EFFICIENT GROUP

ECONOMIC COMMENTARY

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IF NOT INTO EQUITIES, WHERE WILL ALL THE MONEY GO?

Most investors in South Africa (SA) have more exposure to the South African equity market than to any other global market. This unfortunate strategy has cost them much in terms of returns over the long term but will continue to benefit them in the short term. Investors with a large exposure to South African assets have been insulated from the recent correction in global equity markets, especially those in the technology-heavy United States (US) markets. We do, however, believe that this correction will not persist for too long.

Global investors have felt the pinch of the recent stock market sell-off in the US. Market sentiment has turned sharply against high-valued stocks because of a fear that monetary tightening will not only inhibit economic growth, but also the perceived benefit of easy money, both of which the markets believe will reduce the future growth prospects of these high-valued stocks. Superior technology stocks that fall into this category generate trillions of dollars in positive cash flow, with little to no debt, and have, therefore, been the obvious winners of loose monetary policy and its perceived benefits. But, as I have explained in the past, easy money has only perceptually increased the value of equities: Excess liquidity printed by central banks never really made it to companies, and eventually consumers; and lower interest rates did not really translate into a substantial increase in demand for both durable and non-durable goods, including investments. We agree that markets must correct from time to time and, in so doing, re-allocate scarce resources. But, where else can money go now that interest rates are set to increase?

Higher inflation means that money cannot really flow into cash, because its value is depreciating at a faster rate each year. Higher interest rates also mean that bond prices fall as yields increase, so investors cannot really invest in bonds either. Higher interest rates are similarly not good for the property sector and even less so for listed property companies. Commodities might attract some of the liquidity, but if the dollar does not depreciate as much, or global growth is not as high as expected, commodity prices will not perform well. And now we have gone full circle and returned to the wonderful opportunity of investing in equities. The only question that remains now is: How much money is left to prop up valuations? Perceptually, there is not as much as in the past, tighter monetary policy is making sure of that. That being said, I do not believe that consumers will be put under so much pressure in this new world of higher interest rates that they will stop spending in the medium term and thereby reduce the valuations of companies.

Consumers in the rich world are wealthier now than they have probably ever been. In the US in particular, consumers have enjoyed an economy and markets that have grown above trend for more than a decade, and, more recently, they have even enjoyed stimulus cheques issued by their government. But not much is different in the rest of the rich world. It, therefore, comes as no surprise to see employers struggle to keep their employees at the office. Not even rising wages have been able to offset the employee exodus. One interesting statistic shows that there are more job vacancies in the US than people looking for jobs. It is also worthwhile to consider that savings rates are at an all-time high and home prices have ballooned, all of which contribute to making consumers feel richer. Although higher wages and home prices might add to inflation, they also mean that the consumer is much healthier. This, in turn, means that the rich world is still very much intact and with such a healthy consumer should remain so. It also means that the recent stock market sell-off will probably only be short-lived.