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Northstar Asset Management
Market Report: Q4 2017

For the final edition of 2017 we compare small to mid-cap companies against their large counterparts. Rory looks at Marriott International's highly effective capital light model, Andrew highlights value in Life Healthcare, Mark talks bond market pricing and John Steenhuisen shares his views on the ANC December dilemma.

THE BIG PICTURE

SMALL and MID-CAPS VERSUS LARGE-CAPS

By Adrian Clayton (CEO)

Big picture thinking

Identifying mispricing in markets

Stock markets intermittently provide investors with an opportunity to capitalise on mispricing. Mispricing occurs where a business or an industry group is either being overvalued or undervalued by the market. 'Mispricing' is complex and to suggest its existence, requires unfettered confidence in an investment case, with the assumption that all other collective minds within the market are wrong! This level of confidence needs to be heavily endorsed with a body of research to place the odds in favour of being right.

Where is mispricing evident on the JSE?

With this in mind, we dedicate this quarter's big picture thinking to the current disparity of performance and valuation between large companies (large-caps) on the JSE versus smaller companies (mid and small-caps). We try and understand why small and mid-cap companies are so lowly priced compared to larger stocks, and we assess the conditions that are required for this to change. Most importantly, we initiate this discussion with the reasons why it is even worth focusing on this potential opportunity.

Why apply attention to mid and small-cap companies on the JSE?

The attached graph (Figure 1) demonstrates clearly why we, as investors, should take small and mid-cap investing seriously, these indices have enjoyed significant outperformance against large-caps on the JSE.

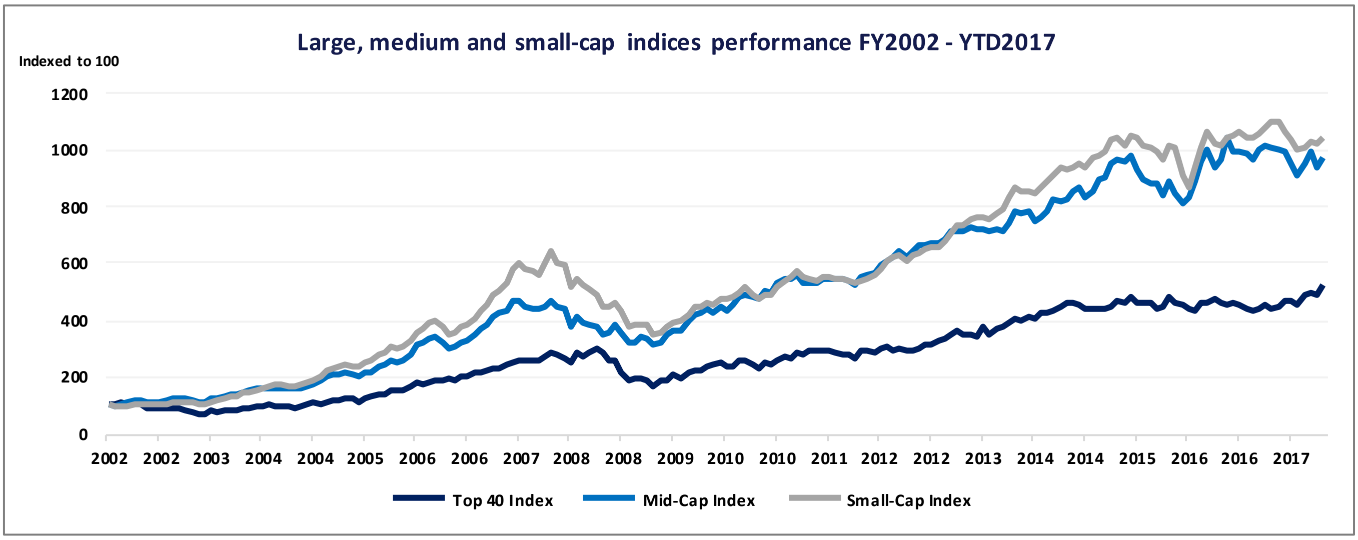

Figure 1. Large, small and mid-cap indices. Source. Bloomberg, Northstar

2002-2017	Cumulative returns	Annualised returns
Small-cap index	1042%	17%
Mid-cap index	969%	16%
Large-cap index	524%	12%

Table 1. Large, small and mid-cap indices total and annualised returns. Source. Bloomberg, Northstar

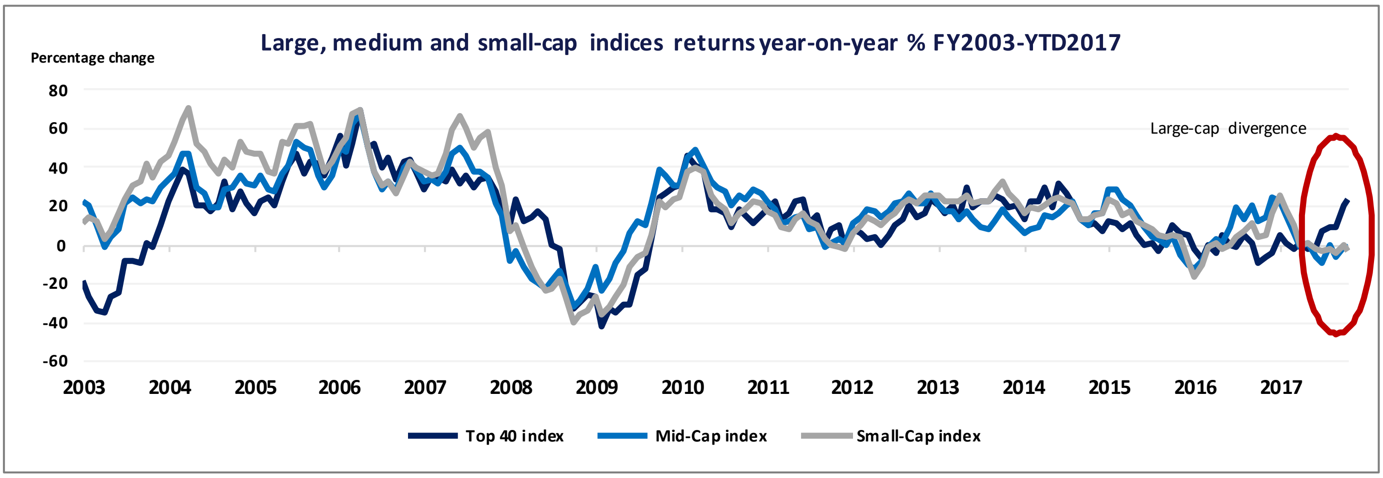

Figure 2. Large, small and mid-cap indices year on year returns. Source. Bloomberg, Northstar

Current performance of small, mid and large-caps

Contrast the above long-term outperformance of small and mid-cap companies against the performances of these indices over the past year and at face value, a real opportunity might be presenting itself in our market. We show in the graph above (Figure 2) the significant outperformance of the large-cap index against the other indices over the past twelve months.

Assessing the annual returns from the three indices in a more detailed fashion (see the table below), we notice the following:

- Mid-caps have led the overall performance race with 8 of the 16 years; small-caps with 5 and large-caps carry the wooden spoon with 3 years.

To a large extent the underperformance of small-caps against mid and large-caps over the last couple of years is ascribable to their levels of profitability disappointing investors. Conversely, large companies have produced stellar earnings with investor interest moving squarely to where profit momentum was more certain.

In 2016, the small-cap index generated returns on equity (ROE) of 4% versus 13% for the Top 40 index, for 2017 small-caps are projected to deliver 7% ROE versus 13% for the Top 40 index. These metrics steadily improve for small companies in 2018 and market consensus for earnings (profitability) growth from small-caps in 2018 is 22%, for mid-caps 28% and large-caps 9%.

In addition, as is evident in the graph over the page, small company EV/EBITDA valuations on a forward looking basis

Calendar year percentage returns (dark blue: large-cap index; light blue: mid-cap index; grey: small-cap index)

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	YTD
23.4%	42.4%	47.8%	44.1%	39.5%	29.8%	-22.2%	30.3%	25.8%	0.6%	25.2%	21.8%	16.0%	4.2%	23.4%	22.2%
9.2%	28.4%	30.8%	41.9%	38.3%	16.1%	-25.9%	28.6%	20.9%	-0.6%	24.4%	19.2%	15.8%	-8.0%	15.9%	-4.1%
-13.4%	9.4%	20.1%	35.0%	37.5%	14.0%	-34.3%	22.8%	14.6%	-2.3%	22.2%	9.4%	6.0%	-10.1%	-4.1%	-4.8%

Table 2. Large, small and mid-cap indices annual percentage returns. Source. Bloomberg, Northstar

- On 3 occasions an index has delivered 2 or more consecutive years of outperformance.
- In both historical instances that large-caps were top (2005 and 2015), their fortunes immediately reversed in the following the year to bottom.
- Figure 1 and the Table 2 both show that the relative outperformance of large-caps against mid and small-caps in 2017 has been the greatest in the last 16 years.

Small and mid-cap share valuations relative to large-capitalised stocks?

Is there mispricing against underlying company value? Are small companies worth more than they are being priced at? Are they being undervalued by the market relative to large companies?

are now at a significant discount to their long-term average against large stocks on the JSE.

When do smaller companies outperform larger companies on the JSE?

In Finance 101 we are taught that small businesses can outperform in poor economic growth cycles as they do not require the market pie to be growing, they can grow at the expense of large businesses during tough times as they steal market share. In contrast, when companies are very large, they require strong economic growth as they are proxies for the economy and plod along at the same rate as nominal GDP.

In reality however, our findings for South African listed small and mid-caps are the converse of Finance 101 in terms

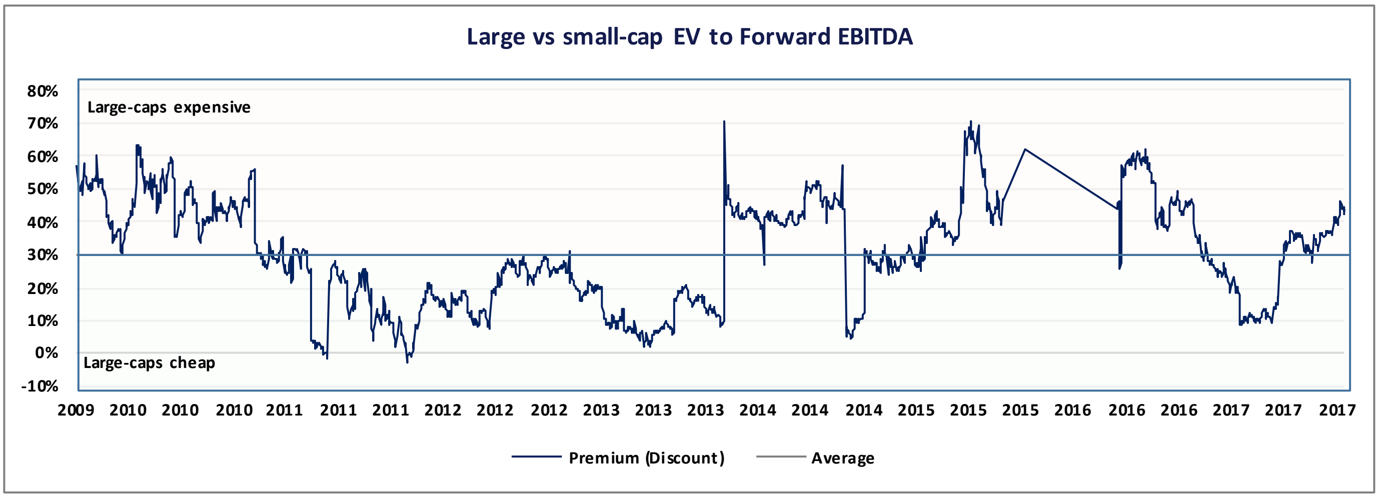

Figure 3. Large versus small-cap EV to forward EBITDA Source. Bloomberg, Northstar

of outperforming conditions. We note three conditions when smaller JSE listed companies prove underperformers relative to their larger listed counterparts:

1. South African economic growth is stalling
2. the rand is weakening, and
3. when interest rates rise.

We believe that small companies struggle during poor economic conditions because:

- They tend to be more operationally and financially geared and when growth diminishes, their profitability is severely impacted.
- When the cost of funding (higher interest rates) rises, their business models can be heavily impacted.

The graph below (Figure 4) shows the clear relationship between the performance of small-caps and GDP cycles. We include an extrapolation of the potential performance of these companies in 2018 and 2019 based on expected improvements in SA GDP growth off the current low base.

Which types of companies interest us in the small and mid-cap indices?

We only invest in companies that are Quality at a Reasonable Price (QARP), and will only show further deep interest in a business that meets very specific financial metrics.

For the sake of brevity we will not elaborate on the details of the financial metrics we screen for, suffice to say that sustainable returns on invested capital and the delivery of cash flow, that backs earnings, are central to our investment thesis. We define a business as ‘quality’ when it is managed by competent management teams, operates within an industry with functional industry dynamics (we avoid industries with dysfunctional industry dynamics such as hyper competition, heavy supplier power etc.) and where the

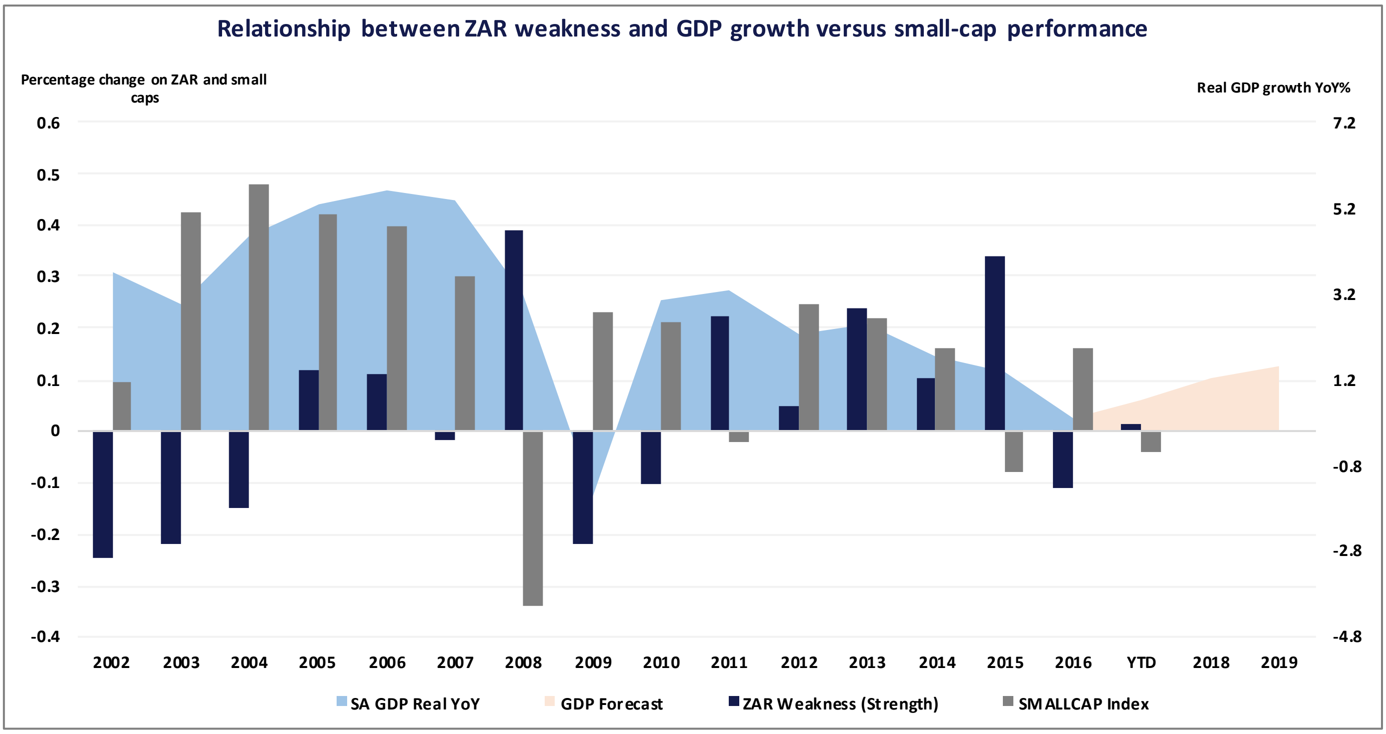

Figure 4. Small –cap relationships. Source. Bloomberg, Northstar

business has an economic moat – this can be a license, a low cost advantage or even a network effect.

Businesses that tick many of these boxes within the mid-cap index include AECI, the JSE, Life Healthcare and Super Group. Quality small-caps are Brimstone, Wilson Bayly Holmes and Advtech.

The investment case:

So our investment case rests on the 5 pillars above.

1. Small and mid-cap companies outperform large companies over time.
2. In the past few years this has not been the case - we view this as a break in a trend and not the end of a trend.
3. Large companies look overvalued relative to many high quality smaller companies.
4. A positive change in GDP growth will have a profound effect on the fortunes of smaller businesses.
5. Only invest in high quality businesses, avoiding twin operational and financial gearing.

We conclude by saying that we cannot predict when local conditions will improve to refloat the boat of smaller and mid-tier market capitalized companies on the JSE. What we can say is that when those conditions do improve, a sizable rerating opportunity exists for quality smaller listed businesses.

FROM THE ANALYSTS: EQUITIES

MARRIOTT INTERNATIONAL

By Rory Spangenberg (Offshore Portfolio Manager)

Marriott International – a capital light, compounder

Following its merger with Starwood in 2016, Marriott International now operates the largest hospitality system in the world with over 1.2 million rooms across 30 brands in 122 countries.

The company has a further 420,000 rooms in development, and benefits from a membership base of over 100 million unique and frequent guests across its three loyalty programs: *Marriott Rewards*, *The Ritz-Carlton Rewards* and *Starwood Preferred Guest*.

The scale and breadth of Marriott's operations ensures that it is able to compete effectively with the threats posed to traditional hotel companies by alternative lodging providers such as Airbnb and the disintermediation by Online Travel Agents (OTA's) such as Bookings.com.

While these are in themselves fundamentally attractive qualities, the key attraction for us, which led to our investment in Marriott 18 months ago, was the shift the business was making from a traditional hotel owner-operator to a capital light, manager and franchisor of hotels.

By steadily reducing the revenue contribution from hotel properties it either owns or leases [1], Marriott has been able to meaningfully reduce the capital intensity of its growth. The company's broad portfolio of brands, across the affordability spectrum, has proved attractive to both property owners and franchisees, who benefit from Marriott's management expertise, the strength of its brands and access to its large loyalty program base.

[1] Company guidance suggests the contribution from owned or leased properties will decline to 16% by 2019, from 48% in 2008 and 29% in 2016.

The capital light model

Generally speaking, capital light businesses share the common characteristics of negative working capital and low fixed assets. Similar to the float income earned by insurance companies, negative working capital implies a scenario where current liabilities exceed current assets, usually a result of cash generated prior to bills falling due.

In the majority of cases, their strategic competitive advantage stems from an intangible asset of some sort, either a strong brand, patent or licence.

"The best business is a royalty on the growth of others - requiring little capital itself." Warren Buffett, Berkshire Hathaway annual report, 1978

By partnering with landlords and franchisees, Marriott's revenue line has come to be dominated by the management fee and royalty income it earns from properties it is contracted to manage or where the property is managed under a franchise agreement by a third party.

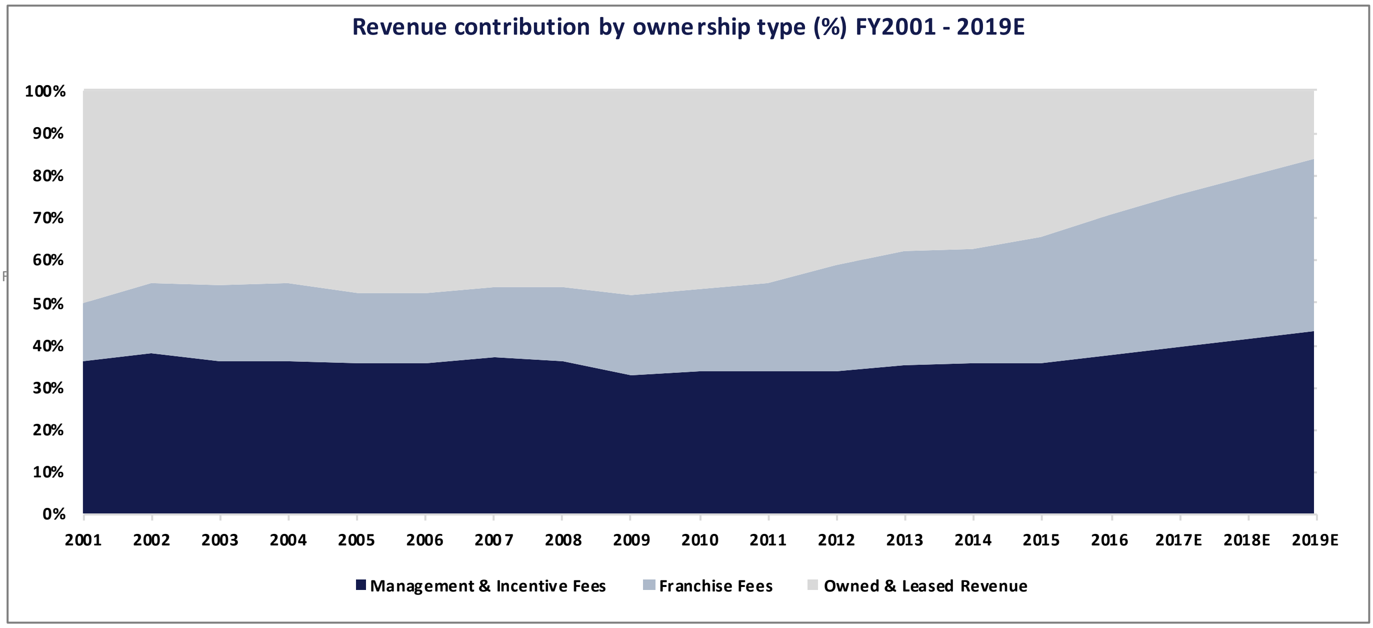

Figure 5. Company annual reports Source. Bloomberg, Northstar

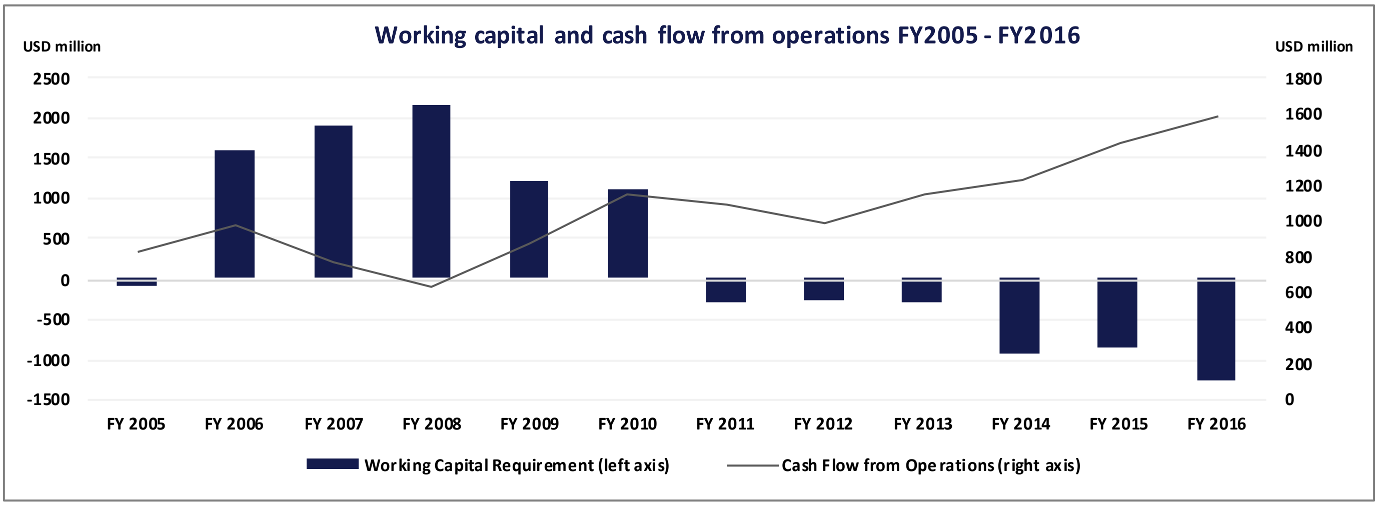

Figure 6. Working capital and cash flow from operations. Source. Bloomberg, Northstar

The cost and margin structure of this fee income is therefore markedly different to the traditional operator model, as is the inherent operating leverage and cyclicality in the business.

A step-change in the working capital required to run Marriott's operations has led to strong growth in the cash flow generated by the business. This is equally the case if we look at free cash flow, which takes into account the capital expenditures required to maintain or grow the operating base. In Marriott's case, the capital expenditure on new hotels or expanded capacity, as well as maintenance expenditure are the responsibility of the landlord or franchisee, resulting in more free cash flow available to shareholders.

Free Cash Flow and total shareholder yield

An added benefit to the positive cash flow dynamics arising from the adoption of a capital light model has been the strategy of disposing of owned properties. In the majority of cases Marriott has been able to secure a long-term management contract on hotel properties disposed of whilst returning the capital raised from these sales to shareholders primarily through share buybacks. Between January 2009 and September 2017, the company returned \$11.6 billion to shareholders – 119% of its market capitalisation at the end of 2008. Following the \$13 billion acquisition of Starwood in 2016, Marriott's total shareholder yield of 6.9% in the 9 months to September is once again approaching the 7.5% averaged prior to the acquisition. Since Starwood had a greater skew towards ownership, the acquisition has provided further impetus to the capital light approach, with disposals of physical properties freeing up additional capital, which Marriott is able to put towards shrinking its share count.

Shareholders have been well rewarded

With the adoption of this strategy Marriott's share price gained 95% since June 2016 (versus the S&P 500 return of 29.9%). While the share now trades at the top end of our Bull-Bear valuation range, we are encouraged by the execution of the strategy as well as the opportunities which still exist to extract synergies from the Starwood acquisition. For this reason we continue to hold a stake in Marriott, albeit that our exposure has been greatly reduced.

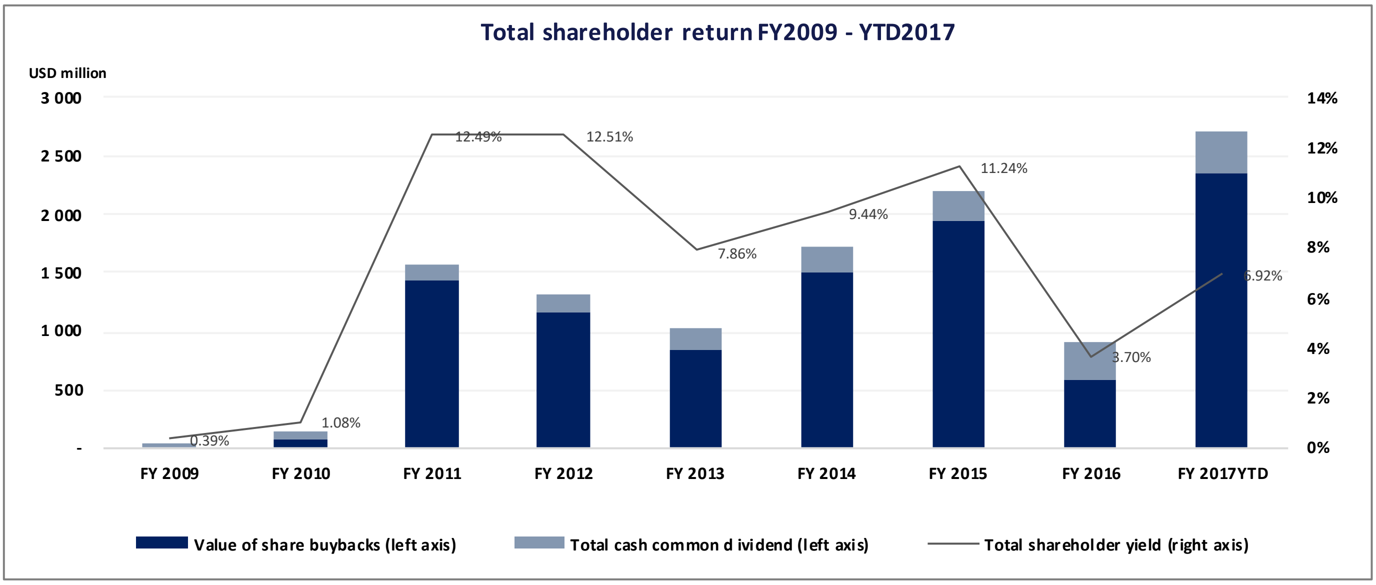

Figure 7. Marriott International total shareholder return. Source. Bloomberg, Northstar

FROM THE ANALYSTS: EQUITIES

LIFE HEALTHCARE

By Andrew Randles (Analyst)

Background

As a current leader in mental healthcare and acute rehabilitation, Life Healthcare was founded in 1983 as the hospital division of African Oxygen Limited with the acquisition of Ammed Group comprising of only four hospitals. The Group now has a market share of approximately 27% of South African's acute hospital beds (*8067 beds*), owning Life Esidemeni, the largest PPP (Public Private Partnership) in South Africa. We view this as a quality investment at a reasonable price and our investment thesis rests on the following pillars.

Regulation for the masses *(pricing)*

As populations age they place increasing pressure on the hospital industry pushing it to innovate and drive efficiencies. Although regulation plays an increasing role in regulating the affordability of healthcare to the population, the need for quality healthcare should continue to place pressure on funding mechanisms to provide access to the best healthcare possible. Life is finite and medical care prices should continue to price accordingly in our opinion. Globally, healthcare as a percentage of GDP is increasing and should continue to do so or stay at the same ratio going forward.

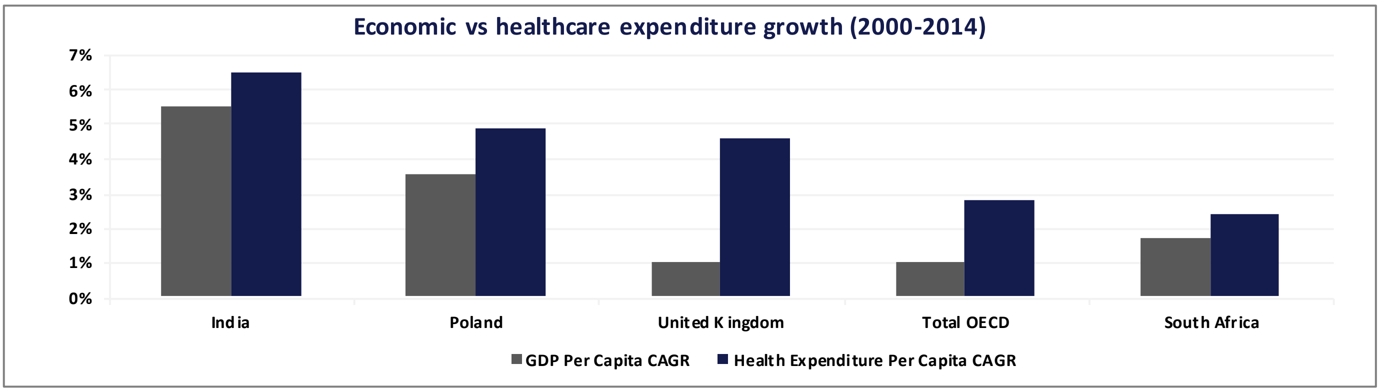

Figure 8. Economic vs healthcare expenditure growth. Source. OECD statistics

Increasing burden on society (volume)

The hospital industry services a vital need in society by providing treatment and care for the ill and elderly. The inherent human need to foster life, coupled with improving technology and diagnosis, leads to healthcare costs growing at a faster rate than most economies. Based on our research, we believe growth rates will at least remain constant as populations increase and age.

South African industry turmoil creates an opportunity

Volume for hospital groups is a function of admissions and the average length of stay for a patient and, recently in South Africa, these have been under pressure (Life Healthcare's share price is down 37% since its peak in

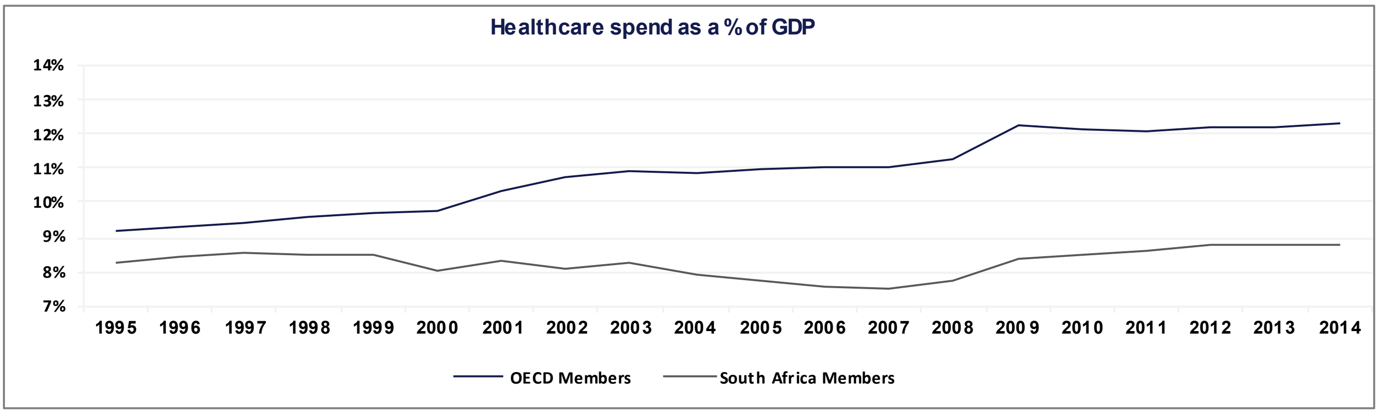

Figure 9. Healthcare spend as % of GDP. Source. World Bank

February 2015) due to Discovery and GEMS (Government Employee Medical Scheme), amongst other medical aids, placing pressure on admissions through active case management, which predominantly includes cutting wasteful admissions out of the system. It is our opinion that the worst of the cuts are over and that the hospital volume base has now been reset. Growth will now re-link to growth in insured lives, which closely correlate. Growth in insured lives links to employment, which is dependent on economic growth.

It is our contention that these factors will inevitably fall into place in time, which will result in a positive re-rating of Life Healthcare's relative market value.

The competitive advantage of Life Healthcare

A hospital group's moat rests, to a large degree, on their built hospital network. Competitors are less likely to build close to already built hospitals due to the exorbitant fixed costs and risks involved. Life Healthcare has a strong share in economic hubs: Gauteng and KwaZulu-Natal as well as dominant shares in the North West and the Eastern Cape, which are yet to reach their economic potential in our opinion.

The South African operations, comprising 81% of profits before interest, taxation, depreciation and amortisation (EBITDA) have the lowest cash costs per bed in comparison to national peers Mediclinic and Netcare.

The Group also has a leading Designated Service Provider (DSP) or 'Preferred Network' status in South Africa. In hard times, this allows patients to trade down their medical aids into medical schemes utilising Life Healthcare hospitals, due to lower costs.

Management - maverick custodians of capital or compulsive spenders?

The Group manages to consistently generate strong net cash flows to run the business and fund capital expenditure to grow the business. The Group's management team has opportunities to either return cash to shareholders or invest in businesses that should generate returns in excess of their cost of capital.

Life Healthcare has invested in emerging markets such as India (*Max Healthcare*) and Poland (*Scanmed*) in stark contrast to their South African peers that have invested in developed markets. Life Healthcare paid R800 million for their initial 26% stake in Max Healthcare, which management now value at just under R3 billion. The annualised return on this investment has been 29% since 2012. Life Healthcare now owns 49.7% of Max Healthcare.

Management's other acquisition in Poland has been a serial underperformer, which has been impaired several times. Poland remains a country with a nascent private healthcare industry exhibiting strong long-term drivers, including: a rapidly aging population, forecast reducing unemployment, lengthy waiting times for public sector services, low spending on healthcare relative to GDP and low medical insurance per capita as compared to Western European peers. This investment decision is being tested and could either prove a maverick investment into a burgeoning market, or a destruction of shareholder capital. Only time will tell.

The Group recently acquired Alliance Medical Group (AMG) for R10.8bn, a multiple of 13 times AMG's earnings before interest, tax, depreciation and amortisation. AMG is a diagnostics imaging and molecular services provider operating in the UK and Europe. This investment is unproven and will be fully incorporated into next year's financials (2018). It shows promise recently winning a 10 year contract to exclusively provide PET-CT scans (growing at a 3 year CAGR of 11.3%) for the NHS (National Health Scheme) in the UK, with pricing capped but unlimited volumes. Volume is expected to grow as the NHS (70% of UK revenues) attempts to meet the European standard of cancer survival of 67%, currently at 50%. These increased volumes should lead to greater utilisation, increased profitability and more valuable economic growth.

It is our view that Life Healthcare management demonstrate more of a long-term, calculated approach to capital allocation in relation to what the market seems to imply by the current share price.

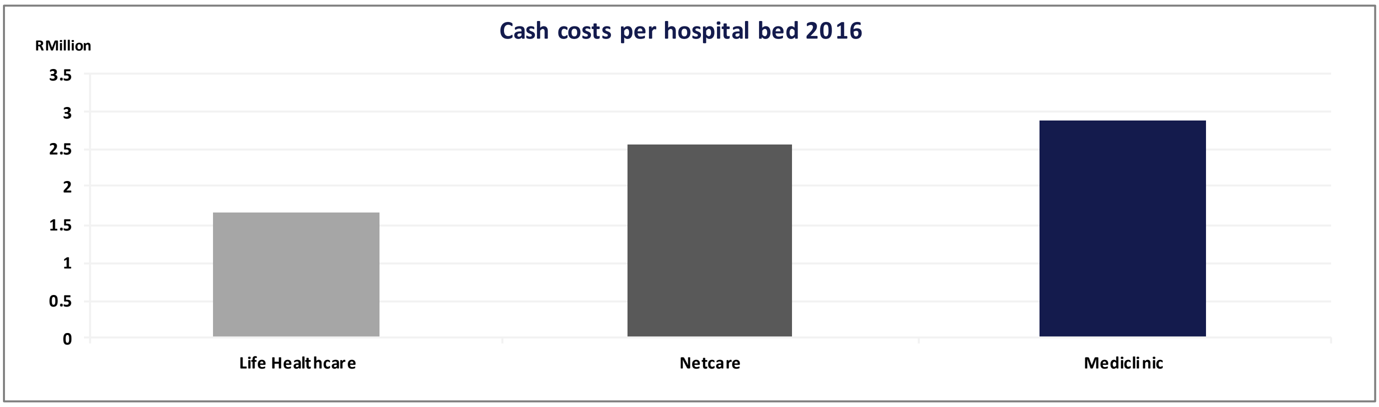

Figure 10. Cash costs per hospital bed 2016. Source. Company reports

So how much is the company worth?

Our valuation method values each of the different geographic segments of the business relative to long-term EBITDA multiples of peers over the last 10 to 20 years making allowances for differences in business mix, profitability and potential geographic growth rates. This method leads us to believe that in a normal environment, Life Healthcare is worth substantially more than the current market is pricing into the company's share price. Furthermore, the share is presently being valued close to our bear case valuation with a deep margin of safety available to investors. We believe that this is a perfect example of a high quality company that is trading at a discount to intrinsic value but facing transitory headwinds.

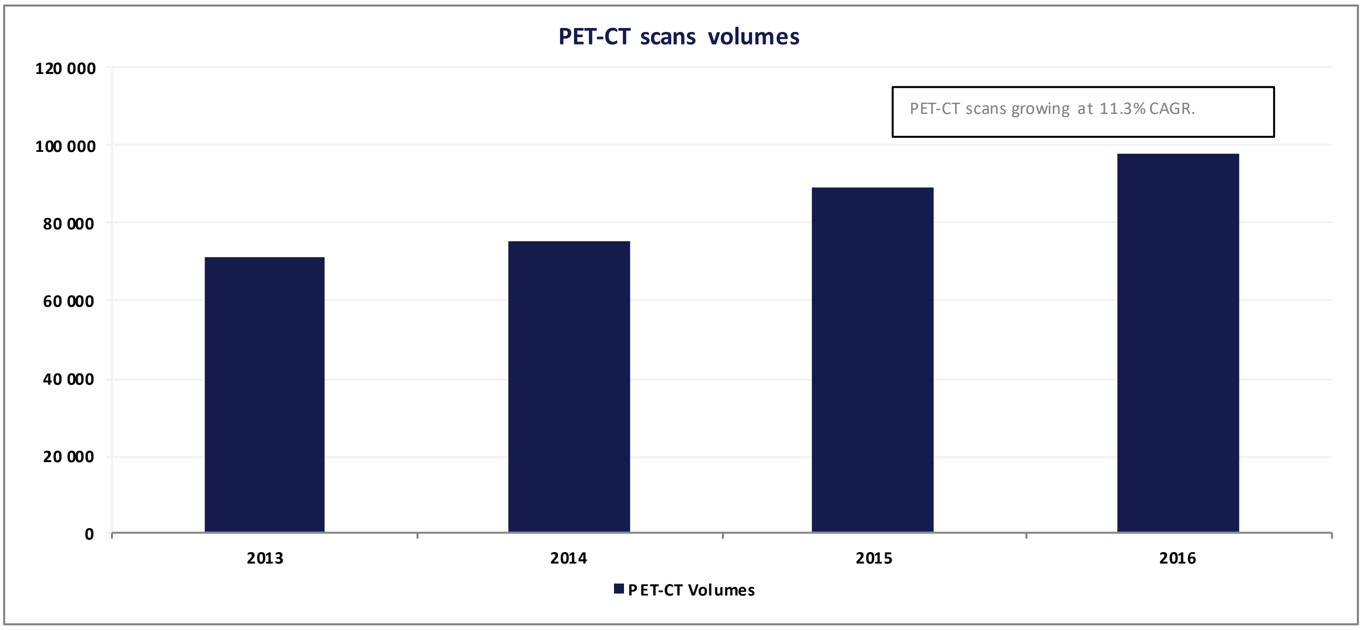

Figure 11. PET-CT volumes. Source. NHS

FROM THE ANALYSTS: FIXED INCOME

IS OUR BOND MARKET FAIRLY VALUED?

By Mark Seymour (Fixed Income Portfolio Manager)

Introduction

The ALL Bond Index (ALBI) is trading on a 9.5% yield 4.7% above inflation (SA CPI YoY 4.8%). Real yields have only been higher 9% of the time over the last 10 years. Interestingly, higher real yields in the past came about mostly as a result of cyclical lows in inflation where CPI averaged 3.7% compared to the overall average of 6.2%. By contrast, inflation is not currently on a cyclical low and is expected to average 5.3% over the next couple of years, which puts into context the potential cheapness of local bonds on a 9.5% yield.

The reason why the market is so cheap

The South African economy has been slowing and with fiscal slippage worsening and debt levels rising, the credit rating agencies have been steadily downgrading South African credit. Moody's initiated this with the first downgrade in September 2012 and after multiple downgrades South African credit (local currency sovereign credit rating) is rated junk by both S&P (BB+) and Fitch (BB+), and one notch above by Moody's (Baa3). The consequence of lower credit ratings is a higher required rate of return by investors, for any new debt issued. Confidence in South Africa's ability to repay its debt is relatively low and as such local government bonds are trading at higher yields. More pressing in the short-term, is the technical need for South Africa to maintain its weighting in the CITI World Government Bond Index (WGBI). The rules for inclusion require that South Africa maintains its investment grade rating by either S&P or Moody's. If Moody's downgrades again South African bonds will be excluded from the index, which will result in an automatic outflow of between R120 billion and R150 billion of local currency bonds.

What is the potential pricing impact in the event of a Moody's downgrade?

R120 billion of bond outflows equates to one third of total net foreign purchases since 2009 (R350 billion). Based on our flow analysis, the impact of foreign sells on the 10 year yield is 3bps change for every R1bn of bond flows. At face value this points to a potential 3.6% rise in bond yields, resulting in an exit yield of 13.1% for the SA10y! This is probably an extreme bear case scenario, but never-the-less highlights the seriousness of a further Moody's downgrade and consequential exclusion from the WGBI.

What is the fair value for local bond yields?

With these dynamics at play, what is the fair price to pay for SA bonds? The reasonable yield spread over US bonds should equate to the inflation differential between the two countries plus a country risk premium with the same duration. Using this framework, the inflation differential between South Africa and the US is expected to be 3.2% plus a 5 year South African credit default spread (CDS) of 2.5%, which equals 5.7%. We then add 5.7% to the expected US5y yield of 2.5% to arrive at a 8.2% fair value yield for the SA5y bond.

The problem with using this framework is that the SA5y CDS spread is notoriously volatile. Over the last 10 years the SA5y CDS spread has breached 3.5% on two occasions (the financial crisis and Nenegate) and traded as low as 1.1%. Based on the best fit curve for all countries (CDS spread vs credit rating) as per the graph over the page (Figure 12), a reasonable spread for "Junk status" is 1.3% (where the dotted grey line crosses the vertical red line). We are unsure about how the market might price an economic crisis or transition to junk status, however looking at the 5y CDS spreads for Brazil, we note that the market pushed CDS spreads to 5% during their economic crisis and subsequent downgrade. On this basis, SA CDS spreads could trade between 1.1% and 5% which means the potential SA5y yield could range between 6.8% (inflation differential of 3.2% + SA CDS spread of 1.1% + US5y 2.5% = 6.8%) and 10.7% (inflation differential of 3.2% + SA CDS spread of 5% + US5y 2.5% = 10.7%).

In summary

With a further Moody's downgrade our flow analysis points to a potential dramatic blow-out in bond yields (the SA10y going to 13.1%). Using the inflation differential plus CDS spread framework, and considering how markets priced CDS spreads during the global financial crisis, Nenegate and the Brazilian economic crisis, the SA5y could spike to 10.7%.
We would consider these as extreme bear case outcomes.

If we were not facing such uncertainty with respect to predicting political outcomes and the response thereto with regards to fiscal discipline, we would argue that a

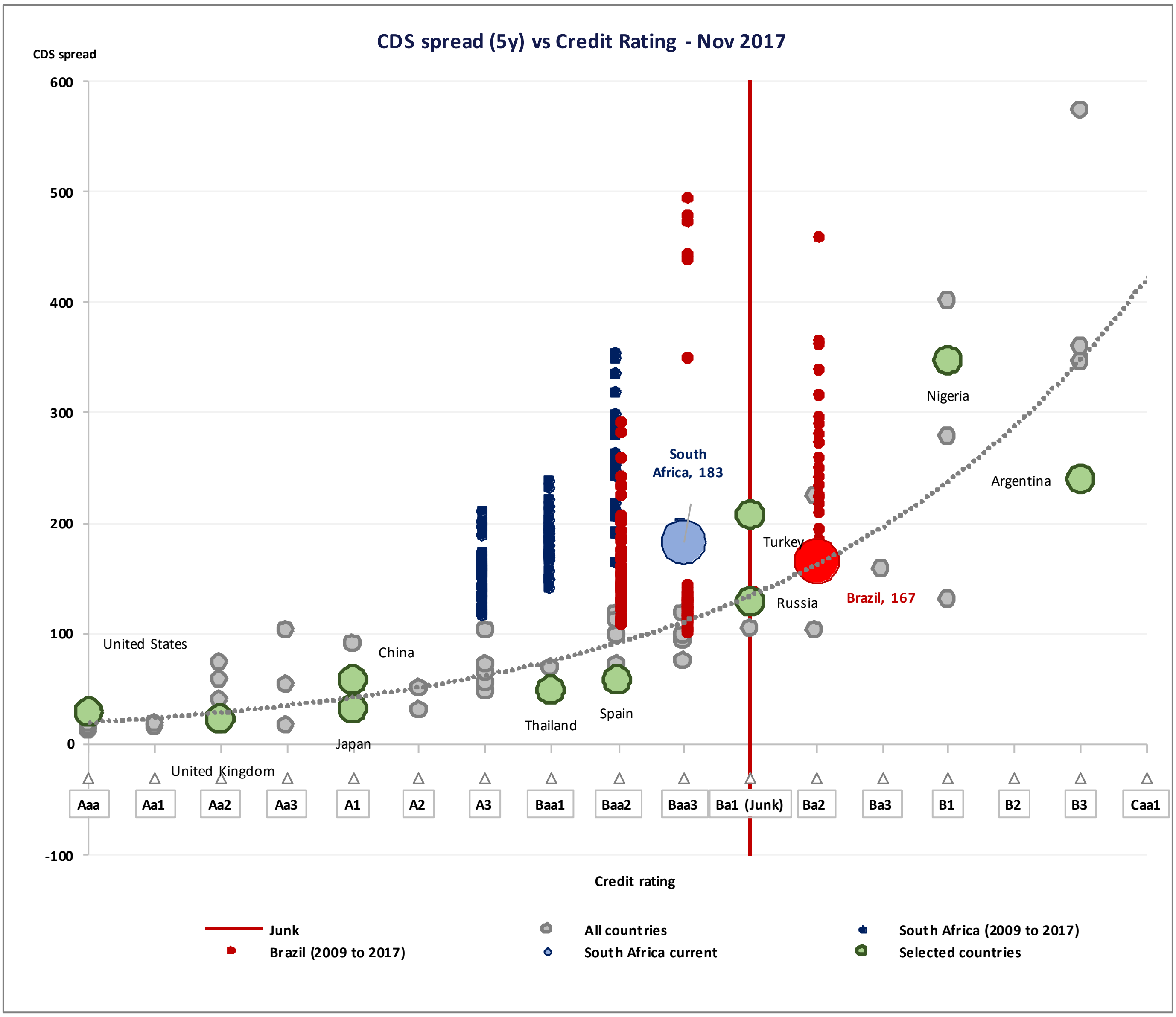

Figure 12. CDS versus credit rating. Source. Bloomberg, Northstar

3% real yield on the SA10y is close to fair value. Assuming inflation of 6%, points to a yield of 9%. With the SA10y trading at 9.5% (coincidentally the same yield as the ALBI), bond yields do look attractive, however against the backdrop of a further potential downgrade and resulting bond outflows of R120bn, a 50bps spread is not sufficient enough to warrant active participation in bonds from our perspective. As such, we are exercising caution in the current bond market and only advocate purchasing instruments at yields above 10% for the SA10y.

We are aware that a rating agency friendly outcome (assuming Moody's holds off downgrading if they like the result of the NEC elective conference) is likely to elicit a powerful and positive bond market response given the currently elevated real yields. However, the binary nature in this space forces investment managers to become political gamblers and we are not comfortable participating in this duel. Either way, yield volatility seems a certain product of the ANC December conference.

CLIENT CORNER AND NORTHSTAR NEWS

2017 IN REVIEW AND LOOKING FORWARD TO 2018

By Matt Bertram (COO)

Operational and client servicing updates

What have we achieved in 2017?

With 2017 now drifting away, we looked back at a very busy year and assess what was achieved and what will carry over into 2018. Highlights included:

- Launching two additional unit trusts, to complete our product range, on the Sanlam Collective Investments (SCI) (RF) (Pty) Ltd platform.
- Launching our offshore unit trust in Ireland.
- Moving the existing Northstar unit trust range from Metropolitan Collective Investments (RF) (Pty) Ltd (Met CI) unit trust company to SCI.
- Restructuring our unit trusts to clean classes.
- Adding manpower to our client services department and targeting specific turnaround times for client requests.
- Actively negotiating with custodians and stock brokers to reduce costs for our clients and improve their service delivery.
- Implementing new client reporting systems.
- Improving the content and depth of information which we provide to clients on a quarterly basis – this report being such an example.

In terms of a significant carry-over project into 2018, completing the implementation of our customer relationship system remains our biggest task. The system strives to provide holistic reporting for clients utilizing more than a single Northstar product. An example being a domestic and offshore bespoke share portfolio. It also will allow us to understand the interactions we have with our clients and respond to those even more efficiently than we do today.

General news

- During the quarter, Northstar provided funding to Tears and St Luke's Hospice, both well-known and excellent NGOs.
- At the end of December, we bid farewell to Alex and Nick, both long-serving staff members. We wish them the very best in their future careers.
  - Nick de Villiers, who has been with Northstar for nearly 4 years leaves to join Foster Wealth Management. Nick has authored multiple due diligences and assisted in numerous interactions with advisors.
  - Alex Adie who has been in operations and client servicing for the last 4.5 years leaves Northstar to pursue a career in Prague. Alex has been a pivotal part of our team and her knowledge of our private clients is significant.
- Peter Steele will join the team at the start of January, in a new role, as Business Development Manager. Peter’s existing values correlate closely with ours and he will be an excellent addition. Having worked in the industry for over two decades he brings a real breadth and depth of experience together with a wide network of contacts. We will provide an in-depth introduction in our next article.
- We are also in the final stages of employing an additional staff member within the operations and client services team and will be informing our clients of this appointment when it is completed.

CORRIDOR CHATTER

THE DECEMBER DILEMMA

By John Steenhuisen

Which horse will win the December derby?

The slide towards the ANC's December elective conference is nearing the finish line, with campaigning by the leadership candidates reaching fever pitch. From a field of eight contenders the race has narrowed substantially to a two-horse race between frontrunners Nkosazana Dlamini-Zuma and Cyril Ramaphosa, and the stakes could not be higher. As ANC internal branch and provincial AGM's are wrapping up both campaigns appear to be claiming massive leads and victory. Political analysts and talking heads have been totting up the results and projecting outcomes. The reality is that the situation is far more nuanced and complex than it appears. Branches and provincial delegates to the elective conference are not bound by these commitments and what looks like a solid lead for a candidate now could evaporate as the horse-trading, vote-buying and coercion starts in earnest.

The favorite of the markets, Cyril Ramaphosa, should be wary to expect his opponent to fold and go quietly. I think the point so many analysts and commentators are missing is, this is a grand battle. Not, as some portray, for the heart and soul of the ANC (that was fought and lost at Polokwane). Instead, this is a battle, as the #Guptaleaks exposed, for control of a multi-billion Rand corporation and network of influence spanning the entire state. Its only goal is to suck up as much public money and opportunity as possible and funnel this into the pockets of the connected few and their patronage network. Interests are huge and entrenched, obscene amounts of money is invested in maintaining the status quo and anybody who thinks this camp, represented by Zuma-backed Nkosazana Dlamini-Zuma, will simply fold and hand control over this vast network to Ramaphosa would be naive.

The true dilemma for Ramaphosa is that if he really wants to win he is going to have to cut a deal with one or all of the so-called "Premier League" represented by Mpumalanga's DD Mabuza, Supra Mahumapelo for the Northwest provinces, and the Free State's Ace Magashule. These individuals are all Zuma-men and the embodiment of state capture. They represent the very antithesis of what Ramaphosa purports to be standing for. In the cutting of this deal lies the fatal compromise that will undermine any Ramaphosa presidency. This will make it virtually impossible, even if he gets elected, for Ramaphosa to implement many aspects of his "New Deal" economic recovery plan, or move with any significance against those who lie at the heart of the state capture project.

Perhaps this realisation lay behind the recent shock decision by international ratings agency, Standard and Poor's (S&P), to downgrade South Africa to junk status. Fellow traveler, Moody's, have adopted a more cautious approach. It is clear that S&P do not believe that the outcome of the ANC elective conference, whichever candidate wins, will have any significant bearing on policy direction, governance models and budget priorities. Whilst the election of Ramaphosa may well deliver some brief market reprieve, in the longer-term the fatal compromise with the corrupt will constrain his ability to strike out with bold policy initiatives that South Africa so desperately requires to start moving forward again.

It is not all doom and gloom. The real game-changer is not the December ANC conference, nor is it even the state of nation address and budget in February. The real game changer lies in the 2019 election a mere 17 months away. This has the potential to really break the logjam in our seemingly intractable political and economic situation. Increasingly the portents for the ruling ANC are not looking good. If the recent re-run of the municipal elections in the Free State Metsimaholo Municipality (Sasolberg, Deneysville) are anything to go by, the ANC are in serious trouble. Their vote was significantly cut in their traditional voting areas, whilst the opposition votes grew significantly. The standout result however, was the contestation by the SACP, their first electoral test outside the ANC, where they managed a noteworthy 8.5%. This points to massive fluidity in voting patterns and it will be difficult for whoever is elected ANC leader in December to reverse this trend in the short time before voters head to the polls in the national election.

Already reeling from the loss of three Metropolitan municipalities to the opposition, these results come as bad news for the ANC. The ANC were brought down to ~54% of the vote in the last local government elections. With the SACP emboldened by this result and the potential for them to contest the 2019 elections on their own, coupled with instability and a potential splintering of the ANC after their December conference and an ever-growing opposition, the game is on for the next election. 2019 will be the first election in post democratic South Africa where the outcome is not a foregone conclusion and this is a massively exciting prospect for real change.

STAFF MEMBER PROFILE

MARCO BARBIERI

By Adrian Clayton (CEO)

Marco joined Northstar in July 2013 and is head of onshore research and shares joint responsibility for Northstar's onshore unit trusts with Adrian Clayton.

When did your interest in financial markets start?

I started reading financial books in high school but developed a true passion for the markets at university after I opened a stockbroking account and started analysing companies more actively. From there I developed a strong desire to improve my financial knowledge to better quantify the value of financial assets.

What did you study and why?

After high school, I went to UCT and completed an honours degree in chemistry. I have always been an inquisitive and analytical person and found physical sciences to be extremely interesting and challenging. At the same time my increasing interest for finance led me to work for a bank straight out of university and start my journey in financial markets. Subsequently, I completed a part-time B.Com in financial analysis and portfolio management at UCT and became a CFA charter holder.

What do you think equips you to do this job properly?

The two most important ingredients to be a good investor in my opinion are to be deeply inquisitive and to have a perpetually strong desire to improve one's understanding of financial markets. One can never know enough and I work tirelessly to improve my financial knowledge and leave no stone unturned during our investment process.

What do you love about investing?

I love the complexity of investing and the satisfaction of eventually understanding difficult concepts and reducing them to their simplest form.

What do you find the most challenging part of your role?

I think the most difficult part of the job is being able to maintain a disciplined approach and level head during periods when the market is challenging your views.

Why do you think clients will do well under you and your research team?

Over time our clients will benefit from the structure of our investment process, our thorough approach to understanding each investment opportunity and our commitment to always improving.

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