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S.A's Downgrade to Junk Status

Your investments

As we move into autumn in South Africa we brace ourselves with unpredictable uncertainty.

While the news of the cabinet reshuffle announced last week may have been anticipated, the extent of the changes, and the swift reaction from S&P and Fitch was not. We understand that as a result, many investors will be feeling very uncertain about how they should react, if at all, when it comes to their investments with us. We would like to take this opportunity to explain some of the subsequent and anticipated effects of current events to provide more context for concerned investors.

What is the impact?

We believe the changes to the Treasury carry the most risk to investors, as unfettered policy decisions have the potential to bring a weaker Rand, higher bond yields, lower ratings for domestically focused stocks and higher inflation.

By now you will be aware that Standard & Poor's (S&P) and Fitch, two of the international credit ratings agencies, have downgraded South Africa's long-term foreign currency sovereign credit rating to sub-investment grade. S&P and Fitch came to this decision following the executive changes initiated by President Jacob Zuma – most notably, the recall of Finance Minister Pravin Gordhan and his deputy minister Mcebisi Jonas. Just as green shoots in the economy were starting to emerge following the hard work over the last year between business, government and labour this is extremely disappointing. It could and should have been avoided.

What does it mean to countries when they are downgraded?

While it is important to remember that the credit rating agencies are research houses and provide an informed opinion on whether a bond issuer will be able to meet the commitments on their debt, this downgrade is not good news for our country and it is probable that other ratings agencies will also downgrade their ratings of South Africa. The immediate impact has been a weaker rand and an increase in bond yields (currently at 9.1%). This is likely to place upward pressure on inflation and in turn interest rates.

What investors should do?

Our philosophy sees us partner with asset managers who typically protect capital better than the average fund manager in volatile markets. Funds were already cautiously positioned to account for, amongst others, the heightened risk of political instability. This means that in some cases, a reversal of the local economic optimism, which has been building since the beginning of 2016, may produce robust performance for some of funds in this market environment.

However, while it is difficult, if not impossible, to map out the sequence of ensuing market moves, this does not mean that we cannot take further protective measures against potential losses and, where possible fund managers have positioned their funds to take advantage of any opportunities. History has shown that such uncertainty also provides opportunities as the divergence between winners and losers increases.

The important thing now is for investors to remain calm and not make rash decisions which could have detrimental long-term implications for their investment portfolios.

Sensational headlines make it very difficult to remain unemotional and there is a very natural reaction of fear of the unknown and of regret that you did not disinvest before any major setback. While we understand these emotions, we stress, as always, that investment decisions made in panic and without proper process are generally destructive.

The benefits of a diversified portfolio (as a risk mitigation tool) are evident and investors should ensure they have a spread of asset classes, industries, stocks and currencies in their portfolios. Often, the best thing to do in volatile markets is to remain level headed and, depending on your circumstances, do nothing or look for the real investment opportunities that others' panic inevitably creates. You should only change your investment strategy when either your objectives or personal circumstances change and we would encourage you to always consult with us before doing so.

As always, happy to talk … Susan Mercer.