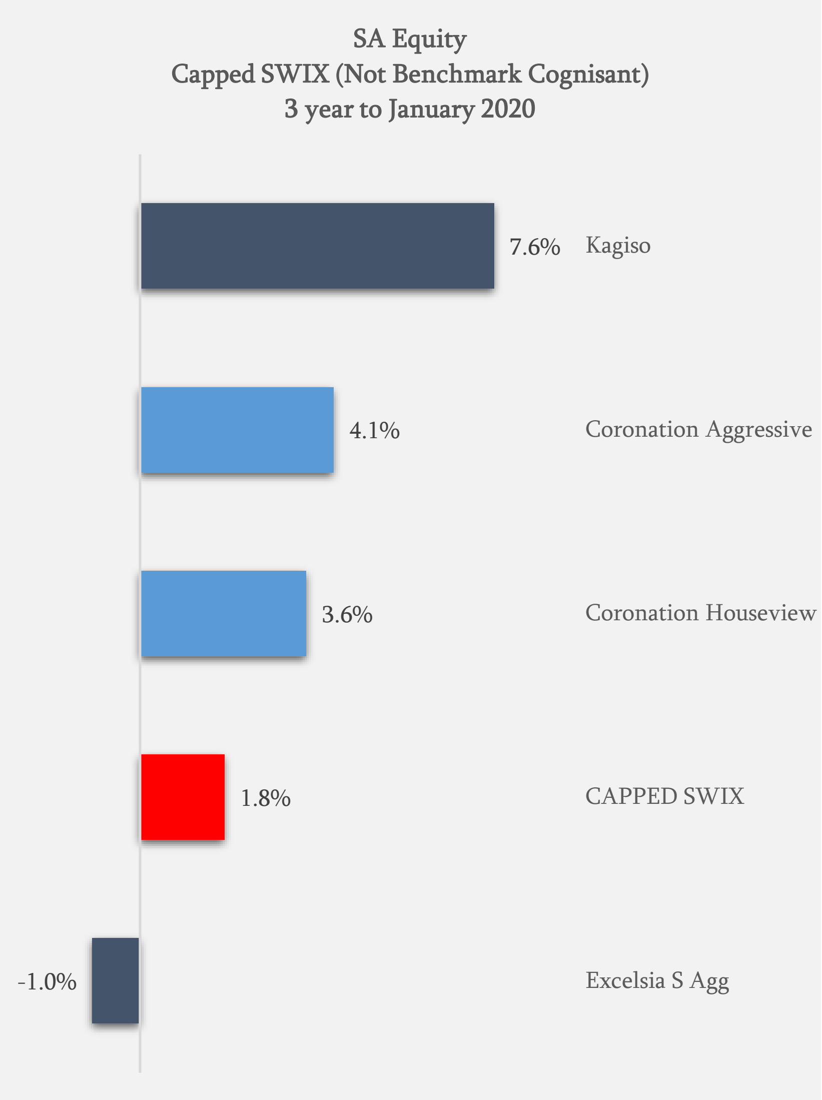




Source: Motswedi Research, Alexander Forbes Manager Watch

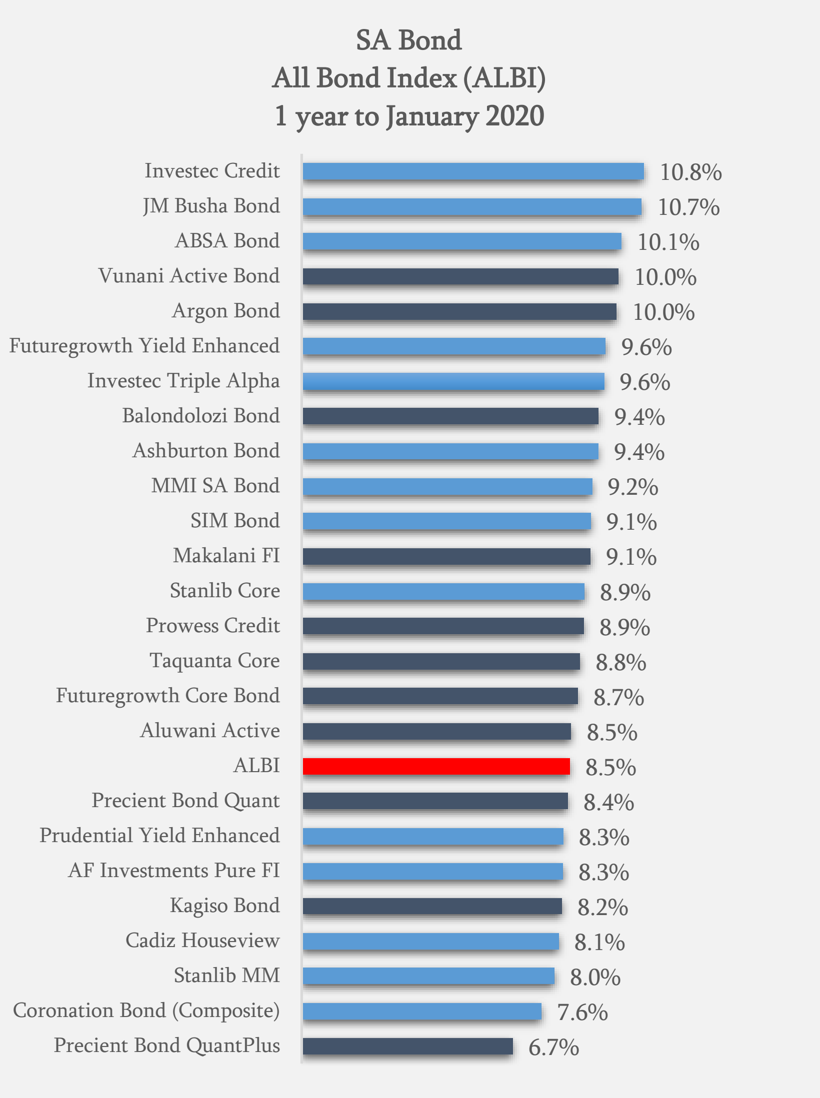
SA Equity - Capped SWIX (Not Benchmark Cognisant)

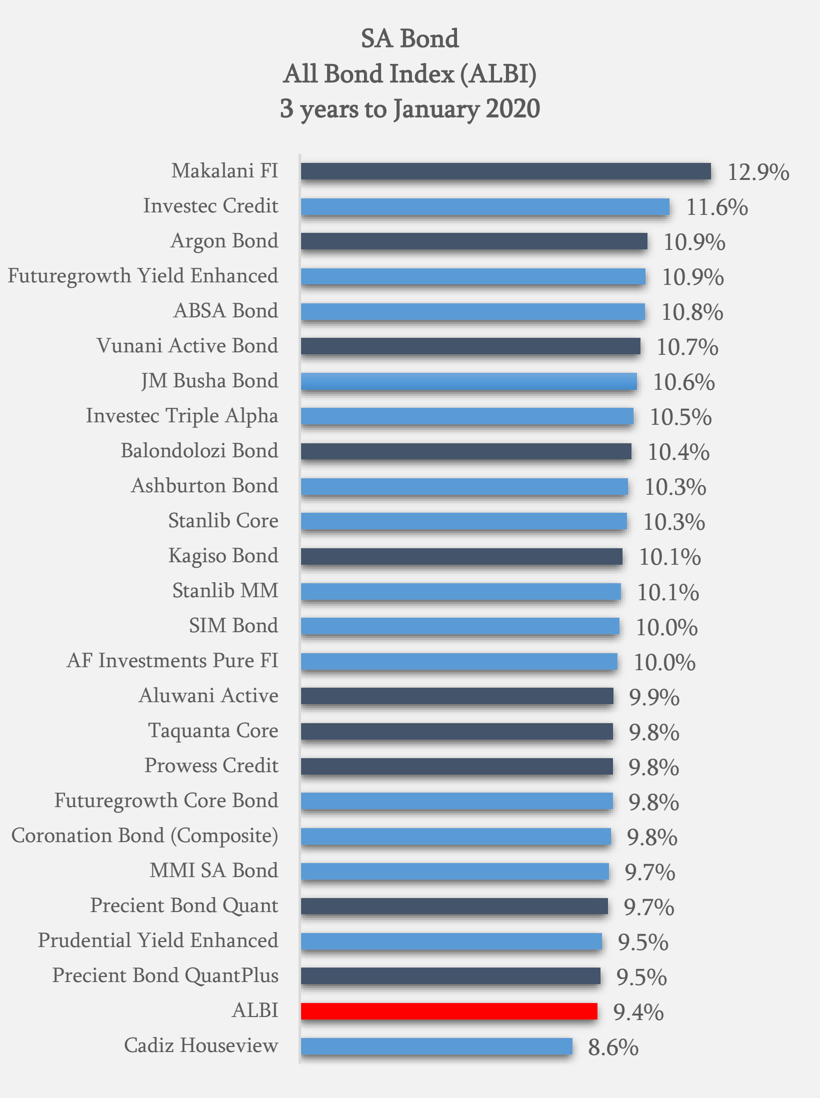


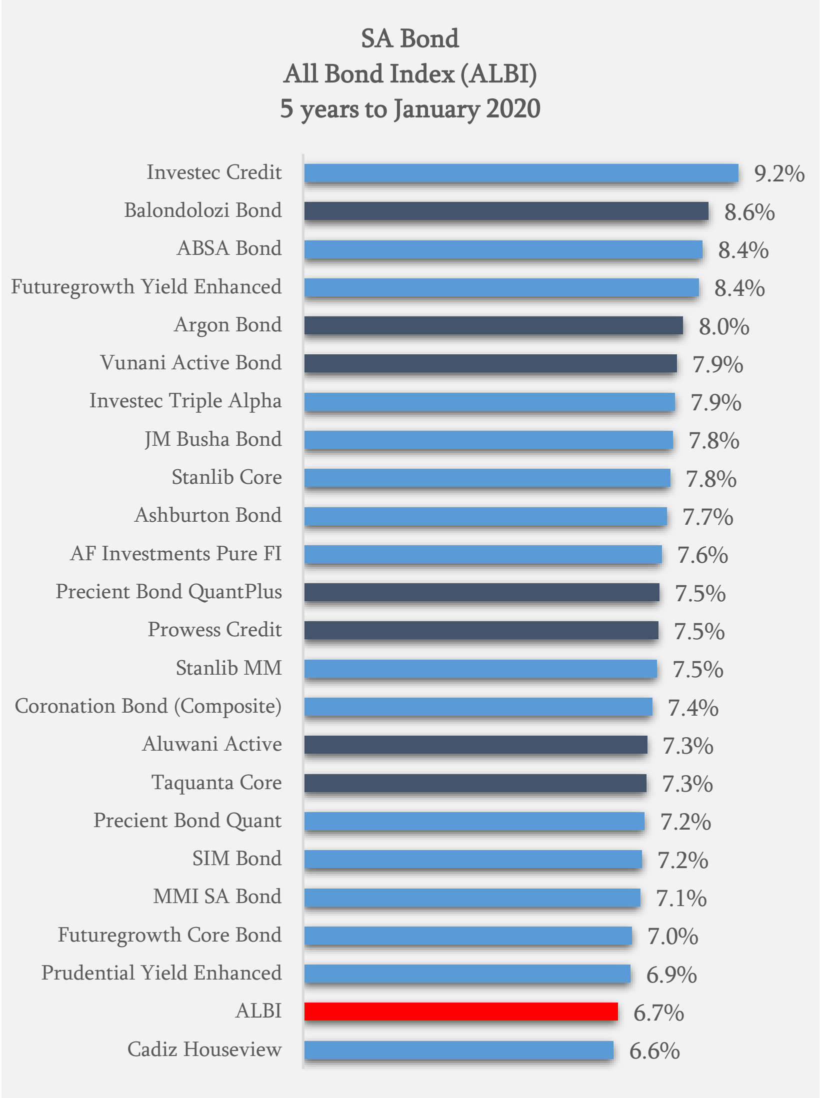


Source: Motswedi Research, Alexander Forbes Manager Watch

SA Bonds - ALBI







Source: Motswedi Research, Alexander Forbes Manager Watch

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Manager Commentary
Coronavirus' Markets and Investment Impact

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The Coronavirus is certainly one of the global risks that must not be underestimated and must be monitored closely for any related developments; we at Umthombo are certainly closely monitoring the Coronavirus risks and associated developments. At this stage it is unfortunately not possible to quantify the potential impact on global growth prospects, but it will certainly have a negative impact.

The Coronavirus has been detected in over 30 countries, with over 3 000 deaths and nearly 80 000 confirmed cases of infection. World bank anticipates over 1 million deaths from the virus outbreak. Most recently, the rapid increase of cases outside China, with the likes of Italy and Korea increasing to 124 cases (4000%) and 763 (756%) respectively, within five days, has resulted in assertions that the virus may be on the brink of switching into a global pandemic. Most countries have implemented forced quarantine, city and state lockdowns in order to curb and contain the spread of the virus, but early signs are not pointing to containment.

Analysts' predict a wipe out to the tune of USD 1 trillion to global GDP. IMF forecasts global growth to slow from 3.3% to 3.2% in 2020 and global growth in Q1 2020 to drop from 3.5% to 0.5% as the Chinese economy shrinks and global consumer confidence is dampened. China's economic growth is expected to slump to 4.5% in Q1 2020, down from 6% in Q4 2019 – the slowest pace of growth since the GFC, if the virus persists.

Global central banks will maintain an accommodative monetary policy stance in order to aid global growth. However, we do not believe a more dovish monetary environment can counteract the global economic fallout; productivity is being severely disrupted by quarantines is the problem.

Trade wars, lower productivity, sliding travel, disrupted supply chains, reduced investment will be the main contributing factors to the global slowdown. Oil prices have slumped by 14% in 2020 YTD; Brent is expected to test the USD 50/ barrel. A direct result of the anticipated slowdown in global demand given China is the biggest import of oil globally. Global demand for oil is predicted to drop by 435 000 bpd Q1 2020 y-o-y; the most in over a decade. OPEC+ members held an emergency meeting in February in an attempt for a collective effort on reducing oil production by 600 000 bpd to prop up oil prices. That has not worked to date as Russia has resisted supporting Saudi Arabia's proposed solutions.

As for other commodities, Gold will continue to rally and might test the USD 1800 level in the near term as a safe-haven trade if the virus continues unabated. Dollar and Yen strength will also continue to persist as safe-haven bets in the currency market. Copper and iron ore prices have declined 8% and 1.5% respectively this year, anticipation of slowing demand.

Manager Commentary continued…
Coronavirus' Markets and Investment Impact

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Equity markets around the world have entered correction territory. The extent of the recent selloff has certainly surprised a lot of investors, ramping up emotions to near panic levels, but we believe it's important to remain calm and not let the emotions dictate our investment decision-making process. Emotions tend to move in a pendulum swing from being too optimistic to too negative, which can create opportunities of which active asset management can benefit from. Recently the VIX (market volatility) spiked to 47% reflecting broader market uncertainty.

We believe our equity portfolios are well positioned for multiple different scenario outcomes. We believe the best approach in this environment is to pro-actively manage risk and react accordingly when new information presents itself (not be anchored to initial views).

On the bonds side, global yields have continued to rally on the back of the safe-haven as riskier assets have sold off. The US 30 year reached an all-time low of 1.83% as Bund yield curve turned negative across the whole curve; and despite the global risk-off sentiment, yield seeking amidst ample global liquidity (expansive global monetary easing) supported EM bonds.

SAGBs still provide very attractive real yields which we expect will continue to attract foreign investors despite the virus concerns. In our view, SAGBs are also supported by the "local safe-haven/flight to quality theme"; essentially reallocation of assets to the less risky bonds.

In February alone locals have been aggressive net buyers of bonds – R17.9bn. Foreigners have still bought R8.1 billion worth of SAGBs, while local investors bought R13.5 billion worth of SAGBs YTD. However, this year's foreign SAGB purchases have mainly been due to a reinvestment of January's coupons rather than a fresh deployment of capital to SA Inc.

Overall, we expect the local bond yield curve to continue steepening mainly due to sustained pressure on the fiscus pre and post the budget speech. We expect the national budget to show a further erosion of the nation's fiscal strength and economic strength. In that regard, we expect Moody's to downgrade SA in March after the budget speech.

Our overall short bonds duration, to the benchmark, positioning has considered the aggregate of these risk factors (prevailing and legacy themes), fundamentals and market technicals. We expect the curve steepening to persist amidst budgetary woes and a clear lack strategy to steer the fiscus back towards consolidation. Having said that, the market continues to surprise positively as the safe-haven inflows (Bonds rallying) remain unpredictable. We are overweight the belly of the curve, neutral on credit (spreads have compressed significantly), prefer high carry securities and underweight linkers due to oversupply concerns. Overall, we expect investors to adopt a "wait and see" approach ahead of the budget and a possible Moody's credit rating downgrade in March.

Written by: Umthombo Wealth Investment Team

About Motswedi

Motswedi Emerging Manager Strategists is an independent asset manager research business focusing on the South African investment management industry with specialisation in transformation initiatives. We are the industry leader in providing insight and access to the new generation of emerging asset managers in South Africa. We encourage the development of a more diverse industry that can contribute towards economic growth.

Our vision is to be a financial services company that services both institutional and retail clients to provide access to high quality and well researched emerging managers. Our higher purpose is premised on "Reshaping the South African asset management industry" by promoting transformation, gender equality, skills development and stimulating economic growth through supporting and investing with transformed asset managers.

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