



South African equities still priced for pessimism

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South African equities present investors with a puzzle. On most conventional measures, the market looks attractively valued. Dividend yields on the major banks already sit above inflation, government bonds yield around 8.5%, and the JSE trades on a forward price-to-earnings multiple of roughly 11 times, well below its historical range of 13 to 15 times. Yet the stock market is not attracting the capital one would expect.

During our recent investment conference, themed “The New World Disorder”, experts in equity and institutional investment discussed whether South Africa is simply a price taker driven by global cycles or if the market is undervaluing an attractive domestic story. We believe it is both, and understanding this distinction is important for how capital should be allocated.

The JSE is largely – but not only – a price taker

Although it may seem easier to view the JSE as a solely domestic market, its composition tells a different story. About a third of the index is made up of resources, meaning commodity cycles can heavily influence annual returns – either strongly, as seen last year, or not at all, as in the first six months of this year. Including Naspers and Prosus, which are linked to Chinese internet assets, along with Richemont, a global luxury brand, reveals that a significant portion of what appears to be ‘South African’ market value actually reflects decisions made in Washington, Beijing and Geneva.

This is the most convincing aspect of the argument for South Africa being a price taker, and it is not wrong; however, it doesn’t tell the whole story. If you set the global proxies aside, a second tier of the market emerges – banks, retailers and Africa-focused businesses – whose earnings are tied far more closely to the domestic growth rate than to the oil price or the dollar.





Bond markets have already recognised South Africa's progress

The strongest indication that South Africa's progress is undervalued is more evident in fixed income than equities. Over the past ten years, the inflation gap between South Africa and the US has shrunk to about one percentage point, largely due to a lower inflation target of 3%. The difference between South African and US government bond yields has decreased from as high as seven or eight percentage points to approximately four now, showing increased confidence in South Africa's fiscal discipline and its removal from the grey list.

Equities have yet to reflect this change in the same way. The market still trades at a discount compared to its emerging market counterparts and has not fully incorporated the lower cost of capital. Bond investors are enjoying attractive returns for near-guaranteed income, whereas equity investors are still expected to support earnings growth in an economy growing by just over 1%. Until the economic growth outlook improves, equities and bonds will likely continue presenting contrasting narratives about the same country.

Stronger growth is the missing catalyst

History demonstrates what can occur when growth prospects change. From 2004 to 2008, GDP growth surpassed 5%, unemployment dropped to about 22%, and fixed investment exceeded 20% of GDP. Company earnings more than doubled, the market was re-rated by over a third, and the JSE's total returns exceeded 200%. Currently, GDP growth is around 1%, unemployment exceeds 33%, and fixed investment has declined to roughly 14% of GDP. While a similar cycle could happen again, it will require a real shift in the growth trend rather than simply a change in sentiment.

Despite the current challenges, opportunity still exists. Our panel highlighted areas where structural demand is already driving growth beyond GDP figures: education businesses filling gaps the state cannot cover, private capital entering rail concessions, and an informal economy worth over R1 trillion annually – an area that is only now attracting the attention of some listed retailers and banks. Although public-private partnerships are still developing and uneven, they are seen as the most promising way to unlock the necessary fixed investment to significantly enhance South Africa's growth.



Selectivity matters more than a binary call

Our specialists emphasised discipline over making a final judgement call. South African equities cannot completely detach from global cyclical trends, which are primarily structural rather than cyclical. However, being a price taker at the index level does not imply that all companies face identical risks. Banks with both corporate and retail exposure, Africa-focused businesses, and companies involved in the informal economy have a different risk profile than the resource-heavy firms that heavily influence the headline index.

This is why we apply the same conviction-based process domestically that underpins our global portfolios: sizing positions according to the clarity of the evidence rather than the mood of the market. Where growth catalysts are visible and durable, conviction and the capital we invest can run higher. Where they remain uncertain, patience and valuation discipline are the more prudent position.

Valuations leave room for patient investors to be rewarded

Our conference reinforced a view we have held for some time: the question is no longer whether South Africa can decouple from global forces, but whether domestic fundamentals can improve for long enough to make staying out of this market too costly. We remain constructive on South African equities and believe that, for patient and selective investors, that point may be closer than current pricing suggests.



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