OLD MUTUAL WEALTH JOURNEY

SUMMER 2018

This is our last newsletter for 2018. I would like to start by thanking you for your continued support and trusting us to help you preserve, grow and manage your wealth so that you can enjoy the life you want.

It's understandable to be worried, and even fearful, about your investments in the current environment, where global and local news is full of economic warnings and markets have been volatile and going sideways for a considerable period of time. Despite 23 years of working in investments, I've even found myself contemplating the merits of stashing money under the mattress in the last year. However, I've managed to stick to the core tenets of successful investing. These include:

1. Time out of the market is costly, and it's almost impossible to time your entry and exit. Rather stick to your optimal asset mix strategy – it will go through ups and downs but it's your best chance of achieving the returns you need over the long term.
2. Don't chase performance, as past performance is not an indicator of future performance. The darlings of this year often turn into the dogs of the next.
3. Don't panic and take emotional action – beware of market noise and ensure that you talk to your financial planner before making any investment decisions.

Unfortunately, it's not only the investment markets that are a cause for concern. Recent governance scandals in both developed and emerging markets continue to erode trust in institutions and governments. In addition, as investors, we are becoming increasingly aware of the inter-connectedness of our economic, business, government, cultural and environmental ecosystems.

To this end, Old Mutual Limited has also made a public commitment to responsible investing and we see the development of innovative and low-cost products taking environmental, social and governance factors into account as a fulfilment of this promise on a product level. You can read more about this on the next page.

While we may go through periods of volatility and upheaval, from an Old Mutual Wealth perspective, we believe that sticking to doing the right things will ensure positive outcomes for all our clients. So we remain committed to putting you, our valued client, at the centre of everything we do by applying our investment philosophy consistently and ensuring our world-class processes are driving responsible investing.

Lastly, I wish you a joyous and peaceful holiday season with your loved ones. We look forward to reaching even greater heights in your wealth journey in 2019!

OLD MUTUAL WEALTH

ESG INVESTING: CHANGING THE WORLD WHILE MANAGING INVESTMENT RISK

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Recent governance scandals in both developed and emerging markets clearly show that non-financial indicators such as environmental, social and governance (ESG) factors should play an increasingly important role in your investment decisions to mitigate risks and maximise investment performance. Growing pressures around compliance from regulators, and concerns related to management, performance, unsustainable corporate practices and costs, have also created a need for investment products that incorporate ESG into their investment criteria to protect investors against value destruction.

A recent report by Merrill Lynch looking at US equities demonstrates how incorporating ESG factors into an investment strategy can aid in mitigating price-earnings volatility associated with poor governance. The report found that companies in the top-fifth in terms of ESG ratings from 2005 to 2010 experienced the lowest (32%) volatility in earnings per share in the subsequent five-year period, while companies with the worst ESG ratings averaged 92% volatility.

Morgan Stanley Capital International's (MSCI) decision to remove international car manufacturer Volkswagen (VW) from the MSCI ESG Index – prior to the company admitting to using defective software to cheat strict carbon emission tests – presents another strong argument in favour of integrating ESG factors into the investment decision-making process to mitigate the risk of poor governance.

While traditional indicators such as elevated warranty expenses were raising questions, MSCI noted a general deterioration in VW's corporate governance practices. They took action by removing the company from the All Country World (ACWI) ESG Index in May 2015 – four months prior to the scandal that destroyed millions of dollars in share price value for VW investors.

Many investors are also concerned about the impact of the long-term risk associated with climate change and social inequality on the performance of their investments. Millennials – the generation currently aged 18 to 34 years – as well as high-net-worth individuals have shown increased awareness of the negative impact of carbon emissions on the environment, as seen with the VW scandal. These investors are increasingly allocating capital towards initiatives that address both global warming and the rising rates of social degradation, such as a rising incidence of child labour in poorer developing nations.

The global trend towards passive ESG investments driven by a consumer demand for sustainable returns has resulted in a wider availability of ESG index tracker funds, thanks to improved ESG data on companies allowing for new approaches to sustainable investing.

Some may think investors sacrifice returns when taking ESG matters into consideration, but research confirms otherwise. According to a meta-study of 190 different sources, 80% of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment performance.

Sustainability is a macro-thematic trend and the South African market is ripe for ESG investment strategies. After steady progression in the institutional investment space, the general perception of sustainable investing is shifting in the retail market, with people becoming increasingly mindful of ESG factors and the role they should play in an investment mandate.

Indexation with an ESG overlay offers investors a competitive strategy that can compete with the price of traditional market cap passive strategies. ESG index tracker funds essentially offer a viable, cost-effective solution for passive investors who, while mandatory holders of the index, are looking for a practical alternative to avoid the unsustainable practices of many listed companies.

The Old Mutual Wealth Tailored Fund Portfolio Global Model Range was launched in response to requests from our financial planners. The offshore low-cost solution with an ESG overlay – the first in South Africa – is exclusively available to independent financial planners and targets real returns by incorporating mandates that track ESG equity indices in both emerging and developed markets.

Incorporating ESG factors into investment decisions will not only drive performance over the long term, but also ensure that your financial planner fulfils his/her fiduciary duty acting in your best interest by reducing investment risk with a cost-effective approach.

UNDERSTANDING ESG

WHAT IS ESG?

ESG involves using environmental, social and governance factors to assess companies and countries on their sustainability. When enough information has been obtained on these three factors, they can be integrated into investment decisions.

ENVIRONMENTAL

- Waste and pollution
- Resource depletion
- Greenhouse gas emission
- Deforestation
- Climate change

SOCIAL

- Employee relations and diversity
- Working conditions
- Local communities
- Health and safety
- Conflict

GOVERNANCE

- Tax strategy
- Executive remuneration
- Donations and political lobbying
- Corruption and bribery
- Board diversity and structure

Source: https://marketbusinessnews.com/financial-glossary/esg-definition-meaning/

IZAK **ODENDAAL** | INVESTMENT STRATEGIST AT OLD MUTUAL MULTI-MANAGERS

A YEAR TO FORGET

2018 started on a high, but it soon became a year to forget. Global markets surged late last year and into January this year, and the JSE followed suit. Following the outcome of the ANC elective conference in December, a new mood of optimism around South African policy and politics prevailed. It didn't last.

FROM RAMAPHORIA TO RAMANOWWHAT?

Local policy uncertainty flared up again after the announcement that Government would seek to amend the Constitution to allow for land expropriation without compensation. The first VAT increase in two decades was announced in February. As more details of state capture emerged, the extent of damage caused to key institutions became depressingly clear. September saw the announcement that the economy had been in a technical recession in the first half of the year after a surprise contraction in the second quarter. This came just as petrol prices reached a new record level. October's Medium-Term Budget surprised the market with news of a R20 billion shortfall in tax revenue due to SARS's bungling of VAT refunds, which, in the absence of offsetting measures, will contribute to government debt levels rising further instead of stabilising.

GLOBAL MARKET VOLATILITY

Led by the US, global markets plunged in February, and again the JSE followed suit. From April onwards, South African shares and bonds (and the rand) were battered from a different direction: this time as investors soured on emerging market assets.

October saw one of the worst sell-offs in recent years. High-flying technology shares were particularly hard hit, including the US household names Amazon, Alphabet (Google) and Facebook, as well as Tencent, the Chinese social media and gaming giant.

RAND HEDGES MISSING IN ACTION

This brings us to perhaps the most disappointing aspect of investments this year: the poor performance of the JSE's non-resources rand hedges despite the rand losing 10% against the US dollar since January. The blame largely lies with the big industrial rand hedges on the JSE that have declined for reasons unrelated to the macro-economy, but rather due to company or industry specific issues.

LOOKING AHEAD

Finally, after this unfortunate year for investors, what can we expect from 2019? The global economy is still growing nicely, but not as fast as investors thought it would. US President Trump's tariffs are unwelcome, but have not fundamentally disrupted global commerce yet. And while interest rates have increased, it is because the US Federal Reserve wants to restore interest rates to more normal levels and not because it is trying to fight inflation (which is still muted). Interest rates outside the US are still very low.

On the local side, although the economy is still weak, there is every reason to expect things to start getting better. South Africa is certainly on the path to cleaner and more competent governance and more rational policy-making. For the first time in a decade, it seems we have a president and finance minister – both respected by investors and business leaders – in the same canoe, rowing in the same direction, and rowing in the right direction. Reforms and policy interventions to date support this view, and should raise business confidence over time.

Equities are also much more attractively priced, and the prospective return outlook has improved even as historic returns have deteriorated.

When faced with tough market conditions, the biggest enemy is often behavioural. We have to fight against the impulses, instincts and emotions that make us human, but also tend to be detrimental to our financial health. 2018 has stress-tested all of us. But those who've stuck to their financial plans despite the temptation to throw in the towel will, in time, reap the rewards.

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Old Mutual Wealth is brought to you through several authorised Financial Services Providers in the Old Mutual Group who make up the elite service offering. Old Mutual Wealth (Pty) Limited.
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