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GLOBAL PERSPECTIVES

THE NEW DAWN

African politics shakes off the blight of corruption

Crumbling Iran nuclear deal a potential game-changer

Pax Africana: How (South) Africa can forge its own economic destiny

ASHBURTON INVESTMENTS

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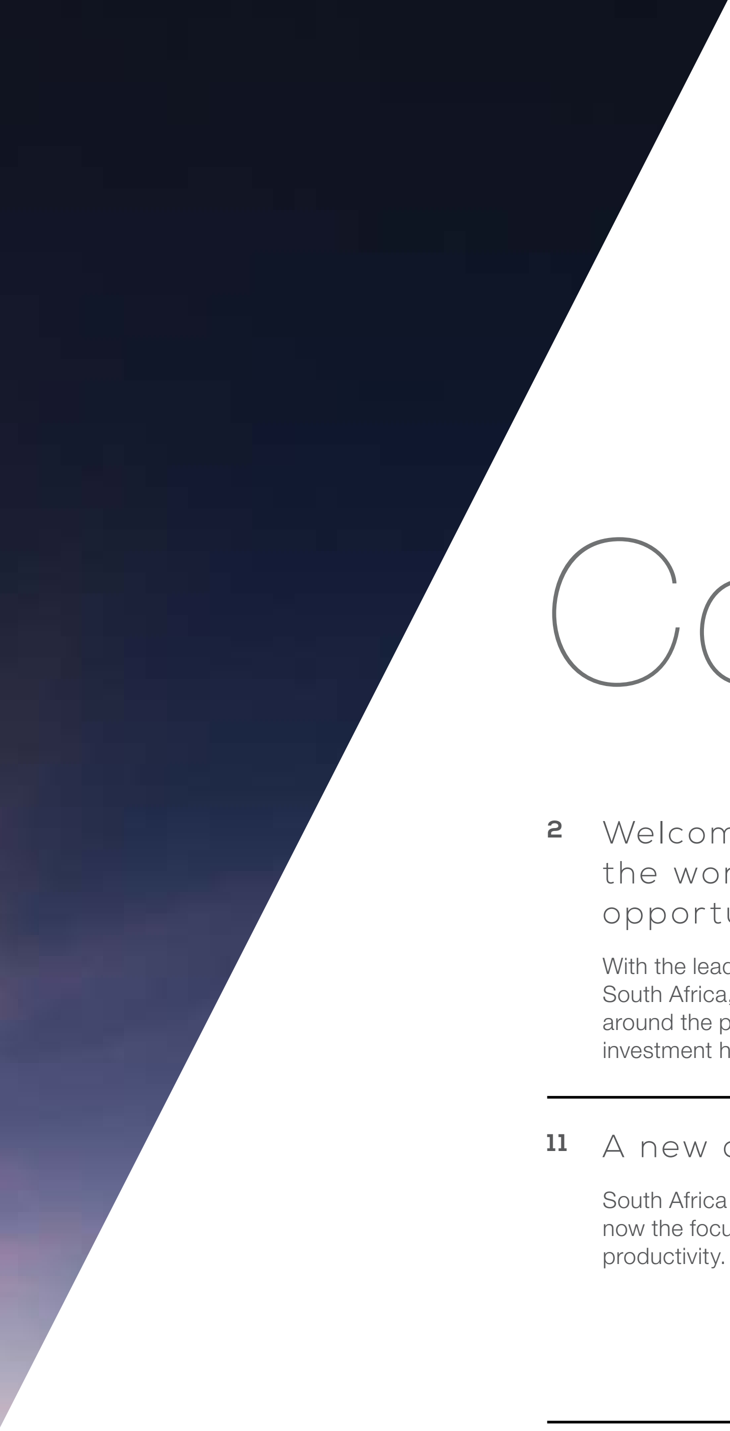

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Welcome to the world of opportunity

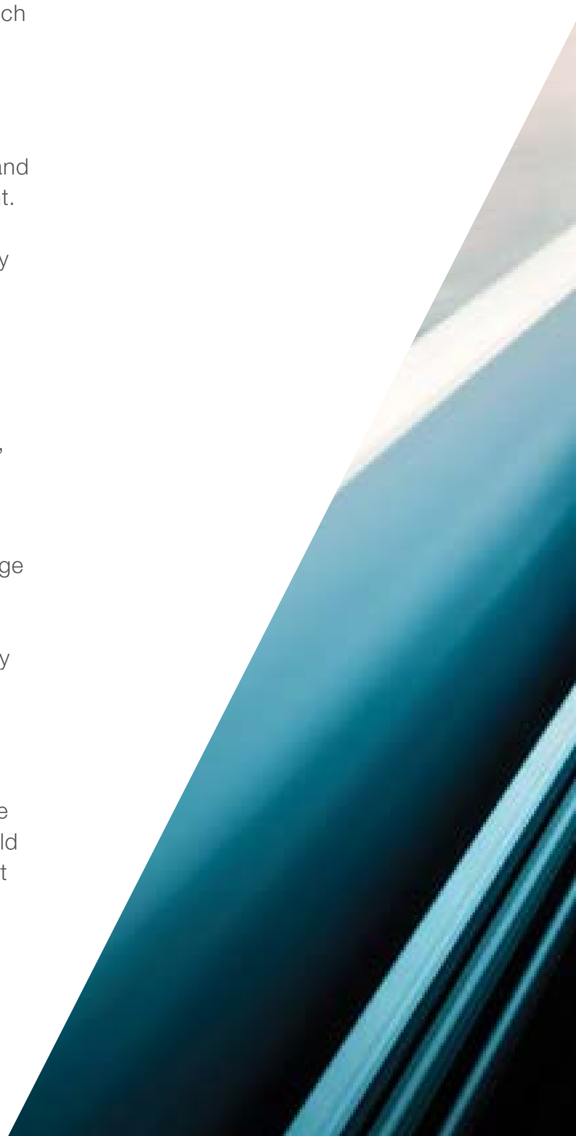
BOSHOFF GROBLER
CEO:
Ashburton Investments

Optimism was in short supply in 2017, in spite of sustained and generally in-sync global growth. Uncertainty continues to swirl around United States President Donald Trump (most recently around his withdrawal from the Iran nuclear deal), as well as concerns around Brexit negotiations, trade wars and political realignments here in Africa. Fortunately, 2018 has brought with it some welcome and notable shifts.

This is particularly true of Africa, which closed 2017 with new leadership in Zimbabwe, Angola, South Africa, Ethiopia and Liberia. These political movements have ushered in new economic and social opportunities and talk of a 'new dawn' for the continent.

But Africa does not have a monopoly on this good news feeling, as Simon Finch and Craig Farley point out in their contribution to this edition of Global Perspectives. This buoyant outlook certainly extends to the dynamic markets of China and India, and we take a closer look at the fortunes of both these markets.

Of course, given the leadership change in South Africa early this year, a new optimism around the potential for investment here has emerged. Murray Anderson speaks of the attraction for foreign investors in his article, but also points out that how we manage our economy in the future will be of paramount importance. In spite of the upswing in sentiment, investors should continue to look for opportunities that



will achieve a balanced mixture of offshore diversification and exposure alongside a pro-South Africa and emerging markets stance.

In a similar vein, and using an Africa lens, Nkareng Mpobane invites us to look beyond our own backyards when it comes to investing and shares compelling data on the diversification achieved by investing in Africa ex-SA equities, not just for developed world investors but also for those investors based out of South Africa.

Africa, of course, continues to be of particular interest given the shifts in accountability and perception, as well as the political shifts during the course of 2017. Paul Clark provides an eminently readable article which looks at developments in a post-Dos Santos Angola and a post-Mugabe Zimbabwe. While this upbeat view of Africa's growing political maturity is encouraging, it is important to note that more needs to be done to entrench democracy across the continent.

Given the significant impact of Cyril Ramaphosa taking over as South African President in February 2018, much of the 'new dawn' feeling at the tip of Africa has to do with the promise of this new administration. Mark Appleton takes us through the ingredients needed to unlock South Africa's potential and provides a realistic assessment of growth potential in the near future, while Rahima Cassim urges South Africa to look outwards, to the rest of Africa, in an effort to forge its own economic destiny. In keeping with this theme, Corneleo Keevy considers these current political changes in the context of credit downgrades – which seriously derailed South Africa's investment standing in 2017. For now, and provided the likes of Appleton's advice finds traction, South Africa has been given a stay of execution.

If one word seems to encapsulate the feeling of 2018, it's mindfulness. We saw this playing out at the World Economic Forum in Davos at the start of the year and, with the growing focus on the emerging knowledge economy and fostering inclusivity in the global economic structure, we certainly seem to be stepping towards a world in which politicians are being held to account, societies are drawing a line in terms of gender discrimination and cultural bias, and where investing considers its impact as well as the bottom line.

Yes, a new dawn is upon us. It behoves us as an industry to be forward-thinking – to be mindful - in our approach, to measure opportunity with responsibility and to create platforms for investing which offer diversification, global options and solid fundamentals.

> "If one word seems to encapsulate the feeling of 2018 it's mindfulness".

NKARENG MPOBANE
CIO, Public Markets:
Ashburton Investments

Using diversification to cut through the fog

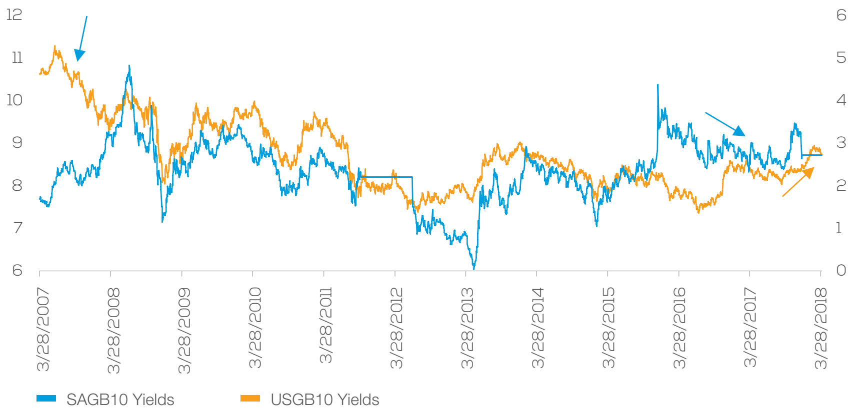
Globalisation and the information age have forged a more fluid world, not just from an investment perspective, but also from a social awareness standpoint. It's a world which challenges investors to look beyond their own back gardens.

The latest conversations to come out of the World Economic Forum in Davos earlier this year highlighted the important emergence of the knowledge economy as well as inclusivity across global economic structures. With political uncertainty diminishing the certainty of stable returns, the case for geographic diversification has seldom been stronger. However, one only has to scan the African continent for notable political shifts that have dramatically changed the outlook for 2018 and beyond to appreciate the new opportunities on the horizon.

If one assumes fair pricing of country specific risks, then these risks should be fully reflected in all asset prices. This means that one way to reduce exposure to such risks would be to look elsewhere. Investors would invariably diversify their wealth to reduce the risk of their portfolio losing total value. After all, because good diversifiers generally have weak, negative or no relationship with other asset classes they may maintain, or even increase in, value when other asset classes in the portfolio lose value.

Often when country risk spikes, asset prices elsewhere may not react or could even move in the opposite direction. For example, during the global financial crisis, South African bond yields spiked, meaning the value of South African bonds declined, while United States bond yields trended lower, meaning that the price of those bonds rose as investors searched for safe havens. The same happened during South Africa's 'Nenegate' fallout in December 2015, and more recently the opposite unfolded as positive political changes locally resulted in a return in investor confidence. In contrast, concerns over United States trade policy and fiscal stability have seen bond yields creep steadily higher following United States President Donald Trump's election to office (among other reasons, such as the signalling of higher rate policies from that country's Federal Reserve).

SA GENERIC 10-YEAR BOND YIELD VS US GENERIC 10-YEAR BOND YIELD



Source: Ashburton Investments, Bloomberg

"A developed market investor could thus achieve more diversification by investing in Africa ex-SA than emerging markets".

	Africa ex-SA	World	GEM	Frontier	S&P 500	China	India	Egypt	Nigeria	South Africa
Africa ex-SA	1									
World	0.24	1								
GEM	0.30	0.81	1							
Frontier	0.52	0.40	0.39	1						
S&P 500	0.16	0.94	0.70	0.33	1					
China	0.14	0.18	0.30	0.16	0.13	1				
India	0.29	0.59	0.74	0.35	0.51	0.20	1			
Egypt	0.71	0.25	0.32	0.41	0.18	0.15	0.31	1		
Nigeria	0.59	0.08	0.07	0.33	0.05	0.05	0.08	0.26	1	
South Africa	0.20	0.77	0.85	0.30	0.66	0.18	0.58	0.20	0.03	1

Source: Ashburton Investments, Bloomberg, March 2018

Often it is said that for emerging market investors the best home for your offshore allocation is in developed markets. And the opposite is said to be true for developed market investors. But is this really the case? For simplicity's sake, let's consider offshore diversification from the perspective of a South African and a developed market investor.

The correlation table above reviews the diversification benefit potentially gained in accessing African equity markets.

Shown here, the diversification benefit is very clear, not just for a developed market investor investing into Africa ex-SA equities (see World and Standard & Poor's correlations as a proxy), but also from a South African investor's perspective, where the correlation coefficient is just 0.20. Note that a coefficient of 1 would mean that markets are completely correlated, whereas zero indicates no correlation at all, where correlation explains the strength in relationship between those equity markets shown. The lower the correlation, the weaker the relationship. A developed market investor would thus achieve more diversification by investing in Africa ex-SA than emerging markets (see correlation of Global Emerging Markets (GEM) versus the World Index or the S&P 500 of 0.81 and 0.70 respectively).

The reasons for investing in Africa ex-SA have been numerous in the recent past. Improving economic conditions have set the continent on an expansion path for the foreseeable future. Furthermore, with inflation expectations declining, this has teed up discussions for lower interest rates across the various geographies. These trends are generally positive for equity markets. Furthermore, smart investors have begun the rotation out of fixed income investments into African equity markets as interest rates expectations trended lower.

While the positive news out of Africa is often predicated on a rising commodity cycle, we believe that the underlying fundamental changes happening in the faster advancing economies are irreversible and should continue to generate significant growth. Infrastructure has been a significant story, while consumerism and an industrialising middle-class have supported our positive longer-term outlook. Negative headlines from the continent typically focus on the worst issues and incidents that occur, and this has typically resulted in oversold levels across these equity markets. But our view is that investors can continue to realise good returns over the medium term.

To his credit, the (now former) Finance Minister of South Africa, Malusi Gigaba, increased the prudential limits that allow pension funds to invest a portion of their members' funds outside the country. Specifically, the limit for African investing outside of South Africa was

"Smart investors have begun the rotation out of fixed income investments into African equity markets as interest rates expectations trended lower".

raised from 5% of the pension fund's assets to 10%.

For the year ended March 2018, the Ashburton Africa Equity Opportunities Fund has returned 45% against the MSCI Africa ex-SA Index which returned 28%.

Risks of offshore diversification

Investing outside of one's home market to provide protection from local asset price pressure invariably introduces a further risk: currency risk. The argument can be made, however, that currency risk is already embedded in most portfolios since it is often reflected in bond prices (an input into the fair valuation of equity prices).

So, while conversations around inclusivity are incredibly important on the world stage, one must also consider the very real impact of contagion and synchronised global recession. If the global financial crisis taught us anything it is that the world is smaller and more interconnected than it has ever been and while it has made geographic diversification easier, it may also leave it less effective.

Verdict: Is it worth the trouble?

Offshore diversification may not provide the best returns in any one year, as has been evidenced in Africa through the recent cycle, but in the context of lowering risk, diversification is vital in successfully executing a balanced mandate. With rising geopolitical risks and increased volatility across many emerging and developing markets, there is a strong case to be made for placing your eggs in as many baskets as possible.

Nkareng Mpobane,
CIO Public Markets

Nkareng Mpobane is Chief Investment Officer for Public Markets. She has over 13 years' experience in the investment industry. Prior to this role, she was the Head of Financials for South African investment process, responsible for all research analysis within this sector. Nkareng has a BCom degree in Economics from the University of the Witwatersrand.

A new dawn

MARK APPLETON
Head of Multi Asset and Strategy:
Ashburton Investments

"I wanna be there when the people start to turn it around".

Quoting a line from a song by the late legendary jazz artist Hugh Masekela, South Africa's new President, Cyril Ramaphosa, delivered an inspirational State of the Nation Address in February 2018 during which he alluded to a 'new dawn'.

"We should put behind us the era of diminishing trust in public institutions and weakened confidence in leaders," was a key statement to come out of the address. Statements such as this show that President Ramaphosa is clearly keenly aware of the issues facing South Africa, and appears to be sensitive to the challenges ahead. During his first address as State President, he spoke of a necessary collaboration between business and labour, the need to ensure economic growth, and a requirement to encourage significant new investment. In addition, he indicated that some tough love was needed to close the fiscal gap, stabilise debt and restore state-owned enterprises to health.

These statements were like a breath of fresh air. A new leader with a credible vision was always likely to be seen as a positive by investment markets, and so far, this has proved to be the case.

At the end of the day it all comes down to good governance. Investing in a country is like investing in a company. Over and above the business case there has to be a competent and honest management team that can be trusted to deliver on strategy. Unfortunately, over the past few years when the rest of the world has been enjoying significant economic vitality, South Africa has been dogged by a lack of confidence both from the consumer and business. The consequence has been a declining private sector investment experience.

The consideration now is just how bad this decline has been? What's it going to take to turn it around? And just how good can it potentially get?

South Africa's potential gross domestic product (GDP) growth rate has slipped from around 3.5% (1995 to 2008) to less than 1.5% by some estimates from 2010 onwards. This is barely ahead of the population growth rate.

Economic growth is a consequence of people plus productivity. South Africa has the people (in fact the country is in a demographic sweet spot) so it is now all about unleashing productivity. So how do you do that?

"A new leader with a credible vision was always likely to be seen as a positive by investment markets, and so far, this has proved to be the case".

The ingredients needed to unlock this potential include:

- Increased investment typically leads to increased productivity. A constraint is that low levels of disposable income lead to low domestic savings and consequently low investment. **Attracting foreign investment** is a way to break out of this conundrum. South Africa is capital hungry and a demonstrable move to good governance will go a long way in achieving this.

- **Efficient financial markets** play a crucial role in allocating capital to investment markets. Fortunately, this is one of South Africa's strong points.

- **Political stability, rule of law and the protection of property rights.** A lack of any of these, increases risk and discourages investment. New and improved governance will go a long way to providing a stable base for economic growth. The land expropriation without compensation debate is, however, a potential threat but hopefully it will be dealt with in a responsible manner.

- **Education and healthcare.** Poor quality education constrains skills and productivity. There is a clear recognition of this problem in South Africa and free tertiary education coupled with a potential partnership with the private sector should see an improvement in producing skilled workers. Poor health is another impediment to growth and a move to national health insurance (albeit complex from a funding perspective) would be positive in the long term.

- **Tax and regulatory systems** play a significant role in supporting economic growth. Lowering barriers to entry from a regulatory perspective would be a big plus for South Africa's economic growth. More efficient government and higher economic growth would likely lead to lower potential tax rates over time, which would reinforce a virtuous economic cycle.

- **Free trade and unrestricted capital flows.** The more open the economy the more global savings can help to finance domestic investment.

Mark Appleton, Head of Multi Asset and Strategy

Mark Appleton is Head of Multi Asset and Strategy at Ashburton Investments with a primary focus of tactical asset allocation. He has over 35 years of investment management experience, having managed the Unilever Pension Fund followed by a five-year stint as Chief Investment Officer for Marriott Asset Management. Mark has been with FNB Securities as Chief Investment Officer for over 12 years and Ashburton Investments as Head of Multi Asset and Strategy (SA) for three years. Mark is a CFA charter holder and has also earned a BCom in Economics from the University of the Witwatersrand and a post-graduate Diploma in Financial Planning from the University of the Free State.

"South Africa could possibly get to a potential growth rate of 3.7% or more".

If South Africa gets it right, then the upside potential is enormous. Let's try to quantify this. Starting with our 1.5% potential growth rate as our base the following could potentially be added:

- 1.5% - current potential growth PLUS
- 0.5% - from mining and manufacturing on the back of improved confidence PLUS
- 0.6% - from telecommunications reforms PLUS
- 0.6% - from competition policy and research PLUS
- 0.3% - from transport reforms PLUS
- 0.2% - from enhanced agriculture and tourism AND
- In addition to the above: privatisation, education and labour reform could add even more potential growth.

So, South Africa could possibly get to a potential growth rate of 3.7% or more.

If this were to happen, what would it mean for investment markets?

Potential GDP growth is a critical input with respect to evaluating the investment appeal of various asset classes and the securities that make up those asset categories.

A high potential growth rate means that strong economic growth can be achieved without triggering a strong inflation effect. This means that the Central Bank does not have to raise interest rates to quell this pressure. Low inflation and low policy rates are clearly positive from a bond market perspective.

From an equity perspective, the effect is marked. High levels of economic growth underpin revenue and earnings growth potential and low discount rates (low interest rates) mean that the present values of those buoyant future earnings streams are boosted.

Implementation is key, but if South Africa can get it right then a new dawn will most definitely have arrived.

Pax Africana: How (South) Africa can forge its own economic destiny

RAHIMA CASSIM
Fund Manager:
Ashburton Investments

South Africa is a country of tremendous promise. It's a dynamic land with the potential for integrated prosperity. Sadly, in the recent past, the forces created by this dynamism have failed to live up to the country's potential. Rather than focusing inwards, many now believe South Africa's secret to success may require looking outwards, to Africa.

As apartheid polarised South Africa and its inhabitants it produced an insulated breeding ground for businesses to grow in order to supply the country with products and services which were made inaccessible by sanctions. Post-apartheid, underlying trends such as an expanding emerging middle class then became positive structural underpins to growth. But currently, corruption and xenophobia are among the many ills leeching away at South Africa's ability to entrench itself as a global African leader.

One strategy South Africa can deploy in an effort to prosper is to leverage off the rest of the African continent through cross-border trade. Going hand-in-hand with this approach would be providing an enabling environment for fellow African investors to invest in South Africa. A vast opportunity lies in this pan-African potential.

In 1967, during the first decade of the 30-year-long Cold War, eminent Kenyan intellectual Ali Mazrui (in his treatise *'Towards a Pax Africana: A Study of Ideology and Ambition')* asked that Africans - rather than outsiders - consolidate and create peace on the African continent. The chance Africans had to independently solidify the governance of their continent was, however, lost as Pax Americana flourished and weapons and war caused destruction in Africa, even as the Cold War reached a bloody end in the 1990s. Mazrui then asked the question: "Now that the imperial order is coming to an end, who is to keep the peace in Africa?".

The geopolitical game

Pax Americana is defined as a state of relative international peace, overseen by the United States and the United Kingdom. What began as a geopolitical platform off which to prosper economically by creating free trade under an umbrella of peace, turned into a stage for military might. This further entrenched the gulf between

the ‘haves’ and the ‘have-nots’. As Pax Americana wanes, Russia and China are filling the vacuum. Now, more than ever, it is imperative that Africa – and South Africa as a consequential inhabitant of the continent – finds the path to achieving economic equality on a global scale.

In his *Pax Africana*? speech, delivered in 2016 at the Munich Security Conference, former United Nations Secretary-General Kofi Annan noted that while Africa had achieved a 5-6% economic growth rate, as well as a 40% fall in poverty since 1990, this growth was neither sufficient nor inclusive. Africa remains the second most unequal continent in the world, he said. Yes, a small minority have benefited, while investment in infrastructure, health and education – the key focus areas required to foster development – have stuttered. This has resulted in the shocking statistic that 40% of those who joined rebel movements were motivated to do so by a lack of employment opportunities.

While South Africa is less exposed to faction fighting and terrorism, social unrest is gaining traction. An idle mind truly is the devil’s workshop, one reason why it’s imperative that the intellectual capital of the continent is nurtured by increasing the amount spent on education – with the hope that this skills increase will inevitably lead to job creation. Fostering public-private partnerships will not only address short-term deficits, but is a way to share and transfer skills and knowledge across borders. Over time, education and an increase in skills will help to alleviate the need for foreign aid to Africa, as economic growth will be bolstered by stronger economic institutions that provide traction for this gain. In this way, Africa will take its economic destiny into its own hands.

Unlocking the opportunities

Deficits produce opportunity, and opportunity abounds in Africa as countries industrialise and sectors

“Corruption and xenophobia are among the many ills leeching away at South Africa’s ability to entrench itself as a global African leader”.

evolve in areas such as energy generation, infrastructure and distribution, and technologies that drive more competitive manufacturing. Potential private-sector investors on the continent should look to these longer-term trends as rich opportunities.

Adopting a Pan-African approach will allow smaller African countries to gain the scale needed to be competitive on a vast continent which continues to face considerable challenges, not least of which includes logistics. Economic institutions like the African Union and free trade agreements such as the Southern African Development Community (SADC) and New Partnership for Africa's Development (NEPAD) are important steps on the road to achieving a Pax Africana. But there is still much that needs to be done.

Many inroads have already been made by South African companies into the rest of Africa (the most recent being Sanlam with its US$1.6 billion investment in Saham, a pan-African insurance company). However, the track records of these businesses when operating across the rest of the continent have been patchy. If South Africa can facilitate more dominant pan-African investment strategies for its public sector it would go a long way towards creating an interesting and alternative investment hub. Investors who want emerging markets exposure will then have the ability to invest in a country that has a strong legal and financial underpin, thereby providing less risky exposure to the diversity of the African continent. At the same time, investors who want developed market exposure will find opportune examples in those South African companies that have grown offshore. There are very few examples of investment destinations that provide this ability to diversify investment portfolios.

Pax, the Roman goddess of peace, is often depicted holding a cornucopia. Africa certainly holds the potential horn of plenty. In order for economies to prosper, stability is an imperative. If South Africa can be the nexus that drives this consistency then, to answer Mazrui's question, the resultant peace and economic prosperity will have been hard won. But it will be well worth it for the fortunes of the continent.

Rahima Cassim, Fund Manager

Rahima Cassim has been a Fund Manager at Ashburton Investments since 2016 and has more than 10 years of industry experience. Rahima started her career as a fixed income and money market dealer before moving on to equity research as a cross-sector analyst. She has experience covering different asset classes (fixed income, equity and property) in the pension fund, asset management and sell side industries. She studied BCom Investment Management at the University of Pretoria and obtained her MBA from Henley Business School.

"If South Africa can facilitate more dominant pan-African investment strategies for its public sector it would go a long way towards creating an interesting and alternative investment hub".

A blended approach that works

SIMON FINCH
Fund Manager:
Ashburton Investments

CRAIG FARLEY
Fund Manager:
Ashburton Investments

Combining Indian rogan josh with Chinese dumplings may seem like an odd marriage. But, as the performance of the Ashburton Chindia Equity Fund demonstrates, investor appetite evolves to follow opportunities and sometimes combining two positive stories makes for an inspired dish.

The optimistic outlooks for both India and China continue to inspire investor interest but, like all successful long-term investing, gaining exposure to these markets requires adaptability and evolution of style in what is an increasingly fast-changing investment environment.

Ashburton Investments has a long heritage of successful investing in markets outside the developed market space, one which stretches all the way back to the 1980s. Furthermore, we have been pioneers in recognising the potential investment returns in Asia. In the mid-2000s, the decision was taken to map this extensive regional expertise with our strategic vision of the future; in this scenario China and India stood out as countries with the highest long-term return potential for our clients. The Ashburton Chindia Equity Fund concept was established and launched in 2006 as a focused emerging market offering.

During the infancy of the fund, the decision was taken to apply a fundamental investment approach to allocating capital and managing risk in both countries, essentially combining a top-down macro thematic overlay with a bottom up stock-picking approach. The emphasis on overall process and methodology was highly qualitative; a blueprint which had formed the cornerstone of Ashburton Investments' investing success across regions for years.

India lends itself extremely well to this approach. The country's stock exchanges are some of the oldest in Asia, resulting in an established culture of equity ownership. Market depth and liquidity are rich, while standards of corporate governance and accountability are high in aggregate, bolstered by the rule of law introduced by the British that facilitates external checks and balances. Finally, India offers among the best corporate management in Asia (if not globally) and unrestricted access to senior management. As a foreign minority shareholder we are able to align with the strategic vision of the company and take a long-term view on every investment made.

Early efforts to apply the same methodology and process to Chinese equities resulted in vastly different investment outcomes for ourselves and clients. Simply put, a chasm had developed between China's speed of economic progress and the (under) development of the capital markets. While cognisant of China's long-term potential and strategic efforts to improve access, liquidity, regulation and transparency at the corporate level, Ashburton Investments (and a plethora of active managers) were not able to apply the traditional approach with the same level of success. Our experience during the global financial crisis was a steep learning curve, laying the foundation for a comprehensive review of the way in which we invested in China.

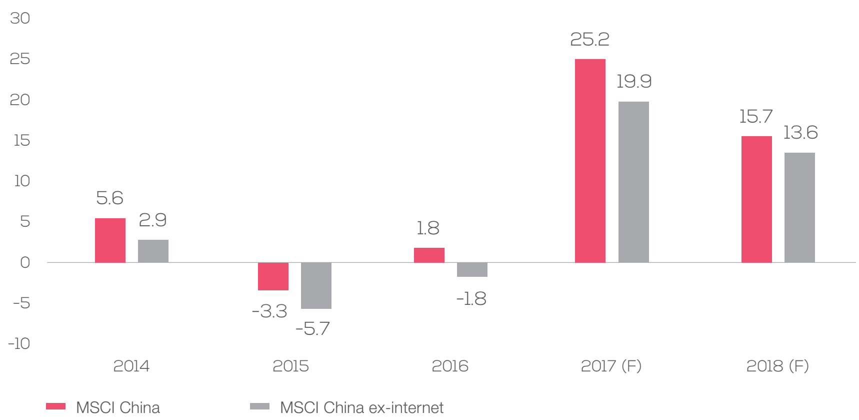
What followed was an extensive period of intensive research and development. Our objective: to cultivate a rules-based strategy to enable the fund managers to adhere to the investment process through market cycles, especially during periods of stress and dislocation. The project was undertaken in conjunction with Ned Davis Research Inc., a world-class research hub based in Florida, United States that specialises in building objective, systematic models to bolster market timing and stock selection capability. Ashburton Investments' strong partnership with Ned Davis Research extends back over 15 years.

Our China quantitative process became operational in 2012 and has been incorporated within the Ashburton Chindia Equity Fund since July 2014. From that point, the fund has delivered strong outperformance over and above the MSCI Emerging Market Index benchmark, with country allocations and stock selection in both China and India adding value. We remain committed to the focused, dual-country allocation and a concentrated portfolio of stocks in each region, rather than diluting the potential outcomes from these two fast-growing nations through a broader investment approach. The rationale underpinning the blended approach remains consistent: to deliver the best outcome for clients.

Sentiment shift

As investors, we operate in a world of probabilities rather than certainties. One exception to this rule is the uncanny ability of capital markets to confound consensus thinking, creating a shift in psychology. Heading into 2018, the mood among financial market practitioners was ebullient, with equities soaring on the back of abundant liquidity, an extended period of ultra-low volatility, a 'Trump bump' and FANG (Facebook, Amazon, Netflix and Google) mania. Fast forward to the current day, and stocks are stumbling hard, with nervousness and anxiety prevalent as attention has migrated towards the realities of spiralling debt, inflation, geopolitical instability and the unpredictable behaviour of United States President Donald Trump.

MSCI CHINA EARNINGS GROWTH (YEAR-ON-YEAR %)



Source: CLSA, Factset

"Corporate China finds itself in its strongest position since the global financial crisis, offering a rare degree of visibility in an increasingly unpredictable global environment".

China in the spotlight

China remains firmly in the spotlight given the escalation in trade tensions with the United States. With no clear answer as yet around whether the conflict remains relatively contained, or will intensify into a genuine and sustained altercation, downside pressure on share prices is the path of least resistance. It is clear that tail-risks are rising and China will not be immune from emerging market pressures in the short term. However, the news is not all bad. Viewed objectively, the argument can be made that corporate China finds itself in its strongest position since the global financial crisis, offering a rare degree of visibility in an increasingly unpredictable global environment.

An exciting development for China watchers has been material evidence that China Inc. has emerged from the earnings slump of the past few years. The pick-up has not just been about internet and e-commerce, but has been broad-based across sectors, from materials to consumer-related to the real-estate companies. This is clearly important, because while the internet sector comprises about 40% of the MSCI China Index by market capitalisation, it represents half that (roughly 20%) when measured by earnings. Earnings growth for 14 out of 24 sub-sectors in 2018 is expected to be greater than 20%, based on current consensus figures, while even banks could register 10% growth if the current pace of upgrades continues (based on data from CLSA investment bank).

Margin improvement and free cash-flow generation at the operating level has also historically been lacklustre, particularly when measured in a global context, but even here the trend has been improving. The bulk of cash flow is being generated outside the technology sector and several companies have delivered positive dividend surprises to the market. Old economy stocks (materials, energy and telecommunications) are producing three times the cash flow of China's well-flagged 'new economy' sectors (internet, healthcare and consumer stocks), offering a yield of around 6.5%.

Turning to valuations, the addition of several internet companies to the market in 2015-16 has significantly altered the composition of the MSCI China Index (comprised of H-shares listed in Hong Kong and United States-listed American Depository Receipts). This makes historical comparisons difficult, even on a short- to medium-term basis. Removing the internet sector, MSCI China remains attractively valued on a price-to-earnings and price-to-book basis measured in a regional and global context at 9.2x and 1.2x respectively. At the same time, investors are witnessing a strong turnaround in both the quantum and quality of earnings for ex-internet sectors.

Nifty moves from India

India too is witnessing an upturn in fortunes for its earnings cycle. Recent past expectations for earnings for the Nifty Index, for example, have been in the high teens, but since 2014 have consistently proved disappointing for investors, with the 50 Nifty Index stocks delivering aggregate earnings in the low single-digits. However, for the period ending 31 March 2018, a mid-teen earnings growth figure was announced, providing a timely respite to the market.

This development comes in the wake of Prime Minister Narendra Modi implementing some rather challenging reform measures over the past couple of years. In November 2016, we had the shock of demonetisation which led to the cancellation of nearly 87% of India's cash currency. This was followed, in July 2017, by the much-delayed introduction of a pan-Indian Goods and Services Tax (GST).

Demonetisation has been credited, in part, with shifting idle money into action. Whether that be into one of the nearly 300 million bank accounts opened in the past three years, or investment into a new business enterprise, or being invested in the domestic equity market, India displayed its resilience to this overnight decision. This rebound has been apparent in numerous positive corporate earnings announcements since the beginning of 2018, a condition we believe will continue to improve.

The arguably hurried introduction of GST resulted in significant teething issues, but the continued refinement of taxes has helped to alleviate the pain suffered in the unsettled opening months. With this fine-tuning now largely behind us, companies are better placed to move forward with greater certainty around the tax regime applicable to them, and customers are also taking advantage of the improvement in transparency around pricing. All of this, supported by a depressed comparative number, has provided a more favourable outlook for earnings.

At the time of writing, India was one of the worst-performing emerging markets on a year-to-date basis, largely due to external factors such as the sharp oil price appreciation, with India being a significant net importer. This interim weakness could be attributable to other factors, including its recent position as a favourite foreign investor investment destination, a ranking that took a knock when investors began reducing their exposure and booking profits. However, the economy's underlying strong fundamentals remain intact. The urbanisation shift is well underway and is being supported by the youthful population moving to cities and towns, which is providing a boost for housing- and consumer-related companies. The government is targeting re-election in less than 12 months, thus its focus is on job creation while infrastructure investments are also at record highs. This is boosting employment and earnings potential for industrial and materials companies.

"India remains the leading foreign direct investment destination and will see its growth profile increasing in the years to come".

Rosy glow for China and India

The bottom line is that, viewed objectively, the aggregate earnings outlook for corporate China looks reasonably healthy at this juncture, underpinned by an attractive valuation backdrop. That said, monetary conditions are clearly tightening and pressures are building for companies that rely on funding channels outside the formal banking system. It will be interesting to see if Beijing is genuinely prepared to remove the implicit government guarantee that has not backstopped to the profligate lending practices of years gone by.

Ashburton Investments does not rely on any economic data or forecasting in our decision-making framework to allocate capital and manage risk in China. The managers continue to pay close to attention to our models. As of now, China country positioning reflects the recent bullish model signal but we remain aware of the fact that the equity market landscape can change quickly. We will be swift to act if need be.

India remains the leading foreign direct investment destination and will see its growth profile increasing in the years to come, with a pick-up evident in the December 2017 data. Ultimately, India's GDP growth will edge towards 8%, the sort of performance that China has witnessed for more than the past two decades.

There is, indeed, a new dawn on the horizon for both of these senior emerging markets. Of course, external events will always impact investor sentiment at the margin and depress equity prices in the short term, but increasing exposure to both markets remains an attractive opportunity, particularly as their visibility relative to the rest of the world continues to improve.

Balancing the unique flavours of both markets has proved a worthwhile investment approach in recent years. And the requirement for a blended approach to China and India has certainly been borne out in the numbers over the past five years or more. We believe this position will continue to demonstrate the most appropriate way to access and invest in these two great nations.

Simon Finch, Fund Manager

Simon Finch is a Fund Manager at Ashburton Investments. He is responsible for managing the India Equity Opportunities Fund and assisting with the management of the Chindia Equity Fund. Simon joined Ashburton in 2007 and has 16 years' experience in the finance industry. Prior to joining Ashburton, he qualified as a Chartered Accountant in 2004, becoming a Fellow in 2014.

Simon has a BA (Hons) in Finance from the Nottingham Business School. He also holds the Investment Management Certificate.

Craig Farley, Fund Manager

Craig Farley is a Fund Manager at Ashburton Investments and Lead Fund Manager for the Chindia Equity Fund and the China Optimal Equity Solution. Craig joined Ashburton in 2003 and has 14 years' experience in the finance industry. Prior to his current role, he worked on the Americas Fund, before moving to manage Asian equities in 2005.

Craig graduated from the University of Reading with a degree in Business and Management. He holds a Masters in Finance and Investment Management from the London School of Business and Finance, specialising in quantitative statistics.

The Chindia Equity Fund has won consecutive Raging Bull awards in 2016, 2017 and 2018 for top investment performance.

A new dawn, a new day, a new opportunity

1 IN 4 PEOPLE on the planet will be African by 2050.

2x The rate at which emerging markets are expected to outpace advanced economies in terms of growth by 2050.

2050 The year by which India could replace the United States as the world's second-largest economy.

90% Of people around the world have a mobile phone.

US$130-170 BILLION
The annual spend required by Africa on infrastructure development, far in excess of the US$93 billion figure touted previously.

88%
The number of companies, globally, that believe they must redesign their organisations to succeed in a digital age.

76% Of banking account holders make use of digital payments. In Kenya this number sits at 97% and in China it is 68%.

75 The number of years, combined, which Angola's Jose Eduardo dos Santos and Zimbabwe's Robert Mugabe held in office before both vacating their respective presidencies in 2017.

515 MILLION
Adults around the world opened a bank account in the last three years. Since 2011, 1.2 billion individuals above the age of 15 opened an account.

US$2.9 TRILLION
The amount the world has invested in renewable energy sources since 2004.

1st

Angola's first planned international debt sales sold at US$397 of 10-year paper in May 2017. The country is promoting 10-year, dollar-denominated bond.

645.71 MW

The collective megawatt contribution of South Africa's five largest renewable energy projects to the national grid. All are multimillion-rand wind farms. All renewables add 3 773MW to the grid, compared with 43 485MW being delivered by fossil fuels.

68%

The average progress on closing the global gender gap, weighted by population. This means an average gap of 32.0% remains to be closed worldwide, compared with 31.7% in 2016.

102 YEARS

The time projected to take sub-Saharan Africa to close the gender gap, compared to 61 years in Western Europe, 62 years in South Asia, 79 years in Latin America and the Caribbean, 157 years in the Middle East and North Africa and 168 years in North America.

130%

Cumulative global gross domestic product (GDP) growth projected between 2016 and 2050.

18

The number of presidential and parliamentary elections, including the DRC's delayed poll, which are due to take place around Africa in 2018.

2%

Africa's share of global manufacturing in 2013, down from 3% in 1970.

58%

Of people around the world have access to the internet.

Number of global companies that already have an open and flexible career model in place.

US$11.1 TRILLION

The economic value which could be generated by the Internet of Things (IoT) by 2025.

10

All 10 of the global economies where mobile money ownership is higher than financial institution account ownership are in Africa: Burkina Faso, Chad, Côte d'Ivoire, Gabon, Kenya, Mali, Senegal, Tanzania, Uganda and Zimbabwe.

Sources: The Global Gender Gap Report 2017; 2017 Global Human Capital Trends (Deloitte); World in 2050 (PwC); Making Progress Towards Attaining the Sustainable Development Goals in Africa (Africa Progress Group); Foresight Africa (Brookings); McKinsey & Company; Electoral Institute for Sustainable Democracy in Africa; African Economic Outlook 2017 (African Development Bank); 2017 Global Findex database (World Economic Forum); Financial Times; Global Trends in Renewable Energy Investment 2018; Business Insider South Africa; Business Day


Bob
RESIGN NOW!!

African politics shakes off the blight of corruption

PAUL CLARK
Fund Manager:
Ashburton Investments

A global survey by Transparency International earmarks political parties and elected representatives as most corrupt, based on perceptions. They are closely followed by police. Could this viewpoint be changing across Africa as we see the political careers of some of the continent's longest-serving leaders coming to an end?

Throughout most of 2017 the four longest-serving rulers in the world (except for royalty, of course) were from Africa. By the end of the year one of these strongmen, Jose Eduardo dos Santos from Angola, had stepped down and another, Zimbabwe's Robert Mugabe, had been forced to resign. These men had ruled their respective countries for 38 and 37 years and their incumbencies had been characterised by allegations of corruption, especially in their latter years.

Although South Africa limits its presidents to two five-year terms, the administration under President Jacob Zuma had also become tainted with a level of corruption dubbed state capture. Under pressure from the ruling ANC party, Zuma resigned in February 2018 and was replaced by ANC leader, Cyril Ramaphosa.

In Botswana we witnessed another peaceful and orderly transfer of power as President Ian Khama stepped down after 10 years in office, the maximum period allowed under the country's constitution, and handed the reins to his former Vice-President, Mokgweetsi Masisi, on 1 April 2018.

Liberia faced a test of its constitution recently when the first elected president after its two civil wars, Ellen Johnson Sirleaf, came to the end of her two six-year terms. Elections were held in the last quarter of 2017 and, in January 2018, President George Weah, the former professional football player-turned-politician, was sworn in.

Except in Botswana, which has a very low corruption score based on Transparency International's Corruption Perceptions Index 2017, these changes have heralded in hopes of significant improvements, greater levels of governance and reduced corruption. As an indication of how strongman politics has dominated the African political landscape, these changes have been widely celebrated in spite of the fact that, in most cases, the appointment of a new leader has

investments. Ultimately this paves the way for an African customs union. The further integration of the continent and increased influence of the African Union will certainly mean that more countries will be under pressure to improve governance and reduce corruption.

Warning lights

Of course, Africa isn't a country and some areas of concern do persist. In Rwanda, Burundi and Uganda we have seen recent changes that have allowed political leaders to extend their terms of office and it must be noted that Cameroonian President Paul Biya continues to hold the dubious distinction of being the world's longest-serving leader, with almost 43 years at the helm.

Despite these warning lights, the continent as a whole is improving and becoming more democratic. If one considers the Economist Intelligence Unit's (EIU's) extremely comprehensive Democracy Index (which considers 60 different indicators for each country), African nations have reduced their gap with the global average from 0.70 to 0.14 over the past eight years (see sidebar for more detail). The recent momentum of better government has not yet been factored into the latest EIU numbers, so this trend bodes well for the future.

On balance, it seems a new dawn has indeed arrived in Africa, and this trend is being driven by a flurry of positivity linked to improved political scenarios across the continent.

not been accompanied by a change in the ruling party. Nonetheless the reactions have been profound: In South Africa, the relief at the end of the Zuma administration has been called 'Ramaphoria' and in Zimbabwe the population celebrated in the streets when Mugabe's resignation was announced.

Bold steps

In an encouraging development, these new leaders have been quick to move against corruption once in power. Although Angolan President Joao Lourenco was handpicked by his predecessor, he didn't waste any time replacing leaders in key sectors across the Angolan economy, including the diamond and oil sector where he sacked the former president's daughter as head of the state-run oil company. Lourenco also replaced the heads of the central bank, police and military intelligence, seemingly tearing up the pact he negotiated with Dos Santos.

In South Africa, the Gupta family, which has deep connections with the former president, were soon facing immense pressure following the change in leadership. Dawn raids on their homes and asset seizures by the police and state legal teams coincided with Zuma's resignation. Some members of the family are now fugitives from the law and have fled the country.

Zimbabwean President Emmerson Mnangagwa, who replaced Mugabe in November 2017, has allowed the Zimbabwe Anti-Corruption Commission to intensify its anti-graft drive, with some of the most corrupt former cabinet ministers being arrested.

With these positive changes to leadership and term limits becoming more entrenched across the continent it certainly seems as if a new dawn has arrived for African politics. The recent signing by African leaders of the Continental Free Trade Area (CFTA) also signals a positive step forward in terms of political co-operation at an economic level. The CFTA envisages a single continental market for goods and services, which allows for the free movement of business persons and

Improving democracies

"In an encouraging development, these new leaders have been quick to move against corruption once in power".

Paul Clark, Fund Manager

Paul Clark is a Fund Manager at Ashburton Investments. He joined Ashburton Investments in 2012 to set up and manage an Africa fund for the FirstRand Group. Paul started his investment career with Standard Corporate and Merchant Bank's Asset Management business before moving to HSBC Equities South Africa. He then joined the African Alliance Group in 2004 as Head of Research and was instrumental in the launch of the Africa Pioneer Fund in June 2007.

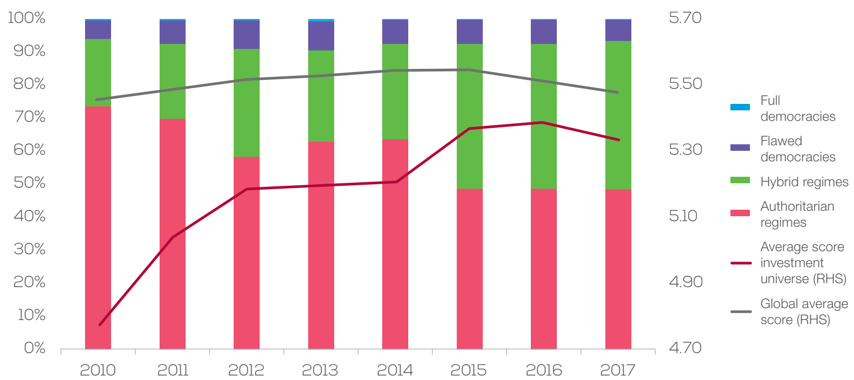
Paul holds a B.Eng degree in Chemical Engineering from the University of Stellenbosch as well as a BCom degree in Accounting from the University of the Witwatersrand. Paul is a Chartered Financial Analyst (CFA) charterholder.

There is a rising sense that democracy is improving in Africa. This trend is aided by improved communication and a younger generation who hanker for better economic management. This perception is confirmed by The EIU, which publishes a comprehensive Democracy Index that rates 168 countries on a scale of 0 to 10. A country's score is based on ratings for 60 indicators grouped in five categories: electoral process and pluralism; civil liberties; the functioning of government; political participation; and political culture.

In terms of this analysis, even countries that hold elections can be classified as 'authoritarian regimes' (yielding a score below four) if the environment is not regarded as conducive to fair vote taking place. African examples of this type of regime include Zimbabwe and Egypt.

The chart below shows the data for the last eight years, indicating the percentage of Africans living under each type of regime.

GOVERNANCE REGIMES IN AFRICA



Source: The Economist Intelligence Unit, International Monetary Fund's World Economic Outlook 2016 and Ashburton Investments

Based on the EIU's 2017 calculations, Mauritius – regarded as a full democracy - is Africa's most democratic country, ranking 16th out of 168 countries, significantly ahead of the United States at 21. Cape Verde (25th), Botswana (28th), South Africa (41st) and Ghana (52nd) make up the rest of the top five African states. All are classified as 'flawed democracies'.

It is important to note, however, that over the last eight years, the improvement in democracy across the continent means that less than 50% of Africans now live in authoritarian regimes, down from 74% in 2010. The average score is also improving for Africa, especially compared with the global average. Sadly half of the world's 52 authoritarian regimes are still found in Africa, so there is still much work to be done.

Crumbling Iran nuclear deal a potential game-changer

RICHARD ROBINSON
Fund Manager:
Ashburton Investments

Following years of heavy criticism, United States President Donald Trump ripped up what he referred to as a "decaying and rotten deal", pulling out of the Joint Comprehensive Plan of Action between Iran and the P5+1 (China, France, Russia, the United Kingdom, the United States and Germany), plus the European Union.

This decision came as no major surprise considering the rhetoric and conduct of the President, who geared up to the decision by replacing Secretary of State Rex Tillerson and National Security Advisor HR McMaster with Iranian hardliners Mike Pompeo and John Bolton. However, the announcement went much farther than was expected and was essentially a full withdrawal from the deal, with no room for further negotiations. France and the United States, in particular, could face a tricky decision in the upcoming United Nations decision during the meeting. If Iran refers the United States to the United Nations over its violation of the deal, then the United States could face a vote that (if it goes against them) risks isolating the country and embarrassing Trump on the world stage. It appears that bargaining chips are up for grabs, particularly in light of Trump's trade war negotiations. Notably, in mid-May the United States softened its stance on the high-profile trade war with China.

> "It is highly unlikely that the deal will continue without the participation of the United States, so a complete collapse is probable".

What does this mean for the oil market?

The worst-case scenario outcome of this move, one which involves strict adherence and policing of sanctions, could see as much as 700 000 barrels per day (bbl/d) removed from the market. A less disciplined approach, with more ambiguous United States guidance, could remove less than 200 000 bbl/d. However, Trump's rhetoric sounded fairly unambiguous, so a bigger impact must be expected.

Although Trump would ideally have liked Europe to join him in re-imposing sanctions on Iran, the eventual effect is likely to be similar nonetheless. Europe currently imports between 500 000 and 600 000 bbl/d of Iranian crude and it is expected that this number will drop by approximately 60%. Iranian barrels can be fairly easily substituted for Iraqi crudes.

European companies that are present in both Iran and the United States, such as Total and Eni, may also choose to stop lifting Iranian crudes altogether, for fear of being precluded from the United States market. It is expected that Asian refiners, with exposure to both regions may also choose to follow the ban. China, on the other hand, may choose to take advantage of the widening discounts and purchase more Iranian crude (through various shell companies). The other potential supply 'dampener' could involve moving Iranian crudes through Iraq as they did with roughly 200 000 bbl/d ahead of the lifting of sanctions.

Lost oil is only part of the story

Britain, France, Germany and the European Union have made it abundantly clear that they would view a re-imposition of oil-related sanctions as a violation of the nuclear agreement. That said, it is highly unlikely that the deal will continue without the participation of the United States, so a complete collapse is probable. Although the Iranian government insists that the deal will endure, simply without the United States' involvement, it is hard to see how it will survive. There is little reason why the Iranian government would continue to cooperate with inspections while European corporations are reducing their presence in Iran and the amount of oil that they are purchasing out of fear of financial reprisals from the United States. This is despite European legislation, enacted in the 1990s, that could protect companies affected by United States sanctions. Ultimately, however, a choice for corporate Europe between the United States and Iran is unequivocally going to fall the way of the United States.

If Iran did decide that its interests were best served by kicking out all inspectors, ripping up the nuclear non-proliferation treaty and pursuing the object of building a nuclear bomb, then we could be in for an even more turbulent period than we are already seeing in the Middle East. Estimates vary, but the UN monitors suspect that Iran is less than 12 months away from achieving that very objective.

Whatever the response, the impact is unlikely to be immediate. For those with existing contracts, they will have between 90 to 180 days to terminate. Iranian exports are likely to face a slow bleed lower, as Iran find cargoes become increasingly difficult to secure. Although this decision has been well broadcast and the short-term pricing response may be flat or even negative, the implications for the market fundamentals are bullish, even if the escalating risk premium that we are likely to see in the future is ignored. The market can hardly afford yet more oil to be removed from an already tight and tightening outlook.

We were and remain bullish with regards to the oil price, even prior to the prospect of Iranian crude being removed. The rate of decline in inventories over the last 12 months has been unprecedented, despite the phenomenal growth in supply from the United States onshore market. This supply growth has been eclipsed by a combination of very strong demand growth - which was far above the International Energy Agency's forecast at the beginning of the year - and due to supply being driven lower in a number of countries, most notably Venezuela.

In 2019 we will also see the start of a sequence of years where the number of projects delivering first oil declines significantly, thanks to the precipitous drop in project spending between 2014 and 2017.

The actual impact on Iran domestically could also be significant. This point is unlikely to be lost on the Trump war office, and regime change could well be the United States' intended end game; a point which Rudy Giuliani, Trump's latest attorney and the former mayor of New York eluded to in a telling remark in early-May that Trump is "as committed to regime change as we are". If regime change is indeed the intention, then there will be little that can be done to salvage the deal.

Trouble at home

Iran has recently seen an alarming pick up in public dissent, with 22 people killed and almost 500 arrested in street demonstrations that lasted several weeks during January 2018. Over the past few days, teachers, bus drivers, steel and rail workers have been on strike across the cities of Ahvaz, Tabriz and Tehran. These are just a few examples of the hundreds of recent outbreaks of social discord felt across the country in recent months.

In 2015 the Iranian government promised that lives would be made easier once sanctions were lifted in early 2017. Despite these promises Iranians have been feeling increasingly frustrated by a lack of improvement in their personal circumstances, and are feeling ignored. The level of frustration is compounded by the fact that billions of dollars of potential domestic spend has been, very publically, diverted to fund Iran's regional conflicts in Syria, Lebanon, Palestine and Yemen.

Hardliners have been pushing for an Iranian airbase to be installed in Syria, something that the Israelis and their allies would be keen to prevent. The prospect of an Iranian airstrip in a bordering country could have acted as an accelerant to re-imposing embargoes. An Iranian airbase in Syria would cost hundreds of millions of dollars, and looks less likely to be undertaken following the re-imposition of sanctions and the potential economic strangulation of Iranian hegemony in the region.

Tough choices

Iran is facing some tough and potentially fractious decisions. The regime must either focus its holed budget domestically, concentrating on survival but in the process handing over the initiative to the Sunni-led Saudi influence, or continue to spend on regional conflicts and risk another revolution at home. Iran's third choice involves renegotiating the deal (however they will surely have their regional aspirations clipped in any subsequent agreement). Either way, the Middle East will continue to be an area of extreme geopolitical risk, the likes of which some say, we have not seen since the start of the First World War.

Richard Robinson,
Fund Manager

Richard Robinson is an Fund Manager at Ashburton Investments and is responsible for the Global Energy Fund. Richard joined Ashburton in 2000 and has 20 years' experience in the finance industry. Prior to his current role, he worked at Abbey National Stockbrokers and, most recently, was Lead Fund Manager on the Ashburton European Equity Fund where he was one of the architects for the move from a regional to a sectoral investment model before launching the Global Energy Fund.

Richard graduated from Cardiff University with a BA (Hons) and is a Member of the Institute for Securities & Investment. He holds the Securities Institute Diploma, the Investment Management Certificate and the Securities Institute Diploma.

The Global Energy Fund was awarded the Investment Week Specialist Investment award in October 2017, in the Natural Resources category, and the Lipper award for outstanding performance.

The fund recently celebrated its 5 year anniversary in June.


FitchRati

Is SA out of the downgrade woods?

CORNELEO KEEVY
Head of Credit Risk Management:
Ashburton Investments

South Africa is the only major emerging market in recent years not to be downgraded to below investment grade by ratings agency Moody's, once placed on review. This means we don't join the ranks of Russia, Brazil and Turkey and instead we can chart our own course. But whereto from here?

On 23 March 2018, Moody's announced that it retained the sovereign credit rating of the government of South Africa at Baa3 (BBB- equivalent). More importantly, Moody's revised its outlook for South Africa's credit rating to 'stable' after it commenced a review for downgrade on 24 November 2017.

The March 2018 announcement capped a remarkable turnaround in the fortunes of South Africa's sovereign credit rating following years of downgrades which culminated in Standard & Poor's and Fitch downgrading South Africa's credit rating to below investment grade on 3 April 2017 and 7 April 2017 respectively.

The main concern regarding a further credit rating downgrade by Moody's centred on the exclusion this would have caused from international bond benchmark indices. The main index is the Citi World Government Bond Index and such a move would have forced international investors tracking this index to sell between US$6 billion and US$9 billion of South African local currency bonds. Such a material sale of bonds would likely have resulted in increased bond yields and currency weakness. Fortunately, this has now been averted for the foreseeable future.

How was the Moody's downgrade avoided?

Following the election of Cyril Ramaphosa as President of the ANC on 18 December 2017, and ultimately his appointment to the State Presidency on 15 February 2018, there has been a marked change in sentiment towards the country. Though the optimism has been tempered to some extent by certain compromises made during the announcement of Ramaphosa's first cabinet reshuffle on 26 February 2018, coupled with increased discussions on land reform, a more buoyant mood persists.

In recent months, there have been a number of developments which have started to stabilise ailing state-owned companies (SOCs), restore credibility to key ministries, and arrest the erosion

"Following the election of Cyril Ramaphosa as President of the ANC, and ultimately his appointment to the State Presidency, there has been a marked change in sentiment towards the country".

at essential government institutions such as the South African Revenue Service (SARS). The much-needed changes to SOCs commenced with the announcement of a new Board of Directors at South African Airways (SAA) in October 2017, thereafter a CEO with extensive corporate experience, in the form of Vuyani Jarana, was appointed to SAA in November 2017. This was followed by the announcement of a new board of directors, along with a credible interim management team, at Eskom in January 2018.

During Ramaphosa's cabinet reshuffle in February 2018, well-regarded technocrats were appointed to key ministries, including: Nhlanhla Nene as Finance Minister and Pravin Gordhan as Minster of Public Enterprises, where he will be entrusted with the finances of some of the largest SOCs, including Eskom, Transnet and Denel. Finally, the suspension of Tom Moyane as Commissioner of SARS in March 2018 was widely welcomed by the market.

The above changes were complemented by the 2018 Budget Speech, which was delivered by Nene's predecessor as Finance Minister, Malusi Gigaba. The Budget Speech provided an element of fiscal consolidation in the form of spending cuts and tax hikes, and more specifically the percentage point increase in the value added tax (VAT) rate, to 15%. The VAT hike presented in the Budget Speech indicated a more pro-active fiscal policy response by the government to addressing its financial constraints, which have gone beyond the expenditure cuts traditionally relied upon to reign in any gaps in the fiscus.

As part of its March 2018 statement, Moody's indicated that the recent actions taken by the South African government had halted the deterioration in South Africa's institutional framework. In addition to the government actions, Moody's credited the strength and independence of South Africa's media, civil society and institutions (including key bodies such as the South African Reserve Bank) as critical in sustaining the country's credit profile over time.

Moody's acknowledged the strong commitment and clear strategies of the South African government to stabilising government finances through meaningful actions on both the revenue and cost side. Finally, Moody's indicated that the recovery in business and consumer confidence increased the prospects of rising levels of investment and ultimately improved economic growth scenarios over the medium term.

Where have we come from?

Moody's assigned a credit rating as high as A- to South Africa as recently as September 2012. Since then, South Africa faced a number of challenges which led to the deterioration in the country's credit rating. The accompanying table illustrates a number of factors raised by Moody's in recent times when taking negative credit decisions on the South African credit ratings.

The table illustrates that the problems being faced by South Africa have not changed much over time and, up to this point, little has been done to address these challenges in a meaningful manner.

SOUTH AFRICA'S CREDIT RATING HISTORY

Date	Action	Factors
9 November 2011	A - outlook to Negative	Growing risk of political commitment to low budget deficits. Slower growth outlook and high unemployment. Negative impact on private investment due to calls for nationalisation.
27 September 2012	Downgrade to BBB+	Lower estimate of government's institutional strength to handle the political and economic situation. Rising government debt metrics. Negative investment climate driven by infrastructure shortfalls, high labour costs, high unemployment and political instability.
15 December 2015	BBB outlook to Negative	Continued probability of low growth over the medium term Rising government debt levels due to increased spending and political pressure
8 March 2016	BBB review for downgrade	Continued probability of low growth over the medium term. Rising government debt levels (currently c.50% of GDP compared with a low of 26.5% in March 2009).
3 April 2017	BBB review for downgrade	Review initiated after abrupt changes in leadership of key ministries following former President Jacob Zuma's 30 March 2017 cabinet reshuffle. This resulted in questions being asked around the following: Progress on economic and policy reforms (as previously announced). Negative impact on domestic and international investor confidence, resulting in weaker growth.
9 June 2017	Downgrade to BBB- with negative outlook	Weakening of South Africa's institutional framework. Reduced growth prospects due to political uncertainty. Rising government debt and contingent liabilities (i.e. guarantees provided to state-owned companies).
24 November 2017	BBB- review for downgrade	Medium Term Budget Policy Statement reflecting more pronounced economic and fiscal challenges. Weaker-than-expected growth outlook resulting in higher debt levels.

Source: Ashburton Investments, Bloomberg, March 2018

Where are we currently?

Despite Moody's retaining its credit rating and the outlook being revised to 'stable', the ratings agency raised familiar concerns as credit challenges facing South Africa during its March 2018 announcement. They are as follows:

- Political and social divisions that generate policy uncertainty and impede structural reforms;
- Low growth and high levels of unemployment; and
- Increased government debt levels and contingent liabilities related to SOCs.

It is due to these persistent challenges that Moody's may still reconsider its view on the South African credit rating at some point in the future, particularly in the event that the current improved sentiment does not translate into meaningful reforms and economic growth.

In summary

The risk of imminent credit rating downgrades have been averted. However, for South Africa to ensure it retains its investment grade rating from Moody's, and is considered for rating upgrades by other rating agencies, it is imperative that Ramaphosa and his new cabinet implement further changes to address the challenges being faced by South Africa. Issues top of mind include the new Mining Charter and the strengthening of governance structures at SOCs through the appointment of qualified boards. Finally, opening the capital markets for SOCs to allow them to issue new funding to address the rising liquidity pressures (an additional threat to the sovereign balance sheet) should be high on the priority list.

South Africa has been given a stay of execution. The question is what we do with it.

Corneleo Keevy, Head of Credit Risk Management

Corneleo Keevy is Head of Credit Risk Management at Ashburton Investments and has over seven years' experience in the fixed-income and credit markets. Corneleo joined RMB in 2010 as a credit analyst in the Resource Finance team of the Investment Banking Division, where he analysed project finance transactions in the mining and oil and gas industries across the African continent. He joined Ashburton Investments in 2014.

Corneleo has a B.Acc (Honours) in Accounting from the University of Stellenbosch. He qualified as a Chartered Accountant in 2007.

Is everything coming up roses?

MURRAY ANDERSON
Head of Retail and Fund Management:
Ashburton Investments

A year ago investing in South Africa was fraught with tension. Today, with a new president at the helm and despite pre-election posturing, the feeling has shifted to one of optimism. But investing based on sentiment – whether good or bad – is never a smart move.

After a raft of negative news headlines over the course of 2017, it was both refreshing and reassuring to see new ANC President Cyril Ramaphosa turning on the charm during the World Economic Forum (WEF) 2018 in Davos in January. The media, investors and the market certainly treated Ramaphosa's victory over Nkosazana Dlamini-Zuma during December's ANC National Conference as a step in the right direction and, during Davos, the then Deputy President was at pains to reassure global investors that the transition would be smooth and managed.

"The reception that we got from potential investors and current investors was very positive," eNCA quoted Ramaphosa as saying. "Everybody is feeling very positive about our country now and the rerating of our currency, the rand having broken through the R12 mark to the dollar, also infuses a lot of confidence in many people. They see that as a great boost for the economy of our country. I think South Africa is being well received at the WEF, so we're on a roll, we're on a very positive roll here at the WEF".

Always a good indication of investor sentiment, the banking index responded positively to Ramaphosa's appointment to the Presidency on 15 February 2018, following the resignation of Jacob Zuma. Similarly the JSE tracked higher and the rand hit a three-year high of R11.59 to the US dollar. While some worrying rhetoric from political parties (positioning themselves ahead of the 2019 elections) is threatening to throw a spanner in the works, the real indication of a sentiment shift will be how both consumers and companies spend.

Just last year the University of Johannesburg's Centre for Competition, Regulation and Economic Development noted that the top 50 companies on the JSE were hoarding cash reserves, and not investing in the economy. With R1.4 trillion in the kitty by 2016 (up from R242 billion in 2005) the surge in positivity may, at last, see some of these funds pouring back into the local economy, which would be good for growth, great for company valuations and earnings in the future.

Such a move would also attract foreign investor attention and interest. They would be inticed by the stronger rand and possibly focused on local companies due to the fact that many multinationals that were poised to make significant investments into South Africa in 2017 abandoned those plans after the country was downgraded by Standard & Poor's and Fitch, and put on review by Moody's in late 2017. So, robust interest and confidence from local firms will indicate to international investors – individual and corporate – that the South African economy has depth. This is evidenced by how well retail shares have rallied following the ANC conference.

How we manage our economy in the future is also of paramount importance. Here, both the banking and retail sectors should be applauded for getting their businesses in shape for future economic growth and an increase in job opportunities. Encouragingly they are taking a firm stance on bad debts. Given the announcement by the then Finance Minister Malusi Gigaba during the 2018 Budget Speech that VAT would increase to 15%, from 14%, on 1 April 2018 this will position such companies well for what will doubtless be a knock to consumer spending.

While the VAT increase will send ripples through the economy, impacting inflation and ultimately interest rates, the good news for investors looking to diversify their portfolios is that two attractive avenues are now open to them: Investing offshore (the rand's recovery is good news for investors eager to take money offshore for long-term diversification benefits) and saving locally (with the appeal being that local shares will do well being supported by a more business friendly government).

Recognising that our clients have diverse needs and that strategies require a mixture of offshore and local exposure, our business model in South Africa has been refined in recent years to ensure that our clients have access to the best global and domestic thinking and to funds that speak to the skillful diversification of their portfolios.

While our Ashburton Chindia Equity Fund has been well-recognised in the industry as the recipient of the Best Offshore Far East Equity General Fund at the acclaimed Raging Bull Awards, our approach to money management and credit risk management requires a range of options which, when combined, create a meaningful portfolio based on our clients' risk profiles.

In the current environment of hope in South Africa, and continued growth globally, we are finding particular interest in the following funds:

- Ashburton Stable Income Fund – Crafted for investors with a low risk profile who don't want equity type risk, but need more than money market returns.
- Ashburton Equity Fund – Focused on achieving capital growth by investing in South African listed equity securities, with the aim of achieving returns ahead of the FTSE/JSE All Share Index.
- Ashburton Balanced Fund – A mixture of local and offshore asset class exposure, which includes equities, bonds, property and the money market. The maximum equity exposure is set at 75% and is limited to 25% offshore exposure.
- Ashburton Global Flexible Fund – A rand-denominated feeder fund, which is ideal for offshore exposure. Investments into international equities, bonds, cash and property is made both directly into these markets and indirectly through collective investment schemes.
- Ashburton Global Leaders Fund – A fund offering true offshore exposure to large-cap blue-chip stocks. Ideal for investing in the long term and for riding out economic cycles.

The final fund worth highlighting, which has low correlation to the South African market where exposure to African stocks is already high through the JSE, is the Ashburton Africa Equity Opportunities Feeder Fund. This fund identifies and invests in undervalued listed African equities, excluding South Africa. Given National Treasury's increase in prudential limits on offshore investments into Africa – from 5% to 10% - the options for additional African exposure is worth noting.

As this taste of our funds highlights, our focus remains a balanced mixture of offshore diversification and exposure (including additional emerging market exposure) and a pro-South African and emerging markets stance for now. Ours is a long-term focus, much like the long-term game we've seen in action from South Africa's new President. Patience is the order of the day as skilled and careful eyes stay sharply focused on future opportunities and risks.

For the investor the message is clear: don't let sentiment rain on your parade. When in doubt stay the course and trust the plan.

Murray Anderson, Head of Retail and Fund Management

Murray Anderson is Head of Retail and Fund Management and is responsible for the client engagement model and coordinating the product offerings for retail clients. Murray joined Ashburton Investments as a result of the acquisition of Atlantic Asset Management. Previously, he was the Co-Founder and Managing Director of Atlantic. Prior to Atlantic he held a number of senior distribution and marketing positions at Cadiz African Harvest, Old Mutual Asset Managers as well as RMB Asset Management and has served the industry in the past on a number of committees of the Association for Savings and Investment of South Africa. He holds a BCom in Financial Management obtained from UNISA, a Diploma in Marketing from the Institute of Marketing Management and is a Certified Financial Planner (CFP™).

Fund name	1 year	2 years	3 years	5 years
SA Multi Asset – High Equity				
Ashburton Balanced Fund	3.11	1.81	4.20	N/A
Ashburton Multi Manager Prudential Flexible Fund	2.13	1.63	3.88	7.80
Benchmark: Peer group average (121 funds)	3.23	1.96	3.58	6.82
SA Multi Asset – Low Equity				
Ashburton Targeted Return Fund	2.39	2.09	4.53	6.21
Benchmark: CPI + 3.5	4.49	4.92	5.35	5.33
SA Multi Asset – Income				
Ashburton Multi Manager Income Fund	6.72	7.49	7.59	7.20
Benchmark: 110 of STEFI 3 month deposit	7.72	7.87	7.60	7.00
Ashburton Diversified Income Fund	N/A	N/A	N/A	N/A
Benchmark: Beassa 1-3 Yr TR ZAR	7.77	8.78	7.98	7.11
Global Multi Asset - Flexible				
Ashburton Global Flexible Fund (ZAR)	1.33	-4.01	3.28	N/A
Benchmark: 60 MSCI AC Index, 40 Citi World Bond Index	4.29	-1.78	7.53	10.73
International Multi Asset Fund				
Ashburton Asset Management Fund (Dollar)	3.00	3.54	0.34	1.69
Benchmark: US CPI +3	6.47	6.35	6.00	5.61
Ashburton Asset Management Fund (Euro)	-0.78	0.92	-1.74	1.35
Benchmark: Eurostat CPI + 3	4.18	4.12	3.67	3.56
Ashburton Asset Management Fund (Sterling)	0.21	3.15	0.34	1.84
Benchmark: UK CPI +3	5.38	5.55	4.79	4.40
Ashburton Global Growth Fund (GBP hedged)	4.01	6.22	1.52	N/A
Benchmark: EAA Fund GBP Moderately Adventurous Allocation	3.98	11.31	6.12	6.70
Ashburton Global Growth Fund (USD)	5.59	7.38	2.21	N/A
Benchmark: EAA Fund USD Aggressive Allocation	6.78	8.61	3.49	4.48
SA Fixed Income – Variable Term				
Ashburton Multi Manager Bond Fund	10.42	11.71	7.92	7.10
Benchmark: BEASSA All Bond Index	11.44	N/A	N/A	N/A
Ashburton Inflation ETF	10.44	11.89	8.13	7.31
Benchmark: GILBx Total Return Index	2.96	2.24	3.65	4.09
Ashburton GOVI Tracker Fund	3.45	2.69	4.10	4.56
Benchmark: Beassa GOVI TR ZAR	9.44	N/A	N/A	N/A
SA Fixed Income – Short Term	10.05	11.66	8.17	7.20
Ashburton SA Income Fund	9.06	9.22	8.52	7.39
Ashburton Stable Income Fund	8.78	8.64	8.34	7.56
Benchmark: STEFI Composite Index	7.39	7.50	7.26	6.67
SA Fixed Income – Money Market				
Ashburton Money Market Fund	7.73	7.79	7.51	6.80
Benchmark: STEFI 3 month deposit	7.04	7.14	6.89	6.35
Emerging Market - Fixed Income				
Ashburton India Fixed Income Opportunities Fund	-2.62	4.95	3.79	N/A

Fund name	1 year	2 years	3 years	5 years
SA Real Estate – General				
Ashburton Multi Manager Property Fund	-6.89	-1.70	2.08	9.00
Ashburton Property Fund	N/A	N/A	N/A	N/A
Benchmark: FTSE/JSE Listed Property Index	-6.45	-1.49	2.00	8.39
Ashburton Property Tracker Fund	-6,72	N/A	N/A	N/A
Benchmark: FTSE/JSE SA Listed Property TR ZAR	-6.45	-1.49	2.00	8.39
SA Equity – General				
Ashburton Equity Fund	1.61	0.56	2.67	7.53
Ashburton Multi Manager Equity Fund	1.09	1.35	2.50	7.95
Benchmark: FTSE/JSE All Share Index (TR)	8.00	5.05	5.45	9.16
Global Equity – General				
Ashburton Global Leaders Equity Fund	5.87	9.44	5.63	N/A
Benchmark: MSCI ACWI GR USD	12.43	15.26	8.12	9.47
Ashburton Global Energy Fund	19.96	5.12	2.86	N/A
Benchmark: MSCI World/Energy PR USD	17.40	8.94	0.04	-1.61
Emerging Market Equity – General				
Ashburton Africa Equity Opportunities Fund	26.38	10.77	-2.38	-1.32
Benchmark: MSCI EFM Africa Ex ZAF PR USD	6.22	0.04	-5.43	-5.69
Ashburton India Equity Opportunities Fund	3.94	13.36	5.50	14.27
Benchmark: MSCI India GR USD	6.68	13.13	5.79	7.71
Ashburton Chindia Equity Fund	14.65	19.87	6.38	12.21
Benchmark: MSCI EM GR USD	14.43	20.97	6.56	4.89
Ashburton Africa Equity Opportunities Feeder Fund	20.80	-2.02	-1.96	N/A
Benchmark: MSCI AFRICA X ZA WED	4.58	-10.12	-3.42	N/A
South African Equity Large Cap				
Ashburton Top40 ETF	8.41	4.45	5.15	8.62
Benchmark: FTSE/JSE Top 40 TR ZAR	8.63	4.75	5.42	8.89
South African Equity Mid/Small Cap				
Ashburton MidCap ETF	1.46	2.28	2.58	7.97
Benchmark: FTSE/JSE Mid Cap TR ZAR	2.18	3.08	3.23	8.73
Global Equity General				
Ashburton Global 1200 SA Tracker Fund	6.81	N/A	N/A	N/A
Ashburton World Government Bond ETF	N/A	N/A	N/A	N/A
Benchmark: S&P Global 1200 (WM) (NTR) ZAR Ashburton	7.30	N/A	N/A	N/A
South African Equity General				
Ashburton Low Beta SA Composite Track Fund	-9.18	N/A	N/A	N/A
Benchmark: S&P Low Beta South Africa Composite (ZAR) NTR	-9.00	N/A	N/A	N/A
Ashburton Momentum SA Tracker Fund	9.67	N/A	N/A	N/A
Benchmark: S&P Momentum South Africa Index (South African Rand) Net Total Return	9.42	N/A	N/A	N/A
Ashburton Enhanced Value SA Tracker Fund	13.02	N/A	N/A	N/A
S&P Enhanced Value South Africa Composite Index (ZAR) Net Total Return	13.41	17.96	16.81	11.95

Source: Ashburton Investments

The above is purely for illustrative purposes. Past performance is not necessarily an indication of future performance.

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