Where is the good news for SA investors?

We are at the stage in investment markets where the doom and gloom mindset needs to be challenged. This is one of the most common pitfalls for investment managers and their clients: getting caught up with general market sentiment and failing to recognise good investment opportunities looking ahead. It is a healthy and valuable exercise to test oneself against this 'common wisdom' to make sure that the other side of the argument is indeed the weaker one. And if not, to consider what changes should be made to investment views and portfolios.

South African investors are typically good at processing bad news. Do we give bad news too much credit? Bad news in our market is well documented so we will not dwell on it here, other than to put forward a few reminders for context: a currency at near record weakness, instability in government policy, poor economic growth prospects, declining competitiveness, a fragile set of parastatals, all embedded in an emerging market which has currently lost its lustre in the global economy. There is no shortage of headwinds.

First to point out an anomaly which we experience in what is a relatively small and concentrated stock market. Current valuation levels remain high on the JSE, at last count trading on a price-to-earnings multiple above 18. This is significantly higher than the long term average of around 13. So we have substantial negative sentiment, a market which has sold off substantially off its highs, yet a valuation level which sits in 'expensive territory'?

This anomaly stems from the increasing global component of our market. Companies like British American Tobacco, SABMiller (now ABInbev), Naspers, Richemont and BHPBilliton are for all intents and purposes offshore companies with local roots. While some of these companies have been performing exceptionally well, their prices reflect this in high valuations. What is less obvious in the overall market numbers is how the lesser known names are faring. These tend to be the smaller mid-cap companies which have a higher reliance on the local economy.

At the moment, the top 50 companies on the JSE are trading at an average PE of 20, while the next 50 are trading on a PE of 14. This gap has become wider as the past year has progressed and the Mid Cap shares have underperformed. So there you have it, the first piece of good news: local mid cap shares seem to be offering decent value and relative diversity to investors.

Taking a step back, recent developments between the government and private sector have also shown promise. Apparently the incentive for this to take place is the very real threat of a credit downgrade, the consequences of which no-one really wants to consider. This has spurred authorities into action, with a number of joint discussions between leadership of both the private and public sector. There has even been talk of secondment of experienced private sector managers to assist with parastatals – a key ingredient to our economy recovering. These discussions have also considered privatization options, or public/private partnerships such as what happened with Telkom. (on this point – when Telkom was coming to market through its listing in 2003 the general 'consensus' was negative. Less so because of its investment prospects, but because of local experience in dealing with the company. Foreign investors did not have these blinkers on, and were very keen to steal a march on local investors by buying up stock). Good news point # 2: government and private sector partnerships can help stabilise and grow the economy.

The fact that our currency has weakened so sharply has made our manufacturing sector more competitive almost overnight. Manufacturing for export is a meaningful contributor to our GDP and employment rates and this is a sector we would hope to see gaining some sizeable offshore contracts. Good news # 3: a weak rand is good for some parts of our economy.

The mining sector is our main export (up to 60% of total exports). While a recovery to levels seen in the 2000's seems unlikely, there will be increasing demand for basic materials such as platinum which is used in car manufacturing worldwide. The platinum price has staged somewhat of a recovery, trading at $910 which is only 10-15% off the typical breakeven price for the sector. South Africa is basically the platinum sector, accounting for 70-80% of global production, and stands to be the main beneficiary when above ground stocks have dwindled and demand for new stock comes through. Good news point # 4: platinum will recover.

While the firing of Minister Nene seems regrettable, the re-appointment of Pravin Gordhan is a positive step. His ability to manage country finances and also to manage at the parastatal level are evidence of a strong individual who understands the dynamic between policy and productivity. His leadership will be central in SA staging an economic, and ultimately investment, recovery from where we are today. Good news point # 5: we have strong leaders like Pravin Gordhan.

The list of headwinds remains substantially stronger than the tailwinds, but here you have five positives to consider. In a 2014 speech Hugh Herman (ex-Chairman of Investec) made the comment that “you have to be an optimist to make money investing”. With negative news abounding, is it time for the optimist to come to the fore?

31 January 2016

Sector		1m	3m	6m	YTD	1yr	3yr pa	5yr pa	10yr pa	10yr Vol
LOCAL MARKET INDICES (In Rands)										
FTSE/JSE All Share Index (ALSI)	ZAR	-3.0%	-8.3%	-4.0%	-3.0%	-1.1%	10.0%	12.8%	12.7%	15.3%
FTSE/JSE SA Listed Property	ZAR	-3.0%	-9.4%	-6.5%	-3.0%	-2.4%	12.5%	17.3%	16.5%	16.9%
SA All Bond Index (ALBI)	ZAR	4.6%	-3.4%	-2.1%	4.6%	-5.6%	3.6%	7.5%	7.4%	7.4%
SA Cash Index (SteFI)	ZAR	0.5%	1.6%	3.2%	0.5%	6.5%	5.9%	5.8%	7.3%	0.6%
Balanced Benchmark [2]	ZAR	-1.2%	-3.5%	1.0%	-1.2%	4.9%	12.0%	13.8%	12.7%	7.0%
SA Inflation (1 month lag)	ZAR	0.3%	0.6%	1.7%	0.3%	5.2%	5.3%	5.5%	6.1%	1.4%
GLOBAL MARKET INDICES (in USD)										
Global Equity (MSCI World)	USD	-6.1%	-8.4%	-11.5%	-6.1%	-6.9%	3.6%	3.6%	1.8%	16.5%
Emerging Markets Equity (FTSE EM)	USD	-6.5%	-11.9%	-18.2%	-6.5%	-21.4%	-8.8%	-5.1%	2.5%	23.4%
Global Bonds (Barclays Global Bond Index)	USD	0.9%	-0.3%	0.6%	0.9%	-2.2%	-1.2%	1.0%	3.7%	5.6%
Global Cash	USD	0.0%	0.1%	0.1%	0.0%	0.2%	0.1%	0.2%	1.5%	0.6%
MAJOR INDICES BASED TO RANDS										
FTSE/JSE All Share Index (ALSI)	ZAR	-3.0%	-8.3%	-4.0%	-3.0%	-1.1%	10.0%	12.8%	12.7%	15.3%
Global Equity (MSCI World)	ZAR	-3.6%	5.5%	11.5%	-3.6%	27.3%	25.5%	21.5%	12.0%	13.5%
Emerging Markets Equity (FTSE EM)	ZAR	-4.1%	1.5%	3.1%	-4.1%	7.5%	10.6%	11.3%	12.8%	15.4%
COMMODITIES										
Gold (US Dollars)	USD	4.4%	-4.6%	1.7%	4.4%	-12.4%	-13.1%	-3.9%	6.8%	19.1%
Gold (Rands)	ZAR	7.1%	9.8%	28.2%	7.1%	19.8%	5.3%	12.7%	17.6%	21.6%
Currencies (positive return = Rand weakening)										
Rand / Dollar	ZAR	2.6%	15.2%	26.0%	2.6%	36.7%	21.2%	17.2%	10.1%	16.2%
Rand / GBP Pound	ZAR	-1.2%	5.8%	14.6%	-1.2%	29.1%	16.8%	14.4%	7.6%	14.4%
Rand / Euro	ZAR	2.2%	12.8%	23.4%	2.2%	31.1%	12.4%	11.8%	8.8%	13.9%

Spot Rates

31-Jan-16		7-Feb-16	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
Rand/US$	Rand	16.02	15.46	11.45	6.62	6.32	3.65
Rand/GBP	Rand	22.82	22.55	17.95	10.31	10.89	5.66
Rand/EUR	Rand	17.88	16.80	13.99	8.84	7.48	4.33
Rand/Aus $	Rand	11.28	11.25	9.45	6.76	4.64	2.72
Libor 6m $	US$	0.87	0.85	0.36	0.46	4.70	N/a
Prime	Rand	10.25	9.75	9.25	9.00	10.50	18.50
Repo Rate	Rand	6.75	6.25	5.75	5.50	7.00	N/a
All Bond Index Yield	Rand	9.03	9.38	8.24	8.58	9.40	13.31
Gold ($/oz)	US$	1,172.74	1,060.82	1,183.15	1,421.40	517.10	387.20
Palladium	US$	517.00	547.00	798.00	797.00	258.00	130.75
Platinum	US$	912.50	891.00	1,209.00	1,770.00	970.50	399.50
Oil (Brent Crude) $	US$	34.06	37.28	57.33	94.75	57.63	18.32
SA Inflation	Rand	N/a	5.20	5.30	3.50	3.60	6.90

data provided by Profile Data Analytics and INET BFA