February 2021

Sygnals

The Monthly Bulletin by Sygnia

Market review

February saw the best market upswing since the 1930s: the S&P 500 is up 75% from its Covid lows, just behind the bull run that followed the lows of June 1932, which peaked at 78%. Markets were driven by the expectation of more stimulus to drive growth, with Biden's $1.9 trillion fiscal package widely expected to be passed by Congress, lifting US and global growth and inflation expectations. The Organisation for Economic Co-Operation and Development's (OECD) leading business cycle index shows that most economies are continuing to expand. The risks of new variants and delays in vaccine rollouts have become secondary concerns as the number of new global cases has dropped dramatically (*Chart 1*). Scientists remain conflicted, with a good portion of the decrease a result of lockdowns and very little a result of vaccine rollouts, leaving a lot of the decrease unexplained.

Expectations of rising growth have seen developed market bond yields rise, while gold is down more than 5% for the year-to-date. We continue to avoid global bonds and gold in our portfolios. and, while we do not expect inflation to derail growth this year, many markets have reached new highs and certain sections of the market are frothy. The Shiller Cape P/E is back to levels last seen in 1929 (*Chart 2*), copper hit its highest level in more than nine years on the back of optimism around the global recovery, and Bitcoin reached a new high of $49,913 after news of Tesla investing $1.5 billion in the cryptocurrency. As global bond yields rise, the present value of further-out cash flow streams becomes lower, reducing the valuation of growth companies, and we could see further rotation from tech into value stocks. Markets continue to rally despite the Texas energy crisis – a super freeze which resulted in the largest outage in US history and the third largest ever globally. The fallout rippled through the global oil market, with almost 40% of crude oil production going offline, but oil prices rose only slightly due to current above-average inventories.

Chart 1: DM and EM Covid-19 infections per 1 million
Source: Bloomberg

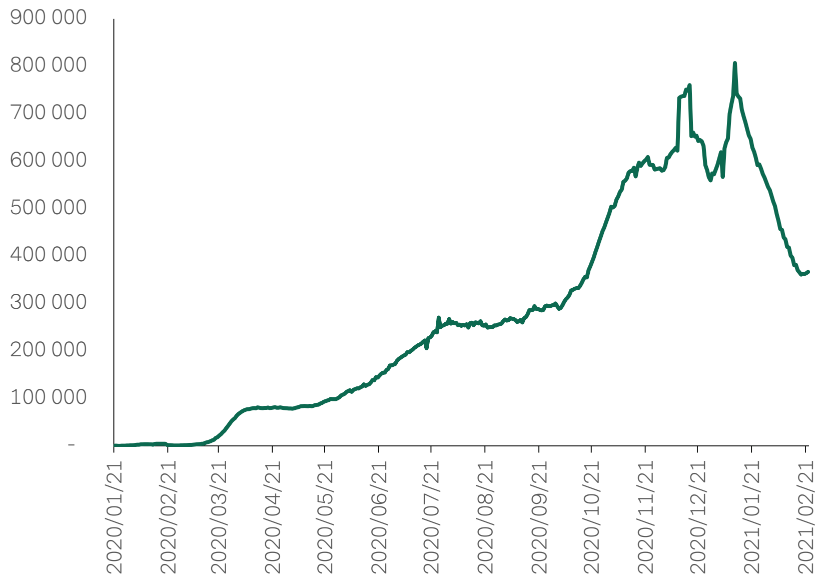
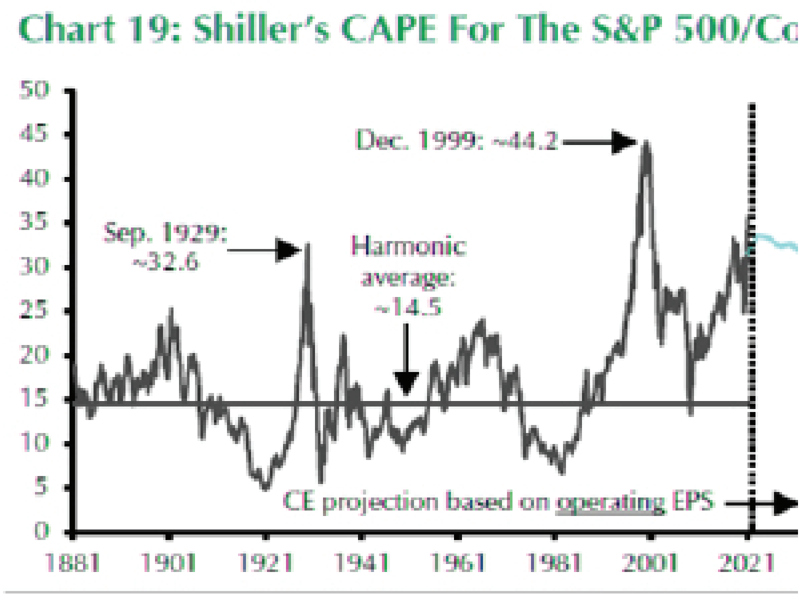


Chart 2: Shiller's CAPE for the S&P 500
Source: Capital Economics



Covid19 – vaccination rate acceleration

The global vaccination rate has accelerated, with more than 220 million shots having been administered across 100 countries. Top US virologist Dr Anthony Fauci says that vaccinating 70% to 85% of the US population will enable a return to "normal" and is achievable by year end. Based on the current global vaccination rate of 6 million doses per day, however, it will take the world five years to reach that same "return to normal".

South Africa halted its rollout of the AstraZeneca-Oxford vaccine after evidence emerged that the vaccine did not protect clinical-trial participants against mild or moderate illness caused by the South African variant, though World Health Organisation Director of Immunisation Kate O'Brien noted it provides meaningful protection against severe disease caused by the South African variant. The WHO subsequently approved AstraZeneca-Oxford vaccine for emergency use. South Africa has begun to vaccinate healthcare workers with the Johnson & Johnson vaccine, which has proven to be 57% effective at preventing mild to moderate illness and 85% effective at preventing severe cases in SA. SA has secured eleven million doses, of which 67 000 have been administered to date. The J&J vaccine has received regulatory approval in the US but has not yet been approved for emergency use there.

South Africa

Despite being the shortest month of the year, the South African calendar was jam-packed in February, with the president's State of the Nation Address (SONA) and then Finance Minister Tito Mboweni's much-anticipated Budget 2021. Mboweni kicked off his budget speech with a quote from Archbishop Desmond Tutu: "Hope is being able to see that there is light despite all of the darkness", which was apt as he managed to deliver on millions of South Africans' hopes for minimal personal tax increases.

SONA

President Cyril Ramaphosa proposed a four-prong approach aimed at delivering growth, dealing with the Covid-19 pandemic, creating jobs and fighting corruption, and for a change he provided some decent details on how this might happen. Accelerating economic recovery and job creation will rely heavily on a pension fund-sponsored infrastructure investment plan with a project pipeline of R340 billion, sorely needed after unemployment levels rose to a record high of 32.5% in the fourth quarter of 2020.

National Treasury has finally released its draft amendments to Regulation 28, which will allow for retirement funds to invest in infrastructure. Regulation 28 is intended to protect retirement fund savings by limiting exposure to any one asset class, and the regulation does not currently define infrastructure as a specific category, with infrastructure investment spread across several asset classes, such as equity, bonds, loans and private equity. Consequently, current data from retirement funds does not record the exact investment in infrastructure. The proposed amendments include the following changes:

- Hedge funds and private equity investments will be split into standalone asset classes with limits of 10% and 15% respectively.
- The overall investment in infrastructure across all asset categories may not exceed 45% for domestic exposure, with an additional limit of 10% for the rest of Africa.

Energy supply is powering up, with a request for proposals for 2 600 megawatts (MW) to be supplied from renewable energy in the weeks to come. The threshold for self-power generation will be raised from 1 MW over the next three months by amending schedule two of the Electricity Regulations Act, and Operation Vulindlela will reduce the administrative burden on generation projects under 50 MW.

While President Ramaphosa waxes lyrical about the fight against corruption, the truth of his words is being tested. Former president Jacob Zuma has openly defied court rulings to appear before the State Capture Commission, where a multitude of witnesses have fingered him as a central pillar in the state capture saga. ANC secretary-general Ace Magashule has similarly refused to step down in the face of multiple charges of fraud, corruption and money laundering. Elsewhere, the Department of Environment, Forestry and Fisheries incurred R3 billion worth of "irregular expenditure" and the Government Employees Medical Scheme has been rocked by allegations of fraud, maladministration and corruption totalling more than R300 million. Meanwhile, beleaguered South Africans will see limited relief in the form of the special Covid-19 grant of R350 per month, which has been extended by a further three months to April.

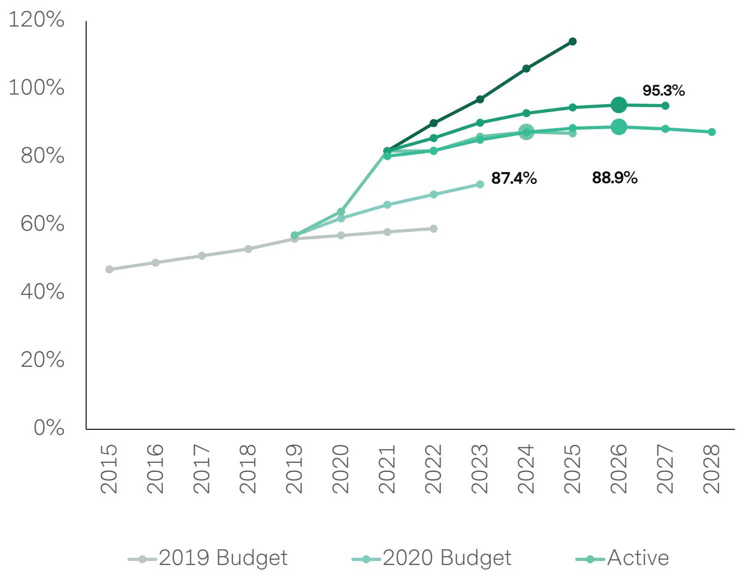
Budget 2021

South African revenue collection overshot its estimated budget by almost R100 billion, due largely to windfalls from mining royalties that accrued after climbing commodity prices bolstered mining income.
This improved revenue collection allowed Mboweni to put forward a "budget for the people", with tax relief for individuals (for the first time in six years) and an above-inflation 5% increase in personal income tax brackets. However, the usual suspects were up for tax increases, with fuel taxes up by 27 cents, translating to a final cost of R6.15 per litre of petrol effective 7 April. Cigarette tax went up to R18.79 for a pack of 20 cigarettes, and alcohol taxes increased by 8%.

The good news for companies is that SA will cut the company tax rate to 27% from April 2022, but there has not yet been an update on the recent SARB directive on inward listings. The Budget was bond positive, and while debt is still expected to peak in 2026, it will be at 88.9% of GDP rather than the previously envisaged 95.3%. There was no mention of Eskom in the Budget, but the Congress of South African Trade Unions (COSATU) has repeatedly urged that PIC funds be used to rescue Eskom, and Nedbank has been appointed to investigate options. Overall, Mboweni delivered a growth-orientated, market-friendly budget that should delay credit downgrades, but there is a large execution risk in the wake of union protests against the wage freeze for public servants.

Chart 3: Gross debt-to-GDP outlook

Source: National Treasury



Key takeaways

There is much to be grateful for as we hurtle into 2021. Mboweni's message of hope proved to be more than just a fanciful notion, delivering a National Budget that looks set to stabilise the country's debt levels while recognising the incredible economic strain that South Africans are currently under. Notably, the Budget made no new allocations to state-owned entities, and any monies received by South African Airways or Eskom will be from funds already allocated in previous budgets. As the saying goes, "Hope springs eternal".

Key indicators

		1 mo.	3 mos.	6 mos.	1 yr.	2 yrs.	3 yrs.	5 yrs.	10 yrs.
J203T	**FTSE/JSE All Share Index**	5.9%	16.1%	20.3%	33.2%	12.1%	7.6%	9.2%	10.7%
J200T	**FTSE/JSE Top 40 Index**	6.0%	16.2%	19.6%	36.1%	13.9%	9.0%	9.9%	10.9%
J210T	**FTSE/JSE Resources 10 Index**	11.7%	28.0%	22.6%	66.4%	26.5%	28.5%	23.9%	4.9%
J211T	**FTSE/JSE Industrials 25 index**	2.0%	9.4%	16.2%	32.3%	15.5%	6.0%	6.9%	15.2%
J212T	**FTSE/JSE Financials 15 Index**	4.4%	9.6%	25.6%	-6.0%	-11.4%	-8.5%	1.6%	8.9%
J403T	**FTSE/JSE SWIX Index**	4.6%	14.2%	18.7%	26.1%	8.5%	3.5%	7.0%	10.5%
J433T	**FTSE/JSE Capped SWIX Index**	5.3%	14.5%	19.7%	23.9%	5.9%	1.7%	5.2%	-
J303T	**FTSE/JSE CAPI Index**	6.2%	16.0%	20.8%	32.3%	10.7%	6.8%	8.5%	10.5%
J253T	**FTSE/JSE SA Listed Property Index**	8.6%	19.5%	24.6%	-15.8%	-17.4%	-13.5%	-7.6%	4.6%
ALBI	**JSE All Bond Composite Index**	0.1%	3.3%	7.5%	8.3%	8.6%	7.1%	9.8%	8.6%
STeFI	**STeFI Index**	0.3%	0.9%	1.9%	4.8%	6.0%	6.4%	6.9%	6.3%
	MSCI World Index in SA Rands	3.2%	3.6%	-0.1%	24.3%	20.7%	20.4%	13.1%	18.3%
	Rand/US Dollar Exchange Rate	0.6%	-2.1%	-10.6%	-3.9%	3.7%	8.7%	-0.9%	8.1%
	Rand/Euro Exchange Rate	0.5%	-0.7%	-9.3%	5.5%	7.2%	8.5%	1.3%	6.7%
	Headline CPI	0.3%	0.5%	1.1%	3.2%	3.8%	3.9%	4.5%	5.1%
	PPI	0.8%	1.0%	2.5%	3.5%	4.0%	4.0%	4.6%	5.6%