Economic Snapshot September 2020

LOCAL HIGHLIGHTS & LOWLIGHTS	NEWS
• All-Share Index 56650.09 (from 49,113 mid-May). • JSE Allshare P/E ratio is 21.43 on the back of lower earnings and high prices. • USD/ZAR consolidating at R16.60/$ after recovering from last months fall. • South Africa 10Y Government Bond yield: Current 9.22%, (10.81% mid-April) (Data: Bloomberg; Sharenet; www.tradingeconomics.com)	• Chinese retail sales grew year-on-year for the month of August, lifting global markets • UK economy stuttering. Boris Johnson may plan to break the Brexit deal, uncertainty still on the cards after the referendum 4y ago. • On 6 Sept. India recorded 90,000 coronavirus infections in one day, overtaking Brazil as 2nd-most-infected nation after US • The US government's war against COVID-19 is straining the Treasury the most since America's drive to defeat Nazi Germany and Japan 75 years ago. • The Oxford vaccine trial was halted due to an unexplained illness in a patient but is reported to be proceeding again.

FACTOR INVESTING: THE VALUE (PART 2)

In the previous newsletter we started discussing 'smart beta' factor investing, and we are focussing on building what is called a Value Factor in this month's edition. The concept that underpins this specific factor is the theory that shares that are undervalued should have a reversion back to fair value in the not-too-distant future, and the same for shares that are overvalued. The question now is how under- and overvaluation are defined, and used for profit?

The most well-known valuation metric is the P/E ratio, which presents the price per rand of earnings. A low ratio means that you are buying every rand of earnings-generation power cheaply. The problem is that earnings can fluctuate and be manipulated by clever accounting or underspending, so the metric is often questioned as a valid valuation gauge. The price-to-book (P/B) ratio has therefore entered the arena strongly, with both academics and practitioners strongly suggesting it is a more stable and dependable measure. A mix between the P/E and P/B is often proposed as a value screening method. After finding the most undervalued stocks, the strategy is to then buy them either in an equal weighted fashion or size weighted, and then to short the overvalued shares accordingly. Easy, right?

The problem is that the value factor has often been underperforming over the last 10 odd years specifically, bringing to an end an era of many successful value funds. The fundamental reason why stocks are undervalued by investors is because it has fallen out of favour with them, caused by anything from a change in management to a failed venture or corporate scandal. The good "Value managers" therefore pride themselves in not just identifying undervalued stocks, but stocks where they believe the management and the core business model will be profitable over time. A bargain stock may therefore be a bargain that is to-good-to-be-true, and it may well be that the market has grown more efficient in not under-pricing quality companies as it may have done in the past.

GRAPH OF THE MONTH: FAANGM vs Market

Technology stocks have played a massive role in the performance of the S&P500 since the start of the Covid-19 Pandemic, being partly to blame for the disconnect between market sentiment and market performance. The following graph from VisualCapitalist.com shows the dramatic performance and influence of the FAANGM stocks **(Facebook, Apple, Amazon, Netflix, Google & Microsoft)** over the past few years.

https://www.visualcapitalist.com/understanding-the-disconnect-between-consumers-and-the-stock-market/

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