

INVESTMENT NOTE

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THE NATION IN A STATE



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OLD MUTUAL MULTI-MANAGERS

In the wake of the 1979 Iranian Revolution, a global energy crisis unfolded characterised by long queues of cars outside petrol stations amidst fuel shortages and sky-high prices. US President Jimmy Carter sought to calm his nation, build its resolve and plot a path forward. His memorable July television address was later dubbed the "malaise speech," even though Carter never used that word. It focused on the profound sense of drift and unease, calling Americans to introspection:

"The threat is nearly invisible in ordinary ways. It is a crisis of confidence. It is a crisis that strikes at the very heart and soul and spirit of our national will. We can see this crisis in the growing doubt about the meaning of our own lives and in the loss of a unity of purpose for our nation."

Though the speech was initially well received, several subsequent missteps saw Carter lose support. By the time the election rolled around in 1980, his popularity was so low, and Paul Volcker at the Fed had hiked interest rates so high (though they were briefly reduced before the election) that Carter became a one-term president. His gloomy image couldn't compete with Ronald Reagan's sunny Californian optimism. The malaise speech is these days thought of as a turning point in Carter's administration, and not for the better.

MALAISE

No one doubts that South Africa suffers from a malaise and Carter's words are applicable here too. While global factors are behind the surge in fuel and food prices, the biggest problems are home-grown, many of them the result of bad policy or weak implementation on the part of government. This is particularly true

in the case of our own energy crisis, but also when it comes to failing infrastructure, rising crime, and increasing municipal dysfunction.

That the State of the Nation Address (SONA) was held again in the Cape Town City Hall as repairs to the fire-



WEALTH

damaged Parliament building drags on seems an apt metaphor for the national condition. We are a nation in a state.

But as investors, our job is not to wallow in pessimism's deep dark waters or bask in the soft glow of naïve positivity. Rather, it is to ask where things are headed. And crucially,

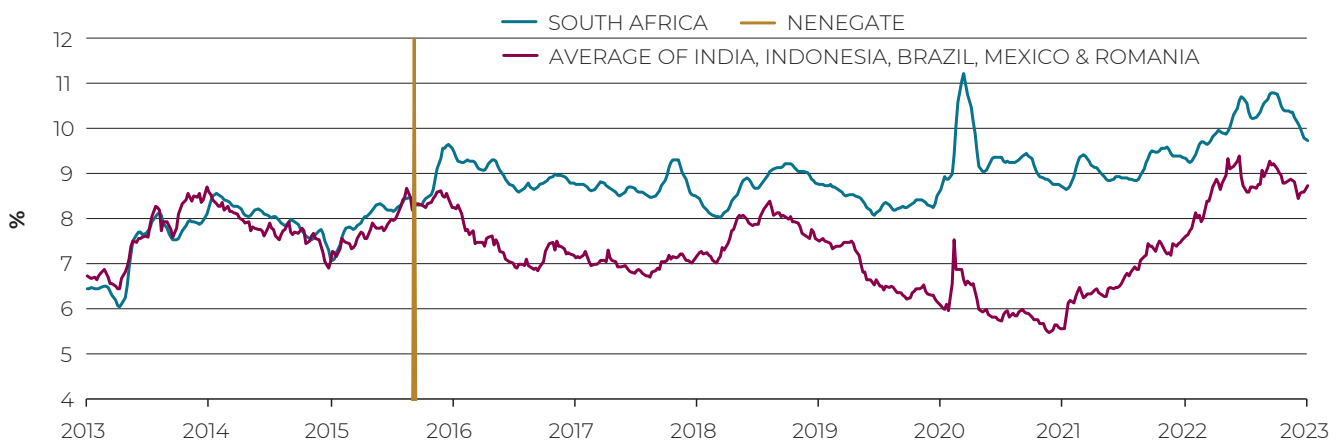
SONA: SO NEAR, SO FAR

President Cyril Ramaphosa's speech has been extensively covered in the media, so no need to repeat the detail. There was also very little new in the address. It is worth noting that commentators typically start their analysis with what ought to be done, and then compare what was announced to that ideal. When measured that way, no SONA or Budget Speech or any other policy announcement can fully meet expectations, because expectations tend to ignore the political, institutional and material constraints to policymaking.

what is priced in the market. Is the market reflecting optimism or gloom? For instance, the malaise speech era was one of the best moments to buy US equities in several generations. The S&P 500 traded on a price-to-earnings ratio of seven in mid-1979, a low it has not reached again since. No one knew it at the time, but a decades-long bull market in bonds and equities lay around the corner.

As investors we should look at things slightly differently, and not ask whether all the problems will be fixed, but rather whether there is enough tangible progress such that the current market pricing will eventually be rendered too pessimistic. When that happens, the risk premium that global investors demand from local assets compared to other emerging markets, which opened up substantially after Nenegate in 2015, can decline.

CHART 1: SOUTH AFRICAN VS EMERGING MARKET 10-YEAR LOCAL CURRENCY GOVERNMENT BOND YIELDS, %



Source: Refinitiv Datastream

It is important to note that rerating or derating always happens in a global context. If global risk appetite improves, South African assets can rally even if our relative position doesn't improve. That is exactly the story of 2023. Similarly, in an environment of global risk aversion, asset values can decline even if the government does the right things that warrant a rerating.

So what progress is there? Ironically, it seems the most acute crisis, loadshedding, is actually the one we can be most optimistic about.

That is not because Eskom's generation problems are going to be fixed in the short term – this will probably take longer than anticipated – and not because of the implementation of a State of Disaster or the appointment of a new Minister of Electricity or any other announcement made in SONA, though these can help on the margin. It is certainly not because loadshedding will end by the end of the year.

Rather, it is because regulatory changes already implemented mean private enterprises can generate as much electricity for own use as they want. It is the single most important

economic reform of the past 20 years and is now largely irreversible. Through the simple act of getting out of the way of the private sector, the government has achieved more for the economy in a few months than what countless ministers, commissions, and advisory boards have done in years. The impact will take some time to be felt, but it is

coming. Next week's Budget will see details on incentives to further encourage rooftop solar rollout by households and companies. This will accelerate the fundamental reshaping of the electricity market from a vertically integrated monopoly to decentralised and deregulated.

CHOKEPOINTS, LOGJAMS AND BOTTLENECKS

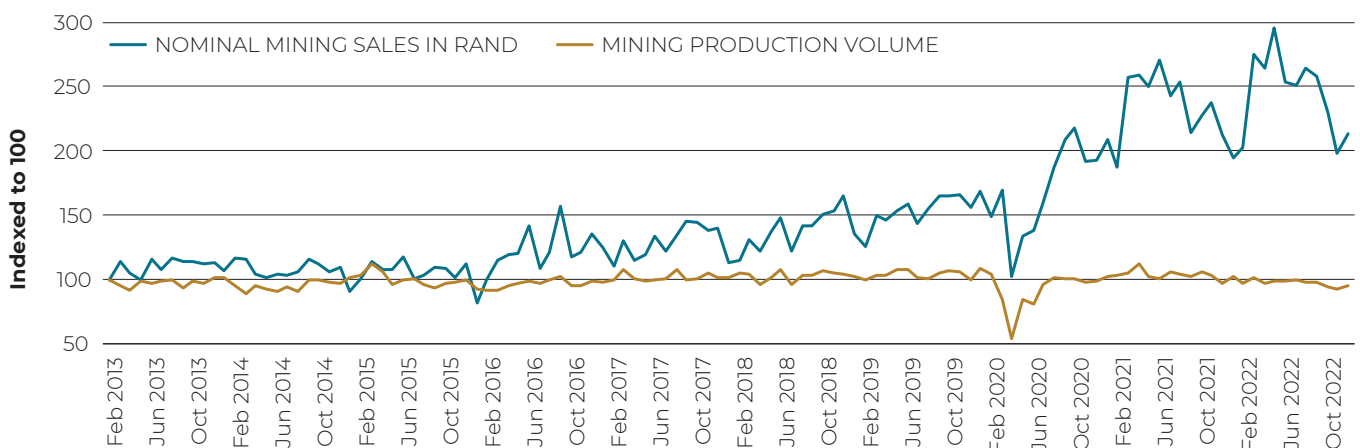
The question is whether this can happen in other chokepoints in the economy. The answer is not quite, but there is some progress. Part of the problem is simply that these other logjams are not visible enough to change voters' minds and scare elected politicians.

For instance, few people know what a mining rights cadastral system is. Yet it is crucial to the growth of mining in South Africa. The long absence of a functional, transparent, online cadastre where prospectors can access geological data and see who owns mining rights over a piece of land has hobbled exploration, investment and job creation. This is also important for non-mining development such as wind and solar farms, since developers need to be sure that there is no mining right held on the area where they want to build.

As a result, there is a massive backlog of mining rights applications being inefficiently (and often corruptly) adjudicated in a paper-based environment. After years of unnecessary stalling, the Department of Mineral Resources and Energy has now finally decided to purchase an off-the-shelf system that works well in other countries, including elsewhere in Southern Africa. This can be implemented relatively quickly and is the first step towards restoring growth in the mining industry.

This key sector in our economy has been stagnating for more than a decade. In fact, new Stats SA data show that the volume of mining output is flat over the past decade and is in fact about 10% lower than before the current mining minister took office. The value of mining sales has climbed in nominal terms, but this is purely global commodity because prices increased. They are not rising anymore.

CHART 2: SA MINING PRODUCTION AND SALES



Source: Stats SA

Another key stumbling block for mining is the inadequate rail freight system. As has been widely publicised, the Minerals Council estimates a loss of R51 billion in revenues last year due to Transnet Freight Rail's inefficiencies. Again, unlike Eskom, Transnet's failings will not animate voters.

But Transnet's worsening financial position is finally forcing it to look to partnerships with private companies, and it recently announced its intention to find a qualified private partner to upgrade and run the key Gauteng-Durban rail corridor for a period of 20 years. It remains to be seen whether

this will happen, but the plan is a marked departure from its past modus operandi. This does not address the key Sishen and Richards Bay lines that hamstring mining exports, however. These would arguably be the easiest lines to concession since they run single commodities (coal and

iron ore respectively) and existing users would be eager to invest. Mining companies run their own railways in many countries, such as BHP and Rio Tinto's famed kilometres-long driverless trains in the Pilbara outback.

MAKE WAY

Operation Vulindlela (make way in isiXhosa) is a unit run jointly by the Presidency and National Treasury that works across departments to remove key stumbling blocks to faster growth. Now, in an ideal world, this bottleneck-unblocking unit would not be necessary, as government departments would work together to achieve common goals. But this is not the case in South Africa, and the Vulindlela unit has to push, prod, and plead to get things done. It focuses on a limited number of key reforms and has made progress.

One area outside Operation Vulindlela's remit is crime, and this is one area where things are getting worse, particularly

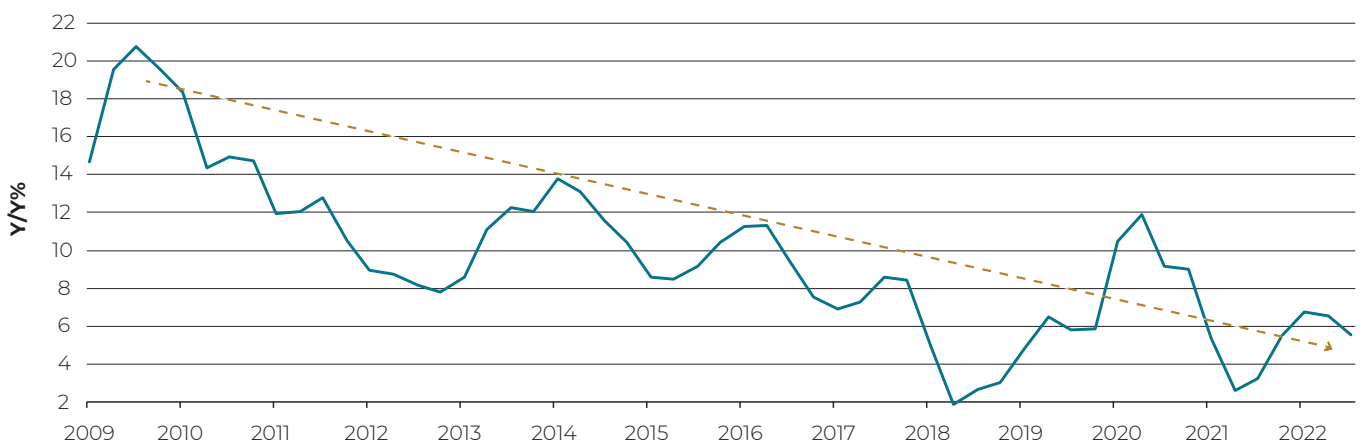
the various 'mafias' that now target businesses. Secure property rights are the bedrock of economic growth, and key to attracting investment. Businesses can beef up security but cannot tackle large gangs of armed men. Government needs a strategy to tackle this scourge along with all the other forms of criminality that plague us, using all its resources and the constitutionally granted "monopoly on violence" (Max Weber's term). SONA was disappointingly light on this score. The Budget is likely to show a greater allocation to the police, National Prosecuting Authority and other crime-busting bodies, but this can only go so far in the absence of a fundamental reform of the broader criminal justice system.

FISCAL CONSOLIDATION TO CONTINUE

Fiscal discipline is one area that has improved, although some will scoff at this statement. Budget deficits have stabilised, and next week's Budget Speech is likely to show a further narrowing of the deficit, with the aim of eventually moving towards a primary surplus where non-interest spending is less than tax revenue. That will stabilise the

debt-to-GDP ratio that has already been growing at a slower pace than the 2010 to 2020 period. This is partly the luck of a recent commodity windfall, but also the deliberate and politically costly steps to rein in spending growth, particularly on wages and salaries.

CHART 3: GROWTH OF THE GENERAL GOVERNMENT WAGE BILL



Source: Reserve Bank

The President mentioned several points in the SONA that will impact the Budget, notably taking Eskom debt onto the government's balance sheet. This has been on the cards for a long time, and hopefully details will emerge soon. It will slightly raise the debt-to-GDP ratio, but since government already guarantees Eskom's debt, the transfer doesn't make a difference to its creditworthiness. It will make a big difference to Eskom's, however, and will allow it to borrow at a lower interest rate and make much-needed investments into the transmission grid among other things

ACTION, NOT WORDS

Ramaphosa's speech was underwhelming given the bold action the country wants to see. Many promises have been made, some will be kept and some not. But if we look closely at what is being delivered, there is progress underway in key areas. Since markets care about tomorrow more than today, at the very least, there is no reason to expect a further sustained derating of SA assets. Tangible evidence of the implementation of the announced measures can result in a rerating of domestic assets relative to our peers, but this will not happen overnight.

Ramaphosa also noted ongoing work on a basic income grant within government's fiscal constraints. In practice this probably means the R350 per month Covid-grant (the SRD grant) will become permanent and rise with inflation over time.

Despite a national election looming next year, the Budget is not expected to be a populist one, and rather remain on the path of fiscal consolidation which will cause some short-term pain but deliver long-term gain.

Jimmy Carter's malaise speech did not help him get re-elected, nor did it solve any problems, and in the end, the crumbling economy undid him. Yet the speech is still remembered as a milestone. In contrast, Ramaphosa's sixth SONA will, like the others, be largely forgotten by history. It is progress on the reforms listed above that will cement his place as a successful or failed president.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US\$	2 784.0	-1.31%	-0.04%	6.95%	-9.84%
United States	S&P 500	US\$	4 090.0	-1.11%	0.32%	6.51%	-9.19%
Europe	MSCI Europe	US\$	1 868.0	-2.20%	-0.69%	7.85%	-9.28%
Britain	FTSE 100	US\$	9 506.0	-0.21%	-0.70%	5.45%	-8.64%
Germany	DAX	US\$	1 467.0	-2.72%	-0.74%	9.87%	-11.04%
Japan	Nikkei 225	US\$	210.5	0.39%	0.23%	5.78%	-11.82%
Emerging Markets	MSCI Emerging Markets	US\$	1 014.0	-2.41%	-1.65%	6.07%	-18.94%
Brazil	MSCI Brazil	US\$	1 442.0	-2.57%	-7.33%	-1.17%	-14.27%
China	MSCI China	US\$	69.2	-2.90%	-3.20%	8.19%	-18.38%
India	MSCI India	US\$	740.8	-0.77%	-0.83%	-3.92%	-11.49%
South Africa	MSCI South Africa	US\$	425.0	-5.13%	-3.63%	0.95%	-16.50%

EQUITIES - SOUTH AFRICA (TOTAL RETURN UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	78 985.0	-1.57%	-0.62%	8.13%	3.13%
All Share	All Share (Total Return)	Rand	13 423.0	-1.57%	-0.62%	8.22%	7.82%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	32 640.5	-2.01%	-0.80%	6.11%	5.80%
TOP 40/Large Caps	Top 40	Rand	12 321.0	-1.43%	-0.56%	9.07%	8.95%
Mid Caps	Mid Cap	Rand	20 435.0	-2.57%	-0.89%	2.90%	2.10%
Small Companies	Small Cap	Rand	30 416.0	-1.28%	1.18%	3.53%	11.09%
Resources	Resource 20	Rand	5 885.6	-3.51%	-4.34%	2.46%	-1.26%
Industrials	Industrial 25	Rand	21 741.0	0.14%	1.29%	14.83%	12.78%
Financials	Financial 15	Rand	10 989.0	-2.74%	-0.30%	3.68%	6.48%
Listed Property	SA Listed Property	Rand	1 677.8	-1.89%	0.17%	-0.84%	4.27%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
IBOXX Global Government S&P Overall (USD Unhedged)		US\$	78.1	-1.64%	-1.50%	1.41%	-14.94%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	879.3	-0.82%	-0.41%	2.54%	4.20%
Government Bonds	BESA GOVI	Rand	867.0	-0.85%	-0.43%	2.54%	4.14%
Inflation Linked Bonds	BESA CILI	Rand	322.9	0.01%	-0.02%	-0.99%	2.43%
Cash	STEFI Composite	Rand	511.4	0.13%	0.19%	0.79%	5.55%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US\$	86.4	8.07%	1.64%	0.45%	-5.07%
Gold	Gold Spot	US\$	1 866.0	0.05%	-2.15%	2.30%	1.86%
Platinum	Platinum Spot	US\$	945.0	-3.08%	-6.53%	-11.93%	-8.25%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	17.89	-2.32%	-2.66%	-4.78%	-15.18%
ZAR/Pound	ZAR/GBP	Rand	21.58	-2.36%	-0.60%	-4.59%	-4.68%
ZAR/Euro	ZAR/EUR	Rand	19.07	-1.03%	-0.82%	-4.44%	-9.06%
Dollar/Euro	USD/EUR	US\$	1.07	0.93%	1.50%	0.00%	6.54%
Dollar/Pound	USD/GBP	US\$	1.21	-0.03%	1.99%	0.33%	12.77%
Dollar/Yen	USD/JPY	US\$	0.01	0.20%	1.03%	0.25%	13.30%

Source: I-Net, figures as at 10 February 2023

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WEALTH

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