ANCHOR

STRATEGY & ASSET ALLOCATION

3RD QUARTER 2018

EXECUTIVE SUMMARY

On the domestic front, both equity and bonds have been under pressure of late. Indeed, investing on the JSE has been a hard grind for the last three years and 2018 has thus far provided little relief. Our market's drivers seem to have conspired against each other with frustrating regularity for some time now. When SA Inc. has rallied, the rand has strengthened (and vice versa); when Naspers was running, SA Inc. was battling; when we were getting some momentum, Steinhoff and Resilient happened. The net result has been a spluttering, stalling, frustrating sideways slog. Remember that eventually some of these factors (except for Steinhoff) will combine positively to produce an outsized positive surprise. In this report we take a step back and survey the fundamental drivers of the domestic market. We also highlight some compelling bargains amongst SA's large corporates. Ultimately, we think these opportunities warrant our modest Overweight stance on SA equity.

The pressure on domestic bonds during the recent quarter reflected both global and domestic factors: worrying developments in Italian politics, and the prospect of a "trade war," sparked a risk-off attitude that affected emerging markets (EMs) in general. This was compounded by an unexpectedly weak GDP number domestically. We think SA bonds should deliver decent returns from these levels, in the region of 10% p.a. However, as we prefer domestic equity on a risk-adjusted basis, we have retained our 'neutral' stance on domestic bonds.

Global equities remained volatile during the quarter. Developed Market Equities (MSCI World) were essentially flat during the quarter, while EM equities (MSCI EM) were down about 10%. Both markets are in the red, YTD. Although we expect strong earnings growth over the next 12-24 months, buoyed by strong global GDP growth, we expect only modest returns from global equities, still in the region of 7% p.a. in US dollar terms. That is, we think markets will lag earnings growth due to important policy shifts (trade, fiscal and monetary), valuation multiples, and "late-cycle" worries. We thus remain neutral on global equity.

We expect yields on global bonds to edge higher, with the US 10-year Treasury ending the year in the region of 3.1%. This reflects a continuation of US growth, and a consequent normalisation of monetary policy. In spite of this unappealing return, we retain a neutral weighting to global bonds due to their risk-diversifying properties.

Our expected returns for these asset classes, both domestic and global, as well as for property and the rand, are predicated upon our view that the outlook for global growth remains positive, in spite of noteworthy risks. This report will therefore revisit the key judgements that undergird this positive and pro-cyclical stance. It will also touch upon our assessment of certain key risks associated with shifts in US fiscal and trade policy, softening macroeconomic data in Europe, and China's changing policy emphasis, from "deleveraging" to "boosting domestic demand".

This report also contains specific thematic notes which address the significance of electric vehicles to the outlook for commodity prices, signs of hope for the SA property sector, and some closing reflections on the importance of philosophy to investment analysis.

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01 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 12M FWD (R)
	UW	N	OW	
LOCAL				
Equity			■	16%
Bonds		■		11%
Property		→	■	18%
Cash	■			6%
GLOBAL				
Equity		■		2%
Government bonds		■		-5%
Corporate credit		■		-2%
Property	■			-2%
Cash	→	■		-3%

UW = Underweight; N = Neutral; OW = Overweight

02 STRATEGY AND ASSET ALLOCATION

Local equity

We have recently updated domestic equity to overweight. This may seem like a strange decision, given that the JSE has consistently disappointed investors over the last three years. In our thematic note below, entitled The JSE: Finding the horizon amid the desert, we make the case for meaningfully improved prospective returns. We expect earnings growth of 12% and 16% over the next 12 and 24 months, respectively. If SA economic growth accelerates, 2019 could see even higher earnings growth rates. Although certain risks have increased, many shares and sectors have moved decisively into attractive value territory. Thus, having nudged equities to overweight (a 14% projected return) in our 1Q18 strategy report, we retain this positioning into 3Q18.

Local bonds

The SA bond market came under significant pressure in 2Q18, giving up all the gains seen in 1Q18. This can be attributed to a cluster of events that transpired during the quarter and which were negative for the SA bond market. The most prominent of these was the rise of political tensions in Italy that prompted a risk-off sentiment, and the ongoing trade war between the US and its trading partners. This put to question future growth in emerging markets (EMs) and the apparent move to tighter global monetary conditions; these, in turn, stirred fears of holding EM assets for global investors. Generally, SA has a high EM sensitivity and thus the events outlined above led to foreigners selling R60bn-plus of SA bonds in over two months. This was further perpetuated by the faster-than-expected contraction in SA GDP for 1Q18 (-2.2%). We believe that fundamentals have not changed in the EM space and thus, when global risk normalises and the risk-on sentiment returns, the same tide that led to SA bonds weakening should lift them back up. During the course of 2Q18, SA bonds sold-off from low yields of 8.02% and moved as high as 9.40%, before settling around 8.90%. The Anchor fair-value model is currently projecting a fair yield of around 8.55%. At current levels, bonds appear relatively cheap and should mean revert when global risk factors normalise. We expect a twelve-month return of 10.90% that comprises of 8.90% interest carry and 1.99% capital gains.

Local property

We recommend an overweight position in domestic property. We estimate a likely return of 18.4% over the next 12 months. Under our bear-case scenario, we still see the potential for positive returns in line with domestic cash. Thus, we consider the sector to be attractive on a risk-adjusted basis.

The relentless selling of The Resilient Group in the first half of the year has filtered down to the broader property market of late. Investors have had their worst period of 6-month performance ever in the sector. Although the underlying fundamentals are not especially compelling at present, the de-rating that has occurred now means that yields, which more than compensate for this, are rather attractive.

Some key risks in the sector are as follows: (1) Land expropriation and the possible impact on asset prices. At this point in time the concern is pervading the entire SA market. (2) Fundamentals are under pressure, and above-inflation distribution growth, which has been delivered consistently, is likely to disappoint in 2018 and 2019. (3) Corporate governance is now in the spotlight, and comes with both the risk of further unseemly disclosures, and the hope of fundamental improvements in response to this new level of scrutiny. (4) There are still investigations of the Resilient stable, which may keep the sector under a cloud until their conclusion.

We think the sector is attractive, even in light of these risks. The forward yield on the benchmark SA Listed Property Index (JSAPY Index) is now over 9%. Even if, through prudence, we were to reduce the growth rate in distributions to 6% (current management guidance would average out higher than that at 7.8%); and, furthermore, we were to mark the exit yield to the current R186, then we would still arrive at a forecast one-year return of over 18%.

Our bear-case scenario cuts income growth to 4% and ramps the exit yield up to 9.5%; even here, returns are still in-line with domestic cash. Consequently, in our judgement, investors are more than sufficiently compensated for the risks attached to this sector, and we have recommended an overweight position.

The rand

The South African rand is one of the world's most volatile currencies. Forecasting the local currency with any degree of certainty is not possible, hence we monitor a wide range of outcomes for the rand. For the purposes of this document, we are forecasting an exchange rate of R13.20/$1 in twelve months' time which is slightly above the midpoint of our range of R10.90-R14.16 vs the US dollar.

If we were to apply a purchasing price parity model (PPP), then we expect US inflation to average 2.3%, whilst we forecast domestic inflation to average 5.5% over the next year. The differential of 3.2% is the rand depreciation implied by a PPP model.

We also know that the US hiking cycle is likely to be negative for the rand, whilst the domestic election year, the widening of the current account, the low growth rate and the negative shift in our terms of trade mean that the rand is likely to depreciate by more than implied by the PPP model.

Taking the local currency at R12.53/$1, which is the fair value per our PPP model, and extending this by a year at higher-than-implied inflation gives a forecast of R13.20/$1.

Global equity

The prior quarter (2Q18) saw global equities up marginally (+1%) in DMs, but down about 9% in EMs. This year's soft performance is due in part to normal, or 'healthy' factors, as the market takes a breather after a heady 2017, and as it 'digests' a relatively tighter interest rate outlook. But, part of the softness can be traced to concerning risks that resurfaced during the quarter: the Italian election outcome reminded investors of deeper structural weaknesses of the EU project; while US President Donald Trump, again on the "campaign trail", threatened further tariffs on Chinese goods.

Although still small in quantum, the proposed tariffs risk a tit-for-tat escalation that becomes a quantitatively significant "trade war". We discuss this risk in our thematic section below (See: Global Growth: Key Judgements in a Time of Turbulence).

We expect global growth to remain strong in the medium term, relative to the past decade. Yet, in spite of this, we think equity returns will be somewhat pedestrian over the next 12 months, as the composition of returns, seen in the last few years, seems likely to change. During the 2009-2016 period, mediocre economic growth was amplified by the asset-inflating effects of policy stimulus to produce high returns in the equity markets. In 2017, something of a transition year, markets benefited from the unusual combination of high GDP growth, reflected in very strong earnings growth, and still supportive policy. Indeed, although monetary policy tightened a little, from a very low level, financial conditions actually eased in the US during this period. This potent cocktail produced astoundingly strong asset returns in 2017. The current year appears to represent the beginning of a new regime, which may be an inversion of the pattern seen in 2009-2016. This would involve strong, as opposed to mediocre, economic growth, but now combined with policy tightening, which is likely to weigh on asset prices.

Global corporate earnings growth is still expected to be strong, and in the region of 15%-20% over the next 12 months. We expect this to moderate to about 9% in the year thereafter. The short-term fillip is due partly to US tax cuts, and higher commodity prices, especially the oil price. Longer-term earnings growth potential, at around 9% p.a., approximately reflects global nominal GDP growth of c. 6.2% (3.8% real growth + 2.4% US dollar headline inflation), plus the effects of gains in market share by large corporations, and operational leverage (another 2%-3%). Given the expected policy headwind (tightening US rates), and the fact that the one-year forward PE is a little higher than its medium-term average, we expect this solid earnings growth to only partly reflect in equity market returns. Our return

Global equity (cont)

expectation remains, therefore, at 7% in US dollar over the next 12 months. This number comprises an expectation of approximately 9% earnings growth in FY19, plus a 2.5% dividend yield, minus a 4.5% forward PE contraction.

Global bonds

US 10-year bond yields seem biased towards edging marginally higher over the next couple of years as monetary policy normalises. In previous economic cycles, US 10-year rates have maintained a 2%–3% premium over inflation, while this cycle has seen that premium average less than 1% as major central banks have more than tripled the proportion of global bonds they own, spending $8trn on bonds through major quantitative easing (QE) programmes. While the US is tentatively unwinding its QE programme and the EU have announced a halt to theirs, Japan is still buying bonds. If Japan were to halt QE and the EU were to begin unwinding, that could see rates head meaningfully higher from here, but that seems a low probability event in the next 12–18 months.

Risks to lower rates are most likely to come from the ending of the current economic cycle, where central banks would possibly have to step in with monetary easing and reduced consumption would put downward pressure on inflation. However, this scenario again seems less likely leaving us to believe that the most probable path is marginally tighter monetary policy combined with a gently flattening curve (as this economic cycle starts to get long in the tooth). This leads us to forecast 2018 US 10-year rates of 3.1% and 2019 rates at 3.2%.

Global credit

US corporate credit spreads have been under pressure since February as market volatility has driven US investment grade credit spreads about 0.3% wider since they peaked at c. 0.8% in early February. This would have resulted in approximately 2% of capital losses from the credit component of investment-grade bonds. Going forward, the current spreads seem reasonable for this part of the economic cycle and only a meaningful deterioration of economic conditions would likely result in wider credit spreads. With interest rates set to drift slightly higher from here, a reasonable expectation for US investment grade credit is about 1.5% of capital losses from higher interest rates, and c. 4.1% of yield for a 12-month total return of around 2.6% in US dollar terms.

Global property

We are currently underweight global property, with an expected 12-month US dollar return of 3.1%. Although this is higher than global bonds and corporate credit, the latter sectors bring certain portfolio benefits which are important, in our judgement, during a late-cycle environment. Much of 1Q18's de-rating in global property stocks was reversed in 2Q18, with the FTSE EPRA/NAREIT Global Developed Property Index up 6.4% (4.6% in local currency terms) as DM yields remained largely subdued as a result of risk-averse investors. Much like 1Q18, most of the action was in US real estate investment trusts (REITs), which were up over 10% for 2Q18. Results from US mall heavyweight, Simon Property Group (which reported its 1Q18 results during the second quarter) positively surprised and included a message that the firm is not focused on merger & acquisition (M&A) activity, instead choosing to redevelop existing space, particularly department-store tenants. Simon's 1Q18 results showed some progress in that regard, with slightly higher occupancy rates and rental growth. Like-for-like net operating income though was still disappointing, coming in below guidance at 2.3%, and showing that retail REITs are far from being out of the woods.

Elsewhere, UK REITs were one of the biggest disappointments largely as a result of some failed M&A activity. French retail property REIT, Klépierre, decided against a bid for UK-listed retail REIT, Hammerson, which in turn pulled its bid for fellow UK-listed retail REIT, Intu, leaving Hammerson and Intu down 8% and 14%, respectively, in US dollar terms for the quarter.

03 EXPECTED RETURNS ON UNDERLYING ASSETS

The table below summarises our return estimates for the major asset classes.

ASSET CLASS							
EQUITY	PE1	E2 g%	EXIT PE	DIV %	RETURN	ZAR	ZAR RETURN (12M FWD)
Local Equity	14.6	16.0%	13.9	3.4%	14.0%	-	14.0%
Global Equity	14.6	9.3%	14.0	2.6%	7.0%	-4.7%	2.3%
Developed markets	15.8	9.0%	15.1	2.5%	6.6%	-4.7%	1.9%
Emerging markets	11.7	10.0%	11.1	2.9%	8.0%	-4.7%	3.3%
BONDS, PROPERTY AND CASH			YIELD	CAPITAL	LC RETURN	ZAR	ZAR RETURN (12M FWD)
Bonds							
Local government bonds			8.9%	2.0%	10.9%	-	10.9%
Global government bonds			2.8%	-2.7%	0.1%	-4.7%	-4.6%
Global corporate credit			4.1%	-1.5%	2.6%	-4.7%	-2.1%
Property							
Local property			9.0%	9.4%	18.4%	-	18.4%
Global property			4.6%	-1.5%	3.1%	-4.7%	-1.6%
Cash							
Local			6.5%	0.0%	6.5%	-	6.5%
Global			1.9%	0.0%	1.9%	-4.7%	-2.8%

Note: Sector weightings are by market capitalisation; Global Equity benchmark is MSCI World; "PE1" is 12-month forward PE; "E2 g%" is our estimate of earnings growth over the 12 month period, commencing in 12 months time; "exit PE" is our estimate of the PE multiple in 24 months time; "Div %" is our estimate of the dividend yield over the next 12 months; "Return" is our return estimate, over the next 12 months, implied in the tables assumptions about earnings growth, dividends and changes in PE multiples; global markets are estimated in US dollar, local markets in rand; "ZAR" is the currency effect of translating into rand; "ZAR Return" is our estimate of rand market returns over the next 12 months as implied in the other columns of this table.

Benchmark SA bonds are the SA 10-year government bond; The Benchmark Offshore Bonds are the US 10-year Government Bond, and the Bloomberg Global Investment Grade Corporate Bond Index; The local property benchmark is the JSAPY Index; offshore property is the S&P Global REIT Index. "Capital " is our estimate of the capital appreciation or depreciation of an instrument over the next 12 months; "LC Return " is our estimate of the total return, i.e. yield + capital, that the instrument will generate over the next 12 months in its local currency; "ZAR" is our estimate of the currency effect of translating non-rand yields into rand; "ZAR return" is our estimate of the "LC Return" in ZAR.

04

ANCHOR INSIGHTS

In this section, staff from across the Anchor Group provide insights into our thinking, strategy and our view of the world. In this quarter: Blake Allen revisits the key judgements we have made in our assessment of global growth; Peter Armitage reflects upon the JSE's recent lean years and future prospects; Seleho Tsatsi explores the implications of electric vehicles (EVs) on commodity markets. Glen Baker will outline certain hopeful signs for the SA property sector. Lastly, Nick Dennis addresses the role of philosophy in investment analysis.

GLOBAL GROWTH – KEY JUDGEMENTS IN A TIME OF TURBULENCE

Blake Allen
Equity Research & Strategy

Some economic variables are so fundamental that they determine the outlook for almost every asset class. Amongst these, the GDP outlook for the world's major economies surely tops the list of systemically important variables. Indeed, this variable is the central determinant of inflation, real interest rates, corporate earnings growth, and currency markets – consequently the expected return for every major asset class. In a world of big governments, policy developments increasingly dominate the economic landscape. US trade policy ("trade war") and the Italian elections have won the recent headlines. There are also shifts taking place in global monetary and fiscal policy that will profoundly affect markets in coming years. While we are in a time of transition and turbulence, we think the fundamentals still justify a basically optimistic and pro-growth bias in asset allocation. This section explores a few key judgements that support this view.

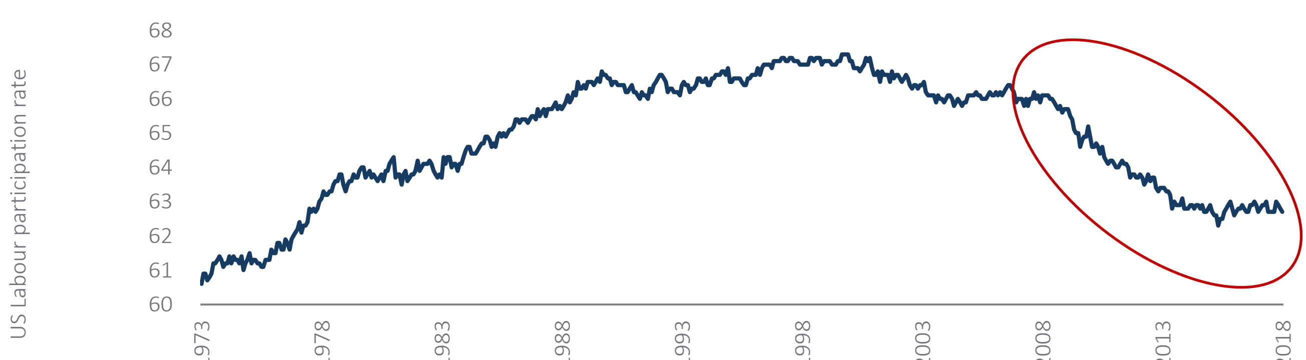
US GDP growth

In formulating an outlook for US GDP, there are a number of key judgements investors will need to make at present. These include: (i) an evaluation of the divergence between US potential GDP growth, which is quite low, and current trend growth, which is somewhat higher; (ii) an estimate of the output gap; (iii) a consideration of whether the current US fiscal policy represents a policy error, or whether it portends positive structural change in the US; and (iv) the likely impact of tightening monetary policy on US growth. Signally, we think that recent US fiscal policy has meaningfully upped the ante, both raising the risk of a stagflationary medium-term outlook, while holding out the hopeful possibility of genuine structural reform that could boost flagging labour-productivity.

The outlook for US GDP growth has reached a crucial threshold during the past few months. First, the economy appears to be operating at, or even slightly beyond, its potential level. This is most evident in the labour market, which is running at "full employment". Although it could be argued that the low participation-rate (Figure 1) suggests significant latent slack capacity, much of its recent decline is due to ageing and hence less likely to reverse. Thus, while there may still be some labour-market slack (a few percentage points are not due to demographics, and retirees now have a higher propensity to take on part-time work), it is nevertheless being mopped up rather rapidly at the current economic growth rate.

Operating at or beyond GDP capacity, as this dwindling slack suggests, indicates a transition to an inflationary, or "overheating," kind of economic environment, associated both with "late-cycle" dynamics and policy tightening, thus with a higher risk of recession. US GDP growth is currently running at about 4.7%, as seen in the Atlanta Federal Reserve's (Fed's) real-time forecast ("nowcast"). This is materially higher than long-term average potential growth, which the US Congressional Budget Office (CBO) estimates to be about 1.9% p.a. over the next decade. The current strength reflects strong growth momentum, amplified by consumers having spent a large proportion of the disposable income flowing from the US tax cuts. The tepid long-term outlook, however, reflects an extrapolation of deteriorating demographics (Figure 2), and low levels of productivity growth (Figure 3).

Figure 1: Declining US labour participation is mostly due to demographics ("ageing")



Source: Anchor estimates; St Louis Fed

The widening fiscal deficit, associated with the recent tax cuts, is highly unusual at this point in the economic cycle (Figure 4). Typically, fiscal deficits are extended during recessions, and when unemployment is high; i.e. the opposite of the present environment. Current fiscal policy effectively creates a broader spectrum of possible outcomes, suggesting both a route to stagflation, and the possibility of a higher level of structural growth. It all depends on how private investment responds to a new suite of incentives.

The outlook for wider fiscal deficits should be GDP stimulative in the short term, but come with the risk of "crowding out" both investment and consumer spending, as higher interest rates (associated with a deteriorating budget outlook), disincentivise both kinds of spending. This risk is more extreme in a late-cycle environment, like the present one. The US fiscal deficit is currently around 3.5% of GDP, but could rise by about 0.5% p.a. under the current fiscal regime, reaching 5% by 2021. If there is indeed crowding out, these fiscal deficits may be associated with a drift towards a stagflationary environment (inflation coupled with the stagnation of GDP growth). This is the bearish side of the current outlook.

Figure 2: Soft labour-force growth is not likely to change...

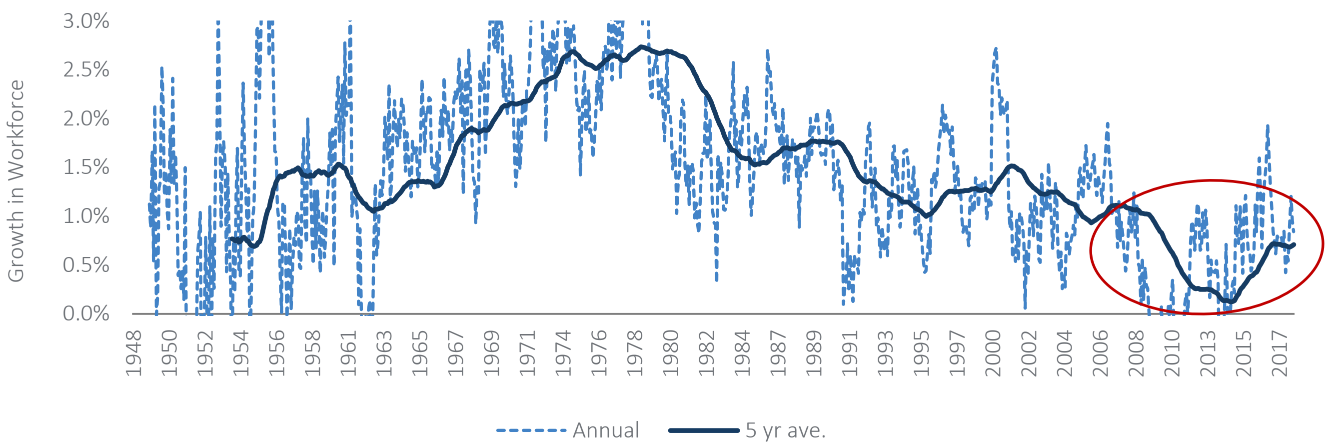


Figure 3: ...But weak productivity growth could get a boost from tax reform

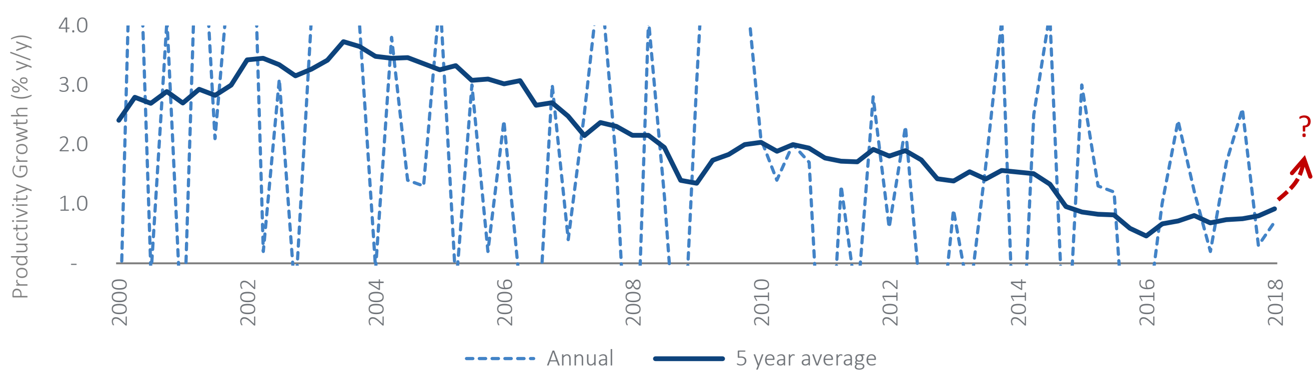
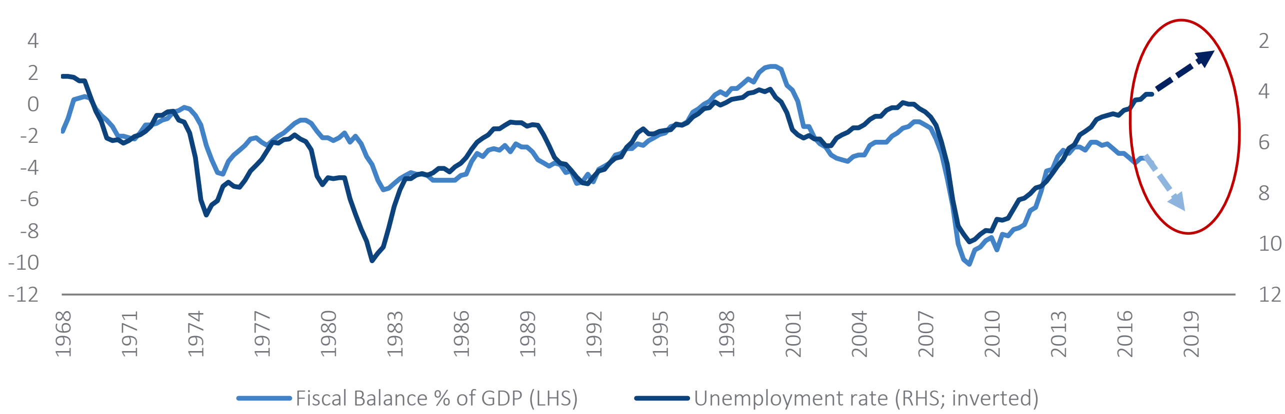


Figure 4: Widening US fiscal deficits are unprecedented at this point in the cycle



Source (Fig 2-4): Anchor estimates; St Louis Fed; Bloomberg

The more bullish scenario, however, would regard US tax cuts as structural in character, rather than standard Keynesian policy stimulus. The US tax reform was, to a significant degree, designed to make the US a more attractive investment destination. This was understood both in terms of relative global tax rates, and in terms of specific write-off provisions directed at investment spending. If successful, this policy has the potential to increase not only GDP (through higher investment spending), but labour productivity (the result of higher capital formation), and consequently to raise the outlook for potential GDP growth. That is, while GDP potential is being held back by weak demographics, which are unlikely to change, the drag coming from weak productivity growth may indeed change materially under this scenario. This would present a more auspicious outlook for the US fiscal balance, the US bond market, and indeed for global equity markets as well.

It is too early to determine which of these more extreme prospects will take hold. The credible potential attached to this more favourable outcome, however, reinforces our existing view that it is too early to turn negative on the US growth story. Indeed we are not yet seeing actual signs of overheating (e.g. spikes in inflation), however much these are intimated and anticipated by recent developments.

In addition to this important shift in fiscal policy, US monetary policy is also in the midst of a historically significant "normalisation". The resultant rising interest-rate outlook is, on balance, likely to weigh on GDP; this is particularly so for such developed economies that are significantly more indebted than in previous cycles. And yet, this debt load has shifted dramatically from interest-rate sensitive households to governments. Indeed households in both Europe and the US have delivered quite significantly since the global financial crisis (GFC). The latter are not commercially motivated in the same way, and thus respond differently to interest rate incentives. Thus, again, in spite of reasons to be worried (debt levels have risen sharply in recent years), we think it would be overly prudent to conclude that one should turn bearish on growth.

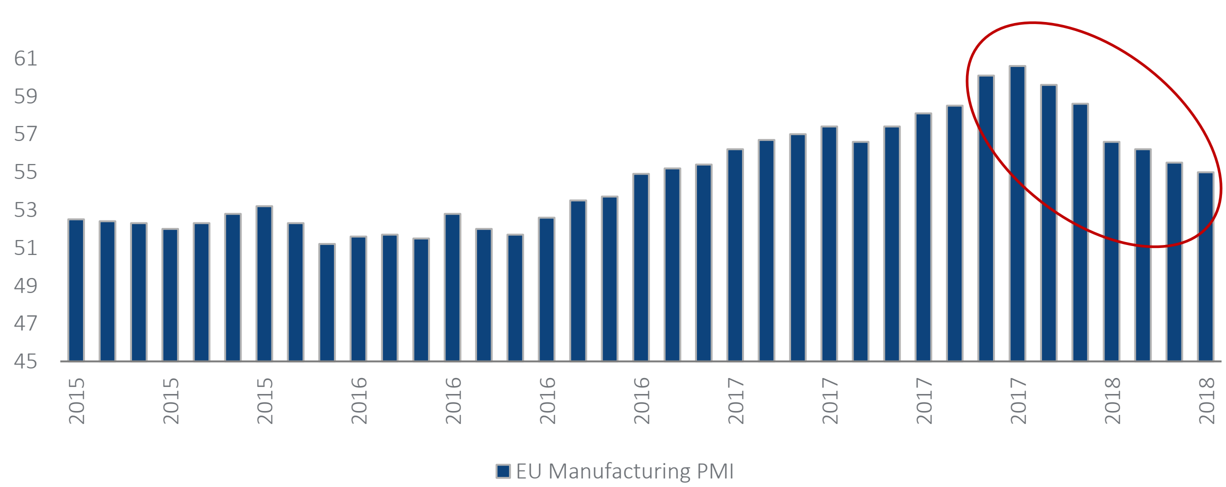
Taken together, and in light of our thoughts on the risk of a possible "trade war" (see below), we think the above factors suggest a growth slowdown in the US, in 2019 and 2020, following a strong CY18. Our base-case expectation, therefore, is for US growth to ratchet down to its long-term potential level, at just under 2%, by the latter half of 2019.

European GDP growth

Although European growth remains comfortably in positive territory, it has softened in 2018 relative to 2017's notable strength. This softening has been most evident in high-frequency data like the purchasing managers indices (PMIs) (see Figure 5). Is this trend likely to continue, or are there yet reasons to remain optimistic on Europe's growth outlook? We are somewhat optimistic on Europe's cyclical recovery, and we think the key to interpreting the recent softness lies in the euro vs US dollar exchange rate, which has followed a similar pattern to that seen in the US when it similarly reached the end of its monetary easing cycle a few years ago.

With the end of that cycle in sight, the US dollar surged in 2H14 through to the end of CY15. This strength was part of the cause of a notable softening in US PMIs during and shortly after that period. The same pattern may currently be in force in the EU, but it is likely to be more pronounced. For, while the US is a relatively closed economy, European economies are typically very "open": German GDP, for example, is 40% exports. Thus, it is not puzzling that the euro surge seen last year (+20% from December 2016 to early January 2018) has resulted in a softening of certain growth indicators. The recent weakness in the euro, seen in 2018 so far (EUR/$ is down 7% from its early January high), is likely to revive some of these flagging growth numbers.

Figure 5: EU PMI has softened in 2018 – we expect a rebound following recent euro weakness



Source: Bloomberg

A real challenge, however, is likely to come when the European Central Bank (ECB) starts to unwind QE. This has the potential to cause very significant euro strength, and thus risks derailing the growth recovery. It seems, consequently, that the ECB's QE unwind will be a very gradual and protracted affair. A second major challenge to the EU is structural, and relates to euroscepticism and a lack of fiscal integration. These two factors flared up in Italy's recent elections. The country represents yet another major economy changing gears on the fiscal front, and moving decisively towards larger fiscal deficits. Lastly, note that Europe would be particularly vulnerable to any future "trade war", should tensions between the US and China not only escalate, but spill over into more generalised trade barriers.

While these structural concerns do pose certain risks, they should not be overestimated. Although there is a lack of fiscal integration in the EU, the region has for the most part still been able to contain its finances, with its fiscal deficit at only 0.9% of GDP in FY17. Even Italy has remained within the EU-imposed limits, running a fiscal deficit of less than 3% of GDP since 2012. Furthermore, factors like cyclical momentum and slack capacity remain, on balance, in clearly positive territory. All things considered, we expect EU GDP growth, consistent with ECB forecasts, in the range of 1.7% to 2.2% over the next three years (see table below for details).

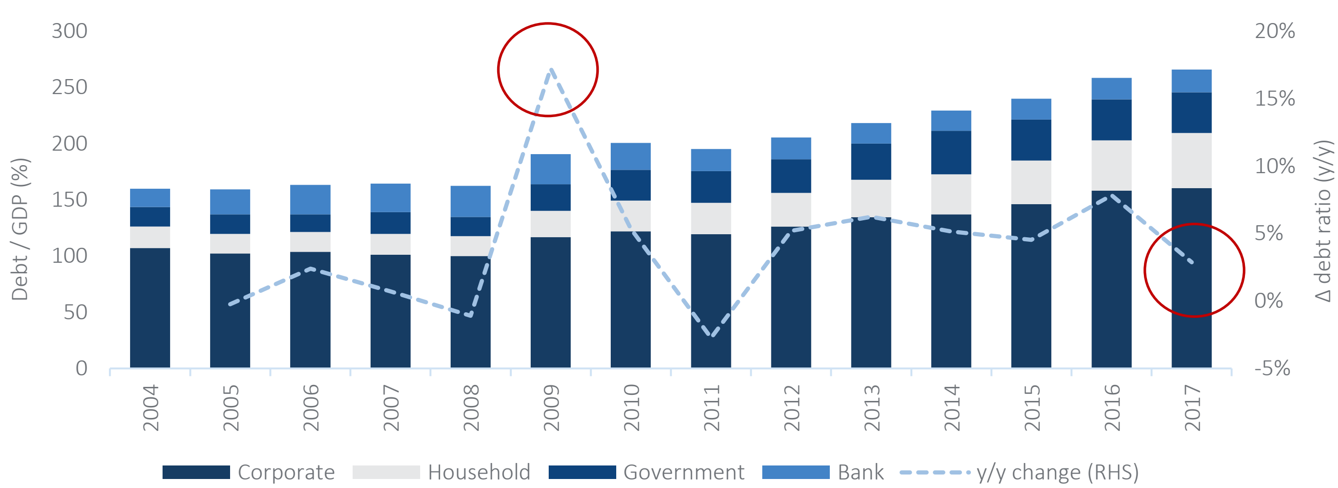
World GDP outlook

In this section we touch upon China and India as major drivers of world growth. We also consider the risks to growth posed by the possibility of a trade war between China and the US. China remains the largest contributor to global GDP growth, accounting for 34% of 2018's estimated increase in global GDP (the US, by contrast, accounts for c. 19%). The country has recently shifted its policy emphasis from "deleveraging" to "boosting domestic demand", a welcome sign for the world's growth outlook.

China's debt increased rapidly following the credit crisis (Figure 6), as global final demand collapsed, exposing China's reliance on external demand (i.e. exports). The strong synchronised global growth we have witnessed since late 2016 reinvigorated global final demand, and allowed China to focus on improving its balance sheet. It is a positive sign that the economy has successfully navigated a period of monetary tightening. This, however, still leaves the deeper challenge of relatively soft domestic demand, outside of debt-funded capex. We are bullish on the outlook for the Chinese consumer, and consequently the prospects for domestic Chinese demand. Thus, we think the Chinese growth story will prove sustainable. The at times unsettling fits and starts, associated with debt and domestic demand, are to be expected in the kind of development path China is following. They are also, to a degree, associated with China's response to the credit crisis - that is, excess debt is for China what QE and zero interest-rate policy (ZIRP) are to the US and EU: a response to the post-GFC malaise which now needs to be unwound.

All things considered, we expect China to continue on its path of a measured deceleration from a growth rate of 6.9% seen in FY17 to at or just below 6% by 2020. This slowdown is a normal part of a transition from a market that is clearly "emerging" to one that is increasingly approaching a "developed" condition.

Figure 6: China's debt/GDP ratio spiked following the GFC, but was contained in 2017



Source: Bloomberg; Anchor estimates

Indian GDP is far smaller than China's in absolute terms but, as the world's fastest-growing major economy, it is still a material contributor to the global growth outlook. India has fantastically sound drivers of GDP: these include strong domestic demand, excellent demographics (a young and growing population), and a very low GDP/capita starting point (about $2,100/capita, vs the US at $62,500/capita and China's $10,000). A low GDP/capita level means that technology transfer, financial penetration, and institutional deepening have a high chance of bearing significant fruit, as the country can grow merely by adopting what already exists, without needing to push the boundaries of technology. We expect India to grow at over 7.5% for the next three years.

Lastly, the global growth outlook will be affected by whether or not the current trade dispute between the US and China spirals into a trade war. At present, enacted tariffs are still very small and unlikely to have a noticeable impact on global GDP. There is, however, a risk that current rhetoric, which may be connected to the upcoming US mid-term elections, spirals through tit-for-tat into a quantitatively significant shift in trade policy. We think it makes sense to evaluate this situation in terms of incentives.

As a relatively closed economy (in trade terms), the US would be less affected by trade-barriers than its more open counterparts (China and the EU, in particular). On the other hand, US equity prices are very much affected by global growth dynamics, and hence the drivers of US wealth make the country somewhat open. In this sense, US trade statistics perhaps understate the country's dependence on the drivers of global growth. In tension with this incentive, Trump has a substantial commitment to putting the US first, hence we may see meaningful follow-through on proposed tariffs. Escalating trade tensions, however, even if they mutate into a severe "trade war", are unlikely to dampen global GDP by more than 0.5%. Relative to the 2018 run-rate, this would leave global GDP at a level still higher than what was observed in 2016.

There are, therefore, clearly political and policy risks on many fronts. These include shifting fiscal, monetary and trade policies that risk creating additional turbulence for financial markets. Yet, in spite of these concerns, the global growth outlook remains robust and positive. The table below summarises our GDP growth expectations for the global economy. These forecasts inform the expected returns of all asset classes considered in this report.

Figure 7: Global GDP growth outlook – still robust in spite of the risks

GPD GROWTH	2016	2017	2018	2019	2020
US	1.5	2.3	2.9	2.2	1.9
EU	1.8	2.4	2.3	2.0	1.7
China	6.7	6.9	6.5	6.3	6.0
India	7.9	6.4	7,.5	8.1	8.0
SA	0.6	1.3	1.8	2.1	2.3
World	3.2	3.8	3.9	3.8	3.3

Source: Anchor estimates; Bloomberg

THE JSE: FINDING THE HORIZON AMID THE DESERT

Peter Armitage
Chief Executive Officer

Investing on the JSE has been a hard grind for the last three years and 2018 has thus far provided little relief. At 29 June 2018, the JSE All Share is down 1.7% (on a total-return basis including dividends) for the year and the three-year compound total return for the Capped Swix is 3.4% p.a. And without Naspers, that's closer to zero …

On a daily basis at Anchor we are experiencing equity fatigue from clients as they question sustained exposure to equity markets. A young talented employee, who has been with us for just over three years, yesterday posed the question: "Pete, does the market ever go up?" It's certainly been among the longest periods of flat returns that I have experienced in my 25-year career in the industry.

JSE market drivers seem to have conspired against each other with frustrating regularity for some time now. When SA Inc. has rallied, the rand has strengthened (and vice versa); when Naspers was running, SA Inc. was battling; when we were getting some momentum, Steinhoff and Resilient happened. The net result has been a spluttering, stalling, frustrating sideways slog. Remember that eventually some of these factors (except for Steinhoff) will combine in a favourable manner to produce an outsized positive surprise.

So, the key question is whether this is reason to be positive or negative. After all, there are some great companies on the JSE that have grown their earnings consistently, but are trading at the same (or lower!) price levels than four years ago. That makes these companies much cheaper and, theoretically, much more attractive. Recent price moves have also taken many of these shares even lower. Human nature is such that when markets are going up, it's easier to be more bullish and vice versa, which seems to defy logic. The expected script from somebody in my position is to talk through the issues and then conclude that the market looks attractive. I will try to avoid that.

So, instead, let's take a step back and think about what drives our market and assess each of the factors. Each of these tend to have differing levels of impact on the market, depending on the mood of Mr Market. It must also be borne in mind that many of these factors are inter-linked:

- Global markets and more especially EMs.
- Commodity markets.
- Rand/US$ exchange rate.
- Tencent and, to a lesser extent, Naspers management.
- Prospects for SA local economic growth and earnings prospects for SA-Inc. companies.
- Valuation of SA companies and company specific prospects.

Global markets and more especially EMs: A stronger dollar, rising global interest rates and intensifying trade tensions have conspired to create a new mood of uncertainty. Ironically, this has had a negative impact on EMs, while the US market has remained firm. In times of risk, investors take refuge in the US (more so for bonds than equities). One of the key questions therefore is whether Trump is embarking on political posturing, or is he really prepared to take the world down the route of a damaging trade war? You will read elsewhere in our musings that we are moderately optimistic on global markets and this offers the prospect of an EM bounce-back in the second half of the year. This will be good for SA.

Commodity markets: A large component of our stock market is driven by commodity prices and thus commodity prices (and demand), in turn, have a material impact on the SA economy. The share prices of the big diversified miners are all pricing in a decline in commodity prices. BHP Billiton and Glencore are trading at free cash flow yields above 10% and Anglo American in the region of 15% - if prices do not decline materially these shares are especially cheap. Unless global economic growth gets derailed, the shorter-term (at least) prospects of commodity prices look fairly positive and this would be supportive to the SA market.

Rand/US$ exchange rate: Our view is that in 12 months' time the rand is more likely to be stronger than weaker; that's after a strong rout from around R11.50/US$1 to R13.80/US$1. YTD, the currency is 11% weaker. There's a sweet spot range for the rand – that's where exporters can make a margin, imported goods are less competitive and the impact on inflation is muted. Based on our collective assessment of the performance of SA companies in different scenarios, our estimation is that this rate is in the region of R12.75-R13.25/US$1. So, if the rand strengthens a few percentage points, we are back in this region and local companies should get a benefit, in aggregate.

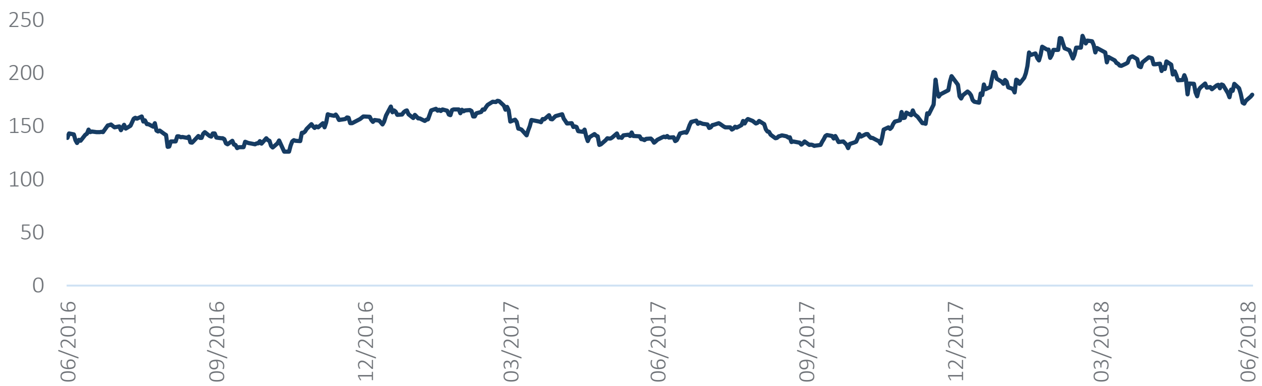
Tencent and, to a lesser extent, Naspers management: The weighting of Naspers in our All Share Index (c. 20%) is such that this share is a market factor all by itself. "What did Tencent do last night?" is a common call in SA trading rooms every morning as fund managers mull over what to expect for the day. We believe Tencent is one of the best businesses in the world and it is also one of the world's top-ten businesses by market cap. Its share price has dropped 17% from its highs and, while the 34x forward PE is optically expensive, we have a relatively high conviction in strong earnings growth for the next three years. Naspers will take most of its direction from Tencent in the short term. However, the recent Naspers results confirmed that its businesses outside of Tencent are all growing rapidly and the investment case is strengthening. Naspers trades at over a 40% discount to its sum-of-the-parts (SoTP) valuation. Frustratingly, Naspers management is not doing any of the obvious things to unlock the discount – they have never taken action to divest of core assets or shrink their business and we don't think they ever will. Their "unlock" actions will be incremental, which means Tencent will be the guiding star for short-term performance and the growth in the core business should result in a gradual move to a lower discount.

Figure 1: Tencent share price

Source: Iress

Prospects for SA local economic growth and earnings prospects for SA-Inc. companies: It's been a rollercoaster ride for SA GDP growth expectations over the last 9 months. From despair in November 2017 to euphoria in December and January to the current phase of uncertainty. There is no doubt that prospects have improved, but a negative 2.2% QoQ GDP growth rate for 1Q18 rocked market confidence and, on the ground, company CEOs are waiting for an upturn with bated breath. Most economists still forecast a steady recovery from here, but recent sharp rand weakness poses risks to the interest rate outlook and the share market is not giving SA the benefit of the doubt. The Foschini Group is a good barometer of the shift in expectations: flat for four years, then up 70% and subsequently down 25%.

Figure 2: The Foschini Group share price



Source: Iress

The future outcome for local shares looks fairly binary. They have reduced to price levels that don't factor in much optimism, with most SA-Inc. shares 20%-40% off their highs. If economic growth accelerates they could deliver 20%-plus returns over the next 12 months, but if the economy remains muted they could very well linger around current price levels. Our positioning at present is to have reasonable exposure to this category of shares, but not to "bet the house". A key indicator we will be watching is vehicle sales, historically a meaningful leading indicator.

Valuation of SA companies and company specific prospects: The weighted forward PE multiple for SA shares is 14.5x. Within that, resource companies are cheap (if commodities hold up), SA-Inc. shares are now attractive and there are specific shares that have retreated firmly into good-value territory. For example:

- Vodacom has declined from R180 to R120/share and now trades at a forward 12x PE and 7.7% DY.
- The implied PE of Outsurance in RMI is now 10x – a bargain for a great quality company.
- Barclays Africa now trades at a forward 7.5x PE and 7.7% DY.
- The basket of mid-cap, SA-listed property companies trades in the region of a forward 11% dividend yield, with 4% growth in dividends prospects for the next 12 months.
- Exxaro trades at a forward 7.6x PE and 5% dividend yield. The implied PE multiple on the annuity-type coal assets is in the region of 4x.
- Sasol trades at roughly a forward 10x PE and you get the impact of the US Lake Charles project for free.
- When you can find bargains like these in big listed SA companies, we tend to view the outlook as positive.

Conclusion

JSE earnings were up over 10% in the last 12 months and we expect earnings growth of 12% and 16% over the next 12 and 24 months, respectively. If SA economic growth accelerates, 2019 could see even higher growth rates. Following the 6% YTD decline in the Capped Swix, many shares and sectors have moved into attractive territory. Risks have certainly increased, but all of the factors highlighted above indicate the potential for more positive returns than we have experienced over the last few years. In our 1Q18 strategy document we had nudged equities to overweight (a 14% projected return) and we retain this positioning.

THE ATTRACTION OF LOCAL PROPERTY

Glen Baker
Fund Management

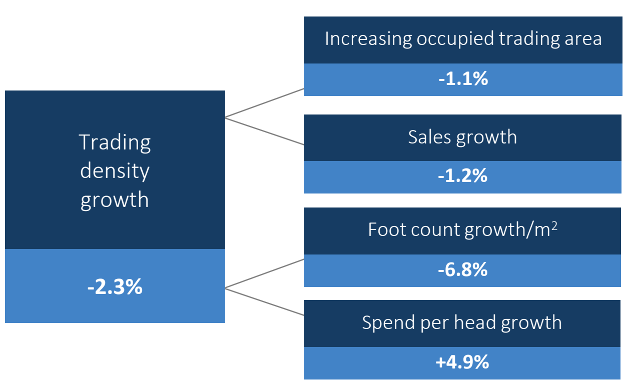
SA property

There can be no doubt that fundamentals in the SA property market are poor - worse than they have been for some time. Even the GFC largely passed SA by, relative to the carnage caused in the global commercial property market. If we analyse the three major segments of the property market, based on the South African Property Owners Association (SAPOA) findings, it is easy to spot the “speed bumps” in the road, particularly in the retail and office property sectors.

Retail sector

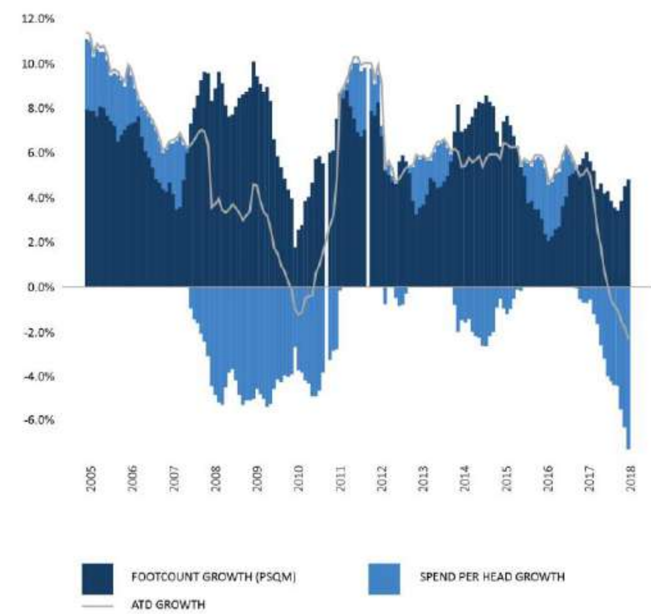
Statistics for 4Q17 show that trading densities (sales per square metre, covering 100 retail centres and 4mn sqm) fell for the fourth consecutive quarter, slowing to -2.3% YoY. Although shoppers were spending more (spend per head +4.9% YoY), this could not mitigate against the sharp drop in footfall. This meant that sales growth fell 1.2% YoY over a sales area that had increased capacity by 1.1% YoY. The overall trading density picture is worse than it was throughout the GFC.

Figure 1A: Trading density growth attribution – September 2017. Weighted contribution to trading density growth



Source: MSCI. Note: number may not add up due to rounding. This graphic illustrates the weighted contribution to trading density growth of changes in sales, trading area, number of shoppers and spend per head.

Figure 1B: Trading density growth mainly driven by spend per head growth over longer term



Source: MSCI Real Estate

Office sector

In terms of the office sector, the vacancy rate of 11.5% looks very high relative to retail (4.7%) and industrial (3.3%). However, this rate has trended largely sideways since 2011. Interestingly, development stock has fallen to 3.1% of existing stock, approximately a mid-cycle level, although pre-let developments have dropped to 50.5% at the last measurement date (end of 2017), indicating to us that slightly more speculative risk is being taken which is reversing a de-risking trend prevalent in this sector post the GFC. We note that this activity seems concentrated in the Rosebank and Sandton nodes.

Industrial sector

This sector seems in relatively good shape. Vacancies in 4Q17 show that the trend is improving, with the vacancy rate standing at 3.3%, down from 5.3% for the same period one year earlier (4Q16). In-line with this, the sector recorded rental growth of 6.7% YoY, although this has not resulted in capital growth as valuators had not materially adjusted their capitalisation rates.

In total, current conditions are resulting in:

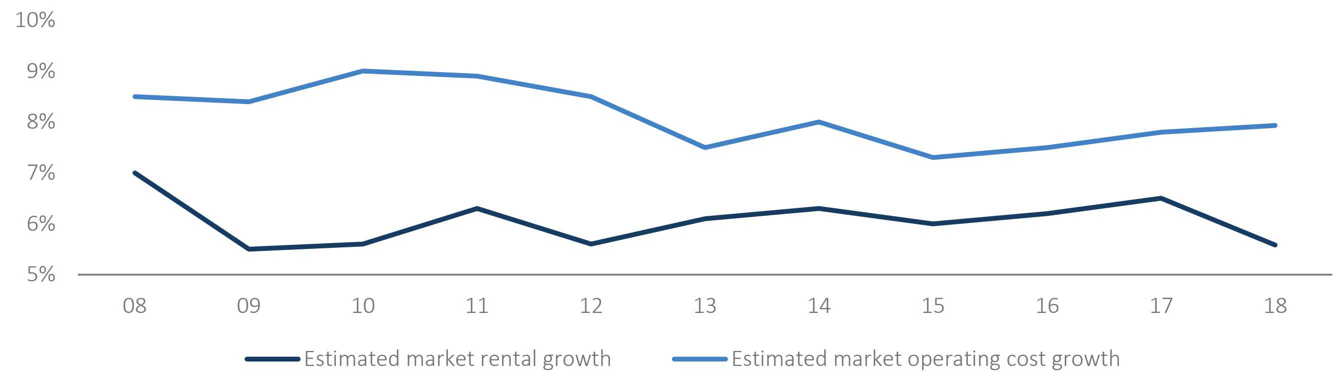
- Lower rental reversions when leases are due for renewal;
- deal lead strategies to fill vacant space when it arises. Evidence suggests that rent-free months (normally 3- to 6-month periods) are being offered, particularly in A- and B-grade office space; and
- lower transactional values as investment into the sector is either put on hold, or negotiations become protracted.

Overall though valuators have not materially altered the cap rates at which they are valuing property assets. To the extent that properties have changed hands, exit cap rates are in-line with those shown in the table below:

		MARKET CAP RATES	MARKET RENTAL GROWTHS
RETAIL	Super regional shopping centres	6.48%	5.75%
	Regional shopping centres	7.00%	5.80%
	Neighbourhood shopping centres	9.51%	5.92%
	Retail warehouses	9.92%	4.33%
OFFICE	CBD Johannesburg offices	9.92%	4.77%
	CBD Cape Town offices	8.89%	6.93%
	Non CBD Prime offices	9.24%	5.04%
	Non CBD Secondary offices	9.86%	4.87%
INDUSTRIAL	High Tech Industrial	9.60%	4.09%
	Standard Industrial units	9.95%	4.46%
	Aggregated average market cap rate	9.40%	
	Estimated market rental growth rate		5.08%

The aggregate average cap rate of 9.4% has not moved from the last SAPOA stats produced in May and those at the end of last year. However, there is evidence that market rental growth rates are trending downward and landlords are not able to contain costs in proportion to this. Thus, “negative jaws” are impacting income statements and distribution growth.

Figure 2: SA property market: Rental growth vs operating cost growth



Source: MSCI Real Estate, SAPOA

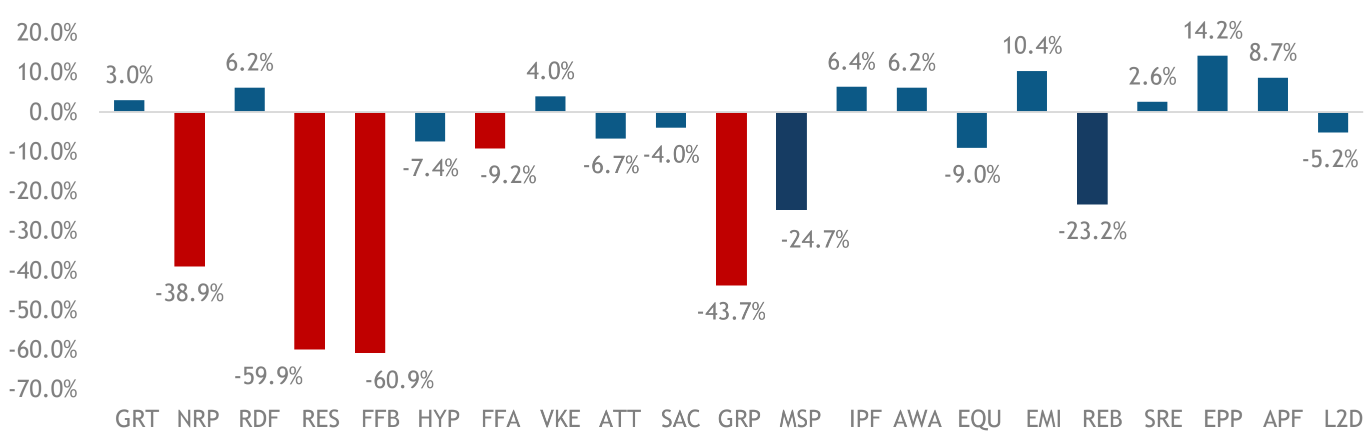
Based on these fundamental issues, combined with the fact that up until the end of 2017, listed property was a top-performing asset class over most measurement periods, some de-rating could have been forecast.

However, few would have expected the extent of the fallout as the benchmark has retraced by over 21% in the first six months of 2018. Analysis reveals that most of the pain has centered around a particular group of companies, who we will refer to as The Resilient Group. The individual companies in this stable – namely Resilient, Fortress, Nepi Rockcastle and Greenbay – had enjoyed tremendous success making accretive acquisitions, investing offshore in listed companies, and developing and acquiring property assets in growth markets in Eastern Europe, up until then unexplored. High ratings i.e. low dividend yields, meant that they could raise cheap equity capital and deploy it into markets where the cost of borrowing was below property stock yields, unlike SA where the reverse is true.

These stocks at one stage accounted for 42% of the benchmark index as their market caps grew significantly faster than any other local companies. However, in early 2018, reports emerged around their internal cross-holdings, capital raises and the accounting treatment of their BEE trust.

This coincided with offshore analysis (by the same organisation that had come to prominence during the Steinhoff scandal) casting aspersions on Capitec Bank's accounting principles. As SA investors became much more corporate-governance focused – and shy of headlines for the wrong reasons – these stocks sold off significantly. Figure 3 shows the extent of the pain during the course of 2018 until the end of May 2018.

Figure 3: JSAPY constituents performance (Resilient Group stocks highlighted in red)

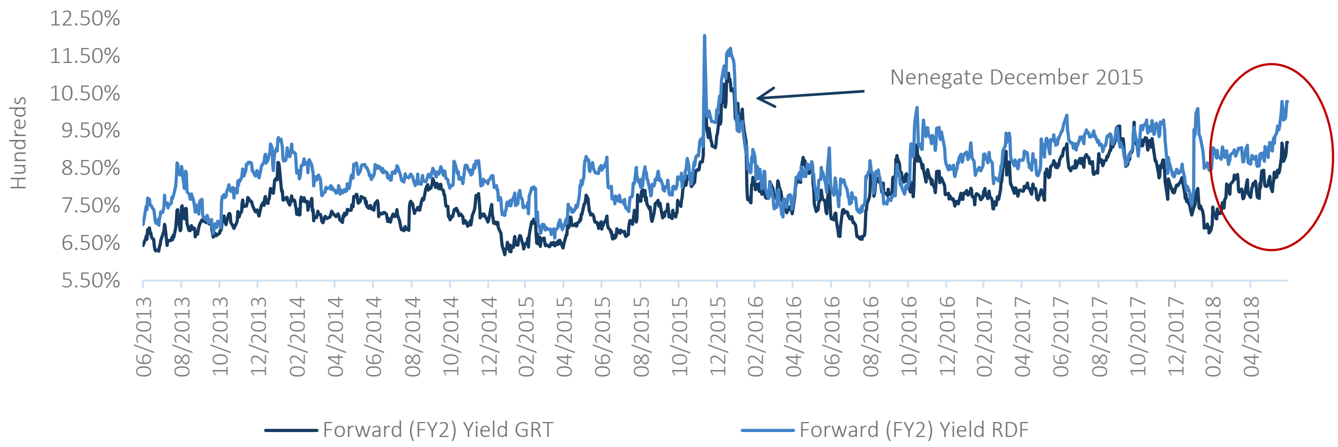


Source: Reuters, Anchor

All of the above-mentioned factors have conspired to make 2018 the toughest six months this sector has had to endure.

Although the hangover may last a while (because the party was a long one), the yields available to investors in the sector have seldom been more attractive. In addition, the derating in the listed property sector is disproportional to the valuations in the physical market. A good way of illustrating this is that when we compare the forward dividend yields of Redefine and Growthpoint they are similar to, or better than, the aggregate average across the industry (9.4%). Indeed, the forward yield of Redefine (10.2%) is higher at this point than it has been for the last five years, apart from the carnage that ensued following the firing of the Minister of Finance Nhlanhla Nene by ex-President Jacob Zuma in late 2015. The argument for these two index heavyweights and bellwether SA property stocks is that they have above-average quality portfolios of SA assets and also have offshore exposures in growth regions outside SA.

Figure: 4: Growthpoint (9.2%) and Redefine (10.3%) forward dividend yields



Source: Bloomberg; Anchor estimates

Although there may not be any "quick fixes" for the sector, and the losses sustained by the Resilient Group are probably a permanent impairment of capital, our conclusion is that this is a very good entry point for investors. Catalysts that we would look for that would gradually re-rate the sector over the next 6–12 months include:

- Property companies being transparent in their reporting and paying distributions out of recurring, genuine, rental and property income.
- The controversies surrounding the Resilient Group fading with the passage of time, including an all-clear from the regulators still investigating certain dealings and capital raises.
- Corporate actions. Apart from some property companies in their own right being able to do yield-enhancing deals, it is possible that private equity and investment companies will begin to take a long, hard look at listed-property assets given current yields.

In conclusion, although fundamentals currently favour tenants, not landlords and growth in distributions are under pressure as a result, we believe that investors with a 12- to 24-month time horizon will be rewarded.

WILL ELECTRIC VEHICLES STUN OIL DEMAND?

Seleho Tsatsi
Investment Analyst

Executive summary

The adoption of the electric vehicle (EV) has the potential to significantly affect energy markets. In this note, we focus on the potential ramifications for oil. We examine three key questions: First, what is the state of the EV market today? We shall argue that EVs are currently a small but rapidly growing sub-section of the car market. Second, what is EV penetration likely to be in future? Here, we estimate that 8% of 2025 car sales will be EVs, based on regulation, battery costs and original equipment manufacturer (OEM) commitments. Finally, and most importantly, what does this outlook mean for oil demand? Our analysis suggests that the oil demand displaced by EV adoption through to 2025 could equate to under 1% of the market. Furthermore, given that the expectation of high EV penetration has resulted in a cautious supply-side response, it may be the case that EVs have actually had a net tightening effect on the oil market. Thus, in our view, EVs are not likely to reduce oil prices, although they are likely to reduce the size of the industry.

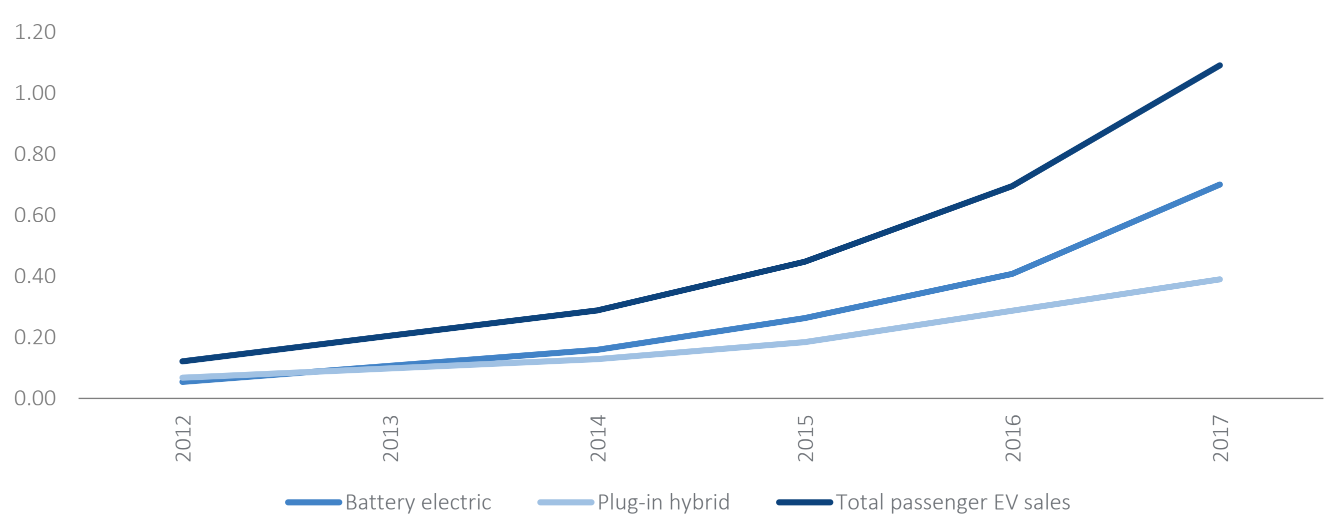
Where does the EV market stand today?

Today, EVs are a small but fast-growing part of global vehicle sales. There were c. 97mn vehicles sold in 2017, of which 71mn were passenger cars and 26mn were commercial vehicles. As Figure 1 illustrates, EVs constituted 1.1mn or 1.5% of 2017 passenger vehicle sales - a small portion. The 55% growth p.a. in EV sales since 2012 is high but starting from a very small base.

It is important to distinguish between battery electric vehicles (BEVs) and plug-in hybrids (PHEVs). A BEV has no internal combustion engine (ICE). Instead, it has an electric motor that uses the battery pack for power. A PHEV is powered by a combination of an ICE and an electric motor. Global BEV passenger sales have grown at 1.6 times the rate of PHEV sales over the past five years.

We outline three scenarios for EV penetration in the year 2025 - a bear case, a base case and a bull case. They are shown in Figure 2. We believe these three factors will be the key drivers of the speed at which EVs penetrate the auto-market - regulation, battery costs and OEM commitments.

Figure 1: Global passenger EV sales by type (mn)



Source: Bloomberg New Energy Finance

Figure 2: 2025 EV penetration scenario analysis

	BEAR	BASE	BULL
2017 EV sales penetration	1,1% (0,7% BEV, 0,4% PHEV)		
2025 EV sales penetration	5%	8%	15%
Drivers	Regulation, battery costs, OEM commitments		

Source: Anchor Capital estimates

Regulation

The 8% base-case scenario is based on 2017 analysis by the California Air Resources Board (CARB). In its mid-range scenario, CARB estimated that an auto manufacturer will need to have about 8% of its 2025-model year, annual sales in California consisting of EVs in order to meet CARB's Zero Emission Vehicle (ZEV) regulation.

CARB's mid-range scenario is used as a base case for a couple of reasons. First, California is the number one state for auto sales in the second-largest vehicle market in the world (the US). Second, thirteen US states have adopted the California standards to date. Other governments, such as that of Québec, have implemented ZEV regulations that largely follow that of California. Thus, although other governments may differ from the California standards, we believe it serves as a useful guideline and starting point.

The 15% bull-case scenario assumes penetration falls slightly higher than halfway between CARB's 8% target and that of China, which is 20%. China is the largest market in the world for automobiles generally and also specifically for EVs.

The Made in China 2025 Initiative is targeting 35mn annual vehicle sales in 2025. The Initiative targets 20% of 2025 annual vehicle sales in China to consist of "new energy vehicles (NEVs)". Other targets in the plan include having 70% of the Chinese market consist of Chinese-branded NEVs by 2020 and having two of the top-ten global NEV firms be Chinese-owned by 2025.

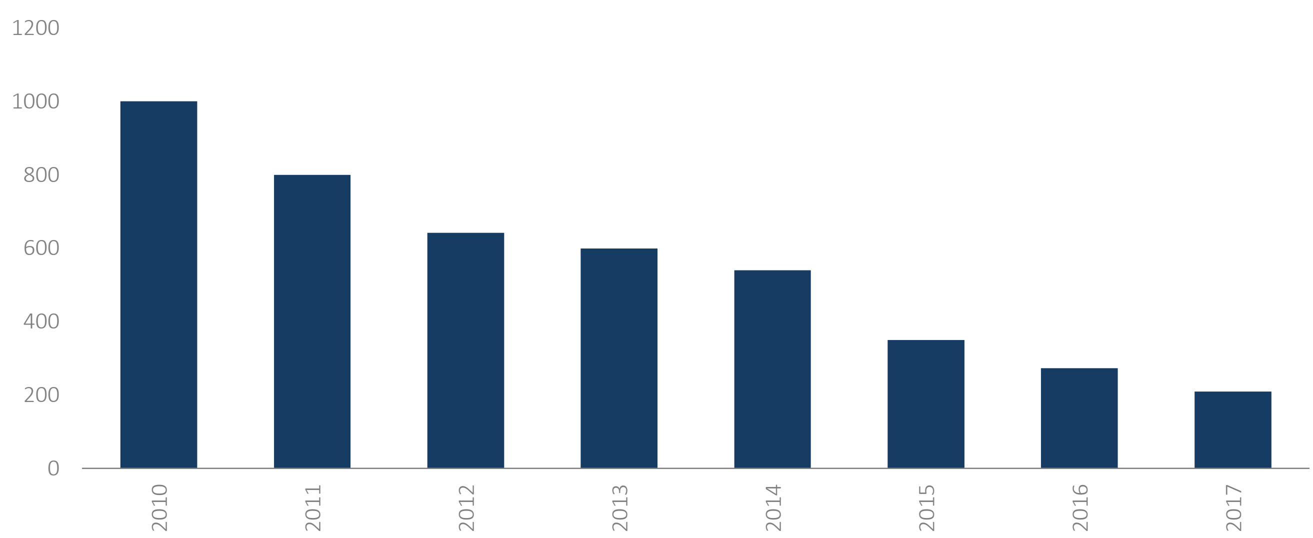
To the extent that other governments have different regulations, 8% may prove to be too high or too low a base-case estimate. Norway is an excellent case study of how governments may accelerate penetration rates. The Norwegian government is targeting no new ICE vehicle sales by 2025. To achieve this, the Norwegian government has incentivised consumers to shift to electric cars through several measures. These include exempting EV drivers from having to pay road tolls or a 25% value-added tax (VAT). As a result, penetration in Norway far exceeds global levels. EVs were 39% of 2017 auto-sales in Norway.

Battery costs

Faster-than-expected declines in battery costs could contribute to higher penetration rates. The single-largest contributor to an EV's cost (relative to an ICE vehicle's cost) is the battery. As battery costs decline, the economic case for automakers to sell EVs strengthens. A battery cost of $100/kwh is estimated to be the battery cost at which most BEVs are cost competitive with ICE vehicles. Average battery costs are estimated to be about $200/kWh at present. McKinsey & Company estimated 2016 average battery costs to be $227/kWh, while Bloomberg New Energy Finance's estimate of the 2017 average battery cost was $209/kWh.

Some OEMs have reported lower costs for their batteries. Tesla indicated a battery cost of about $190/kWh in 2016. Similarly, General Motors (GM) recently said it had a battery cost of $145/kWh that is on its way to $100/kWh

Figure 3: Average EV battery cost ($/kWh)



Source: Bloomberg New Energy Finance

"We have a cell cost per kilowatt hour that's around $145 and that's for the Bolt EV...we're working on a path to get that around $100 or below $100 and we're ahead of the curve on that"

Mary Barra, GM CEO

Source: General Motors 1Q17 earnings call

To the extent that these firms and their peers are able to meet the $100/kWh target faster than the base-case outlined in Figure 2, penetration rates may surprise to the upside.

OEM commitments

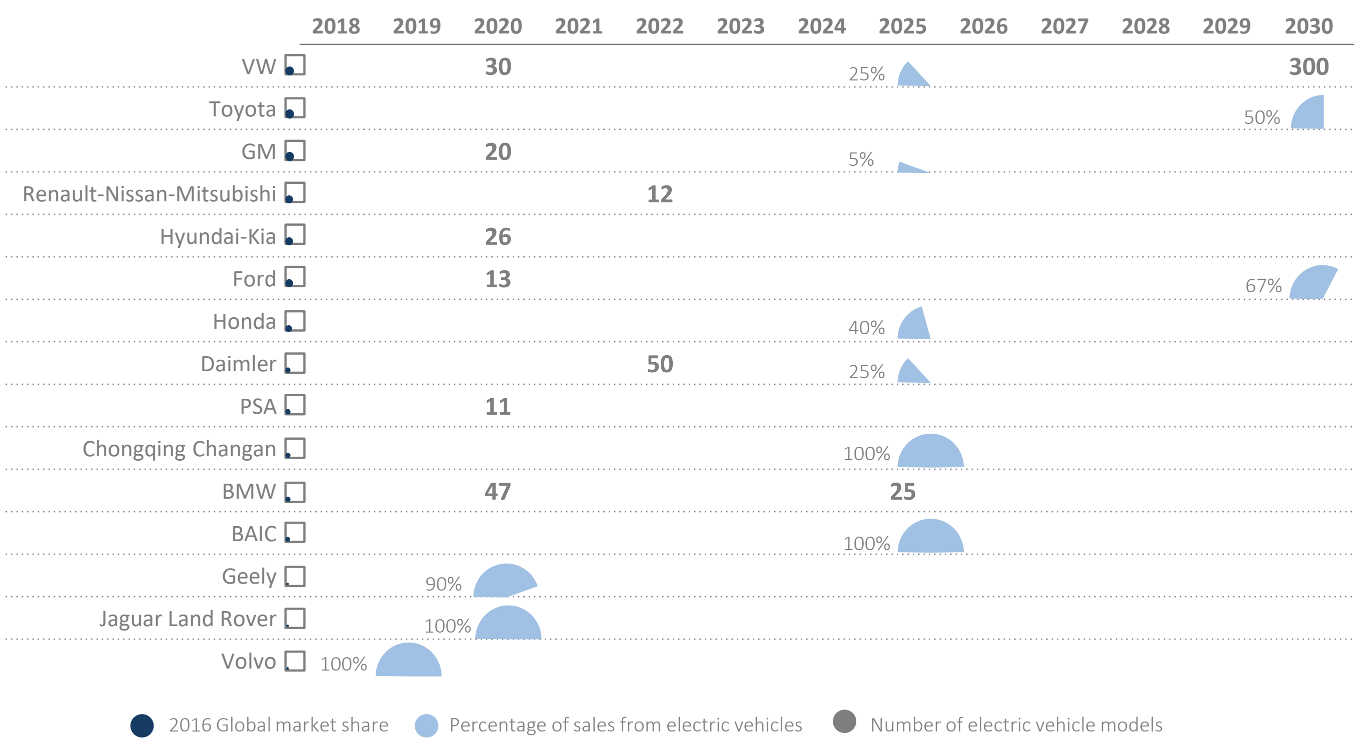
Commitments made by major auto-manufacturers should provide clues as to eventual penetration rates. The 14 auto-manufacturers listed in Figure 4 (on the right-hand side) constituted 77% of 2017 sales globally. Thus, the EV commitments made by this group is likely to be one indication of where the market eventually goes.

Figure 4: OEM by market share

COMPANY	ANNUAL SALES (M)	MARKET SHARE
Volkswagen	10.78	11.1%
General Motors	9.60	9.9%
Toyota	8.96	9.3%
Ford	6.61	6.8%
Nissan	5.77	6.0%
Honda	5.20	5.4%
Hyundai	4.49	4.6%
Fiat Chrysler	4.42	4.6%
Renault	3.76	3.9%
PSA Groupe	3.63	3.8%
Daimler	3.27	3.4%
Suzuki	3.22	3.3%
SAIC Motor	2.97	3.1%
BMW	2.46	2.5%
Tesla	0.10	0.1%

Generally, the OEMs have not made overly specific commitments. Several major auto-manufacturers have not committed to a certain proportion of their future sales being electric or to ending ICE sales by a particular date. This is shown in Figure 5.

Figure 5: EV commitments from automakers



Source: Bloomberg New Energy Finance

GM (the largest US automaker), for example, has left the question of whether it will still be selling gasoline vehicles in 2030 open-ended.

Question: Are you going to be selling gas powered cars by 2030?

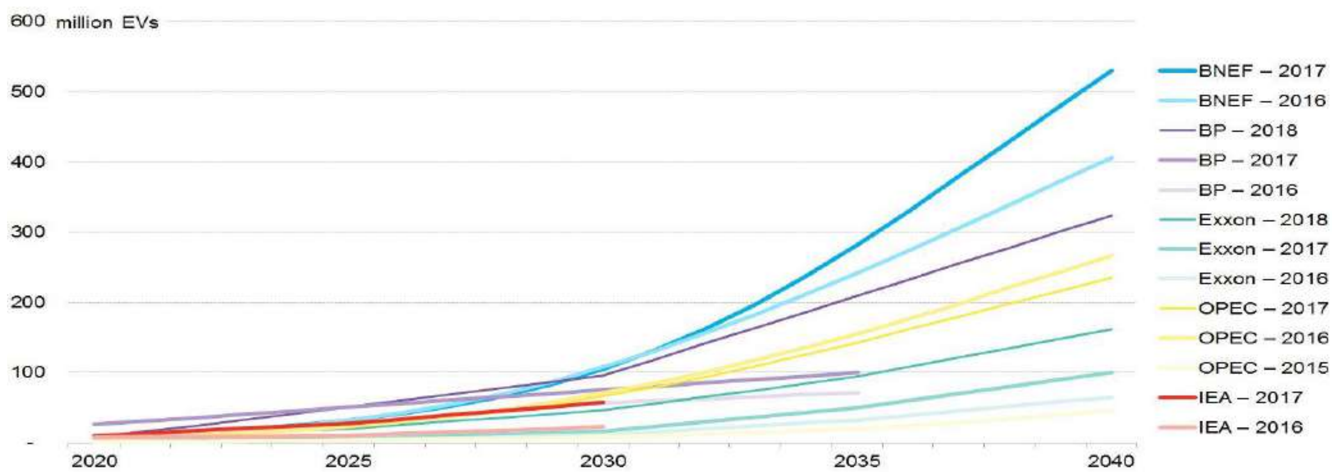
Mary Barra, GM CEO:

We're going to be driven by the customer, I mean when you look at where the market is going, we do believe in an all-EV future but we also are seeing internal combustion engines become more-and-more efficient so we're going to - we have the flexibility to respond to the customer and as we do a new propulsion system for the vehicle whether it's a new ICE or it's adding our electric vehicle - the battery capability and the pack capability, we have tremendous flexibility to do that.

Source: 2017 Barclays Global Automotive Conference

At this stage, it is difficult to glean major insights into potential penetration rates from OEM commitments. Having said that, it remains a vital factor to monitor going forward.

Figure 6: Wide divergence for forecasts of future EV fleet sizes



Source: BNEF, BP, Exxon, OPEC, IEA

Estimation uncertainty

Finally, it is important to acknowledge the wide range of possibilities. Whilst we can say that the world is moving towards an electrified powertrain, a vast amount of factors, some of which are currently "unknown unknowns", will determine penetration rates. This sentiment was recently expressed by Sergio Marchionne, CEO at both Fiat Chrysler and Ferrari.

"These proclamations that we hear about the advent of electrification, artificial intelligence and the inevitable association of artificial intelligence with the electrification, are all things which at best are conjecture. And I start off with a very clear view that most of these things are undoubtedly going to happen directionally. "

Sergio Marchionne, CEO of Fiat Chrysler & Ferrari

Source: NAIAS 2018

The estimation uncertainty over how quickly EVs will be adopted is exemplified in Figure 6. Five reputable entities (BNEF, BP, Exxon, OPEC and IEA) diverge significantly in their forecasts of how quickly the EV fleet will increase over the next two decades. As can be expected, the divergence increases positively with the forecast horizon.

We do believe, however, that it is important and instructive to think through different scenarios and their potential implications.

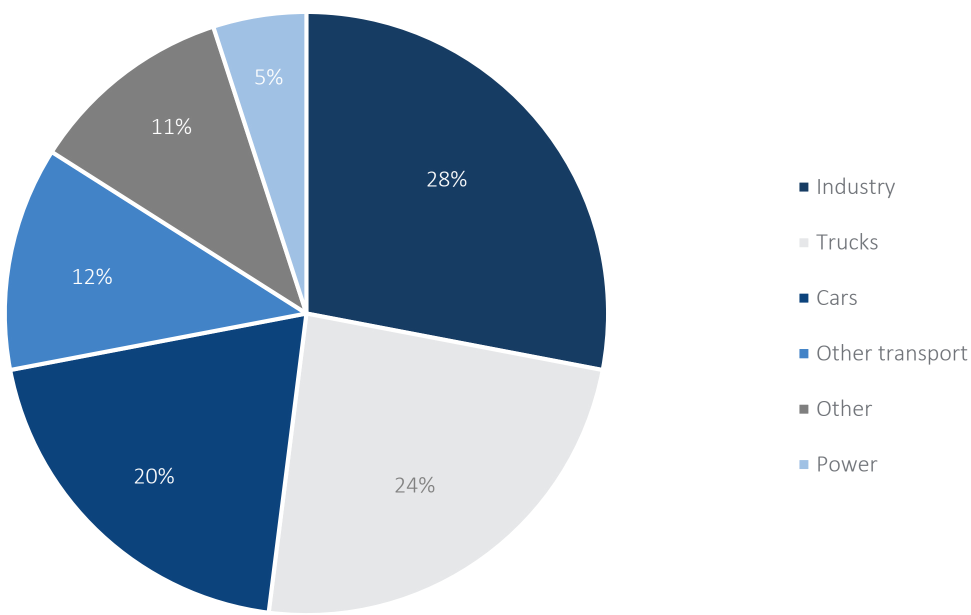
What does this mean for oil?

The emergence of EVs is said to dampen the attractiveness of oil-related assets as investments. Whilst the electrification of the drivetrain will undoubtedly affect oil's long-term demand, we believe the threat of EVs is not material enough to threaten oil demand in the short term. Two reasons underpin this view.

The first is that only about 20% of oil demand comes from cars. Transportation as a whole contributes less than 60% of oil demand. As Figure 7 illustrates, the remaining 40% goes into industry, power generation and other uses. Oil demand from non-auto uses such as petrochemicals is not under threat for displacement by electrification. Cars are most likely to face electrification first due to the large loads and distances involved for trucks.

Second, even if EV penetration surprises to the upside, the current auto-fleet primarily consists of ICE vehicles that will continue to require fuel to operate. Today's global vehicle fleet stands at c. 1bn vehicles. The vast majority (±99%) of that fleet consists of ICE vehicles. These vehicles can operate for over a decade before replacement starts to become necessary.

Figure 7: Oil demand by source



Source: BP

We next examine what the EV penetration scenarios outlined above could mean for oil. The number of barrels of oil displaced is estimated as follows. Based on the 2025 EV sales penetration outlined in each case (bear, base, bull), the 2025 EV fleet is estimated. The number of gallons lost to EVs is approximated by assuming the 2025 EV fleet uses no fuel whatsoever (this is likely overly aggressive as hybrids still require fuel). Approximately 20mn barrels a day (mmbd) of crude oil is required to fuel 1bn cars (the vast majority of which are ICE). This translates to 2 mmbd of crude oil required per 100mn cars. As fuel efficiency gains continue to be made, we believe this number will fall to an estimated 1.8 mmbd per 100mn cars. The number of barrels of oil displaced is thus calculated by assuming 1.8 mmbd is displaced for every 100mn vehicles in the EV fleet.

Our central forecast scenario looks for 8% EV penetration by 2025. We estimate that this will shave 0.78 mmbd off oil demand, under 1% of global oil demand levels in 2017. In our view this is material, but does not pose an existential threat to the oil market. Although we have only focused on oil demand in this note, the expectation of significant EV penetration has also affected oil supply: indeed, in our view, this expectation has accentuated supply-side prudence, such that the future supply contraction due to EVs is greater than the demand reduction. Thus, it may indeed be the case that EVs, and the expectations attached to them, have had a net tightening effect on the market.

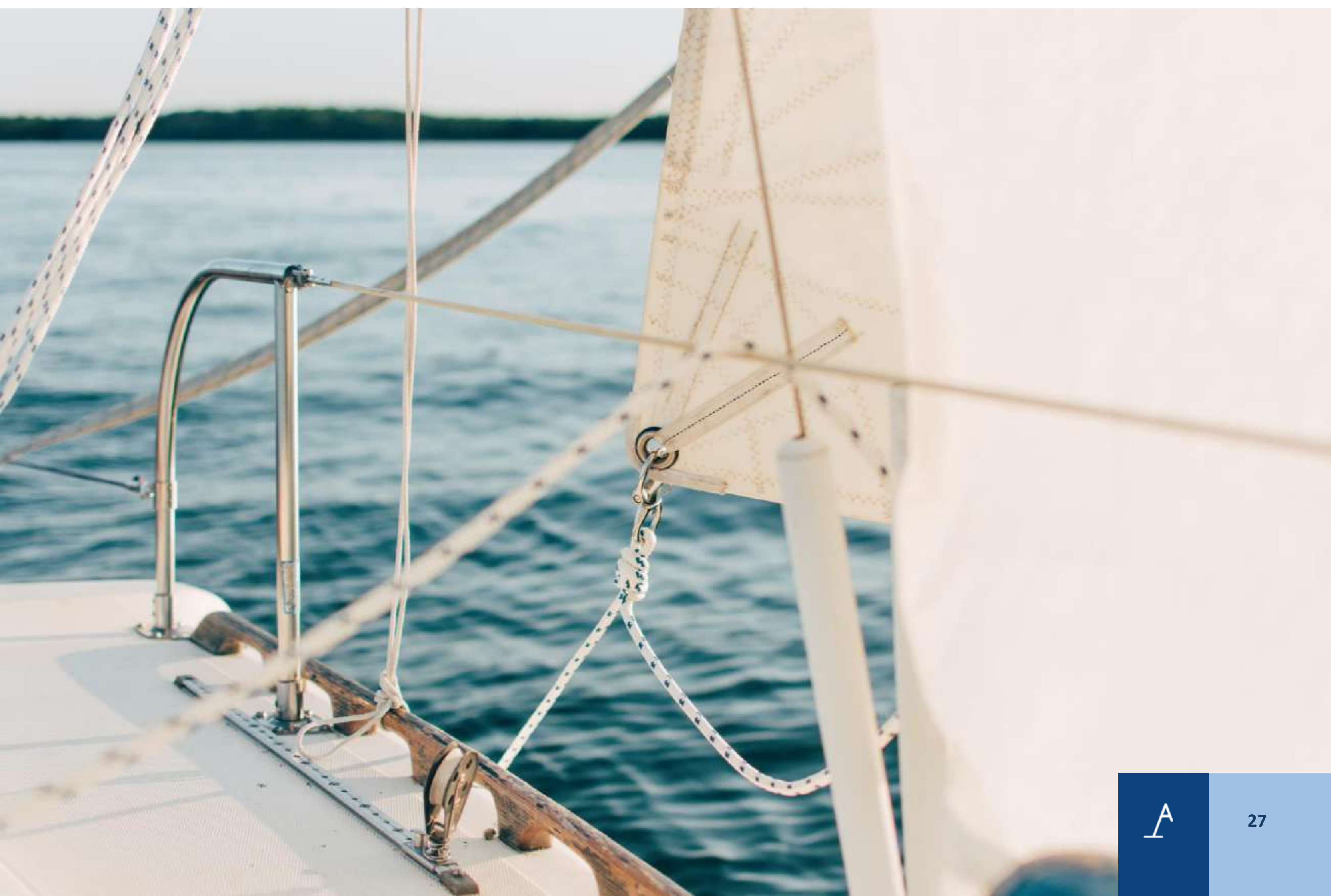
In summary

We believe the adoption of EVs will not pose an existential threat to oil demand in the immediate future. We estimate that less than 1% of oil demand would be displaced by EV adoption under a base case of 8% EV sales penetration in 2025. The seemingly low figure is assisted by only 20% of oil demand coming from cars and the current auto-fleet primarily consisting of ICE vehicles that will continue to require fuel to operate. We acknowledge the difficulty of forecasting technology adoption and cite three factors that we believe will drive the size and speed of the adoption - regulation, battery costs and OEM commitments.

Figure 8: Oil displacement from EV adoption

IN MILLIONS	BEAR CASE	BASE CASE	BULL CASE
2017 EV sales penetration		1.10% (0,7% BEV, 0,4% PHEV)	
2025 EV sales penetration	5.00%	8.00%	15.00%
2025 EV Fleet	31.00	43.00	66.00
Barrels Oil per 100m Cars (MMbbl/d)	1.80	1.80	1.80
Barrels Oil displaced (MMbbd/d)	0.57	0.78	1.19

Source: Anchor Capital, BP



WHY PHILOSOPHY MATTERS IN INVESTING

Nick Dennis
Fund Management

Introduction

Why is it important to have an investment philosophy?

An investor with a well thought-out philosophy and process gives him or herself the best possible chance of outperforming the market over the long term. I put those odds at roughly 20%. This figure may seem depressingly low, but it's consistent with reality – the bulk of investors underperform their benchmarks after fees.

PERCENT OF FUNDS THAT UNDERPERFORMED THE S&P 500 AFTER FEES			
Fund category	3 years	5 years	10 years
US domestic equity	87%	95%	87%
Global markets	77%	82%	81%
Emerging markets	77%	68%	82%

Source: The Concentration Manifesto, Cameron Hight, Alpha Theory.

The table above only tells half the story. Absent a robust and coherent philosophy, I believe the odds of outperforming fall to 5% or less.

The thoughts below are not intended as a prescriptive to-do list. Readers are encouraged to take the underlying principles and apply them to their own specific circumstances, beliefs, and skill-sets.

Philosophy and edge – theory and reality

We all have beliefs about how the world works. Most beliefs operate at a subconscious level – it takes work and self-awareness to recognise these underlying drivers of behaviour. Importantly, not all beliefs are consistent with reality. This creates a challenge, as humans will sooner distort reality to fit their beliefs than change their beliefs to fit reality!

If you want to be a successful investor, your beliefs must align with reality. What should work and what does work are not necessarily the same thing. The most important question when it comes to philosophy is: are there empirical and logical reasons that the market should reward you for pursuing your particular strategy? Do you have an 'edge'?

You also need to do something different from other investors. If research demonstrates that low PE stocks outperform, investors will flock to those names and destroy the strategy's future returns.

I'll provide a relevant example. 'Reversion to the mean' is taken as a universal rule in the investing world, much like gravity. While I have sympathy with this concept, I believe the really interesting outcomes are to be found when mean reversion breaks down and a new set of processes take over. In essence, I am trying to play a different game than the majority of market participants.

Within the specific context of your philosophy, you need to identify where you add value (by virtue of your specific skills) and where you don't (or worse, where you actively destroy value). I try to focus as much time as possible on the areas where I add value, and then create systems to automate (or reduce the need for decisions) in those areas where I don't add value.

Research process

Most research processes boil down to a few common steps: look for good stocks, research them, and then buy some of them. The research process only adds value to the extent that it's executed within the parameters of your investment edge. An investor cannot expect to be consistently successful in areas where they have no edge.

A major benefit of a well-defined philosophy is that it gets everyone on the same page. It helps analysts focus their research time. Counterintuitively, it's liberating to say 'No' to a lot of ideas. There's clearly a trade-off: many ideas you ignore will go on to become winners. That said, I firmly believe that the advantages of a narrow focus far outweigh the opportunity cost.

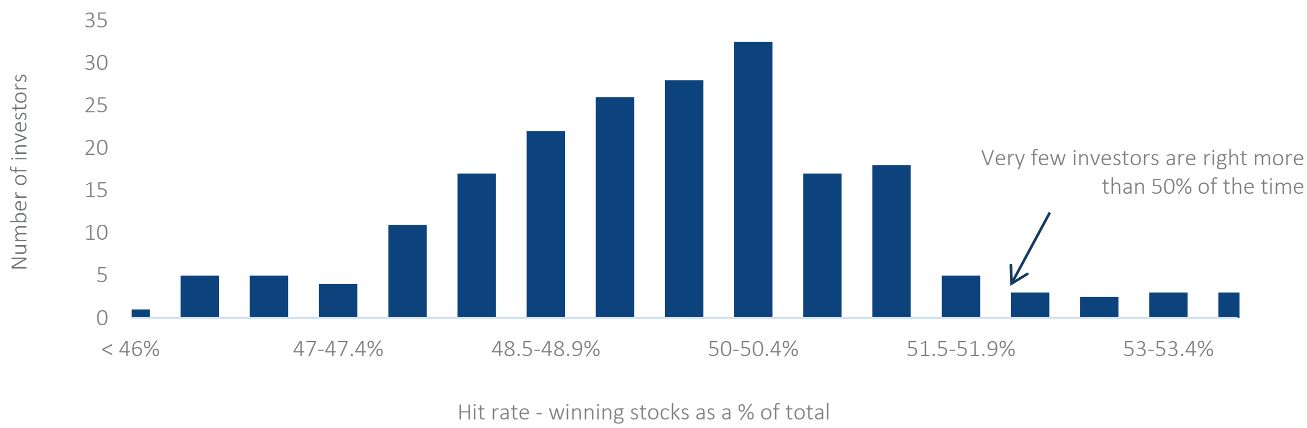
Portfolio management – three main problems

The three main problems investors need to solve with respect to their portfolios are:

1. Position sizing.
2. What to do with losing positions.
3. What to do with winning positions.

The answers to these problems are directly linked to your underlying beliefs about the market and your investing philosophy.

Figure 1: The evidence suggests most investors are right only half the time



Position sizing is arguably even more important than stock selection. The latter implies "Just pick better stocks", but the evidence suggests this is no better than a coin toss for most investors. Even investors that are 2 standard deviations 'good' are only right 53% of the time.

Picking better stocks and achieving a higher hit rate is possible, but only in the context of fully embracing your philosophy (assuming it comes with an actual edge). The bulk of gains in hit rate come from moving from 'no edge' stocks to 'edge' stocks. Once you've done that, you tend to hit a ceiling.

Position sizing is the holy grail of investing and is arguably more important than stock selection. Getting the former right can cover a multitude of sins in the latter. What counts is how much you make when you're right and how much you lose when you're wrong.

Any process should explicitly articulate how you deal with both winners and losers. The approach taken should be consistent with your philosophy and beliefs. For example, a value investor will add to losing positions and reduce winning positions as the stock becomes more or less attractive relative to their estimate of intrinsic value. Conversely, a momentum investor might take the opposite approach. Regardless, knowing your strategy ahead of time adds clarity in the heat of the moment.

Characteristics of a well-functioning system

An investment process can be thought of as a system, with the different elements (e.g. philosophy, research, portfolio management etc.) interacting like cogs in a machine.

How do you know if you have a well-designed system?

The obvious answer is it generates investment performance over the long term. Shorter term, a well-designed system can and will underperform.

A well-designed system that incorporates the above elements will help the investor achieve a kind of 'flow state'. The investor will have a deep understanding and acceptance of when the machine works and when it doesn't. The investor will have made peace with both outcomes. The investor will have minimal internal conflicts – decisions will be clear because all aspects of belief, philosophy, skills and reality will be in sync. Once you've built the machine and understand its workings, it becomes easier to identify where the problems are, and which parts need fixing.

Much like a Formula One team, tweaking and improving the machine is an ongoing, iterative process. One in which each step takes you inevitably closer to defying the odds and winning the race.

05 PERFORMANCE SUMMARY

	FUND PERFORMANCE							BENCHMARK PERFORMANCE					Performance vs Benchmark
	Start date	Annualised p.a.	Since inception	12 Month	6 Month	3 Month	June 2018	Since inception	12 Month	6 Month	3 Month	June 2018	
UNIT TRUSTS													
Anchor BCI Equity	Apr-13	13.6%	94.8%	5.00%	-0.9%	2.1%	1.5%	62.5%	8.2%	-5.9%	-0.8%	0.7%	32.3%
Anchor BCI SA Equity	Jan-15	3.0%	10.5%	5.4%	-1.8%	1.7%	0.9%	18.5%	8.2%	-5.9%	-0.8%	0.7%	-8.0%
Anchor BCI Flexible Income	Jun-15	7.4%	24.5%	6.1%	2.7%	1.1%	0.1%	27.7%	8.3%	4.0%	2.0%	0.6%	-3.2%
Anchor BCI Managed	Jan-15	4.5%	16.3%	4.6%	-0.5%	2.1%	2.0%	41.1%	9.4%	5.3%	2.5%	0.6%	-24.8%
Anchor BCI Worldwide Flexible	May-13	12.2%	80.7%	8.83%	7.8%	12.7%	6.8%	57.7%	8.4%	4.8%	2.3%	0.5%	23.0%
Anchor BCI Property Fund	Nov-15	-1.4%	-3.7%	-3.0%	-11.1%	-2.4%	-2.9%	-5.2%	-9.9%	-21.4%	-2.2%	-3.5%	1.5%
Anchor BCI Global Capital Feeder	Nov-15	-0.7%	-1.9%	4.05%	10.2%	15.6%	9.1%	7.8%	8.8%	13.1%	17.4%	9.8%	-9.7%
Anchor BCI Global Equity Feeder	Nov-15	8.9%	25.6%	14.8%	16.1%	19.3%	9.9%	29.0%	16.7%	10.5%	17.0%	7.9%	-3.4%
Anchor BCI Bond Fund	Feb-16	10.8%	27.9%	10.2%	3.5%	-3.2%	-1.3%	26.4%	10.2%	4.0%	-3.8%	-1.2%	1.4%
Anchor BCI Diversified Stable Fund	Feb-16	6.8%	17.2%	7.1%	2.4%	2.2%	0.9%	14.9%	6.9%	1.5%	2.8%	1.4%	2.3%
Anchor BCI Diversified Moderate Fund	Feb-16	5.7%	14.3%	6.8%	0.9%	2.4%	1.0%	13.5%	6.9%	0.5%	3.5%	1.9%	0.7%
Anchor BCI Diversified Growth Fund	Feb-16	4.9%	12.3%	7.8%	0.3%	2.6%	1.3%	13.9%	7.2%	-0.2%	3.5%	2.0%	-1.6%
Anchor BCI Africa Flexible Income	Mar-16	4.2%	10.0%	6.0%	3.1%	5.3%	2.9%	23.5%	9.3%	4.5%	2.2%	0.7%	-13.5%
EQUITY NOTES & SEGREGATED MANDATES													
Anchor Equity	Jul-13	9.8%	59.7%	0.3%	-4.6%	0.3%	1.8%	61.4%	8.2%	-5.9%	-0.8%	0.7%	-1.7%
Growing Yield*	Jun-12	11.0%	86.8%	-5.4%	-5.5%	-1.2%	-1.7%	81.7%	9.4%	5.3%	2.5%	0.6%	5.0%
HEDGE FUNDS													
Long Short Equity	Mar-13	8.2%	51.0%	1.2%	0.1%	0.3%	0.1%	49.9%	8.9%	4.3%	2.1%	0.7%	1.1%
Property Long Short	Jan-14	10.3%	55.1%	1.0%	-5.5%	-1.0%	-1.7%	47.0%	9.3%	4.5%	2.2%	0.8%	8.1%
OFFSHORE													
High Street Equity - Dollars	Jun-12	12.5%	102.4%	6.1%	-2.4%	-1.4%	-1.2%	97.0%	11.7%	0.8%	1.9%	0.0%	5.5%
High Street Equity - Rands	Jun-12	22.5%	238.2%	11.1%	8.2%	14.3%	7.1%	230.9%	17.7%	11.9%	18.6%	8.5%	7.3%
Offshore Balanced - Dollars	Jun-12	10.6%	83.0%	5.4%	-0.9%	-0.3%	-0.9%	51.3%	7.2%	-0.3%	-0.1%	-0.2%	31.7%
Offshore Balanced - Rands	Jun-12	20.5%	206.5%	10.3%	9.9%	15.6%	7.5%	154.2%	12.9%	10.7%	16.3%	8.2%	52.3%
Global Dividend - Dollars	Jan-14	8.6%	44.0%	5.7%	-3.4%	0.4%	0.2%	46.4%	11.7%	0.8%	1.9%	0.0%	-2.4%
Global Dividend - Rands	Jan-14	13.9%	77.7%	10.7%	7.1%	16.3%	8.7%	81.1%	17.7%	11.9%	18.6%	8.5%	-3.4%
Anchor Sanlam Global Stable Fund - Dollars	May-15	-0.2%	-0.6%	1.2%	0.1%	0.2%	0.1%	8.6%	2.7%	1.4%	0.7%	0.2%	-9.2%
Anchor Sanlam Global Stable Fund - Rands	May-15	3.9%	12.5%	6.7%	11.2%	16.3%	8.6%	22.8%	7.9%	12.4%	16.7%	8.3%	-10.3%
Anchor Sanlam Global Equity - Dollars	May-15	9.6%	32.7%	12.5%	6.3%	4.3%	0.4%	22.8%	10.7%	-0.4%	0.6%	-0.5%	9.9%
Anchor Sanlam Global Equity - Rands	May-15	14.1%	50.2%	18.5%	18.0%	21.0%	8.9%	39.0%	16.7%	10.5%	16.7%	7.9%	11.2%

*Provisional performance returns

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