GLOBAL EQUITY MARKETS: WARY OF CHASING BEAR MARKET RALLIES

Maitse Motsoane | Portfolio Manager & Analyst

Maitse Motsoane

At the beginning of the year, when the S&P 500 Index was flirting with new all-time highs, the market didn't exhibit all the classic signs of a bubble. Fast-forward to today, with the NASDAQ having reached new all-time highs, there are far more of those signs compared to earlier this year.

It can be argued though that equities were in a bubble given the near-vertical decline of 35% that played out over a couple of weeks starting in late February through to the second week of March. However, even though valuations were clearly extended, what lacked was an extreme public emotional involvement with asset prices, which could lead to a sort of populist mass exodus that results in extended losses in the equities space. In line with this, we are aware that bubbles aren't typically just reflected in over-extended valuations, but also in widespread emotional attachment to asset prices.

Before the first quarter's correction, equity markets were driven mainly by corporate share buybacks, passive flows and other dispassionate model-driven technical players – with individual investors largely absent. However, the retail investor community seems to have embraced the rebound and their involvement in the stock market has since increased to levels last seen during the dotcom mania of the late '90s.

Our concern is however that all this is playing out against a less supportive economic backdrop. The global economic landscape is fraught with risks. Most notably, risk assets don't appear to be sufficiently discounting the risks emanating from the dual pandemics of the spread of Covid-19 and a wave of social revolution.

Indeed, a by-product of central banks trying to eliminate the business cycles is the manifestation of a wider division between the haves and the have nots as the asset-rich minority become wealthier, while the rest are being left behind. As a result, a brittle and polarised socio-political environment is created, because certain sections of society feel that the social compact that is based on the notion that the faster the economy grows, the better off everyone will become, has been fractured. The fact that these social protests are happening so soon after harsh lockdown restrictions, and are carried out in densely-packed groups of relatively young people who may carry the virus for weeks without any symptoms, poses the risk to undo much of what's been achieved to fight the spread of Covid-19 in various jurisdictions.

While economic recovery is underway, some investor caution in the second half of 2020 may be warranted. Global equities as represented by the MSCI All Country World Index have retraced most of their losses during the second quarter. The pace of recovery may potentially disappoint investors expecting a rapid V-shaped turnaround in growth as the economic realities of a post-lockdown world start to sink in. While the scale of policy responses to the strict lockdown has been huge, and the speed at which they were delivered was truly unprecedented, it's highly unlikely in the near-term that global growth will be pushed back to the levels seen in January. Historically, pandemics tend to last approximately two years, not five or six months.

With that said, our positioning in the equities space remains moderate- to strong-underweight, depending on the geographical region. Expectations of a significant decline in corporate earnings and the current rebound in prices indicate materially higher price-to-earnings ratios over the short- to medium-term. Furthermore, while the central banks' easing of financial conditions supports risk-seeking behaviour, we are concerned that investor complacency is starting to take root. Sir John Templeton famously said that "bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria". Our assessment of the markets is that we currently find ourselves somewhere between the optimism and euphoria phases – leading us to proceed into the second half of the year with due caution.

ends

About Prescient:

- Prescient Management Company (RF) (Pty) Ltd (the manager) is approved under the Collective Investment Schemes Control Act (No.45 of 2002). Prescient Investment Management is an authorised Financial Service Provider (FSP 612) under the Financial Advisory and Intermediary Services Act (No.37 of 2002).
- This document is for information purposes only and does not constitute or form part of any offer to issue or sell or any solicitation of any offer to subscribe for or purchase any particular investments. Opinions expressed in this document may be changed without notice at any time after publication. We therefore disclaim any liability for any loss, liability, damage (whether direct or consequential) or expense of any nature whatsoever which may be suffered as a result of or which may be attributable directly or indirectly to the use of or reliance upon the information.
- There are risks involved in buying or selling a financial product. Forecasts are based on reasonable assumptions, are not guaranteed to occur and are provided for illustrative purposes only.