The Navigator

Strategy and Asset Allocation Report
1st Quarter 2021

ANCHOR | NAVIGATING CHANGE

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Introduction

Written By:

Nolan Wapenaar and Peter Armitage
Chief Investment Officers

"The numbers are turning into names, and those names are people we know."

Such was a poignant meme that appeared on my phone, pleading with people to mask up and not to drop their guard against health standards that are designed to slow the spread of the virus. Sadly, for me, as for many South Africans, this is true. The names are people we know.

As we write this report, there are discussions around increasing the lockdown restrictions in South Africa (SA). In reality, the lockdown discussion is moot. As this virus is getting closer to those we know, South Africans are responding of their own accord. Shopping centres are emptier than a month ago, there were seats available in Starbucks (for the first time ever), and the streets were eerily quiet this morning. Social distancing is becoming a way of life once again. In the short term, this will hopefully slow the virus, though it certainly is going to slow the economy.

Early January also marked the announcement that the first 1.5mn doses of the vaccine are on the way to SA, with more to follow. We are starting the recovery process. This year promises to have its share of surprises, however, overall we expect that both the domestic and the global economy will end the year stronger than when we started. 2021 is the year of recovery.

A base message from Anchor has been that investors should externalise a significant portion of their assets. This remains our view and we espouse increasing global assets when conditions warrant such a change. By most measures, global equity markets are expensive and have priced in a relatively rosy scenario regarding the recovery. There is certainly some possible upside to holding global equities, however, one must be cognisant of the risks, which have been growing.

Our investment view therefore is that investors who have inadequate global exposure should seek to top this up sooner rather than later even though they may need to stomach more volatility over the near term. For those investors that already have adequate global exposure our view is that they should continue to look for opportunities to top up their global exposure. Perhaps for such investors, patience is advisable right now. We are watching for opportunities to externalise wealth and we will continue to communicate these. Each individual situation is unique, and we implore you to work with your advisor to identify the plan that is most suitable for yourself.

Social distancing is becoming a way of life once again. In the short term, this will hopefully slow the virus, though it certainly is going to slow the economy.

We start 2021 with optimism for a better outcome in the end. We know, however, that the year will have some surprises in store for us. These will throw out opportunities for your investments and for implementation of your long-term plans. We look forward to working with you to achieve your investment goals.

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					
Equity	52		●		11.0
Bonds	16			●	8.8
Listed Property	6		●		8.6
Cash	4	●			3.3
Alternatives*				●	10 to 15
Rand/US$ (rand marginally stronger)					+2.40
GLOBAL					
Equity	13		●		5.0
Government Bonds	1	●			0.4
Corporate Credit	3		●		1.2
Listed Property	2	●			2.5
Cash	1	●			0.0
Alternatives*				●	5 to 10

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

Asset Allocation Summary

The range of possible outcomes for the various asset classes remains wide and is highly dependent on your outlook for the different scenarios. We have decided to display the possible outcomes as a series of graphs below. Anchor's base case is somewhere between a scenario of a fast-tracked vaccine programme spurring economic growth, and that of a slow distribution of vaccines plagued by hiccups and challenges.

There are remarkably few changes since our Navigator publication, which was released on 12 October 2020, though we are incrementally more bullish on JSE-listed shares. The index level returns might seem quite pedestrian; however, we expect that there might be quite significant swings in the performance of the shares underlying the index.

In *Figure 1* below, we highlight the US dollar return outlook for the various global asset classes. The bars in *Figure 1*, represents 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 although the downside risks have increased.

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

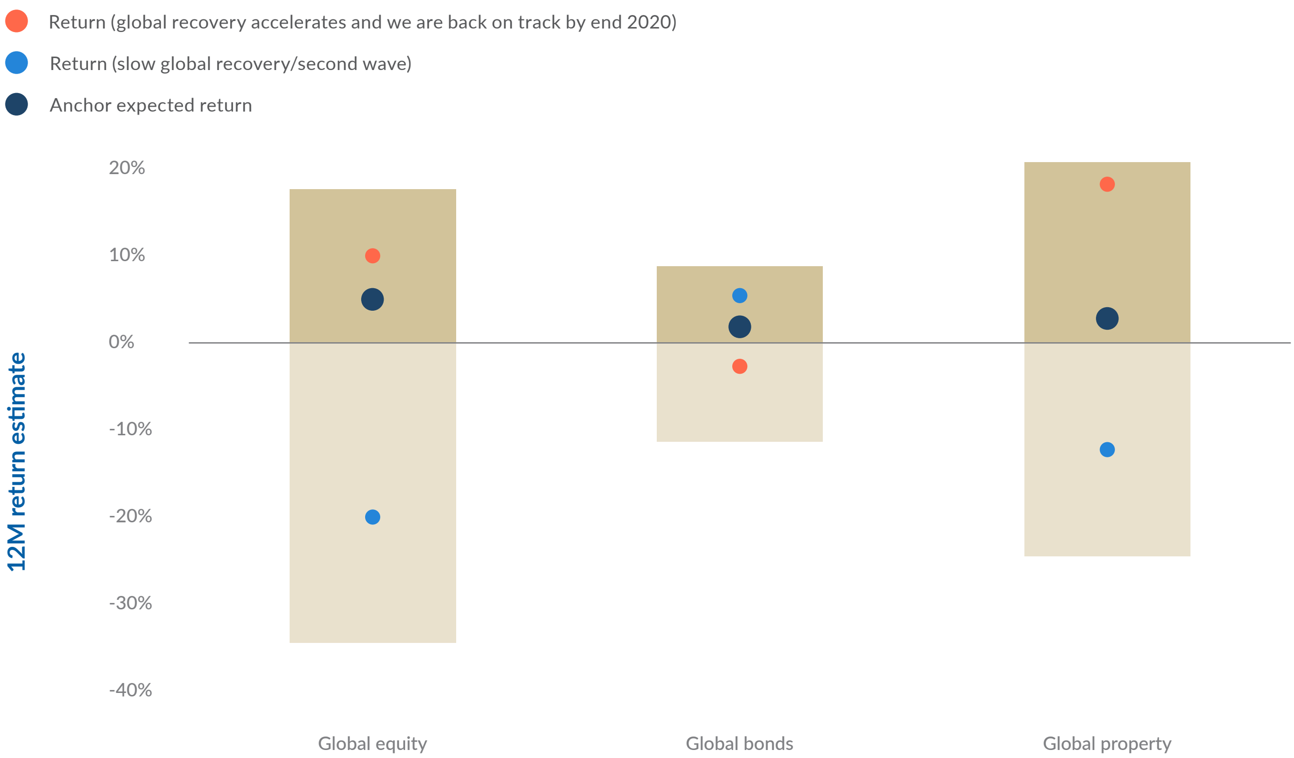


Figure 2: Anchor expected return by offshore asset class
Source: Anchor

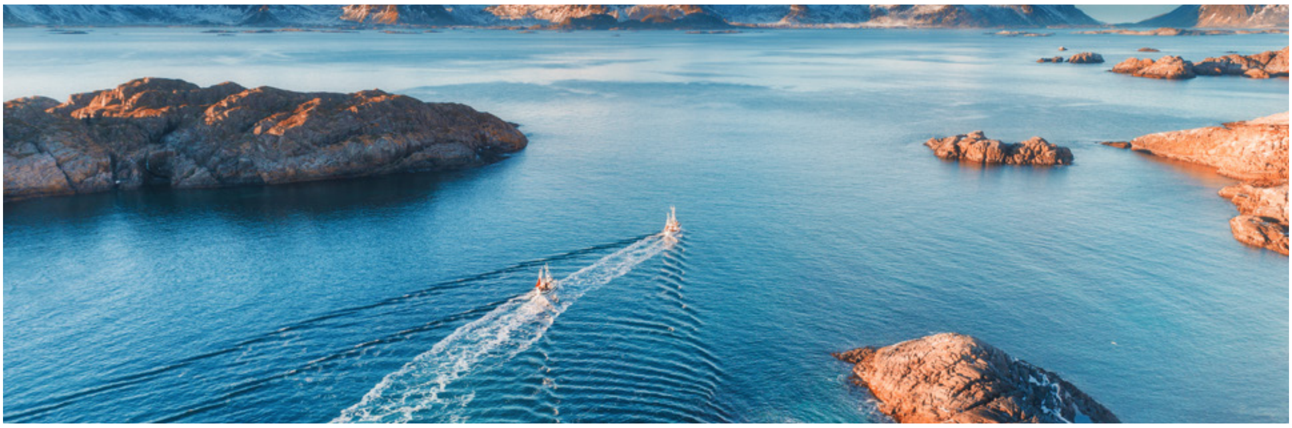
	Global equity	Global bonds	Global property
Anchor expected return (in US dollar terms)	5.0%	1.2%	2.5%

In *Figure 3* below, we highlight the rand return outlook for several domestic asset classes. The bar represents the reasonable range of possible outcomes, with the dots representing our estimate of what the outcome will be under the various scenarios. 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 which is starting to look compelling.

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

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

	Domestic equity	Domestic bonds	Domestic property	US$/rand
Anchor expected return (in rand terms)	11.0%	8.8%	8.6%	2.4%



Strategy and Asset Allocation

ECONOMICS

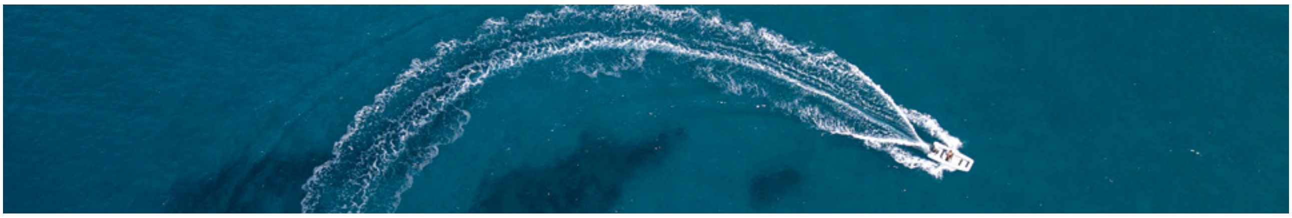
As the world cautiously strides into 2021, global economic data remain largely positive with growth continuing to recover despite the return of global COVID-19 restrictions as infection rates rise sharply and a more virulent strain of the virus spreads. After the first wave of the COVID-19 pandemic hit in early 2020, triggering a collapse in global economies and financial markets alike, central banks across the globe responded by rolling-out unparalleled levels of stimulus measures. These measures have primarily, along with the start of vaccine programmes in many countries, kept the risk-on sentiment buoyant, supported by the adoption of the much-delayed US$900bn stimulus package in the US and the finalisation of a post-Brexit UK/EU agreement. Whilst the renewed vaccine optimism appears to have offset concerns surrounding the further escalation in coronavirus cases globally, given the severe nature of the pandemic (particularly in the US and throughout Europe) as well as the many job losses accompanying these tragic deaths, overall a high degree of caution is still warranted.

Financial markets have largely shifted their attention to the impact that the adjusted level 3 lockdown, and now further load shedding, will have on the already battered economy.

Overall, the forecast staggered recovery process will prevent a significant pickup in global demand and limit the extent of global inflation pressures until vaccines are widely distributed. On the face of it, we expect that much of the developed world will be vaccinated by the end of 2Q21, with many emerging markets (EMs) vaccinated by the end of 3Q21. SA's vaccine plan appears to be gaining shape and we expect that we will also fall within those timelines. Weakness in global economic demand, against an already low inflation backdrop, continues to provide governments and central banks with space to further support their economies. Whilst this global backdrop offers relatively favourable conditions for ongoing fiscal and monetary policy assistance, the economic risks necessitating this will continue to boost safe-haven assets. We think that the vaccines and ongoing recovery will slow down the amount of stimulus being provided and that the peak stimulus will be in 1Q21. Downside risks include rising global indebtedness, oil market volatility, US-China tensions, nationalistic politics and policies, anti-globalisation sentiment and stagflationary-like macroeconomic outcomes.

Locally, SA's investment landscape in 1Q21 will largely be dominated by concerns surrounding the surges in COVID-19 infections following the festive/holiday season. At the end of December 2020, President Cyril Ramaphosa announced restrictions (both national and regional) aimed at curbing the second wave amid a severe strain on the national health sector. Though necessary, these measures will further dampen the local economic recovery, particularly since there cannot be any certainty that tighter restrictions or further rounds of restrictions can be avoided ahead of the arrival of widespread access to vaccines. Thus, financial markets have largely shifted their attention to the impact that the adjusted level 3 lockdown, and now further load shedding, will have on the already battered economy, particularly since vaccines are unlikely to be widely accessible in SA before 2Q21.

Furthermore, the relatively large scale of social support provided in 2020 leaves the country with one of the fastest-growing debt burdens among EM sovereigns. SA's fiscal and consequent debt sustainability woes remain significant concerns, prompting both Moody's and Fitch to downgrade the country's sovereign credit ratings on 20 November 2020. Nevertheless, SA government debt has been attracting foreign buyers given its relatively high real yield. Moving into 2021, the famous quote *"Uncertainty is the only certainty there is, and knowing how to live with insecurity is the only security"* by John Allen Paulos indeed holds true. This uncertainty will permeate the local economic outlook in 1Q21. Still, we anticipate some form of economic recovery in 2021. The extent of such a recovery remains uncertain and depends on the factors mentioned above, however, the point is that 2021 should be better than last year for the domestic economy.



SA EQUITY

Over the last two months of 2020, the JSE's domestically focussed component finally broke out of the range in which it has been since March 2020's pandemic-induced market downturn. Reports around the positive efficacy of COVID-19 vaccine candidates, kicked off the biggest one-day rotation out of growth and into value stocks that markets have ever produced. EMs were the biggest beneficiaries of this increased risk appetite and SA was no exception - from 1 November to 31 December 2020 the FTSE JSE Capped Swix outperformed the S&P 500 by a convincing 14%.

But does this recent rally in SA assets have further to go heading into 2021? With much uncertainty around a return to some type of new "normalised" social and economic life, making bold financial projections is fraught with high forecast risk due to continuously evolving global economic developments. In SA, this is exacerbated by the country's fragile economic position prior to the pandemic. The main reasons we are constructive on SA equities in 2021, have little to do with bottom-up, company specific drivers and are instead premised on higher-level, macro-orientated drivers including:

- Global economic conditions gradually improving and the vaccine rollout resulting in society returning towards some semblance of normality.
- Conventional economic wisdom suggests equities perform best at times of loose monetary and fiscal policy and central banks and government-led stimulus measures should underpin lower real rates and higher equity valuations for the foreseeable future.
- The US Presidential Election has provided some stability to the global geopolitical outlook and greater certainty here should comfort investors to deploy capital into riskier assets with the key beneficiary being EM equities.

While a global economic recovery, fuelled by loose monetary and fiscal policy, underpins our positive view on EM equities, tying this into a constructive view on local equities requires a further look at some core themes that could play out in various components of the JSE this year including:

- A Naspers and Prosus value unlock to narrow the gaping discount to the underlying sum of the parts these shares have been trading at for some time.
- Basic materials (accounting for c. one-third of the FTSE JSE Capped Swix Index), has been a recent outperformer relative to companies more reliant on domestic economic growth.
- Larger, more diversified mining businesses are pricing in commodity prices well below prevailing spot prices and, with cleaner balance sheets and clearer communication around capital allocation, we expect significant upside to these companies' earnings.
- Domestically focussed stocks benefit most from economic recovery and higher EM flows, particularly more liquid sectors such as banks, insurance, and retail.
- We expect a sharp recovery in earnings over the short term, specifically in consumer-facing sectors shut down at the peak of the lockdowns, but a sustained earnings recovery will require a determined effort from policymakers to i) conduct an effective COVID-19 vaccine rollout; and ii) enact key structural reforms.
- Over the past two months, the market has given a V-shaped local economic recovery the benefit of the doubt, with a healthy rerating of larger, more liquid, local counters implying a sharp recovery in 2021 activity levels.

Our SA equities base case is a c. 11% expected return for 2021, although getting the allocation right below the index level will be a key determinant of success.

SA PROPERTY

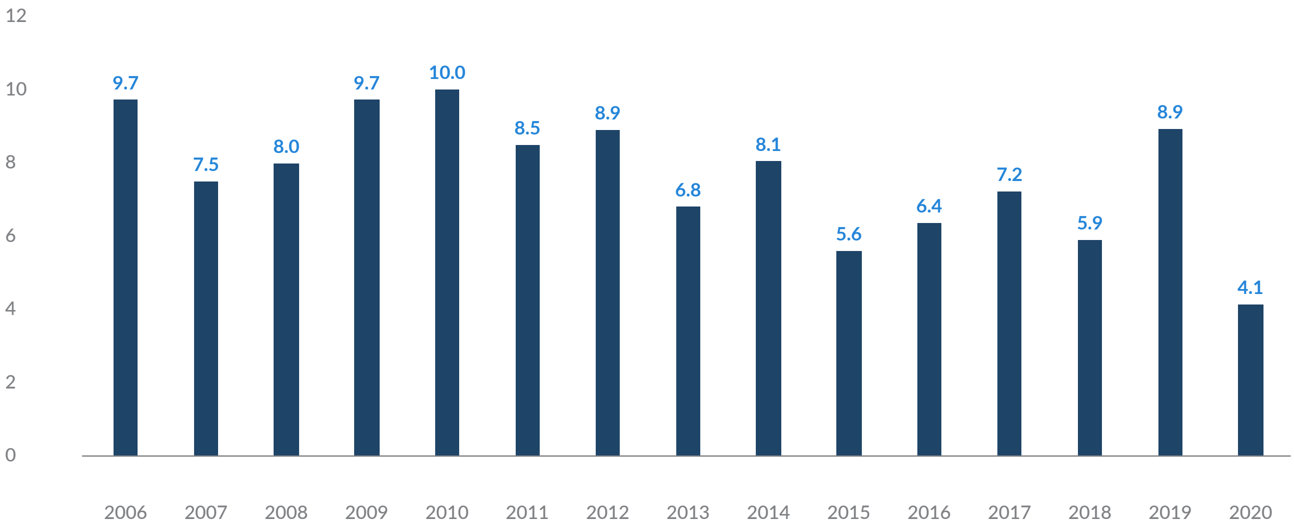
It would be easy to dwell on the negative statistics when analysing the performance of the SA-listed property sector over the past 3 years. However, the price action that occurred in the sector during 4Q20 is a key indicator to us of the potential prospects for investors. After falling by a further 8.5% in October, the SA Listed Property Index (JSAPY) returned 33.5% in the last two months of 2020. This coincided with regulatory requirements that real estate investment trusts (REITs) pay out 75% of their distributable earnings on an annual basis, leading to property companies, which reported in the period, declaring and paying out dividends. In addition, the metrics showed that consumers and tenants were returning to malls and offices, albeit at far below pre-COVID normalised levels.

Nevertheless, we highlight that these "green shoots" should not mask the severity of the pain which the sector has borne the brunt of prior to and during the pandemic. The JSAPY has returned:

- **-34.5% in 2020.**
- **-50.1% over the past 3 years** (to 31 December 2020).
- **-35.6% over the past 5 years** (to 31 December 2020).

The above data measure total return i.e., capital appreciation/depreciation plus dividends. When looking at the past 10 years, the total return is 41.4% (a 3.5% compound annual return). This is comprised of approximately 70% dividends and a negative 30% when measuring share price (capital) performance. A more detailed study of annual dividend yields is presented in *Figure 1* below.

Figure 1: JSAPY dividend yield (%), 2006 to date
Source: Anchor, Refinitiv



From *Figure 1*, we highlight the following:

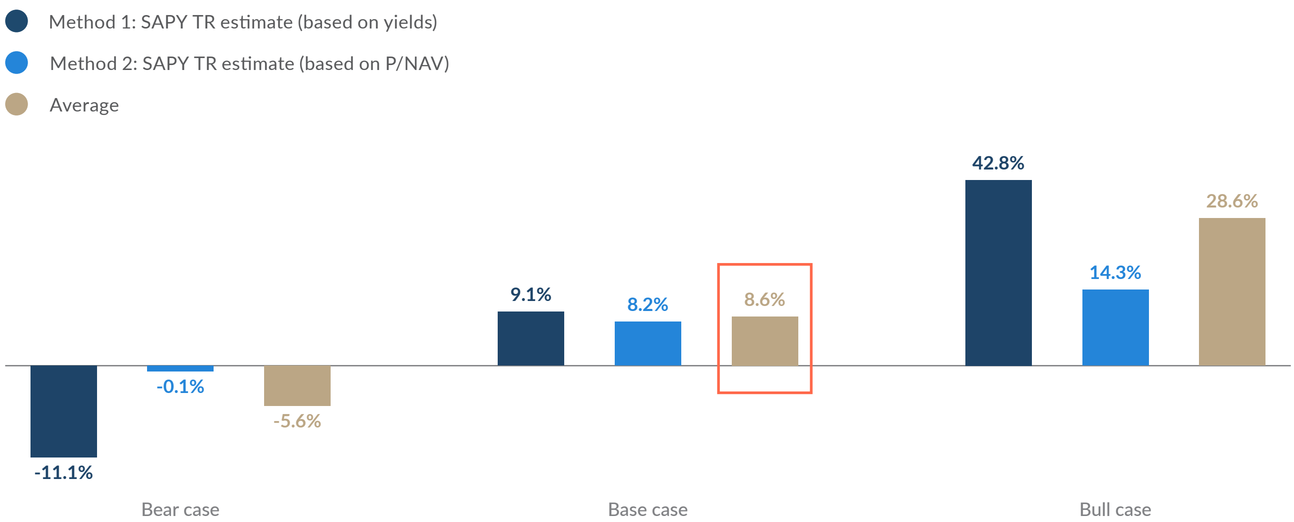
The average **annual yield** for the past **15 years** is **7.7%**	From **2006 to 2015.** the **average yield** is **8.3%**	For the **past 5 years** the **average yield** has **fallen to** **6.5%**	In **2020**. the **COVID-19 crisis** saw the **lowest annual yield** on record **4.1%**

It could therefore be logically argued that share prices anticipate the factors that lead to companies' income, and therefore dividends, falling. So, although the yield is reasonably consistent, the forecast risk of total return, which includes share price performance, is high. This has been magnified by the pandemic and its impact on the property sector. However, we note that some important fundamental factors remain in place, including:

- The prices of physical property assets have come under pressure, but not to the extent of the discounts to net asset values (NAVs) that are currently being priced in for many listed property companies.
- Dividends will continue to flow into shareholders' hands, albeit that payout ratios on distributable income may be reduced.

Therefore, when investors can forecast that earnings and dividends have reached the bottom of this cycle, and will grow off the lower base, share prices will re-rate. In our view, that is currently in process, but the recovery will not be V-shaped, and a reintroduction of harder lockdown rules will mean that the best outcome for the next 6-12 months would be a "muddle-through" result, mainly underpinned by our forecast dividend yield of 9.1% and a total return of 8.6%. This is our base-case scenario using a 50% weighted dividend yield and 50% price/NAV methodology. However, as evidenced in the back end of 2020, there can be fairly extreme volatility and a wide range of outcomes are therefore possible.

Figure 2: Return scenarios for the SA-listed property sector
Source: Anchor



We therefore remain at a neutral weight on the sector, whilst looking for prospects of a turning point in income generation.

SA BONDS

As last year drew to a close, 4Q20 saw SA bonds strengthen, with the FTSE JSE All Bond Index (ALBI) delivering a full-year total return of 8.65%. Given the significant headwinds which EM bonds faced when the COVID-19 pandemic hit markets in 2020, this again shows the resilience and depth of the local debt market.

4Q20 gave support to SA government bonds, with the 10-year benchmark R2030 opening with a yield of 9.445% and closing at a yield of 8.735%. The curve, in general, remains substantially steeper than it did at the start of 2020 – currently the spread between the R186 and the R2040 bond is 4.31%, while it was 1.77% at the start of last year. Throughout 2020, we discussed this phenomenon – the bifurcation of the SA bond curve. In our view, this story will remain prevalent for as long as National Treasury struggles to reign in the fiscal deficit.

However, we also highlight that this presents investors with a strong yield-to-term relationship as duration is being compensated for with a yield far greater in both absolute (the yields on all bonds beyond the 10-year point are now higher than they were one-year ago) and relative (as indicated by the steepness of the curve) terms.

Looking to 2021, the major events which we believe should drive bond yields are the budget announcements, the rollout of a COVID-19 vaccine, the lowering of lockdown levels (particularly those that have strong adverse effects on economic activity and the fiscus), the SA Reserve Bank's (SARB) Monetary Policy Committee (MPC) meetings, and the prosecutions of those guilty of corruption.

Our baseline scenario is for the SARB to start the rate-hiking cycle towards 1Q22 – thus keeping rates at historically low current levels for the year. We note though that this expectation is extremely sensitive to data releases - the MPC has proven to be exceptionally cautious and any sign of heightened inflation will likely result in rate hikes to keep inflationary pressures subdued. Given this possibility, we expect the SA bond curve to remain steep, pegged down at the short end by the low repo rate (currently at 3.5%), and pulled up by the various idiosyncratic risks which the country faces, as well as the general EMs risk premium.

2020 has seen a substantial movement in both the shape of the yield curve and in the volatility local bond investors have faced. At the peak of the March sell-off, the R2030 traded at yields of over 12.3%.

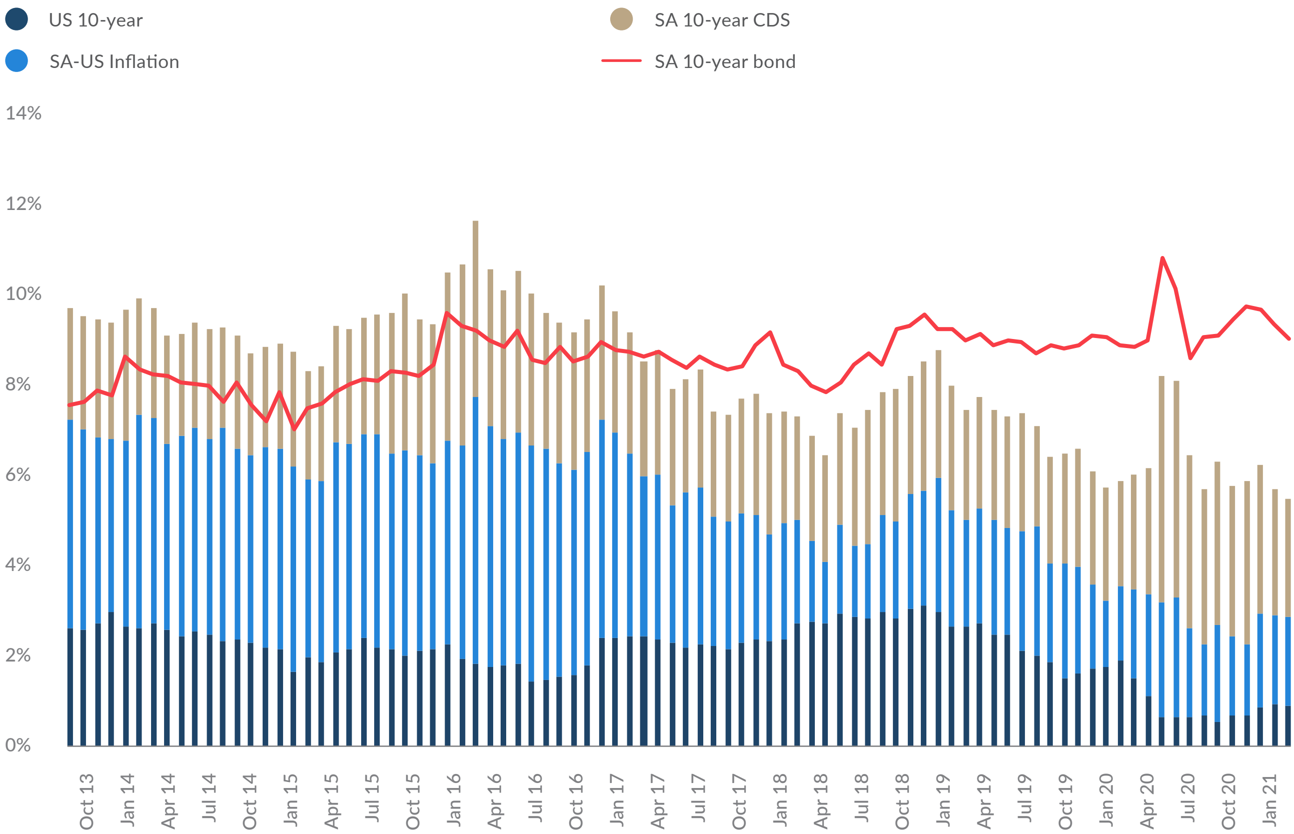
Looking to 2021, inflation has been subdued since the start of the pandemic and is expected to remain low over the near term. In this environment the yield on offer for SA duration assets remains attractive.

Below we construct a comparison of the relative attractiveness of SA 10-year debt vs a synthetic reconstruction using a sum of the following:

1. SA inflation less US inflation (SA CPI-US CPI);
2. US 10-year treasury yields; and
3. SA 10-year credit default swaps (CDS).

The results are depicted in *Figure 3* below, which also shows that the country's fiscal position has deteriorated, and the spread has gone from being negative (where SA debt yields less than the synthetic sum of yields above) to being strongly positive. It is currently 3.6% more attractive to hold SA debt than it is to be a holder of the synthetic construct described above.

Figure 3: Comparison of SA 10-year debt vs US 10-year Treasury yields, the SA-US inflation differential, and the SA 10-year CDS yield
Source: Anchor, Thomson Reuters



We also note the attractiveness of SA government bonds on a relative basis, where SA real yields remain attractive (currently the real yield on the 10-year bond is 5.4%).

We accordingly think that the fair yield on the benchmark R186 bond is about 6.7%, while that of the R2030 bond is about 8.8%. In our view there is some scope for the longer-dated 20-year bonds to rally a little over the period. This gives us an expected return for the ALBI of 8.80% which all comprises interest income.

RAND

Over the year as a whole, the rand was relatively stable in 2020, weakening by 4.7%. However, within that period, we saw extreme moves with the currency setting a new weakest level record of R19.35/US$1 in March, before recovering to end the year at around R14.65/US$1.

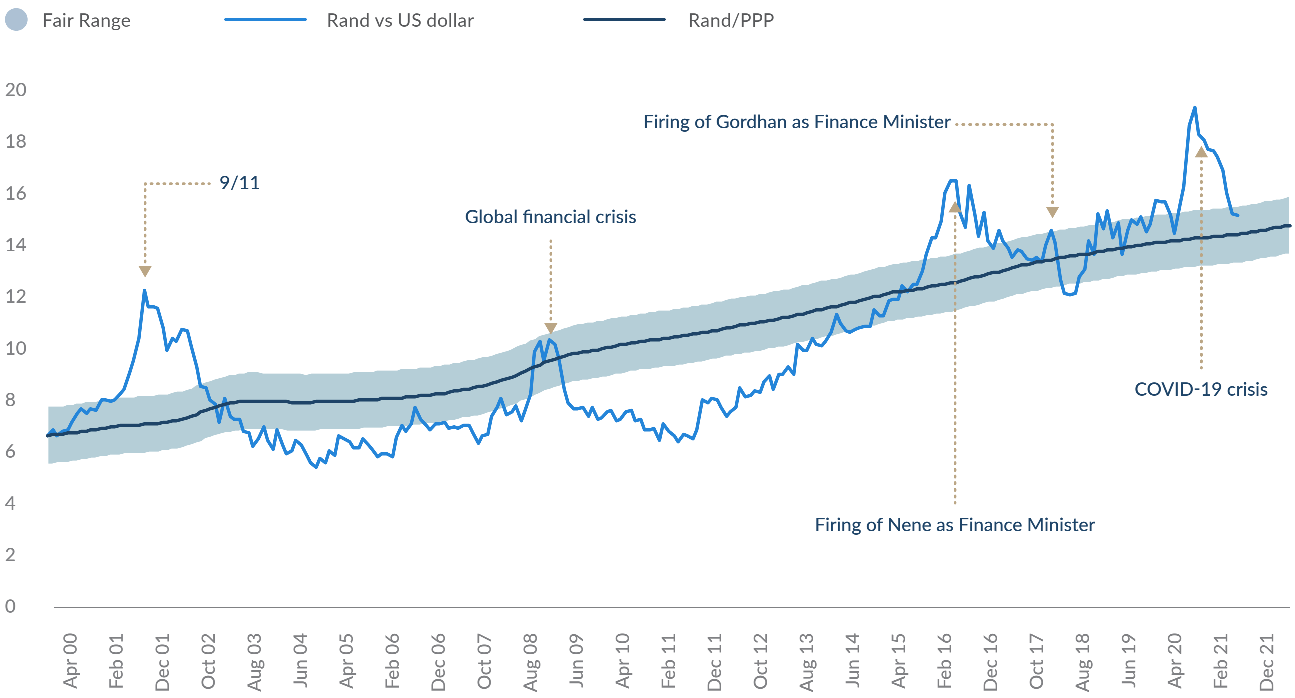
Projecting the rand's value in a year's time is a fool's errand. The rand vs US dollar exchange rate is one of the world's most volatile currency pairs and trades well away from any modelled fair value for long periods. We note, however, that the rand trades within a R2.50 range to the US dollar in most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

Currently, the US dollar seems to be in a weakening cycle. However, we cannot be certain how long this will persist although we maintain our view that the cycle probably has no more than another 5% of dollar weakness remaining. Such weakness, coupled with bringing the COVID pandemic in SA back under control, should give support to the rand. We also remain watchful of SA's trade balance, which remains positive and will also help support the local currency more than we have seen in the past. For now, the risk remains for a slightly stronger rand in the medium term.

We retain our purchasing power parity (PPP) based model for estimating the fair value of the rand and we have extended this out by three months since the publication of *The Navigator – Anchor's Strategy and Asset Allocation, 4Q20* report on 12 October 2020. Our PPP-modelled value for the rand vs the US dollar at the end of the next 12 months is R14.30/US$1 (See *Figure 4*). We apply a R2.00 range around this to get to a fair value range of between R13.30/US$1 and R15.30/US$1.

We expect the rand to remain particularly volatile although we do think that it might touch the mid-point of our fair band. This would imply that we see scope for up to a 2.4% improvement from the rand's current levels as global macro factors dominate.

Figure 4: Actual rand/US dollar exchange rate vs rand PPP model
Source: Anchor, Thomson Reuters



GLOBAL EQUITY

Global equity markets ended the year up around 16% (MSCI World +16%, S&P +18%, FTSE down 14%, EMs +18%), an outcome few would have forecast given the economic slump caused by COVID-19. World GDP growth is likely to end 2020 down around 4.4%, with consensus expecting a rebound of 5.2% in 2021.

While we are able to identify numerous shares, we are happy to own for the next 12 months and beyond, we are more cautious on index levels on a 12-month view. Almost all respected forecasters of market returns were badly wrong in 2020 (twice!) and hence the (very pervasive) consensus for a positive 2021 should be viewed with some healthy scepticism.

Our 5% 12-month US dollar forecast return for the MSCI World Equity index is relatively low conviction, given the range of potential outcomes.

We are at a unique point in history, where technology is changing the world and we are ardent believers in the secular trends being sustained. The way we do business is changing dramatically and the business models that have emerged are creating cash flow monsters with extremely high returns and very high margins.

The primary justification for being bullish on equities in 2021 is the fact that central banks are providing unprecedented stimulus to the global economy, which has manifested itself in the double-barrel impact of low rates (you cannot make money unless you take risk) and massive liquidity. Historically it has generally been unwise to "fight the Fed" and this is probably reason enough to maintain a healthy equity weighting. Reasons two and three for a bullish stance are pretty universally the obvious ... the pandemic being defeated and big YoY earnings growth in 2021 (off a 2020 earnings base in the US, which is likely to end 18% down).

But as fundamental, bottom-up, growth investors we cannot help feeling a little uneasy. We do believe valuations count and on that score the market is very expensive at a forward PE of 21.3x (MSCI World) and 22.6x for the S&P. This incorporates a substantial part of the anticipated global recovery. The average S&P forward PE for the last 10 years is 17, suggesting the market valuation levels are 33% higher than the average of the last decade.

We have been in a rampant bull market since the bottom in March 2020 – in fact, we are up over 65% since the virus-infected bottom. Investors are getting worryingly comfortable and it is not unusual for the market to remain bullish on big companies (with 10%-odd sustainable earnings growth numbers) trading at 30x-40x PE multiples (e.g., Microsoft). New IPOs have experienced extreme bull market characteristics. We valued Airbnb at around US$60/share on listing and it quickly traded at over US$140/share.

So, let us just take a step back and think about the earnings fundamentals – S&P earnings growth numbers for 2020, 2021 and 2022 are projected at -18%, 30% and 17%. The big growth in 2021 should not be interpreted as sustainable or that meaningful, as a big element is clearly recovery from a low base. The key determinant of where market levels trade at the end of this year, will be the expectation for 2022 and sustainable earnings growth thereafter. This will probably revert to historic averages – in the region of 6%-7%.

While our base case is that the market goes up from here, what is glaringly obvious is that perfection is priced into many companies and probably the market as a whole. Rising global yields, an inflation surprise, some virus, or vaccine hiccups (should we not expect these?), or some Chinese economic aggression (or many other things which we cannot anticipate as we have learnt this year!) have a greater-than-usual potential to cause a material drop in markets, given the elevated starting point. We are generally happy to accept these gyrations, but the logical conclusion right now is to be on high alert and construct portfolios with this in mind.

And if stimulus is the key driver, do we need stimulus to get incrementally bigger to sustain the market moves? *Morgan Stanley* uses the phrase "peak stimulus" in its analysis and estimates that this happens in the next few months – the point at which economic recovery and the sheer scale of current stimulus means that the tank attendants slowly start injecting less rocket fuel as the tank becomes full. How much money can the world print?

An important and very material last point is that we are at a unique point in history, where technology is changing the world and we are ardent believers in the secular trends being sustained. The way we do business is changing dramatically and the business models that have emerged, which enable companies to scale at an unprecedented rate if they have a good idea (the network effect) with good execution, is creating cash flow monsters with extremely high returns and very high margins. Anchor clients have benefitted materially from exposure to high-growth tech companies and the compelling and enduring nature of their growth rates means that macro concerns are much less relevant, but it does not mean that they cannot experience material dips on their upward journey. They inevitably will.

Anchor clients have benefitted materially from exposure to high-growth tech companies

We are also very conscious of the fact that, as valuations increase in this sector (which is now over 35% of global market cap), we have to become increasingly sensitive to share selection – many of the tech favourites will not achieve their now ubiquitous five and 10-year forecasts made to justify their valuations (I have never got the three-year forecast for a company right!). You have to own the winning businesses – at these valuations the losers will cost you big. This is no time for indices which provide a broad thematic smattering.

On the subject of ETFs, and passive investing, we believe that they have a place and we sometimes use them in our portfolios for certain themes or geographical exposure. At the end of a bull market, they can become more dangerous as the most expensive shares achieve the highest weightings and there is no ability to exclude bad businesses. We are proud, as active investment managers, to have consistently beaten our chosen equity benchmarks after costs. Passive investing guarantees underperformance relative to the same benchmarks.

We are in a bull market and it is probably equally dangerous to 1) call the top, or 2) dismiss the obvious risks. We feel uncomfortable making a 12-month projection, as is industry convention, and we have learnt this year so much can happen in this timeframe (2020 was down 35% and then up 65%!). Our forecast tables will reflect a mundane and seemingly unconvicted 5% 12-month return forecast, but what is more important is our investment approach over the next 12 months:

- Our portfolios will follow our investment philosophy of investing in high-return companies whose valuations are justified by their long-term growth rates.
- We will ensure investors have sufficient exposure to companies that are changing the world.
- We will also seek to invest in good quality companies whose share prices have not been caught up in the hype.
- We start the year with relatively high equity weightings, cognisant that bull markets can last longer than seems justified. But caution is warranted.
- We will be alert and ever conscious of risks (to growth or valuation). We will be nimble and sufficiently conservative.
- We will be conscious of the facts, especially valuation.
- We will remember that global equities are the best place to invest over the longer term.

GLOBAL PROPERTY

Developed market REITs bounced hard in 4Q20 in response to the prospect of the imminent rollout of COVID-19 vaccines. The sectors hardest by the pandemic were unsurprisingly the ones that bounced hardest (retail REITs rallied 26% in 4Q20 and office REITs jumped by 15%). Despite a mid-teen bounce for global REITs in aggregate for 4Q20, it was still a tough year for the asset class, which ended 2020 down 10% - comfortably trailing most risk assets. The 10% de-rating though, has largely come in the form of lower dividend expectations, with retail-, office- and residential REITs all seeing their expected dividends for 2021 at around 20%–35% lower than investors had expected from them going into 2020 (i.e. before the pandemic upset the apple cart). This contrasts with the pandemic-beneficiaries such as data centers and warehouses which have seen their income expectations jump by the high-teens during 2020. However, given the smaller universe of pandemic beneficiaries, the aggregate numbers still look dismal.

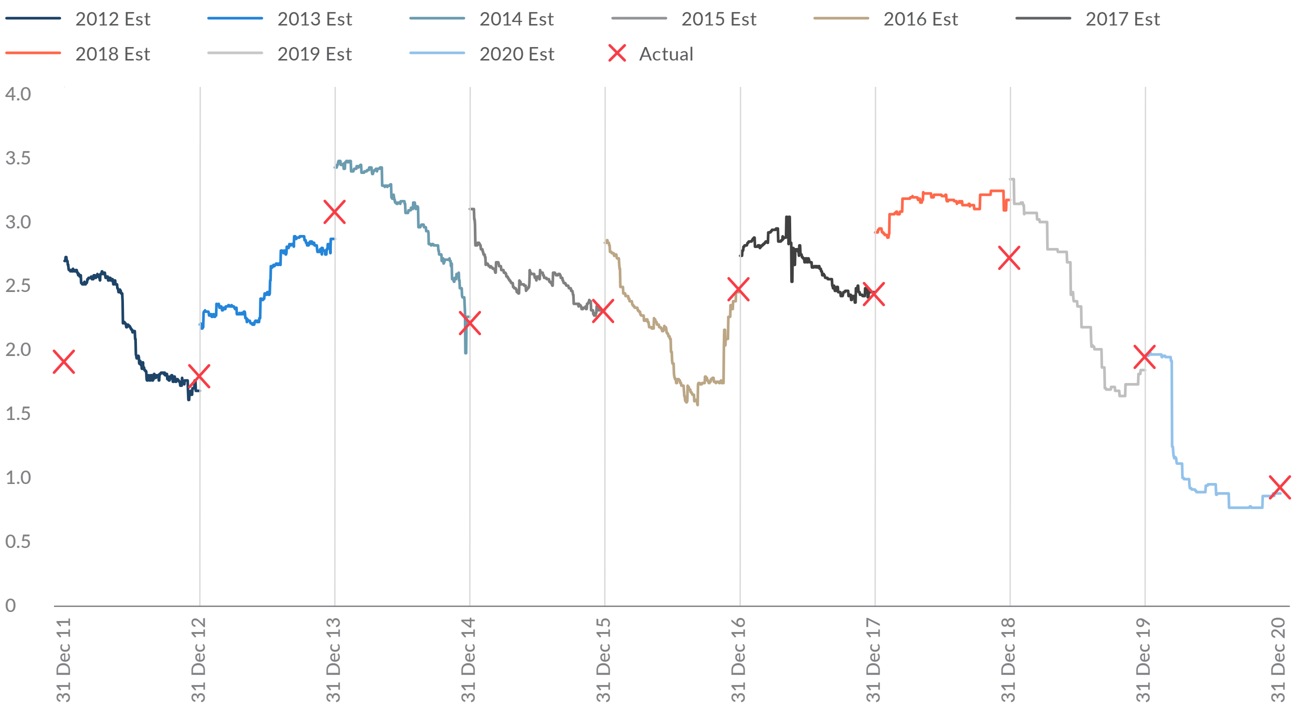
We do expect vaccination rollouts to entice people back into crowded offices and malls as well as high-rise buildings in densely populated cities, but we think this process may take some time and we fully expect things to get worse before they get better. Many tenants are still figuring out their space and location requirements in a post-pandemic world and are unlikely to overcommit before it is clear that trends have indeed shifted. Thus, we think there is still plenty of scope for tough negotiations with landlords and for vacancy rates to get slightly worse before they get better.

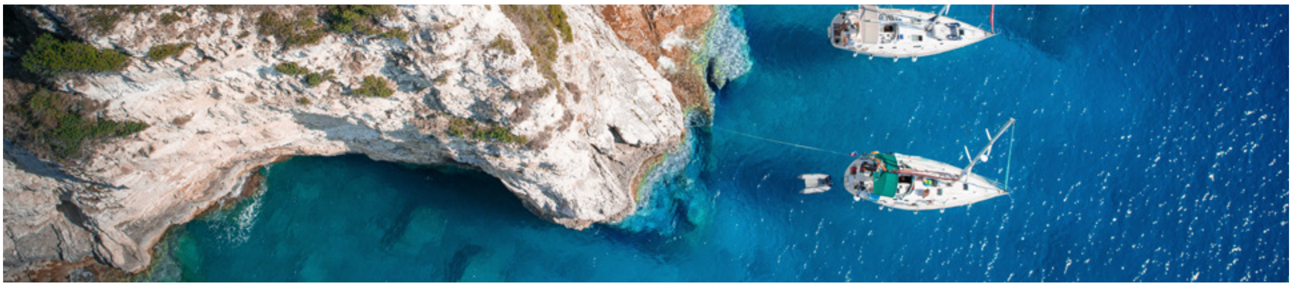
We expect that as 1Q21 and 2Q21 results start to reflect the reality of the still-worsening environment for the retail, residential and office sectors, there is scope for a 3% to 5% de-rating in income expectations, although we believe that at least half of this will start to reverse in 2H21 as the trend starts to improve. As a result, we expect investors to end the year with a total return of around 2.5% for the asset class.

GLOBAL BONDS

It has been said that economic forecasts are only really helpful in making weather forecasts look accurate. While this is perhaps a bit harsh, it is fair to say that even the best econometric models are unable to factor in the "unknow unknowns" - economic shocks like pandemics. Looking back at the recent past, economists have tended to miss on the high side when looking 12-months out at US 10-year government bond yield expectations.

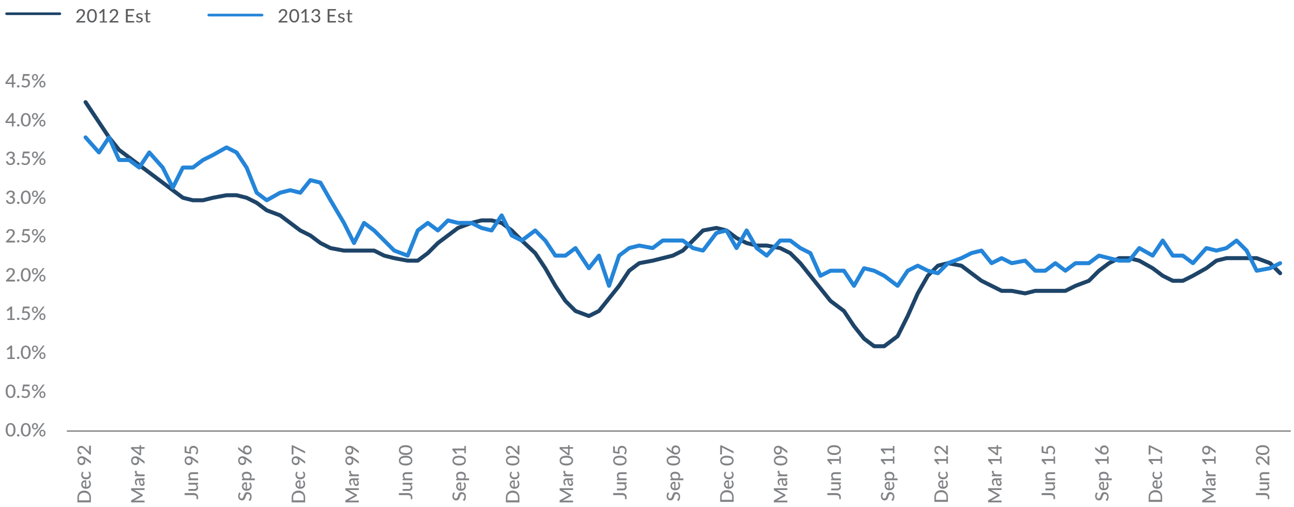
Figure 5: For the last few years economists have generally started the year expecting much higher 10-year US government bond yields than eventually materialised
Source: Bloomberg, Anchor





The exceptions were in 2013 when the "taper tantrum" caught investors off guard with the prospect of indefinite quantitative easing (QE) baked into expectations that the US Federal Reserve (Fed) had caught markets by surprise with the announcement of its plan to gently remove the monetary punch bowl. The other upward rate shock came towards the end of 2016 when a surprise Donald Trump presidential victory ushered in the prospect of fiscal stimulus (via tax cuts) and stronger economic activity. Economists have also generally been more likely to overestimate US inflation, usually missing the shocks to the downside.

Figure 6: Economists have generally missed 12-month forward inflation forecasts on the high side recently
Source: Bloomberg, Anchor



Economists are now expecting US 10-year bond yields to end 2021 at around 1.25% and we think this is probably based on expectations for continued QE, benign inflation, and a steady recovery in economic activity as the vaccine rollout ushers in a reduction in movement restrictions globally.

In our view, shocks to these expectations are likely evenly balanced, with a supply-side shock in the form of larger-than-expected US fiscal stimulus resulting from the Democrats gaining more influence in the Senate and a demand side shock in the form of QE tapering sooner than expected the most likely "surprises". We believe that the Fed will tread extremely cautiously with the latter scenario especially given the fragile state of the global economy and so place a slightly lower expectation on the "higher-than-expected" US rates outcome and end up with a US 10-year yield forecast of 1.15%, leaving investors in US 10-year government bonds with a base-case total return of 0.4%.

Corporate bonds are likely to experience only a marginally better outcome with central banks expected to remain a buyer of last resort for high-grade US corporate bonds. That said, we see it as unlikely that US investment-grade credit spreads can get lower than their current 1% level, particularly as economic stress and the lapsing of fiscal and central bank credit support programmes results in slightly higher defaults. With credit spreads remaining largely unchanged over the next 12 months that should combine with slightly higher interest rates to leave investors in US high-grade corporate bonds with an average total return of around 1.2%.

ANCHOR INSIGHTS

In this section, staff from across Anchor provide insights into our thinking, strategy, and view of the world. This quarter, Liam Hechter discusses SA equities and the encouraging macro-economic drivers which could boost the JSE's performance in 2021; Stephán Engelbrecht provides insight into SA's proposed infrastructure drive flowing from the Economic Reconstruction and Recovery Plan announced last year; Henry Biddlecombe explores the major global investment themes for 2021; Lee Cairns looks to a better future for SA after a disastrous decade under ex-president Jacob Zuma's administration and the COVID-19 pandemic; and, finally, Tamzin Nel outlines the term navigability and how it can make it easier for people, and specifically our clients, to reach their preferred investment destination.

SA equities:

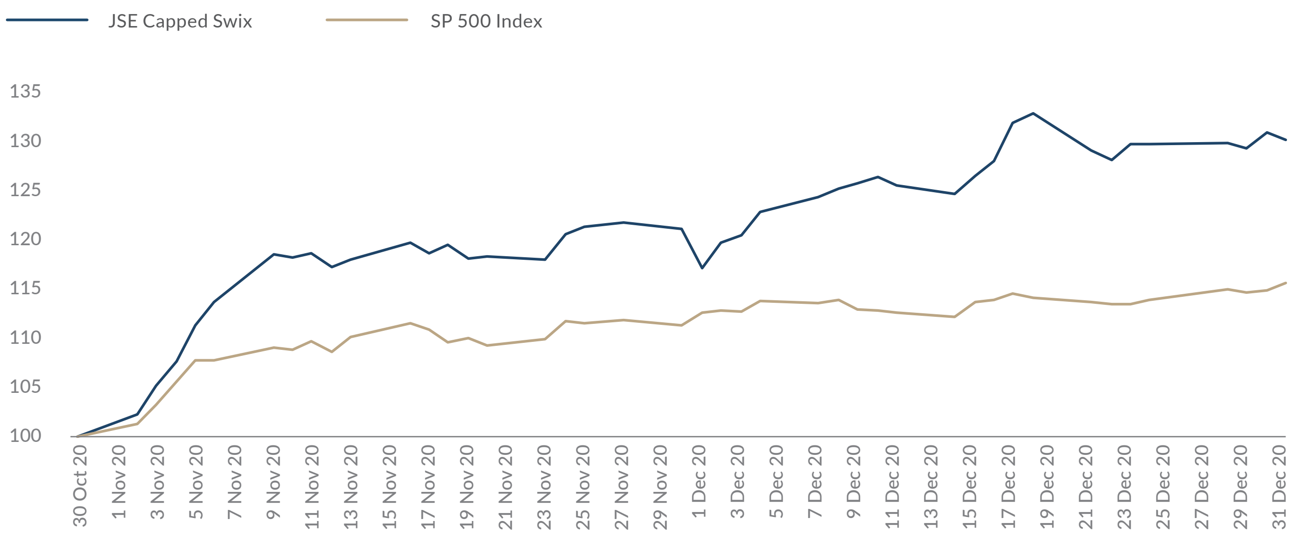
Encouraging macro-economic drivers could boost the JSE's performance in 2021

Written By:

Liam Hechter
Fund Management

Following a few false starts in late 3Q20 and early 4Q20, the domestically focussed component of the JSE finally broke out of the range it has been in since March 2020's pandemic-induced market downturn to take a convincing lead over the last two months of 2020. A few catalysts kicked off the early November rally. First up was the US Presidential Election, which saw a change of guard as Democratic Party candidate Joe Biden ousted Donald Trump as US president, thereby removing the overhang brought about by policy uncertainty in the world's most important economy. Soon after, news started rolling in around the positive efficacy of several COVID-19 vaccine candidates, which kicked off the biggest one-day rotation out of growth and into value stocks that markets have ever produced. EMs were the biggest beneficiaries of this increased risk appetite and SA was no exception, with the FTSE JSE Capped Swix outperforming the S&P 500 by a convincing 14% from the start of November to 31 December (see *Figure 1* below).

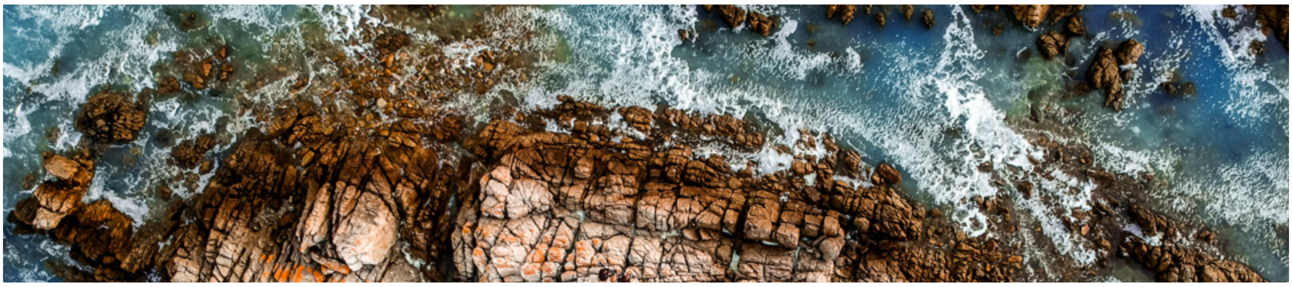
Figure 1: The performance of the FTSE JSE Capped Swix vs the S&P 500, rebased to 100 (in US dollar terms)
Source: Bloomberg, Anchor



Global markets' reaction to the vaccine news momentum and the fact that the world had produced several viable vaccines (first, Pfizer announced in November that it had achieved astounding success with its COVID-19 vaccine candidate, then Moderna and AstraZeneca followed in swift succession, with successful vaccine trial results of their own to entrench the positive sentiment) added to the sheer velocity of the inflection.

The question now facing many local investors, is whether the recent rally in domestic assets, including the currency (the rand clawed back c. 30% against the US dollar since its April lows), has further legs as we head into 2021 and how this will influence our thinking on JSE-listed equities in the year ahead. In a world where so much uncertainty remains around the glide path towards some sort of new "normalised" social and economic life, making bold financial projections remains fraught with an uncomfortably high forecast error and many analysts' forecasts (including our own) are being whipsawed by continuously evolving economic developments around the world. Locally, the situation has no doubt been exacerbated by the fragile economic position the country found itself in prior to 2020. However, as the interconnectedness of markets has increased over recent years, so too have the factors outside of SA's control, which can influence the performance of the local equity market.

In saying that, we are not merely referring to the usual notion that "the JSE offers diversified exposure due to the large component of foreign-based earnings on the exchange", but we are making specific reference to the increased impact that global macroeconomic, and structural changes in markets are having on the prices of JSE equities (as well as on the currency and bonds). In fact, the main reasons we are constructive on the performance of JSE equities over the course of 2021, have very little to do with bottom-up, company specific drivers and are instead more premised on several higher-level, more macro-orientated drivers.



BELOW, WE OUTLINE OUR CORE VIEWS IN THIS REGARD.

- Front and centre to our constructive outlook for JSE equites in 2021 is our belief that, over the course of this year, global economic conditions will gradually improve and the vaccine rollout, which will likely take most of the year, will result in society returning towards some semblance of normality. Crucial for SA is a smooth and, hopefully, uneventful vaccine rollout programme, although this already looks to be off to a controversial start with much uncertainty around the availability, and timing, of SA's vaccine rollout. Still, we believe these issues will resolve themselves in the coming months and SA will be able to join the rest of the world in a cyclical economic upswing.

- Conventional economic wisdom suggests that equities perform best at times of loose monetary and fiscal policy and, in our view, central banks (including the SARB) and government-led stimulus measures will continue to underpin lower real rates and higher equity valuations for the foreseeable future. We are not in the camp that believes inflation will be an issue in the short term and we think that, as we have seen since the first broad-based central bank interventions began after the global financial crisis (GFC), that risk-free rates (an underpin to equity valuations) will remain low enough to continue to incentivise large/overweight allocations to equities. Adding to the attractiveness of EM equities is the lower multiples, and higher yields relative to DMs.

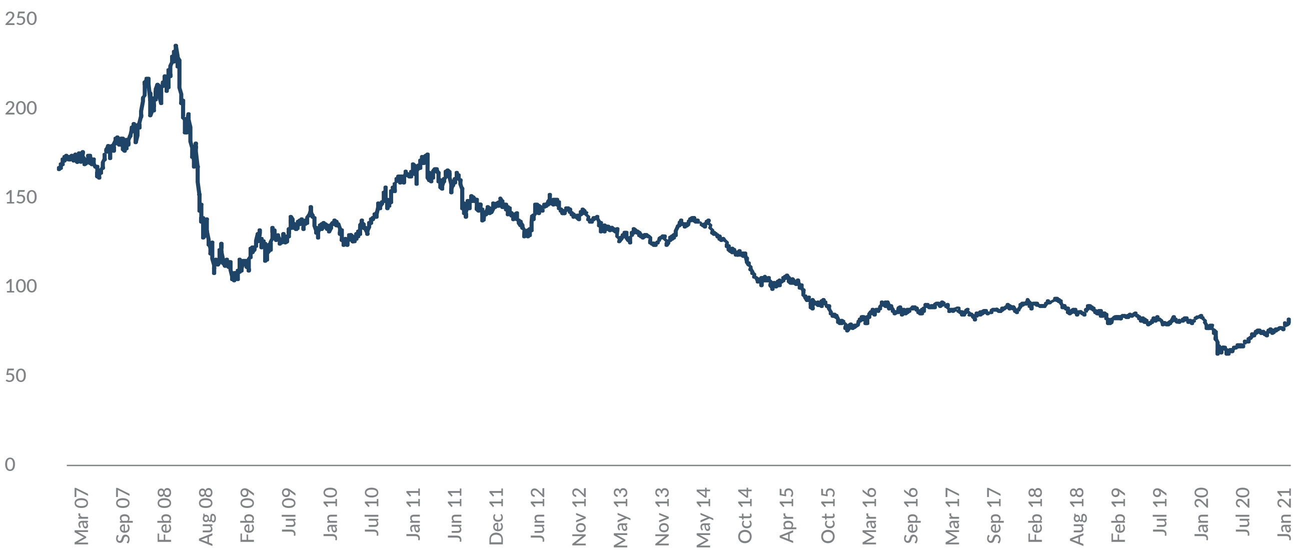
- The US Presidential Election, together with the early January win by the two Democratic Senate candidates in the Georgia twin runoff elections, which gives the party narrow control of the Senate, has provided some stability to the global geopolitical outlook - at least for the next 4 years. The need to reconfigure the working relationship between the world's two most important economies (the US and China) has been bipartisan, although we believe a Democrat-led government will handle complex issues in a more predictable and diplomatic manner than the previous administration. Greater certainty should also provide investors with more comfort to deploy capital into riskier assets with the key beneficiary being EM equities.

A global economic recovery, fuelled by loose monetary and fiscal policy around the world, underpins our generally constructive view on EM equities. However, tying this into a constructive view on JSE-listed equities requires a further look at some of the core themes we expect to play out in the various components of the JSE in the year ahead.

- A value unlock from Naspers and Prosus, as guided by management who have underwhelmed thus far in providing tangible solutions to narrow the gaping discount to the underlying sum of the parts these shares have been trading at for some time.

- Currently accounting for close to one-third of the FTSE JSE Capped Swix Index, the basic materials sector has been a recent outperformer relative to those companies that are more reliant on domestic economic growth. Furthermore, the larger, more diversified mining businesses are still pricing in commodity prices well below their prevailing spot prices and, with cleaner balance sheets and clearer communication around capital allocation, we expect significant upside to earnings estimates should spot commodity prices prevail. Two factors supporting our positive stance on commodities are 1) the conservative capital allocation in terms of expansion capex over the last business cycle, resulting in a tightness of key commodities; and 2) the notion that the flood of stimulus released by central banks (and resulting in increased money supply), will result in a weaker US dollar and firmer commodity prices.

Figure 2: The *Bloomberg* Commodity Index performance
Source: Bloomberg, Anchor



- The domestically focussed stocks are those which benefit most from the economic recovery and an increase in EM flows, particularly the more liquid sectors such as banks, insurance, and retail. Consistent with historic experiences, this has already started off in the form of multiple expansion, with the outlook for earnings still very difficult to forecast, particularly in year-two and year-three of both our and *Bloomberg* consensus profit estimates.

- In the short term, we expect to see a sharp recovery in earnings, specifically in consumer-facing sectors (such as discretionary retail), which were forced to shut down at the peak of the lockdowns in 2Q20. However, a sustained earnings recovery and continuous higher multiples will require a concise and determined effort from SA policymakers to i) conduct an effective rollout of the COVID-19 vaccine, thus allowing market participants to look through further escalations of the pandemic; and ii) enact key structural reforms. Here, we are encouraged by recent developments, including reforms around the partial privatisation of the energy grid. We remain hopeful that policymakers are on the right path, although like most South Africans we remain frustrated at the slow pace of change.

- In terms of valuations, we concede that, over the past two months, the market has given a V-shaped domestic economic recovery the benefit of the doubt, with a healthy rerating of the larger, more liquid, domestic counters implying a sharp recovery in 2021 activity levels. Unfortunately, and more importantly for us as bottom-up stock pickers, the fading away of local entrepreneurs, no doubt stung by a decade of mismanagement under former-president Jacob Zuma's administration, has meant that, outside of the short cycle rebound in activity levels, we have not managed to unearth the types of structural investment opportunities that we had come to expect in the past. There have been pockets of excellence (a company like Transaction Capital is a good example), and we remain hopeful that sufficient depth remains among local management teams to take advantage of any pockets of growth unearthed by policy reforms and increased infrastructure spend.

Our base-case scenario for SA equities remains an expected return of c. 11% for 2021, although getting the allocation right below the index level will be a key determinant of success.

South Africa's infrastructure drive: Are we turning a corner?

Written By:

Stephán Engelbrecht
Fund Management

SA has in the past been good at producing various ambitious plans to support economic growth which, unfortunately, never come to fruition. Since the dawn of our democracy, we have seen many of these economic plans being set out, updated, and, ultimately, replaced. From the Reconstruction and Development Programme (RDP) in 1994, to the Growth, Employment and Redistribution (GEAR) strategy in 1996, to the Accelerated and Shared Growth Initiative of South Africa (AsgiSA) in 2006, to the New Growth Path (NGP) in 2010, and the National Development Plan (NDP) in 2012, we have had many iterations of new growth strategies for our fledgling economy. All of these plans had their respective critics, with the balancing act of righting the wrongs of the past through social spending, while also driving economic growth through capitalist theory always being a difficult task. Still, in general, these plans were embraced and, in theory, they would all have likely helped to grow the country's economy. Unfortunately, most of these plans never achieved their ultimate goal. Mismanagement, bureaucratic red tape, an inability to measure their progress and a lack of real urgency from government, combined with ever-changing global economic conditions resulted in these plans stumbling at the initial critical hurdle of actually being implemented.

In light of the above, it is therefore understandable that the new growth plan, the Economic Reconstruction and Recovery Plan, announced by President Cyril Ramaphosa in October 2020 was met with skepticism and even cynicism. Much of this "new" plan consisted of rehashed projects and goals from previous plans and many commentators, including yours truly, said that there was actually nothing new about this "new" plan.

But then a few weeks after the plan's announcement, we came across an opinion piece entitled *View from up Close: Why this Plan is Different*, dated 16 October 2020 and published on the *Daily Maverick* website. The article was written by Saul Musker, who works for the Project Management Office in the Presidency. Musker stated that most commentators missed a trick in this new plan. He acknowledged that there was no new silver bullet in the plan that was going to turn the SA economy around, but then he said that the authors of this plan realised that they did not need to find a new silver bullet. All of the many previous plans had great ideas - all that was needed was to ensure that this plan is indeed implemented and measurable. And that is precisely the focus of the document.

Reading through the plan with this new perspective, it is encouraging to see that it has prioritised certain projects and goals and has also tried, as far as possible, to put measurable outputs alongside these goals. This plan tried as far as possible not to give a wish list of big goals, but to rather draw up a priority list of projects and objectives. And investment in infrastructure was priority number one. The complete priority list is:

- Aggressive infrastructure investment;
- employment-orientated strategic localisation, reindustrialisation, and export promotion;
- energy security;
- support for tourism recovery and growth;
- gender equality and economic inclusion of women and the youth;
- green economy interventions;
- mass public employment interventions;
- the strengthening of food security; and
- macro-economic interventions.

Infrastructure investment is a very good path to pull an economy out of a slump. Not only is it labour intensive, which will assist in reducing the unemployment rate, but it should also facilitate future economic growth. The proviso is that investment is made into those projects which the country's economy actually needs in order to grow. We can all probably agree that the significant investments in soccer stadiums for the 2010 FIFA World Cup did not do much to enable future economic growth.

So, what are the projects which this plan targets? Most of the plan's infrastructure investments are allocated according to three main sectors - energy, network industries, and social upliftment. This is already a definite improvement from soccer stadiums.

The investment in energy will be guided by the Integrated Resource Plan (IRP) that was gazetted at the back-end of 2020. According to the IRP, renewable energy will be the key growth vector in SA's energy mix. The next bid window (Bid Window 5) for renewable energy should be launched imminently (currently targeted for January 2021), with a targeted capacity of 13 813MW. Bid window 5 is thus expected to be greater than all the previous bid windows combined. The split of generation capacity will be as follows:

2 000MW

of emergency power to meet a short-term electricity gap, which should be connected to the national grid by **June 2022.**

11 813MW

from various sources: 6 800MW from **solar photovoltaic (PV) and wind;** 513 from **energy storage;** 3 000MW from **gas;** and 1 500MW from **coal.**

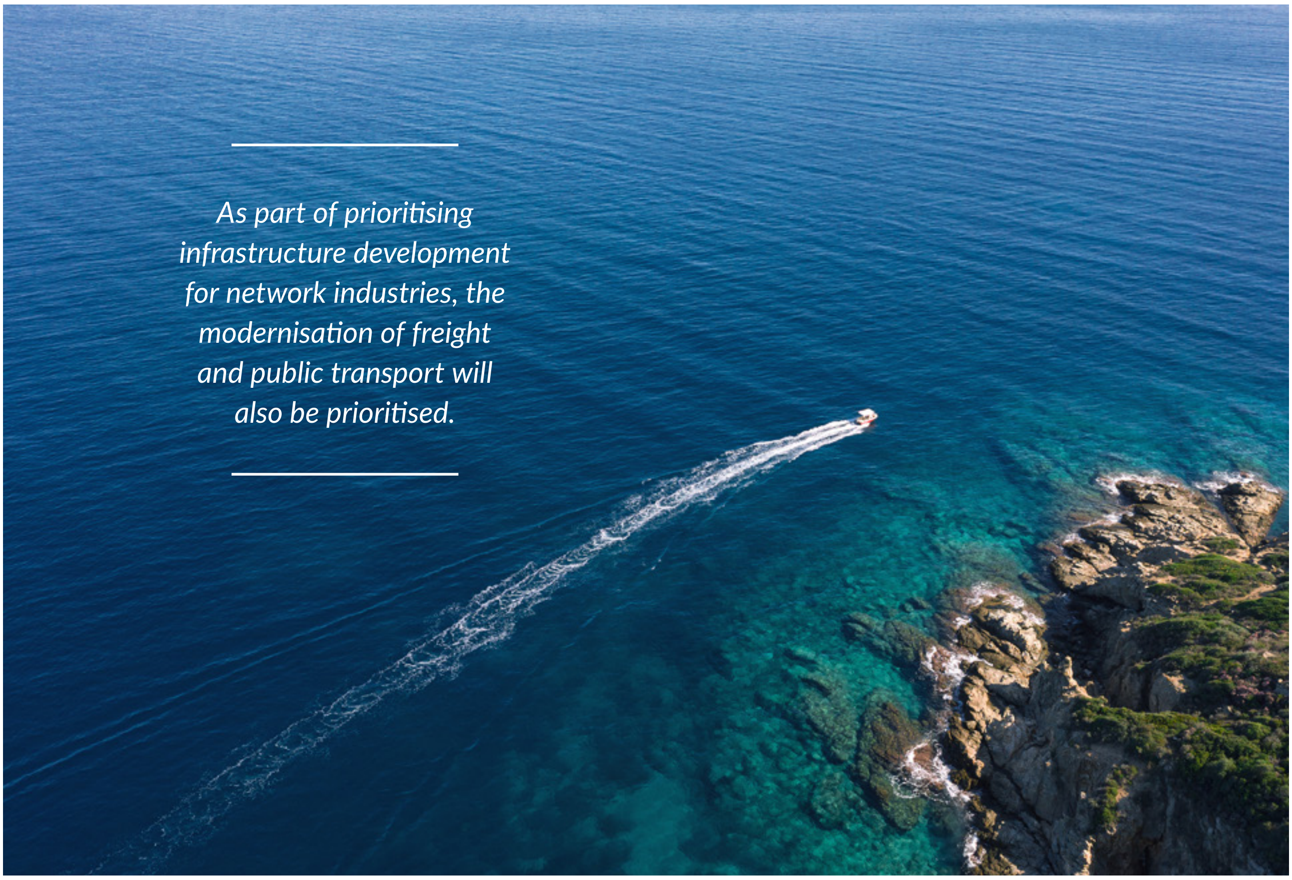
Given the debilitating impact that loadshedding has had on the SA economy, we firmly believe that investment in SA's electricity grid will help drive future economic growth, while also ensuring a more sustainable energy mix going forward.

As part of prioritising infrastructure development for network industries, the modernisation of freight and public transport will also be prioritised. In this regard, the following will be implemented:

- Reversing delays in Metrorail modernisation, including prioritising the refurbishment of the Mabopane line in Tshwane and the central line in Cape Town;
- Ensuring improved efficiencies at ports of entry;
- Protecting passenger and freight-rail infrastructure from vandalism, arson and other crimes;
- Fast-tracking the approved Integrated Public Transport Networks (IPTN) in 5 cities, providing support to the taxi industry, the development of the small harbours project and the roll out of a labour-intensive, rural roads asset network using alternative technologies as well as local supply and value chains.

The South African National Road Agency (SANRAL) will also play a key role in the investment in network industries. For years, SANRAL has been a reliable source of infrastructure investment doing a credible job at maintaining the national road network, but over the past 3 to 5 years new contracts from SANRAL have been scant. Fortunately, this appears to have turned a corner. JSE-listed construction company, Raubex, recently announced that it has won two multi-billion rand contracts from SANRAL and looking at the tender schedule, which is readily available on the SANRAL website, there will be a few more multi-billion rand contracts awarded over the next few months.

The investment in rails and ports will be managed by Transnet. The main goal will be to improve the capacity of the rail and ports network. At present, many of our mining companies are hamstrung by the limited capacity to export our minerals. The details of these projects have not been released as yet, but increasing our export capacity will definitely enhance SA's growth potential.



The question remains though whether the government will be able to implement all of these ambitious projects. Speaking to industry participants the feedback is encouraging. On a conference call with the bankers preparing the documentation for Bid Window 5, they were very complimentary around government's willingness to engage with the private sector and turning from the driver of these projects to the enabler. This attitude can also be witnessed in the government's willingness to allow municipalities to buy electricity from providers other than Eskom and private companies being allowed to generate their own electricity. We can only hope that this change in attitude is maintained.

This agency will play a key role in standardising the design for social infrastructure across the country

In the policy document itself, details are also given on how the government will look to navigate past the capacity constraints, especially at a municipal level. A single window of entry will be created through the establishment of Infrastructure South Africa (ISA) - a central government agency responsible for coordinating and driving the infrastructure investment programme. This agency will play a key role in standardising the design for social infrastructure across the country and, in so doing, making the tender process far less complicated, reinforcing the municipalities where capacity constraints arise, and improving coordination across provincial or municipal boundaries where projects often fall between the cracks.

On a conference call with Raubex management, we noted that they were optimistic that the scheduled projects will come to realisation. From SANRAL to the Department of Minerals and Resources, to Eskom, to Rand Water, the engagement from government with the private sector has improved and contracts are finally being awarded.

Given the dire state of the SA economy the lack of urgency from the government has been excruciatingly frustrating. However, it now appears as though the wheels have been turning, albeit slowly, and we are currently in a position where we may start to see some action on the infrastructure front locally. And with the prices of major SA export commodities (iron ore and the platinum group metals [PGMs]) continuing to perform strongly, we may start to see some private sector infrastructure investment as well.

It is still early days, and much can still happen to upset the apple cart, but the stars may just be starting to align for the long-awaited recovery of the SA economy.

Major global investment themes for 2021

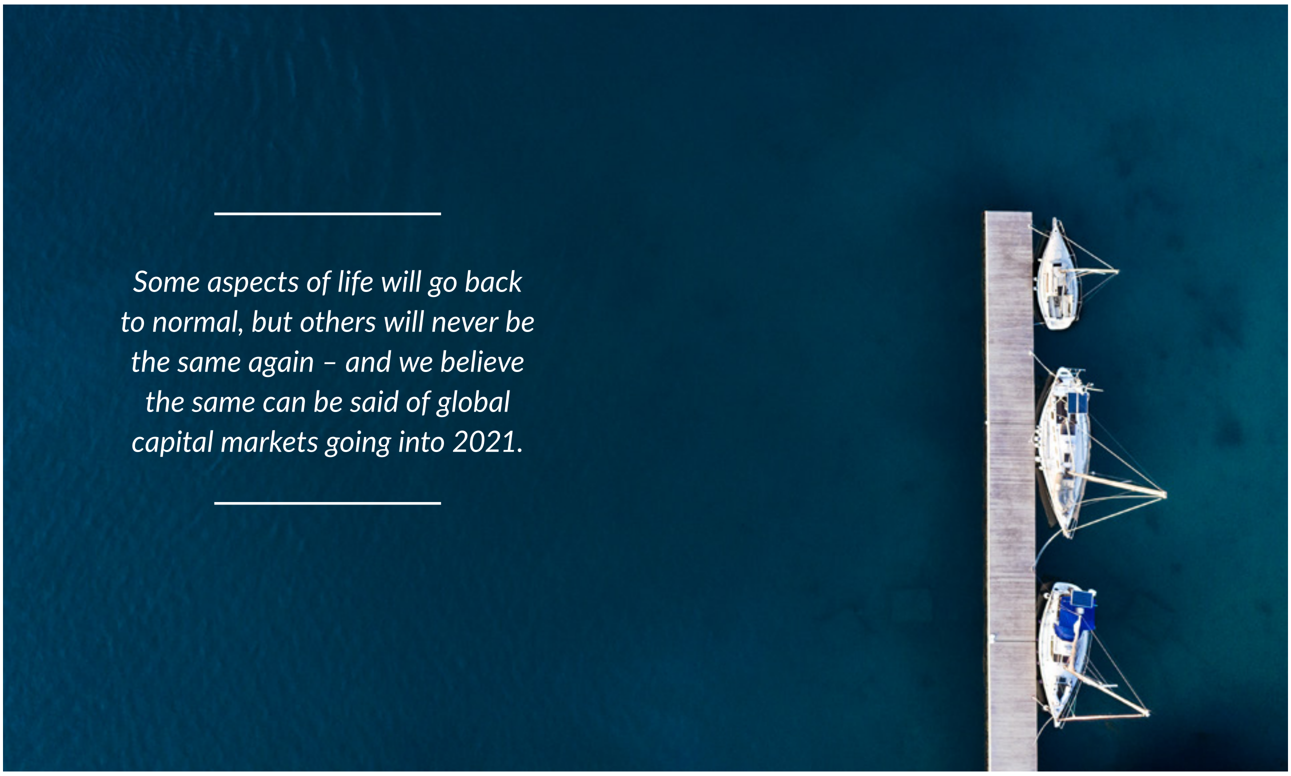
Written By:

Henry Biddlecombe
Fund Management

***"Gradually, and then suddenly".* This rather famous line from Ernest Hemingway's novel, *The Sun Also Rises*, manages to express one of the most profound insights into the human experience of the phenomenon of change.** Hemingway captures exactly how a simple weed may destroy an entire garden, how a tiny termite can bring down a house – or how a seemingly isolated virus in a remote Eastern region could change the world in just 6 months.

And change the world it did. Some aspects of life will go back to normal, but others will never be the same again – and we believe the same can be said of global capital markets going into 2021.

As your appointed investment managers, we would like to share our insights into some of the key themes that will shape our strategy as we head into the new year. We will briefly dissect the significance of each theme and explain how we are incorporating it into our investment process.



INVESTING IN A ZIRP (ZERO INTEREST RATE POLICY) WORLD

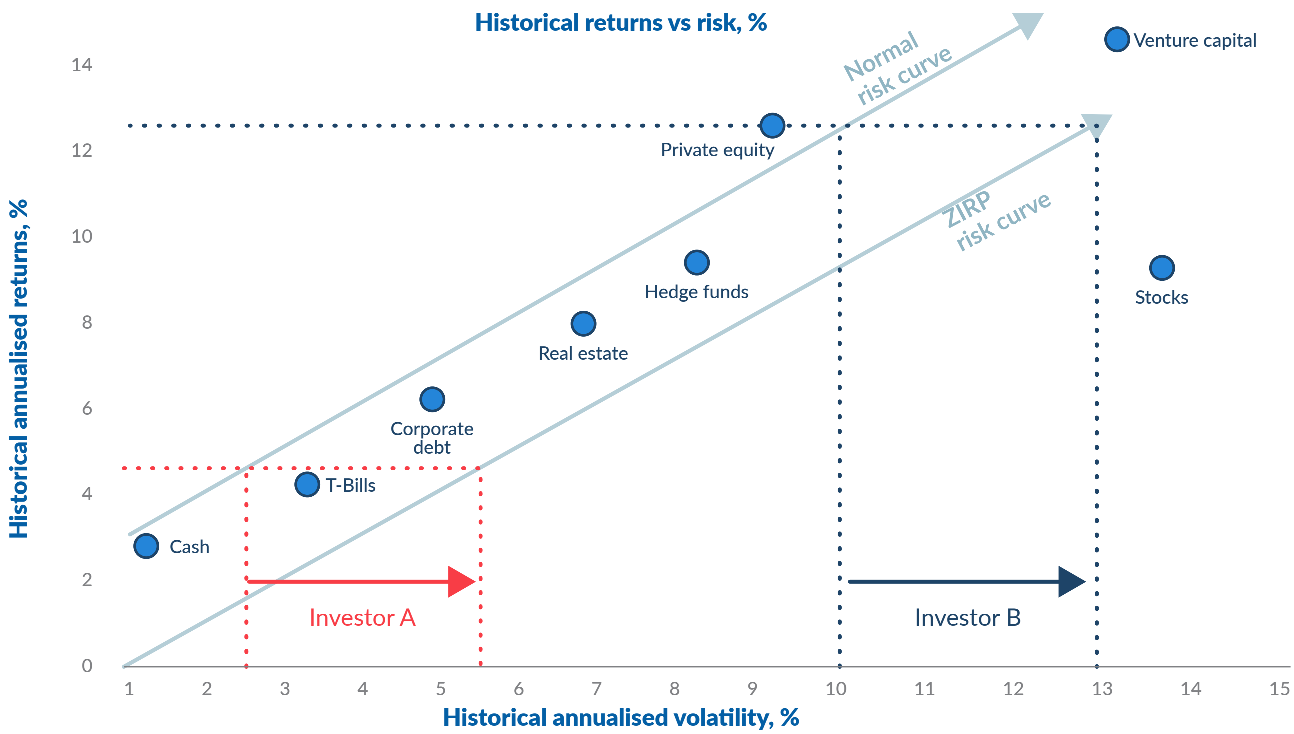
WHY IS THIS SIGNIFICANT?

We are currently experiencing one of the more extreme instances of ZIRP in modern history as central banks around the globe have cut benchmark rates to zero (or close to it). Their actions are both understandable and necessary.

In times of recession, central banks will lower interest rates to force liquidity into the economy to offset the contraction in activity levels - this time around resulting from an unprecedented supply-side shock. The very intentional effect of this is to lower the return earned on risk-free assets, which forces market participants to take on more risk to earn their required return. The result is that companies in need will have access to capital (both debt and equity), which would otherwise have dried up.

This phenomenon is illustrated in *Figure 1* below showing two investors' risk preferences along the "normal" and the ZIRP risk curve. Investor A, who ordinarily invests in a combination of cash and T-bills will now need to include riskier corporate bonds to earn their required return. Investor B, a private equity specialist, will now need to seek out riskier venture capital investments to deliver the requisite alpha to his clients.

Figure 1: The impact of ZIRP on the risk curve
Source: Anchor



However, ZIRP is a blunt instrument. As you may deduce from *Figure 1* above, a lot of money will find its way to places where it is needed – but also to where it is not needed. While ZIRP may drive an abnormally high demand for debt issued by a troubled hospitality business (and hence saving its existence), this same policy will drive an almost incomprehensible tolerance for risk at the higher end of the curve.

How could Tesla, which currently produces just 500k vehicles p.a., be worth more than the next top-6 vehicle manufacturers, which together produce over 45mn vehicles annually? Why was Bitcoin up over 300% for the year? How can Uber, with no clear path to profitability, trade at a market cap of over US$100bn?

The cause is likely excess capital with a near-infinite risk tolerance, and the culprit is almost certainly ZIRP. Calculated risk-taking has been replaced with FOMO (fear of missing out), fundamentals have been replaced by narratives and bull cases have now become base cases.

HOW WILL THIS IMPACT THE WAY IN WHICH WE INVEST?

Clearly, the risk here is the unwind of ZIRP. In our view, it is not a matter of if, but rather a matter of when. While Fed Chair Jerome Powell's most recent comments suggests a dovish view from the US Fed ("we have the ability to be patient"), we also know from experience that this can (necessarily) change rapidly.

Given the rather extreme point from which we are starting (see historical graph of the US federal funds rate in *Figure 2* below), it stands to reason that the negative impact of higher reference rates on valuations would be equally as significant as the recent impact of historically low rates, albeit in the opposite direction.

Figure 2: S&P 500 PE vs federal funds rate over 50 years
Source: Bloomberg, Anchor

It is not difficult to envisage a scenario where a combination of the subsidence of COVID-19, significant US fiscal stimulus and pent-up consumer demand drive a sudden pick-up in inflation in 2021. The market will likely react to the earliest acknowledgement of any evidence of such a trend by the US Fed, which could be as subtle as the mention of "asset price inflation" or "inflation bottoming out".

Naturally, we believe the most exuberant valuations will be hit the hardest when this happens. Fundamentals will come into focus again and, at this juncture, it will be important to own companies which are not priced for absolute perfection and total market domination.

Hence, we find ourselves favouring the large-cap counters which have, to some extent, fallen out of favour as the market chases newer, more exciting, growth stories. We are owners of Facebook, Alphabet, Amazon, and Alibaba – and we find ourselves being wary of Tesla, Uber, and Zoom.

So, the story seems fairly dependent on the state of the US consumer, and the prospects of the more cyclical end of the economy – which leads us to our second key theme ...

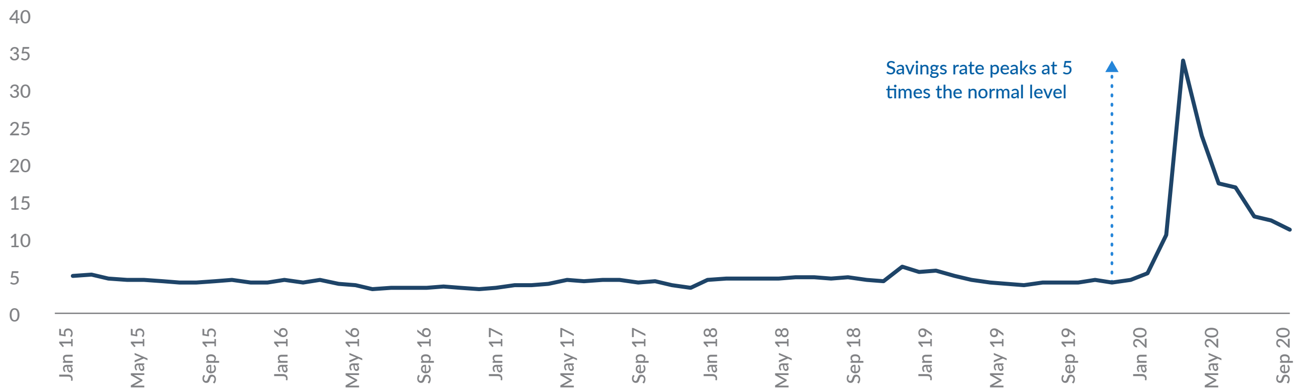
THE FINANCIAL HEALTH OF THE US CONSUMER

WHY IS THIS SIGNIFICANT?

Given that consumption expenditure constitutes around 70% of US GDP, it follows that the financial health of the US consumer is a major determinant of the trajectory of that economy. This is also why the most recent two rounds of US stimulus have directly targeted the pockets of US citizens, both with transfer payments and massively inflated unemployment insurance.

Although there are many statistics to consider, the one that we find the most striking is the US personal savings rate – a measure of the percentage of disposable income that remains after taxes and monthly expenses. A combination of 100% wage replacement through extended unemployment benefits, stimulus cheques and poor economic sentiment sent the savings rate skyrocketing up to five times the normal level (35%) in April – and by October it would still sit at roughly twice the normal level (see *Figure 3* below).

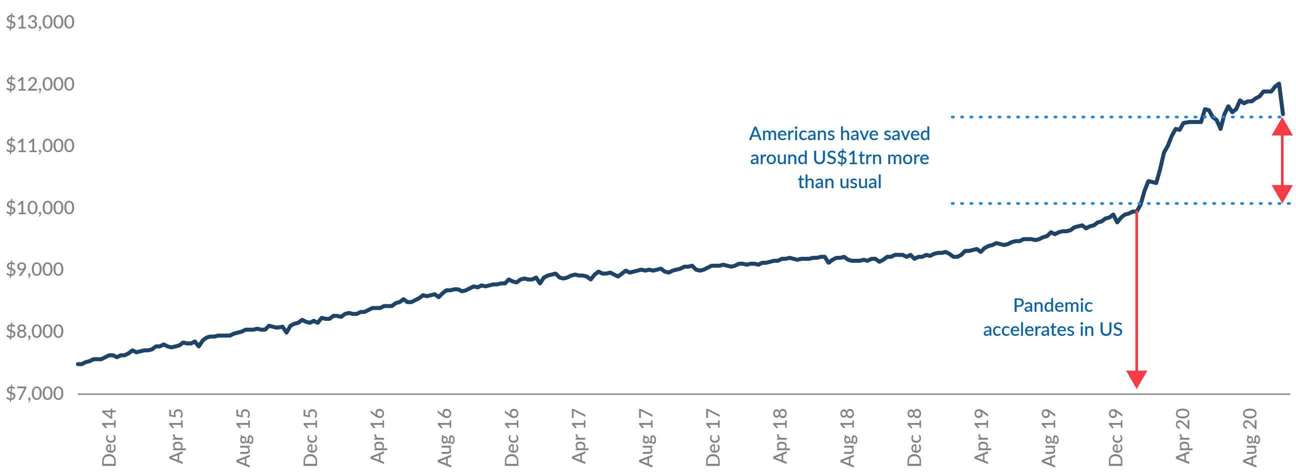
Figure 3: US personal savings rate over the past five years, %
Source: St Louis Fed, Anchor



This has meant that Americans have put away around US$1trn more than usual over the past year, having saved around US$1.7trn by the end of August 2020 as compared to an annual average of around US$500bn (see *Figure 4* below). This is not an insignificant number and amounts to roughly 5% of the country's annual GDP.

This "pent-up demand", from an incremental perspective, could prove to be a tremendous tailwind to consumer spending once the pandemic subsides and consumer confidence returns.

Figure 4: US total savings deposits at all institutions over the past five years, US$bn
Source: St Louis Fed, Anchor



HOW WILL THIS IMPACT THE WAY IN WHICH WE INVEST?

While technology stocks have been the standout beneficiaries of the "pandemic trade" (see *Figure 5* below showing the S&P 500's performance per sector for 2020), the performance of the more cyclical end of the economy has been far more subdued. Banks, industrials, physical retailers, hospitality companies and their associated service providers have all had a relatively weak year – and many of these stocks are still trading at levels meaningfully below their pre-pandemic values.

Figure 5: The S&P 500's 2020 performance by sector
Source: Bloomberg, Anchor
***includes Amazon**

S&P 500	Average weight (%)	Total return (%)	Contributiuon to return (%)
		18.4%	18.4%
Information Technology (TECH)	26%	43.9%	11.0%
Consumer Discretionary*	11%	34.4%	3.7%
Communication Services (TECH)	11%	23.6%	2.6%
Health Care	14%	13.4%	2.0%
Consumer Staples	7%	10.8%	0.7%
Industrials	8%	10.0%	0.6%
Materials	3%	20.7%	0.6%
Utilities	3%	0.5%	-0.1%
Real Estate	3%	-2.2%	-0.2%
Financials	11%	-1.8%	-0.8%
Energy	3%	-33.7%	-1.7%

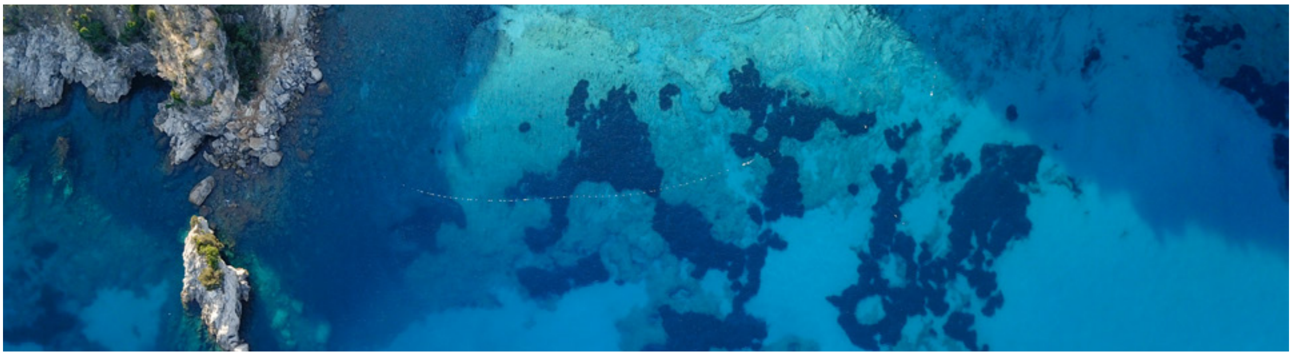
Despite the obvious near-term negative impact of the pandemic, these cyclical counters stand to benefit tremendously from consumers who a.) now sit on excess savings; and b.) who will likely demonstrate an abnormally high propensity to spend these savings as the world returns to normal.

We like Sysco, one of the largest food service companies in the US, which is still down around 15% over the past year. In our view, the value of a solid balance sheet, strong cash flow generation and a structurally entrenched market position all outweigh the temporary hit to revenues from reduced restaurant activity.

Ryman Hospitality Properties is another example, which is still c. 30% below its January 2020 levels. The owner of several premium convention and country music venues has the resources to weather what has become the perfect storm, and it should come out on the other side intact.

We also own several US banks, which collectively now trade at heavily discounted price-to-book ratios given low absolute interest rates and market pessimism around credit book impairments. While prevailing economic conditions remain challenging, this point in the cycle is likely (more than) priced in.

This is not to say that we cannot identify value within the tech sector, however – and over the longer term we still believe that tech will continue to outperform the broader market for fundamental reasons. At present, there is a particularly interesting scenario in that space which we believe is yielding an opportunity – and that brings us to our third key theme for 2021.



THE RESURGENCE OF ANTI-TRUST ACTION IN TECH

WHY IS THIS SIGNIFICANT?

The tech sector has created more value for investors over the past decade than any other sector, explaining around 43% of the returns of the S&P 500 since 2010. Then last year, when the US House Judiciary Antitrust Subcommittee summoned the CEOs of Amazon, Alphabet, Apple, and Facebook to an initial hearing – the market became concerned with what seemed to be a big, new hurdle for tech.

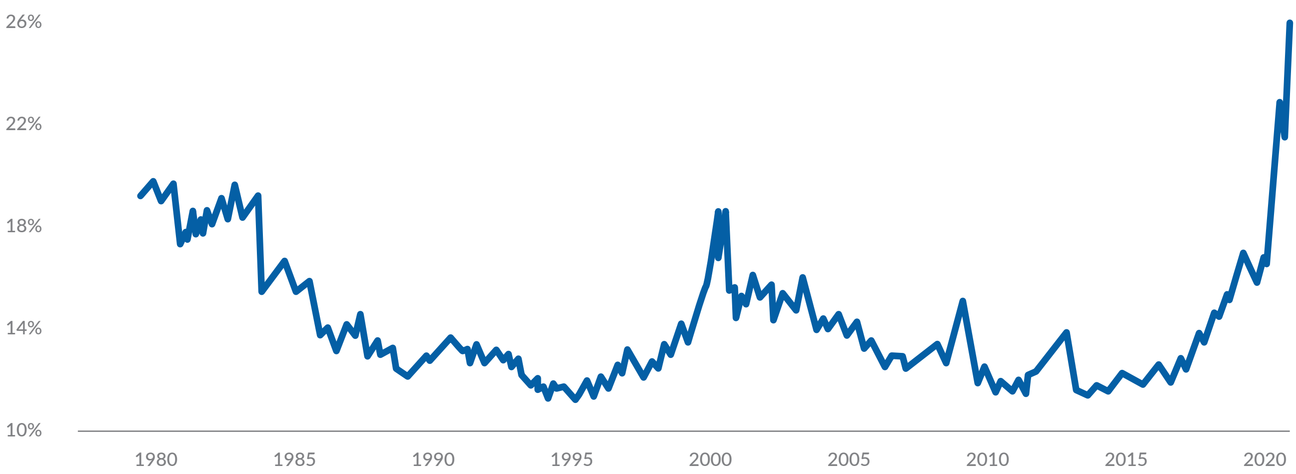
Just months later in China, Alibaba would feel the brunt of similar antitrust action. The growth story now seemed to be under threat, sending the share down c. 25% (until time of writing) from its October high.

Although one may be tempted to blame politicking in an election year in the case of the US, or perhaps Jack Ma's outspokenness against China's legacy banking system in Alibaba's scenario – the truth is that both the US and China are just now coming out of a prolonged period of "inaction" from market regulators. Tech has benefitted from a sort of golden 15-year period, where they have been able to run rampant and either acquire competitors, or to leverage their dominance to crush them.

The result is a historically high concentration of "market power", spread among a few firms which are now virtually impossible to compete with – as is illustrated by the collective market capitalisation of the S&P 500's five-largest companies, expressed as a percentage of the total index (see *Figure 6* below).

Figure 6: The concentration the US equity market reflects tech's dominance
Source: Bloomberg, Anchor

Market cap of the five-largest S&P 500 companies, expressed as a % of the S&P 500 Index



Four of the five companies are the very companies summoned to the August hearings – Apple, Amazon, Alphabet, and Facebook – with the fifth company, Microsoft, having been through its own round of antitrust issues two decades ago.

HOW WILL THIS IMPACT THE WAY IN WHICH WE INVEST?

Here is the thing, though. While antitrust measures sound bad, and certainly do not suit management teams that want to dominate the world – they are in fact a net positive for shareholders. Conglomerate structures, which make the stifling of competition a lot easier, also tend to dilute a lot of shareholder value.

Often acquisitions or subsidiaries are run as the sacrificial enablers of others. Amazon's retail profits funded Amazon Web Services. WhatsApp's user base of over 1bn is simply used as a data mine for Instagram/Facebook. Alibaba offers several services to its merchants below cost in exchange for exclusivity.

Breaking these giants up will necessarily result in enhanced profitability, and hence will lead to the unlocking of trapped shareholder value. It then follows that the best investment opportunities likely lie with the same companies that seem to have fallen foul of regulators.

Antitrust action in 2021 could result in the eventual IPO of Ant Financial (in which Alibaba has a 33% stake), the possible break-up of Facebook or the potential spin-off of Amazon or Alphabet's cloud businesses. These are all instances where the sum of the parts will almost certainly be greater than the whole.

Ironically, these are also some of the most attractively valued companies in the context of the broader tech sector as the market misinterprets antitrust measures - a likely catalyst for value creation - as some kind of punishment. We are inclined to take the opposite view, and we believe that the market will come around eventually.

PUTTING IT ALL TOGETHER

As other contributors to this strategy document will attest, to contemplate the performance of global equity markets through 2020 in aggregate would have caused you to miss gigantic tectonic shifts that have taken place beneath the surface of the indices.

Heading into 2021, it is imperative to look through the market's recovery into the underlying and disparate instances of excessive pessimism and unfounded optimism - and to position your portfolio accordingly.

Hopefully, we have given you some insight into what we believe are the more obvious themes and catalysts that will explain market volatility, and how we plan to leverage the subsequent upside while mitigating the inevitable downside.

We will endeavour to recognise trends early, and to react decisively - remembering that change has a habit of manifesting at first "gradually, then all of a sudden".

It's the end of the world as we know it ...

Written By:

Lee Cairns
Wealth Management

In 1987, the band R.E.M. came out with this song and, as a carefree student at the time, I would merrily belt out the lyrics ... "It's the end of the world as we know it, and I feel fine."

We started the new decade in 2011 on the ultimate high, having hosted Africa's first and a phenomenally successful 2010 FIFA World Cup. Yes, there were concerns about ex-president Jacob Zuma and his somewhat chequered past and apparent alternative agendas, but that aside, we were the Rainbow Nation and we had only just started to show our true potential to the world. Sadly, for SA it was downhill from there.

Fast forward to 2019 and even the most ardent pessimists were astounded by how much further Zuma-era corruption and maladministration had eclipsed even the bleakest of expectations. A trail of destruction ran through every facet of our beloved country, leaving our economy in tatters. Never had the lyrics of that same R.E.M. song seemed so poignant. It really was the end of the (South African) dream as we knew it, but this time I felt anything but fine.

South Africans breathed a huge collective sigh of relief in May 2019 - happy to see the back of a nine-year administration that had devastated our country and the election of Cyril Ramaphosa as president. Give 20Plenty to us immediately please.

I am not even going to try and sugarcoat what played out in 2020. What more is there to say - if 2010 was the best which that decade had to offer SA, 2020 was the worst.

But before you sink into (possibly deeper) despair, hold on a minute. It is trite, but true, to say that with all major crises, come great opportunities. The major opportunities thus far have been in the global tech companies. What was set to be a 10-year transition to online has become an everyday way of life in less than a year. And those tech companies have made their shareholders extremely happy and wealthy - on paper at least. Amazon, Google, Facebook, Etsy, Alibaba, Tencent, Airbnb, to mention but a few. There is such a strong belief that tech has, and will continue to, change the world for the next 10 years that you can simply ignore the valuation of a tech company - buy the share, and the price will go up.

The major opportunities thus far have been in the global tech companies. What was set to be a 10-year transition to online has become an everyday way of life in less than a year.

Furthermore, the attention given to investing in all that is new and shiny has come at the expense of the old economy stalwarts which investors used to consider great investments. Just try and talk to someone about the opportunity to invest in a coal mine today, and you will surely get a rather quizzical look, indicating that you may have lost touch with reality. After all, clean energy is taking over, and coal, and all its dirty associates, will soon have no use in the world.

I agree with these comments, and the sooner this happens the better for our planet and for humanity. However, the world, and certainly SA, will still need coal for at least the next 5 and, possibly even, 10 years. But negative sentiments around these types of old economy stalwart companies have meant that the prices at which investors can buy their shares have become extremely low. So, what am I on about and what is the opportunity? Let us look at two companies on the opposite ends of the spectrum.

TESLA

- The world's leading electric vehicle (EV) company.
- It has a price to earnings (PE) ratio of around 1,150x.
- Dividends paid = zero

EXXARO

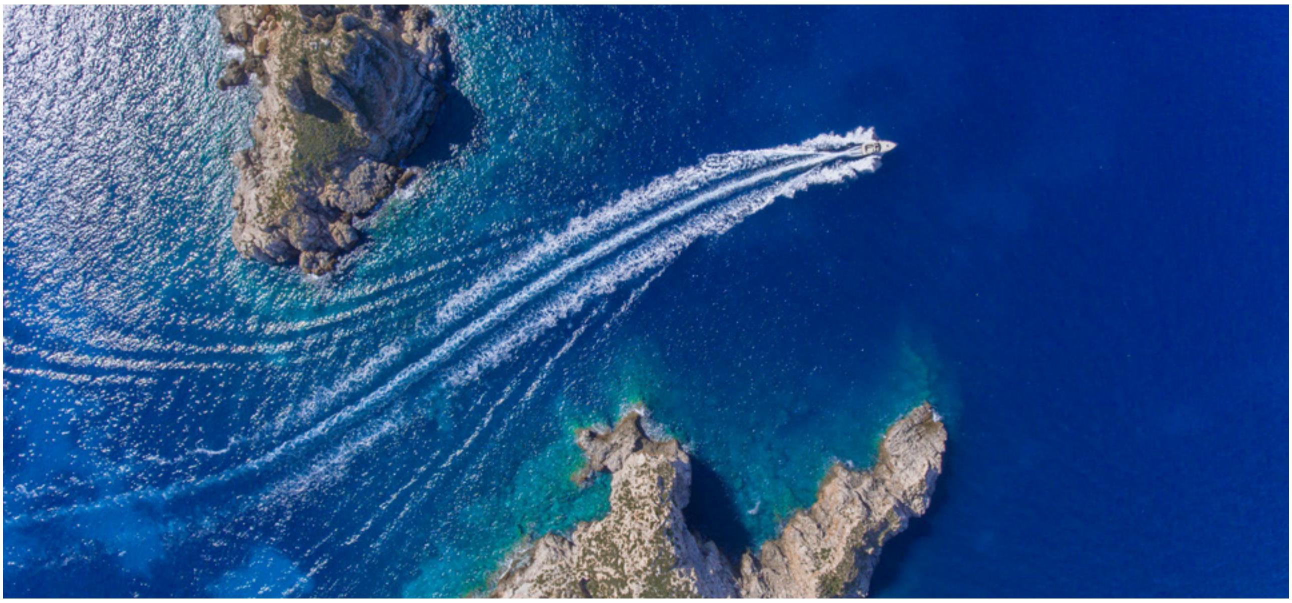
- The largest thermal coal producer in SA.
- It has a PE ratio of only c. 5x.
- A dividend yield of 8%.

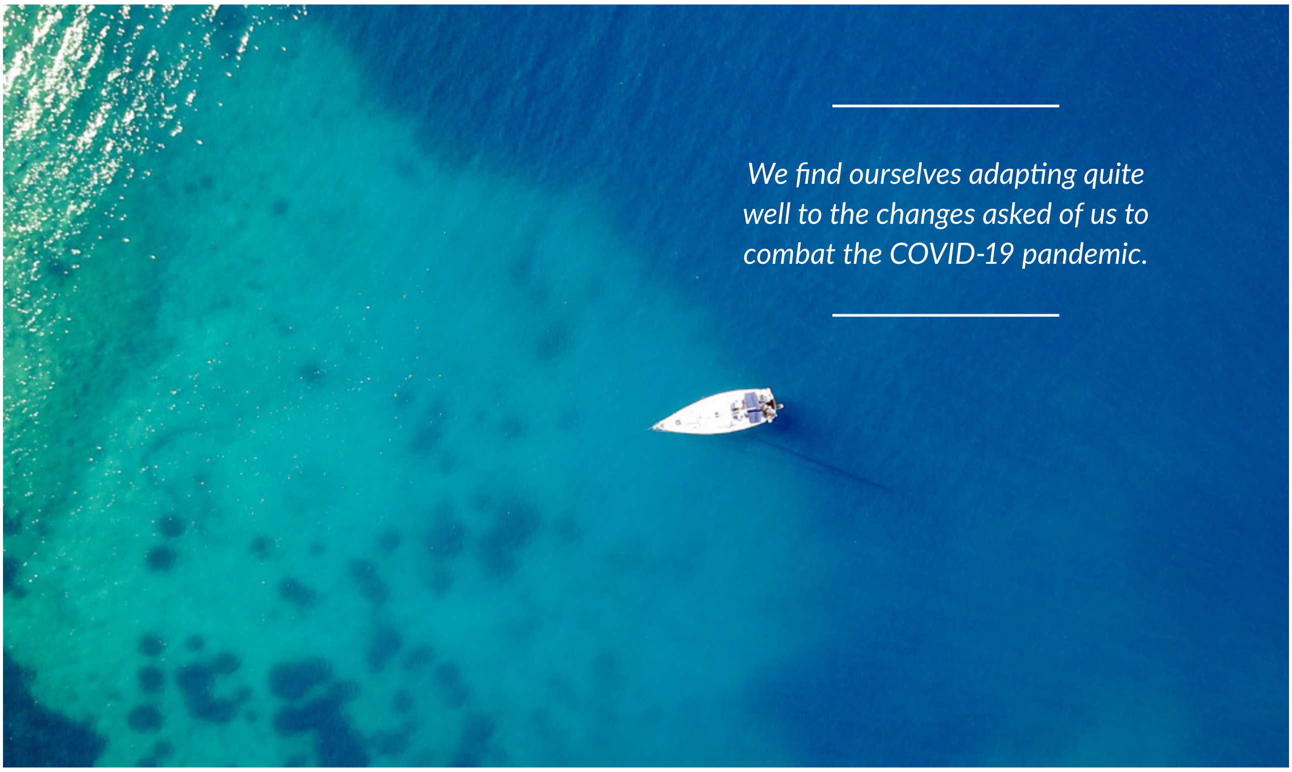
Tesla is spoken about as a battery company, which just happens to have a nice-looking car chassis placed over the battery. The company's co-founder and CEO Elon Musk is a genius, and he will adapt the battery to be able to fly planes, be used by cruise ships, even launch his own rockets into space through Musk's SpaceX venture. So, do not worry about the 1,150x PE ratio when its batteries will literally take over the world. Exxaro, on the other hand, is a coal producer and its ambition is to increase its coal production to 60 tonnes p.a. by 2022. How very unsexy.

Negative sentiments around these types of old economy stalwart companies have meant that the prices at which investors can buy their shares have become extremely low.

I do not need to do a survey to find out which company people are more excited about. But how do these two companies stack up as investments? One is priced for perfection, and the other is priced to plod along and, eventually, perhaps even die. However, even if Exxaro's share price does not move for 5 years, you will have made a 40% gain just from the dividend payments (2.5x more than cash), and the PE will then be 2.5x.

On the valuation model front, if Tesla's sales grew 50% p.a. for the next decade, the company's current margin is not high enough to justify the 100x multiplier of the rest of the industry.





I am very grateful for what Musk's company is doing for the planet. I just happen to think of it as a very bad investment. Yes, EVs are the future of automobile transport and they will change the world, but I thought the same of cellular phones when these first arrived in the 1980s. And they have changed the world, but not all cellular phone companies have changed the world with them - just ask Nokia and Blackberry (remember them?).

Just as companies get forgotten, so do countries, and of course here I am referring to SA specifically. I do not need to pause to find out the answer of which country you would rather own, SA or the US, regardless of the price you have to pay. As humans we are wired to always assume that the trend of the recent past will continue to be the trend of the immediate future. But this is rarely, if ever, the case. In 2001, I arrived back in SA after living abroad for 5 years.

Over the previous 10 years the S&P 500 had risen by an impressive 500% vs the JSE's 75% gain over the same period, while the rand had weakened from R3/US$1 to R7.50/US$1. Effectively, the value of your assets had therefore declined in US dollar terms. Nevertheless, it was extremely difficult to convince any of my clients to invest in SA, regardless of how well priced I showed them our assets were. By 2010, the rand had strengthened to R6.50/US$1 and the JSE had risen by 500%. The S&P, meanwhile, was down 21% over the same 10 years. Over the next 2 years it became as difficult to convince my clients to invest offshore as it had been to convince them to invest in SA just 10 years before.

I am under no illusions as to just how bad things in SA have been or how troublesome our level of debt to GDP is. But the COVID-19 crisis has forced the governing ANC's hand on decisions we have been desperate on for two decades (including clipping the wings of the unions, allowing private energy suppliers to make their excess energy available, and moves to privatise or semi-privatise some SOEs etc.).

We are a resilient bunch in this country and, while we do not necessarily always embrace change, living in an EM means that change is part of everyday life. And so, we find ourselves adapting quite well to the changes asked of us to combat the COVID-19 pandemic, while our "superior" counterparts in the UK, parts of Europe, and the US seem to be floundering on this front.

Could the COVID-19 crisis be just what SA needed to start the process of sorting out some of our systemic issues? Only time will tell. I do believe that investors should absolutely continue to diversify and bulk-up on quality offshore investments. But before you give up on SA entirely, remember history, and call to mind how the many challenges faced as a country have made us more resilient to a crisis. And maybe, just maybe, our future in SA is not as dark as it may seem.

The navigability of freedom

Written By:

Tamzin Nel, CFA
Portfolio Management

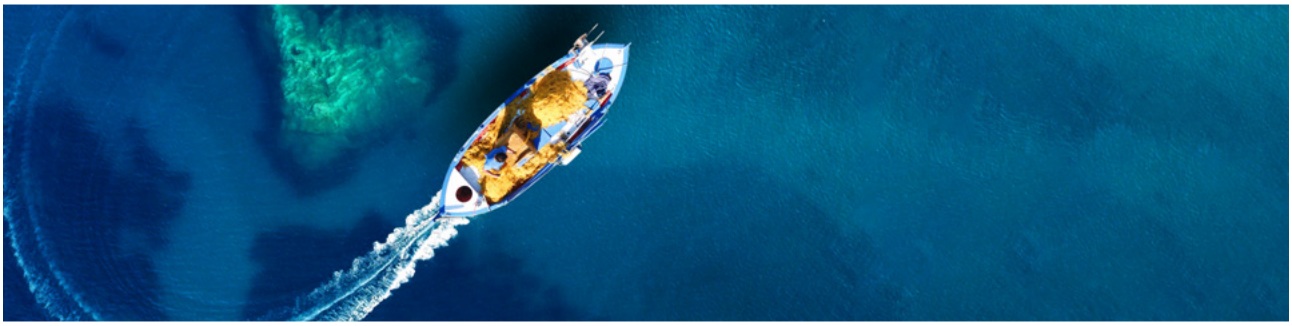
One of my core values is freedom. When I am at my best, I have a great sense of freedom and freedom is the filter through which I make difficult decisions. Why then, in a year in which our so-called freedom has been taken away, am I not feeling frustrated and lonely?

In answering this question, I ask myself, by writing "it is because I have freedom of choice. I cannot choose the act, but I can choose how I react?" This statement is thanks to hours of therapy and research into the topic of choice and it is an affirmation in which I wholeheartedly believe. But I read Cass R. Sunstein's book entitled *On Freedom* recently and in it Sunstein shows that freedom of choice needs to be accompanied by the ability to navigate life. Whilst freedom of choice is critical, it is undermined, if not destroyed, when life cannot be navigated.

Why am I starting an article for *The Navigator* by quoting from my journal? Besides the obvious link being the word "navigate", I am hoping to introduce the word "navigability" as a concept. Navigability is the term Sunstein uses to describe how easy, or difficult, it is to get from here to there and, in the metaphorical sense, to achieve a goal once you have set one for yourself.

People's free choices do make their lives better, however, people might also have no idea what the actionable steps are that they need to take. To progress, people need to be nudged. If you are familiar with Sunstein and Richard Thaler's work you will know that nudges are interventions that steer people in certain directions, but that also preserve their freedom of choice. In his book, *On Freedom*, Sunstein uses the example of a GPS as a nudge. The person knows their here and they know where their there is, in other words, they know where they want to go. The GPS device (the intervention) helps to get them to their preferred destination (it steers them in a certain direction), but they can ignore its advice (thus preserving freedom of choice) if they would like to. There are many different examples of nudges such as calorie labels on food, enrolling in a company's pension plan being the default (i.e. not having to opt in), default settings on cell phones, automatic credit card payments, graphic warnings on cigarette packaging, and road signs being just some of these. Whatever form of choice architecture is in place, it will nudge.

This document that you are reading is also a form of choice architecture.



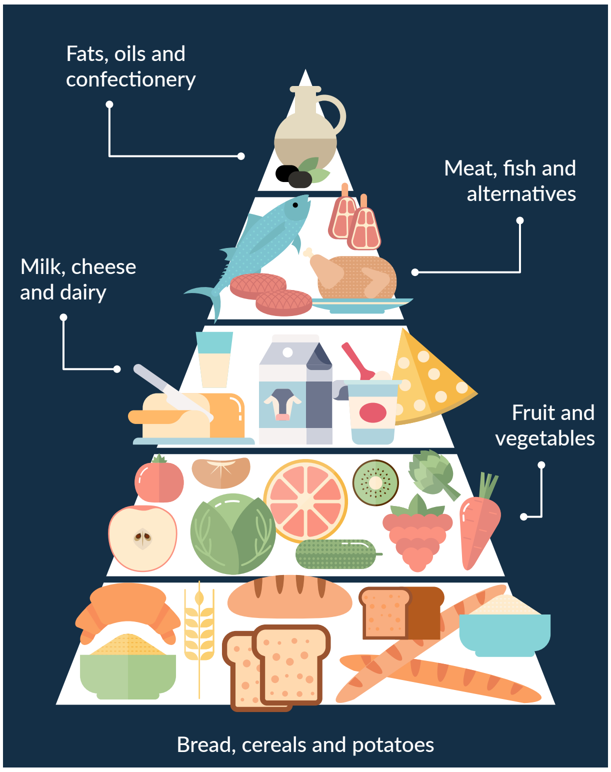
We understand that human beings often lack important information, have limited attention spans, face self-control issues, and suffer from behavioural biases. Nudges help by improving the lives of people who lack information or suffer from behavioural biases, without harming those who do not.

Nudges are designed to increase the likelihood that people's choices will improve their own well-being with the central goal of nudging being to "make choosers better off, as judged by themselves."

That last part is important, we respect a client's autonomy whilst attempting to make life more navigable, through nudging. Our goal is to promote navigability, whilst also increasing our client's capacity for agency and autonomy.

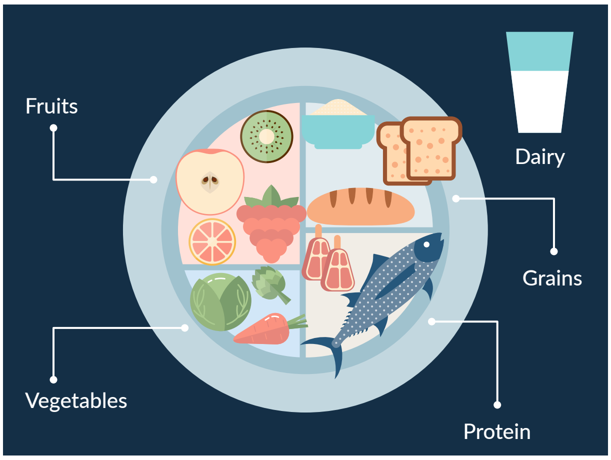
To explain this concept of navigability, Sunstein uses the representation of a Food Pyramid.

Figure 1: Navigability explained by looking at the Food Pyramid



The pyramid has been criticised for not giving people a clear path with respect to healthy food. Whilst they are interested in eating healthy, they do not know what to do and, as such, are unlikely to change their behaviour. The pyramid was later replaced by a simpler model - a plate with clear markings.

Figure 2: The Food plate guide



In addition, the plate was accompanied by straightforward statements that avoided ambiguity, such as "make half your plate fruits and vegetables, drink water instead of sugary drinks, choose unsalted nuts and seeds", as well as being actionable. By using the plate and not the pyramid, a favoured path has been identified.

When there are obstacles to navigability, freedom is reduced (even if there is freedom of choice).

"When life is hard to navigate, people are less free." – Cass R. Sunstein

There are a few problems that need to be considered in the art of navigation. The first being that people might not know what the best path is for them. Research has shown that many people's problems stem from insufficient navigability and, as such, freedom from these problems means making the world more navigable for them. Then we have those people who know what the right path is for them, but who lack the motivation to get on this path. In addition, there might be a wide range of difficult choices and finding the focus to choose the right path might also be arduous. What about when the destination itself is not simple (I want to retire with R100mn), but rather abstract (I want to add value to society)?

Application of carefully constructed choice architecture is much less simple when people, and their behaviour, is introduced to the theory: *"Choice architects cannot contend that they are increasing navigability or merely vindicating choosers' preferences."*

Choice architecture reduces difficulty by providing a framework, or a relevant intervention, which increases navigability. It is designed by the choice architects (at Anchor these are our analysts and fund managers), who identify choices which informed people (considered "normal" in traditional finance) consistently make.

As a complement to the choice architecture, which can be applied in a normative scenario but becomes complex when behaviour is introduced, we need people helping people.

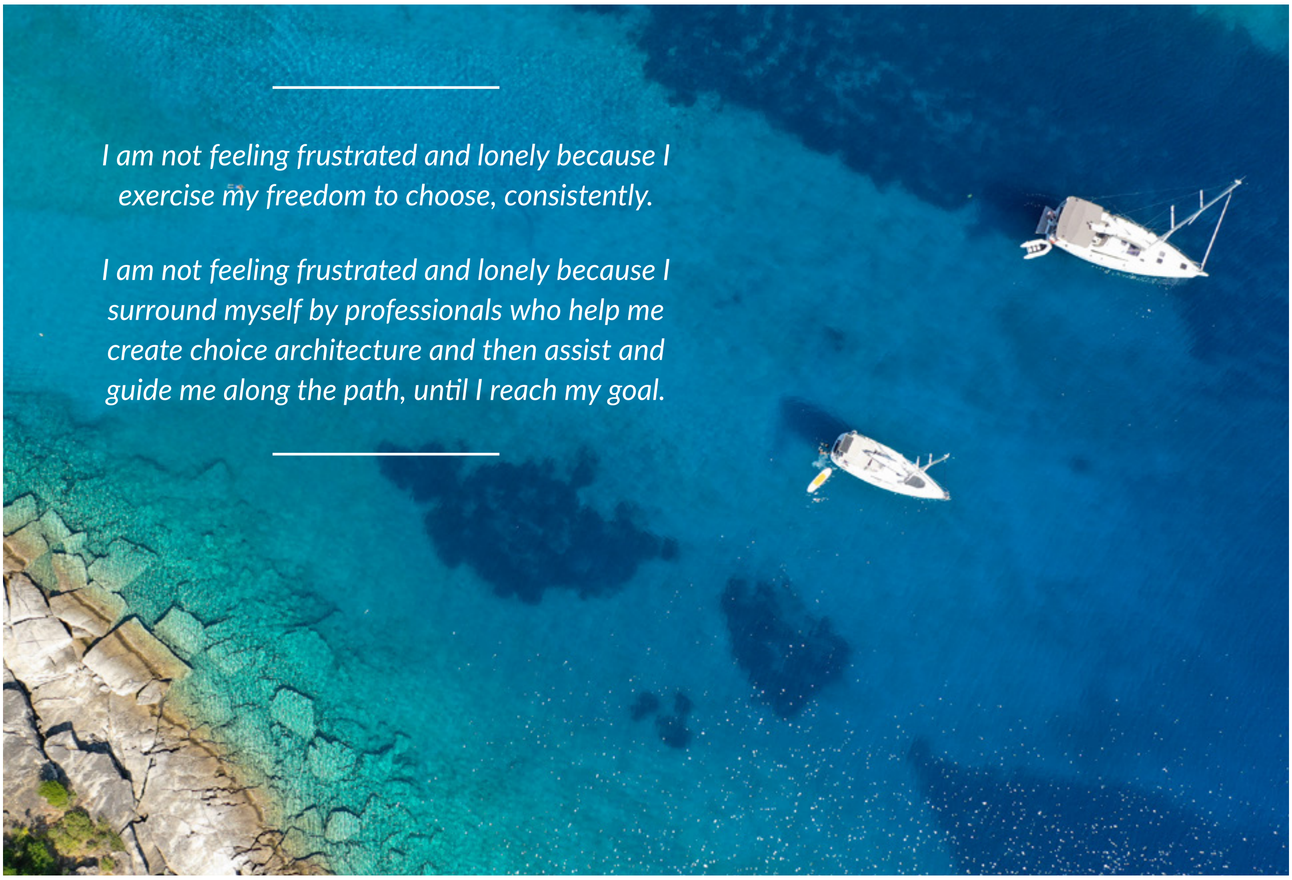
In the asset and wealth management world we often speak about, well, assets under management. Assets under management, in turn, are essentially the wealth under management in a business.

Although this is obviously a critically important part of our business, the most important asset under management, as I read in a recent article by industry pioneer Mitch Anthony, who advises financial services organisations around the globe, is the person behind the wealth. He describes the "advisory relationship as 1) a story of numbers and 2) a number of stories", as it is the story behind what the person hopes to achieve and our role as wealth managers to help them, that sets us apart.

Navigability is inseparable from understanding people's desires – where they come from and how they fit in. Often people need help reaching their goals as they themselves can be the roadblock on their own path, possibly due to a lack of information or inherent behavioural biases.

In the past I spent an enormous amount of (wasted) time worrying about my job being replaced by technology. I have since learnt that it is my human capacity for empathy, creativity, and connection which is irreplaceable. This is important because it is humans that are under management, not assets. Living, breathing, feeling, emotional human beings. They have a past, a present, and a future and we, as advisors, need to understand the past, be present in the present, and make sure we are there for them in their future.

Nudges, choice architecture, The Navigator, has the goal of increasing navigability – of making it easier for people, specifically our clients, to reach their preferred destination. Whilst we do hope that The Navigator is helpful choice architecture, what sets Anchor apart is our people and we hope that, along with your advisor at Anchor, we are able to further simplify the complexity of navigation as we truly believe that improvements in navigability can make all the difference.



Performance Summary

		FUND PERFORMANCE						BENCHMARK PERFORMANCE					
	Start date	Annualised p.a. (%)	Since inception (%)	12-month (%)	6-month (%)	3-month (%)	Dec 20 (%)	Since inception (%)	12-month (%)	6-month (%)	3-month (%)	Dec 20 (%)	Performance vs Benchmark (%)
UNIT TRUSTS													
Anchor BCI Equity	Apr-13	8.9	93.2	-1.2	9.4	8.5	3.4	65.1	0.6	12.6	11.5	5.5	28.1
Anchor BCI Flexible Income	Jun-15	7.6	50.4	6.0	3.8	2.2	0.9	47.6	5.5	2.3	1.1	0.4	2.7
Anchor BCI Managed	Jan-15	4.2	27.3	5.5	7.0	5.4	1.8	30.9	5.2	7.2	5.9	2.5	-3.7
Anchor BCI Worldwide Flexible	May-13	11.3	127.3	11.5	7.1	1.0	-1.3	89.4	7.2	4.4	1.4	0.3	37.9
Anchor BCI Property Fund	Nov-15	-8.2	-35.7	-28.4	4.5	20.0	8.9	-39.8	-34.5	4.9	22.2	13.7	4.1
Anchor BCI Global Equity Feeder	Nov-15	20.5	161.8	91.0	22.6	9.1	1.2	84.3	22.0	4.7	0.8	-0.6	77.5
Anchor BCI Bond Fund	Feb-16	9.9	58.5	8.0	7.1	6.7	2.4	57.0	8.7	8.3	6.7	2.4	1.6
Anchor BCI Diversified Stable Fund	Feb-16	6.3	34.9	4.9	4.5	3.5	0.8	30.9	5.2	4.6	3.6	1.5	4.0
Anchor BCI Diversified Moderate Fund	Feb-16	5.0	27.3	3.6	5.9	4.7	1.1	28.0	5.4	5.7	4.5	1.9	-0.7
Anchor BCI Diversified Growth Fund	Feb-16	3.9	20.5	2.4	7.4	6.0	1.5	26.7	5.2	7.2	5.9	2.5	-6.2
Anchor BCI Africa Flexible Income	Mar-16	7.9	44.2	9.8	4.3	4.0	0.6	51.6	7.4	3.1	1.4	0.5	-7.4
Anchor BCI Global Technology Fund	Jun-19	36.9	64.0	53.8	9.8	3.6	2.3	76.4	53.0	9.7	1.4	1.5	-12.4
EQUITY NOTES & SEGREGATED MANDATES													
Anchor Equity	Jul-13	6.7	62.2	1.6	13.2	11.5	3.3	63.9	0.6	12.6	11.5	5.5	-1.7
HEDGE FUNDS													
Anchor Accelerator	Feb-16	12.0	74.1	18.5	8.9	5.2	2.2	18.9	0.6	12.6	11.5	5.5	55.2
OFFSHORE													
High Street Equity - Dollars	Jun-12	13.6	195.2	23.0	25.2	14.9	5.5	168.4	16.5	23.3	14.1	4.3	26.8
High Street Equity - Rands	Jun-12	21.6	429.7	29.0	5.7	1.1	0.1	381.0	22.3	4.1	0.3	-0.9	48.8
Offshore Balanced - Dollars	Jun-12	10.5	133.4	11.3	17.4	10.4	4.2	94.4	13.9	16.2	9.7	3.1	38.9
Offshore Balanced - Rands	Jun-12	18.3	318.0	16.8	-0.9	-2.9	-1.1	248.7	19.7	-1.8	-3.6	-2.0	69.2
Global Dividend - Dollars	Jan-14	7.9	69.6	3.0	17.9	13.7	4.4	99.6	16.5	23.3	14.1	4.3	-30.0
Global Dividend - Rands	Jan-14	12.3	123.8	8.1	-0.5	0.0	-0.9	163.2	22.3	4.1	0.3	-0.9	-39.4
Anchor Global Stable Fund - Dollars	May-15	2.3	13.5	5.8	7.1	4.6	1.7	16.0	2.6	1.2	0.6	0.2	-2.5
Anchor Global Stable Fund - Rands	May-15	5.8	37.0	11.1	-9.6	-8.0	-3.4	40.4	7.6	-14.3	-11.8	-4.8	-3.4
Anchor Global Equity - Dollars	May-15	20.2	180.3	93.5	48.4	24.1	5.3	64.5	16.3	24.0	14.7	4.6	115.8
Anchor Global Equity - Rands	May-15	24.3	238.3	103.1	25.3	9.2	0.1	98.5	22.0	4.7	0.8	-0.6	139.8
RCI UNIT TRUSTS													
RCI BCI Flexible Growth Fund	Sep-16	16.1	88.7	54.7	19.2	9.0	5.8	45.4	8.2	4.9	1.6	0.4	43.3
RCI BCI Worldwide Flexible Fund	Dec-16	11.6	56.3	21.5	-0.9	-5.3	-3.0	37.6	7.2	4.4	1.4	0.3	18.7

DISCLAIMER

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An authorised Financial Services Provider; FSP no: 39834
www.anchorcapital.co.za | sales@anchorcapital.co.za