Equity market update

A challenging time to invest

by **AMOHELANG MOTSETA**

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Global markets were once again driven by macro concerns in 2011. A solution to the European sovereign debt crisis remained out of reach and markets fluctuated with each attempt to resolve it. Questions over the resilience of the US and Chinese economy persisted throughout the year but markets gained on the back of improving economic data towards the end of the year. However, any recovery in these economies would be nullified by a financial crisis in Europe. As a result we expect periods of volatility to continue haunting the markets until there is a more concrete solution to the debt crisis.

So far, the negative sentiments have not affected the domestic market. The Domestic Companies Index (DCI) was up 8.7% for the 2011 calendar year, but was achieved with less drama than what was experienced in global markets. The return on the DCI was driven by earnings recovery in the banking sector and Sechaba Brewery Holdings. This was to be expected given that these sectors were coming off a low earnings base in 2010. Looking forward, the index could move higher on the back of momentum from Choppies Enterprises, which listed on the DCI in January 2012.

Choppies is a supermarket chain that caters for the low to middle income market. Management is raising money to fund further expansion in Botswana and South Africa. The group has opportunities to grow profits in Botswana through additional stores and the introduction of new revenue streams such as pharmacies and third-party payments (such as electricity and other bills). The focus of future growth is in South Africa where the number of stores is expected to multiply (from the existing nine stores) within the next five years. This market presents a lot of potential for growth but there will be a number of challenges such as intense competition from existing, well established retail chains in the country. The competition will limit the growth potential of the group and is likely to put pressure on margins. In addition, store growth that is too aggressive could become value destructive. Despite these challenges, we believe the investment case for the business is positive. If their expansion in South Africa is well executed then we believe there is upside potential to the listing share price and we have added it to our portfolios.

The volatility in our market came from a less expected source. Money market rates fell sharply on the back of excess liquidity in the market. The Bank of Botswana (BoB) unexpectedly reduced the size of their Bank of Botswana Certificate (BoBC) issuance at one of its auctions and reduced the interest rate on deposits placed at the BoB. The impact of these actions was to drive money market yields lower as demand for limited BoBC paper increased. Commercial banks cut call rates to 0% in some instances, while fixed deposit rates were reduced by an average of 2% to a range of 3% - 3.5%.

The BoB has since increased its BoBC issuance and interest rates for commercial banks but the market is unlikely to fully recover because of the longer-term objective to reduce BoBC paper. We expect bond yields to fall on the back of the decline in money market yields. Further declines in bond yields would reinforce our long held view that long-term government bonds do not adequately compensate investors for inflation and are not attractive at current levels.

Our quarterly portfolio returns continued to swing from one extreme to the other on the back of volatility in global equities. The portfolios however recovered to gain an average of 5% over the period which was ahead of the benchmark return. This outperformance was driven by our overweight position in developed market equities, which recovered strongly from losses in the previous quarter, as well as our underweight position in emerging markets, which lagged as investors stayed away from markets that were perceived to have higher risk.

The Coronation Global Emerging Market (GEM) and Africa funds were impacted negatively by the risk aversion that persisted throughout the second half of 2011. Emerging market equity valuations have since become more attractive and we have taken the opportunity to increase our exposure to the GEM fund. We reduced our exposure to developed markets following the gains during the final quarter of the year.

The lack of stability in the markets has made the current investment climate a challenging time to invest. As previously mentioned, volatility is likely to be a recurring theme. At Coronation we use the more reliable compass of our valuation-driven approach to invest during times of pessimism. It is our view that global equities offer value for the patient long-term investor at current levels and we remain fully invested.