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There are two sides to every coin…

Morningstar Investment Management South Africa

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For Financial Advisors and their Clients

Progressively more articles are appearing warning that the South African economy is heading for a total implosion. The sentiment is incredibly bearish on the ground and South Africans are finding themselves between a rock and a hard place. Should we pack up and immigrate, should we throw in the towel and prepare ourselves for a complete collapse, and/or should we take all our money offshore?

A tough start to the year

South Africa has had a tough start to 2023. Load-shedding has intensified over the last couple of months, we have seen multiple interest rate hikes, the country was greylisted, and political tensions have hammered the local economy. The Rand weakened to its lowest level in history after the US Ambassador to South Africa claimed the country sold arms to Russia. Following this debacle, the South African Reserve Bank (SARB) added sanctions by the United States as a new risk in its new Financial Stability Review (FSR). The SARB also stated that capital outflows, declining market depth and liquidity are additional risks to the country's financial stability.

All of these events have a big impact on local investor sentiment and on confidence from global investors to allocate capital to such a perceived vulnerable country.

Love-Hate relationship

It feels a little bit like South Africans have a love-hate relationship with our country. We love and support our rugby team, we love the sunny weather, we love the hospitality and friendliness of the people, we love the beautiful landscapes and wide open spaces and nothing comes close to a great braai coupled with some of the best wine in the world. On the other hand, we (mostly) hate our politicians, we hate the crime and corruption, the volatile currency, the lack of electricity, the income inequality, and the lack of employment.

The same love-hate relationship applies when it comes to investing. Historically, there have been periods where South African assets outperformed global assets (in 2022 for example), and there have been periods where South African assets sold off indiscriminately. When asset prices are low, newsreels are bad and sentiment is poor, investors tend to worry the most about allocating their hard-earned savings to South African asset classes.

Detangle the economy from the stock market

One of the most important things you can do when you find yourself feeling bleak about the state of the economy is to remember that the economy and the stock market are two different things.

The economy can be defined as the production and consumption of goods and services. Employment rates and gross domestic product (GDP) are measures of economic health.

GDP is the monetary value of all finished goods and services made within a country during a certain period, and it's used to estimate the size of the economy. The stock market is a collection of companies where you could buy and sell shares of those companies.

It's easy to think that the stock market and the economy would go hand in hand. Here are two main reasons why they do not:

- The stock market doesn't represent everyone participating in the economy.
- Share prices on the JSE reflect investor confidence in the future. Things like spending, economic growth, and employment are indicators of the current economic climate.

The stock market might reflect changes in the economy and vice versa, but the state of one doesn't necessarily paint the full picture of the other.

If one looks at every company listed on the South African stock exchange (i.e. the Johannesburg Stock Exchange or JSE), the majority of companies are not reliant on the South African economy to generate earnings. These are companies with business interests that are either predominantly outside of South Africa or entirely outside of South Africa. In fact, roughly 69% of the revenue generated by companies listed on the JSE is generated from outside of Africa.

This is possible because some of the largest companies on our stock exchange are dual-listed companies. In other words, these companies are listed on more than one country's stock exchange - for example Prosus, ABInBev, Richemont etc. We call these rand hedge shares. In short, if the rand weakens, it is a benefit to own these shares as they generate earnings in offshore currencies. So, as an investor, you are hedging your currency exposure even though you are investing in a South African-listed equity.

Diversification is the only free lunch

Everyone should be familiar with the idea of diversification in financial markets. After all, it has been dubbed the only "free lunch" in investing. By spreading your assets across a variety of markets and asset classes, you inherently reduce the probability of extreme outcomes.

At Morningstar we follow a tried and tested investment process to do exactly that – to ensure we have sufficient diversification in our portfolios (between asset classes as well as managers) while maintaining exposure to the more attractive parts of the market and keeping a close eye on costs.

In a Multi-Asset High Equity Portfolio (also known as a traditional Balanced Fund), Regulation 28 allows you to invest 45% in offshore markets – meaning that only 55% of your portfolio is exposed to South African Assets. Within the South African asset allocation, you can have equity, cash, bonds, property etc. As mentioned earlier - some South African companies do not even generate the majority of their earnings within the borders of South Africa.

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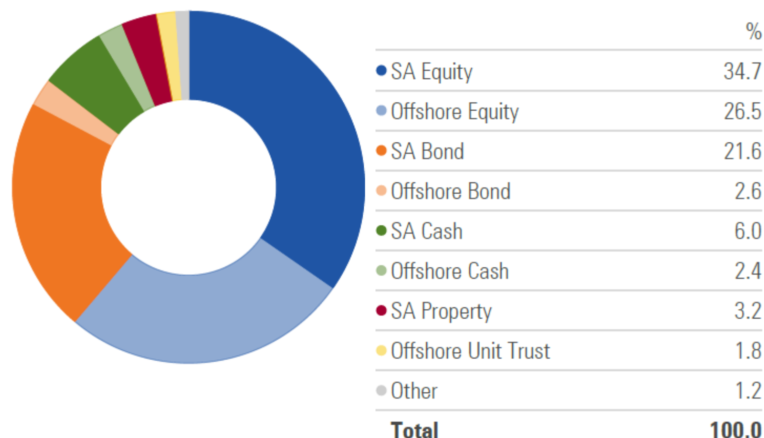
Here is a look at the asset allocation of the Morningstar equivalent of a Multi-Asset High Equity Portfolio:



	%
SA Equity	34.7
Offshore Equity	26.5
SA Bond	21.6
Offshore Bond	2.6
SA Cash	6.0
Offshore Cash	2.4
SA Property	3.2
Offshore Unit Trust	1.8
Other	1.2
Total	**100.0**

Source: Morningstar Direct. Data as at 30 April 2023. Figures are for illustrative purposes only, based on target asset allocation, and are subject to change. Allocation of portfolios at the individual account level may vary.

In closing

One of the most detrimental things you can do for your long-term wealth is to let emotions make decisions when it comes to your finances. This is incredibly hard to do, as human emotion pulls investors in different directions and fear and greed are the two biggest hindrances to investment success. The market is a noisy place with so much information being distributed through the media, that further fuels our emotions.

If you find yourself down about the state of the economy and South Africa in general, remember that there are two sides to every coin. Yes, it feels pretty bleak at the moment but -

1. Companies in South Africa have proven to be resilient, even through the toughest of times in our country's history.
2. Detangle the stock market and the economy from one another.
3. There is a fair amount of revenue that gets generated outside of our country.
4. Fund managers can diversify investments between different geographies and asset classes, even if your fund and/or asset is a "South African" one.

What is certain, is that another crisis will occur in the future. We will probably have another recession at some stage, the electricity crisis won't be fixed overnight and politicians will probably continue to disappoint. Things don't always work out, but most of the time they do.

If you want long-term results, you'll have to take a long-term view of things. Investing is a journey, not a series of separate events. The most successful investors are those who can stay the course despite today's crises and the fact that the future must always remain unknown. M

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