view from the Thames by Deon Gouws

The market is no fool

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"A reckoning is coming for South Africa. The Trump administration sees it. So does Congress. But financial markets don't — and that's a problem."

Not my words, but those of an opinion piece in The Wall Street Journal (WSJ) last month.

The article highlighted South Africa's alignment with certain foes of the US such as China and Russia. It then listed steps taken by the Trump administration in response, including the suspension of financial assistance to the country, the expulsion of ambassador Ebrahim Rasool and the US boycotting G20 meetings held at the southern tip of Africa — all adding up to South Africa's "pariah-like status" in Washington.

So far, so valid, I guess. But then, the killer paragraph: "While the next phase will likely involve harsher economic penalties, markets around the world continue to underprice South Africa's growing risk profile. Companies, investors and compliance teams still treat it like a typical emerging market: a little unstable and volatile but ultimately manageable. That assumption is wrong."

Wow, I thought, when I read it the first time. Strong words those — sounds like a very experienced market participant holding court ... perhaps time to sell some Naspers shares and convert my last few rands to a stronger currency like the kwacha or pula?

But this was no Ray Dalio or Stanley Druckenmiller or Bill Ackman telling the world why they're happy to short South Africa. Instead, the piece was written by a research analyst at the Foundation for Defense of Democracies (FDD) in Washington.

According to its website, the FDD "conducts in-depth research ... with the aim of strengthening US national security and reducing or eliminating threats posed by adversaries and enemies of the US and other free nations".

To say that it has a rather specific agenda is probably an understatement.

With a little further digging, I established that the author holds degrees in government and politics as well as global security studies.

From what I can tell, he has never worked anywhere near Wall Street. Which probably means he'll make much better conversation than me at a cocktail party ... but I'm not sure that I would turn to him for investment advice.

Gloomy or rosy?

And yet, this opinion about markets mispricing assets caused quite the storm. Within 24 hours, the WSJ piece had been referenced by practically every South African news outlet.

When approached for comment by one of them, I suggested that it's an oversimplification to say that the market is underestimating South Africa-specific risks.

While criticism of many of the ills of the country is probably valid, this doesn't necessarily mean that markets are wrong when they don't move in tandem with your opinions about some of these issues.

The market is not a fool: it boils down to the weighted average of a multitude of views, local as well as international, backed by real money in the form of thousands of purchases and sales of securities as well as derivative products linked to those, all based on fundamental research, rigorous debate and investment committee overview.

Yes, the market gets it wrong sometimes (which is why we see quick reversals and corrections every now and then). But more often than not, the market is relatively efficient and sees through all the risks better than any specific commentator (even if that person happens to be pretty knowledgeable and gets exposure in the WSJ).

In short, prospects for South Africa are never as rosy as the government promises or as gloomy as the naysayers warn.

Financial markets appeared to agree with this view and yawned; a few days later, the JSE all share index reached a record high by breaching the landmark level of 100,000 points. The rand also strengthened.

As it happens, journalist and broadcaster Bruce Whitfield released the first of a new business podcast series around the same time as the WSJ article. One of his guests in this maiden recording was Mark Cutifani, who used to head up Anglo American.

The Aussie businessman was full of praise for South Africa and its people, referring to the country as one of the best places he's ever been as far as working relationships are concerned. He lauded the directness and resilience of South Africans as well as their willingness to work through problems.

Is it too optimistic to suggest that "the market" also notices these things, rather than just focusing on a glass that appears to be half empty from a vantage point in Washington? x

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