

Value returning to local equity market



Peter Linley
Head of Toros Equity

The South African stock market is currently offering reasonable value, although equities remain vulnerable to the contagion effect of further global growth shocks and the lingering uncertainty plaguing the Eurozone.

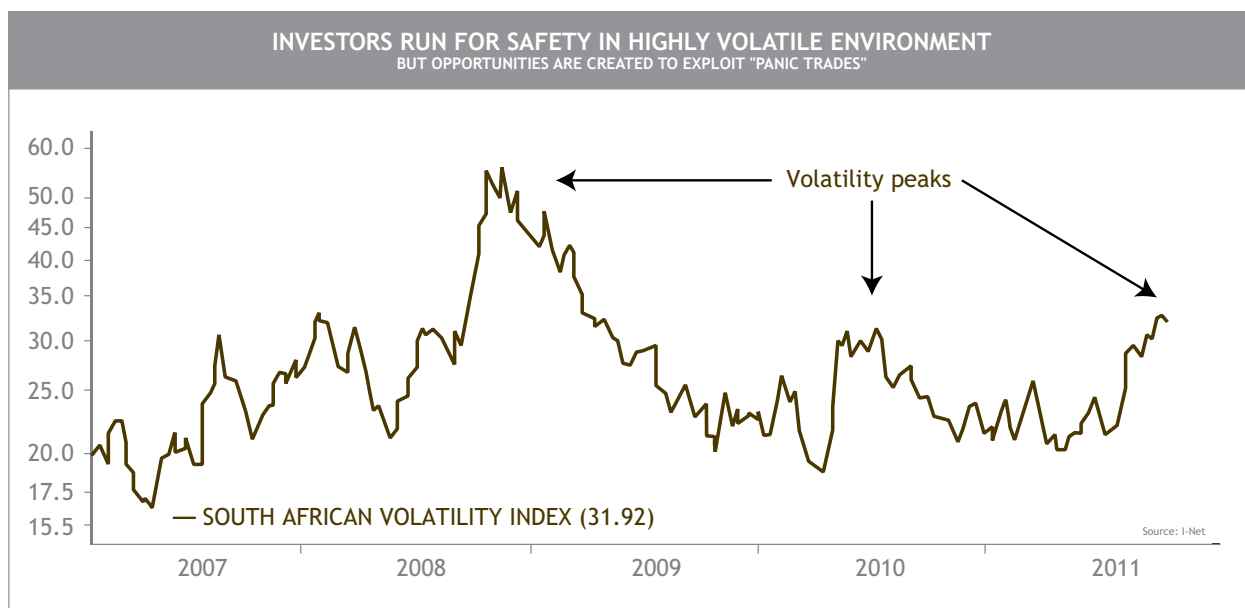
While risks in the global economy remain at elevated levels, I expect global economic growth to improve into 2012 and do not expect a double-dip recession: The world is structurally in a slower growth phase because of fiscal tightening and deleveraging and therefore volatility is likely to continue.

Risk aversion at extreme

After enjoying a steady recovery for more than two years, equity markets have had a rough ride in 2011. The three spikes in volatility since the financial crisis in 2008 have led to an extreme level of fear among

investors. While a recent market recovery has pushed both the JSE's and the US Dow Jones' year-to-date returns into positive territory (in local currency terms), for investors it feels a lot worse because of the volatility. Globally, risk aversion and pessimism are at such extreme levels that we expect a rebound in equity markets over the short term.

These repeated spikes in volatility play havoc with any stock-picking, valuation-driven investment philosophy – as the market is driven by macro issues rather than a focus on valuation. Investors are placing a premium on high-quality, high-yielding shares and earnings, which are less risky to forecast. While the South African equity market is reasonably valued on current valuations, it remains expensive based on long-term trend earnings.



While gold has become the popular safe haven in these worrisome times, I am more cautious and contrarian. It seems to be the obvious place to be, and we have seen significant growth in the pool of gold ETFs globally. It is likely that the gold price will continue to be supported in the short term as investors remain worried about the state of the world economy and the value of money. Personally, I think it is a bubble in the longer term, but timing is everything.

Diversified mining shares Anglo American and Billiton are extremely cheap based on forecast earnings, but are obviously very dependent on global growth, which is why they have been sold down. Share prices are already discounting a recession and significantly lower commodity prices. However, these shares could stay cheap for a while in the current environment, but will outperform when investors' appetite for risk

improves – probably on clear action by European authorities, in particular. ■

