

Looking beyond the corona crisis

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Over the past few months, the epicentre of the COVID-19 outbreak has shifted. In the early days, governments around the world hoped that by acting decisively, the outbreak could be put behind us swiftly. This has not proven to be the case and the disease has shown itself to be a truly global pandemic. The implications are severe, and likely to endure way beyond what was initially hoped.

Shelter-in-place and lockdown measures aimed at containment have decimated economic activity and the ensuing global recession has been faster and deeper than that experienced in the 2008/2009 Global Financial Crisis (GFC). Meanwhile, we have also seen unprecedented monetary and fiscal stimulus measures introduced by policymakers around the world to counteract the impact on economies.

Fiscal support measures are especially noteworthy as they have been significantly larger than over the last decade. In combination, these measures have the potential to be highly inflationary once the demand and oil price shocks have made their way through the global system.

While much remains uncertain, we are increasingly intrigued by the possibility that the future could look very different to the most recent experience. Below is our current perspective on asset classes.

Local equities – not merely a homogenous macro play

The investment case for South African equities is often met with extreme pessimism. With glaringly obvious challenges such as deep structural impediments to growth, unemployment, and depressed aggregate demand, this view is somewhat justified. However, there are also some positive macro fundamentals to consider.

Interest rates and inflation rates are at historic lows, creating a stimulatory backdrop. Headwinds are undoubtedly large and enduring, but this does not mean that there is not an investment opportunity in selective cases. Indeed, history suggests that pervasive gloom is often a necessary pre-condition for being able to buy attractive franchises at attractive prices.

In the race to the bottom, the market may be overlooking the substantial differentiation and quality that exist in the local share investment universe. Some of these companies with particularly noteworthy attributes include portfolio holdings such as AB Inbev (global brewer with temporary headwinds, yet listed on the JSE), Discovery (highly defensive cash flows from core health and life operations and temporarily obscured growth) and the JSE Limited (cash-flush exchange with revenues benefiting from elevated volatility). Smaller companies such as Raubex, WBHO and Afrimat stand to benefit from reduced local competition as competitors fall by the wayside due to tough local conditions. Many shares are now pricing in exceptionally low expectations far into the future.

Foreign equities: a chasm between high and low expectations

Globally, the market is presenting a very large opportunity to invest in above-average companies at below average prices in certain areas outside the current market favourites. The gap between highly rated sectors and companies and the rest is at extreme levels: this chasm in expectations will reward patient investors, much like they have in the past.

Listed property: challenged, with early signs of some opportunities emerging

We have recently begun to see value in the local listed property sector again for the first time in a long time and have started to selectively allocate capital to certain counters. We continue to favour foreign real estate, and believe the local listed property companies will continue to face a challenging period. This is due to a need to reduce debt, and abide by

minimum REIT payout levels against a backdrop of a challenging leasing environment and falling property valuations. We see elevated share count risk for many companies.

We continue to favour SA government bonds over corporate credit and cash

While we acknowledge that there are risks to SA government bonds, we believe they are less risky than the narrative suggests. The exceptionally high income yields they offer have resulted in an asymmetric risk profile that is likely to offer investors equity-like returns over the next few years. By contrast, the corporate credit sector is thinly traded and illiquid, and remains vulnerable to a repricing if liquidity starts to dry up.

A consistent investment process is essential in navigating the current uncertainty and noise

The pandemic has brought about an exceptional amount of uncertainty and noise. It is important to acknowledge that the environment is fluid and to focus on what we know is certain, rather than falling prey to emotional decision-making. We know that normality will return to both our lives and markets at some point: no crisis lasts forever and calm, patient investors will be rewarded in time.

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