

The world's a mess – buy global equities

THE WORLD'S FINANCIAL SYSTEM seems to be unravelling. Credit markets are paralysed. The decline in stock markets and house prices has destroyed US\$9 trillion in the wealth of the United States alone. That translates to 60% of US gross domestic product. In times like this the temptation to sell risk assets and sit in cash is immense. Many are saying it's not the time to be brave and this is the point in the cycle where you should be more concerned about preserving capital than making returns.

While cash might help you sleep better at night we don't think it's the right move for the long-term investor. Consider these issues:

- Unprecedented stimulus (both monetary and fiscal) will ultimately be inflationary. The US Federal Reserve has demonstrated it will stop at nothing to reflate the US economy. It has immense firepower at its disposal and, over time, the safety many see in bonds and cash will prove to be illusory as inflation erodes the real value of your hard-earned savings.
- Global equities currently present a once in a generation buying opportunity. Most SA investors are under-invested in global equities (either due to exchange controls or because of the excellent returns achieved in our market over the past five years).

We think the correct offshore weighting for the average investor is between 20% and 30% (through the cycle). With the excellent values currently on offer we think investors should be at the top end of that range.

Clients have asked us how we can recommend global equities when the world's in recession; we've just experienced the first-ever run on the global banking system and we're about to enter the first synchronised global recession since the Thirties. To add salt to the wound, de-leveraging and inflated house prices (pretty much throughout the Anglo-Saxon world) mean that recession is likely to be deep and long.

That's a great example of the paradox of investing where "buying low" often requires investing when the news flow is poor and "selling high" often requires selling when the outlook is good. We believe it's the time to be buying, not selling.

Our case for global equities is as follows:

This is a crisis but not a financial Armageddon

- Every crisis over the past 20 years has been short and sharp (1987, the early Nineties, 1998, 2002/2003). While we absolutely don't expect that to be the case this time around we think the policy of stimulus will stabilise the world economy. After that it will in all likelihood be several years before we've worked our way through the hangover of inflated house prices and excessive leverage.

- While the economic outlook is poor and news flow unlikely to improve over the near term we aren't in a financial Armageddon. In the Thirties unemployment in the US went to 25%, protectionism damaged trade, early monetary and fiscal responses were restrictive and several farming disasters damaged what was then a very agrarian economy. Today, unemployment is in single digits and the authorities are responding to the crisis with unprecedented stimulus.

Prices have already corrected

- As an investor you should never allow yourself to become too negative after a major sell-off. The market is a very efficient discounting machine and those levels already price in a recession. The Dow Jones has had its second worst year in history and the Nikkei its worst.

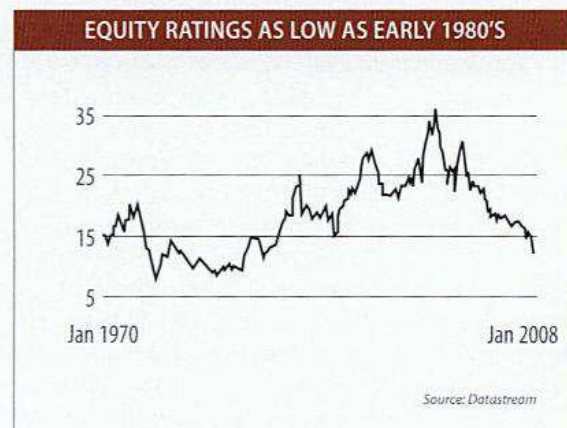
Valuations are compelling with global equities, offering a once in a generation buying opportunity

- The last time the MSCI world index traded at current ratings was the early 1980s (also a time of poor news flow, but a time that provided extraordinary wealth creation opportunity).
- Dividend yields in Europe exceed bond prices for the first time ever.
- Japanese stocks trade at a price to book of 0,85, 75% of stocks have dividend yields exceeding government bond yields and there are several hundred stocks with market caps below the net cash on their balance sheets (ie, you get the business for free).
- The earnings yield of the S&P relative to Treasuries is more attractive than at any time since the mid-Thirties.
- Many companies trade at single-digit multiples, something I never thought I'd see in my investment career.

When markets turn they move quickly and nobody sees it coming

- Markets turn at the point of maximum pessimism

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and always before the underlying economy. In every bear market over the past 40 years (1974, 1987, 1998, 2003) markets have posted massive gains when investors least expected it. The Dow Jones returned 645 in the 18 months after 1974, 485 in the 24 months after 1987 and 43% in the 12 months following 1998.

- At Coronation we don't believe in timing markets. We don't believe we can get it consistently right. We'd rather focus on getting the long-term intrinsic right. If we can get that right – with a big margin of safety – then you actually have time on your side.

The pendulum has swung from greed to fear. Investors will be tested by the very poor news flow likely to come from a "wheels off" for the global economy in the fourth quarter. However, we remain committed to focusing on the long term.

As was the case with our heavily criticised view that commodities were overvalued, we don't know when markets will turn. But when they do we intend being correctly positioned. Buying high quality companies with good franchises at low prices will always be the only sure path to wealth creation.

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About the writer



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Focusing on the long term.

KARL LEINBERGER is Cape Town-based Coronation Fund Managers' chief investment officer and a member of the company's executive committee. He currently manages the Coronation Equity Fund and is co-manager of the Coronation Houseview Portfolios and the Coronation Balanced Plus Fund.

Rated by Morningstar as a four-star fund, the Coronation Equity Fund has been consistently in the top quartile in SA's general equity sector over the past three years. It's down 28% on 12 months and has returned 0,24% over three years.

The Coronation Balanced Plus Fund is a prudential medium equity fund that's down 16,19% over one year, returned 14,86% over three years and returned 112,10% over five years. Equity exposure is limited to between 40% and 60% of the portfolio. ■