Digital Edition

The Navigator

Strategy and Asset Allocation Report
3rd Quarter 2020

ANCHOR | NAVIGATING CHANGE

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Introduction

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We are writing this introduction on 5 July 2020, marking 100 days that South Africa (SA) has been in lockdown. That means 100 days since many waiters last earned a tip, 100 days since personal trainers last had a client and 100 days since many other people have earned any money. Scant savings are likely depleted, and a humanitarian crisis is unfolding. The scale of economic destruction is unprecedented, both in SA and across the world, as governments scamper to balance managing the COVID-19 pandemic with the swelling masses of desperately hungry people that can be found at any street corner in urban SA.

Globally, various governments' economic panacea has been quantitative easing (QE), coupled with government support programmes. However, we have seen globally, and in SA, that these support programmes can only do so much and that a debt overhang is likely for those businesses that are able to survive. QE manifests as support for financial markets rather than for the real economy. In many ways, QE is a tool whereby the rich get richer, from rising stock prices, in the hope that the wealth effect will see them spend money that will trickle down into the real economy.

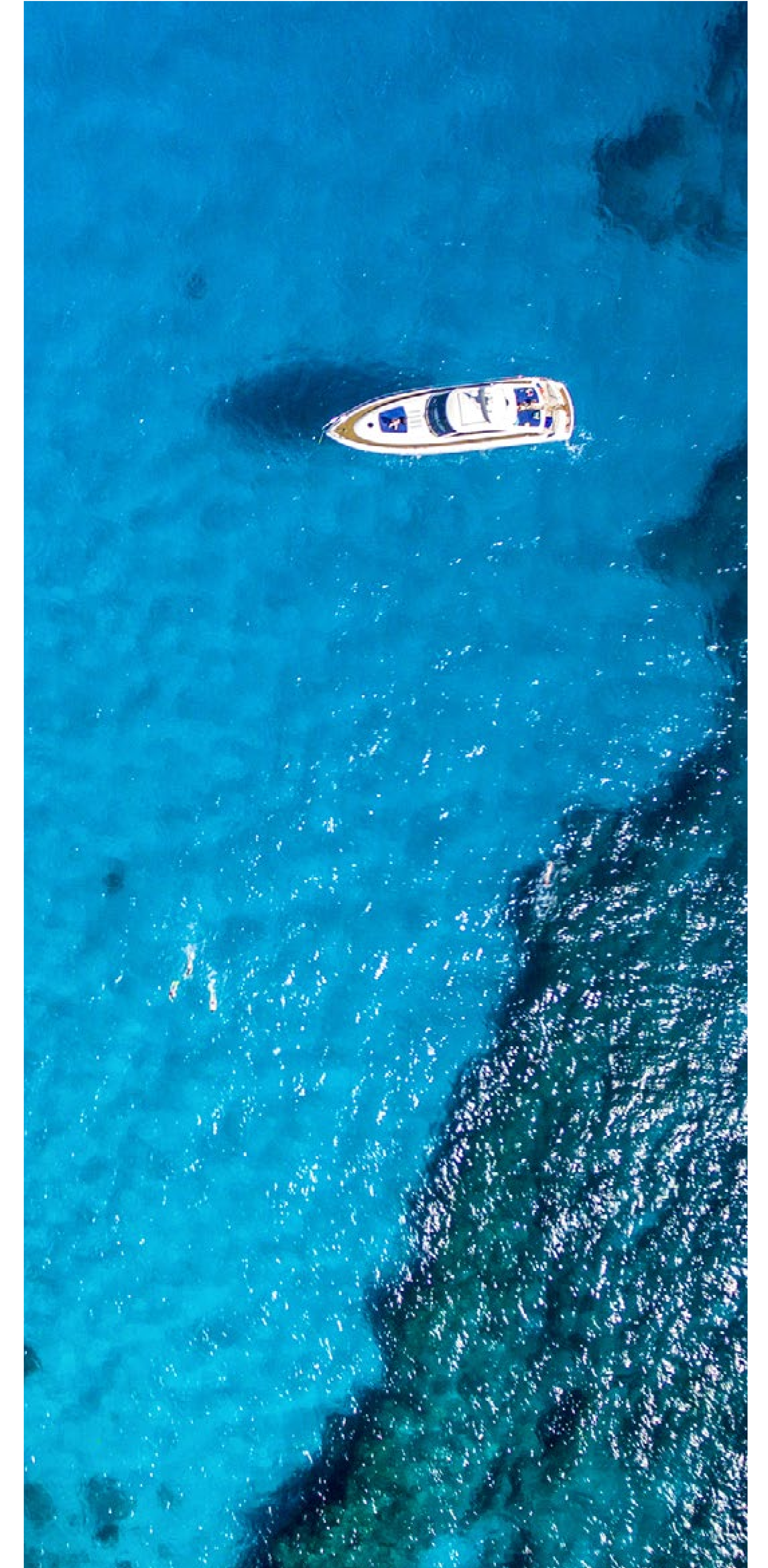
The dichotomy within society has never been greater. The real economy is in trouble, we have hungry masses on the streets, and business profits are slumping while the global financial economy is in an upswing with a stock market recovery that is in full force. Equity prices are soldiering on, ever upward.

Investing in the current global and domestic environment is particularly difficult. Asset prices look to be full and there are several risks around us.

Once the dust settles and the health crisis is over, SA will be left with a massive hunger and unemployment problem and a government that is hopelessly overindebted. We maintain that the government's only option is to win back the trust of investors with a combination of humility and structural reform. We note that June's Supplementary Budget was a sober reminder from Finance Minister Tito Mboweni of the gravity of the situation. Nevertheless, we are positive of his ability to deliver the expenditure savings and structural reform that the country needs. There will be intense politicking as government departments complain about scarcity of funding and vie for their share of the fiscal pie. Headlines will likely be bleak, yet this is all a step in the right direction. We are hopeful for a good outcome as we see incrementally positive steps from government.

Investing in the current global and domestic environment is particularly difficult. Asset prices look to be full and there are several risks around us. Thus, we continue to advocate caution and a diversified approach to investing. Much of the outlook depends on your view of the rand. Should we see a further recovery from the local currency's oversold position in March, then these gains can quite quickly erode any investment gains on global markets, where returns are likely to be lower. Conversely, there is rightfully some nervousness about the outlook in SA. While we are, on balance, positive, it makes a lot of sense to hedge one's bets and also invest offshore.

Perhaps the best advice is that, whilst volatility and uncertainty will remain high within the foreseeable future, opportunities remain throughout most asset classes. Thus, we continue to advocate for a diversified stance on all asset classes with a cautious approach towards risk.



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	Benchmark Weight	Current Stance			Expected Returns (local currency) (%)
		Negative	Neutral	Positive	
LOCAL	80%				
Equity	52%	○	●	○	10.3
Bonds	16%	○	○	●	9.3
Listed Property	6%	○	●	○	8.8
Cash	4%	●	◁	○	3.3
GLOBAL	20%				
Equity	13%	○	●	○	5.0
Government Bonds	1%	●	○	○	-0.9
Corporate Credit	3%	○	●	○	2.9
Listed Property	2%	●	◁	○	1.5
Cash	1%	●	◁	○	0.0

Asset Allocation Summary

The range of possible outcomes for the various asset classes is particularly wide at present and it is also highly dependent on your outlook for the different scenarios. We have decided to display the possible outcomes as a series of tables and charts below. Anchor's base case is somewhere between a scenario of recovering from the pandemic by year-end, or the global economy bumbling along for several years, while this plays out.

In *Figure 1*, we highlight the US dollar return outlook for the various global asset classes. The bars in *Figure 1* represent the reasonable range of possible outcomes, with the dots representing our estimate of what the outcome will be in the different scenarios. From a global perspective, equity is the most attractive asset class if you do not expect the global economy to plunge into a second recession.

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

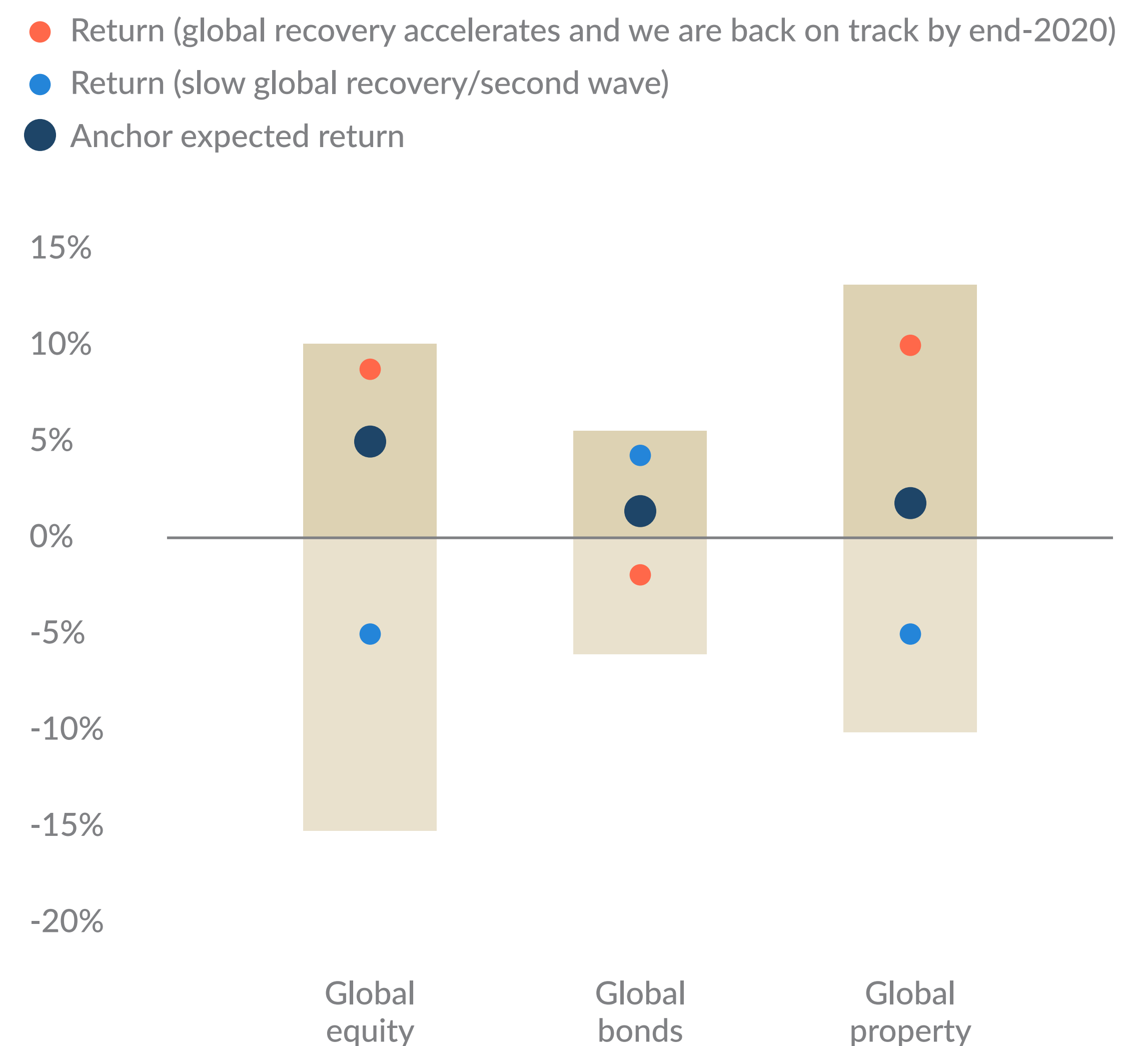


Figure 2: Anchor expected return by offshore asset class
Source: Anchor

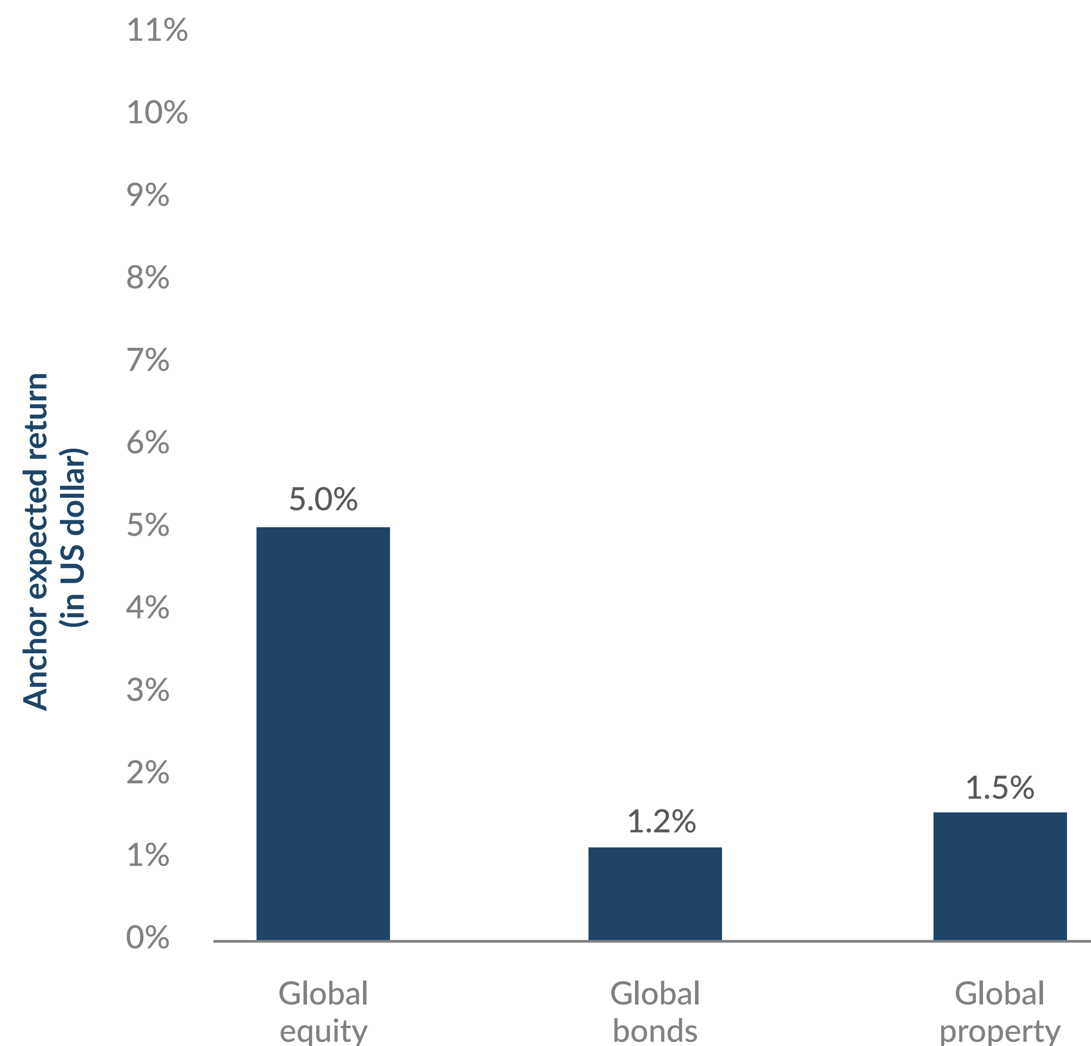
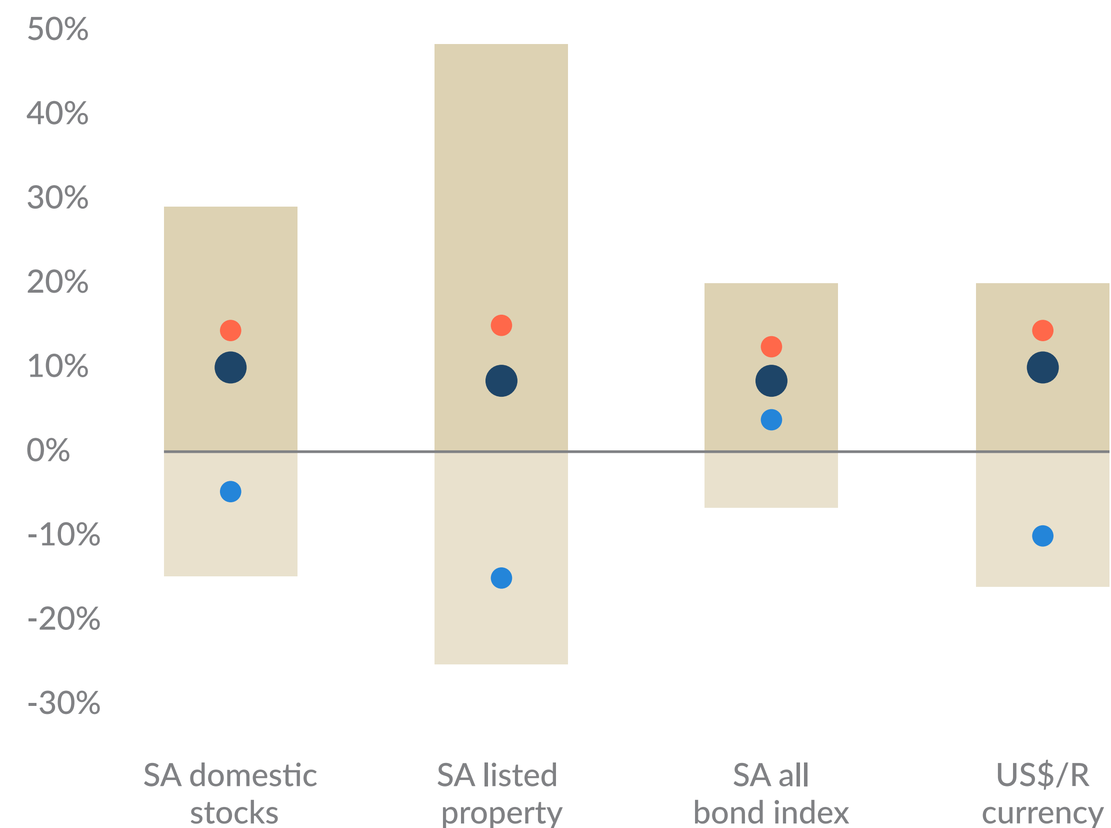


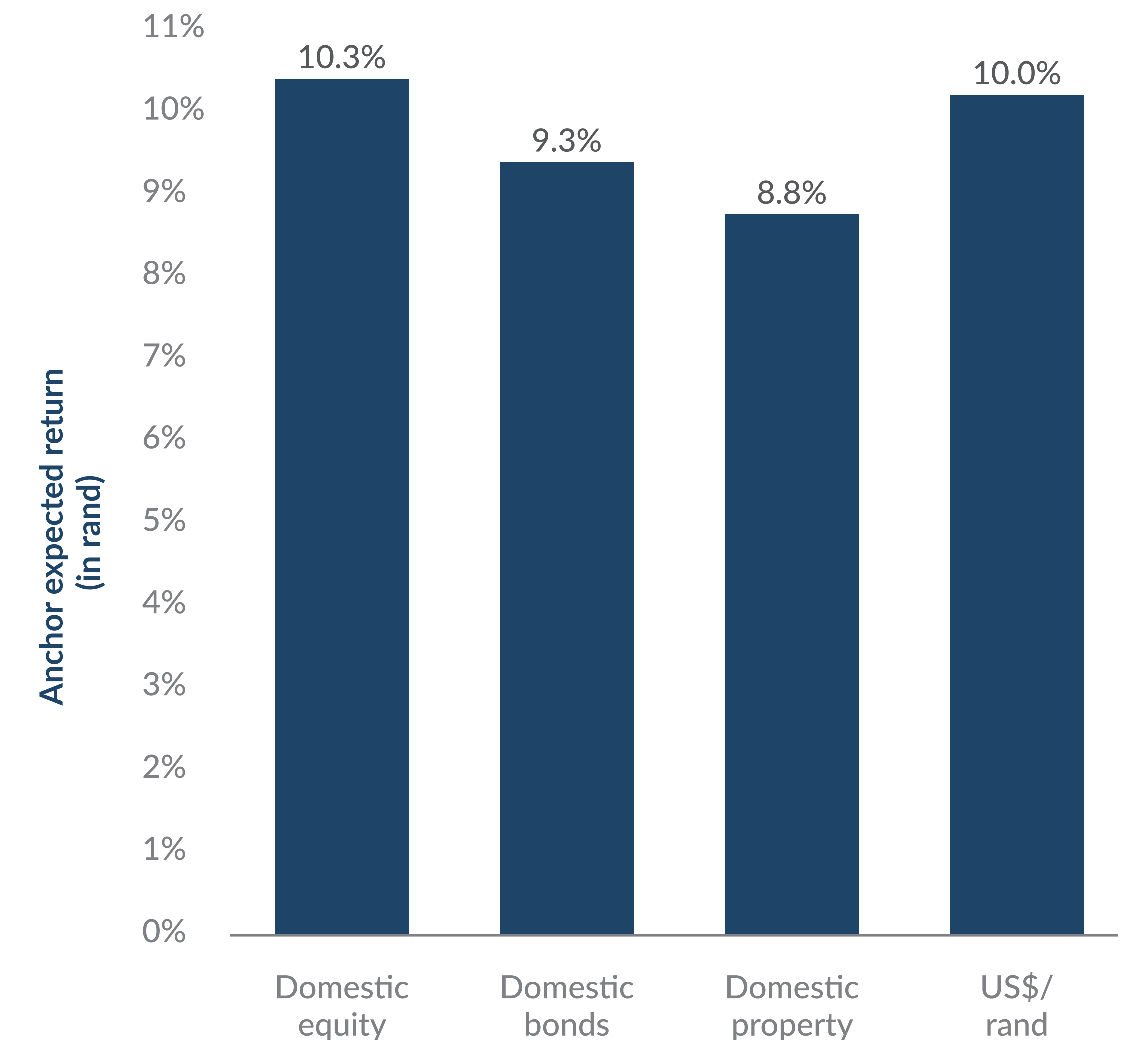
Figure 3: 12M return estimate scenarios for various asset classes in rand terms
Source: Anchor



In SA, the range of possible outcomes is even wider given that much depends on both the extent of government's structural reform and the behaviour of the global pandemic.

In *Figure 3* above, we highlight the rand return outlook for several asset classes. The bars represent the reasonable range of possible outcomes, with the dots representing our estimate of what the outcome will be under the various scenarios. From a domestic investor perspective, bonds are the most attractive asset class on a risk-adjusted basis, but we should also not ignore local equity.

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



Strategy and Asset Allocation

The COVID-19 pandemic has, without a doubt, delivered an enormous shock to the global economy. Lockdowns and other restrictions necessary to address the public health crisis, together with reductions in economic activity by consumers and producers alike, has led to a combination of adverse shocks that is causing deep recessions in many developed market (DM) and emerging market (EM) economies. As it stands, financial markets are in two minds. On the one side, the global economy appears to be hitting the start of a recovery, notably led by China and Europe. This is largely being driven by the increased relaxation of social distancing measures in order to reopen economies, along with record levels of monetary and fiscal stimulus released by central banks and governments across the globe.

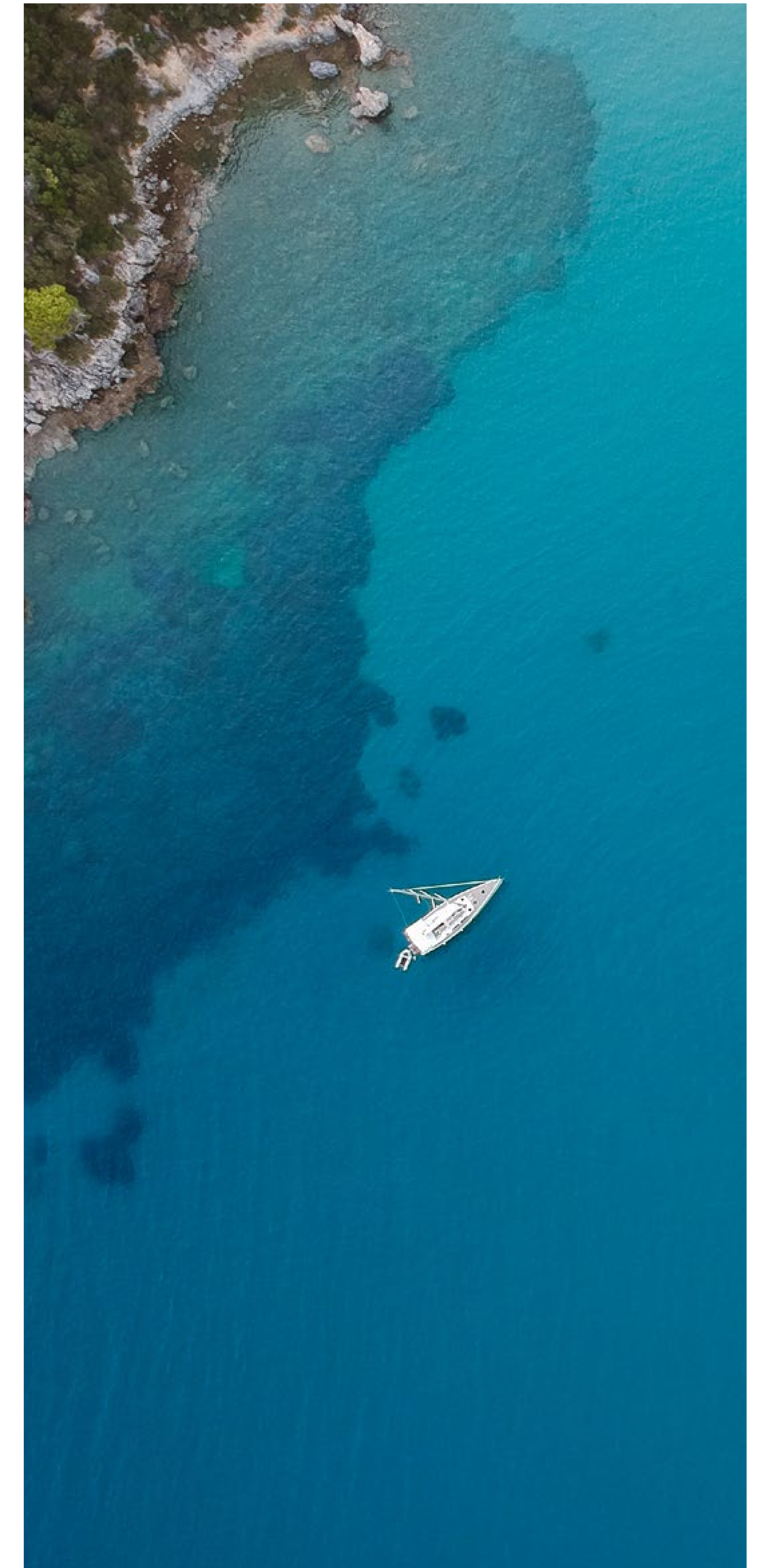
On the other side, investors remain rattled as concerns rise surrounding the rapidly increasing COVID-19 infections in EMs, and the possibility of a second wave of infections in the US and China. Furthermore, global tensions are on the rise, amid ongoing (and quickly escalating) trade frictions between the US, China, and Europe as well as land disputes between China and India, and China's recent passing of controversial security legislation for Hong Kong.

As global investors began to realise the magnitude of the pandemic in March, they pulled funds from EMs and put their money in safe-haven investments. EM portfolio outflows during this crisis dwarfed the levels seen during the global financial crisis (GFC). Fortunately, portfolio outflows from EMs were short-lived this time around. The world's largest central banks, such as the US Federal Reserve (Fed), injected huge sums of liquidity into financial markets, which spilled into EMs. Some EMs were even able to raise funds in international capital markets, with more than US$83bn of bond issuances since April.

Whilst the COVID-19 pandemic has triggered the deepest global recession in decades, the ultimate outcome is uncertain.

Domestically, the pressure in SA continues to ramp up. National Treasury expects tax revenue to undershoot February's budget estimate by more than R300bn this fiscal year. Coupled with unforeseen health and income support expenditures (and the fact that SA's public finances were already on an unsustainable path before the shock), a record consolidated budget deficit amounting to 15.7% of GDP is now expected for 2020/2021. With an annualised 1Q20 GDP contraction of 2.0% QoQ, following QoQ declines of 0.8% and 1.4% in 3Q19 and 4Q19, respectively, and a current unemployment rate of 30.1% SA's road ahead will be tough. Medium-term fiscal frugality is imperative, with Finance Minister Tito Mboweni emphasising in his June Supplementary Budget speech that, if SA fails to deliver on growth reforms and does not manage to consolidate its public debt, a sovereign debt crisis looms in the next four to five years.

Whilst the COVID-19 pandemic has triggered the deepest global recession in decades, the ultimate outcome is uncertain. It is this dichotomy, between a weak global economy and a buoyant financial economy spurred on by central bank support, which makes investing difficult at present. The old adage of 'don't fight the Fed' (meaning you should invest in a way that aligns with the Fed's current monetary policies rather than against it) is particularly poignant yet, ultimately, the value of an investment is driven by its future income generation capacity. Whilst volatility will remain high for the foreseeable future, opportunities continue to exist throughout most asset classes.



SA EQUITY

In 2Q20, SA equities recorded their best quarterly return since 2000, delivering a total return of 22.6%. However, this optically great return should be seen in the context of a very poor 1Q20, where the FTSE/JSE Capped Swix Index ended the quarter 26.3% lower as SA followed the rest of the world into a hard lockdown to curb the spread of the COVID-19 pandemic. The bounce in equities off their March lows, leaves the YTD Capped Swix equity return at a negative 10.6% and, using its sister benchmark, the FTSE JSE All Share Index, which has a longer history, the JSE is on a 12-month forward PE of c. 12x - broadly in line with the average of the past 15 years:

Figure 1: FTSE JSE All Share Index forward PE
Source: Bloomberg, Anchor

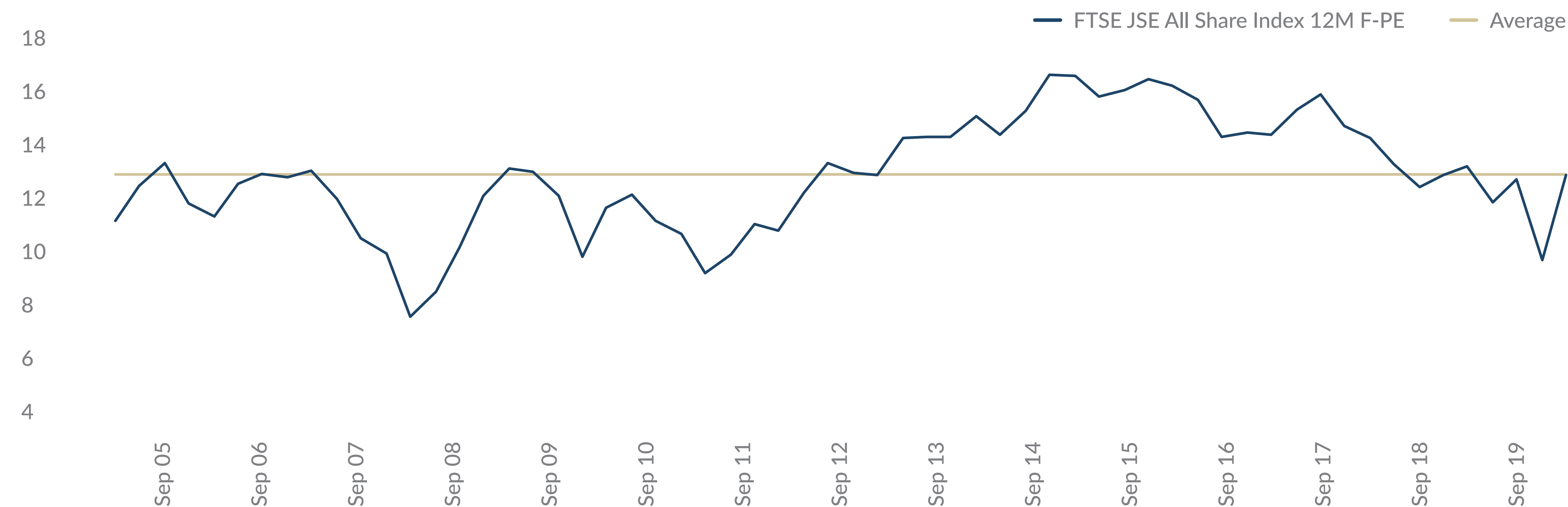


Figure 2: Anchor positioning – domestic equity portfolio construction
Source: Anchor

	Benchmark	Underweight	Neutral	Overweight
Domestic SA companies	43%	●		
Basic material companies (incl. Sasol)	26%		●	
Rand hedges (incl. Naspers and Prosus)	31%			●
Cash	0%			●
	100%			

Overall, positioning for the Anchor equity research process has remained defensive, with a clear bias towards those companies that are less reliant on the SA economy for growth, the so-called rand-hedge shares, and exporters such as basic materials companies. In terms of our allocation to domestically focused businesses, we have a clear bias towards those businesses with strong market position, proven management teams and balance sheets that should be able to withstand the external shock which our economy is currently experiencing. We have used the increase in global risk appetite to further de-risk portfolios where we believe the share prices have possibly moved ahead of fundamentals.

The range of possible outcomes is particularly wide, however, we set out the base case of our forecast below.

As a result of the domestic economy's many years of underperformance, the local equity index has become increasingly concentrated in fewer businesses, most of which are reliant on growth vectors beyond our borders. To date, Naspers (and now investment company, Prosus) still commands a dominant position in most SA equity portfolios. Their key investment, China's Tencent, is seemingly shielded, if not a direct beneficiary of the lockdown measures brought about by the global pandemic, as its core gaming business saw a sharp increase in user engagement during 1Q20. Disappointingly, 1H20 was again a period where investors would have been better off owning Tencent directly as Naspers underperformed Tencent by a full 22%.

Figure 3: Naspers' YTD performance relative to Tencent, %
Source: Bloomberg, Anchor

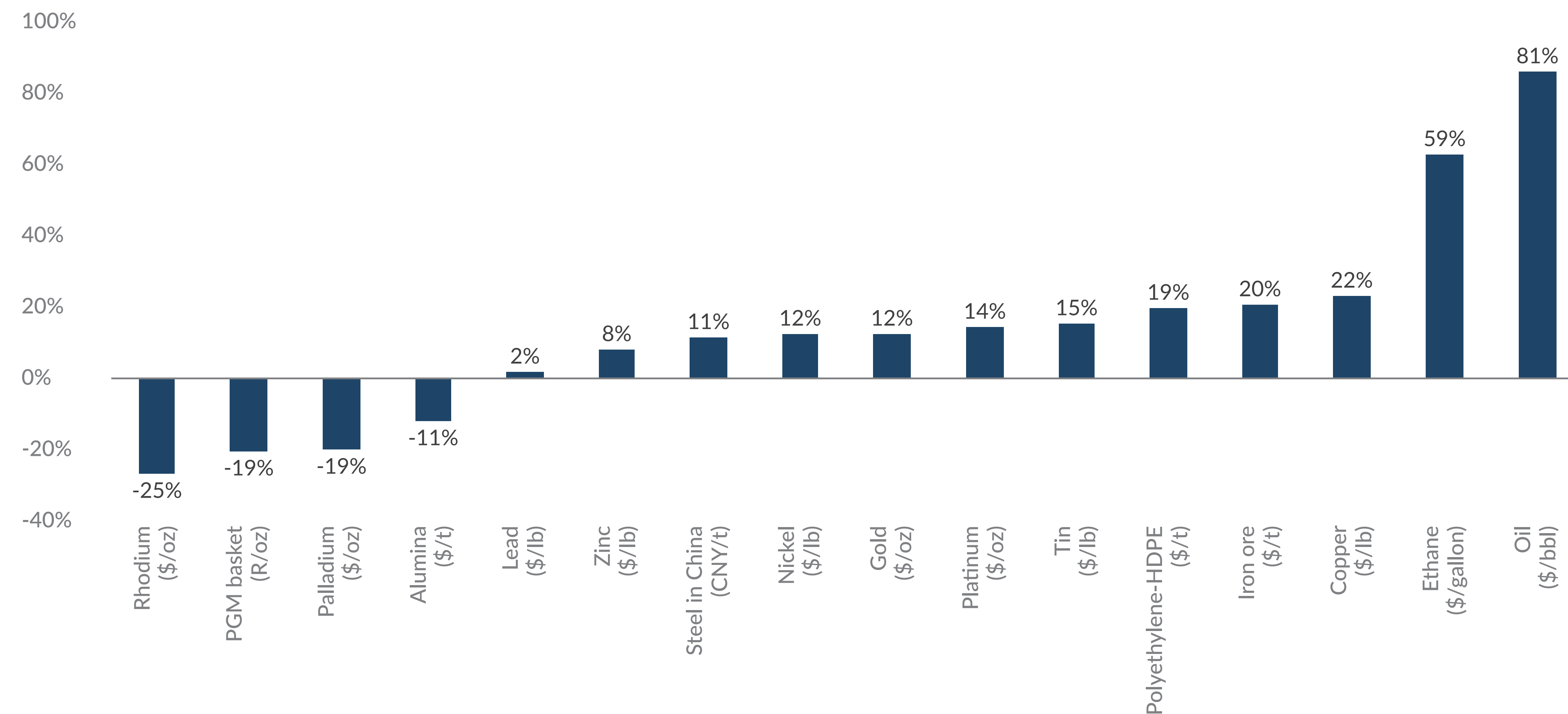
It is positive for Prosus and, by default, Naspers, that the three key verticals these two companies have exposure to outside of Tencent, i.e. online classifieds, food delivery and financial technology (fintech), have also experienced a step change in user engagement as a result of the pandemic. We are optimistic that market conditions are right for the large discount, at which Prosus trades relative to Tencent, to narrow materially.

RESOURCES

The resources sector had a very strong 2Q20. Growth-sensitive commodities such as Brent Crude oil, copper and iron ore rallied 81%, 22% and 20% QoQ, respectively (see *Figure 4*), as risk sentiment returned in a meaningful way. Share prices followed suit. Sasol was by far the sector's star performer, rising by 258% from its March battered lows. Shares of precious metals miners rose c. 60%-80%. In the case of gold, a 14% rise in the gold price had a material effect on earnings expectations, given the substantial operating leverage in gold mining businesses. Although the platinum group metal (PGM) basket price declined by 19% in rand terms, significant supply issues due to Anglo American Platinum's (Amplats') force majeure declaration and lower mined production from the sector due to the lockdown, improved sentiment and helped mitigate against much weaker demand. However, paper and packaging companies, Sappi, and Mondi, lagged the wider sector as pulp and packaging prices remained muted.

Figure 4: Commodity prices, 2Q20 QoQ % change

Source: Bloomberg, Anchor



We expect the resources sector to have its strongest earnings growth in the precious metals complex, thanks to the PGM basket and the gold price rising by 40% and 45% YTD, respectively, in rand terms. Within the diversified mining sector, we expect miners with exposure to iron ore and PGMs to grow their earnings faster than those without that exposure. However, earnings growth for diversified miners, that primarily rely on base metal prices, is expected to remain muted.

Global growth and commodity supply remain key risk factors. Commodities such as iron ore and palladium have been helped by supply growth being weaker than expected. Iron ore output issues from Brazil and PGM supply issues from SA have helped to mitigate the sharp decline in growth that occurred in 2Q20 due to COVID-19. A V-shaped recovery in global growth, coupled with continued supply disruptions, would be ideal for the sector. Conversely, muted growth and a strong rebound in supply would be very bearish, with the key unknown being potential infrastructure-led stimulus measures from China, which could be the dark horse that keeps base metals, such as iron ore, elevated for longer than analysts are forecasting.

DOMESTIC COMPANIES

Turning to the domestically focussed companies, we start off by conceding that the range of potential outcomes is wider than at any point in living memory. Going into the previous deep recession (the 2008 GFC), SA was in a far stronger fiscal position, than the country currently finds itself in, and austerity at a time when spending should be stimulating growth seems to be the only option. In our view, and by our measures, the real "South African" equities peaked sometime between 2014 and 2015, with most domestically focussed companies having to deal with recessionary type conditions since then. It has been a frustrating period for the Anchor investment process, made up of individual stock pickers, who for the most part, have not been able to identify a broad set of domestically focused companies with sustainable/structural growth tailwinds. We are incrementally more positive on the current leadership of President Cyril Ramaphosa relative to the previous administration of ex-President Jacob Zuma. However, change has been too slow to get the economic flywheel turning and, unfortunately, the economic onslaught of COVID-19 could not have come at a worse time for the country.

It therefore comes as no surprise that domestically focussed shares have performed poorly in 2020, with outcomes ranging from several corporate failures to less dramatic 20% drawdowns in equity values. Despite the large drawdowns in equity values, on a PE basis, these shares do not screen as overly cheap due to the expectations of future earnings having been pulled back an equivalent amount to the share price drawdowns.

Figure 5: JSE Financials Index 12M forward PE
Source: Bloomberg, Anchor

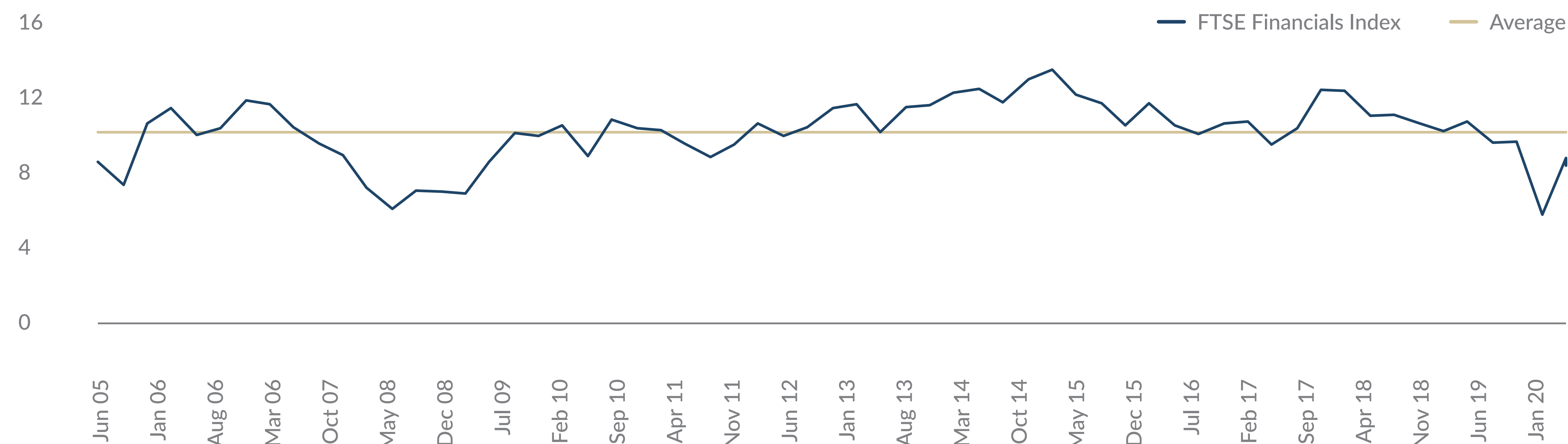
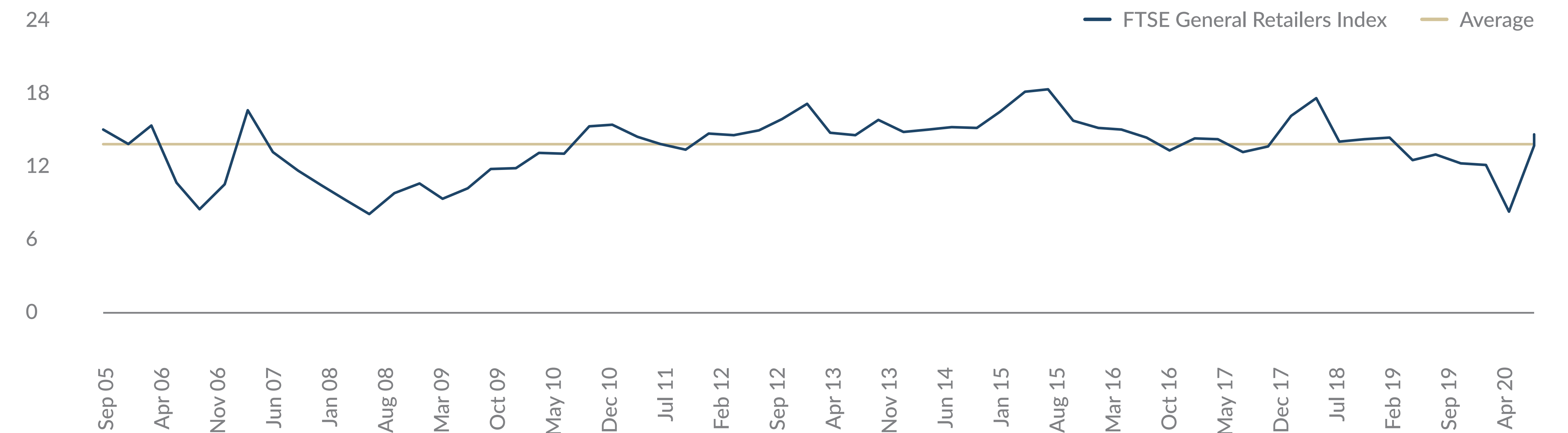


Figure 6: General Retailers Index, 12M forward PE
Source: Bloomberg, Anchor



Given current operating conditions, it is difficult to see SA corporate earnings beating these expectations, especially considering the economic constraints companies are facing.

However, it should be noted that the bad news is not new news. South Africans get very frustrated as they are continuously bombarded with negative news, but a key lesson from the past six months is that equity markets are forward looking and often bottom before the bad news does. Up until about five years ago, SA had always punched above its weight in the global economy. Great local businesses were built by gold-standard entrepreneurs, with many business models successfully externalised (and admittedly some less so, see our article below entitled, *SA corporates' offshore forays have destroyed over R300bn in value*). The big optionality for JSE investors is likely in the domestically focussed names, like best-of-breed banks, insurers, retailers, and industrials, which would likely see aggressive positive earnings revisions on any signs of sustainable economic growth.

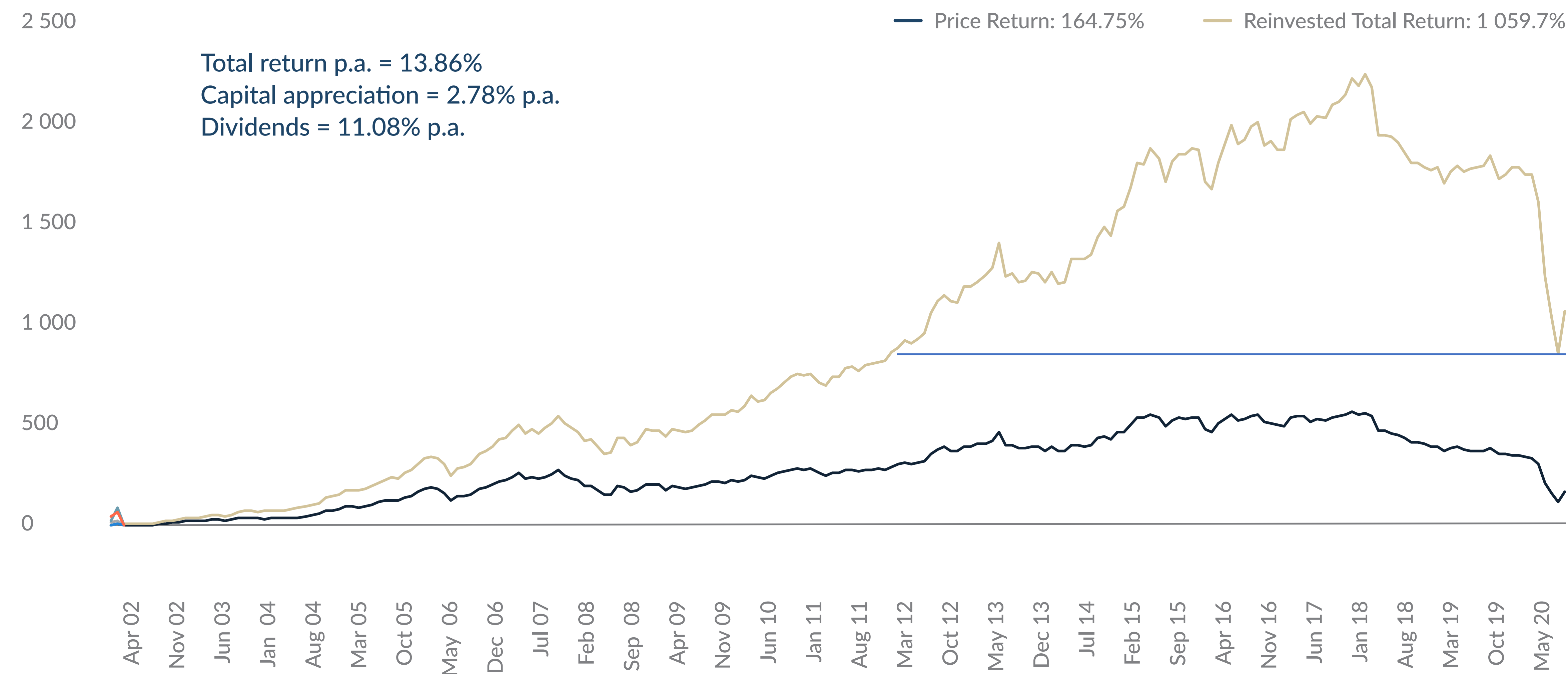
Our chosen approach is to position ourselves for the environment we are currently experiencing, without the desire to make any bold predictions on when SA will return to long-run productivity. As a result, we are underweight SA, with the exposure we have biased towards those companies that display our key philosophical pillars of free cash flow, a strong balance sheet, best-in-class management, and disciplined capital allocation.

SA PROPERTY

Because of the COVID-19 pandemic, SA went into a hard lockdown at the start of 2Q20. The SA listed property market had anticipated some of the pain that this would cause, with the sector having fallen by 48% in 1Q20. While volatility has been the order of the day in 2Q20, the listed property sector has bounced off its lows to record a c. 21% gain for the second quarter.

Figure 7: JSAPY returns, capital vs dividend

Source: Refinitiv, Anchor



The current state of play in the property sector, largely due to the pandemic, is that tenants remain under significant pressures, which property companies could not have mitigated against.

Looking at the longer-term historic performance of the JSE Listed Property Index (JSAPY), we highlight that, since April 2002 when the new FTSE JSE indices were launched, the JSAPY's total return is an impressive 13.9% p.a. (up to the end of May 2020). However, such has been the veracity of share price declines since 2017 and particularly this year, that any investor who had been invested in the listed property market for less than nine years has experienced a negative total return.

This, in turn, has meant that rental collections by landlords have been negatively impacted, sometimes severely.

This has been the case especially in the local retail property sector which, for a long time (20-plus years), had an uninterrupted sweet spot because of rental growth.

However, in the space of only a few months, all property companies' income and distribution guidance are off the table. Forecast risk has never been higher, leading to incredible volatility in listed property shares. As a sector, property is now more volatile than resources, which was once seen as the ultimate cyclical equity segment.

In a trading update, SA's largest real estate investment trust (REIT), and the only property counter remaining in the FTSE JSE All Share Index (ALSI) of top-40 stocks, Growthpoint Group CEO Norbert Sasse commented that property valuations could fall by between 10% and 20%, with 80% of this drop being caused by income statement pressures and only 20% by capitalisation (cap) rates rising. This means that distributable incomes from property shares could fall by 10%–15% YoY and loan-to-value (LTV) ratios could reach uncomfortable levels across the industry and, in some instances, even breach covenants.

Forecasting property sector returns therefore results in a wide range of possible scenarios. *Figure 8* below highlights these sensitivities, with our base-case scenario being a return of c. 9% for a 12-month period. This reflects negative distributable income and yield growth of 3%, using the current yield of 12% as the cap rate valuation. Our bear-case scenario assumes a further fall in distributable income, partly as a result of a possible REIT status 75% pay-out ratio holiday, while our bull-case scenario assumes some normality returning and investors being willing to value property assets at the current 10-year bond rate.

Figure 8: SA listed property sector return scenarios

Source: Refinitiv, Anchor

	Base-case ***No change in rating***	**Bear-case** ***Incl REIT status holiday (exit yield remains at 12%)***	**Bull-case** ***Income growth of 3.5% (exit yield = 10-year bond)***
Starting value year-zero	100	100	100
Forecast income yield year-one (%)*	12.0	8.0	12.0
Income growth year-two	-3.2	0.0%	3.5%
Income yield year-two, %	11.6	8.0	12.5
Exit yield	12.0	12.0%	9.2%
Exit value year-one	96.8	67.0	135.0
Total return	**8.8**	**-25.3%**	**47.3%**

** Due to the uncertainties created in the current environment it is possible that not all distributable income will be paid out as dividends.*

We highlight that current listed property share prices already reflect deep discounts to their net asset values (NAVs). Property companies that went into this crisis with reasonably strong balance sheets and manageable debt levels, and can weather the storm, will provide investors with good returns. However, the journey to that destination will need seatbelts fastened throughout!

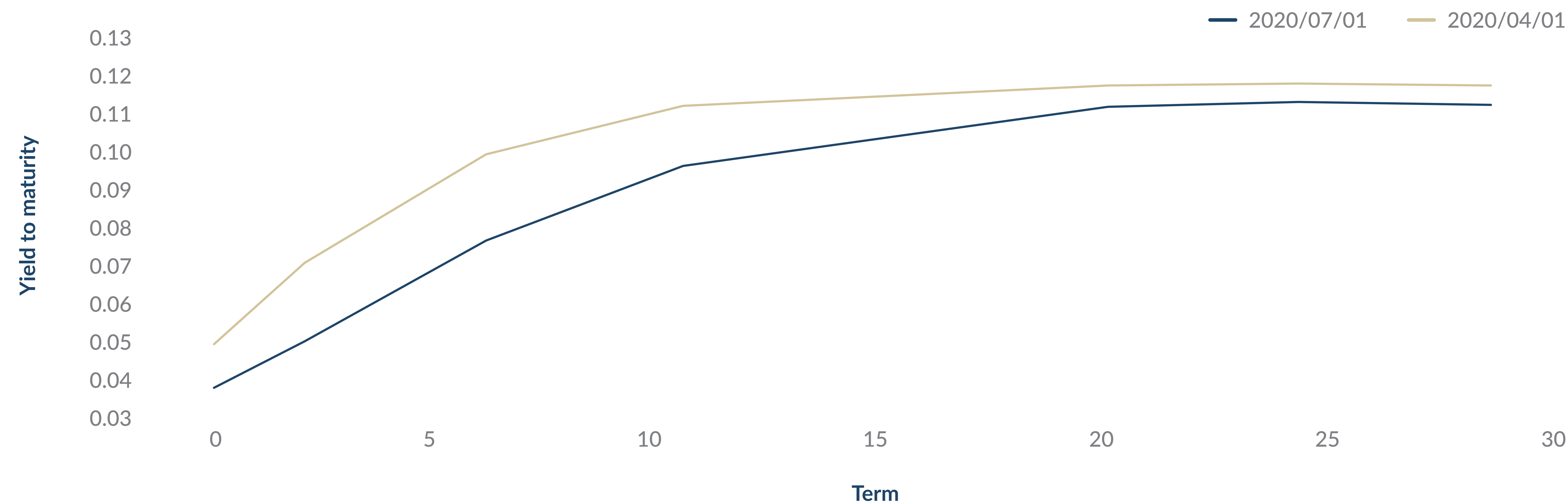
SA BONDS

2Q20 followed on from a dramatic 1Q20, when the COVID-19 pandemic hit globally in March, pushing asset classes around the world into periods of high volatility. Subsequently, as the pandemic spread globally a more measured approach has been witnessed, as governments attempt to deal with the crisis in any manner possible.

In SA, this has taken the shape of a combination of strong rate cuts (the SA Reserve Bank [SARB] has cut the repo rate by 275 bpts YTD), a governmental intervention package (including support for certain sectors), and a business rescue package (pulled from private donors).

The SA bond curve has shifted subtly over the quarter – with the long end remaining at elevated levels, while the continued SARB rate cuts have pegged the short end lower.

Figure 9: SA Government bond curve
Source: Thomson Reuters, Anchor



June's Supplementary Budget indicated a much riskier fiscal position than before. With intervention strongly required to prevent debt/GDP levels soaring to over 100% in the short-to medium term. The finance minister has also been consistent on the message of fiscal discipline. However, one must apply caution given the SA government's spendthrift history.

Figure 10: Anchor SA bond yield monitoring, R2030 bond
Source: Thomson Reuters, Anchor

In *Figure 10* above, we track the R2030 vs our modelled fair yield. In late-March 2020, the COVID-19 induced spike is evident. Subsequently, however, the bond has traded back to within the range of our fair yield. We expect yields to be relatively consistent, absent any major destabilising political news. Recent economic data (for example the balance of trade, which printed positively for the first time in 17 years), suggest that the impact of the pandemic has not yet been fully realised.

Going forward, our base expectation is for SA government bonds (SAGBs) to remain range bound, with the shorter-term bonds (R2023) being tied to SARB rate expectations and realised cuts, while the longer bonds (over R2030, a 10-year plus term) will be pegged to National Treasury announcements. Our base view is for the R186 to drift lower in yield, as it moves from being a "belly" bond to being a "short-term" bond. Further, we expect the R2030 to become standardised as the benchmark bond over the next 6-18 months. This should make it trade in tighter ranges, as it will become the most liquid of the SAGBs.

While yields present at less attractive levels than at the height of the pandemic, when 10-year debt could be purchased yielding 13%, current levels are still above fair and, to this end, we continue to believe that duration assets remain attractive from a yield perspective. This is particularly so considering the repeated SARB rate cuts which bring the JIBAR rate lower, and thus makes floating rates and short-dated debt less attractive.

RAND

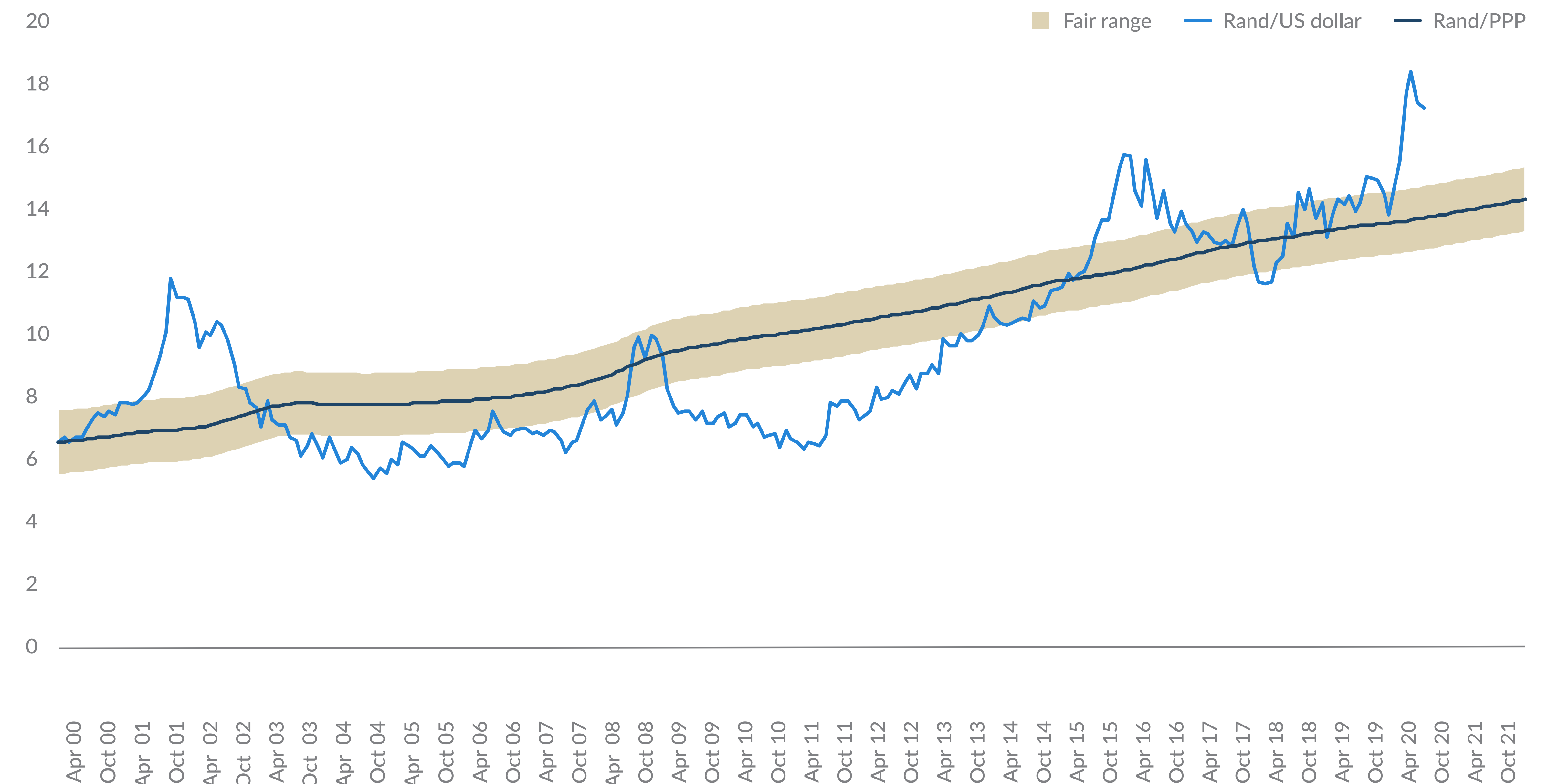
Projecting the rand's value in a year's time is a fool's errand. The rand vs US dollar exchange rate is one of the world's most volatile currency pairs and trades well away from any modelled fair value for long periods. We note though that in most 12-month periods the rand trades within a R2.50 range to the dollar. However, 1H20 was far from normal and we saw the rand set a new weakest-level record of R19.35/US$1 at the height of the COVID-19 crisis.

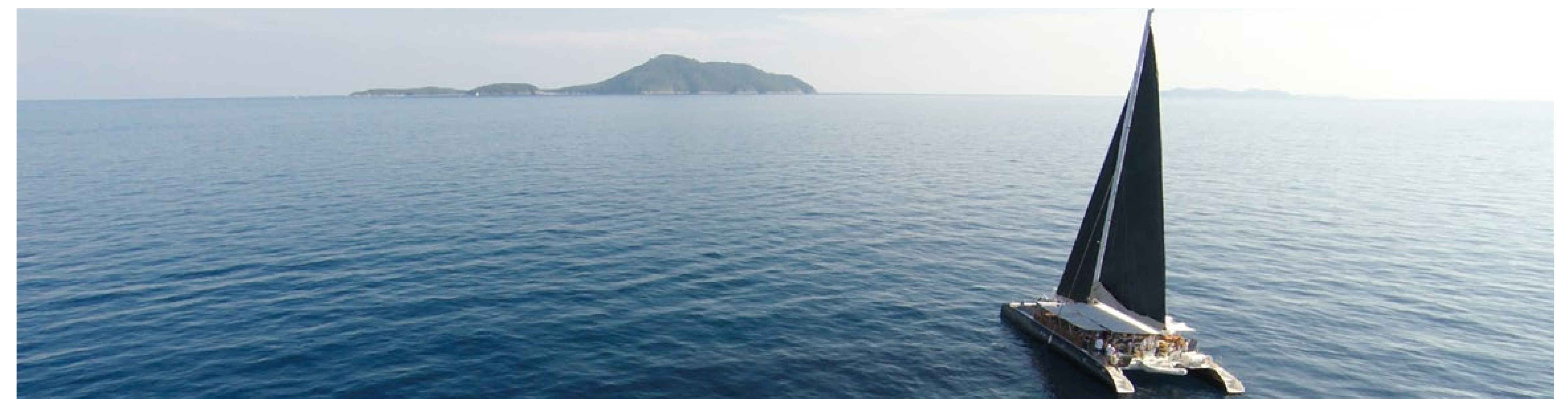
We maintain our view that, while the rand should trade on the weaker side of fair, it is oversold at current levels and therefore as the world recovers from this crisis, we see scope for the local currency to claw back more of its losses. Nevertheless, we think that this will be a slow process and that, for now, the rand will remain range bound in a volatile environment. As with all asset classes, the near-term outlook for the COVID-19 crisis also dictates the near-term outlook for the rand.

We retain our purchasing power parity (PPP) based model for estimating the fair value of the rand and we have extended this out by three months since the publication of our *2Q20 Navigator* report on 9 April 2020. Our PPP-modelled value for the rand vs US dollar at the end of the next 12 months is R14.27/$1 (see *Figure 11*). We apply a R2.00 range around this to get to a fair value range of between R13.27/$1 and R15.27/$1.

We expect the rand to remain particularly volatile and on the weaker side of our fair range band. This would imply that we see scope for up to a 10% strengthening from the rand's current levels as the world recovers.

Figure 11: Actual rand/US dollar exchange rate vs rand PPP model
Source: Thomson Reuters, Anchor





GLOBAL EQUITY

Our team has seldom debated future global equity returns more vigorously than in recent weeks. A 19% decline in the S&P 500 in 1Q20 was followed by a 19% rise in 2Q20, leaving the US market down a few percentage points from the beginning of this year. The world economy has to recover strongly to justify the recent recovery in the market.

However, there is no playbook for current market conditions and sentiment regarding the ultimate 12- to 24-month impact of COVID-19 changes every day, as infections take different directions around the globe. At this stage, the world is opening up, but infections are still increasing. Markets are taking comfort in the strong slowdown of infections in Europe, but this has yet to be replicated in the US and many other EMs.

Global equity markets posted their third-straight positive monthly performance in June to end 2Q20 on a strong footing. DMs had their best quarter (MSCI World +19.4%) since 2Q09, while the S&P 500 Index recorded its best quarter (+20.5%) since 4Q98.

Not surprisingly, company earnings took a dive in 1H20 and US S&P 500 earnings are projected to decline by 18.4% this year (see *Figure 12*). A good example of the impact of the lockdown is one of our highest quality holdings, Nike, which saw sales decline 36% YoY in the three months to May and this resulted in a loss of US$790mn (the Group reported just under US$1bn in profit for the prior three-month period). The Nike share price has already recovered back to pre-pandemic levels. Market consensus is for a sharp recovery in overall US earnings in 2021, but this is by no means a certainty.

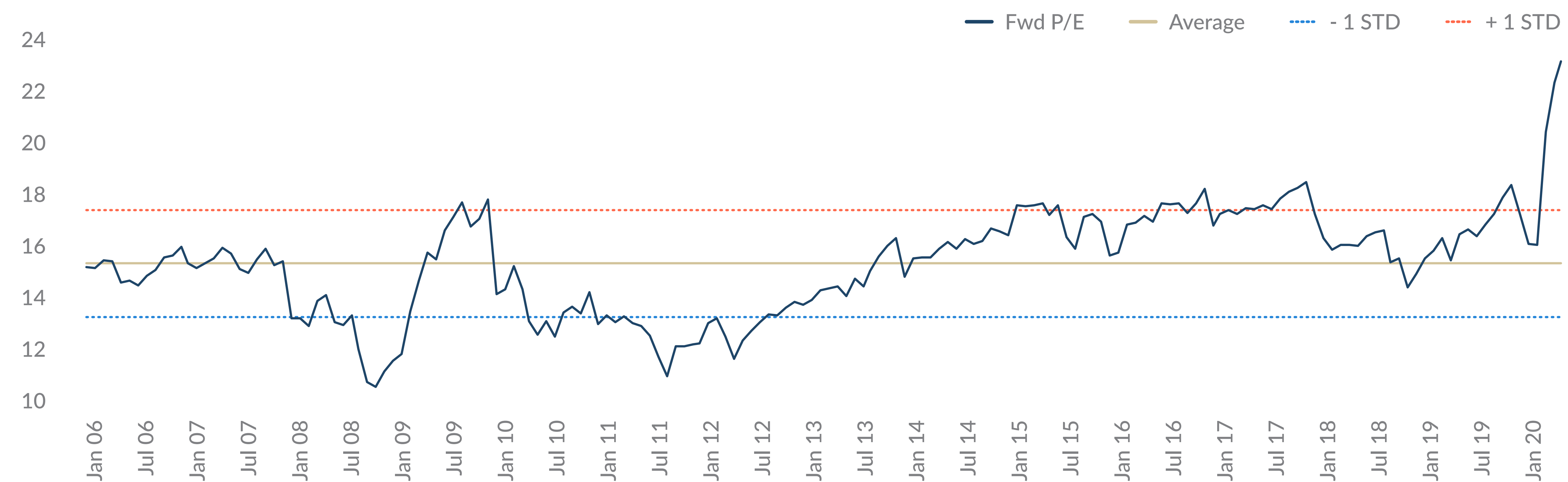
Figure 12: S&P 500 EPS growth (annualised)
Source: Bloomberg, Anchor

The pandemic has changed the prospects of many companies – unemployment is higher (but improving sharply), tech trends have accelerated, resource company prospects have improved as infrastructure stimulus will follow. Meanwhile, companies that rely on travel and tourism will be severely impacted for some time to come. Sectoral performances have been starkly different, and the tech-heavy Nasdaq 100 Index is now 16.9% higher YTD - a full 20% ahead of the S&P 500 Index.

So, at an index level the market looks less attractive on a risk/return basis, but one must look one level lower to reach firmer conclusions. There are numerous shares and sectors which are still down materially from their highs and, if the economy is going to recover quickly, opportunities still exist to take advantage of current market pricing.

Figure 13 below shows the MSCI Index forward PE (23x), which highlights the impact that the decline in earnings has had on valuations.

Figure 13: MSCI World forward PE
Source: Bloomberg, Anchor



The usefulness of *Figure 13* above is limited in current conditions as an indicator of future returns, but as can be seen in *Figure 14*, the one-year (19.6x) and two-year (16x) forward PEs are still in expensive territory. The market is pricing in the recovery.

Figure 14: MSCI and S&P 500 earnings growth and forward PEs
Source: Bloomberg, Anchor

	Earnings growth		FWD P/E		
	YR1	YR2	Current	YR1	YR2
MSCI World Index	19.0%	16.0%	23.0	19.6	16.0
MSCI EM Index	37.1%	11.4%	15.8	12.7	11.0
MSCI All Country World Index (10% EM)	21.0%	14.3%	21.8	18.4	15.4
S&P 500 Index	12.3%	15.9%	25.0	22.5	18.1

While earnings and valuations do not, in aggregate, suggest a compelling equity outlook, one cannot ignore the impact of the global stimulus packages (especially in the US). This has no doubt been the most significant factor behind the market recovery and we think this trend and support will continue. The cost of money will be very low for a long time to come and there are few alternatives to equities in the pursuit of meaningful returns. Investors have to take some risk to have the prospect of returns.

Our equity approach is as follows:

- Retain a core portfolio of high-quality growth shares, which we believe will be higher in 12 months' time, with more volatility expected.
- Recognise the risk of a further correction, given the straight line upwards from the bottom. We are keeping an above average level of cash in equity portfolios to take advantage of price opportunities.
- Take selected advantage of recovery shares, which are still well below their highs – some examples include Sysco, Synchrony and JP Morgan.
- Ensure we have sufficient exposure to the optionality in technology-driven companies, whose futures have become even more exciting.

Our one-year projected return on global equities is 5%. Our bear-case scenario is a negative 15% and the bull case is a 10% return.

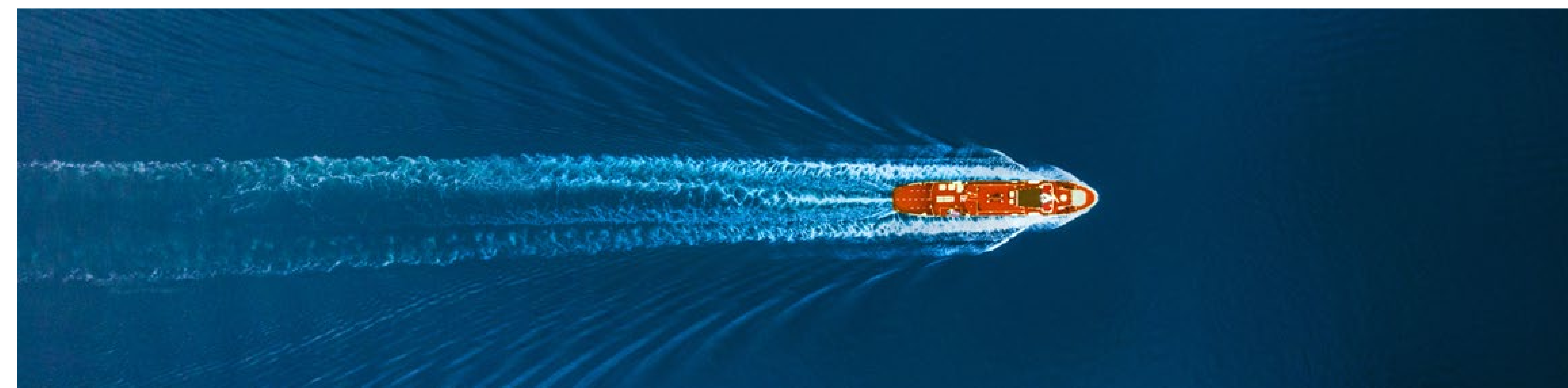
GLOBAL PROPERTY

Some sectors of the commercial real estate market entered the COVID-19 crisis already suffering from the structural challenges of a shift to a more online world. COVD-19 has exacerbated these trends and created additional challenges for other sectors, particularly for hotel and resort REITs and healthcare REITs, which have a high exposure to senior housing. Dividend expectations have come down by c. 27% YTD as REITs have cut dividends to shore up their balance sheets. This has been felt most acutely in the troubled retail REIT sector, where dividend expectations have dropped by almost 50%, while the new work-from-home phenomenon has brought into question what the requirements will be for office space going forward. In addition, a huge spike in unemployment rates has put pressure on the residential housing sector.

Commercial mortgage-backed securities (CMBS) are pricing-in the expectation of at least 15% defaults, while spreads between US government bond yields and REIT dividend yields are now at their highest levels since the GFC, reflecting continued uncertainty for the sector. As with the equity market, where there has been a bifurcation between businesses geared towards the online and offline sectors, REITs have been no exception with industrial and specialised REITs, particularly those focused on logistics for online retail and those supporting the cloud and other online initiatives, benefitting at the expense of the offline economy. We expect that, as lower rental reversions, additional vacancies and bad debts pile up over the course of the next twelve months, dividend expectations are likely to fall further, thus offsetting the majority of the sector's dividend yields to leave investors with a total return of around 1.5% for the year.

Figure 15: COVID-19 has decimated the income generating ability of many global REIT sectors
Source: Bloomberg, Anchor

Sector	Weighting	YTD return ($)	Current Fwd yield	Fwd yield @ 31 Dec 2019	Change in dividend forecasts
Hotels and resorts	2.4%	-49.8%	4.3%	5.8%	-32.5%
Retail	16.8%	-36.6%	6.4%	5.4%	-46.5%
Diversified	11.4%	-28.9%	5.7%	5.1%	-37.0%
Office	14,5%	-24.1%	4.5%	3.4%	-43.9%
Healthcare	9.2%	-23.1%	5.5%	4.9%	-31.6%
Residential	16.5%	-14.4%	3.3%	2.8%	-27.7%
Specialised	12.1%	-0.5%	4.0%	4.2%	4.6%
Industrial	17.0%	5.3%	3.1%	3.2%	7.8%
Total	**100.0%**	**-20.8%**	**4.5%**	**4.2%**	**-26.6%**



GLOBAL BONDS

The end of our one-year forecast horizon is likely to coincide with the rollout of a possible COVID-19 vaccine, or at least reasonably advanced vaccine trials, which should hopefully accelerate the normalisation of economic activity. This is also likely to result in a normalisation of inflation, with forecasters expecting US inflation to reach 1.8% by 2Q21. Our US 10-year bond forecasts combine real-rate expectations with term-premium expectations. In a QE-centric world, we tend to apply higher credence to the term-premium based approach and, as such, we expect US 10-year government bond yields to have negative real yields even once inflation starts to normalise one-year out as the Fed will have to act cautiously in unwinding QE in a post-COVID, debt-soaked world.

On a probability weighted basis, we expect US 10-year bond yields to reach 0.8% by the end of 2Q21, leaving investors in US 10-year government bonds with a 0.6% total return loss over the next twelve months. For US corporate bonds, we see the Fed's corporate bond purchasing programme and the search for yield as slightly offsetting the potential drag from higher corporate defaults. This should leave US investment-grade corporate bond credit spreads slightly lower one-year out (at 1.2%), giving investors in US investment-grade corporate bonds a total return over the next twelve months of around 2.9%.

ANCHOR INSIGHTS

In this section, staff from across Anchor provide insights into our thinking, strategy, and view of the world. This quarter, Peter Little discusses asset allocation and how investors should manage tension between long-term capital growth and short-term capital losses; Peter Armitage looks at how SA corporates' offshore forays have destroyed over R300bn in value; Nolan Wapenaar writes on fixed income and how to make a low interest rate environment work for your investments; Henry Biddlecombe answers the question: Will the tech rally continue?; Stephán Engelbrecht reviews COVID-19 lockdowns and how the SA consumer has reacted and, finally, Leigh Crossman discusses how, at Anchor, we help investors find their "True North".

Asset allocation:

Managing the tension between long-term capital growth and short-term capital losses

Written By:

PETER LITTLE
Fund Management

1. WHAT IS ASSET ALLOCATION?

Investors are universally aligned in the objective of growing their investments as much as possible, but that is usually where the alignment ends. They are often at odds as to from where the best potential for capital growth will likely come. Investors are also rarely in agreement as to how much they are willing to see the short-term value of their capital fluctuate (or more pertinently, drop), in order to achieve long-term capital growth.

Figure 1: Investors are united in their search for maximum growth in their investments but typically have very diverse risk appetites
Source: Anchor

That is where asset allocation comes in. At its most basic level, asset allocation involves creating an investment portfolio with investments spread across various:

- Companies,
- sectors and styles,
- regions, and
- asset classes

Metaphorically, this means investors placing their investment eggs into different baskets to mitigate against unexpected outcomes in any single investment. To put it simply, it means diversifying potential risks in the process of constructing an appropriate investment portfolio.

2. HOW DO WE GO ABOUT ALLOCATING ASSETS?

Investors, being human, run a broad gambit of risk tolerances, so, constructing an appropriate investment portfolio can be a very personal task, but the techniques used for achieving an appropriate portfolio can be broadly split into two main categories:

Accessing different sources of economic and earnings growth.

Investing across different companies, sectors, styles and regions is a way of ensuring that investments are not overly exposed to drivers that could unexpectedly be derailed by events which are often difficult to predict such as regulatory changes, natural disasters, disruption or fraud. An event such as the current COVID-19 crisis is a great example of where well-managed companies have been forced to their knees by events beyond their control or most investors' ability to foresee (e.g. premier global online travel agent, Booking.com has lost a quarter of its market value since the start of the pandemic and, in SA, a business like Sorbet could see up to 40% of its 220 salons across SA closing permanently).

This form of diversification is achieved primarily through bottom-up stock selection, finding companies in different industries, with earnings in different regions, that are unlikely to be linked by the same source of disruption.

Adding different asset classes that are less susceptible to capital losses in the short term.

This part of portfolio construction, by and large, involves adding some level of portfolio insurance. Much like regular insurance there is an ongoing cost involved (in the case of your portfolio it is more of an opportunity cost – forgoing some potential growth) to protect against a potential future loss, which may or may not happen.

The primary asset classes we consider when adding "insurance" to our portfolios are:

Assets whose capital is guaranteed:

a) Cash is typically the safest investment (and the most liquid), particularly when held in a regulated financial institution where the government guarantees deposits. Holding cash though typically guarantees negative real (above inflation) growth after fees and taxes, so it has arguably the highest opportunity cost of all portfolio insurance.

b) Structured products, with an embedded capital guarantee. Structured products usually only offer capital protection at expiry, which is often after several years. So, investors adding portfolio insurance in order to guarantee that they will be able to access liquidity in their portfolio at any time, without worrying about locking-in large capital losses should liquidity be required during a market correction, should bear in mind that structured products may not be well suited to fulfil that role in their portfolio.

Assets that typically appreciate when growth-sensitive assets depreciate:

a) Bonds; and
b) gold

Each of these asset classes have various characteristics that make them attractive from a portfolio insurance perspective, but they all come with unique "costs" to the portfolio and may provide imperfect protection when you need them most.

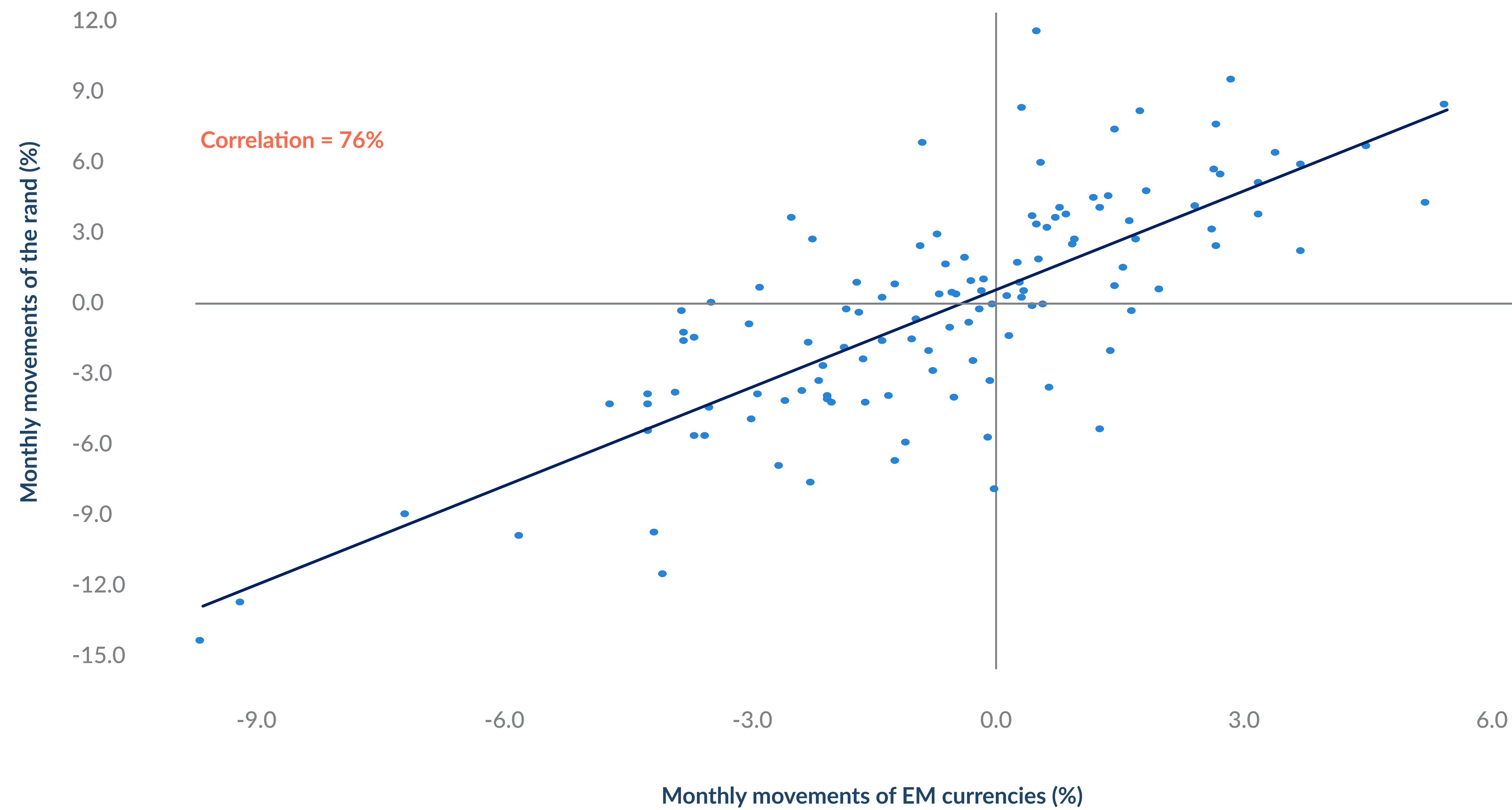
3. POTENTIAL PITFALLS OF ASSET ALLOCATION

The illusion of diversification

Same theme applied in multiple different ways:

This is essentially like having lots of different eggs but keeping them all in the same basket. SA investors are particularly susceptible to this. We are faced daily with the challenges that many EM citizens are forced to live with including corruption, high levels of unemployment, poor governance, and sub-standard basic services, so it is easy to become disillusioned about the local economy. This sentiment can then become pervasive in investors' asset allocation as they maximise their allocation to global investments and favour local companies' shares, which earn some or all of their income outside of SA. This is a perfectly acceptable approach for many investors, but it does make their domestic currency returns extremely susceptible to the local exchange rate, which is extremely volatile and is also, in the short- to medium-term, influenced to a large extent by non-SA factors such as sentiment towards EMs or the value of the US dollar relative to its DM peers.

Figure 2: It is not all about SA - over the past 10-years c. 76% of the rand's monthly movements can be explained by sentiment towards EM currencies
Source: Bloomberg, Anchor

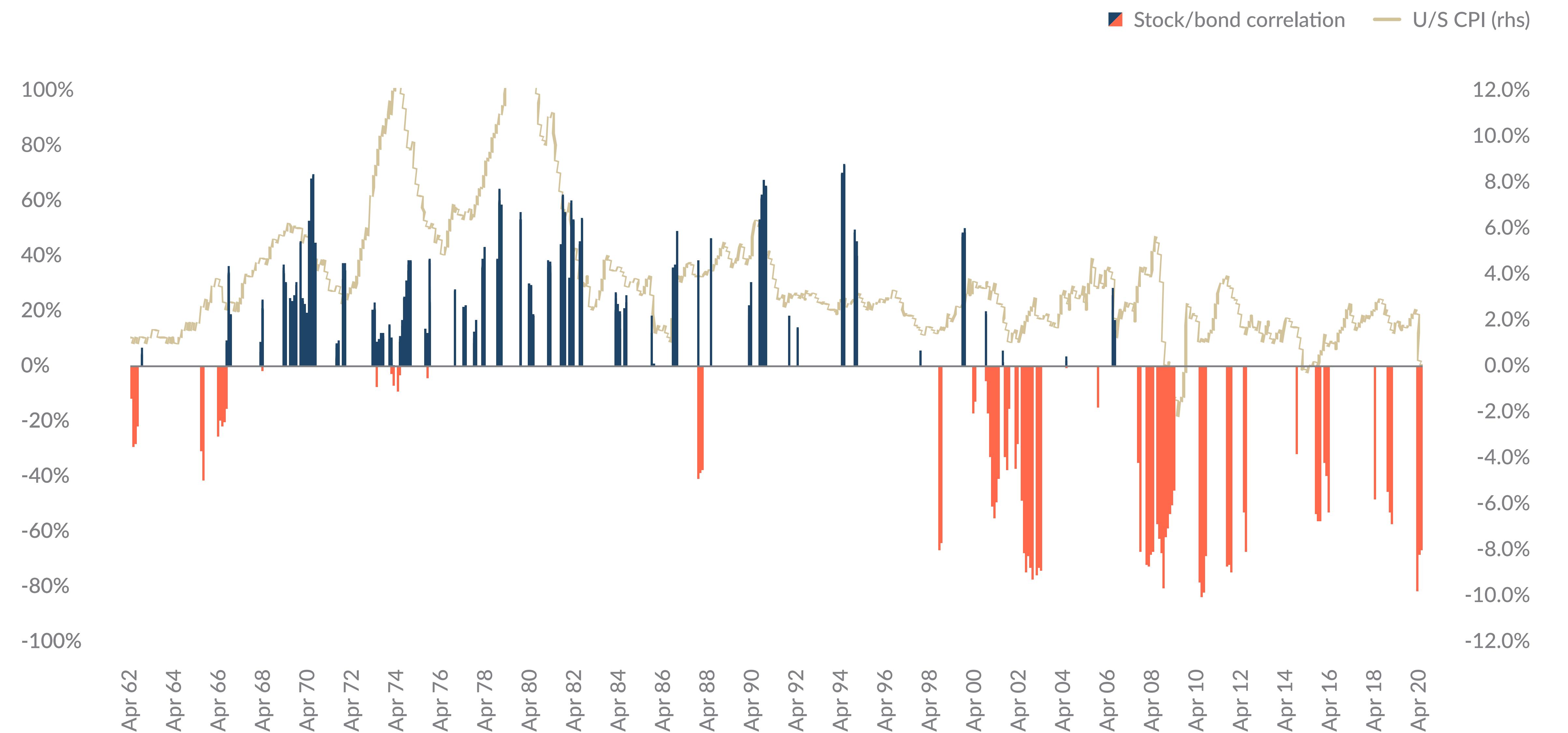


Different themes all linked by a higher-order effect.

a) Liquidity is often a key theme linking seemingly uncorrelated investments in times of crisis. Investors all needing to raise cash at the same time flood the market with supply just as demand dries up. This is most extreme in less liquid investments that even during the good times have limited demand.

b) Inflation, or more specifically inflation volatility, is another factor that is often linked to the performance of stocks and bonds. Before the US Fed started specifically targeting inflation (and getting it under control), predominantly this century, high and volatile US inflation (which tends to be negative for both stocks and bonds) would usually result in bonds falling at the same time as stocks.

Figure 3: Stock/bond correlations when stocks drop by more than 5% over three months
Source: Bloomberg, Anchor



The illusion of capital protection

The worst-case scenario for investors is when they have decided to forgo some of their long-term growth potential to protect capital in the short term and the insurance does not work when they need it to. This is often the case when investors are reluctant to give up too much for their insurance.

BONDS

While DM bonds have certainly worked well as short-term hedges against falling stock markets for the past 20 years or so, the opportunity cost of holding bonds has continued to rise as low inflation and aggressive quantitative easing (QE) has squeezed real bond yields to unattractive levels, limiting their long-term return prospects. Enter the search for yield as investors try and reduce the opportunity cost of insurance – unfortunately, as with many things in life, cheaper is not always better as the higher the credit spread embedded in bonds, the more likely they are to move in synch with equities.

Figure 4: Overreaching for yield tends to negate the ability of bonds to act as shock absorbers in a portfolio
Source: Bloomberg, Anchor

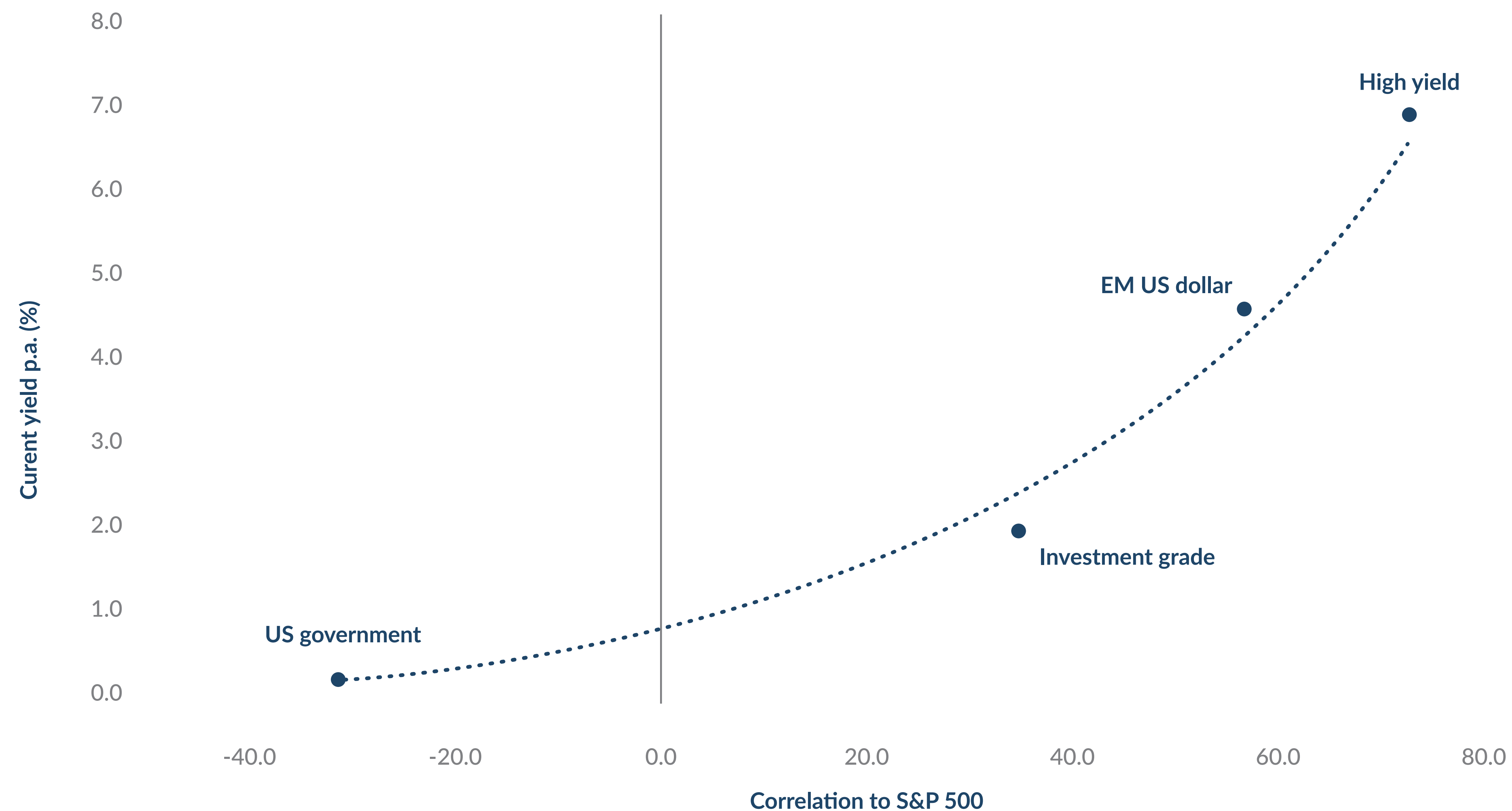
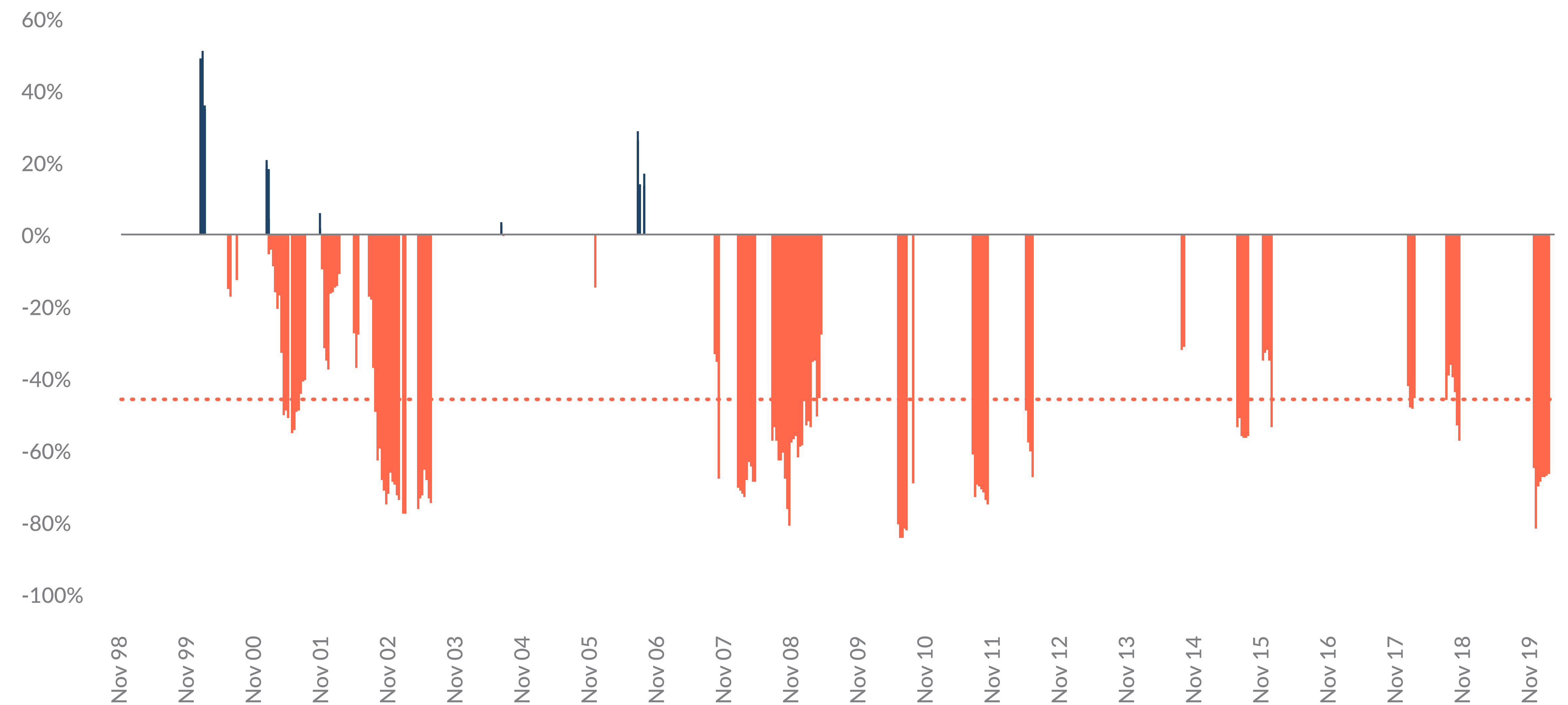


Figure 5: The correlation between stocks and US 10-year government bonds when stocks fall at least 5% over three months
Source: Bloomberg, Anchor

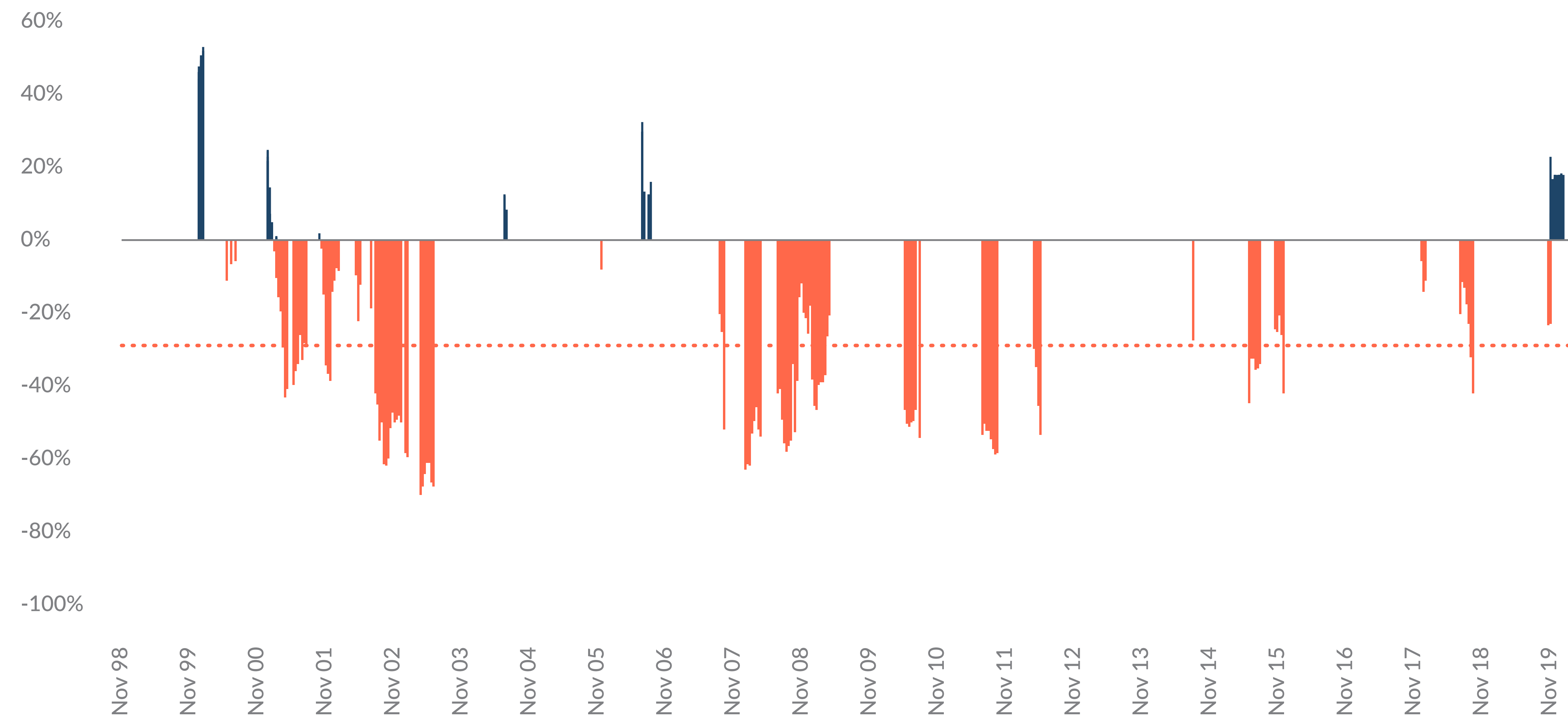


So, investors adding bonds to a portfolio in the hope of achieving some insurance, tend to do themselves a disservice in their overreach for yield. This is particularly true when the insurance is needed most i.e. when equities experience short-term drawdowns.

When equities fall by 5% or more over three months, US 10-year government bonds move strongly in the opposite direction (i.e. up):

US investment grade credit moved somewhat in the other direction (i.e. moderately up):

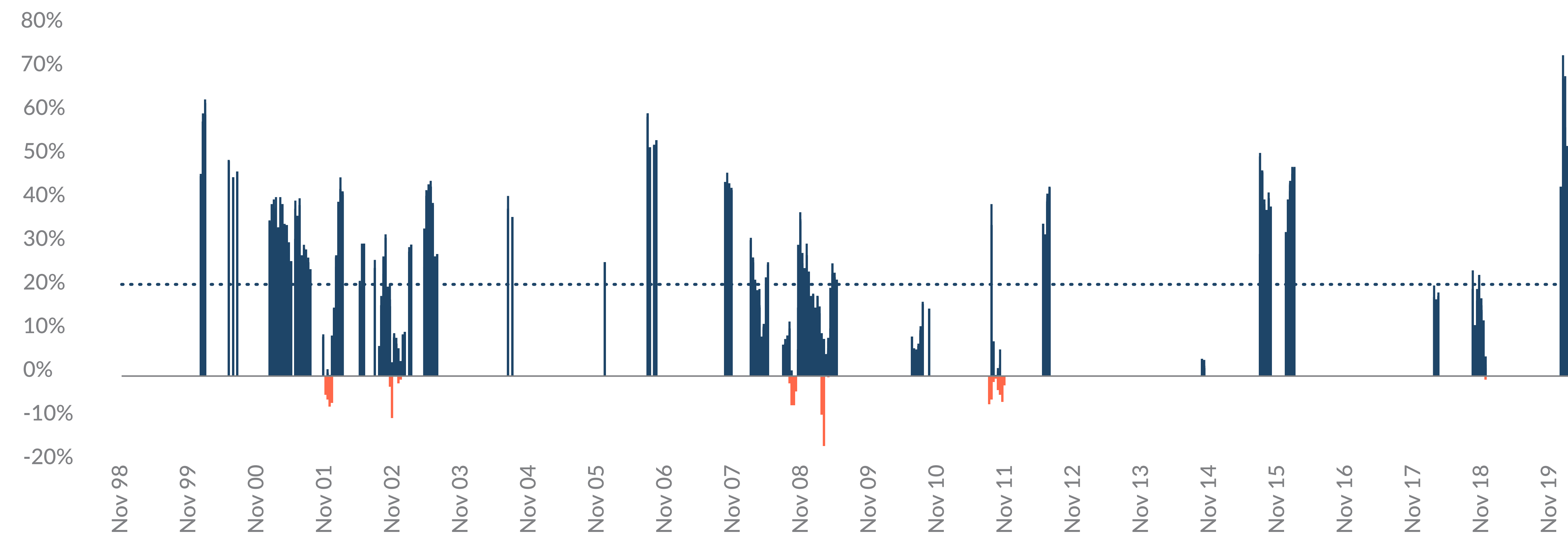
Figure 6: The correlation between stocks and US investment-grade corporate bonds when stocks fall at least 5% over three months
Source: Bloomberg, Anchor



Over the past 20-odd years, the major exception to this was the sell-off in March this year when investors initially panicked that the corporate bond market might seize up (in the wake of the GFC, regulators made it much harder for banks to provide liquidity to corporate bond markets). Fortunately, the Fed stepped in to allay those fears with a corporate bond purchasing programme of its own.

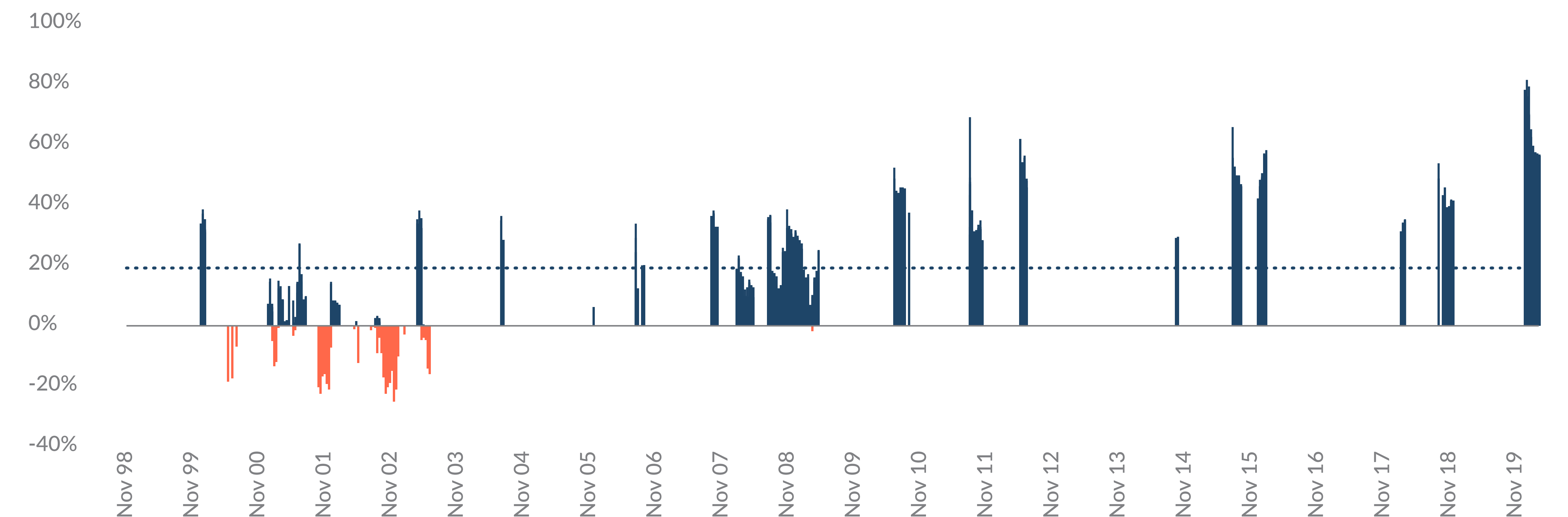
When it comes to high yield bonds the chances of them losing money, when you have a short-term correction in equity markets, is reasonably high. Just because they are called bonds does not mean they are going up (or at least not going down) when equity prices fall.

Figure 7: The correlation between stocks and US high-yield bonds when stocks fall at least 5% over three months
Source: Bloomberg, Anchor



The same goes for high-yielding US dollar bonds issued by EM issuers.

Figure 8: The correlation between stocks and EM US dollar bonds when stocks fall by at least 5% over three months
Source: Bloomberg, Anchor



GOLD

Gold is a popular hedge against uncertainty in investors' portfolios and a complicated one to understand. Victorian Europe's richest man, and bullion broker to the Bank of England, N.M. Rothschild said: *"I know of only two men who really understand the value of gold, an obscure clerk in the basement vault of the Banque de France and one of the directors of the Bank of England. Unfortunately, they disagree."*

We include gold in portfolios primarily because we expect it to appreciate when the value of our stocks goes down in the short term, and so we look at how it moves when equities drop. For the past c. 50 years it has been about 75% effective – i.e. three out of four times when stocks fell by more than 5% over a three-month period, gold rallied. This compares to government bonds, which were effective only 63% of the time, although this increased to 98% over the past 20 years, when inflation has been largely under control.

Figure 9: The correlation between stocks and gold when stocks lose at least 5% over three months
Source: Bloomberg, Anchor

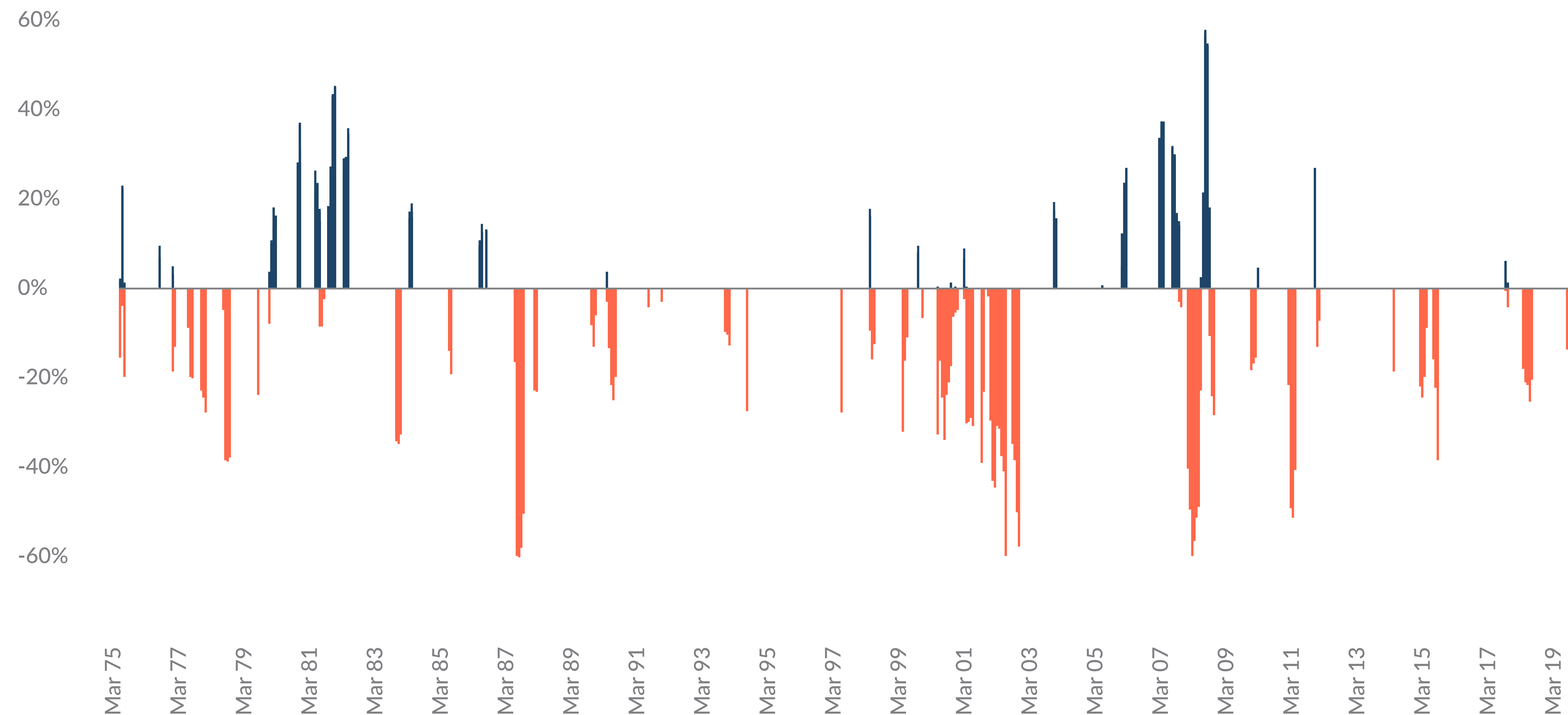
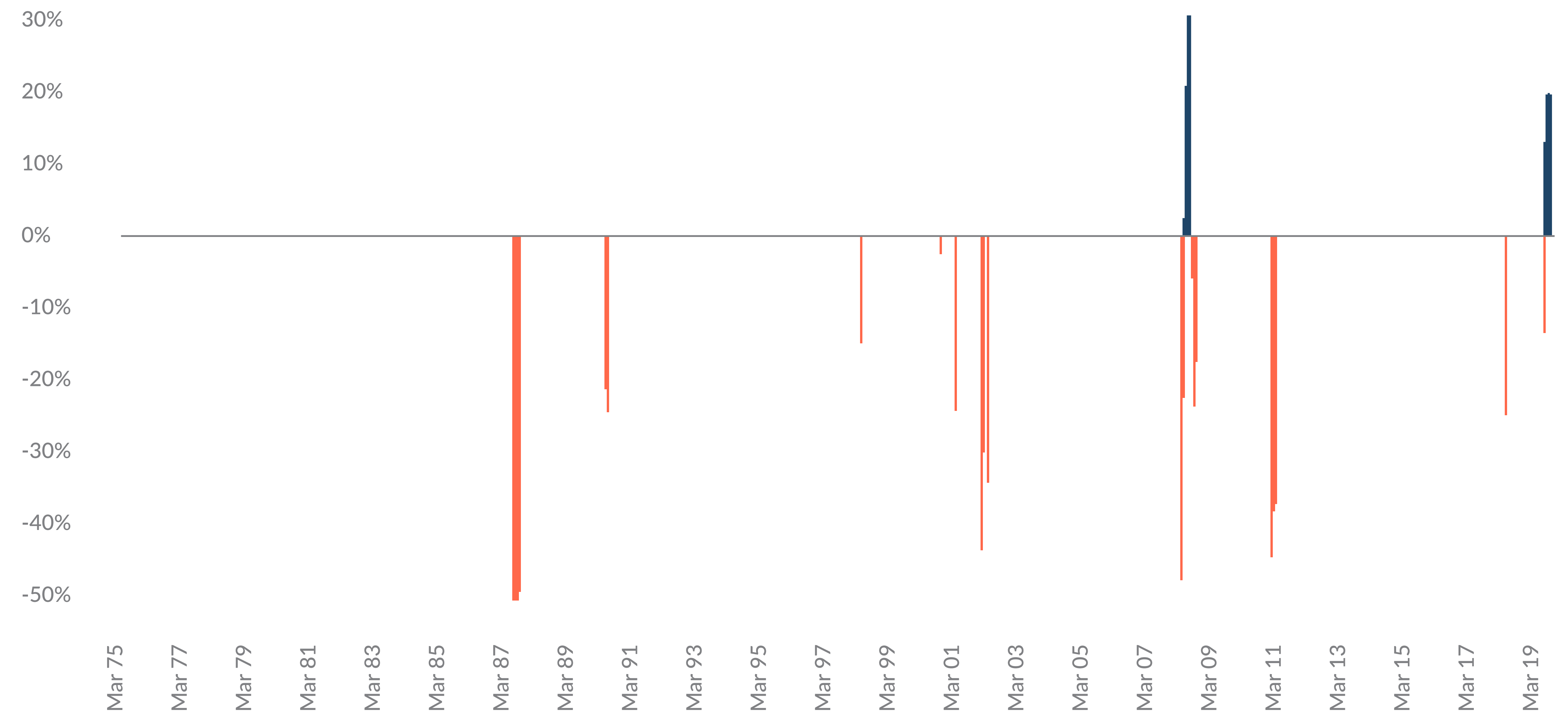


Figure 10: The correlation between stocks and gold when stocks fall by at least 15% over three months
Source: Bloomberg, Anchor



We also looked at how gold did with more meaningful stock market collapses – to see if it perhaps fared better during bigger stock market corrections – when stocks dropped more than 15% over the course of three months. The results were reasonably similar – gold was an effective hedge about 77% of the time. Perhaps what was more worrying was that the times it did not really work well (when gold fell alongside equities), were during the two most recent crisis - the GFC and, recently, during the COVID-19 crisis.

CONCLUSION

Constructing an appropriate investment portfolio is typically a very personal exercise, weighing investors' risk appetite and liquidity requirements. Stock selection can help in the process of accessing a variety of long-term growth sources, which can help investors diversify the risk inherent in specific economies or sectors and, hopefully, reduce the impact of less predictable outcomes like regulatory changes, fraud or natural disasters.

Investors can add other asset classes that offer some form of short-term insurance either because of explicit or intrinsic capital protection or from the nature of the asset classes, which results in them rallying when risk assets are falling. There is a cost associated with adding portfolio insurance in the form of other asset classes – this is predominantly an opportunity cost of forgoing future potential growth. It's important for investors to remember that they may negate the short-term insurance that they desire in an attempt to reduce this opportunity cost by trying to achieve too much yield in their bond allocation or by choosing assets, such as gold, which have historically only rallied as equities fell about 75% of the time.

SA corporates' offshore forays have destroyed over R300bn in value

Written By:

PETER ARMITAGE CA (SA)
CEO, Anchor Group

SA-based companies are having a horrific time in 2020, with the impacts of a struggling economy and COVID-19 taking their toll. However, for many of these businesses it started a long time ago as corporate SA went on a global diversification spending spree over the past decade with mainly very poor, and often disastrous, outcomes.

It is impossible to quantify exactly, but we estimate that corporate SA has destroyed over R300bn of value over the past decade through these offshore forays, with the biggest culprits being Sasol, Woolworths and Brait.

SA has been stuck in a low-growth rut for many years and the years under ex-President Jacob Zuma's presidency saw domestic corporates lose faith in the country and low demand growth did not justify new investment in capacity. Listed SA company management is regarded very highly in the global context and many of the management teams in question had delivered excellent results and returns at home. This combination of factors, together with the low cost of financing offshore, saw many local companies shift their strategies to offshore diversification and growth.

SA companies bought global businesses and, in some cases, started almost from scratch (e.g. Sasol, Investec, Discovery). So, why has the outcome been so different from the goal? We have identified, what we believe to be the major reasons for this:

- SA companies tend to pay too much in their desperation to diversify.
- SA companies often send their "B teams", who are less experienced than the winning team back home, to manage these offshore investments.
- Locals in these destination countries know more and that is the reason why there is a buying opportunity available. Surely if it was a great business, locals would have snapped it up?
- South Africans were romanced by low interest rates compared to what they were used to in SA. However, if a business does not make money, it does not matter what the cost of funding is!
- Local conditions and competitive environments are simply different.

BELOW, WE HIGHLIGHT A NUMBER OF JSE-LISTED COMPANIES THAT HAVE HAD DIFFICULT JOURNEYS IN THEIR INVESTMENT ENDEAVOURS ABROAD:

SASOL

Sasol spent US$13bn on its US Lake Charles Chemicals Project (LCCP), after an initial budget of roughly half of that amount. This disaster has seen Sasol's share price plummet and it is now desperately trying to sell off assets as its balance sheet has become unsustainable. We estimate that the Sasol share price would be over R400/share today if it had never entered the US. Instead, Sasol's share price is currently trading at around R135.

WOOLWORTHS

WOOLWORTHS

Woolworths invested over R20bn in Australian clothing retailer David Jones and, at the time, the business had not grown for years. The company believed it could wave a magic wand Down Under, but the Australian retail foray has been a disaster and David Jones could face bankruptcy. The SA Woolworths business has performed exceptionally, but Australia has weighed it down and Woolworths' share price has plummeted from over R100/share to the current c. R35/share.

BRAIT

Brait has been among the worst performers from a percentage-loss scenario. The acquisition of New Look in the UK turned out to be a failure and Brait's share price has declined from over R160/share to around R3 currently. Subsequent feedback was that Brait's due diligence of New Look prior to the acquisition was far from sufficient.

FAMOUS BRANDS

Famous Brands was one of SA's top business models, before it placed a huge bet on Gourmet Burger Kitchen in the UK. It spent over R2bn on the acquisition and it was worthless just over a year later, after spiralling into massive losses. Famous Brands peaked at over R160/share and is now trading at less than R40/share.

MEDICLINIC

Mediclinic's Spire investment has not performed, and it paid over the odds for its Swiss hospital business that has battled to grow. Soon after investing in Dubai, the government enacted new damaging legislation. These events have left Mediclinic overgeared and the share price is now under R60, after peaking at above R200/share.

TRUWORTHS

Truworths and The Foschini Group have battled with their respective UK acquisitions, with billions of rand in value being destroyed.

REBOSIS

Rebosis Property Fund invested over R1bn in New Frontier Property, a UK mall business. A few years later it sold its 49.4% stake for R700 (!) and this has contributed to Rebosis' debt-driven downward spiral.

INVESTEC

Investec invested and subsequently withdrew from Israel, the US and Australia. Its UK business is still sub-scale and generating poor returns but is showing positive signs. In the meantime, the SA and asset management business have thrived, but this has been overshadowed by offshore losses.

STANDARD BANK

Standard Bank moved aggressively into other EMs including Russia and South America and withdrew several years later, returning its focus to Africa.

DISCOVERY

Discovery invested over R1bn in an aggressive US expansion plan and subsequently withdrew and changed the model to the current Vitality partner model.

OLD MUTUAL

Old Mutual battled with its European strategy, lost tremendous shareholder value, and subsequently unbundled into an African and UK operation (Quilter). Sanlam, by comparison, largely stuck to Africa and has been a far better share.

STEINHOFF

We were not sure whether to include Steinhoff in this article, as it has its unique attributes in that its actions were fraudulent, on top of including many bad acquisitions. We have not included its R250bn-plus loss of value in our R300bn estimate above.

NIGERIA

We also include Nigeria here, where many SA companies (including Tiger Brands, Altron and Nampak) have entered and left with their respective tails between their legs. Cash has often been tied up in countries such as Angola as well.

In the interest of fairness, the author of this article presided over the Anchor Group's acquisition of a UK-based EM hedge fund, which subsequently closed. While not material in the context of the above, over R200mn of value was lost.

So, that is the sad story of SA disappointments offshore and there has been far more instances not documented above. To be fair, there have also been great success stories with the biggest of these being Naspers' investment in China's Tencent. The value creation here has been over R1trn (we note that the calculation is subjective due to the pesky 50% share price discount to NAV!), but SA investors are fortunate that this has overshadowed the collective losses from all of the other SA businesses. Other success stories include MTN, Sibanye, Mondi, Spar, NepiRockcastle, Bidvest/Bidcorp and Super Group.

There are great lessons to be learnt and many of the businesses above still have great SA franchises and cash-generative models. We are hopeful that SA can improve its attractiveness as an investment destination so that domestic companies can confidently deploy their capital locally at rates of return in-line with traditional returns. Even lower returns, that still beat the cost of capital, must surely in many instances be more attractive than the clearly massive risks in deploying capital offshore.

Fixed income:

Making a low interest rate environment work for you

Written By:

NOLAN WAPENAAR
Co-Chief Investment Officer

The South African Reserve Bank (SARB) has cut interest rates by 2.75% YTD and is signalling that it might consider further cuts of up to 0.50% as early as its next meeting that ends on 23 July 2020. This has provided some support to an economy that is in trouble, however, it has also had a devastating impact on those people who are reliant on income from their savings. In fact, if interest rates are indeed cut again in July, people who were earning R58,000/month on their 32-day call accounts in January will see that drop to R31,250/month in July. Faced with such a steep fall in income, investors and retirees have been reaching out to Anchor, asking what can be done to protect their income.

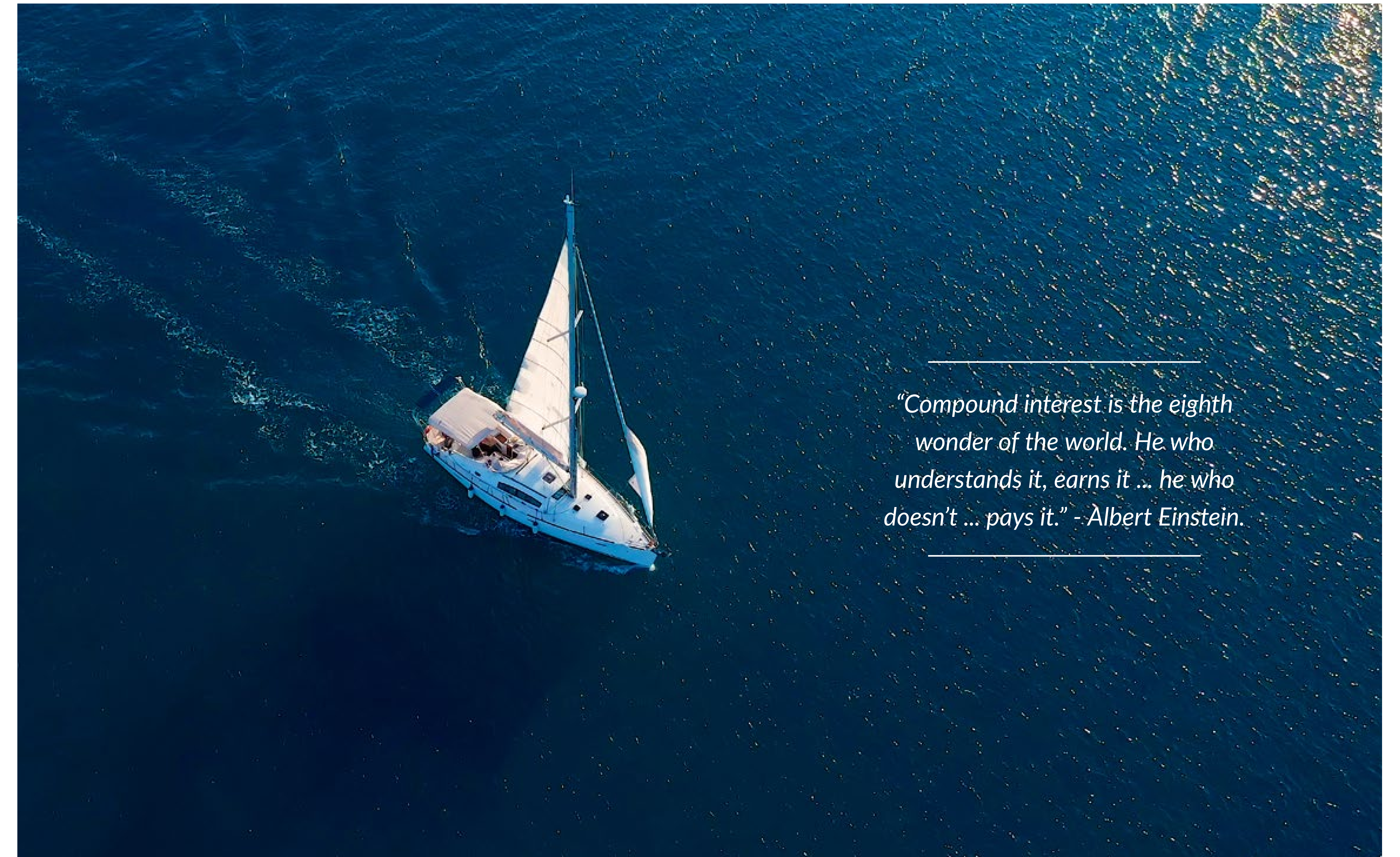
In this article, we look at the options available for investors to increase their yield based on the environment as at 30 June 2020.

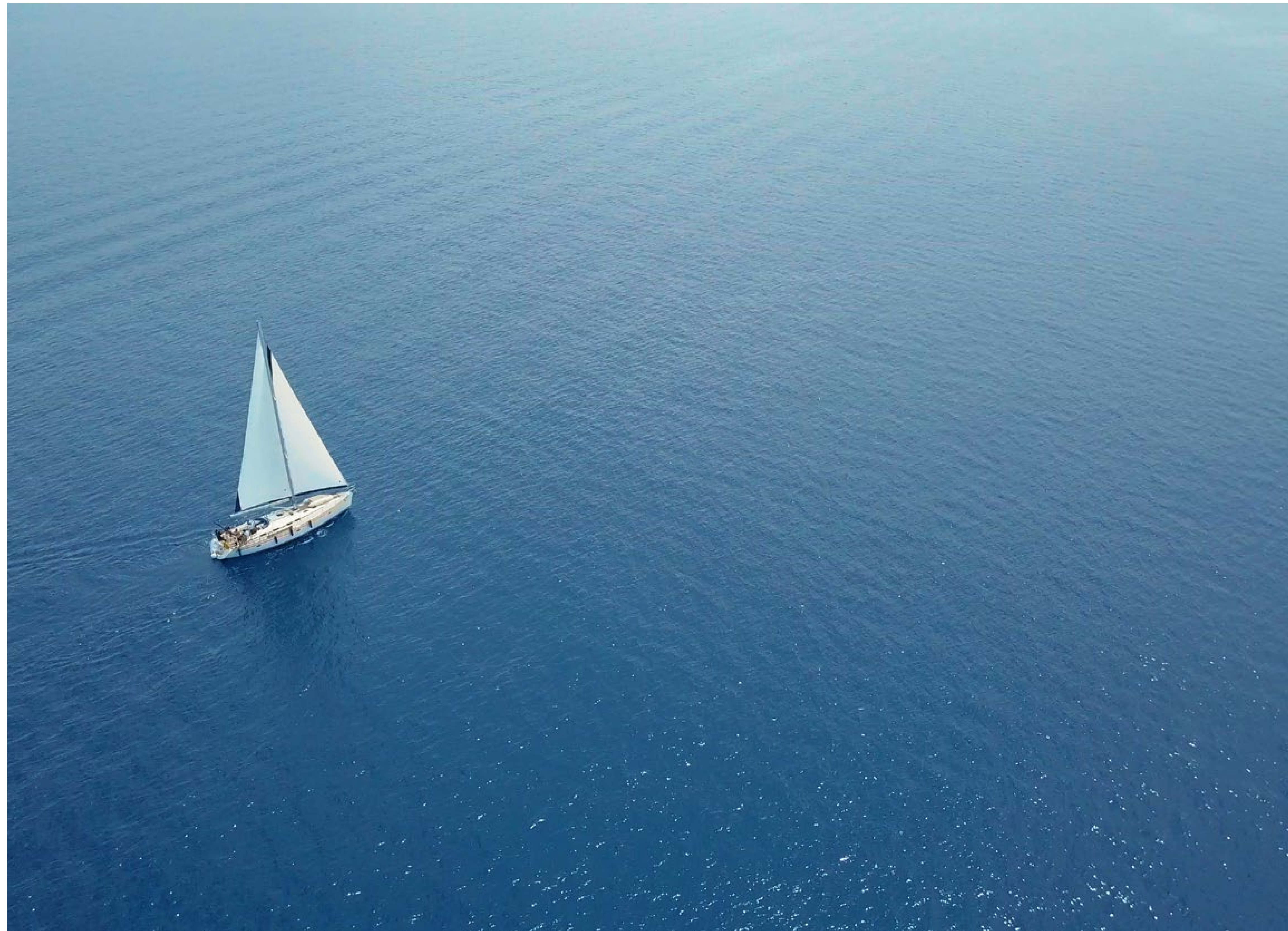
Obviously, the current environment will change should interest rates indeed be cut again and we urge investors to speak to one of our financial advisors before deciding on an investment option.

Below, we highlight the various fixed-income options available to SA investors and provide a comment on each. These options have been sequenced in ascending order of risk.

A 32-DAY NOTICE ACCOUNT

These are deposits at one of the major banks in SA. The value of the deposit is stable, and, over time, your money earns interest at about 4% p.a. An investor can access their cash by giving the bank 32 days' notice of a withdrawal.





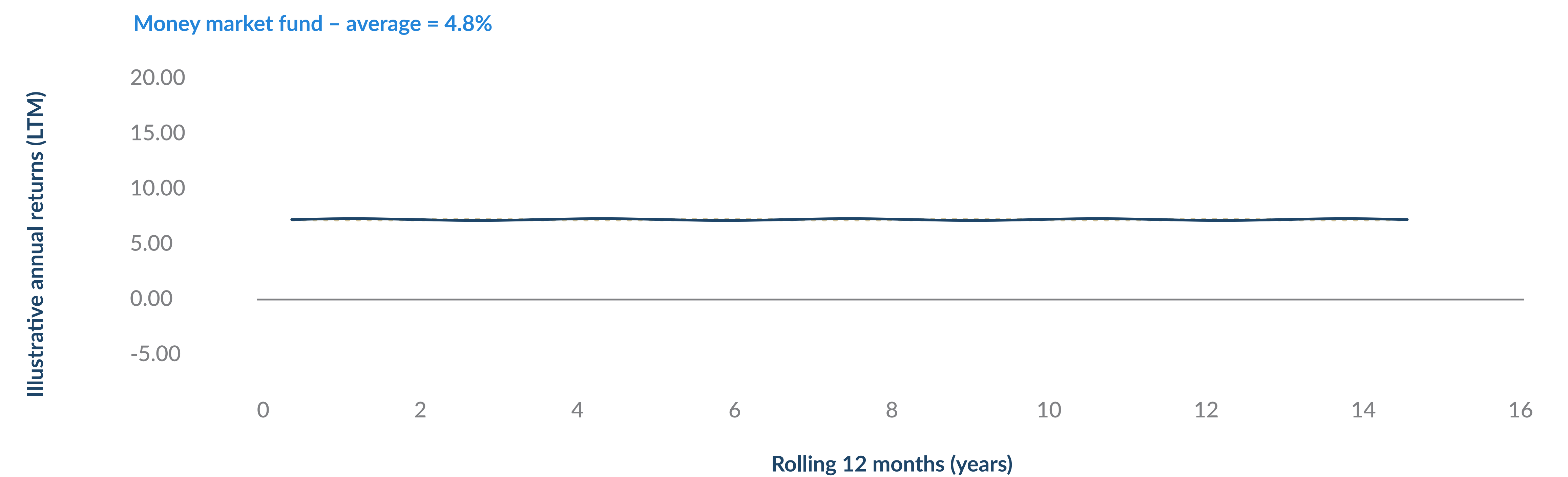
MONEY MARKET FUNDS

Instead of investing money with a bank for 32 days, an investor can invest in a money market fund. A money market fund has several different investors with withdrawals likely to be at different times, allowing it to lend money to SA's major banks and high-quality corporates for periods of up to one year. The average life of the portfolio is always less than six months and money market funds are tightly regulated in SA. These funds are designed so that the value of the investment remains constant over time, with interest income accruing upwards. For taking the extra term risk and blending in a few higher-quality corporate issuers in the portfolio, an investor should earn a yield of about 4.8% (net of fees) in the current environment.

Figure 1 below shows a hypothetical money market fund. The expected yield is about 4.8% (in the dotted line), while the actual yield closely follows this. The fund is ideal for those investors that are not prepared to take any risk with their capital values.

In theory, these portfolios should not report in any calendar month, where they experience a loss.

Figure 1: Theoretical money market fund performance
Source: Anchor



STABLE INCOME FUNDS

Stable income funds are also known as JIBAR plus or cash plus or core income portfolios. The portfolio works on a similar principle to a money market fund, except that it will lend money to the major banks and corporates for longer periods (usually up to three months), enables it to earn slightly more interest income. The loans that these funds make are in the form of bonds.

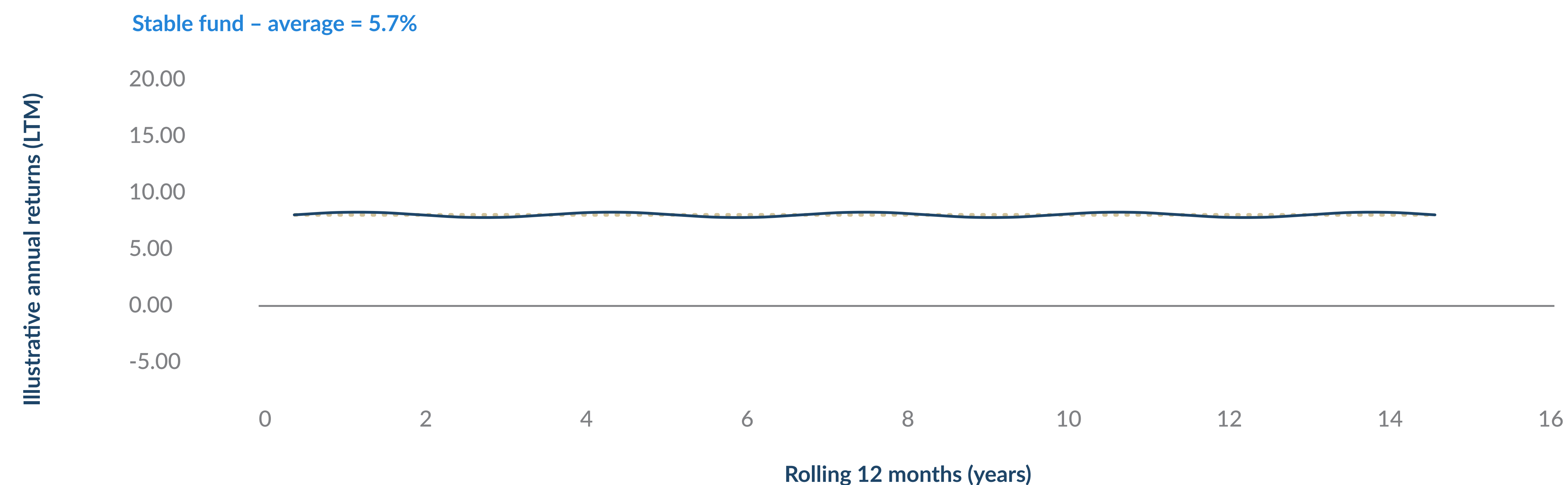
A bond is essentially a loan that is tradable on the bond exchange. In reality, bonds work in a similar way to equities and investors are able to buy or sell the bond over an exchange. Because the loans (bonds) now trade, there is a market price for them which means the value of a portfolio that holds loans can increase and decrease over time.

One of the most important factors that determine the size of possible price swings in the value of a bond is its time to maturity. These portfolios hold bonds that are all quite short-dated, usually with a remaining life of three years or less. As a result, the size of the price swings in these bonds is generally quite small. This means the portfolio will likely see its value remaining relatively stable although it is not dead constant. For taking this extra term risk, and the little bit of volatility in prices, the investor can earn a yield of about 5.7% currently.

However, we highlight that care should be taken in understanding the aggressiveness of the portfolio with regards to credit risk. We are of the view that these portfolios should not take significant risks, although we are aware of a few funds that are on the more aggressive side. The portfolio design of these funds is such that they should only report a monthly loss once every five years or so. These portfolios work well for those corporates that are looking for a low-risk investment for any excess cash that might be on the company's balance sheet.

In *Figure 2*, we show the expected return is 5.70% (the dotted line). There is a small and almost insignificant wave pattern to the returns over time (the solid blue line). There will be some months that are better than others, however, you would expect that over a period of three- to six months the returns will average out to be level with the dotted line.

Figure 2: Theoretical stable fund performance
Source: Anchor



FLEXIBLE INCOME FUNDS

By taking a stable fund and blending in some longer-dated bonds, maybe 5- to 7-year bonds, the portfolio can further increase its yield. As the remaining life of these bonds get longer, the amplitude of the wave pattern around the expected returns increases.

This portfolio will also blend in some listed property (very little at this stage), as well as US dollar exposure and exposure to global bonds. Bringing in different asset classes creates a diversification effect in the portfolio, enabling an investor to earn a slightly higher yield for a given risk appetite. This means that we can target a return for the investor of 6.4% p.a., over time.

Figure 3 shows that stepping up from a stable fund to a flexible income fund again increases the amplitude of the peaks and troughs of the waves. The dotted line is still the expected return over time; however, monthly returns can be quite different. Over a period of 12- to 24- months, you would expect that the monthly returns will average each other out to an anticipated return of 6.4%.

We have found that the flexible income fund reports a monthly loss about once every two years. As a result, this has been the portfolio of choice for those private investors who find that the yield pick-up is quite attractive and who can tolerate a negative outcome once every two years. We note that bonds are mean reverting, which denotes that the biennial loss is usually recovered in the few months that follow the loss.

BOND FUNDS

Bonds in the flexible income fund are usually limited to about 5 to 7 years from maturity. We can choose to lend money to the government for even longer periods of up to 30 years. This will significantly increase the portfolio's yield, but it also increases the amplitude of the waves quite a bit.

These funds are generally focused on bonds only, so there are no other asset classes included in the portfolios.

In *Figure 4* the dotted line has an expected return of 9.4% for the investor. The returns in the solid blue line, however, are quite volatile and the portfolio could report a loss once every three months. On average, if you hold the portfolio for 3 to 5 years, you can expect the monthly oscillations to cancel each other out and the average return to be around 9.4%. This has been a handy investment option for investors who have a higher risk appetite but might not want domestic equities and can also afford to tie up capital for longer periods of time.

We can choose to lend money to the government for even longer periods of up to 30 years. This will significantly increase the portfolio's yield, but it also increases the amplitude of the waves quite a bit.

Figure 3: Theoretical flexible fund performance
Source: Anchor

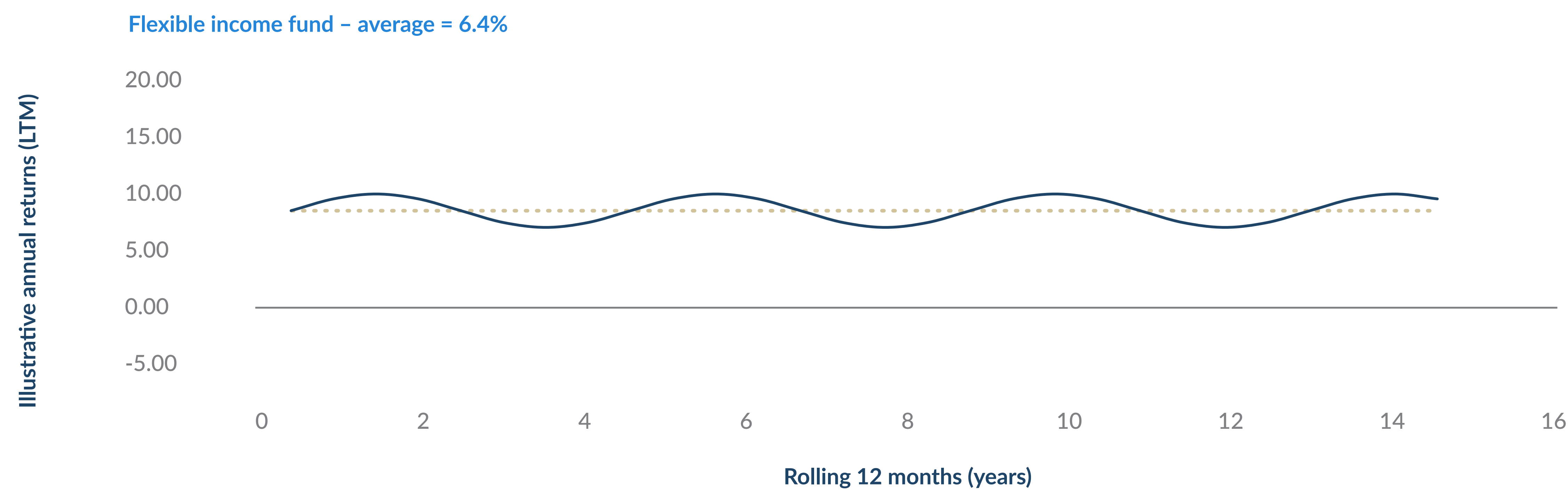
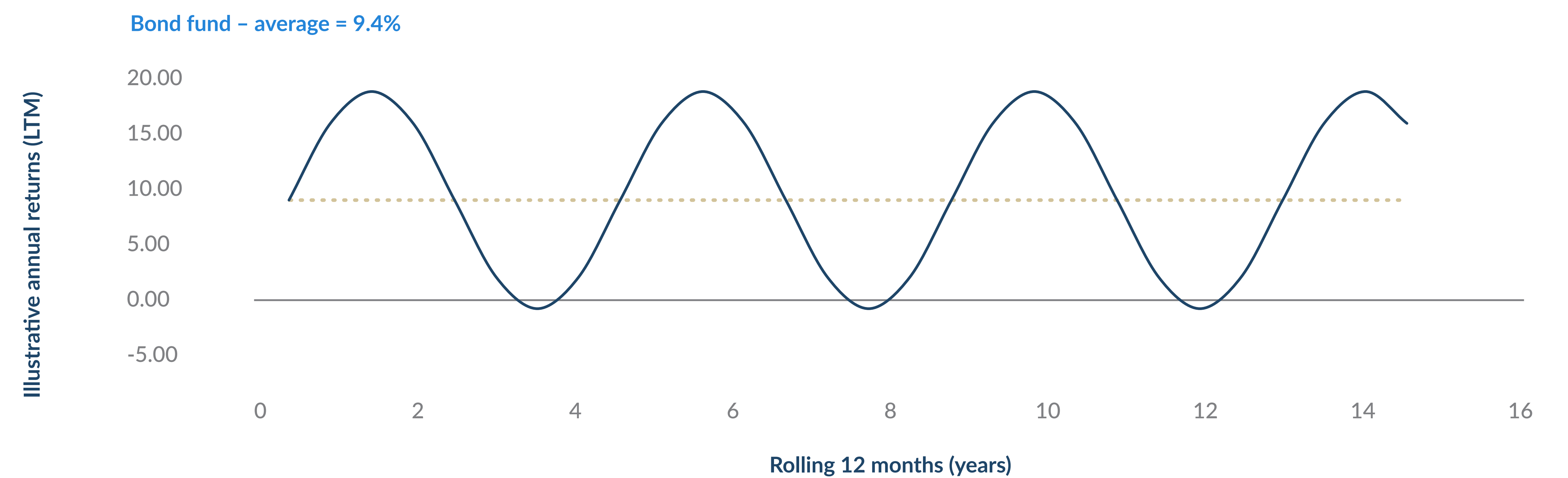


Figure 4: Theoretical Performance of bond funds
Source: Anchor



CONCLUSION

The recent SARB interest rate cuts have made earning interest income more difficult and many investors have been pushed into taking slightly more risk with their fixed income investments to maintain their earnings. We are in a position to assist you, however, the art in fixed income investing is about ensuring that each investor is taking an appropriate amount of risk with their fixed income investments depending on their own unique circumstances. We would suggest that you speak to one of our advisors to assist you in getting the most out of your income investments.

Will the tech rally continue?

Written By:

HENRY BIDDLECOMBE
Fund Management

It is a question that our clients ask us all the time. The tech rally has indisputably defined capital markets over the past decade, with all the COVID-19 drama in the last few months only serving to accelerate the economic paradigm shift where the new ways are replacing the old.

As we progressed into a global lockdown, everyone in the world was forced to become a digital native in a matter of weeks. We all have Luddite friends/co-workers who are suddenly highly proficient with Zoom, Teams, and cloud file sharing! It was an awkward transition that they had avoided for years, but 2020 would be the annum that would force them on a learning curve.

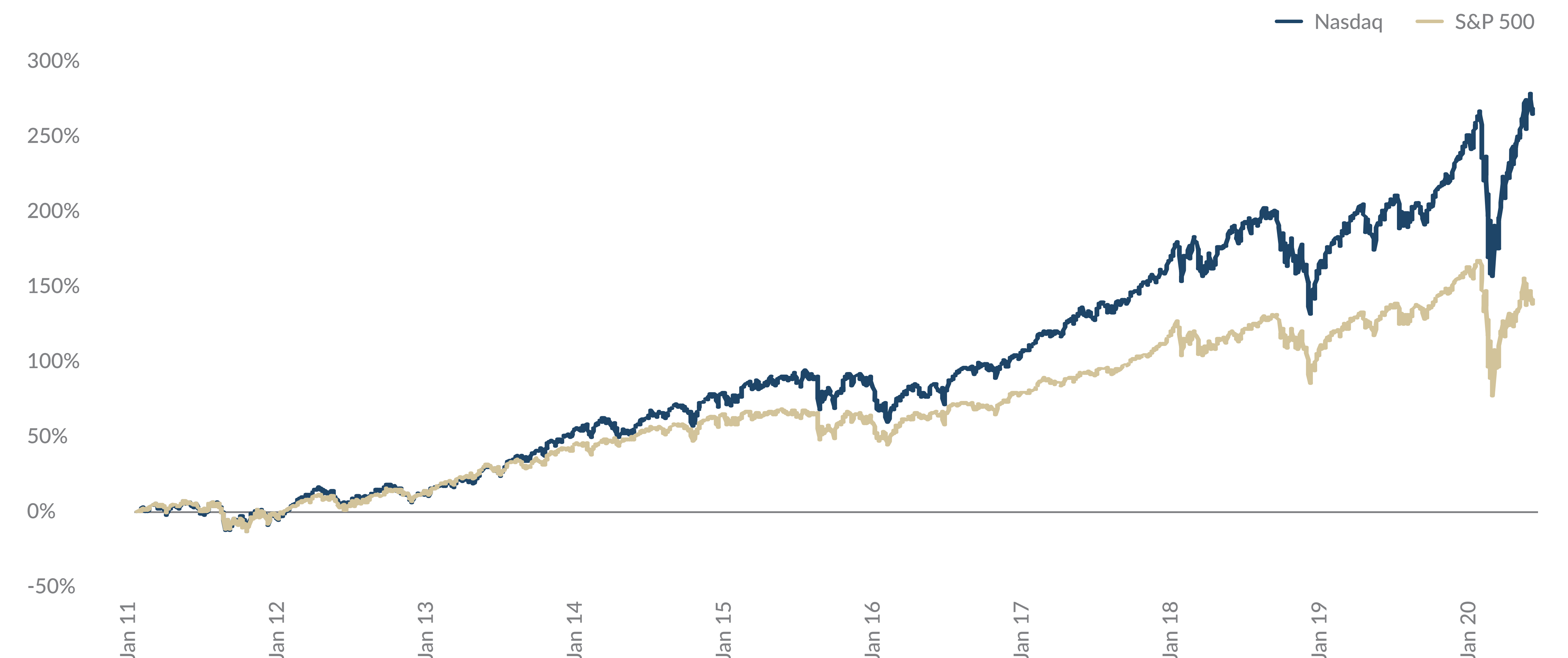
Investors now find themselves in the same dilemma! Often battle-scarred from the dotcom bubble of 2000, the IPO and subsequent rally of many tech firms over the past 10 years have left many believing that it is too late to rebalance their portfolios accordingly. This is an uncomfortable position of course, as it is squarely at odds with the way one is experiencing the change on a practical level in everyday life.

We would like to share our view on the matter.

VERY SIMPLY, EXPECT MORE OF THE SAME

A portfolio skewed toward the broader tech space has outperformed by a notable margin. A good, practical example of this is the relative outperformance of the Nasdaq (a tech-heavy index) vs the S&P 500 since 2011. The cumulative result is staggering, with the Nasdaq having returned 267% vs the S&P 500's 140% return over that period.

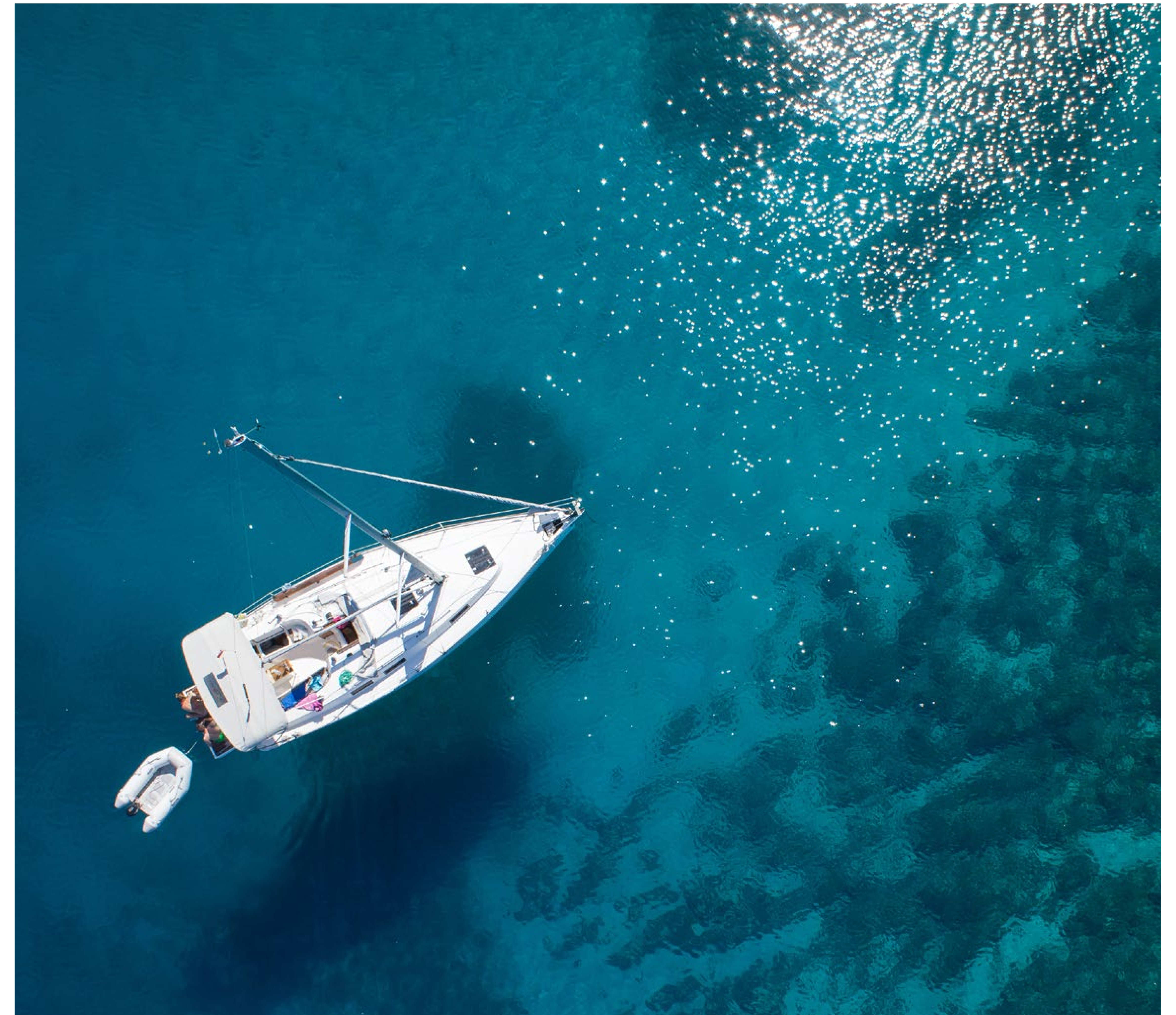
Figure 1: Nasdaq vs S&P 500 returns (1 January 2011 to date)
Source: Bloomberg, Anchor



Another glaringly obvious example is the constitution of the five-largest companies by market capitalisation, and how this list has changed over the years.

At the turn of the millennium, the top spots were dominated by big oil and finance. Fast forward to today, and the top-5 spots are the exclusive realm of the tech juggernauts. Naturally, your portfolio's *relative* performance would have been defined by your positioning into this theme.

Figure 2: The five-largest companies by market cap, 2004 vs 2020
Source: Visual Capitalist (market cap data in 2Q of each year), 2020 data are for 1 May 2020.



Importantly, this outperformance is attributable to factors that remain in force today - and will continue to drive the relative outperformance of the sector. Let us discuss some of the most significant ones.

INVESTMENT IN GROWTH

One of the best leading indicators of growth, is investment. This makes intuitive sense. The companies that will benefit from the future, are those companies that are spending the money to create that future – and nobody is spending more than tech.

Far from the cash-burning cautionary tales of the dotcom bubble, the tech sector today is characterised by oligopolistic titans which generate billions of dollars in free cash flow. This has allowed these same firms to spend unprecedented sums on research and development (R&D).

Amazon currently spends around $37bn on R&D annually – more than the individual revenues of 425 of the companies in the S&P 500. The five-largest tech firms in the US, collectively, have spent around $1trn on R&D over the past decade. On an annualised basis, that is around one-third of SA GDP.

Figure 3: R&D and capital expenditure by the five-largest tech firms
Source: Bloomberg, Anchor

R&D + capex ($bn)	Alphabet	amazon	Microsoft	facebook	Apple	TOTAL
2010	7.8	2.7	10.7	0.4	3.8	**25.4**
2011	8.6	4.7	11.4	1	6.7	**32.4**
2012	9.4	8.4	12.1	2.6	11.7	**44.2**
2013	14.5	10	14.7	2.8	12.7	**54.7**
2014	20.8	14.2	16.9	4.5	15.6	**72**
2015	22.2	17.1	17.9	7.3	19.3	**83.8**
2016	23.9	22.8	20.3	10.4	22.7	**100.1**
2017	29.8	32.7	21.1	14.5	24.1	**122.2**
2018	46.5	40.1	26.3	24.2	27.5	**164.6**
2019	49.5	48.6	30.8	28.7	26.7	**184.3**
	233	**201.3**	**182.2**	**96.4**	**170.8**	**883.7**

These five companies also earn an average return on invested capital (ROIC) of 20.5%. This means that for every $1 spent on R&D, USc20 in shareholder value is created every year. From an investor's perspective, this high rate of reinvestment and the high return on investment are an extremely attractive combination – as this is ultimately the formula that will cause shares to compound in value over the years in a way that no other asset class can.

Given the tech sector's capacity and propensity to reinvest at a high return, it stands to reason that this sector should continue to deliver market-beating returns over time.

From an investor's perspective, this high rate of reinvestment and the high return on investment are an extremely attractive combination

Having said this, one cannot ignore absolute size. The five companies mentioned above constitute 20% of the S&P 500 today. How much bigger can they, and the rest of the sector, really get from here?

SCALE BEGETS MORE SCALE

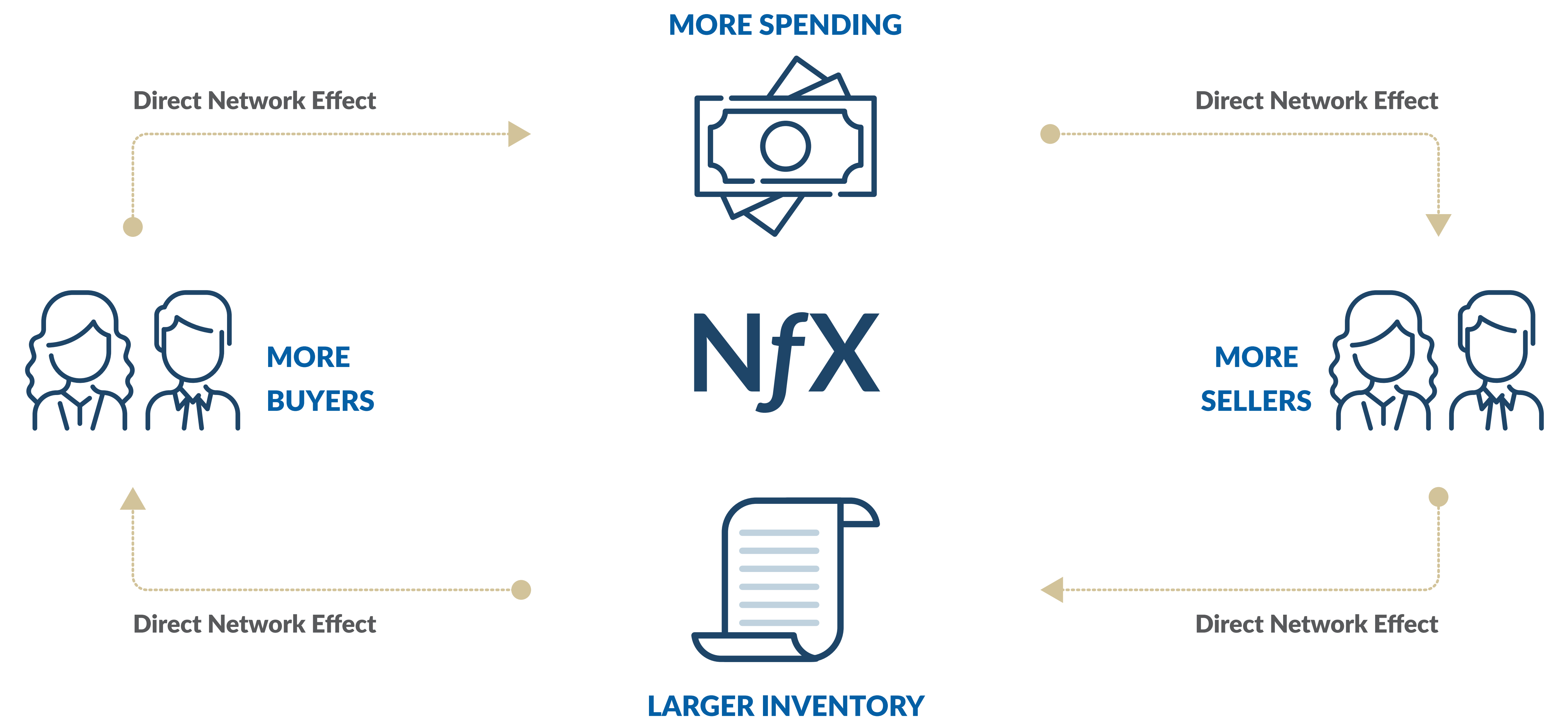
Technology firms benefit from a unique economic dynamic called network effects. Unlike conventional companies, tech firms become more efficient as they grow larger.

Facebook, Amazon, Spotify, PayPal, and Alibaba are a few high-profile examples of how these network effects play out.

As the number of users on the platform increase, so the platform becomes more valuable to suppliers/advertisers/content creators that use it to vend their products. Similarly, as the platform grows its offering of products/services/content, so they become more valuable to their users.

Over time, this allows these platform businesses to earn more dollars per user – and to negotiate more profitable deals with their suppliers.

Figure 4: Network effects of technology firms
Source: Nfx



Financially speaking, this means that these large tech firms will likely earn a higher return on each incremental unit of capital they reinvest into growth. From an investor's perspective, profit growth will likely accelerate as the firms becomes larger – and the value of the businesses will follow suit.

Take for example PayPal, a business that has been in existence since 1998. It took 17 years for the company to go public with an initial public offering (IPO) valued at $40bn, but just six years later this same firm now has a market capitalisation of $207bn. More astonishingly, around 50% of this value has been realised only in the past 12 months.

The point to make here is that the absolute size of the tech giants, and the tech sector itself, do not point to an approaching zenith. Instead, it points to a continuation of a secular trend that is now more powerful than ever.

RELENTLESS INNOVATION

The most important factor, beyond the investment theory, is the capacity to innovate. The tech sector, more so than any other, has an almost singular focus on innovation.

Alphabet spent around 15% of its $35bn in annual operating income on what it describes as moonshots – new ideas that stop at nothing short of changing the world.

Jeff Bezos' infamous aphorism, "Your margin is my opportunity", has come to define Amazon's approach to capital allocation – where profitable segments of the business are used to fund the development of entirely new revenue opportunities (think Amazon Web Services [AWS], or Amazon Prime Video).

The resultant value creation for shareholders, while typically non-linear, can also be explosive. Amazon shareholders who remember when AWS' revenue was first disclosed, or more recently Disney shareholders who can recall the company's recent announcement of its Disney+ streaming service, will understand.

Looking to the future, the landscape is, in our view, as promising as it has ever been. There has never been more breadth of opportunity for investors in public equity markets to invest behind world-changing trends than now.

The most important factor, beyond the investment theory, is the capacity to innovate. The tech sector, more so than any other, has an almost singular focus on innovation.

Facebook is set to put a major dent in global ecommerce with the launch of its partnership with Shopify. Predominantly an advertising platform until now, Facebook Shops leverages the human psyche by giving users the option to make purchases at the exact moment when their propensity to spend is the highest (i.e. when immersed in photos of their favourite activity or holiday).

Spotify is busy usurping the entire record label industry, which today still commands around ZAc60 of every dollar of revenue generated by music sales and streaming. This straightforward process of disintermediation could easily double the revenue of the business.

Chegg, an online tertiary education services platform, has over 3.5mn subscribers currently and aims to disrupt the overpriced, outdated US college system with a suite of affordable online courses that take six months to complete and payment only becomes due once their students are employed.

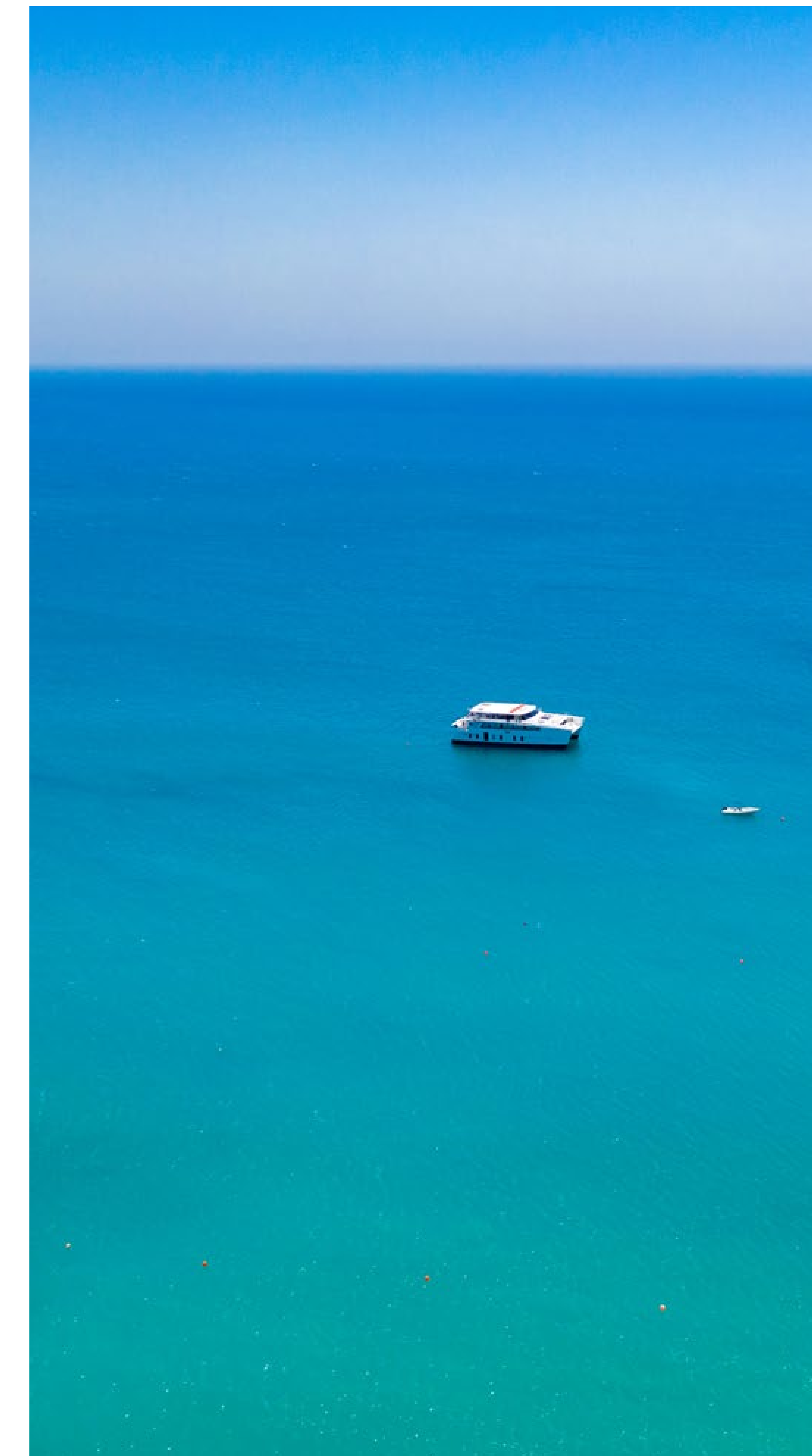
These are three examples of some of the companies we own that stand to create material value for shareholders through innovation over the coming years.

MAKE THE ALLOCATION, AND STAY THE COURSE

As custodians of your wealth, it is necessarily our job to predict future investment trends. While it is notoriously difficult to identify the portions of the market that will outperform in the short term, the potential for the technology sector to continue delivering market-beating returns over the next decade is clear.

There is no one single formula for everyone, but our advice to you is to make an allocation to a tech strategy that is meaningful in the context of your overall equity exposure – and to stay the course. Tech shares, particularly the earlier stage businesses, can be volatile and often the value creation is only realised in later years – but the long-term impact on your portfolio's performance will likely be material.

The Anchor BCI Global Technology Fund is worthy of your consideration. Managed by a dedicated investment team headed up by former Naspers corporate finance executive David Gibb, the fund has just completed its first full year to the end of June 2020 – having returned 49%, as compared to the S&P 500's return at 26% and the MSCI World's 21% return. If you would like to find out more about the fund, please contact your financial advisor or email *sales@anchorcapital.co.za*.



COVID-19 lockdowns:
How has the SA consumer reacted?

Written By:

STEPHÁN ENGELBRECHT
Fund Manager

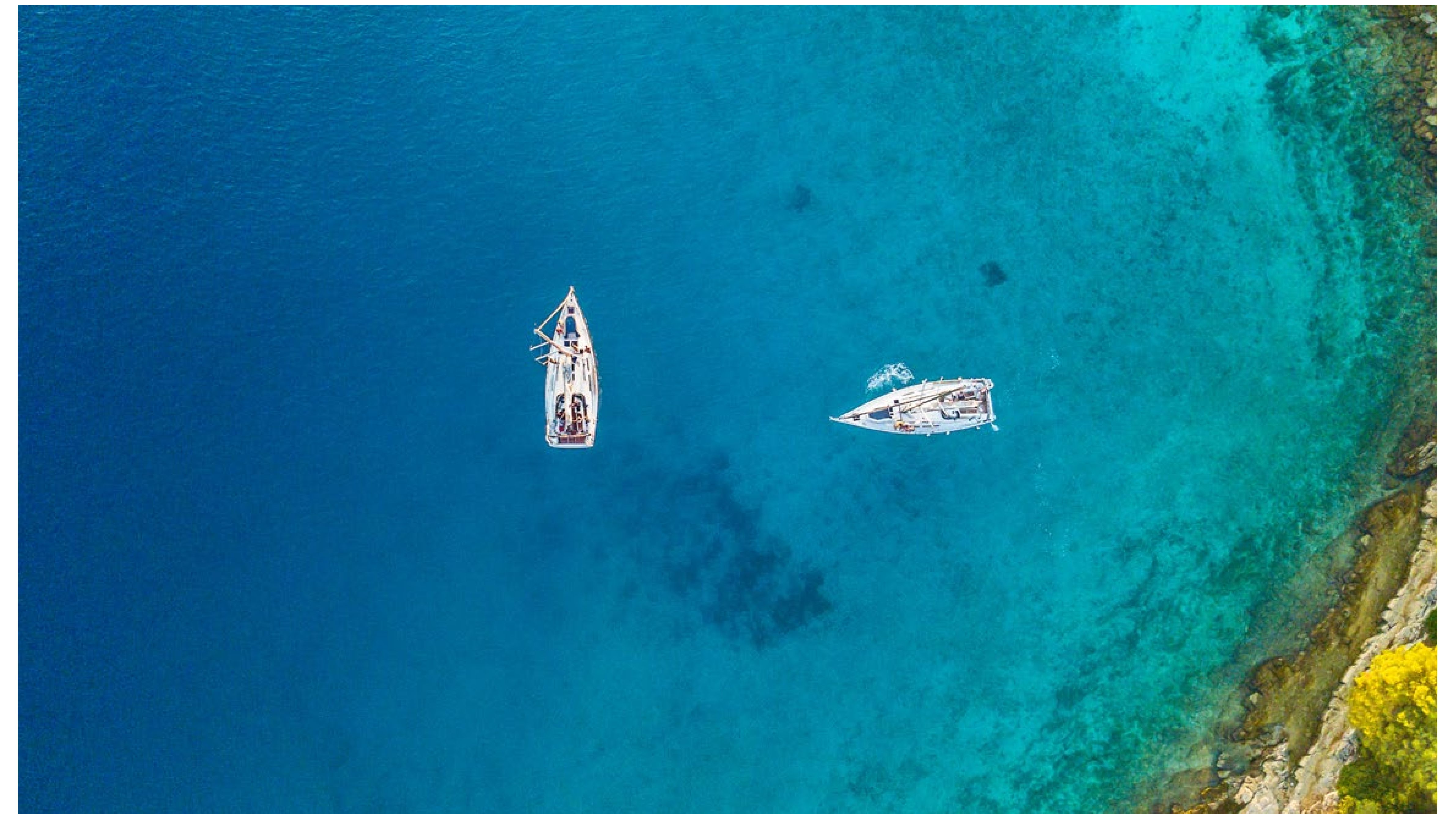
It is a daunting task to write about the COVID-19 pandemic. According to the *Financial Times*, as at 4 June 2020 some 23,000 academic papers have been produced on the subject, of which 18,300 were published by academic journals and 4,700 were on preprint servers (these are online archives with scholarly papers that have not been peer reviewed). And that is just in the academic community! If we look at the wider sample of financial journalism, we are inundated by COVID-19 information. It is thus difficult to add value on this topic.

In this article, we take a slightly different approach by looking at how we, the consumer, have reacted to COVID-19 and the subsequent economic lockdowns that various governments have enforced thus far. We will draw from our interactions with various industry experts and company management teams in an attempt to identify interesting behavioural changes with a specific focus on changes in shopping patterns and general consumer behaviour.

According to behavioural science research (Richard Shotton's *The Choice Factory: 25 behavioural biases that influence what we buy*), major life events disrupt historical behaviour, with an individual up to 75% more likely to try something new (such as a new brand) following such an event and 21% of consumers expected to stick to that new brand or behaviour. What is significant about this specific event is that it is worldwide – the global population as a whole has in some way been impacted by the pandemic. New behaviours will emerge, which will have significant implications for your investment portfolio.

THE LOCKDOWNS

The COVID-19 pandemic caused governments across the world to take the extraordinary step of locking down their economies and restricting the movements of their citizens. The durations of the various lockdown measures differed by country, but the impact was very similar across the board – people were stranded in their homes for an extended period of time, only going out for emergencies. Governments have slowly started lifting restrictions, but people are still encouraged or forced to enact social distancing and to focus on improving their general hygiene. Needless to say, this pandemic has forced people to change their habits, to experience new technologies and, potentially, to develop new habits.



HOW DID CONSUMERS BUY?

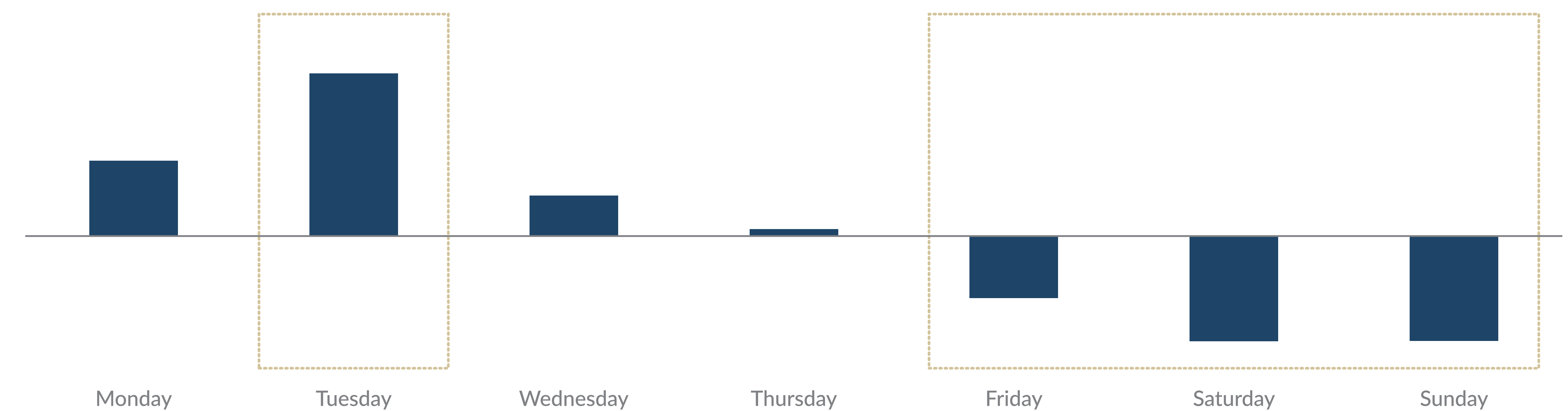
A key trend that emerged during the various lockdown stages locally is the adoption of online shopping in SA. Before the lockdowns were enforced, SA consumers seemed to have reservations about online shopping, with many questioning the reliability of delivery or ease of returning items. However, trapped in their homes and/or reluctant to leave their homes due to safety concerns, local consumers were forced to try out this “new” technology. While increased online sales were a global phenomenon, with e-tailing giants such as Amazon reporting very robust sales numbers, compared with the rest of the world, SA has in the past been slow to take-up online shopping. But SA now also recorded a surge in online retailing, with Mr Price reporting a 90.1% increase in online sales since the initial hard lockdown started on 27 March. We also found it interesting that, according to Mr Price, the basket size of the average Mr Price online shopper is 50% larger than the basket size of the average shopper in a physical Mr Price store.

Which brings us to another trend; over the past few years many local retailers reported consumers increasing the frequency of their store visits but buying smaller basket sizes. This trend reversed significantly during the lockdown. With people feeling uncomfortable going to shopping malls and wearing masks this is probably a natural reaction. Spar, for example, reported that the basket size of its customers doubled across all formats, while Pick ’n Pay highlighted that its average customer shopping bill was 30% higher than before the lockdown. It will be very interesting to see whether this will reverse again once the pandemic subsides.

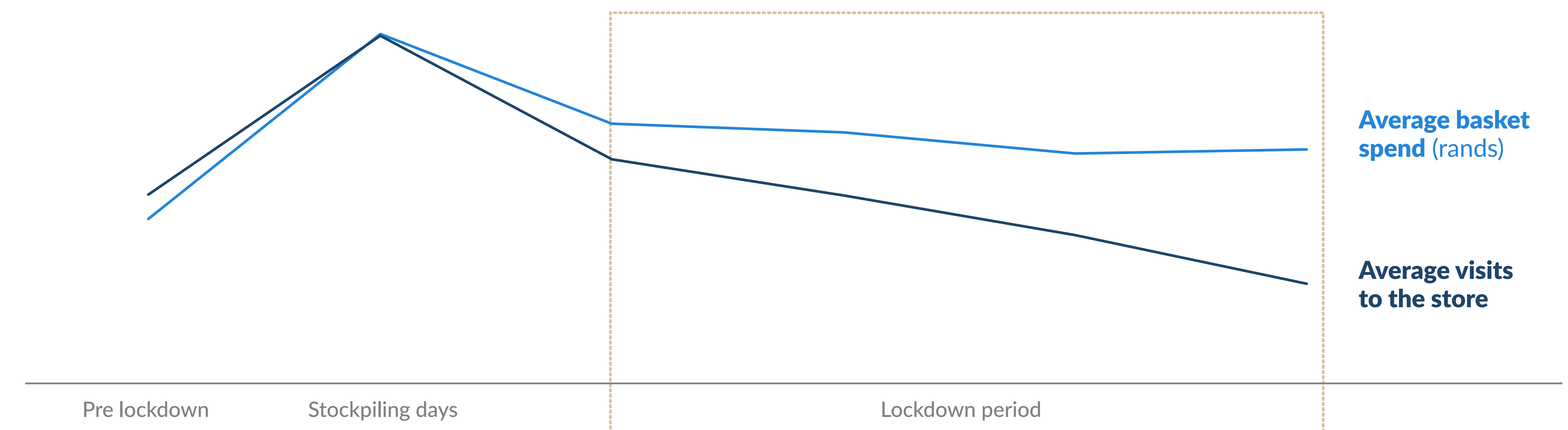
According to Pick ’n Pay, its data shows that during the lockdown South Africans preferred going to a store on a Tuesday. This is probably another proof of Dr John Forbes Nash Jr’s game theory, so well-illustrated in the movie *A Beautiful Mind*. With everybody second guessing one another on when nobody will likely go to the grocery store, everyone ended up going at the same inconvenient time. We, humans, are so predictable.

Figure 1: Customer behaviour shifted during the lockdown
Source: Pick ’n Pay

During lockdown, customers are spending more on Tuesdays and less over the weekend



Shoppers are visiting stores less often. but buying more per visit



During the lockdowns, convenience is also very important to consumers. The prospect of traversing potentially crowded areas, such as large shopping centres, is a real deterrent to many. According to consultancy firm, *Consumer Rock* and market research company, *Ask'd*, Spar and Boxer stores outperformed significantly during April's hard lockdown. They attribute this to several factors including good value from Boxer and quality fresh products from Spar. However, the one factor both have in common is that their stores are conveniently located near taxi ranks or in the suburbs. This trend was further reinforced by Mr Price, which noted that its micro-, small- and medium-stores as well as its standalone Kids stores, experienced significant growth, while its super regional centre stores lagged.

WHAT DID CONSUMERS BUY?

We found it very interesting to hear from companies around the world how people adjusted to homebound living. Trends differed slightly by country, as the severity and duration of the lockdowns varied but, in general, consumers worldwide reacted in a very similar manner. Fearmongering and uncertainty around when stores would reopen caused a mad rush to stockpile as SA moved closer to the initiation of the lockdowns. Essentials, toilet paper and alcohol were high on the priority lists as consumers braced for uncertain times ahead.

Figure 2: Retail/wholesale performance by SA supermarket chain
Source: Consumer Rock

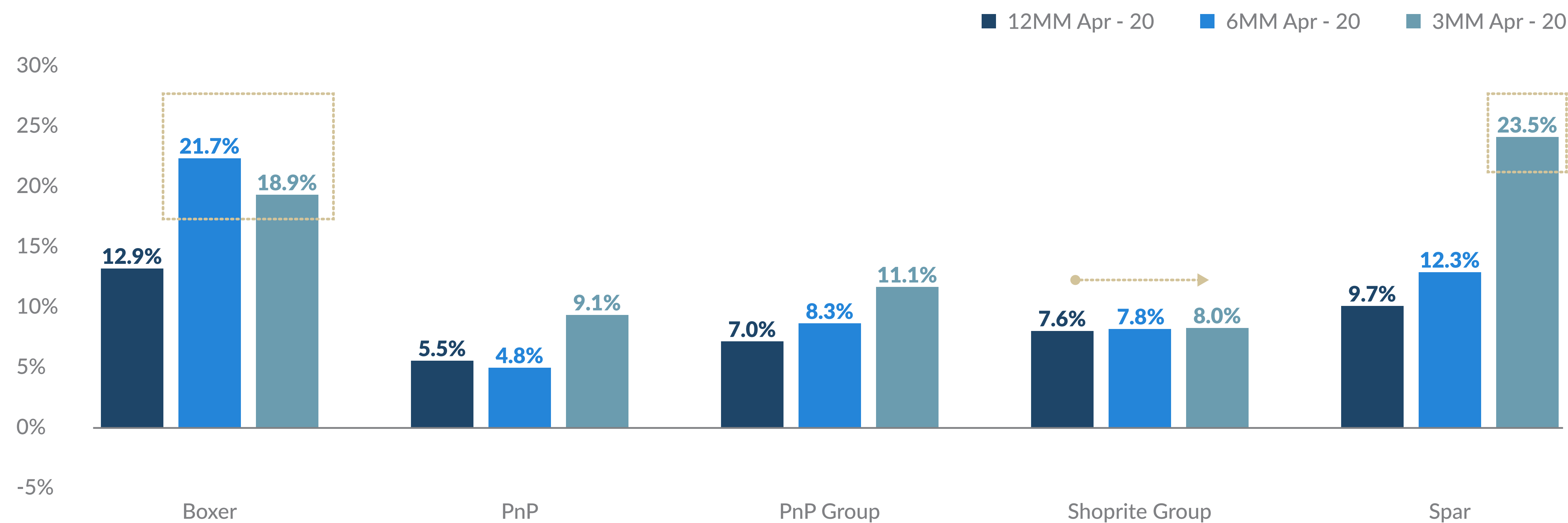
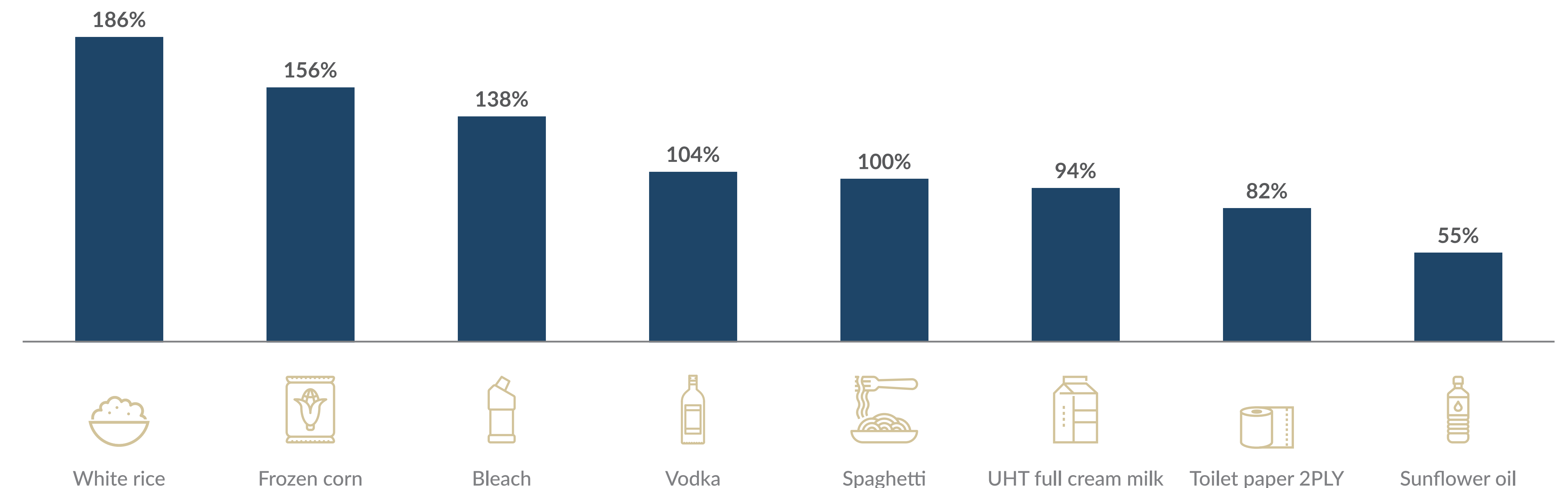


Figure 3: SA consumers stockpiled on groceries, household items and alcohol leading into lockdown, by sales volume growth
Source: Pick 'n Pay



However, after that initial surge, consumers shifted their priorities to comfort, entertainment and staying busy. In SA, entertaining and educating children in the home was the top priority. Pick 'n Pay reported that its stores experienced a surge in demand for paint, brushes and playdough. The onerous lockdown regulations locally meant that it was difficult to assess trends here during that period, but in other countries some very interesting trends emerged.

Consumers shifted their priorities to comfort, entertainment and staying busy. In SA, entertaining and educating children in the home was the top priority.

The social nature of humans was difficult to suppress. With pubs and bars closed, cocktail hour had to take place at home. British supermarket group, Waitrose & Partners reported that in the UK, a quarter of those who consume alcohol drank more during the lockdown, and one-fifth took part in virtual drinking with friends - apparently, it was all about the "quarantini", which was trending on Instagram. As people seek to create their own bar experience, cocktail glasses, shakers, and other drink accessories sold fast. Amara, an online retailer in the UK which specialises in luxury interior goods, reported that its barware sales from January to May increased by 3,430% YoY.

Home decor, storage and DIY also featured prominently as people were confined to their homes. Indoor plants had already experienced an increase in demand due to another Instagram trend, but it really kicked into high gear during the lockdown. Amara reported that sales of its indoor planters jumped 79% YoY from January to May. Candles and home fragrances were also very popular as people tried to relax and create a sanctuary at home. Amara recorded a 127% YoY increase in scented candles, while John Lewis posted a 43% YoY increase in the sale of candleholders.

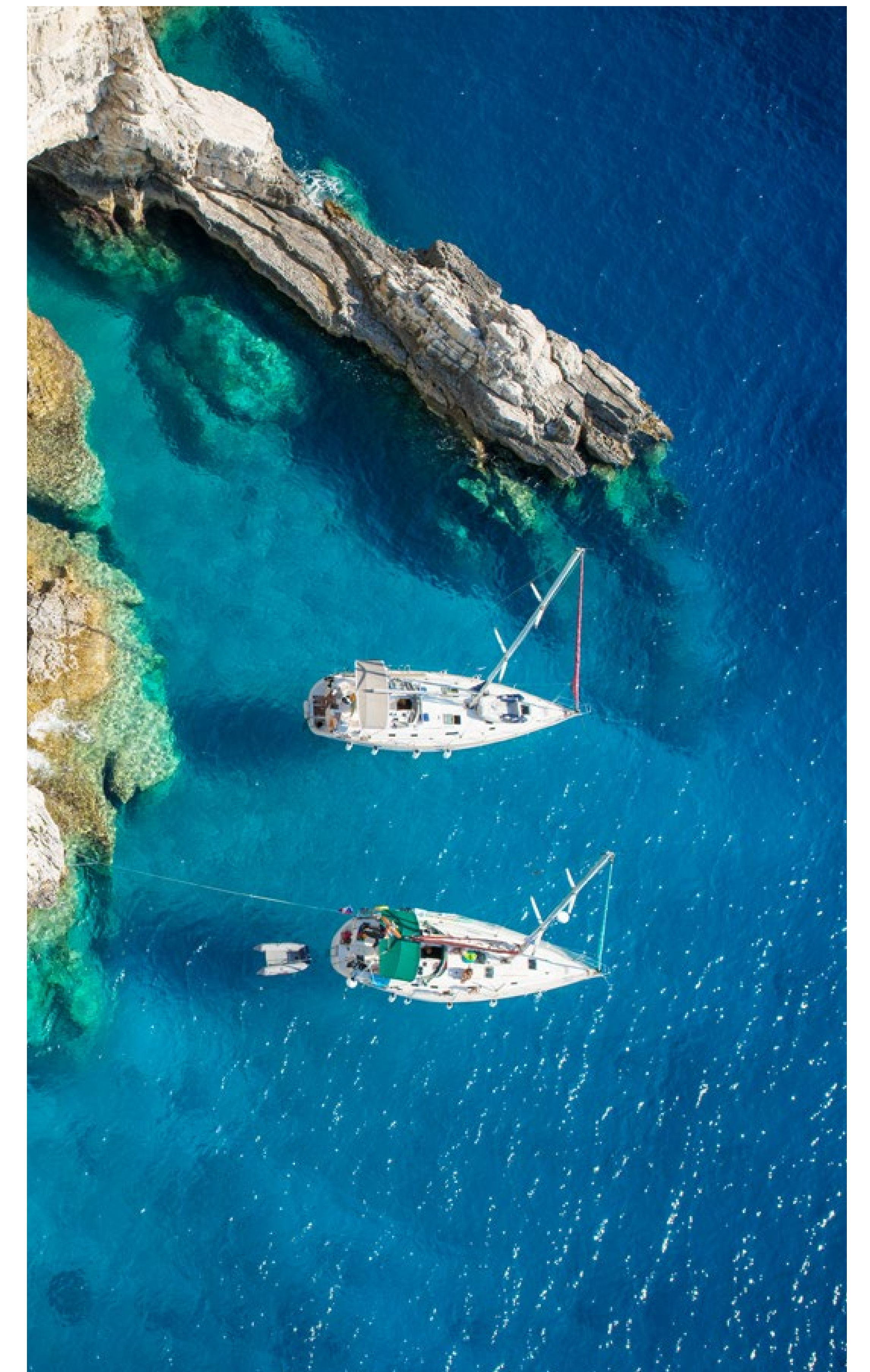
Spending a significant amount of time at home, with some extra time to boot, saw people attempt to restore order to their lives with many investing in home storage. John Lewis recorded an increase of 74% YoY in home storage sales. Home improvement was also a key winner as people fixated on every nook and cranny of their homes. Recently, US paint supplier, Sherwin Williams said that its consumer-brands division will see earnings well above its original guidance and US home improvement and building product supplier, Masco, halved its 2Q20 YoY sales decline forecasts due to better-than-expected revenue trends.

Entertainment was key to staying sane during lockdown. Streaming giant, Netflix announced that it had to reduce the quality of its streaming service in Europe and Africa to be able to service the high demand for its product as new subscribers surged. On the home front, MultiChoice recorded subscriber growth thanks to the lockdown. Gaming also benefited from the lockdown with Google reporting growth of twenty times in search interest for "online games to play with friends" between February and March 2020.

Since the lifting of the hard lockdown in SA, we have seen some interesting habits develop which may remain a feature for some time. A focus on health and wellness as well as home cooking has become prominent. Food retailers have reported a surge in demand for healthy foods such as avocado, citrus, and fresh produce in general. Spar's Natural product range recorded a c. 55% growth rate over the past few months. General hygiene and preventative products including wipes, hand soaps, sanitisers and vitamins remain in high demand, while many consumers also turned to traditional remedies to safeguard against diseases including ginger, garlic, and lemons.

A focus on health and wellness as well as home cooking has become prominent. Food retailers have reported a surge in demand for healthy foods such as avocado, citrus, and fresh produce in general.

At the other end of the spectrum we also saw some interesting shifts. The wearing of facemasks is having a negative impact on the cosmetics market, with sales of make-up under pressure. The Foschini Group reported, as can be expected, that its workwear and occasion wear categories are struggling in all the jurisdictions in which it operates. Big-ticket, highly discretionary purchases have also been severely impacted. Vehicle sales numbers across the globe continue to show very poor demand.

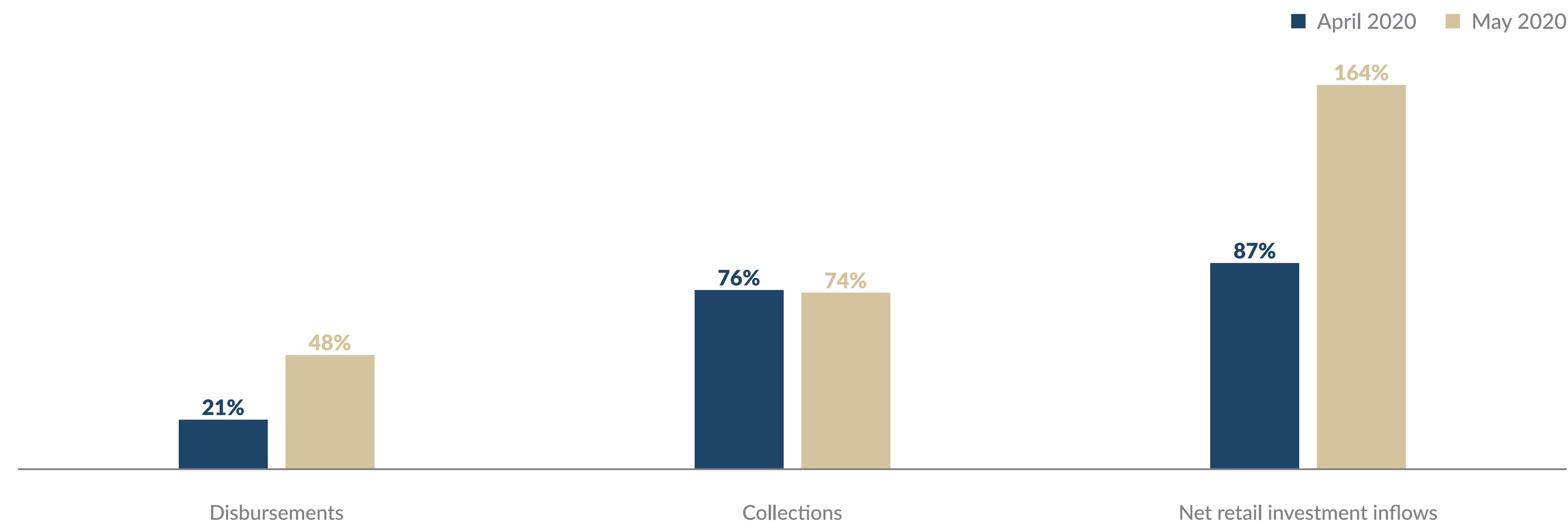


HOW ARE CONSUMERS FEELING ABOUT SPENDING?

The global lockdown measures have had serious financial implications for businesses and consumers. Although governments and central banks have tried to minimise the impact as much as possible, with fiscal stimulus and extremely low interest rates, consumers and businesses are still very weary of an uncertain future. Many companies have announced drastic cuts in expenditure with salaries being cut, people being retrenched, and new projects being put on hold or cancelled.

In this environment, consumers are feeling extremely vulnerable. Many are reluctant to take on unnecessary new debt and they are saving as much as they can while they can. In African Bank's results presentation, the firm highlighted this trend indicating that the bank's loan disbursements have been less than 50% relative to the average before the lockdown, while retail investment inflows were much higher than before. Mr Price reported that consumers preferred to pay for new purchases with cash rather than credit, with cash sales growing by 16.7% and credit sales declining by 9.4% since 1 May. Of course, the lower use of credit may also be due to credit providers pulling back supply in the face of growing uncertainty. It will be interesting to see how this trend develops.

Figure 4: African Bank's post-lockdown performance relative to 1H20 monthly average
Source: African Bank Financial Results for 1H20, Investor presentation



The financial constraints which the average SA consumer is experiencing is also palpable in the outperformance of value offerings. Private label offerings from all local food retailers have outperformed their respective categories. This trend is now so entrenched that even Tiger Brands, which has been unwilling to manufacture for the private label market, publicly announced that it will be looking for private label manufacturing opportunities. In the more discretionary items, value has outperformed, with sales trends post-lockdown for Pep Stores, Ackermans and Mr Price showing a greater improvement than their more fashionable and upmarket peers.

WILL THE WORLD BE MATERIALLY DIFFERENT POST THIS PANDEMIC?

It will be interesting to see how many of the trends highlighted above are sustained as the world recovers from this pandemic. Our view is that the new "lockdown-enforced" trends, such as partying at home and not spending on cosmetics, will be short lived. Humans are inherently social animals and, once we believe it is safe to go out and socialise, we will revert to our old habits. This view was reinforced by the BidCorp management team, which said that globally its Group sales performance exceeded expectations after governments started lifting harsh lockdown measures around the world.

Nevertheless, some trends may be here to stay. This is especially true for those trends that were already being witnessed before the lockdowns and have now just accelerated as consumers had to adapt. Working from home, or at least more-flexible working hours, may remain. Many corporates will be far more willing to consider these new working arrangements. The clearest example of this was Twitter's announcement that it will no longer require any of its employees to work from an office. People are going to spend more time in their homes, which may continue to assist DIY and home décor sales trends. Consumer willingness to try new brands will also probably remain intact. This will put severe pressure on price premiums for branded goods and the fast-moving consumer goods (FMCG) market will have to adapt rapidly to this. And then the acceptance of using the internet for meetings, shopping and a variety of other needs will accelerate as more and more people are forced to embrace technology. This may fundamentally change how companies think about their workforce, where they work, how they work and how many employees are needed.

Our view is that the new "lockdown-enforced" trends, such as partying at home and not spending on cosmetics, will be short lived. Humans are inherently social animals and, once we believe it is safe to go out and socialise, we will revert to our old habits.

When working to form the United Nations after World War 2, Winston Churchill famously said "Never let a good crisis go to waste". Currently, we are facing a serious crisis in COVID-19 but from every crisis new opportunities emerge. It is our goal to identify these opportunities, be open to embrace them and then to take full advantage of them on behalf of investors.

At Anchor We Help Investors Find Their True North

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Life coach and founder of Personal Excellence, Celestine Chua said that "Fear, uncertainty and discomfort are your compasses toward growth." Right now, fear, uncertainty, and discomfort are rife. The COVID-19 pandemic and the ensuing global lockdowns have been a massive burden on society and, as Nolan Wapenaar pointed to in his recent article entitled *Lockdown, Treasury's supplementary budget and your investments,* the brunt of this burden is felt by the impoverished and the disadvantaged. This has intensified social justice movements, which have, in turn, led to protests in some countries and between people it has led to difficult, but important, conversations. The world seems to be in a crisis and people are confused, and angry. Whilst there is so much beyond our individual control, what we can control is our own thoughts, behaviours, and actions.

Yes, it is difficult not to become bogged down by negativity and in Tamzin Nel's article entitled *Focus on the Facts,* she explains that "we are tired of being bombarded by a stream of never-ending negative news". This piece was written in 2019 and little did we know how much fear, uncertainty and discomfort was still to come in 2020. We need to learn about the reality of a situation by focusing on the facts and listening to and taking advice from those people who have superior knowledge to us in certain circumstances and surrounding certain issues. We can control what we consume and, as a result, spend more time thinking about how we behave in response to those thoughts.

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Instead of drowning in a never-ending stream of negative news, we need to learn how to swim and steer ourselves on the right course (sometimes with the aid of a compass). To this extent, whilst we cannot help you navigate all of life's difficult journeys, your financial solutions start with a conversation and we can be your financial compass.

Everyone is unique and has different financial or life goals. There is no True North to navigate towards. Instead, at Anchor, we aim to find your North or end destination, that will make your financial journey a success.

I am currently studying towards the Level III CFA Examination and, whilst revising the course content, I realised that, as portfolio managers (PMs) and wealth managers (WMs), at Anchor we have been making use of a tool known as situational profiling, which considers an individual's preferences, economic resources, goals etc., without giving it the benefit of a formal title.

Once a structured plan is in place for a specific client, it is much simpler to stick to the plan and remain invested instead of panicking and changing course in these situations.

We believe that it has benefited our initial proposals and ongoing implementation of our clients' investments. Situational profiling begins with determining an investor's source of wealth and their perceived measure of wealth vs their actual needs and their stage of life. This provides WMs or PMs with insights into their client's risk tolerance and return objectives in order to set and keep our clients on the correct path towards *their* end destination.

The first step is determining a client's two main objectives - return and risk tolerance. Return can be further broken down into two types - required and desired. The WM then has to determine what is most important to the client, while still considering the facts presented and whether such a return is indeed attainable. In terms of a client's risk tolerance, the WM needs to address both a client's ability and their willingness to take on risk. A client's ability is determined objectively by the WM, whereas their willingness is a far more subjective and emotional matter. The WM is then required to determine the importance of the client's goals by considering the consequences of not meeting these goals. This can be one of the most stressful situations, especially in a volatile and unpredictable market. However, we believe that, once a structured plan is in place for a specific client, it is much simpler to stick to the plan and remain invested instead of panicking and changing course in these situations.

There are a couple of other constraints that need to be considered in conjunction with a client's risk and return objectives. These can be summarised according to the following broad categories: time horizon, liquidity, tax consideration, legal and regulatory factors. It is very important to keep in mind that, the more information your WM has about your unique circumstances, the better they can assist you in reaching your financial goals

The first constraint – **time horizon** – is often the most important, as it can largely affect an investor's ability to bear risk. Time horizon is defined by a liability or cash flow to be paid or a goal to be funded at a future date and therefore should be viewed in multiple stages. The client's asset allocation must consider differing time horizons as defined by each liability or goal, as well as be adaptable to a changing mix of assets and liabilities, as time passes.

Liquidity, which plays an important part in a client's ability to bear risk, is based on the client's capacity to meet both foreseen and unforeseen cash flow needs. The key to successfully addressing liquidity constraints is to integrate the needs of the client and the characteristics of the asset class. The WM would need to consider different requirements for the various portions of an individual client's investable funds. If, for example, a client has a requirement to pay for a child's tuition eighteen months from now, or requires a monthly cash payout from their investment, these shorter-term goals and cash flow requirements mean that such a client will be invested in a more flexible, income type of investment product to avoid equity market volatility. However, the balance of the client's funds might only need to be accessed in thirty years' time, consequently the WM's approach to investing that client's funds will be different and the funds can be invested in equity provided that the client's willingness to tolerate risk matches their ability to take on risk.

Tax constraints are extremely important considerations and because Anchor PMs and WMs are not tax advisers, we refer our clients to those with a superior breadth and depth of knowledge. We have a dedicated tax specialist within Anchor, or we will work closely with your appointed tax advisor.

Legal and regulatory constraints typically pertain to tax relief or the complex issues of wealth transfer across generations. We can offer qualified and expert advice through working closely with the Anchor Family Office at RCI to make sure that your investment structures are as appropriately allocated as your underlying investments.

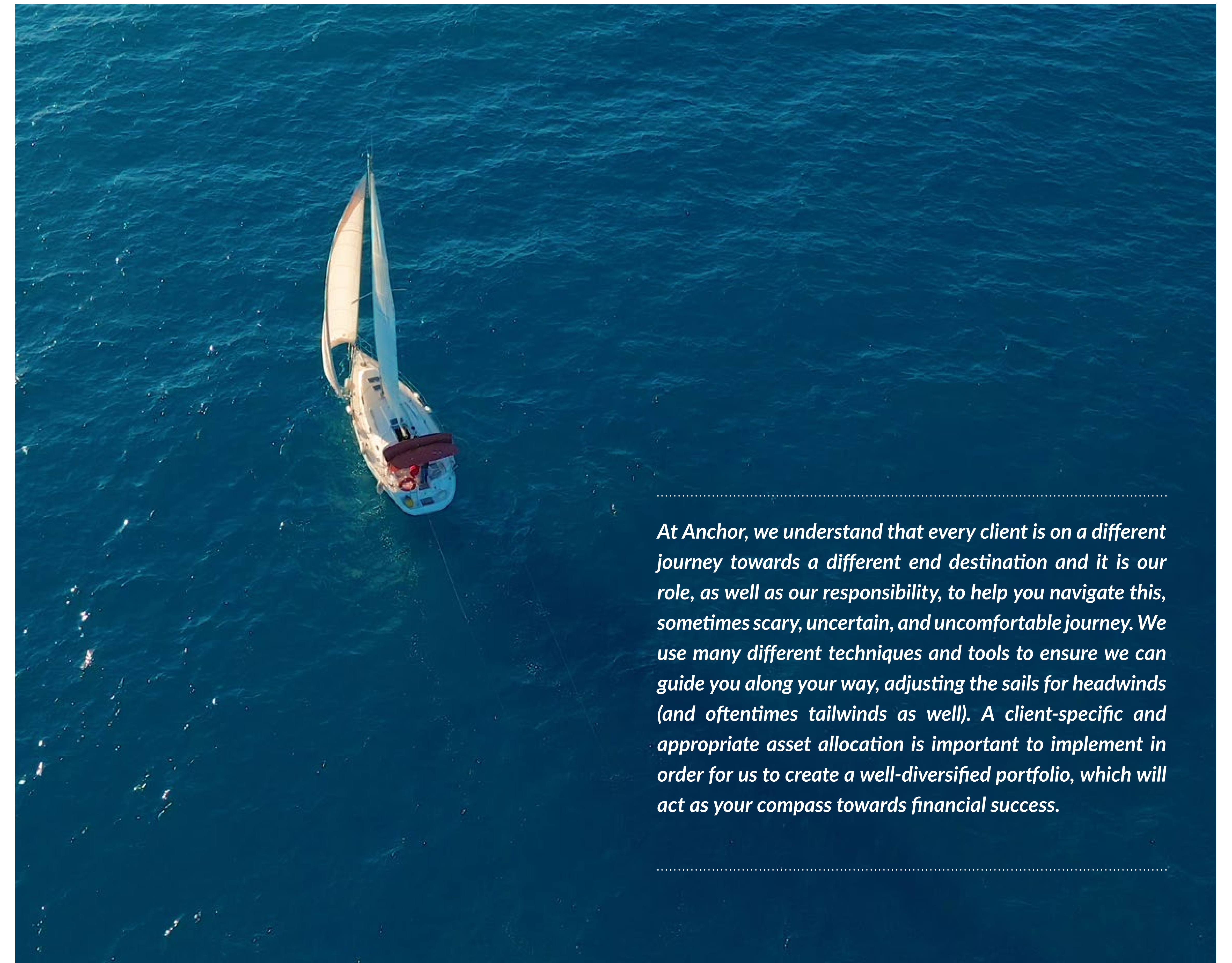
We are all unique and, as such, each person has distinctive circumstances which might not have been previously covered in any of the other, broadly summarised constraints discussed above. As WMs, we need to consider information such as concentrated equity holdings from previous investments or a reluctance on the part of a client to invest in certain investments for personal, social, or political reasons.

Once your risk and return objectives, alongside your individual constraints, have been thoroughly discussed and documented, your Anchor WM will help ensure that your personal goals are consistent and reasonable with capital market expectations. It is of vital importance that a feeling of trust, common understanding and expectation should be achieved between a client and their WM.

Capital market expectations are the risk and return prospects of every investable asset class. The Navigator provides investors with Anchor's quarterly house view on our capital market expectations for the various investable asset classes. As outlined on page 4, this view is based on Anchor's estimates of the risk and return possibilities of each asset class. The Navigator also delves deeper into the reasoning behind our outlined strategy and asset allocation. Your WM will then determine the most appropriate asset allocation for you, taking into consideration your personal risk and return objectives together with our capital market expectations.

The above is done strategically. **Strategic asset allocation** refers to the long-term target allocation for each asset class, whereas **tactical asset allocation** is more of an active management strategy, based on perceived short-term opportunities. We believe that strategic asset allocation should be considered one of the most important decisions in the portfolio management process.

Strategic asset allocation combines capital market expectations with an investor's long-term investment policy needs but, as Darryl Hannington wrote in his article entitled *Invest(ing) in the other 99%,* "Investing is not a proposal and implementation thereof, but rather an ongoing journey." With a constantly changing world, rebalancing and constant monitoring of client portfolios are of the utmost importance to make sure that a client's desired strategic policy needs are continuously maintained. Adjustments to a long-term strategic asset allocation is known as tactical asset allocation, which attempts to take advantage of short-to medium-term changes in capital market expectations.



At Anchor, we understand that every client is on a different journey towards a different end destination and it is our role, as well as our responsibility, to help you navigate this, sometimes scary, uncertain, and uncomfortable journey. We use many different techniques and tools to ensure we can guide you along your way, adjusting the sails for headwinds (and oftentimes tailwinds as well). A client-specific and appropriate asset allocation is important to implement in order for us to create a well-diversified portfolio, which will act as your compass towards financial success.

Performance Summary

		FUND PERFORMANCE						BENCHMARK PERFORMANCE					
	Start date	Annualised p.a. (%)	Since inception (%)	12-month (%)	6-month (%)	3-month (%)	June 2020 (%)	Since inception (%)	12-month (%)	6-month (%)	3-month (%)	June 2020 (%)	Performance vs Benchmark (%)
UNIT TRUSTS													
Anchor BCI Equity	Apr-13	8.2	76.5	-10.8	-9.7	22.5	7.8	46.6	-10.8	-10.7	21.6	7.0	29.9
Anchor BCI Flexible Income	Jun-15	7.5	44.8	5.8	2.1	4.1	0.8	44.4	7.0	3.2	1.4	0.4	0.4
Anchor BCI Managed	Jan-15	3.2	18.9	-1.2	-1.5	18.6	5.1	22.1	0.5	-1.9	13.5	3.1	-3.2
Anchor BCI Worldwide Flexible	May-13	11.1	112.3	10.4	4.2	13.9	1.8	81.6	6.1	2.8	0.3	-0.2	30.7
Anchor BCI Property Fund	Nov-15	-9.9	-38.5	-34.5	-31.4	17.3	12.2	-42.6	-40.0	-37.6	20.4	13.4	4.2
Anchor BCI Global Equity Feeder	Nov-15	17.7	113.5	67.1	55.8	41.0	11.4	76.0	25.8	16.6	16.4	2.0	37.5
Anchor BCI Bond Fund	Feb-16	9.3	48.1	4.1	0.9	11.3	-0.7	45.0	2.8	0.4	9.9	-1.2	3.1
Anchor BCI Diversified Stable Fund	Feb-16	5.9	29.0	3.1	0.4	9.6	1.5	25.2	3.2	0.6	8.3	1.5	3.9
Anchor BCI Diversified Moderate Fund	Feb-16	4.3	20.2	0.0	-2.2	12.5	2.2	21.1	2.2	-0.3	11.3	2.2	-0.9
Anchor BCI Diversified Growth Fund	Feb-16	2.7	12.3	-2.8	-4.6	15.3	3.4	18.2	0.5	-1.9	13.5	3.1	-5.9
Anchor BCI Africa Flexible Income	Mar-16	7.8	38.2	9.4	5.2	14.6	4.3	47.0	8.9	4.1	1.9	0.6	-8.8
Anchor BCI Global Technology Fund	Jun-19	45.7	49.4	0.0	40.1	27.1	7.8	60.8	0.0	39.4	26.5	6.0	-11.4

Source: Morningstar and Bloomberg 30 May 2020
*Provisional performance returns

		FUND PERFORMANCE						BENCHMARK PERFORMANCE					
	Start date	Annualised p.a. (%)	Since inception (%)	12-month (%)	6-month (%)	3-month (%)	June 2020 (%)	Since inception (%)	12-month (%)	6-month (%)	3-month (%)	June 2020 (%)	Performance vs Benchmark (%)
EQUITY NOTES & SEGREGATED MANDATES													
Anchor Equity	Jul-13	5.3	43.2	-13.6	-10.3	18.1	6.4	45.6	-10.8	-10.7	21.6	7.0	-2.3
Growing Yield*	Jun-12	3.9	35.5	-32.3	-28.6	6.0	3.2	113.2	7.2	3.3	0.6	-0.1	-77.7
HEDGE FUNDS													
Property Long Short	Jan-14	0.9	6.1	-31.9	-27.8	10.6	9.3	74.2	8.1	3.5	1.5	0.4	-68.1
Anchor Accelerator	Feb-16	11.3	60.0	20.3	8.9	19.5	5.0	5.6	-10.8	-10.7	21.6	7.0	54.4
OFFSHORE													
High Street Equity - Dollars	Jun-12	11.3	135.8	3.4	-1.8	19.9	3.5	117.8	3.4	-5.5	19.5	2.7	18.0
High Street Equity - Rands	Jun-12	22.3	401.1	28.0	22.1	16.7	2.1	362.2	27.4	17.5	16.7	1.5	38.9
Offshore Balanced - Dollars	Jun-12	9.0	98.7	-1.6	-5.2	11.1	1.1	67.4	3.9	-2.0	12.8	1.9	31.3
Offshore Balanced - Rands	Jun-12	19.7	321.5	21.3	17.7	8.1	-0.2	255.2	27.1	21.9	10.1	0.9	66.3
Global Dividend - Dollars	Jan-14	5.8	43.7	-7.4	-12.7	8.4	-0.0	61.9	3.4	-5.5	19.5	2.7	-18.2
Global Dividend - Rands	Jan-14	13.4	124.7	14.1	8.5	5.5	-1.4	153.0	27.4	17.5	16.7	1.5	-28.3
Anchor Global Stable Fund - Dollars	May-15	1.1	5.9	2.0	-1.2	5.1	0.7	14.7	2.7	1.4	0.6	0.2	-8.7
Anchor Global Stable Fund - Rands	May-15	8.5	51.5	25.7	22.9	2.6	-0.4	64.2	26.7	26.0	-1.7	-0.8	-12.7
Anchor Global Equity - Dollars	May-15	13.3	89.1	41.9	30.4	49.8	12.5	32.6	2.1	-6.3	19.2	3.2	56.5
Anchor Global Equity - Rands	May-15	20.1	154.8	74.8	62.1	46.3	11.2	81.3	25.8	16.6	16.4	2.0	73.5

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