FOREWORD

POLITICS OF OIL

IN THIS ISSUE

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DID YOU KNOW? OPEC

OPEC is an acronym for the Organization of the Petroleum Exporting Countries. It is a permanent intergovernmental organisation of 13 oil-exporting developing nations.

OPEC's mission is to "coordinate and unify the petroleum policies of its member countries and ensure the stabilisation of oil markets … to secure a … regular supply of petroleum ... [and] … a steady income to producers …" (edited).

It was founded in Baghdad in September 1960 by its five founder members: de facto leader Saudi Arabia, Iran, Iraq, Kuwait and Venezuela. These countries were later joined by Libya (1962), the United Arab Emirates (1967), Algeria (1969), Nigeria (1971), Gabon (1975), Angola (2007), Equatorial Guinea (2017) and Congo (2018).

According to current estimates, 79.4% of the world's proven oil reserves are located in OPEC member countries. Middle-eastern members account for two-thirds of the OPEC total. The organisation's headquarters are in Vienna, Austria.

Source: OPEC.org

MIKE TOWNSHEND
Portfolio Manager

There has been a seismic change in global oil markets, with potentially devastating long-term risks to the global economy and geopolitics. Portfolio manager and resources analyst MIKE TOWNSHEND looks at the politics of oil.

On 6 March 2020, Saudi Arabia stunned the world. Global oil demand was already slumping on the COVID-19 pandemic. But then the oil-rich kingdom announced it would not lead OPEC (see *Did You Know?*) production cuts as the world expected. Instead, the Saudis would increase production and offer discounts for increased volume.

The oil price responded viciously. In one week, Brent crude nosedived 40% from $50 per barrel to $30 per barrel. Belated production cuts announced by OPEC and its allies will unlikely offset the dramatic fall in demand.

The oil market is undoubtedly the world's largest commodity market. It is bigger than all mined raw-material markets combined. We have built the modern economy on a global logistical supply chain that cannot function without oil.

Oil fuels aeroplanes, ships and motor vehicles — think how dependent any economy is on imported goods. We have also all become accustomed to affordable travel: far-flung holidays and the daily commute. And there is a complicated downstream industry built on oil derivatives, from plastics to detergents, clothing and pharmaceutical products.

The vibrant US economy is easily the largest global oil consumer. Since the 1970s it has also been the biggest oil importer, heavily dependent on Saudi-led OPEC supply. Saudi stability in the strife-torn Middle East has in turn demanded costly US political and defence support.

However, a decade of elevated oil prices has attracted higher cost producers, notably US shale frackers. US oil production has doubled in ten years. It is now the world's largest oil producing country, eclipsing even Saudi Arabia.

> "The oil market is undoubtedly the world's largest commodity market."

As a net producer, the US could re-evaluate its expensive and divisive involvement in the Middle East. This is not good news for a Saudi leadership grappling with a changing world order.

Saudi Arabia still has the largest oil reserves in the world. It is also at the bottom end of the cost curve. With rising electric vehicle (EV) consumption, the prospect of peak oil before 2030 looms as the country loses runway to act.

By suppressing oil prices now, the Saudis will squeeze higher-cost producers out of the market. This includes the US frackers, threatening newfound US oil independence. The political ramification is continued US political and defence support. At least for now.

On the other hand, China has limited oil resources. It is not by chance that the Chinese are at the forefront of research into new EV technology. The economic behemoth is now the largest oil importer. The Chinese could step into the Middle East vacuum if the US reduces its influence.

COVID-19: THE PIN THAT POPPED THE BUBBLE

BRIAN ARCESE
Portfolio Manager

Global equity markets delivered the best calendar-year return of the decade in 2019. Many markets were at or near all-time highs. Foord Singapore portfolio manager BRIAN ARCESE looks at the market's dramatic fall from grace.

Welcome to 2020, already the most volatile period in modern investing history. We know this because the VIX tells us so (Chicago Board Options Exchange Volatility Index). In three short months, global markets have broken record after record. None of them pleasant.

The S&P 500 recorded its fastest transition from bull to bear market. The benchmark US stock index succumbed 20% in just 20 days. During the global financial crisis in 2008, it took 274 days to enter bear territory. The median length for all bearish drawdowns since 1915 is a sluggish 156 days. The index also posted three consecutive daily moves exceeding 9% for the first time since October 1929.

The media has inundated us with COVID-19 reporting. We all know that the pandemic caused the market rout. But we didn't know it was coming. Donald Rumsfeld would call it an unknown unknown.

Let's momentarily cast our minds back to the pre-pandemic economic environment. The world was still an unpredictable place as we turned the decade. Yet much of the geopolitical uncertainty of 2019 had begun to abate.

The signing of phase one of the US/China trade deal in January was encouraging. Full accord would of course need more and difficult debate. But the world's economic powerhouses seemed to have passed peak trade uncertainty. Removing this economic headwind would add meaningfully to US, Chinese and world GDP growth.

In Europe, the United Kingdom had finally withdrawn from the European Union. Formal withdrawal after 1,317 days of relentless and fractious debate marks only the beginning of a transition period. London and Brussels must now hammer out the details of their future relationship. But business could finally begin to plan and invest.

In the US, the Federal Reserve had cut interest rates three times successively. The loose monetary conditions and persistent real wage growth augured well for an improved 2020. Markets as we have written were on lofty valuations. Barring a material unknown unknown, the chances of a US recession and market rout were therefore low.

Then, in early January, the media reported on a severe new flu emerging from Wuhan, in China's Hubei province. Commentators drew quick parallels with the 2003 SARS epidemic. To limit contagion, the Chinese authorities resolved to quarantine first Wuhan, then Hubei and lastly much of China's 1.4 billion population. With hindsight, this action was not quick enough.

Foord's global investment team sits in Singapore. The city state recorded its first COVID-19 case on 23 January. Today, the infection has spread to millions of confirmed cases in 192 countries and territories. Over one hundred thousand people have perished. Governments have quarantined one fifth of the world's population. All these statistics will inevitably worsen.

> *It is self-evident that investment markets are forward looking. But investors' reaction to the global contagion was mostly coincidental.*

It is self-evident that investment markets are forward looking. But investors' reaction to the global contagion was mostly coincidental. Perhaps because of a grave misunderstanding that regional efforts would restrict the virus to Asia (like SARS in 2003). Or because the human mind struggles to understand and value large unknowns. Whatever the cause, the lag in the market's response gave Foord's global fund managers time.

In January, we increased portfolio hedging in the flagship Foord International Fund. The fund's positioning was already conservative. We hedged more in February. For those with technical knowledge, we bought put options on the S&P 500 index and sold S&P futures. The Foord Global Equity Fund had less exposure to the expensive US markets than peers and global stock indices — it has fared better than most global equity funds.

The market rout began in earnest in March as the virus began to spread globally. Industrial commodities and oil were inevitable casualties of the expected economic slowdown. The Russia-Saudi Arabian oil price war added to the panic. The market declines have been painful for investors. But we are grateful that our decision to protect investor capital has limited Foord International Fund's drawdown to less than half the market's decline.

There is widespread debate about COVID-19's virulence and fatality. Confirmed cases and fatality rates vary markedly by country. It is improbable that different populations have inherently different resilience. The differences are thus due to testing protocols, reporting standards, quality of care and timing. Population age is also a known differentiator in mortality rates.

Quarantines and travel prohibitions will slash global economic output in the first half of 2020. There will be recessions. These will cause millions of job losses, especially in service industries. Governments and central banks have responded with massive liquidity and fiscal packages. The goal is to shore up global markets and allow wage earners to fund daily necessities. But there will be many corporate failures and personal bankruptcies. History will judge whether the virus itself or mankind's response was most damaging to society.

With volatility comes opportunity. However, it would be incautious to load up with risk assets when the economic trajectory is still so speculative. The hedges in the Foord International Fund therefore still guard against further market weakness.

Foord's funds thus remain conservatively positioned and balanced. They are not reliant on one outcome. Many quality long-term investment opportunities are now suddenly attractively priced. Your fund managers will not squander the opportunity. But we will deploy cash warily and wisely.

small caps. BIG OPPORTUNITIES?

WIM MURRAY
Analyst

Small caps are listed companies with market capitalisations of less than R1 billion. Given their size, they are often unknown and overlooked. And, as analyst WIM MURRAY explains, therein lies the opportunity.

Small caps can offer very attractive, long-term investment prospects. Nimbly sized, they enjoy scope to aggressively expand market share and develop new products. They have a long runway to grow profitability. Management can also use sensible acquisitions to add meaningful value to shareholders.

In rare instances, we get to invest in undervalued companies operating in niche markets with few competitors. These small cap gems can generate exceptional long-term returns for early investors.

Because the large brokerage firms do not widely cover the small cap sector, company management are often generous with their time and eager to discuss their companies. Analysts willing to invest time and engage with management often achieve greater insight. This informational edge can help small cap investors profit from undervalued gems.

But small caps investing is an obstacle course with many pitfalls. As with all investments, the quality of company management is critical. But ethical and hardworking stewardship of invested capital is even more essential in small companies.

A key feature of small caps is founders or managers with sizeable shareholdings. Skin in the game is unquestionably positive for minority shareholders. Except when combined with a sense of entitlement and contempt for corporate governance. Excessively generous bonuses or poorly disclosed related-party transactions could easily become the norm if not aggressively challenged.

Small cap stocks are often thinly traded. Building an investment holding may prove deceptively easy. But you must have the time horizon and temperament to marry the stock. When the sirens of deteriorating business dynamics sound, the dangers of poor liquidity become clear: selling is only possible at depressed prices.

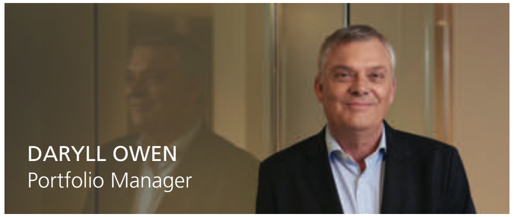
Price volatility therefore abounds for smaller companies. Meaningful dislocations between price and intrinsic value occur sporadically. For proof, look at the small cap index over the past five years to get a sense of how depressed valuations can become. The index has declined 36% in 2020 already and is down 50% over five years.

So how can investors benefit from the prevailing price opportunities while managing the key risks of small cap investing? Foremost is to be incredibly discerning. Illiquidity by its nature makes small caps long-term investment propositions. Rigorous analysis, high conviction and assessment of management's quality and ethics are paramount.

Investors must also clearly appreciate and stand willing to endure the inevitable price volatility. Moderate position sizing can mitigate the valuation impact and enable investors to tolerate bouts of volatility.

At Foord, we strive to capitalise on attractive investment opportunities across the spectrum of the investable universe. Undervalued small cap stocks have consistently formed part of our investors' portfolios. And they have, in the main, delivered outsized returns over very long periods. We are continually assessing the small cap opportunity set for our investors.

FOORD CONSERVATIVE FUND – SHOWING ITS STRIPES



DARYLL OWEN
Portfolio Manager

The since-inception performance of the Foord Conservative Fund has been underwhelming. But it is showing its conservative stripes in tough markets. Portfolio manager DARYLL OWEN revisits the fund's purpose and credentials.

Long-term investment is about achieving meaningful, inflation-beating returns. The best way to beat inflation is to invest in quality companies and property counters that have pricing power. Bonds are lower-yielding alternatives and even cash offers real returns at times. We know that equities attract much more volatility than interest-bearing alternatives. But they also usually deliver much higher long-term returns. Volatility is however not risk. And in the longer term, daily volatility doesn't matter.

Typical balanced funds assume an investment horizon of five to seven years. This time horizon corresponds with the average business cycle and is considered long term. In our view, most investors have a long-term investment horizon. Be it for their own lives, their surviving spouse or their heirs.

A small subset of investors has a time horizon shorter than five years. For this group of investors, Foord created a conservative balanced fund. We called it the Foord Conservative Fund to differentiate it from the Foord Balanced Fund. The principal difference is its restriction to a maximum of 60% in shares.

We are mindful that Foord Conservative Fund investors have a medium-term time horizon. The fund is still managed to deliver inflation-beating returns. But it does so within a more cautious framework. Over time, we expect the fund to deliver a lower yield than its big sister, Foord Balanced Fund.

A key tenet of Foord's investment approach is to match a fund's investment risk to its investment objective. We try to own assets that suit the investors' profile and time horizon. The Foord Conservative Fund is therefore not just a copy of the Foord Balanced Fund with 15% less equity. The types of investments we choose and the position sizes are more conservative.

We are now experiencing a global pandemic and market rout (see *COVID-19: The Pin That Popped The Bubble*). It is natural for investors to be worried. Worried for their own health, for their family and for their retirement savings. It is not comfortable seeing your investments diminish.

The FTSE/JSE Capped All Share Index (CAPI) collapsed 13.3% in March. The worst performing balanced funds tumbled by 14% to 16%. On average, balanced funds fell a little over 10%. In contrast, the Foord Conservative Fund declined 5.3%. It was ranked 12th of 95 comparable funds in the month. This excellent relative performance was achieved without resorting to mass selling of equities. That is a gamble that precipitates a second binary decision on having to time the market low.

Pandemics aside, we believe the JSE has been in a bear market for the past two years as Ramaphoria waned. Over that period, the fund has delivered 8.4% per annum (after fees and after the March drawdown). The CAPI fell 9.1% per annum over these two years. Now that's a meaningful, inflation-beating outcome in difficult conditions.

Foord Balanced Fund is undoubtedly our first-choice investment strategy for retirement fund products. But **Foord Conservative Fund is a good alternative for investors who need to dial down the medium-term risks.**

MARKETS IN A NUTSHELL

	WORLD	SOUTH AFRICA
EQUITIES	Global equities fell sharply on expectations of COVID-19's effect on economic activity and company earnings — the US S&P 500 Index recorded its fastest-ever bear market correction, falling 20% in just 20 days	The JSE plunged on the global sell-off with 'SA Inc.' companies including banks and listed property hit hardest — companies already under severe economic pressure will struggle to withstand a lengthy economic shutdown
BONDS	Developed market bond yields fell sharply as investors scrambled for liquidity and safe-haven investments — while central banks re-ignited market liquidity operations	South African bond yields surged as global investors sold off emerging market assets in a scramble for liquidity — while Moody's finally downgraded SA debt, leaving all three major agencies' ratings on BB+ with a negative outlook
CURRENCIES	The US dollar was unchanged against the majors but rallied against emerging market currencies — the dollar is sought after in times of stress	The rand is amongst the weakest currencies this year — given highly strained public finances and pandemic-driven global liquidation of emerging market assets

COMMODITIES

Crude oil plumbed 17-year price lows as Saudi Arabia and Russia entered an oil-price war just as the COVID-19 demand shock gathered momentum — industrial commodities also succumbed and should stay subdued, although precious metals should find support as alternative stores of value

	WORLD	SOUTH AFRICA
ECONOMY	Global growth expectations plummeted as COVID-19 became a global pandemic and much of the world was locked down — economic recession is a certainty, with only the depth and duration still debatable	SA is in a technical recession after two quarters of GDP contraction in 2019 — the economic standstill will cause a severe GDP contraction for the first half of 2020 at least
MONETARY AND FISCAL POLICY	Governments launched unprecedented fiscal measures to help the real economy survive quarantines — central banks cut rates and took emergency measures to support banks and ease financial market stress	The SARB cut the repo rate by a quarter-point in January to counter recessionary conditions — but made an emergency 1% cut in March and introduced liquidity measures to combat the COVID-19 fallout

FUND RANGE

BEST INVESTMENT VIEW FUNDS

FOORD FLEXIBLE

Exploiting the benefits of global diversification, the fund aims to provide investors with an after-fee return of 5% per annum above the South African inflation rate.

FOR INVESTORS

- With a moderate risk profile
- Seeking long-term inflation-beating returns over periods exceeding five years
- Requiring a balanced exposure to South African and global investments.

FOORD INTERNATIONAL (US$)

The fund aims to achieve meaningful inflation-beating US$ returns over rolling five-year periods from a conservatively managed portfolio of global investments reflecting Foord's prevailing best investment view.

FOR INVESTORS

- With a moderate risk profile
- Requiring diversification through investments not available in South Africa
- Seeking to hedge rand depreciation.

REGULATION 28 FUNDS

FOORD BALANCED

Managed to comply with the statutory investment limits set for retirement funds in South Africa, the fund aims to grow retirement savings by meaningful, inflation-beating returns over the long term.

FOR INVESTORS

- With a moderate risk profile
- Seeking long-term, inflation-beating returns over periods exceeding five years
- From an SA retirement fund investment product (Reg 28).

FOORD CONSERVATIVE

Managed to comply with the statutory investment limits set for retirement funds in South Africa, the fund aims to provide conservative, medium-term investors with inflation-beating returns over rolling three-year periods.

FOR INVESTORS

- With a conservative risk profile
- Close to or in retirement
- Seeking medium-term, inflation-beating returns over periods of three to five years
- From an SA retirement fund investment product (Reg 28).

SPECIALIST EQUITY FUNDS

FOORD EQUITY

The fund aims to outperform the FTSE/JSE Capped All Share Index over the long term, with lower risk of loss.

FOR INVESTORS

- With a higher risk profile
- Seeking long-term growth over periods exceeding five years
- From a portfolio of JSE-listed equity, commodity and property stocks
- And able to withstand investment volatility in the short to medium term.

FOORD GLOBAL EQUITY (US$)

The fund aims to outperform the MSCI All Country World Net Total Return Index from an actively managed portfolio of global equities, without assuming greater risk.

FOR INVESTORS

- With a higher risk profile
- Requiring diversification through investments not available in South Africa
- Seeking to hedge rand depreciation
- And able to withstand investment volatility in the short to medium term.

A MEMBER OF THE ASSOCIATION FOR SAVINGS & INVESTMENT SA **PLEASE REFER TO THE FACT SHEETS CARRIED ON WWW.FOORD.CO.ZA FOR MORE DETAILED INFORMATION.**

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