

INVESTMENT NOTE

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THE INVESTING GAMES



IZAK ODENDAAL

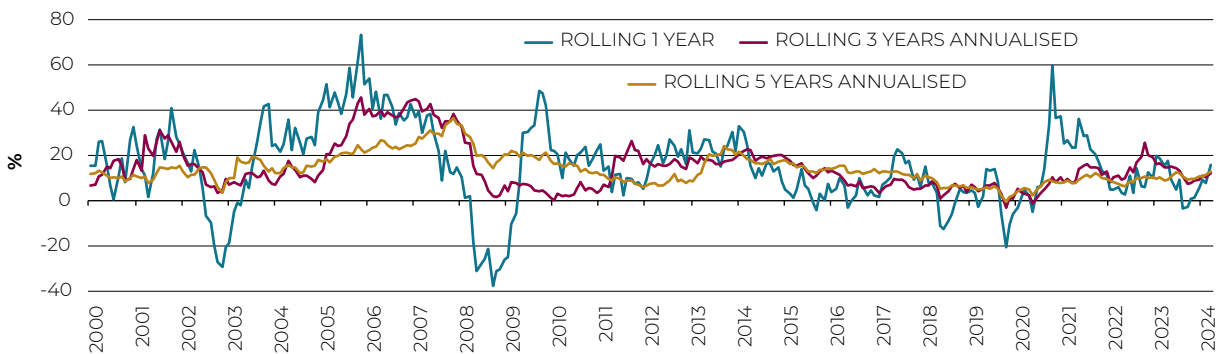
OLD MUTUAL WEALTH
CHIEF INVESTMENT STRATEGIST

The recently concluded Olympics and especially the Paralympics were true testaments to the power of the human spirit. After the disappointing Covid-disrupted Tokyo Games, Paris delivered thrills, spills and spectacle, buzzing crowds, and, of course, a monumental backdrop.

There are a few obvious, even trite, investment analogies. **Investing is a marathon, not a sprint**, it is often said. The 100m sprint is probably the highlight of every Olympic Games, more so this year when the men's race saw mere microseconds separating the winners. Long-distance races might make for less gripping

viewing than the blink-and-you-miss-it sprints, but that takes nothing away from marathon runners and their incredible feats of endurance. Investing similarly requires a kind of stamina, which largely involves being able to ignore bold headlines. There was a time when information was scarce and access to data gave some investors an edge. Today, it is information overload and success comes from filtering out noise. Chart 1 offers a simple example of how market returns are considerably less volatile when you take a step back. Just as marathon runners don't benefit from tracking their pace over very short distances, obsessing over every up and down of the stock market helps no one.

CHART 1: FTSE/JSE ALL SHARE INDEX RETURNS OVER DIFFERENT PERIODS



Source: LSEG Datastream



WEALTH

Keep it simple. One of the surprise heroes of the 2024 Paris Games was the Turkish shooter Yusuf Dikec. His calm, no-nonsense approach, without special glasses or protective gear, one hand in the pocket, not only won him a silver medal, but also made him an internet celebrity. Investing similarly needn't be overly complicated or costly. And if you don't understand it, it's probably best to leave it alone. Moreover, constantly shifting portfolio allocations around is not only hard work, but also increases the risk of getting it wrong and incurring trading costs along the way. Remember that in the context of investing, doing nothing is also doing something.

Teamwork wins medals. There are many team sports at the Olympic Games, and South African teams won medals in the men's 100m relay and rugby sevens. But even individual athletes don't operate alone. There is a support team behind each of them, including coaches, medical personnel, logistics managers and more. Investing success similarly rests on partnerships between clients and advisers, advisers and product providers and so on. Since everybody has blind spots and behavioural biases, it is useful having others around to point those out to us.

Speaking of teams, no football or hockey team would start a match with more than one goalkeeper on the field. Or

with only strikers and no defenders. **Balance** is as important to an investment portfolio as it is to a sports team. Of course, team balance needs to make sense in the context of the coach's strategy, and similarly portfolio balance is very powerful when linked to a desired investment goal and time horizon. Some asset classes are defensive, some deliver growth. Getting the mix right is probably the most important investment decision one can make, far more than picking the best fund managers or securing the lowest fees.

Some countries punch above their weight. Australia has a small population but produces many winners and finished fourth overall at the Paris Games. That says something about the country's sporting culture and competitive spirit, but also about its priorities. Australia invests in sporting victories, and those resources could have been applied elsewhere. The point remains however, that **success doesn't just happen, it requires sacrifice**, obviously from the individual athletes who must show tremendous discipline and dedication, but also from the broader society who supports them. Similarly, there are no get-rich-quick options for investors. Present consumption must be sacrificed to save and invest, and investors must remain committed to their goals.

ALL-TIME CHAMPION

The leading Olympic nation by far, however, is the United States. And this is a less obvious, but equally noteworthy analogy for investors.

The US won a total of 126 medals at the Paris Olympics, ahead of China with 91, though they were tied on gold medals at 40 each. Out of a total of 17 834 medals awarded in the Summer Games since 1896, the US won 2 764. It is ahead of the second placed USSR and its successor states (Russia, Ukraine, Kazakhstan etc). The UK is in third place, since China did not compete at the Games before 1984.

Many winning athletes from other countries train in the US at American universities. According to a *Wall Street Journal* article, athletes from Stanford University in California won 39 medals. If Stanford was a country, it would've finished eighth, ahead of Germany and Canada. Harvard's 13 medals are more than twice South Africa's haul. As a magnet for

talent and incubator of success, US universities are unrivalled. After all, Stanford also gave us Google, Nvidia, Cisco and a host of other tech giants.

The US similarly dominates financial markets, out of proportion to the size of its economy which accounts for around 20% of global GDP, depending how it is measured.

As Chart 2 shows, US-listed companies make up more than 60% of the market value of popular global equity benchmarks such as the MSCI All Country World Index. This number has increased over the past decade as US markets outperformed the rest of the world. Even though China is solidly the number two economy by size and continues to increase its share of global GDP, that has not translated into similar profit growth for its companies. Since equity prices follow profits, Chinese equities are still a small slice of the global market.

CHART 2: US EQUITY SHARE OF GLOBAL MARKET MARKETS

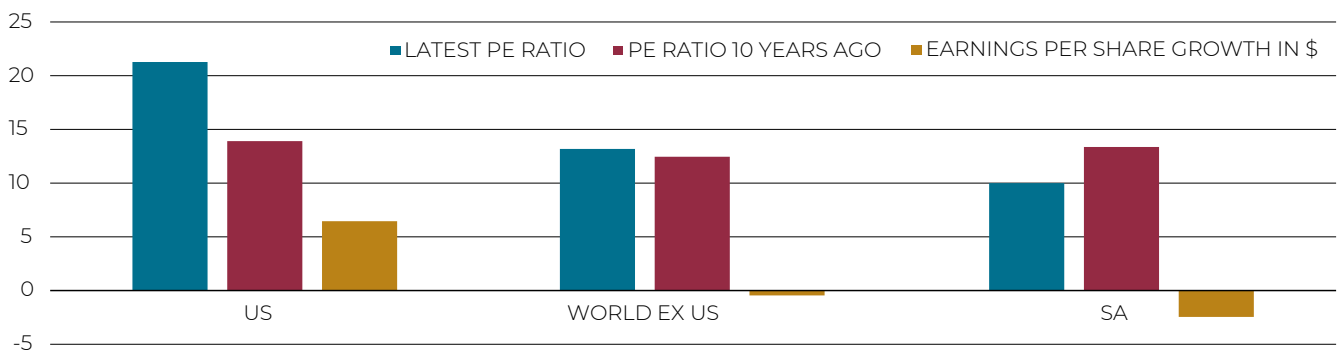


Source: LSEG Datastream

US equities, on the other hand, have grown their earnings per share consistently, partly through the practice of aggressive share buybacks that are not done on a similar scale elsewhere. US companies have a ruthless focus on profitability, which might have negative effects on the rest of society but tend to make shareholders happy. It is also US companies that have most successfully ridden the big wave of technological advances of the past decade, from the smartphone to social media platforms and artificial intelligence.

The big headache for investors is that the superior profitability of US equities is fully priced in. The US market is not only expensive relative to the rest of the world but is also more expensive than a decade ago as chart 3 shows. Having the highest price: earnings ratio is probably one area where you don't want to be a champion, since it unfortunately implies below average long-term returns, after a decade-plus of being above average.

CHART 3: FORWARD PRICE EARNINGS RATIOS AND EARNINGS GROWTH



Source: LSEG Datastream

The size of global bond benchmarks is determined by debt issuance – the more you borrow, the bigger the weight in the index. The US government is the biggest borrower of all sovereigns, with \$35 trillion in debt outstanding. It therefore dominates the global benchmark indices, such as the Bloomberg Global Aggregate Bond Index.

The private sector component of this index is also dominated by US borrowers, partly due to the size of the US private sector (companies and households), but also because it tends to borrow in the bond market, whereas bank finance leads in other countries. For instance, 65% of US mortgages are packaged into securities that can be bought and sold by investors. The benefit to borrowers of bond finance over bank finance was demonstrated when the Federal Reserve

hiked interest rates. Many American borrowers were unaffected since interest rates are fixed, while bank loans tend to have interest rates that rise and fall with the central bank's policy rate, a situation we know well in South Africa.

The size and depth of US capital markets underpins demand for the US dollar. International investors, including reserve managers and sovereign wealth funds, want to buy US assets for reasons of safety, return and convenience. They know that they can move large amounts in and out without hassle. Demand for the dollar is also underpinned by its use in transactions, where it benefits greatly from a network effect – the more widely it is accepted as a means of exchange, the more useful it becomes to everyone who uses it.

As a result, 54% of global trade is invoiced in dollars, even though the US exports only around 9% of global trade. In foreign exchange markets, the dollar accounts of one side of 89% of transactions. The dollar's share of central bank forex reserves has declined by about 10 percentage points to 58% over the past 20 years, but that is largely due to increased use of euros, Swiss francs and Aussie dollars – all US allies. The Chinese yuan only accounts for 2% of reserves. This number should rise, since China is the world's biggest exporter, and ultimately, one of the reasons nations hold forex reserves is to allow them to continue importing even when a crisis hits. However, while China maintains capital controls, the renminbi's attractiveness is diminished to foreigners.

Even as it and the US's other strategic rivals are trying hard to limit the use of dollars in financial transactions between them, it is slow going. Since dollars are welcome everywhere, nobody minds accumulating excess dollars. The same is not necessarily true for Russian roubles, for instance. A country like China could willingly use roubles to buy oil and gas from Russia, but what would it do with excess roubles?

DON'T FIGHT THE FED

But for financial markets, more important than who will occupy the White House is probably the decisions made down the road at the Mariner Eccles Building, head office of the Federal Reserve (The Fed).

The dollar dominance noted above means that the cost borrowing of a dollar overnight is the most important interest rate in the world. That interest rate is set by the Fed, which hiked its policy rate dramatically in response to the post-Covid inflation surge, but it will start lowering those rates next week.

The big question and biggest uncertainty for investors everywhere is whether this cutting cycle is coming too late, too early, or just on time.

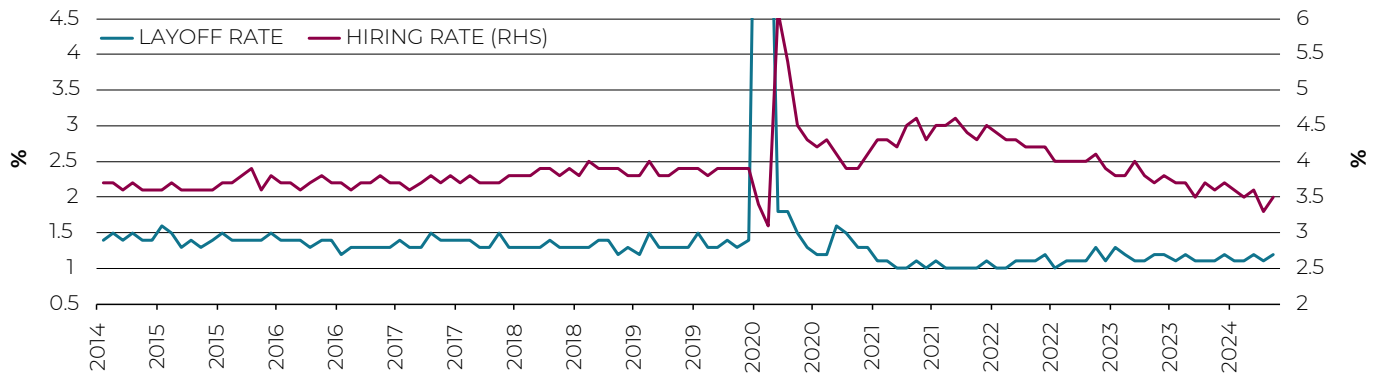
A premature cutting cycle is one where inflation resumes an upward trend necessitating future rate increases. This

There are a few implications of this “exorbitant privilege”. When the Covid pandemic hit, the American government could borrow vast amounts of money to pump into its economy. Today, it is the only major economy that is bigger than its pre-Covid trend would've suggested. In other words, it is possibly bigger than it would have been if Covid never hit (we cannot say for sure, of course, because who knows what else might've happened). We'll tackle the consequences of all this debt in a later note, but for now, it is worth highlighting the benefit of being able to issue bonds in a currency the rest of the world want.

Another implication is that while we in South Africa might safely ignore political and policy developments in, say, France or Germany, we need to keep our eyes on the US. This can be frustrating, especially since US politics has become so polarised, and we as outsiders feel like forced participants who nonetheless have no way of influencing the outcome. This year's election probably matters more than most, since the policies of presidential candidates Kamala Harris and Donald Trump diverge markedly.

seems unlikely for now, partly due to recent oil price declines, but mostly due to increasing evidence customers are pushing back against higher prices and companies are responding by moderating price increases, even resorting to discounts in some cases.

The Fed would be cutting too late if the cooling in the US labour market accelerates into something worse. While hiring has slowed substantially, the pace of layoffs remains low. The reported increase in the unemployment rate has so far been due to more people joining the labour market, not job losses. But if companies start firing workers in large numbers to protect margins, it could spiral into a recession as consumers cut back spending. The health of the labour market will be closely studied in the months ahead.

CHART 4: US HIRING AND FIRING AS % OF EMPLOYMENT

Source: LSEG Datastream (2020 data truncated)

For now, it seems likely that the rate cuts are more or less on time. Lower interest rates will provide relief to vulnerable households and businesses, but the broader economy is still in decent shape. US economic growth is likely to slow from its strong pace over the past year, but this can be interpreted as a return to normal after four pandemic-distorted years. Importantly, though, nothing can be taken for granted given the various sources of uncertainty noted above.

These are things we must be cognisant of, but sometimes it is worth thinking like an Olympic athlete. They do not focus on the weather, the crowds or what competitors do, but only on their own actions and reactions. As investors we do not choose the investment landscape, but we do choose how to respond to it.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US\$	3 519.0	-3.88%	-3.88%	11.04%	19.05%
United States	S&P 500	US\$	5 408.0	-4.25%	-4.25%	13.38%	21.12%
Europe	MSCI Europe	US\$	2 149.0	-3.15%	-3.15%	6.39%	15.48%
Britain	FTSE 100	US\$	10 740.0	-2.33%	-2.33%	9.08%	15.65%
Germany	DAX	US\$	1 754.0	-2.61%	-2.61%	8.52%	17.88%
Japan	Nikkei 225	US\$	255.9	-3.24%	-3.24%	7.83%	13.65%
Emerging Markets	MSCI Emerging Markets	US\$	1 075.0	-2.27%	-2.27%	4.98%	9.58%
Brazil	MSCI Brazil	US\$	1 488.0	-1.06%	-1.06%	-17.33%	-4.25%
China	MSCI China	US\$	55.2	-2.47%	-2.47%	-0.47%	-8.64%
India	MSCI India	US\$	1 107.4	-1.52%	-1.48%	20.11%	34.39%
South Africa	MSCI South Africa	US\$	450.0	-3.02%	-3.02%	8.43%	19.05%

EQUITIES - SOUTH AFRICA (TOTAL RETURN UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	81 365.0	-2.85%	-2.85%	5.82%	9.35%
All Share	All Share (Total Return)	Rand	14 680.0	-2.77%	-2.77%	8.32%	13.50%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	35 973.3	-2.74%	-2.74%	8.41%	14.48%
TOP 40/Large Caps	Top 40	Rand	13 183.0	-3.09%	-3.09%	7.09%	11.25%
Mid Caps	Mid Cap	Rand	23 589.0	-2.93%	-2.93%	8.28%	20.06%
Small Companies	Small Cap	Rand	39 677.0	-0.26%	-0.26%	21.48%	29.41%
Resources	Resource 20	Rand	4 553.4	-5.88%	-5.88%	-6.34%	-4.01%
Industrials	Industrial 25	Rand	24 148.0	-2.76%	-2.76%	8.76%	10.28%
Financials	Financial 15	Rand	15 376.0	-1.46%	-1.46%	19.09%	29.41%
Listed Property	SA Listed Property	Rand	2 355.5	2.09%	2.10%	26.37%	42.50%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
IBOXX Global Government S&P Overall (USD Unhedged)		US\$	78.9	1.41%	1.41%	0.56%	6.12%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	1 072.6	1.49%	1.49%	14.05%	21.58%
Government Bonds	BESA GOVI	Rand	1 055.9	1.48%	1.48%	13.91%	21.43%
Inflation Linked Bonds	BESA CILI	Rand	373.1	0.61%	0.61%	6.83%	12.45%
Cash	STEFI Composite	Rand	579.9	0.16%	0.16%	5.81%	8.56%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US\$	71.1	-7.63%	-7.71%	-7.71%	-21.91%
Gold	Gold Spot	US\$	2 487.0	-0.64%	-0.64%	20.55%	29.33%
Platinum	Platinum Spot	US\$	920.0	-0.65%	-0.65%	-6.79%	0.99%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	17.85	-0.12%	-0.14%	2.51%	7.49%
ZAR/Pound	ZAR/GBP	Rand	23.44	-0.17%	-0.17%	-0.60%	2.43%
ZAR/Euro	ZAR/EUR	Rand	19.79	-0.50%	-0.50%	2.07%	4.04%
Dollar/Euro	USD/EUR	US\$	1.11	-0.90%	-0.45%	-0.54%	-3.60%
Dollar/Pound	USD/GBP	US\$	1.31	0.00%	-0.21%	-3.25%	-4.78%
Dollar/Yen	USD/JPY	US\$	0.01	-2.69%	-2.69%	0.85%	-3.67%

Source: I-Net, figures as at 6 September 2024

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WEALTH

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