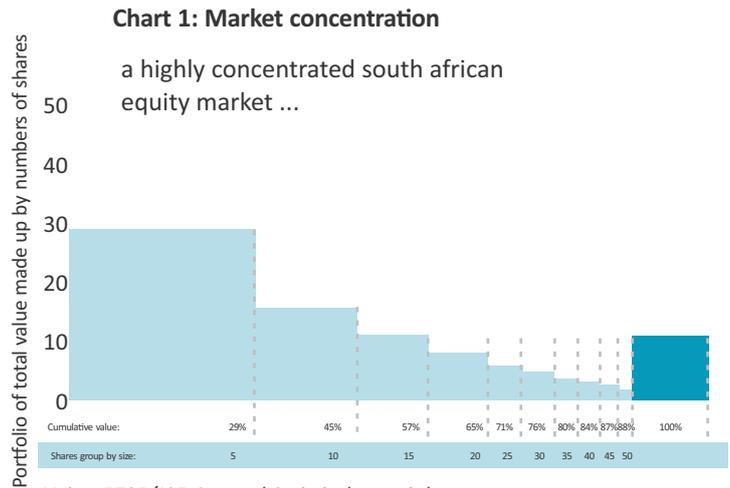


Transforming capital into opportunity: A vision for inclusive growth

South Africa's investment landscape is marked by stark challenges: deep rooted inequality, persistent unemployment, and a highly concentrated Johannesburg Stock Exchange (JSE), where the top 10 stocks command over 45% of market value. This concentration, coupled with traditional fund managers' overreliance on a narrow set of large cap equities, limits diversification and stifles growth potential. Conventional investment models, often tethered to benchmark driven strategies, overlook the structural shifts reshaping our economy thereby missing high potential opportunities in underrepresented sectors like small and medium enterprises (SMEs), infrastructure, and private markets.



Using FTSE/JSE Capped Swix index weights

Source: Index Market Data / Johannesburg Stock Exchange

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Economic transformation should not be seen merely as a moral imperative but as a powerful competitive advantage where a fund manager's mission is to deliver superior financial returns alongside measurable social impact, thereby channelling capital into high impact opportunities that empower communities, create jobs, and foster a sustainable future for all South Africans.

Embedding economic transformation at the core of a retirement fund's investment strategy would redefine investment success. This article explores how a disciplined, research driven process incorporating manager selection, innovative portfolio construction, and robust assessments, could harmonise economic transformation and performance, proving they are not mutually exclusive but mutually reinforcing, and positioning investors to thrive in a dynamic, evolving market.

Selecting fund managers through an economic transformation lens

The manager selection process is arguably pivotal to delivering superior returns through economic transformation. Managers, and even trustees, are able to access evaluation frameworks that integrate economic transformation as a core driver, different from the run-of-the-mill conventional models that prioritise financial metrics alone. By assessing both black-owned and traditional managers through an economic transformation lens, trustees and other decision makers can ensure alignment with South Africa's economic and social goals, while producing long-term sustainable superior returns for members.

We advocate evaluating managers across four equally weighted pillars focusing on economic transformation:

- **Investment professionals:** Prioritise diverse teams with strong black and female representation, as diversity fuels innovation. McKinsey shows diverse teams can outperform peers by 25%.
- **Investment beliefs:** Seek managers whose philosophy embeds, or even considers, economic transformation and sustainability. This ensures investments capture structural economic shifts, unlike short term strategies.
- **Portfolio risk:** Reward managers who actively integrate ESG across environmental, social, and governance factors, engaging investee companies to drive change, like reducing carbon footprints. MSCI research highlights ESG funds' lower volatility and higher quality returns.
- **Organisation:** Transformation should require minimum 51% black ownership, above 50% black representation on boards, management, and investment teams, aligning with B-BBEE goals and fostering inclusive leadership.

A rigorous due diligence should include questions like: How is ESG woven into your investment process beyond screening? What portion of your portfolio advances sustainability and South Africa's economy? This granular insight uncovers undervalued talent, drives inclusive growth, and mitigates risks in a concentrated JSE market, ensuring we select the best managers for sustainable outperformance.

Scoring model: Measuring economic transformation and performance

When assessing managers, trustees are well served to adopt a rigorous and transparent system that meticulously evaluates managers across the four key pillars set out above. Any scoring model used should reflect each manager's commitment to economic transformation, sustainability, and long term financial performance, ensuring economic transformation is a driver of value, not just a peripheral consideration. Both qualitative and quantitative metrics should be considered. And managers unable to demonstrate meaningful economic transformation impact should be penalised, thereby risking capital reallocation. It goes without saying that any due diligence and scoring model must provide a robust, objective, and transparent framework for evaluating managers, ensuring capital is directed towards investments that drive both financial returns and economic transformation, with the bottom line being:

- Measure, track, and reward meaningful economic transformation.
- Reallocate capital away from underperforming managers or those that simply “don't care”.
- Engage managers deeply, avoiding surface-level ESG claims.

Chart 2: An example of an evaluation framework

#Manager scoring grade	Star rating	Individual factor grades	Potential decision based on manager overall rating
>80	*****	“Exceptional” prospects of success	Invest/increase weight
75 - 80	****	“Excellent” prospects of success	Invest/maintain weight
65 - 75	***	“Above-average” prospects of success	On watch/reduce weight
60 - 65	**	“Average” prospects of success	Sell/minimum weight
<60	*	“Below-average” prospects of success	Sell/exit

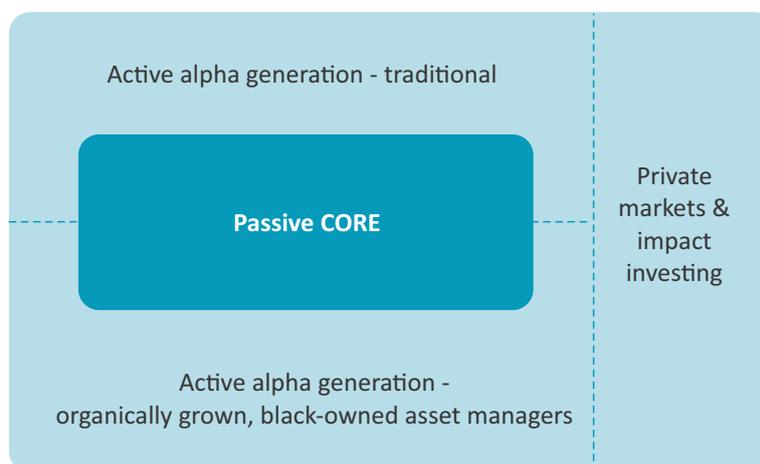
Blending investment levers for optimal impact

We believe the best approach to portfolio construction is deliberately diversified and impact driven, blending four key investment levers to achieve a dynamic balance of risk, return, economic transformation, and costs:

1. **Passive investments** - provide cost effective exposure and portfolio stability. By anchoring returns and reducing costs, passive strategies create room for targeted deployment of capital into high impact areas.
2. **Private market investments** - serve as engines of inclusive economic growth. These investments not only offer attractive long term returns, but also catalyse job creation, entrepreneurial expansion, and the development of vital economic sectors often overlooked by traditional capital.
3. **Black-owned asset managers** - form an important part of an economic transformation strategy. These managers bring differentiated thinking, localised insight, and often untapped alpha, contributing to both performance and the broader agenda of increasing competition and reducing concentration in the asset management industry.
4. **Traditional managers** – should be evaluated and selected based on their adherence to both ESG principles and economic transformation imperatives. Trustees should expect them to contribute meaningfully to inclusive growth while maintaining strong fiduciary standards.

This blended, multi-lever approach not only mitigates the risks inherent in South Africa's concentrated market but also captures structural growth opportunities. Unlike conventional portfolios that remain heavily exposed to the top stocks on the JSE, this strategy intentionally positions retirement funds and investors to benefit from undercapitalised and high growth areas.

Chart 3: Investment Philosophy



Conclusion

Experience reveals that economic transformation and financial performance are two sides of the same coin. By selecting managers (or investment opportunities) through an economic transformation lens, blending diverse investment levers, and enforcing a robust scoring model, trustees and decision makers are able to choose portfolios that thrive in South Africa's evolving economy, and that continue to serve our members and their children for many years to come.