

Special report

Changing politics within our base view

South Africans woke up over the weekend to find that competitive politics have finally arrived in the country. With 100% of voting districts counted and verified by the Independent Electoral Commission (IEC), the ANC is holding its footing nationally, with around 54% of all votes, the DA with just over 26% and party newcomer, the EFF, with 8% of all votes in the 2016 local government elections.

Effects of election: PSG Wealth Investment Division view

	Bear case 25%	Base case 50%	Bull case 25%
Immediate	<ul style="list-style-type: none"> Out of mandate political actions Domestic markets sell-off Bond yields shoot up Rand depreciates further to beyond 4+ standard deviation from purchasing power parity 	<ul style="list-style-type: none"> No policy change No material political surprises No extreme market volatility Bond yields relatively stable Currency marginally strengthens as uncertainty subsides 	<ul style="list-style-type: none"> Renewed leadership showcased Market sentiment improves Equity markets rally Rand strengthens to below 3 standard deviations from the mean
Near term	<ul style="list-style-type: none"> Rating agencies downgrade credit rating to non-investment grade Rand volatility spikes up but ultimately goes nowhere fast 	<ul style="list-style-type: none"> Rating agencies affirm existing ratings Rand strengthens to below 3 standard deviations from the mean 	<ul style="list-style-type: none"> Rating agencies change economic outlook from negative to stable in December Rand strengthens as cost of capital is reduced in light of lower sovereign risk
Long term	<ul style="list-style-type: none"> Political landscape becomes more competitive Ruling party increasingly accountable to deliver results Piecemeal reforms bring about slow change 	<ul style="list-style-type: none"> Political landscape becomes more competitive Ruling party increasingly accountable to deliver results Some challenges are overcome, others not. Everything considered, things improve 	<ul style="list-style-type: none"> Political landscape becomes more competitive Ruling party increasingly accountable to deliver results Renewed leadership improves consumer and investor sentiment

Source: PSG Wealth Investment Division

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The results were as expected

As many expected, the race to win some of the major metropolitan areas in the country were closely contested. For the official opposition, the poll results usher in a new era that has opened up the possibility of governing outside its Western Cape stronghold. The EFF, which contested a municipal election for the first time, now has a footprint in municipalities across the country, and is set to be a kingmaker in key metropolitan municipalities as it decides whether to use its seats to bolster the ANC or the DA, particularly in Nelson Mandela Bay, Tshwane, Johannesburg, Ekurhuleni and Mogale City, where neither large party won an outright majority. The results show that the ANC is losing its grip on urban areas across the country. Even in its stronghold provinces, which are largely rural, its support fell. In the North West, the ANC dropped from 74% in 2011 to 54% in 2016; in the Eastern Cape it fell from 71% to 65%; in the Free State from 71% in 2011 to 62%; in Limpopo from 81% to 69%; and in Mpumalanga from 78% to 71%. On a national level, this is the first time since South Africa's transition to democracy in 1994 that the ANC's support has fallen below 60%. Although the local government elections were coined as one of the most important since 1994, we expected that no significant political change or material political surprises would occur. The fact that opposition parties won more support, especially in urban areas, falls squarely within our base case.

During the day of counting the FTSE/JSE All Share Index (ALSI) was mainly flat. Positive movements in the USD/ZAR exchange rate and domestic bond yields were the only indicators that sovereign change was taking place. The rand rallied to its best level against the dollar in nine months, supported by the peaceful local government elections and expectations that major economies will maintain a low interest-rate environment. The local currency advanced 1.6% to R13.68 against the dollar by 18h36 last Thursday, its strongest closing level since 27 October and the best performance among 31 global currencies. The rand also led gains against the British pound, gaining 3% to R17.98 after the Bank of England cut its main lending rate. At the same time yields on benchmark government rand bonds, due December 2026, declined by nine basis points to 8.57%, the lowest on a closing basis since 27 November 2015.

In the near term, bond yields will remain relatively stable, while the local currency will strengthen marginally as uncertainty subsides. In the medium term, we believe that

rating agencies will affirm our existing credit rating and that the rand could strengthen to below three standard deviations from the mean.

Our institutions are strong

Sovereign risk is just one element international rating agencies consider when analysing a country's credit-worthiness. While most rating agencies have noted political instability as a risk for South Africa's rating, many of the other aspects they consider were seen as neutral or as strengths. Key institutions like our Constitution, judiciary and the South African Reserve Bank (SARB) are strong, and provide checks and balances. On a broader basis, South Africa has shown effective policy-making since 1994, which has produced sustainable public finances. The SARB is operationally independent and its policies are credible. We believe our currency is supported by the SARB's independent monetary policy, a large and active local currency fixed income market, and a prudent fiscal policy.

Impact of the results on our solutions

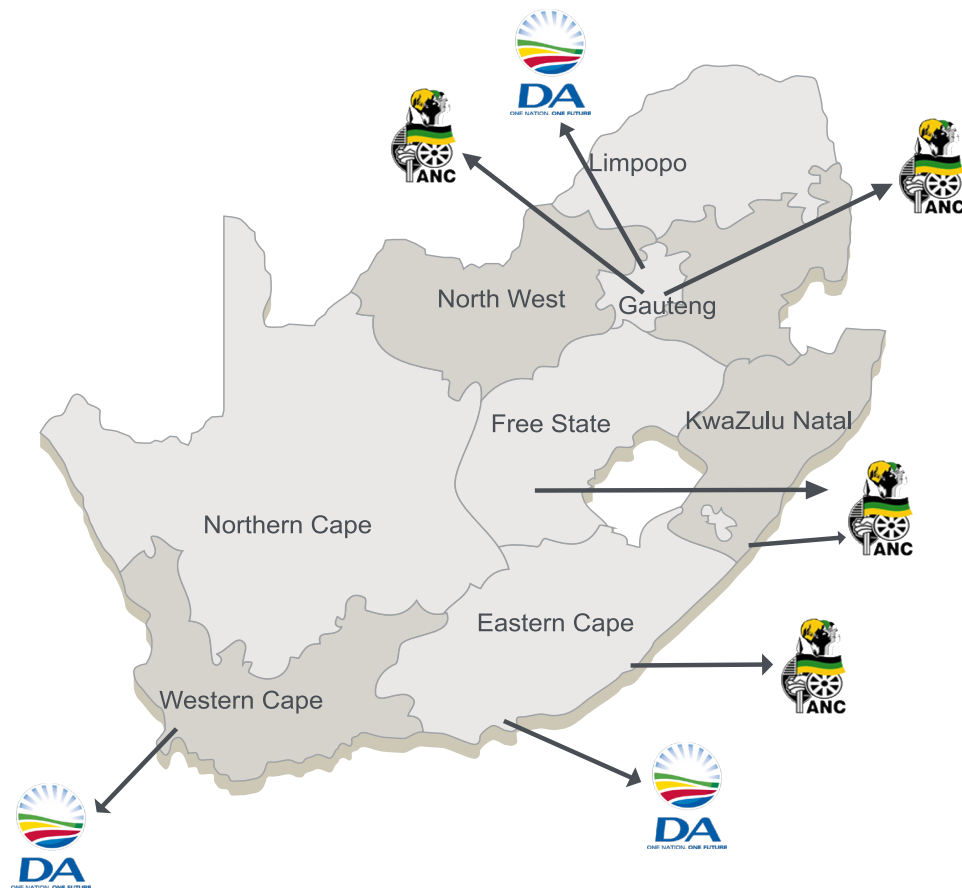
Although no volatility was seen in the ALSI as results trickled in, short-term volatility spikes can always be expected in election periods. As our table on the previous page notes, regardless of the short-term impact of election results, we expect the political landscape will become more competitive in the long term, and that the ruling party will increasingly be more accountable to deliver results. Seeing as the elections turned out largely as expected, we believe that some challenges will be overcome, while others will not. Everything considered, conditions should improve.

Our clients can, however, rest assured that PSG Wealth's solutions have proven their value during the good times and the bad. Our underlying managers are chosen for their skill to maximise performance, especially in times of volatility. We also maintain well-diversified portfolio compositions to ensure that our funds outperform the markets in the long term.

Successfully growing wealth depends to a large degree on not making emotional, knee-jerk decisions in reaction to short-term political events or the volatile market movements they can precipitate. So do not get caught up in the hype. Stick to your investment goals and horizons to keep your wealth growing.

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Local government election results 2016



This table illustrates how things stand in the hotly contested metros

Region/metro	Most votes		Second		Third	
National	ANC	53.91%	DA	26.89%	EFF	8.20%
City of Johannesburg	ANC	44.55%	DA	38.37%	EFF	11.09%
City of Tshwane (Pretoria)	DA	43.10%	ANC	41.22%	EFF	11.70%
Nelson Mandela Bay (Port Elizabeth)	DA	46.71%	ANC	40.92%	EFF	5.12%
City of Cape Town	DA	66.61%	ANC	24.36%	EFF	3.17%
Ekurhuleni (East Rand)	ANC	48.64%	DA	33.65%	EFF	11.23%
Mangaung (Bloemfontein)	ANC	56.52%	DA	25.96%	EFF	8.66%
City of eThekweni (Durban)	ANC	56.01%	DA	26.66%	IFP	4.20%
Buffalo City (East London)	ANC	58.74%	DA	23.40%	EFF	7.97%

Source: Independent Electoral Commission