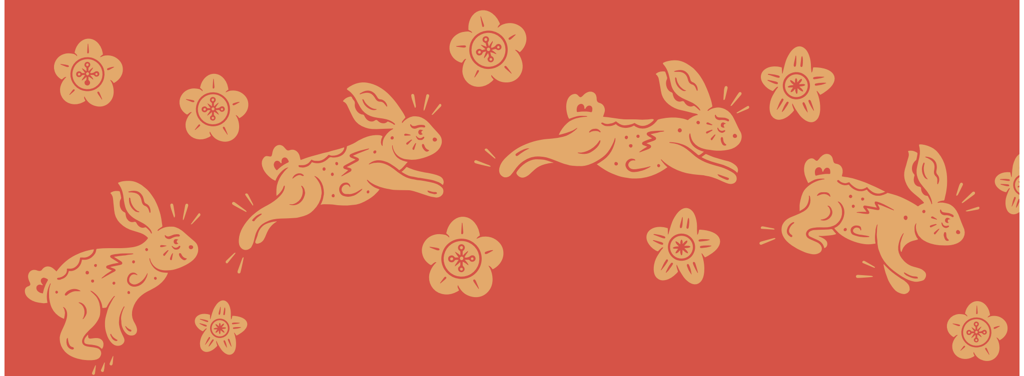
FOREWORD



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DID YOU KNOW? YEAR OF THE RABBIT

Chinese New Year is a festival that celebrates the new year and the transition between zodiac signs. Also known as Lunar New Year, it is one of the most important holidays in China, throughout Asia and in Asian communities around the world.

The Year of the Rabbit (more specifically, the water rabbit) begins on 22 January 2023. The rabbit is a symbol of longevity, peace and prosperity. And 2023 is predicted to be a year of hope.

As we close the door on 2022 and the Year of the Tiger — a very tempestuous one at that — we are more than ready to usher in a year of wealth, prosperity and good fortune.

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FOORD FIXED INCOME FUNDS

PAUL CLUER
Managing Director

We reported on the August appointments of experienced fixed income portfolio managers Rashaad Tayob and Farzana Bayat in *Foreword* Issue 62. Since then, they and the Foord team have launched two new fixed interest funds, which are now available to direct investors. PAUL CLUER introduces the Foord Flex Income Fund and the Foord Bond Fund.

The Foord Flex Income Fund seeks to deliver a high income yield for investors. It carries some prospects for capital gain and a very low probability of capital loss over the investment horizon of one to two years.

It invests in a dynamic mix of listed and unlisted interest-bearing investments and sometimes into shares and listed property in small amounts. The fund does invest into foreign interest-bearing investments, such as those priced in US dollars. However, the managers will typically hedge out the currency risk of such investments to deliver a much smoother return profile for investors.

The Foord Flex Income Fund is a low risk fund. It sits just two notches up from the ultra-conservative money market funds. If you invest for six months or more, the chance of a price decline is low. But because of the nature of its investments, you can expect to earn a higher income yield than what is available in money market funds. Right now, the fund is yielding 8.7% per annum, but the yield will change over time as many of the instruments have variable interest rates.

The fund is appropriate for investors who have short-term savings needs. The yield is high but will be taxable for most investors. If you have a savings horizon of longer than two years, there are better products in the Foord range that will capture more capital growth at a lower tax burden. Investors should not be tempted to time markets by switching out of their long-term savings strategies to use the fund as a parking vehicle for cash. Such activity carries significant risks to investment outcomes and incurs capital gains tax liabilities.

> *"The Foord Flex Income Fund seeks to deliver a high income yield."*

The Foord Bond Fund is a specialist fund that invests in a broad spectrum of South African bond assets. At 10.8%, its yield is substantially higher than the Foord Flex Income Fund, but comes with more risk of loss in the medium term. Bonds deserve a place in most investment portfolios, at least most of the time. However, we would recommend that investors seek financial advice before including this fund into their portfolios in significant amounts.

Both funds should beat inflation over time, but not by the amounts needed to compound meaningful inflation-beating returns. Investors will need other assets to do even heavier lifting on the inflation front in their retirement portfolios. This is where the Foord Conservative, Foord Balanced and Foord Flexible Funds come into their own.

THE YEAR IN REVIEW

LINDA EEDES
Investment Professional

Calendar year 2022 started with a tone of cautious optimism. However, all too swiftly markets succumbed to a new threat: rising global inflation. Investment professional LINDA EEDES describes how the inflation theme came to dominate global markets, leading to the worst year for global stocks and bonds combined in 150 years.

The world's emergence from COVID-19 isolation is what lit the global inflation fire: pent-up savings and stimulus cheques chased too few goods and services amid stretched global supply chains. Russia's invasion of Ukraine in late February fuelled the flames — further disrupting global supply chains and pushing oil prices to more than $110 a barrel in March 2022.

This final price spike forced the US Federal Reserve to abandon its view that global inflation would be transitory. This kicked off the fastest paced, most aggressive US rate tightening cycle in four decades. The Fed's rate hikes reverberated around the world. Most other central banks rapidly followed suit in an increasingly tricky balancing act of fighting inflation with already slowing growth.

The US dollar strengthened against most currencies, buoyed by the Fed's aggressiveness and its safe-haven status. Chinese economic activity slowed, exacerbated by frustratingly rigid lockdowns for the better part of 2022. Recession risks for 2023 were on the rise and most commodities sold off.

> *"The rapid rise in rates weighed heavily on developed world stock and bond markets."*

The rapid rise in rates weighed heavily on developed world stock and bond markets. Both sustained severe double-digit losses. With no diversification benefits between these asset classes, it was the worst year for the traditional 60:40 stock and bond portfolio in 150 years.

The expensive US equity markets fell most amongst developed economies. Long-duration assets — the hottest themes of 2020 and 2021 — fared worst in the market rout. These include US tech names and cryptocurrency, which fell from bubble levels as the opportunity costs rose with sharply higher interest rates.

Emerging markets were also lower, dragged down by Chinese equities (see *China — Turning a Corner?*). The much less expensive South African share and bond markets were marginally positive but fell by low single-digit percentages when measured in US dollars.

True to Foord's safety-first approach, the Foord funds were resilient. The flagship Foord International Fund delivered a small, positive return in US dollars when the worst peer-group fund fell by more than a third. This is a phenomenal achievement.

In South Africa, the Foord unit trust funds all delivered at least positive returns. The multi-asset funds (Foord Conservative, Balanced and Flexible Funds) were ranked comfortably within the top 25% of their peer groups, despite having a good amount of risk assets to deal with the coming inflation threat. The equity strategies (Foord Equity, Global Equity and Asia ex-Japan Funds) were all ahead of benchmark for the year in a stock-pickers environment.

Looking ahead, we're now seeing the unintended consequences of 10-plus years of easy money. Artificially low interest rates incentivised investors to take undue risks and reach for yield. Governments were also free to run up national debts, which have suddenly become expensive as interest rates spiked. Capital flowed to unproductive sectors and weak or failing companies were propped up. Housing in countries such as the US, Canada and Australia rose to unaffordable levels. Central banks ballooned their balance sheets and pockets of leverage were created.

Despite the market drawdowns, most of this is yet to unwind. This will be a headwind to financial markets in the years ahead — it is therefore premature to assume that the worst is over.

We expect that 2023 will be an even tougher year for consumers here and abroad: either interest rates will remain high due to sticky inflation, or they will fall if we enter a global recession.

> *"Looking ahead, we're now seeing the unintended consequences of 10-plus years of easy money."*

Global bond yields are still too low for bonds to prove as defensive as they have been in previous cycles. Geographically, there is opportunity within equities, but the biggest opportunity remains stock selection. Given the significant valuation dispersion within equities, we expect big winners and losers to emerge as companies differentiate themselves in the challenging operating environment.

While asset allocation plays a vital role in protecting and growing investors' wealth, we envisage that stock selection will be paramount in 2023. The bigger call will therefore be less about asset allocation and rather about which securities you own — and, much more importantly, which you avoid. We think we have these risks well managed.

CHINA – TURNING CORNER?

JC XUE
Portfolio Manager

Chinese equities were resilient in 2020 as the country (ironically) avoided the COVID-19 recessions that afflicted most other economies. China then heavily underperformed after implementing strict zero-COVID policies and scoring a slew of policy own goals. Foord Singapore portfolio manager JC XUE looks at whether China has now turned a corner.

Chinese equity markets lagged global bourses in 2021 and 2022 on persistent lockdowns, deteriorating economic prospects, US tech export restrictions, military posturing and swingeing regulatory interventions. The market all but capitulated, after President Xi consolidated his power base at the 20th National Congress of the Chinese Communist Party.

Chinese company valuations were already cheap heading into the party congress. But share prices fell sharply on fears that the new politburo would exacerbate suboptimal policymaking. Lack of meaningful changes to China's zero-COVID policy compounded the disappointment. At its October 2022 trough, the Hang Seng Index traded at a record-low PE multiple (which measures the valuation of a stock market or share).

Today, China is rapidly dismantling its zero-COVID policies, despite rising COVID-19 caseloads. The government is also reviewing its policies for the technology and education sectors, supporting its real estate sector and seeking to boost private-sector confidence. By year-end, the Hang Seng Index had rebounded ~35% from the trough. This is evident in the excellent fourth-quarter returns of the Foord global funds, with the Foord Global Equity Fund having about 25% of its investments in the region and the Foord International Fund about 10%.

The managers largely maintained the funds' Chinese investments through the market turmoil, given the exceptionally low valuations and our estimation for normalising economic growth as pandemic constraints eventually eased. Add to that prospects for attractive earnings growth from an economic upcycle and the upside potential was very attractive.

We note positive prospects despite the elevated political risks. While the politburo is now staffed with more of Xi's men, they are not without credentials. President Xi has himself reiterated that economic reform would continue, and the opening will 'only be wider'. Despite negative media portrayal, next premier Li Qiang is known to be business friendly, having sponsored the STAR market (science-and-tech-focused stock exchange) and brought the likes of Tesla to Shanghai. He Li Feng, who should succeed Liu He as the economic czar, is an experienced pro-growth candidate.

All signs suggest that the Chinese market cycle has started to turn. Prospects are positive heading into the Year of the Rabbit (see *Did You Know?*), especially compared to rest of the world. However, we do not invest in a China index, we invest in quality Chinese companies largely calibrated to the inevitable growth of the Chinese middle class. In our view, these carry less investment risk, but will appreciate with the prospects of the whole economy. The position size of Chinese stocks will continue to be judged relative to the respective risk mandates of the portfolios we manage for investors.

FOORD UMBRELLA PROVIDENT FUND — A THOUSAND-BAGGER INVESTMENT

The Foord staff provident fund in which all Foord employees invest, was started in 1987 as the brainchild of the then Foord & Meintjes principals. The contribution rate was a modest 10% on the expectation that employees should contribute more, where possible. The fund was managed as a separate portfolio until late 2005, when it was transferred into the Foord Balanced Fund unit trust. Staff retirement monies have been co-invested with Foord's other investors in that product ever since.

The fund is separately unitised at each calendar month end. Its starting unit price on 1 April 1987 was just one rand. On 30 November 2022, the unit price ticked over the one-thousand-rand mark to R1,008. This is one thousand times the starting price of 35 years ago, resulting in a total return on those very first units of one hundred thousand percent, after fees and fund expenses.

The average annualised return over the term is 21.3% per annum when inflation has averaged 7.2%. This is an exceptional achievement that demonstrates the power of compounding superior long-term returns.

There are real-people stories behind these numbers. Receptionist Carolyn Bywater was employed for two years between May 1987 and December 1989 before family commitments intervened. Her investment of just R8,545 had grown to R18,145 by her resignation date. She has been a deferred member of the fund for 33 years. Her R18,145 benefit is today worth R4.7 million.

There are several important lessons contained in this result other than the obviousness of Foord's 40-year longevity. Foremost is that when it comes to compounding, it is important to avoid negative returns and then to compound for as long as possible. So, start saving as early as possible.

Secondly, this outcome would not have been achieved if the fund had switched investment managers every couple of years. Foord has a safety-first, value-driven investment philosophy. There are often long periods where its strategy underperforms but staying the course has rewarded the fund members as fads have faded.

Thirdly, long investment horizons deserve appropriate risk budgets. Workers saving for retirement are amongst those with the longest time horizons. These investors can afford to incur investment volatility in the pursuit of superior long-term returns. This includes staying invested through market cycles. Investments into artificially constrained products such as medium or low equity solutions are not appropriate for long time horizons.

Finally, it is possible to achieve meaningful inflation-beating returns despite adverse regulatory or fiscal interventions. The Foord Provident Fund's track record variously includes periods of prescribed assets, a ban on foreign investments, constraints on equity exposure and some years of retirement fund taxation. In our view, these have been a drag on performance outcomes. However, it is still better to compound retirement savings despite these adversities than not to invest at all.

Congratulations to the portfolio managers on this account over the 35 years for safely delivering these eye-popping outcomes — and to those wise employees who let their capital compound over the years. Let this be a lesson to us all.

MARKETS IN A NUTSHELL

EQUITIES

WORLD

World markets rallied aggressively on buoyant GDP prints and expectations for slowing interest rate increases as inflation peaked — but retraced somewhat in December on more hawkish US Federal Reserve commentary

SOUTH AFRICA

Despite falling in December, equities tracked global bourses higher — brushing aside rand gains to post double-digit returns for the quarter and bring the JSE into positive territory for the year

BONDS

WORLD

US and European bond yields were volatile, but rose latterly on hawkish rhetoric from US Fed Chair Powell — while Japanese bond yields spiked after a surprise BOJ tweak of its yield curve control policy

SOUTH AFRICA

The All Bond Index rallied as yields fell — on the ANC reform camp's National Elective Conference victories after President Ramaphosa reportedly almost stepped aside on a damning s89 panel report

CURRENCIES

WORLD

The US dollar retraced as the risk of economic recession rose — the greenback's probable move past peak interest rate differentials strengthened alternative hard currencies

SOUTH AFRICA

The rand gained on improved global risk sentiment and a generally weaker US dollar on post peak interest rate differentials — but faces headwinds as SA's terms of trade deteriorates

COMMODITIES

Industrial commodities weakened on rising economic recession risks and the lagged effect of higher interest rates, while energy prices fell as a mild European winter allowed the bloc to dodge the worst energy crunch predictions — precious metals rose steadily, driven by coincidental peaking of nominal yields and dollar weakness

ECONOMY

WORLD

Inflation receded from recent peaks as the base effects of the Russia/Ukraine war energy and food price shocks abate — but recession risks are rising with the inverted US yield curve at its worst levels since 1980

SOUTH AFRICA

Inflation fell moderately but remains well above the upper end of the 3–6% monetary policy target range — SARB's forecasts of a return to the 4.5% mid-range level by late 2023 seem overly optimistic

MONETARY AND FISCAL POLICY

WORLD

The Fed and other leading central banks hiked rates twice more, marking one of the fastest paces of tightening in history — while rates are likely close to their peak, hawkish central bank rhetoric suggests they are likely to stay higher for longer

SOUTH AFRICA

SARB hawkishness continued, with the bank raising rates another 75 basis points in November — bringing the repo rate to 7% from the extraordinarily low pandemic level of 3.5% and probably its peak given the stressed consumer

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.

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