NAVIGA

Should you remain invested in the equity market?

February 2022

KEY POINTS:

+ Markets will be volatile, owing to interest rate hikes and higher inflation
+ This is not necessarily negative for equity markets
+ Cash, both local and global, delivers negative real returns
+ Equities remain the asset class of choice
+ Do not try to time the markets
+ Remain invested through the market cycle
+ Use the silo approach to provide funds for short-term needs
+ Diversify portfolios

Investors typically either reduce their equity exposure too soon when the markets are going up, or sell their exposure when the markets are going down because they fear that the equity market will continue its downtrend. Research suggests that the best approach to investing is to remain invested unless a recession is imminent. Missing even only a few good trading days in the market can have a significant impact on a portfolio over the long term. It is impossible to know when the good trading days will take place. Therefore, it is more prudent to remain invested throughout the market cycle.

Investment portfolios achieved excellent returns during 2021, both from local and global equity. The question is: **SHOULD ONE REMAIN INVESTED IN THE EQUITY MARKET?**

Global economic growth remains strong. The Omicron variant will moderate this growth during the first quarter of 2022, but from the second quarter, economic growth should accelerate. Inflation, however, is a concern for the market. If global inflation continues to accelerate, central banks will need to raise interest rates faster and higher than expected. Our research suggests that supply-side pressure on inflation should ease as economies are opening up.

The expectation is that interest rates will rise in South Africa (SA) and the United States (US) but real interest rates (after inflation) will remain negative for a significant period of time to come. This should support the equity market. The longer history of interest rates and stock valuations does not show any reliable inverse relationship. In fact, if anything, the opposite tends to be true. Markets tend to perform well during the early stage of interest rate hikes. The slowdown in China is a concern but policymakers seem to have switched to a more growth supportive focus. This should bode well for emerging market equities.

Don't Mind the Fed

When the Fed has raised rates, the stock market has mostly moved higher

Rate Hike Campaign	Fed Funds Rate Change	S&P 500 Index Price Change
7/1954 to 10/1957	2.7	33%
5/1958 to 11/1959	3.4	32
7/1961 to 11/1966	4.6	21
5/1967 to 9/1969	5.2	5
3/1971 to 9/1971	1.8	-2
2/1972 to 7/1974	9.6	-26
1/1977 to 7/1981	14.4	28
2/1983 to 8/1984	3.0	13
3/1988 to 3/1989	3.3	14
12/1993 to 4/1995	3.1	10
1/1999 to 6/2000	1.9	14
6/2004 to 7/2006	4.2	12
11/2015 to 1/2019	2.3	30

Sources: Federal Reserve, Bloomberg

BloombergOpinion

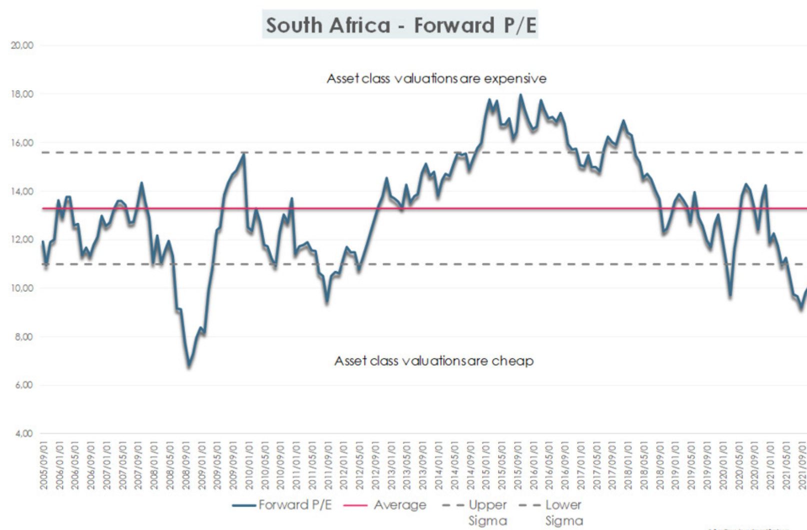
PORTFOLIO CHANGES

At Naviga, we use a 'silo approach' for our clients that require an income from their investment portfolio. The short-term silo invests in cash and bonds to provide the income that is required in the near term. The medium- and long-term components are inherently more volatile, as these silos invest in growth assets such as equity. The growth assets are required to outperform inflation over the long term, this is the compensation received for the volatility accepted over the shorter term in these long-term growth silos. We took profit from the long-term silo during January and allocated it to the short-term silo. This provides comfort in that provision has been made for the near-term income requirements.

We also expect a rotation between the various investment styles. Therefore, we increased the exposure to value and emerging markets. Value managers tend to be underweight in the expensive US market and rather invest in the United Kingdom (UK), Europe, and Asia. In addition to the rebalance of the Naviga Income Series and the style rotation, we replaced the SA Fixed Bond Manager with an unconstrained income fund. Although we believe that SA bonds offer value, these will be volatile, owing to the interest rate hikes and higher inflation prints.

OUTLOOK

Equity remains the asset class of choice as other asset classes, such as SA and offshore cash, currently deliver below inflation returns. Investors should, however, expect some volatility during the next year as markets digest the interest rate hikes and inflation data but South African equity valuations provide a valuation buffer when compared to other more expensive markets.



We are maintaining a broadly neutral exposure to asset classes, striking a balance between the global uncertainties that persist and the opportunities presented by the continuing global recovery, still supported by policy measures. We expect equities to provide the bulk of returns in the years ahead. We continue to hold a blend of equity investment styles to take advantage of the recovery potential in value stocks and the long-term opportunities in growth stocks, while including exposure to higher quality companies that have the resilience and balance sheet strength to ride through the inevitable challenging periods.

Well-diversified portfolios continue to be the best approach to follow for achieving long-term investment goals. Our portfolios are actively monitored in response to market prospects and conditions. Investors can rest assured that their investments are being managed prudently with an eye on the long term.

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