July 2021

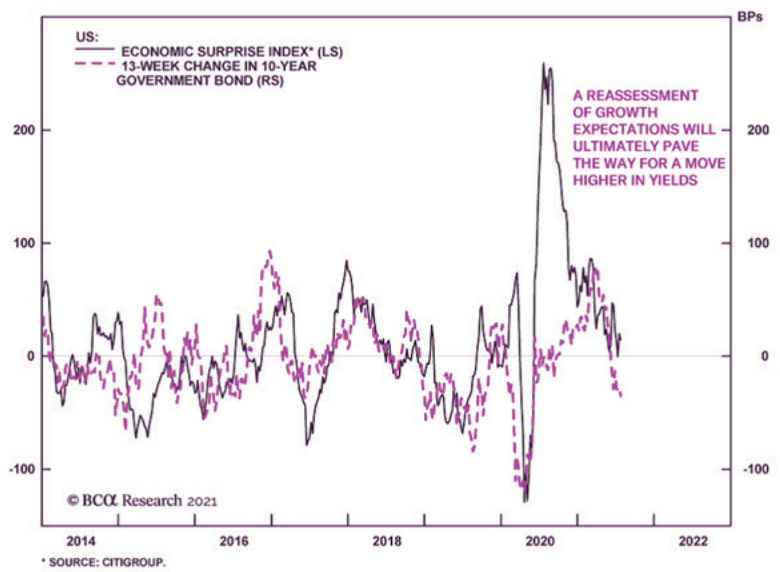
Sygnals

The Monthly Bulletin by Sygnia

Market update

Global bond yields plunged in July on the back of concerns about slowing growth, a hawkish US Fed and the spread of the Covid-19 Delta variant. While growth is slowing (China peaked last year, the US earlier this year and Europe is likely peaking now), it is coming off a very low base. The recovery will slow but remain strong, and while the Delta variant will delay the recovery, the global economy will still transition to a more sustainable upcycle. The uncertainty created by the Delta variant will allow central banks to provide more liquidity for longer, and over the next six to twelve months we believe bond yields will continue to rise with global economic growth.

Chart 1: Slowing growth has weighed on US bond yields.
Source: Citigroup / BCA

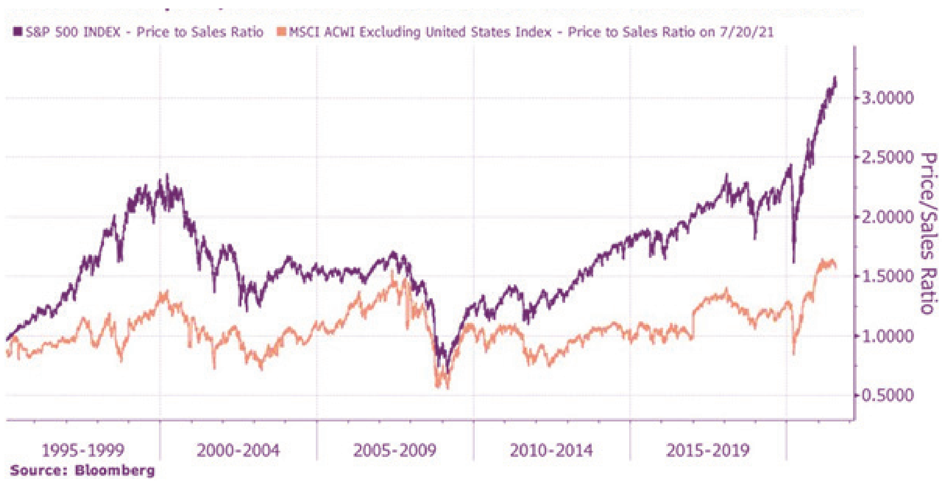


US: Biden tightens anti-trust regulations, sentiment drops

President Joe Biden signed a sweeping executive order to promote competition across (amongst others) technology companies, drug prices, airline luggage fees, shipping and even non-compete clauses. The order also directs federal agencies to scrutinise tech companies' use of consumer data in the face of concerns that companies like Facebook, Amazon, Apple and Alphabet Google use consumer data to gain excessive market power. Along with increased taxes, this will weigh on market sentiment.

More importantly, valuations remain a concern. US equities reached new highs in July and are looking overvalued – according to BCA Research, they are at their most expensive since the start of their valuation series in 1973. Projected returns over the next decade for US stocks are negative – and zero for global stocks – in real terms. The market looks stretched in an absolute sense and relative to sentiment. The S&P 500 has doubled the rest of the world since its relative low in November 2007. By price to sales, the US is more expensive relative to the rest of the world than ever before (Chart 2).

Chart 2: S&P 500 price-to-sales ratio is almost double the rest of world (ex US).
Source: Bloomberg



European Central Bank (ECB) embraces inflation with new symmetrical target

Over the last decade, many developed markets – and the Euro area in particular – have not been able to achieve a 2% inflation target (as shown in Chart 4). The doves were out in full force at the July ECB meeting, where ECB President Christine Lagarde announced a change to the inflation goal: rather than hiking rates when inflation hits 2%, they have adopted a process similar to the US's average inflation target, adopting a symmetric 2% inflation goal and giving the bank some leeway in allowing transitory inflation above the 2% ceiling. Lagarde said the central bank is in no rush to tighten policy and that the pandemic remains the major threat rather than inflation. The central bank will continue to support the recovery process even after the Pandemic Emergency Purchase Program expires in March. In addition, all 27 EU countries ratified the €750 billion Next Generation fund, which, on a relative basis, supports the southern European countries. The fund focuses on public investment projects.

Chart 3: Eurozone core inflation y-o-y.
Source: Bloomberg

China: Tightening control of big tech companies

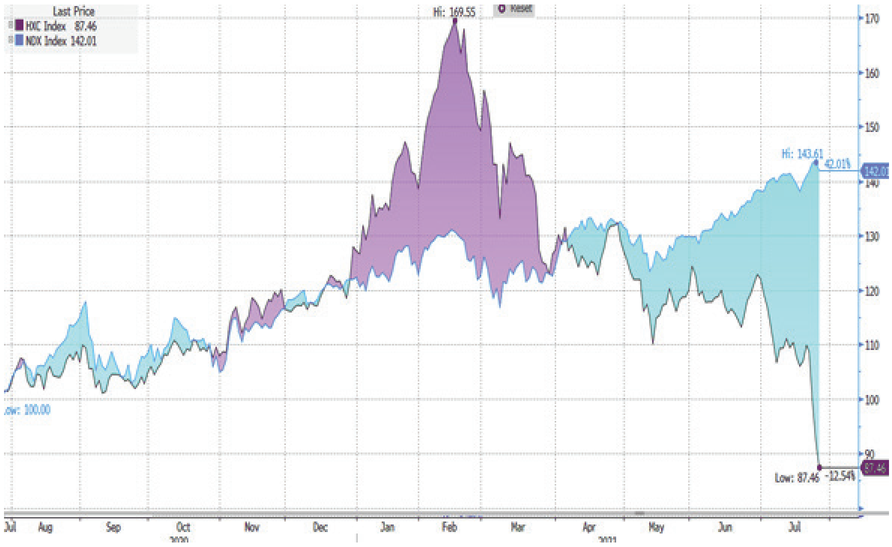
China's wide-ranging crackdown on its technology and education sectors and a slow vaccine roll-out has pushed emerging market shares to a 17-year relative low against their developed market peers. Specifically, Beijing's focus on restricting US listings and tightening controls of the education sector has caused the Nasdaq Golden Dragon Index, which tracks China's largest US-listed firms, to plummet relative to US tech (see Chart 4), wiping out $810 billion since February.

With the backing of the governing State Council, the Cyberspace Administration of China (CAC) has extended its oversight to include overseas initial public offerings. Beijing wants to control access to its data, seeing data security as national security. Under the new measures, China will improve regulation of cross-border data flows and security. Case in point: just two days after Chinese Didi Global pulled off the second largest US IPO by a Chinese firm, the company was forced to remove 25 apps from its mobile platform for violations of data security laws. However, China's anti-trust regulator granted unconditional approval for Tencent Holdings' plan to take search engine Sogou private. "We [China] continue to open up and support the development of internet platforms, and we will continue to encourage Chinese companies to engage in international exchanges and co-operation," said China's foreign ministry spokesman, Wang Wenbin. Many of these firms have already listed on the Hong Kong exchange.

China later unleashed a further set of restrictions focused on the education sector amidst concerns that children are not being placed in appropriate classes, that reckless pricing and advertising are impacting consumers and that online education is widening the divide between the haves and have-nots. Restrictions include limiting after-school tuition fees, fining companies for false advertising claims, banning courses for children six years old or younger, mandatory licensing for all teachers and a moratorium on weekend classes. Firms that teach school subjects are also banned from making profits, raising capital or going public. This is a specific action to address social inequality and does not reflect negatively on the broader Chinese tech sector.

Chart 4: Chinese Golden Dragon Index vs US Nasdaq.

Source: Bloomberg



South Africa downgraded after "attempted insurrection"

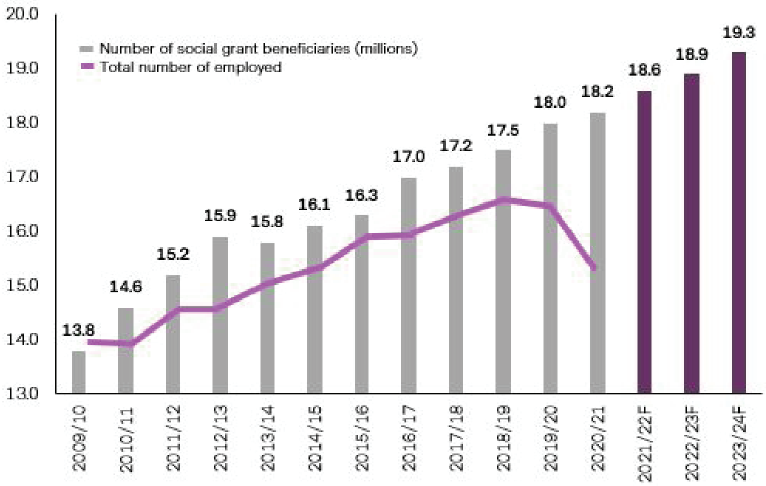
The "attempted insurrection" described by President Cyril Ramaphosa as the "worst civil unrest in the history of our democracy" has dealt a massive blow to South Africa's growth recovery. The widespread looting and social unrest that followed the imprisonment of former President Jacob Zuma has damaged business confidence, disrupted trade routes and seen hundreds of businesses shutting doors, in many cases forcing permanent business closures. "The actions were intended to cripple the economy, cause social instability and severely weaken – or even dislodge – the democratic state," Ramaphosa told a shocked South Africa. During his visit to a KwaZulu-Natal looting site, he also acknowledged that the government "could have done better". The South African Property Owners Association estimates the cost at about R50 billion in lost output, with about 150 000 jobs in jeopardy. This latest drawback will further delay any recovery and is expected to reduce GDP by 0.5% this year.

In addition, PwC estimates that load shedding will reduce real GDP growth by 2.3 percentage points in 2021, potentially costing the country another 275 000 jobs. Moody's has downgraded six South African municipalities in the last two weeks, which are now on review for further downgrades (revenue shortfalls are expected to be ongoing due to very weak SA growth). Transnet has declared force majeure on its port terminals following a cyber-attack. All these setbacks point to an increased and urgent need for structural reforms.

South Africa moved down to an adjusted level three lockdown after presumably breaching the peak of the third wave. After a peak of about 26 500 cases a day in early July, infection rates declined to around 12 000 per day in the third week of July. The R350/month Social Relief of Distress (SRD) grant will be reinstated until March 2022 at an estimated cost to SA of around R27 billion – it is not clear how this will be funded, and Finance Minister Tito Mboweni has moved his press briefing on the issue three times, suggesting he is also not sure where the money will come from. As evidenced in Chart 5, jobs must increase to keep up with social grants.

Chart 5: Total employed vs social grant beneficiaries.

Source: BNP



Key take-aways

Globally, the Covid-19 Delta variant continues to wreak havoc. Microbiologist Sharon Peacock recently called it the "fittest and fastest variant yet", and early signs suggest that vaccination remains the best option to prevent death but is no guarantee against infection. Three-quarters of the active Covid-19 cases in Singapore are among the vaccinated, but none were seriously ill; in Israel, 60% of currently hospitalised Covid patients have been vaccinated. Vaccination is likely to become an accepted solution, much like the polio and chickenpox vaccines, but it also looks like Covid is here to stay.

South Africans are known for their "resilience" and ability to rally in the face of difficult circumstances, and July 2021 proved no exception. After an initial shock and outcry in response to the intense riots and looting that broke out, largely in Gauteng and KZN, citizens quickly formed neighbourhood action groups and mobilised to protect communities and shopping malls from criminal elements. However, Sasria, the only insurer in the country that provides insurance cover against riots and civil unrest, noted that this was the worst case of unrest seen since the 1976 riots, and the true damages are only likely to be reflected in a few months, when all claims have been submitted.

Key indicators

		1 mo.	3 mos.	6 mos.	1 yr.	2 yrs.	3 yrs.	5 yrs.	10 yrs.
J203T	**FTSE/JSE All Share Index**	4.2%	3.2%	12.1%	27.1%	13.6%	9.7%	8.8%	11.6%
J200T	**FTSE/JSE Top 40 Index**	4.5%	3.0%	11.3%	25.5%	14.6%	10.3%	9.7%	11.8%
J210T	**FTSE/JSE Resources 10 Index**	11.8%	3.0%	20.1%	32.5%	30.5%	24.4%	22.2%	7.0%
J211T	**FTSE/JSE Industrials 25 index**	1.0%	2.5%	4.8%	19.7%	11.8%	8.0%	6.6%	14.7%
J212T	**FTSE/JSE Financials 15 Index**	-1.4%	4.8%	12.5%	30.0%	-5.5%	-4.8%	1.4%	9.6%
J403T	**FTSE/JSE SWIX Index**	1.6%	0.1%	7.6%	20.9%	9.0%	5.5%	5.3%	10.7%
J433T	**FTSE/JSE Capped SWIX Index**	2.6%	2.4%	12.8%	27.1%	9.8%	5.2%	4.4%	10.2%
J303T	**FTSE/JSE CAPI Index**	4.6%	4.6%	15.1%	30.8%	14.4%	9.7%	8.5%	11.6%
J253T	**FTSE/JSE SA Listed Property Index**	-0.6%	-0.2%	22.5%	28.5%	-13.1%	-8.9%	-7.6%	4.8%
ALBI	**JSE All Bond Composite Index**	0.8%	5.7%	5.1%	13.9%	9.0%	8.7%	8.9%	8.5%
STeFI	**STeFI Index**	0.3%	0.9%	1.8%	3.9%	5.2%	5.9%	6.5%	6.2%
	MSCI World Index in SA Rands	4.3%	5.7%	13.0%	16.0%	21.5%	18.3%	15.6%	20.1%
	Rand/US Dollar Exchange Rate	2.5%	0.8%	-2.8%	-14.1%	1.0%	3.3%	1.1%	8.1%
	Rand/Euro Exchange Rate	2.4%	-0.7%	-5.1%	-13.9%	4.5%	3.8%	2.3%	6.2%
	Rand/Pound Exchange Rate	3.1%	1.3%	-1.6%	-9.0%	8.0%	5.4%	2.2%	6.4%
	Headline CPI	0.2%	1.0%	2.7%	4.9%	3.5%	3.8%	4.2%	5.0%
	PPI	0.8%	1.8%	4.7%	7.7%	4.1%	4.6%	4.7%	5.1%