

### Fund rating announcement

GCR affirms the rating on Sanlam Alternative Income Fund at AA<sub>-(ZA)(f)</sub>, Outlook Stable

### Rating action

Johannesburg, 19 December 2019 – GCR Ratings ('GCR') has affirmed the national scale fund rating\* assigned to Sanlam Alternative Income Fund ('SAIF', 'the fund') at AA<sub>-(ZA)(f)</sub>, key features of which are summarised below.

Rated Entity	Rating class	Rating scale	Rating	Outlook / Watch
Sanlam Alternative Income Fund	Fund	National	AA <sub>-(ZA)(f)</sub>	Stable Outlook

### Rating rationale

#### Fund summary

Fund currency	South African Rand
Fund data review date	31 July 2019
Assets under management ("AUM")	R7.5bln
Net asset value ("NAV")	Targeted constant price of R1.00
Fund benchmark	Average after tax yield on Money Market Funds

The fund rating on SAIF balances a conservative mandate, good asset quality, moderate investor concentrations, good liquidity, modest market risk, good capital preservation, and its position within the wider Sanlam Group. SAIF is a R7.5bln fund with a mandate to invest mainly in dividend yielding instruments issued mostly by top tier South African banks.

**Portfolio quality:** The portfolio's weighted average credit rating ('WACR') of AA<sub>-(ZA)</sub> is considered to be strong, although it is exposed to structural subordination and high asset concentrations. The fund has c.33% invested in subordinated preference shares of Issuers with which it has no liquidity or default put options that gives senior unsecured rights. The WACR factors in the lower rating on these subordinated instruments. Asset concentrations on the other had is a common feature in most South African cash strategy funds because mandates typically limit the investment universe to top tier banks and government backed instruments, and the structure of South Africa's banking sector is oligopolistic. In addition, the market has fewer dividend yielding asset classes (mostly preference shares) in the fixed income space. Positively, the top tier banks in South Africa are typically of strong quality and well regulated.

**Liquidity risk:** Liquidity is a neutral ratings factor, balancing moderately high investor concentrations, adequate liquidity supported with some liquidity protection tools. Investor concentrations are somewhat high but compare adequately to rated peers, with top 20 investors contributing c.60% of total portfolio investments as of 31 July 2019. Positively, concentrations are mostly from the top investor, the Sanlam Diversified Income Fund of funds, and we consider the investor to be sticky. Liquidity, on the other hand, benefits from instruments that are senior ranking obligations of high credit quality issuers and liquidity and default protection tools, including put options. Top tier banks account for c.64% of portfolio assets, with 41% having liquidity and default put options. Furthermore, 15% of portfolio is in overnight assets placed with rated money market funds 'MMFs'.

**Market risk and performance:** The maturity of instruments is longer compared to 'MMFs', and we view this negatively. At 31 July 2019, the weighted average maturity was 295 days, measuring over 2x above the limit for MMFs. Positively,

the fund buys and hold instruments to maturity as necessitated by mandate. In addition, liquidity put options on instruments limits potential price volatility. Capital preservation is good, supported by returns that continue to exceed benchmark within duration constraints.

**Manager profile:** We view the manager to possess the competence, capability and capacity to manage the fund based on skills and experience of portfolio managers. In addition, adequate compliance and risk management systems aim to meet performance objectives within mandate constraints, leveraging on the systems and capabilities of the Sanlam Group.

\* Fund ratings provide an opinion regarding the fund's ability to preserve principal value under varying market conditions; with reference to the relevant asset management environment (refer to published rating scales and definitions).

## Outlook statement

The Stable Outlook factors no change in mandate and that the fund continues to invest accordingly.

## Rating triggers

The ratings may benefit from an increase in the WACR, reduction in concentrations, and/or strengthening liquidity buffer. A negative rating action would be taken if there is a decrease in WACR, deterioration in liquidity and/or changes to mandate which we view to be negative.

## Analytical contacts

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## Related criteria and research

Global Master Criteria for Rating Funds and Asset Managers, March 2018

## Ratings history

Rated Entity	Review	Date	Rating class	Rating scale	Rating	Outlook / Watch
Sanlam Alternative Income Fund	Initial	October 2016	Fund	National	AA-(ZA)(f)	Stable Outlook
	Last	October 2018	Fund	National	AA-(ZA)(f)	Stable Outlook

## Glossary

Compound Annual Growth Rate (CAGR)	The year on year percentage growth rate of an investment over a given period of time. It is found by calculating: $CAGR = \left\{ \frac{\text{ending value}}{\text{beginning value}} \right\}^{\left( \frac{1}{\# \text{ of periods}} \right)} - 1$
Diversification	Spreading risk by constructing a portfolio that contains different investments, whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding.
Institutional Investors	Financial institutions such as pension funds, asset managers and insurance companies, which invest large amounts in financial markets on behalf of their clients.
Interest Rate Risk	Interest rate risk in the banking book is the risk that earnings or economic value will decline as a result of changes in interest rates. The sources of interest rate risk in the banking book are repricing/mismatch, basis and yield curve risk.
Liquidity Risk	The risk that a company may not be able to meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets. Regarding securities, the risk that a financial instrument cannot be traded at its market price due to the size, structure or efficiency of the market.
National Scale Rating	Provides a relative measure of creditworthiness for rated entities only within the country concerned. Under this rating scale, a 'AAA' long term national scale rating will typically be assigned to the lowest relative risk within that country, which in most cases will be the sovereign state.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Rating Outlook	Indicates the potential direction of a rated entity's rating over the medium term, typically one to two years. An outlook may be defined as: 'Stable' (nothing to suggest that the rating will change), 'Positive' (the rating symbol may be raised), 'Negative' (the rating symbol may be lowered) or 'Evolving' (the rating symbol may be raised or lowered).
Risk Management	Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy.
Tenor	The time from the value date until the expiry date of a financial instrument.
Trustee	A person or firm that holds or administers property or assets for the benefit of a third party.
Yield	Percentage return on an investment or security, usually calculated at an annual rate.

## Salient Points of Accorded Ratings

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the validity of the rating is for a maximum of 12 months, or earlier as indicated by the applicable fund rating document.

The fund rating has been disclosed to SAIF. The rating above was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the rating.

SAIF participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from SAIF and other reliable third parties to accord the fund rating included:

- A breakdown of the fund investment portfolio, including information on the instruments, their terms, conditions and credit quality;
- A breakdown of the fund investor portfolio, including fund flows and withdrawal terms;
- Detail on historical fund returns, fee structures, and expense ratios;
- Details regarding the fund management, investment management and administration activities of the fund;
- Corporate governance and enterprise risk framework; and
- Industry comparative data and regulatory framework.

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