

Homegrown

The South African investment industry is a dynamic and world-class industry that we as South Africans can rightly be proud of.



Over the years, it has evolved and adapted to be the custodian of the savings and investments of a broad array of citizens and businesses and as such plays a critical role in shaping the South African economy and landscape.

As part of the broader world of global investments, the local industry has evolved in consequence to global developments but also importantly in service of our homegrown needs.

Over the last few decades, we have seen the rise of boutique and specialist asset managers, and tracking and index funds have taken off. Over the last few years there has also been an increase in smart beta funds, which are funds that are managed passively but are based on algorithms to pick stocks and investments that have specific characteristics, including value, growth and momentum.

During this period, we have also seen the systematic relaxation of exchange control and as a result different approaches have developed to manage the offshore portion of South African-based funds.

The announcement by the finance minister in the February 2022 budget speech, further relaxing exchange controls whereby up to 45% of retirement funds can be invested in offshore assets, is both a continuation of a longer-term trend but also now makes offshore assets one of the most material exposures within a portfolio.

As a result of the changes to exchange control over the years, we have seen asset managers adopting and evolving their models of managing their offshore assets, from a simple allocation to an offshore mandate and manager, to setting up offices overseas and partnering with global investment managers.

I fully expect that, with the current levels of permissible global exposure, the need for offshore partnerships will increase materially as the global investment landscape dwarfs the local investment arena. It is unlikely that a local asset manager can realistically manage the offshore component of their assets without setting up substantial offshore operations and

partnering with a global player that has the requisite strength and resources to create a credible offshore offering.

At Momentum Investments, we have done both. Our global operations are based in London under the brand Momentum Global Investment Management (MGIM) and we have partnered with Robeco, based in Amsterdam, to give us access to their well-known and regarded financial engineering and smart beta skillsets.

We will see the details of how the South African investment industry adapts to the relaxation of exchange control, which poses both an opportunity and a threat to the local industry. At the moment, based purely on geopolitical risk and slightly better valuations in the South African market, there has not yet been a large-scale movement of assets offshore. Over time as global geopolitics stabilises or achieves some form of new normal and the current inflationary and growth risks subside, I expect that asset managers will start to allocate more capital offshore.

This will reduce the size of the pool of domestic-based investable assets in the South African markets, which are likely to impact how our local markets operate. Over the years we have seen a significant uptick in the ownership of local assets by foreign investors and their continued support and investment in our markets will be a critical factor to the continued health of our markets. As such, maintaining the highest standards and reputation of the local financial industry is critical as we navigate through the implications of this.

In this process there will be winners and losers. As an investor, it will be important to keep an eye on the sustainability of the asset managers that are used.

Sustainability is the other trend that has gripped the global and local industry. I prefer to use the word sustainability as it encapsulates the environmental, social, and governance (ESG) trend that is currently all the rage. Just reading or watching the news gives an insight into why ESG is so important.

The floods in the US and droughts in Europe are placing a key focus on the challenge of climate change. The term sustainability captures the broader scope of what we need to balance when considering ESG factors. The real impact of ESG is to balance the various facets in a way that considers the practical realities of what we need to prioritise and achieve.

We are the custodians of our clients' money first and foremost and need to deliver returns. To do this responsibly, we need to make sure that our business is sound and in good financial health and also take into account the sometimes-conflicting aspects of ESG. For example, a singular focus on one factor, the environment, can have social impacts over the

short term on communities that depend on traditional power production methods for their livelihoods. This is why we support the Just Transition, which means that as we consider climate action, we also need to take into account the social and people implications of the needed energy transition.

Clearly not addressing climate change has significantly longer-term social implications, that absolutely do need to be addressed. Europe was at the forefront of climate action until the roll-over effects of the Russia/Ukraine war posed risks to European energy security. As a result the role of nuclear and coal is being reconsidered, at least in the short term, which risks undoing the progress made. Hence the need for a sustainable and considered approach to addressing ESG.

Another area that is a focus for the asset management industry is that of infrastructure investment. There is a dire need for significant investment in infrastructure in our local economy. The government does not have sufficient resources

to realise the scale of development required and as such needs to crowd in the private sector.

There are many considerations that must be taken into account when we invest in infrastructure. Our investors need an appropriate return on investment, there is a trust deficit with government and a new compact and way of work needs to be established, and with the relaxation of exchange control a big chunk of South African-based assets is going to be invested offshore, thereby reducing the available capital.

Another consideration is liquidity – infrastructure investments are illiquid. This means that the level of exposure that we invest in our portfolios needs to be carefully calibrated taking into account a wide variety of portfolio management considerations.

We need to invest in accordance with our mandates that reflect the needs and desires of our clients. This requires a spread of asset classes and appropriate diversification within asset classes to achieve a prudent spread of desired risks and sufficient levels of liquidity. The consequence is that the level of infrastructure investments in portfolios will likely be conservative.

The South African asset management industry is an exciting, dynamic and ever-evolving industry. There are a myriad of challenges and opportunities that we need to consider when investing our clients' money with the due care and skill that has been entrusted to us. This is a charge that the industry, Momentum Investments and myself take very seriously, because with us, investing is personal. ■

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Mike Adsetts, Deputy Chief Investment Officer, Momentum Investments