

January 2021

Line of THOUGHT

ECONOMIC AND MARKET OVERVIEW

Global

In the past year, the global economy had its worst recession in living memory while global financial markets recorded strong returns – in many cases outperforming their long-term average.

Visio Capital reports that this dislocation between economic growth and financial market performance can be attributed to policymakers, mainly in developed markets, implementing extremely accommodative monetary and fiscal policies. This is being done in an attempt to (at least partially) protect businesses and consumers from the effects of the synchronized global lockdown caused by the spread of Covid-19. A clear illustration of this dislocation can be found in equity markets where extreme valuations can be attributed to very low (if not negative) real interest rates.

In addition to this apparent anomaly between the real economy and investment markets there are several other factors that investors need to take note of. The effective distribution of Covid-19 vaccines throughout the world will be key to a more stable outlook, but it's not the only element that will influence investor sentiment in 2021. According to a recent report from Franklin Templeton, the election of Joe Biden as United States president seems to have calmed financial markets to some extent. The outlook for fiscal stimulus is still unclear though, and any near-term support agreed by the US Congress is likely to be smaller in scope than desired by the Democrats.

Aside from the delivery of emergency economic support, the incoming US administration also has a mandate to change the current approach in many policy areas, including international relations, infrastructure, taxation and climate change. Now that the Democrats effectively control the US Senate it's more likely that they will implement their full wish list.

It would however be short sighted to only focus on the Yanks in the year to come. The International Monetary Fund (IMF) forecasts that emerging and developing economies overall are likely to grow at 6.0% in 2021 after a 3.3% contraction in 2020. Emerging Asia is likely to pace the advance, according to the IMF's latest World Economic Outlook, with the region growing 8.0% in 2021 and China posting an even faster 8.2% growth rate this year.

Japan too may hold some promise and will be in the spotlight whether the Olympic Games go ahead or not. The September 2020 election of a new prime minister, Yoshihide Suga, could bring structural reforms to the country in the areas of regional bank consolidation and digital transformation. Moreover, Franklin Templeton believes Japanese corporations have done a better job of improving their balance sheets than investors have given them credit for, which should create opportunities for fundamentally focused investors.

Lastly, turning to Europe, there could be a leadership change out of the United Kingdom. Given the market's large exposure to the financial and energy sectors, the baton could be passed on to Switzerland, with the latter market's emphasis on the health care and pharmaceutical companies that are in greater demand during the global pandemic.

Regardless of how this coronavirus progresses and what the broader economic environment over the coming year looks like, global investors could do well if they focus on individual company fundamentals when making long-term investment decisions.

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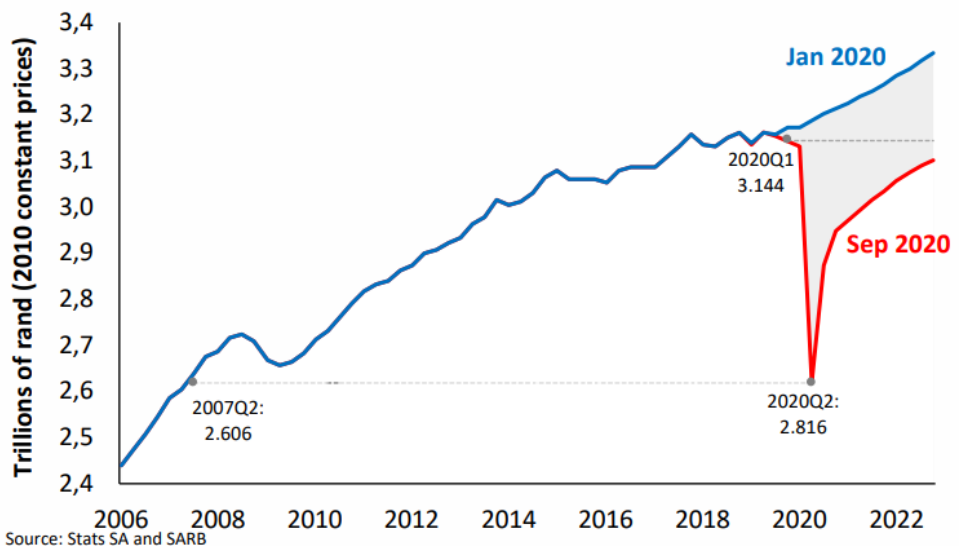
South Africa

South Africa's economic growth bounced strongly in the third quarter of 2020, but available fourth quarter data suggest a momentum slowdown and Covid-19 related disruptions pose further risks to the recovery.

Earlier in December Stats SA released third quarter Gross Domestic Product data which showed that the economy bounced back strongly after a significant contraction in the second quarter of 2020 when the economic impact of the nationwide lockdown was most severe.

The data showed a broad recovery in the economy with all sectors recording growth. Despite the quarterly rebound, the year-on-year decline was 6.0%, highlighting the extent of the lost output during lockdown levels five and four, and resulting in total output being at similar levels to what it was in 2013. South African economic output is expected to recover to its 2019 level by the end of 2024. In a recent presentation, Chris Loewald of the South African Reserve Bank showed how their economic growth forecast changed between January and September 2020:

GDP levels



South Africa's government debt burden continues to grow at an alarming pace. Add to this the continuing woes at Eskom, low levels of business confidence and a continued decline in gross fixed capital formation, the outlook for a sustained and improved recovery in the local economy looks bleak.

There is a glimmer of hope though – lower inflation and low interest rates are both helping the economy to weather the storm. Add to that improving investor sentiment towards emerging markets and there's a chance that 2021 may hold a few surprises on the upside.

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South Africa – Continues.....

It's clear that fiscal sustainability and better electricity supply are both crucial for longer-term growth, so please send your best new year's wishes to both Mr. Mboweni and Mr. De Ruyter. They need all the help they can get...

Market Performance

The upbeat global backdrop and renewed appetite for risk helped the local equity market to end the year on a very positive note. Foreigners were net buyers of SA equities for the first time since June 2019.

It, however, remains a laggard over all periods up to five years compared with both developed and emerging markets (in rand terms). Valuations of JSE listed companies that earn the majority of their revenue in the local economy (the so-called "SA Inc." companies) remain very attractive and may yet prove to deliver handsome returns to patient investors. This subset of companies now make up less than 1% of the MSCI Emerging Markets index, which is dominated by China (over 40%), Taiwan and South Korea. These three markets constitute more than 60% of emerging markets' total market capitalization, with South Africa contributing only 3.5%.

The JSE ended the year 7% higher – an outcome that to many seemed unlikely during the midst of the March meltdown. South African government bonds added 8.7% over the year while cash returns pulled back to 5.5% for the year as the effect of the South African Reserve Bank's aggressive rate cuts kicked in. The repo rate starts 2021 at a level of 3% lower than a year ago, and this will have a significant impact on cash returns in the year ahead. Global equities led the charge (in both US dollar and rand terms) as it ended the year over 22% higher.

Listed property was the best performing asset class (+14%) for the second consecutive month, as it benefited most from attractive valuations and the risk-on environment. The sector, however, remains a poor performer, returning negative real returns over any period from one to ten years.

Market Performance

MARKET INDICES ¹ (All returns in Rand except where otherwise indicated)	31 December 2020		
	3 months	12 months	5 years
SA equities (JSE All Share Index)	9.8%	7.0%	6.4%
SA property (S&P SA Reit Index)	20.8%	-39.6%	-8.8%
SA bonds (SA All Bond Index)	6.7%	8.7%	10.4%
SA cash (STeFI)	1.0%	5.5%	7.0%
Global developed equities (MSCI World Index)	0.5%	22.4%	11.6%
Emerging market equities (MSCI Emerging Market Index)	5.5%	24.7%	12.0%
Global bonds (Bloomberg Barclays Global Aggregate)	-9.0%	14.7%	3.7%
Rand/dollar ²	-11.9%	5.0%	-1.1%
Rand/sterling	-6.9%	8.4%	-2.5%
Rand/euro	-8.1%	14.5%	1.3%
Gold Price (USD)	0.3%	24.6%	12.3%
Oil Price (Brent Crude, USD)	26.5%	-21.5%	6.8%

1. Source: Factset

2. A negative number means fewer rands are being paid per US dollar, so it implies a strengthening of the rand.

Commentary – Predictions beyond 2020

Regular readers will know that this publication is not a big fan of predictions, forecasts or any other economic or financial prophecies – not at the start of the year or any time thereafter. We do however find it interesting to have a look at what other experts are willing to predict when pushed for an answer.

Nick Routley and his team at Visual Capitalist analyzed more than 200 articles, white papers, podcasts and interviews, and produced a hit rate of predictions across all these source. It's almost like playing "Bingo" for predictions. Here are a few memorable and popular predictions for 2021 – we thought you may find some value in these too:

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China has a strong 2021

Financial institutions that issue predictions generally hedge their language quite a bit, but on this topic they were direct. The world's most populous country has already left the pandemic behind and is back to business as usual. Of the institutions that mentioned a specific number, the median estimate for GDP growth in China was 8.4%.

Brands must be authentic and values-driven

Over the past few years, brands have become increasingly values-driven. In their 2021 predictions, experts see this trend being pushed even further.

Millennials, which are now the largest generation in the workforce, are shaping society in their own image, and the expectation is that companies have an authentic voice and that actions align with words. This trend is augmented by the transparency that the internet and social media have enabled.

Being a "values-driven" company can mean many things, and often involves focusing on a number of initiatives simultaneously. At the forefront is racial inequality and diversity initiatives, which were a key focus in 2020. According to McKinsey, nine out of ten employees globally believe companies should engage in diversity and inclusion initiatives. When the chorus of voices grows loud enough, eventually action must follow.

A great rethinking of office life is underway

The great work-from-home experiment will soon be approaching the one-year mark and a lot has changed in a short amount of time.

Even firms that were incredibly resistant to remote work found themselves in a position of having to adapt to new circumstances thanks to COVID-19. Now that the feasibility of at-home work has been proven, it will be tough for companies to walk things back to pre-pandemic times. Over 2021, millions of companies will begin reengineering everything from physical offices to digital infrastructure, and this has broad implications on the economy and our culture.

Source: Visual Capitalist

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Commentary – Predictions beyond 2020 (continued)

Individuals and employers start taking wellness seriously

The past year was not good for our collective mental health. In response, many companies are looking at ways to support employees from a health and wellness standpoint. One example is the trend of giving teams access to meditation apps like Headspace and Calm.

This focus on wellness will persist, even as people begin to return to the office. As commercial leases expire in 2021, companies will be re-evaluating their office needs, and many experts believe that wellness will factor into those decisions.

Lastly, this trend ties into the broader theme of values-driven companies. If brands profess a desire to impact society in a positive way, employees expect actions to extend inward as well.

And then, the elephant in the room:

Covid-19

Covid-19 is the one factor that impacts nearly every one of these 2021 predictions, yet there were few predictions – and certainly no consensus from experts – on vaccine rollouts and case counts. It's possible that the complexity of the pandemic and the enormous task of dealing with this public health crisis makes it too much of a moving target to predict in specific terms.

In general, expert opinions on when we will return to a more “normal” stage again range from the summer of 2021 to the start of 2022. Except for China, most major economies are still grappling with outbreaks and the resulting economic fallout.

It remains to be seen whether Covid-19 will dominate 2022's predictions, or whether we'll be able to look beyond the pandemic era.

Conclusion

Looking at these forecasts it hardly seems to be rocket science (and we're sure Elon Musk will agree). There is, however, some wisdom in crowds so be careful to not discount these trends in the year ahead.

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