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Trendline

Third quarter 2020

Outlook

The year 2020 continues to surprise and will certainly be remembered as a year of almost unprecedented stock market volatility. It has so far witnessed a pandemic, a shutdown of the global economy, the deepest recession since the 1930s followed by a global equity market collapse and subsequently, earlier in the quarter, record highs for U.S. equity markets.

Markets generally experienced some consolidation and correction during September but delivered positive quarterly returns. A risk on attitude emerged in terms of emerging markets and the MSCI Emerging Markets Index outperformed the MSCI World Index delivering 9.56% and 7.93% in dollar terms. However, this performance needs to be viewed against the backdrop of market returns for the year to date with the MSCI World Index delivering 1.70% and the MSCI Emerging Market Index a negative -1.16%.

U.S. markets rose in Q3 on the back of continuing facilitating Federal Reserve monetary policy and early signs of a pickup in economic activity. The Federal Reserve will now employ average inflation targeting in setting interest rates which is indicative of prolonged liquidity easing.

Eurozone equities remained flat as coronavirus infections continued to rise sharply in various countries in spite of local restrictions being imposed to halt the spread of the virus. The MSCI EMU Index for European markets returned 0.2% for the quarter but remained negative for the year to date.

U.K. equities continued to decline over the quarter extending their global underperformance as stocks in the financial and oil sectors came under renewed selling pressure.

Emerging markets advanced, outperforming their developed market peers in spite of an acceleration in new cases of Covid-19 in certain countries and an escalation in US-China tensions. Emerging markets strong performance has been helped by China's remarkable success in containing the virus.

Global government bond yields were little changed save for some European yields declining on the back of the announcement of the Euro 750 billion economic recovery fund. In spite of best efforts in the form of fiscal and monetary stimulus the JSE/FTSE continued its lackluster performance. The rand recovered from its lows to close the quarter at R16.67/$ gaining 4.7% over the quarter.

Global - A vaccine imperative

Even though September ended as a down month, overall Q3 was positive. All the major indices improved over the quarter the S&P 500 up 8.2%,the NASDAQ up 11.0% and the Dow Jones Industrial Average up 7.4%. Big Tech (Amazon, Apple, Alphabet, Facebook and Microsoft) counters were some of the best-performing stocks over the past quarter.

The Federal Reserve's use of average inflation targeting suggests that rates could be almost zero bound up to and including 2023. Markets reflected ongoing uncertainty in the later part of Q3 amid a resurgence of the virus in Europe as well as a continuation of the number of new cases in various U.S. States.

Adding to the uncertainty is the upcoming Presidential election on 3 November with its inherent problems. U.S. unemployment numbers declined down to 8.4% in August from July's 10.2% and below consensus of 9.8%.

The provision of additional fiscal stimulus measures remains deadlocked as the parties, Democrats and Republicans, dispute as to the quantum of the s timulus to be provided. Industrial production continued to improve in August but at a considerably slower rate than previously. Retail sales also showed signs of improvement with food and beverage counters remaining particularly sought after.

Consumer discretionary counters were in demand particularly those involved in distribution as online shopping became the order of the day. Airline companies were under pressure as passenger numbers declined sharply. Energy stocks also came under selling pressure as demand for fuels declined sharply.

Eurozone

Eurozone equity markets delivered an almost flat performance over the quarter in local currency terms. Economic data continued to disappoint and sharply rising Covid-19 infections especially in France and Spain had a profoundly negative effect on local markets.

New restrictions to contain the virus were announced although these were specific to the areas rather than to the Eurozone as a whole. Financial and energy stocks both came under selling pressure with consumer discretionary being the exception and advancing.

Of major significance was the announcement by the EU of the scale of the recovery fund which was approved after protracted and at times fiery negotiation. The fund will consist of Euro 390 billion in grants and Euro 360 billion in loans. The magnitude of this recovery package is likely to have a marked effect on particularly those economies worst impacted by the coronavirus.

Various European countries extended their furlough schemes which are designed to assist jobs for the duration of the crisis. Business activity declined with the PMI declining from 51.9 in August to 50.1 in September. Eurozone annual inflation came in at a negative -0.2% in August following July's positive 0.4%.

U.K.

Renewed fears surrounding a contentious Brexit continued to negatively impact investor confidence whilst fears of a second wave of Covid-19 did little to improve market sentiment. Rising infection rates necessitated the reimposition of localised restrictions once again impacting on consumer spending.

This in turn resulted in U.K. focused and mid-cap equities in particular performing badly. In line with global markets counters in the financial and energy sectors also came under considerable selling pressure. Sterling strength against a weaker dollar weighed particularly on internationally exposed large-cap counters. Considerable merger and acquisition interest was displayed by overseas companies in U.K. quoted companies.

Emerging Markets

Emerging markets were the star performer for the quarter led by a surge in Chinese economic activity. The MSCI Emerging Market Index increased in value and outperformed the MSCI World Index. This was evidenced by the Chinese economy growing 3.2% y/y in Q2 of 2020, reversing a -6.8% contraction in Q1 and beating market consensus of 2.5% growth amid relaxed lockdown measures. China's economic recovery is however somewhat vulnerable to losing momentum as key trading partners struggle with resurgences of the deadly coronavirus and resort to fresh measures to control its spread.

Tensions with the U.S. escalated during the quarter including new restrictions on Chinese company Huawei and President Trump's executive order preventing US companies from doing business with TikTok and WeChat. Chinese Q2 earnings results were also ahead of expectations particularly in the e-commerce sector.

Global Bonds

Global bonds were certainly risk on in markets over the quarter underpinned by the gradual reopening of global economies, hopes of a Covid-19 vaccine, as well as government economic policy measures. The Federal Reserve announced its change to its inflation targeting regime in August indicating it would target an average 2% inflation rate but allow for periods of overshoot. This was well received by markets. Corporate bonds enjoyed a positive quarter as riskier assets became more attractive and government monetary policy helped consolidate yields at lower levels.

Domestic - Implementation is key

The JSE/FTSE All Share performance for the quarter was somewhat pedestrian but nevertheless remained positive returning 0.67% with the JSE/FTSE SWIX delivering -0.33%. Covid-19 escalated during the quarter but the authorities have to be congratulated on the manner in which the pandemic was managed.

Most market sectors delivered lackluster or negative performance as both political and economic uncertainty continued to undermine investor confidence. Overall market performance was fortunately supported by rallies in both gold and platinum counters which both attracted increased demand.

The Resources sector returned 5.71% for the quarter and was by far the best performer. Financials managed to muster a positive return of 0.47% despite having come under repeated selling pressure. The Industrial sector eased as Naspers sold off in line with global tech stocks delivering a negative -2.29% for the quarter. The Property sector came in for a hammering as work from home became the accepted norm and declined a negative -14.14%.

South Africa lost 2.2 million jobs in Q2 due to the lockdown. This has sent unemployment, as per the extended definition, to over 40%. The official jobless rate fell from 30.1% to 23.3%. This is due to the official definition excluding unemployed people who are not actively looking for a job. The extended definition, which includes these people, rose from 39.7% to 42%. Most worrying is that unemployment in the age group 15-24 is standing at over 52%.

Infrastructure initiatives under consideration could be important contributors to lifting South Africa out of its current low-growth trap. An estimated R1.5 trillion is needed to fund the projects over the next decade. However, the private sector is ready to fund them as long as they are well structured and managed, that investors are compensated for the risk they are taking and that the projects ultimately have policy certainty.

The key is implementation.

South Africa plans to tap the global appetite for green bonds to help fund an infrastructure programme worth as much as R2.3 trillion over the next decade. Winning over the private sector and streamlining the project-approval process will be key to the drive. In July, 62 priority projects were announced in the first stage of the programme. There is a shortage of R140 billion in phase one, and a large part of that will come from green bonds.

Concerns about the capacity of South Africa's depleted and financially-distressed construction industry to deliver the government's massive infrastructure investment plan have been downplayed by industry analysts. However, there are concerns about how long it will take for any of the Strategic Infrastructure Projects to be awarded, as well as corruption in the tender process.

Following the commitments made in the state-of-the-nation address in February, government has now gazetted ministerial determinations that will enable the development of more than 11.8GW of additional power generation. To give a sense of the scale of this development, South Africa currently has in the region of over 30GW of electricity available on the national grid each day.

South Africa is banking on a rejuvenation of its depressed mining industry to help counter the economic downturn brought about by the coronavirus. The need to rebuild investor confidence in the sector was identified as key to an economic recovery plan that was agreed by the government and business and labour representatives. They undertook to jointly develop a strategy within three months to target 3% of global exploration expenditure and halve the time it currently takes to secure all mining, prospecting and environmental licenses.

Finance minister Tito Mboweni has agreed the fiscus will finance SAA to the tune of R10.4bn but he insists it will be done in a "fiscally neutral way". That means the fiscal framework, as articulated in the June supplementary budget, will remain sacrosanct and no additional debt will be taken on to finance SAA. The additional money will have to come from existing budget allocations.

The Reserve Bank's monetary policy committee left the benchmark interest rate unchanged at 3.5% even as it revised down its forecasts for growth in an economy still navigating its way through the fallout from the coronavirus shock. The Bank revised its GDP forecasts and is now expecting the economy to shrink -8.2% in 2020, compared to the -7.3%contraction forecast in July. It now expects the economy to grow by 3.9% in 2021 and by 2.6% in 2022. Plans to nationalise the SA Reserve Bank will be shelved as the government tries to get the coronavirus-stricken economy back on track.

The Absa manufacturing business confidence index rose to 22 index points in the third quarter of 2020. This is after the sector had come to a near standstill in April 2020, which led to manufacturing business confidence collapsing to an all-time low of 6 index points in the second quarter of 2020.

The advent of a second wave of Covid-19 in both Europe and the U.K. reminds us that the global battle over the pandemic is far from over and until a vaccine is widely available, economies will likely remain constrained by measures aimed at slowing the spread of the disease. To maintain economic impetus governments need to continue to support consumer incomes and businesses and more importantly need to ensure that policy decisions are implemented.

Investment market returns as at September 2020

Investment market returns (%)	1M	3M	YTD	1YR	3YR	5YR	7YR	10YR
Local Equity (SWIX)	-1.63	-0.33	-6.64	-2.19	-0.39	2.89	5.38	9.11
Local Listed Property	-2.97	-14.14	-46.38	-46.07	-23.80	-12.85	-4.43	1.78
Local Money Market	0.35	1.16	4.38	6.20	6.93	7.11	6.80	6.43
Local Bonds	-0.05	1.45	1.82	3.58	7.33	7.57	7.24	7.62
Global Developed Shares in USD	-3.45	7.93	1.70	10.41	7.74	10.48	8.34	9.37
Global Emerging Shares in USD	-1.60	9.56	-1.16	10.54	2.42	8.97	3.74	2.50
Global Bonds in USD	-0.22	2.94	7.14	6.77	4.37	3.95	2.22	1.86
Oil in USD	-8.17	-0.23	-42.69	-33.41	-7.62	-6.98	-16.56	-8.46
Rand vs. USD	-0.69	-3.17	20.32	10.96	7.61	3.92	7.58	9.20

Above indices returns are gross of fees.

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