Investing through the Turbulence

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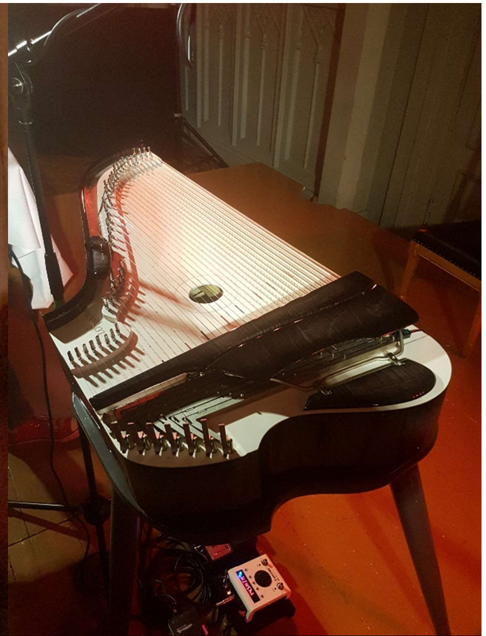
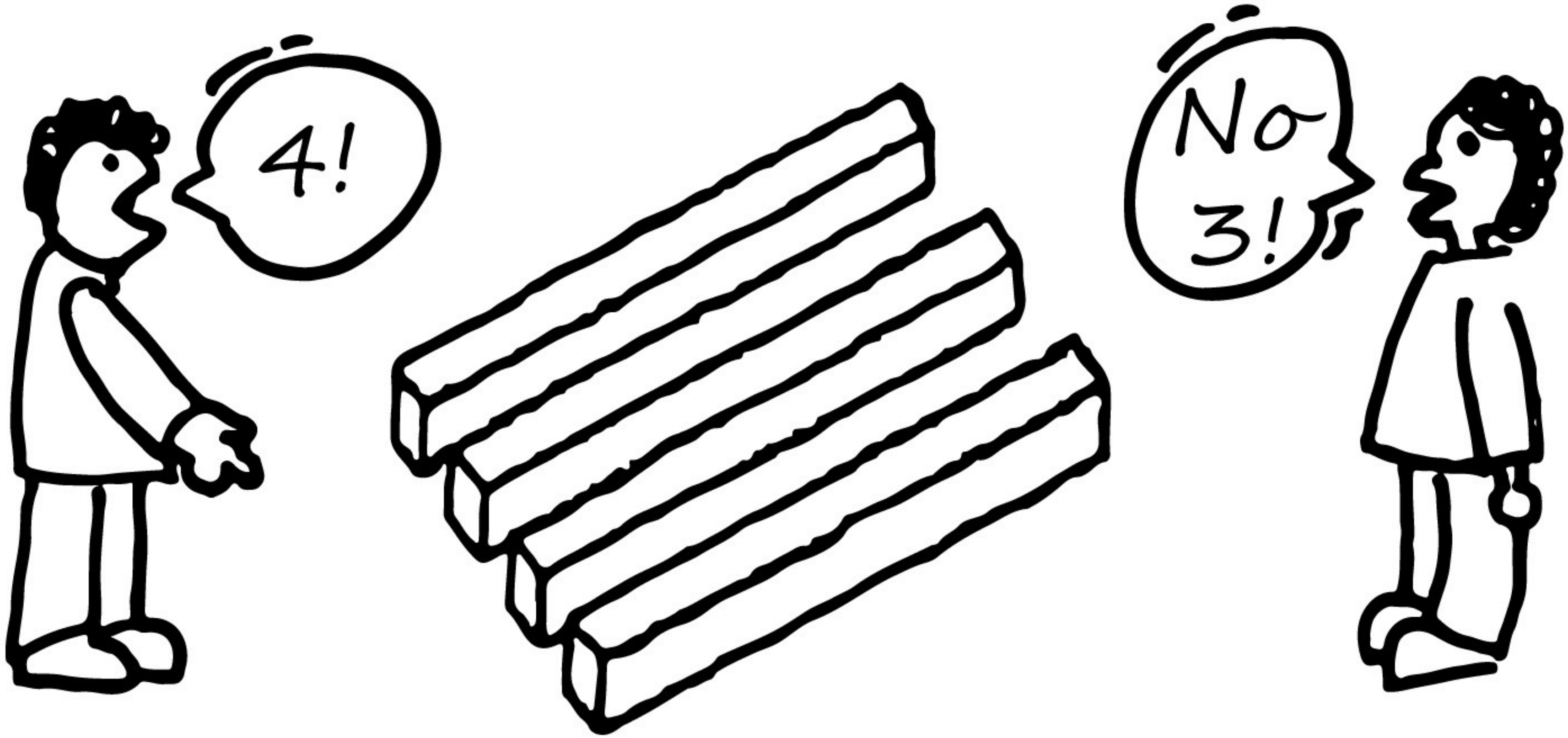
ARCTIC CIRCLE

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No 3!

China
Time to shift our view from West to East

- Economy shifting from production to consumption
  - Chinese consumer brings a demand "shock" to the global economy just as US economy start running into some head winds
  - Belt & Road Infrastructure projects shift infrastructure spend outside the country – demand for commodities to remain strong
- Process of socialist modernisation – fast becoming global leader in innovation
- Use technology to address societal challenges, e.g. financial inclusion, clean energy, etc.
- It has more directional predictability because of policy certainty, central control
- Hard for China to hide its strength, due to its size
  - By 2030 it WILL be largest economy in the world
  - 1st time since late 1800s that US is NOT the biggest economy in the world

India

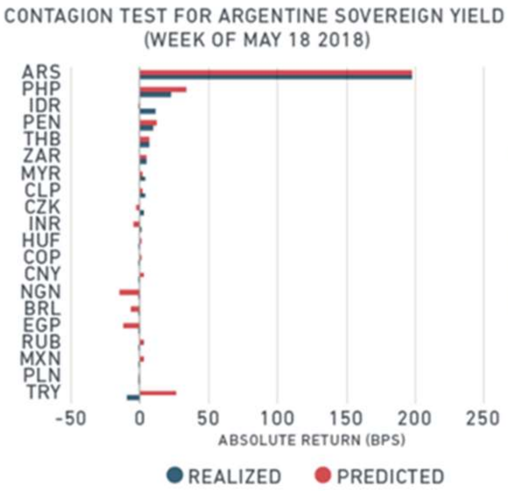
- By 2030, India will be 3rd largest economy, but they will still be relatively poor
  - GDP per capita much less
  - Peaceful growth in *Chindia* is vital (inequality greater risk than apparent financial risks)
- What is boosting growth in India?
  - Ease of doing business
  - Easy-to-administer tax system: GST (goods & services tax – also called general, simple tax), much like VAT in SA
  - Digital India (biometric ID, mobile payments, financial inclusion, healthcare, education) stimulates consumption & growth
    - Enables the poor to join the formal economy; boosts education & literacy levels
- EM growth drivers are irreversible
  - The ride may be choppy, but the direction is irrefutable

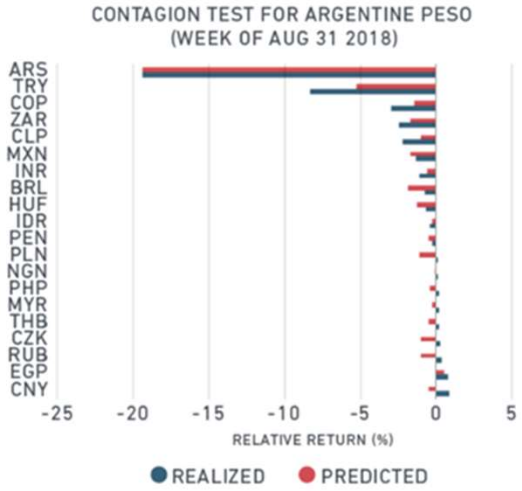
Forget
BRICS
What about
BRATS*?

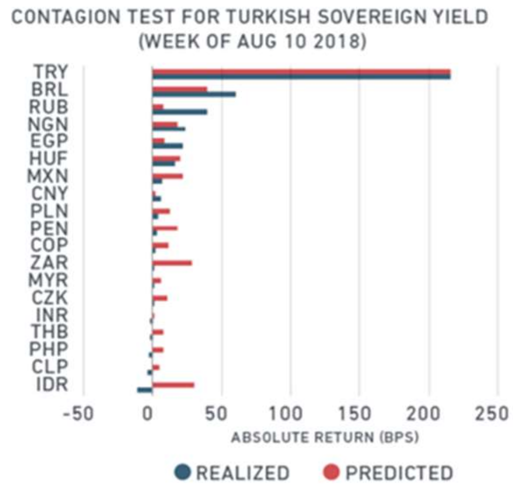
*BRATS: Brazil - Russia - Argentina - Turkey - South Africa

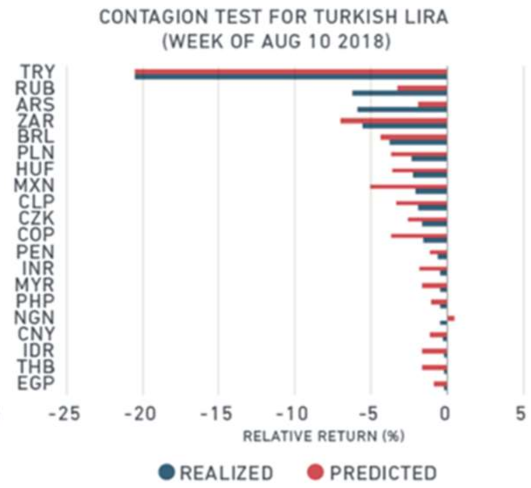
Argentina, Turkey

- Knee-jerk reactions – limited contagion beyond initial shocks





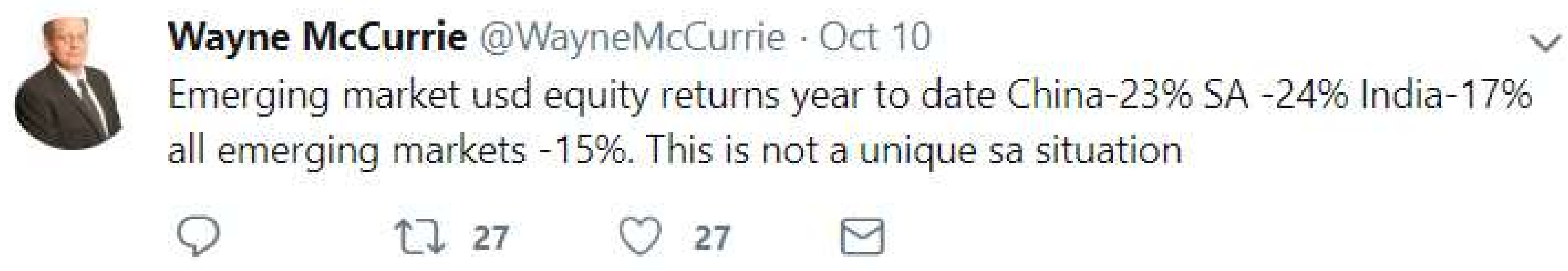




Source: MSCI.com

Emerging Markets

- The weakness has been broad-based – BRICS & BRATS & more



- Easy to identify problems & find faults, but there are plenty of opportunities – challenge is to look for them

YOU MAY THINK THE GRASS IS GREENER ON THE OTHER SIDE, BUT IF YOU TAKE THE TIME TO WATER YOUR OWN GRASS, IT WOULD BE JUST AS GREEN.

Developed Markets

- Europe
  - Worried about regulation and refugees

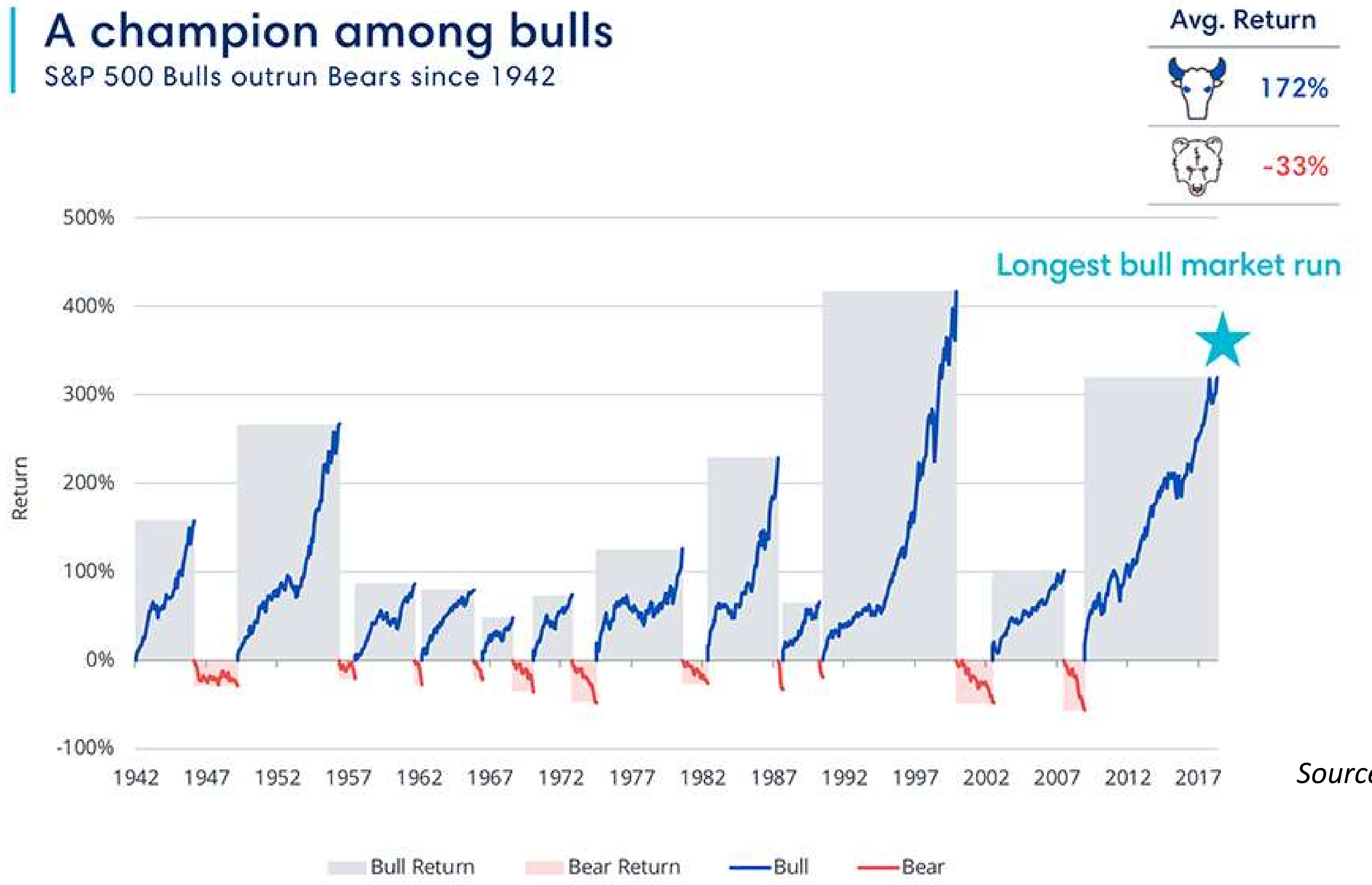
- UK
  - Worried about Brexit and becoming irrelevant

- Japan
  - Worried about sustainability of (global) capital markets due to growing inequality

Japan GPIF
Government Pension Investment Fund

- Largest pool of retirement savings in the world
- "Trendsetters" in investment strategies globally
  - Major shift to "passive" investing as "active" managers delivered zero return after costs
  - Rather than spend time on trying to find active managers that can deliver alpha (which they can't do with predictable success), they rather invest in low cost passive
  - Now spend their time on shareholder activism & ESG
  - Instead of trying / fighting to beat the market, they fight to make the market better for everyone

US – Continuation or Collapse?



Source: GLC Asset Management

US – Continuation or Collapse?

- Last part of bull market fuelled by tax breaks – it's a one-year "wonder", coming to an end soon
- Low unemployment expected to be inflationary as pressure on wages increase
  - → upward pressure on interest rates
  - → further dollar strength (and EM currency weakness)
  - → valuations already stretched, so risks are high(er)
- But it is still 50-60% of global investment markets

  so we (have to) stay invested

US – heading for a market crash?

- Maybe. Maybe not. Who knows?
- "Recent" experiences:
  - 1987 – US market fell 22.6% in one day
  - 1997 (Asian) & 1998 (Russian) EM debt crisis
    - Asian currencies fell 35-40%
    - US markets fell 7-8% in one day
  - 2008 – US market fell <7% in one day, but synchronised fall in most asset classes
    - there was no place to hide

US – heading for a market crash?

- "This time it's different"
- Since 2008
  - Global regulatory response, esp. around derivatives
  - IMF steps in to play a global stabilising role
  - Introduction of mechanisms such as circuit breakers, halting of trade, volatility auctions, etc.
  - Much better access to and availability of data & information
  - Financial institutions much less leveraged than ten years ago
  - Much more control and oversight of "too-big-to-fail" and SIFIs (systemically important financial institutions)

How do we calm the chaos?

Expect the seasonality of markets

1. Since 1990 corrections* happen once a year on average

   * a decline of 10% or more, but not more than 20%

2. Less than 20% of all corrections turn into a bear market
   - i.e. 80% of corrections are just short breaks in an otherwise intact bull market
   - this means selling early would make you miss the rest of the upwards trend

Source: VisualCapitalist.com

Expect the seasonality of markets

3. Nobody can predict consistently if market will rise or fall

Source: VisualCapitalist.com

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Expect the seasonality of markets

4. The market has always risen over the longer term, despite short-term setbacks
5. Historically, bear markets have happened every 3 to 5 years (drop of more than 20%)
6. Bear markets become bull markets

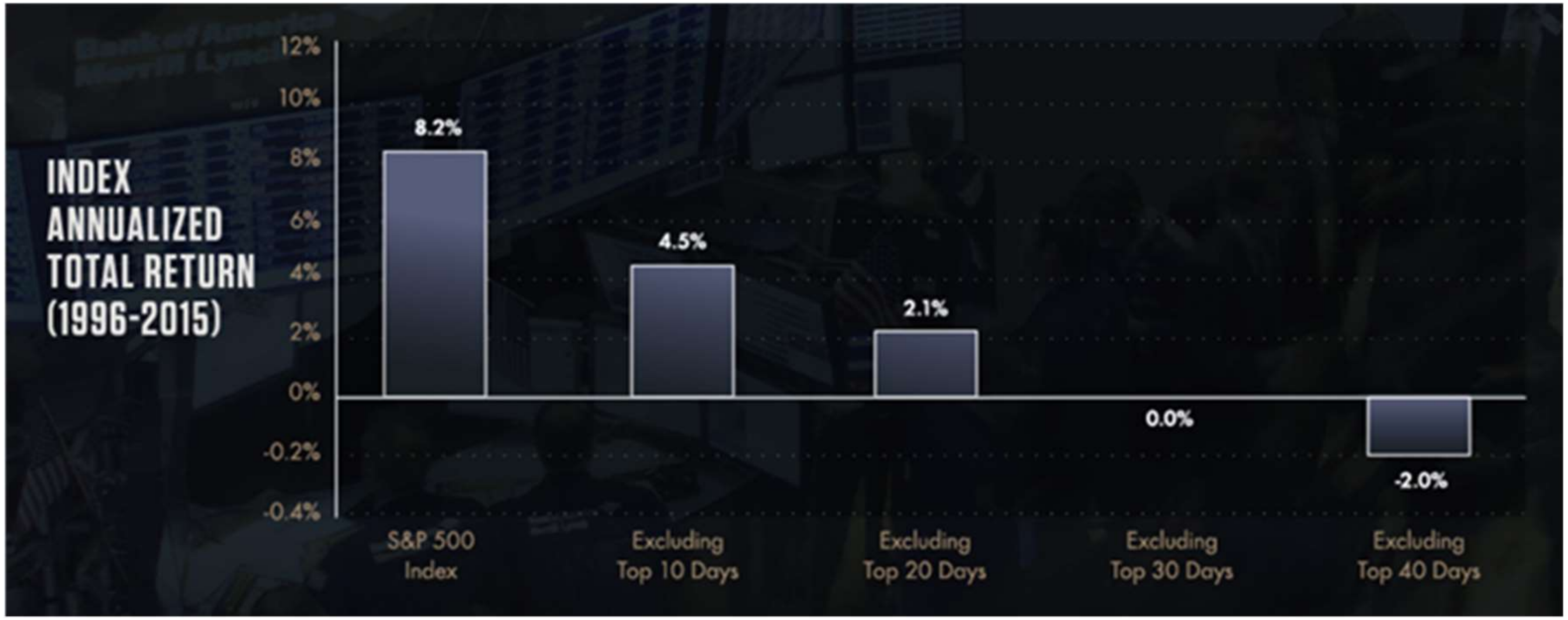
"The stock market is a device for transferring money from the impatient to the patient"

– Warren Buffett

Source: VisualCapitalist.com

Expect the seasonality of markets

7. The greatest risk is not a correction or a bear market, it's being out of the market!



Source: VisualCapitalist.com

So what does this mean for our investment strategies?

“Be fearful when others are greedy”

- Beware past winners

No need to sell out of past winners (except if rebalancing is required), but allocate new money to laggards

Source: Bloomberg

"Be fearful when others are greedy"

- Beware market cap weighted indices (in old bull markets, or markets driven by momentum)
- All Share Index: -13.1%; Naspers: -23.7% (20% of ALSI)

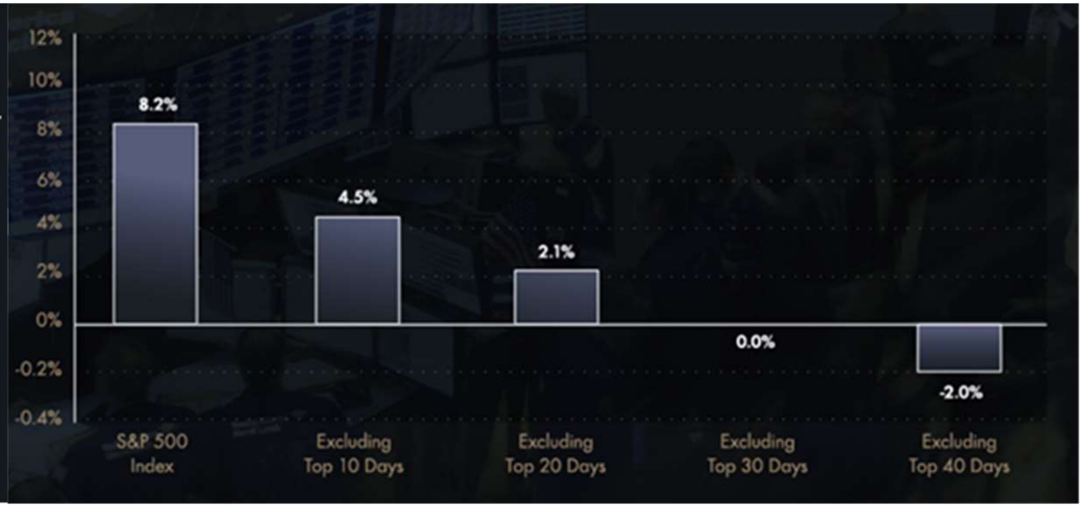
Rest of market down "only" 10.5%

Source: ProfileData

“Be fearful when others are greedy”

- BUT beware de-risking (into cash) trying to time the market

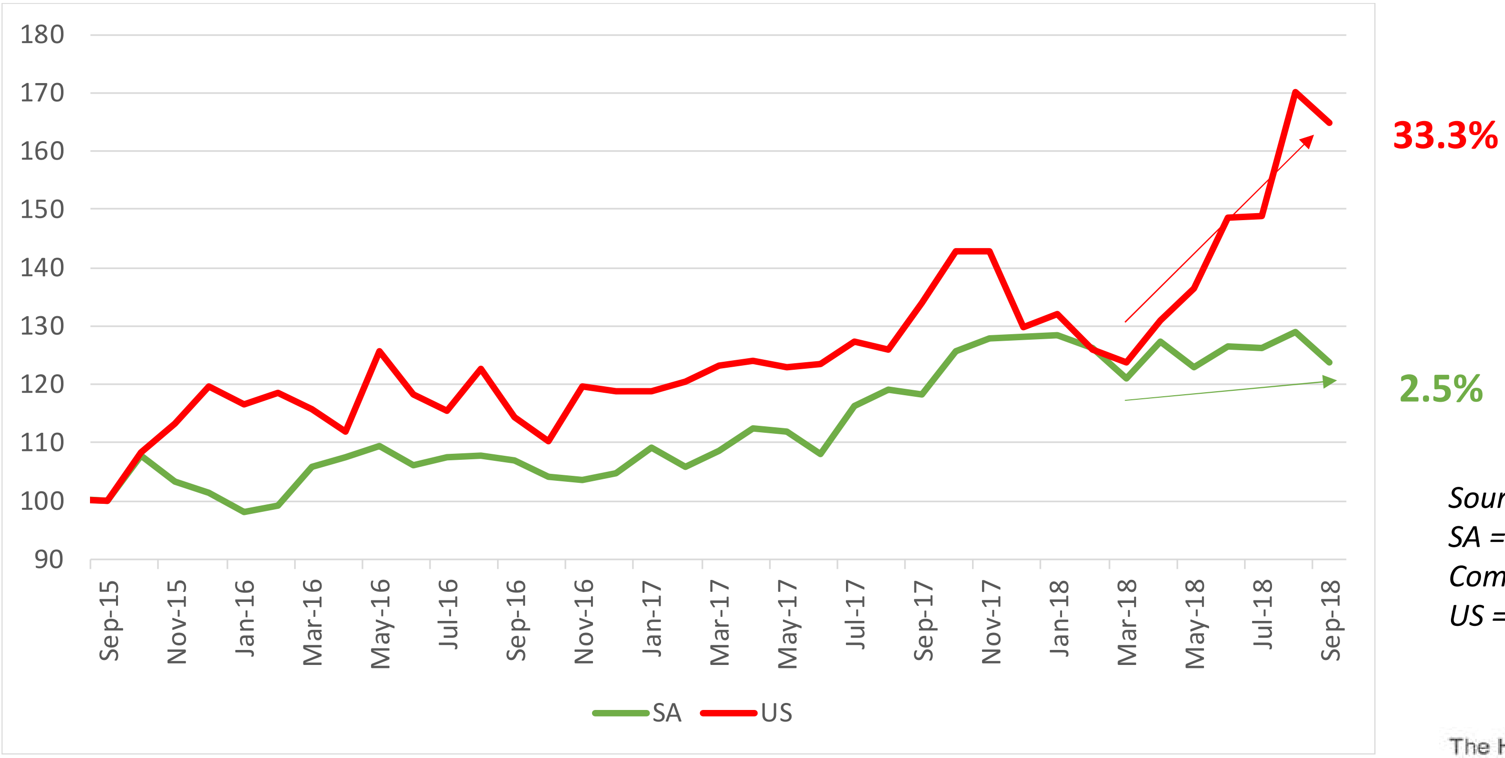
  you must get two decisions timed correctly; it is difficult enough getting just one right!



- Diversification is a better risk management strategy!

"Be greedy when others are fearful"

- Remain invested in SA (good relative investment value)



Source: S&P Dow Jones
SA = S&P South Africa Composite index
US = S&P500 index

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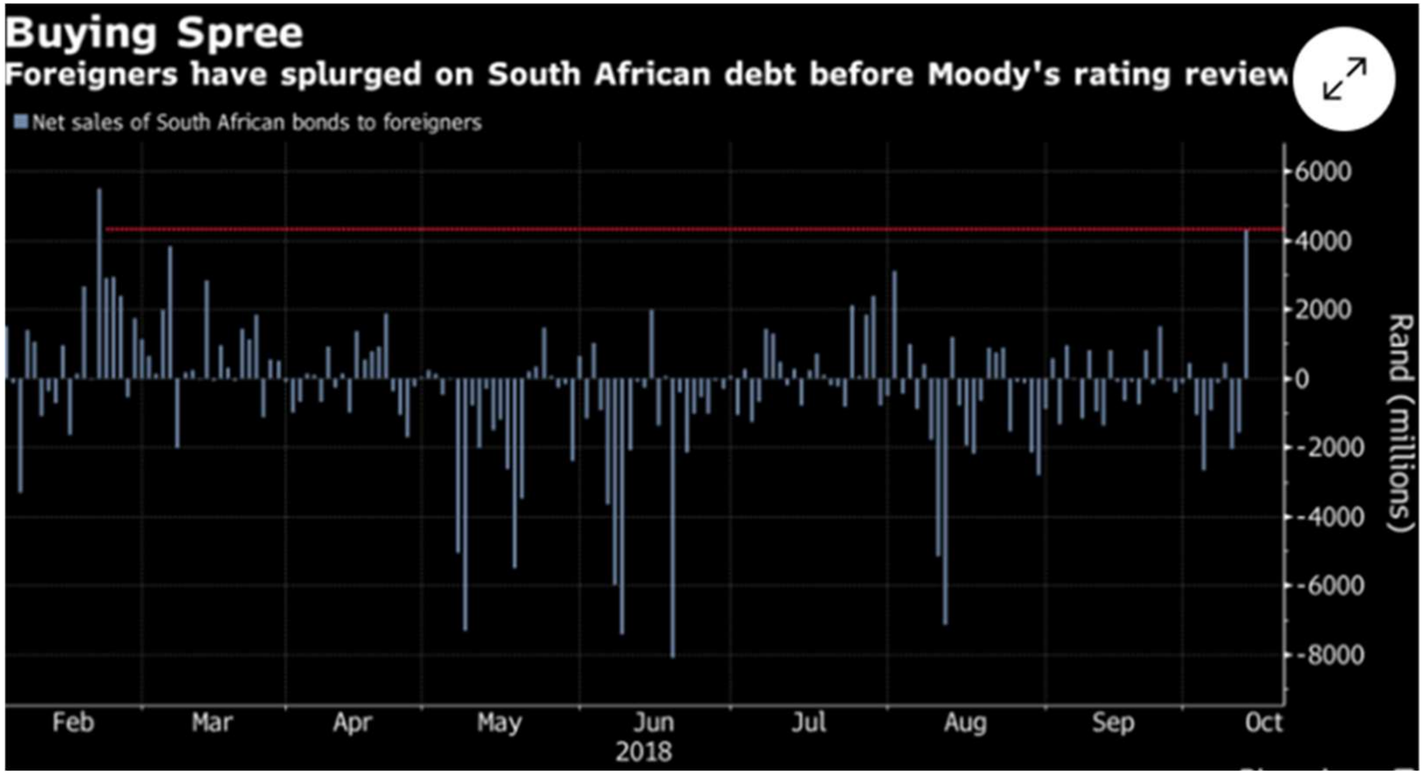
"Be greedy when others are fearful"

- Invest in SA (follow the "smart" money)



When foreigners buy, it often means local investors are selling – what are they seeing that we are not?

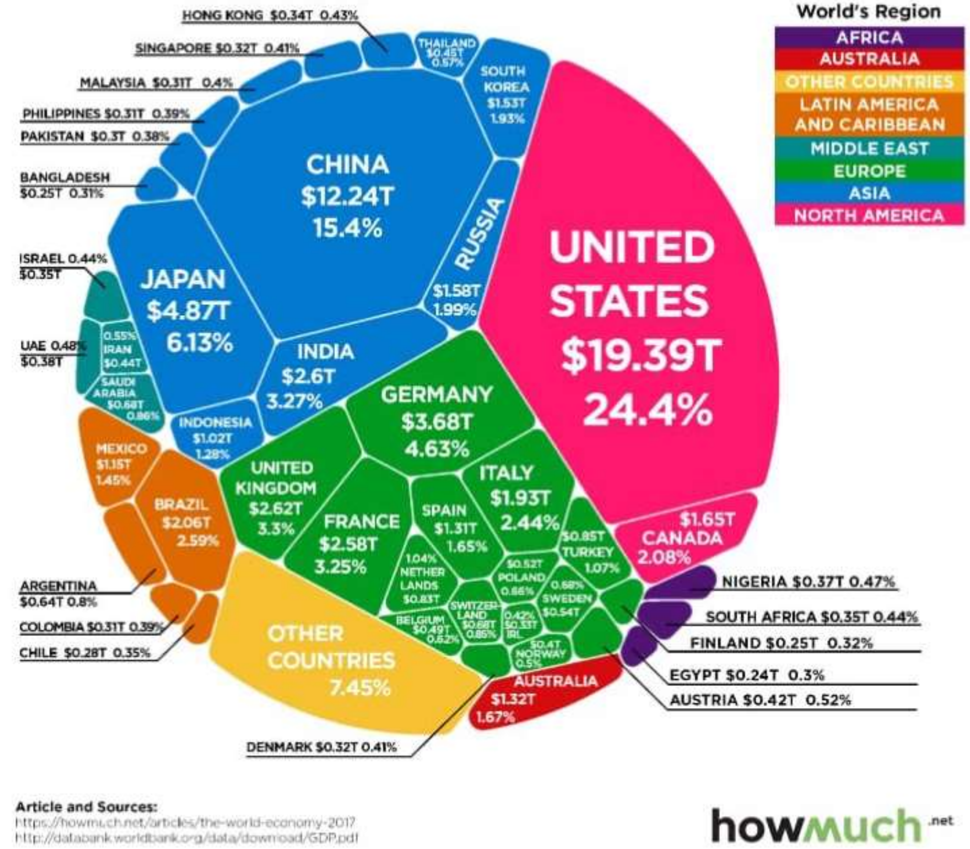
Source: Bloomberg

"Be greedy when others are fearful"

- Invest in Emerging Markets

- Equity markets do not reflect the reality of proportional exposure of global GDP

- Invest for the future, not the past



“Be greedy when others are fearful”

- Invest in factors / “smart” beta to diversify beyond market cap weighting
  - Dividends; Quality; Momentum; Value / RAFI; etc.

- But for this you need to know what you’re doing so make sure you invest with the “ETF specialists”

Let Mike tell us how…

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