South African Investors Need to Fall Out of Love with Equities

22 July 2019

South Africa's equity market capitalisation equates to more than 200% of the country's gross domestic product (GDP), the highest proportion in the world and a level that is simply not sustainable.

That's the view of Stanlib's Chief Economist, Kevin Lings, who was one of the guest speakers at the Allan Gray Investment Summit 2019 in Cape Town today.

"South African investors are in love with equities - we kind of think it's the only place to be," says Lings. "This fixation cannot last. South Africans investors need to embrace different asset classes."

Lings says that while South African equities have underperformed in recent years, especially when compared to US stocks, their performance is actually in line with that of other emerging markets. Much of this has to do with the fact that economic growth in developing countries has struggled to recover since the 2008 financial crisis.

Emerging Market Malaise

For instance, economic growth in South Africa has declined from an average rate of 4.2% between 2000 and 2008 to a mere 1.9% from 2010 to 2018. Similarly, growth in Brazil has slipped from an average of 3.8% to 1.4% over the same timeframes while in Nigeria it has more than halved from an average of 8.3% between 2000 and 2008 to 4% from 2010 to 2018.

"Emerging market equities have not been the place to be and South Africa is simply a part of that," says Lings. "We're beating ourselves up too much. If the growth rates in emerging markets pick up so will equities."

New Asset Classes

Nevertheless, Lings' biggest recommendation for South African investors is to include new asset classes in their portfolio construction, particularly those that are appropriate for the country's low growth environment. This is especially important given that he expects South Africa's economy to expand by no more than 0.7% this year.

"The circumstances we find ourselves in are screaming out for us to embrace other asset classes, such as government and corporate bonds," says Lings. "If you can get a 9%

nominal return from a bond fund, relative to an inflation of say 5%, that's a decent real return with significantly less risk."

A Reality Check

Lings' next message to the almost 2,000 people who packed the Cape Town International Convention Centre was to be realistic and not expect an instant turnaround in South Africa's fortunes. After all, the country's youth employment rate of 55.2% (which jumps to 69.1% when you include discouraged workers) is worse than the levels experienced in industrialised nations during the Great Depression.

"Whenever you have a crisis, as you uncover the extent of the crisis it always gets worse before it gets better," he says. "SA is still in the discovery phase – we're still trying to understand how much damage has been done in last nine years."

He illustrates the scale of South Africa's macro-economic dilemma by pointing out that total debt of South Africa's government, companies and households has surged 106% since 2010, which is an increase of a massive R3.8 trillion. While government debt currently equates to 58% of GDP, the figure jumps to 75% when you include the debt owed by state-owned entities.

"If a South African company was almost bankrupt and it elected a new CEO could you really expect him to turn it around in a year?" asks Lings. "We are creating unrealistic expectation on how quickly this can turn around. "It's much easier to damage an economy than fix it and we've been damaging this economy for the last nine years."

Don't Be a Lazy Investor

Given the scale of the turnaround required, Lings says South African investors will need to work harder to find good opportunities within the broader malaise. For example, despite the fact that South Africa's manufacturing industry has slumped from 21% of GDP in 1994 to 12% of GDP last year, there are still bright spots such as the automotive sector as well as food and beverages.

"We're actually quite good at producing food in this country," says Lings. "We have a pretty good agricultural sector and advanced food processing industry."

Geographic Diversification

Perhaps Lings' most compelling piece of advice for domestic investors is to focus more strongly on geographic diversification of their portfolios, a point driven home by the fact that South Africa accounts for just 0.4% of global GDP. In comparison, the US accounts for

24.3% of world GDP followed by the euro-area (15.8%), China (15%) and Japan (6.1%). Even Sub-Saharan Africa as a whole only accounts for 1.9% of the world economy.

“We’re a small portion of the world so why would you put everything in SA?” asks Lings “We need to change our perspective and stop comparing ourselves with the likes of the United States or Switzerland. SA is a messy emerging market so we should be comparing ourselves with other messy emerging markets.”

-ends-

More about the Allan Gray Investment Summit:

The Allan Gray Investment Summit brings together renowned investment experts from all over the globe to bring investors ideas that build long-term wealth. This is the third consecutive year that the event is being held to sold-out audiences. The Cape Town leg of the event was held on 22 July at the Cape Town International Convention Centre, and the Johannesburg leg at the Sandton Convention Centre on 23 July 2019.