OVERBERG MARKET REPORT

Tuesday 7th September 2021

IN THIS WEEK'S BOTTOM LINE

Contributed by Carel la Cock

- Environmental Social and Governance investing is gathering momentum. The industry has grown from $3 trillion in 2010 to $17 trillion at the end of 2019. Last year saw $51.1bn net inflows into ESG funds in the US alone, according to Morningstar. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- South Africa's trade surplus declined to R36.96 billion in July, compared to a downwardly revised R54.5 billion in June and below market expectations of R45 billion. It was the smallest trade surplus since February, as exports slipped 11.2% to a five-month low of R 145.01 billion. The KZN unrest caused major disruptions at the Durban and Richards Bay ports (the major coal export terminal), while a cyberattack on Transnet operations also resulted in significant delays at the other major ports for a few days during the month. Imports also declined 0.7% to a five-month low of R108.04 billion. However, year-on-year, both exports and imports have increased, by 18% and 27.6% respectively. The trade balance surplus for the year to date was still substantially better than recorded last year. From the start of the year to the end of July, the trade balance surplus was R289.99 billion, compared to a trade balance surplus of R94.88 billion recorded last year. Looking ahead, imports are expected to be subdued as weak domestic consumption and investment activity persist.

- The seasonally adjusted Absa Purchasing Managers' Index (PMI) recovered in August following a major decline in July. The PMI more than recovered from a steep decline and rose to 57.9 points in August from a very low 43.5 points in July. This is well above the 50-point neutral mark separating expansion from contraction. The PMI is an indicator of the economic health of the manufacturing sector. The latest PMI reading is a clear indication that the manufacturing industry is back on the recovery path after the looting and riots that occurred in July. A further boost to the sector also came from less strict lockdown measures during August. Business activity and new sales order indices were both about 30 points better than July's prints. The employment subsector, however, remained below the 50-point neutral mark declining slightly from 47.7 to 47.1 month-on-month. The weak readings for employment in July and August suggest further factory job losses in the third quarter compared to the second quarter. The index tracking expected business conditions in six months' time fell to 59.7, from 64.3 in July. Renewed concerns about the strength of the global economic recovery amid the spread of the Delta COVID-19 variant may have contributed to this decline. In addition, cost pressures for manufacturers remain elevated. The purchasing price index ticked up again after four consecutive declines. The higher fuel price at the start of August likely contributed to the renewed rise in costs, while a weaker rand exchange rate (on average) also added to costs of imported raw materials and intermediate goods.

- The IHS Markit PMI rebounded from its 11-month low of 46.1 to 49.9 in August, signalling a broad stabilisation of business conditions in the private sector economy. Disappointingly, the latest reading is still below the 50-point, which separates expansion from contraction. The headline PMI is a composite single-figure indicator of private sector business performance. Overall, the private sector stabilised well following the significant downturn in July amid the looting and stricter COVID-19 lockdown measures. Raw material shortage remains an issue with many firms finding that a lack of supply harmed output and led to a rise in backlogs. With the Delta variant still spreading globally, supply issues are likely to remain a key hindrance to businesses for some time yet. Input prices and output charges continued to rise sharply, although rates of inflation eased for the third month running. Overall, though, demand and activity fell again in August, suggesting it will take several months for businesses to fully recover from this downturn.

- New-vehicle sales rebounded in August, but exports suffered from the previous month's unrest and cyberattacks. New vehicles sales increased to 41 425 units, up 24.6% month-on-month from 33 259 vehicles in July. This took the aggregate market for the first eight months of 2021 to 301,997 — 32.4% ahead of the 228,010 at the same stage in 2020. The passenger car market led the way with a 40% year-on-year gain, partly due to a resurgence in rental industry sales. Light commercial vehicles and bakkies recorded growth of 3.6% year-on-year. Meanwhile, the medium and heavy commercial vehicle segments declined by 7.2% year-on-year and 0.4% year-on-year respectively. A positive macro-economic outlook, a rejuvenation of rental fleets, subdued consumer inflation, and low interest rates will help support new vehicle demand, Naamsa noted. But business and consumer confidence are expected to challenge the industry's recovery in the short to medium term. "Household finances, impacting consumers' disposable income, remain under pressure while the global semi-conductor shortages continue to negatively affect vehicle production and consequently the availability of premium models, in particular, nationally and internationally," Naamsa said.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Gross Domestic Product. Due Tuesday 7 September. The Gross Domestic Product (GDP) figure is expected to reflect South Africa's continued recovery into the second quarter of 2021 (2Q2021). The consensus forecast is that GDP has grown 2% quarter-on-quarter annualised (down from 4.6% quarterly growth in 1Q2021) and 17.8% year-on-year (up from -3.2% annual growth in 1Q2021). The large increase expected in the annual figure is due to the low base in 2Q2021, the quarter hardest hit by lockdowns last year. From the expenditure side growth is expected to be supported by the positive net export position and growth in consumer spending, while from the supply side growth is expected to be supported by all sectors except manufacturing. Lastly, the rebound in fixed investment activity will likely also contribute to the anticipated growth.

- SACCI Business Confidence Index. Due Wednesday 8 September. The South African Chamber of Commerce and Industry (SACCI) business confidence index (BCI) is expected to have recovered slightly to 95 in August after recording the lowest reading since October 2020 in July (93.2). The small improvement is anticipated as August was not negatively influenced by the looting that occurred during July, nor as heavily impacted by lockdown restrictions.

- RMB/BER Business Confidence Index. Due Wednesday 8 September. The third quarter RMB/BER BCI is expected to dip below the neutral 50-mark reflecting the negative effect of looting and the supply-chain disruptions caused by the cyberattack on Transnet. Business sentiment is, however, expected to be supported by the move to a less strict lockdown level, the expansion of vaccine eligibility, the renewed social relief grants rollout, and the cash gratuity to public sector workers.

- Manufacturing Production. Due Thursday 9 September. Production stoppages and supply-chain disruptions are expected to reflect in the July manufacturing production figure. The consensus forecast is for a sharp monthly decline of 4.4% and a modest annual increase of 2.7% following June's 0.7% monthly decline and 12.5% year-on-year increase.

NORTH AMERICA

Contributed by Nick Downing

- The number of new jobs created in August came in well below consensus forecast, raising concerns that the US economic recovery is losing momentum. The key data release has pushed back the expected date that the Federal Reserve will begin tapering its asset purchase programme. Inflation has met the Fed's threshold for initiating the taper, but full employment remains elusive. In August, only 235,000 nonfarm payrolls were created, down sharply from 1.1 million in July and 733,000 in June. The consensus forecast had been 720,000. The data disappointment is attributed to the Delta wave, which especially affected the leisure and hospitality industry. After creating new jobs at a monthly average of 350,000 over the previous 6 months, the sector created nil jobs in August. In August, restaurants and retailers suffered monthly job losses of 42,000 and 29,000. The payroll data was collected in mid-August since when Covid infections and hospitalisations have increased, which suggests the September nonfarm payroll report is unlikely to show much improvement. The Fed's next policy meetings are on 21-22 September, 2-3rd November and 14-15th December. The Fed will likely wait until the December meeting, by which time an improved October payroll report will have been published, before making any final taper decision. Although the August report showed the unemployment rate dropping from 5.4% to 5.2% and wages rising by a substantial 0.6% month-on-month and 4.3% year-on-year, there were still 5.3 million fewer jobs than immediately prior to the breakout of the pandemic.

- In addition to the weak jobs report, separate data also indicate a temporary slowdown in the US economic expansion. The red-hot residential property market is showing signs of cooling. Pending home sales slipped in July by 1.8% month-on-month capping a second straight monthly decline. The rapid increase in home prices is reducing affordability. Despite record low mortgage interest rates, the National Association of Realtors' housing affordability index fell in June to its lowest level since November 2018. Falling affordability is also undermining home builder confidence, which dropped to a 13-month low in August. Meanwhile, the latest trade figures show the deficit reducing in July by 4.3% on the month due to falling demand for imported goods. Imports fell by 0.2% on the month and imports of consumer goods by 3.4% as households grew more cautious. The data corresponds with the recently reported 1.1% decline in retail sales and slowdown in consumer spending growth from 1.1% to 0.3%, both in July. While the US appears to be coming off its second quarter peak growth levels, other regions around the world seem to be catching up. The trade data revealed a fall in US imports, but exports gained by a solid 1.3% on the month, indicating increasing global demand. Other regions will likely take up the baton in driving world economic growth over the remainder of the year and into 2022.

CHINA

Contributed by Nick Downing

- Purchasing managers' indices (PMIs) slumped in August to their lowest since the outbreak of the pandemic, attributed to a combination of the highly contagious Delta variant, natural flooding, a cooling in the property market and slowing export demand. The official National Bureau of Statistics (NBS) composite PMI dropped from 52.4 to 48.9, below the neutral 50-level which demarcates expansion from contraction and its lowest since February 2020. The non-manufacturing PMI, which tracks the construction and services sectors dropped from 53.3 to 47.5, driven by the services PMI which fell sharply from 52.5 to 45.2, attributed primarily to the Delta variant. The manufacturing PMI was less badly affected, falling from 50.4 to 50.1. The privately run Caixin/Markit composite PMI confirmed the sharply weakened outlook, dropping from 53.1 to 47.2, with the non-manufacturing and manufacturing indices mirroring the NBS data with respective declines from 54.9 to 46.7 and from 50.3 to 49.2, both in contractionary territory and at their lowest since April last year. The PMI data will likely precede poor economic numbers for the month of August and September, but a rebound in activity is likely to follow. The People's Bank of China has already begun to loosen monetary policy, releasing the equivalent of $46 billion in extra liquidity in the past week. Further monetary stimulus is expected in addition to increased fiscal stimulus, to shore-up economic activity, especially while curbs on the all-important residential property market remain in place. Increased infrastructure spending is expected over coming months as authorities catch-up with the backlog in their local government bond quotas. Bond proceeds are traditionally directed at infrastructure projects. Meanwhile the recent nationwide Delta outbreak has been brought under control, with daily domestically transmitted cases reduced to zero over the past week.

- In an apparent contradiction to the recent crackdown on large business and entrepreneurs, President Xi Jinping announced last week the formation of a Beijing Stock Exchange, to promote the growth of small- and medium-sized companies. The initiative signals support for the private sector, for innovation and entrepreneurialism. In the same week, Chinese Premier Li Keqiang pledged at the State Council meeting increased support for small- and medium-sized enterprises. While recent regulatory changes will impact certain sectors of the economy, other sectors are likely to thrive amid greater policy support and regulatory encouragement. Some fortunes will be bolstered, for instance in technology hardware, semiconductors, robotics, electric vehicles and other beneficiaries of the "decarbonisation" trend.

JAPAN

Contributed by Carel la Cock

- A newly published paper by economists Adrien Auclert, Hannes Malmberg, Frédéric Martenet and Matthew Rognlie has challenged the conventional thinking that an aging Japanese population will cause inflation to rise and ultimately lead to higher interest rates. The conventional thought on Japanese demographics was developed by Goodhart and Pradhan and states that as the Japanese population ages, with nearly a third of citizens above 65, pensioners will start to run down their assets, first by spending on goods and services and in the latter years on medical care. The rise in demand together with a shrinking workforce would lead to higher wages and ultimately to higher prices. However, this has not materialised in the last decade and the new paper argues that low inflation and indeed low interest rates will persist for some time. Auclert et al. argue that indeed an elderly population will run down their savings, but an aging population also reduces growth and that in turn lowers the demand for investments by even more. The conclusion is that we won't see a return to higher interest rates once the population reaches a specific age. The paper also has implications for other developed economies that face shifting demographics. Lower real interest rates would lead to asset prices remaining high and low future returns. Also, the different rate of aging across the globe will cause current account imbalances to shift. China is expected to have an increase in net foreign asset positions, while the US will have a deficit.

India will also see a sharp rise in foreign assets in contrast to Germany and Japan which will see their populations at the oldest they will get by the second half of the century. Central banks across the globe will have to deal with prolonged downward pressure on inflation and some argue that there is a case for higher inflation targets and higher nominal rates so that there is some headroom for monetary policy during periods of stagnation in the future. The central Bank of Japan's target inflation rate of 2% remains a goal out of sight.

EUROPE

Contributed by Carel la Cock

- Inflation in the eurozone surged to 3% year on year in August, up sharply from 2.2% reported in July and marking the highest inflation for nearly a decade. All countries in the currency bloc saw prices rise or at least remain flat year on year. Eastern Europe experiencing inflation rates of between 4.5% and 5% while only 2 countries have inflation below the European Central Bank's 2% target compared to 16 in March. The economic rebound following the easing in lockdown measures coupled with supply chain bottlenecks and rising energy costs, have driven inflation to levels not seen in the last decade. Germany's inflation has hit a 13 year high at 3.4% year on year with Spain (3.3%) following closely behind while Italy (2.6%) and France (2.4%) were more in line with the rest of the bloc. Energy prices saw a sharp spike, rising 15.4% compared to last year, while food, alcohol and tobacco prices rose at a more moderate 2%. Industrial goods prices were up 2.7% reflecting the ongoing supply shortages. Core inflation, which excludes the volatile energy and food prices, came in at 1.6%, more than doubling from last month's reading of 0.7%. Although most economists agree that inflation will ease by next year as temporary factors start to fade, the ECB might start scaling back its bond purchases in line with other central banks. ECB rate setters are expected to adjust their inflation predictions for the coming year at next week's meeting, giving economists a hint of rate changes in the year ahead.

UNITED KINGDOM

Contributed by Carel la Cock

- The change in consumer behaviour caused by the covid-19 pandemic is being felt by retailers in the UK's high streets. The latest footfall data from British Retail Consortium (BRC) in association with Sensormatic Solutions shows that shop visits have improved markedly in August but are still some way off pre-pandemic levels. A slow return by city workers and higher online retail are some of the key drivers cited. In August the number of people visiting shops increase by 10% from July but was still 18% below the same month in 2019. The uptick in August was helped by consumers not traveling abroad during summer holidays as well as the boost from children heading back to school. The relaxation of mask-wearing is also said to have made a positive impact. Retail parks saw the greatest improvement in footfall, rising 13% from July and only 1.6% below pre-pandemic levels. However, high street stores were still 25% below pre-pandemic levels, despite a 10% rise in August while shopping centres are nearly a third less busy than before the pandemic. Online retail sales now account for about 28% of all retail sales according to official statistics released for July, pointing to the pandemic accelerating the gravitation of consumers towards online shopping. The BRC has called on government to review business rates and make it more attractive for retailers to do business in brick-and-mortar shops and enable them to compete with online retailers. The future of the UK high street depends on it.

EMERGING MARKETS & THE FAR EAST

Contributed by Carel la Cock

- South Korea is abandoning its decade old debt ceiling of 40% of GDP to address the widening inequality plaguing the post pandemic recovery. A booming demand for semiconductor smartphones and cars has helped the South Korean economy recover from the pandemic. However, it has also exacerbated the disparity between a poverty-stricken elderly population, who helped build the foundations of the current economic success following the Korean war, and those working in the country's successful export sector. Over 40% of the population over the age of 65 live in poverty and with almost a third of the population in self-employment a large swathe of the population has seen income slashed during the pandemic. Youth unemployment has also reached critical levels where every 1 in 10 is without work. To address this widening social gap, the government has expanded its budget and debt ceiling to reach 60% of GDP by 2025 from its the current level of 47.3%. Next year's budget will see an increase in spending on welfare benefits, job creation and developing new opportunities in the economy for future technologies. Although the increase in debt is alarming, it remains well below most developed and developing nations. Some economists fear that it will be difficult to roll back welfare benefits in future years and that the rapidly aging population coupled with a low birth rate will cause an unsustainable burden on the next generation. The key is that the government positions South Korea to benefit from changes in future technologies, in the same way it has benefited and reinvented the economy in the past decade. While the government owes it to the elderly who helped rebuild the nation, investing in the future will sustain the upward trajectory.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 11.52	66253

JSE Fini 15	+ 17.55	14176
JSE Indi 25	+ 8.34	84394
JSE Resi 20	+ 17.43	62892
USD/ZAR	- 3.23	14.24
EUR/ZAR	- 6.18	16.91
GBR/ZAR	- 1.95	19.70
S&P 500	+ 20.75	4535
Nikkei	+ 9.01	29916
Hang Seng	- 3.34	26322
Shanghai	+ 5.08	3649
FTSE 100	+ 11.25	7187
Gold	- 4.05	1821
Platinum	- 4.78	1020
Brent oil	+ 40.10	72.57

BOTTOM LINE

Contributed by Carel la Cock

- Environmental Social and Governance investing is gathering momentum. The industry has grown from $3 trillion in 2010 to $17 trillion at the end of 2019. Last year saw $51.1bn net inflows into ESG funds in the US alone, according to Morningstar. Investors are concerned about the environment and the impact of large companies on sustainability. Large fund managers have seized the opportunity to make a difference by investing their clients' funds for good. But are they making a difference or has ESG investing become an elaborate marketing campaign that has clients fleeced?

- In recent months the Financial Times published articles with titles such as "The ESG investing industry is dangerous", "The dubious appeal of ESG investing is for dupes only" and "The fallacy of ESG investing" in which writers largely criticized ESG funds and ESG investing. In the next few paragraphs, I'll unpack their arguments, but also show that the movement has some merit.

- BlackRock, the world's largest fund manager recently stated that "sustainability- and climate-integrated portfolios can provide better risk-adjusted returns to investors." Robert Armstrong, US financial commentator and self-proclaimed ESG naysayer states "It is true that at some point in the indefinite future, the social good and financial interests must converge. There are no investment returns at all on a planet left uninhabitable by climate change." However, there is a timing mismatch between the time horizon for the average investors, the planning horizon of most corporations and the much longer term ESG and ultimate climate catastrophe, which is just too far out for most investment strategies to capture.

- At the heart of most ESG strategies is divestment from companies seen to do harm. However, when an investor sells shares in the secondary market, someone else is buying it. ESG sellers might drive the price down to a point where it becomes so cheap that the market will start investing again to earn profits. Divestment in a company that does harm is not the same as boycotting its products or services. When an ESG investor decides not to buy a company's stock in the secondary market, it has no immediate impact on the company. Eventually when enough ESG investors do not buy the stock, the share price might fall, and the cost of capital will rise making it more expensive to engage in harmful projects. By the same token the cost of capital for ESG friendly companies will fall, but the flip side is that the price of the stock will rise, *ceteris paribus*, diminishing future returns for new ESG investors and with lower expected return the profit seeking market will again invest in non-ESG firms.

- For ESG funds to really make an impact by divestment they would need to be orders of magnitude bigger. The average ESG fund of $2bn is about 180,000 times smaller than overall global wealth. However, you don't always have to be big to make a change. ExxonMobil, the oil giant, faced the proverbial David, in the form of Engine No 1, the start-up hedge fund from San Francisco named after a firehouse, when Engine No 1 nominated 3 board members in a proxy battle to force ExxonMobil to ease on its commitment to fossil fuels. Engine No 1 was ultimately successful in gaining 2 board seats with the backing of some major pension funds. The proxy battle has been a wake-up call for many other companies that are reluctant to act on climate change.

- Divestment in harmful assets is not in all cases the best strategy for companies. Selling a harmful asset means someone else must buy it and there is no control in what that party does with it. Recently BHP, the world's largest miner, was urged by Market Forces, a shareholder activist group, to run down its fossil fuel assets rather than sell them outright. The group is concerned that selling assets, such as its thermal coal mines, could lead to increased production by smaller companies with less scruples and ultimately lead to more pollution. Environmentalists have changed their views on large multinationals, because they realise that big companies can more easily align with global climate goals and eventually phase out production.

- Some view ESG investing as a distraction from what is really needed, and that is government regulation. A carbon tax for instance will make it more costly for polluting companies to operate and markets, seeking to maximise profits, will ultimately gravitate away from these firms as returns diminish. There are many companies that have embraced sustainability and they will likely prosper not because of the ESG investing and their shares trading at premia in the secondary market, but rather because these companies align with people's values and customers want to buy their products. And therein lies the truth of the matter: as consumers and inhabitants of this planets we can all make a difference with the choices we make and how we live. Simply buying shares in the secondary market is no substitute for taking care of our natural and social environment.

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