ANCHOR

NAVIGATING CHANGE

THE NAVIGATOR

STRATEGY AND ASSET ALLOCATION REPORT, 2ND QUARTER 2024

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Introduction

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The first quarter of 2024 was a period of divergence as the US economy soldiered ever on impervious to higher interest rates and in defiance of economists forecasting a slowdown. In contrast, China's economy continues to wrestle with a beleaguered property sector, making its 5% gross domestic product (GDP) growth target for 2024 seem more aspirational than achievable. Europe is at least behaving as economists might expect, and a gradual slowdown is spurring interest rate cut expectations. In South Africa (SA), we are seeing a diminished drag from loadshedding as domestic solar production reduces pressure on the grid. Most are taking a wait-and-see approach to the upcoming National and Provincial Elections, while economists are discussing a GDP growth rebound towards 1.2% and 1.6% this year and in 2025.

A fractious global geopolitical environment has resulted in a pivot toward holding gold as a hedge. Authoritarian regimes have seen how Russia's US dollar reserves were seized in response to its invasion of Ukraine. The unexpected outcome is that these regimes have been down-weighting their US dollar reserves to hold gold reserves instead. Perhaps gold is regaining its lustre as it sets new record-high prices. Gold might be the tailwind that the South African economy needs. Expectations for global interest rate cuts have been pushed out, and the market now forecasts three US rate cuts in 2024, with the rest being pushed into next year.

Anchor believes domestic shares are poised for a catch-up rally after lagging over the past quarter (1Q24). We think prices are overly depressed and that a modest upturn in the domestic outlook and a middle-of-the-road election outcome could spark a catch-up rally for JSE-listed counters. We maintain the view that we are in a global economic boom (centred around the US) and that while equities have run hard, they have more room to grow.

Anchor is a proponent of balanced portfolios and diversified risks. We believe investors should have a long-term plan for what they seek to achieve with their investments and that the year ahead will likely see them move towards their eventual desired outcome. In our view, this is an excellent time to take a pro-risk stance in your portfolio and structured products and alternatives are valuable tools for achieving your desired outcomes. We advocate that a healthy portion of your investment portfolio should be offshore to take advantage of different opportunities and return profiles while diversifying SA-specific risk. We expect the rand will continue to gravitate around current levels vs the US dollar. Therefore, this is an excellent time to externalise a portion of your portfolio if you have not already done so.

We believe investors should have a long-term plan for what they seek to achieve with their investments and that the year ahead will likely see them move towards their eventual desired outcome.

Overall, it is also a good time to upweight your investments. Anchor strives to help you achieve the best outcomes within your risk tolerances and investment objectives. We see opportunities in all asset classes, and this document highlights some of the best opportunities we believe to be available.

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	Current stance			Expected returns (own currency) (%)
	Negative	Neutral	Positive	
DOMESTIC				
Equity			●	18
Bonds		●		14
Listed property			●	15
Cash		●		8
Alternatives*			●	10 to 15
Rand vs US dollar (rand stronger)				2
GLOBAL				
Equity			●	7
Government bonds		●		5
Corporate credit		●		6
Listed property		●		6
Cash		●		4
Alternatives*			●	8 to 12

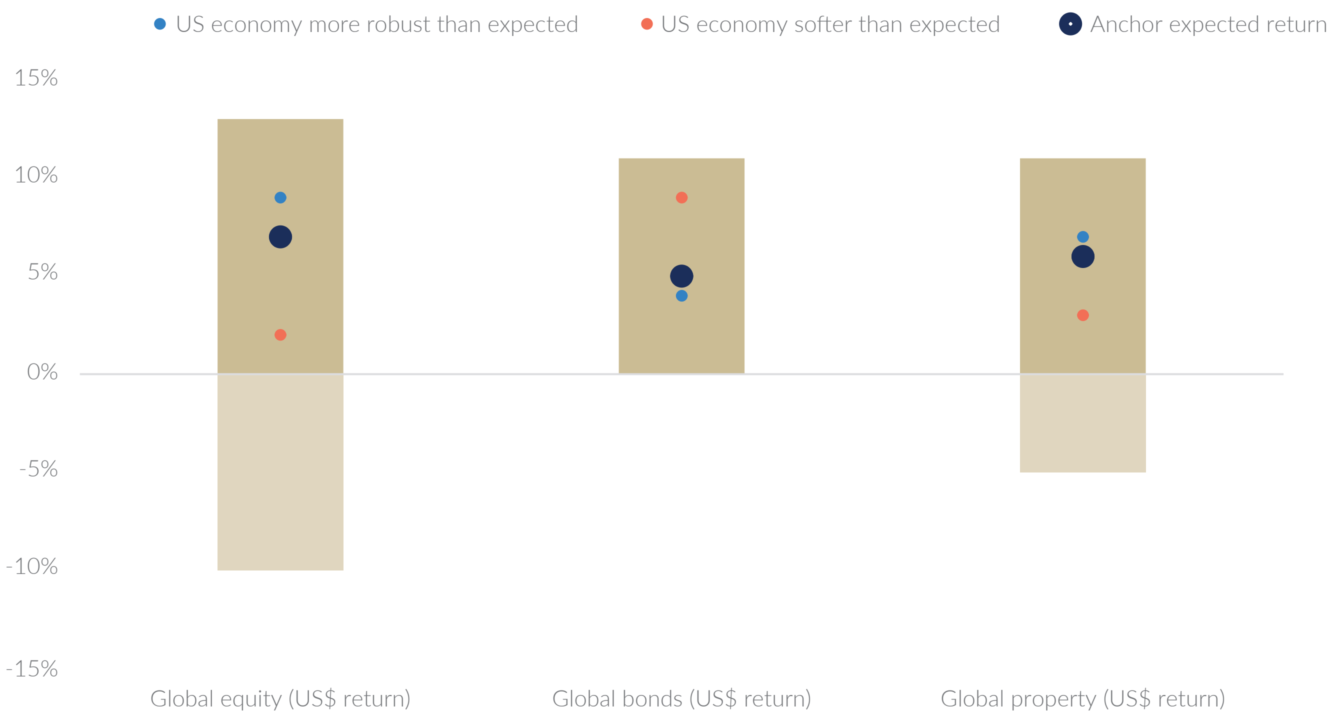
**Alternatives include hedge funds, protected equity structured products and physical property.*

Asset Allocation Summary

The most recent quarter (1Q24) was dominated by market participants pushing the timing of the first interest rate hike out further into the future and shifting market expectations towards a shallow interest rate-cutting cycle. This shift proved negative for interest rate-sensitive investments, while US equities benefited from the stronger-than-expected US economy. Our return expectations for the various asset classes have shifted to reflect different starting prices of assets and a slower interest rate-cutting cycle.

Figure 1 below highlights the US dollar return outlook for the various global asset classes. The bar in *Figure 1* represents the reasonable range of possible outcomes, with the dots representing our estimate of the outcome in the various scenarios. We think global equities (particularly US equities) will likely outperform in this environment as they continue their strong momentum. Global bonds and cash remain compelling.

Figure 1: 12M return scenarios for various asset classes in US dollar terms



Source: Anchor

Figure 2: Anchor expected return by offshore asset class

	Global equity	Global bonds	Global property
Anchor expected return (in US dollar)	7%	5%	6%

Source: Anchor

Figure 3 below highlights the rand return outlook for several domestic asset classes. The bar represents the reasonable range of possible outcomes, with the dots representing our estimate of the outcome under various scenarios. From a domestic perspective, the weak economy, failing state-owned enterprises (SOEs), and the poor state of the government's finances are a few of the factors that detract from our outlook. We think South African society is learning to cope with electricity disruptions and that private generation will lessen the blackouts. There is already much negativity in the price of domestic assets, and we believe there is a decent prospect of some recovery in asset prices from current levels. We think domestic factors should improve into 2024, though there is much uncertainty around this view, with the national election likely to keep markets on edge for 2Q24.

Figure 3 : 12M return scenarios for various asset classes in rand terms

Source: Anchor

Figure 4: Anchor expected return for domestic asset classes

	Domestic equity	Domestic bonds	Domestic property	US$/rand
Anchor expected return (in rand)	18%	14%	15%	2%

Source: Anchor

Strategy And Asset Allocation, 2Q24

ECONOMICS

The global economy continues to progress steadily, showing resilience in the face of various challenges. Despite concerns, there is no significant indication of widespread debt stress in global financial markets, thus mitigating the likelihood of a recession. Factors such as elevated global interest rates, ongoing geopolitical tensions, and other uncertainties have not derailed growth. Notably, the US economy has been a driving force, demonstrating robust demand and a rebound in production, contributing to overall global economic stability. However, risks remain, particularly in the latter half of 2024, as US growth is anticipated to decelerate, potentially impacting global growth negatively. Moreover, the recent increase in crude oil prices could fuel inflation and delay central banks' plans for rate cuts. Factors like increased global military and political tension, disruptions caused by climate change in supply chains (particularly in mining and agriculture), and uncertainties related to upcoming elections in key regions may further influence the global economic outlook.

Whilst the trend of global disinflation continues, there is clear evidence of a split in inflationary trends. While inflation has declined in the eurozone and the UK, the US is experiencing renewed inflationary pressures. China, on the other hand, has stabilised from its deflationary trend earlier in the year. However, geopolitical tensions and disruptions in freight routes through the Red Sea present potential upside risks to near-term global inflation. These risks are further heightened by escalating military conflicts and pipeline disturbances in the Middle East and Russia, leading to increased oil prices. Nevertheless, we anticipate that developed economies will eventually reach their targeted or preferred inflation levels by the end of 2024. With regard to global monetary policy, the rationale for cutting rates in economies facing or nearing recession is clear. However, a less obvious justification exists for rate cuts when economies are relatively strong. Despite global policy rates reaching 15 to 20-year highs, real rates matter more than nominal rates in terms of monetary policy effects. As inflation, or inflation expectations, decreases, the level of policy restraint increases, which can further dampen economic activity and price pressures.

While inflation has declined in the eurozone and the UK, the US is experiencing renewed inflationary pressures.

Global disinflation has resulted in tightening monetary conditions due to increases in real interest rates. While the US Federal Reserve (Fed), European Central Bank (ECB), and the Bank of England (BOE) have all raised policy rates, the divergence in inflation paths between the Atlantic regions has made policymakers cautious about implementing policy loosening measures. The emphasis on fully anchoring inflation expectations in policy discussions suggests that interest rate cuts may be postponed. The recent, largely unexpected rate cut by the Swiss National Bank (SNB) may pressure the ECB and BOE to consider rate cuts ahead of the Fed in response to easing inflation in their respective regions. Furthermore, the depressed prices of natural gas, a significant factor in European energy inflation, suggest that recent increases in oil prices are unlikely to unsettle inflation expectations across Europe. Nonetheless, we anticipate that the ECB and BOE will eventually align their rate moves with the Fed's. Turning to the East, China's economy has reflected tentative improvement, supported by sustained fiscal measures and a rebound in industrial activity downstream, fuelled by a surge in export growth driven by significant price reductions from exporters. These measures are, however, short-term in nature. The real estate sector, which remains a focal point of domestic confidence concerns, continues to hinder growth, as key indicators such as property sales remain subdued. Looking ahead, the rebound in export prices poses a risk to this external growth trajectory, thereby likely challenging the authorities' growth target of "around 5%."

Moving locally, the SA economy narrowly skirted a technical recession in 4Q23, with modest growth of 0.1% QoQ after a revised -0.1% QoQ print for 3Q23. A marginal recovery in household consumption and a slight increase in exports just managed to counterbalance the negative effects of increased imports, stagnant investment, and a decline in government consumption growth. The South African Reserve Bank (SARB) forecasts growth at 1.2% this year, improving to 1.6% by 2026. These projections are better than the 2023 outcome but below longer-run averages of around 2%. The central bank further estimates that while electricity shortages took 1.5 ppts off GDP last year, it will moderate to 0.6 ppts this year and 0.2 ppts in 2025. Over the medium term, we expect growth to maintain a moderate uptick in momentum as the burden of loadshedding eases - driven by the advent of private sector embedded generation and rooftop solar installations. Nonetheless, overall growth prospects will continue to be hampered by persistent challenges in the energy and logistics sectors, compounded by ongoing escalating geopolitical tensions and weak external demand.

On the monetary policy front, the SARB's Monetary Policy Committee (MPC) remains wary of the impact of geopolitical uncertainties persisting into 2024, with the potential to keep global oil markets under pressure. Further risks include the susceptibility of imported commodities to currency devaluation and enduring elevated and unpredictable local food prices (which could potentially derail recent disinflation efforts). At the same time, electricity and logistics expenses present significant inflationary challenges. The fluctuation in fuel and food prices additionally introduces uncertainty into wage growth forecasts. Overall, at the current level of rates, the policy stance in SA is considered restrictive and consistent with the inflation outlook, and there is a need to address elevated inflation expectations. Subsequently, we maintain that the SARB's MPC will not rush to cut the repo rate. Any possible interest rate cuts will likely only materialise towards the end of 2024 and depend on the inflation outlook (locally and abroad) and global interest rate developments as we progress further into this year. Current market sentimen suggests only one interest rate cut of 25 bps this year in SA, possibly two, with the second cut almost fully priced out per our expectations. Over the longer term, we expect the SARB to gradually cut rates from 8.25% to 7.5% through three 0.25% cuts, reflecting the theme of higher interest rates globally.

SA EQUITIES

SA assets continued to underperform their global equivalents on most metrics in 1Q24. For 2Q24, SA equities (as measured by the MSCI SA Index) delivered a negative return of 7.6% vs the MSCI All World Index, which returned a positive 9% in 1Q24. The MSCI SA has underperformed global equities by 40.2% since the end of 2022. For the reasons we outline below, we move to tactically overweight JSE-listed equities with an expected total return of 18% over the next 12 months, relative to global equities at 7% and bonds at 5%.

The market now possesses enough optionality to tactically upweight the JSE, albeit for a post-election rebound.

SA equities' level of underperformance is becoming too difficult to ignore. While several deeper structural issues are unchanged, we see some shorter-term, more technical factors having exacerbated the extent to which local equities have underperformed. The underperformance in 2023 can largely be explained by corporates and investors being caught off guard by the extent of loadshedding and a downturn in certain key export commodities (platinum group metals [PGMs], coal, etc.) coupled with a change in pension fund regulations that allowed a higher proportion of offshore equities to be held by most local equity funds

(resulting in the net selling of billions of dollars of SA equities). However, we believe the JSE's underperformance at the start of 2024 can largely be explained by investor inertia as we approach the upcoming SA general election (29 May 2024), local and international adjustments to interest rate expectations, and the continued negative investor sentiment towards China.

While these factors remain a relevant overhang on the JSE, we believe we are at the point where all of this and more are priced in. The market now possesses enough optionality to tactically upweight the JSE, albeit for a post-election rebound. Our model suggests that should the ANC get between 45% and 50% of the national vote and form a coalition with smaller, more pro-growth parties (our base case), there is the potential for an 18% upside in local equities, primarily led by a rebound in domestic counters (banks, retailers, and local industrials). We see further potential upside should Chinese policymakers increase fiscal stimulus. This would spur a rebound in local equities highly correlated to the Chinese consumer (Naspers, Prosus, Richemont) and the construction sector (basic materials).

Another major influencing factor on the JSE this year has been the rebasing of interest rate expectations locally and abroad. Coming into the year, our base case was for three 25-bp interest rate cuts in 2H24, with further rate cuts in 2025. This expectation anchored our optimism for a rebound in consumer spending and credit performance from the local banking sector, both hamstrung by restrictive monetary policy for the last few years. The increased interest rates have had a far more negative impact on the SA consumer than in the developed world, where consumer spending, particularly in the US, has remained remarkably resilient.

Three months into the new year, the outlook for interest rates has shifted from three cuts to only one 25-bp cut, a significant departure from our view coming into the year. The ramifications of this rebasing of interest rate expectations are profound. One example would be in our local banks, where there is the greatest degree of sensitivity to interest rates. Where we had previously forecast a high likelihood of double-digit earnings growth from SA banks (driven by lower credit impairments), we would now be happy with mid- to upper-single-digit earnings growth. This, coupled with the stubbornly high cost of capital (higher than we had anticipated), meant there had to be a downward revision of earnings and total return for the sector relative to our forecasts in January.

Nevertheless, these changes have been more than priced into SA equities. Our forecasts of total returns from these levels over the next 12 months are conservatively in the mid-teens, driving a significant portion of the index's forecast total return.

We have often lamented the stubbornly high cost of capital and low growth environment being a key reason why investing in a "risk-free" government bond (offering a real return of 6%) makes more sense than taking on the added risk of equities for not much more in terms of a return. What has perhaps changed over the last few months is that SA equities have continued to de-rate relative to other asset classes, and we believe earnings growth expectations have now reached a plateau, with scope for upward revisions from here.

The question then becomes, if valuations are screening extremely cheap on most metrics (in relative and absolute terms, etc.), with a seeming lack of investor interest in SA, what would the catalyst be to drive a rebound on the JSE? We believe a potential catalyst will be a benign outcome in the upcoming general election. Our base case is not b for some sweeping libertarian-type outcome, similar to what we have seen recently in Argentina (things have not reached the same extreme levels of suffering by the majority of the population) and are potentially about to see in Turkey (the current leadership's power seems to be slipping as evidenced by recent sweeping losses in municipal elections).

Our base case is for a continued gradual erosion of power from the ANC, with its share of the vote slipping below 50% and alliances built with smaller, pro-growth parties with the potential to unlock pent-up demand within the economy. This outcome would likely invite parts of the global investor community, currently waiting on the sidelines (taking a cautious approach with the unlikely, yet nuclear, alliance of the ANC with the far-left Economic Freedom Fighters [EFF] party, a significant left-tail threat), to consider SA as an investment option once again.

To reiterate, our call to overweight SA equities will remain tactical (shorter term). Far more concrete pro-growth reforms are needed to get us to take a longer-term, more bullish view on domestic equities. The country and its economy's potential is not questioned; it just requires the right leadership to steer the ship.

SA LISTED PROPERTY

SA property fundamentals declined significantly over the last few years as COVID-19 put pressure on retail rentals and offices emptied. Interest rates subsequently rose sharply, and bottom lines shrank. Share prices tanked, and many SA bellwether property shares are still at prices 50% below their highs. These appear to have bottomed in the last few months, and 1Q24 saw a total return of 3.5% from the FTSE/JSE SA Listed Property Index. This follows a 9.9% increase in December, which accounted for almost all of the 10.1% total return for 2023.

We are projecting a 15% total return for SA-listed property for the next 12 months as conditions improve (off a low property base and a high interest rate base).

SA property still trades at an average 30% discount to net asset value and forward distribution yields of around 11% for local and c. 8% for global portfolios (primarily Central and Eastern Europe [CEE]).

We are projecting a 15% total return for SA-listed property for the next 12 months

Property/REIT share prices are driven by the property fundamentals and the cost of money. Interest rates appear to have peaked globally and in SA, and money will become cheaper in the next 12-18 months. SA property fundamentals are still challenging, but lease reversions in the most challenged sector (office) have declined sharply as a full rent cycle has almost worked its way through post-COVID-19. So, net portfolio growth is returning, and the interest cost will begin to decline towards 2H24. Offshore portfolios are performing better, and growth prospects look reasonable. A reasonable portfolio with a dividend yield of 10% and growth of 5% can be constructed.

Our pick of the property sector is MAS. The share price took a dive when the company announced it would hold back on dividends for two years to fund developments. At a 15% forward distributable income yield, we think the share is worth over 50% more.

DOMESTIC BONDS

South African Government Bonds (SAGBs) recorded a negative 1.8% return at the index level in 1Q24. This follows a strong close to 2023 (when calendar year returns were more than 10% at the index level). Yields closed 1Q24 having increased across the curve, with the R2035 yield (the closest 10-year bond) moving from 11.375% to 12.280% - an increase of 0.905%.

The movement in the curve has been slightly steeper across the quarter, supporting shorter-duration bonds where less of the duration effect is felt and resulting in superior returns for the lower-yielding, shorter SA All Bond Index (ALBI) term splits. The ALBI is holding relatively stable at a duration of approximately 5.5 years – primarily as a result of the large proportion of the index being positioned around the R186 (15% of the index), even as the National Treasury switches this bond out for bonds deeper in the curve (including the R2053, ultra-long-end bond, issued at the end of 1Q24 and now a material part of the index at 1.5%).

The US Fed and the SARB MPC opened the year with unexpectedly bearish statements on interest rates. These statements followed stronger-than-expected economic data prints (for consumption and employment, more specifically) and higher-than-expected inflation prints. The SARB MPC has also been pushing for a downward revision of the CPI target (currently a range of 3%-6%, with the midpoint being 4.5%). With CPI prints persistently approximately 1% above this target, the SARB has not indicated any appetite for rate cuts. The forward rate agreement (FRA) market reacted over the quarter, with expectations at the start of 2024 for 75 bps of rate cuts becoming an expectation of only one rate cut (of 25 bps) for the year.

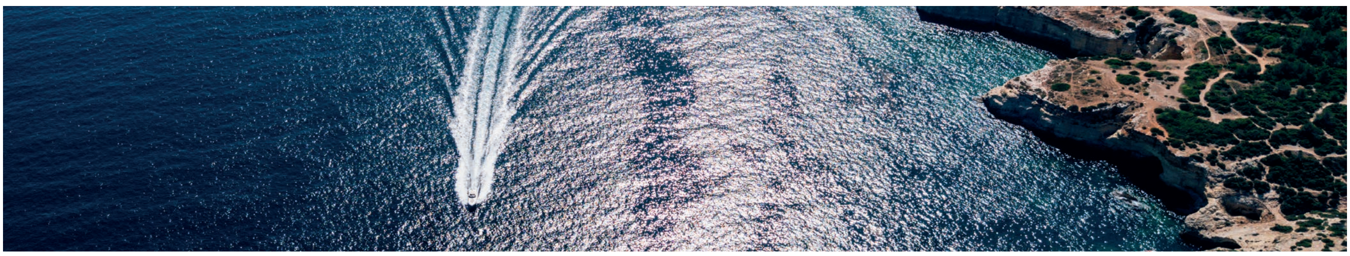
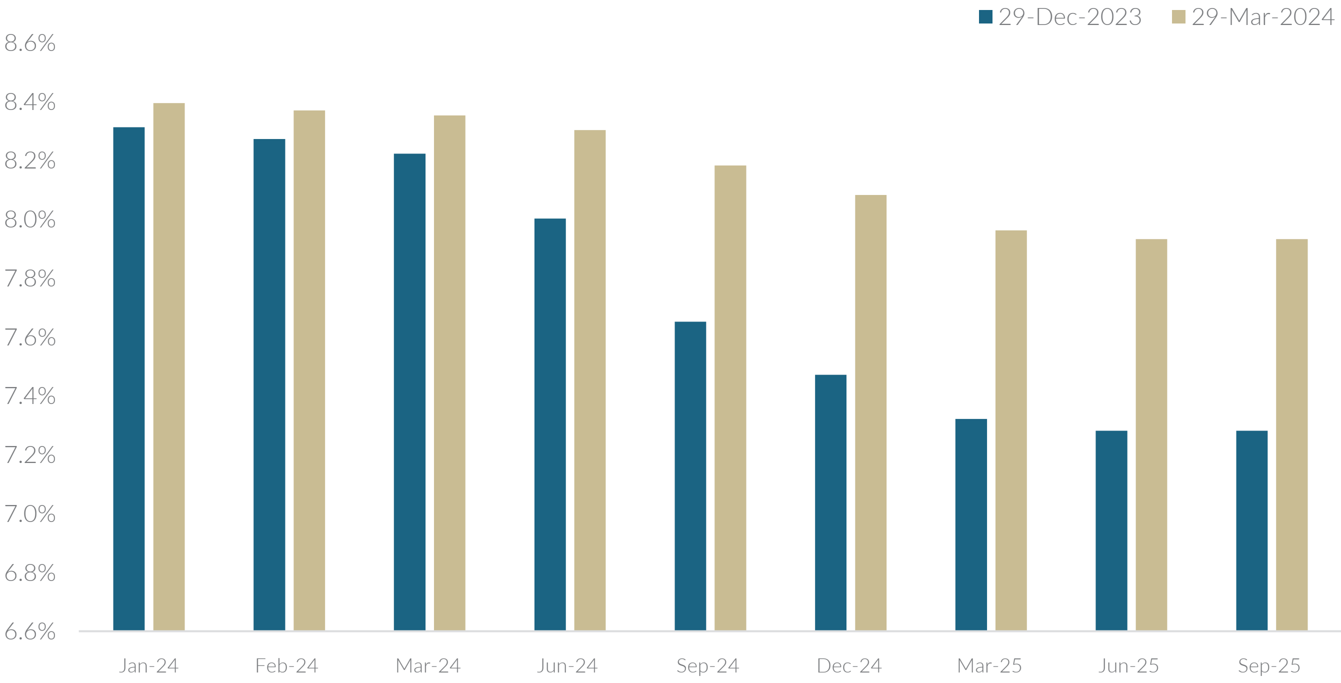


Figure 1: Expected 3-month JIBAR YE24 vs 1Q24



Source: Anchor, National Treasury

At YE23, we stated Anchor's expectation that rates would be stable for 1H24 with a gradual rate-cutting cycle after that. This view is unchanged - we expect two rate cuts in 2H24, with the risk to our view being on the downside (i.e., the higher likelihood of one rate cut rather than three).

With the date of SA's general election confirmed for 29 May 2024 and the US presidential election cycle now a confirmed repeat (as far as presidential candidates – former US President Trump is yet to confirm his running mate), the markets domestically and globally are likely to remain slightly biased towards fear rather than optimism. The US election is currently priced with a small (sub-5%) betting lead for the Republican Party. SA election polling has shown expectations of a decline in ANC support, with the most benign being a 3%-5% drop (in line with the decrease in support the ANC recorded in the 2019 election). The more aggressive polls show that the ANC could lose its Parliamentary majority (an implied 8% drop in support from 2019 levels). The latter outcome would mean a coalition at the national government level. Given the ANC's dominance of party politics at the government level since 1994's dawn of democracy, this would be a watershed moment for the country. Some polls even show that ANC support is dropping nationally to the low 40% level. This would likely require a near-complete collapse in party support in KZN (where the ANC received 54% of the vote in 2019) and Gauteng (just over 50% of the vote in 2019) provinces.

We expect two rate cuts in 2H24, with the risk to our view being on the downside ...

The risk of this outcome would be that the ANC would need to find multiple larger parties and offer concessions, potentially setting up an unstable national governing coalition. In other scenarios, the ANC can retain control with smaller partners and thus smaller concessions without any coalition.

With the domestic bond sell-off during March resulting in bonds being oversold, we have positioned ourselves for a longer duration going into 2Q24. We view current bond levels as unsustainably cheap and attractive at any entry point to the curve. Still, we retain our bias towards the belly of the curve but have lengthened the duration of the funds across the board, with the Anchor Bond Fund duration now sitting at just under six years vs an index duration of just over 5.5 years. We remain neutrally disposed towards the prospects of domestic bonds as the attractive yield draws attention from investors domestically and abroad. One might, however, argue that the yields are attractive with good reason, as the risks in SA remain high, notwithstanding our expectations of more benign outcomes.

THE RAND

The rand weakened during 1Q24 as investors pared back their expectations for an interest rate cut. We had expected the rand to trade around R19.00/US$1 for much of the quarter, which appears to have been correct. Looking forward, we think the rand's prospects have improved slightly, and we see it trading in the range of R18.00-R19.00/US$1 for 2Q24.

Projecting the rand's value in a year's time is a fool's errand. This is because the rand vs US dollar exchange rate is one of the world's most volatile currency pairs and trades well away from any modelled fair value for long periods. We note, however, that the rand trades within a R2.50 range to the US dollar in most 12-month periods.

The indicators for the rand's fair value have reversed course, and slight green shoots of improvement are evident. The general sentiment is that loadshedding will dissipate, allowing the economy to grow at 1.2% this year - still a paltry growth rate but an improvement on the recent past. We are hopeful that the focus on electricity generation and improved logistics will bear some fruit for our economy. Global EMs have been trading poorly for the last few years, and we see some scope for the broader outlook to improve, giving a little more support to the rand. Coupled with what is most likely a benign election outcome in SA, we think a relief rally for the rand might be on the cards. In the context of the very gradual interest rate cutting cycle, domestically and abroad, we do not anticipate a strong movement in the local unit but rather a currency that trades with a positive backdrop for a period.

We retain our purchasing power parity (PPP) based model to estimate the rand's fair value. We have extended this by three months since ***The Navigator – Anchor's Strategy and Asset Allocation, 1Q24*** report was published on 22 January 2024. Over our forecast period, we expect inflation abroad to come under control and return towards more normalised levels. This means that our PPP model shows an increasing propensity for long-term rand weakness from next year again. As a result, our PPP-modelled value for the rand vs US dollar at the end of the next 12 months is R14.74/US$1 (see *Figure 2*). We apply a R2.00 range around this to get to a modelled fair-value range between R13.74/US$1 and R15.74/US$1.

The domestic and global backdrop means we start with the rand meaningfully weaker than our modelled fair-value range. In previous cycles, US dollar strength has tended to dissipate (and reverse) toward the end of the US rate-hiking cycle. Current indications are that the US Fed will start cutting in June 2024 (or later), meaning that we expect to see currency normalisation, with the US dollar giving up some of its gains in the latter part of the year. However, we do not expect the currency to recover fully, and we are projecting a rand in the R18.00-R19.00/US$1 range in one year as domestic issues continue to weigh the rand down. For this report, we have modelled on R18.50/US$1.

We expect the rand to remain particularly volatile, and surprises are certain in the year ahead.

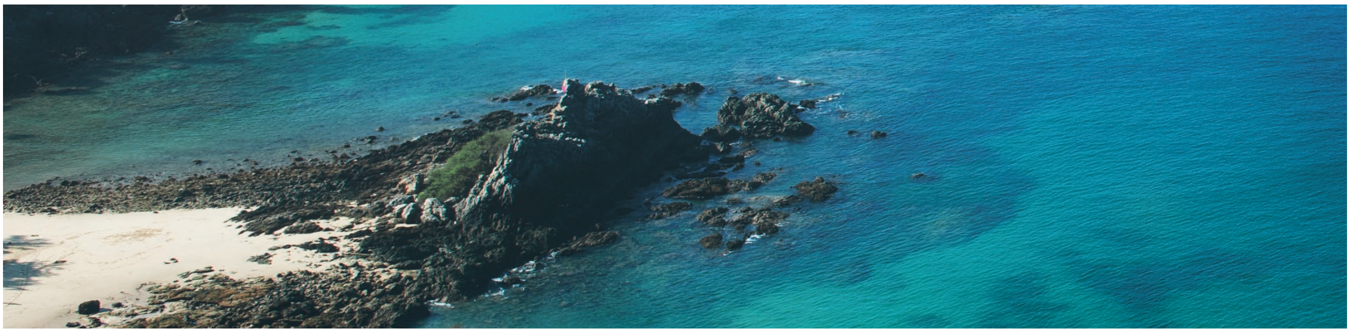
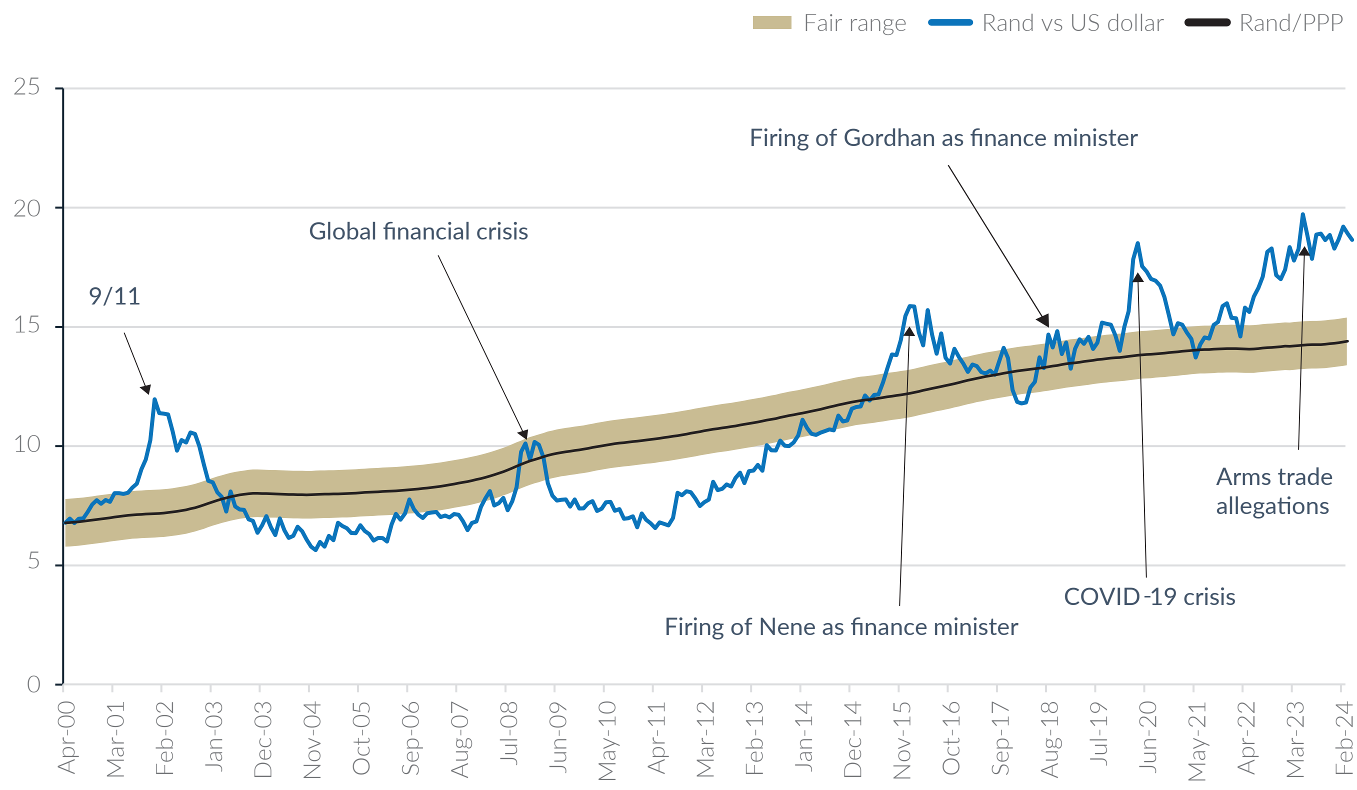


Figure 2: Actual rand/US dollar exchange rate vs rand PPP model



Source: Thomson Reuters, Anchor

GLOBAL EQUITIES

We are bullish on equity markets on a two-year view, but the recent strong global equity markets performance has increased the risk of a correction in the shorter term. For long-term investors, we hold our quality positions.

Global equity markets delivered a robust performance in 1Q24, with DMs up 9% on average (following a 24% return in 2023). This is well ahead of almost all big investment bank forecasts, and high valuations need to be sustained to maintain a bullish stance for the next 12 months.

The S&P 500 Index's forward P/E of 21x is meaningfully ahead of the 15-year average of 16.5x. However, the Magnificent Six tech companies (Apple, Microsoft, Nvidia, Amazon, Alphabet, Meta Platforms) inflate this number, and there is still reasonable value in the 494 companies below the "big tech guys."

We had a good deal of healthy debate in concluding what global returns to project over the next 12 months. This is often the case in bull markets - when the fundamentals look very supportive of equity markets, but a lot seem to be "priced in". Shares are seldom cheap when the future looks promising. We are very cognisant of valuations in our investment process, and this limits our return projection to 7%, a little lower than the long-term average.

The message sent by the US Fed is key to market performance.

Conditions for strong equity performance are favourable for the medium term as inflation declines, central banks begin cutting rates (from very high levels), and medium-term US earnings growth is sustained in double digits. Equity markets tend to do well when earnings growth is strong and accelerating.

The message sent by the US Fed is key to market performance. US interest rates are now at historically high levels

(5.25% from zero only 24 months ago), and expectations of interest rate cuts this year have declined from six cuts to three (which equates to 1.5% of cuts vs 0.75%). This is because the decline in inflation has stalled somewhat, and the economy has remained much stronger than anticipated. In other words, the Fed does not feel compelled to cut rates to avoid a recession. This is good news; at this stage, it appears that the management of the interest rate cycle has been exceptional. Economy doomsayers have been confounded, and strong government expenditure has aided this process. If the economy does slow down, the Fed has plenty of ammunition to provide interest rate support.

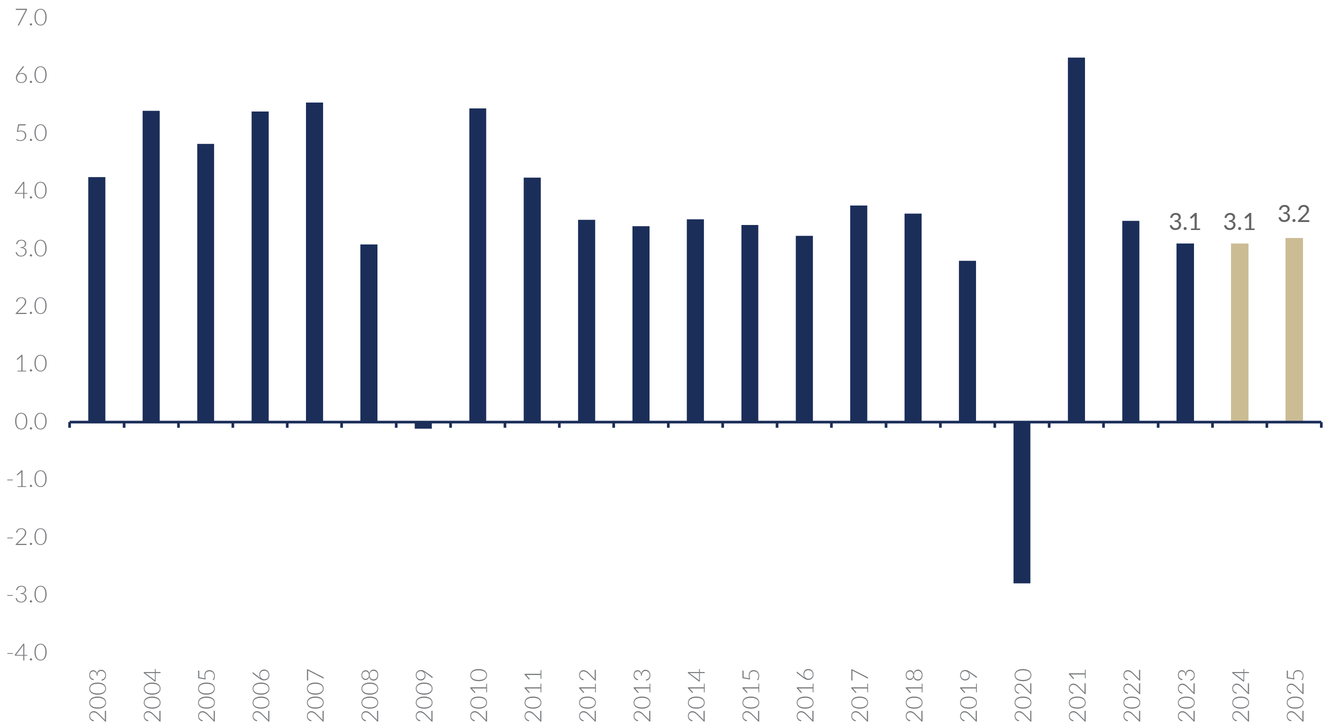
Equity alternatives are considerably more attractive than they have been for the past decade ...

Expectations are for a strong earnings outcome, which is reflected in market performance and levels. Since October 2023, markets have been on an unrelenting march upwards. This means that the risks of a correction are higher, and any disappointments could be very negative for specific shares. We have seen some evidence of this of late in consumer-oriented US companies. The market could be especially sensitive to inflation reports and earnings performance in the coming months. Therefore, stock selection becomes especially important.

Equity alternatives are considerably more attractive than they have been for the past decade, with money market funds offering a 5%-plus return in US dollar terms and US 10-year treasuries trading at yields over 4.3%. If you are prepared to give up some liquidity or take a little more credit risk, 6%-9% yields are available. In our alternative investment offering, we are targeting double-digit, US dollar-denominated returns. Higher rates also mean that the high dividend yield shares in the US have become relatively less attractive, as a 5% dividend yield is not what it used to be if I can get 5% "in the bank".

The economic reality shown in the chart below indicates reasonable and accelerating global GDP growth. US GDP growth has surprised in 2023 and looks set to register around 2.4% for 2024; many were forecasting a recession this year, but strong US national and local government spending has provided a big boost.

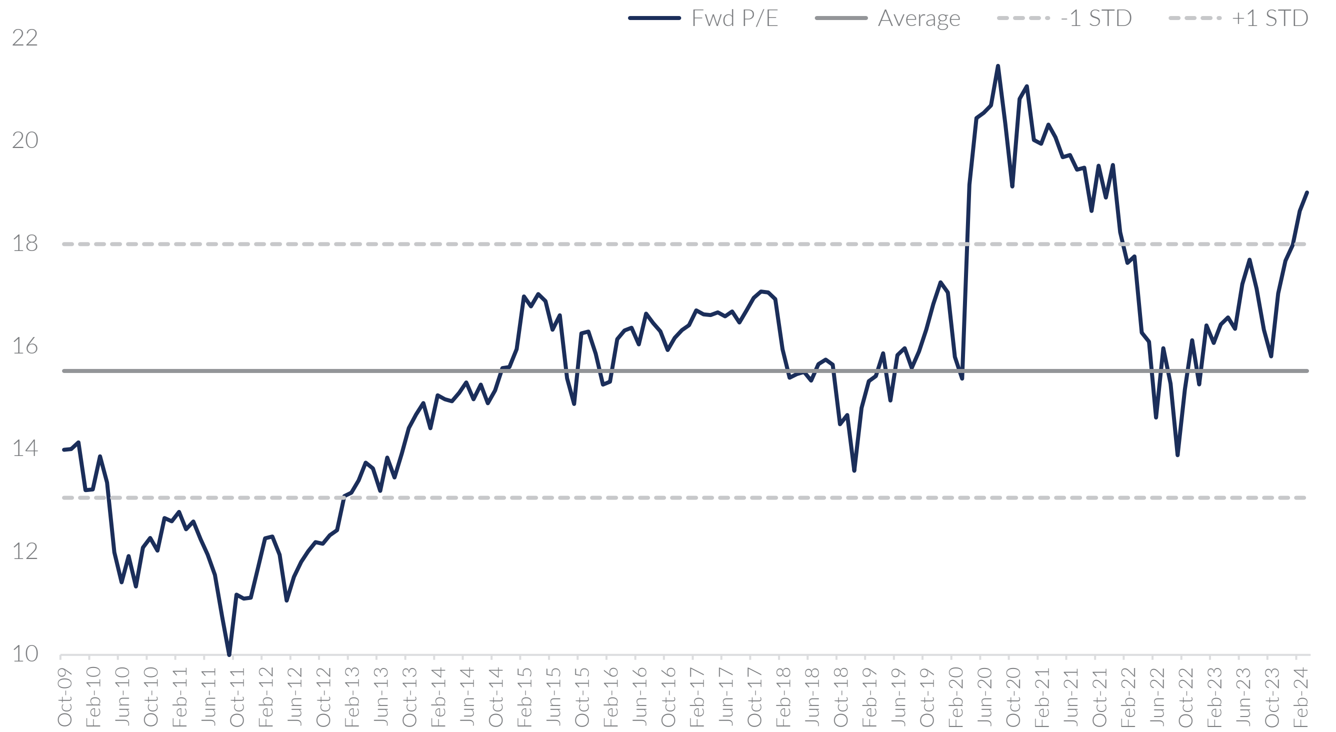
Figure 3: Global GDP growth, YoY % change



Source: Anchor, IMF

Valuations at the index level in global DMs look full (MSCI World forward P/E of 18.4x).

Figure 4: MSCI World Index forward P/E, x



Source: Anchor, Bloomberg

The most important determinant of markets is earnings, which have proved resilient in the face of higher interest rates. While many companies have been negatively impacted, those that have been able to pass on the inflation pressures have flourished. In 2023, US earnings growth recorded a 1% decline. However, double-digit US dollar earnings growth should resume in 2024 and beyond, which is positive for equities. Declining interest rates and increasing earnings are a positive concoction when one looks further out to 2H24 and beyond.

Figure 5: S&P 500 EPS growth (annualised)

Source: Anchor, Bloomberg

The S&P 500 Index forward P/E is 20.8x (*see table below*). Multiples often increase when earnings dip as long as the future outlook is more positive. EMs are much cheaper and have strong recovery potential.

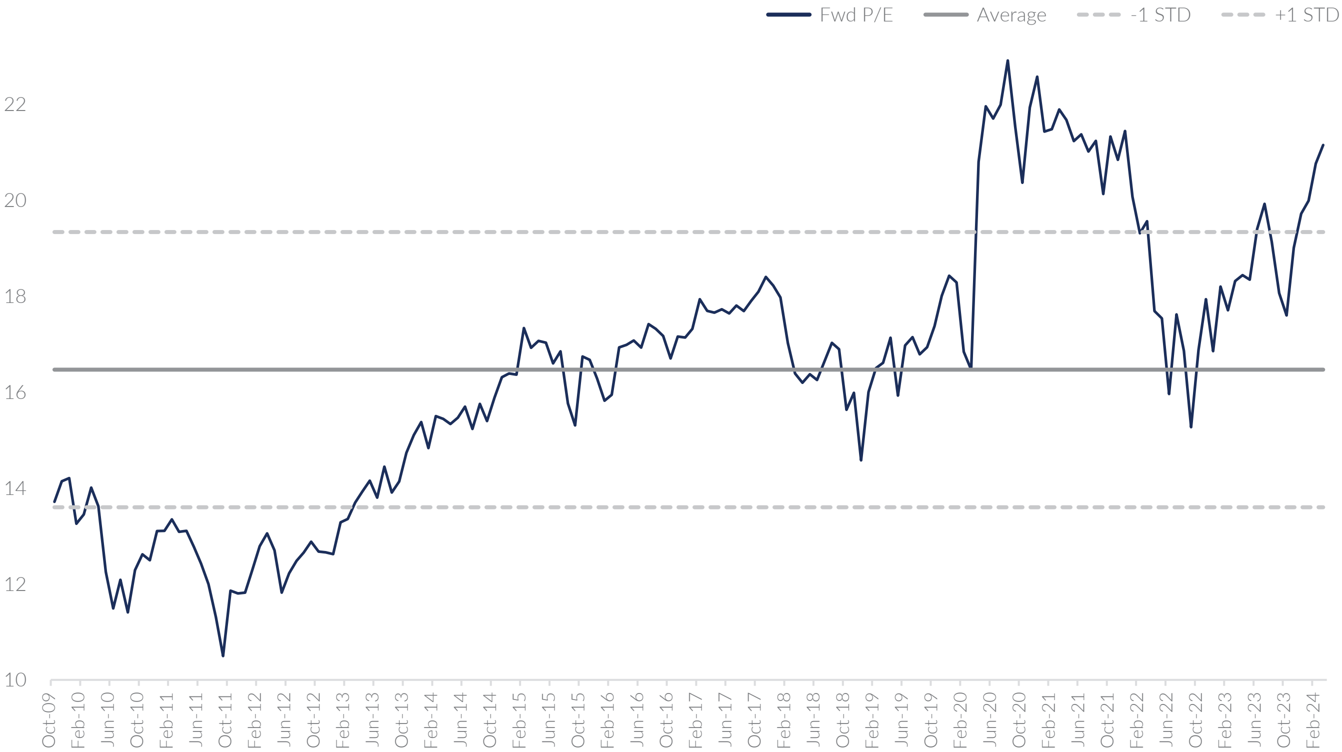
Figure 6: Various major global indices' EPS growth and forward P/E forecasts

	Earnings growth		FWD P/E	
Name	**YR1**	**YR2**	**YR1**	**YR2**
MSCI World Index	7.7%	11.0%	18.4	16.6
MSCI EM Index	21.4%	17.9%	12.0	10.2
MSCI All Country World Index (10% EM)	9.5%	11.9%	17.5	15.6
S&P 500 Index (ex-Energy)	12.4%	10.8%	21.4	19.3
S&P 500 Index	11.6%	10.6%	20.8	18.8

Source: Anchor, Bloomberg

Figure 6 is shown graphically in the charts on the next page.

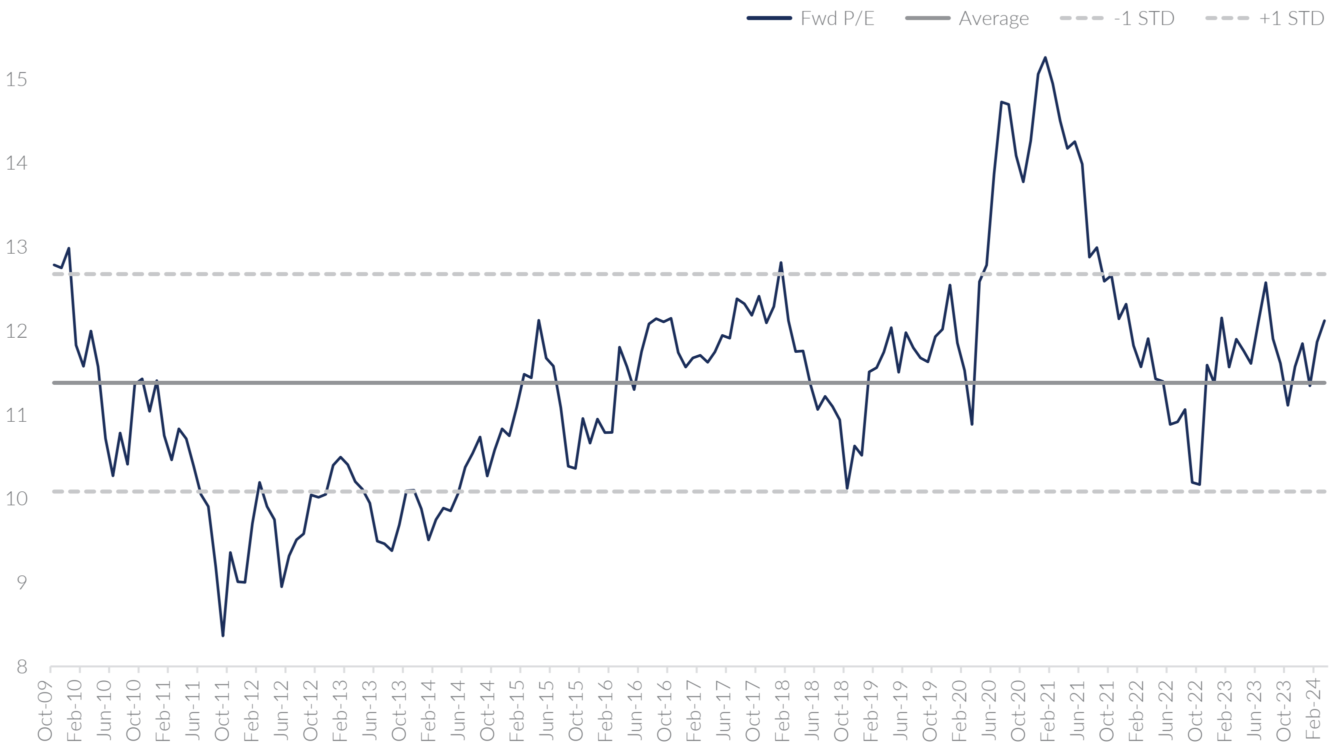
Figure 7: S&P 500 Index forward P/E, x



Source: Anchor, Bloomberg

EMs have started to look interesting recently as global investors look for value. The Chinese market has begun to show some green shoots after being considered uninvestable a year ago. As a result, some of the best companies in the world are trading in single-digit P/E multiples – a stark contrast to the US. EM valuations are cheap, and a shift in sentiment could potentially lead to a sharp short-term rise. An exciting opportunity is the Chinese AI shares, which have not shared the same positive reaction to the rapidly evolving future. This is despite many of these shares having invested heavily in this space in the past decade.

Figure 8: MSCI EM Index forward P/E, x



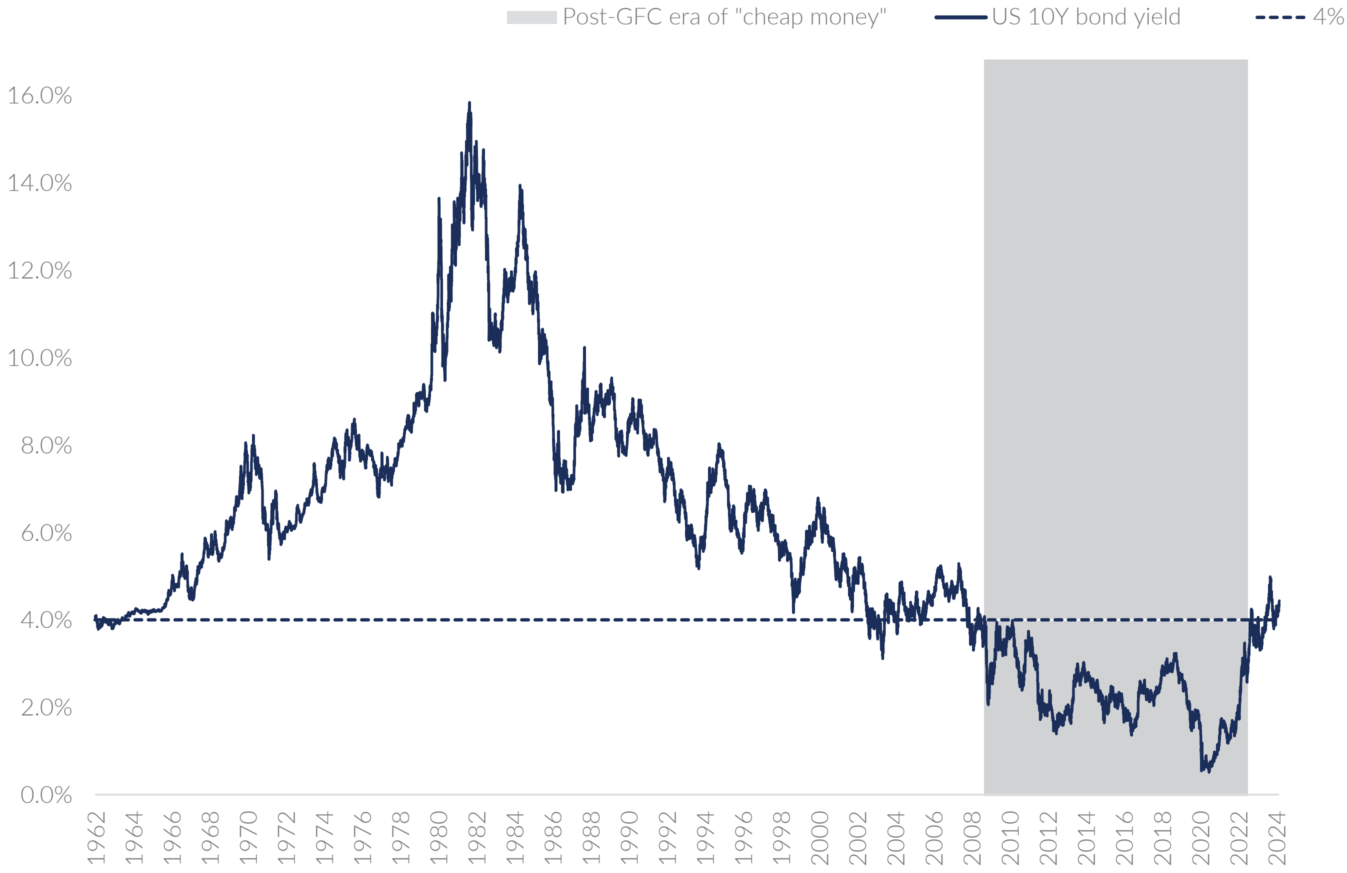
Source: Anchor, Bloomberg

GLOBAL BONDS

Since mid-2023, US 10-year bond yields have spent c. 80% of the time above 4% …

In the 50 years leading up to the 2008 global financial crisis (GFC), rates on US 10-year government bonds were above 4% for all but a few months. The GFC forced the US Fed into some extreme monetary easing that included slashing rates to zero and purchasing trillions of dollars of US government bonds, resulting in 14 years with extraordinarily low borrowing rates (the US 10-year bond yield averaged and Russian invasion of Ukraine caused an inflationary shock that pushed US inflation to 40-year highs and forced a re-think of whether the post-GFC era of cheap money was sustainable. Since mid-2023, US 10-year bond yields have spent c. 80% of the time above 4%, and we think this is probably a level that investors will need to start getting used to again as we exit the post-GFC period of unusually cheap borrowing rates.

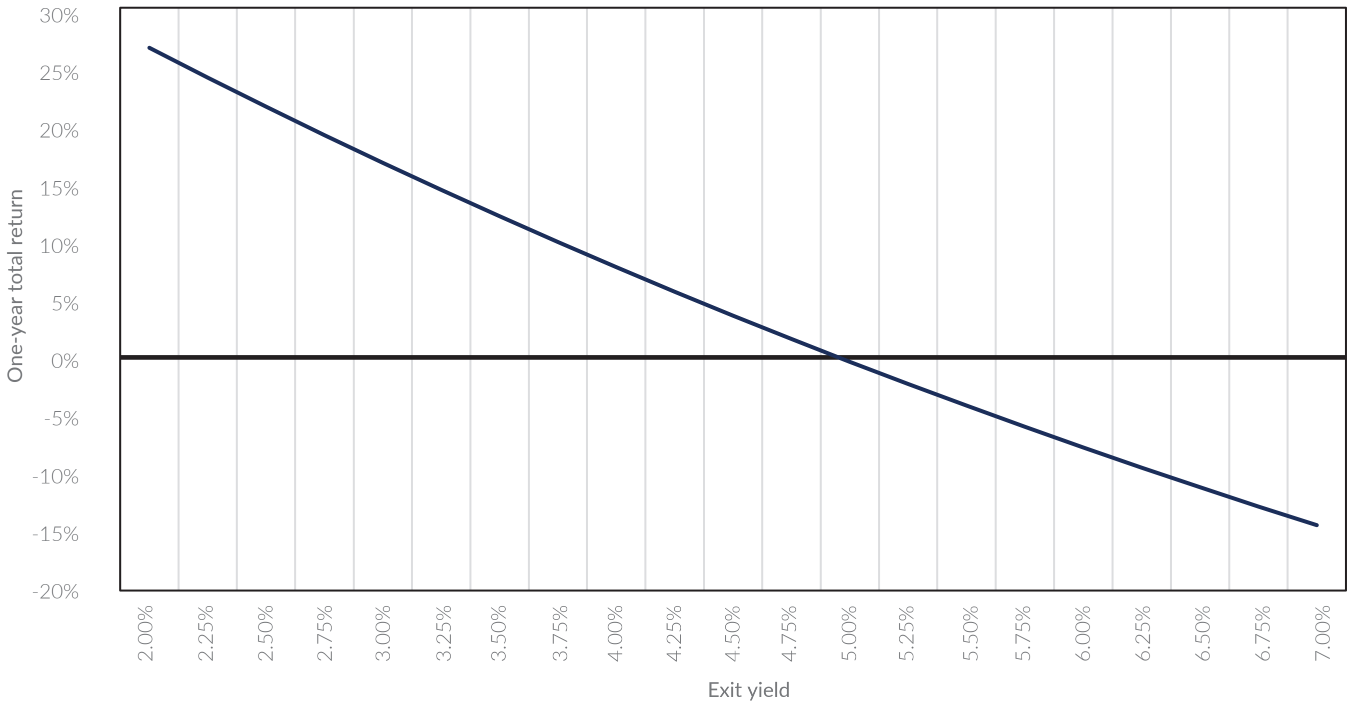
Figure 9: US 10-year bond yields have sustainably exited the post-GFC "cheap money" era



Source: Bloomberg, Anchor

The prospect of earning c. 4% on US 10-year government bonds is unlikely to result in a flood of investors rushing into the asset class. However, it gives risk-averse investors a positive real return (at least on a pre-tax basis). The math that underpins the total return which fixed-rate bond investors achieve on their investments now suggests that with a one-year investment horizon, the realistic outcomes are slightly positively skewed, as one would expect in a conservative investment option. Our assumption that US 10-year government bond yields will hover around the 4% to 4.5% level for the foreseeable future suggests that investors will likely achieve a c. 5% total return in US dollar terms over the next twelve months when investing in 10-year US government bonds.

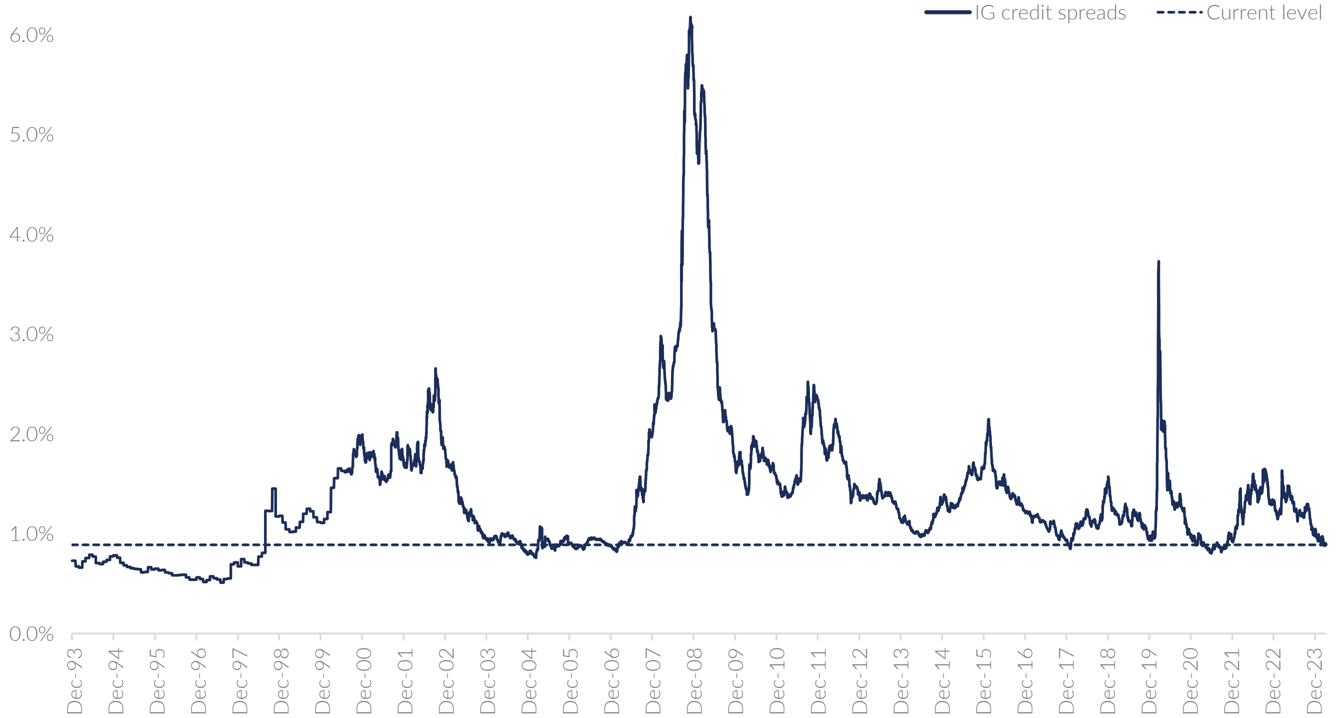
Figure 10: The range of potential one-year total return outcomes for US 10-year government bond investors are slightly positively skewed from the current purchase price, as expected in a conservative investment option



Source: Anchor

While US 10-year bond yields seem fairly valued, the premium investors demand for lending to investment-grade corporate borrowers relative to the US government's borrowing rate has rarely been lower.

Figure 11: The pickup in yields that investors achieve when lending to investment-grade borrowers has rarely been lower than the current level



Source: Anchor, Bloomberg

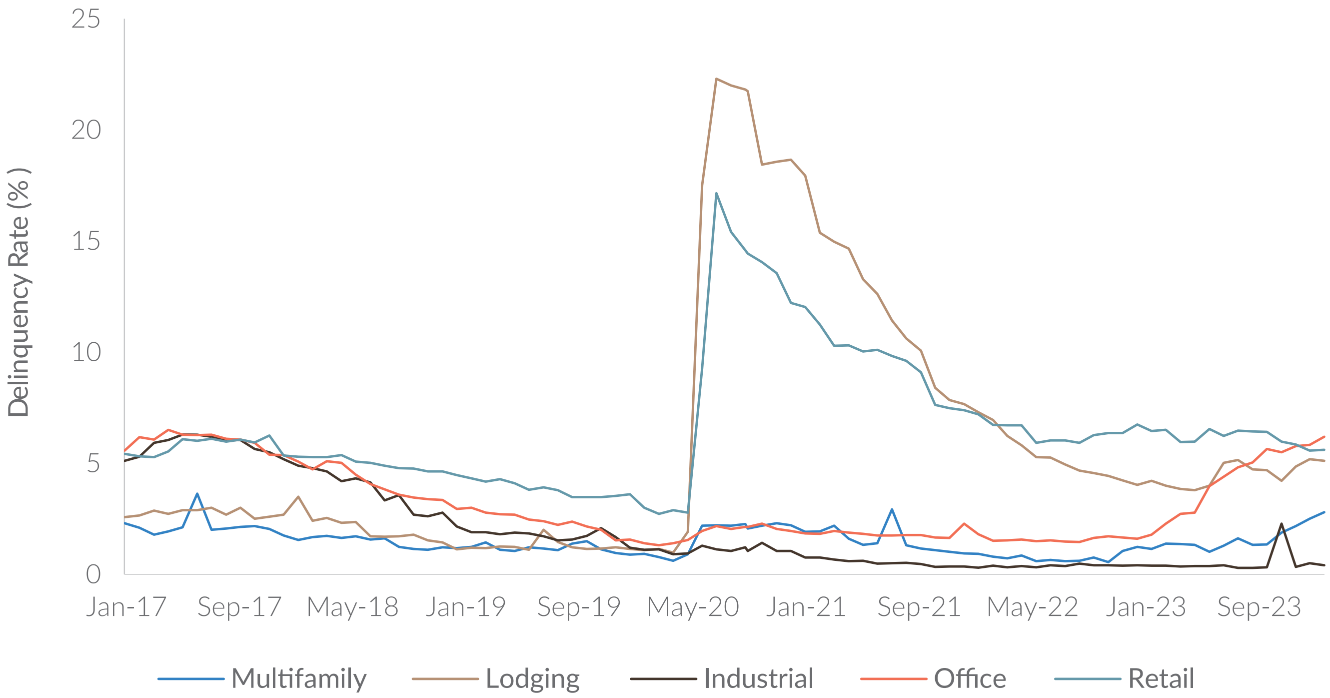
This leaves investors in US investment-grade credit with limited potential for capital gains from tightening credit spreads. However, the fundamentals of these borrows are generally reasonably solid, and the economic conditions are likely to remain relatively benign, leaving limited prospects of material capital losses. The most likely one-year total return outcome for US investment-grade corporate bond investors will likely come predominantly from income of c. 5.5% p.a.

GLOBAL PROPERTY

Global listed property struggled in 1Q24 (-1.8% QoQ) as investors digested the prospect of interest rates staying "higher-for-longer". Added to the rate headwinds faced by listed property was a resurfacing of concerns about delinquencies on commercial real estate (CRE) debt at US regional banks. However, we note that these rising delinquencies seem to be limited to office and multifamily residential properties and, as such, present a reduced likelihood of becoming a systemic challenge for the asset class.

Global REIT dividend yields have also yet to meaningfully adjust to a world of higher rates ....

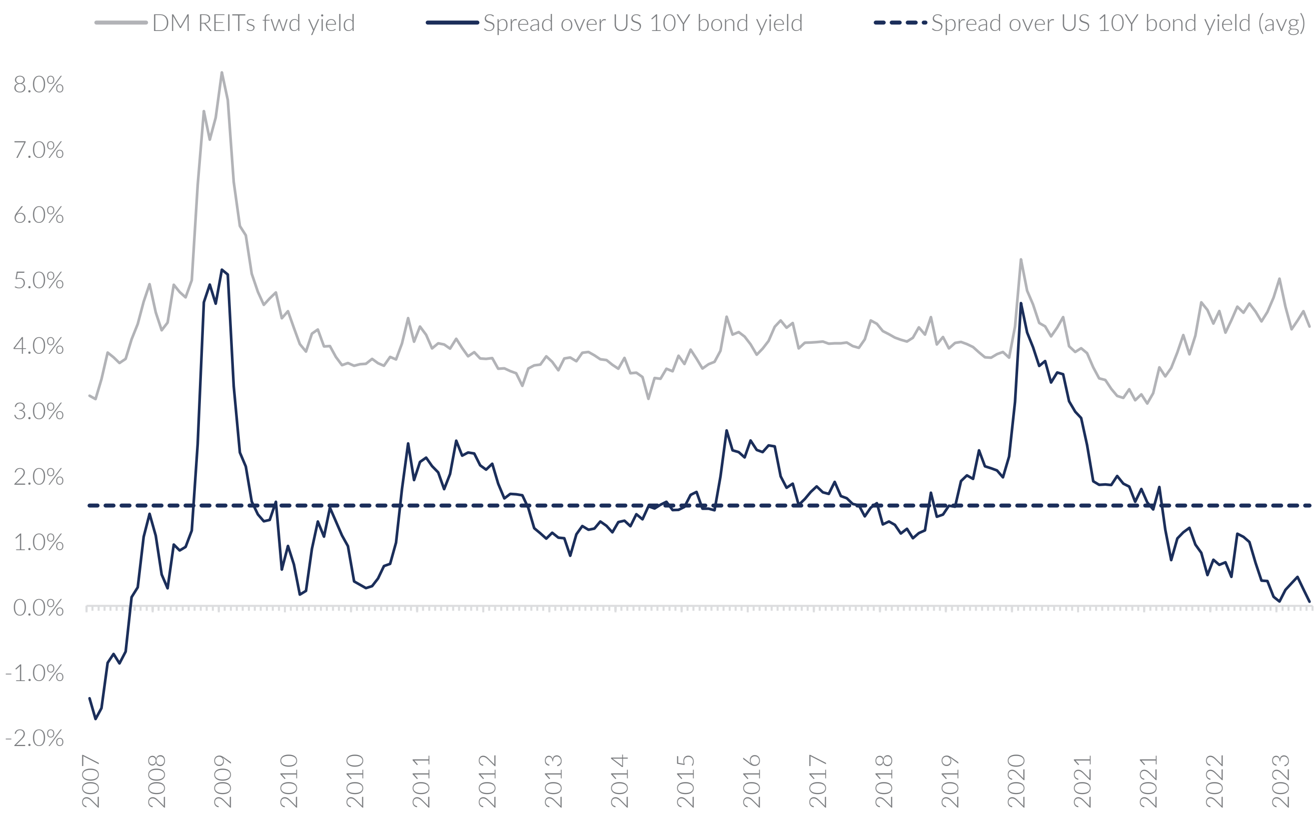
Figure 12: US CRE loan delinquencies are picking up but seem to be limited to the office and multifamily residential sectors



Source: Bloomberg, NY Fed, UBS

The narrative of rates staying higher-for-longer and the prospect of increasing CRE loan delinquencies stifling lending conditions make it seem unrealistic to anticipate a meaningful re-rating in the asset class, despite valuations appearing somewhat depressed for the sector. Global real estate investment trust (REIT) dividend yields have also yet to meaningfully adjust to a world of higher rates, suggesting that the current valuations are perhaps more realistic in a world of generally higher interest rates.

Figure 13: Dividend yields on global REITs have seen their premium relative to US 10-year government bonds erode over the past couple of years



Source: Anchor, Bloomberg

Analysts have pencilled in slightly below-average earnings growth for the sector of c. 3.1% for 2024. This, combined with a c. 4% dividend yield and our expectation for a small de-rating, will result in a total return of c. 6% in US dollar terms over the next twelve months.

ANCHOR **INSIGHTS**

In this section of the Navigator, staff across Anchor provide insights into our thinking, strategy, and world-view. This quarter, David Gibb delves into US tech's growing battle with regulators, Casey Sprake and Thomas Hendricks take a deep dive into the US 10-Year Treasury, Henning Holtzhausen asks whether investors should wait for the rand to strengthen before taking their money offshore, James Bennett discusses Ferrari, a luxury car brand like no other, Lee Cairns provides insights into the impact of COVID-19 on the cost of life insurance, and, finally, Di Haiden and Kate Trollip explain what 'situs' means and why it is important to know what tax will apply to your offshore assets.

US Tech's Growing Battle With Regulators

WRITTEN BY:
David Gibb
Fund Management

David has managed the Anchor Worldwide Flexible Fund since its inception in May 2013 and the Anchor Global Technology Fund since its inception in June 2019. He joined the investment industry in 1994 as an equity analyst at LIBAM. David has a BSc (Med) degree from UCT and is a CA (SA) and CFA charterholder.

There are now too many major lawsuits against the US technology (tech) giants to ignore. The US tech industry is facing more and more legal cases that allege Apple, Google, Amazon, and Meta are involved in anti-competitive activities that violate US antitrust statutes. These four companies, together with Microsoft and Nvidia, both subject to prior antitrust cases, represent c. 28% of the S&P 500 Index. The 'Big 6' are hugely profitable, with profit margins more than double that of the remaining S&P 500 Index companies (21.6% vs 10.6%, respectively). The P/E multiple of the Big 6 - a rough guide to how these companies are priced – is also higher than the rest of the market. It is important to have some understanding of how these lawsuits may pan out.

US antitrust laws are designed to protect competition. These laws, which some have described as sparse, succinct, and vague, fall under three core provisions - Sections 1 and 2 of the Sherman Act and Section 7 of the Clayton Act. Section 1 of the Sherman Act prohibits contracts 'in restraint of trade' which typically harm competition – think 'cartels, tying arrangements, exclusive dealing'. Section 2 prohibits 'unilateral anticompetitive conduct by dominant firms' - think monopolies. Section 7 of the Clayton Act prohibits mergers and acquisitions (M&As) that threaten 'substantially to lessen competition, or to tend to create a monopoly'.

Most of the allegations against the Big 6 relate to Section 2, some refer to Section 1, while the Instagram/WhatsApp suit against Meta also includes Section 7 of the Clayton Act.

As Herbert Hovenkamp, an antitrust expert and professor at Penn Law School, points out, if you try to prove market dominance under Section 2 of the Sherman Act, market power attaches to products, not firms. For example, he notes that Microsoft has market power in PC operating systems of 60%-70%, but its Bing product has a single-digit share of the search market. In the suit against Amazon, another Section 2, he believes it may be difficult, and very costly, to prove market power because Amazon's e-commerce business sells millions of different products.

US antitrust laws are designed to protect competition.

Below, we discuss some notable cases against the Big 6 tech firms. Our focus is on those filed in the US by either the Department of Justice (DoJ) or the Federal Trade Commission (FTC), both of which enforce federal antitrust laws. The DoJ has oversight of Apple and Google, while the FTC has oversight of Meta and Amazon. Although the FTC pursued the Activision Blizzard case, the DoJ has traditionally handled cases involving Microsoft. We also refer to regulation in the EU, specifically the recently introduced Digital Markets Act (DMA). We have not discussed lawsuits filed in other jurisdictions.

APPLE

Notable cases

1) In March 2024, the US DoJ launched a major case against Apple for *'monopolization or attempted monopolization of smartphone markets in violation of Section 2 of the Sherman Act'*. The essence of the case is that through Apple's actions, consumers are forced to pay more and end up having fewer choices. Apple is alleged to have '*maintained monopoly power in the smartphone market, not simply by staying ahead of the competition on the merits, but by violating federal antitrust law'*. The DoJ says that Apple has a 65% market share of the US smartphone market and 70% of premium smartphones.

Having avoided major antitrust activity for years, Apple has called the lawsuit 'wrong on the facts and on the law'. The company will likely respond by saying it only has a 20% share of the global smartphone market. It will also say it maintains a walled garden in the Apple ecosystem to improve the customer experience and security of the devices and to protect the privacy of its more than 100mn US users. This argument won out in the 2020 Epic Games case when Epic unsuccessfully sued Apple for operating an alleged illegal monopoly via the App Store.

The initial feedback from legal experts is that although the DoJ has learned valuable lessons from the 2020 Epic Games case, Apple has case law on its side, and the company's emphasis on the security and privacy benefits of its walled garden may win out. Proving a smartphone monopoly may also be difficult if the judge focuses on the global smartphone market - not just the US.

This lawsuit will take years before reaching court.

In the EU, Apple's App Store is in the crosshairs of the European Commission and the recently launched DMA. The DMA was introduced to limit the powers of the six largest online platforms (known as 'gatekeepers') by opening them up and forcing greater user choice. To comply with the DMA, Apple has already ceded ground by allowing sideloading (where apps are downloaded directly from developer's websites or competing app stores), albeit at a fee of EUR0.5/download after the first 1mn each year. Developers are unhappy with this. EU regulators are expected to investigate whether Apple has gone far enough in complying with the DMA. The company is attracting far more scrutiny and drawing more outrage than the other gatekeepers in dealing with the DMA. We note that Apple's App Store is estimated to have generated US$27bn in commissions in 2023. A portion of this revenue is now being threatened.

In March, the EU also fined Apple EUR1.8bn for stifling competition in music streaming.

However, Apple's biggest immediate risk is the DoJ's case against Google (*see below*). Google is estimated to pay Apple c. US$20bn p.a. to be the default search engine on Apple devices, a practice that the DoJ deems anti-competitive. This is roughly 5% of Apple's revenue. Judgement is expected in the next few months.

Alphabet

ALPHABET

Notable cases

The DoJ has launched two major cases against Alphabet's online advertising arm, Google.

1) In October 2020, the DoJ sued Google for *'unlawfully maintaining monopolies through anti-competitive and exclusionary practices in the search and search advertising markets.'* The essence of this case is that Google has a range of agreements with mobile and PC companies like Apple to be the preset, default general search engine on billions of devices. The DoJ lawsuit, regarded as the most important antitrust action since AT&T in 1974 and Microsoft in 1998, went to trial in late 2023. We expect final arguments in May 2024, after which Judge Amit Mehta, from Washington DC, will rule.

   In November 2023, Google's lawyer 'visibly cringed' when one of its testifiers disclosed that Google had paid US$26.3bn in 2021 alone to be the default search engine on various browsers, with US$18bn of this paid to Apple. This represented about one-quarter of Apple's services revenues in 2021 (5% of total Apple revenues). The press typically assumes the payment to Apple is now c. US$20bn p.a.

   Hovenkamp from Penn Law School believes the judge *'will find a way to condemn the large payments Google makes to Apple and others.'*

   'If the payments are eliminated, that means device makers like Apple are going to have to decide what they want to do. One option is they continue right on using Google as a default, except they're not getting paid for it anymore. Another option is they put in a choice screen, which is what happens in the EU. The third one, which I don't expect to happen, is that Apple will try to develop its own search engine.'

   Whatever the verdict in this case, either Google or the DoJ will appeal it. The appeal process will probably be exhausted by mid-2026.

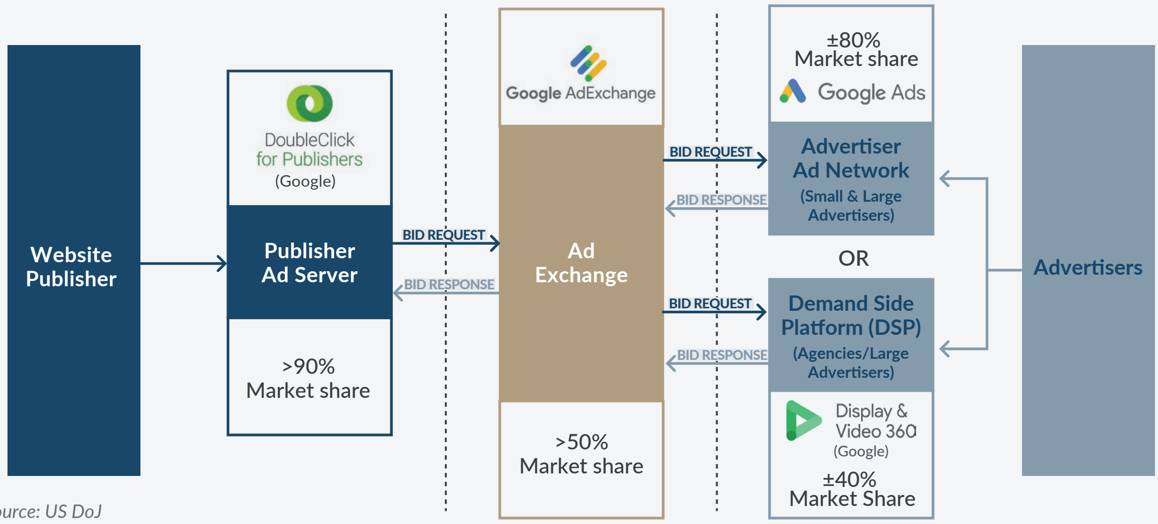
2) In January 2023, the DoJ sued Google *'for monopolizing multiple digital advertising products in violation of section 1 and 2 of the Sherman Act'*. This refers to the ad-tech stack that website publishers depend on to sell ads and advertisers rely on to buy ads and reach potential customers. Figure 1 below shows Google's market shares in each segment of the ad-tech stack. Note that in April 2023, the judge in this case denied Google's request to dismiss the case.

   The DoJ surprised some legal experts by going as far as asking for the unwinding of some prior Google acquisitions like ad-serving Google Ad Manager - formerly DoubleClick - (>90% market share) and called for the divestment of its ad exchange (>=50% market share). In 2022, Google offered to (to avoid this lawsuit) split off some ad tech businesses and place them under the Alphabet umbrella - but the DoJ was not interested. In the final lawsuit, the DoJ included a quote from a Google executive comparing the company's control over ad tech to the financial sector: *'The analogy would be if Goldman or Citibank owned the New York Stock Exchange.'*

   Legal experts believe that Google is vulnerable in this case and may well lose. Its market share is high, and its power over buyers and sellers of advertising in the ad tech stack is unhealthy and ripe for manipulation. Other regulators are also having a look – in the UK and the EU, and in a similar antitrust case in France, Google settled by paying a fine.

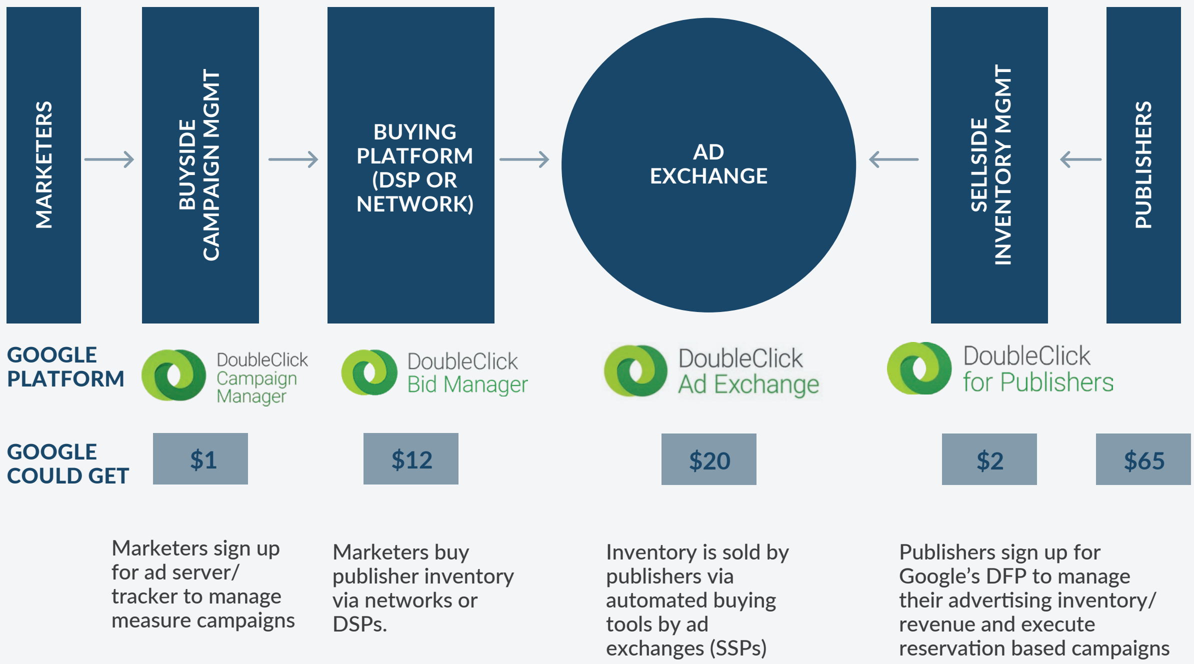
   How big is this area for Google? Although advertising accounts for c. 77% of Alphabet's revenues, this lawsuit only targets a portion of this – ad-brokering activity on third-party websites. This falls under Google Members' revenue on the income statement, representing US$31.3bn in 2023, or 10.2% of Alphabet (down from 12.3% of revenues in 2021). The DoJ claims Google keeps at least USc30 out of each advertising dollar that flows through this ad tech stack. However, this is at lower margins than the core search business, which means that any changes that are made to Google's ad tech stack would probably only be a glancing blow to Alphabet.

Figure 1: The digital advertising market - Google's market shares in each segment of the ad-tech stack



Source: US DoJ

Figure 2: Example of a marketer spending US$100 on display advertising



Source: US DoJ

AMAZON

Notable cases

1) In September 2023, the FTC sued Amazon, claiming that the online retail and tech company is a monopolist that maintains its monopoly by illegally blocking competition, allowing it to inflate prices, degrade quality, and stifle innovation for consumers and businesses. The case is focused on two parts of Amazon's online retail business – the online 'superstore' and the online marketplace (i.e., first-party retail and third-party marketplace).

   One of the juicy revelations in the FTC's papers was 'Project Nessie', where Amazon used an algorithm to increase prices as far as possible, without losing customers, to manipulate the algorithms of other competitors whose pricing strategy is purely to mimic Amazon's prices. The FTC alleged this practice cost US consumers an extra US$1bn through higher prices. Amazon says Project Nessie was discontinued in 2019.

This case is set to go to trial in October 2026.

Michael Carrier, at the Rutgers Institute for Information Policy and Law, says the case *'is a bit of an uphill climb. One of the real challenges here is that consumers are happy with Amazon.' US antitrust doctrine has typically prioritised consumer welfare. Hovenkamp 'doesn't see a lot coming out of the Amazon case.'*

In this lawsuit, the FTC seeks relief from various anti-competitive practices. It does not call for the company to be broken up.

META

Notable cases

1) In December 2020, the FTC sued Meta Platforms (then known as Facebook) for accumulating monopoly power via anti-competitive mergers focused on the acquisitions of Instagram and WhatsApp. The FTC seeks to force Meta to divest from Instagram and WhatsApp. The legal action relates to Section 2 of the Sherman Act and Section 7 of the Clayton Act.

   After initially being dismissed in June 2021, the lawsuit was refiled, then survived a motion to dismiss, and is still alive. The FTC is pushing for this trial to begin in 2024.

   Legal experts believe that if the FTC can prove that Meta has market power in the social media product market, then *'the case for undoing those two mergers is a good one.'* After all, Meta CEO Mark Zuckerberg wrote in an email in 2008 that *'it is better to buy than compete.'* However, proving market power will be difficult in one of the tech industry's fastest-moving segments.

Meta notes in its 2023 annual report that it is facing numerous cases in the US related to section 230 of the Communications Decency Act - which protects online platforms from legal liability over content posted by their users. To date, the US Supreme Court has sided with the tech platforms over Section 230, but there is growing pressure for change in a post-truth world.

Microsoft

MICROSOFT

Notable cases

In January 2022, Microsoft announced a deal to acquire Activision Blizzard (a video game publishing company) for US$68.7bn, the largest deal in tech history. Activision Blizzard is the publisher of Call of Duty. In December 2022, the FTC filed an administrative complaint to block the deal because it would suppress gaming competition. This case was rejected in July 2023, and after a change of heart by the UK regulator, the Capital Markets Authority (CMA), the deal was closed after Microsoft had granted concessions. The FTC is appealing this decision.

This was a win for Microsoft and evidence of its skill at handling regulators. Microsoft had learned valuable lessons the hard way in its historic DoJ antitrust case of the late 1990s when it was found guilty of anti-competitive practices in the internet browser market. The judge ordered Microsoft to be broken up into two units - operating system and other software. Fortunately for Microsoft, this judgement was overturned on appeal.

NVIDIA

NVIDIA

Notable cases

Although Nvidia, the largest graphics processing unit (GPU) company in the world, is being investigated by antitrust regulators in multiple jurisdictions, there are no notable cases against it.

In December 2021, the FTC sued to block the proposed US$40bn acquisition of chip design provider Arm because the combined firm could stifle competing next-generation technologies. The case was closed in February 2022, when the proposed deal was terminated.

US antitrust enforcement has weakened considerably over recent decades. Some argue that this has led to increased market concentration in various industries. The rise of the tech industry, with the inherent tendency to create monopolies through network effects, has presumably played a major role. In July 2021, the White House issued an executive order on competition policy that signalled a change in direction. The executive order highlighted 72 discrete measures to stamp out anti-competitive practices. Personnel changes at the DoJ and the FTC have reinforced this shift. Although some of the antitrust lawsuits under discussion were launched under the Trump administration, we are only now clearly seeing the consequences. Antitrust is witnessing a rebirth and it appears to have bipartisan support.

This will make life more difficult for the Big 6 tech firms. Even if they prevail in most notable lawsuits, they are already more circumspect about pursuing M&A activity.

Antitrust is now a key factor in their acquisition strategies while it used to be an afterthought. If regulators want to pursue an important case with lower odds of success, they are more inclined to file suit than before. As the FTC's Lina Khan says, '*You lose all of the shots you don't take.*' With Congress so fractious and unlikely to pass legislation that would reform aspects of antitrust law, this expensive approach almost makes sense. After all, in antitrust matters, the courts have placed consumer welfare above all else for the past four decades. Maybe it is time for some new legal precedent.

The reality is that Europe, with few of its own major tech platforms, is now the leader in regulating tech. The EU's DMA, which dictates how the six gatekeepers—Alphabet, Amazon, Apple, ByteDance, Meta, and Microsoft—must compete in the EU, came into full effect in early March 2024. The question now is: Will the EU regulators uphold the law aggressively enough? The gatekeepers are not shrinking violets.

The Big 6 are entering a delicate period of having to navigate both antitrust lawsuits of vital importance and a period of heightened vulnerability as the industry races to roll out generative AI. History tells us that IBM, AT&T, and Microsoft were famously debilitated by antitrust cases that dragged on for years. This crop of firms will have little room for distraction. Ultimately, however, the reason we are here is because the tech sector and the economy need healthier competition.

Understanding the US 10-Year Treasury

WRITTEN BY:

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Casey holds an MCom in Economics and joined Anchor in 2019. She brings her passion for economics into the fixed-income space, particularly regarding global and African country analysis.

Thomas started his career in financial markets in 2016, after nine years of studying various disciplines and graduating with three degrees. His passion is a mathematical approach to understanding investments and ensuring that fundamental analysis meets quantitative analysis to generate returns.

The US 10-Year Bond (formally known as the 10-Year Treasury Note) is essentially a long-term debt instrument issued by the US Department of the Treasury.

The US 10-Year Treasury receives more scrutiny and press coverage than any other security. Market participants across the board pay keen attention to movements in the US 10-year Treasury yield because this serves as a benchmark for other borrowing rates, such as mortgage rates. When the 10-year yield fluctuates, it can have significant implications across the financial landscape. As such, changes in the 10-Year Treasury yield tell us a great deal about global markets' view of the economic landscape. Therefore, investors, in turn, attempt to analyse patterns in US 10-Year Treasury yields and make predictions about how yields will move over time.

The US 10-Year Bond (formally known as the 10-Year Treasury Note) is essentially a long-term debt instrument issued by the US Department of the Treasury. It represents a promise by the US government to repay a specified amount of money (the principal) at a predetermined interest rate (the coupon rate) over ten years. The bond pays interest semi-annually until maturity, at which point the investor receives the final interest payment along with the return of the principal. Regarding the specific mechanics of the market surrounding the instrument, the US 10-Year Bond market operates through primary issuance and secondary trading. Via the primary issuance mechanism, the US Treasury conducts auctions to issue new 10-year bonds. These auctions are typically held on a regular schedule and are open to a wide range of investors, including individuals, institutions, and foreign governments. Bids are submitted specifying the quantity of bonds desired and the yield the bidder is willing to accept. The Treasury sets the coupon rate based on the auction results. Once issued, 10-year bonds are traded in the secondary market. This market provides liquidity for investors who wish to buy or sell bonds before they mature. Trading occurs through various platforms, including electronic trading systems and over-the-counter transactions.

US TREASURIES (USTS) ARE GENERALLY ISSUED MONTHLY ACROSS A VARIETY OF TENORS:

- <1-year USTs are titled Treasury bills.
- >1-year and <20-year USTs are titled Treasury notes.
- 20- and 30-year USTs are titled Treasury bonds.

The notes and bonds are similar (paying semi-annual coupons), and the bills are zero-coupon discount instruments. As the instruments are issued monthly, the latest issue is termed "on-the-run," the older issues are called "off-the-run" USTs. When yields for specific tenors (for example, the 10-year) are referenced in the market, the standard understanding is that this reference is to the on-the-run issue.

USTs are a type of bond, and their yield determines their price. The yield-price relationship is inverse – a lower yield results in a higher price and vice versa. At issue, USTs' prices are at par; however, the yield is dynamic in the open market. The coupon rate for treasuries varies and is determined by the issuance auction. Thus, post-auction, the bond price can vary from par depending on the supply and demand movements for the instruments.

From a macroeconomic perspective, the US 10-Year Treasury holds significant importance in financial markets for several reasons:

I. **Interest rate benchmark:**
The 10-Year Treasury yield is a benchmark for interest rates across the economy. It influences borrowing costs for businesses, consumers, and governments, impacting spending, investment, and economic growth. South African investors and financial institutions often use this benchmark to price various financial instruments, including government bonds, corporate bonds, and loans. Changes in the US Treasury yield curve can influence SA's interest rates and borrowing costs.

II. **Risk-free rate:**
Treasury bonds are considered quasi-risk-free assets because the US government backs them. Thus, the interest rate earned can generate discount rates for other investments or more exotic financial instruments.

III. **Investor sentiment:**
Fluctuations in the 10-Year Treasury yield reflect changes in investor sentiment, economic expectations, and risk appetite. When the yield rises, so do mortgage rates and other borrowing rates. Conversely, the housing market strengthens when the 10-year yield declines and mortgage rates fall. This, in turn, positively impacts perceptions of economic growth and the strength of the US economy.

IV. **Policy expectations:**
Investors monitor the yield on treasuries to gauge the market view on long-term interest rates and the likely route policy rates (in this case, the Fed funds rate) will take over the period.

V. **Global market sentiment:**
The US 10-Year Treasury is regarded as a barometer of global market sentiment and risk appetite. Its yield fluctuations can impact global financial markets, currencies, and capital flows, reflecting broader trends in investor confidence and geopolitical developments.

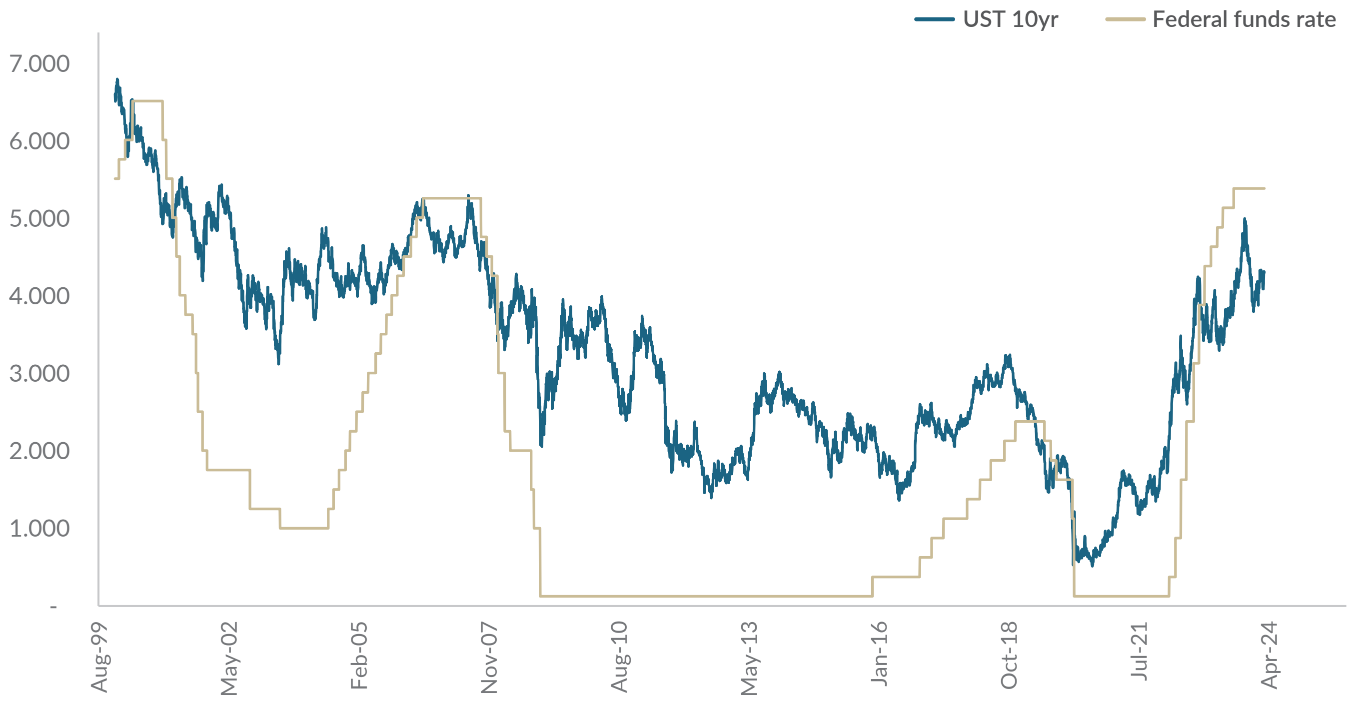
VI. **Capital flows and investment:**
South African investors closely monitor US Treasury bond market developments as part of their global investment strategy. Changes in UST yields can affect the attractiveness of South African assets relative to US assets, impacting capital flows into and out of the country. Additionally, shifts in global investor sentiment driven by UST market dynamics can influence foreign direct investment and portfolio flows into SA.

VII. **Currency markets:**
Movements in the UST bond market can impact currency markets, including the rand exchange rate. Changes in US interest rates and yield differentials between USTs and South African government bonds can affect the relative attractiveness of each currency, influencing exchange rate movements. Moreover, shifts in global risk sentiment driven by UST market dynamics can impact the demand for EM currencies like the rand.

As such, the UST market forms a crucial underpinning to the global financial system. Movements in the price of any UST (but more specifically, the 10-year point) have drastic implications for the price of other assets as the UST is a barometer for the broader economic health of the US (and, by extension, the world) economy.

It has long been established that Fed funds target rates directly impact UST rates. As the Fed funds rate is cut/hiked, longer-term UST rates are also impacted in a direct relationship. Longer-term UST rates are often viewed as an expectation of average Fed funds rates. There are some methodological difficulties in this approach, i.e., those investors who expect to be rewarded for the term itself (so-called term premium). Any analysis of USTs as an expectation of the future must also make some assessment of the market price of term premium.

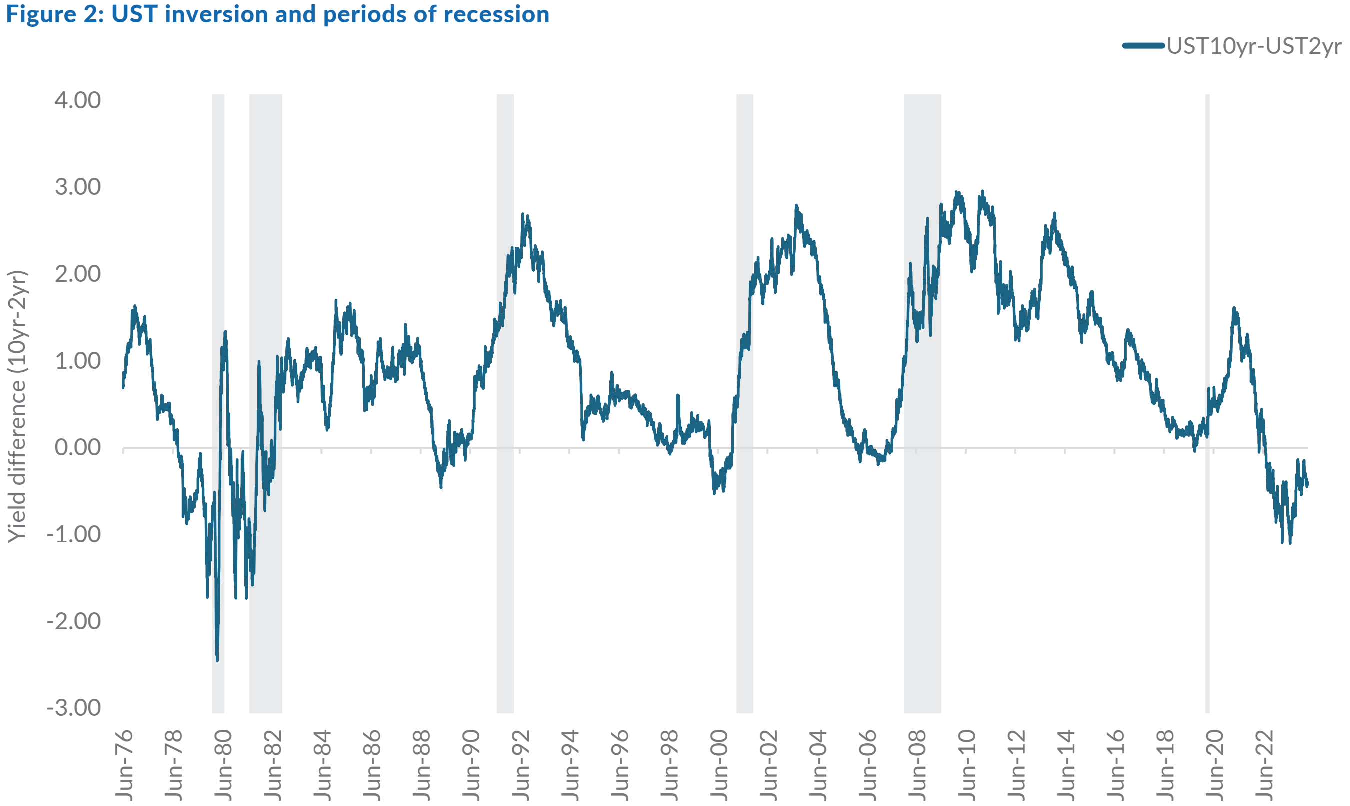
Figure 1: The federal funds target rate vs UST 10-year



Source: Thomson Reuters, Anchor

One key curve parameter tracked by markets is the difference between 10-year and 2-year UST yields. When this becomes negative (i.e., the short-term rate is higher than the longer-term rate), the curve is said to be inverted. Market participants often view inversion in 2v10 rates as a signal of impending recessions.

Figure 2: UST inversion and periods of recession

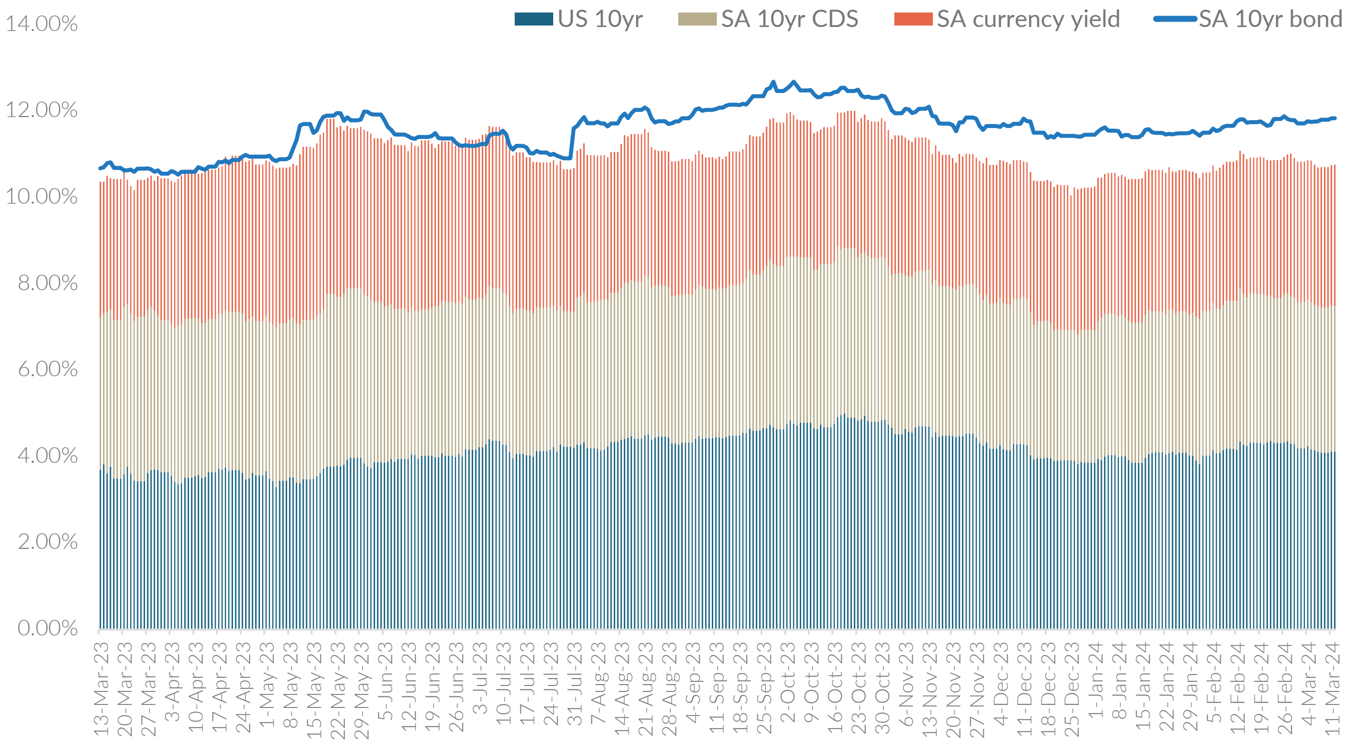


Source: Federal Reserve Economic Data (FRED), Anchor

As the US dollar serves as the currency of global trade, so do USTs serve as the benchmark for global fixed income.

While the UST market has great importance domestically, it is also important globally. As the US dollar serves as the currency of global trade, so do USTs serve as the benchmark for global fixed income. In this way, all other bonds' relative attractiveness is based on their relationship with the UST market. At Anchor, we model SA government bonds' (SAGBs) attractiveness by monitoring the underlying market - visible instruments that can be bought (or sold) to replicate the underlying risk of SAGBs. This is a critical input into our decision-making regarding the outlook for SAGBs.

Figure 3: SA government 10-year bonds vs other market instruments



Source: Thomson Reuters, Anchor

The UST outlook is a crucial indicator whose movement Anchor closely monitors to understand how it reflects domestic and global economic conditions, policy expectations, and market sentiment. Its issuance and trading mechanics and its influence on interest rates and broader economic trends make it an essential instrument for investors, policymakers, and economists.

Should I wait for the rand to strengthen before taking my money offshore?

WRITTEN BY:
Henning Holtzhausen
Wealth Management

Henning joined Anchor in June 2021 as part of the Wealth Management team. In 2020, he completed a BCom Honours in Investment Management from the University of Pretoria and continues to study part-time. He is passionate about all aspects of the investment process.

INTRODUCTION

South African investors are increasingly diversifying their investment portfolios away from SA and into global markets. This shift is driven by the desire to access a broader investment universe and to diversify away from the challenges of the struggling local economy. Furthermore, investors can benefit from a depreciating rand, as weakness in the local currency will enhance their rand returns. As part of this process, investors must externalise their rand for hard currency, typically the US dollar, and the rate at which this transaction occurs will ultimately impact their returns in rand – a stronger rand at the time of the initial investment will enhance investor returns. In contrast, a weak rand will reduce returns. Consequently, many investors perceive the initial exchange rate as crucial to their long-term return profile, often opting to wait for the rand to strengthen before executing this type of transaction. This is especially true in an election year, where investors may view SA's national election as a potential catalyst for rand strength.

However, this decision has an opportunity cost, as investors may miss out on the performance of the underlying offshore investment.

This begs the question: Is it prudent to wait for the rand to strengthen in the short term before investing in offshore markets? This article examines four key aspects of this decision.

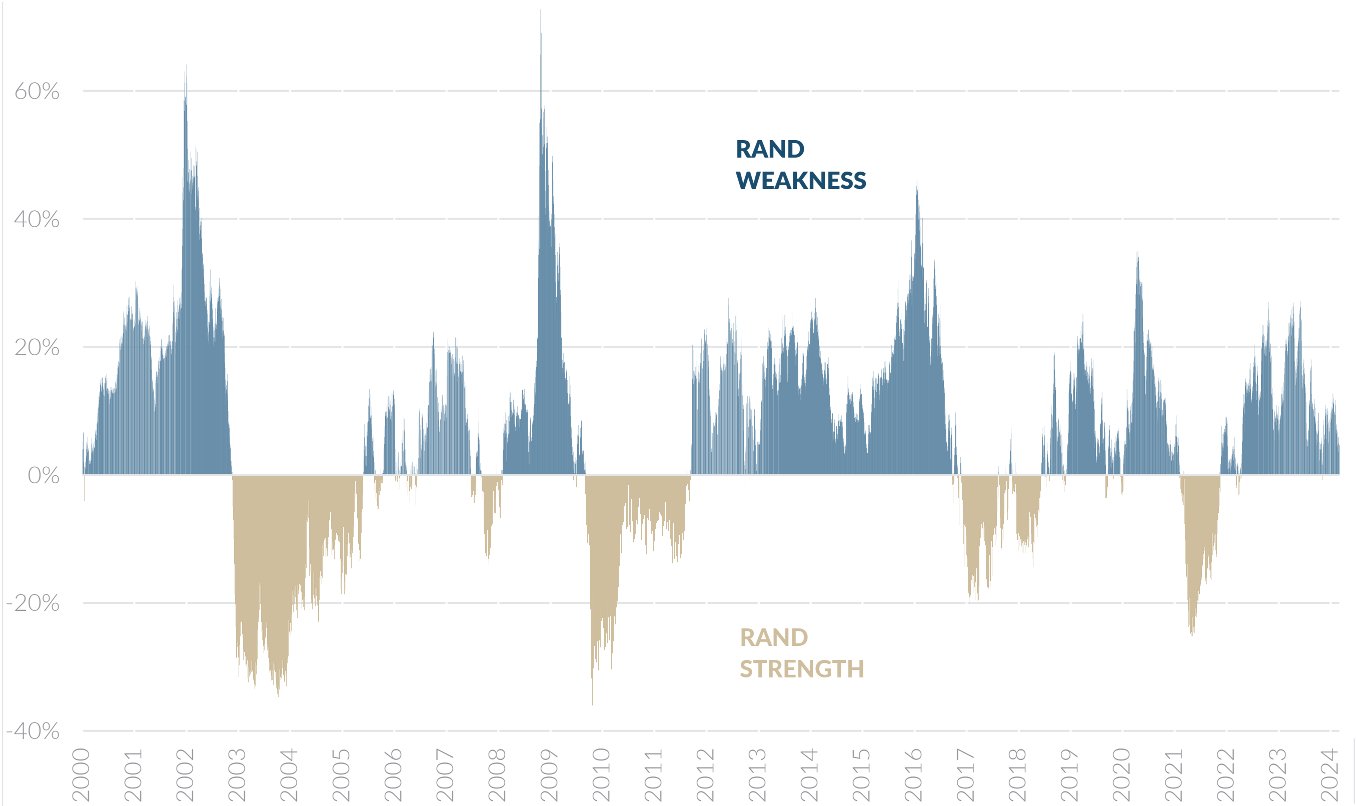
1. How likely is the rand to weaken once you have externalised your investment?
2. How has the rand performed after previous national elections?
3. What are the historical worst-case scenarios when externalising your money?
4. What is the most likely outcome?

HOW OFTEN DOES THE RAND STRENGTHEN?

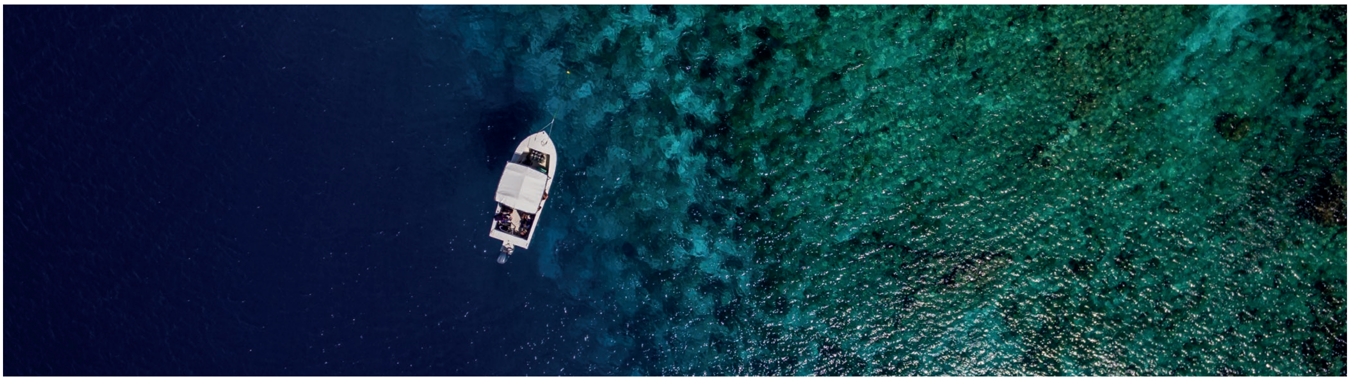
Simply put, the rand is more prone to weakening than strengthening over time. For example, the exchange rate began in the 2000s at R6.15/US$1 and ended at R19.20/US$1 in February 2024, indicating a 4.8% p.a. depreciation rate over that period. Analysing the rolling one-year performance of the rand from January 2000 to February 2024 reveals that the local unit depreciated relative to the US dollar on approximately 67% of the measured days over one year. This likelihood increases significantly over longer periods, reaching 77% and 82% over three and five-year rolling periods, respectively. These statistics suggest that, historically, the rand has been more likely to weaken than strengthen, reinforcing the notion that history is on your side when externalising your funds.

... the rand is more prone to weakening than strengthening over time.

Figure 1: The rolling one-year performance of the rand vs the US dollar



Source: Bloomberg, Anchor



HOW HAS THE RAND PERFORMED AFTER PREVIOUS NATIONAL ELECTIONS?

Many investors may be especially inclined to wait for the rand to strengthen in 2024, as the South African national election presents a potential catalyst. The table in *Figure 2* below highlights the rand's performance after past national elections.

Figure 2: The rand's historic performance vs the US dollar following SA national elections

ELECTION DATE	RAND VS US$ BEFORE THE ELECTION	ONE MONTH LATER	THREE MONTHS LATER	SIX MONTHS LATER	TWELVE MONTHS LATER
08 May 2019	R14.43	3.6%	4.2%	2.9%	27.1%
07 May 2014	R10.50	0.8%	2.6%	7.3%	14.7%
02 April 2009	R8.97	-7.7%	-13.9%	-17.5%	-16.8%
14 April 2004	R6.56	2.7%	-7.4%	-0.7%	-4.3%
12 June 1999	R6.22	-3.1%	-2.8%	-0.9%	11.6%
Average		**-0.7%**	**-3.5%**	**-1.8%**	**6.5%**

Source: Bloomberg, Anchor. Negative %=rand appreciation. Positive %=rand depreciation.

The table above shows a wide disparity in the rand's performance following a national election. The 2009 election was the only year we saw meaningful rand strength from which investors could benefit. However, this move likely had little to do with the South African election but was probably driven by the rand's mean reversion after significant weakness due to the global financial crisis (GFC). Subsequently, there is little historical evidence for rand strength in an election year.

WHAT ARE THE HISTORICAL WORST-CASE SCENARIOS?

Despite the rand's tendency to weaken over time, there have been periods of material rand strength. The worst-case scenario for an investor would be externalising their investment at the start of one of these periods. However, this outcome can only be evaluated by considering the underlying asset's performance (generally equities or bonds). The table below outlines five periods characterised by the greatest rand strength since 1 January 2000 and the US dollar returns for both global equity and bond markets over those same periods.

As an EM currency, the rand is likely to strengthen during those periods when there is a positive investment sentiment, …

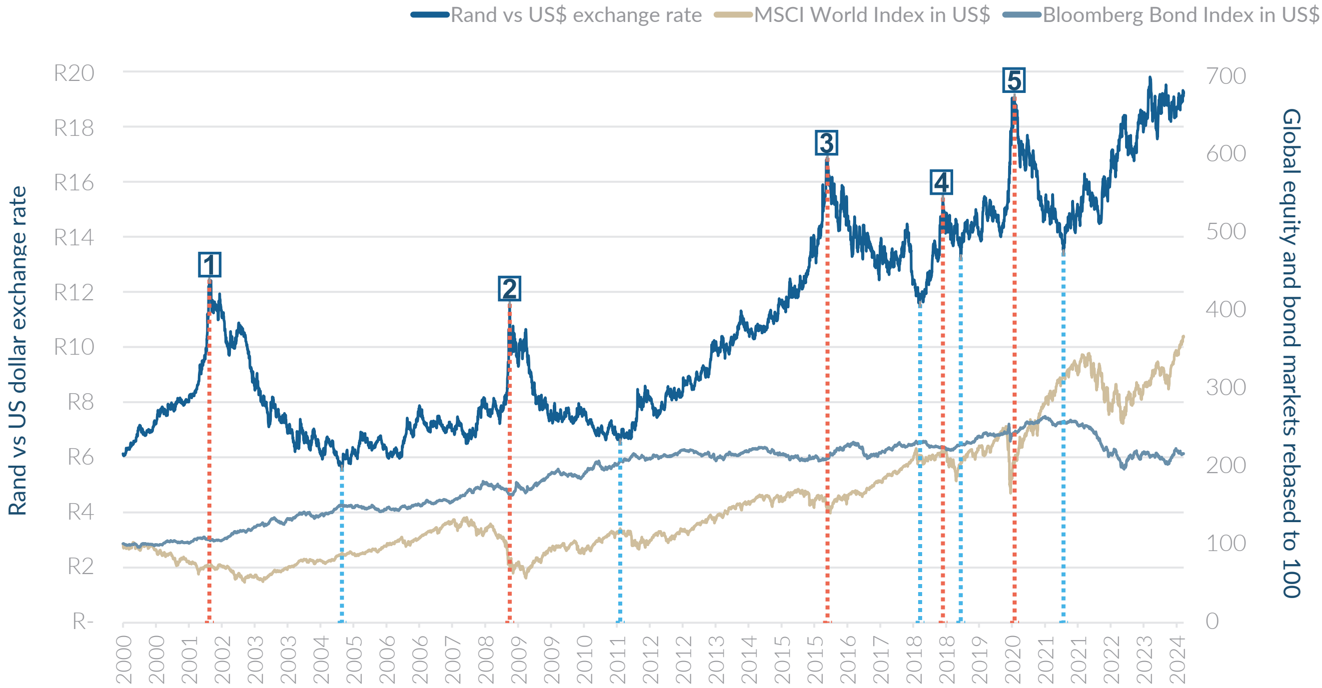
Figure 3: Five periods showing the greatest rand strength since 2000 and the US dollar returns in global equity and bond markets

	START (RAND VS US$)	END (RAND VS US$)	CHANGE	EQUITY MARKETS[1]	BOND MARKETS[2]
19 Dec 2001 to 27 Dec 2004	R12.45	R5.62	-55%	23%	42%
22 Oct 2008 to 29 Apr 2011	R11.57	R6.57	-43%	61%	27%
18 Jan 2016 to 26 Feb 2018	R16.87	R11.55	-32%	49%	9%
23 Apr 2020 to 04 Jun 2021	R19.08	R13.43	-30%	54%	6%
05 Sep 2018 to 31 Jan 2019	R15.42	R13.25	-14%	-5%	2%

Source: Bloomberg, Anchor. 1: MSCI World Index (Total Return), 2: Bloomberg Global Aggregate Bond Index.

Notably, equity and bond markets generated strong returns in most periods of significant rand strength. Subsequently, investors caught on the wrong end of the rand strength were hedged to a certain degree. This can be seen in the chart (Figure 4) below, where the start of each period is indicated by an orange vertical line and the end of the drawdown by a light blue line. As an EM currency, the rand is likely to strengthen during those periods when there is a positive investment sentiment, and global markets are also highly likely to perform well.

Figure 4: Both equity and bond markets generated strong returns in most periods of significant rand strength



Source: Bloomberg, Anchor. MSCI World Index and Bloomberg Global Aggregate Bond Index.

A further takeaway from *Figure 4* is that the five periods highlighted in the table (*Figure 3*) were initiated by severe rand weakness over a short period due to the following events, all of which were very significant at the time:

1. The 9/11 terrorist attacks against the US.
2. The GFC.
3. The firing of Nhlanhla Nene as finance minister.
4. The firing of Pravin Gordhan as finance minister.
5. The COVID-19 pandemic.

Outside of these periods, a negative outcome becomes far less likely.

WHAT IS THE MOST LIKELY OUTCOME?

Lastly, one must consider the most likely outcome over the long term, not only the worst-case scenario over the short term. After all, most South African investors who choose to invest offshore are doing so with a long-term time horizon. *Figures 5 and 6* below show the three-year rolling returns in rand for offshore equities and bonds since 1 January 2002. Over this period, investors would have received a positive rand return in 75% of the scenarios when invested in global equity markets and 83% for global bond markets over three years. Consequently, if investors extend their view well beyond short-term currency fluctuations, their return on the offshore investment will likely be positive for both equity and bond portfolios.

... one must consider the most likely outcome over the long term, not only the worst-case scenario over the short term.

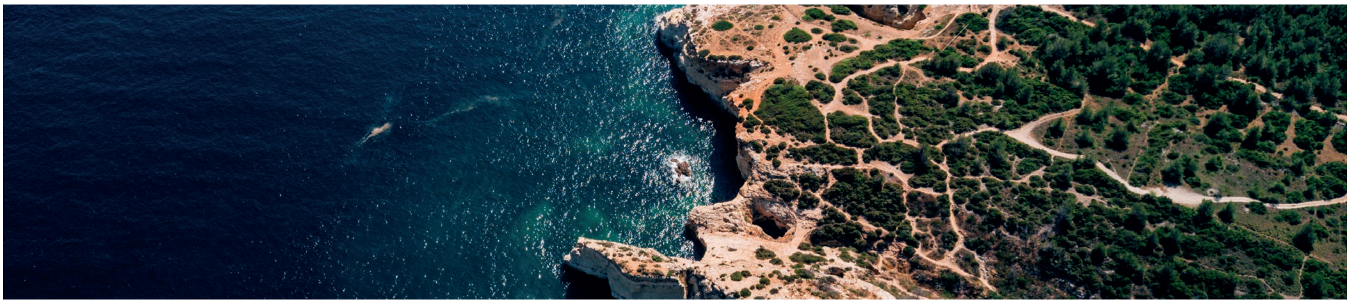
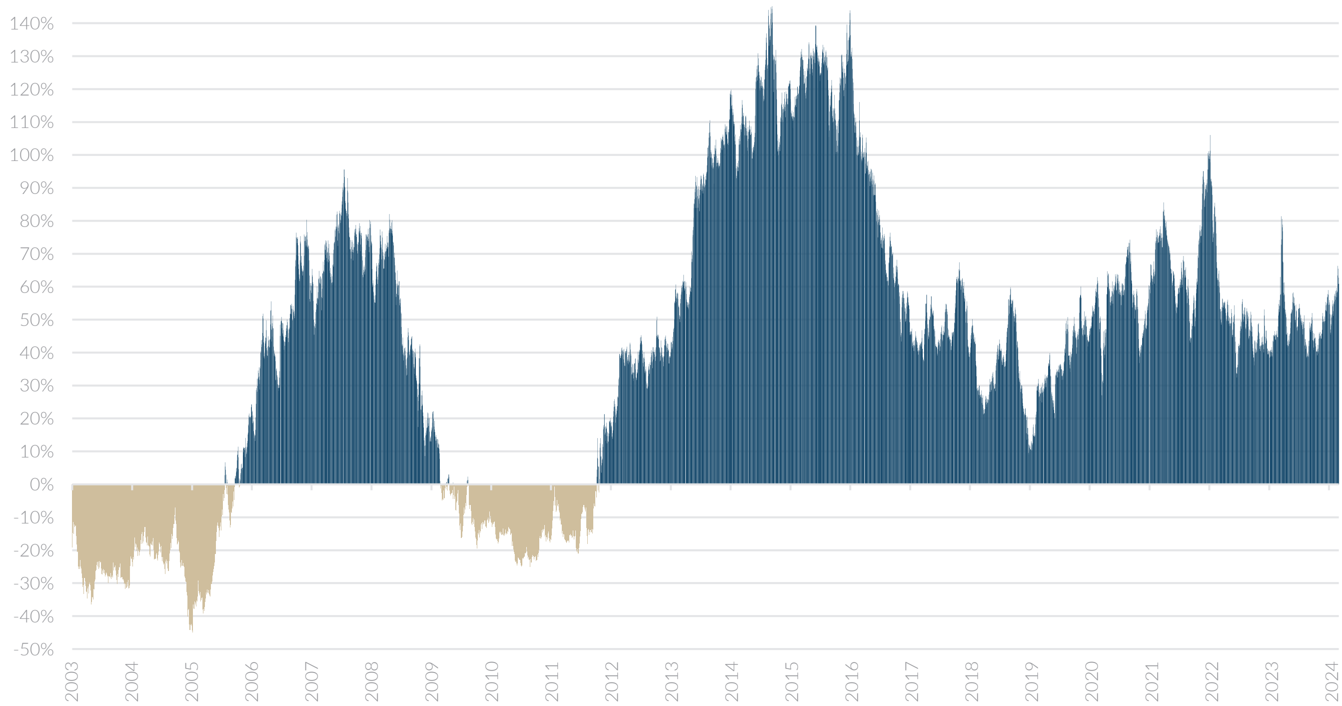
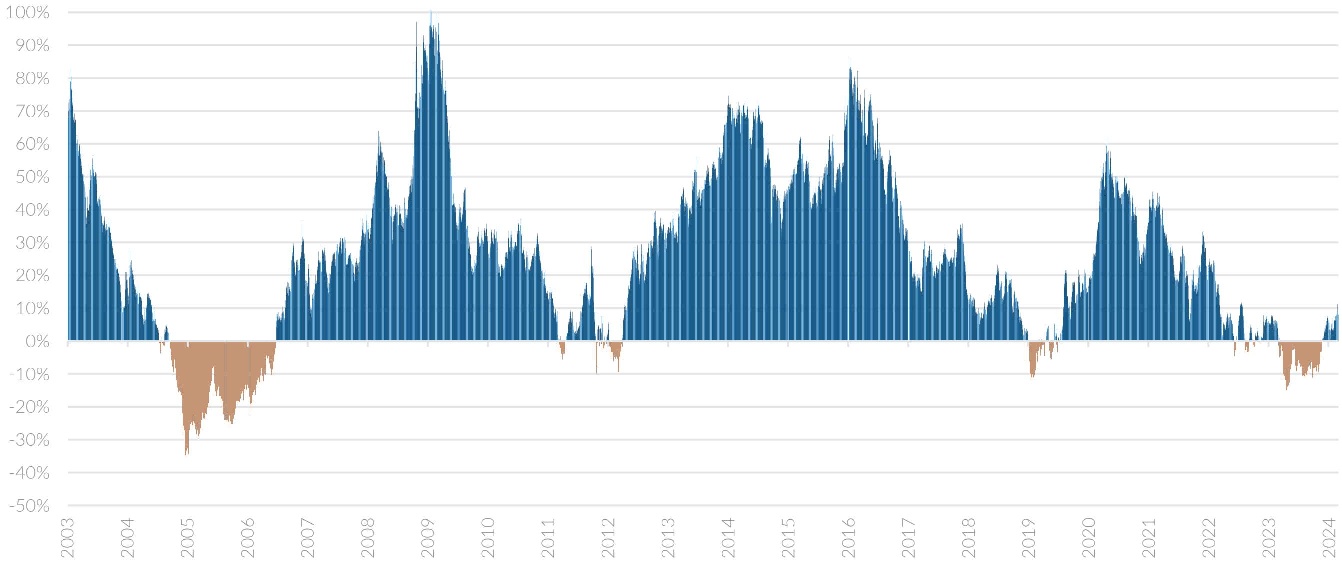


Figure 5: Three-year rolling returns in rand - offshore equity markets



Source: Bloomberg, Anchor. As per the MSCI World Index.

Figure 6: Three-year rolling returns in rand - offshore bond markets



Source: Bloomberg, Anchor. As per the Bloomberg Global Aggregate Bond Index.

CONCLUSION

Investing in offshore markets can be daunting, especially for first-time investors. For many, the first step in this undertaking is the foreign exchange transaction, and often, an investor will pause the process at this step to wait for a favourable movement in the exchange rate.

At this point, it is important to look at the big picture and remember the following:

- The rand is historically more likely to weaken over the next year than it is to strengthen.
- Even if the rand strengthens significantly after investors have traded, this is likely to be offset to a degree by the strong performance of the underlying investment.
- Investors may miss out on performance in offshore markets if they opt not to trade as they wait for the rand to strengthen.
- The most likely outcome in the long term is a positive return.

Ferrari: A luxury business of rare and enduring quality

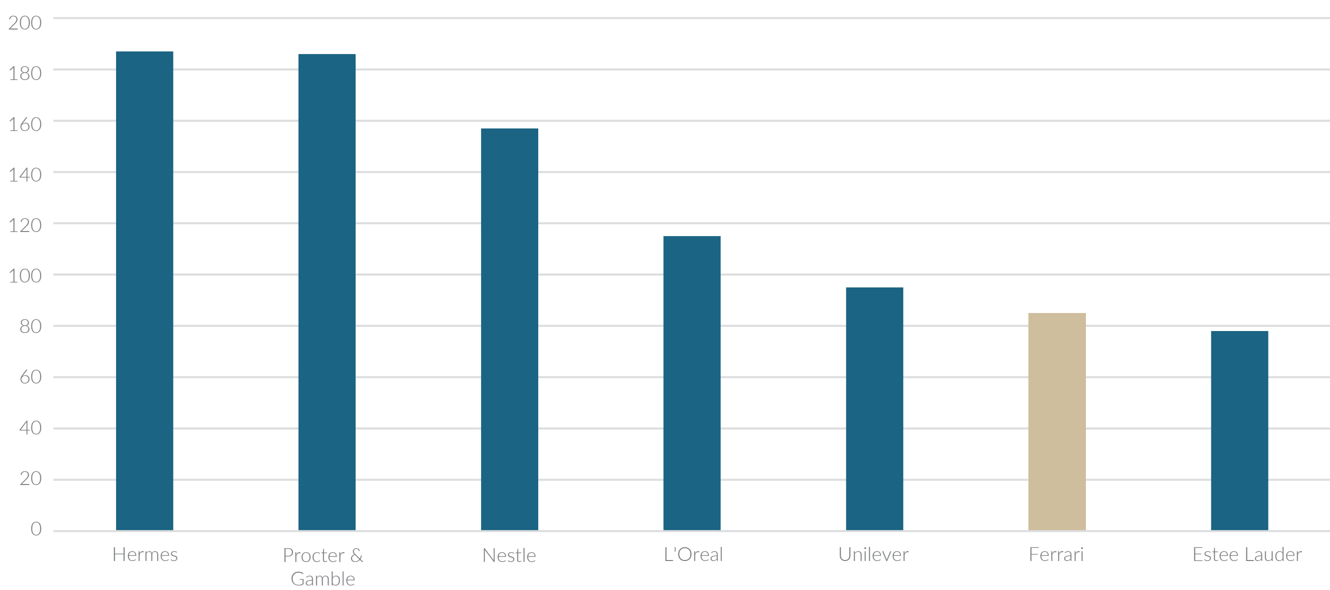
WRITTEN BY:
James Bennett
Global Equity Analyst

James has a BCom Hons from the University of the Witwatersrand and started his career at UBS (and its predecessor firms) in Johannesburg in 1994. During his 20-year career at UBS as a sell-side analyst, he was rated among the top 2 in the SA diversified mining sector for 14 consecutive years (by the annual Financial Mail Ranking the Analysts survey) until his departure in 2014. He was also rated the number one analyst in the SA steel sector for nine consecutive years. From 2015 to 2018, James covered the SA diversified mining sector at Citi. Since then, he has managed his own global stock portfolio, primarily investing in the US, China, and Europe. James started at Anchor in 2022, covering globally listed companies.

Ferrari is a luxury car brand like no other. Although there are many other superb luxury car brands, none quite stir the emotions like Ferrari does. The heritage of the leading European luxury brands cannot be replicated, almost by definition. It is nearly impossible to launch a new, stand-alone luxury brand and expect it to compete with companies that have existed for generations.

This intangible value is real but nevertheless difficult to quantify. Ferrari has existed for over 80 years. Presumably, it will not disappear within the next five years. No business has a guaranteed future, even those that have existed for decades. However, an extremely long corporate history should not be underestimated.

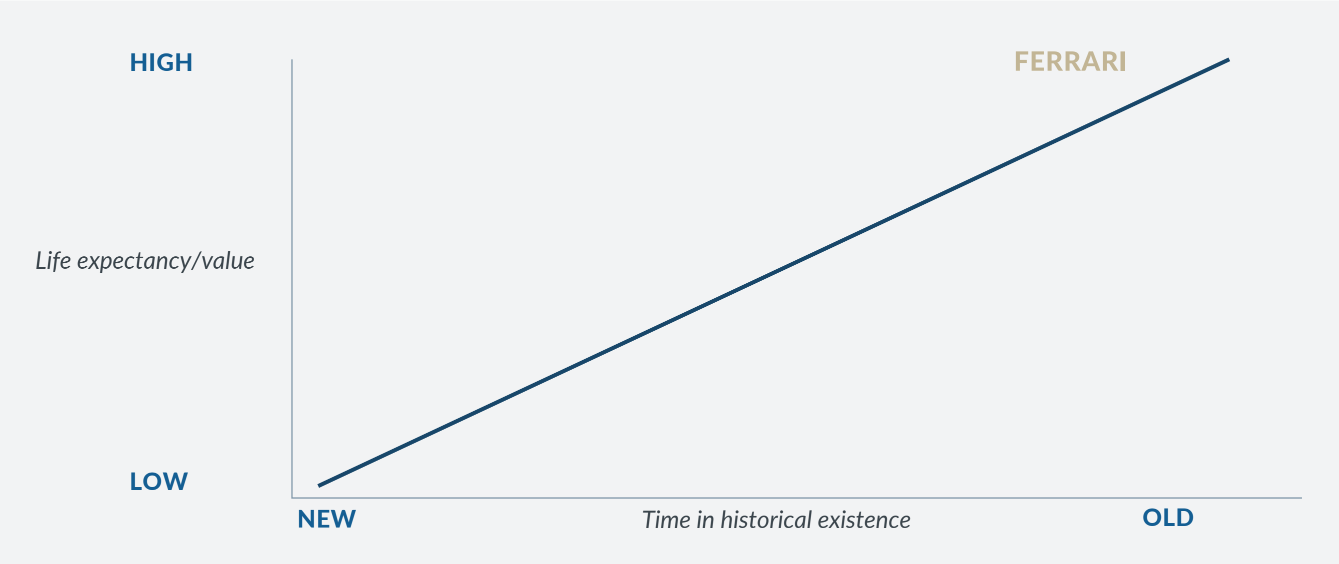
Figure 1: Years in existence of select major European and US companies



Source: Anchor, Company reports

In this regard, there is something called the Lindy effect. This states that the longer something (non-perishable) has existed, the greater the likelihood it will remain in existence well into the future. This effect makes a business such as Ferrari (and other luxury brands) extremely durable. In turn, durable businesses typically attract higher valuation multiples.

Figure 2: The Lindy effect



Source: Anchor.

Note that this applies to non-perishable items.

One of the most crucial aspects to understanding the Ferrari business model is the tiny volume of c. 13,500 cars the company produces yearly. This is minute compared to total global vehicle sales of c.75mn p.a. Porsche produced more cars in 2023 than Ferrari has made in its entire history.

It seems that about two-thirds of Ferrari buyers each year already own at least one Ferrari. Furthermore, one-third of Ferrari buyers already own two or more Ferraris. These small production levels mean Ferrari is mostly insulated from downcycles in the broader auto industry. It also means that Ferrari's environmental impact is extremely low on a global scale. The average Ferrari is driven very little. It is unusual for a Ferrari to be driven more than 8,000km p.a.

In this quote at the Berkshire Hathaway 2023 AGM, Warren Buffett specifically mentioned Ferrari as a different proposition to the rest of the auto industry. ***"I would say Ferrari is in a special place, but they only sell 11,000 or 12,000 cars a year".***

Ferrari manages supply very carefully in relation to demand, constantly keeping the market tight. Hence the quote, ***"Ferrari are very good at saying no to the kind of people who are not used to taking no for an answer"***. Ferrari's production is almost sold out for the next two years. Sometimes, this leads to misperceptions that Ferrari is a no-volume growth model. However, Ferrari can grow its future production volumes (as it has done in the past), provided it does so in a careful, controlled manner while tapping into new target markets.

It seems that about two-thirds of Ferrari buyers each year already own at least one Ferrari.

Below is a quote from the Ferrari 2022 annual report on this issue.

"On the other hand, our current growth strategy contemplates a measured but significant increase in car sales above current levels as we target a larger customer base and modes of use, we increase our focus on reaching a younger customer base and creating new Ferrari collectors, and our product portfolio evolves with a broader product range. We sold 13,221 cars in 2022 compared to 7,255 cars in 2014, the year before our initial public offering, and sales are expected to continue to increase gradually".

About 7% of Ferrari's production by volume (a significantly higher percentage by value) is in limited edition cars. Whereas a "regular" Ferrari sells for an average of US$250,000 before customisations, a new, limited-edition Ferrari can sell for more than US$2mn. For these limited-edition models, production is limited to a few hundred, and they usually sell out before the model even goes into production. Why would a Ferrari customer pay such a premium for a limited-edition car? The answer is these limited-edition cars are immediately worth a few hundred thousand US dollars more than the buyer paid. However, there are restrictions to immediately selling a limited-edition Ferrari.

Ferrari is very unique compared to the other luxury car brands on the market.

A regular or "range" Ferrari, as the company calls them, is likely to slowly depreciate in hard currency terms, albeit at a slower rate than an everyday car. However, the anecdotes of people making meaningful returns from owning a physical Ferrari are usually on a limited-edition model. It also helps if the limited-edition model is based on the heritage of a track Ferrari from back in the day. The most expensive Ferrari ever auctioned was a 1962 Ferrari 250 GT for US$52mn in New York in 2023. Only 56 of these cars were ever made.

The reality is Ferrari must invite one to buy a limited-edition car. Although Ferrari has never published a formal list of what it takes to get an invite, car enthusiasts have pieced together a list of do's and don'ts. Some don'ts include not selling a limited-edition Ferrari for at least the first 12 months and not doing after-market modifications or covering the badge. Turning down an invitation will likely remove you from any future invitations. Also, bad-mouthing Ferrari or being a social media influencer is unlikely to help your cause. Some of the do's include visiting the Ferrari factory in Maranello periodically and attending Ferrari special track days worldwide. Owning at least four Ferraris is also considered to help one's cause.

There is a famous account of a renowned Ferrari collector in the US who sued Ferrari in 2016 for not inviting him to buy the US$1.4mn (c. R19mn at the time) limited edition LaFerrari Aperta. All 200 vehicles were sold out prior to production. The collector owned at least 15 Ferraris at the time, which were considered worth a combined value of over US$100mn. He sent a deposit cheque of US$1mn to the then-CEO of Ferrari, who declined his offer. The collector subsequently withdrew his legal case against Ferrari.

Ferrari entered the Sport Utility Vehicle (SUV) market for the first time in 2023 with the Purosangue model (at a price of c. US$400,000). This model is sold out for the next 2-3 years. Ferrari has committed to limit the sales of this SUV to no more than 20% of its total production. This is to avoid flooding the market with SUVs, as some of its luxury car competitors have done.

Ferrari is very unique compared to the other luxury car brands on the market. It seems to be a case of ***"there is Ferrari, and then there is everyone else"***. The other competing brands are either too niche or have not been in production for very long (thereby lacking Ferrari's heritage). Also, others are part of larger car companies (sharing body frames or interior parts), which arguably reduces their exclusivity.

Owning a Ferrari gives one a membership to one of the most exclusive clubs in the world. The Ferrari Finali Mondiali track event, held in Imola 2022, attracted c. 40,000 global fans. Ferrari is the only team to have competed in every Formula One season since the competition's inception in 1950. Although it has been less successful in recent years in Formula One, it has been the most successful team over time. Ferrari does not formally advertise but uses Formula One to create brand awareness. It also earns additional revenue from its Formula One sponsorships.

Ferrari has materially enhanced its margins from customisations in recent years. Some buyers spend several hundred thousand dollars on expensive customisations. At the lower end, customisations can be ordered at the dealership where the car was purchased. However, the higher-end customisations involve clients travelling to Maranello, New York, or Shanghai to "Tailor Made" Ferrari centres to make their cars more unique.

The potential impact of the rise of electric vehicles (EVs) on Ferrari is a hotly debated issue. The negative implications for Ferrari may be relatively limited, and there could be some positive effects. Here are some salient points to consider. Ferraris are sold in tiny quantities and are driven very little (< 8,000km p.a. equals low utility value). So, the negative environmental impact of Ferrari as a company is small. Furthermore, c. 50% of new Ferraris sold are already hybrids (mild hybrids and plug-in hybrids). Ferraris are more a collectable art form than an automobile.

The first Ferrari Battery Electric Vehicle (BEV) is targeted to come into production in 4Q25, although it will likely be delayed. Ferrari plans for 40% of its vehicles to be fully electric by 2030 (5% initially), although this could be a moving target. No images or details are publicly available yet for this BEV prototype. The Ferrari CEO has already test-driven a prototype version in private during 2023.

The EU is planning to ban the sale of all petrol and diesel cars by 2035. Many believe this will not happen according to that timeline and will get pushed out. However, an all-electric Ferrari brand may not have the same appeal vs if it was still allowed to produce some internal combustion engine (ICE) vehicles. Ferrari and other small supercar brands have been lobbying to be allowed to adopt electric power more slowly than the mass brands.

The Ferrari share price has been an excellent performer since its 2015 IPO.

However, the global shift to EVs might even enhance the value of the Ferrari brand, similar to Apple and other sports watches, which enhance the value of ultra-high-end mechanical watches. In an ever-increasing EV world, Ferrari's small number of ICE vehicles might be considered objects of increasingly rare beauty (with a minimal negative environmental impact).

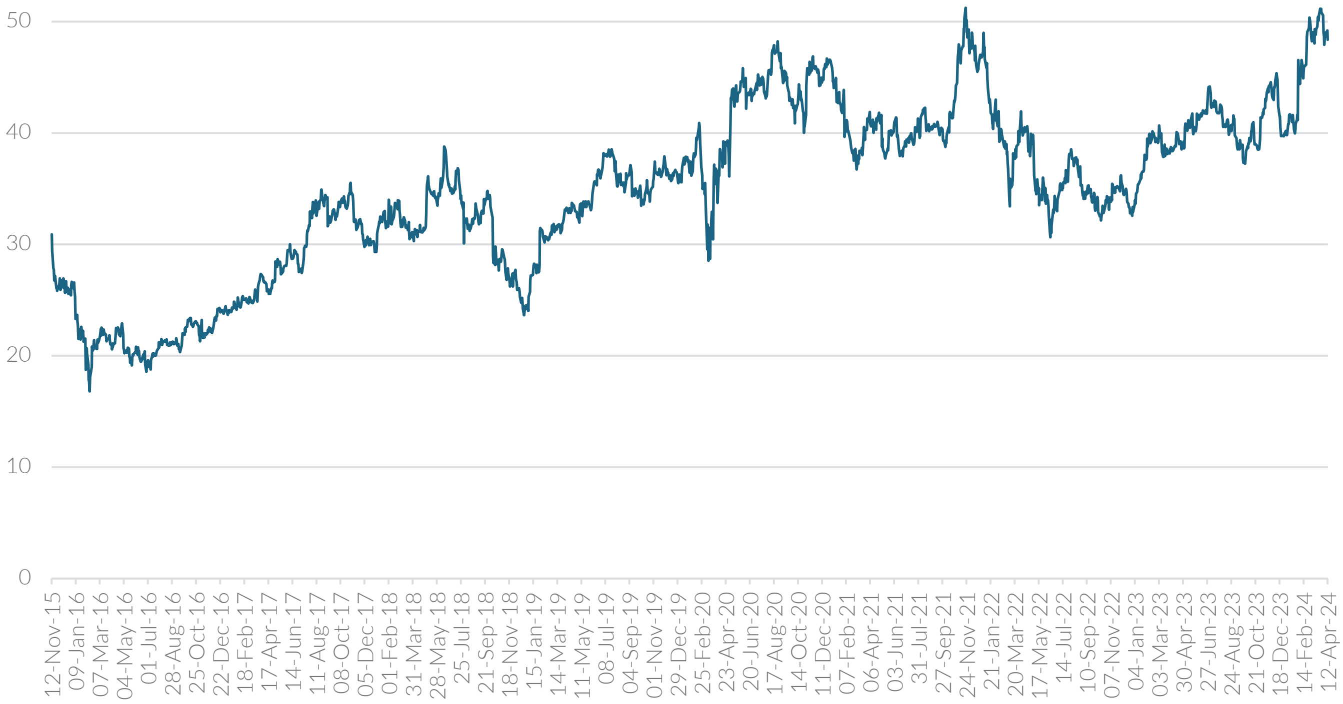
The Ferrari share price has been an excellent performer since its 2015 IPO. With the benefit of hindsight, this has turned out to be a spectacular buy-and-hold stock.

Figure 3: The Ferrari share price performance since its 2015 IPO, US$/share

Source: Anchor, Bloomberg

We believe there are currently two key risks to investing in Ferrari shares: a global decline in asset values and the high P/E multiple of the stock. The typical Ferrari buyer is a high-net-worth individual whose fortunes are not necessarily tied to their salary/bonus in any given year. Instead, these are individuals with financial wealth accumulated over many years. For the most part, the past fifteen years have been good for individuals with financial assets (shares, art, Bitcoin, alternative assets, etc.). A protracted slump in global asset values could remove some of the confidence, which has resulted in the typical Ferrari buyer being so comfortable with the high Ferrari price tag and willing to spend a fortune on customisations.

Figure 4: Ferrari's one-year forward P/E



Source: Anchor, Bloomberg

Since its IPO in late 2015, Ferrari has traded on a high P/E multiple. Analysts have consistently agonised over this high valuation multiple. Over time, though, the market has come to appreciate Ferrari as one of the world's top luxury brands rather than a conventional auto manufacturer. However, even by its own lofty standards, Ferrari is currently trading on a particularly high multiple. This makes the Ferrari share price vulnerable to even small disappointments in the company's financial performance. However, for quality growth investors, one should always look for a temporary pullback in the Ferrari share price to create an entry point into a truly unique, high-quality luxury business.

Since its IPO in late 2015, Ferrari has traded on a high P/E multiple.

What has COVID-19 done to the cost of my life insurance?

WRITTEN BY:
Lee Cairns
Wealth Management

Lee majored in economics and English with a postgraduate CFP Diploma. He has worked in financial markets since 1999. In his previous career, Lee was once a fireman and taught English and economics to A-level students in London. His teaching skillset has been invaluable in conveying investment advice to clients clearly and succinctly. Lee circumnavigated the world with his wife, surviving on a budget of $10/day, and his kids' middle names are Nkosimphile and Lebogang. Ernie Els and CS Lewis are his heroes. Lee absolutely loves what he does.

Our brains have the incredible propensity to forget or block out lived traumatic periods or memories. This process is called dissociation. Dissociation is your brain's unconscious defence mechanism to protect you from emotional pain.

The ability of my brain to call upon this extremely beneficial dissociation mechanism seems very much alive and well. Just four years on from the start of the traumatic and world-changing event that was COVID-19, I find myself unable to remember it clearly and strangely thinking that it was not that bad. And, at the most extreme, I sometimes question whether it was real or just a dream.

The industry that most felt the impact of COVID-19 was life insurance. These companies are run by some of the most brilliant people, the actuaries with spreadsheets that factor in just about every possible eventuality. The global pandemic sat on those spreadsheets with a 0.0027% probability of ever happening. And when a black swan event like COVID-19 happens, the obvious knee-jerk reaction is to price life and disability as if this event might occur regularly in the future. And so, just when my dissociation mechanism is helping me block out the trauma of COVID-19, I see the latest monthly debit for my life and disability run through my account, and my daydream snaps to an abrupt end.

An interesting thing about life insurance is that most people who have it see it as an asset on their balance sheets. However, it is of no more value than car insurance, and yet, for some bizarre reason, a person who is considering changing or cancelling their life cover immediately resorts to the "what if" something happened to me tomorrow scenario, which would result in this "asset" I have been religiously committed to for so many years, being worthless. Life and disability insurance are valuable tools to cover us in the most vulnerable years of our lives. But it should be viewed as no more than that.

Recently, I interacted with a brilliant professional who was complaining about his premiums having skyrocketed to R38,000/month. After a simple cash flow and risk analysis, it was established that his balance sheet was enough to support his retirement. When it was suggested that he cancel his policy, he immediately resorted to the "what if" and "what a waste of all those years of contributions". I then paged through to page 8 of his policy schedule (in *Figure 1* below), which showed that his monthly premium for dramatically reduced cover would be R73,000/month.

Figure 1: Monthly premium for life cover and illustrative benefit projections

YEAR	TOTAL RISK PREMIUMS
1-Sep-22	R33,949.72
1-Sep-23	R38,549.91
1-Sep-24	R43,792.69
1-Sep-25	R49,770.40
1-Sep-26	R56,588.94
1-Sep-27	R64,369.92
1-Sep-28	R73,252.97
1-Sep-29	R83,398.51
1-Sep-30	R94,990.90
1-Sep-31	R108,242.13
1-Sep-36	R208,410.97
1-Sep-41	R401,277.53
BENEFIT PROJECTIONS - RISK BENEFITS	
Inflation is assumed to be 5% p.a. for all risk benefit projections on this policy.	
YEAR	**ILLUSTRATIVE LIFE FUND PROJECTIONS AT CPI P.A.**
1-Sep-22	R7,639,625.00
1-Sep-23	R8,021,606.00
1-Sep-24	R8,422,686.00
1-Sep-25	R8,843,821.00
1-Sep-26	R9,286,012.00
1-Sep-27	R9,750,312.00
1-Sep-28	R10,237,828.00
1-Sep-29	R10,749,719.00
1-Sep-30	R11,287,205.00
1-Sep-31	R11,851,566.00
1-Sep-36	R15,125,935.00
1-Sep-41	R19,304,952.00
Principal's illustrative accelerated severe illness benefit projections at CPI % p.a.	
YEAR	**ILLUSTRATIVE BENEFIT AMOUNT**
1-Sep-22	R2,546,542.00
1-Sep-23	R2,673,869.00
1-Sep-24	R2,807,563.00
1-Sep-25	R2,947,941.00
1-Sep-26	R3,095,338.00
1-Sep-27	R3,250,105.00
1-Sep-28	R3,412,610.00
1-Sep-29	R3,583,241.00
1-Sep-30	R3,762,403.00
1-Sep-31	R3,950,523.00
1-Sep-36	R5,041,980.00
1-Sep-41	R6,434,986.00

The above tables helped move the conversation from a "what if" scenario to one where we instead put together a plan based on known facts, which is that a premium of R73,000/month will be unaffordable in five years. There was a possible slight gap in his balance sheet value for the next 12 months, so we took out a fixed 12-month term cover for the same value as his existing cover at one-third the price of his current premium.

We then devised a plan to help him deal with his feeling of loss and contribute the equivalent premium amount into an investment. With conservative growth assumptions, we showed a balance sheet asset of R3.8mn in five years and, astonishingly, an asset of R10.7mn in 10 years.

Life and disability insurance are valuable tools to cover us in the most vulnerable years of our lives. But it should be viewed as no more than that.

Figure 2: Investment's balance sheet assets over ten years using conservative growth assumptions

Rate of inflation/income escalation rate	**6.00 %**
Annual rate of return (net)	**10.00 %**
Real return	**4.00 %**

Year	Age	Capital value	Income/ month	Savings p.a.	Estimated growth, p.a.	Change in capital
2023	71	R0	R0	R462,598	R23,130	**R485,728**
2024	72	R485,728	R0	R525,512	R74,848	**R600,360**
2025	73	R1,086,088	R0	R597,244	R138,471	**R735,715**
2026	74	R1,821,803	R0	R679,067	R216,134	**R895,201**
2027	75	R2,717,004	R0	R772,439	R310,322	**R1,082,761**
2028	76	**R3,799,765**	R0	R879,035	R423,928	**R1,302,963**
2029	77	R5,102,729	R0	R1,000,782	R560,312	**R1,561,094**
2030	78	R6,663,823	R0	R1,139,890	R723,377	**R1,863,267**
2031	79	R8,527,089	R0	R1,298,905	R917,654	**R2,216,559**
2032	80	**R10,743,649**	R0	R1,376,839	R1,143,207	**R2,520,046**

Source: Anchor

If this person had continued contributing to his life and disability premiums for the next ten years, he would have paid a total of R7,355,476 in premiums for something worthless on his balance sheet.

Figure 3: Investor's contribution to life and disability premiums over nine years

Year	Premium	Total	Insurance benefit increase	Invested asset value
2023	R38,549.91	R462,598.92		
2024	R43,792.69	R525,512.28		
2025	R49,770.40	R597,244.80		
2026	R56,588.94	R679,067.28		
2027	R64,369.92	R772,439.04		
		R3,036,862.32	**R2,304,942**	**R3,799,765.00**
2028	R73,252.97	R879,035.64		
2029	R83,398.51	R1,000,782.12		
2030	R94,990.90	R1,139,890.80		
2031	R108,242.13	R1,298,905.56		
		R4,318,614.12	**R2,151,657**	**R6,943,884.00**
	Total	**R7,355,476.44**	**R4,456,599**	**R10,743,649.00**

Source: Anchor

If, like many, you are seeing a dramatic increase in life and disability premium costs becoming an ever-growing burden, please contact us. We would love the opportunity to potentially turn this expense line into a balance sheet asset which will significantly benefit you and your family.

Understanding situs and situs tax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Di is the CEO of Robert Cowen Investments (RCI), a subsidiary of Anchor, and has been at RCI since 1990.

Kate graduated from Rhodes University in 2006 with a Bachelor of Arts degree. She has tried her hand at many professions, ranging from event management to working in the accounts department as a creditors clerk for Legacy Hotel Management Services. Kate started working at Robert Cowen Investments in February 2011, focusing on trusts and estates.

The concept of situs holds significant importance, especially when determining taxes associated with non-residents in a specific jurisdiction.

The word 'situs' is used in financial and legal jargon as if we all understand its meaning. But do we, and what are the implications for us as SA residents, or any global resident, for that matter? This article explains what situs means and why it is important to know what tax will apply to your offshore assets.

SITUS AND SITUS TAX: UNDERSTANDING TAXATION ON NON-RESIDENT ASSETS

The concept of situs holds significant importance, especially when determining taxes associated with non-residents in a specific jurisdiction. Currently, we have clients spread across the globe, but often, the UK and the US crop up as destinations where assets (listed assets, bonds, property) are held. This article aims to explain situs and situs tax, focusing on the US and the UK, including the tax rates applicable to non-residents in these countries. Obviously, other jurisdictions also have situs tax, and we are more than happy to discuss these with you.

Situs

Situs refers to the location or position where an asset is located for legal purposes. It determines the jurisdiction where the asset is considered to be located and the relevant laws regarding its taxation.

Situs tax

Situs tax (also known as source-based taxation) is a form of taxation imposed on assets based on their location rather than the taxpayer's residence. It is commonly applied to assets such as property, listed shares, and cash, BUT it depends on the laws governing the jurisdiction in which the asset is held.

Situs tax helps governments generate revenue from economic activities within their borders, so it is important to all jurisdictions!

In this article, we have only concentrated on how situs tax works in the abovementioned jurisdictions.

US SITUS TAX RATES FOR NON-RESIDENTS

In the US, non-residents are subject to specific tax rates on income derived from US sources, including certain types of assets in the country. The key considerations for US situs tax rates for non-residents include:

1. **Property:** Non-residents are subject to a flat tax rate of 30% on gross rental income derived from property located in the US.

2. **Dividends and interest:** Non-residents may be subject to a 30% withholding tax on certain types of investment income, including dividends and interest from US sources. However, tax treaties between the US and other countries may lower the applicable tax rate. The W-8 BEN form a client completes allows them to declare that they are not US citizens and alerts the US Internal Revenue Service (IRS) that a double tax agreement (DTA) should be applied to these US assets.

3. **Capital gains:** Non-residents are generally not subject to US capital gains tax on the sale of personal property. However, gains from the sale of US real estate interests by non-residents are subject to taxation under the Foreign Investment in Real Property Tax Act (FIRPTA). Persons purchasing US real property interests from non-residents must withhold a percentage of the amount realised on the disposition.

4. **Estate tax:** Non-residents are subject to US estate tax on certain assets with a US situs, such as real estate and listed shares. The exemption amount is US$60,000, and any amount above that is taxed on a sliding scale with rates ranging from 18% to 40%. For a South African resident it is important to note that the differential between US estate duty (maximum 40%) and SA estate duty (maximum 25%) cannot be refunded. Should the executor of an estate not declare the assets to the IRS, the IRS holds the executor personally liable for a number of years after the deceased's death.

UK SITUS TAX RATES FOR NON-RESIDENTS

In the UK, non-residents may also be subject to taxation on certain assets with a UK situs. The tax rates and rules vary depending on the specific asset and the individual's residency status. The essential considerations for UK situs tax rates for non-residents include:

1. **Real estate:** Non-residents who own residential property in the UK are subject to Non-Resident Capital Gains Tax (NRCGT) on gains arising from the disposal of UK residential property. The tax rates for non-residents are aligned with those applicable to UK residents, currently set at 18% for basic-rate taxpayers and 28% for higher-rate taxpayers.

2. **Inheritance tax:** Non-residents may be liable for UK inheritance tax on assets with a UK situs, such as real estate, listed shares, and cash. The inheritance tax rates for non-residents are the same as those for UK residents, with a standard rate of 40% on the value of the taxable estate exceeding the estate duty exemption amount (currently GBP325,000). Bear in mind a similar tax applies to offshore trusts holding assets in the UK and is applied on a ten-year cycle.

3. **Income tax:** Non-residents are generally only liable for UK income tax on income derived from UK sources. The tax rates for non-residents vary depending on the type of income, with different rates applicable to dividends, interest, rental income, and other forms of income generated from UK sources.

CONCLUSION

In conclusion, situs and situs tax play a crucial role in determining the tax treatment of assets held by non-residents in a specific jurisdiction. Understanding the situs of an asset helps taxation authorities establish the taxable connection and apply relevant tax laws and rates accordingly. For example, in both the US and the UK, non-residents may be subject to taxation on certain types of assets with a local situs, including real estate, listed shares and investment income. The applicable tax rates and rules vary depending on the specific jurisdiction and the type of asset involved, highlighting the importance of seeking professional tax advice to ensure compliance with relevant tax laws and regulations. DTAs are important regarding situs tax, and it is necessary to understand the DTA in place for the specific jurisdiction in which assets are held.

If you have any questions or need clarity on situs and its implications, please contact ***Di Haiden*** or ***Kate Trollip*** for assistance.

Performance Summary

	FUND PERFORMANCE									BENCHMARK PERFORMANCE							
	Start date	Annualised p.a.	Since inception	5 Year	3 Year	12-month	6-month	3-month	Mar-24	Since inception	5 Year	3 Year	12-month	6-month	3-month	Mar-24	Performance vs Benchmark
UNIT TRUSTS																	
Anchor BCI Equity Fund	Apr-13	9,1%	160,4%	6,1%	6,0%	9,6%	9,8%	2,2%	1,8%	130,8%	7,6%	7,5%	2,9%	5,7%	-2,3%	2,9%	29,6%
Anchor BCI SA Equity	Aug-21	8,5%	22,9%	N/A	N/A	3,3%	4,0%	-1,4%	0,9%	20,3%	N/A	N/A	2,9%	5,7%	-2,3%	2,9%	2,6%
Anchor BCI Flexible Income Fund	Jun-15	7,1%	83,2%	6,5%	6,6%	8,1%	5,1%	1,2%	0,2%	81,5%	6,5%	6,7%	9,0%	4,4%	2,2%	0,7%	1,7%
Anchor BCI Managed Fund	Jan-15	6,1%	71,5%	7,9%	8,2%	13,0%	11,1%	2,9%	0,4%	79,4%	8,3%	8,5%	9,4%	7,9%	1,6%	1,0%	-7,9%
Anchor BCI Worldwide Flexible Fund	May-13	11,7%	233,2%	12,0%	12,5%	37,3%	24,5%	15,3%	2,9%	158,1%	9,1%	10,1%	9,6%	4,5%	2,0%	1,3%	75,1%
Anchor BCI Property Fund	Nov-15	-1,6%	-12,4%	-1,0%	8,5%	11,8%	14,3%	1,4%	-0,2%	-5,3%	0,7%	13,9%	20,5%	20,9%	3,8%	-1,0%	-7,2%
Anchor BCI Global Equity Feeder	Nov-15	13,0%	180,5%	17,5%	5,0%	21,4%	15,1%	9,9%	2,1%	203,4%	17,1%	16,1%	31,2%	20,1%	11,9%	1,4%	-22,9%
Anchor BCI Bond Fund	Feb-16	8,2%	89,7%	6,7%	6,9%	3,5%	5,8%	-2,1%	-2,0%	91,1%	7,0%	7,4%	4,2%	6,2%	-1,8%	-1,9%	-1,4%
Anchor BCI Diversified Stable Fund	Feb-16	7,4%	78,9%	7,8%	8,4%	7,0%	6,0%	0,0%	-0,1%	69,5%	7,3%	7,8%	8,6%	6,8%	1,3%	0,3%	9,4%
Anchor BCI Diversified Moderate Fund	Feb-16	7,1%	75,0%	8,1%	9,1%	6,8%	5,8%	0,2%	0,2%	70,3%	7,8%	8,0%	8,7%	7,5%	1,6%	0,7%	4,8%
Anchor BCI Diversified Growth Fund	Feb-16	6,8%	71,3%	8,4%	9,8%	7,4%	6,6%	0,4%	0,4%	73,6%	8,3%	8,5%	9,4%	7,9%	1,6%	1,0%	-2,3%
Anchor BCI Africa Flexible Income	Mar-16	7,5%	79,0%	8,0%	8,2%	21,3%	16,2%	4,3%	1,4%	93,9%	8,0%	8,1%	10,3%	5,1%	2,5%	0,8%	-14,9%
Anchor BCI Global Technology Fund	Jun-19	11,5%	68,7%	N/A	0,4%	30,7%	26,4%	11,8%	0,2%	237,8%	N/A	23,2%	50,0%	32,4%	16,0%	1,0%	-169,2%
Anchor BCI Flexible Fund	Jul-13	9,6%	168,1%	11,8%	6,8%	25,1%	-0,5%	-11,8%	0,0%	10,0%	9,7%	10,4%	8,6%	3,0%	0,4%	0,0%	158,1%
Anchor BCI Core Income Fund	Sep-20	7,1%	27,7%	N/A	7,4%	9,8%	0.0%	2,2%	0,7%	22,0%	N/A	6,1%	8,3%	4,2%	2,0%	0,6%	5,8%
Anchor BCI Global Flexible Income Fund	Sep-20	4,8%	18,0%	N/A	9,1%	12,1%	5,2%	3,5%	-1,0%	24,4%	N/A	12,0%	13,1%	3,5%	5,1%	-0,8%	-6,4%
Anchor BCI Worldwide Opportunities Fund	Feb-21	5,2%	17,3%	N/A	5,3%	16,6%	14,9%	5,2%	0,8%	20,6%	N/A	6,1%	5,6%	2,5%	1,1%	1,0%	-3,3%
EQUITY NOTES & SEGREGATED MANDATES																	
Anchor Equity	Jul-13	8,9%	151.3%	9,0%	11,7%	9,4%	10,5%	0,0%	1,5%	129,2%	-2,3%	7,5%	2,9%	5,7%	-2,3%	2,9%	12,1%
HEDGE FUNDS																	
Anchor Stable SNN RIHF	Jul-03	12,3%	983,8%	8,7%	11,6%	7,3%	4,3%	1,3%	1,8%	316,4%	6,0%	6,1%	8,3%	4,2%	2,0%	0,6%	667,4%
Anchor Accelerator	Feb-16	6,2%	63,1%	4,9%	-4,1%	-0,2%	6,3%	2,1%	0,6%	91,0%	6,1%	6,1%	8,3%	4,2%	2,0%	0,6%	-27,9%
OFFSHORE																	
High Street Equity - Dollars	Jun-12	10,2%	213,1%	8,0%	0.7%	19,3%	20,5%	8,2%	1,7%	266,4%	12,6%	9,1%	25,7%	21,6%	9,0%	3,3%	-53,3%
High Street Equity - Rands	Jun-12	18,3%	625,0%	14,1%	9,4%	27,4%	21,1%	12,0%	0,4%	745,1%	18,9%	18,5%	33,9%	21,5%	12,7%	1,5%	-120,1%
Offshore Balanced - Dollars	Jun-12	7,8%	142,5%	4,8%	0,4%	14,9%	15,9%	6,3%	1,9%	116,3%	6,9%	3,2%	14,8%	15,0%	4,4%	2,1%	26,2%
Offshore Balanced - Rands	Jun-12	15,9%	464,7%	10,8%	9,4%	22,6%	16,5%	10,0%	0,6%	392,8%	12,4%	11,6%	22,2%	14,9%	7,8%	0,4%	71,8%
Global Dividend - Dollars	Jan-14	8,0%	119,5%	8,3%	7,0%	17,0%	17,3%	6,9%	3,8%	172,4%	12,6%	9,1%	25,7%	21,6%	9,0%	3,3%	-52,9%
Global Dividend - Rands	Jan-14	13,8%	271,9%	14,2%	16,0%	24,7%	17,7%	10,7%	2,5%	362,5%	18,9%	18,5%	33,9%	21,5%	12,7%	1,5%	-90,6%
Anchor Global Stable Fund - Dollars	May-15	1,7%	16,3%	2,7%	0,6%	8,8%	8,2%	1,6%	1,4%	34,9%	4,0%	5,0%	5,9%	2,6%	1,2%	0,4%	-18,7%
Anchor Global Stable Fund - Rands	May-15	6,9%	81,1%	8,5%	9,3%	16,1%	8,4%	5,4%	-0,1%	110,4%	9,7%	14,0%	12,7%	2,7%	4,4%	-1,0%	-29,3%
Anchor Global Equity - Dollars	May-15	10,8%	148,7%	14,3%	-2,9%	13,5%	15,7%	7,3%	3,4%	110,4%	10,9%	7,0%	23,2%	20,1%	8,2%	3,1%	38,3%
Anchor Global Equity - Rands	May-15	16,5%	287,5%	20,7%	5,5%	21,1%	15,9%	11,2%	1,9%	227,0%	17,1%	16,1%	31,2%	20,1%	11,9%	1,4%	60,5%
RCI UNIT TRUSTS																	
RCI BCI Flexible Growth Fund	Sep-16	10,3%	109,5%	13,2%	4,2%	45,2%	29,2%	11,9%	-2,5%	104,1%	10,1%	11,1%	10,6%	4,9%	2,3%	1,3%	5,4%
RCI BCI Worldwide Flexible Fund	Dec-16	9,6%	96,5%	10,6%	6,4%	28,7%	19,5%	10,1%	-0,4%	87,5%	9,1%	10,1%	9,6%	4,5%	2,0%	1,3%	9,0%

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