Q4 | November 2020

STAND POINT

STANLIB

SHIFTING PERSPECTIVES

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FROM OUR STANDPOINT

A note from Head of Institutional Distribution,

TRACY COETZER

As we head towards the end of 2020, a uniquely challenging year in all respects, it's difficult to pen an introduction to this edition of STANDPOINT without mentioning the pandemic.

Many of us will feel weary and spent from a work and personal perspective caused by our forced and sudden adaptation to an unusual way of life. While this pandemic-led change created opportunity for some, others experienced profound and adverse effects. Despite our unique experiences, we can agree that it is not a year we will forget.

It began with one of the steepest market crashes in history as investors panicked at the health and economic implications of the rapidly-spreading coronavirus. But it was also one of the shortest lived market crashes on record: most markets rallied hard once unprecedented levels of monetary and fiscal stimulus were announced by the major economies. Tech stocks, especially those which enabled working from home, did particularly well.

With change and uncertainty now a familiar backdrop, we consider investing through change and thinking differently in this edition of STANDPOINT.

We have seen, and continue to see, an extreme shift across the globe in how people work, shop and play, how policymakers effect decisions and how businesses adapt their models to stay afloat. As the global economy rebuilds, propped up by financial systems, we look at trends that accelerated in 2020 and consider which of these may be here to stay.

Mark Lovett, STANLIB's Head of Investments, shares an interesting perspective on the need to think differently as asset managers. Recognising the current environment where the real economy is struggling, yet financial markets have bounced back, it's important to shift our perspectives and adopt a different and innovative mindset, as we continue to deliver to our clients' expected financial outcomes.

Finding alternative sources of return is a good example of embracing change. Enhancements to investing techniques, especially quants-based, have seen new forms of active management emerge. STANLIB Index Investments' Chief Operating Officer, Wehmeyer Ferreira, unpacks smart beta or factor investing and explains how quants experts are able to find alpha in systematic processes.

Another investment perspective is thematic investing, which is a concept that enables investors to identify investment opportunities brought about by structural changes in our world environment. Vaughan Henkel from our Absolute Returns Strategies team provides us with a thought-provoking perspective on clean energy and the shift to cleaner sources of power.

Chief Economist, Kevin Lings, reflects on monetary policy shifts to a new normal of low interest rates and high government debt, questioning the consequences and sustainability of the current regime. And last, our Global Equity Portfolio Manager, Neil Robson, shares his insights on retai sector trends.

As we tread cautiously through to the end of the year, mindful of both the opportunities and challenges change brings, we would like to thank you for your continued support in 2020 and wish you and your families all the very best for the end of the year.

Regards,
Tracy

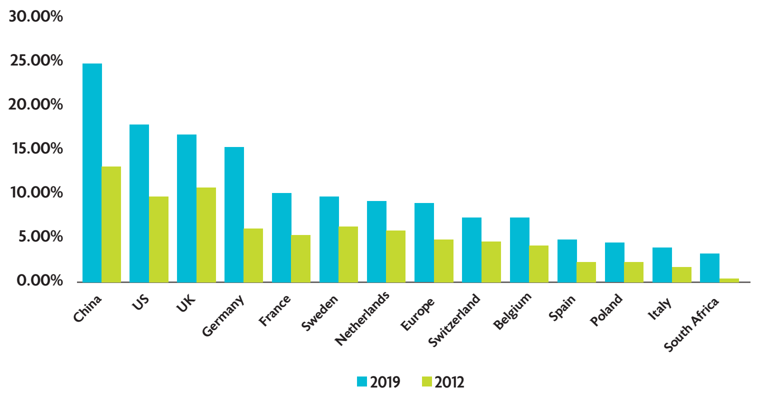
CHARTICLE:

GOING DIGITAL... FASTER

Consumers are increasingly taking to online shopping across developed markets, attracted by the efficiency and ability to save time. 'Staying home' in 2020 has seen online shopping increase further, entrenching behaviours that may not have shifted before the pandemic. As the real-life shopping experience is tainted by hygiene protocols, it's become a better experience to shop from home!

Growth of online retail sales from 2012 – 2019

Online trade as a % of total retail sales



Source: STANLIB Property, Smart Insight

- South African online shopping growth may be constrained by digital access and delivery logistics, but has nevertheless shown significant growth over the last seven years, and 2020 has likely accelerated this trend.
- Transactions are going paperless, too. From healthcare to banking, to investing in Unit Trusts, the shift from 'paper to pixel' is clearly a timesaver, with multiple other benefits.
- Changes to ways of work are clearly shifting business operating models. The rapid and necessary move to 'work from home', and conduct online meetings and virtual events, may be a dramatic shift, but it's likely to linger a little longer, even beyond the virus outbreak, due to cost-saving and efficiencies. ■

VIEWING ASSET MANAGEMENT THROUGH A NEW LENS

By Head of Investments,
MARK LOVETT

2020 has been a year of extreme volatility, both emotionally and for financial markets. The drama of a global pandemic has been extraordinary, and it should make all of us take stock of the world we now occupy. As investors, such contemplation is even more relevant as we also assess the apparent short-term disconnect between the V-shaped recovery in financial markets and the ongoing distress in the real economy.

Understanding that disconnect is an important requirement before we even attempt to predict the future, why is there such a significant disconnect between financial markets and the real economy?

One word – liquidity

Central banks and governments have responded to the crisis with substantial, sustained and co-ordinated monetary and fiscal support. This is the playbook response to a financial shock that these entities established after the global financial crisis (GFC). Major interest rate cuts, quantitative easing and aggressive fiscal spending have been initiated, injecting massive liquidity into the financial system.

As in the GFC, this liquidity has seeped into financial markets, resulting in asset price appreciation even before the process of economic recovery has begun. The stimuli of 2020 have exceeded the GFC period, both in size and global co-ordination, resulting in a very rapid recovery in financial markets, despite the ongoing traumatic implications of the pandemic for the real economy.

What's different this time around?

A key differentiating factor relative to the GFC has been the nature of equity gains. These have not been broad-based but concentrated in certain sectors, particularly in US technology and consumer-related areas. This is understandable and reflects the diverse influence that the virus has had on different sectors of the economy. Some industries have been permanently scarred, while others have experienced accelerated growth in their long-term prospects.

Many investors, particularly if anchored in a traditional mindset, have struggled to navigate these markets and have been forced to question whether these trends are temporary or more permanent in nature. We feel they are permanent, and that investors need to think differently about the future.

Over the last three years, STANLIB's investment platform has been proactive in responding to the structural changes evolving in our investing universe.

> *We firmly believe that COVID-19 is both a catalyst and an accelerant for further change.*

Accelerating consumer trends and government control

Thinking differently will involve recognising that COVID-19 will have important social and governmental consequences. For the broader society, the pandemic has forced some behavioural changes that we believe are unlikely to be temporary. The influence of the digital economy has exploded across all sectors of the economy, accelerating an underlying trend that has been evolving over the past decade.

Five years of future digital growth has been compressed into a few months due to this global pandemic, and not just in the business-to-consumer segment, through companies like Takealot and Amazon. The business-to-business environment is also evolving to capture the opportunities associated with digital tools and disruptive business strategies. This is even occurring in traditional sectors where previous digital acceptance has been low.

We also need to think differently about the influence and reach of governments in the future. The days of political acceptance of a pure laissez-faire market economy are behind us. Around the world, including in SA, governments have been central to the COVID-19 response, although with varying degrees of success and competence. Politicians will be reluctant to vacate this role in society and in the economy, and we anticipate that post-COVID-19 there will be greater governmental involvement in our personal and business lives. Within this shift, there will be pressure for corporates to assume a greater responsibility towards a broader group of stakeholders – potentially hurting profitability.

What about our own industry?

Thinking differently will also make sense for asset managers. At STANLIB, we have thought deeply about the implications for asset management, both for our decision-making processes and our product development. For example, we believe that the value equity bias and low level of asset-class diversification evident in South African, balanced funds needs to evolve.

The lacklustre performance of SA Inc shares this year, building on a disappointing trend over the last few years, is cementing our concerns about investors' historical over-reliance on value-style domestic equities in constructing multi-asset portfolios. The future will require broader diversification in asset class exposure, implemented in both international and South African building blocks. A controlled exposure to alternative assets, such as infrastructure, private equity and private debt, can deliver equity-like returns while providing crucial portfolio diversification.

More sophisticated risk management disciplines are also critical, as the issue of consistency of investment returns is becoming an even more pressing concern for clients. **The era of consistent 'easy' equity returns is almost certainly behind us.** Accessing a broader source of returns will be demanding and will require new skills. Quant analytics and artificial intelligence are such skills for the evolving asset management industry – exciting for a progressive mindset, but terrifying for a mindset anchored in the past.

The need to think differently is all around us. In the midst of all of this change, it would be wrong to assume that everything reverts to normal post-COVID-19. The pandemic has been a catalyst for change and, in several areas, has resulted in a dramatic acceleration of a structural trend. It is important, as both individuals and investors, that we do not dismiss the implications of these trends for our lives.

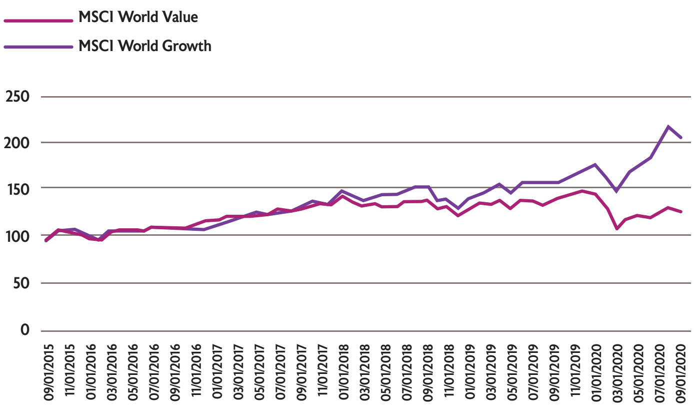
Simply believing that what worked for the previous 15 years will work for the next 15 years, is naïve. For investors, navigating such a fluid environment will require consideration and a greater appreciation of asset management disciplines, including diversification and risk management. ■

A SYSTEMATIC APPROACH TO ACTIVE MANAGEMENT

By ***WEHMEYER FERREIRA,***
Chief Operating Officer STANLIB Index Investments

Growth or value? The debate over which of these investment styles is superior has regained energy over the last year, especially in equity markets. The substantial observed performance differential between the two has recently shown a clear front-runner: growth stocks, such as Amazon and Apple, which have massively outperformed value stocks, such as financials.

Growth vs Value Divergence



Source: STANLIB, Bloomberg

The two investment themes are well-covered in the media and financial literature. Various investment styles perform well over specific business cycles, and it is unlikely that a specific investment style would outperform others into perpetuity, although significant periods of out- and under-performance can and have occurred. As such, what investors should be considering is how they can best position themselves to gain exposure to a specific or various investment style(s).

Another long-standing concurrent debate in the investment management field concerns the relative merits of passive versus active investing; or, put differently, the relative value of index-tracking versus stock-picking.

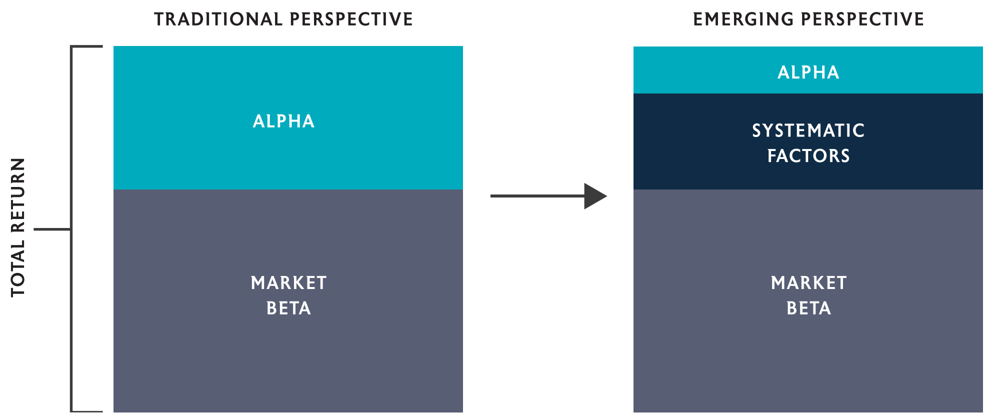
STANLIB Index Investments is firmly in the camp that believes in the power of beta (broad market exposure) to deliver investment outcomes. However, we strategically sit in two camps – not something every asset manager is comfortable doing.

We also believe that outperformance of a market-cap-weighted index is possible through effective active systematic investing, which can be achieved by exposing investors to persistent drivers of return. Systematic investing follows a rules-based approach – taking the emotion out of investing when making investment decisions. Investment outcomes are based on these rules.

Over the last decade, we have seen the steady rise of new types of investment funds, termed 'Smart Beta' and 'Multi-Factor'. These funds may best be described as 'systematic active', due to the rules-based nature of investment management and the source of returns.

The rise of Smart Beta is due to an evolution in investment thinking, where a large portion of what was previously considered to be alpha is now viewed as exposure to systematic styles or factors via Smart Beta funds (see Figure 1).

Figure 1: The evolution of total investment returns



Understanding Smart Beta

> *'Smart Beta', a specific systematic investing approach describes rules-based investment strategies that are based on specific market factors, for example, growth or value.*

A Smart Beta process passively tracks an index, but targets only the identified or chosen set of risk factors expected to add value over time. This approach represents an ideal blend of passive and active portfolio management styles, in a systematic quant-based approach. The main premise is that persistent and systematic drivers of returns (the factors) exist in the market; therefore, combining these drivers in an unemotional, systematic and rules-based way, leads to outperformance in the long term.

Active managers can be systematic managers

The aim of active management is simply to outperform a chosen benchmark through successful asset or security selection and portfolio construction. This is achievable when the active managers have an 'edge' over other investors (and the market), which allows them to identify superior investment opportunities and deliver optimal outcomes for investors. However, if the notion of active management creates the mental image of a fundamental active manager, you will need to adjust your thinking – active managers include systematic managers.

> *The active manager's 'edge' typically comes from better market information, better information processing systems, better investment processes, or better risk management.*

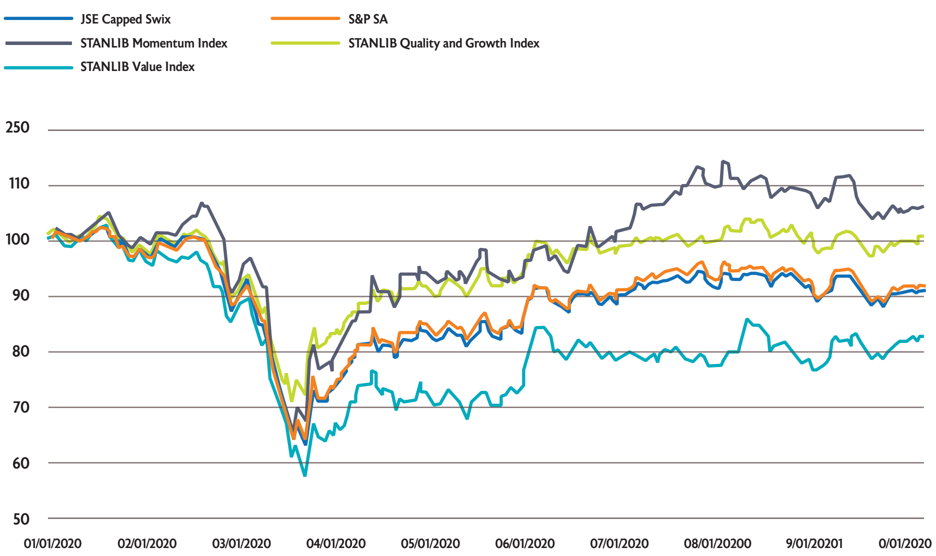
Systematic managers would argue that the four areas apply to them as well; but since a systematic process is followed, systematic managers can consume more market information, apply more processing power, and deploy an investment process and risk management system without any behavioural biases. As such, systematic managers are very much active managers.

The STANLIB Index Investment team has discussed in a previous STANDPOINT article, Tilting Towards Opportunities in the Midst of a Crisis, how different styles and factors perform in various market conditions.

View article

This demonstrated the robustness of style/factor investing at the height of COVID-19, but it also applies through any business and/or economic cycle. If we look at the three STANLIB Smart Beta products, and their performance year-to-date versus broad market indices (see Figure 3), style leaders and laggards are clearly observed. But these results are not unique to this tumultuous year. Different individual investment factors outperform and underperform from year to year, as mentioned earlier.

STANLIB Smart Beta fund range performance vs relevant indices



Source: STANLIB, Bloomberg

Investing in Smart Beta

Single-factor Smart Beta funds are typically used by investors as:

1) a long-term investment to buy and hold through an entire business and economic cycle (which could be more than 10 years for full benefit); or

2) a product or building block investment to complement or complete an existing equity portfolio; or

3) a tool to take advantage of a specific outlook on the cycle or a factor.

However, investing in Smart Beta funds requires dynamic allocation and risk management by an investor to ensure an optimal outcome. Periods of volatility and underperformance will test the best investors and expose them to unavoidable and natural behavioural traits, often leading to adverse asset allocation decisions.

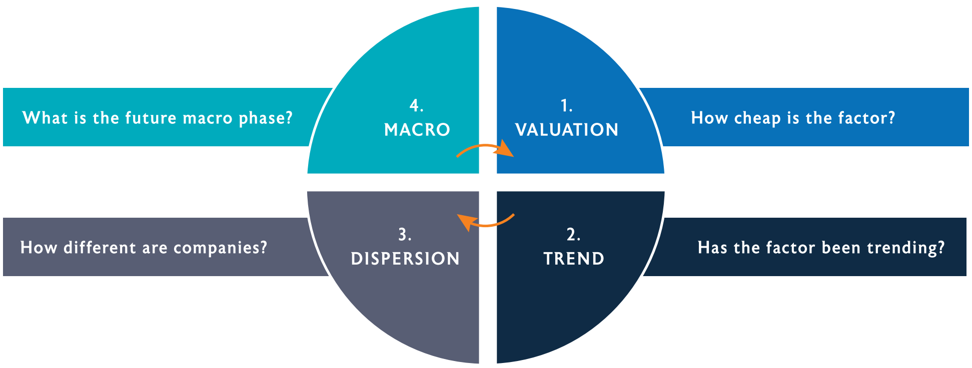
For this reason, when the STANLIB Index Investment team considers what our best equity view and approach is, we refer to the Multi-Factor approach. Multi-Factor funds offer investors simultaneous exposure to more than one investment factor (style). The investment process combines the benefits of Smart Beta, allocation to proven factors or style, and sound portfolio construction (where we combine factors in the most optimal manner).

Top-down or bottom-up factor allocation

Multi-Factor strategies can be implemented with two different approaches: top-down or bottom-up factor allocation.

Top-down Multi-Factor funds blend single-factor or Smart Beta, portfolios to create a diversified equity portfolio. Bottom-up Multi-Factor funds score individual shares on multiple factors, which translates into a multi-factor score per share. The stocks with the highest multi-factor scores are then included in the multi-factor portfolio. While these definitions oversimplify the full processes of both methods, in this article they serve to give a high level of understanding.

The STANLIB Index Investment team is of the firm belief that utilising a bottom-up approach delivers the most robust result. This approach creates a targeted portfolio with higher factor exposure or factor purity, which should deliver superior long-term risk-adjusted returns. The image below shows our approach to bottom-up factor allocation.



Rules-based, data-driven, and multi-style focused investment approaches offer investors and asset allocators a return outcome that is not influenced by behavioural biases. Smart Beta funds based on individual factor allocation are ideal for existing portfolio style enhancements or existing portfolio risk mitigation. Concurrently, we believe that the multi-factor approach will achieve consistent long-term results by allocating to multiple and prevalent investment styles. ■

INVESTMENT OPPORTUNITIES IN A CHANGING WORLD

*By **VAUGHAN HENKEL**, Portfolio Manager, Absolute Returns Strategies*

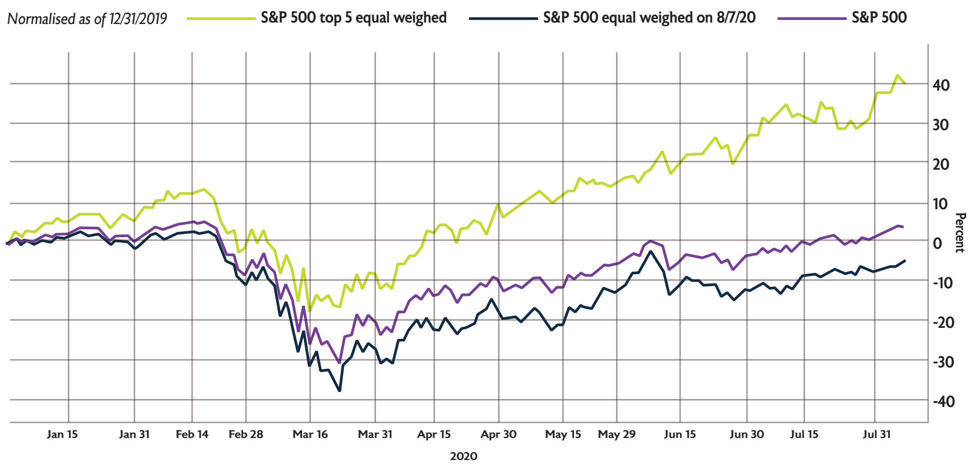
Thematic investing

Long-term thematic investments are those that benefit from structural changes to the world in which we live. These themes tend to be long-lived and provide significant performance advantages over time, if correctly identified.

The latest and most recognisable structural change is the shift to digital socialising, shopping and entertainment, resulting in the recent FAANG (Facebook, Amazon, Apple, Netflix and Alphabet formerly Google), phenomena, where five technology stocks now constitute 37% of the S&P500 index. In 2020, these stocks have been the sole drivers of the index's growth as the pandemic drives digital acceleration.

As these pandemic-led shifts continue to impact the longer-term sustainability of business, it is beneficial to recognise themes that are arising or those that are accelerating when constructing portfolios, thereby optimising exposure to areas of sustained growth.

Far Ahead: SP 500's five most valuable companies leave the other 495 in the dust



Source: Bloomberg. Top 5: Amazon, Apple, Facebook, Google/Alphabet, Microsoft

What's next?

Identifying a theme that will drive long-term growth, and finding ways to access companies or investments that will benefit from this theme, underpin the thematic investing concept. Environmentally-related themes have gained recognition over the last few years as the world aims to curb the adverse impact of various activities on our planet.

Clean energy

Clean energy is the creation and delivery of energy without harm to the environment.
For the purpose of this analysis, we view it as non-oil types of energy. Once the focus of environmental activists only, championing cleaner ways to deliver energy or power has now become more mainstream for a number of reasons:

Governments

- The United Nations Paris Agreement, which was signed by countries worldwide, commits them to lowering carbon emissions, given the harmful impact on the environment.
- US President-elect Joe Biden, promises to direct US$2trn to clean energy, over the next four years. The US also plans to derive all electricity from carbon-free sources by 2035 (renewables were <10% of US Energy consumption in 2019).
- The EU climate plan targets at least a 55% reduction in carbon emissions by 2030, another key driver of clean energy. Indeed, the EU climate plan is to derive 40% of energy from renewables by 2030 (the share of production needs to rise from 32% to 65% by 2030 to achieve this).
- China derives only 3.2% of its electricity from wind and solar, but this is forecast to grow to 22% by 2040 at a CAGR of 6% – well above total electricity growth of 1.2% CAGR, from 2015 to 2040 (EIA stats).

Society

- The COVID-19 pandemic has renewed the focus on health and well-being, impressing on people the need to take physical precautions and measures to ensure not only a healthier life, home and working environment, but also the macro global environment.
- The current Gen-Zers, personified by child activist Greta Thunberg, are significantly more attuned to and focused on the sustainability of a healthy environment.
- The groundswell towards ESG as a 'right to play'.

Business and investment

- Even Big Oil, as evidenced by BP's recent plan to increase green energy by 50 Gw by 2030, has understood something clearly at last (Note green energy in the UK totals 50 Gw today).
- Furthermore, our analysis shows that this strategy (for selected ETFs) has kept pace with the S&P500 over the past eight years.

Clean energy: a sustainable theme?

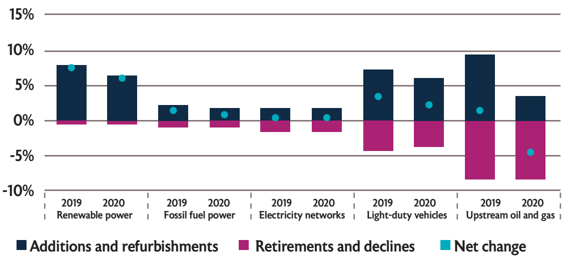
Two primary indicators or drivers of the clean energy theme are capital expenditure (capex) and historical performance of clean energy investments relative to the tech phenomena stocks.

1. Energy capex

Over the last five years, the global clean energy capex has been tracking at approximately US$600bn per year, and largely flat over the period (IEA statistics). Global oil-related capex has, on the other hand, declined from US$875bn in 2014 to less than an estimated US$400bn in 2020 – a more than 50% drop. This demonstrates that the global shift in capital spent on energy has already been in play for the last five years, before the current focus on the environment (the E in ESG). The chart below (showing the latest year only) shows the increase in renewable power investment vs oil and gas.

The crisis is hastening the retirement of some older plants and facilities,but also dampening consumer spending on new and more efficient technologies,

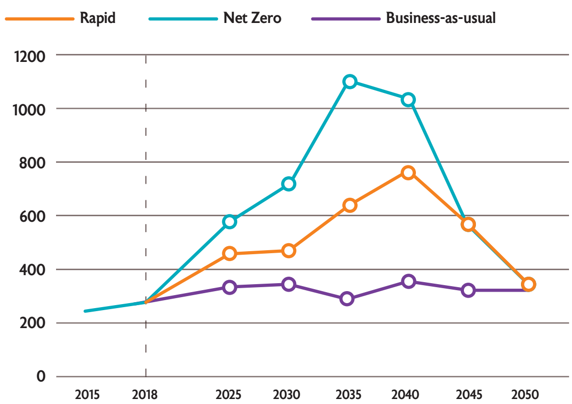
Changes to the energy-related capitial stock in 2019 and 2020
as a share of total stock in the preceding year



Source: IEA 2020

Looking further out to 2050, we show how BP (in their new Energy outlook for 2020, September 2020) forecasts a rapid increase in clean energy capex, regardless of which type of carbon-reduction scenarios are accepted. The investment required in wind and solar alone (a clean energy subset), will be between US$500 and 750bn per year (in both carbon-emission reduction scenarios of 70-95% by 2050). This is two to three times greater than the current level of investment.

Average annual investment in wind and solar based on two carbon reduction scenarios vs business as usual
Five-year rolling average, 2018 US$ Billion



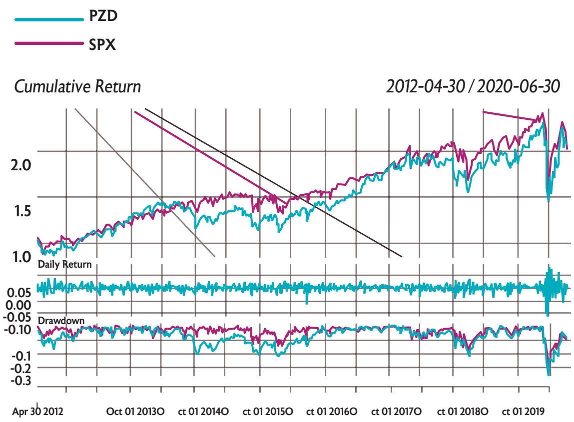
Source: BP Energy Outlook: 2020 edition

2. Relative performance: Clean energy vs the S&P index

The performance of the Powershares Cleantech Portfolio (PZD), which tracks a global index of cleantech companies, has kept pace with the Standard & Poor's index (SPX) over the last eight years (9.8% CAGR vs 9.9% for SPX), which is somewhat surprising given that SPX comprises many tech stocks. PZD is likely to outperform SPX into the future, with increasing attention to clean energy.

We also note how the PZD has greater drawdowns (bottom part of the chart) than the SPX. This is due to a smaller number of stocks, but it also highlights how a longer timeframe is required to offset the volatility.

Powershares Clean Tech – PZD ETF (Black) vs SPX (Red)



Source: Bloomberg

Where does South Africa fit in?

South Africans are all too aware of the challenges we are experiencing with our main energy provider, Eskom, on a daily basis. The CEO of Eskom optimistically indicated to the market that we will only experience electricity challenges for another 18 months.

While coal provides the base-load for South Africa and will continue to do so for the foreseeable future, transitioning to more clean energy is critical for South Africa's contribution to global carbon-emission reduction and to be in line with the Paris Agreement. The Integrated Resource Plan 2019, gazetted by the Department of Energy in October 2019, demonstrates this direction, and by 2030, 24.1% of SA's energy contribution is expected to come from solar (PV) and wind.

As the world continues to drive change towards a cleaner environment, it's a good time to invest in this thematic growth story. Investors are effectively collaborating with stakeholders across the world to drive a positive sustainable environmental impact, and will benefit from the resulting 'clean' financial returns.

LOW INTEREST RATES AND HIGH GOVERNMENT DEBT HAVE BECOME THE NORM

By Chief Economist,
KEVIN LINGS

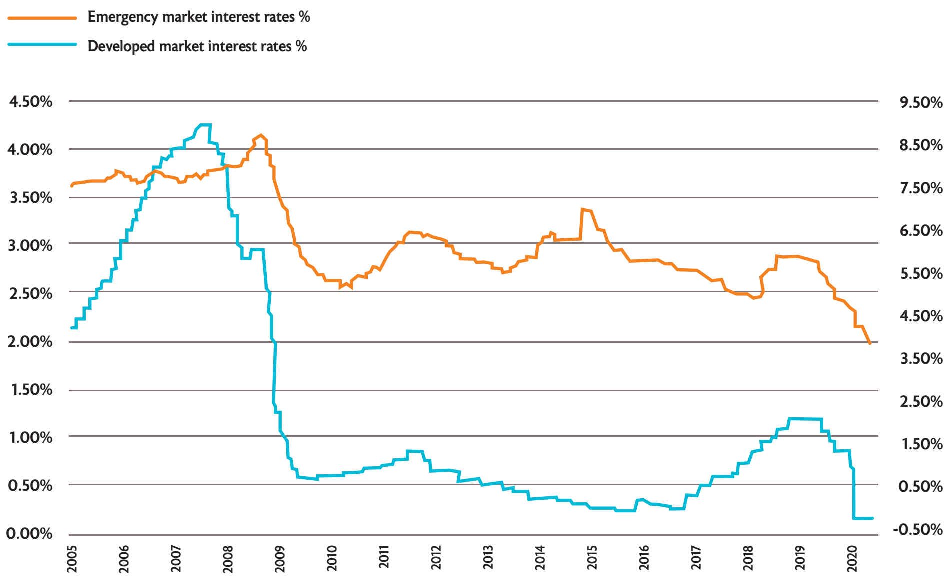
The world economy was overwhelmed by the introduction of extreme COVID-19-related lockdown measures in 2020. Apart from the human tragedy associated with the spread of COVID-19, these measures forced the world economy into an unprecedented economic recession. This has been accompanied by a substantial increase in unemployment, a loss of business and household confidence, as well as a significant increase in debt.

Global GDP is on track to record an unprecedented decline in economic output during 2020 of around -4.4%.

'Unconventional' policy measures

Understandably, in early 2020, governments and central banks quickly came under enormous pressure to respond to the crisis. This included a substantial increase in government transfers to support businesses and the household sectors, but also an increased effort by central banks to provide further monetary policy relief.

Global interest rates



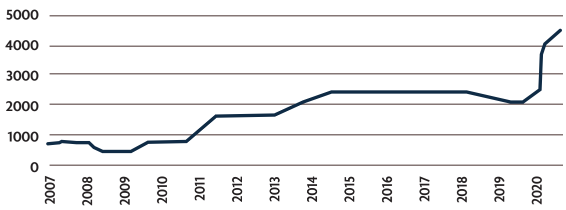
Source: Macrobond, STANLIB

While some central banks, like the South African Reserve Bank, had scope to cut interest rates further, most major central banks did not. With little or no scope to reduce interest rates any further, they were forced to expand their use of 'unconventional' policy measures, such as quantitative easing or yield curve control to provide financial market stability and sustain economic growth.

These policy initiatives manifested in a rapid expansion of both government and central bank balance sheets, especially within developed economies such as the United States, United Kingdom and Euro-area. In particular, most of the large central banks now own vast quantities of risky assets, including government bonds.

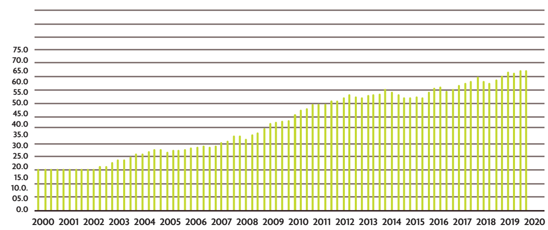
For example, by the beginning of October 2020, the United States Federal Reserve had accumulated a phenomenal $4.88 trillion in US government bonds. This, compared with less than $600 million prior to the 2008/2009 global financial market crisis. This perpetual accumulation of government bonds by the large central banks effectively allowed governments to run much larger-than-normal fiscal deficits, confident in the belief that their central banks would continue to accumulate a significant portion of any outstanding government debt.

US Federal Reserve purchase of government bonds



Source: US Federal Reserve

Global government debt



Source: Institute of International Finance

Consequently, what started as a set of temporary but 'unconventional' monetary policy measures at the time of the global financial market crisis in 2008/2009, have now become a permanent component of central bank monetary policy.

From a central bank's perspective, they would argue that they needed to introduce this unprecedented set of policy measures to prevent the global economy from collapsing into another depression. **Furthermore, central banks have vowed to withdraw the extraordinary policy measures once the crisis is over. However, just like the quantitative easing enacted after the 2008/2009 global financial crisis, shutting off the liquidity tap could prove more challenging than opening it.**

This signals that there has been a paradigm shift in the management of monetary policy

Most central banks can no longer afford to simply focus on only one primary policy objective, namely achieving their inflation target. Instead, they need to prioritise ongoing financial market stability, while at the same time stimulating economic growth. This change in the role of central banks runs the risk of severely undermining their operational independence, which they have fervently guarded for decades. At the same time, it exposes the world economy to a series of largely untried and untested monetary policy strategies.

Consequences: rising government debt and low interest rates

The net result is that world government debt has more than doubled in the last 12 years. It has risen from less than $33 trillion (57% of world GDP), prior to the global financial crisis in 2008, to more than $70 trillion (91% of world GDP) in 2020. This represents an average annual growth rate of over 6%, which is well in excess of the growth in global GDP over the same period. In addition, private sector debt (measured on a global basis) has jumped from $117.5 trillion during 2007 to $118.1 trillion in 2020.

A government's ability to increase or sustain a high level of debt is highly dependent of three key factors, namely:

- the maturity profile of the debt
- the government's ability to collect tax revenue, and
- the interest cost of the debt.

While the maturity profile of government has not altered substantially in recent years, the current recessionary conditions have clearly undermined government tax revenue collection. Fortunately, this has been significantly offset by a sustained reduction in global interest rates.

For example, policy interest rates in developed economies were recorded at a GDP weighted average of only 0.11% at the beginning of October 2020, which is a record low. At the same time, official interest rates in emerging markets have fallen to a GDP weighted average of a mere 3.9% – also a record low.

How does this play out?

The immediate and obvious uncertainty presented by this new normal of high government debt and record-low interest rates is the question of how most central banks will eventually unwind the current monetary stimulus – both in terms of the record-low interest rates, and also the unprecedented injection of liquidity.

Under these circumstances, even a small increase in interest rates could derail the global economy's fragile recovery. Knowing the danger of a premature withdrawal of the highly accommodative monetary policy, few central banks will be willing to risk a severe recession in the pursuit of policy normalisation.

> *In other words, no major central bank will want to be held responsible for crashing the financial markets because they started to reverse monetary policy without clear justification.*

Furthermore, even if the withdrawal of financial liquidity appeared fully justified, it is highly likely that it would still result in a significant sell-off in financial markets.

Moreover, with central banks now being the largest holders of many risky assets like government bonds, these banks will be mindful of how changes in monetary policy could damage the public sector's own balance sheet, with dire consequences for stability in the broader economy.

Fortunately, in the short-term, global inflation remains extremely well-contained, with most countries currently more concerned about the risk of deflation rather than inflation. In fact, consumer inflation in the Euro-area has averaged less than 1% during the last eight years, while in the US, the average has been a mere 1.5% over the same period.

Furthermore, even if inflation does start to rise, the United States Federal Reserve has already signalled its willingness to tolerate price increases above their target of 2%, arguing that, since inflation has been below 2% for a considerable period, they should rather focus on the average rate of inflation and not merely a point target of 2%. Hence, without a persistent increase in inflation, many central banks may find it difficult to justify an exit from their supportive monetary policies.

Equally, should the existing fragile global economic recovery start to stall, it seems fair to assume that the major central banks will endeavour to introduce even more innovative policy tools, such as the purchase of highly risky assets, active control of the yield curve, and perhaps even greater use of negative interest rates.

Overall, the current global monetary policy of record-low interest rates and increased liquidity appears likely to persist for a considerable period, despite the obvious risks.

Under these circumstances, investors are having to fundamentally change how they take account of risk in constructing their portfolio, with a traditional low-risk portfolio providing a return well below the historical average.

In the meantime, any sustained emergence of consumer inflation around the world that might necessitate a tightening of monetary policy, will start to make central banks, governments and investors extremely nervous. ■

THE RETAIL SECTOR: PERSPECTIVES ON GLOBAL TRENDS

The pandemic-led global economic slowdown has had a significant and unforeseen impact on the retail sector worldwide. As consumers are shifting to online shopping experiences, landlords are agreeing to rental concessions. Our global equities portfolio manager shares some interesting perspectives.

By Neil Robson, Head of Global Equities at Columbia Threadneedle Investments

A major acceleration in the long-term trend for e-commerce to gain share within retail sales overall has resulted from the COVID-19 crisis. At a time when our mobility has been constrained in an effort to lower infection rates. This has been a trend globally as can be seen in the credit card data for online spending in the table above, where in Q2 this year over year spending grew 31% in the US, 32% in Europe and an astounding 55% in the UK.

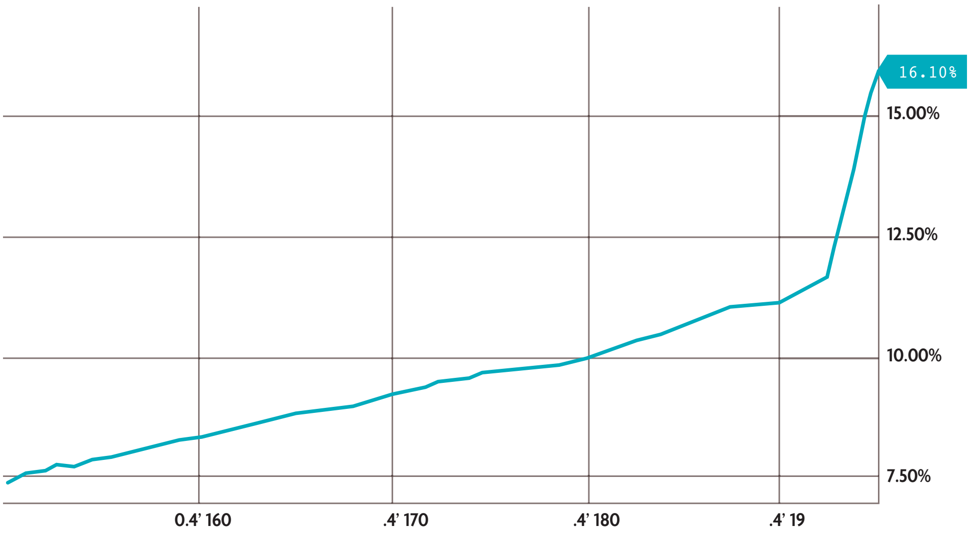
US, EU, and UK Card Volume Y/Y Growth

Metric	Source	3Q19	4Q19	1Q20	2Q20	1Q20
US E-Commerce Spending Growth*	US Census	16.2%	14.2%	8.6%	31.2%	26.2%
EU E-Commerce Spending Growth*	Eurostat	12.8%	9.5%	11.0%	32.1%	21.2%
UK E-Commerce Spending Growth*	UK Office for National Statisitcs	11.0%	6.4%	8.7%	55.3%	53.8%

Source: US Census Bureau, UK Office for National Statistics, Eurostat
**Represents April and May only*

The figure below shows the jump in the penetration of online sales in the US from under 12% to over 16% (in the UK, this rose from 20% to well over 30%). This is a significant acceleration on the prior trend. There is cause for caution, as some of this change is due to the fall in overall retail sales (the denominator), rather than just the growth of e-commerce.

US E-commerce Sales as Percent or Retail Sales



Of course, this penetration rate will drop once this crisis passes, the physical retail infrastructure reopens fully, and consumers' confidence recovers. However, some changes will remain.

Analysis shows that it takes 60 days to form a new habit, and we have all lived for far longer under COVID-19, many in lockdown conditions. Almost everyone will have experimented with buying something new online, and some of those habits will stick, as the convenience and price point of e-commerce, or simply the habit, will influence our behaviour.

What will the important shifts be? For me, who had rarely ever shopped online, it was small items like guitar strings and vinyl records – and I don't see myself going back. The big category in which the online businesses have been investing to break into is groceries, and for many, this crisis has been our first experience of buying our food and drink online – everything from toilet rolls and flour (apparently, we all tried to bake at home), to meal kits. I believe this spending pattern has started a permanent shift online.

Traditional retail formats have done their best to adapt, shifting to a multi-channel offering and investing in their online offering and fulfilment. For large businesses like Walmart, this is a continuation of strategy, and one they can afford, but for many small businesses, it is impossible to match the fulfilment capabilities of the giants like Amazon. To offer next-day or even later-in-the-day delivery takes enormous investment, and Amazon has not been a standing target. Amazon themselves have invested aggressively to further embed themselves in our habits, hiring some 175 000 new employees since the crisis started.

Physical retail seems stuck in a never-ending restructuring, ceding space to focus on prime/destination shopping centres, while focusing on a highly curated/high-end offering. Are we at the end of the shift online? No, perhaps it has just shown us a glimpse of the future. If the UK can get to over 30% of retail sales online, why not the US? If 30%, why not 50%? The implications for retail still look bleak – vacancy rates are likely to rise further, and we will see further bankruptcies in the sector.

One change that may become semi-permanent is the location of our consumption. At Columbia Threadneedle, we have been working from home for many months now – we are no longer buying our lunch at Pret or Marks & Spencer, and we are no longer shopping near St Paul's.

While I am sure we will return to the office in time, I believe we will all work from home more frequently than in the past. If we all worked one day a week from home, I am sure there are many retail businesses local to our office that will struggle to adjust to a -20% drop in revenues. This is a further threat to the sustainability of our towns and cities, and as retail vacancy rates grow, the appeal of the physical retail experience declines.

Conversely, is there an opportunity for retail in our small towns and villages once their role as dormitory towns is partially reversed and office workers' consumption shifts back to where they live?

Behind it all, a key trend has been the growth of 'shopping with purpose', as consumers of all ages become increasingly aware of the social and environmental implications of their consumption.

The existence of COVID-19 itself is cause for thought in this regard. The range of implications is extremely broad, from a shift towards a plant-based diet with benefits on climate change, to an aversion to fast fashion and the throwaway society.

I enclose a link to a piece written by my colleague Pauline Grange on the efforts of one company in our portfolio, Adidas, in this regard. It describes her visit to the company's new flagship store in London, and clearly demonstrates their environmental intent in their changing product offering and using the store as a brand promoter. All of this sits in front of their massive investment in their direct to consumer online offering and suggests a dim future for footwear stores and sports shops.

View article

In the global equity portfolio, we have no exposure to traditional retail formats. Instead, we have investments in the two pre-eminent online retailers worldwide, Amazon and Alibaba. We also have exposure to brand businesses, like adidas, who have some exposure to physical retail. Finally, we should not forget that the rise of e-commerce cannot exist alone, and has profound implications for associated businesses like the payments industry and advertising, where we also hold significant investments.

STAND POINT

PERFORMANCE AT A GLANCE

MARKET INDICATORS

For the period ending 31 October 2020

October 2020	1 Year	3 Years (p.a.)	5 Years (p.a.)	10 Years (p.a.)
SA markets				
All share (J203T)	-5,8	-1,3	2,2	8,7
Top 40 (J200T)	-2,7	-0,4	2,6	8,9
SWIX (J403T)	-1,7	-1,7	-1,7	-1,7
Financial 15	-37,6	-10,9	-6,7	6,2
Industrial 25	7,0	-1,8	2,1	13,7
Resource 10	5,3	12,7	10,9	2,4
Property (J253T)	-51,6	-26,5	-14,7	0,7
Inflation (CPI)	3,0	4,0	4,6	5,1
All bond index (ALBI)	4,2	4,2	4,2	4,2
Cash (STeFI)	2,4	5,9	6,8	7,1
Offshore markets (Base currency)				
MSCI AC World	5,4	6,1	8,7	8,5
Dow Jones US	0,3	6,7	11,1	11,8
S&P 500 US	9,7	10,4	11,7	13,0
FTSE 100 UK	-20,5	-5,7	1,4	3,7
Barclays Global Aggregate (Global Bonds)	5,6	4,3	3,9	2,2
S&P Global Property	-19,4	-1,6	2,0	5,1
3-Month LIBOR (ZAR)	8,4	6,2	4,3	9,3
3-Month LIBOR (USD)	0,5	1,4	1,0	0,4

Source: Morningstar, October 2020

PERFORMANCE AT A GLANCE

CORE FUND PERFORMANCE

For the period ending 31 October 2020

	Fund	1 Year		3 Years		5 Years		10 Years		Highest or lowest annual returns over the last 10 Years (%)	
		Return (%)	Quartile	Return (%)	Quartile	Return (%)	Quartile	Return (%)	Quartile	Highest	Lowest
INCOME	STANLIB Income Fund	6,72	2	7,89	2	8,27	1	7,40	1	10,69	4,85
	STANLIB Flexible Income Fund	6,01	2	6,02	4	6,88	3	6,95	3	13,88	1,84
STABLE GROWTH	STANLIB Balanced Cautious Fund	5,21	1	4,67	1	5,15	1	7,99	2	16,29	-1,31
	STANLIB Absolute Plus Fund	0,91	2	2,75	1	4,48	1	7,63	2	18,17	-3,86
GROWTH	STANLIB Balanced Fund	2,39	1	3,03	1	3,62	1	8,59	1	26,49	-7,46
	STANLIB Equity Fund	0,59	1	0,52	1	2,36	1	9,62	1	34,37	-12,78
	STANLIB Property Income Fund	-51,80	3	-27,72	4	-15,26	3	0,33	2	46,75	-51,80
OFFSHORE (ZAR)	STANLIB Global Equity Fund	20,64	1	14,15	1	12,84	1	17,26	1	56,44	-16,62
	STANLIB Global Balanced Fund	16,04	1	12,10	1	10,23	1	14,31	1	37,05	-12,9
	STANLIB Global Balanced Cautious Fund	13,77	1	10,07	1	7,58	1	11,21	2	30,73	-14,91
	STANLIB Global Property Fund	-12,08	3	3,85	2	2,50	1	12,79	1	43,48	-19,27

Source: Morningstar, October 2020

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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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