FOREWORD

ISSUE 62 | 2nd QUARTER 2022

DID YOU KNOW? STOCK KEEPING UNITS

Stock keeping units (SKUs) are unique identifiers for each product item and are used to manage inventory. They are often eight alpha-numeric digits but could conceivably comprise any unique code system.

Each retailer will assign unique SKUs to products within their inventory management system. The SKUs are assigned based on product attributes such as manufacturer, description, size, colour and packaging. Inventory systems and stock takes are done based on units of each SKU.

Some product manufacturers may assign a unique product code (UPC) to their products. UPC codes will be standardised across retailers and could possibly be assigned as the SKU for that product by retailers.

SKUs and UPCs can be incorporated into scannable bar codes affixed to products. When incorporated into point-of-sales systems, scannable SKUs become critical for inventory management and restocking.

IN THIS ISSUE

POLITICS AND INVESTMENT PROCESS

The political environment is top of mind for most South Africans. Portfolio manager NANCY HOSSACK explains how Foord looks at voting trends to assess future political outcomes as part of Foord's forward-looking investment process.

South African national and local government elections (LGEs) are held non-coterminously every five years. Between national elections, we can use the outcome of LGEs and by-elections to infer voter trends. The IEC calls by-elections when an elected ward councillor can no longer serve due to death or incapacity.

Monitoring by-elections results allows us to assess shifting voter support for political parties in real time. We need to be cognisant that there are some significant differences between ward by-elections and national government elections. Firstly, not all political parties are represented in every ward, and independent candidates not on the national elections roll also take votes. Secondly, there are differences in voter turnout and voter apathy for by-elections; and, finally, there are differences in strategic voting patterns.

There have been 52 by-elections since the last LGEs in 2021. This is a very small sample size, but by-elections happen surprisingly regularly — and as we move towards the next national elections in 2024, the data gets richer and richer. We build up our projections for the 2024 national elections by analysing the shifts on a provincial level and then aggregating these to a national forecast.

Despite the small sample size, the model nevertheless suggests support for the ANC dropping to about 45%, the EFF being the biggest opposition party at roughly 20%, the DA at 15% and other parties at 20%. Within other parties, we are seeing Action SA doing very well in Gauteng and the IFP taking share in KZN. The ANC's own current polling is reported to be in the same range as our model, so that adds some confidence to our forecast.

The forecast implies that SA may be headed for coalition politics at the national level. However, because it is politically unpalatable for politicians to throw in their lots with parties their supporters didn't vote for, we're more likely to see informal co-operation between the parties, as has been the case in some of SA's large metros. The game changer would be if the ANC could find a coalition partner above the 5% support level to hand them a majority, which I see as a low probability outcome.

Without an outright majority, parliamentary election of the president will become interesting. The constitution dictates that parties nominate their presidential candidate and then, in successive votes, the candidate with the lowest number of votes is removed until only one remains. This means that all the political parties would need to coalesce around just one alternative candidate to elect a president from outside the ANC. That seems unlikely to me at this stage, and so my base case is that the next president will still be from the ANC.

Legislative change will be difficult in a fragmented political space, although sometimes that's a good thing for economies. We want to avoid investing in markets where public policy can get too wild. With no party holding a majority, there is a reduced chance of black swan outcomes.

Businesses also seem to prefer environments where the rules don't change too quickly or too radically. For example, studies show that the US economy performs best when the House and Senate are in different party control and regulatory change becomes difficult. Within the South African context, it will be more difficult to execute state capture.

WE'RE GOING ON A BEAR HUNT

LINDA EEDES
Investment Professional

Michael Rosen's award-winning children's book *We're Going on a Bear Hunt* tells the story of five children who venture out to hunt a bear. In this article, investment professional LINDA EEDES tells the story of Foord's fund managers venturing out to hunt a bear market.

Rosen's five hunters face several obstacles along the way, such as thick oozy mud, a dark forest and a whirling snowstorm. After careful consideration of each obstacle, they declare in unison: "We can't go over it. We can't go under it. Oh no! We've got to go through it!"

Like the children in the story, long-term investors must occasionally 'go through' bear markets. They must navigate their way through various obstacles such as rising interest rates, rising inflation and impending recession in the journey towards long-term investment success.

In June, the US stock market officially crossed into bear market territory — marked by the S&P 500 falling more than 20% from its year-end record high. Stock markets around the world, including in South Africa, are also materially down. Even traditionally safer asset classes, such as government bonds, are in negative territory this year.

Foord has been anticipating this bear market environment for some time. Unsurprisingly, all of Foord's multi-asset investment strategies, including the Foord Flexible, Foord Balanced, Foord Conservative, Foord International and Nedgroup Stable Funds are near the top of their respective peer groups this year.

> *"Bear markets may be unsettling, but they are part and parcel of every market cycle."*

Bear markets may be unsettling, but they are part and parcel of every market cycle. If navigated successfully, bear markets provide investors with the opportunity for far better prospective returns by being able to buy quality businesses at lower prices. It's also comforting to remember that bear markets have always come to an end. Permanent capital losses — where assets are permanently written down such as with insolvencies or credit defaults — scare us much more than bear markets.

A major part of Foord's investment success lies in astute asset allocation. We invest using a top-down process that starts with understanding where we are in the current interest rate cycle. This helps us understand exactly where we should be invested in terms of asset classes, geographies and sectors.

We also always keep our eyes on the primary objective: to produce inflation-beating returns over the medium to long term. We reduce risk of loss by diversifying between different assets with different performance drivers. We have the full toolkit to do this in our flagship Foord Flexible Fund of Funds. Bottom-up stock selection rounds out the investment process.

The positioning of the Foord Flexible Fund is instructive of Foord's prevailing investment strategy. More than half of the fund is invested outside of South Africa, which protects investors against currency risk and the structural headwinds that weigh on the prospects of many local companies. Even within South Africa, we prefer businesses that are more global in nature.

To diversify risk, the fund does not have more than 25% in any one single geography. European stocks are also in bear market territory, having fallen 20% this year. Our global stocks have exposure in that region to mostly defensive consumer staples companies, which have pricing power and can pass inflation on to consumers.

Given that we expect interest rates to continue to rise, we prefer businesses that don't have excessive debt on their balance sheets. We are cautious about having too much exposure to US stocks, where share prices are still trading too far above what we believe the underlying businesses to be worth. In the technology sector, we prefer to invest in Asian communication services and technology companies that are very attractively priced due to what should prove to be transitory concerns.

The fund also has some exposure to gold, precious metals streamers, lithium and copper producers, as well as to agricultural stocks with pricing power — all should fare well in an inflationary environment. Outside of equities, we have some exposure to near-term SA government bonds, which offer an attractive yield with low risk. We have recently added shorter maturity US Treasury bonds to the portfolio, given the now more compelling yields.

> *"We always keep our eyes on the primary objective: to produce inflation-beating returns over the medium to long term."*

The story I mentioned earlier ends with the children finally coming face to face with a bear in a cave. They panic, run all the way home, jump into their beds and declare: "We're not going on a bear hunt again!" Fortunately for our investors, our investment team is made of stronger stuff. As a result, we remain comfortable that we are well-equipped to protect and grow your savings capital in absolute terms over time, irrespective of the prevailing bear market conditions.

RETAIL – FEELING THE PINCH

Rising food and energy prices due to Russia's invasion of Ukraine are compounding other inflationary pressures. Equity analyst DHERSAN CHETTY writes about how rising food inflation and rising interest rates are headwinds for consumers and food manufacturers alike in South Africa.

"Food retailers are not immune to the consequences of food inflation."

The net effect of rising food, transport and borrowing costs is the reduction of discretionary –– or non-essential –– spending by consumers. Higher inflation disproportionately impacts lower income consumers, given the contribution of food and transport costs to their total expenses. This is compounded by this consumer cohort tending to have lower savings. Middle-income consumers with mortgages, car loans and credit card debt are also squeezed because of their exposure to rising interest rates. A higher interest burden eats into budgets, causing consumers to be more conscious of their spending.

Unlike other consumer products such as clothing, entertainment, and cars, food is an essential expenditure item. However, a consumption squeeze still affects food expenditures as consumers reduce their monthly basket sizes by eating less, reduce non-essential foods such as sweets and snacks, switch to cheaper proteins and trade down to cheaper products.

Food companies with strong brands are better able to retain their customers and pass on these high price increases. However, those with weak brands or in highly competitive segments are more likely to be impacted by lower volumes, lower price increases and higher input costs.

Food retailers tend to outperform food manufacturers during periods of high food inflation. The market dominance and bargaining power of big retailers end up squeezing the margins of more competitive food manufacturers. These bigger retailers also benefit from a switch into their better-priced private-label products (they participate in the manufacturing profits) and from eat-in trends (eating out is even more expensive during periods of high food inflation).

However, food retailers are not immune to the consequences of food inflation despite generally being able to pass it on to consumers. Higher till prices can result in lower volumes for retailers as consumers reduce their basket size. Food retail sales growth has been positive in SA every year since records began in 1980. Volume growth was negative in ten of the last forty-two years, but the average volume decline in these years was just 1.6%, which is not material.

This defensiveness has enabled food retailers to outperform cyclical sectors during periods of high food inflation. However, stiff competition for market share in the food retail segment should stimulate more promotional activity to offset some of this inflation. Some retailers might reduce the number of SKUs (see *Did You Know?*) in the store and try to get lower prices from manufacturers for bulk discounts (thus a large portion of the food inflation is funded by food manufacturers).

Therefore, in periods of high food inflation, you want to be invested in food retailers over food producers. Within the Foord portfolios, we hold a big overweight position in food retailer Spar and have a low weight to food producers. We believe that Spar offers significant upside from these levels with its defensiveness, high cashflow generation, consistent earnings growth and strong divisional management.

NEW FACES

Foord has always taken a forward-thinking approach to its multi-generational investment team. We are pleased to announce the appointment of two senior portfolio managers in RASHAAD TAYOB and FARZANA BAYAT. We expect them to contribute meaningfully to the success of the investment boutique's various investment strategies and to thereby add value to investors.

Rashaad is a leading light in the asset management sector. He joins Foord as a macro strategist, head of fixed income and multiple-counsellor portfolio manager on stable fund portfolios. He will also be actively involved in global fixed interest and credit research, as well as contribute to the management of Foord's conservative US dollar-denominated flagship fund, Foord International Fund.

Having previously worked together as fund management colleagues at Prescient Investment Management earlier in their careers, Rashaad handpicked Farzana Bayat to join him at Foord. Together, they will develop a fixed income product offering covering South African and global income funds, bond funds and sophisticated tailor-made solutions for the institutional market.

Rashaad has two decades of investment experience covering the gamut of low-risk multi-asset solutions and macro research. He holds a B.Bus.Sci (Finance) (Hons) degree from UCT and is a CFA charter holder. Rashaad started his career at Prescient Investment Management in 2002. He moved to ABAX in 2012 where he was head of fixed interest investments and the portfolio manager on the R18-billion Nedgroup Investments Flexible Income Fund, which he helped build to its current prominence. Rashaad left ABAX in March 2021 to take a sabbatical while considering new opportunities.

Farzana has a Bachelor of Business Science (Actuarial Science) from UCT and is a CFA charter holder. Her principal career experience was at Prescient (2003 – 2018), where she managed fixed income portfolios. The past four years were a period of entrepreneurship for her with the founding of Ngwedi Investment Managers. Farzana was the CIO of Ngwedi and started a range of fixed income and multi asset funds which delivered excellent return for clients. Farzana helped grow the business into R10bn asset manager before it recently merged with Taquanta Asset Managers for reasons of scale.

Rashaad and Farzana were a formidable duo at Prescient until 2008, and then continued to have successful careers independently. They have always wanted to work together again and Foord has presented them with the ideal opportunity. For Farzana the decision to upend her career at this junction was not easy, but she believes that together they will make a powerful team and should achieve good traction in the fixed income investor market.

Foord is delighted to welcome Rashaad and Farzana to the team and look forward to benefiting from their energy and expertise.

MARKETS IN A NUTSHELL

WORLD / SOUTH AFRICA

EQUITIES

World: Rising inflation and recession fears caused global equities to retreat further — tipping US and European bourses into bear market territory with declines exceeding 20% this year

South Africa: The JSE tracked other markets sharply lower, despite a late surge by media giants Naspers/Prosus — compounded by the bourse's higher weighting to economically sensitive resources companies

BONDS

World: Developed market government bonds provided little refuge for investors — rising yields caused bond prices to fall, despite a brief quarter-end rally as yields fell on recession fears

South Africa: The All Bond Index was lower as yields followed global yields higher — the SA listed property sector also retraced sharply on higher yields

CURRENCIES

World: The US dollar was materially stronger against the other majors — on widening interest rate differentials and the dollar's safe-haven appeal

South Africa: The rand weakened in tandem with other emerging market currencies — increased risk aversion saw a flight to US dollar safety

COMMODITIES

Commodities were mixed as sharp price falls in industrial metals on rising recession fears were offset by rising energy prices on supply constraints — but precious metals were lower on the increased opportunity costs afforded by rising fixed interest yields

ECONOMY

World: The global economic outlook is clouded by dual concerns of elevated inflation and slowing growth — the Russia-Ukraine war has potentially dire economic consequences for Europe amid potential gas shortages and planned rationing

South Africa: After a relatively strong first quarter, the likelihood of a contraction in the second quarter of 2022 increased markedly — on flood damage in KwaZulu-Natal, escalating loadshedding and weakening global demand

MONETARY AND FISCAL POLICY

World: The US Fed implemented a series of aggressive rate hikes to tame 40-year high inflation — raising the federal funds rate by 0.75% in June for the first time since 1994

South Africa: The increasingly hawkish SA Reserve Bank raised interest rates another 0.5% in May to 4.75% as was widely expected — the largest interest rate increase since 2016

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.

 PLEASE REFER TO THE FACT SHEETS CARRIED ON WWW.FOORD.CO.ZA FOR MORE DETAILED INFORMATION.

FOORD ASSET MANAGEMENT | Tel: 021 532 6988 | Email: info@foord.co.za | www.foord.co.za