Outlook for global, local asset classes: What's ahead?

By Herman van Papendorp

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The highest-ever proportion of the world's population will be experiencing some form of elections in their countries or regions during 2024, with almost half of the planet's people heading to the polls this year.

Source: Pexels

For global financial markets, this could imply a higher-than-usual potential for election-induced volatility risk in 2024.

For South African investors, our preference remains tilted towards local asset classes over their global counterparts in the upcoming year. SA assets exhibit more appealing valuations compared to global alternatives and already reflect significantly negative scenarios.

Any uptick in global risk appetite throughout 2024, possibly ignited by potential future declines in policy rates in developed markets, or better-than-expected local outcomes, might alleviate the valuation discount of SA assets. Furthermore, the potential strengthening of the rand linked to either of these developments could diminish the returns from global assets denominated in local currency.

Global equities facing recession

History shows that the behaviour of global equities after the last US rate hike in the cycle, as well as after the first rate cut, depended on whether both these interest-rate milestones were associated with US recessions or not. Whether there will be a recession in the US is therefore important for the outlook for global equities.

While the global equity market has largely discarded the US recession probability in recent quarters, some indicators point to a lingering and non-negligible risk of recession. There could be a significant downside for equities should a recession ensue.

US bonds are presently trading at a discount to US equities, a situation seldom witnessed in the 21st century. Furthermore, equities are currently priced more than one-and-a-half standard deviations expensive relative to US bonds.

This is a departure from the extended trend observed since the global financial crisis (GFC) when US equities consistently traded at a comparatively lower valuation compared to bonds.

SA equity valuations discounted

The valuation metrics of the SA equity market have reset to consistently lower levels since the pandemic. SA equities remain very under-owned by local and global portfolio managers, enhancing their re-rating potential should there be positive surprises on the local economic-growth front or if a global risk-on environment takes hold.

I believe that SA’s elevated nominal bond yields already incorporate substantial fiscal and country risk premiums. Break-even widening and above-average monthly accruals in 2024 in line with an expected rising inflation trend should fundamentally support inflation-linked bonds (ILBs) this year.

I foresee a necessity for investors to extend the duration of their SA fixed-income holdings during 2024 to mitigate the escalating reinvestment risk associated with shorter-duration fixed-income assets like cash as we near the start of the domestic rate-cutting cycle.

There has been a recovery in SA listed property operating income due to improved fundamentals. However, the strong recent returns from the listed property sector show that at least some of the apparent fundamental improvements have already been discounted, which should constrain future returns.

Gold price drivers dominant

Given the anticipated persistence of geopolitical tensions in the foreseeable future amid the ongoing trend of deglobalisation and the emergence of a multipolar world order, particularly between the Western powers and China, gold is poised to sustain its strategic appeal within central bank and investment portfolios due to its perceived role as a hedge against political volatility and uncertainty, making it a preferred asset for risk-mitigation purposes.

Gold also has a strategic rationale as a portfolio risk diversifier, because it is expected to hold its value through turbulent times and has limited correlation with other asset classes.

For a SA investor, the rand gold price has been a consistently strong relative asset class performer historically, as perennial rand weakness has provided huge support over many years.

Geopolitical factors, along with central bank gold purchases, are expected to continue as primary positive catalysts for the US dollar gold price in the near term.

ABOUT THE AUTHOR

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