CINNABAR

Cinnabar Monthly Insight: July 2020

The beginning of quarter three of 2020 has seen the trends of quarter two continue. Equity markets continue to advance higher. The US markets are pushing to record territory no matter how the country's infections increase. The stimulus and the yearn for positive markets may be irrationally driven by the sentiment of summer in the Northern Hemisphere. The US dollar lost ground as a "risk-on" environment continued.

The tensions between the US and China are escalating, and it would be difficult to see this dissipating in the run-up to the US presidential election. Prior to the pandemic, we did not see these tensions escalating, particularly from the US side. President Trump had a strong economy under his watch and maintaining this for his re-election campaign relied on strong trade with China. Fast-forward half a year and the economy is in the worst situation in a generation, so this does not help his campaign.

Here in South Africa, it is increasingly difficult to find any positive points on which to focus. Our equity market did have a good month and quarter, and the Rand did strengthen versus the US dollar. Unfortunately, this seems to be more the US dollar weakening than anything else. Against Pounds Sterling and the Euro, the Rand lost ground to the end of July and has continued to fall so far in August. We do not see much support for a strengthening Rand, other than foreigners investing in our bond market (which has seen inflows in June and July). Unfortunately, this is negated by the constant drag (for the past two years) of our equity market.

We continue to favour global equities and rand hedge equities in South Africa. We have made some changes to our SA based funds, selling out of PSG Flexible and adding Ninety One Opportunity. Historically managers that have more of a quality investment style are more likely to outperform in a bear market. At the same time, we still maintain an allocation to value/contrarian managers who typically recover quickest when a new bull market begins.

There is debate over when a vaccine will be ready; however, almost all sources say it won't be this year. The announcements will undoubtedly cause further positive momentum in equity markets. Coupled with the mantra "Don't Fight The Fed" in terms of the stimulus, we are maintaining a reasonably large allocation to equities.

Market Update

United States of America

The second quarter saw financial markets rally, reversing the decline in the first quarter. The recovery in shares was driven by the combined fiscal and monetary policy response, brought on by the federal government and the Federal Reserve. It is through this combination that uncertainty amongst companies and investors has been reduced in the near term. However, it is only when an effective vaccine is available for delivery to billions of people globally, will the root cause of all this uncertainty, the COVID-19 pandemic, ease. Until then, advanced

Sources: Trading Economics, Focus Economics, MoneyWeb

estimates show the US economy is set to shrink by an annualized 32.9% in the second quarter, its most significant contraction ever. The Federal Reserve left the target range for its federal funds' rate unchanged at 0-0.25% with policymakers reiterating the Fed will keep the federal funds rate near zero until the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals. In June, the annual inflation rate increased to 0.6%, with retail sales surging 7.5% month-over-month. The IHS Markit US Manufacturing PMI came in at 50.9 in July compared to June at 49.8, suggesting the economy is moving in the right direction.

<u>UK</u>

UK equities had progressed steadily since hitting year-to-date lows back in March when the UK government announced the lockdown, but not without volatility. Volatility was driven by a combination of central bank stimulus actions, continued concerns over a "second wave" of the virus, and a volatile oil price. This dynamic is likely set to continue over the coming quarters. Looking back at May, Britain's gross domestic product tumbled 24%, which is a slight improvement from April's contraction of 25.3%. Rishi Sunak, Britain's finance minister, announced more measures to help the UK economy. Companies that bring back furloughed workers will be given a £1 000 bonus for each job saved. Stamp duty will be suspended until March for home purchases of less than £500 000. In other economic indicators, UK inflation edged up to 0.6% in June from 0.5% in May. With lockdown restrictions easing, consumers are slightly more optimistic, with the United Kingdom's Gfk Consumer Confidence rising to -27 in July. Although the number of people claiming unemployment related benefits in the UK decreased by 28 thousand, unemployment has stayed stagnant at 3.9% for the three months ending May as more people who are out of work are not looking for a job.

<u>Europe</u>

Governments and central banks put forward an aggressive and globally coordinated monetary and fiscal response to mitigate the effects of the COVID-19 pandemic. This response calmed equity markets after a volatile first quarter. As part of this response, European leaders have agreed on a €750 billion recovery fund to rebuild EU economies severely affected by the coronavirus crisis. The fund will comprise €390 billion in grants to the hardest-hit EU states, with the rest provided as low-interest loans. During its July meeting, the European Central Bank left monetary policy unchanged, with the main refinancing rate at 0% and the deposit rate at its record low of -0.5%. Policymakers are taking a wait and see approached to assess the effectiveness of a series of unprecedented measures taken over the past four months to support the bloc's economy. Manufacturing PMI crept across the 50 mark, coming in at 51.8 for July up from 47.4 in June. However, consumers are less optimistic with confidence shrinking to -15 points in July from -14.7 points in the previous month.

<u>Japan</u>

After reopening its economy and doing a comparatively decent job containing the spread of COVID-19, the country still faces obstacles to trade in the tech sector. Despite these obstacles, the Japanese economy could see strong growth in the coming quarters. Looking back on the first quarter, the Japanese economy contracted by 0.6%, which follows a contraction of 1.9% in the previous period. This took Japan into its first recession since 2015. The Japan Manufacturing PMI came in at 45.2 for July, up from 40.1 in the last month. Consumers seem more optimistic with the recovery process; the Consumer Confidence Index reached its four-month high, increasing to 29.5 in July. Unemployment edged down from 2.9% to 2.8% in June. Inflation stays at its three year low of 0.1% with the Bank of Japan keeping its key short-term interest rate at -0.1% and maintaining the target for the 10-year Japanese government bond yield at around 0% during their July meeting. The Japanese government has also become ever more aggressive in both monetary and fiscal policy. Prime Minister Shinzo Abe has managed to pass two stimulus bills which together amount to 3%–4% of GDP. Before these events, Japan's debt levels had been on a steady downward trajectory.

China

After reopening its economy without a significant second wave of infections, China's economy returned to growth in the second quarter due to a gradual normalization of work and production. Second-quarter GDP expanded by 11.5% after contracting 9.8% in Q1 with year-on-year growth rebounding to 3.2%. Purchasing Managers' index releases have indicated a notable improvement in business confidence in China as it ramps up production, which in turn will benefit their trading partners as demand improves. A third consecutive expansion in factory activity sees the Caixin China General Manufacturing PMI rising to 52.8 in July up from 51.2 in the previous month. With this continued recovery from the initial impact of the COVID-19 pandemic, policy officials remain comfortable with the degree to which monetary policy is supporting domestic activity and have left rates unchanged at the monthly review. In the political arena, trade has once again come to the fore in US-China relations, with potential consequences for all emerging markets.

South Africa

South Africa's economy worsened further in the second quarter after GDP fell at its sharpest rate in a year during Q1. After reaching a seven-year high of 53.9 in June, manufacturing PMI fell to 51.2 in July. Consumer confidence plunged in the second quarter to -33 from -9 in the prior period, reflecting the impact of movement restrictions imposed by the nationwide lockdown. Though inflation ticked up marginally from 2.1% to 2.2% in June and well below the SA Reserve Bank's target range of 3% - 6%, the South African Reserve bank slashed the repo rate by 25bps to an all-time low of 3.5% last month, this following a move of a 50bps cut in May. In late July, the IMF approved South Africa's Rapid Financing Instrument credit facility of $4.2 billion. South Africa would need to repay the RFI financial aid in 3.25 to 5 years. The Reserve Bank leading, coincident and lagging composite business cycle indicators, have all decreased month-to-month during May, signalling a further contraction in the South African economy. This can be expected as containment measures are set to hammer household and capital spending, while depressed foreign demand will negatively impact the external sector.

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Sources: Trading Economics, Focus Economics, MoneyWeb

As At 31 July 2020	YTD	Last Month	Last Quarter	1 Year	2 Years	3 Years	5 Years	10 Years
South African Asset Classes								
STeFI Call Deposit ZAR	3.0	0.3	1.0	5.8	6.2	6.4	6.5	5.9
Beassa ALBI TR ZAR	1.0	0.6	6.4	4.2	6.1	7.8	7.4	7.9
FTSE/JSE SA Listed Property TR ZAR	-39.5	-3.2	9.0	-41.2	-23.3	-20.2	-10.5	3.7
FTSE/JSE All Share TR ZAR	-0.7	2.6	10.8	1.6	1.9	3.6	4.6	10.3
FTSE/JSE Market Capitalisations								
FTSE/JSE Small Cap TR ZAR	-19.9	1.3	9.1	-22.3	-15.9	-11.4	-5.5	6.4
FTSE/JSE Mid Cap TR ZAR	-24.4	1.7	8.1	-14.5	-6.4	-4.4	0.1	7.4
FTSE/JSE Top 40 TR ZAR	2.8	2.4	10.9	4.6	3.4	4.9	5.1	10.6
FTSE/JSE Sectors								
FTSE/JSE Ind/Financials TR ZAR	-31.4	0.4	1.2	-29.7	-18.5	-9.9	-5.9	6.9
FTSE/JSE SA Industrials TR ZAR	5.4	-1.3	5.0	1.5	0.5	0.2	2.8	13.5
FTSE/JSE SA Resources TR ZAR	15.1	9.0	25.2	29.3	22.7	23.0	14.4	5.3
Global Equities in ZAR								
FTSE/JSE All Share TR ZAR	-0.7	2.6	23.2	1.6	1.9	3.6	4.6	10.3
MSCI World Free GR USD	20.6	2.7	16.3	29.5	20.9	17.7	14.8	20.0
MSCI EM GR USD	19.9	6.9	15.0	28.5	16.8	12.4	13.1	12.9
S&P 500 TR USD	24.7	3.5	17.3	34.5	25.4	22.0	18.4	23.9
FTSE 100 TR GBP	-3.9	-0.3	5.8	4.0	3.7	5.1	4.1	12.3
Nikkei 225 Average TR JPY	16.2	-2.6	14.8	27.1	17.6	16.1	13.0	18.1
SSE Composite PR CNY	31.9	10.2	5.9	33.8	21.0	8.0	1.6	11.0
Global Equities in USD								
FTSE/JSE All Share TR ZAR	-18.4	4.6	26.6	-15.4	-10.6	-4.8	-1.5	1.4
MSCI World Free GR USD	-0.9	4.8	19.5	7.8	6.0	8.1	8.1	10.2
MSCI EM GR USD	-1.5	9.0	18.2	6.9	2.5	3.2	6.5	3.7
S&P 500 TR USD	2.4	5.6	20.5	12.0	10.0	12.0	11.5	13.8
FTSE 100 TR GBP	-21.1	1.8	8.8	-13.4	-9.1	-3.4	-2.0	3.2
Nikkei 225 Average TR JPY	-4.6	-0.6	18.1	5.8	3.1	6.6	6.4	8.5
SSE Composite PR CNY	8.3	12.4	8.8	11.4	6.1	-0.8	-4.3	2.0
Commodities in USD								
S&P GSCI Copper Spot	4.0	6.7	23.9	8.3	1.0	0.3	4.2	-1.3
LBMA Gold Price PM USD	29.7	11.1	15.4	37.6	26.9	15.7	12.3	5.3
Oil Price Brent Crude PR	-34.4	5.2	71.3	-33.6	-23.6	-6.3	-3.7	-5.5
LBMA Platinum PM PR USD	-4.9	11.2	18.0	3.7	4.4	-1.2	-1.6	-5.3

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

	2020/07/31		YTD	Last Month	Last Quarter	1 Year	2 Years	3 Years	5 Years	10 Years
Currencies										
US Dollar	R	16.96	-17.2%	2.4%	8.3%	-16.4%	-12.1%	-8.0%	-5.7%	-8.1%
Euro	R	20.10	-21.5%	-3.3%	-2.2%	-21.1%	-12.6%	-8.5%	-7.1%	-7.2%
Pound Sterling	R	22.26	-16.7%	-3.6%	4.1%	-22.0%	-12.2%	-7.9%	-2.4%	-6.4%

Source: Quandl as at 31 July 2020.

Sources: Trading Economics, Focus Economics, MoneyWeb