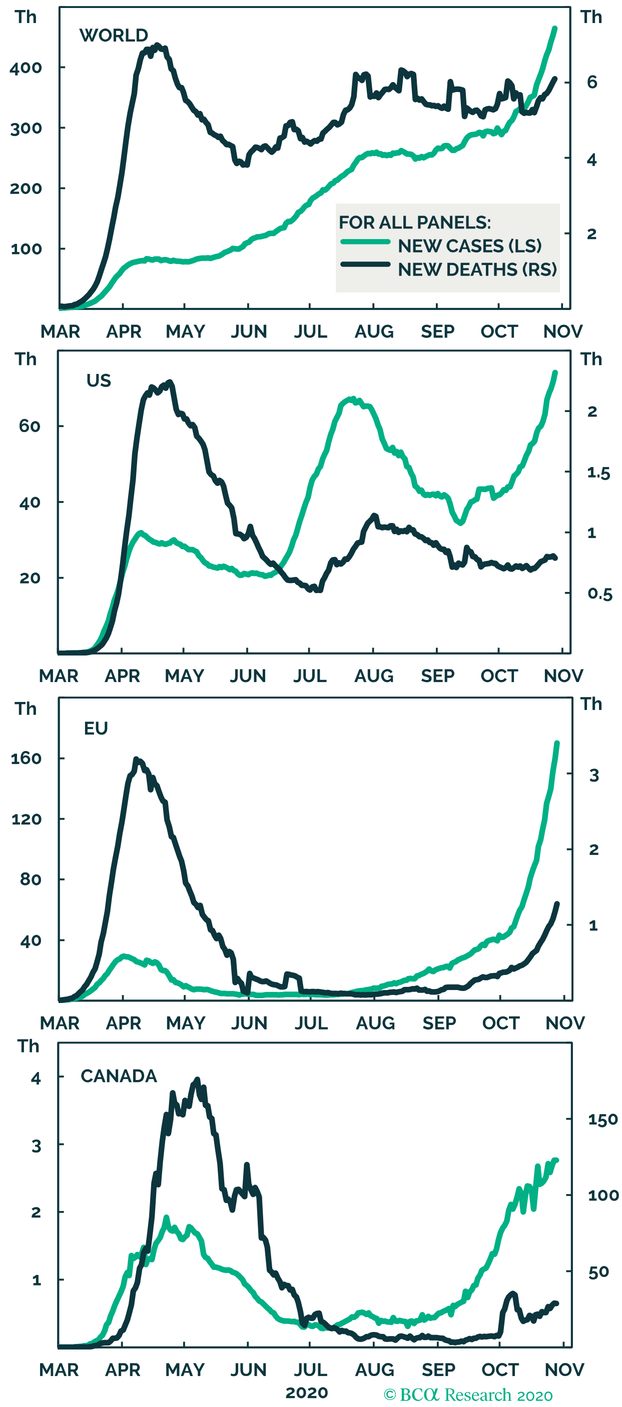
Market Synopsis – October 2020

In last month's Market Synopsis, we mentioned that the global economy is at a complex juncture, buffeted between factors that will either propel its recovery or sink it. We discussed to two key headwinds: Fiscal stimulus hiccups in the US and the evolution of the COVID-19 pandemic. Both of these have gained momentum over the last month and thus market participants have become increasingly concerned about the viability of the so-called reflation trade: Risk assets have rallied over the last three months on hopes that the worst of the pandemic was over and that fiscal stimulus would continue to prop up employment and spending.

The number of coronavirus cases continues to rise worldwide. In both Europe and the US, the daily tally of confirmed new cases exceeds its March peak. The only saving grace is that the number of deaths has not risen by as much as experienced in the past – see Figure 1. Governments are reacting to the rising case counts by tightening social distancing rules. In Germany and France comprehensive lockdown measures have been announced. The Italian government recently announced that bars and restaurants must close by 6 pm. The UK government is reported to be preparing a slate of new restrictions. While the most recent lockdowns in Europe are not as severe as those introduced earlier this year, they will still weigh on growth over the coming months.

There has been less movement toward shuttering the US economy in response to what is now the third wave of the pandemic. This may be partly because the latest cases have been localised and concentrated mainly in the central North of the country. So far at least, the heavily populated South and coastal states have been spared the brunt of this third wave. If more states, however, start seeing rising case counts, stricter restrictions could be introduced across most of the country creating a drag on economic activity.

While governments have understandably tightened restrictions to control the latest surge in COVID cases, they are unlikely to fully revert to the extreme measures taken in March. Back then, there was considerable uncertainty over how fatal the virus was, with estimates for the mortality rate ranging from 0.5% to over 5%. The latest research suggest that the true number is near the bottom of that range, and perhaps even below it. In addition, progress continues to be made on a vaccine.



NOTE: ALL SERIES DISPLAYED AS A 7-DAY MOVING AVERAGE.
SOURCE: THE CENTER FOR SYSTEMS SCIENCE AND ENGINEERING (CSSE) AT JOHN HOPKINS UNIVERSITY.

Figure 1 – Another COVID-19 wave building

Meanwhile in Washington, both Republican and Democrat leaders conceded that there will be no stimulus plans announced around the election. With US election happening today, both opinion polls and betting markets suggest that Joe Biden ("Biden") will become the next president while the Democrats will regain control of the Senate – see Figure 2. That said, this is not the only possible outcome: BCA Research Geopolitical Strategy's forecasting models suggest that the race for control of the Senate will be much closer than the Biden vs Donald Trump ("Trump") battle. There is little chance that control of the House of Representatives would switch back to the Republicans. Four scenarios, each with their specific economic and financial market impact, are thus possible (estimated probability shown in brackets):

1. **Biden wins in a Democratic or Blue Sweep (Estimated probability = 27%)**

The US economy will benefit from higher odds of unfettered fiscal stimulus in 2021, although financial markets will simultaneously have to adjust for the negative shock to US corporate earnings from higher taxes and regulation. Government bond yields should rise on the generally reflationary agenda.

2. **Trump wins with a Republican Senate (Estimated probability = 23%)**

In this status quo scenario, a re-elected President Trump would still face opposition from House Democrats on most domestic economic issues, forcing him to tilt towards more protectionist foreign and trade policies in his second term. Fiscal stimulus would be easy to agree, though not as large as under a Democratic sweep. US Treasury yields would rise but would later prove volatile due to the risk to the cyclical recovery from a global trade war, as Trump's tariffs will not be limited to China and could even affect the European Union.

3. **Biden wins with the Senate staying Republican (Estimated probability = 28%)**

This is ultimately the most positive outcome for financial markets – reduced odds of a full-blown trade war with China, combined with no new tax hikes. Bond yields would drift upward over time, but not during the occasional fiscal battles that would ensue between the Democratic president and Republican senators. The first such battle would start soon after the elections. Treasuries would remain well bid until financial market pressures forced a Senate compromise with the new president sometime in the first half of 2021.

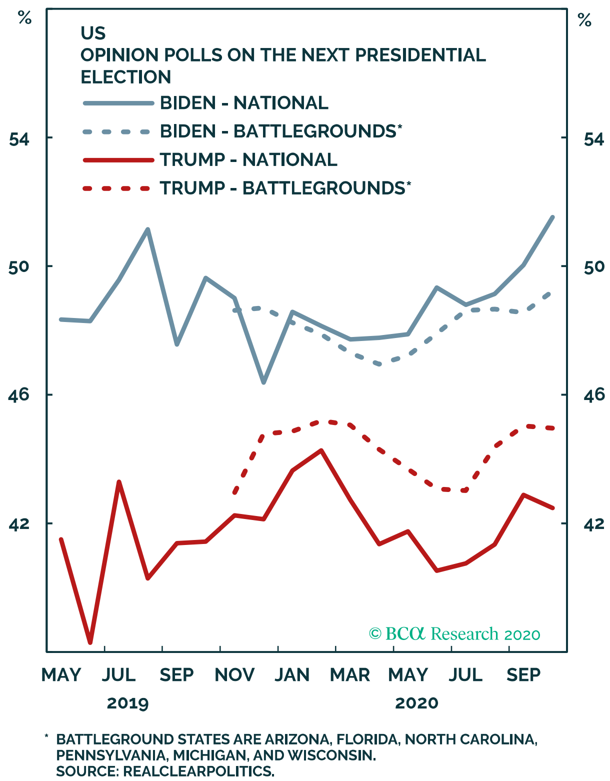


Figure 2a – Opinion polls favour Biden

4. **Trump wins with a Democratic Senate (Estimated probability = 22%)**

This is the least likely scenario but one that could produce a big positive fiscal impulse. Trump is a big spender and will veto tax hikes but will approve populist spending on areas where he agrees. The Democratic Senate would not resist Trump's tough stance on China, however, thus keeping the risk of US-China trade skirmishes elevated. This is neutral-to-bearish for US Treasuries, depending on the size of any bipartisan stimulus measures and Trump's trade actions.

In short thus, a 55% estimated probability of Biden becoming the next US president with almost a toss-up for control of the Senate. With such a close call either way (Presidency and Senate control) elevated risk asset volatility will remain, especially if Trump does not want to go without a fight.

The combination of a vaccine and further fiscal support against a backdrop of ultra-easy monetary policy should provide a decent tailwind for global risk assets over the medium term. While the near-term picture however

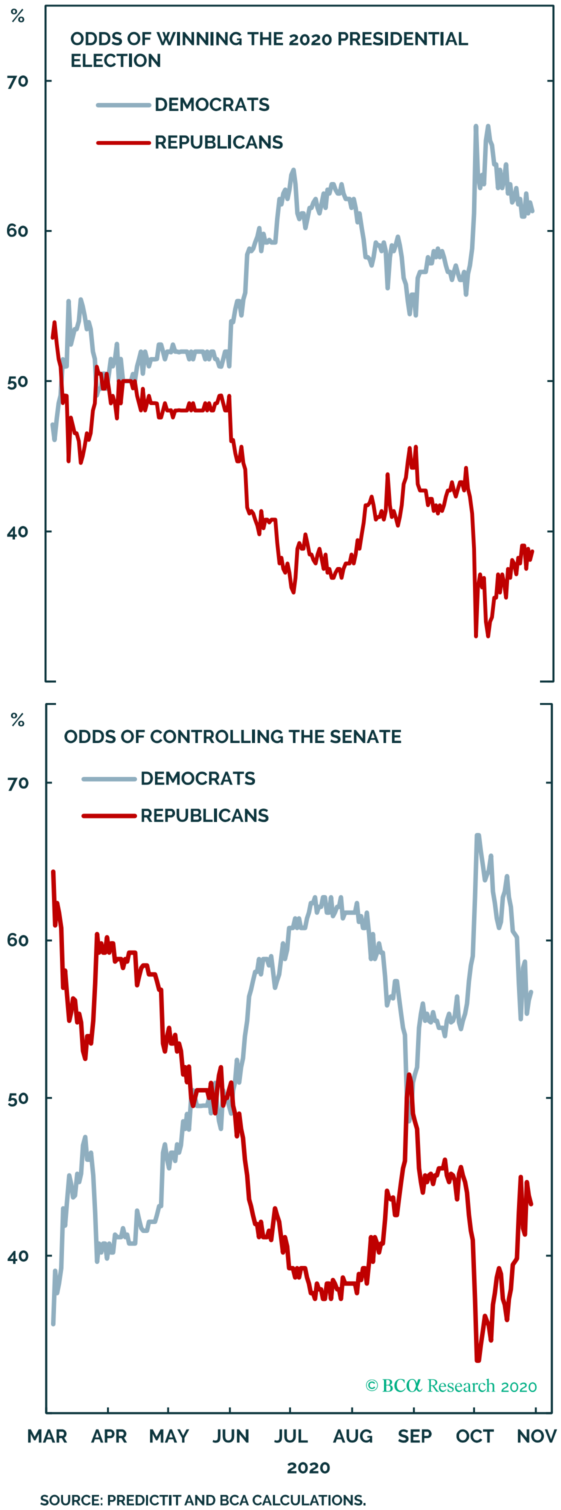


Figure 2b – Betting markets seeing a Blue Sweep

remains murky, we maintain elevated cash holdings as dry powder.

As a countercyclical currency, the USD is poised to continue weakening next year. Typically, non-US equities outperform when global growth is strengthening, and the USD is weakening. Value equities also tend to do better in such macro environments – see Figures 3 and 4. In addition, Once the latest wave of the pandemic crests, as it inevitably will, market participants will look to shift their equity portfolios from equities that benefited from the lockdowns (i.e. growth equities) towards those that will benefit from economies reopening (i.e. value equities).

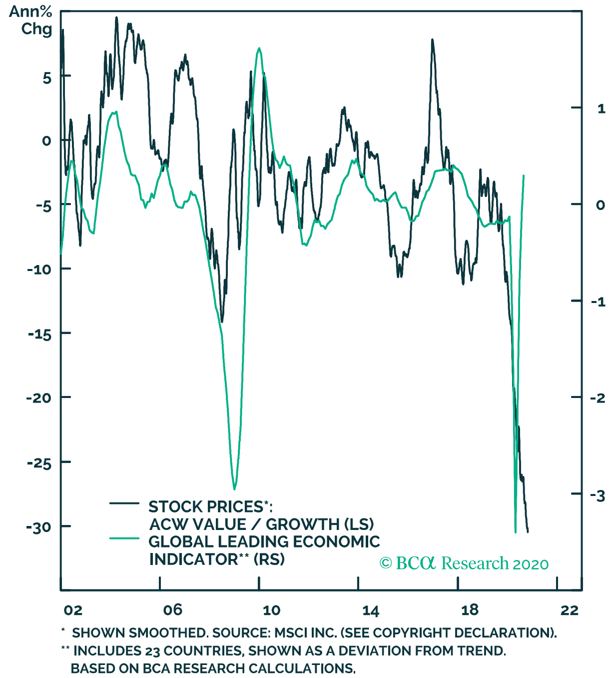


Figure 3 – Value equities enjoy strong growth...

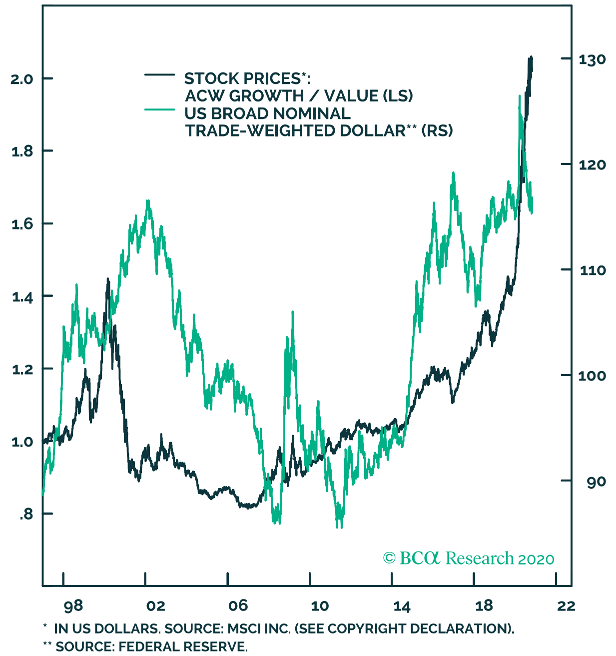


Figure 4 – ...and a weakening USD

For more information on this Market Synopsis or to discuss solutions provided by Integrity Asset Management, please contact us at:

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Indicator	Spot	MTD	YTD	Y-o-Y
Gold	1 878.81	-0.4%	23.8%	23.6%
Brent Crude	37.46	-8.5%	-43.2%	-38.0%
USDZAR	16.2439	-2.7%	16.2%	6.9%
EURZAR	18.9211	-3.3%	20.6%	13.4%
GBPZAR	21.0434	-2.4%	13.5%	13.9%
JSE All Share TRI	8 044.39	-4.7%	-7.1%	-2.6%
JSE Resources TRI	3 358.41	-11.4%	-0.5%	12.4%
JSE Industrials TRI	14 793.30	0.4%	7.3%	6.3%
JSE Financials TRI	5 902.91	-6.1%	-37.2%	-33.3%
JSE Listed Property TRI	920.72	-8.5%	-50.9%	-50.5%
S&P 500	3 269.96	-2.8%	1.2%	11.7%
Euro STOXX 50	6 402.86	-7.3%	-19.5%	-11.7%
FTSE 100	5 305.32	-4.7%	-24.0%	-19.6%
Nikkei 225	37 921.07	-0.9%	-1.1%	14.0%
Hang Seng	71 997.75	2.8%	-11.8%	-2.7%

Source: Bloomberg, as at 30 October 2020