10X INVESTMENTS

Annual Investment **Review**

2020

The first mentions in western media of the novel coronavirus (Sars-CoV-2) surfaced at the beginning of 2020. The news flow became gradually worse as the scientists confirmed human-to-human transmission, the first fatalities were reported, the Chinese city of Wuhan went into a full lockdown, and the virus spread around the world.

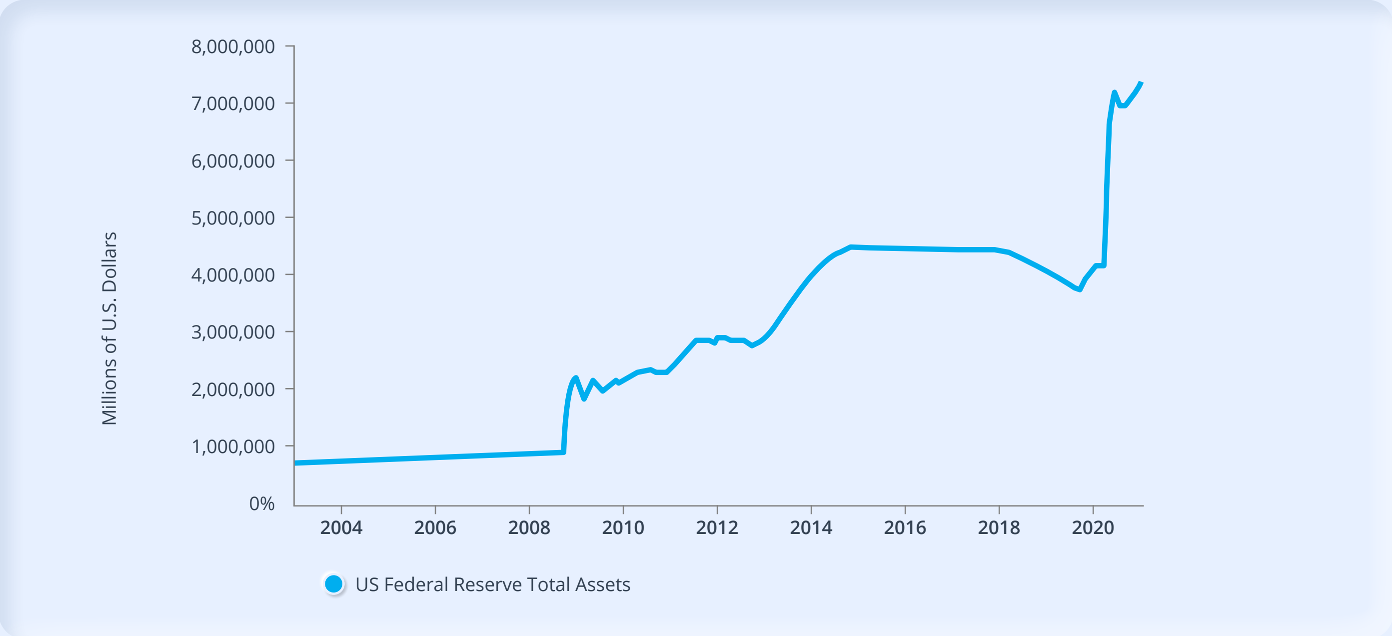
As cases surged in Europe and the US, governments implemented co-ordinated measures to stop the spread of the virus. Travel and economic restrictions became the norm. The negative impact of this was felt everywhere. Many lives and livelihoods were lost as economic activity slowed (and, in some industries, all but stopped). As the full extent and effect of the Covid-19 containment measures became clear, all types of assets around the world sold off in a quest for liquidity. At the peak of this dash for cash, in the third week of March, even typical safe-haven assets such as gold and US Treasuries were not spared.

Many investors sought refuge in US dollars. The rand, accordingly, depreciated sharply – to over 19/$ from 14.3/$ at the start of the year – as investors dumped local assets. The South African 10-year bond yield jumped from 9% to over 13% and the FTSE/JSE All Share index sold off 33%. It would have been much worse had the rapid rand depreciation not cushioned the price drop of the large dual-listed stocks that dominate the JSE.

This coincided with rating agency Moody's long-expected downgrade of South African rand-denominated government debt to sub-investment grade. This demotion to 'junk' status triggered the anticipated exclusion of these bonds from the FTSE World Government Bond Index. In fact, this was so anticipated (and therefore pre-empted) that when this exclusion finally became reality, at the end of April, it barely registered in the local market. At the time the downgrade was announced, the 10-year yield had already improved to 11.2%, and by the time the bonds were finally excluded from the index, it was already back down to 10.2% (bond prices move inversely to the yield).

The worldwide lockdowns and resultant liquidity crisis prompted co-ordinated global fiscal and monetary stimulus on a scale never seen before. Most developed market rates where immediately cut to zero (if they weren't there already), and central banks around the world embarked on massive asset purchase programmes to reduce interest rates across the curve (ie both for long-dated and short-dated debt) and push money into the global economy.

Figure 1: US Federal Reserve Balance Sheet



Source: Board of Governors of the Federal Reserve System (US)

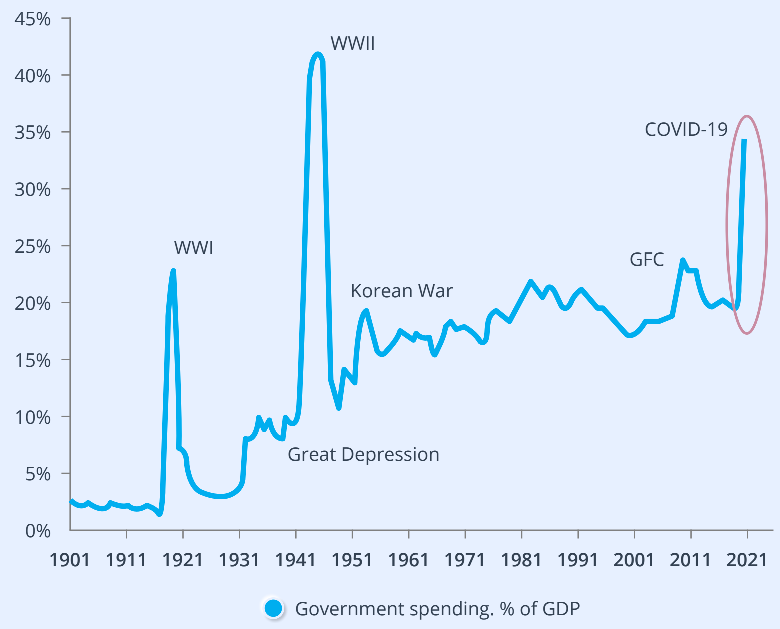
Figure 1 shows by how much and how quickly the US Federal Reserve increased its balance sheet to support the asset purchase programme. This had two main impacts:

1) it reduced the cost of capital for firms and borrowing costs for individuals, and
2) it supported the price of risk assets by making bonds less attractive.

This was a repeat of the 2008 playbook, but the speed and size with which it was implemented was multiples greater. What also distinguished the response in 2020 from 2008 was the level of direct assistance that found its way into the pockets of individuals rather than corporates.

In terms of the increase in government spending, as a percentage of US GDP, the only other parallels that can be drawn over the last 120 years are the spending increases in support of the war efforts related to WW1 and WW2.

Figure 2: US Government Spending as % of GDP since 1901



Source: BofA Research Investment Committee, Global Financial Data

Locally, the South African Reserve Bank cut interest rates aggressively in March, April and May, supported by falling inflation, to assist the South African economy and provide relief to borrowers.

Supported by the combined global monetary and fiscal stimulus, markets rebounded strongly from the March lows, at a time when many where drawing parallels with the stock market crash in 1929 that accompanied the Great Depression. But this time, the unprecedented government support saw the stock market disconnect from the reality of the economic environment.

As the first Covid wave hit South Africa, National Treasury tabled a supplementary budget in June. This very clearly restated South Africa's fiscal position and reversed any improvements that the February Budget had projected.

With some exceptions, SA-focused companies, already under pressure from the fragile local economy, bore the brunt of the lockdown. The JSE-listed companies with offshore earnings held up considerably better, their earnings inflated by the weaker rand.
By the third quarter, when South Africa's first wave subsided and the economy started re-opening, the return of load-shedding reminded us of the poor state of infrastructure in the country. At the same time, other countries faced their second wave of infections, which inhibited the reopening of economies and travel.

Still, the move into the dollar started to reverse as investors sought opportunities elsewhere. And markets kept climbing to new highs, fully decoupled from the economic impact of Covid-19.

Commodities prices strengthened as the dollar weakened and the global economic engine restarted. Given the relatively large weight of resource companies on the JSE, the increase in commodity prices provided a strong underpinning for these shares and drove our market higher. The higher commodity prices also proved a windfall for our terms of trade: month after month, South Africa posted a trade surplus as our commodity exports brought in more hard currency than we paid away for imports.

Globally, the technology sector outperformed strongly as many tech companies profited from the new work-from-home regimes and the socially distanced lives that people around the world were leading. And, with interest rates near zero, the opportunity cost of investing in companies with high valuations and distant profits was relatively low.

The 4th quarter saw sentiment improve as successful vaccine trials brought hope that this signalled the beginning of the end of the pandemic and lock-downs. The US presidential election prompted some market volatility, but once Joe Biden's win was confirmed the market finished the year strongly.

Investors' increased appetite for risk supported the rand, which ended the year strong despite further rating downgrades of South African Government debt, a second wave of Covid cases and the re-imposition of some restrictions.

Even if anyone could have predicted that Covid-19 would ravage the globe in 2020, no would have predicted that global stock markets would finish the year at or near all-time highs. This speaks to the fallacy of basing investment decisions on predictions, irrespective of whether they foresaw a Black Swan event like Covid-19 or telegraphed South Africa's rating downgrade. 2020 proved yet again that investors are better served aligning their portfolio's asset mix to their time horizon, rather than to economic and market forecasts. Selling out of a high growth portfolio in April would have crystalised losses and meant missing out on the big gains that followed thereafter.

It also proved that for investors with a time horizon of five years or longer, the 10X High Equity portfolio is the appropriate choice, even if that period overlaps with a global pandemic, provided they are able to ignore all the short-term noise and stick to this choice.

Recent returns vs long-term returns

At 10X, we do not make economic forecasts or align our portfolios to speculative predictions. That would go against the very essence of the 10X investment philosophy and our one optimal solution. We do, however, take a view on return prospects, based on how much markets have delivered in the recent past relative to what they have delivered over the long-term. We do this because we believe in mean reversion, that asset class returns (after inflation) ultimately trend back to their long-run average.

Figure 3: Real (after inflation) growth asset returns vs long-term mean

Source: 10X Investments, Dimson, Marsh and Staunton

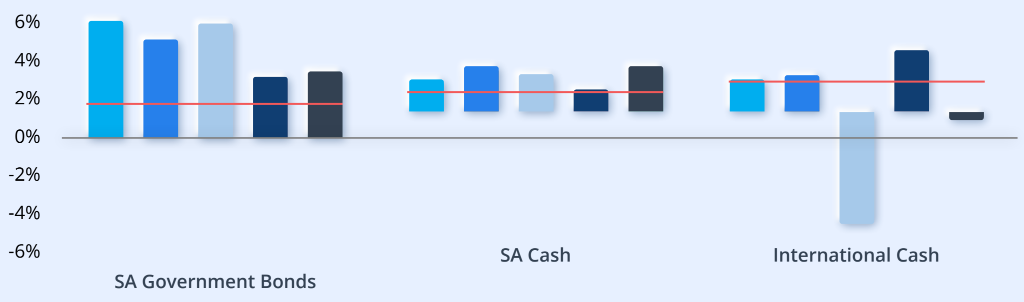
Figure 3 shows the real (after inflation) annualised return of the 10X growth asset classes over different periods (1, 3, 5, 10 and 20 years). The red lines represent the long-term average return for each asset class. Short-term returns (up to 5 years) can deviate markedly from the average, but over longer periods (10 years or more) we would expect returns to trend back towards the historical average.

SA Equity 2020 mirrored much of the last 5 years with returns just above inflation, well below the long-term average. Whilst the 10-year return still delivered a premium to inflation of over 4%, this is now also below the long-term mean. However, the 20-year return is still above average, which underlines how much the last 10 years' relatively soft performance has offset the preceding 10 years' exceptionally strong return.

SA Property had a horrendous year, delivering extremely negative returns. This, combined with poor returns in 2019 and 2018, also caused the 5-year return to be deeply negative, and even reduced the 10-year return to well below average. Although these returns now barely beat inflation, the 20-year returns are still excellent. This underlines how abnormally high property returns were during the early 2000's and also our belief that markets, and the economy, cannot sustain excessive returns (and profits) indefinitely, for any asset class.

International Equity returns have two main drivers: the performance of international equity markets and the performance of the rand. Over 2020, the strong excess returns to international equities were primarily driven by the strong performance of offshore markets, not rand depreciation. The 10-year return is markedly above the long-term mean, which shows that international equities have been the right place to be since 2010. However, despite this strong performance, the 20-year return is still below average as it includes the period between 1999 and 2009, called the 'The Lost Decade' by US investors. During this period, the S&P500, the most widely followed stock market index in the US had a total return of -2%. This is an apt reminder that once markets reach extreme valuation levels, extended periods of low, or even negative returns can follow. For South African investors, taking their money offshore is not a one-way bet, especially as negative international returns may be compounded by rand strength. This is what happened during the early 2000's and it may well happen again if we have another extended commodity cycle.

Figure 4: Real (after inflation) defensive asset returns vs long-term mean



Source: 10X Investments, Dimson, Marsh and Staunton

Comparing Figures 3 and 4, it is immediately apparent that the range of outcomes for our defensive asset classes is much lower than for growth assets. That is the point. It also becomes immediately apparent that these asset classes continue to deliver positive, if modest, real returns over all periods. The one exception is International Cash, which has to contend with rand volatility.

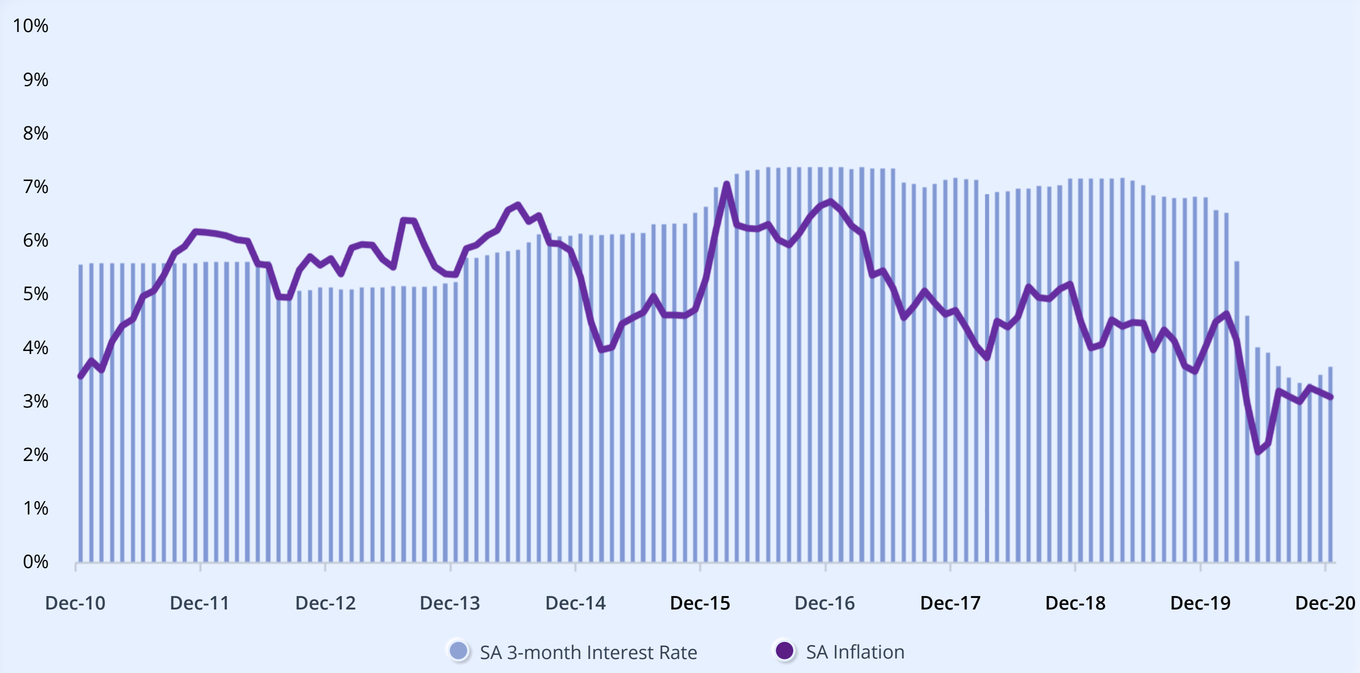
Despite the downgrade to sub-investment grade, **SA Government Bonds** delivered a return above inflation of 6%, in excess of their long-term average returns. The market has demanded a high yield from SA Government bonds to compensate investors for the fiscal risks. It is this high yield, coupled with failing inflation that has seen this asset class perform strongly when compared with historical periods often characterised by high inflation.

SA Cash returns over the last 5 years have consistently been above inflation, but this moderated somewhat over 2020. The above-average returns have been driven by falling inflation combined with conservative monetary policy. However, the SARB aggressively cut rates during 2020, indicating looser monetary policy so we may see more moderate real returns going forward.

As international interest rates are close to zero, the return to **International Cash** was driven almost exclusively by exchange rate movements for the past few years. Returns were volatile this year, as the significant outflows from emerging markets during the first few months reversed towards the year end. Despite this volatility, the one-year return ended in line with the long-term average. The 5-year and 20-year real returns are both negative and significantly below the long-term mean whilst the 10-year return is significantly above. This underlines how prone our exchange rate is to exogenous shocks and volatility.

Given the recent performance of SA Cash, which has provided better real returns over the last 5 years than SA Equities, many investors have begun to believe that this asset class is an appropriate long-term investment . This is a type of recency bias, expecting a short-term trend to become the long-term norm.

Figure 5: SA 3-Month interest rate and SA Inflation for the period 31 December 2010 to 31 December 2020 (last 10 years)



Source: Refinitiv Datastream, StatsSA

The recent memory of returns to SA cash may be one such case, where investors expect high, inflation-beating returns to be a sure thing for the future. When making investment decisions one should not let recent performance drive decision-making.

At the start of the decade, 2011 through to 2015, we saw negative real returns to SA Cash, in other words, SA Cash returns were lower than inflation. Given declining inflation over the last 5 years, coupled with a conservative monetary policy from the SARB by keeping interest rates high, we have become accustomed to relatively high returns to SA Cash in both real (CPI+3%) and nominal terms (7%). However, after aggressive interest rate cuts through 2020, rates have fallen to 50-year lows, and the current yield on SA cash is now roughly in line with inflation.

Cash investments on a forward-looking basis are likely to yield inflation-like returns that are significantly lower than over the last 5 years. SA Cash is a defensive asset class and is not suitable for investors who have a long-term time horizon.

As much as we emphasise focusing on the long-term, in the real world it is hard to ignore the current stock market level and sentiment. It almost never feels like the right time to invest. After strong performance, all the good news seems to be in the price; after a sharp correction, the economic outlook seems so poor that it makes no sense. This dilemma can cause anxiety but, rather than listening to the short-term noise, we need to strip out the emotion and personal beliefs, and follow the factual evidence.

What are the investment facts?

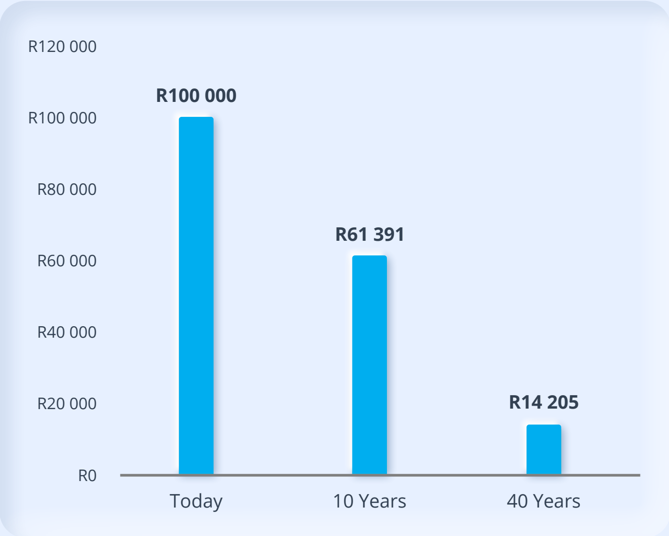
1. Asset allocation determines the long-run return
2. Diversification improves the risk-adjusted return
3. Fees have the highest predictive value
4. No-one knows which asset class will outperform over the short term
5. No-one knows which manager will beat their benchmark over the long term

The 10X investment strategy is designed around these 'knowns' to deliver the optimal long-term return and thus improve our clients' odds of achieving their retirement savings goal.

Successful investing is simple, but not easy. Designing the optimal long-term strategy is one thing, sticking to it through the market's ups and downs and during times when other strategies seem to be working better, is quite another. Successful investors manage their emotions during times of market stress, like we experienced in 2020, and stick to the plan.

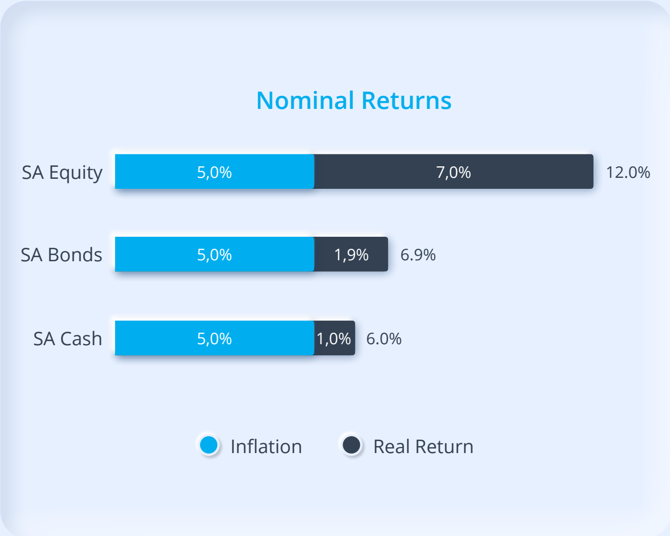
1) **Asset allocation** determines long-term returns

Figure 6: Impact of inflation on a starting value of R 100,000



Source: 10X Investments

Figure 7: Nominal and real returns since 1990



Source: 10X Investments; Dimson, Marsh and Staunton

Equities have historically provided the best inflation-beating returns over the long run. While it might feel safe to hold cash, as has been the case over the last 5 years, the reality is that for long-term investors cash is trash. Looking at data going back to 1900, it would have taken nearly 7 times as long to double the value of your cash in real (after-inflation) terms compared with being invested in equities.

Our message to long-term investors is to maintain a high proportion of their portfolio in equities, even if other asset classes intermittently deliver higher returns.

Table 1: Years to double money in real terms

	SA Cash	SA Bonds	SA Equity
Years to double money in real terms	68	37	10

Source: 10X Investments; Dimson, Marsh and Staunton

2) **Diversification** improves risk-adjusted returns

The previous section begs the question: Why not invest your entire portfolio in equities if you are a long-term investor?

The table below shows the annual and 10-year average return of each asset class over the last decade. What it shows is that the asset classes that deliver the best returns over the long-term (typically growth assets) don't do so every year. In some years, they rank near the bottom, and defensive asset classes outperform by a considerable margin. Every year, the ranking is different as each asset class performs differently under different market conditions.

Holding some of your savings in defensive asset classes buffers your return in times of market stress. It ensures that at least part of your portfolio is delivering a positive return. This helps you avoid the full impact of a share market correction and, in so doing, lowers the risk that you react emotionally and abandon your long-term investment strategy.

Table 2: Asset Class performance and diversification

2020	2019	2018	2017	2016	2015	2014	2013	2012	2011	10 Year Average
EM Equity 23.1%	DM Equity 24.9%	Int Cash 16.2%	EM Equity 23.8%	SA Govt Bonds 15.6%	SA Prop 45.0%	DM Prop 29.2%	DM Equity 57.8%	DM Prop 34.6%	SA Prop 25.5%	DM Equity 19.0%
DM Equity 21.3%	DM Prop 19.4%	DM Prop 10.6%	SA Prop 18.5%	SA Prop 11.1%	Int Cash 33.7%	DM Equity 16.8%	SA Prop 34.7%	SA Equity 28.7%	Int Cash 22.0%	DM Prop 15.1%
SA Govt Bonds 9.2%	EM Equity 16.0%	SA Govt Bonds 7.6%	SA Equity 16.9%	SA Cash 7.0%	DM Prop 33.4%	SA Equity 13.0%	DM Prop 29.8%	10X High Equity 24.1%	DM Equity 15.1%	EM Equity 12.2%
10X High Equity 6.1%	10X High Equity 11.2%	SA Cash 7.0%	10X High Equity 13.7%	SA Infl Bonds 6.1%	DM Equity 32.7%	10X High Equity 12.9%	Int Cash 23.8%	EM Equity 24.1%	DM Prop 14.9%	10X High Equity 10.2%
SA Infl Bonds 5.1%	SA Equity 10.2%	DM Equity 5.2%	DM Equity 10.4%	SA Equity 2.9%	EM Equity 13.6%	SA Infl Bonds 10.9%	SA Equity 21.4%	DM Equity 20.8%	SA Infl Bonds 13.3%	SA Equity 9.2%
SA Cash 4.8%	SA Govt Bonds 10.2%	SA Infl Bonds 0.0%	SA Govt Bonds 10.3%	10X High Equity 2.0%	10X High Equity 9.1%	Int Cash 10.3%	10X High Equity 21.0%	SA Infl Bonds 19.4%	SA Govt Bonds 8.7%	SA Govt Bonds 8.3%
Int Cash 4.6%	SA Cash 6.9%	EM Equity -0.6%	SA Cash 7.1%	EM Equity -1.3%	SA Cash 6.1%	SA Govt Bonds 10.2%	EM Equity 20.5%	SA Prop 18.1%	10X High Equity 7.6%	Int Cash 8.2%
SA Equity 4.0%	SA Infl Bonds 2.4%	10X High Equity -2.9%	SA Infl Bonds 2.6%	DM Equity -5.2%	SA Infl Bonds 3.5%	EM Equity 7.8%	SA Cash 5.0%	SA Govt Bonds 16.6%	SA Cash 5.5%	SA Infl Bonds 6.2%
DM Prop -3.7%	SA Prop 1.2%	SA Equity -8.0%	DM Prop 1.4%	DM Prop -8.6	SA Equity 3.0%	SA Cash 5.7%	SA Infl Bonds 0.5%	SA Cash 5.4%	SA Equity 4.5%	SA Prop 6.0%
SA Prop -36.9%	Int Cash -2.7%	SA Prop -26.2%	Int Cash -9.9%	Int Cash -11.2%	SA Govt Bonds -4.0%	SA Prop -0.6%	SA Govt Bonds 0.3%	Int Cash 4.7%	EM Equity -0.2%	SA Cash 6.0%

Source: 10X Investments; SPDJI; FTSE EPRA/NAREIT; Refinitiv Datastream

In addition to being invested in local and international shares, 10X clients are invested in local and international property, SA nominal and inflation-linked bonds, SA cash and international cash.

It is important not just to diversify across asset classes, but also within. With a concentrated share portfolio, there is a risk of being over-exposed to an unforeseeable event with a specific company, such as we saw with Steinhoff. That is why, at 10X, we cap our holding in any one stock to 6% when we rebalance (twice annually). This means that no share in our 10X High Equity portfolio (which has a 45% allocation to SA Equity) makes up more than 2.7% of the entire portfolio at rebalance. Internationally, our clients are invested in more than 3,000 global shares.

The benefit of diversification in the 10X High Equity portfolio is evident in the more consistent returns from year to year, whilst still providing strong returns over the long run.

3) **Fees** matter

While returns vary over the short-term, fees are constant. If a high equity portfolio delivers an after-inflation return of 6.5% before fees, and you are paying the industry standard of approximately 3% in fees, you are giving up 45% of your real return.

Many proponents of high-cost active management argue that fees are irrelevant, that only the return after costs matters. This is true. The problem is that these managers are willing to guarantee only their fees, not their return. So, this argument can be made only with the benefit of hindsight.

Investors need the benefit of foresight and for that fees have the highest predictive power when trying to assess which funds will outperform.

In a 2016 US study, Morningstar found that the cheapest 20% of funds were three times more likely to outperform the most expensive 20% of funds.

Even this evidence is sometimes disputed by the industry-at-large in South Africa, with arguments being made that the JSE is less efficient than the US market, or that the South African universe of stocks is somehow different from that of developed markets.

In 2017, Morningstar conducted research in South Africa and the results were in line with those in the US: the cheapest 20% of funds had a much higher probability of delivering returns in the top one-fifth of funds. This should come as no surprise to anyone who understands the corrosive impact of fees over the long term.

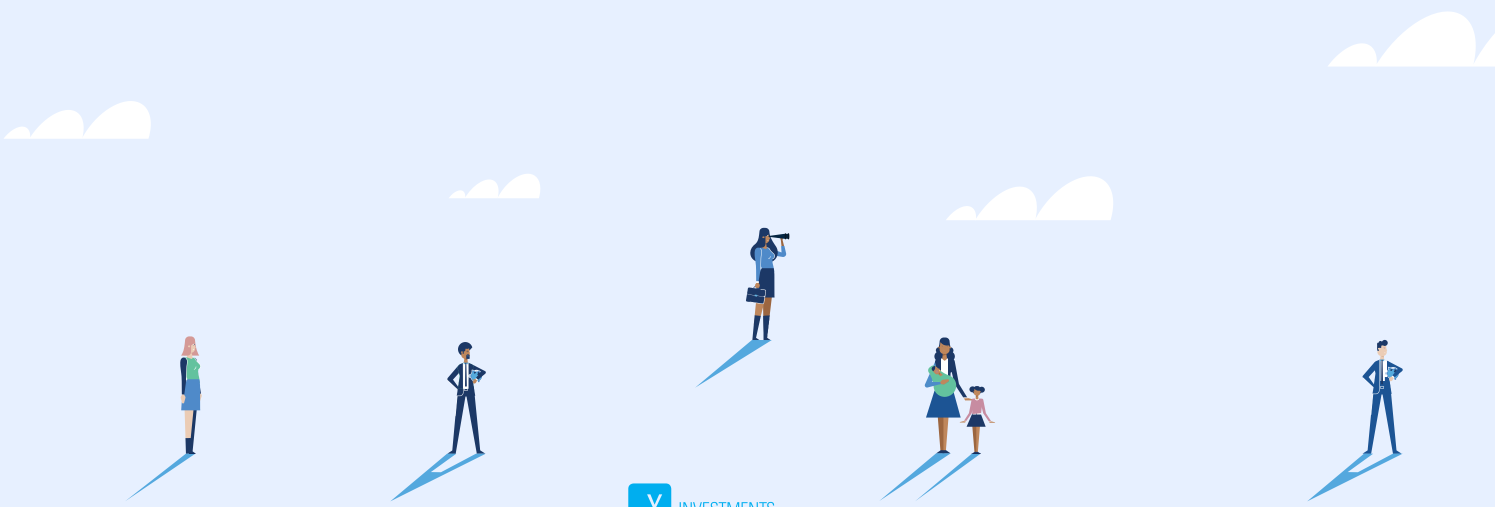
Assuming a long-term nominal return of 12.5% per annum, Table 3 illustrates the impact of the fee differential over a savings life.

Table 3: Impact of fees over a lifetime

	Today	10	20	30	40
1% Fee	100,000	293,682	862,491	2,532,979	7,438,899
3% Fee	100,000	239,465	573,436	1,373,181	3,288,291

Source: 10X Investments

The key takeaway for long-term investors is that fees are almost as important a driver of your long-term portfolio return as the asset allocation.



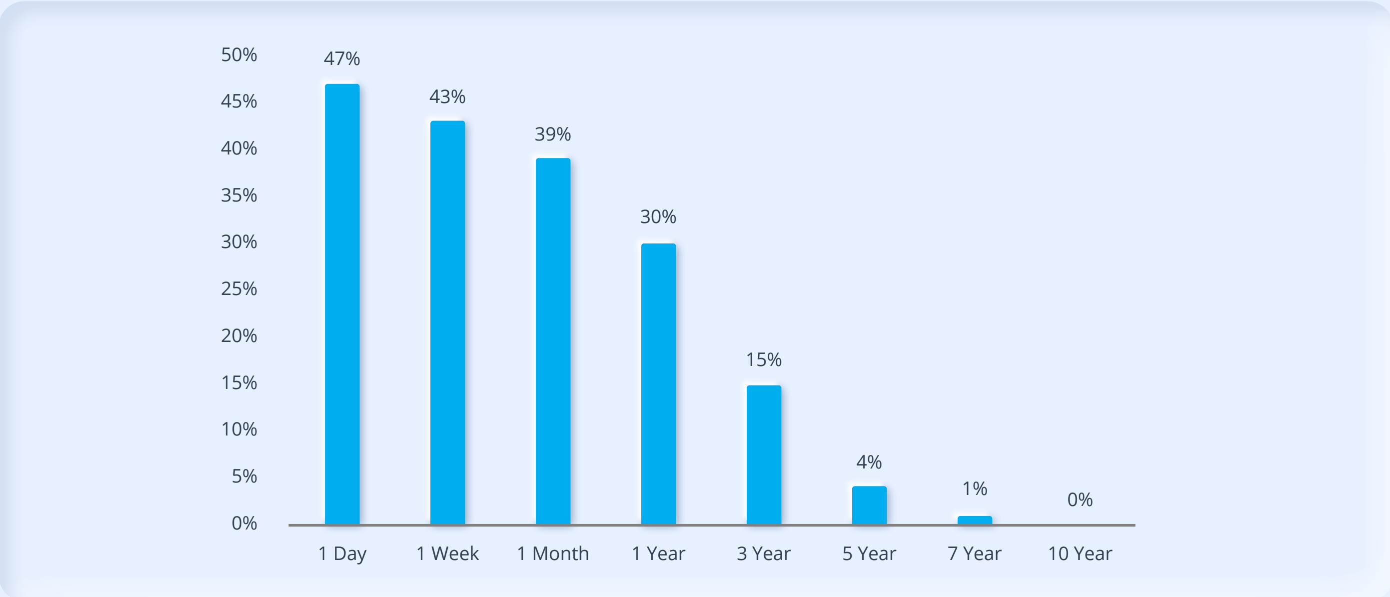
4) **No one can time the markets**, so rather match your asset mix to your time horizon

Investors are often tempted to try to pre-empt market moves, or to respond to market events with knee-jerk reactions in order to avoid portfolio losses. The reality is that even if the market falls sharply it should not matter to investors, financially at least (it will always hurt emotionally, even if you know it doesn't matter financially).

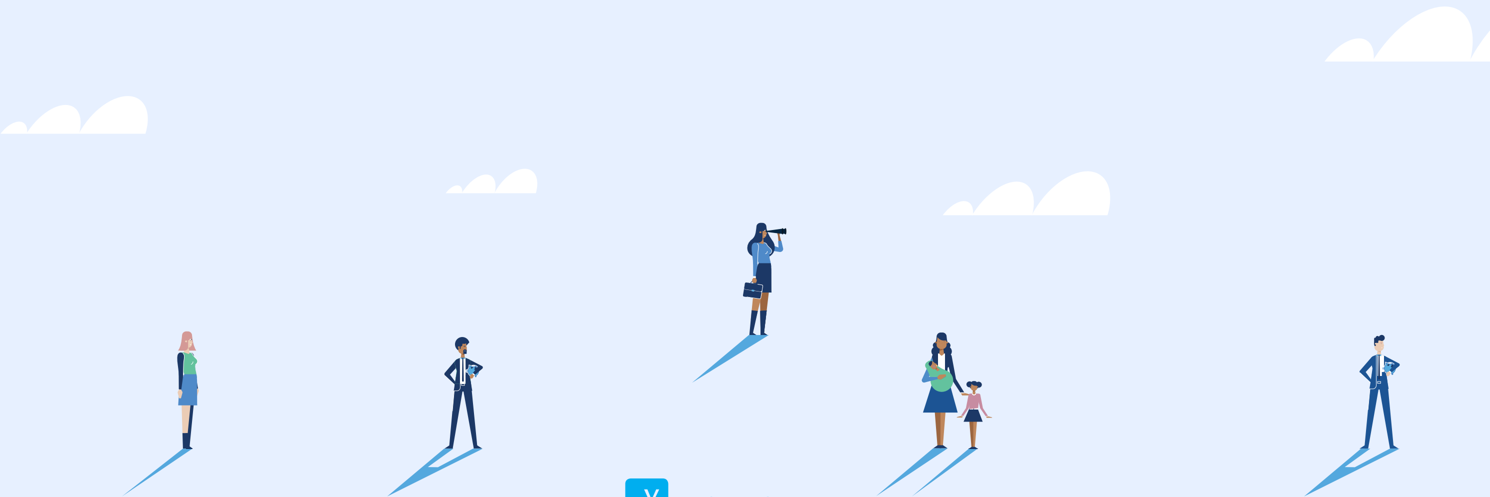
That's because as a short-term investor you should be carrying very little market risk, and as a long-term investor you have time on your side to ride out what happens over the next year or two.

So, rather than speculating on what the markets will do next, focus on maintaining the right asset mix for your time horizon. If you have 5 years or longer to go, you can afford to have a high weighting in shares. As your time horizon increases, the probability of negative returns in SA shares decreases. But, if you have a short time horizon, your focus should be on preserving your pot with a lower weighting in shares. This will ensure that short-term volatility does not take a big chunk of your savings when you have little time to recover.

Figure 8: Probability of negative returns over different time periods – SA



Source: 10X Investments; Datastream; Dimson, Marsh and Staunton. 1 day to 1 month, 1973-2020; 1 year to 10 years, 1900-2020



5) Over all time periods index-trackers beat active managers

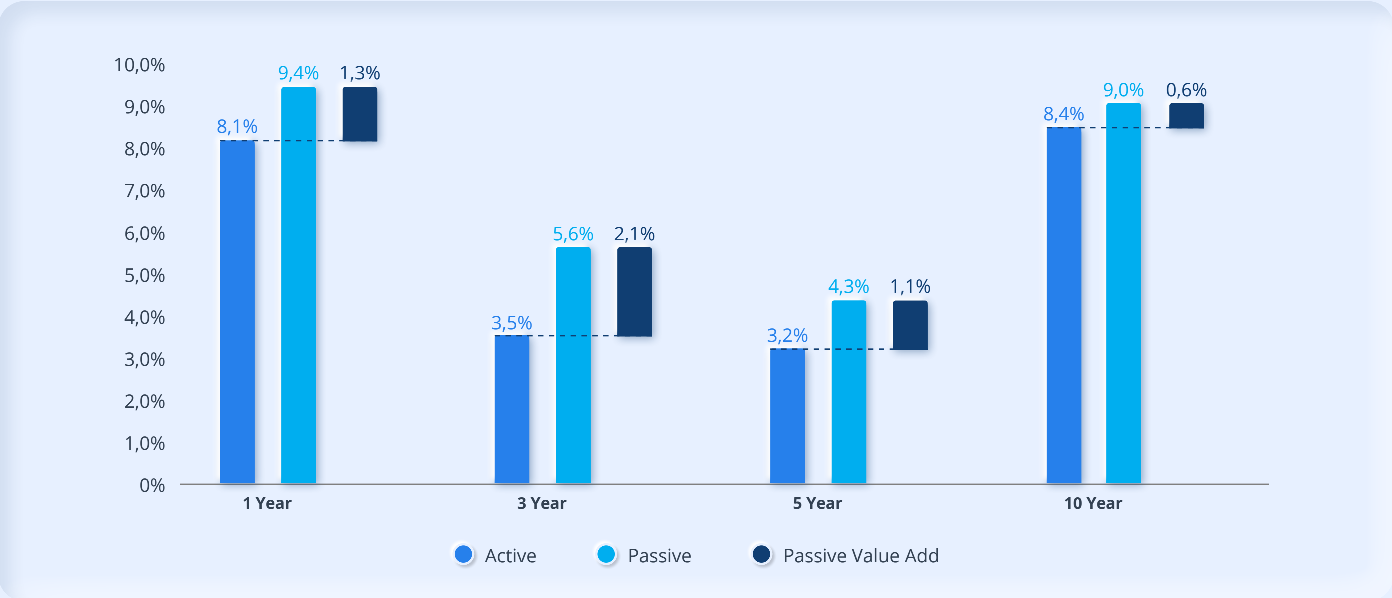
On the subject of active management (using stock picking to try to beat the index return) versus indexing (replicating the index return), the evidence is clear: indexing is the optimal approach. Per the latest research from Morningstar into the performance of active and passive equity funds in South Africa, passive funds outperformed active funds over all time periods. The differences ranged between 0.6% and 2.1% p.a. This superior performance by passive funds is significant. Compounded over many years, it can improve long-term savings outcomes by 30%-40%.

Inevitably, some active funds outperform passive funds. No one disputes this, but the probability of owning one of those funds is low.

If you were lucky enough to pick the 1 in 4 (or 5) active funds that have beaten the benchmark in recent times, chances are that your fund will not outperform in future. This lack of persistent performance is a major failing of the active management industry. Research by S&P Dow Jones Indices looked at persistence among active managers in the US. Of 556 funds that made up the top quartile of funds in June 2016, only 9 were still in the top quartile 4 years later.

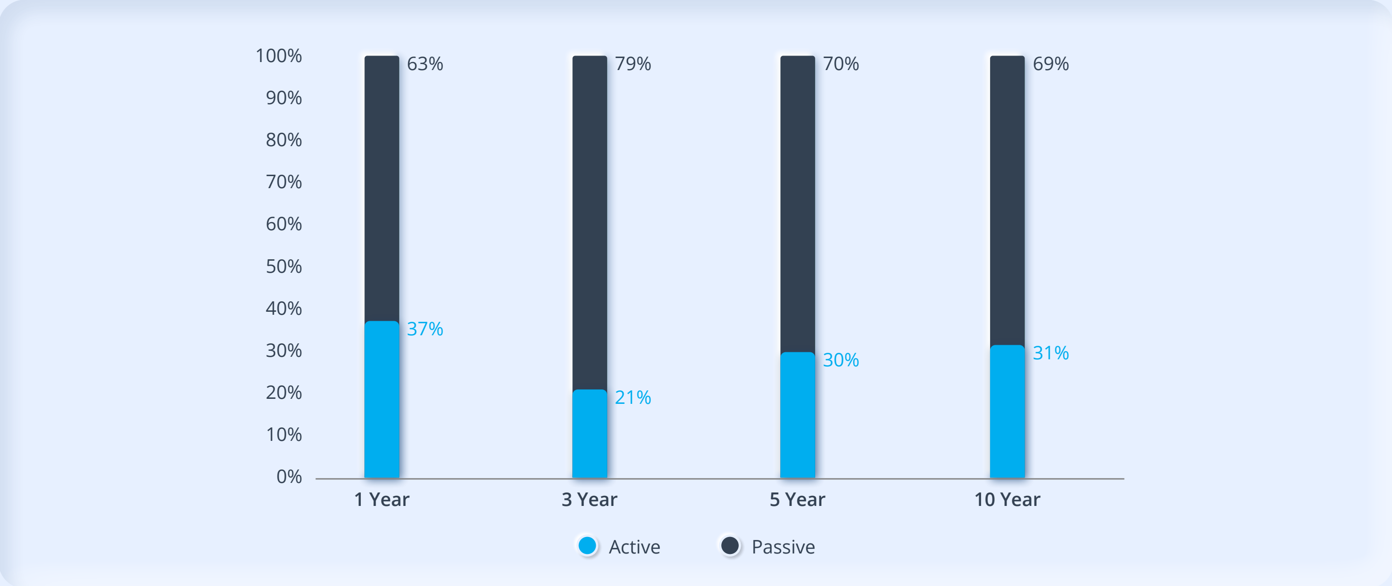
So, yes, your active manager might beat a passive fund but, with such low odds over the log-run, it is not worth the gamble. The data shows that investing via a passive fund is anything but settling for average.

Figure 9: Investment performance p.a. of South African equity funds



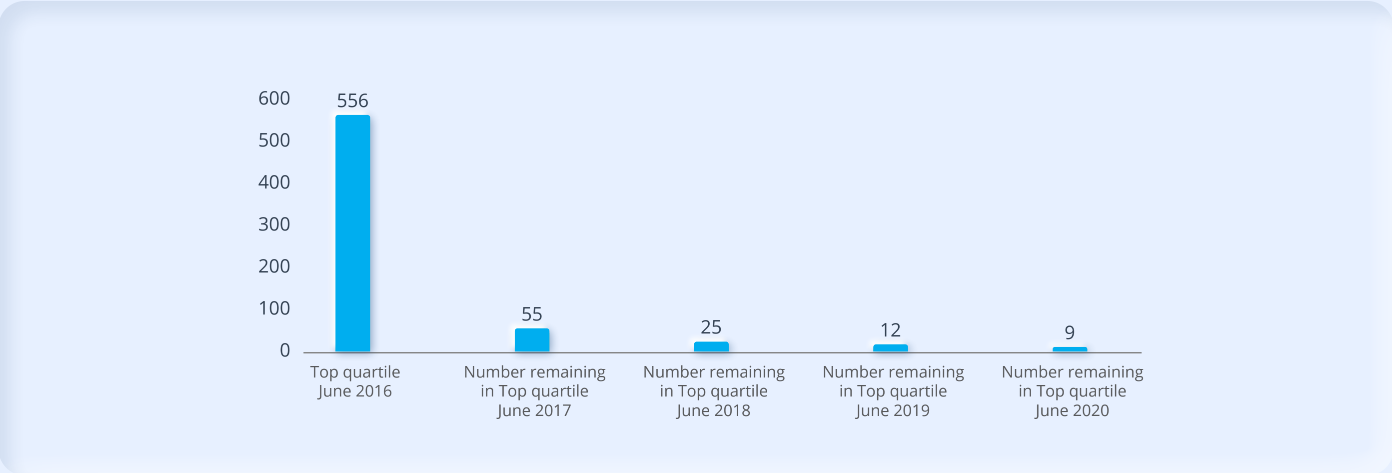
Source: Morningstar Active Passive Barometer Year-end 2019

Figure 10: % of active funds that beat passive

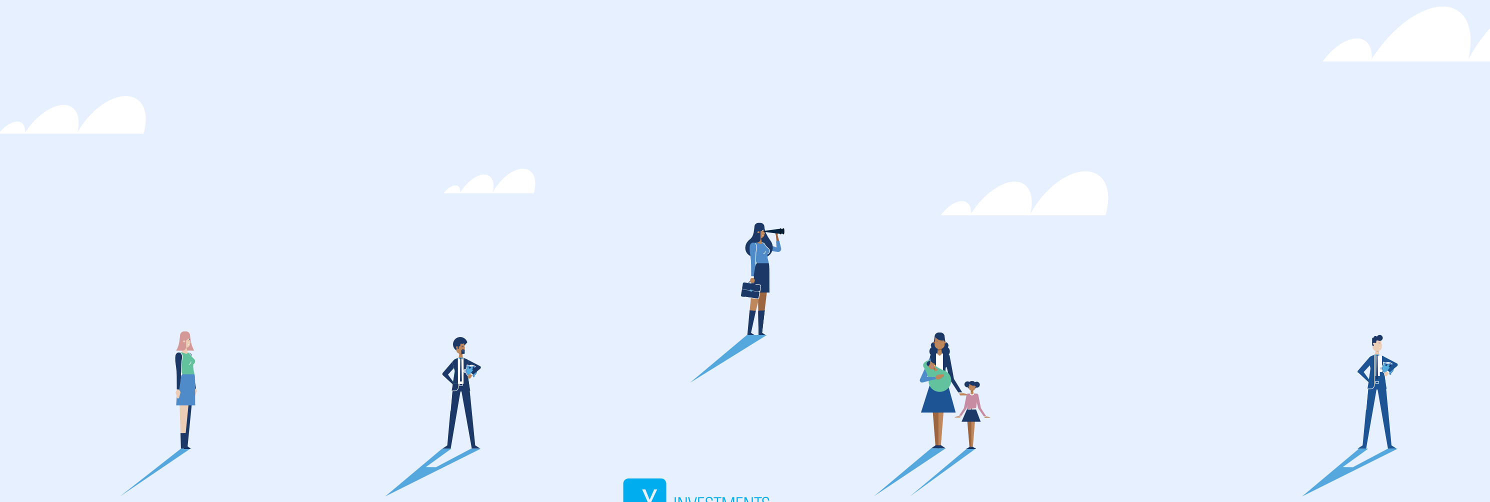


Source: Morningstar Active Passive Barometer Year-end 2019

Figure 11: Fund performance persistence



Source: S&P Dow Jones Indices Persistence Scorecard June 2020



PART 4

10X Asset Class Performance

Table 4: 10X Asset Class Performance at 31 December 2020

10X Asset Class Performance	2020	2019	2018	3 Years	5 Years	7 Years	10 Years
SA Equity	4.0%	10.2%	-8.0%	1.8%	4.9%	5.7%	9.2%
SA Bonds	9.2%	10.2%	7.6%	9.0%	10.5%	8.3%	8.3%
SA Inflation-linked Bonds	5.1%	2.4%	0.0%	2.5%	3.2%	4.3%	6.2%
SA Property	-36.9%	1.2%	-26.2%	-22.2%	-9.1%	-1.6%	6.0%
SA Cash	4.8%	6.9%	7.0%	6.2%	6.6%	6.4%	6.0%
International Developed Markets	21.3%	24.9%	5.2%	16.8%	10.8%	14.5%	18.9%
International Emerging Markets	23.1%	16.0%	-0.6%	12.4%	11.6%	11.3%	12.2%
International Developed Property	-3.7%	19.4%	10.6%	8.3%	3.4%	10.7%	15.1%
International Cash	4.6%	-2.7%	16.2%	5.8%	-1.1%	4.9%	8.3%
Inflation	**3.1%**	**4.0%**	**4.5%**	**3.9%**	**4.6%**	**4.7%**	**5.1%**

Source: 10X Investments, StatsSA

The tepid 2020 returns for **SA Equity (4%)** don't tell the story of the tempestuous year we had.

For the local market to finish the year with inflation-beating returns, after losses of more than 33% at the height of pandemic uncertainty in March, was a much better outcome than most would have expected.

Despite this speedy recovery, 2020 increased the frustration of South African equity investors, who have seen the local market track sideways for seven years now, with an annualised return of just 1% above inflation, well below the long-term mean.

The Industrial sector, which is dominated by locally listed rand hedge shares, held up best during the March sell-off, as the rand depreciated by 21% over this period. It was also the first to recover, breaking even for the year by mid-April. Despite the rand strengthening into the second half of the year this sector continued its positive trend, to end the year up 14%.

The Resource sector was hard hit by various effects of the initial lockdowns – from forced production stoppages to reduced demand for raw materials – as the global economy slowed. However, as the scale of the global monetary and fiscal stimulus became evident, and combined with positive implications for future economic growth (both of which caused the dollar to weaken), commodity prices rallied. This revived the sector which, after being down more than 42% at one point, finished the year up 21%.

The locally-focused Financials sector sold off the most, by 48%, in March. The underlying stocks – banks, insurers and property companies – bore the brunt of the economic lockdown. They were most exposed to struggling businesses and people losing their jobs and thus unable to service their debts, or pay their rents and premiums. While the sector recovered somewhat, concerns persisted and the sector ended the year down 20%.

The divergent performance of the different SA Equity sectors once again underlines that the composition of the SA equity market does not mirror the SA economy.

Covid-19 induced lockdowns, coupled with a supply overhang, severely impacted **SA Property (-36.9%)**. The lockdown saw a decrease in traditional retail spending, which hurt retail landlords.

The shift to work-from-home, coupled with failed businesses and an oversupply of office space has seen office vacancies increase. The increased vacancies and negative rental reversions caused some counters to not declare distributions and risk their REIT status, to shore up weak balance sheets. The sector is now negative over seven years with the 10-year return only in line with SA cash.

Moody's finally downgraded rand-denominated South African Government debt to sub-investment grade in March. SA Government Bonds were thus excluded from the World Government Bond Index in April. This was anticipated by investors, so SA bond yields had already peaked prior to the downgrade. But as global liquidity eased, local rates eased and returned to levels not far from where they started the year.

Despite another round of downgrades in November **SA Bonds (9.2%)** delivered a very strong return, albeit driven mainly by the high running yield rather than bond price appreciation. The high yield is a measure of the risk perception around South Africa's financial position, in terms of our rising debt-to GDP ratio and the increasing share of interest payments in our expenditure budget.

Inflation (3.1%) has continued its downward trajectory in the face of weak consumer demand and low energy prices. This has seen **SA Inflation-linked Government Bonds (5.1%)** deliver a lower return than nominal bonds. Inflation-linked bonds perform well in an environment of rising inflation and, conversely, deliver relatively softer returns in environments of falling inflation. This is because the amount of interest paid by these bonds is linked to the CPI index.

SA Cash (4.8%) returns have moderated somewhat over the last year, compared with preceding years. Falling inflation provided room for the SARB to cut interest rates aggressively when the lockdowns were instituted. The five interest rate cuts in 2020 totalled 3% and pushed the Repo Rate (the rate at which the government lends money to our commercial banks) to its lowest level in 50 years.

International Developed Market Equity (21.3%) suffered the same roller-coaster ride as the local market but eventually reached record levels (in the US at least, which makes up the bulk of this class). Despite the sharp economic contraction, investors "re-rated" markets on two grounds: discounting near-zero interest rates for longer, and on expectations that the massive government relief measures would support higher earnings in future, despite current earnings being muted.

International Emerging Markets (23.1%) also delivered a strong return for the year. China, which was the first in and first out of the initial lockdown, handled the pandemic better than most western countries and returned more than 35%. It now makes up nearly 50% of the Emerging Markets index, masking the poorer performance of some other emerging markets. As elsewhere, the strong performance was based on re-rating expectations rather than current earnings.

International Cash (4.6%) returns are driven primarily by exchange rate fluctuations as interest rates in developed countries are close to zero. Over the long-term, the return reflects inflation differentials between South Africa and the US. The relatively benign return masks the volatility through the year with the Rand depreciating from under 14/$ to over 19/$ and then back down to below 15/$. This underlines how our currency can be pushed to extremes during periods of market stress, and that most short-term swings are unrelated to local developments.

10X Portfolio Performance

Table 5: 10X Portfolio Performance at 31 December 2020

Investment Class	2020	2019	2018	3 Years	5 Years	7 Years	10 Years
10X High Equity	6.1%	11.2%	-2.9%	4.6%	5.8%	7.3%	10.2%
10X Medium Equity	3.2%	8.9%	-2.2%	3.2%	4.8%	6.5%	9.1%
10X Low Equity	4.3%	7.5%	2.7%	4.8%	5.6%	6.7%	8.0%
10X Defensive	3.5%	6.6%	5.2%	5.1%	5.8%	6.5%	7.3%
SA Inflation (CPI)	3.1%	4.0%	4.5%	3.9%	4.6%	4.8%	5.1%

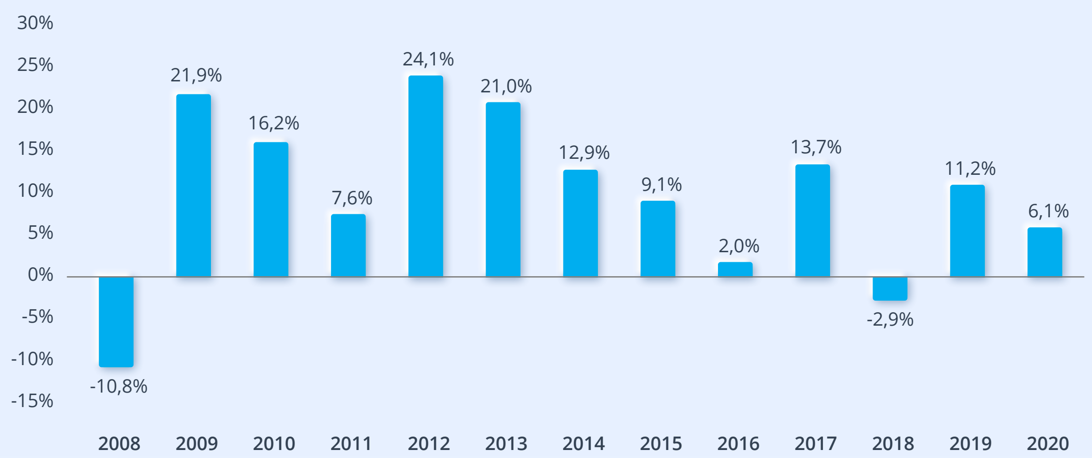
Source: 10X Investments, StatsSA

Each 10X portfolio blends the returns of the various asset classes in proportion to its asset allocation.

The strong offshore equity returns were offset by deeply negative SA Property returns. Coupled with inflation-matching SA Equity returns, all portfolios delivered returns within a relatively tight range, from 10X Medium Equity at 3.2% to 10X High Equity at 6.1%. Inflation ended the year at 3.1%, which means that all portfolios delivered positive real returns in 2020. When looking out over 3 and 5 years, we see a similar picture to 2020, with all portfolios clustering in a narrow range of returns.

Whilst the journey has been comfortable in the Defensive Portfolio, the 3- and 5-year numbers mask a volatile ride in the High Equity Portfolio, as is evident from the annual return chart below.

Figure 12: 10X High Equity annual performance



Source: 10X Investments

Despite the inflation-like average return over the last 5 years, all 10X portfolios are still delivering solid real returns over the longer term, with High Equity beating inflation by 5.1% over 10 years

10X Performance relative to competitors

How do our portfolios measure up against the competition in the South African retirement fund industry? To find out, we regularly compare the performance of the 10X High Equity portfolio (held by more than 85% of 10X fund members) against the median return delivered by the large retirement fund managers, as published monthly in the Alexander Forbes Global Manager Watch Best Investment View Survey.

10X's goal is to beat the median fund manager's return over time, net of fees. To quantify the impact of our lower fees, we reduce the median fund manager return by 1% pa. This is a reasonable (and conservative) estimate, especially for small- and medium-sized funds, many of which pay total fees well above 2% pa (versus the average 10X fee of well less than 1% pa).

The table below shows that the 10X High Equity Fund has beaten the median manager by 1.6% since inception after adjusting for our lower fees. The last 12 months has seen the High Equity portfolio delivering outperformance of 2.1%. Over ten years, the 10X High Equity portfolio has outperformed the median return by an estimated 1.5% pa, net of fees.

The power of compounding this seemingly small advantage can, over an average working life of 40 years, deliver up to 60% more money at retirement, and up to 150% more by the end of an investment lifetime (factoring in the post-retirement investment period).

Table 6: 10X High Equity vs the average Large Manager
Returns for the period ending 31 December 2020

31 Dec 2020	10X High Equity (before fees)	Global Manager Watch median	Global Manager Watch median (after fees)*	10X excess
1 Years	6.1%	5.1%	4.1%	2.1%
3 Years	4.6%	4.8%	3.8%	0.9%
5 Years	5.8%	5.9%	4.9%	1.0%
7 Years	7.3%	7.0%	6.0%	1.3%
10 Years	10.2%	9.8%	8.7%	1.5%
Since inception (Dec '07)	9.7%	9.2%	8.1%	1.6%

Source: Alexander Forbes Global Manager Watch, Best Investment View; 10X Investments
*assumes that 10X provides a 1% fee saving vs the average large manager

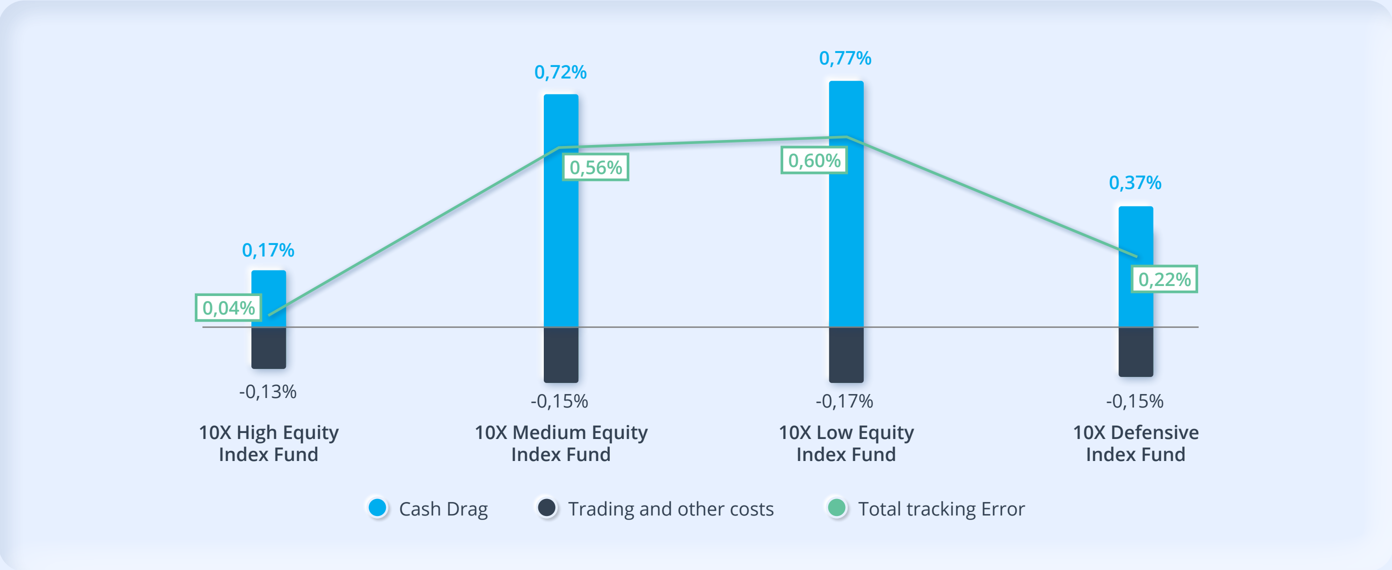
10X Portfolio Tracking Error

10X's indexed investment strategy aims to deliver the investment type (asset class) performance at low cost. We monitor our investment performance by comparing the 10X portfolio return to the benchmark return (i.e. the asset class return multiplied by its weighting in the portfolio over the period). This difference in performance is called the tracking error. It is our goal to keep the tracking error – positive or negative – as low as possible.

The tracking error has two main sources. Firstly, it relates to trading costs (brokerage), securities tax when buying shares (0.25%), the cost of investing internationally as well as money market and ancillary, trading-related expenses. Secondly, it reflects the time delay in receiving funds (contributions and dividends) and re-investing these funds. This is called the cash drag and represents the opportunity cost of not being fully invested in an asset class (e.g. equity markets). Cash drag can be positive (i.e. improve the return) or negative (reduce the return).

In the graph below, we have broken the tracking error down into trading costs (navy columns) and cash drag (blue columns). The green line shows the net tracking error (trading costs and cash drag combined).

Figure 13: 10X portfolio tracking error



Source: 10X Investments

Volatile markets, like 2020, increase the risk of greater cash drag, which was positive in 2020 across all the portfolios ranging from 0.17% for the 10X High Equity portfolio to 0.77% for the 10X Low Equity portfolio.

The 10X portfolios' trading costs and other costs for the year ranged from 0.17% for 10X Medium Equity and 10X Low Equity to 0.13% for 10X High Equity. Our trading costs are typically much lower than that of active funds as indexing is largely a buy and hold strategy.

The higher costs in the lower equity portfolios reflect the higher weighting of money market portfolios, compared with higher equity portfolios. As the portfolios become larger the scale tends to reduce trading costs even more. The net tracking error ranged between 0.04% for 10X High Equity to 0.60% for 10X Low Equity.

The returns published by 10X in this review (as well as on the fact sheet and in your benefit statement) are net of this tracking error.

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10X INVESTMENTS

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