INVESTMENT VIEWS

Twist in the 2023 interest rate tale

By CHARLES DE KOCK

THE QUICK TAKE

During the final quarter of 2023, the market consensus view on interest rates shifted, resulting in a strong rally in asset prices

Our balanced portfolios had low cash levels at the time of the shift, resulting in strong returns for clients to close out the year

Charles is a portfolio manager with more than 38 years of investment industry experience.

THE FINAL QUARTER of 2023 was marked by a major shift in sentiment, which resulted in very strong positive returns for all asset classes. The change in sentiment revolved around the expectations for the future path of interest rates. While the consensus view at the start of the quarter was that interest rates would remain higher for longer, favourable inflation data during the quarter resulted in the financial markets shifting to the view that interest rates had peaked and that 2024 would be marked by a cutting cycle. Further fuelling this positive sentiment was the resilient growth performance of the US economy.

To understand the mood shift and gain perspective, it is helpful to revisit some of the significant events of the past few years. Following the Russian invasion of Ukraine and the resulting spike in energy and food prices, central banks around the world had to quickly reverse their very low interest rate policies that had prevailed largely since the global financial crisis and had been reinforced by the Covid pandemic. The result was a surprisingly sharp up-cycle in interest rates that started in early 2022. Most observers believed such a sharp rise in interest rates would inevitably lead to a recession. The view was that central bankers had underestimated inflation and had kept rates far too low for too long and that when the inflation genie had escaped, they had to act. It became the market consensus that the sharp tightening of monetary policy was necessary but that it would push the US economy into a recession. The analogy used was that engineering a fall in inflation back to the 2% target level without tipping the economy into a recession was akin to landing a jumbo jet on an aircraft carrier. In other words – pretty unlikely.

It became clear in the last quarter of 2023 that the jumbo jet had, in fact, landed on the aircraft carrier. Most investors were not positioned for this very benign outcome and the positive mood shift led to a scramble for bonds and equities by those with far too much cash in their portfolios.

One of our pillars of investment at Coronation is that time IN the market is far better than timING the market. True to that approach our multi asset

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funds were fully invested across various asset classes and held very low levels of cash. We saw good value in many equities and that global bonds, after many years of very unattractive yields, now also offered investors a good entry point. Our view on the interest rate cycle was that we were in peak territory and that yields in government and corporate bonds had reached attractive levels. The timing of anticipated rate cuts came sooner than most investors expected (including us) and our fully invested portfolios therefore performed very well in the year and especially so over the final quarter.

The outlook for the South African economy and markets is not as positive. Years of neglect in infrastructure spending have taken its toll and we are unfortunately stuck in a very low growth rut. The good news is that the Reserve Bank will most likely follow developed world central banks in reducing interest rates as domestic inflation seems to have been contained.

Geopolitical events, along with several key elections in democracies worldwide, will continue to influence market sentiment this year. We follow these events with great interest and will react to surprises by adjusting our portfolios accordingly but we do not claim to have special insights in predicting the outcomes of these big events. As always, we will be driven to invest where we see risk-adjusted value. ✚

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South African Readers

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