Market Synopsis – January 2021

2020 ended with the proverbial bang as global equities accelerated to post a Q4 return of 14.68% (in USD terms). With this frothy market action, we entered 2021 with the mention of financial excesses and irrational exuberance in certain sectors and regions becoming all the more prevalent. Last week brought clear evidence of these financial excesses: GameStop, a has-been bricks-and-mortar retailer, soared to stratospheric levels in an epic short squeeze instigated by users of the "wallstreetbets" Reddit group. Short interest for the median S&P 500 share as a percent of market capitalization is however currently at multi-year lows. A broad-based short squeeze of the nature that GameStop and a handful of other shares have experienced is thus unlikely to occur. Nevertheless, recent market action could send a dangerous message to retail investors that the "sky is the limit" when it comes to buying equities, and anyone who bets otherwise risks having their account blown up. Post the drama of last week, some sanity has prevailed or the retail investor mob has merely lost interest and moved to another target, resulting in an 85% drop in GameStop shares. The poor fool who was the last fool to buy, must now feel really clever – the market remains the great equaliser!

Amidst this foolishness, and getting back to the reality of broad-market conditions, the S&P 500's tactical vulnerability is only increasing. BCA Research's Equity Capitulation Index is at its highest level since 2010 and 2004, two readings that were followed with 10% or more correction in the US benchmark – Figure 1. When the capitulation Index reached similar heights in the 1980s, then too, the market corrected meaningfully.

Fundamentals that matter for equities remain particularly supportive over the cyclical horizon. The problem is that market participants already understand this all too well and have pushed valuations, expected earnings growth and positioning to treacherous levels.

In the real economy, the outlook for growth in the US and other developed economies remains poor over the very near term. The combination of another major wave of the COVID-19 pandemic, at least partially driven by more transmissible variants of the virus, as well as the lagged effects of diminished US fiscal support in the second half of last year have led to a slowdown in economic activity that is likely to linger for the coming several weeks. Outside of the US, the pressure on the medical system has led to the re-imposition of heavy control measures that mechanically weigh on consumer spending. Within the US, some restrictions have been re-imposed, but spending has also slowed due to the exhaustion of the stimulative benefits of last year's CARES act for a sizeable portion of recipients. Positively, there are early signs suggesting that the second wave is cresting in advanced economies as hospitalisations appear to have peaked in the US and a few major European economies, and the number of new cases is either trending lower or has plateaued – see Figure 2 on the following page. Globally, vaccination programs are also being rolled-out en masse.

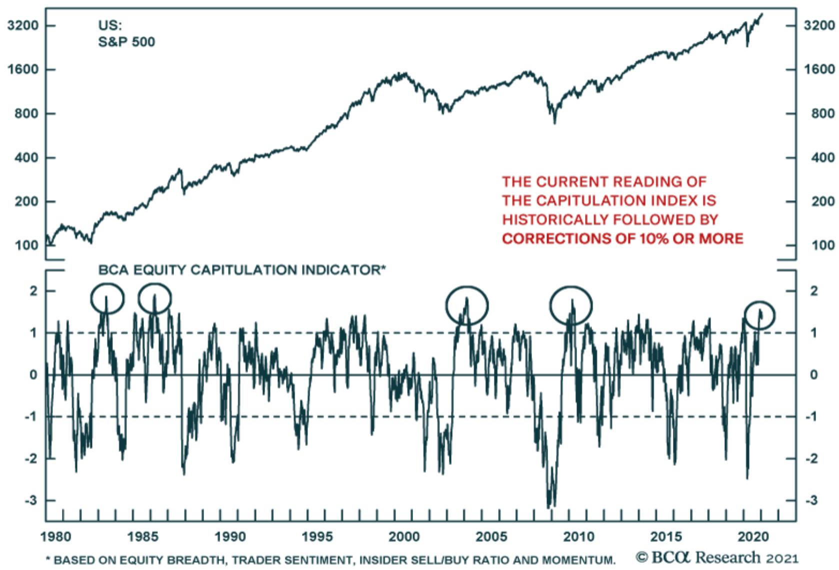
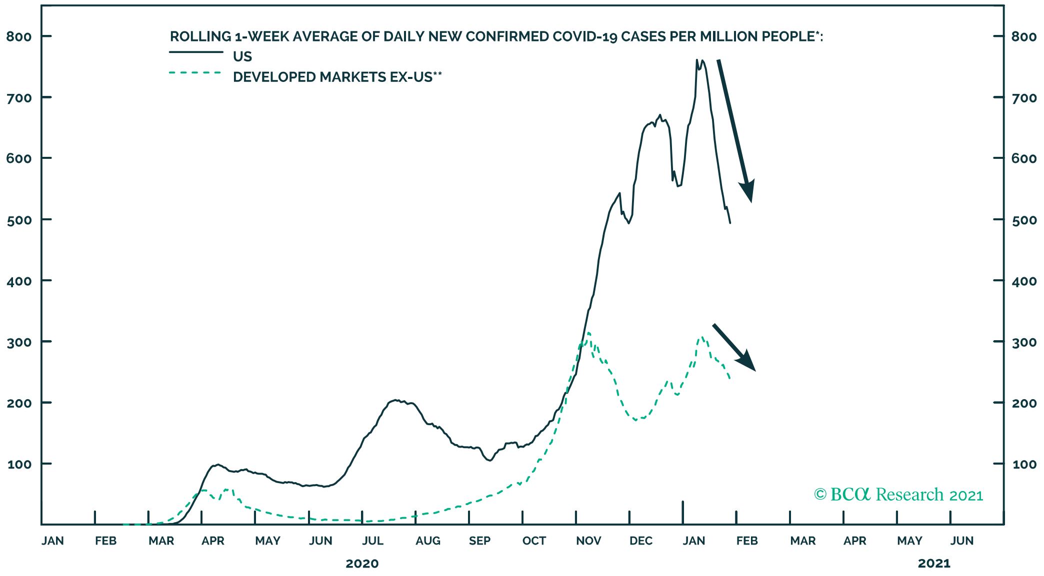


Figure 1 – S&P 500 ripe for a 10%-15% correction

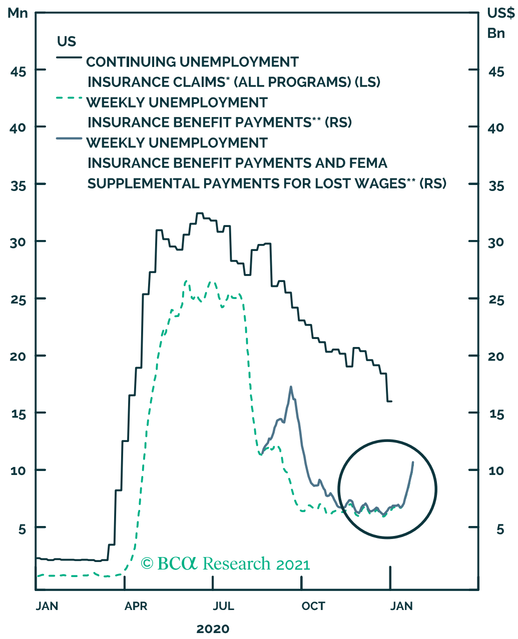


* SOURCE: CSSE JOHNS HOPKINS.
** INCLUDES AUSTRALIA, CANADA, FRANCE, GERMANY, ITALY, JAPAN, NETHERLANDS, SPAIN, SWEDEN, SWITZERLAND,AND THE UK.

Figure 2 – Second wave seems to have plateaued in developed economies

Governments have also not been standing against this backdrop: In Europe and Canada, the fiscal response to the second wave has generally been to extend wage subsidy and income support programs. In the US, after having let unemployment benefit payments lapse in the second half of 2020, the US congress passed a USD900 billion aid bill in late December that provides USD300 per week in supplemental unemployment benefit payments and USD600 in direct checks to most Americans. These payments have already begun to reach US households – see Figure 3.

In addition, following the Democratic Senate seats won in Georgia in January, President Biden ("Biden") announced a USD 1.9 trillion emergency relief package that topped up individual direct payments to USD2,000, assistance to small businesses, aid to state and local governments, and funding for pandemic-related expenses such as testing and the rollout of vaccines. While the size and contents of Biden's proposal may get scaled down, we expect most of the plan to gain approval in Congress early this year. That implies that the federal deficit is on track to peak at between 22% and 25% of GDP in fiscal year 2021. This is a very significant amount of stimulus, and will provide a substantial reflationary bridge to help counter the negative impact on Q1 growth from the pandemic. But in the aggregate, some portion of the fiscal stimulus is unlikely to be spent by households until there is no longer a need for social distancing and the economy fully reopens. How long it takes to arrive at that moment



* SOURCE: US DEPARTMENT OF LABOR.
** SOURCE: US TREASURY; SHOWN SMOOTHED.

Figure 3 – US consumers' wallets being stuffed

depends enormously on the US' progress at vaccinating its population. Recent PMIs further highlighted that the economy is not out of the woods yet. Lastly, the recent decline in inflation breakeven rates is putting upward pressure on both real interest rates and the USD, which is tightening liquidity conditions in the US.

This combination of frothy sentiment, near-term economic risk and tightening liquidity conditions creates the perfect cocktail for a market correction. Nonetheless, we remain

buyers of risk assets over the medium term. Vast amounts of fiscal stimulus injected into the economy will meet decidedly dovish central bankers, which creates a process that will limit the upside to real interest rates. Thus, the recovery has legs and investors will ultimately succumb once again to the FOMO mentality, putting a floor under risk assets. Over the short-term however we have been building cash exposure in portfolios. Once a meaningful corrections has been had, this dry powder can be swiftly deployed to equities and other risk assets.
Turning to equity selection opportunities: We have been arguing for a while that non-US equities should start outperforming their US counterparts and that the value investment style will, after years of relative underperformance, reverse this trend and start a multi-year outperformance period. The "reopening trade" favours both these expectations.

Figure 4 highlights that global ex-US equities are now in a clear uptrend versus their US peers, whereas value equities have yet to decisively break out. We expect the latter to occur during 2021.

In conclusion, the frothy market conditions enjoyed towards the end of 2020 and into 2021 has sown the seeds for a market correction. Once this occurs, opportunities to increase equity exposure and to remain invested over the medium term will be in the offing. Non-US and value equities are particularly attractive. This is especially true should one consider the vast amounts of fiscal stimulus being pumped into the global economy, the ultra-dovish monetary policy stances of global central and COVID-19 vaccination programs being rolled-out at varying rates globally supporting the so-called "reopening trade".

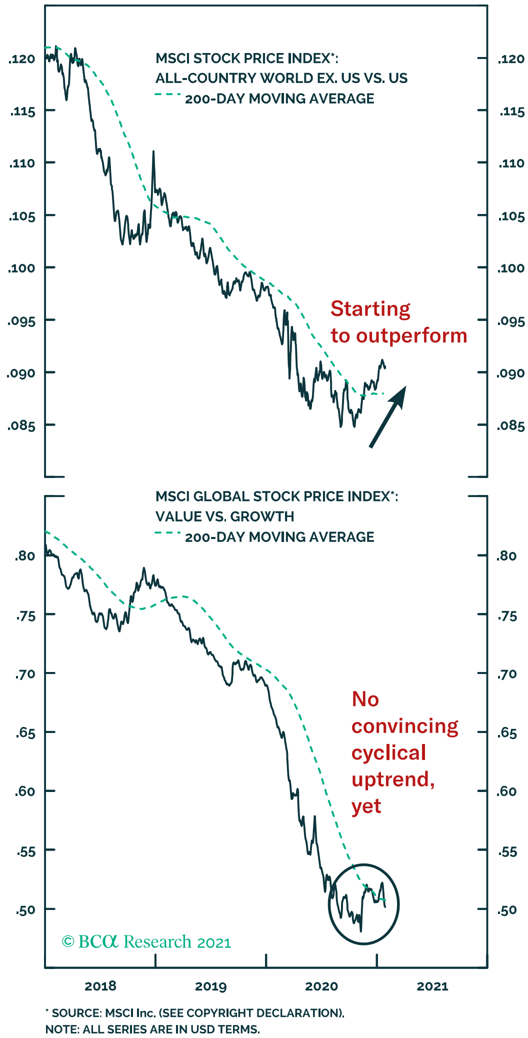


Figure 4 – Status quo being challenged?

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	1 847.65	-2.7%	-2.7%	16.3%
Brent Crude	55.88	7.9%	7.9%	-3.9%
USDZAR	15.1609	3.3%	3.3%	0.9%
EURZAR	18.4153	2.7%	2.7%	10.6%
GBPZAR	20.7726	3.7%	3.7%	4.8%
JSE All Share TRI	9 749.19	5.2%	5.2%	14.5%
JSE Resources TRI	4 285.18	4.9%	4.9%	31.7%
JSE Industrials TRI	17 076.98	8.5%	8.5%	21.3%
JSE Financials TRI	7 314.82	-3.1%	-3.1%	-17.3%
JSE Listed Property TRI	1 190.08	-3.2%	-3.2%	-34.6%
S&P 500	3 714.24	-1.1%	-1.1%	15.2%
Euro STOXX 50	7 549.97	-1.9%	-1.9%	-2.4%
FTSE 100	6 126.19	-0.8%	-0.8%	-9.2%
Nikkei 225	45 718.51	0.8%	0.8%	21.5%
Hang Seng	84 567.03	3.9%	3.9%	11.0%

Source: Bloomberg, as at 29 January 2021