FOREWORD

DID YOU KNOW? EVERYTHING RALLY

The 'everything rally' is a phrase that describes the rapid price gains in the past decade of most financial and nonfinancial assets, including shares, bonds, precious metals, industrial and soft commodities, cryptocurrencies, property and even art. The term first started appearing in financial literature some years after the 2008/2009 Global Financial Crisis (GFC).

The genesis of the broad-based price rallies was the massive monetary and fiscal stimulus injected into financial systems by leading central banks and governments in the wake of the GFC to avert an economic depression. These measures included cutting short-term interest rates to zero and below.

Low interest rates increase the attractiveness of all other assets relative to cash, pushing up their prices. But extreme volumes of central bank liquidity, FOMO (fear of missing out) and TINA (there is no alternative) are also blamed for the rally.

Latterly, the 'everything rally' was renewed after unprecedentedly large monetary and fiscal interventions following the COVID-19 recessions of 2020.

ISSUE 60 | 4th QUARTER 2021

IN THIS ISSUE

- Safety First
- New Portfolio Manager
- Year In Review
- Book Dash Milestone
- Hospital Stocks
- Markets In A Nutshell

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SAFETY FIRST

PAUL CLUER
Managing Director

Foord has often described itself as a 'safety-first' fund manager. But what does this mean in the context of investment returns and the stage of the market cycle? PAUL CLUER revisits the concept.

The father of value investing, Benjamin Graham, said that an investment operation was one that "promises safety of principal and an adequate return". This seems to summarise what most of us want from our retirement portfolios.

Foord's safety-first approach embraces this definition of investing. We eschew speculative activity, which carries unnecessary risk. To us, risk means loss of investment capital. The biggest destroyer of capital over long periods is inflation. Graham's 'adequate return' must therefore exceed the long-term inflation rate for investors to achieve their investment goals.

So, we must preserve investment capital and compound inflation-beating returns over extended periods. Long experience has shown us that avoiding big losses (drawdowns) helps dramatically with this outcome, since compounding negative returns is as dangerous as compounding positive returns is helpful.

The risk of investment loss is countercyclical: risks increase as the business cycle matures and investment markets rally to new highs. Conversely, risk of loss abates after markets draw down in anticipation of a slowing business cycle or an external economic shock such as the COVID-19 pandemic.

After the March 2020 reset, global markets have been on a tear. Massive global monetary (lower interest rates and central bank stimulus) and fiscal (government transfers to corporates and individuals) interventions fuelled the 'everything rally' (see *Did You Know?*), pushing global share bourses to all-time highs. The US S&P 500 Index has doubled since its March 2020 lows. Global bourses in aggregate have gained 92% in US dollars. In South Africa, the FTSE/JSE Capped All Share Index also doubled, with the resources index returning a staggering 177% in rands.

Concurrently, labour shortages and supply constraints have raised the spectre of uncontrolled inflation. Global bond markets have been the first to retrace on the prospect of hard choices which central bankers will need to take.

Coupled with worrisome global geopolitical risks, high valuations and rising inflation pose threats to investment portfolios that warrants caution. Foord's strategy has been to have a lower than average weight to the most frothy areas of the market, which include stratospheric US tech stocks, global bond markets, the SA listed property sector and — especially in South Africa — resources shares.

Many of these areas have pushed ever higher. As a result, our investment returns in the last 18 months have lagged less cautious peers. In hindsight, we were overcautious and should have captured more of the returns that were on the table. We have nevertheless delivered more than the yardstick 'adequate return' needed to compound long-term inflation-beating returns.

That said, the safety-first strategy worked in the 1997 Asian financial crisis, the 2008 Global Financial Crisis and the 2020 COVID-19 pandemic. It should again deliver the goods if 2022 proves to be a watershed investment year, should interest rates rise unexpectedly to counter the inflation threat.

YEAR IN REVIEW – AND WHAT'S IN STORE

NICK CURTIN
Head: Business Development and Investor Relations

Last year kicked off optimistically with the pandemic-stained 'annus horribilis' of 2020 left behind. Behind this mini psychological victory there were other reasons for early optimism. NICK CURTIN writes about the year that was and what could be in store for investors in 2022.

The unprecedented speed with which vaccines were made available *en masse* offered early hope that socio-economic activities might quickly return to normal. Expectations for a ramp up in US fiscal spending, record levels of monetary stimulus and China's rapid economic recovery augured well for resurgent economic growth. South Africans relished the relaxation of beta-wave restrictions that had curtailed summer holiday spirits and pent up consumer demand started to unleash. Prospects of watershed local elections later in the year also created some silent hope.

But it was soon clear that another year of nerve-wracking turmoil lay ahead. On 6 January, incredible scenes in Washington DC of disgruntled Trump supporters violently occupying the Capitol shocked the world. First signs of rising inflationary pressures also sparked alarm, as re-opening economies bumped up against constrained global supply chains and energy shortages. It also quickly became plain that new COVID-19 variants would continually assail the globe.

But unambiguously dovish and globally coordinated central bank actions rapidly allayed market fears. Developed market consumers (notably in the US) were flush from government emergency income-replacement programs. They spent with abandon, powering the economic recovery. Combined COVID-19 global support programs now exceed $31 trillion, resulting in record levels of government debt globally. We have borrowed from the future to save the today.

Midway through the year, the more virulent Delta variant caused market flutters. Inexcusable delays in vaccine procurement and rollouts across most emerging markets and even in the EU (which embarrassingly lagged US and UK efforts) compounded matters. Markets were nevertheless largely unfazed: corporate earnings steamed ahead, central banks maintained extreme monetary policy settings, and indications were clear that US fiscal policies would still be exceptionally expansionary — even as emergency direct-to-consumer fiscal support measures started to fade.

> It seems that the multi-decade epoch of low and falling inflation is now mostly behind us.

As the year got underway, China seemed set for annual GDP growth exceeding 8%. However, momentum faded into the second half as the country sustained its first pandemic-related GDP contraction as swingeing regulatory interventions and potential credit default by China's largest property developer spooked investors. GDP growth for the year is likely to have been among the lowest in almost 30 years.

In South Arica, the economy continued to recover on increased production in agriculture, mining and trade as well as a solid rebound in consumer spending. But manufacturing, construction and the leisure and tourism industries are still mired in recession. Unemployment levels are stubbornly high with little prospect for recovery. Debt metrics only improved after Stats SA rebased SA GDP after a routine review. The positive revenue surprise from a massive rally in the country's commodity exports has also temporarily improved public finances.

Sadly, the seemingly orchestrated, violent and deadly looting in large parts of KZN and Gauteng in July caused significant damage to property and investor sentiment. The economy can ill afford such self-inflicted wounds. It was a timely reminder perhaps of the unsustainably high levels of inequality. Combined with lacklustre, obsolete and ideologically driven economic policy, it supports our thesis of structural weakness of the South African economy and the rand.

Notwithstanding the multitude of nail-biting events and mounting risks, financial markets globally and in SA recorded a stellar year as the 'everything rally' (see *Did You Know?*) continued — such has been the power of the decades-long experiment in extremely low interest rates, latterly combined with massive governmental fiscal injections.

Looking forward, it seems that the multi-decade epoch of low and falling inflation which has allowed central banks the policy space for such largesse is now mostly behind us. Central banks and governments appear to have finally reached their limits, with little choice now but to withdraw extreme levels of support. The policy toolkit is empty and must be replenished — failure to do so can only result in calamity farther down the road.

Most asset classes are trading at historically expensive valuations. Any economic or geopolitical shock (of which there could be any number) may cause 2022 to be a watershed investment year. Notwithstanding external shocks, asset class returns will in general be lower in the years ahead. It is also probable that after a decade of very low dispersion, returns across and within the major asset classes and their sub-components will bifurcate. There will be clear winners and losers in this changing paradigm.

Nevertheless, well-diversified investors can still achieve inflation-beating returns. This will require careful positioning and avoidance of investments with the highest risk of permanent capital loss. To finish first, first you must finish. Foord has been refining its investment strategy over the last few years for precisely this watershed moment. We expect that investor patience will soon be well rewarded.

HOSPITAL STOCKS ON THE MEND

DHERSAN CHETTY
Equity Analyst

The past two years of living with COVID-19 has started some trends and accelerated others. Trends such as remote working are now well entrenched. Equity analyst DHERSAN CHETTY discusses another developing trend — greater awareness of and need for medical aid cover.

The pandemic has disproportionately affected older people. Nearly 90% of COVID-19 deaths have occurred in people older than 45. Unsurprisingly, medical aid schemes have reported greater demand for medical insurance from this cohort (up 0.6% in 2021), despite falling overall medical aid demand (down 1.1%).

There has therefore been an influx of older individuals that are now more conscious of their health needs and the importance of having medical aid. The average age of the medical aid pool is thus older. This is important because the over-45 cohort accounts for 60% of total healthcare spend, but only 32% of insured lives.

The longer someone is on private medical aid, the less likely they are to return to public health facilities. Their medical aid membership is therefore 'sticky' over time. This is especially true in South Africa, where medical aids may not price for risk. This cross-subsidisation model incentivises older members not to lapse their policies.

Given the trauma of COVID-19 deaths, people are now more likely to cut other expenditure before removing their healthcare benefit. The industry also offers some well-regarded low-cost plans that give the same quality of care, but in a reduced hospital network to improve access.

Elective surgery ground to a halt during the four South African pandemic waves due to the risks of cross infection. The milder incidence of Omicron, increased natural immunity in the population and vaccination progress should unleash pent-up demand for elective surgeries. Vaccination rates among medically insured people are much higher than the national average. For example, 72% of Discovery members were at least partially vaccinated by 28 November 2021 compared to the 40% national average.

Mental health issues have been rising over the past decade and have been exacerbated by COVID-19. Globally, there has been a reduction in the stigma of seeking mental health treatment. Private hospitals in South Africa have been expanding into this fast-growing healthcare segment. The sector therefore stands to be a beneficiary of the trend for improved mental healthcare.

A return to normality means increased costs for medical aids, but will provide tailwinds to the SA hospital sector. The pandemic understandably battered the share prices the JSE's hospital stocks — Netcare, Life Healthcare and Mediclinic International. The sector declined by approximately 30% at its 2020 low.

These stocks seemed to us to be a bargain, given their prospects for post-pandemic growth and their defensiveness during tough economic conditions. We own meaningful amounts of all three stocks in the Foord Equity Fund, and lesser amounts in other portfolios. They should deliver good double-digit returns for investors over the coming years.

FOORD EQUITY FUND'S NEW PORTFOLIO MANAGER

WIM MURRAY
Portfolio Manager

We are pleased to announce that Wim Murray has been added to the multiple-counsellor manager mix for South African equity mandates. He joins Nick Balkin, Dave Foord and Nancy Hossack as portfolio managers on this strategy, which includes the Foord Equity Fund unit trust.

Wim joined Foord from Peregrine Capital in 2013 and later took a hiatus to read for an MBA in Spain. Luckily for us, Wim returned to SA and rejoined Foord in 2017. We were very pleased to have him (and his unbridled passion for investments) back.

Wim is a CFA charter holder with 10 years' investment experience, which followed on BSc and LLB degrees from the University of Stellenbosch. Wim has covered most areas of the South African market, including general industrials, banks and retailers.

BOOK DASH'S MILESTONE TWO MILLION BOOKS

Foord has sponsored the efforts of Book Dash, a local NGO that works to promote literacy and the love of books to all South African children, for three years now. The Book Dash vision is for every child to own a hundred books by the age of five. A massive endeavour, but a feat they are well on their way to achieving — one book at a time.

In January 2022, Book Dash reached the massive milestone of over two million picture books printed. These will be distributed through literacy and early childhood development partners to children across South Africa, often being the first books they will own. All Book Dash books are created in 12-hour sprints throughout the year by volunteer writers, illustrators, designers, editors and translators from across the continent.

We are immensely proud of their achievement. And grateful for their guidance and inspiration for Foord's own TEACH YOUR CHILD TO INVEST financial literacy initiative.

For more information about Book Dash visit www.bookdash.org.za. And Foord's TEACH YOUR CHILD TO INVEST financial literacy initiative at https://foord.co.za/insights/publications/teach-your-child-to-invest.

MARKETS IN A NUTSHELL

EQUITIES

World: Equities brushed aside the Omicron threat to rally into the year end — but markets have already begun to discount the changing real economy drivers and policy backdrops

South Africa: The FTSE/JSE Capped All Share Index followed global equities higher, led once again by resources counters — capping a very strong calendar-year performance

BONDS

World: Developed market bond yields were remarkably little changed — given the spectre of structurally higher inflation and almost universal monetary policy tightening

South Africa: SA bonds were positive, especially the longer dated maturities — despite negative global emerging market sentiment, and rising SA inflation and interest rates

CURRENCIES

World: The US dollar strengthened on the Omicron risk-off sentiment and expectations for rising US interest rates — but any policy U-turn by the Fed is likely to see the dollar weaken

South Africa: The rand weakened against the US dollar — on a combination of dollar strength and negative emerging market sentiment, despite monetary tightening by SARB

COMMODITIES

The stronger dollar, strained global supply chains and higher energy prices buoyed commodity prices — these are all likely to stay well bid near-term, given heightened socio-political sensitivities

ECONOMY

World: Pandemic-related global economic growth uncertainties have started to fade — markets are now increasingly turning to the fundamentals of the real economy

South Africa: The economy continued to recover from the deep 2020 recession on sensible, data-driven policy response to Omicron — but early red-listing of SA by primary tourist markets hampered tourism

MONETARY AND FISCAL POLICY

World: Global central banks are rapidly moving towards policy normalisation — with the US Fed planning to end its asset purchases program by March and hike interest rates three times in 2022

South Africa: The spike in mining royalties and tax receipts has helped the country's fiscal revenues — while SARB joined a host of other central banks in increasing the repo rate

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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