RECAP OF A MADCAP YEAR

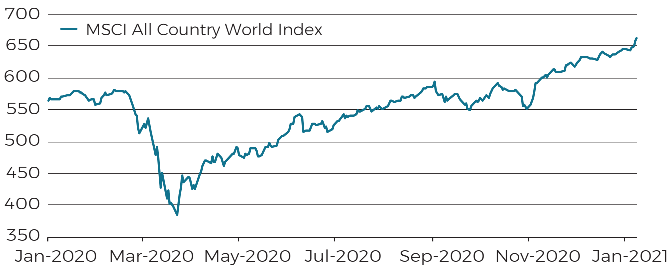
QUARTER 4, 2020

2020 is the year we are all happy to put behind us. So perhaps reading about last year is not what you want to do now. Or ever. All of us were impacted by the pandemic and lockdowns, and some lost loved ones or livelihoods or, tragically, both. But there are some important investment insights we can gleam from revisiting some of the key events of 2020.

The first is the unpredictability of life and the markets. For all the effort economists, strategists and other commentators put into forecasting the future, no-one could have predicted SARS-CoV-2. Some people have warned for years that the world is extremely vulnerable to a pandemic, but even they would not have known when, where and how it would emerge. When it did emerge from Wuhan late in 2019, few imagined how devastating it would be. A few lone voices argued that things were going to get bad, and with hindsight policymakers and investors should have listened to them. Even as China locked down Wuhan and surrounds, the rest of the world carried on as if nothing was happening. When it started spreading uncontrollably outside of China, markets crashed and supermarket shelves were cleared of toilet paper.

Here's the thing: if I told you a year ago that much of the world was going to spend months quarantining at home, you wouldn't have believed me. But if I then told you that global equity markets would end the year higher, not lower, you would have told me I am mad. But that is what happened. Both the pandemic and the market response were unpredictable. It turns out that doing nothing was a good investment strategy.

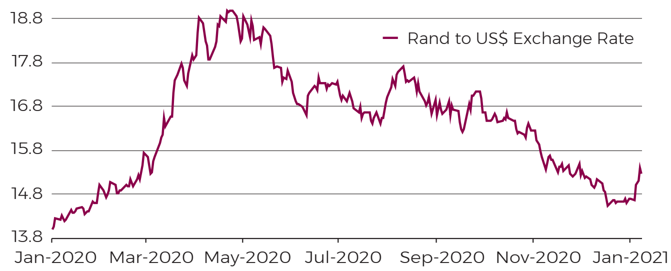
Chart 1: Global equities in US dollars



Source: Refinitiv Datastream

The second important insight is how South African financial markets track global sentiment, irrespective of local developments. Last year was an extremely difficult year for South Africa. We were in recession even before Covid-19 hit (thanks to Eskom) and government finances were already in a precarious state. The lockdown resulted in a historically bad plunge in economic activity and tax revenue. Foreign investors pulled out of the local bond market at a record pace, causing bond prices to fall and yields to spike (this mostly happened before the Moody's downgrade to junk status, proving again that ratings agencies are lagging indicators, while the market rates in real time). The rand also fell to its weakest ever closing level against the dollar of R18.99 on 23 April.

Chart 2: Rand-dollar exchange rate



Source: Refinitiv Datastream

And yet as global risk appetite revived, the rand started recovering and bond yields stabilised. At the end of 2020, bonds had delivered a positive return for the year, while the rand's total depreciation against the dollar had narrowed to only 5%. This had very little to do with domestic fundamentals. Without the massive fiscal and monetary support that other economies enjoyed, the local economy's recovery is likely to lag other major countries. Policy reform has been slow, and the impact of the new electricity supply and infrastructure push will be measured over years, not quarters (the impact of the potentially game-changing African Continental Free Trade Area will be measured over decades). There is also no firm indication of when Coronavirus vaccines will be available here.

Where we have benefited in particular is that dollar commodity prices increased in 2020, and this led not only to surging JSE-listed mining shares, but also a record trade surplus.

It is worth repeating: South African investors should focus on global developments, and not get carried away with the latest political and economic twists and turns. The rand is certainly not a one-way bet. And as the chaotic aftermath of the US election – which culminated in the invasion of the Capitol Building in Washington, D.C. – showed, political turmoil is not unique to South Africa.

Finally then, it is worth reflecting on the following. The average SA balanced fund returned 5% in 2020. This was behind cash but ahead of inflation. Overall, however, that is not a bad outcome given the worst recession in South African history and the deepest global slump since the 1930s. In 2008, the last time there was a global crisis, the average balanced fund lost 9%.

The difference is the nature of the crisis – in 2008 it sprang from within the financial system, while in 2020 it was an external temporary shock – and the aggressive way in which policymakers responded. This was partly due to having learned some hard lessons from 2008 and its aftermath. Policymakers cannot and should not respond to every single wrinkle and ripple of financial market, but they will not allow a catastrophic meltdown and this gives us comfort going into 2021.

As we wonder what this New Year has in store for us, the focus will not be on trying to forecast the future. This is clearly not something we can expect to do successfully. Rather, the focus will be on ensuring that all the funds we manage on your behalf are appropriately diversified. After all, the biggest lesson from 2020 was this: always expect the unexpected.

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