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Trendline

Second quarter 2020

Outlook

Following the catastrophic downturn of global equity markets in the latter part of March, the rebound and resilience of the markets during the past three months has been little short of remarkable. Odds were stacked against equity market performance resulting from the devastation wrought by the Covid-19 pandemic, but it was the speed with which Governments and the Central Banks of the world reacted to the crisis that provided the necessary monetary stimulus and fiscal support.

Whilst the performance of global equity markets over the quarter has been significant ,it is as well to bear in mind that stocks are for the most part trading at levels below those that prevailed prior to the onset of the pandemic. This is clearly illustrated with the MSCI World Equity Index having returned 18.84% for Q2 but returning a negative -6.64% for the year. Similarly, the MSCI Emerging Market Index returned 17.27% for Q2 but returned a negative -10.73% for the year.

Despite the strong rebound in terms of risk assets, traditional safe-haven investments continued to perform well with gold up 18.0% and U.S. bonds up 9.0%. Economic data is displaying signs of a strong rebound and it is encouraging that central banks have demonstrated that they are able and willing to do whatever it takes to provide sufficient ongoing liquidity in order to keep government and corporate interest rates at very low levels.

As economies have started to reopen the full economic impact of global lockdowns is being realised and a return to the previous levels of global economic activity seem at this time to be distant. However, risks remain as the virus is far from contained and the provision of a meaningful vaccine is still awaited. The IMF has forecast that global GDP will contract -4.9% this year, a significant increase from its earlier forecast of a negative -3.0%. The IMF did however indicate that many economies were on the mend and welcomed the stabilisation of global capital markets. It urged a continuation of bold monetary and fiscal stimulus despite its concern that this might eventuate in global government debt soaring to between 80% and 101% of GDP.

Global - Easing lockdowns

U.S.

With the U.S. now being the epicentre of the coronavirus pandemic the number of new virus infections continues to rise which is impacting significantly on the re-opening of the entire economy. New moves are in place to prevent virus hot spots from flaring up and the compulsory wearing of face masks is gaining more acceptance.

Personal incomes have so far been supported by government payments and generous unemployment benefits which are due to expire at the end of July. There is hope that these benefits may be extended failing which the economy could experience a sharp decline in consumer spending.

U.S. President Donald Trump said the phase one trade deal with China is fully intact after his adviser Peter Navarro created confusion and caused a temporary stock market sell-off with his comments being interpreted as a decision to end the agreement.

The S&P 500 looks to be trying to price in a V-shaped recovery but sector performance would suggest otherwise. Retailers, whose sales rose 17% last month, are doing extremely well particularly those offering on-line services whilst department stores are coming under heavy selling pressure.

Other sectors severely impacted by the virus include airlines, hotels and any travel or leisure business. Household expenditure rose a record 8.2% y/y in May boosted by increased sales in furniture, appliances and motor vehicles.

The HIS/Markit PMI rose sharply in June from 37.0 to 46.8 only marginally below the neutral level of 50 demarcating expansion from contraction. The US economy likely added 3 million jobs in June as more businesses reopened after the coronavirus lockdown. It is the second straight month of employment gains after the economy lost a record 20.5 million jobs in April. However, the job market still has a long way to go to full recovery.

Eurozone

Economic data and business sentiment improved in June as widespread lockdown measures were eased but trading conditions remained subdued. Business sentiment for the remainder of the year improved but employment numbers were under pressure due to a lack of demand. French manufacturing output grew for the first time since February. GDP is indicated to decline by as much as -8.0% in 2020.

The ECB launched a new facility that will provide euro liquidity to a broad set of central banks outside the euro area and US regulators eased restrictions on large banks' investments. Both these moves will add further liquidity to the global economy. Airbus is cutting 15 000 jobs within a year, including 900 already earmarked in Germany, saying its future is at stake after the coronavirus outbreak paralysed air travel.

The IHS Markit Eurozone Composite PMI increased to 47.5 in June from 31.9 in May beating forecasts of 42.4. It is the highest reading in 4 months. The IHS Markit Manufacturing PMI for Germany edged up to 44.6 in June from 36.6 in May and better than market forecasts of 41.5. It is the highest reading in 3 months. The IHS Markit Flash Manufacturing PMI for France increased to 52.1 in June from 40.6 in May, beating market forecasts of 46. The reading pointed to the biggest expansion in the manufacturing sector since September of 2018.

U.K.

Manufacturing output continues to improve following further lifting of restrictive measures which were occasioned by the Covid-19 pandemic. However new orders continued to decline particularly in the aviation and automotive sectors. Nevertheless, business confidence remains positive with optimism at its highest level since 2018. Financial services improved while business in the hotel, restaurant and catering industries remained severely constrained.

Britain's economy shrank by -2.2% in Q1, after showing no growth in Q4 and compared with a preliminary estimate of a -2.0% drop. That was the largest fall in UK GDP since the third quarter of 1979. Retail sales in the UK rose 12% m/m in May ahead of market forecasts of a 5.7% gain and reversing the -18% plunge in the previous month.

Japan

After weakness in early April, the Japanese equity market recovered to record a total return of 11.3%. Although there was some short-term currency volatility in June, the yen remained in a fairly stable range throughout the quarter. The Bank of Japan's Tankan index for big manufacturers' sentiment plunged to eleven-year low of -34 in the second quarter of 2020, worse than market consensus of -31.

Meanwhile, Japan's Consumer Confidence Index posted the highest reading since March,while the Jibun Bank Japan Manufacturing PMI was seen to decline at a slower rate, as sentiment turned positive for the first time since February. Japanese Q2 business confidence is at its weakest in 11 years.

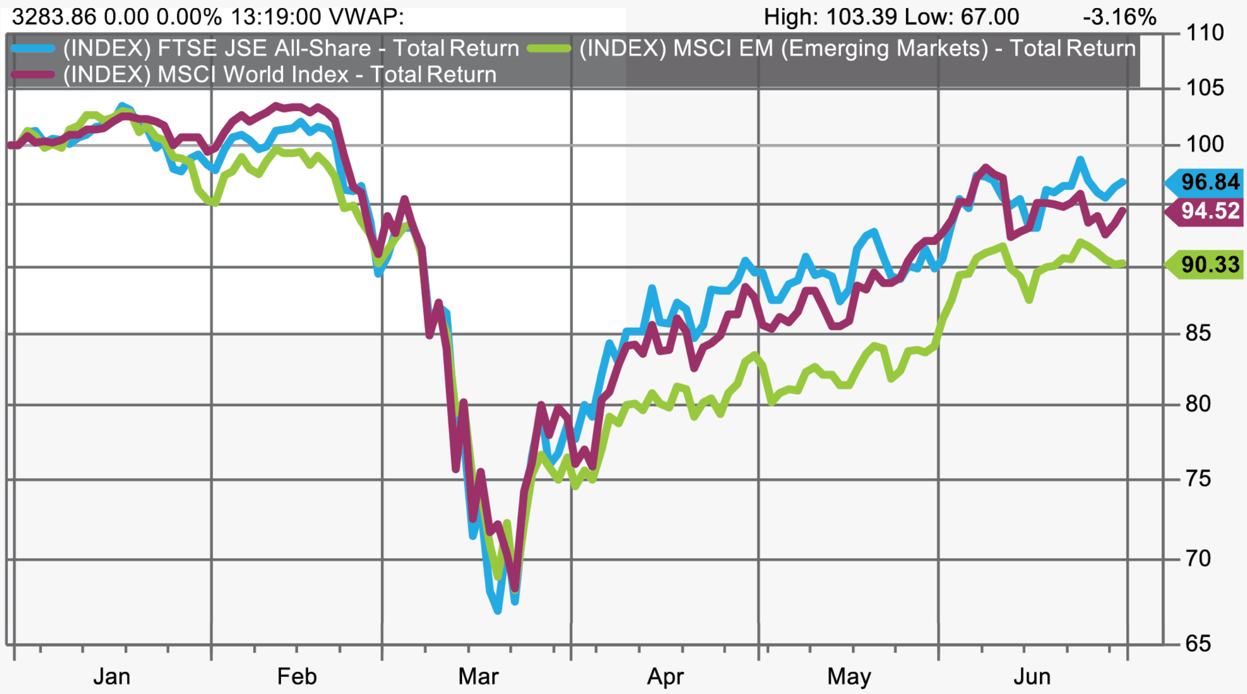
Industrial production in Japan declined by -8.4% m/m in May 2020, compared with market consensus of a -5.6% drop, and after a -9.8% fall a month earlier. This was the fourth straight month of a decline in industrial output.

China

The People's Bank of China pledged stronger fiscal and monetary adjustment and better policy coordination and implementation to help offset the impact of the coronavirus on economic growth. The central bank said it will implement multiple monetary policy tools to maintain liquidity at a reasonable and sufficient level.

The Official NBS Manufacturing PMI in China unexpectedly rose to 50.9 in June 2020 from 50.6 in the previous month and compared with market estimates of 50.4. This was the fourth straight month of increase in factory activity and the strongest since March. The Caixin China General Manufacturing PMI unexpectedly rose to 51.2 in June 2020 from 50.7 in the previous month beating market consensus of 50.5.

FTSE JSE ALL-Share



Source: Factset

June investment market returns (%)	1M	3M	YTD	1YR	3YR	5YR	7YR	10YR
Local Equity (SWIX)	8.07	22.09	-6.33	-6.09	2.00	2.08	7.05	10.61
Local Listed Property	13.41	20.43	-37.56	-39.98	-18.33	-9.06	-2.51	4.68
Local Money Market	0.46	1.52	3.25	6.93	7.21	7.22	6.82	6.49
Local Bonds	-1.18	9.94	0.36	2.85	8.11	7.49	7.30	8.30
Global Developed Shares in USD	2.65	19.36	-5.77	2.84	6.70	6.90	8.38	9.95
Global Emerging Shares in USD	7.35	18.08	-9.78	-3.39	1.90	2.86	3.22	3.27
Global Bonds in USD	0.64	2.04	4.08	4.60	3.98	3.70	2.21	2.37
Oil in USD	8.14	31.31	-42.56	-37.26	-2.97	-12.44	-15.60	-7.76
Rand vs. USD	1.46	2.79	-19.52	-18.84	-8.98	-6.92	-7.69	-7.86

Above indices returns are gross of fees.

Local - Crippling debt

The dramatic recovery of JSE equities from the catastrophic nosedive towards the end of the first quarter brought great relief to investors. Whilst some comfort can be taken from this performance prudence would suggest that the market is not yet out of the woods and that considerable headwinds remain.

The magnitude of the market movement is highlighted in the performance numbers for the quarter. The JSE/ALSI returned 23.18%, the Top40 24.18%, the Financial sector 11.09%, the Industrial sector 16.59% and resources a whopping 40.63%.

However, despite these excellent quarterly returns, when taken on an annual basis the ALSI is still down -3.30%, Financials down -36.93% while Resources and Industrials are up 11.69 % and 4.04% respectively.

Finance minister Tito Mboweni's supplementary budget failed to address certain key issues but the proposed debt levels were alarming. More certainty and clarity are required to inspire investor confidence but take note that tax increases of R40bn over the next four years will also be required.

The government will announce details of these tax proposals in the 2021 budget. The medium-term budget policy statement scheduled for release in late October will be key. For the current budget to succeed we certainly need an agreement with unions on proposed employment and wage reductions.

The Supplementary Budget

The consolidated budget deficit is expected to reach 15.7% of GDP for the current financial year 2020/2021. Debt levels will rise to 81.8% of GDP by the end of this fiscal year. This is compared to an estimate of 65.6% of GDP projected in February. Consolidated debt will increase to R4 trillion.

Government aims to stabilise debt at 87.4% percent of GDP in 2023/24 and is aiming for a surplus that year. In terms of GDP the Treasury expects negative growth of -7.2%, the largest contraction in nearly 90 years. It also expects the revenue shortfall to exceed R300bn. The government also intends borrowing $7bn (R121bn) from international finance institutions such as the IMF, World Bank etc. In terms of Covid-19, R21.5bn has been allocated for healthcare relief.

The South African economy recorded its third consecutive quarter of economic decline of negative -2.0% in Q1 of 2020.This followed a contraction of -1.4% and -0.8% in Q4 and Q3 of 2019, respectively. Market expectations were for a -4.0% decline.

Mining and manufacturing were the most significant detractors to the economy's performance in Q1. Mining activity slowed by -21.%, the manufacturing industry by -8.5% and construction registered its 7th consecutive quarter of decline down by -4.7%.

Agriculture recorded a particularly good quarter rising by 27.8%. This was on the back of favourable weather conditions and a rise in agricultural exports. The full impact of Covid-19 on SA's economy is only expected to reflect in GDP data for Q2 and Q3 of the year.

South Africa recorded its first current account surplus in 17 years in Q1 of 2020. The current account swung to a surplus of 1.3% of GDP, or R69.7 billion in January - March from a deficit of -1.3% of GDP or R68 billion in the previous three months. The last recorded surplus was in Q1 of 2003.

The economy probably contracted more than -30% in the second quarter when restrictions to curb the spread of the coronavirus halted almost all activity for five weeks, according to the Reserve Bank. The annualised decline in GDP is forecast at -32.6% for the three months through June from the previous quarter the Reserve Bank said.

We live in turbulent and uncertain times which is reflected in the volatility that is being experienced in both global and domestic stock markets.

The investment team at GTC is indeed conscious of the necessity to minimise downside market risk and has implemented and will continue to implement the appropriate investment strategies to mitigate against this possibility. Recent market behaviour has certainly been a salutary lesson in avoiding trying to time the market.

Nevertheless, these performances underscore the need to remain invested in terms of your long-term investment objectives as market volatility remains at heightened levels.

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