ANCHOR

STRATEGY & ASSET ALLOCATION

2ND QUARTER 2018

EXECUTIVE SUMMARY

This report outlines our strategic views on global financial markets and our corresponding asset-allocation decisions. After 2017, a year of extremely high returns and minimal volatility, 2018 has thus far been characterised by a decisive return of volatility, and low or even negative returns. The principal driver of this development has been rising interest rates and concerns over increased protectionism from the Trump administration.

On the domestic front, bond markets have rallied, reflecting an improvement in domestic fundamentals, and thereby reducing our expected 12-month return on bonds. Our expected return from local equities has however increased, partly because we no longer expect a headwind from rand appreciation. By our bottom-up estimates, South African (SA) equities represent fairly attractive value. Consequently, our estimate of the excess return potential in local equity has increased meaningfully. We have therefore shifted our domestic allocation to equities from neutral to overweight. Local bonds remain neutral.

In offshore markets, bonds have moved in the opposite direction, with yields on the US 10-year having risen. We expect limited upside to rates from these levels (hence limited erosion of the bond yield caused by price movements): inflation is rising but only modestly and higher global debt levels mean that the ‘braking’ effect of rate hikes is incrementally larger than it would be in lower debt environments. Our expected return on offshore equity is still around 7% in US dollar terms. Thus, our expected return differential between offshore bonds and offshore equities has narrowed, with offshore equity now presenting as a relatively less attractive proposition (recall that this decision is made on a risk-adjusted return basis). Offshore equity has therefore been reduced to a neutral weighting, funding an increased allocation to both offshore bonds (now neutral, from underweight) and domestic equity, as noted above.

After reviewing the fundamentals that support these general asset-class decisions, we shall focus on a few specific themes. These include important contrasts between the SA and Brazilian economies, French banks in light of shifting developed-market (DM) monetary policy, and continued developments in local and offshore bond markets.

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01 ASSET ALLOCATION

The following table illustrates our house view on different asset classes. This view is based on our estimate of the risk and return properties of each asset class in question. As individual Anchor portfolios have specific strategies and distinct risk profiles, they may differ from the more generic house view illustrated here.

ASSET CLASS	BENCHMARK WEIGHT	CURRENT STANCE			EXPECTED RETURNS (R)
		UW	N	OW	
LOCAL	**80%**				
Equity (ex. preference shares)	52%		→		16%
Bonds	16%				8%
Property	6%				16%
Preference shares	2%				11%
Cash	4%				7%
OFFSHORE	**20%**				
Equity	13%			←	7%
Government bonds	1%	→			1%
Corporate credit	3%				1%
Property	2%				7%
Cash	1%				2%

UW = Underweight; N = Neutral; OW = Overweight

02 STRATEGY AND ASSET ALLOCATION

Here we set out the thesis for our strategy and asset allocation ahead of the second quarter of 2018.

Local equity

Following a robust end to 2017, 1Q18 was characterised by significant volatility in equity markets, both domestically and offshore. The principal driver of this has been rising bond yields, pressuring equity valuations via higher discount rates. Growing concerns over a more protectionist approach from the Trump administration also weighed on equity markets. The pressure on valuation multiples associated with normalising interest rates has been felt most acutely in "yield proxies" such as British American Tobacco (down 16% in 1Q18) and Anheuser-Busch InBev (AB InBev), which played a part in holding back returns on the JSE. The strong rand (+4% during the quarter) also proved a continued headwind to the sizeable rand-hedge component of the local market.

We continue to expect mid- to high-teen annualised returns from SA equities in the next twelve months, with the de-rating in 1Q18 happening faster and to a greater extent than we expected. By our bottom-up estimates, SA equities trade at 13.8x forward earnings and offer a 3.5% dividend yield – we believe this represents fairly attractive value. We also don't expect a repeat of the deep losses from the Resilient stable which were a material influence on equity market returns at an index level. Rising interest rates in the developed world suggest that the rand has experienced the bulk of its gains. As a reminder to investors, a strong rand tends to be a net negative for most of the JSE outside of banks, retailers, insurance and listed property. This asset class is explored further in the thematic note entitled: *Domestic Equity: Not a good start to 2018*.

Local bonds

SA headline inflation continues to face downward pressure from the combination of a stronger rand and the weak consumer environment. Our forecast of CPI at 4.0% was met in February this year. The VAT increase means, however, that headline inflation will increase from 1 April. Nevertheless, we continue to expect that CPI will average 5.1% for 2018. We think that improving fundamentals on the political front will take a while to work through the system, although an uptick in consumer sentiment might give a boost to the economic growth rates for 2018 towards 1.8% (2017: 0.8%). We note in this regard that Standard & Poor's (S&P) recently upgraded its SA GDP growth expectation to 2.0% for this year. In our view, S&P has become a little over optimistic on the country's near-term outlook.

The South African Reserve Bank (SARB) is naturally reluctant to cut interest rates, but were eventually pushed into the rate cut in March, as we had expected. The SARB has signaled a desire not to cut further, although we think that there is still the slight prospect of a second cut later this year. This will keep domestic bonds well supported and we believe that the benchmark R186 bond should trade down towards 7.90% yields and maybe lower.

We expect that SA inflation will average 5.1% for 2018, whilst US inflation is likely to average 2.1%, resulting in a 3.0% differential. The SA Credit Premium has narrowed to 1.4% at the time of writing, however, we model with 1.7%, which is more in-line with the long-term average. As stated below, we calculate a fair yield on the US 10-year bond to be around 3.0% at year-end. Adding the inflation differential (3%), the credit premium (1.7%) and the US yield expectation (3.0%), we get a fair yield on the SA benchmark bond of 7.7%. We are not convinced that the bond will fully move towards these levels against the backdrop of rising rates in the rest of the world. Therefore, we are comfortable with our projected yield of 7.9%. With bonds starting the quarter at a yield of 8.05%, we are also expecting a total return for the next twelve months of c. 8.5% on SA bonds. The risk factor with bonds is that our view is predicated on the assumption that the potential trade war between the US and China will be averted, otherwise we will find ourselves negatively impacted by slower global growth and a global risk aversion.

Local property

For SA property counters, 1Q18 has been the most difficult quarter on record since the start of the SA property indices in 2002. The local reasons for this are documented in more depth in the Equities section of this document, however taking a step back, we note that the property sector has also been under pressure globally in 1Q18. The sharp sell-off, as measured by the S&P Global Real Estate Investment Trust (REIT) Index, in late January and early February was, in part, related to rising US bond yields, although the most direct correlation is in fact to the S&P 500 Equity Index. The cause of the sell-off during this time was the first distinct "wobble" in the all-important tech sector (the so-called FAANG stocks [Facebook, Apple, Amazon, Netflix and Google]). Although these companies are certainly not directly linked to the fortunes of the commercial property sector, it is indicative that the risk profile of property shares in most offshore markets is associated with equities.

Locally, the outlook has been complicated somewhat by the spectacular fall from grace of the Resilient stable (also discussed in the Equities section). These index heavyweights were down between 45% and 70% in the quarter resulting in the dire index performance outlined above. Our preference at the beginning of the year was for SA-focused property stocks, given the higher yields that these shares trade at and the potential of good news centered on SA, with the further potential of growth-oriented policies in a new political dispensation. This remains the case.

A look at the makeup of the SA REIT Index (J805) shows that the 12M clean forward yield is 9.6%. This compares to a 10-year bond proxy (R186) of 8.02% currently and seems an attractive entry point into the local property sector. Some caution must be highlighted, however, due to the controversies surrounding the Resilient stable, but we believe that this is unlikely to directly contaminate the overall sector permanently. A more fundamental issue may relate to the growth in distributions at inflation rates or better, which has underpinned the sector to a large extent historically and has meant that it has traded at a premium to bond rates. Continued below-par GDP growth and soft conditions have also meant that local rental reversions are not necessarily positive and contractual escalations are under pressure.

On the positive side, interest rates seem to be headed in a downward trajectory, albeit that the pace of the repo cuts may be gradual. Nevertheless, we believe that the market will buy current property yields based on falling interest rates, even where growth rates are lower than historic norms, and then compress yields further once economic activity picks up and the sector regains some pricing power. Based on the current 12M forward yield forecast on the SA REIT sector of 9.6% and a growth in distributions forecast of 4.8%, together with a forecast of a slightly lower bond yield of 7.8%, we expect a return from current levels of 16% over the next 12 months.

SA preference shares

The SA preference share market has become too small to be of consequence as a viable asset class. There are no issuances as banks, in particular, tap capital markets instead through traditional debt (Commercial Paper, Medium-Term Bond Programmes etc.) or by raising Additional Tier 1 and Tier 2 capital notes, which have an element of equity risk and where the impact of Basel IV treatment is much clearer. Consequently, price transparency and liquidity in the preference share sector are very poor.

The performance in 1Q18 was -1.8% as measured by the CoreShares PrefTrax exchange traded fund (ETF), with some encouraging price activity from mid-February as yield hunters came into the market and bought. This as the fixed-income market reacted positively to Jacob Zuma's resignation and the swearing-in of Cyril Ramaphosa as SA President.

Large bank preference shares are currently yielding 10.7% and industrial preference shares (for which there are fewer and fewer proxies) approximately 11.5%. On a blended basis, we therefore forecast preference shares will yield 11% for the next 12 months.

Global equity

During 1Q18, global markets were roiled by protectionism fears, associated with the risk that the Trump administration could spark a trade war; the effects of rising interest rates, particularly on bond proxies; and a technology share sell-off, as privacy concerns associated with Facebook had a contagion effect across the sector. The S&P 500 Index ended the quarter about 1% down, and this with much volatility.

We recently shifted our allocation to offshore equity from Overweight to Neutral. While our expected return on offshore equity is still around 7% in US dollar terms for the next 12 months, our expected return on offshore bonds has risen. This means the excess return on offer in equities has narrowed to the point that an overweight position is no longer justified.

Global GDP growth is still very strong and is expected to drive solid double-digit earnings per share (EPS) growth in global stocks: we expect c. 20% earnings growth over the next 12 months from the MSCI World, and about 8% for the year thereafter. As noted in our previous strategy note, we expect a large proportion of this growth to be absorbed by PE-multiple compression as higher interest rates, market volatility, and concerns about "late-cycle" dynamics continue to assert themselves.

One important feature of the global economy, at present, is macroeconomic convergence: that is, the divergence in growth, inflation, and interest rates between major economies looks set to continue narrowing. We pursue this theme in more detail below in the thematic note entitled: *French Banks and Macroeconomic Convergence*.

Offshore bonds

We expect that US growth will be robust during 2018. This will likely give the impetus for US bond yields to rise further. We note that the US Federal Reserve (Fed) is anticipating three interest rate hikes of 0.25% each during the course of 2018 (the first of which already took place in March). We concur that the economy will be resilient enough to withstand these hikes, even though inflation is not yet feeding through into the US economic system. Our regression model of the fair US 10-year bond yield is derived from the US 3-month Libor rate, the ISM Manufacturing Index, net purchases of treasuries and core inflation. We are estimating that a current fair yield is 3.30%, although we continue to hold that the effects of global stimulus will keep rates below this. Accordingly, we are projecting a US 10-year rate of 3.00% in twelve months' time.

Global property

1Q18 saw a fairly dramatic de-rating in global property stocks, with the FTSE EPRA/NAREIT Global Developed Property Index down 4.3% in US dollar terms (5.1% in local currency). The pain was mostly concentrated in US REITs, which de-rated almost 10% and now trade on a forward dividend yield of 4.7% (up from 4.2% at the beginning of the year). US bond yields were the catalyst for the initial sell-off, rising 0.25% during the quarter and, while most real estate sectors suffered, it was again the retail REITs which were worst affected. European REITs were largely flat for the quarter, with much smaller exposure to the retail sector (which was also down significantly in Europe) and a much smaller sell-off in European bond yields. Japanese REITs were also largely flat for the quarter. At the beginning of the year we were looking for a 4% derating in global developed property stocks and that has more than happened, leaving valuations and yields looking relatively attractive in spite of benign growth expectations.

While the quarter saw a fairly meaningful 0.15% sell-off in credit spreads, that was somewhat offset by a tightening of interest rates. As the forecast horizon extends further into this economic cycle, it's likely that we'll need to adjust credit-spread forecasts higher. Credit usually de-rates earlier in the economic cycle than other asset classes, and with the extended period of low interest rates, corporates have been the biggest culprits in accumulating debt, making corporate bonds, particularly from non-financial corporate issuers, a likely source of pain in the next recession.

03

EXPECTED RETURNS ON UNDERLYING ASSETS

The table below illustrates our return estimates for the broad underlying asset classes shown in the asset-allocation table above. The other aspects of asset allocation, principally risk and portfolio considerations, are covered in the asset-specific discussions.

ASSET CLASS	PE1	E2 G%	EXIT PE	DIV %	RETURN	ZAR	ZAR RETURN
EQUITY							
LOCAL EQUITY	13.8	10.0%	14.1	3.4%	16.0%	-	16.0%
Resources	11.3	4.0%	12.5	3.0%	18.0%	-	18.0%
Financials	12.4	10.0%	12.0	4.1%	11.0%	-	11.0%
Industrials	16.1	14.0%	16.0	3.4%	17.0%	-	17.0%
OFFSHORE EQUITY	14.8	8.4%	14.3	2.6%	7.3%	0.0%	7.3%
Developed Markets	15.5	8.0%	15.0	2.6%	6.8%	0.0%	6.8%
Emerging Markets	12.2	10.0%	11.8	2.8%	8.9%	0.0%	8.9%

Note: Sector weightings are by Market Capitalisation; offshore equity benchmark is MSCI World; "PE1" is 12-month forward PE; "E2 g%" is our estimate of earnings growth over the 12-month period, commencing in 12 months time; "exit PE" is our estimate of the PE multiple in 24 months time; "Div %" is our estimate of the dividend yield over the next 12 months; "Return" is our return estimate, over the next 12 months, implied in the tables assumptions about earnings growth, dividends and changes in PE multiples; offshore markets are estimated in US dollar, local markets in ZAR; "ZAR" is the currency effect of translating into ZAR; "ZAR Return" is our estimate of ZAR market returns over the next 12 months as implied in the other columns of this table.

ASSET CLASS	YIELD	CAPITAL	LC RETURN	ZAR	ZAR RETURN
BONDS					
Local government bonds	8.0%	0.5%	8.5%	-	8.5%
Offshore government bonds	2.8%	-2.1%	0.6%	0.0%	0.6%
Offshore corporate credit	3.8%	-2.6%	1.2%	0.0%	1.2%
PROPERTY AND PREFERENCE SHARES					
Local property	9.6%	6.4%	16.0%	-	16.0%
Local preference shares	11.0%	0.0%	11.0%	-	11.0%
Offshore property	4.3%	2.5%	6.8%	0.0%	6.8%
CASH					
Local	6.6%	0.0%	6.6%	-	6.6%
Offshore	1.7%	0.0%	1.7%	0.0%	1.7%

Note: Benchmark SA bonds are the SA 1-year government bond; The benchmark offshore bonds are the US 10-Year Government Bond, and the Bloomberg Bond Investment Grade Corporate Bond Index; The local property benchmark is the JSAPY Index; offshore property is the S&P Global REIT Index. Yield % for property is our estimated one-year forward income yield; "Capital " is our estimate of the capital appreciation or depreciation of an instrument over the next 12 months; "LC Return " is our estimate of the total return, i.e. yield + capital, that the instrument will generate over the next 12 months in its local currency; "ZAR" is our estimate of the currency effect of translating non-rand yields into rand; "ZAR return" is our estimate of the "LC Return" in ZAR.

04

ANCHOR INSIGHTS

In this section, staff from across the Anchor Group provide insights into our thinking, strategy and view of the world. In this quarter: Sean Ashton takes a further look at the drivers of domestic equity returns and investigates important differences between the SA and Brazilian equity markets; Blake Allen considers French banks in light of impending monetary policy developments in Europe and the US; Mpumelelo Kondlo addresses pertinent developments in the bond market, both locally and offshore; Brendan Gace discusses using available tax breaks to help with your investment strategy; Peter Armitage talks about the anxiety of equity markets; and Henry Biddlecombe looks at The Walt Disney Company.

DOMESTIC EQUITY: NOT A GOOD START TO 2018

Sean Ashton
Chief Investment Officer

Executive summary

Following a robust end to 2017, 1Q18 was characterised by significant volatility in equity markets, both domestically and offshore. The principal driver of this has been rising bond yields, pressuring equity valuations via higher discount rates. Growing concerns over a more protectionist approach from the Trump administration also weighed on equity markets. The pressure on valuation multiples associated with normalising interest rates has been felt most acutely in "yield proxies" such as British American Tobacco (down 16% in 1Q18) and AB InBev, which played a part in holding back returns on the JSE, while the strong rand (+4% during the quarter) proved a continued headwind to the sizeable rand-hedge component of the local market. Most notably for the JSE, listed property was a big drag, while Naspers' discount continued to widen sharply. The Capped SWIX Index ended the quarter down by 5% on a total return basis, with Naspers and the Resilient group of companies (property) accounting for ~60% of the decline.

Listed property a large 1Q18 detractor: a terrible advert for passive investment in SA

The SA-listed property sector is highly bifurcated and demonstrates that passive investment is a bad strategy in this particular sector locally. Despite modest gains from "domestic" bellwether stocks such as Growthpoint (we hold an overweight in our equity mandates) – the Property Index was held back by steep losses from the Resilient Group of companies. This is due to a combination of very high starting valuations (in many cases 2x P/NAV), a business model which relied on continued capital raises at premiums to book value; and well-publicised corporate governance concerns over the economic merits of the Group's cross-shareholding structures and associated intra-group share trading. Given how steep the losses have been in these shares (~45%-70% down in 1Q18), a detraction of close to 2% from the performance of the Capped SWIX during 1Q18 is perhaps unsurprising. Whilst share prices have begun to more closely reflect valuation reality, we believe corporate governance will continue to prove an overhang on these stocks for some time, hindering the Group's ability to effect capital raises as in the past. Our positioning in listed property remains focussed on the large liquid counters which will benefit from a decline in the cost of capital in SA, notably Growthpoint and Redefine.

Figure 1: Sharp losses from Resilient group companies in 1Q18

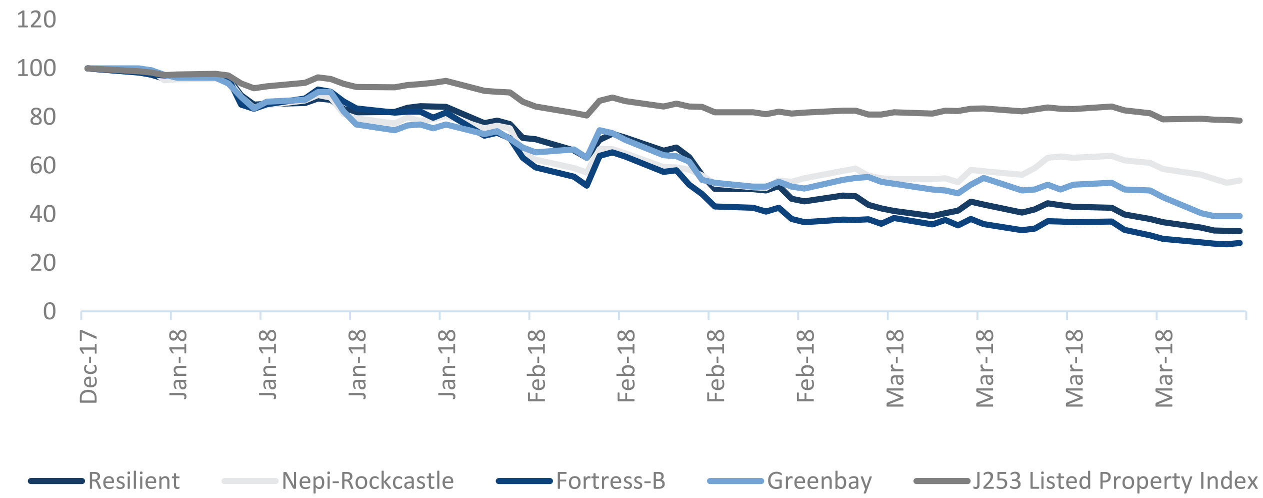


Figure 2: Domestic equities - valuation metrics and total return expectations for the next twelve months

	12-M FWD P/E	YR +2G	EXIT P/E	DIV %	12M EST. TOTAL RETURN
Resources	11.3	4%	12.5	3.0%	18%
Financials	12.4	10%	12.0	4.1%	11%
Industrials	16.1	14%	16.0	3.4%	17%
SA EQUITY	13.8	10%	14.1	3.4%	16%

Source: Anchor Capital

Naspers under pressure to justify its existence outside of Tencent; significant drag on 1Q18 market returns

Following an investor day in New York in late 2017, which failed to allay investors' concerns about how much value is being created by Naspers' management outside of its Tencent stake, the Group in late March announced a book-build to sell down around 2% of its 33% holding in Tencent to free up capital to deploy into its other e-commerce businesses. Our reaction to this news is mixed: while it is encouraging that the Group has demonstrated a willingness and ability to partially monetise this asset (and hence unlock the discount it trades at on this portion of Tencent), it could also signal that the other e-commerce assets still do not have sufficient scale to self-fund their growth, while investors could suggest that Naspers would be "throwing good money after bad." We would have preferred to see a larger placement of Tencent stock, with at least a portion of the proceeds being utilised to buy back Naspers shares and hence convincingly reducing the discount to sum-of-the-parts (SoTP). The discount remains unacceptably large at >40% and, while we believe there is reason for it to shrink (as a result of our expectation that e-commerce ex-Tencent losses begin to contract), we don't expect to see it in the low-30%s due to management's apparent stubbornness in not pursuing a buy-back, despite many shareholders raising this issue. Furthermore, it should be noted that Tencent's valuation – despite continued excellent results – is high at a forward 37x multiple, and we believe some share price consolidation is likely, which is what we saw in 1Q18 (albeit with significant volatility). Naspers' share price declined 16% in 1Q18, exerting significant pressure on overall market returns. We are more sanguine about returns going forward, given the recent underperformance and a very high discount to SoTPs, despite our expectation of a further valuation multiple compression from Tencent.

Figure 3: Naspers SoTP value per share

	Value
	Per share
Pay TV - SA and SSA	233
Media24 + Technology	40
Tencent (31%)	4,439
Mail Ru	61
E-commerce *	229
Other **	270
Total sum of the parts	5,273
Current share price	2,892
Discount	-45%

(*) Includes OLX (Classifieds), e-tailing.
(**) Cash from Tencent placement.

Source: Anchor Capital

Sectors which witnessed a continuation of the gains of late 2017 included banks and general retailers. This, as investors continued to price in a prospective rise in the earnings and return on equity profile of these companies as a consequence of much higher consumer and business confidence. This has been our logic in rotating our equity positioning into domestic cyclicals as we believe consumer sentiment leads fundamentals. However, much of this has been priced into valuations fairly swiftly (see Figure 4 below; general retailers close to peak ratings, albeit on still-depressed earnings bases). Thus, while we believe the trend is upward for these companies, we think that a tactical approach is required and we have actively taken profits on certain counters in anticipation of better entry points.

Figure 4: General Retail Index P/E: substantial 1Q18 re-rating

Source: Iress

We continue to expect mid- to high-teen annualised returns from SA equities in the next twelve months, with the de-rating in 1Q18 happening faster, and to a greater extent, than we had expected. By our bottom-up estimates, SA equities trade at 13.8x forward earnings and offer a 3.5% dividend yield – we believe this represents fairly attractive value. We also don't expect a repeat of the deep losses from the Resilient stable which were a material influence on equity market returns at an index level, while rising interest rates in the developed world probably mean that the rand has experienced the bulk of its gains. As a reminder to investors, a strong rand tends to be a net negative for most of the JSE outside of banks, retailers, insurance and listed property.

FIXED INCOME PERSPECTIVES

Mpumelelo Kondlo
Fund Management

In our bond market review, published in January 2018, we highlighted a number of events expected to unfold during the course of 2018. In particular, we had postulated on a potential rise in global yields precipitated by volatility and risk premia repricing higher. We further argued on the attractiveness of SA bonds. We continue to uphold this narrative.

During 1Q18, global yields have risen substantially. Yields on the US 10-year benchmark bonds rose by over 0.5% (2.4% to 2.95%) before ending the quarter at 2.75%. The Japanese 10-year benchmark rose as high as 0.095% from 0.05% at the beginning of the year, while German bunds touched 0.8% from 0.46% during the course of 1Q18. On the local front, bonds rallied during 1Q18, strengthening by over 50 bps.

Various factors have contributed to what has been seen in 1Q18. Most notably the upbeat economic data prints in developed economies which have been suggestive of these economies growing faster than the slow pace that previously persisted. The International Monetary Fund (IMF) has projected global growth at 3.9% for 2018, an upward revision from the previous 3.3% set in October 2017.

This global growth euphoria, particularly in developed economies, has sparked fears of inflation pushing yields higher.

This arises from the accepted theory where changes in nominal yields from period to period stem from a combined effect of changes in investor expectations about future inflation and the real returns investors demand.

Thus, the outlook going forward, not just for fixed income but across asset classes, weighs heavily on the expected inflation trajectory and the pace thereof.

The inflation issue has been a topical theme for the last 2–3 years and its relevance, importance and implication today has increased. Much of the focus on the inflation puzzle has been centered on the Phillips curve. According to the Phillips curve, an environment characterised by tightening labour markets and a narrowing output gap should experience a rapid rise in inflation. This, however, has not been the case notwithstanding continued labour market strength and improving growth across economies. This has left market participants extremely puzzled.

We take the view that inflation is a process. Although impacted by temporary shocks, it remains fundamentally driven by endogenous dynamics and expectations. Thus, the inference drawn from the Phillips curve provides an empirical observation of the inflation paradigm though it lacks the complete theory thereof. Figure 1 below, provides a high-level version of the complete inflation process.

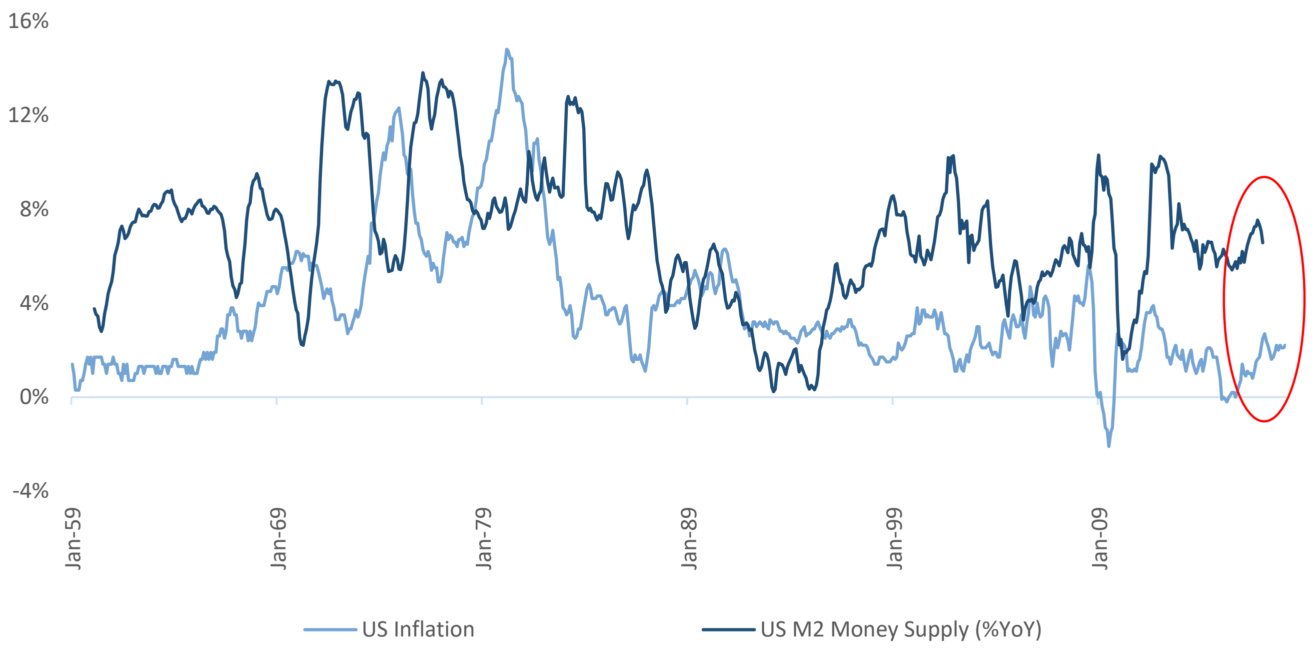
Figure 1: Inflation process

Source: Invesco

Fundamentally, inflation is a monetary phenomenon which, in its completeness, should include factors such as money and credit growth. This forms the starting point in the inflation process above. The Phillips curve, on the other hand, considers the final steps in the above inflation process thus omitting and failing to capture the importance of monetary growth in an economy. Accounting for money and credit growth, we provide a different basis on which we can analyse the present inflation puzzle and how we can use this process to form our expectations going forward.

A closer look at growth in US M2 money supply and US inflation in Figure 2 below, reveals a strong behavioural relationship. It can be seen that a rise in inflation has always followed from a sustained rise in money supply. Currently, we observe that the money supply growth rate has trended sideways since 2012. On average, US M2 money supply has been subdued averaging 6.4% p.a. since 2009, while other research shows that M3 (a slightly broader classification of money supply) has grown even more slowly (averaging 4.5%). This provides an explanation on the subdued inflation within this period. On the other hand, in the EU, M2 money supply has been rising rapidly from negative growth to positive growth since 2015. This has equally been followed by an increase in inflation over the same period. More broadly, across the Organisation for Economic Co-operation and Development (OECD), money and credit growth have slowed since 2008.

Figure 2: US CPI vs US money supply (% change, YoY)



Source: Thomson Reuters

It is without a doubt that we are in uncharted territory with numerous factors creating "push-and-pull" theatrics. However, based on our analysis, we do not share the same narrative of threatening runaway global inflation. We believe that federal authorities will keep inflation at bay. This is evident from Figure 3. The US Fed has over time managed to keep inflation within the required band.

More importantly, we hold the view that the global economy could be heading towards a record long expansionary cycle, characterised by a steady pace in inflation.

According to the National Bureau of Economic Research (NBER), the longest expansion cycle spanned a period of 10 years (March 1991–March 2001). The current cycle is in its ninth year (June 2009 to present) and appears set to span beyond the 10-year mark

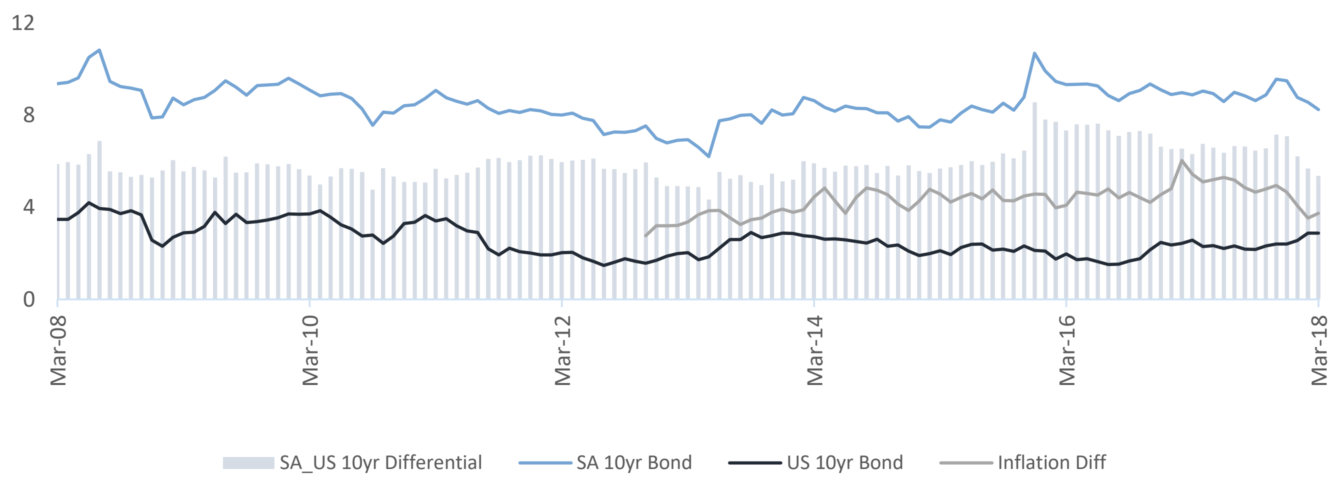
Undoubtedly, the end to a business cycle is never defined by its age but predominantly by tightening liquidity conditions, which result in a squeeze in money and credit growth. It is under these conditions where we would start fearing runaway inflation. However, current data suggest that we are miles from such an occurrence.

Figure 3: US PCE Core (% change, YoY)

Source: Thomson Reuters

We thus view global yields, particularly in the US, to be closer to their mid–term peaks. We do not see bond yields moving significantly higher from current levels. In the US, assuming real GDP of 2.5%, while core inflation moves to 2%, nominal GDP then becomes 4.5%. Based on historic correlations, the 4.5% nominal GDP growth implies long-term bond yields (30-year) of 4%. Given that the 30-year bond has moved as high as 3.2% this year, we expect a gradual move towards 4% in the long run (12 months out). This further implies that the US 10-year (currently at 2.85%) potentially has its mid-term peak level at 2.9% and should gravitate towards a long-run peak of 3.30%.

Figure 4: SA 10yr and US 10yr bond



Source: Thomson Reuters

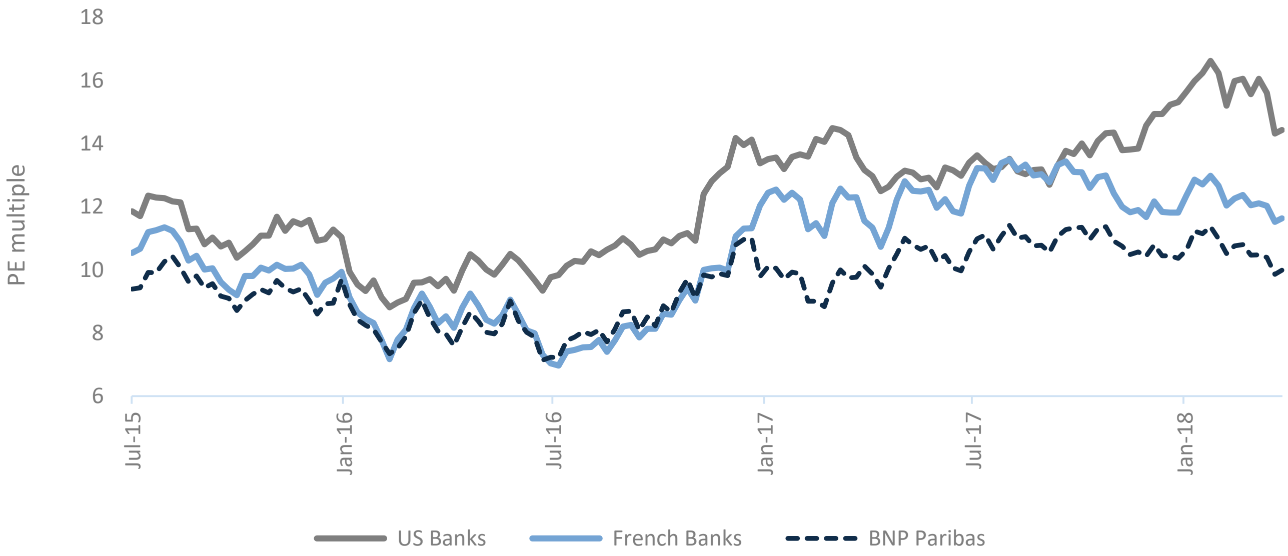
Locally, bonds should remain strong through 2Q18. More specifically, the decline in the inflation deferential between SA and the US should provide support for the strength in SA bonds. The recent positive credit rating review on SA by Moody's has lifted a major cloud of uncertainty and should provide a breather for foreign investors. The unsurprising rate cut by the SARB has also helped reinforce bond strength, although the cut itself had no impact on the market.

FRENCH BANKS AND MACROECONOMIC CONVERGENCE

Blake Allen
Equity Research & Strategy

At present, many important features of the global economy can be expressed through the lens of global banks. One such theme is macroeconomic convergence, evident in GDP growth rates, and the associated likelihood that global central banks will increasingly follow the Fed in a normalisation path. This note focuses on the theme of macroeconomic 'convergence' between the US and EU, and the associated opportunity presented by the 'divergence' between valuation multiples attaching to US and EU banks. In particular, we focus on BNP Paribas (BNP), the largest French bank, and some important macroeconomic developments in its home economy, the second largest in the EU. Although we do not own BNP at present, it is on our list of potential buys in Europe as we continue to monitor economic developments and reflect upon the composition of our DM exposure.

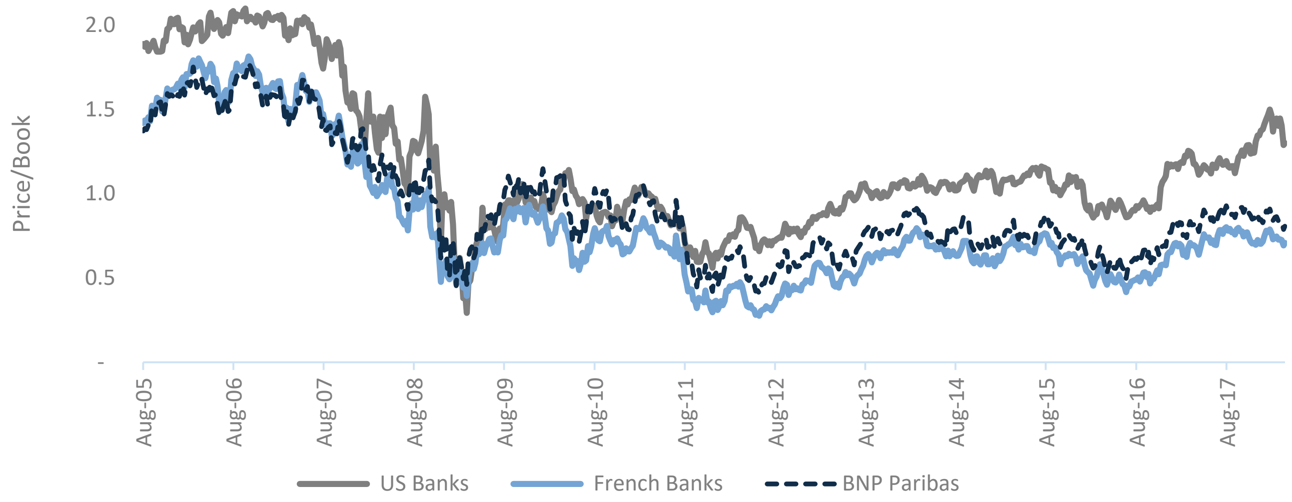
Figure 1: US and French banks' PE multiples



Source: Bloomberg; Anchor estimates; US banks = Bank of America, JP Morgan, Citi and Wells Fargo; French banks = BNP Paribas, Société Générale, Credit Agricole

Is there a genuine value-gap between EU and US banks? The PE differential between US and EU banks (*Figure 1*) is about 24% which, on the face of it, seems fair: US banks are better quality and have better growth prospects. But US banks are currently closer to peak ROEs, while EU banks are closer to a trough, which suggests that an underlying value-gap does exist. The divergence between Price/Book multiples is very wide, with US banks trading at almost double the PB multiple seen in their French peers. Prior to the global financial crisis (GFC) this differential was narrower (US banks attracted a c. 25% premium). The respective dividend-yield premiums over bond yields (*Figure 3*) also quite strikingly suggest a valuation divergence.

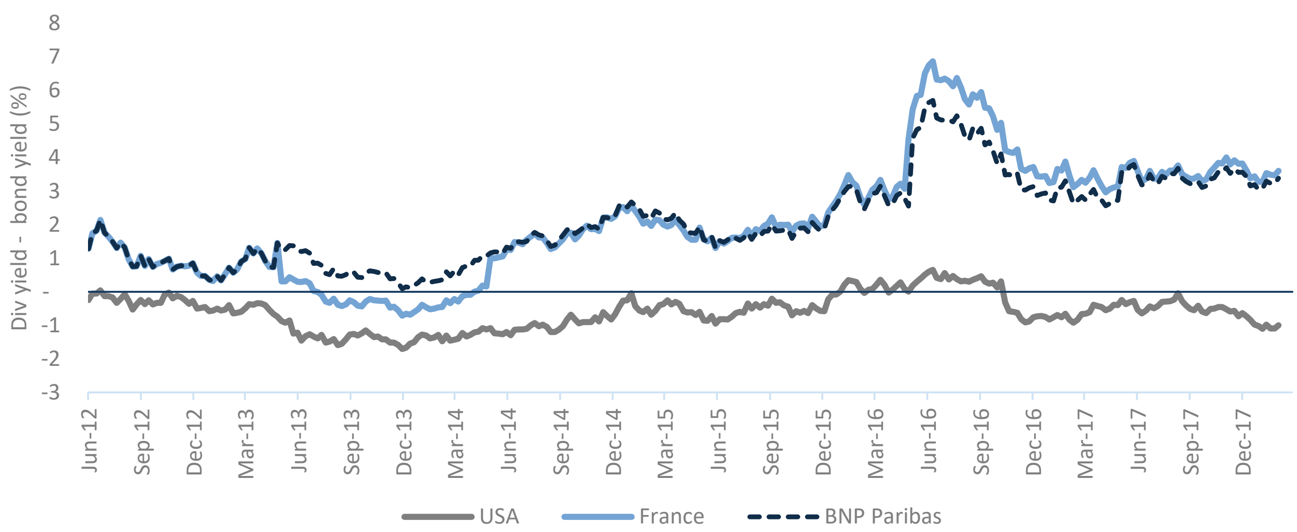
Figure 2: A widening Price/Book differential



Source: Bloomberg

Whether or not these divergences are an opportunity appears to hinge largely on whether, and to what degree, there is a normalisation of the post-GFC financial malaise in Europe. Historically, European interest rates have cycled in line with US rates, but with a 12-18 month lag (*Figure 4*). In the current cycle that lag is longer, probably about 3 years, with the European Central Bank (ECB) expected to start hiking in 2Q19. It is important to note that, with the GDP differential between the US and EU having closed (*Figure 5*), the interest rate differential is apparently far too wide. It is true that central bank policy is set with respect to the inflation outlook, not GDP levels. But real GDP is one of the best leading indicators of core CPI. Furthermore, ECB rates are still at "emergency" levels, which do not reflect the current economic reality.

Figure 3: Banks' dividend yield premiums: a very wide gap

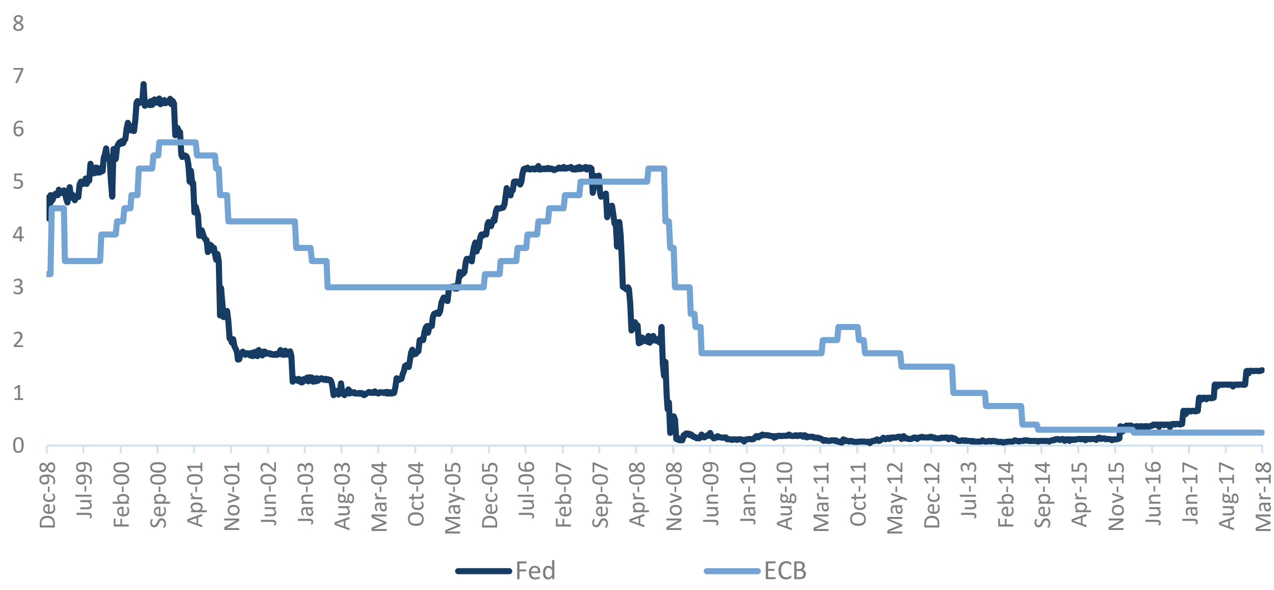


Source: Bloomberg; Anchor estimates

Quantitative easing (QE) by the ECB has been particularly dramatic, in our view, in its repression of interest rates. Consider, for example, that European firms have funded 50%-60% of new corporate issues in the US during this period.[1] These enormous flows of capital from Europe to the US, largely the result of QE, are likely to reverse with the commencement of quantitative tightening (QT) – see *Figure 6*. Similarly, we expect this development to result in a normalisation, in part or even entirely, of the interest rate divergence seen in the era of QE (*Figure 7*).

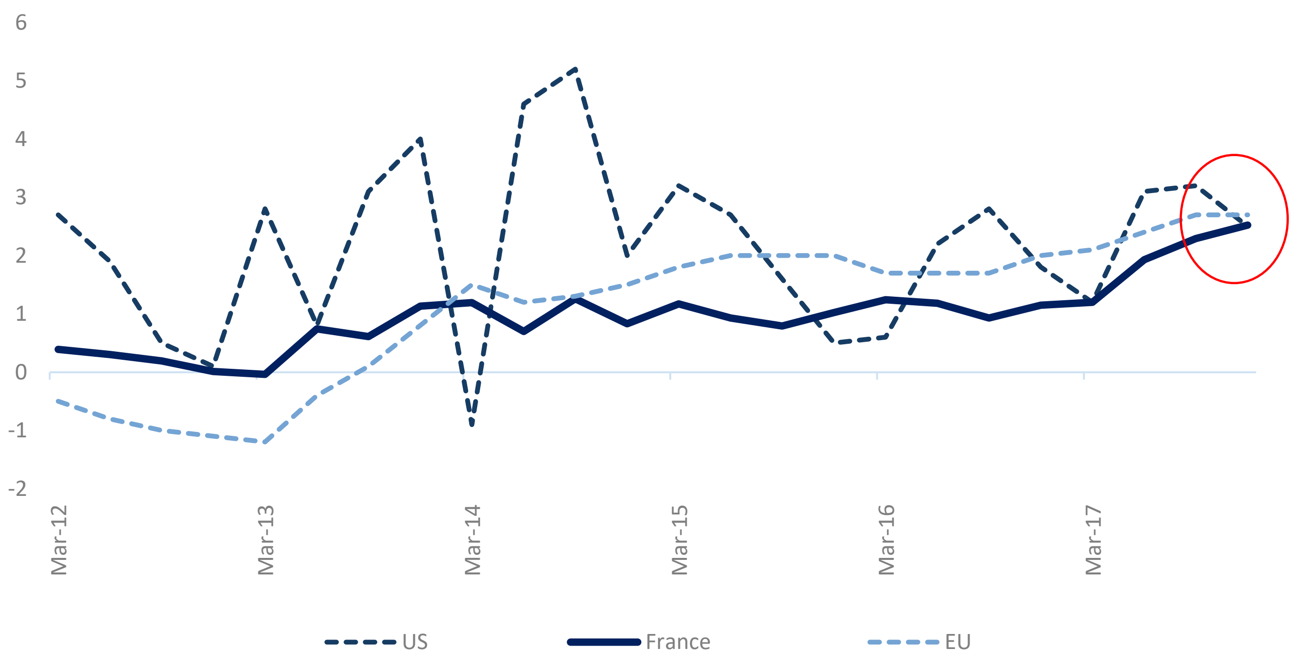
US banks have already seen most of the benefits of interest-rate normalisation. This is not to say rates won't get any higher in the US, but that new dynamics start to kick in from here (e.g. deposits need to be repriced), such that rising interest-rates yield proportionately less of a rise in bank profitability. European banks are yet to see such rate hikes and thus the corresponding benefits of normalisation are yet to flow through to them. Hence they are both "cheaper" and on the right side of expected developments in interest rate markets. In short, this suggests that we should expect the valuation differentials, noted above, to narrow.

Figure 4: Fed rates typically lead ECB rates by 12-18 months



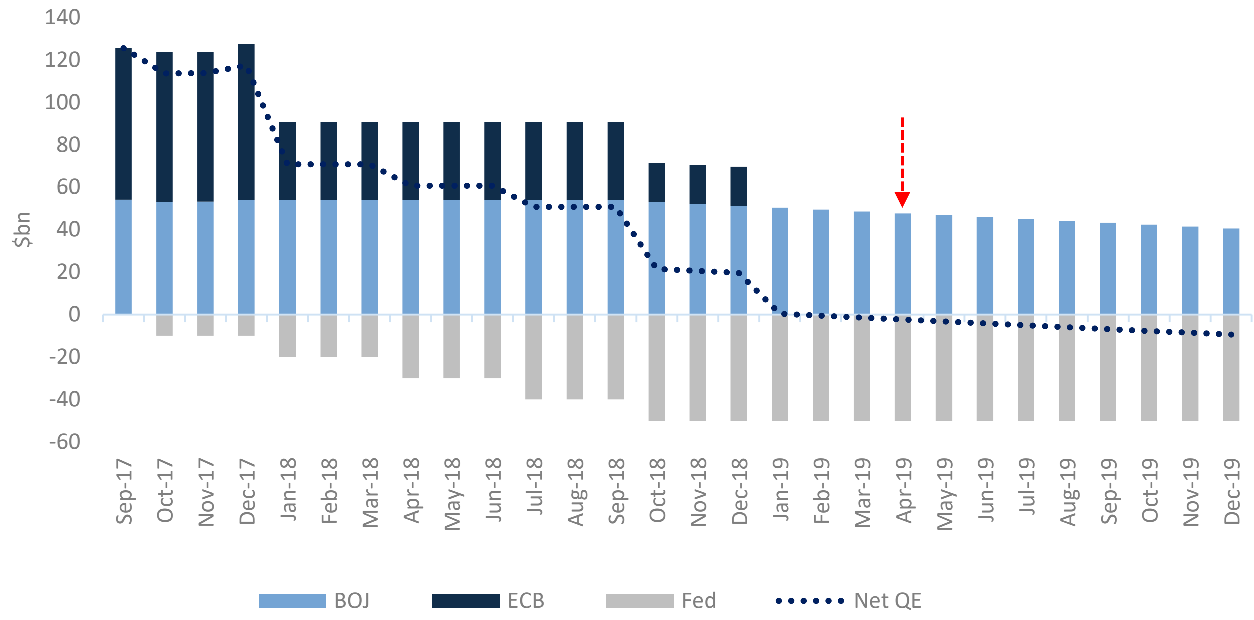
Source: Bloomberg

Figure 5: US and EU GDP have converged



Source: Bloomberg

Figure 6: Central bank bond purchases: QE to QT within the next 12 months



Source: Anchor estimates; Bloomberg

It should be noted that the unwinding of QE is not unambiguously bullish for EU banks. Indeed, at least two key risks could be noted: (1) QT is likely to strengthen the euro, lowering current account surpluses that have buoyed EU GDP, and furthermore acting as a disinflationary pressure. (2) In the QE-regime, weaker EU sovereigns have been able to issue debt at very low rates, temporarily masking their fiscal weakness. QT means that any fiscal "cracks" could start to show again.

Of the suite of opportunities available to investors at present, we think global banks deserve an overweight allocation. Many of the last decade's extreme headwinds, are finally turning into tailwinds: interest rates, GDP growth, and inflation rates are shifting in the right direction and, while banks have struggled for years to build sufficient capital, many now have excess capital. Further, while the regulatory environment was becoming increasingly onerous and draconian in the post-GFC years, banks are now largely on top of new regulations, with the pile of GFC litigation mostly behind them. Indeed, the regulatory tide is actually turning towards deregulation – though the latter is more evident in the US than the EU.

In turning to consider the French economy, it should be borne in mind that French banks – like the members of the CAC more generally - are really global players, often more representative of the EU economy than France in isolation. But the French economy is the second largest in the EU (15% of EU GDP) and, in some ways, a microcosm of more general EU developments.

France is interesting at present because of its meaningful recovery in GDP growth, which seems to have a relatively sustainable outlook, given that unemployment is falling from quite high levels (*Figure 8*). That is, the absorption of labour slack is likely to follow a virtuous cycle for some time: better employment bolsters confidence, which allows less conservatism with respect to household savings (*Figure 9*); this in turn should boost consumer spending, GDP, and employment.

There is also a structural element to France's longer-term growth outlook, as French President Emmanuel Macron attempts to push ahead with his reform agenda. This is a thorny issue for France, and one is rightly wary of the prospects of success (note the industrial action taking place at the time of writing this report). However, it should be borne in mind that Macron was elected on a reform / pro-business agenda and such reforms are, in our view, more politically tolerable in an environment of strong GDP growth. One might note, for example, how "bad politics" like Euroscepticism tends to flare up when growth is weak, and to subside in more economically affluent environments.

Macron has already achieved some liberalisation of the labour code and cuts in taxes. In 2017, Parliament approved a progressive reduction in the corporate tax rate from 33% to 25% over the 2017-2025 period. More broadly, Macron's structural reforms are aimed at reducing France's bloated state, and reducing employment-related risks faced by companies.

Figure 7: 10-year bond yield: Will France catch up when QE ends?

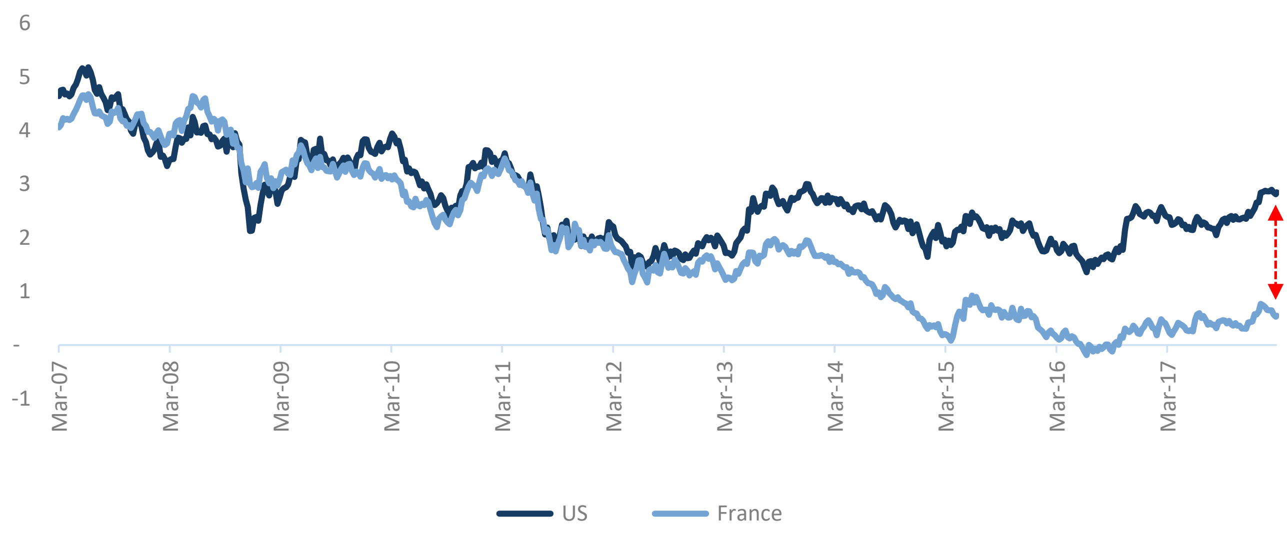
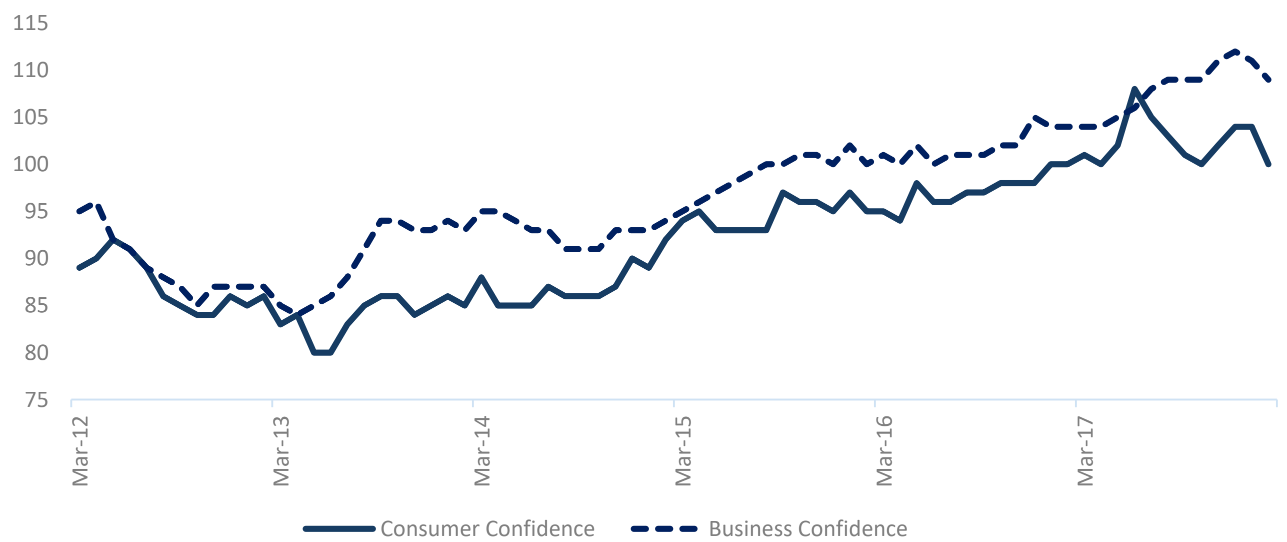
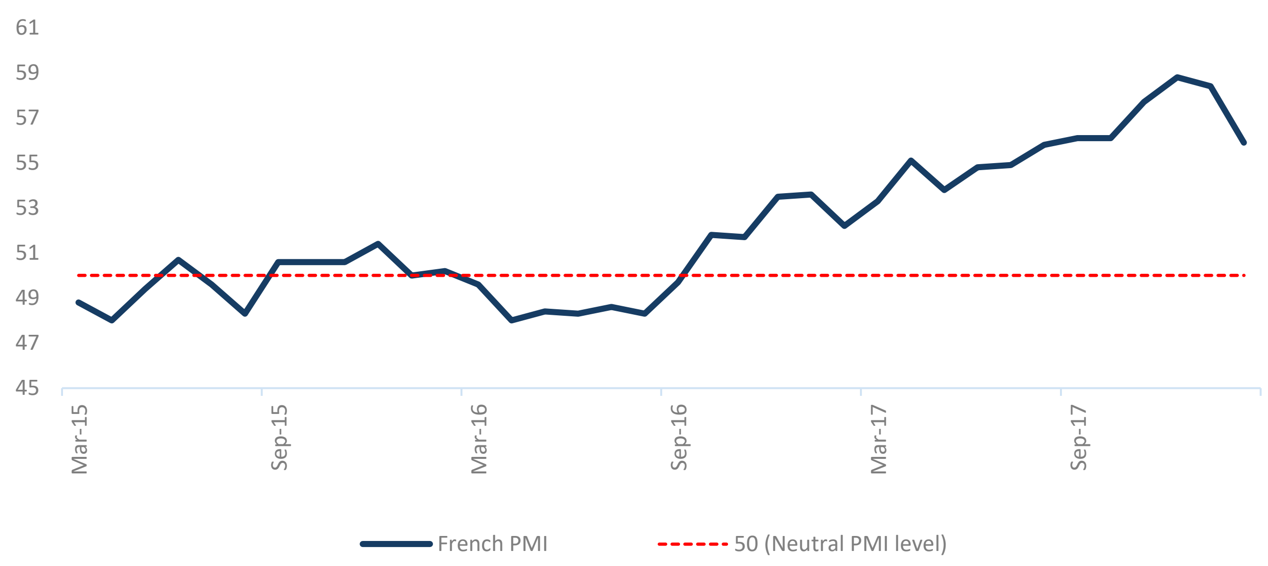


Figure 8: French business and consumer confidence still at high levels



Source: Bloomberg (Figure 7 and 8)

Figure 9: French PMI has corrected, but remains high

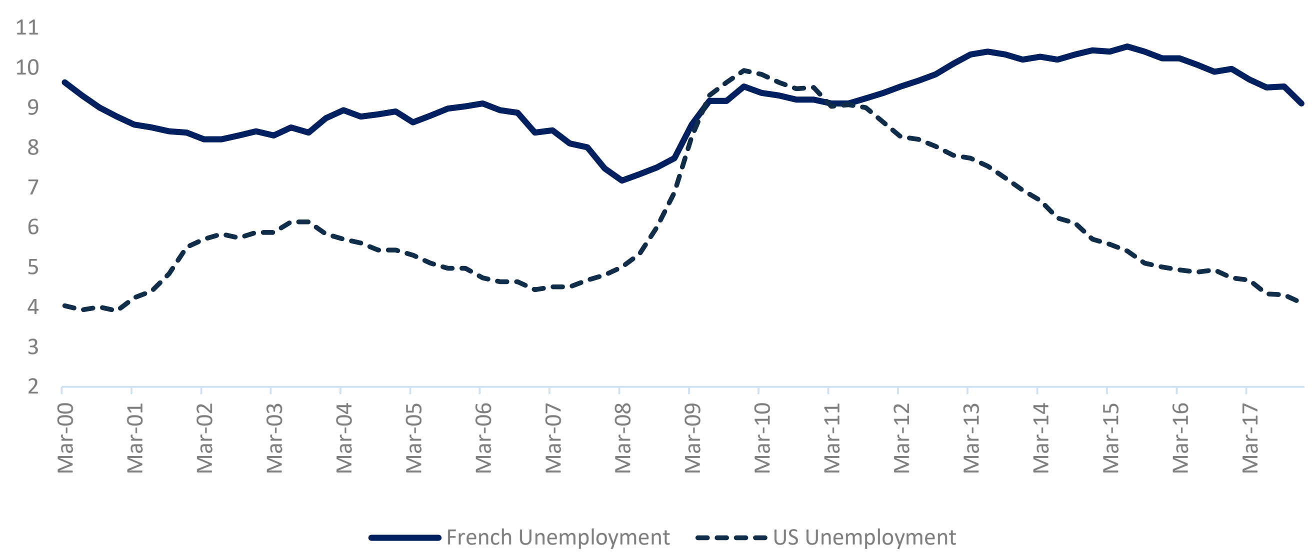


Source: Bloomberg

Macron wants France to play more of a leading role in Europe, but the country's credibility in this regard is hampered by its high fiscal deficit, which has been outside of EU limits since 2007 (the EU limits fiscal deficits to 3% of GDP). This means France faces what is called the Excessive Deficit Procedure unless it reigns in spending. France would surely need to play by the rules if it hopes to have a leading role in the EU. But cutting fiscal deficits generates a negative fiscal thrust, as GDP growth is affected by the change in deficit, more than its absolute level. While this should dampen GDP growth, there is a reasonable expectation that France will be able to reduce its deficit without causing a recession, provided GDP growth momentum remains robust.

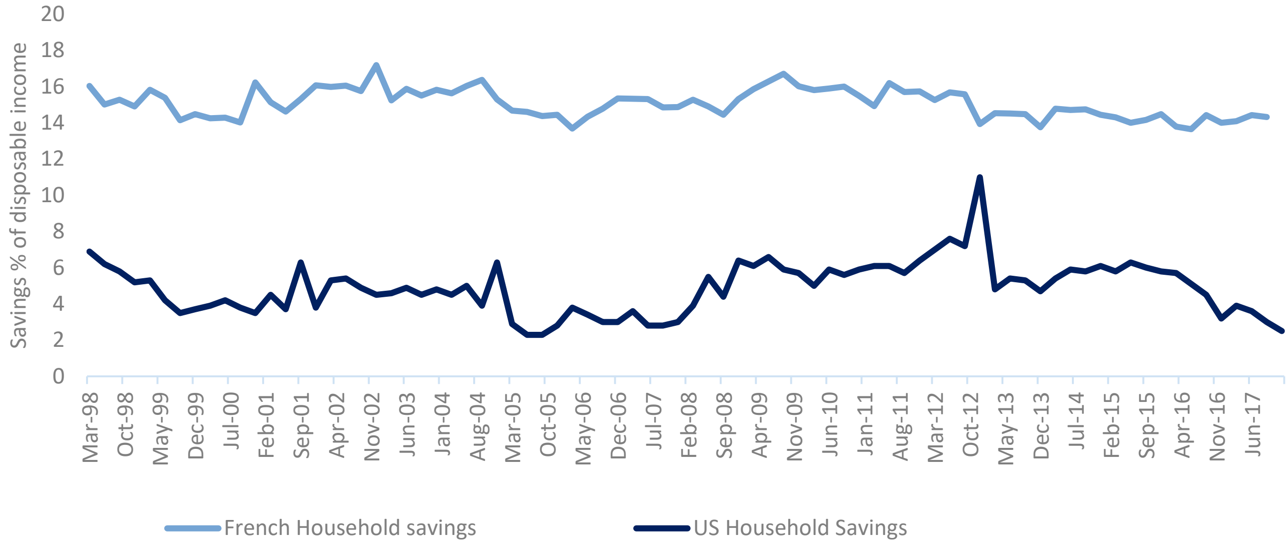
So, France's growth outlook is not straightforwardly positive. While cyclical momentum and Macron's structural reform agenda bode well for the region, it is hampered by risks associated with its fiscal deficit (the latter is, however, a quite pervasive feature of DM economies at present). In our view, the theme of French reform is, on balance, modestly attractive. In spite of the abovementioned concerns, there are reasonable prospects of some success, and the associated valuation multiples are still quite depressed. As noted, however, the value proposition for French banks is predominantly an EU-wide theme of monetary normalisation, and strong EU GDP growth. The French reform story, touched on here, is but one important component of this larger picture.

Figure 10: French unemployment – lots of slack to absorb



Source: Bloomberg

Figure 11: French household savings are relatively high



Source: Bloomberg

BNP Paribas

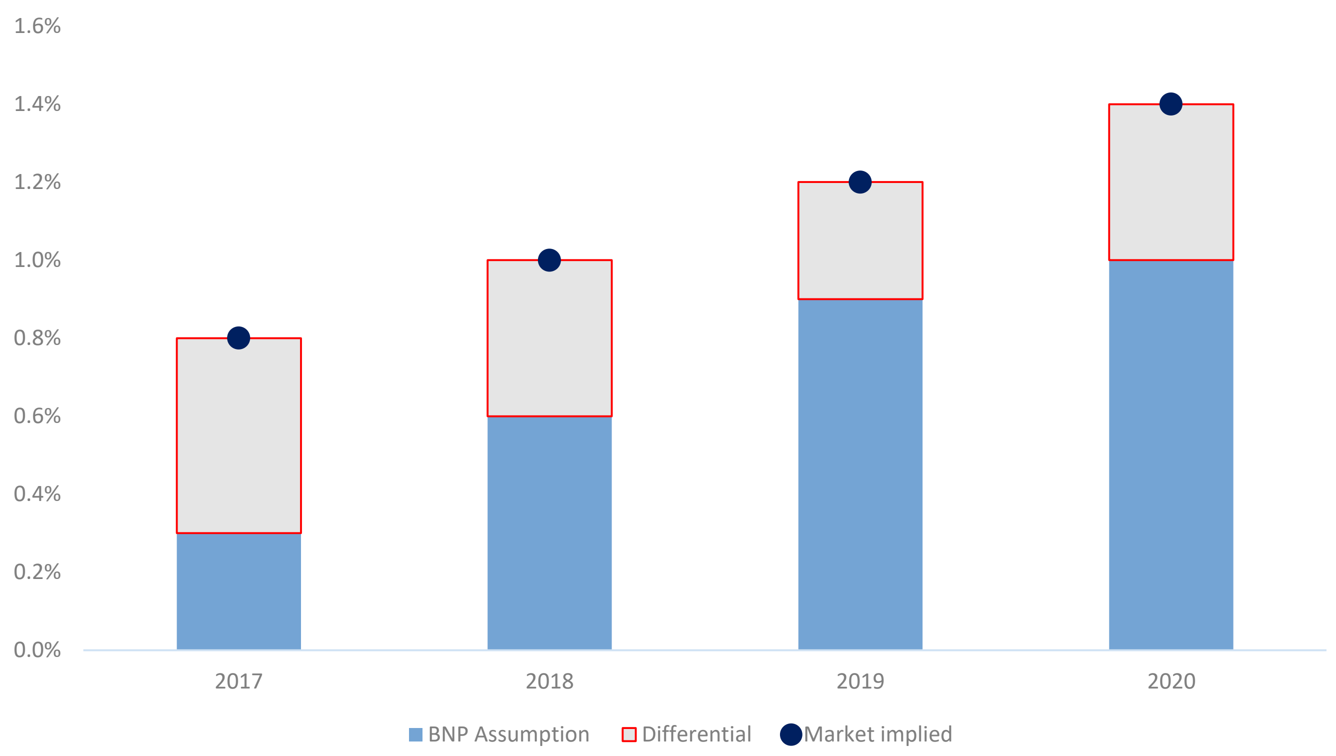
We shall now drill a little further into the details, and consider BNP Paribas, the largest French bank (EUR77bn Market Cap). Its operations are split between EU (75% of assets) and non-EU (25% of assets) geographies. This section briefly touches upon the latest financial results, the content of BNP's 2020 strategic plan, and our estimate of the fair value of the stock.

BNP's most recent results (FY17) saw net income up a modest 4.4% YoY, comprising revenue growth of 1.5% and operating cost increases of 0.5%. These numbers reflect the current low interest-rate environment, mitigated by good cost-control. The dividend increased 12% on 2016's level. These higher payout levels reflect increasing clarity on the regulatory environment, and the fact that EU banks have built up sufficient capital in terms of more demanding post-GFC regulations. In BNP's case, the CET1 ratio was at 11.8%, +30 bps on the prior year, and modestly ahead of the regulatory minimum of 11.5%.

BNP's strategic plan for 2020 includes an ROE target of ">10%". But one should ask: how far above 10% and is this representative of a 'normal', mid-cycle, environment? In our view, a normalised ROE is probably closer to 12% (although this may appear to be a small differential, it has a material effect on the fair P/B multiple estimate). BNP's ROE in 2017 was already at 9.4%, and the strategic plan includes quite meaningful cost reductions by 2020, with the cost to income ratio falling from the current 69% down to 63%. Further, there should be a tailwind from falling French tax rates, from the earnings boost due to acquisitions made in 2017 (estimated to add 1% to ROE in 2020), and from GDP growth and interest rates being somewhat higher than what has been assumed in BNP's strategic plan.

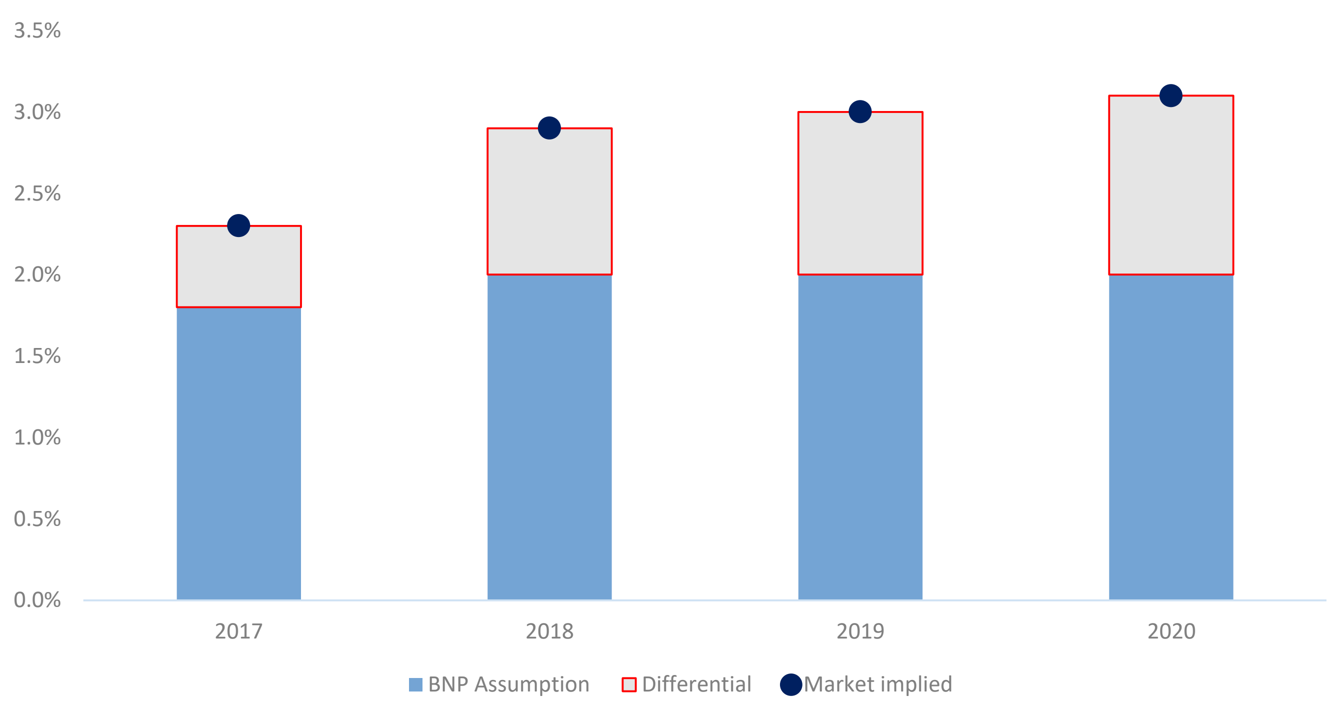
Consider, for example, *Figures 12 and 13*, which illustrate the differential between interest rates assumed in BNP's plan, and those currently implied in the market. BNP has been similarly conservative in its estimates of GDP growth (*Figure 14*). We estimate that the 2020 ROE, based on current market-implied rates and less conservative GDP assumptions, would be closer to 12%. If EU rates move meaningfully higher, say a 1%-2% upward shift in the yield curve (i.e. closing the gap in rates shown in *Figure 7* above), this could see BNP's ROE approaching 14%. It would, however, probably take 3 years or more for higher rates to show their full effect on the income statement. This is because BNP's interest-rate sensitivity has a "lag" effect: for a given change in interest rates, the major effect is felt only 2-3 years thereafter. This lower level of interest-rate optionality is evidently part of the reason why EU banks trade at a structural P/B discount to US banks.

Figure 12: ‘BNP 2020 Plan’ assumptions on French interest rates



Source: BNP Paribas

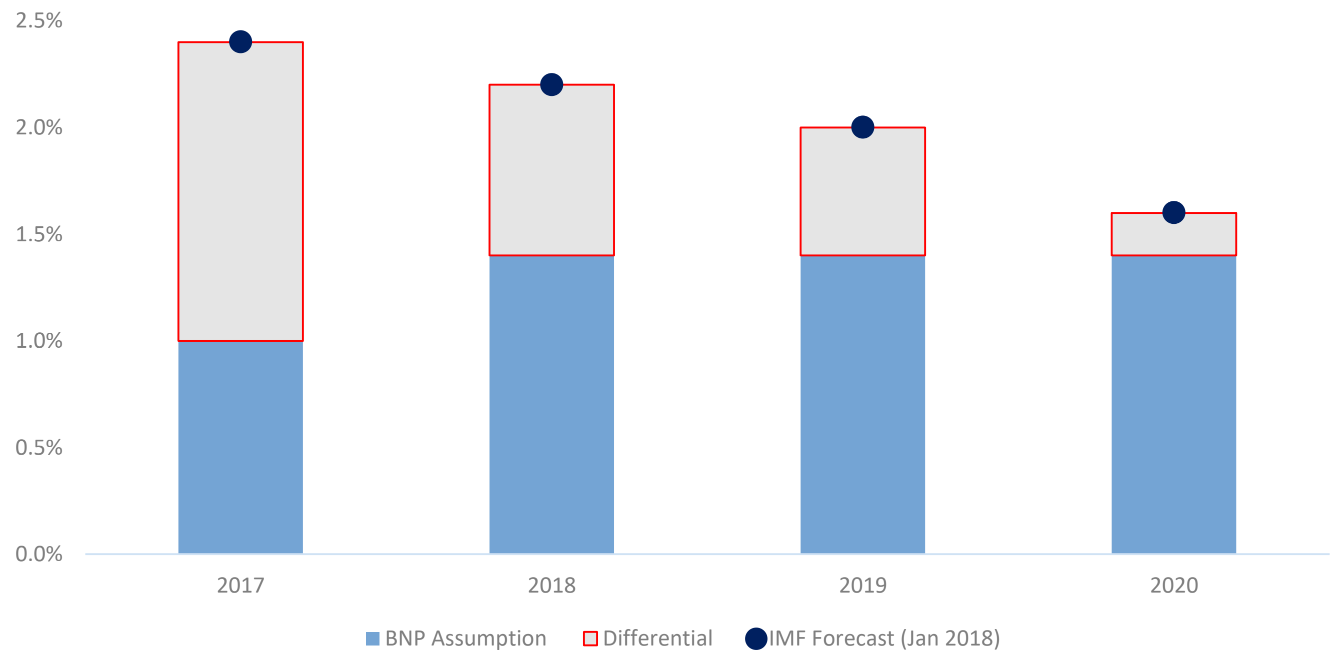
Figure 13: BNP’s assumptions on US interest rates



Source: BNP Paribas

How does this translate into a fair-value estimate? On the basis of this normalised ROE estimate, and an estimate of the cost of capital, we can estimate a 'fair P/B' multiple for BNP. For the sake of prudence, we think it is reasonable to work with an ROE range of 10%-12%, and a cost of equity range of 9%-10%. This generates a fair P/B range of 1-1.6x (*Figure 15*). Relative to the current P/B multiple of 0.78x this suggests, at least theoretically, very meaningful upside (1.25x P/B is 60% higher than spot). We would prefer to be conservative, and pencil in a 0.95x P/B multiple; this still suggests 20%+ (euro) potential return on the stock. This is attractive relative to our 7% (US dollar) expected return on global equities in 2018.

Figure 14: 'BNP 2020 Plan' assumptions on EZ GDP



Source: Bloomberg

Figure 15: Price/Book estimates for BNP

PRICE / BOOK		ROE						
		7%	8%	9%	10%	11%	12%	13%
COST OF EQUITY	8%	0.8	1.0	1.3	1.7	2.2	3.0	4.3
	9%	0.6	0.8	1.0	1.3	1.6	2.0	2.6
	10%	0.5	0.7	0.8	1.0	1.2	1.5	1.9
	11%	0.5	0.6	0.7	0.8	1.0	1.2	1.4
	12%	0.4	0.5	0.6	0.7	0.8	1.0	1.2

Source: Anchor estimates

IN SUMMARY: This investigation has considered the value proposition offered by French banks and BNP Paribas in particular. Although French banks trade at structurally lower valuation multiples than their US peers, the gap appears to be wider now than what is currently justified. Under still quite modest assumptions, French banks like BNP could justify P/B multiples closer to 1x. This suggests potential returns of 20%+. The likely catalyst for such a rerating is a continued normalisation of monetary policy; particularly the possibility of an ECB rate hike in mid-2019, and the end of ECB QE during the current year.

Notes:

1. Source: Oxford Economics, UK.

DOUBTING DISNEY - WHY THE MARKET HAS GOT IT WRONG

Henry Biddlecombe
Equities Analyst

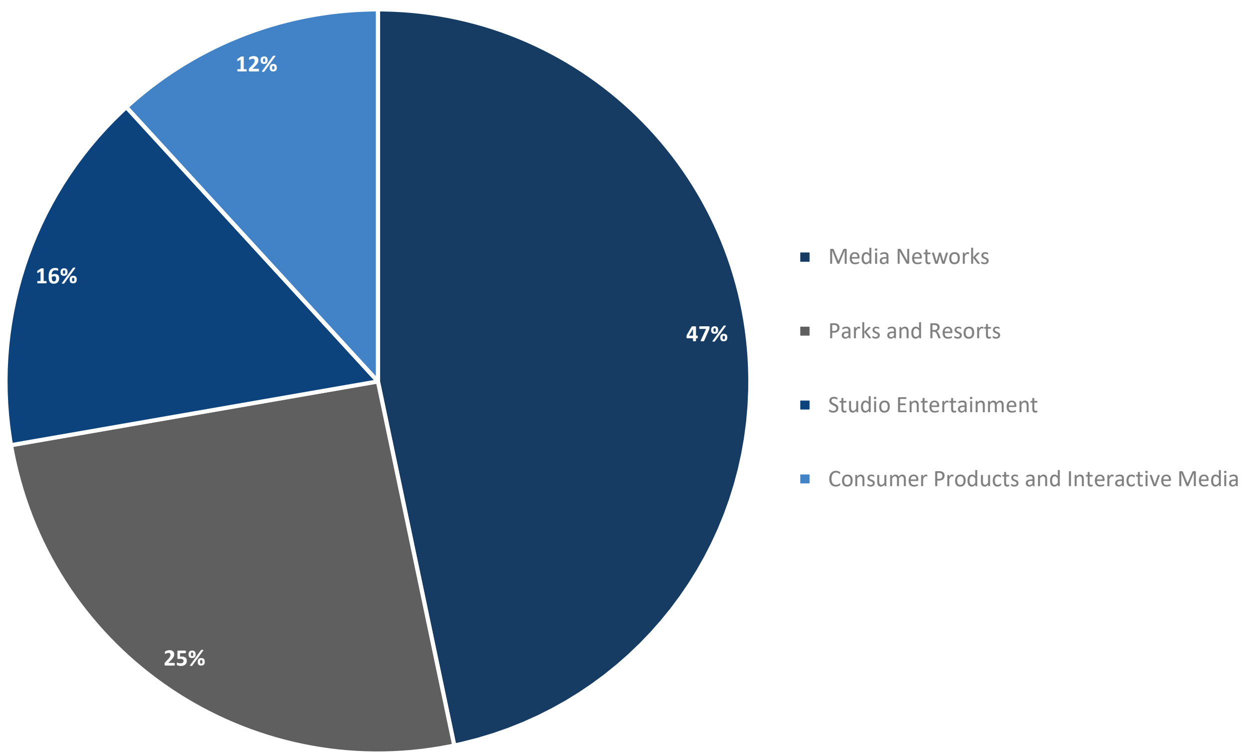
The threat of disruption

Investors by now have become accustomed to one constant: change. Not predictable, incremental evolution – but rather violent and jarring disruption. Innovators continue to smash down seemingly insurmountable barriers to entry which, in the absence of foresight, renders the corporate establishment more vulnerable than ever to Goliath's fate.

The media industry currently finds itself in the midst of such transformation, with consumers driving change from the bottom up through shifting consumption habits. TV programming schedules have been usurped by on-demand content, and streaming technology has connected content creators directly to global audiences – outflanking the previously all-powerful TV networks and distributors in the most brutally undramatic fashion.

Disney, as one of the world's largest producers and distributors of TV entertainment and sports content, has naturally been impacted. Disney's Media Networks division accounts for almost half (47%) of the Group's operating profits and, until now, has depended on the US' large TV networks for distribution. Naturally, this leaves the Group vulnerable to displacement by on-demand Direct-To-Consumer (DTC) providers (the most obvious example of which is Netflix).

Figure 1: Disney divisional EBIT contribution



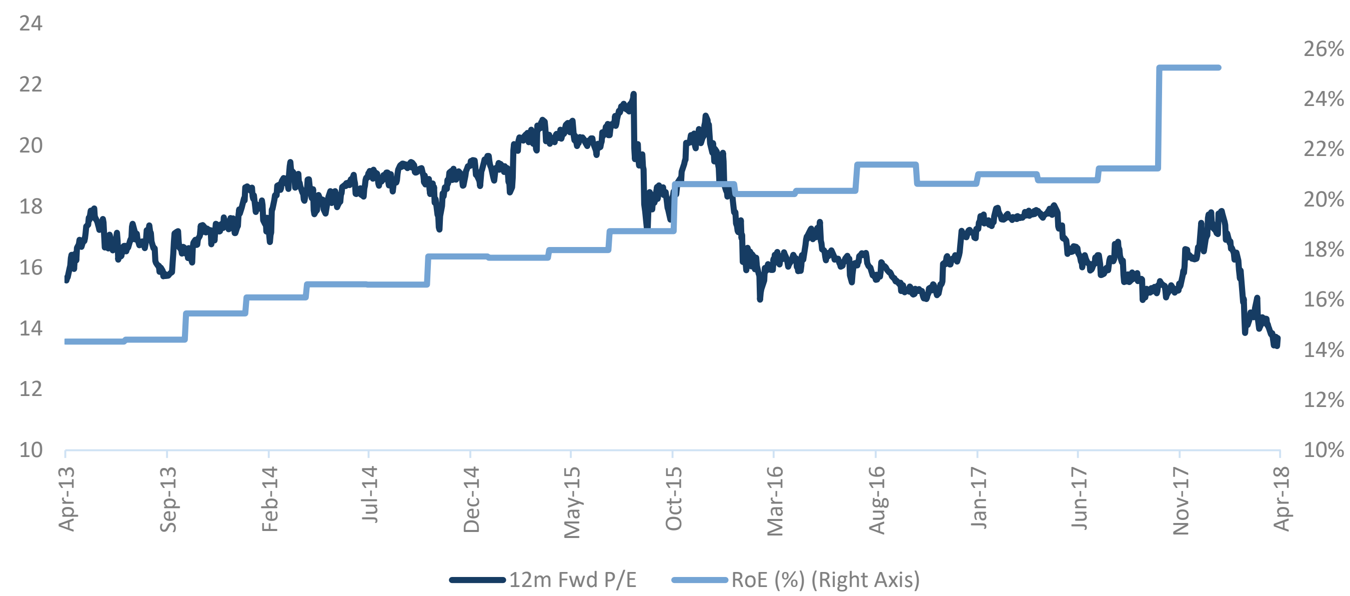
Source: Bloomberg

Disney's highly necessary and arguably overdue opening gambit in this game will be the launch of an ESPN streaming service in mid-2018, followed by a Disney-branded streaming service in 2019. In what will surely be the toughest test of management's prowess yet, the company will need to balance the disintermediation of its largest customers with the introduction of its on-demand DTC streaming business model.

Against this backdrop of uncertainty, Disney's share has derated and currently trades at just 13.7x estimated forward earnings – the lowest multiple in over 6 years. This stands in stark contrast to the Group's return on equity profile, which has steadily improved from 13.5% in 2011 (the last time Disney traded on this P/E multiple) to over 25% as of FY17. (*see Figure 2 below*).

We believe management will execute successfully on a global DTC strategy that will leave Disney well-positioned to leverage the next generational shift in global consumer behaviour. Hence, we view the current rating as a rare and exceptional opportunity for investors to gain exposure to a world-class media business at a material discount to fair value.

Figure 2: Disney's 12m Fwd P/E vs return on equity



Source: Bloomberg

The obsession with subscriber numbers

Few companies have been more successful at leveraging investors' myopic focus on headline-grabbing growth metrics as Netflix. The streaming service's admittedly impressive 5-year CAGR of 35% in global subscribers has seen the share trade up to a forward earnings multiple of over 80x (an irrational valuation, in our view).

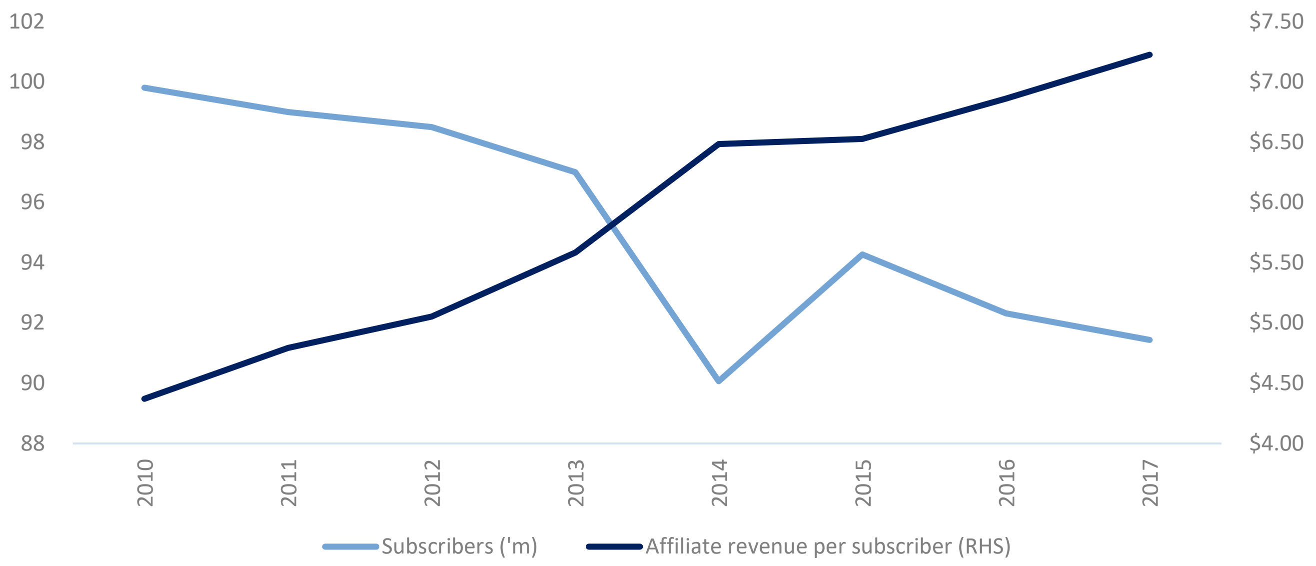
It is the market's same obsession with subscriber growth, then, that has weighed on Disney's valuation. ESPN, arguably the crown jewel of Disney's media assets, has seen consistent subscriber declines since 2011. ESPN's subscriber erosion has become a favoured focal point of the financial media after each quarterly Disney earnings report – with the statistic often quoted as confirmatory evidence of the migration of consumers from traditional cable TV networks to streaming services.

Given that ESPN has achieved full market saturation among traditional TV networks (+/- 95% penetration), it isn't surprising to see the sports network's subscribers move in tandem with cable TV subscribers as "cord cutting" (the term given to the adoption of streaming services in lieu of cable TV) gains momentum.

Of course, subscriber numbers are but one of two drivers of revenue growth – with the other being the fees earned per subscriber. Against an average annual decline of 1.3% in subscribers since the peak in 2011, ESPN has achieved a 7% CAGR in affiliate fees earned per subscriber over the same period *(see Figure 3 below).* The result is a revenue CAGR of 5% over the same period – hardly a business in decline.

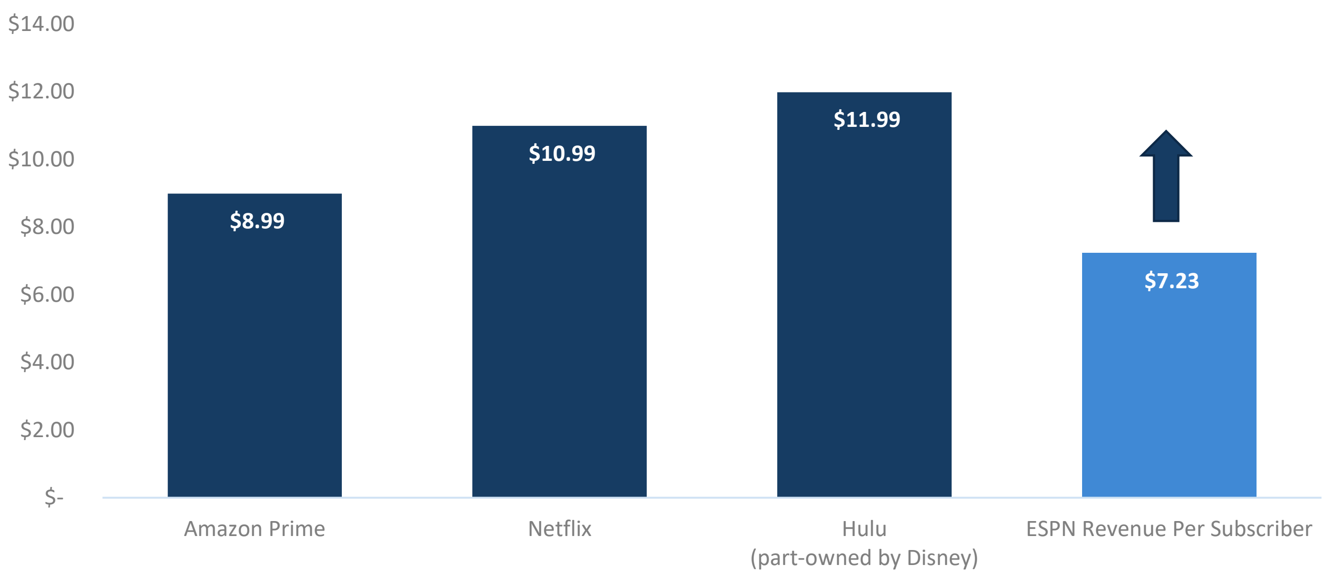
Also interestingly, ESPN's affiliate fees per subscriber compare favourably with the subs charged by several established streaming services (e.g. Netflix, Amazon Prime – *see Figure 4*) – which we believe presents opportunity for ESPN to achieve a materially higher average fee per subscriber through its forthcoming DTC streaming service.

Figure 3: ESPN subscribers vs affiliate revenue per subscriber



Source: Disney

Figure 4: Cost of existing streaming services vs ESPN's existing revenue per subscriber (scope for growth!)



Source: Anchor Capital

The strategic importance of Disney's acquisition of Fox

Beyond earnings growth, the 21st Century Fox (Fox) deal is a critically important development for Disney. As the media market shifts to a largely DTC model, the key differentiator between competitors will not be technology – but rather CONTENT. The acquisition of Fox creates what we believe is the most valuable and comprehensive content portfolio in the industry – spanning the TV, film and sports categories on a global scale.

The brands and franchises now controlled by the Group will mean Disney can build a truly global multi-category DTC offering that will be incredibly challenging to match (*see Figure 5*).

Figure 5: Disney's mind-boggling entertainment and sports content portfolio post the Fox acquisition

Source: Disney

Significantly, Disney has also announced the reorganisation of the company's leadership around the newly-identified four core segments of the business, namely:

- **Direct-to-consumer and international.** A newly-created segment headed by Disney's current chief strategy officer, Kevin Mayer. This segment will house the forthcoming streaming services, and highlights the importance of the Group's DTC strategy to management. It also gives investors a clue as to how significant management expect the DTC business to become in the context of the Group.
- **Parks, experiences & consumer products.** A highly profitable segment that leverages the flywheel effect of Disney's masterful content creation into theme parks and consumer products.
- **Media networks.** The traditional TV business, minus the international operations that now fall under the DTC & International segment.
- **Studio entertainment.** Disney's film production business, which needs little adjustment. Disney's family of studios own 7 of the top 12 all-time box office spots.

The Fox deal by the numbers

Disney's acquisition of Fox represents the third-largest media deal by transaction value in US history, with a total enterprise value of US$66.1bn (as at announcement date). Disney will issue 513mn shares (33% of DIS shares in issue), and assume US$13.7bn in net debt obligations in settlement of the deal.

Disney management expect the deal to close within 12–18 months from the announcement date, and have guided to earnings accretion in the 2nd financial year after the close date.

The synergies that have been identified by Disney management are significant, amounting to US$2bn at an EBITDA level. This represents over 42% of Fox management's estimated FY18 EBITDA, and Disney has guided that the synergies can be realised within 24 months of the deal closing. The implied EV / EBITDA multiple of the deal then seems relatively undemanding at 8.3x (as compared to typical deal multiples of 12–13x) in this sector.

The pro-forma leverage of Disney in a post-Fox deal world (assuming Fox's acquisition of the remainder of Sky also goes through) will be considerable at 2.9x net debt: EBITDA. As per Disney's guidance, we expect this to normalise to between 1.0–1.5x within 24 months of the deal closing.

Given that a significant number of Disney shares will be issued to fund the Fox transaction (515mn additional shares on 1,500mn shares currently in issue), Disney management have also made the decision to embark on a significant share repurchase programme.

Disney intends to repurchase US$10bn in stock over the next 12 months, representing 6.7% of the company's current shares in issue. A further US$10bn will then be repurchased after the Fox deal closes – bringing total share repurchases to over 13% of Disney's shares in issue (assuming a DIS share price of US$100).

In modelling the pro-forma impact of the deal, we have assumed that Fox's acquisition of the remainder of Sky is successfully concluded (regulatory approval remains the last hurdle). The resultant earnings accretion is material in year 2 post close date (we estimate FY21) – adding 13% to the market's previous estimates of Disney's earnings (*see Figure 6*).

Figure 6: Pro-forma impact of Fox acquisition on Disney earnings forecasts

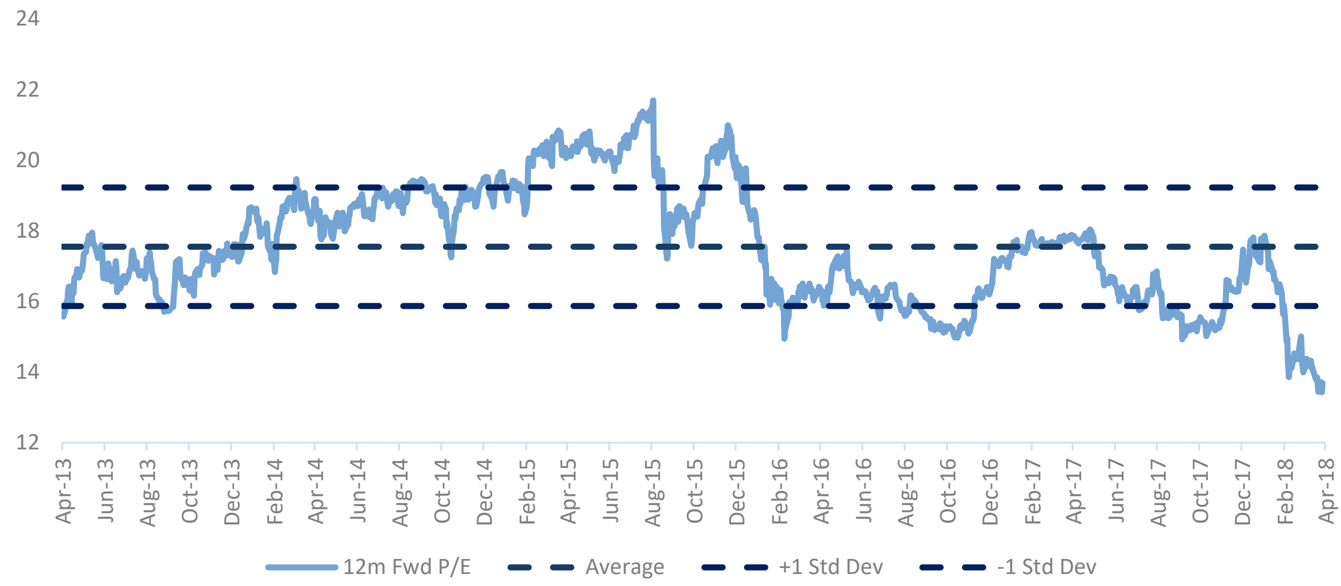
	FY'19e	FY'20e	FY'21e
Incremental net income ($mn):			
Net income (Fox and Sky)	$4,624	$5,087	$5,595
Finance costs	$(1,607)	$(1,308)	$(935)
Synergies	$750	$1,500	$1,500
Pro-forma net incremental income	**$3,768**	**$5,279**	**$6,160**
Disney net income (ex-Fox)	$10,331	$10,488	$11,028
Pro-forma Group net income	**$14,099**	**$15,767**	**$17,188**
New DIS shares in issue	1,966.00	1,928.12	1,893.69
Pro-forma DIS EPS	**$7.17**	**$8.18**	**$9.08**
DIS consensus (pre-transaction)	7.06	7.41	8.04
Deal accretion	***1.6%***	***10.4%***	***12.9%***

Source: Anchor Capital

An extreme valuation

Disney's valuation has now reached what we would consider an extremity, with the 12m fwd P/E ratio of 13.7x sitting at more than two standard deviations below the five-year mean *(see Figure 7)*.

Figure 7: DIS forward rating now at extreme level



Source: Anchor Capital

We feel this is attributable to two primary reasons:

1. **The market is concerned that Disney will be left behind.** There is no doubt that consumers will continue to switch away from relatively expensive, one-size-fits-all cable TV services to more affordable, on-demand streaming services. We believe the market is unconvinced that Disney will successfully execute on this front, which has weighed on the share's rating as ESPN's subscriber numbers have continued to drift lower.

   We remain convinced that Disney's somewhat late adoption of a DTC platform and business model has been a necessary consequence of balancing the disintermediation of the Group's existing cable TV network customer base, while adapting to shifting consumer behaviour.

   Additionally, we believe the adoption of DTC technology is of secondary importance next to the quality of the service's content portfolio. Given the breathtaking content portfolio created through the Fox transaction (*see Figure 5*), we believe Disney now has devastating pulling power to attract a global customer base to its forthcoming DTC services.

2. **A relatively high level of balance-sheet leverage.** After the Disney-Fox and Fox-Sky deals are completed, the Group's pro-forma balance sheet leverage will sit at 2.9x net debt : EBITDA. This is well north of even the highest levels of leverage that Disney has taken on in recent history, and we believe this will weigh on the share's rating in the short term.

   Management have expressed confidence that leverage will return to normalised levels (we estimate between 1.0–1.5x net debt: EBITDA within 24 months of the Fox transaction's closing date. Given the high level of cash generation of the newly-formed group, we believe this goal is achievable.

Conclusion: a rare opportunity

In our view, Disney, on a forward P/E of just 13.7x, presents a compelling opportunity for investors to gain exposure to one of the world's truly timeless businesses and brands at a material discount to fair value.

The company boasts an exceptional calibre of management, with Bob Iger pleasingly committing to see the Fox deal through its multi-year integration (despite a well-flagged impending retirement).

While the recent departure of Sheryl Sandberg (COO, Facebook) and Jack Dorsey (CEO, Twitter) from the Disney board, due to potential conflicts of interest, can certainly be read as an impending competitive threat from Silicon Valley to Disney – we also believe this is a firm acknowledgement that Disney will remain a worthy opponent in the battle for consumer's leisure time and spend.

In our view, Disney remains one of the few businesses that investors can buy and "forget about" – safe in the knowledge that the model will remain relevant and generate healthy returns through time. Given today's entry-point, investors would be off to a great start with a prospective 12m total return of over 35%.

Figure 8: Disney earnings forecast and valuation

FY June	FY18'e	FY19'e	FY'20e	FY'21e
Diluted HEPS	**$7.05**	**$7.17**	**$8.18**	**$9.08**
% growth		*1.7%*	*14.0%*	*11.0%*
PE	**13.9x**	**13.7x**	**12.X**	**10.8x**
DPS	$1.76	$1.79	$2.04	$2.27
DY	1.8%	1.8%	2.1%	2.3%
Share price	$98.00			
Market cap ($mn)	**$149.174**			
12m fwd PE	13.78x			
12m target price	$130.46		**Total 12m return**	35.1%

Source: Anchor Capital

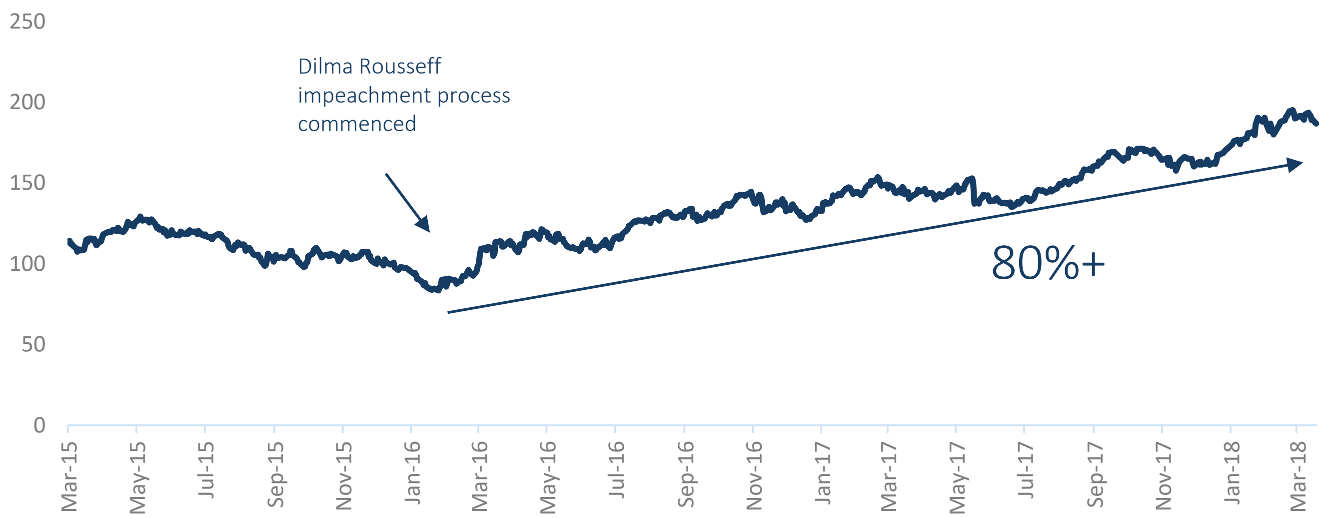
WHY SA IS NOT BRAZIL (FROM AN EQUITY PERSPECTIVE)

Sean Ashton
Chief Investment Officer

Given the stark change in SA's political direction since Cyril Ramaphosa's victory at the ANC elective conference, many commentators have been drawing parallels between SA and Brazil - concluding that SA's "Brazil moment" has arrived.

To provide context to these parallels, Dilma Rousseff – Brazil's then corrupt president - was impeached on 31 August 2016 in a process which had begun in December 2015. This saw the Brazilian iBovespa Stock Exchange Index (Bovespa) rise by 86% since the impeachment process was initiated, and by 45% since Rousseff was impeached in August 2016:

Figure 1: Brazilian Bovespa Index – rebased to 100 at 2 December 2015 (impeachment proceedings started)



Source: Bloomberg, Anchor Capital

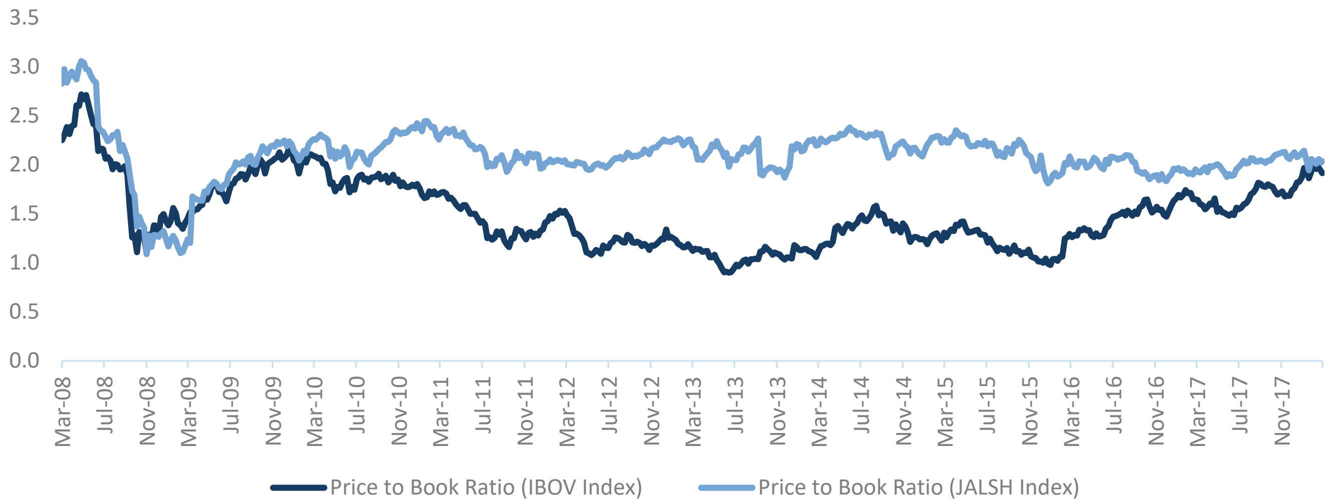
By comparison, the FTSE JSE All Share Index (ALSI) has delivered zero return since the end of the ANC elective conference (and the precursor to Jacob Zuma's "encouraged" resignation as SA president), while the capped Shareholder Weighted Index's (SWIX's) performance is marginally lower. To be clear, gains were indeed achieved in the months leading up to the event, but investors may reasonably have expected a more enthusiastic response post-confirmation of these changes or may conclude that further substantial returns are yet to come.

However, our conclusion is that the Brazil comparison is flawed for a number of reasons – at least in as far as stock markets are concerned, and at a headline index level. While we expect SA economic growth to improve materially off a low base, and domestic-focussed assets to do well, we do not expect local currency stock market gains akin to what happened in Brazil. There are a number of reasons for this:

1) Brazil had valuation levels on its side – at least by one important measure

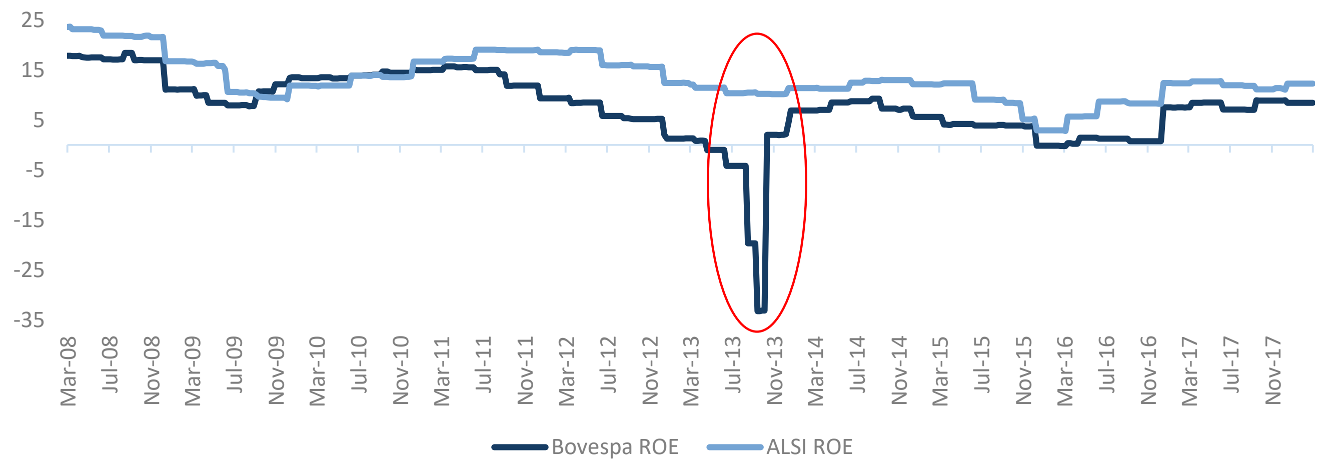
The starting point for valuation of the Brazilian Bovespa Index is probably the key reason for the extent of the subsequent gains – investors digested the potent combination of the scent of a fresh reform agenda in Brazil, and very low valuations. To be sure, this exercise is made problematic by the fact that the Bovespa had negative earnings at an index level (caused by oil companies), which skews valuation comparisons when P/E multiples are used. However, on a price to book (P/NAV) basis, Brazil was almost 50% cheaper than SA (ALSI) at the time of Rousseff's impeachment process commencing in December 2015. Given subsequent gains by the Bovespa, this gap has now largely closed relative to SA valuation levels.

Figure 2: Brazil vs SA indices: Brazil was significantly cheaper than SA on a price to book (P/BV) basis; gap has subsequently closed…



Source: Anchor Capital; Bloomberg

Figure 3: … while P/E comparisons between Brazil and SA's equity indices is clouded by losses in Brazilian oil companies – lower ROE



Source: Anchor Capital, Bloomberg

2) Domestic vs global exposure at index level – Bovespa is for "Brazilian"

The devil is often in the detail. On closer analysis, it becomes clear that Brazil's Bovespa is far more representative of a "Brazilian" stock market than is the case for SA. While this may not be immediately apparent from merely eyeballing index weightings by sector, we highlight a high weighting to financials (high beta to domestic economics) relative to SA, as well as consumer staples and consumer discretionary. These sectors alone account for over 50% of the Bovespa, while most of the materials sector weighting comprises companies which are not globally priced, i.e. dual-listed heavyweights such as Anglo American, as in the case of SA. Furthermore, SA's stock market has a large contingent of industrial dual-listed companies such as Richemont, AB InBev and British American Tobacco, whose valuations have little to nothing to do with SA's outlook.

Figure 4: Bovespa Index make-up by sector – largely a “domestic” market

Consumer discretionary	5.9%	
Consumer Staples	12.5%	*Domestic companies*
Energy	13.4%	*Largely Petrobras*
Financials	34.9%	*High weighting vs SA*
Healthcare	1.5%	
Industrials	5.3%	
Information Technology	1.9%	
Materials	15.5%	*Non dual-listeds*
Real Estate	1.1%	
Telecommunication services	2.4%	
Utilities	5.6%	
Grand total	100.0%	

Source: Anchor Capital, Bloomberg

Figure 5: FTSE JSE All Share Index construct: Far more “global” than local: >60% rand hedge

Rand hedge		62%
Dual listeds		31%
Other hedge		31%
Rand “plays”		24%
Banks		11%
Retail		6%
Listed property		4%
Insurance		6%
Other non-categorised		13%
Grand total	100%	

Source: Anchor Capital

An issue closely allied to the above is currency exposure. While in the Brazil experience, the Brazilian real's appreciation would not have weighed on market performance by virtue of significant dollar exposure in the index, this is not the case for the JSE. The rand has gained 5% against the US dollar since the ANC elective conference, while more than half of the index could be regarded as "hard-currency" exposure (as shown above).

Conclusion

There are many parallels between what has happened in Brazil politically and the current political evolution in SA, but we believe these factors do not extend to equity markets due mostly to: 1) valuations and a more-depressed starting earnings base in Brazil; and 2) a far more global stock market index construct in the case of SA. As a consequence, we do not expect annualised gains of 40%-plus in the next two years from SA equity indices, as was the case in Brazil. The implications for portfolio construction are profound – investors cannot simply "index" their exposure to SA equities by buying passive product in order to benefit from a potentially brighter future in SA. Furthermore, creating concentrated exposure in portfolios to those parts of the market which will perform well in a strong rand environment, will result in limited factor diversification at a portfolio level. We believe a balanced approach is required, but our portfolios are currently tilted towards benefitting from a better economic outlook in SA over the coming years.

THE ANXIETY OF EQUITY MARKETS

Peter Armitage
Chief Executive Officer

We might be able to do a mean spreadsheet, but that does not mean we are definitely going to make you money right now. That's because the market does not know about our spreadsheets and often the value that we calculate for a company is very different from where a share trades - at least in the short term.

This is one of the factors that often makes our jobs incredibly frustrating, but equally fascinating. There are many dynamics that influence a share price and varied skills that are required to "make the right call". In order to invest on the stock market, at the very least, you should be smart, analytical, balanced, intuitive and, most importantly, patient. And a little bit of luck also helps at times!

As custodians of people's wealth, our primary mission is to make money (with the appropriate risk etc.). We wake up in the morning thinking about shares and we spend most of our day digging through information and vigorously debating economics and companies. Nothing brings us greater joy than seeing a share price rise and nothing makes us more anxious than a plummeting counter or simply not delivering the returns that we would expect as a client.

There are times when it just seems easy and the runs flow and then there are times when it's just downright difficult. That's the story of the market over the last few years. An equally weighted FTSE JSE Top-40 portfolio has now been flat for three years and the FTSE JSE All Share Index return over the same period has been a paltry 5% p.a. It's not a disaster, but it's just plain boring. However, this is exactly when we shift up a gear and our collective skills and experience become critically important.

So how do we respond?

First, with the understanding of context. In a 24-year career, I have personally been through several periods of equity market fatigue. It was never right to lose faith in the market. Staying invested and being in the right shares always delivers a great return over time. I always get reminded of that when I look at older share portfolios and observe the value created by owning a growing company over time. Over the last 15 years, JSE investors have, on average, made 17.5% p.a. (that's a 1,000% return!) and many great companies have delivered much more than that. I remember writing a report on Naspers at R16/share and Capitec at R20/share. This is the place to make money. It sounds simplistic, but the longer the market goes sideways or down, the better the chance of a great future return.

Second, we respond with passion. There are always ten shares that are going to give you an outsized return over the next year and it is our job to find them. Our analyst team hits the road and visits swathes of companies, digests the analysis and finds future gems. Opportunities are created by the performance of a company or the mispricing of a share. When the market has been moving strongly upwards it is often harder to find the latter. Equity investment is the world we choose to live in and we love what we do.

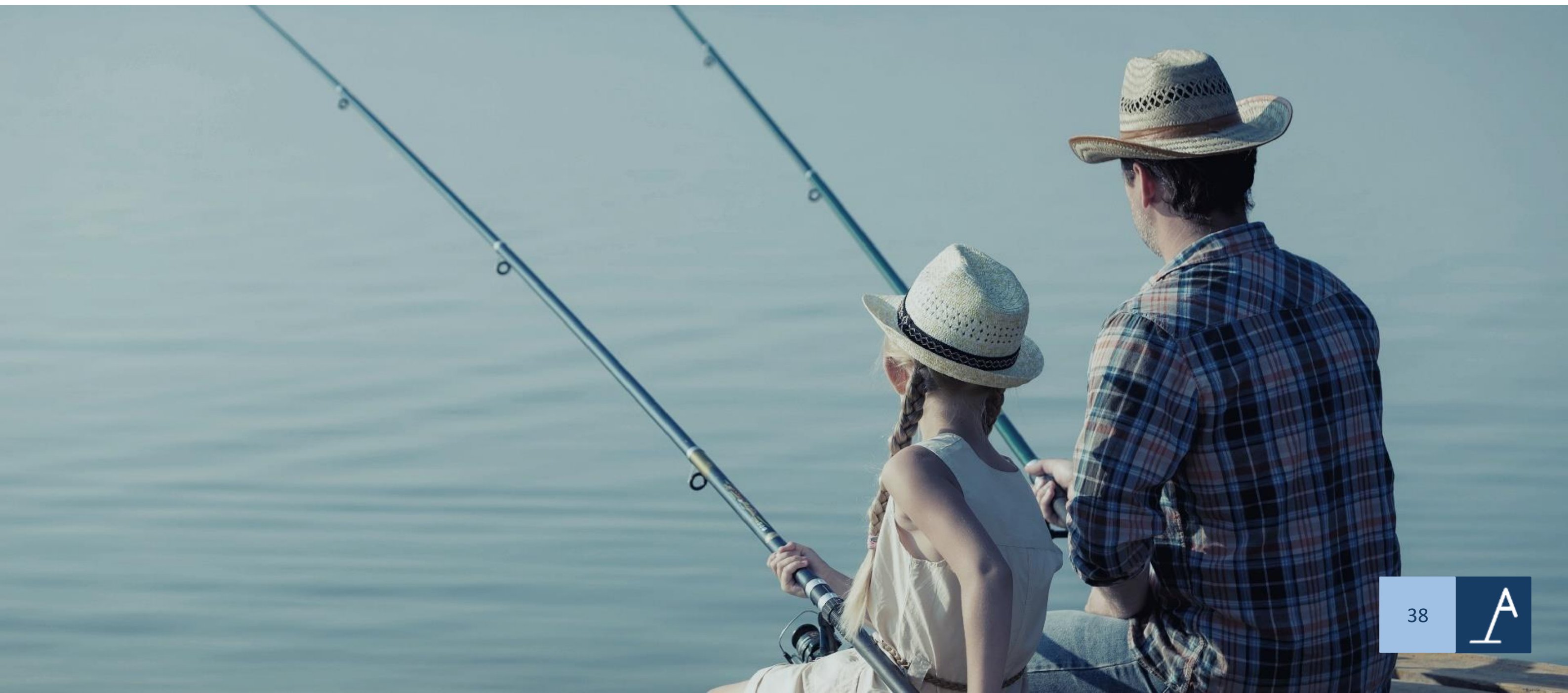
Third, we respond with patience and sticking to the plan. As we indicated earlier, shares don't always move logically and often returns come when you least expect them – nobody has the ability to predict exactly when returns will materialise. Our philosophy is to invest in companies that are growing and that can reinvest capital at a high return, generated in cash. If we can find these companies and identify appropriate entry prices, the underlying value of your investment will go up every year. Share prices sometimes run ahead of this underlying value and sometimes they lag but, over time, share prices follow earnings.

Fourth, we respond with a level head. We don't panic, and we always bear fundamentals in mind. Knee-jerk reactions are usually wrong. We also seek opportunities where sentiment and emotion depress prices.

It's also worth putting into context the performance of the market over the last year or so. There are two important drivers of the SA market – Naspers (given its weighting in the overall index) and the currency, especially since c. 50% of SA earnings are generated in currencies other than the rand. Running into the end of 2017, local economic prospects looked dire and SA Inc. shares were battling – the biggest positive drivers of the market were Naspers and the weaker rand. With a reversal of the Zuma economic drag as a result of Cyril Ramaphosa's victory at the ANC elective conference in December 2017, the currency has strengthened remarkably – from over R14.50/$1 to levels well below R12/$1. This resulted in a reversal of 2017 conditions. SA Inc. shares have performed very well, but this has been more than offset by the negative moves in Naspers and rand-hedge shares. A perfect storm, in a sense, with the negatives outweighing the positives in both instances, with a muted aggregate outcome.

However, nothing lasts forever and we know that the currency will weaken over time and that prospects for SA companies have improved markedly, with the risk being the time it takes for this to materialise.

So, we will carry on doing our spreadsheets and keeping a keen eye on fundamentals, which enables us to invest with conviction. And we will apply an overlay of the other skills we have learnt over time. A healthy dose of anxiety is also not a bad thing. But most of all we will be patient and the returns will come. Our SA equity fund has now compounded at around 15% p.a. since its inception just over five years ago, but recent returns have been more muted. We are working hard to try and repeat that performance over the next five years.



A PRACTICAL ILLUSTRATION OF USING AVAILABLE TAX BREAKS TO HELP YOUR INVESTMENT STRATEGY

Brendan Gace
Head: Private Clients

Many people are feeling stretched by the ever-increasing tax burden, on top of this loopholes which existed in the past keep getting closed. However, there are a number of opportunities still available to investors to reduce their overall tax burden. We look at some of these opportunities that exist in the overall planning of your investment portfolio. We use the following base assumptions: a 10% p.a. growth assumption; a tax payer in the top tax bracket of 45%; and an effective capital gains tax (CGT) rate of 18%.

First up is using the allowable retirement annuity / pension / provident contributions. Each taxpayer is permitted to contribute up to 27.5% of taxable income up to a maximum of R350,000 p.a. This will equate to an annual tax saving of R157,500 p.a. That equates to an additional retirement capital sum of ±R9mn over 20 years.

Next, each taxpayer is permitted to make an annual donation of R100,000 p.a. Over 20 years this could amount to over R5.7mn being outside of one's estate, in a family trust. The CGT saving would be ± R666,000, and just over R1mn would be saved in estate duty.

Use your annual capital gain exemption of R40,000 p.a. or LOSE IT. The tax saved is a mere R7,200 p.a., however, that will equate to a saving of R412,000 over 20 years.

The tax-free savings account allows for a lifetime contribution of R500,000 and a maximum of R33,000 p.a. Assuming this is invested into an equity portfolio, the CGT savings would be ±R123,000 after 20 years. This tax saving would be even larger if you set these accounts up for children or grandchildren and stayed invested for longer periods of time.

How you invest and diversify your portfolio can also amount to significant tax savings. For example, if you had R5mn invested in your Pension fund and R5mn of personal discretionary investments, the normal practice is to place both amounts into a balanced or moderate investment strategy with a mix of equites/ cash / bonds and property. If you split both investments equally your result would look something like this:

	MODERATE ALLOCATION	PENSION FUNDS	PERSONAL FUNDS
Equities	60%	R3,000,000	R3,000,000
Bonds	15%	R750,000	R750,000
Property	15%	R750,000	R750,000
Cash	10%	R500,000	R500,000
TOTAL		R5,000,000	R5,000,000

The pension fund investments are exempt from CGT, Income tax of interest and rental, and dividends tax. The personal funds are all subject to these taxes. Using the same assumptions, the estimated tax on personal funds, if invested this way, would amount to ±R150,000 tax p.a.

If you restructured the portfolios with the same overall asset allocation but moved assets around a bit to look something like this:

	MODERATE ALLOCATION	PENSION FUNDS	PERSONAL FUNDS
Equities	60%	R1,250,000	R4,750,000
Bonds	15%	R1,500,000	R0
Property	15%	R1,500,000	R0
Cash	10%	R750,000	R250,000
TOTAL		R5,000,000	R5,000,000

The result would be a tax bill of ±R85,000 p.a. This is a reduction of around 1.17% p.a. in tax payable. If you use this percentage saving on an initial investment of R5mn over 20 years, the tax saving will mean your final investment value is enhanced by over R6.4mn.

Finally, all these tax savings can be improved further by doubling up on the tax savings by using these allowances for your spouse.

These simple steps of using available tax breaks and getting the compounding benefit over a number of years will mean that your pot of money in later years is hugely enhanced.

**Before making these types of changes please consult with a financial planner or your tax practitioner to ensure that these solutions are appropriate for your circumstances.*

05 PERFORMANCE SUMMARY

	Start date	FUND PERFORMANCE Annualised p.a.	Since inception	12 Month	6 Month	3 Month	March 2018	BENCHMARK PERFORMANCE Since inception	12 Month	6 Month	3 Month	Mar 2018	Performance vs Benchmark
UNIT TRUSTS (rand)													
Anchor BCI Equity	Apr-13	13.8%	90.8%	3.73%	-2.4%	-3.0%	-3.6%	63.9%	8.0%	2.9%	-5.1%	-3.9%	26.9%
Anchor BCI SA Equity	Jan-15	2.7%	8.7%	3.0%	-1.4%	-3.4%	-3.3%	19.5%	8.0%	2.9%	-5.1%	-3.9%	-10.8%
Anchor BCI Flexible Income	Jun-15	7.6%	23.2%	7.1%	2.2%	1.6%	0.9%	25.2%	8.4%	4.1%	2.0%	0.6%	-2.0%
Anchor BCI Managed	Jan-15	4.2%	13.9%	4.0%	-2.8%	-2.6%	-1.5%	37.6%	9.0%	4.8%	2.7%	1.1%	-23.7%
Anchor BCI Worldwide Flexible	May-13	10.2%	60.4%	-3.03%	-7.3%	-4.3%	-2.0%	54.2%	8.0%	4.4%	2.5%	1.1%	6.2%
Anchor BCI Property Fund	Nov-15	-0.6%	-1.3%	0.9%	-5.3%	-8.9%	0.9%	-3.1%	-7.1%	-12.9%	-19.6%	-1.0%	1.7%
Anchor BCI Global Capital Feeder	Nov-15	-6.6%	-15.2%	-10.83%	-12.2%	-4.7%	-0.4%	-8.2%	-9.0%	-11.3%	-3.6%	0.7%	-7.0%
Anchor BCI Global Equity Feeder	Nov-15	2.2%	5.3%	1.3%	-7.5%	-2.6%	-2.7%	10.3%	1.3%	-8.6%	-5.5%	-1.8%	-5.0%
Anchor BCI Bond Fund	Feb-16	13.9%	32.1%	16.1%	9.6%	7.0%	2.1%	31.4%	16.2%	10.5%	8.1%	2.1%	0.7%
Anchor BCI Diversified Stable Fund	Feb-16	6.5%	14.7%	6.0%	1.2%	0.2%	-0.8%	11.8%	4.8%	0.2%	-1.3%	-0.6%	2.9%
Anchor BCI Diversified Moderate Fund	Feb-16	5.2%	11.6%	5.4%	0.1%	-1.5%	-2.2%	9.7%	3.8%	-1.2%	-2.9%	-1.7%	1.9%
Anchor BCI Diversified Growth Fund	Feb-16	4.3%	9.5%	5.8%	-0.1%	-2.2%	-2.8%	10.0%	3.4%	-1.5%	-3.6%	-2.2%	-0.5%
Anchor BCI Africa Flexible Income	Mar-16	2.2%	4.5%	2.3%	-3.8%	-2.1%	0.4%	20.8%	9.4%	4.5%	2.2%	0.7%	-16.2%
EQUITY NOTES & SEGREGATED MANDATES													
Anchor Equity	Jul-13	10.3%	59.3%	-1.8%	-3.5%	-4.9%	-3.5%	62.7%	8.0%	2.9%	-5.1%	-3.9%	-3.4%
Growing Yield*	Jun-12	11.7%	88.7%	-2.7%	-8.4%	-4.6%	0.3%	77.3%	9.0%	4.8%	2.7%	1.1%	11.4%
HEDGE FUNDS (rand)													
Long Short Equity	Mar-13	8.5%	50.5%	2.2%	-1.5%	-0.2%	-0.6%	46.7%	9.0%	4.3%	2.1%	0.7%	3.8%
Property Long Short	Jan-14	11.2%	56.8%	3.3%	-3.4%	-4.6%	1.2%	44.2%	9.6%	4.7%	2.3%	0.7%	12.6%
OFFSHORE													
High Street Equity – dollar	Jun-12	13.3%	105.2%	15.9%	5.3%	-1.0%	-1.5%	93.2%	14.2%	4.4%	-1.2%	-2.1%	12.0%
High Street Equity – rand	Jun-12	20.8%	196.0%	2.6%	-7.6%	-5.3%	-1.1%	179.0%	0.7%	-8.8%	-5.7%	-1.8%	17.0%
Offshore Balanced – dollar	Jun-12	11.1%	83.5%	12.8%	3.7%	-0.7%	-0.5%	57.0%	10.2%	2.9%	-1.0%	-0.7%	26.5%
Offshore Balanced – rand	Jun-12	18.5%	165.2%	-0.2%	-8.9%	-4.9%	-0.1%	127.1%	-2.8%	-10.1%	-5.5%	-0.4%	38.1%
Global Dividend - dollar	Jan-14	9.0%	43.4%	12.2%	1.5%	-3.8%	-1.9%	43.7%	14.2%	4.4%	-1.2%	-2.1%	-0.2%
Global Dividend – rand	Jan-14	10.7%	52.8%	-0.7%	-10.8%	-7.9%	-1.5%	52.7%	0.7%	-8.8%	-5.7%	-1.8%	0.1%
Anchor Sanlam Global Stable Fund– dollar	May-15	-0.3%	-0.8%	2.3%	0.4%	-0.1%	-0.1%	7.9%	2.7%	1.4%	0.7%	0.2%	-8.7%
Anchor Sanlam Global Stable Fund – rand	May-15	-1.2%	-3.3%	-9.5%	-12.1%	-4.4%	0.5%	5.2%	-9.4%	-11.5%	-3.7%	0.6%	-8.5%
Anchor Sanlam Global Equity – dollar	May-15	8.8%	27.3%	15.0%	5.1%	1.9%	-2.0%	22.1%	14.8%	4.6%	-1.0%	-2.2%	5.2%
Anchor Sanlam Global Equity - rand	May-15	7.9%	24.1%	1.7%	-7.9%	-2.5%	-1.4%	19.1%	1.5%	-8.4%	-5.3%	-1.6%	5.1%

**Provisional performance returns 0*

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