PRUDENTIAL **INSIGHTS**

Hamilton van Breda
Head of Retail Sales

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Balanced funds offering promising returns

Despite the broadly disappointing returns from South African assets in recent times, particularly equities, at Prudential we believe many assets are currently valued to deliver promising inflation-beating returns over the medium term. Therefore investors have good reason not to switch to cash, but instead to have faith in diversified portfolios like balanced funds.

Higher-risk local assets – equities and listed property – have underperformed their longer-run averages over the past three years to 30 June 2018, falling short of local bonds and cash. SA equities have returned only 5.3% p.a., just matching inflation, and SA listed property 0.9% p.a. This compares to 7.8% p.a. from SA bonds and 7.3% from SA cash. This muted performance has pushed returns from multi-asset funds below their expected longer-term average.

But going forward we believe these funds should perform better over time, based on current asset class valuations and our fund positioning. The Prudential Balanced Fund is overweight global equities generally, which have the potential to deliver estimated returns of 12.6% p.a. over the medium term. Despite the long global equity rally, certain regions and sectors remain attractively priced, such as Germany, Japan, South Korea, China and Indonesia, while we are underweight relatively expensive US equities. We also believe global investment-grade corporate bonds offer good yields compared to their risk, but developed market sovereign bond yields remain too low.

The fund is also overweight South African equities, where valuations are relatively attractive, being priced to produce a return of around 12.9% p.a. over the medium term. The fund holds companies with substantial exposure to strong global growth, including resources companies like Anglo American, BHP Billiton, Sappi and Exxaro, as well as Naspers and British American Tobacco. We also like financial shares including Old Mutual, First Rand, Standard Bank and Barclays Group Africa which have offered low valuations with relatively high dividend yields. Additionally, the fund is broadly underweight retail stocks, given the financial stresses faced by SA consumers.

Besides equities, the Prudential Balanced Fund has a moderately overweight holding in SA government bonds, where current valuations indicate a return of around 9.7% over time. We prefer longer-dated bonds for the higher yields on offer. However, we are neutral in listed property and inflation-linked bonds. Even though listed property has fallen sharply in value so far this year, this is due largely to the decline in the share prices of the Resilient group of four property companies. Excluding these companies, the asset class is priced somewhat expensively - modestly above its fair value range - and the sector faces risks from higher inflation, rising interest rates and low growth. Yet valuations for listed property suggest a return of 14.4% p.a. return in the next 3-5 years.

Finally, prospective SA cash returns compare unfavourably over time, the lowest of the local asset classes at 7.3% p.a. So for medium- to longer-term investors, switching to cash now is not likely to give you better returns. Some patience is required: we believe that the current portfolio positioning of the Prudential Balanced Fund will allow it to continue to significantly outperform its benchmark and offer investors returns that strongly beat inflation over the medium term.

Prudential recently launched a US dollar-denominated global balanced fund, the Prudential Global Balanced Fund, which also has a rand feeder option, the Prudential Global Balanced Feeder Fund.

To invest in one our top-performing Balanced funds, contact your Financial Adviser or our Client Services team on 0860 105 775 or at query@prudential.co.za.