OVERBERG MARKET REPORT

Tuesday 25th August 2020

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- Two hundred years ago, Thomas Jefferson (1743 – 1826), the third pres. of the USA, wrote, "The selfish spirit of commerce knows no country, and feels no passion or principle, but that of gain." Unfortunately, there are corrupt businessmen who are only interested in exploitation and self-enrichment by any means. This has led to global pressure on business to put People and Planet before Profits. Read more in the Bottom Line.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- The Composite Leading Business Cycle Indicator: Due Tuesday 25th August 2020. The South African Reserve Bank's (SARB) composite leading business cycle indicator is expected to have declined for a fourth consecutive month in June albeit at a slower pace than the previous declines. Consensus forecast is for a 0.4% month-on-month decline, from a 0.7% decline recorded in May. This expectation is in line with the depressed Covid induced domestic and global economic outlook.

- Consumer Price Inflation: Due Wednesday 26th August 2020. After recording two consecutive months below the SARB's inflation target band, consumer price inflation (CPI) is expected to have returned to the 3-6% target band in July. This is attributed to the base effect of low CPI in July 2019, as well as the increase in the petrol price and the annual electricity tariff hike at the beginning of July 2020. Consensus forecast is that CPI increased in July to 3.1% year-on-year and 1.2% month-on-month up from respective readings of 2.2% and 0.5% in June. Core CPI, which measures the change in the price of goods and services, excluding food and energy, is expected to have remained unchanged at 3% in July.

- Producer Price Index: Due Thursday 27th August 2020. Producer Price Inflation (PPI), which generally leads CPI, is expected to have recorded a 1.7% year-on-year and 1% month-on-month increase in July, up from respective readings of 1.5% and 0.7% in June. The expected pick-up in PPI is attributed to the increase in the petrol price and the annual electricity tariff hike at the beginning of July.

GLOBAL

Contributed by Nick Downing

- In the past week the S&P 500 index scaled a new record high, capping a phenomenal 50% increase since its low point on the 23rd March. The rapid equity market rally has been fuelled by extraordinary central bank and government intervention, which the research house MRB Partners refers to as a "reflationary bridge". MRB notes that "A consequence of near zero interest rates and aggressive credit easing is that the monetary authorities have created a situation for investors where 'there is no alternative' (TINA) to buying equities, credit or gold, or in some cases residential real estate." The latest monthly Bank of America investor survey found that despite a growing concern over overvaluation in equities and bonds, a majority believe that equities are in a sustainable bull market rather than in a bear market rally. Although the S&P 500 index is trading on an elevated forward price-earnings multiple of 23x, the highest since the dot.com bubble burst in 2000, valuations are less demanding when comparing equity earnings yields with bond yields. On this basis, valuations are in line with their long-term average. However, the risk lies in authorities losing their resolve in maintaining aggressive monetary policy and fiscal support. MRB cautions that "questions about the resolve of policymakers could lead to a meaningful equity shakeout." In this scenario bond yields would rise, in turn damaging the TINA trade. Some analysts believe bonds, which normally provide "risk-free returns", are now so expensive at the zero-yield band that they can now only provide "return-free risk."

NORTH AMERICA

Contributed by Nick Downing

- Weekly initial jobless benefit claims unexpectedly increased in the week ended 15th August, rising back above the 1 million mark to 1.1 million, breaking the steady four-month decline. In the prior week ended 8th August, jobless benefit claims declined to 963,000. The increase in benefit claims was especially obvious in Texas and Florida, states badly affected by a recent rise in Covid infections. A concern is that the number of overall new job postings fell in the past week for the first time since April, indicating a potential stalling in the jobs market recovery. While the unemployment rate has dropped rapidly from a peak of 14.7% in April to 10.2% in July, the pace of decline is expected to decelerate. In this context of fragile jobs growth, the continuing impasse between the White House and Democrats over additional fiscal policy support is likely to exacerbate investor unease.

- Minutes from the Federal Reserve's 28-29th July policy meeting reveal that the Fed's year-long "Framework" review is close to completion. Results may be forthcoming at the next policy meeting on 15-16th September. The most notable change to the Fed's policy framework is likely to be a shift from an absolute 2% inflation target to an average 2% target. This will pave the way for acceptance of inflation overshoots to make-up the prolonged period of below target inflation over the past ten years. The expected framework change would signal that the Fed funds interest rate will be kept at the zero bound for a prolonged period, potentially to 2023. Financial markets have also been expecting the Fed to adopt “yield curve control”, whereby the maturity composition of the central bank’s Treasury bond purchases is altered to peg longer-dated yields at pre-agreed levels. However, according to the minutes “Many participants judged that yield caps and targets were not warranted in the current environment.” The minutes again warned that the economic outlook remained highly uncertain, pledging additional accommodation if required but stressed the importance of additional Congressional relief. Further clues on US monetary policy and the global coordination of monetary policy will likely be revealed at the upcoming annual Jackson Hole Economic Policy Symposium, which runs from 27-28th August and is presided over by Fed Chair Jerome Powell.

- The surge in existing home sales continued in July with a month-on-month increase of 24.7% building on June’s 20.7% increase and its fastest pace since the data series began in 1968. On an annualised basis, unit sales reached 5.86 million, the highest level since December 2006. According to Lawrence Yun, chief economist at the National Association of Realtors (NAR), which compiled the data, “The housing market is actually past the recovery phase and is now in a booming stage.” The NAR reported that 68% of homes sold in July were on the market for under a month. The surge is attributed to record low mortgage interest rates, with the 30-year rate now below 3%. In addition, the Covid pandemic has created demand for larger homes as people are increasingly able to work from home. Encouragingly, there has been a notable increase in first time buyers, which signals a sustainable uptrend in the housing market. A rising housing market has many positive spin-offs for the economy, including increased construction activity and rising demand for building materials, home renovations and furnishings. Housing starts, measuring new homes construction, increased in July by 22.6% well above expectations and the biggest increase since October 2016. Meanwhile the total number of homes for sale has reduced by 21.1% year-on-year, indicating a sizeable fall in inventory and therefore continued growth in demand for new home construction.

- In similar fashion to the buoyant existing home sales, the IHS Markit composite purchasing managers’ index (PMI) was also stronger than expected despite the resurgence in Covid infections across numerous states. The composite PMI, which measures activity across both manufacturing and service sectors of the economy, increased in August from 50.3to 54.7 its highest since January 2019, powered by a rebound in demand. The forward looking composite new orders index surged from 49.7 to 54, signalling a continuation of the uptrend in activity over coming months. The opening-up of export markets helped foreign sales increase at their fastest pace since September 2014. By economic sector, the manufacturing PMI gained from 50.9 to 53.6 and the services PMI, which accounts for two-thirds of US GDP, gained from 50 to 54.8, both comfortably above the expansionary 50-level. According to Michael Pierce, senior economist at Capital Economics, “We’ve had a few reasons to worry that the recovery might have lost momentum or gone into a bit of a reverse, but they don't seem to have materialised. The economy seems to be powering ahead."

JAPAN

Contributed by Carel La Cock

- The Japanese private sector is stuck in a downturn according to the latest Jibun Bank Flash Composite PMI. The Index reading for August at 44.9 was unchanged from July and remained below the key 50-level indicating a further broad-based decline in economic activity over the month. Despite improved readings in previous months, the latest figures point to a lack of momentum and highlight the fragility of the recovery amid challenging global conditions. Demand for new business, both local and abroad, remained weak and work backlogs have eased, indicating headwinds for business activity in the coming months. The labour market also saw a further deterioration in both manufacturing and services for a sixth consecutive month with employment falling at the steepest rate since May. The outlook also deteriorated in August as reflected by Future Output which turned negative from positive in July. Global demand and rising unemployment will be the key metrics to follow in the coming months. IHS Markit expects the economy to contract by 5.7% this year.

EUROPE

Contributed by Carel La Cock

- The IHS Markit Flash eurozone PMI has deteriorated in August to 51.6 from 54.9 in July. Although it is still above the key 50-level, indicating that business activity has improved, the latest reading points to a recovery running out of steam. The reading has put a dampener on expectations of a strong recovery in the third quarter and reflects the resurgence of covid-19 cases in Europe leading to regional lockdowns and negatively impacting on the service sector. Manufacturing output continued to improve reaching a 28-month high. Across the region, employers reduced staffing levels for a sixth consecutive month, and it was most pronounced in the manufacturing sector as business confidence for future output remains subdued as a result of weak global demand. Germany performed well, only down slightly from July and saw further improvements in demand which led to the strongest business activity outlook in two years. In contrast, France saw a reversal in the strong rebound in July mainly driven by a decrease in new export orders. Andrew Harker, economics director at IHS Markit writes: "The eurozone stands at a crossroads, with growth either set to pick back up in coming months or continue to falter following the initial post-lockdown rebound. The path taken will likely depend in large part on how successfully COVID-19 can be suppressed and whether companies and their customers alike can gain the confidence necessary to support growth." Economists are discounting the probability of a V-shaped recovery and expect output to only return to pre-pandemic levels in 2022.

UNITED KINGDOM

Contributed by Carel La Cock

- The United Kingdom is expected to make a strong economic recovery in the third quarter after suffering the deepest recession on record. This according to the latest consumer spending data showing that total consumer spending in the first two weeks of August was up 7% from a year earlier and City of London economists expect third quarter GDP to rebound by 14.3% quarter-on-quarter. The higher consumer spending followed higher retail sales in July, up 3.6% on the month and 1.4% the year before reflecting pent-up demand and success in the government's "eat out to help out" scheme. July car sales were up 11.3% on the year and economists expect other big-ticket purchases to persist in the third quarter. Other contributing factors are the opening of schools in September and a rebound in the health sector where many procedures were postponed in lieu of the pandemic, both expected to further boost GDP. However, beyond the third quarter the outlook remains uncertain as a high reliance on consumer services and the unwinding of government schemes will cause significant headwinds. The labour market remains under pressure and the latest IHS Markit/CIPS Flash UK Composite PMI revealed that sustained job cuts occurred across the private sector despite increased output and new orders. The headline PMI figure of 60.3 in August was the highest recorded since October 2013 and was led by the manufacturing sector which increased at a faster pace than the service sector. In both sectors there were concerns about future orders, the driver behind further job cuts as optimism waned compared to July. The weakening labour market will be a major concern for policy makers while trying to navigate a consumer led recovery.

FAR EAST AND EMERGING MARKETS

Contributed by Carel La Cock

- Latin America has been hit particularly hard by the covid-19 pandemic and has been the epicentre of the pandemic since June, contributing 40% of all new covid-19 cases amongst a population of only 8% of the world. The response to the pandemic has varied greatly, from early strict lockdowns in Peru and Chile to a more casual approach in Brazil and Mexico. However, the spread of the virus has followed a similar path with both strategies as Peru has recorded the second highest per capita death toll in the world and Mexico is the nation with the world's third highest overall death toll. Bank of America forecasts the region will contract by 8.2% this year and rebound by only 3.5% next year. Brazil and Mexico have thus far recovered fastest. Brazil's economy is expected to contract by 5% this year and grow by 3% in 2021, but upcoming elections in Brazil and strained public finances could cause major disruptions in the year ahead. Mexico also has some pre-covid-19 conditions that will hamper its recovery, key amongst these is the low private investment in the last two years. Peru and Chile are expected to recover better as both have responded to the pandemic with better fiscal measures and both enjoy healthier public finances. Colombia and Argentina are expected to struggle, the former still dealing with high levels of infections and the latter going into the pandemic already in a deep recession and having to negotiate a sovereign debt default. Citibank forecasts Argentina will contract by 11.5% this year. It is clear that the region faces an uncertain future in 2021 and according to Bank of America will underperform the Middle East, Africa and emerging Asia.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 0.80	56625
JSE Fini 15	- 33.28	10458
JSE Indi 25	+ 8.72	75349
JSE Resi 20	+ 14.91	56602
R/$	- 17.50	16.97
R/€	- 21.56	20.00
R/£	- 16.29	22.17
S&P 500	+ 6.21	3431
Nikkei	- 2.84	22985
Hang Seng	- 9.36	25551
FTSE 100	- 19.06	6104
DAX	- 1.38	13066
CAC 40	- 16.23	5007
MSCI Emerging	- 0.58	1108
MSCI World	+ 2.48	2417
Gold	+ 27.75	1947

Platinum	- 4.47	927
Brent oil	- 32.96	44.35

BOTTOM LINE

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- RESPONSIBLE INVESTING: Responsible investing is gaining ground rapidly. The public, and activists, demand responsible investing – business must put People and Planet before Profits. Contrary to popular opinion, investing responsibly does not mean sacrificing profits. Often the opposite is true. Responsible investing boasts a record of substantial outperformance. We examine trends and developments through the years.

- THE 10th CENTURY - ETHICAL INVESTING: Ethical investing is the practice of selecting investments based on ethical, moral, or religious principles. The roots of Ethical Investing can be traced back to religious movements. Investments in “sin stocks” are frowned upon. Islamic Shariah Law goes back to the 10th century. It prohibits investments which derive most of their income from the sale of alcohol, pork products, pornography, gambling, military equipment, or weapons. Earning interest is not allowed. Interest earned must be donated to charity.

- 1993 - THE KING CODE: In 1993 the Institute of Directors in SA asked retired Supreme Court judge, Mervyn King (83), to chair a committee on corporate governance. The first King Report in 1994 coincided with the birth of our new democracy. Further King reports followed - King IV was published in 2016. The code addresses issues like ethical culture in organisations, ensuring adequate and effective controls are in place and respect for the law. The code also applies to State-Owned Entities and Municipalities. The code is a guide – it is non-legislative. In contrast, the USA equivalent, the Sarbanes–Oxley (SOX) Act of 2002, is a federal law.

- 1994 - THE TRIPLE BOTTOM LINE (TBL) OF PEOPLE, PLANET, PROFIT (PPP): British business writer, John Elkington (71), coined the phrase Triple Bottom Line in 1994. Elkington suggested a broader definition of the conventional Bottom Line, involving People, Planet and Profits. (1) People, or human capital, pertains to fair and beneficial business practices, and social justice. (2) Planet, or natural capital, refers to sustainable environmental practices. (3) Profit, the economic bottom line, deals with the economic value created. Economic value looks wider than the conventional internal profit created. Indirect benefits gained outside the business, by People and Planet, are part and parcel of economic value. The criticism is, that while it is easy to calculate Profit in terms of cash, it is problematic to measure the effect on People and Planet in terms of cash. And if you cannot measure it, you cannot manage it.

- 2005 - ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG): The term ESG was first coined in 2005. It has created a great deal of noise in the investment world over the last five years. Lately much of the noise came from the 17-year-old Swedish activist Greta Thunberg. She has gained international recognition for her environmental activism. ESG factors are becoming increasingly important for investors, especially younger investors. Investments are ranked on three metrics. In short, ESG means (1) Investments must be Environmentally Friendly. For example, businesses must minimise their carbon footprint. (2) Investments must be Socially Responsible. Anglo American spends millions on Corporate Social Investment (CSI). In 2019 it invested $41 million (R700 million) on education, training, health, and welfare projects. (3) Companies must have strong governance in place. Anglo American subscribes to the UK Corporate Governance Code.

- ESG FRIENDLY COMPANIES: Companies are given ESG scores by ESG rating agencies. There are even ESG Friendly Unit Trusts mandated to invest exclusively in ESG compliant companies. The top ten companies in a well-known South African ESG friendly unit trust are: Naspers, Prosus, FirstRand, Richemont, Standard Bank, AngloGold, Anglo American Platinum, Old Mutual, Kumba Iron and Sanlam. Some of these companies are indeed beating the market. In 2019, nine ESG Friendly Funds in the USA outperformed the S&P 500 Index.

- 2016 - TREAT THE CLIENT FAIRLY (TCF): TCF was introduced in SA in 2016. Financial Services Providers (FSPs) are required by the Financial Services Conduct Authority (FSCA) to conduct their business in a way that clients are treated fairly. TCF needs to be ingrained in the culture of the FSP. From day one, until the day they leave, clients must be treated fairly – the TCF “outcome” must be: satisfied clients. However, the concept of satisfied clients is overrated – every FSP tries to satisfy clients. To retain clients, the mission and vision of an FSP should be to get clients emotionally connected to its business. The payoff is substantial. Research shows that emotionally connected clients are anywhere from 30% - 100% more valuable annually than merely satisfied clients. Lifetime revenue can be six times more. It is a win-win strategy.

- GOVERNMENT: Government has not been spared - the King Code applies to it too. In his newsletter of yesterday, Pres. Ramaphosa wrote about government’s commitment to the environment. It is all talk and little action. Most municipalities have bad governance, do not have clean audits, no clean water, inadequate refuse removal, poor electricity supply, poor sewerage – sewerage is often running in the streets. Pres. Trump has a special pet name for this type of country, which we cannot repeat here.

- SUMMARY: Jefferson was right – there are bad apples in the business world. But there are more good apples than bad apples. The best example of a good apple is Apple Inc. Apple is all in on addressing climate change – Apple believes doing right for the planet is good for business. It did not stop Apple from becoming the biggest company in the world. Protecting the environment is not a liability or a burden – we have a responsibility to take care of our planet and to preserve it for our children. Don't kill the world – it is all we have. (Boney M. 1981).

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