ANC54 – what does the outcome mean for our economy? | 21 December 2017

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As the ANC's 54th national conference drew to a close, with Cyril Ramaphosa delivering his first address as party president, the question is whether the governing party's new leadership can make a difference to some of the local economy's shorter and longer-term issues.

Our economy has suffered terribly in the past five years. GDP growth has slowed from an average of 2.5% from 2007-2012 (including the financial crisis), to just 1.6% over the past five years and 0.3% last year. This year (2017) we will be lucky if growth exceeds 1.0%. The fiscal position has deteriorated meaningfully, with debt to GDP set to rise from 38.6% of GDP in 2012 to 60.8% by 2022 in the latest projections from National Treasury. South Africa’s sovereign credit ratings have been downgraded four times since 2012. Confidence – the driver of growth through consumption and investment – has fallen to multi-year lows. This deterioration coincides with President Zuma's second term as president of the ANC and the country. It also reflects a coincidence with a modest recovery in post-crisis global growth, and the fruition of poor economic policies, badly implemented under the oversight of compromised leadership.

Can the new ANC president salvage South Africa’s weak economy?

Only time will tell if the election of Cyril Ramaphosa can sustainably change South Africa’s weakening economy. It is important to note that many of the country's economic challenges are now entrenched, and have become structural in nature. Corruption, inefficiency and capacity within the state are all high hurdles to clear for better growth. However, in order to successfully address critical issues such as inequality, poverty, education, failing infrastructure and, as a result, falling potential growth, we need rational policy formulation and diligent implementation of feasible economic and social strategies.

Certainly Cyril Ramaphosa’s victory offers a better opportunity to make the right decisions to put the economy back on a more sustainable path. The composition of the top six shows a mixture of the two dominant factions within the ANC. This, together with the rest of the membership of the National Executive Committee may make it challenging for the party president to meaningfully drive his stated commitment to dealing with corruption and to implement economic policies which facilitate growth and transformation. Building a consensus out of a divided group will be time consuming.

We do not know at this stage if President Zuma will complete his term as national president, or be recalled. Had Cyril Ramaphosa gained a clear victory, he may have been able to act more decisively than seems likely now, either as party president, or in a future role as national president. On balance it seems reasonable to expect an improvement in dialogue between government, labour and the private sector, which should improve confidence and growth. Appointing capable, uncompromised people to key state institutions would also raise efficiency and economic sustainability. This will be the litmus test for new leadership. Change will surely come, but investors may be too eager in anticipating new outcomes, and could be disappointed.

Our portfolio positioning

The outcome of the ANC elective conference, although very important to the future direction of our country, is one of those political events that was extremely difficult to predict. The possible outcomes included a clear victory for either the patronage group, the reformist group, a compromised outcome or even a shambolic conference with many disputes and even violence. We understood that every possible outcome would undoubtedly have a short-term impact on the financial markets.

However, our approach to managing clients' savings does not rest on our prediction of political or macroeconomic events. Instead, our aim is to build robust portfolios, comprising the most undervalued securities, from the bottom up.

All our balanced portfolios share the following common features:

- full exposure to offshore assets, in line with Regulation 28;
- high exposure within our domestic equity portfolios to global companies listed on the JSE (e.g. Naspers, British American Tobacco, MTN, Richemont, Mondi and others);
- meaningful exposure within our property holdings to London-listed property companies (such as Intu, Hammerson and Capco); and
- low modified duration within our bond portfolios, which mainly comprise corporate bonds.

None of these positions were built based on the prediction of the conference outcome. Instead, the case for holding each asset is supported by its valuation and long-term prospects.

Given our full offshore weighting and preference for global stocks, we expect our balanced portfolios to perform better in a weak rand environment. In order to manage risk within the portfolios, and to provide some shelter against the impact of a stronger currency, we did buy some protection (currency options) ahead of the conference.

As a Cyril Ramaphosa presidency became a greater possibility, the rand started strengthening and with it government bond yields declined, while the prices of domestic-focused stocks rose sharply. The currency options we bought are now well in the money, and we will look to exercise these.

In addition to the currency options, we also added government bonds at very attractive yields following the very disappointing Medium-Term Budget Policy Statement. Our portfolios have therefore enjoyed some benefit from the stronger bond market too, but we remain conservative in our bond positioning and are likely to keep a low duration until yields offer more attractive risk/return metrics.

South Africa faces many deep-seated structural issues, such as a very uncompetitive labour force, poor education and low productivity. The fiscal deficit remains a major concern, worsened by the recent downgrades of our sovereign debt to junk status. A new leadership in the governing party can make a difference to some of the shorter-term issues such as mismanagement of the SOEs, but to truly address the long-term issues will take decades.

As always, we will remain focused on valuation and will seek to take advantage of attractive opportunities that the market may present, and in so doing aim to generate superior inflation-beating returns for our investors over the long term.