May 2020 Market Commentary

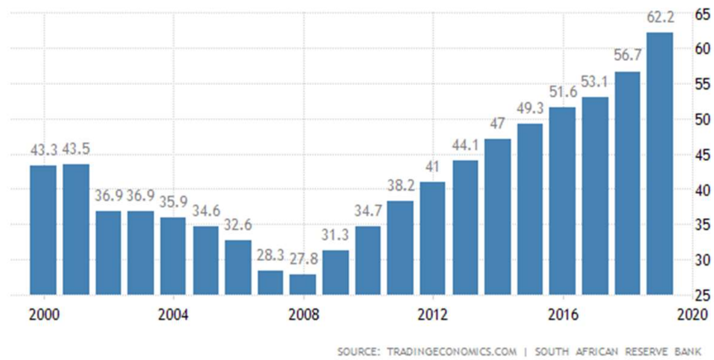
SA Market Overview

South African markets were mostly pulled along with the global trend of risk on and off during the month of May. The global capital markets struggled for clear direction during the month, however the hope of a quick economic recovery after the COVID-19 pandemic was the main driver of positive returns. The South African markets and currency has long been a lightning rod for emerging market exposure thus the risk on sentiment drove the positive returns in the local capital markets. In particular the bond market had a big rally as both locals and foreigners piled into our high yielding government bonds. They gained +7% in Rands and 11.5% in Dollars in the month.

South Africa has entered level three of lockdown conditions from 1st June 2020 and this will see roughly 8 million South Africans returning to work as part of the phased reopening of the economy. This has been coupled with the suspension of the 8pm curfew and the strict exercise time of 6am-9am, as well as the resumption of the sale of alcohol. This is a big step to returning to some resemblance of normality. There is however still confusion over some of the lockdown regulations and post month end the High Court in Pretoria has found the regulations of level 3 & 4 are unconstitutional and has given the Minister of Cooperative Governance and Traditional Affairs (N Dlamini-Zuma) 14 days to amend these regulations to comply with the constitution of our nation, but the State is appealing this ruling.

South African state-run enterprises have long been a thorn in the sides of tax paying citizens, the list of failing SOE's now include, among other, SAA, ESKOM, Land Bank, and most recently DENEL. SAA has already been placed under business rescue and the process has been put in place for provisional liquidation. Landbank is severely cash strapped and has drawn on liquidity channels to finance the repayment of some of its debt in order to avoid a technical default. DENEL had stated earlier in May that it has a serious lack of liquidity and may not be able to meet some of its upcoming pension plan payments. This once again highlights the dismal state of the State-owned enterprises in South Africa and the desperate need for sweeping fiscal reform. On the front of reform, the PIC is reviewing a proposal to swap some of the ESKOM debt held in the public pension fund for equity of the strained SOE, while it is unlikely that the deal will go through in its current form, the proactive nature of the proposal is a breath of fresh air in the usually bureaucratic debate on SOE reform.

Another point of concern for investors in South Africa has been the steady increase in government debt. Since 2008 we have seen a steady increase in government debt as a percentage of economic output to a point where it has reached 62.2% in 2019, this will be further exacerbated by the fiscal response to the coronavirus pandemic as well as the increase in debt servicing cost due to the recent weakness in the ZAR. The increase in debt will likely not affect the interest in government bond auctions though as the SARB has purchased R10.2 billion worth of government debt in the secondary market during May, bringing the total to roughly R22 billion since the start of the purchasing program. This will support demand for government debt, as the SARB effectively stands as a buyer of last resort in the secondary market. The purchasing program is likely to continue over the medium term, as the reserve bank governor Lesetja Kganyago stated that they have effectively no upper limit on the amount of bonds they are willing to purchase. The graph on the <u>right</u> shows SA government debt as a percentage of GDP since 2000.



The recent weakness in the local currency unit has been reverting over the past month or so. The ZAR appreciated 5.6% against the Dollar over May and continued strongly after month-end. This brings the total YTD performance to a depreciation of (-20.2%) among the worst performers in the emerging market space. The Rand is currently roughly 15% undervalued on a purchasing power parity basis and is hovering around a resistance level of 16.65 per USD.

The table below shows shorter- and longer-term trends in currencies. In SA case longer term the weakness is about 2-3% p.a. above the inflation differential that is a typical long-term trend beacon. This difference is largely attributable to economic growth and political risk.

Currency Performance (USD Base)	1 Month	Year to Date	1 Year	3 Years	5 Years	10 Years
Developed Markets						
Australian dollar	2,39%	-5,05%	-3,95%	-3,55%	-2,69%	-2,36%
British pound	-1,96%	-6,95%	-2,28%	-1,42%	-4,19%	-1,62%
Euro	1,29%	-1,01%	-0,75%	-0,43%	0,20%	-1,03%
Japanese yen	-0,57%	0,77%	0,45%	0,92%	2,86%	-1,66%
Norwegian krone	5,37%	-9,68%	-9,94%	-4,62%	-4,38%	-4,01%
Swiss franc	0,42%	0,69%	4,12%	0,22%	-0,44%	1,86%
Emerging Markets						
Argentine peso	-2,47%	-12,56%	-34,62%	-38,29%	-33,35%	-24,89%
Brazilian real	2,82%	-24,69%	-26,50%	-15,44%	-9,84%	-10,20%
Chinese yuan	-1,05%	-2,44%	-3,25%	-1,55%	-2,78%	-0,44%
Mexican peso	8,99%	-14,62%	-11,53%	-5,66%	-7,06%	-5,25%
Russian ruble	6,04%	-11,63%	-6,72%	-6,92%	-5,69%	-7,87%
Turkish lira	2,44%	-12,78%	-14,40%	-19,73%	-17,15%	-13,65%
South African rand	5,59%	-20,23%	-16,89%	-9,26%	-7,08%	-7,93%

Cumulative returns are shown for periods less than one year. Returns for periods greater than one year have been annualised.
Source: Investing.com

Global Market Overview

Markets across the globe were caught in a tug-of-war between the bulls and the bears over the past month. Risk sentiment was boosted throughout the month as more countries started lifting their quarantine and lockdown restrictions in a bid to jumpstart their respective economies. Risk averse investors were quick to point out that this was likely to lead to a 'second-round' of infections and could cause governments to tighten their lockdown policies again later. By month end the bulls had their way and we saw safe haven assets such as US treasury bills drop while global equities surged +4.68% in Dollars, mainly on the back of a few specific stocks outperforming, such as big tech and work-from-home solutions, while banking and manufacturing sectors suffered.

Most countries have now started to ease their self-isolation restrictions with markets reacting positively to the coming pickup in economic conditions. The current economic data prints are only now starting to reflect the global quarantine periods and we are expecting some more dismal data over the coming month or so. This must be taken with a grain of salt however, as it must be considered that markets are forward looking and are considering the data yet to come once the usual lag in economic data is considered this could be either more positive or more negative than in the current price.

The US and China have once again started saber-rattling on the political front regarding Hong Kong, trade conditions and cyber security led by 5G. While President Trump is facing reelection, his electoral base is largely finding themselves unemployed. On the surface Trump might be inflating tensions with China in an attempt to make them a scapegoat for the health crisis and subsequent economic crisis. This culminated in the Trump administration stating that they had obtained 'significant evidence' that the virus had originated in a Chinese laboratory in Wuhan, the Chinese responded by stating that the Presidency is attempting to create 'a new Cold War'. These tensions were put on the backburner however as Beijing's introduction of a security law that would significantly impact the autonomy of Hong Kong that spurred global criticism and ignited renewed Hong Kong protests. This in turn led to the US state department ceasing any special economic treatment to Hong Kong, effectively making the city-state a part of China in the eyes of the US.

The price of oil has started to normalize as production cuts have started to take effect. The US cut production by roughly 1.7 million barrels/day during May, this comes after a combined cut by Russia and the Kingdom of Saudi Arabia of 10 million barrels/day in early April. With Lockdown policies leaving many businesses closed, the lack of demand left the bounce in oil prices muted, but as economies started to open up, oil prices rebounded and WTI was trading at 37.19 $/b and Brent Crude at 39.35 $/b by month end.

US unemployment has been drastically increasing over the past few months, reaching 14.7% in April, but the May (ADP) unemployment claims only totaled 2.8 million, while this is still a significant increase in the number of unemployed people, it is in stark contrast to the 19.6 million job losses in April and also quite significantly less than the expected consensus of 9 million odd jobless claims. This could be the first signal that we are nearing a bottom in the economic decimation caused by COVID-19 and the subsequent lockdown measures. After month end however, the department of labor released their total employment numbers, which showed an increase of 2.5 million jobs. The main difference between these conflicting reports is that the ADP report counts active workers, while the department of labor counts all workers currently receiving payment, hence any temporarily suspended workers (such as people on strike) would not be counted in the ADP calculation, but will be included in the department of labor statistic.

The US is experiencing a level of civil unrest unseen since the civil rights movement of the 50's and 60's. This period of protesting has come as a result of the death of an African American man, George Floyd, while in police custody. A video of the incident in question was circulated on social media and has sparked widespread outrage across the globe. The incident ties in with the already widespread criticism of the treatment of African Americans by police in the US and resulted in many large US cities including both New York and Washington DC being placed under a curfew. Markets have however shrugged off or looked through these events, as the hope of an economic recovery has taken center stage.

Asset Class Performances in ZAR

As at 31st May 2020	MTD	YTD	1 Year	3 Years*	5 Years*
Global Equity – MSCI ACWI	0.49	13.77	26.91	15.82	13.62
Global Property - FTSE EPRA Nareit DR	(3.34)	(2.88)	1.83	9.05	9.24
Global Bond - JPM GBI Global Traded	(4.05)	31.24	29.55	14.50	11.62
Global Cash - ICE LIBOR 1 Month	(3.98)	26.78	23.33	12.22	9.11
SA Equity - FTSE/JSE All Share	0.31	(10.12)	(5.96)	1.33	2.46
SA Property - FTSE/JSE SA Listed Prop	(0.76)	(44.94)	(45.92)	(21.61)	(11.38)
SA Bond - Beassa ALBI	7.06	1.56	6.45	8.20	7.72
SA Cash - STeFI Call Deposit	0.36	2.36	6.26	6.54	6.56

Asset Class Performances in USD

As at 31st May 2020	MTD	YTD	1 Year	3 Years*	5 Years*
Global Equity – MSCI ACWI	4.68	(9.76)	4.80	5.14	5.50
Global Property - FTSE EPRA Nareit DR	0.69	(22.96)	(15.91)	(1.02)	1.43
Global Bond - JPM GBI Global Traded	(0.05)	4.10	6.98	3.94	3.64
Global Cash - ICE LIBOR 1 Month	0.03	0.56	1.84	1.87	1.31
SA Equity - FTSE/JSE All Share	4.49	(28.71)	(22.34)	(8.02)	(4.86)
SA Property - FTSE/JSE SA Listed Prop	3.38	(56.33)	(55.34)	(28.84)	(17.72)
SA Bond - Beassa ALBI	11.53	(19.44)	(12.10)	(1.78)	0.02
SA Cash - STeFI Call Deposit	4.55	(18.81)	(12.26)	(3.29)	(1.06)