Babies and Bathwater: A Case for South African Equities

An Analysis of the Investment Climate

Bay Asset Managers (Pty) Ltd

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If

If you can keep your head when all about you
Are losing theirs and blaming it on you,
If you can trust yourself when all men doubt you,
But make allowance for their doubting too;
If you can wait and not be tired by waiting,
Or being lied about, don't deal in lies,
Or being hated, don't give way to hating,
And yet don't look too good, nor talk too wise:

If you can dream-and not make dreams your master;
If you can think-and not make thoughts your aim;
If you can meet with Triumph and Disaster
And treat those two imposters just the same;
If you can bear to hear the truth you've spoken
Twisted by knaves to make a trap for fools,
Or watch the things you gave your life to, broken,
And stoop and build 'em up with worn-out tools:

If you can make one heap of all your winnings
And risk it on one turn of pitch-and-toss,
And lose, and start again at your beginnings
And never breathe a word about your loss;
If you can force your heart and nerve and sinew
To serve your turn long after they are gone,
And so hold on when there is nothing in you
Except the Will which says to them: "Hold on!"

If you can talk with crowds and keep your virtue,
Or walk with Kings-nor lose the common touch,
If neither foes nor loving friends can hurt you,
If all men count with you, but none too much;
If you can fill the unforgiving minute
With sixty seconds' worth of distance run,
Yours is the Earth and everything that's in it,
And-which is more-you'll be a Man, my son!

Rudyard Kipling
(1865-1936)

Introduction

This report is provided as a service to the clients of Bay Asset Managers (Pty) Ltd, the company's subsidiaries and its associates. The aim of the report is to provide an overview of the recent key drivers and performances of equity, bond and cash markets. Against this backdrop, the report also considers forecasts of asset class performances over the remainder of 2003 and into 2004. The principal objective of this forecasting exercise is to offer comment on expected asset class performances, and to provide clients with a view into our thinking behind extant positioning of investment portfolios.

Market Backdrop

The sting delivered by asset markets over the course of 2001 and 2002 has continued into 2003. And it seems that there is little that will relieve investors from their plight in the near term. Almost regardless of geography, currency or asset class, the suffering inflicted upon investors in risky assets – especially bond and equity markets – has progressed to the status of 'acute' over the past quarter. This is despite the efforts of policy makers in the West to inflate waning economies. However, after displaying an early disinterest in the war in the Middle East, asset prices have pursued a 'bear rally' over the past month. As a consequence, the MSCI World Index, which measures global equity price performances, has been elevated by some 5.9 percent since the outbreak of war in the second half of March. Nevertheless, the recent relief has done little to challenge the global equity market bear trend that has been in place since early 2000. The net result is that the MSCI World Index reveals a decline in equity prices on world stock markets of 46.7 percent between the bull market peak (March 2000) and the end of March 2003 (see Figure 1).

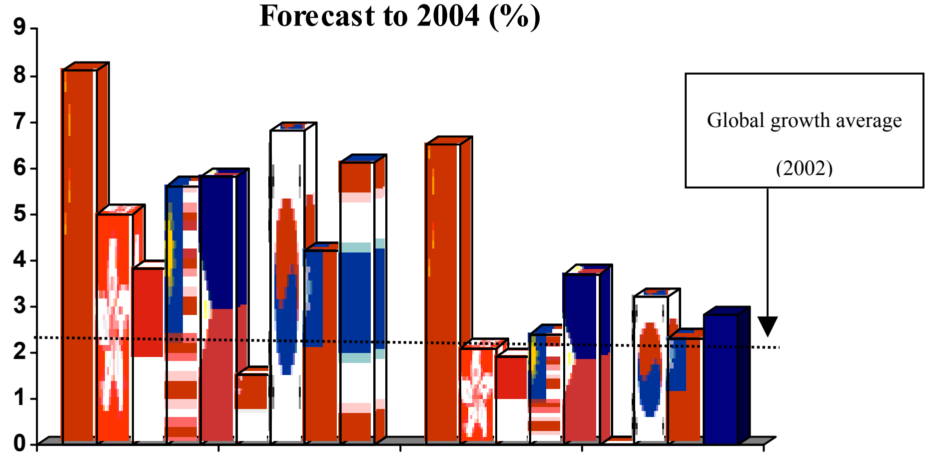
Figure 1: MSCI World Index (1998-2003)

Source: MSCI

Further to the above, it remains the case that after the anaemic performances of 2002, equities have continued to suffer in 2003, almost regardless of domicile. After the pain taken during the course of 2002, equity markets in developed economies have continued to shed value, losing 0.58 percent (measured in local currency terms) over the year to date, whilst emerging market equities have fallen by 0.86 percent (measured in local currencies) over the same period.

But the above aggregate figures mask at least two independent experiences in world equity markets. The first is the significant underperformances of equities in some regions over the course of 2003. Without doubt, the worst regional figures emerge from the Far East. In that area, Japan's Nikkei 225 Index has dropped 8.43 percent over the course of 2003, whilst Hong Kong's Hang Seng Index is off 9.20 percent. At the same time, Singapore's Strait Times Index has shed 4.84 percent of its value since the end of 2002. Whilst the figures point to substantial regional underperformance relative to the MSCI World Index (which is down less than one percent over the course of 2003), it is arguable that this outcome is principally attributable to a single swing factor: the recent outbreak of severe acute respiratory syndrome (SARS), which has its origins in the Far East. Undeniably, the epidemic has plunged whole parts of Asia into a sharp cyclical downgrade during a period when economic growth was previously advancing meaningfully.

Figure 2: Far East GDP Growth (Year-on-Year) (March 2003) and Forecast to 2004 (%)

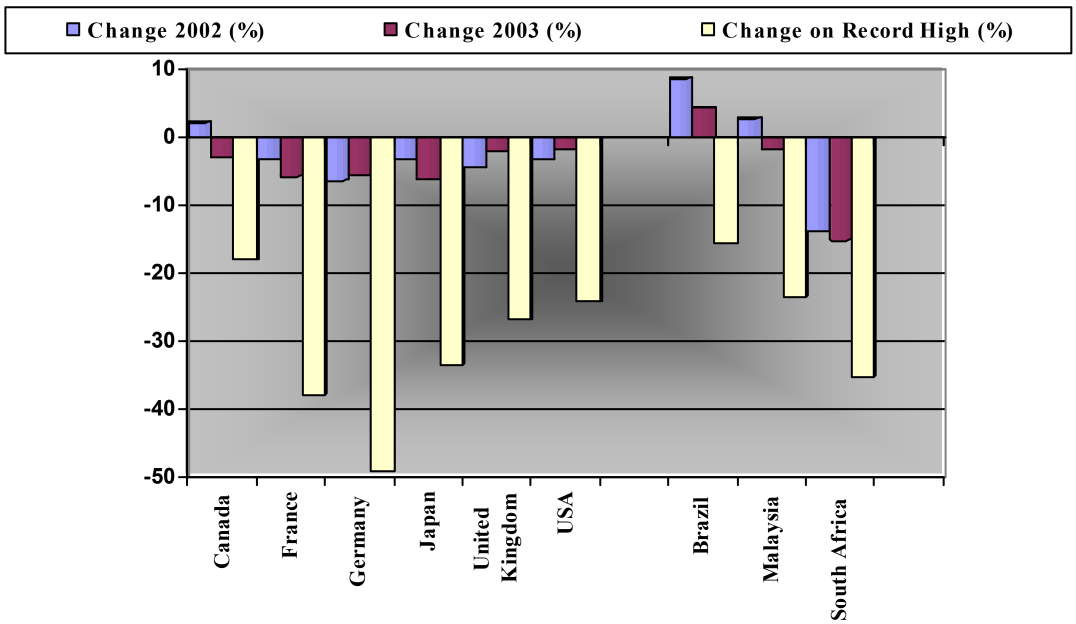


Source: National statistics offices, Morgan Stanley

A Doctor a Day Keeps the Big Apple at Bay

Year-on-year growth in gross domestic product (GDP) in China, Hong Kong, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan and Thailand averaged 5.2 percent (well beyond the most recent estimates of global GDP growth of 2.1 percent). However, with the outbreak of SARS, growth forecasts for key East Asian economies have been cut significantly. Following on from these forecasts, East Asia, excluding Japan, is now expected to expand only 4.5 percent this year, compared with 5.1 percent previously. Major downgrades include China at 6.5 percent (reduced from a previous forecast of 7.0 percent), Taiwan at 2.3 percent (2.8 percent) and Hong Kong at 2.1 percent (2.7 percent). Unfortunately, since these downgrades were made, China has acknowledged an even higher incidence of SARS than previously declared. On this basis it would appear that, along with the structural constraints of the region, once-off shock factors will pull the growth cycle down further than previously anticipated. Indeed, with a global economy that was already under strain, it is our view that the slowdown in the Far East will be sufficient to pull the global economy into recession (defined on a global basis as GDP growth below a 2.0 percent threshold).

Figure 3: Equity Market Indices (% Change)



Source: Thomson Datastream, I-Net Bridge

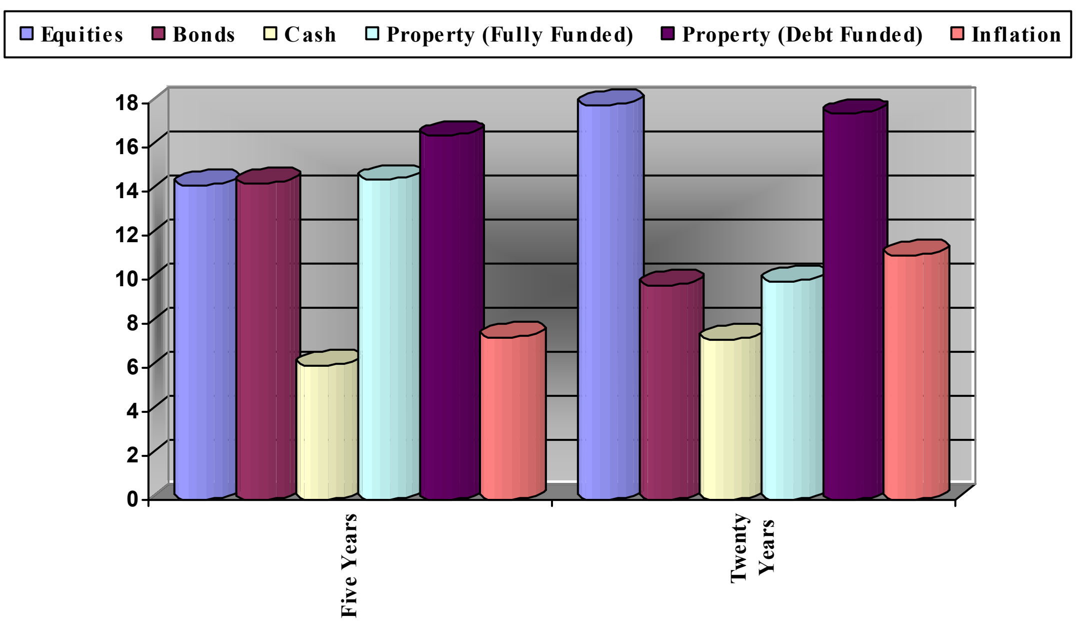
A second feature of the current bear market in equities is the degree of stock price depression. Figure 3 provides a summary of recent performances on leading equity markets, as well as a handful of emerging markets, for the periods 2002 and 2003-to-date. The chart also presents data on the extent of the bear market drawdown, measured by the difference between current price levels and the record highs achieved on various markets under consideration. From the data, it is apparent that the pain felt by some markets is acute. The German DAX Index, which is some fifty percent off its record high, offers an obvious case in point. However, the degree of decline is highly variable – in Canada the decline from the all-time high of 2000 has been confined to less than 20.0 percent. Idiosyncrasies aside, the net result for equity investors remains that they find themselves ensconced in the most severe equities bear market since the Great Depression of the 1930s. Additionally, with bleak prospects for economic growth – and so corporate profit recovery – it seems that the subdued corporate investment environment will persist for some time. The situation is further aggravated by ongoing evidence of an absence of global pricing power, as well as high levels of excess capacity in a host of industries. This translates into an inability by companies to grow earnings even in static business environments. On the surface, then, the investment outlook for global equities appears miserable.

Myopic Investor Sentiment Draws on Fear as the Major Market Driver

At such 'economic junctures', market commentators often 'over extrapolate' and investors are encouraged – or feel compelled – to 'overreact' to the business environment. Here, the 'fear' part of the 'fear and greed' analogy often plays out perfectly. This is because at such times the typical reaction on the part of investors is to head for supposedly out-performing, lower-risk assets, such as cash, property and bonds, or to remain out of the riskier asset classes where fresh funds would otherwise be available for investment.

An excellent contemporary example of this mindset is offered by numerous local market commentators who have pointed to the dismal performance of South African equities over the recent past.[1] Drawing on this recent underperformance of equities, many commentators have urged investors to protect themselves from further pain by moving to lower risk-higher return asset classes, such as bonds and even cash (see Figure 4). At first blush, their arguments appear to have considerable validity.

Figure 4: Asset Class After-Tax Return (%)



Source: JP Morgan Equities

If one considers domestic asset class performance over the past five years, four of the conventionally defined asset classes – equities, bonds, debt-funded and fully-funded property – have all provided positive real rates of return after tax. Of this set, however,

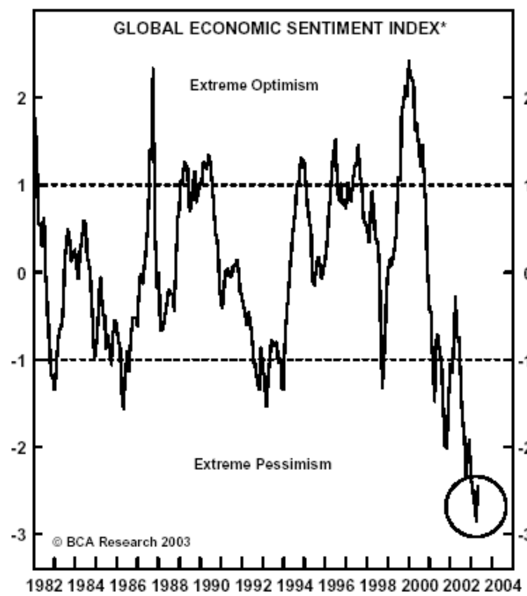
[1] On this score, over the year-to-date, the JSE Securities Exchange's leading All Share Index has shed 16.4 percent of its value.

equities have produced the lowest rates of real return (6.9 percent), with the highest level of price volatility. As a consequence, five-year risk-adjusted returns on equities are significantly lower than for the other mentioned asset classes. With high levels of drawdown risk, investors are tending to use this evidence as 'convincing and sufficient proof' of the need to be 'out of equities' in the current market environment.

The situation is little different elsewhere in the world, with sentiment towards equities extremely subdued. For instance, data recently released by emerging market research house BCA Research shows global economic sentiment towards equities is at a 'bearish extreme' (see Figure 5).

Figure 5

Sentiment is at a Bearish Extreme



*Based on a comparison of our proprietary equity valuation and bond valuation indexes; standardized.

Source: BCA Research

A Case for Equities

However, the argument favouring an exit from equities is shortsighted on at least two major fronts.

- First, the case being made against equities ignores the longer-term data, which reveal only two domestic asset classes as having delivered positive real rates of return on investment after tax: equities and debt-funded property (see Figure 4). Yet, problems relating to liquidity, cost of carry, market size and non-market risk mitigate against property as a 'significant' investible asset class in domestic portfolios. This leaves investors with only equities as a long-term real-return asset class with low liquidity risk and acceptable cost of carry. As an aside, extrapolating from the very long run is often senseless – one is always reminded of John Maynard Keynes' famous quote about being dead in the long run. Nevertheless, extrapolation is often helpful as the exercise provides 'anchor points' from which analysis can be conducted. On this score, it is useful to look back over the so-called golden age of capitalism, where one finds evidence of four major bear markets, namely: the market crash associated with the Great Depression of the late 1920s and the early 1930s; the war-induced slump of the 1940s, the so-called stagflation decline witnessed in the late 1960s and 1970s; and, the current market decline that has stemmed from the excesses of the 1990s. Despite these setbacks, international evidence confirms our earlier argument: equities have consistently offered investors a long-term performance that is ahead of other asset classes. By way of example, over the seventy-year period 1926-1995, annual US$ returns on large-capitalisation stocks and small-capitalisation stocks averaged 10.5 percent and 12.5 percent, respectively. These rates of return are comfortably ahead of returns offered by comparable asset classes over the same period: property (6.7 percent), long-term corporate bonds (5.7 percent), long-term government bonds (5.2 percent), cash (4.5 percent) and short-dated bonds (3.7 percent).[2] Thus, whilst current sentiment towards equities is heavily bearish, the long-term data are overwhelmingly bullish. In this vein, Figure 6 provides a comforting reminder of the long-term upward march in equity values (as measured by Barron's Top Fifty Stock Index).

- Second, excluding equities from current investment portfolios ignores the need for investors to allocate assets across asset classes (to lessen systematic risk within asset class markets), as opposed to attempting to secure returns via an 'all-or-nothing' approach. Indeed, the 'all-or-nothing' approach generates market timing risk, raises transactional costs and may have tax implications. On these points, empirical evidence suggests that (a) investors need to be correct on approximately three-quarters of their timing strategy calls to secure out-performance – the likelihood of achieving such rates of success are extraordinarily low; and (b) even where out-performance is delivered, this is often eroded by transactions costs and higher rates of taxation. In other words, a more viable investment strategy is to match assets with long-term investment goals (and risk profiles), and then to seek out excess investment performance from *within* asset classes. That said, the case may not necessarily hold at the margin where one finds argument in favour of up-weighting and down-weighing asset classes as a basis for promoting internal rates of return on investment. This approach is clearly more subtle and more refined than any form of the 'all-or-nothing' stance, and gives appropriate recognition to the need to match investment classes and investment goals.

2 Data sourced from Ibbotson Associates (Chicago) and adapted by Bay Asset Managers (Pty) Ltd.

Figure 6: Barron's 50 Stock Index (1930-2003)

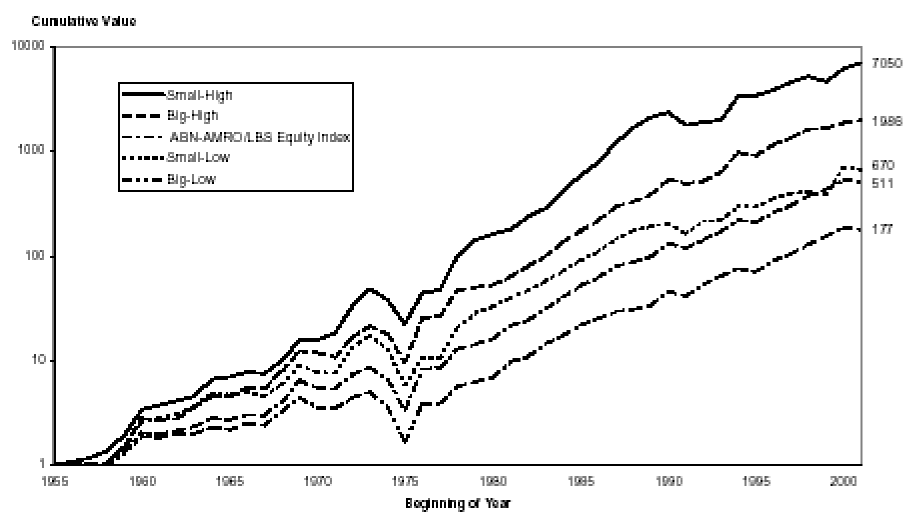
Source: Data compiled by Mark J. Lundeen

But Is Backward-Looking Evidence Sufficient to Build the Case for Forward-Looking Equities?

Whilst there is no reason to expect the future to resemble the past, the theoretical and empirical arguments favouring long-term equity allocations remain compelling. However, two earlier points demand emphasis. First, at the margin, asset allocation remains a convincing driver of portfolio outperformance. Second, allocations within asset classes can often be more significant that asset class allocation. Drawing from earlier examples, it would seem fair to conclude that, over the recent past, allocations to equities generally proved to be disastrous avenues for investors in risky assets. However, certain classes within equities delivered significant outperformance. Whilst the JSE Securities Exchange's All Share Index fell 27.0 percent over the year to end March 2003, over the same period the Small Cap Index gained 16.4 percent – outstripping returns delivered by the most risk free of assets – cash – which delivered 12.25 percent. Of course the mathematics of averages makes this statement disingenuous, but the point remains: whilst asset classes underperform, this does not mean all portions of the asset class should be ignored. Indeed, it is often beneath a lackluster surface that the most precious treasure is buried.

Furthermore, investors' behavioural quirks – such as overtrading, overconfidence, inappropriate benchmarking, anchoring and various other psychological baises – often result in even more fertile grounds for equity outperformance. A classic example of such behaviour is the traditional shunning of value situations by investors who prefer chasing more glamorous growth positions, as well as the shunning of 'higher risk' small company investments by giving preference to 'more stable' large company investments. These baises persist despite overwhelming evidence that both beliefs are fundamentally flawed. To illustrate this point, investors holding positions in large-capitalisation growth stocks listed on the London Stock Exchange over the period 1955-2000 – a not insignificant 45 year sample covering some 100 000 firm years of accounting data – would have grown the value of their initial investment 177 fold. An impressive figure, until one considers the case of small-capitalisation value investors, who would have grown their investment 7 050 fold over the same period. As a footnote to the above, investors despairing in the current equity environment may want to dwell on the figure below – where we would highlight the significance of terminal investment values, and the nature of the investment value trajectory (the mid-1970s being a pertinent period for deliberation).

Figure 7: Size-Value Evidence (London Stock Exchange, 1955-2000)[3]



Source: Dimson, Nagel and Quigley (2001)

Throwing Babies out with the Bathwater

This draws us back to the argument favouring equities as an investment class in the current global environment. Currently, most global fund managers have a dim outlook on the world's economic growth prospects. Europe continues to struggle from so-called Eurosclerosis; North America hangs heavy under the burden of the twin deficits in the US; and Japan continues to battle to overcome its deep-rooted structural faults. With the world's economic heavy weights out of the picture, it is up to emerging economies to

[3] Note, 'small' refers to small-capitalisation stocks and 'big' refers to large-capitalisation stocks; 'high' refers to high value stocks and 'low' refers to low value (or growth) stocks.

deliver the ‘swing factor’. However, as already noted, the Far East is in the process of grappling with the effects of a heavy hitting supply-side shock; Latin America has its own structural wars to wage; and Africa and the Middle East are simply too small to matter.

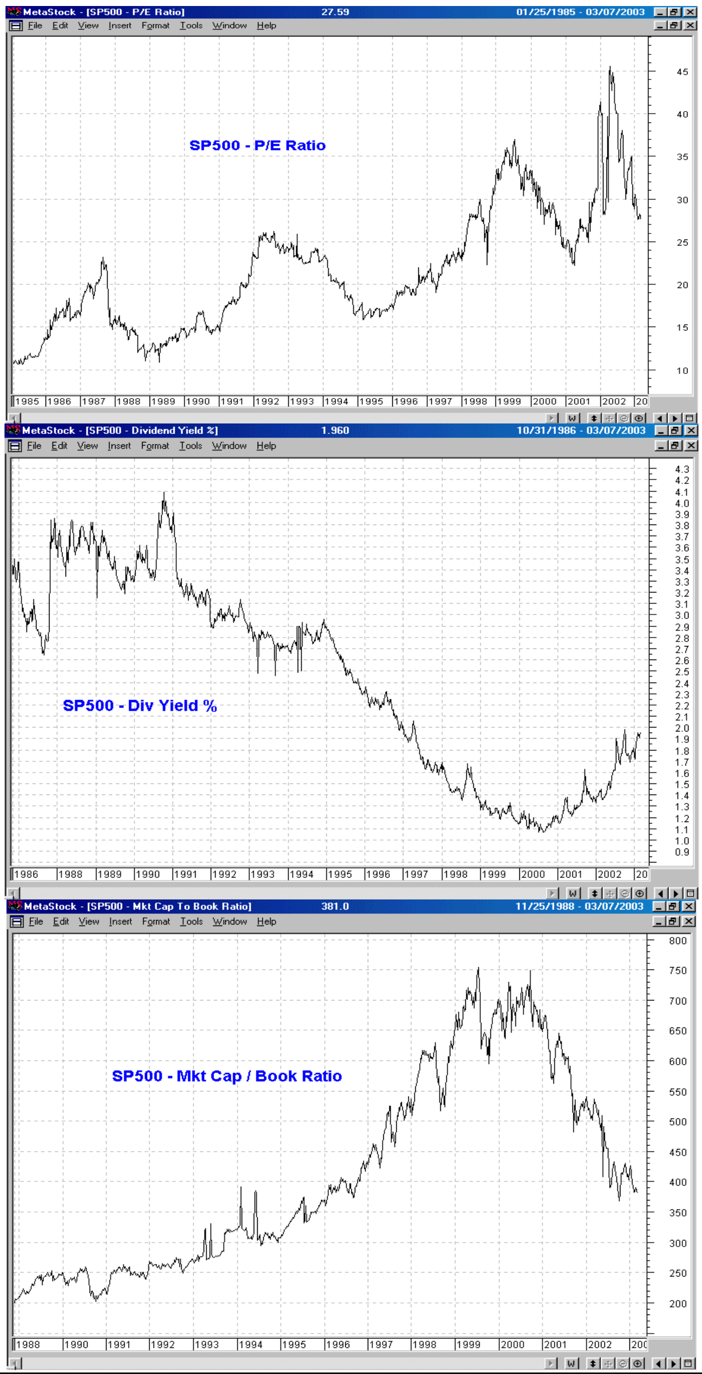
On the back of this, most global asset managers continue to hold equities in low weights. Confidence in this stance is bolstered by on-going pessimism *vis-à-vis* ratings of equities relative to other asset classes and relative to their own historical valuation paths and patterns. On the basis of price-earnings ratios (Figure 8a), whilst the ratings on US equities (as measured by the S&P 500 Index) have fallen 50.0 percent from their 2002 peak, the current rating of 23.0 times trailing earnings is still some 53.0 percent above the long-term average. Other conventional valuation methods, including dividend yields (Figure 8b) and the ratio of market capitalisation to book prices (Figure 8c) are also well off their extremes recorded in late 2000, but remain stretched relative to historical levels. Data for the European and Japanese markets reflect similar outcomes.

This sentiment has had a contagion effect: the extreme pessimism towards developed market equities has spilled over into emerging markets. But, because emerging market circumstances and investment climates do not necessarily mirror those of more developed markets, in many instances the baby has been thrown out with the bathwater. In a host of emerging markets, we find valuations and sentiment following industrialsed patterns, whereas businesses are capturing far more positive local market fundamentals. In some instances, this divorce of expectations and reality has provided a rich environment for investing in equities. The abundance of opportunity is further enhanced if one accepts the argument that it is when voices are most unified in one direction that the greatest prospects materialise in the opposite direction. This outcome is driven by one factor alone – investors’ herdlike instinct.

The Herding Instincts of Investors

On this last point, Warren Buffett often compares equity investors to lemmings. Lemmings are small rodents indigenous to the tundra region and are noted for their mass suicidal exodus to the sea. During normal times, lemmings scurry about in search of food and shelter. Every few years, however, something odd happens as the lemming population swells. The lemmings, for yet fully understood reasons, begin to move about erratically with increasing boldness, confronting larger animals and barriers of every kind. A panic-like pack reaction intensifies and the lemmings stampede through all obstacles until they reach the sea where they plunge in and swim to their death of exhaustion. Yet, and going on to paraphrase Buffett, when investors get hold of a concept, they make lemmings look like individualists. To clarify the point, it is in betting against the crowd, and in opposing sentiment, that the greatest opportunities present themselves. Recent examples of such types of ‘investment bets’ might have included shorting the Nasdaq Composite Index some time around early 2000 as huge walls of water pushed the index steadily higher towards it localised peak of 5050 points; shorting the Dow Jones Industrial Average as it crossed through 10 000 points – supposedly on its way to 20 000 in the near term; buying the Rand at close on R14.00 to the US$ at the end of 2001, or being long of small capitalisation domestic equities over the past year. These types of bets illustrate the essence of contrarian investing – all too often, the crowd is wrong. Cutting to the chase, by offering exceptional value in a distressed sentiment setting, we believe that the South African equities market currently represents a sound contrarian bet.

Figures 8a-8c: US Equity Market Ratings (S&P 500)



Source: Data compiled by Mark J. Lundeen

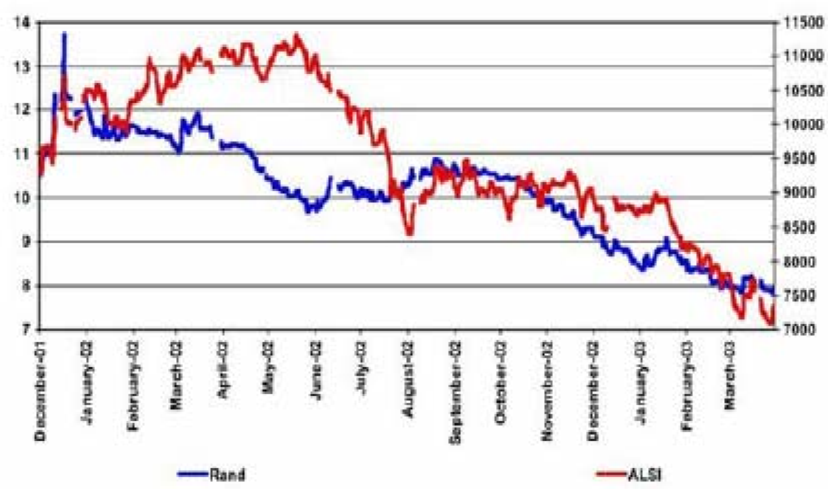
Statistic, Satistic, Sadtistic … Sadistic?

As already noted, the recent performance on local equity markets has generally been extremely weak. The JSE Securities Exchange's All Share Index is off 27.0 percent year-on-year. One of the prime factors in driving domestic equity prices lower has been sentiment. However, other forces have come to play a central role in driving equity prices off their earlier highs. The two most obvious causes have been the series of interest rate hikes that were put in place last year in an effort to drive consumer price inflation out of the system. The second has been the (associated) rapid appreciation in the Rand, which has unhinged two prime weights in domestic equity price indices, namely:

- dual-listed stocks (that are principally priced in offshore markets, such as Anglo American, Anglo American Platinum, Anglogold, Barloworld, BHP Billiton, Dimension Data, Goldfields, Implats, Liberty, Old Mutual, SAB Miller, Sappi and Tiger Brands); and
- Rand-hedged stocks (many of which are dual-listed).

Figure 9 provides a useful summary of the recent correlation between the Rand-US$ exchange rate and the JSE Securities Exchange's All Share Index (ALSI). However, other idiosyncratic factors have also played some role in diminishing the performance of domestic equities over the recent past. These influences include the mining charter and threats of civil suits by US-domiciled litigant Ed Fagan against companies that played a role in supporting the apartheid state. None the less, certainly the greatest negative-performance driver over the past year has been the rampant Rand.

Figure 9: Rand versus ALSI



Source: Stanlib

The above forces have pushed domestic equities into extreme undervaluation territory.

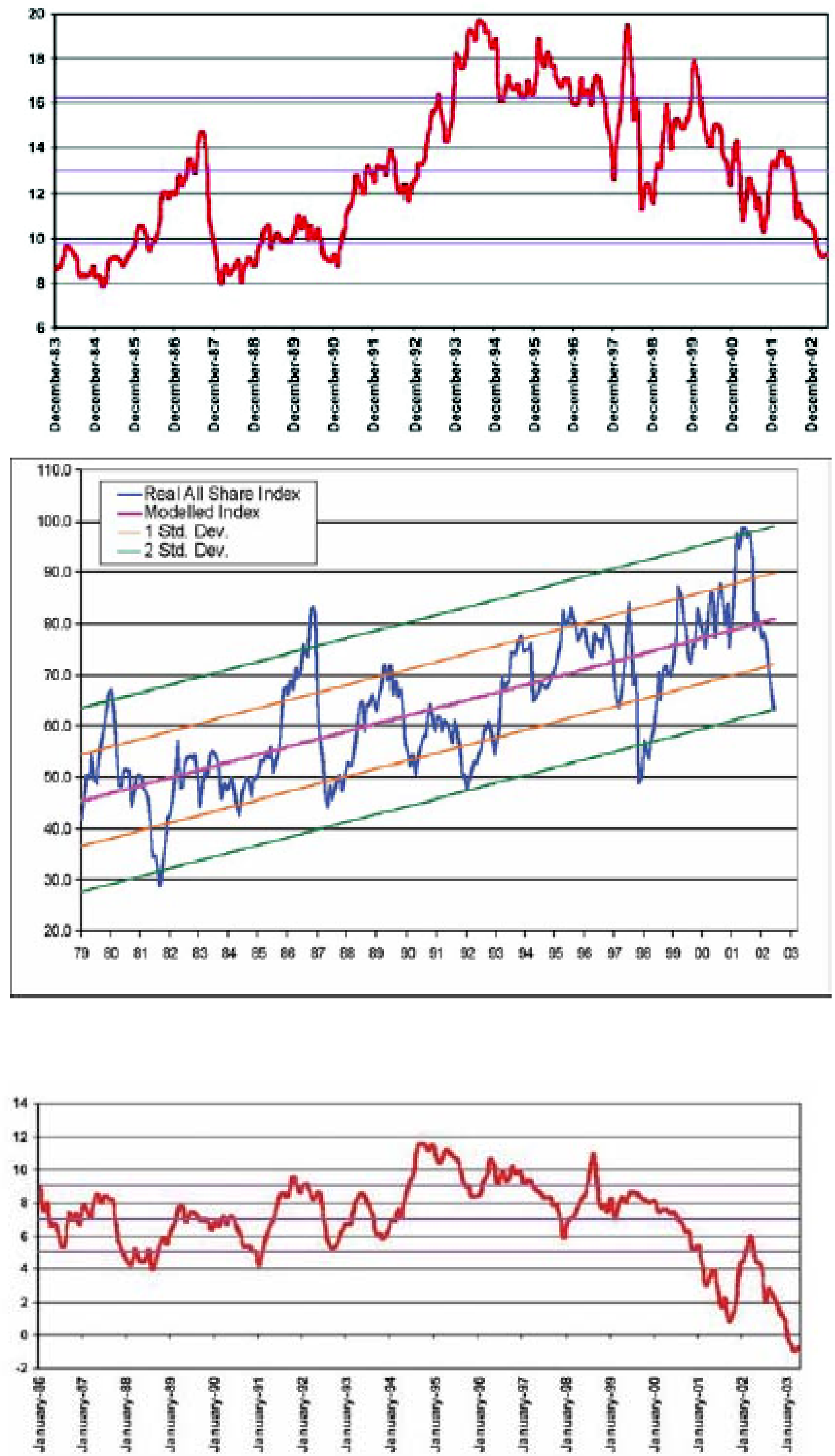
Stating the case broadly, the domestic equity market is now compellingly cheap, valued on a price-earnings ratio of 9.1 times trailing earnings.[4] This places the market at a twelve-year low in terms of the price-earnings valuation multiple (Figure 10a). Moreover, the last time we saw domestic equities priced similarly to current levels was during crisis – namely, the East Asian crisis of 1998 (Figure 10b). In addition, outside the current low and the East Asian crisis, a deflated (real price) valuation model of the local equities markets reveals that equities have only sunk to current valuation multiples on two other occasions in the past two decades. In each of these instances clear arguments for extreme price depression could be found: high prime overdraft rates (1982 and 1998), high levels of uncertainty (1992 and 1998) and structural crisis (1987). In the current case, however, we find extreme undervaluation, but lack of evidence – other than sentiment – for the current depression: the contrarian argument abounds.

The argument is reinforced by 'bottom up' evidence. Our in-house dividend discount model, which covers a universe of 160 stocks (including the top forty stocks measured by market capitalisation), currently places the universe on a valuation multiple of 0.72 (where 1.00 represents fair value). This implies that the stock universe is currently 28.0 percent undervalued. Putting the same argument differently, the universe of stocks has the potential to rise approximately 35.0 percent before it recaptures fair value. These data, when added to the top down evidence, bolster the case for domestic equities.

Further, if one compares equity valuations to other risky asset classes – most obviously bonds – one finds relatively attractive valuation multiples. More specifically, the current earnings yield on equities sits at 10.8 percent, which is only fractionally lower than the current yield on the All Bond Index of 10.9 percent (Figure 10c). On this basis, listed equities are currently priced on the lowest valuation relative to bonds seen in the past twenty five years.

[4] It is worth commenting that the price-earnings ratio of 9.1, whilst already 'cheap', is overstated. This outcome is attributable to the JSE Securities Exchange using a zero earnings figure for Old Mutual in all its price-earnings ratio and earnings yield calculations, but continuing to include the full market capitalisation of Old Mutual (R41 386 million) in the calculations. Old Mutual carries a weight of 4.1 percent in the All Share Index. If the price-earnings ratio is recalculated using headline earnings based on long-term investment returns, the price-earnings figure on the All Share Index falls to 8.5; if UK GAAP numbers are used, the figure falls to 8.9. In either outcome, the exercise reveals the domestic equity market to be cheaper than indicated by the extant price-earnings ratio on the All Share Index.

Figure 10: JSE Securities Exchange Ratings: Price-Earnings Multiple; Real Price Model; and Bond Yield Relative



Source: Stanlib

However, a static analysis is only a partial basis for assessing the prospects for a particular investment class or specific investments. A dynamic forward-looking analysis of the investment environment provides a more comprehensive tool. On this score, we find a host of macroeconomic and microeconomic arguments aiding the case for South African equities. These include:

- a favourable inflationary environment, where we see consumer price inflation following producer price inflation into the South African Reserve Bank's (SARB's) 3.0-6.0 percent tunnel by year end. Our year end forecasts for producer price inflation and consumer price inflation at the headline level stand at 4.8 percent and 5.9 percent, respectively.
- a Rand that has recaptured fair value after abandoning purchasing power parity (PPP) in 1998, at around the R6.00 to the US$ level (see Figure 11). Since then, we have seen the Rand trade up to close to R14.00 to the US$ – representing extreme undervaluation. However, if one values the Rand on the basis of trade-weighted inflation differentials, fair value is at R7.13 to the US$. Further to this, accommodating a mildly expansionary export-led growth strategy, we place fair value for the Rand at R7.67 to the US$. Inflation differentials will drive this number lower. Our trade-weighted US$-denominated estimates for 2004 and 2005 are R8.01 and R8.37 to the US$ to end 2004 and end 2005, respectively.
- slowing, but nevertheless encouraging, GDP correlates on both the real and monetary sides of the economy, including building and construction data, trade and retail data and motor vehicle trade data; and money supply growth and credit extension figures.

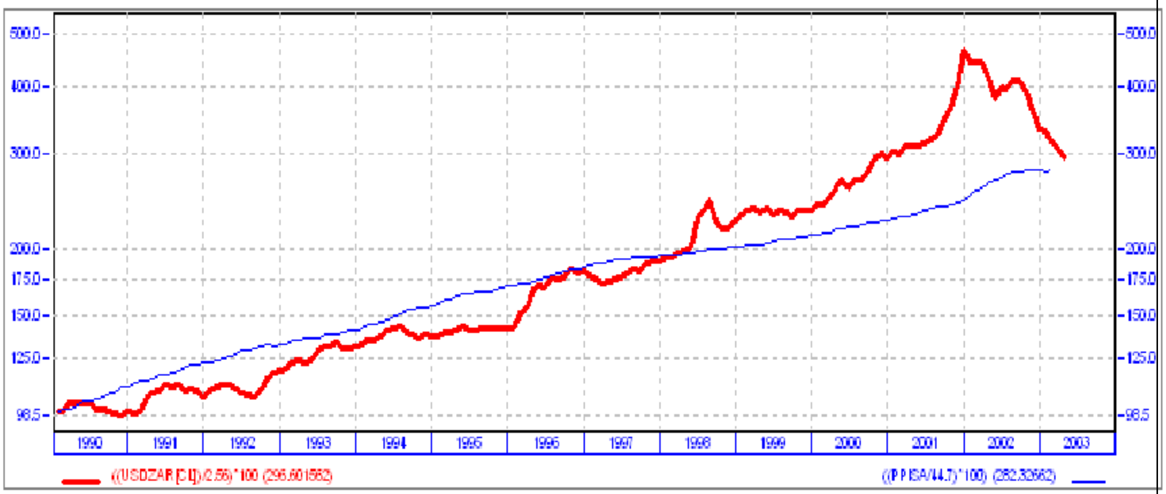
The above factors provide a compelling case for domestic interest rate cuts. Our view is that rates will be cut by 100 basis points (1.0 percent) in June, September and November of this year. However, we attach a 0.5 probability to a June cut, placing the year-end prime rate at 14.5 percent. Either way, though, rate cuts will act as a catalyst in driving the domestic equities market upwards from its base. To boot, rate cuts will serve to erode the arbitrage attraction of the Rand. As a consequence, we anticipate the Rand will start to weaken as rates cuts work into the system. Indeed, the greater fear here is that the Rand will whipsaw, falling dramatically against hard currencies as rate cuts materialise and 'hot money' washes out local capital markets. In either event, the expectation is for the Rand to weaken from its current highs (R7.20 to the US$ at the time of writing), aided by additional events, such as the relaxation of foreign exchange controls with effect from May 2003.

Promoting the above view, from a bottom up perspective, our earnings forecasts are supportive of a firmer equities market. The stock universe alluded to above is forecast to deliver 11.2 percent growth in headline earnings per share on a twelve-month rolled basis, with lower interest rates and a weaker Rand expected to push the figure higher as we reach the latter half of 2003.

Finally, using a beta valuation tool – styled on the basis of the Capital Asset Pricing

Model – we forecast that domestic equities will deliver a year-on-year return of the order of 21.25 percent, as measured by the All Share Index. This outcome is based on the assumption that interest rates will be cut by 2.5 percentage points through 2003.

Figure 11: South African Rand versus US$ and PPP (January 1990 = 100)



Source: Nedcor Securities

Risk Profiling and Stock Picking

Whilst we are extremely bullish on the prospects for domestic equities, it remains necessary to cater for different investment profiles. The table below suggests that in a static setting, investors can look to bonds, property and cash as inflation beating investment income vehicles. However, equity exposure serves as the most important base for capital accumulation; and the pickings are rich.

Table 1
Domestic Asset Allocation by Risk Profile

	Yield	Risk Profile				
		Aggressive Growth	**High Capital Growth**	**Balanced Growth**	**Capital Preservation**	**Income Generation**
Equities	4.1	86.0	80.0	64.0	51.2	46.1
Bonds	10.8	12.0	17.2	24.5	30.6	33.7
Property	13.5	2.0	2.7	7.5	8.3	19.3
Cash	11.5	0.0	0.2	4.0	9.9	9.9
Total		100.0	100.0	100.0	100.0	100.0
Implied Forward Yield		5.1	5.5	6.7	7.7	8.1
Implied After Tax Yield		4.5	4.5	4.6	5.1	5.4

Source: Bay Asset Managers (Pty) Ltd

Drilling down into asset classes, with regard to equities, we remain overweight value, underweight growth, with core holdings including Goldfields, BHP Billiton, Implats, Clientele, Sasol, Standard Bank, SAB Miller, Remgro, Steinhoff, PPC, Wetherlys, Mr Price, Hudaco, Dorbyl, Aspen, Tourvest, Brandcorp, Oceana, Reunert, BTG and Pikwik.

Considering the domestic bond market, short-dated paper still remains in thin supply, which has led to pricing anomalies – value has evaporated on this end of the market. Moreover, we continue to hold the view that price inflation will surprise on the downside, which creates excellent opportunity at the longer-dated end of the market. On the back of this, core gilt holdings include the R184 and R157; core non-government fixed income instruments include the TK01 and LB01.

Summing It Up

Summing up our current views:

- With the war in the Middle East behind us, attention has turned to economic growth prospects. The outlook is generally bleak – this includes the previous bright spot of the Far East. In that region growth has been dragged lower by the recent outbreak of SARS, which is threatening to constrict growth in GDP.
- Despite the significant fallout experienced in risky asset markets, prices remain under pressure due to an amalgam of factors including investor sentiment, overpriced instruments (on a near-term basis) and poor economic prospects. On the last point, we see the global economy heading into a technical recession in the second half of 2003.
- Poor sentiment has spread into emerging markets – even where pessimism is not fully justified. The South African market represents an excellent case in point, where macroeconomic fundamentals and policy are sound and markets are extremely attractively priced.
- Despite this positive spin, investors in domestic equities remain shy of the market. We see this as another example of investors playing their investment strategies out of the 'fear and greed' pack. More to the point, currently we see domestic equities as extremely attractively priced, offering exceptional value on a one-year view.
- The low hanging fruit is still on our side of the fence. As a contrarian play, our investment advice is for holders of risky assets to significantly upweight their exposure to domestic equities.