Market Commentary

Q4 2020

Vaccine news buoys stock markets

In the long dark tunnel that was 2020, November stood out as the month that light appeared. Some might have seen it as a bright light, others as a faint light – but it was unmistakably a light as good news on candidate vaccines was published.

On 9 November, Pfizer announced the interim results of its candidate vaccine, showing it to be "more than 90% effective" in preventing symptomatic COVID-19 in late-stage human trials. The news was greeted with joy. Not to be outdone, Moderna then announced that its candidate vaccine showed 94.5% efficacy. Oxford University followed with its vaccine candidate, developed in partnership with AstraZeneca, that showed an overall effectiveness of 70.4%. Although the Johnson & Johnson vaccine is still in the final trial stages, it showed antibodies in more than 90% of volunteers. Its efficacy has not yet been proven.

The subsequent approval of vaccine candidates by global regulators paved the way for immunisations to begin. With the rollout of COVID-19 vaccines, the stakes are huge as governments desperately look for ways to reopen economies, lift restrictions and save lives. Sadly, at the time of writing, globally more than 1.9 million people had lost their lives, with more than 35 000 of those being South African.

Disappointingly, resurgent infection cases (i.e. second wave) and subsequent lockdown restrictions in key markets dampened optimism for a near-term economic recovery despite the positive vaccine developments.

Domestically - the good and the bad

Businesses pledge close to R110 billion at Ramaphosa's third investment conference

SA looks set to achieve its ambitious investment target of R1.2 trillion by 2023 despite the impact of the pandemic. The SA Investment Conference held in November last year concluded on a surprisingly positive note with businesses pledging new investments totalling R109.6 billion. More than 50 investments were announced in both greenfields and expansion projects across the country, taking investment commitments made over the past three years at the conference to R773 billion.

Around R172 billion from earlier commitments, has already been invested. JSE-listed Aspen Pharmacare, which announced an investment of R3.4 billion in 2018, said that most of these funds have already been invested into its new plant in Port Elizabeth, representing the single largest investment in the history of South Africa's pharmaceutical industry. Coincidently, the plant will be manufacturing Johnson & Johnson's Covid-19 candidate vaccine.

Rand makes a comeback during the year

At the end of 2020, the rand was trading around R14.70 to the US dollar. This is pleasing given that the currency came under massive pressure shortly after SA went into a hard lockdown in the first quarter and the currency blew out to R19.26 in the first week of April. The stronger rand was mainly due to dollar weakness, high interest rates in SA and a bigger appetite for emerging market currencies towards the end of the year. Having said that, the beginning of 2021 has seen the currency lose a bit of momentum due to new restrictions introduced on 28 December. It is currently trading above R15 to the US dollar.

Interest rates remains low

During the fourth quarter, the Monetary Policy Committee (MPC) opted to keep interest rates unchanged at 3.5%, thus closing the year with the lowest policy rates in decades. The MPC cut interest rates by a total of 300 basis points in 2020 as inflation remained on the lower end of the SARB's 3 to 6% target. The November print came at 3.2%, thanks to a stronger

STANLIB

MULTI-MANAGER

rand, lower petrol price and a deterioration in the pricing power of most retail companies. The committee expects inflation to average 3.9% in 2021, which implies that rates are likely to be anchored low for longer.

Unemployment rate is a time bomb

The expanded definition of unemployed, which is not flattered by an increase on the number of people regarded as 'not-economically active', rose from 42.0% to a shocking 43.1% in the third quarter of 2020. This largely reflects the fact that although the economy added back hundreds of thousands of jobs in Q3, the gain was relatively modest in comparison with the increase in the labour force. Unfortunately, this calculation of the rate of unemployment is probably a more reflective estimate of SA's underlying level of unemployment as well as the ongoing level of deterioration in the labour market. Of major concern is that youth unemployment increased to 74.1% in Q3. Put frankly, this means that out of the 10.2 million people below the age of 35, only 796 000 are employed.

Moody's and Fitch cut SA further into junk

During the fourth quarter Moody's downgraded SA's international credit rating by one notch from Ba1 to Ba2 and maintained its negative outlook. Fitch also downgraded SA's credit rating by one notch from BB to BB-, also with a negative outlook, voicing concern about ballooning government debt, with little confidence that the state will make good on its promises to cut spending on civil servant wages. In contrast, S&P maintained SA's credit rating at BB-, with a stable outlook.

Medium term budget – a clear plan of action still missing

The massive growth in SA's national debt – expected to reach R5.5 trillion in 2023/24 – overshadowed all the good things Finance Minister, Tito Mboweni referenced in his October budget speech. These included projected growth of 3.3% in the next fiscal year, R100 billion set aside for job creation and the lack of tax hikes.

Government reiterated its commitment to reduce spending growth, shift spending patterns and stabilise the debt-GDP ratio in the medium term. Positively, the projected fiscal consolidation is not premised on unduly optimistic revenue expectations or excessive tax hikes. Furthermore, economic growth estimates for 2021 (3.3%) and 2022 (1.7%) are on the low side, thus leaving scope for a positive uptick.

While there is commitment from Treasury to ensure economic growth, bolster employment and enhance the ease of doing business with SA, a concrete plan of action still needs to be provided and successfully implemented.

Financial markets – the strong recovery from the equity market is not enough

Strong recovery from domestic equities is not enough

The FTSE-JSE All Share Index (ALSI) lost significant ground in the first 3 months of 2020, plummeting 21.4%. However, in the subsequent quarters, it made back more than the Q1 losses and ended up 7.0% for the year. Spearheading the rally were resource companies, up 21.2% for the year. The sector benefitted from higher commodity prices as China recovered from the impact of Covid-19 quicker than most countries. Resources have led equity markets since 2016.

It is worth mentioning that the recovery was not even. Industrials posted a positive return of 12.0% for the year but financials plunged 19.7%. Within industrials, the Naspers and Prosus stable – which has a combined weight of almost 20% in the ALSI – took a lead from global technology companies, benefitting from the increase in demand for the services it offers on the back of lockdowns and the new 'working from home' norm. The two companies rallied 32.1% and 52.6% respectively. Financials took a beating as property companies lost 35.5% and banks plunged 17.7%. Were it not for the risk on trade in Q3 where the financial sector went up 19.5%, the numbers would have been worse.

Bond market – best performing asset class

Local fixed income assets again posted better returns than other domestic asset classes. Bonds have now outperformed growth assets in four of the past five calendar years and in 2020, they gained 8.7%. The 10-year government bond yield came from 12.4% at the height of the sell-off in March to finish the year at 8.7%. The 3-to-7-year area of the curve produced most of the returns, rallying 16.3%. Short dated bonds shrugged off the effects of the downgrades from major rating agencies and the increasing COVID-19 cases in SA. The market seems to have focused more on the positive real yield. With inflation expected to be lower than recent years and the SARB cutting interest rates, bonds appear to be one of the few places where investors can still earn a positive real return.

Listed property – the market continues to face several headwinds

The local property market has taken the most pain from the Covid-19 pandemic, falling 35.5% in 2020. The decision by most governments to implement lockdown restrictions in their effort to curb the spread of the virus hurt property. Having said that, property recovered 23.6% in the fourth quarter when the country moved to level 1. However, the resurgence of tighter restrictions in late December sent it back into the red as lower foot traffic in many retail outlets is expected. Loan-to-value ratios also remain elevated and many companies have cut their pay-out ratios, thus lowering the income return from the asset class.

Globally – vaccine euphoria boosts global markets

The MSCI World Index gained 14.1% in US dollar terms for Q4 and 16.5% for 2020, after being down 20.9% in the first quarter. The disparity amongst economies and industries is wide, with big tech stocks – cloud computing and social media – racking up massive earnings in the lockdown, up 44.3% whilst the higher composition of 'old school' industries such as financial services, energy and real estate were negative.

Emerging market (EM) equities generated their strongest quarterly return in more than a decade, with US dollar weakness amplifying gains. The MSCI Emerging Market Index gained 19.8% in US dollar terms for the quarter and ending the year up 18.7%, ahead of developed markets. The rally in commodity prices coupled with the risk-on trade in Q4 helped EM assets.

Tesla's S&P 500 debut

Tesla was the best-performing large-cap stock in the US in 2020, soaring almost 700% as investors showed increasing confidence that electric cars, trucks and buses will dominate the future of the auto and transportation industries.

Given Tesla's massive market size, S&P had sought a consultation with investors early in November, asking for feedback on whether the stock should be folded into the index all at once or in two parts, which would have been unprecedented.

Tesla was added to the S&P 500 Index on 21 December, a move that rippled through the entire market as money managers adjust their portfolios to make room for shares of the $538 billion company. The electric-vehicle maker is the seventh largest company in the S&P 500 at its current market value, falling between Berkshire Hathaway Inc. and Visa Inc. It is larger than any other company on debut in the S&P 500. Berkshire Hathaway previously held that record – It was worth approximately $127 billion on inclusion in the index in 2010.

DID YOU KNOW?

– Only six parts on a Tesla car will ever need replacing – four tyres and two wiper blades.

The global pandemic is not over – but the light is getting brighter

COVID-19 cases remain high at the start of 2021 and most countries remain in lockdown. But 'the light has appeared' as vaccinations are rolled out globally, requiring successful navigation of complex obstacles including distance, terrain, politics and logistics. SA will receive a million doses of the Oxford-AstraZeneca vaccine in January 2021 and a further 500 000 doses from the Serum Institute of India in February, to vaccinate healthcare workers.

Unfortunately, SA's problems extend further than the current pandemic, as we continue to face a number of key economic challenges. Ensuring we can execute a plan to vaccinate all South Africans has now been added to the list of challenges.

First and foremost, fiscal credibility needs to be reinstated and then economic growth lifted on a sustainable basis. While the government has identified a number of key policy initiatives that could help reinvigorate the local economy – such as infrastructural development – there is still not enough evidence of implementation. In that regard, the upcoming multi-year government wage negotiation represents a vital test of government's political will to implement critical fiscal reforms.

The government's ballooning debt is consuming much of the savings that SA would otherwise have available for fixed investment spending. The high cost of that debt cascades through to make the private sector's cost of long term borrowing to fund long term investment projects high too. It is only if and when reforms become real that investment may become real too.

> *"Ultimately though, economic success is a function of job creation, job creation is a function of investment and investment is a function of confidence. Unsurprisingly, the implementation of sound economic policies builds confidence, but the opposite is also true".* **– Kevin Lings (STANLIB – Chief Economist)**

Albert Louw CFP®
STANLIB Multi-Manager: Head of Business Development
Albert.Louw@stanlib.com
www.stanlibmultimanager.com