Market Synopsis – November 2020

November proved to be a record-breaking month for markets – the MSCI All-Country World Index rallied more than 12% in USD terms! This as the US presidential election, although an embarrassing spectacle, resulted in Joe Biden being elected as the 46th US president. The last week of November also gifted encouraging news regarding the Covid-19 pandemic. The number of reported daily cases continues to decline in Europe, and the 7-day average has now fallen by 30% from its November 8th peak – see Figure 1 below. In the US, there are weak signs that the number of new cases is flattening out, particularly in the hard-hit Midwest.

Nevertheless, it is too early to relax, especially considering that Covid-19, as with other coronaviruses, spreads more easily in colder weather. Additionally, last weeks' US festivities with Thanksgiving as well as the rest of the holiday season approaching should provide greater opportunities for the virus to spread.

Despite the peak in new cases in Europe, the absolute number of confirmed daily infections remains high. The 7-day average confirmed daily infections currently stands at roughly 175 000 in the US. Adjusting for the three-weak lag between new cases and deaths, the case-fatality rate is approximately 1.8%. The Centre for Disease Control and Prevention ("CDC") in the US estimates that the "true" fatality rate of Covid-19 is closer to 0.7%. This infers that for every individual who tests positive for Covid-19, 1.5 people go undetected. Therefore, around 450,000 Americans are catching the virus every day which translate to 3.2 million people per week or roughly 1% of the entire US population. Other estimates from the CDC suggest that the actual number could be as high as 11 million people infected per week. If the number of new infections continues to remain at such elevated levels, the US will almost certainly be forced to follow Europe with more stringent lockdown measures in order to lessen the spread – see Figure 2 on the following page.

The availability of vaccines should curb the spread of the virus and pave the way for stronger growth in the medium -to-long term. However, we expect a dampening of economic activity over the near-term as more people avoid being infected before the vaccine is available.

A key question is whether inflation will make a return with the introduction of the vaccine and improvement in global economic activity. Significant price declines were experienced in a number of areas most impacted by the pandemic, namely; air transport, accommodation, apparel and gasoline. While the pandemic caused

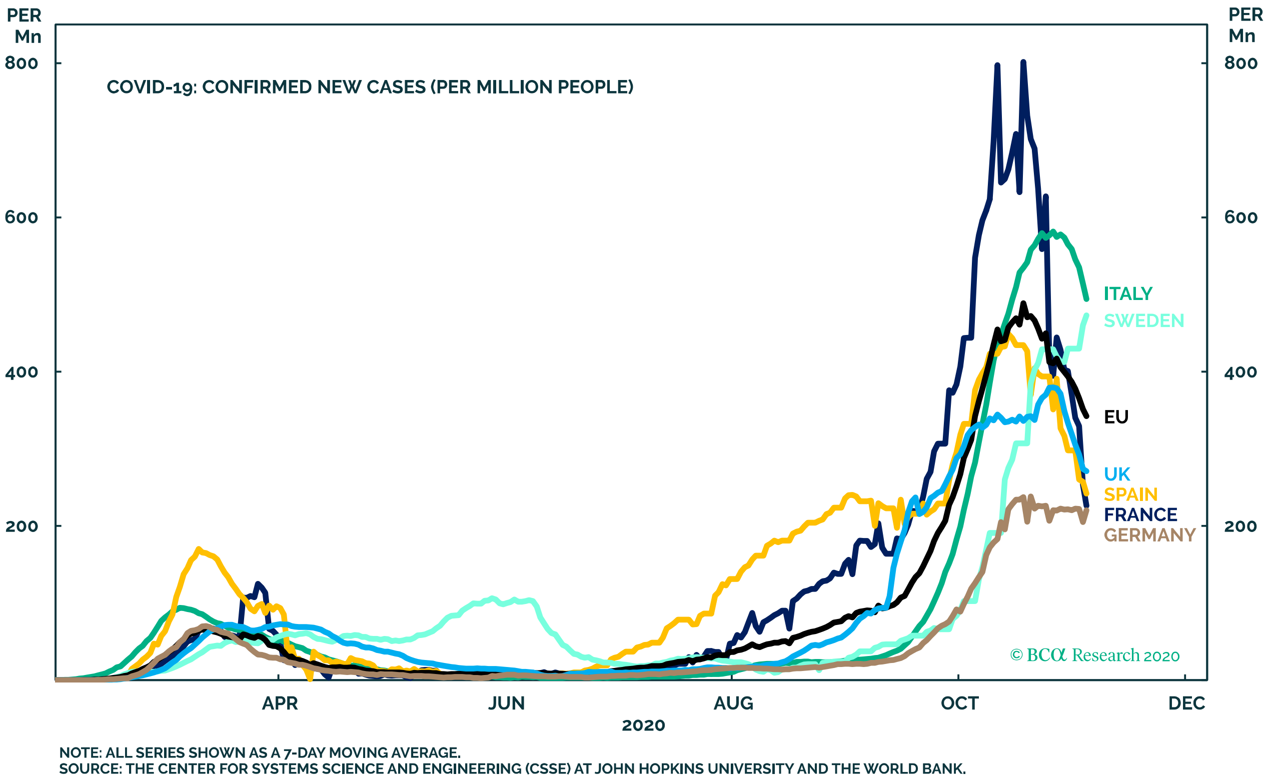


Figure 1 – Peak in Europe daily infections reported

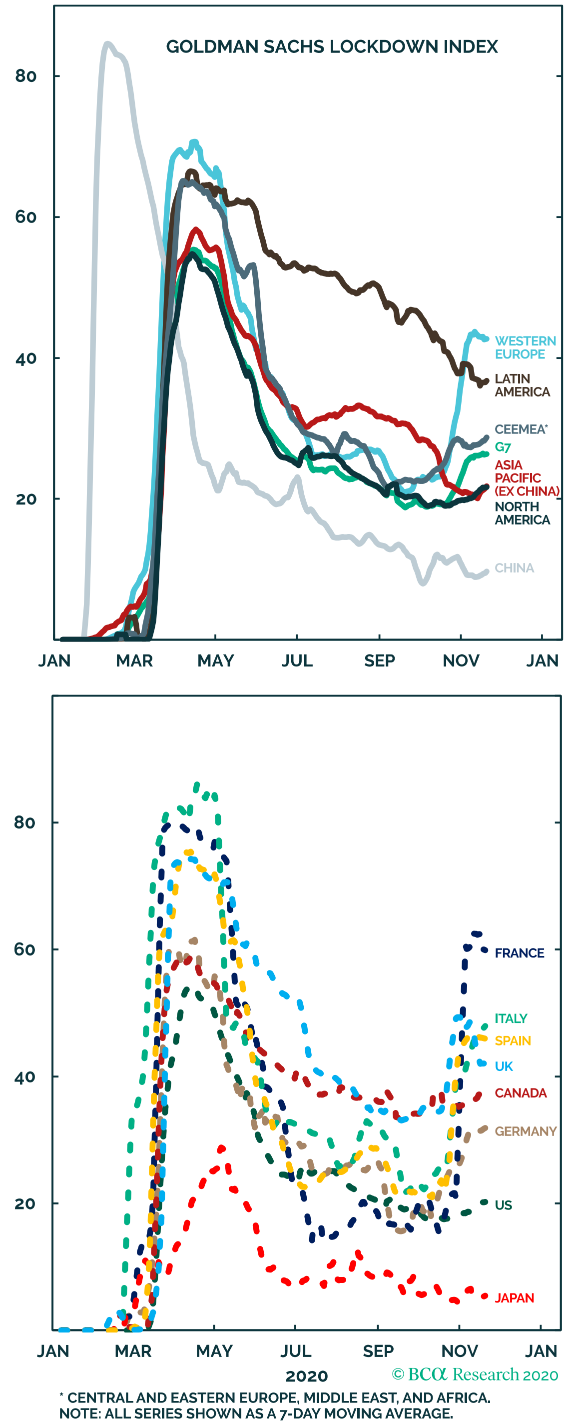


Figure 2 – US may need to follow Europe with stricter lockdown

certain products such as certain toiletries, eggs, meat and used cars to rise in price, the net effect was a significant decline in overall inflation.

Inflation is expected to increase over the next six months with the recovery in prices of the most impacted sectors. Ignoring the temporary oscillations in inflation due to the current low base, a more sustained increase in inflation would require the slack in the labour market to be absorbed to pre-Covid-19 levels. The IMF, in its October 2020 World Economic Outlook, projected that it will take until roughly 2025 before the major economies operate at full employment once again. The introduction of a vaccine should materially improve the conditions of the labour markets; however, it is unlikely that the economy will overheat in the next three years based on current unemployment levels. Low long-term bond yields echo this expectation.

The state of inflation over the past few decades and the current mechanics of the global economy raises the argument whether inflation is dead or just dormant. We believe the latter applies. Two key effects in the tech sector contributed to subdued inflation historically. However, going forward these effects could fuel to a reappearance of inflation:

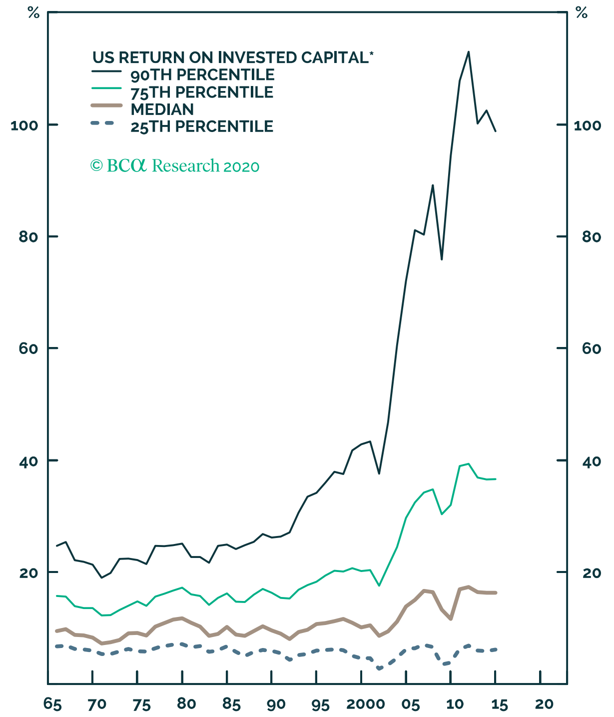
1. Technological innovation has been regularly referred to as a driver of falling inflation. From numerous points of view, this is fairly peculiar as economic theory states that faster innovation should lead to higher real income but it does not indicate that this is due to lower inflation. However, the higher potential GDP growth caused by innovation could fuel inflation through the rise of neutral interest rates which will lead to monetary policy becoming more stimulative for any given policy rate.
2. Focusing on the change to dominance of a few participants in the US, a recent study by Grullon, Larkin, and Michaely found that 75% of all US industries have increased in market concentration since 1997. Furman and Orszag have shown that since the start of the 1990s, the dispersion in the rate of return on capital across firms has widened sharply. In the last year of their analysis, firms at the 90th percentile of profitability had a rate of return on capital that was five times that of the median firm, a massive increase from the historic average of two times – see Figure 3 on the following page. Both these observation points to monopolistic characteristics. Historically, monopolists tend to experience an initial rapid growth phase in which they capture a greater portion of the market by leveraging its market power. However, this is followed by a mature phase where they effectively operate as utilities by generating stable cash flows to shareholders with plateaued future growth. It is

impossible to say how far along the cycle current market leaders in the tech sector are today; however, it does appear that the period of rapid growth for a number of them is beginning to come to an end. Currently, roughly 75% of US households have an Amazon Prime account with slightly over half having a Netflix account. 70% of US citizens have a Facebook account and Google controls 92% of the internet search market. Once this transition commences, the decline in monopolistic power generates inflationary pressure.

As the global economy heats up, labour market slack is absorbed and above-mentioned tech sector influences play out, inflation should start roaring back.

Interestingly, tech sector participants had the greatest dispersion in performance. Based on BCA Research's proprietary Equity Analyzer, tech companies in the bottom quartile for growth, measured by a number of valuation metrics, have not only lagged other tech companies but have also lagged similarly valued financial companies – see Figure 4 below. This emphasises the point that the outperformance of growth shares to value shares over the last year has not been solely attributable to technology, but rather that certain tech companies are doing significantly better than other tech companies.

The divergence in performance within the tech sector can primarily be explained by the following two factors:
Firstly, tech companies are inherently susceptible to network effects. The greater the number of participants on a tech platform, the more attractive it is for other to use it.

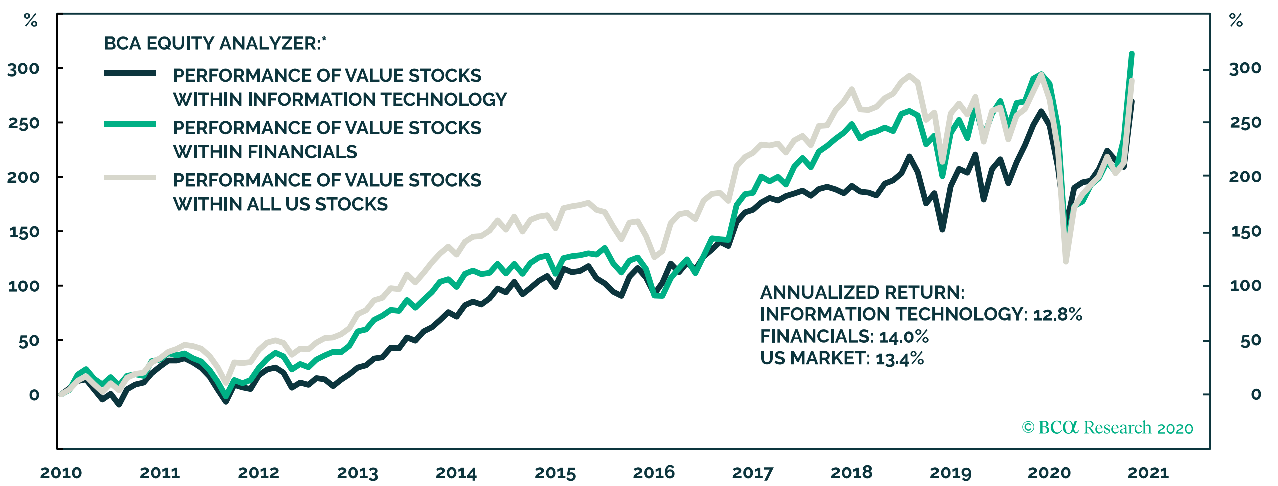


* EXCLUDING GOODWILL, PUBLICLY TRADED NONFINANCIAL FIRMS.
SOURCE: JASON FURMAN, AND PETER ORSZAG, "A FIRM-LEVEL PERSPECTIVE ON THE ROLE OF RENTS IN THE RISE IN INEQUALITY," PRESENTATION AT "A JUST SOCIETY" CENTENNIAL EVENT IN HONOR OF JOSEPH STIGLITZ, COLUMBIA UNIVERSITY, (OCTOBER 16, 2015).

Figure 3 – Dispersion in return on invested capital for US companies

Secondly, economies of scale are significant for tech companies. The initial costs of development is relatively high of these companies; however, once produced, the marginal cost of producing additional items or incorporating new users is significantly low.

These factors create a winner-take-all environment where success in the tech universe offers a feedback loop which leads to further success. The shift to a winner-take-all market explains why several companies were able to



* TOTAL RETURN BASED ON A MONTHLY REBALANCED, EQUAL-WEIGHTED PORTFOLIO OF US EQUITIES WITH A MARKET CAP. ABOVE $1B. VALUE/GROWTH STOCKS FOR A SECTOR DEFINED AS THOSE WITHIN THE TOP/BOTTOM 25% ACCORDING TO THE BCA EQUITY ANALYZER COMPOSITE VALUATION METRIC.

Figure 4 – Value tech underperforms value financials

become majorly successful. Ultimately, increased monopoly power, as reflected in higher relative valuations and rising profit margins, has been the largest contributor in driving tech shares outperformance since the mid-1990s as opposed to faster revenue growth – Figure 5.

The transition from growth to utility status for some tech monopolists could however result in a loss of valuation premium assigned to these companies by investors. Additionally, the risk of government regulation in order to ensure that monopoly power is not abused has always been a factor concerning these mega-cap tech companies. This may lead to a further decline in valuations.

Equity prices have increased significantly since the start of November. Given the resultant current over-optimism, it is likely that equities will experience increased volatility over the short-term with slight correction should economic growth surprise on the downside. Nevertheless, the rising odds of an effective vaccine and continued easy monetary policy justifies our bullish view on equities over the next 12 months. Looking further, the acceleration of inflation caused by the improvement in labour markets, sluggish productivity growth, and a backlash against monopoly power, provides a negative backdrop for growth companies performance, specifically mega-cap tech companies. This could prove to be the mechanism that shifts the tide for the value style's outperformance.

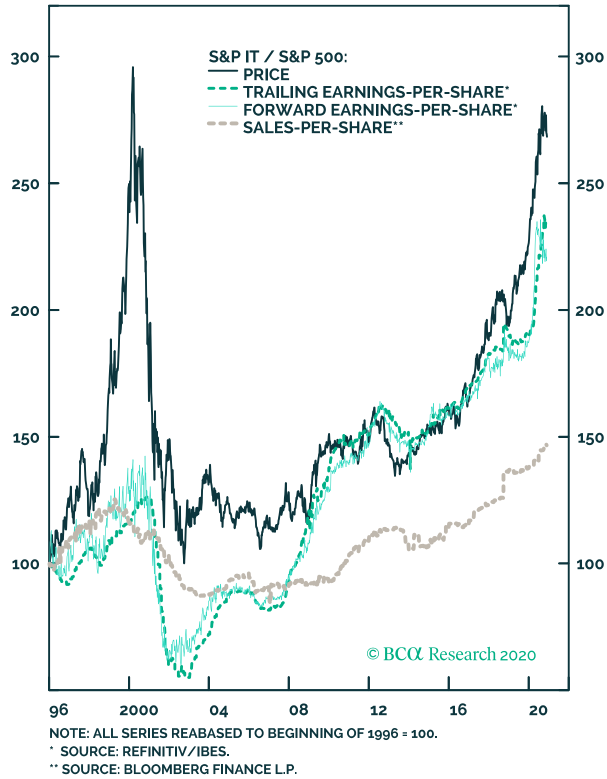


Figure 5 – Contributors to tech outperformance

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	1 776.95	-5.4%	17.1%	21.4%
Brent Crude	47.59	27.0%	-27.9%	-23.8%
USDZAR	15.4419	-4.9%	10.5%	5.3%
EURZAR	18.4599	-2.4%	17.6%	14.3%
GBPZAR	20.6168	-2.0%	11.2%	8.8%
JSE All Share TRI	8 890.15	10.5%	2.6%	6.0%
JSE Resources TRI	3 740.67	11.4%	10.9%	18.5%
JSE Industrials TRI	15 918.43	7.6%	15.5%	18.3%
JSE Financials TRI	6 966.78	18.0%	-25.8%	-25.3%
JSE Listed Property TRI	1 081.59	17.5%	-42.4%	-43.6%
S&P 500	3 621.63	10.8%	12.1%	15.3%
Euro STOXX 50	7 560.87	18.1%	-4.9%	-3.7%
FTSE 100	5 978.52	12.7%	-14.4%	-12.0%
Nikkei 225	43 630.05	15.1%	13.8%	15.7%
Hang Seng	78 747.86	9.4%	-3.6%	3.2%

Source: Bloomberg, as at 30 November 2020