OVERBERG MARKET REPORT

Tuesday 21st July 2020

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- Want to build a successful career? Find a partner – duos work. Two heads are better than one. "Alone we can do so little; together we can do so much," Helen Keller. We look at the "Power of Two" across several industries. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- Mining production declined by 29.8% year-on-year in May. The decline was mainly caused by the global and local Covid-19 lockdowns, which interrupted supply chains, restricted production, and reduced global demand. The largest contributors to the annual change, however, were iron ore, which fell 66.3%; platinum group metals, which declined 27.3%; and manganese, which fell 45.4%. Although it is down, the May figure is a noteworthy improvement from the 50.3% decline recorded in April and better than the -32.5% Bloomberg consensus forecast. The month of May saw South Africa move into level 4 lockdown which lead to more companies returning to work and production levels picking up. On a month-on-month, seasonally adjusted basis, mining production rose 44% in May compared with the previous month's decline of 36.8%. Mining production is expected to improve over the coming months as lockdown regulations continue to ease. However, the outlook for the industry remains challenging, as it faces weaker demand and interruptions as a result of new Covid-19 cases and continued periods of load-shedding.

- Consumer price inflation (CPI) declined in April to 2.1% year-on-year, its lowest recording since 2004, and down from 3% recorded in April. The fall was driven largely by fuel prices, with the fuel index now 25.9% lower than it was in May 2019. Core CPI, which excludes fuel and food prices, measured 3.1%. On a month-on-month basis, CPI fell 0.6%. The April inflation reading is below the South African Reserve Bank (SARB) inflation target range of 3% to 6%, creating an opportunity for the SARB to continue cutting interest rates. The central bank has already slashed interest rates by 2.75% over the past few months, taking the repo rate down to 3.75%, the lowest it has been since it was introduced in 1998. Consensus view is for the SARB to cut the repo rate at the next Monetary Policy Committee (MPC) meeting by 25-50 basis points. This will be bringing much needed additional relief to struggling households and businesses during a very tough economic environment. The money market is discounting a 50-basis point rate cut at the upcoming meeting. The SARB expects consumer inflation to average 3.4% this year and 4.4% next year, which is still well within its 3%-6% target.

- The producer price index (PPI) for final manufactured goods declined to 0.4% year-on-year in May down from 1.2% in April. The May figure is higher than Bloomberg's consensus forecast of 0.1%. The main contributor to the May headline PPI was food, beverages, and tobacco products, which increased by 3.4%. Unsurprisingly, coke, petroleum, chemical, rubber and plastic products was the largest detractor from the annual reading, contracting by 10.5%. This can largely be attributed to lower fuel prices and the relatively high May 2019 base for coal and petroleum. PPI is expected follow a similar trend to consumer price inflation over coming months due to the shared impact from lower oil prices and generally subdued demand.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- The Composite Leading Business Cycle Indicator: Due Tuesday 21st July 2020. After falling by a record 5.1% month-to-month in April the South African Reserve Bank's (SARB) composite leading business cycle indicator is expected to have continued declining in May, albeit at a slower rate of 4.4%. This is premised on the economy gradually restarting in May, which especially boosted new vehicle sales, one of the main culprits in the index decline in April.

- Retail Sales: Due Wednesday 22nd July 2020. Following the hard Covid-19 lockdown measures implemented in April, retail sales are expected to have recorded the largest decline on record over that month. Consensus forecast is that retail sales recorded a 25.5% year-on-year contraction in April accelerating from the 2.7% decline in March. Furthermore, only a slight recovery is expected in May. While the economy started to reopen confidence amongst consumers has been affected by the highly uncertain environment.

- South African Chamber of Commerce and Industry Business Confidence: Due Wednesday 22nd July 2020. During April, the South African Chamber of Commerce and Industry (SACCI) Business Confidence Index recorded its lowest reading (77.8) since the series began in January 1985. It is expected that the SACCI Business Confidence Index picked up slightly in May to 80 but contracted again to 78 in June as the operating environment has remained highly uncertain despite the economy restarting.

- Interest Rate Decision. Due Thursday 23rd July 2020. All eyes will be on the SARB monetary policy committee (MPC) with regards to their upcoming decision on interest rates this coming Thursday. Following the monetary stimulus trend implemented globally to soften the effects of Covid-19 on economic activity, the SARB has cut the repo rate by a cumulative 275 basis points year to date and it is expected that it will continue with this approach. This is especially the case since May saw a decline in consumer price inflation to below the 3-6% target range, paving the way for a further 25 basis point rate cut.

GLOBAL

Contributed by Nick Downing

- The Covid pandemic is raising enthusiasm among lobbyists and investors for a “green recovery”. The theme ties in with surging inflows into investments with high environmental, social and governance (ESG) ratings. It is debatable whether companies with high ESG ratings enjoy stronger earnings growth, but it is indisputable that their shares tend to be valued more generously. Increasingly, institutional investors and asset managers are altering their mandates to enforce minimum exposure to ESG stocks, while simultaneously enforcing the exclusion of environmentally degrading sectors such as fossil fuels. In this regard, the ‘sin” sectors such as tobacco, have also been a casualty. In a recent report, ShareAction found that 61% of the world’s largest asset managers mentioned climate change in their investment policies. Demand for ESG stocks is expected to gather momentum if Joe Biden wins the US presidential election. Biden has pledged to cut emissions and for the US to join the Paris climate accord. He intends making clean energy the centrepiece of his infrastructure spending plans, to “build more climate-resilient communities, put millions of skilled workers on the job and make life markedly better and safer for the American people all at once.”

NORTH AMERICA

Contributed by Nick Downing

- Retail sales, which include spending at stores, restaurants and online, increased in June by a stronger than expected 7.5% month-on-month, while May’s increase was revised upwards from 17.7% to 18.2%. Growth on the year registered 1.1%, the first positive annual reading since February. Retail sales have made a V-shaped recovery, with the June total only 1% below the pre-pandemic monthly pace. The continuation of the positive trend is however threatened by a resurgence of coronavirus cases in some states. Credit card transaction data already shows a flattening in retail activity in the first half of July. Furthermore, the $600 weekly enhanced unemployment benefit payments are due to expire at the end of July. While Congress is expected to approve a renewal of the fiscal support programme, the

Republican party are in favour of a watered-down version. Nonetheless, consumers appear to have a positive mindset, evidenced by a powerful recovery in the residential property market, which some analysts are predicting will be the main engine of the economic recovery. The National Association of Home Builders' Housing Market Index surged in July from 58 to 72, well above the consensus forecast of 60 and back to pre-pandemic levels. Home buyers are in a far stronger position to purchase homes, having increased their savings during the lockdown period and assisted further by record low interest rates. The average 30-year fixed mortgage interest rate fell in the past week below 3% for the first time on record. With bond yields anchored at record low levels by the Fed's unlimited bond buying programmes, the fixed-mortgage rate is expected to fall even further over coming months.

- Industrial production, which includes output from factories, mines and utilities, increased in June by 5.4% month-on-month, following a 1.4% increase in May. Although better than expected, the recovery path is less impressive than consumer-driven markets, which are already close to pre-pandemic levels. By contrast industrial production is still 10.9% below the pre-Covid trend and on a quarter-on-quarter basis industrial production collapsed in the second quarter at a shocking annualised pace of 42.6%. Among the industrial sectors, manufacturing performed best with a 7.5% increase in June, followed by utility output which gained 4.2%, while mining output fell 2.9%, due to lower oil production. The tentative recovery in industrial production is echoed by the Federal Reserve's Beige Book report, which compiles anecdotal summaries from businesses. Although businesses reported that economic activity had increased in almost all districts, there was a long way to go before activity normalised. Businesses indicated a high level of uncertainty about the outlook for the US economy, attributed primarily to the path of the coronavirus.

- Consumer price inflation (CPI) gained in June by a stronger than expected 0.6% month-on-month, its first positive reading in four months, helping to placate fears of a deflationary spiral. On a year-on-year basis, CPI was less impressive at just 0.6%, well below the Federal Reserve's 2% target. Much of June's monthly gain is attributed to the 12.3% surge in gasoline prices and the buoyant food price gain of 0.6%. Core CPI, which excludes food and energy prices due to their volatility, increased by a far more subdued 0.2% on the month although on the year by a more robust 1.2%. Despite the recent recovery in inflation, the yield spread between 10-year fixed rate Treasury bonds and Treasury Inflation Protected Securities (TIPS) of the same maturity, which reflects the predicted annual inflation rate over the period, remains subdued at just 1%, well below the pre-Covid level of 1.5% recorded at the end of February. However, analysts are increasingly forecasting that inflation could spike higher in two to three years' time in delayed response to unprecedented central bank liquidity expansion, a weakening US dollar, and a strong cyclical recovery in end consumer and business demand.

CHINA

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- China's GDP grew in the second quarter (Q2) by a stronger than expected 11.5% quarter-on-quarter and 3.2% year-on-year making back some of the ground lost in Q1 when GDP contracted by 6.8% on the year. Over the first half of 2020 GDP is down by only 1.6% on the year. The most recent economic data indicate improving momentum across all sectors. Industrial production increased in June by 4.8% on the year up from 4.4% in May. Fixed asset investment fell in the first half of the year by 3.1% over the same period in 2019 although by far less than the 6.3% decline in the first five months of the year. Investment in commercial and residential real estate increased in the first half by 1.9% compared with a contraction of 0.3% in the first five months. The urban unemployment rate fell to 5.7% from 5.9% the previous month. Although retail sales improved in June to a decline of 1.8% on the year compared with a 2.8% decline in May, consumer spending remains conspicuously absent from the economic recovery. In Q2 retail sales fell 3.9% on the year, indicating a patchy recovery. Authorities have prioritised their support of industrial activity at the relative expense of household disposable income, which fell in the first half by 1.3% on the year. However, China's households enjoy a high savings rate, putting them in a strong position to resume pre-pandemic spending habits as soon as uncertainty over the Covid virus dissipates. Over the past fortnight, the country announced 10 consecutive days with zero local virus transmissions, raising hopes of improved consumer sentiment. China is the only major economy expected to show positive GDP growth in 2020, measuring 2.5% according to consensus forecast.

- Between the China Banking and Insurance Regulatory Commission and the China Securities Regulatory Commission, the two regulators seized control in the past week of nine troubled financial institutions, with a combined $143 billion in assets. The nine institutions include insurers, trust companies and securities brokers, all seized to contain the spread of systemic risk. Under new control, insurance and business at the affected financial institutions will continue to run as normal. The measures illustrate the contrast in Covid related rescue measures being adopted by China and Western economies. In the latter, central banks have launched unprecedented quantitative easing measures but cannot force banks to lend however many incentives they put in place. China on the other hand has been able to force state-controlled banks to provide debt forbearance measures, effectively transferring bad debt liabilities onto the state's balance sheet. This provides the respite needed for businesses and industry, while limiting the need for quantitative easing. Some argue that western style quantitative easing is a blunt tool compared to the more focussed measures dictated by Beijing.

JAPAN

Contributed by Carel La Cock

- The Bank of Japan (BoJ) held overnight interest rates unchanged at -0.1% and maintained the cap on 10-year yields at 0% in a second consecutive monetary policy meeting. This despite lowering its economic growth forecast for the year and warning that “risks to both economic activity and prices are skewed to the downside, mainly due to the impact of COVID-19”. For the fiscal year 2020, the BoJ expects the economy to contract by 4.7% and prices to fall by 0.5%, rebounding in 2021 with economic growth of 3.3% and inflation at 0.3%. The BoJ has adopted a wait and see approach like other G7 central banks, giving markets a breather before embarking on more stimulus if needed. To date ultra-low interest rates and unprecedented purchases of ETFs and Japanese REITS in addition to quantitative easing has done little to bring inflation in line with the BoJ’s target of 2%. The outlook for Japan remains extremely uncertain and is highly dependent on no major second wave of infections, but the BoJ reassured that it stands ready “to take additional easing measures if necessary.”

- Financing demand by Japanese companies has soared to record levels. Bank loans in the last three months have increased significantly according to the quarterly survey of senior loan officers at 50 banks. The corporate fund demand index jumped to +59 in July from +14 in April seeing an increase in demand for loans from large firms (+46 compared to +6 in April) as well as medium-sized firms (+39 compared to +6) and small firms (+54 compared to +13). Loan officers indicated that the most common reasoning for funding demand remains a decline in internally generated funds followed by a decline in available funding from other sources. In contrast demand for loans by households declined in both categories of Housing loans (-19 compared to -8 in April) and Consumer loans (-31 compared to -8) indicating that households are tightening their belts and reducing their consumption which will delay a swift economic recovery. However, it remains a positive sign that banks are willing to lend to businesses enabling them to weather the covid-19 storm with bridge financing.

EUROPE

Contributed by Carel La Cock

- The European Central Bank (ECB) has left its policy rate unchanged at 0% and the deposit rate at -0.5% and made no changes to the scale of its bond-buying, citing that although there has been improvement in the region, there remains a considerable amount of uncertainty. The ECB has been ramping up support for the economy in the last four months but has called time to “wait and see” how previous policy changes filter through the economy. According to ECB president, Christine Lagarde, inflation is likely to remain low while “exceptional elevated uncertainty” weighs down on consumer spending and business investment. She added that “ample monetary stimulus remains necessary to support the economic recovery and to safeguard medium-term price-stability”. Ms Lagarde indicated that the stimulus measures to date would add 1.3 percentage points to the eurozone's GDP and 0.8 percentage points to inflation by 2022 but warned of potential threats to the recovery. In the ECB's latest bank lending survey, many banks indicated that they expect to tighten lending criteria in the coming months as governments start to unwind their loan guarantees, leading to potential liquidity constrains and scuppering the recovery efforts. Furthermore, the eurozone's reliance on exports could be impacted if the covid-19 pandemic causes a reduction in trade over the long term. The decline in economic growth in the second quarter of the year is likely to be as much as 13% but is expected to rebound in the third quarter. Inflation will continue to fall and move further below the 2% target for the foreseeable future with additional downward pressure coming from the cut in the German value added tax. Ms Lagarde called for a speedy agreement to the €750bn EU recovery fund, which was still at a deadlock during deliberations over the weekend.

UNITED KINGDOM

Contributed by Carel La Cock

- Dark clouds are forming on the horizon as manufacturers expect a "jobs bloodbath" as a result of a sustained downturn in demand in some key industries including automotive and aerospace. Manufacturing trade group, Make UK, has warned that many of the 20,000 companies it represents are ramping up redundancy plans as the time for a return to normal is fast running out. Many companies have benefited from the government's furlough scheme which will start unwinding this month and end in October. However, Make UK is lobbying government to extend the scheme for strategic industries for a further six months in order to avoid a loss of highly skilled workers. Prime minister, Boris Johnson, has urged people to ditch "working from home" in contradiction to his chief scientific advisor and has downplayed the risk of a second national lockdown, instead insisting that a second wave outbreak could be managed at a local level. Make UK says that in a survey 53% of respondents are expecting to make redundancies in the next 6 months, more than double the number when asked two months ago. A third of companies expect to cut between 11% and 25% and some expect to cut as much as half of their workforce. The survey also revealed that only 42% of companies expect trading to return to normal in 12 months or longer and only 15% of companies are trading at full capacity. Manufacturers see the likelihood of a V-shaped recover as "remote".

FAR EAST AND EMERGING MARKETS

Contributed by Carel La Cock

- **Politicians in Brazil are putting aside differences and looking to push through some structural reforms in the next 18 months that will get the economy back on track following the devastation from the covid-19 pandemic.** Brazil has been one of the hardest hit countries with over 75,000 covid-19 related deaths. According to Adolfo Sachsida, the secretary for political economy in Brazil, in an interview with the Financial Times, the government wants the next 18 months to be marked by the re-establishment of the ambitious economic reform plans that were derailed due to political infighting and near constitutional crisis. The plans include a simplification of the tax system and aims to cut much of the red tape that has stifled growth. Government further promises to promote fiscal discipline to attract private investment and the possible independence of the central bank. Many economists agree that reform is necessary to kickstart an economy that last year only expanded 1.1%, but that is expected to shrink by 8% in 2020 according to the World Bank. Brazil's gross debt is expected to jump to 95% of GDP this year with the economy minister's emergency support package more than offsetting the savings made on pension reforms last year. Some fear that tax reforms could lead to an increase in taxes and the introduction of a financial transaction tax to help shore up the coffers, while other commentators warn that the current byzantine tax system has many vested interests and local administrators won't trust a centralised tax collection. Any reform is likely to be small and dependent on the economic recovery. Brazil is the largest economy in Latin America and sorting out its house is crucial for the prosperity of the whole region.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 1.43	56265
JSE Fini 15	- 32.28	10615
JSE Indi 25	+ 8.24	75017
JSE Resi 20	+ 12.45	55393
R/$	- 15.78	16.62
R/€	- 17.55	19.03
R/£	- 11.82	21.05
S&P 500	+ 0.65	3251
Nikkei	- 3.97	22717
Hang Seng	- 11.11	25057
FTSE 100	- 16.98	6261

DAX	- 1.53	13046
CAC 40	- 14.80	5093
MSCI Emerging	- 4.50	1064
MSCI World	- 1.93	2312
Gold	+ 18.72	1809
Platinum	- 13.50	840
Brent oil	- 34.78	43.14

BOTTOM LINE

Contributed by Gielie Fourie

- THE POWER OF TWO: There are many instances where two people, often total strangers, were brought together by chance. They find that they share a common interest, or that their skillsets complement each other's. They come up with an idea. The idea becomes the launch pad for a global success. Apple, Google, and Microsoft were all started by (a) duos in (b) a garage.

- INVESTMENT DUO: The most successful investment duo ever must be Warren Buffett and Charlie Munger. The overall growth of their company, Berkshire Hathaway, from 1964 to 2019 was 2,744,062% (2.7 million percent) or 20.3% per year. Comparative figures for the S&P 500 are 19,784% and 10.0%.

- TECH DUO No. 1: In 1975 childhood friends Bill Gates and Paul Allen started Microsoft out of a garage in Albuquerque, New Mexico. Allen suggested the name "Micro-Soft", later changed to Microsoft. They built up Microsoft meticulously – at the time of writing it is the second biggest company in the world. More important, they shared their wealth – an estimated 12,000 Microsoft employees are millionaires – in total they are worth more than $12 billion.

- TECH DUO No. 2: Steve Jobs and Steve Wozniak met through a mutual friend. On April Fool's Day, 1 April 1976, they started Apple in the 21-year-old Jobs' parents' garage in California – not all parts were manufactured in the garage. They built and sold a computer developed by Wozniak. They grew the company - at the time of writing it is the biggest company in the world. Remarkably, not many Apple employees are millionaires. Neither are there many Apple billionaires – Steve Wozniak is worth "only" $100 million. CEO Tim Cook is worth $1.3 billion.

- TECH DUO No. 3: In January 1996 Larry Page and Sergey Brin, two PhD students at Stanford University, started Google in the garage of a friend, Susan Wojcicki in Silicon Valley. The garage start-up grew into the biggest search engine in the world. Susan became Google's first marketing manager. A little-known fact is that Jeff Bezos, who was an angel investor before he founded Amazon, provided start-up capital for Google. An estimated 1,000 Google employees are worth more than $5 million each – in total they are worth more than $5 billion.

- MOTORBIKE DUO: In 1901, in a garage in Milwaukee, USA, two childhood friends, William Harley and Arthur Davidson, started working on their first "motor-bicycle". From its inception, Harley-Davidson (H-D) branded its motorcycles as respectable and refined products. H-D motorbikes developed an almost cult like following. When Honda started with its campaign, "You meet the nicest people on a Honda", H-D's response was to draw the working-class, macho, and even a little anti-social attitude associated with motorcycling's dark side. They took it a step too far – it backfired. H-D developed a "bad boy" image. Marketing had to work hard to change that image. H-D's image improved to such an extent that it now even supplies many American police forces with their motorcycle fleets.

- AUTO DUO: Around the same time, in England, Charles Rolls and Henry Royce got together. Rolls was the son of a wealthy baron, an aristocrat – Rolls was educated at Eton and Cambridge. Royce grew up dirt poor and basically fatherless - his father died when he was nine. He became an apprentice at the railways and qualified as an engineer. The two had a common interest in the hot technology of the time, the motorcar. They were brought together in 1904 by a mutual friend. Rolls was an entrepreneur and marketer. His ambition was to build the best cars in the world. Royce had similar ambitions. Despite their vastly different backgrounds, the duo got along well. Rolls suggested that they produce cars and sell it under their names. To which Royce remarked: "Royce-Rolls! Yes. It has a certain ring to it." It was later changed to Rolls-Royce. They quickly developed a reputation for building "the best car in the world". In 1930, at the age of 67, Royce himself became an aristocrat, a Baron, no less. Today Rolls-Royce is owned by BMW.

- A FIZZY DUO: The Moët & Chandon duo lived 100 years apart. Claude Moët founded Moët & Cie in 1743. Moët made excellent champagne – his clientele included nobles and aristocrats. After his death, Pierre-Gabriel Chandon, a great grandson, continued the family tradition in 1833 under the name of Moët & Chandon. In 1971 Moët & Chandon merged with Hennessy Cognac, and in 1987 with Louis Vuitton to become LVMH (Louis-Vuitton-Moët-Hennessy) the largest luxury group in the world. Bernard Arnault (71) is the chairman and CEO. In January 2020 Arnault was, briefly, the richest person in the world. Since then Jeff Bezos and Bill Gates have overtaken him. Today, three centuries after Claude Moët started making champagne in 1743, Moët & Chandon boasts: “We are proud to say that a bottle of Moët & Chandon is enjoyed by someone every second of every hour, somewhere in the world”. Madame de Pompadour, mistress of Louis XV, famously remarked: “Moët is the only wine that enhances a woman's beauty”.

- SUMMARY: “The Power of Two” can create miracles. Teamwork makes the dream work. Clean out your garage, find a partner, take a few calculated risks, and always keep a bottle of Moët in the fridge. Vladimir Putin’s favourite Russian proverb? “He who doesn’t take risks, never drinks champagne”.

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