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JANUARY 2021

Good returns for SA investors in a bad year: What it teaches us

The very unusual year of 2020 has had many things to teach us as investors, not the least of which being the impossibility of predicting the future. Amid a pandemic that continues for the tenth consecutive month (as of end December), and widespread lockdowns that have caused serious damage to economic growth and business revenue, the South African equity market (FTSE/JSE All Share Index, ALSI) has managed to deliver a total return of 7.0% to investors for the year. Investors who maintained their equity exposure for the year are likely to have come out of 2020 better than would have been expected.

Equities deliver 7.0% as economy shrinks by 8.0%

Who would have imagined even as recently as 30 October that local equity returns would be positive for the year? The ALSI had lost about 30% of its value at its worst point in mid-March, and after a slow, volatile recovery, by the end of October had returned -7.1% for the year-to-date. Of the four ALSI sectors, only Industrials had recorded a positive return (4.7%), while Listed Property was down over 50%. At that point the market had a long way to go to even fully recover its losses for the year, with GDP expected to shrink by 8.0% in 2020.

Most people would not generally think that conditions where economic growth is -8.0% could also produce equity returns of +7.0%. Who could have correctly forecast this? (Of course much of the reason behind this solid outcome has to do with the high offshore earnings exposure of the ALSI, but that is another story).

This highlights how financial markets are seldom driven by the reality on the ground, and instead impacted largely by future expectations - right or wrong. As soon as the news of the development of two effective Covid-19 vaccinations broke in early November, investors ignored the worsening of the second wave of the pandemic across many countries and focused solely on the hope that the virus would be fully contained sooner than expected. They enthusiastically bought up higher-risk assets.

Yet after the drastic plunge in the ALSI in March and ongoing terrible social and economic news in its aftermath, many South African investors chose to opt for “safe” investments like cash and reduced their risk exposure, locking in losses by selling at low levels. With hindsight we now see that they likely missed out on the rebound that led to solid equity returns for the year. If they were not already in the market in the first week of November, they had little time to benefit from the rally sparked by the vaccines.

In retrospect, a better outcome would likely have been to stay the course and remain exposed to equities, so that when asset prices rebounded it would have been possible to reap the full benefits. It is impossible to forecast what could happen to drive market valuations, to predict the quantum of those market moves and to time the market correctly.

Bonds return 8.7% despite downgrades, new supply

Just as surprisingly, South African bonds were able to deliver an impressive 8.7% return for investors in 2020. This, in a year during which the government's credit rating was downgraded further into junk status and the budget suffered severe revenue shortfalls and funding challenges. Given the extra bond supply required, investors could have reasonably expected a weaker local bond market for the year, but in the last three months of 2020 as the "risk-on" sentiment grew, both local and global investors snapped up SA government bonds due to their attractive yields. This resulted in unexpectedly good gains for bondholders in a year of very bad news for the bond market.

So SA investors are left with surprisingly good returns in the bad year that was 2020 – who would have predicted it? Better to leave the forecasting to the meteorologists, like Prudential does. Rather just ensure your portfolio is invested appropriately, according to your return goals and risk profile, and stay the course through the ups and downs of the markets.

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

https://www.prudential.co.za/insights/articlesreleases/good-returns-for-sa-investors-in-a-bad-year-what-it-teaches-us/