Q3 | August 2020

STAND POINT

STANLIB

FROM SURVIVING TO THRIVING

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FROM OUR STANDPOINT

A note from Head of Retail Distribution,
ALAN EHRET

SA is now more than 150 days into lockdown, which will have a long-lasting impact not only on our country, but on all of us. My thoughts are with all of those affected by COVID-19 and our sympathies go out to everyone who has lost loved ones during this crisis.

Reflecting on the first half of 2020, we find it hard to grasp the exponential pace of change. The post-pandemic investment landscape could be described in some ways as a strong catalyst for accelerating positive trends and teaching us new behaviours.

At STANLIB, we've learned and adapted quickly to virtual ways of working. We have seen governments worldwide respond quickly to a health and economic crisis, while at home it is heart-warming to see communities reach out to support each other in times of desperate need.

Yet we cannot escape the devastating economic deterioration of an already-weak South African fiscus, the strain on our healthcare system and the decimation of sectors such as tourism and hospitality. From an investor perspective, financial markets may have offered some respite in the second quarter, climbing from the all-time lows of Q1. The reality is that every day is a new one and the road ahead remains very challenging.

In this edition

In this edition of STANDPOINT, we focus our lens on SA. Our portfolio managers remain attentive to and agile in this environment, while remaining steadfast in their commitment to our investment philosophy.

COVID-19 will end. We are mindful of both the temporary and permanent shifts that will result. We are resetting expectations for the future and, while we recognise the enormous challenges for our government and business, we are hopeful that SA's resilience and determination will pave the way to a brighter future.

STANLIB CEO, Derrick Msibi shares his thoughts about how COVID-19 could encourage South African investors to build up savings buffers. Much like the global financial crisis has done for corporates in the previous decade.

Kobus Nell, our Balanced Portfolio Manager, shares an interesting perspective on South African mining companies. Historically, crises have thrown out the demand/supply balance in commodity sectors and left miners struggling to stay profitable. Could this sector be the silver lining of 2020?

The South African fixed income market has to date experienced numerous interest rate cuts and the impact of the well-publicised Moody's downgrade. While fiscal stimulus has provided strong support; can the bond market remain a compelling investment story? Sylvester Kobo, Senior Portfolio Manager, sheds light on the state of SA bonds.

As we look forward, our Chief Economist, Kevin Lings, highlights what it could take to see growth again in SA and part of his discussion considers infrastructure and development. Our Credit Alternatives team expand on the story, clarifying the sustainable growth opportunities of impact investing in our country.

The urgency for social connection can only become stronger as we head out of winter and hopefully reach the other side of SA's COVID-19 infection peak.

As we search for a path through and out of an extraordinary environment and seek answers to many questions, both at a macro-economic and investment level, it is critical to hold a balanced and positive perspective. I hope these articles provide food for thought and perhaps lead to answers. And I look forward to a handshake soon.

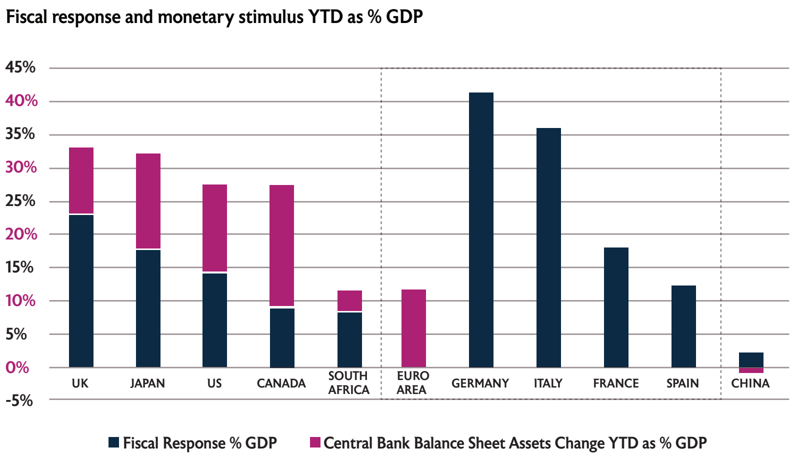
Perspective is everything. Please stay positive and healthy, and maintain that much-needed resilience.

Regards,
Alan

CHARTICLE:

ECONOMIC LIFELINES IN 2020. HOW DOES SA STACK UP?

Stimulus packages in 2020 relative to size of economy (as a % of GDP)



Source: STANLIB Absolute Return Strategies, Bloomberg, DB, JPM.

- Unprecedented financial support from governments worldwide to ease the impact of COVID-19-induced lockdowns has been remarkable in both speed and size.
- Considering the stimulus packages relative to size of economy (as a % of GDP) shows SA is not far behind developed market counterparts.
- Global markets have also been beneficiaries of the liquidity support and have rallied on the hope of the discovery of a vaccine in the near term.
- The South African government's economic stimulus package will undoubtedly support an already fragile economy. What remains to be seen is whether these economic lifelines are enough to stimulate a much-needed recovery. ■

SOUTH AFRICA: SEEKING AN ECONOMIC REVIVAL

By Chief Economist,
KEVIN LINGS

The big picture

The past six months have been extremely challenging, from a social, political and economic perspective. COVID-19 has disrupted every major economy, with more than 17 million infections recorded in the first seven months of 2020, resulting in almost 700 000 deaths. During this time, most countries imposed some form of lockdown for one to three months, resulting in a significant contraction in economic activity, a surge in government debt and a sharp rise in unemployment.

From an economic perspective, it has been extremely difficult gauging the extent of economic contraction in the first two quarters of 2020. It is also challenging to assess the prospects for an economic revival over the next few quarters. In June 2020, the International Monetary Fund (IMF) released its quarterly World Economic Outlook, aptly entitled *A Crisis Like No Other, An Uncertain Recovery*.

Encouragingly, while the IMF revised down its 2020 global growth estimate relative to its April 2020 calculations, it revised up the 2021 growth outlook. Overall, the IMF is now forecasting that global GDP will decline by a substantial -4.9% in 2020, down from its April 2020 estimate of -3%, but will grow by a very welcome 5.4% in 2021.

The downward revision to the 2020 economic outlook reflects the fact that the COVID-19 pandemic has had a more damaging impact on all aspects of society than anticipated at the start of lockdown restrictions. This is highlighted by the fact that the US shed 20.5 million jobs in April 2020 alone, and although they have already added back around 7.5 million jobs in May and June, the level of employment remains 14.7 million jobs below the peak prior to COVID-19.

Overall, all major economies, except China, are expected to experience an outright decline in GDP during 2020. Key areas of weakness include:

US	Euro Area	Japan	UK	Russia	Brazil	India
-8%	-10.2%	-5.8%	-10.2%	-6.6%	-9.1%	-4.5%

Source: IMF, June 2020

At this stage, it seems clear that global economic recovery in the second half of 2020 will face three key constraints, provided key economies are not confronted by a resurgence in COVID-19 infections.

1. **Persistent social distancing** lasting well into the second half of 2020, leading to a significant drop in consumption and services output.

2. **Greater supply-side scarring** from the larger-than-anticipated impact on activity during the lockdown in the first and second quarters of 2020. In this case, firm closures and an increase in unemployment may make it harder for activity to bounce back, even as the pandemic fades.

3. **A negative impact on productivity**, as surviving businesses enhance workplace safety and hygiene standards. Companies' efforts to stem the spread of the virus, such as staggered work shifts, enhanced hygiene and cleaning between shifts, and new workplace practices relating to proximity of personnel on production lines, will not only affect productivity, but will lead to additional business costs.

The local lens

Unfortunately, the South African economy was under severe pressure ahead of the COVID-19 lockdown at the end of March 2020. The impact of the lockdown was to push the economy into a severe and unprecedented recession and a full recovery will take a long time.

> *For 2020, we now expect the South African economy to contract by -8.6%, after growing by only 0.2% in 2019 and averaging growth of a mere 0.8% over the past five years.*

The severity of the current economic recession, which has included a notable increase in unemployment and a sharp deterioration in government finances, has, understandably, heightened the need to improve SA's economic outlook for 2021 and the country's economic prospects over the next few years.

Infrastructure development: a sound solution

Unsurprisingly, given the record-low level of consumer and business confidence within the private sector, as well as government's desire to remain at the centre of economic development, the recent policy announcements from government, and the ANC more broadly, have focused heavily on infrastructural development as a key driver of growth.

In fact, every major growth initiative or policy document in SA in recent decades has referred to the need to invest in infrastructure as a key source of economic upliftment. And for good reason. Over time, the government has established several institutions to strengthen the state's capacity to improve infrastructure delivery. These have included, for example, the National Planning Commission, the Department of Performance Monitoring and Evaluation, the Presidential Infrastructure Coordinating Commission, and the Presidential Review Committee on State-Owned Enterprises (SOEs).

This does not mean that other policy initiatives, such as cutting interest rates or improving the ease of doing business, are unimportant. Instead, SA's revival over the next few years is highly dependent on a wide range of policy changes being implemented successfully.

... still to be delivered

Unfortunately, while government's infrastructural development plans have always appeared compelling in their scope and ambition, covering most areas of social and business infrastructure, projects have either been 'permanently' delayed, remained endlessly in the early stages of planning or have been scrapped due to budget constraints, changing political priorities, or simply a shift in the leadership of the institution or department needing to undertake the infrastructural development.

The result is that fixed investment spending by central government has dwindled while infrastructural development by SA's State-Owned Enterprises (SOEs), which still control the bulk of the business infrastructure, have declined in each of the past four years and in seven out of the past ten years, leaving total investment spending by SOEs at their lowest level in twelve years. In fact, the current level of infrastructural investment is insufficient even to maintain SA's existing infrastructural capacity, leading to a decline in a wide range of critical services, including, most recently, water and sanitation.

The pattern of highlighting infrastructure as a critical source of economic growth and then failing to implement the strategy, has led to successive bouts of disappointment, and as a result, a high level of scepticism. The business sector is likely to first wait for infrastructure upgrades to be completed before initiating large investment projects of their own that are dependent on the upgraded infrastructure for success.

The result is the level of fixed investment activity in SA is currently barely enough to simply maintain the country's base of capital stock, let alone expand the productive capacity of the country and create job opportunities. It is telling that the capital stock in the manufacturing sector has declined by 17% since 2008, while the output of the sector has stagnated for more than a decade.

What next? A positive plan

More positively, the government recently held its first Sustainable Infrastructure Development Symposium, which was themed *Investing in infrastructure for shared prosperity: now, next and beyond*.

This is clearly a very welcome initiative that required significant preparation under difficult circumstances, given the limitations imposed by the COVID-19 lockdown. During the symposium, government highlighted a 'shortlist' of 55 infrastructure projects, categorised into six sectors, namely water and sanitation, energy, transport, digital infrastructure, agriculture and agro-processing and human settlements.

... and a collaborative solution to fund and implement

There are also important questions regarding how government intends to fund its infrastructure initiative. Over the past ten years, the government has become significantly more indebted, while the COVID-19 lockdown has led to a dramatic fall-off in tax revenue collection, which the Minister of Finance estimates to be in excess of R300 billion.

On 7 July 2020, the Standing Committee on Finance released its tabled report on the 2020 Special Adjustment Budget. The report states that the majority in the committee believe that government should engage with all stakeholders, including the private sector, on how to unlock domestic investment through impact investments and Regulation 28 of the Pension Funds Act. Specifically, the report states that; "National Treasury needs to consider creating the necessary regulatory mechanisms to ensure increased pension fund investments directly into infrastructure projects, including real estate, which can unlock capital that currently is not finding its way into projects."

If this is done on a purely voluntary basis, it could prove highly beneficial, especially if the selected infrastructural projects encourage further private sector investment and are implemented in a timeous and budget-conscious manner, free of any corruption scandal. However, if the change in Regulation 28 effectively forces pension funds to invest in government's infrastructure initiative, it could lead to several important and unintended consequences that negatively impact future investment, as well as the level of contractual savings in SA.

It also seems clear that most development initiatives in SA, particularly infrastructural investment, would benefit substantially from the increased use of public-private partnerships. This is especially the case since government's balance sheet is under enormous pressure at a time when economic growth has become much more vital and urgent. Equally, the corporate sector's balance sheet remains relatively strong, but the sector lacks the confidence to unlock its potential through an increase in fixed investment and employment.

Proudly South African

Under these circumstances, identifying a highly-focused set of infrastructure projects that can be initiated relatively quickly, have a meaningful impact on employment, utilise mostly domestically-produced raw materials and can demonstrate tangible progress, will showcase the ability for government and the private sector to combine to start to uplift the economy.

Ultimately, economic success is a confidence game. Right now, economic confidence in SA, both internally and externally, is near record lows and in desperate need of revitalisation.

SOUTH AFRICANS NEED SAFETY NETS

By CEO,
DERRICK MSIBI

Donald Rumsfeld, former US Secretary of Defense, once said; "There are known knowns; there are things we know we know. We also know there are known unknowns; that is to say, we know there are some things we do not know. But there are also unknown unknowns – the ones we don't know we don't know… it is the latter category that tend to be the difficult ones."

Crises are inevitable – only their timing, scale and impact tend to be unknown or unknowable, while their ability to accentuate existing structural cracks or hidden problems is well known. However, out of every crisis, there is opportunity, even for a pandemic.

In SA, our general lack of 'safety nets' and/or 'shock absorbers' at both an individual and national level, has long been an issue.

After the 2008 global financial crisis, individuals and corporates took markedly different paths. The balance sheets of corporates were bolstered and a healthy dose of conservatism led to an increase in overall corporate liquidity. Yes, the corporates paid dividends, but they were not reckless in their distributions. Corporate treasurers created funding lines and listed companies cultivated shareholder support to ensure that they were best placed to tap markets for long-term funding, as evidenced by the recent rounds of rights offers.

In contrast, individuals did not necessarily reform their behaviour. As much as lenders tightened their lending criteria, individuals' appetite or need for credit continued unabated. At the same time, the overall level of individual savings in formal structures such as bank deposits, unit trusts and general contribution to long-term savings has been measly.

> *In July, our team of economists issued a report on the topic, focused on the importance of precautionary savings, the obstacles in growing savings in SA, and macro remedies to better equip individuals, businesses and even government to improve their readiness to respond to short-term cash flow interruptions.*
>
> **Access the report here:**
> Savings Month Report 20July2020

As a result, when the crisis arrives, like the COVID-19 pandemic, there is no shock absorber – no 'rainy day' fund and, given already overextended credit lines, no further funding available. In fact, instead of being able to access credit in a time of need, the reality is that individuals will be under more pressure to meet their credit obligations.

In SA, the level of long-term savings since 2008 represented by pensions has seen uninterrupted net cash outflows with benefits payments exceeding contributions. As a result, investment markets have patched the crack of a shrinking formal pensions market, like botox papering over wrinkles. With our national funding needs increasing, the local pool of savings is insufficient, requiring offshore borrowing in hard currencies. As much as it is useful to have diversified sources of funding, raising hard-currency funding, when emerging markets are under pressure due to global uncertainty, becomes costly and unsustainable.

So, how do we paper over this savings crack? We all expect that governments will provide forms of social security as a safety net. The South African government was no exception during the COVID-19 lockdown.

However, we have to question the sustainability and appropriateness of a government solution here. We need a solution which goes beyond crack fixing and enables us to build the right foundations to help survive future crises. The time has come to empower individuals and provide them with the dignity to be able to fend for themselves; the imperative for a stronger South African savings culture is now greater than ever.

Individual personal financial planning must become a national priority. We should start by laying the foundations among our learners at school, and seeking ways to reinforce a savings culture throughout their working lives, with potentially mandatory incorporation at critical junctures like starting a new job.

The importance of practical financial planning elements, like using insurance to protect us from potential crises, should be a critical part of the national education drive. Emerging research on individual financial planning shows that the biggest causes of financial hardship are events that may be insurable – like the death of a family member, vehicle accidents, and illnesses. COVID-19 has taught us lessons here, as did the last major pandemic in 1918, which was soon followed by the growth of the insurance industry.

As a country, we need to appreciate that long-term savings are a national asset. These savings should act as a shock absorber and therefore, it is necessary to shore up the current state of our savings. To achieve this, the efforts to create and sustain confidence in the savings industry need to take on a new dimension: savings need to be nurtured, protected from misuse and invested with a long-term perspective. This is one opportunity that can stem from the crisis – if we are willing to embrace it.

Corporates learnt some lessons from 2008/2009 and shifted their behaviour accordingly. This time around, individuals and the nation as a whole, will have to take some lessons and not pay school fees again when the next known unknown (crisis) surfaces. What we can be sure of, is that the next crisis will be bigger than this one and we have a duty to empower all South Africans to be ready. ■

THE SA BOND STORY – FINDING VALUE WHERE ANGELS FEAR TO TREAD?

By ***SYLVESTER KOBO****,*
Fixed Income Portfolio Manager

The backdrop: not a pretty picture. SA's fiscal position has unfortunately been deteriorating since the Global Financial Crisis (GFC).

While running a persistent budget deficit averaging 4% of Gross Domestic Product (GDP) a year since 2009, the South African government has increased debt as a percentage of GDP from 26% to 64%. The annual GDP growth rate has fortunately been positive throughout this period (other than in 2009), but growth is expected to contract by approximately 8% in 2020. In addition to a rising debt bill, the South African government is likely to experience significant pressure on its tax revenue.

SA was already in recession at the start of the year. However, the impact of the global pandemic has substantially amplified these challenges.

Against this backdrop, the investment case for South African assets appears weak, especially for government bonds. Accordingly, the market has seen an increase in supply. The country has now been downgraded by Moody's to junk status and foreign investors have voted with their feet, reducing their South African bond holdings from 42% in 2018 to around 30% currently.

However, all may not necessarily be lost. Markets typically discount information a long time in advance, and it is fair to ask whether local bond market valuations reflect this discount.

We outline an investment case for South African bonds, despite this challenging fiscal backdrop. Our case is largely premised on the following factors:

1. Global liquidity and accommodative monetary policy
2. Fiscal consolidation
3. Positioning and valuations

Global liquidity and monetary policy

Cash needs to find a home

In their attempts to lift economies out of pandemic-induced recessions with much-needed stimulus packages, many other countries, both developed and emerging, find themselves in a similar fiscal position to SA. The fiscal deficits of the G20 countries are expected to average over 15% this year, while the government debt-to-GDP ratios of the same group of countries are set to average around 110%.

J.P. Morgan Asset Management estimated that around $17 trillion of stimulus packages have been announced to deal with the fallout from the pandemic. The balance sheets of the G4 central banks have expanded from 35% to 47% in a space of a few months, and they have pledged to keep this liquidity in the system for longer to allow for economic repair.
This cash will need to find a home earning attractive return.

> *One lesson from the GFC is that, like flowing water, liquidity finds a path to risky assets once the environment improves.*

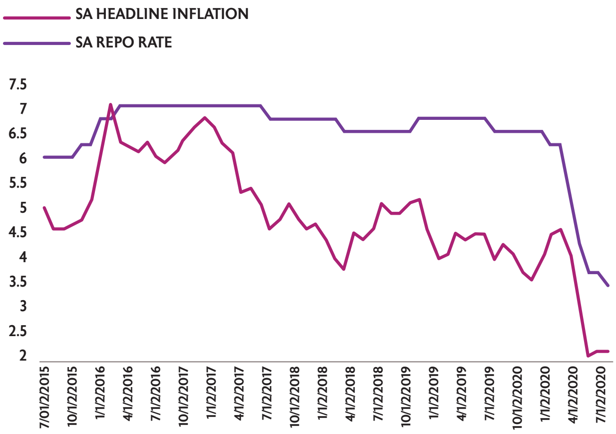
Interest rates: staying low for longer

Central banks globally coupled their asset purchase programmes with interest rate cuts. Most of the developed market short-term rates are either at zero or negative yields. The US Federal Reserve (Fed) recently indicated that it is comfortable keeping rates at current low levels until at least 2022. The increase in liquidity and accommodative monetary environment has improved risk sentiment and bodes well for emerging market assets like South African bonds.

Emerging market central banks followed suit by cutting rates. Unlike their developed market counterparts, they have the space to reduce rates further. The South African Reserve Bank (SARB) has cut interest rates by a total of 300 basis points this year and provided liquidity through bond purchases.

Core and headline inflation numbers continue to trend lower in SA, suggesting further rate cuts. We expect the repo rate to be lowered to 3% over the coming months and to remain at these levels through 2021. This is very supportive for SA bonds, especially in the shorter end of the yield curve, and can be a mechanism to tame fiscal pressures.

SA inflation and repo rate trajectory



Source: Bloomberg

Fiscal consolidation

Governments have choices

Governments have several policy tools to address fiscal imbalances and create healthier balance sheets. They can choose to run higher inflation rates, which over time will help to reduce the real value of their debt. This is generally not advisable for economies like SA, given the negative impact of inflation on the livelihood of the lower-income market.

Another option is debt-monetisation, in which the central bank prints money to finance the deficit. This can also lead to inflation and currency depreciation.

Governments may also consider financial repression policies intended to keep interest rates artificially lower and reduce pressure on domestic debt. SA's government may prescribe to pension funds and financial institutions a minimum holding of government bonds.

Lastly, governments can also choose to introduce austerity measures to reduce spending. While these measures help to bring public finances back on track, they are usually unpopular with the electorate.

SA government: choosing austerity

The South African government has chosen the austerity route. It aims to cut expenditure by R230 billion over the next two years to reach a primary surplus with debt set to stabilise around 87% of GDP by 2024. This is in addition to the 'pencilled in' R160 billion of expenditure cuts in the February 2020 Budget.

These are very ambitious targets and have huge implementation risks, given a poor track record of tightening spending. However, National Treasury's recent refusal to cave into trade unions' demands around wage increases and decision to refuse further funding to SOEs like SAA, are encouraging. While full targets are unlikely to be achieved, some meaningful cuts will be positive for South African bonds and will support a flattening of the steep bond yield curves.

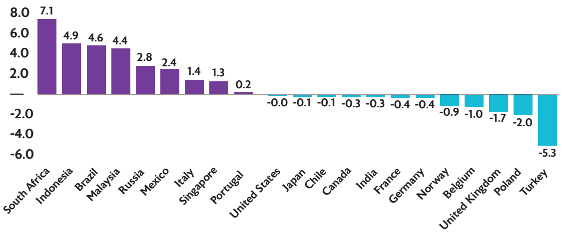
Positioning and valuations

Emerging market portfolio outflows during the peak of the COVID-19 market crisis in 2020, are estimated to be over $100 billion, compared with around $30 billion during the GFC.

Around the same time, SA was finally downgraded by Moody's to sub-investment grade, which led to more selling of its government bonds. With foreign investors now holding less than 30% of SA's debt, positioning is light. There is scope to expect an increase in inflows, especially if the fiscal picture and global risk environment improve.

A compelling investment?

Investors in our longer-term government debt instruments are currently offered a real yield of over 7%, one of the highest in the world, which contrasts with negative real bond yields in developed markets.



Source: Bloomberg

Furthermore, SA's yield curve is already pricing in a worst-case scenario in terms of the fiscal position. The injected liquidity worldwide will be seeking a home once the risk environment improves and the hunt for yield resumes. Most emerging-market economies will once again become beneficiaries of these carry trades, as was the case post-GFC. SA will be on that list, given the attractive valuations it offers. But with one proviso – SA avoids a default.

Given the low growth environment locally, rotation away from growth assets by local managers who also have light bond positions will also support the bond market. A general IMF programme and a prescribed assets programme are likely to precede a default and will be supportive for South African bonds. ■

MINING PROVIDES A SILVER LINING FOR SA

By **KOBUS NELL**, Balanced Portfolio Manager

SA's resources have attracted wealth-seekers for many decades, making the mining industry the bedrock of the economy. After surviving many economic highs and lows, mining companies now face a different threat – a recession caused by COVID-19.

The South African economy, which was already struggling, has been severely affected by the initial strict COVID-19 lockdown restrictions and continued regulatory-driven and behaviour-induced activity constraints. Consumer and business confidence levels in 2020 have dwindled to record lows.

Many South African companies, attempting to manage profitability in a far weaker consumer environment, are embarking on extensive cost-cutting measures, centred on a reduction in employment costs. This will have consequences, such as lower compensation, slower economic growth and potential credit events that may have a more prolonged negative effect on the structure of the economy.

The South African economy broadly comprises manufacturing, services, agriculture and mining. During previous recessions, which were triggered by an overheated economic system and characterised by excess investment for growth and high debt levels, the mining industry was usually the most severely impacted. The current COVID-19-induced recession is proving to be different for miners.

SA mining: recessionary pressures of the past

Salaries and wages (compensation) comprise approximately 50% of South African GDP.

> *As an industry, mining comprises about 8% of GDP, while contributing approximately 3% to employment.*

The impact of the percentage contribution to jobs is understated, given the multiplying effect. It is estimated that four to five additional jobs are created from each new mining job, arising from the supply of goods and services to the mines.

The 2008 recession, triggered by the global financial crisis, caught miners by surprise. At the time, the industry was still enjoying one of the biggest bull markets (lasting almost five years, when the index advanced over 400%) as a result of ongoing elevated demand from China.

At the time, it was expected that demand would remain at these very strong levels, given it would take China many years to complete its infrastructure-led industrialisation. Miners therefore incurred significant debt to fund the high levels of growth they expected to persist for several years, while operating at record margins.

When recession hit and commodity prices tumbled, their cash flow positions quickly changed, requiring them to curtail growth plans. Some mines closed or were sold. This impacted production and subsequent employment negatively, detracting from SA's GDP growth.

Lessons learned

The scars from a blow-out of corporate bond yields and indebted miners finding themselves on the brink of collapse, ultimately introduced good balance sheet and operational discipline into the sector. This included rationalising growth plans and consolidating assets into higher-quality portfolios, which improved the effectiveness of these businesses.

When supply growth resumed, it was at lower levels, helping to maintain greater supply and demand balance in commodity markets. The global drive towards cleaner environments prompted the closure of large emitters of harmful particles into the atmosphere. China has taken active steps to address its serious levels of air pollution on a large scale. This has further reduced their production footprint and stimulated demand for higher quality iron ore and coking coal, which is generally more efficient.

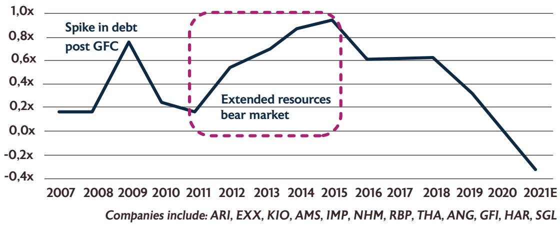
The subsequent prolonged resources bear market, from 2011 to 2016, resulted from overcapacity, with weaker global demand for commodities leading to low product prices. The financial health of the listed South African miners deteriorated materially after the global financial crisis (GFC), with net debt/EBITDA increasing from 0.2x to 0.7x the year after the crisis.

Today's positive outcomes

1. Mining jobs remain buoyant

Mining companies have offered a silver lining in the clouds of an unprecedented worldwide crisis. The high operating leverage of the last recession is in stark contrast to the current healthier cash positions expected for mining companies. This is anticipated to further increase to 0.3x net cash/EBITDA in 2021, as illustrated in the chart below. Healthier cash balances improve mining companies' ability to support employment, even at a time of declining commodity prices.

SA mining Proxy: EBITDA



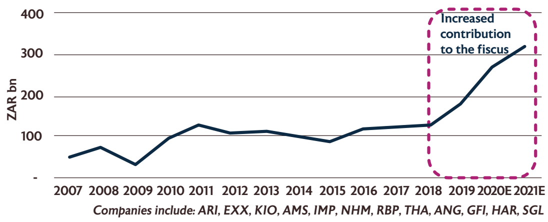
Source: Rencap

2. SA fiscus receives a boost

The robust pricing environment, coupled with a moderate increase in production profiles and the more efficient cost structures evident in the last few years, have helped to propel growing profits for SA miners. Fortunately, the consequential contribution of mining taxes to the fiscus provides an additional pillar of support for the struggling government's income statement.

As shown in the chart above, miners are expected to achieve approximately R300 billion in operating profits in 2021. This will provide a very welcome source of tax revenue in a time where the contribution from many other industries is being negatively impacted by the COVID-19-induced recession.

SA mining Proxy: Total EBITDA



Source: Rencap

3. Commodity pricing robust

We are confident that the aggregate commodity supply/demand dynamic is much better positioned now than it was in the past. To date, the current COVID-19-induced recession has had a limited impact on supply, despite some temporary stoppages in SA and, to a much lesser extent, globally. Commodity prices remain well ahead of the current cost of production in SA and their resilience reflects accelerated commodity demand, driven by aggressive stimulus in China.

The SA mining industry is gradually returning to normalised production and some companies are planning to marginally increase output. The sector is maintaining strong employment rates and minimal, if any, job losses. Strong balance sheets have enabled businesses to weather a temporary shutdown of economies, supported by a robust pricing environment in a well-balanced market from a supply and demand perspective. This is a remarkable outcome and certainly a silver lining in an otherwise complicated and uncertain COVID-19 environment.

Looking forward, uncertainty remains. The shape of a global recovery is dependent on many factors and we continue to question and assess what may be the sustainable effects, both good and bad, of this pandemic. In the short term, SA's mining industry overall is well placed to maintain relatively healthy profits and provide much-needed support for the economy. ■

IMPACT INVESTING – A CATALYST FOR SA's GROWTH

By **ZEYN ISMAIL**, Credit Alternatives, Head of Investment Team

At the dawn of the new decade, the outbreak of COVID-19 has, amid existing challenges, brought about severe economic challenges for most countries around the world.

SA is no exception and the circumstances have forced us to rethink our investment landscape and to identify ways to unlock opportunities that support reliable and sustainable growth in SA.

Although investing for impact is not a new concept or investment strategy, the benefits and intended outcomes are now more critical than ever to SA's current economic situation.

What makes impact investing different?

The rise of impact investing comes in response to the more traditional one-dimensional search for the highest return. Instead, the impact investor considers the tangible impact of investments on the environment and society while seeking financial outcomes. As a result, large global pension funds and foundations, such as Ford Foundation in the USA, now commit a portion of their investment to "impact investing".

The concept to impact investing has grown significantly in the last decade, leading investors to realise that there is no such thing as a neutral investment. It goes beyond considering environment, social and governance (ESG) factors to unlock opportunities and identify investment risks. Impact investors acknowledge that each transaction has an impact, positive or negative. Therefore, they seek investments in products and services that purposefully drive a change to society and our environment. The goals and measurement of such changes are critical to evaluate investment returns.

The 17 United Nations Sustainable Development Goals, or SDGs, ranging from poverty alleviation, zero hunger, climate change and inequality, to environmental degradation, provide a globally recognised blueprint for measurement.

Source: United Nations

SA, along with many nations, has committed to achieving these SDGs as part of its National Development Plan (NDP) with specific targets identified for 2030. Impact investing allows the private sector to support government in achieving these targets. As such, impact investing allows those who take up this opportunity to play a more purposeful role in shaping SA's future, while elevating the standing of the entire financial sector.

Why is impact investing so relevant to SA?

SA's economic woes are not new. The COVID-19 pandemic has simply exposed and amplified existing economic vulnerabilities, placing more pressure on government to raise funding, and thereby increasing their already heavy debt burden. The country's budget deficit is expected to widen to a considerable -14.6% of GDP in 2020/21. Furthermore, National Treasury has revised SA's growth estimates to -7.2% in 2020, 2.6% in 2021 and 1.5% in 2023.

The South African government will need to hasten sorely needed structural reforms to address the many challenges. It will also need to find solutions to raise and drive funding to support economic growth and prosperity. This is a significant task for government to achieve alone. How can impact investing help support economic growth and prosperity?

Investor perspective

For long-term investors, there is a growing recognition that further investments into traditional asset classes, whilst potentially serving as a tool for wealth preservation, will not be enough to contribute to solving SA's socio-economic problems.

Deploying capital into equity and debt structures may support companies that contribute to creating jobs and stimulating economic activity. While these efforts are important, they must also be supported by strategic capital deployment into projects that will have a catalytic effect on development and the creation of a competitive enabling environment. Without this, the capital deployed through traditional channels will take time and require significant scale to affect the real economy.

To secure a future that will do justice to our wealth creation efforts, it is therefore not enough to pour investment into the symptomatic effects of imbalanced societies, but emphasis must be placed on filling gaps in market ecosystems and value chains.

Examples of the impact investing initiatives that have the potential to act as change catalysts in South Africa include:

- Inclusive and quality healthcare
- An effective education system
- Access to financial services for previously marginalised communities
- Access to affordable housing
- A cleaner and more stable supply of energy

Leveraging funding and expertise

The private sector has the funding and expertise to develop, manage and deliver projects that can alleviate SA's most pressing challenges. And, to its credit, the government is now engaging with the private sector to bring impact investing opportunities to life. SA's Public Investment Corporation (PIC) is spearheading impact investing in Africa.

To quote the Chair of Impact Investing SA, Mr Elias Masilela; "The impact investing movement is mindful that governments around the world have failed to make meaningful progress around SDG issues. This is particularly the case with the National Development Plan (NDP) in SA." He goes on to state that the need, not only for public-private partnership but also for leadership, is at the heart of the movement.

In our engagements with relevant government forums, there are indications suggesting that there is definite positive momentum for government to work more closely with the private sector and seeing these various initiatives come to fruition. The result is that significant investment opportunities are opening up for investors, across both equity and debt asset classes.

An investee perspective

Small to Medium Enterprises (SMEs) and the informal sector in SA play a significant role in economic activity, job creation and growth. A study conducted by the Small Enterprise Development Agency suggests that the SME contribution to economy-wide employment stands at 66% and Stats SA pegs the SME contribution to total turnover in the country at approximately 39%. This business sector therefore represents an important example of an investee perspective that would benefit from impact investing.

While playing an important role in supporting and sustaining the economy, large corporates, including the banks, are unlikely to drive the required growth impetus. The pandemic has forced these entities to shift their focus to preserving their bottom line through cost curtailment efforts, and in doing so, they are exacerbating the country's unemployment problems.

With business confidence at an all-time low and businesses adopting a conservation mentality, new initiatives and investment in innovation are being stifled. Add to this a lack of financial and other support into the SME and informal sectors, the problems of growing unemployment and low growth will compound.

Where impact investing could bridge the gap, is by unlocking and placing capital that will naturally support fund flows to these smaller enterprises as investment objectives align to the business purpose and growth strategy. A policy environment that supports and stimulates small business growth will further ignite the potential.

What next?

By allocating capital to investments that provide more than just returns, South African investors can play a meaningful role in alleviating the host of damaging socio-economic challenges our country currently faces.

Advisers and capital allocators who choose to invest with impact could, through their actions, take an active role in changing the course of our shared future.

As the Case Foundation says; “A growing number of investors are making the case that ‘impact’ may represent a fundamental insight that the rest of the market doesn’t yet fully value, raising the possibility of market-beating returns. These investors reject the trade-off between social impact and financial return – rather than seeing returns or impact, they see returns from impact.”

PERFORMANCE AT A GLANCE

KEY MARKET INDICATORS

For the period ending July 2020

July 2020	1 Year	3 Years (p.a.)	5 Years (p.a.)	10 Years (p.a.)
SA markets	%	%	%	%
All share (J203T)	1,6	3,6	4,6	10,3
Top 40 (J200T)	4,6	4,9	5,1	10,6
SWIX (J403T)	-1,7	0,7	2,6	10,0
Financial 15	-31,3	-7,9	-5,3	7,0
Industrial 25	4,3	1,8	4,1	15,0
Resource 10	28,6	22,1	13,1	4,9
Property (J253T)	-41,2	-20,2	-10,5	3,7
Inflation (CPI)	2,2	3,7	4,5	5,0
All bond index (ALBI)	4,2	7,8	7,4	7,9
Cash (STeFI)	6,7	7,1	7,2	6,5
Offshore markets (Base currency)				
MSCI AC World	7,8	7,6	8,0	9,4
Dow Jones US	0,8	9,0	11,1	12,5
S&P 500 US	12,0	12,0	11,5	13,8
FTSE 100 UK	-19,2	-3,3	1,5	5,1
Nikkei 225	3,0	5,0	3,1	10,7
Barclays Global Aggregate (Global Bonds)	7,8	4,3	4,2	2,8
S&P Global Property	-11,7	-0,4	2,6	6,7
3-Month LIBOR (ZAR)	21,3	10,5	7,2	9,3
3-Month LIBOR (USD)	1,0	1,4	1,0	0,4
Commodities				
Oil price (Brent Crude $)	-34,39%	-6,31%	-3,67%	-5,74%
Gold ($)	38,50%	15,89%	12,51%	5,27%
Currencies				
GBPZAR	28,84%	8,51%	2,40%	6,89%
USDZAR	20,13%	8,76%	6,08%	8,84%
EURZAR	27,91%	8,70%	7,56%	7,74%

Source: Morningstar, July 2020

PERFORMANCE AT A GLANCE

STANLIB CORE FUND PERFORMANCE

For the period ending July 2020

		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	6,7	4	7,9	2	8,2	1	7,5	1	10,7	4,9
	STANLIB Flexible Income Fund	5,3	3	5,7	4	6,8	4	7,1	3	13,9	1,8
STABLE GROWTH	STANLIB Balanced Cautious Fund	8,9	1	6,7	1	6,0	2	8,6	1	16,3	-1,3
	STANLIB Absolute Plus Fund	2,4	3	3,6	3	5,1	1	7,9	2	18,2	-3,9
GROWTH	STANLIB Balanced Fund	6,6	2	5,8	1	4,5	2	9,5	2	26,5	-7,5
	STANLIB Equity Fund	4,8	1	4,4	1	3,4	1	10,7	1	34,4	-12,8
	STANLIB Property Income Fund	-39,0	2	-21,2	3	-11,1	3	3,3	2	46,7	-47,2
OFFSHORE (ZAR)	STANLIB Global Equity Fund	33,5	1	20,1	1	15,3	1	18,0	1	56,4	-12,6
	STANLIB Global Balanced Fund	29,9	1	17,3	1	13,0	1	15,0	1	37,1	-12,9
	STANLIB Global Balanced Cautious Fund	28,4	1	14,7	1	10,5	1	11,8	2	30,7	-14,9
	STANLIB Global Property Fund	5,9	3	8,4	2	6,8	2	14,2	1	43,5	-19,3

Source: Morningstar, 31 July 2020

SPOTLIGHT ON

STANLIB BALANCED FUND

Fund Managers

HERMAN VAN VELZE & HENK VILJOEN

About the fund

Inception:
August 1994

Size:
R3.96 billion

Benchmark:
ASISA Peer Group SA – Multi-Asset – High Equity

ASISA Category:
South African – Multi-Asset – High Equity

Regulation 28:
Yes

Managed by a team with extensive experience in managing investments across asset classes and through investment cycles, the STANLIB Balanced Fund has shown robust top-quartile performance over these challenging times. In navigating the pandemic environment, it has been critical to remain committed to a philosophy that uses bottom-up fundamental analysis. Collaborating with and leveraging the expertise of STANLIB specialists, while challenging and validating all views, adds significant value to our process.

Why choose this fund?

A traditional high-equity, balanced fund, delivering strong long-term performance.

- **Highly-experienced team**
  Our team has a depth and breadth of experience in asset allocation and stock selection, following a growth quality style approach.
- **In-depth bottom-up research**
  Our approach to analysing the business cycle is unique. This analysis strengthens our conviction on asset allocation decisions.
- **Specialisation**
  We draw on the specialisation of STANLIB's investment teams focusing on equities, listed property, fixed interest, cash and global opportunities.
- **Strong global partnership**
  Leveraging expertise and ideas from our offshore managers.

Who should invest in this fund?

The STANLIB Balanced Fund is suited to investors seeking capital growth over the long term through investing in a diversified portfolio, which over time holds a significant allocation to local and offshore equity. The investor in this fund would be comfortable with return volatility and a relatively high-risk appetite to achieve long-term growth.

Fund performance

Annualised performance for the period ending 30 June 2020

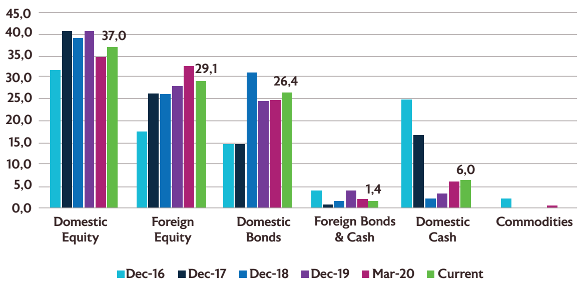
	1 Year	3 Years	5 Years	7 Years	10 Years
STANLIB Balanced Fund	3,48%	5,45%	4,22%	6,41%	9,77%
Benchmark	-0,65%	5,42%	5,14%	8,36%	11,05%
High	11,07%	11,23%	11,23%	21,03%	26,49%
Low	-7,46%	-7,46%	-7,46%	-7,46%	-7,46%

Source: STANLIB

Active global diversification

Our active diversification across local and offshore asset classes ensures that we can manage risk while seeking growth through all investment cycles.

Tactical asset allocation



Source: STANLIB

Selecting quality growth companies

We own shares that exhibit strong quality and growth characteristics within both local and offshore equity.

Top 10 local holdings

Name	% of fund
Naspers	9,1
Prosus NV	3,9
Anglo American Plc	2,6
BHP Group	2,3
Sanlam	1,9
MTN Group	1,8
Standard Bank	1,5
Northam Platinum	1,1
Bid Corp	1,1
The Bidvest Group	1,1

Top 10 offshore holdings

Name	% of fund
Microsoft Corporation	0,9
Alphabet	0,9
Amazon.com	0,9
Facebook	0,4
Mastercard	0,4
Visa	0,4
Samsung Electronics	0,4
Reckitt Benckiser Group	0,4
Centene Corporation	0,4
Comcast Corporation	0,4

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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, had 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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