Momentum Investments

2018 SA equity market return in perspective

The 2018 calendar year has been a particularly challenging period for local growth asset classes, which include the equity and property market.

Global trade tensions, political uncertainty and rising oil prices further affected local sentiment and return delivery. SA fell into a recession during the earlier part of 2018, which dented sentiment and foreign flows, with the resultant effect being a relatively painful correction in equity markets, after a protracted bull market since the 2008 global financial crisis.

The question on the minds of many SA investors, after the dismal returns in 2018 from the SA equity market, is perhaps: "Whereto from here?"

First and foremost, it is important to remember that, with increased expected returns over the longer term, comes increased risk of capital loss over the shorter term.

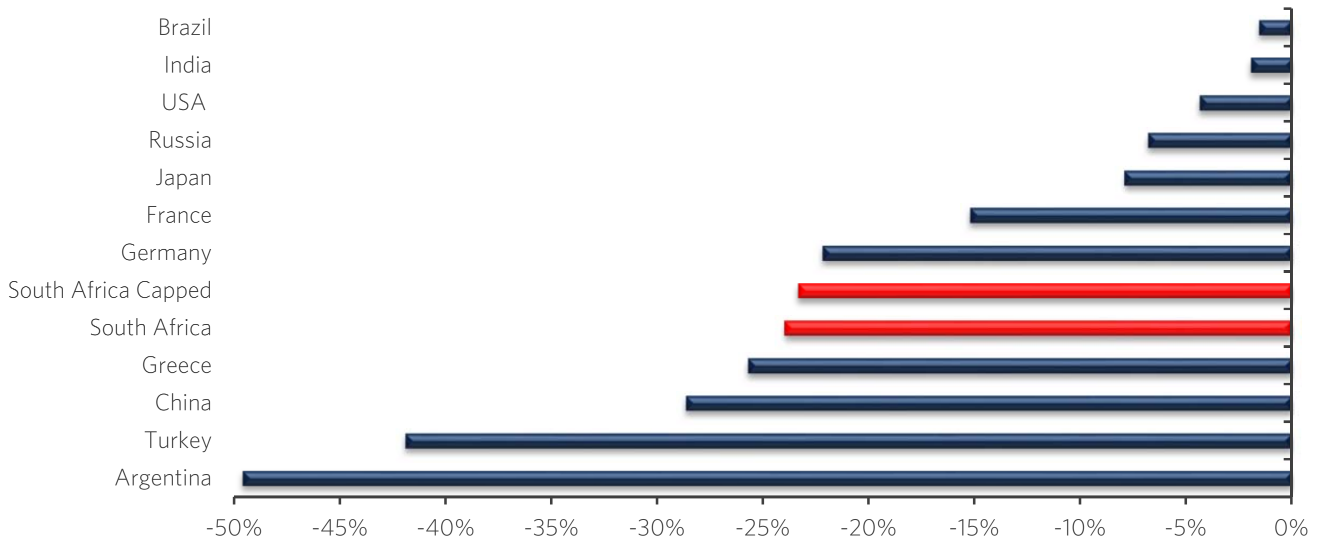
Remember that equity investment is risky by nature and, therefore, only suitable for the longer term. No investor likes to see a negative investment return but we also should not over react to short-term market conditions. Often, at a particular point of the cycle, it feels like we made a wrong decision, but we should allow that cycle to play out to see the real benefit. So, was 2018 really that dismal in comparison to what we can and should expect from equity markets in general? Below, this is discussed from two perspectives, namely:

- Compared to other countries globally
- Compared to its own history

The chart below shows that SA equity did have a poor return in US dollar terms. Compared to other emerging markets, South Africa still stacks up relatively well, given that some of the markets, like Argentina, Greece and Turkey, had an extremely bad 2018. This is related not only to equity market returns, but also to quite a bit of currency depreciation against the US dollar.

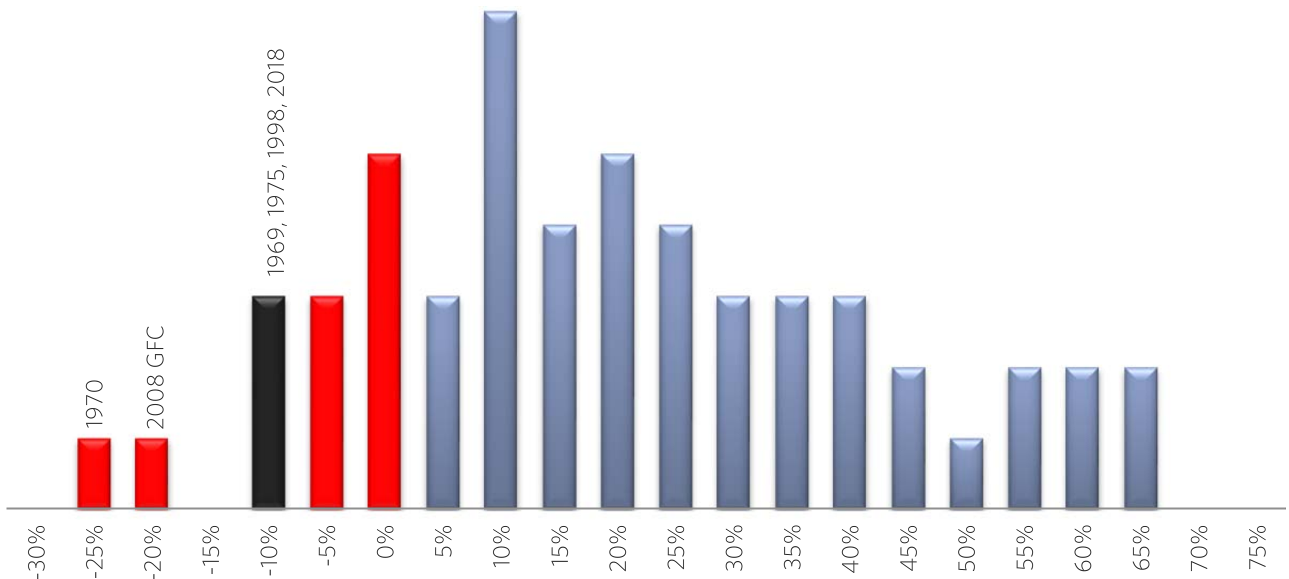
Even though SA equity retracted about 25% in US dollar terms for 2018, the rand depreciated about 15% for the same period. The resultant effect was that SA equity was down 10% in rand terms.

Major security markets returns for 2018 in US dollars



Another perspective is to look at how the SA equity market performed in 2018 compared to previous calendar years, which shows just how normal the market return has been. From the histogram of the distributions of calendar year returns since 1964, it is clear that the market delivered very disappointing returns, even from a historical perspective. There were even worse calendar years. Returns experienced in 2018 were similar to what was experienced during the Asian crisis in 1998 and the great default crisis experienced during 1975. The global financial crisis, however, delivered much worse returns for the SA market, returning negative 24% for the calendar year of 2008.

Distribution of calendar year returns from 1964 to 2018



From a probability perspective, the likelihood of the SA market delivering returns lower than a negative 10% return in any one calendar year is only about 10%. So, it does show that we should expect a market return to the same extent or even worse, once in every 10 to 11 years. This expectation is aligned to the global financial crisis, which occurred 10 years ago.

A 10% loss in capital effectively means your R100 is now worth R90. For the R90 to grow back to R100, an 11.1% return is required. The time of recovery and longer-term financial objectives are important to keep in mind when evaluating shorter-term market returns. It is often more important to stay invested if none of the above have changed.

Even though the returns for 2018 were disappointing and can create an emotional reaction, it is important to remain focused on the objective and plan and, therefore, not make unnecessary and costly changes. More often than not, staying invested leads to a quicker recovery than moving to a more defensive strategy or asset class, causing one to miss out on the market recovery.

Eugene Botha
Deputy Chief Investments Officer

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