2024: WHAT WILL THE ELECTION YEAR HOLD?

From macroeconomic decisions to political outcomes, markets – and sentiment – can be temporarily influenced by various external factors. If 2023 will be remembered as the year where interest rate decisions drove the markets, 2024's fate seems to sit squarely in voters' hands. In an increasingly divided world, outcomes are uncertain and risks are heightened. In his first investment update of 2024, Duncan Artus, our chief investment officer, reviews 2023 and touches on what's in store for the year ahead. Watch this 5-minute video and read the commentary below.

Review of 2023

Allan Gray celebrated its 50th anniversary during 2023. We are proud of our long-term track record, having managed our clients' assets and the firm through many geopolitical, financial and performance cycles. We are grateful for our clients' support, especially during the inevitable cycles of underperformance. You cannot be a fund manager without funds. Over the years, we have learned the importance of communication that is informative, transparent and interesting, that helps clients stay the course.

I mentioned in my 2022 commentary that exchange controls for South African investors had been further relaxed, with the maximum allowable amount to be invested offshore increasing to 45% – a positive long-term outcome for local investors. I also noted that, together with our sister company, Orbis, we could offer a compelling investment proposition to take advantage of the increased opportunities and risks. The Investment team in Cape Town is now managing a portion of the offshore component. I believe this process is working well and will add value to client portfolios over time.

The South African equity market, represented by the FTSE/JSE All Share Index (ALSI), returned 9.3% in 2023, outperforming money markets at 8.1%[1] and inflation of 5.1%. The FTSE/JSE Capped SWIX All Share Index, which many funds use as a more representative equity benchmark, returned 7.9%. The ALSI is trading at similar levels relative to the MSCI World Index as it did at the COVID-19 lows. The FTSE/JSE All Bond Index returned 9.7% after an end-of-year rally. Internationally, the MSCI World Index[2] returned 23.9% and the J.P. Morgan Global Government Bond Index returned 4.0%, respectively, in US dollars. The World Index is close to all-time highs. The rand weakened 7.0% against the US dollar, which is itself well off its 2022 highs.

Market movers

Markets continued to be moved by interest rates – and therefore central banks and inflation. Every remark is being scrutinised for clues that we have reached the peak in rates. This can feel frustrating for bottom-up investors, but it is the world in which we find ourselves.

It was always going to be a complex task to extract the global economy and asset prices from the huge expansion in central bank balance sheets.

Equity returns were dominated by the large US technology shares, which had sold off significantly in 2022. Returns from these shares seem to have inflected from an oversold position and were boosted by the significant public awareness generated by the success and adoption of ChatGPT. The potential expansion in the uses of artificial intelligence (AI) was confirmed by a massive increase in forecast revenue by US technology company Nvidia, whose chips are used to power AI. Nvidia added more than US$800bn to its market cap during the year. The other potential breakthrough that could have large implications for the future of many industries is the development of obesity drugs by pharmaceutical companies Novo Nordisk and Eli Lilly. Novo Nordisk is now the most valuable company in Europe, having taken the crown from the French luxury goods conglomerate, LVMH.

Locally, the high cost of capital, underpinned by our high government bond yields in combination with our low growth, continues to compress valuations for domestically focused businesses. That is simply the maths. I believe that for local equities to rally, we need one of these, or ideally both, variables to change, which needs sustained foreign buying of our bonds. And for that to happen, we need to make structural changes that improve long-term economic growth. This will be complicated in the short term given that 2024 is an election year – not only in South Africa, but globally. According to Deutsche Bank, 2024 will be the year when the most people will vote in recorded history. Heightened geopolitical and social tensions globally is something to keep in mind when constructing a portfolio.

Performance

Relative performance in 2023 was satisfactory across most of our unit trusts. Performance was particularly strong during the third quarter sell-off, with market conditions suiting our positioning. A portion of this outperformance was retraced in the last quarter, as global equities and long bonds rallied.

Over the last 12 months, the Balanced Fund returned 13.0%, underperforming its benchmark by 0.3%. The Stable Fund returned 11.2%, outperforming its absolute benchmark by 1.9% and in line with its peer group. The Equity Fund returned 13.9%, outperforming its benchmark by 7.4%.

The Orbis Global Equity Fund returned 20.4% in US dollars for the year, underperforming the MSCI World Index by 3.5%. The Orbis SICAV Global Balanced Fund returned 14.2%, underperforming its 60/40 benchmark by 1.4%.

1. The Alexander Forbes Short Term Fixed Interest (STeFI) Composite Index.
2. MSCI World Index, including income, net of withholding taxes.

Positioning

While we are bottom-up investors, we want to be on the right side of long-term secular trends, as I highlighted in my 2022 note. Our broad positioning remains similar to that of the last two years: We are better positioned for a world characterised by higher inflation and therefore higher interest rates. We have thought about how to invest in an increasingly divided world. We are open to changing our minds if provided with sufficient evidence to do so.

Conclusions

The world appears to be entering a period in history where risk is heightened across the board. A lot of things could go wrong.

The Investment team continues to apply the same philosophy we have for the last 50 years in managing your hard-earned savings. We tweak and improve our investment process incrementally, which eventually compounds into an endurable competitive advantage.

With worrying headlines dominating the news flow, it is hard not to panic and make rash decisions driven by emotion. As always, I encourage you to focus on your long-term financial plans and goals, rather than reacting to short-term events. On behalf of the Investment team, I thank you for the trust you have placed in us.

Adapted from the chief investment officer's comments, which will appear in the Allan Gray Unit Trust Annual Report, 2023.

Commentary contributed by Duncan Artus, chief investment officer, Allan Gray.

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