



OPPORTUNITY PRIVATE CAPITAL

Economic Snapshot November 2020

LOCAL HIGHLIGHTS & LOWLIGHTS

- All-Share Index on 16/10: 57,607 (from 57,718 on 01/01).
- USD/ZAR consolidating at R15.63/\$ after touching 15.21/\$ after US elections.
- South Africa 10Y Government Bond yield: Current 8.85%, (10.81% mid April)

(Data: Bloomberg; Sharenet;
www.tradingeconomics.com)

NEWS

- Joe Biden yet to be declared president of America after Trump launches legal attacks questioning the voting processes. Biden has received a record number of individual votes (>77 million).
- Tech stocks are leading a post-election rally in markets after getting hammered a few weeks back.
- Ramaphosa announced a boost for SA's tourism, SA will be opening its borders to all countries, benefitting the entire economy and allowing return to full operation. The tourism industry normally contributes around 9% of GDP and around 1mil jobs.
- A 92% recovery rate has been recorded for the just over 742,000 coronavirus cases registered South Africa

FACTOR INVESTING: PROFITABILITY (PART 4)

When we step away from technical and statistical analysis of investments, the fundamental foundation of any investment decision is that the investment must generate enough money to exceed the cost of doing business. Investing 101 kind of stuff, right? Any rational person will agree with the aforementioned, and shareholders will naturally gravitate towards profitable companies - especially if they deliver a positive earnings surprise or two.

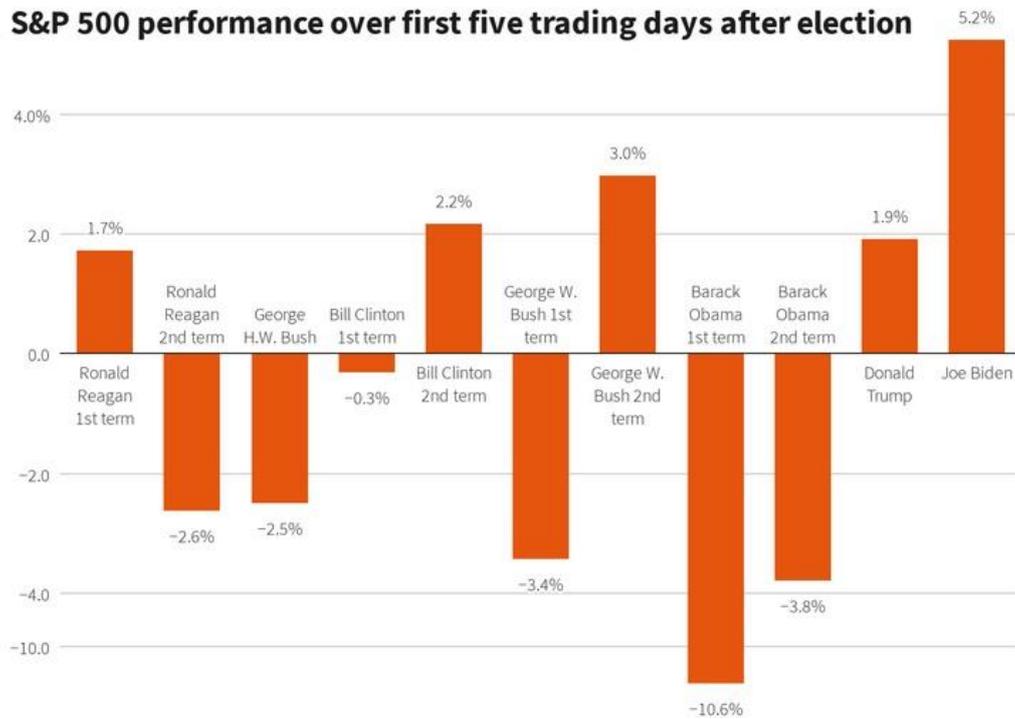
The predicament lies not in judging if a profitable company is a good company, but the right questions to ask are (i) if all future profitability has been priced into the share already, and (ii) if you can predict future performance using current and past profitability? Here things become a bit more murky, and needs some analysis to confirm our suspicions.

In a massive academic study published in 2016, Hou, Xue and Zhang studied "*hundreds of significant anomalies as testing portfolios*" and found the profitability factor to be a dominating driving force of returns when tested against other factors (Here's the [Link](#)). (By the way - They also found that the investment factor from the previous newsletter was the other significant predictor of performance.)

The profitability factor definition that is often used to rank shares and distinguish the profitable group from the non-profitable group is as follows: Profitability is the ratio of operating profit (which is total annual revenue, net of sales and other expenses), relative to the most recent book value for the previous year (Definition coined by academics Fama and French in 2014). Interestingly enough, shares with high Profitability factor ratios can often outperform other

lower ranked shares despite typically having lower book-to-market ratios and higher market capitalisation.

GRAPH OF THE MONTH: 5-day Market reaction to new US presidents



Source: adapted from www.reuters.com

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