

News release from GTC

Finding investment opportunities among the many COVID-19 risks – GTC Investment Analytics

9 April 2020

With many countries around the world in lockdown as they try to contain the spread of the COVID-19 virus, the global economy is facing an unprecedented situation of balancing health against financial livelihoods.

“With the world at a standstill, many people will be particularly worried about the effect of the virus on their investments, but all is not lost,” says Clive Eggers, head of Investment Analytics at leading wealth and financial advisory business GTC.

First, central banks and regulators are beginning to intervene in attempts to lessen the economic impact of lockdowns.

“Our own Reserve Bank is working to provide stability and stimulus for the South African economy, and even directly to those affected by layoffs or debt obligations,” says Eggers.

Examples of interventions include interest rate cuts, government injections of cash alongside private donations, tax and debt repayment holidays for small businesses, the use of UIF and the repurchase of bonds by the treasury to create liquidity in markets. “These measures are all aimed at alleviating financial consequences suffered by our corporates and citizens,” he continues.

But Eggers adds that there are still external pressures on our economy, such as the drop in global trade and a ‘risk-off’ investment environment in which investors tend to sell riskier assets such as equities in favour of safer assets such as bonds or cash, the recent removal of South Africa’s last investment-grade credit rating by global credit ratings agency Moody’s and a drop in the value of the rand against other currencies.

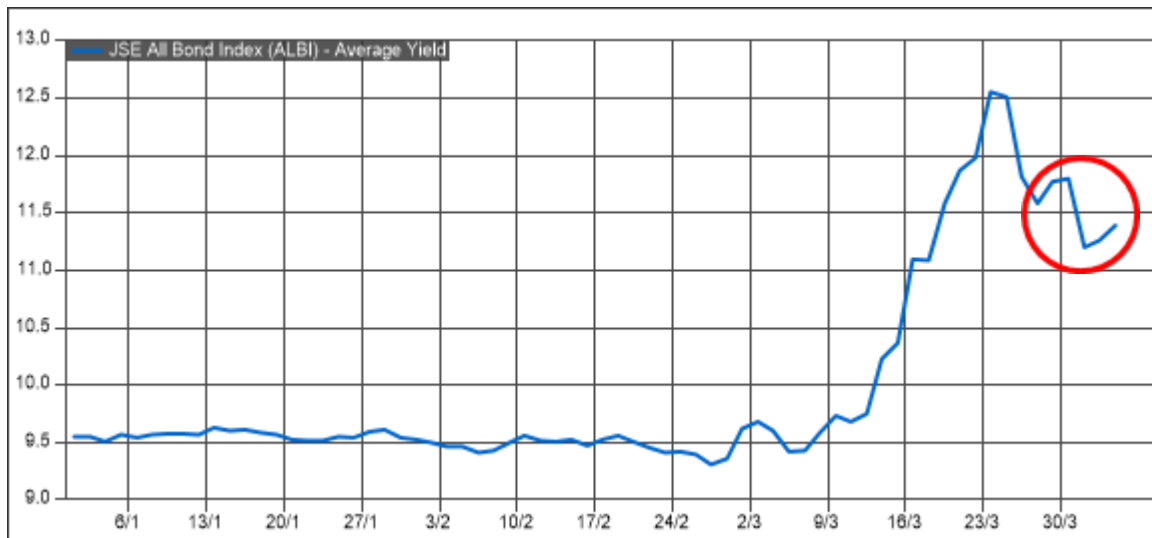
Kicking the economy when it’s down?

Moody’s lowered its rating of South Africa’s creditworthiness, assigning a sub-investment grade, or “junk”, status to bonds issued by the South African Government. Moody’s is primarily concerned about South Africa’s low economic growth, increased government spending and debt, in weighing up the government’s ability to honour its debt repayments through its bond programme.

Moody’s was the last of the recognised ratings agencies to downgrade South African bonds to junk status. The downgrade, while long expected by investment markets, compounds South Africa’s experience of the global economic crisis driven primarily by the Coronavirus and the subsequent respiratory disease, COVID-19 pandemic which has seen large losses of value in almost all asset classes around the world.

“The direct impact of the downgrade on investment markets has been difficult to isolate given the extreme levels of volatility already present due to the impact of the Coronavirus lockdown,” says Eggers.

The graph below illustrates this:



(Source: GTC Investment Analytics, Factset)

The blue line shows the average yield of the South African bond market the JSE All Bond Index (ALBI) since the beginning of the year. A rising line indicates increasing losses for holders of South African Bonds, with a falling line showing a recovery in value.

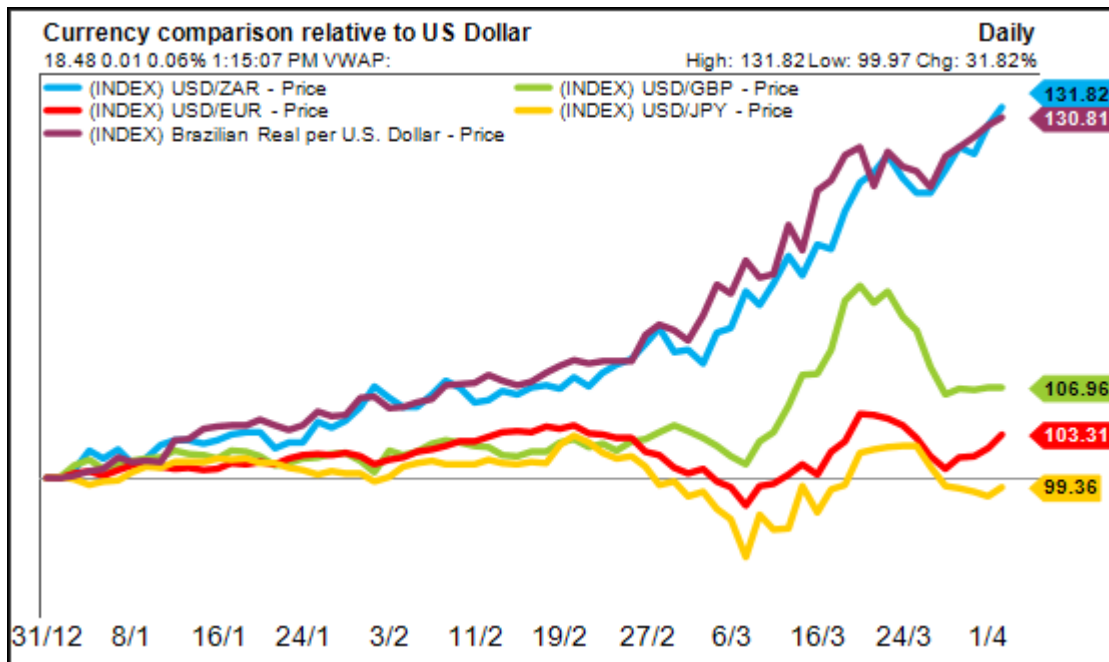
“Much of the fear amongst investors relating to the downgrade was due to the expected selling of our bonds by international investors who, in certain cases, in accordance with their investment mandates, are prohibited from holding junk bonds. This forced selling was expected to result in large losses in the ALBI which, in reality (at the time of writing) has not materialised,” says Eggers.

The announcement of the Moody’s downgrade occurred late on 27 March and the red circle on the graph highlights the relatively small reaction in the bond market when compared to the losses suffered since 9 March due to the impact of COVID-19.

“In fact, our bonds have increased in value! This is likely due to two factors. Firstly, while the investment environment remains volatile, with news flow changing daily, the evidence suggests that South African assets had largely already been discounted ahead of the anticipated downgrade,” Eggers adds. “Secondly, the impact of the downgrade was all but dwarfed by the far larger impacts of the COVID-19 pandemic.”

While some investors believe the rapid slide in value of the rand against the dollar is evidence of the downgrade, again research points to various factors at play. “The main factor is actually a shortage of the supply of US dollars and an increase in the demand for them that is creating enormous pressure on the exchange rate,” says Eggers.

The graph below compares a number of currencies, including the rand, to the US dollar, highlighting the relative strength of the US dollar.



(Source: GTC Investment Analytics, Factset)

The Dollar has strengthened against the euro (red), the pound (green), the Brazilian real (purple) and the South African rand (blue) with only the Japanese yen (yellow) largely flat.

“The fact that the rand has weakened against the US dollar in line with the Brazilian real, another commodity-based emerging market currency, provides evidence that the sell-off in the rand has been largely driven by the risk-off environment that the COVID-19 pandemic has created,” Eggers explains.

All is not lost

The downgrade confirms the current reality of the South African economic environment which most investors already understood to be poor. It does highlight the fact that the money the government needs to borrow to assist people and companies in weathering this global storm will come at a higher cost due to our lower creditworthiness. This higher cost will provide a further headwind to overcome in improving the situation.

“Recent market activity shows demand for new issuance of South African government bonds with real yields is at all-time highs, which means that the country will have access to funding which it desperately needs. Also providing comfort is the fact that many investors still see South Africa as an attractive investment opportunity,” says Eggers.

Silver linings for those saving for retirement

There are some measures being taken around the world to lessen the impact of the COVID-19 pandemic. “Internationally, monetary authorities have created stimulus packages that are aimed at not only providing stability to markets and liquidity to those under duress, but also at trying to ensure that banks are adequately capitalised in the face of the inevitable defaults and insurance claims that will come,” says Eggers.

While the picture remains bleak for global growth, there are nevertheless opportunities for some businesses and – by extension – investors.

“Financial markets are still very volatile, and this Coronavirus-initiated crisis is far from over, but under the outlined stimulus initiatives, some support seems to have been found.

Investment professionals and analysts have been compelled to rethink the pricing of assets,” says Eggers.

“We continue to analyse our portfolios to employ the best risk-weighted strategies in the medium and long term. There are, and will continue to be, opportunities to invest.” says Eggers.

As always, there are risks – it will take careful analysis to decide which companies’ business models will be negatively affected by the impact of Coronavirus, and which may emerge unscathed, but in the medium term global trade is almost certain to reach a ‘new normal’.

“Under this ‘new normal’ we will live in a world where interest rates generally are low, limiting central banks options, and where excess liquidity has to be drained from the economy at some future point. This will see investors critically assessing the best opportunities in terms of returns and yields.

“Emerging markets will likely be targets for capital acquisition and South Africa will be no exception, especially as we are coming off such a low base. Furthermore, the carry trade – which means buying into the Rand currency as it swings back – will offer some of the highest real returns in the world. Logic dictates that this should build Rand strength,” Eggers continues.

But Eggers cautions that investment decision-making should never be made on market news alone, advising that “Investment decisions should be taken based on sound reasoning and verifiable knowledge, with guidance and advice from a financial advisor”.

“The downgrade does not in any way change our message to clients over the past few weeks, which is that essentially no action is required. As long as portfolio allocations remain optimally positioned, investors’ objectives remain achievable over the long term despite this rapidly changing environment,” Eggers concludes.

Ends (1323 words)

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About GTC

GTC is a leading financial advisory business, specialising in the areas of retirement fund administration, consulting and counselling; healthcare consulting; private client wealth management; short term risk solutions; investment and asset management, fiduciary services and other areas of financial advice. GTC also operates a unit trust management company and is a licensed investment manager for both retirement funds and private clients in accordance with the Financial Sector Conduct Authority (FSCA).

Collectively the GTC group employs approximately 120 staff in three major national centres. Assets under management and administration total R42 billion.

Over 100 000 fund members participate in 350 retirement funds, most through one of several GTC umbrella funds. Additionally GTC consults to approximately 3 000 private clients in terms of their wealth management goals.

GTC was established in 1991 from within the Grant Thornton Johannesburg audit practice, itself part of Grant Thornton International. Effective late 2012, GTC was obliged to separate itself from Grant Thornton due to various international regulations imposed by the SEC in the United States, with Grant Thornton Capital changing its name to GTC and rebranding.

GTC has consistently been recognised within the industry for its leading principles when conducting best practice, and GTC has been awarded various awards over the years, culminating in the 2019 PMR.Africa Diamond Arrow Award, being honoured as the highest rated company in the category of pension fund administrators and consultants administering between 100 000 and 150 000 members in this survey.

GTC is an enthusiastic supporter of the Arts. The financial advisory and wealth business is a proud sponsor of the Rotary Art Expo and specifically is the sole sponsor of the GTC Portrait Awards, a competition which has run for the last four years. GTC also contributes to the collection of art at our corporate offices in Illovo, culminating in several hundred pieces, many regarded as important South African artworks.

Additionally, GTC sponsors the Johannesburg Symphony Orchestra (JSO) as well as the Wanderers Golf Club. These projects are a social responsibility, a support of South African youth, and a BEE initiative. But the real reason why GTC enthusiastically supports these various initiatives is that they are all strong commitments to building a community. GTC believes this is as strong a commitment as a company can make. Most importantly, it feels to them like the right thing to do.