ViewPoints

Winter Edition - July 2021

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, how changes impact each asset class and the unique needs of each client.

While our long-term real return assumptions are derived assuming that markets are in equilibrium, we do not believe that this 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	Overweight – potential beneficiary of a risk-on trade			+
Listed property	Overweight – weak fundamentals but valuations are attractive			+
Bonds	Overweight – attractive real yield opportunities			+
Income*	Overweight – defensive characteristics			+
Money market	Underweight – short-term rates are too low	–		

Global	Comment	–	°	+
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 June 2021*

Domestic asset classes

Equities

- Following the strong recovery since the lows in Q1 2020, SA equities produced muted returns over the quarter as metal prices fell, leading to a sell-off in resource companies. Technology companies also lost momentum as scrutiny of the sector by regulators in China and the United States increased. Financial companies performed well as the market rewarded attractive valuations of SA sensitive companies.
- We understand the reasons for the recent market activity and remain comfortable with our overweight position. SA is expected to grow at 4.4% this year and is committed to procuring more vaccines, which will ultimately lead to less severe lock-down restrictions. We acknowledge that SA's vaccination programme roll-out has been slow but we expect more positives to flow as the country ramps efforts.
- Compared to other asset classes, equity valuations remain attractive with multiples not too demanding. To highlight a few, the forward PE is below 10x, dividend yield at 2.6% and PB is 1.7x.

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Listed property

- We are marginally overweight property. The risks for the asset class are balanced – on the one hand is the tough trading environment that companies find themselves in, coupled with the recent unemployment rate of 32.6% in Q1 2021, poor retail sales in recent months and reduced foot traffic in malls – especially super regional malls – caused by the third wave of the COVID-19 pandemic. On the other hand is the attractive valuations caused by four years of poor returns.
- Another positive is that property companies have resorted to self help measures i.e. reducing pay-out ratios, selling non-core assets and strengthening balance sheets. As a result, the sector has done well recently, up 25.6% in the past year.

Bonds

- We increased our overweight position in the first quarter when bonds sold off. The 10-year SA government bond weakened to 9.9% in March, providing an opportunity to buy more. Since then, it has rallied to 9.2%. However, despite the recent rally, the yield curve remains steep and the long end still reflects market concerns of higher inflation in the future.
- We do not expect future inflation to be as high as the market expects it to be – break-even inflation was above 6% in June and we believe this is too high for an inflation-targeting country.

Income

- We are marginally overweight income. Over the past year, we liked income due to its defensive nature when compared to long-dated bonds. Currently we like it for different reasons – most notably, its relative attractiveness compared to cash.
- Yields on 3-year bonds are 5.5%, which is 180 basis points higher than the 3-month JIBAR's 3.7%.

Cash

- Default asset class – following the 300 basis point interest rate cut by the SARB in 2020, cash rates remain low. Having said that, the 3x6 FRA is pricing higher rates in the next 6 months – approximately 50 basis points. The underweight exposure to cash also captures our preference for risk assets at this point.

Global asset classes

Equities

- We are overweight global equities. This asset class has benefitted from the wall of money from major central banks, as well as the recently announced US infrastructure stimulus. Buy and sell side analysts still call for an overweight position citing that developed countries have been able to acquire more vaccines than emerging markets and will thus reach herd immunity sooner.
- Valuations look stretched at face value with an historic PE of 30x compared to a long term median of 20x. While earnings expectations remain high, the forward PEs are still 21x. Having said that, the asset class remains attractive relative to global bonds and cash.

Bonds

- We are underweight global bonds. Although the sell-off in March when inflation concerns resurfaced made bonds more interesting, we did not change our position. We are of the view that the carry in South African bonds is high enough to compensate for the additional risk.

Cash

- Default asset class – we use global cash to increase/decrease offshore exposure and currently, we have reduced cash to an underweight position as we believe SA assets are more attractive relative to global assets.

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