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Investing during Covid-19

At Saica's *Leadership in a time of crisis* webinar series, Investec's Chief Investment Strategist, Chris Holdsworth, shared insight on how the pandemic is shaping investment strategies.

As if there isn't enough to worry about during the coronavirus pandemic, many people have seen their investments tank over the past few weeks. Chris Holdsworth, Chief Investment Strategist at Investec Wealth & Investment, explains how he and his team see the market, and how the data they analyse helps them implement decisions in their portfolios.

Chris Holdsworth

Looking at the domestic markets

When looking at investment in domestic equity and domestic bonds, there are seven specific signals that Holdsworth and his team are on the lookout for and which they continually evaluate:

1. Sustained risk-on appetite globally
2. Resumption of emerging market (EM) versus developed market (DM) outperformance
3. Coherent plan on how to deal with Eskom and other SOEs
4. No more load-shedding from Eskom
5. More clarity with regards to policy from the ANC
6. Interest rate cuts – other central banks (including EM) are cutting rates. South Africa's real interest rate is extremely high in this context and there is ample room to cut.
7. Improvement in business confidence

"Looking at this list, the only real opportunity we can see currently is where interest rates are concerned," says Holdsworth. "Unfortunately, at the moment there's just not much to work with."

That said, Holdsworth explains that while we know the economic data is going to be dire over the next months, we also know we have all sorts of fiscal stimulus coming through. "If the economic trajectory is something like what we're describing here, we think a lot of the bad news is already in the price, making the markets appear cheap."

Key indicators for South Africa

Business confidence depressed

"Currently, the data shows business confidence is remarkably depressed," says Holdsworth.

"It probably won't come as a surprise to anyone to hear that we are not expecting significant job creation over the next 12 months, but there is a further consequence to that," he adds, going on to explain that the wage bill for the entire economy is currently growing at 4% per annum, the same rate as inflation. "What that means is we don't have any real income growth in South Africa, and that was ahead of the Covid-19 crisis hitting us."

This implies that retail and general consumer activity are going to be very modest, and therefore the SA Inc component of our market (retailers, banks, etc.) will see little growth. "There may be a short-term relief rally once the Covid-19 numbers start to improve, but for genuine sustained relief, you need to see earnings growth of more than 10% for a number of years, and we're far from that," explains Holdsworth. "The best we can do is hope for is a bounce, but for genuine long-term growth for SA Inc stocks, we need nominal wage growth to pick up, and that is not going to happen now."

Junk status

After our recent downgrades by Moody's, S&P and Fitch, the finance minister was given the go-ahead to pursue reform policies in South Africa, proving that the state has recognised the severity of the situation.

"While this is positive, it is going to take more than words to convince the market, so we are not getting too optimistic just yet," says Holdsworth.

Moody's also cited Eskom as a constraint to growth, and a positive factor is that Eskom has accelerated their maintenance plan during the lockdown period. "Ironically, some long-term structural issues are being addressed thanks to the Covid-19 pandemic."

Bonds in South Africa

According to Holdsworth and his team, bonds in South Africa are very cheap at the moment. "Our yields are currently incredibly high, and comparing them to other emerging markets, who are also in junk status, who also have weak currencies and so on, we feel they are being unfairly penalised," says Holdsworth.

"Analysts always look at what catalyst is required to cause bond yields to narrow, and in fact, we already have such a catalyst – the South African Reserve Bank (SARB) is buying bonds."

In order to be able to implement the UIF's R30-billion Covid-19 relief policy, R30 billion of government bonds need to be converted to cash. Due to our downgrades, many foreigners have been obliged to sell bonds in a market where there are few buyers, and according to Holdsworth, this caused our bonds to blow out, more so than we've seen in other emerging markets. "SARB has addressed that fear, by becoming a buyer for these bonds," he says.

Holdsworth goes on to explain that while this is not quite Quantitative Easing (a monetary policy whereby a central bank buys government bonds or other financial assets in order to inject money into the economy), as SARB is buying on the secondary market, from people who are selling, not from the government directly, he says the effect is the same.

"We therefore see a high margin of safety in South African government bonds, and that is why bonds are our first call within our asset allocation."

Equities in South Africa

"Equities are currently proving a much riskier investment than bonds," says Holdsworth. He goes on to explain that the South African price plays are placed for around 6% real cashflow return on capital over the next five years, with commodity price plays being most heavily penalised, at around 0% or lower cash flow return on capital priced in over the coming five years. "We don't think that's likely to be the case," says Holdsworth, "we may not be calling the bottom yet, but we see a recovery coming."

For this reason, while Holdsworth is quick to note that they will always hold a balanced portfolio, he says that within the equity market, they have tilted and increased weight in resource counters. "The manufacturing PMI numbers are not as dire as those of services," he says, explaining that the real slowdown is in hairdressers, restaurants and so on. "When the world gets up and running again, there will be a demand for SA's commodities."

For this reason, Holdsworth believes there is rare opportunity in the local market. "Close to 60% of ALSI constituents have a dividend yield higher than the inflation rate of 4%, so while some companies will struggle to make it through, you will find some very cheap stocks among those that do," he explains, cautioning that all decisions will require a lot of bottom-up analysis.

Holdsworth says that in terms of a person's age, equities are a riskier investment, so if you are under 35 you can invest substantially in equities but that gradually as you approach retirement, your risk should be reduced.

He also stresses that you should invest a large proportion of your assets abroad, not only due to reducing exposure to SA, but for the opportunity that offshore investing offers. "Globally you have access to 100,000 stocks that are operating in various sectors and geographies; these are opportunities you just don't get here."

To help address the challenges faced by many, SAICA is hosting a complimentary virtual leadership series called Leadership in a time of crisis. This series focuses on various elements affecting individuals, businesses and the profession as a whole during the Covid-19 pandemic. Previous sessions in this series have been recorded and can be viewed on SAICA's events page.

About Saica

The South African Institute of Chartered Accountants (Saica), South Africa's pre-eminent accountancy body, is widely recognised as one of the world's leading accounting institutes. The Institute provides a wide range of support services to more than 50 000 members and associates who are chartered accountants [CAs(SA)], as well as associate general accountants (AGAs(SA)) and accounting technicians (ATs(SA)), who hold positions as CEOs, MDs, board directors, business owners, chief financial officers, auditors and leaders in every sphere of commerce and industry, and who play a significant role in the nation's highly dynamic business sector and economic development.

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