ViewPoints

Spring Edition - October 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	–	o	+
Equities	Underweight – potentially lower earnings due to Covid-19	–		
Listed property	Underweight – weak economic fundamentals	–		
Bonds	Overweight – attractive real yield opportunities			+
Income*	Overweight – defensive characteristics			+
Money market	Overweight – default asset class			+

Global	Comment	–	o	+
Equities	Overweight – support from central banks			+
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 September 2020*

Domestic asset classes

Equities

- We started the year with an overweight position in SA equities when valuations were supportive; and US and China had agreed to a ceasefire. However, COVID-19 changed the playing field and introduced new risks to company earnings. As this unfolded, we changed our equity positioning to an underweight exposure in February.
- This position protected well in the March sell-off and markets have since recovered. Despite the recovery, we remain concerned about SA equities – the local economy was already in a recession before the pandemic hit.
- Valuation metrices are currently a mixed bag. By historic standards, dividend yields and trailing PEs point to an expensive market but the forward PE is arguing the opposite. At this point, we are happy with our underweight position.

Listed property

- We remain negative on SA property. The market is facing many headwinds – a high unemployment rate; poor economic growth and oversupply in certain sectors. The negative impact of Covid-19 is also likely to continue to affect the market as companies reassess the needs for office space. People are reluctant to gather in numbers in retail establishments as fears of a second wave remain a possibility.

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- At face value, valuations look attractive with a forward yield of 10.7% and it is encouraging that companies have lowered pay-out ratios and focusing on improving balance sheets. Despite this, we prefer to remain underweight property.

Bonds

- We maintained our overweight position in bonds for the third quarter. While bond yields have come down from their March highs, we believe bonds remain attractive and the recent interest rate cuts by the SARB has increased the attractiveness of longer dated/higher yielding markets.
- The SA 10-year government bond is currently yielding 9.4% while cash rates, as measured by SA 3-month JIBAR, are at 3.4%. We understand SA's fiscal challenges, but feel the current yields compensate for this.
- It is also worth pointing out that SA is not the only country facing these challenges. Many countries, including the developed ones, are struggling with debt problems and lower tax collections. Hence, we are happy to remain overweight bonds for now.

Income

- For similar reasons to bonds, we prefer income relative to cash.
- The 3x6 FRA implies that the SARB could cut rates by another 25 basis points in the next few months. However, even if this does not happen, inflation remains very low and short-term interest rates are likely to be anchored for a bit longer.

Cash

- This is our default asset class. Although we do not like the low interest rates, we are marginally overweight as an expression of our preference for fixed income assets relative to equities and property in SA.

Global asset classes

Equities

- Although we continued to cut our global equity position in Q3, we remain overweight. The market has rallied hard since March and our concerns around the SA earnings outlook extend to global companies. Moreover, the resurgence of the US/China feud, as well as a second wave of Covid-19 cases in Europe and UK, needs to be monitored closely when considering equities.
- We take comfort that many technology companies stand to benefit from the pandemic but it is fair to say that they have already rallied in the past few months. Furthermore, the actions of central banks remain supportive of equities.
- We are monitoring this position closely as valuation metrics have started to point to expensive territory.

Bonds

- We remain underweight global bonds. When comparing the 0.68% offered by 10-year US treasuries to the 9.4% in SA, it does not justify being overweight global bonds.
- We acknowledge that yields on global bonds can and have, continued to fall and hence, capital returns have been better. We also understand the risks priced by higher yield markets such as SA.
- However, we currently still prefer local bonds to offshore bonds.

Cash

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

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