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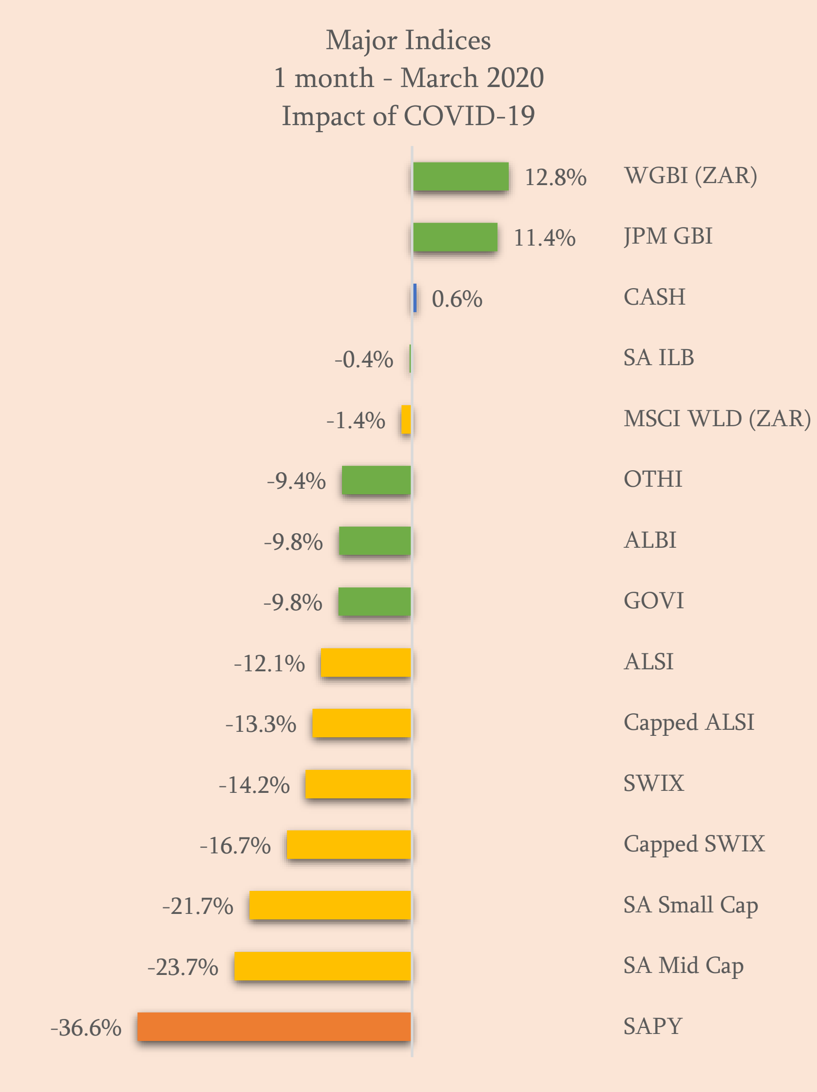
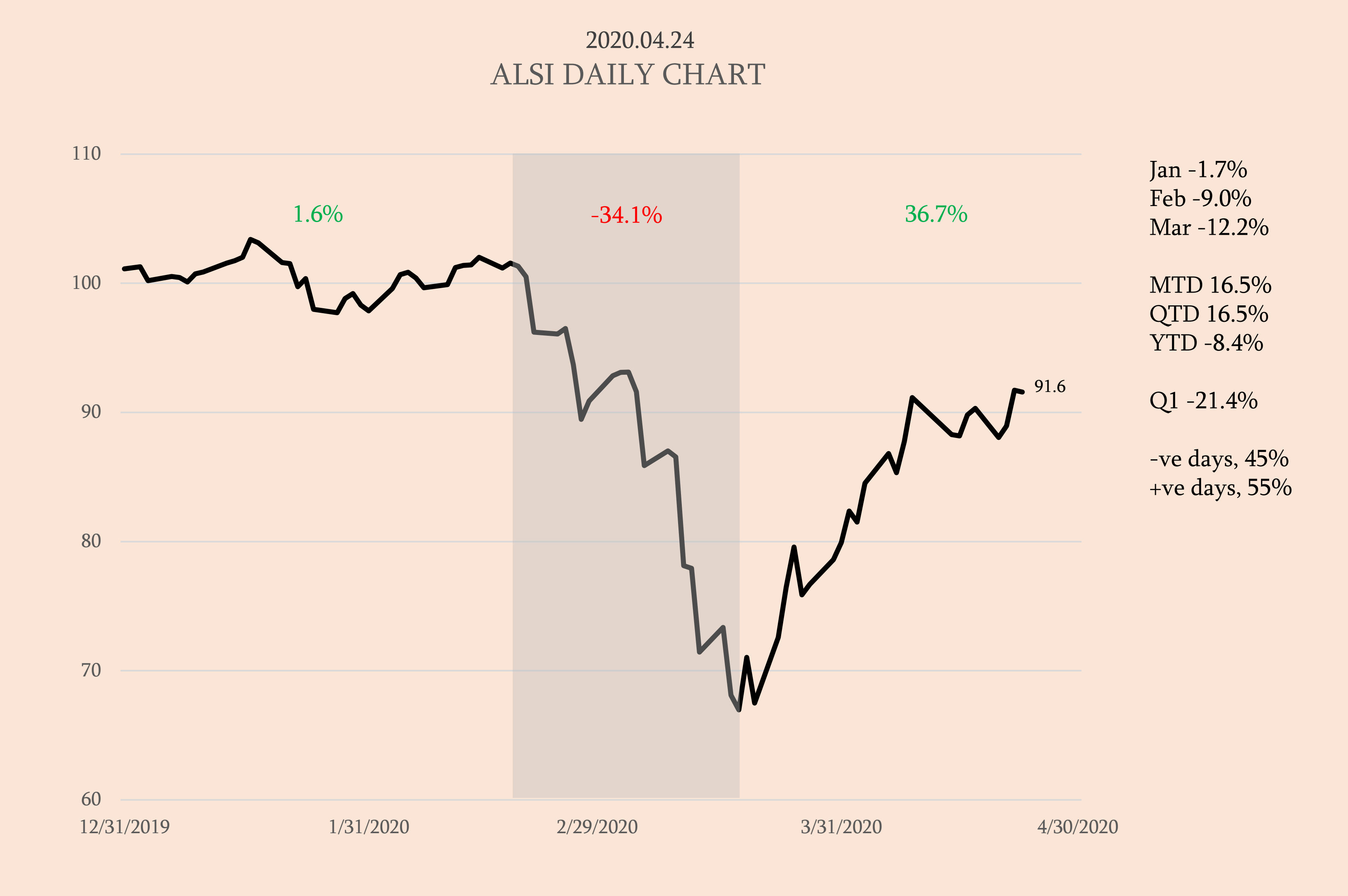
South Africa Listed Investments Survey

March 2020

"Reshaping the SA Asset Management Industry"

Bear market in March 2020





Source: Motswedi Research

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SA Equity - SWIX (Benchmark Cognisant)

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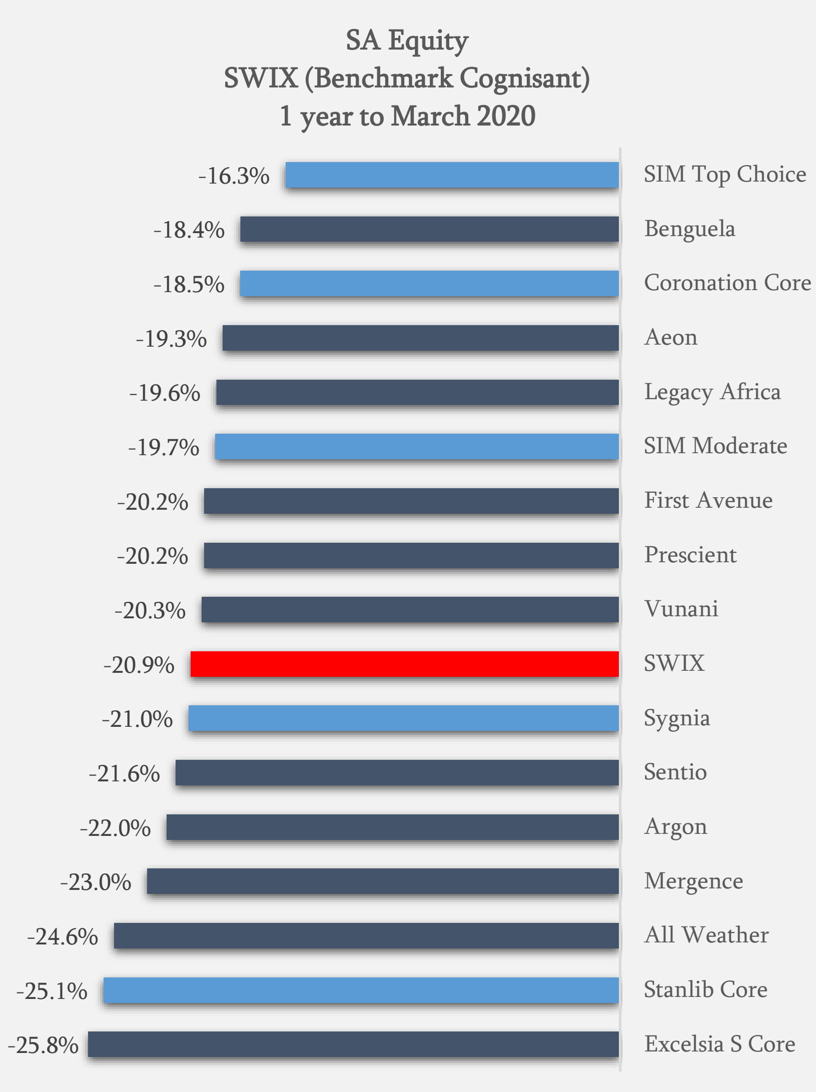

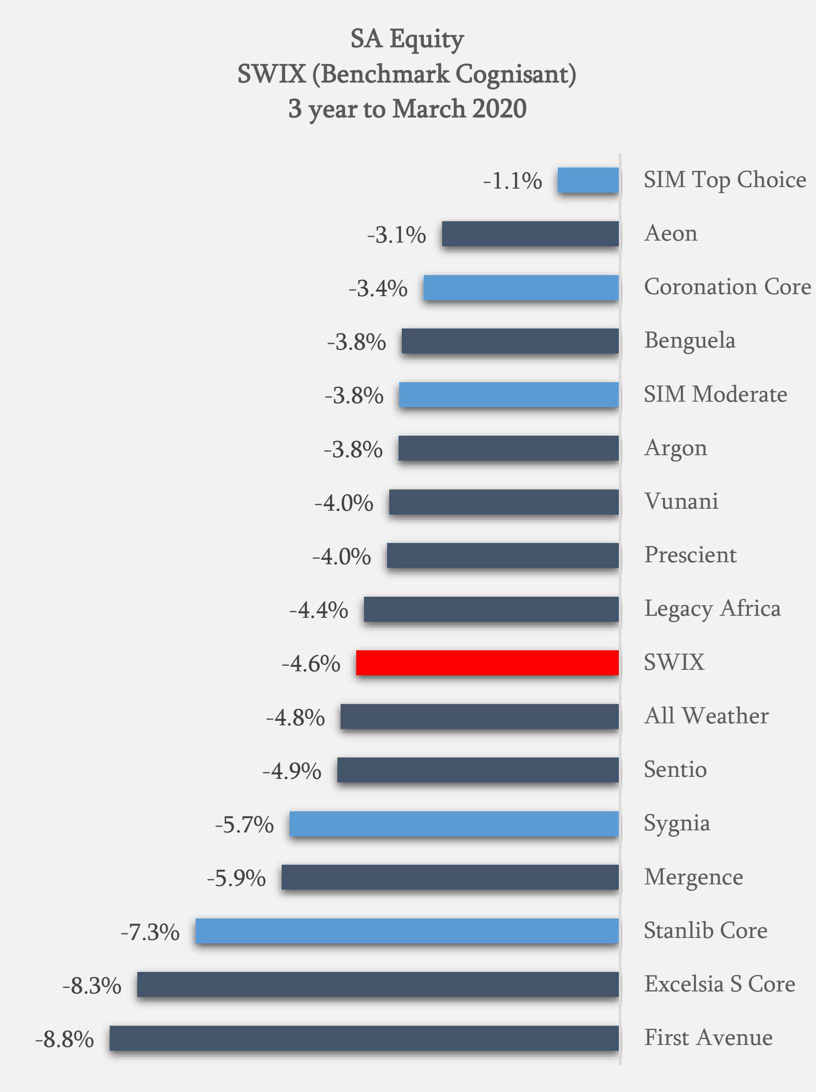

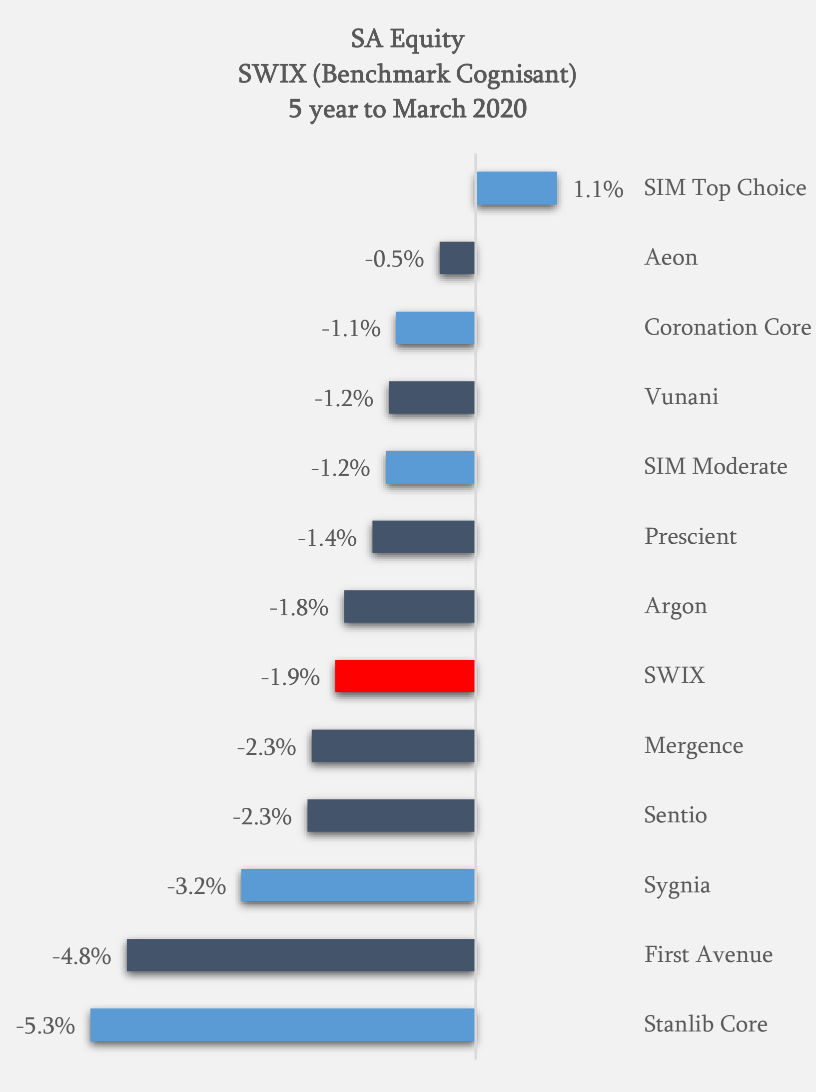

Source: Motswedi Research, Alexander Forbes Manager Watch

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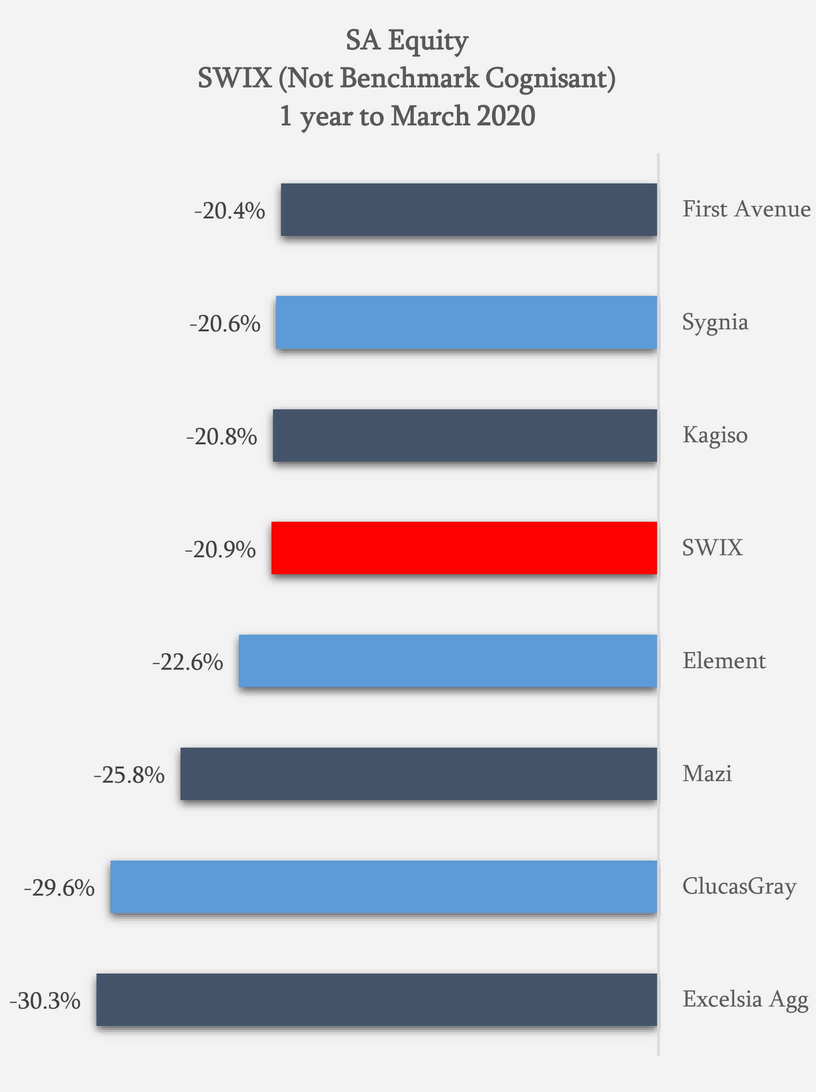
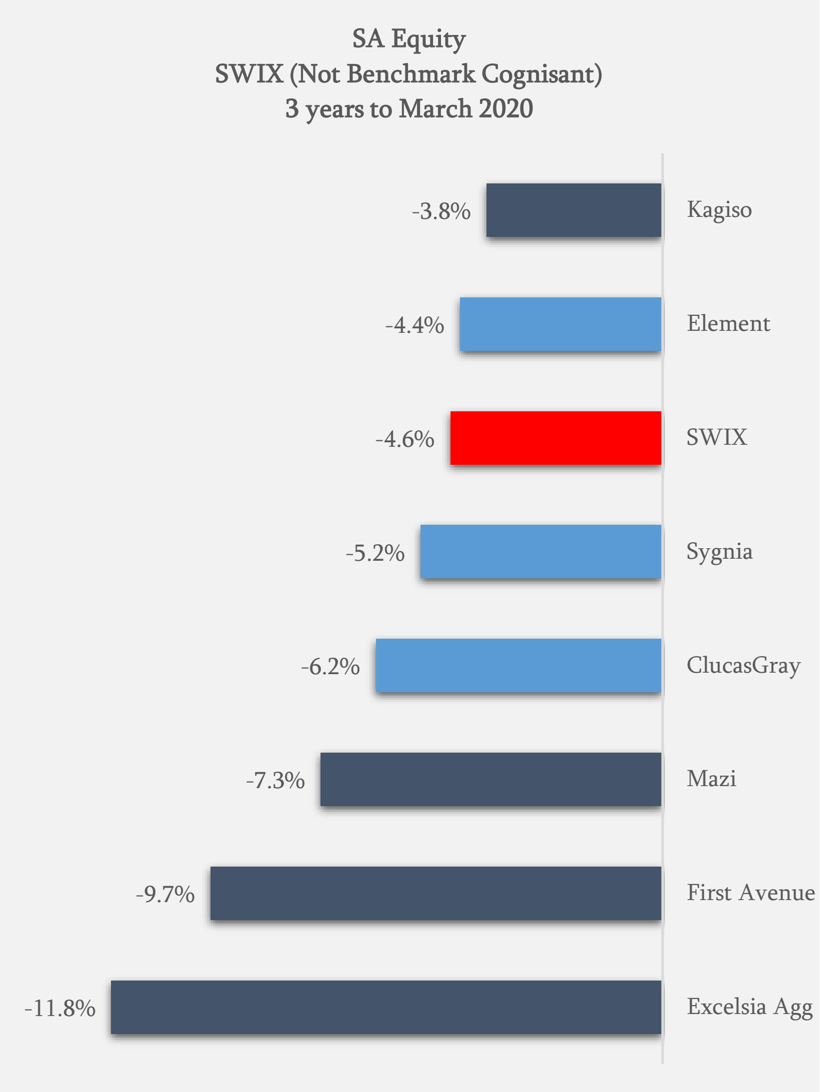
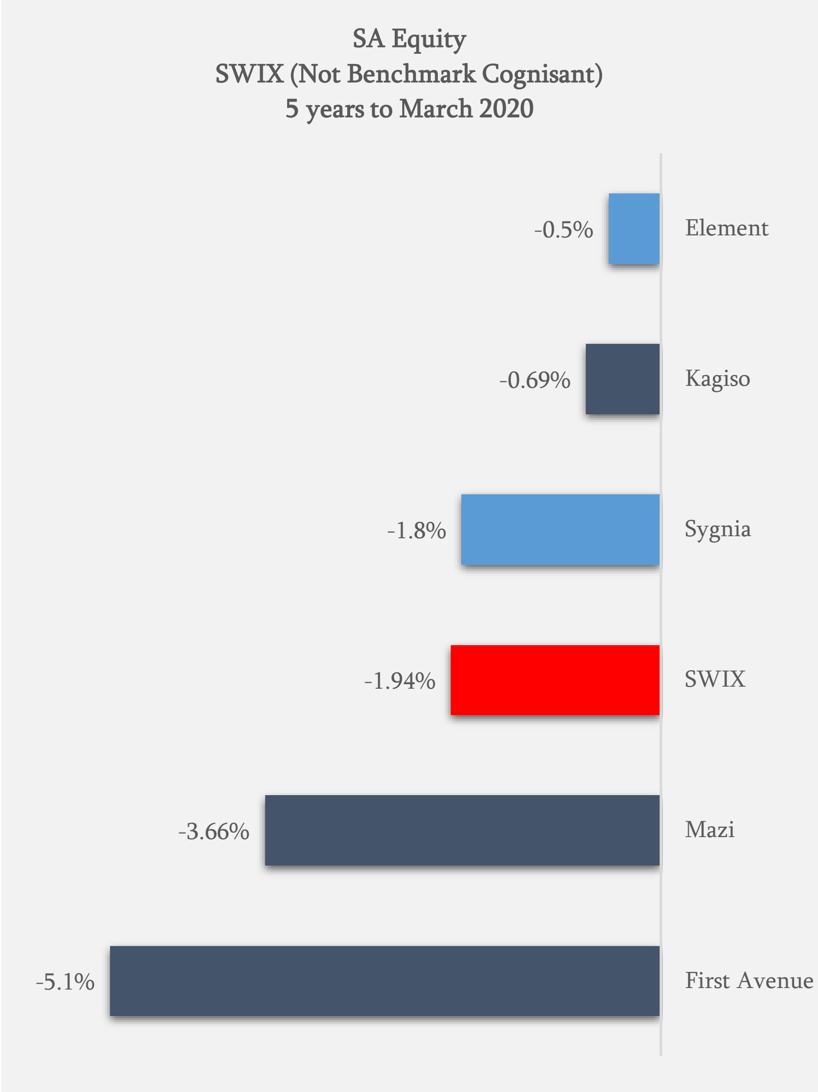
SA Equity - SWIX (Not Benchmark Cognisant)







Source: Motswedi Research, Alexander Forbes Manager Watch

SA Equity - Capped SWIX (Benchmark Cognisant)

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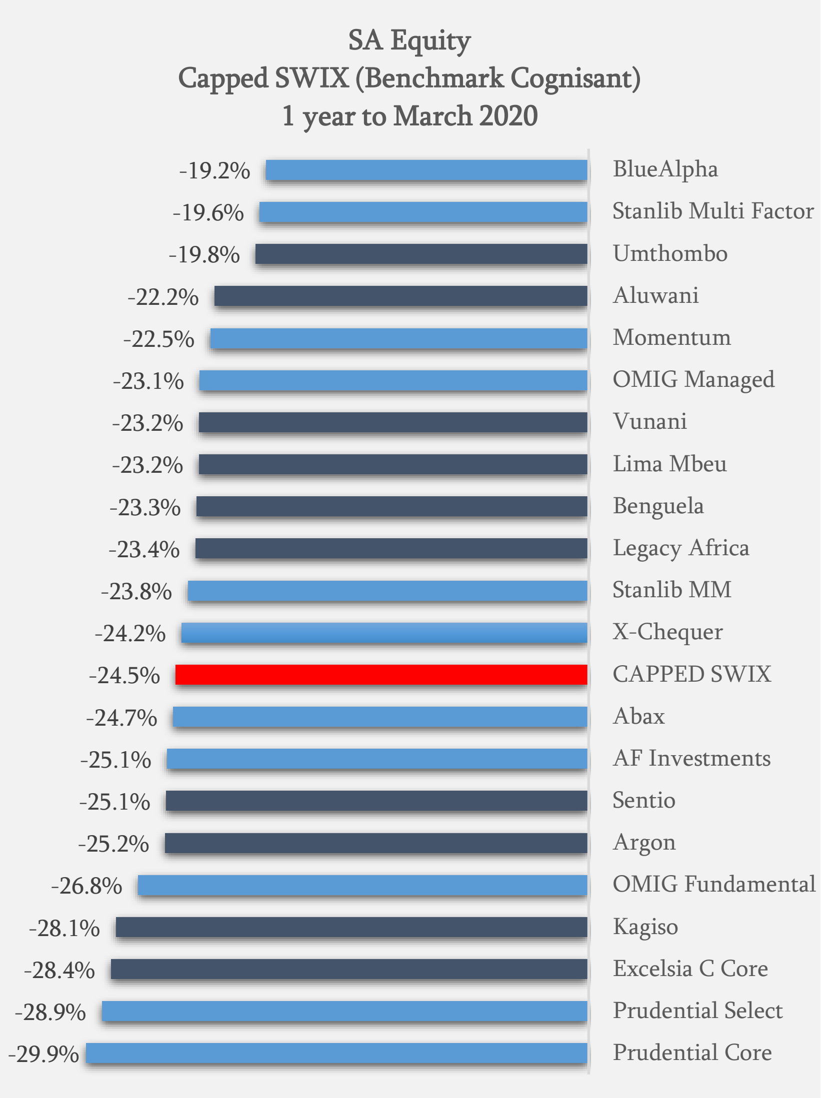
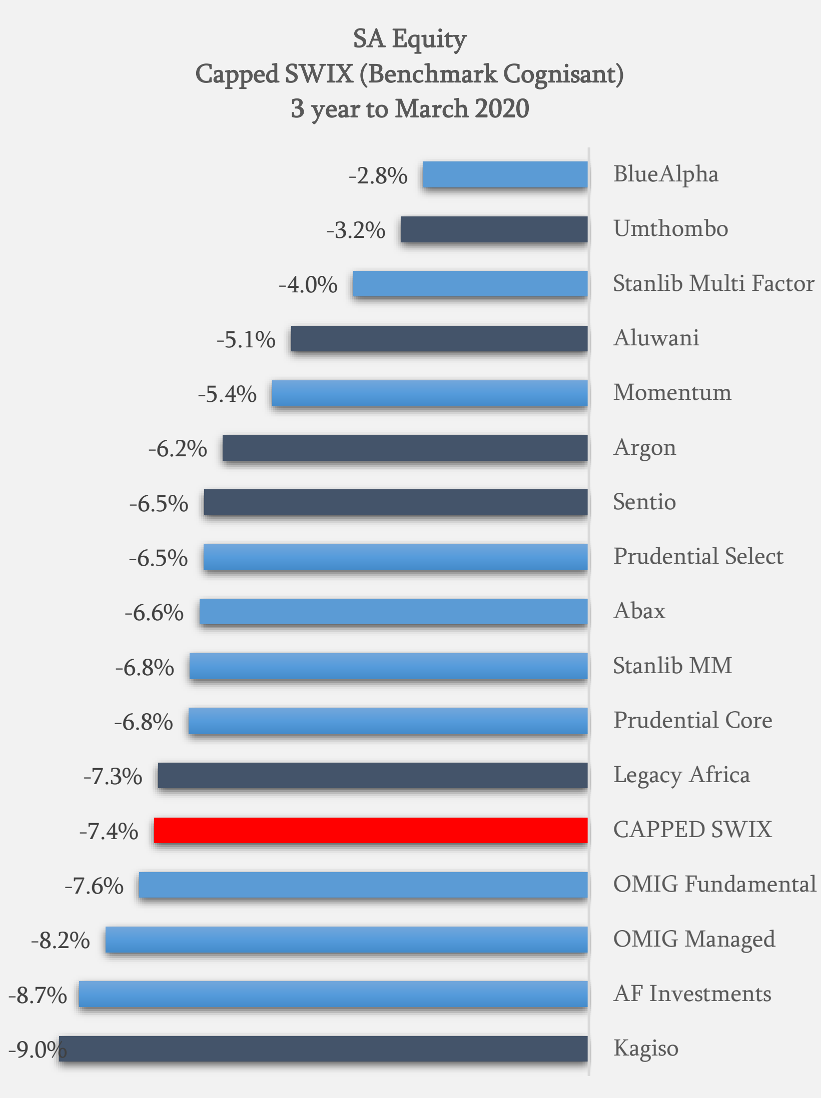
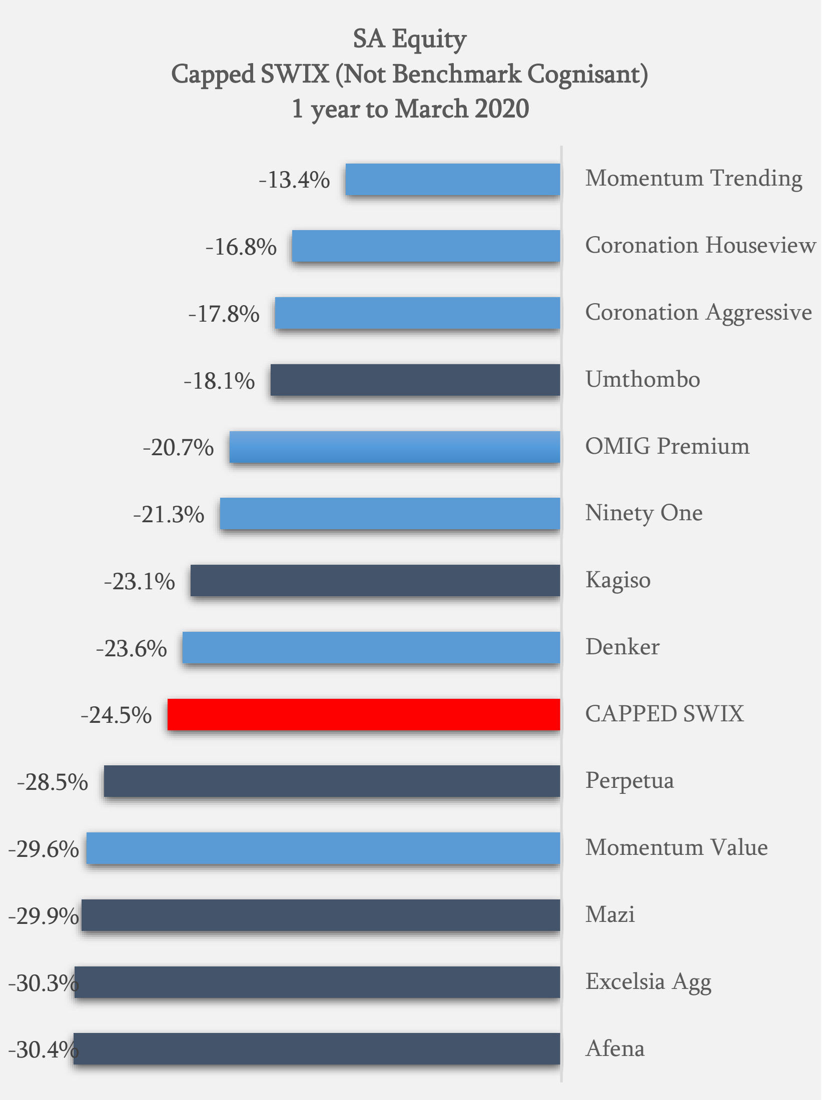
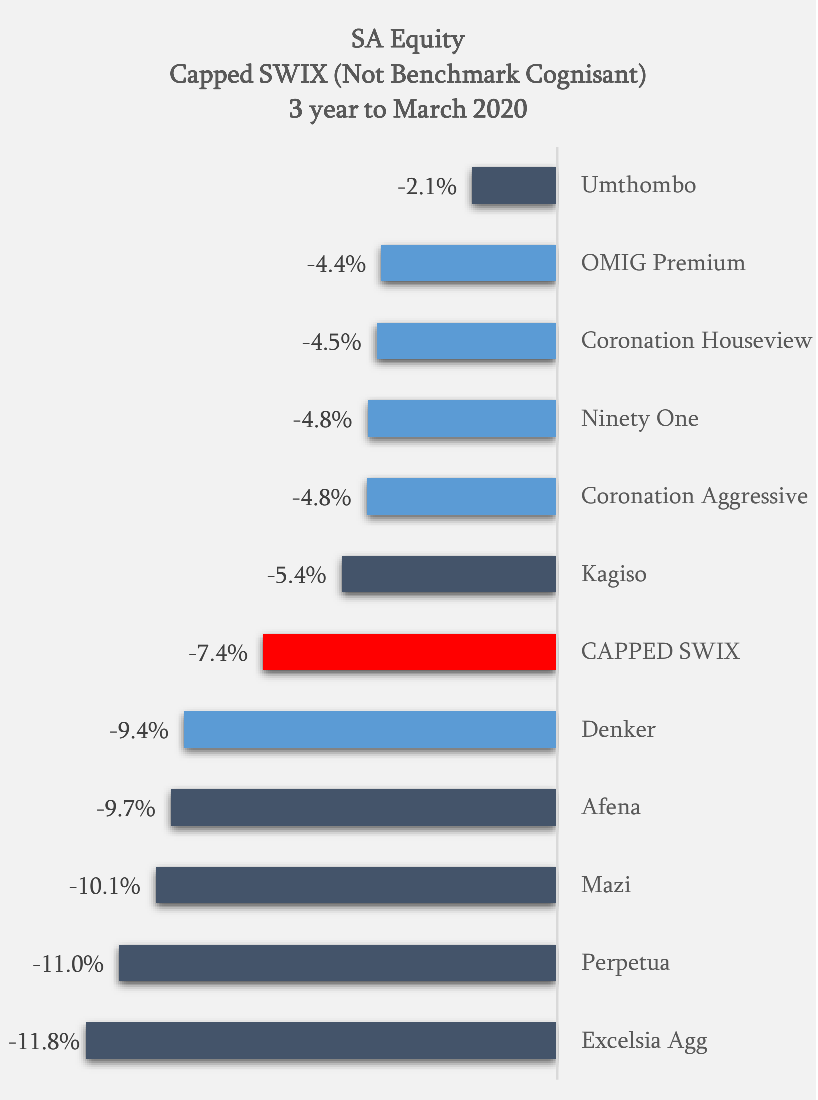




Source: Motswedi Research, Alexander Forbes Manager Watch

SA Equity - Capped SWIX (Not Benchmark Cognisant)





Source: Motswedi Research, Alexander Forbes Manager Watch

SA Bonds - ALBI

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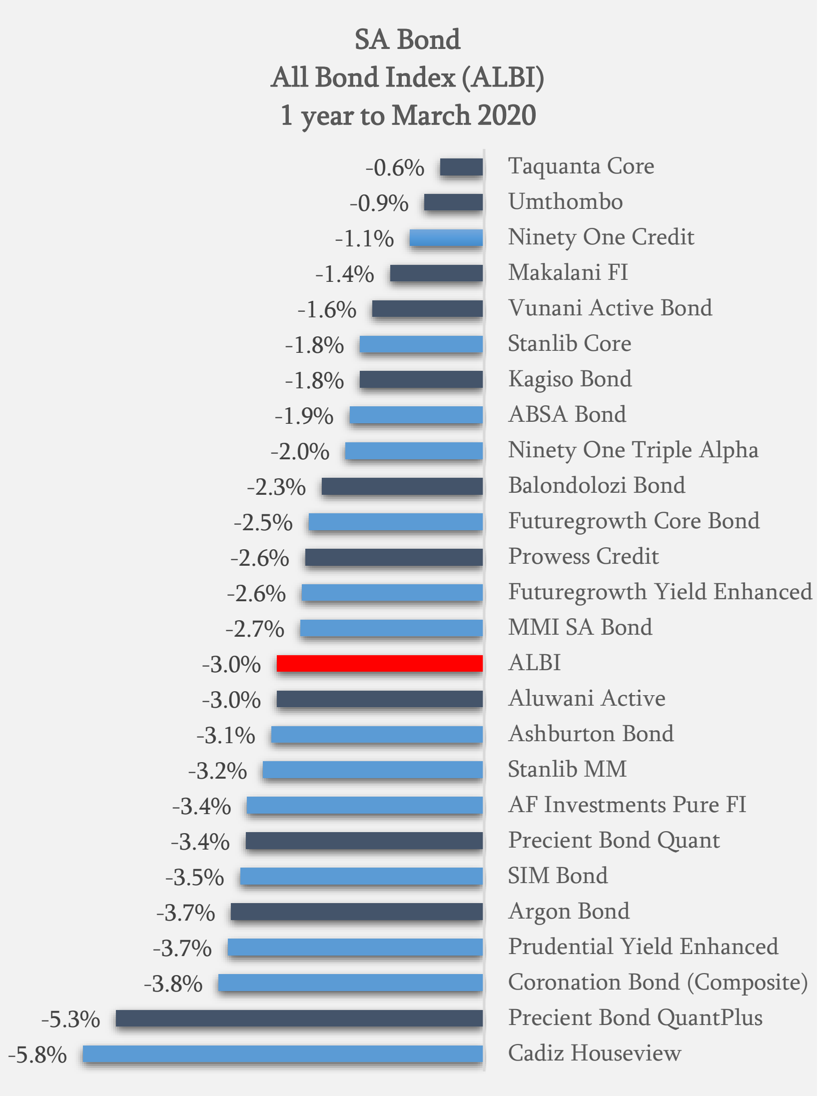
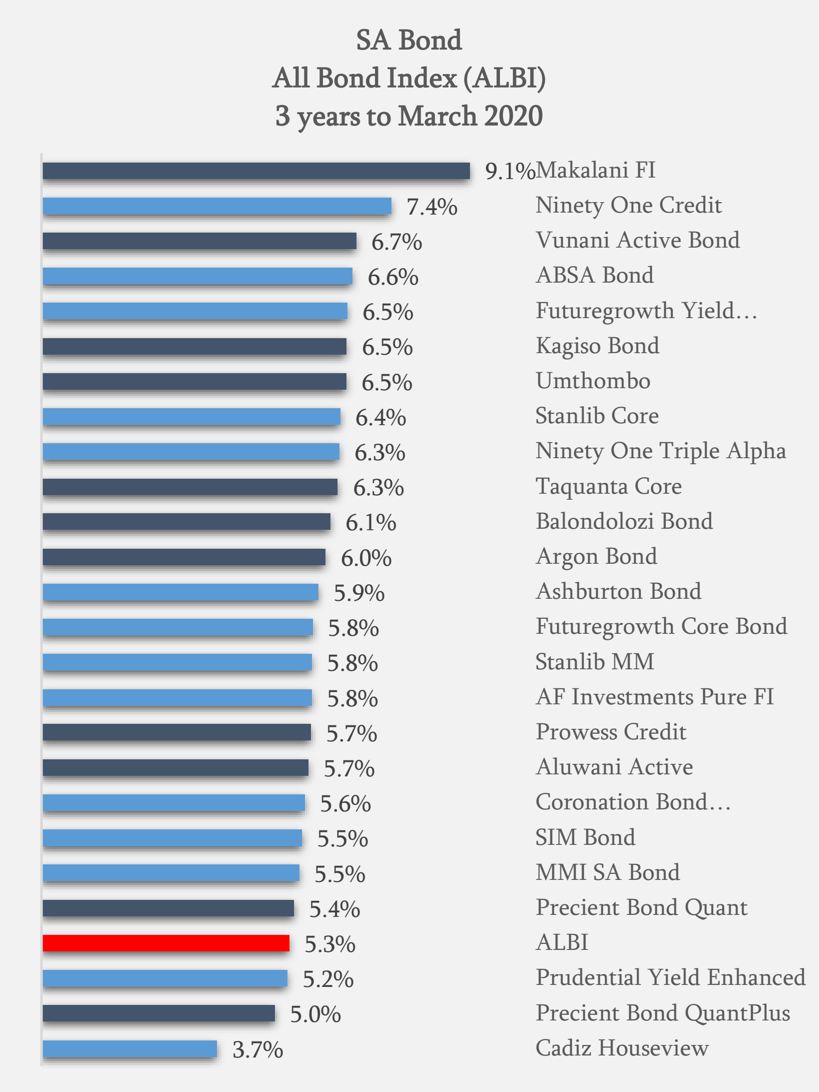
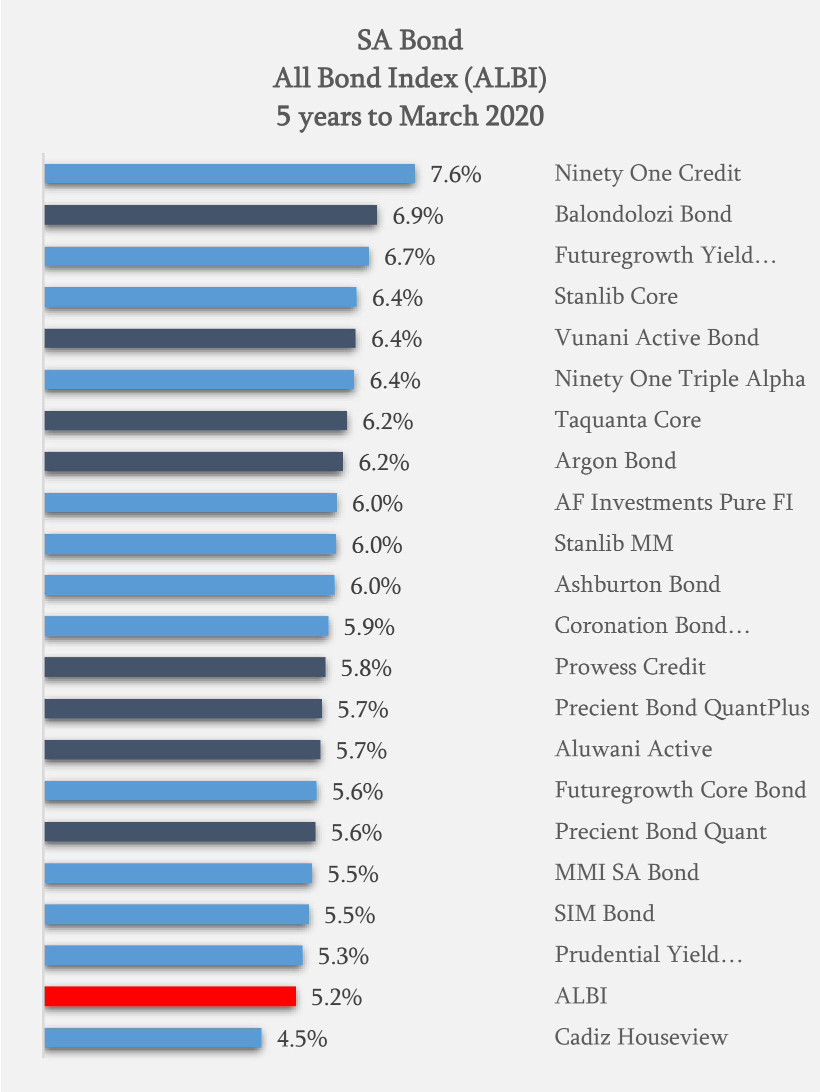
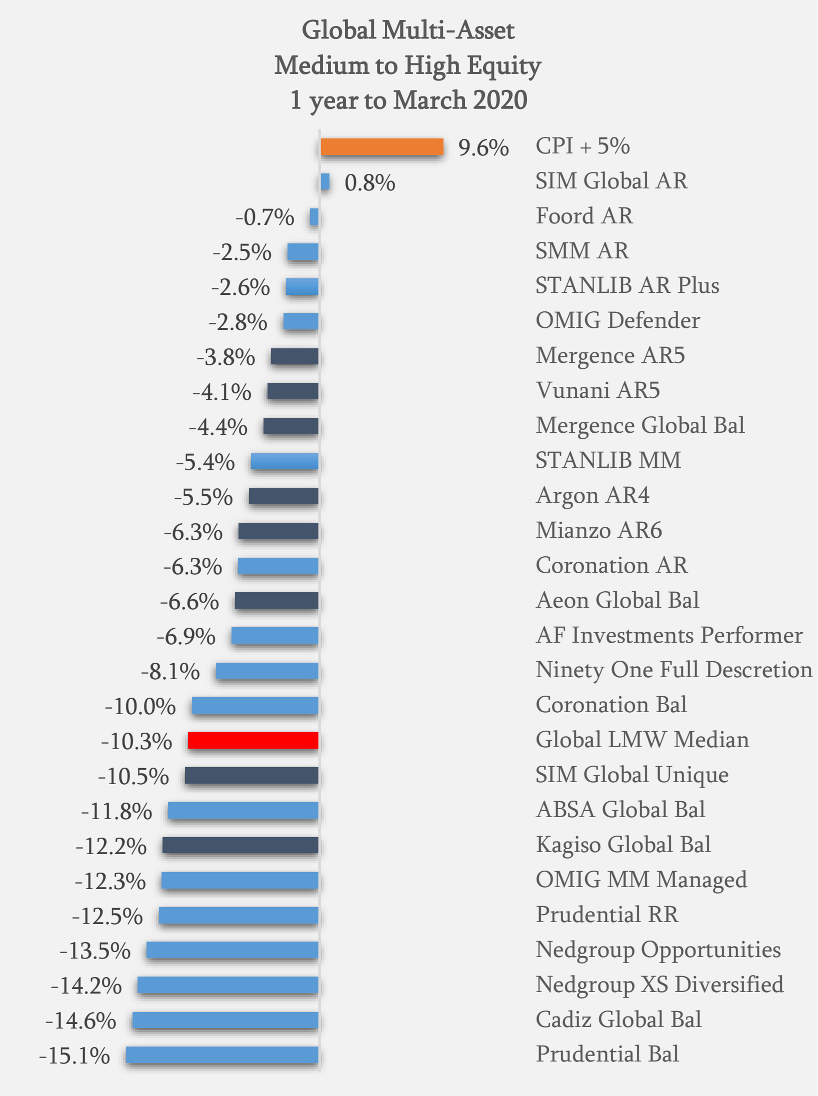


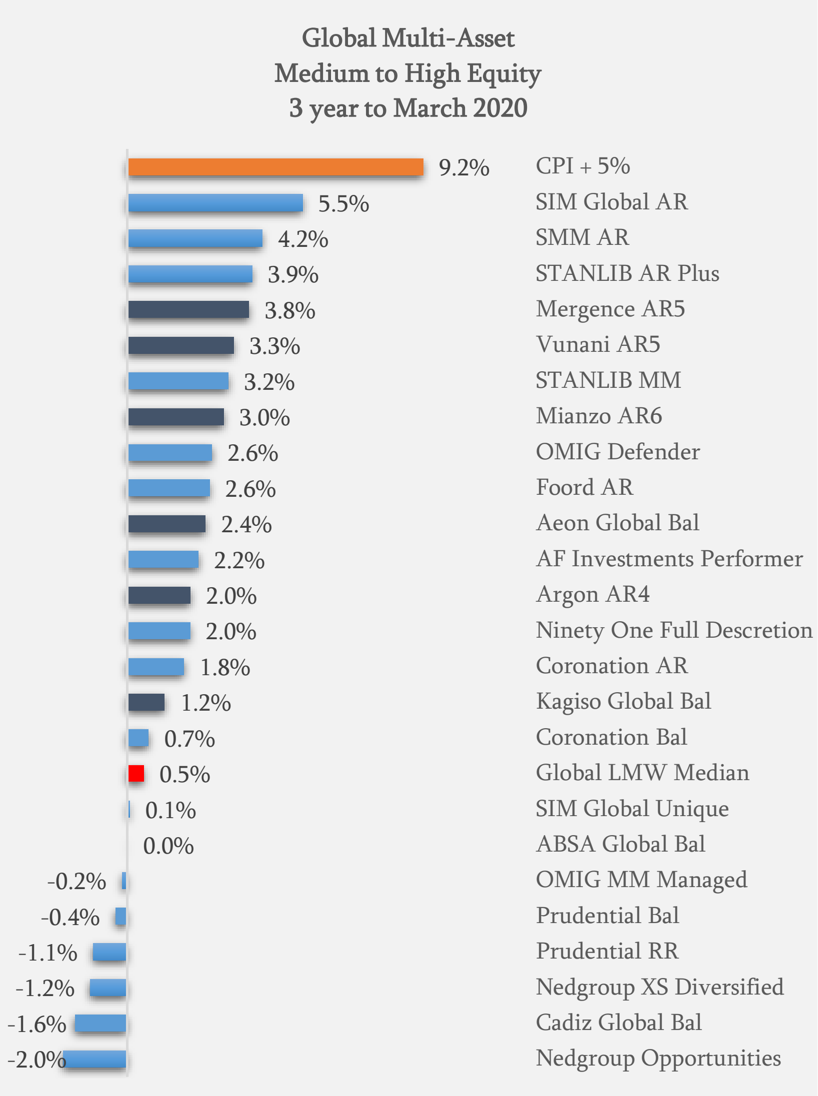


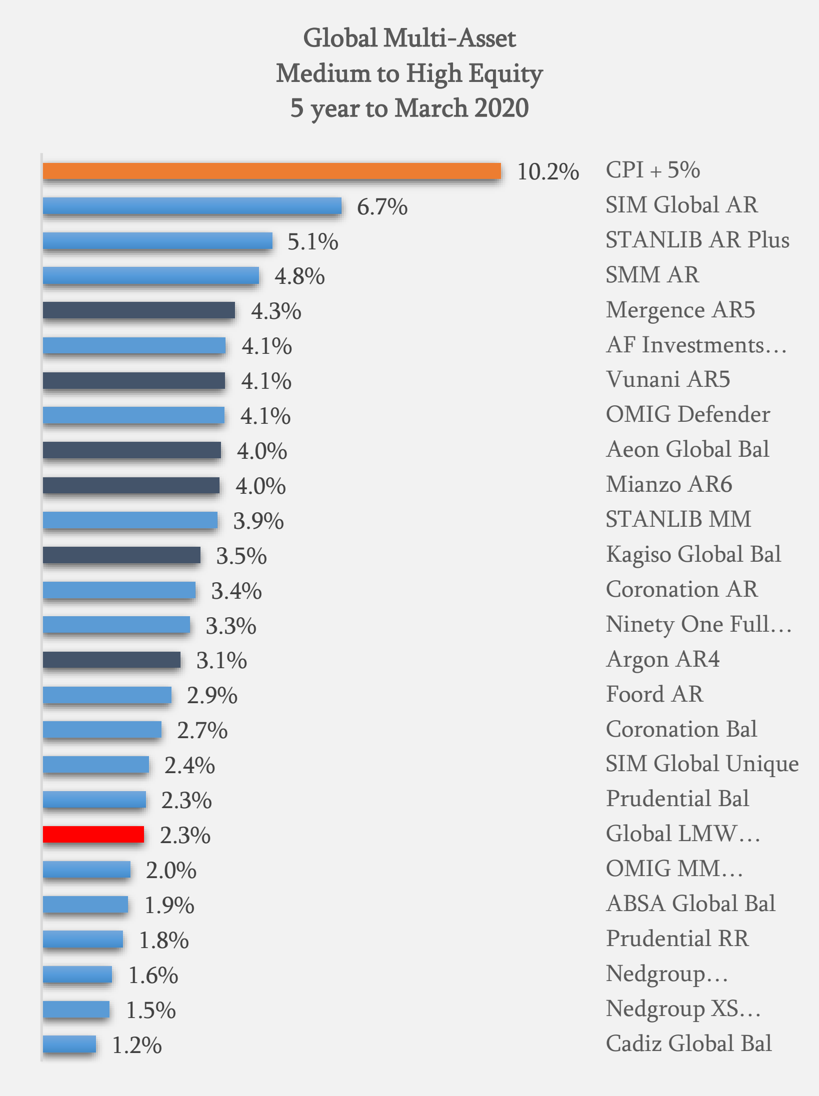


Source: Motswedi Research, Alexander Forbes Manager Watch

Global Multi-Asset







Source: Motswedi Research, Alexander Forbes Manager Watch

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Manager views: Multi-asset strategy

by Lima Mbeu Investment Managers

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A critical period for a multi-asset strategy

The performance of asset classes often varies in response to shifting economic conditions. However, as the economy moves beyond certain thresholds, financial market behaviour is usually very different from its behaviour during more normal times. The relationship between economic fundamentals and financial markets often breaks down at the extremes, and the response of financial markets to various stimuli is not necessarily uniform. Multiple studies, detailed in our reference list, show that Bonds typically outperform in periods of low economic growth accompanied by low inflation. Government bonds provide relative stability in times of economic uncertainty as well as effective risk-reduction to portfolios often dominated by explicit or implicit equity risk. In a recession that is coupled with disinflation, companies lack pricing power. This is an adverse environment for equity returns, and nominal bonds usually generate above average to very strong returns. We used asset class return, and macro-economic data sourced from IRESS and Bloomberg, dating back to 1970, to study the performance of asset classes during global recessions.

Buy bonds during the recession but retain sufficient exposure to equities for the recovery

Our findings show that domestic equity has historically been the worst-performing asset class during recessions while domestic and offshore bonds have delivered the best returns. Offshore asset classes have often benefitted from the currency's weakness during recessions. The global flight to quality often drives significant portfolio outflows from 'high-risk' emerging market economies. In the 12-month recovery period, immediately after each recession, we found equities (domestic and global) to be the best performing asset class – an indication that investors often overreact during market crises.

Countercyclical monetary and fiscal policy measures have generally helped shorten recession spells during crisis episodes, leading to riskier assets outperforming during the recovery period. Similarly, today, central banks across the world have taken bold and decisive actions by easing monetary policy, purchasing a range of assets, and providing liquidity to the financial system. Large, timely, and targeted fiscal measures have been rolled out to ensure temporary shutdowns do not lead to more permanent damage to the productive capacity of the global economy. Some investors are worried that this recession may be different from previous downturns. Uncertainty is highly elevated, given the unpredictable course of the pandemic. We are not virologists or medical experts, but we certainly hope that hindsight bias does not lead the market into thinking that the course of the 1991 Gulf War or the 2008 financial crisis was any less certain than that of the current pandemic.

Therefore, the most optimal strategy, based on historical data, is one that prefers domestic and offshore bonds during the recession but switches this into domestic and offshore equities during the subsequent economic recovery. Market timing is challenging to get right. We think that a better strategy is one that remains neutral equities, with an overweight position in bonds that is acquired at the expense of cash. The most significant risk to keep an eye on will be sovereign default risk.

Bonds are Incredibly cheap relative to cash

SA has entered the 2020 recession with fiscal policy space that is constrained - debt is at structurally higher levels accompanied by wider structural deficits. Furthermore, economic growth was already weak, coming into the current global recession. The IMF notes that initial fiscal conditions have historically been an important indicator of how well an economy is likely to navigate a shock. In countries with high pre-crisis public debt levels, lack of fiscal space undermines the effectiveness of the fiscal stimulus. Crises can have long-term adverse effects, damaging human and physical capital with negative implications for productivity and potential output growth.

Similarly, the COVID-19 pandemic is expected to have a significant adverse impact on economic activity. Government revenues will fall as activity and trade decline, while temporary spending will increase materially. The IMF expects a considerable increase in SA's 2020 fiscal deficit – from -6% to -13% of GDP – one of the highest fiscal deficits among developed and emerging economies. Gross debt is estimated to increase to 77,4% of GDP in 2020, from 57% in 2019. This fiscal expansion is a necessary measure that is expected to save lives. Limited fiscal policy space, the recent credit rating downgrade, and aggressive interest rate cuts have led to domestic bonds being the cheapest they have been in 30 years, relative to cash.

The inflation outlook has deteriorated on expectations of sustained economic weakness, giving the SARB enough headroom to cut rates aggressively. Are bonds a screaming buy or avoid? We think that once the COVID-19 crisis is over, SA may have to enter a period of fiscal consolidation. We don't have a crystal ball on the size, composition, or pace of fiscal consolidation that may be undertaken. Still, we think that adopting the right policy actions post the pandemic, may decrease the sovereign default risk.

Contact Lima Mbeu Investment Managers to retrieve the full paper titled AN INVESTMENT STRATEGY FOR THE WORST OF TIMES.

About Motswedi

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Motswedi Emerging Manager Strategists is an independent asset manager research business focusing on the South African investment management industry with specialisation in transformation initiatives. We are the industry leader in providing insight and access to the new generation of emerging asset managers in South Africa. We encourage the development of a more diverse industry that can contribute towards economic growth.

Our vision is to be a financial services company that services both institutional and retail clients to provide access to high quality and well researched emerging managers. Our higher purpose is premised on "Reshaping the South African asset management industry" by promoting transformation, gender equality, skills development and stimulating economic growth through supporting and investing with transformed asset managers.

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