Market Commentary

March 2020

RisCura

1 Cash

2 Bonds

3 Equity

4 Property

5 International Markets

6 Currencies & Commodities

7 Performance

Here are this month's highlights:

The world economy continues to feel the impact of the COVID-19 outbreak and subsequent spread. The South African Reserve Bank cut its repo rate by 100 basis points. Inflation-linked bonds experienced its worst month on record. Local equity indices experienced its most severe declines since the Global Financial Crisis. Declines in Property effectively halved the value of the SA Property Index in just three months. Globally, there was a large-scale scramble for safe-haven assets and there is a general consensus among major global banks of a global recession in 2020.

1 Cash
2 Bonds
3 Equity
4 Property
5 International Markets
6 Currencies & Commodities
7 Performance

Cash

Cash returned 53 basis points (bps) in March. Consumer inflation ticked up marginally to an annualised 4.6% in February, up from 4.5% the month prior. The latest reading is the highest since November 2018, driven primarily by food and non-alcoholic beverage inflation, which posted its largest annual gain, 4.2%, in two years.

> *The South African Reserve Bank (SARB) voted unanimously to reduce the key lending rate by 100 basis points to 5.25%.*

The SARB is typically conservative in conducting the country's monetary policy; thus, the size of the cut came as a surprise to market-watchers. This decision follows soon after the SARB's downward revision of its inflation and 2020 GDP growth forecasts, now 3.8% and -0.2%, respectively. Given the fluidity of the economic fallout due to COVID-19, it is highly likely that the SARB will revise these forecasts lower in the coming months given the high probability of a global recession this year. The repo-rate is at a record low since 2013.

The SARB announced further policy-easing measures due to extreme market volatility; stating that it will conduct its own version of Quantitative Easing (QE), buying government bonds in the secondary market i.e. from commercial banks and financial institutions. This is being done across the yield curve, both short-dated and long-dated bonds, at the SARB's discretion. The intention here is to provide the banking system with enough liquidity to maintain stability and allow it to weather the economic ramifications of COVID-19.

Note that the SARB is prohibited by the SARB Act to directly purchase government debt from National Treasury as this amounts to direct funding of government; hence its actions only relate to the secondary market.

1 Cash

2 Bonds

3 Equity

4 Property

5 International Markets

6 Currencies & Commodities

7 Performance

Bonds

SA nominal bonds and inflation-linked issues both experienced their worst month on record, falling by -9.7% and -7.0%, respectively – per the All Bond and Composite Inflation-linked Bond indices. Local fixed income assets sold-off in dramatic fashion, in line with other Emerging Market (EM) countries and broader risk-off selling – the JP Morgan EM Bond Index lost -11.1% (USD). Developed Market fixed income assets were spared the brunt of the pain, closing the month -2.2% down Barclays Aggregate Bond Index (USD); investors were likely forced sellers in these markets to raise cash to cover the losses in more risky areas of their portfolios.

> *On Friday 27 March, Moody's downgraded SA's sovereign debt rating to Ba1 from Baa3; it retained its credit outlook as negative.*

SA is now rated as sub-investment grade by all three major US rating agencies. The firm noted that downside risks to economic growth and SA's fiscal position, both in the short-term, due to COVID-19, and the long-term, lack of material progress in terms of social and political reforms, remain hence it retains the negative outlook. What will change this outlook is the occurrence of fiscal consolidation, in line with market expectations. Moody's now expects domestic growth to decline by -2.5% in 2020, followed by a 1.1% rebound in 2021.

SA will now exit the FTSE World Government Bond Index (WGBI), implying \$2-\$3 billion in passive bond outflows from this index. This has not commenced yet as exit was delayed to end April, allowing investors to position themselves accordingly over the next month. The market response to the announcement was fairly muted, given broader global and local market developments.

The rand weakened to R18/\$ by end March, moving from the R17.6/\$ level just prior to the announcement on the evening of 27 March. It is likely that both equity and fixed-income investors were aware of the potential for a downgrade over the past 18 months with the key issues cited continuously by Moody's (worsening fiscal outcomes and outlook, low growth, lack of effective policy responses) broadly recognised and priced into markets by investors.

1 Cash
2 Bonds
3 Equity
4 Property
5 International Markets
6 Currencies & Commodities
7 Performance

Equity

In line with global markets, local equity indices experienced its most severe declines in 12 years since the Global Financial Crisis (GFC). Broad indices, the All Share and Capped Shareholder Weighted Index (SWIC), lost -12.1% and -14.2%, respectively. The pain was unevenly distributed across sub-sectors; Financials were the worst hit, losing -29.3%; bank shares fell in line with global peers as investors expressed concern about how the lack of economic activity would impact these businesses' earnings going forward. Industrial shares went largely unscathed, in relative terms, down -3.1%, in large part thanks to Naspers, a dominant weighting in this sector which benefitted from rand weakness in March, it closed 7.26% higher. Resource shares lost -12.4%; Sasol led the decline, falling -80.1% as it experienced two tail-risk type events, steep decline in oil prices and the economic impacts of COVID-19 simultaneously. Market capitalisation indices took further beatings, following steep declines in February. The Mid and Small Cap indices lost -23.7% and -21.7%, respectively.

> *A national state of disaster was declared by South African President Cyril Ramaphosa on 15 March.*

Travel bans to and from high-risk countries such as Italy, Spain, Iran and South Korea took immediate effect. This was followed by the announcement on 23 March that a national 21-day lockdown would commence at midnight on 26 March. To address the economic knock-on effects of COVID-19, government established a Solidarity Fund with seed capital of R150 million; asking individuals and business, locally and abroad to contribute in support. President Ramaphosa further announced that reserves within the Unemployment Insurance Fund (UIF) would be used to avoid employee retrenchment through direct payments to those affected. And, workers in the private-sector, who earn less than R6500 per month, are to receive a subsidy of R500 for each of the next four months; this is expected to support 4 million people.

1 Cash
2 Bonds
3 Equity
4 Property
5 International Markets
6 Currencies & Commodities
7 Performance

Property

SA listed property experienced another month of pain, the worst in its 13-year track record. The SA Property Index (SAPY) fell -36.3% in March, bringing the year-to-date decline to -48.1%, effectively halving the value of the index in three months.

> *Global property suffered the same fate, albeit with milder declines.*

The FTSE/NAREIT Developed Rental Index fell by -22.8% (USD) in March and is down -28.5% (USD) over the first three months of the year.

1 Cash
2 Bonds
3 Equity
4 Property
5 International Markets
6 Currencies & Commodities
7 Performance

International Markets

The spread of COVID-19 has presented the global economy with two unexpected shocks, a demand-side impact and a supply-side one. The drastic actions taken by governments globally to halt the spread of the virus, partial to full lockdowns and social-distancing measures, has meant a difficult trade-off has and is being made to allay a humanitarian crisis while causing an economic one. Both business and consumer spending has slowed dramatically, a demand-side impact on the global economy; while non-essential businesses across value-chains, mining to retailers, have shuttered their doors – a supply-side impact on global growth. The combination of both impacts on the global economy, to this degree, is unprecedented. Hence, it's very difficult to assess what this will mean for global GDP growth over the coming months and longer-term.

This uncertainty comes glaringly to the fore in financial markets.

The Volatility Index (VIX), a widely-watched barometer of market distress, posted its highest daily close – 16 March – in the index's 30+ year history. Another measure such as Goldman Sachs Financial Conditions Index spiked to its highest level since the GFC. US recession probability indicators rose dramatically in congruence with the above metrics. Broad consensus by major global banks, international finance organisations the International Monetary Fund indicates that at minimum, the world economy will contract in the first half of 2020 for the above reasons.

The oil price nose-dived on 9 March; Brent Crude oil fell from $45 to $31 per barrel, following a collapse in negotiations over production cuts between Saudi-Arabia and Russia at the most recent OPEC+ meeting that took place on 7 March. Saudi Arabia announced it would increase its daily output by 1 million barrels and offer key trading partners large price discounts. Oil prices, prior to this development, was already in decline as investors accounted for the fall in demand for oil off-the-back of a COVID-19 economic impacts. The surprise action by Saudi Arabia hit global equity markets hard on 9 March, compounding investor fears of a highly uncertain economic outlook. European and US equities indices closed lower by between 8% and 12% on the day.

In response to these three economic shocks, demand and supply-side impacts of COVID-19 and an oil price war, both central banks and governments world-wide have taken unprecedented steps to address this crisis.

Over the month, the US Federal Reserve (Fed) cut interest rates by a cumulative 150 bps, reducing the rate range to 0% to 0.25%. It recommenced Quantitative Easing (QE), direct purchase of US Treasures and Mortgage-backed Securities in bond markets. This, while providing guarantees to back-stop cash-equivalent markets in attempts to stabilise the frantic rush by corporates to shore-up cash to fund operational needs, wages, rent etc. All these emergency actions have amounted to an addition of $1.6 trillion to the Fed's balance sheet in March alone; for context, the Fed added $1.1 trillion over an 18-month period during the GFC. More broadly, the European Central Bank (ECB) launched a $820 billion support programme, purchases of government and corporate debt across the region, as a response measure; while the Bank of England (BOE) reduced rates by 15 bps to 0.1% and commenced a £230 billion programme. Emergency monetary policy measures were announced across most major economies including China, Canada and Australia aimed at alleviating the economic impact of COVID-19.

1 Cash
2 Bonds
3 Equity
4 Property
5 International Markets
6 Currencies & Commodities
7 Performance

The government response, fiscal policy, was similarly spectacular.

As of end March, a total of $5 trillion is to be added to the global economy on an immediate to short-term basis. Global GDP is $86 trillion, meaning these fiscal emergency measures equates to 6% of the world economy. This stimulus comes in the form of tax breaks, short-term loan funding for small-to-medium business and direct payments to individuals. The details of the numerous emergency packages vary by country, but all ultimately aim to off-set the negative economic impacts of measures to fight the spread of the virus.

Global financial markets sold off violently, given all the above. US equity markets were temporarily halted, 15 minutes, on at least three occasions over the month as market circuit-breakers were triggered by extreme selling.

The US 10-year government bond, traded in a yield range of 1%, reaching an all-time, intra-day low of 0.34% as investors sought a safe harbour from the alarming price declines occurring in equity markets. The market for the 10-year bond is one of the largest of all financial markets globally, a yield range of 1% in a single month is an extreme and rare occurrence. The large-scale scramble for safe-haven assets: US 10-year bond, the US Dollar, Japanese Yen and Swiss Franc most significantly, meant a massive risk-off wave hit risk assets over March. Developed and Emerging Market (EM) equities saw 25% to 40% declines, global investment grade and high-yield as well as EM sovereign credit market spreads blew out to 12-year highs; no risk asset market was spared from the carnage.

1 Cash

2 Bonds

3 Equity

4 Property

5 International Markets

6 Currencies & Commodities

7 Performance

Currencies and Commodities

The consensus amongst major global banks is an expected global recession in 2020. Commodities are pro-cyclical, meaning demand for these inputs are positively correlated with economic growth. No surprise then that all commodities types, hard – industrial metals – and soft – coffee – sold-off significantly in March. The Goldman Sachs Commodities Index (GSCI) closed -29.4% lower (USD). Leading this decline was oil, which due to the twin impacts of an economic slowdown and a surprise price dispute between two key producers – described above – meant that this vital input into the global economy lost -55.0% in one month.

EM currencies, across the board, weakened against the US Dollar due to the risk-off environment.

> *The rand was not the worst performer, although its one-month depreciation of 12.1% was its largest move since mid-2013.*

The Mexico Peso, Russian Ruble and Brazilian Real all experienced more severe depreciations against the US Dollar; 17.0%, 14.7% and 14.1%, respectively. The Japanese Yen and Swiss Franc, meanwhile, acted as safe-havens, appreciating marginally against the US Dollar; up 0.4% and 0.3%, respectively.

1 Cash

2 Bonds

3 Equity

4 Property

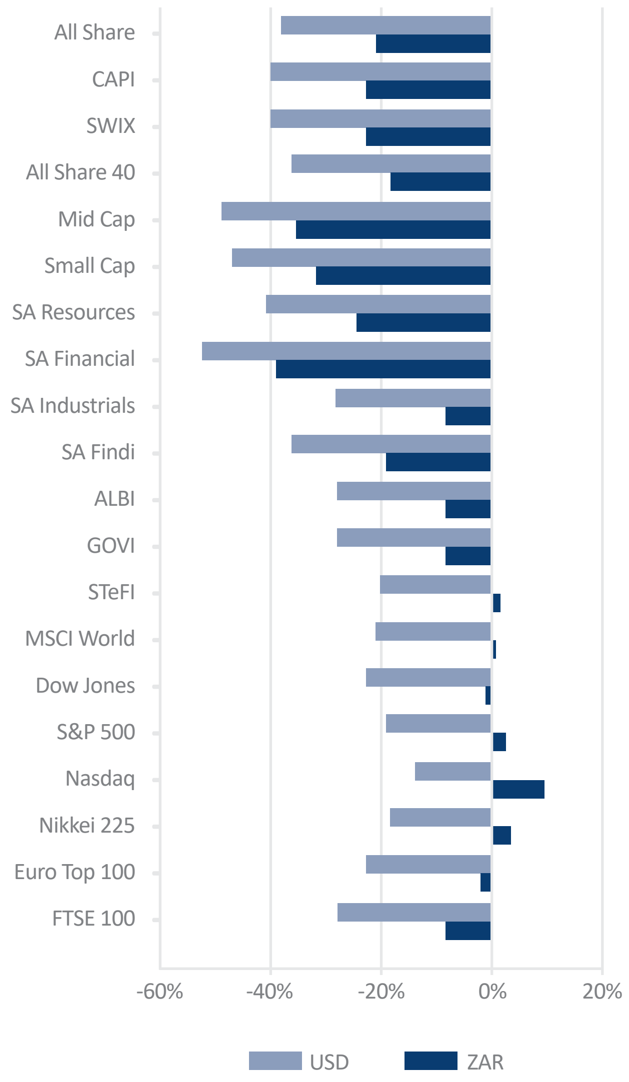
5 International Markets

6 Currencies & Commodities

7 Performance

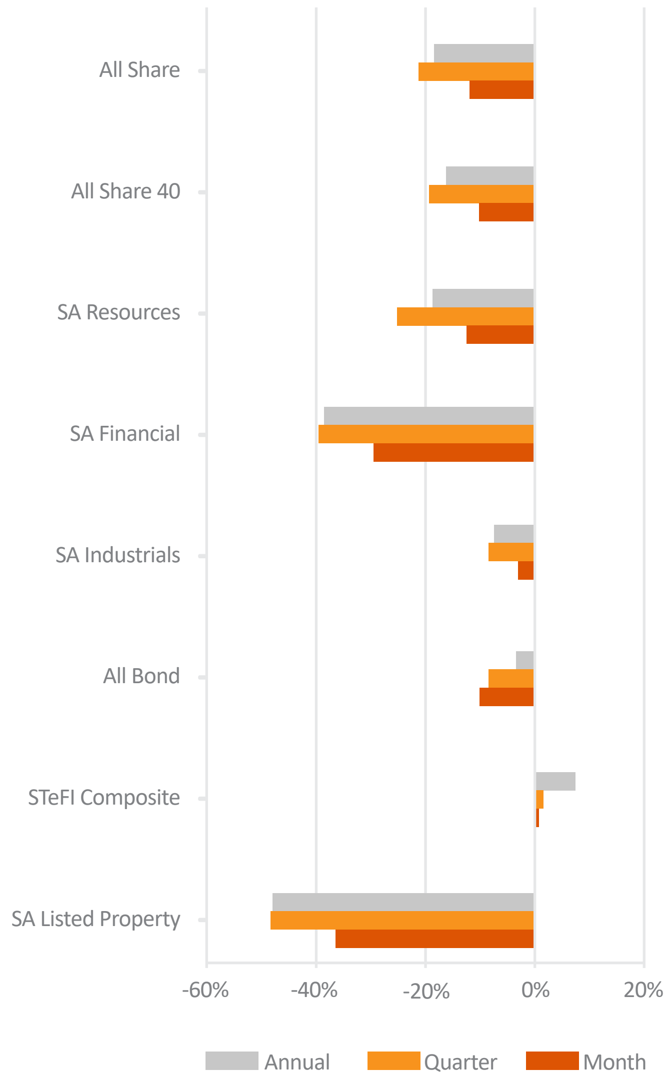
World Market Indices Performance

Monthly return of major indices



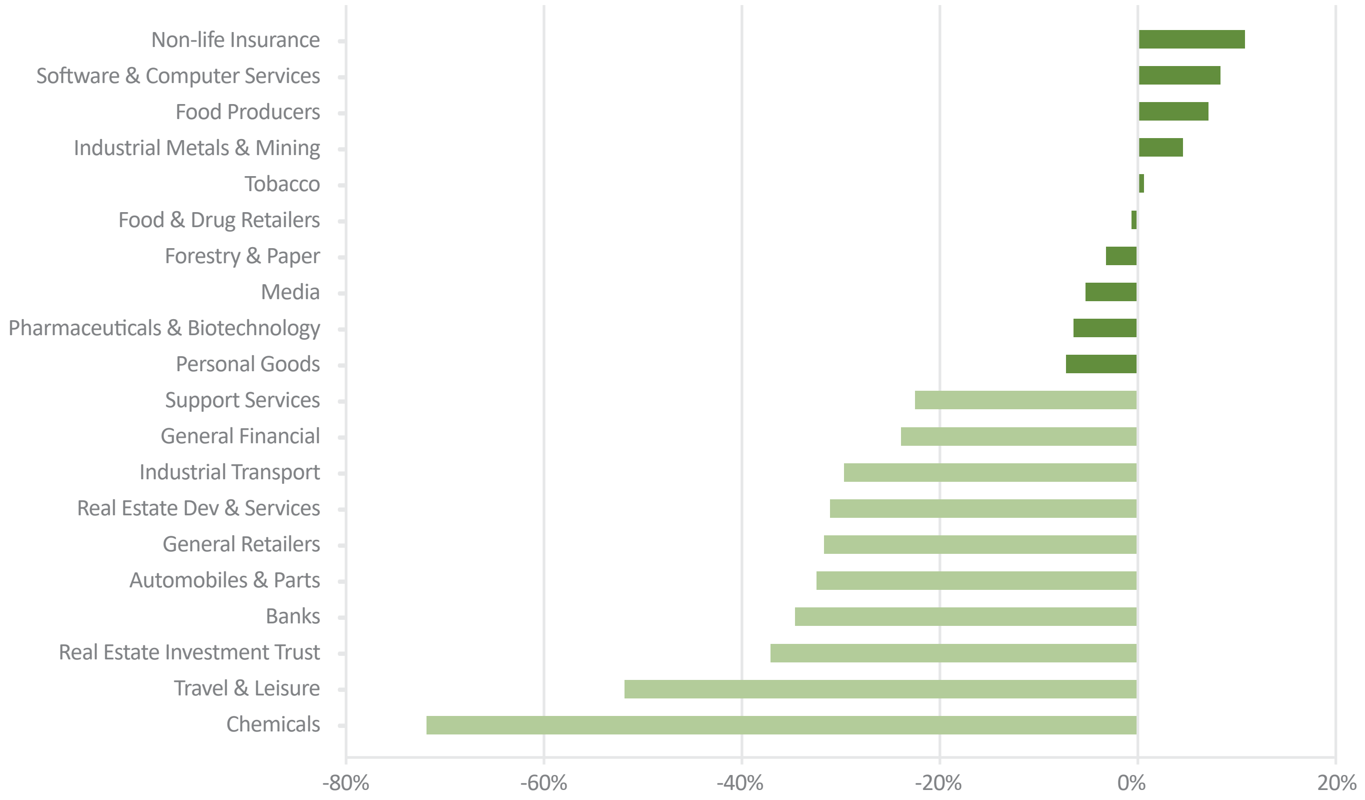
Local Market Indices Performance

Returns of the FTSE/JSE sectors and indices



1 Cash
2 Bonds
3 Equity
4 Property
5 International Markets
6 Currencies & Commodities
7 Performance

Monthly Industry Performance



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