The Navigator

Strategy and Asset Allocation Report
4th Quarter 2019

ANCHOR | NAVIGATING CHANGE

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Introduction


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An asset manager's role in society is to assist clients with safeguarding and growing their wealth over time. Our daily lives are overrun with EBITDA, operating leverage, CGR ratios and other jargon. We, as your asset manager, must guard against this jargon distracting us from our actual role - to safeguard and invest your wealth.

In plain speak, this has been a dreadfully difficult environment in which to invest. As we write this introduction, the World Trade Organization (WTO) has approved tariffs on $7.5bn of goods exported from Europe to the US. This is in retaliation to European government support being given to Airbus. The interconnectivity of the globe means that, while it would take me a few minutes to find Leiden (Netherlands) on a map, events at Airbus, headquartered there, have the potential to move the value of your investment portfolios up or down by a few percentage points in less time than that.

There has been a clear shift in the political landscape globally, where collaboration between countries is increasingly giving way to protectionism and socialist rhetoric. As these shifts take place we find that developed markets (DMs) are now unconventional in their approach. The UK is pursuing isolationist policies with a populace that is deeply divided over Brexit, youth in Hong Kong are refusing to submit to rulers in Beijing, Europe is seeing political parties that were once on the margin become more mainstream in Italy, Spain and France.

As asset managers, we have a part to play in rebuilding SA. A different SA that is stronger than before.

The US is increasingly bellicose as it seeks to assert its dominance in global trade and immigration. Many of these events are to the detriment of global trade and economic growth, making for a difficult investing environment. We cannot predict where the next destabilising event will take place, nor what the likely outcome is from each of these events. Our role is to assist investors in navigating the safest path through the maelstrom of the global economy.

South Africa (SA) is an emotional topic for us - we live here and would like to continue as proud SA citizens. However, damage wrought on our country due to the self-interest of a few individuals infuriates us. It also jeopardises our domestic wealth and, potentially, our ability to continue living as South Africans in the country of our birth. We are hopeful for the future and think that the domestic situation has improved ever so slightly over the past quarter. While we might not agree with all the policies that are being discussed, we do think that fixing the economy will remedy many of the challenges the government faces currently. We are strongly against prescribed assets and would rather work with government to develop projects that are able to stand on their own merits than to invest the futures of our clients on a wink, a prayer and a trust-me memo from government. Eskom is concerning and we see how talks around approximately 10,000 excessive employees might hold hostage an economy that feeds c. 57 mn people. We need to see government do the right thing, not for a small group of beneficiaries of past policies, but rather for all South Africans.

As asset managers, we have a part to play in rebuilding SA. A different SA that is stronger than before. We are excited by the opportunities that this presents us, and we look forward to a partnership with government and labour. We are not enemies that must dominate and destroy each other. Society is a necessary collaboration of labour, government and business. A symbiosis that needs to benefit all parties and all South Africans.

As we navigate this changing world, we need to be flexible in our views and we have to accept that circumstances can change quickly. These are difficult times and we believe that a balanced approach towards investing will also bring the best rewards. Readers will see that, in this document, we are positive on domestic bonds. It is at times like these that portfolio construction and asset class diversification can bring both comfort and rewards. Circumstances can change quickly, and yesterday's losers can easily be tomorrow's winners. We therefore advocate constantly assessing the appropriateness of your asset allocation decisions, and patience to allow asset classes to do their work.

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 (ZAR)
	Negative	Neutral	Positive	
LOCAL				
Equity		●	<	9.9%
Bonds			●	10.0%
Property		●		10.5%
Cash		>	●	6.3%
GLOBAL				
Equity		●		-1.1%
Government Bonds	●			-8.5%
Corporate Credit	●			-7.3%
Property	●	<		-4.1%
Cash		●		-6.6%

Strategy and Asset Allocation

GLOBAL BACKDROP

The extent of the rot in the SA state sector is only now becoming apparent, far exceeding what we had feared. In this context, the rebuilding of SA is going to be a protracted task as the state works to recreate its ability to provide basic services and infrastructure to its citizens. Fixing Eskom and other SOEs is a step in the right direction, but this is in and of itself not enough to kickstart our economy. A trust deficit has been established at job creators as political policies and utterances have generally sought to tilt the playing field away from business and job creation. Policies have been focused on taking the pie from business and giving it to other segments of our country.

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The surprise factors of prescribed assets and the proposed National Health Insurance (NHI) continue to incentivise the upper middle class to focus on income and job creation outside of our borders and as such the country's tax base is being exported. The continued pressure from government on business and the upper middle class means that the RMB/BER Business Confidence Index is currently at its lowest level in two decades (3Q19's reading stood at 21 – well below the 50-point mark separating expansion from contraction).

That being said, we do think that we are in a better place than we were a quarter ago. The direction of change is an improvement, albeit gradual. We are also pleased to see that economic policy is coming to the forefront of discussions and that sensible proposals are being discussed. We expect this trend to continue for a while and, accordingly, we remain more positive on SA's longer-term outlook.

The global environment is also coming under pressure as isolationist and nationalist policies are taking hold. Trade and growth are slowing, whilst uncertainty is rising. We have seen particularly disappointing manufacturing numbers out of most developed countries, which portends a further slowdown of their economies. Europe has been pushed to restart its bond buying programme (quantitative easing [QE]) less than a year after having terminated it, and the US has cut interest rates twice already this year. Perhaps the only bright spot currently is the US consumer, who is still benefitting from strong balance sheets and earnings growth. We think that they will be enough to keep the US economy grinding on, albeit at a slower pace than before.

Overall, the world economy has been slowing and is likely to bumble along at its current pace for the remainder of 2019.

SOUTH AFRICAN EQUITIES

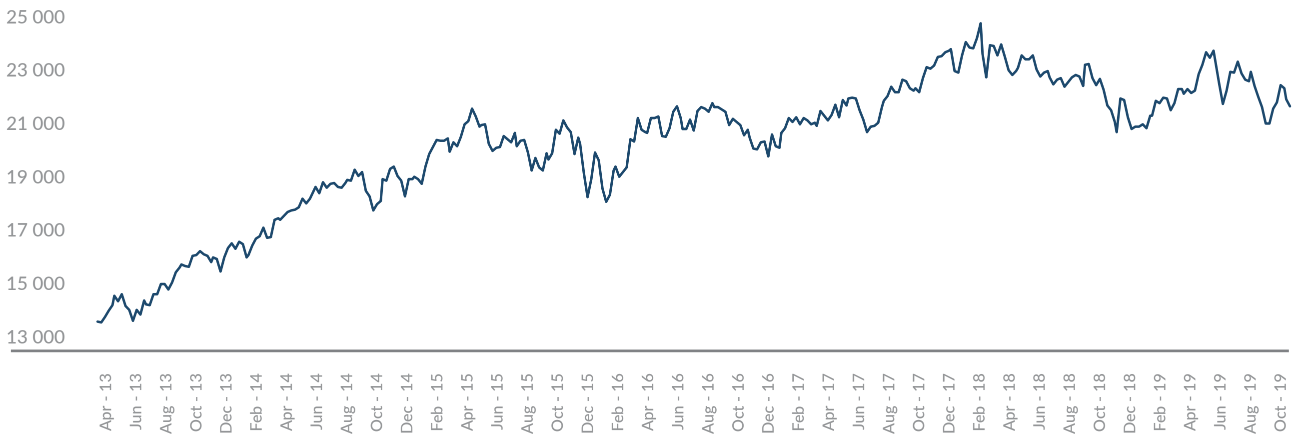
We head into the last quarter of this decade with the domestic market still in the doldrums. The SA market is in cheap territory but is lacking the growth required to kickstart a sustained upturn. With sentiment and expectations at low levels, the potential exists for some resolution of the SA macro issues to boost equities.

Hence, on a 12-month view, we maintain a moderately overweight position, but our conviction levels in the shorter term are not particularly high. Our 12-month return projection for domestic equities is 10%. On balance, we believe investors should remain patient, as valuations already reflect a very slow recovery. We hope to be positively surprised.

Figure 1 below shows the total return of the JSE Capped SWIX Index. The relatively flat performance should be seen in the context of positive returns from resources and Naspers but a sharp decline of domestic counters.

Figure 1: JSE Capped SWIX Index total return

Source: Bloomberg, Anchor



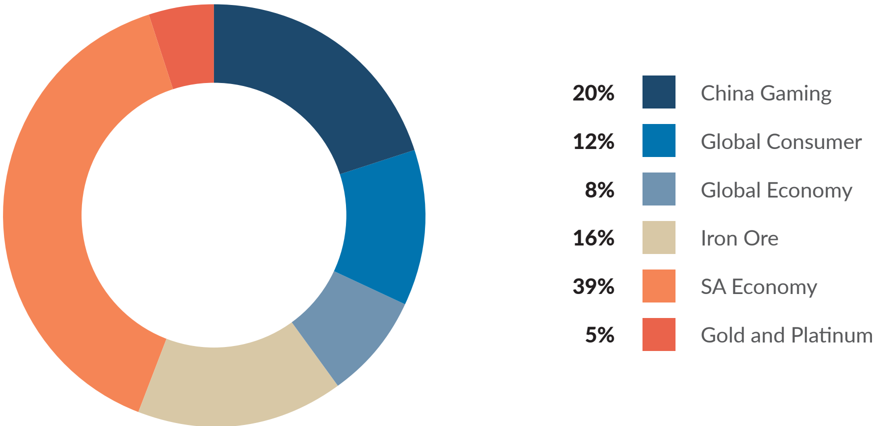
The direction of global markets and, more specifically, emerging markets (EMs) are important for the local market. However, global macro conditions have worsened over the past quarter and EMs are reflecting this.

We are comfortable owning these equities at current valuations, although we acknowledge that the next 12 months could produce returns below historical trends.

When assessing the SA market, one must always bear the drivers in mind. This is shown in Figure 2 (measured with reference to the FTSE JSE All Share Index).

Figure 2: Contributors to the FTSE JSE All Share Index by sector (measured by market cap)

Source: Anchor



The SA economy drives roughly 40% of our share market. Earnings have been under pressure locally and a low-growth environment means that this is likely to continue over the next 12-24 months. However, shares already reflect this and the share prices of many big companies are down 20%-50% since their highs. In the case of Anchor portfolios, the shares that we own in this category are, in aggregate, trading at less than a forward 9x PE and greater than a 4.5% dividend yield.

A recovery in the local component of the index is unlikely to be earnings driven, but good news on the political front could spur a share price recovery, which is why we are still comfortable holding higher-quality counters. Among these are Bidvest, FirstRand, Rand Merchant Investment Holdings (RMI), Clicks, Dis-Chem and The Foschini Group. Some decisive actions by government on Eskom and the economy, as well as evidence of the National Prosecuting Authority (NPA) acting against corrupt individuals in the public and private sectors could see an improvement in confidence. Within the next month we should also see announcements on the new Eskom turnaround plan, a growth plan for the economy, the medium-term budget policy statement (MTBPS) and the Moody's rating review.

Naspers (characterised as Chinese gaming in the pie chart above) is the second-biggest driver of market performance. The Naspers/Prosus combination will largely be driven by the performance of Tencent. It seems evident that the recent Amsterdam Prosus listing is unlikely to be the key to a discount unlock. Tencent growth fundamentals look great for the next 3-5 years and the recent share price pressure is largely due to macro pressures on EMs, rather than the underlying company. Tencent tends to be fairly volatile and it is generally a good time to buy when the price is materially off its highs (currently 30%). We note that Tencent is currently trading at close to its low for the year.

20% of our share market is driven by the global consumer and economy (with a further 20% driven by Chinese gaming). We are moderately positive in this space, although less so than a few months ago, after a marked slowdown in global growth. Company specific factors tend to dominate share price moves here. We are cautious on Richemont in the short term after Hong Kong retail sales took a dive following domestic protests and unrest.

Another c. 21% of our market is commodity price driven. Gold and platinum shares have been the stars this year and we continue to hold platinum exposure, with the increased demand being driven by carbon emission standards outweighing the reduction in global car sales. In the very short term, the risk of strikes in the platinum sector has increased after trade union, the Association of Mineworkers and Construction Union (AMCU) declared a dispute and we are monitoring this closely. High platinum basket prices will no doubt lead to high wage increase expectations.

SOUTH AFRICAN EQUITIES

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Sasol is in a category of its own and the key event for the share price is the release of delayed full-year 2019 results, which we believe will be accompanied by a board review of its Lake Charles Chemicals Project in the US. This should take place in October and will be the key driver of Sasol's share price performance.

Within SA equities we are still comfortable with a balanced approach to portfolio construction, selectively taking on more risk when the right opportunities present themselves

Most analysts have a valuation of the share materially above the current price, but management need to win back the faith of the investment community following the Lake Charles debacle. This US project will now cost closer to $13bn, compared to the $6bn budget when the project commenced.

Gold is not in our natural investment arc but is serving as a good defensive asset at present. Iron ore has remained strong at around $80-$90/t, although well off its highs from earlier in the year. The share prices of the likes of Anglo American and BHP are cheap relative to the iron ore price and are currently generating strong free cash flows.

We are watching this sector with caution as the remainder of the commodity sector has been under pressure and, in many cases, are down substantially YTD.

Within SA equities we are still comfortable with a balanced approach to portfolio construction, selectively taking on more risk when the right opportunities present themselves.

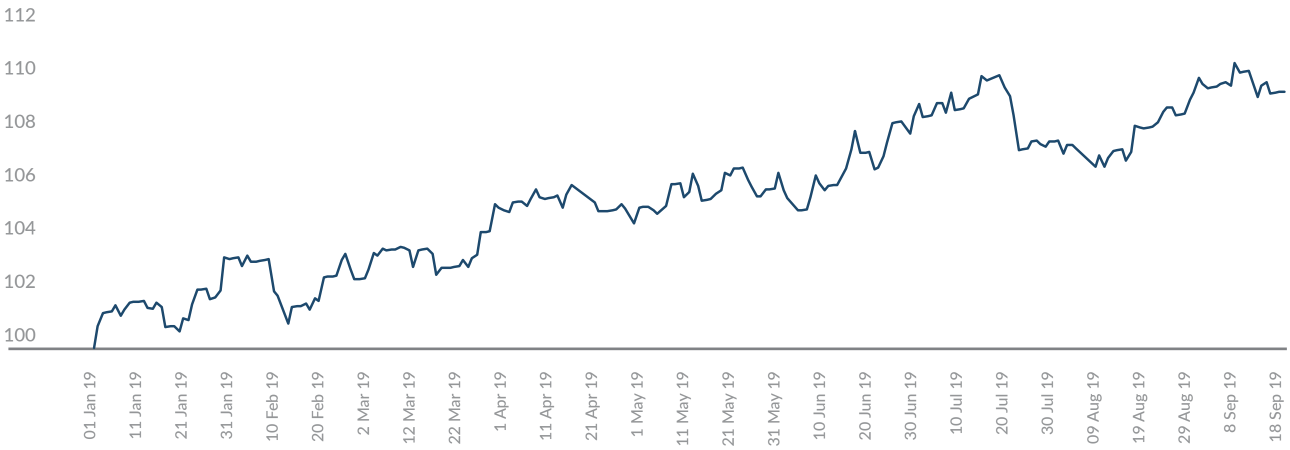
SA BONDS

The SA bond market has remained strong into 3Q19, with the All Bond Index (ALBI) growing 1.36% over the quarter, with a 9.01% increase YTD (as at 23 September 2019). The curve shape has held stable over the quarter, with the 2-year yield weakening 4 bps and the 20-year weakening by 8 bps.

The 5-year credit default swap (CDS) has consistently traded below 200 bps throughout the quarter, currently sitting at 188 bps. The US 10-year yield has traded in a band from 1.41% to 2.12%.

Figure 3: The ALBI return for R100 invested on 1 January 2019 (YTD)

Source: Reuters, Anchor



We note that ALBI returns YTD have been strong with a R100 initial investment, yielding a current value of R109 (See Figure 3). Furthermore, at no point this year has the ALBI dropped below its 1 January 2019 level of 631.293.

The local political situation remains tenuous - violence against women has become a flashpoint, alongside xenophobic attacks and the uncovering of political beneficiaries of the VBS collapse. These are all proving that the domestic situation is fraught with difficulties in the run-up to the MTBPS on 30 October. Much depends on the viability and believability of the economic growth plan.

This MTBPS will therefore be closely monitored by ratings agencies, potentially with a view towards a future downgrade.

The market is also deeply concerned about how Treasury plans to finance Eskom, while the state electricity utility is undergoing a turnaround. Many of the possible new initiatives such as the proposed NHI and prescribed assets are also negative for the market and are creating distrust. This MTBPS will therefore be closely monitored by ratings agencies, potentially with a view towards a future downgrade. Beyond SA, global uncertainty continues to dampen investments into EMs in general, however 2Q19 reporting did see foreign direct investment (FDI) inflows of R26.3bn.

Current interest rate expectations remain tied to whether the low-growth environment persists hand-in-hand with the SA Reserve Bank's (SARB's) targeting of a 4.5% inflation rate. We view SA inflation at 4.8% and US inflation at 1.8% - giving a differential of 3.0%.

The long-run CDS spread of 220 bps and a US fair-yield of 2.2%, gives a fair value of the 10-year benchmark bond at 7.4% (being the summation of these three factors). We adjust this fair yield upwards, considering the political uncertainty discussed above, and we maintain a fair yield for the SA benchmark bond of 8.0%. The bond is currently trading at 8.34% and it has traded in the band of 7.98% to 8.45% for the past quarter (3Q19).

This gives us an expected return of 10% over the next twelve months, which comprises of interest income of 8.3% and capital gains of 1.7%.

SA LISTED PROPERTY

The quarter ended 30 September (3Q19) has been a difficult market for SA equities overall and the listed-property sector once again proved to be an ineffective hiding place, ending over 4% down QoQ. Among the twenty worst-performing stocks on the JSE for 3Q19, c. 20% were property companies, including Delta Property Fund (-70.0% QoQ), Rebosis Property Fund (-54.0% QoQ) and Accelerate Property Fund (-44.6% QoQ). SA-focused mid-and small-cap companies were among the hardest hit, with some property fund companies such as Rebosis, Delta and Accelerate starting to exhibit price behaviour reflecting existential stress.

The weak local economic conditions mean that landlords are being squeezed hard by cost-conscious tenants and growth in rental streams is being eroded. This has the knock-on effect of property valuations falling because property companies are making less money and, in turn, where there is a less than very conservative loan-to-value (LTV) ratios, investors are getting spooked.

Those property companies that are attracting investment have one or a combination of the following attributes:

- An LTV ratio of less than 35%.
- Niche property sector positioning i.e. modern logistics assets, regional retail malls, etc.
- An offshore strategy focused on growth economies and asset categories.
- A formulaic pay-out, which guarantees at least inflationary growth in distributions i.e. Fortress -A- shares.

Until such time as the SA economy shows some sign of a recovery it is unlikely that this trend will change dramatically. However, as we highlight in our article entitled *SA Property: Light at the end of the tunnel?* on page 25, the local listed property sector is now offering yields that will, aside from the unlikely event of an Armageddon-type scenario playing out, reward the long-term investor.

We therefore maintain our neutral weight asset allocation to the sector as we forecast the harvesting of a double-digit dividend yield, even in an environment where capital growth is being challenged.

THE RAND

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

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 our last Navigator's publication.

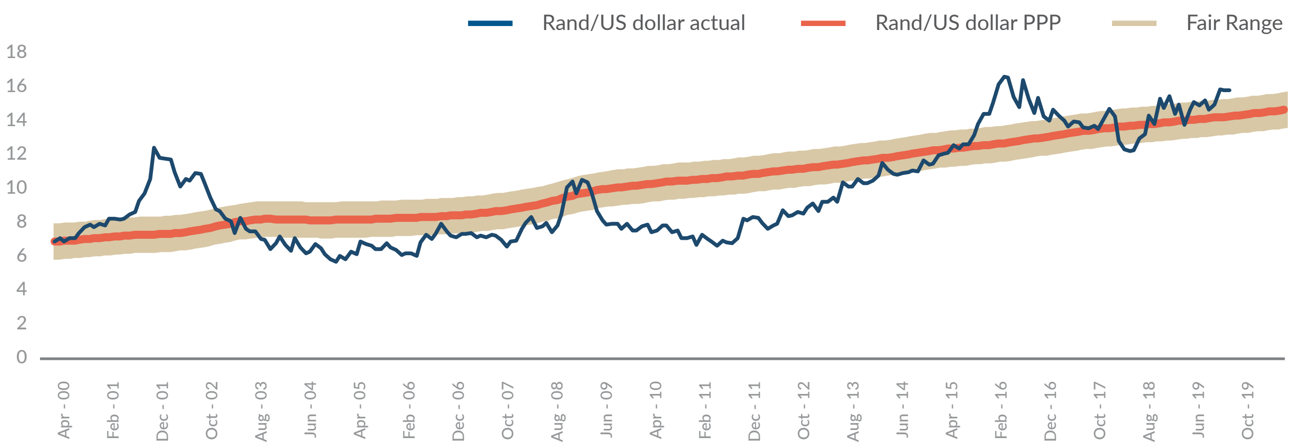
Our PPP-modelled value for the rand vs US dollar at the end of the next 12 months is R14.05/$1 (See Figure 4). We apply a R2.00 range around this to get a fair value range of R13.05-R15.05/$1.

We have become less optimistic about the outlook for EM in general. In the context of a slowing global economy and global event risk, we expect that the dollar will remain supported as a currency of refuge and that the rand (along with many EM currencies) will trade slightly weaker than its fair value.

We note that the rand ended 3Q19 at R15.18/$1, which is just outside our fair-value range. We expect that the rand will remain on the weak side of fair for the next while. For modelling purposes, we have used the R14.05/$1 midpoint of our range.

Figure 4: Actual rand/ US dollar exchange rate vs rand PPP model

Source: Thomson Reuters, Anchor



GLOBAL EQUITY MARKETS

World markets have traded sideways for close to two years now, with the only interlude being the sharp decline in late 2018, followed by a matching rebound earlier this year. The past five months have been flat, with a few unconvincing S&P attempts to break through to meaningful new highs. At the same time, global growth prospects have declined, and volatility has increased. The US Federal Reserve (Fed) has responded by cutting rates and the market has held up as investors remain hopeful that further cuts will follow.

The market feels like it is looking for direction and the strength of the US consumer has been the saviour. We are also cognisant of the fact that US President Donald Trump will be focussed on economic growth prior to the November 2020 election. This might pave the way for more market-friendly moves going into next year.

It would be reasonable to expect continued volatility in the coming months but, on balance, we anticipate a 6% US dollar return from global equity markets over the next 12 months, which is slightly below historic averages. The rand return is likely to be less positive, given our view that the local currency is likely to strengthen over the next 12 months.

Our key observations are that valuations are at the high-end of normal and expectations are relatively high, although coming off a low base, where the last few quarters have had a moderate headwind from US dollar strength.

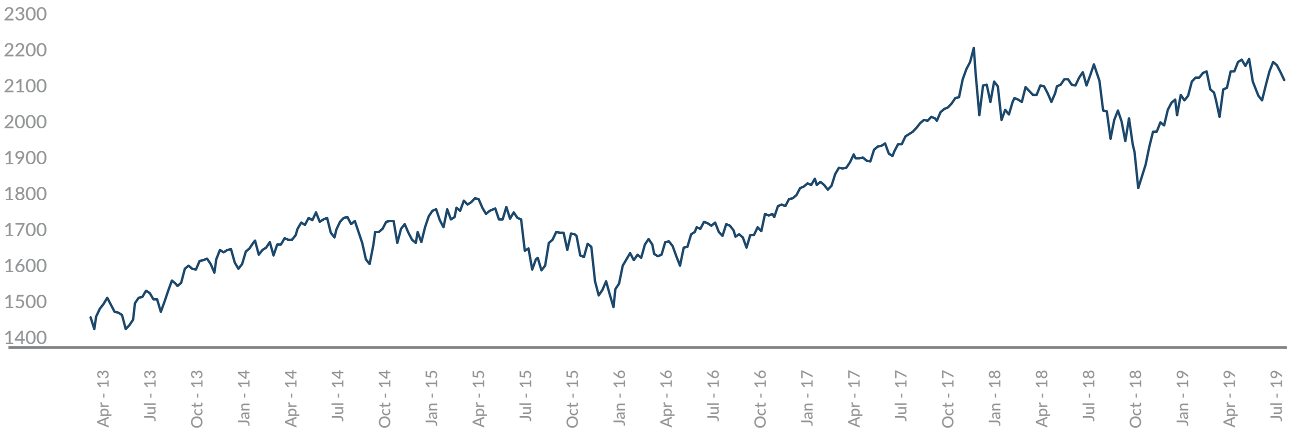
It would be reasonable to expect continued volatility in the coming months but, on balance, we anticipate a 6% US dollar return from global equity markets over the next 12 months.

The major risk to our moderately constructive view is that we encounter a period of increasingly bad data and company results, which could see the market lose confidence in the global slowdown being moderate in nature. This could, in turn, see the moderation or reversal of some of the more damaging Trump moves of the past year.

Figure 5 below shows the MSCI World Index over the past six years:

Figure 5: MSCI World Index performance, April 2013 to date

Source: Bloomberg, Anchor



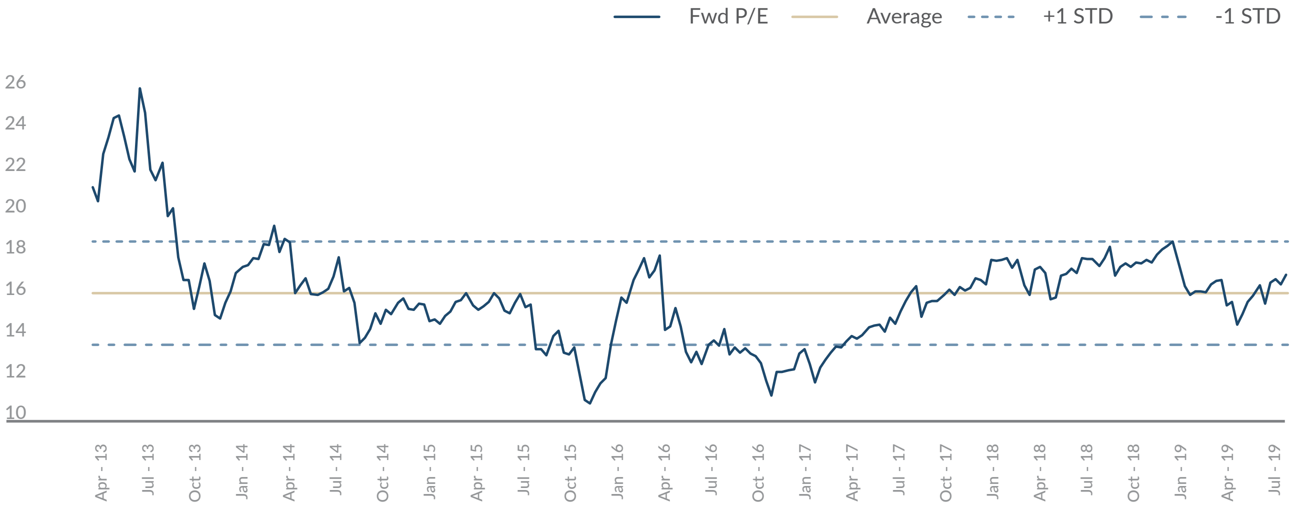
Trump's antics have dominated global economics over the past two years. The US has been the major beneficiary and, while the S&P 500 is near its all-time high at 3,000, other key indices are well off their highs since October 2018 - MSCI EM Index (-20%), Japan's TOPIX (-15%) and Euro Stoxx (-7%). This leaves all these indices exactly where they traded c. one-year ago.

Despite this being one of the longest positive runs in global markets, dollar returns have been relatively muted and have lagged earnings growth. The MSCI World Index is up 2% over the past 12 months (S&P is up 2.1% over the same period) and the compound return over the past five years is 4.9% p.a. (S&P=8%).

The MSCI World's forward PE has oscillated either side of 16x for the past five years and is trading just above this level currently. Markets seem fairly priced assuming reasonable world economic growth. However, the risks to this have risen and hence our base-case return projection is moderate.

Figure 6: The MSCI World Index fwd P/E

Source: Bloomberg consensus



All eyes will be on earnings growth over the next 12 months. The jitters caused by trade tensions has seen confidence levels reduce and the consensus view is now for just over 3% world economic growth (from close to 4% a year ago.) A positive resolution to the trade spats and a reasonable outcome could see a further bounce in markets.

The level of bullishness regarding global equity markets has retracted and individual exposure to the market is low by historic standards.

Nevertheless, analysts are fairly bullish about earnings (see *Bloomberg* consensus numbers in Figure 7) and, if the 17% forecast earnings growth for the next 12 months for the S&P materialises, our projected return could be exceeded. Average earnings growth over the past 10 and 20 years is in the region of 8%.

GLOBAL EQUITY MARKETS

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Figure 7: Bloomberg consensus forecasts for global equity markets' earnings growth

Source: Bloomberg consensus

	Earnings Growth		FWD P/E		
Date	YR 1 (%)	YR 2 (%)	Current	YR 1	YR 2
MSCI WORLD INDEX	17.4	7.6	16.5	14.0	13.0
MSCI EM INDEX	13.6	-10.3	12.9	11.4	10.3
MSCI ALL COUNTRY WORLD INDEX (10% EM)	16.6	6.5	16.0	13.7	12.9
S&P 500 INDEX	15.4	11.2	17.8	15.4	13.9

The forward PE of 15.4x for the S&P 500 (and 14x for the MSCI World Index) is relatively undemanding and should underpin markets if confidence levels do not deteriorate further. US bond yields are back at levels well below 2% and borrowing costs are likely to be subdued for an extended period, making equities relatively attractive.

We favour the US market for equity exposure. The negative impact of the stronger dollar should work its way out of the system in the coming months and there is strong growth momentum from the tech giants which, on average, generated 17% turnover growth in their recent results. Traditionally, defensive shares such as utilities and tobacco companies have performed well in these market conditions, but their relative lack of growth has seen their share prices lag.

Europe has delivered a similar return to the US this year, but a lack of earnings growth in this region will make superior returns hard to achieve and the core German economy, Europe's largest, is looking particularly worrying. The upside surprise could be the UK, where Brexit has restrained share prices. Any certainty as to the path forward could be a catalyst.

EMs are trading at a 20% discount to DMs, although this has been the trend for the past decade. We like the tech space in EMs, where secular trends are relatively unimpacted by tariffs. There is a reasonable chance that commodity prices will roll over towards the end of the year (as the current perfect storm reverses) and these are especially important for this segment of the market. All eyes will be on China's ability to stimulate its economy as many metrics currently point downwards.

The risks in global equities have increased as global growth slows, but the actions of politicians and central bankers could spur markets further. While the economic expansion is long in the tooth (and the slow bull market continues), we would still maintain at least neutral exposure to equities, especially given the relative unattractiveness of other asset classes.

GLOBAL BONDS

A year ago, markets were expecting the Fed to deliver one more rate hike for this cycle (the ninth since 2015), which was duly carried out by Fed Chair Jerome Powell in December 2018. Since then, trade wars have impacted global trade and market sentiment and the Fed has had to reverse course, cutting rates twice in the past two meetings. While the Federal Open Market Committee (FOMC) members are split on whether we'll see another US rate cut by the end of next year, markets are pricing-in three cuts over the next twelve months, with two of those expected to come in the next six months.

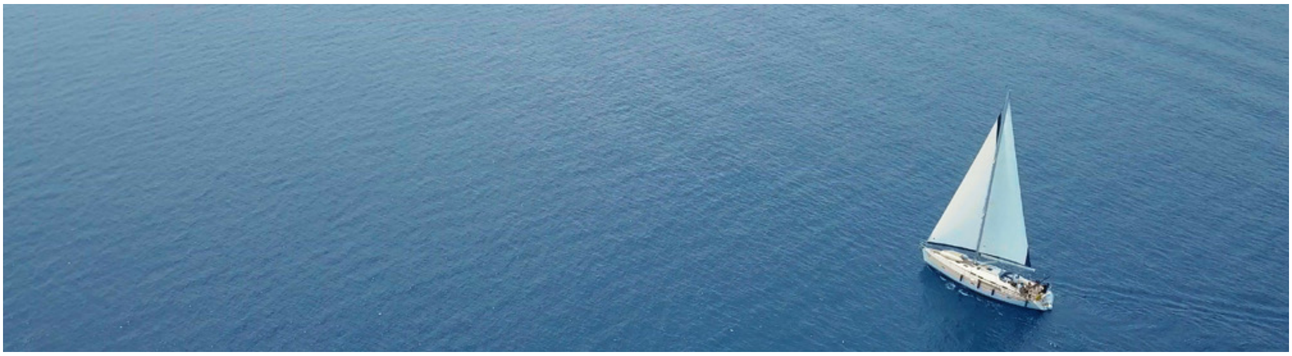
Trade wars have impacted global trade and market sentiment.

Across the Atlantic, the European central bank (ECB) has also been forced to reverse course on its attempts to normalise monetary policy. The ECB stopped adding to the size of its balance sheet at the end of last year and, at that stage, were hopeful that it could start edging interest rates back up towards positive territory by 4Q19. The exact opposite has happened as ECB President Mario Draghi used his second-last meeting at the helm of the ECB to deliver a cut deeper into negative territory for European interest rates and a resumption of the ECB's balance sheet expansion, with an open-ended pledge to purchase EUR20bn of bonds per month starting in November.

The backdrop of falling rates and weakening sentiment has pushed US short-term rate expectations over 1% lower over the past two quarters and, with short-term rate expectations as a key input to our models for valuing US long term bonds, we've seen our US 10-year government bond yield forecasts fall largely in tandem.

The other key input to our model is inflation expectations and although these have moderated slightly, we struggle to see US inflation below 2% over the next twelve months. We've increased the probability of a recession over our forecast horizon, though this remains far from our base case. We think that the Fed will probably deliver two rate cuts in the next twelve months, which should do enough to stabilise markets. This leads us to a US 10-year government bond yield forecast of 1.9% twelve months out, delivering investors a 1% total return loss in US dollar terms over that time horizon.

In credit markets, while we've seen a mild deterioration in credit spreads recently, we think it's reasonable to assume that credit spreads will continue to drift higher as we get deeper into this economic cycle. Deteriorating credit spreads and slightly higher interest rates will combine to deliver a small negative US dollar total return for investors in US investment grade bonds of around 0.1% over the next twelve months.



GLOBAL PROPERTY

When global yields started falling in 2Q19, we would've expected property stocks to re-rate. However, these stocks were left behind, held back by the retail real estate investment trust (REIT) sector (which accounts for more than 20% of global property indices), caught in the throes of a shift in shopping habits and the UK REITs (c. 5% of global property indices) having Brexit uncertainty hanging over them. As yields fell further in 3Q19, global REITs finally benefitted with the asset class one of the best-performing for the quarter (the FTSE/EPRA/Nareit Developed REIT Index was up over 5% for 3Q19).

We typically expect the global REIT dividend yields to adjust by about half of the move in US 10-year bonds and, if that holds, it's reasonable to expect capital losses of c. 2.5% in global REITs as US 10-year bonds head to our target of around 1.9% over the next twelve months. An average dividend yield of c. 3.8%, which should grow about 2% p.a. should leave global DM REIT indices with a total return of around 3.3% in US dollar terms over the next twelve months.

Expected Returns on Underlying Assets

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

Equity	PE1	E2 g (%)	Exit PE	Div (%)	Return (%)	ZAR (%)	ZAR Return (%)
LOCAL EQUITY	11.3	9.0	10.9	4.4	9.9	-	9.9
GLOBAL EQUITY	15.4	7.1	14.9	2.8	6.4	-7.4	-1.1
Developed Markets	16.5	8.0	16.0	2.6	7.4	-7.4	0.0
Emerging Markets	12.5	5.0	12.0	3.0	3.8	-7.4	-3.6

Bonds, Property & Cash	Yield (%)	Capital (%)	LC Return (%)	ZAR (%)	ZAR Return (%)
BONDS					
Local Government Bonds	8.3	1.7	10.0	-	10.0
Global Government Bonds	1.7	-2.7	-1.0	-7.4	-8.5
Global Corporate Credit	2.1	-2.0	0.1	-7.4	-7.3
PROPERTY					
Local Property	9.5	1.0	10.5	-	10.5
Global Property	3.8	-0.5	3.3	-7.4	-4.1
CASH					
Local	6.3	0.0	6.3	-	6.3
Global	0.8	0.0	0.8	-7.4	-6.6

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; “Rand” is the currency effect of translating into rand; “Rand 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 South African 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; “Rand” is our estimate of the currency effect of translating non-rand yields into rand; “Rand return” is our estimate of the “LC return” in rand.

ANCHOR INSIGHTS

In this section, staff from across Anchor provide insights into our thinking, strategy and view of the world. This quarter, Anchor Group CEO Peter Armitage looks at SA's listed corporate space and identifies 20 high-profile companies whose share prices have plummeted and explains the reasons for this; Glen Baker asks whether there is a light at the end of the tunnel for SA's property shares, which have dropped from their respective pedestals since the end of 2017; Nick Dennis explores investing in uncertain times; Di Haiden discusses trusts; and, finally, Tamzin Nel, Anchor's perennial optimist, examines how being constantly bombarded by (and focusing on) negative news, impacts investment decisions and by seeking out positive (and factual) news it will not only improve your mental wellbeing but your financial health as well.

ANCHOR INSIGHTS

SA's corporate meltdown:

Billions of rand vaporised

Written by: **PETER ARMITAGE, CA(SA)**
CEO, Anchor Group

Peter is CEO and founder of Anchor Group. He has 23 years' experience in global financial markets. Peter has worked as an analyst, Head of Research and Chief Investment Officer at several of SA's top financial institutions. He has been rated the top investment analyst in the annual Financial Mail rankings a record 21 times.

SA's listed corporate space has seen an unprecedented number of big market cap meltdowns over the past 2 years
In this article, we identify 20 high-profile listed companies whose share prices have plummeted and explain why. The temptation is to jump to the conclusion that SA business is fraught with malfeasance, but this analysis seeks to illustrate that, while there has no doubt been unethical behaviour, the majority of failures have been through a combination of bad luck, tough market conditions, one-off unanticipated events and poor judgement.

Many SA corporates' share prices have been toppling at a time when the public sector has been exposed as having dodgy business practices. This gives one the sense that everybody is dishonest and most people are for sale at the right price. We have more faith in humanity than that. SA has a long-standing good name globally for the quality of management in the listed company space. This has no doubt been dented, but investors can rest assured that, in general, SA corporate's ethics are sound.

Let's first deal with the failures that might imply some level of impropriety: Steinhoff, Tongaat and EOH.

> *Many SA corporate share prices have been toppling at a time when the public sector has been exposed as having dodgy business practices.*

Steinhoff, with its share price 99% off its highs, is an anomaly. Once in an investment career, fund managers might come across a high-profile, high-value fraud. For me, and most of my industry peers, that was Steinhoff. I clearly remember telling our investment team the night before Marcus Jooste's resignation that it was inconceivable that such a big company could be a giant fraud, especially considering the high profile nature of the directors, auditors and everybody else associated with the company.

To put it in context, this is the second-biggest listed company fraud in global history. Yes, read that again. The Enron fraud of 2000 brought down Arthur Anderson and changed global risk assessment forever. The Enron fraud involved $60bn of assets and by comparison Steinhoff's was $30bn. And now it's all gone – zero value remains and the share price of around R1.50 (from a high of R95), represents a faint glimmer of hope that there might just be something left. We posit there is no value left. Zero. A combination of false profits, related party transactions and dubious property valuations deceived the smartest minds in the country.

Then comes Tongaat. From a high of R140/share, it was recently suspended from the JSE at a price of R13.21/share. The problem is that the company built up a high level of debt and a decrease in asset value has a negative multiplier effect. The beans have not been spilt yet, but it appears that sugar cane valuations were overstated, and property deals brought to account were nowhere near done and many had to be reversed after new management faced this reality. The company is in the process of a forensic investigation. The accounting fraternity is alarmed and the previous management will be under pressure. The question being asked is if they inflated profits to secure generous incentives.

Then comes the previously high-flying EOH, with the share price down from R168 to R15. The highly regarded new CEO, Stephen van Coller, who was brought in to regain credibility, found worms when he peeled back the can. In the part of the business that deals with the public sector, certain individuals are being investigated for their part in transactions which "may relate to legitimate transactions, theft or bribery and corruption payments" (this might be the best way for the stretched National Prosecution Authority [NPA] to get irrefutable evidence of corruption). Microsoft has cancelled its licence for the group and there is a risk that other global vendors will follow suit. There appears to be some value left, but it's a long road ahead and will involve selling off some of the family jewels.

Those three are the companies where bad behaviour has been implied. For the rest it's bad luck, poor judgement and the toughest local operating conditions in decades:

Aspen (share price down from a high of R385 to R95 currently): The low cost of money globally lured Aspen into numerous deals which have not turned out as expected. The heroes of SA pharmaceuticals have not cracked it internationally and debt increased as profits went sideways or down. We back the management team to recover value and get the company back on the growth path but, in a common theme, some of the crown jewels are being sold off to right-size the balance sheet.

Mediclinic (R215 to R58): One of the best businesses in SA ventured offshore and got body blows in Dubai and Switzerland as regulators changed the rules of engagement. This saw a 75% drop in the share price off a highly geared balance sheet. It will be a long, slow recovery, but the underlying assets are of a high quality.

Tiger Brands (R467 to R230): This decline was caused by a combination of bad luck (Listeriosis), poor judgement (Nigerian investments), dismal market conditions and a global trend away from premium-priced food brands. There is a question mark over whether things have changed structurally – will consumers switch back from the Pick n Pay house brand to the much more expensive All Gold tomato sauce?

Netcare (R36 to R17): A company changing UK acquisition was eventually written off. Massive value was destroyed. Netcare is now trading at less than a 10x PE and a recent midnight appendix operation for my daughter reminded me that it provides an essential service. It's cheap, but Discovery Health is pressuring the top line and it might not grow meaningfully for some time.

British American Tobacco (R942 to R590): The management team is doing just fine, but the market has marked down the share on concerns of reduced tobacco demand and regulatory moves.

MTN (R250 to R95): This share was smacked by Nigerian regulators who irrationally demanded $8bn back from the company (almost the entire current market capitalisation). This was subsequently retracted, but left investors in a quandary as to how to value EM businesses. Having 10% exposure to Iran has not helped in a Trump world.

Ascendis (R28 to R4): Buy lots of small businesses. Gear up, buy more, repeat. It's all ended in tears and again it's the theme of selling off the family jewels to repay debt.

Brait (R170 to R15): The value and prospects were destroyed by the acquisition of UK-retailer New Look. It (New Look) is effectively valued at zero in the Brait share price and has dragged the company into the doldrums.

Blue Label Telecoms (R21 to R3.60): The acquisition of a controlling stake in Cell C was a negative turning point. It is not working as planned and it's a case of too much ambition and too much debt.

Intu Properties (R74 to R8): This is the Liberty offshoot into UK property where the retail sector has been a bloodbath. The company had to do the unspeakable and not pay a dividend to reduce debt.

Consolidated Infrastructure Group (R35 to R1.30): Government delays on power infrastructure projects, together with cash locked up in the Angolan subsidiary saw this company fall from grace. High debt levels and poor cash generation exacerbated the situation.

Woolworths (R97 to R54): A great SA business has been brought down by a disastrous Australian acquisition spree – the implied market value of the Aussie business is zero. The current valuation gives investors some optionality on at least the partial recovery of the Aussie business.

Truworths (R110 to R65): Ventures into the UK have seen value destroyed and the company is busy with massive store closures in the UK.

Resilient REIT (R152 to R63) and family: The sharp decline in the "Resilient family" shares were driven by accusations surrounding share dealing and related activities. The shares were trading at massive premiums to net asset value. While they have not been found guilty of anything, the shares have not recovered what they lost.

Rebosis Property Fund (R13.25 to 40c): Another example of a SA corporate borrowing money to buy a UK business. With the UK retail bloodbath, this R3bn acquisition has been written off. This leaves the company with unsustainable debt levels and, once again, it has to sell off the family jewels.

Almost the entire listed construction sector has been a disaster, with the big two exceptions being WBHO and Raubex. Poor local conditions, which were often exacerbated by offshore losses have seen Group Five and Aveng virtually vaporise. Another one is Omnia, which is another story of too much debt and not enough profit.

So what have we learnt? Some of the people we have trusted the most are not trustworthy. Analysts will be more sceptical for years to come and numbers do not lie (unless the numbers themselves are lies, as suggested by Steinhoff and Tongaat). But, for the most part, it was bad judgement. Be wary of companies with high gearing, be sceptical of big offshore investments and be aware of the risk posed by regulators who can change the rules of the game overnight.

Be wary of companies with high gearing, be sceptical of big offshore investments and be aware of the risk posed by regulators who can change the rules of the game overnight.

Are there more to come? The unexpected can always happen, but our view at present is that most of the pain has been felt and companies like Anheuser-Busch InBev are actively de-gearing in order not to be exposed if the global economy turns south.

ANCHOR INSIGHTS

SA Property:

Light at the end of the tunnel?

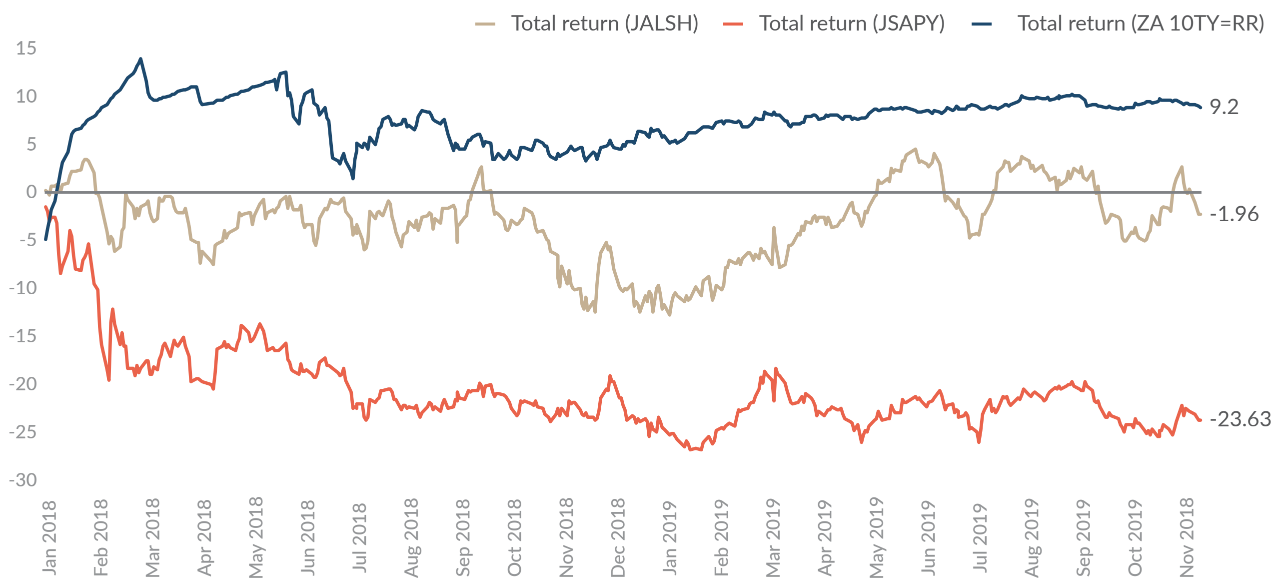
Written by: **GLEN BAKER**
Fund Management

Glen has 30 years' experience in financial markets, heading up equity derivatives and research distribution divisions at major local and international institutions. He has both an equity and fixed-income background, with his direct investment experience including the management of exchange traded funds (ETFs). He is currently chairman of the FTSE JSE index advisory committee. Glen is involved in the fund management process across a range of mandates at Anchor with a focus on yield and alternative investment categories including property where he is responsible for the investment process in that sector.

Once seen as an attractive combination of yield-producing assets with capital-growth potential, SA property shares have plummeted from their respective pedestals since the end of 2017. As a brief reminder, up to that point SA listed property had outperformed the local equity market, bonds and cash over 3-, 5- and 15-year periods. However, since then the listed property sector has significantly underperformed a misfiring SA general equity market and also missed out on the relative safe haven that bond yields and income-producing assets have provided.

Figure 1: The SA Listed Property Index (JSAPY) vs the FTSE JSE All Share Index vs the SA 10-year benchmark bond (returns from 1 January 2018 to date), %:

Source: Anchor, Refinitiv



SO, WHAT HAS CAUSED THIS DRAMATIC FALL FROM GRACE?

There can be little doubt that, to some extent, returns generated in the sector, particularly post the global financial crisis (GFC) until 2018, were the result of the ability of highly rated counters to raise equity capital well below their cost of debt and, therefore, their overall cost of capital. This had the immediate impact of enhancing returns via the ability to invest money raised at say 5% (the share's dividend yield), into property assets that yield 8%-9%. Companies that could do this were in a virtuous cycle that made investing in these businesses compelling, particularly in a small and concentrated sector where momentum and index inclusion generally equate to alpha generation and a fear of missing out for underweight asset-allocation positions.

This ended abruptly in early 2018. An initial catalyst was information that began to swirl around an interconnected property group (the Resilient stable), which comprised of four listed companies with crossholding ownership structures. This grouping accounted for over 40% of the JSAPY at the time. The result was Financial Sector Conduct Authority (FSCA) and independent investigations into share dealings by these companies, which had the effect of an emergency brake being applied to their respective operating models. This, in turn, spilled over into the entire property sector.

More fundamental reasons were also emerging that would challenge the sector at this time, subsequent to the optimism experienced after the ANC Elective Conference, which was held in December 2017, when Cyril Ramaphosa emerged victorious as ANC president. Currently, as the Resilient stable's problems start to dissipate, these macro headwinds are still ongoing:

- **The SA consumer remains under pressure**: This has manifested in slowing retail sales and the disappointing results from key anchor tenants such as Shoprite, Woolworths, Mr Price and others.

- **Online sales**: While online sales are less of a threat locally than in the UK and Europe where retail-focused property companies have been severely affected it is still a business risk to shopping centres.

- **Oversupply in the office-space category**: Statistics from the South African Property Owners Association (SAPOA) show that office vacancies (at 11.3%) are at a ten-year high, as B-and C-grade offices are vacated in Sandton and Rosebank, given the construction activity there.

All of the above factors demonstrate that the property sector is not immune to economic conditions and, unfortunately, the SA economy remains stuck in its longest downward trend since 1945. According to the SA Reserve Bank's (SARB's) latest Quarterly Bulletin (released late last month), SA entered the 70th month of this weakening cycle in September. GDP growth has not exceeded 2% p.a. in any calendar year since 2013.

SA property companies have become accustomed to tenants signing leases, generally for long periods of time, where rentals escalate at rates in excess of inflation (5% to 6%). Rental reversion conversations between a landlord and tenant, when the lease came up for renewal, were generally comfortable due to tenants trading well. However, this environment has changed markedly, and for the worse.

- **Leases signed are getting shorter.** Uncertainty and the lack of confidence in the business environment mean that tenants, and indeed landlords, are not keen to commit for long periods of time.

- **Rental reversions are under pressure**. Most property companies are now reporting negative renewals i.e. rentals are falling when leases are signed for new periods of tenancy.

- **Property owners are having to incentivise tenants** to sign or renew leases in various ways. This often means increased capex and maintenance spend.

The picture painted is therefore bleak. Nevertheless, it is important to know that this is all now historical. As we seek to navigate markets going forward, what determines our asset-allocation strategy and decision on property assets?

The two main valuation building blocks in the sector have been, and remain, the following:

1. The yield received by investors via distributions paid by property companies; and

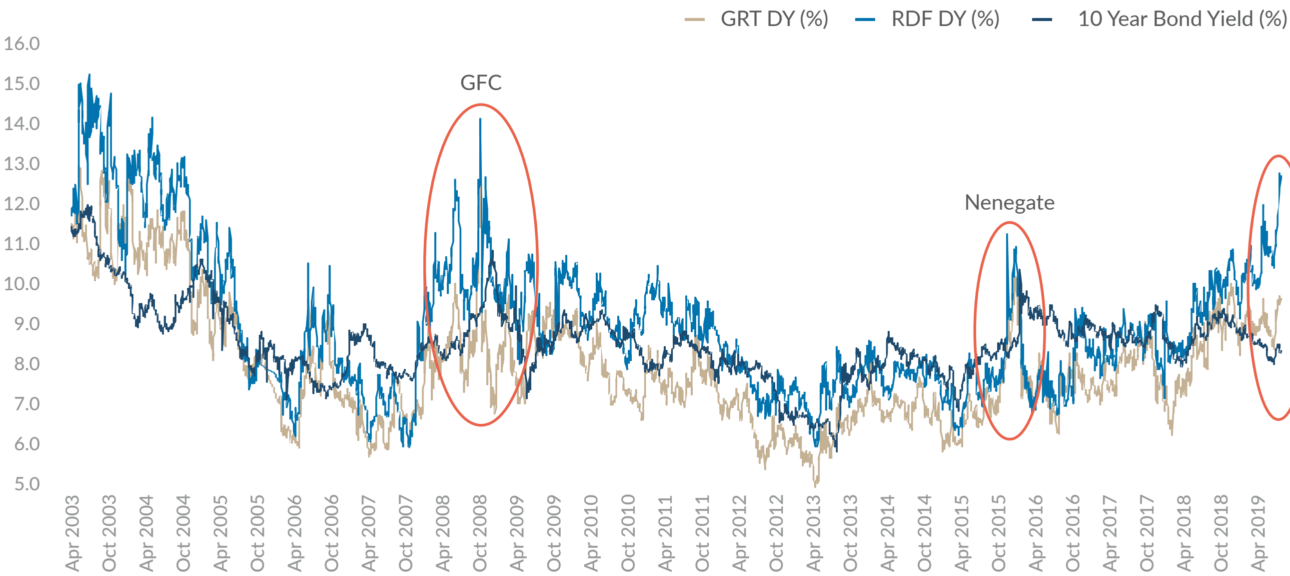
2. growth in these distributions paid.

To the extent that growth is strong, investors are comfortable with lower yields than benchmark interest rates such as 10-year government bonds, because those instruments pay a coupon which does not offer growth potential. The total return equation has thus been modelled on yield + growth = total return (TR).

Whilst we are cognisant of the fact that fundamental SA economic conditions have deteriorated, the yield component of this equation is attractive. Twenty-seven stocks, or 90% of the SA equity universe, now yield above the R186 (excluding offshore focused property companies, which have a different cost of capital) and 15 stocks offer a yield above 12%. Figure 2 below shows two bellwether SA property companies - Growthpoint and Redefine - which, together, own over 700 SA property assets.

Figure 2: There has seldom been such a discount to bond yields: The Redefine and Growthpoint dividend yields vs the 10-year benchmark bond yield:

Source: Anchor, Refinitiv



Even if the SA Property Index yield (including offshore-focused companies) continues to trade at a 170-bpt discount to the R186, and growth in distributions is forecast at 2% YoY - well below inflation - then the total return equation should yield 10.5% as per the formula in Figure 3 below.

Figure 3: Total return equation – SA Property Index:

Source: Anchor

	No change in rating	Bear case	Base case	Bull case
Starting value year 0	100	100	100	100
Income year 1 (Projected 12M forward yield)	9.9	9.9	9.9	9.9
Income growth year 2	4.8%	2.0%	2.0%	4.0%
Income year 2	10.3	10.1	10.1	10.3
Exit yield (current R186 Yield = 8.3%)	9.9%	11.0%	10.0%	9.0%
Exit value year 1	105	92	101	114
Total return	14.6%	1.4%	10.5%	23.9%

It is difficult to predict when economic conditions in SA will turn and GDP growth will be restored. In addition, the traditional way property shares have been used by SA investors – to provide good yield with capital upside – may well have been structurally affected by the investor experience over the past two years. Consequently, the sector may not attract income fund investors who are not prepared to stomach some volatility, as SA-listed property trends towards a higher correlation with the equity market, similar to property shares in US, European and Asian markets. But, in our view, some mitigating fundamentals are being ignored:

Vacancies are rising, but not dramatically.

Escalations are still being signed at above inflation. In this context, it is important to note that SA consumer price inflation (CPI) is now running at 4.5% compared to 5%-6% previously. In general, property escalations are still between 5% and 8% p.a.

Reversions are often negative because escalation clauses mean that, at expiry, properties are over-rented. We believe that this trend will continue until tenants experience better conditions, but it can be viewed currently as a quid pro quo situation.

Valuations of physical assets, which constitute the portfolios of the listed property companies, are at lower cap rates than listed shares' dividend yields. This means that listed shares are effectively trading at a discount to their sum of the parts. Sceptics may point out that independent valuators will adjust their cap rates higher (bringing property valuations lower) in accordance with economic conditions. In some cases, this may be true, but the discrepancies between the listed and physical markets are very wide in many instances. Evidence of physical property transactions for 2019 YTD, do not point to a fire sale of SA properties.

Property investors are often reminded that the nature of the investment is long term. Currently this may sound like "your portfolio has seriously underperformed in the short term, now you have to keep it for the long term." However, we believe the present valuations make for a compelling case, and we are certainly closer to the bottom than the top of the current property cycle. Where companies can stem the tide of falling income statements, carry on investing in and improving their properties, and keep their loan-to-value ratios at reasonable levels, these firms will prove to be very good investments at current levels.

ANCHOR INSIGHTS

Investing in uncertain times:
What would Peter do?

Written by: **NICK DENNIS**
Fund Management

Nick manages the Anchor Global Equity Fund and has been with Anchor since September 2014. Prior to joining Anchor, Nick was a senior Investment Manager at Pictet Asset Management in London.

Boris. Brexit. Trade wars. Trump. Orange is the new black. Unorthodox is the new orthodox.

It certainly feels like uncertainty is on the rise - for the man on the street and the professional investor alike. In times of constant flux, it's helpful to remind ourselves of the things that don't change. The constants. We need wisdom that is timeless and enduring.

For guidance, I like to ask the rhetorical question, "What would Peter do?"

Notwithstanding his many (many!) years in the market and ample wisdom, I am not referring to Anchor's CEO, Peter Armitage (sorry Pete!). Rather, I'm referring to Peter Lynch, who ran the Fidelity Magellan fund for 13 years in the 1980s and 1990s, compounding capital at an astounding 29% p.a. Lynch also authored two investing classics, *One up on Wall Street* and *Beating the Street*. Both are aimed at retail investors and are written with infectious enthusiasm and without complicated jargon. As Lynch describes the challenges the markets were grappling with at the time, it seems that the only certainty in the market (and arguably, life) is uncertainty. Reflecting on the worries of the day, Lynch noted:

"You can find good reasons to scuttle your equities in every morning paper and on every broadcast of the nightly news."

Investors try to assess the impact of the latest 'unknowables' on the economy and then, in turn, on the market itself (two additional unknowables) causing asset prices to move. Of course, a feedback loop exists between asset prices and the economy. For example, as bearish investors pour money into bonds, interest rates fall, lowering the cost of financing for consumers and businesses in the real economy. This is bullish for the economy and, theoretically, for stocks. The logic quickly becomes circular and infinitely complex. Unknowable to the power of unknowable. It's no wonder that Lynch concluded:

"Predicting the economy is futile. Predicting the short-term direction of the stock market is futile."

Lynch's alternative solution is for investors to focus instead on something they can wrap their heads around:

"Invest in companies, not the stock market."

Lynch's success was driven in large part by a small group of companies whose stocks became "baggers". A double bagger is a stock that doubles, a ten bagger is a stock that rises tenfold, and so on.

"All you need for a lifetime of successful investing is a few big winners, and the pluses from those will overwhelm the minuses from the stocks that don't work out."

This observation also applies to the broader market. Professor Hendrik Bessembinder found that, in the US between 1926 and 2016, just 4% of shares accounted for 100% of the market's excess return over 1-month Treasury bills. The other 96%, in aggregate, merely matched the returns of short-term fixed income.

If baggers are so essential to wealth creation, then it is surely a worthwhile endeavour to explicitly seek out those stocks with "multibagger" potential. Unfortunately, there are no hard and fast rules for finding and profiting from these companies. Lynch does, however, provide the foundational principle:

"This in a nutshell is the key to the big-baggers and why stocks of 20-percent growers produce huge gains in the market, ***especially over a number of years****. It's no accident that the Wal-Marts and The Limiteds can go up so much in a decade.* ***It's all based on the arithmetic of compounded earnings.****"*

Another fund manager and author, Chris Mayer, took the bagger idea to an extreme in his book *100 Baggers – Stocks that return 100 to 1 and how to find them*. Mayer researched 100 baggers and attempted to find common attributes among them. Needless to say, there is no magic formula or three easy steps to riches. However, Mayer distils the essence of the book into a handful of key ideas, which include:

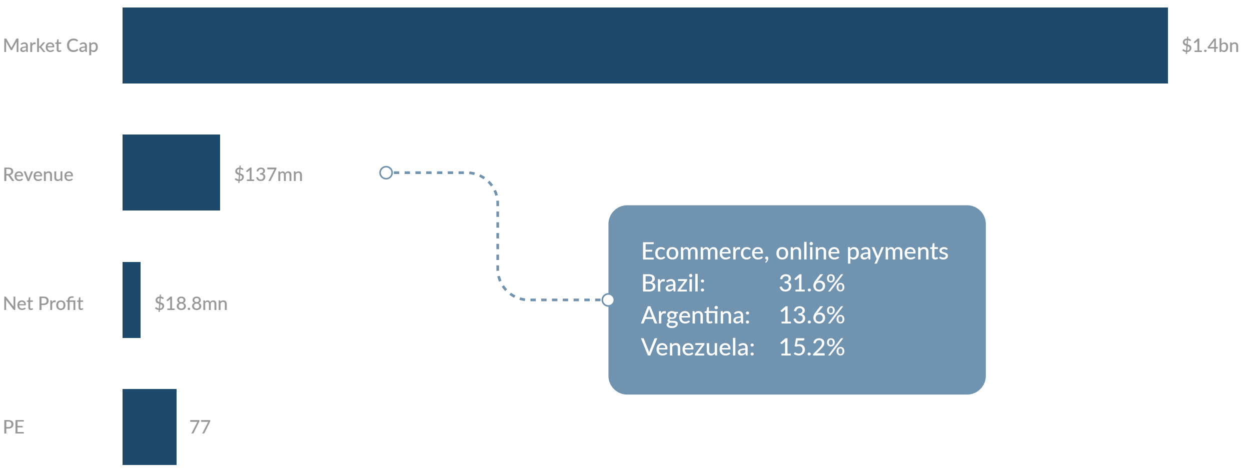
- You have to look for them.
- Growth, growth and more growth.
- Lower multiples preferred.
- Economic moats are a necessity.
- Owner-operators preferred.
- You need time.
- Luck helps.
- You should be a reluctant seller.

Armed with Lynch and Mayer's wisdom, let's look at a company and consider whether it has bagger potential. The company is headquartered in Argentina and operates an ecommerce marketplace with an integrated online payments solution. By country, significant contributors to revenue include Brazil (32% share), Argentina (14%) and Venezuela (15%). Revenue grew approximately 25% (in US dollar terms) over the past year and is expected to continue to grow at that rate over the next few years. The company has a market capitalisation of $1.4bn and trades on a price to earnings ratio of 77.

Do you think this stock is a "Buy" or an "Avoid"?

Figure 1: To buy or not to buy?

Source: Bloomberg, Anchor



I have a confession to make. The information above pertains to 2009 and the company in question is MercadoLibre. Despite widespread economic malaise in Latin America (and outright collapse in Venezuela) over the last decade, the stock has been a stupendous winner, rising almost 20-fold.

Figure 2: 10 years later ... up almost 20x

Source: Bloomberg, Anchor

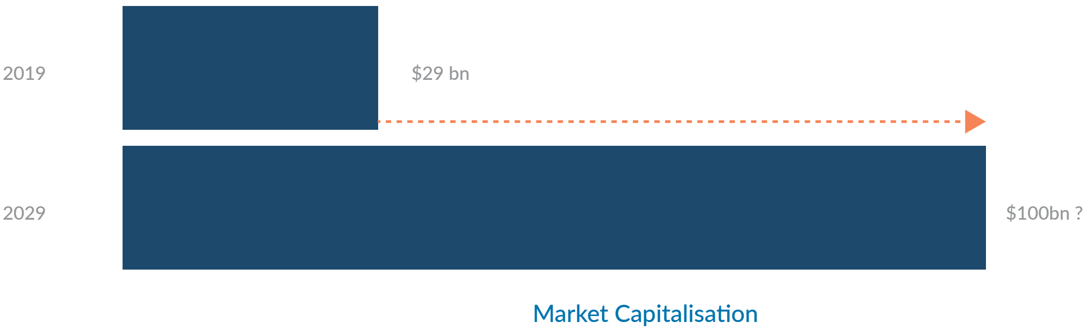
Don't feel too bad if you put it in the "avoid" pile. I did - in 2009! For most of the past 10 years I found good reasons to scuttle an investment in what turned out to be an exceptional performer. For the bulk of that period, Latin America looked like a mess and the stock appeared expensive (at least by conventional metrics). Peter Lynch understood that orthodoxy can get in the way of outstanding returns:

"Investing in stocks is an art, not a science, and people who've been trained to rigidly quantify everything have a big disadvantage."

Thankfully, all is not lost; the future is full of baggers lying in wait. And the next MercadoLibre might just be ... MercadoLibre. Ecommerce penetration in Latin America is at a nascent stage, comprising only 3.5% of the overall retail market. This compares with 14.7% in the US; a surprisingly low number with substantial headroom for growth. It is not inconceivable that MercadoLibre could one day reach a market capitalisation of $100bn. As Jeff Bezos, founder and CEO of Amazon likes to say in his shareholder letters, *"It remains Day 1."*

Figure 3: It's still Day One for MercadoLibre

Source: Bloomberg, Anchor



Just as important as identifying potential baggers, is holding onto them through thick and thin. As Chris Mayer points out, "you need time" and "you should be a reluctant seller" in order to fully benefit from baggers in your portfolio. Peter experienced this first-hand in his fund:

"The typical big winner in the Lynch portfolio generally takes three to ten years to play out."

The final hurdle for achieving bagger nirvana is ... ourselves. Mayer highlights that "You need a good filter", referring to the deluge of noise (usually negative), which gets thrown at the investor on a daily basis and can unsettle even the most battle-hardened among us.

There are always valid reasons to be pessimistic about the economic, political and social outlook. As surely as a broken clock is right twice a day, the pessimists will have their short-term victories.

As surely as a broken clock is right twice a day, the pessimists will have their short-term victories.

But it is the optimists that triumph in the end. Lynch knew which camp he wanted to be in:

"Unless you're a short seller or a poet looking for a wealthy spouse, it never pays to be pessimistic."

Peter would focus on companies, not the stock market or the economy. Peter would be on the hunt for baggers. And Peter would choose to maintain an optimistic outlook.

That's what Peter would do.

ANCHOR INSIGHTS

Trusts:
A layman's guide

Written by: DI HAIDEN
CEO, Robert Cowen Investments

Di is CEO of Robert Cowen Investments, a subsidiary of Anchor, and has been at RCI since 1990. She has 30 years accounting and investment experience and is a registered key individual with the Financial Services Conduct Authority (FSCA). She currently concentrates on investment structuring and the effect of tax legislation on investment advice.

INTRODUCTION

The topic of trusts is frequently spoken about and, more often than not, misunderstood. In this article we attempt to give the reader a simple understanding of an extremely complex subject which is ALWAYS very case specific. Although general principles may apply, each individual or family's circumstances have to be analysed independently to decide on the application of trusts and the case for, and against, using these structures.

WHAT IS A TRUST?

A trust is a fiduciary relationship in which one party, known as a settlor or donor, gives another party, the trustee, the right to hold title to property or assets for the benefit of a third party, the beneficiary. All of the above is set out in the trust deed.

TRUST LEGISLATION

In SA, trusts are governed by multiple pieces of legislation, primarily the Trust Property Control Act 57 of 1988, the Administration of Estates Act 66 of 1965 and the Income Tax Act 58 of 1962. Locally, trusts have to be registered with the Master of the High Court (Master).

Offshore, trusts are governed by the legislation applicable to trusts in the jurisdiction in which such a trust is set up. Registration with local authorities will be specific, once again, to the applicable jurisdiction. In some instances, trusts do not have to be registered with the equivalent of our Master.

WHY DO YOU NEED A TRUST?

The primary reasons for setting up a trust are to protect assets from creditors, to act as an estate duty blocker and to distribute capital and income to beneficiaries according to the wishes of the Settlor.

WHEN DO YOU NEED TO CONSIDER A TRUST?

When you start to accumulate wealth (in this instance, wealth for a family means assets above R7mn), start a business, inherit assets and/or if you need protection from creditors e.g. when you run your own business.

WHERE DO YOU NEED A TRUST?

Depending on individual circumstances, a trust can be set up in SA or in various offshore jurisdictions; primarily those places which have become renowned for the set up and administration of trusts such as the Channel Islands, Mauritius and the British Virgin Islands (BVI), to name a few.

TYPES OF TRUSTS

In SA, there are a number of different types of trusts including a special trust, for persons not capable of managing their own affairs, charitable trusts, which are specially set up to make distributions to charitable organisations, testamentary trusts, set up in terms of a will, and an *inter vivos* trust, which is set up by an individual - *inter vivos* meaning 'between the living'.

SETTING UP A TRUST

There is always a trust deed required which governs the workings of the trust and also does the following: appoints trustees, names beneficiaries, allocates powers to the trustees, dictates how distributions of income and capital can be done, defines how the trust terminates and prescribes how the administration and accounting of the trust is to be undertaken.

CONSIDERATIONS IN THE DEED

One needs to decide who the settlor is, who are the trustees going to be (locally, it is usually the settlor, other family plus ONE compulsory independent trustee, while offshore one always appoints corporate trustees with no SA link). Beneficiaries are also appointed in the deed, as is the accounting officer.

The following also needs to be considered: the administration of the trust, whether the trust has to be registered for tax and if a bank account has to be opened.

As important (almost) as the trust deed is a letter of wishes, which guides the trustees as to what the settlor's wishes are with respect to his requirements and his intent as to how the beneficiaries benefit from the trust.

TAXATION OF TRUSTS

Taxation of trusts is complicated. Locally, trusts are taxed at the top marginal individual tax rate i.e. 45%, with no rebates allowed. However, there is the ability to apply the conduit principle and distribute income and capital gains to beneficiaries and then tax these in the beneficiaries' hands at their respective tax rates.

Taxation of offshore trusts is a different matter altogether and more complex rules apply (these rules are too detailed to highlight in this article and would be best discussed at an individual level).

THE TRANSFER OF ASSETS INTO AND OUT OF TRUSTS

The transfer of assets into a trust is done by donation or as a loan - once again each has its own tax implications.

The transfer of assets out of a trust is done by distribution to a beneficiary or as a loan – there are often no tax implications, but this does also vary according to individual circumstances.

Trusts are extremely complicated structures which need to be used in the right circumstances and for the right reasons.

THE COST OF A TRUST

Trusts come with extra annual costs that need to be factored into the equation. These include trustees fees (which range from R5,000 to R30,000), accounting and administration fees (which differ depending on the complexity of the trust) and company fees if a business is held by the trust – these costs can range from R15,000 to R40,000. Costs do vary and offshore trusts are generally much more expensive to run than local trusts. There are also fees to set up trusts.

THE ADVANTAGES AND DISADVANTAGES OF A TRUST

The advantages of trusts range from the protection of assets from creditors, as an estate duty blocker, to accelerate wealth accumulation from generation to generation and trusts also have certain tax advantages.

The disadvantages of trusts include the fact that the individual gives up all control of the assets in the trust, legislation as it changes has to be monitored, and increased costs.

CONCLUSION

Trusts are extremely complicated structures which need to be used in the right circumstances and for the right reasons. They need to be constantly managed and administered and have to keep up with changing legislation to make sure they continue to play the effective role for which they have been established.

In this note we have only scratched the surface of a very complex subject so we would suggest contacting RCI directly if you would like to have a conversation about setting up a trust.

ANCHOR INSIGHTS

Focus on the facts

Written by: TAMZIN NEL, CFA
Portfolio Management

Tamzin has nine years' experience in financial markets, working with private clients and managing mining rehabilitation funds. Tamzin is a CFA charterholder, and has completed a Social Entrepreneurship programme through the University of Oxford. With a keen interest in behavioural finance, social entrepreneurship, impact investing and financial literacy, she loves understanding and working with people to help them achieve their financial goals.

I am tired as an investor. I am tired as an individual. I know that I am not alone. On the investment side, Darryl Hannington, Anchor's head of portfolio management, spoke to equity fatigue and the various options available to investors in his article entitled, *Invest(ing) in the other 99%* published in the 3Q19 Navigator. Obviously, all the facts, figures and suggestions he made, makes sense. However, sometimes, as human beings, we might not necessarily.

In my previous article for the Navigator entitled *Three money memories*, I spoke about how financial behaviour tends to be more emotional than rational and that our financial behaviour, as with the rest of our actions, is a deep-rooted expression of our internal psychology. The problem, though, is that, as human beings, there are numerous behavioural biases which impede our ability to reason if we don't understand these inclinations and make a conscious effort to work around them. In this note, I want to talk about one of the options available to us as individuals to manage our mental health and, as a consequence, our financial health.

We are tired because we are constantly being bombarded by a seemingly never-ending stream of negative news. And, unfortunately, we are hard-wired on an evolutionary level to focus more on the bad news than (admittedly, the harder-to-find) good news. This is a psychological phenomenon known as the negativity bias.

A couple of years ago, I read a book by Rick Hanson, a neuroscientist and psychologist, called *Buddha's Brain*. In this book, he simply explains our focus on negativity. Our ancestors needed to be alert to danger because it was a matter of life or death for them. We inherited these genes and, as such, we are inherently negative. In addition, not only does our brain's "alarm bell" use more capacity (two-thirds) to look for bad news, but this bad news imprints far more quickly and lingers longer in our memory (in contrast to positive events and experiences, which are usually only held in our consciousness for a dozen or so seconds). There is positive-negative asymmetry.

Thanks to evolution, our biological and chemical make-up, we register and recall the negative over the positive. Did you really have a bad day, or did you only have a bad ten to twenty minutes during the day? Have you found yourself fixating on past mistakes or insults but rarely take note of your achievements or the compliments which you receive? Does it cause you more pain to lose money than the pleasure of gaining an equivalent amount?

This last one is an example of another behavioural bias called loss aversion as explained by prospect theory and explored in detail in the book *Thinking, Fast and Slow* and other works by Daniel Kahneman, a Nobel prize-winning economist. Kahneman did extensive research and writing in applying psychological insights to economic theory, especially with regards to making judgements and decision making.

So, not only are we subjected to bad news more regularly and easily, we also tend to focus on this more. Unfortunately, we cannot do much about the way in which news is reported since sensationalism sells. However, what we can do, is change the news that we actively seek out, and our subsequent interpretation thereof.

One of the best gifts I received last Christmas was a book (books always make for the best gifts). Unfortunately, I only started reading it recently. Although, in retrospect, maybe I started reading it at exactly the right time. I am an inherently positive person, but the past few months I have felt myself being weighed down by negativity.

"It is easy to be aware of all the bad things happening in the world. It's harder to know about the good things; billions of improvements that are never reported."

The book I received and I am reading, which I think every single individual, and investor should read, is called *Factfulness* by Hans Rosling. This (*Factfulness*) is the one option available to all of us as individuals to manage our own mental and financial health. *Factfulness* is the stress-reducing habit of only carrying opinions for which you have strong supporting facts.

As a working example from the very document that you are reading, I would highlight Peter Armitage's contribution to the Navigator (refer to page 22) entitled, *SA's corporate meltdown: Billions of rand vaporised*. You could read just the title and assume the worst, or you could delve deeper into the details of the piece and understand the facts being explained. As he writes in his opening paragraph: *"The temptation is to jump to the conclusion that SA business is fraught with malfeasance, but this analysis seeks to illustrate that, while there has no doubt been unethical behaviour, the majority of failures have been through a combination of bad luck, tough market conditions, one-off unanticipated events and poor judgement."* Similarly, Glen Baker's contribution, *SA Property: Light at the end of the tunnel?* (on page 25) demonstrates that, even though the property sector is not immune to economic conditions, there may well be a structural change in the way investors value property and SA-listed property is now trending towards an equity-like profile, which is in-line with property sectors across US, European and Asian markets.

In addition, as he explains, there are some mitigating fundamentals being ignored which present valuations that make for a compelling investment case. Both of these articles should be read in their entirety for the whole message to be properly understood and this also applies to almost any information we consume, albeit research, news, books etc. Of course, there are articles and news reports which are not even based on facts so it's always important to curate what you consume and not only how you consume it.

The sub-heading of *Factfulness is Ten reasons we're wrong about the world - and why things are better than you think*. Hans and his collaborators, Ola Rosling and Anna Rosling Rönnlund, offer a radical new explanation of why we are wrong about the world and why it is better than we think. They reveal ten instincts that distort our perspective and how to overcome these behavioural biases. His second reason, and Chapter Two explains the negativity bias, *"our tendency to notice the bad more than the good"*, as referred to earlier. There are numerous examples and stories and, most importantly, facts. In summary, we are negative because we misremember the past, are exposed to selective reporting by journalists and activists and a part of us feels heartless to say that things are getting better when some things are still bad (even if they are improving).

It is easy to be aware of all the bad things happening in the world. It's harder to know about the good things.

On page 7 in the first few paragraphs of our Strategy and Asset Allocation section, we speak to the latter – we acknowledge that, even given the work that needs to be done locally and globally, we are pleased to see that the direction of change is improving. We need to recognise when we get negative news and remember that bad news is far more likely to reach us, and stay with us, than good news. Nick Dennis's article entitled, *Investing in uncertain times: What would Peter do?* (on page 29) speaks to this wisdom and Nick quotes Peter Lynch who echoes this sentiment throughout. He summarises by noting that often we are our own biggest hurdle due to all the (usually negative) noise, but highlights that if we focus on companies (the facts) and maintain an optimistic outlook we will reach "nirvana".

The world is constantly changing, and it is important for us as investors and individuals to update our knowledge and worldview accordingly. In my previous article for the Navigator, I wrote that financial integrity encompasses understanding why you manage money in the way that you do and if you are feeling competent to either continue in that manner, or to make the necessary changes. In this article, I want to encourage you to understand the type of information you are consuming and to make sure that you are making your decisions based on FACTS and not on your primordial negativity instinct. If you are not, make the necessary changes or allow us to assist you. Seeking out positive facts and factual news will not only improve your mental health but, as a result, your financial health as well.

Performance Summary

	FUND PERFORMANCE							BENCHMARK PERFORMANCE					
	Start date	Annualised p.a. (%)	Since inception (%)	12-month (%)	6-month (%)	3-month (%)	Aug 2019 (%)	Since inception (%)	12-month (%)	6-month (%)	3-month (%)	Aug 2019 (%)	Performance vs Benchmark (%)
UNIT TRUSTS													
Anchor BCI Equity	Apr-13	10.2	88.4	-2.9	-2.8	-4.8	1.0	55.9	-2.4	-2.4	-5.1	0.7	32.5
Anchor BCI Flexible Income	Jun-15	8.0	39.7	9.8	4.7	2.1	0.5	37.4	7.6	3.7	1.9	0.6	2.3
Anchor BCI Managed	Jan-15	3.7	18.4	1.5	0.8	-1.6	0.4	21.4	2.0	1.0	-0.1	0.9	-3.0
Anchor BCI Worldwide Flexible	May-13	11.8	103.8	8.6	7.7	6.0	1.0	74.4	8.3	4.7	1.9	0.6	29.4
Anchor BCI Property Fund	Nov-15	-2.9	-10.7	-7.5	-3.3	-5.0	0.4	-8.7	-2.7	-0.1	-4.4	0.3	-2.1
Anchor BCI Global Equity Feeder	Nov-15	7.4	32.4	-0.2	5.7	3.6	-1.4	50.4	8.5	9.0	7.5	1.9	-18.0
Anchor BCI Bond Fund	Feb-16	10.5	44.0	12.3	5.0	1.2	0.2	42.0	11.4	4.5	0.7	0.5	2.0
Anchor BCI Diversified Stable Fund	Feb-16	6.7	26.7	5.7	2.9	1.3	1.3	22.6	5.0	2.9	1.2	0.7	4.1
Anchor BCI Diversified Moderate Fund	Feb-16	5.2	20.5	3.2	1.7	0.3	1.9	19.1	3.3	2.0	0.5	0.8	1.4
Anchor BCI Diversified Growth Fund	Feb-16	3.8	14.8	0.6	0.5	-0.6	1.9	17.5	2.0	1.0	-0.1	0.9	-2.7
Anchor BCI Africa Flexible Income	Mar-16	8.2	32.7	15.2	8.7	5.0	0.1	38.1	9.4	4.6	2.3	0.7	-5.4
Anchor BCI Global Technology Fund	Jun-19	0.9	2.8	0.0	0.0	0.0	-2.5	16.1	0.0	0.0	10.3	1.9	-13.3
EQUITY NOTES & SEGREGATED MANDATES													
Anchor Equity	Jul-13	7.6	58.2	-2.2	-3.2	-4.5	1.7	54.8	-2.4	-2.4	-5.1	0.7	3.4
Growing Yield*	Jun-12	9.2	89.6	-0.9	-1.2	-5.3	1.2	103.3	9.3	5.1	2.2	0.7	-13.7
HEDGE FUNDS													
Property Long Short	Jan-14	6.8	46.1	-5.6	-3.4	-6.2	-0.4	64.7	9.4	4.5	2.2	0.7	-18.6
Anchor Accelerator	Feb-16	8.5	33.9	18.9	4.2	0.6	1.6	12.3	-2.4	-2.4	-5.1	0.7	21.6
OFFSHORE													
High Street Equity - Dollars	Jun-12	11.6	121.6	4.3	3.8	-2.8	0.4	112.0	2.4	4.9	0.7	2.2	9.6
High Street Equity - Rands	Jun-12	21.5	310.8	12.2	9.5	4.9	0.6	292.8	9.7	10.3	8.2	2.0	18.0
Offshore Balanced - Dollars	Jun-12	10.0	99.6	5.4	4.1	-1.1	0.8	62.2	4.5	4.5	0.6	0.9	37.4
Offshore Balanced - Rands	Jun-12	19.7	269.3	12.9	9.4	6.3	0.6	202.6	12.8	10.4	8.3	0.7	66.7
Global Dividend - Dollars	Jan-14	8.0	54.3	2.1	4.8	-0.6	1.9	57.6	2.4	4.9	0.7	2.2	-3.3
Global Dividend - Rands	Jan-14	14.0	110.4	9.3	10.1	6.9	1.7	115.0	9.7	10.3	8.2	2.0	-4.6
Anchor Sanlam Global Stable Fund - Dollars	May-15	1.0	4.5	4.2	2.9	0.7	0.5	12.4	2.7	1.3	0.7	0.2	-7.9
Anchor Sanlam Global Stable Fund - Rands	May-15	6.3	30.5	11.5	8.3	8.3	0.3	40.5	10.2	6.0	8.4	0.1	-10.0
Anchor Sanlam Global Equity - Dollars	May-15	6.1	29.5	-5.1	1.6	-2.8	0.2	29.9	1.4	3.6	0.0	2.1	-0.4
Anchor Sanlam Global Equity - Rands	May-15	10.2	52.3	-4.2	6.9	4.5	0.0	55.0	3.8	9.0	7.5	1.9	-2.7

Source: Morningstar and Bloomberg 31 August 2019

*Provisional performance returns

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