# REZCO

## REZCO WEBINAR FEBRUARY 2022: WHY 2022 WILL BE MORE LIKE 2000 THAN 2021

## MARKETING AND DISTRIBUTION TEAM



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## **REZCO 2021 LOOKING BACK & 2022 LOOKING FORWARD**

## 2021: Balanced funds pain trade:

Policy actions would cause inflation and central banks to sharply tighten policy

Restrictive monetary policy - Higher Rates and no more QE

Negative for already expensive markets

### **Investment Error:**

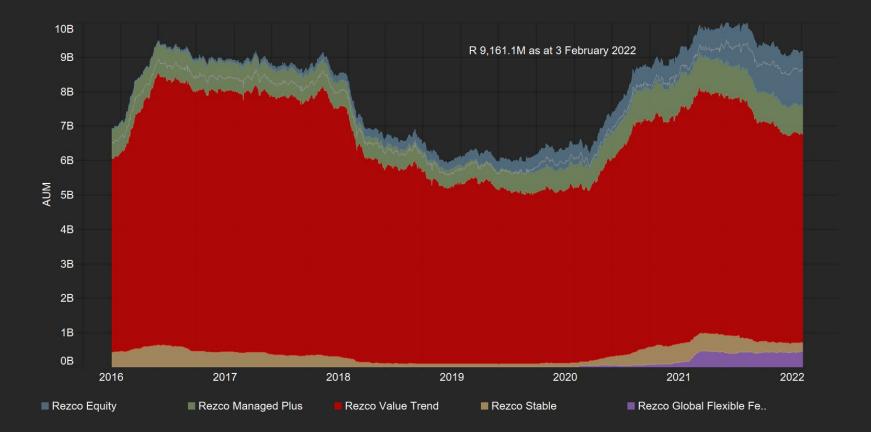
The central banks eg Federal Reserve would allow inflation to get so badly out of control to the worst inflation in 40 years.

## **Currently Positioned For:**

Equity and bond markets are now having to rapidly reprice (Fall) :

- a. Interest rates going up a lot faster than expected
- b. Fed doing Quantitative Tightening from mid 2022

## **ASSETS UNDER MANAGEMENT HISTORY**



## USA INFLATION: WE DIDN'T BELIEVE THE FED WOULD GET SO FAR BEHIND THE CURVE

US CORE CONSUMER PRICE INFLATION

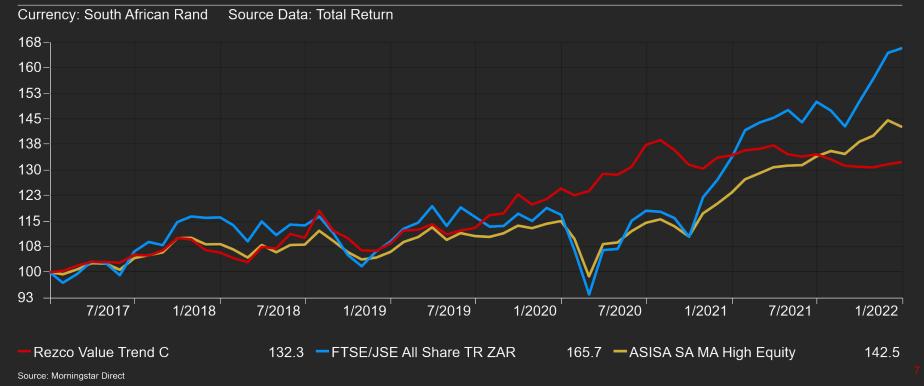


Source: Refinitiv Datastream / Rezco

# **REZCO VALUE TREND**

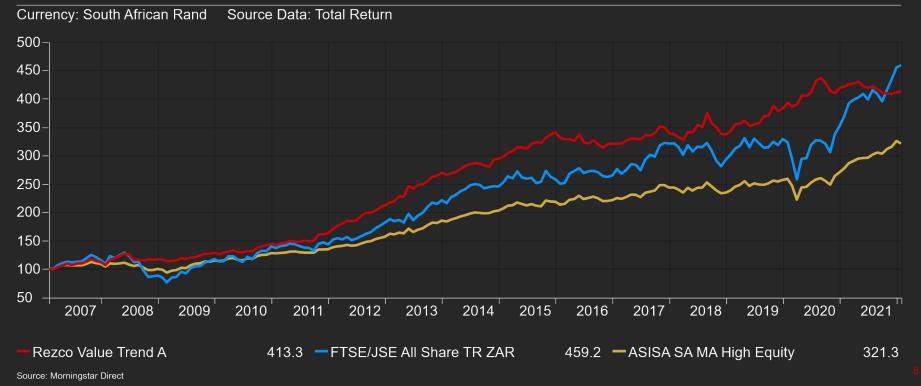


#### Time Period: 2/1/2017 to 1/31/2022

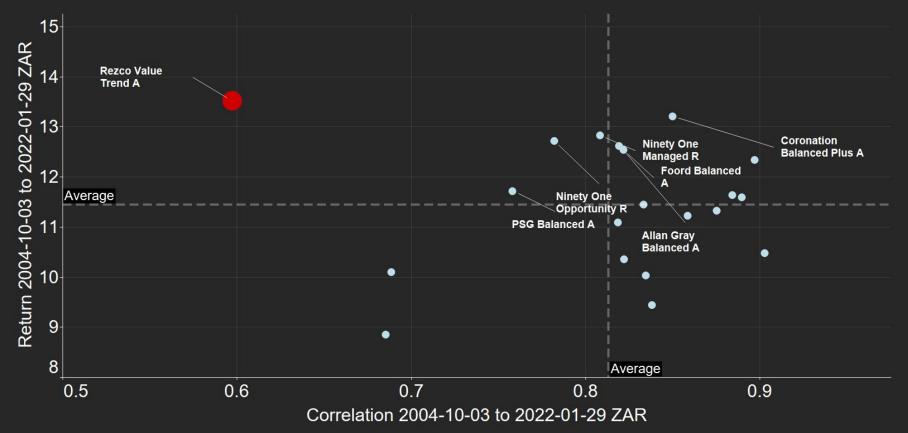




#### Time Period: 2/1/2007 to 1/31/2022

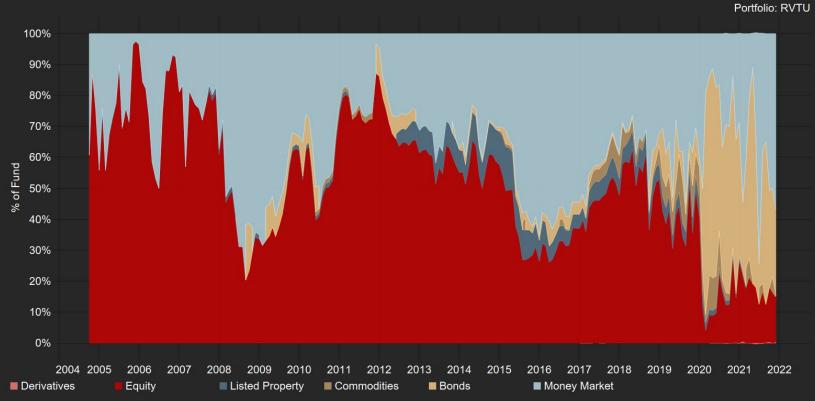


## **REZCO VALUE TREND FUND**



## **REZCO VALUE TREND FUND**

HISTORICAL ASSET ALLOCATION

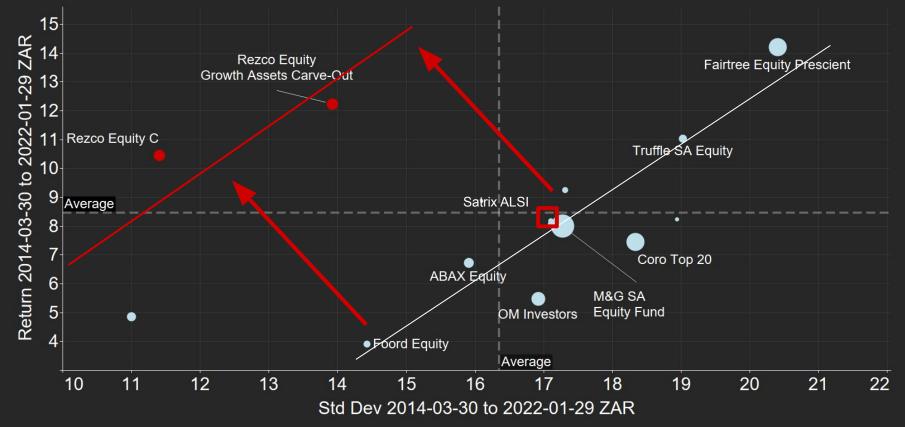


Source: JTC Group/Rezco

# **REZCO EQUITY FUND**

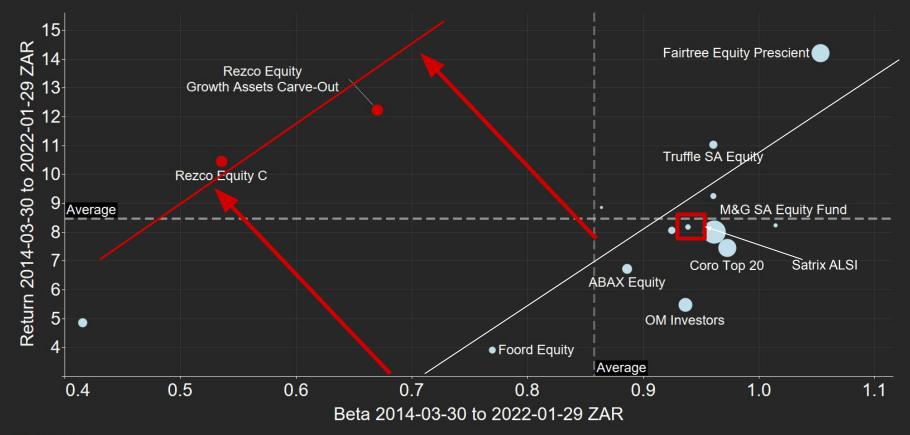
# **REZCO SA EQUITY FUND**

(RSA only Equity Funds above R500m)



Weekly Frequency Data

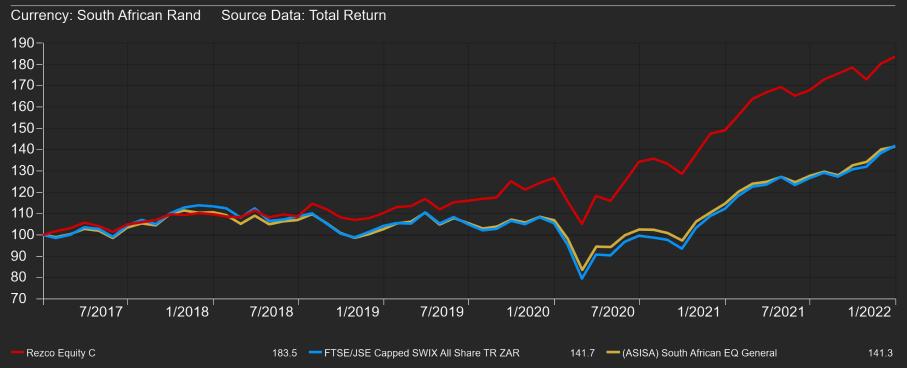
## BETTER RISK METRICS ARE THE RESULT OF OUR PROCESS



Weekly Frequency Data

## **REZCO EQUITY 5 YEARS**

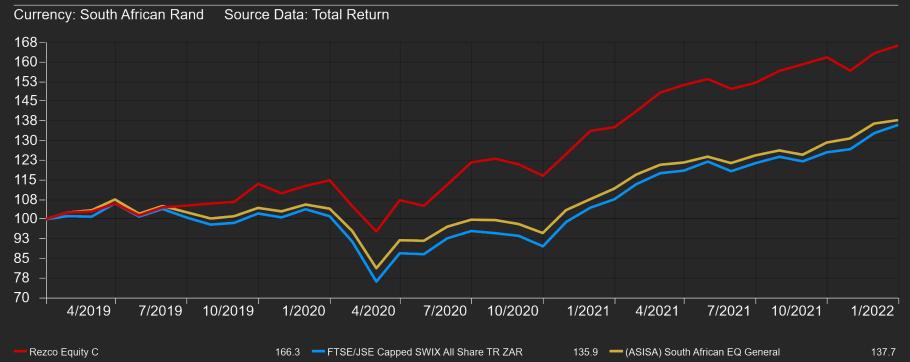
#### Time Period: 2/1/2017 to 1/31/2022



Source: Morningstar Direct

## **REZCO EQUITY 3 YEARS**

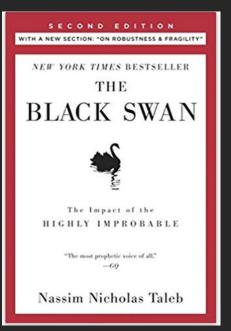
#### Time Period: 2/1/2019 to 1/31/2022

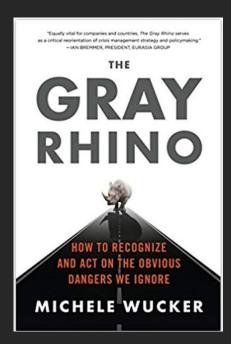


Source: Morningstar Direct

# 2022: THE ICEBERGS AHEAD

## **GREY RHINO OR BLACK SWAN?**



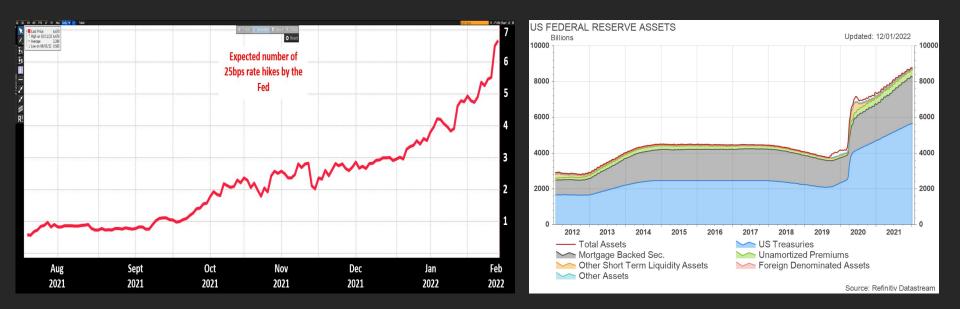


## WHY INFLATION IS IMPORTANT

- Very expensive global markets
- Pillars holding it up:
  - ZERO INTEREST RATES FOR YEARS (TINA)
  - LIQUIDITY FROM QE SEMI-PERMANENT (CASH IS TRASH)
- Inflation removes the pillars

## The market now has to reprice two major issues

# MORE RATE HIKES + SHRINKING THE FED BALANCE SHEET THE BIG ICEBERGS OF 2022



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# Transcript: St. Louis Fed Chief James Bullard Interviewed by WSJ

### About inflation

committee's favorite measure. But no matter how you cut it, we've got quite a bit of inflation in the U.S. economy and more than we had expected a year ago, and broader and more persistent than we had expected.

### About supply and demand bottlenecks

to this. But my gut instinct if that, you know, a large portion – like half – is due to demand, and that's a part that we can – that we can influence.

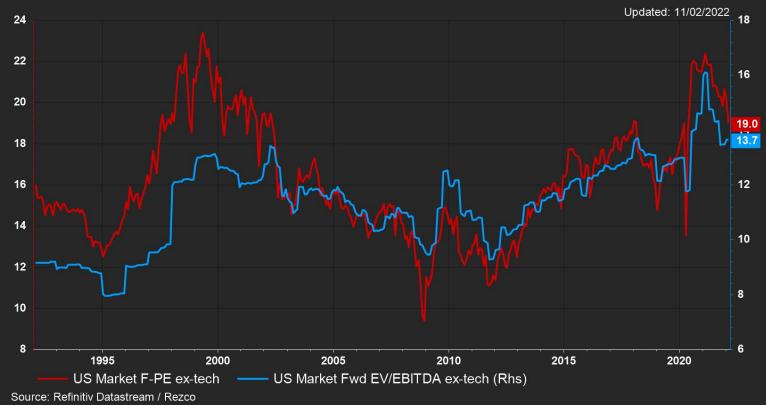
### About starting Quantitative Tightening

accommodative on the margin. And in an environment where you have the highest inflation you've had in 30 or 40 years, you probably want to take some of that accommodation back now in order to make sure that inflation goes back toward 2 percent. So I think that makes sense and we should get going on that during the spring.

# EXPENSIVE MARKETS: NEED TO REPRICE

## **US MARKET VALUATION**

#### F-PE vs FWD EV/EBITDA



## **EARNINGS GROWTH IS SLOWING**

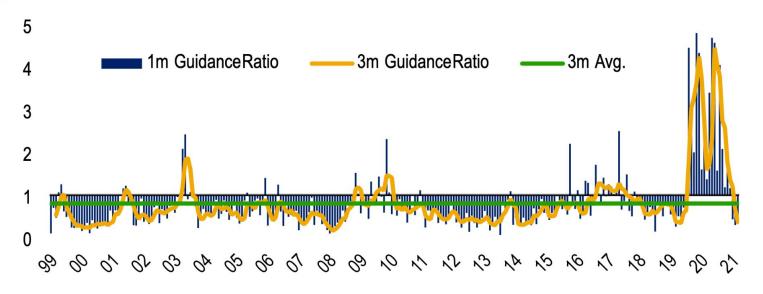
#### **US MARKET EARNINGS** Updated: 03/02/2022 60 **⊢ 60** 40 39.8 20 20 12.2 0 0 -20 -20 -40 -40 2006 2008 2012 2014 2018 2004 2010 2016 2020 2022 12M Fwd Earnings y/y% (1Y Lead) 12M Trailing Earnings y/y%

Source: Refinitiv Datastream / Rezco

## **CEOs are worried about earnings growth**

### **Exhibit 1: Guidance ratio plummets to COVID lows**

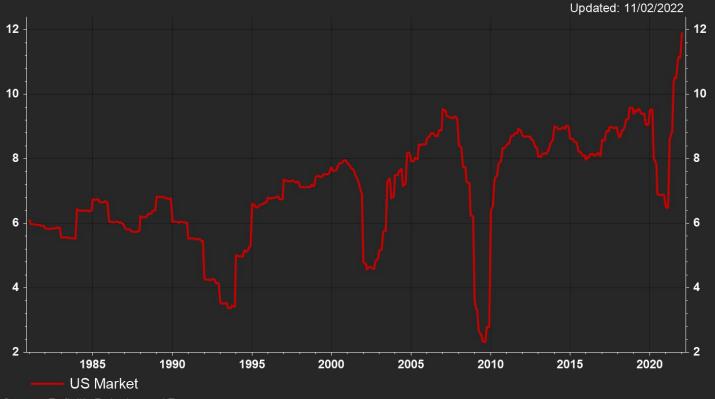
S&P 500 Management Guidance Ratio (# Above vs. Below Consensus) - 2/22



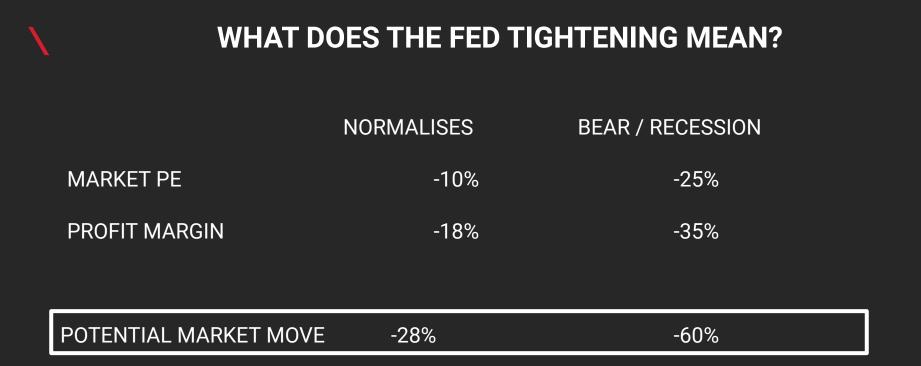
**Source:** BofA US Equity and Quantitative Strategy

## **USA CORPORATE PROFIT MARGINS**

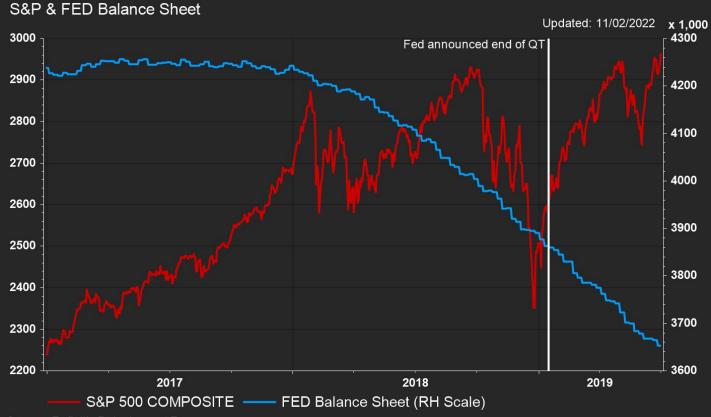




Source: Refinitiv Datastream / Rezco



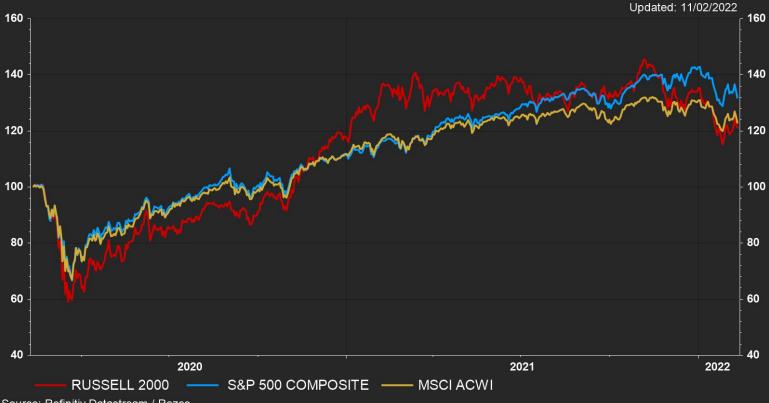
## LAST TIME THERE WAS Q.T.



Source: Refinitiv Datastream / Rezco

## **INTERNATIONAL MARKETS LOOKING WEAK**

#### Russell, S&P & MSCI ACWI Rebased



Source: Refinitiv Datastream / Rezco

## AFTER A VERY LONG RALLY

### Russell, S&P & MSCI ACWI (2008)



Source: Refinitiv Datastream / Rezco

## THIS IS A MARKET THAT DOES NOT WANT SHOCKS



## **RSA DEFYING THE WORLD**

### JSE & MSCI ACWI (2008)



Source: Refinitiv Datastream / Rezco

## **RSA AND WORLD MARKETS - CORRELATE**



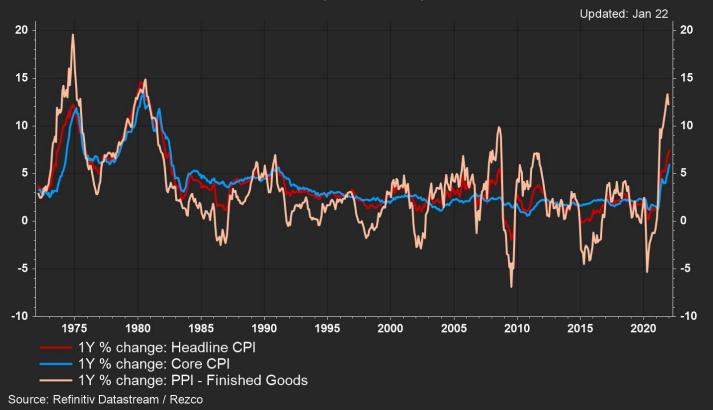
JSE & MSCI ACWI (2010) [1Y % Change]

Source: Refinitiv Datastream / Rezco

# MAJOR INFLATION HAS ARRIVED

## **USA INFLATION**

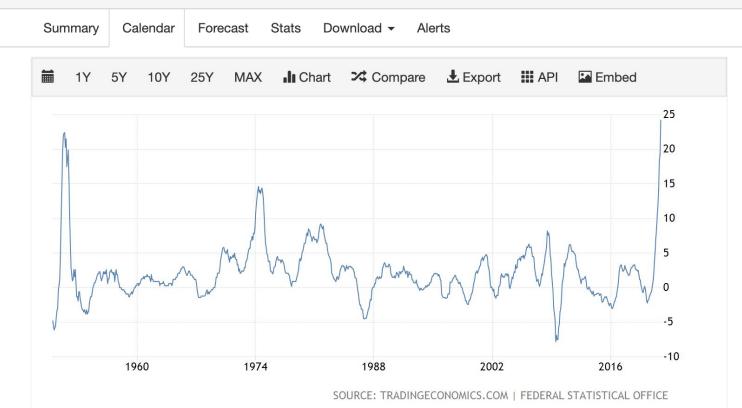
US INFLATION & PPI: FINISHED GOODS (LONG TERM)



34

## **INFLATION: NOT JUST A USA PROBLEM**

### **Germany Producer Prices Change**



# INFLATION IS STILL ACCELERATING

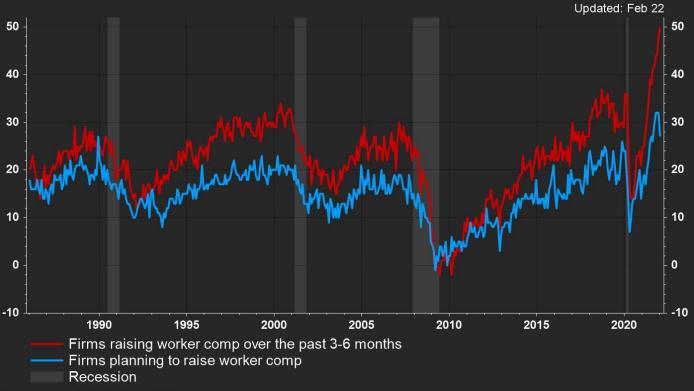
#### USA AT MAXIMUM EMPLOYMENT ALREADY



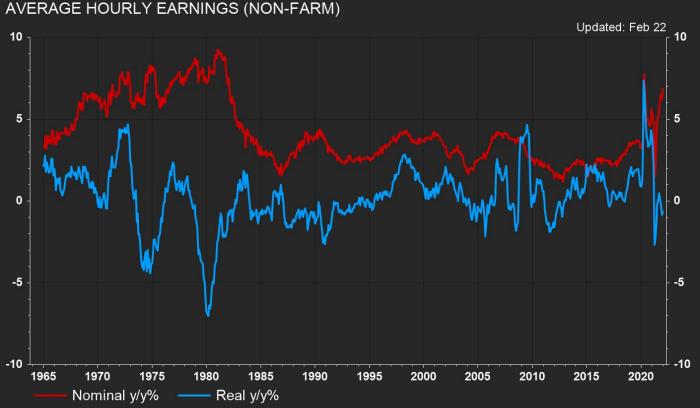
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## A LOT OF WAGE INFLATION STILL TO COME



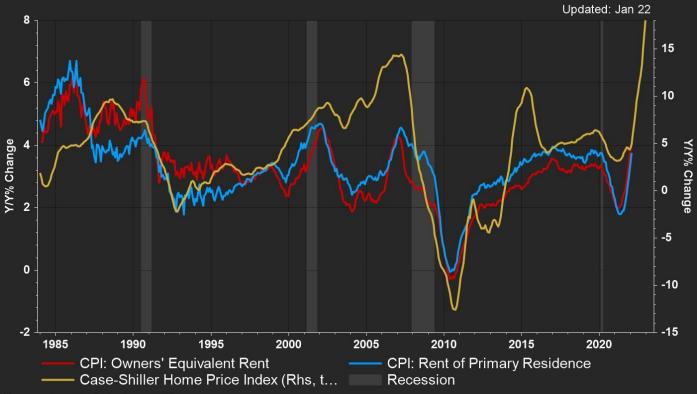


### USA: HIGHEST WAGE INFLATION SINCE 1982 BUT WAGES GOING BACKWARDS IN REAL TERMS



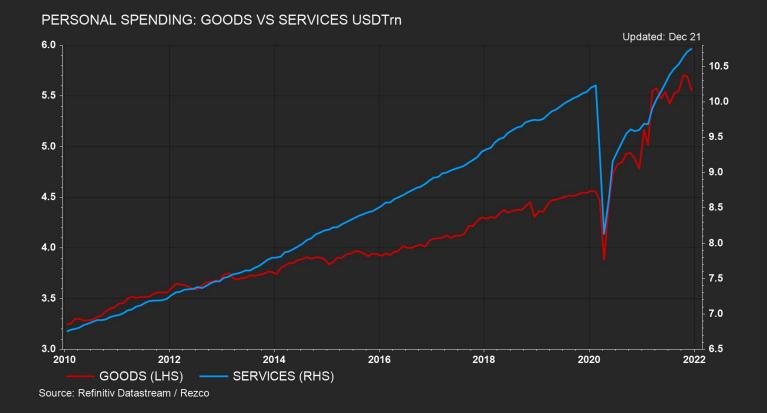
Source: Refinitiv Datastream / Rezco

## HOUSING INFLATION STILL TO COME



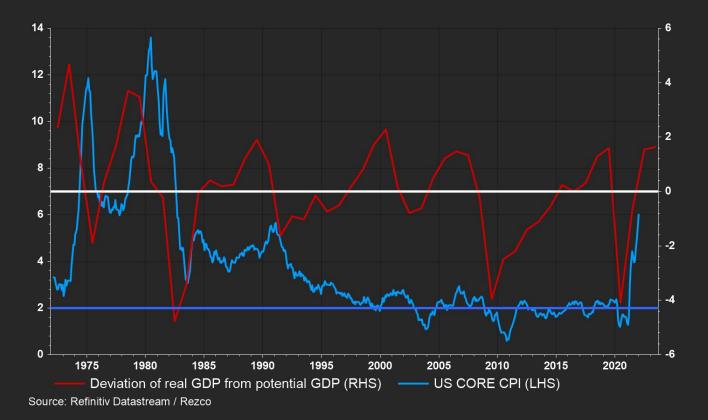
House Prices Eventually Flow into Shelter Inflation

## **IT IS NOT A SUPPLY BOTTLENECK PROBLEM**



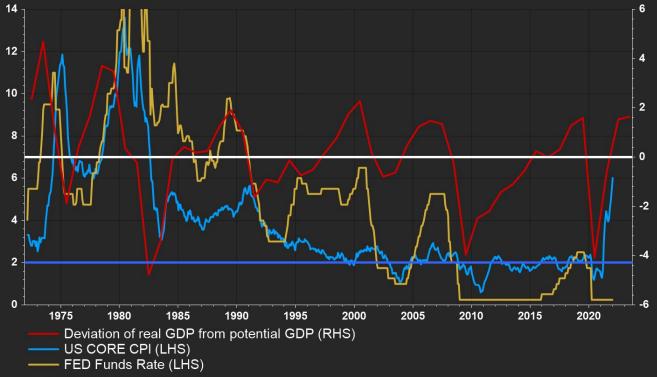
#### **US OUTPUT GAP VS CPI**

(FEELS LIKE THE 1970's)



#### **US OUTPUT GAP VS CPI**

(FEELS LIKE THE 1970's)



Source: Refinitiv Datastream / Rezco

## THE INFLATION PARADIGM MAY HAVE SHIFTED

# HISTORICAL FORCES FOR LESS INFLATION

- Globalization
- Technology
- Demographics
- FED policy

CURRENT FORCES FOR MORE INFLATION

- Onshoring supply chains (i.e. non China)
- Demographics (USA retiring population)
- Decarbonising the world economy
- Demand > Supply
- Policy: QE, zero rates and deficits

#### FINANCIAL TIMES

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**Eurozone inflation** 

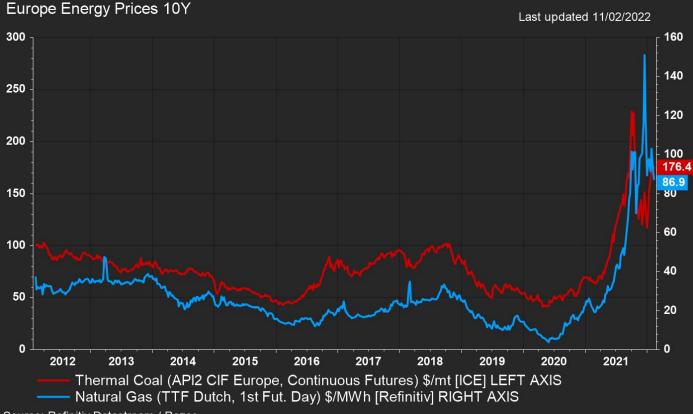
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# ECB executive warns green energy push will drive inflation higher

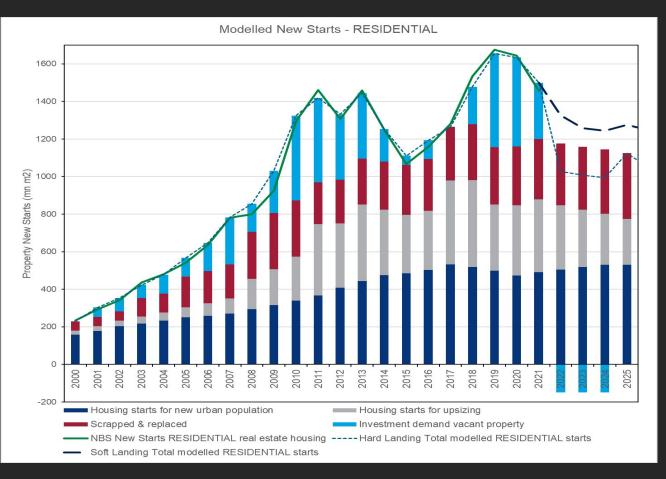
Isabel Schnabel says low-carbon economy 'poses measurable upside risks' to inflation projections over medium term

#### **ZERO CARBON WILL COST**



# **EM AND SOUTH AFRICA**

#### **CHINESE PROPERTY: COMMODITIES?**

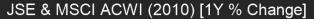


#### **RSA DEFYING THE WORLD**

#### JSE & MSCI ACWI (2008)



#### **RSA AND ACWI- CORRELATE**



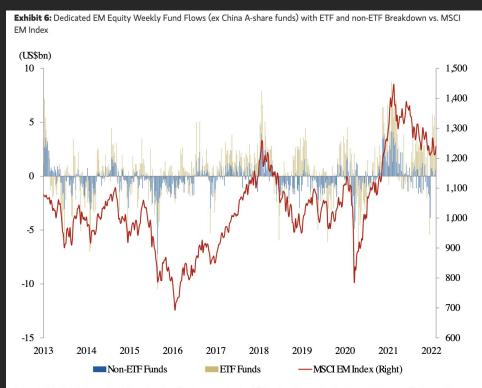


#### SA RALLY GONE TOO FAR...

#### SA vs EM vs US SMALL CAPS Updated: 10/02/2022 130 130 125 125 120 120 115 115 110 - 110 105 105 103.9 100 100 96.9 95 95 90 90 Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec Jan 2021 2022 MSCI EM U\$ **RUSSELL 2000** FTSE/JSE CAPPED SWIX ALL SHARE (USD)

#### **EM MARKET BENEFITTING FROM ROTATION**

#### INFLATION IS A DM PROBLEM?



Source: EPFR Global, Equity Fund Flows Database (see last page for details), FactSet, Morgan Stanley Research. Data as of February 09, 2022.

#### **FLOWS MATTER IN SHORT TERM**

SOME STRATEGISTS CALLING FOR EM INVESTMENT AMIDST DM INFLATION PROBLEMS



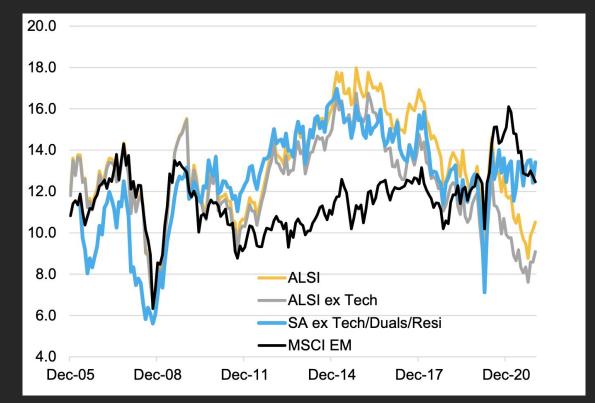
#### **EARNINGS GROWTH IS LOWER**

#### SA PE vs GROWTH



#### **CLEANING UP THE PE - NOT CHEAP**

#### SA INC PE ABOVE PRE COVID LEVELS



SOURCE: MORGAN STANLEY

## SA Yield spreads not a buffer in a rising yield environment

#### SA 10 Yr Gov Bond Yield Spread



#### Structural risks in SA justify rising spread

#### SA 10 Yr Gov Bond Yield Spread



## POLITICAL RISK INCREASES THROUGH THE YEAR



#### **EM BONDS CAN BE RISKY**



# STRESSES IN THE BOND MARKETS

## **Corporate Bonds in Europe Suffer Biggest Fall Since Pandemic Began**

Worries about the ability of indebted economies and companies in southern Europe to withstand tighter monetary policy prompts selloff

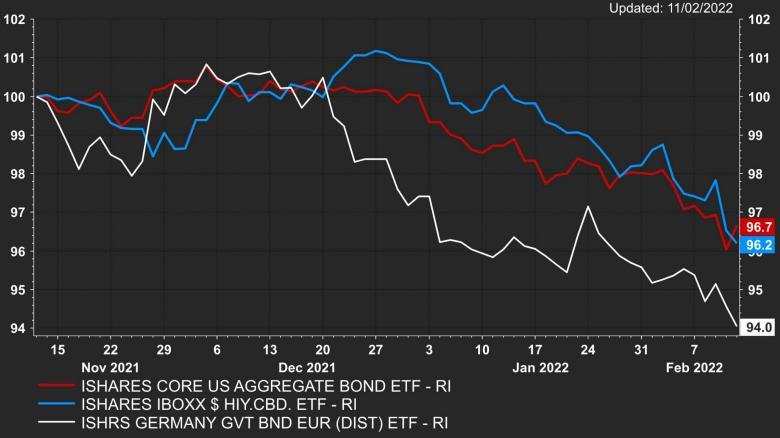
# Markets A \$10 Trillion Market Has a Big Interest-Rate Odd Lots Shock Problem

**Bloomberg Opinion** 

# How Safe Assets Became Investors' Biggest Risk

"Risk-free" is the most important concept in financial markets because it's the baseline for setting the value of pretty much everything. Now the pandemic has drained it of meaning.

#### BOND FUNDS PERFORMANCE



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Markets Economics

#### Inflation Risks Getting Sticky as Big Firms Flex Pricing Power

Powerful firms bump up prices to more than offset high costs

	THE WALL STREET JOURNAL. Rob Spanjaard 🔻														
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SHARE (f)	repare for an ensetting monetary rightening cycle														

Bloomberg

Business Economics

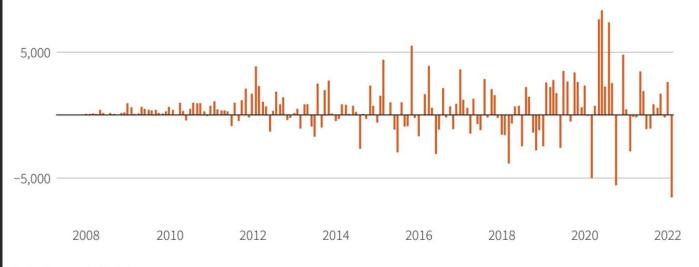
# Hot Inflation Data Risk Pushing Fed Closer to a Super-Sized Hike

Greater-than-expected CPI could pressure a 50-basis-point move

Fed policy makers usually prefer to move gradually at liftoff

#### Monthly flows into U.S. high yield bond ETFs

U.S. high yield bond ETFs saw a record outflow of \$6.5 billion in Jan



Note: Amount in \$ millions

Source: Refinitiv Eikon | Patturaja Murugaboopathy

**Reuters Graphics** 

#### Fixed income flows turn negative

Net flows to bond ETFs, globally (\$bn)



© FT

# **SUMMING UP**

#### The Fed & ECB seem to have missed the off ramp.

# Opportunity to carefully manage inflation lower has passed. Aggressive tightening.

EM & South Africa unlikely to escape the global impact.

## The Fed has missed the off ramp- scenarios from here:

Scenario	Probability	Positioning & Performance
Inflation Soft Landing - somehow falls on its own to 2-3% level	18%	Underperform - stock picking is positioned well for this scenario through yield beneficiaries / resources & commodities / value bias, growth at a reasonable price. <b>Don't see a lot of upside to</b> <b>equity indices from these levels.</b>
Inflation not transitory - recession to cool inflation	70% -ve for equity	Bear market as the economy adjusts, margins and earnings disappoint, valuations derate, funds outperform more gradually over the adjustment period, aim to have small positive returns in a falling market.
Fed slams the brakes / market structure risks	12% very negative	Multi asset crash (Equities, Bonds, Housing) due to systemic risk in financial markets, expect funds to outperform substantially but still have a drawdown.

## HOW WE ARE POSITIONED

FUND	EQUITY EXPOSURE	HIGHLIGHTS
VALUE TREND	Very low Approx 10%	No Bond Duration Hedged Equity additional 10%
GLOBAL FLEX FUND	0%	Approx 35% - Fully Hedged Negative Duration on Bonds
RSA EQUITY FUND	Target 95%	Portfolio Construction: Construct a defensive portfolio of shares that will fall less than the market

# **THANK YOU**

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