ELECTION 2024:
INVESTMENT IMPLICATIONS & OPPORTUNITIES

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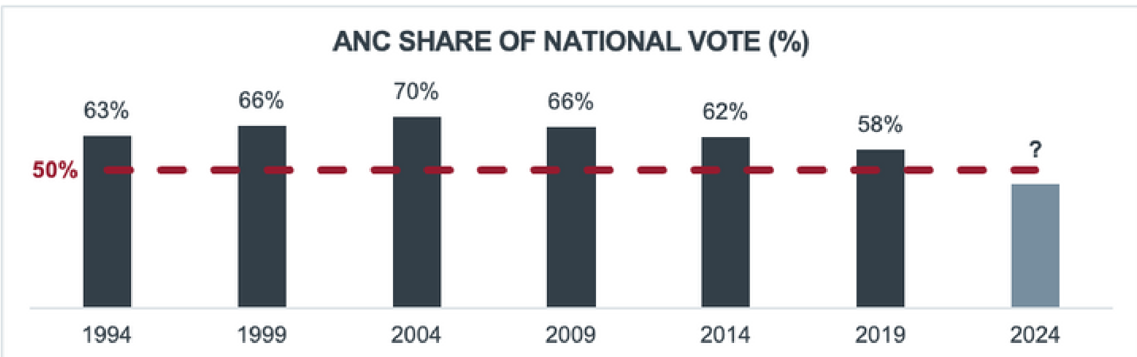
Zandile joined 36ONE in August 2021 as an Investment Analyst. Prior to this she worked as an equity analyst at CDAM, a boutique investment management firm based in London. She has over 7 years of financial services experience including investment banking at J.P. Morgan. Zandile holds an MBA from London Business School, a Bachelor of Business Science (UCT) and is a CA (SA).

This month's National Election marks the first time that the African National Congress (ANC) may receive less than 50% of the vote. Many questions have, understandably, been raised about the implications that such a change would have on equity markets. When assessing the risk from elections, the market is forward looking. Investors try to determine whether an election will result in any significant policy changes. As such, elections, on their own, tend to have a limited long-term impact. In the short term, however, there is a measurable effect on markets. The risk of change creates uncertainty and additional political risk. This, in turn, leads to elevated volatility in the market.

36ONE, as a business with hedge fund origins, appreciates the opportunities that are created by volatile markets. This year has been no different as, in our view, the market has been pricing in a considerably high political risk premium. The resultant historically low valuations have been a buying opportunity for our funds. In this article, we outline our base case expected outcome for the election, the impact on financial markets and how our funds are responding to this dynamic environment.



Source: IEC, 36ONE analysis

EXPLORING OUR BASE CASE EXPECTED OUTCOME

When assessing the potential market impact of an event such as an election, our team does not attempt to forecast a specific result. Political events are inherently unpredictable, but it is important to assess the potential risk. Our approach is to determine a finite set of likely outcomes and assign a probability to each one. The probability evolves as we learn new information. For this election, we have identified three potential outcomes. The estimated probability has been informed by polling data and by-election results.

Our base case is for the ANC to obtain mid-40% of the vote, requiring them to form a coalition with smaller political parties and provide policy continuity.

POTENTIAL RESULT	THE PROBABILITY	MOST LIKELY COALITION PARTNER	POLICY CONTINUITY?	LIKELY RESPONSE FROM MARKET
ANC 48% or above	15%	None	Yes	Positive
ANC 43-47%	60%	IFP and other smaller parties	Yes	Positive
ANC below 42%	25%	Larger party such as DA or EFF/MK	Unclear	Depending on coalition partner: Positive – DA (deemed business friendly) Negative – EFF (not deemed business friendly)

In the months leading up to the election, a great deal of emphasis was placed on the risk that the ANC would win close to or just under 40% of the national vote. There was concern that a coalition would be formed with the EFF, a political party with some far-left policies. This is seen as an outcome which is not business friendly and likely to result in a negative market response. We believe that leading up to the election, the probability of this outcome was overstated and caused elevated political risk. As we move closer to the election result, the market has assigned more probability to the above base case (ANC wins 43-47% of the vote). Given our base case is for continuity, we are likely to see little material policy change post-election. The current ruling party is likely to retain control of key positions in the cabinet and continue the reform agenda as it stands.

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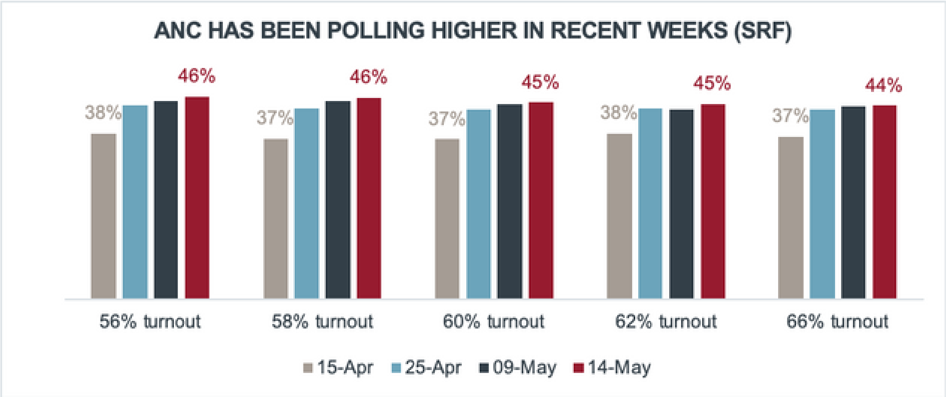
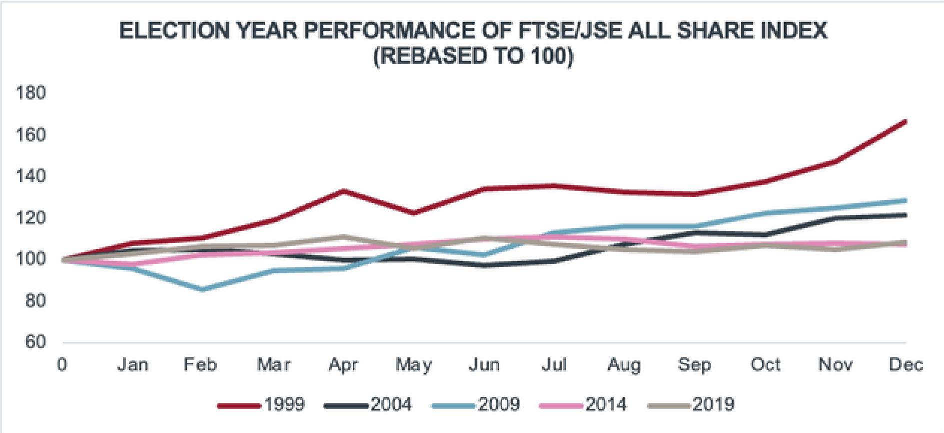


Source: Social Research Foundation (SRF) as of 15 May 2024

HISTORICAL IMPACT OF ELECTIONS ON THE EQUITY MARKET

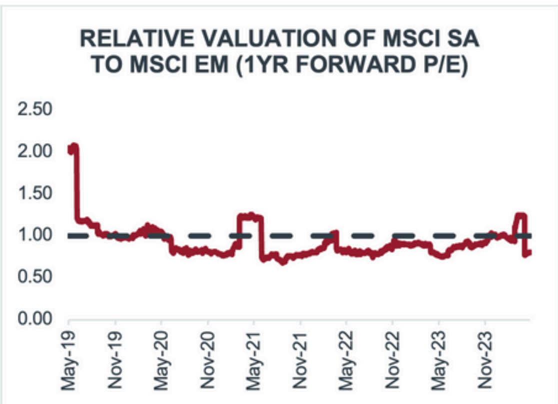


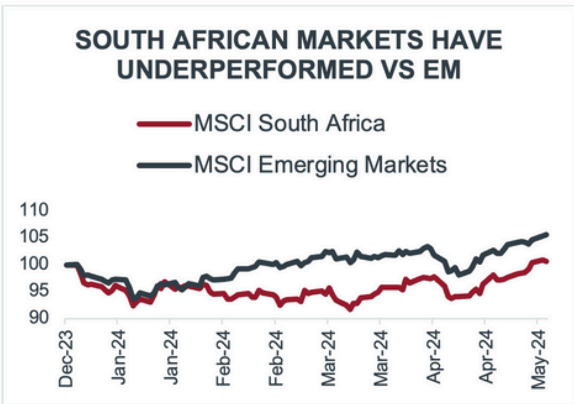
Source: Bloomberg (start of each year rebased to 100)

South African markets have, on average, been weak in the months leading up to an election and outperformed in the months following the result. This reflects the short-term nature of political risk premiums in the absence of significant leadership and policy change. It is also important to note that elections do not occur in a vacuum. There are many other macroeconomic risks that impact the equity risk premium. In addition to our own election in 2024, we have an upcoming US election, which will bring further uncertainty to global markets. These events are occurring against a backdrop of increased geopolitical tension, uncertain monetary policy, and an evolving Chinese economy. All these factors are likely to impact local markets in the medium term.

OUR RESPONSE TO THIS DYNAMIC ENVIRONMENT

The South African equity market has been experiencing several challenges, including lacklustre economic growth, foreign investor net outflows and local investors increasing their allocations to offshore equities. All these factors have weighed on equity markets, resulting in thin liquidity and record low valuations.





Source: Bloomberg

At 36ONE, our process is to analyse equities from the bottom up and apply a macro-overlay to our portfolios. The volatility caused by the above factors and exacerbated by the upcoming election has been a buying opportunity for our funds. We have found that many high-quality companies have been trading at a meaningful discount to their fair value. This impact has primarily been seen in companies that generate most of their earnings in South Africa, commonly referred to as "SA Inc.".

Our funds entered the year with an underweight in SA Inc and Resources. We have been closing this underweight in the last few months by investing in selected equities which were undervalued, with a meaningful self-help narrative driving their earnings growth. This includes positions in selected equities in Banks, Retail, Pharmaceuticals and Food Producers. We believe that our base case election outcome will result in a relief rally that will be a catalyst to realise value in these positions.

In the last month, we've already seen a recovery in the local equity market. This recovery has partly been driven by the increased probability of the election result matching our base case, leading to limited policy changes post-election. The positive performance in the local market has also been supported by a recovery in China's local market and a rally in resources. The election may become a "sell the news" event. As such, we have been taking profits as the market moves higher but retaining our exposure to SA Inc. names where the valuation remains attractive.

THE ELECTION IS NOT A SILVER BULLET – STRUCTURAL REFORM IS STILL REQUIRED TO REALISE LONG-TERM VALUE

Even if the election result is in line with our base case, the local market still faces structural challenges around growth. Policy continuity, at a minimum, ensures that current conditions are unlikely to worsen from here. The SA market is still cheap. Current valuation levels are reflecting a challenging environment with limited improvement. However, we believe that there is some upside risk to the macroeconomic outlook that can support local equities higher. We believe that there will be a meaningful improvement in the energy crisis, which will positively impact earnings from 2025. Solutions to logistical challenges at Transnet will likely have an impact in the next 3 years or so. We continue to apply our fundamental stock picking approach and are finding value in companies that will benefit from these improvements.

Sources: Bloomberg, IEC, SRF, Standard Bank Group Securities, Investec