Newsletter I October 2020

Capricorn Asset Management
a member of Capricorn Group

Risk is good

The above statement will come to many of our readers as a very strong statement to make, which at first glance will be frowned upon. This may especially be true for our older readers so let's explain.

In general risk is defined as the possibility of something bad happening. This is why the average person will not be willing to take any risk with their investments but in doing so, some context towards risk is ignored.

We all know that life is full of risks. As an example, just the mere fact of getting into a car imply risk taking. The fact is that if you want to reach your destination you have no choice but to get into that car. What you can however control is who the driver of the car is, the condition of the car, how fast you will drive and what route you will take. By doing so you control the risk, albeit taking it, to enable you to reach your destination. If you understand these risks and take the appropriate quantity of risks, the taking of risk can be said to be good as it enables you to reach your destination.

Investment risk is the same. In order to achieve your investment goals it is good to understand your investment risk profile and take the appropriate amount of risk. If you do not take the appropriate amount of risk, you risk not achieving your investment goals at all.

Understanding your unique risk profile

Understanding your personal risk tolerance is a critical step to ensure you achieve your investment success.

There are 3 types of risks and all three are connected with each other in order to define your unique risk portfolio.

- Risk required
  The level of risk required to be taken on investments to achieve your desired level of investment return.
- Risk capacity
  The level of financial risk you can afford to take.
- Risk tolerance
  The level of financial risk you are emotionally comfortable with or willing to take.

Your unique risk tolerance and risk capacity may change overtime due to life events and life stage cycles. This may in turn have an impact on your current portfolio recommendation and may need to be reviewed and reassessed.

Our Risk Profiling Solution

We are excited to announce that we have launched a risk profiling assessment.

The assessment consists of various questions that will take about 10 minutes to complete and in turn measure your risk tolerance and risk capacity in order for us to present you with your risk profile to make an appropriate investment portfolio recommendation.

This test is done free of charge and available on our website. Alternatively you can contact our sales team to send you a link for the assessment. So let us be your sensible partner to ensure you know your risk profile and take the right risks to achieve your investment success.

Make the sensible choice to start your investment journey by knowing your risk profile.

Follow this link to take the risk assessment now.

Capricorn Enhanced Cash Fund Now Open

Within this past year we have seen interest rates being cut that have caused all money market type investments to decrease returns. In light of this we decided to temporarily close the Capricorn Enhanced Cash Fund to protect the higher yielding returns.

We believe that the market has now levelled out and the effects have been muted, thus the Capricorn Enhanced Cash Fund is now officially open again for new investors, additional investments and deposits of existing clients.

Should you want to find out more about this Fund, please contact our sales team at 061-299 1950 or send an email to cam.service@capricorn.com.na

Economic Update

The patients are still in the ICU. One can be forgiven for using a medical analogy in the age of Covid. Only this time the patients are the fiscal regimes of Namibia and South Africa. The Ministers of Finance (MoF) of both have tabled mid-term Budgets within the space of a week. Fiscal years run from April to March and is usually kicked off in February with a Main Budget and followed in September-October with a review in the middle of the fiscal year. Covid played havoc with most carefully laid plans in 2020 and fiscal policy was no exception. In fact, the Main Budget of Namibia was postponed to May and SA has had three Budgets this year as policy makers grappled to come to grips with the effects of lockdowns.

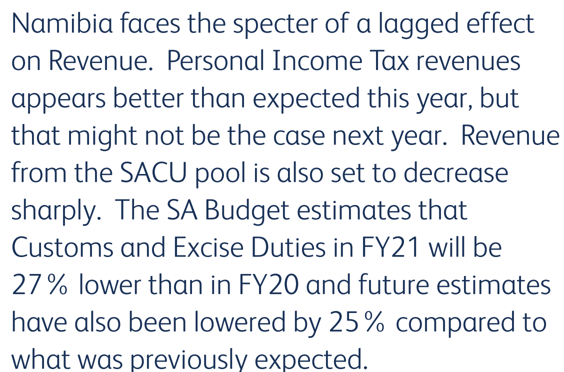
In Namibia's case the vitals of the patient have improved somewhat. Government revenue is estimated to be better than previously feared and so is nominal GDP, albeit marginal, while Expenditure is capped at the same level foreseen in May. This means that the deficit (N$17.6bn) should turn out to be 10% of GDP for the current fiscal year ending in March 2021, FY21, as opposed to 12.5% (N$21.4bn) previously expected – an improvement but still unsustainable. Hence, the ICU analogy. Only by virtue of economic recovery over a period of years, combined with continued spending discipline, will the patient be able to move, first to high care, then to general ward before he can be released.

For instance, healthy vitals would typically be ratios of 3% deficit-to-GDP, 35% debt-to-GDP (or at least below 50%) and 10% interest-to-Revenue, as well as a proper diet of investment spending over consumption spending.

Meanwhile the debt-to-GDP ratio will climb from an estimated 69% (N$119.8bn) this year to 77% in three years' time – 82% if guarantees are included – while the deficit is being managed down to 4%. Numbers-wise it means a deficit of N$8bn, total debt of N$157bn and nominal GDP of N$205bn in FY24. A couple of years ago, the N$200bn GDP level was expected to have been reached already, now it is estimated at N$174bn for FY21. All of this goes to show how critically important economic growth is – it is the lifeblood that will help the patient recover. In its absence, well…

All these numbers are pale in comparison to those of South Africa, both in size of numbers as well as ratio's to GDP. The lockdown-induced shortfall in Revenue, compared to February estimates, amounts to R312bn. Combined with Covid-induced relief spending measures, it results in a deficit of R708bn or 14.6% of GDP in FY21, more than double what was initially budgeted. This amount is equal to four times Namibia's GDP. Adding redemptions, brings the borrowing requirement to 16% and debt to 82% of GDP. The latter is virtually now R4tn and is set to rise to R5.5tn in three years' time, which would constitute an estimated 93% of GDP.

Risks to the plans of both treasuries abound. In SA the trade unions are very grumpy. The MoF hangs his hat on the hope that the wage bill can be contained and even slashed. He will be opposed at the negotiating table by a partner that he will need to help save Eskom. All that, while the interest bill will soon eat up 20% of Revenue, more than what is spent on Health. A large portion of the Budget is entrusted to the Provinces where the National Treasury struggles to enforce good governance.



Namibia faces the specter of a lagged effect on Revenue. Personal Income Tax revenues appears better than expected this year, but that might not be the case next year. Revenue from the SACU pool is also set to decrease sharply. The SA Budget estimates that Customs and Excise Duties in FY21 will be 27% lower than in FY20 and future estimates have also been lowered by 25% compared to what was previously expected.

Now, we must be mindful of the fact that the current fiscal year continues to play out as a complete "black swan" crisis year that will cast a long shadow over the immediate future. No one can dig himself out of such a hole in the blink of an eye and without suffering scarring. In the case of the two patients, scarring can be seen in the deterioration in creditworthiness, i.e. credit rating downgrades.

We can continue to list a litany of risks and problems here, but the media does a good enough job of that. We need to adjust our sails and continue to be cautious and vigilant. We do not foresee a default by either the Government of Namibia or that of South Africa. However, a high degree of watchfulness is warranted.

Meanwhile, we view bond yields as appropriately priced for risk. This means that lenders to Government, i.e. investors in bonds, receive attractive compensation. Compare 10-year bond yields of 9.5% to 10%, to inflation of 2.5% to 3.5%, short term rates of 3.9%, and overseas rates of -1% to +1%. This makes it an appropriate holding as part of a balanced portfolio.

Finally, in a broader sense, we need to think about and engage in debate about the following question: What should be the guiding philosophy for economic policy? Collectively we must take responsibility to recover confidence – consumer-, business- and investor confidence. It is the golden thread that runs through the fabric of the modern economy. Policies, actions, and ideologies that destroy confidence, cuts off the lifeblood that is needed for our "patients" to recover.