PRUDENTIAL
INVESTMENT MANAGERS

Lynn Bolin
Head of Communications and Media

SEPTEMBER 2020

Five guidelines for investing during a recession

With the news headlines shouting about a shrinking economy, rising unemployment and high risk in financial markets, it's not surprising that the average investor would be afraid to put their hard-earned money anywhere but in the bank. It's a natural human instinct to avoid losses, but in fact you will likely be doing your portfolio more harm than good by playing it completely safe in a recession like the present. Here are five tips on how to make the best of the current conditions.

1. Diversify, diversify, diversify

The first basic rule for investing during a recession is to make sure you have an appropriately well-diversified portfolio, invested broadly across higher- and lower-risk assets, geographies, currencies, and instruments. Some assets like bonds can offer steady, attractive income in a low-growth environment, and currently longer-dated South African government bonds are offering investors excellent yields if they are held to maturity. For example, 10-20-year bonds were yielding between 9.3%-11.4% at the end of August 2020.

Equally, growth prospects vary widely across countries, with some countries and regions recovering from the Coronavirus pandemic more

quickly than others (like Australia, Canada, Central Europe and Scandinavia, among others). While you shouldn't over-react and move all your money overseas, you should determine how much of your portfolio is exposed to the local economy versus offshore and ensure it is an appropriate amount. And don't forget that over 50% of the earnings on the JSE are generated offshore, so your portfolio may already be more diversified than you think.

For example, Prudential's Balanced Fund is overweight both South African equities and bonds to help investors take advantage of the excellent valuations on offer in both asset classes and capitalise on the diversification benefits. It also has broad global holdings. All three of these factors make it well-positioned to deliver higher-than-average returns compared to its history over the next five years.

2. Avoid de-risking if you can

Although risk assets like SA equities and listed property are very volatile, the flip side of the coin is that they still have the potential to outperform other local assets over the longer term. They should form an important part of any longer-term investor's portfolio to ensure your savings grow to beat inflation over time. Plus, don't assume that equities can't deliver solid returns during a recession. This hasn't proved to be the case consistently in the past. Rather, it has been a good time to buy local equities in recent months - many shares have offered excellent value, having been sold down to extremely low levels. At Prudential we have taken advantage of this by increasing our SA equity holdings across many of our Prudential Balanced and Inflation Plus Funds to give our clients the best chance of earning above-market returns going forward.

3. Don't "over-invest" in short-term interest-rate products

While these cash investments may seem "safer" than others, in fact they aren't from a longer-term return perspective. Because the South African Reserve Bank (SARB) has cut interest rates by a total of 3.0% so far this year, to record-low levels, they are offering very unattractive prospective returns compared to other assets. Prudential estimates that cash investments won't beat inflation over the next three to five years. So while cash holdings do play a constructive role in a portfolio, you should ensure you aren't holding too much to erode your potential longer-term returns.

4. Choose your equity holdings carefully

In the current recession, the risks facing SA companies have risen and market conditions have changed significantly since the beginning of the

year. To address this, be sure to invest in companies with strong balance sheets (where debt levels are manageable), a track record of generating consistent, growing income, and strong, experienced management teams. These blue-chip companies should be able to weather the challenges ahead better than others.

We have researched our investments thoroughly at Prudential to ensure each company that we include in our funds, no matter how cheaply valued, is worth the risk involved. For example, although the SA listed property sector is currently trading exceptionally cheaply, we have chosen to remain underweight the sector due to the higher risks it faces. Better diversification and returns can potentially be obtained from inflation-linked bonds, we believe.

5. Expect some bad news
As companies recover from the extraordinary Coronavirus lockdown, it's to be expected that for many, their earnings and general financial results will be well below historic performance levels. At the same time, don't be surprised if many suspend their dividend payments in order to shore up their cash on hand, or if they issue new shares to raise additional cash. This isn't likely to mean that they're in financial trouble, but rather that they're acting prudently to ensure they can continue to operate smoothly. Because financial markets are forward looking, concerns over a company's viability would likely be already reflected in exceptionally weak prices for their shares and/or debt. So don't over-react to perceived "bad news" by unloading your holdings - it's important to understand why a company may be undertaking these measures.

As professional investors, the Prudential team tracks company developments closely and can understand and anticipate management's financial moves. They are very unlikely to over-react to bad news, and are able to use their expert knowledge to their advantage by knowing when the market is mis-pricing a share. This gives them an edge over novice investors, and results in higher returns for clients.

Going forward, the recessionary conditions exacerbated by the pandemic will certainly be challenging for even the most seasoned investor. But by remembering these guidelines, you're likely to have a better chance of weathering the storm by avoiding the common mistakes investors make. Prudential incorporates all of these into how we manage our clients' portfolios, with the aim of producing the best possible returns with the

most appropriate risk. The Prudential Balanced Fund is an excellent example of our consistent approach.

For more information on our fund offering, visit the Our Funds section of our website. Alternatively, please feel free to contact our Client Services Team on 0860 105 775 or email us at query@prudential.co.za.