Cinnabar Monthly Insight: March 2020 Global Bear Market and SA Junked!

The first quarter of the year and the decade has been terrible in terms of health, economies and financial markets. Most major markets entered "bear" territory after falling more than 20%; however, there have been some large upswings subsequently. Global equities are down -21%, US equities -20%, emerging market equities -24%, UK equities -28% and SA equities -38% all in USD.

Other asset classes were not immune to the carnage, with SA bonds falling -9%. But the worst asset class of all was SA Listed Property that fell a massive -48% – this as the Lockdown happened and the impact on retailers and shopping malls was acutely felt.

Rubbing salt in our wounds, Moody's finally downgraded us to junk during March, which did result in rand weakness to major currencies – at one point falling to ZAR19.30 per USD. At quarter-end, it was down almost 20% year to date. Bond yields blew out following the downgrade, with 10-year government bond yields rising to 11.3%. There was some solace with the South African Reserve Bank cutting the Repo Rate by 1% to 5.25%. Economists are predicting a further 1% rate cut this year as inflation remains low – 4.24% – and expected to fall further still, supported by the oil price that collapsed during the coronavirus crisis.

The outflow of foreign investors from our bond market has been due to the global Risk-Off sentiment. The downgrade of our credit rating has not resulted in the worst of the outflows. This because the World Government Bond Index (WGBI) is only being rebalanced at the end of April – the delay due to lack of liquidity in global bond markets. The exact quantum of assets set to leave our shores is not precise, but there will be an effect on the longer end of the bond curve.

As with the massive drop in equity markets, the exit from the WGBI will provide market opportunities for fixed income managers to buy these bonds at historically high yields (low prices). Also, the departure from the WGBI will occur in an environment where the SARB will be supporting the market with liquidity by buying back government bonds. This may help cushion the blow.

We have continued to take advantage of the incredibly cheap prices of assets and have been topping up equities following big down days. Even with maintaining these equity levels, the portfolios have largely fallen less than peers year-to-date. We affirm that exiting risky assets at this stage would be extremely dangerous because when the recovery comes, it will be incredibly swift.

Market Update

United States of America

February figures show the annual inflation rate in the US eased to 2.3 percent from 2.5 percent in January, coming in slightly higher than market expectations of 2.2 percent. More recently, the impact of the COVID-19 health pandemic is beginning to find its way into the real economy. The week ending 22 March saw 3.3 million Americans filing for unemployment, followed by a further 6.6 million in the week ending 28 March, a new record high. The labour force participation rate in the US decreased by 0.7 percentage point over the month to 62.7 percent, the lowest since August 2018. This saw the US unemployment rate jump to 4.4 percent in March, the highest since August 2017. The preliminary IHS Markit US Services PMI index is expected to be 39.8 for March. Not surprisingly, economists and analysts are anticipating negative growth for the US economy for 2020. With this being said, Monetary authorities and politicians are doing all what that they can to aid the economy in these extraordinary times. The Federal Reserve has launched "QE infinity': buying unlimited amounts of government debt, mortgage-backed securities and corporate debt, while offering loans directly to companies. Matching the financial muscle of monetary authorities, the Trump administration has signed a $2 trillion CARES Act deal which will do everything from giving students a 6-month debt repayment holiday to funding hospitals to putting money directly into people's pockets.

UK

A contraction in fixed investment and a slowdown in household consumption led to annual economic growth of 1.1 percent for the fourth quarter of 2019 for the British economy. Turning to 2020, unemployment rate edged up to 3.9 percent in the three months ending in January from its lowest level since early 1975 and above market expectations of 3.8 percent. Consumer price inflation crept down to 1.7 percent year-on-year in February from 1.8 percent in the previous month, while retail sales remained unchanged in February. The IHS Markit/CIPS UK Manufacturing PMI index was at 47.8 in March. Output contracted by the most since July 2012 and new orders declined sharply as the outbreak of COVID-19 led to lower demand from both domestic and overseas markets. This has led the Bank of England's MPC to vote unanimously on holding the Bank Rate at 0.1 percent during its scheduled March meeting, with policymakers taking a wait-and-see approach to monetary policy after delivering two emergency cuts. Further to this, its new bond-buying round of £200 billion dwarfs the previously most substantial package of £75 billion in 2011. The bank also said the UK GDP is seen falling sharply during the first half of the year and unemployment is likely to rise rapidly across the country.

Europe

The IHS Markit Eurozone Manufacturing PMI plummeted to 44.5 in March, lower than preliminary estimates of 44.8, and below February's one-year high of 49.2. Consumer confidence fell to -6.6 in March from -1.6 in the previous month. This 5 point decline was the largest on record, led by a sharp fall in expectations due to the general economic situation. Business confidence has declined during March with the business climate indicator dropping 0.22 points from the previous month. The combination of the COVID-19 outbreak and an oil price war between Saudi Arabia and Russia will see inflation detracting to lows of around 0.7 percent, estimates show. In a surprise announcement, the European Central Bank (ECB) decided to hold interest rates at current levels. Much like most advanced economies, the ECB has launched a new €750 billion asset purchase programme, to counter the severe risks posed by the COVID-19 outbreak. The ECB will be buying government debt and private securities until the end of the year to ensure that all sectors of the economy, including families, firms, banks and governments, can benefit from supportive financing conditions that enable them to absorb the shock. Policymakers also pledged to increase the size of its asset purchase programmes and adjust their composition by as much as necessary and for as long as needed.

China

Widespread business closures, factory shutdowns, and travel restrictions resulted in manufacturing PMI falling from 50 to a record low of 35.7 during February. The COVID-19 outbreak continues to disrupt economic activity severely and will weigh heavily on economic growth in the first quarter of the year. January-February joint trade figures saw China record a trade deficit of USD 7.09 billion, missing market expectations of a surplus of USD 24.6 billion. Further to this, China's annual inflation rate fell to 5.2 percent in February 2020 from an over eight-year high of 5.4 percent in January. With that being said, recent data suggests China has gotten through the worst of the virus depression. China has begun to ease restrictions implemented during the COVID-19 Lockdown with workplaces being reopened and transportation restrictions easing. This has helped the manufacturing employment sub-index recover from 31.8 to 50.9, and the NBS Manufacturing PMI was rebounding to 52.0, indicating an expected expansion in the coming months. Although markets can see some glimmer of optimism from these readings, it is expected that economic activity will be subdued in quarter one. At the time of writing, Wuhan has ended its Lockdown after 11 weeks with rail and road links reopened.

South Africa

Quarter four saw South Africa end 2019 in a technical recession as the economy contracted -1.4 percent after shrinking from -0.8 percent in quarter three. Fast forward to 2020 and South Africa enters a global pandemic armed with continued deterioration in fiscal strength and structurally very weak growth caused by an unreliable electricity supply along with persistent fragile business confidence and investment. March was not any easier, seeing an increased COVID-19 count, forcing President Cyril Ramaphosa to follow measures taken by global economies and declare a nationwide 21-day lockdown across South Africa. One day later, the inevitable Moody's downgrade to junk status occurred. South Africa's bonds were downgraded to Ba1 (below sub-investment grade) with a negative outlook. Moody's said the "unprecedented deterioration" in the global economic outlook caused by the rapid spread of the COVID-19 outbreak will exacerbate the country's economic and fiscal challenges, and "complicate the emergence of effective policy responses". Following Moody's, Fitch moved to downgrade South Africa further into junk terrain, with a negative outlook. Despite the annual inflation rate in South Africa increasing to 4.6 percent in February 2020 from 4.5 percent in January, the South African Reserve Bank unanimously decided to axe its key repo rate by 100 bps to 5.25 percent during its March 2020 meeting.

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

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As At 31 March 2020	YTD	Last Month	Last Quarter	1 Year	2 Years	3 Years	5 Years	10 Years
South African Asset Classes								
STeFI Call Deposit ZAR	1.6	0.5	1.6	6.6	6.6	6.7	6.6	5.9
Beassa ALBI TR ZAR	-8.7	-9.7	-8.7	-3.0	0.2	5.3	5.2	7.4
FTSE/JSE SA Listed Property TR ZAR	-48.2	-36.6	-48.2	-47.9	-29.9	-23.0	-13.5	2.8
FTSE/JSE All Share TR ZAR	-21.4	-12.1	-21.4	-18.4	-7.4	-2.1	-0.1	7.7
FTSE/JSE Market Capitalisations								
FTSE/JSE Small Cap TR ZAR	-32.6	-21.7	-32.6	-33.0	-25.2	-18.4	-8.5	4.5
FTSE/JSE Mid Cap TR ZAR	-35.6	-23.7	-35.6	-27.5	-16.5	-10.6	-4.7	6.4
FTSE/JSE Top 40 TR ZAR	-19.2	-10.4	-19.2	-16.2	-5.7	-0.4	0.5	7.8
FTSE/JSE Sectors								
FTSE/JSE Ind/Financials TR ZAR	-39.5	-29.4	-39.5	-38.8	-24.1	-12.2	-8.0	5.8
FTSE/JSE SA Industrials TR ZAR	-8.4	-3.1	-8.4	-7.2	-5.5	-1.9	0.5	12.4
FTSE/JSE SA Resources TR ZAR	-25.3	-12.4	-25.3	-18.5	7.4	8.4	2.1	0.1
Global Equities in ZAR								
FTSE/JSE All Share TR ZAR	-21.4	-12.1	-21.4	-18.4	-7.4	-2.1	-0.1	7.7
MSCI World Free GR USD	1.0	-1.4	1.0	11.6	19.2	12.8	12.2	17.1
MSCI EM GR USD	-2.4	-3.9	-2.4	2.3	7.6	8.6	8.1	10.4
S&P 500 TR USD	2.7	-0.5	2.7	15.2	23.9	15.6	15.3	20.8
FTSE 100 TR GBP	-9.0	-4.6	-9.0	-3.8	8.2	5.2	4.8	11.3
Nikkei 225 Average TR JPY	3.9	2.4	3.9	15.8	16.9	13.5	12.3	15.9
SSE Composite PR CNY	13.1	6.8	13.1	4.4	7.7	3.4	-1.1	7.5
Global Equities in USD								
FTSE/JSE All Share TR ZAR	-38.4	-22.6	-38.4	-34.1	-24.6	-11.0	-7.6	-1.5
MSCI World Free GR USD	-20.9	-13.2	-20.9	-9.9	-2.9	2.5	3.8	7.2
MSCI EM GR USD	-23.6	-15.4	-23.6	-17.4	-12.4	-1.3	0.0	1.0
S&P 500 TR USD	-19.6	-12.4	-19.6	-7.0	0.9	5.1	6.7	10.5
FTSE 100 TR GBP	-28.7	-15.9	-28.7	-22.3	-11.9	-4.4	-3.0	1.8
Nikkei 225 Average TR JPY	-18.7	-9.8	-18.7	-6.5	-4.8	3.2	3.9	6.0
SSE Composite PR CNY	-11.4	-5.9	-11.4	-15.7	-12.3	-6.1	-8.5	-1.6
Commodities in USD								
S&P GSCI Copper Spot	-19.8	-12.2	-19.8	-23.7	-14.1	-5.3	-4.0	-4.4
LBMA Gold Price PM USD	6.2	-0.1	6.2	24.2	10.2	8.9	6.3	3.7
Oil Price Brent Crude PR	-65.5	-55.0	-65.5	-66.7	-43.1	-24.5	-16.2	-12.0
LBMA Platinum PM PR USD	-23.6	-16.5	-23.6	-14.5	-11.9	-8.2	-8.4	-7.8

Source: Morningstar Direct as at 31 March 2020. Annualised returns are presented for periods longer than 1 year.

	2020/03/31		YTD	Last Month	Last Quarter	1 Year	2 Years	3 Years	5 Years	10 Years
Currencies										
US Dollar	R	17.86	-19.5%	-12.0%	-21.4%	-19.2%	-18.6%	-9.1%	-7.5%	-8.5%
Euro	R	19.61	-16.1%	-12.8%	-19.5%	-17.1%	-13.7%	-10.1%	-7.7%	-6.6%
Pound Sterling	R	22.15	-17.1%	-9.3%	-16.3%	-15.1%	-13.4%	-8.8%	-4.1%	-6.6%

Source: Quandl as at 31 March 2020.