Cinnabar Monthly Insight: June 2020

Where the first quarter of 2020 was terrible for markets, the second saw an almost complete recovery. The US equity market did momentarily recover all its losses rising 20% during the quarter to end the first half of the year down only 4%. The South African All Share Index similarly advanced 22% during the last three months to hit -4.8% on a YTD basis. The main difference between the two indices is that the South African rand remains over 19% weaker than it was at the end of 2019, having strengthened less than 3% during the last quarter.

Our portfolios have done well as a whole during the first six months on a relative basis. During the first quarter, the portfolios fell less than peers, and by topping up our equities, we took advantage of the low prices and hence enjoyed much of the swift rebound. Our view and positioning continue to be bullish on growth assets, in particular equities. Interest rates will stay low for the foreseeable future as central banks artificially restrain yields through their stimulus programmes. The US equity market on face value does appear to be relatively expensive, and hence we are considering other regions with cheaper valuations. However, we cannot discount the disproportionate stimulus thrown at the US market compared to other developed markets.

The disparity of returns of different managers within the various fund categories is highest in many years, caused by split views on whether the market has entered a new bull market or has simply experienced a profound bear market bounce. The recent second wave of positive Coronavirus cases has continued to shake equity markets. Still, we believe that the recovery is well on its way with vaccines becoming available in the next six months to a year. The critical concern is how much will economies be permanently damaged by having been effectively turned off for several months.

Looking past the virus, we see exacerbated global trade tensions with a continuing rivalry between the US and China, as well as Brexit, representing a trend toward deglobalisation. Emerging markets, which have drastically underperformed over the past decade, are likely to be the source of much of global growth in the next. However, in the shorter term, they will likely struggle to recover from the COVID-19 crisis simply because many emerging market countries have weak health systems and far less money to stimulate and restart their economies.

We are encouraged by the differing recoveries of countries and regions, as this provides an excellent opportunity for diversification which is the best risk mitigator for portfolios.

Market Update

United States of America

Q2 2020 has seen reopenings around the globe, but unfortunately for the US has also caused a second wave of COVID-19, and the end of the quarter saw virus numbers passing 2.5 million in the US alone. A GDP estimate made by the Atlanta Fed shows the US economy falling by -32.5% in Q2. The US dollar likewise weakened over 5% from a March high to end 97.34 on June 30th, where a 100 reading would indicate equal value as measured against a basket of currencies. The

US Manufacturing PMI, however, saw much better news, increasing over 25% to end June at 49.80, just below the level which marks an expansion of manufacturing activity. Unemployment also looked favourable in June, with 4.8 million jobs added, but the unemployment rate still sits at 11.1% - higher than any previous period since WWII. The S&P 500 saw a rally in Q2 of over 25%, its biggest quarterly gain since 1998, riding a wave of momentum from the market low of $2,237 on March 23rd to hit $3,100 on June 30th. Stimulus measures have investors convinced that this is not the last of the market's gains for the year.

UK

Revised GDP estimates for Q1 saw GDP sinking 2.2%, the most significant drop since Q3 1979. Earlier estimates had underestimated the negative drag that imports and exports experienced, as well as worse readings than expected for household (-2.9% down from est -1.7%) and government consumption (-4.1% down from est -2.6%). Rebound in the manufacturing sector saw June's reading rising to 50.1, reflecting the first expansion in manufacturing activity since February. Consumer confidence increased slightly to -30 from May's reading of -34, the lowest reading since the financial crisis. The UK stock market did not experience the same rebound as other developed markets, coming back only 23% from its March low, and rising only 13% during the second quarter. Headwinds to the market rally include rocky Brexit talks and the makeup of the UK's stock market, with a significant allocation to the heavily hit financial and energy sectors.

Europe

Even though Europe's GDP saw only a 0.1% growth in Q4 2019, the EU was one of the few areas that saw an upwardly revised Q1 2020 reading, confirmed at -3.6% from an original estimate of -3.8%. The EU's manufacturing PMI has also seen favourable movement, increasing in June to a reading of 47.30. Unemployment remains relatively close to March's record low of 7.1%, coming in at 7.4% in May, although the youth unemployment rate spiked to 16%. The inflation rate in the EU area had hit a four year low of 0.1% in May, and June estimates show improvement at 0.3%. A significant 750 billion Euro stimulus package has buoyed investors' sentiments about the area recently, even though the package still has to go through negotiations among all 27 EU leader members. The is one of the smaller announced relief efforts; hence many doubt it is enough to keep investor sentiment up.

Japan

Japan was another area that saw a better than expected GDP growth revision, confirming a reading of -0.6% in Q1 2020 versus an original estimate of -0.9%. Although unemployment increased in May, Japan still has one of the developed world's lowest readings at 2.9%, which is its highest reading since May 2017. Manufacturing numbers, however, while only rising above an expansionary level of 50 once in 2019, came in at only 40.1 in June. The reading signalled a 14th consecutive month of contraction. May's year-over-year inflation reading of -0.2% marked the second month in a row of adverse price movement – long a struggle in the Japanese economy. The Nikkei 225, which experienced over a 30% drop in Q1 like most other developed economies, has seen a healthy rebound of 34% from its March 19th market low, likely boosted by the highest pledged stimulus to GDP ratio in the world.

China

China's revised Q1 2020 GDP growth reading of -9.8% marked the first-ever quarterly GDP contraction on record. However, Q2 is estimated to show a positive reading of 1.1%, as China's economy was the first to reopen during the second quarter. Experts credit the swift Chinese recovery to the Chinese government's strict handling of the Wuhan outbreak and subsequent smaller outbreaks that were aggressively and successfully managed. Manufacturing numbers also look good, with the Caixin Manufacturing PMI hitting above 50 for the second month in a row, showing a sharp rebound for Chinese production. Unemployment also came down to 5.9% in May, down from 6% in April, although inflation took a dive and hit the lowest level in 14 months at 2.4%. The typical economic indicators don't tell the story of China's current political struggles. New national security laws aimed to quash dissent and limit Hong Kong's system of self-governance will strip Hong Kong of some of its autonomy which has been in place since the handover of Hong Kong from the British in 1997. Several governments around the world, including the US, have condemned the move and are taking action to protect or monitor their ties to the specially administered region as business confidence in the area erodes.

South Africa

A transition to a 'lighter' restriction lockdown level 3 in June saw the return of the sale of alcohol as well as the opening of several businesses including beauty salons and restaurants. Q1's GDP estimate of -3.8% was revised to -2% after positive surprises in the agriculture and finance/business activity sectors prevented a harder hit. Nevertheless, South Africa's GDP is expected to contract drastically in Q2 considering Levels 4 and 5 of lockdown prevented most of the economy from working. Unemployment hit the highest jobless rate on record since quarterly data became available in 2008, hitting 30.1% for Q1 and expected to grow even direr in Q2. Inflation fell mostly due to oil price to 3% in April, the lowest rate since 2005 and still within the SA Reserve Bank's target range of 3% - 6%. Positive news came in the form of the manufacturing sector bouncing back and hitting 53.90 in June, showing substantial expansion after hitting its lowest level since the financial crisis in February. The stock market too has seen a healthy rebound since its March 19th lows, returning over 20% in Q2 alone, marking the best performance of any quarter since 2001. The surge seems to be attributed to mining companies (particularly gold) and tech giants like Naspers. However, the return of risk appetite driven by the developed markets run has also been a factor.

Sources: WSJ, BizNews, Trading Economics, MoneyWeb

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As At 30 June 2020	YTD	Last Month	Last Quarter	1 Year	2 Years	3 Years	5 Years	10 Years
South African Asset Classes								
STeFI Call Deposit ZAR	2.7	0.3	1.1	6.0	6.3	6.5	6.5	5.9
Beassa ALBI TR ZAR	0.4	-1.2	9.9	2.8	7.1	8.1	7.5	8.3
FTSE/JSE SA Listed Property TR ZAR	-37.6	13.4	20.4	-40.0	-22.2	-18.3	-9.1	4.7
FTSE/JSE All Share TR ZAR	-3.2	7.7	23.2	-3.3	0.5	5.1	4.2	10.9
FTSE/JSE Market Capitalisations								
FTSE/JSE Small Cap TR ZAR	-20.9	11.3	17.2	-22.9	-17.1	-11.6	-5.8	6.5
FTSE/JSE Mid Cap TR ZAR	-25.7	6.1	15.4	-17.6	-6.9	-3.5	-0.6	8.0
FTSE/JSE Top 40 TR ZAR	0.4	7.8	24.2	-0.5	2.0	6.7	4.8	11.2
FTSE/JSE Sectors								
FTSE/JSE Ind/Financials TR ZAR	-31.7	4.2	12.9	-34.5	-16.8	-8.5	-5.3	7.9
FTSE/JSE SA Industrials TR ZAR	6.8	8.3	16.6	4.0	0.1	2.5	3.3	14.6
FTSE/JSE SA Resources TR ZAR	5.5	8.8	41.2	12.4	16.7	24.6	10.5	5.0
Global Equities in ZAR								
FTSE/JSE All Share TR ZAR	-3.2	7.7	23.2	-3.3	0.5	5.1	4.2	10.9
MSCI World Free GR USD	17.4	1.2	16.3	27.4	18.4	17.9	15.5	20.0
MSCI EM GR USD	12.2	5.9	15.0	19.5	11.7	12.4	10.9	12.5
S&P 500 TR USD	20.4	0.5	17.3	32.5	22.7	21.7	19.0	23.7
FTSE 100 TR GBP	-3.7	0.1	5.8	3.1	1.9	6.3	5.4	13.1
Nikkei 225 Average TR JPY	19.3	0.4	14.8	31.7	16.5	17.8	14.6	18.3
SSE Composite PR CNY	19.7	4.2	5.9	19.9	11.6	5.9	-2.6	10.5
Global Equities in USD								
FTSE/JSE All Share TR ZAR	-22.1	9.3	26.6	-21.5	-10.8	-4.3	-3.0	2.2
MSCI World Free GR USD	-5.5	2.7	19.5	3.4	5.2	7.3	7.5	10.6
MSCI EM GR USD	-9.7	7.4	18.2	-3.0	-0.7	2.3	3.2	3.6
S&P 500 TR USD	-3.1	2.0	20.5	7.5	9.0	10.7	10.7	14.0
FTSE 100 TR GBP	-22.5	1.6	8.8	-16.3	-9.5	-3.3	-1.9	4.2
Nikkei 225 Average TR JPY	-4.0	1.9	18.1	6.9	3.5	7.2	6.7	9.0
SSE Composite PR CNY	-3.6	5.7	8.8	-2.7	-0.9	-3.6	-9.4	1.8
Commodities in USD								
S&P GSCI Copper Spot	-2.5	12.1	21.6	0.3	-4.8	0.5	0.9	-0.8
LBMA Gold Price PM USD	16.7	2.3	9.9	25.5	18.9	12.5	8.6	3.6
Oil Price Brent Crude PR	-37.7	16.5	81.0	-38.2	-28.0	-5.0	-8.3	-5.9
LBMA Platinum PM PR USD	-14.5	-1.3	12.0	-0.5	-2.2	-4.1	-5.5	-6.1

Source: Morningstar Direct, annualised returns are presented for periods longer than 1 year.

	2020/06/30	YTD	Last Month	Last Quarter	1 Year	2 Years	3 Years	5 Years	10 Years
Currencies									
US Dollar	R 17.37	-19.2%	1.4%	2.8%	-18.8%	-11.1%	-9.0%	-6.9%	-7.9%
Euro	R 19.44	-18.9%	-0.1%	0.9%	-17.1%	-9.1%	-8.4%	-6.8%	-7.0%
Pound Sterling	R 21.47	-13.6%	1.5%	3.2%	-16.4%	-8.2%	-7.5%	-2.3%	-6.1%

Source: Quandl as at 30 June 2020.

Sources: New York Times, Trading Economics, Bloomberg, IMF, Cinnabar Investment Management, The Economist