Sygnals

June 2020

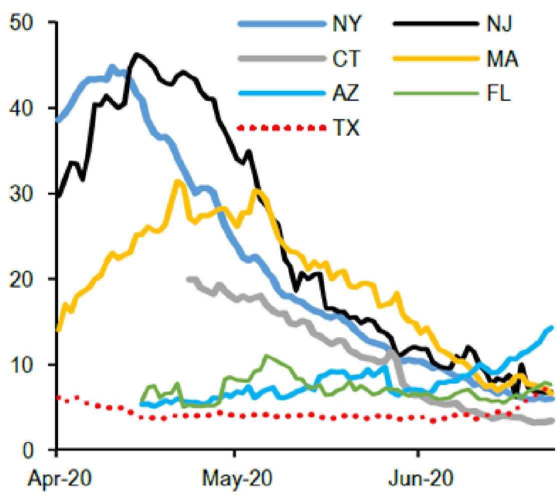
Market Review

We are halfway through the year and, despite a strong recovery, markets are still caught between conflicting signals. On the positive side, forward-looking indicators such as Empire and Philly Surveys suggest that the recession is already over in the US; global growth is set to rebound in Q3 as economies open up; a Covid-19 vaccine is likely soon given the unprecedented government funding to drug makers; policy remains supportive; and a potential Biden victory could contain geopolitical risk with China.

On the negative side, the IMF revised its global growth outlook lower and now expects GDP to contract by 4.9% in 2020 (previously -3.0%), the most in six decades; company results show massive damages to earnings; Trump continues his sabre-rattling against China; and the Covid-19 infection rate is on the rise again. However, the increase is far slower than before and for now, policymaker preferences are leaning towards isolated measures for lockdowns, partly due to lower-than-modelled hospitalisation rates (see chart 1). Locally, despite not having reached a peak in the infection rate, South Africa has implemented further easing in lockdown restrictions, allowing restaurants, casinos and personal care businesses to open. According to Minister of Health, Zweli Mkhize, while the number of confirmed cases has grown exponentially in South Africa, hospital utilisation rates are still far below what was expected.

Chart 1: % of Covid-19 hospital patients in the US has not risen materially despite increases in cases.

Source: JPMorgan



US – Trump and the dollar

As Trump's campaign for re-election in November heats up, we are likely to see a continued escalation of US/China tensions. US President Trump criticised China's handling of the Covid-19 pandemic, stating that the US could consider a complete decoupling from the Chinese economy. An underwhelming rally in Tulsa dampened Trump's odds of retaining the presidency, down to 47% compared to Biden's 53% (Chart 2).

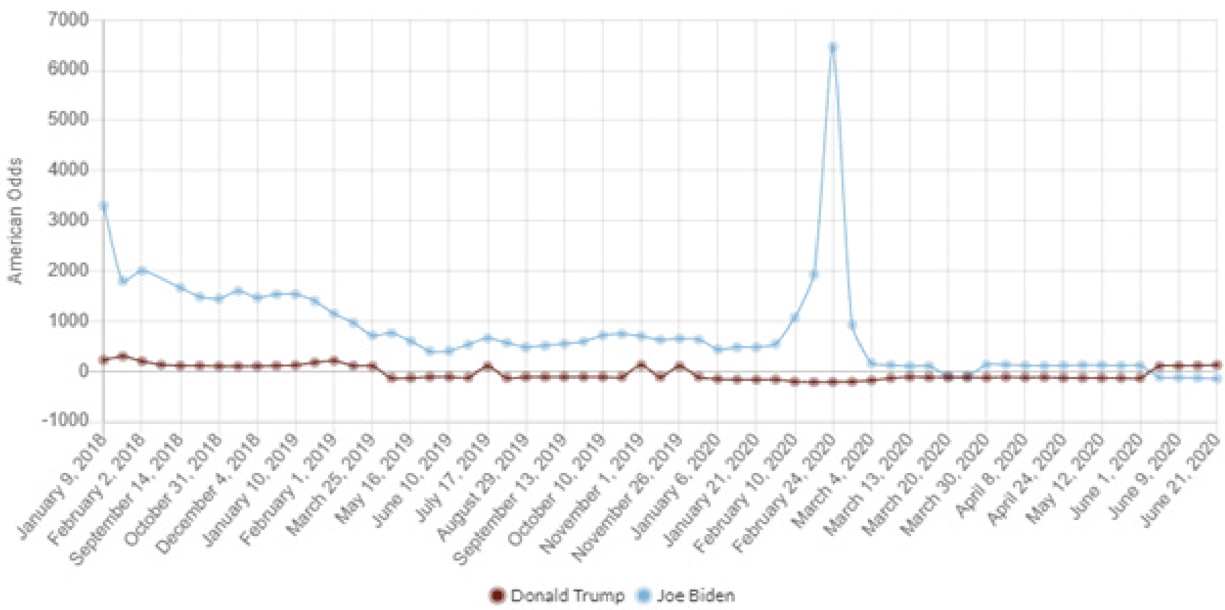
The outlook of the dollar is a key driver of asset allocation that we review regularly; a weak dollar is very supportive of emerging markets, trade and commodities. The dollar moves in long-term cycles that last an average of nine years, moving between periods of undervaluation and overvaluation. We are currently in the ninth year of a strong dollar rally. While turning points are impossible to pick, we may be getting close, with the US elections being the key.

- The dollar is overvalued on a long-term inflation differential (purchasing power of parity), and interest rate differentials have narrowed in favour of non-US currencies.
- The US has a significant twin deficit (budget account and current account), which is traditionally a headwind to currency strength. The combined deficit is close to 20% of GDP, the highest since WWII.
- The US's deficit on its net international investment position has increased, which is a further headwind to dollar strength.
- The rise of the US shale oil industry and US energy independence is likely to reverse with lower oil prices.
- ECB has set up a Eurosystem repo facility that will supply euros to non-eurozone central banks to raise the "importance of the euro in global financial markets". This follows similar moves by China, and it increases the international attraction of EUR and CNH relative to the USD.
- Most important for now, and the key unknown, is the November election. Any improvement in the Democrats' chance of victory is likely to see a weaker dollar.

The coronavirus crisis will keep the dollar elevated in the near term as a safe haven asset, but as the crisis resolves we could see the start of long-term dollar weakness, particularly if Biden takes the reins.

Chart 2: Biden takes the lead.

Source: Sportsbettingdime.com



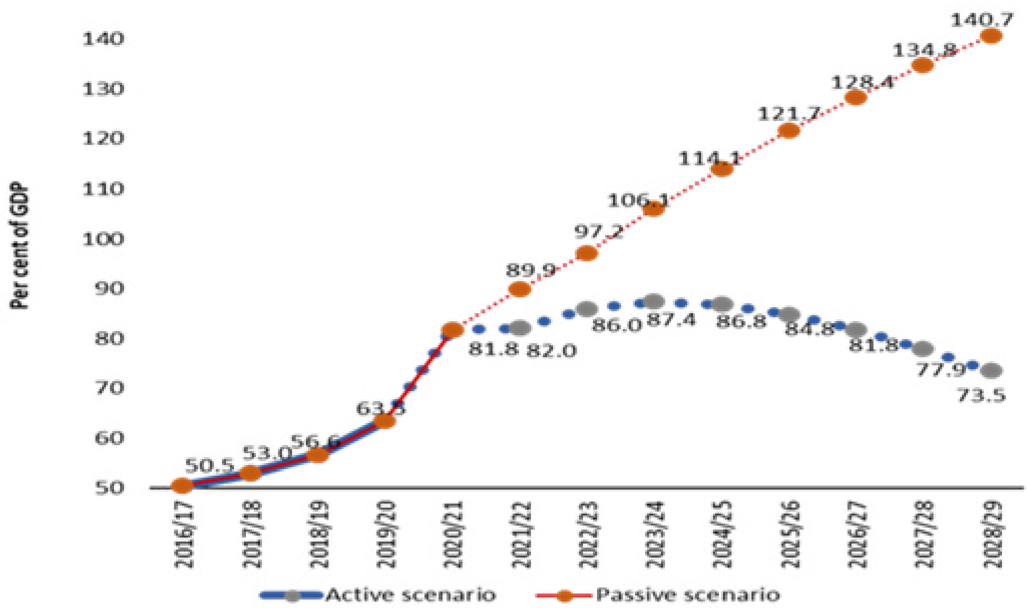
South Africa – Debt skyrockets

Government debt was projected to increase from 65.6% in the current year to 71.6% of GDP by 2022/23. In a special adjustment budget, the first of its kind, Tito Mboweni announced that with the Covid-19 recession, fiscal deterioration accelerated: gross national debt is now expected to reach 81.8% of GDP in the current year due to a budget deficit of 14.6% of GDP this year. The IMF estimates GDP growth in South Africa to contract by 8% this year. Without structural reforms, this will only get worse (passive scenario in Chart 3), with the country spiralling into default. However, government has resolved to implement active economic reform measures that will raise growth, create jobs and stabilise the debt-to-GDP ratio. These proposals will be set out in the 2020 MTBPS, but even with these reforms, gross debt-to-GDP is expected to peak at a massive 87.4% in four years. As unemployment figures rose to a 17-year high of 30.1% (even before the visible effects of lockdown), these reforms are desperately needed. Moody's responded to the budget stating that the reforms "will be very difficult to achieve." Meanwhile SAA's restructure has once again been delayed by the unions.

We will have to wait and see if the promises are delivered.

Chart 3: South Africa's skyrocketing debt.

Source: National Treasury



Key indicators

		1 mo.	3 mos.	6 mos.	1 yr.	2 yrs.	3 yrs.	5 yrs.	10 yrs.
J203T	**FTSE/JSE All Share Index**	7.7%	23.2%	-3.2%	-3.3%	0.5%	5.1%	4.2%	10.9%
J200T	**FTSE/JSE Top 40 Index**	7.8%	24.2%	0.4%	-0.5%	2.0%	6.7%	4.8%	11.2%
J210T	**FTSE/JSE Resources 10 Index**	8.6%	40.6%	6.2%	11.7%	15.0%	24.1%	9.5%	4.6%
J211T	**FTSE/JSE Industrials 25 Index**	8.3%	17.1%	9.7%	7.2%	2.0%	4.2%	4.6%	16.2%
J212T	**FTSE/JSE Financials 15 Index**	3.1%	11.1%	-33.4%	-36.9%	-16.5%	-6.6%	-4.9%	8.0%
J403T	**FTSE/JSE SWIX Index**	8.1%	22.1%	-6.3%	-6.1%	-2.5%	2.0%	2.1%	10.6%
J433T	**FTSE/JSE Capped SWIX Index**	7.0%	21.6%	-10.7%	-10.8%	-5.0%	-0.8%	0.1%	-
J303T	**FTSE/JSE CAPI Index**	7.0%	22.9%	-5.2%	-5.6%	-0.6%	3.8%	3.4%	10.5%
J253T	**FTSE/JSE SA Listed Property Index**	13.4%	20.4%	-37.6%	-40.0%	-22.2%	-18.3%	-9.1%	4.7%
ALBI	**JSE All Bond Composite Index**	-1.2%	9.9%	0.4%	2.8%	7.1%	8.1%	7.5%	8.3%
STeFI	**STeFI Index**	0.4%	1.5%	3.2%	6.8%	7.1%	7.2%	7.2%	6.5%
	MSCI World Index In SA Rands	1.2%	16.2%	17.1%	27.0%	17.7%	17.3%	14.8%	19.3%
	Rand/US Dollar Exchange Rate	-1.4%	-2.7%	24.3%	23.4%	12.5%	10.0%	7.4%	8.5%
	Rand/Euro Exchange Rate	-0.5%	-0.9%	24.3%	22.0%	10.4%	9.4%	7.6%	7.6%

Note: Headline CPI and PPI figures are unavailable for June.