THE BUSINESS UPDATE

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IMPLICATIONS OF JUNK STATUS FOR SA INVESTORS

RATINGS AGENCIES have different approaches to assessing the debt issued by the National Treasury in domestic and local currency, explains Lesiba Mothata*.

To fund government expenditure, Treasury borrows in local currency (90% of total outstanding stock) or in foreign currency (10%) in international markets. In other words, the so-called junk status relates to 10% of total debt issued by the Treasury.

Moody's and Fitch ratings do not differentiate between the currencies used when debt is issued. The credit quality assigned to South Africa's total debt is similar for both local and international currency issuances.

In contrast, Standard & Poor's (S&P) provides a rating on local and foreign debt. In its latest action on South Africa, the foreign currency component of debt issued (10% of the total) has been downgraded to non-investment grade BB+ (see the figure below) and local-currency denominated debt (90%) has been pushed one notch down to BBB-, which is still investment grade.

S&P has become the first agency to downgrade South Africa's sovereign debt to non-investment grade. It is expected Fitch is likely to do the same soon, an outcome which will prove challenging for South Africa given that the local dominated debt (the 90%) is likely to be non-investment grade from Fitch.

The Moody's outcome, even if it holds a more favourable outlook on South African debt relative to the other two agencies, could contribute negatively to the downward trajectory of South Africa's ratings.

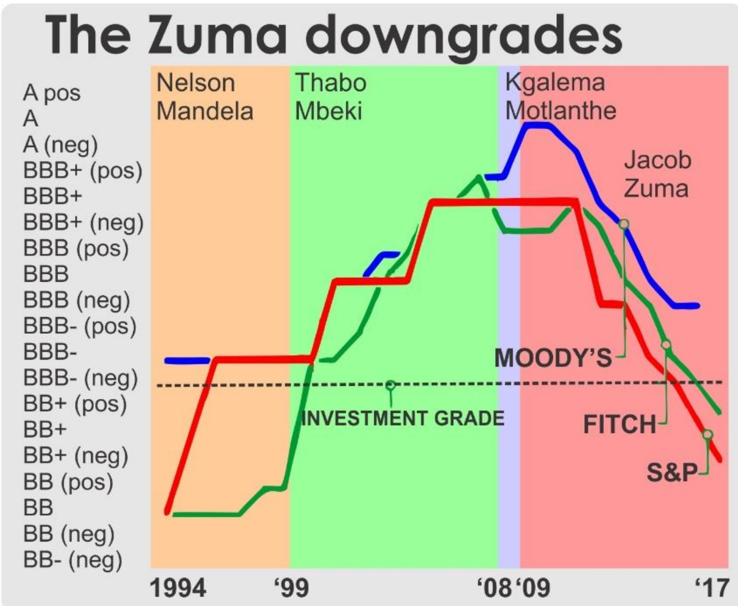
Lessons from other emerging market countries: Our study of emerging market countries downgraded to non-investment grade suggests the impact of junk status depends heavily on how fiscal authorities respond after the decision. Where there is agility in policy response — making hard and frugal decisions, which involves opening up the economy further, as seen in South Korea in 1998 — it took a shorter time to arrive back at investment grade (24 months).

For countries with complex internal political structures and a lethargic fiscal policy response, it took a much longer time to shake off the effects of the downgrade — it took Colombia 12 years.

Risks in the market going forward: Volatility is likely to increase in local financial markets. The South African Reserve Bank (SARB) will be closely monitoring the developments in the markets to see if the ensuing sell off becomes disorderly and threatens the stability of the financial system.

Should the decline in bank shares, the rise in bond yields and the fall in the rand create instability in markets through intensified capital flight, it would not be surprising to see a response from the SARB, which includes hiking interest rates, even when the recent dovish comments were premised on moderating inflation expectations.

Investors face challenges from this point forward. Depending on the type of response put together by authorities, usually, when countries get downgraded to non-investment grade, the cost of funding increases, a recession ensues, currency depreciation induces inflation, which leads to monetary tightening. The short- to medium-term impacts could prove painful.



Graphic: RUBY GAY MARTIN Source: NEDBANK

Need for diversification: It is in times like these that investors need to hold on to a diversified and long-term investment strategy. Even as a political storm is once again battering South Africa, history has shown that, in the long-term, markets have the ability to return to fundamentals even when short-term noise, especially from the political sphere, creates much angst.

*LESIBA MOTHATA IS CHIEF ECONOMIST AT INVESTMENT SOLUTIONS.

THIS AND THAT – SOME FACTS

- Indian mining tycoon Anil Agarwal has acquired a 12% stake in Anglo American for $2.4 billion, now making him the second largest shareholder behind the (PIC) Public Investment Corporation which owns 13.5%.
- PPC expands into Africa by recently opening a R3.8 billion plant in the Democratic Republic of Congo.
- SA ranks 55 out of 137 Countries globally in a study done by the Global Entrepreneurship and Development Institute (GEDI).
- Panama Papers: SARS have indicated that there are 1917 cases involving South African residents in the Panama Paper scandal.
- Taste Holdings who owns the licences to Starbucks and Domino's Pizza are selling their holding in Arthur Kaplan Jewellers, NWJ and World Finest Watches in order to focus on the fast food business. They are hoping to open a Starbucks this year and between 15 and 20 next year. They also have the Starbucks rights in Africa.
- More on the Fast Food Industry – Tashas has 14 restaurants in South Africa and will be opening two more, have just opened in Dubai.
- Old Mutual have just sold a stake in its VS Fund Management business in the US for $446 million, which is all part of the managed separation of its business.
- On the 27 March 2017 only 18% of domestic Fund Managers expected SA to lose its investments grade rating before the end of 2017 – It's unreal what can happen in a week in South Africa.
- The World Bank has committed $57bn in funding Saharan Africa over the next 3 years.
- China Sunopec will pay about $900m to purchase a 75% stake in Chevron South Africa.
- South African Airways is expected to report a loss of R3.5bn for the 2016/2017 financial year.
- This year's Maize crop will be the best in 36 years due to the good rain up North.

TAX FREE SAVINGS ALLOWANCE INCREASED TO R33 000 PER YEAR

TALK TO US IF YOU DO NOT HAVE A TAX FREE SAVINGS INVESTMENTS

10 key themes investors must not ignore in 2017

By Marianna Georgakopoulou – Ashburton Investments

1. Global reflation – how much more.
2. De-globalisation and protectionism.
3. Rising nationalism.
4. Pro-business Trump policies.
5. US Growth expectations risk.
6. EM differentiation and value.
7. Euro break-up risk repricing.
8. Limits to monetary policy.
9. China secular slowdown.
10. Continued support for commodities.

Source: tracx.com

Investing when emotions are running high

When emotions are running high, follow a disciplined approach and take a balanced view when investing.

Stay Calm

Carefully assess risks

When the facts change, you need to be prepared to change your mind.

Ensure portfolios are diversified

Diversification across currencies, geographies and industries provides very important protection against an unpredictable future

Think long term and do not forecast

We have witnessed a string of unpredictable political events over the past year-and-a-half.

Value cash

Cash can be very valuable in times of panic.

Buy with a margin of safety

Owning assets that trading at a discount to an intrinsic value over long term helps to prevent against a permanent loss of capital.

Be greedy when others are fearful

Keeping a cool head and buying when others are panicking provides the best opportunity to generate the long-term returns that clients require

By Shaun le Roux – PSG Fund Manager

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