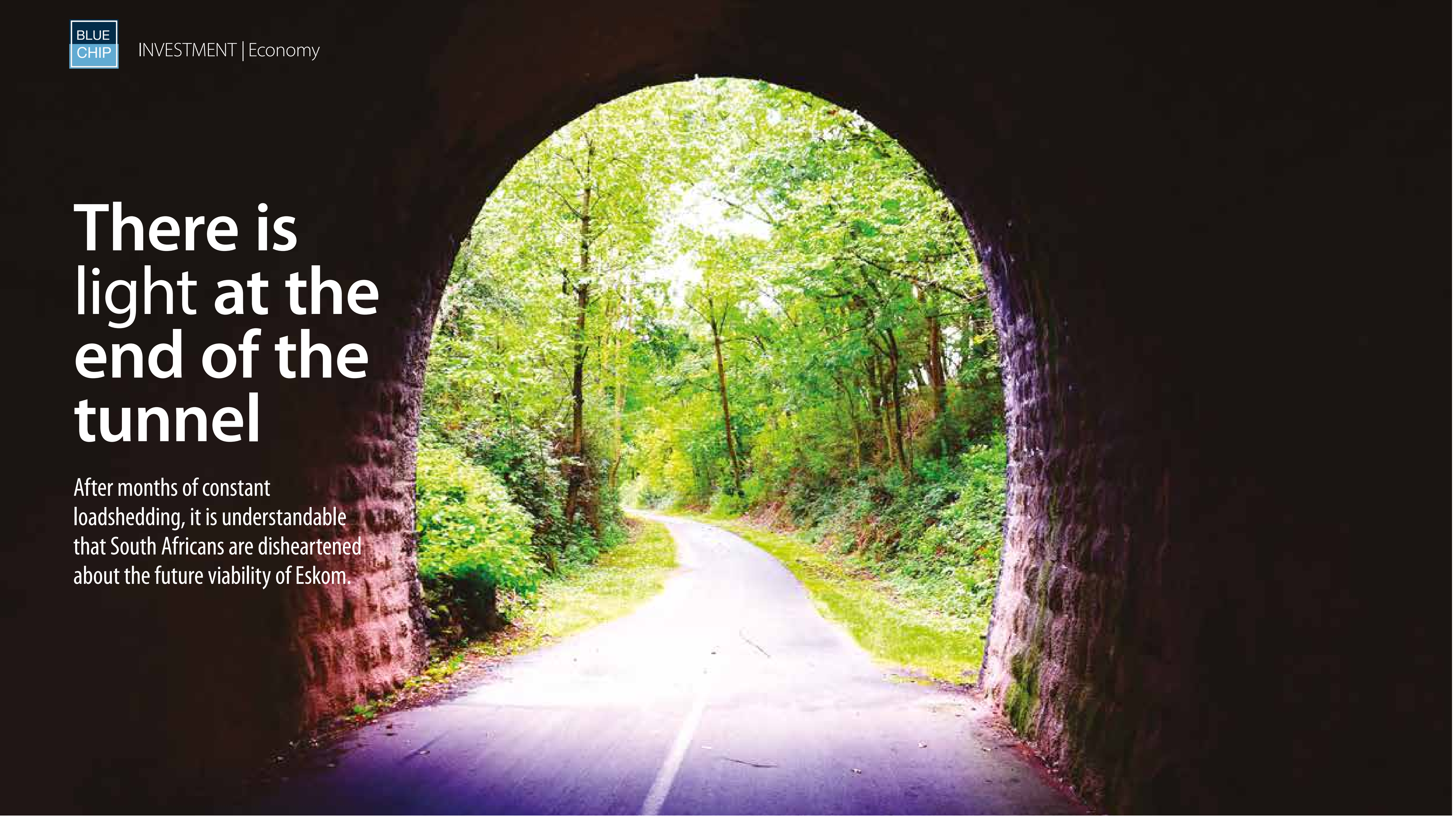

There is light at the end of the tunnel

After months of constant loadshedding, it is understandable that South Africans are disheartened about the future viability of Eskom.

This extends itself to the fear of the country becoming a failed state. Against this backdrop, you may feel anxious about your clients' investments here. However, it is important to know that risk is not always a negative. In fact, understanding and managing risk can lead to greater long-term success.

In the case of Eskom, while the situation is dire, some lights are beginning to appear at the end of this dark tunnel. Firstly, in his February 2023 budget speech, Minister Enoch Godongwana announced a debt relief package of R254-billion (60% of Eskom's current debt) over the next three years. This action removes a big hurdle in the way of the much-anticipated break-up of Eskom which would enable greater private-sector participation.

Secondly, Eskom and government are aware of the gap in generation capacity required and steps have already been taken, in line with the National Energy Plan, to bridge this gap. Examples include the increase in the private generation threshold to 100MW as well as the awarding of renewable energy projects under bidding windows one to five, with more than 100 projects in the pipeline[1]. National Treasury has also allowed for R9-billion[1] in tax incentives for domestic solar installations and commercial renewable energy projects. Even though it may be a couple years before we see these actions relieving capacity constraints, they are a step in the right direction and take a much shorter time to implement than coal-powered alternatives.

Finally, government is more committed to ease the short-term pressures on loadshedding. Not only has our army been deployed to mitigate sabotage, but the recent declaration of a State of Disaster in President Cyril Ramaphosa's State of the Nation Address, along with the announcement of a new Minister of Electricity, may lead to more barriers to private generation being removed.

With all this in mind, a total grid collapse is not our base case. Rather, we anticipate a muddle-through scenario where loadshedding becomes a part of our lives for the next two years until greater capacity can be added to the grid.

The question remains: what does this mean for your local investments? Given our expectations around loadshedding, economic growth in South Africa will come under severe pressure, a point that the South African Reserve Bank (SARB) made clear when they revised growth forecasts for 2023 down to 0.2%. However, despite this bleak macroeconomic outlook, we remain positive about the outlook for our local asset classes. Starting with equity, the South African market is still cheap relative to global counterparts and to our own history.

While equity markets globally may come under pressure due to a potential global recession and the delayed economic impact of interest rate hikes, the compelling local valuations may help our market fare better. The dire local growth outlook also does not necessarily translate into poor equity returns. This is perhaps more relevant when you consider that, based on an analysis that RMB Morgan Stanley did in 2020, less than one-third of the aggregate operating performance of companies in the JSE Top 40 index originate from South Africa.

Like local equities, the local bond market also offers compelling valuations, with some of the highest real yields relative to peers and our own history. Taking this into account, we believe a lot of the bad news and fiscal risks locally are already priced in. With the SARB having done a good job on managing inflation and staying ahead of the curve, we expect to see inflation come down this year, which should benefit local bonds. Therefore, investors who stomach the risks and stay invested stand to benefit greatly in the long run.

Although we have painted an optimistic picture of Eskom and local markets, we are aware that salient risks remain. The dire financial state of other state-owned enterprises, specifically Transnet, could significantly impair South Africa's fiscal position. Similarly, the potential for further sabotage and Eskom's infrastructure deteriorating mean that the risk of more loadshedding remains. When dealing with these unquantifiable risks, our primary defence is sound investment principles. To this end, well-diversified portfolios with a range of local and global asset classes, constructed to deliver on a risk and return profile, should be top of mind, and partnering with a discretionary fund manager such as Equilibrium can assist financial advisors in this regard. ■

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1 National Treasury, Budget speech, February 2023