Seed Weekly

23 January 2019

Past Performance Is Not Indicative of Future Results

From an investment perspective, 2018 was not nearly as bad as the sharp declines some ten years back. What investors do find extremely disappointing is the long, slow grind of going nowhere slowly.

Local investors are absolutely right to be less than enamoured with their investment returns – not only over 2018 but over the past 3 years and even 5 years. Sub-optimal performance from capital subjected to the local stock market of barely matching inflation does little to inspire confidence. As investment advisors, we share in this disappointment.

Historical returns aside, when investors look at the topical news of the day, they find it difficult to see how things will improve over the next few years. News items widely distributed in the local media include the forecast of low economic growth, expropriation without compensation, talk of prescribed assets for pension funds, an important election year, Eskom debt levels, a possible further downgrade by Moody, the Zondo commission into allegations of state capture, etc.

So where do investors turn to for those elusive excess returns above inflation? Definitely offshore (if they have had low exposure here).

While global markets retreated some 9.5% in USD terms last year, the rand fell some 16% and so investors at least received a positive rand outcome. Over the past 5 years global shares have returned 11% in rand terms and had at least beat local inflation. However, things like ongoing Trade Wars, Brexit uncertainty, a slowing down of growth in China, rising interest rates in the US, etc lead concerned investors to ask if there may be more risk in Global Markets. The answer is yes, these are all risks to global growth and therefore by definition to global investments. But, as with the local market, much of these concerns and possibly even more have also been factored into prices – especially as they reset fairly sharply into the last quarter of 2018.

At this stage, while the global bull market in equities has been going for almost 10 years now, it is unlikely to end just yet. It is often said that "*bull markets don't die of old age, but rather they're killed by the Federal Reserve*.". I.e. short term interest rates are pushed up in order to quell inflation but to levels that eventually push the economy into recession. The last time this occurred was when the US Federal Reserve raised short term rates from levels of 1% in mid 2003 to a peak at 5.25% in mid 2006. The recession began in late 2007 and markets plummeted in 2008 (down over 40%). Subsequently interest rates were dropped sharply from September 2007 down to essentially 0% in December 2008.

While the US Federal Reserve has been raising rates slowly, beginning at the end of 2015, it's been a very gradual process back to the current 2.5%. Our analysis indicates that the US Federal Reserve will continue to hike rates into 2019 as inflationary pressures continue to take hold. While caution needs to be exercised, there is still upside potential for at least the current year and possibly into 2020.

Chart 1 (below) reflects the price adjustment of global equities. From multiples of 17 at the beginning of 2018, prices were pushed back at the end of the year to multiples of below 13 times – back to 2013 levels.

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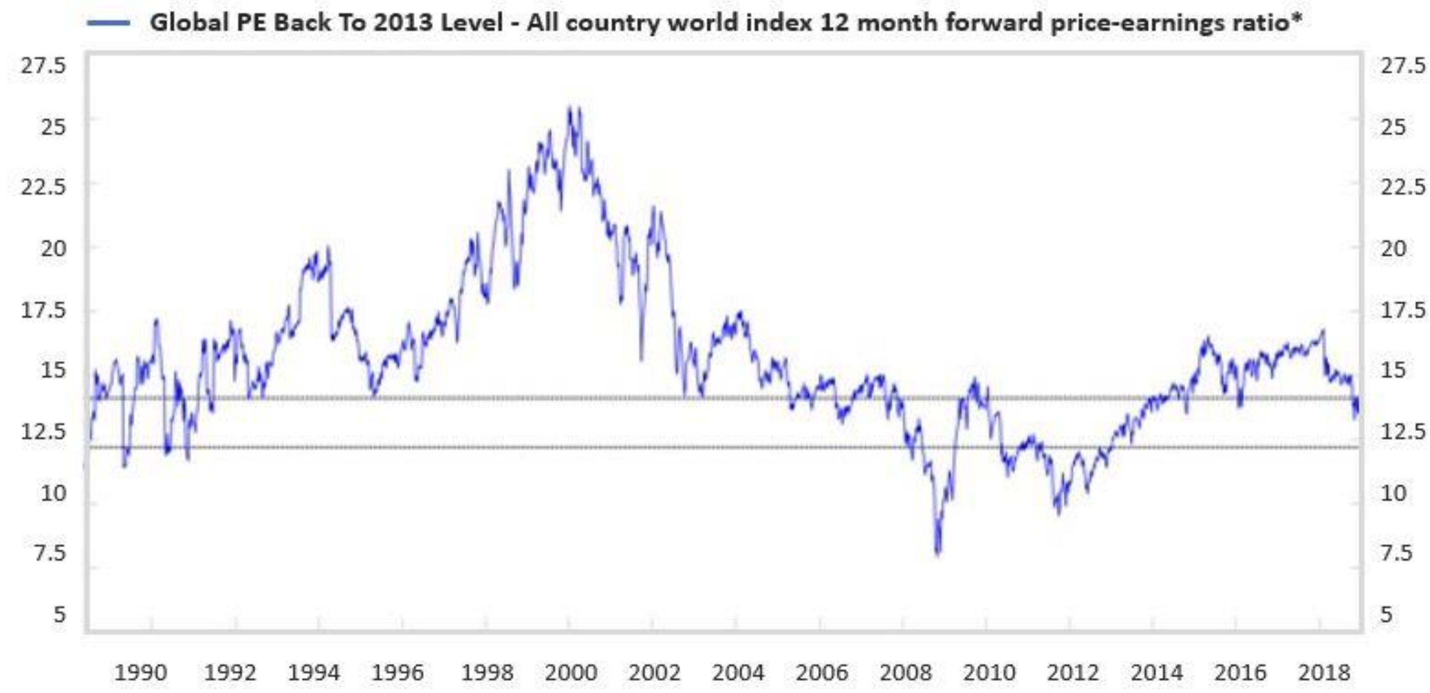
Chart 1: BCA Research (31/12/2019)



<u>Conclusion</u>

The 5-year historical return from both local shares (5.8% per annum) and global shares (4.5% per annum in USD) has really disappointed investors and dented their enthusiasm for continuing to subject their savings to the ordinary shares of listed companies.

Many investors have either capitulated or are considering to do so and they are moving their funds into cash or cash equivalent strategies that have delivered more consistent returns.

Nonetheless, what investors need to take into consideration is that the major price adjustment in 2018 downward has naturally set the base for improved returns from listed shares from these improved starting valuations. In the absence of a recession, poor return years are typically offset with strong up years in equity markets.

Kind regards,
Ian de Lange

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ADDITIONAL INFORMATION (where applicable)

Performance has been calculated using net NAV to NAV numbers with income reinvested. Full performance calculations are available from the manager on request.

DEFINITIONS (where applicable)

Annualised Return	Annualised return shows longer term performance rescaled to a 1-year period. Annualised return is the average return per year over the period. Actual annual figures are available to the investor on request.
Highest and Lowest Annual Return	The highest and lowest returns, since launch, for any rolling 1-year period have been shown.