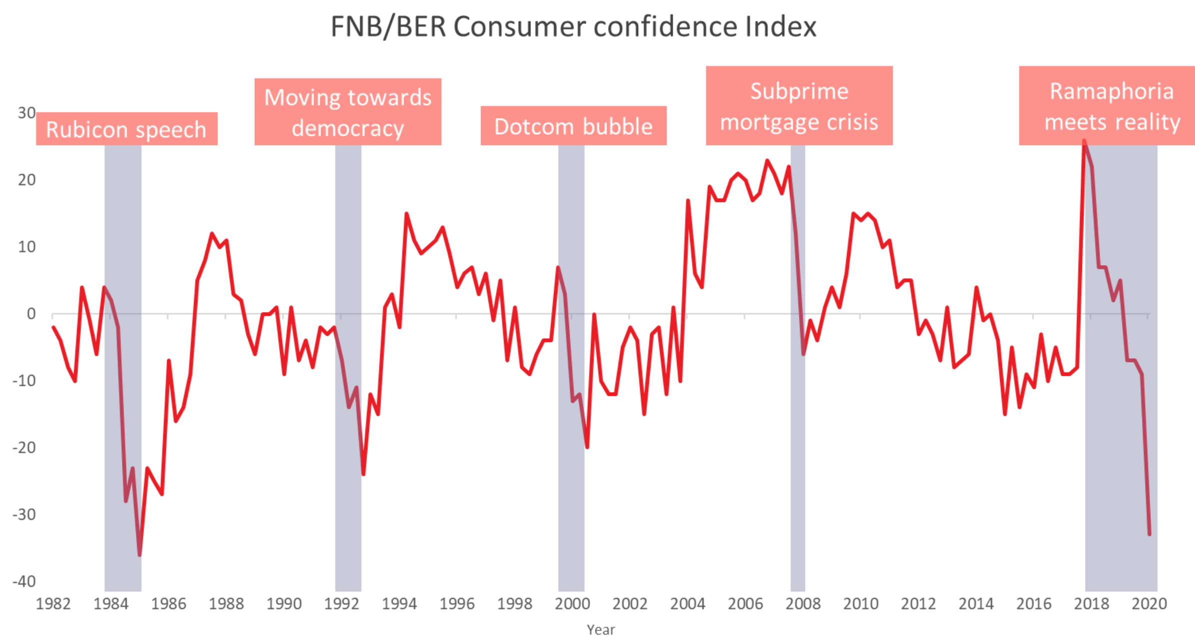
GRANATE
ASSET MANAGEMENT

# SA: Still some reasons to be positive

## Confidence is low but counterbalance is important

The impact of COVID-19 has pushed South African consumer confidence to its lowest level in more than three-and-a-half decades. The FNB/BER Consumer Confidence Index has fallen from an already low -9 in the first quarter to -33 in the second quarter. It is now only three points above its all-time low recorded in 1985. This was not a rosy era. It was the time of violent resistance against apartheid and P.W. Botha's infamous Rubicon speech, which was followed by a sovereign debt crisis.




*Source: Chart data from the Bureau for Economic Research (BER); shading and comments added by Granate Asset Management*

Comparing 1985 and 2020 is infinitely complicated, especially if you try to infer possible similarities to a path of recovery. However, no matter the nature of the crisis, when the public is this negative it is reflected in the prices of even the highest-quality assets. Asset prices are a function of spending power and emotions, and both are pretty worn down at the moment.

For us, a 'low price' is one that reflects a far higher probability of a bad outcome than we believe to be realistic. If you only spend time looking at bad possible outcomes there is no way you will make rational decisions. In South Africa, this means working hard to counterbalance the streams of depressing news flow. Below are some of the positives we are including in our decision making.

## 1. The South African fiscal situation is dire, but we have both room and reason to improve

The emergency supplementary budget speech delivered by Finance Minister Tito Mboweni last month indicated that there will be an under-recovery of tax collection of over R300 billion this year, resulting in some woeful metrics. We know that our public sector is bloated and littered with unproductive expenditure. Plenty of these allocations are legacy spend that has not been addressed, partially because closing funding taps is politically very challenging.

The crisis has offered an opportunity for the minister to announce that National Treasury is 'suspending allocations to programmes with a history of poor performance and slow spending'. It is therefore unlikely that money will be reallocated to these areas in coming years. Another important consideration is that the president's hand is forced: any further funding will come with significant conditions. The domestic savings pool will not be able to fully fund deficits and growth initiatives, while foreign funding tends to come with far more strings attached.

**2. The economy stands to benefit from lower interest rates**

Prior to the COVID outbreak, near-term, cash-like instruments were offering very attractive real yields. This incentivised capital to remain in cash, especially against a backdrop where domestic security prices were flatlining. Interest rate cuts now mean that cash no longer offers risk-free, inflation-beating returns. Money should therefore start to flow into assets that do offer such protection. These include listed securities (bonds and shares) and productive assets like manufacturing and infrastructure.

A further benefit of interest rate cuts is the stimulation of consumption. Large rate cuts, like the 2.75% repo rate reduction we have experienced, free up disposable cash. This money finds its way into the tellers of retailers and eventually, if low rates are sustained and we start to see some economic recovery, into the property market. Most of the increased spending is facilitated by banks in the form of greater credit extension and transaction fee income. While we are mindful that the economic impact of COVID-19 may be felt by many households for some time yet, lower interest rates provide an underpin to spur recovery as this pressure eases.

**3. Intended infrastructure spend could provide a welcome boost**

Our president has made a very clear public commitment to infrastructure investment. Such spend, as well as new capacity that results, will have both direct and indirect benefits for economic growth. The cynic's view is that we have heard this intention before, with little follow-through. However, we believe that the president has been so vocal on this that his reputation now hinges on execution. He has a record of carefully timed but bold movements. This applies not only to his re-entry into politics and his time in the presidency, but over his full career, which spanned involvement in resistance movements, trade unions, transition negotiations and business. He needs to step up now, and we believe he will.

**4. Our institutions remain strong**

Through this crisis our National Treasury, Reserve Bank and commercial banks have again proven that they are indeed world-class operations. They managed to stabilise a significant shock to our economy, which should prevent a deep recessionary spiral.

**5. Less competition**

The strongest detractor from company profits is competition. This crisis is resulting in the closure of less robust businesses, which creates opportunity for consolidation and pricing power for the survivors. We are only investing in strong businesses.

**6. Quality securities are available at bargain prices**

We pick our investments carefully, looking for companies that have strong balance sheets, exceptionally capable management teams and favourable growth prospects. Normally, you need to pay up for such businesses. But several are currently available at bargain prices on the JSE. You will find some of these names among our top 10 holdings listed in the MDD.

**Counterbalance goes both ways**

We do not make predictions and do not build portfolios that bet wholly on specific outcomes. We are therefore not betting your entire portfolio on a South African recovery. What we are doing is ensuring that a portion of your portfolio is invested in the strongest domestic companies, so that you don't miss out on what could be a multi-year compounding growth story.