INVESTMENT VIEWS

Market watch: Seizing opportunities amid market rallies and political shifts

By CHARLES DE KOCK

THE QUICK TAKE

The final quarter of 2024 saw the US dollar strengthen amidst resilient US economic growth and a shift in the political landscape

Excellent global and domestic stock selection drove strong returns for Coronation's multi-asset portfolios

We continue to find value in select stocks but caution against extrapolating past success into the future

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

THE US DOLLAR SURGES

The final quarter of 2024 was marked by a sharp rally in the US dollar. This began with Donald Trump's victory in the US Presidential election and his threats of higher tariffs on imported goods. Then, in December, although the Federal Reserve cut interest rates by another 25 basis points, the accompanying statement dampened expectations for further rate cuts. Chairman Jerome Powell indicated that in light of the resilient US economy, the pace of interest rate reductions could be slower and the trough in rates higher than the markets had anticipated.

From a macroeconomic perspective, most economists expected US growth to slow during 2024. The pessimists warned of a "hard" landing, the optimists predicted a "soft" landing, but the real outcome is more akin to a "no" landing, with growth remaining quite strong. In Europe, the economic slowdown has been more pronounced, raising expectations that the European Central Bank may need to pursue deeper interest rate cuts than the US. This interest rate differential is expected to favour the US and, therefore, contributing to a stronger US dollar.

STRONG RETURNS IN RISK ASSETS

The past year proved rewarding for investors willing to take on some risk as the combination of falling inflation and easier monetary policy contributed to higher ratings for stock markets. The strong showing of the so-called Magnificent Seven tech giants pushed the S&P to record highs.

Our multi-asset portfolios had an outstanding year with strong performance across the risk spectrum. Strong stock selection within global allocations delivered returns that beat the >

benchmark in the final quarter, while funds with South Africa-only mandates also outperformed, generating positive alpha from local stock selection. The South African bond market also enjoyed an excellent year, benefiting from the sharp decline in yields on longer-dated government and corporate bonds following the national election and the formation of the Government of National Unity.

TROUBLING DEVELOPED MARKET DEBT LEVELS

It is with trepidation that I venture into the territory of forward-looking views, as the future is never certain, and surprises will almost always arise. Forecasters, consequently, often end up looking misguided. Financial markets are, however, forward-looking and one has to acknowledge that reality. Rather than attempting to predict the future we find it far more effective to start with current valuations and build portfolios from a valuation-driven perspective.

After two consecutive years of strong returns, we believe that there is little doubt that the S&P is highly valued. We therefore caution against extrapolating the strong returns of the past two years into the future. Although we still find good value in select stocks, we do not anticipate another year of 20%+ returns from global stocks.

The most concerning aspect of the global economy is the high levels of government debt in many of the developed world economies (and their spill-over effect into the rest of the world). After the Global Financial Crisis of 2008/2009 and the Covid pandemic, most governments experienced soaring debt levels as they implemented expansionary fiscal policies to mitigate the shocks of these events. Debt servicing costs have become a burden to many governments and tackling it by raising taxes and spending less is obviously an unpopular choice. Bond investors are rightly demanding higher yields.

The very important US 10-year bond yield, currently hovering around the 4.5% level, is a far cry from the lows of around 1.5% seen during the lockdown period. Although somewhat more attractive, it reflects the state of debt markets and we do not find it sufficiently compelling to warrant building meaningful positions in sovereign bonds. The unsustainable sovereign debt levels are a long-term concern that will, at some point, have to be addressed by some difficult policy decisions.

SA: TIME FOR OPTIMISM TO REFLECT IN EXECUTION

The South African stock market also had a stellar year, benefiting from a post-election rerating driven by the hope of a better government. However, for the rally to be sustained, these hopes must materialise into tangible economic growth. The much-improved power supply is a promising sign that economic conditions could indeed improve. However, progress is also needed across other infrastructure areas to sustain growth.

From a valuation perspective, the domestic market rallied from very cheap levels to a more normal but not yet expensive level. We continue to favour the higher quality companies with stronger management teams who we believe will manage the bumpy ride of the local economy the best.

FINAL THOUGHTS

The operating environment continues to present both challenges and opportunities. While valuations in some areas demand caution, we remain optimistic about the ability to find compelling long-term opportunities in both global and domestic markets. As always, our disciplined, valuation-driven approach will guide us as we seek to deliver consistent value for our clients amidst a rapidly evolving investment landscape. +

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South African Readers

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