INVESTMENT NOTE

SHUT DOWN, LOCKED DOWN, GOING DOWN

DAVE MOHR AND IZAK ODENDAAL | OLD MUTUAL MULTI-MANAGERS
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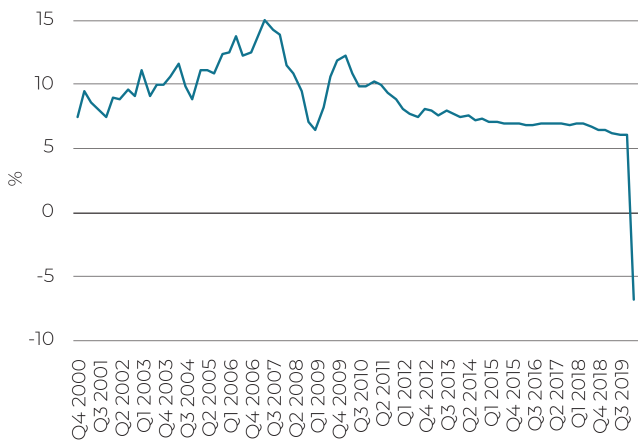
WEALTH

It remains difficult to describe the extent of damage being done to the global economy, quite deliberately, by governments seeking to contain the spread of the coronavirus. With more than two million confirmed Covid-19 cases worldwide, lockdowns are being extended to the end of the month and beyond in many parts (including South Africa). Economic activity has come to a standstill in many sectors and places.

Already the data on the economic carnage are off the charts. China, ground zero of the virus outbreak, registered negative economic growth for the first time in more than 40 years in the first quarter. Its economy contracted almost 7% compared to a year ago. More than 20 million Americans registered for unemployment insurance in the past four weeks, many times more than the entire span of any previous post-war recession. Not surprisingly, US retail sales fell 6% from a year ago in March. The surge in online spending did not come close to compensating for the fact that most non-essential stores were closed. (They were not closed the entire month of March, but they were in April, suggesting even deeper declines ahead.)

CHART 1: CHINA REAL ECONOMIC GROWTH, YEAR-ON-YEAR %



Source: Refinitiv Datastream

FORECAST UNCERTAINTY

The International Monetary Fund's (IMF's) bi-annual forecast has tried to estimate how bad it can still get. Its baseline forecast is for the global economy to contract 3% in 2020. The 2008 Great Recession looks mild by comparison with a 0.1% decline. The big difference then was that Chinese growth was still relatively robust, partly due to a flood of credit and fiscal spending. That is clearly not the case this time round, though China will probably recover more quickly than other countries, being the first country to impose and then end mass quarantines.

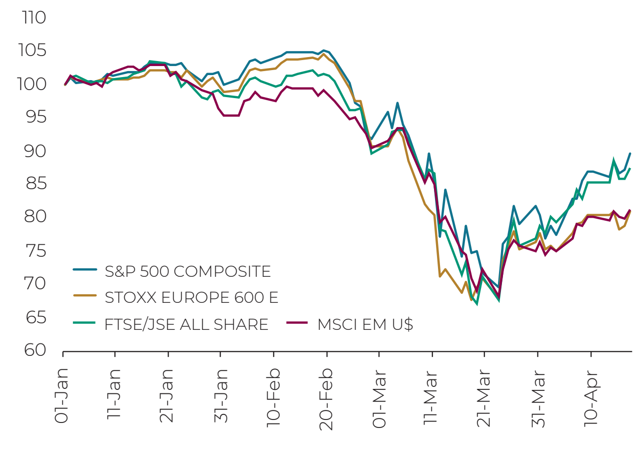
The severity of the collapse looks more like the Great Depression of the 1930s. Importantly, however, the prolonged nature of the Great Depression was due more to a series of policy mistakes than the sharp initial downturn or the 1929 Wall Street crash. Central banks allowed banks to fail, wiping out many depositors; the gold standard forced weaker countries to hike interest rates; the tariff barriers were raised, worsening the slump in global trade; and when things had started to get better by 1937, the US government prematurely tried to balance its budget.

Given the speed and magnitude of the policy response this time, such an L-shaped economic growth trajectory seems very unlikely. Fiscal authorities in developed countries are pouring trillions into the income gap left by the coronavirus. Central banks are rewriting the rulebooks. The Bank of England will now by-pass the bond market and directly fund government spending. Only a few days earlier, it ruled out such a drastic step, which will see the UK becoming the first major country to (temporarily) monetise its deficit in this crisis.

Bond traders shrugged off the news. The Federal Reserve of the United States (the Fed) now has nine lending facilities to address the crisis, including a new programme to buy high-yield (junk) corporate bond exchange traded funds and one to support new borrowing by 'fallen angels' (large companies that have lost their investment grade rating). It also created a new facility to encourage lending to small businesses. The Fed injection of funds into the economy and financial markets could exceed $4 trillion.

Equity markets, smelling that lockdowns will end soon, seem to have priced in a V-shaped recovery where life returns to normal fairly quickly and most job losses are reversed due to the strength of the policy response.

CHART 2: GLOBAL EQUITIES IN LOCAL CURRENCY



Source: Refinitv Datastream

THE NEW NORMAL

However, this seems optimistic. Many people might want to return to work post-lockdown only to find their employers have gone out of business. Many businesses may decide that they can manage with fewer employees. Consumer behaviour may change in deep but unpredictable ways. If consumers want to increase savings to be better prepared for any other nasty surprises the future may hold, no amount of rate cuts or stimulus cheques will convince them to spend now. The recovery may end up being slower as a result of this 'new normal'.

Even under a relatively robust recovery, as the IMF assumes, the global economy will be some $9 trillion smaller compared to a no-Covid-19 scenario. That is a staggering loss of income, output and profit.

Of course the most important variable – and unknown – is the virus itself. When does the outbreak decisively end? How soon can lockdowns safely be lifted? Is there a second wave? Can we find an effective treatment or vaccine soon? We are all still hostages of this microbe, physically, economically, emotionally and intellectually.

The IMF's forecast assumes lockdowns will end by June and the world will gradually return to normal in the second half of the year. If the virus is not contained by June, it estimates the global economy could contract 6% this year. But any forecast from anyone at this stage should be seen as not much more than a guess. The IMF's army of PhD economists with their massive computer models and extensive contacts have no greater insight than the rest of us into when this all ends.

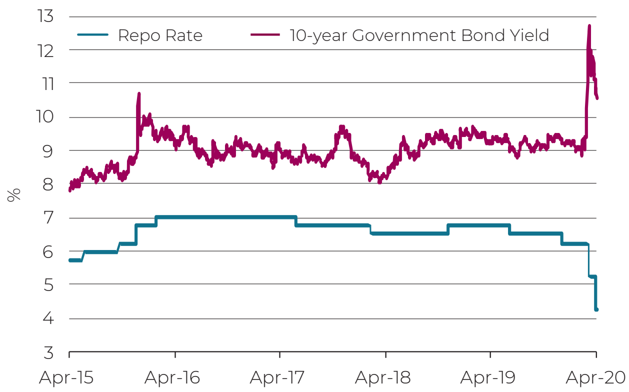
BLEAK OUTLOOK FOR SOUTH AFRICA

Forecasts put forward for the local economy are equally astounding. The IMF expects a 6% decline in the 2020 calendar year, with a 4.8% recovery next year. The SA Reserve Bank similarly expects a 6% contraction this year, but a much more muted 2% recovery next year.

This bleak outlook will put further downward pressure on inflation, aided by low global oil prices (the OPEC+ production cuts have failed to raise prices), and this gave the SARB's Monetary Policy Committee scope to cut the repo rate by another 100 basis points last week, at an unscheduled meeting. In truth, the cut was necessary irrespective of the inflation outlook.

While the SARB cut short-term interest rates, long-term rates are still substantially above pre-crisis levels (though they have receded from worst levels). The drastic steepening of the yield curve risks completely overwhelming any positive impact of its rate cut. Having ensured the smooth functioning of the bond market after a period of stress, it needs to flatten the yield curve to ensure its policy stance is reflected in market interest rates. It can buy as many government bonds as needed to do so. Its monthly balance sheet update shows it bought R1bn in government bonds in March and increased accommodation to banks in the money market by around R40 billion. The latter is a substantial jump, the former not. Unfortunately, it seems to have ruled out a large scale quantitative easing programme in the belief that it would be inflationary.

CHART 3: SOUTH AFRICA LONG AND SHORT-TERM INTEREST RATES, %



Source: Refinitiv Datastream

INVESTMENT IMPLICATIONS

However, that leaves us with incredibly high bond yields, well above any reasonable expectation of future inflation. Meanwhile, short-term interest rates are no longer offering the juicy real returns of the past few years.

Equities are also attractively valued if you think the recovery will be decent, but no longer as cheap as a few weeks ago. Local equities are definitely cheaper than global equities on standard valuation metrics (such as price to book and price to earnings), but our economic outlook is worse and high bond yields are a headwind. Probably the strongest argument in favour of global equities as an asset class is that record low interest rates make it more valuable. If that is the case, the same cannot be said for local shares.

In summary, there is still tremendous uncertainty on all fronts. While we don't know how sustainable the current rally will prove to be – big bear markets usually contain strong upward surges on the way down – no one is complaining for now. Bonds and equities rebounded strongly in April and have already delivered a year's worth of cash returns. Anyone who sold out of equities into cash after March's sharp declines may now sit with seller's and buyer's remorse.

Things can still change, but it is a powerful reminder of how dangerous it can be to try timing the market, especially when a timing decision is driven by the sentiment of the day. It also illustrates the importance of sticking to an investment strategy.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	2 018.0	8.90%	-14.42%	-6.62%
United States	S&P 500	US$	2 875.0	11.22%	-11.02%	-0.86%
Europe	MSCI Europe	US$	1 384.0	3.13%	-22.42%	-18.20%
Britain	FTSE 100	US$	7 235.0	2.76%	-27.66%	-25.74%
Germany	DAX	US$	1 081.0	5.67%	5.63%	-16.46%
Japan	Nikkei 225	US$	185.0	5.20%	6.30%	-6.89%
Emerging Markets	MSCI Emerging Markets	US$	901.0	6.12%	-19.19%	-17.79%
Brazil	MSCI Brazil	US$	1 248.0	6.48%	-47.41%	-37.94%
China	MSCI China	US$	80.3	5.08%	-5.68%	-7.07%
India	MSCI India	US$	437.4	8.01%	-26.11%	-27.10%
South Africa	MSCI South Africa	US$	296.0	4.23%	-38.08%	-41.85%

EQUITIES - SOUTH AFRICA (TR UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	49 135.0	10.44%	-13.93%	-16.59%
All Share	All Share (Total Return)	Rand	7 565.0	11.10%	-12.65%	-13.58%
TOP 40/Large Caps	Top 40	Rand	6 905.0	11.28%	-10.06%	-11.34%
Mid Caps	Mid Cap	Rand	12 493.0	9.48%	-29.47%	-23.69%
Small Companies	Small Cap	Rand	13 111.0	12.89%	-23.86%	-26.47%
Resources	Resource 20	Rand	2 981.8	16.99%	-11.63%	-4.87%
Industrials	Industrial 25	Rand	14 048.0	8.79%	1.94%	-2.12%
Financials	Financial 15	Rand	6 045.0	7.35%	-35.65%	-39.98%
Listed Property	SA Listed Property	Rand	1 123.9	15.51%	-40.12%	-41.68%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
US Aggregate Bond Index	Bloomberg Barclays	US$	515.3	1.04%	0.71%	5.85%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	665.2	4.32%	-4.77%	-0.04%
Government Bonds	BESA GOVI	Rand	657.2	4.34%	-4.86%	-0.29%
Corporate Bonds	SB JSE Credit Indices	Rand	50.8	-1.83%	-8.90%	-47.70%
Inflation Linked Bonds	BESA CILI	Rand	260.5	7.26%	0.18%	1.12%
Cash	STEFI Composite	Rand	449.6	0.30%	2.00%	7.18%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	28.1	8.00%	-57.45%	-61.00%
Gold	Gold Spot	US$	1 695.0	4.95%	11.22%	32.53%
Platinum	Platinum Spot	US$	776.0	7.03%	-20.08%	-12.61%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	18.80	-5.03%	-25.53%	-25.58%
ZAR/Pound	ZAR/GBP	Rand	23.50	-5.74%	-21.02%	-22.38%
ZAR/Euro	ZAR/EUR	Rand	20.43	-3.53%	-23.21%	-22.67%
Dollar/Euro	USD/EUR	US$	1.09	1.28%	2.84%	3.67%
Dollar/Pound	USD/GBP	US$	1.25	-0.82%	6.37%	3.98%
Dollar/Yen	USD/JPY	US$	0.01	-0.02%	-1.05%	-4.08%

Source: I-Net, figures as at 17 April 2020

WEEKLY INVESTMENT NOTE

THE WEEK AHEAD

SOUTH AFRICA

- Consumer inflation

US

- First quarter corporate earnings season
- Flash Markit Purchasing Managers' indices
- Durable goods orders
- New home sales

EUROPE

- Flash Markit Purchasing Managers' indices
- Eurozone consumer confidence
- Eurozone trade balance

JAPAN

- Flash Markit Purchasing Managers' indices
- Inflation

The Old Mutual Wealth Investment Note is published on a weekly basis to keep our clients and financial planners informed of what is happening in financial markets and the economy and to share our insights. Markets are often very volatile in the short term and similarly, economic data releases or central bank actions may cause concerns for investors. This does not mean that investors should take action based on the most recent events. It is better to be disciplined and remain invested in well-diversified portfolios that are designed to achieve long-term objectives. Our Strategy Funds are actively managed, with asset allocation changes based on valuations and in anticipation of future real returns, and not in response to the most recent market noise. The future is always uncertain and that is why our Strategy Funds are diversified and managed with a long-term focus.

WEALTH