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Managing investments in the Coronavirus crisis

Investors are rightly concerned about their portfolio values following the sharp market crash in March, due to fears around the human and economic impact of the Coronavirus. While some may be feeling helpless, at Prudential we are optimistic that with patience, time and astute active portfolio management, investor portfolios can recover their values and clients can meet their investment goals over time.

Above all, investors need to resist selling their holdings at very low valuations. During the March sell-off, the South African equity market lost over 25% of its value, but then recovered by some 11% during the first two weeks of April. Had you sold in March, your portfolio would have experienced a permanent capital loss and missed out on this recovery, as well as any further gains. We believe SA equities and SA bonds are likely to continue to recover gradually from their current undervalued levels, so investors should maintain their exposure.

Equally, investors can be proactive and ensure that their portfolios are positioned both to benefit from the exceptionally low valuations now available, and to avoid the assets that have become more risky. Active portfolio management is key, as the large and rapid market moves during the global sell-off have changed prospective investment returns significantly.

Regarding SA equities, our analysis shows that, as of 15 April, the FTSE/JSE Capped SWIX Index) was priced to deliver a prospective real return of around 10.6% p.a. over the next three to five years, far higher than the 6.5% p.a. historic average. We have been adding exposure to companies with strong balance sheets, steady cash flows and defensive-quality earnings that we believe can successfully weather the economic downturn. In the sell-off we saw opportunities to buy some of South Africa's top blue-chip companies at excellent valuations. On the other hand, there are also companies that are trading very cheaply for a reason – because their risk has increased sharply. For example, we have been cautious about the listed property sector, which we believe is particularly vulnerable to earnings weakness going forward.

SA government bonds are also offering an excellent opportunity to capture exceptional returns following their sell-off. Based on our analysis as of 15 April, 10-year nominal bonds should deliver a real return of approximately 5.4% p.a. over the next three to five years, more than double the 2.5% p.a. historic average. We have been taking advantage of this by adding SA bonds to our portfolios wherever possible. Although more volatility is likely, we would not expect to see significant further weakness from these valuation levels, and we believe current bond yields largely reflect the risks involved.

In contrast to these assets, however, South African cash investments have become much less attractive following the South African Reserve Bank's 2.00% reduction in interest rates: SA cash is now offering a real return of only 0.2% p.a. going forward, we estimate, barely above inflation. For investors who have been holding high levels of cash as a "cushion", this positioning is now much riskier: it considerably reduces the chances of a full portfolio recovery the longer it is held.

Investors should also be cautious about increasing their offshore exposure going forward. The future returns from global assets have become less attractive relative to local assets due to both the depreciation of the rand, and because developed market asset valuations are more expensive than those in South Africa. The rand has lost about 25% of its value and is currently undervalued, making it likely more to appreciate over time. This would detract from future offshore returns.

Additionally, our analysis shows that the MSCI All Country World Index is priced to deliver a real return of around 6.0% p.a. over the next three to five years, very close to its 5.9% p.a. historic average. So global equities are not cheap on an absolute basis, nor are they cheap relative to SA equities. At Prudential we have been taking advantage of this by selling some of our offshore equity holdings to buy up better-valued SA equities and SA nominal bonds.