A glass half full?

By Jeremy Gardiner, director, Investec Asset Management

2011 was a tough year. Regardless of what industry you operate in or where you were invested, it wasn't much fun. Economies across the world, particularly developed markets, struggling as consumers cut back on spending and tried desperately to rebuild savings. Adding fuel to the fire in those countries that were already struggling the most, governments were cutting wages, hiking taxes and cutting back on their own spending. As John Maynard Keynes said back in 1937, "the time for austerity is during the boom, not the slump".

Across the world jobs were lost, companies collapsed and even countries came close to collapse. Although America's finances are in worse shape than Europe, one fiscal system means that they can plug holes across the country when necessary, so last year the focus was and indeed remains today firmly on Europe.

Markets last year were justifiably skittish, concerned primarily with the possibility of a domino-style European collapse or on the other side of the world, a hard landing in China, both of which would have had a devastating impact on global economies, not to mention stock markets.

Then came the festive season; everybody took their eye off the economy and markets for a while and started the new year full of enthusiasm. Kevin Rudd, former prime minister of Australia commented recently at Davos that the mood had changed to "Optimism with a small o", as opposed to last year's "Pessimism with a capital P".

So what are the reasons for this change in attitude?

- Investors are tired of bad news.
- Investors are equally tired of returns close to zero on cash holdings.
- Investors have also realised that while problems in the Eurozone remain, they are working their way through the system.
- Investors therefore also feel that the likely prognosis for Europe is one of stumbling along uncomfortably rather than complete collapse.
- Investors celebrated fourth quarter Chinese growth of 8.9%, when the world was expecting a substantially weaker 8.2% (a hard landing would be approximately 6%), indicating that a soft landing is now the more likely outcome.
- And finally, investors have realised that while problems remain across the world, a lot of bad news is already priced into stock markets, bond markets and currencies.

In summary therefore, while the world looks as though it has retreated from the abyss, the problems have not disappeared and it is going to be bumpy going forward. The current rally in global equities is most likely not the beginning of a bull market. Valuations are stretched and there are issues, however many investors were caught off guard sitting in cash during the recent rally, and coupled with the change in mood globally, any weakness in markets is now seen as an opportunity to get in rather than a reason to get out. As a result, weakness is generally short-lived.

So what should investors be doing?

Don't avoid equities and offshore investments; a lot of the bad news is already priced in – in some cases more than necessary. With cash yielding less than inflation (and almost less than zero internationally) plus given the fact that we're all going to live longer, investors cannot stay in cash forever.

Investors' attitudes have changed, as they are now more concerned about "return of their investment" rather than "return on their investment". However, don't allow fear to keep you sitting on the sidelines too long.

A stumbling along, rather than imminently collapsing world will see risk appetite return as investors, starved of yield, become bolder and look further afield. This environment will be good for emerging markets, equities and the rand.

Given the confusion in terms of what to do, unit trust flows will most likely continue to move predominantly into multi-asset funds, as investors outsource the decision-making from an active asset allocation perspective to professionals.

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Notes to Editors

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