M1 CAPITAL
INVESTMENT MANAGEMENT

Volatility and Styles

Commentary March 2021

The SA market was more subdued in March returning 1.6% in local currency terms and just over 4% in USD terms. This was attractive compared to both Developed Markets and Emerging Markets. The MSCI World returned 3.3% in USD terms, and the MSCI Emerging Markets Index returned -1.5% respectively. These returns are summarised in Table 1 below.

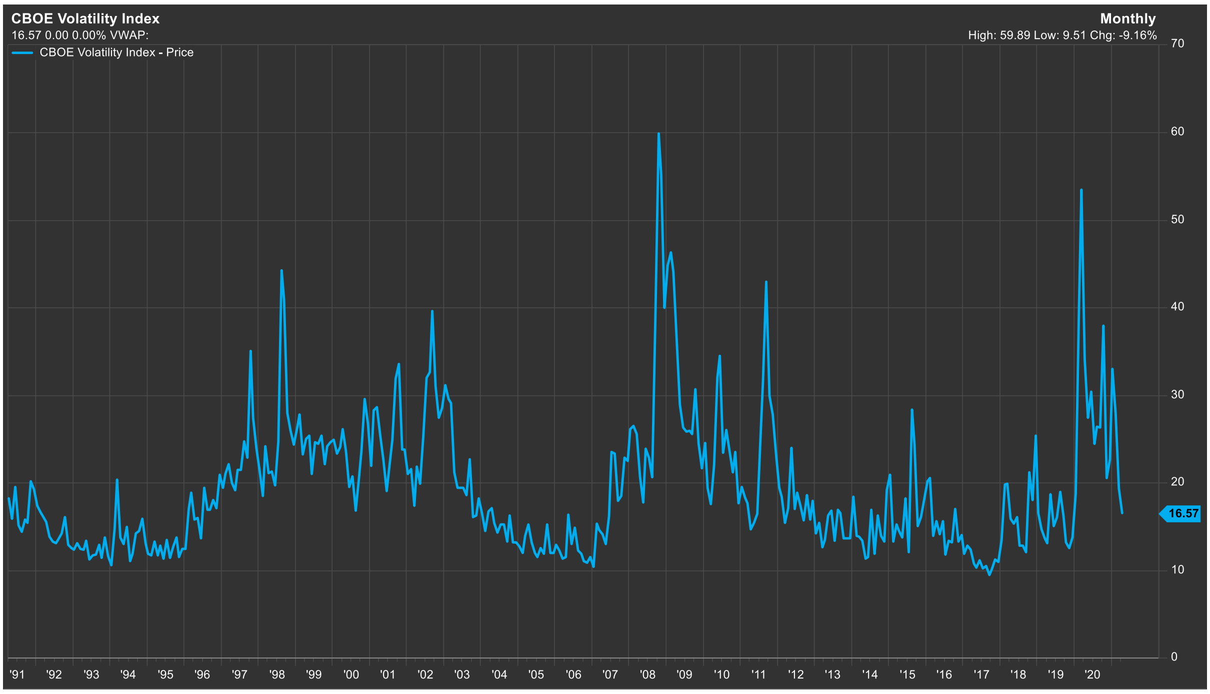
Table 1. South African and global asset returns for February 2021

SOUTH AFRICA & GLOBAL (ZAR)		Mar-21	YTD 2021
SA Equity	FTSE/JSE ALSI	1.6%	13.1%
Global Equity			
- Developed markets	MSCI World	0.7%	5.5%
- Emerging markets	MSCI EM	-4.0%	2.8%
SOUTH AFRICA & GLOBAL (USD)			
SA Equity	FTSE/JSE ALSI	4.2%	12.5%
Global Equity			
- Developed markets	MSCI World	3.3%	4.9%
- Emerging markets	MSCI EM	-1.5%	2.3%

The US long bond yield continued to dominate attention though as discussed last month, it is not clear that this has risen above long term trend yet. This month we briefly draw attention to two other series – the volatility index and the gap between Value and Growth.

Chart 1 below sets out a long term history of the VIX index

Chart 1. US VIX



Source: Factset

In times of crisis there are distinct and sharp spikes in volatility which present trading opportunities for volatility funds. It is clear this period has passed and here we point out that while not quite back to normal more benign levels, the VIX is close.

Secondly we consider the MSCI Value and Growth Indices set out in Chart 2 below.

Chart 2. MSCI AC Large Cap Value and MSCI AC Large Cap Growth Indices

Source: Factset

The chart is a stark illustration of the extent of outperformance of Growth in recent years. This period has been marked by the steady disappearance of more and more value funds globally due to underperformance. Another observation is the extent of Value outperformance in the runup to the global financial crisis as well as the well-known dotcom boom.

Important to note here is a Warren Buffet quote on value and growth – "Market commentators and investment managers who glibly refer to "growth" and "value" styles as contrasting approaches to investment are displaying their ignorance not their sophistication." This, of course, is correct and true. The indices themselves also represent somewhat arbitrary value and growth indicators. In terms of observations, more than anything, the Growth Index outperformance in recent years reflects the dominance of tech shares which was evident well prior to 2020. Of course, the question is what happens going forward. Market commentators are frequently referring to the cheapness of Value and how there is so much more to go from the outperformance in January and February. In truth, January and February probably had more to do with stocks hit by the crisis rebounding than any particular reversion of the Value style. Further outperformance of Value, much like the long bond yield, is therefore not immediately clear from the chart. There will be the usual fluctuations but there is nothing to prevent further Growth Index outperformance. This is not to say Value outperformance will not revert. As usual what happens from here on is difficult to say.

In terms of positioning, M1 Capital equity funds prefer not to second-guess markets and economic indicators, and rather focus on individual assets with some characteristics of quality – strategy, competitive advantage, stability of revenues and profits, relatively less leverage, clear and preferably entrepreneurial ownership, within an acceptable valuation range. As a strategy it may experience periods of underperformance but over the longer term represents greater relative safety and a better investment opportunity.