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INVESTMENT MANAGEMENT

Cinnabar Monthly Insight: 31-10-2020

Leading up to the US elections on the 3rd of November, markets continued to whipsaw with the US S&P 500 suffering its largest weekly drop (-6%) since March. When the news media decided that Joe Biden had won the election, the markets reacted extremely favourably recording the most significant surge following an election in history. On closer inspection, investors' positive sentiment is less buoyed by a Democratic US President, than it is relieved that a "Blue Wave" did not swamp the Senate. The split Congress will make it difficult for the Biden administration to push through higher taxes and toughen regulations on Big Tech, which the market appreciated.

At the time of writing, global markets are soaring further with the breaking news of Pfizer's positive update on its vaccine trial. It is incredible to note that Joe Biden has still not officially won the election because President Trump has not conceded. It is not hard to assume that if and when he does concede, this will also be favourable for markets. However, an official result may still be days or weeks away because of court challenges and recounts. All this favours continued volatility, particularly as COVID infections continue to surge – the virus didn't stop like the rest of the world to watch the election results.

No matter the volatility, we continue to favour equities mainly due to TINA – There Is No Alternative, particularly in the global environment. Our positioning through the election has been moderately overweight equities and US equities. As the economic recovery continues and with more positive news of vaccines, together with more certainty on US politics, we are incredibly optimistic for 2021 and beyond.

Market update

United States of America

US GDP rose at an annualised rate of 33.1% in Q3 following a contraction of 31.4% in Q2. The main growth driver came from personal spending, up 1.4% month-over-month in September, helped by checks and weekly unemployment benefits from the federal CARES Act. Overall US income increased 0.9% for September, whilst retails sales jumped 1.9% month-over-month. Annual inflation rate in the US edged up to 1.4% in September, which has been rising consistently since hitting 0.1% in May. The Federal Reserve left the target range for its federal funds rate unchanged at 0-0.25%. It said it would increase its holdings of Treasury securities and agency mortgage-backed securities over the coming months. This will help sustain smooth market functioning and foster accommodative financial conditions, supporting the flow of credit to households and businesses. Looking ahead, the Fed reiterated its commitment to keep rates at record low levels until labour market conditions reach levels consistent with maximum employment and inflation rises to 2%. Meanwhile, at the time of writing, the US election intensifies as Biden edges closer to a presidential victory. Under a Biden administration, economic growth could benefit from increased spending on infrastructure and social security.

UK

The UK economy is likely to gain back some lost ground in Q3 following the contraction of Q2. GDP rose solidly in July and August, while retail sales increased by 4.7% in September. However, Manufacturing PMI decreased to 53.7% in October from 54.1 in September, suggesting the recovery lost momentum due to the reimplementation of restrictions. The UK unemployment rate increased to 4.5% in the three months to August, and the annual inflation rate rose to 0.5% with the Bank of England expecting an increase to 0.6% in Q4. The Bank of England left its Bank Rate at a record low of 0.1% on the 5th of November and increased the size of its bond-buying program by a larger-than-expected £150 billion, bringing the total to £875 billion. Moody's cut Britain's sovereign debt credit rating by a notch to Aa3, citing the 'diminishing' quality of the UK's 'legislative and executive institutions' as one factor behind the decision. On the political front, talks between the UK and EU over a post-Brexit trade agreement stalled in early November. Prime Minister Boris Johnson suggested that the EU was unwilling to seriously consider his preferred option of a comprehensive free trade agreement, which is based on the bloc's existing arrangement with Canada.

Europe

The European economy is expected to rebound in Q3 following its decline in Q2; however, the pace of the recovery slowed towards the end of the quarter. The need for further stimulus was seen in the GDP data, as economic activity was 12.7% higher in Q3, not enough though to reverse the declines in the first half of the year. A resurgence of the pandemic in recent weeks has prompted the European Commission to lower its GDP forecast for 2021, which was expecting the EU to grow by 4.2% in 2021. The European Central Bank (ECB) left policy unchanged, even though ECB President Christine Lagarde appeared to signal easing ahead, saying that "the Governing Council will recalibrate its instruments, as appropriate, to respond to the unfolding situation". The main refinancing rate was held at 0% while the deposit rate remained at a record low -0.5%. Also, the ECB will continue its purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1.35 trillion.

Japan

Economic recovery is improving; however, consumers are still pessimistic, and according to the latest Tankan business confidence survey for Q3, business confidence shares the same sentiment, remaining profoundly negative. As the pandemic weighs on service sector output, the central bank has revised its GDP projection for the current fiscal year ending in March 2021 to a contraction of 5.5% from an estimate of a 4.7% decline made in July. The Bank of Japan (BoJ) left its key short-term interest rate unchanged at -0.1% and kept the target for the 10-year Japanese government bond yield at around 0% during its October meeting. The unemployment rate remained at 3% for September, while retail sales plunged 8.7% year-on-year. Turning to Q4, the economy began the period on a muted footing, with the au Jibun Bank Japan Manufacturing PMI higher at 48.7 in October but remaining deep in contractionary territory. Japan's leading economic indicator came it at 88.4 in August, its highest reading since February, following the reopening of business units.

China

One area of the world which is returning to pre-Covid levels of activity is China. China's trade surplus narrowed to USD 37.0 billion in September; exports increased by 9.9% while imports rose 13.2%. Retail trade rose by 3.3% year-on-year in September, suggests that consumers were gradually returning to the shops, boosting private consumption. Unemployment in China came in at 5.4% for September with General Manufacturing PMI rising to 53.6 in October. China's economy grew by 4.9% in the third quarter an improvement on the second quarter's 3.2%. The economy is forecasted to grow by 2% this year despite the sharp contraction in activity at the start of the year. The People's Bank of China left both its one-year loan prime rate (3.85%) and its equivalent five-year rate (4.65%) unchanged at its monthly review. This suggests that officials remain comfortable for now with the degree to which monetary policy is supporting domestic activity.

South Africa

Despite South Africa's manufacturing PMI rising to 60.9 in October, well above the 50 mark, which is an indicator for an economic expansion, the economic scenario remains bleak. Retail trade went down 4.2% from a year earlier in August, the inflation rate slowed to 3%, and the business confidence index remained unchanged at 85.7. Turning our focus to the medium-term budget policy statement presented by Finance Minister Tito Mboweni, the minister spoke about the increase in the probability of a debt trap. Government debt continues to surge with gross debt set to peak at 95.3% of GDP in 2025-26. Treasury estimates tax increases of R5 billion in 2021-22, while tax collection is seen at R8.7 billion less than the June projection. Treasury will look to decrease spending, equating to a saving of R300 billion over three years. South African Airways gets another R10.5 billion to help it restart; however, support for Eskom is reduced to R4.2 billion over the medium term. The expected economic contraction for this year is 7.8% with a 3.3% expansion in 2021 and 1.7% in 2022.

Sources: Trading Economics, Bloomberg, Office for National Statistics, Bank of England, Cinnabar Investment Management

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As At 31 October 2020	YTD	Last Month	Last Quarter	1 Year	2 Years	3 Years	5 Years	10 Years
South African Asset Classes								
STeFI Call Deposit ZAR	3.9	0.3	0.9	5.0	5.8	6.1	6.4	5.8
Beassa ALBI TR ZAR	2.7	0.9	1.7	4.9	8.8	8.5	7.5	7.6
FTSE/JSE SA Listed Property TR ZAR	-50.9	-8.5	-18.9	-51.6	-30.1	-26.5	-14.7	0.7
FTSE/JSE All Share TR ZAR	-7.1	-4.7	-6.5	-5.8	2.5	-1.3	2.2	8.7
FTSE/JSE Market Capitalisations								
FTSE/JSE Small Cap TR ZAR	-18.1	0.1	2.2	-18.9	-13.2	-12.2	-5.4	5.5
FTSE/JSE Mid Cap TR ZAR	-27.0	-3.1	-3.5	-23.1	-7.3	-6.6	-1.0	6.2
FTSE/JSE Top 40 TR ZAR	-4.2	-5.1	-6.8	-2.7	4.6	-0.4	2.6	8.9
FTSE/JSE Sectors								
FTSE/JSE Ind/Financials TR ZAR	-36.7	-5.8	-7.7	-37.1	-19.7	-13.0	-7.7	5.8
FTSE/JSE SA Industrials TR ZAR	4.7	0.4	-0.6	4.4	7.7	-2.9	1.2	12.3
FTSE/JSE SA Resources TR ZAR	-0.2	-10.8	-13.2	5.8	12.9	13.2	12.3	2.8
Global Equities in ZAR								
FTSE/JSE All Share TR ZAR	-7.1	-4.7	0.7	-5.8	2.5	-1.3	2.2	8.7
MSCI World Free GR USD	15.1	-5.5	3.7	13.2	14.4	11.6	12.3	18.9
MSCI EM GR USD	17.5	-0.6	5.3	17.2	15.9	7.2	11.9	11.9
S&P 500 TR USD	19.4	-5.2	4.6	18.3	17.5	15.7	15.4	23.0
FTSE 100 TR GBP	-13.8	-7.2	-3.6	-14.3	-2.9	-2.1	1.1	10.5
Nikkei 225 Average TR JPY	19.4	-2.5	2.7	14.0	13.9	11.5	12.5	18.5
SSE Composite PR CNY	27.7	-0.8	7.5	24.7	19.1	2.6	1.1	9.7
Global Equities in USD								
FTSE/JSE All Share TR ZAR	-20.1	-2.2	4.9	-12.6	-2.3	-5.7	-1.0	-0.2
MSCI World Free GR USD	-1.0	-3.0	8.0	4.9	9.0	6.5	8.7	9.2
MSCI EM GR USD	1.1	2.1	9.7	8.6	10.4	2.3	8.3	2.8
S&P 500 TR USD	2.8	-2.7	8.9	9.7	12.0	10.4	11.7	13.0
FTSE 100 TR GBP	-25.8	-4.7	0.4	-20.5	-7.4	-6.5	-2.2	1.5
Nikkei 225 Average TR JPY	2.8	0.1	7.0	5.7	8.6	6.4	8.9	8.8
SSE Composite PR CNY	9.9	1.9	12.0	15.6	13.6	-2.0	-2.1	0.8
Commodities in USD								
S&P GSCI Copper Spot	8.9	0.6	4.7	16.0	5.8	-0.6	5.6	-2.0
LBMA Gold Price PM USD	24.2	-0.3	-4.2	24.5	24.5	14.0	10.5	3.4
Oil Price Brent Crude PR	-43.2	-8.5	-13.5	-37.8	-29.5	-14.8	-5.4	-7.7
LBMA Platinum PM PR USD	-10.5	-3.6	-5.9	-9.0	1.1	-2.3	-2.9	-6.7

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

		2020/10/31	YTD	Last Month	Last Quarter	1 Year	2 Years	3 Years	5 Years	10 Years
Currencies										
US Dollar	R	16.25	-13.6%	2.7%	4.4%	-7.3%	-4.7%	-4.5%	-3.2%	-8.1%
Euro	R	19.04	-17.1%	3.5%	5.6%	-11.2%	-6.1%	-4.8%	-4.4%	-6.5%
Pound Sterling	R	21.02	-11.8%	2.6%	5.9%	-7.3%	-5.3%	-3.7%	0.3%	-6.2%

Source: Quandl as at 31 October 2020.

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