



Quarter-end comment

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A brave new world

By Jeremy Gardiner, director, Investec Asset Management

As we enter the second half of 2009, it is important to reflect on what has happened thus far this year. The first quarter was characterised by a continuation from last year of both equity market and economic carnage. The second quarter ushered in a sense of optimism; talk of green shoots prevailed and equity markets rebounded.

Investors in equities felt a sense of relief as their portfolios recovered some of their losses. Investors in cash, however, were disappointed. Nobody bought at the bottom, since the mood was so dire, and the prevailing consensus at the time was that any recovery was a dead cat bounce anyway. So investors stood back, waiting for a better buying time which never came, and suddenly markets were up 25% from their lows.

As quickly as 'green shoots' came into our vocabulary, so quickly they were discredited as premature. Conflicting economic data currently gives both optimists and pessimists a strong argument. But recent weakness should not come as a surprise. Anyone who thought that this recovery was going to be smooth was naïve. Volatility, especially the extreme levels we experienced during the peak of the crisis, doesn't just go away; it subsides gradually, and over time.

Secondly, global expectations of what green shoots would grow into, were also too optimistic. I regularly get asked how long it will take before equity markets return to pre-crisis levels, and the simple answer is probably not for a long time. Previous Western bull market earnings were driven by easy and widespread access to credit, and a spending rather than saving culture – a cocktail of factors that simply no longer exists. Today consumers are saving and paying back debt, while credit is virtually non-existent.

To make matters more confusing for investors, the Western world, along with its currencies, have lost much of their appeal, which poses a particular dilemma to investors who traditionally invested almost exclusively in these markets and currencies. How many South Africans look further from a currency perspective than the US dollar, the Euro or the Pound?

Going forward, it is pretty certain that the developing world – Asia in particular – is where the growth is going to be. Expect a far more equitable spread of global capital, across global stock markets, economies and currencies. Investors' obsessions with everything Western and developed is changing fast.

In summary, there are still many unknowns and the system, while healing, is by no means healed. So what do we know? It looks pretty certain that:

- This is a recession, not a depression.
- While there will certainly be more volatility, it is very unlikely it will be anywhere near the scale evidenced at the peak of the crisis.
- You have pretty definitely seen the worst.
- Global stimulus is working.
- Credit markets are loosening.
- Although economic conditions are still deteriorating, the pace of the decline is slowing.

Quarter-end comment continued

- Analysts' forecasts, although negative, are being revised more positively as they prove to have been too pessimistic.
- In general, results – although bad – are better than expected. Oil is up significantly from the lows, indicating a return of economic activity.

Markets look six months to a year ahead. That is why they collapsed last year, because they could see what 2009 looked like and it wasn't pretty! Now markets are looking at 2010, and there seems to be general consensus from analysts to the IMF that the world will be growing again in 2010, albeit slowly. The IMF is now forecasting 2.5% global growth for 2010, up from 1.9% in April.

Market sentiment is improving as investors start to understand the scale of the disaster. They still don't fully understand the size of the hole, but they understand a lot more than they did six months ago, and they are realising that although the world will slow, it won't collapse; that the situation is bad, but not catastrophic.

In addition, there is in excess of \$4 trillion sitting on the sidelines in cash, waiting to invest, earning basically zero percent interest. It is probably safe to say that the mood amongst investors has definitely changed from 'sell into strength' to 'use any weakness as a buying opportunity'.

So what should investors be doing?

- Be careful of trying to time the market. There are wild stories out there of investors moving all of their money into cash in March, and needless to say they are still not back in. Despite the recent rally, there are still quality stocks at reasonable valuations on a longer term basis.
- Don't expect markets to rebound to where they were. The world has changed. Consumers are saving again, paying off debt and borrowing is almost non-existent. These three factors will significantly influence spending and thus earnings, which means company earnings will remain challenged for a while.
- The world has also changed in terms of geography. At least for the next three years, the developed world is no longer the place to be, investors will increasingly look east, not west. Investors must, however, be careful of climbing into emerging markets/Asian stocks/funds. There is risk in these areas and mistakes will be made. Rather choose a fund manager who agrees philosophically that the world is changing (something many US, European and UK fund managers refuse to acknowledge) and therefore tilts a global equity fund in the direction of the developing world – Asia in particular – rather than the West.

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