ViewPoints

Winter Edition - July 2020

At a glance – our asset class views

Please be aware that there are risks in simply implementing these views into a portfolio without carefully considering the dynamic nature of the environment and how change impacts each asset class.

While our long-term real return assumptions are derived assuming that markets are in equilibrium, we do not believe that is the case all the time. We therefore take views (tactically over/underweight) on relative asset class performance over three to twelve months, specifically ignoring shorter term noise, and not relying on long-term expectations i.e. we need to see the catalyst for the relative performance.

Domestic SA	**Comment**	–	°	+
Equities	Underweight – potentially lower earnings due to Covid-19	–		
Listed property	Underweight – weak economic fundamentals	–		
Bonds	Overweight – real yield opportunities			+
Income*	Overweight – defensive characteristics			+
Money market	Overweight – default asset class			+

Global	**Comment**	–	°	+
Equities	Overweight – valuations not too demanding			+
Bonds	Underweight – low yields	–		
Money market	Underweight – default asset class	–		

**Floating rate instruments of maturity longer than one year*

***Views expressed for each asset class are subjective and are for the asset class as a whole. All views are as at 30 June 2020*

Domestic asset classes

Equities

- We changed our exposure in SA equities earlier in the year from an overweight to an underweight position. It had become evident that Covid-19 was spreading faster than expected and forcing many countries to close down certain parts of their economies. In the second quarter, equity markets rallied strongly but we remained concerned about the earnings outlook for most SA companies.
- Earnings expectations from some of the buy and sell side analysts suggests that companies could see as much as a 15% drop in earnings this year compared to 2019, due to the lockdown restrictions.
- Having said that, it is not all bad. A few valuation metrices imply that SA equities remain cheap. The market is trading on a trailing PE of 14.4x with a dividend yield of 4.4% but for now, we maintain the underweight position.

Listed property

- We remain negative on SA property. The headwinds highlighted last quarter remain at play, if not more elevated right now. These include a high unemployment rate, poor economic growth and high vacancy rates.

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- The lockdown restrictions have exacerbated the situation over the past few months and most companies have struggled to meet their rental payments. On the positive side, bond yields have come down; the SARB cut interest rates by 150 basis points in Q2 and some of the lockdown restrictions have been eased.
- Valuations look attractive at face value with a forward yield of 10.7%. However, the 30.1% unemployment rate in SA and negative 7.2% GDP growth expectation by National Treasury trumps the valuation argument.

Bonds

- We maintained our overweight bond position in the second quarter. Although bond yields have come down from March highs, bonds remain attractive. The 10-year government bond is yielding 9.4% while inflation is at 3%. Even if you substitute the 3% with breakeven inflation – roughly about 3.4% – bonds remain attractive.
- The recent budget update from National Treasury painted a bleak picture of SA finances. While we believe this could pose challenges in the next few years, in the short term we like bonds.

Income

- For most of 2019, we preferred income relative to long-dated bonds and cash as it has some of the defensive characteristics of cash with the potential for higher upside. We maintain this view in 2020.
- Recent interest rates cuts by the SARB have made income more attractive relative to cash. The 3x6 forward rate agreements suggests that future short-term rates are likely be lower, around 3.5% and this adds to income's relative attractiveness.

Cash

- This is our default asset class – we increased cash to express our preference for defensive asset classes in SA.

Global asset classes

Equities

- We are marginally overweight global equities. Our concerns on the SA earnings outlook extends to global companies but the dominance of technology companies in these markets provides a bit of comfort.
- Moreover, the amount of liquidity that central banks have put in the system is likely to support global equities and possibly dampen the Covid-19 impact.
- Valuations are starting to be demanding and we are monitoring them. The market is on a historic PE of 21.4x and a dividend yield of only 2.3x which is less attractive relative to what we have seen previously. The forward PE is also not attractive.

Bonds

- We reduced bonds from neutral to an underweight exposure in the second quarter. The risk-off trade in the first quarter pushed bond yields lower from already depressed levels.

Cash

- We use global cash to increase/decrease offshore and currently, we have reduced cash to an underweight position as we believe local assets are more attractive than global assets.

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