MARKET REVIEW
February 2020

NEDGROUP INVESTMENTS

International overview

SPREADING

After demonstrating a surprising level of resilience, risk assets gave way to fears around the severity and impact of the coronavirus. Several factors are troubling markets. Arguably a moving target, the veracity of the official figures from China have been questioned as a source for confirmed cases. What really moved sentiment, however, was confirmation in late February of infection in Italy and Iran, followed by other countries in the developed world.

Robust first quarter corporate earnings results long forgotten, the S&P 500 declined by -8.2% over the month, setting the tone for other risk assets. The MSCI World Index ended the month down -8.4%, with emerging markets also losing ground as risk appetite diminished. Global measures of volatility have spiked as uncertainty put a dampener on confidence while safe haven assets such as gold and the USD also strengthened. Global bond markets benefitted from the flight to safety, with the Barclays Global Aggregate Index gaining +0.7% over the month.

MARKET PERFORMANCE (USD)

Index total returns in USD (%)	February	YTD	12-m
Dow Jones Industrial 30	-9.8	-10.6	0.4
S&P 500	-8.2	-8.3	8.2
NASDAQ 100	-5.8	-2.9	20.5
FTSE 100	-12.0	-15.4	-6.4
CAC 40	-9.2	-12.8	1.2
DAX 30	-9.1	-11.9	-0.2
NIKKEI 225	-8.6	-10.0	3.9
Hang Seng	-0.8	-7.1	-4.7
MSCI World	-8.4	-8.9	5.2
MSCI Emerging Markets	-5.3	-9.7	-1.5
FTSE/JSE All Share	-13.4	-20.6	-15.7
MSCI SA South Africa	-12.9	-20.6	-17.3

Source: Bloomberg

“TEMPORARILY CONSTRAINED”

In early February, the World Health Organisation announced COVID-19 as the designated name of the new coronavirus disease. By 25 February the organisation reported that the epidemic in China had peaked and plateaued by 2 February and had been declining since. What could have been an inflection point was subverted when it became known that cases outside China were accelerating at a more rapid pace than inside the country. South Korea, Iran and Italy quickly became the major centres for the outbreak. Italy has since placed an average 11 towns under lockdown, cancelling sports events and closing schools. The country also announced meaningful fiscal stimulus to mitigate the immediate impact.
World leaders have offered a largely coordinated response. In early March, the IMF and World Bank formally opened credit lines and emergency facilities to countries facing liquidity pressures due to the outbreak. G7

leaders acknowledged the scale of potential economic impact of COVID -19, confirming that they would use "all appropriate tools" to support the global economy. Stimulus is likely to be two pronged. The Reserve Bank of Australia was the first to take action, cutting interest rates to a new low of 0.5%. Although the January minutes and commentary from the US Federal Reserve reaffirmed their caution to act prematurely, the Fed Governor has since signalled that they would respond to "evolving risks". The market is now predicting* a 50bps interest rate cut by the Fed by their March meeting, with the possibility of more should the economic backdrop worsen. Other central banks may follow suit. In other instances, finance ministers may opt for fiscal stimulus, as was the case in Italy.

Over and above the terrible loss of human life, the effect on demand and supply matters greatly to a global economy that was holding steady at best as the year started. Technology giant Apple issued a revenue warning in their quarterly guidance and confirmed that "worldwide iPhone supply will be temporarily constrained". Although we surmised in our January writing that this outbreak will be a setback for global growth, the shape of any recovery will remain uncertain until we get confirmation of a stabilisation of cases. Until then, we expect activity indicators and estimates to be "temporarily constrained" and volatility to continue as data points confirm the impact of disruption. The evolution of this outbreak is still unknown, but we closely watch for any escalation which would signal evolution from temporary to more persistent weakness.

*At the time of publication, the Fed had already acted with a 50bps interest rate cut.

DOMESTIC OVERVIEW

MARKET PERFORMANCE (ZAR)

Index total returns in ZAR (%)	February	YTD	12-m
All Share	-9.0	-10.5	-5.7
Preference Share Index	-3.9	-4.6	10.6
All Bond	-0.1	1.1	8.9
Inflation Linked Bonds	0.6	0.5	1.8
Cash	0.5	1.1	7.2
Indices			
Top 40	-8.4	-9.8	-4.6
Mid Cap	-12.9	-15.6	-6.8
Small Cap	-13.3	-13.9	-16.7
Resource 10	-11.6	-14.7	-3.8
Industrial 25	-6.5	-4.5	1.0
Financial 15	-8.2	-13.6	-16.6
SA Listed Property	-15.7	-18.3	-19.1
Best Sectors			
Household Goods	48.9	59.7	-34.9
Equity Investment	-0.2	15.4	44.1
Gold Mining	-1.7	-0.3	74.9
Worst Sectors			
Industrial Engineering	-36.5	-44.2	-64.9
Beverages	-22.7	-24.4	-17.4
Construction & Materials	-21.1	-24.6	-30.0

Source: Bloomberg

SHARING THE BURDEN

In the toughest of times, long dated plans can seem like empty promises. The State of the Nation address therefore sought to highlight the areas where implementation (rather than pledges) was underway, including in critical areas such as energy reforms and youth unemployment. It remains painfully clear however how much more still needs to be done. The President drove home principles of accountability and the need for a social compact for change across broader society. In many ways, this was a prelude to the steps to be announced in the February Budget later that month.

Against a difficult backdrop and low expectations, the Finance Minister presented a reasonable Budget that even delivered some positive surprises. Tax payers received marginal relief on personal taxes, in addition to transfer duty adjustments. Arguably the bigger surprise, the 2020 Budget also proposed meaningful reductions to compensation spending (circa R160bn over the medium term), signalling the clearest resolve to date to slim down the public sector wage bill. After a short lived rebound, domestic bond markets gave way to scepticism around the ability to successfully negotiate with unions and comments from credit ratings agency that commended government for taking steps in the right direction, but highlighted budget deficits that still look grim and a fiscal trajectory that fails to consolidate, even with the proposed expenditure cuts. The All Bond Index declined marginally by -0.1% over the month, but still delivered +1.1% year to date.

A combination of poor domestic conditions, downdraft in global risk assets and tax harvesting resulted in a sharp move in domestic equities, leaving the FTSE/JSE All Share down -9.0% in February. Although the pain was felt across the board, smaller capitalisation counters were most exposed, losing -13.3% over the month and culminating in a decline of -16.7% over the last 12 months. Results from the property sector are starting to reflect downgrades to capital values. A lagging indicator to the difficult operating environment that has plagued the sector over the last year, but nonetheless one that the market has taken note of. The sector had a dismal month, losing –15.7% and bringing the performance over the last twelve months to -19.1%.

Prices of assets are reflecting a tough environment. Risks remain and we retain balance in portfolios, while remembering that volatility and crises often go hand in hand with opportunity for long term investors.

ECONOMIC INDICATORS

Economic indicators	Month	Latest	Previous
CPI (y/y)	January	4.5	4.0
PPI (y/y)	January	4.6	3.4
Repo rate	December	6.25	6.5
GDP (q/q, annualised)	2019Q4	-1.4	-0.8
GDP (nsa, y/y)	2019Q4	-0.5	0.1
PSCE (y/y)	January	5.0	6.1
M3 (y/y)	January	7.0	6.2
Net reserves (US$bn)	January	45.1	44.9
Trade balance (Rbn)	January	-1.9	13.9
Current a/c (% GDP)	2019Q3	-3.7	-4.1
Manufacturing production (Y/Y)	December	-5.9	-3.2
ABSA Manufacturing PMI	February	44.3	45.2
Standard Bank South Africa PMI	February	48.4	48.3
SACCI Business Confidence Index	January	92.2	93.1
Retail sales (constant, y/y)	December	-0.4	2.6
Vehicle sales (y/y)	February	-0.7	-8.1

Source: Bloomberg, Refinitiv

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