SA LISTED PROPERTY OUTLOOK

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MENTENOVA

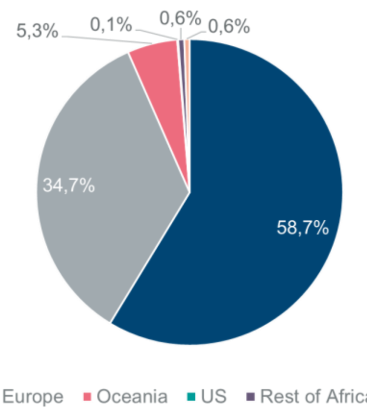
WEAK DOMESTIC PROPERTY OUTLOOK TRIGGERS STRATEGIC DOWNWEIGHTING

The COVID-19 pandemic has had a major impact on everyday life, changing the way we work and interact and how we respond to business opportunities. These shifts have significant implications for the property market, with the acceleration in digitalisation and greater flexibility in the workplace poised to drive higher vacancy rates in the retail and office sectors for the next couple of years.

As the world slowly emerges from the gloom of the COVID-19 pandemic, the retail sector finds itself facing the onslaught of online shopping, while changes in consumer behaviour have led to a dramatic increase in empty office space. While these are global trends, South Africa's fragile economic climate makes local property companies particularly vulnerable, with the rapid adoption of digital solutions expected to exert further downward pressure on rental reversions in the coming years.

A weak domestic economic outlook, coupled with higher vacancy rates, low or negative escalation rates, oversupply, and structural changes due to the impact of e-commerce, imply a structurally weaker outlook for the domestic property sector. This has prompted us to reconsider the strategic weight of SA property within our portfolios. We therefore believe that a reduction in the strategic weighting towards local listed property is prudent at this juncture. However, we still believe that local listed property deserves a place in our portfolios.

FTSE/JSE SAPY Revenue per region



First of all, the South African listed property index (SAPY's) revenue distribution is not 100% South African. It provides local investors with the opportunity to further increase their offshore exposure. Within the offshore property market, industrial and residential property exposure has increased over time, thus giving investors access to segments of the global property market that are showing positive structural trends. For instance, increasingly brisk e-commerce activity has driven the demand for industrial real estate. Previously, the logistics network was all about ensuring efficiency when delivering goods from point A to point B. Now, the logistics network also needs the resilience to handle disruptions in the supply chain. Companies are thus focusing on building additional capacity instead of just-in-time models.

Asset class correlations over the long term

Jan 1988 to Oct 2020	SA Bonds	SA Inflation Linked Bonds	Foreign Bonds	SA Commodities (Gold)	SA Equity	SA Listed Property	Foreign Equity	SA Money Market	Foreign Cash	EM Equity
SA Bonds	1									
SA Inflation Linked Bonds	0.31	1								
Foreign Bonds	-0.35	-0.14	1							
SA Commodities	-0.20	-0.07	0.63	1						
SA Equity	0.34	0.16	-0.17	0.04	1					
SA Listed Property	0.44	0.28	-0.26	-0.15	0.43	1				
Foreign Equity	-0.19	-0.04	0.51	0.27	0.37	0.03	1			
SA Money Market	0.12	0.10	0.06	-0.08	-0.03	0.01	-0.02	1		
Foreign Cash	-0.43	-0.17	0.89	0.57	-0.19	-0.29	0.51	0.04	1	
EM Equity	0.00	0.01	0.16	0.17	0.57	0.16	0.67	0.01	0.20	1

Secondly, the South African property sector offers favourable diversification possibilities within a portfolio. The asset class is negatively correlated with SA commodities (gold) and foreign assets, such as foreign bonds and foreign cash and has a low correlation with off-shore equity and SA cash and a relatively low correlation to the SA asset classes

Taking these factors into consideration, we do not want to exclude South African property from our portfolios altogether, but rather down-weight the asset class to reflect the fundamentally weaker outlook for the sector over the medium term.

We will continue to closely monitor the underlying fundamentals of this asset class as time goes by. However, until such time as domestic structural challenges and fiscal headaches are given sufficient attention, we believe that a lower strategic exposure to this asset class across our portfolios is the optimal approach.

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