What to do with your money amid S.A. economic pessimism and the worry of prescribed assets

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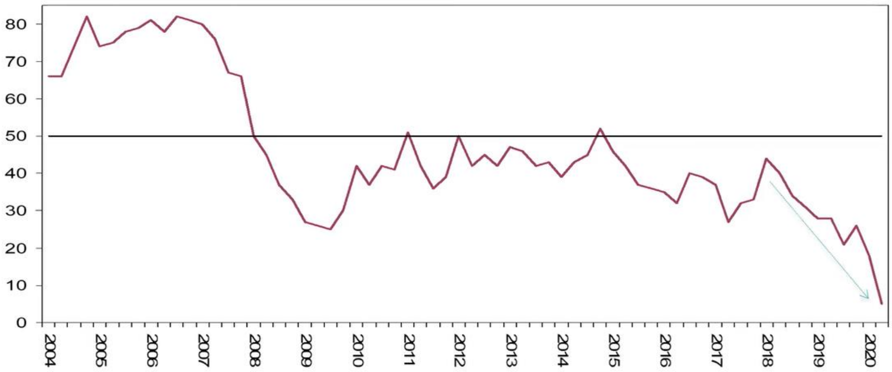
For Financial Advisors and their Clients

South African investors have had no shortage of challenges over the past decade. Going into 2020, we were all hopeful that this was going to be the year we would turn the proverbial ship around. Covid-19 and its associated challenges have, however, steered us into unchartered (and choppy) waters.

From a South African perspective, the economic shock came at a time when we were already under pressure. The impact of job losses and the lockdown will have a big impact on South Africa's GDP growth.

One prevalent effect has been the decline in business and investor confidence. According to Kevin Lings, chief economist at Stanlib, confidence indicators are now at their lowest levels since 1975. Confidence is a key ingredient required to grow an economy. This lack of confidence has understandably caused investors to question their investment in South Africa.

S.A. Business Confidence (BER) Index



Source: SA Bureau of Economic Research

We are often asked the following two questions:

1) Why should I have exposure to South African equities/assets in my portfolio given the state of the economy?
2) Given the government's debt burden, what will happen to my investment if they implement prescribed assets?

Let's unpack these two questions.

Why should I have exposure to South African equities/assets in my portfolio given the state of our economy?

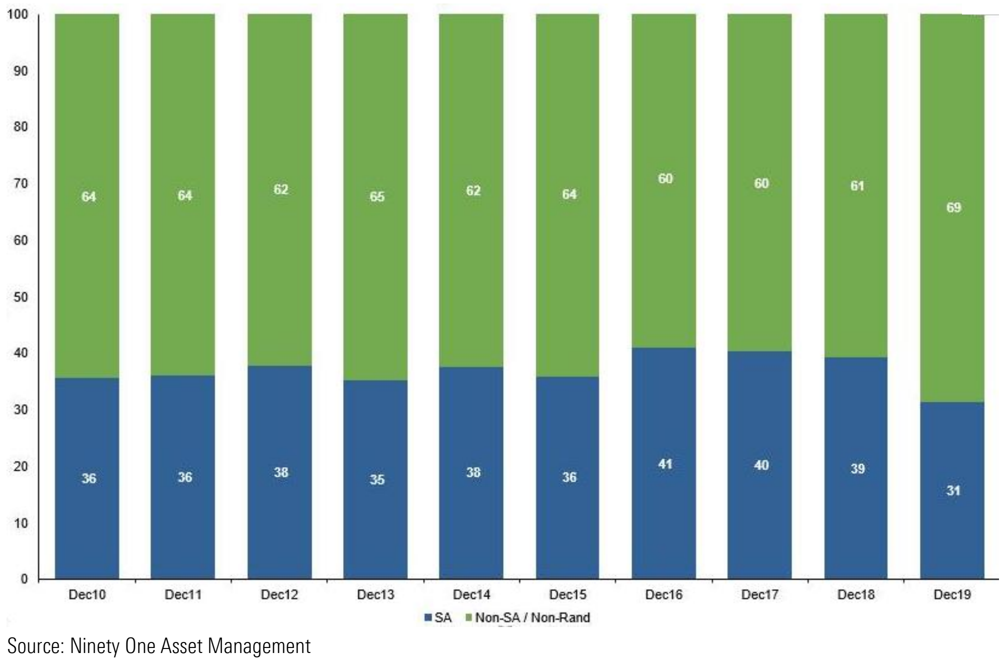
This is a fair question because, at this stage, it's hard to see the light at the end of the tunnel. South Africa was already battling the tide before Covid-19, and the current challenges have caused us to drift even further from our targets. All of this has made the paddle back to safety and the recovery from the crisis, both harder and more strenuous. While we don't have the answers to the economic conundrum, we can address some of these concerns for investors.

The first point for investors to remember is that the South African equity market is not the economy.

If one looks at every company listed on the South African stock exchange (the Johannesburg Stock Exchange or JSE), the majority of companies are not reliant on the South African economy to generate earnings. These are companies with business interests that are either predominantly outside of South Africa or entirely outside of South Africa.

In fact, if one looks at the South African stock market, 69% of all revenue generated by the Top 40 companies listed on the JSE was generated from outside of South Africa for the 2019 calendar year. In essence, when you are investing in the South African equity market (as represented by the Top 40), only 31% of company revenues are reliant on the South African economy.

Breakdown of the Top 40 companies listed on the FTSE/JSE All Share Index by market capitalisation in terms of percentage of South African and non-South African revenues



Source: Ninety One Asset Management

This is possible due to the fact that some of the largest companies on our stock exchange are dual-listed companies. In other words, these companies are listed on more than one country's stock exchange.

For example - the BHP Group is listed on the London Stock Exchange as well as the Johannesburg Stock Exchange. While the BHP Group used to have operations in South Africa, currently the company does not generate any earnings in South Africa.

There are many similar examples in our stock market and most of these companies carry larger weightings in the index. We call these rand hedge shares. In short, if the rand weakens, it is a benefit to own these shares as they generate earnings in offshore currencies. So, as an investor, you are hedging your currency exposure even though you are investing in a South African listed equity.

The below table highlights the top 20 shares on our market and the respective weight each carries in the JSE All Share Index. We have also classified the percentage of each company's revenue as either South African or non-South African.

Breakdown of top 20 companies by market capitalisation in the FTSE/JSE All Share Index by South African and non-South African revenues

	Name	Ticker	Price	Weight	S.A.	Non-S.A. / Non-Rand
1	NASPERS LTD-N SHS	NPN SJ	278,829	19.2	0,0%	100,0%
2	BHP GROUP PLC	BHP SJ	34,406	11.5	0,0%	100,0%
3	FINANCIERE RICHEMONT-DEP REC	CFR SJ	10,213	8.3	0,0%	100,0%
4	ANGLO AMERICAN PLC	AGL SJ	36,555	7.2	0,0%	100,0%
5	BRITISH AMERICAN TOBACCO PLC	BTI SJ	69,340	3.1	0,0%	100,0%
6	PROSUS NV	PRX SJ	142,455	3.1	0,0%	100,0%
7	ANGLOGOLD ASHANTI LTD	ANG SJ	42,450	2.8	0,0%	100,0%
8	MONDI PLC	MNP SJ	32,790	2.5	0,0%	100,0%
9	STANDARD BANK GROUP LTD	SBK SJ	10,161	2.1	72,5%	27,5%
10	FIRSTRAND LTD	FSR SJ	4,013	2.0	87,4%	12,6%
11	GOLD FIELDS LTD	GFI SJ	13,710	1.8	0,0%	100,0%
12	SANLAM LTD	SLM SJ	5,657	1.6	100,0%	0,0%
13	MTN GROUP LTD	STN SJ	5,390	1.5	33,2%	66,8%
14	IMPALA PLATINUM HOLDINGS LTD	IMP SJ	11,708	1.4	0,0%	100,0%
15	BID CORP LTD	BID SJ	24,630	1.3	0,0%	100,0%
16	VODACOM GROUP LTD	VOD SJ	12,623	1.2	78,7%	21,3%
17	REMGRO LTD	REM SJ	13,896	1.1	75,0%	25,0%
18	SIBANYE STILLWATER LTD	SSW SJ	3,237	1.1	0,0%	100,0%
19	ANGLO AMERICAN PLATINUM LTD	AMS SJ	110,995	1.1	0,0%	100,0%
20	ABSA GROUP LTD	ABG SJ	8,120	0.9	76,1%	23,9%

Source: Ninety One Asset Management as at 31 May 2020.

Given the government's debt burden, what will happen to my investment if they implement prescribed assets?

Prescribed assets refer to the implementation of a ruling by government, that would force financial institutions/asset managers to invest a certain percentage of clients' money (from sources such as pension funds) into government assets (such as government bonds). The intention of these funds is to support the growth of the South African economy.

Whether government will enforce the implementation of prescribed assets has not yet been finalised. We do believe that the financial bodies governing our country are sound, strong and considered and that no decision will be made that would be detrimental to the savings pool in South Africa and the financial stability of our country.

Would prescribed assets be good or bad for South Africans? This has been a hotly debated topic of late. The success of prescribed assets would depend on many factors, but the most important factor is ultimately the use of the funds raised. With that said, the truth is we simply don't know if it will be a good or a bad outcome for South Africa and investors. There are too many unknown factors to speculate about.

As counterintuitive as it may seem given the amount of uncertainty that comes with this topic – we would encourage investors not to panic.

If you break down your investment options into four broad categories, it would typically be made up of the following asset allocation options -

1) Money in the bank (cash, money market accounts, fixed-term savings)
2) Living annuities
3) Non-Regulation 28 products/discretionary investments: Money invested in equities, offshore – any post-tax and non-retirement savings.
4) Compulsory savings: Pension fund savings (including provident funds and retirement annuities)

When prescribed assets were last enforced in 1956, the Pension Funds Act was promulgated and the assets in question were South African government bonds. Should the same approach be applied today, then the investments affected above would be the savings pool in category 4 – compulsory savings. Assuming a repeat of the 1956 prescription, it would not apply to 100% of the money invested in your pension fund/provident fund/retirement annuity. It will most likely only be a portion of the assets that need to be allocated to government funding.

Unfortunately, given the uncertainty regarding the implementation of prescribed assets and the lack of a framework of how it will ultimately be done, many investors have been left feeling quite unsettled. The speculation by media surrounding the possibility of prescribed assets has added further fuel to the fire of uncertainty. The impact prescribed assets could have on the total investment portfolio of investors has, in many cases, been painted disproportionately.

Perspective is key. Again, whether prescribed assets are a good or bad call, we simply can't say. What we can do is to encourage investors to make informed decisions and encourage them to take a step back and assess how much of their total portfolio would be affected.

Remain calm, with your sights set on your financial goals

Investors too often redirect their attention away from the destination to the journey when faced with a lot of outside noise. Much like in other walks of life, we can lose focus, making us susceptible to capitulation or giving up at the moments when fortitude and resolve pay off most.

Patiently allocating to assets that will help you achieve your financial goals should remain key. So, if you catch yourself getting down about the state of our economy, or speculation around government policies or trying to predict what is next, always remember why you are investing in the first place.

There's no doubt that the current market conditions are unsettling. It is at these moments that we would discourage investors from making changes that could harm their ability to reach their financial goals. It is often during these difficult times that we have the greatest opportunity to add value for our clients, acting rationally when others struggle to do so.

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