EFFICIENT GROUP

Weekly Economic Newsletter

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ECONOMIC COMMENTARY

- By Francois Stofberg

It's always darkest before the sun rises

Local equity markets have been very depressed over recent years, for reasons we have addressed extensively in previous newsletters. Most notably was the political turmoil (driven by corrupt leaders and a complete lack of leadership from an ideologically-confused ANC), which lead to policy turmoil and ultimately, to economic turmoil. The result was a fundamentally weaker economy, bloody and bruised consumers (who faced high interest rates, unemployment, and inflation), and severely depressed markets. The economy seems to have dragged itself through its low point, leading the markets that are now also bottoming out.

Although markets appeared positive, this was only an illusion caused by considerable growth at Naspers (roughly 23% of the JSE-market cap) which, on average, grew by 40% annually over the past five years. When we strip out its performance, the picture of local equity markets is a clear downward trend. Also, just to remind you, your balanced portfolio cannot be invested 23% in one stock. Just imagine if Naspers turns out to be another Steinhoff (which was also a favoured child, just a while back). Besides this, there is enough evidence to support the hypothesis that a well-diversified portfolio yields better returns over the long term, rather than picking a handful of lucky horses. This also supports the decision to be invested offshore — to diversify geographically as well.

Just as South Africans started to consider a better tomorrow, Steinhoff happened. It pulled down every local portfolio. Coinciding with this was the rapid strengthening of the rand to levels far below long-term (since 1980) undervaluation levels. The result was another downward jerk to every local portfolio that is invested offshore for long-term diversification benefits, but also to hedge against local uncertainty. In addition, even though the rand may strengthen in the short term, the long-term trend is depreciative, which is why a good balanced portfolio will still have considerable global exposure.

As if this wasn't enough of a shock to local markets, Viceroy made some false allegations and Capitec bore the brunt. A listeriosis-crisis pulled down a whole industry. Volatility spiked through a two-year stability cycle. Trump instituted trade restrictions (and is already leaning towards a second round of trade barriers) and global tech firms (of which Naspers is one) bore the brunt of a renewed regulatory interest in data protection. Resilient and its sister-companies (roughly 25% of South Africa's listed property industry) are also being investigated for accounting irregularities. The result has been a 22% pullback of the listed property index. It really looks to only be getting worse in South Africa's equity markets.

Nevertheless, during the latter parts of 2017, we relooked our long-term investment outlook. We were, and still are, of the opinion that within the next 36 months, South Africa's markets are heading to a 12-month cycle of considerable growth. We might even see another 25% year! The reason is simple: a return of sentiment and confidence (of investors, business and consumers), which the hard numbers are already supporting.

Recent developments only move the cycle out, they don't remove the expected upward cycle. In fact, we will most likely see some upward support in the upcoming months. I was recently made aware of an interesting fact: 80% of a portfolio's annual performance is made in 10 trading days. This all supports our theme of staying invested and faithful to your long-term (5+ year) strategy. Rather understand your position in this protracted downward cycle by speaking to your financial advisor. Understand that, even in the investment world, it is always darkest just before the sun rises.