

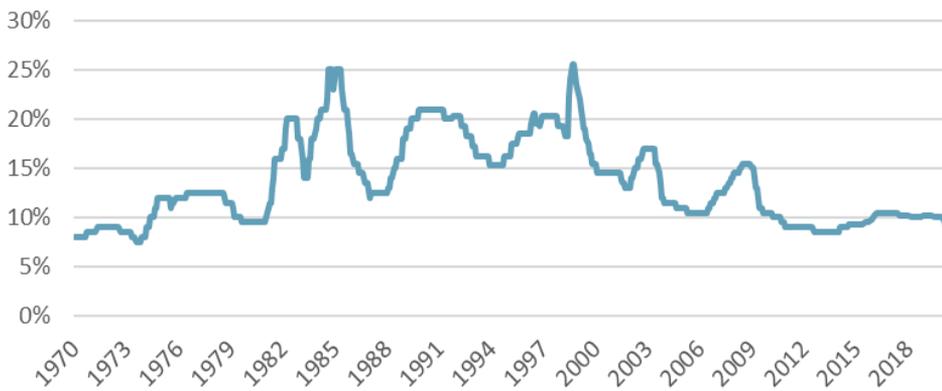
In the world's second largest economy there is also reason for optimism. China's official manufacturing Purchasing Managers' Index (PMI) remained above the neutral 50-point level in May, suggesting that manufacturing continues to expand as China returns to normal activity. However, this was at a slower pace amid some domestic and global challenges.

## South Africa

The South African Reserve Bank's Monetary Policy Committee (MPC) announced a reduction of 0.50% in the repurchase rate, taking it to 3.75% and the prime lending rate to 7.25%.

This brings the prime rate to levels last seen in the early seventies as the graph below illustrates:

South African Prime Overdraft Rate



Source: South African Reserve Bank

The economic outlook for South Africa, however, remains bleak. The Reserve Bank's forecasted economic contraction for 2020 is now 7%, which indicates an erosion in the real growth in the local economy since 2014. The bank expects some of the lost ground to be made up in 2021 and 2022, but it will take an extraordinary effort from government, corporates, labour and consumers to set South Africa on the growth path that's required to address ever increasing unemployment and greater inequality.

The silver lining is that inflation is likely to remain low for some time: 3.4% this year and below 4.5% to the end of 2022. Against this backdrop the MPC may consider one or two more cuts of 0.25% each before the end of the year.

## Market Performance

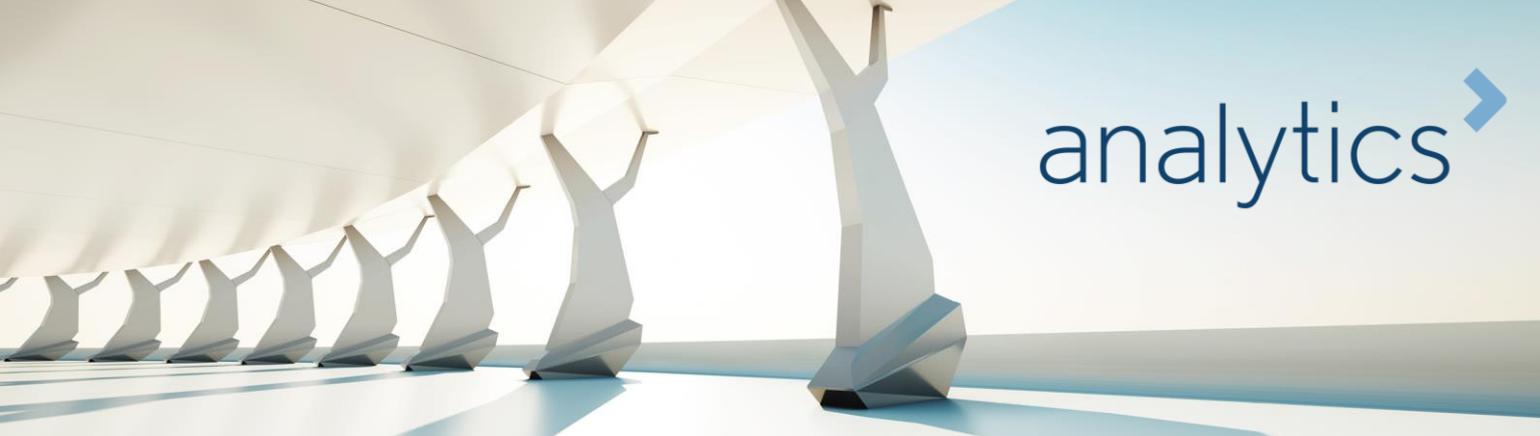
Tantalum Capital reports that global risk appetite continued to rebound in May. On balance, markets took their cue from the more optimistic outlook with regards to the Covid-19 pandemic and the wave of easy money on the back of the various fiscal stimulus packages. The MSCI World (all Country) index rose by 4.4% (in USD) in May, with US Equities (measured by the S&P 500) came to within 10% of its high in February.

In their monthly market overview, Visio Capital noted that domestic bonds had their best month since July 2008 and now have fully recovered March's losses as the South African Reserve Bank cut the repo rate to an all-time low, continuing the disinflationary trend. The strong equity market rally of April fizzled out to a large extent as investors digested the weak and increasingly uncertain outlook for company earnings. Domestically focused sectors such as financials and consumer goods and services remain out of favour despite government's effort to provide relief to consumers.

The property sector, having lost its appeal as a "certain" income generator, continues to suffer from its equity-like volatility making the asset class, for now, unsuitable for income funds.

The Rand steadied itself after much weakness and ended the month around 5% stronger against the US Dollar. The JSE All Share Index returned 0.3%, with Financials down 4.7%. Industrial shares shed 1.6% for the month, but Resources helped the All Share index into positive territory as they gained 5.6% in May.

Lastly the oil price also showed signs of recovery and gained over 33% last month as the global economy began to open. This led to fuel price increases in South Africa after two months of significant reductions.



MARKET INDICES <sup>1</sup> (All returns in Rand)	31 May 2020		
	3 months	12 months	5 years
SA equities (JSEAll Share Index)	0.5%	-6.0%	2.5%
SA property (S&P SA Reit Index)	-37.6%	-53.0%	-12.2%
SA bonds (SA All Bond Index)	0.4%	6.4%	7.7%
SA cash (STeFI)	1.6%	7.1%	7.2%
Global developed equities (MSCI World Index)	13.3%	30.0%	14.6%
Emerging market equities (MSCI Emerging Market Index)	4.4%	16.2%	9.0%
Global bonds (Barclays Global Aggregate)	12.2%	27.9%	11.2%
Rand/dollar <sup>2</sup>	12.1%	21.1%	7.7%
Rand/sterling	8.5%	18.8%	3.3%
Rand/euro	13.5%	20.9%	8.0%
Gold Price (USD)	11.0%	33.0%	7.9%
Oil Price (Brent Crude, USD)	-30.1%	-45.2%	-11.6%

1. Source: Factset

2. A negative number implies fewer rands are being paid per US dollar, so it implies a strengthening of the rand.

## Commentary – The misery of choice

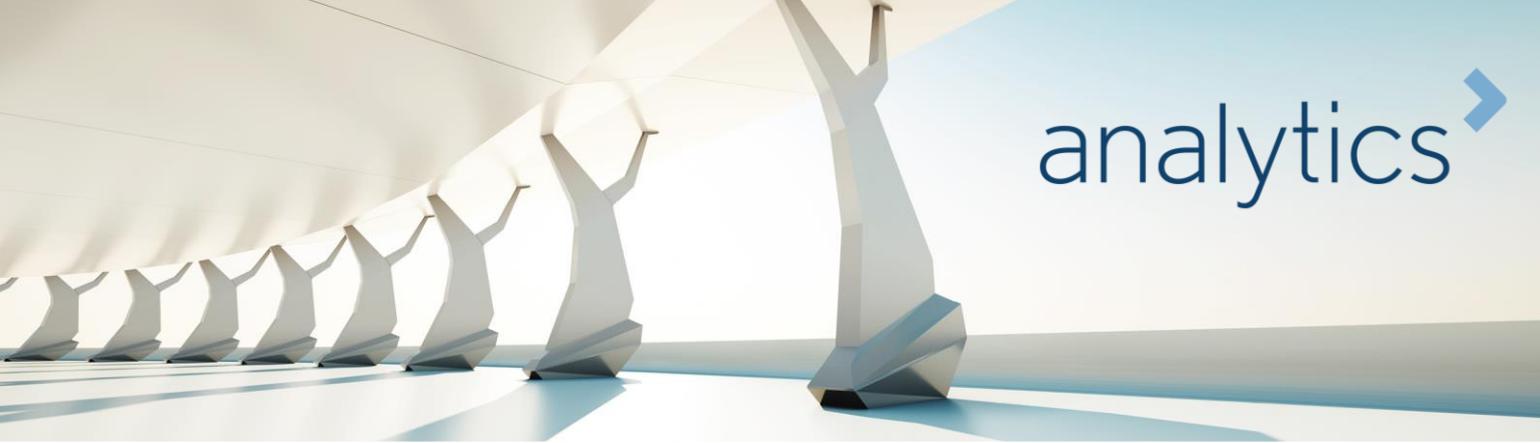
In recent years the debate about active versus passive management has featured in almost every investment conference worth attending. The active managers talk about their ability to make a judgement call and manage risk during market downturns while advocates of passive investing talk about lower fees, rationality and the historical inability of the average active manager to beat the index or benchmark. More recently “smart beta” or “factor” investors have joined the party with the best of both worlds (their words, not mine...) as they combine different investment themes or strategies with methodical and formula-driven stock selection, all at a price lower than active managers. A consequence of all the research that’s gone into this area of investments is that the number of indices used by active managers (to measure their performance), passive managers (to track a market capitalisation index) and factor investors (to create a rule for anything in-between) has ballooned: from one recognised index in 1884 to nearly 3 million today.

According to a recent Citywire article by James Phillips, The Dow Jones Industrial Average (DJIA) is regularly cited as the granddaddy of all benchmarks. Introduced in 1896, it was actually launched 12 years after its sister index, the Dow Jones Transportation Average. Set up by Charles Dow, who was also the co-founder of The Wall Street Journal, it was designed to provide consistent price data on the blue chips of the day. Initially comprising nine railroad stocks, along with Western Union and the Pacific Mail Steamship Company, it very much reflected the underlying economy of the time but was soon overtaken by the DJIA as the most-quoted index when manufacturing became all-powerful in the US economy.

More and more formalised regional equity benchmarks began springing up around the world, with the FT 30 index – a forerunner to the FTSE 100 – launched in the UK in 1935. Its constituents also provided a snapshot of what was powering the country at the time. Stuffed full of heavy industry, such as coal, rubber and steel, it was designed to ‘test the feel and changing moods of the equity market’, with the number of members capped in part so its value could be calculated manually and published every 15 minutes.

Comparing indices proved very difficult right from the start. The Dow, for example, was constructed using a price-weighted methodology, which ranked companies by the cost of their individual shares, rather than the firm’s overall worth, while the FT 30’s components were equal-weighted, with the constituents of both selected by committee. The highly concentrated nature of these early indices and the idiosyncrasies in their calculation limited their usefulness as benchmarks.

The introduction of the S&P 500 index in 1957 provided a much deeper and more diversified market cap-weighted universe of stocks that could truly be used as a benchmark. The FTSE All-Share followed in 1962. As investors grew evermore sophisticated so too did their requirements. New indices were established at home and abroad, with the MSCI World index introduced in 1969, opening up global equities to a new audience, while 1984 saw the FTSE 100 launched to provide a UK index with greater breadth, and the Russell 2000 in the US, the first American small-cap index.



Today, benchmarks (and the investment recipes for passive investments) are ubiquitous. There are indices covering every possible investment, whether you are allocating money according to your religious beliefs, geographical preferences or desire to gain exposure to the hottest new areas, such as robotics or medicinal cannabis.

At the last count, there were 2.96 million investment indices worldwide, according to the New York-based Index Industry Association, and many expect that number to only rise from here.

The exponential growth in the gauges used to measure investments is very much a recent phenomenon which mushroomed over the last two decades, as pointed out by David Barron, head of index equity and factor-based investing at Legal & General Investment Management. He believes the drivers were twofold: the emergence of exchange-traded funds (ETFs) at the turn of the century and the wider adoption of passive investment strategies as fee pressures and concerns about active managers' ability to deliver consistent outperformance grew.

'The proliferation of benchmarks has been massive. We've seen an explosion in strategies since the mid-2000s and that really ramped up when we passed through the financial crisis in 2008,' Barron says.

'Because everything went down so much, people started looking at what they were paying for that return and moving their core exposure into passives – with a much lower fee – on the equity and fixed income side. It was also a catalyst for them to look beyond the traditional market cap-weighted indices at alternative strategies, with indices being used more as solutions rather than just as benchmarks.'

Total assets in ETFs ballooned from around \$800bn in 2008 to over \$5.4tn at the end of March 2020, underlining the size of the wall of money that moved into passive or rules-based investment strategies. This saw the creation of a myriad of new benchmarks for fixed income, an area that initially lagged in passive take-up, as investors sought increasingly specific mandates to target their exposure, whether by credit, issuer or geography.

At the same time, the rise of smart beta and factor-based products, which now hold \$680bn, saw a whole industry emerge in creating new approaches to diversifying exposures, all requiring new underlying benchmarks.

South African investors took longer to warm up to the idea of passive investing but in recent years these products have started to appear in most investment portfolios. The success of the Satrix range of exchange traded funds has opened the door for many more providers of passive investments to follow suit. The market capitalisation of South African listed ETFs now exceeds R100 billion – a fourfold increase since 2009. Add to this another estimated R50 billion in index funds and it's starting to become a sizable industry. It is, however, still very small compared to the total savings industry of over R6 trillion.

Against the backdrop of a rapidly expanding passive investment industry the question, of course, remains which strategy (i.e. index) should an investor choose? Soon there will be more than 3 million indices. This is almost 5 times more than the number of exchange listed stocks around the world. Just as passive managers are able to find an index that outperforms most active strategies so active managers can find an index that they can consistently beat.

What is the secret to investment success with so much choice? Know what you're investing in and pay the right price for it. It may just be a sensible combination of the above. And if you don't know? Ask your financial adviser. It will be worth it.