OVERBERG MARKET REPORT

Tuesday 22nd June 2021

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- This week we look at the differences between private share portfolios vs unit trusts and pooled investments. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- Retail trade sales increased by 95.8% year-on-year in April 2021. This increase was unsurprising and mainly due to the low base in April 2020. The strong year-on-year growth in retail sales volume was largely driven by textiles, clothing, footwear, and leather goods. The second-largest contribution originated from all "other" retailers, followed by hardware, paint, and glass sales. All seven categories of retail sales posted positive year-on-year growth in April. On a month-on-month basis, the data was less flattering, with retail sales decreasing by 0.8% in April compared with March. This followed month-on-month changes of -4.5% in March and 7.7% in February. The recent implementation of the level 3 lockdown restrictions could partially derail retail sales performance, in particular at food and beverage outlets although this negative impact is expected to taper in the second half of the year. Aside from statistical base-effects, sales should be supported by improved job prospects, low interest rates, and the Covid-19 vaccination rollout during the rest of the year.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Leana Kruger

- Composite Leading Business Cycle Indicator, due Tuesday 22 June. The South African Reserve Bank's (SARB) composite leading business cycle indicator is expected to have increased 2.3% month-on-month in April 2021, up from the 1.7% month-on-month increase recorded in March.

- Consumer Price Inflation, due Wednesday 23 June. Data is expected to show that consumer inflation breached the 4.5% midpoint of the South African Reserve Bank's target band for the first time since the pandemic started. After April's Consumer Price Index (CPI) came in marginally above expectations at 4.4% year-on-year and 0.7% month-on-month, CPI is expected to tick up further to 5.2% on the year and 0.1% on the month in May. This expected acceleration is powered by rising food and fuel prices as well as supply-chain disruptions. Should the forecast meet expectations, it would put inflation at its highest pace since February 2020.

- Producer Price Inflation, due Thursday 24 June. The consensus forecast is that in May Producer Price Inflation (PPI) increased 0.3% month-on-month and 7.3% year-on-year, driven primarily by the transport category, particularly fuel prices which have lifted sharply from last year's depths. Tobacco and alcohol price increases will also be major contributors, mainly due to the ban on sales under the strict lockdown this time last year.

GLOBAL

Contributed by Nick Downing

- Last week's Federal Reserve monetary policy guidance shift, signalling interest rate hikes in 2023 rather than 2024, as previously envisaged, will have ramifications for monetary policy across the world's central banks. Developed nations will be anxious not to be left too far behind the Fed, as a protracted delay could cause an unwanted spike in their currencies versus the US dollar. A strong dollar tends to choke off economic expansion. A strong dollar is especially damaging for emerging market economies, which would suffer under the weight of dollar denominated debt. The more "hawkish" bias from the Fed was telegraphed even before last week's policy meeting, evidenced by reduced liquidity injections. This enabled some emerging market central banks to pre-empt the Fed with earlier interest rate hikes of their own. The Central Bank of Brazil and the Bank of Russia have already lifted their benchmark interest rates three times in the current tightening cycle, with promises of further rate increases to come. Other emerging markets are bound to follow, including South Africa. Despite the slow and uneven economic recovery across the world, emerging markets have to a large extent play to the tune of the Federal Reserve, which governs the price of the global reserve currency.

- Commodity prices were a casualty of the Federal Reserve's tilt towards earlier than previously expected interest rate increases. The Fed's policy meeting statement caused a sharp rally in the dollar index, which gained 1.9% over the week. Commodities are predominantly priced and traded in US dollars, so prices tend to fall when the dollar strengthens. The Fed's more "hawkish" message also deflated the demand for traditional inflation hedges, including commodities. Copper, the bell-weather base metal due to its wide variety of applications, suffered an 8% price decline last week, pulling back by over 13% from its recent historic peak of $10,550 per ton recorded in May. The decline in base metals prices was exacerbated by the recent announcement form China's National Food and Strategic Reserves Administration (NFSRA) that it would start selling some of its strategic reserves of copper, aluminium and zinc, to address market shortages and excessive prices. The move follows warnings from China's authorities, concerned by the impact of rising commodity costs, that hoarding and speculation in metals markets will be met with zero tolerance. Attempts at cost controls may work over the short-term but run the danger of attracting even more speculation. It is unclear how many reserves the NFSRA holds. Some analysts believe they are far less than widely assumed.

NORTH AMERICA

Contributed by Nick Downing

- The Federal Reserve altered its forward guidance at the Federal Open Market Committee (FOMC) policy meeting, signalling a likely start to interest rate increases in 2023 rather than 2024, as had been previously telegraphed. While leaving the fed funds rate at 0-0.25% and asset purchases unchanged at $120 billion per month, the majority of the 18 FOMC members now expect interest rates to start rising in 2023 (13 versus 7 in March), while 7 members expect a rate hike as early as 2022 up from 4 previously. The Fed's forecast of its preferred inflation measure, the personal consumption expenditures index, was lifted for 2021 from 2.4% to 3.4%, although it expects inflation to subside rapidly to 2.2% by the end of 2022 and 2.1% by end 2023. The Fed expects GDP to grow by 7% in 2021 up from its earlier forecast of 6.5%, but then slow to 3.3% next year. Fed chair Jay Powell commented after the policy meeting that "the real near-term discussion that we'll begin is really about the path of asset purchases", although he also emphasised that any tapering of the programme would be "orderly, methodical and transparent." The central bank is at pains to avoid a repeat of a 2013-style "taper tantrum", which caused panic in global financial markets. So far, in its transition to a gradual removal of pandemic-related stimulus, the Fed has been successful, provoking only mild market reaction. Admittedly, the US dollar index gained 1.9% over the week, its biggest gain since the pandemic and the 10-year US Treasury bond yield fell from 1.56% to 1.40% amid increased market confidence that the Fed is getting ahead of the inflation curve. However, the S&P 500 index only lost 1.9% over the week, although the more volatile Russell 2000 index lost 4%. Meanwhile, the Nasdaq index suffered a negligible loss of 0.3%. With the Fed flexing its inflation fighting muscles, the pendulum of market anxiety is moving again. The risk of slow growth may start to replace the risk of excessive inflation as the biggest market concern, which would prompt a rotation back from value/cyclical towards growth/momentum market sectors.

- Consumer spending patterns are changing as lockdown restrictions are lifted and the vaccination programme progresses. Online spending and purchases of durable goods items, which flourished at the height of the pandemic, are making way for increased expenditure on services, which were previously restricted. Auto dealership sales fell in May by 3.7% on the month, affected also by stock shortages and rising prices. Building material store sales dropped 5.9%, sales at electronics and appliance stores by 3.4% and online retail sales by 0.8%. Meanwhile, restaurant and bar sales increased 1.8%. Casino sales surged by 17% and gym sales by 4%. Overall, retail sales increased in May by 28.1% year-on-year, but on a month-on-month basis fell by 1.3%, although April's figure was revised upwards from no change to a

0.9% increase. The plateauing in the data belies underlying strength in consumer spending. Most services, including healthcare, education, travel and hotel spending are excluded from the retail sales data. Retail sales only comprises around 40% of consumer spending, which in turn comprises over two-thirds of US GDP. While the increase in retail sales may be decelerating, the shift in spending habits should continue to provide a solid boost to US economic growth over coming months. Fiscal stimulus packages will be wound down, but households have accumulated an estimated $2.3 trillion in excess savings since the pandemic. Meanwhile, a strong jobs market, rising wages and the positive impact of buoyant equity markets and property values should continue to support household expenditure.

CHINA

Contributed by Nick Downing

- The pace of economic growth slowed in May as the base effect of last year's dramatic slowdown continued to fade. Year-on-year growth in industrial production eased to 8.8% from 9.8% in April, while retail sales growth slowed from 17.7% to 12.4%. Fixed asset investment spending grew in the January to May period by 15.4%, down from 19.9% between January and April. Urban unemployment reduced for a third straight month to 5.0% its lowest in two years, yet consumers remain reluctant to spend. Analysts were disappointed by the sluggish retail sales figures. China's strong economic recovery has been powered mainly by external demand, prompting buoyant performance from industrial production and exports, while domestic demand has failed to reignite. While investment spending has been robust, household spending is being held back by weak wage growth, and continued unease over Covid amid a relatively slow vaccination programme. However, households have amassed substantial savings over the pandemic, which should help consumer spending take over from industrial output and exports as the main pillar of support for economic growth, once Covid concerns dissipate.

JAPAN

Contributed by Carel la Cock

- The summer Olympic Games have been given the proverbial shot in the arm with the announcement from prime minister, Yoshihide Suga, that the Olympic flame will be lit on the 23rd July and that venues will be allowed up to 50% of spectator capacity to a maximum of 10,000 people. The announcement contrasts the advice of the government's medical advisors who have urged organisers to hold the games without spectators in fear that it could lead to a new outbreak of covid-19 infections. However, Mr Suga is willing to take the risk in hope that a successful Olympic Games could prove invaluable in regaining power for another four years, given that 2021 is also an election year. According to reports, the financial benefits of hosting the games at this stage have already diminished to such an extent that cancelling the games would not significantly increase the loss. This fact has led political analysts to conclude that hosting the games and taking the risk must be with the election in mind. As recently as May, polls have shown that more than 80% of the public wanted the government to cancel the Olympics. However, a pickup in vaccinations means that nearly 40% of the public will be vaccinated by the time the Olympics start which has swayed public opinion with only 30% now calling for a cancelation. The turnaround in sentiment is vindication of the government's perseverance. Although the limited spectators would still mean a big financial hit to organisers, who expect ticket sales to be less than half forecasted, the boost to national pride in hosting a successful summer games ahead of China hosting the Winter Olympics in 2022, will go a long way at the polls at the end of the year for Mr Suga.

EUROPE

Contributed by Carel la Cock

- The European Central Bank (ECB) is investigating the launch of a digital currency to counter the rise of cryptocurrencies which could threaten the monetary sovereignty of the eurozone. Benefits of central bank digital coins (CBDC) include cheaper and faster international payments while also opening the monetary systems to all individuals. Another benefit according to executive board member of the ECB, Fabio Panetta, is that consumers' privacy will be better protected as there is no commercial value in user data for central banks. However, the comment contrasts widely held fears that CBDCs would allow governments to monitor every transaction and record the flow of money in their economies, the kind of privacy offered by bitcoin and the like. Central banks and regulators have been slow in response to the rise of cryptocurrencies but calls for tougher oversight from the Basel Committee on Banking Supervision has come at a time when El Salvador has announced that it would accept bitcoin as legal tender, the first country to do so. China has recently stepped up its push-back against cryptocurrencies and has cracked down on the mining of virtual currencies. As the popularity of cryptos rise, central banks have the choice to either regulate or compete and according to the Bank of International Settlements, most central banks have now launched projects to issue their own digital coins whilst also calling for tougher regulation. It is no surprise that central banks and governments are reluctant to relinquish their control on monetary systems and it could still prove detrimental to the crypto market.

EMERGING MARKETS AND THE FAR EAST

Contributed by Carel la Cock

- **Latin America's fortunes have always been tied to the rise and fall of commodity prices, but the recent surge in commodity prices has not seen a commensurate rise in economic fortunes in the region.** According to Ruchir Sharma, chief global strategist at Morgan Stanley, the reason Latin American countries are lagging the rise in commodity prices is the fact that thirteen countries will hold elections this year and next and that investors are reluctant to invest during such uncertain times. Political unrest in Columbia, Bolivia and Chile is a stark reminder of how populism and anti-establishment movements can destabilise the region. Mr. Sharma points out that during the pandemic right leaning governments were in power across many South American countries, but the poor handling of the pandemic and the dire economic situation in many countries have benefitted candidates on the left and far left. Mr. Sharma believes that commodities are entering a "supercycle" and that countries such as Peru and Chile, which supply 40% of the world's copper, should benefit from the boom in demand for "green metals" used in electronics. Looking past the political upheavals, the region has been at the forefront of renewable energy and 2020 saw $16.4bn invested in renewable energy projects according to Bloomberg data. Brazil and Columbia have been actively promoting investments in renewable energy and are poised to take advantage of the environmental, social and governance (ESG) movement currently gaining momentum.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 10.36	65563
JSE Fini 15	+ 6.72	12870
JSE Indi 25	+ 12.94	87977
JSE Resi 20	+ 6.19	61142
R/$	+ 3.25	14.23
R/€	+ 5.84	16.96
R/£	+ 1.27	19.83
Dow Jones	+ 10.69	33876
Nikkei	+ 2.07	28010
Hang Seng	+ 4.62	28489
FTSE 100	+ 9.31	7062
Gold	- 6.39	1773

Platinum	- 0.69	1062
Brent oil	+ 43.9	74.56

BOTTOM LINE

Contributed by Gielie Fourie

- There is an ongoing debate whether one should invest in the stock market through private share portfolios (PSPs) or unit trusts (UTs) or similar pooled investment vehicles. We all know what UTs are – their massive advertising campaigns take care of that. PSPs are lesser known. PSP investing involves a bespoke investment portfolio in which shares are held in the client's name and are bought and sold on behalf of the individual client by the asset manager. The asset manager will invest directly in the market and will avoid investing through middlemen, like UTs. Asset allocation and share selection within the portfolio can be customised to suit the client's precise risk profile.

- PSPs are tailored to each investor's unique needs. An asset manager with 1,000 investors will have 1,000 segregated portfolios, one portfolio for each investor. A young investor will normally prefer an aggressive growth portfolio, while an older investor will require a more conservative portfolio with a high dividend yield. UTs and other pooled investments follow a one-size-fits-all approach. Irrespective of their needs, the funds of, say 1,000 investors, both young and old, will be invested in the same pool. If you are serious about your investment, this broad approach does not make sense.

- PSPs are actively managed, while UTs tend to be less actively managed. It stands to reason that PSPs must be actively monitored and managed. PSPs are agile. They can act quickly without moving the market. They can buy shares in small cap and big cap companies alike. UTs on the other hand follow a more passive approach. Managing a big pool of investments results in big purchases that may move the market. This makes it a problem to invest in profitable small cap companies. A UT's universe of investable shares is smaller than that of a PSP.

- PSPs can provide personalized services to their clients. On a quarterly basis consultants will contact their clients to discuss their portfolios and needs. It means that consultants must work long hours and travel a lot to service their clients. Clients are also able to communicate directly with the asset manager. Communications with clients are frequent and face-to-face. UTs are more passively managed with little or no personal interaction with clients. Asset managers rarely, if ever, interact directly with clients. Communication with clients is often done through the media.

- The fee structure of PSPs is transparent, simple and flexible. Total fees should not exceed 1.5% per annum and are flexible for larger portfolios. This is not the case with UTs. There are many middlemen all charging fees, including custodial fees, audit fees, legal fees, trustee fees, distribution and marketing fees, platform fees and performance fees. UTs will quote their Total Expense Ratio (TER), but the TER often does not include all the fees mentioned above.

- With PSPs capital gains tax (CGT) is levied every time a share is sold. Where applicable, clients will pay CGT every year. Clients can make full use of their annual CGT exclusion (currently R40,000.00 for natural persons) and locking in relatively low CGT rates. With UTs the scenario is very different. CGT is only levied when investors sell the UT. The client is exposed to losing several of his annual CGT exclusions. This means that CGT may not be paid for several years. But the sting is in the tail. When the client sells his UT after several years, he can be hit with a massive CGT liability.

- The global trend is more transparency for investors and consultants. Because of the transparency provided by PSPs, there is a growing appetite to invest through PSPs. The cost implications have been highlighted above. Over the life of an investment the cost differential between PSPs and UTs can be significant. If you want to invest in a PSP, you are welcome to consult one of our highly qualified consultants. Consultations are free, even if you decide to invest at a later stage, or if you decide not to invest at all.