



Entrance Façade of the Old Stock Exchange in Barberton, South Africa

SAIS DIGEST

FIRST EDITION

JUNE 2020

South African Institute of Stockbrokers



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Just a Quick Word...

Natércia Faustino, General Manager

SAIS

Welcome to the very first edition of The SAIS Digest! This is a first for the Institute and we are quite excited! The SAIS Digest is a periodical that will be published bi-annually. The aim is to provide our membership with articles of interest and relevance to the industry. Contributions to the content of The SAIS Digest will be drawn from a wide range of sources.

We hope to provide you with articles of interest, that focus on both local conditions as well as those abroad, giving our members a varied range of information. In this edition, we feature the recent downgrade from Moody's and its impact as well as an article covering responsible investing and ESG integration. We also have an article directly from S&P Dow Jones Indices' blog on the unprecedented start to 2020.

We trust that our initial foray will prove interesting and useful to our members. Enjoy your read!

This is the first edition of the SAIS Digest and we want to provide you with a great experience which is why we want to hear from you. Your feedback will help us bring you more of the information you need to know in this ever-changing environment. Please send any ideas, feedback or requests for this publication to romaana@sais.co.za.

Impact of the Downgrade

JSE, Johannesburg, 28 March 2020

The decision by Moody's on Friday 27 March 2020 to downgrade South Africa's long term foreign and local currency debt ratings to 'Ba1' from 'Baa3' and maintain its negative outlook, was unfortunate though not unexpected, the Johannesburg Stock Exchange (JSE) said on Saturday 28 March 2020.

South Africa's debt rating is now rated below investment grade by all three major ratings agencies, namely Standard & Poor's, Fitch and Moody's.

The biggest impact of the downgrade, said JSE Group CEO Leila Fourie, would be in the bond market as South African government bonds will fall out of the FTSE World Government Bond Index (WGBI), sparking an outflow of investment grade capital in the run up to and including the April rebalancing. Foreign investors own 37%, or about R780bn, of South Africa's local-currency bonds, according to National Treasury data.

"While index exclusion is likely to force outflows from passive funds in the coming weeks, some active managers could pick up the slack, limiting some of the net market fall out," Fourie said. "The world capital markets are efficient and they have already priced in the sub-investment grade risk that South Africa reflects, which is a slight relief. In fact, I believe we could see a partial bounce back after an initial negative reaction settles."

She cautioned that markets would in the interim period more likely be punctuated by Covid-19 news flow: "Markets and people are not reacting the way they might have in the past because of the sense of panic and uncertainty."

"During a time of crisis, the information value from ratings agencies can be drowned out by other factors influencing market movements. In fact, right now Covid-19 and the epidemiological forecasts outweigh Moody's agency downgrade as they are better predictors of government action and economic growth."

Moody's noted South Africa's continued deterioration in fiscal strength and structurally weak economic growth supported its decision to downgrade. The agency expects government's gross debt ratios to climb to 91% of GDP and the government deficit to widen to 8.5% of GDP in the near term.

Moody's announcement came at the end of the first day of South Africa's unprecedented 21-Day lockdown period as part of the government's bid to break the chain of transmission of the Covid-19 virus.

"Junk status will have major implications for us as a country and could fast-track structural reform in the country, accompanied by tectonic political and economic shifts," said Fourie.

"There's no doubt that navigating through this will require incredible courage and resolution, but South Africa is renowned for just that; achieving it in 1994 and again in 2018."

With regard to the impact on the real economy, "There is no doubt that the downgrade will impact the cost of capital of our banks too, who won't be able to pierce the sovereign ceiling so the cost of borrowing for South Africans is going to increase."

"In President Cyril Ramaphosa, the country has a leader whose management of the current global health crisis, should fill everyone with immense confidence," Fourie concluded.

[Link to article on JSE website.](#)

ESG Integration and Responsible Investment: The New Normal

Nicole Martens, Head of Africa & Middle East,
Principles for Responsible Investment (PRI)

These days, if you find yourself attending an investment-related event or even engaging in a general discussion around investment trends, it will only be a matter of time before the topic of discussion shifts toward that of ESG integration, responsible investment, and increasingly, understanding investment impact. When this happens, it can be difficult to distinguish whether the conversation is about mainstream investment, responsible investment, socially responsible investing, impact investing, sustainable investment, ethical investment, green investment or some combination of these approaches – or indeed, none of these at all!

The discussion is especially complex in the context of emerging markets where the investment environments and conversations are not always as developed as might be the case in established market contexts.

Regardless of the presently varied nature of the conversation, what is clear is that ESG integration and responsible investment are here to stay. It's the new normal. And if you work in investment, you need to be able to talk this talk (as a precursor to walking the walk). To this end, outlined here is a brief overview for SAIS members of what PRI's definition is of responsible investment and why this investment approach is so undeniably material to investors on the continent.

What exactly is responsible investment? And what is it not?

The mission of [the UN-supported Principles for Responsible Investment \(PRI\)](#) is to work toward the creation of a sustainable global financial system. PRI understands that this requires the generation of sustainable long-term financial returns, achieved through strategies and practices that incorporate environmental, social and governance (ESG) factors into investment decisions and active ownership (engagement) - i.e. through responsible investment (RI) practices.

This approach differs from those of green or impact investment, where investors seek to combine financial return with a social or environmental return. RI can and should be pursued even by the investor whose sole purpose is financial return, because it argues that to ignore ESG factors is to ignore risks and opportunities that have a material effect on the returns delivered to clients and beneficiaries.

Contrary to investment approaches such as ethical investment, RI does not target any specific themes, and is instead a holistic approach that aims to include any information that could be material to investment performance.

In this way, RI does not require ruling out investment in any sector or company, but involves including ESG information in investment decision-making to ensure that all relevant factors are accounted for when assessing risk and return, to maximise shareholder and stakeholder return.

RI does not require the use of any specialised products. It is primarily about bringing additional data and analysis into existing approaches. Tailored products whose remit overlaps with areas of responsible investment do exist, such as environmentally- or socially-themed funds, green bonds or social impact bonds, and these can form part of a responsible investment strategy – but they are in no way a requirement for responsible investment.

Why bother with responsible investment?

It might sound like an intuitive approach – largely because it is – but there is growing justification to take ESG integration seriously (or, in the case of many investors, *far more* seriously).

According to a [recent Morgan Stanley report](#), 84% of asset owners globally are pursuing or considering investing approaches that integrate ESG. The increasing global take-up of the responsible investment approach is reflected in PRI's signatory growth. We now have signatory sign-up to the PRI, with the association currently encompassing [more than 3000 signatories worldwide](#), representing in excess of US\$90trn of assets under management.

The rationale behind the mainstreaming of the responsible investment approach worldwide can be boiled down to three key factors: materiality; market demand, and; regulation.

[Academic studies](#) consistently demonstrate that effective integration of material ESG factors into company operations can lead to meeting or exceeding market benchmarks, with these companies experiencing more effective risk management, lower costs of capital, better loan spreads and even improved customer loyalty. The latter is especially powerful in a market where 86% of millennials stated in a recent [global investment study](#) that they believe sustainable investing is important, a view shared by 79% and 67% of GenX and baby boomer investors, respectively. Arguably, the investors of today – and, importantly, of tomorrow – are demanding more from their investments than mere short-term financial performance.

Internationally, the regulatory environment is responding with vigour. [More than 700 responsible investment-related regulations are currently in play around the world](#). Of those, more than half have been instituted over the past five years. The regulations in place and those proposed reflect the fact that the materiality of ESG integration feeds directly into fiduciary duty – because ESG issues can affect the value of investments, investors have a legal duty to their clients and beneficiaries to integrate ESG issues into their investment processes. And while the regulatory environment is evolving more quickly and publicly in geographies abroad, Africa is not far behind, with the [Financial Services Conduct Authority of South Africa's recent](#)

[guidance note for pension funds on sustainability reporting and disclosure](#) just one example of the regulatory trend as it manifests here at home.

What does this mean for African investors?

The three things investors in Africa should note are:

First, RI has nothing to do with a personal value system. It does not have to involve taking any kind of ethical or moral stand on investment approaches. It is an approach that prioritises the maximisation of sustainable long-term financial returns.

Second, RI is not a fringe ideology, but rather an increasingly mainstream approach to investment. This approach is gaining momentum because it is backed by evidence, driven by market demand and aligned to the fiduciary duty of investors.

Third, RI presents an opportunity for African investors who adopt the approach early. Investors who wait for the [inevitable build-up of pressure that is on its way from the market and the regulator](#) will undoubtedly lose out to those investors who proactively made the move early on and will be able to claim leader status in the space.

In this context, what SAIS members need to be asking themselves right now is whether they are adequately equipped to advise clients and make decisions that reflect this new normal.

About the author



In her role of Head of Africa & Middle East of the PRI, Nicole's focus is on identifying and addressing the needs of African investors with respect to integrating ESG into investment processes in an effort to foster the maximisation of long-term sustainable financial returns across the continent.

Prior to PRI, as a Development Economist, Nicole's career has focused on supporting local and international organisations across the public and private sector in the design and implementation of strategies aimed at achieving large-scale developmental impact in Africa.

About the PRI

The PRI is the world's leading proponent of responsible investment.

It works to understand the investment implications of environmental, social and governance (ESG) factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The PRI is truly independent. It encourages investors to use responsible investment to enhance returns and better manage risks, but does not operate for its own profit; it engages with global policymakers but is not associated with any government; it is supported by, but not part of, the United Nations.

For more information, feel free to check out www.unpri.org

Volatile Start to 2020 – What’s Next?

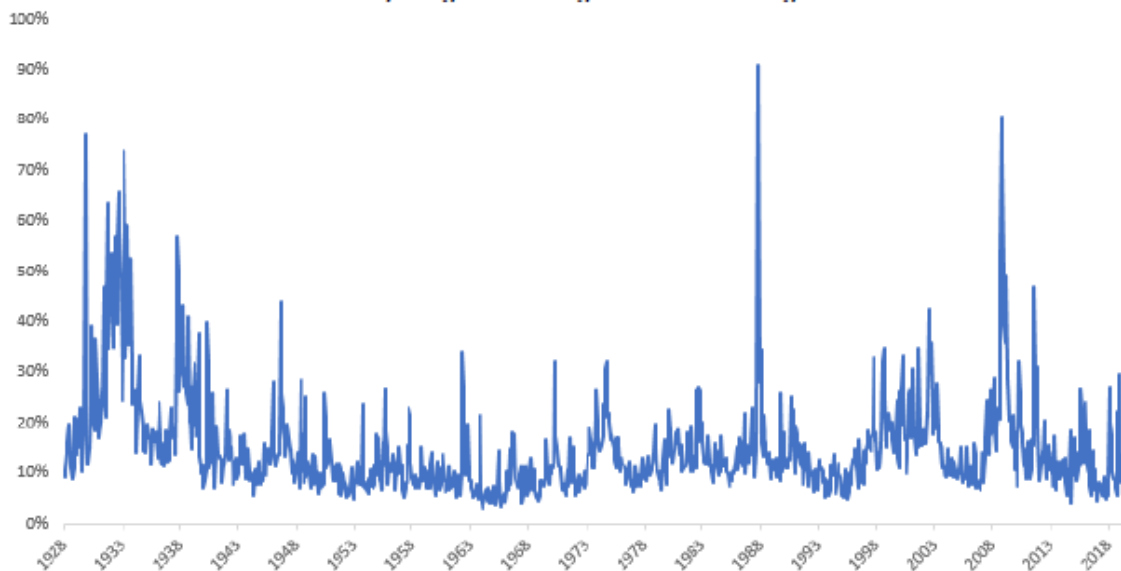


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This article was originally published at [Indexology® Blog on April 1, 2020.](#)

Last year’s prognostications about the events and trends to monitor in 2020 have evaporated as COVID-19 has upended people’s lives and caused massive recalibrations in financial markets. In Q1 2020, we said “goodbye to the bull market”; large market movements became the new normal; correlations and dispersion shifted drastically; quantitative easing returned; and access to liquidity was important for many, in both equity and fixed income markets. Remarkably, all of this took place in little over a month. So much for 2020 foresight!

Exhibit 1: S&P 500 Realized Volatility Surged to its Highest Ever Reading in March

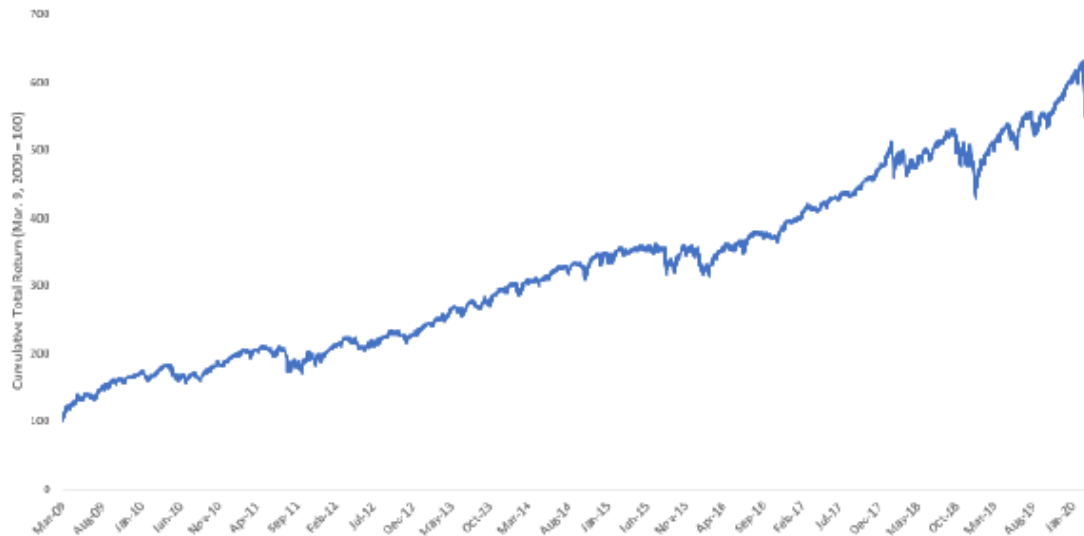


Source: S&P Dow Jones Indices LLC. Chart based on daily S&P 500 price returns between Jan. 3, 1928, and March 31, 2020. Volatility is calculated as the annualized standard deviation of daily price returns in each month. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

As COVID-19 dominated headlines, the S&P 500 finished with its worst quarterly total return (-19.60%) since Q4 2008’s 22% decline. Matters would have been even worse had it not been for the S&P 500’s best 5-day total return since November 2008; the benchmark rose 17.4% between March 23 and March 30 to recover some of the prior losses. [Through March 23, the S&P 500’s cumulative total returns since the start of the last bull market stood at the same level as in May 2017.] Volatility goes both ways!

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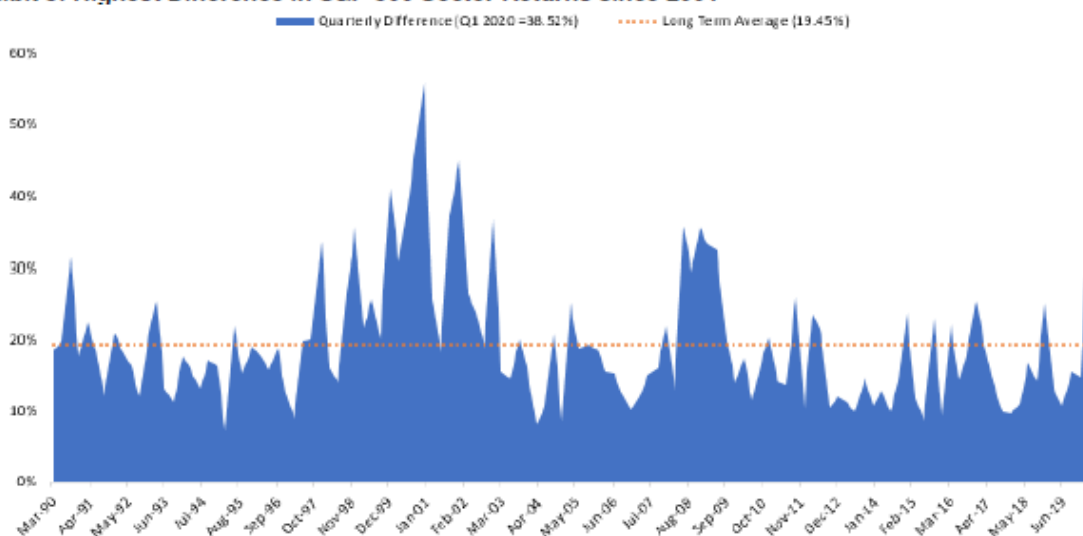
Exhibit 2: The S&P 500 Wiped Off Several Years of Returns in March



Source: S&P Dow Jones Indices LLC. Chart based on daily S&P 500 total returns between March 9, 2009, and March 31, 2020. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

At a sector level, there was no place to hide to avoid declines in absolute terms in Q1: all S&P 500 sectors finished down for the quarter, only the seventh time this has happened since the end of 1989. However, there was enormous value in identifying the relative winners or avoiding the relative losers: a whopping 38.5% separated the best performing sector in Q1 (Information Technology, -11.93%) and the clear laggard (Energy, down 50.45% amid oil prices plunges). This quarterly difference was the highest since December 2001, and reflected a dramatic increase in stock and sector dispersion.

Exhibit 3: Highest Difference in S&P 500 Sector Returns since 2001



Source: S&P Dow Jones Indices LLC, FactSet. Chart based on quarterly total returns between Dec. 29, 1989, and March 31, 2020. Chart shows difference in quarterly total returns between the best- and worst-performing S&P 500 sector. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

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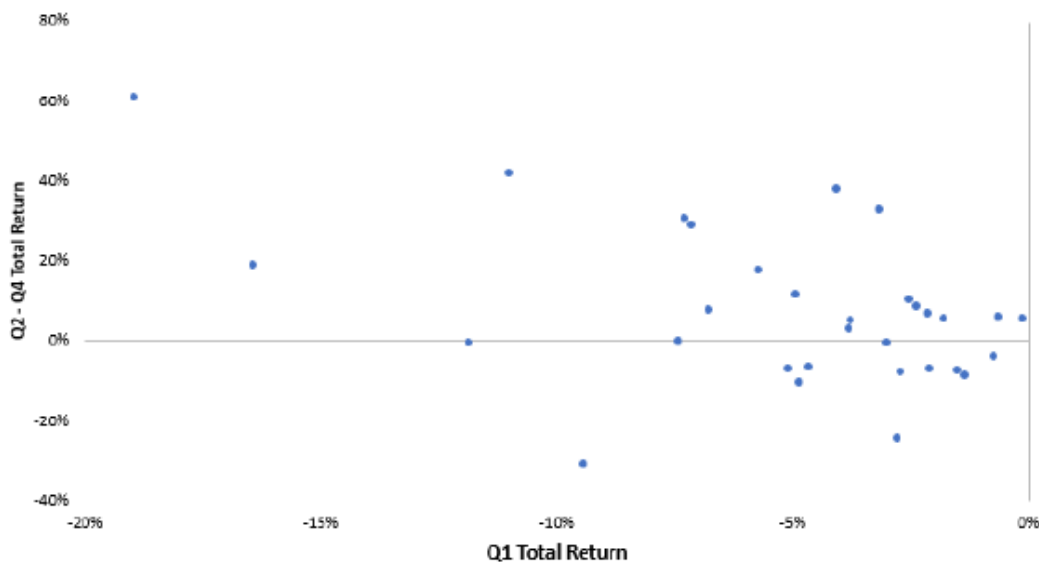
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Across the market capitalization spectrum, the S&P 500 beat both the S&P MidCap 400 (-29.70%) and the S&P SmallCap 600 (-32.64%). This may reflect expectations that larger companies may have stronger balance sheets and may be better able to weather the storm.

So what's next? Although the sea of red across [dashboards](#) makes for unpleasant reading, it is worth noting that first quarter declines don't necessarily mean the rest of the year will be negative. For example, the S&P 500 posted 31 negative first quarter total returns between 1937 and 2019. In most cases (19), the benchmark posted a positive return over the next three quarters, including in 2009 when the S&P 500 fell more than 11% in the first three months before rising 42.11% over the last three quarters.

As a result, even though 2020 foresight has gone out of the window, it may be worth [staying the course](#) instead of giving up on a possible recovery.

Exhibit 4: Q1 Declines Don't Guarantee Declines for the Rest of the Year



Source: S&P Dow Jones Indices LLC. Chart shows Q1 and calendar year total returns for years when the S&P 500's Q1 total return was negative. Chart based on quarterly data between 1937 and 2019. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

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