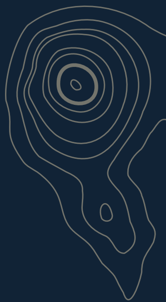
STRATEGY AND ASSET ALLOCATION REPORT

2nd Quarter 2023



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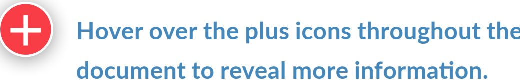

Introduction

WRITTEN BY:
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Chief Investment Officers

Fractures have begun to appear in the global economy as higher interest rates expose fault lines that were hidden from view. Three bank failures in the US and the forced sale of Credit Suisse have reminded us that there are limits to how high interest rates can go. Increasingly, there are signs that we are approaching peak interest rates. Yet, we think the journey to higher interest rates is ongoing, and we fully expect inflation to be with us for much of the next year.

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The investment landscape will remain volatile as central banks debate how high rates should go, and animosity between groupings of nations stands in the way of globalisation benefits that have been prevalent for much of the last decade. The consensus is that the next six months will be telling for the globe. Against this backdrop, we have seen asset prices that have risen to varying degrees while cash investments are attractive for the first time in a decade.

In this context, investors should be thinking about how to add risk and when to phase it in. The increased volatility also brings structured products and alternative investments to the fore. We believe that investors should consider upweighting their holding of these.

We continue to caution that now is not the time for wholesale changes to your portfolios. The risk of such changes resulting in permanent losses is too high. However, over time, if you need to adjust your risk tolerances, then a gradual and patient approach towards such changes is warranted. Therefore, we continue to advocate for asset class diversification domestically and abroad.

As you will see in this document, we are cautiously optimistic as to what the next twelve months hold for investments.

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		●		11
Bonds			●	10
Listed property	●			8
Cash	›	●		8
Alternatives*			●	10 to 15
Rand/US$ (rand stronger)				4
GLOBAL				
Equity		●	‹	8
Government bonds		●		4
Corporate credit		●		5
Listed property		●		6
Cash		●		4
Alternatives*			●	8 to 20

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

Asset Allocation Summary

This year started strong with better-than-expected outcomes for various asset classes as global financial markets rebounded from their 2022 lows. We find that global economic prospects are by and large unchanged, while financial asset prices are slightly higher as a starting point.

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 what the outcome will be in the various scenarios. From a global perspective, equity is the most attractive asset class though downside risks remain. We note that for the first time in decades, global bonds and global cash have compelling investment cases as well. Perhaps the most important change since our previous edition is that the range of expectations for all asset classes has narrowed, reflecting that investor confidence is returning as we progress through this part of the economic cycle.

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

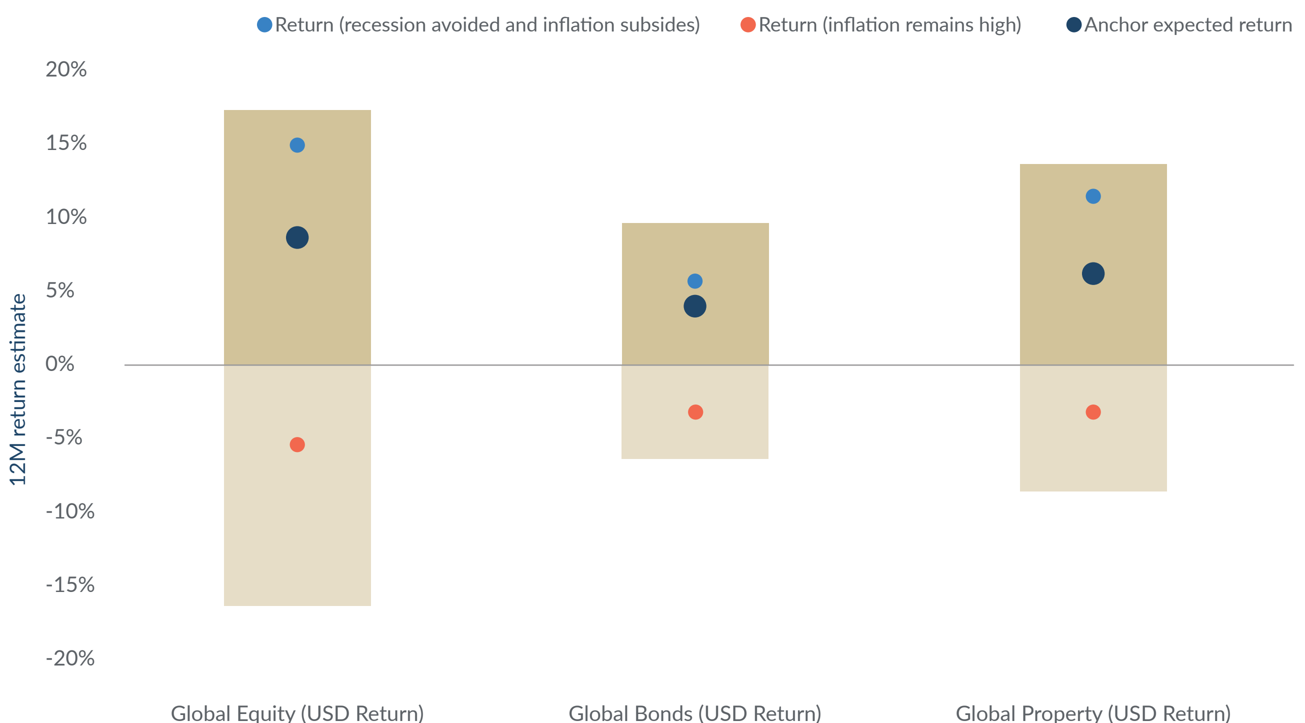
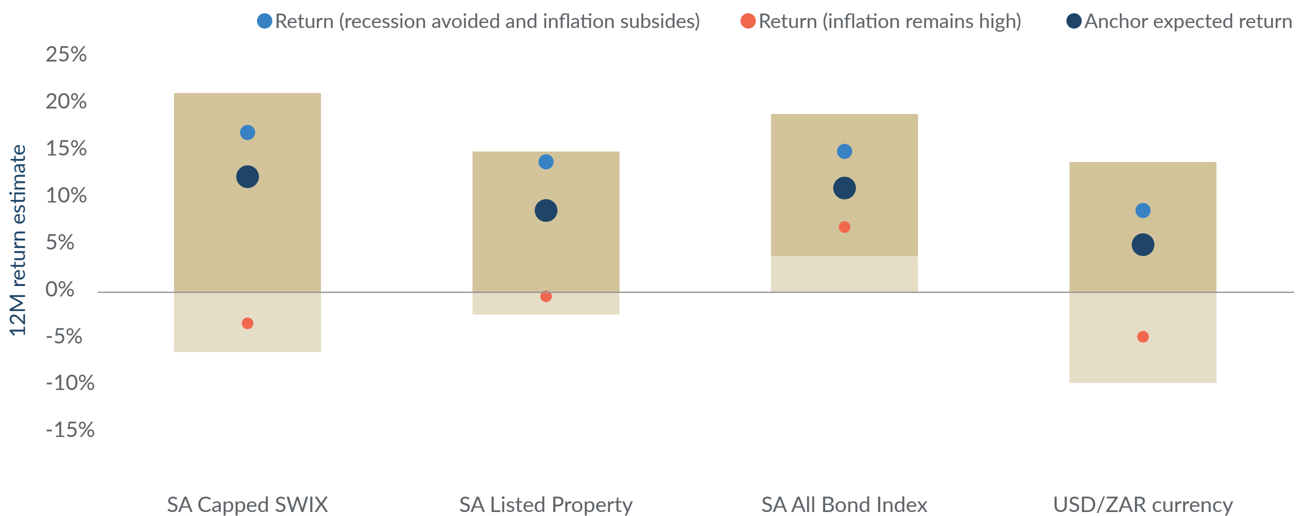


Figure 2: Anchor expected returns by offshore asset class
Source: Anchor

	Global equity	Global bonds	Global property
Anchor expected return (in US dollar)	8%	4%	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 what the outcome will be under the various scenarios. The local bond market is more compelling as loadshedding and other challenges create uncertainty around domestic earnings outlooks.

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



Domestically, we think this is a positive investment environment. All asset classes are positive and have compelling investment cases, although we believe that domestic bonds have the most compelling risk/reward relationship. We see the rand recovering over the next year, although this recovery will be uneven and less than many are forecasting.

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

	Domestic equity	Domestic bonds	Domestic property	US$/rand
Anchor expected return (in rand)	11%	10%	8%	4%

Strategy and Asset Allocation

ECONOMICS

Throughout much of the beginning of the year, the global economy swung towards a fairly optimistic direction. Energy prices (particularly European gas) have decreased significantly, and global food prices continue their downward trend. In addition, improving official data and strengthening survey evidence suggested that Beijing's reversal of its zero-COVID policy had resulted in recovering demand. However, as we enter 2Q23, over the past few weeks, turmoil across the banking sector (including the failure of Silicon Valley Bank [SVB] and the forced takeover of Credit Suisse) has erased much of the positive economic sentiment present at the start of the year. As such, markets have experienced a tidal wave of volatility with fears expressed over the possible contagion effect across the greater global banking system. Whilst central bank authorities in the US and Europe responded quickly via generous liquidity provisions, concerns are that banks will tighten lending standards, thus impacting growth. As a result, global growth forecasts are slowly being revised downward.

Despite this latest round of banking woes, the US Federal Reserve (Fed) raised its policy interest rate by 25 bps to a target range of 4.75%-5% on 23 March. As a result, the Fed's target range now stands at its highest level since 2007. Notably, in his post-meeting press conference, Fed Chair Jerome Powell said that the Fed had considered pausing its hiking campaign as conditions in the banking sector remain volatile. Indeed, Powell emphasised how the impact of the current banking mini-crisis on the real economy is still unknown. Moreover, while investors pause to reflect on this latest policy move, the Fed's most recent full monetary policy statement read "some additional policy firming may be appropriate" instead of the February statement, which noted, "ongoing increases in the target range will be appropriate". Minor tweaks make a big difference in Fed statements, and this change is a sign that rate hikes could be winding down.

Moving east, China's recent annual National People's Congress (NPC) opened with outgoing Prime Minister Li Keqiang presenting a growth target of around 5% for this year (the lowest in over three decades), with the focus being to 'prioritise economic stability'. Given that the country's recently disbanded zero-COVID strategy kept growth at just 3% in 2022, economic activity year to date has seemingly been rebounding. In light of this, the 5% target does not seem ambitious. However, aside from the demographic challenges of an ageing population, China is still grappling with the woes of its property development sector. Furthermore, as we move further into 2023, the prospect of stimulus in China (policymakers' favoured response to past bouts of weakness, notably after the 2008 global financial crisis [GFC]) sits uneasily with the current political rhetoric to push to contain high debt levels.

Throughout much of the beginning of the year, the global economy swung towards a fairly optimistic direction.

Locally, in an unexpectedly hawkish move (and in sharp contrast to market expectations of a 25-bpt hike), the South Africa Reserve Bank (SARB) hiked the interest rate by 50 bps in its latest March Monetary Policy Committee (MPC) meeting, taking the repo rate to 7.75%. As a result, the prime lending rate now sits at 11.25% - its highest level since 2009. The latest rate hike marks the tenth hike in the current cycle, with the total adjustment being 425 bps since the current rate-hiking cycle started in November 2021. Whilst the magnitude of the rate hike was surprising, it has taken place against the backdrop of a sharp weakening in the exchange rate since the last SARB MPC meeting was held on 26 January, with the rand weakening by 4.4% in trade-weighted terms. Furthermore, loadshedding continues unabated, and food price inflation remains stubbornly high. Many factors that have driven local food inflation over the past year are not unique to SA. These include high global agricultural commodity prices and increased energy costs, which influence the prices of inputs such as fuel and fertiliser.

While a number of these global factors are easing, as evidenced in the continued decline in the FAO Global Food Price Index (FFPI), which declined for an eleventh consecutive month in February, the depreciation in SA's exchange rate has offset much of the benefits of the decline. At the same time, persistently high levels of loadshedding have added significant costs across the agriculture and food value chain. Notably, the sharp exchange rate depreciation has prevented much of the observed decline in world food prices from transferring to SA.

With higher inflation (particularly food prices) eroding households' real wages, big interest rate increases lowering disposable income, extreme loadshedding, an increasingly tricky socio-political environment and a generally uncertain future weighing on local consumers across the board, we hold a particularly subdued outlook for household consumption spending in 2023. Typically, in the local economy, material job creation has only occurred when GDP growth approaches 3% p.a. Thus, the SA economy is simply not growing at an adequate rate to sustainably boost long-term employment prospects for South Africans. The latest forecast from the SARB indicates that SA's economic growth is set to slow to a meagre 0.2% YoY.

Notably, the sharp exchange rate depreciation has prevented much of the observed decline in world food prices from transferring to SA.

In 2023, loadshedding is expected to continue at a relatively high intensity throughout the year. Household consumption is expected to weaken, given the high-interest rate environment. Additionally, the economic slowdown in developed markets (DMs) will likely reduce export demand (even as imports grow). However, this could be countered to some extent by demand from China. Electricity supply and other structural constraints prevent the domestic economy from taking off in any real, meaningful way. Without power, the cogs of our economy cannot turn. Nonetheless, whilst global and local economic growth prospects may appear muted for the foreseeable future, opportunities remain throughout most asset classes.

SA EQUITIES

The FTSE/JSE Capped Swix ended 1Q23 up 2.5% in rand. In US dollar terms, the index ended the quarter 1.5% lower, with the rand depreciating by 4.3% for the quarter (after a strong 3% rally in the final two trading days of March). 1Q23 started strong, with the index up c. 9% at the peak in late January, with the highly volatile basic materials sector still rising on optimism around the likely stimulus out of China after that country abandoned its zero-COVID policy in October 2022. However, as results started to trickle in across the JSE, investors were made aware of how difficult conditions on the ground have become in SA, mainly due to loadshedding reaching stage 6 in 4Q22. As a result, downgrades have come in across the board. GDP estimates are still positive in aggregate, but we note that these estimates are falling, and conditions are deteriorating. Therefore, we may see a few quarters of negative growth. Nevertheless, with the JSE trading at multi-decade valuation lows, we caution investors on getting too negative on the performance outlook, and we believe that our 11% total return outlook (down from 13% a quarter ago) and neutral rating on JSE-listed equities captures the balance between low valuations and low growth estimates.

1Q23 was a challenging quarter for diversified portfolios across the JSE. The positive index return would suggest the outcome was fairly ordinary. However, there were extreme outcomes below the surface in various sectors, nowhere more so than in the divergent performances of the platinum group metal (PGM) and gold sectors. The gold sector added 1.6% to the overall FTSE/JSE Capped Swix Index performance for the quarter, and at the start of the year, the sector was just shy of a 4% weighting in the index. Gold rallying is typically not good for the rest of the market, as the conventional thinking is that gold rallies during times of great uncertainty (globally) and the extreme moves we saw in the global banking space (particularly in the US and Europe) seem to have added fuel to the rally. Outside of gold, the rest of the positive performance of the index was again concentrated in the showing of a few large-cap global franchises, namely Naspers and Richemont, both benefitting from increased growth expectations from China for the rest of the year.

Across our investment universe in SA, there were a few other very positive operational performances, some from businesses operating predominantly in SA, like Bidvest, but also from those outside our borders, such as food services group Bidcorp, both with excellent operating performances for the six months to December 2022. The local banks were another sector that produced really strong results, and this was off a high base after a few periods of earnings tailwinds from impairment unwinds. A year ago, we thought that SA banks would struggle to grow off the relatively high earnings base, but their performances, across the board, far exceeded the expectations we had set at that stage. It was, therefore, surprising for us to see the extent to which the banks pulled back off their highs over the quarter as their valuations are around the cheapest they have ever been (apart from March 2020, when there was extreme uncertainty on how to value them). In the face of continued positive operational momentum in a tough operating environment, the de-rating in local banks seems to be driven by factors at play globally and, on our assessment, factors that should not have a material impact on their earnings. We have been saying this for a few years, but we continue to see the local banks as a critical pillar in constructing a JSE portfolio. In our view, developments over the past quarter, including strong results, double-digit expected earnings growth and dividend yields north of 7% in aggregate, have set JSE-listed banks up for another positive year.

While we remain positive on the banks, in aggregate, the recent surprise 50 bps interest rate increase, which pushed the prime lending rate north of 11%, is a development we had not anticipated. From years of discussions with the local banks' management teams, the impression we get is that higher interest rates are generally good for banks as they can earn higher rates of interest on their lending portfolios (margins go up). However, when the prime lending rate exceeds 11%, banks typically start to see some stress in the system, and bad debts begin to pick up. So, it is safe to say that higher interest rates are good up to a point, and in SA, we are now dangerously close to high interest rates becoming too much of a burden on the general consumer.

While loadshedding and policy uncertainty/inertia seem to plague corporate SA, one positive development we are starting to factor in is the additional energy capacity coming online from the private sector. We see this as one of the most promising developments for corporate SA since Cyril Ramaphosa took over the SA presidency from Jacob Zuma in February 2018. One could probably argue that privatising the energy grid is more bullish for the country than Ramaphosa becoming president, as the same issues that plagued the country seem to still be prevalent today – and privatising the grid seems to be happening much faster than we thought. It is difficult to factor that into earnings and valuations. Still, we believe a multiplier effect on the economy following years (possibly decades) of underinvestment by corporate SA could be unleashed. When we met with the Standard Bank management team at its Africa Conference in London in 2Q22, we started getting a sense of the size of the potential investment into private energy generation. In the meeting, they commented that the investment bank's entire lending pipeline for the next year was in energy generation. That statement alone is difficult to comprehend. However, there are now more detailed research reports suggesting that local banks could fund up to R1trn (or US$55bn) worth of renewable energy projects over the next five years – primarily focused on creating additional capacity at mines, thus freeing up the grid for the rest of the country. We will keep monitoring developments in this space with great interest. If it transpires along the lines that the initial research points to, we think there could be material upgrades to growth expectations across the market.

If, in one year, loadshedding is in the rear-view mirror, there will be some fairly low earnings bases and trough multiples, specifically across the discretionary retailers. We could be in a position where we are at peak rates, loadshedding, and negative consumer sentiment but at trough valuations. On our models, this part of the market offers a highly attractive upside should there be evidence of a reversal of the above negative factors. Nevertheless, our base case is that we still have not seen the worst of the bad news, with the half-year reporting season potentially a catalyst for finding the lows.

Positioning within our local funds remains defensive. We remain underweight in the basic materials sector and domestic companies. We are overweight rand-hedge industrial shares. Drilling deeper into each subsector, we retain our preference for banks, Naspers/Prosus, Bidcorp, and diversified miners over gold. Within the retailers, we prefer best-in-class general retail (Shoprite) over discretionary retail. However, we note that this positioning is being heavily tested considering the value on offer in discretionary retail. Within telcos, we have a preference for MTN at current levels.

SA LISTED PROPERTY

Over the last three and 12 months, the average SA property share has gone broadly sideways, with returns coming from distributions rather than capital. We expect the outcome for the next year to be similar, as SA property companies are stuck in a no/low-growth environment. As a result, we are underweight SA property with a projected 12-month total return of 8%. The forward distribution yield is closer to 11%, implying flat to slightly negative share prices.

The prospects for SA property companies have worsened of late, with interest rates rising ahead of expectations and loadshedding increasing the costs of a tenancy. The challenged outlook is reflected in share prices (with average discounts to book NAV of around 30%). At the same time, higher interest rates have also resulted in alternative income-yielding assets becoming relatively more attractive.

For SA-domiciled properties, the growth outlook is mediocre – a reasonable quality SA diversified portfolio should grow in the low single digits for the next few years. This is through a combination of 6%-7% escalations, roughly 10% reversions for new leases, and increasing cost pressure from rates and utilities. We remain concerned about the challenged long-term net rental growth trajectory of large urban malls and the inability of landlords to pass on increasing utility and other property operating costs to tenants in the current environment. In addition, the prospects for filling office space are limited as office occupation in the professional services space is very low.

For foreign-dominated property portfolios, Eastern European (the majority of exposure in SA-listed offshore property companies) profit growth still looks reasonable. However, the impact of the Russian-Ukraine war is still uncertain. For now, the impact on countries like Poland looks profit-positive as millions of people have flowed over the border from Ukraine.

In summary, it is tough to grow out there, but earnings risks are also much lower than the average listed company. A reasonable portfolio of SA-listed property equities can generate a distribution yield of around 11%, but we are not projecting material capital growth given the abovementioned scenarios. When bond yields decline, there are prospects for capital revaluation.

DOMESTIC BONDS

For 1Q23, SA government bonds (SAGBs) returned 3.42% at an All Bond Index (ALBI) level. This follows a strong performance in 4Q22, where the index returned 5.19%.

Currently, yields across the curve remain attractive, with most bonds having strengthened by 20-30 bps over 1Q23. The most important actions throughout this year have been central bank actions to curtail inflation. Domestically, the SARB MPC has continued its rate hiking cycle, ending the quarter with a surprise rate hike (hiking rates by 50 bps and not the widely expected 25bps) and taking the repo rate to 7.75% - 125 bps higher than the level at which the repo rate entered the COVID-19 pandemic. Given the pace of the rate hiking cycle, most analysts and the forward rate agreement (FRA) market have responded by increasing their expectations for future rate hikes, with peak rates now being seen at 8%-8.25% (25 bps to 50 bps of additional hikes). This is expected to be followed by a rapid cutting cycle, with the repo rate at 7.5%-7.75% by mid-2024.

As measured by the consumer price index (CPI), SA headline inflation has moderated downwards since its 7.8% peak in July 2022. However, the most recent print (February 2023) accelerated slightly, back to 7% (from 6.9% in the prior month). Of note is that the inflation prints have consistently been above the SARB target band and materially above the midpoint (4.5%) of the band which the SARB MPC has explicitly targeted. Given this, the MPC has been persisting with its rate-hiking schedule.

We have for some time viewed rate hikes as more likely to curtail growth, which, combined with the heavy burden of elevated stages of loadshedding, has resulted in the SARB slashing its projections for 2023 growth to a mere 0.2% YoY.

Added to the above, loadshedding is broadly viewed as inflationary. A persistent stage 6 loadshedding schedule contributes as much as 50 bps to inflation, depending on the underlying assumptions regarding replacement electricity.

Considering the above, we are cautiously optimistic and have positioned our funds appropriately.

With bond yields across the back end of the curve at over 11% and with the 3-month JIBAR at just below 8%, we have attractive instruments in the duration and floating rate spaces in which to invest. We expect bond yields to be somewhat volatile in the short term, with a portfolio-level yield expectation of 10.1% over the next year.

THE RAND

In 1Q23, the rand weakened on the back of a stronger dollar, risk aversion and domestic economic malaise. However, the shock 0.5% interest rate hike from the SARB on 30 March helped the local unit bounce back to about R17.73/US$1 at the end of March.

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.

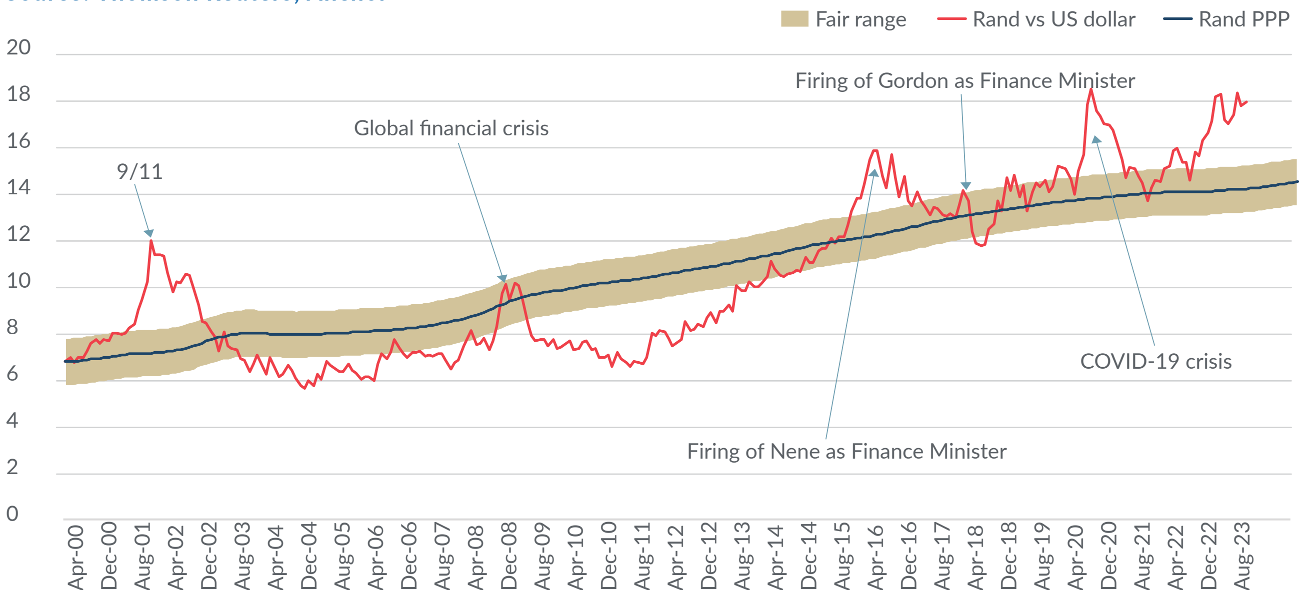
The indicators for the rand's fair value are continuing to turn negative. We note that the current account surplus of 2022 will most likely give way to a shallow deficit in 2023, thus eroding some currency support. The boon from high commodity prices will also dissipate, shining a light on SA's fragile fiscal situation and poor government finances. Thus, we expect the rand to be under pressure for much of 2Q23.

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, 1Q23* report on 20 January 2023. Over our forecast period, we expect inflation abroad to come under control and return towards more normalised levels. This means that our PPP model shows an increasing propensity for long-term rand weakness from next year again. As a result, our PPP-modelled value for the rand vs US dollar at the end of the next 12 months is R14.52/US$1 (See *Figure 1*). We apply a R2.00 range around this to get to a modelled fair-value range between R13.52/US$1 and R15.52/US$1.

The 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 reach peak rates toward the end of 1H23, 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 R16.50 to R17.50 range against the dollar in one year. For this report, we have modelled on R17.00/US$1.

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

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



GLOBAL EQUITIES

In our 20 January edition of *The Navigator – Anchor's Strategy and Asset Allocation, 1Q23* report, we wrote, "We expect global equities to recover some of their lost ground in 2023." This has indeed been the case, and the 7.9% return for the MSCI World Index in 1Q23 was even higher than our positive expectations. In addition, we indicated an expectation of an S&P 500 year-end level of 4,400 – materially above consensus outlooks (ironically, now a little more positive). A lot has happened (good and bad) in 1Q23, but we maintain that expectation and project an 8% return from global markets over the next 12 months.

After falling sharply at the beginning of 2022, global equity markets have moved broadly sideways over the last 11 months – the S&P 500 has mostly traded between a band of 3,800 and 4,200. This range is likely for the foreseeable future, but if we are genuinely looking out 12 months, by then, interest rates will probably be on the way down, and earnings growth will likely have resumed meaningfully. These conditions should be conducive to positive markets and returns.

Our hesitation with getting more overtly bullish in the short term is that the US Fed is acting very aggressively in raising interest rates (the fastest in 40 years), and this will still have some consequences that we cannot predict, as the much higher-than-expected cost of money has upended many business models and plans. An unforeseen manifestation of this was the collapse of some big global banks in the last two months (notably Credit Suisse and SVB) for precisely this reason. So for now, the market has reacted with a classic "bad news is good news" knee-jerk, with the thinking being that the Fed's actions have impacts, and that means its job is close to being done, and interest rates will peak sooner.

The consensus among global investors (according to *Bloomberg*) is that the May 2023 interest rate hike of 25 bps will be the last. Of course, we could still experience a bout of "bad news is bad news" reactions, where the market faces the reality that we will likely enter a short recession, and US earnings in 2023 will go slightly positive. But the short-term moves are impossible to forecast, and if we look further out, our outlook is positive.

It is also crucial to look at the level below the indices, and we are excited about many specific shares. The sharp increase in inflation and interest rates saw the growth premium disappear on many quality shares (or, put simply, their share prices crashed!). Much of this was regained in 1Q23, but we believe there is more to go. Longer duration assets (where typically a higher proportion of cash flows are in the future because of higher-than-average growth rates) have started re-rating again.

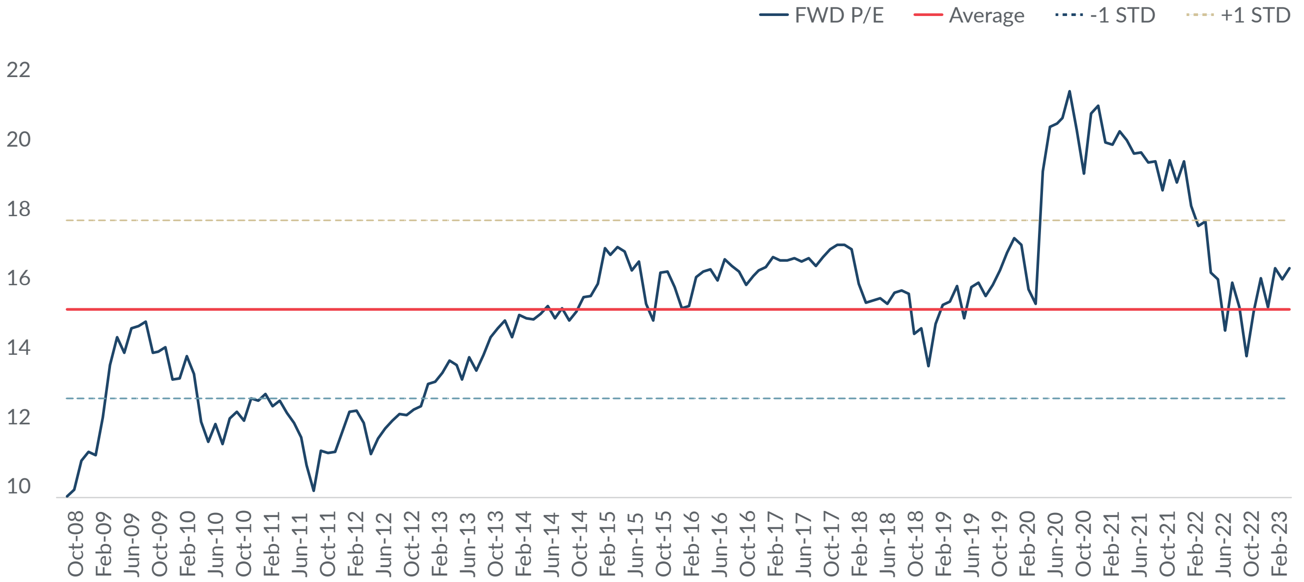
The MSCI World Index forward P/E of 16.6x (see table in *Figure 2* below) leaves room for an upside but is undoubtedly on the high side. Multiples often increase when earnings dip as long as the future outlook is more positive. In addition, emerging markets (EMs) are much cheaper, with strong recovery potential.

Figure 2: Various major global indices' EPS growth and forward P/E forecasts
Source: Bloomberg, Anchor

	Earnings growth		FWD P/E	
Name	**YR 1**	**YR 2**	**YR 1**	**YR 2**
MSCI World Index	1.3%	7.8%	16.6	15.4
MSCI EM Index	-4.7%	18.5%	12.2	10.3
MSCI All Country World Index (10% EM)	0.5%	8.5%	16.0	14.8
S&P 500 Index	-0.8%	9.8%	18.7	17.0
S&P 500 Index (excl. Energy)	2.0%	11.0%	19.4	17.5

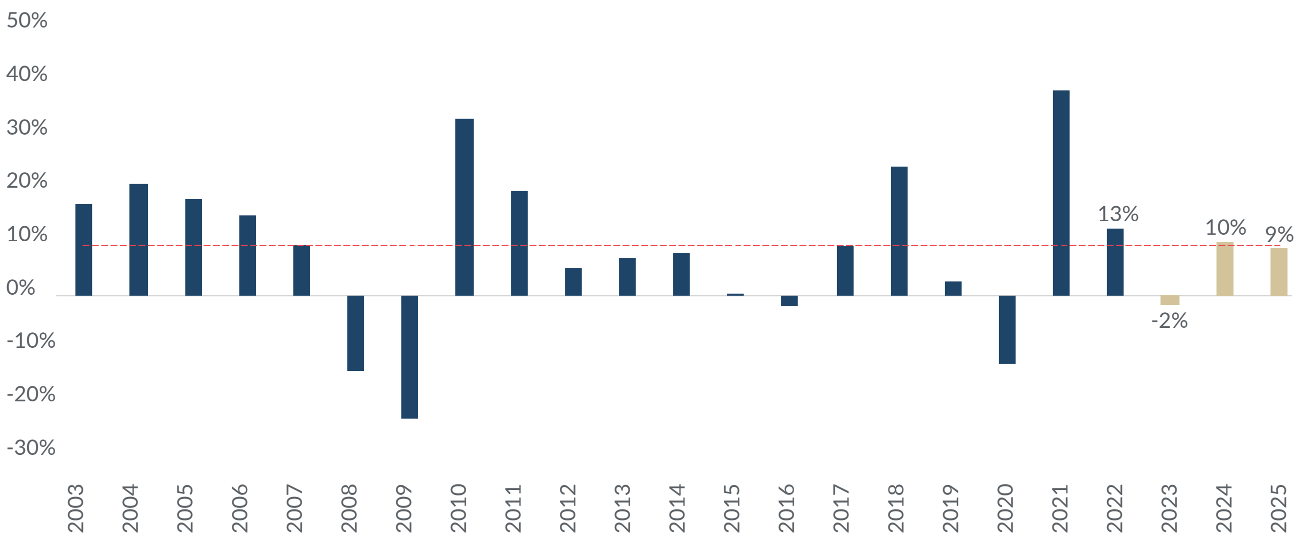
The MSCI World Index's forward P/E is shown in the chart below.

Figure 3: MSCI World Index fwd P/E
Source: Bloomberg, Anchor



But the most important determinant of markets is earnings, and downgrades have already flowed for 2023 (minus 2%). However, double-digit US dollar-denominated earnings growth should resume in 2024 and beyond, which is positive for equities.

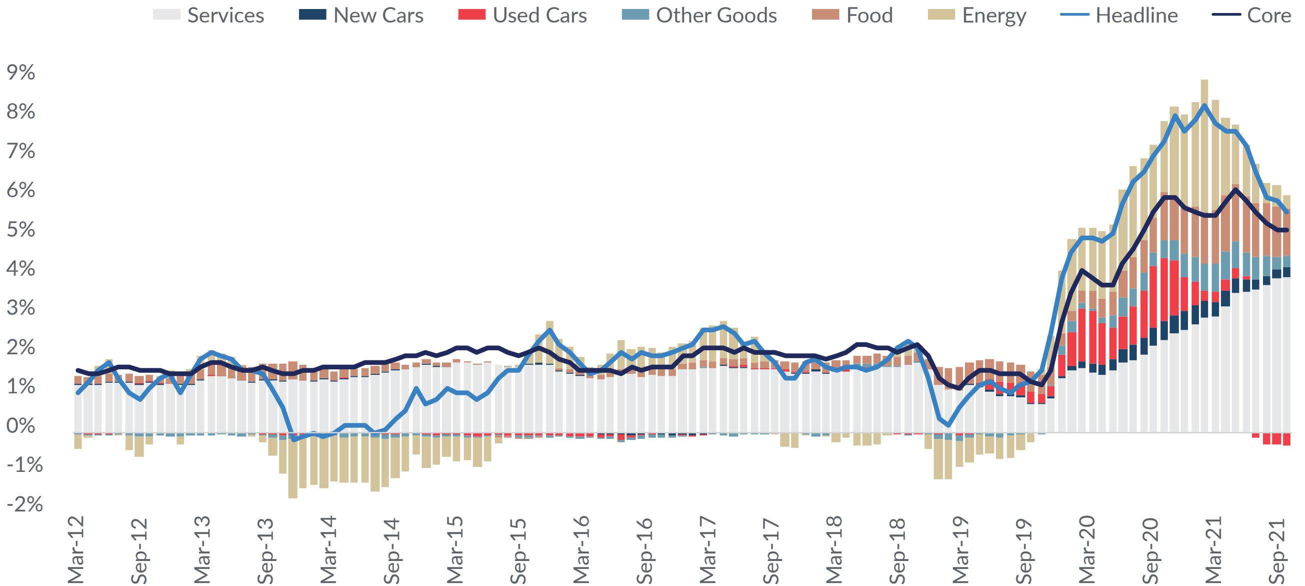
Figure 4: S&P 500 EPS growth (annual)
Source: Bloomberg, Anchor



GLOBAL BONDS

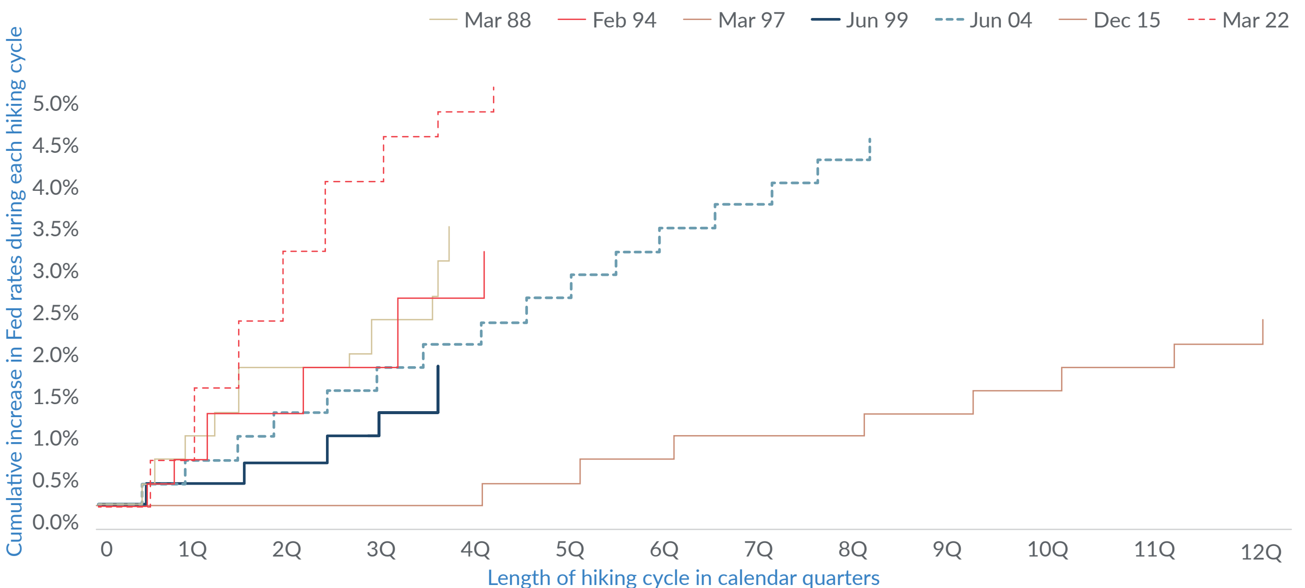
US inflation remains elevated relative to central bank targets. Still, the factors contributing to inflation have shifted from the COVID-19-related supply chain challenges driving goods price inflation and the Ukraine-Russia war-related challenges driving food and energy inflation to service price inflation (predominantly a shelter inflation problem).

Figure 5: The drivers of US inflation have shifted from goods, food and energy to services
Source: Anchor, Bloomberg



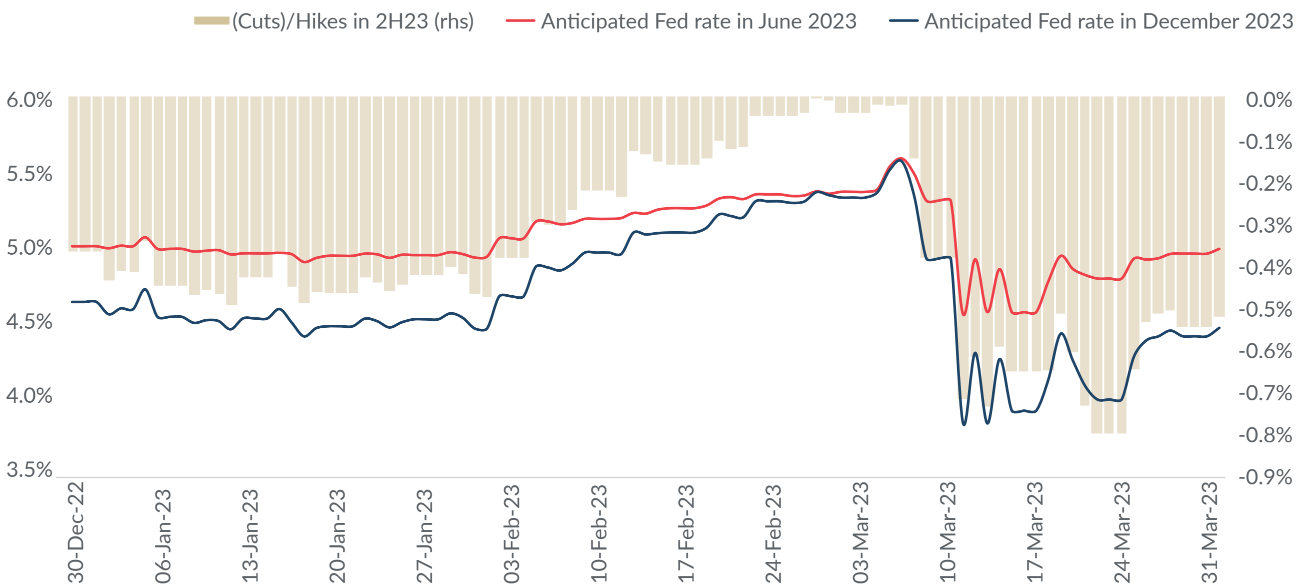
The Fed has embarked on the most aggressive cycle of rate hikes in over 35 years to get inflation under control, raising rates by 4.75% over four quarters – c. 50% more tightening than it achieved in the first year of the previous five hiking cycles.

Figure 6: The current Fed hiking cycle is the most aggressive one we have seen in over 35 years
Source: Anchor, Bloomberg



While inflation remains a concern, its trajectory is encouraging, and investors have shifted their focus to anticipating the end of the current hiking cycle and prospects of rate cuts. Messaging from the Fed has attempted to caution investors that it is still too early to declare victory over inflation (and, as such, too early to start anticipating rate cuts). However, that has not deterred investors from pricing in a high probability of rate cuts in 2H23. Just as investors had begun digesting the Fed's message that there were potentially a few more rate hikes to come in 1H23 and a very low probability of any cuts in 2H23, the banking mini-crisis arrived. As a result, investors have resumed expectations that the Fed will be forced to halt rate hikes by the end of 1H23 and start cutting rates into 2H23 to mitigate against deteriorating economic conditions.

Figure 7: Just as investors were starting to internalise the Fed's guidance that it was unlikely to cut rates in 2H23, the banking mini-crisis raised investor expectations that the Fed would be forced to ease rates soon
Source: Anchor, Bloomberg



US 10-year government bond yields (which are, to a large extent, a reflection of investors' expectation for long-term interest rate levels plus a spread to compensate for the uncertainty of 10-year forecasts) have spent the past six months oscillating between 3.3% and 4.3% p.a. as investors shift between the possibility of structurally higher and more volatile inflation and a return to a more benign inflation environment.

Our expectations are skewed towards a return to a more benign inflation environment, with perhaps slightly more volatility in inflation than we have been accustomed to, and a somewhat more vigilant Fed. This leads us to believe that US 10-year government bond yields will reach the bottom end of their recent trading range by the end of our twelve-month forecast horizon. As such, we anticipate a 3.5% total return for US 10-year government bond investors over the next 12 months, predominantly of income.

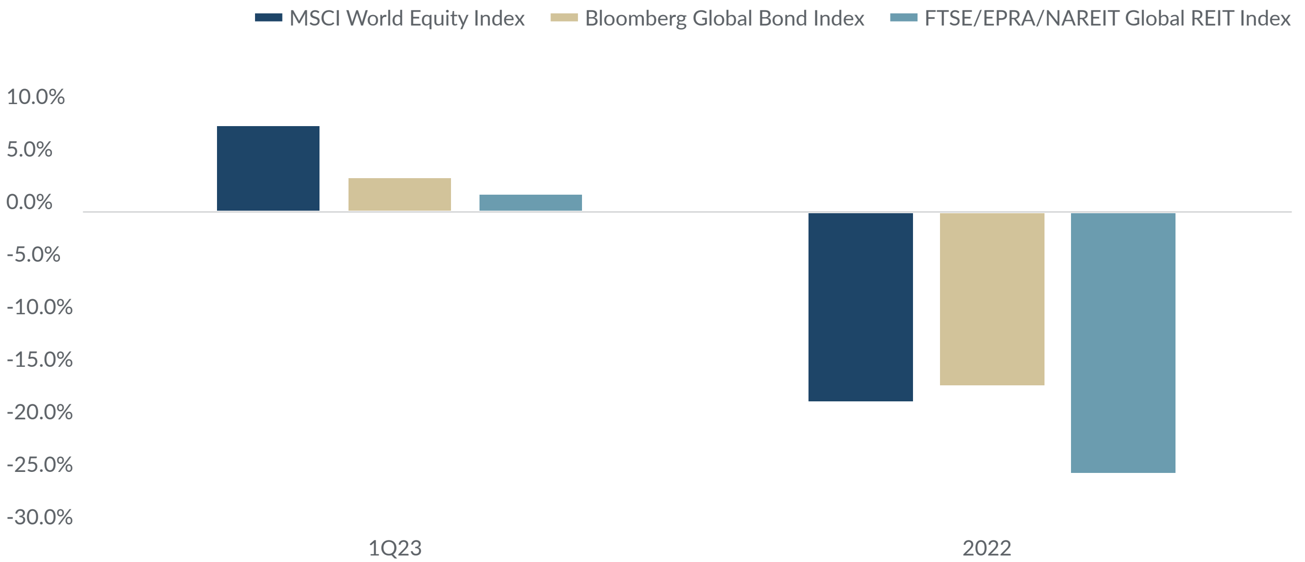
While US government yields are at the top end of where they have been for the past couple of decades, the same cannot be said for credit spreads. The pick-up in yield corporate bond investors are achieving is around the average level they have been at for the past couple of decades and still well below the peak levels they can experience during a crisis.

With financial conditions tightening in response to the recent banking strains and the aggressive Fed tightening, we think it is reasonable to expect a slight pickup in defaults over the next twelve months. However, we believe that current credit spreads are already priced for this eventuality. Consequently, we forecast a 12-month total return for US investment-grade corporate bond investors of 5.3%, all in the form of income.

GLOBAL PROPERTY

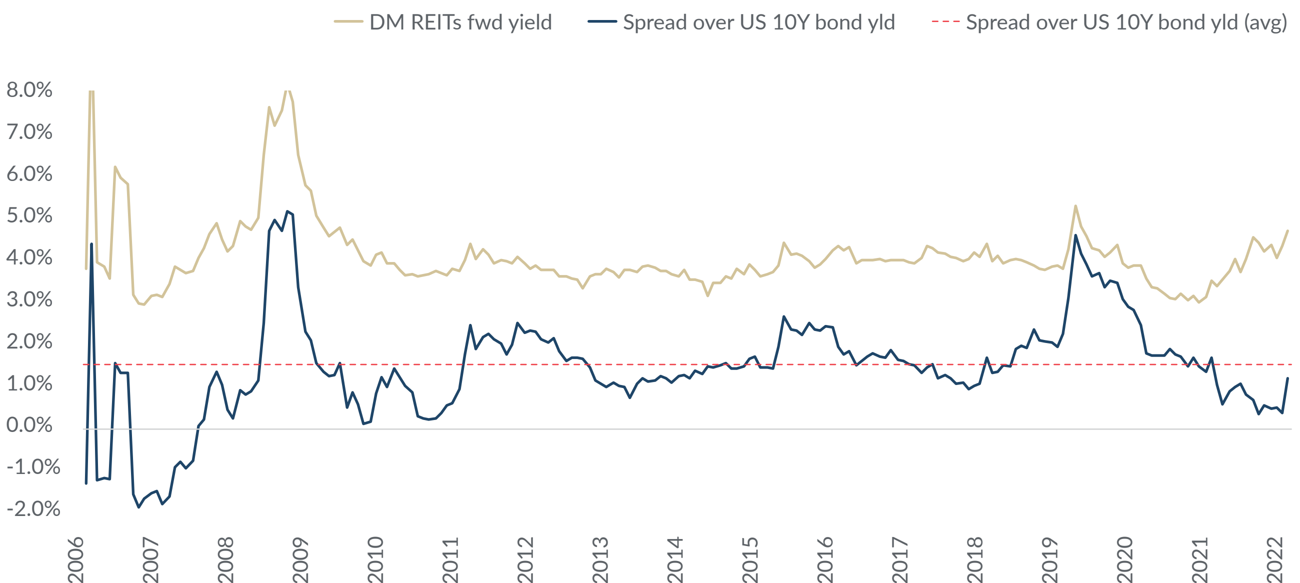
After ending 2022 as the worst performing major asset class (FTSE/EPRA Global DM REIT Index -24.5%), DM real estate investment trusts (REITs) started 2023 strong, only for the banking mini-crisis to derail that progress into quarter-end and leave the asset class as one of the laggards in 1Q23 again.

Figure 8: DM REITs lagged other asset classes in 2022 and again in 1Q23
Source: Anchor, Bloomberg



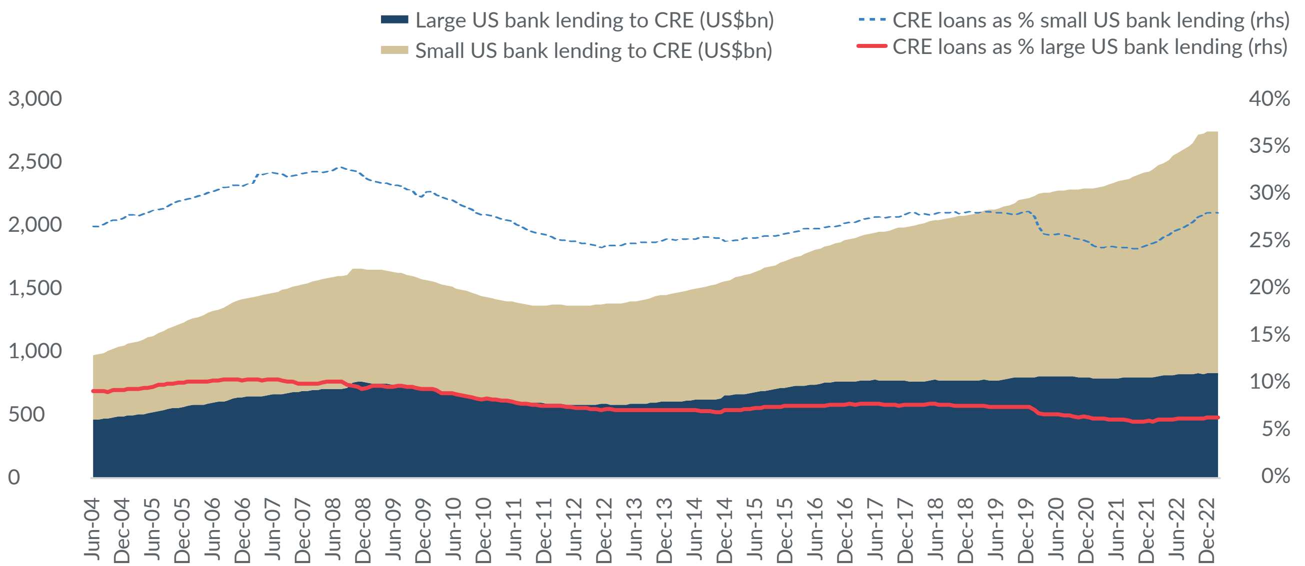
Despite such a dismal run recently, the anticipated yield on the asset class remains below average compared to yields on offer in the bond markets.

Figure 9: Despite recent underperformance, the relative yield on offer for REITs remains below average
Source: Anchor, Bloomberg



Much of the recent underperformance of listed property is due to concerns about tightening lending conditions, particularly among smaller US banks, where we have recently seen a few bank failures. Smaller US banks have not only been the most significant source of commercial real estate (CRE) lending, particularly over the past decade, but CRE is also a material portion of small bank lending.

Figure 10: Smaller US banks are a key source of funding for CRE and are heavily exposed to the sector
Source: Anchor, Bloomberg



The tightening lending standards and higher funding costs will likely act as a headwind to CRE for the foreseeable future, putting growth under pressure. As such, we anticipate that the bulk of DM-listed property returns will be in the form of dividend income over the next year, and we forecast a return for DM REIT investors of 6% in US dollar terms.

ANCHOR INSIGHTS

In this section, staff across Anchor provide insights into our thinking, strategy, and worldview. This quarter, James Bennett discusses looking for the bottom in individual stocks, not in markets, Casey Delport looks at the actual cost of SA's failing electricity and rail infrastructure and asks whether there is any light at the end of the tunnel, Nick Dennis provides insights into the role of emotions in investing in his article entitled '*The wisdom of back pain*', David Bethell talks about asset allocation and diversification within asset classes and, finally, Di Haiden asks why the SA Reserve Bank is important.

Look for a bottom in individual stocks, not in markets

WRITTEN BY:
James Bennett
Global Equity Analyst

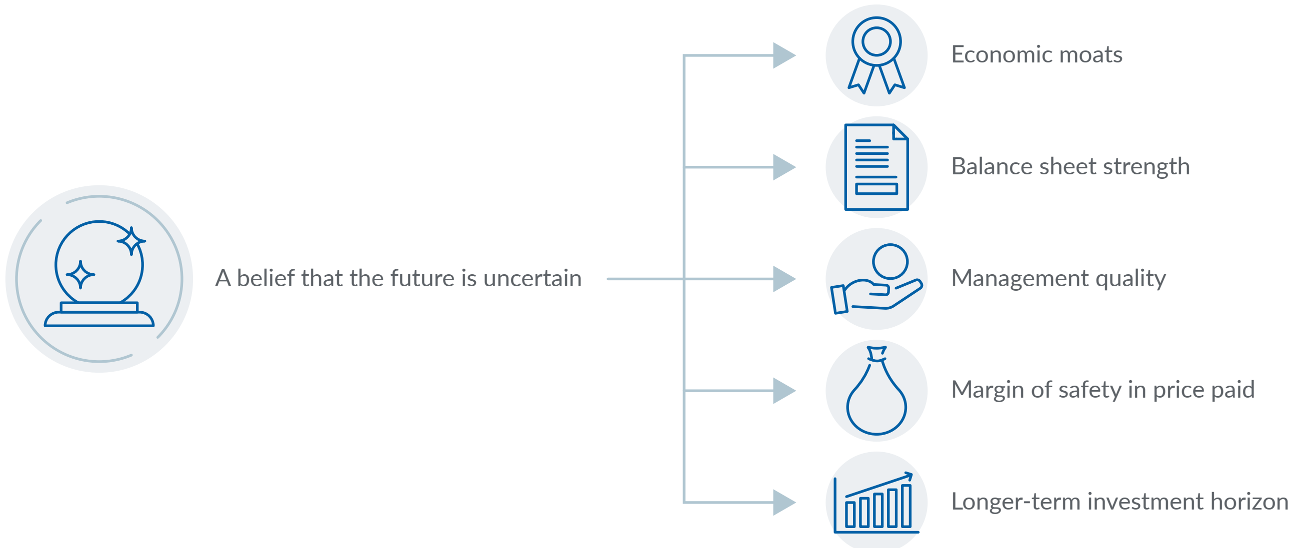
James has a BCom Hons from the University of the Witwatersrand and started his career at UBS (and its predecessor firms) in Johannesburg in 1994. During his 20-year career at UBS as a sell-side analyst, he was rated among the top 2 in the SA diversified mining sector for 14 consecutive years (by the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

Many people, early on in their investing journeys, believe they have an innate ability to see the future. The reality is that we become far better investors when we make peace with the fact that we cannot know the future. Once we start investing because we cannot see where the world will be tomorrow, let alone in five years, we tend to make far better investment decisions. We are then inclined to allocate different priorities to the stocks we invest in.

Definition of innate: An innate quality or ability is one you were born with, not one you have learned. *Source: dictionary.cambridge.org*

In an unpredictable world, we emphasise factors such as economic moats, balance sheet strength and management quality. An uncertain view of the world makes us build in a margin of safety around the value we are willing to pay for a business. In addition, viewing the future as unpredictable likely makes us allow for a longer-term time horizon when investing. Simply put, believing we can see the future makes us overconfident as investors. Incorporating the abovementioned factors into our investment process acknowledges our inability as investors to see the future.

Figure 1: Belief in an uncertain future makes us better investors
Source: Anchor



Since early 2022, there has been heightened volatility and uncertainty in global stock markets. The S&P 500 Index is materially down from its highs, with many individual stocks falling by 50% to 70% or even more. As a result, business and finance news shows have been dominated by individual experts and panel discussions searching for the elusive "market bottom". Many investors might feel they need to hold off on buying new stocks or adding to existing positions until the market bottom is in.

Debates are raging around whether this is a "market bottom" or a "bear-market rally"? The market rallies we have seen in recent months are often dismissed as being merely driven by short covering. However, the reality is that all bear markets end with a sharp short-covering rally, so this point adds little value to the current debate.

Global strategists publish a range of year-end targets for the S&P 500 Index, and we all wait with bated breath to see who ends up being the most accurate. Given that markets typically go up over time, strategists usually predict a rising market for the coming year. The exception is after a difficult year like 2022, where a much bigger focus is on trying to call the market bottom.

There is nothing wrong with having an overall market view. We are all humans with opinions. Any strategist worth their salt will try and establish a view of where the market is headed and at what level the broad index might bottom out. However, this should not cloud our judgement when it comes to stock picking.

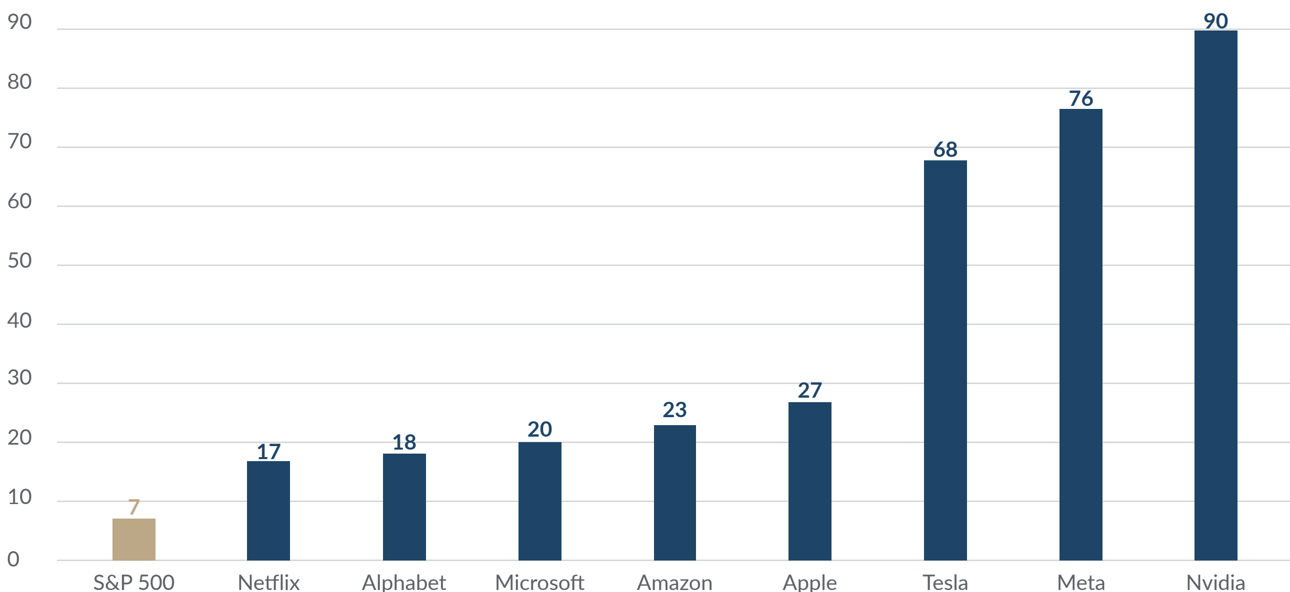
In more uneventful times, when markets steadily trend higher, investors do not worry too much about the broader market view. However, in a protracted sell-off (such as the current one since early 2022), investors often treat individual stocks as untouchable until there is some magical all-clear that the S&P 500 Index has bottomed. One of the issues with this is that we only know where the market bottom is well after the event. Once we can identify the market bottom with hindsight, the market has typically rallied significantly off its lows. Unfortunately, the bottom all-clear is sometimes only given months or even years after the market has bottomed.

After a difficult year like 2022, a much bigger focus is on trying to call the market bottom.

It could be true that the current overall S&P 500 Index in 2023 might have further to fall. That certainly seems to be the consensus view amongst global sell-side strategists. Some also believe the market will first collapse in 1H23, followed by a strong rally in 2H23. However, that view could just as easily be wrong. Essentially this is another form of market timing. Also, there are always individual stocks that bottom well before the broad market index does.

A recent example, using a broad definition for "Big Tech", shows that there has been a decent comeback for the sector in 2023. In some ways, these big stocks are relatively safe havens in the current banking sector turmoil. Durable business models, strong balance sheets, decent margins (for most), and having underperformed in 2022 have set them up well for 2023. However, going with the consensus negative view about the near-term outlook for the overall market would have prevented an investor from taking advantage of some of these individual stock opportunities that had presented themselves during 2H22.

Figure 2: Big tech share price performances in 1Q23, %
Source: Anchor, Bloomberg

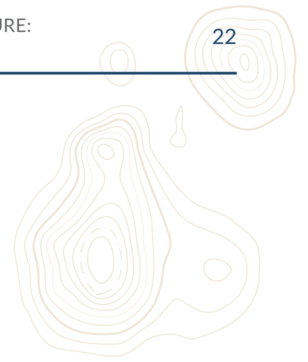


My advice is to avoid mingling market timing with stock picking. Too often, consensus top-down views on markets end up being wrong. I am in the camp that believes market timing is a skill that very few investors consistently get right over time. We might get it right once or twice. However, once market timing becomes part of our mindset, one is tempted to start knee-jerking and selling some shares whenever we think the overall market looks a bit toppish. Then it becomes a case of calling "11 of the past 3" market corrections.

When one makes a call on the overall S&P 500 Index, the investor is making an aggregate call on 500 companies spread out over many different industries. The composition of the S&P 500 Index has also changed over the years. So, the history around aggregate multiples and margins is not a perfect science. In many ways, it is much easier to have a high conviction on an individual stock than an overall market index. This is especially true if you thoroughly analyse the business you want to invest in. Of course, some diversification is always prudent.

The question could be asked whether a top-down view that tech shares were extremely overvalued in 2021 could have saved the investor a lot of pain in the 2022 sell-off. The answer is that we would have gotten our pointer about where the overall tech market might be heading when each individual stock we were looking at was trading at extremely elevated multiples. A robust bottom-up, stock-by-stock analysis should lead us to the correct top-down decision rather than the other way around. That same negative top-down view of the tech sector would have been a disaster over the past decade.

If we are looking for signs that the overall market might be approaching a floor, often the best pointer is when individual stocks we know well start trading at compelling valuations that have not been seen in a long time. So here is the bottom line; If you come across a quality business trading at a decent valuation, take a longer-term view and buy some shares. Try not to let your top-down market view dissuade or influence you in any way.



The actual cost of South Africa's failing electricity and rail infrastructure:

Is there any light at the end of the tunnel?

WRITTEN BY:

Casey Delport
Investment Analyst – Fixed Income

Casey holds an MCom in Economics and joined Anchor in 2019. She brings her passion for economics into the fixed-income space, particularly regarding global and African country analysis. Casey also focuses on the Agri-sector, both locally and abroad.

No one will disagree that SA currently finds itself in a deep state of internal economic lethargy as a country. Over the last decade, the economy has only grown by a mere 1% average, significantly lower than the 3.4% average of its BRICS (Brazil, Russia, India, China) counterparts. Moreover, for 2023, SA's economic growth is expected to slow to below a meagre 1% as it continues to face a growing number of domestic headwinds. Notwithstanding the various global crises that manifested over the last few years or so, SA's failure to advance its growth prospects despite the country's diversified economic structure, deep financial markets, cutting-edge business capability and strength of institutions speaks to the inherent structural weakness present – in turn manifesting in chronically high levels of inequality and persistent unemployment.

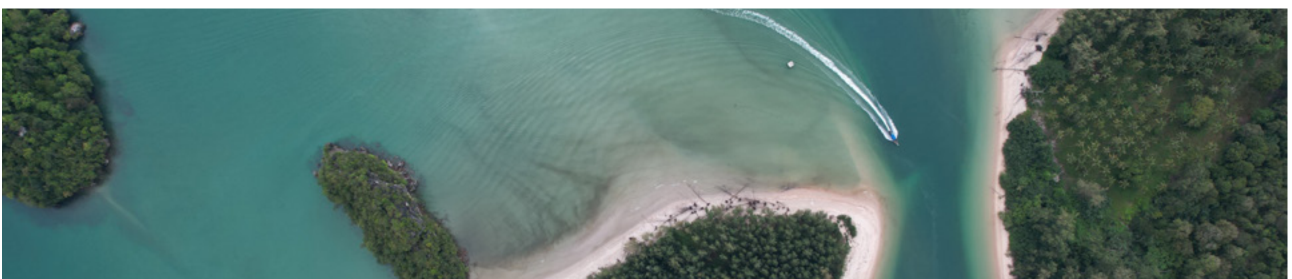
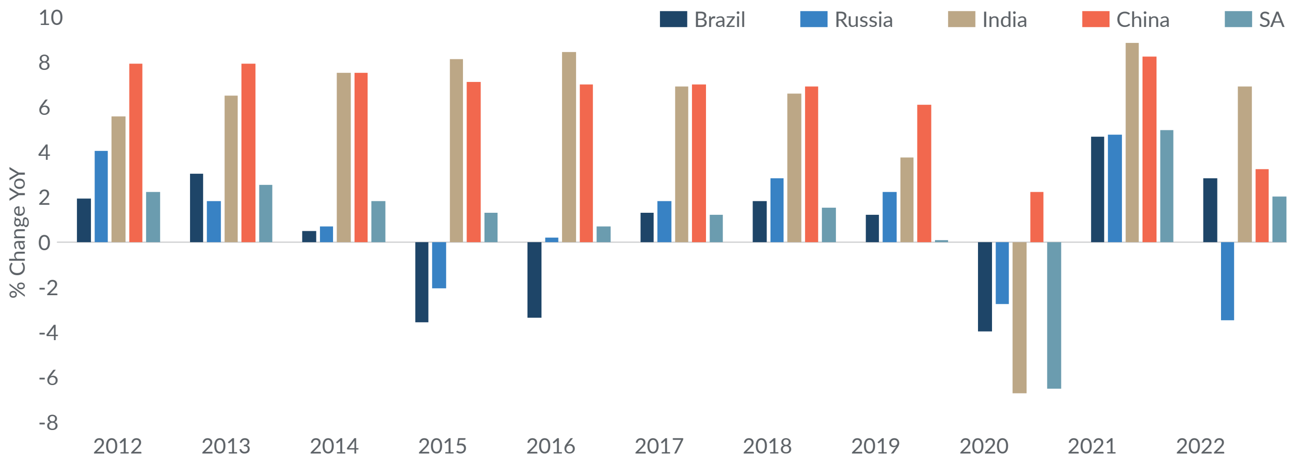
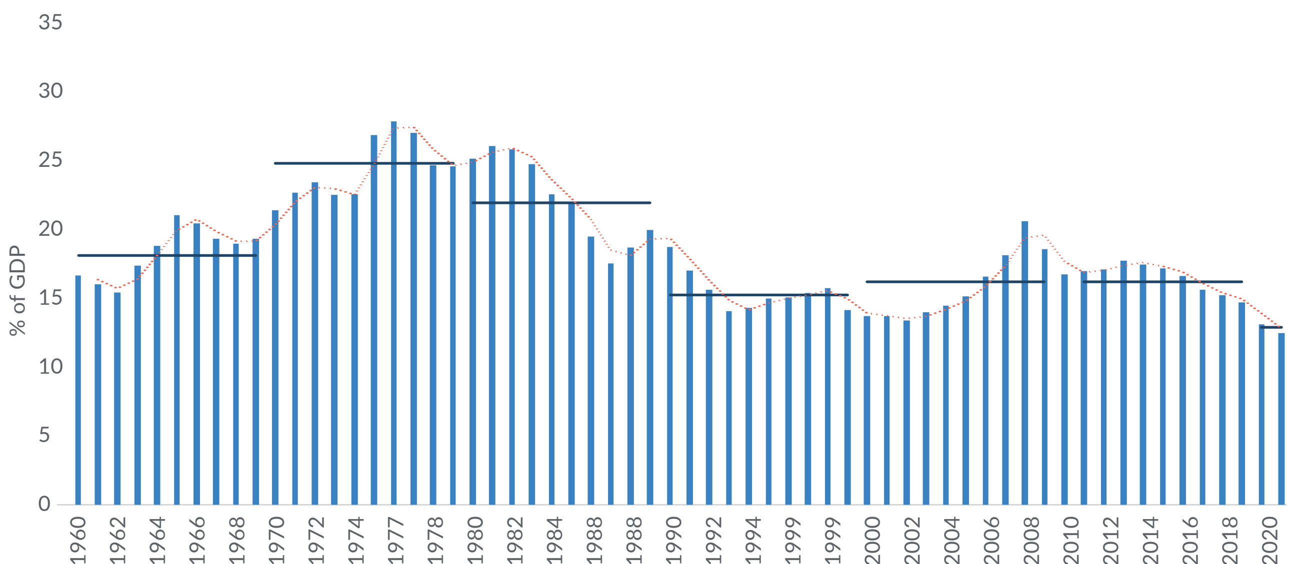


Figure 1: SA GDP vs BRIC countries
Source: IMF, Anchor



As a result, investment in SA's economy is unsurprisingly faltering, with gross fixed capital formation (GFCF) dropping well short of the aspirational ratio of 30% of GDP set out in the National Development Plan of 2009 (SA's key economic policy directive). A historic low of 13% of GDP was recorded in 2021 - as illustrated by *Figure 2* below. Whilst the steady decline in GFCF can be partly ascribed to a minimal savings rate across the general SA populace, it can also be attributed to diminishing levels of expected return. This, in turn, adversely affects investment considerations for both local and international corporates. If a country's investment climate (matched with its policy environment and economic conditions) is perceived to be overly restrictive, then future returns are called into question, hobbling expansion or new investment. Capital outlays are therefore driven by survival rather than a fundamental belief in growth opportunities, as has been the case for the past two years, thereby limiting the overall contribution of GFCF to the expenditure side of the local economy. For the economy to attract significant new investment (be it by domestic or offshore firms), the country will need to address, among others, electricity supply, transportation, and ports. Intuitively, if the cost of doing business is reduced, then investment and growth will follow.

Figure 2: SA GFCF, annual vs average per decade
Source: World Bank, Anchor



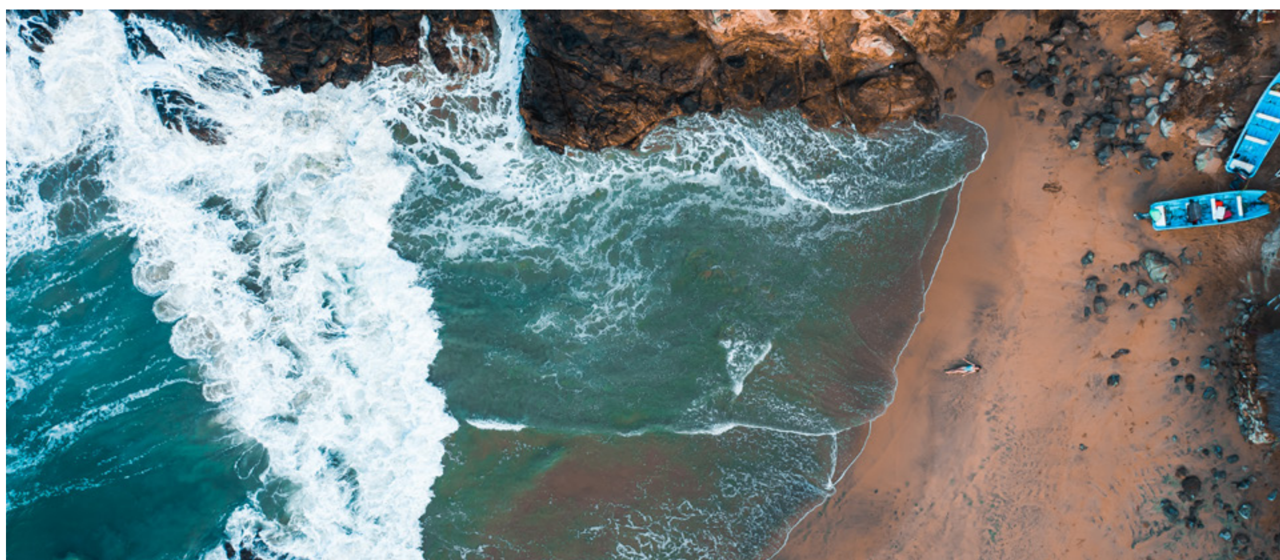
However, calculating the economic cost of SA's failing infrastructure (let alone trying to address it sustainably) is no easy task - particularly regarding the current electricity crisis and our failing rail infrastructure. Conventional wisdom states that 'loadshedding is destroying the economy,' but how much is it genuinely costing? Is it even possible to put a number on it? Depending on which methodology or numerical inputs you consider, the cost of the rolling blackouts in 2022 ranges anywhere from R70bn (Eskom's estimates) to R560bn (The Council for Scientific and Industrial Research [CSIR] estimates). Factoring in all the secondary effects of loadshedding, the actual number is more than R3trn. While the 'raw cost' of loadshedding is naturally high due to the direct interruption of production etc., its multiplier effect across the greater economy is devastating, and its secondary effects are difficult to quantify. To calculate the true cost of SA's chronic power failures over the past 15 years or so, one must consider the following:

- The many local businesses that have failed and closed, resulting in lost jobs.
- Families made destitute as a result of said business closures.
- The rising cost of managing and restoring the national power supply.
- Loss of investor, local consumer and business confidence.
- The loss of valuable skills to the economy as emigration rises due to a lack of confidence, which, in turn, has long-term detrimental effects on entrepreneurship, job creation and investment flows.
- The downgrading of SA from an investment grade sovereign risk rating to junk status by leading credit rating agencies due to the power crisis and various other policy failures.
- The loss of confidence in government and various institutional structures and the stress that, in turn, is placed on the socio-political environment and greater democratic disposition of the country.

This list is by no means exhaustive. There are plenty of other secondary effects to consider. What the above points do illustrate, however, is that arriving at the actual numerical cost of SA's energy crisis is nearly impossible. Whilst the energy crisis is the current overwhelming constraint to economic activity in SA, similar concerns are also being expressed over rails, ports, and water. SA's failing rail infrastructure poses particularly unique challenges in itself, which are exacerbated by the rail industry's intrinsic ties to the energy supply sector. The local rail network covers over 30,000km, including two of the world's premier heavy-haul lines – the Sishen-Saldanha Iron Ore Export line with an annual nameplate capacity of 60mn tonnes p.a. (MTPA), as well as the North Corridor (also known as the Coal Line) to Richards Bay with a nameplate capacity of 81 MTPA.

Whilst the energy crisis is the current overwhelming constraint to economic activity in SA, similar concerns are also being expressed over rails, ports, and water.

In recent years, Transnet, and its major subsidiary and freight rail operator, Transnet Freight Rail (TFR), have been subject to orchestrated corruption, which has impeded the state-owned enterprises' (SOEs) ability to perform their commercial undertakings. Furthermore, the ability to execute a turnaround in the entity is increasingly undermined by the decision-makers within the entity itself and greater government. Further compounding the issue are poor operating standards, inefficient service delivery, a deterioration in the quality of infrastructure (due to theft, vandalism, and an inadequate maintenance regime), and recalled rolling stock contracts with international locomotive original equipment manufacturers (OEMs) resulting in the inability of the SOE to receive spares for its increasingly idle locomotive fleet. This has resulted in a large number of Transnet's 1,900 locomotives being left standing. Overall, this has resulted in Transnet's performance on some of its key strategic lines (such as the Richards Bay Coal Terminal) declining by 50% throughput to an estimated 43 MTPA in the current financial year (*Figure 3*) at the expense of the customers and economy that rely on these rail services to get SA's output to international markets. The figure allocated to this decline solely on the Coal Export line is R1bn per day for Transnet's 2022/2023 financial year.



This decline is felt across many sectors within SA's greater economy, such as grain, where more grain is currently moved via conveyor belt than rail network. As a result of poor service levels from Transnet over the years, the industries that were fortunate enough to move their freight to road transport have done so. The only sectors left that utilise SA's rail network are those that do not have a choice due to the nature of the payload and volume (i.e., mining, timber, bulk liquids, automotive manufacturers etc.). Ironically, these industries are some of the country's biggest employers and economic contributors (such as Ford South Africa, which makes up 1.5% of SA's GDP). As such, one cannot underestimate or disregard the importance of the rail industry to the SA economy, particularly in these current times of economic lethargy. As indicated by *Figure 3* below, roughly 44% of SA's GDP directly relies on rail. In turn, 1.6mn South Africans are directly employed by these industries with up to c. 7.3mn dependants.

Figure 3: SA's economic reliance on rail
Source: National Rail Policy, RMB, Anchor

	Mineral	Containers	Automotive	Liquid Fuels & Gas	Agriculture
SA GDP	7.5%	20%	4.3%	9%	2.43%
Direct employment	53 316	375 000	110 000	240 000	830 000

THE LIGHT AT THE END OF THE TUNNEL

However, it is not all doom and gloom. SA can pull itself out of its current economic inertia by sustainably addressing its failing infrastructure. Suppose one considers the current electricity crisis in particular. In that case, Vietnam offers a compelling case study of a country that is steadily enacting market reforms in a heavily state-led environment (much like SA), with the realisation that without a consistent energy supply, a country will never be able to sustainably meet the demands of a growing economy - something the SA government is only seemingly starting to realise. Vietnam has one of the most energy-intensive economies in the world. Since 2010, electricity consumption has increased by about 10% p.a. This is attributed to strong economic growth, increasing industrialisation, universal electrification, and modernisation. As a result, installed electrical capacity grew ten-fold, from 5GW in 2000 to 55GW in 2020, and Vietnamese citizens with access to electricity increased from 14% in 1993 to 99% in 2020.

Central to Vietnam's steady progress in introducing legal and regulatory reforms to gradually open the electricity market to competition without adversely affecting supply (as is similarly required in SA) is a functional, vertically integrated, state-owned Vietnam Electricity (EVN) which is mildly profitable, and a political class (while not corruption-free) that understands the vast energy supply required to power the future growth of that country's economy. The Vietnam government's careful and considered approach is clearly working. Compare this to a country like the Dominican Republic, where far-reaching, market-orientated reform was enacted in an unsupportive political environment and a turbulent macroeconomic context that eventually led to the renationalisation of its power utilities.

A transition to greener energy supplies represents the quickest path out of loadshedding and a once-in-a-generation opportunity to place SA on a high (and green) growth and development pathway.

At the end of the day, privatised utilities operate at higher levels of efficiency while adopting better governance and management practices. However, transitioning to that requires broad political agreement and careful and considered reforms - Vietnam demonstrates this. SA has the potential to follow a similar pathway to the likes of Vietnam in ensuring the security of energy supply while attaining the twenty-first-century climate change targets of weaning the energy sector off coal and other so-called "dirty" inputs. Such a transition to greener energy supplies represents the quickest path out of loadshedding and a once-in-a-generation opportunity to place SA on a high (and green) growth and development pathway.

The same can be said for challenges centred around SA's failing rail infrastructure. The first signs of a turn in our rail industry will not be a change in the fortunes of a mining house on a different continent but rather the potential for job security in SA's manufacturing sector with the further potential of SA's export base. It will mean the decision of both local and international companies to invest in and expand their production facilities - it will mean market entrants rather than exits. The effect will be expansive across SA's economy, which means investment and job creation. But a country's economic prosperity is underpinned by firm confidence, rising levels of productivity and constructive physical and human capital investment. It is the foundation for SA to sustainably increase potential growth and narrow the income divide.

The wisdom of back pain

WRITTEN BY:
Nick Dennis
Fund Management

Nick has managed the Anchor Global Equity Fund (which won two 2020 Raging Bull Awards and the 2022 Raging Bull Silver Trophy for Best FSCA-approved Offshore Global Equity Fund [best straight performance over three years] at the 2022 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.

Control your emotions! Emotions are the enemy!

Googling the phrase "quotes about emotions and investing" yields just over 2.2mn results. Click on any of the links, and you will find endless quotes extolling the virtues of rationality and warning against the evils of emotions. This wisdom, passed down through the ages and backed by the field of behavioural finance, is an incontrovertible fact.

Except ... it is not.

Research from the field of neuroscience reveals that emotions, far from being an unnecessary distraction, are a critical component of **all** decision-making. According to neuroscientist Antonio Damasio, we would struggle to make the simplest decisions, like choosing breakfast cereal, without emotions. Denise Shull, a trading coach and author with a background in neuropsychoanalysis, goes a step further. Shull contends that we make decisions based on a prediction of **future** emotions. I buy a share because I anticipate feeling happy after it goes up. I sell a share because I anticipate feeling relief after it falls, and I no longer hold it. This is a by-product of our brain's primary purpose: to keep us safe.

Even though we believe we are making rational decisions based on hard data, Shull has a different take: "You think you make a decision based on some analysis. You don't. You make the decision on how you **feel** about the analysis, your confidence in the outcome that you're predicting."

SIGNAL IN THE SPASM

Emotions can be extremely useful. One example is intuition, a form of pattern recognition based on experience. Sometimes investors have a sense that 'something is off', even if there are no hard facts to support that view. This sense of knowing may even manifest physically. Robert Soros said the following about his father, legendary hedge fund manager George Soros: "My father will sit down and give you theories to explain why he does this or that. But I remember seeing it as a kid and thinking ... at least half of this is BS; I mean, you know the reason he changes his position in the market or whatever is because his back starts killing him. It has nothing to do with reason. He literally goes into a spasm, and it's his early warning sign".

Intuition and gut instinct are not the same. The former is domain-specific based on experience, while the latter has no such grounding. A novice investor may think he knows what is coming next but has no basis for that view. Unfortunately, intuition is often seen as flaky and unserious. Hard facts and data are regarded as robust, intuition is not.

Occasionally an investor will have a gnawing sensation that a stock is not acting as it should. For example, a company will release strong financial results or announce the launch of a new product, but instead of rising, the stock sells off on the news. The investor has a vague sense of unease but does nothing, as no facts suggest his thesis has changed. The stock then falls 20%, prompting the investor to rework the numbers, which confirms that the story is unchanged. This process repeats for every 20% the stock falls until the company announces a significant deterioration in its financial results. The investor plugs the new scenario into his model, at which point the numbers no longer support the investment. Anticipating the embarrassment of looking like an idiot, the emotion becomes too great, and the investor capitulates, selling the stock. This ends up being at or close to the bottom. In the post-investment review, the lessons are usually: "I let my emotions get the better of me. I need to be more disciplined/patient/rational. I should not change my numbers based on market sentiment."

Unfortunately, intuition is often seen as flaky and unserious. Hard facts and data are regarded as robust, intuition is not.

This scenario is all too common. Ironically, while emotions are cited as the enemy, listening to the emotional warning signs far earlier in the process would have prevented substantial pain. But how can we distinguish between the first emotion (intuition) and the second (panic)? This is a function of urgency. With intuition, we have a sense of unhurried knowing; contrast this with the feeling of being compelled to do something this instant (Buy! Sell!).

DEBUNKING EMOTIONAL DOGMA

The economist John Maynard Keynes said, "Practical men who believe themselves to be quite exempt from any intellectual influence are usually the slaves of some defunct economist." Keynes' quote could be readily applied to investing. The famous investors who talk dismissively about emotions are not necessarily wrong per se, but I suspect they may have lower emotional capacity than the average person. If you do not feel anything (including pain), there is nothing to control. For the rest of us, attempting to follow in their footsteps is almost impossible, not to mention counterproductive.

Put together, we have a situation where society and the established investing dogma (which can be quasi-religious) put investors in a position where they are constantly experiencing internal conflict and reinforcing the wrong lessons in a vicious circle.

Simply recognising, naming and writing down our emotions when making decisions has tremendous power.

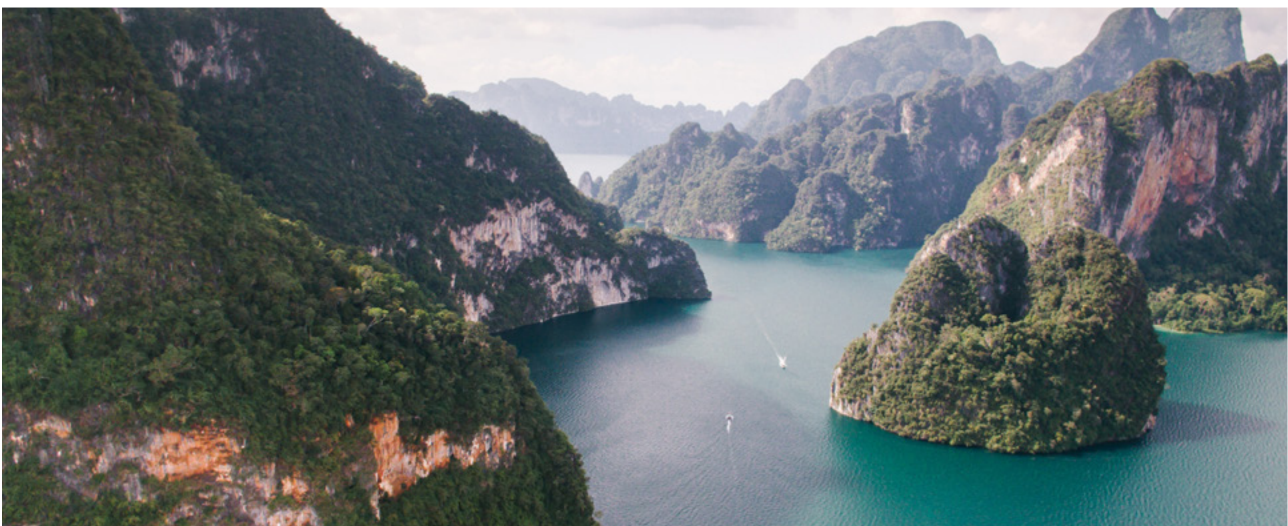
What is the solution? According to Shull, simply recognising, naming and writing down our emotions (both present and anticipated) when making decisions has tremendous power. For example, when buying XYZ stock, I might say, "I'm feeling FOMO (fear of missing out), and I think I'll feel relieved and happy after it rises". Just writing that out may cause me to rethink the trade or start with a smaller position. Alternatively, I may take the trade, but if I notice a pattern where I write about FOMO three times in a row and every trade fails, I will be less likely to do so the fourth time.

Listening to our emotions in other contexts is also helpful. For example, perhaps we are angry at ourselves for making a series of poor choices that led to a bad investment. Instead of brushing our feelings aside, we should channel that anger into researching those decisions and looking for ways to improve.

DIGGING DEEPER, DISCOVERING YOUR 'WHY'

Understanding markets and the role of emotions is a good start, but it only scratches the surface. Jesse Livermore was among the greatest traders of all time and understood the psychology of markets and the human condition, noting, "Successful trading is always an emotional battle for the speculator, not an intelligent battle." Livermore was the basis for the main character of the book *Reminiscences of a Stock Operator*, which to this day is compulsory reading for aspiring traders. Livermore made and lost several fortunes, with an estimated peak net worth of US$100mn (US$1.5bn in today's money). Sadly, Livermore could not overcome his demons and committed suicide on Thanksgiving Day in 1940, his note to his wife talking about his sense of failure and unworthiness.

Many investors may need to delve deeper into their psyches and journey into their past to solve the root causes of their problems. These often stem from our childhoods and relationships with parents, which form the basis for all subsequent relationships with others, the world, and even ourselves.



Investing is one of the most psychologically taxing pursuits (even more so with the added burden of managing other people's money and being measured daily). Yet, 80 years after Livermore's passing, investor Charles Harris recounts his incredible story with unusual candour and vulnerability (*A Trader's Journey: Charles Harris*). At one stage, Harris had converted a few thousand dollars starting stake into several million for a cumulative gain of over 100,000%. But a series of inexplicable mistakes saw his account drop by over 80% from its peak, causing immense stress and, eventually, the end of his marriage after 27 years.

The whole video is worth watching for those with more than a passing interest in investing, but the crux of the story starts around the 1-hour 16-minute mark. Harris asks, "How does a person who is clearly so capable of succeeding in the markets, and who was able to achieve spectacular heights, end up sabotaging himself with a string of bad choices that fly in the face of everything he knows and everything he teaches? Why did I break every rule in the book? I sabotaged my success because, deep down, I didn't feel I deserved it. I didn't feel worthy. How I felt on the inside wasn't matching up with how I was doing on the outside, so unconsciously, I did something about it and put the two in line."

While the topic of emotions is highly relevant to investing, it also has broader applicability.

Harris goes on to talk about his search for worthiness and finding meaning in relationships rather than money and status. Later he makes a key observation, "Anyone can figure out what they're doing wrong, but figuring out **why** is another thing entirely."

Hopefully, it is apparent that while the topic of emotions is highly relevant to investing, it also has broader applicability. With that in mind, I will leave the parting words to Shull: "Don't judge yourself. Just don't judge yourself. Stop being self-critical, stop self-doubting. Just try to understand what you're feeling, why you're feeling it, and look for that information."

Asset allocation and diversification within asset classes

WRITTEN BY:
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Wealth Management

David comes from an auditing background, and he articled at PKF Johannesburg, where he worked as a consultant before joining Anchor as a wealth manager in 2018. He specialises in wealth and asset management.

I would describe 2022 as learning how to surf for the first time. But then, just when you think you are getting the hang of it, you get knocked down and realise that the ocean (markets) can be unpredictable, and every wave you try to catch has an unknown element - volatility.

It has been difficult for investors to navigate markets in 2022 and 1Q23. Last year was probably the hardest to navigate, but it is getting easier in 2023 to see past high interest rates and earnings downsides for companies. Over the last few years, clients with offshore, long-only equity exposure have had a challenging ride. Depending on when an investor got into the market or started to deploy their capital offshore, such an investor probably experienced a volatile journey - going from all-time highs during the COVID-19 pandemic to all of their profits being wiped out in 2022.

Nobody thought that the Fed and other countries' central banks would be hiking interest rates as high and fast as they did, leading to company valuations declining substantially from their 2021 highs. At the beginning of 2022, market consensus forecasts only expected US interest rates to increase by 2%. Still, we are now at over 5% and possibly expecting further rate hikes in the next 6-12 months. Nevertheless, economies are holding up at these high interest rate levels, indicating that rates will stay higher for longer. This is not great news for share prices or clients investing in equities, as valuations are impacted by higher rates, especially those high-growth and tech companies in which Anchor likes to invest.

WHAT DOES THAT MEAN FOR CLIENTS MOVING FORWARD?

As a wealth manager, the last year has been very uncomfortable dealing with market volatility and ensuring our clients have the correct risk profile and asset allocation. The hardest part for me has been keeping clients calm during incredible fluctuations in global markets, which affects client portfolios, and ensuring that we decrease clients' risk to generate returns during this period. As a result, I have driven our portfolio managers and macroeconomic teams up the wall over the past 12 months, asking for guidance. After every conversation where I would be trying to take some risk off the table for clients, we would end up discussing each client's overall asset allocation. The conclusion would be that nine out of ten clients are sufficiently diversified in terms of their overall asset allocation.

However, I have still not been satisfied just holding long-only equities during this period, and, as a business, we have been identifying ways in which we can generate returns and de-risk our clients during these volatile periods while still having the correct equity exposure as not to miss out when sentiment starts to change (no one knows when this will happen). I have a responsibility towards my clients to find further diversification within the asset classes to generate returns during volatile periods while also being aware that market sentiment can change and that we should be taking advantage of the good months during the next 6-12 months.

So, what has Anchor done to diversify clients within the various asset classes? We have identified hedge funds that perform during times of volatility in both local and offshore equities that play on different macroeconomic themes. Alternatives in private equity/credit that are generating a steady yield locally of 13%-14% p.a. and an offshore yield of 9% p.a. as well as structured products which, depending on your level of risk, generate a 10%-12% p.a. return while having capital protection barriers at different levels.

These are great diversifiers because they generate equity-type returns in a very volatile market environment with downside protection. This does not mean we should take all the equity risk off the table and only invest in alternatives, but rather that we are diversifying each asset class. Let us take January as an example of when market sentiment changed to positive. Markets were up anywhere between 5%-10% in January alone. If you miss these positive months, it can severely impact your long-term overall portfolio performance. In *Figure 1*, *Bank of America* highlights the impact of missing the US market's best and worst days in each decade.

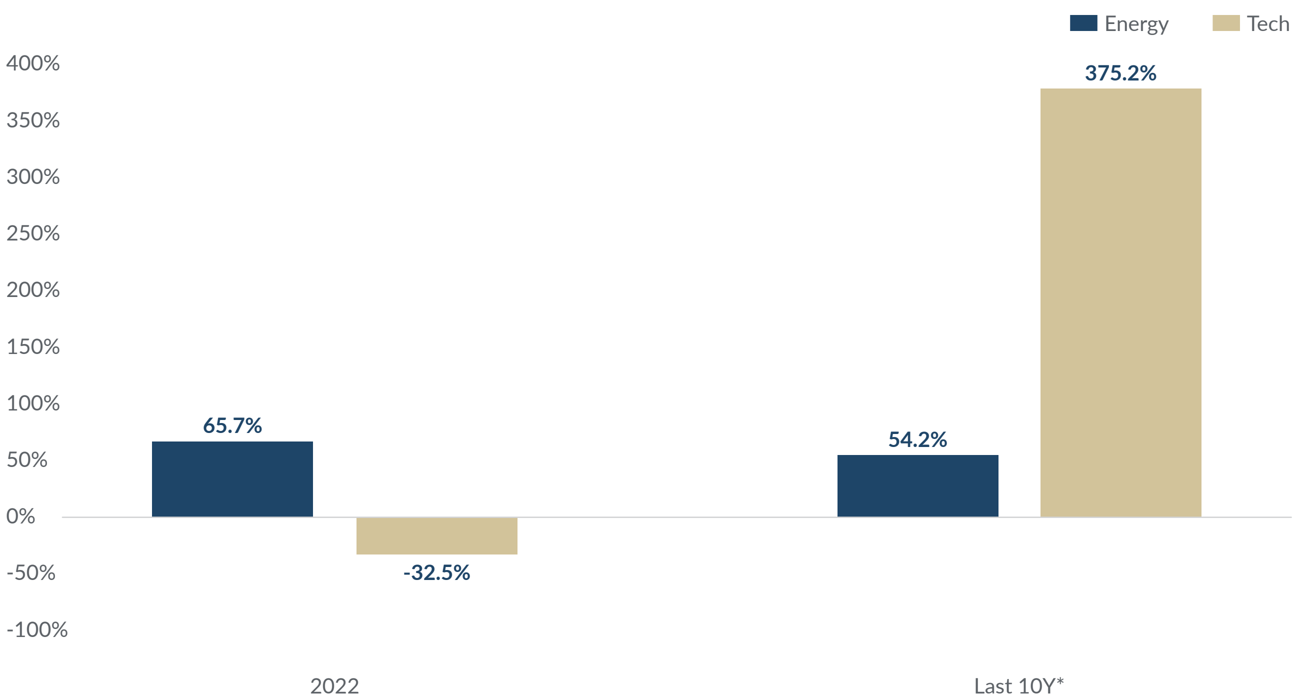
Figure 1: The difficulties of trying to time the market
Source: Bank of America, S&P 500 returns, CNBC

Decade	Price Return	Excluding worst 10 days per decade	Automotive	Liquid Fuels & Gas
1930	-42%	39%	-79%	-50%
1940	35%	136%	-14%	51%
1950	257%	415%	167%	293%
1960	54%	107%	14%	54%
1970	17%	59%	-20%	8%
1980	227%	572%	108%	328%
1990	316%	526%	186%	330%
2000	-24%	57%	-62%	-21%
2010	190%	351%	95%	203%
2020	18%	125%	-33%	27%
Since 1930	**17 715%**	**3 793 787%**	**28%**	**27 213%**

Markets are going to be choppy over the next 12 months. Your asset allocation and diversification within various asset classes are going to be very important when markets start to recover (no one knows when this will take place and what else may happen during this journey, in March, we have already seen a banking mini-crisis in the US and a crisis of confidence in Swiss bank Credit Suisse- *see our report entitled, The excess deposits banking mini-crisis, dated 16 March 2023*). I cannot predict what will happen next in markets, but as wealth managers, we can most certainly de-risk clients where appropriate within the various asset classes and, by doing so, try to prevent their portfolios from being very volatile, instead only having portions of volatility within the various asset classes. Whether it is in your portfolio's fixed income or equity portion will depend on your appetite for risk and volatility.

We are constantly looking for opportunities to achieve better returns for our clients or themes that can generate better returns in the future. Tech shares have been hit hardest during the past year's volatility while the share prices of energy companies have been soaring. Market cycles repeat themselves, and we believe in upweighting into good tech companies with growth prospects. These companies will have their turn to shine again; this is one theme we are starting to upweight in our portfolios.

Figure 2: The performances of energy counters vs tech shares , 2022 and over the past decade
Source: Bloomberg, Anchor



**10 years is to 28 February 2023*

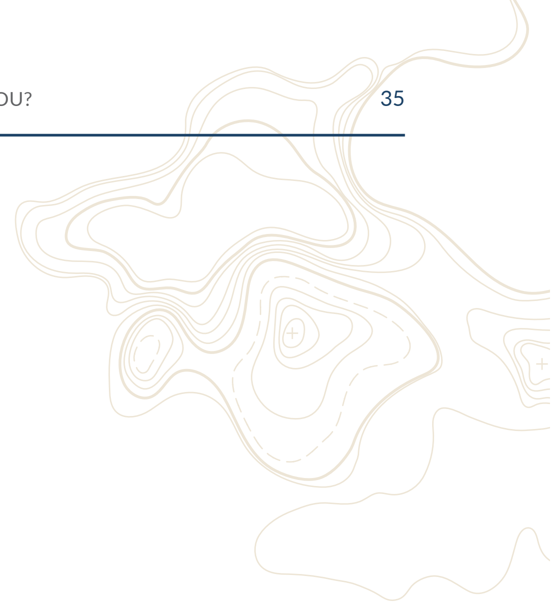
CONCLUSION

We cannot predict the future. All we can do is manage to catch the wave and ride it for as long as we can, knowing that there is still some volatility ahead this year. We can also diversify across various asset classes and de-risk where appropriate to limit volatility within a client's portfolio.

We cannot predict the future. All we can do is manage to catch the wave and ride it for as long as we can.

Interest rates are higher now, allowing us to take some risk off the table and still generate a good return without the volatility of holding equities. Alternative investments have been a great diversification within the fixed-income space, generating equity-type returns in a low- to medium-risk profile. Equities have been very volatile, but the SA market has performed well over the past year. However, over the past 5-6 years, the JSE has not performed as well, and investors would likely be disappointed with their overall returns over that period. Over this period, hedge funds have performed consistently and are a great way to diversify your portfolio. In addition, hedge funds love the market volatility we have been experiencing, and we recommend that you have an allocation in this asset class. Offshore equities performed well over the past 5-6 years, but 2022 was incredibly volatile, and we have diversified clients into hedge funds, structured products and alternatives. This type of diversification in a highly volatile market environment allows us to de-risk the asset class and generate some returns while holding equities for when market sentiment does turn.

As Bette Davis said in the movie *All About Eve*, "Fasten your seat belts, it's gonna be a bumpy ride", and that is why it is important to diversify within asset classes and take some risk on themes!



The South African Reserve Bank: Why is it important to you?

WRITTEN BY:
Di Haiden
CEO: Robert Cowen Investments

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

WHAT IS THE SOUTH AFRICAN RESERVE BANK (SARB)?

Established in 1921 as a direct result of the abnormal monetary financial conditions which World War 1 had brought, the SARB is the central bank of SA.

The SARB is responsible for the following:

- **Monetary policy:** Protecting the value of the rand and using interest rates to keep inflation low and steady.
- **Financial stability:** Identifying and mitigating risks that may disrupt the SA financial system.
- **Prudential regulation:** Regulating financial institutions in SA.
- **Financial markets:** Managing SA's gold and foreign exchange reserves.
- **Financial surveillance: Regulating cross-border transactions.**
- **Payments and settlements:** Ensuring the safety and soundness of the national payment system.
- **Statistics:** Providing statistics that present an overview of SA's economic situation.
- **Research:** Supporting policy decision-making.
- **Banknotes and coin:** The SARB has the sole right to make, issue and destroy banknotes and coin in SA.

As you can see, the SARB has various mandates and tasks to fulfil. However, this article focuses on **FINANCIAL SURVEILLANCE, i.e., regulating cross-border transactions with respect to individuals.**

WHAT ARE CROSS-BORDER TRANSACTIONS?

These are financial transactions where the payer and the recipient are based in different countries. The SARB is responsible for the daily administration of exchange controls in SA, including monitoring ALL cross-border transactions. To do this, the SARB appoints certain registered banks as Authorised Dealers in foreign exchange with limited authority (ADLAs).

HOW DOES THIS AFFECT YOU?

Every transaction you undertake that goes 'across the border' has to be declared to the SARB, e.g., your foreign investment allowance of R10mn AND your discretionary allowance of R1mn p.a. These movements are monitored by the use of Balance of Payment (BoP) forms which are completed when the transaction takes place.

HOWEVER, what happens when the transaction is not technically going across the SA border, i.e., it is a transaction with an SA resident but does not involve the SA banking system, and no BoP form is completed?

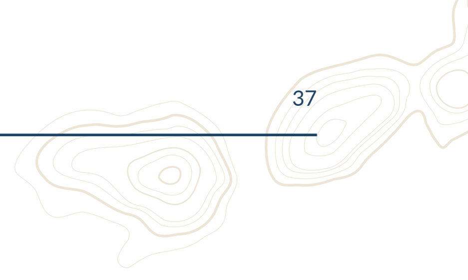
- Does it have to be approved by the SARB?
- Does it have to be reported to the SARB?
- Does it need to be regularised with the SARB?
- Does it need to be declared in terms of a Voluntary Disclosure Programme (VDP)?
- What are the consequences of not reporting a transaction?
- Do penalties apply if a transaction is not declared?

To know the answers to the above, it is important to understand the detail of what you have either done or are going to do, and often the answer to the above questions is, 'Well, it depends ....".

Examples of which transactions need to be considered for submission to the SARB, bearing in mind that Joe Soap is an SA resident, include the following:

- In 2012, Joe Soap inherited a property offshore but has never declared it to the SARB.
- In 2016, Joe Soap gave his daughter in the US a lump sum but paid her from his existing offshore account with funds sent offshore from SA.
- In 2020, Joe Soap was paid a sum of money by his sister, who lives in Malta, into his offshore account.
- Joe Soap has received a distribution from an offshore trust into his offshore bank account.
- Joe Soap took travellers' cheques in the '90s when going on holiday and deposited the funds into a bank account offshore.

All of these are cross-border transactions and, depending on the detail, may or may not have to be declared to the SARB. So, it is important to look at the specific circumstances of the transaction and when it was done. In the 2022 budget, several amendments were made. However, suppose a transaction took place before 23 February 2022. In that case, the old rules still apply, and the transaction needs to be regularised and declared to the SARB via an Authorised Dealer, i.e., your bank.



Have you been involved or intend to undertake any of the following?

1. Received funds as a donation from a non-resident?
2. Received funds as a loan from a non-resident?
3. Transferred funds to an SA resident offshore?
4. Received an inheritance offshore from a non-resident estate?
5. Received an inheritance offshore from a SA estate?
6. Received distributions offshore from an offshore trust?
7. Did you declare all your assets if you immigrated to SA?

There are many variations on the above which could mean you are in contravention of SA's foreign exchange regulations, and it is important to address them so that any future transactions are not 'tainted' by old transactions that are non-compliant.

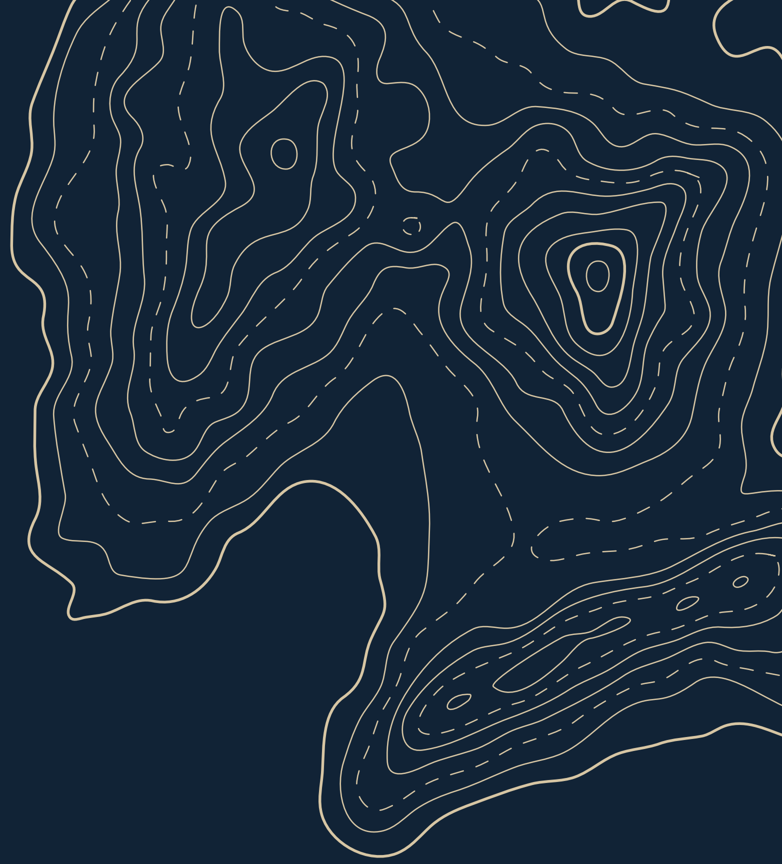
This article does not seek to address any tax issues that fall under the auspices of the South African Revenue Service (SARS) and NOT the SARB. Still, all cross-border transactions are subject to local tax disclosure and compliance.

If you have queries or need assistance, please contact Di Haiden or Kate Trollip, and we can point you in the right direction to resolve your issues.

Please note that any contravention of exchange control regulations may be subject to a penalty. Now that the financial world has become far more integrated and financial data are shared between jurisdictions, it is essential to have your affairs in order.

Performance Summary

	FUND PERFORMANCE									BENCHMARK PERFORMANCE							
	Start date	Annualised p.a.	Since inception	5 Year	3 Year	12-month	6-month	3-month	Mar-23	Since inception	5 Year	3 Year	12-month	6-month	3-month	Mar-23	Performance vs Benchmark
UNIT TRUSTS																	
Anchor BCI Equity Fund	Apr-13	9.1%	137.7%	4.5%	18.2%	2.1%	12.4%	4.4%	-2.9%	124.4%	6.5%	23.0%	0.2%	15.0%	2.4%	-2.0%	13.3%
Anchor BCI SA Equity	Aug-21	12.1%	18.9%	N/A	N/A	4.6%	13.3%	2.5%	-3.5%	16.9%	N/A	N/A	0.2%	15.0%	2.4%	-2.0%	2.0%
Anchor BCI Flexible Income Fund	Jun-15	7.0%	69.4%	6.6%	6.8%	6.4%	5.2%	2.3%	0.7%	66.5%	6.2%	5.3%	6.7%	3.7%	1.9%	0.7%	2.9%
Anchor BCI Managed Fund	Jan-15	5.2%	51.8%	5.9%	14.8%	4.3%	9.7%	3.7%	-2.3%	63.9%	7.6%	15.1%	5.0%	11.5%	4.2%	-1.5%	-12.1%
Anchor BCI Worldwide Flexible Fund	May-13	9.4%	142.7%	8.6%	9.2%	10.3%	17.0%	9.7%	-2.6%	135.6%	8.8%	9.2%	11.0%	3.7%	2.0%	1.0%	7.1%
Anchor BCI Property Fund	Nov-15	-3.2%	-21.7%	-4.5%	14.3%	-7.0%	7.1%	-4.9%	-4.9%	-21.4%	-4.1%	18.2%	-3.4%	13.3%	-5.1%	-3.4%	-0.3%
Anchor BCI Global Equity Feeder	Nov-15	12.0%	131.0%	17.0%	15.1%	1.4%	2.1%	3.5%	-0.6%	131.3%	16.0%	15.2%	12.2%	15.6%	11.7%	-0.3%	-0.2%
Anchor BCI Bond Fund	Feb-16	8.8%	83.3%	6.8%	11.3%	5.6%	9.3%	3.6%	1.3%	83.5%	6.9%	11.6%	5.8%	9.3%	3.4%	1.3%	-0.2%
Anchor BCI Diversified Stable Fund	Feb-16	7.4%	67.1%	7.8%	12.4%	8.9%	9.8%	4.4%	-0.2%	56.0%	6.9%	10.5%	6.0%	8.6%	3.6%	-0.4%	11.1%
Anchor BCI Diversified Moderate Fund	Feb-16	7.1%	63.8%	8.0%	15.3%	9.8%	12.2%	4.9%	-0.7%	56.7%	7.4%	12.9%	5.6%	10.3%	4.0%	-0.9%	7.2%
Anchor BCI Diversified Growth Fund	Feb-16	6.7%	59.5%	7.8%	17.9%	10.1%	13.8%	6.1%	-0.9%	58.7%	7.6%	15.1%	5.0%	11.5%	4.2%	-1.5%	0.8%
Anchor BCI Africa Flexible Income	Mar-16	5.7%	47.6%	7.1%	7.0%	7.6%	11.9%	2.4%	-2.9%	75.8%	7.8%	6.8%	8.0%	4.3%	2.2%	0.8%	-28.1%
Anchor BCI Global Technology Fund	Jun-19	6.9%	29.0%	N/A	3.2%	1.2%	12.2%	17.3%	0.9%	125.3%	N/A	21.0%	12.3%	25.7%	25.6%	5.8%	-96.2%
Anchor BCI Flexible Fund	Jul-13	8.1%	114.3%	10.9%	5.3%	-0.3%	12.4%	18.9%	6.1%	10.1%	9.8%	10.2%	12.1%	4.2%	2.2%	1.1%	104.1%
Anchor BCI Core Income Fund	Sep-20	6.1%	16.4%	N/A	N/A	7.0%	0.1%	2.1%	0.7%	12.6%	N/A	N/A	6.0%	3.4%	1.8%	0.6%	3.8%
Anchor BCI Global Flexible Income Fund	Sep-20	2.0%	5.3%	N/A	N/A	19.9%	1.8%	5.2%	-2.7%	10.0%	N/A	N/A	25.1%	1.0%	5.6%	-2.9%	-4.8%
Anchor BCI Worldwide Opportunities Fund	Feb-21	0.3%	0.6%	N/A	N/A	2.9%	11.8%	7.5%	0.6%	14.2%	N/A	N/A	7.0%	1.8%	1.0%	0.7%	-13.6%
EQUITY NOTES & SEGREGATED MANDATES																	
Anchor Equity	Jul-13	8.9%	129.8%	7.6%	23.7%	2.8%	12.9%	2.3%	-4.3%	122.8%	2.4%	23.0%	0.2%	15.0%	2.4%	-2.0%	7.0%
HEDGE FUNDS																	
Anchor Stable SNN RIHF	Jul-03	12.4%	909.9%	8.4%	17.8%	13.9%	10.0%	3.5%	0.5%	284.4%	5.8%	4.8%	6.0%	3.4%	1.8%	0.6%	625.6%
Anchor Accelerator	Feb-16	7.1%	63.5%	8.9%	6.9%	-6.1%	7.3%	0.2%	-2.5%	61.6%	6.5%	23.0%	0.2%	15.0%	2.4%	-2.0%	1.9%
OFFSHORE																	
Anchor High Street Equity - Dollars	Jun-12	9.4%	162.4%	5.0%	10.1%	-7.0%	21.9%	12.6%	6.3%	191.4%	8.6%	17.0%	-6.5%	18.5%	7.9%	3.2%	-29.1%
Anchor High Street Equity - Rands	Jun-12	17.5%	469.2%	14.0%	9.8%	13.0%	20.3%	17.5%	2.8%	531.2%	17.7%	16.8%	13.2%	16.3%	12.3%	-0.2%	-62.0%
Anchor Global Balanced - Dollars	Jun-12	7.2%	111.1%	2.8%	5.7%	-7.6%	13.0%	6.2%	2.0%	88.5%	4.5%	8.3%	-7.2%	14.0%	5.8%	3.1%	22.6%
Anchor Global Balanced - Rands	Jun-12	15.3%	360.4%	11.7%	5.7%	14.5%	13.8%	13.0%	0.6%	303.3%	13.0%	7.7%	11.1%	10.1%	10.4%	-0.1%	57.1%
Anchor Global Dividend - Dollars	Jan-14	7.1%	87.5%	5.5%	12.3%	-5.8%	13.9%	2.1%	0.6%	116.7%	8.6%	17.0%	-6.5%	18.5%	7.9%	3.2%	-29.1%
Anchor Global Dividend - Rands	Jan-14	12.7%	198.2%	14.3%	11.9%	14.5%	12.4%	6.4%	-2.8%	245.4%	17.7%	16.8%	13.2%	16.3%	12.3%	-0.2%	-47.2%
Anchor Global Stable Fund - Dollars	May-15	0.9%	6.9%	1.5%	2.0%	-2.8%	5.4%	1.6%	0.6%	27.4%	3.4%	3.8%	5.8%	3.1%	1.6%	0.5%	-20.5%
Anchor Global Stable Fund - Rands	May-15	5.8%	56.0%	10.0%	1.8%	17.8%	3.4%	5.7%	-2.7%	86.7%	12.1%	3.7%	28.8%	1.5%	6.1%	-2.6%	-30.7%
Anchor Global Equity - Dollars	May-15	10.5%	119.2%	11.5%	20.3%	-12.6%	7.5%	1.9%	5.1%	70.8%	6.9%	15.4%	-7.4%	17.8%	7.3%	3.1%	48.4%
Anchor Global Equity - Rands	May-15	16.0%	219.9%	21.0%	20.1%	5.9%	5.4%	6.1%	1.7%	149.2%	16.0%	15.2%	12.2%	15.6%	11.7%	-0.3%	70.7%
RCI UNIT TRUSTS																	
RCI BCI Flexible Growth Fund	Sep-16	5.8%	44.3%	7.0%	3.9%	-7.7%	8.8%	14.2%	0.1%	84.6%	9.8%	10.2%	12.1%	4.2%	2.2%	1.1%	-40.3%
RCI BCI Worldwide Flexible Fund	Dec-16	6.9%	52.7%	9.8%	2.1%	4.5%	15.2%	16.5%	0.6%	71.1%	8.8%	9.2%	11.0%	3.7%	2.0%	1.0%	-18.5%



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