Market Synopsis – February 2021

Although it would be too soon to declare victory over the COVID-19 pandemic, it does appear that we are heading in the right direction as new case counts have plummeted from their January peak – see Figure 1. The stringent restrictions in Europe has helped decrease the spread of the virus, albeit at the detrimental cost of the economy – see Figure 2. Despite shunning EU-style restrictions, Sweden and the US both saw a reduction in the momentum of the virus. The increased vigilance of the populace was able to keep the virus at bay despite the fears that the coronavirus would flourish in the northern hemisphere winter. The greatest threat to this trend in optimism is the potential for vaccine-resistant variants of the virus. Despite this concern, pandemic news is clearly trending in the right direction.

As the number of new infections continues to decline, so too does the strain on the public health care systems. Hospitalisations globally have plunged recently, indicating the recovered capacity of the health care systems. Hospitalisations are an important metric for tracking COVID-19's impact on the economy and serves as a leading indicator to governments' implementation of social and economic restrictions. When hospitalisations are reaching full capacity, government are likely to increase restrictions; however, when they are declining with sufficient capacity, governments ease their restrictions. For services-heavy developed economies, easier restrictions are the key to a return to something more closely resembling normal activity until vaccinations confer herd immunity.

Until we conquer the virus, there will be those that continue to be displaced by the pandemic which will require fiscal support in order to cope during this time. Looking at the US, as an example, the fourth-quarter deceleration in fiscal support highlighted the important role that fiscal transfers have played in keeping vulnerable

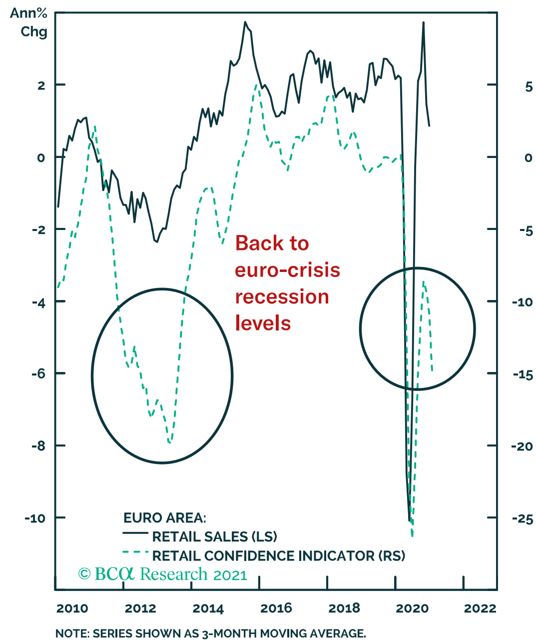

Figure 2 – Lockdown restrictions strain European economies

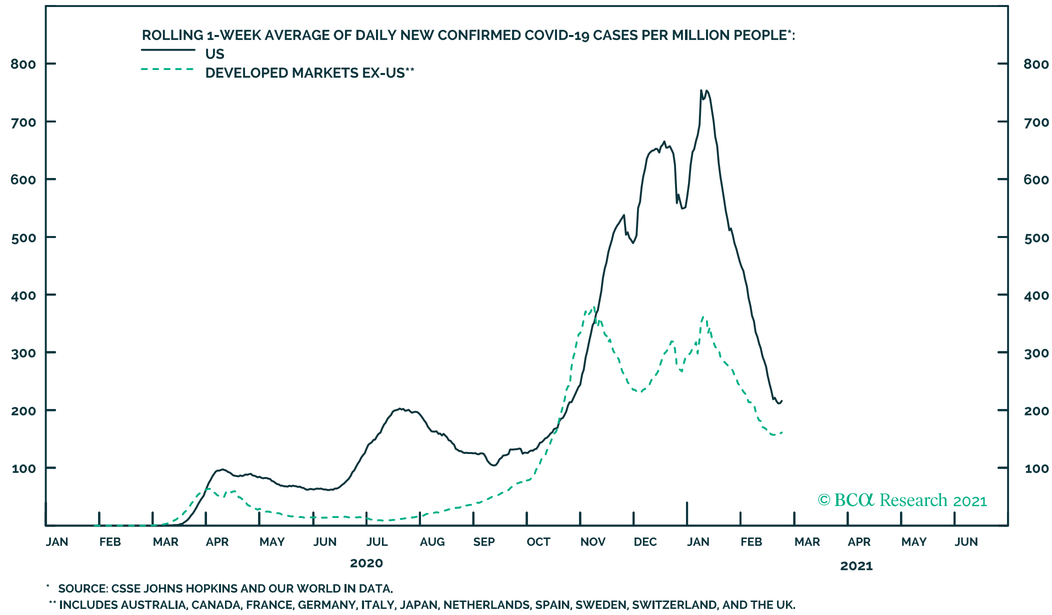

Figure 1 – New confirmed cases significantly lower in developed markets

households, businesses and communities from falling victim to the harsh economic reality of the virus should these measures not be implemented. The majority of the fiscal transfers authorised under the CARES Act were distributed in two phases. The first phase was in April and May through the economic impact payments of USD 1,200 per adult and USD 500 per child which was received by two-thirds of US households.

The second phase came in the form of a weekly USD 600 federal unemployment insurance ("UI") benefit which was received in April, May, June and July. Additional aid was provided by the pandemic unemployment assistance (PUA) program, which served to supplement UI benefits for independent contractors, self-employed individuals and other workers who would not usually qualify to receive them. Fiscal transfers and forbearance programs have limited credit distress to a greater extent than one would have expected when COVID-19 first impacted global economies. However, households' ability to meet their credit and rental obligations have worsened as 2020 wore on.

The increase in January retail sales serves as evidence that high marginal propensity to consume households needed the second round of transfers provided for in December's compromise spending bill. The economic impact payments, USD 600 per qualifying adult and USD 600 per child, and the supplement UI benefits, USD 300 per week, were small compared to previous transfers; however, the most vulnerable households put these to immediate use. We expect that February rent collections and consumer loan delinquencies will also show improvement, although not as dramatically as retail sales. With another, larger round of stimulus in the pipeline, it appears that the US economy will avoid a repeat of its fourth quarter fraying around the edges. Slumps, however, remain a possibility in economies that allow transfer schemes to lapse before COVID-19 can be tamed. The above highlights the instrumental part that fiscal support has played in keeping the global economy afloat during the progression of the pandemic.

Maintaining our focus on the US, which comprises nearly 60% of the MSCI All-Country World Index, our base case is the so-called Goldilocks scenario that markets appear to be discounting. This scenario would entail solid growth, although manageable, and continued monetary accommodation from central banks – see Figure 3. This since the Fed will only tone down monetary stimulus if the economy appears to be at risk of overheating – an unlikely outcome over the medium term. It is more probable that it will take a growth disappointment, most likely from a negative virus surprise, to cause US economic growth to falter.

One cannot rule out the possibility of vaccine-resistant mutations of the virus or a rebound in new infections cause by the relaxation of populace tired of prolonged restrictions. Although a concern, the most likely disappointment to an improved economic outlook is the inability to vaccinate at a pace consistent with achieving

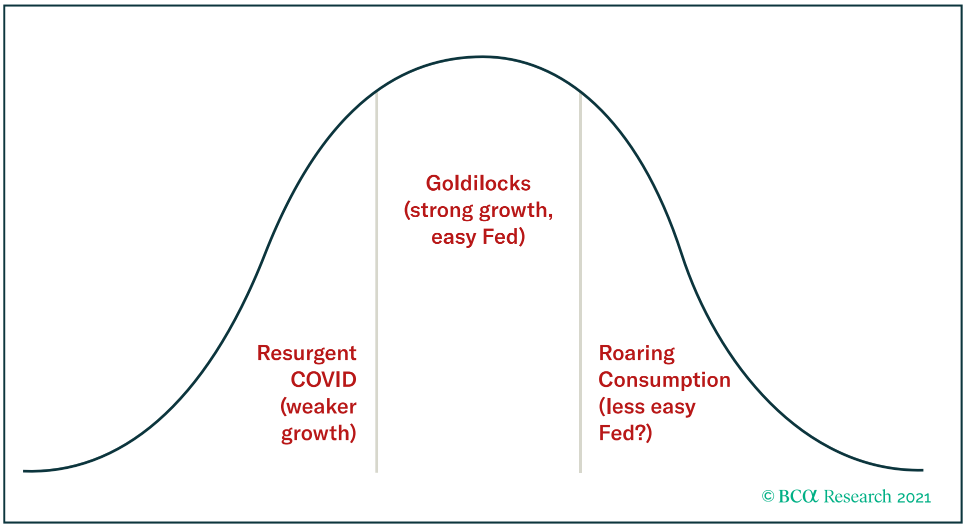

Figure 3 – Goldilocks scenario most likely outcome

herd immunity by the end of September 2021. Therefore, we are monitoring the vaccination progress against the level required to get 50-80% of the US population inoculated by the end of the third quarter – see Figure 4. Despite its slow start, we are confident that the US will be able to gain momentum especially considering the current administrations priority of eliminating the pandemic and a Congress that is providing the resources to enable local health authorities to meet their requirements.

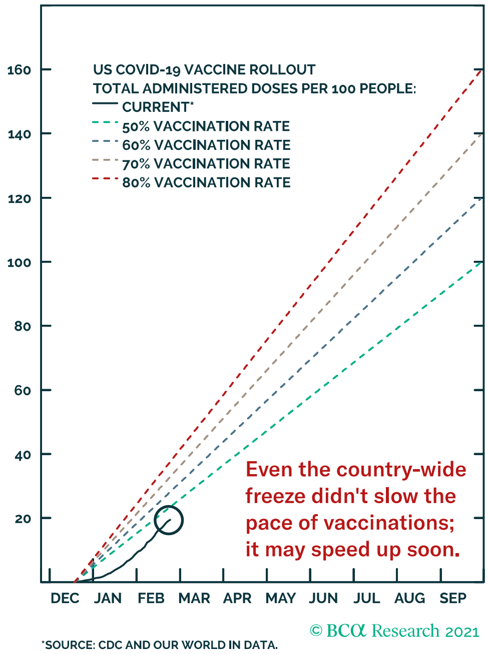

Figure 4 – US vaccination rollout accelerates

Despite our constructive long-term outlook above, one should not overlook how bond yields have jumped in recent weeks. After bottoming at 0.52% in August, the US 10-year Treasury yield has climbed to 1.54%, up from 0.93% at the beginning of the year. Government bond yields in the other major economies have followed suit – see Figure 5. Despite the rebound in inflation expectations, the most recent increase in yields has been caused by the real component of bond yields. Optimism regarding recovery in global growth caused by the successful roll out of vaccines, reinforced by continued fiscal stimulus, most notably in the US, has caused investors to move forward their expectations of when and how high policy rates will rise.

Increases in bond yields, as seen over the past two weeks, are detrimental to equity prices. There is a close

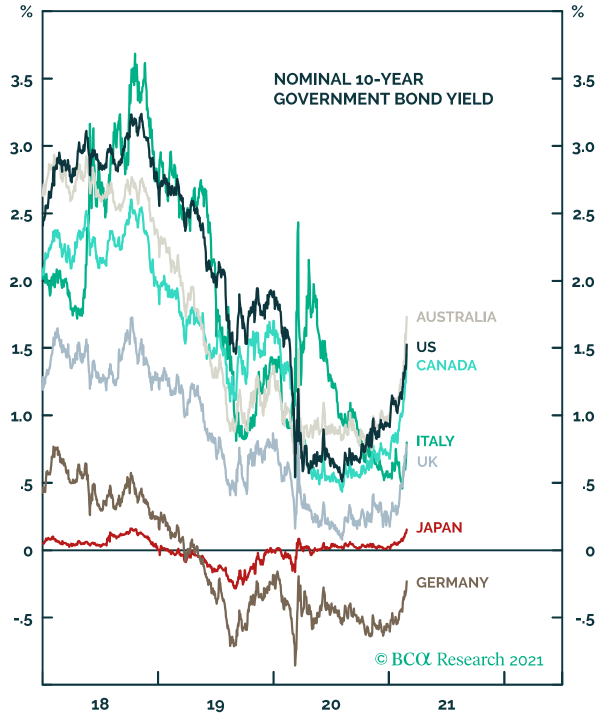

Figure 5 – Bond yields rise across developed markets

correlation between real yields and the forward price-to-earnings ratio of the S&P 500. The 5-year/5-year forward real yield, in particular, has moved up sharply, which could put further downward pressure on equities in the near term.

Despite the bearish short-term view on equities, we remain constructive on risk assets over a 12-month horizon. Rising real yields have historically been more destructive to equities when yields have increased in response to hawkish central bank rhetoric. As evident above, this is not currently the case and one can expect it to remain so for the foreseeable future. We expect the 10-year Treasury yield to stabilise in the 1.6%-to-1.7% range, still well below the level that would threaten the health of the economy. The accommodative stance of the Fed should also limit any near-term upward pressure on the USD. Since the Fed is unlikely to change their monetary policy over the foreseeable future, one can expect US short-term real rates to fall as inflation rises – causing the USD to weaken.

Taking the above into consideration, one should continue to favour cyclical shares, which are overrepresented outside of the US, as they tend to benefit the most from a recovery in global growth and a weakening USD. Additionally, value shares do well in a weak dollar/strong growth environment. More specifically, bank shares, which are concentrated in value indices, typically outperform when long-term bond yields rise – see Figure 6. The above picture is detrimental to long-duration assets, companies with a large portion of their cash flow expected far into the future, such a growth shares which struggle as bond yields rise. The same is true for more speculative plays such as cryptocurrencies.

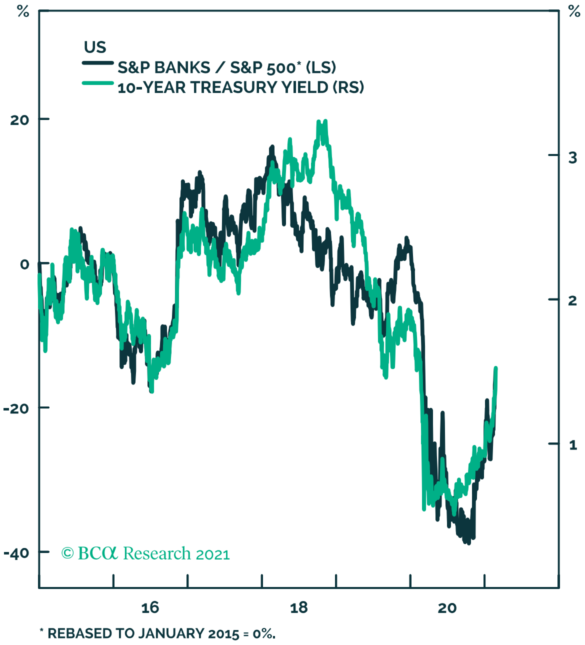

Figure 6 – Rise in long-term bond yields supportive for banks

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

Tel: (021) 671 2112
Cell: 072 513 2684 / 084 601 1025
E-mail: nic@integrityam.co.za / herman@integrityam.co.za
Website: www.integrityam.co.za

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Indicator	Spot	MTD	YTD	Y-o-Y
Gold	1 734.04	-6.1%	-8.7%	9.4%
Brent Crude	66.13	18.3%	27.7%	30.9%
USDZAR	15.1204	-0.3%	3.1%	-3.5%
EURZAR	18.2455	-0.9%	1.7%	5.6%
GBPZAR	21.0417	1.3%	5.1%	4.8%
JSE All Share TRI	10 321.44	5.9%	11.4%	33.2%
JSE Resources TRI	4 788.01	11.7%	17.2%	66.4%
JSE Industrials TRI	17 417.06	2.0%	10.6%	32.3%
JSE Financials TRI	7 634.75	4.4%	1.2%	-6.0%
JSE Listed Property TRI	1 292.48	8.6%	5.1%	-15.7%
S&P 500	3 811.15	2.6%	1.5%	29.0%
Euro STOXX 50	7 893.07	4.5%	2.6%	11.4%
FTSE 100	6 222.88	1.6%	0.8%	1.3%
Nikkei 225	47 891.40	4.8%	5.6%	39.6%
Hang Seng	86 649.54	2.5%	6.4%	14.1%

Source: Bloomberg, as at 26 February 2021