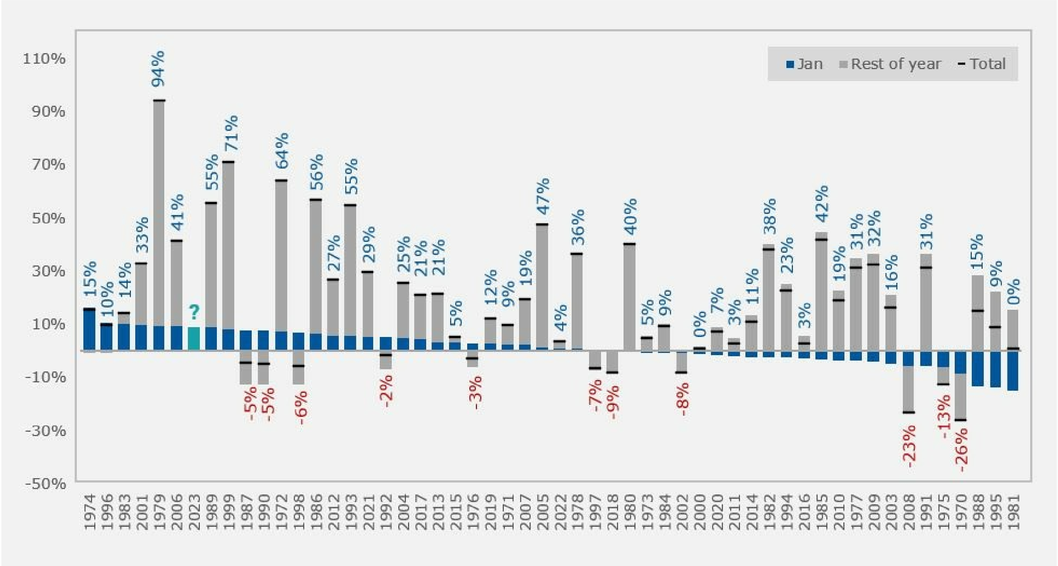
A Phenomenal January - What is Next?

Investors would have noticed that January 2023 was a month of exceptional returns for equity markets, with the JSE All Share up 8.9% on the local side and the S&P 500 (6.3%) and MSCI All County World Index (7.2%) also producing strong USD returns.

Today we will take monthly JSE All Share data from 1970 and have a look at previous years that also started off very well, and what the subsequent returns were for the rest of the year. The chart below ranks the calendar years by strongest start, with January 2023 the 7^{th} best start we have seen since 1970. In the three years ranked at the top (1974, 1996 ,1983), the market has not done much in the following 11 months and closed the calendar year at around the same level.

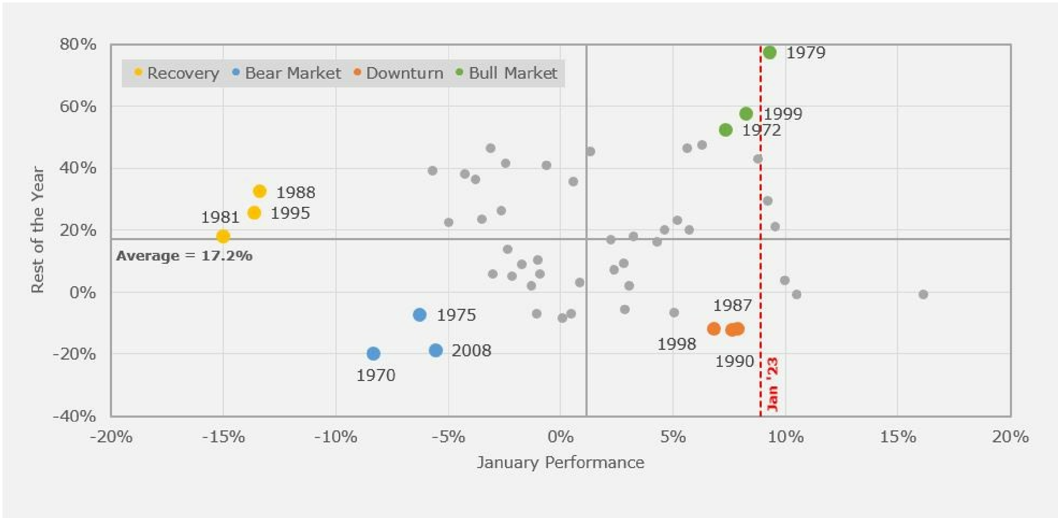
Of course, often a good January has been the foundation for a very strong year (1979: 9% + 85% = 94%).



The chart below takes a different view on the same dataset – the X-axis displays January returns, and the Y-axis the performance for the rest of the year. The three most extreme cases for four scenarios are highlighted, for example a 'Recovery' scenario (1981, 1988, 1995) where the year started off badly but still produced an above-average calendar year return.

The dotted red line charts January's 8.9% start, and off course we have no idea yet if we will end up in the 'Downturn' or 'Bull Market' scenarios in the short term.

The best we can do is look at the current market valuation to give us an idea of where the market is heading over the long term.



As part of Seed's multi management process, we perform monthly asset class valuations using our in-house quantitative models. The output of these models guides our tactical asset allocation decisions, where we under- or overweight certain asset classes in the short term, compared to our longer-term target weights.

Our primary valuation model on the Local Equity side uses the Price/Earnings (PE) ratio as one of its inputs, which is the multiple of annual earnings investors are willing to pay up for a certain company, sector or the market as a whole. A low market PE ratio is not a great predictor of higher returns over the short to medium term, but does work very well as an indicator of value over the long term.

JSE Valuation (PE) versus Subsequent 5Y Return

The chart above clearly shows the relationship between a low PE ratio and subsequent higher returns over a 5-year time horizon. The latest valuation of 12.9 times is still lower than the long term average of 14.6, indicating that there is some value on offer. The shaded area indicates a range around the current valuation, and the market has been in this block 20% of the time, and has been cheaper 23% and more expensive 57% of the time. Subsequent returns have averaged 17% in the current block, 22% in the cheaper scenario and only 11% in the expensive scenario.

So how does the above information inform the asset allocation of the Seed Balanced Fund?

Although we might take some short-term profit from our local equity managers (who have also produced significant alpha) in order to align our asset class weights again, the portion of the Seed Balanced Fund managed on a Tactical Asset Allocation basis remains slightly overweight Local Equities on a long-term view.

Cor van Deventer *CFA, FASSA*
Portfolio Manager

For guidance and assistance, please reach out to our Investment Team on investmentteam@seedinvestments.co.za.

Chart Source/s : Seed Investments (31 January 2023)