INVESTMENT VIEWS

Market watch: A quarter of change

By CHARLES DE KOCK

THE QUICK TAKE

Supportive policy measures in both the US and China have driven strong performance across developed and emerging markets

In South Africa, investor and consumer confidence benefit from promising early outcomes from the government of national unity and improved energy security

Our multi-asset portfolios maintain a high offshore exposure, while select South African securities also present attractive valuations

Charles is a portfolio manager with 39 years of investment industry experience.

POSITIVE MACRO POLICY SHIFTS

The past quarter has been eventful for both global and domestic financial markets, driven by a few significant macroeconomic policy changes.

Firstly, the US Federal Reserve surprised the market by cutting interest rates for the first time since the Covid-19 pandemic in 2020. While a rate cut was anticipated, the magnitude – an aggressive 50 basis points (bps) – exceeded expectations. Comments by some of the Federal Reserve committee members in the days following the cut were generally dovish, fueling the market with expectations of further rate cuts.

The second major global macroeconomic news was China's announcement of a substantial stimulus package. As we have seen in the past, policy changes in China often come as a surprise, with little or no guidance before the announcement. This time was no exception. The stimulus for the economy comes in the form of lower interest rates as well as specific support for the ailing property sector. Global financial markets responded positively, with commodity prices and Chinese equities rallying on the news.

On the domestic front, the South African Reserve Bank (SARB) also cut interest rates, but in our case by a modest 25bps. Still, the market expects this to be the start of the downward cycle, with more cuts to follow in the coming year. The SARB certainly has room to cut more, supported by well-contained inflation, a stable rand and declining oil prices.

GEOPOLITICAL TENSIONS INTENSIFY

On the downside, geopolitical tensions in the Ukraine and the Middle East have shown no signs of easing. In fact, the conflict in the Middle East has escalated to Lebanon and may spread further. Despite these growing tensions, global financial markets have largely focused on the positive macroeconomic developments thus far, downplaying the risks posed by these geopolitical uncertainties.

In other political news, the US presidential election is now just a month away. At the time of writing, most polls suggest the result will be very close. As in previous elections, the result will depend on a few key swing states where voters aren't traditionally aligned to one party. We cannot forecast the outcome of the election, and even if we could, it is not clear how the economy or stock markets may react.

What is a longer-term concern, however, is that neither candidate has any plan to address the mounting levels of government debt. Raising taxes and cutting government spending are politically unpalatable solutions, but the continuous rise in debt levels could eventually lead to higher bond yields. This isn't just a US issue – most developed economies are grappling with similarly unsustainable debt burdens. This is a problem that will need to be addressed at some point. One cannot know how or when the unsustainable debt levels will become an issue, but as investors, we remain cautious about sovereign debt markets.

STRONG PERFORMANCE OF FINANCIAL MARKETS

Emerging market equities, after a prolonged period of underperformance, staged a strong comeback in September, and this momentum has so far carried into the early days of October. The cuts in US interest rates played a role, but the Chinese stimulus package was undoubtedly the big driver of this welcome change. From a valuation perspective, we believe EM equities, and especially the Chinese market, offer exceptional value.

Developed market equities and bonds also performed well, buoyed by growing consensus that inflation has been largely contained, and the likelihood of a recession in most developed economies is diminishing. In addition, the expectation is that interest rates will continue their downward trend over the next year or more, further supporting the favourable performance in these markets.

A POSITIVE START TO THE GNU

After the May elections, where no single party secured a majority, South Africa established a government of national unity. Initially, many were sceptical about the feasibility of aligning such a diverse coalition of parties with differing ideologies into an effective governing body. While challenges remain, the early signs suggest that the parties are making concerted efforts to collaborate and find common ground on key issues. This has fostered a more optimistic outlook among businesses and consumers. The absence of loadshedding has clearly helped to lift the mood of most citizens.

The positive shift in confidence is reflected in a sharp contraction in government bond yields, a recovery in domestic stock prices from previously depressed levels, and a firmer rand.

OUR PORTFOLIO POSITIONING

Our multi-asset funds have a high global component. From a risk diversification point of view, we continue to believe this is the correct stance. The stronger rand and outperformance of the domestic market is extremely welcome and has contributed to total fund returns even though some of our big holdings in rand hedged counters have underperformed the so-called SA Inc. stocks.

Although we have had a very strong quarter behind us, we are of the view that the landscape has improved more than expected and it is still too early to take profits. We therefore remain fully invested with low levels of cash in most funds.

As always, we remain valuation driven and act accordingly. The rerating in our domestic stocks and bonds came from such depressed levels that, in many cases, valuations are still very reasonable despite the significant rally.

Hang on for the ride a little longer. +

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South African Readers

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