The Navigator

STRATEGY AND ASSET ALLOCATION REPORT

4th Quarter 2023

ANCHOR | NAVIGATING CHANGE

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Introduction

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Inflation has dominated the investment landscape since 2021 and is finally beginning to subside. Central banks are weary of their experiences in the 1970s when cutting interest rates prematurely necessitated a second round of rate hikes a couple of months later as inflation resurfaced. We are seeing tough talk from the US Federal Reserve (Fed) and the South African Reserve Bank (SARB) on keeping interest rates higher for longer. Accordingly, yields on income instruments are now at levels not seen for many decades. The investment world has changed.

Anchor is favouring global bonds for the first time as we adapt to changing global opportunities. You can lock in attractive real yields, which are compelling compared to other investment opportunities. We think that investing in high-quality bonds at these yields comes with an attractive risk/return profile for now. Over the medium term, we remain bullish on equities, which should outperform other asset classes over time.

While there are several changes to our asset allocation recommendations, we remain aware of world events rapidly developing around us. Geopolitical tensions are flaring up in Israel while Russia's war on Ukraine is dragging on. On the more positive side, the artificial intelligence (AI) revolution has the potential to be a big game changer in terms of enhancing productivity and disrupting old economic paradigms.

Anchor is favouring global bonds for the first time as we adapt to changing global opportunities.

Overall, now is a good time to upweight your investments. Anchor strives to help you achieve the best outcomes within your risk tolerances and objectives. We currently see opportunities in all asset classes, and in this document, we highlight some of the best investment options available.

Asset Allocation

The following table illustrates our house view on different asset classes. This view is based on our estimate of the risk and return properties of each asset class in question. As individual Anchor portfolios have specific strategies and distinct risk profiles, they may differ from the more generic house view illustrated here.

Asset class	Current stance			Expected returns (own currency) (%)	Expected returns with soft landing and rate cuts (own currency) (%)	Expected returns, rates higher-for-longer (own currency) (%)
	Negative	Neutral	Positive			
DOMESTIC						
Equity	○	●	○	12	16	5
Bonds	○	●	<	12	14	6
Listed property	>	●	○	11	15	7
Cash	○	●	○	8	8	8
Alternatives*	○	○	●	10 to 15	10 to 15	10 to 15
Rand/US$				-2	+8	-6
GLOBAL						
Equity	○	●	○	7	9	2
Government bonds	○	>	●	9	12	5
Corporate credit	○	>	●	8	8	8
Listed property	○	●	○	5	9	1
Cash	○	●	○	4	4	4
Alternatives*	○	○	●	8 to 15	8 to 15	8 to 15

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

Asset Allocation Summary

The most recent quarter (3Q23) ended on a difficult note as the US Fed signalled higher rates for longer, sending bond yields higher and risk assets lower. Our return expectations for the various asset classes have shifted because it is difficult for yields to rise much higher before something in the economy breaks, and we see the US Fed cutting rates in reaction. We, therefore, think that the most likely path for bond yields is lower over the next year while equities appear to be fully valued.

Figure 1 below highlights the US dollar return outlook for the various global asset classes. The bar in *Figure 1* represents the reasonable range of possible outcomes, with the dots representing our estimate of the outcome in the various scenarios. We have an unusual set of outcomes for an equity-centric business. From total return and risk-adjusted return perspectives, we find bonds to be more attractive. Global bonds and global cash have become compelling. Nevertheless, we remain bullish on equities over the medium term.

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

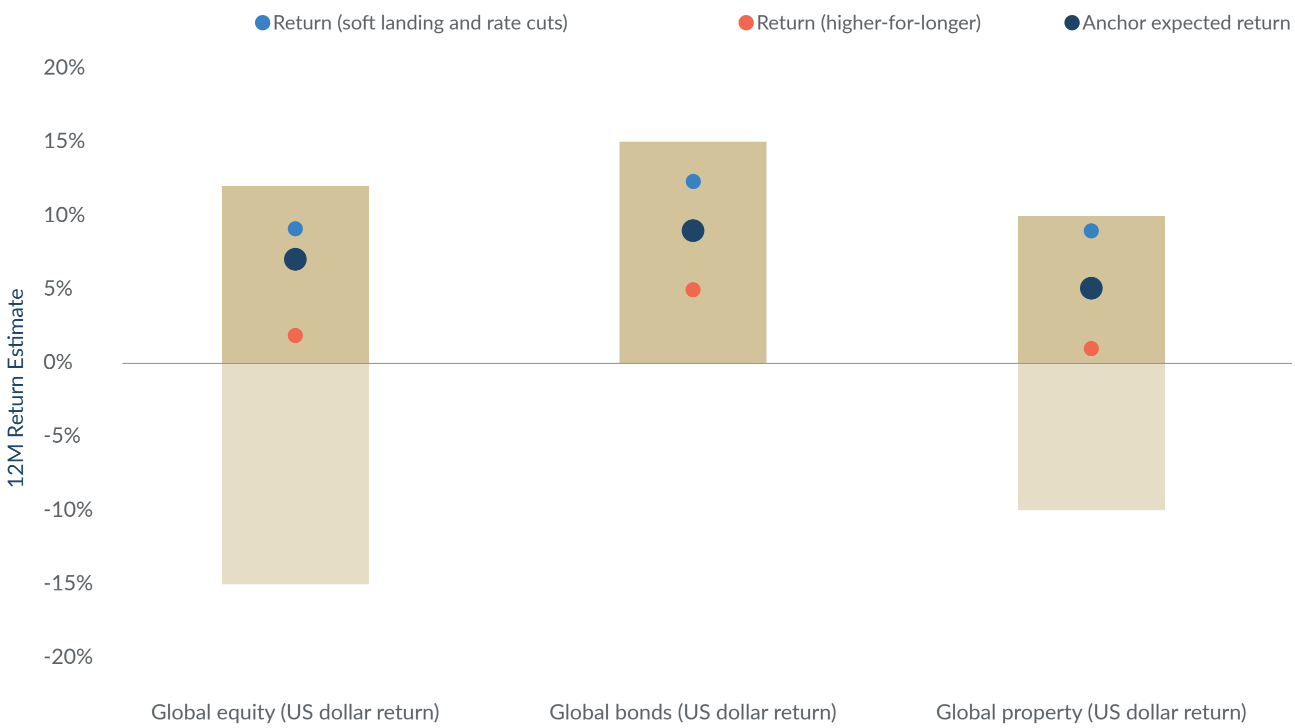


Figure 2: Anchor expected return by offshore asset class
Source: Anchor

	Global equity	Global bonds	Global property
Anchor expected return (in US dollar)	7%	9%	5%

Figure 3 below highlights the rand return outlook for several domestic asset classes. The bar represents the reasonable range of possible outcomes, with the dots representing our estimate of the outcome under the various scenarios. From a domestic perspective, the weak economy, failing state-owned enterprises (SOEs) and the poor state of government finances are a few of the factors detracting from our outlook. There is already much negativity in the price of domestic assets, and we have a neutral stance amongst equity, listed property and bonds. We believe that domestic factors may improve into 2024, though there is much uncertainty around this view.

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

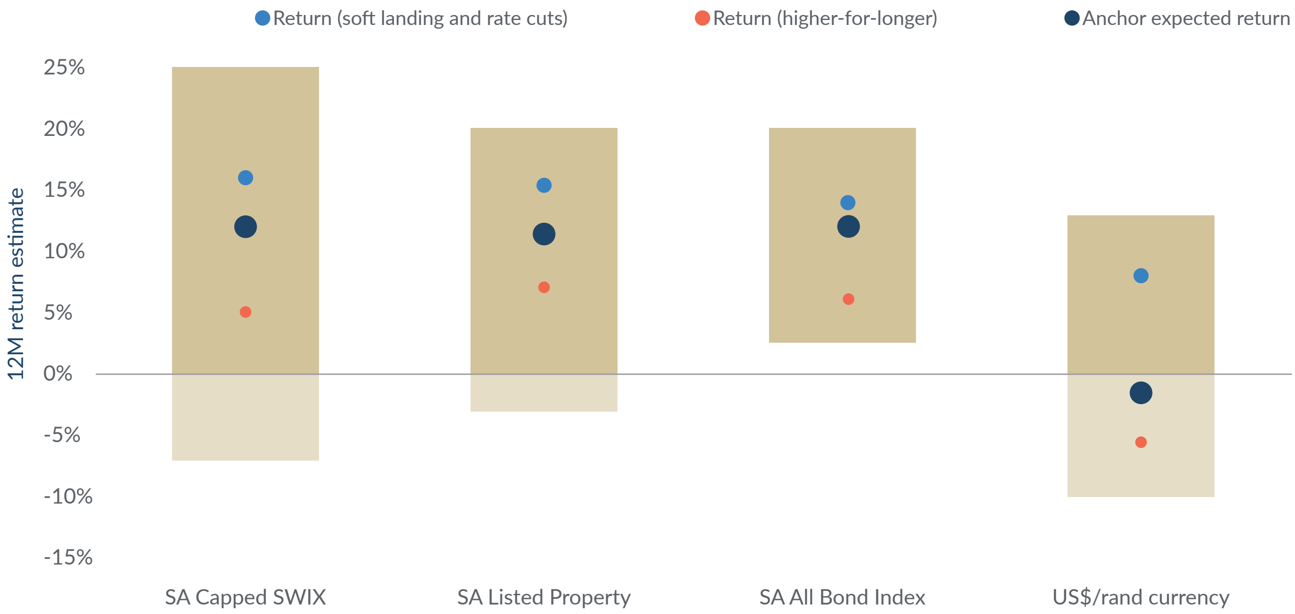


Figure 4: Anchor expected return for domestic asset classes
Source: Anchor

	Domestic equity	Domestic bonds	Domestic property	US$/rand
Anchor expected return (in rand)	12%	12%	11%	-2%

Strategy and Asset Allocation

ECONOMICS

As we move into the last quarter of this year, central bank policy remains the nucleus theme across financial markets. Overall, there appears to be an increasing view amongst monetary policymakers that the time has come to sit back and allow previous tightening to work through the economy. With activity slowing notably in the eurozone (EZ) and the UK and inflationary pressures easing, the need for the Bank of England (BoE) and the European Central Bank (ECB) to pause seems greater than in the US, where output and employment growth remain surprisingly strong. However, despite general growth concerns and easing price pressures, central bankers (even in the US) have been at pains to stress that policy rates are likely to remain at a restrictive level that would dampen economic activity for some time. For all intents and purposes, this is a necessary evil to ensure that the disinflation process is sustained and that inflation timeously returns to targeted levels (2% in the US, the EZ and the UK; 4.5% in SA). To put it in simple terms, there does not appear to be any rush on the part of monetary policymakers in any of these regions to cut the policy rate.

Locally, SA's precarious fiscal situation has again come under the spotlight, with the upcoming Medium Term Budget Policy Statement (MTBPS) looming on 1 November. The latest estimates point to this year's revenue shortfall amounting to around R50bn-R60bn, with further spending pressures on the horizon as the politicking begins in earnest as next year's elections draw closer. From a long-term perspective, the root causes of SA's fiscal woes are long-standing and relatively familiar to most investors: persistently low growth, inefficient and misaligned policy, poor performing SOEs, political instability in key metropoles, chronic underinvestment by the state in key infrastructure projects, and poor decision making on government expenditure (particularly during the state capture years), to name a few. However, from a more near-term perspective, a variety of other factors have compounded SA's fiscal challenges, such as lower commodity prices, lower revenue collection, Eskom and public sector wage increases, the expected continued roll-over of the Social Relief of Distress (SRD) Grant and increasing borrowing costs. Whilst the consensus is that SA's fiscal story is indeed deteriorating at pace this year, we will unlikely get the complete picture in November's MTBPS - that will only become fully clear in the main budget, which will be presented in February 2024. Regardless, Finance Minister Enoch Godongwana must convince the market in November's MTBPS that a credible rebalancing process is indeed plausible.

A variety of factors have compounded SA's fiscal challenges, such as lower commodity prices, lower revenue collection, Eskom and public sector wage increases, the expected continued roll-over of the Social Relief of Distress (SRD) Grant and increasing borrowing costs

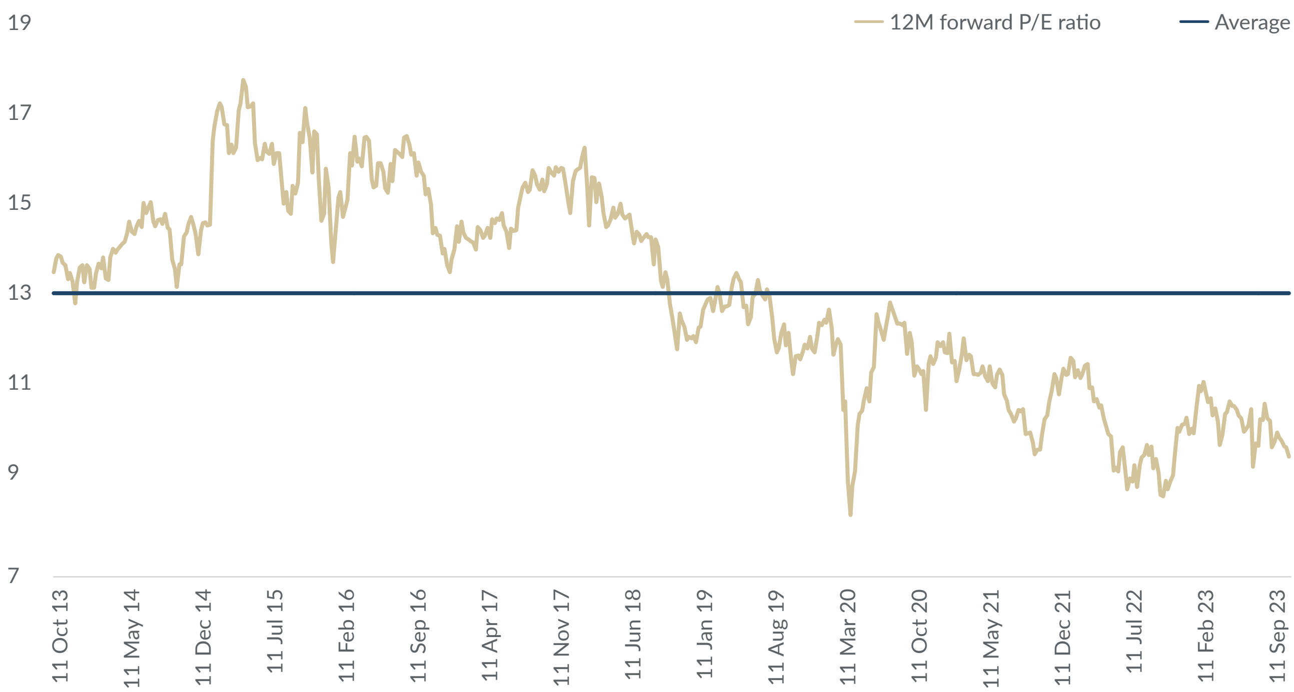
On the monetary policy front, SA's near-term inflation outlook has deteriorated due to two successive large petrol and diesel price increases and a severe breakout of avian influenza (more commonly known as bird flu) that has raised concerns about chicken and egg prices. At the same time, the intensity and duration of the upcoming El Niño weather event pose an upside risk to food inflation. Nonetheless, the SARB's Monetary Policy Committee (MPC) has continued to look through the first-round inflation impact of these supply-side shocks and left the repo rate unchanged (for the second meeting in a row) at 8.25% at the September MPC meeting. However, it remains a hawkish pause, as the balance of risks remains to the upside. During the MPC's last two meetings, near-term prospects for the global economy have been broadly unchanged. Whilst global inflation has broadly eased over the year, any further slowdown is beginning to look less certain.

In addition, in SA specifically, loadshedding continues to hamper the economy, and prices for commodity exports continue to weaken. In the near term, stronger El Niño conditions threaten the agricultural outlook, while global climatic events present additional risks. Energy and logistical constraints remain binding on the growth outlook, limiting economic activity and increasing costs. As such, the renewed upside risks from rand weakness and higher global fuel and food prices will likely keep the possibility of modest further tightening alive in the last MPC meeting for the year, which will be held in November.

SA EQUITIES

The JSE (as measured by the FTSE/JSE Capped Swix Index) ended the quarter 3.8% lower, bringing the YTD return slightly into negative territory (-0.2%). Interestingly, since its 2023 peak, towards the end of January, the JSE is down c. 8.0%, with most negative returns occurring in August and September. We maintain our neutral relative rating on JSE-listed equities with a 12-month total return expectation of 12%, only marginally ahead of our expectation for fixed-income returns (11%). Notably, the expected total return assumes zero multiple expansion and is driven entirely by our aggregate earnings expectations of 12% growth.

Figure 1: FTSE JSE Capped Swix 12-month forward P/E ratio
Source: Anchor, Bloomberg



In analysing the underperformance of JSE equities, we find that this is mainly attributable to a sharp deterioration in domestic earnings estimates for calendar year (CY) 2023, with the impact of loadshedding adding further headwinds to an economy that has muddled along for the best part of 10 years. The slump in domestic earnings, coupled with cyclically high interest rates in SA and abroad, has resulted in us paring back exit multiples across the various sectors and companies, making forecasting the market's future trajectory extremely difficult. We concede that certain scenarios, mainly driven by top-down, more macro-related factors, could see a healthy rebound on the JSE, the most notable of which is linked to the outlook for the US economy and the trajectory of global interest rates.

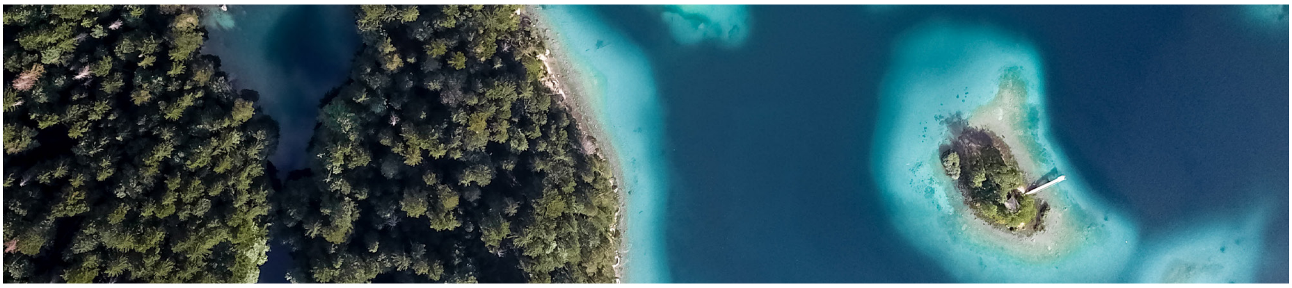
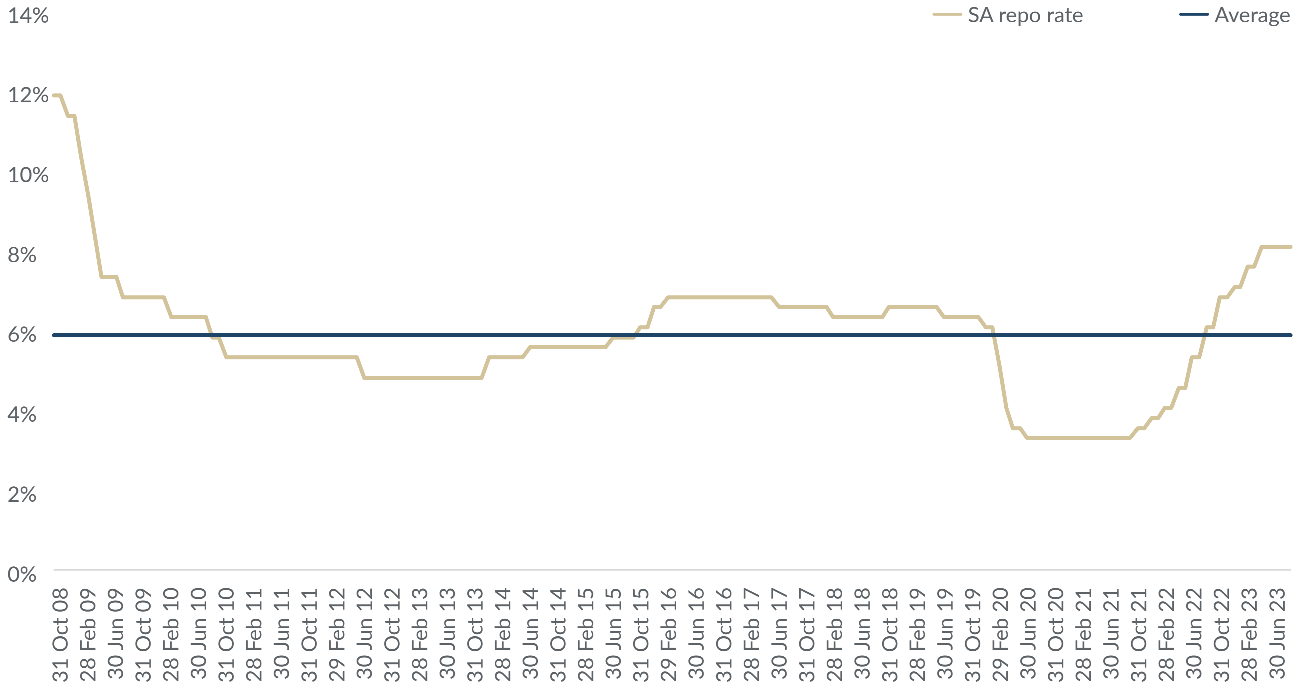


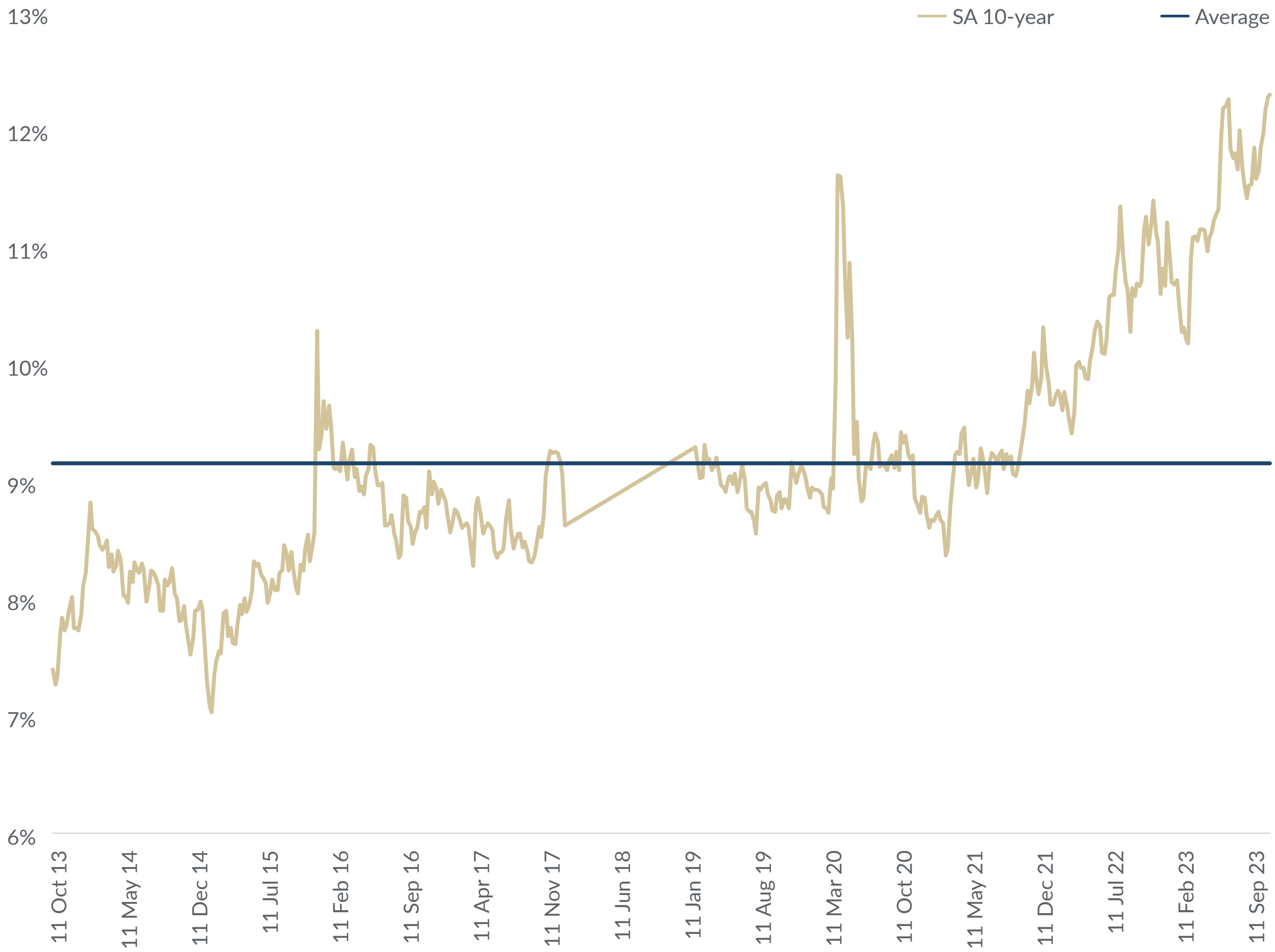
Figure 2: SA Reserve Bank repo rate post the global financial crisis high
Source: Anchor, Bloomberg



The current high cost of capital domestically and abroad is having a visible impact on the overall rating of the domestic market. Considering the operational underperformance of many bellwether SA companies, with cyclically low margins (some even loss-making) and low ratings due to cyclically high interest rates, the current market set-up could become very interesting. Twenty-twenty-four could see a complete reversal of that trend; with interest rate cuts expected in 2H24 and the worst of loadshedding behind us, we could see a powerful return combination of a lower cost of equity and a strong earnings rebound. Under this scenario, we could see index returns of over 20%. On any visible signs of this scenario playing out, we would likely see a relatively quick repricing of the local market. However, we note that data worldwide over the last few months has, if anything, moved in the opposite direction.

The best illustration of the point is the ratings of the local banking sector. When viewed in isolation, our local banks look extremely attractive. In aggregate, investors should receive earnings growth in real terms over the next three years (reasonable forecast horizon), with c. 50% of that paid out in the form of dividends and a forward rating of less than 8x earnings (a forward dividend yield of 7.3%). The more technical analysts will point to the price-to-book value of banks trading at 1.2x, held up by Capitec (4.5x) and FirstRand (2x). In aggregate, this looks like good value at a 30% discount to the last ten years and good operational execution. However, when one considers that SA 10-year bonds are trading at 12.4%, a 34% discount to the past decade, the reason for the banks trading at such big discounts becomes clearer. The cost of capital has risen too much.

Figure 3: SA 10-year government bond
Source: Anchor, Bloomberg



We believe domestic equity valuations will continue to be suppressed while the cost of capital remains cyclically high and growth remains elusive. Without sustained economic growth, the incentive to buy equities when the return hurdle is as high as it is will not be big enough to drive a meaningful rerating in aggregate. The global macro environment has undoubtedly played an outsized role in creating this scenario, as our companies have dealt with a low-growth environment for most of the past decade. However, as mentioned above, there is a good chance that we are currently at a cyclical low point for JSE-listed equities, and it would not take much to see a meaningful outperformance from here. We will continue to wait patiently for evidence of this playing out.

DOMESTIC BONDS

In 3Q23, South African government bonds (SAGBs) returned a negative 2.37% at a FTSE/JSE All Bond Index (ALBI) level. This follows a weak 2Q23 performance when the index produced a negative 1.53% return.

Yields across the curve have entered cheap territory, with the belly bonds returning over 12% and the long-end bonds returning over 13%. With the forward rate agreement (FRA) strip no longer assuming any SARB rate hikes until mid-2025, we maintain that further rate hikes will do more to curtail growth rather than control inflation or defend the local currency. However, we caution that further rate hikes may occur due to the hawkish tilt of the SARB MPC (which is in tune with the US Fed announcements).

While local bonds' 2Q23 performance was driven by domestic factors (growth, loadshedding and the "Lady R" controversy), 3Q23's performance has been driven by the steady climb in US rates, with the US 10-year yield climbing from 3.83% to 4.57% over the quarter.

Figure 4: The US 10-year yield performance
Source: Thomson Reuters, Anchor

Inflation remains a concern, with the Brent crude oil price rising to near US$100/bbl; domestically, the petrol price has also seen back-to-back increases. This has resulted in the August core and headline inflation levels ticking 0.1% higher to 4.8% YoY.

In the previous edition of this article, we highlighted that while yields remain attractive, they must be tempered by the caution that the near-term horizon covers some risk events. This quarter has seen (1) "higher-for-longer" rates become enmeshed in expectations and (2) SA's precarious fiscal situation come to the fore. This combination has weakened global bonds and further weakened SAGBs. At current levels, the fixed-income universe is increasingly attractive. Nominal bond yields are such that for total returns to be negative over a 12-month outlook would require a c. 200-bp bond yield weakness over the period (at an index level). Our view is thus cautiously optimistic with a neutral duration positioning in the Anchor Bond Fund. This positioning retains the attractive yield outcome attainable in SAGBs while defending against the downside risks in yield climbing.

Similarly to our global bonds outlook, we can calculate a range of outcomes depending on the 12-month forward yield. The ALBI currently has a duration of 5.6 years; thus, every 1% yield increase results in a negative c. 5.6% total return. Our base case is that yields will not drive either way and that 12 months out, we are in a similar position to where we currently find ourselves. Given the above, we have expectations of double-digit 12-month return outlooks in SAGBs from current levels.

THE RAND

Throughout 2023, the rand has weakened due to a stronger US dollar, risk aversion and domestic economic and political malaise. We had expected the rand to trade in the range of R18.25-R19.00/US$1 for much of 3Q23. In retrospect, it spent much of the past quarter within this range, ending 3Q23 at R18.90/US$1. Looking ahead, we think the rand's prospects have deteriorated, and we now see it trading in the range of R19.00-R20.00/US$1 for 4Q23.

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

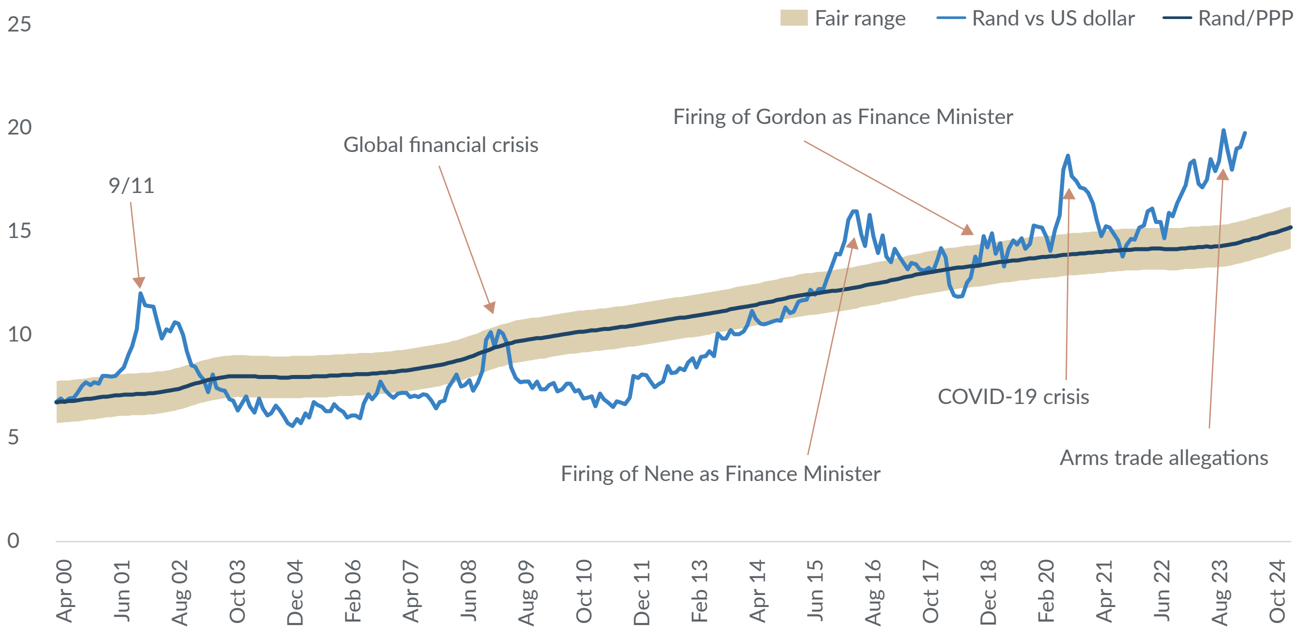
The indicators for the fair value of the rand are continuing to worsen. We note that the current account will likely deteriorate further as our export commodities see prices decline while imported oil is more expensive. Financial markets are focusing on SA's worsening fiscal situation and questioning the government's ability to achieve a sustainable primary surplus by 2025, if at all. We expect the global environment to gradually become more supportive, but foreign central banks are pushing that out into the future. In 2024, it looks like the strong dollar will persist. Therefore, we expect the rand to continue to trade with a negative overhang.

We retain our purchasing power parity (PPP) based model for estimating the rand's fair value. We have extended this out by three months since *The Navigator – Anchor's Strategy and Asset Allocation, 3Q23* report was published on 13 July 2023. Over our forecast period, we expect inflation abroad to come under control and return towards more normalised levels. This means our PPP model shows an increasing propensity for long-term rand weakness from next year. As a result, our PPP-modelled value for the rand vs US dollar at the end of the next 12 months is R15.15/US$1 (See *Figure 5*). We apply a R2.00 range around this to get to a modelled fair-value range between R14.15 and R16.15/US$1.

The domestic and global backdrop means we start with the rand meaningfully weaker than our modelled fair-value range. In previous cycles, US dollar strength has tended to dissipate (and reverse) toward the end of the US rate-hiking cycle. Current indications are that the US Fed will reach peak rates toward the end of 2023, meaning that we expect to see currency normalisation, with the US dollar giving up some of its gains in the latter part of next year. However, we do not expect the currency to recover fully, and we are projecting a rand in the R19.00 to R20.00 range against the US dollar in one year as domestic issues continue to weigh the rand down. For this report, we have modelled on R19.30/US$1.

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

Figure 5: Actual rand/US dollar exchange rate vs rand PPP model
Source: Thomson Reuters, Anchor



GLOBAL EQUITIES

As expected, the global equity march slowed in 3Q23 (DM indices were down 3.5%), and we expect a continued grind in the short term. The combination of higher rates, higher oil prices and a stronger US dollar are putting pressure on US company earnings. With current valuations at above-average levels (MSCI World Index forward P/E of 16x), we expect a below-average return from global equities over the next 12 months (our base-case projection is 7% in US dollar terms).

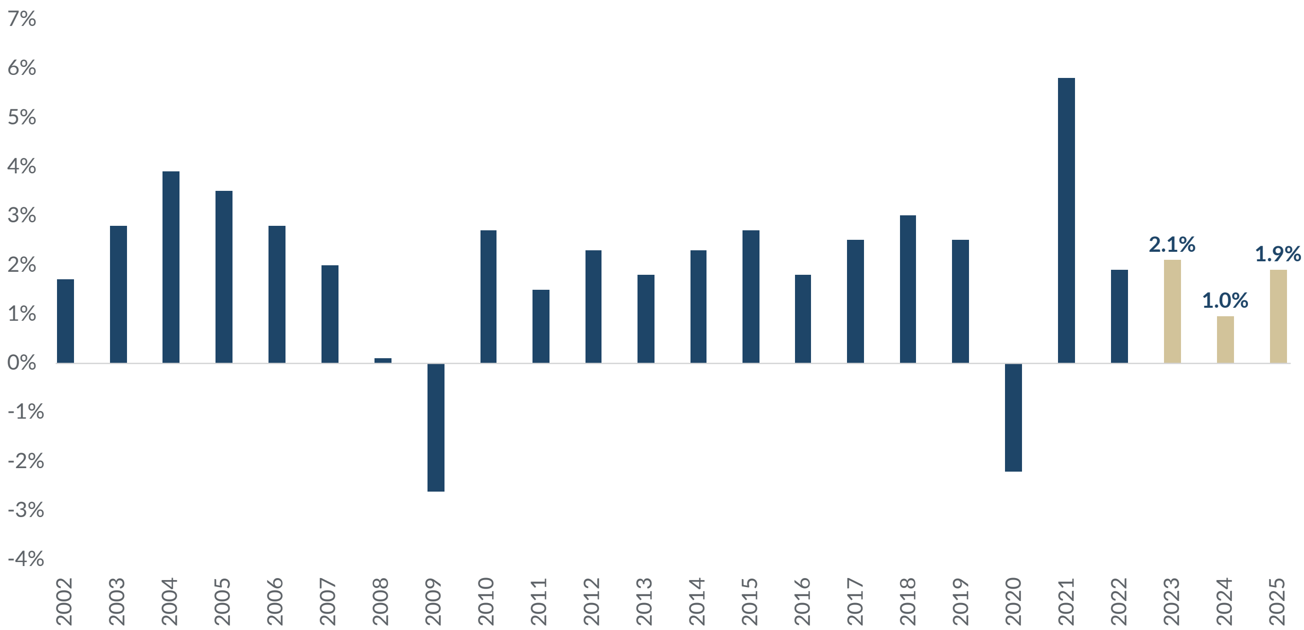
Equity alternatives are considerably more attractive than they have been for the past decade, with money market funds offering 5%-plus in US dollar terms and US 10-year treasuries trading at yields of over 4.7%. If you are prepared to give up some liquidity or take a little more credit risk, yields of 6%-9% are available. In our alternative investment offering, we are targeting double-digit US dollar-denominated returns. Higher rates also mean that the high dividend yield shares in the US have become relatively less attractive, as a 5% dividend yield is not what it used to be if I can get 5% "in the bank".

It is important to put the YTD performance of global markets in context. Almost all the action has been from the technology and AI-related sectors, where price appreciation has been more than 50%. The average share in the US S&P 500 Index is down YTD, and attractive valuations exist across many non-tech sectors. We remain positive on equity markets over a medium-term basis, as the next phase of the economic cycle will boost US earnings (as rates *eventually* decline and the strong dollar cools off).

Hence, while the moves in the market index level look strong, there is still much potential catch-up for the rest of the market. The outlook for the general market is reliant on how the economic cycle continues to play out. Global bond yields have been rising of late as the prior expectations of interest rate cuts in 2023 have faded. Inflation remains strong, the US economy is proving resilient, and the US Fed is insistent that there will probably be more interest rate hikes in the remainder of this year. The key risk is that the Fed goes too far, and the economy suffers late in the cycle.

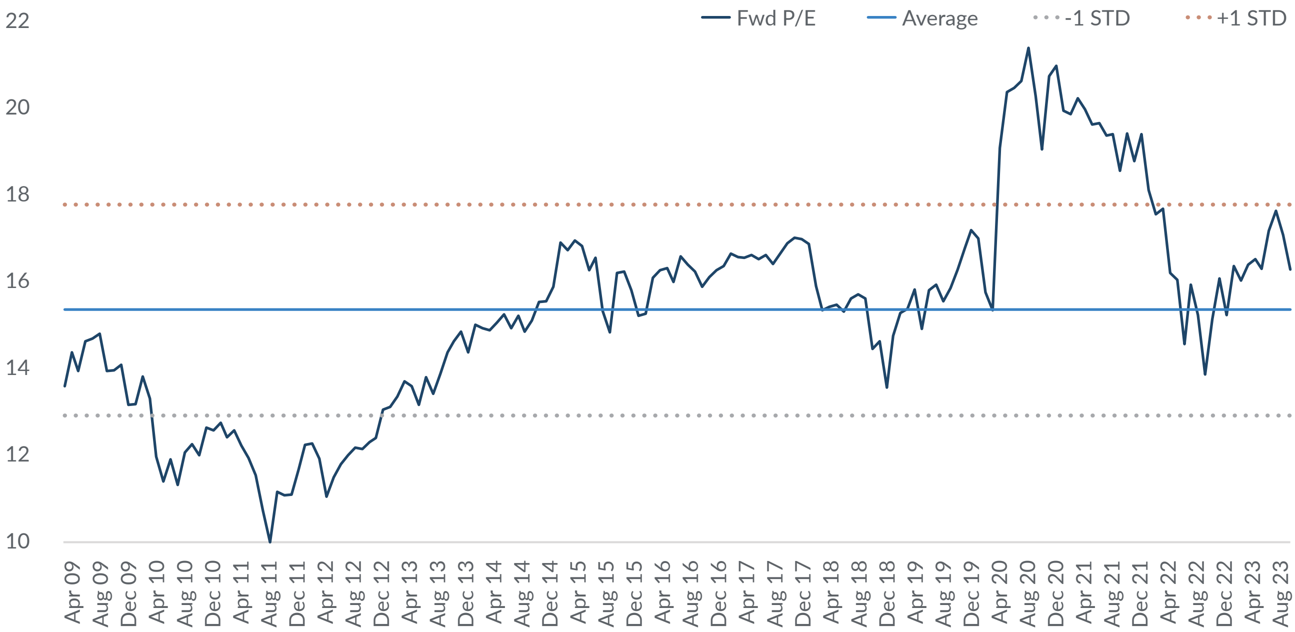
The economic reality shown in the chart below also makes us a little more cautious about equities – growth is more robust, and the economic cycle has been extended by six months compared to expectations at the beginning of the year. US GDP growth has surprised in 2023 and looks set to register around 2% YoY growth for 2023; many were forecasting a recession this year, but strong US national and local government spending has provided a big boost. The result, however, is that 2024 GDP forecasts are now looking relatively muted (+0.9% YoY) as the impact of higher interest rates starts to bite.

Figure 6: US GDP growth
Source: Anchor, Bloomberg



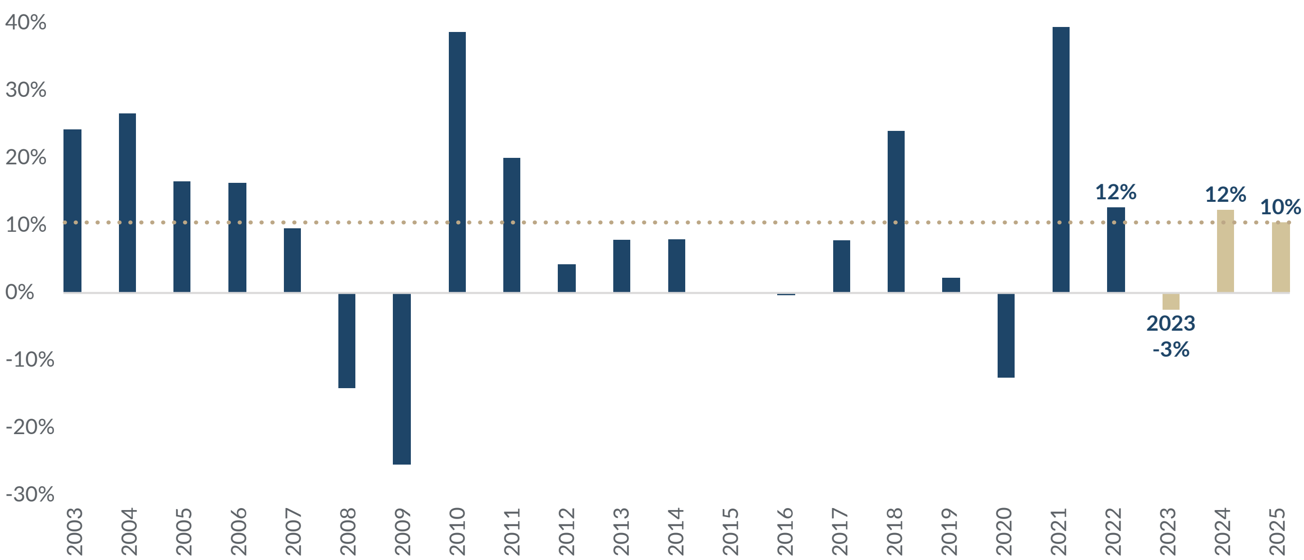
Global DM valuations at the index level look full (MSCI World forward P/E of 16x).

Figure 7: MSCI World forward P/E
Source: Anchor, Bloomberg



The most important determinant of markets is earnings, which have proved resilient in the face of higher interest rates. While many companies have been negatively impacted, those which have been able to pass on the inflation pressures have flourished. US earnings growth in 2023 is projected to record a 2% YoY decline. However, double-digit US-dollar earnings growth should resume in 2024 and beyond, which is positive for equities. Declining interest rates and increasing earnings are positive concoctions when looking further into 2H24 and beyond.

Figure 8: S&P 500 EPS growth (annualised)
Source: Anchor, Bloomberg



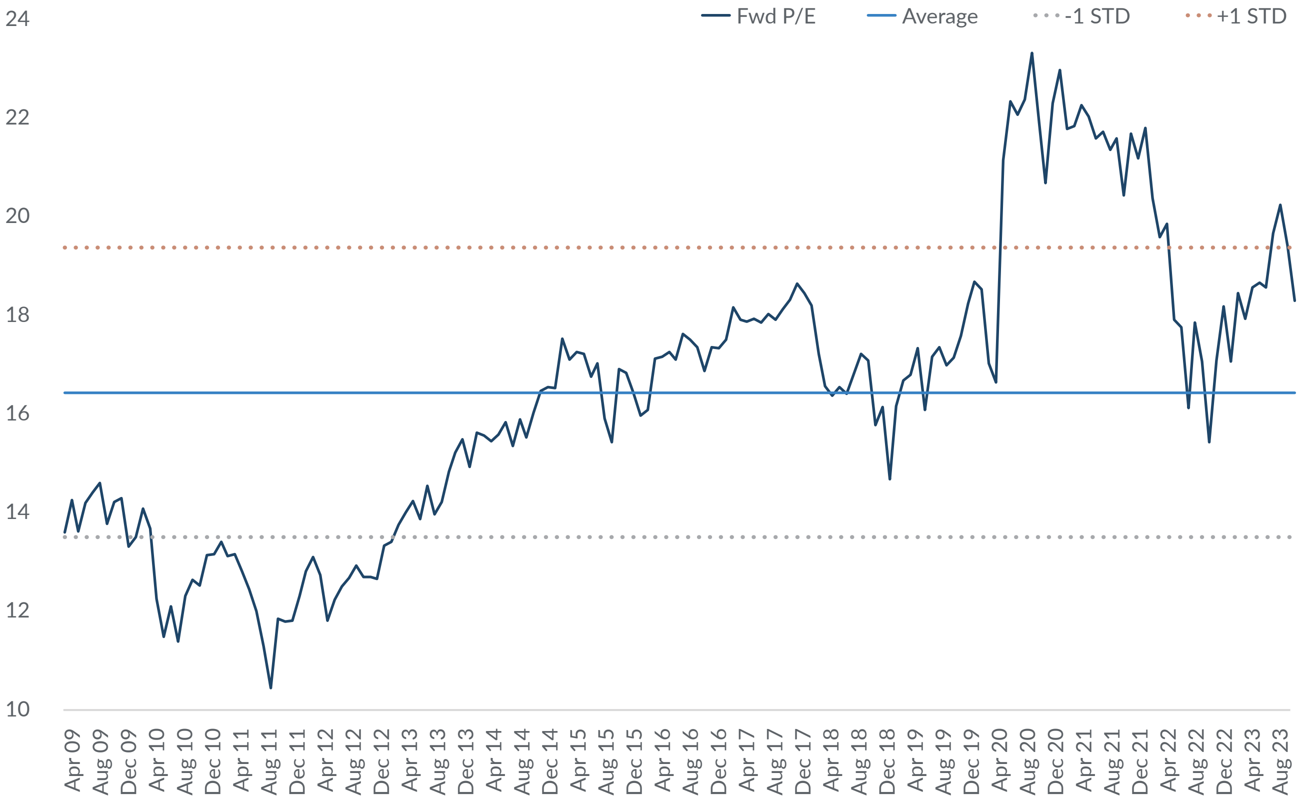
The S&P 500's forward P/E is 18.2x (*see table below*). Multiples often increase when earnings dip as long as the future outlook is more positive. EMs are much cheaper and have strong recovery potential.

Figure 9: Various major global indices' EPS growth and forward P/E forecasts
Source: Anchor, Bloomberg

	Earnings growth		FWD P/E	
Name	**YR1**	**YR2**	**YR1**	**YR2**
MSCI World Index	4.7%	9.4%	16.2	14.8
MSCI EM Index	12.7%	14.3%	11.2	9.8
MSCI All Country World Index (10% EM)	5.9%	10.1%	15.5	14.0
S&P 500 Index (ex-Energy)	10.7%	11.6%	18.8	16.8
S&P 500 Index	8.0%	10.9%	18.2	16.4

This is shown graphically in the chart below.

Figure 10: S&P 500 Index forward P/E
Source: Anchor, Bloomberg



EMs have been a letdown in 2023, as the much-vaunted Chinese recovery has been disappointing. Chinese government stimulus has been less aggressive than in previous cycles, but the government could act more decisively in the next six months. EM valuations are cheap, and a shift in sentiment could see a sharp rise, but current sentiment is extremely negative. An exciting opportunity is the Chinese AI stocks, which have not shared the same reaction to the rapidly evolving future. This is despite many of them having invested heavily in this space over the past decade.

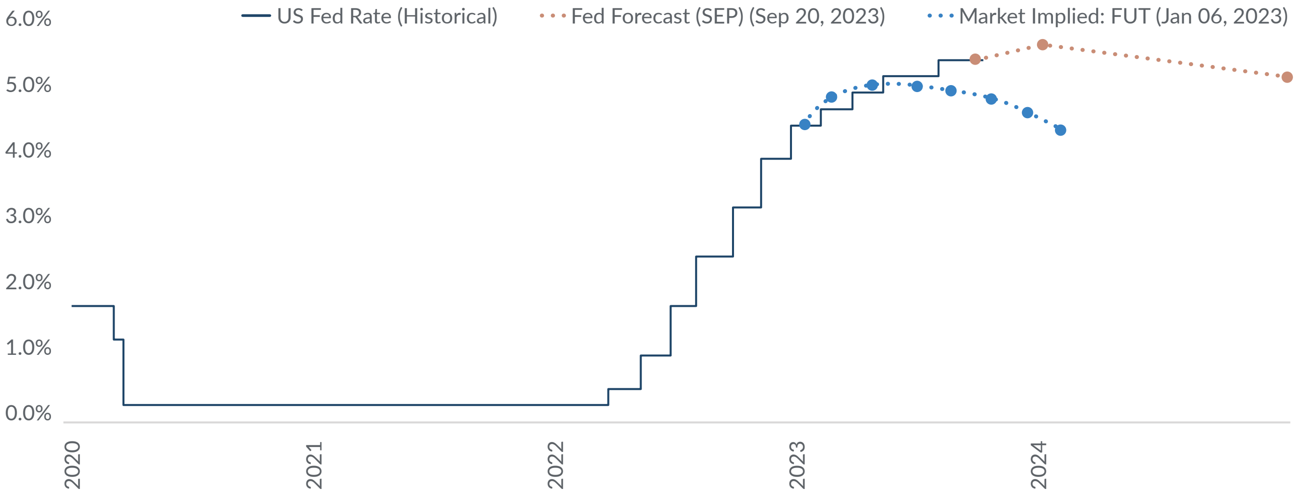
GLOBAL BONDS

After the worst global bond market sell-off on record in 2022, investors entered 2023 with the prospect of some of the most attractive **developed** market (DM) bond yields in decades.

Figure 11: The yield on the Bloomberg Global Bond Index started the year as high as it has been in decades
Source: Anchor, Bloomberg

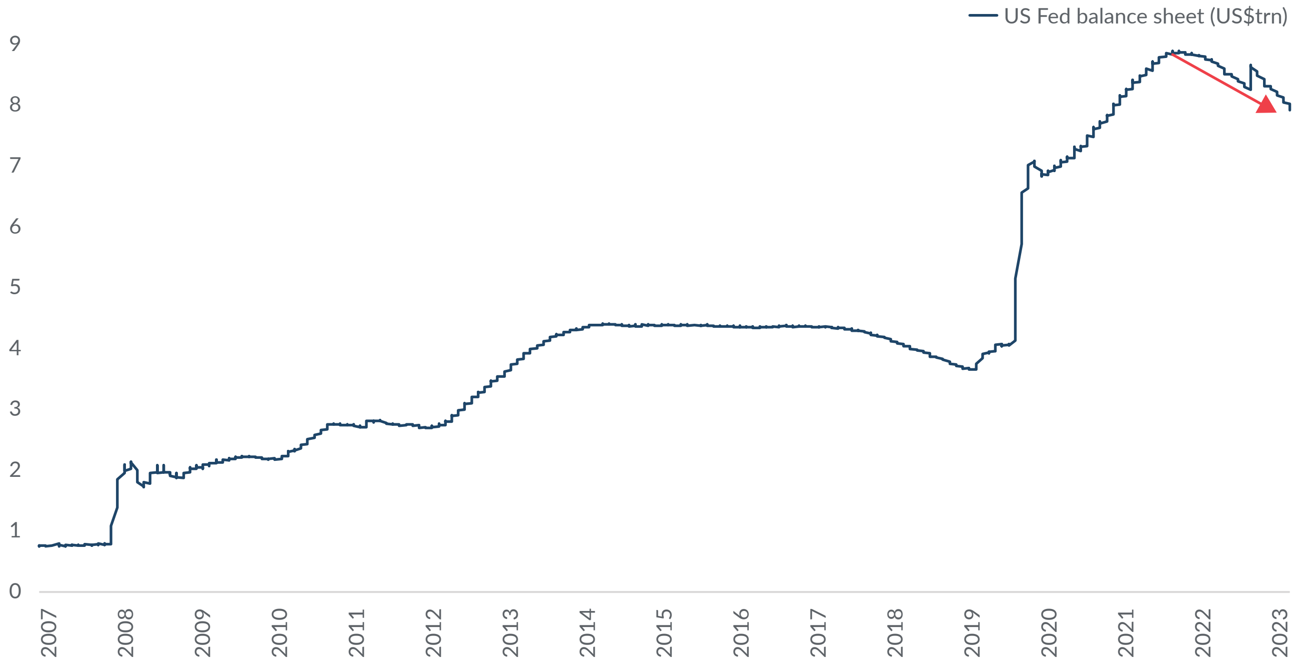
This year, DM economic activity has remained surprisingly resilient (particularly in the US), keeping inflation stubbornly high and requiring DM central banks to hike rates higher than anticipated. Central bankers have also sent the message that they will likely have to keep rates elevated for much longer than investors had expected.

Figure 12: Investors started the year anticipating the Fed would hike rates to 5% and then start cutting rates in 2H23. The Fed has already hiked rates to 5.5% and anticipates rates going higher and staying elevated through 2024
Source: Bloomberg



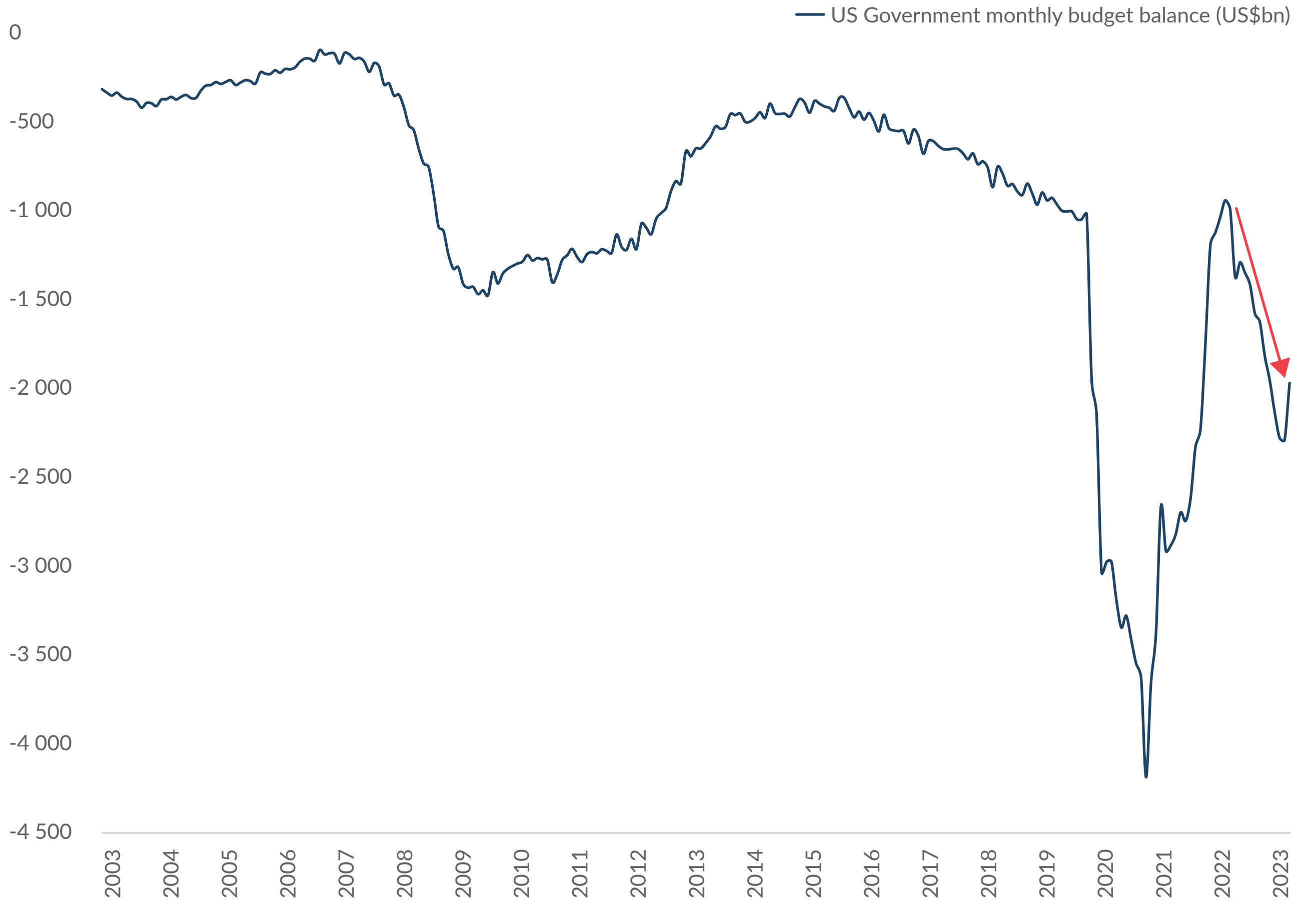
At the same time, the supply/demand dynamics for US government bonds have worsened, with the US Fed trying to normalise the size of its balance sheet after a dramatic COVID-19 era quantitative easing (QE) programme.

Figure 13: A key source of US government bond demand has subsided as the Fed has started trying to right-size its balance sheet in the wake of extraordinary COVID-19 era QE
Source: Anchor, Bloomberg



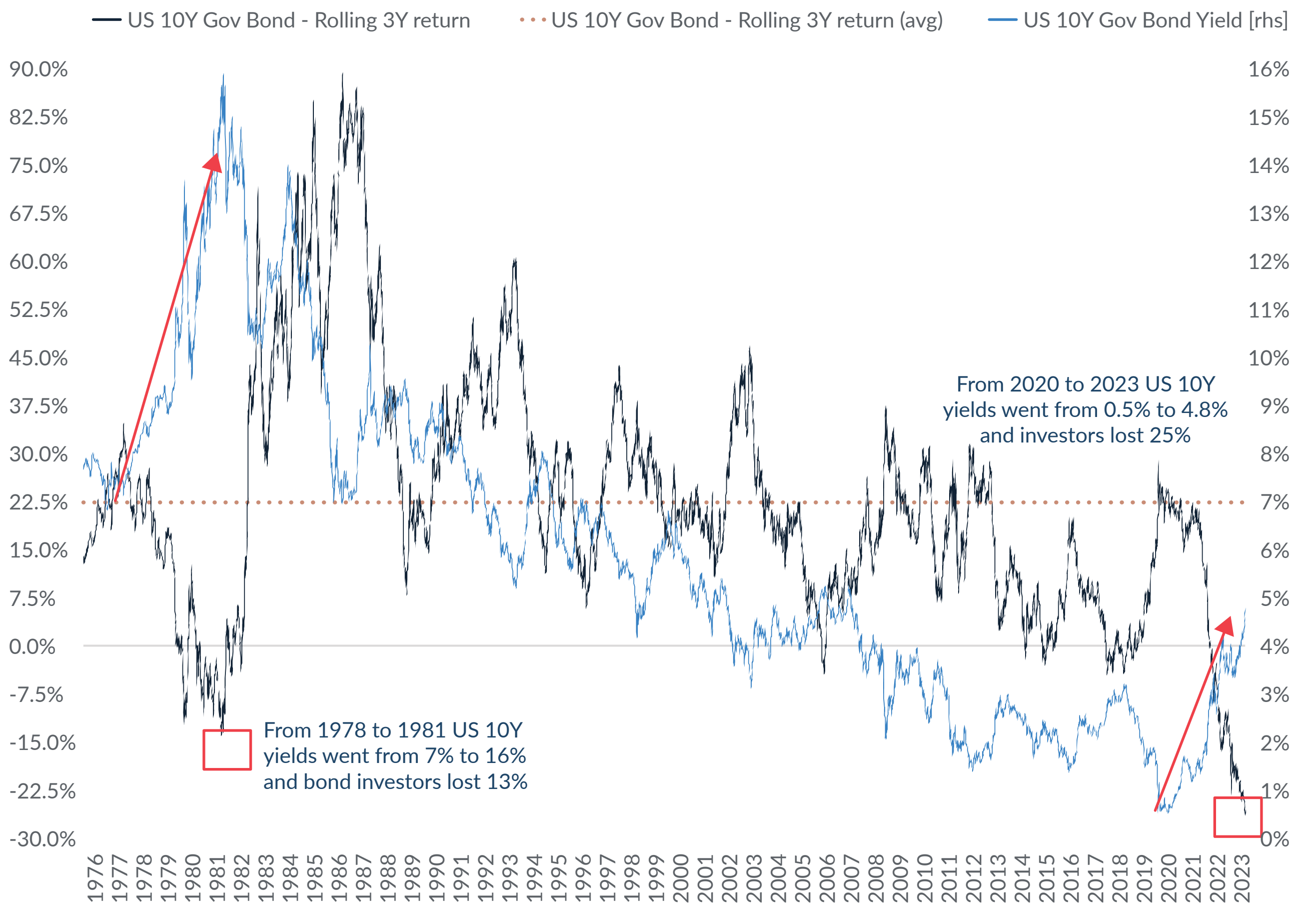
The supply of US government bonds has accelerated as the US government's budget deficit has ballooned on the back of government stimulus programmes adopted during the COVID-19 crisis.

Figure 14: The US government's increased need for funding has increased the supply of US government bonds
Source: Anchor, Bloomberg



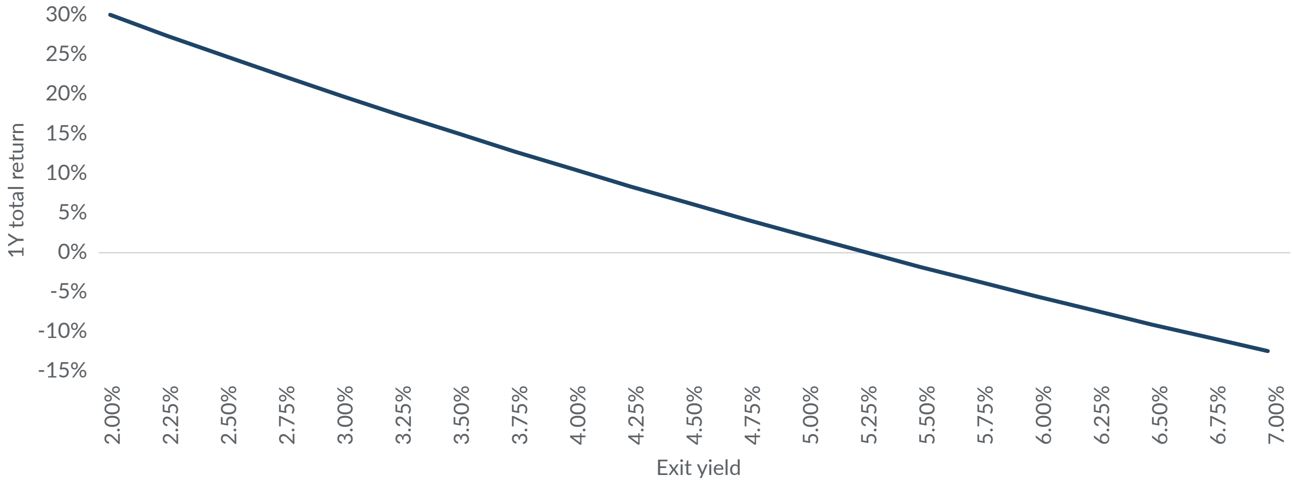
Deteriorating supply/demand dynamics and the prospects of US central bank rates remaining **higher for longer** have resulted in continued upward pressure on US 10-year government bond yields, resulting in the worst bear market in US long bonds going back at least 50 years.

Figure 15: US 10-year government bond investors have experienced a c. 25% loss over the past three years as yields rose from 0.5% to 4.8%. The most recent 3-year losses are double those experienced by US 10-year government bond investors in the early 1980s (the last time investors experienced such a prolonged bond bear market)
Source: Anchor, Bloomberg



The aggressive bond bear market over the past three years is now in the rearview mirror, and we must decide what investors can expect over the next twelve months. For bonds, the outcome is purely mathematical – we plug our forecast of the yield that US 10-year government bonds will be trading at 12 months from now into the calculation and out pops the total return (the combination of price change and coupon income) that investors will experience over the next 12 months.

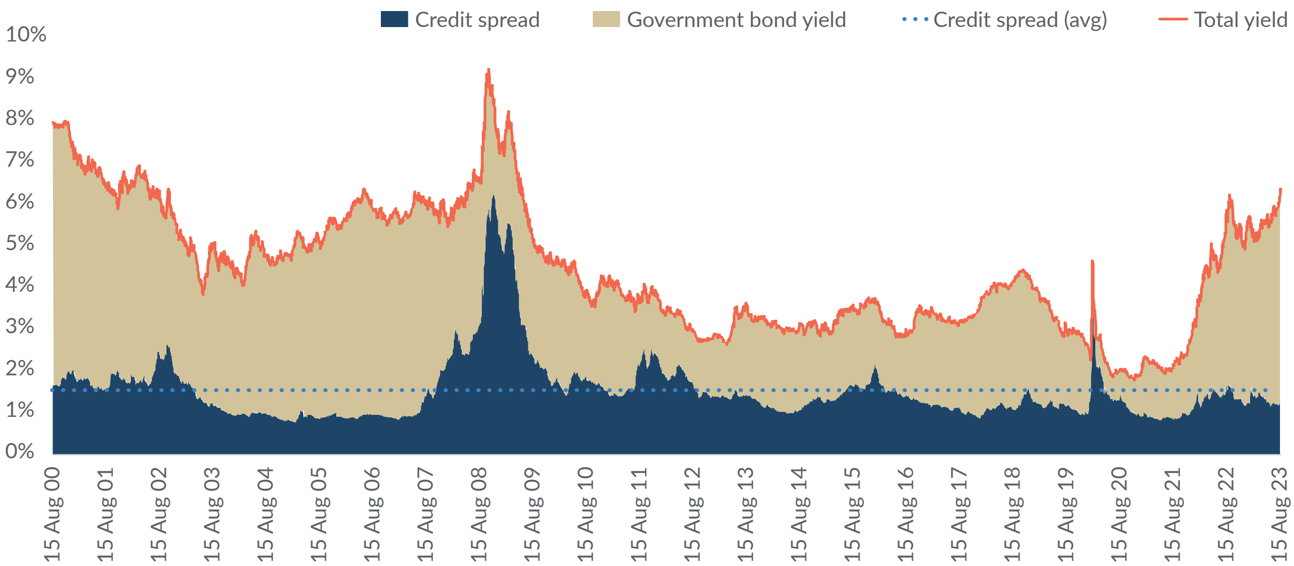
Figure 16: The range of 12-month return outcomes for US 10-year government bond investors is positively skewed with the elevated starting yields on offer
Source: Anchor



We assume that current yields are unsustainable. We anticipate that US 10-year government bond yields will head lower over the next 12 months (though not in a straight line), leaving them at c. 4.2% p.a. one year hence for a total return of 9% in US dollar terms for US 10-year government bond investors over that one-year horizon.

The picture is slightly more complicated for US dollar investment-grade corporate bonds investors. The similarity is elevated starting yields, but a component of that yield is the credit spread investors earn for taking on the risk that corporates default on their debt. As yields rise, the prospect of higher funding costs generally increases credit spreads as investors demand more compensation for the increased possibility of some corporate defaults. Rising credit spreads result in capital losses for corporate bond investors (all else being equal).

Figure 17: US dollar-denominated investment-grade corporate bond yields appear attractive, though credit spreads are likely to rise from here as higher funding rates result in an increased likelihood of corporate defaults
Source: Anchor, Bloomberg

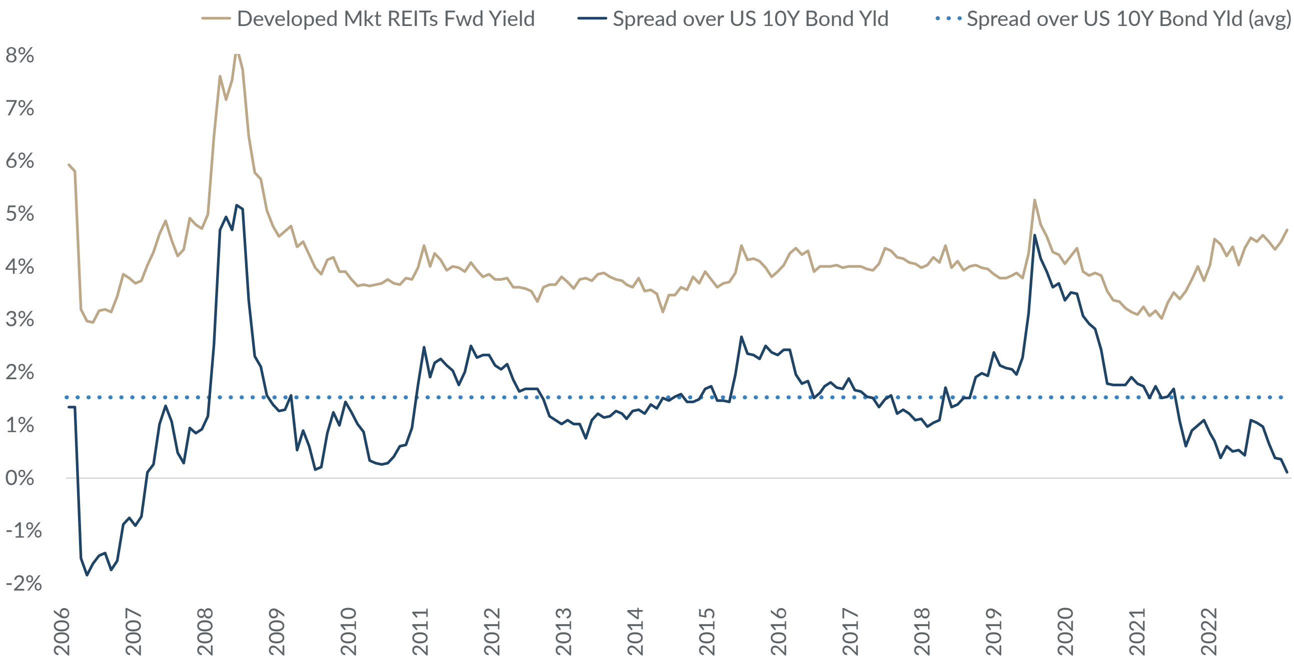


We have not yet seen a meaningful increase in credit spreads, but we anticipate this will start to happen over the next 12 months as credit conditions deteriorate. The combination of government bond yields narrowing by around 0.5% and credit spreads widening to about 1.6% (slightly above their average over this century) will result in aggregate investment-grade corporate bond yields of c. 6% p.a. one year from now, delivering a total return for investors in that asset class of c. 8% in US dollar terms over the next twelve months.

GLOBAL PROPERTY

Global DM-listed property shares followed global risk assets lower in 3Q23 (-6.8% QoQ), underperforming global DM stocks (-3.4% QoQ) for the sixth consecutive quarter. Despite the prolonged underperformance of listed commercial real estate companies, they have seen their aggregate forecast dividend yields compress relative to global bond yields, leaving them with the lowest yields relative to US 10-year government bond yields since 2007.

Figure 18: Despite a prolonged period of disappointing performance for listed DM property shares, their forecast dividend yields have compressed relative to bond yields.
Source: Anchor, Bloomberg



We anticipate that some of this relative yield advantage will return in the form of lower US government bond yields, which we forecast could fall by around 0.5% over the next twelve months. However, even factoring in that adjustment, forward dividend yields are still c. 1% below their long-term average, suggesting they are still overvalued relative to other yielding assets.

Putting aside the valuation argument, we think the asset class's cyclical headwinds, including significantly higher funding rates and tightening funding conditions, pose earnings and liquidity risks for many of these companies. Some of the biggest sectors, including office and retail real estate investment trusts (REITs), continue to face structural challenges. These are related to evolving online practices like remote working and online shopping, where COVID-19 disruptions have made it difficult to figure out how far that adjustment still has to run.

The starting forward dividend yield of 5.1% provides a decent underpin to the prospective returns for investors, and the inflation environment should provide a decent tailwind to operating income growth in the short term. Nevertheless, we anticipate that most of the earnings growth will be offset by a derating in valuations in the asset class as it adjusts to the higher-yield environment, delivering investors a total return of 5% in US dollar terms over the next twelve months.

ANCHOR INSIGHTS

In this section, staff across Anchor provide insights into our thinking, strategy, and worldview. This quarter, Seleho Tsatsi examines the nature of stock market returns, James Bennett argues that, in the long run, it pays for investors to be optimists, Stephan Erasmus uncovers the hidden costs of emotional biases in investing, Sandy van der Zanden talks about the process a family has to follow in terms of claiming money from retirement funds when a loved one dies, Lana van Coller provides insights into how a tax-free savings account could be your ultimate path to financial freedom and a wealthier retirement, and, finally, Di Haiden discusses the practical implications of SA's greylisting for the country's residents.

The Counterintuitive Nature of Stock Market Returns

WRITTEN BY:
Seleho Tsatsi, CFA
Investment Analyst

In 2013, Seleho completed his BCom in Economics and Finance at Wits University, where he received the SASFIN Securities Prize. In 2014, he was awarded the Postgraduate Merit Award upon enrolment for Honours. He joined Cannon Asset Managers in January 2015 and moved to Anchor in November 2015. Seleho covers the basic materials sector locally and co-manages the Anchor BCI Global Technology fund. He is a CFA charterholder.

In this article, we examine the nature of stock market returns. We conclude that the distribution of stock market returns is highly concentrated in a tiny number of stocks with sizeable positive performances that drive total returns for entire indices. We believe public equity returns resemble venture capital returns far more closely than investors would believe to be the case. Most individual stocks also underperform Treasury Bills over the short and long term.

A small proportion of index constituents generate significant returns and drive overall returns for the entire index. This phenomenon is true across time periods in the US. *J.P. Morgan Asset Management* published a fascinating study that examined the distribution of stock market returns from 1980 to 2014 (34 years). The study focused on the Russell 3000 Index, a US equity index that includes the 3,000 largest US stocks by market capitalisation. Over the 34 years, 40% of these stocks lost 70% or more of their value and never recovered. A small group of just 7% of the stocks in the index generated essentially all of the index's returns. This small group of stocks outperformed the overall index by at least two standard deviations.

A small number of stocks generate significant returns and drive total returns for entire market indices.

Hendrik Bessembinder, a US professor of finance and economic analyst, observed similar findings in his paper for *The Journal of Financial Economics*, entitled *"Do Stocks Outperform Treasury Bills?"*. The report studied all stocks listed on the American Stock Exchange (AMEX), the New York Stock Exchange (NYSE) and the Nasdaq from 1926 to 2016. There were 25,967 stocks in total in the universe studied over the period. Five companies out of a universe of 25,967 shares accounted for 10% of the total returns generated over 90 years. Put another way, 0.02% of the companies accounted for 10% of the total returns generated over 90 years. Even more surprisingly, just 4% of the companies accounted for all the returns generated. The J.P. Morgan Asset Management study and Bessembinder's paper demonstrate that a small number of stocks generate significant returns and drive total returns for entire market indices.

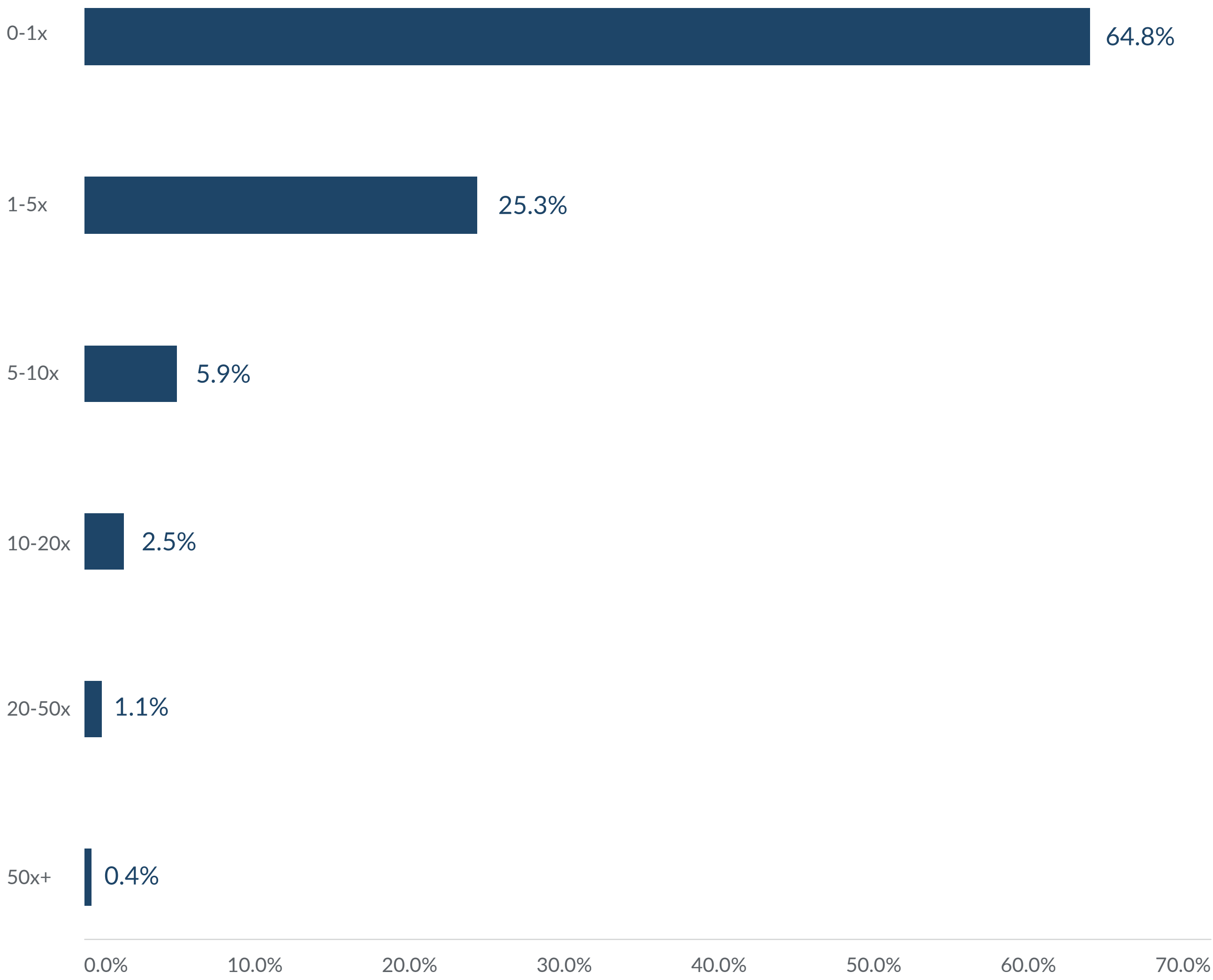
Most stocks deliver returns that are worse than bonds. Again, this is counterintuitive considering old investment adages such as "stocks outperform bonds" or "stocks outperform bonds due to their higher degree of risk". According to Bessembinder, of the 25,967 stocks studied over 90 years, 57.4% of monthly returns were lower than the returns on one-month US Treasury Bills for the same month. This was found when looking at each stock's return over its listed lifetime until it either delisted or at the end of the period. This was true even with the reinvestment of dividends. Despite this underperformance of most stocks in comparison to US Treasuries, stock market indices do, in fact, outperform bonds in total because exceptionally strong positive performances from a small number of shares in those stock market indices more than compensate for the mediocre performance from the rest of the index. Bessembinder found this to be true when looking at one-month and ten-year returns. Returns over a decade are lower for most stocks than those over a decade for Treasury Bills.

The degree of concentration of stock market returns in a small number of stocks appears to be increasing over time. Bessembinder established that the percentage of stocks underperforming US Treasuries has increased over time. From 1947 to 1956, 87% of stocks outperformed US Treasuries. From 1957 to 1966, 62% of stocks outperformed. By the time we reached the 1977 to 1986 period, just 32% of stocks outperformed US Treasuries. Astonishingly, since 1977, the median stock has had a negative return and underperformed Treasuries.

We believe public equity returns resemble venture capital returns much more closely than investors believe to be the case. Investors generally accept that a small number of investments drive the entire portfolio's performance in venture capital investing. For example, *Correlation Ventures* studied US venture returns from 2004 to 2013 and found that 64.8% of US venture investments did not have positive returns over the period. Twenty-five percent had 0% to 400% returns, and just 0.4% of venture investments returned 50x their investment. This small group of investments would have been a significant driver of returns for the portfolios in which they were included. It is noteworthy to see how similar this distribution of returns is to the studies by *J.P. Morgan Asset Management and Bessembinder.*

Several implications can be drawn from these findings on the nature of stock market returns. First, most stocks

Figure 1: US venture returns, 2004 to 2013
Source: Correlation Ventures, Dow Jones VentureSource



in equity indices generate small to negative returns. The large positive returns generated by a few stocks more than offset these mediocre to poor returns from the majority. A second implication is that the driving factor behind frequent investor underperformance of equity indices is the failure to identify ex-ante (based on what is expected to happen, i.e., based on forecasts) this small group of winners. Conversely, market-beating portfolios are likely to contain an above-average proportion of the small group of winners. These findings also have implications for the degree of concentration or diversification investors should pursue in their portfolios. Highly diversified portfolios increase the likelihood of investors owning the small group of winners over the period in question but also increase the probability of poor performance being contributed by most mediocre-performance stocks.

Portfolio concentration increases the stock picker's responsibility to identify ex-ante the future small group of winners. It may also, however, give the stock picker the ability to avoid the large group of mediocre-performance stocks, assuming the portfolio concentration leads to more stringent filtering for any stock to be included in the portfolio.

To conclude, we note that stock market returns are naturally counterintuitive and much more right-skewed than we, as investors, naturally perceive. Furthermore, this phenomenon has increased over time. Despite general convictions to the contrary, public equity market returns may be much more akin to venture capital returns than we would otherwise have believed to be the case.

For investors, it pays to be an optimist in the long run

WRITTEN BY:
James Bennett
Global Equity Analyst

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

When it comes to investing in shares, be a pessimist in the short term, a realist in the medium term, and an optimist in the long term.

The financial media is constantly full of headlines imploring investors to sell some or all their shares to avoid an imminent market catastrophe. Bad news sells better than good news in the media. It is not impossible that one day, this impending doom view will come true. Theoretically, almost anything can go wrong with the world we live in.

The question is whether anyone can accurately forecast or predict when it will happen. Investors cannot constantly react to this type of negative newsflow. If we did, we would seldom be invested in the market. One rarely sees an article headline suggesting we should hold our portfolios for "steady, compounding gains over the next 20 years". After all, this makes for boring journalism.

I believe being an optimist at heart makes for more successful investing over the long term.

"Optimistic – hopeful and confident about the future." (Oxford Dictionary definition)

"Optimists see the positive side of things. They expect things to turn out well. They believe they have the skill and ability to make good things happen." (kidshealth.org)

Here is my philosophy regarding investing in shares:

SHORT TERM

Be a pessimist. Be extremely careful what you invest in. Assume that whatever can go wrong in the short term probably will. This is particularly helpful when trying to invest in turnaround situations. Often, things get worse before they get better. Keep your expectations very low about possible short-term outcomes. Markets always feel like they are climbing a wall of worry in the near term.

MEDIUM TERM

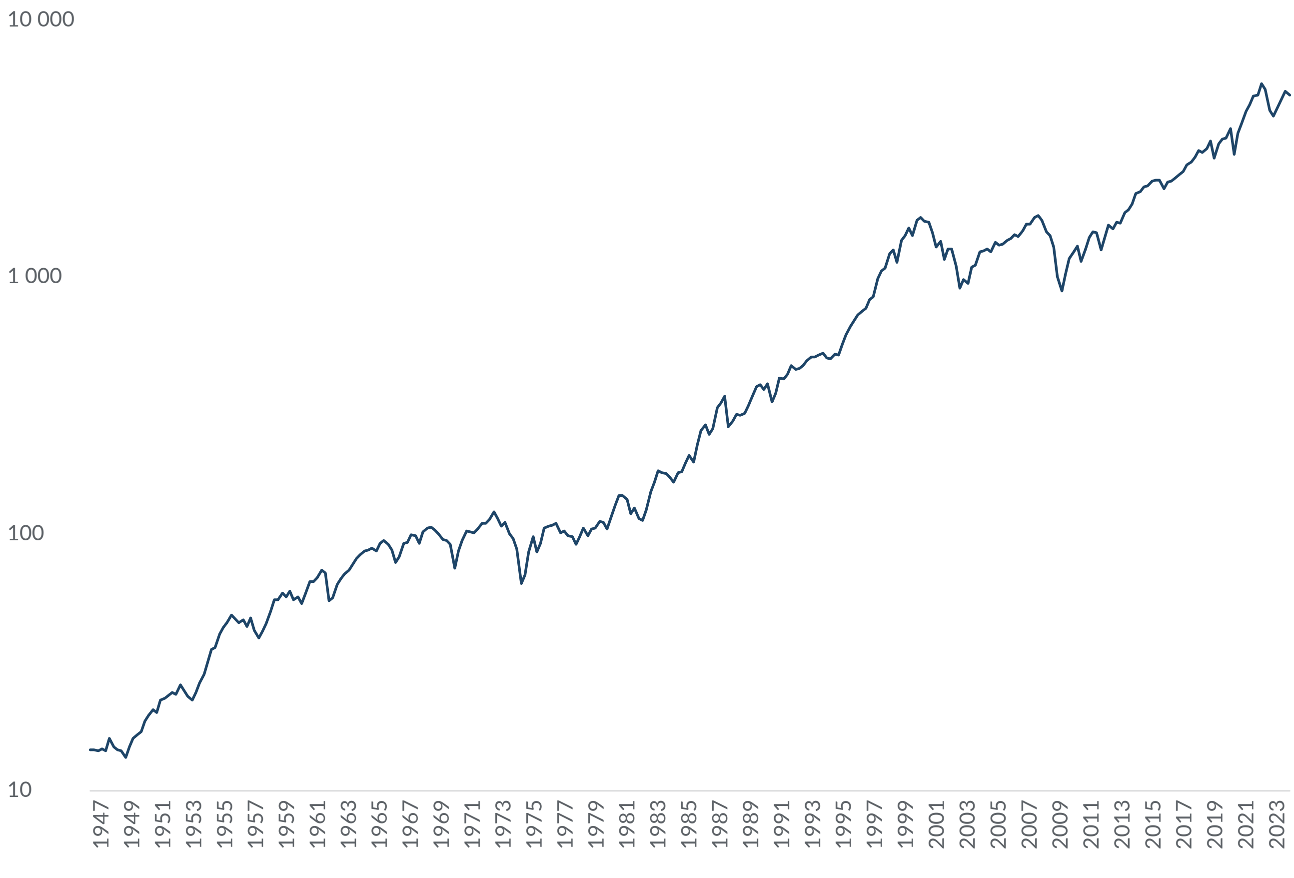
Be a realist. In the medium term, a mixture of things will go right and wrong with the shares in your portfolio. Some things will end up worse than you expected, and other things will turn out better. Often, the shares you thought would be your winners disappoint you. Conversely, the shares you expected the least from sometimes end up positively surprising you the most.

LONG TERM

Be an optimist. Humanity is resourceful and has demonstrated an ability to successfully navigate change and find solutions to challenges. Many issues generally work out in the long term. We can look back at investments we made years ago and realise how futile our worries were at the time. This is especially true for broad macro issues. Most importantly, we invested in a portfolio of high-quality companies over the long term. Being an optimist also helps us grind through a few years where the market might have done nothing but move sideways or down.

Figure 1 below shows the performance of the S&P 500 Index since the 1940s. Consider all the things to worry about over these many decades. Being optimistic that concerns and issues generally work themselves out, in the long run, would have given us the best chance of capturing this superb market performance over the years.

Figure 1: The S&P 500 Index* ... imagine all the things to worry about during this period
Source: Anchor, Bloomberg



Note logarithmic scale and 2023 is the year to 6 October.

An exercise I like to do periodically is to go back and watch a few clips of market commentators from years ago. So many of their concerns back then are the same issues we worry about today. I recall recently watching a panel of US market experts discussing their worries about the overall market. I was struck by their timely, relevant, and insightful concerns. Only halfway through the clip did I discover that I was watching an interview conducted several years ago. The issues and concerns never really seem to change. Yet here we are in 2023, and the market has found a way to work through our perennial concerns.

In the moment, market pullbacks feel severe when we experience them. However, years later, looking back at that same sell-off on a long-term chart, it appears to be nothing more than a blip. That is when we look back and think, "Why were we so worried at the time?". An optimist is best placed to use these periodic blips as long-term buying opportunities.

I would argue that the world's highly successful businesspeople achieved what they did partly by being optimists at heart. Being an optimist does not mean we blindly invest in every supposed hot idea that crosses our path. Instead, it means we believe that hard work and application, coupled with a small dose of good fortune and taking some risk, will lead to good outcomes over the long term. Provided we do our part, things will typically work out in the long run.

The impact of good fortune is an underappreciated element of success. No matter how hard we work, we must be in the right place at the right time. However, I would suggest that if you are an optimist, you increase the chances of some good fortune coming your way many times over.

Being a pessimist leads us to make poor, long-term investment choices. It makes us reactive to short-term, negative newsflow. It also makes us more likely to sell our shares at a market low. A pessimist leans towards putting their money under the mattress, thereby missing out on overall market returns over the years. Inflation is enemy number one for our assets in the long run. Few things in life are assured. However, cash under the mattress is almost guaranteed to suffer the ravages of inflation over time, leading to poor investment outcomes.

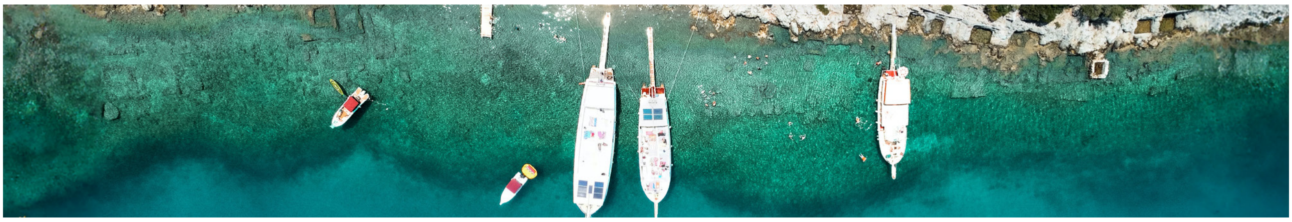
The following is often true of market commentators or financial analysts. Being bullish makes us sound unwise, inexperienced, and possibly even gullible. However, being bearish makes us sound knowledgeable and wise. Yet the entire underlying thesis of equity investing is that markets rise over time, beating inflation. Why else would we invest in the market?

I heard the following quote from Nick Train (a UK fund manager) in a TV interview a while ago, and it struck a chord with me. I am sure he meant this somewhat tongue-in-cheek, but he nevertheless made a powerful point.

"I would rather give my money to a foolish optimist than a wise pessimist, for the optimist has history on their side"
Nick Train (Lindsell Train, UK fund manager)

Here is a view I often express to friends who ask for financial guidance while voicing their concerns about the uncertain future; "You cannot financially plan for World War III". There is always a what-if scenario for which the best-laid plans cannot cater. Whether it is money under the mattress, a passive index fund, a value strategy or a property portfolio, there is always a scenario under which no investment strategy can come to our rescue. It is pointless dwelling on these types of extreme scenarios. Even if they happen, there will not be much we can do about it.

Instead, we must assume that the world as we know it will continue as a going concern for the foreseeable future. Furthermore, it helps to understand that humanity has an incredible ability to navigate and adapt to difficult circumstances. This gives us the best chance to succeed as a long-term investor. As a bonus, life is more enjoyable if we take an optimistic view.



Uncovering the Hidden Costs:
The Role of Emotional Biases in Investment Decisions

WRITTEN BY:
Stephan Erasmus, CFA
Investment Analyst

Steph joined Anchor as a senior investment analyst in 2022. Steph worked in several financial management positions after studying at Rhodes University, UNISA, and the University of Pretoria. He joined Avior Capital Markets in 2018 as a sell-side analyst. While at Avior Capital Markets, Steph was rated fourth in the annual Financial Mail Ranking the Analysts survey for healthcare and pharma sector coverage in 2021 and was rated joint-first as the top-rated industrial small- and medium-cap analyst for 2020 and 2021. Steph holds the CFA designation and the CGMA global designation for management accountants.

It is common for individual investors to underperform the market when it comes to returns, but have you ever wondered why? A 2023 *DALBAR Quantitative Analysis of Investor Behaviour (QAIB)* study uncovers a startling truth: Over the past 20 years, the average equity investor has lagged the S&P 500 by almost 4%. Surprisingly, this gap is attributed more to investor behaviour than the performance of the funds they invest in. What is behind this significant gap between market benchmarks and the average returns of individual investors?

Similarly, a 2019 report by *Barclays* indicates that emotional biases influence about 75% of retail investors' decisions, leading to an average annual loss of nearly 3%. Despite the wealth of tools and information, why do many investors still make these costly errors?

The often-ignored answer lies in behavioural finance, which delves into the psychological aspects and biases influencing our investment choices. These biases can skew our judgement and lead us to make emotion-driven decisions.

This article will delve into the fascinating domain of behavioural finance and its impact on individual investors and broader financial markets. We will use three case studies to highlight the psychological pitfalls that can significantly sway market outcomes. More importantly, we will provide actionable insights to help you recognise and mitigate these biases in your investment strategy.

By the end of this article, you will have a comprehensive understanding of the psychological factors that influence financial decisions. You will also discover how to leverage this knowledge for your benefit. So, let us dive into the intricate psychological elements that shape our financial behaviour and its repercussions on investment outcomes.

COMMON EMOTIONAL BIASES AND THEIR IMPLICATIONS

These biases often shape our financial decisions:

Groupthink and the influence of social media:

Nobel laureate Robert J. Shiller describes groupthink as a self-reinforcing cycle, emphasising that the sway of social influence has been around for a long time. In investment, groupthink can be particularly dangerous because it encourages conformity over critical thinking. Social media platforms amplify this effect by creating echo chambers where only similar opinions are voiced and validated. This can lead investors to decide based on popular sentiment rather than objective analysis. For example, when a particular stock trends on social media, the fear of missing out (FOMO) can drive investors to buy without adequate research. This herd mentality, fuelled by social media, can inflate asset bubbles and exacerbate market volatility. Groupthink and social media can cloud our judgement, making us susceptible to investment choices that may not align with our financial goals or risk tolerance.

Overconfidence:

This bias can make us overly optimistic about our skills and the potential returns on investment, leading us to ignore warning signs or expert advice. For example, many amateur day traders enter the stock market believing they can easily outperform seasoned professionals, only to face significant losses. As Warren Buffett once said, “Overconfidence is the enemy of the rational investor.”

> *Overconfidence is the enemy of the rational investor.*
> Warren Buffett

Loss aversion:

According to psychologist Amos Tversky, “The emotional impact of a loss is twice that of a gain.” This psychological bias can have a profound effect on our investment decisions. The fear of losing money often outweighs the potential joy of making a profit, leading us to make choices that may not be in our best financial interest. For example, this loss aversion can cause investors to hold onto underperforming stocks far longer than they should, hoping that these stocks will rebound. This emotional attachment to avoiding loss can result in missed opportunities for higher returns in more promising investment avenues. Loss aversion can keep us in a financial rut, hindering our ability to make rational, forward-thinking decisions.

CASE STUDIES: THE DOT-COM BUBBLE, THE 2008 GLOBAL FINANCIAL CRISIS (GFC), AND THE GAMESTOP PHENOMENON

The dot-com bubble: A tale of overconfidence and herd behaviour

Timeline: Late 1990s to early 2000s

Overview: The dot-com bubble witnessed a meteoric rise and subsequent crash in tech and internet stocks. Investors, enticed by the allure of a “new economy,” invested heavily without adequate research.

Behavioural biases: Overconfidence and herd behaviour were prevalent. Investors felt invincible in a booming market and often followed the masses into tech investments without grasping the fundamentals.

Quote: Alan Greenspan, the then Federal Reserve Chairperson, cautioned against “irrational exuberance,” spotlighting the overconfidence permeating investor behaviour.

The 2008 GFC: Overconfidence meets loss aversion

Timeline: 2007-2008

Overview: The downfall of major financial institutions due to subprime mortgage exposure and government bailouts led to a significant decline in consumer wealth and market instability.

Behavioural biases: Overconfidence in the housing market and intricate financial products, coupled with loss aversion, were key players. Many investors clung to depreciating assets, hoping for a market recovery.

Quote: Ben Bernanke, the then Federal Reserve Chairperson, observed that "financial institutions' risk management systems were inadequate," highlighting systemic overconfidence in risk evaluation.

The GameStop saga: Individual investors challenge the financial elite

Timeline: January-February 2021

Overview: Online platforms like Reddit's WallStreetBets became a rallying point for individual investors to buy GameStop shares. Many joined the cause without thorough analysis.

Behavioural biases: Overconfidence and herd behaviour were again at play. Individual investors became increasingly self-assured, thinking they could outsmart financial professionals.

Quote: Daniel Kahneman, renowned for his research on decision-making psychology, warns that "overconfidence is a potent source of delusions."

STRATEGIES TO COUNTERACT BIASES

"Knowing is not enough; we must apply. Being willing is not enough; we must do," Leonardo da Vinci wisely stated. Acknowledging that emotional biases exist is the first step, but applying this knowledge to our financial decisions is the task. So, how can we effectively steer through this maze of biases?

Self-reflection: The first line of defence is self-awareness. As Charlie Munger, vice chairman of Berkshire Hathaway, suggests, "You don't have to be a genius; just avoid making foolish decisions consistently." Keeping an investment journal to document your thoughts, feelings, and the reasoning behind each investment can be invaluable.

Consulting experts: The adage "two heads are better than one" rings true in investment decisions. A trustworthy financial advisor can provide an impartial view and challenge your assumptions, helping you sidestep emotionally charged, rash decisions.

Portfolio diversification: As Warren Buffett advises, "Don't put all your eggs in one basket." Diversifying minimises your financial risk and dampens the emotional highs and lows of investing in a single stock.

Automated investment platforms: While not foolproof, algorithmic trading systems and robo-advisors can minimise the impact of emotional biases. These platforms make decisions based on set criteria, removing the emotional pitfalls that can cloud human judgement.

CONCLUSION

Behavioural economics is central to understanding market dynamics and why individual investors often commit predictable mistakes. Daniel Kahneman aptly says, "You're neither rational nor irrational; you're human." This captures the essence of behavioural economics: our financial choices are deeply rooted in our emotional and cognitive limitations.

So, what is the takeaway? First, understanding emotional biases is an intellectual exercise and a practical toolkit enabling us to make improved financial decisions. From the historical lessons of the dot-com bubble and the 2008 GFC to the recent GameStop trading phenomenon, these case studies serve as tangible examples of the influence of emotional biases.

The quest for financial wisdom is a profoundly individual journey.

Second, the journey to becoming a more rational investor is ongoing. Even as you become more mindful of your biases, the dynamic nature of financial markets means new biases can arise. Continuous self-evaluation and adaptation are not optional; they are essential for long-term investment success.

Lastly, the intricacy of human behaviour means there is no one-size-fits-all solution. What works for one person may not work for another. Therefore, the quest for financial wisdom is a profoundly individual journey that demands introspective practices, expert advice, and continuous refinement of investment strategies.

In summary, behavioural economics equips us with the frameworks to comprehend the 'why' behind our financial choices, adding depth to our investment strategies. With this knowledge, we are better prepared to navigate our economic future.

Retirement Funds and Death

WRITTEN BY:
Sandy van der Zanden
Wealth Management

Sandy has worked in the financial services industry since 2006, addressing the key investment outcomes for private clients and high-net-worth individuals.

Death comes unexpectedly to us all. For the family left behind, there are always unanswered questions and immediate concerns to be dealt with. At such a time of grief, claiming money from retirement funds can be daunting for the deceased's family, as a wide variety of retirement funds are available for investors within SA. An investor may have any combination of these products, and the claims processes differ for each. This can be confusing and concerning for the family trying to access the money. This article will endeavour to assist you in understanding the various retirement funds available and how the death claims process works for each.

In simple terms, retirement funds can be broken down into two main categories:

1. **Pre-retirement funds:** These funds include retirement annuities (RAs), preservation, pension, and provident funds. These funds are the vehicles used to build up retirement savings over time.

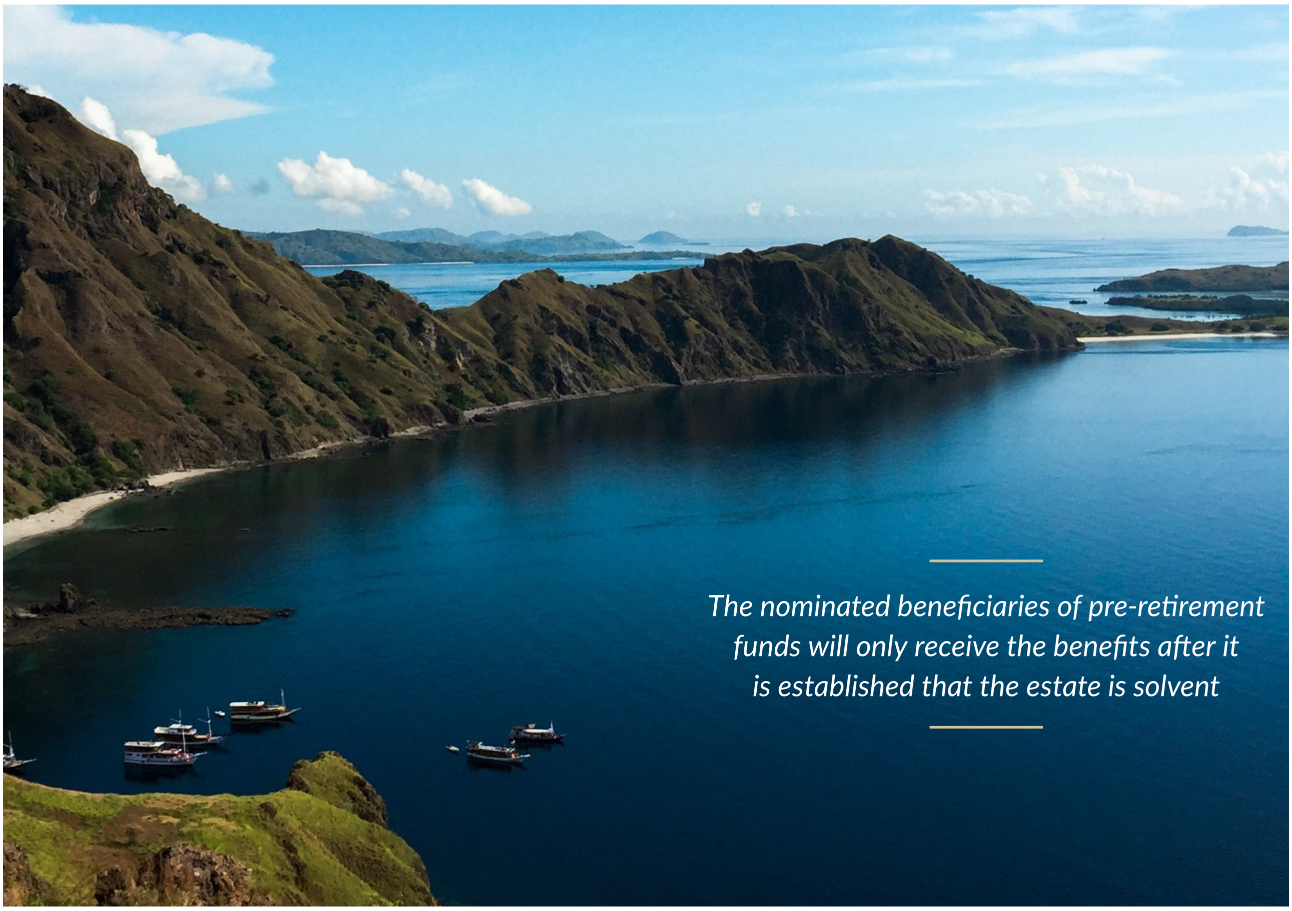
2. **Post-retirement funds:** These funds pay you an income at retirement and are generally known as annuities. Post-retirement funds include living annuities, guaranteed annuities and with-profit annuities.

What payment options do I have?

Beneficiaries can select either a cash lump sum, an annuity, or a combination of both.

What about estate duty and tax?

The death benefits payable from pre- and post-retirement funds do not form part of the deceased member's estate.



This means that no estate duty is payable on the death benefits. However, tax is payable on any cash lump sum received according to the retirement table of the deceased member. Any amounts invested into an annuity are transferred entirely tax-free. The income drawn from the annuity is taxable as income in the hands of the beneficiary when it accrues.

WHO GETS THE MONEY ON DEATH?

Beneficiaries vs dependents

Both pre-and post-retirement funds allow investors to nominate beneficiaries on death. However, there is a major difference between the two types of funds regarding the nomination and payment of beneficiaries.

Pre-retirement funds

The Pension Funds Act governs all pre-retirement funds in SA. Death benefits are paid according to Section 37C of the Act. The Act requires the fund's trustees to consider the interests of any dependent of the deceased. This may even be contrary to the wishes of the deceased. This means that even if the deceased nominated beneficiaries, the trustees must consider any dependents for possible payout (e.g., minor children, ex-spouses receiving maintenance, etc.). The trustees have the final say about who will receive the benefits and in what proportion.

Another important nuance is that the nominated beneficiaries of pre-retirement funds will only receive the benefits after it is established that the estate is solvent (i.e., there is enough money to settle liabilities). If there is a shortfall in the estate, the death benefit must first be used to settle the shortfall. Any remaining benefit will then be paid to beneficiaries.

Post-retirement funds

Post-retirement funds (e.g., living annuities) are treated differently to pre-retirement funds, as the Long-Term Insurance Act and the Income Tax Act govern these funds. On death, these funds will be paid out according to the beneficiaries nominated or according to the terms of the contract. No dependents are considered for receipt of any benefit. This obviously provides greater certainty as to who will receive the death benefits.

The table in *Figure 1* below summarises the main differences between the two retirement fund types and how the death benefits are handled:

Figure 1: Retirement funds death claims
Source: Anchor

	PRE-RETIREMENT FUNDS	POST-RETIREMENT FUNDS
PRODUCTS INCLUDED	• Retirement annuity fund • Preservation fund • Pension fund • Provident fund	• Living annuity fund • Guaranteed annuity/ life annuity • With-profit annuity
BENEFICIARY NOMINATIONS	Beneficaries are chosen by the investor	Beneficiaries are chosen by the investor.
BENEFIT RECIPIENTS	Beneficiary payments on death are subject to the discretion of the Trustees of the fund. The Trustees, by law, have to consider dependents at the claim stage.	Beneficiary payments on death are made according to the investor's beneficiary nomination/the terms of the investment contact.
BENEFIT PAYOUT OPTIONS	• Cash lump sum (subject to tax). • Living annuity fund. • Guaranteed annuity/ life annuity. • With-profit annuity.	• Cash lump sum ([subject to tax] excl. guaranteed annuities). • Continue with the existing policy (policy contract dependent).
DIVORCE PAYOUT OPTIONS	• Cash lump sum (subject to tax). • Transfer to an RA/ preservation fund in the name of the ex-spouse.	• No capital lump sum available. • Ex-spouse may become entitled to a portion of the income paid from the annuity.

Death claims from any fund involve time delay, and a defined process will be in place to protect all parties involved. Your financial advisor should be able to help you navigate the claims process and avoid any unnecessary delays and hassles along the way.

Disclaimer: The contents of this article are for information purposes only, and the accuracy, completeness, timeliness, or correct sequencing of any of the information contained herein cannot be guaranteed and should thus not be construed as investment advice. Readers should, therefore, only act after consulting their financial advisor.

Retire wealthier:

How a tax-free savings account could be your ultimate path to financial freedom

WRITTEN BY:
Lana van Coller
Assistant Portfolio Manager

Lana joined Anchor in 2021 after completing her undergraduate degree in investment management at the University of Stellenbosch. She also holds a postgraduate diploma in financial planning and obtained her CFP® designation in 2022. Lana is currently involved in the portfolio management team, which focuses on servicing bespoke private client needs.

A comfortable retirement, that elusive chapter of life that often feels like a distant dream, is within your grasp. Retirement can be a financially challenging time if not effectively managed. However, for the prudent investor, who manages their financial affairs with purpose and recognises the power of compounding, it is not as daunting a task as it may seem. Financial decisions made with your retirement in mind are vital in attaining a stress-free retirement.

As South Africans, we live in an era where financial security during retirement is a primary concern that should not be taken lightly, particularly if you are still young or have recently started working. According to a recent *Sanlam* report entitled *Finances through the life stages: How is SA doing?*, only 6%-8% of South Africans can retire comfortably, only 36% have a retirement fund, and just 7% feel prepared to retire.

In SA, where financial stability in one's golden years takes centre stage, retirement funds stand as pillars of assurance. They are designed to provide a structured approach to accumulating funds throughout one's working life, ensuring a consistent income stream post-retirement. Retirement funds also play a pivotal role in safeguarding the financial well-being of individuals during their retirement years.

The concept of retirement planning has evolved favourably for retirees over the past few years to equip people with a multitude of ideas to plan their retirement effectively.

One solution involves integrating a tax-free savings account (TFSA) into traditional retirement funds to optimise your retirement income through a sequential drawdown approach.

Individuals are allowed a maximum contribution of R36,000 p.a., whether owning one or multiple TFSAs and a R500,000 lifetime limit. Any growth within a TFSA is tax-free, whether it be interest, dividends, or capital gains.

As with all correctly managed investment programmes, the magic of a TFSA is in the power of compounding. By starting to contribute earlier rather than later, you allow yourself the advantage of compounded growth over a more extended period. As per the table in *Figure 1* below, assuming contributions start at age 21, once you reach age 55, your contributions would have compounded to roughly R6mn.

Figure 1: A TFSA and the power of compounding
Source: Anchor

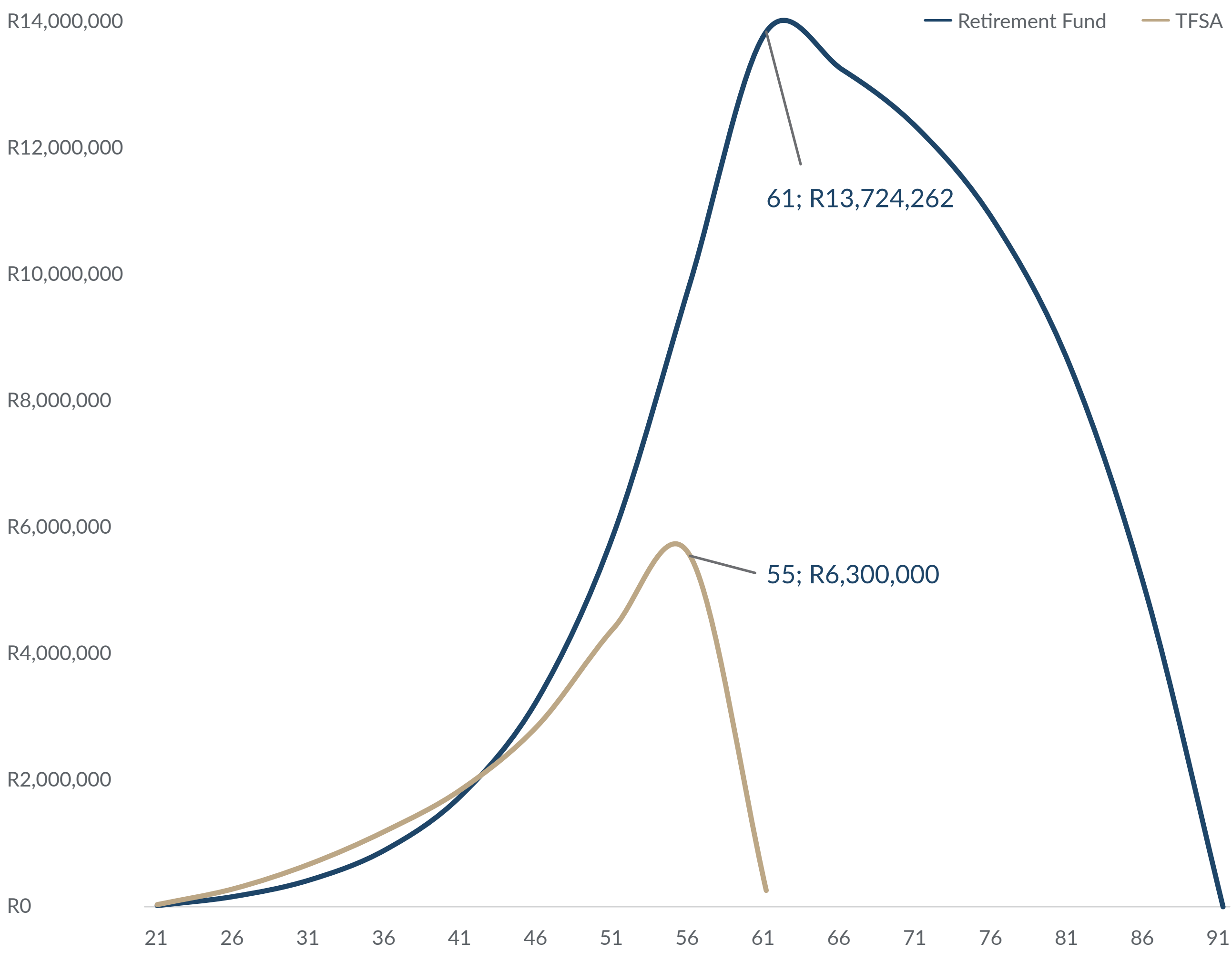
AGE	CONTRIBUTIONS	TFSA
21	R36 000	R37 523
22	R36 000	R78 565
23	R36 000	R123 458
24	R36 000	R172 562
25	R36 000	R226 272
26	R36 000	R285 021
27	R36 000	R349 281
28	R36 000	R419 568
29	R36 000	R496 450
30	R36 000	R580 543
31	R36 000	R672 525
32	R36 000	R773 135
33	R36 000	R883 183
34	R32 000	R999 389
35	R0	R1 089 334
36	R0	R1 187 374
37	R0	R1 294 238
38	R0	R1 410 719
39	R0	R1 537 684
40	R0	R1 676 076
45	R0	R2 578 850
50	R0	R3 967 881
55	R0	R6 105 077
60	R0	R9 393 417

Early retirement age

Note that our assumptions in the table above are for growth of 9% p.a.

Utilising your TFSA to meet your immediate needs during early retirement ensures tax-free access to funds and grows your retirement funds. As the balance of your TFSA slowly depletes, you transition to drawing income from your retirement funds - this combination strategy optimises tax efficiency, minimises the immediate impact on your retirement funds and maximises your long-term financial well-being by compounding the growth in your larger retirement funding base.

Figure 2: The strategic drawdown approach using a TFSA and a retirement fund
Source: Anchor



Note our assumptions for the above are as follows: A growth rate of 9%, TFSA contributions from age 21, retirement fund contributions from age 21, R1,500 p.p. escalating at 5% for ten years, after that 8% for the remainder of the period until retirement at age 55, retirement from the TFSA at age 55, retirement from the retirement fund at age 61, and a drawdown of R110,000/month from age 55.

Figure 2 demonstrates the potential for exponential growth within a retirement fund, particularly when strategically leveraging the early utilisation of a TFSA as a source of retirement income instead of drawing down from a traditional retirement fund.

Opting to delay your retirement from a retirement annuity (RA) or any other retirement fund by a minimum of 5 to 7 years could allow your retirement savings to double in value, allowing you to purchase a larger living annuity when retiring and commencing withdrawals. A more substantial living annuity value would allow you to select a lower drawdown rate, e.g., 2.5%-8%, effectively extending the 'lifespan' of your living annuity.

This significantly boosts the ability to provide sustained financial support throughout your retirement. It is essential also to note that once you elect to retire and draw income from your retirement funds, the tax will automatically be deducted, and you will receive the after-tax income value at every income period.

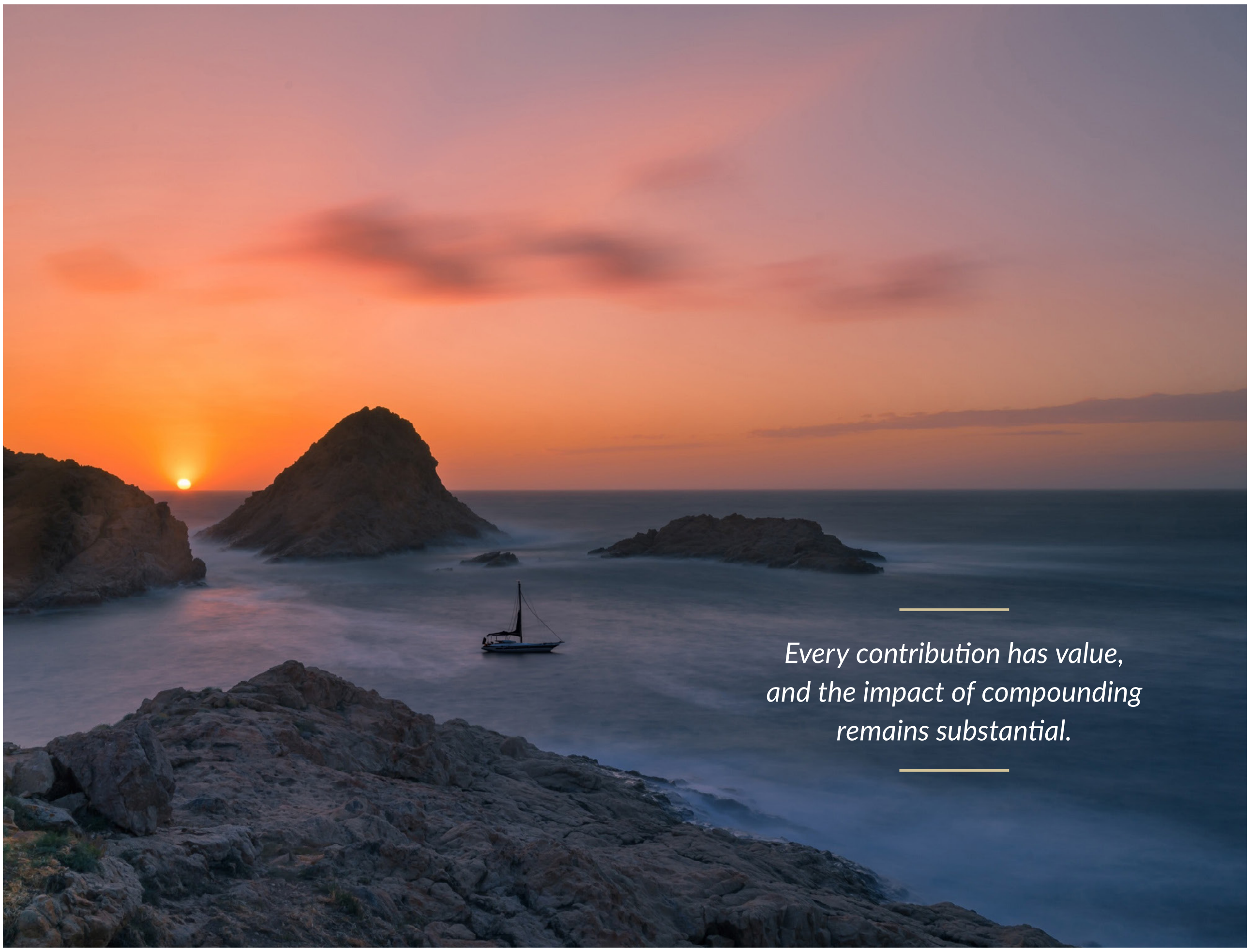
There are a few other key points to consider. First, the above information should not motivate anyone to invest in a TFSA rather than a pension fund. It should, however, encourage South Africans to invest in a TFSA over and above their retirement funds, thus creating a larger nest egg for retirement.

Second, starting with small contributions holds significance. Every contribution has value, and the impact of compounding remains substantial. Do not delay contributing until you can commit to R36,000 p.a.; even small beginnings yield significant results.

Third, the *Figure 1* table data are relevant regardless of the starting age chosen to open a TFSA. For example, by opening a TFSA for your children at birth, the later potential commitments of tertiary studies, buying a vehicle, or even a house can be cushioned when navigating your retirement.

Lastly, while living annuity drawdowns can only be adjusted annually on the anniversary date, the flexibility of varying the value and frequency of drawdowns from a TFSA provides a well-suited solution. This adaptability proves advantageous during the first few years of retirement, accommodating changing income requirements and unforeseen expenses.

In the grand tale of life, retirement is your final act, your well-deserved standing ovation. By making the right choices early in life, you are penning a script that ends with applause – your applause, even when your earnings potentially take a pause. Embrace the tools at hand and pave the ultimate path to financial freedom. After all, comfort in retirement is not a privilege but a mark of a well-lived life (and money wisely invested!).



The practical implications of SA's greylisting for the country's residents

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We start this article with an excerpt from the National Treasury (NT) fact sheet entitled What does the Financial Action Task Force (FATF) greylisting mean for a country?

'"The FATF does not call for the application of enhanced due diligence measures to be applied to these jurisdictions. The FATF Standards do not envisage de-risking or cutting off entire classes of customers, but call for the application of a risk-based approach. Therefore, the FATF encourages its members and all jurisdictions to take into account the information presented below in their risk analysis."

However, despite the FATF requirement, selected institutions are expected to undertake more enhanced monitoring for their own business reasons or as may be required by their own laws, e.g., the EU's Directive 4 (the EU's Directive on Anti-Money Laundering and Terrorist Financing), which is designed to strengthen its efforts to combat money laundering and terrorist financing. Hence, institutions based in a greylisted country engaging in cross-border trade and other activities may be subject to higher levels of customer due diligence by financial institutions outside of that country. In practice, this means being more thorough in processing and vetting clients and understanding the sources of their funds.'

WHAT HAS HAPPENED?

SA's greylisting is now very definitely in place, and it has had more of an impact than we would like to believe! Relevant from the above NT excerpt is that suddenly, what was already an onerous process dealing with anything cross-border related has been made much more complicated and lengthier following the greylisting, and institutions have undertaken 'more enhanced monitoring'.

How do we know? Because it affects our daily tasks, such as;

- opening accounts,
- sending funds offshore for clients,
- what to invest in,
- the compliance required when redeeming investments, and
- documentation required to prove wealth.

In some instances, one has to delve into records going back 40-50 (and even more) years to:

- produce proof of all sorts of transactions,
- include death certificates of people who died many decades ago,
- provide the source of wealth,
- provide the source of funds,
- provide details on individuals who are settlors of trusts, protectors and beneficiaries.

It is, therefore, imperative to understand what one is being asked for so that the salient information can be provided timeously. Defining some of the basics is a good start, bearing in mind that the client needs to provide the information. The list below is not all-inclusive but attempts to cover the common requests from various administrators.

DEFINITION 1 – KNOW YOUR CLIENT (KYC)

As a financial advisor, one is subject to KYC legislation, which stands for **know your client.**

Globally, there has been an exponential increase in money laundering and terrorist financing activities, and the COVID-19 pandemic did not improve the situation.

The KYC legislation (the Financial Intelligence Centre Act of 2001) insists that financial institutions make their customer due diligence practices as robust as possible to ensure that they are not on the receiving end of any misdemeanours which have to be reported to the FATF and their watchdogs on the ground, e.g., SA's Financial Intelligence Centre (FIC). The challenge is to know and understand our clients and any changes in their circumstances, including residency, political exposure or links to political persons. When one lives in a greylisted country, its residents' status and circumstances change overnight. In many instances, the residents of greylisted countries are considered 'high-risk' individuals for money laundering and terrorist financing. More questions are being asked than ever before, and offshore administrators have become even more vigilant.

Unfortunately, the impact on the client is that more questions and documentation are required for investing or cross-border transacting.

DEFINITION 2 – THE SOURCE OF WEALTH (SOW) AND THE SOURCE OF FUNDS (SOF)

These two sources have come to the fore, and although they have always been around, they now have far more practical implications than before SA's greylisting.

What is the difference?

- SOF is the origin of the money per transaction, while SOW is the origin of all the money an individual has amassed during their lifetime.
- SOF and SOW checks are an essential element of KYC measures and part of the AML recommendations laid out by the FATF.

SOF: As mentioned above, SOF is the origin of the money used in a transaction. If a client makes a purchase, the information required includes:

- what account did their funds come from?
- whose account is it coming from? and
- what activity generated those funds in the first place?

Legitimate sources of funds include personal savings accounts, employment income, redemption/liquidation of investments, property sales, inheritances, gifts, legal settlements (including divorce settlements) and distributions from trusts. The fact that the source is legitimate does not mean these questions will not be asked.

SOW: This refers to the origin of all the money an individual has amassed during their lifetime. Essentially, it analyses the activities that have contributed to an individual's total wealth. SOW examples include family inheritances, investments, business ownership, and income from employment.

SOF/SOW IMPACT SINCE THE GREYLISTING

The best way to illustrate this is by an example:

An SA resident has died (an elderly lady of 90). In terms of the will and distribution to her heirs, it was decided to redeem an offshore investment.

BEFORE SA'S GREYLISTING, THE FOLLOWING WAS REQUIRED:

- A death certificate
- ID
- A redemption form sent to the administrator
- Estate late bank account details

AFTER SA'S GREYLISTING, THE FOLLOWING IS REQUIRED:

- A death certificate
- ID
- Redemption form
- A copious number of emails to ascertain what would be appropriate
- Constant reminders that this client is now considered high-risk
- Estate late bank account details
  - The source of wealth (this meant tracing the [now-deceased] client's original accumulation of capital),
  - The source of funds (this entails calling up archived records from storage from 2012 to prove the transactions of transfers into the fund).

The point here is that unless you know your client (and their history) exceptionally well, it is often difficult to produce the required information for anti-money laundering as per FATF regulations. This leads to time being wasted and frustration for the client when funds are not released timeously. Unfortunately, the environment is such that administrators are unrelenting on what is required so that they are not in the firing line.

There are many more examples, such as fund managers not accepting direct SA investors unless it is done through a platform. Suffice it to say that the global environment is a lot more difficult to manage now that we are greylisted!

To assist in this laborious and time-consuming process, please do NOT throw away ANY documents (or delete any digital records) pertaining to financial transactions. It has been invaluable to have records readily available to answer the myriad of queries being thrown at us!

Performance Summary

	FUND PERFORMANCE									BENCHMARK PERFORMANCE							
	Start date	Annualised p.a.	Since inception	5 Year	3 Year	12-month	6-month	3-month	Sep-23	Since inception	5 Year	3 Year	12-month	6-month	3-month	Sep-23	Performance vs Benchmark
UNIT TRUSTS																	
Anchor BCI Equity Fund	Apr-13	8.6%	137.1%	4.1%	10.0%	12.2%	-0.2%	-4.2%	-3.5%	118.4%	6.4%	13.8%	11.9%	-2.7%	-3.8%	-3.0%	18.8%
Anchor BCI SA Equity	Aug-21	8.6%	18.2%	N/A	N/A	12.6%	-0.6%	-1.9%	-3.0%	13.8%	N/A	N/A	11.9%	-2.7%	-3.8%	-3.0%	4.4%
Anchor BCI Flexible Income Fund	Jun-15	6.9%	74.2%	6.5%	5.8%	8.2%	2.9%	1.6%	-0.2%	73.8%	6.3%	6.0%	8.3%	4.4%	2.2%	0.7%	0.4%
Anchor BCI Managed Fund	Jan-15	5.1%	54.3%	5.8%	8.5%	11.5%	1.6%	-2.7%	-3.5%	66.2%	6.9%	10.4%	13.0%	1.4%	-1.5%	-2.4%	-12.0%
Anchor BCI Worldwide Flexible Fund	May-13	9.9%	167.7%	7.4%	6.0%	29.0%	10.3%	-2.0%	-2.6%	147.1%	8.9%	9.8%	8.8%	4.9%	2.3%	0.6%	20.6%
Anchor BCI Property Fund	Nov-15	-3.3%	-23.4%	-4.5%	12.6%	4.8%	-2.2%	-3.3%	-4.7%	-21.6%	-3.5%	16.8%	12.9%	-0.3%	-1.0%	-4.1%	-1.8%
Anchor BCI Global Equity Feeder	Nov-15	11.9%	143.8%	12.9%	0.5%	7.7%	5.5%	-2.9%	-5.5%	152.7%	12.8%	11.4%	26.3%	9.3%	-2.9%	-4.1%	-8.9%
Anchor BCI Bond Fund	Feb-16	7.9%	79.3%	6.9%	6.5%	6.9%	-2.2%	-0.7%	-2.7%	80.0%	7.2%	7.0%	7.2%	-1.9%	-0.3%	-2.3%	-0.8%
Anchor BCI Diversified Stable Fund	Feb-16	7.1%	68.7%	7.1%	9.0%	10.9%	0.9%	-0.4%	-2.2%	58.7%	6.3%	7.9%	10.5%	1.7%	-0.4%	-1.7%	10.0%
Anchor BCI Diversified Moderate Fund	Feb-16	6.8%	65.5%	7.2%	10.8%	13.3%	1.0%	-0.8%	-2.4%	58.4%	6.6%	9.0%	11.5%	1.1%	-1.4%	-2.2%	7.1%
Anchor BCI Diversified Growth Fund	Feb-16	6.4%	60.7%	7.1%	12.2%	14.7%	0.8%	-1.3%	-2.9%	60.9%	6.9%	10.4%	13.0%	1.4%	-1.5%	-2.4%	-0.2%
Anchor BCI Africa Flexible Income	Mar-16	5.9%	54.1%	6.0%	3.6%	16.8%	4.4%	-1.6%	-0.8%	84.5%	7.9%	7.3%	9.5%	5.0%	2.5%	0.8%	-30.4%
Anchor BCI Global Technology Fund	Jun-19	6.9%	33.4%	N/A	-5.5%	16.0%	3.4%	-8.6%	-6.7%	155.1%	N/A	13.6%	42.4%	13.3%	-6.4%	-7.0%	-121.7%
Anchor BCI Flexible Fund	Jul-13	10.1%	169.4%	11.3%	7.1%	41.3%	25.7%	0.4%	-4.4%	10.2%	10.0%	10.8%	9.8%	5.4%	2.5%	0.7%	159.2%
Anchor BCI Core Income Fund	Sep-20	6.7%	22.0%	N/A	6.7%	9.1%	0.0%	2.4%	0.7%	17.1%	N/A	5.3%	7.5%	4.0%	2.0%	0.7%	4.9%
Anchor BCI Global Flexible Income Fund	Sep-20	3.9%	12.2%	N/A	3.1%	8.5%	6.6%	-0.1%	0.0%	20.2%	N/A	6.3%	10.3%	9.2%	1.2%	0.0%	-8.0%
Anchor BCI Worldwide Opportunities Fund	Feb-21	0.8%	2.1%	N/A	N/A	13.4%	1.4%	-4.9%	-4.4%	17.6%	N/A	N/A	4.8%	3.0%	1.4%	0.3%	-15.6%
EQUITY NOTES & SEGREGATED MANDATES																	
Anchor Equity	Jul-13	8.3%	127.4%	7.0%	16.1%	11.7%	-1.1%	-2.8%	-2.8%	116.8%	-0.3%	13.8%	11.9%	-2.7%	-3.8%	-3.0%	10.6%
HEDGE FUNDS																	
Anchor Stable SNN RIHF	Jul-03	12.3%	939.4%	8.7%	14.3%	13.2%	2.9%	0.6%	-0.6%	299.8%	5.9%	5.3%	7.5%	4.0%	2.0%	0.7%	639.6%
Anchor Accelerator	Feb-16	5.8%	53.5%	6.4%	-2.5%	0.7%	-6.1%	-4.5%	-4.8%	57.2%	6.4%	13.8%	11.9%	-2.7%	-3.8%	-3.0%	-3.7%
OFFSHORE																	
High Street Equity - Dollars	Jun-12	8.9%	159.8%	4.1%	0.4%	20.7%	-1.0%	-6.5%	-4.3%	201.4%	7.8%	8.6%	22.6%	3.4%	-3.4%	-4.3%	-41.6%
High Street Equity - Rands	Jun-12	17.2%	498.6%	10.3%	4.5%	26.6%	5.2%	-6.7%	-4.7%	595.4%	14.2%	13.2%	28.1%	10.2%	-2.9%	-4.3%	-96.8%
Offshore Balanced - Dollars	Jun-12	6.8%	109.2%	2.0%	-0.3%	12.0%	-0.9%	-4.8%	-3.5%	88.2%	3.9%	2.0%	13.9%	-0.2%	-3.5%	-3.8%	21.0%
Offshore Balanced - Rands	Jun-12	15.1%	384.7%	8.2%	4.1%	19.8%	5.3%	-5.0%	-3.9%	329.0%	9.8%	5.9%	17.1%	6.4%	-3.0%	-3.7%	55.7%
Global Dividend - Dollars	Jan-14	6.7%	87.1%	4.4%	7.8%	13.6%	-0.3%	-2.1%	-3.3%	124.1%	7.8%	8.6%	22.6%	3.4%	-3.4%	-4.3%	-37.0%
Global Dividend - Rands	Jan-14	12.6%	215.9%	10.4%	12.2%	19.1%	5.9%	-2.4%	-3.7%	280.6%	14.2%	13.2%	28.1%	10.2%	-2.9%	-4.3%	-64.6%
Anchor Global Stable Fund - Dollars	May-15	0.9%	7.5%	1.4%	-0.3%	6.0%	0.6%	-0.8%	-1.6%	31.4%	3.7%	4.4%	6.4%	3.2%	1.5%	0.5%	-23.9%
Anchor Global Stable Fund - Rands	May-15	6.3%	67.1%	7.4%	3.9%	10.8%	7.2%	-0.3%	-1.6%	104.8%	9.9%	8.8%	11.3%	9.7%	1.9%	0.8%	-37.7%
Anchor Global Equity - Dollars	May-15	9.6%	115.1%	9.5%	-1.6%	5.4%	-1.9%	-3.1%	-4.7%	75.2%	6.5%	6.9%	20.8%	2.6%	-3.4%	-4.1%	39.9%
Anchor Global Equity - Rands	May-15	15.6%	234.3%	16.0%	2.6%	10.2%	4.5%	-2.6%	-4.7%	172.3%	12.8%	11.4%	26.3%	9.3%	-2.9%	-4.1%	62.0%
RCI UNIT TRUSTS																	
RCI BCI Flexible Growth Fund	Sep-16	7.1%	62.1%	6.3%	-2.2%	22.3%	12.3%	-5.8%	-5.0%	93.2%	9.8%	10.5%	9.1%	4.7%	1.9%	0.0%	-31.1%
RCI BCI Worldwide Flexible Fund	Dec-16	7.5%	64.4%	5.9%	-0.1%	24.0%	7.6%	-4.4%	-5.8%	79.5%	8.9%	9.8%	8.8%	4.9%	2.3%	0.6%	-15.1%

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