OVERBERG MARKET REPORT

Tuesday 29th September 2020

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- The world's view on South Africa is very negative, to put it mildly. However, in January this year the Bank of America (BofA) had a bullish view on the South African market. It issued a research note headlined: "SA coming back". It is insightful to revisit the research note. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- The South African Reserve Bank's (SARB) leading business cycle indicator increased 2.6% month-on-month in July. The improvement is welcome although on a year-on-year basis it is still down 4.2%. The leading business cycle indicator provides an indication of the economic environment 6 to 12 month from now with the latest reading indicating an improvement. Eight of the ten available sub-components increased while the remaining two components decreased. The largest positive contributions were increases in the number of residential building plans approved and in the RMB/BER Business Confidence Index. The two negative contributors were a deceleration in the six-month smoothed growth rate in the real M1 money supply and in the twelve-month percentage change in job advertisement space. The overall positive direction is good news for an economy which has been severely damaged by the Covid-19 crisis and the severe lockdowns, which brought economic activity to an almost complete standstill. SARB economist, Adri Wolhurter, warns that despite the data improvement, one must be wary in concluding that this implies a full recovery from the lockdown. These measures, while continuously improving over the past two months, remain well below long-term averages and therefore one must remain cautious as to the timing of a full recovery to pre-lockdown levels of output.

- Annual producer price inflation (PPI) was 2.4% year-on-year in August 2020, up from 1.9% in July 2020. The August reading is the highest in 5 months and higher than the expectations of most economists, who had predicted a more moderate increase of between 1% and 2%. PPI increased by 0.7% month-on-month. The main contributors to the increase were food products, beverages and tobacco products, and transport equipment. The expectation is for a reflationary environment to persist over coming months, with the low base effect of subdued fuel prices in October and November 2019 adding to the mildly higher inflation backdrop. However, continued weakness in domestic demand will make it difficult for businesses to pass higher prices on to consumers, which means consumer price inflation should remain unaffected by the pick-up in inflation at the producer level.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Unemployment: Due Tuesday 29 September 2020. The first official indication of how Covid-19 and the strict lockdown measures influenced employment in South Africa will be released this week. Unemployment is expected to have increased to 34.8% in the second quarter of 2020 up from 30.1% recorded in the first quarter. Although the second quarter saw the most stringent lockdown measures with the majority of economic activity brought to a halt in April, the unemployment figure will not be an accurate representation of the full impact. Some workers became discouraged to look for work as a result of the lack of opportunities during this period, thereby excluding themselves from the unemployment formula. Moreover, many workers who were temporarily unemployed may have managed to find work by the time the survey was conducted at the end of the quarter.

- Private Sector Credit Extension: Due Wednesday 30 September 2020. Private Sector Credit Extension (PSCE) growth is expected to have continued slowing due to rising unemployment, weak real income growth and the weakening of consumer credit standings. The consensus forecast is that PSCE growth fell to 4.9% year-on-year in August, down from 5.1% recorded in July.

- Inflation rate: Due Wednesday 30 September 2020. Apart from an increase of 45c/litre in the diesel price, there were no major changes in the determining factors of the prices of goods and services purchased by households. Consumer price inflation (CPI) is expected to have remained subdued during August with the consensus forecasting 3.1% year-on-year and 0.2% month-on-month compared with respective July readings of 3.2% and 1.3%. Core CPI, excluding food and energy prices, is expected to remain unchanged at 3.2% year-on-year.

- Balance of Trade: Due Wednesday 30 September 2020. During August domestic economic demand together with oil prices, when compared to the same period in 2019, remained low. This led to downward pressure on imports. The decrease in imports together with the continuing increase in precious metal prices that supported export sales indicate that South Africa's trade balance remained in surplus in August 2020. The consensus forecast expects a R29.7 billion surplus in August, down from the R37.42 billion surplus recorded in July.

- ABSA Manufacturing Purchasing Managers' Index: Due Thursday 1 October 2020. The ABSA Manufacturing Purchasing Managers' Index (PMI) is likely to have declined marginally but remained in expansionary terrain during August. It is expected to have declined to 55 down from 57.3 recorded in July, but with the reading still above 50, indicating strength in the manufacturing sector and a gradual return to pre-lockdown levels.

- New Vehicle Sales: Due Thursday 1 October 2020. With consumer and business confidence remaining at depressed levels along with the uncertain economic outlook, new vehicle sales are likely to have increased only slightly in September, remaining close to the low levels seen since the start of the Covid-19 pandemic.

- Standard Bank Purchasing Managers' Index: Due Monday 5 October 2020. The Standard Bank/IHS Markit economy-wide private sector purchasing managers' index (PMI) is expected to have increased from 45.3 in August to 47 in September. The downturn in business activity is expected to have softened, albeit at a gradual pace, as private sector business performance continues to suffer as a result of Covid-19. However, firms will remain hopeful of an upturn in business activity over the coming 12 months, as government has lifted most restrictions, which should restore consumer confidence and lead to an uptick in sales.

NORTH AMERICA

Contributed by Nick Downing

- Democrats have proposed a watered-down version of the $3.5 trillion aid bill the House of Representatives passed in May. The new $2.4 trillion package covers the same expenditure items but is shorter in duration. Motivated by a loss of momentum in the jobs market recovery, Republicans are expected to raise their proposed aid package to $1.5 trillion, but the divide remains considerable, pertaining mainly to the size of weekly unemployment assistance and state and local government aid. While centrists from both parties are hopeful of a breakthrough before the October recess, others are less hopeful of any agreement before the presidential inauguration in January. In his testimony to the House financial services committee, Federal Reserve chairman Jerome Powell once again stressed the need and urgency of additional fiscal support, citing the vulnerability of low-income households and small businesses, as well as specific industries such as airlines. He referred to the Fed as providing "lending powers" and the Congress as providing "spending powers", adding that "The recovery will go faster if we have both tools continuing to work together." Financial markets had expected a supplementary aid package in July and have since pulled back, due largely to the Congressional impasse. Over the past month, the S&P 500 index has dropped 8%. An additional aid package would likely provide the catalyst for the next up leg in financial markets.

- Initial jobless benefit claims unexpectedly increased in the week ended 18th September, rising from 866,000 to 870,000 in contrast with the consensus forecast of 840,000, raising concerns that the recovery in the labour market has stalled. Although claims are down considerably from the peak of 6.9 million reached in March, the figure appears stuck above the 2008/09 Global Financial Crisis peak of 665,000. Businesses appear to be unwilling to step up hiring due to a lack of demand growth in the service sectors of the economy. According to Ryan Sweet, economist at Moody's Analytics, "We're getting to that point where the easy hiring is behind us." Further employment gains will require a dependable vaccine, and sustainable demand-led economic growth.

- The IHS Markit composite purchasing managers' index (PMI), measuring private sector activity across manufacturing and service sectors of the economy, slipped slightly from 54.6 in August to 54.4 in September, although remained well above the key 50-level demarcating expansion from contraction. While the services PMI decreased from 55.0 to 54.6, the manufacturing PMI increased from 53.1 to 53.5. Like other economic data points, the latest PMI numbers are signalling that the rebound in activity may be losing momentum. Chris Williamson, IHS Markit chief business economist said "The question now turns to whether the economy's strong performance can be sustained in the fourth quarter. Risks… seem tilted to the downside for the coming months as businesses await clarity with respect to both the pandemic and the election."

- Durable goods orders increased on a month-on-month basis for a fourth straight month, rising in August by 0.4%, although this was well down on July's 11.7% surge and below the consensus forecast increase of 1.5%. However, the closely watched business investment measure, which excludes defence and aircraft orders, increased by a solid 1.8%, below July's 2.5% increase but well above the 0.5% consensus forecast. Business investment orders were driven higher by transportation, machinery, and electronics orders, which gained by 0.5%, 1.5% and 1.2%, respectively. According to Andrew Hunter, senior US economist at Capital Economics, "Business equipment investment staged a V-shaped rebound in the third quarter". Business investment spending is expected to maintain its positive trend in the fourth quarter, especially as businesses need to address low inventories, which were depleted during pandemic related lockdowns and supply chain disruptions.

- The housing market continued to provide a bright spot in the US economic rebound. Sales of new homes increased in August for a fourth straight month, rising by 4.8% month-on-month to an annual rate of 1.01 million, the highest since 2006. At the current sales rate the number of new homes for sale fell to 3.3 months' supply, the shortest since 1963, indicating considerable pent-up demand for new residential construction. According to the National Association of Home Builders Index, homebuilder optimism increased in September to an all-time high. Existing home sales mirrored the bullish outlook, rising for a third straight month by 2.4% on the month, building on July's 24.7% surge. On an annual basis, existing home sales registered 6 million, the highest reading since 2006. According to Lawrence Yun, chief economist at the National Association of Realtors, "Home sales continue to amaze, and there are plenty of buyers in the pipeline ready to enter the market. Further gains in sales are likely for the remainder of the year, with mortgage rates hovering around 3% and with continued job recovery. The need for housing will grow even further, especially in areas that are attractive to those who can work from home.” The strong housing market should provide many spin-offs for the economy including demand for home improvements and furnishings and demand for construction activity, which is labour intensive, and positive for jobs growth.

CHINA

Contributed by Nick Downing

- In an unexpected move, President Xi Jinping announced at the UN General Assembly that China will be carbon neutral by 2060. Until this week, the official line had been that the country needed leeway as it is an emerging economy and the only commitment given, that net emissions would be cut from around 2030 onwards. The announcement almost matches the pledge given by the EU and UK of attaining carbon neutrality by 2050, and puts the spotlight on the US, which is poised to leave the Paris climate accord in November. China’s announcement is politically astute, helping to shore up international support amid the trade war with the US. The climate pledge will accelerate the demand for green energy and the demise of fossil fuels, boost the global environmental lobby and demand for ESG (Environmental, Social and Governance) investments.

JAPAN

Contributed by Carel la Cock

- The Jibun Bank flash Japan Composite purchasing managers’ index (PMI) edged up in September to 45.5 from 45.2 in August but remains firmly below the key 50-level indicating a further decline in private sector output and further economic weakness in the third quarter. New orders continued to decline reflecting weak global demand. However, the fall in employment slowed and has moved closer to a new equilibrium, while business sentiment has improved to levels not seen since the start of the year, especially amongst manufacturers. The Jibun Bank Japan Manufacturing PMI inched forward to 47.3 in September from 47.2 in August and the Services PMI was 0.6 points higher in September at 45.6, although both still in sub-50 contractionary territory.

EUROPE

Contributed by Carel la Cock

- Business activity slowed in the eurozone due to a second wave of covid-19 cases and the possibility of further lockdowns. The IHS Markit Flash Eurozone Services Purchasing

Managers' Index (PMI) fell to a four-month low from 50.5 in August to 47.6 in September indicating a decline in the service sector. By contrast, the Manufacturing PMI rose to 53.7 in September from 51.7 the month before, marking a 25-month high. The survey also revealed the divergent fortunes of countries in the eurozone with Germany leading the recovery while business activity in France deteriorated for the first time in four months. While manufacturers were buoyed by improved export demand, face-to-face service providers felt the impact of a second wave of covid-19 infections leading to higher job-losses as businesses continue to reduce fixed overheads. In the manufacturing sector, employment has stabilised, indicating that job losses have peaked. Firms' expectations for the coming year improved but are highly correlated to an improvement in infection rates. The coming month will be key in determining whether the rebound in the third quarter can be sustained into the final quarter of the year.

UNITED KINGDOM

Contributed by Carel la Cock

- Consumer confidence in the UK edged higher according to the latest GFK Consumer Confidence Index, but the threat of a second lockdown could derail the recovery. Consumers' expectations of the economic situation over the next 12 months and willingness to make major purchases were key drivers, but both are vulnerable to the possibility of a second lockdown and further increases in the covid-19 infection rate. According to Fable Data, the company collecting payment information, consumers spent less on travel, clothing, hotels and leisure accommodation in September, a trend that might continue as the northern hemisphere moves into winter and further covid-19 prevention measures are implemented. Meanwhile, private sector output experienced a setback in September reflected by the lower reading in the IHS Markit /CIPS Flash UK Composite Output Index, down from 59.1 in August to 55.7 in September, marking a three-month low. Although private sector output still expanded, the lower rate of expansion indicates that the UK economy has lost some if its momentum and business expectations for the coming year have fallen to their lowest level since May. Chris Williamson, Chief Business Economist at IHS Markit notes: "Encouragingly, robust growth in manufacturing, business services and financial services has offset weakness in consumer-facing sectors, meaning the overall rate of expansion remained comfortably above the survey's long-run average, which adds to expectations that the third quarter will see a solid rebound in GDP from the collapse seen in the second quarter." Mr Williamson also expressed his concern over the continued deterioration in the labour market and impact of the government's furlough schemes ending next month.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 4.14	54718
JSE Fini 15	- 36.64	9932
JSE Indi 25	+ 6.76	73991
JSE Resi 20	+ 10.37	54366
R/$	- 17.92	17.06
R/€	- 21.14	19.90
R/£	- 15.20	21.88
S&P 500	+ 3.74	3351
Nikkei	- 0.61	23511
Hang Seng	- 16.72	23476
FTSE 100	- 21.41	5927
DAX	- 2.85	12870
CAC 40	- 18.98	4843
MSCI Emerging	- 4.02	1069
MSCI World	+ 0.34	2366
Gold	+ 21.84	1857
Platinum	- 12.43	850
Brent oil	- 36.63	41.92

BOTTOM LINE

Contributed by Gielie Fourie

- BANK OF AMERICA BULLISH ON SA: BofA became bullish on South Africa in September 2019. BofA believed the Moody's downgrade of the country's bonds to "junk" was already priced in. It also believed that the Reserve Bank would finally cut interest rates after the February budget. At that stage Covid-19 was not even on the horizon. In January 2020, in a research note headlined "South Africa coming back", BofA took a bullish view on the local market.

BofA is the second largest bank in the USA, after JPMorgan Chase. It is the eighth largest bank in the world. It is insightful to revisit the research note.

- THE JSE IN 2019: BofA noted that the JSE had a pretty solid 2019, with the all-share index up 8%. Including dividends, the total return was 12%, which handily outperformed inflation. But the local market trailed global shares, with key US indices up almost 30%. The top performers in the local market were all mining shares, with Impala Platinum up by more than 290%. Retailers and other South African-focused companies had a tougher time, with Shoprite losing a third of its value.

- EASTERN EUROPE, MIDDLE EAST, AND AFRICA (EEMEA): BofA singled out twenty shares across the EEMEA markets which offered value. Although BofA ranked Turkey higher than SA, it was bullish on SA, "South Africa's higher ranking is driven by earnings growth and strong momentum." BofA added that from a country perspective, Turkey was at the top of its rankings thanks to its solid valuations compared to historic levels and strong dividends, among other factors. Other EEMEA countries on the list were Russia, Poland, and the Czech Republic.

- THE TOP EIGHT SHARES: Eight (40%) of its twenty top EEMEA shares which offered value, screened by quantitative measures like (1) valuations, (2) earnings growth, and (3) dividends, were from South Africa. The eight companies were Sibanye Stillwater (SSW), Anglo American Platinum (AMS), Gold Fields (GFI), Harmony Gold (HAR), African Rainbow Minerals (ARI), Impala Platinum (IMP), Rand Merchant Investment Holdings (RMI), and Fortress Income Fund (FFA).

- HOW DID THE SOUTH AFRICAN COMPANIES PERFORM? Of the eight companies, six were mining companies. How have they performed since 1 January 2020? SSW is up 27%, AMS is down 13%, GFI is up 113%, HAR is up 72%, ARI is up 20%. IMP is up 1% after rising 290% in 2019. RMI, an insurance holding company, is down 9% and FFA, a property company, is down 38%. With the exception of AMS, BofA was correct with its six mining picks. BofA was wrong with its insurance and property picks. Admittedly Covid-19 had a negative impact on these two sectors.

- RECENT BofA PICKS: In June 2020 BofA wrote about the effect of the pandemic on SA shares: "Our top healthcare pick is Aspen. The other likely beneficiaries are technology, media and telecoms. Companies which can outperform due to digitalisation and changing consumer preferences are Naspers and Prosus."

- SUMMARY: If you had invested R10,000.00 in each of the eight companies, your R80,000.00 would have grown to just short of R100,000.00, for a return of 24% over nine months (figures rounded). Over the same time the JSE All-Share index was down 7.1%. The Dow was down 5.1%. It is worth noting that the eight companies have offshore exposure, which helped to beat the market. The BofA exercise proved that investing on the JSE can deliver excellent returns but the current consensus seems to be that South Africa is on the tipping point of becoming a failed state. Mark Twain once advised: “If you find yourself on the side of the majority, it is time to pause and reflect.”

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