Sentiment and free advice, you may as well roll a dice

As humans we are conditioned to fight for survival. As an investor in South Africa, our survival instincts are kicking in right now. But can our instincts lead us astray? This month we look at choosing wisely when considering who to take your advice from, in a world where free advice is often worth as much as what you pay for it.

#Imnotstaying

While the hashtag #Imstaying has gathered momentum in South Africa in 2019, when money is considered we are seeing investors do the opposite, with flows out of SA into offshore assets a steady trend over the past few years. Investors are voting with their feet, but is it a one way bet against SA?

Perhaps we are conditioned to recognize adversity over opportunity. As the quote by John Burroughs goes:

"There is hardly a man on earth who will take advice, unless he is certain that it is positively bad".

We love to reinforce a negative view, and there is much of it around. Reflecting on the year just passed, we have had to deal with more depressing stories of state capture, looting of public funds, the demise of the SOEs, corporate failures, land redistribution, credit rating downgrades, and weak economic growth. And none of these items seem to be improving. Bad news sells, and it's everywhere. Spilling over into our everyday lives, making it difficult to avoid and placing a great weight on our shoulders to carry day in and day out. Isn't it odd how the purveyors of bad news are seen as realists, and those with good news stories the wishful optimists? It's a one-sided bias we seem to have adopted in SA.

The bad news realists have the stage and set the mood. Particularly at this time of year, when the confluence of the Gregorian Calendar and annual holidays cause us to 'take action', 'plan for the year' and 'evaluate our options' as a way of gaining control over things (investments) which are difficult to control.

The economic forecasts are out, predicting worse to come. Investment Outlooks offered freely, with no accountability one, two or three years hence if they are wildly inaccurate. Market commentators make a living breeding the party line which may or may not have value, but headlines sell. The media loves to feast on bad news too, and all of this spills over into our day to day lives. Holiday conversations will no doubt be laced with negativity and concerns around the future. Plans are made for foreign passports and emigration, and very few are laying down new foundations in South Africa when it comes to capital investment.

The chart below confirms the mood: business sentiment is at its lowest point since we have data (1985 – PW Botha was president). We are more negative now than during the 1980's with sanctions, apartheid and the Rubicon speech, the early 1990's recession, the late 90's Emerging Markets crisis, and even more negative than during the Global Financial Crisis in 2008/2009. By a significant margin!

The chart below is a mood indicator, of consumers and business.

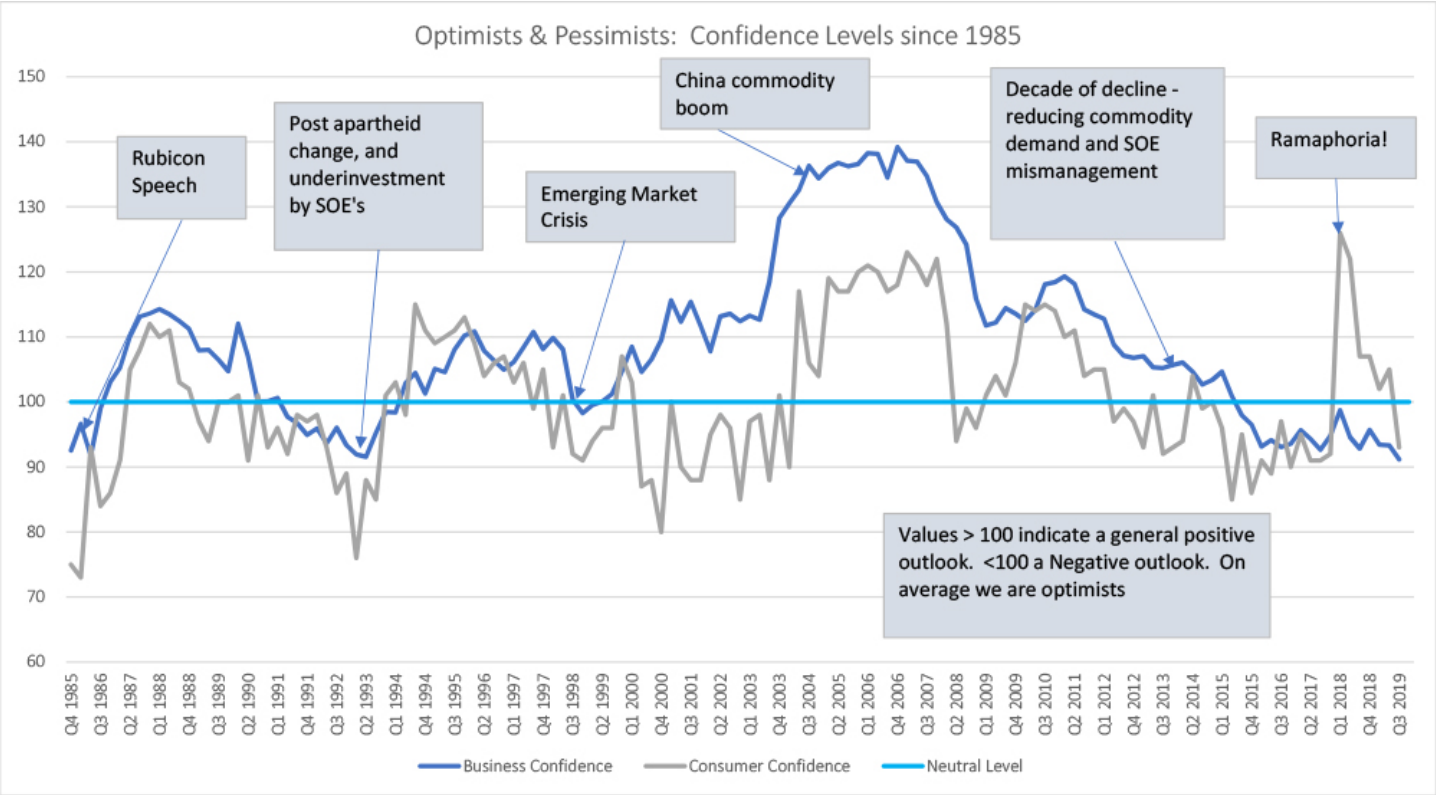

Chart1: Business and Consumer Confidence levels since 1985. Source: Refinitive

Not to labour the point, but you don't have to look far to find the bad news. It's offered freely, and in abundance.

So, do the realists have a point?

Should we link our mood with our investment strategy? To be honest, it's hard to back up with evidence. We can try and 'mine the data' to try and demonstrate relationships which prove that negative sentiment drives negative returns. We can try and forecast what the economy, interest rates and inflation are likely to do, and typically our mood will dictate our forecasts (which will be lower).

Simply put, the relationship between sentiment and investment returns is weak at best, and should most often be disregarded. This is hard to digest, as bad news can feel so real. No matter how convincing the bad news, most often you should do the opposite with your money.

Bad news creates opportunity to buy good assets at low prices. South Africa right now is a classic 'value trade': lots of bad news, lots of negative sentiment, and it's hard to see the path to recovery. Share prices are low, and its uncomfortable to commit more capital to what seems to be a losing decision. While we struggle to demonstrate a link between sentiment and future returns, we can show a strong link between valuation levels and future returns. For the most part, local assets are pricing in the bad news, and all things considered this is a good starting point for adding to local portfolios, not reducing allocations.

Choose your source of advice wisely

Rather than receiving free advice which may not be worth much, we should rather heed those with a vested interest in our financial success.

The past five years have been a torrid time for local investors. In 2014, after a lengthy rally in shares, the 2015 outlook was more of the same from most market commentators. However, if we had taken Ian Liddle's advice from Allan Gray to heart, we should not have been surprised at the poor future returns: "*The Fund's relatively low net share exposure of 55.9% is a function of the South African market offering few compelling value opportunities. Similarly, global markets have had an excellent five years and do not offer the value of a few years ago. In this environment we prefer low-risk fixed income investments and the Orbis Optimal SA funds to many JSE-listed equities. These liquid, low-risk assets put the Fund in a position to take advantage of opportunities as they present themselves.*"

He was right, valuations were high, and future returns were low.

At the start of 2019 (a great year for local investors so far, despite the mood), Coronation made mention that "*After being very negative about the South African equity market for most of the last five years, we are now much more optimistic about future returns: We have taken advantage of depressed sentiment to significantly increase the quality of our equity portfolio (currently very high-quality stocks comprise an abnormally high 57% of the portfolio).*"

Their Coronation SA Equity Fund is up almost 10% so far this year. Importantly, they took advantage of depressed sentiment to help generate this return.

If anything, that makes sentiment a contra-indicator!

Looking Offshore

To briefly consider the standard trade right now, with assets flowing from SA to offshore: It's a case of buyer beware. The confidence indices in global markets are essentially the inverse of SA, with confidence at very high levels across markets like the US. Many sectors of the share market are also trading at high valuations. There are opportunities though, with global markets broad and diverse in nature compare with SA. Invest carefully, and expect less.

To add perspective to the key decisions investors are making:

1. Reducing investments locally and taking funds offshore: there is a reasonable likelihood that this is a classic 'sell low/buy high' trade if you are selling local equities. Test that you are not locking in losses in SA.
2. Funding retirement by moving investment portfolios offshore: this creates a substantial mismatch between the underlying assets (global shares, non-SA currency based) and the liability (spending in rands). This leaves investors materially exposed to a strong Rand, but more acutely, a weak US Dollar.
3. Moving from local portfolios to income-based investments: this trend is significant, and has created huge demand for income investments. However, this has a knock-on effect, where risks in income assets have increased. Ensure you are adequately diversified to protect capital.

More importantly, listen to those who have a vested interest to look after your interests. It's hard to avoid the negative news, but asking a simple question of "*is this an opportunity rather than a threat*" might change your outlook over the holidays and into the new year.

Happy holidays!
The Fundhouse Team.

8 BESPOKE
EST. 2001
FINANCIAL SERVICES

November 2019

data provided by Reuters and Datastream

30 November 2019

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
FTSE/JSE All Share Index (ALSI)	ZAR	1.5%	8.5%	13.1%	6.6%	5.3%	10.7%	11.4%	11.8%
FTSE/JSE SA Listed Property	ZAR	3.0%	4.1%	3.0%	-1.7%	1.9%	11.2%	13.4%	13.3%
SA All Bond Index (ALBI)	ZAR	0.4%	8.3%	9.0%	9.3%	7.0%	8.8%	7.5%	6.9%
SA Cash Index (SteFI)	ZAR	1.7%	6.7%	7.3%	7.4%	7.2%	6.5%	0.1%	0.2%
Balanced Benchmark	ZAR	1.2%	10.4%	13.0%	7.8%	7.2%	11.2%	7.5%	7.4%
SA Inflation (1 month lag)	ZAR	0.5%	3.7%	3.7%	4.5%	4.9%	5.1%	1.3%	1.3%
GLOBAL MARKET INDICES									
Global Equity (Datastream World)	USD	7.8%	24.6%	15.2%	13.0%	8.4%	10.0%	11.7%	13.0%
Emerging Markets Equity (Datastream EM)	USD	6.1%	10.6%	7.7%	9.4%	3.5%	3.7%	15.6%	17.0%
Global Property	USD	1.4%	22.4%	16.0%	11.0%	6.9%	9.8%	11.3%	13.9%
Global Bonds (Barclays Global Bond Index)	USD	-1.9%	5.6%	8.1%	3.8%	1.8%	1.3%	5.4%	5.6%
Global Cash	USD	0.5%	2.2%	2.4%	1.9%	1.4%	0.8%	0.2%	0.2%
MAJOR INDICES BASED TO RANDS									
FTSE/JSE All Share Index (ALSI)	ZAR	1.5%	8.5%	13.1%	6.6%	5.3%	10.7%	11.4%	11.8%
Global Equity (Datastream World)	ZAR	4.0%	26.9%	21.7%	14.6%	14.7%	17.7%	15.6%	13.9%
Emerging Markets Equity (Datastream EM)	ZAR	2.4%	12.6%	13.8%	11.0%	9.5%	11.0%	13.7%	12.7%
Global Property	ZAR	-2.2%	24.7%	22.6%	12.6%	13.1%	17.5%	15.8%	13.7%
SA All Bond Index (ALBI)	ZAR	0.4%	8.3%	9.0%	9.3%	7.0%	8.8%	7.5%	6.9%
Global Bonds (Citigroup)	ZAR	-5.3%	7.6%	14.3%	5.3%	7.8%	8.4%	15.0%	14.0%
COMMODITIES									
Gold (US Dollars)	USD	-4.4%	14.1%	19.9%	7.6%	4.3%	2.2%	13.2%	15.9%
Gold (Rands)	ZAR	-7.8%	16.2%	26.7%	9.2%	10.4%	9.4%		
CURRENCIES									
Rand / Dollar	ZAR	3.5%	-1.9%	-5.7%	-1.5%	-5.8%	-7.0%	15.7%	15.1%
Rand / GBP Pound	ZAR	-2.5%	-3.5%	-7.1%	-2.6%	-1.8%	-4.5%	16.7%	14.6%
Rand / Euro	ZAR	3.4%	1.8%	-2.9%	-2.8%	-3.2%	-3.8%	14.8%	13.5%

Spot Rates		29-Nov-19	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US$	Rand	14.65	15.16	13.87	11.05	7.43	6.18
Rand/GBP	Rand	18.95	18.68	17.69	17.29	12.20	9.83
Rand/EUR	Rand	16.16	16.53	15.70	13.77	11.16	6.22
RATES							
Libor 6m $	US$	1.90	2.06	2.89	0.33	0.49	6.06
Repo Rate	Rand	6.50	6.50	6.75	5.75	7.00	12.00
Prime	Rand	10.00	10.00	10.25	9.25	10.50	15.50
All Bond Index Yield	Rand	9.70	9.47	9.61	7.86	9.11	N/a
COMMODITIES							
Gold ($/oz)	US$	1,461.54	1,473.85	1,219.15	1,181.97	1,177.70	291.70
Platinum	US$	894.00	900.00	805.00	1,205.00	1,442.00	437.00
Oil (Brent Crude) $	US$	62.62	60.89	58.74	71.95	76.70	24.98
INFLATION							
SA Inflation	%	3.7	4.1	5.2	5.8	4.9	N/a

Fundhouse is a leading investment adviser specialising in fund research, ratings and portfolio construction services. We help clients manage investments on behalf of the end investor. Our experienced team understands the complexities of the fund management world. We apply this knowledge alongside a client first mindset to improve the outcome for the end investor.

Fundhouse was founded in 2007 by professionals from the investment management industry. We currently operate from offices in the United Kingdom and South Africa, where we cover the local and global fund industry first hand. Our business is 100% independent and owner managed which means we can offer objective advice and services in the best interests of our clients.