Sygnals

July 2020

Market Review

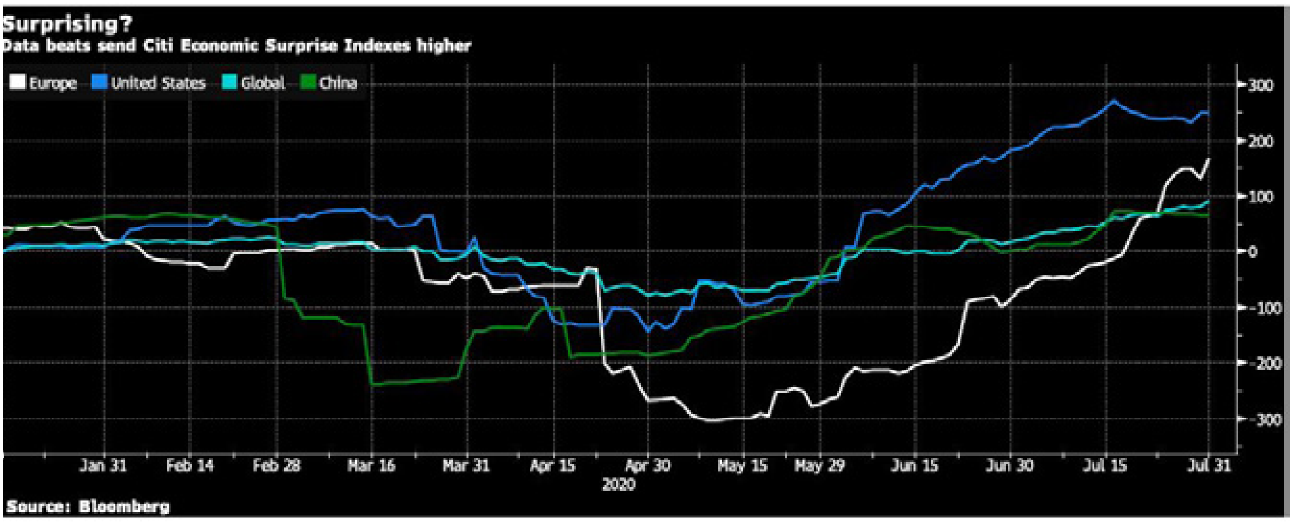
Markets rallied on strong economic data surprises (Chart 1), as pent-up demand from the lockdown continues to drive a growth rebound. This was supported by positive news from the Moderna Covid-19 vaccine trial, which revealed the presence of antibodies, and similar positive news from both the Johnson & Johnson and AstraZeneca/Oxford Covid-19 vaccine trials.

The dollar had its weakest month in 5 years as US data disappointed, the number of confirmed Covid-19 cases rose, and the probability of a Democratic victory increased. While Trump trailed Hillary Clinton in the 2016 presidential polls, he only lagged by 3%, and national opinion polls put Biden almost 10% ahead of the incumbent going into November's US elections. Nevertheless, Trump made sure to steal the headlines, implementing sanctions against Chinese and Hong Kong officials, stripping Hong Kong of visa-free travel to the US and removing Hong Kong's special economic status. The US rejected China's claims to resources in the South China Sea and plans to prevent investment in US-listed Chinese firms. The US also ordered China to close its consulate in Houston to protect American IP and subsequently invaded the consulate. The UK declared that Huawei technology will not be used in its 5G network, while the EU is preparing to take action against China for the controversial Hong Kong security law. Despite this, China's stock market led the equity rally in July, as Trump's influence begins to wane.

So far, Covid-19 has continued to accelerate trends already in place over the last two years – lower growth and higher volatility. The winners have remained winners: not surprisingly, lockdowns have accelerated the trend of online shopping, while increased healthcare spend is being driven by ageing populations as well as vaccine research. The losers have remained losers: geopolitics between the west and China were already under scrutiny over human rights concerns and trade deficits, and this has only increased as parts of the world blame China for the coronavirus. Debt levels have continued to accelerate as quantitative easing and fiscal support ramp up, and bond yields have continued to decline as low growth from yet another global shock has made deflation more of a risk than inflation.

Chart 1: Economic Surprise Indexes

Source: Bloomberg

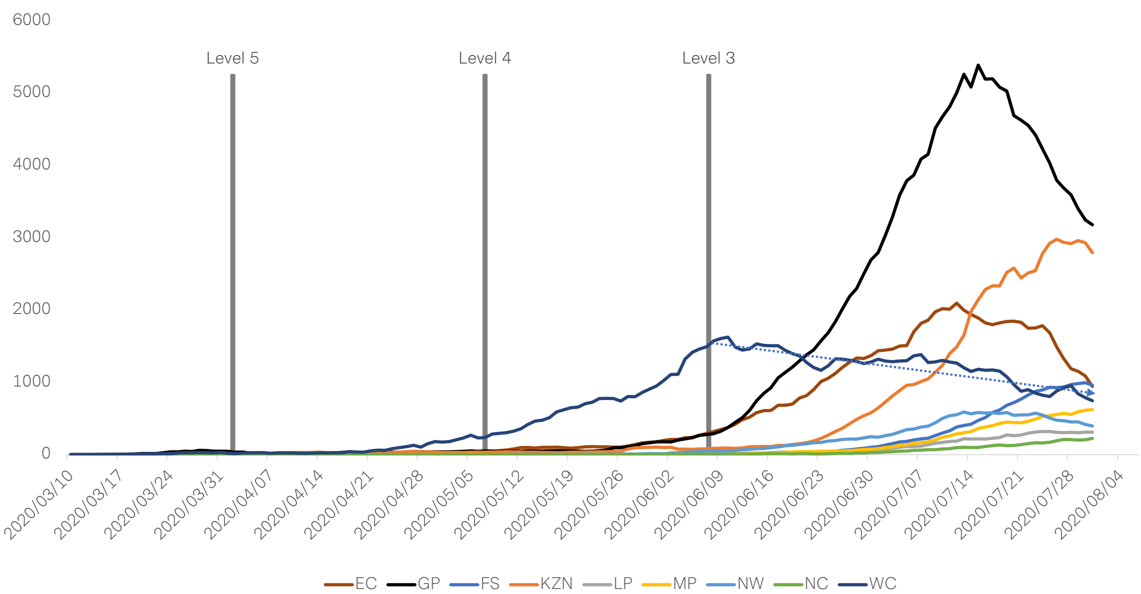


South African caseload skyrockets

SA has the world's fifth-highest caseload, above Mexico, Chile, the UK, Spain and Italy. As active cases in South Africa exploded, the country refined the lockdown; banning alcohol sales again and closing public schools for four weeks, while opening up intra-provincial accommodation for leisure. The epicentre is clearly now in Gauteng, (Chart 2), while the Western Cape has experienced a declining rate of new cases despite lockdown restrictions opening up to level 3. May's headline inflation decreased to 2.1%, its lowest point since October 2004, which allowed the SARB to cut rates a further 25bp to 3.5%. Despite these low cash yields, South Africa has the highest 10-year real yields, hedged into dollars, in the investable EM universe, followed by Brazil, which will keep South African bonds and currency in demand due to the global search for yield. However, South Africa does have a lot of debt to finance, and though this has been partly achieved through the IMF's approval of $4.3bn in emergency funding to assist fighting the coronavirus pandemic, they note that "there is a pressing need to ensure debt sustainability and implement structural reforms". The New Development Bank has granted a $1bn loan, and South Africa is also expected to approach the World Bank for a $2bn facility..

Chart 2: Daily new cases in South Africa (7-day rolling average)

Source: https://sacoronavirus.co.za/



Beware Big Tech; the US has already peaked; ground-breaking EU deal

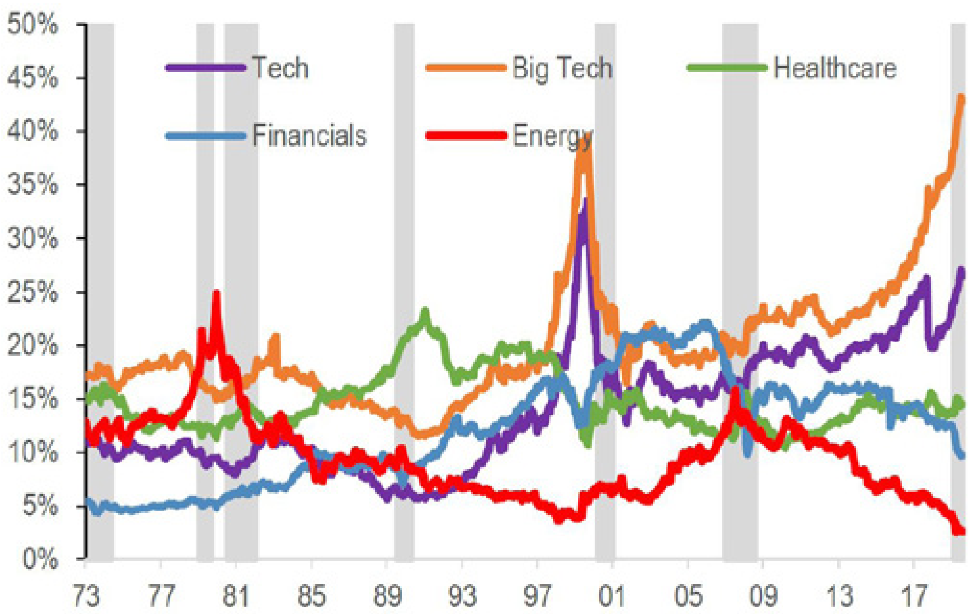
Recessions often result in leadership changes as economies and markets are disrupted. The US remains the equity market leader, driven partly by its high weighting in Tech and Healthcare, but positioning in the Big Tech stocks is looking stretched. Big Tech stocks make up more than 40% of the S&P, a higher concentration than during the Y2K tech bubble (Chart 3). Covid-19 has reinforced the secular trend to online spending, but valuations are looking extreme in the short term.

In the long term, the US has other headwinds: based on World Bank and IMF data, China is set to eclipse the US in GDP size in four years, with Asian countries expected to make up four of the top five countries in the world by size of GDP in 2024. China's economic growth has been phenomenal since the 1990s, but it has recently handed growth leadership to India and Indonesia, which are expected to reach ranks three and five respectively by 2024. Asia's burgeoning middle class is one of the reasons for this global shift in GDP. Given that the US makes up 65% of the MSCI World Index, it is a diverging from their economic weight.

Currency markets have begun to reflect this economic shift. As Europe and China open up their FX markets, so a growing share of liquidity is moving out of the US, and over the last two decades, the US's share of foreign currency reserves has dropped from 70% to 60% – still by far the bulk, but the trend is against the dollar. One of the biggest headwinds to the euro has been its sustainability given the lack of fiscal union. However, the euro got a boost relative to the dollar thanks to a ground-breaking agreement by which EU leaders agreed to a recovery fund worth €750bn. This agreement marks the first time the EU Commission will be able to issue euro debt for all 27 EU members, leveraging its AAA credit status and marking a step towards fiscal federalism. While this is only temporary debt, it is at the equivalent of 6–7% of EU GDP, and the EU will become one of Europe's largest bond issuers, a meaningful step towards the permanent creation of a single bond market and fiscal union.

Chart 3: Sector weights in S&P500

Source: JPMorgan



Key indicators

		1 mo.	3 mos.	6 mos.	1 yr.	2 yrs.	3 yrs.	5 yrs.	10 yrs.
J203T	**FTSE/JSE All Share Index**	2.6%	10.8%	1.0%	1.6%	1.9%	3.6%	4.6%	10.3%
J200T	**FTSE/JSE Top 40 Index**	2.4%	10.9%	4.3%	4.6%	3.4%	4.9%	5.1%	10.6%
J210T	**FTSE/JSE Resources 10 Index**	8.3%	24.2%	19.3%	28.6%	20.6%	22.1%	13.1%	4.9%
J211T	**FTSE/JSE Industrials 25 Index**	-1.2%	5.3%	6.2%	4.3%	2.6%	1.8%	4.1%	15.0%
J212T	**FTSE/JSE Financials 15 Index**	1.2%	-0.5%	-28.4%	-31.3%	-18.6%	-7.9%	-5.3%	7.0%
J403T	**FTSE/JSE SWIX Index**	2.4%	9.6%	-2.4%	-1.7%	-1.4%	0.7%	2.6%	10.0%
J433T	**FTSE/JSE Capped SWIX Index**	3.0%	9.7%	-5.6%	-5.1%	-4.3%	-1.5%	0.7%	-
J303T	**FTSE/JSE CAPI Index**	2.9%	10.9%	-0.4%	0.0%	0.5%	2.6%	3.9%	10.0%
J253T	**FTSE/JSE SA Listed Property Index**	-3.2%	9.0%	-37.6%	-41.2%	-23.3%	-20.2%	-10.5%	3.7%
ALBI	**JSE All Bond Composite Index**	0.6%	6.4%	-0.2%	4.2%	6.1%	7.8%	7.4%	7.9%
STeFI	**STeFI Index**	0.4%	1.4%	3.0%	6.6%	7.0%	7.1%	7.2%	6.5%
	MSCI World Index in SA Rands	2.7%	4.5%	12.7%	27.3%	19.5%	17.1%	14.1%	19.3%
	Rand/US Dollar Exchange Rate	-2.0%	-7.3%	13.5%	18.7%	13.3%	8.9%	6.1%	8.9%
	Rand/Euro Exchange Rate	3.2%	0.1%	21.0%	26.7%	14.0%	9.0%	7.7%	7.8%
	Headline CPI	0.5%	-0.6%	1.0%	2.2%	3.3%	3.7%	4.5%	5.0%
	PPI	0.5%	-0.5%	0.1%	0.5%	3.1%	4.0%	4.6%	5.1%