

INVESTMENT NOTE

22 JULY 2024

THE OCEAN NEXT DOOR



IZAK ODENDAAL

OLD MUTUAL WEALTH
CHIEF INVESTMENT STRATEGIST

The shocking assassination attempt on former US president and current Republican presidential candidate, Donald Trump, will no doubt revive an age-old debate among historians. Does the arc of history depend on such fluke events as a bullet missing its target by a few millimetres, or is it determined by deep structural forces beyond the influence of individuals? The short answer is both, though given our human love of storytelling and our ingrained hindsight bias (everything is obvious after the fact), we probably tend to elevate such historical “hinge moments”.

Structural forces matter, however, even if they are not absolute destiny. One such force is geography. Some countries are in good neighbourhoods, others aren't. It is safe to say that South Africans don't think too much about neighbouring countries, unless there is trouble. This is probably a byproduct of our colonial history. We know more about what is happening in UK politics, for instance, than in Botswana. Perhaps southern Africa is not exciting enough, or South Africa's economy is simply too large, bigger than all its neighbours combined.

But there is another neighbourhood South Africa belongs to, and it holds great promise.

OCEANS CONNECT

Arthur C. Clarke famously observed that our planet shouldn't have been called Earth, but rather “Ocean” since nearly three-quarters of Earth's surface is covered by sea. And while vast oceans separate the continents, they also connect them in important ways, particularly economically. That is because, given decent ships, it has always been significantly cheaper and easier to move goods by water than over land.

The Mediterranean is sometimes called the Cradle of Civilisations and it lay at the heart of ancient empires. For most of the past three or so centuries, the Atlantic Ocean, particularly the North Atlantic, has been the centre of



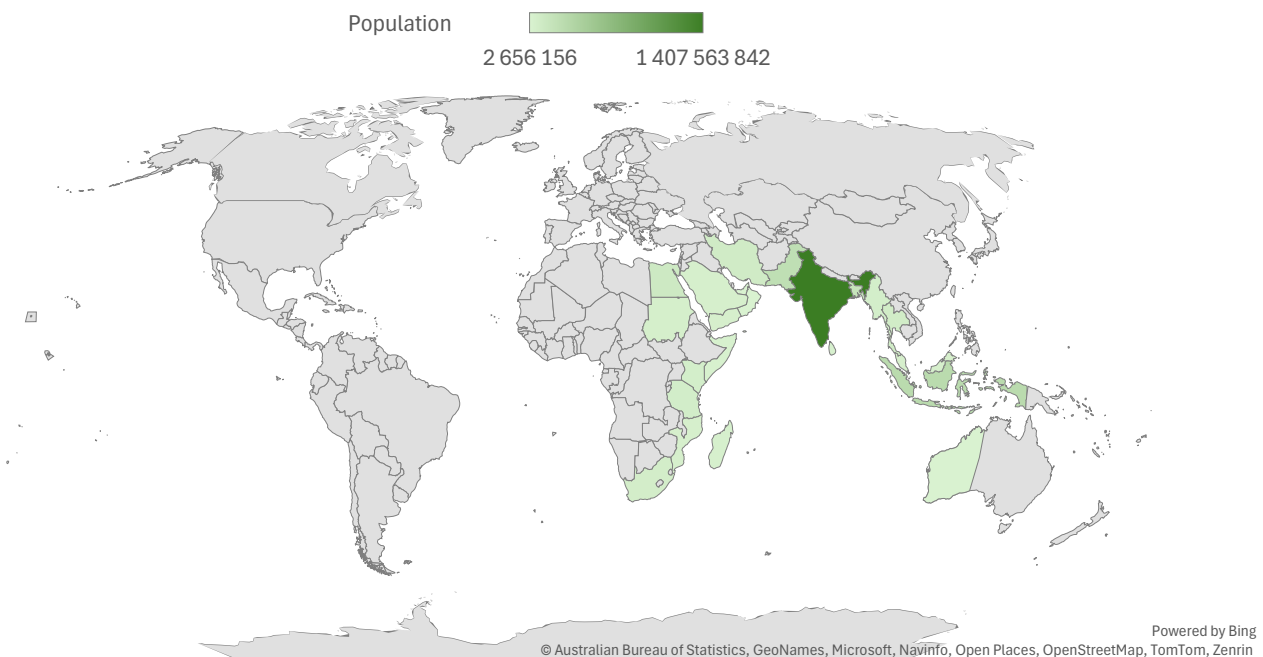
WEALTH

the global economy. Today, the Pacific has a strong claim to that throne, since it connects the two superpowers, the US and China.

Could it be the Indian Ocean's turn to take its place as a great economic region? The Indian Ocean and its seas, such as the Red Sea and Gulf of Arabia, are of course already

important links in the global economy. The Carnegie Endowment estimates that almost 90 000 vessels, carrying 9.8 billion tons of cargo, travel through the Indian Ocean annually. This includes two of the five busiest shipping channels feeding into it, namely the Suez Canal and the Strait of Malacca.

MAP 1: THE INDIAN OCEAN RIM



Source: Microsoft

But it is the current rapid economic growth of south and south-east Asia that will really put this region on the map, and fittingly, given the ocean's name, India is increasingly at the core of this growing economic ecosystem. India is the only large economy forecast by the International Monetary Fund (IMF) to grow by more than 6% per year over the next five years in real terms. However, the likes of Indonesia are not far behind with growth forecast to average 5% over the medium term, while Malaysia is expected to grow around 4%. Notably, however, the IMF projects that East African countries Tanzania and Kenya will also post rapid growth rates of 5% to 6% per year off a low base.

Depending on how you define the Indian Ocean Rim, it is home to a 2.8 billion people. Half of them live in India, but Indonesia is home to 275 million people and Pakistan 230 million. Bangladesh and Egypt are each home to more than 100 million souls. Between them, Kenya, Tanzania and Mozambique are home to another 120 million. These are a lot of potential customers, and a massive potential workforce.

Sparsely populated Western Australia can also connect into this ecosystem, since Perth is closer to Singapore than to Sydney. With a large and sophisticated navy, Australia is a particularly important player in maintaining the security of the region.

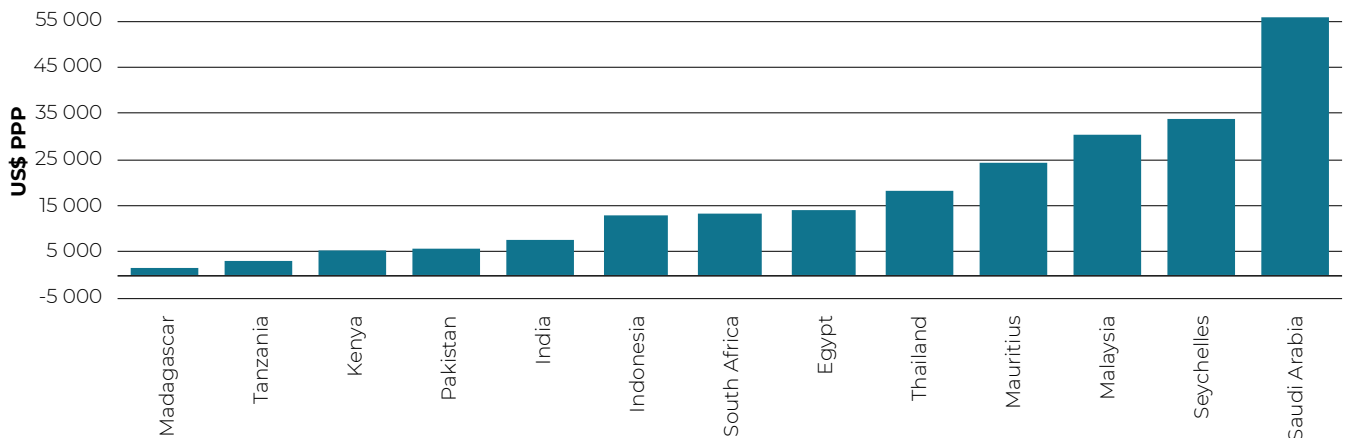
India sits at the geographic centre of this region and has unimpeded access into it on its eastern and western coasts, with around 7 500km of coastline and hundreds of ports. This contrasts with China, which despite its massive landmass, faces potentially inhibited access to the Pacific Ocean due to the proximity of US allies Taiwan, Philippines and Japan. As a side note, this again emphasises that the US absolutely won the geo-strategic lottery with free access to the Pacific and Atlantic Oceans. While Australia and Canada are also continent-sized countries with access to two oceans, they are too dry and cold respectively to sustain a large population. Russia has oceans, land mass and population, but its ports tend to freeze over in winter, and its land borders offer little natural protection.

LARGELY POOR

Despite very dynamic economies, the Indian Ocean Rim remains largely a poor region. The Gulf States have oil wealth, Singapore is a trading and financial global hub, Mauritius

an emerging offshore financial centre, and Australia is a rich developed country. For the rest, real per capita incomes are mostly below \$20 000 (adjusted for living costs).

CHART 1: REAL GDP PER HEAD, SELECTED COUNTRIES



Source: International Monetary Fund

The glass half empty view is that poor countries stay poor because they cannot mobilise the internal resources necessary to invest in skills, infrastructure and technology. They also often suffer from political instability and weak institutions. The glass half full view is that there is lots of room to leapfrog technological adoptions and benefit from the research and development work done elsewhere. Since infrastructure is underdeveloped, there are high returns to improving it, even only a little bit. A single new highway in a country with poor roads can unlock huge economic value, whereas it will only make a small contribution in countries with well-developed road systems. Finally, and importantly, small and poor countries can grow by tapping into much bigger global markets. Growth comes not only from export revenues, but also from the learning process of competing in tough markets.

For now, trade in the Indian Ocean is still dominated by raw materials, notably oil and petroleum from the Gulf, and iron ore from Western Australia, but also coal from Richards Bay. And of course it serves as conduit for Chinese goods travelling to Europe.

The big question is whether countries in the region can increase the share of manufactured exports to sustain

economic growth. An opportunity to do so is presented as the West increasingly aims to de-risk from China and shift production to friendlier locations. If Trump wins, which seems increasingly likely (though anything can happen in an election that is still four months away), trade tensions between the US and China will only increase. The other question is whether trade between the countries in the region can accelerate.

If so, the Indian Ocean presents a more practical prospect for South African firms than BRICS, which remains an incoherent collection of countries with few deep historical or geographical connections. And while South African policymakers have pushed a pan-African agenda since 1994, looking simply at logistics costs, it is easier to trade with Malaysia or Indonesia than landlocked Chad or Niger.

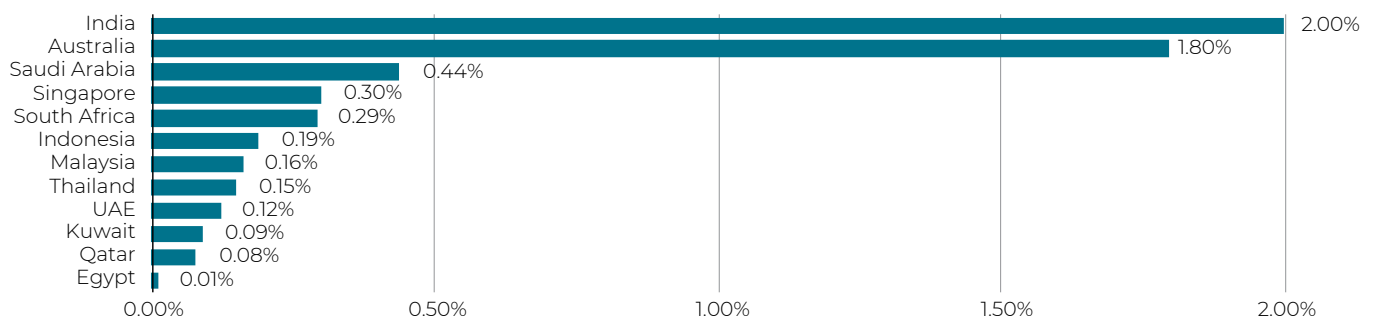
It means Durban and other east coast ports need to be world class, instead of languishing at the bottom of the World Bank's ranking table year after year (though Transnet disputes this assessment). Private sector investment is key to improving the ports, and the appointment of a Philippines company, ICTSI, to run Africa's busiest container terminal, Pier 2 in the Port of Durban, is a major step forward.

FINANCIAL MINNOW

South Africa has one of the more sophisticated financial systems in this region, and this can be a competitive advantage. But overall, the region is still tiny compared to global financial markets. The market value of all the stock exchanges that form part of the 47 country MSCI All Country World Index, a global equity benchmark, is 5.6%, with Australia contributing 1.8% and India 2%. By comparison, Japan's weight is 6% and the UK's is 3.6%. The three biggest companies in the index – Microsoft, Apple and Nvidia – each

have a weight of more than 4%. Unsurprisingly, there is no pan-Indian Ocean equity index yet, and most investors sitting in New York or London will probably just view this region as part of emerging markets as a whole or part of Asia. Fair enough. However, as thematic investment grows in popularity, don't be surprised if an Indian Ocean ETF pops up in future. Moreover, this doesn't mean that individual companies, irrespective of where they are listed, cannot benefit from increased trade links across the region.

CHART 2: MSCI ALL COUNTRY WORLD INDEX COUNTRY WEIGHTS



Source: MSCI, as at Dec 2023

FLASHPOINTS

Of course, this doesn't mean that everything is hunky dory. There are real geopolitical risks and areas of fragility. Somali pirates and Houthi rebels are a nuisance to maritime transport around the Horn of Africa and through the Red Sea. Iran is a perennial source of concern, since it could close the Strait of Hormuz, a key chokepoint in the transport of oil. The recent election of the moderate Mazoud Pezeshkian as president, another surprise in a year of unexpected election outcomes, probably limits extreme actions from Iran for now.

The biggest flashpoint is probably the decades-long tension between India and Pakistan, nuclear-armed neighbours. However, as the economic gap between India and Pakistan widens, the nature of the rivalry is arguably changing. India is booming, and Pakistan is stagnating. The latter could not hope to win a conventional war since it already teeters on the edge of bankruptcy. It could export its domestic instability in the form of terrorism, however. Either way, there is probably less risk of an India and Pakistan conflict triggering global war than is the case in the South China sea and Strait of Taiwan.

Put slightly differently, so far, unlike China, India has shown little interest in being a regional hegemon that throws its

weight around unfairly. This might change, but for now bodes well for economic cooperation in the Indian Ocean Rim.

China itself is a significant player in the region, even though it sits outside it geographically. It is a major trade partner for many countries on a bilateral basis and was until recently a big source of foreign direct investment through the Belt and Road Initiative (BRI). However, enthusiasm towards the BRI has faded in many quarters, partly because China has less money to throw around these days, and partly because many developing countries are wary of being saddled with large debts. The poster child for a BRI investment gone wrong is the Hambantota Port in Sri Lanka, built at huge cost with Chinese loans, but widely considered to be economically unviable. With Sri Lanka unable to service the associated debts, China has now taken it over, and faces accusations of "debt-diplomacy" and bullying.

In conclusion, a growing and increasingly interconnected Indian Ocean economy is probably not on the radar screens of most South Africans and businesspeople. It should be. For now, it is still the Cinderella of the large ocean regions, and it faces many obstacles, but that won't necessarily always be the case.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US\$	3 554.0	-2.04%	1.20%	12.15%	16.60%
United States	S&P 500	US\$	5 505.0	-1.96%	0.82%	15.41%	20.57%
Europe	MSCI Europe	US\$	2 119.0	-2.93%	1.15%	4.90%	7.29%
Britain	FTSE 100	US\$	10 532.0	-1.74%	2.01%	6.97%	7.26%
Germany	DAX	US\$	1 716.0	-3.27%	1.18%	9.49%	7.45%
Japan	Nikkei 225	US\$	254.5	-2.46%	3.40%	7.23%	8.03%
Emerging Markets	MSCI Emerging Markets	US\$	1 090.0	-3.02%	0.37%	6.45%	6.86%
Brazil	MSCI Brazil	US\$	1 451.0	-2.22%	3.05%	-19.39%	-11.47%
China	MSCI China	US\$	56.5	-4.86%	-1.52%	1.89%	-6.99%
India	MSCI India	US\$	1 085.5	-1.02%	1.17%	17.74%	30.94%
South Africa	MSCI South Africa	US\$	428.0	-3.60%	0.23%	3.13%	0.47%

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	79 923.0	-2.16%	0.27%	3.94%	3.69%
All Share	All Share (Total Return)	Rand	14 380.0	-2.14%	0.34%	6.11%	7.88%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	35 241.9	-2.00%	0.46%	6.21%	8.74%
TOP 40/Large Caps	Top 40	Rand	12 981.0	-2.37%	-0.04%	5.45%	5.36%
Mid Caps	Mid Cap	Rand	23 197.0	-1.43%	0.77%	6.48%	14.85%
Small Companies	Small Cap	Rand	36 872.0	-0.70%	3.04%	12.89%	24.43%
Resources	Resource 20	Rand	5 208.3	-1.97%	2.72%	7.13%	-1.39%
Industrials	Industrial 25	Rand	23 174.0	-3.03%	-1.29%	4.37%	3.76%
Financials	Financial 15	Rand	14 109.0	-1.43%	0.46%	9.28%	19.61%
Listed Property	SA Listed Property	Rand	2 063.6	-1.71%	1.06%	10.71%	26.52%

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\$	75.0	-0.16%	1.59%	-4.42%	-3.94%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	1 021.0	-0.45%	2.85%	8.57%	15.43%
Government Bonds	BESA GOVI	Rand	1 005.4	-0.47%	2.82%	8.47%	15.31%
Inflation Linked Bonds	BESA CILI	Rand	359.6	0.20%	0.90%	2.95%	9.55%
Cash	STEFI Composite	Rand	573.6	0.16%	0.47%	4.66%	8.56%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US\$	82.6	-2.82%	-2.79%	7.31%	4.59%
Gold	Gold Spot	US\$	2 395.0	-0.70%	2.97%	16.09%	21.08%
Platinum	Platinum Spot	US\$	964.0	-3.60%	-3.02%	-2.33%	-0.82%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	18.28	-1.80%	-0.48%	0.12%	-2.24%
ZAR/Pound	ZAR/GBP	Rand	23.62	-1.27%	-2.58%	-1.35%	-2.12%
ZAR/Euro	ZAR/EUR	Rand	19.89	-1.57%	-1.97%	1.55%	0.65%
Dollar/Euro	USD/EUR	US\$	1.09	0.00%	-1.74%	1.28%	2.75%
Dollar/Pound	USD/GBP	US\$	1.29	0.57%	-2.43%	-1.66%	-0.11%
Dollar/Yen	USD/JPY	US\$	0.01	-0.28%	-2.11%	11.65%	12.74%

Source: I-Net, figures as at 19 July 2024

The Old Mutual Wealth Investment Note is published on a weekly basis to keep our clients and financial planners informed of what is happening in financial markets and the economy and to share our insights. Markets are often very volatile in the short term and similarly, economic data releases or central bank actions may cause concerns for investors. This does not mean that investors should take action based on the most recent events. It is better to be disciplined and remain invested in well-diversified portfolios that are designed to achieve long-term objectives. Our Strategy Funds are actively managed, with asset allocation changes based on valuations and in anticipation of future real returns, and not in response to the most recent market noise. The future is always uncertain and that is why our Strategy Funds are diversified and managed with a long-term focus.



WEALTH

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. This document is for information purposes only and does not constitute financial advice in any way or form. It is important to consult a financial planner to receive financial advice before acting on any information contained herein. Old Mutual Wealth and its directors, officers and employees shall not be responsible and disclaims all liability for any loss, damage (whether direct, indirect, special or consequential) and/or expense of any nature whatsoever, which may be suffered as a result of or which may be attributable, directly or indirectly, to the use of, or reliance upon any information contained in this document.