Sanlam

Investments

# INVESTMENT STRATEGY

**Q4 | 2020**

## THE ECONOMY

- Joe Biden is voted in as president-elect of the US.
- The Pfizer and BioNTech Covid-19 vaccines prove to be more than 90% effective.
- Janet Yellen is selected as the next Treasury secretary of the US.
- Britain and the EU finally come to an agreement on trade in a post-Brexit world.
- Global food prices jump by 8% between May and Oct 2020.
- Minister Mboweni projects a consolidated budget deficit of 15.7% of GDP in 2020/21.
- IHS Markit's PMI index rises to 51.0 in October, indicating a slight expansion.
- SA GDP increases by an annualised rate of 66.1% in the third quarter (Q3).
- SA's new orders index drop to 45.0 from 60.4, suggesting a near-term recovery is not imminent.
- SA retail sales fall 1.8% year-on-year in October.
- Restaurant income is more than 50% lower than a year ago; tourism occupancy stands at only 23%.
- Compared to 2.1 million jobs lost in SA in Q2, 543 000 were added in Q3.
- The SA current account records a surplus of 5.9% of GDP in Q3.
- Fair value for the rand is estimated to be around R14.00 per US dollar.

## EQUITIES

- China halts the listing of Ant Group and calls Jack Ma in for supervisory interviews.
- Amazon faces an antitrust complaint from EU regulators.
- US federal and state antitrust enforcers file suit against Facebook.
- Cathay Pacific announces that it will cut more than 5 000 jobs.
- Pick n Pay reports a 56.3% drop in first-half profit.
- Clicks reports a 13.7% increase in annual earnings.
- Vodacom's headline earnings per share rise by 15.7%.
- The MSCI Emerging Markets Index is up 19.8%; the MSCI World Index is up 14.1% in Q4.
- The FTSE/JSE Capped SWIX) is up 11.5%; financials perform best, up 19.5% for Q4.
- Platinum miners' 29.1% stellar performance is offset by weakness in gold shares (-24.8%).
- Using consensus one-year forward earnings estimates, a 50% SWIX/50% Capped SWIX benchmark is trading at a forward PE of about 12.5.
- The MSCI SA Index's forward PE is at a 30% discount to the forward PE of the MSCI EM Index – the lowest since 2000.

## FIXED INCOME

- The US Congress approves an $892bn relief package.
- The ECB increases the pandemic emergency purchase programme by €500bn to €1 850bn.
- US Treasury increases security holdings by at least $80bn per month.
- The Bank of Japan intends purchasing government bonds to keep 10-year JGB yields around 0%.
- Fitch and Moody's downgrade SA sovereign debt deeper into junk.
- The SARB's MPC indicates no further repo rate cuts in the near term, and two increases in H2 2021.
- The SA money market yield curve steepens significantly during the quarter.
- The US 10-year bond yield rises to end the quarter at 0.92%.
- Ten-year bond yields in Germany, Japan and England end the quarter lower at -0.57%, 0.02% and 0.20% respectively.
- For the year, outflows from SA bonds totalled some R40bn.
- The ALBI delivers 6.71% in Q4 compared to 5.47% for the IGOV index and 0.97% for the STeFI.
- • The 12+ sector of the ALBI is the best performer with a 8.73% return in Q4.

# Market view of the **SIM Balanced Fund**

How did global equity markets react to the second wave of the pandemic? It rallied by yet another 14% over the quarter (as measured by the MSCI Global Equity index in US$). This would have been a great **annual** return for equities for any normal (full) year, but to have that as a **quarterly** return – and that off a record high base during very uncertain and risky circumstances – is nothing short of astounding. Global equity markets seem squarely focussed on the recovery angle associated with the introduction of vaccines and the possibility of continued stimulus and have thus far shrugged off any risks associated with renewed flare-ups of the pandemic.

With equity markets this buoyant our real asset exposure was never going to keep up with the broader market performance. Our high quality fund also experienced a quarter of underperformance relative to global equity markets. This was to a large extent offset by our emerging market exposure, which strongly outperformed the MSCI World index during the quarter.

The global property exposure that we started adding during the previous quarter could also could not keep up with the rapidly rising equity markets, but still strongly outperformed global bonds and thereby validated its inclusion relative to fixed interest assets.

In the local market all asset classes offered positive returns. Nominal bonds and inflation-linked bonds (ILBs) returned 6.7% and 5.5% respectively, which handsomely outperformed the diminishing returns available from cash, validating our preference for these asset classes. But these came nowhere close to the near 10% from local equities or more than 20% from local listed property.

We thought it prudent after the extraordinary rapid market recovery to position our portfolios more defensively, given the additional Covid-19-related risk that we believed still existed. This resulted in a drag on performance when markets rallied much more strongly than what we deemed warranted, given the circumstances. And even though we added back some growth exposure to our portfolios, both locally and offshore, through a combination of direct investments and reductions in protective structures, the remaining protective structures and the reduced exposure relative to what we'll on average hold in the longer term, continued to cause a lag, given the rapid increases yet again experienced in growth asset markets.

Many of the protective structures that incurred opportunity cost and resulted in lower than market returns, especially on the foreign portion of our portfolios, have either been unwound or are nearing their expiry dates. And where possible, we have replaced the foreign protective structures with ones without caps to performance, utilising the increased portion of portable alpha in our foreign construct to fund any related premiums. So, the performance drag should reduce into the future. But if the markets remain as buoyant as they have recently been, we might still incur a bit of opportunity cost through the first part of 2021. That said, despite the very positive recent developments regarding vaccines and hopefully a return to something closer to normality in the next couple of months or quarters, this will be accompanied by the reality that stimulus should eventually come to an end and the real permanent impact (damage) of the pandemic on economic activity and on company earnings will slowly be revealed. This continues to hold the risk of disappointment and markets could at some stage encounter a period of negative sentiment or a reality shock, especially given their record high base. We therefore continue to deem it prudent to retain some protection in our portfolios through this very uncertain set of circumstances.