Q1 | February 2021

STAND POINT

STANLIB

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FROM OUR STANDPOINT

A note from our Head of Institutional Distribution,

TRACY COETZER

We are now firmly into 2021, which started with another series of lockdowns worldwide, again causing a slowdown in economic activity. However, significant events have occurred that are likely to shift global economies and investment markets in a positive direction.

We can expect a calmer political playing field to follow Biden's victory in the US Presidential Elections. Globally, vaccine roll-out programmes have started and, at the time of writing, several countries were reporting declining infection rates as a result.

SA has, unfortunately, been slow to find a solution to end the local COVID-19 crisis, but we expect an effective vaccine roll-out will gather pace in 2021, which will give us room to face other issues.

In the meantime, we are mindful that this health crisis is not over, and the recent COVID-19 case count surge has placed our healthcare system under severe strain. Many of us were personally touched and we extend our condolences to each of you who lost relatives and friends. To those still recovering from COVID-19, we wish you a speedy recuperation.

Top of our minds as we continue to navigate uncertain markets, will be the:

- effective roll-out of vaccines,
- ongoing, and potential narrowing of the disconnect between financial markets and the real economy,
- divergence in the type and timing of recovery between developed and emerging economies, and
- how we invest through these ongoing changes and uncertain market conditions.

As we focus on the future, we have gathered some insightful pieces which we hope will provide thought-provoking reading. Kevin Lings shares his views on economic changes that could lead to much-needed growth and he offers reasons for South Africans to be hopeful.

Joao Frasco, CIO at STANLIB Multi-Manager, updates us on the history of equity market returns. Using historical data, he reminds us to focus on the future and long-term financial objectives rather than succumbing to our emotions at times of crisis and volatility.

Kobus Nell, Equity Portfolio Manager within our Equity and Balanced team, analyses the current driving forces of earnings growth and valuations, and highlights the relevance of equity as an asset class to deliver growth in a balanced fund.

Finally, our offshore partners at Columbia Threadneedle share their lessons of 2020 and thoughts on 2021. They expand on how they are applying their thinking to their asset allocation strategy and portfolio positioning as they head through the "brighter days of winter".

We all face another challenging year. However, it is heartening to know that, as we focus on the future, we are heading towards a much-needed recovery in the local and global economies.

I wish you all well as you begin this year. Thank you, as always, for partnering with STANLIB. Please stay safe, healthy and hopeful.

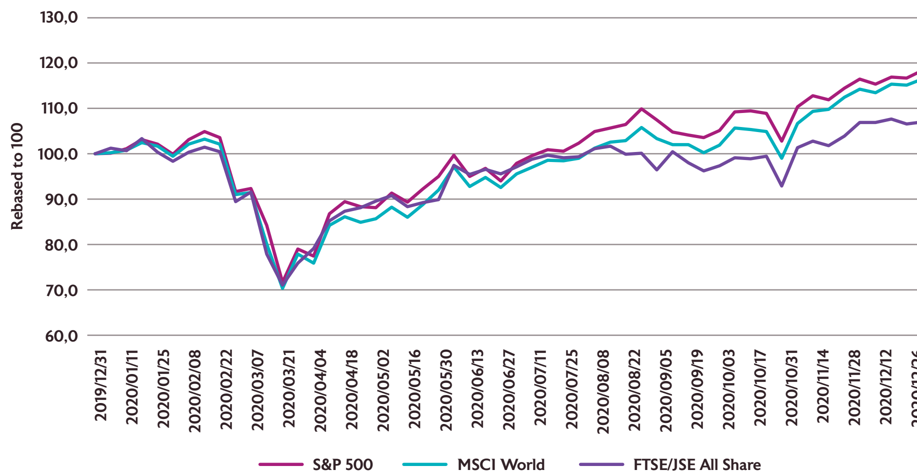
Regards,
Tracy

CHARTICLE:

REMEMBER, IF YOU'RE INVESTING FOR THE LONG TERM,

THEN KEEP YOUR LONG TERM IN FOCUS

Equity market performance in 2020



Source: Bloomberg

- 2020 was a stark reminder of the risks involved in trying to time an entry into, and exit from, equity markets.
- In January 2020, few people in the investment community could have foreseen that a global pandemic would significantly impact our lives and livelihoods and result in a sharp global recession. Even with perfect foresight that a pandemic would occur, it would have been hard to correctly predict how equity markets would perform during the year.
- A sharp but brief decline in major equity markets was followed by an equally sharp and swift market recovery, which resulted in all indices shown in the chart, ending the year higher than they started.
- The financial market crisis prompted by the pandemic was deliberately rescued by unprecedented government stimulus. However, we are reminded that, as with previous bear markets, investors who have appropriate investment strategies for their investment objectives and time horizons will be well-served in the long term by staying invested, despite the emotions that naturally arise in times of great uncertainty.
- Read ***The structure of market drawdowns: part II*** on page 07 for deeper insight and analysis into equity market behaviour.

STAND POINT

GREEN SHOOTS FOR SOUTH AFRICA'S GROWTH

AT A GLANCE

2020 amplified SA's fiscal and economic challenges

Looking ahead, SA faces six positive growth catalysts

Keys to growth are effective vaccine distribution and policy implementation

By ***KEVIN LINGS,*** Chief Economist

The South African economy has gone through a difficult time in the last couple of years. It has experienced rising unemployment, persistently low economic growth, rampant corruption, a systematically weakening fiscal position, and a clear lack of policy direction.

Between 2015 and 2019, SA has achieved an average annual growth rate of only 0.8%, and it grew by a mere 0.2% in 2019. Unfortunately, this is well below the level of output required to generate a meaningful increase in employment.

Unemployment has remained stubbornly high. In fact, the unemployment rate has increased from 26.4% in 2015 to 29.1% in 2019, rising further to 30.8% in the third quarter of 2020 (using the standard definition). In addition, government debt has risen from a low of 26% of GDP in 2009, to an estimated 63.3% of GDP in 2019/2020. It is expected to have breached 80% of GDP in the 2020/2021 fiscal year.

It is clear that, prior to 2020, SA was already on a weak footing, both economically and socially. Unfortunately, the COVID-19 outbreak at the beginning of 2020 exacerbated the situation.

Despite government's efforts to limit the economic impact of the outbreak, such as introducing a R500 billion fiscal relief package, the economy was brought to a near-sudden stop during the year. As a direct result of the COVID-19-related lockdowns, we expect South African GDP will contract by around 7.5% in 2020, with the unemployment rate expected to end the year at 31.3%.

Positively, however, as we enter a new year, SA finds itself in a rare but welcome position to benefit from a number of important positive events. Specifically, the economy is facing six positive developments that it can use as catalysts for a better, more sustainable economic performance.

1. Higher global commodity prices

The COVID-19 outbreak delivered a large negative shock to commodity markets. Almost all commodity prices experienced steep declines at the beginning of 2020 as a direct result of the pandemic. In the second half of the year, however, commodity prices rebounded quite strongly, with metals and minerals prices ending the year well above their pre-pandemic levels, driven by rising demand from China.

While metals and minerals prices were largely flat in 2020 as a whole, increasing by only 1% from 2019, the strong rebound in the second half of the year resulted in prices being 28% higher in December than in January 2020. Precious metals prices had an even better year, with prices increasing by an impressive 27% in 2020, boosted by the depreciation of the US dollar and lower interest rates.

Notably, during 2020, the gold price increased from $1 514 per ounce at the start of the year to $1 887 per ounce by the end of the year – a rise of over 24%. If you average the gold price for 2020 ($1 392/oz) and compare that with the average in 2019 ($1 770/oz), and adjust for the weaker exchange rate, the rand price of gold jumped by almost 49% year-on-year in 2020.

The improvement in the global price of gold, PGMs and iron ore in 2020, resulted in an estimated 24% growth in the value of South African exports during 2020, despite the fall in production. This improvement has had a major impact on overall export performance. Higher commodity prices have also benefited SA's currency performance, trade balance and tax revenue collection.

South African mining exports make up around 66% of total mining sales, with export sales of PGMs, gold and iron ore accounting for 91%, 72% and 96% respectively of each commodity's total sales. This puts the South African economy in a position to derive great benefit from commodities exports in early 2021.

While the outlook for 2021 remains uncertain and highly dependent on an effective global roll-out of COVID-19 vaccines, January 2021 data shows a good start to the year for commodity prices. Metals and minerals prices and precious metals prices have already increased by 32% year-on-year and 23% year-on-year respectively in January 2021. With commodity prices expected to remain relatively elevated in 2021, the South African economy has an opportunity to continue to benefit from this trend.

2. SA's trade and current account balance moving into a surplus position

SA recorded a record trade surplus of R270.6 billion in 2020, compared with a surplus of only R23.7 billion in 2019. This has helped the balance on the current account switch from a sustained deficit into surplus for the first time in decades.

A breakdown of trade data reveals that the surplus in 2020 was due to a combination of lower imports (-11.8% year-on-year, which represents a decline of -R149.8 billion in the rand value of South African imports) and an increase in exports (+7.5%, which represents an increase of R97.2 billion). It is also worth highlighting that there was a trade surplus every month from May to December 2020, with a remarkable average monthly surplus of +R34.2 billion in the eight-month period.

A detailed analysis of SA's export performance in 2020 reveals, unfortunately, that the growth was highly concentrated. Increased exports of gold and platinum explain more than 100% of the overall increase in South African exports in 2020. In other words, if you exclude gold and platinum from the data, then exports would have declined by R103 billion, or roughly 0.5% in 2020, resulting in a significantly reduced trade surplus.

There was also an outperformance from other components of exports last year. For example, exports of citrus fruit, grapes and apples recorded combined growth of more than 31% year-on-year in 2020, which amounted to an increase of over R11 billion year-on-year. However, these increases were more than offset by large declines in other export categories, especially motor vehicles. In 2020, South African exports of motor vehicles (both passenger and commercial) declined by more than -22% in value, representing a fall-off in vehicle export revenue of almost -R32 billion.

While the recent surge in gold and platinum exports is extremely encouraging, to provide much-needed relief for those sectors of the mining industry, it is critical that the authorities responsible for the formulation of economic and industrial policy urgently start to implement a range of critical reforms. These are needed to help a broader base of manufactured exports to achieve similar success – especially in a global environment that is likely to experience substantial growth in international trade over the next 24 months.

The large trade balance in 2020 has helped the country attract some foreign inflows and kept the rand exchange rate relatively strong, contributing substantially to GDP growth in the second half of the year.

3. Historically low domestic interest rates

Since March 2020, the South African Reserve Bank (SARB) has progressively reduced the Repurchase (Repo) rate, cutting it by a total of 300 basis points. This amounts to almost a halving of the bank's reference interest rate within nine months. That can be considered a fairly aggressive reduction in interest rates, given that the Repo rate is currently at 3.5%, the lowest since it was introduced as a monetary policy tool. From our perspective, the policy response from the SARB has been entirely sensible, given global and local economic developments.

At the same time, not only has the inflation rate consistently surprised on the downside, but the SARB has managed to get inflation expectations anchored around the mid-point of the inflation target. While this achievement has been assisted by a range of unfortunate economic outcomes, especially in terms of economic growth and employment, it should lead to a more stable interest rate environment in the months ahead.

Both these developments mean that the SARB can afford to keep the Repo rate low and steady for an extended period. This does not only bode well for over-indebted consumers and businesses, but it should also help to boost domestic demand and spending once government has effectively rolled-out the COVID-19 vaccine.

4. Improved South African tax revenue collection

Recent tax collection data shows that gross tax revenue collection continued to show strong recovery, improving more than expected towards the end of the year. Fiscal year-to-date, gross tax revenue has grown by -10.6%. While that is disappointing, it is higher than the revised growth estimate of -17.9% and much better than expected earlier in the year. It also reflects an improvement in tax collection in the second half of the year.

The outperformance relative to the National Treasury's estimates is a combination of three things. Firstly, the National Treasury's forecasts at the time of the Medium-Term Budget Policy Statement (MTBPS) were conservative, given the uncertainty around economic recovery.

Secondly, tax collection was helped by a strong rebound in corporate income tax from robust mining sector revenues, amid higher international commodity prices.

Lastly, personal income tax collection was higher than expected, which can be attributed to the fact that the increase in job losses was concentrated among low-income earners, whose contribution to personal income tax is relatively small.

The rebound in tax collection in recent months indicates that the government's total revenue collection is likely to be better than expected. This means that the shortfall will not be as bad as the R312.8 billion projected in the 2020 MTBPS. This will give government some additional funds that could be used for things like the procurement of COVID-19 vaccines.

5. Increased weekly government borrowing in 2020

In the middle of 2020, the South African government made a decision to increase the amount of debt on sale at its weekly auctions, in an effort to cover a rising budget deficit from the R500 billion fiscal stimulus package and a fall in tax revenue collection. The government decided to increase the amount of debt on sale at its weekly auctions

by over R3 billion. The amount on offer at the fixed-rate government bond auction increased by R2.07 billion to R6.6 billion, while the weekly inflation-linked bond auction amount increased by R960 million to R2 billion.

The decision to increase weekly borrowing was successful, not only because the weekly bond auctions have been consistently oversubscribed, but also because government borrowing is now well ahead of budget. The strong cash balance from the over-funding has given government some extra flexibility to buy the required vaccines for the country; plug unexpected spending requirements like assisting SOEs; or fund future budget deficits, which would reduce future borrowing requirements.

6. Increased foreign investment into SA

Throughout 2020, foreigners have been systematically disinvesting from SA, amid both increased risk aversion following the COVID-19 outbreak and an increase in the country's sovereign risk. Between January and December 2020, foreign portfolio outflows amounted to R251 billion, with outflows in 10 of the last 12 months. A breakdown of the outflows reveals that R125 billion is attributable to equity outflows, while R132 billion is due to foreign investors selling government bonds.

Given this level of disinvestment, it is understandable that foreign ownership of South African government bonds has fallen from a peak of over 42% in early 2018 to just under 29% in October 2020.

Positively, the trend seems to be reversing, with an increase in foreign investment since November, especially in the bond market. In November and December 2020, foreigners bought South African government bonds for the first time since June 2020, buying over R9.5 billion in November and R17.5 billion in December. The ratio of foreign ownership of South African government bonds increased from 28.96% of total ownership in October 2020 to 30% in December 2020.

While it is sometimes easy to dismiss foreign portfolio investment as 'fickle', the reality is that foreign portfolio investment has been SA's only real source of foreign investment for many years. Without regular foreign investment inflows, it will be near-impossible for the country to fund a meaningful and prolonged economic upswing that includes substantial infrastructural development – partly because SA has an extremely low level of domestic savings.

SA needs to take advantage of these opportunities

Going into 2021, it is critical for SA to capitalise on these opportunities, to ensure that positive momentum is created so that the economy can start the process of recovery (in the short term) and prosperity (in the long term). However, to fully take advantage of the positive events that unfolded towards the end of 2020, two things must happen.

Firstly, SA must find a way to meaningfully increase economic growth. For this to happen, government needs to start implementing at least part of its policy strategy. In general, government has done a good job in constructing comprehensive policy documents that identify and outline the most important issues facing the country. This includes the infrastructure initiative and the Economic Reconstruction and Recovery Plan. Unfortunately, all these initiatives and policy priorities lost momentum as the year progressed. Re-igniting some of these initiatives will be vital in starting the push that the country needs to take advantage of all these positive developments.

Secondly, to save lives, fully re-open the economy and release the pent-up demand within the economy, the government will need to successfully distribute the vaccines within the country. Consequently, limiting the spread of the virus, providing relief for vulnerable populations, and overcoming vaccine-related challenges should be key immediate priorities for SA. Government needs to take advantage of the vaccine dividend that will come from efficiently implementing an effective vaccine roll-out plan.

If these two things are done, in an environment where global economic activity seems more prosperous, the economy will release some pent-up demand from consumers and businesses, improving confidence and ensuring that SA is on a better growth path. Alternatively, SA can let these positive developments pass it by, just adding them to the list of opportunities that the government has, once again, failed to take advantage of. ■

STAND POINT

THE STRUCTURE OF MARKET DRAWDOWNS: *PART II*

AT A GLANCE

Equity market behaviour proved again that recoveries follow drawdowns

SA equity markets delivered a total return of 68% between the low in March and high in January 2021

By staying invested, investors can participate in the recoveries

Create a long-term strategy to remain invested during short-term market crises

By ***JOAO FRASCO,***
CIO, STANLIB Multi-Manager

The structure of market drawdowns is an interesting concept to inform investment decisions. This is particularly relevant as we continue to grapple with the ongoing temporary slowdowns in economic activity worldwide and protracted market uncertainty.

In May last year, we looked at South African equity returns since 1925.

In our conclusion, we placed the current equity market drawdown in context as follows:

The current drawdown began in December 2017 when our equity market reached a significant high. The drawdown period has continued for 28 months and at 31 March 2020, we were at the lowest point thus far. However, it is impossible to know whether the market will move lower.

While it has recovered substantially in April, this could reverse, given continued market uncertainty driven by the pandemic. Measuring -25.6%, it is the 11th worst drawdown over the period, and at 28 months it sits as the 6th longest to reach the bottom, if this is indeed the bottom. We cannot be sure how long it will take to recover, but what analysis reminds us of, is that over time, the impact of a drawdown, especially combined with the recovery period which is typically shorter, is limited.

Moving to the start of 2021

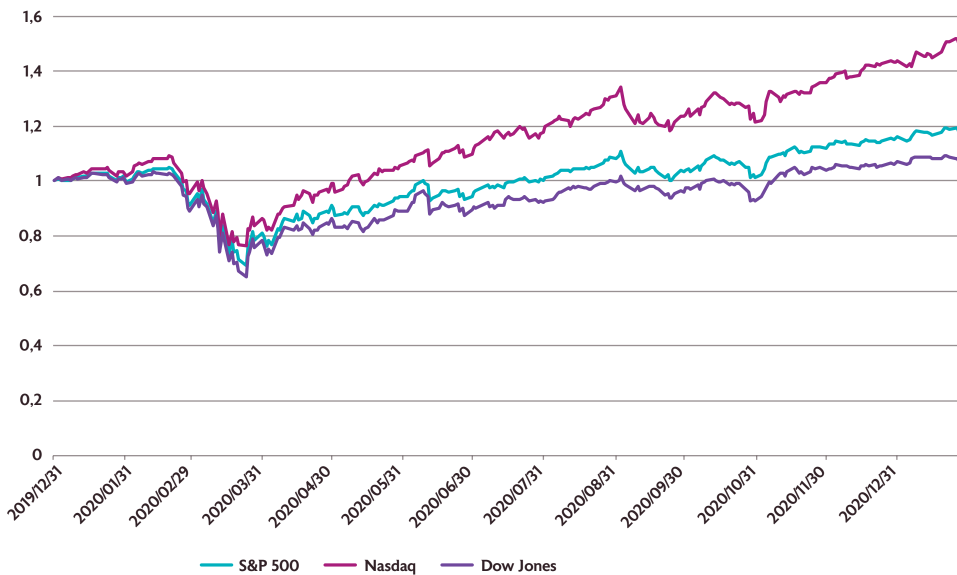
The South African equity market ended 2020 below its previous high in 2017, which technically means that the so-called recovery had not yet happened. However, the All-Share Index achieved significant gains off a low March and almost reached 60 000 points during the year. It changed quickly in the first few days of 2021, when it moved substantially higher and past the 64 000 level.

The most important message from our previous article was to remain invested through the worst drawdowns in history. Our analysis demonstrated that average returns, both before and after drawdowns, were on average very high. Trying to time the market is very difficult and can be detrimental to your wealth and long-term investment strategies.

Did 2020 prove anything different?

To further analyse the latest drawdown, I reviewed daily data to gain a more accurate picture. My previous analysis observed data dating back to 1925, for which only monthly data was available.

Global equity market performance in 2020



Source: Bloomberg

The latest South African equity market drawdown using daily data actually started after a daily high on 25 January 2018 (using monthly data, this was December 2017), and it reached a low on 19 March 2020 (due to COVID-19), almost 26 months later. The subsequent market recovery was swift, surpassing the previous high at the close of 6 January 2021, less than nine months later. **The total return between the low and the recent high of just below 64 000 (using daily closing prices), was a staggering 68%.** If investors had disinvested from equities after the initial drawdown, they would have missed out on this significant recovery.

Unfortunately, as investors flocked to safety during the uncertainty of the pandemic, we saw massive flows from risky to more secure assets and funds during the year. This means that many investors suffered losses from the negative market performance in this period, and had not returned to participate in the subsequent recovery.

For example, in the ASISA South African MA (Multi-Asset) High Equity category, there were outflows of R26.9 billion for 2020, whereas the ASISA South African IB (Interest-Bearing) Money Market category had inflows of R22.9 billion. With perfect foresight, this would have happened before the crisis and reversed at the bottom, but this was sadly not the case. **Most of**

the inflows to the money market funds happened in the second quarter (R20.8 billion) after the crash, when markets had already begun recovering.

Shifting our perspective globally

Although the previous article did not discuss global drawdowns, global markets, as we know, behaved similarly to those of SA. In the US in particular, the equity market hit new highs much sooner. The recovery from the initial COVID-19 crisis occurred as early as June for the Nasdaq 100 (less than four months), as early as August for the S&P500 (less than six months), and as early as November for the Dow Jones Industrial Average (less than nine months).

The chart on page 8 shows the three major US indices discussed above, and their path since the beginning of 2020, through the COVID-19 crisis and subsequent recovery. While this recovery was primarily led by the technology sector, the 2020 crisis accelerated many disruptive businesses.

Stay invested through a short-term market crisis

Although many of these ideas are already well-understood by seasoned investors, they remain important to reiterate, especially during times of market volatility and uncertainty.

It is critical to create a long-term investment strategy focused on achieving clearly-specified objectives and goals and staying invested when things get temporarily tough.

Understanding upfront how markets can perform is essential to avoid trying to predict what markets may do. Key to protecting your financial well-being is remaining steadfast during these times, based on having longer-term investment plans and enough liquidity and secure investments or income to see you through tough market conditions. ■

STAND POINT

THE RELEVANCE OF EQUITY IN A BALANCED FUND

AT A GLANCE

Asset allocation decisions are key to achieve longer-term returns in balanced funds

Understanding the behaviour of equity return drivers critical to evaluate relative attractiveness of the asset class

Consumer spending changes are influencing business models and earnings growth

By ***KOBUS NELL***, Multi-Asset Portfolio Manager

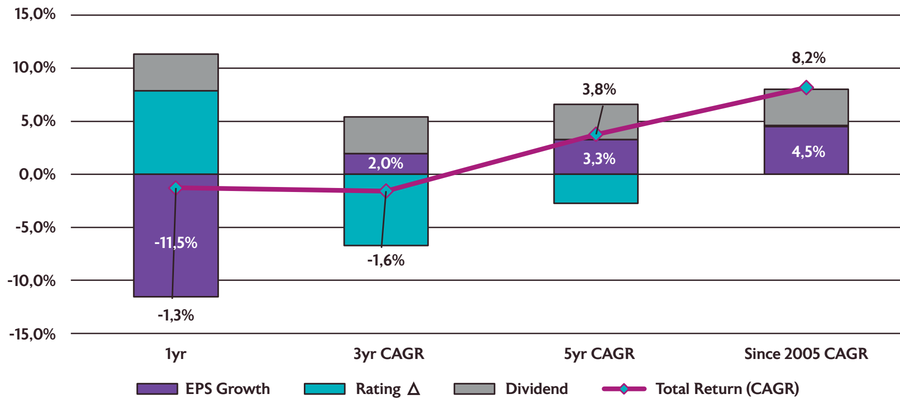
The asset allocation decision within a balanced fund, largely based on the well-known and not always appreciated, concept of understanding the relationship between risk and reward and what ultimately drives returns, remains one of the most important opportunities in achieving longer-term returns.

Historically, equities have been relied upon by asset allocators as a growth or return driver in balanced funds with the appreciation that higher returns are accompanied by higher risk, owing to the volatility in equity prices. The asset class has proven to be an excellent inflation hedge and an important asset to include within a fund to grow the real value of capital. Investing in the right amount of equity at the right time of the cycle, can clearly differentiate return outcomes.

The basics of equity return drivers

Equity returns are primarily driven by earnings growth and, to some extent, by the distributions made to shareholders in the form of dividends. Data shows that rating changes (market valuations) are often cyclical and over the long term, they have not consistently driven the overall market return for South African equities. As shown in the chart below, there is some deviation from this rule in the short term, when ratings changes impacted overall returns more materially.

FTSE JSE Shareholder Weighted All Share: Total Return Composition



Source: Factset

Understanding the different equity return drivers in each cycle is critical in making an allocation to equities within a balanced fund, especially relative to other asset classes.

1. Earnings growth: changing share of consumer wallet

It is important to note, when considering both earnings growth and valuation, that there is a wide divergence between valuation levels or ratings across different markets and individual company shares within these markets. The spread between earnings growth and capital returns has grown over the years, as markets and industries have become more polarised.

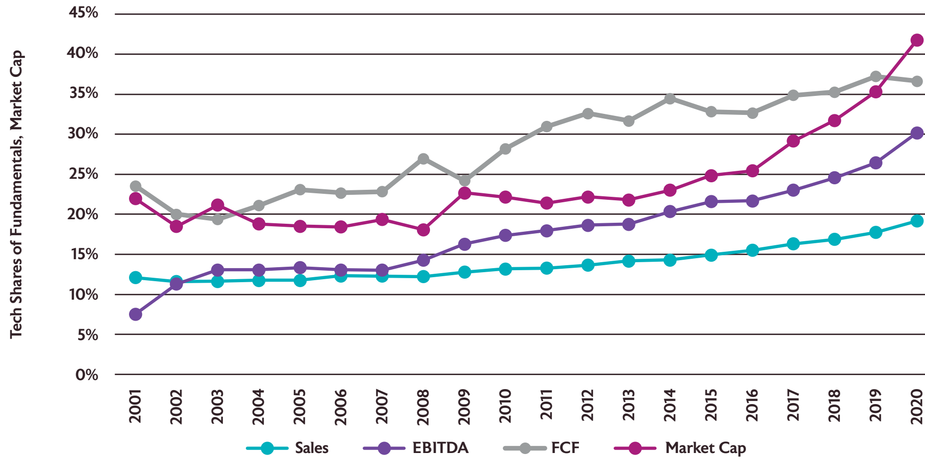
The polarisation of the market is evident in changing consumer spending behaviour over the last decade. Consumers are spending more and more time and money on the internet of things, including online shopping and gaming and social media activities. They are also reverting more to online services such as banking, healthcare and transport (Uber).

Companies that were able to reinvent themselves by adopting technology to meet changing consumer demand trends have been able to reap rewards. Structural changes in the share of consumer wallet, where disruptive competitors have taken market share from some of the more traditional players, were accelerated by the COVID-19 pandemic. This pushed dislocation to extreme levels as a result of reduced consumer activity during lockdowns. Although we expect this will recalibrate as the environment recovers, the underlying structural trend is expected to persist over the longer term.

This is evident from the technology sector's aggregate percentage of fundamentals (sales, EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation) and Free Cash Flow (FCF)) and market capitalisation in the Russell 1000 Index, which has increased significantly over the last 10 years.

Tech sector: Increasing share of the Russell 1000 Index

Share of Sales, EBITDA, FCF & Market Cap



Source: Compustat, Columbia Threadneedle (Tech includes Google, FB and Amazon)

This shift is also evident in a report published by Accenture Research. It showed that, of 8 300 companies, the top 10% demonstrating technology adoption, technology penetration, and organisational change, were achieving rates of revenue growth double those of the bottom 25%. These top 10% of companies are also growing revenues more than 50% faster than the middle 20%.

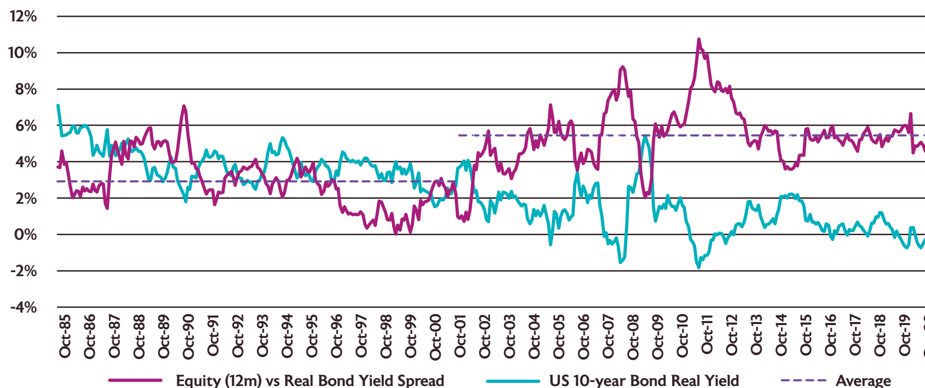
We believe that companies able to drive sustainable top-line growth (especially organic growth), while maintaining margins/FCF, will deliver the greatest growth in shareholder value. Earnings growth must be accompanied by value creation, an essential ingredient in achieving superior shareholder returns.

2. Contextualising valuations

Some investors argue that lower real interest rates, or the expectation of lower real interest rates in future, should justify higher share earnings ratings and valuations. As shown below, what is more relevant, is the differential between equity and real bond yields.

US Treasury yields and inflation have been steadily falling since the 1980s, with some cyclicality. However, it is important to note that the 10-year real yield has been moving in and out of negative territory for the last 15 years, with a tighter oscillation around the zero point for the last five years.

US Equity vs Real Bond Yield Spread



Source: Refinitiv, Factset

The current differential shows the relative value in holding equities. However, the expectation of a more substantial rise in future real bond yields could be negative for equity valuations. We believe that the risk of bond yields increasing in the current environment is low.

Impact of COVID-19 on equity valuations

Equity markets reacted sharply at first to the potential and planned co-ordinated COVID-19 lockdowns worldwide. This resulted in the most significant sell-off in the domestic market on record on a daily, weekly and monthly basis during March 2020.

Markets rebounded rapidly as it became clear that global policymakers would protect the capital structure of economies and would do 'whatever it takes' to protect the integrity of the financial system. Investors in risky assets took comfort from this reassurance and restored valuation levels in the course of the year. Towards the end of 2020, news about viable vaccines gave the market another push higher, as investors effectively looked through the current environment of lower consumer activity and company earnings.

In this environment, the compression of credit spreads has been a good proxy for equity valuations. Credit spreads (the difference between risk-free government bonds and corporate bonds) are seen as a barometer of the risk of corporate distress. These spreads, across the issuance curve, increased significantly with concerns over the economic and financial impact of the COVID-19 lockdowns. Spreads in the lower quality spectrum of the issuance curve blew out significantly, signalling potential defaults and spill-over effects into the equity market. This triggered widespread panic selling, which in turn fuelled the unprecedented sell-off in the equity market.

Actions by policymakers across the globe to compress these credit spreads by vouching their support for many of these debt instruments, especially those below investment grade, helped to ease investors' fears and in time increased the risk appetite for equities.

Conclusion

We remain focused on investing in companies that can demonstrate a high-quality business model and have the ability to differentiate themselves from their competitors. They must, through their sustainable competitive advantage, be able to deliver above-average earnings growth consistently, while adding economic value to shareholders. The environment after the peak of the COVID-19 crisis, could again be characterised by very low global growth, similar to the period after the global financial crisis recovery in 2008.

In this environment, our strategy leans towards growth shares (especially those with previously unidentified secular growth), while taking advantage of some shorter-term opportunities. We will stay committed to our investment philosophy. We remain constructive on equities as an asset class, particularly emerging markets at this stage of the cycle. The US leadership change, coupled with the expected cyclical, and importantly synchronised global, economic recovery followed by accommodative monetary policy, should support this asset class, in our view. ■

FROM THE DARK DAYS OF SPRING… TO THE BRIGHTER DAYS OF WINTER

AT A GLANCE

2020 brought about the deepest global recession since World War II

This reinforced the importance of being active asset allocators with long-term investment mindsets

STANLIB's Global Balanced portfolio managers found opportunities in these unusual times

While the immediate economic outlook remains uncertain, we must share the optimism reflected in risk markets today

By ***COLUMBIA THREADNEEDLE INVESTMENTS***

When we look back on 2020's headline market return in years to come, it will tell us very little about this extraordinary year. A 17% return from global equities, for instance, is an outcome few would associate with one that delivered the deepest global recession since World War II.

But the astonishing volatility disguised by that number did bring with it some important reminders, for us, two in particular. The first is the importance of being active, something we at Columbia Threadneedle Investments believe is vital in both asset allocation and security selection. The other is the need to think – and invest – for the long term. In other words, we must be able to hold our nerve, as there were remarkable profits to be made last year by those brave enough to 'lean in' to risk, when others might panic.

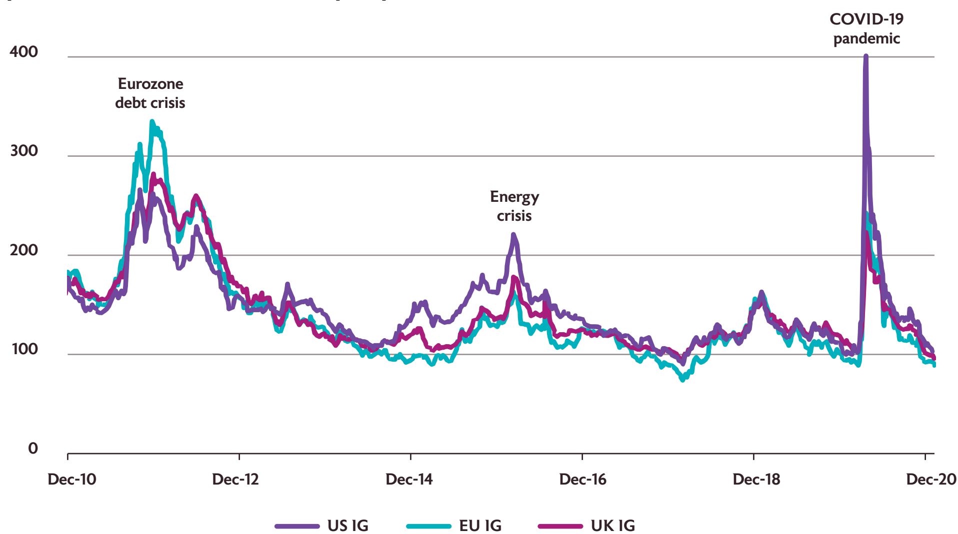
Both financial markets, and our expectations, have come a long way since those dark days of spring. And being active when opportunities presented themselves (but always with an eye to the future) proved a successful strategy for investors in the STANLIB Global Balanced portfolios.

From the dark days of spring

Back in March, as countries were essentially shut down to contain the spread of COVID-19, fear and uncertainty permeated the valuation of pretty much every asset class. Investment grade corporate bond yields (Figure 1), for instance, were compensating investors for 50 times the historical rate of defaults, while several equity indices were priced at or close to their book value. We, like most others, marked our expectations sharply lower for economic and corporate earnings growth in 2020.

Yet at the same time, unprecedented global policy stimulus was released into credit and labour markets, dwarfing anything we have seen before in both scale and speed of delivery. It was our view that – although sharp recessions were likely – this would ultimately prove to be a temporary shock, as policymakers committed vast resources to prevent the public health crisis morphing into a deeper structural one.

Investment Grade credit spreads were compensating investors for 50x the historical rate of defaults



Source: Bloomberg, as at 8 January 2021. Indices used are BoA Merrill Lynch: C0A0, ER00 and UN00

STANLIB Global Balanced portfolios were presented with a rare opportunity to 'lean in' to those markets that had been badly beaten up, but which looked well-positioned to benefit from the extraordinary policy measures, notably global equities and higher-grade corporate credit.

It felt bold explaining to clients in late March – arguably the point of maximum fear – that we were increasing our allocations to risky assets. But we expected investors to be overcompensated for the economic risks ahead – substantial though they were.

The strength of the market recovery that followed brings us back to where we started: the ability to hold your nerve. Those who were not able to think long term and avoid knee-jerk reactions might have missed out on the fleeting opportunity to participate in the strongest month for global equities since 2009.

But just as policymaker interventions dragged risk markets higher, there was huge variation in the post-crash return profile of different asset classes and companies. The ability to be active within asset classes too, was even more important in a year when certain sectors became almost un-investable. It was our expectation that both economies and corporates would emerge from the crisis saddled with higher levels of debt. An overarching theme across assets we held within the Global Balanced portfolios was quality. In equities, for instance, our stock-picking colleagues were seeking companies with strong balance sheets,

high free cash flow and healthy returns on capital, well-placed to grow earnings in a sea of companies burdened with financial leverage.

To the brighter days of winter?

COVID-19 case count was rising rapidly in January 2021 across the US and Europe, the immediate economic outlook associated with renewed lockdowns turned darker. Yet risk asset prices have never been higher.

It is worth remembering that stock markets – large, public companies – are only a subset of the economy and, as long-duration assets, equities are forward-looking. So we must be too, and in looking to the future, share the optimism reflected in risk markets today – for three chief reasons.

First, a relatively favourable US election outcome has removed some large tail risks and brought with it some (unanticipated) fiscal reprieve. Second, the number of vaccines with greater-than-expected efficacy creates investment opportunities in more cyclical areas of the world. And last, economic contractions in 2020 have been shallower than previously feared, leaving us – in certain regions – with almost 'V-shaped' recovery forecasts. While the immediate economic outlook remains uncertain, these factors have set the foundations for a more sustainable cyclical recovery.

Our most recent moves within the STANLIB Global Balanced portfolios have been to tweak our equity allocations higher once more, this time, with a joint focus on quality companies that also stand to benefit from a cyclical upturn. For instance, Pernod – a high-quality drinks business – should benefit from a re-opening of hotels, bars and restaurants, and Disney (a new holding, bought at a substantial discount) has already seen considerable uptake on its Disney+ subscription service, but the broader business stands to benefit as its parks and cruise lines re-open.

Meanwhile, within the global bond sub-portfolios, we have trimmed our duration overweights. This proved helpful in 2020 as government bond yields found new lows, but the outlook for sovereign duration may be challenged in the recovery scenario we anticipate. Importantly however, our expectations are that there will not be a meaningful rise in bond yields, and those low discount rates remain a powerful support to sustain risk asset valuations.

Volatility will probably continue to dominate markets in 2021, as the world takes on the monumental challenge of a global vaccine roll-out, but to our minds it would be a mistake to make knee-jerk reactions. As active, but long-term investors, we must maintain our strategic positions and continue to look for the winners of this ever-changing world. ■

PERFORMANCE AT A GLANCE

MARKET INDICATORS

For the period ending January 2021

January 2021	1 Year	3 Years (p.a.)	5 Years (p.a.)	10 Years (p.a.)
SA markets	%	%	%	%
All share (J203T)	14,51	4,85	8,10	10,41
Top 40 (J200T)	17,61	6,04	8,49	10,58
SWIX (J403T)	9,67	1,55	6,09	10,18
Financial 15	-17,29	-8,29	0,11	8,38
Industrial 25	21,35	4,07	5,90	15,21
Resource 10	31,72	21,83	24,20	4,24
Property (J253T)	-34,59	-18,76	-8,46	3,63
Inflation (CPI)	3,08	3,86	4,60	5,07
All bond index (ALBI)	8,20	8,49	9,62	8,56
Cash (STeFI. Composite)	5,11	6,54	6,92	6,35
Offshore markets (Base currency)				
MSCI AC World	17,59	8,47	14,17	9,49
Dow Jones US	8,54	7,12	15,47	12,43
S&P 500 US	17,25	11,70	16,16	13,50
FTSE 100 UK	-9,20	-1,41	5,13	4,80
Nikkei 225	21,52	8,36	11,74	12,59
Barclays Global Aggregate (Global Bonds)	6,87	4,13	4,43	2,72
S&P Global Property	-7,74	1,27	6,17	6,20
3-Month LIBOR (ZAR)	0,46	9,58	-0,14	8,10
3-Month LIBOR (USD)	0,10	1,25	0,96	0,39

Source: Morningstar

PERFORMANCE AT A GLANCE

CORE FUND PERFORMANCE

For the period ending January 2021

		1 Year		3 Years		5 Years		10 Years		Highest or lowest annual returns over the last 10 years (%)	
	Fund	Return (%)	Quartile	Return (%)	Quartile	Return (%)	Quartile	Return (%)	Quartile	Highest	Lowest
INCOME	STANLIB Income Fund	6,10	2	7,79	1	8,23	1	7,45	1	9,63	4,85
	STANLIB Flexible Income Fund	7,11	1	6,62	4	7,57	3	7,30	2	11,86	1,84
STABLE GROWTH	STANLIB Balanced Cautious Fund	11,13	1	7,63	1	6,55	2	8,61	1	16,29	-1,31
	STANLIB Absolute Plus Fund	7,80	2	5,82	2	6,63	1	8,15	2	18,17	-3,86
GROWTH	STANLIB Balanced Fund	11,45	1	6,82	1	5,93	2	9,38	2	26,49	-7,46
	STANLIB Equity Fund	12,11	2	5,14	1	5,52	2	10,52	1	34,37	-12,78
	STANLIB Property Income Fund	-34,06	2	-19,71	3	-9,05	3	3,15	2	46,75	-51,80
OFFSHORE (ZAR)	STANLIB Global Equity Fund	19,25	2	18,60	1	13,40	1	16,71	2	56,44	-12,62
	STANLIB Global Balanced Fund	13,71	1	16,27	1	9,37	1	13,87	1	37,05	-12,93
	STANLIB Global Balanced Cautious Fund	10,51	1	13,97	1	5,36	1	10,69	2	30,73	-14,91
	STANLIB Global Property Fund	-11,99	4	8,71	2	0,80	3	12,01	1	43,48	-19,27

Source: Morningstar

DISCLAIMER

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Portfolio performance figures are calculated for the relevant class of the portfolio, for a lump sum investment, on a NAV-NAV basis, with income reinvested on the ex-dividend date. Individual investor performance may differ due to initial fees, actual investment date, date of reinvestment of income and dividend withholding tax. Portfolio performance accounts for all costs that contribute to the calculation of the cost ratios quoted so all returns quoted are after these costs have been accounted for. Any forecasts or commentary included in this document are not guaranteed to occur. Annualised return figures are the compound annualised growth rate (CAGR) calculated from the cumulative return for the period being measured. These annualised returns provide an indication of the annual return achieved over the period had an investment been held for the entire period. A portfolio that derives its income primarily from interest-bearing instruments calculates its yield daily and is a current effective yield.

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