INVESTMENT WEEKLY

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Adviceworx

POLL POSITIONING

Izak Odendaal, Old Mutual Wealth Chief Investment Strategist

In exactly a month, South Africa heads to the polls for a national general election. It is one of several notable elections worldwide. The stakes are particularly high locally, as it is the first time since the dawn of democracy in 1994 that a coalition government at national level seems the most likely outcome. What kind of coalition we end up with is keeping both armchair and professional political analysts deeply occupied.

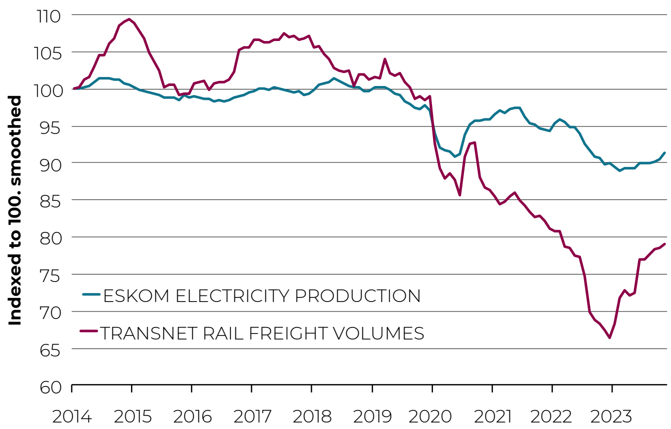
Global and local investors are particularly concerned over the possibility of an EFF-ANC coalition that could pull policy in a sharply leftist-populist direction. As one analyst put it, it is a "low probability, high anxiety outcome." But there are many other possible coalition permutations. Much has been written about these various scenarios elsewhere, so no need to spend much time on them here, other than to say that in almost any plausible coalition the ANC remains the majority partner. It should therefore retain the key cabinet positions, and not give up the position of finance minister to an opposition party, for instance. Its policies will also dominate the coalition's list of priorities, pointing to broad continuity.

And from investors' point of view, it is policy that matters most, not politics. Politicians say a lot of things; it is what they do that matters, particularly when it comes to the economy. What we don't want is an outcome that potentially sets back the gradual progress that has been made in addressing the economy's biggest constraints.

There are many, of course, but the five issues that probably top the list of factors holding back growth and job creation are:

- **Electricity.** It is well near impossible to run a modern economy without a reliable energy supply. The impact of fifteen years of loadshedding, and really intense loadshedding over the last five years or so, is measured not only in the jobs lost but also in the jobs that could not be created.
- **Transport.** The logistics crisis is of a more recent vintage, but the underlying cause of a failing monopoly state-owned enterprise is the same. Particularly in the transport of bulk items like coal and iron ore, the poor state of rail and port facilities is costing the economy billions.
- **High interest rates.** This is not just due to the Reserve Bank's policy stance, which will change as the inflation outlook improves. Market interest rates in South Africa are high because of fiscal risks. Failure to stabilise government debt levels are hurting the local economy today due to the resultant high borrowing costs and negative impact on confidence over the longer term.
- **Service delivery failures at local government level.** It is extremely difficult to grow businesses when basic services like water, sewage and roads are not delivered. For instance, how do tourists get to South Africa's beautiful countryside if the roads are more pothole than tarmac? How do farmers get their goods to market? Meanwhile, unreliable water supplies in many towns and even big cities like Durban and Johannesburg are increasingly a headache for businesses.
- **Organised crime.** South African has internationally high levels of unemployment and inequality and crime has long been a consequence. All South Africans are impacted, but the poor are most exposed. Recent years, however, have seen the very worrying emergence of crime syndicates targeting bigger businesses, and causing large losses. These include extortion 'mafias' in construction and transport, cable theft and illegal mining.

Chart 1: Electricity and logistics constraints



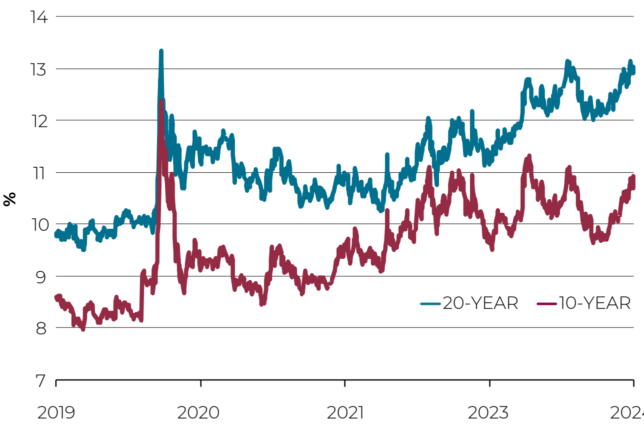
Source: LSEG Datastream

Progress in these areas will go a long way to faster economic growth, which in turn can start to ease many of the social pressures. The good news is that there has been a lot of progress on the electricity side. There is great scepticism over whether the current streak of loadshedding-free days will continue after the election, but that misses the point. There has been massive private investment in electricity generation and more in the pipeline. It seems extremely unlikely that any incoming coalition arrangement will roll back these reforms.

The process of liberalising rail and port network is also underway but lags the electricity sector. This too is likely to continue after the election, since the government's own finances have been badly hurt by lost tax revenue, particularly from depressed coal export volumes.

This brings us to fiscal policy, perhaps the biggest area of uncertainty after the election. Considering the elevated government bond yields in chart 2, investors are clearly concerned that a new governing coalition go on a spending spree, abandoning the attempts at fiscal discipline we've seen in recent years.

Chart 2: SA government bond yields, %



Source: LSEG Datastream

Ultimately, even a hardcore leftist must confront the reality: South Africa needs to stabilise government debt levels, otherwise its interest burden will become unsustainable and crowd out other spending areas. As it stands, 20c out of every rand collected by SARS goes towards servicing government debt. This number will continue to rise if borrowing isn't reduced, because the market charges such a high interest rate. Even forcing institutions to lend to the government ("prescribed assets") will not sufficiently reduce government's borrowing costs.

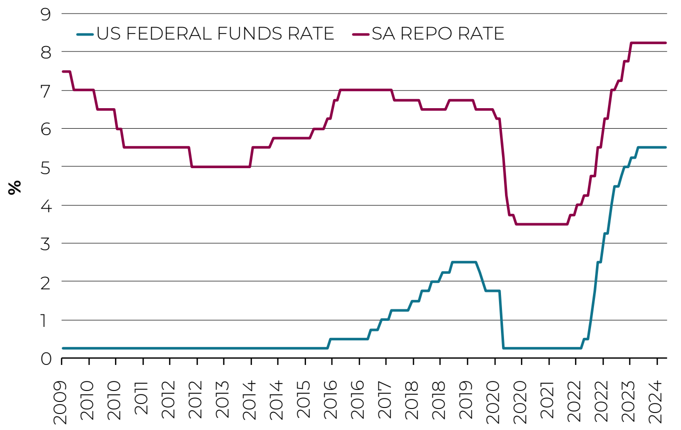
To put it differently, countries can perhaps afford reckless policies when debt levels are low, but when they are high, the market keeps you on a short leash. The only question is whether the incoming administration needs to learn this lesson afresh, or if it can refer to previous experience.

Two examples: In 1994 the ANC came into power with the intention of using the fiscus to drive economic development and reconstruction, only to discover that the cupboard was bare. By 1996, it switched to a policy of macroeconomic stability and debt reduction.

In 2015, President Zuma fired his finance minister (Nenegate) for nefarious reasons. The resultant crash in the rand and government bonds is what ultimately forced him to reverse course. It also turned out to be the beginning of the end of his presidency.

Long-term interest rates (bond yields) will probably only start trending lower relative to peer countries once there is evidence that fiscal discipline and growth-enhancing reforms are bearing fruit. As for short-term interest rates, the Reserve Bank's room to reduce rates is limited by the outlook for US rates. Ongoing strong economic growth in the US means expectations for Federal Reserve rate cuts keep being pushed out, but US rates are by no means the only factor that guide the Reserve Bank's thinking. We should still see modest rates relief in the months ahead.

Chart 3: US and SA policy interest rates, %



Source: LSEG Datastream

In terms of crime syndicates, it is encouraging to see better collaboration between government and organised business. Since big business has much to lose, it has much to offer to combat the scourge. The fact that the government is willing to accept help in a number of areas is promising, and tackling crime and corruption is one of the three Presidential Workstreams set up between government and big business (the other two are energy and logistics). There is still a lot to be done, however.

In other words, there is gradual but uneven progress on four of the five key constraints facing the economy. This should continue after the elections. The fifth is an area where much more needs to be done before one can get optimistic, and that is the poor performance of many local governments. But this is also the area where ordinary people can get most involved in and make a difference in their own communities. There are many tales of municipal dysfunction, but also examples where community organisations are doing stellar work to counter this.

DEMOCRACY

In this vein it is worth pondering whether democracy has been good for economic growth. The example of East Asian countries who experienced rapid economic growth under authoritarian governments (Korea and Taiwan transitioned to democracy but China has not) is sometimes touted. The amazing transformation of Rwanda from the ashes of genocide 30 years ago is another example. People often yearn for a strong leader with dictatorial powers who can "sort things out".

The problem is that for every example of a strongman who guided their country to prosperity there are many more who looted state coffers, brutalised the population and left the country in worse shape. For every Paul Kagame, there are several Robert Mugabes. For every Lee Kwan Yew, there are several Saddam Husseins. Mussolini, who famously made Italy's trains run on time also dragged the country into the Second World War and ultimate ruin.

Democracy can slow the process of economic growth since policies must have broad support and not just be business friendly. But democracy ultimately is the best safeguard against arbitrary and destructive decision-making on the part of government. An abusive government is usually more dangerous than a neglectful one, and in a democracy, there are safeguards against that. It is no surprise today that democracies are on average richer than autocracies.

Democracy itself is much more than just voting every few years (though you absolutely must vote!). It is also about having a set of robust institutions that can limit the government's powers when needed, while amplifying its effectiveness in other instances. These include the courts, opposition parties, a vibrant media, civil society, universities, labour unions, and organised business. An independent central bank is also a key foundation for macroeconomic stability. The market is also a guardrail against reckless policies as described above, by giving real time feedback.

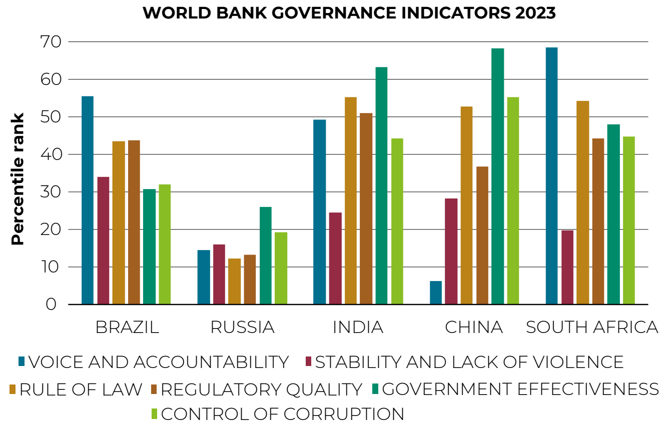
INSTITUTIONS

There are many different measurements of institutional strength across countries. South Africa tends to score above average compared to our peer group of emerging markets, though mostly behind developed countries. One set of measures is the World Bank's Governance Indicators, which compare countries across six categories:

- Voice and accountability
- Control of corruption
- Rule of law
- Violence and political stability
- Regulatory quality
- Government effectiveness

Chart 4 below compares South Africa with its peers in BRICS and puts each country in the percentile rank of all countries. South Africa scores poorly on violence, hardly a surprise. But on the other measures, we are no worse that the other BRICS and on voice and accountability, it is head and shoulders above the others. Countries like Venezuela and Zimbabwe, sometimes considered as "failed states," score in the lowest decile across these six categories.

Chart 4: World Bank Governance Indicators for BRICS countries



Source: World Bank

In other words, South Africa is not as fragile as often assumed and the medium-term economic outlook is better than in recent years. Nonetheless, pessimism persists and South African assets are not pricing in much improvement. People often ask what the catalyst would be to unlock this value. It could be a "positive" election result that sees renewed interest in the country from foreign investors, but more likely investors will want to see evidence of improvement. Diversification remains the correct approach when positioning for the upcoming polls and beyond.

While this might seem like a very uncertain environment, it pales in comparison to the situation in the 1980s and early 1990s. We shouldn't forget what an achievement the largely peaceful transition to democracy was 30 years ago.

EQUITIES – GLOBAL

Description	Index	Currency	Index Value	Week	Month-to-date	Year-to-date	1 Year
Global	MSCI World	US$	3 335.0	2.43%	-2.97%	5.24%	19.96%
United States	S&P 500	US$	5 100.0	2.68%	-2.93%	6.92%	25.74%
Europe	MSCI Europe	US$	2 073.0	1.92%	-1.89%	2.62%	5.87%
Britain	FTSE 100	US$	10 170.0	4.13%	1.30%	3.29%	3.87%
Germany	DAX	US$	1 674.0	2.83%	-2.39%	6.06%	8.35%
Japan	Nikkei 225	US$	239.8	0.05%	-9.63%	1.05%	12.78%
Emerging Markets	MSCI Emerging Markets	US$	1 042.0	3.78%	0.19%	1.76%	7.64%
Brazil	MSCI Brazil	US$	1 592.0	2.45%	-3.28%	-11.56%	13.47%
China	MSCI China	US$	57.9	8.25%	6.81%	4.31%	-8.19%
India	MSCI India	US$	990.6	2.00%	1.49%	7.44%	34.40%
South Africa	MSCI South Africa	US$	388.0	4.02%	1.04%	-6.51%	-5.83%

EQUITIES – SOUTH AFRICA (TOTAL RETURN UNLESS INDICATED OTHERWISE)

Description	Index	Currency	Index Value	Week	Month-to-date	Year-to-date	1 Year
All Share (Capital Only)	All Share (Capital Index)	Rand	75 371.0	2.74%	1.12%	-1.98%	-3.52%
All Share	All Share (Total Return)	Rand	13 512.0	2.75%	2.00%	-0.30%	0.33%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	33 051.2	2.67%	1.95%	-0.39%	1.71%
TOP 40/Large Caps	Top 40	Rand	12 313.0	3.04%	2.34%	0.02%	-0.78%
Mid Caps	Mid Cap	Rand	20 977.0	0.01%	-0.19%	-3.71%	3.48%
Small Companies	Small Cap	Rand	32 441.0	0.67%	0.38%	-0.67%	7.96%
Resources	Resource 20	Rand	5 342.9	-1.46%	9.00%	9.90%	-6.60%
Industrials	Industrial 25	Rand	22 474.0	5.27%	0.34%	1.22%	0.38%
Financials	Financial 15	Rand	11 998.0	4.27%	0.01%	-7.07%	9.73%
Listed Property	SA Listed Property	Rand	1 890.6	1.54%	-2.30%	1.42%	12.47%

FIXED INTEREST – GLOBAL

Description	Index	Currency	Index Value	Week	Month-to-date	Year-to-date	1 Year
IBOXX Global Government Overall (USD Unhedged)	S&P	US$	73.4	-0.62%	-3.09%	-6.37%	-7.13%

FIXED INTEREST – SOUTH AFRICA

Description	Index	Currency	Index Value	Week	Month-to-date	Year-to-date	1 Year
All Bond	BESA ALBI	Rand	932.8	0.86%	1.04%	-0.81%	6.66%
Government Bonds	BESA GOVI	Rand	918.7	0.85%	1.00%	-0.89%	6.57%
Inflation Linked Bonds	BESA CILI	Rand	348.2	0.17%	0.04%	-0.31%	5.22%
Cash	STEFI Composite	Rand	562.9	0.16%	0.65%	2.71%	8.45%

COMMODITIES

Description	Index	Currency	Index Value	Week	Month-to-date	Year-to-date	1 Year
Brent Crude Oil	Brent Crude ICE	US$	89.5	2.53%	2.87%	16.23%	14.74%
Gold	Gold Spot	US$	2 345.0	-1.64%	6.93%	13.67%	17.37%
Platinum	Platinum Spot	US$	922.0	-2.23%	1.65%	-6.59%	-15.26%

CURRENCIES

Description	Index	Currency	Index Value	Week	Month-to-date	Year-to-date	1 Year
ZAR/Dollar	ZAR/USD	Rand	18.81	1.42%	0.65%	-2.73%	-2.15%
ZAR/Pound	ZAR/GBP	Rand	23.51	0.38%	1.70%	-0.89%	-2.42%
ZAR/Euro	ZAR/EUR	Rand	20.11	1.13%	1.58%	0.44%	0.98%
Dollar/Euro	USD/EUR	US$	1.07	0.00%	0.84%	3.18%	2.80%
Dollar/Pound	USD/GBP	US$	1.25	-0.99%	0.85%	1.65%	0.05%
Dollar/Yen	USD/JPY	US$	0.01	2.29%	4.51%	12.18%	18.37%

Source: I-Net, figures as at 26 April 2024

This newsletter is prepared by the Old Mutual Investment Management Team for Adviceworx and is published on a weekly basis to keep our clients and financial planners informed of what is happening in financial markets and the economy and to share our insights. Markets are often very volatile in the short term and similarly, economic data releases or central bank actions may cause concerns for investors. This does not mean that investors should take action based on the most recent events. It is better to be disciplined and remain invested in well-diversified portfolios that are designed to achieve long-term objectives. Our Strategy Funds are actively managed, with asset allocation changes based on valuations and in anticipation of future real returns, and not in response to the most recent market noise. The future is always uncertain and that is why our Strategy Funds are diversified and managed with a long-term focus.

Adviceworx Head Office
1st Floor, Building 5, Commerce Square, 39 Rivonia Road
Sandhurst, 2194
011 268 9600
www.adviceworx.co.za

Adviceworx
Professional Financial Advice