THE NAVIGATOR

STRATEGY AND ASSET ALLOCATION REPORT

3rd Quarter 2024

ANCHOR | NAVIGATING CHANGE

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Introduction

WRITTEN BY:

Nolan Wapenaar and Peter Armitage,
Chief Investment Officers

We are delighted to be able to write that South Africa's (SA) future is looking better than we had expected, with the formation of a Government of National Unity (GNU) ushering in a new era of coalition politics in the country. In Africa, risks often arise when an erstwhile liberation movement looks set to lose power in a particular country. There are many examples of election fraud, manipulation of constitutions, populism, civil wars and coup d'etats across the continent. However, we achieved a peaceful power-sharing agreement in SA in a month. The power-sharing arrangement moves the ruling political party toward the centre of the political spectrum rather than to the left. Many naysayers are discussing the risks of such a coalition arrangement, but that misses the point. Currently, SA is in a much better position than we had expected before the 2024 National and Provincial Elections (NPEs). Our nation's Constitution proved its mettle.

Much of the knee-jerk relief rally has already taken place. However, it takes time for the benefits from the extension of the long-term visa deadline to be felt, for the improved rail traffic to feed through the system, for improved governance at state-owned enterprises (SOEs) to take hold, etc. We expect that Cabinet meetings will be more transparent and that the discussions in these meetings will be more robust, with new ideas to ignite economic growth being brought to the table. We think that the seeds of a reform agenda have been planted, and we are hopeful that, with time, they will take root.

Investing is a long-term game – think of it as a marathon, not a sprint. Although we are more optimistic about the outlook for domestic assets, the benefits of these changes may take time to feed through to corporate earnings and share prices. The point is that the next five years look better than the past five, and SA should be on your investment radar when constructing your portfolios.

We continue to believe that the bulk of your wealth should be invested abroad and that there are opportunities in all offshore asset classes. Nevertheless, recent robust gains in US equities are making us cautious; still, the momentum is strong, and the projected US earnings growth is high.

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We are increasingly proponents of alternative assets (including hedge funds, protected equity structured products, physical property, etc.) with better defensive characteristics if we see a wobble abroad. This is a new asset class for most South Africans, even though it commands a significant share of the investment wallet for family offices abroad. We expect most domestic investors to benefit by increasing their exposure to this asset class over time.

Anchor is a proponent of balanced portfolios and diversified risks. We believe it is crucial for investors to 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. We advocate that a healthy portion of your investment portfolio should be offshore to leverage diverse opportunities and return profiles while mitigating SA-specific risk. We expect the rand will continue to hover around current levels vs the US dollar. Therefore, this is an ideal time to externalise a portion of your portfolio if you have not already done so.

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			●	14
Bonds		●		12
Listed property	●		←	12
Cash		●		8
Alternatives*			●	10 to 15
Rand vs US dollar (rand stronger)				1
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 (2Q24) was dominated by the positive response to the outcome of the SA elections. This provided a solid boost for domestic investments while global equity markets powered on with stellar returns. Our return expectations for the various asset classes have shifted to reflect different starting prices of assets, a more positive outlook for SA 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) are likely to perform best; however, downside risks are growing. Global bonds and cash also 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
Source: Anchor

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

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, we believe the worst is likely behind us. We anticipate less loadshedding, improved governance and slightly positive steps being taken by the government. There is still a significant political risk premium in the price of domestic assets, and we believe the country may become attractive to foreign investors if the reform narrative takes hold in time to come. We are optimistic that domestic factors should continue improving as we progress further into 2024.

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

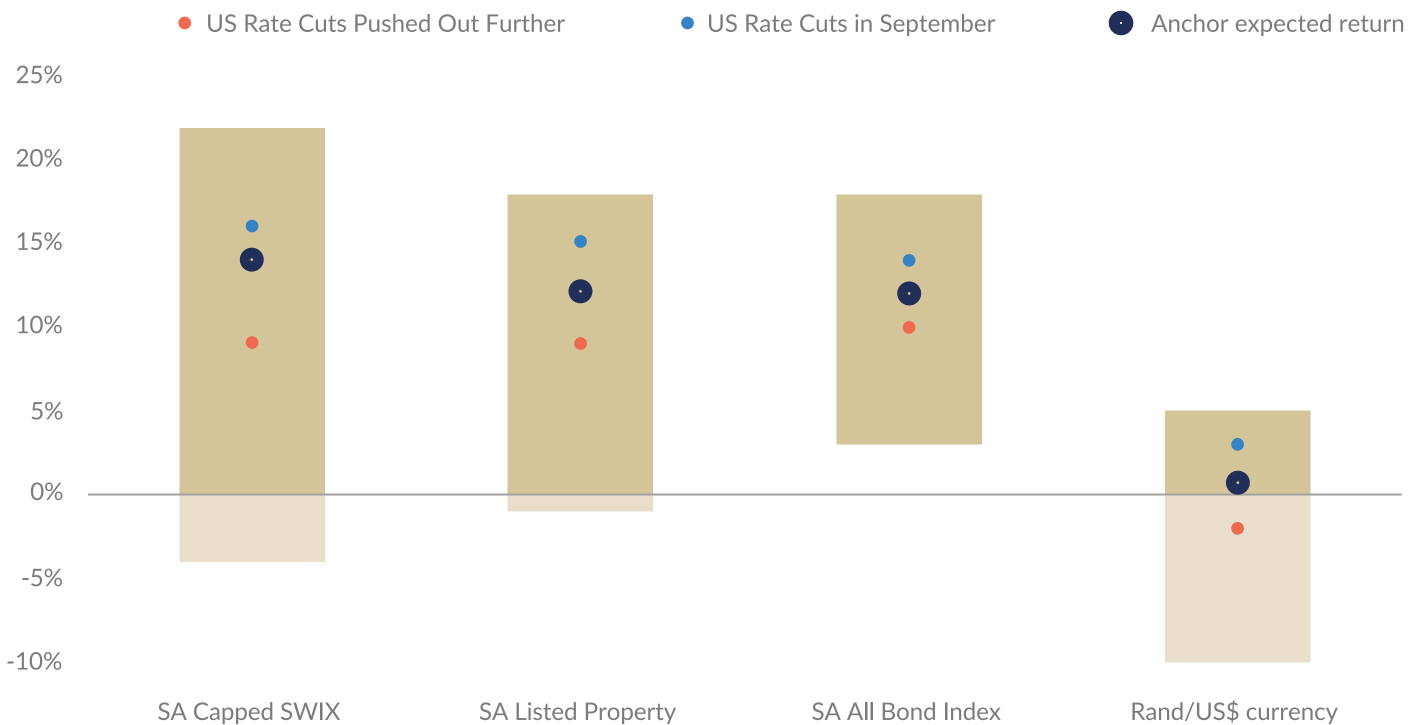


Figure 4: Anchor expected return for domestic asset classes
Source: Anchor

	Domestic equity	Domestic bonds	Domestic property	US$/rand
Anchor expected return (in rand)	14%	12%	12%	1%

Strategy and Asset Allocation

ECONOMICS

Moving into 2H24, it is reassuring to note that the global economy remains remarkably resilient despite the challenges of heightened geopolitical risk and high interest rates in major developed markets (DMs). Nonetheless, economic growth continues to vary across individual countries, mainly due to robust US economic activity defying high interest rates and a surge in post-pandemic savings supporting the economy. The stronger-than-expected growth in China has also played a significant role in global growth outcomes. *The International Monetary Fund* (IMF) projects global gross domestic product (GDP) growth at 3.2% YoY for 2024 and 2025, up from a 2023 estimate of 3.1% YoY. This 2024 GDP forecast is 0.2 ppts higher than the IMF's previous October 2023 forecast due to resilience in the US and several large emerging market (EM) economies and anticipated fiscal support in China. However, it is worth considering that these figures are below the historical average of 3.8% YoY growth from 2000 to 2019 due to high central bank policy rates, reduced fiscal support, and low productivity growth. Evolving risks may also slow global economic activity as the year progresses. China faces ongoing challenges despite a robust 5.3% QoQ annualised expansion in 1Q24. Debt sustainability risks and a struggling real estate sector constrain economic activity in China. Authorities have supported strategic sectors and allocated US$42bn to buy excess property stock to stabilise China's beleaguered property sector. However, these measures are insufficient to reverse negative trends. China's recent spurt in growth has been driven by an export-led rebound in industrial activity, which may face obstacles due to steep US import tariffs targeting China's strategic exports, including electric vehicles (EVs).

The continued divergence in growth outcomes between EMs and DMs has primarily been driven by differences in productivity growth and the impact of high borrowing costs. US fixed-rate debt instruments have helped maintain household balance sheets, while the withdrawal of pandemic-era fiscal support has introduced volatility to short-term growth across economies. Country-specific monetary policies have significantly influenced post-pandemic growth outcomes. A mild economic slowdown is likely, but there is reason for optimism. If central banks can control inflation, a less restrictive monetary policy in late 2024 should stimulate economic activity in 2025. Major Western central banks' shift towards looser monetary policy supports this outlook. The European Central Bank (ECB) recently cut interest rates, following the Swiss National Bank (SNB), Sweden's Riksbank, and the Bank of Canada (BoC) earlier this year. Further rate cuts are expected from the Bank of England (BoE) in August and the US Federal Reserve (Fed) in September, contingent on favourable inflation and wage trends. The easing pace will be gradual and dependent on inflation and wage developments. Regardless, downside risks remain - particularly concerning major upcoming elections and growing protectionist policies.

.... the global economy remains remarkably resilient ...

On the local front, in 1Q24, SA's economic activity contracted by 0.1% QoQ (with a 0.2% decline on the expenditure side), following an upward revision to a 0.3% expansion (previously reported as 0.1%) in 4Q23. Persistent structural challenges, including inadequate logistical infrastructure, limited energy availability, and emerging water scarcity, drove the 1Q24 contraction. Additionally, high interest rates and dampened sentiment across the economy contributed to subdued growth. Looking ahead, we expect inflation to remain subdued, albeit at levels higher than initially envisioned at the start of this year. Core inflation (particularly that of goods) will likely be subdued as consumer demand continues to be constrained by the pressures of elevated interest rates. Nonetheless, inflation remains some way off from the SA Reserve Bank's (SARB) target

of 4.5%. This will likely keep the SARB's tone hawkish in any near-term remarks. The central bank has remained steadfast in communicating that it will not move the policy rate lower (and thus essentially usher in a rate-cutting cycle) until inflation is under control and sustainably hitting that target. As such, we foresee potential rate cuts materialising towards the end of 2024, depending on the inflation outlook (locally and abroad) and global interest rate developments as we progress further into this year. At this stage, we expect an initial rate cut of 25 bps in November, followed by a further 50- to 75-bp worth of cuts in 2025 and leading into 2026.

The executive is now in a far stronger position than in many years to guide the country's much-desired (and needed) reform course in critical areas.

On the political front, it is still too early to draw any concrete conclusions about the effectiveness and efficiency of the GNU and the resultant new Cabinet. Regardless, as it stands, the executive is now in a far stronger position to guide the country's much-desired (and needed) reform course in critical areas than it has been in many years. At the time of writing, the new Cabinet, on balance, has been viewed positively by financial markets. Bond investors have been particularly encouraged by the continuity in National Treasury, which remains committed to fiscal consolidation. The addition of a deputy minister is also viewed as supportive. The portfolios focused on priority areas for the policy reform agenda have seen several improvements and strong appointments, further bolstering our optimism regarding the positive impact of policy reforms supported by Operation Vulindlela, the policy implementation unit of The Presidency and National Treasury. Despite structural reforms' complex and protracted nature, this continuity and focus on critical areas strengthen our confidence in the ongoing reform efforts.

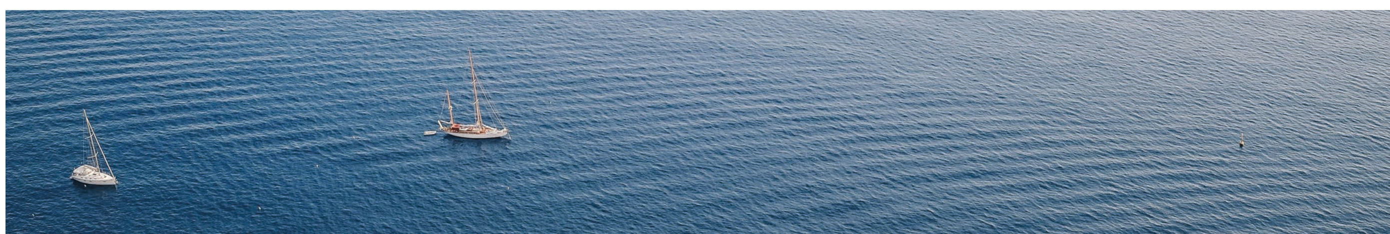
The election outcome and GNU are steering SA politics toward the centre. The Radical Economic Transformation (RET) faction will be positioned to the left (or far right, depending on your perspective), libertarians to the right, and a pragmatic centre will advocate for social-democratic policies. This marks the most significant political realignment since 1994. Nonetheless, this new Cabinet is by no means a "silver bullet" for the domestic economy - the road ahead will be difficult, fraught with the usual politicking and disagreement amongst the various members of the GNU. Up until the announcement of the new Cabinet, investors had become increasingly concerned about the GNU potentially collapsing at its first major challenge. This, in turn, unfortunately, damaged confidence in the GNU itself and in its ability to influence SA's economic and political direction positively. This moderation or correction in sentiment (think Ramaphoria 2.0) was necessary in some measure. Market sentiment now better reflects the complexities and risks inherent in SA's evolving, dynamic coalition landscape.

As such, 2H24 holds the potential for an uptick in the local economy. As interest rates ease and inflation slows, there is the possibility of a boost in consumer spending. Positive developments include progress in energy and rail sector reforms and efforts to address grey-listing concerns. However, inconsistent international relations, infrastructure bottlenecks, and residual policy uncertainty remain constraints to SA's growth.

SA EQUITIES

As measured by MSCI SA, South African equities delivered a strong 2Q24, up 11.3% in rand and 4.4% in US dollar terms. In 2Q24, the FTSE JSE All Share Index (+6.9%) outperformed both DM equities (MSCI World +2.8%) and the broader EM universe (MSCI EM Index +5.0%). The FTSE/JSE Capped Swix Index, a more commonly used local index performance measure, delivered a similarly solid performance, up 8.2% in 2Q24.

As an investment house, we turned bullish on local equities at the end of 1Q24, citing several technical factors that had set the index up nicely relative to global equities and local fixed income. At the margin, the developments over this past quarter have reaffirmed our positive stance towards local equities, with our 12-month total return of 14% still comfortably above that of global equities (7%). Accordingly, we maintain our overweight stance on domestic equities.



... developments over this past quarter have reaffirmed our positive stance towards SA equities ...

Several factors led to the outperformance of JSE-listed equities during the past quarter. BHP Group's failed attempt at buying local mining champion Anglo American Plc, if anything, highlighted the extreme value on offer across the local market. The takeover attempt reignited interest in domestic assets as we headed into the 2024 NPEs. The elections, late in the quarter, proved to be the ultimate catalyst to reprice SA assets, which, for once, managed to surprise for the right reasons.

Going into the elections, our base case was for the ruling African National Congress (ANC) to drop below 50% and settle somewhere around 45%, with the controlling balance gained from forming coalitions with smaller, more aligned parties such as the IFP. The final tally, with the ANC's support plummeting to 40.2% of the vote (vs 57.6% in 2019) and the party losing its parliamentary majority for the first time in democratic history, came in well below our expectations. The NPE results opened up the possibility that the ANC would need to go into a coalition with the far-left (the M.K. party or the Economic Freedom Fighters [EFF]), which would have been interpreted as being market unfriendly. However, the result also opened the possibility of the ANC working with the broadly centrist Democratic Alliance (DA) to form a GNU, thereby taking a step forward in advancing a reform agenda and pursuing a more market-friendly outcome.

It is worth noting that the possibility of the ANC and the DA sharing responsibility in running the country was not even part of our pre-election planning discussions. We interpret this outcome to be as positive as we could have hoped for a few months ago.

The initial response to the NPEs was favourable, with an almost instant repricing of the local risk-free rate (as measured by the generic ten-year government bond) from 12.5% to 11%. The knock-on effect was a re-rating of domestically focussed assets, with the JSE-listed banks being most leveraged to a move in the risk-free rate. The FTSE JSE SA Banks Index ended the quarter 20% higher.

The move higher in SA assets can largely be explained by a re-rating of domestic assets due to the risk-free rate changing. Both moved from extreme levels heading into the NPEs and still screen as cheap compared to any period in post-apartheid SA. The moves to date have seemed orderly and rational.

With the post-election relief rally now largely behind us, attention turns to whether the country and its corporates can capitalise on the incredible opportunity to ignite growth and invite foreign investors (including local assets managers sitting at their maximum offshore exposure limits) back to the JSE.

We remain cautiously optimistic, with the 12-month total return of 14% not considering much-improved earnings prospects. We maintain the view that local bonds offer good value and that earnings expectations have not yet been revised higher despite the outlook for domestic growth having increased vs a few months ago on the back of an improvement in local operating conditions. This has been helped along by a marked improvement in the energy situation (three months of no loadshedding from stage 6 just one year ago) and an improvement in consumer sentiment following a peaceful and orderly election outcome, not to mention a few interest rate cuts expected over the next six months. Changes to retirement savings legislation (the so-called two-pot system) are also expected to add 0.5% to SA's GDP when it becomes effective later this year.

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Our views on SA equities are not without risk, and investors have fresh wounds from 2017/2018 when President Cyril Ramaphosa ousted ex-president Jacob Zuma for the leadership of the ANC and the country. Ramaphosa was perceived as being market-friendly, and domestic equities enjoyed a stellar run, only for the result to be a continuation of the same mismanagement of the economy and state finances that plagued the Zuma administration (and subsequent de-rating of SA equities). Since then, SA has been a perennial underweight in most global and EM portfolios. The investor exodus was felt most acutely in the ratings on local bonds (after SA lost its last investment-grade rating, it was ejected from the FTSE World Government Bonds Index [WGBI], prompting a sell-off in SA government bonds) and the domestically focussed JSE businesses (financials, retailers, property, mid-caps). The risk is obviously that the parties that make up the GNU fail to find a way of working together to kick-start growth. Globally, coalition

politics have a poor track record in making timely decisions that satisfy all parties and objectives.

... we have maintained our bias towards quality, dependable earnings streams ...

We believe the best way to approach this potential local inflexion point is to keep an open mind and a sharp eye on whether the renewed optimism around governance in SA translates into a durable investment and earnings cycle – attributes that will kick-start a sustained rally in domestic risk assets. While we expect a tough earnings season to July (particularly from the retailers), commentary from corporates on their post-election trading outcomes will be vital in framing earnings expectations going into the back end of this year. In our portfolios, we have maintained our bias towards quality, dependable earnings streams. Still, we have also earmarked several mid-cap counters to watch closely for signs of domestic recovery.

DOMESTIC BONDS

Despite a negative 1.8% return at the index level in 1Q24, South African Government Bonds (SAGBs) demonstrated resilience, bouncing back in 2Q24 to return 7.49%. The result is a YTD return of 5.55%. The curve's movement has been flattening across 2Q24, which has supported longer-duration bonds. The SA All Bond Index (ALBI) term splits reflect this reality, with the 12-year-plus split outperforming all others. The ALBI duration remains 5.5 years, even with the weighting of the R186 (now the shortest SAGB in the index, maturing in 2026) dropping by c. 20 bps every month as the index is reweighted and reconstituted.

As 1H24 closes, we have seen no interest rate movements thus far. The US Fed and the SARB MPC have kept rates steady year to date, with both central banks highlighting concerns about inflation and the underlying strength of their respective economies.

We previously highlighted SARB Governor Lesetja Kganyago's drive to reduce the inflation target band, currently between 3% and 6% (with the midpoint currently interpreted as 4.5%). However, any change to the inflation target does require sign-off from the finance minister, although interpretation of the target range is open to the MPC itself.

Our outlook for rates going forward has moderated slightly downwards. We started 2024 with expectations for rates to remain stable through 1H24 and for two rate cuts in 2H24 (we did highlight that the risks to this view were heavily biased towards two cuts becoming one, rather than two cuts becoming three). We now foresee one rate cut through year-end and two more cuts arriving through 2025. We thus expect the repo rate to end 2024 at 8% and to move to 7.5% by the end of 2025.

The outcome of the SA election materialised at the lower end of pre-election polling ranges, with the ANC netting a 40.2% national outcome. Most of its loss of support can be attributed to the rise of former president Jacob Zuma's M.K. party. Zuma was able to motivate a base in KwaZulu Natal ([KZN] and, to a lesser extent, in Mpumalanga and Gauteng), which saw the party net a total of over 4.5mn votes (14.6% of the ballot). In addition, voter turnout collapsed from over 65.9% in 2019 to 58.6%, further eroding ANC support.

Our outlook for rates going forward has moderated slightly downwards

Post-election, the ANC was forced to form a coalition government called the GNU. Fundamentally, the GNU comprises the ANC, DA, and the IFP, as well as a coterie of smaller parties, forming a cabinet of 32 ministers, 43 deputies, the president and the deputy president.

We remain cautiously optimistic. The addition of coalition partners means that government departments have the added oversight of competing parties monitoring one another. Coupled with the absolute return on offer from SAGBs across the curve (with belly bonds offering yields over 11%), we remain confident in a broadly positive medium-term outlook for bond investors.

As we enter the back half of 2024, the significant event risk is the US Presidential Election (slated for Tuesday, 5 November 2024). The first debate was brought forward, resulting in a poor performance from the sitting president, Joe Biden. His age (Biden will turn 82 two weeks after the election), mental acuity, and physical ability to be president were brought into severe focus by a rambling and, at times, incoherent debate performance. Conversely, ex-president Donald Trump has thirty-four felony convictions (the first former US president to be convicted of such), charges of fraud, election subversion, and obstruction hanging over him—a depressing situation for the most powerful nation in the world.

Betting markets reacted sharply post-debate, evaluating a Trump victory in November at 55% likely as at most recent prints. Biden's odds have dropped sharply, with an increasingly vocal demand for him to step aside before the Democratic National Convention (DNC) to allow the party to coalesce around a new candidate. At the time of writing, Biden resisted these calls and insisted that US voters judge him based on his record rather than an individual debate performance.

We forecast a policy mix under a Trump presidency that is more dollar-positive and inflationary, i.e., leading to higher rates for longer than a Biden (or any moderate Democratic candidate) policy mix. Our positioning remains cautiously optimistic, slightly above the index (the Anchor Bond Fund duration currently sits at 5.9 years vs the index at 5.5 years) to take advantage of the highly attractive yields still on offer in the belly.

THE RAND

The rand strengthened during 2Q24 as investors took a positive view on the outcome of the SA elections. We also note that SA's trade balance has been positive, which is broadly supportive of the rand. We had expected the rand to average around R18.50/US$1 for much of 2Q24, which appears to have been correct. Looking forward, we think the rand's prospects will continue to improve, and we see it trading in the R17.50-R18.50/US$1 range for 3Q24.

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 highlight, however, that the rand trades within a R2.50 range to the US dollar in most 12-month periods.

We think that SA screens attractively against its competitor EMs, and it is plausible that foreign investors' upweighting of the country could significantly boost the rand. However, we are not convinced that such an outcome is imminent. Hence, our forecast is only for muted rand gains at this stage. We think investors might take a wait-and-see approach before buying into the GNU. Still, if the renewal and reform narrative takes hold, domestic financial assets and the rand stand to benefit significantly, much as Brazil's economy did a few years ago. Our more moderate base case is that the positive trade balance, higher gold price, and a supportive global environment as the US starts to talk about interest rate cuts will see the rand eke out small gains over time.

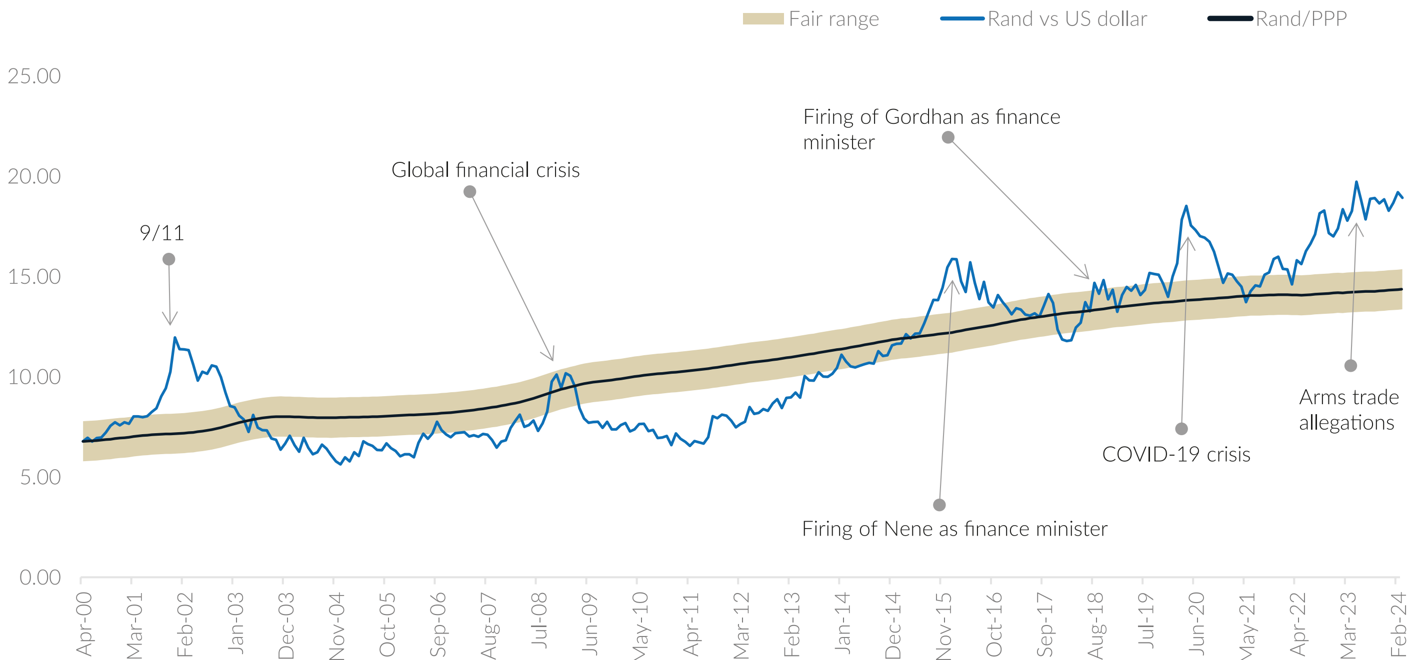
... if the reform narrative takes hold, domestic financial assets and the rand stand to benefit ...

We retain our purchasing power parity (PPP) based model to estimate the rand's fair value. We have extended this out by three months since *The Navigator – Anchor's Strategy and Asset Allocation, 2Q24* report was published on 17 April 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. As a result, our PPP-modelled value for the rand vs US dollar at the end of the next 12 months is R14.79/US$1 (*see Figure 1*). We apply a R2.00 range around this to get to a modelled fair-value range of between R13.79/US$1 and R15.79/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 rates in September 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 this year. Nevertheless, we do not expect the local unit to recover fully, and we are projecting a rand exchange rate in the R17.50-R18.50/US$1 range in one year as domestic issues continue to weigh on the currency. For this report, we have modelled on R18.05/US$1.

We expect the rand to remain particularly volatile, and surprises are inevitable for the remainder of this year.

Figure 1: Actual rand/US dollar exchange rate vs rand PPP model
Source: Thomson Reuters, Anchor



GLOBAL EQUITIES

US equity markets have surged by more than 30% since their October 2023 lows, but as valuations approach 15-year highs, it is becoming increasingly difficult to remain bullish. We have downgraded our stance on global equities to neutral and forecast a respectable 7% 12-month US dollar-denominated return. However, there is an increasing chance of a shorter-term correction, given the complacency that is setting in as markets trend upwards.

Below, we detail our bull- and bear-case scenarios for global equities:

The bull case is centred around strong forecast earnings growth for the next 12 months (14% in the US, which is close to 60% of global equity markets). While the US S&P forward P/E multiple is near 15-year highs at 21x, if the big tech "Magnificent 7" stocks are excluded it declines to 18.2x. This appears justifiable, given the earnings growth outlook for the next two years. US economic growth is powering ahead, and the US Fed looks set to start lowering interest rates in September of this year. If this happens for the right reasons (normalisation of rates and inflation reaching targets rather than slowing economic growth), it will further boost sentiment and earnings growth. Even if there is some multiple compression, a double-digit market return could still be achieved. High interest rates have also seen a flood of money into money-market funds and a portion of this US$6trn could be looking for better returns as interest rates decline.

The bear case is that sustained decade-high interest rates will eventually take their toll on segments of the economy, and economic growth starts to falter. If this is accompanied by stubborn inflation, the Fed might have less latitude to reduce rates to stimulate economic growth. With high starting multiples, there is the potential for some meaningful downside in markets. Markets are priced for perfection; anything less will put pressure on equities. The first signs of this might be lower-than-expected payroll numbers as employers start expressing some caution regarding the future. Uncertainty regarding the US Presidential Election in November could also reduce risk appetite. The market could be especially sensitive to inflation reports and earnings performance in the coming months. Thus, stock selection becomes especially important.

The VIX index (which measures US stock market volatility) is at very low levels

The market is largely dismissing the bear case, and the VIX index (which measures US stock market volatility) is at very low levels. At the beginning of the year, investment banks were, in aggregate, forecasting an S&P 500 level of 4,600 at year-end 2024, and most are still constructive on equities as the S&P

powers through 5,500. Underinvested fund managers are hating this bull market!

Given the scenarios above, our approach is to remain invested in equities but to be selective with valuations and stick to quality companies that can grow through the economic cycle. Passive index-level investing is riskier, given the very expensive tech shares concentration. Very few active asset managers have matched the index over the past 12 months, but this has the potential to reverse over the next 12 months. There is also an argument for shifting some exposure to Japan and Europe, as lower valuations and earnings upgrades provide a positive backdrop.

The market dynamics of the past six months are interesting. Half of the 12% return of the S&P 500 has come from the top-six tech shares, with 3% of this 12% return coming from Nvidia, which recorded a share price increase of 150% in 1H24 and is now the second-biggest company by market cap in the world – at over US$3trn. The remaining 494 companies contributed 6% of the 12%. In 2Q24, most sectors were negative, with sparse returns outside technology. Perhaps this reflects some of the caution expressed in the bear case above, but it has also provided a breather and allowed earnings to catch up with valuations.

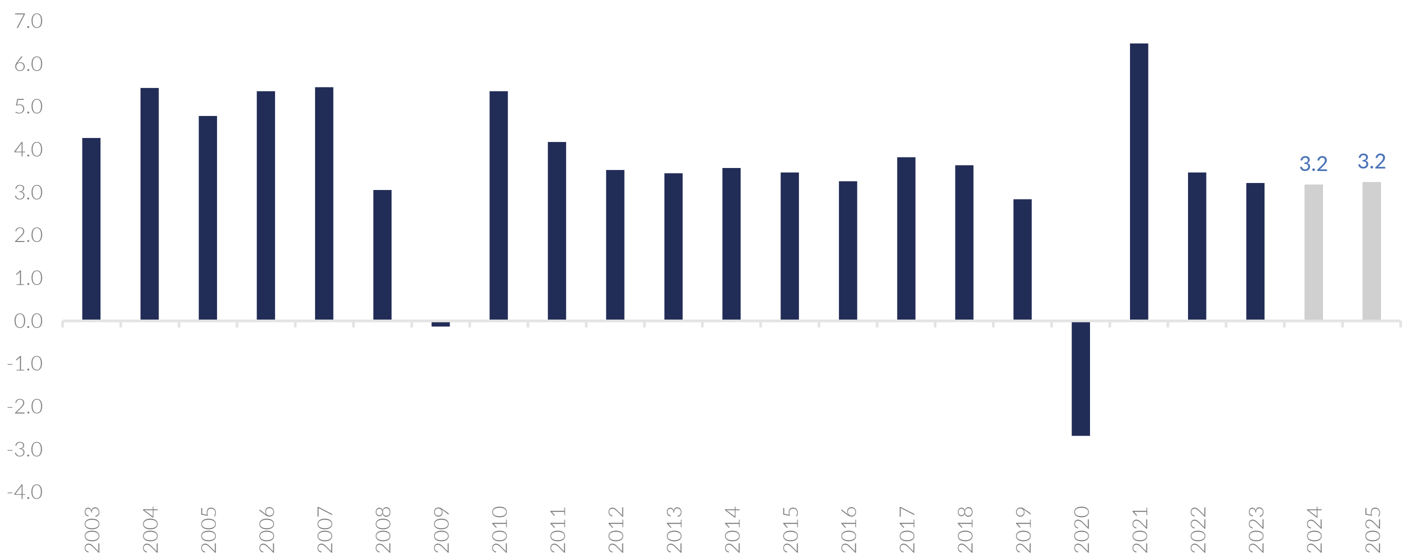
The message sent by the US Fed is key to market performance. Interest rates are now at historically high levels (5.25% from close to zero only 18 months ago), and expectations of interest rate cuts this year have declined from six to two (which equates to 1.5% of rate cuts vs 0.5%). This is because the decline in inflation has stalled somewhat, and the US economy has remained much stronger than anticipated (until recently). In other words, the Fed does not feel compelled to cut rates to avoid a recession. This is good news, and at this stage, it appears the management of the interest cycle has been exceptional. Economy doomsayers have been confounded, and strong US government expenditure has aided this process. If the economy slows, 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, with money market funds offering 5%-plus in US dollar returns and US 10-year treasuries trading at yields above 4.3%. If you are prepared to give up some liquidity or take a little more credit risk, yields of 6%-9% are available. In Anchor's alternative investment offering, we are targeting double-digit US dollar-denominated returns. Higher rates also mean that high dividend-yield shares in the US have become relatively less attractive, as a 3% dividend yield is not what it used to be if I can get 3% "in the bank."

The economic reality in the chart below shows reasonable and accelerating 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.

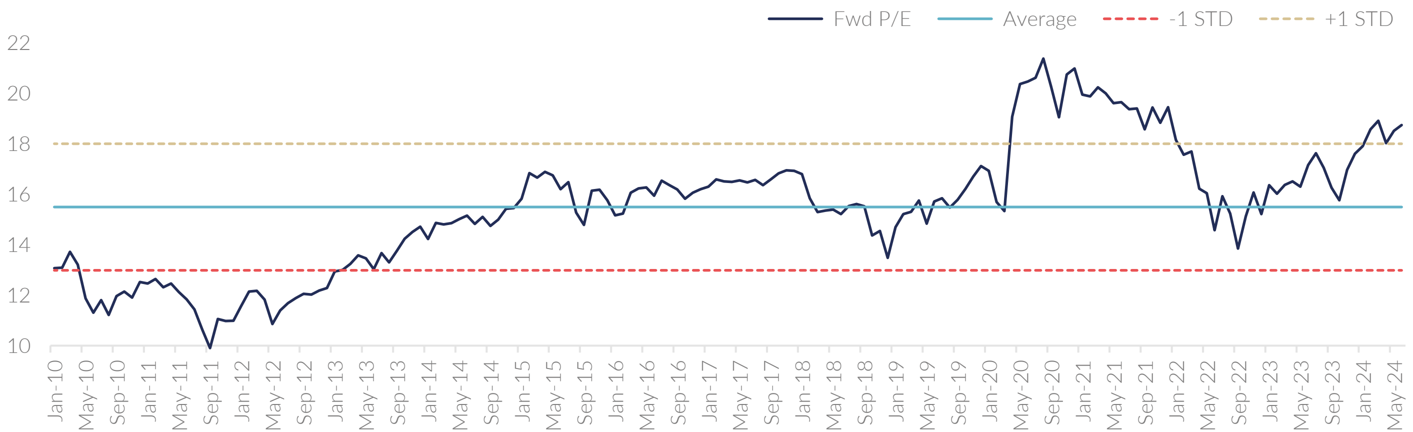
Figure 2: Global GDP growth, YoY % change

Source: Anchor, IMF



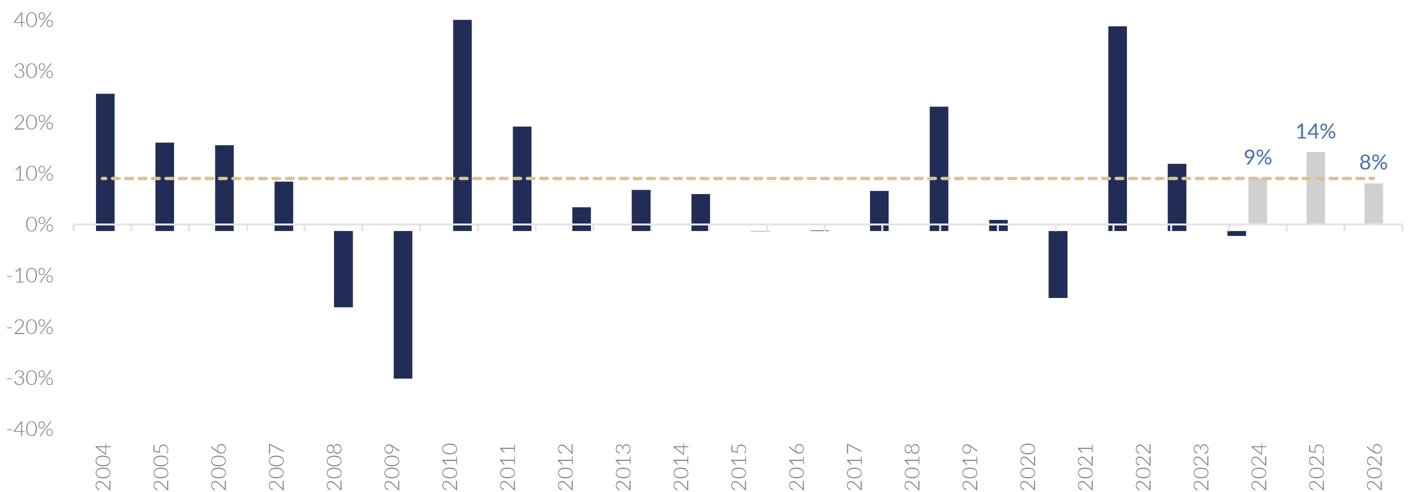
Valuations at the index level in global DMs look full (MSCI World forward P/E of 18.7x).

Figure 3: MSCI World 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% YoY 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 looking further to 2H24 and beyond.

Figure 4: S&P 500 EPS growth (annualised)
Source: Anchor, Bloomberg



The S&P 500 Index's one-year forward P/E is 21.4x (*see table below*). Multiples often increase when earnings dip if the outlook is more positive. EMs are much cheaper and have strong recovery potential.

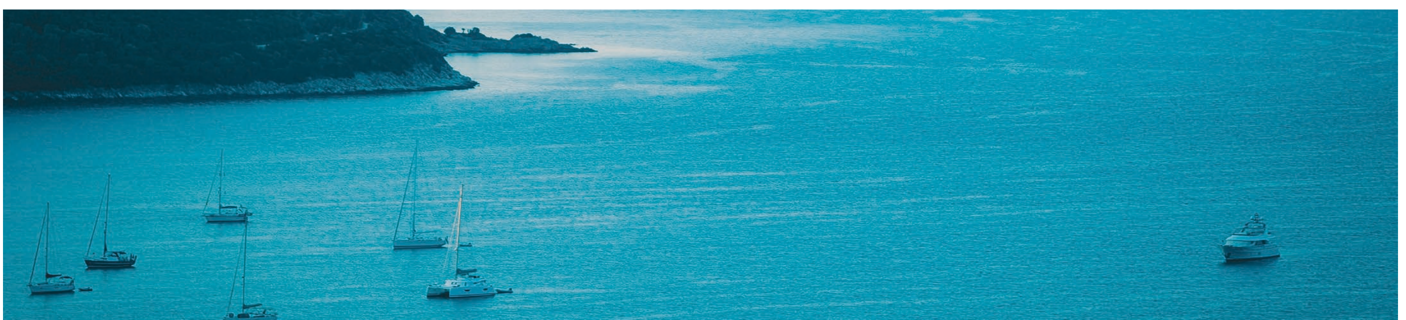
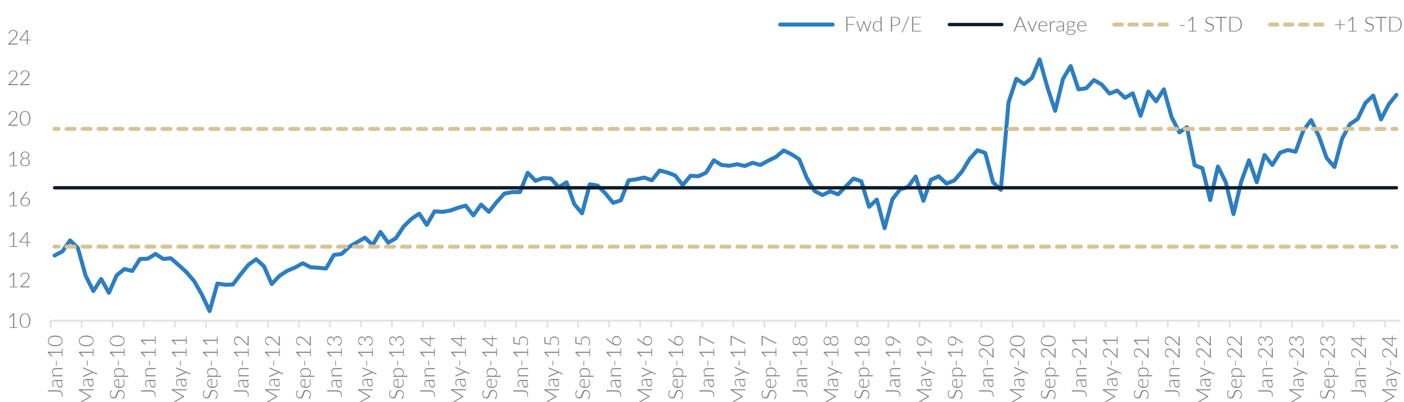


Figure 5: Various major global indices' EPS growth and forward P/E forecasts
Source: Anchor, Bloomberg

	Earnings growth		FWD P/E	
Name	**YR1**	**YR2**	**YR1**	**YR2**
MSCI World Index	11.7%	11.0%	18.7	16.8
MSCI EM Index	23.8%	14.5%	12.2	10.7
MSCI All Country World Index (10% EM)	13.4%	11.5%	17.7	15.9
S&P 500 Index (ex-Energy)	19.5%	11.5%	21.2	19.0
S&P 500 Index	14.5%	11.0%	21.4	19.3

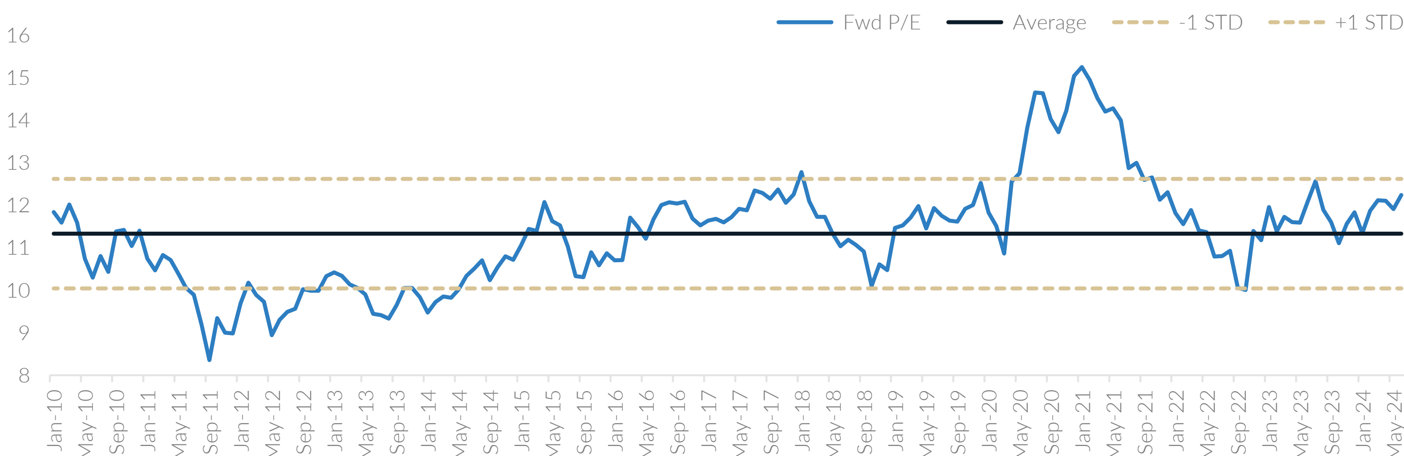
This is shown graphically in the chart below.

Figure 6: 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 sentiment shift could lead to a sharp short-term rise. An interesting opportunity is the Chinese AI shares, which have not shared the same positive reaction to the rapidly evolving future. This is despite many of them having invested heavily in this space in the past decade.

Figure 7: MSCI EM Index forward P/E, x
Source: Anchor, Bloomberg



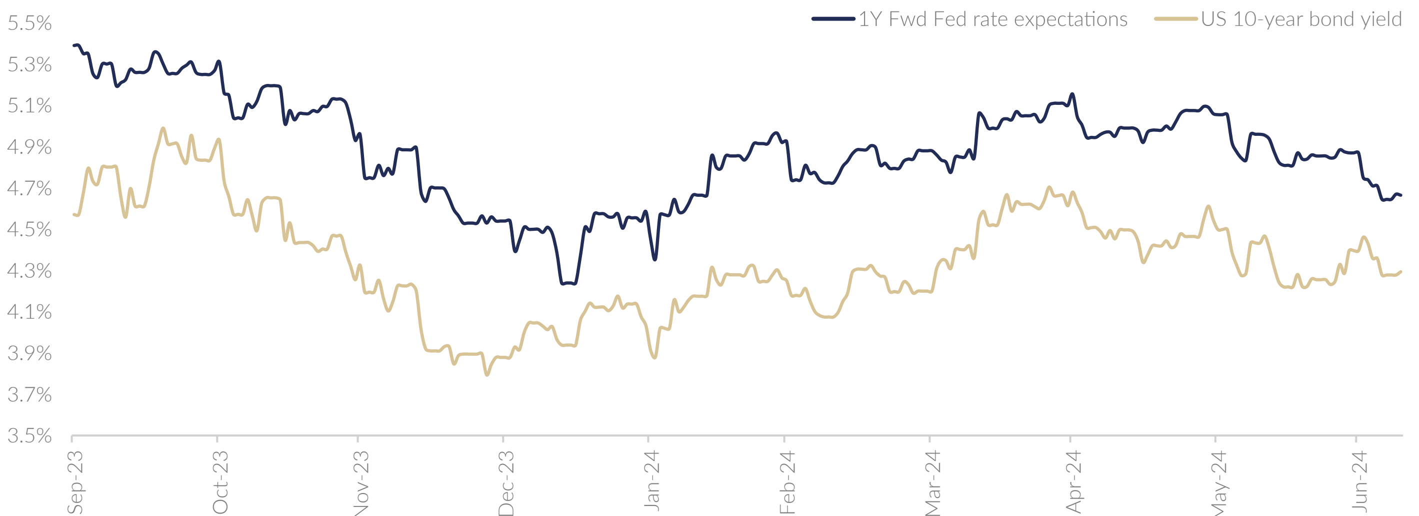
GLOBAL BONDS

Over the past year, the US government's 10-year funding rate has consistently been above 4% p.a. We think it is reasonable to assume that this could be considered the "new normal", or perhaps more correctly, the "old normal" as we move away from the unrealistically low funding rates of the post-global financial crisis (GFC) era. This transition to more realistic global long-term funding rates has coincided with a period of historically high DM inflation and high cash rates. The prolonged spike in inflation and the return to more subdued inflation levels have dragged on for longer than most had anticipated, making it an exceptionally tough period for forecasting the path of global central bank rates. As US Fed Chair Jerome Powell succinctly stated in his recent press conference, "a broad range of outcomes all remain plausible" for the path of US Fed rates.

The prolonged spike in inflation and the return to more subdued inflation levels have dragged on for longer than most had anticipated

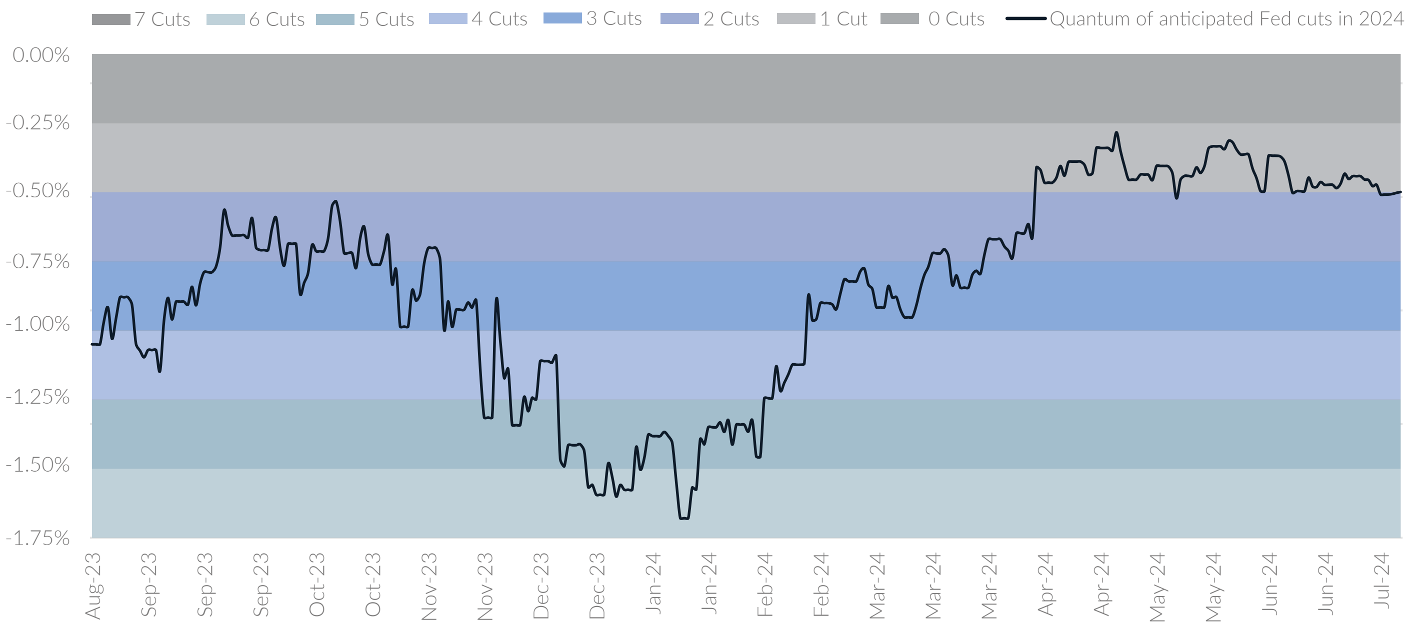
Typically, economists would expect US long-term interest rates to be more sensitive to shifting expectations for future economic growth, with shorter-term rates more sensitive to investor expectations about the short-term path of US Fed fund rates. Over the past nine months, though, those rates have tracked each other around in an unusually tight band.

Figure 8: US 10-year bond rates and derivatives pricing investor expectations for the path of US Fed rates one year out have tracked each other around in an unusually tight band recently
Source: Anchor, Bloomberg



Given the level of uncertainty around the path of US Fed rates and, at least over the recent past, the volatility that has caused in US 10-year government bond yields, US 10-year government bond investors have experienced some uncomfortable levels of capital volatility. We believe, though, that the level of volatility in Fed rate expectations will decrease as investors become more pragmatic about the pace of inflation and Fed fund rate normalisation.

Figure 9: Expectations for the path of Fed rate cuts have been volatile over the past year but are settling in a much tighter range recently
Source: Anchor, Bloomberg



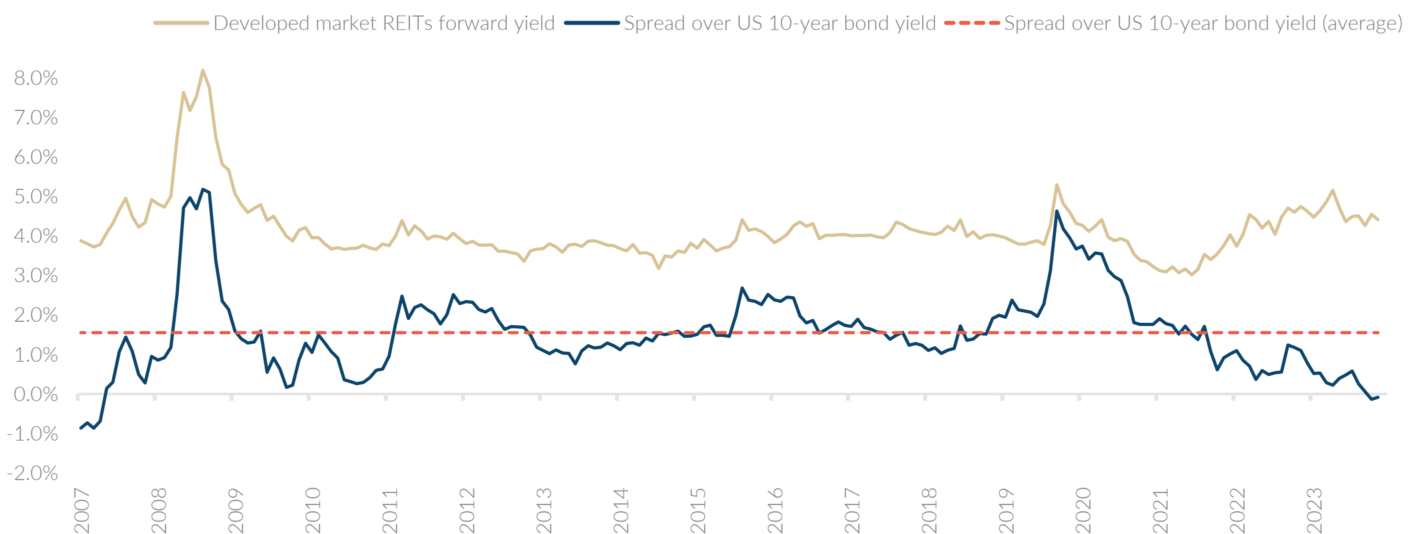
Our conclusion is that the US 10-year borrowing rate will remain above 4% but likely trade in a much tighter band. This should give investors a total return of around 4% to 5% in US dollar terms over the next twelve months.

High-grade corporate bond investors still receive historically low additional yields for taking on the default risk associated with corporate bond investments. As such, our anticipated total return outcome over the next year (5%-6%p.a.) is roughly in line with investments in US government bonds.

GLOBAL PROPERTY

2024 YTD has been all about mega-cap US tech stocks, and pretty much everything else has lagged. Listed property shares found themselves at the back of that distant chasing pack, and real estate investment trusts (REITs) in the S&P 500 were the only sector with a negative performance at the halfway point of 2024 (-2.4% YTD). Despite this underperformance, for the first time since 2007, DM REITs now have aggregate one-year forward dividend yield expectations (4.3%) below US 10-year government bond yields.

Figure 10: Dividend yields on global REITs are below the US 10-year government borrowing rate for the first time since 2007
Source: Anchor, Bloomberg



Given our expectation that the current long-term US dollar funding rates are probably at an appropriate level, it is unlikely that a significantly lower funding environment will push spreads back towards their historical average (c. 1.5%). So, we have low conviction that a meaningful re-rating will drive returns in the sector. That means investors will need to rely on the dividend yield and the growth of those dividends for their total return. There also remains the prospect of a small de-rating to restore relative spreads. There are lots of structural undercurrents that are impacting rental growth differently across the various commercial real estate sectors. However, we think we are near the point where the traditional sectors have largely worked through negative rental reversions and started digesting higher borrowing rates. Thus, we believe there is a reasonable prospect of seeing some dividend growth over the next few quarters. The combination of those factors should result in an aggregate total return of c. 6% in US dollar terms over the next twelve months in global DM REITs.

ANCHOR INSIGHTS

In this section of the Navigator, staff across Anchor provide insights into our thinking, strategy, and worldview. This quarter, Mike Gresty delves into what investors can learn from the performance of JSE-listed financial and industrial shares following Ramaphosa's appointment as ANC and SA president in 2017/2018 and after the establishment of a market-friendly GNU, in what can best be described as a "Ramaphoria 2.0" trade, Lelethu Poswa take a deep dive into the Bank of Japan's policy shift back to managing inflation, Michael Ncube discusses the vital role uranium is poised to play in transitioning from fossil fuels to cleaner, sustainable sources, Darryl Hannington looks at hedge funds as a viable alternative for SA equity market investors, Chris Lemmon provides insights into active portfolio management and asks whether the market is efficient or not, and, finally, Di Haiden explains the why and the how of offshore asset structuring.

Ramaphoria 2.0: What next?

WRITTEN BY:
Mike Gresty,
Fund Management

Mike joined stockbroker Barnard Jacobs Mellet in 1999, where he covered the SA banks and specialty financials sectors. In 2003, he moved to Deutsche Bank, where Mike continued to cover local banks and specialty financials before covering telecoms, media, and local investment strategy. He was appointed head of investment research at Deutsche in 2008. In 2015, Mike joined Citibank before moving to Robert Cowen Investments in 2018 as chief investment officer. During his years in investment research, Mike was recognised in the Financial Mail and Institutional Investor investment research surveys for coverage of the various sectors for which he was responsible. He also led the Deutsche research team to the top of the rankings. Mike holds a CFA designation.

So far, SA seems to have threaded a needle that few investors would have wagered heavily on ahead of the 2024 National and Provincial Elections (NPEs). Investment markets have reacted predictably to developments since the election in what can be summed up as a "Ramaphoria 2.0" trade – those shares geared to the local economy have rallied strongly, while rand-hedge shares have underperformed. In this article, we set out to see what we can learn from the performance of JSE-listed financial and industrial shares in the years following Cyril Ramaphosa's appointment as president of the ANC and his subsequent inauguration as president of SA following the ANC's recall of ex-president Jacob Zuma. Was tactically positioning in those shares which were likely to be the biggest beneficiaries of Ramaphoria a successful long-term investment?

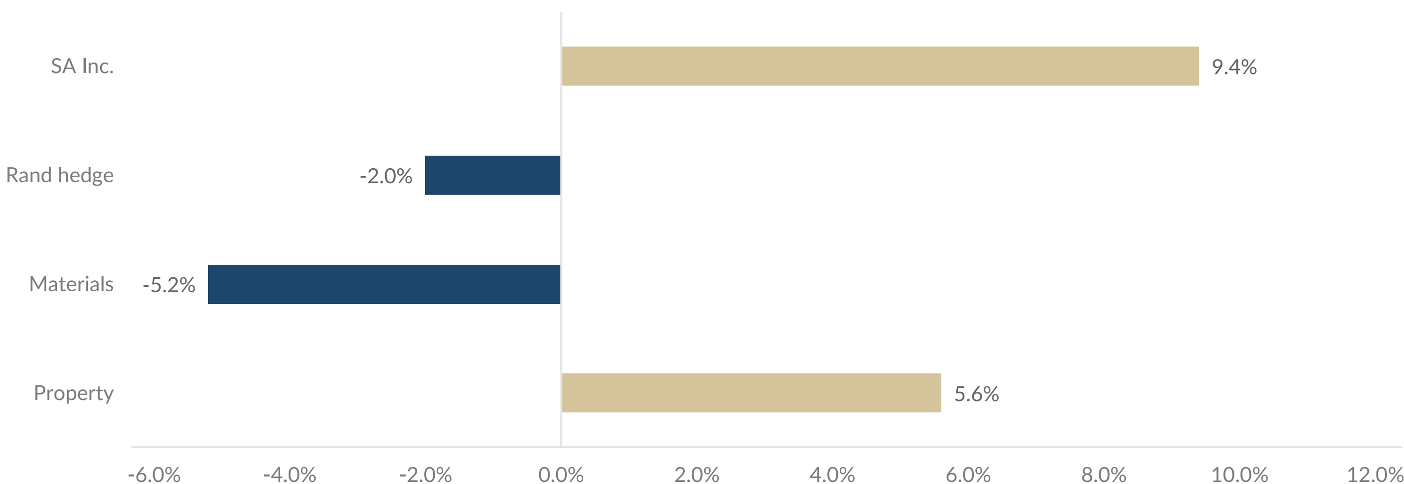
The rivers of ink spilt by investment commentators on the implications of SA's NPEs held on 29 May left one in little doubt that they were likely to be the most pivotal since 1994. At the possible risk of oversimplification, the majority view of these commentators immediately ahead of the NPE was that the ANC was likely to lose its majority. Still, by securing c. 45% of the vote, it would likely manage to cobble together a coalition of small (inconsequential?) parties to maintain the *status quo* - a sort of "better the devil you know" scenario. The feared alternative, albeit less likely, was that a greater loss of support for the ANC could force it into a coalition with either the EFF or the M.K. party. It is interesting to ask yourself, had you correctly predicted an outcome in which the ANC secured just 40.2% of the vote and M.K. would significantly exceed expectations at 14.6%, how would you have positioned your investments? Most likely, your odds on an investor-unfriendly future ahead for SA would have risen considerably vs the consensus! Even with the NPEs result known, the course ahead was far from obvious.

Coalitions globally do not have a great record in government, and SA's performance at a municipal level is hardly grounds for optimism either.

So far, it is safe to say that those rivers of commentators' ink were all spent in vain. That SA's political parties would agree relatively quickly on establishing a market-friendly government of national unity (GNU) is a welcome outcome. Much remains to be seen as to how things turn out. Coalitions globally do not have a great record in government, and SA's performance at a municipal level is hardly grounds for optimism either. Despite securing a meaningful share of the vote, whether the radical parties will meekly accept what looks like political marginalisation remains to be seen. However, these are questions for another day, and this is not intended to be yet another article opining on SA politics!

Since the election, a better-than-feared outcome from an investor's perspective has driven a strong rally by shares most geared to the local economy. With the rand having appreciated 3.0% vs the US dollar in the same period (to 28 June 2024), rand-hedge shares have struggled. Mining shares' performance is linked chiefly to the changing fortunes of commodity prices, and while the rand has been a slight headwind, SA's politics are unlikely to have been much of an influence. So far, so predictable – we are seeing Ramahporia 2.0 unfolding before our eyes!

Figure 1: SA equity market returns, 29 May 2024 to present (27 June 2024)
Source: Anchor, Bloomberg

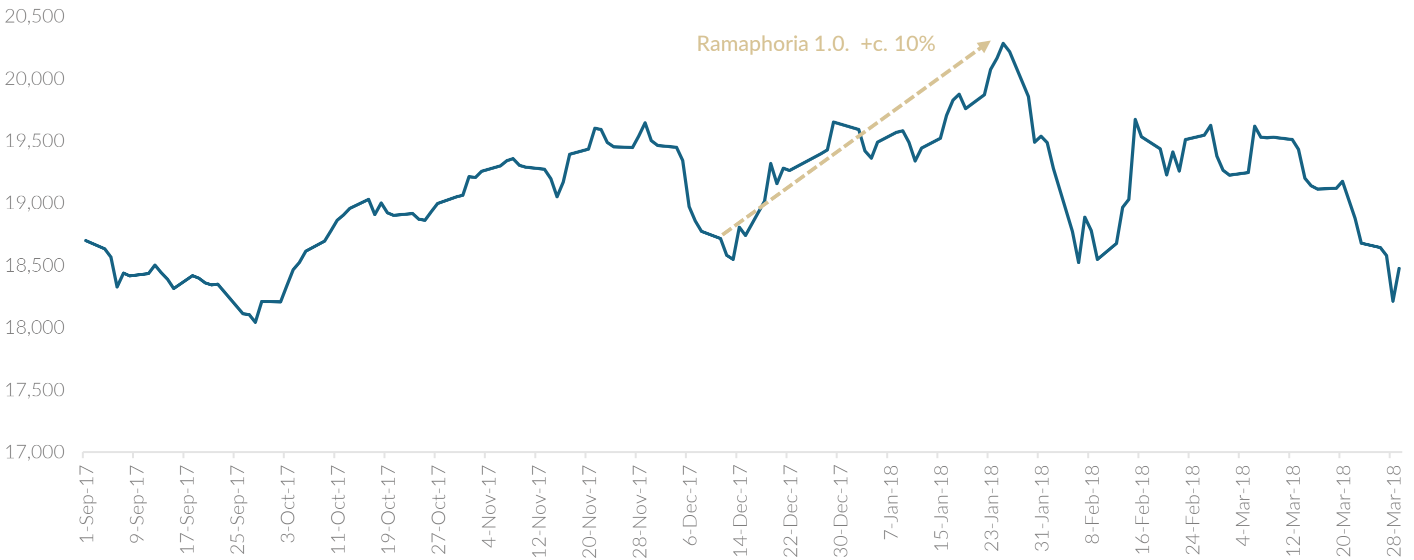


Tactically, as long as the better-than-feared newsflow continues, there are many reasons to support the case for the pattern of relative performance to continue: (1) still depressed valuations of SA Inc. shares relative to their histories, (2) very underweight positioning in domestic shares relative to benchmarks by institutional investors, (3) reduced incidence of loadshedding offering the prospect of a sharp rebound in earnings for a wide range of SA-orientated companies, to mention a few. A possible pitfall with tactical trading linked to themes like an election result is that it can lead investors to disregard individual companies' fundamentals as they seek out those businesses expected to be most sensitive to the particular theme of the moment.

In this case, it is better-than-expected news; thus, the tendency is to seek out the most out-of-favour/lowly rated sectors and shares. To those investors who successfully positioned themselves for Ramaphoria 2.0 in good time – well done! It is now important to see what lessons we can learn from how Ramaphoria 1.0 turned out over the longer term. Below, we look at the performance of SA equities from Ramaphosa's appointment as ANC president (December 2017) until the end of 2023 – a period of six years.

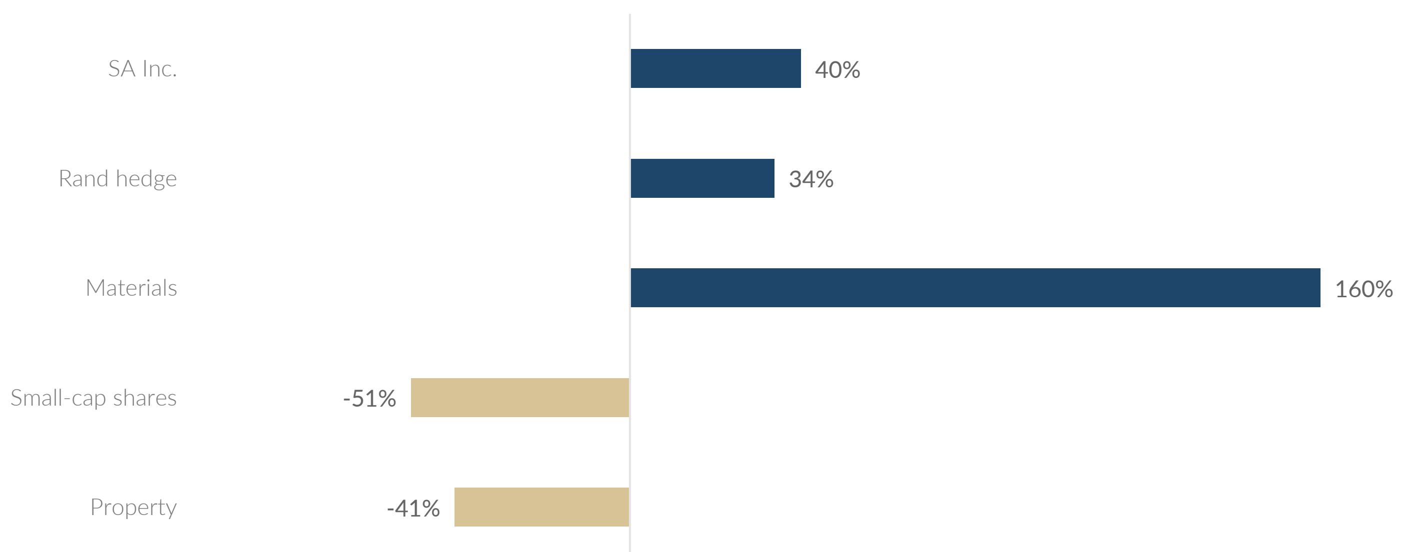
The first point to note is that Ramaphoria 1.0 did not last very long. In fact, by the time Ramaphosa was inaugurated as SA president in mid-February 2018, it was all but over! The lesson here is that investors should dance close to the door – the time that SA equities can swim against the tide of global investment sentiment might be shorter than you think.

Figure 2: The performance of the FTSE JSE Capped SWIX, 1 September 2017 to 29 March 2018
Source: Anchor, Bloomberg



Those familiar with SA equities will likely be all too aware of the paltry returns the JSE has delivered over the last few years. Over the past six-year period of our study, the FTSE JSE Capped SWIX delivered a price return of just 14.5% - rather disappointing considering that 10% of that came in the first month of Ramaphoria 1.0! Admittedly, with dividends reinvested, the total return over this period improved to 46%, better, but equating to a pre-tax compound annual growth rate (CAGR) of just 7%, hardly likely to have set your hair on fire. Disaggregating the performance of the local equity market below, it is evident that infatuation with Ramaphoria 1.0 would likely have caused investors to miss the one thing that did work relatively well – the favourable commodity cycle driving miners. Interestingly, despite the rand depreciating by 40% against the US dollar over this period, rand hedge shares in aggregate did not provide a particularly good place for investors to hide, albeit more for company-specific reasons (a big de-rating in British American Tobacco and China's crackdown on its technology sector severely impacting Naspers's key investment, Tencent, for example).

Figure 3: SA equity market returns, December 2017 to December 2023
Source: Anchor, Bloomberg



In the table *(Figure 4)* below, we have drilled down to a stock-level view to see how things might have turned out for investors who leaned heavily into the Ramaphoria 1.0 trade and held on. Admittedly, at a stock level, it becomes apparent that the SA stock market is full of idiosyncratic investment cases, which tends to muddy the picture that emerges. At the risk of being accused of torturing the numbers until they confess to what we want, we decided to exclude stocks linked to the commodity cycle (a performance driven by factors largely unrelated to our study) and SA-listed property shares (a speculative bubble of sorts popped as past financial engineering was revealed – again not relevant to our study).

Figure 4: SA financials and industrials – top- and bottom-25 stocks December 2017 to December 2023
Source: Anchor, Bloomberg

The leaders	Investment return	The laggards	Investment return
Textainer	643%	Nampak	-96%
City Lodge	247%	EOH	-95%
Investec	204%	Brait	-93%
Richemont	181%	Murray & Roberts	-92%
Altron	159%	PPC	-90%
Cartrack	158%	Tongaat	-87%
Capitec	143%	Invicta	-86%
Outsurance	145%	Stadio	-85%
Datatec	138%	Blue Label Telecom	-71%
Bytes Technology	123%	RCL Foods	-71%
PSG Financial Services	122%	Curro	-68%
Clicks	111%	KAP Ltd	-60%
Alexander Forbes	97%	Mpact	-57%
Advtech	91%	RFG Holdings	-55%
AECI	84%	Pick 'n Pay	-55%
FirstRand	83%	Libstar	-48%
Reinet	79%	Massmart	-46%
Raubex	73%	Spur	-45%
PSG Group	73%	Transaction Capital	-45%
Standard Bank	72%	Cashbuild	-45%
Hudaco	70%	Novus Holdings	-37%
RMBH	69%	Trencor	-35%
NinetyOne	64%	Tiger Brands	-34%
BidCorp	64%	Famous Brands	-31%
HCI	63%	Telkom	-28%

For us, the picture that emerges from the above scorecard is that quality wins over the longer term. It would have been unlikely that highly rated shares (BidCorp, Clicks, Capitec, and Richemont, for example) were among investors' choices for those stocks expected to benefit most from a recovery in the SA market. However, their capital allocation acumen and ability to compound growth steadily over time won out. Among the laggards, several company-specific corporate disasters (EOH, Tongaat, and Transaction Capital) come to mind. However, looking beyond that, many of the laggards were in troubled sectors or were the competitive underdogs (think Tiger Brands vs AVI; Pick n Pay vs Shoprite). These are interesting options for investing in an expected positive shift in sentiment towards SA equities, but ultimately, they let investors down.

In conclusion, if those reforms that the brief Ramaphoria 1.0 rally had anticipated materialised, things may have turned out very differently for SA Inc. shares. Once again, there is reason for optimism, and a welcome rally in SA Inc. shares has already begun to reflect that. We hope this time will be different, with expectations matched by delivery. However, the key lesson we draw from Ramaphoria 1.0 is that, while fundamentals can be suspended for a short while, quality is worth paying up for because it ultimately rises to the top. Date the lowly rated out-of-favour corners of the SA market with Ramaphoria 2.0 in mind, but do not marry it!

Bank of Japan: Monetary policy shifts back to managing inflation

WRITTEN BY:
Lelethu Poswa,
Fixed Income Analyst

Lelethu holds a BBusSc triple-major degree from UCT, specialising in finance, economics, and statistics. He has worked in fixed income for companies such as Old Mutual Investment Group and Investec Asset Management. He joined Anchor in 2020 as a fixed-income analyst focusing on the credit space.

The BoJ's policy shifts are of global interest because Japanese investors are significant exporters of capital.

Japan's central bank, the Bank of Japan (BoJ), has made significant changes to its monetary policy, bidding farewell to a range of unconventional monetary policy tools, such as the negative interest rate policy (NIRP), yield-curve control (YCC), and quantitative and qualitative easing (QQE), marking the end of an era in extraordinary monetary easing. These tools were key components of the BoJ's extensive monetary policy approach to stimulate inflation following the plunge in asset prices in the 1990s. Although none of these tools led to visible inflation, Japan's new inflationary landscape has allowed the BoJ to retire some of its measures, marking a historic policy shift from a complex and overly accommodative stance to a simpler approach. In this article, we examine the monetary policy shifts given Japan's new inflationary landscape and the recent currency intervention.

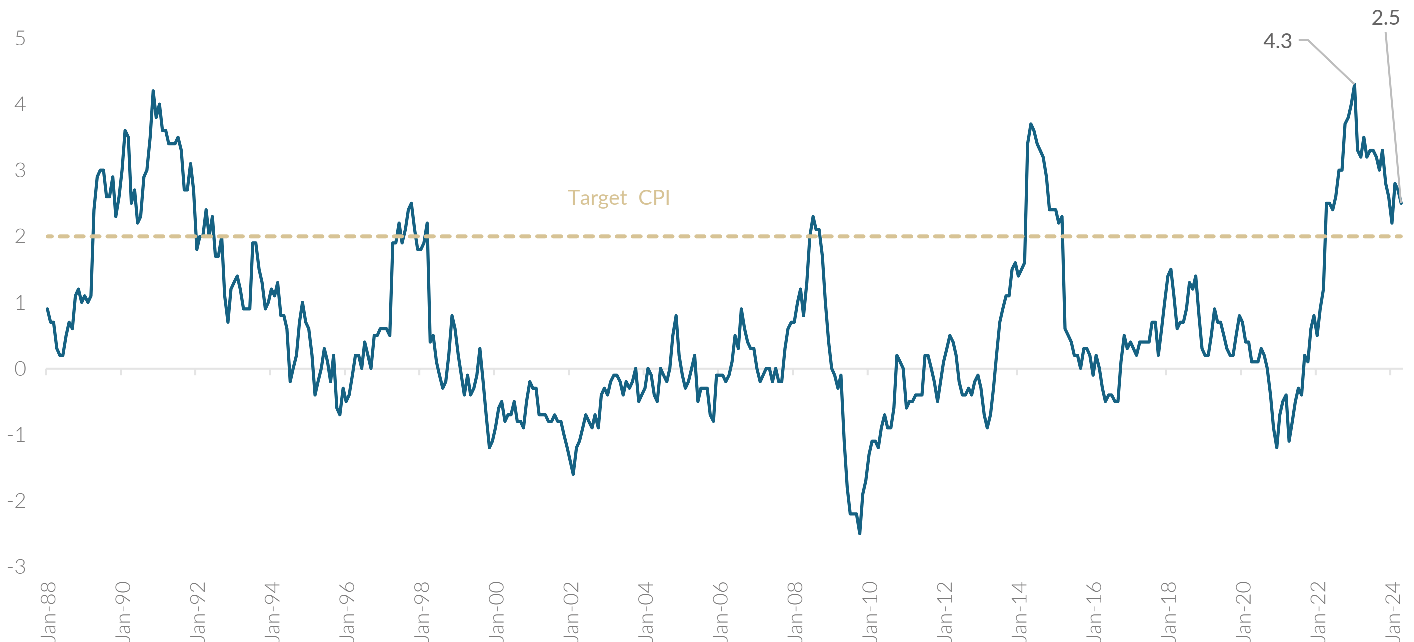
GLOBAL IMPLICATIONS OF THE BOJ POLICY SHIFT

The BoJ's policy shifts are of global interest because Japanese investors are significant exporters of capital. Since the 1990s, Japanese investors have purchased substantial US and European government bonds. To contextualise the scale of foreign bonds bought by Japanese investors, it is notable that Japan is the largest foreign holder of US government bonds, owning over US$1trn worth. Therefore, any shifts in Japan's monetary policy towards monetary tightening—even if widely telegraphed—will always be accompanied by fears that Japanese investors might lose interest in foreign bonds, as rising Japanese government bond (JGB) yields could lure investors back to domestic bonds.

THE TIME HAD COME TO SHIFT AWAY FROM NIRP, QQE AND YCC - THE NEW INFLATIONARY LANDSCAPE

Figure 1: Japan headline inflation, YoY % change

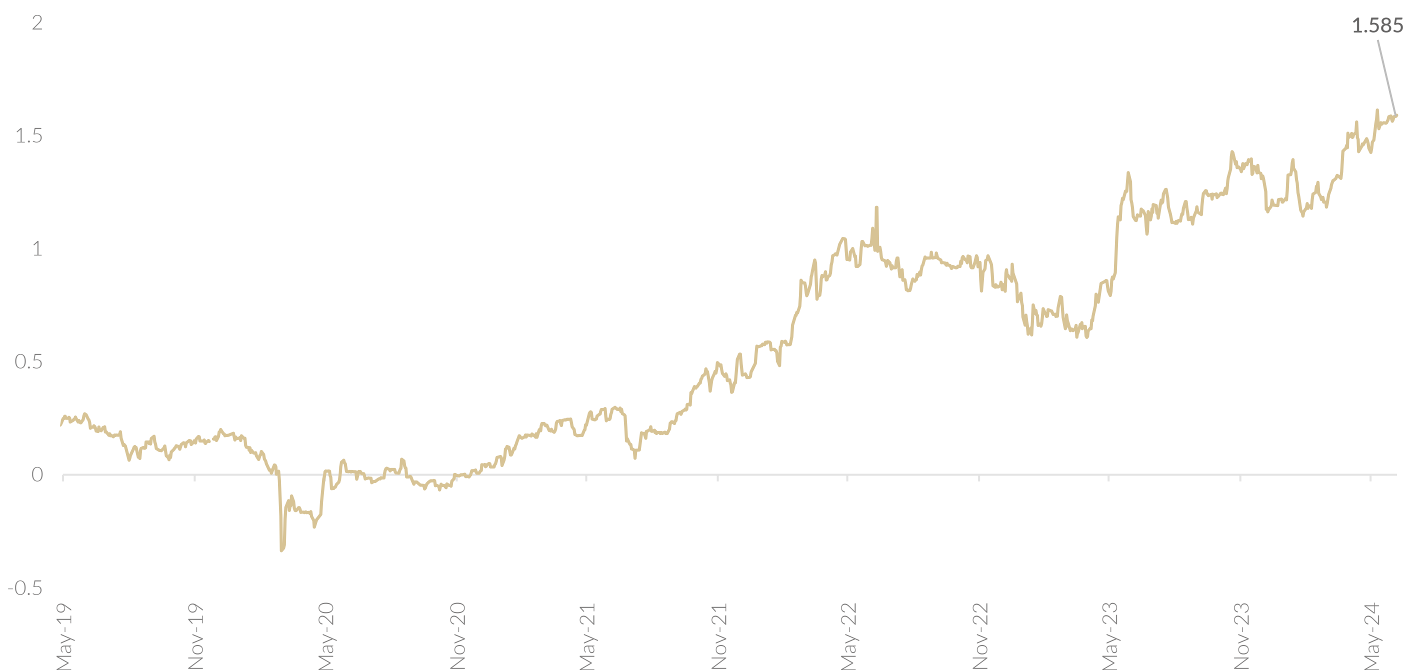
Source: Anchor, Thomson Reuters



In March 2024, the BoJ took its first step towards normalising monetary policy by ending NIRP and raising its policy interest rate by 10 bps, from -0.1% to 0.0%–0.1%. This marked the first policy shift towards monetary tightening in 17 years. Subsequently, the central bank decided to halt and, in some cases, taper QQE measures. This occurred after the BoJ had gradually backed away from YCC by allowing the yield on 10-year JGBs to fluctuate more freely.

Figure 2: Japan's 10-year breakeven inflation, %

Source: Anchor, Thomson Reuters



The BoJ's policy shift to a simpler approach was no surprise. The economic fundamentals were supportive, and the shift was well-telegraphed through commentary and a gradual move away from YCC. The Japanese economy has faced deflationary pressures for years and has finally seen healthy inflation in recent months *(Figure 1)*. This inflation has been driven by a combination of global inflation induced by the COVID-19 pandemic, higher wage growth, and a depreciating currency. By January 2023, headline inflation in Japan had jumped above 4%, the highest level since the 1980s and well over the 2% target *(Figure 1)*. Inflation has since remained well above the BoJ's target.

A key question for future BoJ policy direction is where Japan's inflation will stabilise post-pandemic. Although inflation moderated throughout 2023, and further moderation is quite possible, market-based inflation expectations in Japan have been re-anchored at more favourable levels, fuelled by higher wage growth and excessive currency depreciation *(Figure 2)*. This marks a significant departure from the near-zero percent trend observed over the past three decades. The pandemic's global inflationary impact has undoubtedly catalysed Japan's new inflationary landscape. However, judging from recent statements by the BoJ, accommodative conditions are still necessary for Japan. The pace of upcoming interest rate hikes will depend on incoming economic data and how confident the BoJ is that post-pandemic inflation is stable at around 2%.

THE CURRENCY HAS A YIELD PROBLEM THE BOJ CANNOT EASILY FIX

Figure 3: The US dollar vs Japanese yen and the US-Japan 10-year bond spread, %

Source: Anchor, Thomson Reuters

WHY IS THE YEN DEPRECIATING?

The value of a country's currency rises and falls relative to other currencies in line with the laws of supply and demand. Japan's currency, the yen, has depreciated significantly against the US dollar to levels last seen in the 1990s. The yen is similarly weak against other major currencies, such as the euro and the British pound. The yen is typically a funding currency for carry trades, making its exchange rate highly correlated with the US-Japan bond yield spread *(Figure 3)*.

A currency carry trade is a strategy that involves borrowing money in a currency with a low interest rate and investing it in a currency with a higher interest rate. This strategy aims to profit from the difference between the interest rates, known as the interest rate differential. The interest rate differential between the US and Japan is the main driver of the yen's weakness against the greenback. The interest rate in the US is above 5%, while the interest rate in Japan remains near zero. Running unhedged positions even boosted carry trade returns. This gap in interest rates reflects the different inflation environments in the two countries. While Japan has struggled to get prices and wages to rise for decades, the US has been battling to bring prices down amid robust economic growth.

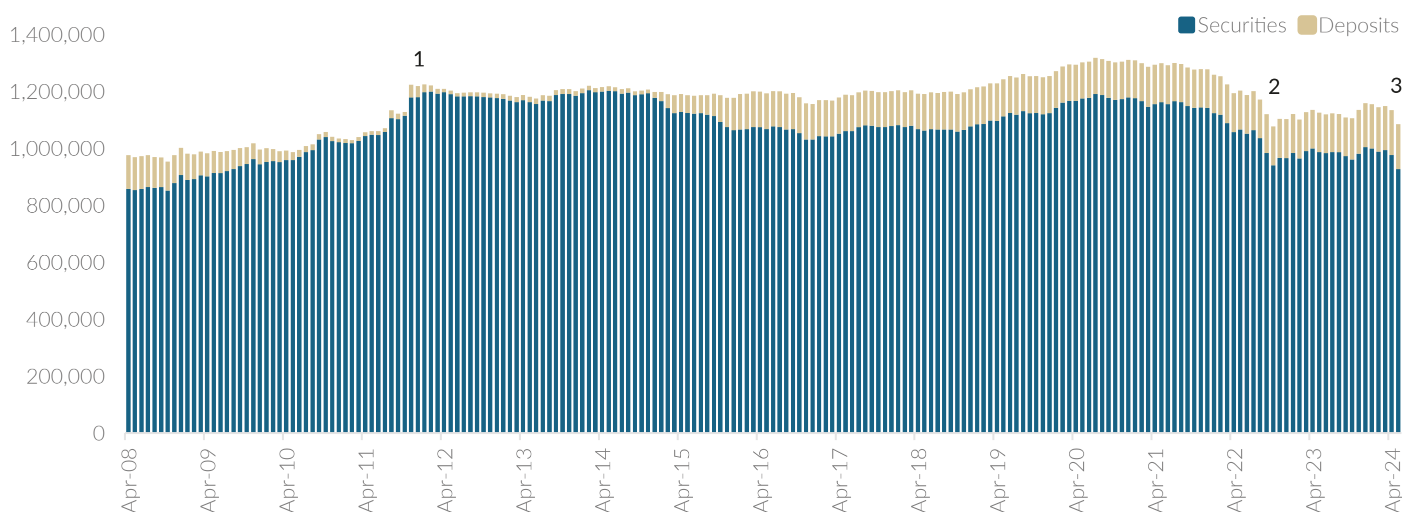
In addition, rapidly changing market expectations regarding the US Fed's monetary policy are also resulting in yen selling. Market expectations for a near-term narrowing of the US-Japan interest rate differential are rather pessimistic. The US economy is showing good growth momentum, a resilient labour market, and lingering inflationary pressures. The Fed and markets have scaled back expectations of interest rate cuts in 2024 compared to expectations at the start of this year. With the Fed not in a hurry to cut interest rates (gradual easing cycle) and the BoJ not in a hurry to raise interest rates (gradual tightening cycle) in the near term, the interest rate differential will likely remain wide. This exacerbates carry trades, leaving the yen weaker and investors (those with exchange rate risk tolerance) benefitting from running unhedged positions.

WHY IS EXCESSIVE CURRENCY DEPRECIATION A PROBLEM FOR JAPAN?

Japan is a net importer of many goods, including agricultural products and crude oil. Therefore, a weak currency increases import costs, squeezing Japanese household budgets, particularly for food and fuel. Despite the BoJ not having a mandate to manage the currency, a weak yen complicates its objective of maintaining price stability, as it is inflationary.

WHAT CAN JAPANESE AUTHORITIES DO TO CONTAIN YEN DEPRECIATION (YEN INTERVENTION)?

Figure 4: Japan's foreign currency reserves, US$mn
Source: Anchor, Thomson Reuters



Japan's fiscal and monetary authorities can employ two main economic levers to contain yen depreciation: buying the yen through foreign exchange interventions or raising interest rates - monetary tightening. The latter is not a near-term solution, as we previously discussed the BoJ's cautious, data-dependent approach towards increasing the policy rate. This leaves Japanese authorities with currency intervention operations. Japan's fiscal authority, The Ministry of Finance (MoF), decides whether to intervene in the currency market, and the BoJ (monetary authority) does the buying or selling. Japan has a history of conducting currency interventions. In 2022, it intervened in the currency market several times by selling US dollars to buy yen ("2" in *Figure 4*). Similarly, in 2011, the BoJ sold yen and bought US dollars ("1" in *Figure 4*).

In May 2024, a sharp, sudden surge in the yen's value prompted speculation that Japanese authorities had intervened in the currency markets to halt the yen's depreciation as the US dollar/Japanese yen (USD/JPY) pair approached the JPY160/US$1 level. Central banks aiming to prevent their currencies from depreciating too rapidly typically intervene by selling US dollar-denominated assets from their foreign currency reserves and purchasing their currency with the proceeds. Japan possesses a substantial pool of foreign currency reserves, primarily denominated in US dollars, which it can utilise to buy yen, although this resource is not unlimited. As of the end of May 2024, Japan's foreign currency reserves, which include securities and deposits, totalled US$1.08trn (*Figure 4*).

Japan's holdings of foreign securities decreased by US$50.4bn in May 2024, indicating that the government likely financed most of its recent currency intervention by selling US government bonds and other foreign securities ("3" in *Figure 4*). As US government bond prices rose and yields declined in May, the market value of Japan's foreign securities would have increased if assets were left untouched. Foreign deposits saw a slight increase, suggesting they were not a significant source of intervention funding. The decline in foreign security holdings suggests that Japanese authorities used similar funding sources for currency intervention as they did in 2022 when they spent US$62bn to strengthen the yen on three occasions.

JGB yields have tracked higher in recent months, with 10-year JGB yields approaching 1%.

The impact of currency interventions is generally short-lived and does not reverse fundamental dynamics; these interventions are typically used to "buy time." The April/May currency intervention initially moved the USD/JPY pair from around JPY158-JPY153/US$1. However, today, the currency pair has almost entirely reversed course following the intervention, with USD/JPY trading back up, just below the JPY158/US$1 level. To alter the yen's trajectory, either the BoJ would need to promptly adopt a more hawkish stance (which seems unlikely), or the Fed would need to clearly signal potential interest rate cuts (also doubtful). Ultimately, this problem can only be addressed by time. Currency interventions provide the BoJ with the necessary time to assess incoming economic data before deciding on future policy direction. Fortunately for Japan, the size of its foreign currency reserves suggests that it still has ample ammunition to conduct more of these currency operations if the USD/JPY pair approaches the JPY160/US$1 psychological level again soon, buying additional time if necessary.

CONCLUSION

The BoJ is trying to balance the Japanese economy in this new inflationary environment. While economic fundamentals supported the BoJ's decision to phase out a range of unconventional monetary policy tools, the central bank still requires additional supportive economic data to be confident that future inflation will stabilise around the 2% target. For investors, a more normalised Japanese bond market is expected to offer a higher risk premium and modestly higher yields in response to ongoing policy adjustments and the transition of Japanese government bonds back to market-driven forces. JGB yields have tracked higher in recent months, with 10-year JGB yields approaching 1%. This presents fresh opportunities for investors who are cautious about this space over the past decades. Institutional flows into Japanese bond markets are also anticipated to increase in the short to medium term.

Navigating the uranium market: From ore to energy

WRITTEN BY:
Michael Ncube,
Portfolio Analyst

Michael holds a BCom Hons Investment Management degree from UJ. Subsequently, he completed a Master of Management in Finance and Investment from Wits Business School. He is currently pursuing a CFA designation. Michael brings his passion for financial markets to the investment team, particularly regarding local equities.

INTRODUCTION

Having powered our world for over six decades, uranium is poised to play a vital role in transitioning from fossil fuels to cleaner, sustainable sources. In this article, we explore the uranium market, its journey from a natural element to a powerful energy source, its role in nuclear power, global demand, leading uranium producers, and potential risks and rewards of investing in this resource.

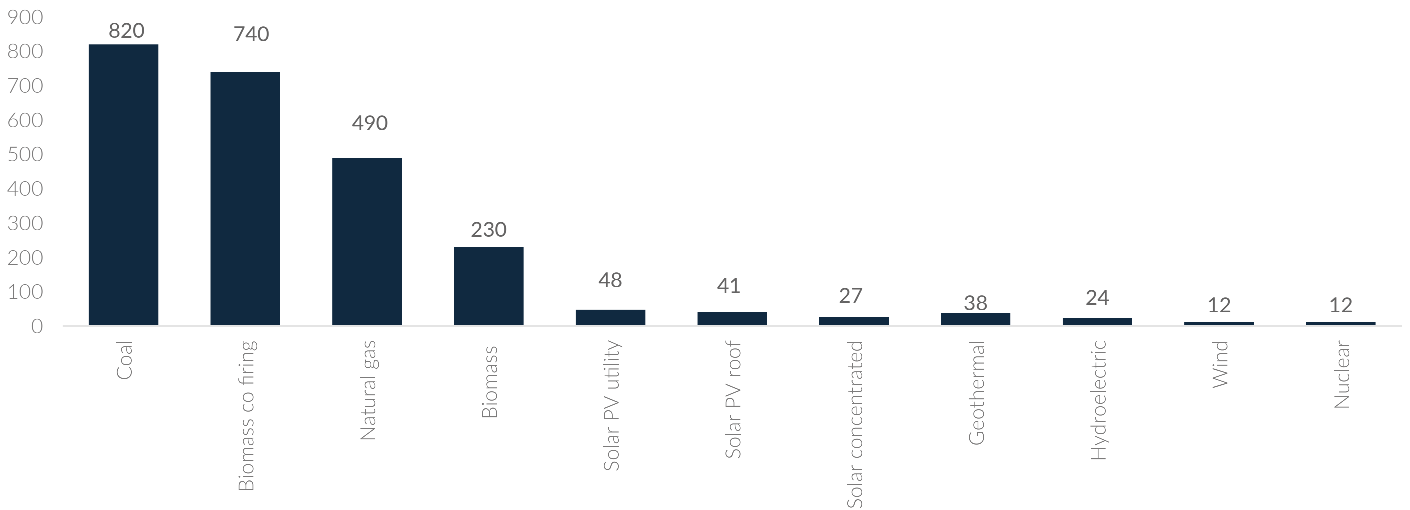
WHAT IS URANIUM, AND HOW DOES IT WORK?

Uranium, a dense metal, is found in rocks and oceans at low concentrations, making it as abundant as metals like tin. Discovered by Martin Heinrich Klaproth in 1789 and named after Uranus, uranium originated from supernovae 6.6bn years ago. Melting at 1,132°C and denoted by 'U' on the periodic table, uranium is experiencing increased demand due to its crucial role in clean energy generation through nuclear power.

IS NUCLEAR ENERGY CLEAN POWER?

Nuclear power generates electricity with little carbon output compared to other sources. It is a clean form of electricity generation and is considered the safest. On a life-cycle basis, nuclear power emits just a few grammes of CO2 equivalent per kWh of electricity produced. A median value of 12g CO2 equivalent/kWh has been estimated for nuclear power—similar to wind and lower than all types of solar.

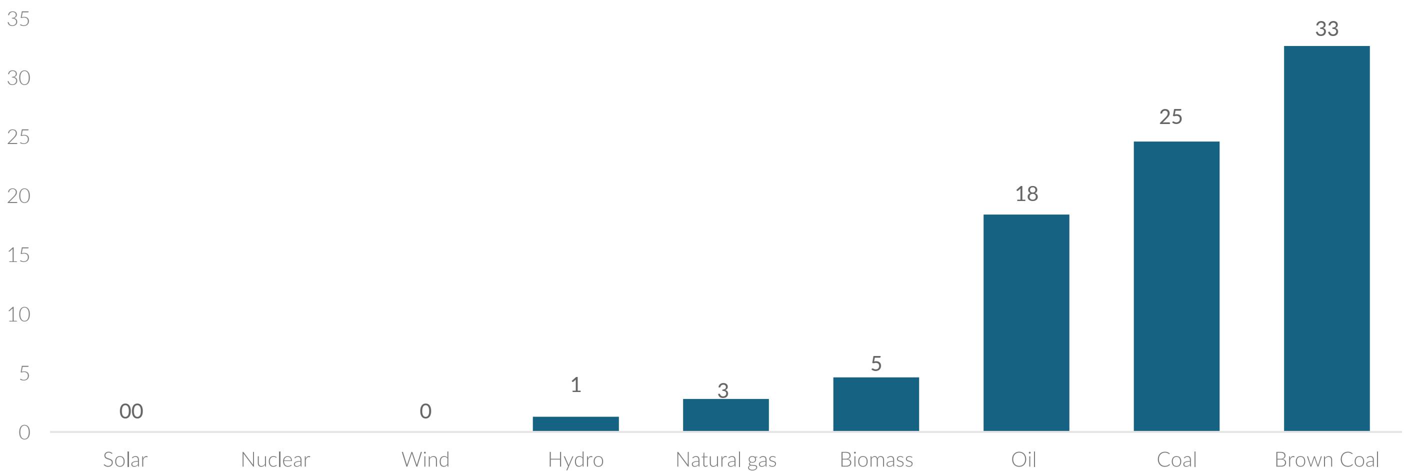
Figure 1: Carbon dioxide produced per kilowatt-hour of electricity generation by energy source (gCO2 emissions/kWh)
Source: Anchor, World Nuclear Association



IS NUCLEAR POWER SAFE?

Nuclear energy has a low death rate, even after nuclear catastrophes like Chornobyl and Fukushima.

Figure 2: The average nuclear energy mortality rate or deaths per thousand-terawatt hour
Source: Anchor, Statista



THE NUCLEAR FUEL CYCLE PROCESS

Uranium's journey to being a nuclear energy source is a complex and meticulously controlled transformation. It starts with mining, where uranium is extracted from the earth and processed into a concentrated form. This concentrated uranium is crafted into small pellets, loaded into metal tubes to form fuel rods, grouped into bundles, and placed inside a nuclear reactor. In the reactor's core, the uranium atoms are bombarded with neutrons, causing them to split in a process known as fission. This fission generates immense heat, which is used to boil water, creating steam that turns turbines to produce electricity.

After c. three years of energy generation, uranium fuel becomes less efficient and is termed 'spent'. This spent fuel is carefully removed from the reactor and initially stored in pools of water on-site to cool down and decrease its radioactivity. Depending on a country's nuclear policy, this spent fuel can be reprocessed to extract usable materials for new fuel or be prepared for permanent disposal. If reprocessing is not an option, spent fuel is encapsulated in robust, long-lasting containers and buried deep underground in geological repositories, ensuring safe and secure isolation from the environment for thousands of years. Careful management of uranium from extraction to disposal/recycling is essential for the sustainable and responsible use of nuclear energy.

GLOBAL URANIUM DEMAND

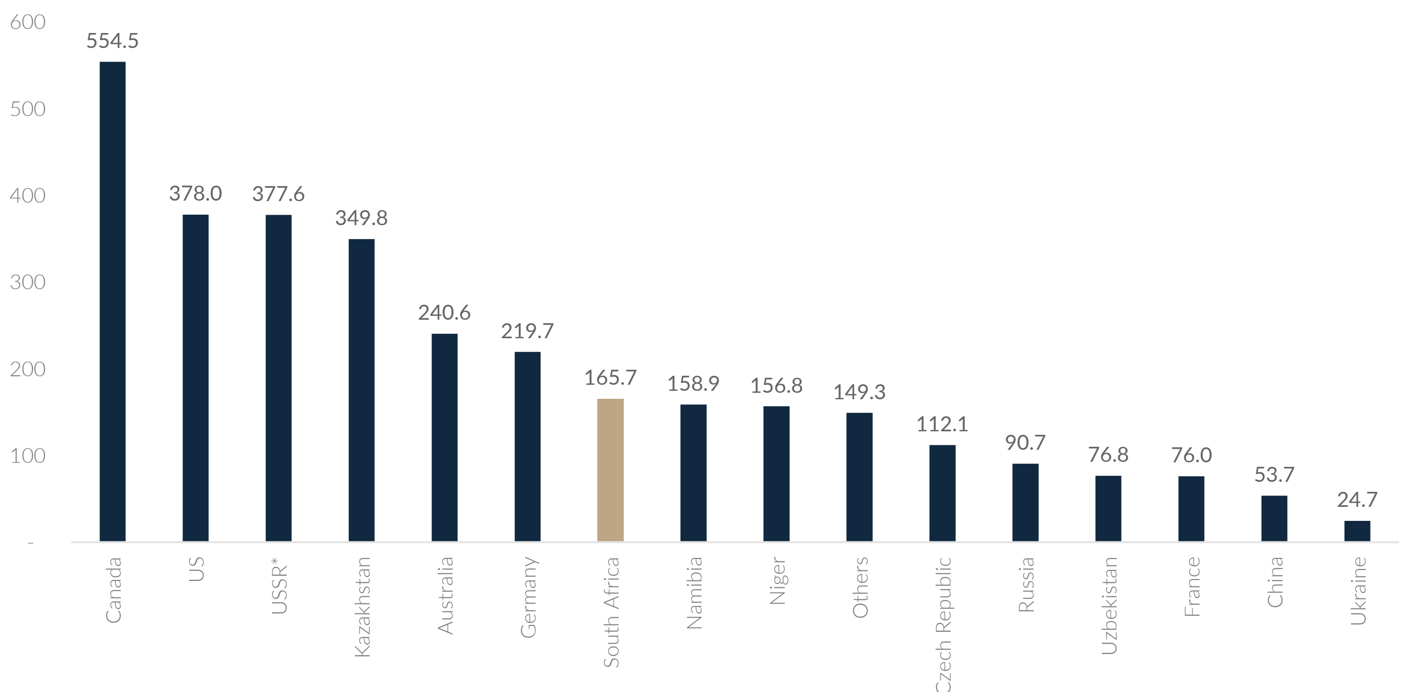
With about **436** operational nuclear reactors worldwide and c. **173** in the pipeline, uranium demand is rising. The US, China, and France collectively represent c. **58%** of global uranium demand. Given the current demand, there is still a **supply shortage**, with uranium projected to face a persistent supply-demand imbalance, with a cumulative gap of c. **680k** metric tonnes by 2040. Reactivating inactive mines is vital to increasing short-term uranium supply, as new mines can take 10–15 years to become fully operational. Based on current resources and consumption rates, uranium mines can supply fuel for nuclear reactors for over 200 years. Nuclear power plants are initially licensed for 40 years, with possible extensions allowing operation for 80 or even 100 years, depending on maintenance and technological updates. Technologies like uranium extraction from seawater and fuel-recycling reactors could extend this to 60,000 and 30,000 years, respectively.

WHO USES NUCLEAR POWER?

Around **10%** of the world's electricity is generated from uranium in nuclear reactors. There are 436 nuclear reactors with a total output of 390,000 megawatts (Mwe) operating in 32 countries, and c. 60 more reactors are under construction. Belgium, Bulgaria, the Czech Republic, Finland, France, Hungary, Slovakia, Slovenia, Sweden, and Ukraine all get **30% or more** of their electricity from nuclear reactors. The US has about 90 reactors, supplying 20% of its electricity, while France gets c. **70%** of its electricity from uranium.

URANIUM PRODUCERS

Figure 3: Cumulative uranium production in tonnes of elemental uranium (tU), 1945-2022
Source: Anchor, World Nuclear Association
**Until 1991, the USSR comprised uranium produced in Russia, Kazakhstan, Uzbekistan, Ukraine, and other former Soviet Union republics.*



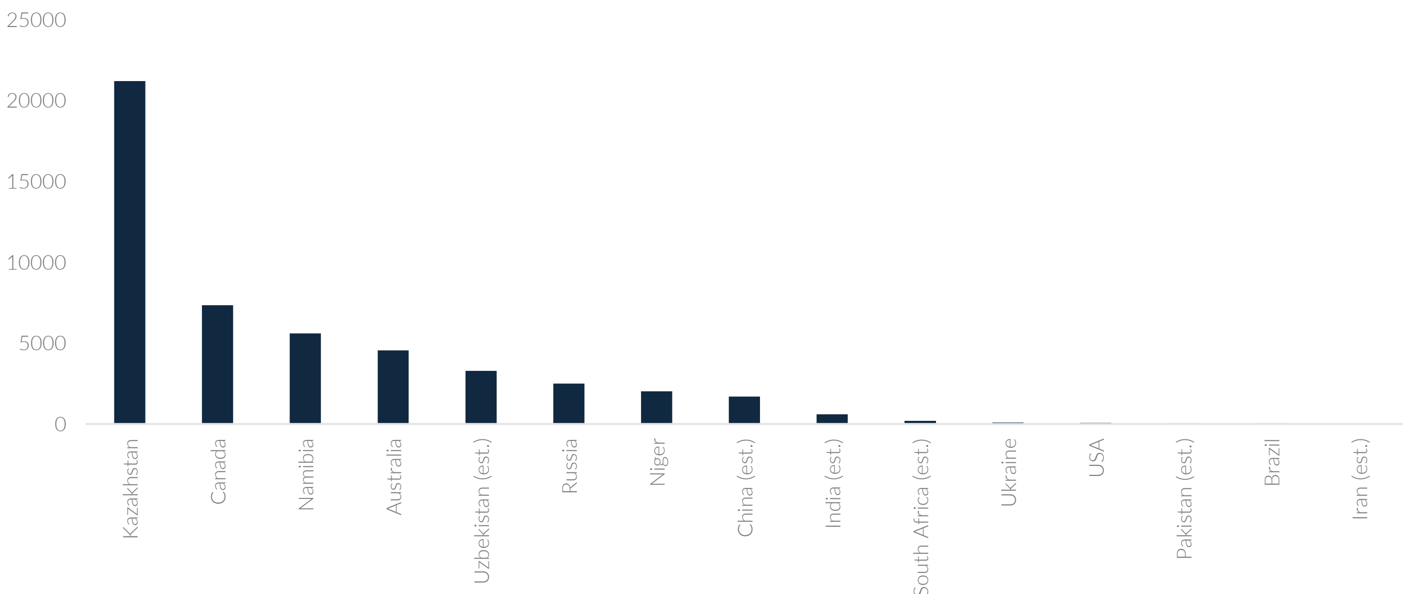
The Journal of Nuclear Fuel Cycle and Waste Technology summarises the history of uranium production into four main periods:

- **Military era (1945 to mid-1960s):** Initially driven by military needs, uranium production surged in the 1950s for nuclear weapons, leading to a peak and subsequent decline by the mid-1960s as demand decreased.
- **Civil nuclear power growth (mid-1960s to mid-1980s):** With the rise of civil nuclear power, uranium production rose to meet the growing number of reactor orders, reaching its zenith in 1980 and fulfilling annual reactor needs until 1985.
- **Market contraction (the mid-1980s to 2002):** Post-1985, nuclear construction slowed as the market was oversupplied due to pre-signed contracts and uranium from the former Soviet Union entering the market in 1993, leading to lower production and mine closures.
- **Market fluctuations (the early 2000s to the present):** The early 2000s saw a price surge due to expected nuclear sector growth, which peaked in 2007. It declined after the 2011 Fukushima accident, resulting in some of the lowest uranium prices in history.

Kazakhstan, Canada, Namibia, and Australia accounted for over **70%** of global uranium production in 2022. However, recent geopolitical developments threaten disruptions in the uranium supply chain, including sanctions on Russian uranium and related services, risks of supply interruptions in Kazakhstan due to transportation routes passing through Russia, and a halt in Niger's uranium exports following coups. Still, uranium demand for nuclear reactors is projected to escalate over the next decade, rising **28% by 2030** and nearly **doubling by 2040**, as governments scale up nuclear power capacity to achieve zero-carbon targets.

Figure 4: Uranium production from mines in 2022 by country, tU

Source: Anchor, World Nuclear Association



NUCLEAR POWER: BACK IN FOCUS

Nuclear power is increasingly becoming part of the solution to achieve carbon neutrality, with a baseload source of energy available 24/7 with little direct carbon emissions. It is increasingly becoming a part of national energy security strategies, providing stable, baseload power to underpin renewable generation. With thousands of cumulative reactor years of safe power production, it is recognised by the EU, the UK, South Korea, and Canada taxonomies as green. Japan has approved a nuclear energy U-turn, with plans including restarting idle reactors, extending its current fleet, and constructing new reactors. Over 20 countries pledged to triple their nuclear output by 2050 at the 2023 *United Nations Climate Change Conference* (COP28).

MARKET PRICING

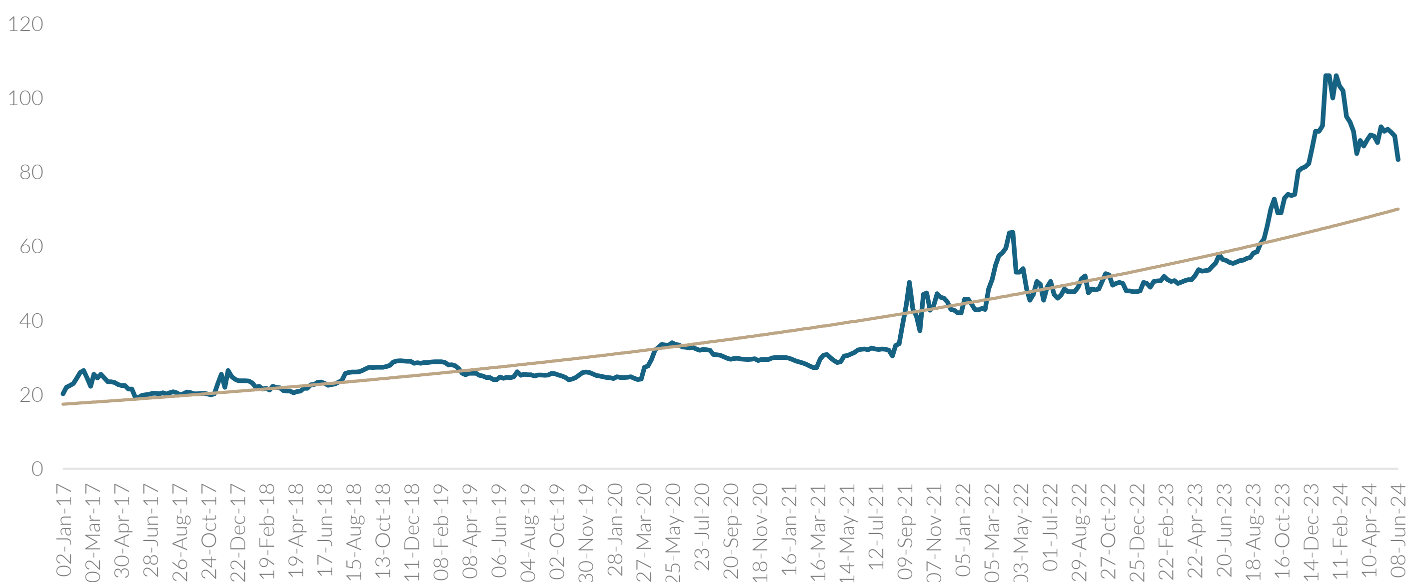
Mineral commodity markets are cyclical. However, these fluctuations are typically overlaid on a downward trend in real prices over the long term, thanks to technological advancements that lower mining costs. Uranium stands out because, after a period of high prices in the late 1970s, it suffered through prolonged low prices in the 1980s and 1990s, with spot prices often falling below production costs, except for the most cost-efficient mines. Although spot prices recorded a resurgence from 2003 to 2009, they remained relatively weak after that. Until c. 2007, quoted spot prices were relevant only for immediate, small-scale trading and constituted a minor fraction of the overall supply. However, since 2008, this has grown to about one-quarter. The bulk of trade happens through term contracts ranging from 3 to 15 years, where producers sell directly to utility companies at prices above the spot market, ensuring a stable supply. Nonetheless, contract prices are often influenced by spot prices at delivery time.

In 2000, the primary participants, including utilities and producers, comprised 95% of the spot market. This dropped to two-thirds by 2005 and one-third by 2011, stabilising at 30% to 40% in subsequent years. The financial sector, including traders and financiers, has taken over the remainder of the market share, introducing more liquidity and efficiency.

THE JOURNEY OF URANIUM PRICES

Figure 5: Uranium U3O8 weekly spot prices, US$/pound

Source: Anchor, World Nuclear Association



Ux U3O8 spot includes conditions for delivery timeframe (less or equal to 3 months) and quantity (greater than or equal to 100,000 pounds U3O8). Weekly-on-Monday prices update on a one-day delay, and history is limited from 2 January 2017 to the present.

Uranium prices have been tumultuous, mainly influenced by the Fukushima disaster in March 2011. Japan, which accounted for 13% of world uranium demand, had 54 reactors that generated c. 30% of its electricity. The accident led to the shutdown of these reactors and prolonged safety inspections, with 12 reactors permanently closed, causing investor interest to dry up. Meanwhile, Kazakhstan, the largest and lowest-cost producer, continued to ramp up supply. The world's largest listed uranium company, Cameco, brought significant supply online into an oversupplied market in 2014. Despite being protected by long-term contracts, producers were slow to make the necessary cuts, and weak demand led to increased secondary supply from enrichment companies. There has been a persistent global supply shortage since, with demand growing at 5% p.a. The gap between global production and consumption remains substantial, contributing to the price increase.

FACTORS INFLUENCING URANIUM PRICES

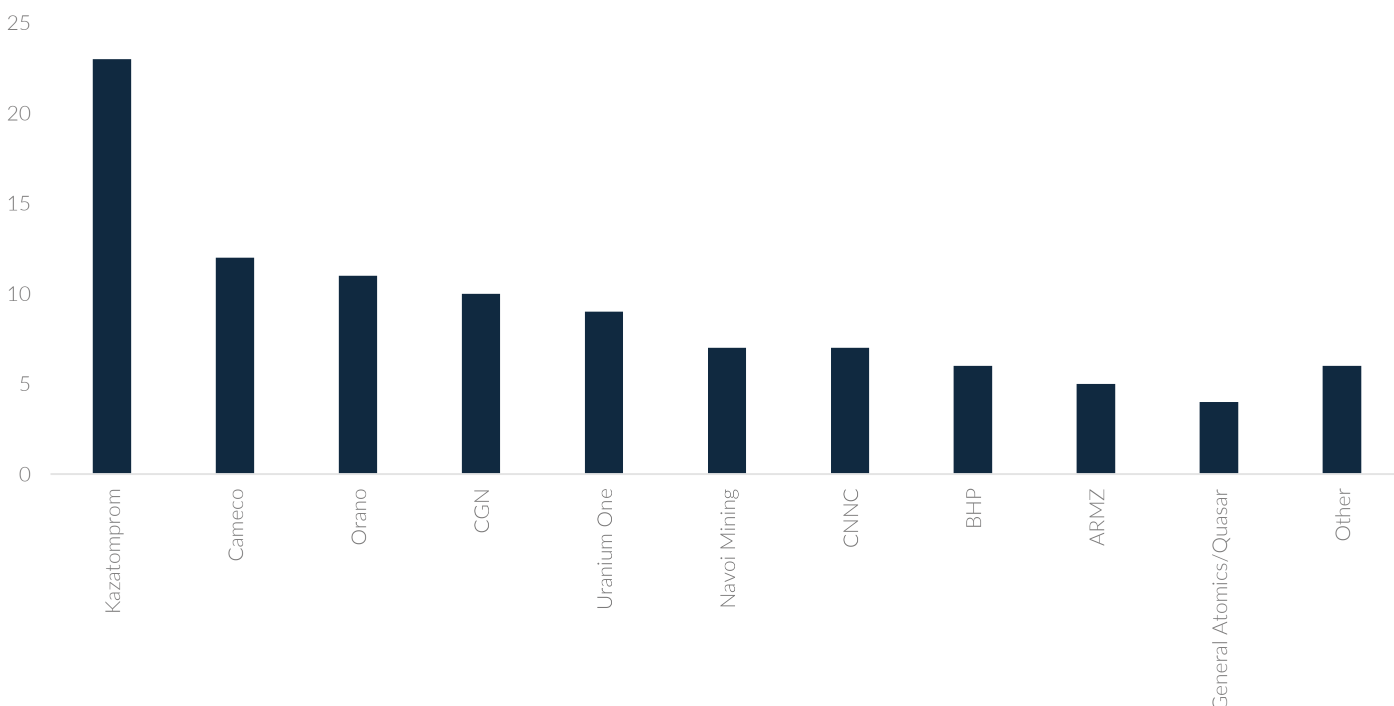
Uranium prices typically reflect shifts in nuclear energy generation, especially when a country embarks on constructing/reactivating nuclear power plants or after significant nuclear mishaps. International political developments, such as the US imposing sanctions on a uranium-exporting country like Russia, also influence prices. Moreover, the global economic climate crisis plays a role in uranium pricing. Energy providers may opt for more economical fuel options in times of financial distress or impending challenges. Currently, natural gas is a more affordable choice, leading to lower power and uranium prices. Still, even without a global economic downturn, cost-effective energy alternatives can reduce uranium demand.

THE TOP URANIUM PRODUCERS

Figure 6 shows the leading uranium-producing companies based on production (in metric tonnes) in 2022.

Figure 6: Uranium production by company in 2022, % of the world total

Source: Anchor, Statista



POTENTIAL RISKS TO URANIUM PRICES

Russia's ongoing war on Ukraine has disrupted the uranium trade, contributing to supply concerns and price increases. Excess supply or decreased demand due to shifts in energy policies or market preferences can lower prices, but this is unlikely. If uranium production rises, it could lead to oversupply and push prices down. Breakthroughs in nuclear technology could lead to more efficient use of uranium, decreasing demand. The growth of renewable energy sources like wind and solar could displace nuclear power, reducing the need for uranium.

THE EMERGENCE OF SMALL MODULAR REACTORS (SMRS)

Unlike traditional large reactors, SMRs can be built in factories and assembled on-site, significantly reducing construction costs and timelines. SMRs are called "modular" because they can be scaled up by adding more units, providing flexibility in power generation capacity. SMRs have advanced safety features, such as passive safety systems requiring no active intervention in an emergency. The US, Canada, and the UK are actively developing SMRs, with companies like NuScale, X-energy, TerraPower and Rolls-Royce, among others. These projects receive government support to mitigate the risks associated with first-of-a-kind ventures.

OUR PREFERRED URANIUM SECTOR SHARE PICK: UEC URANIUM

Uranium Energy Corp. (UEC) transitioned from exploration to production in 2023, positioning itself to capitalise on rising uranium prices. As the fastest-growing North American uranium company, UEC boasts a diverse portfolio of projects across the US, Canada, and Paraguay. Despite reporting no revenues and a loss in 3Q24 due to unsold uranium inventory and higher operating expenses, its share price is up c. 85% over the past year, reflecting investor confidence and willingness to pay more for potential upside. UEC's strategic uranium purchases have strengthened its balance sheet and increased marketing flexibility. It plans to restart production at its operations in Wyoming in August 2024 and is well-positioned to capitalise on rising uranium prices, making it a promising investment in the sector.

FINAL THOUGHTS

Given the increasing global demand for clean and reliable energy sources, investing in uranium presents a unique opportunity. As countries shift away from fossil fuels towards nuclear power as an alternate source, uranium demand is expected to rise. Moreover, supply constraints and geopolitical factors make the uranium market more attractive for investors. However, like any investment, it comes with its own set of risks, including regulatory changes and public sentiment towards nuclear energy. Therefore, a thorough understanding of market dynamics and careful risk management are crucial for success in uranium investing. This exciting space warrants careful consideration for any diversified investment portfolio.

The US, Canada, and the UK are actively developing SMRs, with companies like NuScale, X-energy, TerraPower and Rolls-Royce, among others.

Hedge funds: A viable alternative for South African equity market investors

WRITTEN BY:

Darryl Hannington,
Head of Portfolio Management

Darryl has worked in the financial services industry since 2005, servicing the needs of high-net-worth clients in South Africa. He obtained a BCom Honours in Finance from Wits and is a CFA charter holder. Most importantly, Darryl is passionate about global investment markets and obsessed with providing exceptional client service.

I am a long-term investor at heart. Nothing excites me more than identifying a great company with solid earnings growth potential at a decent price. As long as markets have existed, the relationship between earnings growth and share price performance has remained steadfast. While fear and greed can drive short-term performance, over the long term, assets that can compound earnings growth consistently almost always produce the best returns. Owning equity in a company gives an investor the most direct exposure to its earnings growth potential and, therefore, tends to provide a higher return over time than bondholders of that same company can expect to receive.

As long as markets have existed, the relationship between earnings growth and share price performance has remained steadfast.

I was too young to enjoy the fact that the JSE was the best-performing equity market in the world during the 20th century. In addition, the early 2000s were very profitable for South African equity investors. Between 2000 and 2015, a period which included the global financial crisis (GFC) of 2008/2009, the JSE recorded an impressive compound annual return of 11.9%. Unfortunately, the JSE's return outcome since 2016 has been nothing short of dire until a few weeks ago. Between 2016 and May 2024, JSE-listed equities returned c. 6.7% p.a., which is very disappointing and well below SA inflation or a cash return over the same period. The macroeconomic issues facing the domestic economy are well known, but two of the most concerning problems, from an equity market perspective, are unemployment and SA's anaemic GDP growth. Similar to the link between corporate earnings growth and share price performance, the link between economic growth and corporate earnings growth also holds true. For c. 50% of the largest (by market capitalisation) JSE-listed companies facing the SA consumer and economy, it has been incredibly challenging to grow their earnings consistently in the low-growth environment we have been in for many years.

It would be remiss of me not to mention, at this point, the inherent potential for JSE-listed equities should the economic backdrop and operating environment in SA improve materially and consistently over the next few years. Equity market valuations for SA Inc. shares (those companies whose earnings are predominantly linked to the local economy) have become very cheap over the past few years, even by EM standards. Consequently, these stocks can be compared to a coiled spring, i.e., ready to react quickly to any positive developments. The JSE's rally over the past few weeks following the 2024 National and Provincial Elections (NPEs) feels like a minor prequel to the returns available to shareholders if the government of national unity (GNU), through sensible and market-friendly policy directives, can give the SA economy the kickstart it needs for robust economic growth.

South African investment managers are collectively underweight SA Inc. shares, and foreign investors, who can best be described as "growth tourists", lost interest in the SA market years ago. As a result, the JSE now accounts for a mere 0.6% of the global investable equity universe. Capital is fickle; memories are short; low valuations and improving economic conditions are a potent cocktail to entice even the most sceptical investors back to the SA market. Consequently, the potential wave of money set to hit our shores will be a powerful driver of share prices over the short term.

Having said that, I am steadfast in the view that we are only likely to see a sustained continuation of positive equity market returns if the companies whose shares we own can grow their earnings consistently over the medium- to long-term. Unfortunately, that is impossible without a meaningful improvement in SA's economic growth. As a portfolio manager, I (with the assistance of my investment team at Anchor) am responsible for producing consistent returns for my clients that meet their individual objectives in the long term. I believe that consistent returns are achieved primarily in two ways, namely:

1) Diversification across different asset classes and geographies: Regardless of the potential relative attractiveness of SA equities, it is crucial to remember that diversification is a key strategy for mitigating risk. Ignoring the other 99% of equities listed on exchanges globally would be irresponsible, as they can provide a buffer against an anaemic or volatile local market.

2) Never speculate: It is important to identify quality assets with decent growth potential and be prepared to buy and hold them through different market cycles. Although this strategy requires patience, it has proven to be a reliable way to weather market fluctuations and achieve long-term investment goals. It is important to remember that investing is a marathon, not a sprint. By staying the course and avoiding short-term speculation, investors can build a robust portfolio that stands the test of time.

As a result, the JSE now accounts for a mere 0.6% of the global investable equity universe.

I have mentioned the difficulty SA portfolio managers and equity investors have faced over the past eight years. Many of us have found alternative investment strategies for our clients to improve their returns and consistency. The most obvious of these strategies has been to invest a growing proportion of investable assets offshore, particularly in US equities that have been in a secular bull market since the GFC. Although the compound returns over that period have been stellar, the volatility of equity market returns over the last few years has tested the risk tolerance even for those investors with a very long investment horizon. The result is that many family offices globally invest a significant and growing proportion of their clients' investable assets in alternative asset classes. Alternatives are those financial assets that do not belong to the conventional income, cash, or equity categories and include but are not limited to private equity, private credit, hedge funds, physical property, and structured products.

Select hedge funds have offered a compelling alternative to a long-term, buy-and-hold SA equity investment over the past few years for those SA investors who require a consistent rand return. As an asset class, hedge funds globally have been viewed by some investors with a fair degree of uncertainty and scepticism and, in my view, for a good reason. Many of these hedge funds have opaque investment strategies, are expensive and, most importantly, have been unable to live up to what their names suggest; these investments have failed to hedge investors during significant equity market turmoil.

Nevertheless, a well and often conservatively managed hedge fund should be able to capture two-thirds of the upside of a bull market and experience only one-third of the downside in a bear market. The investment toolkit available to hedge fund managers is also far broader than the one long-only managers have at their disposal. This toolkit allows hedge funds to extract returns in various market cycles by taking advantage of market dislocations as these present themselves. In my view, this is where the real opportunity has been in an equity market like the JSE, which has lacked any clear direction over the past several years, and the liquidity (or the volume of trade going through the market) has dropped significantly.

To evidence this, I have included *Figure 1* below, which shows the cumulative return over the past seven years of an equally weighted allocation to two of the hedge funds available from Anchor. I have compared these funds to the local equity market as measured by the FTSE JSE Capped SWIX Index. While the return differential (130% vs 58%) stands out for the right reasons, the consistency of returns p.a. makes considering hedge fund strategies a potentially viable alternative to owning JSE-listed equities on a long-term, buy-and-hold basis.

Figure 1: Hedge funds combination* vs FTSE JSE Capped SWIX Index returns, rebased to 100, 31 July 2017 to 30 April 2024

Source: Anchor, Bloomberg

**Hedge funds combination includes 50% invested in the Anchor Stable Retail Hedge Fund and 50% invested in the AG Capital Rainbow Hedge Fund.*

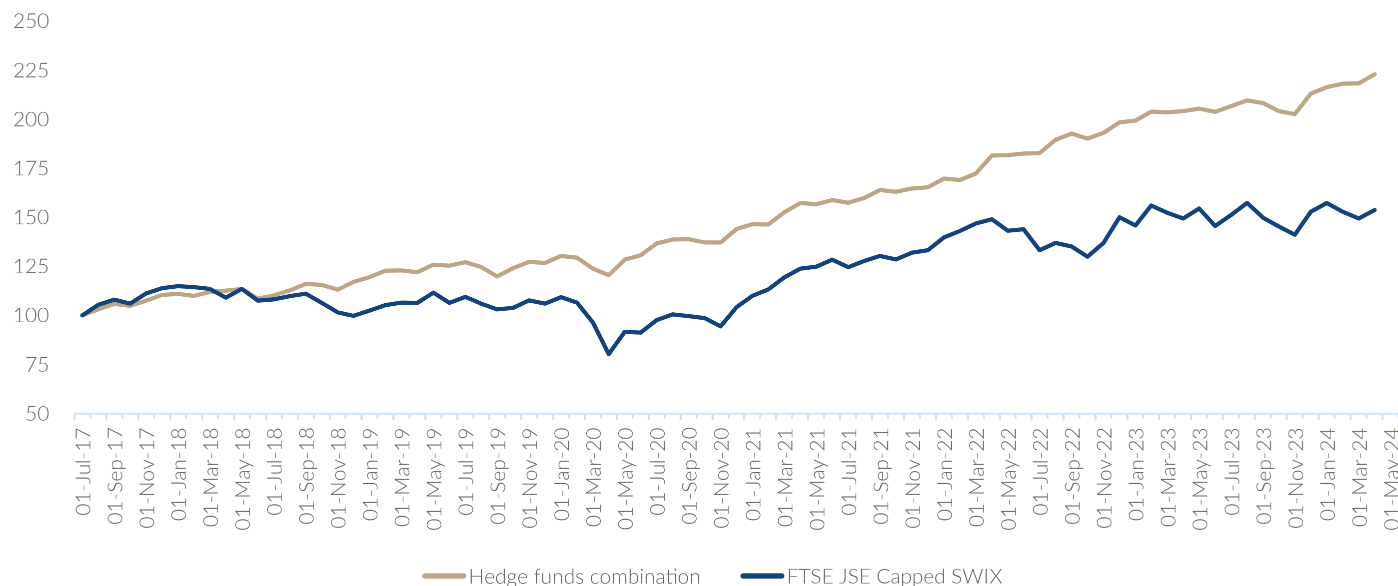


Figure 2: Anchor hedge funds combination vs FTSE JSE Capped SWIX Index returns, 31 July 2017 to 30 April 2024

Source: Anchor, Bloomberg

**The 2017 return is the total return from 31 July 2017 to 31 December 2017/ the 2024 return is the total return to 30 April.*

	2017*	2018	2019	2020	2021	2022	2023	2024*
FTSE JSE Capped SWIX Index	13.9%	-10.1%	6.8%	0.6%	27.1%	4.4%	4.8%	3.5%
Anchor Stable Retail Hedge Fund	11.4%	-0.1%	4.7%	-1.4%	17.0%	17.1%	9.6%	1.3%
AG Capital Rainbow Hedge Fund	9.1%	17.0%	13.3%	26.9%	14.8%	17.6%	7.5%	9.1%

In simple terms, a hedge fund is a structure that allows the investor to invest in various assets (equities, cash, bonds, listed property, etc.) and uses investment strategies to preserve the invested capital and achieve real above-inflation returns. An essential distinction between hedge funds and typical long-only investment portfolios is that a hedge fund can make money out of falling share prices as well as rising share prices due to its ability to short shares (i.e. sell shares these funds do not own) and hence profit from the subsequent price decline. Hedging techniques can protect capital during falling or volatile equity markets - in many instances, hedge funds can benefit/profit during market volatility. Anchor is at the forefront of this trend by providing access to products such as the Anchor Stable FR Retail Hedge Fund, the Anchor Accelerator FR Retail Hedge Fund and the AG Capital Rainbow Hedge Fund.

If you have any questions on hedge funds *or require more information, please contact Darryl Hannington.*

The philosophical musings of an active manager

WRITTEN BY:
Chris Lemmon,
Portfolio Management

Chris has worked in the financial services industry since 2002, focusing on private client portfolio management since 2006. He has fulfilled several roles in this space and has been fortunate to lead a large national stockbroking business and have the opportunity to start new operations from the ground up. Chris has served as a director of multiple stockbroking entities and was a prior council member of the South African Institute of Stockbrokers. Chris joined Anchor in November 2022 as a portfolio manager with a specific focus on running segregated equity portfolios, both locally and offshore, for wealthy South African families.

As an active manager*, Anchor naturally believes in the power of a considered investment decision-making process to deliver positive investment outcomes for its clients over the medium term. However, as the debate around active vs passive investment strategies continues (with quite extreme views in some instances), one key question to the discussion is often left out. Is the market efficient or not? Without a firm view on this cornerstone of the debate, we believe it is difficult to create a solid foundation to confidently build one's case, either way.

As a result, the intention of this article is not to try to add to this emotive debate in the context of a binary one vs the other position but rather to look at the genesis of active management. Is there evidence to suggest that markets are, in fact, inefficient? If one can answer 'yes' to this question, the debate revolves around the difference between 'good' and 'bad' active managers - an entirely different discussion.

Unsurprisingly, this issue has been explored in detail by academics and market practitioners alike. While theoretical frameworks such as the efficient market hypothesis (EMH) have received considerable attention over the years, only some, if any, seem to effectively provide a framework that reasonably explains the real-world variance that investors experience over time. Equities' prices can swing wildly; mispricing can appear to exist for extended periods in multiple areas, all within the context of an efficient market. How?

Various attempts have been made to discredit the notion of the EMH, with strong contributions from areas such as behavioural finance theory, which essentially deals with why investors often make behavioural mistakes and act against their best interests (think fear and greed, lack of self-control, etc.). While this area of finance makes a strong case, my personal favourite is a paper written by George Soros for the *Journal of Economic Methodology* in January 2014. The paper is entitled *Fallibility, Reflexivity and the Human Uncertainty Principle*. For those unfamiliar with Soros, he is one of the US' most successful investors and philanthropists, probably most famous for making a US$1bn profit in a single day in 1992 when he 'broke the Bank of England'. His Quantum Fund achieved annual returns of 30% from 1970–2000, an undeniable alpha generator.

** Active portfolio management entails frequently buying and selling equities to outperform a specific benchmark. This management style strives for superior returns but with greater risk. Conversely, passive management requires replicating an index or benchmark to match your investments' performance.*

In his paper, Soros explains why pursuing dogmatic empirical frameworks (as found in physics) in the social sciences leads to oversimplified frameworks, which lack credibility and fail miserably in real-world applications, particularly in financial markets. He firmly believes that, while pursuing empirical testing of social science constructs remains important, they should not be held to the same level of scientific cause and effect proofing as something like the laws of gravity.

Once they have formed their views, participants act based on these imperfect views.

My take is that their role is not supposed to be purely mathematical but rather to facilitate deductive decision-making in the investment process.

What seems evident is that there is significant value to be added by understanding ideas that provide more nuanced outcomes when trying to map out the actions of thinking participants rather than looking to produce universal and timeless generalisations with symmetrical and reversible explanatory and predictive powers (Soros' words, not mine, but this would be the type of criticism that the pure sciences would direct at social science).

You may be asking, what are fallibility and reflexivity in the context of investment philosophy and the EMH? Quite simply, with these two principles, Soros takes dead aim at short-term market efficiency and shoots it right between the eyes - a headshot. EMH is as dead as disco.

These two principles work in tandem. Soros' definition of fallibility contends that where you are involved in trying to understand the actions of thinking participants in financial markets, the participants' views of the world will never correspond with the full extent of reality. Participants can gain knowledge of individual facts, but when they roll these into forming theories or views, they are bound to be biased, inconsistent, or both. That is fallibility in its most simple form.

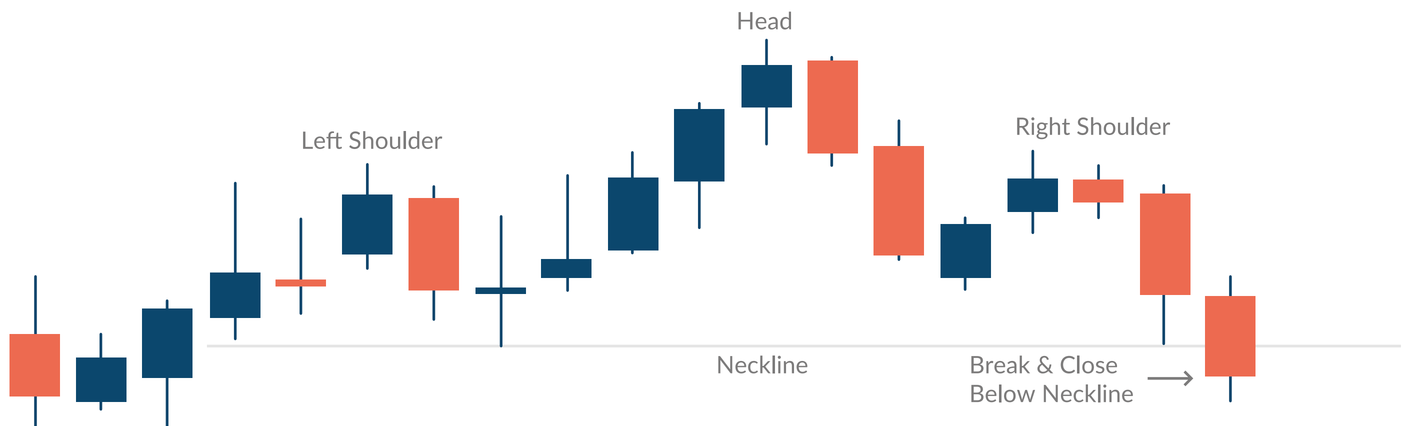
Once they have formed their views, participants act based on these imperfect views. These actions can change the nature of the market they participate in (though not necessarily making it more efficient). To make this construct a little less nebulous, here are a few examples to chew on:

- Rare-coloured wildlife: Approximately seven years ago, black impalas sold for around R750k per animal. With high demand and limited supply, prices rocketed, causing more speculation. According to *Huntershill Safaris*, in 2022, these black impalas could be hunted for R1,500 each.

- Bitcoin: Who knows what Bitcoin's value should be? But when prices go up, people chase it higher even though they have no clue what the value of bitcoin should be. And when it gets some downward momentum, people run for the door. Greater fool theory … efficient?

- Technical analysis: What does a head and shoulders (HS) chart pattern have to do with a stock's underlying value? Zero. However, suppose enough people believe in technical analysis (which tens of millions of participants do – I am certainly not knocking technical analysis) and trade these patterns and their associated trading rules. In that case, the nature of their buying and selling in accordance with that pattern will shape the outcome.

Figure 1: HS chart pattern – euro vs British pound weekly
Source: Forexuseful.com

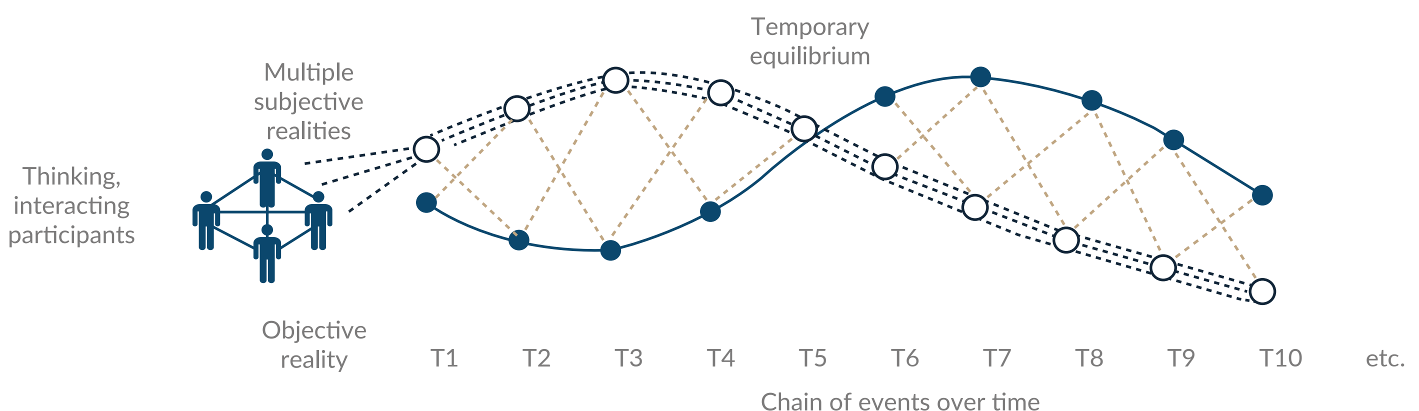


See above for an example. A HS pattern is a signal for a change in direction. If the neckline breaks, the expectation is that the trend change is confirmed, and the target price to the downside is the difference between the top of the head and the neckline, subtracted from the neckline. If everyone believes that outcome, they sell for profit, with more selling bringing lower prices. Once the target is reached, they begin to buy to lock in their profits. As buying comes in, falling prices abate, and the pattern is confirmed. For no other reason than participants shaped the outcome by the sheer weight of their expectations and the actions they took based on those expectations – reflexivity.

In a genuinely simplistic form (and I am nowhere near doing justice to the depth of thought that has gone into Soros' paper), from my perspective, more buyers than sellers mean prices go up. Higher prices reinforce the subjective view that a stock's price should be higher based on some explicit or implicit assumptions, bringing further conviction to these ideas. So, the higher prices, which have been caused by initial changes in expectations but not necessarily by a fundamental shift in the investment case, are being used to reinforce the view that prices should go higher. And so, the virtuous cycle begins, and a reflexive system takes hold.

When does it recalibrate? Remember, in the market, all investors' expectations are doing is shaping the price of a listed instrument. In the case of a company, the buying and selling of shares in the secondary market has zero impact on its ability to earn a profit. The system recalibrates when the disconnect between perception (this company is going to quadruple in three years, so that I will pay 100x earnings for it now) and reality (it reported compound EPS of 10% p.a. instead) stretches too far apart, expectations change, and prices adjust accordingly. Invariably, given imperfect information and fallible participants, markets are very rarely in equilibrium where expectations match pricing. Soros illustrates it nicely below.

Figure 2: Social phenomena
Source: George Soros (13 January 2014), 'Fallibility, Reflexivity, and the Human Uncertainty Principle', Journal of Economic Methodology



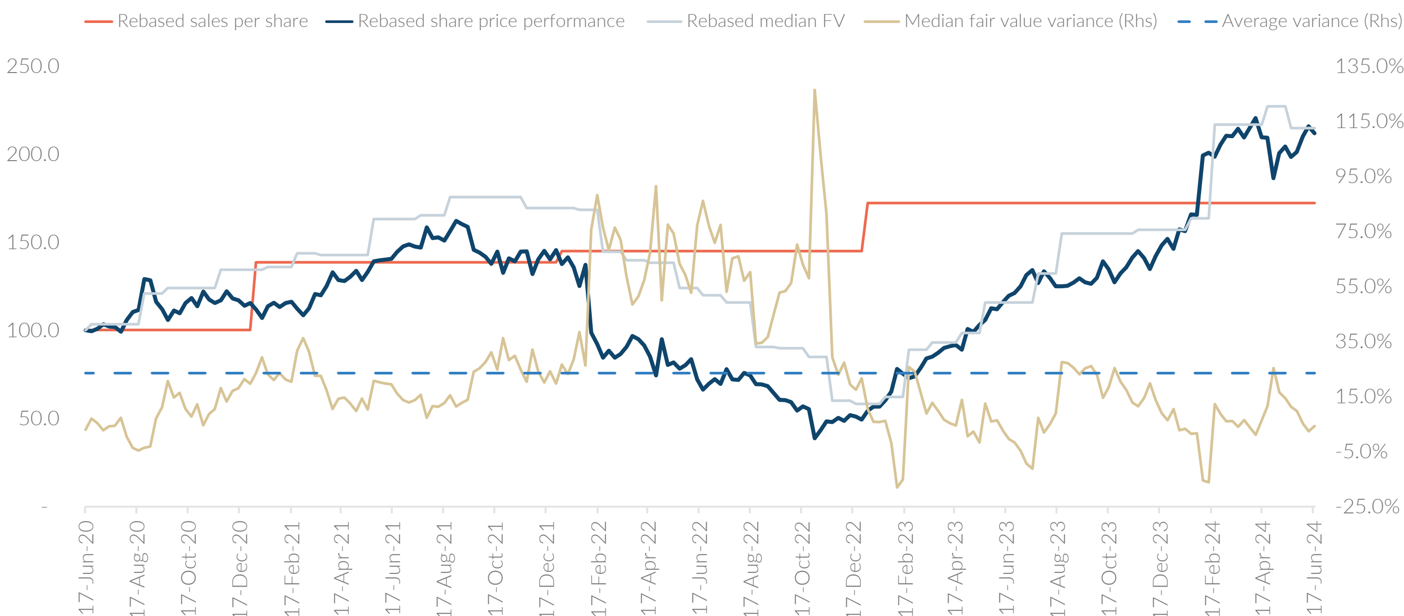
The key to any reflexive system is the participation of thinking and interacting participants, which is exactly what a financial market represents. Millions of participants bring their ideas, thoughts, and imperfect views of the world to bear on the price of financial instruments. Therein lies the opportunity. In fact, I would go one step further and say that as investor participation broadens (a much larger retail presence than ever before), investment time horizons shorten, investor patience wears thin, and the degree of analysis taking place has more to do with price moves and news headlines than fundamental analysis, the bigger the opportunity becomes to take advantage of the gap between expectations and reality.

I mentioned earlier the need to loosen the hurdle rate for empirical proof of social science constructs. However, if all we have is theory, what value does it add to actually managing money? Without a practical use case, all we have is philosophical musings, which may be intellectually stimulating but do not pay the school fees.

I will conclude this discussion by looking at reflexivity in action by analysing one of the largest stocks in the world. The name is irrelevant for this exercise, but the scale certainly is. The company has an enormous market cap, well over US$500bn. On *Refinitiv* consensus analysts' forecasts, more than 60 of the top analysts in the world are submitting their estimates. It catches all the global headlines, sometimes for the right reasons, sometimes for the wrong reasons. It is a household name heavily held by managers worldwide and has ample liquidity. If there was a stock where the collection of fallible ideas would ultimately offset each other with the various gives and takes to settle on a short-term equilibrium fair value (think EMH), this would be it. *Figure 3* below paints an interesting picture over the past four years.

Figure 3: Reflexivity in action - stock with a market cap above US$500bn example

Source: Anchor, Refinitiv



The red line is sales per share. Notice how sales have gone up YoY. The black line is the performance of the share rebased to 100 in June 2020. If you had held the share during this period, with sales stable and growing, you would have been up 60% in the first year. Then, one year later, if you measured your performance, you were down 65% in total. Only to wake up two further years later and realise that you are actually up 115% from inception! What a ride. For a company with growing sales during the period, an enormous change in circumstances (or perception) has had to occur to justify the move. Daily active users during the period hardly budged ...

The last three lines on the chart in *Figure 3* are as follows:

- **Green:** Analyst median assessment of one-year fair value (FV). In 18 months, the smartest minds in the business cut their FV by 65%, only to backtrack 18 months later, taking that cut number back up by 259%.
- **Solid blue line:** The difference between the stock price and the share's 'supposed' FV.
- **Dotted blue line:** The average weekly variance between stock price and the median FV.

It resonates intellectually with my experience of managing money for the past twenty years on exchanges around the world.

You should always expect a premium between FV and current prices in aggregate for bull stocks as analysts submit one-year target prices. Still, it is interesting how big the variance between FV and price can get during dislocations: +100% and -25% at extremes. That does not look like efficient pricing to me.

While thousands of financial theories abound, the idea that investor expectations can shape a pricing outcome for a period until they are eventually weighed by the reality of earnings resonates with me. It resonates intellectually with my experience of managing money for the past twenty years on exchanges around the world. Disconnects can routinely occur idiosyncratically and structurally across sectors, regions, and at stock levels, which are all part of the investment journey. But, if you can get a handle on when the disconnects are at actionable levels, therein lies the opportunity.

The why and the how of offshore asset structuring

WRITTEN BY:
Di Haiden,
CEO: Robert Cowen Investments

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

In its first Financial Stability Review (FSR) of 2024, the SARB refers to 'Domestic institutional investors' total offshore asset allocations being almost the size of SA's nominal GDP at the end of last year.' At market prices in 2023, this was R6.97trn!

SA investors have increasingly diversified offshore, with estimates suggesting that around 40% to 50% of their collective assets are held outside the country. Considering our article in the 2Q24 Navigator on situs and situs tax, entitled *Understanding situs and situs tax*, dated 17 April 2024, and this massive transfer of wealth outside of SA's borders, we think it is crucial for investors to understand the options available to them to protect that asset base and why they should consider doing so!

Investors should consider the following when investing offshore:

1. **Exchange control**
SA has exchange control regulations that govern the movement of money in and out of the country. These regulations are designed to manage and stabilise the national currency (the rand) and to protect the domestic economy from excessive capital flight. Failure to comply with these regulations can result in fines or legal consequences. Investors can navigate these regulations more effectively and efficiently by using established offshore structures such as trusts, companies, or investment funds. These structures can often facilitate legitimate transfers of funds and investments across borders while ensuring compliance with local laws.

2. **Asset protection and estate planning**
Offshore structures can offer significant advantages in asset protection and estate planning. They can help safeguard your wealth against political instability, economic fluctuations, or changes in local laws. For example, placing assets in a trust or offshore company can provide a legal layer of separation between personal assets and potential creditors or litigants, instilling confidence in your financial security.

3. **Diversification of assets**
Offshore structures can enhance investment opportunities by providing access to a broader range of international markets, products, and currencies. Diversifying your assets globally can reduce overall risk and potentially increase returns over the long term.

4. **Business opportunities**
Whether you engage in international business or invest globally, offshore structuring can facilitate access to foreign markets, investment products, and opportunities. These may offer higher returns or better diversification prospects than those available domestically.

5. **Tax considerations**

Consider the tax implications in SA and the offshore jurisdiction when structuring assets offshore. Seek advice from tax professionals to optimise tax efficiency and ensure compliance with local tax laws and reporting requirements.

6. **Legal and regulatory compliance**

Ensure that any offshore structure complies with SA exchange control regulations and other relevant laws. Consulting with legal advisors specialising in international law and offshore structuring is essential to establish a compliant and effective offshore investment strategy.

Ultimately, the decision to diversify your assets offshore becomes a sums game: Does the cost of setting up a structure warrant the potential savings you may make? Structuring assets means holding said assets in a 'structure' and NOT in your name. Different structures will be more beneficial than others, depending on the amount of assets considered and your specific financial circumstances.

OPTIONS AVAILABLE

So, what are the various options available to investors?

Several options can effectively meet your financial goals while navigating the legal and regulatory frameworks applicable in SA, including:

1. **Offshore trusts**

Establishing an offshore trust can provide asset protection, estate planning benefits, and certain tax-planning scenarios to be considered. Offshore trusts are managed by trustees in a jurisdiction with favourable trust laws, separating assets from personal ownership and potentially providing beneficial estate and tax planning tools.

2. **Offshore companies**

Setting up an offshore company in jurisdictions like Mauritius, Seychelles, or the British Virgin Islands (BVI) can offer operational flexibility, tax efficiency, and asset protection. These companies can hold investments or intellectual property or serve as a vehicle for international trade and investment activities.

3. **International investment funds**

Investing in offshore mutual funds or hedge funds domiciled in reputable jurisdictions can provide diversification across global markets and access to specialised investment strategies unavailable locally.

4. **International endowments**

An insurance product that 'wraps' your investments and is taxed according to the four funds approach, whereby income is taxed at a flat rate of 30% and capital gains at 12%. This is less than the top personal SA income tax rates of 45% and 18%, respectively. No SA tax reporting is required, and proceeds are paid out tax-free. These products also provide an extra layer of protection from situs tax and reduce executors' fees.

5. **Banking services**

A bank account in another jurisdiction in a foreign currency provides standard banking services outside of SA.

6. **Offshore real estate**

Purchasing property in stable offshore markets can diversify your asset base and provide potential rental income or capital appreciation. Offshore real estate investments can also offer residency or citizenship benefits in some jurisdictions.

7. **Offshore investment accounts**

Opening offshore brokerage or investment accounts lets you directly invest in international stocks, bonds, exchange-traded funds (ETFs), and other financial instruments. These accounts provide access to global markets and currencies, potentially offering higher returns and diversification benefits.

This is not an exhaustive list, but it covers investors' primary options when investing offshore. Many of the above options can be used in conjunction with each other, but the correct combination will depend on your individual circumstances.

CONCLUSION

By carefully evaluating the abovementioned options and seeking guidance from experienced financial, legal, and tax advisors, investors can design an offshore asset structuring strategy that aligns with their financial objectives, risk tolerance, and long-term wealth preservation goals while adhering to regulatory requirements.

Our role is to assist you in finding the correct offshore investment structure for you. We strongly believe that it is worth considering all of the various options available to you and deciding which would be the right one, taking into account your unique personal circumstances. Understanding all your offshore investment options will empower you to make informed decisions about your financial future.

If you have any questions or need clarity on investing offshore and its possible financial implications, please contact Di Haiden 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	June-24	Since inception	5 Year	3 Year	12-month	6-month	3-month	June-24	Performance vs Benchmark
UNIT TRUSTS																	
Anchor BCI Equity Fund	Apr-13	9,4%	175,4%	6,8%	7,9%	11,3%	8,0%	5,7%	1,9%	149,8%	8,7%	10,1%	10,0%	5,7%	8,2%	4,2%	25,6%
Anchor BCI SA Equity	Aug-21	11,3%	34,6%	N/A	N/A	11,8%	8,0%	9,6%	4,2%	30,2%	N/A	N/A	10,0%	5,7%	8,2%	4,2%	4,5%
Anchor BCI Flexible Income Fund	Jun-15	7,2%	88,6%	6,6%	7,0%	9,9%	4,2%	3,0%	1,6%	85,5%	6,6%	7,1%	9,1%	4,4%	2,2%	0,7%	3,2%
Anchor BCI Managed Fund	Jan-15	6,3%	77,6%	8,1%	8,7%	11,9%	6,5%	3,5%	2,5%	86,2%	8,9%	9,2%	10,3%	5,5%	3,8%	1,8%	-8,7%
Anchor BCI Worldwide Flexible Fund	May-13	11,5%	236,6%	11,9%	12,8%	23,2%	16,5%	1,0%	-3,0%	163,7%	9,0%	10,0%	9,2%	4,2%	2,2%	0,5%	72,8%
Anchor BCI Property Fund	Nov-15	-1,2%	-9,8%	-0,8%	6,7%	13,9%	4,5%	3,1%	4,3%	-0,1%	0,9%	11,7%	26,3%	9,6%	5,5%	6,0%	-9,7%
Anchor BCI Global Equity Feeder	Nov-15	12,4%	176,3%	16,7%	-0,1%	10,1%	8,3%	-1,5%	-2,9%	201,4%	16,6%	14,3%	15,8%	11,1%	-0,7%	-1,0%	-25,1%
Anchor BCI Bond Fund	Feb-16	8,9%	105,1%	7,6%	7,3%	13,6%	5,8%	8,1%	5,5%	105,4%	7,8%	7,6%	13,7%	5,6%	7,5%	5,2%	-0,4%
Anchor BCI Diversified Stable Fund	Feb-16	7,7%	86,9%	8,4%	9,3%	10,3%	4,5%	4,5%	2,0%	75,1%	7,6%	8,1%	9,9%	4,7%	3,3%	1,8%	11,8%
Anchor BCI Diversified Moderate Fund	Feb-16	7,4%	82,5%	8,7%	9,9%	9,4%	4,5%	4,2%	1,6%	76,4%	8,3%	8,6%	9,8%	5,2%	3,6%	1,9%	6,1%
Anchor BCI Diversified Growth Fund	Feb-16	7,2%	79,4%	9,2%	10,8%	10,1%	5,1%	4,7%	2,0%	80,2%	8,9%	9,2%	10,3%	5,5%	3,8%	1,8%	-0,9%
Anchor BCI Africa Flexible Income	Mar-16	6,6%	70,5%	6,2%	5,7%	8,9%	-0,6%	-4,7%	-3,6%	98,8%	8,1%	8,5%	10,5%	5,1%	2,6%	0,8%	-28,3%
Anchor BCI Global Technology Fund	Jun-19	11,2%	71,5%	11,5%	-0,5%	17,5%	13,7%	1,7%	1,0%	262,8%	29,7%	23,4%	33,1%	24,6%	7,4%	5,8%	-191,3%
Anchor BCI Flexible Fund	Jul-13	9,4%	168,1%	11,2%	3,6%	-0,1%	-11,8%	0,0%	0,0%	9,9%	9,5%	10,1%	7,6%	2,3%	0,0%	0,0%	158,1%
Anchor BCI Core Income Fund	Sep-20	7,3%	30,8%	N/A	7,8%	9,8%	0,0%	2,4%	0,8%	24,5%	N/A	6,5%	8,5%	4,2%	2,1%	0,6%	6,3%
Anchor BCI Global Flexible Income Fund	Sep-20	3,7%	14,6%	N/A	8,7%	2,1%	0,5%	-2,9%	-1,7%	21,7%	N/A	12,4%	2,5%	2,8%	-2,2%	-2,6%	-7,1%
Anchor BCI Worldwide Opportunities Fund	Feb-21	4,8%	17,1%	N/A	4,3%	9,2%	5,1%	-0,2%	-0,3%	22,1%	N/A	6,0%	5,2%	2,3%	1,2%	0,2%	-4,9%
EQUITY NOTES & SEGREGATED MANDATES																	
Anchor Equity	Jul-13	9,5%	172,7%	10,5%	13,4%	16,5%	8,5%	8,5%	4,2%	148,0%	5,7%	10,1%	10,0%	5,7%	8,2%	4,2%	24,7%
HEDGE FUNDS																	
Anchor Stable SNN RIHF	Jul-03	12,4%	1037,5%	9,8%	13,7%	10,1%	6,4%	5,0%	1,6%	325,0%	6,1%	6,5%	8,5%	4,2%	2,1%	0,6%	712,5%
Anchor Accelerator	Feb-16	6,6%	71,2%	5,2%	-2,8%	6,5%	7,1%	5,0%	0,7%	95,0%	6,1%	6,5%	8,5%	4,2%	2,1%	0,6%	-23,8%
OFFSHORE																	
High Street Equity - Dollars	Jun-12	9,9%	209,2%	6,3%	-1,8%	11,3%	6,8%	-1,2%	0,6%	276,6%	12,3%	7,4%	20,8%	12,0%	2,8%	2,1%	-67,4%
High Street Equity - Rands	Jun-12	17,5%	590,1%	12,0%	6,5%	7,6%	6,6%	-4,8%	-2,4%	738,6%	18,2%	16,4%	17,1%	11,9%	-0,8%	-1,2%	-148,5%
Offshore Balanced - Dollars	Jun-12	7,6%	141,0%	3,6%	-1,5%	9,7%	5,6%	-0,6%	0,6%	118,8%	6,3%	1,9%	12,2%	5,6%	1,1%	1,3%	22,2%
Offshore Balanced - Rands	Jun-12	15,1%	441,0%	9,3%	7,2%	6,0%	5,4%	-4,2%	-2,4%	380,8%	11,5%	10,0%	8,7%	5,1%	-2,4%	-1,9%	60,1%
Global Dividend - Dollars	Jan-14	7,7%	117,3%	7,0%	4,9%	13,7%	5,8%	-1,0%	0,1%	180,0%	12,3%	7,4%	20,8%	12,0%	2,8%	2,1%	-62,6%
Global Dividend - Rands	Jan-14	12,9%	255,0%	12,5%	13,6%	9,7%	5,6%	-4,6%	-2,8%	358,9%	18,2%	16,4%	17,1%	11,9%	-0,8%	-1,2%	-104,0%
Anchor Global Stable Fund - Dollars	May-15	1,7%	16,8%	2,4%	-0,2%	7,7%	2,1%	0,4%	0,7%	36,4%	4,1%	5,1%	5,4%	2,3%	1,1%	0,4%	-19,7%
Anchor Global Stable Fund - Rands	May-15	6,4%	75,2%	7,8%	8,2%	4,5%	1,9%	-3,3%	-2,5%	104,4%	9,5%	13,9%	1,7%	1,4%	-2,9%	-2,9%	-29,2%
Anchor Global Equity - Dollars	May-15	10,8%	153,3%	13,7%	-6,6%	14,1%	9,2%	1,8%	-0,7%	116,5%	10,8%	5,4%	19,4%	11,3%	2,9%	2,2%	36,8%
Anchor Global Equity - Rands	May-15	15,8%	280,0%	19,7%	1,2%	10,7%	9,1%	-1,9%	-3,9%	224,8%	16,6%	14,3%	15,8%	11,1%	-0,7%	-1,0%	55,2%
RCI UNIT TRUSTS																	
RCI BCI Flexible Growth Fund	Sep-16	9,6%	103,8%	11,9%	1,4%	18,4%	8,9%	-2,7%	3,6%	109,0%	10,0%	11,0%	10,2%	4,7%	2,4%	0,6%	-5,2%
RCI BCI Worldwide Flexible Fund	Dec-16	8,8%	89,1%	9,4%	3,1%	10,0%	6,0%	-3,8%	0,0%	91,6%	9,0%	10,0%	9,2%	4,2%	2,2%	0,5%	-2,5%

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An authorised Financial Services Provider; FSP no: 39834
www.anchorcapital.co.za | invest@anchorcapital.co.za