MoneyMarketing

In today's newsletter we take a look at the ever present topic of the global recovery and what we could expect in 2010. The recession hit everyone hard – at mostly the same time. But the recovery from that recession is significantly different across the globe. Key to how well you recover from this recession is what sort of shape you were in when it happened. We also have an article on the South African listed property sector.

Synchronised recession

Speaking at a Plexus media day presentation, Pimco's managing director and portfolio manager Paul McCulley, said that while the recession most recently experienced was synchronised, the recovery from the recession will not be as synchronised. Plexus has been appointed as Pimco's South African representative and distribution partner.

How well you come out the recession depends on how healthy you were when it happened.

A hit from the centre

McCulley said that the reason the recession hit everyone was because it emanated from the centre – and no matter where you were when the recession happened it hit everyone. McCulley used the heart attack/cardiac arrest analogy. A severe attack for everyone – with a circumstance dependent recovery for everyone. "A global cardiac arrest (after Lehman Brothers) – BUT it did not kill us."

The better the shape you were in before the recession – the better your recovery.

The US, said McCulley was already heading towards a recession. "The fact of the matter is the US was not healthy." Emerging markets were in far better shape.

And that means a desynchronised recovery – very different region to region, sector to sector.

(We have to question the South African experience in light of these comments. In December last year, Busa (Business unity SA) deputy CEO Raymond Parsons, said that South Africa was already heading for a soft landing (prior to the 2008/9 events). Reasons for this included our over burdened and underdeveloped infrastructure and service delivery issues. Was South Africa healthy when the recession hit and will it slow our recovery?)

Inventories - the sunnyside of the production cycle

Demand fell when the recession hit, but production fell even further – McCulley noted. Purely because inventories were so much lower than demand there will be build up and the inventory cycle, said McCulley, can be a very powerful turbo charger.

Omigsa (Old Mutual Investment Group SA) chief economist Rian le Roux, commented earlier in the month that the inventory cycle would be a boost to growth.

But – McCulley says – it is a once off. Once inventories have been rebuilt – for continued growth there then needs to be demand. He expects this "sunnyside of the production cycle" to last for the next three to six months.

Inventory grows GDP – once off – and then demand grows GDP – and for McCulley that boils down to consumer demand which comes down to household expenditure – and the corporate sector to a lesser extent. (McCulley said the US corporate sector has relatively good balance sheets but there is a lot of excess capacity) And the outlook for final demand from the household sector is anaemic. McCulley says they will do well to get 2% US growth in the next three to five years.

Preferring the emerging

So the developed world faces sluggish growth, and consumers are getting rid of debt and increasing their savings.

Headwinds to growth

The developed world faces significant headwinds to growth – deleveraging for consumers and for the financial sector the prospect of regulation and lower risk appetite (the idea of the only people who can get credit are those who don't need it). Couple this with what McCulley calls the extraordinary shift to large deficits at sovereign level and you have a "mosaic of headwinds."

And at some point there has to be fiscal consolidation.

The mistake – if there is one – (and we are human without the benefit of hindsight) will not be exiting too soon but rather too late. If you wait too long the prospect of inflation arises but as McCulley said the US inflation is below target.

It means very low interest rates.

Quantitative easing ends in March and McCulley said you may see long rates go up 25 basis points.

The emerging markets don't have these headwinds to growth.

If anything, China has too little consumer spending. McCulley said China has to get a model of domestic demand. This requires the "wallet and the will." And there are demonstrations that both of these exist.

McCulley sees very robust growth in emerging markets. For equities the preference is for emerging markets.

SA listed property shows its mettle

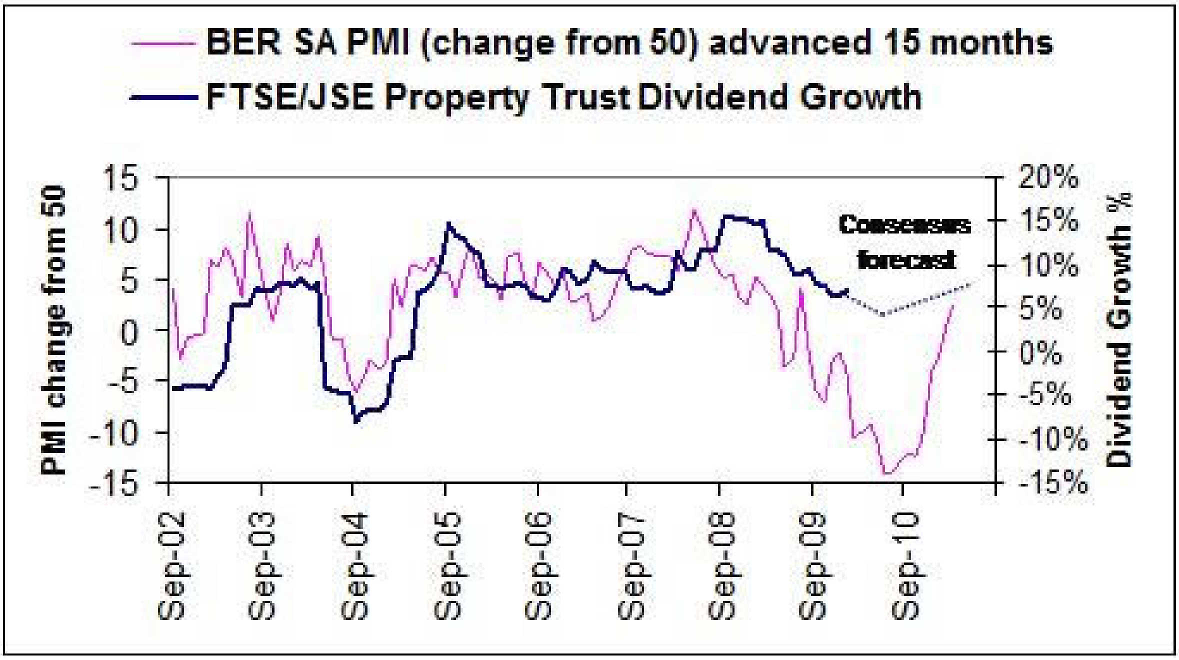
Listed South African real estate instruments are showing their mettle and continue to offer value in the global context, says Dr Prieur du Plessis, Plexus group chairman.

The global real estate market has recovered by a massive 65% in US dollar terms since the carnage ended in February 2009, according to Plexus Asset Management research into the performance of Real Estate Investment Trusts (REITs). The bear market saw prices, as measured by the Plexus Global GDP-weighted REIT Index, fall by more than 68% from the all-time high in January 2007. According to Du Plessis, the Plexus Global REIT Index is still more than 47% below the all-time high.

"Singapore and Canada have enjoyed spectacular price returns in excess of 90%, while South African real estate investment trusts returned a commendable 49,2% in US dollar terms," says Du Plessis. "With prices down by 12,1% and 5,6% respectively since the top in the Global REIT Index in January 2007, South African and Hong Kong REITs have outshone the rest of the world."

So how may the severe economic downswing in South Africa affect South African REITs? According to Du Plessis, "earnings growth of South African REITs, as measured by the FTSE/JSE Property Trust Index as proxy, tends to lag the economy."

"The BER Purchasing Managers Index (PMI), an excellent leading indicator for the South African economy, leads earnings growth of Property Trusts by approximately 15 months. Where the downswing in 2002/2003 severely impacted on earnings of listed property companies, it seems the impact of the current slowdown on the earnings of listed property companies will be limited," says Du Plessis.



According to the recent *Rode's Report on the Property Market*, commercial, industrial and residential rentals are feeling the pinch of weak economic conditions. However, yearly growth in rental markets remains positive, with surprising firmness in some areas. "The other most important factor in the profit equation is vacancy rates and, although increasing, these remain relatively low," says Du Plessis. "The consensus forecast of analysts as per I-net indicates the market expects growth of the Property Trust Index to slow to 4,5% this year and then to accelerate by more than 7% next year." On a historical basis the Property Trust Index is yielding 8,7% while one and two years out the Index is offering 9,1% and 9,7% respectively.

FTSE/JSE Property Unit Trust index	**Historical**	**1 year forward**	**2 years forward**	**3 years forward**
Income distribution yield	8,7%	9,1%	9,7%	10,6%
Growth on previous year		4,5%	7,1%	8,7%

Similar yields and growth are forecast for Growthpoint. "These yields are not bad, given the current rate on cash and short-term notes," comments Du Plessis. "It should be remembered, however, that dividends paid by property trusts and loan stock companies are taxable in the hands of the investor."

In addition, there is capital risk to investing in listed property.

According to Du Plessis, the capital value is highly correlated to long-dated bond yields. "If long-bond yields rise while the dividend remains unchanged, the tendency is for the market to require virtually a similar rise in the yield on listed property instruments such as property trusts," says Du Plessis. "As a result the capital values of listed property decline notwithstanding an unchanged or increased underlying value of the listed property company's property investments."

According to Du Plessis a significant gap has opened between South African bond yields and those of the JP Morgan Emerging Market Bond Index. Emerging market bonds have significantly outperformed South African bonds on a price basis as global investors upped their risk appetite.

"As SA bonds currently offer excellent defensive value relative to other emerging-market bonds, the same can be said for South African listed property," says Du Plessis. "However, the upward trend in sovereign risk may limit a significant re-rating of South African listed property."

Although the market has probably bottomed and stabilised, the outlook for the other important property market, namely residential properties, remains grim, says Du Plessis. This is mainly due to households' high debt levels and rising unemployment.

Those who wish to invest domestically in South African listed property can choose a range of domestic property unit trusts or JSE-listed property unit trusts. Those seeking exposure to international listed property can opt for rand-denominated foreign funds such as the Oasis Crescent International Property Equity Feeder Fund and Marriott Global Real Estate. Alternatively, one can invest in UK property through Liberty International.