The Navigator

STRATEGY AND ASSET ALLOCATION REPORT

1st Quarter 2024

ANCHOR | NAVIGATING CHANGE

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Introduction

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2024 has been dubbed the year of elections, with almost half of the globe's population heading to the polls to elect their leaders. The polarising nature of former US President Donald Trump makes the US presidential election more fractious and more economically significant than usual. The US election is impossible to call, with independent election polling saying that the outcome is still a 50/50 split between Trump and US President Joe Biden. Domestically, the ANC is likely to slip below 50%. However, the party is expected to remain in power. The nature of possible coalitions has South Africa (SA) on edge, and the trepidation heading into this year's SA general election will likely have a greater impact on markets than the eventual outcome.

Last year ended on a risk asset boon as the US Federal Reserve (Fed) pivoted toward discussing the timing of interest rate cuts. This means that we start 2024 with financial asset prices reflecting an optimistic outlook. We think all risk assets stand to gain over the year, but high starting prices warrant caution. Overall, we prefer domestic listed property, which should benefit most from interest rate cuts, while we believe that US equities should grind higher on the global stage.

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

We believe that investors should have a long-term plan for what they seek to achieve.

Overall, this is a good time to upweight your investments. Anchor strives to help you achieve the best outcomes within your risk tolerances and 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	○	●	○	10
Bonds	○	●	○	10
Listed property	○	>	●	12
Cash	○	●	○	8
Alternatives*	○	○	●	10 to 15
Rand vs US dollar (rand weaker)				-3
GLOBAL				
Equity	○	>	●	7
Government bonds	○	●	<	5
Corporate credit	○	●	<	4
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 (4Q23) was dominated by the US Fed pivoting its narrative from rate hikes and fighting inflation toward considering when the first interest rate cuts will be appropriate. This shift provided a significant boost for risk assets languishing under the rate-hiking regime of the past two years. Our return expectations for the various asset classes have shifted as we have much higher starting prices for most assets. At the same time, earnings growth is likely to be positive but pedestrian as the global economy continues to cool off. We think lower interest rates will benefit more leveraged companies, with listed property in particular looking appealing for the first time in years.

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 those in the US) will likely outperform in this environment. Global bonds and global cash remain compelling.

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

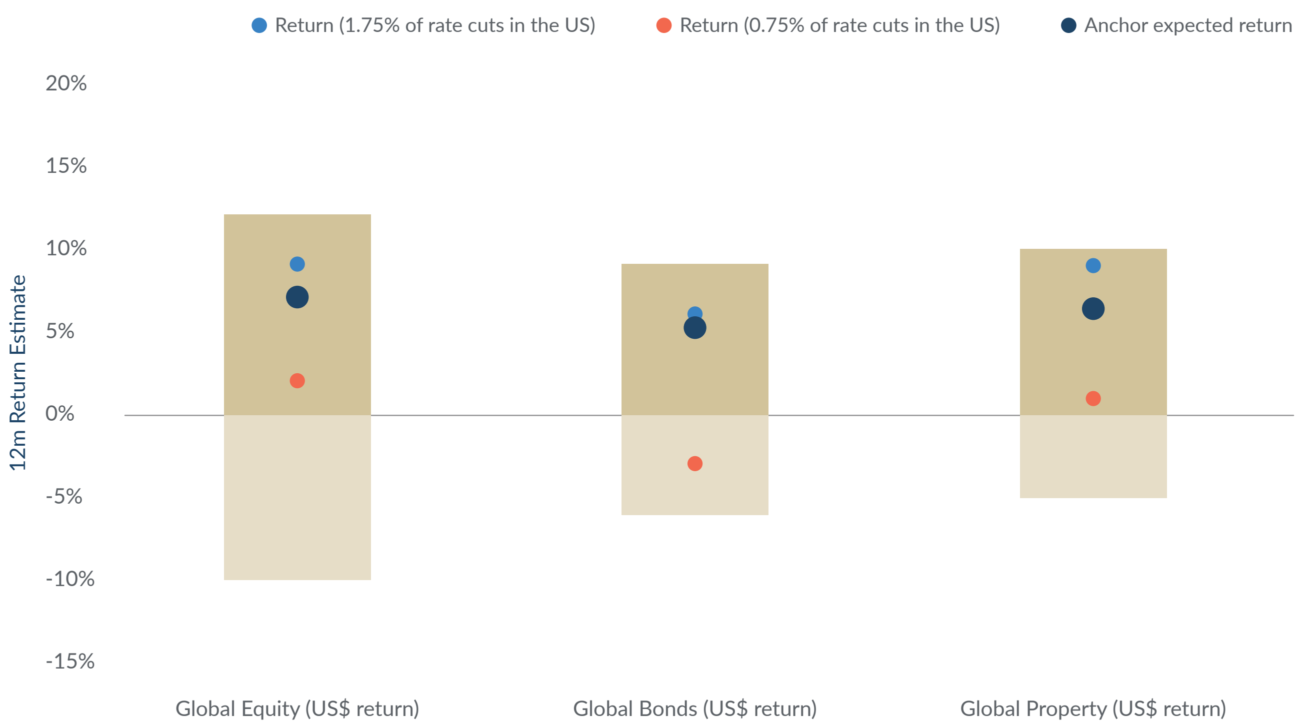

Figure 2: Anchor expected return by offshore asset class
Source: Anchor

	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 the various scenarios. From a domestic perspective, the weak economy, failing state-owned enterprises (SOEs) and the poor state of government finances are a few of the factors detracting from our outlook. We think South African society is learning to cope with electricity disruptions and that private generation will lessen the blackouts. There is already much negativity in the price of domestic assets, and we have shifted domestic listed property to a positive stance as this asset class is relatively cheap, and earnings should benefit from interest rate cuts over this year. We think domestic factors should improve into 2024, though there is much uncertainty around this view, with the national election likely to keep markets on edge for the first half of 2024.

Against this backdrop, we are modelling the rand weakening by 3% over the year ahead.

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

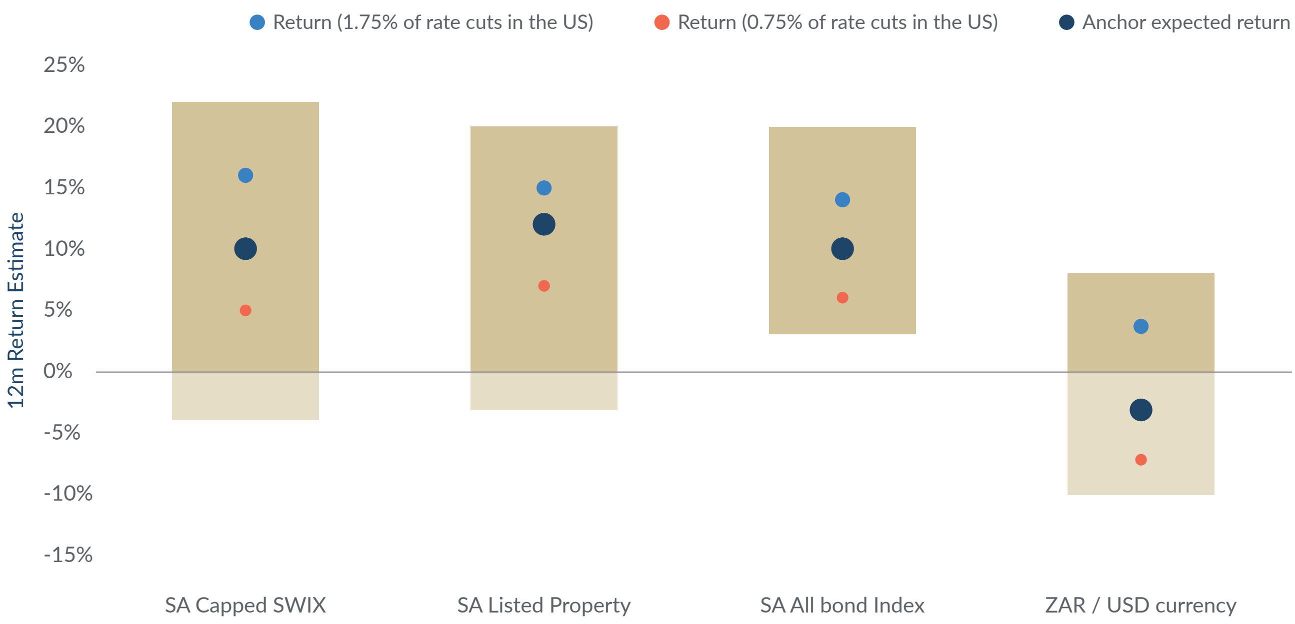

Figure 4: Anchor expected return for domestic asset classes
Source: Anchor

	Domestic equity	Domestic bonds	Domestic property	US$/rand
Anchor expected return (in rand)	10%	10%	12%	-3%

Strategy and Asset Allocation

ECONOMICS

As we welcome the new year, we expect economic activity to remain subdued in 2024 amid a gradual global slowdown. This anticipated slowdown in global economic activity will be driven by a decline in consumer and investment action due to elevated interest rates and diminished savings. Moreover, extended geopolitical and economic fragmentation periods will likely impact global manufacturing supply chains, reducing trade flows. Significant risks to the outlook for 2024 include the potential for further geopolitical tensions, particularly with current apprehensions about the potential regionalisation of conflicts in the Middle East. This situation raises concerns about the possible repercussions on oil prices and its impact on global economic activity. As a small, open commodity-exporting economy, SA's prospects are intrinsically tied to the global economy. As such, we expect slower global economic growth to dominate the agenda over the next year. Moreover, 2024 is set to be an incredibly important year on the global political front, with around 40 democracies that are set to hold elections. This will represent roughly 41% of the global population and 42% of global GDP. Notable countries holding elections include the US, the UK, SA and Taiwan – markets will closely watch these election results.

The US, in particular, has demonstrated significant economic resilience during 2023. However, this is expected to fade in 2024 amid a gradual slowdown. The early signs of a softening labour market are beginning to show, and weaker household consumption is also expected, given the high interest rates, lower savings rates and contracting disposable income. Moreover, there will likely be some volatility within US markets (and, by proxy, global markets) due to continued uncertainty over whether the US government can pass a budget amid increased politicking between Republicans and Democrats as the US Presidential Election looms. Global Inflation is expected to continue to trend lower, albeit at levels surpassing pre-pandemic figures. Regionalisation effects on production costs across supply chains influence this shift. While global prices are decreasing, they remain sticky due to oil price volatility. There is a near-term risk of an oil price surge tied to geopolitical tensions in the Middle East.

Global Inflation is expected to continue to trend lower, albeit at levels surpassing pre-pandemic figures.

Notably, advanced economies have experienced a significant decline in their inflation rates throughout 2023, with the UK facing persistent inflation challenges. However, we continue to hold the view that the US Fed has reached the peak of its current rate-hiking cycle, with the federal funds rate at a midpoint of 5.375% for the past two meetings. In a broader context, we anticipate that the general global trend of hiking interest rates has, too, reached its peak. The major market driver in December 2023 was the US Fed pivot shown in its projection of a 75-bp cut (three 25-bp cuts) in the Fed funds rate from a midpoint of 5.375% to 4.625% by the end of 2024. Markets were pricing in nearly six cuts to 3.875% at the time of the December Federal Open Market Committee (FOMC) meeting, which has now declined to five cuts to 4.125% (at the time of writing), implying a 50-bp gap between the Fed and market expectations. Thus, financial markets across the board will remain on edge surrounding the timing and extent of the anticipated Fed cuts. As it stands, the Fed is broadly expected to start cutting rates during 1H24. A similar pattern is expected from the European Central Bank (ECB) and the Bank of England (BOE). This will, in turn, likely create space for emerging markets (EMs) to follow suit – some of which have already begun.

Locally, the proverbial chickens came to roost with the release of SA's latest 3Q23 GDP print – despite a relatively robust and resilient 1Q23 and 2Q23, the SA economy contracted by 0.2% QoQ seasonally adjusted (sa) in 3Q23. Unsurprisingly, key issues such as the enduring financial strain on households and the continued supply-related obstacles caused by disruptions in rail and inefficiencies at our ports are beginning to meaningfully weigh on the local economy. Household consumption remains weak across all major categories, and investment is starting to slump - reversing the previous quarters' surge, which was driven by solar energy projects. The decline is widespread among all types of enterprises and most types of capital outlay, reflecting low confidence and structural challenges. Furthermore, exports and imports were weak, indicating the domestic and external headwinds facing the economy.

On the inflationary front, SA faces a range of possible inflationary shocks over the coming months. The El Niño Southern Oscillation, typically associated with lower rainfall in the country, may contribute to an escalation in food prices. Additionally, intermittent geopolitical tensions could sustain elevated oil prices. Risks emanating from the ripple effects of heightened electricity costs and escalating logistical expenses loom, potentially leading to price hikes. Furthermore, there is apprehension regarding household inflation expectations, given the volatility observed in food and fuel prices in recent months, which might increase wage demands.

On the monetary policy front, the SA Reserve Bank (SARB) Monetary Policy Committee (MPC) kept the repo rate at 8.25% at its November meeting (the last for 2023). We maintain that this marks the peak in the current hiking cycle, and we foresee the first interest rate cut occurring in 2H24. Nevertheless, the MPC has underscored that risks to the inflation outlook lean towards the upside. Overall, looking ahead into 2024, we expect growth to remain subdued on the local front. Consumer spending growth will likely remain under pressure amid muted wage growth and the persistence of elevated interest rates. The existing bottlenecks at the country's ports are expected to exert further pressure on both short-term growth and overall sentiment. Moreover, there are indications that the escalating issues at the ports are beginning to impact real economic activity, posing concerns for both near-term growth and general sentiment across the board. Nonetheless, whilst global and local economic growth prospects may appear muted for the foreseeable future, opportunities remain throughout most asset classes.

SA EQUITIES

In the context of a robust global equity market backdrop (MSCI World +24.4% in 2023), JSE equities experienced a disappointing 2023 (MSCI South Africa -1%). In rand terms, the dominant local equity benchmark (FTSE/JSE Capped Swix) was up 7.9% in 2023, with more than 100% of that performance recorded in the last two months of the year. The only other major equity index we tracked that recorded a worse performance last year was that of China (MSCI China -11%). The mediocre performance from the JSE should be viewed in the context of the local bourse having experienced a strong relative year in 2022, with the MSCI South Africa Index having outperformed global equities by 14.3%. Having updated our models, which seek to capture c. 85% of the index from the bottom up, our total return expectation for 2024 is 10% in rand terms and 7% in US dollars. We continue to expect both global macro factors (particularly the direction of developed markets [DMs] interest rates) and the economic performance of China to have an outsized influence on the local market, with the added tail risk of SA's general election expected midway through 2024.

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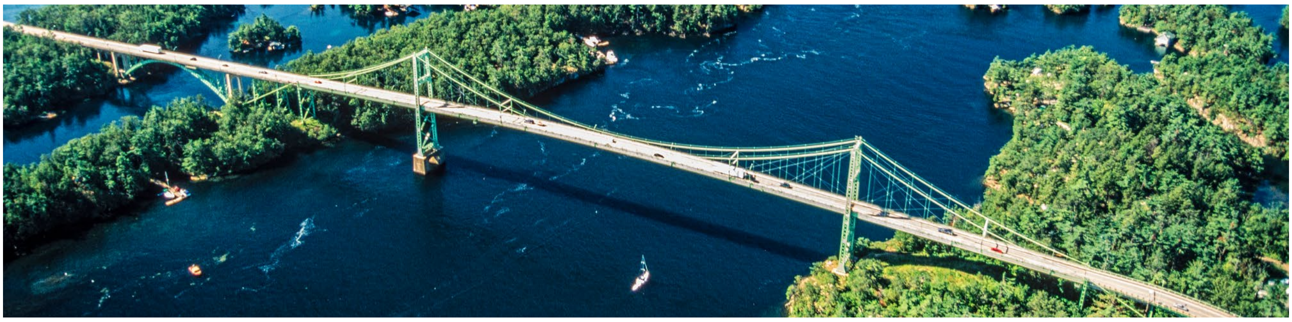
There have not been many changes to our assumptions since the end of the previous quarter (4Q23), with our earnings growth expectations remaining essentially flat (no further deterioration from the cuts we took to our numbers halfway through last year) and the restrictively high cost of capital remaining the key reason for us having had to drop the exit multiples we use to forecast total returns. In other words, the current high interest rate and low-growth environment have resulted in us having to reduce our total return expectations over the last year. In most cases, we would view these headwinds as cyclical that would typically reverse in the near term. However, with the continued deterioration in the SA economy, determining how long the current low-growth environment will last has become more challenging. Without structural reform, we would expect the current tough operating conditions to persist.

As disappointing as the underperformance of the local economy might be, our base case is that conditions will not get dramatically worse for the local companies we look at, as was the case in 2023. We expect loadshedding to have at least reached a peak, with private generation expected to pick up strongly in 2024, coupled with the fact that South Africans have become far better at coping with the disruptions that come with loadshedding.



The last quarter of 2022 and the first half of 2023 were a shock to the system because of just how bad loadshedding got. Retailers went into the 2023 festive season with too much inventory they could not sell and spent much of the first half discounting stock and having to invest in different ways of keeping the lights on. Some retailers were more effective in adapting to the changing conditions, a good example being Shoprite, which had the luxury to spend disproportionately on diesel and effectively capture market share at the expense of Pick n Pay and Spar, which, due to cashflow constraints, did not have the same luxury.

With less direct impacts on operations because of loadshedding, the local banks index experienced another strong year (FSE/JSE Banks Index +18%). The high interest rate environment has been a kicker to banks' earnings for the last few years, while lending books have proven resilient in the face of weakening local operating conditions. With interest rates expected to have peaked for this cycle, the tailwinds to the banks' earnings should start to recede towards the back end of 2024. As many domestically focused companies' earnings have deteriorated over the last few years, the resilience of the banks' earnings resulted in us taking a constructive stance on the sector. In aggregate, we expect the banking sector to continue to grind out high single-digit earnings growth with close to double-digit dividend yields for mid- to upper-teen total returns.

Outside of the purely domestically focused counters, the local market continues to rely heavily on China's economic outcome. Optically, Naspers, Prosus (and Tencent) offer excellent value. However, the latest developments with the gaming regulator in China are expected to add further regulatory overhang in the sector. We await the outcome of the draft regulations that seek to cap in-game spending within the Tencent gaming ecosystem, which will clarify the direction of travel for the earnings profile over the medium term. Regardless of the outcome, the latest developments have not been helpful from a sentiment perspective and have resulted in us having to temper our expectations from an exit multiple standpoint.

Another company heavily reliant on the performance of the Chinese consumer in 2024 is CFR Richemont. Going into 2023, we were optimistic about the prospects for a bout of post-COVID-19 revenge spending by the Chinese consumer, with the outcome somewhat disappointing.

The local market continues to rely heavily on China's economic outcome.

Turning to the highly cyclical basic materials sector, the difficult operating conditions locally (Transnet underperformance, loadshedding etc.) combined with a tough demand backdrop, primarily because of the continued underperformance of the Chinese property market, resulted in a disappointing performance in 2023 (JSE Basic Materials Index -12%). As an investment house, we gravitate towards higher-quality businesses, and we often use mining companies as an example of the type of business we tend to avoid in any meaningful size. The outcomes in 2023 demonstrated the reasons why. Simply stated, costs have been rising (many of which are dollar-denominated), and the commoditised top lines have come under pricing pressure. Locally, issues with Transnet rail and ports created further headaches for iron ore and coal mines, which could not export their full quota of mined production. We acknowledge the optionality in the basic materials sector, yet we have maintained cautious/underweight positioning, waiting for a turnaround in operating momentum before adding additional exposure.

With risks abounding globally and locally, we expect another eventful year ahead for the JSE. The total return forecast of 10% is our base case, and it would not take much to see a far greater return. Interest rate cuts globally, a positive outcome in SA's national elections and the simmering down of geopolitical risks could drive positive upside surprises. On our numbers, should the JSE revert to the average P/E multiple of the past five years, we could expect total returns of over 25% - a vastly different picture from DM equities.

SA LISTED PROPERTY

This article is not so much about the historic performance of the local property sector but rather the impressive performance of SA-listed property in December 2023 - a reminder of why investors should keep a diversified portfolio. The SA-listed property sector delivered a spectacular return of 9.9% in December 2023, accounting for almost all of the 10.1% total return for the year. During the month, the FTSE/JSE SA Listed Property Index outperformed bonds (+1.43% MoM), cash (+0.65% MoM) and equities (+2.0% MoM). In December, Lighthouse Capital, Hyprop Investments, and Equites Property Fund (EQU) were the top performers among the property counters, delivering total MoM returns of 23.3%, 21.4%, and 18.7%, respectively.

For the first time in recent years, we are projecting a higher total return for SA-listed property (12%) than domestic equity and SA bonds. After a few years of poor performance, SA property eked out a double-digit return but still trades at an average 30% discount to NAV and a forward distribution yield of around 13% for local portfolios and c. 8% for global portfolios (primarily Central and Eastern Europe [CEE]).

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

We highlight that the SA REITS trade at an attractive forward dividend yield compared with five years ago even though dividend payout ratios are now lower (except for Resilient and EQU) and distributable income definitions are also more conservative than five years ago (except for EQU on our assessment). Our pick of the property sector is MAS PLC, where the share price took a dive when it announced that it would hold back on dividends for two years to fund developments. At a 15% forward distributable income yield, we think the share is worth over 50% more.

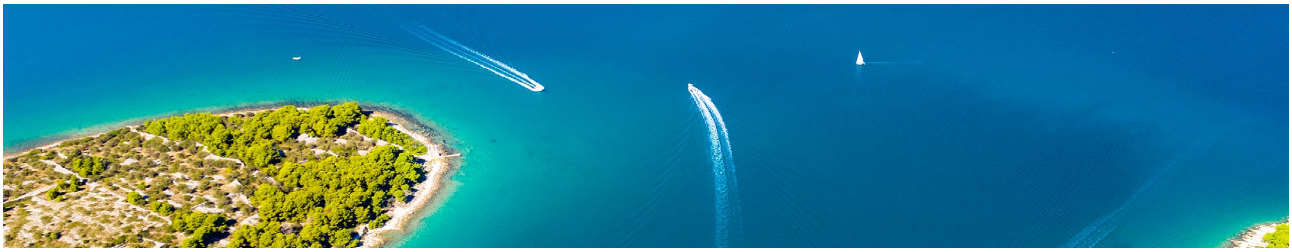
DOMESTIC BONDS

For 2023, SA Government Bonds (SAGBs) returned 10.14% at an SA All Bond Index (ALBI) level. Given their weak performance in 2Q23 and 3Q23, SAGBs gained significant ground in 4Q23. Yields bounced back from the weak absolute and relative levels reached in 3Q23, with the R2035 (now the bond nearest to the 10-year term) closing the year at 11.375%, having reached a maximum yield of 12.58% in 3Q23.

The movement in the curve has been linear across the year, with the index term split returns being directly proportional to their duration. Indeed, comparing a short-duration bond (R186, yield moving from 8.75% to 8.67% over the year) vs a long-duration bond (R2044, yield moving from 11.565% to 12.215 over the year), the longer-duration bonds have been the most attractive to hold. Additionally, the ALBI itself has become short-biased due to the decreasing duration of the heaviest-weighted bond in the index - the R186 (accounting for c. 15% of the index).

On the central bank front, the year ended with strong statements from US Fed members that no further rate hikes are expected and that the next rate movement is likely to be downward. This sparked a year-end rally across financial markets, with SAGBs moving in tandem.

The SARB is likely (albeit not certain) to follow suit. We expect the SARB to keep rates at their current levels (the repo rate is at 8.25%) for 1H24, with a gradual rate-cutting cycle expected in 2H24. Current market expectations are more bullish, with 75 bps of cuts priced into the domestic forward rate agreements (FRAs) strip to year-end 2024.



The major 2024 domestic risk event will likely occur in 2Q24 – SA's national election, expected to be held in April or May. Forecasts vary, but the governing ANC is widely expected to drop below 50% nationally. If this comes to fruition, post-election negotiations regarding a coalition government will occur. If the ANC is only slightly below 50%, these negotiations will likely be straightforward in finding one or two smaller coalition partners. However, if the ANC is materially below the 50% level (in the low-40% range), it will require a bigger coalition partner and more concessions from the ANC to this partner.

Given the combination of the above factors (the national elections and the potential for rate cuts), we have retained a neutral duration position in the fund. However, considering its low-yield characteristics, we are cognizant of the shortening R186, a bond we do not believe is appealing. Our preference remains the belly of the curve, where the duration can be managed while offering more desirable yields. We are projecting a twelve-month return on bonds of 10% for this report.

THE RAND

During 2023, the rand weakened due to a stronger US dollar, risk aversion, and domestic economic and political malaise. We had expected the rand to trade in the range of R19.00-R20.00/US$1 for much of 4Q23. In retrospect, it spent much of 4Q23, stronger than our expected range, ending at R18.43/US$1. This strength was primarily a reaction to the financial markets becoming more enthusiastic about US rate cuts than we had anticipated. Looking forward, we think the rand's prospects have deteriorated, and we see it trading in the R18.75-R20.00/US$1 range for 1Q24.

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

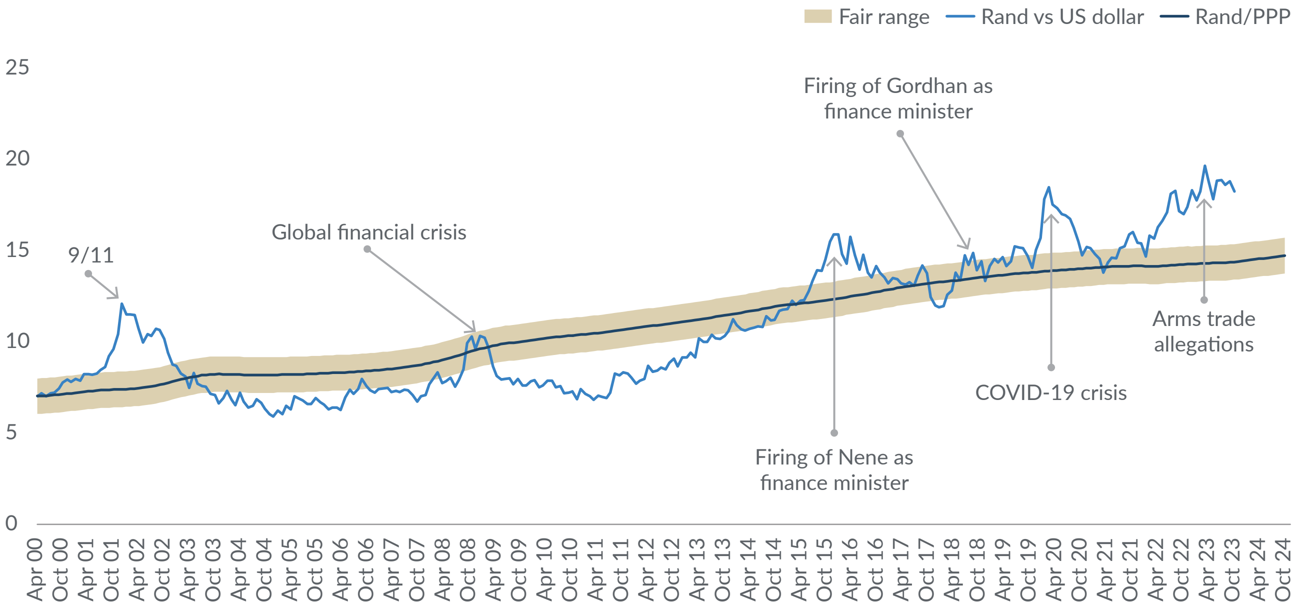
The indicators for the rand's fair value continue to deteriorate. We note that the current account will likely weaken further, as the SARB keeps explaining. Financial markets are focusing on SA's worsening fiscal situation, questioning the government's ability to achieve a sustainable primary surplus by 2025. However, loadshedding, poor government infrastructure and logistics, and negative sentiment continue to weigh on the domestic economy. We expect the global environment to become more supportive gradually, but one might argue that it is already priced in. Therefore, we expect the local unit to continue to trade with a negative overhang.

We retain our purchasing power parity (PPP) based model for estimating the rand's fair value. We have extended this out by three months since the publication of *The Navigator – Anchor's Strategy and Asset Allocation, 4Q23* report on 13 October 2023. Over our forecast period, we expect inflation abroad to come under control and return towards more normalised levels. This means our PPP model shows an increasing propensity for long-term rand weakness from 2024. As a result, our PPP-modelled value for the rand vs US dollar at the end of the next 12 months is R15.10/US$1 (see *Figure 1*). We apply a R2.00 range around this to get to a modelled fair-value range of R14.10-R16.10/US$1.

The current domestic and global backdrop means we are starting with the rand meaningfully weaker than our modelled fair-value range. In previous cycles, US dollar strength has tended to dissipate (and reverse) toward the end of the US rate-hiking cycle. Current indications are that the US Fed will start cutting in March 2024, meaning that we expect to see currency normalisation, with the dollar giving up some of its gains in the latter part of this year. However, we do not expect the currency to recover fully, and we are projecting a rand in the R18.75-R20.00/US$1 range in one year as domestic issues continue to weigh the rand down. For this report, we have modelled on R19.00/US$1.

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

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



GLOBAL EQUITIES

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

However, this has to be viewed in the context of relatively high valuations, so the starting point for 2024 is already factoring in some fairly good news going forward. Consequently, our 7% projected 12-month return for global equities seems less impressive than the narrative. Still, we would be comfortable taking longer-term equity positions, knowing that conditions need to catch up with the market after a very strong 4Q23.

Very few big global banks and investment houses expected a great year in 2023 as interest rates started the year in a strong rate-hiking cycle. The opposite happened, and the MSCI World was up 24.4% for the year, and the US S&P 500 rose by 26.3% (up 11.7% in 4Q23 alone). Likewise, market expectations are fairly muted this year because of the high starting valuations and recent strong performance. But, given improving conditions, we are biased towards a positive performance with the risk of the market taking a breather for a few months.

About half of the 2023 US equity market performance came from the Magnificent Seven stocks. These artificial intelligence-driven (AI-driven) tech shares (Apple, Amazon, Nvidia, Microsoft, Meta, Tesla, and Alphabet) are trading at high valuations. While retained exposure to these counters is essential, they might not be where the outperformance comes from, and hence, stock-picking becomes increasingly important.

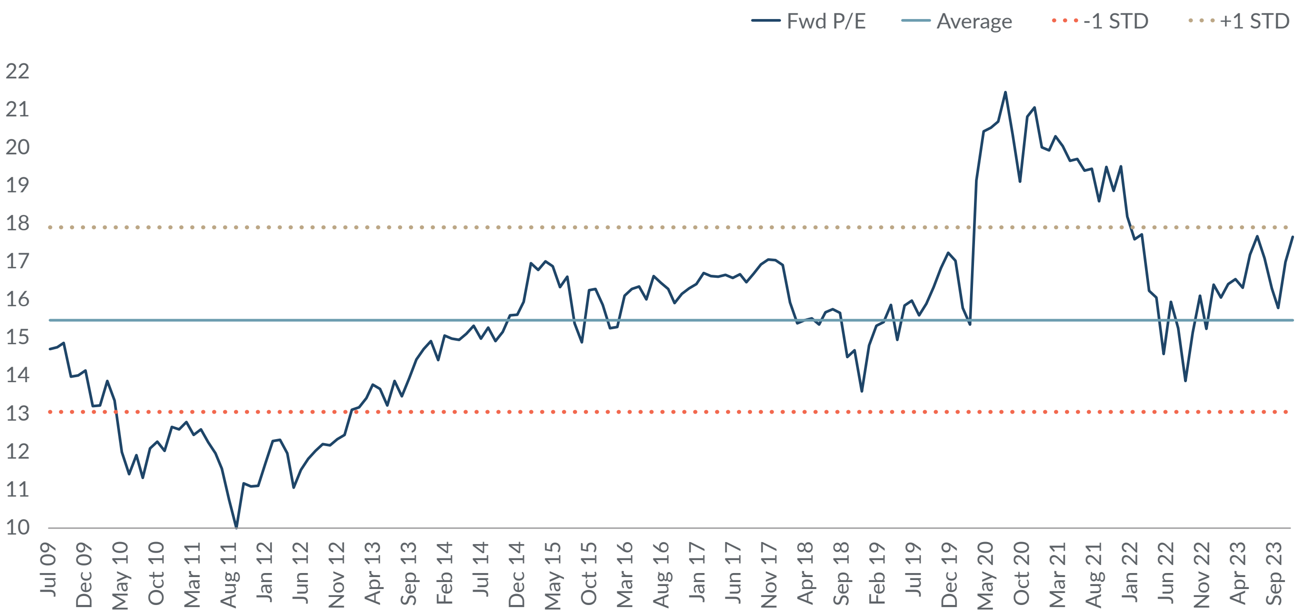
Equity alternatives are considerably more attractive than they have been for the past decade, with money market funds offering 5%-plus returns in US dollar terms and US 10-year treasuries trading at yields above 4%. If you are prepared to give up some liquidity or take a little more credit risk, yields of 6%-9% are available. In our alternative investment offering, we are targeting double-digit US dollar returns. Higher rates also mean that the high dividend yield shares in the US have become relatively less attractive, as a 5% dividend yield is not what it used to be if I can get 5% “in the bank”.

The economic reality 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% YoY growth for 2023. Many were forecasting a US recession in 2023, but strong US national and local government spending has provided a big boost. The result, however, is that 2024 forecasts are now looking relatively muted (+1.3%) as the impact of higher interest rates starts to bite. The market, however, is looking forward beyond the bottoming.

Figure 2: Global GDP growth
Source: Anchor, IMF

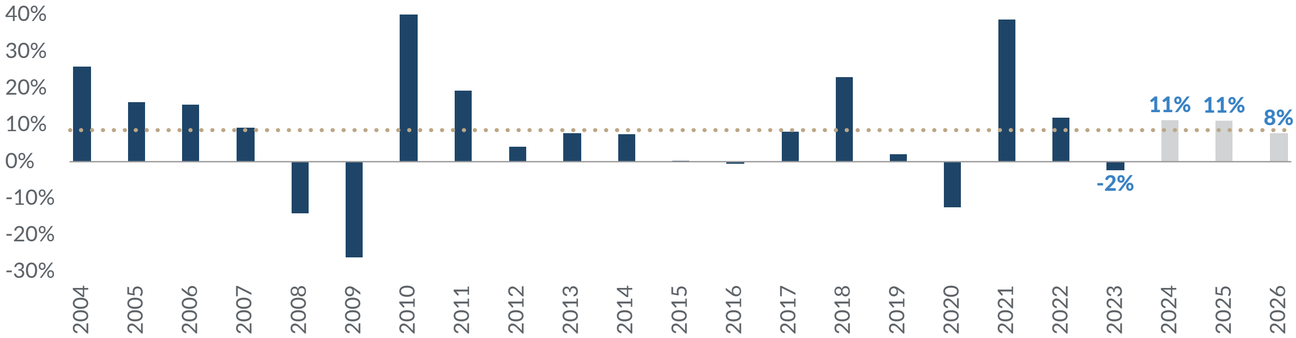
Valuations at the index level in global DMs look full (MSCI World forward P/E of 17.3x).

Figure 3: MSCI World forward P/E
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 to their customers have flourished. For 2023, US earnings growth is projected to record a 2% 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 positive concoctions when looking further into 2H24 and beyond.

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



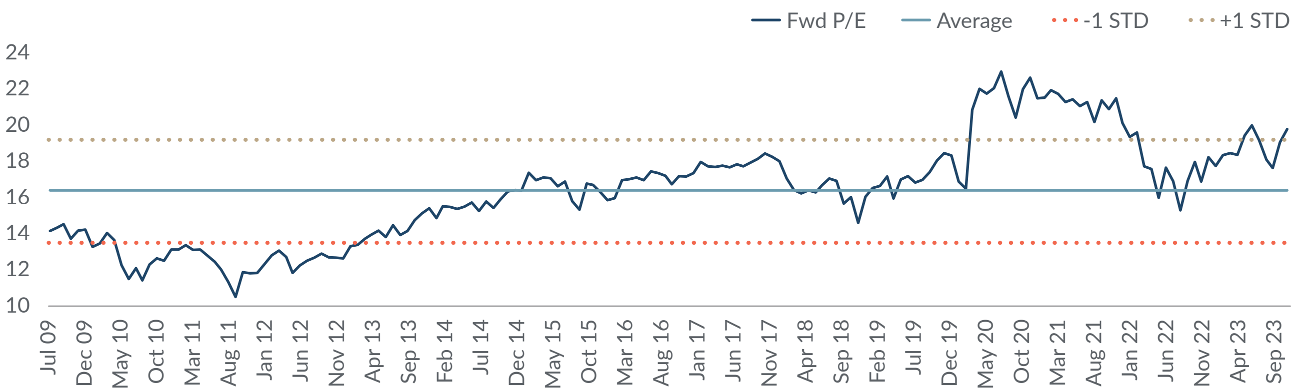
The S&P 500 Index forward P/E is 19.7x (*see table below*). Multiples often increase when earnings dip as long as the future outlook is more positive. EMs are much cheaper and have strong recovery potential.

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

	Earnings growth		FWD P/E	
	YR1	YR2	YR1	YR2
MSCI World Index	9.6%	8.5%	17.3	15.9
MSCI EM Index	22.5%	14.7%	11.6	10.1
MSCI All Country World Index (10% EM)	11.2%	9.4%	16.5	15.1
S&P 500 Index (ex-Energy)	13.7%	11.7%	20.3	18.2
S&P 500 Index	11.5%	11.3%	19.7	17.7

This is shown graphically in the chart below.

Figure 6: S&P 500 Index forward P/E
Source: Anchor, Bloomberg

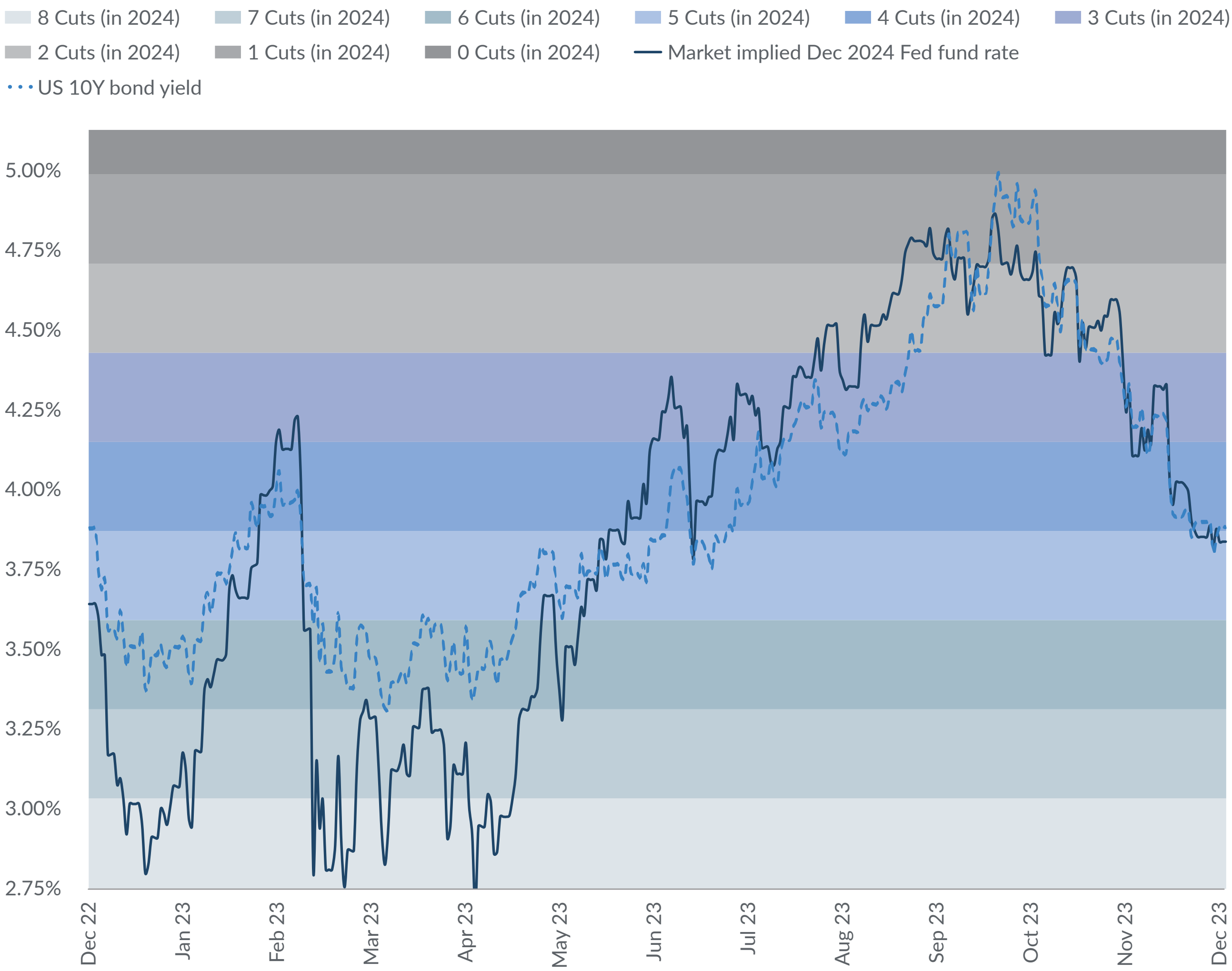


EMs have been a letdown in 2023 as the much-vaunted Chinese recovery has disappointed. Chinese government stimulus has been less aggressive than in previous cycles, but the government could act more decisively in the next six months. EM valuations are cheap, and a shift in sentiment could see a sharp rise, but current sentiment is extremely negative. An exciting opportunity is the Chinese AI stocks, 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 over the past decade.

GLOBAL BONDS

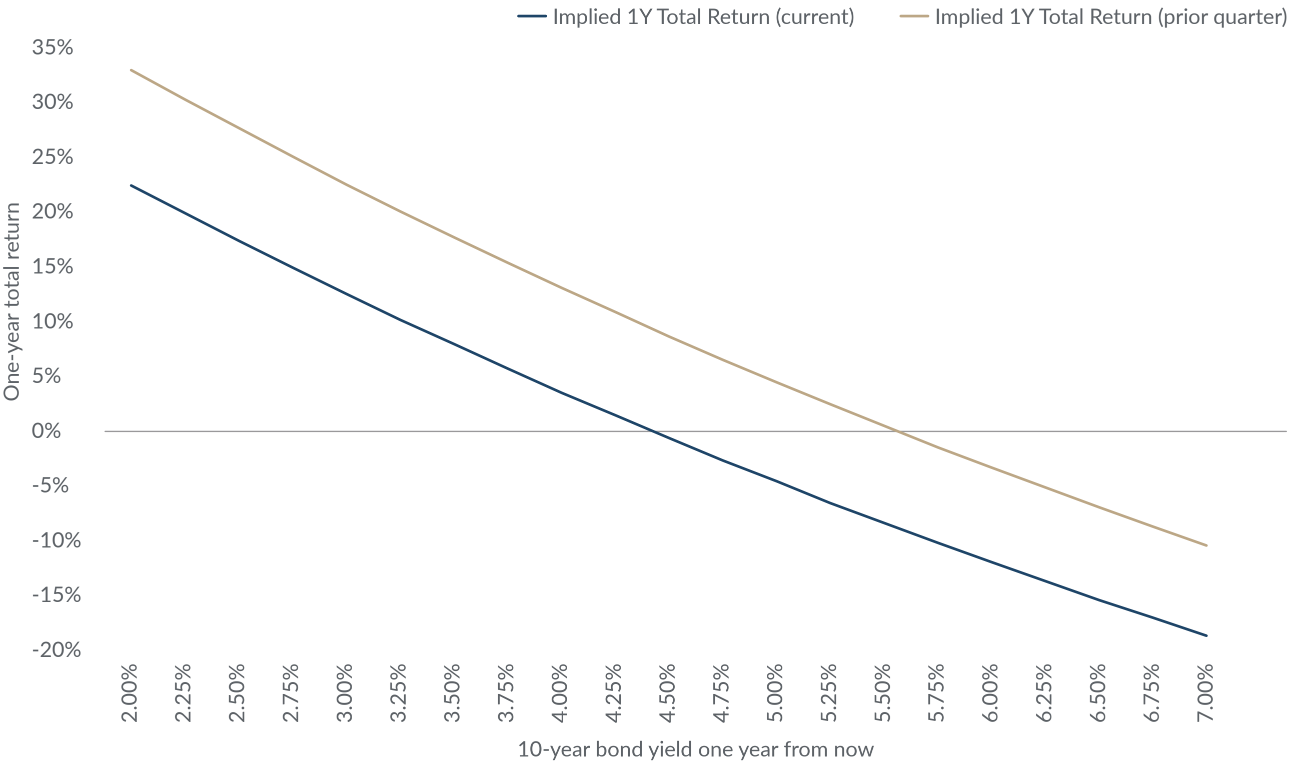
In 2022, global bonds experienced their worst year on record (Bloomberg Global Bond Index -16% YoY) when the US 10-year government bond yield started at 1.5% and ended 2022 at 3.9%. On the surface, 2023 seemed positively dull by comparison, with US 10-year bond yields beginning and ending the year at 3.9%. However, beneath the surface, 2023 was a real rollercoaster ride, with the US 10-year bond yield reaching a low of 3.3% in May and a high of 5% in October. The 5% level that US 10-year bonds reached in 2023 was the first time that level had been attained since 2007. While investors largely agreed that the US Fed would hike rates to around 5% during 2023 and keep them there through year-end, what happened beyond that in 2024 left investors guessing. The consensus expectation for what the Fed would do in 2024 (implied by market pricing) shifted between eight rate cuts (2.0% of cuts) and no rate cuts, with the year ending at the midpoint of that range.

Figure 7: In 2023, investor expectations for how many times the Fed would cut rates in 2024 gyrated between no cuts and eight cuts, with US 10-year government bond yields being dragged around by those changing expectations
Source: Anchor, Bloomberg



That is all behind us now, and what is more important for investors is what happens in 2024. In 4Q23, we saw significant upside potential removed from the bond market as rates dropped from their 15-year high (c. 5%) to 3.9% at year-end. This has resulted in an 8% QoQ total return for the Bloomberg Global Bond Index, leaving the range of potential return outcomes for bond investors in 2024 far more balanced.

Figure 8: As US 10-year bond yields dropped from 5% to 3.9% in 4Q23, the range of potential one-year total return outcomes became far more balanced
Source: Anchor



We expect the US economy to maintain its strong momentum (that surprised investors in 2023) into 1H24, dragging inflation normalisation out for longer than anticipated and perpetuating the gyrating Fed expectations and rate volatility through 1H24. However, on a one-year view, we anticipate that the US economy will start to cool in 2H24, allowing inflation to normalise and the Fed to embark on a more consistent rate-cutting path, bringing more certainty to investors and pushing US 10-year bond yields slightly lower. We expect this outcome to deliver small capital gains alongside the 3.9% of income for a 5.2% total return in US dollar terms over the next twelve months for US 10-year government bond investors.

For those investors in US corporate bonds, the equation is a little more challenging, with credit spreads below 1%, a level rarely achieved and maintained over the long run. As such, we expect that spread to drift back towards the long-run average, particularly into the back of this year, as elevated funding rates start to weigh on credit affordability. The headwind from normalising credit spreads will be slightly offset by our expectation of slightly lower interest rates, but this should still result in a slight capital loss over the next twelve months, which will dilute the decent income on offer (c. 5.1% p.a.) for a total return of 4.3%.

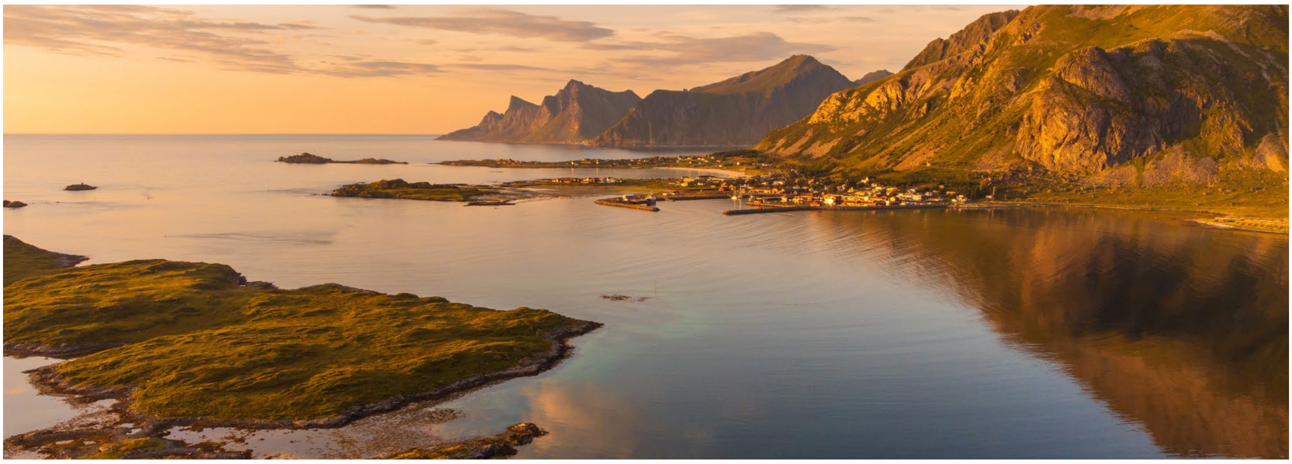
GLOBAL PROPERTY

Global listed property (4Q23 +15.2% QoQ) experienced a quarter of outperformance relative to global equity markets (4Q23 +11.5% QoQ) for the first time in about two years, as investors became increasingly optimistic about the prospect of lower rates and the probability of the US avoiding a recession. Before COVID-19, US REITs generally traded at c. 17 times forecast funds from operations ([FFO] the REIT equivalent of earnings) but have de-rated over the past few years to c. 13.3 times anticipated FFO.

Figure 9: Valuations on global REITs (as measured by price/forecast FFO) have de-rated c. 20% over the past couple of years
Source: Anchor, Bloomberg

Part of the de-rating is justified and reflects a higher interest-rate environment relative to the pre-COVID-19, post-global financial crisis (GFC) period characterised by global central banks deploying significant quantitative easing (QE) and keeping rates anchored around 0%. This probably justifies a shift in fair values from 17 times to 14 times forward earnings, and on this basis, global REITs appear marginally cheap in aggregate. With structurally lower ratings, commensurately higher dividend yields (c. 4.4%) and a lot of the COVID-19-related commercial real estate challenges largely behind us and in the earnings base, we are starting to get incrementally more interested in global listed property, which we think can start to see moderate earnings growth combined with attractive dividend yields for a decent total return outcome of c. 6.2% over the next twelve months.

As always, with listed property, the various sectors will likely experience mixed fortunes. Office REITs now have vacancy rates similar to those experienced during the lows of the GFC in their base. Still, they probably need to spend significantly on refurbs in the short term to meaningfully entice the work-from-home (WFH) cohort back. Residential REITs have been a beneficiary of limited housing supply recently, but that should reverse in 2024 as the US residential REIT market sees the biggest wave of new apartment supply in decades come online with the anticipated delivery of 440,000 new units and c. 900,000 units currently under construction. There will be plenty of winners and losers in all these shifts, but for the next twelve months, at the asset class level, we anticipate conditions being more conducive than they have been in years.



ANCHOR INSIGHTS

In this section, staff across Anchor provide insights into our thinking, strategy, and worldview. This quarter, Ross McConnochie examines where stock market returns come from, Reko Nare explores the performance trends of S&P 500 sectors during various business cycles and under different interest rate regimes, Lelethu Poswa talks about why he believes recession risks remain high despite a growing soft-landing optimism, Nick Dennis discusses the lessons he learned about investing from Pulak Prasad's book entitled *"What I learned about investing from Darwin"*, and, finally, Di Haiden looks at the SA Revenue Service's (SARS') Voluntary Disclosure Programme (VDP), in the hope of helping you assess whether you should be looking at this programme to regularise any of your tax affairs.

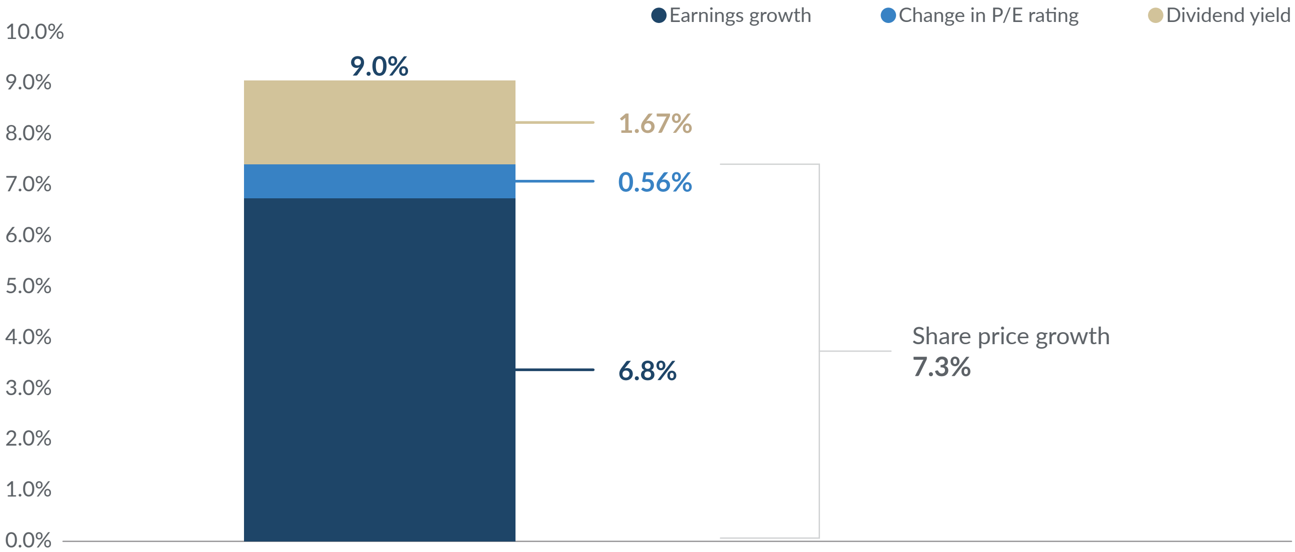
Where do stock market returns come from?

WRITTEN BY:
Ross McConnochie
Offshore Analyst/Portfolio Management

Ross has worked for Robert Cowen Investments since 2011, with a current focus on offshore analysis and portfolio management. Ross holds a B. Bus Sci Finance Honours from the University of Cape Town and is a CFA charterholder.

The US stock market has produced an incredible investment return over the past twenty years, far greater than any other stock market. Over the short term, anything can impact prices, but over the long term, an investor's total return consists of two factors: the change in the index level (i.e., share prices) and the yield you earn each year in the form of dividends. The price of the S&P 500 Index has grown 311% over the past 20 years, or c. 7.4% p.a. and it has paid an after-tax dividend of about 1.67% p.a. over the period or roughly a 34% payout over 20 years. Thus, your total return over 20 years was approximately 345%.

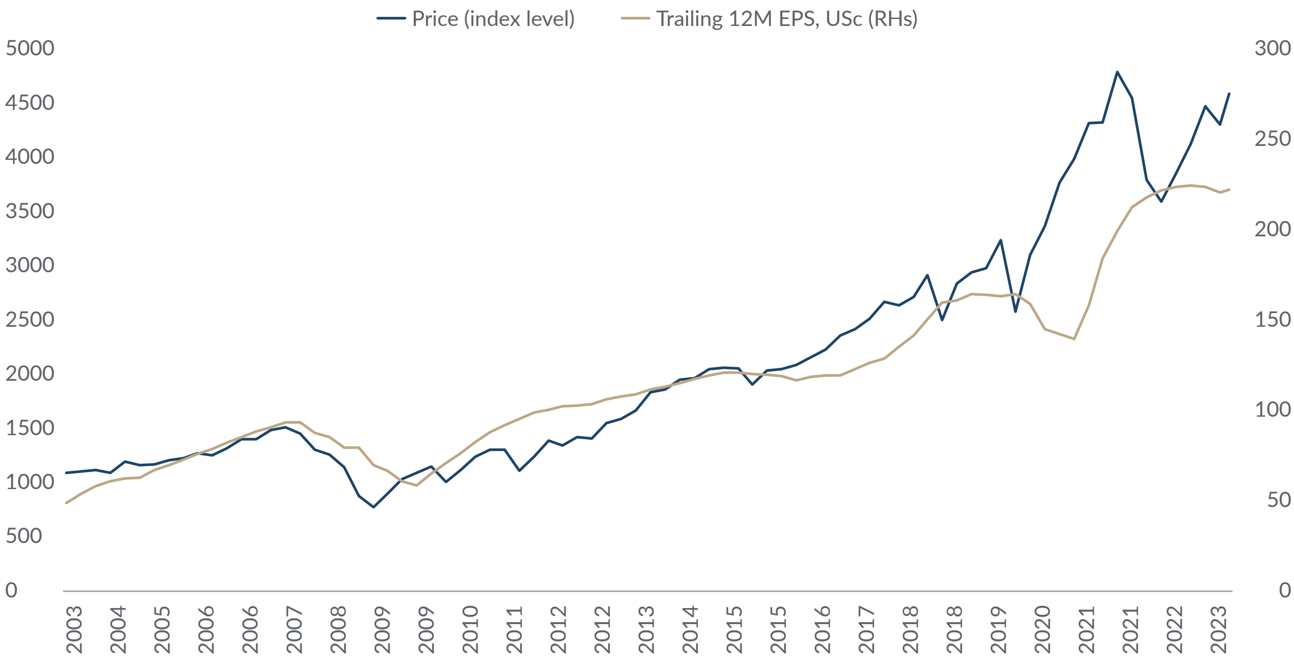
Figure 1: Breakdown of the S&P 500's annualised returns*
Source: Anchor, Bloomberg



**The S&P 500 Index's level grew, on average, 7.3% p.a., 6.8% came from earnings growth, and 0.5% came from valuation change. The net-of-tax dividend yield averaged 1.67%. Thus, on average, your total return was about 9% p.a.*

We can see from *Figure 1* above that the largest contributing factor to the **price** of the index over the long term was the performance of the underlying earnings growth of the companies that constitute the index. Over the 20 years, EPS has grown 286% or 6.8% p.a., which is well ahead of US inflation over the same period. This performance has by no means come in a straight line, with multiple periods of boom and bust, but this clearly shows how impressive businesses tend to grow in the long run.

Figure 2: The relationship between price and earnings*
Source: Anchor, Bloomberg

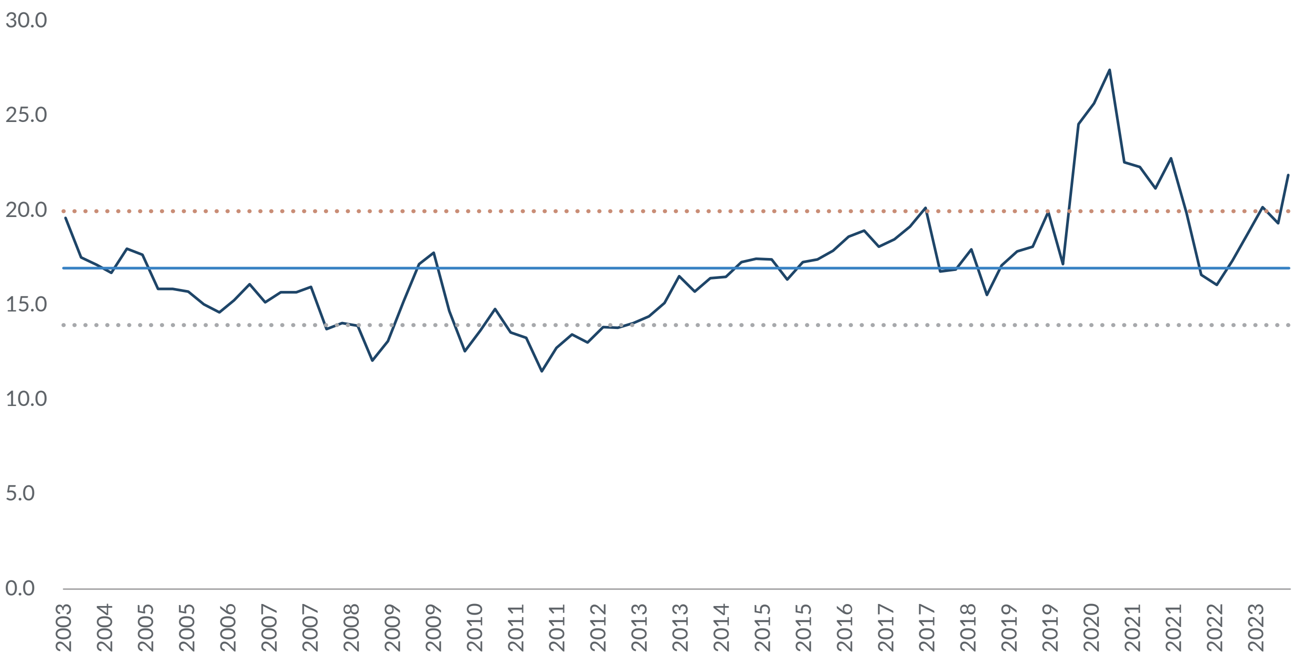


**Blue is the Index price. Red is the 12-month EPS. The valuation may become too expensive when share prices rise too quickly relative to company earnings.*

Comparing the EPS of the index with the index price, we can see how well correlated they are over time. The market price is a forward-looking mechanism; thus, we often see the price reacting to events that could impact company performance in the future. If the price rises too aggressively relative to the underlying earnings growth, this would increase the valuation. Conversely, if the price falls too far, this will indicate a possible buying opportunity.

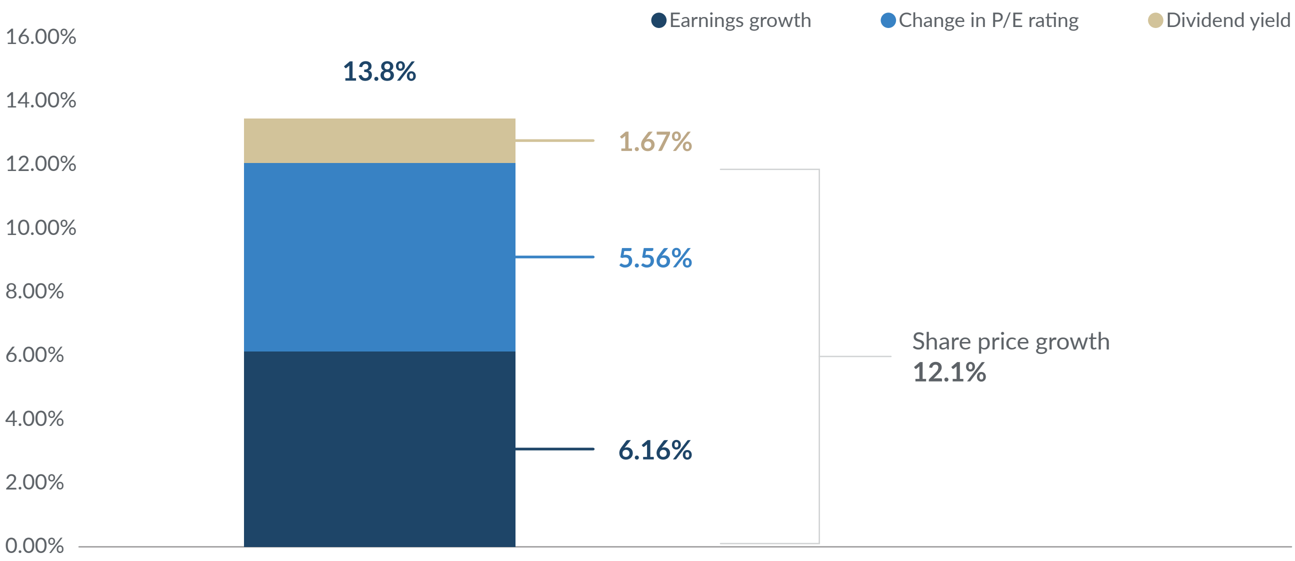
The second component of price is the valuation rating at that time. The simplest metric used is usually the price-to-earnings ratio (P/E). If you buy a company at a 10x P/E and sell it tomorrow at a 12x P/E, then your total return would be 20%, and it would be entirely attributed to the rating change and not earnings growth or dividends earned. From the start date 20 years ago till now, the historic P/E has hardly changed at all and thus has had an insignificant impact on the price of the index over this period.

Figure 3: S&P 500 P/E ratio, 2003-2023
Source: Anchor, Bloomberg



The historic P/E of the S&P 500 has ranged from about 11x to 27x over the past 20 years, with an average rating of 13.7x over the period. An interesting exercise would be to examine what the valuation contribution could have been if we had invested in September 2011 at the S&P 500's cheapest valuation of 11.2x and held to 21.9x today, increasing 95% or 5.6% p.a. In this scenario, we have almost perfectly timed the buying of the market, and our annualised total return from this point would have been 13.8% p.a. Interestingly, it still would not have contributed more to your total performance than earnings growth, which has grown at an annualised rate of 6.1% since September 2011.

Figure 4: S&P 500 breakdown of annualised returns since 2011*
Source: Anchor, Bloomberg



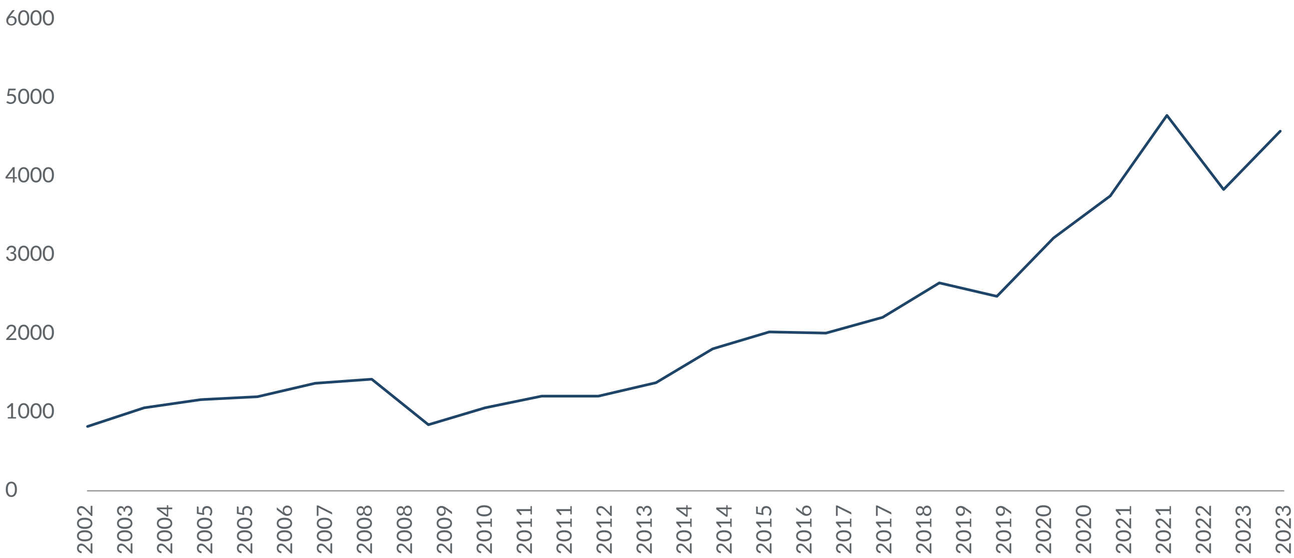
Even by picking your index buy point perfectly, it still would not have contributed more to your total return than earnings growth.

Conversely, if you overpay on the valuation, you may experience a negative return over the short term. Still, you should be confident that future earnings growth will float you back to profitability.

Another interesting exercise is to calculate the total performance over 20 years, where you reinvest it into the market each year instead of spending your earned dividends. On average, the after-tax dividend has been approximately 1.6% p.a. Although this does not sound like much on its own, if we reinvested this cash flow into additional units of the index, we would boost our total return from 345% to 458%.

This proves the age-old adage that "it is not about timing the market, but about time in the market." Even though markets are very volatile in the short term, they show relatively smooth returns over the long term. If you had the fortitude to only look at your portfolio once per year at the end of December, you would likely have been oblivious to the worst dips that occurred during the year, and your state of mind would be far more at ease.

Figure 5: S&P 500 Index December price*
Source: Anchor, Bloomberg



**We note that an annual price graph shows a much smoother market performance over the long run.*

Riding the Wave: Sectors Thriving as Interest Rates Fall

WRITTEN BY:
Reko Nare
Portfolio Management

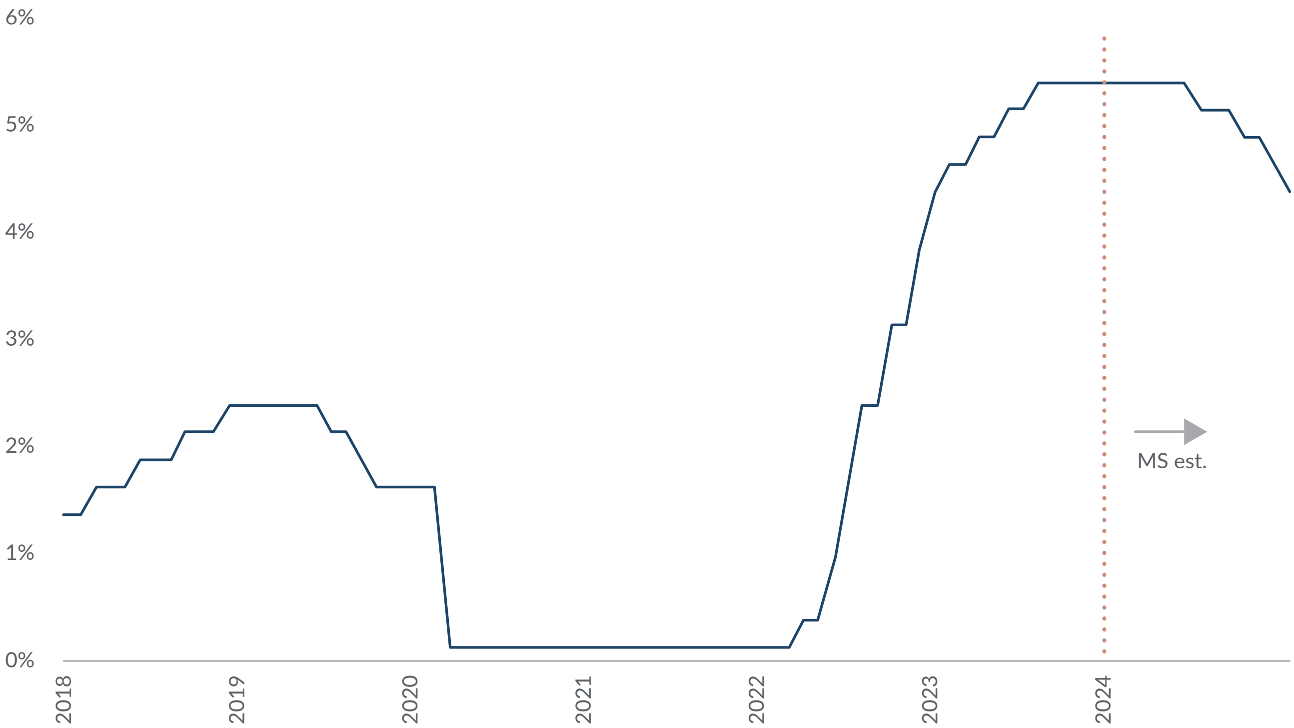
Reko is an economics graduate from the University of Pretoria. He holds a postgraduate diploma in investment analysis and portfolio management from UNISA and is currently pursuing a CFA designation. Reko is a member of the South African Institute of Financial Markets and joined the portfolio management team focusing on servicing the investment needs of high-net-worth clients in South Africa.

SETTING THE SCENE

Against a backdrop of soaring inflation (reaching levels last seen four decades ago) that has shaped the global investment landscape since 2021, central banks globally have responded with decisive measures. These have included notable reductions in their balance sheets and substantial interest rate hikes, collectively contributing to heightened levels of volatility across asset classes globally over the past 24 months.

As inflation is widely believed to have reached its peak, the assumption is that central banks are now pivoting away from hiking rates as global growth starts to soften due to the higher interest rate environment. Amid market participants forecasting a slowdown in global growth for 2024 and some anticipating the potential for a shallow recession, attention has shifted toward the prospect of rate cuts. Some participants even anticipate these cuts to begin as early as 1H24. The graph below shows the upper limit of the federal funds target range set by the US Fed's Federal Open Market Committee (FOMC). Additionally, it includes estimates from the global investment firm *Morgan Stanley* on its anticipated timing for the US Fed's first interest rate cut, which is expected to take place in the middle of 2024.

Figure 1: Federal funds target range – upper limit
Source: Bloomberg, Morgan Stanley



Given these expectations, investors are faced with the crucial task of determining which sectors and individual stocks are positioned to thrive in a decelerating growth environment, potentially leading to a shallow recession and the subsequent declining interest rates. This article explores the historical impact of different interest rate regimes on equity market returns, shedding light on those sectors that have historically outperformed during periods of slowdown, recession, and recovery in the economic cycle, along with decreasing fund rates.

WHY STOCKS THRIVE AS INTEREST RATES FALL

The rationale behind why stock prices rise as interest rates fall lies in the impact of falling discount rates on the present value of equities. The assumption is that as discount rates decrease, the current value of future cash flows from stocks rises, thereby pushing up stock prices. An illustration of this dynamic unfolded during the COVID-19 pandemic. In response to the economic challenges posed by the pandemic, central banks globally, including the US Fed, swiftly implemented substantial interest rate cuts. This aimed to stimulate economic activity and prevent a prolonged downturn in the global economy.

The consequence of these drastic rate cuts was a significant boost to equity valuations. Investors seeking returns in an environment of lower interest rates turned to stocks as attractive investments. The increased demand for equities and the lowered discount rates contributed to a notable surge in share prices.

Investors seeking returns in an environment of lower interest rates turned to stocks as attractive investments.

Given historical trends and recent events, the empirical support for the idea that shares tend to perform well when interest rates decline is noteworthy. The following graph, once again from *Morgan Stanley*, illustrates the average monthly S&P 500 returns during periods characterised by falling, flat, and rising interest rates. The chart illustrates that the S&P 500 experiences an average monthly growth rate of 1.7% during a US Fed rate-cutting cycle. This contrasts with the positive 1.2% growth rate observed in stable or flat rate environments and stands in even starker contrast to the negative return of 0.4% during a rate-hiking cycle.

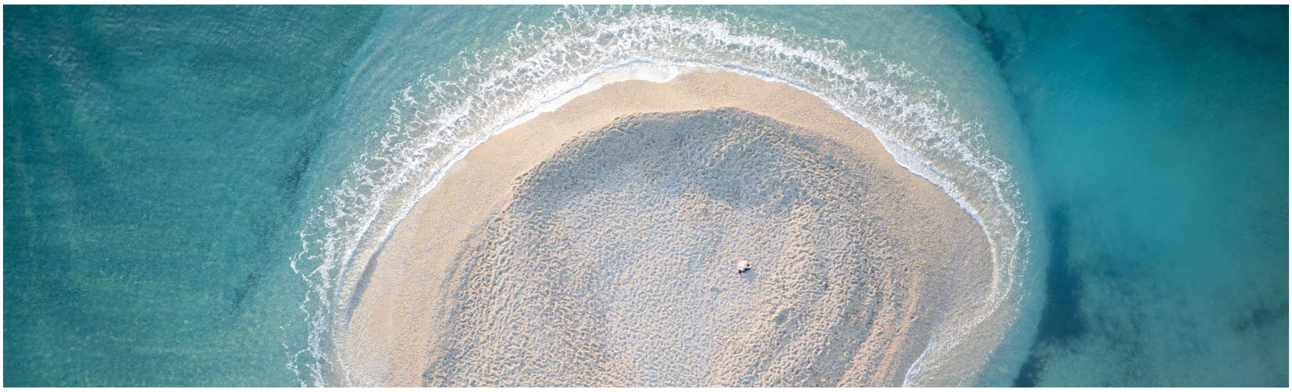
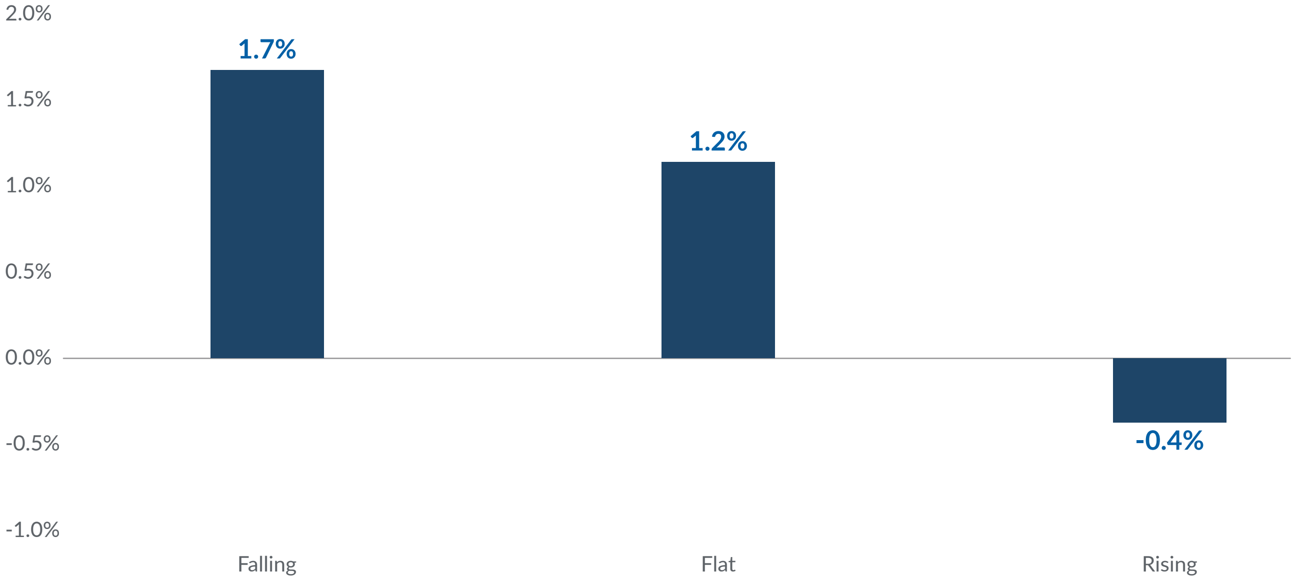


Figure 2: Average monthly S&P 500 returns in different fed funds rate regimes
Source: Bloomberg, Morgan Stanley



PERFORMANCE TRENDS OF S&P 500 SECTORS ACROSS THE BUSINESS CYCLE

Looking at the performance of various S&P 500 sectors throughout distinct phases of the business cycle since 1960 provides some valuable insights. Recessions, commonly defined as two consecutive quarters of falling GDP, signify a substantial decline in economic activity, reduced outputs, and diminished aggregate demand from consumers and businesses. These periods often witness increased unemployment, low consumer confidence, and a contraction in domestic production, leading to monetary policy interventions to stimulate aggregate demand through interest rate reductions.

Since 1960, seven recessions have occurred. Looking at the average sector returns during these downturns shows that Consumer Staples, Utilities, and Health Care consistently outperformed the overall market by an average of 10% in six of the past seven recessions.

Economic recovery, the subsequent phase following a recession, is characterised by increased economic activity and growth. This period is marked by GDP expansion and a surge in aggregate demand. Consumers show optimism about economic growth, capitalise on low interest rates, and increase discretionary spending, while businesses stop cutting back on commercial activity. Over the past 60 years and across the last seven recovery periods, the Real Estate and Consumer Discretionary sectors have consistently outperformed the market following periods of economic contractions.

Figure 3: Performance trends of S&P 500 sectors across the business cycle
Source: SPDR Americas Research. 2019. Sector Business Cycle Analysis.

1 SLOWDOWN

Rank	S&P 500 sector	Average period return
1	Health Care	15%
2	Consumer Staples	15%
3	Financials	14%
4	Utilities	12%
5	Industrials	12%

2 RECESSION

Rank	S&P 500 sector	Average period return
1	Consumer Staples	1%
2	Utilities	-2%
3	Health Care	-3%
4	Energy	-4%
5	Consumer Discretionary	-12%

3 RECOVERY

Rank	S&P 500 sector	Average period return
1	Real Estate	39%
2	Consumer Discretionary	33%
3	Materials	29%
4	Information Technology	28%
5	Industrials	27%

4 EXPANSION

Rank	S&P 500 sector	Average period return
1	Information Technology	21%
2	Financials	19%
3	Real Estate	18%
4	Consumer Discretionary	17%
5	Industrials	16%

SECTORS OUTPERFORMING IN FALLING INTEREST RATE ENVIRONMENTS

Recession and recovery represent distinctive phases in the economic cycle, marked by falling interest rates. As we have seen, specific sectors consistently show strong performances during these business cycle stages, given the defensive nature of their business during recessions and the favourable impact of lower borrowing costs and increased consumer spending during recovery periods. Standout sectors under these conditions include Consumer Staples, Utilities, and Health Care during recessions and Real Estate and Consumer Discretionary during recoveries.

Non-cyclical sectors such as Consumer Staples, Utilities, and Health Care show resilience during economic slowdowns and recessions, as their businesses are not tied to discretionary spending and are less sensitive to economic fluctuations. In the recovery phase, an uptick in the labour market and consumer confidence drives increased discretionary spending on durable goods, restaurants, and travel, which benefits Consumer Discretionary sectors.

The subsequent low interest rates and eased monetary policies make real estate acquisition more affordable and accessible.

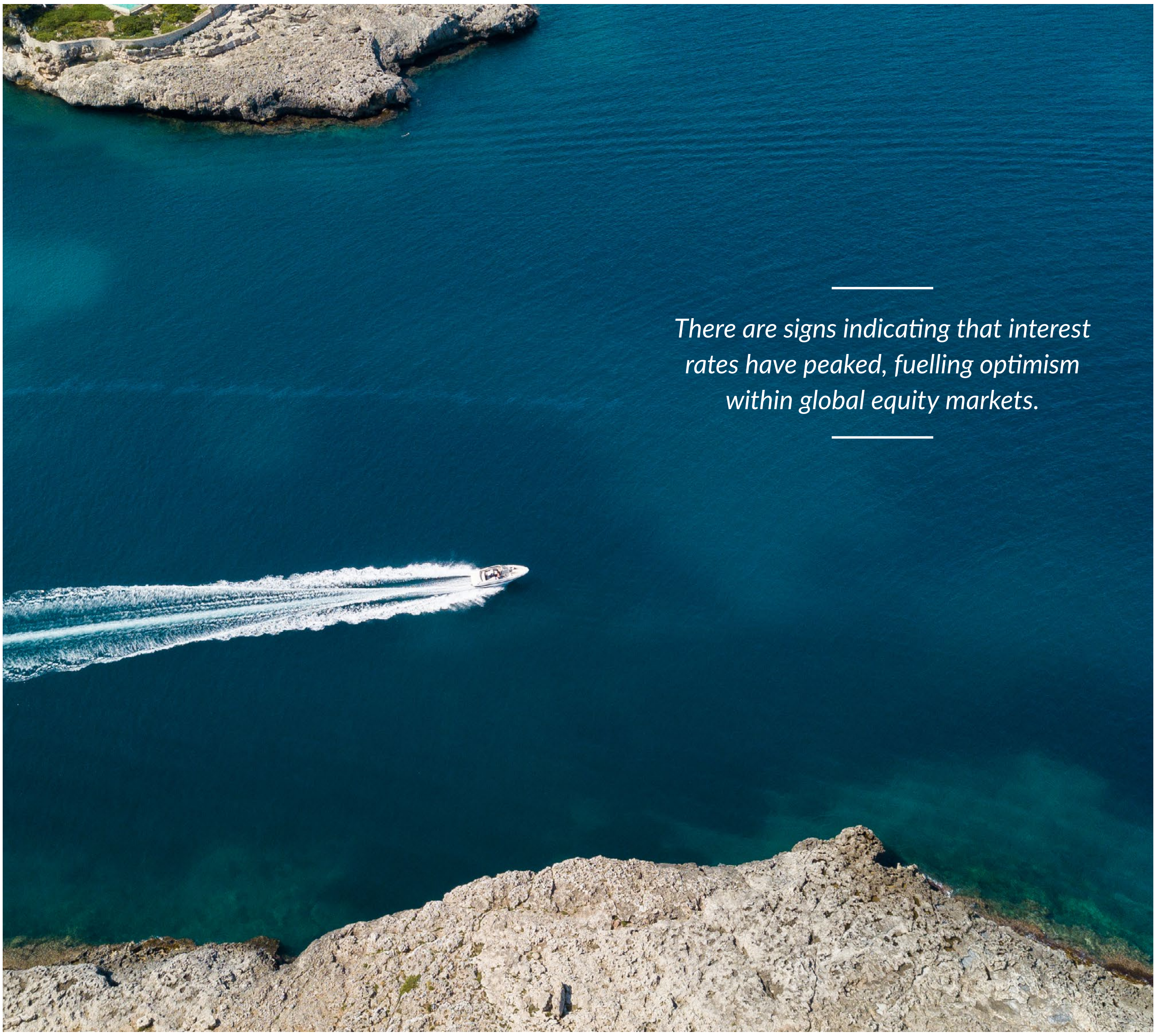
Although recessions typically impact the Real Estate market significantly, the subsequent low interest rates and eased monetary policies make real estate acquisition more affordable and accessible. The recovery in commercial activities also enhances the value of commercial real estate and contributes to the sector's notable outperformance during the recovery phases of the economic cycle.

Conversely, sectors that thrive during a recession — specifically Consumer Staples, Utilities, and Health Care — lose their appeal as the market rebounds. Investors then pivot towards more cyclical sectors to capture opportunities in the market, indicating a shift in preferences as economic conditions improve during the recovery period.

CONCLUSION

Looking ahead to 2024, there is little doubt that the global economic slowdown is underway. The key question is whether this deceleration will tip the global economy into a recession and when we might start seeing a decline in interest rates. Investors are currently focused on navigating these market dynamics as the landscape evolves in the coming year.

On the one hand, global equity markets grapple with significant macroeconomic risks, and various economists project a slowdown in global growth and anticipate declines in company margins and profit growth. On the flip side, a noticeable shift in investor sentiment has already occurred as inflation retreats from multi-decade highs. There are signs indicating that interest rates have peaked, fuelling optimism within global equity markets. With inflation trending downward and the potential for accommodative monetary policies, the outlook for specific sectors and equities looks compelling for investors prepared to ride the wave.



Achieving a soft landing is possible, but recession risks remain high

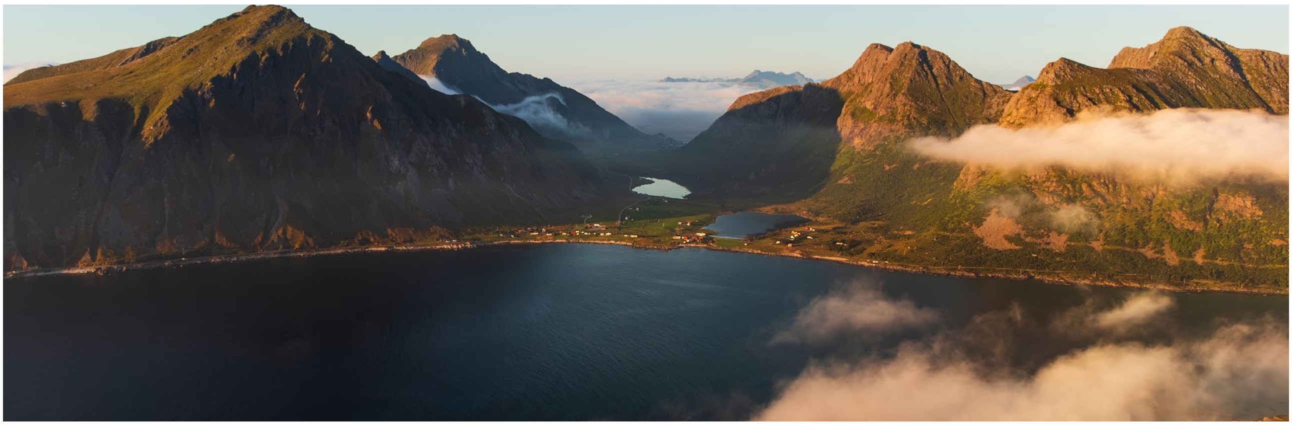
WRITTEN BY:
Lelethu Poswa
Fixed Income Analyst

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

The US Fed is facing a difficult challenge - bringing inflation back to its 2% target without triggering a recession. This precarious balancing act is known as a soft landing. Soft landings are the holy grail of monetary policy. However, achieving this feat has historically proven challenging for the Fed. Since 1980, the Fed has embarked on eight monetary tightening cycles (excluding the current one), with the US economy tipping into a recession six times (see *Figure 1*). So far, the progress of the current tightening cycle has been relatively painless, as inflation has moderated while the labour market remains tight. This article explores why we believe recession risks remain high despite growing soft-landing optimism.

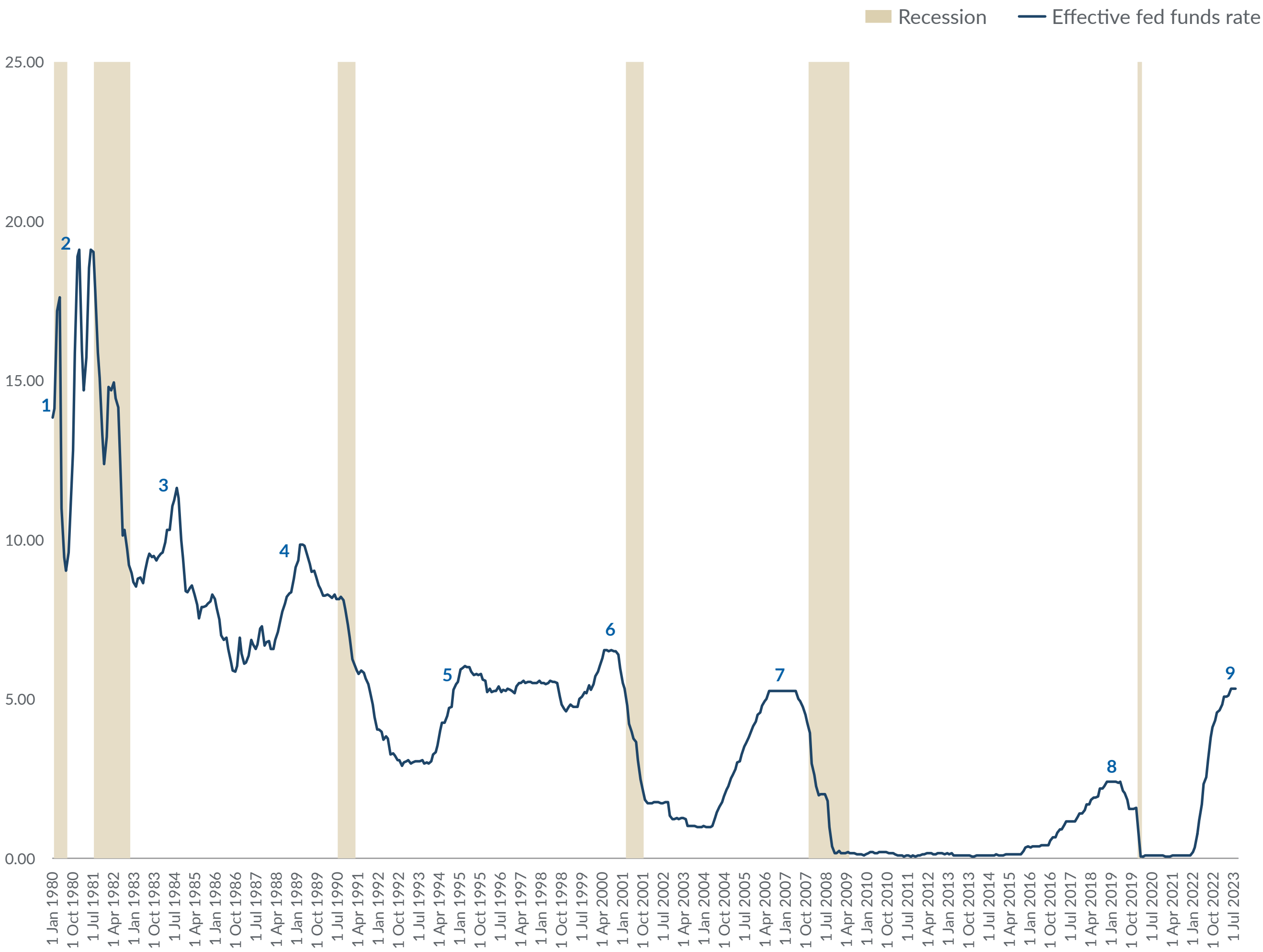
HOW DOES THE FED CONTROL INFLATION?

When the Fed is concerned about actual or developing inflation, it raises the interest rate in the federal funds market. This action subsequently increases other interest rates throughout the economy via financial arbitrage. Higher interest rates make credit more expensive and dampen aggregate demand, especially for houses and vehicles. Dampened aggregate demand reduces inflation. If the Fed raises the policy interest rate just enough to slow the economy and bring inflation down (closer to its 2% target) without causing a recession, it is known as a soft landing.



A classic example of a soft landing is the monetary tightening cycle conducted under former Fed Chair Alan Greenspan in the mid-1990s (see *Figure 1*). However, if the Fed raises the policy interest rate too much, it may cause a recession – this is known as a hard landing. An example of a hard landing is the monetary tightening cycle conducted under another former Fed Chair, Paul Volcker, in the early 1980s (see *Figure 1*).

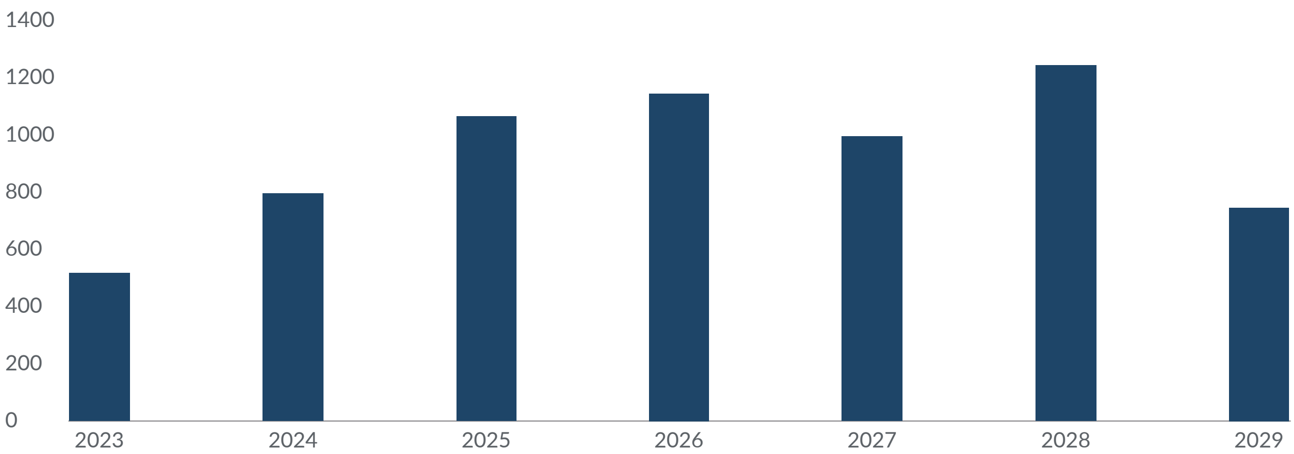
Figure 1: The effective federal funds rate, 1980-2023
Source: Anchor, Federal Reserve Economic Data



THE CURRENT MONETARY TIGHTENING CYCLE

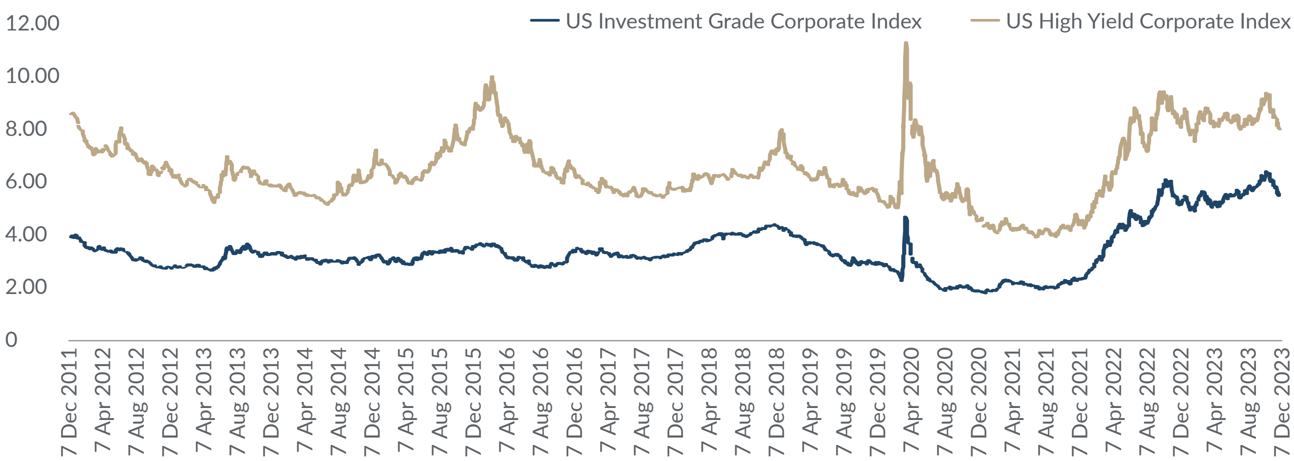
Since 2022, the Fed has raised the fed funds target range to 5.25%-5.5%. The Fed's current policies include unconventional monetary policy tools such as quantitative tightening (QT). So far, a recession has not occurred. US economic data has revealed a moderation in price pressures and a gradual cooling of the labour market – indicating a relatively painless progress in the Fed's fight against inflation. This has fuelled optimism for a soft landing, with many investors rethinking the narrative of higher interest rates persisting for an extended period. Indeed, the US economy has shown surprising resilience thus far. However, we remain attuned to the following recessionary risks.

Figure 2: US corporate debt refinancing risk on the rise, US$bn (US corporate [IG and HY] debt maturity profile
Source: Anchor, Federal Reserve Economic Data



The pace of US corporate debt (investment-grade [IG] and high-yield [HY]) maturing picks up sharply from 2024 onwards, following muted refinancing needs due to the cheap debt raised in 2020 and 2021. US corporate debt maturities increase from US$500bn in 2023 to US$800bn, US$1.1trn, and US$1.15trn in 2024, 2025, and 2026, respectively (see *Figure 2*)

Figure 3: US corporate debt refinancing risk on the rise - interest costs have risen significantly for US corporate bonds, %
Source: Anchor, Federal Reserve Economic Data



The Fed's tightening cycle has increased corporate funding costs over the past few years. To provide context, US IG corporate borrowing rates are now three times higher than those seen in 2020-2021 and nearly double the rates witnessed between 2012 and 2019 (see *Figure 3*). Similarly, the US HY corporate borrowing rates have doubled compared to the 2020-2021 levels (see *Figure 3*).

Corporates typically refinance debt obligations several months in advance. This means that US corporates aiming to refinance upcoming debt obligations today will continue encountering at least twice as high funding costs due to elevated interest rates. As these substantial debt maturities approach, US corporates will confront challenging decisions. They must choose between reducing their debt levels and scaling down their operations or implementing cost-saving measures, such as job cuts, to facilitate refinancing at double the cost, maintaining their sustainability.

US corporates aiming to refinance upcoming debt obligations today will continue encountering at least twice as high funding costs due to elevated interest rates

The combination of tighter financial conditions stemming from increased funding costs, rising operating expenses due to inflationary pressures, and the substantial rise in refinancing requirements due to significant debt maturities will hasten the softening of the labour market, accelerate the pace of corporate defaults and cause a harder slowdown in economic activity. A similar situation is also observed in Europe.

THE PRESENCE OF EXTERNAL SHOCKS COMPLICATES LANDINGS

Steering the economy toward a soft landing is a delicate task that can be easily disrupted by external shocks—shocks beyond the scope of monetary policy. Examples of such shocks include supply and fiscal shocks. Central banks, including the Fed, have various conventional and unconventional monetary policy tools to fight or stimulate inflation. However, these tools primarily target aggregate demand, leaving the Fed with very little control over aggregate supply.

Historically, adverse supply shocks, such as oil and food shocks, have complicated the mission of achieving a soft landing, often leading to severe recessions. A prime example is the Fed's tightening cycle from 1972 to 1974, which was significantly affected by two adverse supply shocks (oil and food) and the end of price controls. Another instance is the Fed's late 1980s and early 1990s endeavour, which faced negative impacts from adverse supply shocks (particularly oil shocks) triggered by Saddam Hussein's 1990 invasion of Kuwait.

Fiscal shocks have also historically caused turbulence in achieving a soft landing. An example is the Fed's modest tightening cycle from 1965 to 1966. The Fed embarked on a tightening cycle because it was worried that the overheating economy (caused by the increased defence spending for the Vietnam War in the mid-1960s) may be inflationary. These worries proved to be well-founded.

External shocks, such as supply and fiscal shocks, have impacted the current tightening cycle. These external shocks are:

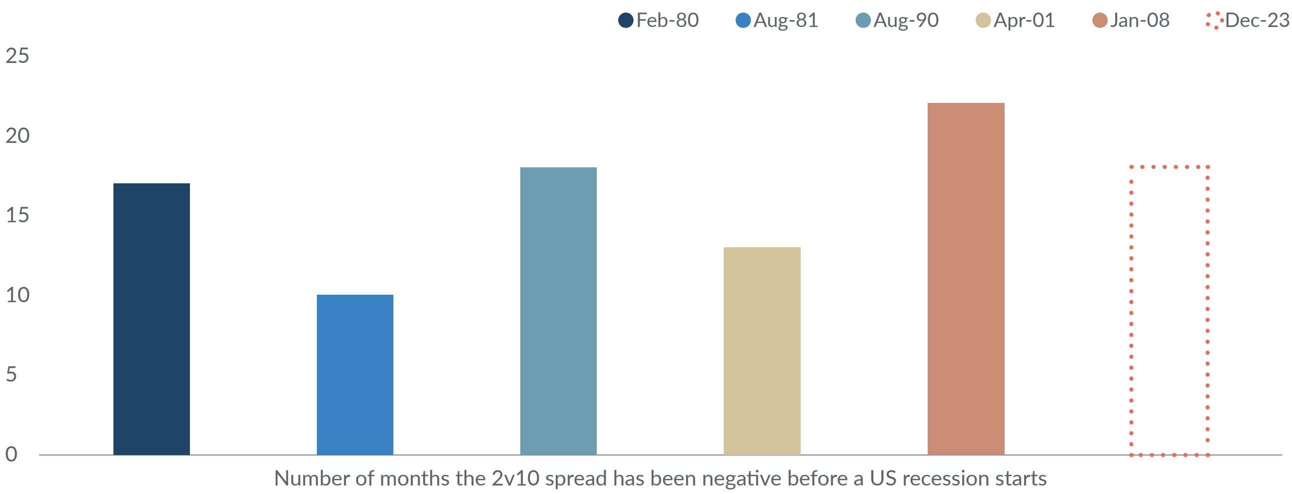
1. COVID-19-induced global supply disruptions.
2. Oil shock.
3. Food shock.
4. COVID-19-induced fiscal stimulus.

All four external shocks in the current cycle are inflationary, making it more challenging for the Fed to rein in inflation. This means that the Fed becomes forced to keep interest rates higher for longer as it fights against stubbornly high inflation. The longer the interest rate stays elevated, the harder the economic slowdown.

LONG AND VARIABLE LAGS IN MONETARY POLICY CREATE A HUMAN DANGER.

Monetary actions, such as changes to the policy interest rate, take time to impact various elements of the real economy, like inflation, employment, and economic growth – a phenomenon known as the long lags. The lags are also variable as the time between cause and effect can differ for each element and tighten the cycle in a nearly impossible way to predict. Moreover, external shocks can extend these lags, creating a real human danger as policymakers might witness minimal or no immediate effect in reducing inflation due to these additional inflationary pressures. Consequently, they may continue raising interest rates beyond what is necessary to reduce inflation, potentially leading to a hard landing. All else equal, altering interest rates until its full effects on the real economy can take a year or two. Despite the tightening nearing the two-year mark, many believe that the full impact of the current tightening is still working its way through the real economy, given the continued strength of the labour market and growth acceleration.

Figure 4: The recession indicator is still on
Source: Anchor, National Bureau of Economic Research



Bond markets, by nature, are forward-looking - prices reflect what investors think will happen to the economy in the future. The bond market is still calling a recession, albeit with a lower probability than 12 months ago. Historical data suggest that yield curve inversion often precedes a recession – it is considered a key recession indicator. When the 2v10 spread (the difference between the yield on the 10-year US bond and the yield on the 2-year US bond) turns negative, the yield curve is considered inverted. Since the late 1970s, an inverted US yield curve has been able to anticipate five of the six recessions. *Figure 4* shows the number of months the 2v10 spread was negative before a US recession started in 1980. The average number of months is 16 – a recession generally hits the US economy 16 months after the US yield curve inverts. After more than 500 bps of Fed hikes, today's US yield curve has been inverted for about 18 months, well within historical standards.

What I learned about investing from "What I learned about investing from Darwin"

WRITTEN BY:
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Fund Management

Nick has managed the Anchor Global Equity Fund (which won three Raging Bull Awards) since March 2015. Before joining Anchor, Nick was a senior investment manager in the Emerging Market Equities team at Pictet Asset Management in London. Nick is a CA (SA) and CFA Charterholder.

I am a voracious reader, and I have developed a pet theory - most non-fiction books would be better if they had been written as articles instead. Punchy and to the point! Typically, the author has one or two big ideas which are spelt out in the first few chapters, with the remaining 300-plus pages dedicated to providing endless examples to 'bulk up' the book. Since I value my time, if I think a book's subject sounds interesting, I will often just listen to an interview with the author, who usually explains the key concepts well in under half an hour. If my interest is sufficiently piqued, I will buy the book. I often stop reading before the halfway mark, having absorbed the author's main messages.

Occasionally, there are books that are so rich that I finish them completely and re-read them every few years. I also make notes and highlights on my Kindle and revisit those more frequently. There are countless books about investing and trading, with the majority adding little to the corpus. Recently, however, I found a gem called *"What I learned about investing from Darwin"* by Pulak Prasad, a fund manager working for Nalanda Capital, which focuses solely on Indian equities. Prasad has a passion for biology and evolution, which, as the name of the book implies, has given him unique insights into the parallels between the worlds of nature, business, and markets. Nalanda's long-term record is outstanding, adding credence to Prasad's perspectives.

FINCHES AND FOXES: LESSONS FROM THE NATURAL WORLD

Before you rush off to buy the book, I probably would not recommend it unless you are a full-time investor (or biologist, for that matter). Prasad dives into the topic of evolution in surprising depth, citing case studies on subjects ranging from Siberian foxes to Galapagos Island finches. While I found these fascinating, I nevertheless caught myself thinking, "This is all well and good Prasad, just get to the point about how this relates to investing!". In service of my pet theory, my goal with this article is to share the book's big ideas. Just be thankful I do not go through all 56 highlights and 13 notes from my Kindle!

Some of Prasad's observations and lessons might appear blindingly simple and obvious, but that does not mean implementation is easy. As the late (and ever forthright) Charlie Munger said, "It's not supposed to be easy. Anyone who finds it easy is stupid." Regardless, a number are profound and worth pondering:

1 **There are very few good investments in the market.**

2 **It is far more important to reduce errors of commission (i.e., buying a bad stock) than to reduce errors of omission (i.e., not buying a good stock, e.g., Apple).** I will not go into the mathematics and probabilities, but Prasad's logic is compelling. While academia and the investing profession concentrate on making good investments, we would be better off focusing on avoiding bad investments. Prasad contends that Warren Buffett is the best investor in the world because he is also the best rejector in the world.

3 **The more robust the company, the greater its ability to evolve.** This observation is relevant over longer periods; while smaller companies are often credited with being nimbler, the strong balance sheets and cash flows of larger, slower-moving companies allow them to survive first and then adapt and evolve through a range of environments.

4 **There is a treasure trove to be found in analysing the past.** The investment industry spends an inordinate amount of time attempting to predict the future. One can understand the temptation, given the potential rewards on offer. The future is unknowable; even if we could predict the exact path of the economy and individual businesses (we cannot), we still would not know how share prices would react. By spending our time analysing facts (rather than forecasts) like the company's financial statements and capital allocation history, we can gain greater insights than by peering into murky crystal balls.

5 **When evaluating a business, risk comes first, quality second, and valuation last.**

6 **Invest in convergent patterns (i.e., patterns that repeat).** 'Convergence' is a phenomenon in the natural world in which unrelated organisms develop similar solutions to similar problems. For example, eighteen types of plants have developed red flowers to attract hummingbirds for pollination. Applied to the business world, Nalanda has found that business models that are successful in the US are more likely to be successful in India. Conversely, traditionally challenging industries, like airlines, are more likely to fail, even in nascent growth markets like India. Prasad notes a big difference between asserting "I love this business" and "I love this business construct". Nalanda does not care about a business; it is deeply attached to a business template. For example, it would have been more beneficial to note the patterns Apple shares with branded consumer staples and luxury goods companies rather than getting lost in the weeds on its hardware business.

7 **Convergence is the dominant pattern in the business world.** There are definitive patterns to the success and failure of companies. It makes sense to ask where one might have seen a business template before and what the outcome was.

8 **When you find high-quality businesses that do not fundamentally change their character over the long term, one should exploit short-term fluctuations for buying rather than selling.** The critical phrases are 'high-quality' and 'that do not change'; bending these criteria even slightly to average down in average quality businesses can be disastrous.

9 **Business stasis is the default (i.e., good companies tend to stay good and bad companies stay bad), so it does not make sense to be highly active if you hold a good company.**

10 Given this logic, Prasad advocates for **being a 'lazy' buyer and a 'very lazy' seller** (only in the context of the highest-quality companies). Nalanda has taken this ideology to an extreme, only buying during the global financial crisis, the European crisis, and the COVID-19 pandemic.

11

One of the mysteries of compounding is that it leads to large numbers but does not do so for a long time. Patience is everything in investing; unsurprisingly, it is also arguably the hardest thing.

12

Perhaps surprisingly, Nalanda has no interest in finding the 'best investment'. Rather, it is focused on **executing a sound investment process which is simple and repeatable.** The real challenge is discipline: tuning out the incessant noise and turning the theory of investment management into practice day after day, year after year.

These tenets are not intended as a to-do list or template for success. There is no 'one true path' to win in the market. Certain investors have a multi-decade horizon, while others (traders) could have a holding period ranging from seconds to days. Legendary trader Steve Cohen would be hopeless trying to emulate Warren Buffett, and vice versa. Regardless, as Prasad reveals, certain fundamental truths and processes operate within nature, business, and markets. As investors, we need to be aligned with those truths, or we are doomed to fail. If you repeatedly buy the shares of bad businesses in the hope that they will improve, you cannot expect to succeed.

In a world of ceaseless change, "*What I learned about investing*" is a timely and comforting reminder that some things (like outstanding businesses) only change gradually. It is also reassuring that, in a noisy era of instant gratification, quieter attributes like discipline and patience can still be highly rewarding. Finally, the revelation that extreme laziness is the greatest of virtues must be the most counterintuitive and gratifying conclusion in anyone's book.

SARS and the Voluntary Disclosure Programme

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

Most of you may look at the heading of this article and assume it bears no relevance to your circumstances. Unfortunately, we have often found that clients do not know that they have fallen foul of their tax reporting obligations or that something needs to be done. Below, we explore the Voluntary Disclosure Programme (VDP), and by asking some questions, we hope to help you assess whether you should be looking at this programme to regularise any of your tax affairs.

The VDP is permanently available to a qualifying individual, company or trust that seeks to voluntarily disclose and regularise their tax affairs.

Please note that this article refers **ONLY** to the South African Revenue Service (SARS) VDP programme, and it does not include non-compliance on exchange control matters, which is regulated by the South African Reserve Bank (SARB).

WHAT IS THE PERMANENT VDP?

'The South African Revenue Service (SARS), in terms of the Tax Administration Act No. 28 of 2011, has made provision for the Voluntary Disclosure Programme (VDP) to be permanently available to a qualifying individual, company or trust that seeks to voluntarily disclose and regularise their tax affairs. This step is aligned to the SARS' strategic objective, which seeks to provide clarity and certainty as well as make it easy and seamless for taxpayers and traders to comply with their obligations.' (extract from SARS.gov.za website).

WHY IS THERE A VDP?

The SA tax landscape is complex and challenging. Over the years, SARS (and the SARB) have put specific VDPs (often referred to as amnesties) in place with fixed rules that apply to the various VDPs. There was a VDP in 2003/2004 and several more since then, the last being in 2016, referred to as a Special Voluntary Disclosure Programme (SVDP). The VDP we cover in this article is a **PERMANENT** VDP and has been implemented as a mechanism promoting tax compliance without punitive measures. It acknowledges that taxpayers may unintentionally fall short of compliance for several reasons.

FEATURES OF THE VDP:

Scope of disclosure: The VDP covers a broad spectrum of undisclosed tax affairs, including unreported income, incorrect tax returns, and other tax-related liabilities. This includes local and offshore assets – we have come across both types of assets requiring disclosure, but offshore seems to be a particular focus.

Perhaps a few questions would assist here as further explanation and give you an idea as to whether you may be non-compliant:

- Have you applied for the Portuguese Golden Visa programme and bought a property you rent out? If so, have you declared the rent?
- Have you been 'gifted' property in the UK and not declared it and any income you may be earning?
- Have you sold investments and omitted to include the capital gains in your tax return?
- Have you earned interest or 'deemed' interest on loans you have made?
- Do you have an offshore share portfolio but have not declared the dividends earned?
- Have you received a distribution from an offshore trust and not declared it?

Please note the fact that you have paid tax in another jurisdiction does not mean you are tax-compliant in SA!

Eligibility: The VDP is open to individuals and businesses who wish to rectify their tax affairs voluntarily. The disclosure **must** be voluntary and must not result in a refund. The taxpayer must not have disclosed a similar default in the preceding five years, and the taxpayer **must** initiate the process BEFORE any prompting or investigation by SARS. It is important to note that the current Common Reporting Standards (CRS) legislation in place means that SARS will likely find you considering the financial data it receives on global and local transactions. Non-compliance is not considered a VDP offence.

Penalty relief: The **primary** incentive to participate in a VDP is the potential relief from specific penalties. The taxpayer must still pay the outstanding taxes, but penalties typically levied for non-compliance may be reduced or waived. The VDP process is silent on the remission of interest.

Limited criminal prosecution: Taxpayers who voluntarily disclose their undisclosed tax affairs are generally protected from criminal prosecution.

Confidentiality: SARS treats the information disclosed in the VDP as confidential.

Application process: This involves submitting a detailed disclosure statement to SARS and includes a comprehensive overview of the undisclosed tax affairs, the nature of the non-compliance, the periods involved (often several years) and the corrective measures taken.

The more detailed and accurate the information you provide, the better your chances of a successful VDP.

Our recommendation on applying is to consult a VDP expert, i.e. someone who does this for clients regularly and understands precisely how the authorities require the information to be submitted and the possible queries the tax authorities will raise. The more detailed and accurate the information you provide, the better your chances of a successful VDP. The application has to be submitted via e-filing.

BENEFITS OF THE VDP

Some of the benefits to consider include the following:

- Avoiding harsher penalties – one can avoid the penalties that would be imposed if SARS discovers the irregularities before they are voluntarily declared.
- Legal certainty – SARS cannot pursue further action once the disclosure is accepted.
- Global tax compliance – with the increasing focus on international tax transparency, the VDP assists individuals with offshore assets in complying with global tax standards.

CONCLUSION

In conclusion, it is important to notify SARS of any non-compliance before the tax authorities contact you. If you think there is an issue and/or that you may be subject to exchange control non-compliance, please contact us to discuss it so we can ascertain whether there is a problem and the best way to tackle it. As mentioned, in our experience (and we have been involved in several VDPs since 2003), it is always better to use the services of an expert.

Please email Di Haiden at ***di@rcinv.co.za*** *if you require further assistance.*

Performance Summary

	FUND PERFORMANCE									BENCHMARK PERFORMANCE							
	Start date	Annualised p.a.	Since inception	5 Year	3 Year	12-month	6-month	3-month	Dec-23	Since inception	5 Year	3 Year	12-month	6-month	3-month	Dec-23	Performance vs Benchmark
UNIT TRUSTS																	
Anchor BCI Equity Fund	Apr-13	9.1%	154.9%	7.0%	9.7%	11.9%	3.0%	7.5%	1.6%	136.3%	9.0%	12.7%	7.9%	4.1%	8.2%	2.9%	18.6%
Anchor BCI SA Equity	Aug-21	10.2%	24.7%	N/A	N/A	7.5%	3.5%	5.5%	1.5%	23.1%	N/A	N/A	7.9%	4.1%	8.2%	2.9%	1.6%
Anchor BCI Flexible Income Fund	Jun-15	7.2%	81.1%	6.9%	6.4%	9.3%	5.6%	3.9%	1.3%	77.7%	6.4%	6.4%	8.8%	4.5%	2.2%	0.7%	3.4%
Anchor BCI Managed Fund	Jan-15	5.9%	66.7%	8.6%	9.4%	13.9%	5.1%	8.0%	2.0%	76.5%	9.2%	10.5%	12.3%	4.6%	6.2%	2.0%	-9.8%
Anchor BCI Worldwide Flexible Fund	May-13	10.5%	188.9%	11.6%	8.3%	30.6%	5.8%	7.9%	1.6%	153.0%	9.0%	10.1%	9.5%	4.8%	2.4%	0.2%	36.0%
Anchor BCI Property Fund	Nov-15	-1.8%	-13.7%	-1.4%	10.3%	4.9%	8.9%	12.7%	8.5%	-8.8%	0.2%	14.9%	10.1%	15.2%	16.4%	9.9%	-4.9%
Anchor BCI Global Equity Feeder	Nov-15	12.2%	155.2%	18.8%	-0.8%	14.3%	1.7%	4.7%	1.7%	171.2%	17.2%	13.8%	31.0%	4.2%	7.3%	1.4%	-16.0%
Anchor BCI Bond Fund	Feb-16	8.7%	93.8%	8.0%	6.9%	9.6%	7.4%	8.1%	1.4%	94.6%	8.2%	7.4%	9.7%	7.7%	8.1%	1.5%	-0.8%
Anchor BCI Diversified Stable Fund	Feb-16	7.6%	78.8%	8.6%	9.8%	11.7%	5.5%	6.0%	1.6%	67.3%	7.8%	8.5%	11.0%	5.0%	5.4%	1.6%	11.5%
Anchor BCI Diversified Moderate Fund	Feb-16	7.3%	74.6%	9.0%	11.1%	11.8%	4.7%	5.5%	1.8%	67.6%	8.6%	9.4%	11.3%	4.3%	5.8%	1.7%	7.1%
Anchor BCI Diversified Growth Fund	Feb-16	7.0%	70.6%	9.4%	12.3%	13.5%	4.8%	6.2%	2.1%	70.8%	9.2%	10.5%	12.3%	4.6%	6.2%	2.0%	-0.2%
Anchor BCI Africa Flexible Income	Mar-16	7.1%	71.6%	8.4%	6.0%	19.1%	9.6%	11.4%	6.3%	89.1%	7.9%	7.7%	10.0%	5.1%	2.5%	0.8%	-17.5%
Anchor BCI Global Technology Fund	Jun-19	9.4%	50.9%	N/A	-2.7%	37.2%	3.4%	13.1%	0.1%	191.2%	N/A	18.2%	62.3%	6.8%	14.1%	0.9%	-140.3%
Anchor BCI Flexible Fund	Jul-13	11.2%	204.0%	17.7%	12.0%	68.7%	13.3%	12.9%	0.4%	10.2%	10.0%	11.1%	10.5%	5.2%	2.6%	0.3%	193.8%
Anchor BCI Core Income Fund	Sep-20	6.9%	24.9%	N/A	7.0%	9.6%	0.0%	2.4%	0.7%	19.5%	N/A	5.7%	8.0%	4.2%	2.1%	0.7%	5.4%
Anchor BCI Global Flexible Income Fund	Sep-20	4.1%	14.1%	N/A	7.6%	14.1%	1.6%	1.7%	-0.5%	18.4%	N/A	10.4%	13.6%	-0.3%	-1.5%	-3.0%	-4.3%
Anchor BCI Worldwide Opportunities Fund	Feb-21	3.9%	11.5%	N/A	N/A	19.1%	3.9%	9.2%	3.1%	19.3%	N/A	N/A	5.5%	2.8%	1.4%	-0.1%	-7.8%
EQUITY NOTES & SEGREGATED MANDATES																	
Anchor Equity	Jul-13	9.2%	151.4%	10.0%	15.7%	11.9%	7.5%	10.6%	2.3%	134.6%	7.9%	12.7%	7.9%	4.1%	8.2%	2.9%	16.8%
HEDGE FUNDS																	
Anchor Stable SNN RIHF	Jul-03	12.3%	969.4%	9.2%	14.5%	9.6%	3.5%	2.9%	1.0%	308.0%	5.9%	5.7%	8.0%	4.2%	2.1%	0.7%	661.4%
Anchor Accelerator	Feb-16	6.1%	59.8%	7.7%	-2.8%	-2.0%	-0.6%	4.1%	0.9%	87.1%	6.3%	5.7%	8.0%	4.2%	2.1%	0.7%	-27.4%
OFFSHORE																	
High Street Equity - Dollars	Jun-12	9.7%	189.4%	9.2%	-0.7%	24.3%	4.2%	11.4%	5.1%	236.1%	13.4%	7.8%	24.4%	7.8%	11.5%	4.9%	-46.7%
High Street Equity - Rands	Jun-12	17.6%	547.3%	14.7%	6.9%	33.6%	0.9%	8.1%	1.5%	649.7%	18.9%	15.9%	33.4%	4.7%	7.8%	1.6%	-102.5%
Offshore Balanced - Dollars	Jun-12	7.4%	128.2%	5.7%	-0.7%	14.9%	3.9%	9.1%	4.3%	107.2%	7.7%	2.1%	16.3%	6.3%	10.1%	4.6%	21.0%
Offshore Balanced - Rands	Jun-12	15.3%	413.3%	11.0%	7.1%	26.0%	0.6%	5.9%	0.7%	357.3%	12.7%	9.5%	25.2%	3.4%	6.6%	1.5%	55.9%
Global Dividend - Dollars	Jan-14	7.5%	105.3%	8.5%	6.6%	11.8%	7.4%	9.8%	4.6%	149.9%	13.4%	7.8%	24.4%	7.8%	11.5%	4.9%	-44.6%
Global Dividend - Rands	Jan-14	13.0%	236.0%	13.7%	14.5%	19.9%	3.8%	6.4%	1.0%	310.3%	18.9%	15.9%	33.4%	4.7%	7.8%	1.6%	-74.2%
Anchor Global Stable Fund - Dollars	May-15	1.6%	14.4%	3.5%	0.3%	8.7%	5.5%	6.4%	3.0%	33.2%	3.9%	4.7%	6.3%	3.0%	1.4%	0.4%	-18.9%
Anchor Global Stable Fund - Rands	May-15	6.5%	71.9%	8.5%	7.9%	16.5%	2.5%	2.9%	-0.3%	101.5%	9.1%	12.8%	14.5%	0.3%	-1.6%	-2.2%	-29.6%
Anchor Global Equity - Dollars	May-15	10.3%	131.9%	16.3%	-6.1%	7.8%	4.5%	7.8%	4.2%	94.5%	11.7%	5.7%	22.2%	7.3%	11.0%	4.8%	37.4%
Anchor Global Equity - Rands	May-15	15.6%	248.5%	22.0%	1.0%	15.6%	1.5%	4.2%	0.8%	192.3%	17.2%	13.8%	31.0%	4.2%	7.3%	1.4%	56.2%
RCI UNIT TRUSTS																	
RCI BCI Flexible Growth Fund	Sep-16	9.0%	87.1%	13.2%	-0.3%	48.1%	8.7%	15.4%	5.3%	99.6%	10.0%	11.1%	10.5%	5.2%	2.6%	0.3%	-12.5%
RCI BCI Worldwide Flexible Fund	Dec-16	8.5%	78.4%	10.8%	4.5%	36.1%	3.8%	8.5%	2.9%	83.8%	9.0%	10.1%	9.5%	4.8%	2.4%	0.2%	-5.4%

DISCLAIMER

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