InvestSense

December 2020

Finding the road to recovery

Who would have thought that 2020 would be a strong year for investors? In the depths of the COVID panic the term 'depression' was bandied about by many, a reset of the financial system in its entirety. Sentiment in our country was at its lowest as businesses shut and jobs were lost, with our government scrambling to source funding to plug the necessary gaps. Yet here we sit, reflecting back on a year where investors have for the most part done very well. The beleaguered local investor with healthy inflation beating retirement fund returns; the global equity investor with returns in excess of 20% in US$ following a similar year prior; inflation near historical lows and a positive if somewhat cautious mood prevailing over global markets looking ahead?

If there is one thing we should really acknowledge, it's that we should stay well clear of predicting investment markets in the short term.

Looking a little bit deeper, what has driven this positive outcome? To start with, massive financial stimulus from global central banks, encouraging investors to take more risk and extend their investment horizons by making low risk money (i.e. cash and bonds) wholly unattractive. They also acted as the backstop, becoming the buyer of last resort for a range of assets to show the world that they need not panic, risk can just be shifted elsewhere. This managed to see us through a period where the speed of the decline in assets was almost met by the speed of the recovery. Yet, markets have subsequently moved even higher. This 'reflationary' phase being driven by a few factors: the prospect of vaccines being distributed at an accelerated pace; the reduced political tensions with the US eventually landing on a Biden victory, and another round of substantial financial stimulus on the table.

The last quarter of 2020, and into the early parts of 2021 have seen the payoff of this recovery trade. Value shares, emerging markets, high yield bonds, smaller caps, in fact any higher risk asset you can shake a stick at, have outperformed on the prospect of economies moving forward, spending coming into the system and the world reverting to a positive trajectory as was the case in early 2020.

What is clear to see is that everyone wants an economic recovery and a return to normality. But are you willing to bet the farm that it will happen in the way we expect? Many risks persist and while this is not abnormal, when overlaid with expensive valuations in some assets, it can be a recipe for disappointment. The same culprits can be named: global bonds, US equities, quality companies, growth shares. By the same token, going all in on the recovery trade can also lead to disappointment should the way the world is dealing with the virus falter. This among many other 'unknown-unknowns' we may come across through 2021.

South African investors have had a torrid time since around 2015, but 2020 was not one of the bad years. With positive gains for the year as a whole, and gains of 70% since the lows in March, it goes to show that we should be very careful mixing sentiment with investments. No doubt we were helped by foreign actions more than our own, but it does serve as a reminder that perhaps things are not quite as bad as they could be. The resources sector stood out as the main beneficiary as investors moved to gold as a haven asset, and then to broader commodities as the recovery looked to set in.

Funnily enough, many investment markets have ended up quite similar to where the year started, with the result that any change in outlook we have across them is quite limited. There are a few things to bear in mind going back to work in 2021:

- While the financial markets have seemed resilient to this massive global shock, you do need to question the gap that has opened between the comfort seen here, with that in the real economy which is much, much weaker.

- The 'reflation/recovery' trade seems to be on for now. But it is dependent on the good news being priced in continuing. A set back in the infection and death rates will expose higher risk assets again. Saying that, the potential upside in certain sectors is significant, and such an outcome will see the return of the so-called value share.

- A watershed year for big tech? It does seem like they may be crossing that line of influence and it would be no surprise if the legislators upped the ante here and started to clip their wings.

- SA assets have made a decent comeback, but we are still beholden to the direction of government policy and some critical tests which still need to be passed. This is likely to come back into focus soon. Upside potential in certain sectors looks very

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significant, but we are not yet on a solid footing to achieve this.

- Lag effects: to what extent have certain industries and companies genuinely recovered? How exposed are they to a delay in the global recovery from COVID? We could yet see a fall off here across various sectors, including debt and equity.

- An inflationary surprise? It may seem unlikely, but this could scupper many investment portfolios should there be any nasty surprises, both locally and offshore. After all, a 'reflation' policy is intended to do just that, and central banks are keen to get inflation averages up.

All of this leaves us slightly schizophrenic at the start of 2021. Optimism around a global recovery continuing to bring good news, but quite aware that we are not there yet, and the potential downside is significant. And for once this applies to both local and offshore markets. The world is evenly balanced as we speak, and while the crisis has galvanized all sectors, including governments, to focus on a recovery, it is far from in the bag. An overlying cautious mindset will be valuable as we navigate 2021.

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data provided by Reuters and Datastream

31 Dec 2020

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
FTSE/JSE All Share Index (ALSI)	ZAR	9.7%	7.0%	7.0%	3.1%	6.4%	9.6%	15.2%	13.2%
FTSE/JSE SA Listed Property	ZAR	22.2%	-34.5%	-34.5%	-20.7%	-8.4%	3.5%	25.5%	20.5%
SA All Bond Index (ALBI)	ZAR	6.7%	8.7%	8.7%	8.9%	10.4%	8.2%	8.3%	7.9%
SA Cash Index (SteFI)	ZAR	1.0%	5.4%	5.4%	6.7%	7.0%	6.4%	0.3%	0.3%
Balanced Benchmark	ZAR	6.6%	8.3%	8.3%	5.9%	7.2%	10.5%	10.5%	8.8%
SA Inflation (1 month lag)	ZAR	0.4%	2.9%	3.2%	4.0%	4.6%	5.1%	1.3%	1.3%
GLOBAL MARKET INDICES BASED TO USD									
Global Equity (Datastream World)	USD	14.1%	16.5%	16.5%	11.1%	12.8%	10.5%	15.1%	14.0%
Emerging Markets Equity (Datastream EM)	USD	19.8%	18.7%	18.7%	6.6%	13.2%	4.0%	17.6%	17.8%
Global Property	USD	8.8%	-4.2%	-4.2%	3.9%	6.1%	7.0%	14.9%	14.7%
Global Bonds (Barclays Global Bond Index)	USD	2.8%	10.1%	10.1%	5.0%	4.8%	2.3%	5.4%	5.0%
Global Cash	USD	0.1%	0.7%	0.7%	1.8%	1.5%	0.9%	0.2%	0.2%
MAJOR INDICES BASED TO RANDS									
FTSE/JSE All Share Index (ALSI)	ZAR	9.7%	7.0%	7.0%	3.1%	6.4%	9.6%	15.2%	13.2%
Global Equity (Datastream World)	ZAR	0.5%	22.4%	22.4%	17.7%	11.6%	19.7%	17.1%	14.8%
Emerging Markets Equity (Datastream EM)	ZAR	5.5%	24.7%	24.7%	12.8%	12.0%	12.6%	14.5%	13.4%
Global Property	ZAR	-4.1%	0.6%	0.6%	10.0%	5.0%	15.9%	16.7%	14.7%
SA All Bond Index (ALBI)	ZAR	6.7%	8.7%	8.7%	8.9%	10.4%	8.2%	8.3%	7.9%
Global Bonds (Citigroup)	ZAR	-9.5%	15.7%	15.7%	11.1%	3.7%	10.8%	16.4%	14.7%
COMMODITIES									
Gold (US Dollars)	USD	-0.1%	24.8%	24.8%	13.3%	12.3%	3.0%	13.5%	16.1%
Gold (Rands)	ZAR	-12.0%	31.1%	31.1%	20.0%	11.1%	11.5%		
CURRENCIES									
Rand / Dollar	ZAR	11.9%	-5.0%	-5.0%	-5.9%	1.1%	-8.3%	17.0%	15.7%
Rand / GBP Pound	ZAR	6.9%	-8.4%	-8.4%	-6.2%	2.5%	-6.8%	17.6%	15.1%
Rand / Euro	ZAR	8.1%	-14.5%	-14.5%	-6.5%	-1.3%	-7.3%	15.3%	14.0%

Spot Rates		31-Dec-20	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US$	Rand	14.69	16.68	13.98	15.50	6.62	7.57
Rand/GBP	Rand	19.88	21.57	18.55	23.11	10.36	11.32
Rand/EUR	Rand	17.97	19.56	15.70	16.83	8.88	7.11
RATES							
Libor 6m $	US$	0.26	0.26	1.91	0.85	0.46	6.20
Repo Rate	Rand	3.50	3.50	6.50	6.25	5.50	12.00
Prime	Rand	7.00	7.00	10.00	9.50	9.50	14.50
All Bond Index Yield	Rand	9.62	10.20	9.55	10.11	8.15	9.74
COMMODITIES							
Gold ($/oz)	US$	1,897.77	1,899.84	1,520.50	1,062.38	1,417.63	272.95
Platinum	US$	1,068.00	884.00	971.00	868.00	1,755.00	611.00
Oil (Brent Crude) $	US$	51.89	40.99	66.31	35.70	92.81	22.38
INFLATION							
SA Inflation	%	3.2	3.0	4.0	5.3	3.5	9.4