GLOBAL WEALTH

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IN THIS EDITION

sasfin

beyond a bank

Contents

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Letter from the CEO

EROL ZEKI

Dear clients, colleagues and friends.

The national lockdown, as announced by President Ramaphosa, is well underway. As I pen this letter, it is day 5.

THE UNCERTAINTY CONTINUES

Earlier in March, I sent out multiple communications regarding the Coronavirus and the adverse impact it was having on financial markets. Markets have had a little respite through the various global stimulus packages offered by central banks in recent days. A high level of uncertainty remains, however, and the recent relief rally does not necessarily indicate that the worst is behind us.

These events have resulted in unprecedented market movements. Markets tend to be forward-looking, with one of the biggest factors fuelling this market shock being the uncertainty of outcomes as Coronavirus cases increase globally. This is having a marked impact on investor-confidence. The most startling characteristic of the Coronavirus is the pace of its impact on the financial markets where it has had a shock-effect. This is the fastest broad market decline in history.

It was always clear that economies, corporate profits and growth worldwide would be subdued by the effects of the virus as investors, businesses and consumers take precautionary steps and try to make sense of the current events. Initially, it seemed unlikely that the Coronavirus would have a longer term structural impact on economies and financial markets. As the drastic response required by governments around the world has become clearer and more widespread, however, the probability of a longer structural impact on the real economy is increasing. The disruption we are seeing to curb this is unprecedented.

The Table below outlines possible scenarios from here with a broad range of outcomes (source: UBS).

	VIRUS	ECONOMY
UPSIDE SCENARIO	Some combination of high compliance with social distancing, viral seasonality, and/or pharmaceutical solutions means that new cases of the virus peak in Europe and the United States by early April, allows measures to be relaxed gradually from early May onwards, although some travel restrictions are likely to persist through 2020.	Government stimulus is sufficient to avoid lasting damage to the economy, and allow growth to begin a V-shaped recovery in the third and fourth quarters.
CENTRAL SCENARIO	New cases of the virus peak by mid-April, allowing the most severe restrictions to be lifted in mid-May, though re-emergence of the virus means restrictions are reimposed intermittently in some countries for the remainder of the year.	A coordinated monetary and fiscal response eventually provides the necessary funding to backstop affected businesses and industries, but it arrives too late to protect all. A U-shaped economic recovery only takes hold around the fourth quarter.
DOWNSIDE SCENARIO	Containment measures do not prove sufficient to halt the spread of the virus, and new cases continue to rise in Europe and the United States into May/June. We also see the virus re-emerge in China. Most restrictions remain in place into June or July, and are reimposed intermittently for the remainder of the year.	Demand shock leads to higher unemployment which government policy is unable to fully offset. A rise in bankruptcies and joblessness would be inevitable. Companies would forego significant revenue, and shareholders and banks would need to bear losses. For 2020 the economic trajectory is L-shaped.

Source: UBS, as of 19 March 2020.

continued

Our view is that the probability of the 'upside scenario' is low at this point. The most likely scenario is the 'central scenario', but the possibility of a 'downside scenario' cannot be ruled out.

> **"The first line of defence should be to stick to the basics of staying invested and remaining diversified. Markets always recover, but the timing and path of this recovery remains unknown..."**

Primary effects such as liquidity shortages and supply chain challenges have already been felt. Central banks and governments around the world have tried to calm markets with a variety of packages aimed at providing stimulus.

The challenge locally, unlike markets like the United States, is South Africa's limited fiscal firepower. Our economy was already teetering on recession before this event, as well as struggling to contain rising debt to GDP levels. With rising local bond yields on the back of the Coronavirus, and the downgrade of South Africa's sovereign credit rating to sub investment grade by ratings agency Moody's over the weekend, South Africa's cost of funding is becoming increasingly expensive. Second round effects will include rising unemployment in South Africa, further weakening the economy.

WHAT SHOULD OUR INVESTMENT RESPONSE BE?

The first line of defence should be to stick to the basics of staying invested and remaining diversified. Markets always recover, but the timing and path of this recovery remains unknown, again highlighting the importance of sticking to your investment plan. It has been empirically shown that trying to 'time the market' to improve returns adds another layer of risk, which often does not work out well. Panic, hasty decisions, or trying to chase higher returns blindly, often results in investors taking on additional risk without fully considering the possible unintended consequences, which can have a long-term impact on investment returns.

SASFIN'S OPERATIONAL RESPONSE TO THE CORONAVIRUS

Sasfin has implemented and broadly communicated a 5-point plan:

1. Health and Safety – Protecting Human Life

We took enormous steps to best ensure the health and safety of the Sasfin Community. We have now shifted our efforts in this regard to broader society.

Firstly, we have contributed R1m to The Solidarity Fund chaired by one of our Directors, Gloria Serobe, of Wiphold, launched by President Ramaphosa on 23 March 2020.

Secondly, we have been working with the incredible teachers of the Forest Town Special Needs School, which currently feeds many of its learners each day at school, to try and ensure that these young children are still able to get food during the lockdown period.

2. Remote Working – Always Online

As of today, less than 20 of our staff are working from the office. As a banking and broader financial services group, we are required to ensure that we remain online, and certain essential staff will be working from our offices. During this period all our services are, and will, remain available to clients.

New and existing clients will be able to invest, borrow, save and transact online. We have digital capabilities across all our business lines, which means that we will be able to service you at this time. At the same time, our Relationship Managers and service team are available to engage with you remotely.

3. Financial Stability – Weathering the Storm

Sasfin Group CEO, Michael Sassoon, has been invited to join the Board of the Banking Association of South Africa as the independent banks' representative, which is meeting regularly via virtual conferencing solutions at this time. The banking sector has strong capital, liquidity and funding buffers in place and is engaging directly with National Treasury, the South African Reserve Bank, as well as the Auditors, to see how we can continue to support the economy at this time within the regulatory framework. The South African Reserve Bank has implemented several measures to ease regulatory capital, credit and liquidity requirements to help allow banks to continue lending in this environment.

4. Stakeholder Engagement – Together, Apart

All of our people have been trained in engaging remotely. While it is critical that we adhere to the social distancing guidelines and the rules of the lockdown, there is no reason to be isolated. What we have seen and learned in the last few days is that there is an opportunity to connect in a very real way, even though this is done through 'virtual means'. >

continued

5. Client Support – Going Beyond

Our purpose of going beyond a bank to support our Business and Wealth clients couldn't be more important than now. We have made every effort to step up our communication and accessibility during this time. We have already hosted a few virtual client sessions and there are more planned. There will be further communication in this regard in the coming days.

Please reach out to your Relationship Manager who is contactable via the normal email and telephonic channels.

CONCLUSION

Where to from here nobody knows, but we are doing all we can to support all our stakeholders during this time. Please reach out to us as we endeavour to provide uninterrupted service levels.

We are in this together. We will do what we can to support you.

Regards,

Erol

News in brief

Sasfin lives its purpose in time of crisis

When President Ramaphosa initially announced a national 'state of disaster' followed subsequently by a national lockdown, no South African was spared from the unprecedented restrictive consequences. However, for certain segments of the population, the lockdown has hit harder than for others, whereby necessities which were previously taken care of seemed to no longer be available.

When the school system was essentially shut down, thousands, if not millions of students and teachers who benefited from the various national feeding schemes, were left empty-handed. One such school, the Forest Town School for learners with special educational needs, as well as cerebral palsy, physical and learning disabilities in Johannesburg, was adversely affected as some of its day students and their families were reliant on the food subsidies which were routinely distributed. An urgent meeting between Maston Lane, Sasfin Bank's Chief Operating Officer (COO), whose daughter, Rachel, is a teacher at the school, and Sasfin Group CEO, Michael Sassoon, swiftly addressed the situation.

After being alerted to the gravity of the situation, Sasfin Management agreed to contribute R40,000 to ensure groceries would be purchased, packaged and distributed to the 66 learners (and their families) that rely on the school's support.

This culminated on Wednesday, 25 March, two days before the commencement of the national lockdown, in some of the teachers, therapists and general assistants spending time at the school packing and delivering all parcels.

The school's Principal, Ronalda Lucas, was overwhelmed by Sasfin's gesture and thanked the Group for its support that enabled young children to be fed during the 21-day lockdown.

About Forest Town School

Forest Town School was established in 1948 by a small group of parents who needed education, care and treatment for their children with cerebral palsy. Today, the school caters for learners with a wide variety of special educational needs. The school motto is "Arise", whereby children with difficulties and disabilities are given the opportunity, encouragement and expert support they need to arise and be the best they can be.

The Forest Town School journey starts in the Pre-Primary Department. From there, the children either progress to the Junior Modified Department or the Foundation Phase (Grades 1 - 3), depending on their ability and special needs. The senior section of the school consists of the Senior Modified Department and the Intersen Phase (Grades 4 - 7).

Finally, depending on their abilities and needs, learners still attending Forest Town School at the age of 16 years enter the Work Experience Programme.

Donate Now

If you wish to donate towards this incredible institution, please contact Elisheva Gilbert at Elisheva.Gilbert@sasfin.com **SW**

continued

Global and Local Fixed Income – Looking forward past the Corona Crash

PHILIP BRADFORD

continued

In financial markets, an unexpected disaster always causes more damage than a disaster that you are expecting. There is no better example of this than the 'Corona Crash'.

Globally, equities had a very good 2019 and had continued to perform strongly into 2020. Considering what has happened in March, it may be hard to believe that the S&P500 achieved its all-time high on 19 February 2020.

What happened?

Everyone is likely aware that the threat of a global COVID-19 pandemic, and the subsequent global physical and economic lockdown has caused investments of all shape and form to be sold in panic to raise liquidity. Even assets like gold unexpectedly fell as investors sold 'the family silver' to raise money to settle obligations. The only assets that have done well over this period are government bonds of stronger developed market countries like the United States.

The weak economic outlook was exacerbated, but by the standoff between Russia and Saudi Arabia over proposed OPEC oil production cuts. This has caused oil to fall approximately 60% since January. Whilst a lower oil price is positive for oil importers (like South Africa), it is potentially devastating for oil producing countries. The United States, which recently became the largest oil producer in the world, is seeing a large portion of its fledgling oil industry potentially facing bankruptcy if oil remains below $30 per barrel.

> "We also know that in the past, the time to buy is when investments are cheap during the point of maximum pessimism."

Corporate bonds and sovereign emerging market bonds were not spared the panic-selling either. After a strong performance in the second half of 2019, spreads on both groups of bonds had reached very low levels, indicating that financial markets were not anticipating an immediate economic slowdown. The chart below shows how low the spreads of United States corporate bonds were before the recent sell-off.

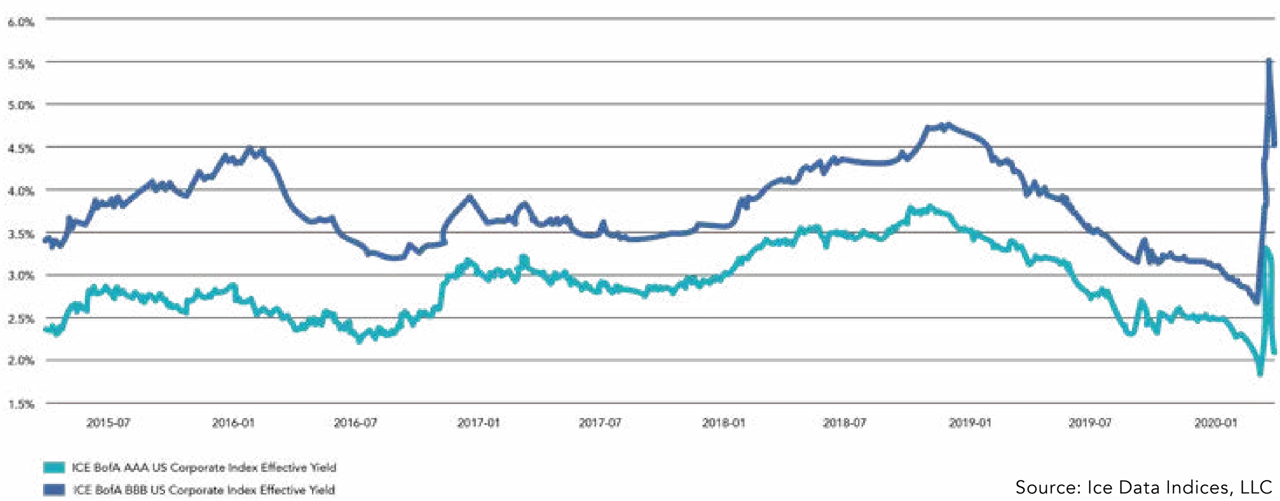
Adding insult to injury

South African bonds experienced the worst sell-off in their history (as shown in the chart below) in line with other emerging markets, as the 'risk off' environment took hold. Unfortunately, this COVID-19 crisis came at a time when South Africa was already struggling to turn around its ailing economy. Minister Tito Mboweni had just delivered a Budget Speech that was probably good enough for Moody's to give us the benefit of the doubt and hold off on changing their debt rating of South Africa.

Unfortunately, the economic lockdown and the fiscal spending measure that will be required to avoid the pandemic left Moody's with no choice but to drop our debt rating to non-investment grade or 'junk status'.

Markets are forward-looking

Ironically, our local bond market largely took the downgrade in its stride and actually improved for a few days after the Moody's announcement. This is the nature of markets where expected bad news is factored into prices ahead of the event.



Source: Ice Data Indices, LLC

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We also know that in the past, the time to buy is when investments are cheap during the point of maximum pessimism. Almost without exception it has been very profitable to buy a country's bonds around the time they are downgraded to junk. South African longer-dated bonds are offering yields of around 12% at the moment, which in an environment of sharply falling interest rates, makes for a very compelling investment from a conservative asset class.

Markets have been badly disrupted by an unexpected and unforecastable risk event, and the longer it continues, the more economic damage will be done. However, we know that this pandemic will end, and when it does, investors that have identified oversold assets are likely to be well rewarded. **SW**

SOUTH AFRICAN 10-YR BOND

COVID-19

IS UNPRECEDENTED, AS IS THE NEED TO HELP.

GLORIA SEROBE

Gloria is the Chairperson of the Solidarity Fund and is a non-Executive Director of Sasfin Holdings, Sasfin Wealth and Sasfin Asset Managers.

continued

South Africans are set to confront one of the toughest moments of our history. Fortunately, all indications are that we will do so united. As a country defined by various struggles, by all the people of this country, I do not make this comment lightly. Our nation, and the world, face an unprecedented threat – one that is oblivious to identity and demographics, and enabled by the hyper-connectedness of our modern world. That menace is Coronavirus 2019 (COVID-19), a respiratory illness that spreads from person to person and likely to spread mainly between people who are in close contact with one another (within about 2 metres), and through touching surfaces that have been touched by infected people.

People spread the virus by coughing or sneezing into the air or their hands and then touching surfaces with those hands. Epidemiologists believe that it stays in the air for up to three hours and on most surfaces for up to four days. There is currently no vaccine to protect against COVID-19. The best way to prevent infection is to take everyday preventive actions, like avoiding close contact with people who are sick, washing your hands often and ensuring that you sneeze or cough into tissues that you throw away, and washing your clothes as soon as possible after possible exposure is vital.

In South Africa, COVID-19 represents a grave and pressing danger to an economy and society already under strain. Furthermore, it threatens to deepen the impact of inequality in our country, a side effect we can ill afford. The New York Times recently pointed out that "In societies where the virus hits, it is deepening the consequences of inequality, pushing many of the burdens onto the losers of today's polarised economies and labour markets. Research suggests that those in lower economic strata are likelier to catch the disease."

It is within this context that President Cyril Ramaphosa announced the formation of the Solidarity Fund (the Fund), as one of the measures to combat the anticipated impact of COVID-19. The Fund has been set up to create a platform for all South Africans, from the public and private sectors, as well as the general public at large to contribute to one consolidated effort to assist those least able to weather the financial consequences of fighting against COVID-19.

"In South Africa, COVID-19 represents a grave and pressing danger to an economy and society already under strain. Furthermore, it threatens to deepen the impact of inequality in our country, a side effect we can ill afford."

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“COVID-19 is oblivious to demographics and infects people regardless of wealth or colour, threatening all our economic livelihoods, but more especially those of the poor and the working classes.”

The Fund will be a rapid response vehicle through which pooled contributions can be deployed to fund four key initiatives – preventative and supporting measures to ‘flatten the curve’ by lowering infection rates; detect and understand the magnitude of the infection problem; assist with the management of those people in hospital or medical care; and support those people whose lives are disrupted by COVID-19.

COVID-19 is oblivious to demographics and infects people regardless of wealth or colour, threatening all our economic livelihoods, but more especially those of the poor and the working classes. In South Africa, a significant portion of our more impoverished population lives with chronic, underlying conditions such as tuberculosis and diabetes, and the Coronavirus threatens to compound these pre-existing health challenges.

These are people likely to be at a higher risk of severe symptoms, complications and potentially death if infected by the Coronavirus. They live in environments where social distancing is difficult, if not impossible. For them, the extra vigilance we must all take in terms of hygiene comes with difficult trade-offs. The most vulnerable members of our society also face the increased prospect of lost income, deepening poverty and hunger, as a consequence of measures we are initiating to fight the virus. They will pay a higher price for the steps we need to take to protect us all.

There are three million people who earn a living in our informal sector. These are communities that do not have savings and have limited security of income. This includes domestic workers, street vendors and waste pickers. The families of the three million workers reliant on the informal economy will already be running out of money as we progress through the very early stages of the necessary lockdown intended to protect us all.

It is clear that their current situation sees them unable to effectively protect themselves and this is where we hope that the Fund can play a role in addressing some of these challenges, not just financial, but through collaboration and collective action and innovation. The response from South Africans to the announcement of the Fund has been extraordinary. Though limited against the scale of the challenge we face, we have already begun receiving contributions and offers of assistance.

As the pandemic continues to evolve at a rapid rate, we are moving with urgency to establish the systems to ensure the most efficient and transparent allocation of resources is made available to cushion the impact of the COVID-19 pandemic for the most vulnerable members of society.

While it will work closely with government and BUSA’s response teams, the Fund is separate from both the government initiatives and organised business initiatives that are being driven by BUSA (Business for South Africa). It will, however, provide a nimble and agile platform to augment government and business interventions.

COVID-19 is a reminder that we all have the same biology, that we are all connected beyond identity and class. We are all human beings who ultimately share the same planet and all that it throws at us, be it COVID-19 or climate change and the degradation of our habitat. The virus is already disrupting our social and economic organisation, and there is a real chance that some of these changes could be permanent, in a world defined by new models of work, economic and social organisation.

In this enormous threat lies an opportunity to redefine our present and our future, to build a genuinely inclusive society, and a (political-) economy defined by social solidarity and cooperation, not simply a Darwinian winner takes all survivalism. In the long run, this may be an opportunity for us to think more creatively about the different types of institutions that could enable us to allocate and distribute public resources and goods more effectively.

“COVID-19 is a reminder that we all have the same biology, that we are all connected beyond identity and class. We are all human beings who ultimately share the same planet...”

For the time being, as demonstrated by our President, this is a time for collaboration and consolidation. We hope that all South Africans will unite with us in this fight against the COVID-19 virus. The Solidarity Fund is a vehicle through which we can all contribute to a single effort that will enable our country to quickly and comprehensively deal with the challenges we are currently facing. Simunye. **SW**

Monstrous March – where to from here?

MIKE HAWORTH

March was a month of unprecedented market volatility and concerted policy action. The market moves and policy actions in March went well beyond anything seen in 2008. In many cases, what took three years to unfold between 2008 and 2011, happened in three weeks in March.

Two 'black swan' events occurred – the global pandemic spread of the COVID-19 disease, and the breakdown of the OPECplus agreement and consequent oil glut.

The COVID-19 pandemic has resulted in major lockdowns around the world, where the movement of goods and people have virtually come to a halt. This is unprecedented in global terms. While the shutdowns are understandable to control the infection rate around the world so as not to overwhelm their respective healthcare systems, the economic consequences of the lockdowns will be severe. The demand destruction and disruption to supply chains due to the shutdowns will be unprecedented and consequently impossible to accurately predict. It is becoming increasingly apparent that the world will fall into recession in Q2:2020 and perhaps even in Q3:2020.

While countries around the world have been very clear as to how to >

continued

start their lockdowns, they are very vague as to what metrics they will use to judge when and how to unlock the shutdowns. The recovery or resumption process is undetermined, which together with sequencing of the lockdowns, dictates that the world will not rebound directly out of this crisis. The economic damage to industries, real estate and banking will be material raising issues around liquidity and solvency in financial markets. These will only become apparent in second and third round effects.

OIL OF THE TIMES

The second 'black swan' has taken the form of a price war developing in the oil market. The OPECplus grouping failed to agree on further production cuts at its meeting in Vienna on 5 March 2020. The result is that the two largest members, Saudi Arabia and Russia, have announced they will boost production to record levels at a time when global oil demand is collapsing due to the COVID-19 related economic shutdowns around the world.

The expectation is that there will be around 10 million barrels per day excess oil supply in Q2:2020 and potentially longer. Global oil inventories were rising before the COVID-19 'black swan', now there is a real chance that available spare storage gets fully utilised, resulting in fire sale prices for oil cargos on the high seas. This is likely to result in the oil price falling materially below $22 per barrel in Q2:2020 after its 60% fall in March 2020.

South Africa was already on the back foot before the recent global 'black swan' events. It was in technical recession, experiencing load shedding and facing a fiscal crisis. In mid-March the South African government announced a State of Disaster and a 21-day lockdown a week later. These actions were in response to the accelerating COVID-19 infection rate inside South African borders. The South African population is especially vulnerable to the rampant COVID-19 infection, given 13% of the population live in informal settlements and a 13.5% have HIV, to which a high level of comorbidity is associated.

The COVID-19 related lockdown will have serious consequences for the South African economy. The main hit to the economy will be felt in Q2:2020, but the overall effect will depend on how quickly the economy returns to normal levels of activity. Our base case is for South Africa's real GDP to fall 7% in 2020.

Already the banking system is facing stresses, which became serious enough for the South African Reserve Bank to provide additional liquidity to its repurchase markets, and indicate it would buy bonds to reduce the sudden illiquidity in the bond market. The disruption to domestic economic activity will create a serious tax revenue shortfall for the fiscus, which will push up the budget deficit, worsening the public debt trajectory. The State-owned Companies, already crippled, will be hurt further with repercussions for the fiscus.

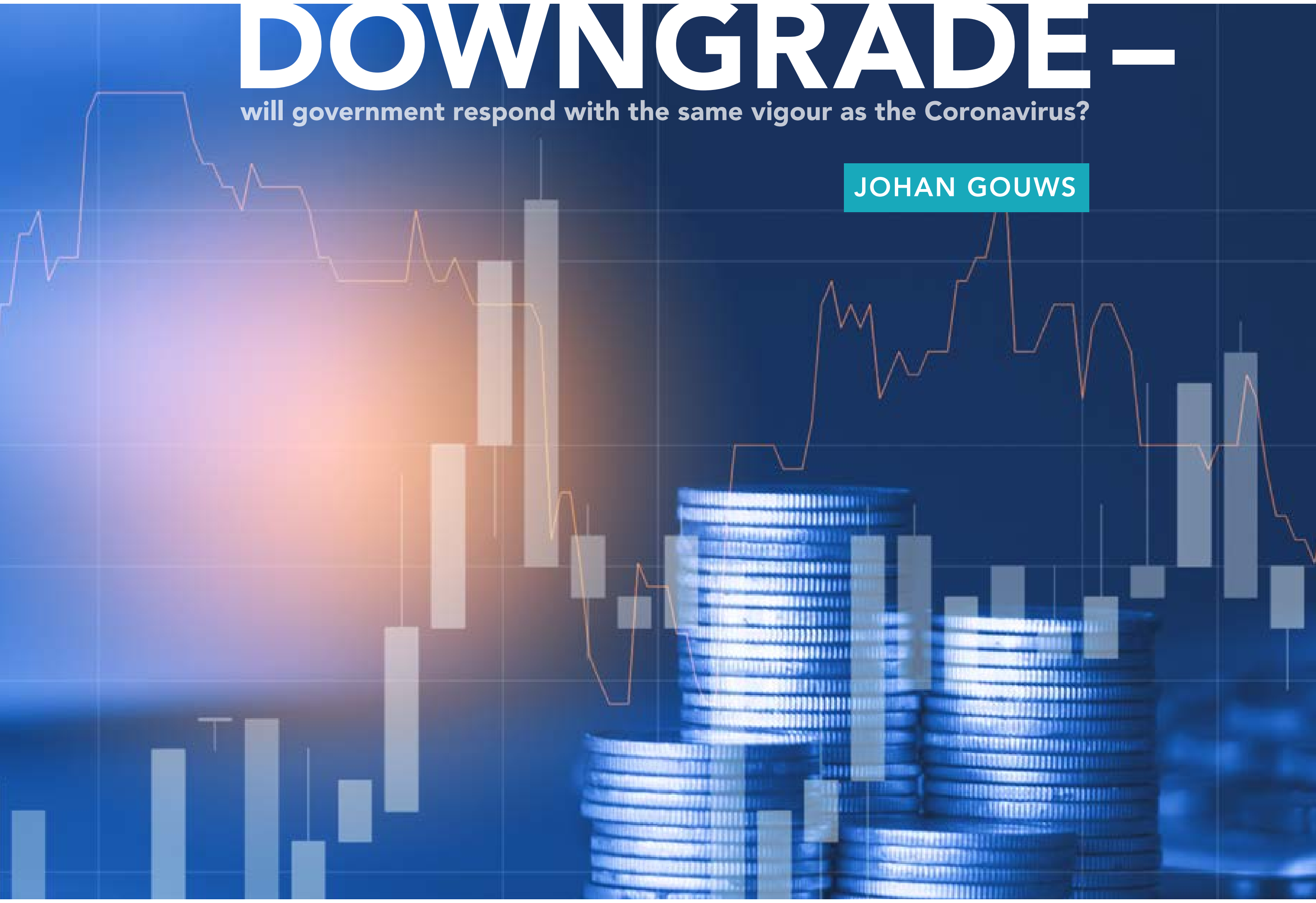
"Global oil inventories were rising before the COVID-19 'black swan', now there is a real chance that available spare storage gets fully utilised, resulting in fire sale prices for oil cargos on the high seas."

It looks like the South African Reserve Bank will have to do most of the heavy lifting to support the proper functioning in the domestic financial markets in the weeks ahead. **SW**

MOODY'S DOWNGRADE –

will government respond with the same vigour as the Coronavirus?

JOHAN GOUWS



The long-awaited downgrade by Moody's of South Africa's long-term foreign and local currency credit ratings from Baa3 to Ba1 came on Friday, 27 March and coincided with Day 1 of government's national lockdown. A result of the downgrade is that South Africa, which constitutes 0.45% of the FTSE World Investment Grade Bond Index (WIGBI), will no longer form part of the index from 1 May 2020. Passive strategy investors following the WIGBI will have to sell their rand bond holdings to avoid breaching their investment mandate. South Africa has a 0.45% weighting in the WIGBI that represents $3tn of investments, which suggest that there could be as much as $14b of investment outflows.

The announcement by Moody's confirmed the first downgrade into speculative status since an investment grade rating was awarded to South Africa 25 years ago. This downgrade by the last of the trio of recognised rating agencies was the result of years of flawed government policy, weak governance, corruption and state capture. The legacy of the Zuma presidency has left South Africa in a vulnerable state from a financial and economic perspective. The post-Zuma government under President Ramaphosa has been struggling to make any meaningful inroads in fixing the structural deficiencies of the South African economy. Internal party politics, ideological differences and low levels of trust between government, the private sector and labour resulted in a lack of focus and action to start addressing the growing socio-economic challenges.

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The outbreak of the COVID-19 pandemic has now also left the country exposed and in a fragile state from a humanitarian perspective.

The build up to the Moody's latest downgrade started as far back as 9 December 2015 with 'Nenegate', when President Zuma, as part of a politically driven agenda, decided to remove the then Minister of Finance, Mr Nhlanhla Nene. Since then, South Africa's benchmark fixed interest instruments traded at yields of emerging market peers that have already been relegated to the sub-investment grade league. Fragmented and slow decision making by government, pedestrian economic growth, faltering state owned enterprises, the Eskom energy crisis and rapidly rising government debt were raised repeatedly by Moody's as the main factors they were concerned about before deciding to change their credit rating outlook from Stable to Negative on 1 November last year.

Every dark cloud has a silver lining, and with the Moody's downgrade also comes several positives. Firstly, some uncertainty has now been removed that was hanging over the local bond market and our currency in recent years. Secondly, South Africa is now ranked as one of the most attractive investment options in the sub-investment grade league, and offers yields that are higher than some emerging market peers with lower credit ratings. Thirdly, the downgrade comes as a clear wake up call for government to stop putting the interest of the ANC before that of the country, and to start prioritising the critical actions required to get the local economy growing again. In addition, the COVID-19 crisis and subsequent lockdown has pushed the agenda of the fourth industrial revolution from a digitalisation and remote working perspective.

Very importantly, it also helped the President to find his voice in order to unite the country in an effort to manage the crisis and to protect the lives of its people.

Given the additional pressure that COVID-19 will place on the local economy and the fiscus, South Africa might be left with no choice but to approach the World Bank, the New Development Bank (aka the Brics Bank) or the International Monetary Fund for financial assistance. The highly emotive topic of 'prescribed assets' can be expected to raise its head again as an alternative to knocking on the door of the World Bank or the IMF. Further credit rating downgrades by the three credit rating

"Fragmented and slow decision making by government, pedestrian economic growth, faltering state owned enterprises, the Eskom energy crisis and rapidly rising government debt were raised repeatedly by Moody's as the main factors they were concerned about before deciding to change their credit rating outlook..."

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agencies during the remainder of 2020 remains a real possibility with all the agencies maintaining a negative credit rating outlook. In addition, the Budget announcement on 26 February has become obsolete in the space of three weeks, as the assumptions on which it was based is not valid anymore.

Despite these challenges, the South African economic and financial landscape still has various positive features to nurture and protect. The country has a relatively large and diversified economy which allows for low volatility in GDP growth. The South African Reserve Bank still enjoys independence in setting the monetary policy. The local financial services industry and banking system are well regulated, and have the necessary depth and financial strength to navigate the current storms. Most of South Africa's government debt is denominated in local currency, which still has a AAA status from a local ratings perspective and is long term in nature.

Building on these pillars of strength, South Africa needs to work its way back up the ratings scale by focusing on a few key ingredients. The first and most critical is fiscal consolidation over the medium term, in order to bring it broadly in line with the central expectations of the ratings agencies. Secondly, the aim should be to create an environment for a steady, but sustainable improvement in economic growth. This will allow for a gradual reduction in primary deficits in the next few years and increase the likelihood of government debt remaining below 90% of GDP.

The world currently has many of its own challenges to deal with and South Africa should use this opportunity to quietly, but purposefully, go about turning around its economic, fiscal and credit rating fortunes. While we do not have the luxury of unleashing large fiscal stimulus packages like the United States or the United Kingdom, the South African Reserve Bank still has room to further reduce interest rates to stimulate the economy. In the short term, debt relief and tax holidays for households and small to medium businesses will create some breathing space and limit further structural damage to the local economy.

> “...there never is a good time to receive a downgrade for a country that has a weak economy and limited financial resources to protect itself.”

The President should capitalise on the current sense of national unity and mobilise government, the private sector and labour to collectively find solutions to creating long-term growth and save the economy.

Government's view was that the Moody's downgrade could not have come at a worse time given South Africa's existing fiscal challenges. However, there never is a good time to receive a downgrade for a country that has a weak economy and limited financial resources to protect itself. The worst time to have received our credit rating downgrade might also be exactly what we as a country needed to create the necessary sense of urgency and take control of our own destiny. **SW**

Stay invested in challenging times

VEENESH DHAYALAM

After a very strong 2019, the first quarter of 2020 has been littered with unprecedented events, not just financial in nature, but also of economic policy and social impact. What has been more unsettling is the uncertainty that has been driving some of these events, and investors could be forgiven in thinking that the safest course of action is to move out of markets, especially equities.

Whilst plausible, one should always carefully contemplate the opportunity cost of not staying invested even in tough market conditions, especially when the pain and loss has already been felt.

When selling out in market downturns, one is potentially selling at a lower level, and may realise and lock in absolute losses. Whilst market pullbacks are never welcomed, they can, and should be expected, with the timing of these, however, unknown. Decisions taken hastily could lead to unintended consequences, which could have long-term value-destroying effects on investment returns.

The next two examples illustrate the benefits of remaining invested and avoiding the temptation of exiting markets when things get tough. >

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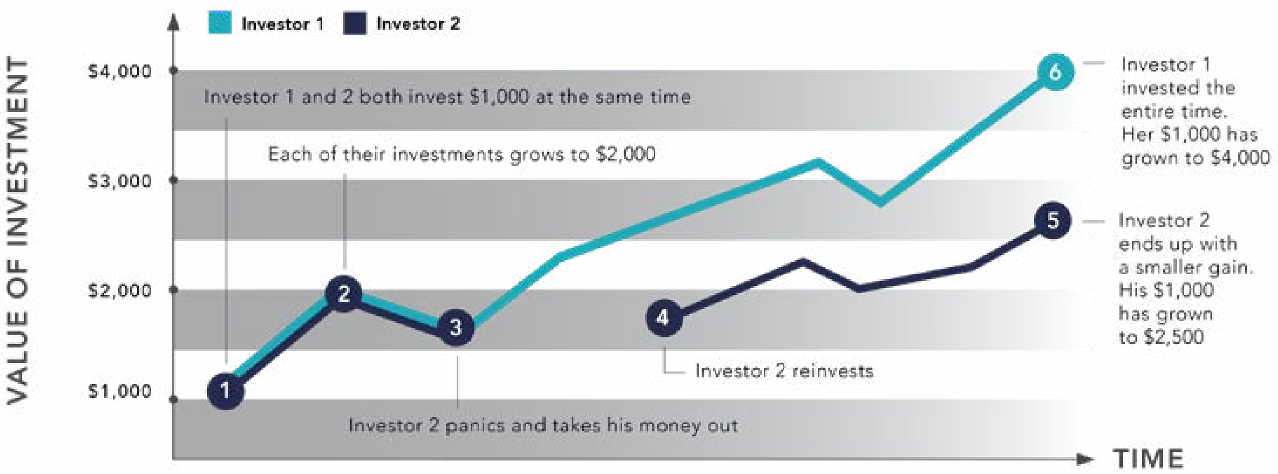
EXAMPLE 1



Source: Scotiabank

Example 1 illustrates how two investors invest at the same time and both their investments begin to grow. When the market declines, investor 1 continues to remain invested and takes advantage when the market recovers, while investor 2 exits the market and consequently lags investor 1.

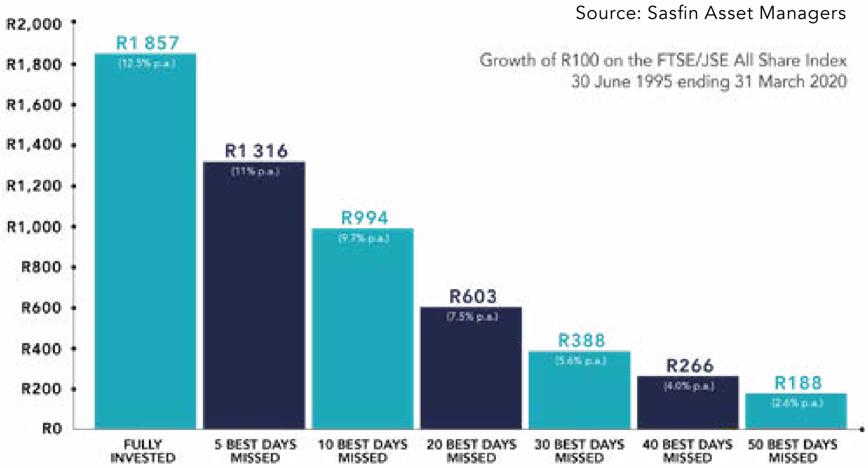
Example 2 shows the lost opportunity cost in trying to stay out of markets versus remaining invested. If one had invested R100 at the end of June 1995 and remained fully invested until 31 March 2020, with the recent market volatility included, the outcome would have been at R1,857 or 12.5% per annum. By missing just only the 20 best days, the outcome would have been less than a third of the original value. By missing more of the best performing days, the investment accumulation would naturally have been further reduced.

Recent market fluctuations should not encourage one to lose sight of the long-term investment plan as markets generally tend to recover after a decline. Whilst trying to exit markets, especially when there is volatility and uncertainty, can be persuading. Having a well-diversified portfolio, a long-term investment plan and the patience to remain invested may be what is needed to achieve one's investment goals. Something worth considering is that historically since January 1960 ending March 2020, the FTSE/JSE All Share Index realised roughly 38% of monthly losses – however, on a rolling 10-year basis over the same time frame, no loss has been realised.

Whether this persists may be arguable, but the point remains that long-term investing delivers more consistent outcomes than trying to time, based on short-term market movements. **SW**

EXAMPLE 2

Source: Sasfin Asset Managers



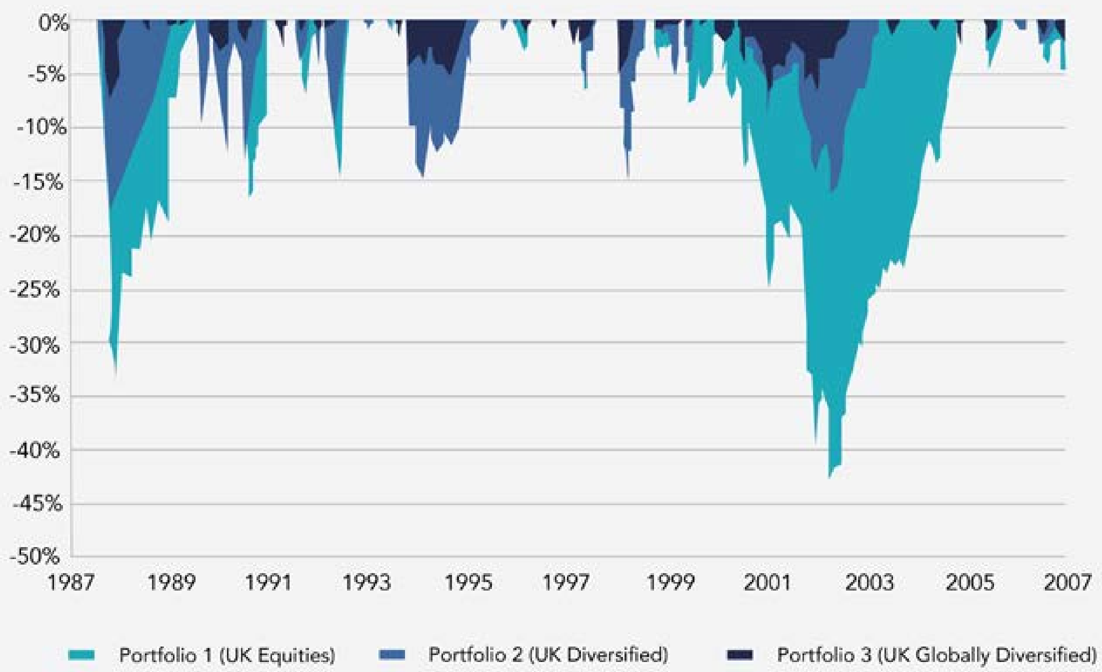
ASSET CLASS CORRELATIONS

AND PORTFOLIO DIVERSIFICATION IN A CRISIS

JONATHAN SIEFF

continued

Portfolio diversification is essentially adding variety to a portfolio. It could be across asset classes (i.e. shares, bonds, etc.), or across sectors and shares in one particular asset class. It is an investment strategy that helps mitigate the unpredictability of markets for investors. Correlation is a statistical measure that determines how assets move in relation to each other. By combining assets that are uncorrelated, the embedded risks in a portfolio are lowered, and higher risk-adjusted returns can be achieved – in other words, a lower level of risk for a particular return outcome. The main benefit of diversification is a reduction in risk. In the following graph, it is clear that over a long-term period, the drawdowns or peak-to-trough maximum losses of a globally diversified portfolio are nearly always less than those of the other portfolios. Even the locally diversified portfolio suffers losses substantially worse than Portfolio 3. This is particularly evident during the equity bear market of August 2000 to January 2003, when United Kingdom equities lost 43%, the United Kingdom diversified portfolio lost 17% and the globally diversified portfolio only 8%. Another benefit of smaller losses are shorter recovery times. It took Portfolio 3 just eight months to recover from its maximum loss, while it took Portfolio 1 almost two and half years. This reinforces the importance of diversification.



Source: Bloomberg, Frontier Investment Management LLP

"The lower the correlation of an asset to another, the greater the diversification benefit."

An asset class whose returns are not expected to deviate significantly from its historical average is described as low risk. An asset class whose returns are volatile from year to year is regarded as risky. Modern Portfolio Theory informs investors how to combine asset classes in portfolios, to give them the lowest possible risk consistent with the return they seek. It shows that if an investor wants to reduce investment risk, diversification is the answer.

The theory indicates that risk can be broken into two parts. The first part is associated with the tendency of returns in an asset class to move in the same direction as the general market. The other part of the risk results from factors peculiar to a particular asset class. The first part of the risk is labelled systematic >

continued

risk, the second part, unsystematic. According to Modern Portfolio Theory, through diversification only, unsystematic risk is eliminated. Systematic risk cannot be removed through diversification.

> “The true benefit of multi-asset class investing is that when you invest this way, you tend to be less exposed to large shocks, such as COVID-19.”

The systematic risk of asset classes captures the reaction of available investment instruments in those asset classes to general market movements. Some asset classes (such as equities) tend to be more sensitive to market movements, while other asset classes (such as bonds) display less sensitivity. The relative sensitivity to market moves (correlation) is estimated by means of statistical methods and is known as beta (beta is the numerical description of systematic risk). If an investment instrument has a beta of 2, it means that on average it swings twice as much as the market. If the market goes up 10%, the investment instrument tends to rise 20%. If, however, the stock has a beta of 0.5, then it tends to be more stable than the market.

However, the stark reality is this – in a crisis (systematic risk, such as COVID-19), correlation goes to 1 and everything moves in lockstep, usually for short periods when investors sell all assets and prefer to hold cash as a general rule in periods of extreme uncertainty. Correlation is the risk that nobody sees. Correlation is the risk that nobody saw in 2008, which was the first time that every asset class moved in unison. Even during the Great Depression, one asset class provided positive returns – corporate bonds. Correlation is always lurking. It’s the relationship between asset classes that you don’t see until it’s too late, usually brought on by ‘black swan’ events such as COVID-19.

The true benefit of multi-asset class investing is that when you invest this way, you tend to be less exposed to large shocks, such as COVID-19. The point of putting bonds, infrastructure, absolute return strategies, real estate, private equity and commodities alongside equities in your portfolio is for the diversification benefits.

Conclusion

The question is whether clear investment priorities were set in the first place with regard to an investment plan or an explicit asset allocation. The answer is a firm “yes” regarding Sasfin’s investment approach. The next question is whether it served its purpose or needs revision. We believe it has served its purpose by reducing downside in this crisis, so it is quite consistent to stick to your guns or even add exposure, albeit slowly and cautiously, after the recent drop in asset prices. What we advocate for is to hold a steady course, put some cash to work and stick to your investment principles. When the panic subsides, correlations will return to normal and the diversification benefits will continue to add value to portfolios. **SW**

"Conservative positioning has prepared the Fund well to take advantage of any weakness."

PHILIP BRADFORD

With the current volatility and uncertainty in the financial markets, both globally and locally, we felt it prudent to provide an update on the Sasfin BCI Flexible Income Fund.

The objective of the Fund is to provide investors with a high level of income whilst preserving capital. The Fund has a flexible mandate and actively invests in conservative instruments like cash, and fixed-rate and floating-rate bonds.

WHAT ARE BONDS?

• Bonds are loans where investors lend money to entities like companies (e.g. banks) or governments

• They typically have a fixed maturity and pay a predetermined rate of interest

• Buying a bond is similar to placing money in a fixed deposit with a bank

• Bonds are considered conservative investments

CURRENT FUND POSITIONING:

The Sasfin BCI Flexible Income Fund has been conservatively positioned.

• The Fund management team had actively reduced the risk in the Fund in January 2020 to its lowest exposure to fixed-rate bonds, and its highest exposure to cash and liquid assets since inception in 2015

• This conservative positioning has prepared the Fund well for this sell-off in the markets and to take advantage of any weakness

• The performance of the Fund is -1% year-to-date, but has continued to perform relatively well when compared to the ALBI and peers over all periods (see graph on next page). By comparison, the All Bond Index is down -8.7% year-to-date

• The current AUM of the Fund is over R4bn

GOING FORWARD:

• The liquidity of the Fund remains very good with a high exposure to cash and liquid investments >

continued

• The recent volatility has presented us with the opportunity to selectively buy conservative investments at very attractive yields

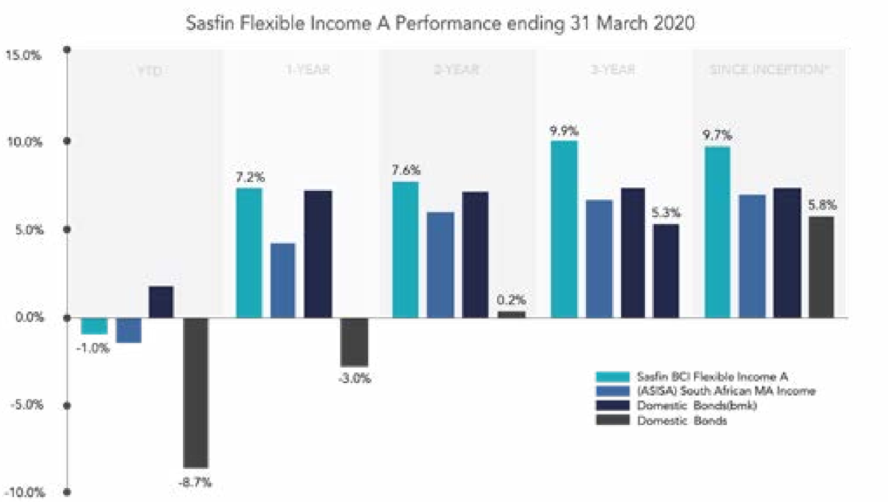
• This will allow the Fund to continue to provide a high level of income for investors for many years to come

• Preservation of capital will remain at the forefront of any investment decisions

CONCLUSION:

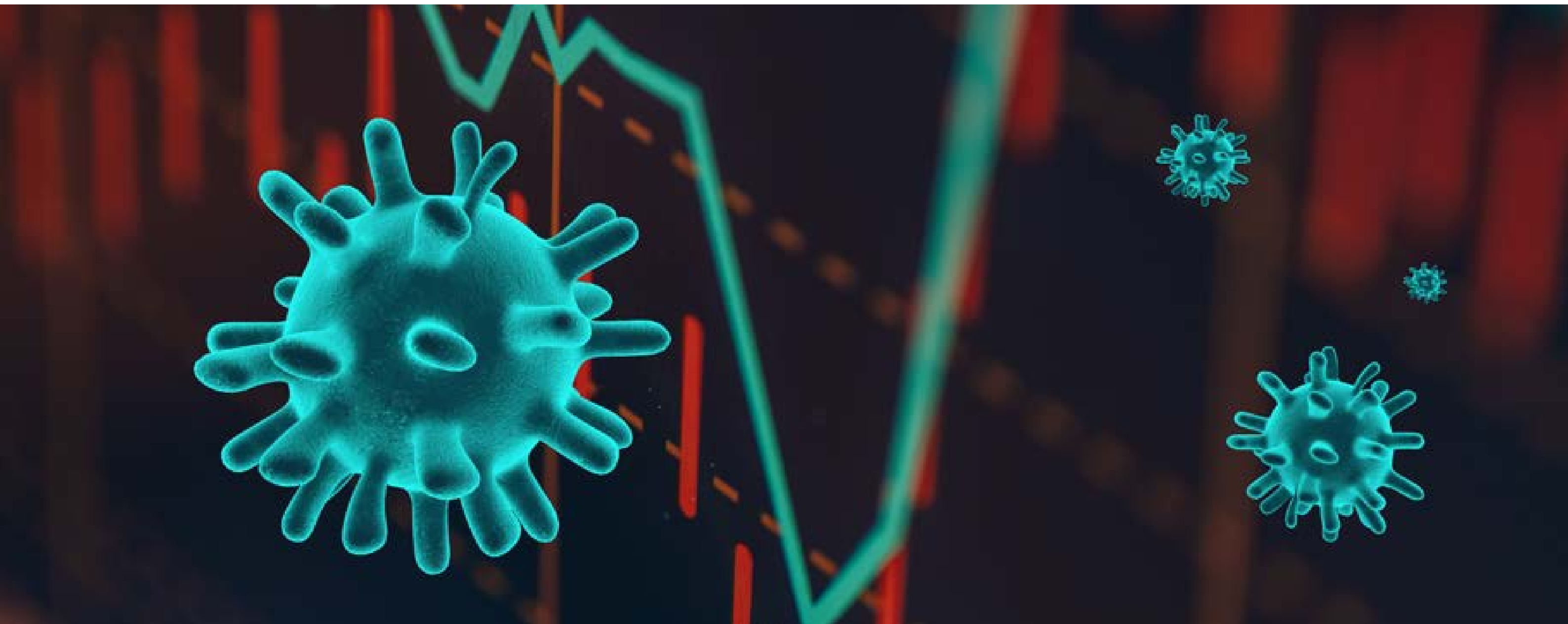
In summary, the current gross yield on the Fund is still over 10%, and we remain confident that we are well positioned to navigate this turbulent time and to continue to provide a high level of income to investors into the future. **SW**

INVESTMENT PERFORMANCE SUMMARY (TO END 31 MARCH 2020)



Source: Morningstar

Source: Morningstar, pre-month end sign-off; Notes: *Since inception date is 1 July 2015; Performance greater than 1-year is annualised; Annualised return of the Fund refers to the weighted average compound growth rate over the measured period. Highest annual return was 14.22%; Lowest annual return was 9.98%; Actual annual figures are available to the investor on request. Domestic Bonds refers to the FTSE/JSE All Bond Index; Domestic Cash refers to the STEFI Composite Index; (ASISA) South African MA Income refers to the peer average of that category. Boutique Collective Investments (RF) (Pty) Ltd ("BCI") is a registered Manager of the Boutique Collective Investments Scheme, approved in terms of the Collective Investments Schemes Control Act, No 45 of 2002 and is a full member of the Association for Savings and Investment SA. Collective Investment Schemes in securities are generally medium-to long-term investments. The value of participatory interests may go up or down and past performance is not necessarily an indication of future performance.The Manager does not guarantee the capital or the return of a portfolio. Collective Investments are traded at ruling prices and can engage in borrowing and scrip lending. Aschedule of fees, charges and maximum commissions is available on request. BCI reserves the right to close the portfolio to new investors and reopen certain portfolios from time to time in order to manage them more efficiently. Performance figures quoted in the portfolios are from Morningstar, as at the date of this document for a lump sum investment, using NAV-NAV with income reinvested and do not take any upfront Manager's charge into account. Income distributions are declared on the ex-dividend date. Actual investment performance will differ based on the initial fees charge applicable; the actual investment date; the date of reinvestment and dividend withholding tax. Income funds derive their income from interest-bearing instruments in accordance with Section 100(2) of the Act.



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