M&G **Insights**

Sandile Malinga
Portfolio Manager
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Investing in 2023: New year, new opportunities for investors

The 12 months of 2022 may have proved disappointing for many South African investors, but there were opportunities in local financial markets to take advantage of cheap asset valuations that added value to portfolios. Risk management through diversification and careful asset selection were also key to adding value and protecting portfolio downside. We're sure that all three of these elements will hold true in 2023 as well.

Looking at the opportunities ahead, in our view, SA bonds continue to offer investors strong prospective returns compared to history and relative to other markets, even after having outperformed global bond markets in 2022 with a 4.3% annual return versus -11.2% from the Bloomberg Global Agg Bond Index (both in rands). For example, our 10-year government bonds started 2023 with a yield of over 10%, and our analysis points to a prospective real return of 5.7% p.a. from these assets over the next five years or so, significantly above their 3.0% p.a. historical real return. And compare this to the 0.9% p.a. real return we would expect from global bonds over the next three to five years. SA real yields also compensate investors for the elevated inflation and interest rate risk we are experiencing. Therefore, SA bonds should offer attractive, above-inflation returns together with less volatility for investor portfolios in the new year.

SA equities are also presenting good buying opportunities as the FTSE/JSE Capped SWIX Index ended 2022 on a 12-month forward price/earnings ratio of around 9.0X, below its historic average. Our latest analysis shows a prospective real return of around 9.5% p.a. over the next five years from these assets compared to a long-term average of 7.0% p.a. Within equities, we believe it's important to be somewhat cautious in stock selection, preferring companies with strong balance sheets that will not incur undue costs in a high interest-rate environment and can deploy cash strategically where necessary. Equally, we would opt for businesses that can pass on price increases to customers to protect their margins, and those that can benefit from higher interest rates, like banks. As interest rates rose globally last year, the prospects for profit growth in the banking sector rose commensurately. We believe SA banks like Investec, Absa and Standard Bank have been, and continue to be, trading on undemanding valuations, especially given that their earnings and dividend growth are currently exceptionally strong. As such, we are overweight the banking sector in many of our client portfolios.

Other equities that we consider attractive in the current environment are Naspers and Prosus. These shares were battered last year by the Chinese government's imposition of tighter regulations on the gaming industry and a hiatus in granting gaming licenses, among the broader global sell-off in technology stocks. However, December and January saw Chinese elections, the lifting of the exceptionally strict Covid lockdown regulations and a restart in licensing, as the government aimed to revive very slow economic growth. These all helped improve sentiment in the companies' underlying holding, Tencent, which helped their share prices rebound. In turn, the Naspers and Prosus share buyback programmes also had the desired effect of providing valuation support to the companies, such that their discount to Tencent narrowed, leading to significant outperformance in December. We expect this improvement to continue as the shares (and Tencent) still have much value to recoup and the government intensifies its support for the economy in the months ahead.

Meanwhile, we believe other South African assets are less attractive than bonds and equities. Our multi-asset funds are neutral or underweight inflation-linked bonds (ILBs) and listed property. ILBs offer less attractive prospective returns than nominal bonds, despite the inflation protection they provide, while property stocks present higher risk than most other locally listed equities. They typically carry relatively high levels of debt, which becomes costly in a rising interest rate environment. Our listed property holdings include companies with lower exposure to the hard-hit office sector, and those focused on logistics and storage.

Finally, offshore investments are also vital to include in any 2023 portfolio, thanks to the important diversification benefits they offer; but, as in South Africa, investors need to be selective in their equity choices. US Treasuries are the most effective assets in countering local equity risk, with 30-year USTs, in particular, offering attractive yields for the first time in many years.

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