# SA'S POTENTIAL AS **A TOP EMERGING MARKET BUY YET TO RIPEN**

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## ABOUT **THE AUTHOR**

Feroz is the joint boutique head of the Global Emerging Markets boutique. His passion for investments has seen him managing local and global portfolios for over 10 years. He is currently jointly responsible for managing this investment boutique and the Old Mutual Global Emerging Market Fund.

In the first quarter of 2017, the average GDP growth experienced by emerging markets was around 4%, while South African GDP growth came in at a dismal -0.7% as the country entered into a technical recession. For a foreign investor looking into emerging markets, South Africa isn't a very attractive prospect at this point. However, pockets of market value are likely to emerge.

When it comes to South Africa's macro economy, the worst isn't over yet, but the deteriorating economy is expected to yield more market opportunities – as the local equity market is still not looking very cheap compared with other emerging markets.

In managing the Old Mutual Global Emerging Market Fund, we remain considerably underweight to South African stocks. In terms of pure South African companies, we only hold ABSA and Netcare, which make up about a 4% weighting in the Fund (compared with the roughly 8% South Africa constitutes within the MSCI Emerging Markets Index).

We've been fundamentally vindicated for this underweight position in SA stocks, considering that the MSCI Emerging Markets Index has delivered 9.7% in rand terms for the 12 months to the end of June 2017, while the JSE Shareholder Weighted All Share Index (SWIX) was up only 0.4%.

Despite this underperformance, the South African market is now trading on a forward price earnings multiple of 15.3 times versus the MSCI Emerging Markets Index on 12.8 times (as at August 2017). The emerging markets composite as a whole is still cheaper than the local market.

This implies that while the negative sentiment around South Africa is slowly starting to feed into companies, none of these companies have de-rated to a level that would position South Africa as a screaming buy right now. However, despite the local market having been fairly resilient recently compared with other emerging markets, a continued decline of performance should create better buying opportunities.

## GOOD GOVERNANCE PROTECTS SA COMPANIES

South Africa, in the emerging market context, has excellent, world-class companies with good corporate governance standards and first-world financial systems, which allow money to flow into and out of the country. While this has largely protected us from any major corporate decline, the market does appear to be turning and is beginning to underperform. This underperformance is what will trigger value in South Africa from an emerging markets perspective.

Unless something politically significant were to happen that drives up confidence and strengthens the rand, there is more pain to come. Our fear is that the worst is not over yet, with heightened political instability and the potential for another downgrade. However, if the trend of underperformance continues, over time, we expect to see increasingly more pockets of opportunity unfold in South Africa.

Figures sourced from FactSet and Bloomberg