UNIVERSITY OF THE WITWATERSRAND RETIREMENT FUND

JUNE 2022 – HIGH INFLATION AND HIGHER INTEREST RATES

High level view

Much has changed in the first six months of the year with the good returns from markets in 2021 all-but-forgotten as the war in Ukraine rages on and central banks across the globe raise interest rates to try contain high inflation.

The current surge in inflation is the result of a number of events that together have created an environment of demand outstripping supply.

i. The unwinding of COVID-related restrictions
ii. Increased demand for goods from consumers
iii. Supply chain disruptions
iv. US wage increases
v. High oil and energy prices due to the war in Ukraine

This has led to a surge in prices of everything from bicycles to petrol and even rent. At the beginning of the year, expectations for global economic growth were positive as countries recovered from the COVID-related downturn but this has now turned sharply negative as central banks raise interest rates aggressively to cool their economies and keep prices from rising further.

Equity and bond markets reacted negatively to the aggressive interest rate hikes which left little place for investors to hide. This dynamic is reflected in the most recent returns of the various UWRF investment portfolios, as reflected in the table below showing returns up to 30 June 2022.

	1 Year	3 Years	5 Years
Shariah Product	6.5%	7.1%	6.4%
Capital Protection	4.6%	5.5%	6.2%
Conservative Product	0.5%	6.4%	5.6%
Growth Product	-1.7%	7.0%	6.6%
CPI (Inflation)	5.9%	4.2%	4.4%

We believe that most of the bad news has now been priced into the market and it is likely that markets will enter a recovery phase within the next 6 to 12 months. However, members should expect high volatility in returns until the effects of high inflation have passed and there is a resolution to the war in Ukraine.

More detailed commentary

As noted above, equity markets reacted to central bankers' more aggressive stance on inflation by falling the most on record in the first half of this year. Global markets fell 20% in dollar terms while the local equity market fell just 5% in rand terms in the first six months of 2022 as investors accounted for higher interest rates and the increased probability of a recession in the US.

The local equity market fared better than its global counterparts, supported by higher commodity prices (until recently) and as share prices for many non-commodity local companies lagged global counterparts through much of the previous year. With less "hot air" in share prices in aggregate, a smaller "deflation" was needed to bring share prices in line with the new expectations.

Local bond yields followed global yields higher. The difference is that South Africa's bond yields were already high (close to 10%) so the move to 10.5% was not as severe as for the US which saw yields rise from 2% to 3.5% in the first six months of the year, resulting in severe capital losses. Local bond investors also suffered losses, but these were offset by the higher income yield.

With inflation in South Africa rising to 6.5% in May, the South African Reserve Bank was forced to raise interest rates and will likely continue to do so until it is evident that prices are normalising. The SARB's Monetary Policy Committee has a difficult job to do as much of our local inflation is driven not by increased demand (as in the US) but by a combination of higher oil prices and a weaker rand. The rising price of petrol feeds into prices of everyday goods and services as transport costs rise. Similarly, higher commodity prices feed into the prices of fertiliser (food inflation) as well as input costs for most manufactured goods.

Market Returns

The table below shows different market returns over various periods to give members a better understanding of how markets performed over the longer- and shorter term. It is important to note the vast differences in returns between asset classes, currencies, commodities and market sectors, which means that there is still some value to be found in parts of the investment universe.

30 June 2022	1 month	3 months	1 Year	3 years	5 years	10 years
All Share Index	-8.0%	-11.7%	4.7%	8.2%	8.7%	10.5%
Resources 20 Index	-17.2%	-21.9%	8.5%	15.9%	21.7%	7.3%
Industrials 25 Index	1.6%	-2.6%	-7.2%	5.2%	4.2%	11.7%
Financials 15 Index	-13.6%	-15.6%	16.9%	-0.6%	4.9%	8.9%
SA Listed Property (SAPY)	-10.3%	-11.6%	0.2%	-9.0%	-7.3%	2.7%
All Bond Index	-3.1%	-3.7%	1.3%	5.8%	7.8%	7.2%
Stefi Composite	0.4%	1.2%	4.2%	5.0%	5.9%	6.1%
Rand-Dollar	4.1%	11.5%	14.1%	4.9%	4.5%	7.2%
Rand-Euro	1.6%	5.6%	0.8%	2.1%	2.7%	5.1%
Dollar-Euro	-2.3%	-5.3%	-11.6%	-2.7%	-1.7%	-1.9%
Brent Crude (USD/barrel)	-5.7%	4.1%	46.1%	19.2%	17.5%	1.2%
Gold (USD/oz)	-2.1%	-6.0%	3.1%	8.8%	7.9%	1.3%
Platinum (USD/oz)	-5.1%	-7.7%	-14.5%	3.2%	-0.2%	-4.5%
MSCI Global Equity (USD)	-8.8%	-16.6%	-15.6%	5.3%	5.8%	7.5%
MSCI Emerging Markets (USD)	-7.1%	-12.4%	-27.2%	-1.7%	-0.2%	0.7%
Barclays Global Aggregate (USD)	-3.2%	-8.3%	-15.2%	-3.2%	-0.6%	
S&P 500 Index (USD)	-8.4%	-16.4%	-11.9%	8.8%	9.3%	10.8%
Shanghai Composite Index	6.7%	4.5%	-5.4%	4.5%	1.3%	4.3%
Nikkei 225 Index	-3.3%	-5.1%	-8.3%	7.4%	5.7%	11.4%

Outlook

We do not know when markers will stabilise but we feel that we are near the bottom of the current market downturn as inflation in the US is expected to "roll over" from the highs of 8.6% as the housing market softens and higher interest rates dampen consumer spending. Locally, higher petrol prices and loadshedding have severely dented consumer sentiment which will take some time to recover. We do know that the global and local consumer is surprisingly resilient and we have seen many examples of people wanting to get back to normal after having to endure a lengthy period of lockdown restrictions.

We are comforted by the commitment from global central bankers to only raise interest rates as much as necessary (although a policy mistake remains a possibility) to rein in inflation and stabilise prices and while a recession in the US is likely, it is as likely to be shallow and short. With current asset prices accounting for this probability and valuations of most markets back below long-term averages, it is likely that the second half of the year will be better than the first. Volatility however will remain high until the effects of high inflation have passed and there is some resolution to the war in Ukraine.

Portfolio considerations

The UWRF's investment portfolios are governed by a set Investment Policy Statement. All investment portfolios have a long-term investment strategy with investment objectives to outperform inflation by a certain percentage per annum (after fees). To achieve these objectives, the assets of the various portfolios are invested in accordance with their respective long-term investment strategies across various asset classes including local equities, bonds, cash, listed property, and international assets.

These allocations are optimised through various modelling and optimisation techniques to ensure that the targets are achievable over long-term investment horizons.

Members in general should remain focused on the longer-term return prospects and investment strategies, as reacting to short-term volatility can easily result in poor investment decisions. The UWRF remains committed to providing members with well-diversified investment portfolios which should provide satisfactory returns and capital growth over the long term.