PRUDENTIAL **INSIGHTS**

Lynn Bolin
Head of Communications and Media

JULY 2018

How do you add returns? Harness local vs global growth trends

In recent months, the contrast between weak economic conditions in South Africa and strong global growth has been particularly evident in the diverging performance of two sectors of the South African equity market: Retailers and Resources. Active investment managers like Prudential have been able to take advantage of these opposing trends to add extra returns to their clients' portfolios.

On one hand, weak local factors and sentiment have weighed on the earnings outlook for "SA Inc." companies – those with the majority of their earnings from South Africa – with retailers at the forefront. Consumer spending has been under significant pressure largely due to higher taxes and rising fuel and energy costs, and inflation has been fuelled by rand depreciation relative to the US dollar. This, in turn, has been reflected in the weak performance of SA Retailers: the General Retailers subsector of the JSE has returned -12.8% in the second quarter of 2018.

On the other hand, Resources shares have benefitted from robust international demand for commodities on the back of accelerating global growth, as well as the stronger US dollar. Contrary to local retailers, local miners earn a substantial portion of their revenues from overseas, with their earnings based on the combination of commodity prices (in US dollars) and the rand/dollar exchange rate. Given the uptick in commodity prices and the depreciation of the rand in recent months, resources shares have been among the few positive performers on the JSE, returning 21.7% in the second quarter of 2018.

Prudential's portfolios have been positioned to capitalise on these sectors' starkly different earnings prospects, to the advantage of our clients. We have been underweight the Retail sector and overweight Resources across many of our unit trusts like the Prudential Equity Fund, Prudential Balanced Fund and Prudential Inflation Plus Fund. This highlights key advantages of active management: investors have been protected on a relative basis from the downturn in Retailers, while also benefitting from the upturn in Resources. In fact, we recently took some profits on our Resources overweight after the sector's strong rally. Passive investors are unable to add such value.

This active fund positioning is a result of Prudential's consistent application of our prudent, valuation-based investment process. It is also one of the many reasons why our Balanced Fund, Equity Fund and Dividend Maximiser Fund are consistently ranked in the top-quartile of their respective ASISA categories, currently for all annual periods from 1 – 10 years through 30 June 2018.