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IN CONVERSATION

A DISCUSSION ON TODAY's INVESTMENT CLIMATE AND PROSPECTS FOR THE CONTINENT

AT THE OCCASION OF THE 2nd AFRICAN PENSIONS and SOVEREIGN FUNDS INVESTMENT CONFERENCE LONDON, 2 – 3 SEPTEMBER 2013

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In the past, I have presented quite extensively about the PIC, at these fora. I am not sure if there will be anything excitingly new about the PIC, today. However, what I do think we can talk about, is the context within which we, PIC, make our investment decisions.

The context is that the global economy is at the crossroads. Africa and so, South Africa, with it, are also at the cross-roads. Characterising the context, is a global economy in a malaise. One that is suffering under a strangle hold of low consumer and investor confidence, across the world. Until we snap out of this state, we are doomed to stagnate and probably find ourselves in stagflationary environments. We cannot afford this.

Way back in 2009, I undertook an analysis of the global financial crisis, based on findings from an OECD study, and what possible impact it is likely to have to the global economy. The results I came up with then, hold true to this very day. The findings were:

i. Bank crises have a deeper negative impact than non-bank crises. This is because they have a much deeper psychological impact on economic players than other sources;
ii. To get out of this crisis we need increased market flexibility, in particular labour market flexibility;
iii. We need to transition from the mode of work first to skills first;
iv. We need to keep people in contact with labour market;
v. We need to pay attention to youth, in particular youth unemployment;
vi. We cannot entertain the luxuries of early retirement. The experience of Europe is proving this today;
vii. We need increased moral suasion for higher voluntary savings; and
viii. Are compelled to get rid of structural constraints to growth. We need to think long rather than short term, in the manner in which do business and run our economies.

In the same analysis, it was predicted that the turnaround would slow and painful, with the below specific observations. All of these have been found to be true:

i. The turnaround would be cautious and tentative. It has done so, for much longer than anticipated;
ii. Economic and social damage will be deeper;
iii. High debt burdens will weigh against a quick turnaround;
iv. Deep seated poverty will be experienced;
v. A dearth of long term capital will characterise the global investment environment; and
vi. Ironically, US recovery will be faster.

For the world to get out of this situation, someone has to take the lead. But unfortunately, those who are in a position to do so, are not doing it. If they are, they are tentative.

Who are these…? It is owners of capital. That is where the PIC and the GEPF come in and that is what will make the discussion more relevant and fresh, for this forum.

To take a more macro view on this matter, it may be essential to take stock of what is happening globally. The quantitative easing programme implemented across the developed world, injected liquidity into the system (particularly the banking system). However, the result was not a flow-through to the real economy as banks sat on mountains of cash. They did not have the risk appetite to loan out the surplus cash, due to the uncertainty brought about by the credit crunch This has meant that excess liquidity has not done much to translate into new investment. That is why macro variables are not responding as expected – owing to the confidence issue.

The situation for corporates was similar in a sense. Either corporates struggled financially, so were not in a position to invest, or those corporates with excess cash reserves, also sat on them, too cautious to invest.

The same can be said of most pension funds, who deliberately took a cautious approach. All these factors, apart from the crisis around sovereign debt, meant that the owners of capital have not stepped up enough to the plate, in terms of investing. This has had the implication that recovery from the crisis has been slow.

What is now needed – is that the owners of capital step forward and invest (*albeit*, in a responsible and sustainable manner, so that we do not have another crisis!). Huge opportunities, and specifically growth enhancing opportunities, are available in the private equity/unlisted space. Africa's developmental needs are huge, and the political economies mostly stable.

We need owners of capital that understand the long term relationship between the macroeconomy and asset price performance. We need owners that are willing to take long term views about their investments, not grudgingly or tentatively.

In the PIC we are able to this, because our principals fully appreciate the importance of long termism and investing not for today, but for the future. The GEPF is a living example of a good proponent of UNPRI and UNGC principles.

Gone are the days of maximising profits at all costs, in the shortest possible time. In this regard, we have developed and employed what we call a Developmental Investment Strategy. This is a strategy that responds to socio-economic imbalances obtaining on South Africa. The same are observed in the rest of the continent, and therefore influence the manner in which we think about our role in the rest of the continent.

The strategy is characterised by a four pillar framework, looking investing in economic infrastructure, social infrastructure, greening the economy as well the support and development of SMEs. Each of these pillar, are design to unlock the economic potential of the continental economy, by rendering the economy more productive and competitive as well as ensuring a productive labour complement.

That is the view we are taking for the continent. It is not about short term returns. It is more about creating and nurturing a new market for African trade - goods, services and labour. Over reliance on the west and the east, is an inherent risk in our model, one that we have to shake off.

However, the most daunting question is how we stop short-termism across the board? For an example, Trustees that look focus heavily on short-term returns; shareholders who seek the highest profit in the shortest possible time; asset managers who get bonuses based on how they have done in the last 6 months to one year? Is part of the answer not just moral suasion ("please invest for the long term…") or is it more controversial, like for instance, henceforth, "… Mr Asset Manager, your performance fee will be based on a three year rolling return…" or something like "… we only pay you a modest base fee and any bonus to you is based on outperformance over a three year rolling return (or even five! – for those who are brave enough?)"

What is also needed in terms of getting owners of capital to also change mind sets, is data and information sharing. Too little is said publicly about what returns are on private equity, or what returns are to roads, rail, infrastructure, ports etc. How can one change the minds of the owners of capital if they are not given the information that will help them change their mind? Link to this is the basic understanding and appreciation of the fundamental link between the macroeconomy and asset price performance.

We need owners that understand the long term gains of investing in infrastructure, for greater performance. We need owners that understand the benefits of social investing, to ensure sound economic environments. How do we avoid Arab Springs and Marikanas in the future?

We need owners that are willing to commit by explicitly writing into the mandates of their agents, the need for the above.

.... The list is long...

Also, it is about ensuring that we increase reliance on own/African resources, partnering with non-continentals, as equal partners. The collaboration of African owners of long term capital, pension funds, is an important piece of this puzzle. Bring African savings sitting in Europe, back onto the continent to be managed by Africans and aligned to African long term objectives. Allow for continental pension funds to collaborate on continental investment programme, crafted in line with Africa's long term visions, as espoused by the African union. This is the one key way we can have a meaningful dent on our growth and poverty reduction potential.

This is the line we ought to be thinking about an aggressive turnaround to the global economic malaise. Is it controversial? Yes. Is it important, yes.

I thank you.