ALLAN GRAY

GRAY ISSUE

21 October 2021 **Issue 247**

# It's the price you pay that matters

*As investors we shouldn't pretend we operate in a vacuum that is nicely insulated from the prevailing macroeconomic and political trends. However, it is equally important to distinguish between the economic environment, and the prices one is paying for assets in that environment. While the underlying value of the assets we invest in can be impacted by tough economic conditions, if sentiment is low and those assets are already pricing in a poor economic outcome, they can still generate healthy investment returns. If changes in price and sentiment are more volatile than changes in value, there could be great opportunities on offer for patient, long-term investors. Rory Kutisker-Jacobson discusses this in the piece below, which is based on his 15-minute presentation delivered at the recent virtual Allan Gray Investment Summit.*

We are not bulls on the South African economy, and it is incredibly hard to predict the future. We don't have a crystal ball that tells us what South Africa will look like 10 or 15 years from now. However, while we don't believe in making long-term economic forecasts, we can make inferences based on history and what we see prevailing today. Based on this, and on a balance of probabilities, we would expect that South Africa will experience more of the same: relatively muted growth and scoring the odd own goal.

## Where are we finding value?

However, within this context, we believe it is possible to find a number of companies that are either positioned to do well despite a poor macro backdrop, or pricing in a sufficiently dire outlook in today's share price, so that even if the economy continues to be dire, the investment returns from that company can be very healthy.

One area where we are finding value is the domestic banks, whose share prices remain below where they were at the end of 2019. Our biggest exposure is to Standard Bank, which has an excellent long-term track record and trades well below historic multiples. At today's share price, Standard Bank can deliver muted earnings growth and still generate good investment returns.

Meanwhile, there are a number of companies that are listed on the JSE, but whose fortunes are completely divorced from the state of the domestic economy – either because they are multinational corporations, which happen to be listed here, or because they derive the majority of their income from exports or services supplied in offshore jurisdictions. One example is Glencore, which we believe is out of favour with the market given its large exposure to coal production. However, Glencore is also a major producer of copper, nickel, cobalt and zinc, among other commodities. These commodities are heavily used in wind, solar and battery technology and, as a result, are well positioned to benefit from the growing demand of renewable energy. Over time, the contribution from coal will decline and the contribution from these other commodities will increase. Today, you can buy Glencore for less than 10 times our estimate of normal earnings.

As always, it is a question of price: How much am I paying? How large is my margin of safety? And to what degree am I being compensated for the downside risks? Currently, on the JSE, we believe you can find a number of companies whose prices are sufficiently low, that the odds are skewed in your favour.

To view highlights from the 2021 Allan Gray Investment Summit visit www.investmentsummit.co.za

Commentary contributed by Rory Kutisker-Jacobson, portfolio manager, Allan Gray