OVERBERG MARKET REPORT

Tuesday 1st December 2020

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- MEGA – Make Emerging Markets Great Again. Rotation is the new buzz word in financial markets. Emerging markets can be a beneficiary of these rotations. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- The year-on-year inflation rate rose to a seven-month high of 3.3% in October from 3% in September. Inflation was mostly driven by food and non-alcoholic beverage prices (increasing 5.4%); housing and utilities (increasing 2.8%); and miscellaneous goods and services (increasing 6.7%). Meanwhile, core inflation (which excludes food and energy prices) increased to 3.4%. Inflation has remained within the South African Reserve Bank's 3%-6% target band since July, and below the midpoint of 4.5% since March. Despite the recent uptick in October, inflation is expected to remain benign in the coming months. Limited buy side pressure from a struggling economy and stable supply side risks (strengthening exchange rate and low oil price) support this outlook. The Reserve Bank's headline consumer price inflation forecast averages 3.2% in 2020, 3.9% in 2021 and 4.4% in 2022. Annual producer inflation (PPI) is also moderate registering 2.7% in October, slightly up from 2.5% in September. The annual increase was driven by food products, beverages, and tobacco products (up 5.1%). On a monthly basis, producer inflation ticked up by 0.4% in October compared with 0.3% in the previous month but with ample spare capacity in the economy it is unlikely to gain momentum.

- The RMB/BER Business Confidence Index (BCI) rose to 40 in the fourth quarter of 2020 from 24 in the third quarter. It was the highest reading since the second quarter of 2018, as the easing of lockdown restrictions helped to boost economic activity. Sentiment improved across all sectors (building, manufacturing, retail, wholesale and motor trade) and confidence in the wholesale and retail sectors moved back into net positive terrain for the first time in more than two years. Retail and wholesale confidence are usually linked to Black Friday and the festive season. The uptick in business confidence is a welcome surprise, although the sustainability remains a concern as the growth outlook for South

Africa remains highly uncertain. Pent up demand could run out of steam if the resurgence in Covid-19 infections, both locally and globally, leads to further lockdowns causing economic activity to decline. The increase in the RMB/BER BCI since the second quarter has mainly been driven by retail, wholesale and new vehicle trade, but it is imperative that activity in sectors linked to the supply-side of the economy (building, manufacturing and mining sectors) catches up to ensure the uptrend in confidence is sustained.

- Growth in private sector credit extension (PSCE) rose to 3.2% year-on-year in October, marginally up from September's decade low of 3.1%. The increase is the first after six consecutive months of slowdown. Against expectations, corporate credit extension picked up to 3.5% from 3.1% in September and a pre-lockdown peak of 9.3% in March. By contrast, household credit extension slowed to 2.9% from 3.2% in September, pulled lower by unsecured credit components as well as car finance. Mortgage advances, on the other hand, edged up marginally to 3.2% from 3.1% the previous month, in line with robust home-buying activity. Though the increase in PSCE driven by an uptick in corporate credit, may hint at a comeback from the decade low recorded the previous month, economists cautioned that lending will remain muted with households and firms likely to remain reluctant to take on more debt. Lenders meanwhile are likely to keep a tight leash on credit extension, amid rising bad debts in the wake of the Covid-19 shock.

- The trade surplus surprised to the upside at R36 billion in October up from R33 billion in September. The upside surprise emanated from stronger than expected exports and occurred despite an ongoing recovery in imports. The latest print is the sixth consecutive trade surplus. On a year-to-date basis (January to October) South Africa recorded a surplus of R203.2 billion, which is a major improvement from the R3.3 billion surplus recorded in the same period last year. Elevated terms of trade are providing strong support to the trade balance and while this persists the exchange rate outlook is biased towards a strengthening rand. Overall, the outlook is for South Africa to retain a trade surplus in the immediate future as exports continue to be supported by elevated commodity prices and a continued recovery in global economic activity with many countries returning to normal economic activity levels. The import bill, on the other hand, is likely to be curtailed by soft oil prices and weak domestic demand.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- New Vehicle Sales: Due Tuesday 1 December 2020. The Covid effect on passenger vehicle demand and the slowdown in rental companies' replacement cycles are expected to have continued weighing on the South African car market during November. Despite the cautious outlook for new vehicle sales some improvement is expected from the 25.4% year-on-year fall suffered in October.

- Absa Manufacturing Purchasing Managers Index: Due Tuesday 1 December 2020. The Absa manufacturing purchasing managers' index (PMI) is expected to have continued rising in November, although at a slower pace due to new lockdowns in Europe which will affect local export-oriented manufacturers. The consensus forecast is for manufacturing PMI to have dropped to 60 index points in November, down from 60.9 recorded the previous month.

- Standard Bank Purchasing Managers Index: Due Wednesday 2 December 2020. After recording the first expansion in the private sector since April 2019 as well as the strongest expansion in 31 months, the IHS Markit composite PMI is expected to have pulled back slightly in November. The expected easing in sentiment is attributed to the effect of new lockdowns in Europe which may affect export-oriented manufacturers.

NORTH AMERICA

Contributed by Nick Downing

- Minutes from the Federal Reserve's latest policy meeting in early November reveal increased discussion over providing clearer forward guidance on the central bank's asset purchase programme. The programme, currently comprising monthly purchases of $120 billion of Treasury and Mortgage backed securities is likely to be linked to more precise economic outcomes as early as the next policy meeting on 15-16th December. The chosen economic outcomes may be similar to those attached to interest rate policy, for instance that the fed funds interest rate will remain at the zero bound until inflation exceeds the 2% target for a period of time, predicted by the Fed to occur at the earliest in late 2023. The expected policy guidance could incorporate conditions for a change in the composition of bond maturities. A greater emphasis on longer-dated bond purchases would compress the all-important long-term interest rate which determines mortgage rates and other consumer lending rates, as well as the discount rate used to value financial assets. In large part, the strong rally in equity markets since the March low is attributed to historically low long-dated yields. A Fed sponsored "yield curve control" would help sustain the bull market in equities, especially for high profile digitally enabled "growth" stocks. The valuation of these stocks is especially vulnerable to changes in the discount rate, due to their longer than usual prospective earnings trajectories.

- Business activity continued to strengthen in November according to the IHS purchasing managers' index (PMI) surveys. The composite PMI, measuring activity across both manufacturing and services sectors of the economy, increased from 56.3 to 57.9, its highest since March 2015. The reading is well above the neutral 50-level which demarcates expansion form contraction. According to Chris Williamson, IHS Markit's chief business economist, “Expectations about the year ahead have surged to the most optimistic for over six years, reflecting the combination of a postelection lift to confidence and encouraging news that vaccines may allow a return to more normal business conditions in the not too distant future.” The manufacturing PMI defied expectations for a slight retracement, instead surging from 53.4 to 56.7 while the services PMI increased from 56.9 to 57.7 well ahead of the consensus forecast, which had also predicted a retracement. Among the PMI sub-indices, the forward-looking new orders readings were especially strong, which bodes well for further gains in activity levels over coming months.

- Initial jobless benefit claims increased for a second straight week, rising from 748,000 to 778,000 the highest in 5 weeks and the first consecutive gains since July. Other consumer related economic data continued to improve but at a slower pace. Consumer spending increased for the sixth straight month although the growth rate slowed from 1.2% month-on-month in September to 0.5% in October. Durable goods orders also grew for a sixth straight month but slowed from 2.1% in September to 1.3% in October. Meanwhile, personal incomes fell in October by 0.7% on the month, impacted by a slowdown in jobs growth and the expiry of government federal aid programmes. The Conference Board consumer confidence index slipped from 101.4 in October to 96.1 in November, corroborating the loss in momentum in consumer activity. The drop in consumer confidence is attributed to the surge in Covid infections and renewed lockdown restrictions. However, restrictions are less onerous than earlier in the year and positive vaccine news should boost consumer confidence and spending habits over coming months, especially if the long-awaited fiscal relief package is finalised. Consumer spending contributes over two-thirds to US GDP.

CHINA

Contributed by Nick Downing

- Economic data continued to surprise to the upside as China’s economic recovery broadened to consumer demand and the services sector, which have so far lagged the recovery in industrial production. The official National Bureau of Statistics manufacturing purchasing managers’ index (PMI) increased in November from 51.4 to 52.1 its ninth straight increase. The non-manufacturing PMI, which measures activity in services and construction, increased from 56.2 to 56.4 its highest level since June 2012. The buoyant survey data was corroborated by the private sector Caixin manufacturing PMI, which also increased from 53.6 to 54.9. Encouragingly the survey data reveal low inventory levels, which signal further production gains as depleted stocks are replenished. The nation’s large industrial firms reported a sharp pickup in earnings growth in October. Earnings grew year-on-year by 28.2% up from 10.1% in September, with prospects of further acceleration at the start of next year, helped by the comparative effect of a depressed first quarter 2020. Consumer spending is also recovering strongly. Online retailing giant Alibaba reported that its online sales on Singles Day on 11th November were 26% above the previous year. Analysts are predicting that consumer spending will take over from industrial production as the main driver of GDP growth in 2021, as the labour market continues to stabilise and households start to dip into their excess precautionary savings.

JAPAN

Contributed by Carel la Cock

- The Jibun Bank Flash Japan Composite PMI survey for November gave back some of the gains made in the past few months and showed a nineteenth straight monthly decline in private sector business activity, signalled by a sub-50 reading. Both the Flash Manufacturing Output Index (47.6 from 48.7) and the Flash Services Business Activity Index (46.7 from 47.7) declined from the previous month and are firmly stuck below the key 50-level. The declines are attributed to a drop in production and new orders emanating from weaker global demand following the resurgence in covid-19 cases and subsequent lockdowns in Europe. Employment in the manufacturing sector was also weaker, but only marginally, while business outlook remains optimistic, but less so than a month ago.

EUROPE

Contributed by Carel la Cock

- The second wave of covid-19 infections in Europe and the latest lockdown measures to curb the spread have further exacerbated the diverging recovery paths of European nations. While manufacturing in Germany has recovered significantly and followed a sustained improvement since the first lockdown, services activity has slowed due to restrictions on movements. In France where restrictions have been more onerous, both manufacturing and services have seen a decline and over a broader range across both sectors, as reported by the latest PMI survey results. Employment in France also remains fragile given that most of the recovery in the jobs market was driven by temporary contracts that are easily reversed. Permanent roles are more than 12% below last year. The latest GDP figures from Germany showed what effect government support had on the economy in the third quarter. Disposable income has recovered to pre-pandemic levels, mostly thanks to public transfers, but the savings rate has also remained high as consumers brace for an uncertain future. A fourth quarter contraction is now almost certain and a weak start to the new year is looking likely. There are fears that a “cash crunch” is looming large as nearly a quarter of businesses in the eurozone fall in covid-19 sensitive sectors, which will require further policy support from the European Central Bank and fiscal support from governments to stay afloat and prevent a significant deterioration in the quality of banks’ assets.

UNITED KINGDOM

Contributed by Carel la Cock

- Brexit trade negotiations have seen another deadline come and go as trade talks continue unabated with no real breakthrough in sight. Previously analysts have warned that a trade deal should be negotiated by the end of November for any real chance of being ratified this year. European member states have called for contingency plans to be rolled out, but the European Commission (EC) refuses to be drawn on when it might issue last minute alternative plans in the event that negotiations are unsuccessful when the Brexit transition period ends this year. The UK is committed to not extend the transition period beyond the end of the year and the EC insists that it does not want to make alternative plans that might give the UK the impression that it can sidestep a comprehensive deal. EU ambassadors speaking at Brexit discussions last week, have told the EC that business and public authorities are currently unprepared for a "no-deal" outcome, a fact some commentators say points to the likelihood that a last minute deal will be pushed through. The EC further added that the EU divorce treaty that was agreed and now in place will help to contain some of the fallout should a trade deal not be in place by year end. Any threats to financial markets have already been addressed and European banks would still be able to access UK clearing houses and central securities deposits. Thus far financial services have largely been left out of trade talks and as such are more likely to continue unchanged.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 0.01	57091
JSE Fini 15	- 28.82	11158
JSE Indi 25	+ 13.94	78965
JSE Resi 20	+ 6.99	52703
R/$	- 9.49	15.47
R/€	- 14.96	18.45
R/£	- 9.92	20.60
S&P 500	+ 12.10	3621
Nikkei	+ 11.74	26433
Hang Seng	- 6.56	26341

FTSE 100	- 16.92	6266
DAX	+ 0.32	13291
CAC 40	- 7.69	5518
MSCI Emerging	+ 8.11	1205
MSCI World	+ 9.53	2583
Gold	+ 16.52	1776
Platinum	- 1.22	959
Brent oil	- 27.62	47.88

BOTTOM LINE

Contributed by Gielie Fourie

- MEGA – MAKE EMERGING MARKETS (EM) GREAT AGAIN: Rotation is the new buzz word in financial markets. Emerging markets can be a beneficiary of these rotations. We are witnessing several rotations in international financial markets. The two main rotations are: (1) A rotation from Growth Stocks to Value Stocks. (2) A rotation from Developed Markets to Emerging Markets. We look at the drivers of these rotations.

- ROTATION FROM VALUE STOCKS TO GROWTH STOCKS: The divide between the performance of growth and value stocks is at its highest point in five years. We have witnessed a scenario where the cheaper a stock is, the less investors seem to want it. The most expensive stocks have outperformed the least expensive stocks by more than 115% over the past 10 years. JP Morgan guru, Mark Kolanovic: "The long-awaited rotation into value stocks is here to stay".

- IRRATIONAL INVESTOR BEHAVIOUR: Data taken on 30 June 2020, covering the past ten years, divided stocks into five quintiles by the size of their dividend payments. The results were shocking. The highest-paying 20% (the top quintile) vastly underperformed the lowest-paying 20% (the bottom quintile) by 57.5%. Investors viewed companies with high free cash flows with scepticism. You cannot make this stuff up - the behaviour of investors is totally irrational. It makes no financial sense. The best precedent for this sort of behaviour is 2000, the last time that growth stocks were outperforming value stocks at anything close to this level.

- STOCKS PAYING HIGH DIVIDENDS ARE PUNISHED: Investors are punishing the stocks with the highest dividends. These stocks tend to be more established, stable companies. What is the motivation for this anomaly? With interest rates, and the cost of capital so low, investors seem to prefer that companies take advantage of low rates to borrow and reinvest in themselves. The upshot is higher rates of growth and the potential of reaping higher rewards than they could by investing elsewhere, rather than returning money to shareholders by paying dividends.

- OVERREACTION: We believe that investors are overreacting. They are overplaying their aversion to value stocks yielding higher dividends. We are also sceptical about the market's current rejection of financial stocks. Financial stocks, particularly large banks, have lagged every other sector. Their fundamentals do not justify this level of underperformance. It will be rewarding to focus on banks with strong balance sheets. The rotation has started – during the first half of November financial stocks, up 17.5%, have outperformed information technology stocks, up 10.4%. New vaccine news has sent pharmaceutical shares soaring across the globe. Shares of airlines have also soared on the vaccine news, as have hotels, cruise liners, and travel companies.

- RECOVERY OF EMERGING MARKETS: EM are experiencing strong growth. A drop in markets of nearly 35% in the first quarter of 2020, was followed by a sharp 18% recovery in the second quarter. The MSCI Emerging Markets Index rose 9.6% in the third quarter to climb nearly all the way back (96%) to its pre-COVID-19 peak. ROTATION FROM DEVELOPED MARKETS TO EM: The latest growth forecasts from the International Monetary Fund (IMF), updated in October 2020, confirmed that EM are expected to outperform developed markets by more than 2% annually in both 2020 and 2021. The average growth forecast for developed markets for 2021 is 3.9%. Emerging markets are expected to grow at a rate of 6.0% in 2021. Whichever way you look at it, EM are expected to grow faster than advanced economies. The superior EM growth thesis remains firmly in place.

- CHINA WILL DRIVE GROWTH: China will be driving the growth in EM. The experience in the US will be different. The US had a rotation of its own - from Republican to Democratic rule. The policies of the Biden Administration could actually slow down growth. President Trump lowered corporate taxes. President-elect Biden plans to hike several taxes. Biden is expected to hike corporate taxes. Biden also plans tax increases on the ultra-wealthy (those earning $400,000 annually and above). Higher taxes will have a negative impact on corporate earnings and by implication, on the stock markets. Admittedly, a split Congress should make it difficult to pass sweeping tax increases.

- RELAXED TRADE ENVIRONMENT: Trade wars have been one of the costliest and most unnecessary parts of the Trump presidency. Higher tariffs make goods more expensive for consumers on both sides of the war. It hurts consumers, Gross Domestic Product (GDP), and it hurts employment levels. A more relaxed global trade environment could provide a further upside boost for the global economy. The IMF expects EM to be the main beneficiaries. The success of the new vaccines will help EM countries to perform even better than expected.

- SUMMARY: Rotation is the new buzz word. We expect at least two rotations. Firstly, a rotation from growth stocks to value stocks. A second rotation is from advanced economies to emerging markets. Long suffering value investors and EM will be the main beneficiaries of these rotations. Patient investors will be rewarded. Warren Buffett once remarked: "The stock market is a device for transferring wealth from the impatient to the patient".

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