OVERBERG MARKET REPORT

Tuesday 22nd September 2020

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- Can you rely on the Johannesburg Stock Exchange (JSE) Indices? The indices tend to be exclusive, not inclusive. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- The South African Reserve Bank (SARB) has ended its aggressive rate cutting cycle as the Bank's Monetary Policy Committee (MPC) kept the repo rate unchanged at 3.5%. The decision was not unanimous, with two members of the MPC voting for a 25-basis point cut and three members voting to keep rates unchanged. The latest decision marks the end to one of the most aggressive cutting cycles by an emerging market central bank since the outbreak of Covid-19. The SARB expects inflation to remain well within the Bank's 3% to 6% target range for the foreseeable future, with headline consumer price inflation forecast to average 3.3% in 2020 (lower than previously forecast), 4.0% in 2021 and 4.4% in 2022. The forecast for core inflation is also lower at 3.4% in 2020, remaining broadly stable at 3.7% in 2021, and 4.0% in 2022. Overall inflation risk remains balanced as oil prices remain low, local food prices remain contained and pass-through price increases remain low. Demand side pressure also remains muted, although electricity prices and other administered prices remain a concern as well as heightened fiscal risks potentially resulting in exchange rate pressures. Gross Domestic Product (GDP) is now expected to contract by 8.2% in 2020, compared to the 7.3% contraction forecast in July, although the projections incorporated better third and fourth quarters. Further easing of the lockdown has supported economic growth. GDP is expected to grow by 3.9% in 2021 and by 2.6% in 2022. Consensus does not foresee another rate cut from the SARB, citing the Bank's uneasiness with negative real yields and the need to support the local currency and attract foreign investment. The SARB's Quarterly Projection Model implied policy rate path indicates no further repo rate cuts in the near term, and two rate increases in the third and fourth quarters of 2021. The Bank's MPC again reiterated that monetary policy cannot in isolation lift the economy's potential growth rate or reduce fiscal risks. It urged the implementation of prudent macroeconomic policies and structural reforms as key to increasing investment opportunities, stimulating growth and creating jobs.

- Real retail trade sales declined by 9% year-on-year in July, following a downwardly revised contraction of 7.2% in June. The July figure was worse than the -5% consensus forecast. The biggest negative contributions came from all “other” retailers and retailers in textiles, clothing, footwear, and leather goods. On a monthly basis, sales fell by 1.1% following solid increases of 6.6% and 68.8% in June and May, respectively. The recent retail sales disappointment follows the latest consumer confidence figure, which is at its lowest level since 1993, despite a partial recovery off the historic trough recorded in the second quarter. Consumers are expected to remain under pressure as general income levels have dropped and unemployment has increased with job cuts taking place across the economy. The pain has been particularly felt in the low-income groups and among small- and medium-sized enterprises. Nevertheless, the retail sector is expected to experience some improvement in the comings months as lock down restrictions are eased and economic activity gradually returns to normal.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- The Composite Leading Business Cycle Indicator: Due Tuesday 22 September 2020. After increasing month-on-month in June for the first time since March 2020 the composite leading business cycle indicator, which signals changes in the economy before they happen, is expected to have continued its rising trend in July although at a slower pace. Consensus forecast is that the indicator increased 2.3% month-on-month in July, down from the 2.7% increase recorded the previous month. Even though a month-on-month increase is expected, July will have likely recorded its 21st consecutive year-on-year decline. The magnitude of the annual decline is however expected to have lessened as a result of the easing of lockdown restrictions.

- Producer Price Index: Due Monday 28 September 2020. After beating market forecasts with a higher than expected reading of 1.9% year-on-year and 1.2% month-on-month in July, the Production Price Index (PPI) is expected to have slowed down slightly in August. Consensus forecast is for PPI to have increased 1.7% year-on-year and 1% month-on-month in August. Regardless of the increase in energy costs, the fluctuating cost of imports and logistics, the volatile fuel prices, and Covid related supply chain disruptions, PPI is expected to remain low.

GLOBAL

Contributed by Nick Downing

- While citing continued uncertainty over the pandemic and waning fiscal support, the Organisation for Economic Co-operation and Development (OECD) scaled back its forecast for global economic contraction in 2020 to 4.5% from a previous 6%. In its interim economic outlook, the OECD noted that most developed economies will suffer shallower economic contractions than it had previously projected, while most emerging economies except for China would suffer deeper recessions. Countries which depend on trade have performed best due to the faster than expected rebound in global trade volumes, favouring China, South Korea and Germany. Global trade has recovered faster than during other global recessions, attributed to the speed and scale of policy response to safeguarded credit flow. Unlike previous recessions, demand has also remained intact. Among emerging economies, the OECD downgraded South Africa's contraction in 2020 from a previous 7.5% to 11.5% and in 2021 it reduced its GDP growth forecast from 2.5% to 1.4%.

NORTH AMERICA

Contributed by Nick Downing

- The Federal Reserve left its monthly asset purchases unchanged at $120 billion and kept the fed funds rate at 0-0.25%. In its first policy meeting since adopting "Average Inflation Targeting", the Fed stated that it would maintain a zero interest rate policy until there is evidence of a tight labour market and inflation "is on track to moderately exceed 2% for some time", which it projected would be late 2023. Thus, the Fed pushed out its zero-bound horizon by an extra year from a previous 2022, despite upgrading its economic forecasts. It lowered its June forecast for 2020 GDP contraction from 6.5% to 3.7% but also lowered its 2021 growth forecast from 5% to 4%. Unemployment is expected to end the year at 7.6% compared to a previous 9.3%. The Fed noted a stronger than expected economic rebound but cautioned that the recovery is still far from complete and continues to face medical risks and the risk of waning fiscal support. The Fed also announced additional stress tests to ascertain the ability of banks to withstand two pandemic related recessions, a more severe scenario than conducted in the June stress test. The stress tests results will be available by year-end.

- The pace of the economic rebound appeared to lose momentum in August. Retail sales grew for a fourth straight month rising in August by 0.6% month-on-month but down from 0.9% in July, in turn revised lower from the initial estimate of 1.2%. While retail sales exceeded February's pre-pandemic level for a third straight month and were up on a year-on-year basis by 2.6%, economists are concerned that July's expiry of the $600 per week enhanced unemployment benefit may have a more noticeable effect on September's retail sales. Industrial output also grew in August for a fourth straight month, but growth slowed to 0.4% compared with 3.5% in July and remains 7.3% below February's level. Over the year, industrial output was down by 7.7%. The jobs market also appeared to plateau. Initial jobless benefit claims fell by 33,000 in the week ended 12th September to 860,000 but compared with earlier sharp declines from the record figure of 6.9 million reached in March, recent improvements have decelerated. The claims figure is still higher than any figure recorded prior to the pandemic and well above the peak of 665,000 recorded in the 2008/09 Global Financial Crisis. Encouragingly however, the University of Michigan US consumer sentiment index increased in September from 74.1 to 78.9, its highest level since March prior to the Covid-19 onslaught. While unemployment remains elevated and fiscal support has waned, household savings are in rude health at 18% compared with the long-term average of 7%, helped by huge fiscal transfers earlier in the pandemic.

CHINA

Contributed by Nick Downing

- China's economic rebound gathered pace in August, with the recovery spreading to consumer spending, which had been the missing part of the puzzle. Retail sales grew in August by 0.5% year-on-year compared with July's decline of 1.1%, helped by further easing in social distancing restrictions and more buoyant consumer confidence. Other economic data also improved. Industrial production grew by 5.6% on the year up from 4.8% in July, while fixed asset investment increased in the year to date compared with the same period in 2019 by 0.3% compared with a decline of 1.6% in July. Exports were also strong, rising in August by 10%, the strongest monthly gain since the start of the year. The overall data will likely prompt analysts to upgrade their third quarter and 2020 GDP forecasts. Current data is consistent with annualised GDP growth of 6-6.5% in line with the long-term trend rate, supported by solid investment expenditure, reinvigorated consumer spending and a resurgence in export volumes. The outlook for China's trade balance was burnished last week when the US and China re-confirmed their commitment to the Phase-One Trade Deal. Trade relations between the two countries are likely to stabilise further if Biden wins the US presidential election.

JAPAN

Contributed by Nick Downing

- The Bank of Japan upgraded its assessment of the economy stating that growth has "started to pick up with economic activity resuming gradually." The BOJ forecasts GDP will contract in the year to March 2021 by 4.7%, an improvement on its earlier forecast range of 4.5%-5.7% published at the July policy meeting. The BOJ kept its benchmark interest rate unchanged at -0.1% and maintained its programme of unlimited government bond purchases. The central bank's highly accommodative monetary policy is expected to continue following Yoshihide Suga's victory at the Liberal Democratic Party's election. Suga replaced Prime Minister Shinzo Abe, who resigned earlier in the month for health reasons. Suga had been a key figure behind his predecessor's economic reform policy known as Abenomics and is likely to maintain the programme of structural improvements to boost economic growth and bring an end to the country's decades long battle with deflation.

EUROPE

Contributed by Nick Downing

- The European Central Bank (ECB) relaxed its bank capital ratio requirement, releasing a potential €73 billion in extra bank lending. The added lending power was achieved after the ECB said banks could exclude from their balance sheet calculations the €2 trillion deposited by them with the central bank. Meanwhile, The ECB initiated a review of the Pandemic Emergency Purchase Programme (PEPP), its €1.35 trillion Covid bond buying programme due to expire at the end of June 2021. The PEPP has greater flexibility than the ECB's traditional asset purchase programmes, which are restricted from purchasing more than a third of a country's debt and from purchasing non-investment grade debt such as Greek sovereign bonds. The ECB's review may result in lengthening the duration of the PEPP and a broader adoption of its more flexible parameters. A broader asset purchase mandate would boost the ECB's ability to fight the threat of deflation and stimulate the economic recovery. The Eurozone's industrial production growth slipped in August to 4.1% month-on-month, down from 9.5% in July although the year-on-year contraction continued to improve to 7.7% from a previous 12%. The region's trade balance also improved with the surplus rising from €23.2 billion in June to €27.9 billion in July.

UNITED KINGDOM

Contributed by Nick Downing

- Retail sales grew in August for a fourth straight month, rising by 0.8% month-on-month. Although slower than July's 3.7% increase, retail sales were 4% higher than February's pre-pandemic level and up 2.8% on a year-on-year basis, the biggest annual increase since last October. Home improvement spending was especially strong in line with gains in the residential property market. Online retail sales were also noteworthy, up 46.8% compared with February. The retail sales numbers are the first of the economic data points to be released and bode well for third quarter GDP figures and the UK's continued economic rebound. However, threats to the recovery linger, notably the second wave in Covid infections and the impasse in Brexit negotiations. The threats were cited by the Bank of England (BOE) in its policy meeting last week, in which it kept the benchmark interest rate unchanged at 0.1% and maintained its asset purchase programme at £745 billion, which is expected to reach capacity by the end of the year. The BOE is scheduled to update its economic forecasts at its next policy meeting in November, at which point it may also increase its asset purchase programme, particularly with the end-year Brexit deadline looming.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 6.60	53319
JSE Fini 15	- 39.27	9519
JSE Indi 25	+ 2.47	71014
JSE Resi 20	+ 9.48	53931
R/$	- 16.56	16.78
R/€	- 20.56	19.75
R/£	- 13.71	21.51
S&P 500	+ 1.56	3281
Nikkei	- 1.25	23360
Hang Seng	- 15.04	23950
FTSE 100	- 23.04	5804
DAX	- 5.33	12542
CAC 40	- 19.84	4792
MSCI Emerging	- 0.55	1108
MSCI World	+ 0.40	2367
Gold	+ 27.78	1948
Platinum	- 4.08	931
Brent oil	- 34.77	43.15

BOTTOM LINE

Contributed by Gielie Fourie

- WHAT THE JSE INDICES DO NOT SHOW YOU: Can you rely on the JSE indices? There are 50 indices and sub-indices on the JSE. Only “qualifying” companies are included in these indices. It is prestigious to be included in an index – you have “made it”. These indices are a proxy for all listed shares, even if they are not included in the index. Companies may be excluded because they are too small. But were not all big companies once small companies? The JSE indices are exclusive, not inclusive.

- 2001 - A WATERSHED YEAR – A SPIKE IN LISTINGS FOLLOWED BY AN EXODUS: When SA became a democracy in 1994, about 320 companies were listed on the JSE. Following the birth of our democracy, the JSE experienced a spike in new listings. Within seven years, 281 new companies listed – an increase of 88%. In 2001 the JSE had 601 listed companies – an all-time high. Sadly, 2001 was a watershed year. After 2001 no less than 260 (43%) companies delisted. Today only 341 companies are listed. The exodus continues. How low can it go?

- EXAMPLES OF DELISTINGS: The list of delistings is long. Two recent examples - Pioneer Foods delisted after it was bought by USA giant PepsiCo. Clover delisted following a merger with Milco, a Tel Aviv-based consortium. Other notable recent delistings were Assore, Afgri, Masonite, Verimark, and many more. Metrofile will delist soon. The reasons for these delistings vary – from being targeted by international investors, to being too small.

- THE JSE ALL-SHARE INDEX (ALSI): Despite its name, the ALSI does not include the value of all the shares on the JSE – it reflects the value of the top 160 (currently 151), or 44%, of the listed companies. The figure of 160 shares seems to be fixed, irrespective of the number of listed companies. The name "ALSI" is a misnomer. We need an inclusive SA index that captures the market capitalisation of every single share listed on all SA stock exchanges - the JSE, A2X, ZAR X and 4AX. Why is this important? See below.

- THE WILSHIRE 5000 INDEX: In the USA, the Wilshire 5000 Total Market Index is composed of all companies listed and actively traded on a USA stock exchange. It is the broadest stock market index of publicly traded US companies. It is often used as a benchmark for the entirety of the USA stock market and is widely regarded as the best single measure of the overall USA equity market. Today the Wilshire 5000 contains around 3,500 stocks. It did hold 5,000 when it was first introduced in 1974. Like the JSE, USA stock exchanges also experienced an exodus. By comparison, the Dow Jones index is composed of only 30 companies. It is a poor representation of the total market - the importance of the Dow is overrated. WARREN BUFFETT AND THE WILSHIRE 5000: The Wilshire 5000 is also called the "Buffett Indicator". Buffett compares the Wilshire 5000 with US GDP. Buffett calculates the Wilshire 5000 as a percentage of GDP - Wilshire is the numerator and GDP is the denominator. Buffett will not invest when the Wilshire is higher than the GDP. When the Wilshire drops to below the GDP, Buffett will invest. As of 19 Sep 2020, the stock market is significantly overvalued – the total Wilshire market cap over GDP is currently standing at 174.8%. This may be the reason why Buffett is "sitting" on his cash, and on his hands. SA has no Wilshire equivalent. A comparable index would be a valuable addition to our suite of 50 market indices.

- WHY DO COMPANIES DELIST? The JSE is highly regulated. Being listed adds additional layers of expensive and cumbersome compliance for listed companies. Non-compliance could lead to hefty fines and reputational damage. The main benefit of being listed is the ability to raise capital. For small companies raising funds could be difficult and expensive. Smaller companies tend to be undervalued, making raising capital difficult. The shares of small companies tend to be illiquid – there are few buyers and sellers. Large institutional investors avoid investing in illiquid companies. Small companies are often excluded from indices. Exchange-Traded Funds (ETFs) and Index Funds only invest in companies included in market indices. Many of the benefits of listing on the JSE are lost to smaller companies. No wonder they delist.

- ADDRESSING THE DELISTING TREND: The trend and quantum of delistings is a concern. The JSE has a near invisible presence in the world. It is being reduced further by what is happening in our economy – mainly crime, corruption, and red tape. To turn this around, pres. Ramaphosa must firstly address the issues of crime and corruption. Secondly, both Ramaphosa and the JSE must clamp down on red tape. We need more red carpets, and less red tape. Red tape is expensive, negative, unproductive and demoralising. SUMMARY: Adding a Wilshire 5000 equivalent to our suite of indices would add value. The new CEO of the JSE, Dr Leila Fourie, is a breath of fresh air at the JSE. Maybe she could champion an inclusive SA All-Share Index. Make the JSE inclusive, not exclusive.

Disclaimer