Of Styles and Sectors in a Pandemic

Commentary July 2021

A relatively strong month in ZAR terms for the JSE was reduced in USD terms by 2.5% in ZAR depreciation. This was mostly attributable to the unrest in the country during the month. It was nevertheless far better than the -6.7% return registered for the MSCI Emerging Markets Index. Overall, for the year-to-date, Emerging Markets have returned near 0% in USD terms vs 15% for Developed Markets as represented by the MSCI World Index. The latter continues to be driven by strong returns in the US. These are, however, still beaten by the ALSI which has returned over 18% for the year in USD terms.

In terms of Growth and Value, the month was also strong for the MSCI Large Cap Growth Index, with the Growth and Value Indices now largely in line for the year to date.

The various index movements are summarised in Table 1 below.

Table 1. South African and global equity returns (USD) for July 2021*

	Jul-21	YTD 2021
FTSE/JSE ALSI (ZAR)	4.2%	17.9%
FTSE/JSE ALSI (USD)	1.7%	18.4%
MSCI World	1.8%	15.1%
MSCI EM	-6.7%	0.2%
MSCI Value	0.6%	15.4%
MSCI Growth	2.9%	14.4%
S&P 500	2.3%	17.7%
Nasdaq 100	2.8%	16.5%

*Total return indices, Source: Factset

February this year as well as November of 2020 were widely covered as months in which "Value" outperformed "Growth", globally as well as in South Africa. Similarly, and more or less concurrently, over the last 12 months in South Africa "Small Caps" were widely covered as having outperformed following several years of underperformance. A common theme runs through both these assertions and this month's commentary is intended to suggest that things are not as readily apparent as they may seem.

Value vs Growth

Start with the Growth/Value theme. From August last year to April this year US long bond yields were rising as markets were expecting inflation. In fact, yields could also have been interpreted to be reverting back to their original levels, and to their longer term trend, following the shock of the virus crisis. The narrative at the time was that rising interest rates on higher inflation would drive Growth stocks down while Value stocks would maintain their value since they are already "cheap" and therefore would not fall further.

Chart 1 below sets out relative performance for the MSCI Large Cap Growth and Value Indices over the previous 12 months. For ease of discussion we set out in Table 2 below the monthly returns for the MSCI Large Growth and Value Indices for November 2020 and February/March 2021.

Chart 1. MSCI World Large Cap Growth and Value Indices over 12 months

Source: Factset

Table 2. MSCI World Large Cap Growth and Value Indices November 2020 and Feb/March 2021

	Nov-20	Feb-21	Mar-21
MSCI GROWTH (USD)	10.1%	0.4%	0.8%
MSCI VALUE (USD)	13.9%	4.7%	5.7%

Growth shares were certainly more volatile over the period however from Table 2 it can be seen that they didn't register monthly declines but rather maintained their value. Value actually increased, outperforming growth over a 2 month period.

The reason the argument that Value outperformed Growth is fallacious is because the Value subset is not static. This commentary suggests that rather than some sort of style outperformance occurring, it was more a case of shares hit by the pandemic recovering.

Table 3 below provides a sample of international sectors affected by the virus – Airlines and Hotels, Restaurants and Leisure for the entire 2020 as well as November 2020 only and February 2021.

Table 3. MSCI World Airlines, MSCI World Hotels, Restaurants and Leisure, and MSCI World Indices for calendar year 2020, November 2020 and February 2021.

	2020	Nov-20	Feb-21
MSCI World Airlines	-38.4%	25.8%	23.5%
MSCI World Hotels, Restaurants & Leisure	-0.5%	13.7%	10.7%
MSCI World	11.7%	11.8%	2.5%

From Table 3 it can be seen how hard particularly Airlines were affected, as well as how significant their outperformance was in November 2020 and again in February 2021.

Of course, the more share prices decline the more their metrics such as Price to Book decline as well, and more and more they become classified as Value shares. When they recover it appears that a style effect occurred when in fact it was a purely industry / sector recovery.

South African Small Caps

A similar effect occurred in South Africa, not only as a Value / Growth style effect but also as a capitalisation effect.

Chart 2. FTSE/JSE Small Cap vs All Share Indices over 12 months to August 2021

Source: Factset

Tables 4 and 5 illustrate the SA Small Cap Index vs the ALSI for November 2020 and calendar year 2020 and the sector indices for Banks, Retailers and Property for November 2020 and calendar year 2020 respectively.

Table 4. SA Small Caps vs the ALSI for November 2020 and calendar year 2020.

	2020	Nov-20
Small Caps	-3.3%	15.4%
ALSI	4.1%	10.5%

Table 5. Banks, Retailers and Property vs the ALSI for November 2020 and calendar year 2020

	2020	Nov-20
BANKS	-21.6%	19.5%
PROPERTY	-38.6%	17.4%
RETAIL	-17.1%	16.2%
ALSI	4.1%	10.5%

We consider November 2020 and calendar year 2020 only for the SA case since Naspers and Resources are so dominant that they can obscure the returns in other periods.

Similar to the Value / Growth argument above, it can be seen that Small caps outperformed in November 2020 (and indeed for most of 2020 post-March 2020). Small caps however are not a static set of shares. In fact most Property shares, as can be seen from Table 5 above, along with others, became small caps in March last year, due to their steep declines in value. When these same shares, now part of the Small Cap Index recover, the recovery is mistakenly referred to as Small Cap outperformance – which it truly is, but not the same small caps as underperformed in previous years.

M1 Capital prefers to focus on more resilient companies in its share selection as opposed to focus exclusively on valuation. As a result both its South African and global equity funds performed well in 2020. In 2021 they lagged in January and February – this was not due to a loss in value but rather sector recoveries to which there was no or more resilient company exposure in 2020. The M1 Capital Global Equity Prescient Fund has since recovered this initial underperformance. While the M1 Capital Equity Prescient Fund is still behind the ALSI for the year to date it is also catching up albeit more slowly.