



Keep cool in the midst of the noise

We have been receiving many queries from investors as to what is going on in the market and what to do amid the extreme volatility. What happened in the market in the latter part of May was triggered largely by signals of a retraction of the expansionary monetary policies of global central banks. This news resulted in what resembles the much talked about “great rotation”. The market effectively took a sudden pause in the quest for yield that had been supporting bonds at their high levels. The onset of this shift was heralded by the mild mentions to Congress, by the US Fed’s Ben Bernanke, that slowing the pace of asset purchases, or quantitative easing (QE), is under discussion.

Different Fed regional governors have made different comments about the issue in recent weeks, adding to the market’s confusion. While no formal decision about a tapering off QE has officially been made, markets have clearly taken Bernanke’s comments as a given, especially as a number of incoming data releases in the US have recently surprised to the upside. The market responded strongly to this and the result was a spike in bond yields globally, especially in US inflation-linked bonds, but spreading to higher interest rates globally. Emerging markets were no less affected and South Africa has been no exception.

The South African rand, embattled by a high current account deficit, a widening budget deficit, sluggish economic growth, mounting fiscal and social pressures, and threats of rating agency downgrades, was now additionally faced with this reversal by foreign investors in South African bonds. Foreigners have turned from big buyers of SA bonds to sellers. And, as foreigners still own some R475bn of SA bonds, they can still have a major say in the rand’s next movement. So SA bonds lost 5% of their value, the rand lost 11% to the US Dollar, and listed property took a huge hammering and was also down 11% in May (scroll down for more on listed property).

A weak rand means that international assets, especially equities benefited, while local equities and the large cap shares in particular, experienced steep increases. This resulted in stellar performance from the more aggressive Profile Pinnacle portfolio. There is now a huge dispersion between bonds and equities and lots of volatility.

At MacroSolutions all our funds (other than Old Mutual Real Income Fund) already had maximum exposure to international assets, and we had been steadily reducing property in our portfolios prior to the recent fall. Furthermore, Wikus Furstenberg from Futuregrowth, who manages the bond exposures in our portfolios, had reduced the duration of our bonds, and we hold a greater proportion of inflation-linked bonds which have weathered the storm relatively well. This has led to our lower risk solutions to be resilient in this period of bond weakness.

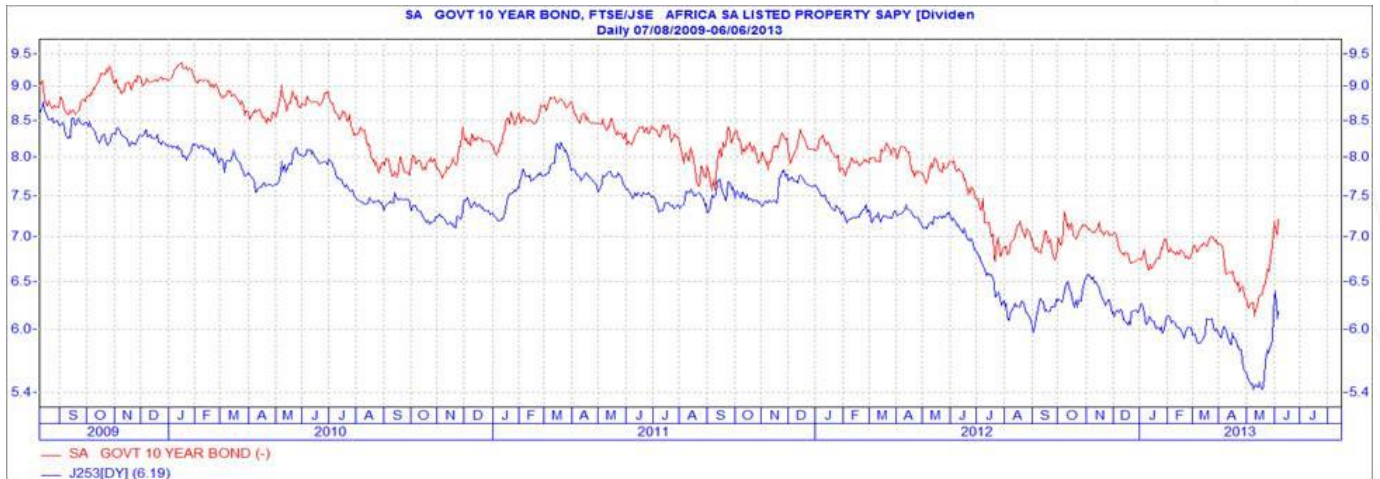
What is important to note, is that extremes in the market tend to be temporary, for example: daily moves in Harmony Gold of 17% up and Nampak’s fall of 13% are not reflective of reality. This type of wild volatility points to the impact of speculators and hedge funds on the markets, and underscores the necessity of maintaining a long-term view in your portfolio, to not get swept up in large moves based on investor sentiment, and to ensure that you are not over-exposed to any one asset class. As you know, at MacroSolutions, diversification across asset classes and regions is our mantra.



Listed property – “bonds giveth and they taketh away”

Listed property has for many years been a major beneficiary of falling bond yields resulting in large property capital gains. Listed property prices have now fallen dramatically over a short period of time as bond yields have given up some of their gains because internal and external factors caused rand weakness, and removed hopes of a rate cut. Bond yields (and property prices) have now returned to their levels of mid-2012. There has been no negative news regarding property per se and investors can now buy the same cash flow for less money. In the short-term, property capital values will continue to be the hostage of bond yields which are volatile. We see listed property as a long-term investment which offers an increasing income stream. The asset class remains an important component of a well-diversified portfolio.

The chart below shows how bond and listed property yields have moved together. When yields rise prices fall.



For more information on the relationship between bonds and listed property, please visit www.macrosolutions.co.za and read the August 2012 and April 2013 editions of our monthly newsletter, Perspectives.

Old Mutual Investment Group (South Africa) (Pty) Limited is a licensed financial services provider, FSP 604, approved by the Registrar of Financial Services Providers (www.fsb.co.za) to provide intermediary services and advice in terms of the Financial Advisory and Intermediary Services Act 37 of 2002. Old Mutual Investment Group is a wholly owned subsidiary of Old Mutual (South Africa) Limited. Reg No 1993/003023/07. The investment portfolios are market-linked. Products are either policy based or unitised in collective investment schemes. Investors' rights and obligations are set out in the relevant contracts. Market fluctuations and changes in rates of exchange or taxation may have an effect on the value, price or income of investments. Since the performance of financial markets fluctuates, an investor may not get back the full amount invested. Past performance is not necessarily a guide to future investment performance. In respect of pooled, life wrapped products, the underlying assets are owned by Old Mutual Life Assurance Company (South Africa) Limited, who may elect to exercise any votes on these underlying assets independently of Old Mutual Investment Group. In respect of these products, no fees or charges will be deducted if the policy is terminated within the first 30 days. Returns on these products depend on the performance of the underlying assets. Old Mutual Investment Group has comprehensive crime and professional indemnity insurance, as part of the Old Mutual Group cover. For more detail, as well as for information on how to contact us and on how to access information please visit www.omigsa.com.