Market Commentary

Q1 2021

Stock markets continued to surge as the largest vaccination drive in history gets underway

At the start of 2020, a family meeting was confined to mom, dad and the kids, and curfews generally only applied to kids. If you had mentioned contact tracing, social distancing or a second wave, few people would have understood what you were referring to. On 5 March 2020 the first case of COVID-19 was confirmed in South Africa and sadly, on 27 March 2020, the first COVID-19-related death was reported in South Africa.

Life over the past 12 months has changed drastically. Despite the occurrence of a second wave and fears of a third, things have gotten better with the vaccine rollout that commenced in February.

'The first wave was like Kilimanjaro, the second like Everest' - **Prof Karim**

The largest global vaccination campaign in history is underway. At the time of writing more than 590 million doses had been administered across 141 countries, according to data collected by Bloomberg. The most recent rate was roughly 15.3 million doses per day. In SA the rollout had a slow start. To date only 264 000 doses have been administered, which accounts for approximately 0.4% of the South African population.

Vaccine divide threatens global economic recovery

Last month Fitch upgraded its global growth forecast for 2021 from 5.3% to 6.1%. The new estimate would make for the fastest worldwide expansion since 1980. The sad reality is, however, that the global economy's recovery may be dampened or even derailed by the lag in vaccinations for poorer nations relative to their wealthier peers. That means emerging economies – which includes SA – risk falling further behind economically. Worse still, not combating COVID-19 everywhere may lead to 'harder-to-contain' mutations of the virus, which could generate fresh health and economic crises.

A recent study commissioned by the International Chamber of Commerce concluded than an unequal allocation of injections could deprive the world economy of as much as $9.2 trillion. This serves as a reminder that we are not out of the woods yet.

'Global growth this year could be less than half the World Bank's estimate if vaccine distribution does not move quickly' **– Chief Economist, Carmen Reinhart**

Global markets

Rising interest rates remain top of mind for investors

While the rollout of vaccines, slowing infections and the $1.9 trillion US relief are breathing life back into economies, investors are increasingly worried that ultra-loose monetary policies will have to be tightened at some point to deal with higher inflation. This is despite the US Federal Reserve expressing comfort in letting inflation run in the near term. These concerns saw investors rushing out of bonds during Q1. The benchmark 10-year US Treasury yield sold off from 0.51% in Q2 2020 to 1.74% by the end of Q1 2021.

Equity markets still going strong as investors rotate into cyclical stocks

Investors' search for real returns continued to provide the much-needed support for equity markets. Global equities rallied 4.7% in Q1 and were up 55.3% over the past 12 months, largely thanks to base effects. ***Higher bond yields**** led to a rotation out of technology companies into the 2020 laggards – banks and energy companies.

Why would a rise in interest rates hurt stocks, particularly high-flying technology stocks? Companies relying on future cash flow growth experience much greater risk as rates rise – this has been the part of the market that has really driven returns in the stock market, such as the Nasdaq, which is heavy in technology stocks. The market is a discounting mechanism: it is a way of trying to figure out what a future stream of cash flows – or earnings – is worth today. This model, known as the Discounted Cash Flow model, is at the heart of the problem for technology stocks.

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The sharp contrast between the performance of the S&P 500 and Nasdaq was also testimony of the tilt away from technology stocks in favour of value and cyclical stocks with earnings closely tied to a strong economic recovery.

These factors have all worked to make growth and technology stocks less appealing to investors, especially after many of their break neck run-ups last year. For example, shares of Zoom Video Communications – a paragon of the "work from home" trade of 2020 – have fallen 4.8% for the year-to-date, pulling back after a nearly 500% surge last year.

Antitrust regulations also weighing on large fintech companies

Fresh threats by US regulators over a possible ban on Chinese company listings in the US, as well as China's new antitrust regulations, hurt tech stocks over the quarter.

The Securities Exchange Commission is taking steps to force accounting firms to let US regulators review the financial audits of foreign companies – the penalty for non-compliance being ejection from exchanges. That threat worsened sentiment in China's giant tech sector at a time when Beijing is widening a crackdown on the country's largest corporations, fearful of their growing clout after years of relatively unfettered expansion.

The biggest casualty of Beijing's crackdown to date is Alibaba's fintech arm, Ant Group, which had a record-breaking $35 billion Hong Kong-Shanghai initial public offering pulled from under it at the last minute in November. This was an embarrassing comedown for Pony Ma who was once vaunted as the poster child for Chinese entrepreneurship.

Tencent is also in the regulator's crosshairs. The Chinese government is unhappy with Tencent's equity acquisitions, which have been an extremely profitable part of its growth strategy. During the quarter the market regulator announced penalties on Tencent and 11 other companies for violating anti-monopoly laws in the acquisition of an online education platform.

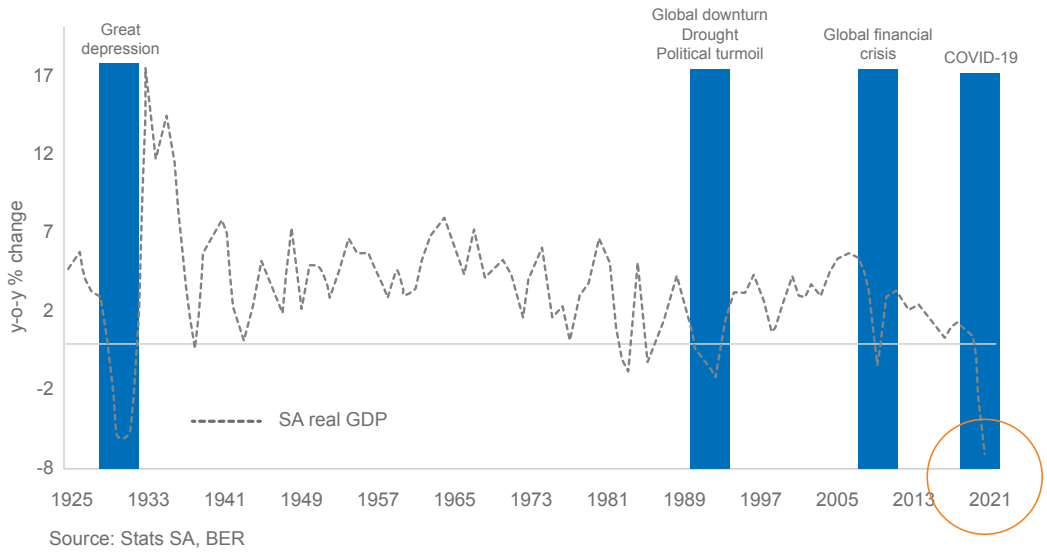
Local market

The already ailing SA economy slumped 7.0% in 2020

The positive growth recorded in Q3 and Q4 was not sufficient to offset the devastating impact of COVID-19 that occurred in Q2 when lockdown restrictions were at their most stringent. Economic activity for 2020 fell 7.0% compared with 2019, representing the largest decline in decades.

To provide some perspective, the second largest fall was recorded in 1992 when the economy contracted 2.1%, as illustrated in the chart that follows. At the time, the country was struggling through a recession that lasted two years, which was mainly the result of a global economic downturn. During the 2008/09 global financial crisis, the economy shrank 1.5% in 2009. That said, economic growth in SA is expected to rebound to 3.8% in 2021 according to the South African Reserve Bank's (SARB) latest forecast.

A historic GDP decline in 2020



Source: Stats SA, BER

Repo rate unchanged

The SARB kept the repo rate steady at 3.5% in March, in line with expectations of most economists and market commentators. The unanimous decision to hold the rate for the fourth consecutive MPC meeting, means that the prime lending rate of commercial banks remains at a more than four-decade low of 7%. But more notably, it is the first time in as many meetings that all members of the committee voted 'hold'. This implies that members who previously voted in favour of further interest rate cuts, are becoming more hawkish.

The good – largest investment in Ford's 97-year history

During the quarter, Ford announced that it will plough R15.8 billion into SA as it scales back in other regions, including Brazil and Europe. The Silverton plant in Tshwane will boost the site's annual capacity by almost a fifth to 200 000 units and create about 1 200 direct jobs, as well as adding an estimated 10 000 new jobs across the automaker's local supplier network.

The bad – Greyhound closure could see 700 job losses

Greyhound, which has been in business since 1984, confirmed in February that its operations will cease due to the impact of COVID-19. The owner of Greyhound buses, KAP Industrial, said it was shutting down the passenger bus line, as well as Citiliner after operating the brands at 'significant losses' for a number of years. Reduced travel due to COVID-19, closure of borders and lockdown rules added to the company's woes.

And the not so ugly budget

In February the Minister of Finance tabled the much-anticipated Budget Speech. On the revenue side, despite the massive shortfall, there were a few positive surprises. One was the tax relief on consumers, as well as lower corporate taxes. The corporate income tax rate will be lowered to 27% for companies with years of assessment commencing on or after 1 April 2022. This puts SA on the path to a more competitive and investment-friendly rate. It was one of the few structural reform levers directly in Mboweni's control and he pulled it.

The government held the line on its fiscal consolidation stance – an essential ingredient to restoring credibility. There were no additional allocations to SOEs except for the R5 billion allocation to the Land Bank. Execution risk remains high, however, given the challenges associated with reducing the public sector wage bill, which is where most of the expenditure cuts are envisaged. The wage bill remains high at 34% of spending and remains the fastest growing spending item.

> *"SA does not have a funding problem – it has a spending problem... fiscal credibility is difficult to earn, easy to lose, and once lost, almost impossible to regain"* **- Thabi Leoka, independent economist**

Equity markets riding the global wave, up 12.6% in Q1 and 54.3% in the past year

The local bourse took its cue from global markets and continued to post positive returns in Q1, aided by the rally in resources which gained 18.7% as China came out of the pandemic faster than most countries. The recovery in Sasol's share price also deserves a special mention. It gained 54.6% in Q1, shaking off the low oil price in 2020 and the Lake Charles concerns that threatened its existence. Industrials were not far behind, up 13.0%. The easing of lockdown restrictions helped retailers such as Truworths and Woolworths, which gained 36.1% and 25.1% respectively.

The technology sector bucked the global trend, posting 15.5%, while the financial sector unfortunately lost its Q4 momentum, gaining only 3.8% in the first quarter.

On the contrary, property companies had another strong quarter, rallying 8.1%. The recovery of retail companies increased foot traffic in large malls and coupled with the resilience of neighbourhood centres, helped property markets.

Winds of change – from online brokers to buying a Tesla

Maarten Mittner, a freelance journalist, recently wrote an article in the Finweek on the 'new players' that threaten to fundamentally change the ways in which markets have been operating up until now. New players – such as retail brokers – acting as 'social media trading strategists', have come to the fore, drawing the attention of asset managers.

GameStop, a struggling gaming outlet in the US, saw its share price rocket more than 400% after digital retail gamers – the 'new players' – bought shares in a unified, concerted effort through established trading platforms and in the process, upsetting established hedge funds with short-selling strategies in place. While the onslaught by the new players on behalf of GameStop ultimately failed, the new players have not only showed their bravery, but also that new forces in the market can disrupt established patterns.

Younger, tech-savvy investors are joining trading platforms en masse. Credit Suisse reports that since the start of 2020, retail trading as a share of global market activity has nearly doubled to more than 30%. In South Africa, the cut-price trading platform, EasyEquities, has seen a steady increase of 1 000 to 2 000 new users per day, according to Carel Nolte, chief marketing officer of Purple Group, which owns the platform.

It is not only asset managers that are becoming nervous, but also the banks. Tesla will now start accepting the world's largest electronic currency, Bitcoin, as payment for its electric cars, just one of more and more developments that could disrupt established patterns. In February, Tesla disclosed its R$1.5 billion investment in Bitcoin, which sent prices to a record highs.

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