COVID-19 AND DISTRIBUTION UPDATE – JUNE 2020

19 June 2020

In the first week of April, we published updated guidance for our 2020 distributions across the Payers & Growers® portfolio range. At the time, South Africa had followed the lead of many other countries and moved into a state of lockdown in order to prevent the rapid spread of COVID-19, which meant only companies providing essential products and services were operating and there was significant uncertainty around the future path of economic growth. While there is still a lot of uncertainty about the full impact of COVID-19 on growth and corporate profitability, we have moved from alert level 5 to alert level 3, which has seen many more businesses resume trading although most are unlikely to see a return to pre-COVID levels of activity in the immediate future.

Against this backdrop, the South African Reserve Bank has aggressively cut interest rates, reducing the repo rate by 275 basis points in 2020. While this has been welcomed as a means of stimulating economic activity (and was much needed), it does mean that income dependant investors are finding it much more difficult to maintain the level of income they had become accustomed to from their investments. Compounding the problem is the fact that many companies have either cancelled or deferred the payment of their dividends to preserve their balance sheets and ensure they have sufficient liquidity while revenues remain depressed. This implies that investors who use equities and/or listed property securities as a source of income have also seen a substantial reduction in their income levels during the second quarter of 2020.

Our Payers & Growers® portfolios have been impacted in the second quarter and distributions are going to be lower than usual. While lower interest rates and cancelled or deferred dividends are the main reasons for the lower distributions, a few companies owned in the portfolios have also been forced to delay the publication of their financial results due to delays in their audits caused by the lockdown. The JSE has allowed companies to delay their results and this means that those companies that would normally have paid a dividend in the second quarter are now expected to pay those dividends in the third quarter, if the dividend is not cancelled or deferred. The table below highlights our updated forecasts for the second quarter:

Table 1: Updated forecasts for the second quarter

	Current forecast
Bridge High Income Fund – A class	13.50c
Bridge High Income Fund – C class	14.10c
Bridge Stable Growth Fund – A class	24.30c
Bridge Stable Growth Fund – C class	25.30c
Bridge Managed Growth Fund – A class	1.45c
Bridge Managed Growth Fund – C class	1.50c
Bridge Equity Income Growth Fund – A class	1.10c
Bridge Equity Income Growth Fund – C class	1.15c

Source: Bridge Fund Managers

We are expecting the fourth quarter distributions to be higher than the equivalent quarter last year as those companies that have deferred the payment of their most recent dividends will pay some of those dividends in the fourth quarter (and possibly even towards the end of the third quarter).

We therefore expect the total distributions for 2020 will show smaller declines than the declines in the second quarter, as highlighted in the table below:

Table 2: Updated forecasts for 2020

FUND	Calendar Year Distributions - 2020	
	Current forecast	% change from 2019
Bridge High Income Fund – A class	70.70c	-12%
Bridge High Income Fund – C class	73.30c	-12%
Bridge Stable Growth Fund – A class	114.10c	-10%
Bridge Stable Growth Fund – C class	118.40c	-10%
Bridge Managed Growth Fund – A class	6.60c	-12%
Bridge Managed Growth Fund – C class	6.90c	-13%
Bridge Equity Income Growth Fund – A class	4.00c	-21%
Bridge Equity Income Growth Fund – C class	4.20c	-21%

Source: Bridge Fund Managers

While there is still significant uncertainty in global financial markets, our Payers & Growers® portfolios will continue to pay a relatively high level of income (certainly a lot higher than what investors can get by being invested in cash). We also anticipate that distributions will grow well above inflation in 2021 as companies resume dividend payments and interest rates start rising slowly, although the first hike is only expected in the second half of 2021.

Our current distribution forecasts have been built on the assumption that South Africa remained in lockdown for a period of 3 to 5 months, before gradually reopening as the number of active COVID-19 cases in South Africa started to decline. That has clearly not happened, and most companies have started trading far sooner that we had anticipated. This should bode well for a more rapid resumption of dividend payments, but trading conditions for most businesses in South Africa will remain challenging in the medium-term as people come to terms with the “new normal”. Based on our assessment of balance sheet strength, liquidity and assuming a gradual recovery in economic activity, virtually all the companies in our portfolios will be able to resume dividend payments in 2021.

We have made some changes to the portfolios recently to reflect the rapidly changing situation in global financial markets. Our growth asset exposure is a bit lower than normal (both in equities and listed property), while we were able to add significant exposure to government’s R186 bond when the yield spiked to just under 10.5%. We identified industries and companies that we felt were likely to struggle during and after the lockdown and either reduced our exposure or disposed of the positions entirely.

We have slowly started to add back some of that exposure where a combination of government support and the sooner-than-expected reopening of the economy have now improved the shorter-term fundamentals of those businesses. We have also reduced exposure to non-banking corporate paper as liquidity in the secondary market has slowly started returning.

While capital values are still a lot lower than they were at the start of the year, we have seen a significant recovery since the end of March. In fact, since 24/03/2020 (which marked the low point for South African equities and listed property securities), the Bridge Managed Growth Fund is up 15%. We expect prices to continue recovering as the global economy reopens and government and central bank stimulus drives market liquidity. Asset prices in South Africa and other emerging markets look extremely attractive relative to their own history and the valuations in developed markets, particularly in the United States.

South Africa has now been downgraded to “junk” status by Moody’s and our bonds have been removed from the FTSE World Government Bond Index. These two events had weighed heavily on investor sentiment towards South Africa and once they were behind us, our bond market rallied almost 20% in a matter of weeks. A similar experience is likely in our equity and listed property markets once the worst of COVID-19 is behind us and economic activity starts accelerating again.

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