INVESTMENT STRATEGY FOR 2014

MARKETS HAVE BEEN GOOD TO INVESTORS OF LATE WITH GROWTH ASSETS SUCH AS EQUITIES AND OFFSHORE DELIVERING INFLATION BEATING RETURNS FOR INVESTORS. INVESTORS IN BONDS AND LISTED PROPERTY HOWEVER HAVE NOT HAD A GREAT YEAR FROM A RETURN PERSPECTIVE, BUT THEY HAVE DONE WELL OVER LONGER MEASUREMENT PERIODS.

As always, the question for investors with money to invest is 'where to now?' I am quite humble about my ability (or inability) to forecast, so I am not going to make any predictions here.

Interest rates have moved sideways for over a year with another downward move highly unlikely. Given the outlook for inflation, interest rates are likely to go up, meaning that bonds and listed property are likely to experience volatility.

Staying at a macro-level, South Africa is currently coming into the global spotlight more and more following its inclusion in a less-than-prestigious group of countries – the Fragile Five. The Fragile Five refers to the five emerging economies – SA, Turkey, India, Indonesia, and Brazil – with the largest budget and current account deficits. This points to further potential for currency volatility and capital outflows by foreign investors. Recent rand movements suggest that some investors are already shifting funds, while others continue to dance a lot closer to the door. In fact, all five countries have experienced currency weakness relative to the dollar over the past year. Three of the five have increased interest rates while South African rates have remained flat, and Turkey has decreased rates. Incidentally, only Turkey is worse off than SA in terms of the size of its deficits.

SA is also heading into an election year in 2014. I am not a political expert, but as an interested and engaged layman, I do not see the ANC simply taking a comfortable majority as it has done in elections since 1994. Any instability or major surprises could impact negatively on markets.

Turning our attention to the markets, we see an equity market reaching new all-time highs every so often. However, as interesting as where the market is, it is earnings (profitability) and earnings growth that matter in the long run, and what price investors are paying for those earnings. At the moment, they're paying a premium to be invested in equities with the market trading at a P/E rating of around 18. This is higher than the long-term average of around 14, and is more than one standard deviation above this long-term average. Coupled with this is the fact that dividend yields are quite muted at around 2.6%, which is close to the long-term average for the market. Earnings growth for the Alsi for the year ending 30 November 2013 were also negative.

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Given the largely gloomy picture painted above it is unsurprising then that our strategy for investors committing capital to the markets at this stage would be one of caution. We would suggest that investors take a more cautious approach for the next few months. Funds that we are using a lot more for clients at the moment include the **Allan Gray Balanced, Allan Gray Stable, Coronation Capital Plus, Grindrod Stable** and **Nedgroup Stable.** Given that we expect lower returns from markets going forward, investors would do well to mitigate costs wherever they can. To assist with this aspect we would be looking at funds such at the new **Satrix Balanced** and **Satrix Stable funds** as well as **Coronation Strategic Income.** The Satrix funds are priced at 0.35% per annum, which is cheap compared to the standard 1%-1.25% charged by many balanced funds. It also does not charge performance fees, which is a plus. We've been able to achieve total annual fees in the order of 1.5%/annum for clients including admin, advice and asset management fees, by combining a number of these funds into a portfolio on a platform such as the Stanlib platform, which is one of the few to offer the Satrix funds to investors.

We are also avoiding single-asset class funds at the moment in favour of multi-asset class funds such as those mentioned above. This is because the managers are better positioned to be making critical asset allocation decisions compared to advisers or investors. They have the benefit of bigger, more skilled teams and access to data and information to inform views. Those who are not convinced of asset managers' ability in this regard can consider the tracker funds mentioned above. The other major advantage of multi-asset class funds is that they do not trigger capital gains when switching between asset classes.

A cautious approach such as this may not look terribly smart if markets continue to run. However, over time, such a strategy tends to underperform in rising markets and outperform in falling markets, and deliver similar (if not better) returns at much lower levels of risk.

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