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WEEKLY REPORT

OVERBERG MARKET REPORT

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IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- Books written on the subject of investing could fill several library shelves, public or private, and they often do. Investing is as much a science as it is an art. We look at some of the top investors and their advice and techniques. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- The South African economy recorded its third consecutive quarter of economic decline, falling by 2.0% in the first quarter of 2020, although this was better than market expectations of a quarterly decline of 4%. The latest GDP figure, of course, largely preceded the national lockdown implemented from the end of March, although there was already some impact from the coronavirus pandemic via voluntary social distancing and weak global demand. The first quarter GDP numbers mark the third consecutive quarter of decline, following a contraction of -1.4% and -0.8% in the fourth and third quarters of 2019. For the whole of 2019, the South African economy grew by a mere 0.2% (in real terms) and in 2018 by a marginal 0.8%. Quarter-on-quarter, Mining (-21.5%) and manufacturing (-8.5%) were the most significant contributors to the economy's poor performance in the first quarter while agriculture surged 27.8% quarter-on-quarter due to higher production of animal products, horticulture and field crops amid favourable weather conditions. Looking ahead, the economy is expected to contract by 7.2% in the second quarter according to the Treasury. Estimates from some private economists and business organisations believe the contraction could exceed 10%. This is due to the severe lockdown measures that almost brought economic activity to a standstill during April and May. The combination of low growth and rising unemployment means that South Africa's economic trajectory is unsustainable. Government should implement a series of growth reforms that support labour-intensive growth and create a globally competitive economy. Some of these potential reforms include : (i) modernizing network industries; (ii) lowering barriers to entry and addressing distorted patterns of ownership through increased competition and small business growth; (iii) prioritize labour-intensive growth in sectors such as agriculture and services, including tourism; (iv) implement focused and flexible industrial and trade policies; and (v) promote export competitiveness. A commitment to structural reform and an ambitious infrastructure programme could boost growth longer term, which will have an ultimately beneficial impact on the equity market if executed.

- The Absa manufacturing purchasing managers' index (PMI) spiked in June to 53.9 points, up from May's 50.2, pointing to a continued monthly recovery since April, when sub-components for business activity and new sales orders hit historic lows. The index reached its highest level since 2013, but ABSA warned that this does not mean that actual production increased to a multiyear high. "Many respondents noted that despite the monthly uptick, production was still below normal capacity" the bank said. Particularly encouraging was the increase in new sales orders, which rose to 60.3 from 41.2 signalling a pickup in economic activity from a low base. The monthly gauge gives insight about conditions in the manufacturing sector, which accounts for about 13% of Gross Domestic Product (GDP). A reading below 50 indicates a contraction in activity, while a reading above 50 indicates expansion. The improvement in June reflects the systemic removal of lockdown restrictions which resulted in most businesses returning to work.

- The IHS Markit South African purchasing managers' index (PMI), an economy-wide gauge of business conditions, recovered in June to reach 42.5 points, its highest level in three months. Business conditions in the private sector improved as lockdown measures were eased. The PMI gives insight into private-sector business performance with a reading of more than 50 showing overall improvement in the sector. Of the 5 subcategories- new orders, output, employment, suppliers' delivery times, and stocks of purchases- making up the PMI index, employment remains a big concern. Employment recorded its eighth-consecutive decline in June. Like the ABSA manufacturing PMI, the broader-based Markit PMI also showed some recovery, although unlike the former remained in sub-50 contractionary territory. Further improvements in the Markit PMI are expected over coming months as the remaining sectors of the economy also benefit from an easing in lockdown measures.

- South Africa registered its first current account surplus since 2003 with a positive balance of R69.7 billion in the first quarter of 2020, equal to 1.3% of GDP compared with a deficit of R68.1 billion (or -1.3% of GDP) in the fourth quarter of 2019. This was due to the fact that the trade surplus more than doubled to R208 billion in the first quarter. The trade surplus was driven by South Africa's terms of trade hitting an all-time high due to lower prices for imports like oil, and higher prices for export commodities. The Reserve Bank noted that the impact of the Covid-19 lockdown on overall trade was still limited in the first quarter of 2020, with a significant impact on imports and exports expected in the second quarter. It is anticipated that the overall trade balance will remain in surplus as external demand recovers in line with key export markets lifting lockdown restrictions over coming months. In addition, elevated gold and platinum metal prices should boost nominal export sales, while subdued international oil prices, despite recovering off their April lows, will likely contain the overall import bill.

- Private sector credit extension (PSCE) growth slowed to 6.3% year-on-year in May from 7.2% in April. Corporate credit growth slowed to 8.4% from 9.3% in April. Likewise, household credit extension growth softened further to 3.8% from 4.5% the previous month. The slowdown was broad-based but more evident in "asset backed" credit - mortgages that slowed to 3.4% from 4.2% previously, while vehicle finance credit slowed to 2.6% from 3.1%. This can be attributed to depressed consumer sentiment, elevated uncertainty, as well as the effect of lockdown measures. Looking ahead, a further deterioration in household credit extension is expected amid rising unemployment, weak real income growth and a deterioration in household balance sheets, which limits households' capacity to take up more credit. However, cash pressure and lower borrowing costs as a result of the Covid-19 lockdown could result in increased credit uptake from corporates especially those with stronger balance sheets.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- FNB/BER Consumer Confidence Index. Due Tuesday 7th July 2020. Given the impact of Covid-19 on the already struggling domestic economy, the consumer confidence index (CCI) is expected to have decreased in the second quarter to its lowest levels since the second quarter of 1985. Consensus forecast is that the CCI decreased to -21 in the second quarter of 2020 from -9 in the previous period.

- Manufacturing Production. Due Thursday 9th July 2020. The April manufacturing production figures are expected to reflect a gloomy picture as it was the month when Level-5 lockdown caused economic activity, and manufacturing output to come to a partial stillstand. Consensus forecast is that manufacturing production contracted in April by 46.6% year-on-year and 30.9% month-on-month following March contractions of 5.4% on the year and 1.2% on the month.

GLOBAL

Contributed by Nick Downing

- In a survey of 50 leading executives and investors in the life sciences industry, conducted by Stifel Financial Corp in the US, 98% of respondents are expecting a “second wave” of

Covid-19, which 52% feared will be severe enough to prompt government-imposed lockdowns. Over half of respondents forecast a vaccine will gain regulatory approval in the US by the first quarter 2021, although only 40% believe it will be available by the end of next year, with expected delays attributed to the scaling-up of mass manufacturing. An overwhelming 84% of respondents anticipate another pandemic within ten years or less, which signals a substantial increase in private and state-led investment in healthcare and biotechnology. According to Mark Dempster, Co-head of the Stifel Healthcare Group, "We continue to see strong interest in the biotechnology sector from both healthcare-dedicated investors and generalist investors, which has resulted in a healthy pipeline of capital-raising activity."

- "Value" style investment has been on a steady decline over the past ten years in terms of its performance versus "growth" style investment, exacerbated by ultra-low interest rates and a slow economic growth environment, the perfect setting for technology stocks to stand out. The Covid-19 pandemic has allowed typical growth stocks to shine even more, with earnings of many technology companies actually enhanced by social distancing and moves to work from home. Strong earnings growth coupled with further sharp declines in interest rates have caused the premium of growth to value stocks to increase to a 25-year high. Value-style investors are understandably losing patience, although arguably after such a long period of underperformance, the current market is offering the best potential returns for the strategy. Typically, value investors need to be patient and wait it out before their strategy is vindicated, which can often be a slow process, while growth investors tend to be rewarded earlier. The quid pro quo is that value investors have a greater margin of safety and tend to suffer smaller declines than growth investors in the event of negative news. Given the wide and protracted disparity in performance, a method for maximising the consistency of returns is to build investment portfolios around a combination of the two strategies.

NORTH AMERICA

Contributed by Nick Downing

- Nonfarm payrolls increased by more than expected for a second straight month. The US economy added 4.8 million new jobs in June, well above the 3.2 million consensus forecast, while the May figure was revised upwards by 170,000 to 2.7 million. The unemployment rate reduced to 11.1%, from 13,3% in May and 14.7% in April. By sector 356,000 jobs were added back to the manufacturing sector and 740,000 to the retail sector, while as expected 2.1 million were added to the leisure and hospitality sector, mainly in restaurants and bars. However, these latter jobs are the most vulnerable if the recent rise in Covid-19 cases prompts renewed lockdown measures. Although the employment data was better than expected and likely to boost economic recovery projections, there were some concerns. There are still 14.7 million fewer jobs than before the pandemic and in June the number of jobs deemed to be permanently lost increased from 2.3 to 2.9 million. The Congressional Budget Office reduced its year-end unemployment forecast from a previous 11.5% to 10.5% but cautioned that it would take until the end of the decade before the pre-pandemic rate of 3.5% is restored. As the 31st July fiscal cliff approaches, when $600 dollar per week unemployment benefit payments are due to expire, the White House and Congress are under pressure to compliment the $3 trillion spending pledges passed since March with additional fiscal support measures.

- Minutes from the Federal Reserve's policy setting meeting on 9-10th June indicate that the fed funds interest rate will remain at its current level of 0-0.25% until at least the end of 2022. With the prescribed short-term interest rate pegged at zero, the Fed's discussion centred on how to provide additional monetary stimulus measures, if required. The priority appeared to be firmer forward guidance on the fed funds rate and asset purchases, with settings conditioned on economic thresholds such as inflation or employment levels being attained. These appear more likely than calendar-based forward guidance, with most policy makers in favour of tying forward guidance to inflation outcomes. The idea of a symmetric 2% inflation target is gaining favour, where overshoots are accommodated in order to make-up for periods of below target inflation. However, so-called "yield curve control" appeared to garner little support among policy makers, who cited the potential cost of capping longer-dated bond yields with open-ended bond purchases. Some also cited the risk of the Fed losing control of its balance sheet and of it ceding control to fiscal authorities. The Fed's next Federal Open Market Committee (FOMC) policy meeting is on 28-29th July, at which forward guidance settings may be announced.

CHINA

Contributed by Nick Downing

- The Caixin/IHS Markit service sector purchasing managers' index (PMI) surged higher in June from 55.0 to 58.4 its highest level in over ten years and well above the key 50-level, which demarcates expansion from contraction. The PMI hit a record low of 26.5 in February at the height of Covid-19 infections in China. However, the rapid rebound in the PMI vindicates the country's uncompromising response to the virus and signals positive GDP growth in the second quarter (Q2), in contrast to the 6.8% annualised contraction in Q1. The data is likely to prompt economists to upgrade their 2020 GDP forecasts, with some predicting a return to 6% growth levels in the second half of the year. The upbeat outlook was corroborated by official National Bureau of Statistics PMI data. The official manufacturing and service sector PMIs increased in June from 50.6 to 50.9 and from 53.6 to 54.4, both headline readings in expansionary territory although some sub-indices, including new export and employment indices remained below 50. With authorities prioritising job creation and a stabilisation in employment, Beijing is unlikely to unwind its accommodative monetary and fiscal settings until employment PMIs are sustainably back in growth territory. The prospect of rapidly improving economic activity and a continuation of easy policy settings helped the Shanghai and Shenzhen CSI 300 index to a 5.7% rally on Monday 6th July, its biggest daily gain in over a year. State-run media also encouraged the rally with headlines advocating the positive wealth effect of a rising stock market.

JAPAN

Contributed by Carel La Cock

- Japan's Consumer Confidence Index continued its recovery in June rising to 28.0 from 24.0 in May following the record low of 21.6 in April. Consumer optimism picked up across all sentiment sectors - Overall Livelihood (+5.4), Income Growth (+3.6), Employment (+4.1) and Willingness to buy Durable Goods (+4.5). The Cabinet Office upgraded its assessment saying that consumer confidence remains severe but showed signs of recovering compared to last month's assessment of "having stopped falling". The percentage of respondents expecting prices to rise in the year ahead fell to 71.5% from 72.3% in May while only 11% expect prices to go down, a decrease of 0.1 percentage points from May. Inflation expectations amongst Japanese companies also fell according to the Bank of Japan's (BoJ) Tankan Survey. The survey showed that expectations on one-, three- and five-years ahead all came down compared to the survey results of three months ago. The BoJ cautioned that the momentum towards reaching its 2% inflation target has been temporarily lost and that upward pressure on consumer prices are expected to remain weak. Unemployment also worsened for a second straight month in May to 2.9% from 2.6% in April reversing all jobs created since February 2017. The number of unemployed increased by 190,000 in March accelerating from the figure of 60,000 recorded in April. The job to applicant ratio dropped to 1.20 in May compared to 1.32 in April, marking the lowest ratio in five years and the biggest points decline in nearly three decades. Expectations remain that the unemployment rate will steadily rise to 3% in the coming months, but that consumer confidence is being supported by central bank and government initiatives which should soften the impact.

EUROPE

Contributed by Carel La Cock

- Annual inflation in the euro area was up 0.3% in June compared to 0.1% in May according to initial estimates. Energy prices continued to decline falling by 9.4% following a decline of 11.9% in May, but was offset by rising prices in food, alcohol and tobacco up 3.1% in June after increasing by 3.4% in May. Services were also higher in June by 1.2% compared to 1.3% in May while non-energy industrial goods were 0.2% higher and comparable with May. Excluding energy, annual inflation stood at 1.3% in June compared to 1.4% in May. One reason inflation has remained weak is because Europeans saved an unprecedented 16.9% of their gross disposal income in the first quarter. Policymakers face a dilemma in answering the motive behind this increase in savings. If households saved up to brace against economic headwinds and continue to do so, too little stimulus would not be effective and would not prevent a spiralling economic downturn. However, if households' increased savings represent pent-up demand, too much stimulus could cause an overheating of the economy with high inflation. Some evidence suggests that there is a fair amount of pent-up demand as seen by a surge in French consumer spending rising by 36.6% in May and German retail sales recovering by 13.6%. Yet economists have warned against celebrating a V-shaped spending recovery too early as the outlook for some countries in the Eurozone like Spain and Italy remains subdued and precautionary savings are likely to increase. It is therefore likely that the European Central Bank will adopt a "wait and see" strategy before launching any new stimulus programs.

UNITED KINGDOM

Contributed by Carel La Cock

- In true British fashion, UK firms are not letting a good crisis go to waste. British companies raised capital at an unprecedented rate last quarter. More than £17bn has been raised since the middle of March by 136 companies. Many companies cite covid-19 reasons but also building a war chest to take advantage of any opportunities that present themselves as a result of covid-19 disruptions. Anecdotal evidence suggests that many firms are already looking past the covid-19 crisis and positioning themselves to come out stronger after the downturn. One example is hotel group Whitbread which raised £1bn as insurance against any further downside, but also to fund acquisitions if no further covid-19 headwinds persist. It could mean that the UK is poised for a series of mergers and acquisitions (M&A), and consolidations in many sectors this year. Some firms will emerge as clear winners and investors have been keen to back the likely winners, looking past current year valuation multiples and choosing instead to focus on the outer years beyond 2022 and 2023. Although some market commentators have warned that there are still a significant number of firms that will have to raise funds this year to pay back government loans and for liquidity needs, and not all will make it through the downturn. It is important for investors to critically review companies' strategies and how the raised capital will be employed. Advisory firms and investment banks will also benefit from M&A activity in the year ahead and could help to offset bad loans at many of the big UK banks.

FAR EAST AND EMERGING MARKETS

Contributed by Carel La Cock

- Car sales are a good barometer of economic activity, but in India it is all about motorcycles. India's biggest motorcycle producers reported that demand has returned to levels seen prior to the covid-19 pandemic and it is a sign that economic activity is picking up. Hero MotoCorp sold 450,000 units in June compared with 112,000 in May and a total of 17m sold in 2019. Economists say that the increased sales in motorcycles and scooters is a good indication that the rural economy is getting back to health, but also that consumers are shifting their mode of transport away from crowed buses and trains. However, India is still gripped by the spread of the coronavirus and a sustained recovery will only be possible if the government can successfully flatten the virus infection curve. The strategy of prime minister Narendra Modi of a swift and strict lockdown without warning followed by a quick reopening has not yielded the desired outcome and many Indians are reluctant to return to work while the virus is still spreading rapidly. Moody's expects India's economy to contract by 3.1% in 2020, which would mark the lowest level of economic growth in a decade, although ratings agencies still have India's debt rated as investment grade. Economists expect India to benefit from the global trend to diversify supply chains away from China, but that it would depend on the speed it can bring the spread of the disease under control.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	- 3.92	54846
JSE Fini 15	- 35.35	10134
JSE Indi 25	+ 10.29	76434
JSE Resi 20	+ 3.82	51142
R/$	- 17.53	16.97
R/€	- 19.20	18.29
R/£	- 12.53	21.22
S&P 500	- 1.58	3179
Nikkei	- 3.98	22714
Hang Seng	- 6.56	26339
FTSE 100	- 16.66	6285
DAX	- 3.89	12733
CAC 40	- 15.00	5081
MSCI Emerging	- 4.86	1060

MSCI World	- 3.99	2264
Gold	+ 16.52	1776
Platinum	- 15.78	818
Brent oil	- 34.85	43.1

BOTTOM LINE

Contributed by Gielie Fourie

- FOUR GURUS: Benjamin Graham laid the foundations for investing. His student, Warren Buffett and his business partner, Charlie Munger, and later Peter Lynch each added their own personal touches to Graham's work. It is interesting to track the line of developments. It would be impossible for you, the reader, to be the next Bill Gates or Steve Jobs. They were successful inventors living at the right time (both born in 1955), in the right place (the USA). But you can be the next successful investor, the next Warren Buffett, Charlie Munger or Peter Lynch.

- INVESTMENT STYLES: There are two main investment styles (a) Value Investing and (b) Momentum/Growth Investing. The four gurus were Value Investors. Their strategy is to buy shares that appear to be under-priced or miss-priced. Momentum investing is a strategy of buying shares whose prices have performed well over the past three to twelve months.

- GURU TOOLS: The gurus used the simplest of ratios. No spreadsheets for them. Graham used two ratios that linked the Share Price to both the Balance Sheet and the Income Statement. He used (a) the PE (Price Earnings) Ratio which links Price to the Income Statement and (b) the PB (Price to Book) ratio which links Price to the Balance Sheet. PE should not be higher than 15; PB should not be higher than 1.5. Graham then multiplied the PE by the PB to get the BM (Blended Multiplier). The BM should not be higher than 22.5.

- BENJAMIN GRAHAM 1894 – 1976: Graham was an American economist, professor, and investor. He is considered the "Father of Value Investing". His book, "The Intelligent Investor", is prescribed reading for any aspiring investor. Buffett says chapter 8 of the book is the best essay on investing ever written. His book has created many billionaires, like Warren Buffett, Charlie Munger, Sir John Templeton, and Bill Ackman. Graham was a "Cigar Butt Investor". The analogy is that you pick up discarded cigar butts. You find there is still a puff or two left in it. You take the last few puffs - quite unappetising, but still technically good value. That is deep value investing. Graham introduced the Margin of

Safety (MoS) to the investment world. MoS means: The price that you pay (for an asset) must be less than the value of the asset. Here Graham calculated his BM – which must be less than 22.5. The lower the BM, the better your MoS. However, if the BM is too low, it could be a Red Flag – a value trap. These requirements are set up for the needs of a conservative (value) investor.

- WARREN BUFFETT (89) AND CHARLIE MUNGER (96): Buffett was a student of Benjamin Graham. He met Charlie Munger in Omaha. They became best friends and business partners. They used the principles of Graham to invest and became billionaires. Buffett added two additional factors to Graham's principles before he would invest. Firstly, in addition to a large MoS, the business must also have a "wide moat" around it. Secondly, he must understand the business – he does not invest outside his "circle of competence". A moat refers to some barrier of entry to the business to keep competitors at bay. Buffett and Munger found that the Cigar Butt concept was a waste of valuable resources. They discarded it. Charlie Munger came up with the concept: "Rather buy a wonderful company at a fair price, than buy a fair company at a wonderful price". Buffett and Munger did not add any financial ratios to the investment domain. Although Buffett never wrote a book, several books have been written about him.

- PETER LYNCH (76): Peter Lynch was the manager of the Magellan Fund at Fidelity Investments. Between 1977 and 1990, Lynch averaged a 29.2% annual return, making Magellan the best-performing mutual fund in the world. It made Lynch the best investor in the world over a period of 13 years. A humble man, he is described as "legendary". Lynch's number-one bestseller book, "One Up on Wall Street", is a must read if you want to "Up your Game". Lynch was the first guru to add the element of "Growth in Earnings" to the investment domain. He said growth should be higher than the PE ratio. He created an acronym for this: GARP – Growth At a Reasonable Price. The link to Value Investing and MoS is obvious. To "measure" GARP he created the PEG ratio. The PEG ratio: The PE ratio divided by the annual growth rate in earnings. It should be <1.0.

- GURU QUOTES: GRAHAM: "The Intelligent Investor is a Realist, who buys from Pessimists and sells to Optimists. BUFFETT: "Rule No. 1: Never lose money. Rule No. 2: Never forget rule No.1". MUNGER: "In my whole life, I have known no wise people (over a broad subject matter area) who didn't read all the time -- none, zero. ...". LYNCH: "Gentlemen who prefer bonds don't know what they're missing".

- SUMMARY: The gurus have certain personality traits in common. Despite their wealth they remained kind, nice, honest, focussed, hardworking gentlemen. Buffett is known to be patient, friendly, humble – never a show-off, never aggressive. Buffett said of his relationship with Charlie Munger: "We've never had an argument in the entire time we've known each other, which is almost 60 years". Buffett is able and willing to acknowledge his errors — and does so frequently. The gurus' wisdom and their personality traits are good starting points to embark on a career of investing and creating great wealth. The sooner the better.

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