March 2021

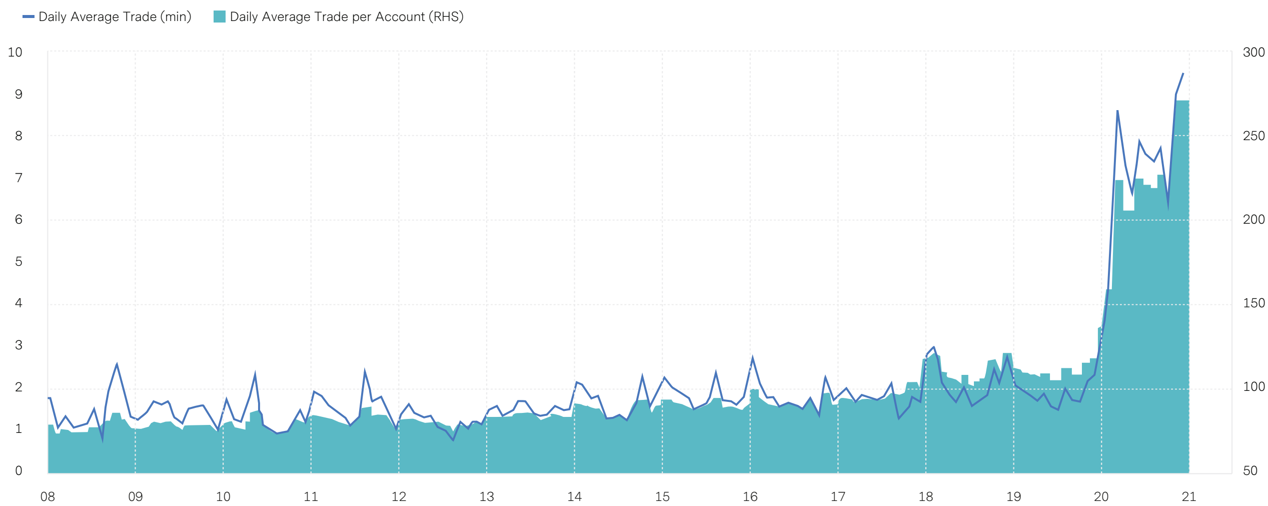
Sygnals

The Monthly Bulletin by Sygnia

Market review

Markets are up a roaring 13% in the first quarter of 2021 but with such a swift rally, the question of a bubble arises. Unfortunately, a market bubble is a phenomenon best identified with hindsight. Having said that, there are bubble characteristics that you can watch out for, such as exponential price movement, extreme valuations, retail leverage and a "this-time-its-different" investment case. Looking at price action, the only truly exponential moves seem to be linked to digital innovation and ESG. Since 2014 cryptocurrencies have risen by a factor of 160, innovation stocks are up six times, special purpose acquisition companies (SPACs) and solar energy have tripled while European renewables have doubled. A lot of this meteoric rise has happened in the last year and is most likely linked to extreme activity (relative to the past) in US retail trading (as shown in chart 1). Fortunately, the recent price correction in this area has reduced some concerns.

Chart 1: US retail-only broker account trades are very elevated
Source: Goldman Sachs



Covid19 – the third wave sparks vaccine wars

Despite respite in most of the world, Central and Eastern Europe are currently being overrun by a third wave, forcing countries such as Italy, Estonia, and Hungary to introduce new lockdown restrictions. This comes at a time when vaccination rollout is struggling across the EU and is further complicated by developments regarding the AstraZeneca/Oxford vaccine, where the Netherlands, Ireland, Germany, Italy, Spain, Portugal and France suspended use of the vaccine over potential blood clotting concerns. AstraZeneca and the World Health Organisation (WHO) are denying reports that the vaccine is linked to blood clotting risks. Towards the end of the month Europe restarted AstraZeneca vaccines following a safety endorsement from the European Medicines Agency, but now the EU is threatening to stop exports of the vaccine from EU production facilities into the UK and ongoing bickering continues between EU countries over all vaccine allocations. South Africa has vaccinated just over 200 000 people. However, the South African government has not yet set up the required compensation to cover damage claims as the rollout is still part of a clinical trial; and incoming shipments of the Johnson & Johnson vaccines have been delayed.

US – $2.25bn infrastructure package next … and more taxes

In the month, Congress passed President Joe Biden’s $1.9 trillion Covid relief bill - the second largest ever US fiscal stimulus package. This adds $1.9trn worth of fiscal stimulus on top of the $900bn already introduced by former president, Donald Trump, at the end of last year, bringing the total estimated combined fiscal support from these two packages to the significant amount of 13% of GDP.

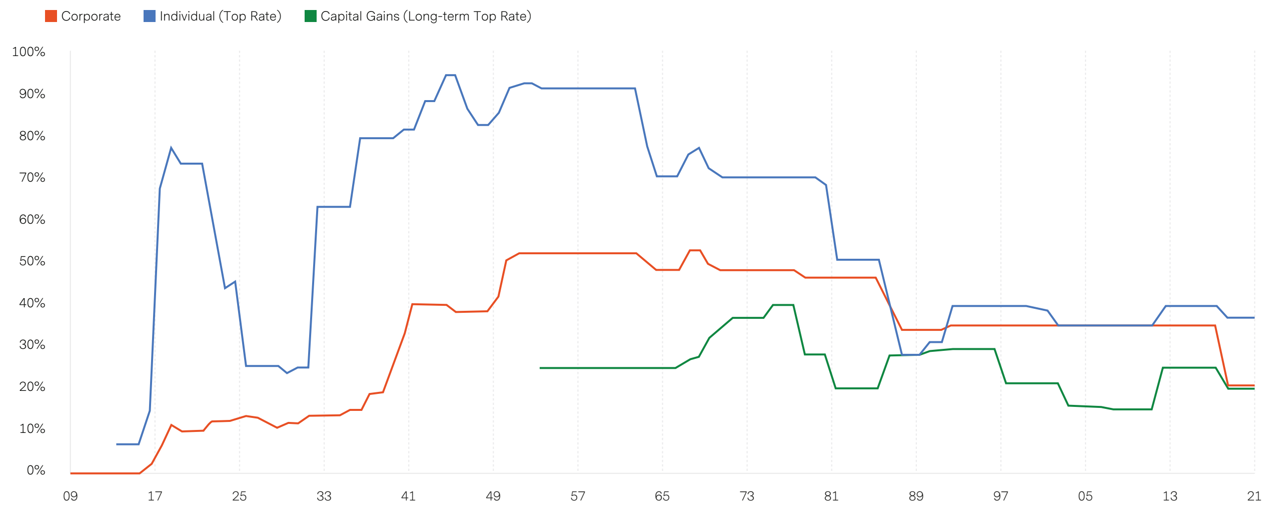
Focus now turns to Biden’s $2.25trn infrastructure package, a massive number. According to the Bureau of Economic Analysis, the current value of government fixed assets considered as infrastructure is about $6trn, so this represents about more than a third of the stock of fixed assets. Concerns are now being raised about inflation risks, given the huge amount of stimulus. Clearly the US has learned from Japan and is fighting tooth and nail to avoid deflation. In the short-term, inflation and US rates will certainly rise, but we maintain that this will be a one- or two-year event.

The biggest challenge facing advanced economies remains the weak rate of productivity growth. This is a result of several factors including:

- quantitative easing.
- low rates of business cost of capital which allows inefficient businesses to survive; and
- the failure of new “social media” digital technologies to feed through into productivity.

Remember that all stimulus is just stealing from the future. Biden is already planning the first major federal tax hike since 1993 to help pay for his long-term economic programme. The tax changes in the infrastructure program will likely include repealing portions of Donald’s 2017 tax law that benefitted corporations and wealthy individuals and making the tax code more progressive by providing relief for middle-class households. Taxes are low by historical standards (chart 2). Biden’s plan sees the corporate tax rate rising from 21% to 28%.

Chart 2: US tax rates are low in historical context
Source: JP Morgan



SA – power preferred bidders announced while load shedding continues

The economy contracted by 7.0% in 2020 from an increase of 0.2% in 2019. While this was better than expected, electricity generation continues to constrain growth. Load shedding continued unabated in March. Aside from Eskom's spiralling debt, fading sales, and ailing power stations, the utility faces another unsustainable predicament. There is a growing trend of serious allegations against executives from staff who have been taken to task for underperformance, with more than 3 686 of Eskom's 44 000 employees facing disciplinary proceedings.

South Africa announced preferred bidders to provide emergency power to prevent load shedding. The eight bidders - Acwa Power Project DA, Karpowership SA Coega/ Saldanha/ Richards Bay, Mulilo Total Coega, Mulilo Total, Hydra Storage, Oya Energy Hybrid Facility and Umoyilanga Energy - will provide a total of 1.8MW from various technologies to be connected to the grid by August 2022. There is some concern as a number of these projects are foreign-owned, expensive, and using dirty power. Turkish-owned Karpowership ships are anchored off our shores and produce power via Liquid Natural Gas while Acwa is a Saudi company. Black ownership for these projects is at 41%, according to Minister of Mineral Resources and Energy Minister, Gwede Mantashe. A pending request for proposals for procurement of an additional 2600MW for private power producers is expected to further boost energy supply. Pension funds will be able to invest in a number of these projects as part of the new Private Public Pension Infrastructure Programme. Draft regulation 28 has several shortcomings, and Sygnia has submitted feedback to National Treasury.

China – new economy growth increases along with regulations

China's economic activity surged in the first two months of the year, exports soared 61% in dollar terms reflecting strong global demand and imports climbed 22.2% highlighting a divergence in the economy as demand for iron ore and crude slowed and imports of high-tech parts accelerated. China's 14th five-year plan has a dedicated section for tech development with the clear objective of self-reliance for the country.
The plan lays out seven technology research areas of focus including artificial intelligence, quantum computing, semi-conductors, and space. Premier Li Keqiang said that China would increase research and development spending by more than 7% a year over the next four years, in pursuit of "major breakthroughs" in technology.

We've seen increased focus on regulation with China's antitrust regulator issuing fines against some of its largest tech giants including Tencent. Alibaba has been asked to dispose of its media assets. Alibaba, China's largest e-commerce operator, is planning to offer its bargains service on rival Tencent Holdings' WeChat platform in a major concession to regulators seeking to crack down on monopolies.

Chart 3: China's 14th five-year plan – major targets
Source: Global Times, Government work report

1. Keep major economic indicators within an appropriate range
2. Above 7% annual growth in research & development spending
3. Keep urban unemployment rate within 5.5%
4. Raise urban residents to 65% of the population
5. Increase life expectancy of Chinese citizens by 1 year
6. Promote green development
7. Promote the high-quality development of the Belt and Road
8. Usher in new stage in building a Peaceful China

In conclusion

While Covid-19 is not quite done with us yet, the pace of events (and recovery) is picking up. Leaders the world over can be seen to be taking swift action to correct the plummets of 2020 by putting recovery plans into motion. From concrete steps locally to address South Africa's energy crisis to Biden's stimulus package and infrastructure plans in the US, to China's ambitious 14th five-year-plan– all point to concerted efforts to ease financial pressures by stimulating growth and pressing forward. How successful each of these initiatives will be remains to be seen (and a sigh of relief is not in order yet), the shoots of a global recovery are already breaking ground.

Key indicators

		1 mo.	*3 mos.*	*6 mos.*	*1 yr.*	*2 yrs.*	*3 yrs.*	*5 yrs.*	*10 yrs.*
J203T	**FTSE/JSE All Share Index**	1.6%	13.1%	24.2%	54.0%	12.1%	9.7%	8.2%	10.9%
J200T	**FTSE/JSE Top 40 Index**	1.3%	13.2%	23.2%	54.0%	13.6%	11.1%	8.9%	10.9%
J210T	**FTSE/JSE Resources 10 Index**	1.3%	18.7%	28.1%	90.4%	24.6%	29.7%	23.1%	5.2%
J211T	**FTSE/JSE Industrials 25 index**	1.6%	12.4%	20.1%	37.0%	14.5%	8.7%	6.2%	15.0%
J212T	**FTSE/JSE Financials 15 Index**	1.1%	2.3%	22.9%	37.1%	-8.7%	-7.0%	-0.6%	8.7%
J403T	**FTSE/JSE SWIX Index**	3.2%	13.3%	24.5%	51.5%	9.5%	6.4%	6.0%	10.6%
J433T	**FTSE/JSE Capped SWIX Index**	3.7%	12.6%	25.5%	54.2%	7.9%	4.3%	4.4%	-
J303T	**FTSE/JSE CAPI Index**	2.0%	12.8%	24.7%	55.6%	11.5%	8.7%	7.5%	10.7%
J253T	**FTSE/JSE SA Listed Property Index**	1.2%	6.4%	30.0%	34.4%	-16.3%	-12.9%	-9.0%	4.4%
ALBI	**JSE All Bond Composite Index**	-2.5%	-1.7%	4.9%	17.0%	6.5%	5.5%	8.7%	8.2%
STeFI	**STeFI Index**	0.3%	0.9%	1.8%	4.5%	5.9%	6.3%	6.8%	6.3%
	MSCI World Index in SA Rands	0.7%	5.5%	5.9%	27.4%	19.2%	21.4%	13.5%	18.8%
	Rand/US Dollar Exchange Rate	-2.5%	0.5%	-11.5%	-17.3%	1.4%	7.6%	0.2%	8.1%
	Rand/Euro Exchange Rate	-5.6%	-3.4%	-11.3%	-11.8%	3.8%	6.0%	0.8%	6.1%
	Headline CPI	0.7%	1.2%	1.6%	2.9%	3.7%	3.9%	4.4%	5.1%
	PPI	0.7%	1.7%	2.5%	4.0%	4.3%	4.4%	4.6%	5.5%