OVERBERG MARKET REPORT

Tuesday 2nd September 2020

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- One of the top performing investments in our Global Portfolios is Scottish Mortgage. It has a remarkable history dating back 111 years. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- Consumer inflation rose in July, exceeding economists' forecasts as lockdown measures eased. The Consumer Price Index (CPI), accelerated to a four-month high of 3.2% year-on-year in July, from 2.2% in June. The latest print was marginally above market expectations of 3% and moved back to within the South African Reserve Bank's (SARB) target range of 3-6%. Food and non-alcoholic beverages, housing and utilities (reflecting the annual water and electricity tariff hikes) as well as miscellaneous goods and services were notable contributors to the annual CPI rise. Core inflation, which is headline CPI excluding the volatile food and non-alcoholic beverages, fuel, and energy components, measured 3.2% year-on-year in July, slightly up from the 3% recorded in June. Looking forward, inflation is expected to remain low as demand-pull inflation remains depressed amid weak income growth, rising unemployment, and a highly uncertain operating environment.

- The SA Reserve Bank's composite leading business cycle indicator, which signals changes in the economy before they happen, increased 2.7% month-on-month in June, rising for the first time since March. Seven of the nine available components increased in June. The increase in the June print was largely supported by an improvement in the number of residential building plans approved and new passenger vehicles sold. However, despite advancing in June, measured year-on-year, the leading indicator remained in negative territory for a 20th consecutive month. The negative contributors were a deceleration in the six-month smoothed growth rate in the real M1 money supply and a narrowing in the interest rate spread. The coincident indicator, which gives an early reading on the impact of GDP, decreased by 0.8% month-on-month in May following a 22% month-on-month decline in April. The suspension of economic activity resulting from strict lockdown regulations has resulted in a marked decline in production and demand for goods and services. Consequently, this has adversely affected income and employment prospects and will continue to weigh on future economic growth.

- Private sector credit extension (PSCE) growth continued to decelerate in July, to just 5.1% year-on-year from 5.6% recorded in June with most loan categories trending sideways or rising only marginally. Households' credit increased R6.7 billion with the year-on-year growth at 3.2%. On a seasonally adjusted basis, mortgages, general loans, instalment sales and credit cards have generally recovered from their slumps at the start of the lockdown, while leasing finance and overdrafts continue to decline. Growth in the corporate sector's loans and advances decelerated marginally to 1.6% year-on-year from June's 1.8%, in line with the growth rate in May and still below the 1Q20 average growth rate. Looking ahead, weak growth in household credit extension is expected to continue amid rising unemployment, weak real income growth and a deterioration in consumer credit standings. Furthermore, the waning pandemic-induced borrowing by the corporate sector suggests further weakening in private sector credit extension in the near term.

- South Africa's trade balance recorded a surplus of R37.4 billion in July, softer than the trade surplus recorded in June of R45.7 billion. Exports were valued at R122.49 billion, while imports were valued at R85.07 billion. Overall, export activity has picked up in line with the increase in global demand which coincides with the easing of the Covid-19 lockdown restrictions globally. Exports increased 6.1% month-on-month, mainly led by a spike in vehicle and transport equipment sales (+42% month-on-month). While precious metals and stones exports softened over the month, the overall level of sales remains relatively upbeat. The 22.1% month-on-month surge in imports was largely responsible for the softer trade surplus. The trade balance is likely to remain in surplus in August as elevated precious metal prices will have continued to boost export sales, while lower international oil prices (when compared to the corresponding period last year) and weak domestic economic demand will continue to put downward pressure on imports.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Werner Erasmus

- ABSA Manufacturing Purchasing Managers' Index: Due Tuesday 1st September 2020. The ABSA Manufacturing Purchasing Managers' Index (PMI) is likely to have shown a modest expansion in manufacturing activity in August above July's 51.2 reading, reflecting South Africa's gradual return to business. Even so, the sector's output remains 16% below its 2019 level. South African manufacturing has been under enormous pressure for a considerable time with the lockdown pushing many subsectors to the point of collapse. The key question is how much lasting damage has been inflicted on the sector by Covid-19 and whether there will be sufficient improvemewnt in demand in the months ahead to allow a recovery to take hold.

- New vehicles sales: Due Tuesday 1st September 2020. Expectations are for new vehicle sales to have contracted by 22% year-on-year in August compared with the 29.6% decline in July due to depressed consumer and business confidence combined with the uncertain economic outlook. New vehicle sales slumped to their lowest level on record in April 2020, although they have been on a recovery path since.

GLOBAL

Contributed by Nick Downing

- The Organisation for Economic Cooperation and Development (OECD) reported that the 37 developed economies in the group shrank in the second quarter (Q2) by an aggregated 9.8% quarter-on-quarter, far worse than the 2.3% decline in Q1 2009, amid the Global Financial Crisis. The OECD stuck with its forecast that the global economy will shrink in 2020 by 6% although warned that the contraction could be as bad as 7.6% if the pandemic deepens. It cautioned that the pandemic will continue to affect economic activity until a vaccine becomes widely available. It also warned that continued government fiscal support was vital to the economic recovery, a view shared by central bankers at the annual Jackson Hole Economic Policy Symposium. While central bankers at the symposium were unanimous in their call for continued extraordinary monetary support, there are growing signs of government fatigue in providing fiscal support, illustrated by the prolonged impasse between the White House and Senate and the Democrat led House of Representatives. OECD chief economist Laurence Boone cautioned that "We cannot afford at the current juncture a repeat of the fiscal tightening that we saw in the great financial crisis."

NORTH AMERICA

Contributed by Nick Downing

- Federal Reserve chair Jerome Powell announced the results of the Fed's two-year policy framework review at the annual Jackson Hole Economic Policy Symposium. As widely anticipated the Fed will alter its 2% inflation target from an absolute target to a "symmetric" average target, allowing inflation to exceed 2% for periods of time to make up for previous shortfalls. The Fed also announced that it will allow unemployment to move much lower than in the past before tightening monetary policy. Powell stated that in a disinflationary environment brought about by demographic changes, technological advancement, excess savings and globalisation, the Fed needed to avoid "an adverse cycle of ever-lower inflation and inflation expectations." He said the policy framework change "reflects our view that a robust job market can be sustained without causing an outbreak of inflation." Some economists said that the change did not go far enough in altering inflation expectations, arguing that the Fed's inflation target should have been raised to 3%. Others warned that the framework change would stoke asset price bubbles and financial imbalances. The reaction in financial markets was muted as the changes have long been telegraphed. However, the US 10-year Treasury yield increased on the news to 0.76%, its highest in three months while the 30-year yield increased to 1.5% up from 1.2% at the beginning of August. The yield curve, measuring the gap between long-dated and short-dated Treasury bonds also steepened, indicating more optimism over a return of inflation and economic activity. Now that the framework review has been finalised, markets are anticipating some announcement of forward policy guidance at the Fed's next policy meeting on 15-16th September. The guidance is certain to confirm that interest rates will remain at the zero bound for a prolonged period, at least until 2023. The next policy framework review will be in five years' time.

- US personal income increased in July by 0.4% month-on-month showing a recovery from the declines of 1% in June and 4.2% in May, and beating the consensus forecast for a 0.2% decline. However, the recovery in incomes may suffer with the end-July expiry of $600 per week enhanced unemployment benefits. President Trump has signed an executive order to reinstate payments at $300 per week but there have been administrative delays and the programme only has funding for 6-8 weeks. The Conference Board consumer confidence index fell sharply from 91.7 in July to 84.8 in August due to growing consumer concerns over the economic recovery and their financial wellbeing. According to the survey, the percentage of respondents who though jobs are hard to get increased from 20.1% to 25.2%. The shift in consumer unease reflected in personal spending, which although rising in July by 1.9% month-on-month, is substantially below the 6.2% rise in June. Precautionary savings remained elevated at 17.8%, down from 19.2% in June and 24.6% in May, but well above the rate of 7.6% recorded in January prior to the pandemic. While retail spending regained its pre-pandemic February level in July, overall personal spending remained 4.6% below its February level, held back by a reluctance to spend on services, which often involve closer physical proximity. Personal spending is closely followed by economists as it accounts for around 70% of US GDP.

- Durable goods orders increased in July by a stronger than expected 11.2% month-on-month, up from a 7.7% increase in June and well ahead of the 4.3% consensus forecast increase. The gain is attributed to a 35.6% increase in transportation equipment orders, which are notoriously volatile. Excluding these, durable goods orders grew by a more modest 2.4%. However, much of the transportation equipment orders related to motor vehicles and parts, which surged by a massive 21.9% on the month, encouragingly surpassing pre-pandemic levels. The closely watched new orders for non-defence capital goods excluding aircraft, a barometer of business investment spending, gained by 1.9% on the month, which although below the 4.3% increase in June, is nonetheless a solid number and off a growing base. According to Michael Pearce, Capital Economics' senior economist, "The recovery in business equipment investment looks pretty V-shaped to us."

CHINA

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- The Caixin/ Markit manufacturing purchasing managers' index (PMI) unexpectedly maintained its uptrend in August, rising from 52.8 to 53.1, well above the expansionary 50-mark and its highest level since January 2011. The forward-looking total new orders sub-index also gained to its highest level since January 2011, signalling further output gains in the months ahead. The official National Bureau of Statistics (NBS) manufacturing PMI, which tends to focus on the larger state-owned enterprises, was less buoyant, slipping from 51.1 to 51.0, but nevertheless stayed above the key 50-level for a sixth straight month. More encouragingly, the NBS non-manufacturing PMI, which surveys service sectors of the economy as well as construction, gained from 54.2 to 55.2 its highest level since January 2018. Among the non-manufacturing PMI sub-indices, the services index increased from 53.1 to 54.3 and the construction index from 60.2 to 60.5. The buoyancy in the services index should alleviate analyst concerns that China's recovery has been focussed solely on the industrial sectors of the economy. The data confirms that the economic recovery is broadening out. Additionally, with a slowing in the global Covid pandemic, export markets are also finally coming to the rescue. The Caixin manufacturing new export orders sub-index returned to expansionary levels in August for the first time this year.

JAPAN

Contributed by Carel La Cock

- Japan's prime minister, Shinzo Abe, resigned on Friday ending an eight-year term that has economists divided on the economic success of his "Abenomics" policies. Inflation is still well below the 2% target and economic growth was faltering even before the arrival of the coronavirus. He presided over a period of ultra-low interest rates, yen weakness and expansive government bond and ETF purchases. The Topix returned 85% during his 8-year term, underperforming the S&P500 but outstripping the MSCI Europe and MSCI Emerging Markets. During the initial years of "Abenomics" foreign direct investments totalled ¥25tn according to analysts at CLSA, however much of the earlier successes were undone with two consumption tax increases from 5 to 10%. Although the markets have been jittery since the announcement, some analysts have eased nerves by saying that it is unlikely that a successor would dramatically veer off the current course, especially with Haruhiko Kuroda still at the helm of the Bank of Japan. Mr Abe will further be remembered for reforming the prime minister's office and centralising its powers, increasing employment by 4m and forging trade deals and links with other G7 leaders. While analysts might lament the current state of Japan's economy, Warren Buffett has been steadily increasing his investment in Japan by $6bn in the last 12 months, according to regulatory filings. He invested in five general trading houses also known as "sogo shosha" which are diversified across many sectors and geographies and stand to benefit over the long term as the global economy recovers. The share prices of the trading houses have been impacted by the pandemic but rebounded on Monday after news broke of Buffet's investment. Mr Buffett's de facto endorsement of the Japanese economy will certainly help to allay fears until the appointment of a new prime minister.

EUROPE

Contributed by Carel La Cock

- Business and consumer survey results in Europe improved further in August after the record lows in March and April caused by the global lockdown. The Economic Sentiment Indicator (ESI) for the euro area was up 5.3 points to 87.7, recovering nearly two thirds of the losses from the pandemic. The ESI recovery was due to a continued advance of industry (+3.5), retail trade (+4.6) and services confidence (+9.0) partly offset by construction (-0.4) while consumer confidence remained largely flat (+0.3). The ESI improved markedly for France (+9.3), Netherlands (+7.1), Germany (+5.9) and Italy (+2.7) while Spain (-2.5) experienced a setback. The Employment Expectations Indicator (EEI) at 89.6 improved by 2.9 points and although still below pre-pandemic levels, marked the highest reading in five months reflecting broad based improvement in employment plans. Furthermore, selling price expectations improved in construction and retail trade while declining in services and industry. Consumer price expectations were lower in August which will be a concern to policy makers targeting 2% inflation.

- Germany announced the issuance of its first green bond this week, raising up to €6bn via a 10-year bond, the start of a programme projected to raise €12bn this year. Although Germany is not the first European country to issue a bond that is linked to environmental spending, it is significant because the bond is likely to serve as a reference point for debt with environmental, social and governance (ESG) aims, an investment area that has become popular in recent times. It will serve as the risk-free rate for green bonds. German chancellor, Angela Merkel, has been propagating increased fiscal spend on environmental projects to help revive the European economy post-pandemic. The bond will be priced in line with conventional bonds of the same maturity, currently yielding -0.46%, enabling Germany to invest in climate change at historic low interest rates.

UNITED KINGDOM

Contributed by Carel La Cock

- The United Kingdom will take a step towards normality this week when schools reopen after the national lockdown and summer holidays. Prime minster Boris Johnson and chancellor of the exchequer Rishi Sunak have urged workers to return to city centres and back to “safe” offices amid concerns that a protracted period of working from home could be devastating to city centres and the services industry, which might lead to further job losses. The government’s furlough scheme will also continue to unwind this week. The furlough scheme will conclude by the end of October and it is hoped that business activity will have recovered by then. However, signs of a shift in behaviour abound with official figures showing passenger trains carrying less than a third of their normal load. Pret A Manger, the fast-food restaurant that caters for city workers, has announced it will reduce its staff by nearly a third. Dame Carolyn Fairburn, director general of the lobby group CBI, has warned that city centres could become “ghost towns” if more people decide to work remote and that the daily influx of city workers that supports local small businesses, is vital to spearhead a recovery from the coronavirus pandemic. Not everyone agrees that the old way was best. Sarah O’Connor, writing for the Financial Times, argues that city centre economies were under strain even before the outbreak of covid-19 as significant house and rental price increases over the last two decades have meant that the median household income after housing costs has increased by only 6% in London. City workers are also commuting longer distances and wellbeing surveys showed that Londoners were most anxious about their daily commute. The post-pandemic world will certainly look different as the lockdown has accelerated the shift to working remote, a trend already seen pre-covid in San Francisco and New York. Well paid workers will be more evenly spread across the country and city centres will have to adapt.

FAR EAST AND EMERGING MARKETS

Contributed by Carel La Cock

- The latest GDP figures from India highlight the government’s poor handling of the covid-19 pandemic. The economy contracted by an annualised 23.9% quarter-on-quarter from April to June reflecting the draconian lockdown measures, which saw businesses close overnight with millions losing their jobs. Moreover, the strict lockdown has done little to prevent the spread of the virus and India is now leading the world in new detected cases, just shy of 80,000 in the last 24 hours. At the current rate it will soon be the country with the second highest number of cases, surpassing Brazil and just behind the US, although the official death toll at 65,000 is still well below Brazil at 120,000 and the US at 183,000. India’s government support has failed to make an impact in alleviating the daily struggles of those affected by the pandemic. Private consumption contracted by 27% on the year and investment fell by 47.5% year on year in the second quarter. Construction and manufacturing were devastated by the lockdown, dropping 50% and 40% respectively and only agriculture showed growth of 3.4% as farmers could return to work sooner. The initial uptick in economic activity after the lockdown, driven by pent-up demand, has faltered in July and August impacted by further regional lockdowns. Economists have called for a greater fiscal response by the government to support a quick recovery, but much of its success would depend on containing the spread of covid-19 first.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 2.82	55476
JSE Fini 15	- 37.82	9747
JSE Indi 25	+ 7.86	74753
JSE Resi 20	+ 12.90	55612
R/$	- 17.36	16.94
R/€	- 22.40	20.22
R/£	- 18.04	22.64
S&P 500	+ 8.34	3500
Nikkei	- 2.18	23139
Hang Seng	- 10.69	25177
FTSE 100	- 20.93	5963
DAX	- 2.29	12945
CAC 40	- 17.24	4947
MSCI Emerging	- 1.18	1101
MSCI World	+ 4.11	2455
Gold	+ 28.47	1958
Platinum	- 4.22	930

Brent oil	- 31.55	45.28

BOTTOM LINE

Contributed by Gielie Fourie

- UNDERSTANDING INVESTMENT TRUSTS: An investment trust is simply a company, which is quoted on the London Stock Exchange (LSE) and has its own independent board of directors and fund managers. There are about 300 investment trusts listed on the LSE. They offer many unique benefits that unit trusts do not offer. Hence their reputation as being "one of the City's best kept secrets". We look at one of the top performing investment trusts, Scottish Mortgage.

- SCOTTISH MORTGAGE: One of the top performing investments in our Global Portfolios is a 111-year old company, Scottish Mortgage Investment Trust (Scottish Mortgage). The name is historic, rather than descriptive. Scottish Mortgage Trust has changed. Today it is not Scottish – it invests globally. It has no connection whatsoever with mortgages. It is also not a Trust, but an investment company. Like so many other great companies, the origins of Scottish Mortgage lie in a credit crisis, namely the Panic of 1907. The Panic started on 14 October 1907 - markets quickly dropped by almost 50%. This is when Baillie Gifford entered the scene.

- ENTER BAILLIE GIFFORD: The law firm, Baillie Gifford, was formed in 1907 by Colonel Augustus Baillie and Carlyle Gifford in Edinburgh, Scotland. In 1908 the great demand for credit created by the Panic of 1907, swayed them to switch from being a law firm to an investment company. And what a great switch it was. Much of the demand for credit came from rubber planters in Asia. Rubber was required by the growing motorcar industry – the industry needed rubber tyres for their cars – most notably the popular Model T Ford. Baillie Gifford formed Straits Mortgage Trust to lend money to rubber planters in Asia. Loans were secured by mortgages on the rubber estates. In 1913 Straits Mortgage changed its name to Scottish Mortgage & Trust Company. In 2003 the name was changed again - to Scottish Mortgage Investment Trust. To this day, 111 years later, Scottish Mortgage is still managed by Baillie Gifford.

- THE MANAGERS: The two joint Managers of Scottish Mortgage are James Anderson (since 2000) and Tom Slater (since 2015), both of Baillie Gifford. Their investment strategy is to have a long-term horizon of five years and more. This is reflected in the fact that there is not much movement in their investments. A secondary strategy is to use modest gearing. Their philosophy in these extraordinary times? "When there is a temptation to do 'something', we prefer to do nothing". DIVIDEND HISTORY: Scottish Mortgage boasts an enviable record of paying dividends. It survived two world wars, the Great Depression, and several recessions. Most remarkably, except for one blip in 1933, it has increased its dividends every single year since inception 111 years ago in 1909. The only time in history that it had to cut its dividend was during the Great Depression in 1933. PERFORMANCE: Scottish Mortgage is listed and traded on the London Stock Exchange (LSE). The Fund's benchmark is the FTSE All-World Index (GBP). It aims to achieve a greater return than the benchmark over a five-year rolling period. The total return, with the benchmark in brackets: 1 Year 58.2% (0.4%), 3 Years 118.3% (24.5%), 5 Years 232.6% (73.8%), 10 Years 727.1% (193.1%).

- LISTED HOLDINGS: Around 70% of Scottish Mortgage holdings are listed companies. The managers focus on technology companies, as demonstrated by investments in listed eCommerce giants. Some of their top ten holdings on 31 July 2020 were (the percentages refer to the percentage of their Assets Under Management): Tesla (13.4%), Amazon (9.7%), Tencent (5.9%), Alibaba (5.4%), Netflix (2.6%), Spotify (2.4%). Outside the tech sector they own: In the Food sector, Delivery Hero (2.8%). In the Luxury Cars sector, Ferrari (2.5%). In the Work sector, Zoom (0.6%). UNLISTED HOLDINGS 1: Around 30% (currently 45 companies) are unlisted companies. Their strategy is to invest in disruptive growth companies. Unlisted companies have been major drivers of performance. In addition, they are often highly cash generative. The unlisted companies are by no means small, immature, start-up companies. They are strong established companies, each valued at more than $1bn (billion).

- UNLISTED HOLDINGS 2: In Fintech they have invested in the Ant Group (2.5% of AUM). Ant, 33% owned by Alibaba, operates Alibaba's Alipay app. Ant is expected to list as soon as October 2020. The expected valuation is $225 billion, making it one of the biggest listings in history and the world's fourth-largest financial company – a very big ant indeed. Another unlisted investment is the technology company, ByteDance, which owns TikTok. ByteDance is reportedly worth more than $100bn. When unlisted companies successfully list on a Stock Exchange huge profits can be made.

- FUND INFORMATION: The Fund is an actively managed, low cost, investment trust. It invests in a global portfolio of companies. On 31 July 2020, Assets Under Management (AUM) totaled £13.49bn. Total borrowings were £1.1bn - gearing is modest between 6% - 7%. Ongoing charges are 0.36%. Dividend yield is 0.4%. The share price was 860.00p and the NAV was 846.24p. SUMMARY: During the Panic of 1907 colonel Augustus Baillie and Carlyle Gifford founded two great companies, Scottish Mortgage and Baillie Gifford. They have a long and proud tradition of delivering extraordinary returns. Managers James Anderson and Tom Slater are continuing the tradition. Long may it last.

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