May 2018

The Next 100 Years: What is South Africa's USP*?

**A "Unique Selling Proposition"*

Some investors may find it interesting to note that South Africa has been one of the globe's best performing stock markets for almost 100 years. We have been fortunate to say the least, with returns outstripping inflation by more than 8% since 1926. Global investors have not been as lucky, a relatively low 6% real return above inflation over the same period, in US$. While this may seem like a small percentage, over this horizon it equates to three times the capital for local over global equities by the end.

Comparison of returns 1926 - 2018[1]

	Rands			US$		
Annualised Returns	SA Inflation	Local Equities	Real Return	US Inflation	MSCI World USD	Real Return
1926 - to date	5.9%	14.3%	8.3%	2.9%	8.9%	6.0%
AVERAGE PAST 10	5.6%	9.8%	4.2%	1.6%	6.1%	4.5%
AVERAGE PAST 20	6.1%	14.2%	8.1%	2.2%	5.8%	3.6%
AVERAGE PAST 30	7.6%	16.5%	8.9%	2.6%	7.6%	5.0%
AVERAGE PAST 50	9.2%	16.8%	7.6%	4.0%	9.4%	5.3%

So what makes SA so special, and can we expect it to continue? Do we have a 'USP' to help drive future investment returns?

Over such an extensive period, we can break down our good fortune into a few key elements, all of which have played a part in delivering for local investors:

1. With the industrialization of first the developed nations and more recently emerging markets, the demand for our countries rich deposits of mineral resources has been a major role player in providing equity returns to investors. With these companies at times constituting half of our listed stock market, it has been difficult to avoid them. Globally this would be a significant anomaly, where broad equity markets have minimal exposure to resources and the return premium they have attracted.

2. This may sound unusual, where one country creates opportunity in another, however China's economic reforms which started in 1979 led to what became known as the "commodity super cycle" which took place from the early 2000's until its peak in 2011. So in addition to being a general production engine of the world's resources, we now had its biggest customer driving demand to unprecedented levels. This super cycle alone accounts for half of the excess return of local over global equities since 1926.

3. Special companies. In global markets the breadth of equity markets generally means that any particular share is quite small in investor's lives. For example, Apple today – the world's largest company by size - is just 2.4% of the global equity market. In South Africa, with only around 100 shares investable across the market, single share exposure can breach significantly higher levels, as high as 20% per share. Anglo's, MTN, SAB and more recently Naspers are all examples of local companies which have become globally relevant, and their success beyond our borders has driven shareholder returns as they have become increasingly large parts of our portfolios.

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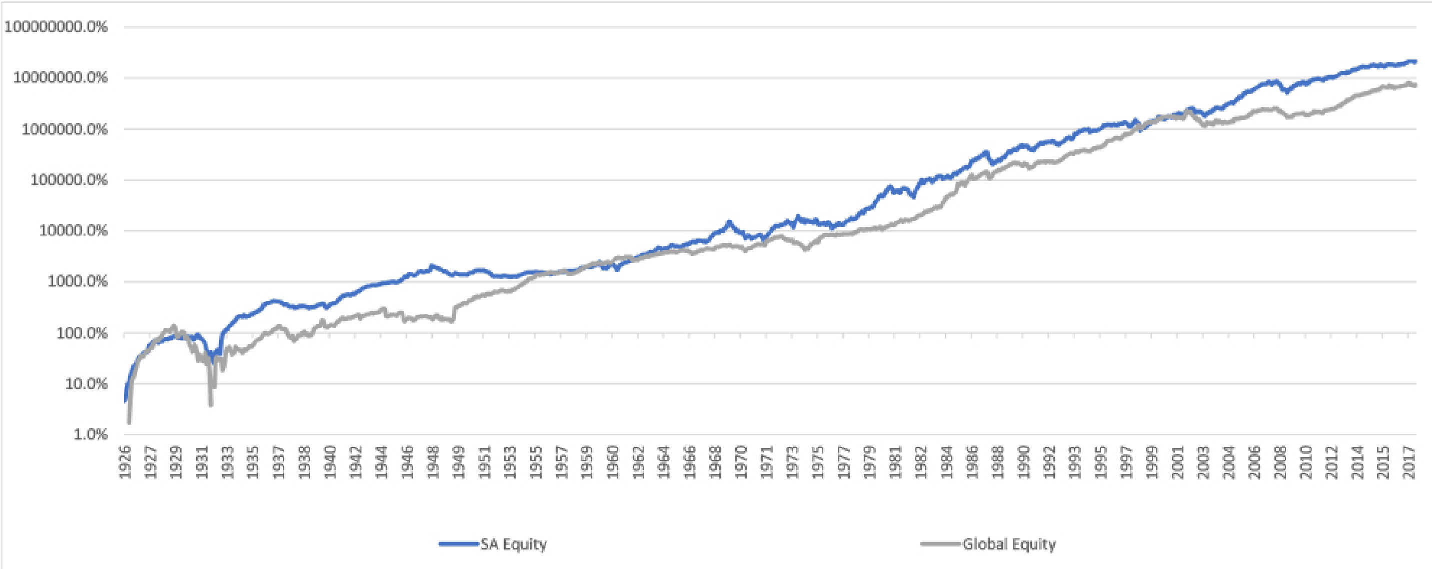
4. The fact that we have historically had a stock market quite distinct from global markets means our return profile has been somewhat different. While this has meant we have had twice the amount of material capital drawdowns, at times – such as in the GFC – we have had a materially quicker recovery, which results in higher rates of compounded return. Interestingly, this also shows how volatility and drawdowns, while anxiety inducing, don't necessarily lead to worse return outcomes.

What pitfalls may we find along the way? Looking again to history, there have been many: a depression, 9 significant drawdowns where you lost 30% or more (ie one on average every 10 years or so), world wars, political isolation and any number of seemingly disastrous events which, all told, have not changed the trajectory of equity returns, as shown below:

Cumulative equity returns: 1926 - 2018[1]



Looking then to the future, what can we make of our good fortune and can it repeat? By all accounts, the prospect of 100 years of support for commodities in future seems optimistic at best. While general industry will still require basic material inputs, one can't help but feel that the time for this sector is past us. While this may mean we get 'average' returns from commodity producers, its seems unlikely they will be the growth driver of our share market.

Countries such as India, and continents such as Africa, hold the key here, where the potential untapped demand still rests but without an obvious catalyst to unlock it.

The potential for 'special' companies will always remain, and provided that our stock market stays narrow (likely), the potential for the next big star is there. Who could it be next? Potential suitors include companies with global potential, such as Discovery, Investec and Shoprite. (Steinhoff was on this list too). No pressure then.

The diversification argument has also weakened considerably. With globalization, the increasing inter-reliance of developed and emerging markets, we are not as different to the globe as we used to be. In fact, we are becoming more like other emerging markets (Naspers = Chinese tech!), and emerging markets are becoming more like developed markets (Chinese tech = Facebook and Alphabet!).

Are there any new USP's we might be able to focus on in future? These would have the defining characteristics of being significant in potential size, a sustainable competitive advantage, and a product of our South African 'uniqueness'. Without it, we may just become

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a consumer economy, reliant on others to make our goods and provide our services. Unfortunately, and for the time being, it is not obvious we have any USP's. A few potential options do exist however:

- The 'Gateway to Africa'. With the largest undeveloped economy on our doorstep we may just be the most effective access point for Africa to integrate itself with the world economy. While the disparate nature of African leadership may make this exponentially more complex than the China or India equivalent, there is significant potential for all forms of goods and services, including commodities. A number of South African companies are already making inroads here – some of which we have listed above.
- The emerging middle class. This is touted as one of the key drivers for the expected 'emerging market return premium', where the fact that a country's standard of living is climbing means there is a wealth benefit which compounds across the economy. This demographic trend has been evident in many emerging markets, with SA trailing somewhat as a function of our history and leadership.

Which other industries offer a potential USP for South Africans to offer the world? Financial services could be one given our relative sophistication, however with a relatively volatile political environment it wouldn't work as a safe custody domicile for global investors. Quite often our time zone, use of the English language and general education levels are seen as a destination for outsourcing services such as administration and call-centres. Geographically we don't have the positioning of Dubai (transport hub) or the appeal of Ireland (services, technology and financial services). Our agriculture sector, while being a current net exporter (our biggest customer is Africa), does have negative trends in key segments.

The government has started implementation of its National Development Plan, aimed at improving socio-economic welfare across the population. The target list is long, to be achieved by 2030, and in most cases involves a step-change in approach to execute effectively. However, the outcomes are improved services, education, infrastructure and the like. This should be the bedrock of the emerging middle class growth aspect, and could also improve foreign direct investment if executed well. The path to achieving this is complex though, with leadership being a key determinant.

In short, it's difficult to see what could or should drive the next 100 years of growth for investors in South Africa. The niggling thought is that the next 100 years is technology and science driven, and we are not positioned well for that as we stand today.

There is one USP we can attribute to South African's, and in some way is present in all of the success stories of the past 100 years: our culture of 'making a plan'. By our nature we are resilient, innovative, hard-working and optimistic. This is not the easiest USP to work with, but retaining it will be the minimum we require to navigate the next 100 years.

[1] *Source: Fundhouse, Thompson Reuters, Robert Shiller, Colin Firer*

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data provided by Profile Data Analytics, Reuters and Datastream

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
FTSE/JSE All Share Index (ALSI)	ZAR	-2.5%	-4.4%	8.0%	5.4%	9.2%	9.0%	10.9%	14.7%
FTSE/JSE SA Listed Property	ZAR	0.3%	-18.6%	-6.5%	2.0%	8.4%	15.3%	14.1%	15.1%
SA All Bond Index (ALBI)	ZAR	-0.6%	5.3%	10.4%	8.1%	7.3%	9.7%	7.8%	7.7%
SA Cash Index (SteFI)	ZAR	1.8%	3.0%	7.4%	7.3%	6.7%	7.0%	0.2%	0.5%
Balanced Benchmark	ZAR	0.0%	-1.7%	7.1%	6.6%	9.4%	9.9%	7.0%	8.9%
SA Inflation (1 month lag)	ZAR	1.9%	2.2%	4.5%	5.4%	5.3%	5.6%	1.4%	1.3%
GLOBAL MARKET INDICES									
Global Equity (MSCI World)	USD	-0.2%	0.8%	12.2%	8.3%	10.0%	6.0%	10.1%	16.2%
Emerging Markets Equity (MSCI EM)	USD	-5.7%	-2.5%	14.4%	6.6%	4.9%	2.0%	15.0%	22.4%
Global Bonds (Barclays Global Bond Index)	USD	-1.6%	-0.7%	2.1%	2.8%	1.0%	2.1%	5.3%	6.5%
Global Cash	USD	0.6%	0.9%	1.7%	1.0%	0.7%	0.7%	0.2%	0.2%
MAJOR INDICES BASED TO RANDS									
FTSE/JSE All Share Index (ALSI)	ZAR	-2.5%	-4.4%	8.0%	5.4%	9.2%	9.0%	10.9%	14.7%
Global Equity (MSCI World)	ZAR	7.1%	3.1%	7.7%	9.7%	15.2%	11.5%	13.2%	14.4%
Emerging Markets Equity (MSCI EM)	ZAR	1.2%	-0.3%	9.9%	8.0%	9.8%	7.2%	12.8%	15.6%
SA All Bond Index (ALBI)	ZAR	-0.6%	5.3%	10.4%	8.1%	7.3%	9.7%	7.8%	7.7%
Global Bonds (Citigroup)	ZAR	5.6%	1.6%	-2.0%	4.2%	5.8%	7.4%	11.9%	14.4%
COMMODITIES									
Gold (US Dollars)	USD	-1.3%	-0.1%	2.7%	3.0%	-1.3%	3.9%	15.2%	18.1%
Gold (Rands)	ZAR	5.9%	2.2%	-1.4%	4.4%	3.3%	9.3%		
CURRENCIES									
Rand / Dollar	ZAR	7.3%	2.3%	-4.0%	1.3%	4.7%	5.2%	13.4%	16.5%
Rand / GBP Pound	ZAR	3.6%	0.6%	-1.0%	-3.2%	2.0%	1.1%	15.0%	15.5%
Rand / Euro	ZAR	2.7%	-0.6%	-0.3%	3.5%	2.5%	2.2%	12.2%	13.1%

Spot Rates		1-Jun-18	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US$	Rand	12.65	11.85	13.10	9.93	7.83	5.89
Rand/GBP	Rand	16.86	16.62	17.02	15.05	15.58	9.84
Rand/EUR	Rand	14.75	14.57	14.94	12.90	12.33	-
RATES							
Libor 6m $	US$	2.47	2.45	1.45	0.41	3.11	5.78
Repo Rate	Rand	6.50	6.50	7.00	5.00	12.00	20.21
Prime	Rand	10.00	10.00	10.50	8.50	15.00	22.25
All Bond Index Yield	Rand	9.24	8.62	9.49	7.93	-	-
COMMODITIES							
Gold ($/oz)	US$	1,301.83	1,323.43	1,243.47	1,215.43	922.60	297.65
Platinum	US$	903.00	936.00	922.00	1,317.00	2,064.00	357.25
Oil (Brent Crude) $	US$	76.54	70.09	47.82	102.61	139.39	12.14
INFLATION							
SA Inflation	%	-	3.8	5.1	5.5	11.4	-