FUNDAMENTALS

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INVESTMENT GROUP

REAL RECOVERY STILL OUT OF REACH DESPITE EASING MONETARY POLICIES

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ABOUT THE AUTHOR

As Chief Economist, Johann is responsible for all local and global macroeconomic research. Specific focus areas include the rand, inflation, interest rates and fiscal matters.

KEY **TAKEOUTS**

- DESPITE WIDESPREAD RATE CUTS, A TRADE WAR RESOLUTION IS NEEDED FOR ECONOMIC RECOVERY.
- CURRENT FRUSTRATIONS CENTRE ON THE LACKING TURNAROUND PLAN FOR ESKOM.
- NDP AND BETTER POLICY IMPLEMENTATION CAN HELP SA'S GROWTH IN THE SECOND HALF OF 2019.

GLOBAL ECONOMY: CONTINUED TRADE TENSIONS RAISED RISKS OF GLOBAL RECESSION

While overall global growth was always expected to be slower in 2019 than last year, the ongoing and escalating trade war between the USA and China has lifted risks that the USA, and indeed the global economy, might enter a recession some time in 2020. The prolonged trade war has meant that growth forecasts have been downgraded even further in the past few months.

Throughout April and early May, optimism was still building that a trade deal between the USA and China could be signed by late May. However, negotiations broke down and the USA raised tariffs from 10% to 25% on US$200bn worth of Chinese imports with threats of tariffs on the remaining US$300bn of untaxed imports as well. Tensions eased somewhat after Presidents Trump and Xi met on the sidelines of the G20 summit but this did not last long; President Trump soon announced tariffs on the remaining US$300bn of Chinese imports not yet taxed. China retaliated quickly and this re-escalation hit business confidence hard. We have since seen a significant impact on markets, with the manufacturing purchasing managers' index (PMI) and currencies of a number of countries being notably hit.

Apart from this extension to the trade war, the other surprise in Q2 was the easing policy stance virtually everywhere. While the policy stance of the Federal Reserve Board in the USA (the Fed) had already evolved from the tightening bias during 2018 to a more patient approach early this year, the resultant trade-related growth risks moved them to an easing policy stance at their June policy meeting. The Fed did go on to cut rates by 25 basis points at the July meeting, however it disappointed the market when it indicated that this shouldn't be interpreted as the start of a lengthy cutting cycle. Nonetheless, the recent risk escalation probably means a slightly more aggressive cutting cycle than what was assumed just after the Fed's July meeting.

Worldwide many other central banks have turned more dovish, and with quicker rate cuts than expected. Apart from the USA, Australia, New Zealand, India, Philippines, Thailand, Peru, Brazil, Russia, Malaysia and South Africa have cut rates recently. Many of these have cut multiple times and deeper than expected. The European Central Bank (ECB) has turned more dovish and a rate cut is now on the cards within the next few months. Furthermore, the ECB could even extend Quantitative Easing (QE). And China could potentially join the rate cutters in the next few months.

While easier policy will certainly help the global economy avert recession, it will not be enough on its own to engineer a stronger economic recovery. Confidence will only recover sufficiently once the trade war has been resolved. And though it is unlikely that a deal will be signed very soon, any news of progress on this front will help confidence.

Outlook for the global economy: I remain of the opinion that recession risk remains low and growth rotation from the USA to elsewhere could still be on the cards if the trade war is resolved. With USA rate cuts on the cards, I expect the dollar to weaken towards the end of this year and into 2020. This could still be a better environment for emerging markets in general and South Africa in particular.

SA ECONOMY: A turnaround in growth needs urgent policy change

First off, despite uncertainty, volatility and very weak economic growth, I believe the "Winds of Change" investment theme is still on track. While recent events have meant more depressed consumer, business and investor confidence, I believe that all the small, incremental improvements of the past 18 months mean that the potential for an upside surprise is somewhat bigger than the potential for a downside surprise. While slower than expected or needed, the broad underlying trend is still up. Thus, despite all the inherent Eskom and fiscal risks, my strong believe is still that the next five years will be better than the past five years.

The election outcome in May was in line with my expectations – a positive outcome for the political centre. The fringe parties have remained at the fringe while the ANC's share of the vote has improved from the 2016 local government elections. This better election outcome allowed President Ramaphosa to improve his Cabinet – cutting the size and removing some non-performing ministers. Perhaps the Cabinet is not perfect yet, but it certainly is a vast improvement. Again, it would be unrealistic to expect overnight change. We are moving in the right direction: the headwinds holding us back are dying down and even turning into tailwinds pushing us forward.

The second quarter did have its share of bad news. The economy turned out to be even weaker than previously expected. While negative growth was expected for the first quarter – due to loadshedding – growth was recorded at -3.2% at an annualised pace. The slump was fairly widespread – going beyond the impact of electricity shortages – and obviously confidence among consumers and business was very weak amidst the pre-election uncertainty. A strong turnaround in some of the key sectors like electricity and mining production as well as some uplift in manufacturing production and retail sales means Q2 GDP growth could be in the region of +2.5% to +3.0% annualised growth. Nevertheless, 2019 GDP growth is now likely to stay close to the 0.8% reached last year.

The more recent sense of depression and frustration centres around the lack of more decisive policy change and action regarding Eskom's turnaround plan. While a Chief Restructuring Officer for Eskom was appointed, the lack of progress and significantly higher budget deficit on the back of extra spending to support Eskom have raised concerns about potential negative ratings action from Moody's.

Clearly a confidence turnaround is needed to help lift economic growth. And this is still possible through policy change. One of the highlights of President Ramaphosa's State of the Nation Address was the return of the National Development Plan (NDP) as the guiding light to get economic growth onto a higher trajectory. The NDP is a great plan but has not been implemented to the extent needed. Recent news suggest that a slight rewrite is under way by the National Planning Commission (NPC) to improve the focus of the NDP. Better policy and stronger confidence could lead to increased economic activity and then I believe 3% growth is possible by 2022/2023.

Investors are now awaiting the promised Eskom policy document in mid-September, which should provide more clarity around Eskom's debt and corporate restructuring, and the Medium Term Budget Policy Statement toward late October. While it has become clear that the budget deficit will be significantly higher this year (around -6% of GDP vs the February budget estimate of -4.5%) and the next few years (due to extra spending and much lower growth), some positive news came from planned expenditure cutbacks over the next few years. National Treasury has instructed government departments to plan for expenditure cuts of 5% in the 2020/21 fiscal year, 6% in 2021/22 and 7% in 2022/23. This will alleviate some of the pressure on extra taxes. Nevertheless, the Budget deficit will be higher over the medium term versus previous plans.

Inflation remains muted, with almost no evidence of second round price pressures despite significant cost increases in areas such as electricity and petrol. Food inflation has been well contained but is expected to rise towards December. I expect inflation to average 4.3% this year and 4.7% in 2020.

A much more dovish global monetary policy stance, combined with local growth downside surprises (both in terms of actual and forecast growth) and muted inflation has led to an easier policy stance by the South African Reserve Bank. I now expect another rate cut to follow the cut at the July Monetary Policy Committee (MPC) meeting. Unfortunately, there is not room for a significant down cycle – we can have one or two more rate cuts at most. While rate cuts will certainly help lift sentiment, I do not expect them to have a big impact on the growth outlook. For that we need confidence boosting policies.

Outlook for the SA economy: Easing global policy and a weaker USA dollar should help to improve the environment for emerging economies. However we also need an end to the trade war. This, in turn, should help SA this year. The comeback of the NDP and better policy implementation should also help growth to slowly gather pace in the second half of the year. Inflation will likely remain subdued. While another rate cut is on the cards, better policy implementation and stronger confidence are needed. I expect the rand to benefit later this year from the weaker dollar and improved confidence and growth.

ALL THAT YIELDS IS NOT GOLD

EVAN ROBINS | PORTFOLIO MANAGER

ABOUT THE AUTHOR

Evan manages Old Mutual's institutional and unit trust SA quoted property portfolios at MacroSolutions. He has experience in a wide range of roles in the asset management industry, particularly in equity research, portfolio management and strategy.

KEY TAKEOUTS

- PROPERTY INVESTORS SHOULD LOOK BEYOND HIGH HISTORIC OR PROJECTED YIELDS.
- CONSIDER THE MACROECONOMIC ENVIRONMENT, THE TRAJECTORY AND ROBUSTNESS OF EARNINGS, GOVERNANCE AND STRATEGY.
- PROPERTY INVESTORS SHOULD NOT EXPECT IMMEDIATE INCOME RETURNS.

Buying property shares on the basis of an enticingly high historic or projected yield can be an easy way to lose money. This can be the case especially when prevailing conditions are challenging or in a downturn. In addition to yield, investors need to consider a multitude of factors and must understand why the share appears cheap and whether the risk premium is justified.

VALUATION IS JUST ONE OF THE FACTORS

At MacroSolutions, when assessing an investment we do not look at the price (valuation) in isolation. We also look at factors that have the ability to drive capital gains or losses. We call these factors "Theme". Such factors include the macroeconomic environment, the trajectory and robustness of earnings, governance and strategy. Taking a long-term perspective is key in considering such factors. A used car that seems like an amazing bargain can be a lemon. By taking into account more than the price, such as costs and availability of future maintenance, one can put that price into perspective. Assessing property should be no different.

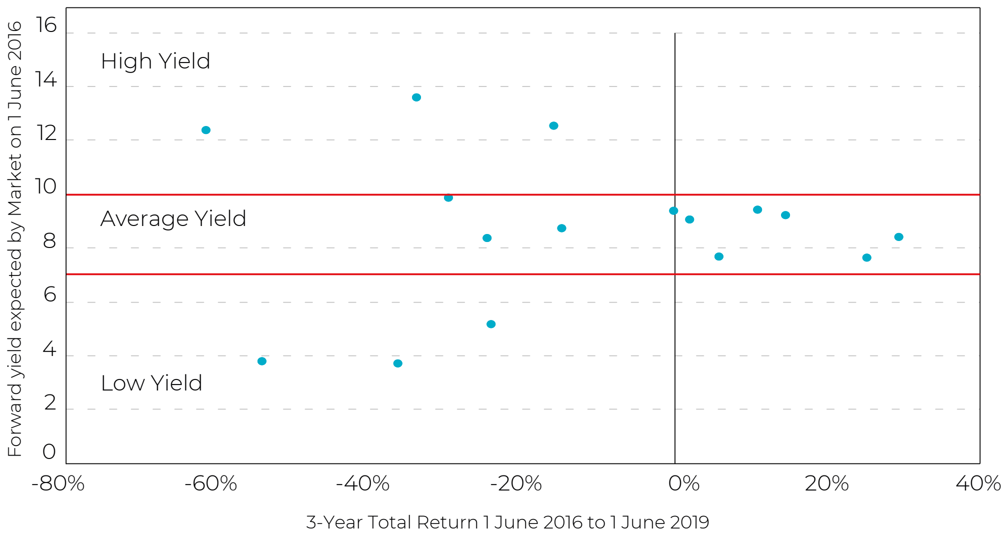
Property shares that trade at high yields, generally do so because the market expects earnings to fall or believes that the risks around the company are particularly high, necessitating a premium. If those risks come to fruition, the downside can be steep. So observing the forward-looking yields is a reasonable proxy for the market's expectations of risk around earnings. Refer to the chart titled "Forward Dividend Yield…". The blue dots represent all the domestic SA REITs which were sufficiently large and well covered three years ago. On the vertical axis we plotted the consensus forward-looking 1-year dividend yield three years ago. (These consensus figures were sourced from FactSet, a prominent global data provider.) On the horizontal axis we plotted the actual total return on the shares over the subsequent three years.

By observing a forward-looking and not a historic dividend yield, on the vertical axis, we incorporated existing market expectations of earnings declines for at least one year. By measuring total return and not price, on the horizontal axis, we incorporated the disproportionate income benefits investors in high-yield shares receive. The plot therefore reveals very interesting insights around the risk and return trade-off.

HIGH YIELDS, POOR RETURNS

Shares with the highest forward yields were amongst the worst performers. Those with a yield above 12% in June 2016 recorded

FORWARD DIVIDEND YIELD ON 1 JUNE 2016 AND SUBSEQUENT 3-YEAR TOTAL RETURN



Sources: FactSet

total returns of -15% or worse. This of course goes against finance theory. There should be an upward sloping risk, i.e. forward yield, total return line as investors should be compensated by the higher yield for the greater cash flow risk they accept. Over the cycle and longer term this indeed may be the case. With higher yielding shares, a materially higher total return is a just reward for the downside risk, not a bonus. If investors are not receiving one, they are being short-changed.

LOW YIELDS, NEGATIVE RETURNS

Those shares with the lowest yields, i.e. the most expensive, also gave negative returns as they were overpriced to begin with, and their share prices normalised. It is no surprise to those who follow the sector that two of these three lowest yield shares were Resilient Group companies. We were underweight to these companies because we believed they were excessively overvalued and had under-appreciated risk factors. We are not arguing that entry price is not important; it is critical, but it is not the only factor that needs to be considered. We are prepared to pay a reasonable premium for a company with superior attributes for long-term advantage.

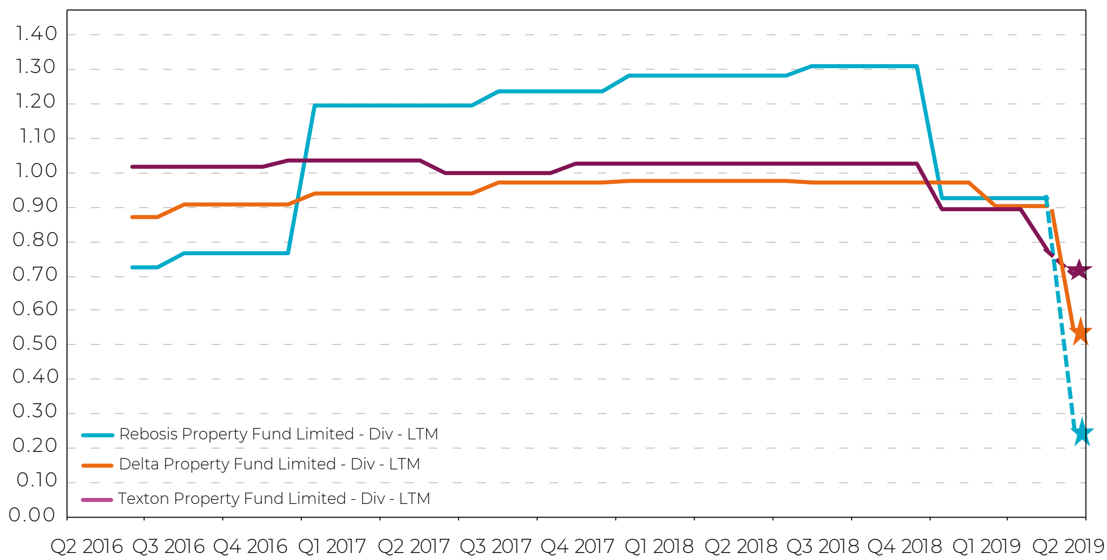
AVERAGE YIELDS, MIXED RETURNS

There were mixed fortunes for those shares with an average yield. A common retrospective feature of the shares which provided a negative total return, is that they disappointed materially in earnings and had or developed governance concerns of various degrees.

Let's focus in on the three high yielding shares in the chart titled "Dividends: Rand per share". These had forward yields greater than 12% when the next highest yielding share provided 10% and the average yield was around 8.5%. This is a substantial dividend yield pick-up. Think of this in fixed deposit terms.

The chart below shows how the actual dividends of these companies have changed since 1 June 2016. The stars are the maximum dividends that are likely for the current financial year, generally based on guidance. The actual dividend could be as much as 25% less. To be fair, some of these dividends may be below sustainable levels if these companies can correct, and we are making no comments on whether these shares are a good buy today. As you can see, with the benefit of hindsight these companies were not "cheap for a reason" but were expensive, considering how much their dividends have fallen

DIVIDENDS: RAND PER SHARE



Sources: FactSet (historical) & MacroSolutions or are still to fall. It took years for the “reason for the high yields” (or risk) that the market was pricing in to reflect in results – the dividend lines only started turning down in Q4 2018.

COMPREHENSIVE INVESTMENT PROCESS

As mentioned, in investing, we consider both Price and Theme. By including consideration of the characteristics and prospects of a company, in addition to valuation, as a key component of the investment process helps to avoid the value traps discussed. Our funds were, on listing, among the largest shareholders of two of these three high-yield companies. We never held the third. We sold out of these companies as we grew concerned about the strategic, governance and dividend sustainability and/or operational outlook. None of these factors were a secret.

It will take a lot of space to tell the story of why these companies got into trouble. Even though we had concerns, we didn’t anticipate this degree of earnings decline. What pushed some companies over the edge was in most cases an unfavourable external environment. Nonetheless, the potential seeds of what became the undoing of these companies was apparent years ago – and these concerns were reflected in the yields.

INVESTING IS NOT ONE-DIMENSIONAL

Many factors must be considered, of which yield is just one. While our process navigated these landmines very well, our portfolios have occassionally been caught with seemingly cheap shares where we should have taken greater cognisance of the declining outlook or where we under-appreciated gathering clouds. Firmly building this understanding into our investment process should reduce the frequency of this occurring. It also builds more robust portfolios for our clients. Property investing is about assessing risks and being forward looking not the “sugar rush” of immediate income returns.

GLOBAL SHIFTS IN THE ASSET MANAGEMENT INDUSTRY

HYWEL GEORGE | DIRECTOR OF INVESTMENTS

ABOUT THE AUTHOR

Hywel is responsible for the investment performance delivered by Old Mutual Investment Group. He has worked at leading global institutional and private client asset management companies across the globe. His experience spans 30 years in asset management in Europe and the Middle East.

KEY TAKEOUTS

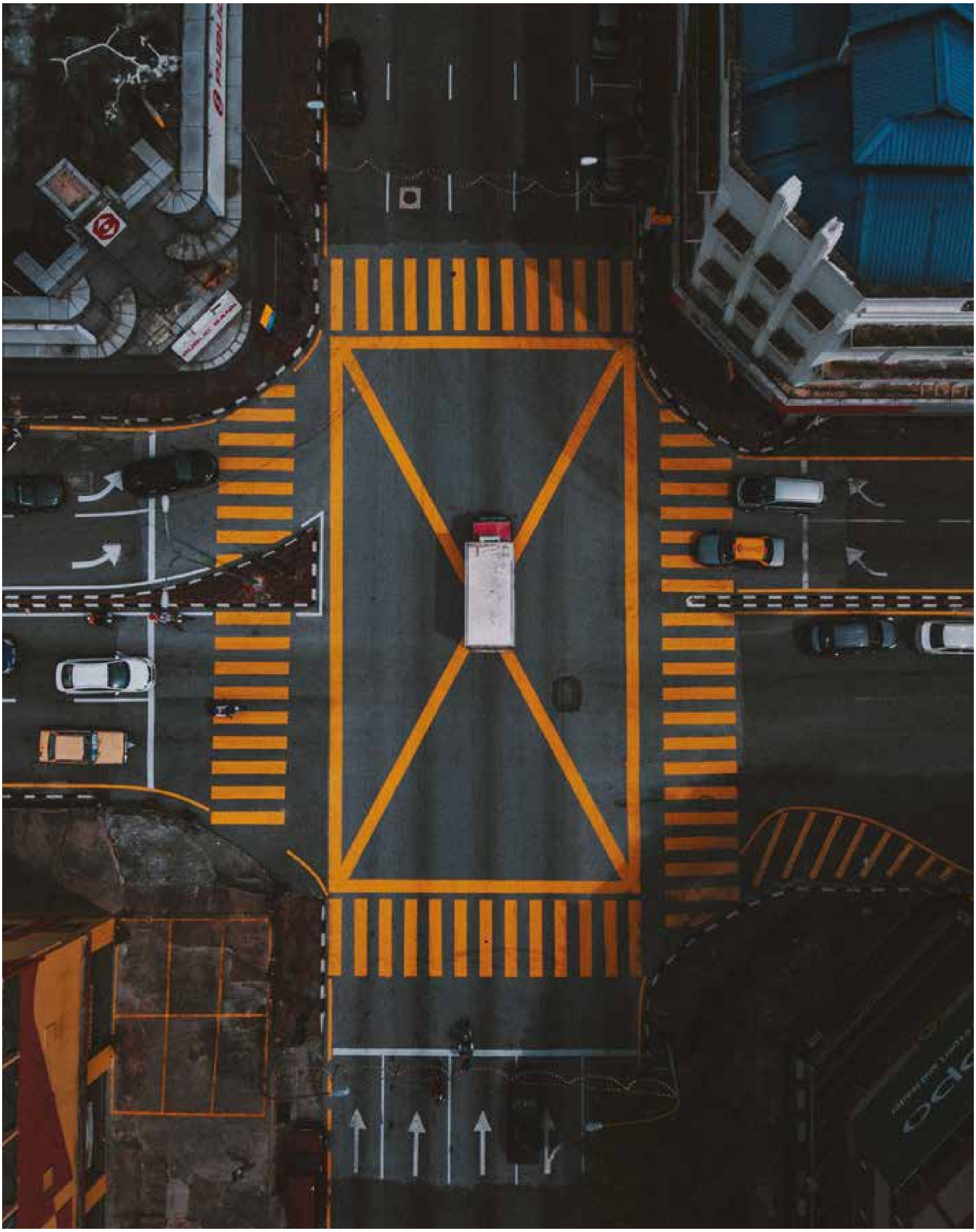
- THE GROWTH OF PASSIVE FUNDS AND THE INCREASING DISRUPTION BY TECHNOLOGY PUTS PRESSURE ON REDUCING ACTIVE ASSET MANAGER FEES.
- INVESTORS ARE LOOKING FOR BESPOKE MULTI-ASSET INVESTMENT SOLUTIONS, OFTEN WITH AN ESG ETHOS.
- THERE IS A RISING DEMAND FOR ALTERNATIVE, NON-TRADITIONAL INVESTMENT PRODUCTS, PARTICULARLY THE DEMAND FOR IMPACT INVESTING, INFRASTRUCTURE INVESTMENTS, PRIVATE EQUITY, AND CREDIT (YIELD-ENHANCING) STRATEGIES.

More than 40% of US asset owners have incorporated ESG factors into their investment decisions, up from just 22% in 2013, states the annual Callan ESG Survey Report (August 2018). The top two reasons cited for this ESG incorporation were expectations to achieve an improved risk profile and fiduciary responsibility.

Many investment management advisers have also identified the need to launch “ESG funds”, for example, UBS Global Wealth Management is now offering its clients sustainable funds in cooperation with the Swiss giant’s asset management arm. From January to August 2018, UBS’s sustainable mandates, which the new strategies are built on, have doubled in size from CHF1.2 billion (€1.05 billion) to CHF2.45 billion (€2.15 billion).

From a real asset perspective, the Netherlands’ largest pension fund investor, APG, has set internal ESG targets. The €482 billion pension investment manager now invests €21.7 billion of its nearly €42 billion property portfolio in sustainable assets – an increase of €1.3 billion from 2017. The trend is similar in infrastructure, where €2.3 billion of the €11 billion portfolio is deployed in sustainable investments. Responsible investment is evidently becoming an important part of institutional clients’ investment decision-making. So what are the key drivers causing the need for these responsible investment strategies? Well, we have identified some dominant global shifts that call for greater, more intentional ESG integration.

These shifts will define the future of the asset management industry, both globally and here in South Africa:



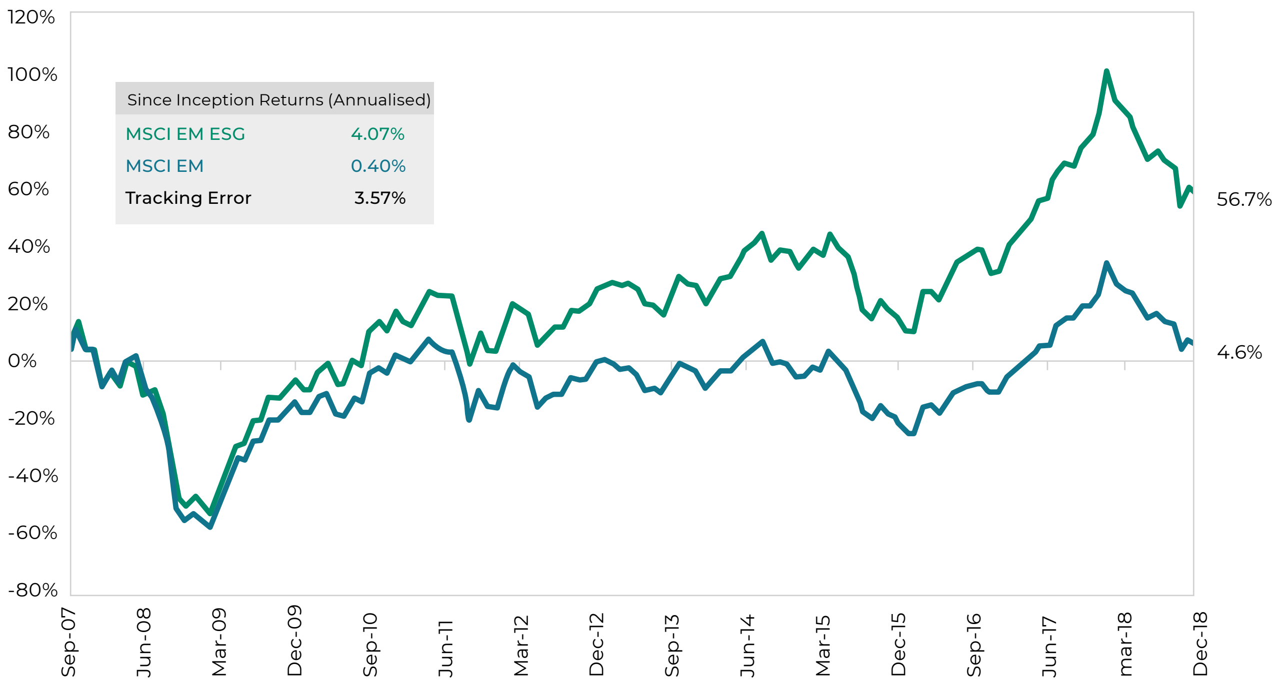
1. THE GROWTH OF INDEXATION (PASSIVE MANAGEMENT)
   As indexation/passive funds continue to grow, pressure on active asset manager fees to be reduced will continue.

2. TECHNOLOGICAL TRANSFORMATION / EVOLUTION
   Technology and digitisation are expected to be increasingly disruptive to the industry – this will further put pressure on asset manager margins as well as the need for them to invest in technology.

3. CLIENT-DRIVEN BESPOKE SOLUTIONS / PARTNERSHIPS
   Investors increasingly want specific outcomes rather than plain vanilla funds, e.g. bespoke multi-asset investment solutions for institutional investors, often with an ESG ethos. In the coming years, the value of active and passive management will be more clearly defined. While passive investments may form the foundation of multi-asset solutions, active and alternative investments that deliver high and non-correlated alpha will be important components that boost performance.

4. SEARCH FOR SUSTAINABLE ALPHA
   The increased demand for alternative, non-traditional investment products continues to grow, particularly the demand for impact investing, infrastructure investments, private equity, and credit (yield-enhancing) strategies. These global shifts highlight two key pressures facing asset managers: lower fees and the need for sustainable profitability. Let's now explore ways in which ESG could address these global shifts and their consequent pressures.

CHART 1: MSCI EMERGING MARKETS ESG LEADERS INDEX VS MSCI EMERGING MARKETS INDEX (USD)



(Net Total Returns as of 30 June 2018) | Performance price to 6 June 2013 has been back-tested.

PASSIVE AGGRESSION?

With the growth of indexation, ESG can be used as a differentiator in terms of ESG passive offerings. In this respect Old Mutual Investment Group already offers a variety of both local and global ESG funds. Our Customised Solutions investment boutique manages the very first responsible investment equity index fund in South Africa. For active managers, we have incorporated ESG into the investment processes of our actively managed funds. The search for sustainable alpha through alternative, non-traditional investment products is a strategy well known to Old Mutual Investment Group. Across our alternative strategies – including impact investing, infrastructure investments, private equity, and credit (yield-enhancing) investments – we apply an ESG filter/ consideration to each investment offering. This incorporation of ESG is also often an essential component of a bespoke client solution. Even with this increasing adoption of responsible investment practices, many critics still argue that ESG does not necessarily represent an alpha opportunity but that it is more effective as a risk management tool. In our view this is not necessarily true, as indicated by Chart 1, which compares the MSCI Emerging Markets ESG Leaders Index to the MSCI Emerging Markets Index (USD).

So, as these global shifts continue to gain momentum, the need to look to ESG as a cornerstone to manage the impending changes to their landscape has never been more important to investors, which include millennials, many pension and provident funds, and asset managers.

This article first appeared in our 2019 Responsible Investment Report, titled *The Future Matters*. For the full report visit www.oldmutualinvest.com.

SHAREHOLDER RESOLUTIONS ON CLIMATE CHANGE AND OTHER ESG RISKS

JON DUNCAN | HEAD OF RESPONSIBLE INVESTMENT

ABOUT THE AUTHOR

With over 20 years' experience in sustainability research and engagement, Jon leads the Responsible Investment programme at Old Mutual Investment Group. His focus is on driving systematic integration of material ESG issues across Old Mutual.

KEY TAKEOUTS

- 62% OF SHAREHOLDERS VOTED AGAINST STANDARD BANK PREPARING A REPORT ON ITS CLIMATE RISK.
- THE BANK MUST NOW PUBLICLY DISCLOSE A COAL POWER AND MINING LENDING POLICY.
- ASSET OWNERS PAYING GREATER ATTENTION TO THEIR INVESTMENTS' CARBON INTENSITY.

June this year saw South Africa's first ever climate risk-related resolutions tabled at the Standard Bank Annual General Meeting. The first resolution called on the bank to prepare a report on its exposure to climate risk in its lending, financing and investment activities. The second resolution called on the company to adopt and publicly disclose a coal power and mining lending policy. These resolutions, the first of their kind to be tabled by a South African listed company at its AGM, are a significant step in local shareholder activism on climate change.

While the majority of shareholders voted against the first resolution (62%), the second resolution received the support of 55% of the shareholders and is therefore binding on the company. The move may have set a new precedent and the

industry can expect to see more shareholder resolutions and activism of this kind this year, as well as on other ESG-related issues.

This is already evident in the recent news that Absa will become SA's first bank to voluntarily develop a comprehensive policy on climate change, an announcement that followed the events surrounding Standard Bank's AGM.

Despite the first resolution not being passed, the listed markets will never-the-less be forced to contend with one aspect of climate risk through the newly gazetted Carbon Tax Bill, which came into effect from 1 June. Ten years in the making, the Carbon Tax bill sends an important signal to the markets that the direction of travel is towards long-run decarbonisation of growth.

The Standard Bank resolutions and Absa's voluntary development of a climate change policy indicate that environmental, social and governance (ESG) issues will increasingly be showing up on the corporate agenda.

The fact that climate risks were raised at a large corporate's AGM shows that stakeholders and shareholders alike recognise that the risk associated with transitioning business models to align with a two degree Celsius future are material. For long-term investors, having transparency on this risk is not an unreasonable request, and so we expect that the climate change debate in South Africa will gain further traction going forward. Additionally, we expect greater consideration of these risks in the context of how our national energy system is planned, rolled out and capitalised.

The risks posed by climate change can be seen through the lenses of physical risk, technology/ disruption risk and tax/legal risk. Importantly, climate risk is a social risk multiplier and given the triple social challenges faced by South Africa of poverty, inequality and unemployment, it's critical that theses knock on risks are considered. The climate models for South Africa predict that the country will generally get drier in the west and wetter in the east with higher intensity weather events. We have witnessed the effects of the droughts in Western Cape and recent flooding in the KZN/ Eastern Cape and so, have first-hand experience of how these events impact the vulnerable, let alone industry.

In Old Mutual Investment Group's recently published Responsible Investment report, we penned an article which flagged that the remainder of 2019 will see a greater amount of shareholder proposed resolutions at company annual general meetings coupled with more vocal pushback from civil society organisations to corporate responses on ESG issues. The pressure that was applied to Standard Bank is sure to flow over to other companies and, from an ESG perspective, this should be seen as a positive move for the entire country.

Ultimately, the investment community is starting to realise that large asset owners will need to transition their asset registers to be aligned with a low-carbon future. For asset managers this presents an innovation challenge that calls for bringing low-carbon investment products to the market.

The retail market in South Africa is also waking up to the fact that they can, and should have, a choice when it comes to how ESG issues are incorporated into their investments. Our expectation is that there will be growth in demand for ESG-themed investment products and coupled with this, innovations in this area.

As a large asset manager, we recognise that the new paradigm of investing requires a shift from balancing risk and return to balancing risk, return and impact. We have embraced this shift and embed it as a part of our fiduciary commitment to our clients across all our investment capabilities. The climate change debate is an important one and we will continue to actively engage with investee companies to reduce investment risk and, additionally, seek further opportunities to build out our already substantial investments in the low carbon and renewable energy sectors.

A TALE OF TWO BANKS

NEELASH HANSJEE | PORTFOLIO MANAGER

ABOUT THE AUTHOR

Neelash is responsible for analysing companies within the financial sector. He is also a portfolio manager for the Old Mutual Financial Services Fund (unit trust).

KEY TAKEOUTS

- STANDARD BANK'S REMUNERATION STRUCTURES SUFFICIENTLY ALIGNED WITH SHAREHOLDERS' INTERESTS.
- ENGAGING WITH ABSA GROUP ABOUT EXECUTIVES' LONG-TERM INCENTIVE PLANS AND REMUNERATION STRUCTURE AFTER BARCLAYS PLC DECOUPLING.
- IT'S OUR FIDUCIARY ROLE TO ENSURE REMUNERATION POLICES ALIGN TO A COMPANY STRATEGY THAT CREATE SHAREHOLDER VALUE.

As a long-term investor, we believe that incorporating relevant environmental, social and governance (ESG) factors into our investment and ownership decisions ultimately leads to improved risk-adjusted returns for our clients. Identifying issues that currently or at some point in the future may materially impact the long-term value of a company, gives us insight into a business's ability to grow sustainably. As shareholders on behalf of our clients, we regularly engage with companies' executive teams as well as actively exercising our voting rights. With me being a financial services sector analyst, Robert Lewenson (Head of ESG Engagement) and I engage with companies across this sector, specifically on governance issues. Given that a significant portion of financial services companies' expenses is remuneration, it is our responsibility to ensure that the remuneration policies of companies in which we invest are aligned to shareholders by being appropriate, transparent and set against clearly defined and sufficiently challenging targets. By way of example, two financial services companies with which we have had numerous engagements are Standard Bank and ABSA. While these discussions have been constructive, we have not always voted in favour of their remuneration polices.

STANDARD BANK is the largest South African banking group ranked by assets and earnings. It has a strong market position in corporate and investment banking, and in retail banking and operations in 20 African countries. It has a controlling stake in Liberty Holdings. Given the diverse nature of the business, we need to clearly understand remuneration, compliance and policy decisions taken by its remuneration committee.

ABSA GROUP is one of Africa's largest diversified financial services groups. It has a presence in 12 African countries. The group offers a range of retail, business, corporate and investment, and wealth management solutions. Apart from the share's current extremely low valuation and its solid dividend yield, the investment case also lies in the benefit of Barclays plc no longer being a controlling shareholder. We believed this move would give management greater scope to drive growth without the constraint of the parent company.

STANDARD BANK ENGAGEMENTS

Over the years, we have met with Standard Bank to better understand a number of key remuneration issues, including special incentives, performance-related pay targets and adjustments to targets relative to profits. The outcome of these engagements influenced how we voted at the AGMs as follows:

2015

QUALIFIED VOTE IN FAVOUR

The performance measurements for the long-term incentive plan seemed easily attainable over the near term, but we concede that over the longer term this may not be the case.

Action: To monitor the stretch of the metrics over the next year.

2016

QUALIFIED VOTE IN FAVOUR

Our concerns listed in 2015 remain.

Action: Continue to actively engage with the company on these issues.

2017

VOTED IN FAVOUR

Appropriate changes were made to the stretch of performance targets.

2018

VOTED IN FAVOUR

Our concerns were satisfactorily addressed in the remuneration policy.

[1] MSCI Inc., which is a global provider of equity, fixed income, hedge fund stock market indices and multi-asset portfolio analysis tools.

We appreciate the frankness with which Standard Bank responded to our queries and the consequent amendments it has made to it remuneration policy and reports. We continue to view Standard Bank as a valuable holding in our client portfolios and are comfortable that its remuneration structures are sufficiently aligned with shareholders' interests.

ABSA ENGAGEMENTS

We have engaged with the bank both under the Barclays plc brand and, subsequently, as an Africa-only organisation. Our engagements have largely concerned executives' long-term incentive plans and revisions to its remuneration structure after decoupling from Barclays plc (ABSA was previously constrained by the UK regulatory framework, which calls for role-based pay). Specific issues addressed with ABSA include clarity on performance targets, the appropriateness of the stretch criteria used and the calculations used for short-term incentives. The outcome of these discussions influenced how we voted at the AGMs as follows:

2015	VOTED AGAINST We were concerned by the lack of disclosure on key performance criteria for the long-term incentive plans. **Action:** Continue to engage with the company to improve disclosure and better understand how incentives link to company strategy.
2016	QUALIFIED VOTE IN FAVOUR While the long-term incentive targets were disclosed, they were unclear in some respects. The company explained that the remuneration policy would change after its separation from Barclays plc. **Action:** Monitor changes to the remuneration policy post the separation.
2017	QUALIFIED VOTE IN FAVOUR Our concerns listed in 2016 remained. **Action:** Actively engage with the company for greater clarity on targets post the separation from Barclays plc.
2018	VOTED AGAINST Previous remuneration concerns were not addressed. **Action:** Review the performance criteria that were disclosed to ensure remuneration targets align to performance.

We understood that when Barclays plc was the majority shareholder, UK legislation bound its remuneration policy. However, we expected amendments to be made thereafter. We viewed the separation from Barclays as a significant change that provides opportunity to unlock value over the longer term, as it is now in control of its own destiny. It gives ABSA management full control of the company's risk appetite and frees the bank up to lend more appropriately to drive growth. As such, we are keen to see remuneration that is better aligned to management achieving these growth targets.

In conclusion, I must stress that our engagements as shareholders are not an attempt to run the companies, but I do believe that we have a role to play in working with management to ensure remuneration polices are realistic and aligned to a company strategy where value is created for shareholders, being you, our clients.

This case study first appeared in our 2019 Responsible Investment Report, titled *The Future Matters*. For the full report, with more case studies, visit www.oldmutualinvest.com.

A GREAT STORY TO TELL

As a responsible investor, we've committed to sustainable investments to both generate long-term returns and positively impact our communities. Here's a glimpse at some of our impact on the green economy.

R1BN IN AGRICULTURE

5 658
workers employed at 15 mega-farms in AFRICA

750
employees with access to pre-paid **primary healthcare**

167
employees receiving **adult education**

R19BN IN AFFORDABLE HOMES FOR LOW-INCOME FAMILIES

9 620
affordable homes built and transferred (incl 1 433 RDP houses)

7 347
students with **affordable accommodation**

7 016
rental units

1ST EDGE*
certified **residential project** in SA

EDGE (Excellence in Design for Greater Efficiencies) is a green building certification system developed by the International Finance Corporation (IFC), a member of the World Bank Group.

R122bn

COMMITED TO A SUSTAINABLE ECONOMY ON BEHALF OF OUR CLIENTS

R34BN IN CLEAN ENERGY

3 052 638
tonnes in **carbon emissions reduction**
(equal to taking 587 963 cars off the road for a year)

800 000
homes **powered**

R2.3BN IN QUALITY EDUCATION

18 600
learners enrolled
at 33 schools

94.4%
average matric
pass rate

1 300
teachers **employed**

50.2%
average **bachelor**
pass rate

Figures as at 31 December 2018 | Sources: Old Mutual Alternative Investments, African infrastructure Investment Managers (AIIM), Old Mutual Specialised Finance, Futuregrowth Asset Management, UFF African Agri Investments, Old Mutual Investment Group.

MARKET INDICATORS

AS AT 30 JUNE 2019

	DY %	P/E Ratio	1 Month %*	12 Months %*
FTSE/JSE All Share Index	3.3	18.1	4.8	4.4
FTSE/JSE Resources Index	3.6	15.5	10.2	21.2
FTSE/JSE Industrial Index	3.3	13.7	3.8	-3.7
FTSE/JSE Financial Index	5.3	15.1	1.3	5.7
FTSE/JSE SA Quoted Property Index	9.0	11.2	2.2	0.8
ALBI BEASSA Bond Index			2.3	11.5
STeFI Money Market Index			0.5	7.3
MSCI World Index (R)			3.3	10
MSCI World Index ($)			6.6	6.9

Economic Indicators		Latest Data	Previous Year
Exchange Rates			
Rand/US$	June-19	14.10	13.73
Rand/UK Pound	June-19	17.89	18.13
Rand/Euro	June-19	16.03	16.04
Rand/Aus$	June-19	9.89	10.17
Commodity Prices			
Gold Price ($)	June-19	1409.1	1252.7
Gold Price (R)	June-19	19917.8	17205.1
Oil Price ($)	June-19	64.4	79.2
Interest Rates			
Prime Overdraft	June-19	10.3%	10.0%
3-Month NCD Rate	June-19	7.0%	7.0%
R186 Long-bond Yield	June-19	8.1%	8.8%
Inflation			
CPI (y-o-y)	May-19	4.5%	4.4%
Real Economy			
GDP Growth (y-o-y)	March-19	0.1%	1.6%
HCE Growth (y-o-y)	March-19	0.7%	2.8%
Household Consumption Expenditure (HCE) Growth (y-o-y)	March-19	-2.9%	0.1%
Gross Fixed Capital Formation (GFCF) Growth (y-o-y)	April-19	4.9%	-1.3%
Manufacturing Production (y-o-y) (seasonally adjusted)			
Balance of Payments			
Trade Balance (cumulative 12-month)	May-19	$1.7	$3.8
Current Account (% of GDP)	March-19	-2.9%	-4.6%
Forex Reserves (incl. gold)	May-19	$709.4	$643.3

Sources: JSE, Iris, I-Net

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WHY YOUR INVESTMENT CHOICES MATTER

Our investors want their investments to do well and do good. That's why we incorporate environmental, social and governance factors into all our investment and ownership decisions. And why we have committed over R122bn of our clients' capital to sustainable investments that generate long-term returns, while solving some of society's biggest challenges.

Invest for a future that matters. Read more at oldmutualinvest.com

INVESTMENT GROUP

DO GREAT THINGS EVERY DAY

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