4TH QUARTER 2019

itransact Investment Platform

PORTFOLIO MANAGER QUARTERLY REVIEW

Justin Solms
Bachelor of Science Degree in Engineering (BscEng) and a Master's Degree in Electronic Engineering (MEng) from Stellenbosch University.

Waheed Swales (Under Supervision)
MSc in Mathematical Statistics, with a research specialisation in Financial Mathematics and Financial Economics, along with a BCom (Hons) in Econometrics.

ITRANSACT IS A LICENSED FINANCIAL SERVICES PROVIDER

CONTENTS

1. INDEX-TRACKER FUND PORTFOLIO RETURNS

DISCRETIONARY PORTFOLIOS	1 YEAR	2 YEAR	3 YEAR	4 YEAR	5 YEAR	6 YEAR	7 YEAR	8 YEAR
Conservative	7,79	6,32	6,45	6,09	6,04	–	–	–
Cautious	11,62	5,88	5,81	5,59	5,93	6,52	5,78	7,01
Moderate	15,04	6,62	7,20	6,75	7,39	8,15	7,81	9,02
Growth	15,87	3,86	7,27	5,37	7,34	7,10	7,83	9,03
International	25,71	13,96	13,56	11,50	11,52	11,58	–	–
REGULATION 28 PORTFOLIOS	**1 YEAR**	**2 YEAR**	**3 YEAR**	**4 YEAR**	**5 YEAR**	**6 YEAR**	**7 YEAR**	**8 YEAR**
Conservative	10,18	4,49	4,16	4,64	6,32	–	–	–
Cautious	9,77	3,49	4,16	4,64	5,64	6,11	–	–
Moderate	11,29	2,54	4,37	4,10	5,84	6,82	–	–
Growth	11,63	1,41	5,29	4,91	6,24	7,15	–	–

Performance is annualised and net of the underlying index-tracker fund, portfolio manager's total fees and expenses, trading costs and VAT.

2. WHICH INDEX TRACKER FUNDS DO I CHOOSE?

With over 100 local and international index tracker funds (such as Exchange Traded Funds, or ETFs for short) to choose from, selecting the correct blend of funds that will reduce risk and cut costs, but still provide attractive returns, can be a difficult, if not impossible challenge for investors.

We solved this challenge in 2011 by offering financial advisors a range of managed risk adjusted index tracker portfolios.

Our fund selection process

We firstly ensure that all the index tracker funds we analyse for possible selection into our portfolios are funds approved and regulated by authorities such as the Financial Services Conduct Authority (FSCA) and certain acts, such as the Financial Markets Act. We only consider index tracker funds provided by leading index fund asset managers such as Satrix, Sygnia, Standard Bank, Absa, Coreshares and Ashburton.

In a nutshell: investors are ultimately offered purpose built, carefully thought out and constructed blends consisting of best of breed local and global index trackers in one convenient portfolio.

We continue to refine our fund selection by disqualifying all index tracker funds that use so called "smart beta", "active" or "multifactor methods". These are not index tracker funds in the purest sense. They are mostly dressed up funds that attempt to be seen to behave like stock picking active funds. It has been proven by many experts from all over the world that, over decades, very few actively managed funds are able to beat their market tracking cousins or manage to survive over time.

We therefore only use unpolluted low cost vanilla index tracker funds as our portfolio building blocks. These carefully selected funds provide us with broad, well-diversified exposure to the market sectors and asset classes at the lowest cost. Each of our portfolios is designed to tolerate the failure of a few companies (i.e. Steinhoff) within the index tracking fund itself with little to no impact on the overall portfolio results.

From this process, we derive an efficient basket of carefully selected index tracker funds. The funds are well diversified from one another so that they can focus on tracking their objectives over local and global equity, property, fixed income and money markets.

We now need only select those index tracker funds to represent each asset class by allocating capital to each portfolio based on its content and risk weightings to achieve cautious, conservative, moderate, growth and international portfolios.

Our portfolio construction and asset allocation process

Now that we have determined the most efficient basket of index tracker funds, we use them as building blocks to construct portfolios. We take the historical price and total return series (net of its Total Expense Ratio – TER for short) of each building block and apply it to our propriety owned and highly advanced quantitative algorithmic systems. This system produces hundreds of thousands of portfolio options. Our investment committee uses this refined information in a qualitative way to choose and confirm the range of model portfolios which have the best chance of meeting their goals at the lowest cost and risk to the investor.

3. IN-FOCUS: EXTERNALISING RETIREMENT FUNDS

Our discretionary Growth and International portfolios have been providing consistently exceptional returns from inception. With that said, certain considerations will need to be made when moving your discretionary savings offshore.

Considerations:

Ongoing current public discourse around perceived threats of n prescribed assets in SA retirement funds being pressurised to invest in State Owned Enterprise (SOE) debt or in pre-determined infrastructural and social development projects has been met with resistance and trepidation from investors, leading to reluctance to further invest in retirement funds.

With the advent of Section 7C of the Income Tax Act which deals with interest on income derived from loan accounts and trusts, retirement saving vehicles form part of a very small effective estate planning toolset.

The difference between pre- and post- retirement taxes is significant. Pre-retirement tax on withdrawals has a R25 000 threshold, with any funds in excess of that amount subject to a minimum of 18% tax (along with aggregated previous withdrawals). The rate is progressive and goes up to a maximum rate of 36%. Post-retirement withdrawals are defined by a tax threshold of R500 000, at a rate of 18%, up to a maximum rate of 36%.

If an investor ceases contributions, the reduced tax deduction is forfeited. Any investment capital outside of official retirement funds will be subject to duties; 20% for estates of less than R30 million and 25% for estates greater than R30 million. Further, executor's fees of 3.5% plus VAT are due if no nominated beneficiary has been appointed.

There are also considerations to be made for CGT[1]. Some offshore investments will incur CGT at death (max 18% above a R300 000 threshold). There are also offshore investments that are no longer free from dividend income-, interest- and situs taxes.

Retirement funds also enjoy exceptional protection against creditors' claims under the Pension Funds Act, specifically business owners and farmers. The risk of moving investment capital from the currently out-of-favour JSE to a more favoured US equity market should also be considered.

There are further risk considerations around moving investment capital away from a weakened and undervalued South African rand and buying into USD[2], for example. It would be wise to consider the long-term forecasted average exchange rate. The rand has been estimated to depreciate on average at 1% per annum to the USD (per Deloitte's Rand Depreciation Report - 2016). Currencies are often undervalued when economic uncertainty characterises the investment climate. SA has the most liquid capital markets in Africa and is therefore susceptible to currency value drains in times of pessimism.

A comparison between retirement funds and direct offshore investment:

Retirement funds require a long-term commitment. They grow at a much slower pace than full-equity

1 Capital Gains Tax

2 United States Dollar

portfolios, but offer a balanced risk level for many investors. Indexation funds such as those offered by Index Solutions offer the perfect point of access to realise the aforementioned growth opportunities.

Direct offshore investments are not as risk-free and stable as some investors are lead to believe. Returns from an offshore high-equity fund over the last 5 years, compare favourably with a local balanced fund. When tax is taken into account, the negatives start adding up.

Investors need to take cognisance of the current market price disparity. We are experiencing local record lows vs record high indices and a long-term currency reversion.

Our International Managed Portfolio vs Competitors

TOTAL ANNUALISED RETURNS 5 YEARS ENDED 2019-12-29

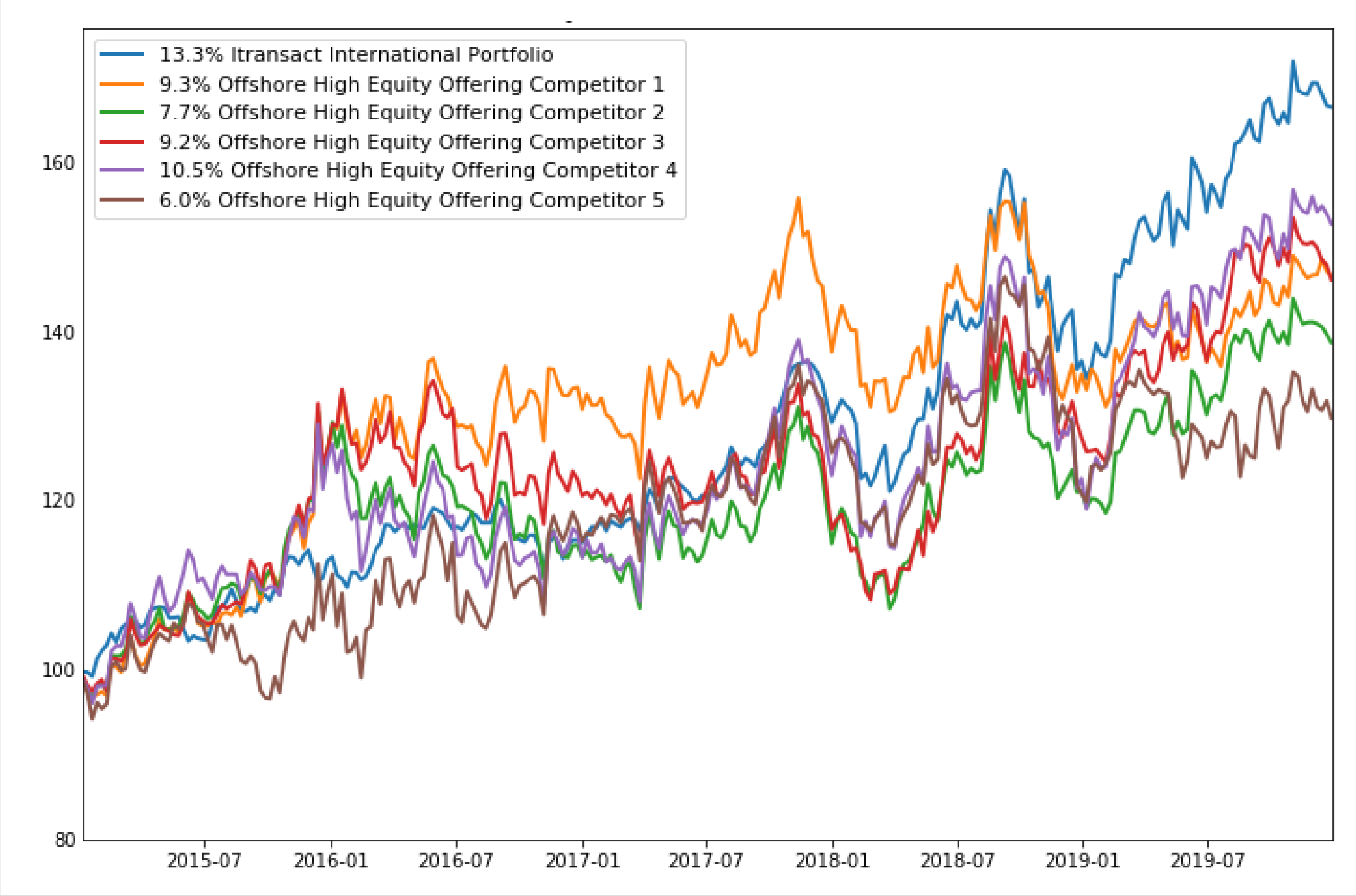


Figure 1: International Fund Comparison with 5 leading competitors. Source: FE Analytics, Index Solutions 2019

By combining a blend between foreign equity and foreign property weighted in favour of offshore exposure (62.7% and 21,8 respectively), coupled with 16% in domestic cash, we have been able to extract value in conditions where local property and local equity offer a lower value proposition in the current economic climate. A significant portion of the exceptional performance can be attributed to this asset blend.

A gross annualised 5 year return of 13.3% is not easily matched by similar foreign equity funds on offer. On average, an investor can expect excellent returns in this product segment, however the defining factors will be fees and returns. As both a low-cost and high return leader in this segment, Index Solutions offers full access to global equity markets, along with additional efficiencies that streamline an already high-risk investment vehicle.

Our Growth Portfolio vs Competitors

TOTAL ANNUALISED RETURNS 5 YEARS ENDED 2019-12-29

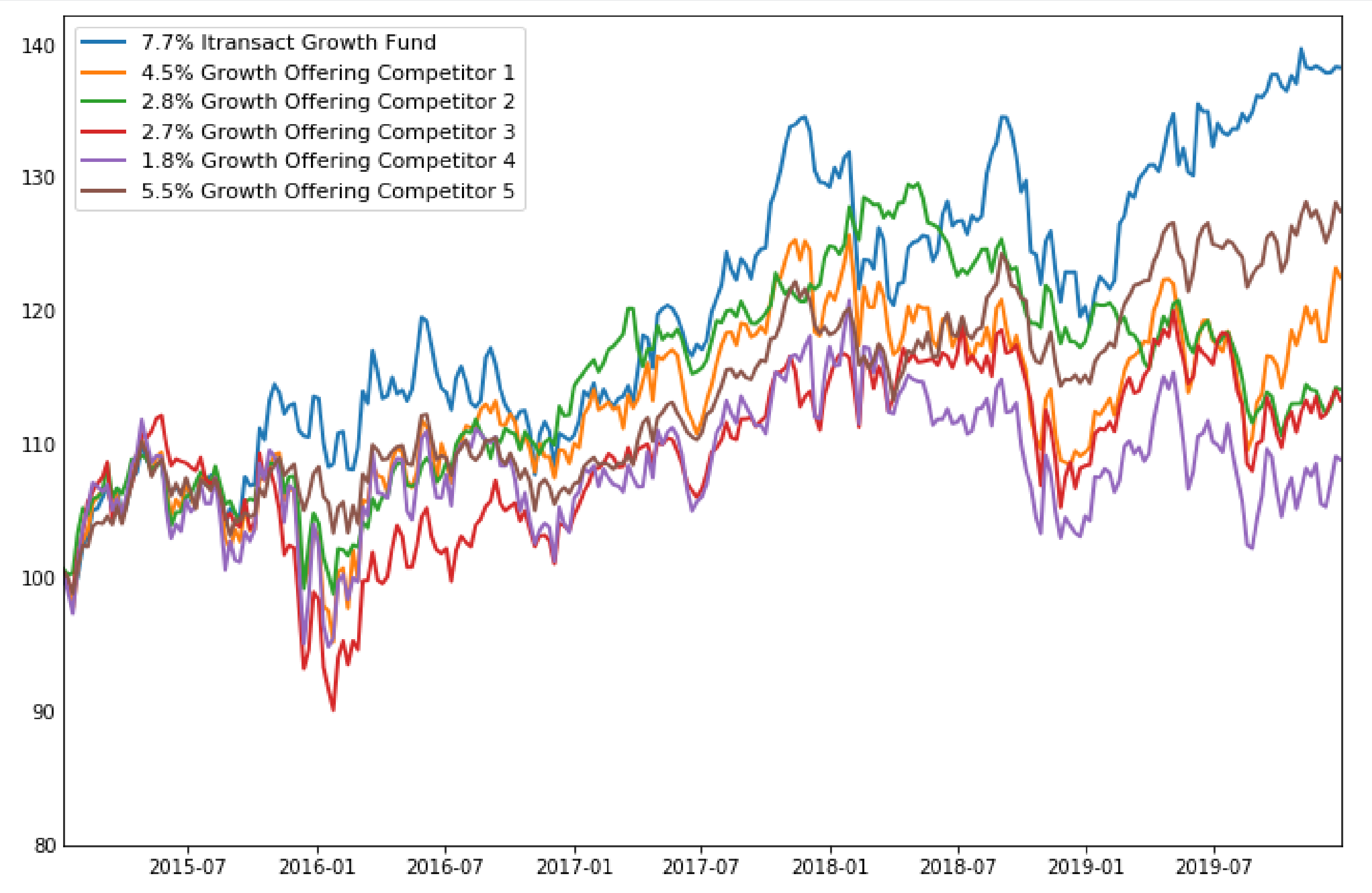


Figure 2: Growth Portfolio Comparison with 5 leading Competitors

Source: FE Analytics, Index Solutions 2019

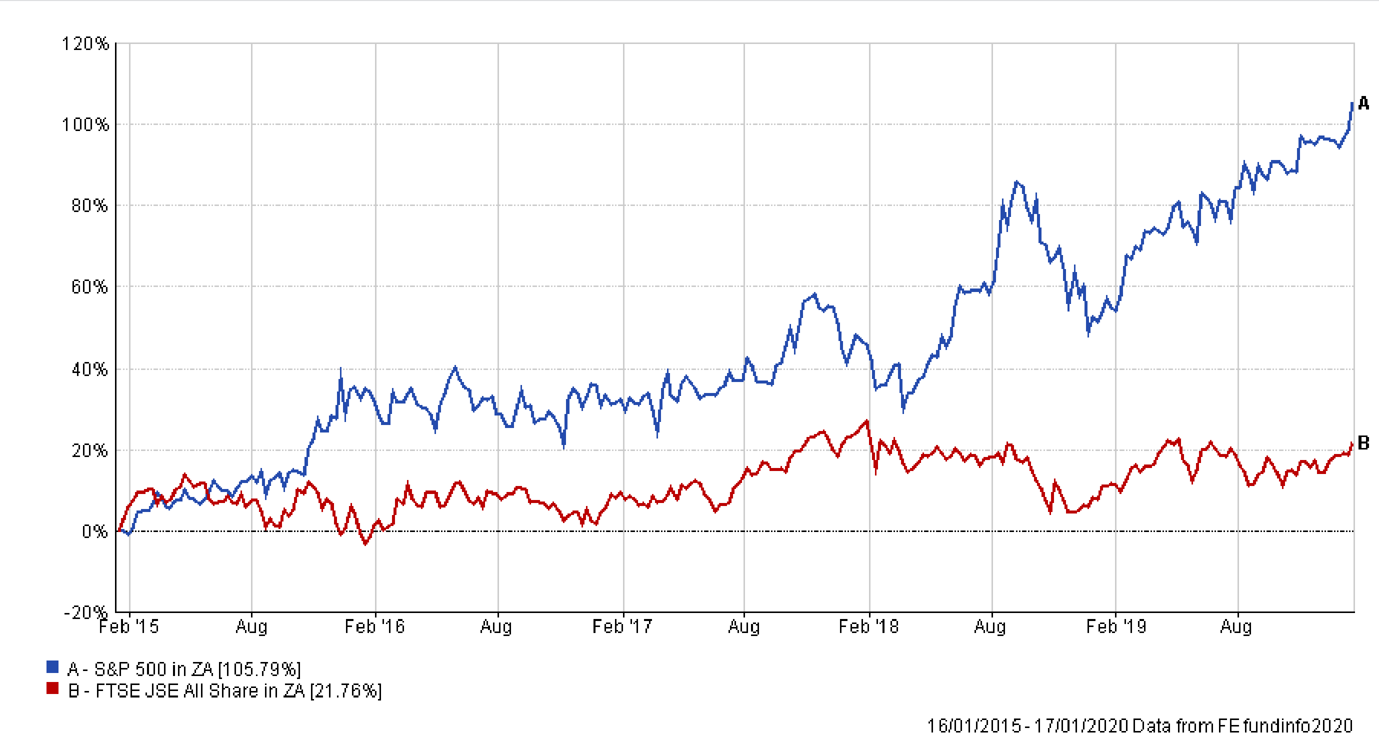
Similarly; with 26.4% exposure to foreign equity and 18.6 % exposure to foreign property, we see a positive performance trend to our Growth product (7.7% annualised), with value being extracted overseas to counteract the current local low-growth climate. This is a more risk adjusted product offering that caters to those who are looking to temper the risk of foreign market exposure with a domestic equity and domestic property.

Since-inception our annual performance obtained on both our International (8.92%) & Growth (8.9%) offerings is exceptional and highlights that a well-geared indexation strategy will extract the best value from both global and international markets. Comparative active strategies find it very difficult to extract the same return levels at a low cost.

Going forward, we expect to apply our efficiency models in an expansive methodology, which hopes to marry the exceptional value we have been able to extract both domestically and internationally and continue on our path of consistency. With a stable inflationary outlook, there is an opportunity to keep real returns on investment high. Along with further maintaining our 8 year track record in applying the strong principles of market indexation investment.

As seen in the chart below, foreign equity markets have been offering a better prospect of growth as opposed to a relatively stagnant domestic equity market.

STANDARD & POOR'S (S&P) 500 INDEX PERFORMANCE VS JSE ALLSHARE INDEX (5 YEARS)



Source: FE Analytics 2020

Conclusion

Deciding to withdraw retirement capital causes clear and substantial changes to the investor's wealth tax structure. We encourage a holistic, diversified approach to investing by optimising taxes and avoiding irreversible decisions (specifically the ones driven by emotions).

It appears that many South Africans are concerned about their retirement fund savings over the long term. However, retirement fund returns are clearly just the first dimension of such decision.

The consensus is that inflation will be stable in early 2020. There are likely to be hikes in electricity, fuel and water costs in the first quarter of 2020. The local bond markets have seen a reasonable uptick, along with gains in the local equity market and it is expected to continue this trend.

As expected, the listed property sector was the worst performing asset class locally continuing on from Q3 to Q4 2019. There was positive close to 2019 for emerging markets, along with respite from the ongoing US-Sino trade war. The local currency showed steel even when faced with Eskom's structural issues.

The opportunity to prop up your retirement savings with a discretionary international offering has never been more marked. It stands to reason that a long-term view will be paramount when considering the risks of investing in foreign asset classes, along with the continued vulnerability of the rand over the medium to long term.

4. MARKETS IN REVIEW OVER THE LAST QUARTER

Cash and Money Markets

Returns of 0.59%, 0.55% and 0.60 % have been realised in our portfolio cash holdings for the months of October, November and December 2019 respectively.

Inflation fell to an 8-year low of 3.7% in November (down from 4.1% in October) and lowered further to 3.6% in December. The South African Reserve Bank has indicated that its medium-term inflation outlook is largely unchanged.

Local Bonds

South African bond yields jumped sharply at month-end as investors reacted negatively to Finance Minister Tito Mboweni's Medium-Term Budget Policy Speech. Markets were flat during November. The ALBI (All Bond Index, comprising "vanilla" bonds from across the full range of maturities in the bond market and serving as a useful measure of daily movements in the bond market) posted a 0.020% return over the last quarter. Inflation Linked Bonds (ILBs) dropped into negative territory over the last quarter of 2019.

Global Bonds

Global bond markets performed solidly throughout December 2019. High-yield and emerging markets debt performed comfortably and finished the year well, with a 14.4% gain over 2109. Complimented by local currency strength, local currency denominated bonds performed well.

Local Equity

The local equity market posted solid gains during October (2.6%), while November was disappointing with both a decline in the ALSI (-1.8%) and SWIX (-1.5%). Local equities posted solid gains with the SWIX improving at 3.68% higher at the end of December. The best performing local equity index was the RESI index in tandem with the sharp uptick in global commodity prices. Financial and Industrial indices also generated positive returns resulting in local equities ending 2019 positively.

South African Airways was the subject of industrial action as workers downed tools from 15 to 22 November 2019. The strike cost the airline an estimated R50 million a day. Eskom impacted the local economic outlook via the resumption of load-shedding. With the World Bank forecasting economic growth at 0.9% for 2020, it is clear that the power utility has contributed significantly to this sentiment. Uncertainty around SOEs has added further fuel to the fire highlighting that investing in single stocks is high risk compared to investing in broad stroke indices which are designed to largely tolerate the failure of a few individual stocks.

Credit ratings are likely to remain at risk, with the Finance Minister looking for certainties on structural reforms from government. Most macroeconomic data has not yet fully reflected the current local economic situation. Conversely, the business confidence index reflected a quarterly increase for the first time in 2 years. This appears to reflect the increase in confidence among constructors, manufacturers and retailers.

South African investors may be in for a difficult start to 2020, with little positive news about the future flowing from this last quarter of 2019 horizon. This means, however, that several high-quality 'SA Inc.' stocks are trading at significant discounts, and this creates opportunities for the index tracking funds we use as constituents for our range of risk adjusted managed investment portfolios

Local Property

The SAPY (SA Listed Property) posted gains of 1.8% & 0.81% in October and November 2019 respectively, while the ALPI (Global Listed Property) posted 2.8% and stayed flat in the aforementioned months. The SA listed property sector closed lower in December 2019, making it the worst performing local asset class for the quarter in review. With household finances facing downward pressure and low business confidence, the focus for the average household is on affordability, value for money and cost-saving.

In the rental sector, this will be characterised by higher demand for rentals which have lower rates and levies and easy access to key transport hubs. Until overall economic sentiment improves, it will remain a buyers' market and turnover is likely to be low.

As of December 2019, office vacancy rates are at a disturbing 11.2% per SAPOA reports. This fact makes the argument for using global property index tracking funds (as opposed to local), a continued staple of our managed index tracker portfolios.

International Markets

October and November 2019 were good months for developed global equity markets. African markets tracked their developed market peers and beat other emerging market regions. The rapid depreciation in Latin American currencies prompted President Trump to level allegations of competitive devaluations, sparking concerns that the US would hit Brazil and Argentina with metal tariffs.

The US and China reached a first landmark in a trade deal due to be signed on 15 January 2020. In Europe, the Stoxx All Europe gained nearly 3%. Eurozone macroeconomic data was mostly positive.

The MSCI World Index gained 3%; (up from 2.8% in November, and 2.54% in October) with the MSCI emerging markets outperforming developed markets with 7.4% (up from 4.22% in October 2019), along with MSCI BRIC (7.7%), MSCI EFM Africa (4.9% - ex SA) being outperformed. Returns are expressed in Rands.

Japanese markets ended December 2019 higher, with the Nikkei closing 1.73% higher in Yen terms. Tech and financial stocks were the biggest gainers in December.

Currencies and Commodities

The energy subsector lead gains in GSCI commodities index (benchmark for investment in the commodity markets and as a measure of commodity performance over time). Commodity prices were helped by the encouraging news of renewed Sino-US trade talks. Oil particularly gained off this news and the price was bolstered by 9% in December 2019.

Currency markets saw the US dollar dip, with the USD index losing 2% in October. The USD index dropped 1.8%, with commodity-based developed market indices showing the biggest gains against the dollar.

Emerging Market currencies were mostly stronger, with the biggest gains in the Brazilian real and Russian rouble. The South African rand proved resilient despite the Eskom-induced gloom and appreciated by 4.8% during the month.

Sources

- Riscura – Monthly Insights: October, November, December 2019, Moneyweb: "Racing your retirement funds offshore" – R Nel Dec 2019, Index Solutions client portfolio performance data – International Portfolio, Growth Portfolio, FE Analytics