Prudential Investment Managers

JULY 2021

The economy isn't the stock market (and vice versa)

When the economy is in the doldrums, investing in the stock market can be the last thing on people's minds. Perhaps their personal finances have been negatively affected by the poor economic environment and they simply don't have enough spare money. Perhaps they've become more risk averse.

Often, however, they have an inherent belief that the health of the economy provides a good indication of what sort of returns they can expect from investing in shares. There is some logic in this assumption as stock markets are made up of companies, whose fortunes can be directly affected by economic conditions.
But the reality is that the relationship between the economy and the performance of stock markets is much less direct. In fact, the extent to which South Africa's real GDP grows and contracts has little impact on our stock market returns. This is partly because stock markets are forward-looking, which means that economic events that are likely to influence stock market returns are usually already priced into the value of the stocks. It's worth remembering that the stock price is typically a reflection of the outlook that investors have on a company's

future cash flow. Any perceived disruption or improvement to a company's future revenue stream will influence the price that investors are willing to pay for that stock.

We need only look at the events in late February and early April last year, when investors feared the potential impact that the Covid-19 pandemic could have on company earnings, sparking a global stock market sell-off. However, it wasn't too long thereafter when global markets began to rebound, and investors not only made up for any losses, but they've also done very well to date. The economy at that point had not felt the impact of the pandemic – further illustrating the point that the stock market is forward-looking.

A second major factor that helps to separate equity market performance from the prevailing economic conditions is the existence of the rest of the world (i.e., globalisation). When the local economy isn't firing on all cylinders, bigger economies like the US, EU and China may be growing quickly. Therefore locally listed companies with significant offshore earnings from those rapid-growth areas would likely record faster earnings growth than more locally-focused companies, reflected in superior share price performance and helping drive the JSE higher than might otherwise be expected from the local economy. Global growth and stock rallies can also help to lift the South African economy and equity market to an extent that might not be justified by purely local conditions.

All the above suggests that equities can still be a sound investment despite a low-growth economic outlook locally. In fact, over the long term equities continue to outperform almost all other asset classes and significantly beat inflation. Investing in equities is a good way to grow your capital and enjoy the benefits of compounding.

The first rule of investing, in general, is to diversify your investments. With equity exposure, one of the best ways to achieve this is to invest in a proven top-performing equity unit trust.

Top-quartile funds over 15 years

The performance of Prudential's equity funds has consistently ranked in the top quartile of the SA – Equity – General ASISA category over 15 years*. Our two equity funds for retail investors are the Prudential Equity Fund and the Prudential Dividend Maximiser Fund.

In conclusion, whatever the economy is doing, the right time to invest is always now. The longer you leave it, the more you stand to lose out on your short-, medium- and long-term savings goals. Try our Past Performance Calculator to see how much your investment would be worth today if you started investing sooner.

For more information, please feel free to contact our Client Services Team on 0860 105 775 or email us at query@prudential.co.za.

**Source: Morningstar as at 30 June 2021*