OVERBERG MARKET REPORT

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IN THIS WEEK'S BOTTOM LINE

Contributed by Nick Downing

- The surge in global money supply growth and ballooning global debt are driving the extraordinary gold price rally. There is a strong correlation between money supply and the gold price. Read more in the Bottom Line.

SOUTH AFRICA POLITICAL REVIEW

Contributed by Nick Downing

- Emboldened by the steady decline in new infections and the sharp reduction in active Covid cases, President Ramaphosa announced on Saturday that the entire country would move from level-3 to level-2 lockdown from the 18th August. Most restrictions on the resumption of economic activity will be removed, although the government extended the national state of disaster until 15th September, so it can maintain remaining restrictions, which include: Restrictions on international travel; no gatherings of more than 50 people; curfew from 22hr00 to 04hr00. The easing in lockdown restrictions should boost economists' forecasts for third quarter GDP growth. A solid rebound is expected, although it will take several quarters before pre-pandemic economic output levels are achieved. The extent and sustainability of the economic rebound depends greatly on the government's appetite for and sense of urgency in implementing structural economic reforms.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Nick Downing

- As expected, mining, manufacturing and retail sales data were broadly disappointing in June, cementing the end of a depressing quarter. On a quarter-on-quarter annualised basis, the three economic sectors shrank by a bewildering 76.2%, 76% and 65.8%, respectively. However, sequential month-on-month growth is encouraging, except in the case of mining production, which fell in June by 1.4% on the month, despite a return to full production. Manufacturing was more upbeat, with production rising by 16.8% on the month, building on the 30.4% gain in May. Retail sales growth showed further growth of 6.4% on the month, having recovered by a massive 68.7% in May. On a year-on-year basis, manufacturing and mining output and retail sales, still remained in deeply negative territory, with contractions of 16.3%, 28.2% and 7.5%, respectively. Although agricultural production figures have not been released yet, the dismal data released so far are consistent with a severe contraction in GDP in the second quarter (Q2) of between 40-45% quarter-on-quarter annualised. Fortunately, the Q2 decline will likely mark the low point in the pandemic-related recession, with a strong rebound expected in the second half of the year, although sustained momentum will depend greatly on government's implementation of structural economic reforms.

GLOBAL

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- The upward movement in global equities is broadening, which indicates greater sustainability in the current rally. The current bull market is no longer the sole domain of the large-cap technology stocks. Cyclical stocks, such as industrial and smaller cap shares are now joining the party. For the month to date, the Russell 2000 index of small cap shares surged by 6.6% far outweighing the 3.1% gain in the S&P 500 index. The industrial sector has provided a standout performance, rising by 8%. Is the rotation from defensive technology stocks into cyclical stocks sustainable? It depends on the sustainability of the economic rebound, which in turn depends on the rapid approval and rollout of an effective vaccine and continued monetary and fiscal support. The managers of Ruffer Investment Company are wary of the winning shares such as Amazon and Apple, which have already risen by 50% since the start of the year. According to Ruffer, "We think if you want to play economic recovery, these are precisely the wrong sort of stocks to be in… Remember that if GDP growth picks up, the valuation premium granted to secure growth stocks becomes unwarranted." Recent earnings results confirm the broadening economic rebound, with 80% of companies making up the S&P 500 index beating their second quarter earnings forecasts. Meanwhile, watchers of the Dow Theory, which requires both the Dow Jones Industrial index and Transportation index to climb concurrently in order to confirm an upward trend, will be encouraged by the recent resurgence of the Transportation index. The index has rocketed by 9.7% since the start of August, enjoying its longest winning streak since 2010. The broadening market rally is good news for equity investors.

NORTH AMERICA

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- At its next policy setting meeting on 15-16th September, the Federal Reserve is widely expected to announce new forward guidance measures, tying monetary policy to an average 2% inflation rate rather than an absolute 2% inflation rate, allowing for overshoots over periods of time. The Fed is also expected to indicate some form of yield curve control, as adopted by the Bank of Japan, whereby longer dated Treasury bond yields are pegged by asset purchase programmes. While the Fed is prepared to do whatever it takes to safeguard the economic rebound, it is urging Congress to provide more fiscal support. Talks between the White House and the Democrat party collapsed again at the weekend as parties failed to find common ground between the Republican's $1 trillion proposal and the Democrat's $3 trillion proposal. The impasse prompted President Trump to sign Executive Measures, which will provide $300 per week in enhanced unemployment benefits. Although less than the $600 per week programme which expired on the 31st July, the Labour Department stated that around half of recipients would be receiving the same or more than if they were working. The Department indicated that the interim programme had sufficient funding to last about 6 weeks. Meanwhile presidential candidate Joe Biden is proposing significant fiscal spending aimed at modernising the nation's infrastructure, addressing climate change, education and healthcare. He has stated that the spending programmes will be funded via $4 trillion in tax increases over the following decade, although reassured his audience that any tax cuts would wait until the coronavirus threat passes and the economy is on an even footing.

- Initial jobless benefit claims shrank for a second straight week in the week ended 8th August, falling from 1.2 million to 963,000 well below the 1.1 million consensus forecast. The sharp decline follows the upbeat July non-farm payroll report, which confirmed the creation of 1.8 million new jobs during the month, the third straight month of jobs growth. The unemployment rate fell in July to 10.2%, although far off the 50-year low of 3.5% recorded in February, shows a solid improvement from April's peak of 14.7%. The jobs recovery appears to be gaining momentum notwithstanding the resurgence in coronavirus infections and renewed restrictions in certain states. There is clear evidence that layoffs are easing and that hiring is picking up. Most of the new hiring is centred on the service sector of the economy, most affected by social distancing measures, especially in the hospitality, leisure and retail portions. The flipside of the encouraging labour market data is that it slightly reduces the urgency for Congress to agree on fiscal support measures.

- Maintaining the recent trend in positive economic data surprises, retail and industrial production data were both stronger than expected in July, despite the resurgence in coronavirus infections and newly imposed restrictions in some states. Both increased for a third straight month on a month-on-month basis. Retail sales increased 1.2% on the month and were unexpectedly higher than the pre-pandemic February level by 1.7%. Consumer spending has benefitted from the $1200 personal cheques and $600 per week enhanced unemployment payments, authorised under the $3 trillion Cares Act. Although much of the windfall has been saved by consumers due to uncertainty over the pandemic, the net effect is positive for consumer spending, which drives three quarters of US GDP. Consumer spending is expected to surge higher as pandemic anxiety dissipates and the household savings ratio reduces. Although industrial production failed to reach pre-pandemic levels, remaining 8.2% below the year-ago figure, it gained in July by a solid 3% on the month, beating the 2.8% consensus forecast. Manufacturing output, the largest industrial component, was especially strong with a 3.4% gain on the month, powered by a 28.3% increase in car and car part production.

- Consumer price inflation (CPI) increased in July by 0.6% month-on-month, its second straight monthly increase, equalling June's monthly figure. Core CPI, which excludes food and energy prices due to their volatility, also registered 0.6% in July gaining on June's 0.2% increase. Both inflation readings were far stronger than expected, well ahead of the respective 0.3% and 0.2% consensus forecasts. According to Paul Ashworth, chief US economist at Capital Economics, the inflation data "Should end any speculation that the pandemic-related slump in demand will quickly push the economy into a deflationary spiral." If anything, markets are more fearful of a resurgence in inflation than deflation, due to the impact of massive monetary easing and fiscal stimulus. Morgan Stanley's chief US equity strategist Mike Wilson warns that the Fed may lose control of the expected inflation burst. He states that while the massive monetary easing following the 2008/09 global financial crisis did not trigger a surge in inflation, this time may be different as governments have launched massive fiscal stimulus rather than fiscal austerity, the case ten years ago. Moreover, banks are in far better shape, and able to facilitate a broader expansion in money supply. Money supply growth cannot generate inflation on its own unless it is accompanied by a healthy money multiplier, which is more likely to be achieved with strong fiscal stimulus and a healthy bank sector.

CHINA

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- Although confirming a continuing recovery, China's economic data were slightly weaker than expected in July, especially the retail sales figure. Industrial production, boosted by government support of state-owned enterprises, gained by a solid 4.8% year-on-year matching June's increase. Fixed asset investment also fared well, helped by state sponsored infrastructure spending programmes. Although falling year-on-year by 1.6% in the January-July period, this was an improvement on the 3.1% decline published in June. Property investment increased by 3.4% and homes sales turned positive for the first time since the pandemic, rising by 0.4% on the year. The weak spot was retail sales, which fell in July by 1.1% on the year and although improving from June's 1.8% contraction, failed for a second straight month to meet expectations of a return to growth. Fiscal stimulus in China has centred on the supply-side of the economy rather than the demand-side, explaining the uneven economic recovery. The data is likely to prompt China's authorities to increase their fiscal assistance to households, especially as government attention turns to the domestic economy as the preferred means to sustain the economic recovery. This recent shift in policy focus is attributed to the deteriorating relations between China and the US and increasingly, with other key export destinations.

JAPAN

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- Japan's economy contracted for a third consecutive quarter, recording a 7.8% quarter-on-quarter decline in real output in Q2. The decline was broadly in-line with expectations and confirmed the severe impact of preventative measures implemented in April and May to reduce the spread of the coronavirus. Private consumption, which contributes roughly 60% to Japan's output, fell sharply, down 8.2% on the quarter, and contributed -4.5 percentage points to the overall decline in GDP. Net exports detracted 3 percentage points as a slump in global demand caused exports to fall by 18.5% on the quarter in Q2, following the decline of 4.2% in Q1. Business investment remained resilient and added only 0.2 percentage points to the quarter's decline, giving hope that the underlying economy is perhaps in better shape than previously thought. Compared to other G7 nations over the same period, Japan has fared better than the US (-9.5%), UK (-20.4%) and even Germany (-10.1%), but worse than other Asian countries such as South Korea (-3.3%) and Taiwan (-0.7%). The difference in economic performance highlights the effectiveness of the various strategies in dealing with the covid-19 pandemic. Japan acted early and managed to avoid the strict lockdown measures compared to the United Kingdom which acted late and had to implement much stricter measures for longer. Both countries have experienced renewed outbreaks but have thus far avoided another state of emergency.

EUROPE

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- The eurozone's GDP fell by a record 12.1% quarter-on-quarter in the second quarter of the year following the 3.6% decline in the first quarter. Spain was hardest hit, suffering an 18.5% decline quarter on quarter and 22.7% cumulative decline in the first half of the year. France (-13.8%) and Italy (-12.4%) both recorded the steepest quarter-on-quarter declines since WWII, and the latter is now in its fourth recession in just over a decade, bringing output in-line with levels three decades ago. Germany by contrast contracted by a moderate 10.1% on the quarter and a cumulative 11.9% in the first half of the year. Economists attribute the widening divide in economic performance between the southern and northern European countries to the relatively higher indebtedness of countries such as Spain and Italy compared to Germany and the Netherlands, which had more firepower to support their respective economies. Many southern European countries rely heavily on tourism, being threatened by a resurgence in covid-19 cases. The eurozone labour market also suffered its biggest decline on record during Q2, as employment plummeted by 4.6m or 2.8% on the quarter. However, economic data in the last few months point to a faster than expected recovery with exports, manufacturing and consumer demand all showing promising signs of increased activity.

UNITED KINGDOM

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- The United Kingdom experienced the biggest drop in economic output since quarterly records began in 1955 and reflected the devastation on the real economy caused by the covid-19 pandemic. The economy contracted by 20.4% quarter-on-quarter in Q2, marking the second consecutive quarterly decline after a 2.2% contraction in the first quarter of the year and plunging the UK into the deepest recession on record. Year-on-year the economy fell by 21.7% and was down 22.1% since the end of 2019. Although there was some recovery in June, the economy remains below the level seen after the last recession in 2010. Household expenditure, down 23.1% on the quarter, contributed more than 70% to the decline in GDP. Alarmingly, gross fixed capital formation plummeted 25.5% in Q2. This was driven by a drop of 31.4% in business investment, the biggest fall on record, as businesses, facing an uncertain future, are preserving cash buffers. The services sector contracted by 19.9% on the quarter while consumer-facing services, which account for roughly 80% of the economy, have been particularly hard hit during the lockdown. Production, down 16.9% on the quarter, and construction, down 35% on the quarter, both followed declines in quarter one and highlight the fact that the UK came into the pandemic already facing weak output. Compared to its peers, the UK fared worse than the US and Europe ex-Spain and this can be attributed to the UK's relatively large consumer-facing services sector. The UK faces a long road to recovery and concerns about employment figures once furlough schemes unwind remain a likely headwind to a consumer driven recovery this year.

FAR EAST AND EMERGING MARKETS

Contributed by Carel La Cock

- Former UK prime minister, Tony Blair, lists three priorities for developing nations to deal with the covid-19 pandemic, in an opinion piece published in the Financial Times. He rightfully argues that we cannot end the pandemic globally until all countries have succeeded in bringing it under control and highlights the important role that developed nations must play in support. Firstly, healthcare workers and services should be protected, because without them other diseases such as HIV, tuberculosis, malaria and malnutrition will spiral out of control. An emphasis should be placed on PPE and testing for healthcare workers. Secondly, the public should be engaged by clear messaging through media campaigns and an outreach to religious leaders about hygiene and social distancing rules.

Cost sharing by governments in mobilising community action should help facilitate a change in behaviour and has proved to be successful in previous pandemics in Africa. Lastly, governments should build capacity to deal with a sudden surge in new cases to avoid vulnerable health care systems failing under the pressure. Mr Blair asks the international community to assist by offering resources where necessary and to fairly distribute vaccines once developed. To a large extent, South Africa has been successful in implementing the above strategy and has seen numbers fall in some provinces. Developing nations do not have the luxury of spending themselves out of the crisis and with many citizens living from hand to mouth it is essential to keep the economies open and connected to the global economy. We truly are in this together and if low- and middle-income countries cannot deal with this pandemic, there will be no hope of eradicating the disease globally.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 0.01	57077
JSE Fini 15	- 35.21	10156
JSE Indi 25	+ 8.37	75107
JSE Resi 20	+ 19.62	58926
R/$	- 19.41	17.37
R/€	- 23.74	20.57
R/£	- 18.45	22.75
S&P 500	+ 4.40	3372
Nikkei	- 1.55	23289
Hang Seng	- 10.67	25183
FTSE 100	- 19.26	6090
DAX	- 2.62	12901
CAC 40	- 16.98	4962
MSCI Emerging	- 1.66	1096
MSCI World	+ 1.34	2390
Gold	+ 27.84	1948

Platinum	- 1.57	956
Brent oil	- 32.03	44.96

BOTTOM LINE

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- Very few investments have performed as well as gold bullion in 2020. The gold price started the year at $1521 per ounce and by the 14th August had reached $1944, a glittering return of 27.8%. In rand terms the return is truly gilded at a staggering 57.3%. Can it go higher? Should investors lucky enough to have exposure take profit and for the less lucky is it too late to join the party or have they missed the boat?

- The surge in global money supply growth and ballooning global debt are driving the extraordinary gold price rally. There is a strong correlation between money supply and the gold price. Central banks around the world are gushing liquidity into the financial system to stem the economic fallout from the Covid pandemic. Governments are doing their bit too through gargantuan fiscal support measures, which means budget deficits and debt levels are going through the roof. Since the last peak in the gold price in 2011, also in August when the price hit $1921, the world's monetary base and the total value of the world's US dollar denominated debt, have increased to a level consistent with a gold price of $2500-$3000.

- Traditionally, gold investment has been ignored by mainstream investors and remained the preserve of "gold bugs", who tend towards eccentricity and conspiracy theories. Gold is often ridiculed as an investment, considered by many respected investors, including Warren Buffet, as a very poor investment. He famously said that "Gold gets dug out of the ground in Africa, or someplace. Then we melt it down, dig another hole, bury it again and pay people to stand around guarding it. It has no utility. Anyone watching from Mars would be scratching their head." Yet astonishingly, Warren Buffet, one of the greatest critics of gold investment, reported on 14th August that his investment company Berkshire Hathaway had bought $560 million worth of Barrick Gold, the world's second largest gold mining company.

- Perhaps the gold bugs have been correct all along. Now that interest rates have dropped to zero, mainstream investors are becoming increasingly bullish on gold bullion, citing central banks' search for increasingly radical monetary policy instruments, such as helicopter money and Modern Monetary Theory (MMT). Under MMT, government deficits are funded by central banks' open-ended money printing. The debt ends up on the balance sheets of the central banks. Bank of America, citing the resulting monetary debasement, gave an 18-month gold price target of $3000 in its report titled "The Fed Can't Print Gold."

- With traditional safe-haven assets offering very little return, investors are having to look elsewhere. Bonds are the conventional safe-haven asset, typically comprising a 40% weighting in balanced pension fund portfolios, but with a large swathe of the world's bonds trading at negative yields, pension fund managers are having to look elsewhere. Moreover, at negative yields, bonds are no longer that safe but contain significant downside risk if interest rates or inflation go on a tear. Bond investment guru, Mohammed El-Erian, has observed "a gradual shift among investors regarding the role of gold in long-term asset allocations as a result of the very low yields on government bonds associated with central bank market interventions." Even a slight shift from bonds to gold could drive the bullion price sharply higher and gold shares even higher. The total market capitalisation of the New York Stock Exchange HUI Gold Stock Index is little less than the market capitalisation of Tesla, providing some context on how little value is ascribed to the sector.

- If the price of gold has upside potential, the potential for gold shares is even greater. In proportion to the gold price, the valuation of gold shares is at decade lows, indicating (all else being equal), significant upside for the shares. The pricing anomaly is even more evident when considering the fine health of gold mining companies, which over recent years have been exercising capital discipline, fixing their balance sheets, cutting costs and improving margins. The investment community is conspicuously under-weight the sector, a condition which normally suggests a very nascent bull market.

- Despite the increasingly positive mood, there are clear risks. Gold price forecasts are notoriously difficult to model as gold provides no cashflow. Given the difficulty, one can't help feeling that models are sometimes developed retroactively to explain historic price movements, which are then extrapolated to generate forecasts. Negative real interest rates are the most frequently cited reason for the surging gold price. Yet CrossBorder Capital economist Michael Howell has identified a "reverse causation" in the relationship arguing that rising gold prices precede falling real interest rates rather than the other way around.

- In real terms, the gold price is already near the peak levels hit in 1980 and 2011. A price of $2215 would be equivalent to the inflation-adjusted level of $800 reached in 1980. After that peak and the 2011 peak, the gold price declined dramatically. We are little more than 10% from $2215, and so some caution is warranted. We stick with our original motivation for investing in gold, as an insurance tool to reduce portfolio risk rather than for outright speculation. It is an effective risk diversifier. Since 1973, there have been 14 years in which the S&P 500 index has suffered negative returns. The gold price outperformed in 12 of these years, producing a solid 12% average annual dollar return over the 14 years.

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