overberg asset management

WEEKLY REPORT

OVERBERG MARKET REPORT

Tuesday 28 June 2022

GLOBAL

Carel La Cock

Weak Yen offers an investment opportunity

Inflation in Japan hit 2.5% in April, a level of price increases last seen in 2014 when the government raised the sales tax by 3%. Japan has had a decades-long battle with deflation and news of prices quickening at a rate exceeding the Bank of Japan's (BoJ) inflation target of 2% was met with cheers from many corners of the economy. The BoJ has kept its ultra-loose monetary policy in place, just as the rest of the Group of Seven (G7) countries embark on aggressive monetary tightening. The result is that an interest rate divergence between Japan and other G7 countries has put the Japanese Yen under pressure. The currency has depreciated by over 20% against the US dollar in the last year marking a 24-year low point and some analysts predict that the Yen could go lower still.

There have been mixed emotions about the depreciating Yen. Conventional wisdom says that a depreciating Yen would benefit exporters, making their products more competitive in the global market. Japan is a major exporter of heavy machinery and vehicles, and the weaker Yen has been a boon for these industries. Prime minister, Fumio Kishida, has made economic security one of the pillars of his economic policy. A weaker Yen will help incentivising the return of production to Japan and reduce its reliance on China. It is hoped that increasing local production would boost the job market and the virtuous cycle that supports stronger economic growth.

However, the counter argument is that the higher prices paid for raw materials imported by manufacturers would offset the gain from higher export sales. On top of that, Japan's main importer of heavy machinery, China, is going through a slump. Re-shoring production will also exacerbate an already tight labour market that boasts unemployment at a mere 2.5%. There simply are not enough workers. Lastly, a weaker Yen will also cool consumer spending as the cost of living rises due to the soaring cost of food, logistics and energy. The Japanese nation are astute savers and there have been periods in the past where the high savings rates were to the detriment of economic growth.

While the BoJ has not condemned the level of the Yen against the US dollar, it has expressed concern about the rate of decline and in a recent press conference the governor of the BoJ, Haruhiko Kuroda refrained from previous remarks that the weaker Yen was broadly positive for the economy. The coming elections in the upper house will see politicians strike a more sympathetic tone towards the consumer, but it remains to be seen if there is anything to be done about a weaker Yen.

While the Yen remains weak, it poses an opportunity for savvy investors. The chief executive of Nomura, Kentaro Okuda, recently predicted that the weak Yen will kick-off a wave of mergers and acquisitions by foreign buyers. A relative strong dollar and low valuations for Japanese assets have prompted large Asia-focused funds to pivot away from China and focus its gaze an a more liquid and accessible Japan. Warren Buffett invested about $6bn in Japan during the summer of 2020 and has made some handsome returns. In the first six months of investment, Berkshire Hathaway booked gains of $1.4bn. Capital Economics, forecasts that the rotation from growth to value stocks will continue for the foreseeable future and mature Japanese industries are well placed to benefit from these capital flows.

In a recent note to investors, Matt Brett, principal manager of the Baillie Gifford Japan Trust, highlighted by way of example the incredible quality of Japanese companies in which they are invested. The Baillie Gifford Fund, which many of our clients have held for several years, have a stake in Bridgestone, the world's leading car tyre manufacturer in terms of market share. It is a mature industry, but one that offers incredible value. While the motor industry is going through a period of disruption with new electric vehicle manufacturers such as Tesla and Rivian breaking the mould, the one constant that remains is that cars still need tyres to stay on the road. In fact, it becomes even more important to keep traction as electric engines have increased acceleration and torque. Matt Brett argues that Bridgestone is better placed than most tyre manufacturers to keep up with innovation and new products that will evolve as the car industry takes a new turn. Through the Baillie Gifford Japan Trust, our clients have access to many excellent Japanese companies. At a discount to net asset value of nearly 6.5% it offers an incredible opportunity to invest in quality Japanese mid and small cap firms. Speak to one of our highly qualified investment consultants on how you can invest in quality Japanese firms.

LOCAL

Gielie Fourie

Investing in times of Inflation

INTRODUCTION: "Inflation is the most regressive tax of all, yet it is advocated by those who proclaim to be progressive" – Elon Musk. In economics inflation is a progressive increase in the general level of prices. Inflation erodes the purchasing power of money. While high inflation is generally considered harmful, some economists believe that a small amount of inflation can help drive economic growth. The US Federal Reserve targets a 2% inflation rate. Investors should invest in assets that grow at a higher rate than inflation. For example, current inflation in South Africa is 6.5% per year – your investment should grow at 6.5% plus at least 5% to protect you from getting poorer.

SOCIAL SCIENCE RESEARCH NETWORK (SSRN): A 2021 research paper by research house SSRN, "The Best Strategies for Inflationary Times", looked at historical returns of different US equity sectors when the country's headline inflation figure moved above 5% over the past 95 years. Its findings revealed that across all sectors only energy stocks showed positive annualised real returns. Energy-linked companies that focus on the exploration and production of oil, gas, and renewable energy sources were the optimal stocks to hedge against inflation, according to the report. The reason these companies benefit from inflationary spikes is that rising commodity prices, including the cost of energy, is what often drives inflation.

SCHRODERS: Research by UK asset managers, Schroders, found that during high periods of inflation, two of the best assets to hold were energy and Real Estate Investment Trusts (REITS). Energy, they found, beat inflation 71% of the time and could offer returns of 9% a year, higher than current levels of inflation, while REITs beat inflation 64% of the time.

WELLS FARGO: Wells Fargo, a US bank, looked at 15 major asset classes and calculated which ones did the best and worst during inflationary periods since 2000. The findings are instructive. It boils down to this: Inflation is bullish for oil. If you want to know what to own during inflation, know one word: Oil. Wells Fargo found the price of oil to jump more than 40% during inflationary periods since 2000. It surely tops the 10% inflation-period gain of U.S. large stocks like the S&P 500. Oil's inflation-times rise is also more than any other major asset class the bank looked at. Oil's gain during inflationary periods is also roughly three-times higher than the average 12% rise of all 15 assets Wells Fargo studied. Remarkably, investors have already sniffed this out. The United States Oil Fund (USO), a major ETF that tracks the price of oil, is up 89% in the past 12 months so far. That is a larger jump, too, than any other ETFs tracking the asset classes Wells Fargo analysed. Wells Fargo research shows that the three best asset classes to hold during times of high inflation are Oil, Emerging Market Stocks and Gold. The three worst asset classes to hold are US Large Cap Stocks, Value Stocks and lastly, High Yield Income Stocks.

BANKS: Banks could be another type of stock to buy during times of high inflation, as an unexpected spike in prices introduces the possibility of an interest rate hike by central banks. In 2022, the policy tightening cycle has already started, with central banks around the world, including the BoE, the Fed, and the Swiss National Bank, responding to inflationary pressures by raising interest rates and tapering bond buying programmes. That is good news for banks and lenders, as higher interest rates mean borrowing is more expensive, resulting in higher profits from lending margins. In theory, banks should benefit from an inflationary environment.

BOTTOM LINE: It is noteworthy that Warren Buffett invested in Chevron, Occidental Petroleum and Citigroup this year – two oil companies and one bank. Investing during inflation can be risky. Analysts' views can be wrong and should not be used as substitutes for your own research. Remember that past performance does not guarantee future returns. This is not investment advice. If you are concerned about investing in these times of high inflation and high interest rates, contact one of our highly qualified consultants.