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Investors see lack of opportunities in current market

Pieter Koekemoer, Coronation Fund Managers head of Personal Investments.

NET retail flows into unit trusts declined from R25bn in the fourth quarter of 2010 to R6,3bn in the first quarter of this year, reflecting a reluctance by individuals to commit their savings to current markets.

Jeremy Gardiner, director, Investec Asset Management, says: "This is quite understandable, given the low returns on cash and the fact that investors are being told from every angle that domestic equities are expensive.

"Interestingly, nor do investors appear not to be following professional advice to diversify offshore, evidenced by a reduction in offshore flows. This suggests that investors continue to remain jaundiced to offshore investment, probably as a result of having been burnt over the last 10 years due to dollar weakness and a poor performance from offshore assets. However, this will not always be the case and investors should take advantage of the current strong rand and recent exchange control relief to diversify their portfolios," says Gardiner.

Investors have heard this all before, of course, and Coronation Fund Managers head of Personal Investments Pieter Koekemoer attributes this reluctance evidenced by Asisa's (Association of Savings and Investments SA) latest statistics to the fact that local investors have been spoiled over the last decade with exceptional returns as all asset classes in South Africa exceeded their long-term averages.

"Over the past 10 years domestic equities delivered an average annual return of 18 percent compared to 6 percent inflation. The only asset class that local investors did not do well with was offshore equities, where many have been lucky to break even over the 10 years, as global equities delivered no real return and the rand strengthened," says Koekemoer.

"As a result, the situation today is that South African investors remain over-exposed to domestic equities and under-exposed to offshore ones, indicating they expect a continuation of what occurred over the past 10 years. We don't expect that to be the case: in fact we expect a reversal of that scenario," he says.

This viewpoint is in fact the consensus opinion shared by most fund managers in South Africa.

Valuations on the JSE and global exchanges are not dissimilar – but this does not reveal the full picture. A decade ago global equities were expensive and the rand weak. They remain fairly priced with pockets of exceptional value, despite offshore markets having recovered on average 70-90 percent since the lows of the financial crisis.

In contrast, the rand is now expensive and the JSE is fairly priced with pockets that are expensive.

"What this means is that offshore equities offer better value for money if one takes the longer-term view. Right now, murky economic indicators are causing some pessimism but we look at the normal long-term indicators of a company and its long-term valuation.

"What we use as a benchmark for assessing valuation levels is a normal price/earnings (P/E) ratio of 16 for global equities compared to a domestic ratio of about 12,5. Most developed equity markets currently trade at a P/E of 12 to 15 compared to 15 for the domestic market. More importantly, at the moment you can buy blue chip stocks in the US and Europe, for companies that are defensive in nature, diversified and well capitalised with strong brands, for as little as 9 times earnings. We think over time these multiples are likely to rise closer to the normal P/E of 16," explains Koekemoer.

In contrast, Coronation expects the JSE's rating to reduce over time from the current 15 to a more normal 12,5 times.

Some of the best value is to be found in companies that are highly exposed to emerging markets, but do not have their over-valued price tags. You can get such companies in Europe at earnings multiples of 8-15 whereas the equivalent in China would typically be valued at a multiple of 25-30. Coronation's Global Managed Fund can be used to gain exposure to these investment ideas.

Clyde Rossouw, portfolio manager of the Investec Opportunity Fund, says: "We are underweight local equities and have an overweight position in international equities. The portfolio has exposure to select quality companies which have strong brands and are defensive. British American Tobacco, Tiger Brands and Richemont form part of our top ten holdings and we are confident that these shares will deliver attractive returns for investors over time.

However, bear in mind there is risk attached to investing offshore simply as a rand hedge.

Chris du Toit, an analyst at Allan Gray which invests offshore through its global asset management partner Orbis, explains: "An interesting dynamic is the growing link, or correlation, between share prices globally and the value of emerging market currencies. This link can work against you if you are investing in offshore equities in order to benefit from potential rand weakness."

Emerging markets are widely perceived to offer investors better prospects for growth than developed markets. When investors are in the mood to take on risk, the resulting capital inflows in these markets have caused their currencies to strengthen and their share prices to rise at the same time. South Africa recorded net inflows of R186bn from foreigners into our stock and bond markets during 2009 and 2010.