



INSIGHT

Investment perspectives from the Harvard House Group

REBUILDING CREDIBILITY

Is credit rating such a big thing?

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What Went Wrong?

Why could we potentially be junk rated?



“9/12”

- Most quoted surnames Dec’15
 - Nene/Van Rooyen/Gordhan



SA = 3 Finance Ministers = 24H

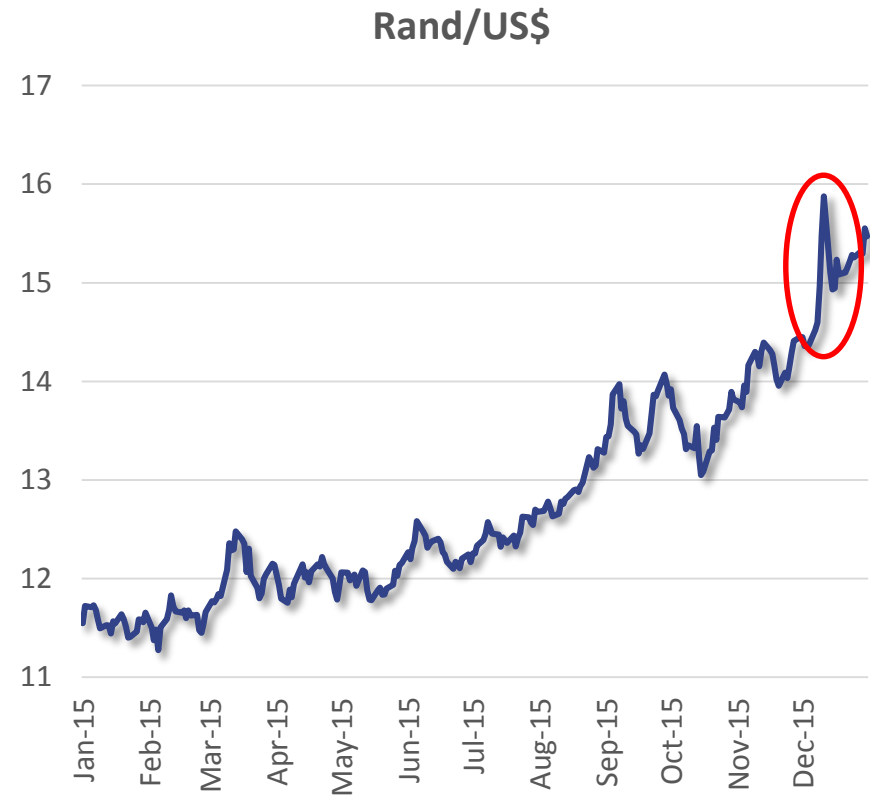
- Rand “overshoot”
- SA offshore bonds “collapse”
- Expected rate hiking cycle “intensifies”



Caused Credit Rating Agencies to move forward in their chairs



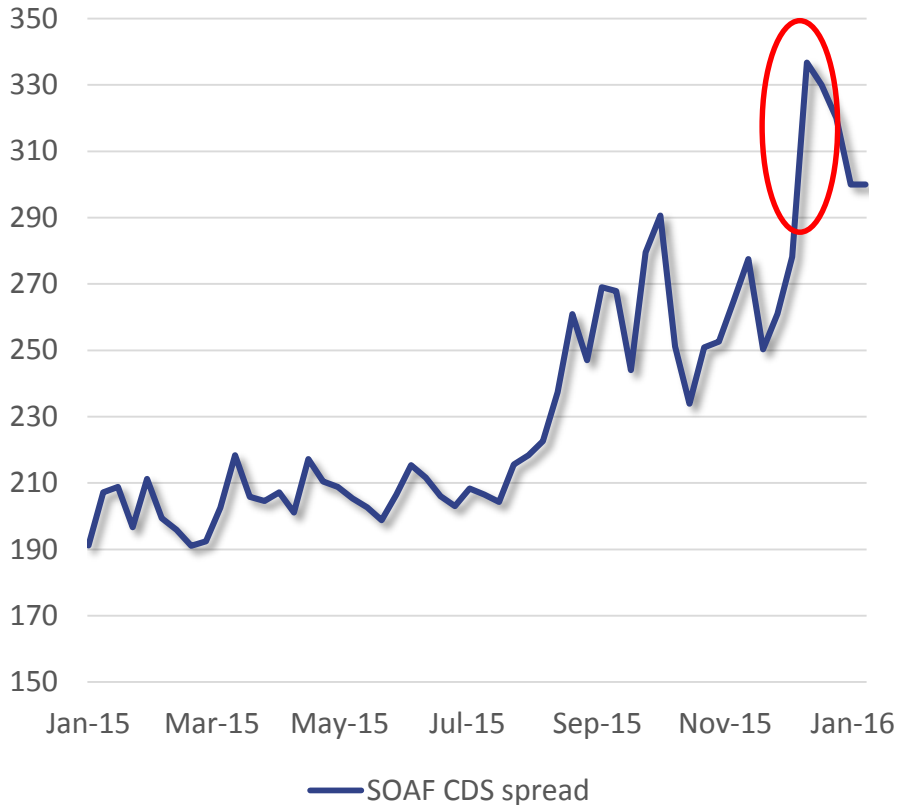
More than just the Rand!



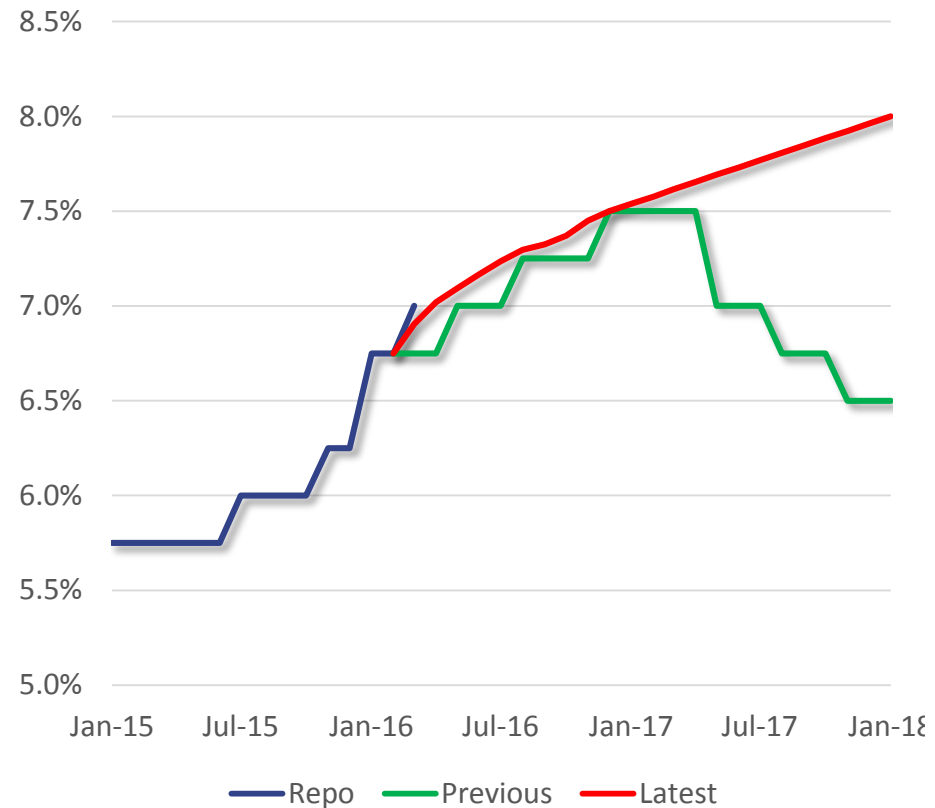
What Went Wrong?

The fundamental pattern shifted, but can unwind “quickly”

SA offshore bonds



Repo rate expectations



The Rand in this mix (mess?)

Unfortunately home developments bigger driver than previously

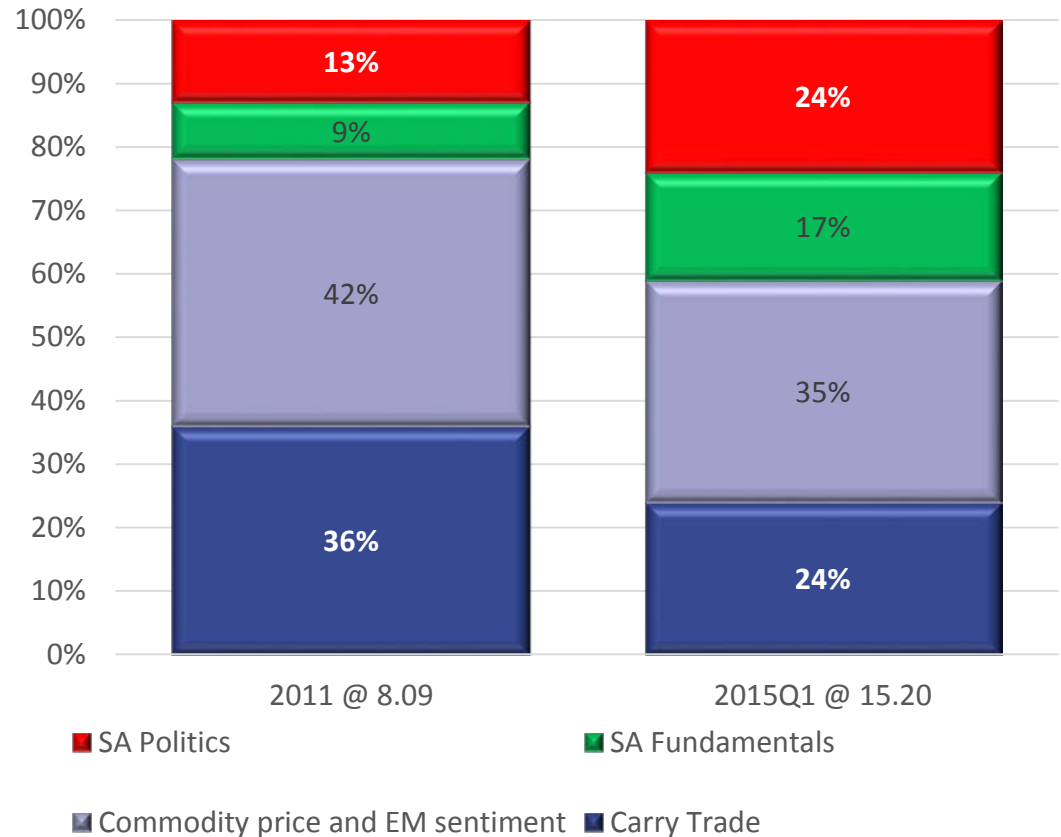


Growth/trade balance/investment explains 17% of rand move (vs 9%)



Global factors used to have a bigger impact - 78%)

Drivers of the Rand



Credit Rating Agencies

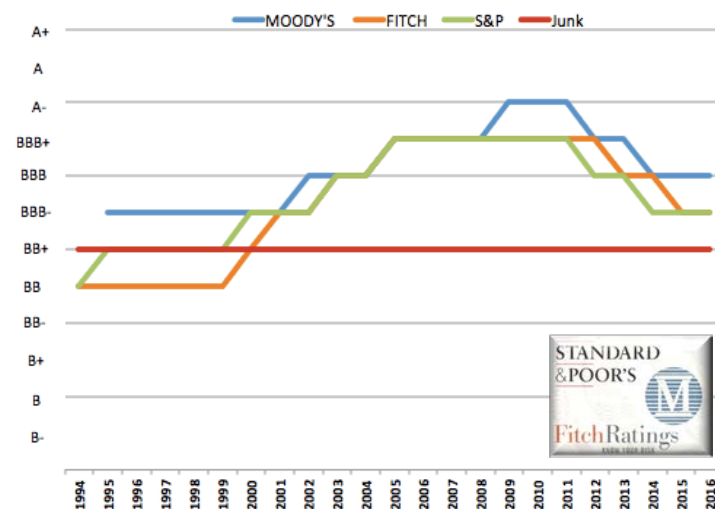
Why the brouhaha around a downgrade to junk?

-  Need to understand!
 - Local / foreign rating
-  Cost of funding up (Govt and firms)
-  International institutions selling?
 - Not the action but deterioration in the international perception of the credit worthiness of this debt
 - BUT - only 10% SA Govt debt offshore
 - Investors holding rand-denominated debt (by far the majority) should arguably be more concerned with the domestic currency rating
-  Is there appetite for Junk?
 - Investment flows
-  What can Gordhan do?

South Africa credit ratings at present

		Local currency		
		BBB+	BBB	BBB-
Foreign currency	BBB+	Moody's		
	BBB			
	BBB-	S&P	Fitch	

South African Sovereign Credit Ratings (1994 - 2016)



Source: National Treasury

Investment flows

Brazil example; a read-through for SA downgrade



Sharp decline in portfolio inflows

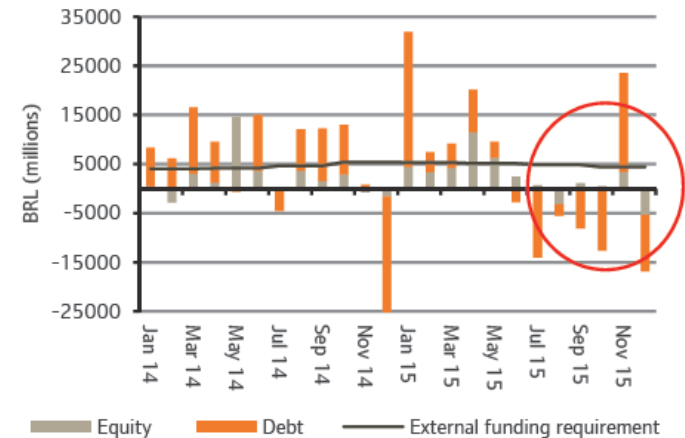
- Emerging markets in general
- Brazil after downgraded not substantially worse off



SA specific – “downgraded”

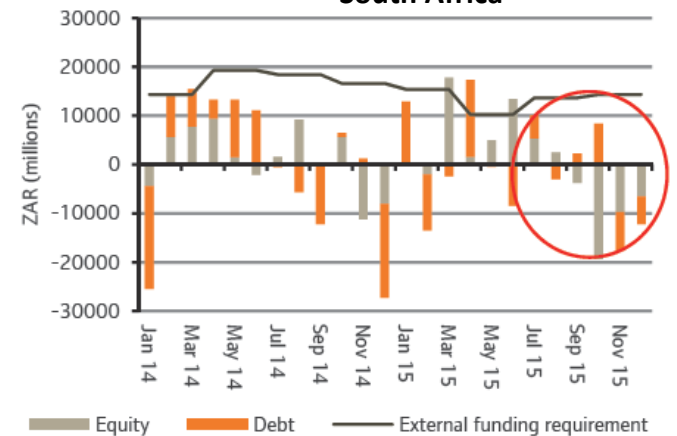
- Credit risk, well “priced-in”
- SA will not fall out of major bond indices (positive):
 - CITI World bond index – only if SA “local” currency rating below investment grade
 - JP Morgan EM bond index – based on per capita income criteria

Brazil



Source: Bloomberg

South Africa



Source: Bloomberg

Rating priced in

Risks well known

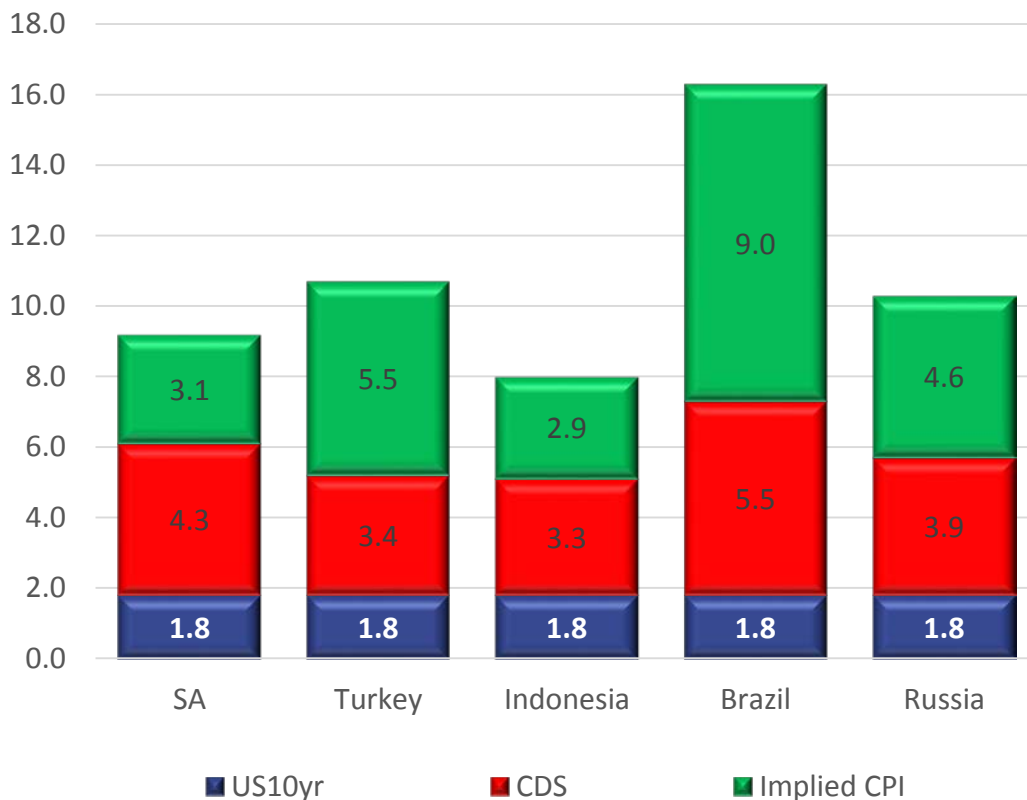


The RED bit –
“sovereign risk”
– SA CDS’s already high



The GREEN bit –
“currency risk”
– monetary policy
independent

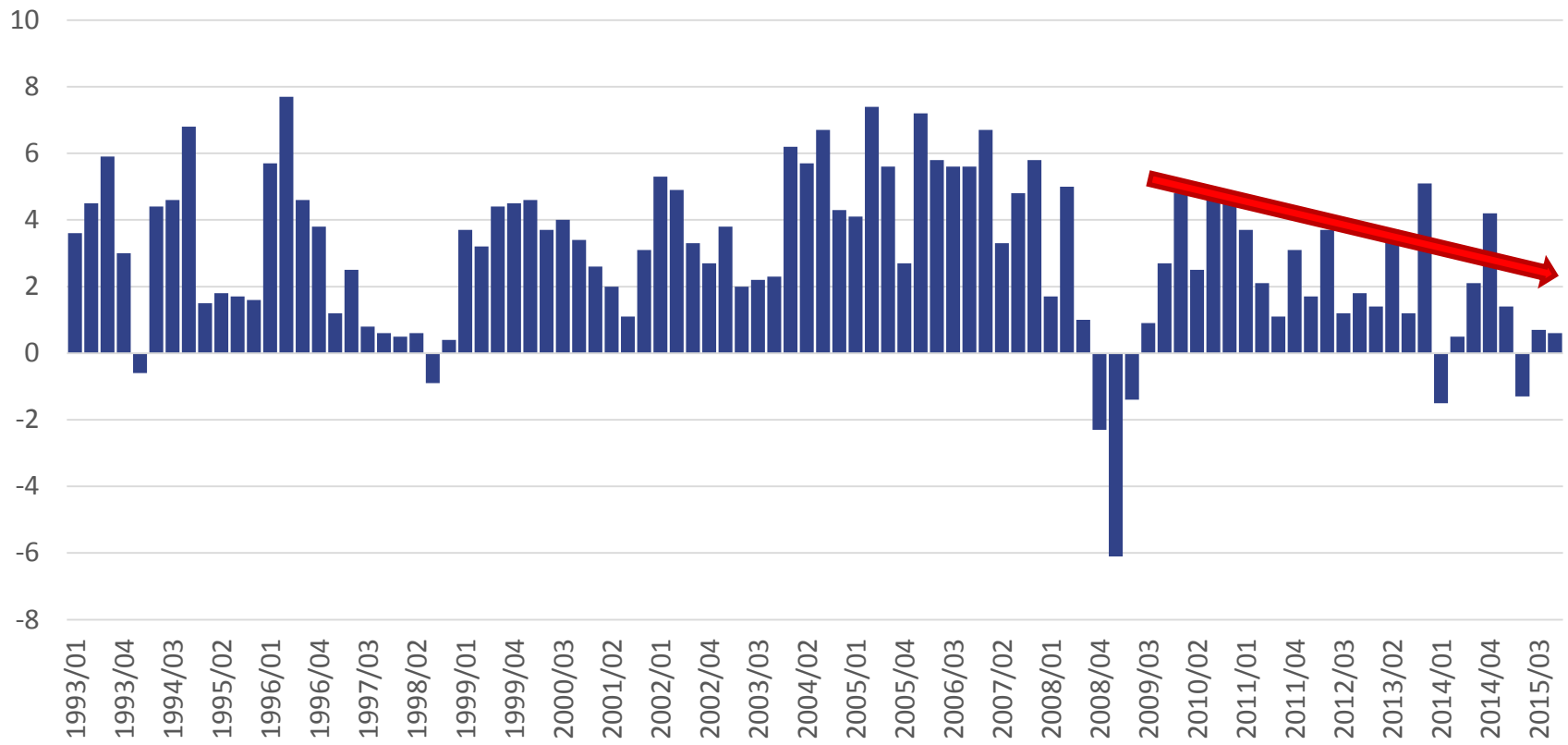
Implied 10yr Government bond yields



It is all about growth!

Everything changes as % of GDP..., so if the “engine” starts ...

Real GDP Growth



It is all about growth!

Where is growth going to come from?

GDP (production)		
	Size	Growth Q4'15
Agriculture	2.1%	-14.0%
Mining	7.4%	1.5%
Manufacturing	12.5%	-2.6%
Electricity	2.2%	0.9%
Construction	3.5%	1.1%
Trade	13.7	2.8%
Finance	20.0%	1.9%
GDP	100%	0.6%

- Review of loss-making SOE's
- Infrastructure
- Job creation/education
- One of the worst droughts in 40 years

GDP (demand)		
	Size	Growth Q4'15
Private consumption	60.1%	1.6%
Government consumption	20.3%	1.2%
Fixed investment	20.0%	2.6%
Export	-0.4%	0.6%
Imports		11.2%
GDP	100%	0.6%

- Remember the impact of the World Cup:
 - Not just stadiums
 - Gautrain, Roads, etc
- Relief has to come out of the global environment (commodity cycle)

Have we done enough?

Lets consider the following: **They are very intertwined**



Political change

- “Managed exit” vs “Recall” - it was very divisive when former president Mbeki was recalled



Social pact – Bus/Gov

- mostly focussed on transformation for government and mostly focussed on an easier environment for business



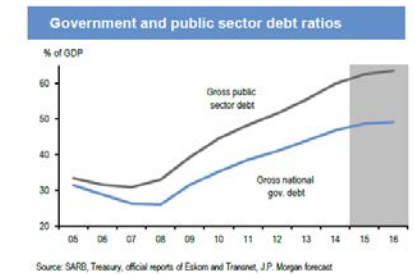
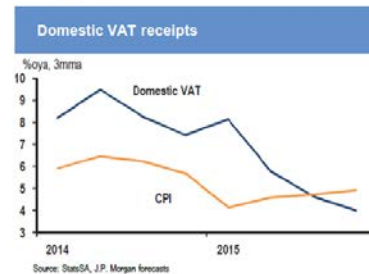
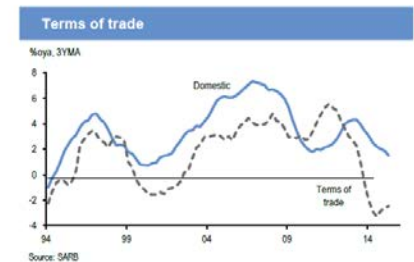
The Budget – was it a key event?



Investors need to evaluate

- fiscal policy (composition & magnitude of change, and how the fiscal risk from SOEs is reduced) and
- signs of growth policy improvements (NDP implementation or structured negotiation between government and business)

South Africa: Activity indicators reveal elevated recession risks



Portfolio activity

How are we acting



Not just about the Credit rating

- A rating downgrade priced in
- Actual announcement might see some shuffling



Emerging markets under pressure



Rand hedge vs SA Inc.

- Shying away from SA Inc based on growth
- Politics plays a secondary role



CASH - not a bad holding

- Slow growth globally





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Q & A

Please feel free to ask questions

Thank you for listening