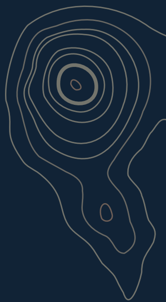
STRATEGY AND ASSET ALLOCATION REPORT

1st Quarter 2022



NAVIGATING CHANGE

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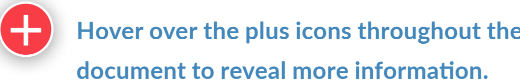

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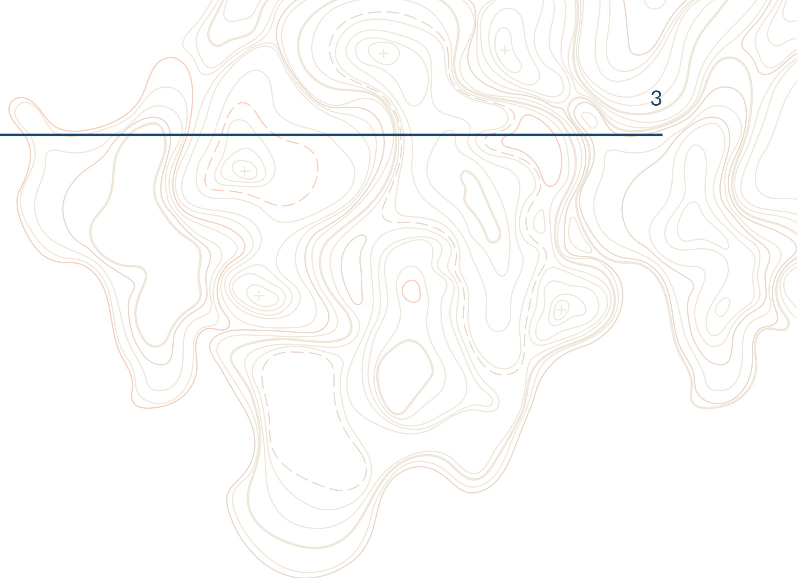


Introduction

WRITTEN BY:
Nolan Wapenaar and Peter Armitage
Chief Investment Officers

This introduction is being written on the 667th day of South Africa's (SA) National State of Disaster on COVID-19. What started as a short-term mechanism to reduce stress on hospitals has become a long-term event that will permanently change how we live. As we start 2022, hopes are high that we are moving into the final phase of the pandemic, where we learn to live with the virus and can return to a more normal life.

The themes of 2021 are equally carrying into the new year. Supply chain blockages, where people are either too sick to work or are on lockdown, continue to hamper the supply of goods. Against this backdrop, individuals have shifted their spending towards goods, while services such as travel remain difficult under pandemic conditions. The increased demand for goods at the time of a decline in supply is the perfect recipe for inflation. This was the dominant theme in 2021 and has carried on into 2022.

Central banks are responding, the US Federal Reserve (Fed) should stop printing money by March, while most central banks (including our own) are expected to hike interest rates a couple of times over the coming months. Inflation and rising interest rates are going to be the theme for the first half of this year at least. The headwind from rising rates makes for more volatile markets (giving both entry and exit opportunities from time to time). The debate is about how drastically the central banks need to respond. Markets are delicately balancing the optimism from higher economic growth expectations with the pessimism from higher interest rates.

We expect that the next six- to twelve months will bring clarity as the goalposts for central bank action and economic growth become clearer. Asset allocation is particularly difficult in this environment and active management is essential as adjustments will be necessary once we have a clearer view of which way the goalposts are moving. The fortunes of an asset class that might appear unattractive today, can change rapidly as we gain clarity on likely developments ... this is the season of active management.

The increased demand for goods at the time of a decline in supply is the perfect recipe for inflation.

In this context, Anchor continues to believe in diversification between asset classes. We have specialists in the various asset classes, who are actively focused on comparing the risks and rewards of their respective asset classes to suggest subtle portfolio shifts. Within each asset class, there are always opportunities to be had, particularly in the more volatile environment. An asset class might appear uninteresting on the surface, however, underlying that superficial index level view are individual companies and investments. We remain focused on digging around in those possible investments to find the couple of compelling opportunities that inevitably present themselves.

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 (local currency) (%)
	Negative	Neutral	Positive	
LOCAL				
Equity	○	○	●	12.0
Bonds	○	●	○	9.1
Listed property	○	>	●	11.0
Cash	●	○	○	5.0
Alternatives*	○	○	●	10 to 15
Rand/US$ (rand marginally stronger)				6.2
GLOBAL				
Equity	○	●	○	6.0
Government bonds	●	○	○	-1.5
Corporate credit	●	○	○	-1.0
Listed property	○	●	○	5.2
Cash	●	○	○	0.1
Alternatives*	○	○	●	5 to 10

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

Asset Allocation Summary

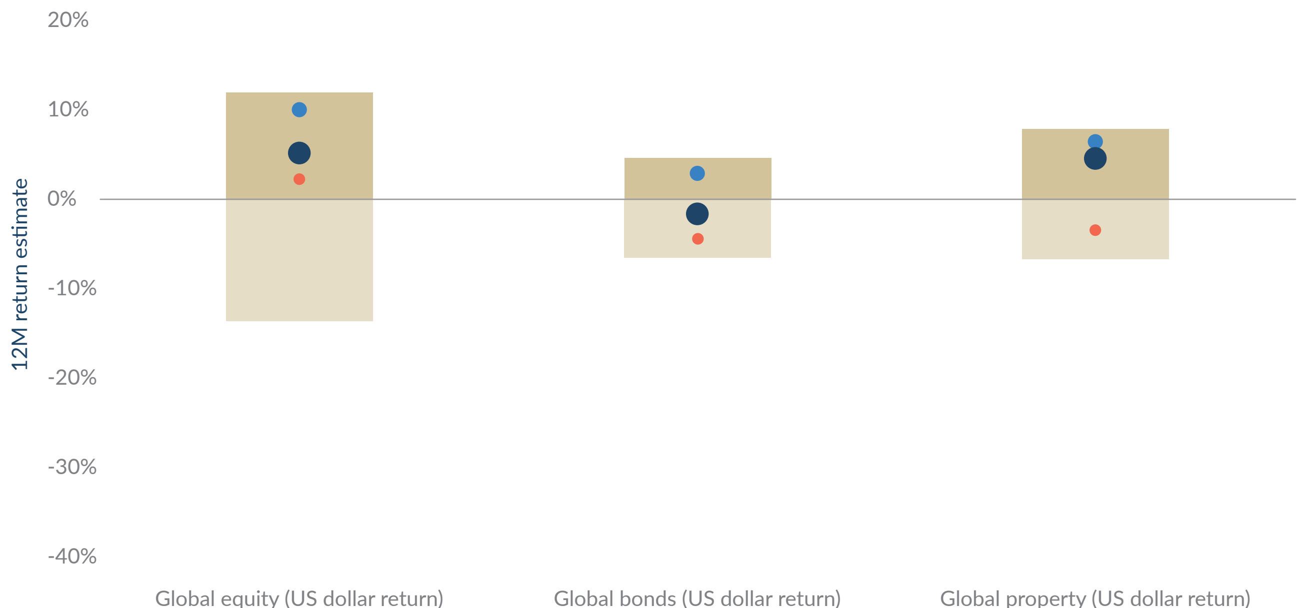
The recovery from the pandemic is well underway and world financial markets are now focused on the inflation surge that is proving worrisome. Central banks around the globe are cutting support and hiking rates and the debate is shifting to how drastic the rate-hiking cycles will be and what this means for individual asset classes? This factor will have a significant impact on investment outcomes over the next year and, although risk assets are still appealing, we advise a phased approach towards investing new money into portfolios, with volatility likely to remain high.

We maintain our overweight view towards domestic equity based on the skew of risks to the upside and we have also shifted our view of JSE-listed property to be positive as we gain clarity for the outlook on rentals and demand in the coming months. The index level returns might seem quite pedestrian; however, we expect that there might be fairly significant swings in the performance of the shares underlying the index, presenting investors with attractive opportunities.

In *Figure 1* below, we highlight 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 what the outcome will be in the various scenarios. From a global perspective, equity is the most attractive asset class though downside risks remain.

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

Source: Anchor



Globally, equity has been performing well and returns have been supported by strong company earnings. This is likely to continue in the coming year, although there is a risk that earnings misses will be met with strong disappointment. Bonds are uninteresting, while property appears more attractive and is supported by strong dividend yields. Much depends on the outcome of the transitory inflation debate and, should inflation prove stubbornly high, the risk of central banks needing to chase with rate hikes will precipitate disappointing outcomes. Conversely, inflation that recovers towards historic norms would be more market supportive.

Figure 2: Anchor expected return by offshore asset class
Source: Anchor

	Global equity	Global bonds	Global property
Anchor expected return (in US dollar)	6.0%	-1.5%	5.2%

In *Figure 3* below, we highlight 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 what the outcome will be under the various scenarios. From a domestic investor perspective, the equity markets remain compelling.

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

Domestically, we think that this is a positive investment environment where the risks are skewed towards the upside. All asset classes are rather positive and the pro-risk environment favours equities the most. We see more scope for rand appreciation than depreciation, although our base case is that this will be relatively modest.

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

	Domestic equity	Domestic bonds	Domestic property	US$/rand
Anchor expected return (in rand)	12.0%	9.1%	11.0%	6.2%

Strategy and Asset Allocation

ECONOMICS

As we welcome the new year, the global economic environment remains as challenging as ever. As a small, open and commodity exporting economy, SA's prospects are intrinsically tied to those of the global economy. Positively, the outlook for global growth generally remains robust, with the International Monetary Fund (IMF), as of October 2021, forecasting global GDP growth of 5.9% for 2021 and 4.9% in 2022, whereas 6 months ago its forecasts were 0.1-ppt lower and 0.5-ppts higher, respectively. Against this backdrop of strengthening global economic activity, trade volumes have been improving, supporting SA exports. In line with a positive global GDP growth outlook, the IMF forecasts trade growth of 10% in 2021 and 7% in 2022. However, two big markets for SA exports (China and the rest of Africa) face significant headwinds. Growth in China (which remains Africa's single biggest customer, accounting for c. 11% of all SA exports mainly via iron ore) is projected to slow to 3% in 2H21 and 5.6% in 2022 - down from 13.1% in 1H21. Meanwhile, the recovery in economic activity across the rest of Africa looks considerably weaker than the rest of the world, thus adding further downside risks for SA GDP growth. The IMF forecasts that, after contracting by 1.7% in 2020, sub-Saharan Africa's GDP will expand by 3.7% this year and by 3.8% in 2022.

Rising global inflationary pressure remains a key spillover risk into SA via arbitrage between different markets for tradeable goods, and by a policy-induced shock to capital flows that impacts SA's exchange rate. Worryingly, much of the world has been experiencing higher inflation due to various supply chain bottlenecks, rising demand as economies slowly reopen, and various mismatches of demand and supply. The IMF forecasts that inflation will ease for advanced economies from 2.8% this year to 2.3% next year and for emerging economies from 5.5% to 4.9%, but the risks are mounting that inflationary pressures will prove stickier-for-longer than policymakers had initially anticipated, possibly necessitating a sudden burst of aggressive tightening from key central banks globally. As expected, December's US Fed communications confirmed that quantitative easing (QE) tapering should end by 2Q22. The potential timing of the rate-hiking cycle has moved, with the hawkish shift in the Federal Open Market Committee (FOMC) dot plot showing a median three hikes in 2022 – consequently a start in June 2022 is a strong possibility. Despite the upward revisions to inflation, risks are still viewed on the upside, but the market has already been pricing-in an early start to the cycle.

Much of the world has been experiencing higher inflation due to various supply chain bottlenecks, rising demand as economies slowly reopen, and various mismatches of demand and supply.

Nonetheless, the rapid spread of the Omicron variant across the globe brought more announcements about lockdowns with various levels of severity - stretching well into January for some countries. A global return to near-normal economic activity has consequently become patchy, promptly reigniting inflation fears. In SA, positively, the fourth wave of COVID-19 infections appear to have peaked without overwhelming the healthcare system. Nonetheless, high levels of unemployment remain a primary concern. The effects of COVID-19 have simply served to exacerbate SA's labour market situation, which even pre-pandemic had one of the lowest labour absorption rates in the world. As of 3Q21, SA holds a 34.9% unemployment rate, the highest jobless rate since comparable data began in 2008, off the back of the July unrests and the still-stringent lockdown measures.

Relief measures provided by government have helped to ease the burden on some households in the formal sector of the economy, however elevated levels of financial uncertainty remain. Whilst the fourth quarter typically sees a seasonal pick-up in employment, travel bans put in place by several important SA tourist markets (albeit having since mostly been lifted), following the discovery of the Omicron variant, is likely to dampen the level of economic activity anticipated.

The release of the 3Q21 GDP negative growth rate of 1.5% led to a fairly muted market reaction, the data print within itself serves to remind us of the risks and social costs of the unrest as well as extreme inequality. At the end of the day, current economic growth rates remain insufficient to make a meaningful dent in SA's prevailing unemployment problem. Furthermore, state-owned enterprises (SOEs) remain a drag on potential economic growth, labour markets remain rigid and investor confidence remains low. As a consequence, SA's economic potential also remains weak in this environment. On the positive side, the steps taken by government to bring its finances under control appear plausible as tax collection remains robust and SA continues to benefit from stronger terms of trade. We continue to see a positive trade balance even though it is likely to gradually decline as commodity prices soften. Subsequently, SA bonds screen as incredibly attractive on a real yield basis, which is attracting some foreign interest. The likely three or four rate hikes in 2022 will also be supportive of the rand.

SA EQUITIES

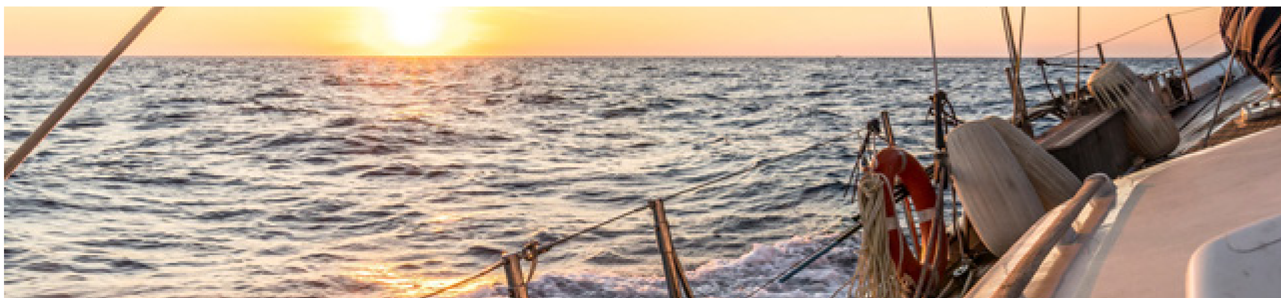
SA equities, as represented by the FTSE/JSE Capped Swix enjoyed a stellar 2021, delivering a total return of 27.1%. While the Capped Swix, a widely adopted measure of local equity performance, only has a track record going back to December 2016 (with 2021 being its best year since inception), the previously dominant barometer of local equity performance (the FTSE/JSE All Share Index) experienced its best year dating all the way back to 2012.

Arguably, the most pleasing aspect of this return outcome was that the contributions to returns were broad-based, across most sectors – unlike the narrow market breadth experienced in other major indices. Another interesting aspect of the return outcome for the Capped Swix was that 2021 represented the first year that the Naspers/Prosus complex was a detractor (and a material one at that, with a negative 2% return) from the total return of the Capped Swix. Every other sector and subsector* contributed positively to the index's performance. The key debate investors are now faced with is whether the strong performance can continue in the year ahead or whether those factors that drove index returns to new highs are beginning to fade as we enter a world of higher inflation and what looks to be tighter monetary conditions? While all factors are not unique to the JSE, as we have come to experience, global macro factors are playing an increasingly important role for portfolio construction on the JSE. On our numbers, we forecast a total return of 12% for the JSE in 2022 and we continue to see reasonable value across the market, with telcos the one sector in which we remain largely underweight following its recent outperformance.

The key debate investors are now faced with is whether the strong performance can continue in the year ahead or whether those factors that drove index returns to new highs are beginning to fade.

As highlighted a year ago (in *The Navigator – Anchor's Strategy and Asset Allocation, 1Q21* dated *14 January 2021*), the makeup of the JSE heading into 2021 made the index well placed if we were to see some outperformance of value over growth (after more than a decade of growth outperforming value). Heavy weightings to the basic materials sector and financials, in addition to relatively low valuations and earnings bases (and expectations) across many economically sensitive "domestic" stocks following years of stagnant GDP growth and a very high unemployment rate, has resulted in the ideal mix for the more valuation-sensitive investor. However, going into 2021 not many investors correctly forecast the stubbornly high inflation, particularly in the US, which has further amplified demand for rate-sensitive sectors (such as banks etc.), inflation hedges (commodities), and for those businesses with strong pricing power and the ability to pass on the increase in costs. On the flipside, these dynamics have resulted in the heavy underperformance of long duration, highly valued growth stocks – which experienced stellar gains in 2H20 – with the JSE not having any meaningful exposure to these types of businesses.

**Using Anchor's proprietary sector and subsector classifications*



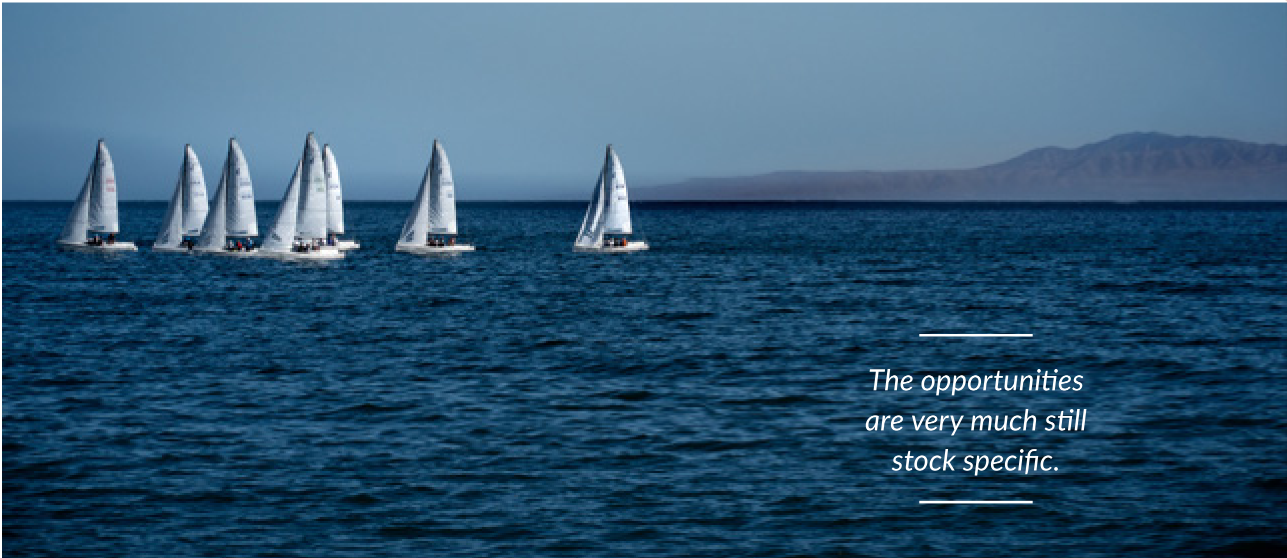
Of course, we concede that the above is an oversimplification of the dynamics at play globally – with many more nuances to each. Looking ahead to 2022, the monetary policy divergence between the US and China remains a key portfolio construction consideration for us, even as we focus inwardly on the JSE. With the Chinese set to embark on a period of monetary easing, we expect to see further support for bulk/industrial commodities in the near term, with iron ore, a key export commodity, having recovered from its recent pullback to rally by over 20% in December 2021 and thus providing further support for SA's current account balance and the rand. In addition, we expect to see a bottoming out of Chinese equity valuations as the looser monetary policy conditions fuel demand for equities. We expect this to feed into a rerating of Tencent after a year of continuous derating in the face of a domestic regulatory reset (we have addressed our view on the Chinese tech sector at length in previous iterations of *The Navigator* including in an article entitled *Navigating China's regulatory reset*, dated 12 October 2021).

Last year was the first time in many years that we believed conditions were right to get constructive on the domestic banks and we remain constructive heading into 2022.

It therefore come as no surprise that the biggest expected contributors to the total return for the JSE over the next 12 months are the diversified miners and Naspers/Prosus – with the former not necessarily due to overly high return expectations but rather moderate expectations coupled with the large weightings in the index (we are forecasting low double-digit total returns across most of the miners).

Turning inwardly to the economically sensitive "domestic" stocks, we remain cautiously optimistic despite the economic data prints setting the tone for an underwhelming growth backdrop, beset with stubbornly high unemployment and policy uncertainty (we are getting dangerously close to retiring the word "uncertainty" when describing domestic economic policy). The reason for our cautious optimism is largely due to being able to find adequate investible opportunities across the local market. Last year was the first time in many years that we believed conditions were right to get constructive on the domestic banks and we remain constructive heading into 2022, with a total return expectation in the mid-teens for the local banking sector. Higher local rates, further impairment unwinds (following a better-than-expected COVID-19 recovery), and shrewd cost management should fuel another 2 years of above-trend earnings growth. We expect the earnings momentum, coupled with undemanding valuations across the sector (with Capitec the exception from a valuation perspective) to result in an outperformance on the JSE.

Outside of the banks, we remain encouraged by the opportunity set in front of us, many of which is not largely represented in big index heavy stocks, but one level below them in the mid-cap space. Last year was the first time in a while that the Anchor investment team could uncover interesting investment opportunities on the local market. Many of the companies have spent the five years prior to the pandemic on the back foot, with 2020 providing an opportunity to "reset" many of the cost bases, exit loss-making or low-return operations/geographies and consolidate overcrowded sectors. Unfortunately, many of the of the "self-help" actions taken by SA corporates have resulted in a headcount reduction and a further increase in local unemployment – which does not bode well for the long-term economic outlook of the country – but still results in a positive outcome for equity holders. Within SA, we continue to favour higher-quality, more defensive businesses and, as always, we are on the lookout for tactical opportunities during periods of dislocation, the most recent of which was the overreaction to news around the new Omicron COVID-19 strain.



SA LISTED PROPERTY

We are moderately positive for another good year from JSE-listed property shares in 2022, as earnings levels and dividends become more predictable after the uncertainty brought about by the pandemic since the beginning of 2020.

The sector should pay out dividends of 7.2%, in aggregate, and sustain a two-year growth rate of 5%-10% as conditions normalise further. We project a 11% total return from JSE-listed property in 2022.

The FTSE/JSE Listed Property Index (SAPY) staged a strong recovery in 2021, with the sector returning a chart-topping 37%. However, we note it was coming off an extremely low base after a very weak performance over the preceding 3-4 years. While the listed property sector still trades at a discount (c. 12 % – based on the latest SAPY index weights) to reported net asset values (NAVs), the opportunities are very much still stock specific given, inter alia, the following: relative balance sheet strength; sector and geographic exposure (continued divergence given the outlook at a sector and geographic level); liquidity profile; and current discount to NAVs.

The SA-driven segment of the market has some recovery growth in 2022 (less rental concessions etc.), but thereafter growth will be challenged as interest rates rise and negative reversions continue. By contrast, we expect sustained c. 5% earnings growth in the offshore counters, largely driven by development profits and better underlying GDP growth, particularly in Central and Eastern Europe. The offshore exposure we have in our property fund is in aggregate trading at a 6%-7% euro yield with sustainable dividend growth, and all of this in hard currency. This should create a profile of sustained 10%-15% rand returns over the medium term, which we consider attractive in the context of global opportunities.

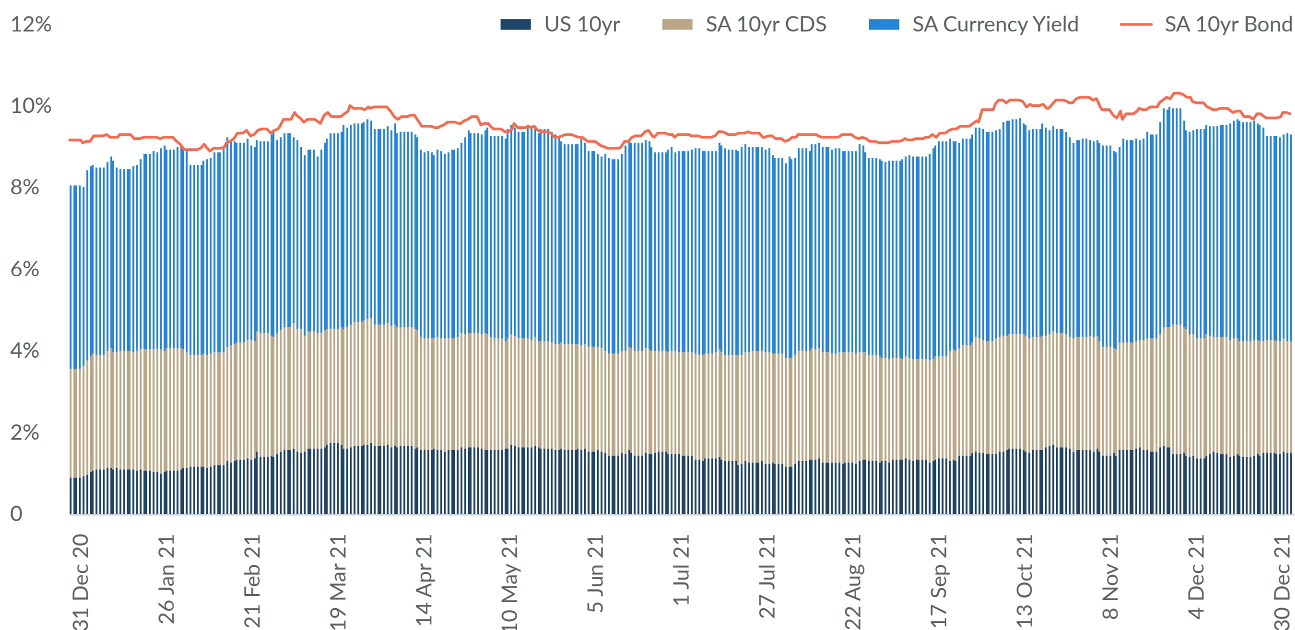
Another dynamic to bear in mind is that SA companies no longer, as a default, pay out 100% of their earnings as a dividend. Payout ratios vary between 75% and 100% (zero for some companies that are degearing) and hence earnings yields differ from dividend yields. This brings SA in line with global practice, where companies hold back a portion of their earnings for maintenance capex and development/growth. Previously, this was funded by additional debt, which was enabled by steadily increasing NAVs. As NAV growth has come under pressure, access to additional debt has become problematic/less desirable for certain companies.

We favour the offshore companies (MAS, Nepi Rockcastle and Lighthouse), but we also see value in some local counters and especially Growthpoint, which has recovery potential from the V&A Waterfront.

DOMESTIC BONDS

SA government bonds (SAGBs) recorded a mixed 4Q21 as the R2030 benchmark closed the year with yields that were 12.5 bpts weaker over the quarter. The resultant index level return for the All Bond Index (ALBI) was 2.9%. Over the whole curve, the belly (R186 and R2030) weakened, the long end (R2032 onwards) strengthened and the short end (currently represented solely by the R2023) firmed slightly (by 5 bpts).

Figure 1: SA government 10-year bond
Source: Anchor, Thomson Reuters



Above we track the build-up of generic SA 10-year debt, the notable factors are:

- US 10-year yields remaining stubbornly below 2% - back to pre-COVID levels.
- The SA 10-year credit default swaps (CDS) are range bound at between 250 to 300 bpts – only 10-40 bpts weaker than their pre-COVID levels.
- The currency yield is expected to be over 5% - historically, over long cycles, the rand weakens, on average, by 4% p.a.

In our previous Navigator report (*The Navigator - Anchor's Strategy and Asset Allocation, 4Q21* dated *11 October 2021*), we again highlighted the aggressive rate-hiking cycle priced into derivatives markets. In November 2021, the SARB's MPC announced its first rate hike of this cycle (by 25 bpts), to leave our central bank rate at 3.75%. We retain our view that further hiking is likely as we progress through 2022 and our baseline remains for 3 rate hikes this year (of 25 bpts each), with leeway for the SARB to make a +25-bpt or -25-bpt adjustment, depending on economic data releases and global factors. Current forward rate agreement (FRA) market expectations are for approximately 200 bpts of hikes in 2022. We thus see the FRA market as overly confident of a strong hiking cycle.

These rate hikes will apply pressure to domestic bonds, however given the magnitude of hiking currently assumed in the market, a slower-than-expected rate of hiking should allow bonds to tighten yields over time.

The ALBI Index at present yields 9.2%. Assuming a slower-than-expected hiking cycle and benign local and global economic factors could result in a net 2022 return for SAGBs of 9.1%. This compares with a 2021 return for the index of 8.4%.

Risks to the downside remain domestic, politically driven factors - the riots that took place in mid-2021 around former president Jacob Zuma's imprisonment are an example of the outsized political risks that SA still faces. Given the extent of the corruption revealed at the Zondo Commission and the lack of visible progress on charging and arresting those chiefly responsible, there is the potential for further unrest and instability.

On the global front, the rate-hiking cycle expected in DMs has not yet begun to materialise. US 10-year treasury notes closed the year yielding 1.512%, which poses further downside risk to SAGBs if DMs are forced to hike at a materially more rapid pace than expected, the yields on their bonds could rise, leading to a less desirable carry trade in EM bonds – this would have a negative impact for SAGBs.

Upside potential exists if SA can insulate itself from the political instability that flared up at times last year, if corrupt individuals are brought to justice, if those state institutions that have degenerated in the past decade (such as the SA Revenue Service [SARS] and major SOEs) can begin to be placed on a positive path to recovery and if inflation in DMs slows.

THE RAND

The global economic backdrop has been shifting with an acceleration of expectations of DM rate hikes. The South African rand has been caught in the whirlwind of wildly fluctuating policy expectations as central banks have pivoted towards more rate hikes, sooner. Much of the volatility of the rand has been attributed to the strengthening US dollar, while domestic factors have taken a back seat.

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

With expectations of rate hikes in the US, the European Central Bank (ECB) begrudgingly being pushed into a more hawkish stance and rate hikes in SA, we expect that 2022 will be more volatile than normal and we anticipate that some wild swings in the currency might take place. This will give opportunities to take funds abroad and to take profits on US dollar positions.

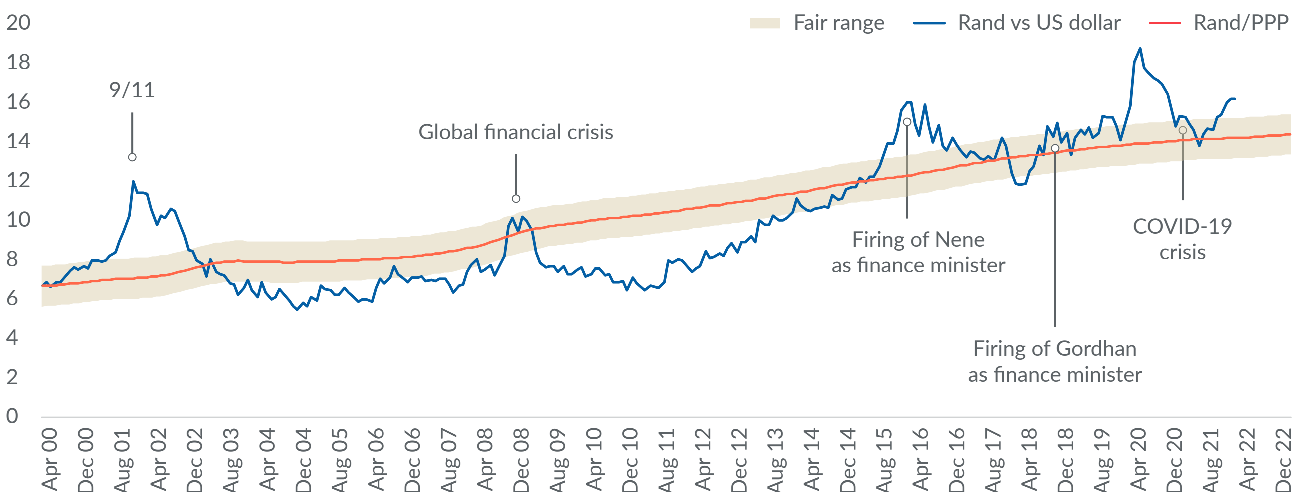
We retain our purchasing power parity (PPP) based model for estimating the fair value of the rand and we have extended this out by three months since the publication of *The Navigator – Anchor's Strategy and Asset Allocation, 4Q21* report on 11 October 2021.

US inflation rates are expected to remain high for much of 2022. Our PPP-model is sensitive to the extent to which domestic inflation exceeds that of the US. Consequently, the low differential means that our expectation of long-term rand weakness is modest. Our PPP-modelled value for the rand vs US dollar at the end of the next 12 months is R14.27/US$1 (see *Figure 2*). We apply a R2.00 range around this to get to a fair-value range of between R13.27/US$1 and R15.27/US$1.

We note that the dollar has traditionally strengthened into the Fed's first rate hike and thereafter given up some of its strength as we progress through the hiking cycle. If this pattern is anything to go by, then the rand may remain weak for a while before regaining some lost ground later in the year.

For practical purposes, we retain our fair value range of R14.50 to R15.00/US$1, although the rand will probably spend much of 1Q22 trading above this level. For the purposes of this document, we are basing our estimates off the top end of the range of R15.00/US$1, which implies rand strengthening of 6.2% from its R15.9921/US$1 close at the end of 2021.

Figure 2 Actual rand/US dollar exchange rate vs rand PPP model
Source: Thomson Reuters, Anchor



GLOBAL EQUITIES

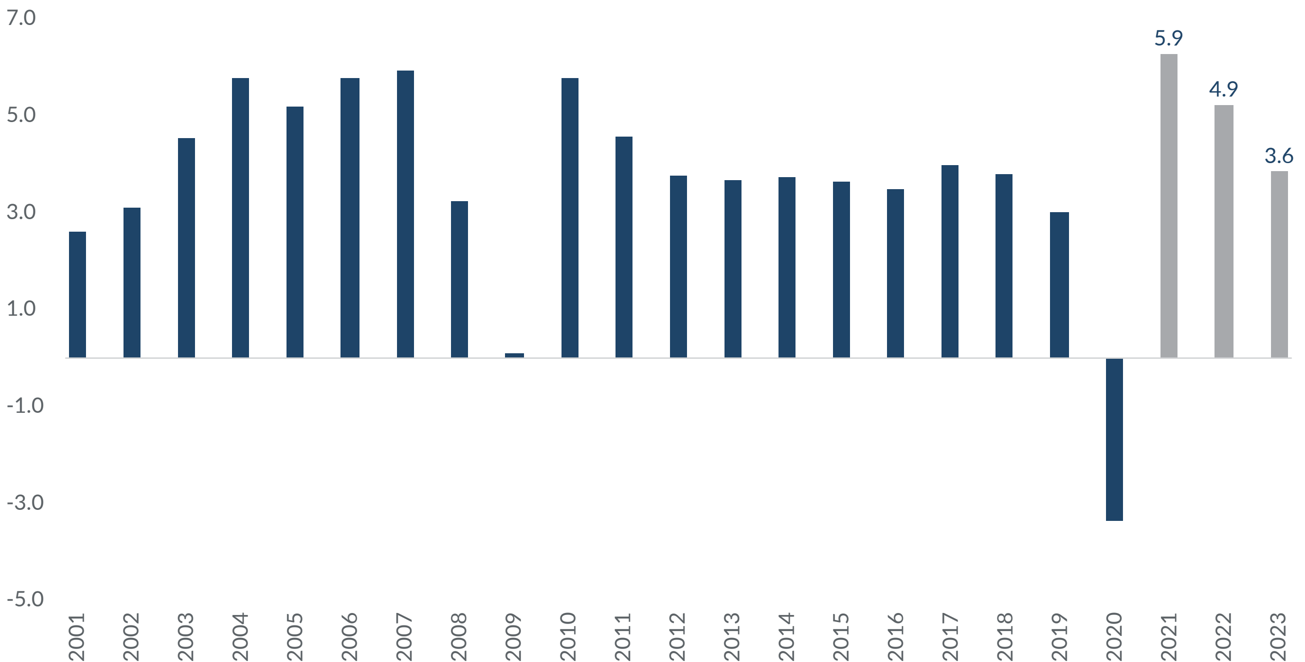
We enter 2022 with companies and markets thriving (MSCI World up 21.8% in 2021), but with COVID-19 rampant, valuations high, inflation ballooning, and interest rates set to rise - risks are elevated for share prices. We have remained positive on equities for the past 18 months and with strong GDP growth set to be sustained, many companies will continue flourishing.

The 12-month risk/return equation for global equities is becoming less attractive at the index level, and investors have to be increasingly selective in their choice of equities. While overall market performance could well be in the 0%-7.5% range, we strive to own global equities that we believe can compound at 10%-15% p.a. We believe we can still identify these after the volatile market moves in recent months.

It is important to note that, beneath the index level in 2021, there was a huge difference in relative performances. In 2020, growth shares were the market leaders, but many of these stars corrected in 2021 as value sectors such as energy and financials took the lead. Chinese technology (tech) shares got hammered and EMs declined 2.5% for the year. Most growth investors had a very difficult year as rampant inflation saw the US Fed indicate that interest rates would rise quicker than expected. This had a negative impact on the value of long-duration growth assets, where a higher proportion of the value is in the future, and this is being discounted at a higher rate. More than 40% of Nasdaq shares are down over 50% from their 52-week highs – a remarkable statistic in the context of the strong market conditions.

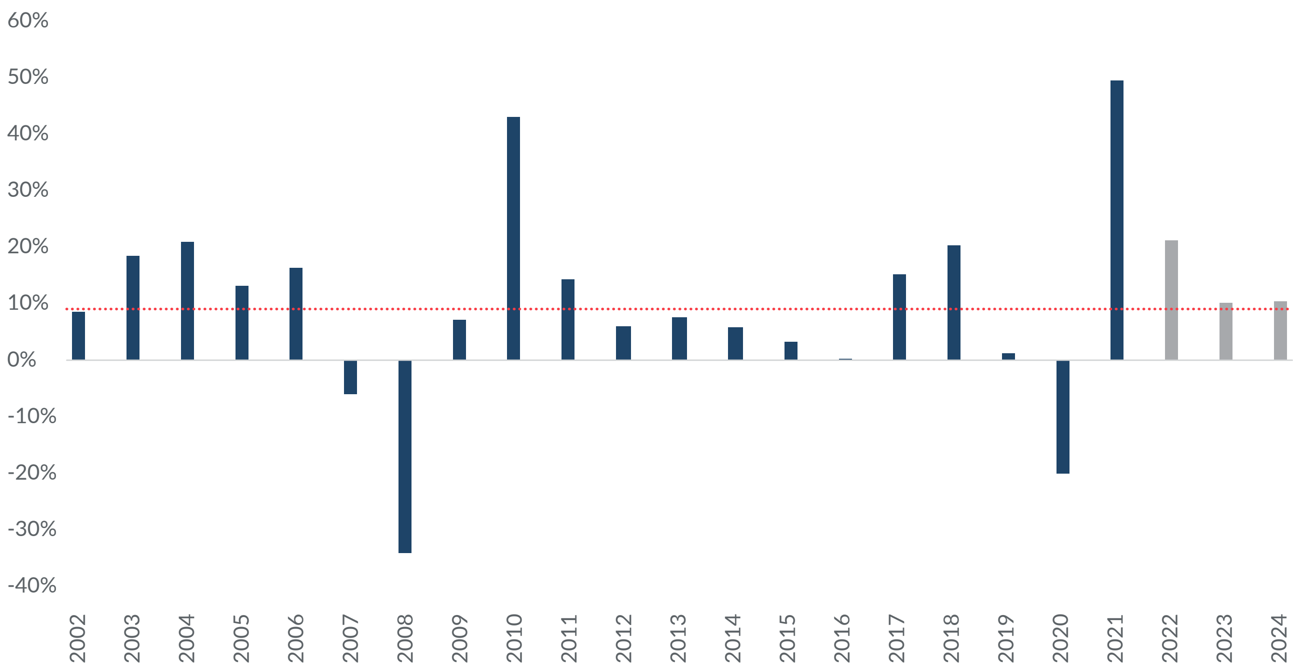
The outlook for company earnings is positive. As shown in *Figure 3* below, the *IMF* forecasts another strong year of global GDP growth in 2022 (+4.9% YoY).

Figure 3: Global GDP growth, %
Source: IMF, Anchor



This provides a backdrop for growth and consensus earnings growth for the US S&P 500 is another 20% in 2022, following a sharp recovery in 2021 (+50% YoY) to levels 20% above the pre-COVID earnings base of 2019. Earnings are projected to return to trend growth of 8%-10% in 2023 and 2024.

Figure 4: S&P 500 annual EPS growth
Source: Bloomberg, Anchor



Global companies are dealing with dynamics not seen in decades. Demand is surprisingly strong, with goods demand 10% higher than in 2019, but supply has been constrained by a number of factors including global logistics, labour shortages and consumer hoarding. This has seen US inflation spike to levels of around 7% and if you switch on *Bloomberg TV* at present this will inevitably be mentioned within five minutes. For companies with pricing power this has been very positive but for many others it is resulting in margin pressure.

This will be the most-watched factor for company earnings this year and in 2H22 it could well reverse sharply due to base effects and the resolution of supply chain issues. Chip shortages have restricted motor vehicle supply and US vehicle inventories are heading towards zero, while used car prices have risen sharply. New capacity will see this pressure being eased this year. Further risks to earnings for consumer companies are: 1) goods spending returning to trend as more household spending shifts back to travel, transport, and services, 2) higher prices being demand destructive, and 3) higher interest rates.

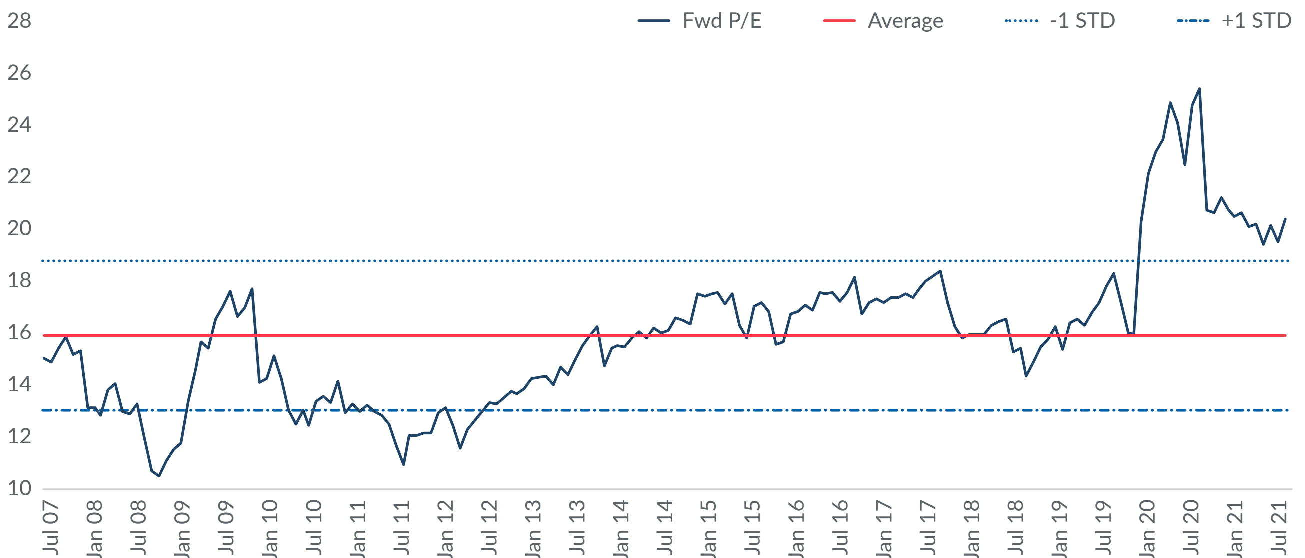
The impact of the conditions discussed above are very company specific and we continue to favour those companies that can compound earnings growth through economic cycles, with high returns on capital and strong pricing power. Most of the companies we own are underpinned by strong secular trends, which are usually less impacted by economic cycles. Opportunities to buy these companies at more attractive prices have arisen in recent months and more could well present themselves in the coming year.

So, earnings prospects are positive for 2022 and beyond (with some risks), but valuations reflect this in many instances. *Figures 5 and 6* on the following page show a MSCI World Index P/E of 19.3x, well above the 15-year average of 16x.

Figure 5: S&P 500 annual EPS growth
Source: Iress, Anchor

	Earnings growth		FWD P/E	
Name	**YR1**	**YR2**	**YR1**	**YR2**
MSCI World Index	18.4%	8.6%	19.3	17.8
MSCI EM Index	18.3%	10.2%	11.7	10.6
MSCI All Country World Index (10% EM)	18.3%	8.9%	18.0	16.5
S&P 500 Index	20.8%	10.0%	21.4	19.4

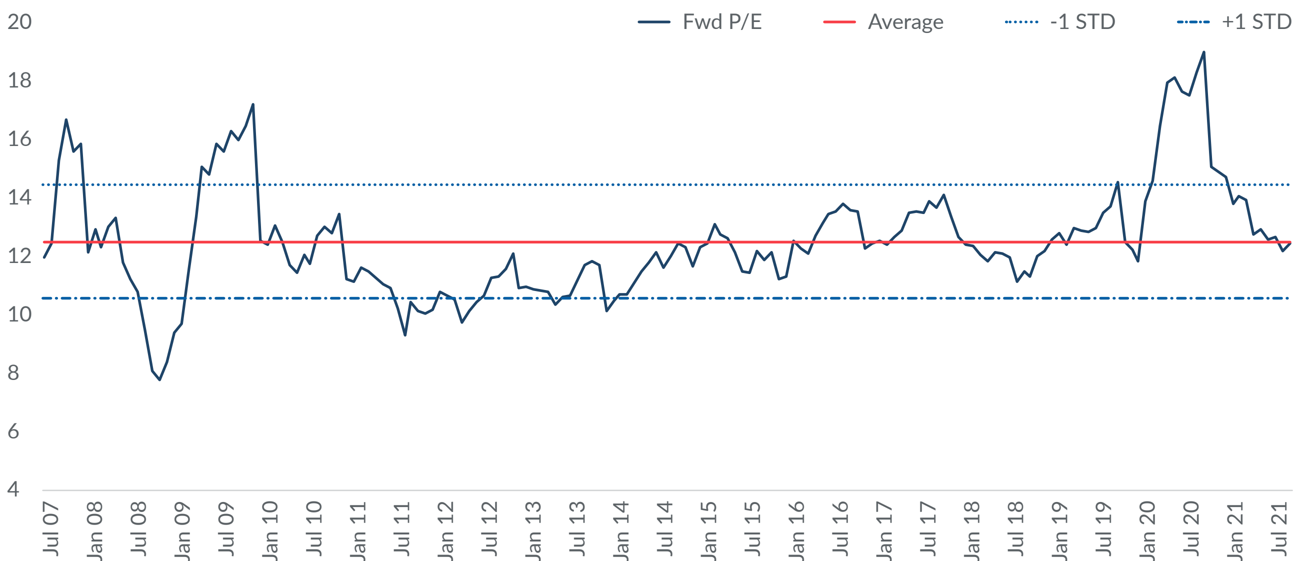
Figure 6: MSCI World fwd P/E, x
Source: Bloomberg, Anchor



Elevated valuations could well be sustained and justified by strong earnings prospects and relatively low bond yields, but downside risk is higher than average if things do not turn out as well as projected.

EMs, by contrast, are trading at below average multiples (see *Figure 7*) and could well present opportunities during the year as inflation fears subside. The risk/return in beleaguered Chinese shares is starting to look very attractive.

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



No equity outlook commentary would be complete without a mention of the COVID-19 pandemic – ultimately this has been the driver behind the extraordinary economic conditions and share market dynamics of the past two years. Consensus is for a milder Omicron variant, but we are currently experiencing unprecedented case numbers. The world is learning to adapt, and the actions taken by governments are more important than the virus itself. However, we have learnt that the virus can continue to surprise, and this remains a key factor to watch. Many companies are still operating at levels below those of 2019 and a return to normality still presents opportunities in the likes of airlines and travel/hotel companies.

In summary, the benign behaviour of global equity indices (other than EMs) belies underlying volatilities. This has presented attractive opportunities in tech companies with secular growth stories. Value counters have outperformed as the certainty of cheap near-term earnings has been a place of safety in a world where rates are rising, and inflation is creating uncertainty. This could well persist in the short term, but we continue to invest for the long term in quality companies that can compound earnings at a high return on capital. Risks are high relative to lofty valuations, but earnings prospects still look strong. We suggest remaining invested in equity markets over the longer term and this could well be a year of very attractive investment opportunities.

GLOBAL BONDS

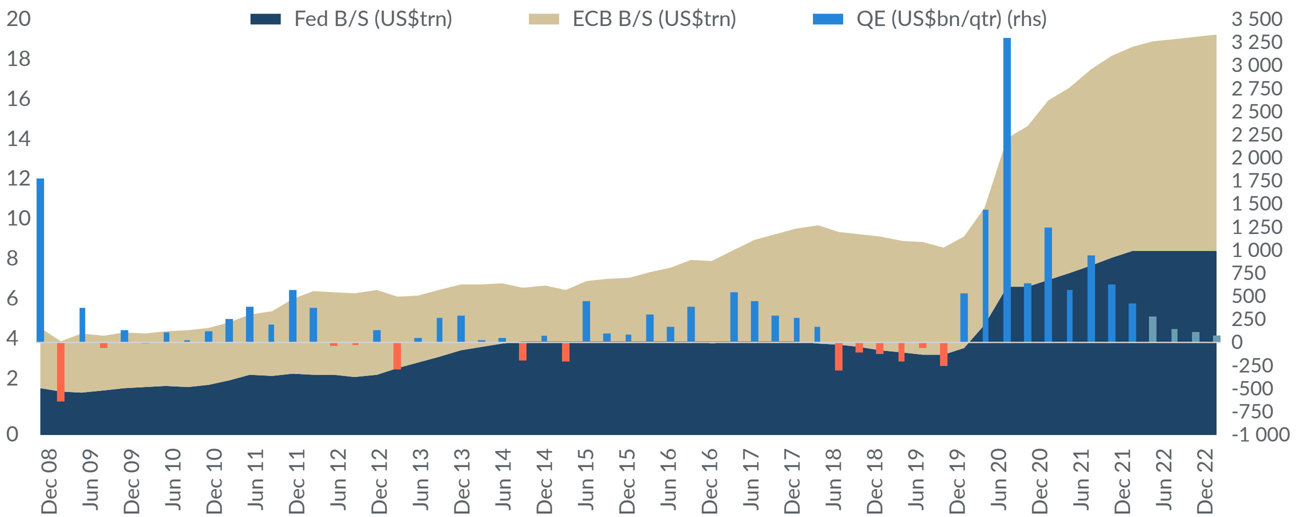
We enter 2022 with monetary policy at major DM central banks either tightening or with their intention to start tightening imminently having been announced. So, with maximum monetary policy accommodation largely behind us, we expect 2022 to be a year where the path of least resistance for DM rates is higher. That being said, central banks have gone out of their way to issue very clear guidance on policy tightening. With markets being forward looking, we expect that this tightening is already somewhat reflected in current rates, and we are not expecting rates to move dramatically higher unless DM central banks find themselves needing to act more aggressively than they have guided. This is only likely if the current bout of above-average inflation starts to become entrenched. This is not our base case.

Tightening monetary policy looks set to happen in 3 stages:

- A gradual tapering of QE i.e., central banks reducing the quantum of bonds that they have been purchasing.
- Increasing short-term rates.
- Shrinking of central bank balance sheets (by allowing the bonds they have purchased to mature without being replaced).

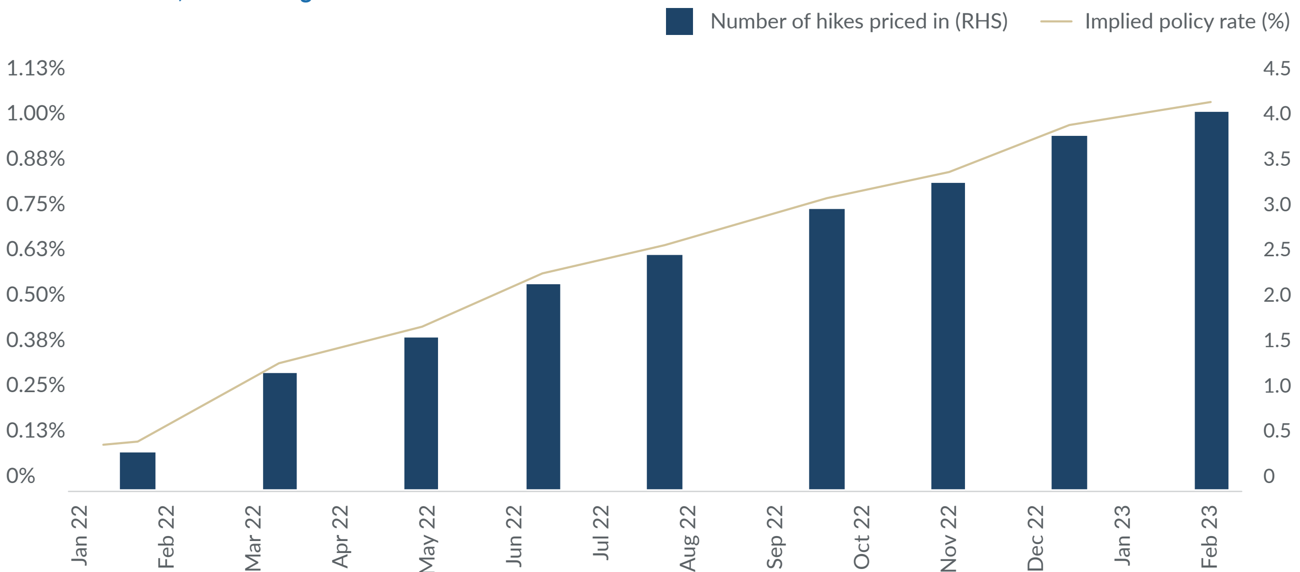
QE has already started in the US (in November 2021) and by the end of 1Q22 we expect the US Fed will no longer be expanding the size of its balance sheet (the Fed was purchasing US$120bn of bonds p.m. until its tapering programme started in November). The ECB is the other DM central bank which has been providing significant amounts of liquidity to global markets via its QE programme. It has guided that a large part of this accommodation (which has been running at c. EUR85bn p.m.) will be removed from the end of 1Q22 with QE dropping to EUR40bn p.m. in 2Q22, then EUR30bn p.m. in 3Q22 and EUR20bn p.m. in 4Q22.

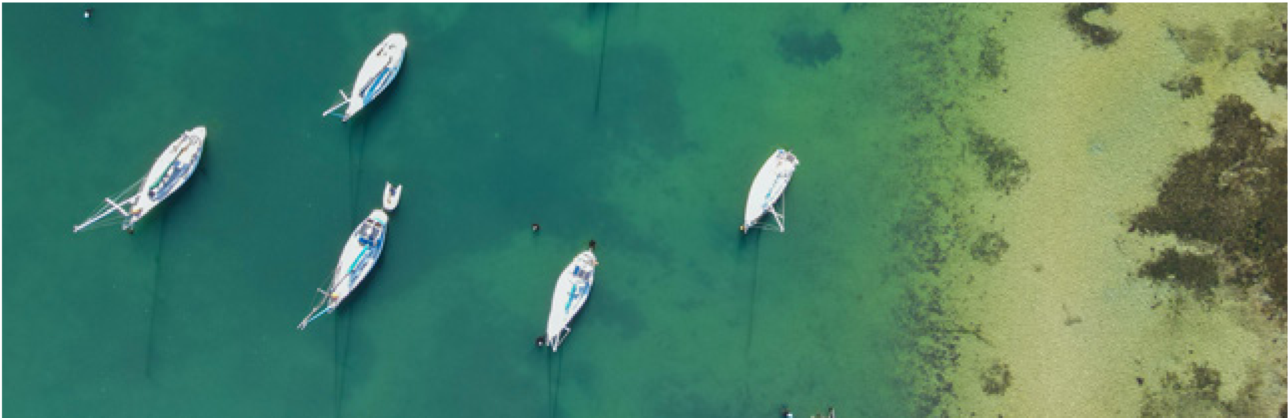
Figure 8: Major DM central banks will make solid progress in tapering QE during 2022
Source: Anchor, Bloomberg



The Fed and the ECB have both suggested that they will only start increasing policy rates after they have fully tapered QE so, for the US, higher policy rates become a possibility from 2Q22, while the ECB is unlikely to be in a position to hike rates in 2022. Derivatives markets are currently pricing in four US rate hikes in 2022, with the first rate hike most likely at the Fed's meeting on 16 March, another hike at the meeting in June, and then the other two rate hikes in 2H22.

Figure 9: Investors expect the Fed to start hiking rates in 2022
Source: Anchor, Bloomberg





We think that the shrinking of major DM central bank balance sheets is unlikely to happen until well into 2023 at the earliest and so that is certainly not on our radar when forecasting where we expect yields to end the year.

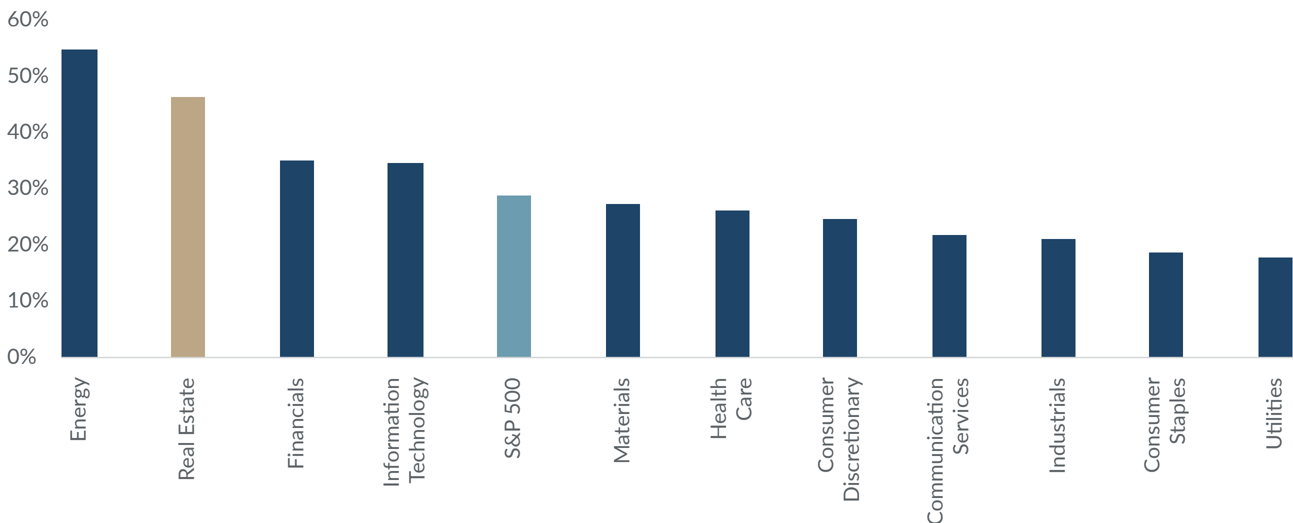
The first half of 2022 is likely to be pretty uncomfortable for central banks as we expect base effects and supply chain issues to keep inflation in the US (and to a slightly lesser extent in Europe), uncomfortably high and well above their 2% target. However, we expect 2H22 to see a significant easing of those pressures and so, to the extent that the Fed and ECB can hold their nerve in 1H22, we expect them to be under significantly less pressure in 2H22, allowing them to proceed cautiously with monetary policy tightening. The net result of all of this is likely to be a somewhat volatile 1H22 for rates, with volatility subsiding into the back of the year, where we expect US 10-year government bond rates to close 2022 at 1.9%, leaving investors in US 10-year government bonds with a total return loss of 2% in 2022.

US dollar investment-grade corporate credit spreads are slightly off the lows they have traded at for much of 2021. We expect them to be able to maintain current levels during 2022, but with rates drifting slightly higher during the year, we anticipate that investors will experience a total return loss of 1% for 2022.

GLOBAL PROPERTY

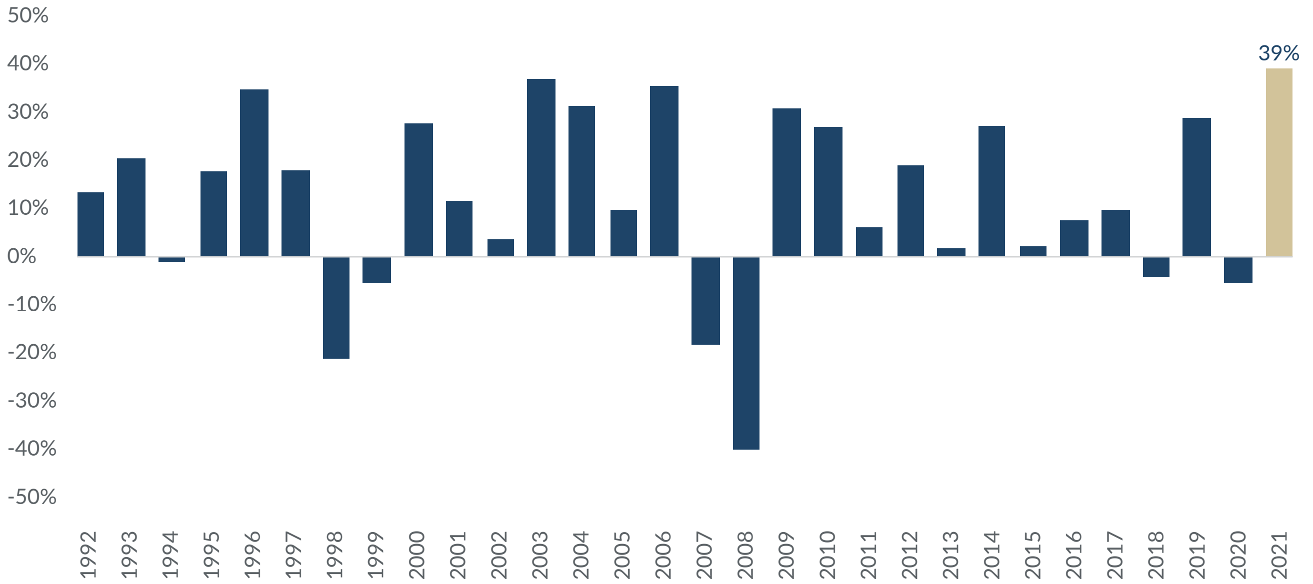
2021 was a great year for listed property stocks (real estate investment trusts [REITs]), particularly those in the US (where c. 70% of the market cap of DM REITs reside).

Figure 10: REITs were the second-best performing S&P 500 sector in 2021
Source: Bloomberg, Anchor



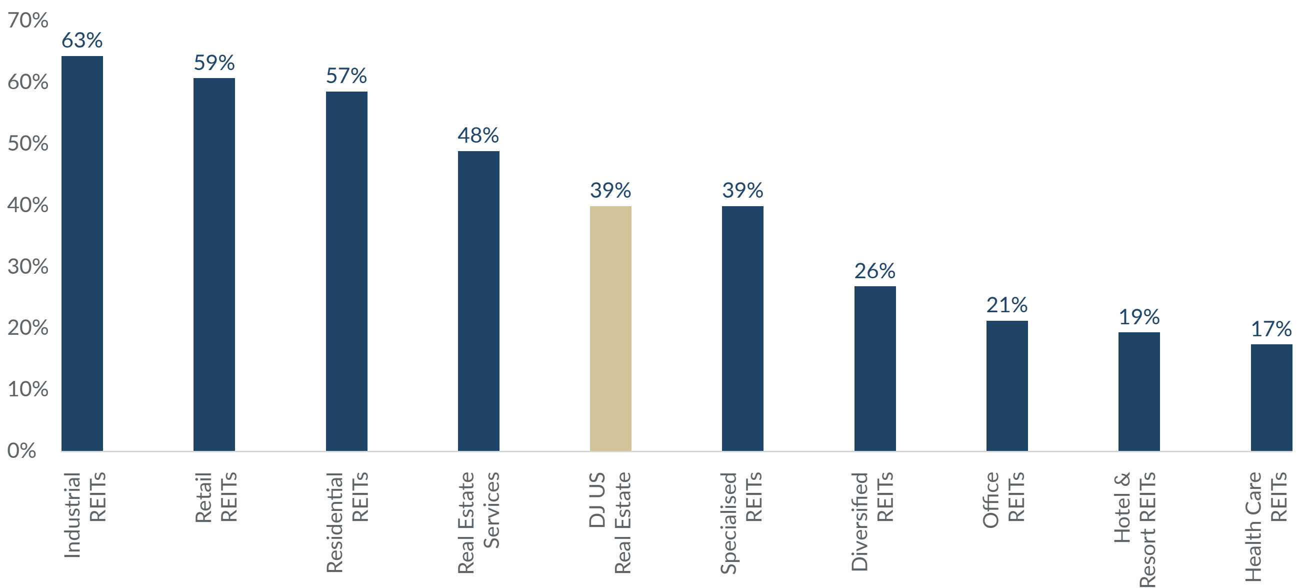
The Dow Jones US Real Estate Index had its best year going back to its inception 30 years ago.

Figure 11: US REITs (as represented by the DJ US Real Estate Index) had their strongest annual performance on record
Source: Bloomberg, Anchor



Amongst the US REIT sub-sectors, industrial, retail, and residential REITs were the star performers.

Figure 12: Industrial, retail, and residential REITs were the best performers in 2021
Source: Anchor, Bloomberg



This strong rally in REIT share prices has left them with elevated valuations, which we think will be a headwind to 2022 performance.

Figure 13: After a stellar 2021, US REITs now trade at a significant valuation premium relative to history (as measured by price/fund from operations [P/FFO])
Source: Worldscope, IBES, Datastream, UBS

Forward dividend yields on DM REITs have been squeezed by the rally and, even when factoring in a slightly lower yield environment relative to pre-COVID, the current forward dividend yields (c. 3.1%) are still c. 0.4% lower than pre-pandemic levels. In 2022, we expect above average net operating income (NOI) growth for the sector in the high single-digits, particularly as some of the pandemic-impacted sectors get some relief from elevated vacancies, but we think that this is already more than factored into above average multiples. We expect a slight unwind of elevated multiples to combine with the 3% dividend yield and the high single-digit NOI growth to result in a 5.2% total return for REIT investors in 2022.

**as of 31 December 2021*

ANCHOR INSIGHTS

In this section, staff from across Anchor provide insights into our thinking, strategy, and view of the world. This quarter, Mike Gresty unpacks Anchor's approach to investing in equities, Casey Delport discusses the outlook for SA interest rates, Seleho Tsatsi looks back at the past year in the tech sector, Matthew Stroucken highlights death taxes and offshore investing, and Tamzin Nel provides insights into patience in investing and doing less to make more.

Anchor's approach to investing in equities

WRITTEN BY:
Mike Gresty
Analyst/Fund Management

Mike holds a CFA designation. He 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 moving on to cover telecoms and media, as well 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 CIO. 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, and he led the Deutsche research team to the top of the rankings.

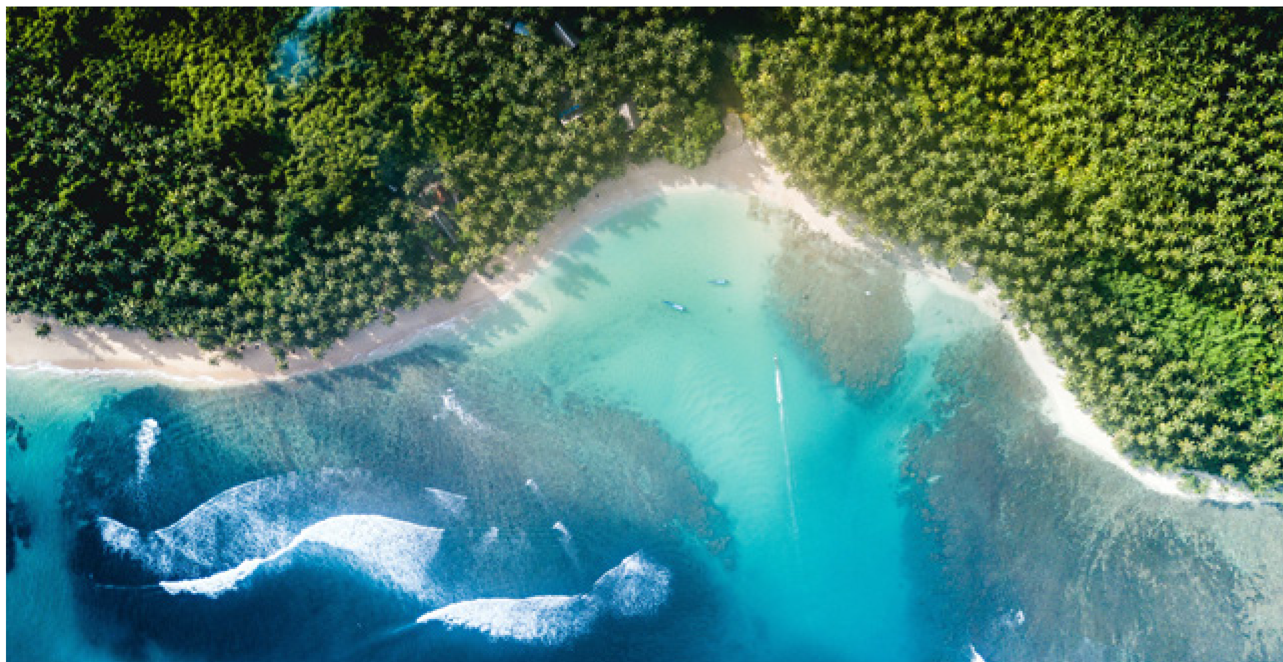
After a remarkably steady recovery in global markets from their initial COVID-induced panic in March 2020, oiled by extremely accommodative monetary and fiscal policy globally, the volatility experienced in the closing months of 2021 may prove to be the trailer for the next season of where markets are headed. As 2022 kicks off, a number of factors are conspiring to create conditions for a period of continued turbulence ahead, including:

1. policy accommodation, that has been so positive for asset prices, is being steadily withdrawn and interest rates seem set to move higher;

2. with a few exceptions (tourism and travel, for example) companies' earnings have largely recovered from the lockdown-induced collapse in 2020 – from here, some disappointment risk exists for companies unable to pass on current inflationary cost pressures to their customers; and

3. as *Figure 1*, which shows the current price of world equities as a multiple of expected earnings in 12-months' time illustrates, equity valuations have moderated a bit as earnings have recovered but still remain elevated relative to their history.

Figure 1: MSCI World Index - price as a multiple of expected earnings in 12 months' time
Source: Bloomberg, Anchor



It is not all bad news though. If one thinks of the world's economy as being on a dimmer switch, as the world emerges from the restrictions imposed due to COVID-19, from an economic perspective, it is the equivalent of the dimmer switch being steadily turned up. This implies a strong global growth backdrop, which is typically supportive for equity markets. Taken together with the headwinds discussed above, it is very conceivable that we may experience an emotionally taxing "love-hate" relationship with equities for several months to come, depending on which force is front of mind. It is an environment in which, without the rising tide of the broader market lifting all boats so to speak, investors will need to rely more heavily on stock selection to generate returns. The March 2020 COVID-19 scare aside, after what has been an extended run of strong returns from global equities, many investors are no longer accustomed to the rigours and discipline of grinding it out in a less supportive market.

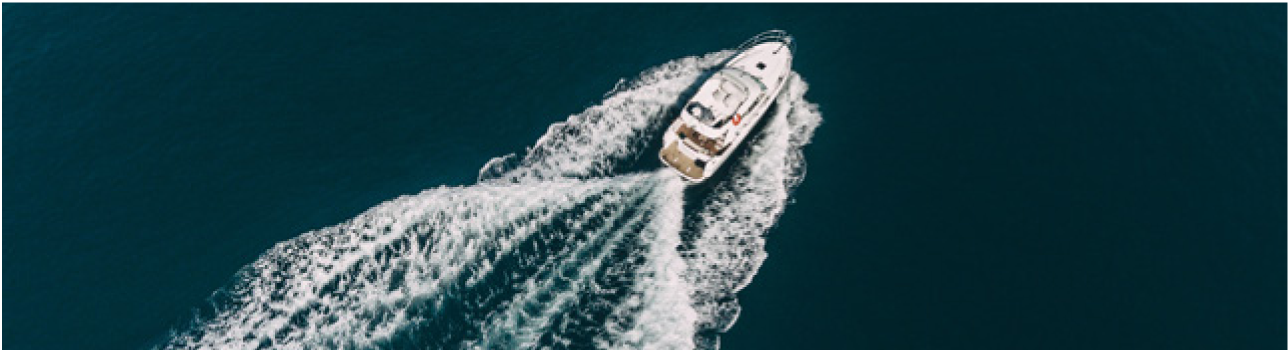
Our aim is to grow our clients' assets in real terms, in a consistent manner over time.

Investment philosophy and the courage to stick to it will be tested. As we face this prospect, it is an opportune time to remind readers of our investment principles here at Anchor.

WHAT IS OUR OBJECTIVE?

Our aim is to grow our clients' assets in real (meaning above inflation) terms, in a consistent manner over time, while limiting trading costs as far as possible. Investing in equities means returns are likely to be bumpy at times but, as we explain below, our focus on quality is likely to smooth out the bumps, particularly in more challenging times.

Although we would expect that our approach to selecting stocks will lead to outperformance of the broader market over the long term, we accept that, if one remains true to an investment philosophy, there will be periods of underperformance. Indeed, as we have seen market indices becoming increasingly influenced by a handful of mega-cap stocks, we think focus on short-term outperformance of such benchmarks carries a great deal more risk than many investors realise. SA investors have become familiar with how individual stocks can have an outsized influence on a market, given the experience with Naspers, which grew to a level where it accounted for >20% of the entire SA market. We are seeing more examples of this internationally – for example, although the Nasdaq has c. 3,200 companies listed, the top-10 account for slightly under 50% of the index.

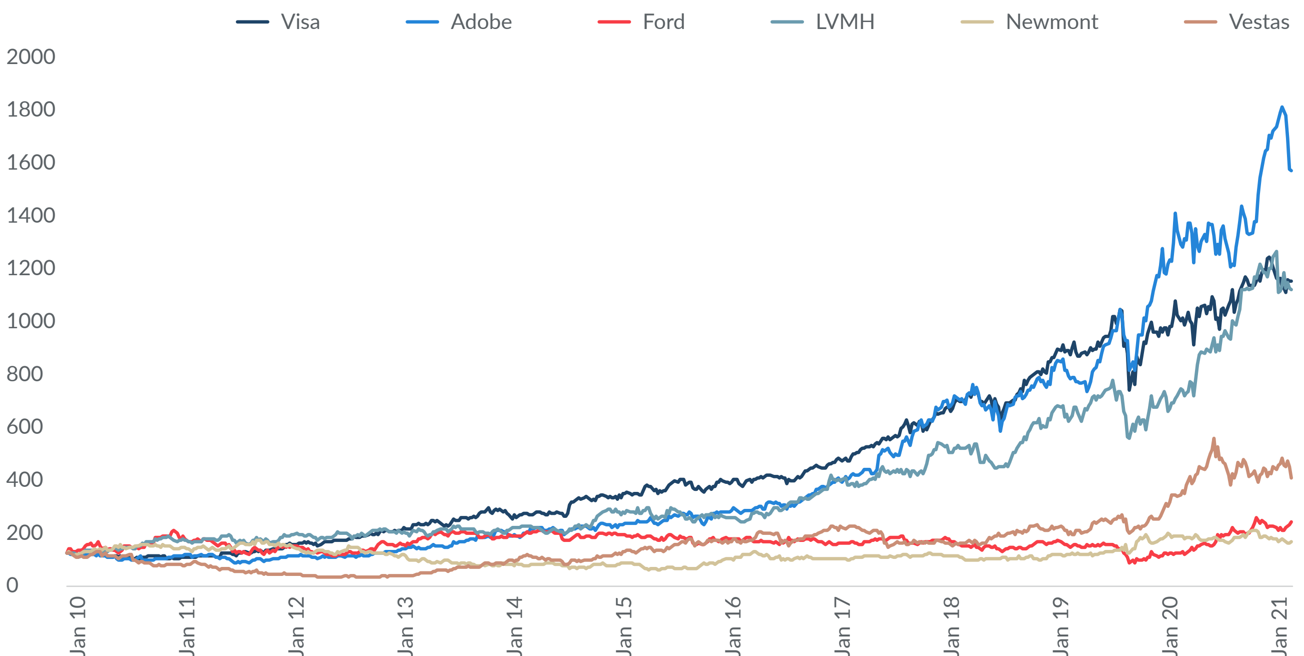


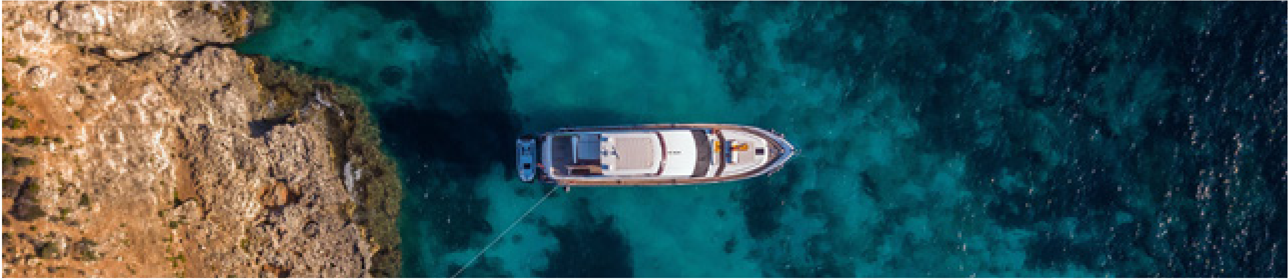
BACKING QUALITY – HIGH ROCE COMPOUNDERS

We seek companies that have a consistent track record of generating a superior return on capital employed (ROCE) – seeking to benefit from the principle once claimed by Albert Einstein as the eighth wonder of the world – compound interest! These are companies that are not only able to generate a high return on the capital they deploy but are also able to reinvest the capital that they generate at a similarly high level of return. They tend to be dominant players in the industry in which they operate. They are businesses that have already won and use the superior returns they generate to entrench themselves further relative to weaker competitors. They have what investors refer to as a strong competitive moat.

In *Figure 2* below, we compare the investment performance of several high ROCE compounders (shades of blue) with that of several low return or cyclical businesses. In the low-return group, we have included Vestas, which is a large player in the manufacture of wind turbines. Although the appeal of the renewable energy theme has caught on among investors in recent months, which has resulted in a significant rise in share prices of many companies associated with this theme, the low returns on capital which Vestas has generated mean that even with the share having benefitted meaningfully from its association with the renewable energy theme, its longer-term investment performance has fallen well short of the high ROCE compounders.

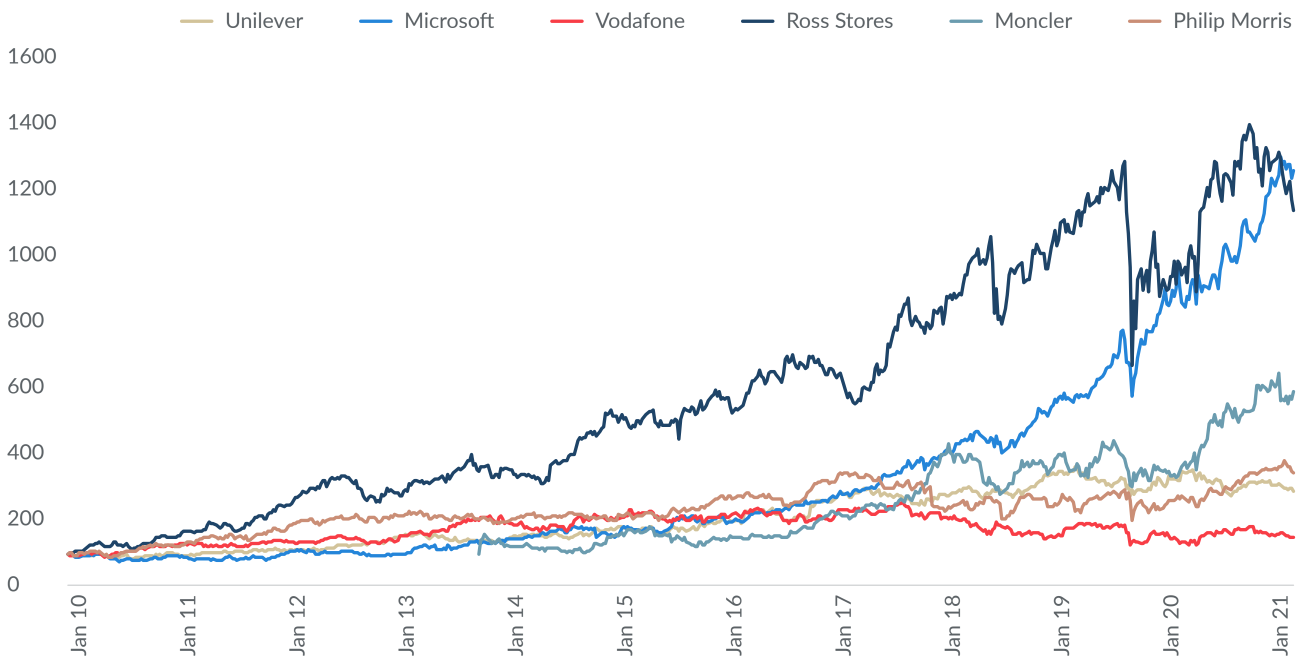
Figure 2: Total return of high ROCE compounders vs low ROCE/cyclical businesses
Source: Bloomberg, Anchor



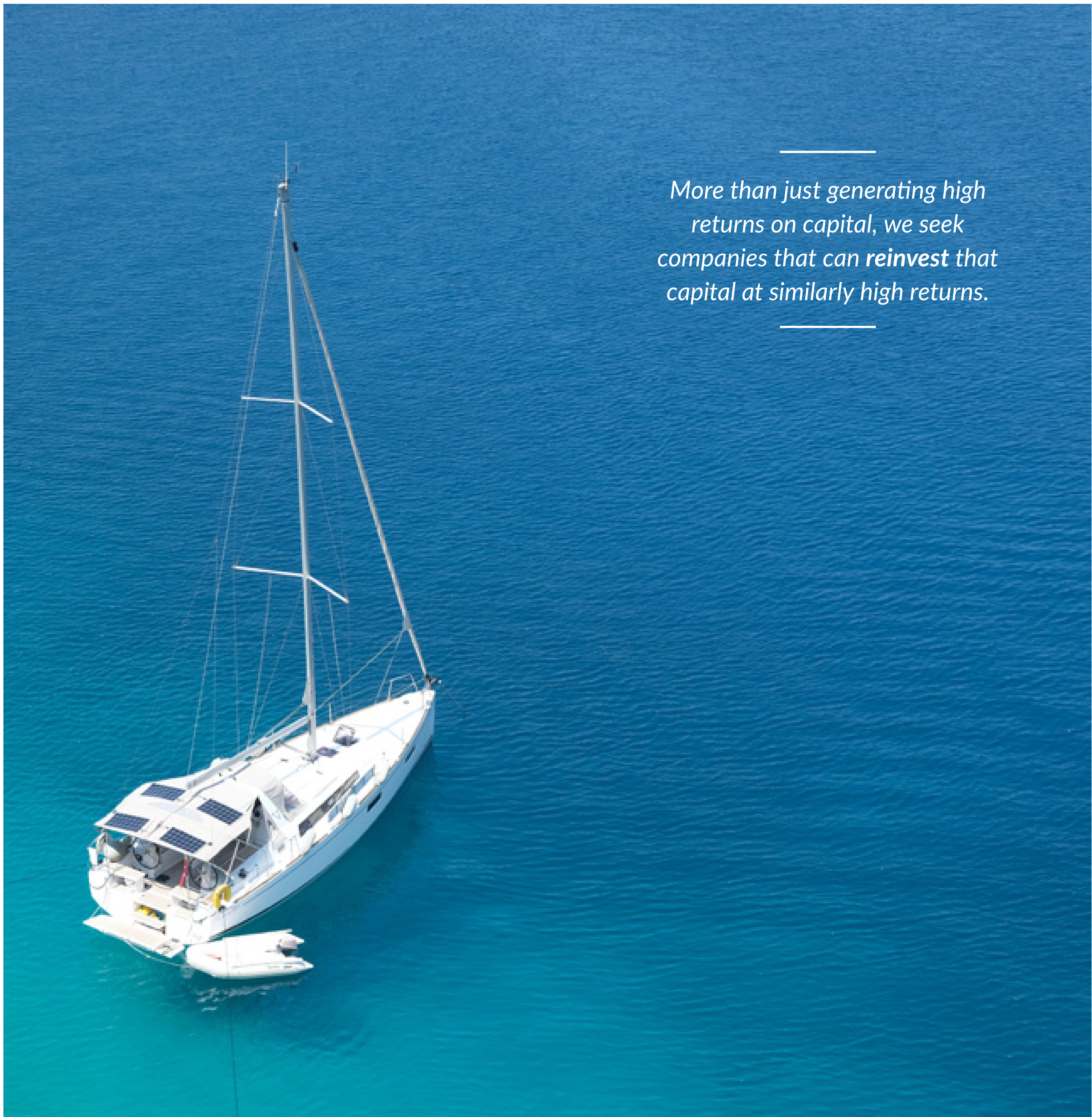


More than just generating high returns on capital, we seek companies that can **reinvest** that capital at similarly high returns. It is this reinvestment that compounds the rate of growth. There are many examples of companies that generate high returns on their capital but are not retaining and reinvesting and are therefore not compounding their growth. In *Figure 3*, we show the investment performance of several other high ROCE compounders (again in shades of blue) compared with examples of businesses that generate high returns on capital but are not reinvesting to the same extent.

Figure 3: Performance of high ROCE compounders vs high ROCE payers
Source: Bloomberg, Anchor



While the appeal of superior compounding of returns is clear in good times, it is also important to consider how such companies behave under difficult market conditions when it is time for defence. Such companies are certainly not immune to market downturns. However, importantly, their high margins provide significant capacity to weather such downturns, ensuring they will survive. In contrast, weak marginal businesses run by management teams that have a poor record of capital allocation face a high risk that they will not survive a downturn at all, leaving their investors without the prospect of recovering their capital value as economic conditions improve. The severe economic contraction brought about by the COVID-related lockdowns, provided several recent examples of the latter – brick-and-mortar retailers (J.C Penny, among others) and offshore oil drilling contractors (Valaris Plc, for example) that had been performing poorly before the downturn, were quickly pushed into Chapter 11 by the pandemic-driven downturn.



STICKING TO OUR LANE

Investing can be a lonely pursuit when, amidst the ebb and flow of themes that are driving the market at any given time, companies that meet one's investment criteria are not in vogue. Quality, high ROCE compounders are typically highly rated from a valuation perspective. During 2021, there has been considerable debate about whether it is time for the so-called "value" theme to have a resurgence after many years of holding the wooden spoon. Furthermore, many fret that higher-rated shares will be particularly vulnerable as interest rates begin to increase – higher interest rates are seen as a potential headwind for the valuations that can be justified for equities. It can be very difficult to resist the temptation to abandon one's investment philosophy when tested by periods of underperformance. We will, however, stick to our guns. A further virtue of quality, high ROCE compounders is that time is their ally – they have the ability to grow their way out of a demanding valuation relatively quickly.

The outlook for SA interest rate hikes in 2022 - a shift to normalisation?

WRITTEN BY:
Casey Delport
Investment Analyst - Fixed Income

Casey holds a MCom in Economics and joined Anchor in 2019. She brings her passion for economics into the fixed income space, particularly with regards to global and Africa country analysis.

After the first wave of the COVID-19 pandemic hit in early 2020, triggering a collapse in global economies and financial markets alike, central banks across the globe responded by rolling-out unparalleled levels of stimulus measures. The SARB was no different, cutting the repo rate by a cumulative 300 bpts in response to the onset of the pandemic. All in all, the extraordinary amount of monetary policy easing in 2020 supported the SA economy in its recovery from the depths of the COVID-19 induced slump. Since lowering the repo rate to record lows in 2020, the SARB maintained these highly accommodative monetary policy settings through most of 2021. However, with inflationary pressures mounting, and global economic activity having recovered faster than initially expected the policy challenge for monetary authorities is shifting from solely supporting the economy to aiding the recovery, whilst also managing inflation risks and keeping inflation expectations anchored. Consequently, the SARB's MPC hiked rates by 25 bpts at its November MPC meeting in what we believe was a pre-emptive move to signal its commitment to anchoring inflation expectations, and to prevent falling behind other key global central banks such as the US Fed (failure to do so would be highly detrimental to the rand). As such, our interpretation is that one hike now probably softens the need for more drastic action later.

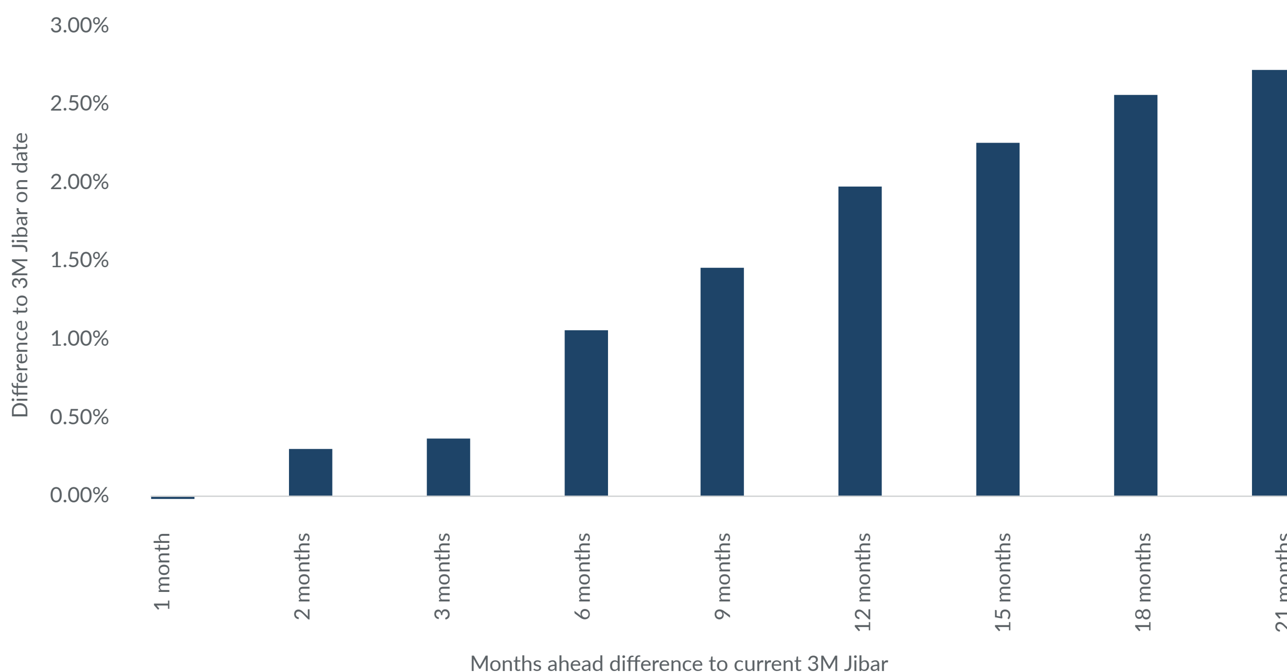
In the November MPC post-announcement Q&A session, SARB Governor Lesetja Kganyago clarified that, given the nature of the upside risks to the inflation outlook, the MPC should not necessarily have to wait for second-round effects to materialise as this might leave it too late. It is, however, a fine line to manage, with no clear consensus on either side.

One hike now probably softens the need for more drastic action later.

This is evident by the fact that the MPC itself had no clear consensus in the November meeting, with three members voting for the rate hike and two members voting to keep the repo rate on hold. Nonetheless, the return to a rate-hiking cycle has now officially begun, with the key question being how fast the pace of normalisation is going to be.

In this respect, there is a considerable difference between analyst consensus and financial market expectations as expressed in the forward rate agreement (FRA) market. *Figure 1* below shows the difference between the current 3-month Johannesburg Interbank Average Rate (JIBAR) and the par rates for relevant future dates (1,3,6 months ahead etc.). At the time of writing, the FRA market was fully discounting further rate hikes worth about 180 bpts over the next 12 months. Given that the SARB will have six meetings between now and the end of 2022, this implies some mix of 25-bpt and 50-bpt hikes. We continue to believe that the SARB will hike carefully and incrementally by 25 bpts each, in the region of 3 to 4 hikes (thus a cumulative level of around 75-100 bpts) for 2022.

Figure 1: FRA strip comparison
Source: Reuters, Anchor



Whilst volatility in FRA market rates is not unusual, we view the current FRA market pricing as being too hawkish especially given that SA's inflation rate is well within the SARB's 3%-6% target range and is expected to remain around the mid-point of that target range over the medium term. Furthermore, SA's current account surplus helps to cushion the risk of a big exchange rate response to external shocks. Generally speaking, the pace of tightening implied by the FRA curve is in contrast to the SARB's stated preference for gradualism in the face of uncertainty. Therefore, whilst we agree that we are now officially entering a hiking cycle, we believe that the pace of normalisation will be gradual as overall economic growth remains muted with significant downside risks ahead and consumer inflation is generally muted outside of the effects of fuel price shocks. The MPC itself appeared to offer some forward guidance in its November statement when it said that "... given the expected trajectory for headline inflation and upside risks, the committee believes a gradual rise in the repo rate will be sufficient to keep inflation expectations well anchored ..." even as it stressed the continued data dependency of its future decisions.

Figure 2: SA inflation YoY
Source: Stats SA, Anchor

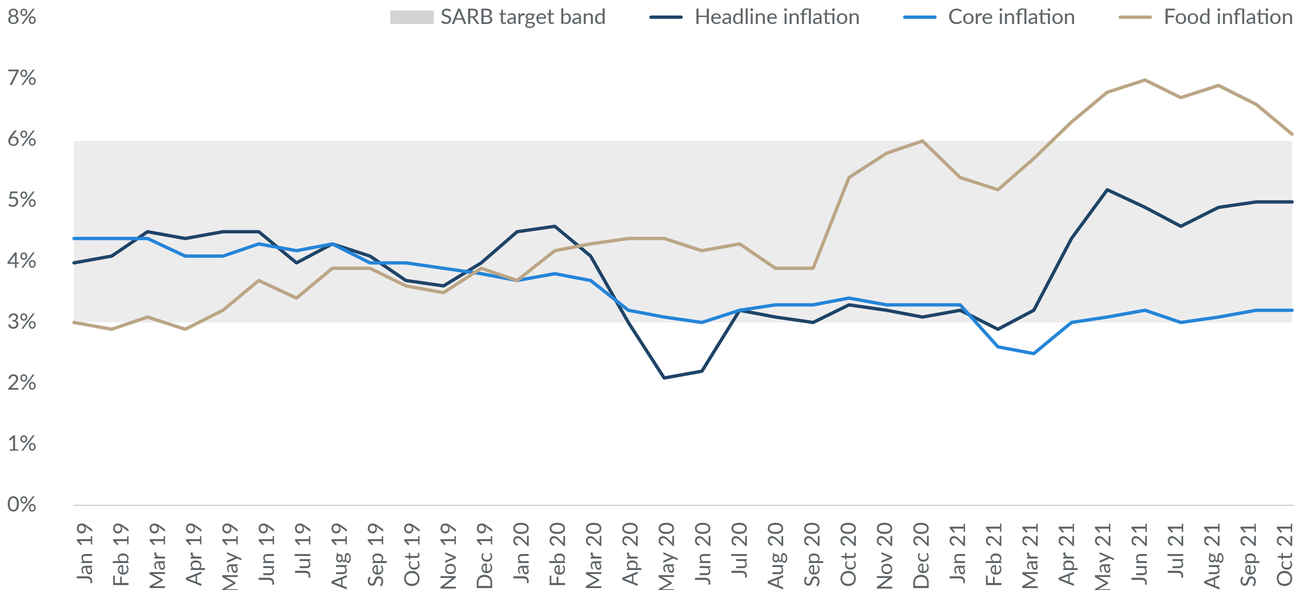
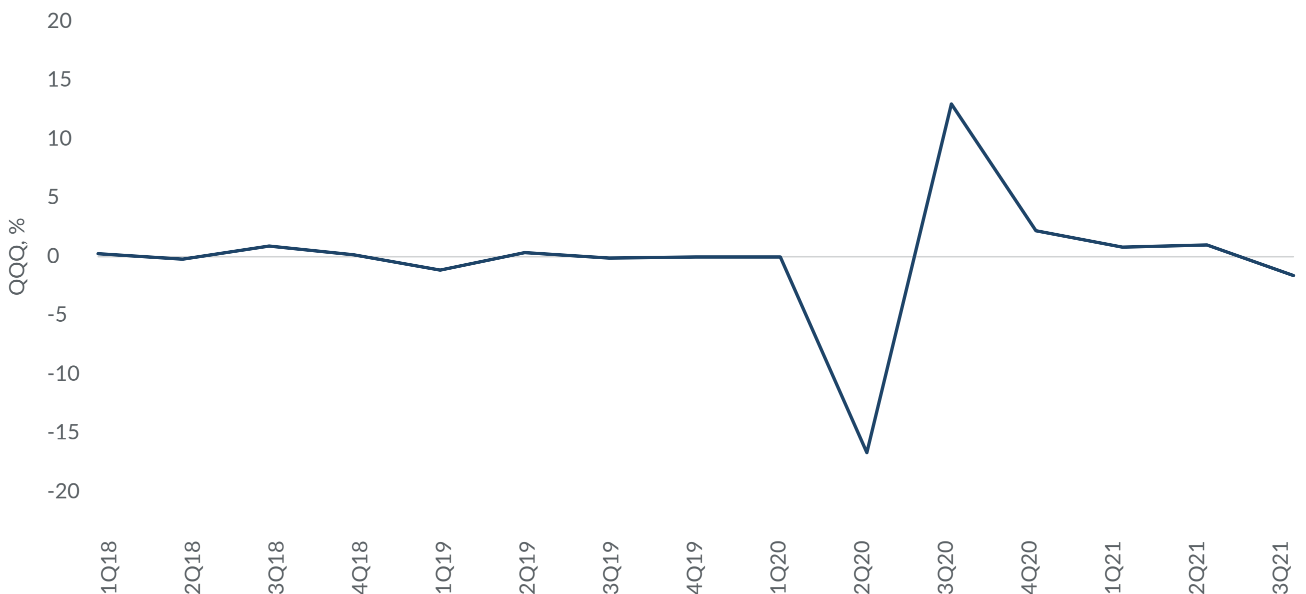


Figure 3: SA GDP growth rate, QoQ
Source: Stats SA, Anchor



Nonetheless, it is difficult to know exactly what the MPC defines as 'gradual' as this can be interpreted in many ways. However, as mentioned previously, we do see further repo rate hikes proceeding at a modest pace at magnitudes of 25 bpts at alternate MPC meetings, particularly given that survey-based inflation expectations remain anchored at the mid-point of the SARB's target range. Still, it is important to note that the MPC is clearly concerned about upside inflation risks. Therefore, a further increase in upside risks to inflation, a further weakening of the rand or a clear manifestation of second-round inflation effects at the CPI level or signs of a de-anchoring of inflation expectations from the mid-point of the target range could accelerate the front-loading of the tightening cycle. Thus, the above-mentioned factors will require careful monitoring.

Interestingly, the SARB's quarterly projection model (QPM) has forecast 10 interest rate hikes of 25 bpts each (including the one delivered at the November meeting) to the end of 2023. This was, however, slightly less hawkish than at the September MPC meeting, when the QPM embedded 11 hikes of the same magnitude. Whilst the QPM remains a critical input into the overall monetary policy process, as stated by the most recent Monetary Policy Review, the QPM "… it is not equivalent to the MPC's role … " – which at the end of the day is to carefully assess the balance of risks in a highly uncertain environment.

Consequently, it is important to further note that the QPM also does not directly factor an employment variable in its calibration. Employment has significantly lagged the overall recovery in economic activity and could form another factor that the MPC will closely monitor in its deliberations (even though employment is not a formal policy objective of the SARB). Thus, this should further support a gradual normalisation path.

Employment has significantly lagged the overall recovery in economic activity

Therefore, we maintain a more dovish approach than most, and we believe that the SARB will hike carefully and incrementally by 25 bpts each, in the region of 3 to 4 hikes (a cumulative level of around 75-100 bpts) for 2022.

2021: The year in tech

WRITTEN BY:
Seleho Tsatsi
Investment Analyst

In 2013, Seleho completed his BCom in Economics and Finance at Wits University, where he received the SASFIN Securities Prize. In 2014, he was awarded the Postgraduate Merit Award upon enrolment for Honours. He joined Cannon Asset Managers in January 2015 and moved to Anchor in November 2015. Seleho covers the basic materials sector locally and co-manages the Anchor BCI Global Technology fund. He is a CFA charterholder.

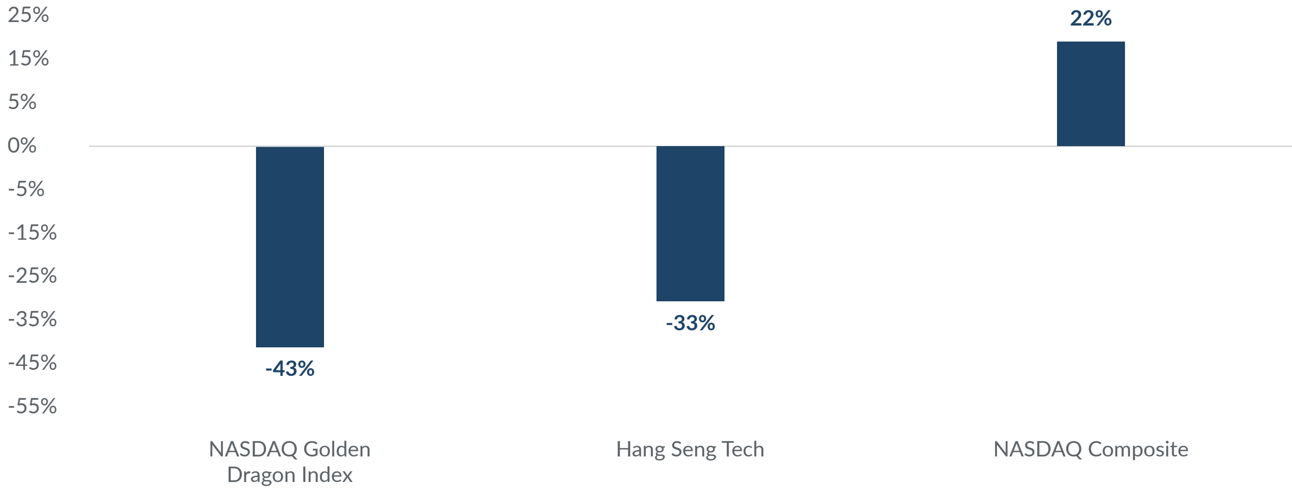
In this article, we review the past year in the technology (tech) sector. We find it instructive to look at 2021 returns in the tech sector by geography, market cap and profitability. The major learnings we get from this are the staggering underperformance of Chinese tech when compared to US tech, the generally solid returns enjoyed across all large-cap US tech stocks and the sizeable underperformance of unprofitable companies when compared to profitable businesses. We also examine those subsectors that struggled last year (such as online retail and media) to determine if their challenges are structural or more transitory.

When examining 2021 returns in the tech sector by geography, the most striking difference can be seen between the world's two largest tech hubs - the US and China. As is now well documented, the past year has been tumultuous for Chinese tech shares as increased government regulation, slowing earnings growth and rising capital expenditure cast a shadow over the sector during 2021.

When examining 2021 returns in the tech sector by geography, the most striking difference can be seen between the world's two largest tech hubs - the US and China

Even with this backdrop in mind, the extent of the Chinese tech stocks' underperformance, when compared to the US, is astounding. Chinese tech underperformed the NASDAQ Composite Index by 50% when using the Hang Seng Tech Index as a proxy for Chinese tech and by 60% when using the NASDAQ Golden Dragon China Index. The BAT stocks (Baidu, Alibaba and Tencent) were down by 31%, 49% and 19% respectively last year. In contrast, FAANGM (Facebook, Apple, Amazon, Netflix, Google [Alphabet] and Microsoft) were up 21%, 36%, 6%, 13%, 69% and 55% YoY, respectively.

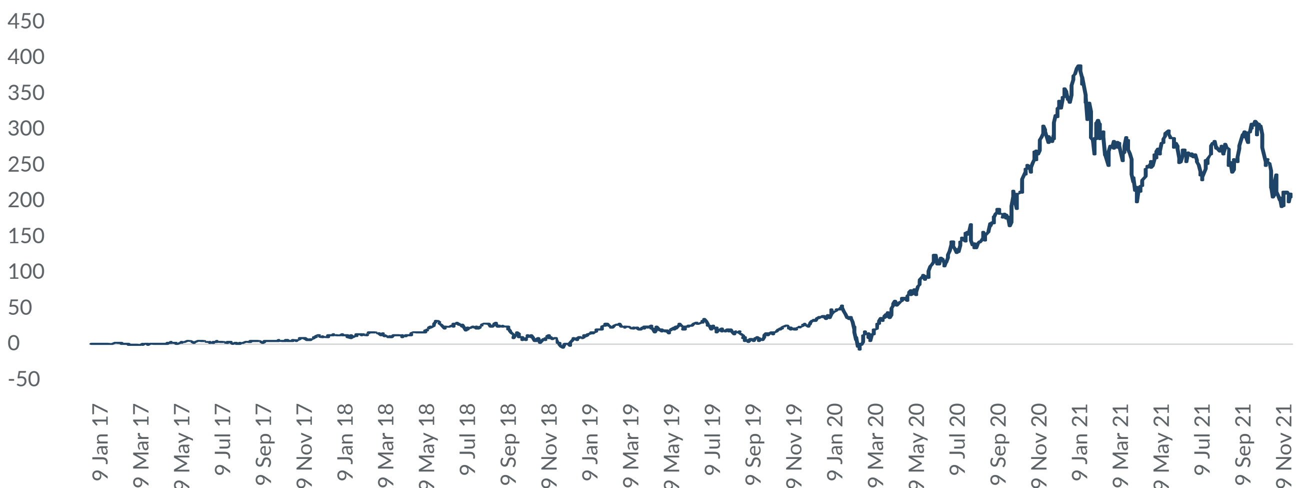
Figure 1: Total returns of US vs China tech
Source: Bloomberg, Anchor



A key question as we start 2022 is where the relative opportunity lies between these two geographies. The increased uncertainty brought about by Chinese government regulations and perhaps a higher cost of capital must be balanced against valuations that were slashed in 2021. Similarly, while US large-cap tech stocks continue to grow earnings at decent rates with seemingly impenetrable moats, these advantages must be weighed against valuation multiples that now comfortably exceed those of their Chinese counterparts.

The second point we find instructive to outline is the generally solid performance of large-cap US tech shares in 2021. Given their high weight in indices, these shares were once again a major driver of US equity indices in 2021. The five largest shares in the S&P 500, for example, accounted for 31% of the S&P 500's total return in 2021 (8.8 ppts of the index's 28.7% return). All five of these shares (Alphabet, Apple, Microsoft, Nvidia and Tesla) are tech related. As noted above, the FAANGM shares enjoyed a generally strong year, albeit with admittedly large variance in returns within the group. Nevertheless, it is noteworthy that all these shares had positive returns in 2021. This contrasts with many smaller tech shares that ended the year with total returns that were negative and, in some cases, severely so.

Figure 2: Goldman Sachs Non-Profitable Technology Index
Source: Bloomberg, Anchor



The final comparison worth making is between the performance of profitable and unprofitable companies in 2021. We look at the Goldman Sachs Non-Profitable Technology Index (see *Figure 2*) as a proxy for loss-making tech companies. It is important to note that companies can be loss-making according to standard GAAP accounting rules but nonetheless still be creating economic value. Nevertheless, this index serves as a useful, although imperfect, proxy for the more speculative part of the sector. After quadrupling in 2020, this index of unprofitable tech companies has declined by 48% from its highs in 2021. All in all, the index declined 19% in 2021. The larger, more profitable businesses in the sector have meaningfully outperformed in 2021.

In many ways, 2021 was the opposite of 2020. Subsectors that thrived in 2020, such as payments, e-commerce, and video gaming, generally struggled in 2021. The emergence of COVID-19 in 2020, in hindsight, turned out to be the perfect environment for many of these businesses. With individuals forced to stay at home under lockdown restrictions, online shopping and video gaming were natural activities in which to engage in this new environment. As lockdown restrictions have gradually been lifted around the world, we have seen several of these beneficiary sectors slow down.

Online retail has steadily increased as a share of total retail sales over the past two decades. As the pandemic hit, US online retail sales penetration jumped strongly from 11.4% in 1Q20 to 15.7% in 2Q20. At the time, the prevailing view in the market was that the pandemic had accelerated e-commerce adoption by an order of magnitude and in a permanent manner. Instead, US online retail sales penetration has consistently declined since 2Q20, reaching 13.0% in 3Q21. It now seems more likely that we are headed back towards the long-term trend of roughly a 1%-2% p.a. rise in online sales penetration. This has also been evident in the performance of the e-commerce sector in equity markets.

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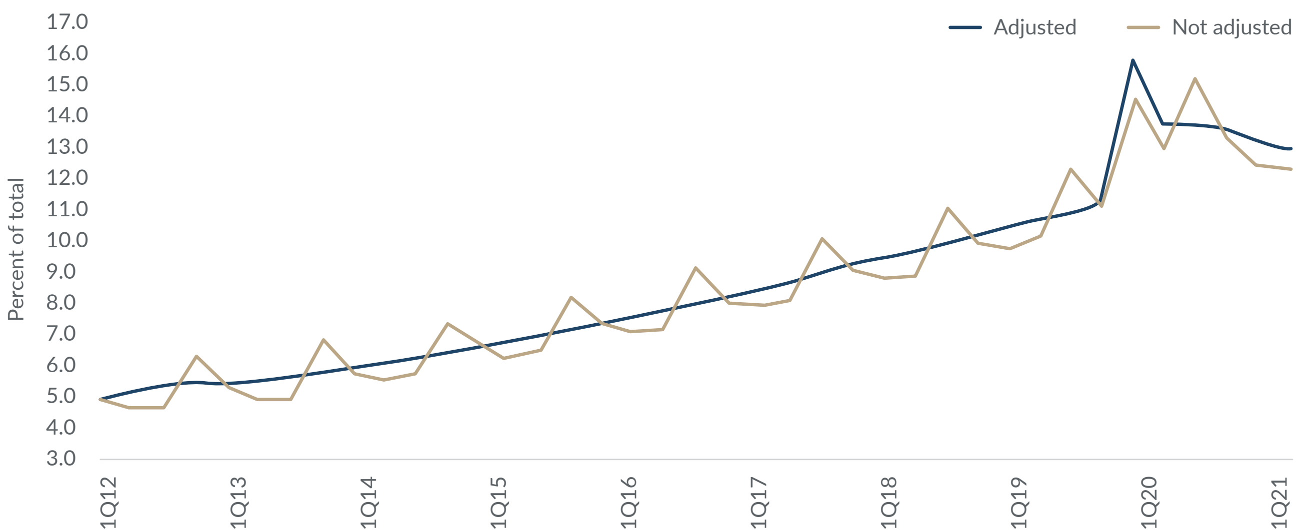
These businesses generally underwhelmed investors in 2021, particularly in the second half of the calendar year where YoY comparisons became difficult. We believe online retail sales will continue to grow as a proportion of total retail sales over time. In certain instances, therefore, the pullback in share prices represent opportunities for investors and the attractive characteristics of the e-commerce sector make it worth studying for investors. It is a sector that generally favours scale ("survival of the fattest", requires minimal capital [and therefore high returns on capital]) and allows for strong earnings growth over long periods of time.

Figure 3: Estimated quarterly US retail e-commerce sales as a percentage of total quarterly retail sales, 1Q12 to 3Q21
Source: US Department of Commerce



When COVID-19 hit, over-the-top (OTT) streaming was another beneficiary of the pandemic. People stayed home. Those who had not yet subscribed to streaming services had the time and the motivation to try it out. As 2021 started to unfold it became clear that YoY comparisons were going to be difficult for the sector. We saw a sharp slowdown, for example, in Netflix's subscriber growth in 2021. Initially the share came under pressure but the company has guided to subscriber growth picking up in the final quarter of the year. Similarly, The Walt Disney Co.'s subscriber additions for its streaming service, Disney+, disappointed investors in the third calendar quarter of 2021. Clearly, YoY comparisons were difficult for OTT streaming in 2021. Similar to online retail, however, we do not believe that this represents a structural change in the growth profile of the sector. Several statistics illustrate this. For example, pay TV is still in c. 60% of US households and OTT streaming continues to represent less than a quarter of the addressable market of global pay TV households. It therefore seems likely that the growth opportunity for OTT streaming remains despite the short-term challenges brought by 2021.

In this article, we examined the returns in the tech sector in 2021. We found three major trends. First, Chinese tech substantially underperformed US tech. Second, large-cap tech counters enjoyed generally solid returns as a group. Finally, unprofitable tech companies really underperformed their larger, more established counterparts. We also looked at some of the subsectors that came under pressure in 2021. We found that in several cases such as online retail and video streaming, although YoY comparisons were challenging due to a high 2020 base, we expect these sectors to continue to enjoy structural growth over the long term.

Death taxes and offshore investing

WRITTEN BY:
Matthew Stroucken
Portfolio Management

Having joined Anchor in 2012, Matthew has been with the company since its inception. His key focus is portfolio management and marketing. As a senior portfolio manager, Matthew manages money for high-net-worth individuals both locally and globally. He runs share portfolios, unit trusts, and hedge funds for private clients. Matthew also takes responsibility for marketing within the Anchor Group and has a BCom (LLB) from Rhodes University.

Your portfolio is offshore and invested in global shares (dominated by US-listed stocks), there are a few funds in the portfolio and a small cash allocation. After your death, your heirs inherit 60% of what the portfolio was valued at on your death – they have lost a huge amount of your wealth.

We acknowledge that this is a greatly simplified example, but the essence and effect are accurate. Situs taxes, paid on your UK- and US-domiciled assets (including cash, shares, physical property, and shareholdings in non-listed companies), are responsible for the loss of wealth. While paying tax is an inevitability, one is not required to pay more than necessary and is entitled to structure one's affairs to pay the lowest amount of tax. In the example above, an appropriate investment structure would have dramatically reduced the tax bill and left the heirs with a value far closer to what the original investor saw before their death.

As a SA-based investment manager, we are seeing more and more of our clients externalising their money and investing in global assets. While we are hugely supportive of the idea of "living in the sun and investing in the shade", we are profoundly aware of the risks associated with buying these types of assets. There are many risks and issues that one needs to address when investing outside of SA. For this article however, we are going to focus on the inheritance and estate taxes levied on so-called "situs assets".

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'Situs' is Latin for 'position' or 'site'. In the context of investing, the word is used to refer to taxes levied against assets deemed to be domiciled in regions such as the UK and the US. Situs taxes are inheritance and estate taxes (hence the reference to "death taxes") charged by the country in which the assets are deemed to be situated. The SA equivalent tax is estate duty.

"Situs assets" are thus the assets on which "situs taxes" are charged*. While listed equities are an obvious inclusion in the group of assets referred to as 'situs assets', investors should keep in mind that assets from cash to listed property are also included, as are shareholdings in unlisted companies.

Local investors that have invested in these assets in countries such as the UK and the US need to be aware of the implication of these taxes on their wealth and should take steps to ensure that they structure their financial life in such a way as to reduce the amount of tax paid on death. For example, a SA investor with investments in listed US equities would pay up to 40% in situs taxes on death. This is double the SA estate duty rate of 20%. Further, US assets do not receive a spousal exemption (as would apply in SA) and so those assets would be taxed on the death of the first spouse and again on the death of the second – an effective double taxation of up to 40%.

The introduction of Common Reporting Standards (CRS) has dramatically increased the ability of tax authorities around the world to collaborate and share information. Under this regime, it is even more important to ensure one's affairs are appropriately structured.

Offshore trusts are a popular, if at times expensive, means of ensuring one's wealth is not punitively taxed. With recent changes to looping structure regulations, SA investors can now enjoy the situs tax protection offered by an offshore trust and can have their local, SA assets held in the same structure. The way assets, or the ownership of assets, are moved into an offshore trust is complex but there are ways in which SA investors can externalise the ownership of their local assets without triggering unnecessarily severe tax consequences.

A more accessible, easier to set up and often cheaper means of reducing one's exposure to situs taxes is to house investments in a life wrapper. Investors can appoint beneficiaries of the investments who inherit the investment on death. The investments thus pass directly to the heirs and are not caught up in the winding up of the investor's estate. There are also several tax benefits to the structure during the life of the investor.

Appropriate structures, such as offshore trusts and life wrappers, ensure that taxes owing on death are paid at the lowest possible rate. With each structure and each jurisdiction having its nuances, engaging with an appropriately informed advisor is essential.

Adding to the complexity of jurisdictions and structures is the fact that each investor's financial life is unique. It is essential that your advisor takes the time to intimately understand your unique situation. A one-size-fits-all, blanket solution is extremely unlikely to be appropriate. Anchor has a highly skilled and experienced team that can assist our clients with structures, both local and offshore. Appropriate structures not only protect against punitive death taxes and the efficient transfer of assets to heirs but can also offer tax and estate planning benefits during one's life. Speak to your Anchor advisor or contact us at **invest@anchorcapital.co.za** for more information.

**UK assets over the value of GBP 325,000.00 are subject to inheritance tax of up to 40%. US assets over the value of US$60,000.00 are subject to estate tax of up to 40%.*

Do less to make more

WRITTEN BY:
Tamzin Nel, CFA
Portfolio Management

Tamzin completed a BCom (Investment Management) at the University of Pretoria and is a CFA charterholder. She has also completed a Social Entrepreneurship programme through the University of Oxford as well as a Masters in Coaching. Tamzin has worked in financial markets since 2011, working with private clients as well as managing mining rehabilitation funds. With a keen interest in behavioural finance, social entrepreneurship, impact investing and financial literacy, she loves understanding and working with people to help them achieve their financial goals.

"There is no such thing as a once-in-a-lifetime opportunity. A hurried mind is an addled mind; it cannot see clearly or hear precisely; it sees what it wants to see, or hears what it is afraid to hear, and misses much. A knight makes time his ally. There is a moment for action, and with a clear mind that moment is obvious." – Ethan Hawke, Rules for a Knight.

This advice is timeless and was first penned by Sir Thomas Lemuel Hawke of Cornwall in 1483 during his last days before he died in battle. He wished to pass along to his four children a compass for their life's journey and wrote them a letter which was later adapted and reconstructed by Ethan Hawke of Dead Poets Society fame and a four-time Academy Award nominee (twice for writing and twice for acting). The resultant fable is a series of ruminations on solitude, humility, forgiveness, honesty, courage, grace, pride, and patience. He draws on the ancient teachings of Eastern and Western philosophy, and on the great spiritual and political writings of our time. It is a profoundly simple read.

Warren Buffet, who needs no introduction, has said that "investing is simple but not easy", however, putting into practice the simplicity of plain math and plain language is another story. For many, this is because of the psychological pitfall of not **having the capacity to accept or tolerate delay, problems, or suffering, without becoming annoyed or anxious. This is the definition of patience.**

Regular readers of Anchor's *The Navigator* will know that one of my passions is the field of behavioural finance. Financial behaviour tends to be more emotional than rational and our financial behaviour, as with the rest of our actions, is a deep-rooted expression of our internal psychology. As human beings, there are numerous behavioural biases that impede our ability to reason if we do not understand these inclinations and make a conscious effort to work around them.

If you google “patience in investing”, more than 13,200 results come up and the mathematical and real-world examples of the power of compounding are easily searchable. In *The Navigator – Anchor's Strategy and Asset Allocation 2Q19*, Matthew Stroucken wrote an article entitled *The most difficult thing in investing- the power of compounding*, which succinctly summarises the power of compounding and notes that the most difficult thing in investing, is staying invested due to our behavioural biases. In this note, I would like to provide some practical insight and practices for understanding our inclinations to be impatient and how we can make a conscious effort to work around them as investing is not about timing the markets, but time in the markets.

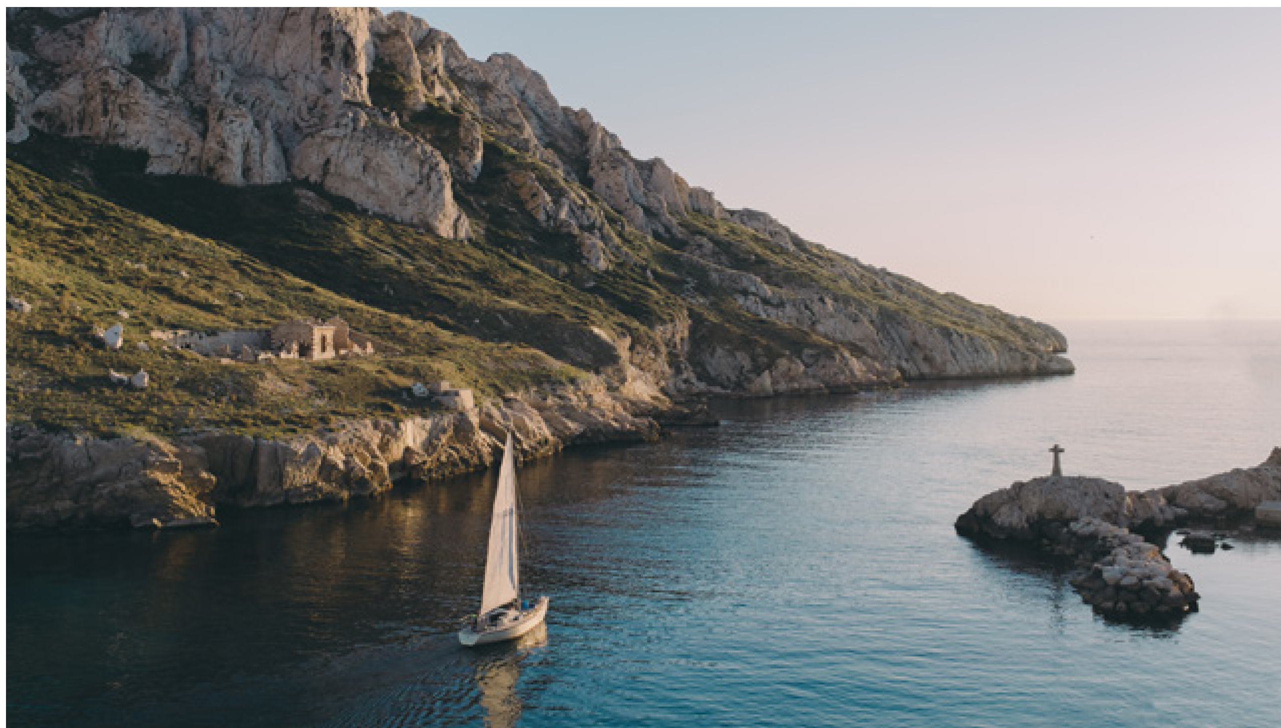
Figure 1: Investment process – a roller coaster of emotion
Source: Credit Suisse, toptal.com

Increasingly so, people want instant gratification and one of the most underused investing skills has nothing to do with the ability to value equities or bonds, analysing financial statements or economies but rather in the diligent process of practising patience. Jason Zweig, author of the book *Your Money and Your Brain: How the New Science of Neuroeconomics Can Help Make You Rich* has the view that the three qualities an investor needs above all others are independence, scepticism and emotional self-control.

Emotional self-control is the ability to manage disruptive emotions and impulses and to maintain effectiveness under stressful or even hostile conditions.

So, how do we develop the capacity to accept or tolerate delay, problems or suffering without becoming annoyed or anxious? How do we gain self-control over our emotions? How do we stay calm in situations where we lack control? How do we practise patience?

In this case, practise really does make perfect.



Before you berate yourself for not being patient across all areas of your life, I would like to remind you that you can blame your brain here. Human beings were designed to react to threats, either real or perceived. Stressful situations trigger a physiological response in people – a "fight-or-flight" mode. The body cannot differentiate between psychological triggers, such as turbulent equity markets, and actual physical danger. Unfortunately for impatient investors, when emotions take over, the result is often poor decision-making that could decrease the risk of meeting future financial objectives. Practising patience means learning to overcome these natural instincts. Sacrificing in the short term for the longer-term benefit. As with all emotions, we do not want to suppress them but rather learn how to control these emotions.

Echoing the opening quotation, cognitive science tells us that the more upset you are, the less you can focus satisfactorily on what is important, take it in deeply, or respond nimbly. Being "hijacked" by your emotions, sabotages your ability to make good decisions or to react skillfully. Market volatility is an easy trigger to overwhelm and, because our bodies and our brains cannot differentiate between real or perceived threats, they perceive a threat to our financial well-being (which is not a physical threat) and this triggers the fight-or-flight response. Your emotions take control, and your brain is shouting: "Do something!".

Sometimes, the best action to take is taking no action. Do something by doing nothing.

Another psychological phenomenon that comes into play here is negativity bias: There is this seemingly neverending stream of negative news and we are hard-wired on an evolutionary level to focus more on the bad news than (admittedly, the harder-to-find) good news.

Both Benjamin Graham, who also needs no introduction, and Warren Buffet consider patience – or lack thereof – as a defining trait of success in investing.

Patience + investing = a natural partnership.

The most benefit lies in investing for the long term and it is no coincidence that the benefits of patience too, are long term. You must be able to endure some short-term hardship for that future reward. Impatient investors let anxiety and emotion rule their decision-making. Their tendency towards "doing something" can lead to detrimental investing behaviour: checking account balances too often, focusing on short-term volatility, selling or buying at the wrong time or abandoning a long-term strategic investment plan. Often these behaviours damage investors' long-term returns.

In addition to taking no action, what are some of the other practical tools we can practise to cultivate patience (and returns) for the long term?

FAIL TO PLAN AND PLAN TO FAIL

One of our primary roles as your wealth managers at Anchor is to help you plan. We are here to map out your long-term investment journey and then to navigate stormy seas with you.

THE ONLY CONSTANT IS CHANGE

I have been working in the investment industry for twelve years and I cannot think of a single year in which we have not experienced volatility. I am surrounded by far more experienced professionals, and I am confident they will attest to the same, as they often do. Volatile markets are normal. Accept them as a given as this will help you to mentally prepare and equip you to take control of your emotional thoughts and reactions.

TIME IN THE MARKETS IS MORE IMPORTANT THAN TIMING THE MARKETS

Often you will benefit by being invested in the market more than by trying to find the perfect time to invest. Being invested is the only way you benefit from the wonder that is the power of compounding.

DETERMINE THE DIFFERENCE BETWEEN FEAR AND FUNDAMENTALS

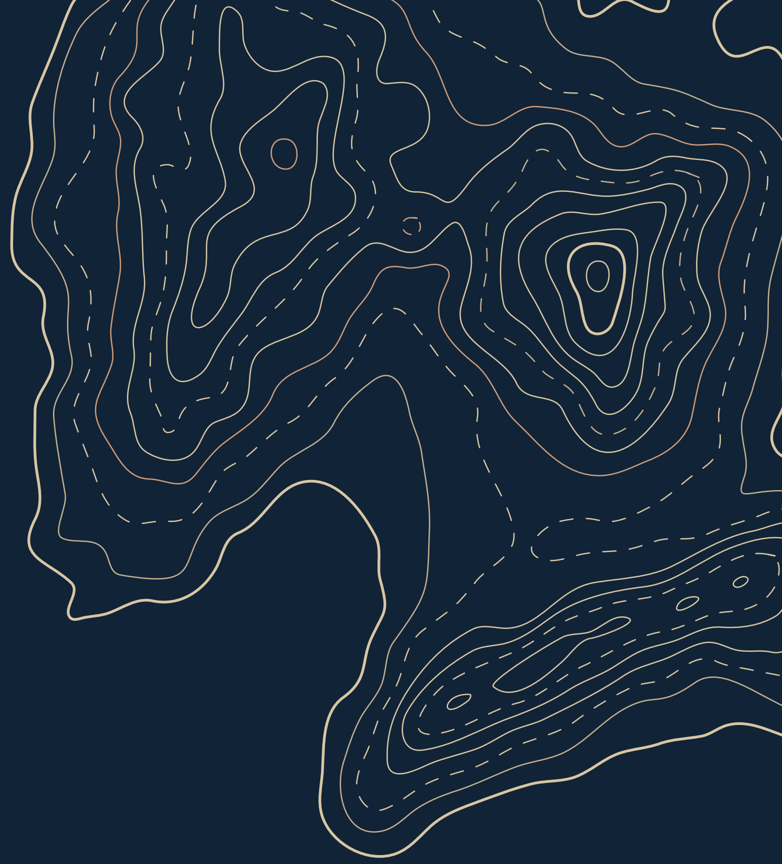
Not to be viewed as a contradiction to everything I have said, sometimes you have to do something. Is the volatility due to fear or fundamentals? If the former, do nothing. If the latter, yes, it would be best to restructure if the long-term fundamentals of a share, economy or your personal financial situation have changed. We have a team of highly skilled, both from a technical and practical perspective, analysts who will do this analysis work for you and you are always more than welcome to contact your manager at Anchor to talk through your long-term strategic investment strategy. Sometimes, tactical changes may be necessary. As Ethan said, there is a moment for action and, with a clear mind, that moment is obvious. Although, I would reiterate here that sometimes doing nothing is the active choice.

"In the end, how your investments behave is much less important than how you behave." — Benjamin Graham

Personally, I find this comforting. I can control my behaviours but not those of others.

Performance Summary

	FUND PERFORMANCE									BENCHMARK PERFORMANCE							
	Start date	Annualised p.a. (%)	Since inception (%)	5 Year (%)	3 Year (%)	12-month (%)	6-month (%)	3-month (%)	Dec-21 (%)	Since inception (%)	5 Year (%)	3 Year (%)	12-month (%)	6-month (%)	3-month (%)	Dec-21 (%)	Performance vs Benchmark (%)
UNIT TRUSTS																	
Anchor BCI Equity Fund	Apr-13	10.5	139.0	5.7	9.6	23.7	9.1	7.8	2.8	109.8	7.2	10.9	27.1	12.1	8.7	4.9	29.2
Anchor BCI SA Equity	Aug-21	N/A	N/A	N/A	N/A	N/A	N/A	9.9	4.8	N/A	N/A	N/A	N/A	N/A	8.7	4.9	N/A
Anchor BCI Flexible Income Fund	Jun-15	7.3	58.7	7.1	6.9	5.5	3.0	1.5	1.2	54.3	6.6	5.8	4.5	2.2	1.1	0.4	4.4
Anchor BCI Managed Fund	Jan-15	6.1	50.9	7.1	11.1	18.6	9.3	6.2	2.8	57.5	8.0	11.5	20.3	10.0	7.3	3.2	-6.6
Anchor BCI Worldwide Flexible Fund	May-13	11.2	150.2	9.0	14.4	10.1	6.6	4.3	0.0	107.3	8.4	8.1	9.5	4.7	1.9	0.8	42.9
Anchor BCI Property Fund	Nov-15	-2.5	-14.2	-2.3	-2.5	33.4	15.5	8.2	7.7	-17.6	-4.4	-2.9	36.9	14.8	8.3	7.9	3.3
Anchor BCI Global Equity Feeder	Nov-15	17.5	170.6	22.6	35.9	3.4	-2.3	2.5	-4.5	137.2	17.8	24.6	28.7	17.5	12.5	3.8	33.4
Anchor BCI Bond Fund	Feb-16	9.5	71.1	9.1	9.0	7.9	3.0	2.7	2.9	70.2	9.1	9.1	8.4	3.2	2.9	2.7	0.9
Anchor BCI Diversified Stable Fund	Feb-16	7.6	54.1	7.8	9.1	14.3	7.6	4.9	2.4	48.6	7.3	9.0	13.5	7.1	5.0	2.4	5.5
Anchor BCI Diversified Moderate Fund	Feb-16	7.1	50.5	7.7	9.9	18.2	9.6	6.2	3.0	50.2	7.8	10.6	17.3	8.9	6.7	2.9	0.3
Anchor BCI Diversified Growth Fund	Feb-16	6.7	46.7	7.7	10.4	21.8	11.2	7.5	3.6	52.4	8.0	11.5	20.3	10.0	7.3	3.2	-5.7
Anchor BCI Africa Flexible Income	Mar-16	7.0	48.3	7.5	8.9	2.9	2.9	0.3	2.2	60.4	8.3	7.5	5.8	2.9	1.5	0.5	-12.0
Anchor BCI Global Technology Fund	Jun-19	24.3	74.9	N/A	N/A	6.7	0.5	2.1	-3.6	144.1	N/A	N/A	38.4	26.5	19.4	2.6	-69.2
Anchor BCI Flexible Fund	Jul-13	12.2	165.3	18.1	25.3	22.5	10.2	5.5	-1.9	9.9	9.4	9.1	10.5	5.2	2.2	0.9	155.4
Anchor BCI Core Income Fund	Sep-20	5.2	7.0	N/A	N/A	4.9	0.0	1.2	0.4	5.2	N/A	N/A	3.8	1.9	1.0	0.3	1.9
Anchor BCI Global Flexible Income Fund	Sep-20	-0.4	-0.5	N/A	N/A	8.7	11.6	5.2	-0.2	-4.1	N/A	N/A	8.8	11.9	6.1	-0.4	3.6
Anchor BCI Worldwide Opportunities Fund	Feb-21	6.7	5.9	N/A	N/A	N/A	2.6	5.0	0.7	5.3	N/A	N/A	N/A	2.7	1.0	0.5	0.6
EQUITY NOTES & SEGREGATED MANDATES																	
Anchor Equity	Jul-13	9.1	110.2	5.3	10.4	29.6	12.3	7.9	5.1	108.3	7.2	10.9	27.1	12.1	8.7	4.9	1.9
HEDGE FUNDS																	
Anchor Accelerator	Feb-16	10.6	80.9	14.6	17.9	3.9	-2.9	1.1	0.1	51.0	7.2	10.9	27.1	12.1	8.7	4.9	29.9
OFFSHORE																	
High Street Equity - Dollars	Jun-12	13.1	223.3	14.8	20.1	9.5	-1.1	2.1	2.3	228.4	15.6	22.3	22.3	8.0	7.9	4.3	-5.1
High Street Equity - Rands	Jun-12	21.4	530.8	18.5	24.5	19.1	10.5	8.2	1.9	539.0	19.1	26.6	32.9	20.1	13.7	4.1	-8.3
Offshore Balanced - Dollars	Jun-12	10.2	152.3	10.7	13.4	8.1	0.1	2.1	1.7	115.0	10.5	14.5	10.6	4.0	4.4	2.5	37.2
Offshore Balanced - Rands	Jun-12	18.2	391.3	14.1	17.3	17.6	11.8	8.2	1.4	318.8	13.8	18.5	20.1	15.9	10.2	2.5	72.5
Global Dividend - Dollars	Jan-14	9.4	103.9	11.4	14.2	20.2	8.2	7.8	5.6	144.2	15.6	22.3	22.3	8.0	7.9	4.3	-40.3
Global Dividend - Rands	Jan-14	14.5	191.5	14.8	18.1	30.3	20.4	13.9	5.2	249.7	19.1	26.6	32.9	20.1	13.7	4.1	-58.2
Anchor Global Stable Fund - Dollars	May-15	2.7	18.9	4.6	7.2	4.8	1.2	1.0	1.3	19.3	2.7	2.7	2.8	1.6	0.9	0.3	-0.4
Anchor Global Stable Fund - Rands	May-15	7.0	55.9	7.7	11.0	13.8	12.6	6.5	1.0	44.3	4.1	3.5	2.8	4.5	6.7	4.0	11.6
Anchor Global Equity - Dollars	May-15	16.6	175.0	22.4	36.1	-1.9	-11.6	-4.0	-3.3	95.0	14.4	20.4	18.5	5.6	6.7	4.0	80.0
Anchor Global Equity - Rands	May-15	21.4	260.5	26.0	40.8	6.6	-1.6	1.2	-3.5	155.6	17.8	24.6	28.7	17.5	12.5	3.8	104.9
RCI UNIT TRUSTS																	
RCI BCI Flexible Growth Fund	Sep-16	13.8	97.5	N/A	25.2	4.7	1.1	3.0	-4.3	60.7	N/A	9.1	10.5	5.2	2.2	0.9	36.9
RCI BCI Worldwide Flexible Fund	Dec-16	12.5	81.8	N/A	19.4	16.3	5.2	3.8	-1.2	50.6	N/A	8.1	9.5	4.7	1.9	0.8	31.2



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