Not quite light at the end of the tunnel

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The start of 2022 was a hopeful time. We were finally getting past the Covid-19 pandemic, interest rates were low, and everyone expected some growth to boost market returns. There was a build-up of Russian troops along the Ukrainian border, but that was just some sabre-rattling, of course.

There was a bit of inflation, but experts agreed that it would be temporary, as global supply networks normalised and things were under control again. China's zero-Covid policy was also surely something that would not last and have major global ramifications.

After almost two years of a global pandemic, the world was finally on the right track again.

Then, on 24 February, Russia started it's "special military operation" into Ukraine and the cards started to unravel. Inflation continued to increase rapidly around the world, and China stuck to its guns and their zero-Covid policy.

As these factors unfolded, there were major ramifications around the world. Energy prices spiked and there was a concerted effort by central banks to rein in inflation by aggressively hiking interest rates. Global economic growth started to come under huge pressure, and it is anticipated that large economies worldwide will go into recession.

All these macro-economic factors had a significant impact on global markets with risk appetite diminishing. At the time of writing (9 November 2022), asset classes across the board had delivered dismal performance. Global equities are down more than 20%, emerging market equities down 27%.

In South Africa, we had some protection through the weakening of the rand over the year (this benefits resource-based equities and companies with foreign earnings) and strength in commodity markets, especially energy (oil and gas). The local equity market delivered -5.5% year-to-date. Even the defensive asset classes, apart from cash (4.2% year-to-date), offered little protection. The year-to-date returns of bonds (1.9%) and inflation-linked bonds (3.7%) don't quite capture the level of volatility that these asset classes experienced during 2022.

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What we expected to happen in 2022, and what actually transpired, was therefore very different. Looking forward, what should we expect over the next year?

Firstly, as markets decline, better valuations create better prospective returns. In general, equities, and especially SA equities, are showing good value. A key part of the valuation is earnings, and realistically a lack of global growth will influence earnings. As such, valuations need to be considered cautiously and over time. Local bonds are giving real rates of return, and getting exposure to them at levels of 11% yield offers good prospective yields.

Although it is anticipated that inflation will be stickier than expected, there has been signs that inflation is turning. Therefore, central banks will potentially start decreasing interest rates in the middle to latter part of 2023. This will bode well for asset class returns as markets start to anticipate a resumption of economic growth.

There are both risks and opportunities looking forward. Fortunately, as investors we can take a longer-term view and see through the current risk and volatility. In the medium to longer term, growth will resume and investments will deliver sound returns.

Ultimately, the key to investment success is to make sure you align your objectives with the portfolio that you select and remain invested. That is what we do at Momentum Investments, because with us, investing is personal.

Source: Momentum Investments, 9 November 2022