SAVINGS & INVESTMENT MONITOR

July 2019

THE TIME IS NOW
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DO BETTER

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Savings: The Macro perspective

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Why do savings matter?

Macro vs. Micro

Macro

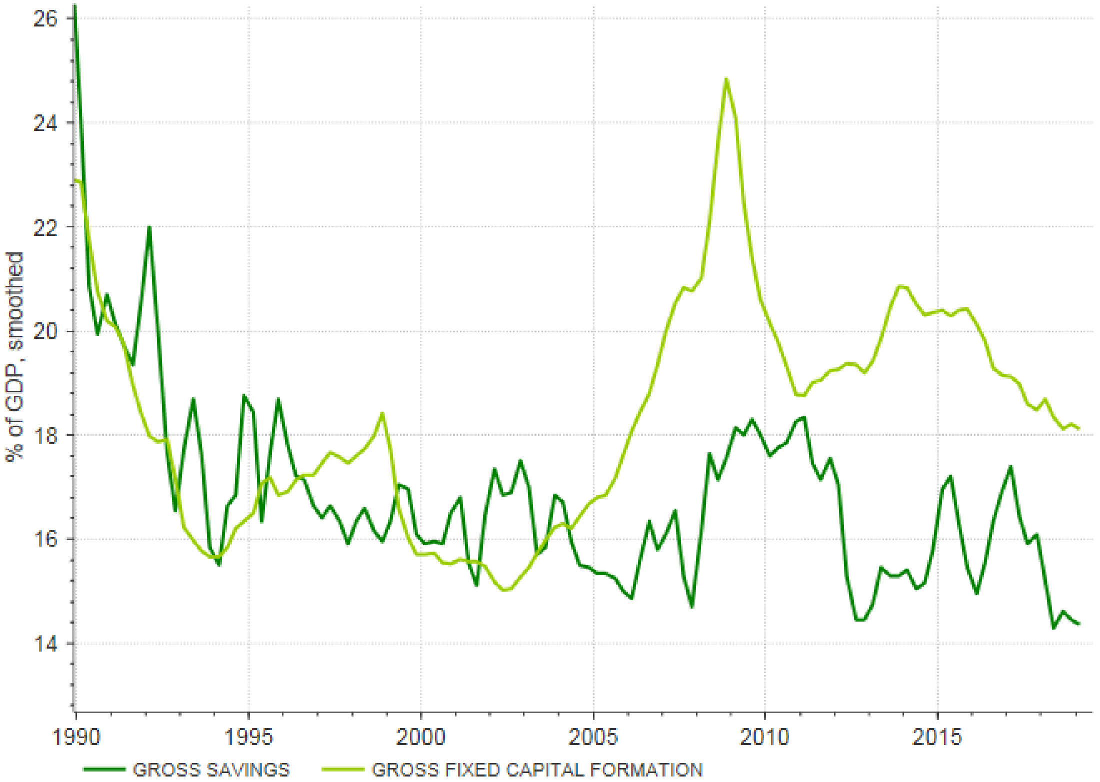
Savings matter because investment is funded from savings. If there is insufficient savings, capital has to be imported. This comes with some risks.

Micro

Need to fund future expenditure.
This can range from small planned outlays (a holiday), to large unplanned expenditure (emergency surgery). The biggest is retirement, which is usually planned, but we don't like to think about it!

The macro context

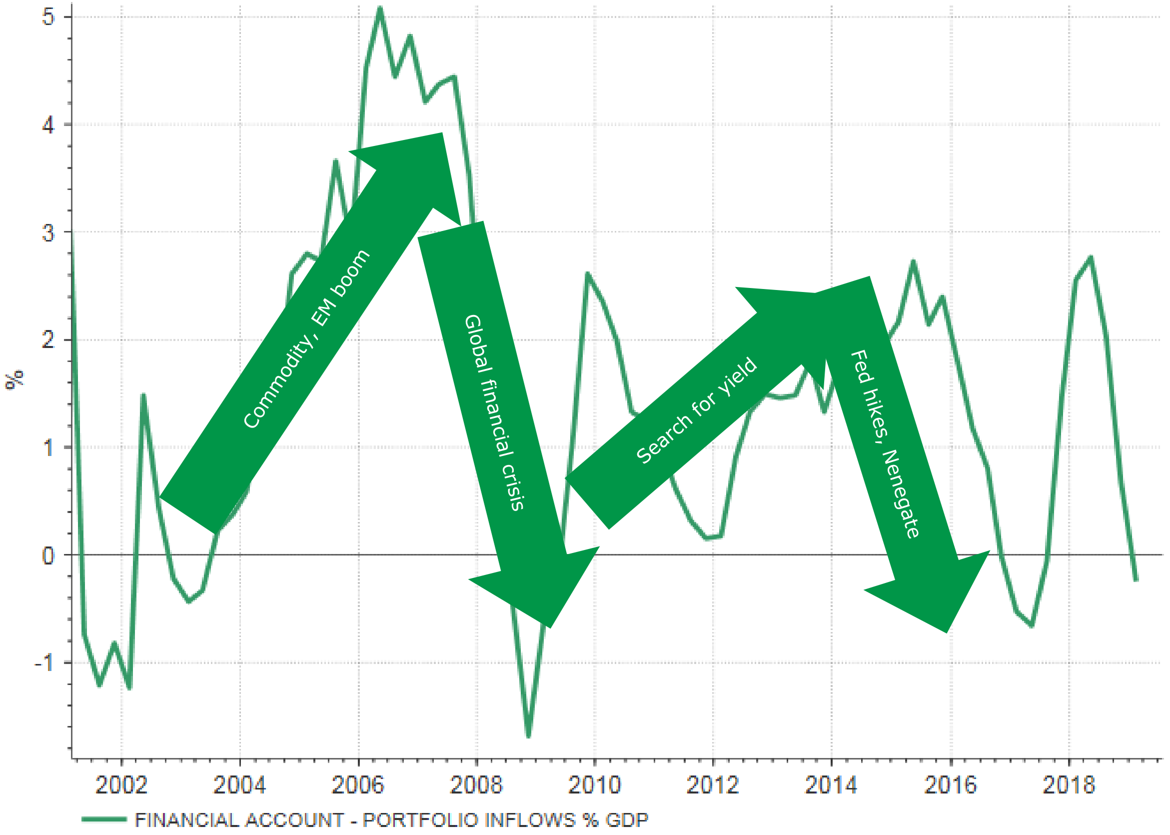
In theory, savings are required to fund investment



Source: Thomson Reuters Datastream/ Old Mutual Multi-Managers

- In practice, in a world of flexible exchange rates, this is not a binding constraint as funding can be sourced abroad.
- The bigger challenge has been the lack of demand, and lack of business confidence.

We rely on the kindness of strangers to fund our National savings shortfall



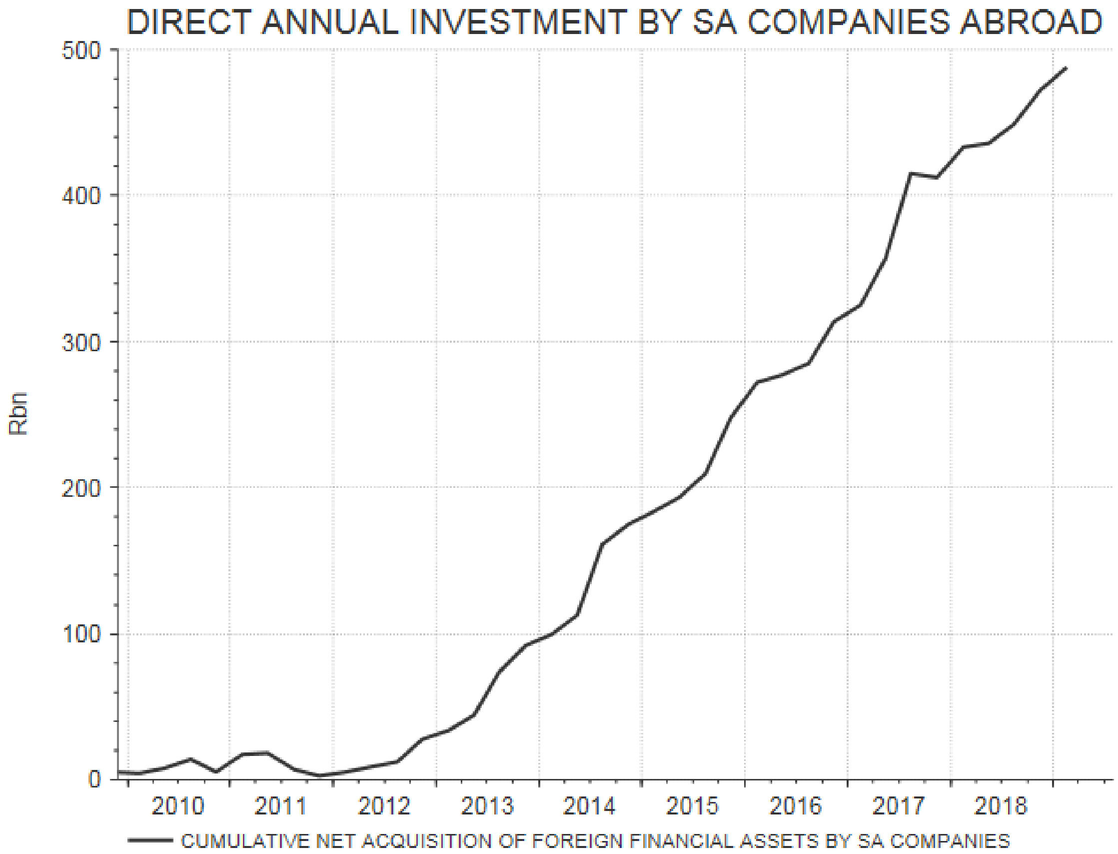
Source: Thomson Reuters Datastream/ Old Mutual Multi-Managers

Current account deficit is mostly funded by ‘hot money’ portfolio flows, attracted by high interest rates and profitable listed companies.

These flows can – and have - reverse leading to a weaker currency.

The current macro environment is potentially more conducive as global central banks are cutting rates.

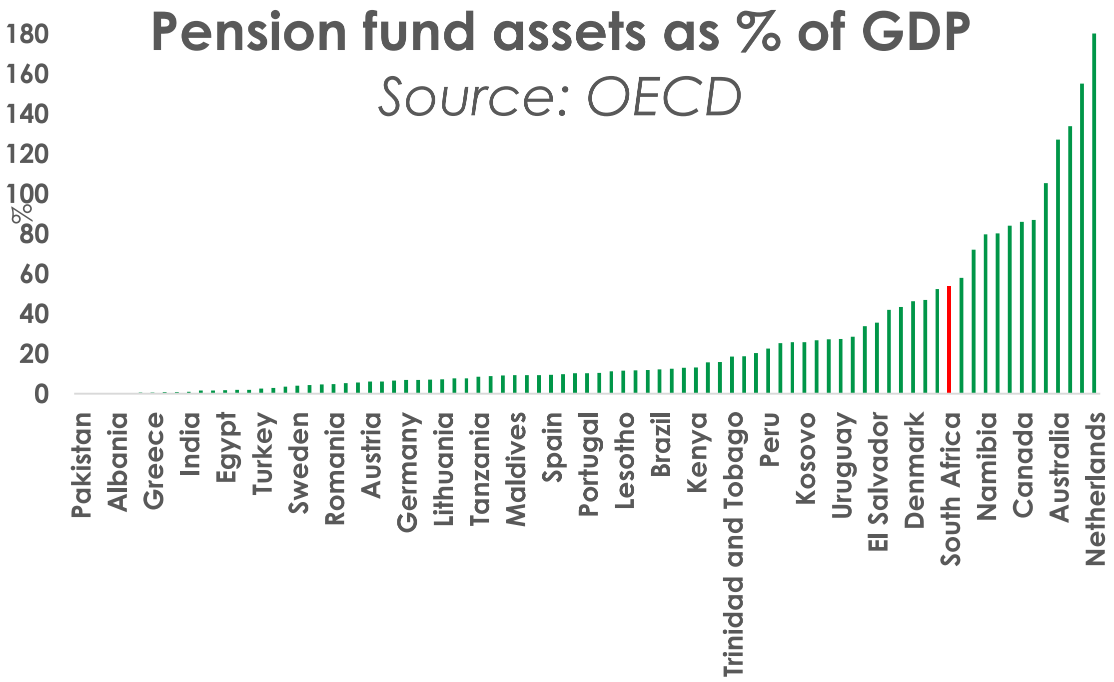
South African firms have instead been investing abroad



Source: Thomson Reuters Datastream/ Old Mutual Multi-Managers

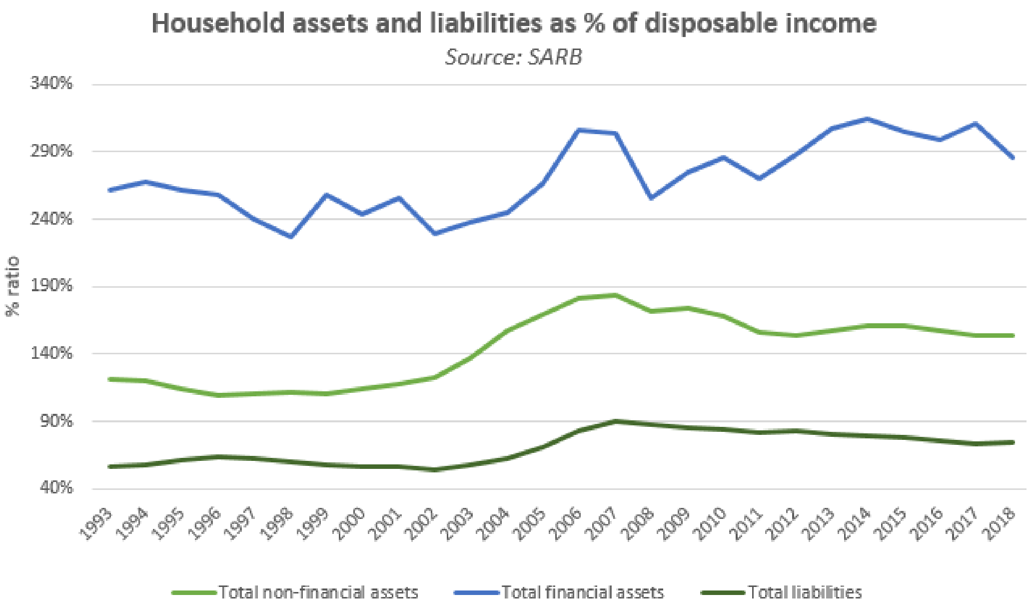
- Amid slow local growth, currency weakness and political & policy uncertainty outward investment by local firms surged over the past 6 years...
- …with mixed success.
- This as domestic private investment has not kept up.

The irony of low savings is that we have a large and sophisticated savings industry…



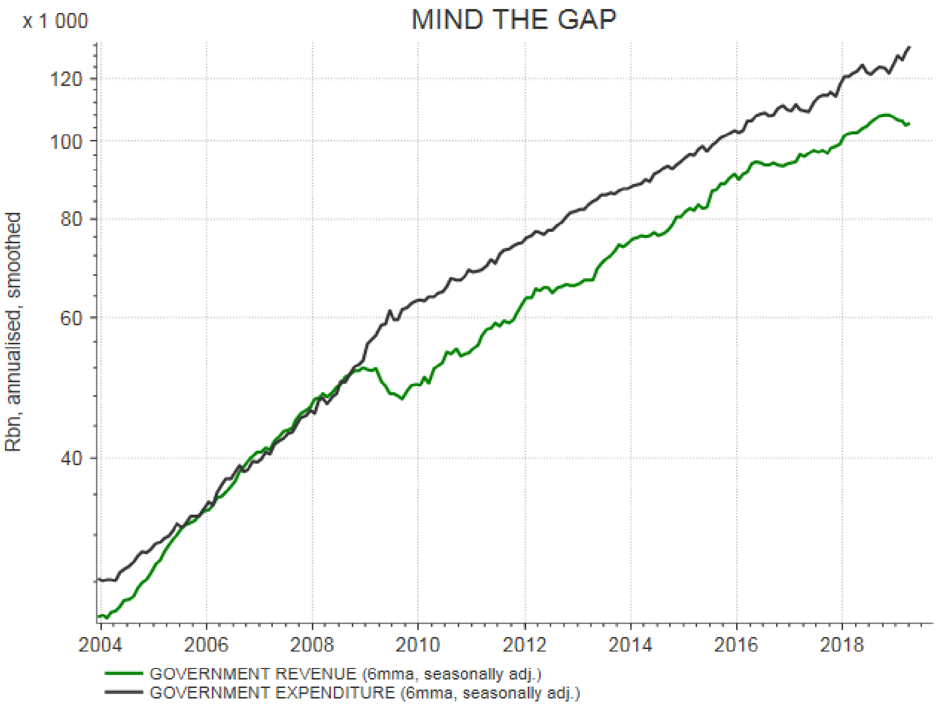
- …and deep and liquid capital markets, hence the persistent portfolio inflows.
- Compared to other middle-income countries similar countries, our financial system is very sophisticated.

A massive pool of domestic savings …… but not evenly distributed



- Total household financial assets were estimated at R8.3 trillion in 2018.
- Non-Financial assets (mainly property) was R4.5 trillion.
- Household debt was R2.1 trillion – this is negative savings, and also a function of a sophisticated financial system.

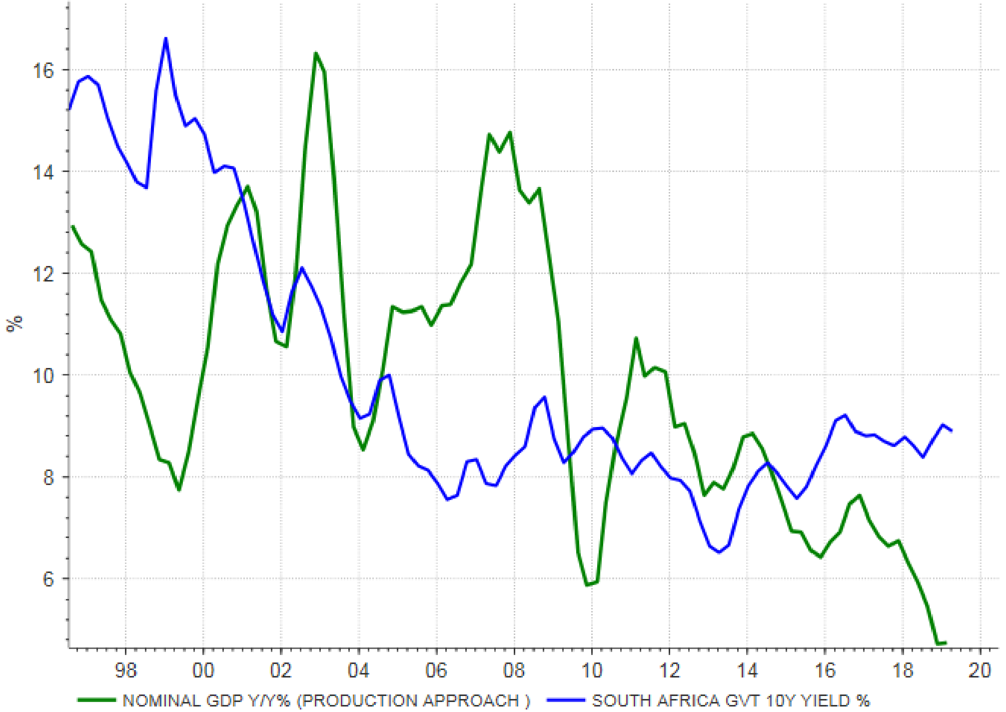
Government is the biggest dis-saver, …..and it is getting worse



Source: Thomson Reuters Datastream/ Old Mutual Multi-Managers

- Running large deficits, mainly to fund current spending (*of which only R76 bn goes to the State Old Age Pension*).
- While much public investment spending delivers a low return (think Kusile & Medupi).
- SOE Bail-Outs Is pushing up spending while weak economy is dragging down revenue.

The unpleasant fiscal reality – low growth & high rates

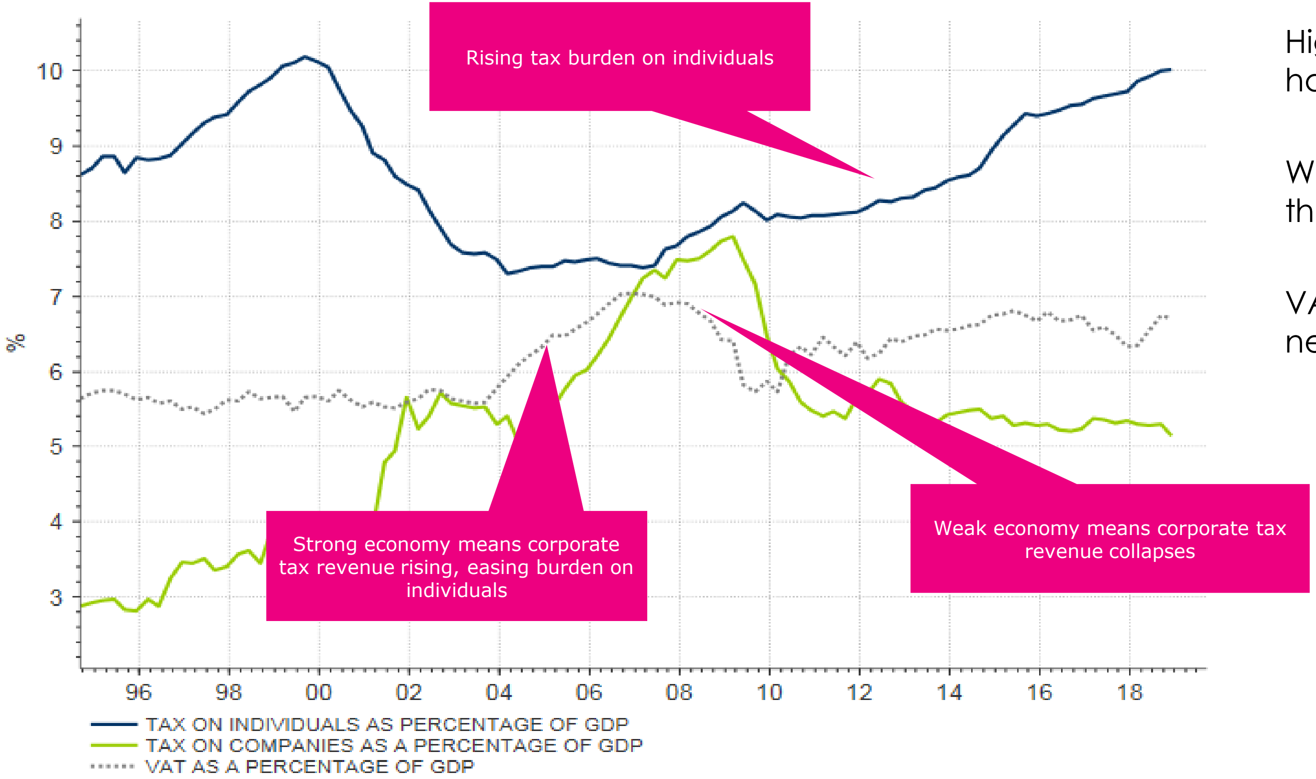


Source: Thomson Reuters Datastream/ Old Mutual Multi-Managers

- Economic growth is as slow as its ever been, and interest burden is rising.
- But there are 2 things we don't have to worry about:
- 1) No massive unfunded pension obligations weighing (Though The GEPF is a defined benefit scheme, it has substantial assets, R1.8 Trn in 2018).
- 2) Most government debt is in Rands – no need to call the IMF.

The Micro context

Tax burden on individuals has increased…



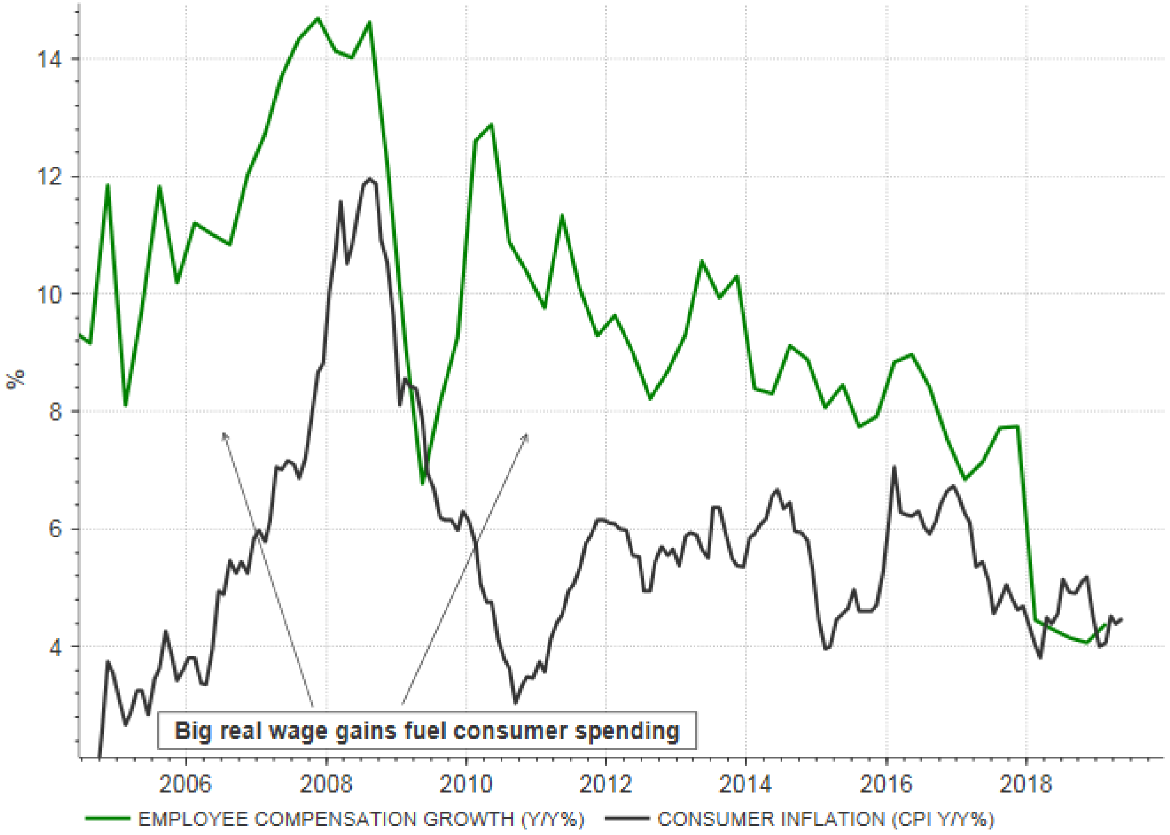
Source: Thomson Reuters Datastream/ Old Mutual Multi-Managers

Higher taxes means individuals have less money for saving.

We have probably reached the limit of taxing individuals.

VAT and companies tax will need to do the heavy lifting.

…adding to the squeeze on households



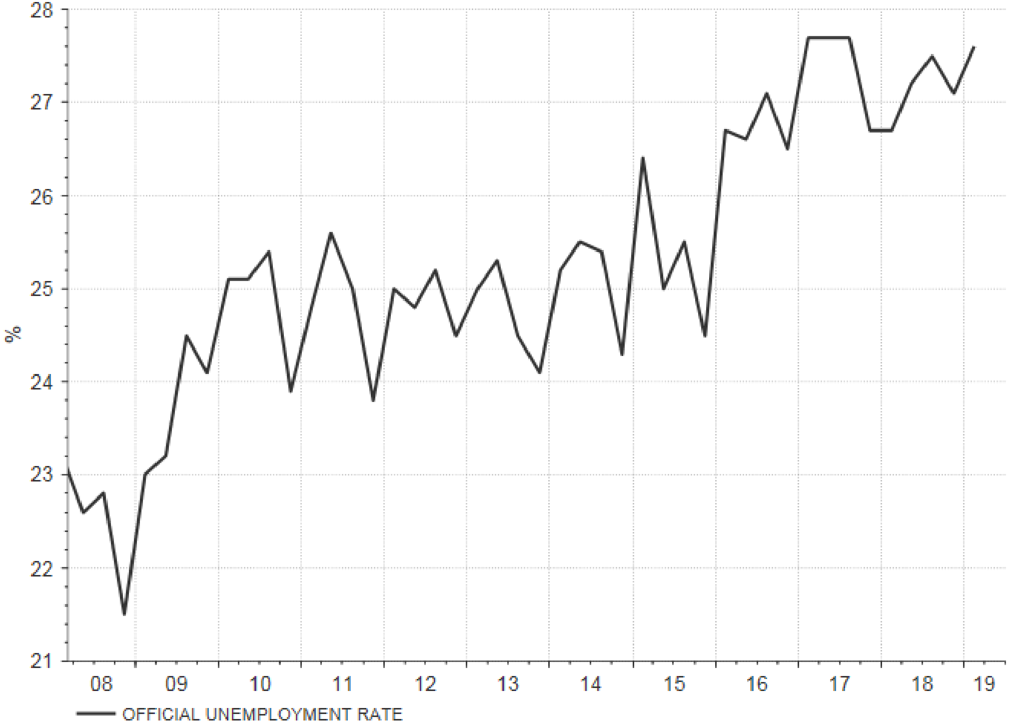
Source: Thomson Reuters Datastream/ Old Mutual Multi-Managers

Inflation is low, but tax increases and lower income growth are biting.

Income growth is starting to reflect weak economy, after years of above-inflation wage increases.

Very difficult to save more in this environment.

Poverty and unemployment are significant barriers to personal saving



Source: Thomson Reuters Datastream/ Old Mutual Multi-Managers

- Without income, how do you save? Basic, immediate needs take preference, understandably.
- Even when there is an income, it is spread across an extended family (vertically and horizontally).
- Employers play a key role in getting people to save through pension schemes.
- The lack of formal employment is an significant barrier.

Interest rates are high, but should decline

Source: Thomson Reuters Datastream/Old Mutual Multi-Managers

Little evidence that higher rates entices savings, but it does hurt consumer spending.

Cutting cycle will probably be shallow, offering modest relief for consumers.

In the current climate lower rates are unlikely to lead to higher borrowing

Apart from the tough economic climate, there are behavioural reasons why we don't save enough.

- **Conspicuous consumption –** we need to show our status through the things (and increasingly experiences) we buy. Retailers know how to exploit our behavioural biases very well!

- **Overconfidence** – People underestimate how much they'll need later in life, and overestimate how much they will be able to earn towards the end of their careers.

- **Status quo bias** – We procrastinate and postpone unpleasant tasks even if we know them to be important. Adding to the unpleasantness is the overwhelming complexity which can lead to sense of loss of control. More choices leads to fewer decisions being made!

- **Loss aversion** – Losing R100 hurts more than the enjoyment of gaining R100. Putting money away for some future event is painful. The opposite is also true – paying by credit card pushes the pain into the future while the pleasure is immediate.

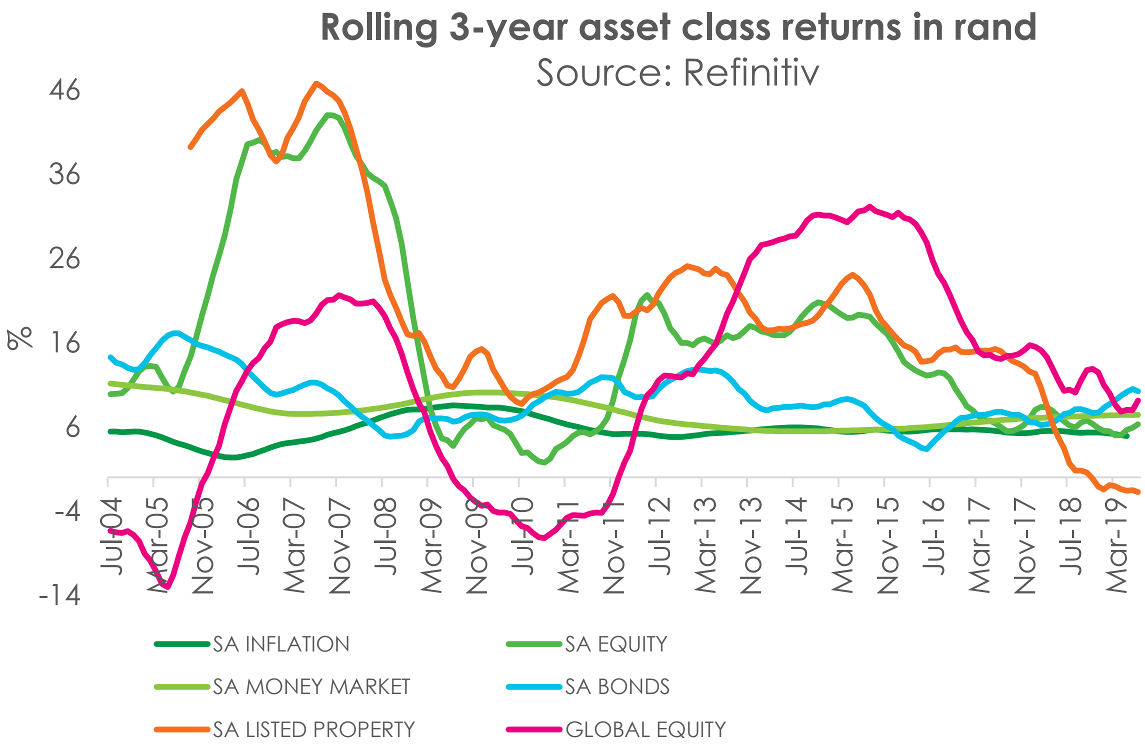
- **Identity gap** – we struggle to identify with our future selves, and therefore don't take actions to help "them." We simply do not like thinking about old age.

- It can be **hard** to save (lots of paperwork), and **easy** to withdraw money (click of a button). We need to make saving the default position (nudging).

- We make behaviour mistakes with investing too…destroying value of our savings.

Is Saving and Investing in this climate worth it?

Recent returns have disappointed, but over time South African investors have been rewarded



- We are unlikely to experience the outsized returns of pre-2008 (when exceptional markets bailed-out many with insufficient savings).
- but investors should expect decent real returns from a sa balanced portfolio (which is increasingly global), but patience is required
- Global and local equity valuations are reasonable, while local fixed income yields are among the highest in the world.

Local returns are not uniquely bad

Source: Thomson Reuters Datastream/ Old Mutual Multi-Managers

- In dollar terms, South African assets have performed in line with the rest of the world excluding the US. Local political uncertainty is not the main driver of investment returns!
- The big outlier over the past decade has been the us market, not South Africa.
- Despite our difficult history, local asset classes have delivered high real returns over the past 100 years.

Remember that you cannot control what the market gives you

- You <u>can</u> control how much you save
  - and every extra rand you save helps

- You <u>can</u> control how long you invest for
  - and the earlier you start, the better

- You <u>can</u> get the right long-term mix of asset classes
  - Don’t put all your eggs in one basket, but also make sure you have the right amount of eggs in the right baskets.

Important information

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