Notes from my inbox

"In the short run, the market is a voting machine, but in the long run, it is a weighing machine." – Benjamin Graham

By **PIETER KOEKEMOER**

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A BRUTAL FIRST HALF

THE SOUTH AFRICAN Reserve Bank raised its policy rate by 0.75% to 5.50% in July, in response to CPI's year-on-year increase to 7.4% in June. This brings the increase in the current hiking cycle to 2.0%, with further hikes to come. As Marie Antelme reports here, inflation remains rampant in most countries around the world. In response, 75% of the central banks tracked by the IMF raised policy rates over the last year, by, on average, 3% in emerging markets and 1.7% in developed markets. As monetary conditions continued to tighten, investors became more fearful of increasing near-term recessionary risks.

These macro factors caused a further sell-off in global equity and bond markets during the second quarter, bringing the respective declines in global equities and global bonds for the half-year to -20% and -14%, measured in US dollars. The rand, domestic equities and bonds held up relatively well earlier in 2022, but South African assets also came under pressure towards the end of the six-month period, recording declines over the half year of -2%, -8% and -2%, respectively. While the global equity market as well as the local equity and bond markets are currently priced in line with their values in late 2020 and late 2021, respectively, investing in global bonds has delivered no return over the past decade. The interplay between inflationary and recessionary risks poses a difficult balancing act, which is likely to dominate headlines in the months to come.

THE CAPRICIOUS MR MARKET

When recent results have been disappointing and there have been few places to hide, it is easy for investors to become despondent. When times are tough, it is often useful to revisit the tried-and-tested mental models that have served generations of investors well before making outcomes-defining investment decisions.

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One of these is a timeless and useful idea coined by Ben Graham, the father of value investing, way back in 1949. He wrote about Mr. Market, a highly accommodating business partner that provides investors with a daily offer to either buy their holdings or to sell you his. Mr. Market has two very important traits. Firstly, he is highly emotional and his daily price quotes will vary dramatically depending on his mood. When he feels euphoric, he only thinks about the positive factors affecting the outlook for the assets he quotes on, so he offers high prices to avoid you snapping up his holdings and so denying him future gains. When he feels depressed, he can see nothing but dark clouds on the horizon and is happy to offer low prices to avoid you selling your unwanted holdings to him. Secondly, he does not mind at all if you ignore him on any given day. He will be back with a new offer tomorrow and every business day thereafter.

The key benefit of framing the daily market price quotes in this way is that it helps us to avoid getting sucked into the market emotions of the moment, which is heavily influenced by the most recent events. It serves as a reminder that the market is your service provider, offering daily liquidity that you can make use of whenever you choose, rather than a guide, who tells you with perfect accuracy what the true long-term values of your investments are at any point in time.

Critics of Graham's analogy may counter with the efficient market hypothesis, which holds that share prices already reflect all available information. Even if the theory was completely applicable – and there are multitudes of examples that confirm that it isn't – the market can't simultaneously be efficient in its assessment of fair value over both the short and the long terms. Structural changes in markets also contribute to weaker price discovery as rules-based rather than fundamental investors now dominate daily market transactions, which means that market prices can become very disconnected from company fundamentals in the short term. These implicit inefficiencies regularly create opportunities for patient investors to exploit Mr. Market's mood swings and underpin our long-term valuation-centric approach to investing.

OUR KEY MESSAGES THIS QUARTER

The core theme of our commentary this quarter is that after an indiscriminate sell-off, we are finding several very attractively valued opportunities across global and local markets at present. At current market prices, our portfolios are showing significant upside to fair value, which, historically, has been consistent with above-average returns over the next several years.

Neville Chester argues that selected South African assets, including banks and resources companies trading at dividend yields that are higher than cash interest rates, and government bonds with double-digit yields, provide significant inflation protection and should not be ignored.

Danie Pretorius and Chris Cheetham from our global developed markets team show how the indiscriminate sell-off in global equities has created opportunities across a variety of different industry sectors and investment themes, from software companies such as Adobe, to consumer cyclicals such as Capri Holdings, and steady compounders such as Visa.

Marc Talpert, co-portfolio manager of the Global Optimum Growth Fund, does a deep dive on lossmaking long duration growth companies. This sector initially outperformed the overall market since the start of the Covid pandemic, as behaviour changed and cost of capital remained close to zero; but it has underperformed in 2022 as the world normalised and cost of capital started to increase. While limited exposure to these companies detracted from recent performance, Mark explains how we remain excited about the return prospects from a select subset of these businesses where we think the structural growth drivers remain intact but are now available at much reduced market prices.

Finally, Gavin Joubert and Suhail Suleman report that after a tough performance period, they currently see triple-digit weighted upside from our Global Emerging Markets funds.

There is no doubt that, whether a policymaker, an asset owner or an investor, we are all walking a tight line at the moment. At Coronation, our portfolios have not been immune to the sell-off, yet our north star remains our long-term valuation-based philosophy, which really has stood the test of time. We believe that it will do so again in time, as there is compelling value to unlock in our portfolios.

Pieter