

Closing our tactical positions in Brazil and South Africa

- ▶ Brazilian equities have returned 5.5% and 16.9% since 13 January and year-to-date respectively...
- ▶ ...while South African equities have registered a loss of 6.2% and flat performance over the same time frames
- ▶ Sticking to the 'time discipline', we close our tactical positions in both Brazil and South Africa

In our note [The Equity Tactician: Embracing Brazil and South Africa, January 13 2019](#), we introduced tactical trades on Brazil and South African equities after indicating our selective preference for these markets in our [Quarterly Investment View, January 2019](#). At that time we defined our tactical time frame as 'less than a year'. Brazilian equities (as measured by MSCI Brazil net total return USD index) have returned 5.5% and 16.9% since the publication and year-to-date respectively while South African equities (as measured by MSCI South Africa net total return USD index) have registered a loss of 6.2% and flat performance over the same time frames.

Brazil: what worked and what didn't

For Brazil, our investment case rested on the implementation of structural reforms (pension reforms, fiscal consolidation and privatisation), acceleration of the economic growth, lower interest rates, scope for foreign investors to buy the market, strong earnings growth and potential strength in BRL.

Through 2019, economic recovery remained weak and GDP numbers saw meaningful downgrades. Brazilian Real (BRL) weakened by c8% against the USD year-to-date (in fact stronger USD was one of the risks we highlighted earlier). Materials sector, with idiosyncratic issues for some large players in the sector, was a drag on the overall index. Weaker Chinese growth remained a constraint too.

Despite these headwinds, earnings momentum for Brazilian corporates held up relatively well. Thanks to the well-behaved inflation, interest rates fell and resulted in lower cost of equity. The reform momentum played out in part. Pension reform managed to restore debt sustainability. Scope for further reforms remains – especially privatisation could be a lot more supportive for equity markets.

South Africa: what worked and what didn't

Macro improvement, stable USD, cyclically depressed valuations, scope for reforms following general elections and potential for strong earnings growth were the arguments behind our investment case for South Africa at the beginning of the year.

During 2019, South African equities experienced a range of headwinds. To start with, the economic growth remained anaemic. Fiscal deficit widened and the debt stock, albeit low, turned unsustainable. Despite the success of African National Congress in the general elections, Cyril Ramaphosa was not able to pursue much needed reforms which in turn resulted in weaker investment. However, the biggest drag on equity market performance came from a sharp rise of concerns surrounding Eskom, South Africa's public utility company. This, in our view, has created negative perception amongst investors. Though the country avoided its last investment-grade sovereign rating being downgraded by Moody's, it however could not escape the negative outlook at the credit rating agency. Against this backdrop, South African Rand (ZAR) was remarkably resilient against the USD. Looking ahead, case for owning South African equities largely rests on reform implementation.

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As the quote from an unknown source runs, "discipline is doing what needs to be done, even if you don't want to do it". Whilst we might be slightly inclined to allow more time for our investment cases for Brazil and South Africa (especially the former) to play out, we however want to have a disciplined approach to investing. Given that we initially defined our tactical time frame as 'less than a year', we would stick with it and close our tactical positions in both Brazilian and South African equities.

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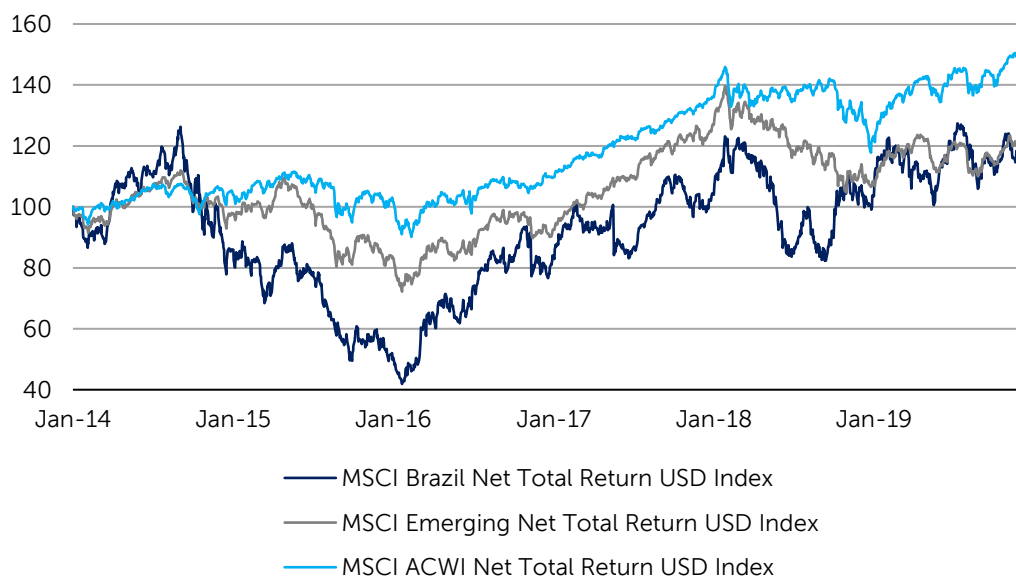
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Brazil

In 2019, Brazil outperformed Emerging markets but underperformed ACWI

Net total return indices (indexed to 100 at the start)



Source: MSCI, Bloomberg, ADCB calculations

Know Your Trade > Risk, return, valuations and earnings: Brazil, EM and ACWI

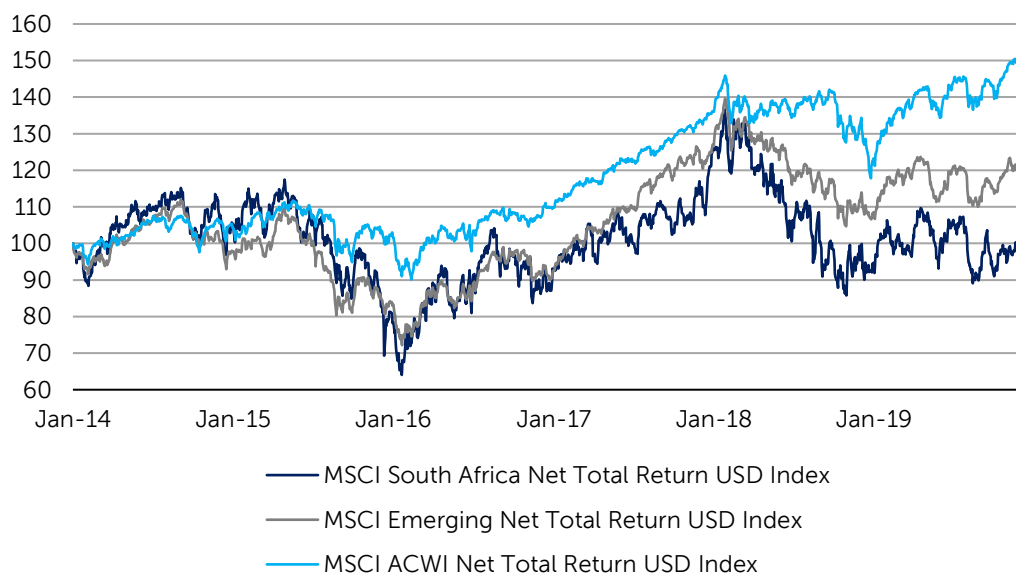
	MSCI Brazil Net Total Return USD Index	MSCI Emerging Net Total Return USD Index	MSCI ACWI Net Total Return USD Index
1 month total return (%)	-0.7	-1.8	1.3
3 month total return (%)	4.7	4.4	5.7
6 month total return (%)	6.1	6.2	9.6
12 month total return (%)	17.0	10.0	16.8
YTD total return (%)	16.9	11.2	22.6
3 year annualised total return (%)	14.6	9.4	11.8
5 year annualised total return (%)	5.8	3.7	7.3
10 year annualised total return (%)	-1.9	3.5	8.7
30 day volatility	18.9	10.0	6.3
90 day volatility	22.9	10.2	9.9
180 day volatility	22.9	11.5	9.9
360 day volatility	27.8	13.6	11.5
162 week volatility	26.2	14.4	11.3
Correlation (52 week)	0.4	0.7	1.0
Beta (52 week)	1.0	0.9	1.0
12M forward Price/Earnings per share (x)	15.6	13.8	17.2
12M forward Price/Book value per share (x)	2.1	1.6	2.3
12M forward Dividend yield (%)	2.9	2.9	2.4
12M forward Price/Sales per share (x)	1.8	1.3	1.7
12M forward Price/Cash flow per share (x)	8.8	6.6	10.9
12M forward earnings growth (%)	22.5	14.6	9.9

Source: MSCI, Bloomberg Consensus, ADCB calculations | Data as at close of 9 December 2019

South Africa

After correcting sharply in 2018, South African equities moved sideways during 2019

Net total return indices (indexed to 100 at the start)



Source: MSCI, Bloomberg, ADCB calculations

Know Your Trade > Risk, return, valuations and earnings: South Africa, EM and ACWI

	MSCI South Africa Net Total Return USD Index	MSCI Emerging Net Total Return USD Index	MSCI ACWI Net Total Return USD Index
1 month total return (%)	-3.5	-1.8	1.3
3 month total return (%)	-2.8	4.4	5.7
6 month total return (%)	-5.2	6.2	9.6
12 month total return (%)	0.4	10.0	16.8
YTD total return (%)	0.0	11.2	22.6
3 year annualised total return (%)	1.2	9.4	11.8
5 year annualised total return (%)	-1.5	3.7	7.3
10 year annualised total return (%)	2.5	3.5	8.7
30 day volatility	21.3	10.0	6.3
90 day volatility	21.8	10.2	9.9
180 day volatility	23.2	11.5	9.9
360 day volatility	28.5	13.6	11.5
162 week volatility	25.9	14.4	11.3
Correlation (52 week)	0.5	0.7	1.0
Beta (52 week)	0.9	0.9	1.0
12M forward Price/Earnings per share (x)	13.1	13.8	17.2
12M forward Price/Book value per share (x)	1.7	1.6	2.3
12M forward Dividend yield (%)	3.8	2.9	2.4
12M forward Price/Sales per share (x)	1.7	1.3	1.7
12M forward Price/Cash flow per share (x)	11.3	6.6	10.9
12M forward earnings growth (%)	16.5	14.6	9.9

Source: MSCI, Bloomberg Consensus, ADCB calculations | Data as at close of 9 December 2019

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTT News
4. Reuters
5. Gulfbase
6. Zawya

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