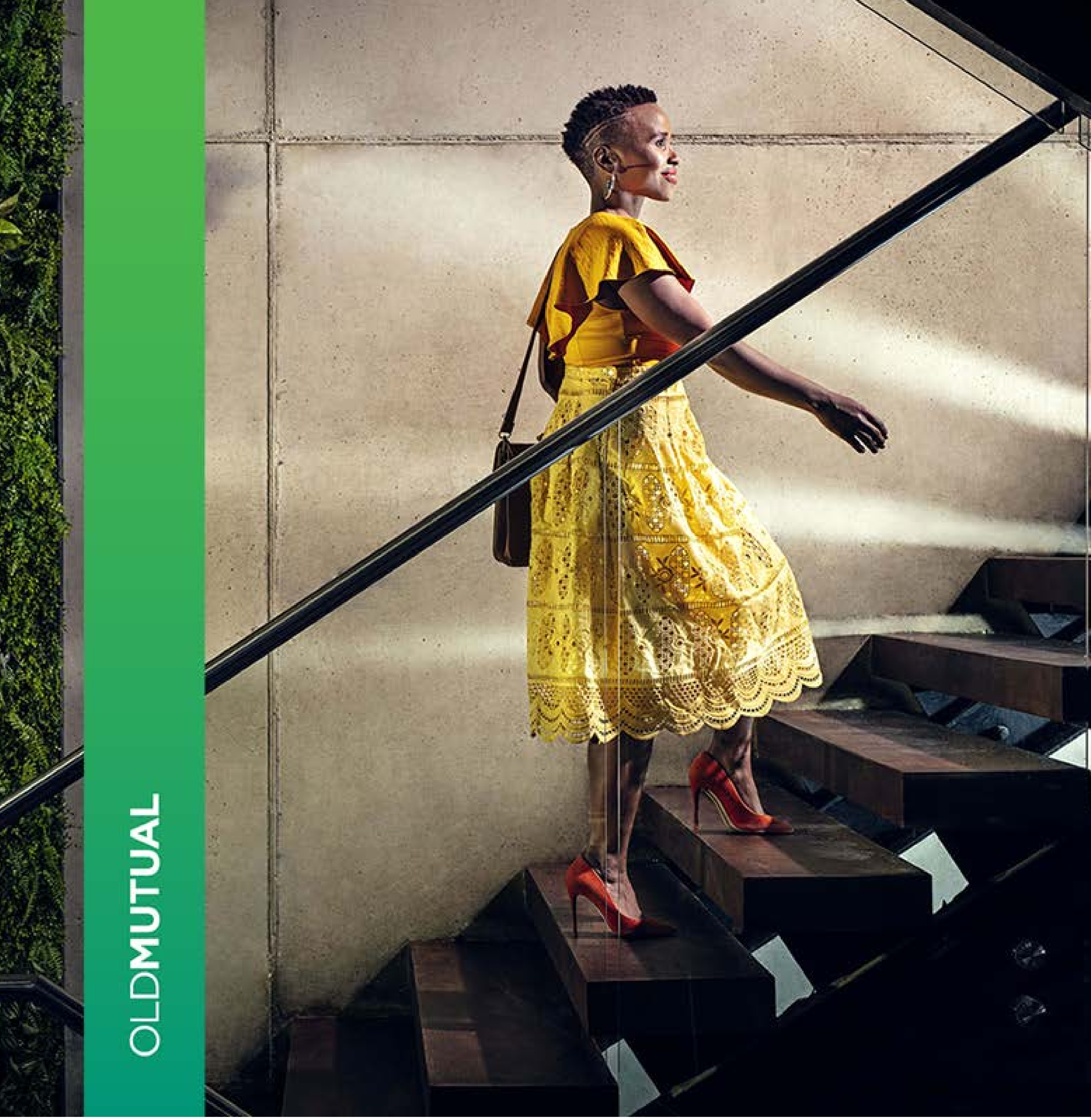

COMFORT THROUGH THE STORM

CORPORATE

DO GREAT THINGS EVERY DAY

19 March 2020

COMFORT THROUGH THE STORM

The month of March 2020 will be remembered alongside those of previous significant market crashes. Seldom have we seen such extremes of market volatility, mirrored only in the crashes of 1929, 1987 and 2008. COVID-19 is about three months old, yet has wreaked havoc on normal economic activity, and is severely disrupting supply chains and choking demand. This of course, alongside the tragic ongoing human cost of the virus. The purpose of this note is to give an update on recent market movements and to position the performance and potential management actions associated with our smoothed bonus portfolios.

Market update

At the time of writing, the US equity market is down 30% from its very recent peaks. In South Africa, the All Share index is down 34% from its high in early 2018. The cost of 10-year government borrowing in the US has fallen from 1.8% per annum just two months ago to a low of 0.5% per annum last week. The oil price has halved this year to a current low of around $30/barrel.

We want to assure you that we are continuously monitoring your investments, and whilst they are subject to these negative moves, they will over time recover and grow again as markets recover their poise. Indeed, it is often at times like these that the best investment opportunities present themselves at very attractive levels.

Impact on Smoothed Bonus Portfolios

These rare episodes are unnerving and often investors panic and sell out of the markets. To the extent that many of our customers are invested in our market leading smoothed bonus portfolios, customers can take comfort in the fact that these portfolios are based on a sound risk management framework that provide significant protection against the recent market downturns. Our Smoothed Bonus Portfolios are designed to protect investors during times like these by utilising three robust risk management mechanisms - diversification, smoothing and guarantees.

Diversification across a wide range of asset classes

Our smoothed bonus portfolios are well diversified portfolios that invest across a wide range of asset classes such as local and international equities, bonds, property and other alternative asset classes. Our portfolios are also diversified across a number of different asset managers that adopt different management styles such as active and passive management styles. By following a well-diversified investment strategy across different asset classes and management styles, investors are shielded against the extreme downside risk of a particular asset class or individual share.

Smoothing – protection against extreme volatility

Unfortunately, even well-diversified balanced funds have experienced significant losses over the last few weeks due to the fact that most asset classes around the world lost value at the same time. It is during times like these that smoothing adds additional value for investors by protecting them against this extreme volatility. Our smoothed bonus portfolios are specifically engineered to smooth out the ups and downs of market performance. Doing so results in a far less stressful investment experience, removing the temptation to react emotionally to external forces like we have seen in recent weeks.

Guarantees – designed to give ultimate protection

Although smoothing is a very effective risk management mechanism and able to protect investors against the sharp downturns in the markets, there remains the risk of a much more long-term severe sustained downturn in the economy. The capital guarantees attached to our smoothed bonus portfolios are designed to give investors ultimate protection against this risk. Investors can choose from a range of different guarantee levels that effectively lock in a proportion or all of the accumulated value of the investment. Even though smoothed bonus portfolios may also fall to some extent, the extent of the fall is protected by the level of the guarantee. The combination of smoothing and guarantees allows these portfolios to offer much better protection than most balanced funds available in the market.

Recent performance of smoothed bonus portfolios

Our Smoothed Bonus funds are built to deliver risk-managed outcomes that are particularly valuable when markets are volatile. They are designed to pursue returns in line with their stated return targets over the long term, while regulating bonuses in a way that smooths out the investment journey compared to typical balanced funds. The latest market crisis spurred on by the COVID-19 outbreak has been devastating, but its effect on markets is similar to many crises we have faced in the past. Our smoothed bonus funds have protected investors from significant downturns through some of the largest global financial crashes in history - including the OPEC Oil Embargo (1973), Black Monday (1987), the Asian Financial Crisis (1997), the Dot-com Bubble (2000) and the Sub-prime Mortgage Crisis (2008).

A more recent illustration of our Absolute Growth Portfolios (AGP) resilience compared to typical balanced funds can be found by looking at AGP Stable's (80% guarantee level) performance since 2015. Despite the volatility of South African markets over the last five years, AGP Stable has been able to deliver relatively consistent, smoothed bonuses. Over the five-year period ending March 2020, typical balanced funds[1] produced returns of 3.0% per year. Over the same period, AGP Stable declared bonuses of 7.2% per year (before investment management fees), which represents relative outperformance of roughly 4.2% per year.

Impact of markets on reserve levels and future return expectations

Because the underlying portfolios of our smoothed bonus funds have significant exposure to growth assets that have fallen sharply in recent weeks, it should be noted that the Bonus Smoothing Reserve (BSR) levels have subsequently also fallen significantly. If markets continue to fall from the current levels, it may be necessary to declare some negative returns on portfolios that do not offer a full capital guarantee.

While this BSR mechanism ensures that clients are sheltered from the full brunt of the market downturn over the short term, if and when markets recover, some of this recovery will be used to replenish the BSR back to its target range of 0% to 5%. This means that, if the underlying balanced fund delivers very good returns over the next few months, or even years, we should expect AGP to lag behind because of the smoothing mechanism and the need to replenish the negative BSR.

Opening a new bonus Series for AGP (at this stage for institutional clients only)

In order to manage fairness between new and existing clients, we plan to launch a new bonus series of AGP in April 2020. The current series of AGP is referred to as "AGP 2007" (to signify its 2007 launch date) and the new series will be called "AGP 2020". This new series will be a replica of the current series in that it will have the same underlying investment strategy, fee structure and bonus formula, but it will channel all investments from April 2020 onwards towards a new BSR while the current AGP 2007 BSR recovers from its current underfunded position. Over time, we expect the BSR levels to converge and when this happens we will likely merge the two series into the future.

[1] Typical balanced fund returns are based on the monthly returns of the median performing balanced fund as published in the Alexander Forbes Large Manager Watch surveys. Returns for March 2020 are based on estimates derived from representative market indices.

In summary, we want you to know and take comfort in the fact that we design our smoothed bonus portfolios to deliver long-term real returns while at the same time providing effective protection against the real risks associated with investment in growth assets. We have more than 50 years of experience in managing smoothed bonus portfolios and we intend to use this collective experience to weather the current storm and continue to protect our customers' retirement savings.

For more information, please speak to your Old Mutual Corporate Consultant.