



ECONOMIC AND MARKET OVERVIEW

Global

Global economic activity continues its steady recovery from the Covid-19 economic shock, although the upswing will be low by historical standards due to the persistent risk of further rounds of infection.

In a recent report from RMB Global Markets they note that, as the virus plays out differently in different economies, some can continue to gradually reopen while others are expected to implement further social distancing and lockdown measures. This staggered recovery process will prevent a significant pickup in global demand and limit the extent of global inflation pressures. Weakness in global economic demand, against an already low global inflation backdrop, continues to provide governments and central banks with space to provide further support to their economies. This is expected to help stabilise global financial conditions and provide an important support to the global recovery. While this environment provides relatively favourable conditions for ongoing fiscal and monetary policy support, the economic risks necessitating this will continue to provide support to safe-haven assets. The primary risk to global growth remains to the downside as various themes continue to circle overhead: Covid-19 infection waves, rising global indebtedness, oil market volatility, trade wars, nationalistic politics and policies and anti-globalisation sentiment.

In an environment where low inflation and low-to-negative interest rates are likely to persist for a few more years, the search for positive investment returns has seen investors rush into selected equities. The dominant global theme is leadership of new economy stocks, ranging from technology and healthcare to the green economy. As long as the FAANGMs¹ continue their relentless rise, US equities will retain their attraction. Attention is shifting, albeit slowly, to the fundamentals – cash flow generation, increasing return on capital and strong balance sheets. Persistent central bank intervention in asset markets, however, distorts the importance of fundamentals in determining the asset prices. Under these circumstances index tracking may remain an appropriate strategy to equity investing, but the early signs of a tilt to active investment strategies are becoming visible.

The November 3rd Presidential election in the United States will continue to make headlines, albeit for all the wrong reasons. As was the case in 2016, it's extremely difficult to predict the outcome with any degree of certainty. Even if investors could do so, it would prove no less challenging to figure out how investment portfolios should be positioned for any particular result. Markets appear to be considering a more tactical approach with the US elections and year-end looming, particularly given the growing risk that investors will need to wait beyond election day for a result. In the case of a Biden win, while expectations for more regulation and higher taxes might initially hurt the performance of risk assets, a return to multilateralism and a rule-based approach would be good news for emerging markets over time. Markets might view a Biden presidency as less antagonistic on trade with the rest of the world.

Given the wide range and accompanying uncertainty of outcomes related to the Covid-19 pandemic and the resulting policy response, as well as the US elections and other global political developments, it may be best to trust the benefits of well diversified investment portfolios and not tinker with them too much as we approach the end of what will turn out to be a year that few of us will ever forget.

South Africa

The South African Reserve Bank's Monetary Policy Committee (MPC) decided to leave the repurchase rate unchanged, keeping it at 3.5% and the prime lending rate to 7%.

Three of the MPC members voted to keep the rate unchanged, with two members favouring a reduction of 0.25%. In his statement, the governor of the Reserve Bank, Lesetja Kganyago noted that the Bank now forecasts an economic contraction of over 8% in South Africa in 2020. He did, however, comment that the further easing of the national lockdown has supported economic growth. Getting back to pre-pandemic output levels will take time, however. Even with expected growth levels of nearly 4% in 2021 and a little over 2.5% in 2022 the economy won't return to its 2019 output much before 2023.

1. Facebook, Amazon, Apple, Netflix, Google (Alphabet) and Microsoft

This is expected to help stabilise global financial conditions...

Another silver lining is the favourable inflation outlook.

...gold...over five years...matches the return of global equities

History informs us that great crises bring great change, and they dramatically accelerate trends already underway

...we know much more about the virus now; we've have identified the vulnerable and how best to protect them...



One glimmer of hope is that South Africa's terms of trade remains robust. As a nation we're typically an exporter of industrial and precious metals, and a net importer of energy (represented by oil). High commodity prices (earnings from exports) and generally low oil prices (cost of imports) continue to boost our terms of trade and could, over time, be supportive of the rand (all else being equal, which of course it won't be.)

Another silver lining is the favourable inflation outlook. The overall risks to the outlook at this time appear to be balanced. Global producer price and food inflation have bottomed out. Oil prices remain low. Local food price inflation is expected to remain contained. Risks to inflation from currency depreciation are expected to stay muted. This is very good news for the already embattled local consumers.

South Africa's challenges are plentiful and well known. Most state owned enterprises require additional funding, civil servants are demanding salary increases and the majority of municipalities are functioning way below par. All of this puts an additional burden on the continuously shrinking taxpayer pool. The sharp rise in South Africa's public financing needs arising from falling tax revenue and higher spending has been financed by higher private sector savings and borrowing from international financial institutions. Alongside SARB liquidity-management operations, resident investors, including banks, have increased purchases of sovereign bonds, helping to ease yields (and therefore the cost of government borrowing) in recent weeks.

The governor concluded his statement by saying that monetary policy, however, cannot improve the potential growth rate of the economy or reduce fiscal risks on its own. These should be addressed by implementing prudent macroeconomic policies and structural reforms that lower costs, increase investment opportunities and potential growth, and bolster job creation. Such steps will enhance the effectiveness of monetary policy and its transmission to the broader economy.

Earlier this year we quoted Gavekal Research saying that "if it's in the press, it's in the price". From an investment point of view it seems as if just about all the bad news surrounding the local economy is reflected in the valuations of companies that earn most of their revenue in South Africa. This is in stark contrast with the valuations of companies such as Tesla and Netflix, where every morsel of good news seems to be reflected in its share prices. Investing in what feels comfortable has very seldom lead to long term success, so perhaps its time to set emotions aside and approach investment decisions with cold-hearted rationality.

Market Performance

September may have heralded the start of spring in the southern hemisphere but there was very little green to be found among asset class returns during the month. South African equities shed 1.6% during the month, led by resource stocks which gave up some of their year-to-date gains as they pulled back by 3.4%. Industrial stocks also pulled back (-1.5%) while Financials added 2.3%. However, the latter is still about a third down from the levels at the start of this year as it reflects the dire state of the local economy on which most of the financial shares depend.

Global equities did not fare much better as measured by the performance of the MSCI World Index (down 3.4% in USD) and emerging markets held up only slightly better (down 1.6%). Global bonds (measured in local currency) added 0.7% for the month and was the only broad asset class that beat a holding in South African cash in September.

The Rand gained 1.5% against the greenback, but this was largely due to broad US Dollar weakness rather than any specific development in South Africa. Despite the stronger rand, domestic bonds ended the month flat as appetite for emerging market bonds was subdued. Over the quarter, however, the stronger rand and attractive yields resulted in bonds outperforming all other domestic asset classes.

Property (-3.0%) had another poor month and has now underperformed all other domestic asset classes over all periods in the last 10 years.

Lastly, gold has retraced some of the very strong gains made since the start of the year as it gave up a little over 4% in US Dollar terms. Year to date it's up 24% however, and over five years it matches the return (11.1% per annum) of global equities, also measured in Dollars.

MARKET INDICES ¹ (All returns in Rand)	30 September 2020		
	3 months	12 months	5 years
SA equities (JSE All Share Index)	0.7%	2.0%	4.8%
SA property (S&P SA Reit Index)	-13.0%	-49.7%	-13.4%
SA bonds (SA All Bond Index)	1.5%	3.6%	7.6%
SA cash (STeFI)	1.2%	6.3%	7.1%
Global developed equities (MSCI World Index)	3.7%	22.1%	15.3%
Emerging market equities (MSCI Emerging Market Index)	5.3%	22.0%	13.5%
Global bonds (Barclays Global Aggregate)	-1.4%	16.9%	7.9%
Rand/dollar ²	-4.0%	10.0%	3.8%
Rand/sterling	0.4%	15.4%	0.6%
Rand/euro	0.2%	18.3%	4.9%
Gold Price (USD)	5.3%	28.8%	11.1%
Oil Price (Brent Crude, USD)	-0.5%	-32.6%	-3.3%

1. Source: Factset

2. A negative number implies fewer rands are being paid per US dollar, so it implies a strengthening of the rand.



Commentary – the only constant is change

In his concluding remarks¹ at their recent investment conference Glyn Owen, Investment Director of Momentum Global Investment Management, provided a balanced yet sobering analysis of the current state of the world economy and investment markets. In this commentary we provide an extract of his round-up² and highlight a few of the trends that have originated or have been accelerated as a result of the Covid-19 pandemic.

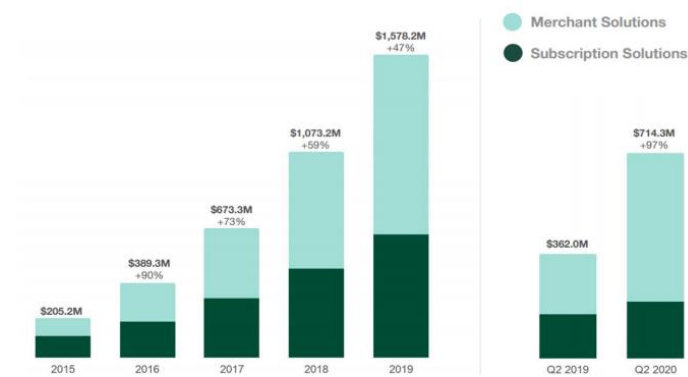
History informs us that great crises bring great change, and they dramatically accelerate trends already underway. World War II led to the foundation of the welfare state and an era of multilateralism, with the creation of the United Nations and the European Coal and Steel Community, the forbear of today's European Union. The global financial crisis gave us negative interest rates, financial repression and the blurring of lines between central banks and governments.

Today's crisis has yet to run its full course but already we can see some of its structural and far-reaching impact. Trends already underway; the growing dependence on technology, the weakening of international bodies, rising inequality, anti-globalisation and the rise of nationalism, the shift of economic power to Asia, the clash between the established super-power, the US, and the rising challenger, China, now an increasingly ideological battle, are all moving forward more rapidly.

At the same time, the changes in working habits of the past decade, the rise of self-employment and more flexible working arrangements, are now seeing a potentially era-defining shift towards working from home, with untold consequences for real estate markets and spending habits. Perhaps most importantly, the encroachment of the state in the economic affairs of the nation has taken a dramatic step forward, and we are surely a step closer to direct monetary financing of government debt.

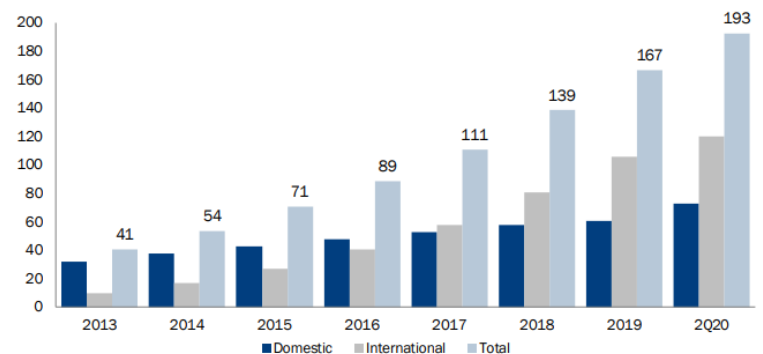
Three areas that have seen significant growth are e-commerce, media subscriptions and digital payments:

The Pandemic has accelerated growth in ... E Commerce Sales



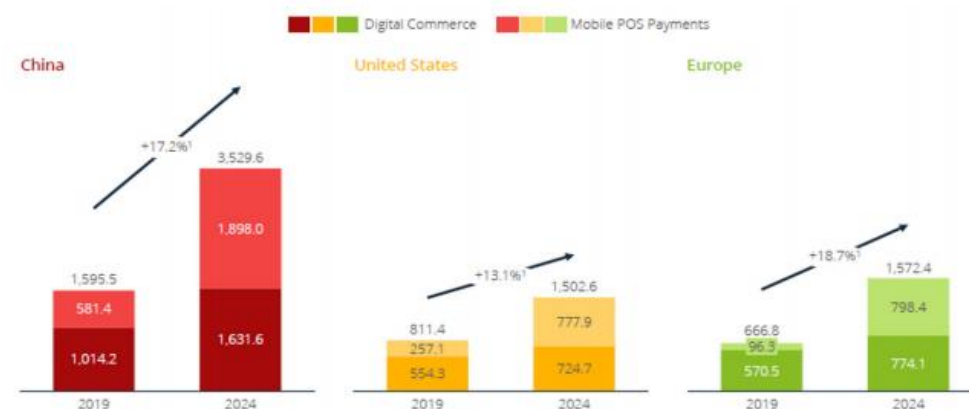
Source: Shopify, Jennison Associates

Media Subscriptions



Source: Netflix, Jennison Associates

Digital Payments



Source: Statista Digital Market Outlook 2020, Jennison Associates

1. https://youtu.be/A_yF_Rc5Yiw

2. https://cdn.hubilo.com/brochure/272461/1854_7141_719304001600974853.pdf

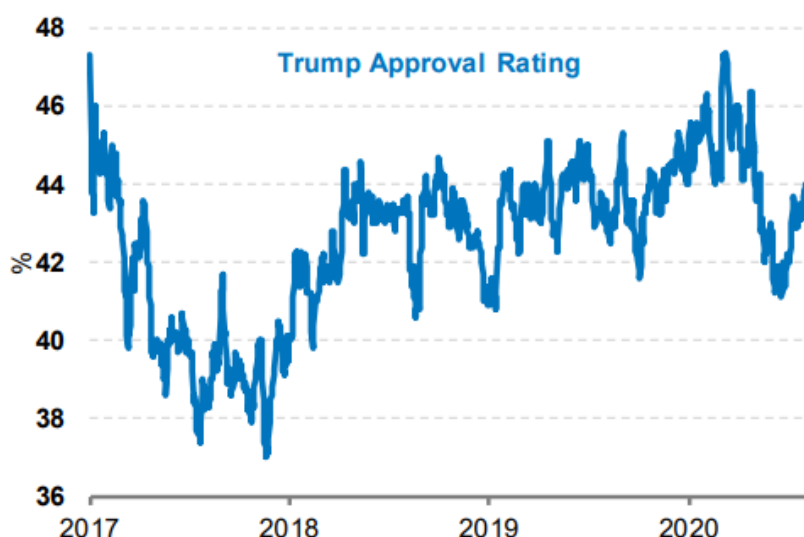


These changes create uncertainty, but at the same time opportunity. But first, we need to see out the pandemic. As we approach winter in the northern hemisphere, home to 90% of the world's population, fears are rising that a second wave, potentially more deadly and economically damaging than the first, is approaching.

Momentum does not share this prognosis. Owen stated that we know much more about the virus now; we have identified the vulnerable and how best to protect them; we have a much-improved understanding of how it can be treated; and healthcare systems are better prepared. Encouragingly, while cases have risen in many countries, hospitalisations and deaths have remained relatively low. It is the young who are mainly contracting the virus now, and they are at much lower risk of becoming seriously ill. As testing capacity is ramped up, and contact tracing is rolled out, the ability to identify outbreaks rapidly and control them locally is much improved.

While the virus has dominated everything this year, there are other hurdles to overcome. Foremost are the US-China relationship and the Presidential election.

The direction of the US-China relationship could be determined by the outcome of the election. Another term for Trump would see a further escalation of the dispute, whereas Biden would be less protectionist and more willing to re-engage internationally. Nevertheless, the trade issue has bipartisan support and anti-China sentiment has grown significantly, so any measures to roll back tariffs are very unlikely. On current polling, Biden will be the next President and the Democrats will have control of Congress. But Trump came back from larger polling deficits in 2016, his rating has picked up in recent weeks, and he is polling higher than Biden in two key areas, the economy and law and order. The outcome is by no means a foregone conclusion. Biden is the least market friendly of the two; he plans to raise taxes on companies and higher earners, and roll back Trump's deregulation agenda, so the equity market could be under a cloud if polls continue to show a clean sweep for the Democrats. But in practice there would probably be little lasting impact, with both candidates intent on big fiscal spending and the Fed firmly committed to ultra-loose policy.



Source: Bloomberg, BMO Global Asset Management

Owen concluded by saying that investors need to be realistic about return expectations over the next several years; global growth is recovering well but long term sustainable levels of growth are likely to be below pre-virus levels. Valuations across fixed income markets, especially safe haven government bonds in developed economies, are at historic highs, and parts of the equity markets are also extended, notably the tech sectors which have dominated returns to an extraordinary degree. While these assets have important roles to play in portfolios, future returns will surely be more subdued. But there are very good opportunities in other parts of the equity market, and considerable recovery potential in the most depressed areas. The overarching approach should be to remain invested.

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