MARKET MATTERS

ROARING OR MEOWING TWENTIES?

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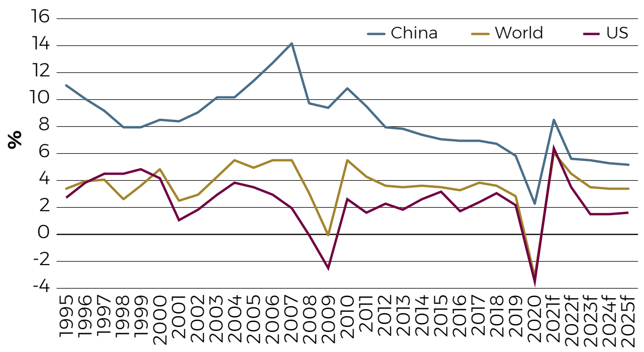
The world is experiencing a phase of rapid economic expansion as the vaccine-aided reopening of economies is supported by substantial fiscal and monetary support, particularly in the US and other rich nations.

If the 6% global growth forecast of the International Monetary Fund (IMF) is realised, it will be the best year in decades. This partly reflects the rubber band effect: it was stretched too far in 2020 and is now snapping back in the other direction in 2021. However, there is also strong underlying momentum that should carry over into next year. But what lies further ahead?

CHART 1: PAST AND FORECAST ECONOMIC GROWTH, %



Source: International Monetary Fund

ROAR

Some have argued that we face a new decade of plenty, akin to the Roaring Twenties that followed the last deadly global pandemic a century ago. The theory is that, having been through the distress of recession, lockdowns and social distancing, people will want to let loose.

The 1920s, following the horror of World War I and the devastation of the 1918/19 flu epidemic, was famously the era of jazz and glitzy nightclubs. It was the age of Jay Gatsby and the Flappers. It was also the age of rapid technological change. Cars gave freedom of movement, while telephones and radios connected people like never before. The thrilling possibilities of commercial aviation became apparent when Lindbergh crossed the Atlantic in 1927.

Of course, the era also saw an epic stock market rally in the US, partly because new technologies made the stock market accessible to ordinary people for the first time. They jumped in with abandon. President John F Kennedy's father Joseph famously realised the market was out of control and sold out near the peak after a shoe-shine boy gave him stock tips.

And of course, it all ended in tears eventually. The market crashed in 1929, and as the Great Depression unfolded and spread around the world, it kept falling.

Some of this already feels very contemporary. The urge to escape the confines of lockdowns is real. Technological progress has been rapid, and the pandemic accelerated the pace of adoption. Grannies now use Zoom, while entire businesses have permanently vacated their offices as people work remotely. And once again, the stock market is being democratised, this time through social media forums, free trading apps like Robinhood, and frenzied buying of crypto-assets. Over the last few weeks, Dogecoin, created in 2013 as a joke alternative to Bitcoin, briefly surged to a larger market value than established multinational corporations like Ford.

Blockchain may be overhyped as a world-changing technology, but there have been genuine technological breakthroughs, most notably the development of mRNA vaccines. The decline in the cost of solar and wind energy is providing hope in the battle against climate change, as does the increased sale of electric vehicles. There is also a greater focus on social justice and equality issues, as there was in the years after World War 1, when women were allowed to vote for the first time in several countries (UK in 1918, Sweden and the Netherlands in 1919, the US in 1920 and Ireland in 1922).

But historical parallels only take you so far. There are several issues to consider before concluding that the current boom will last.

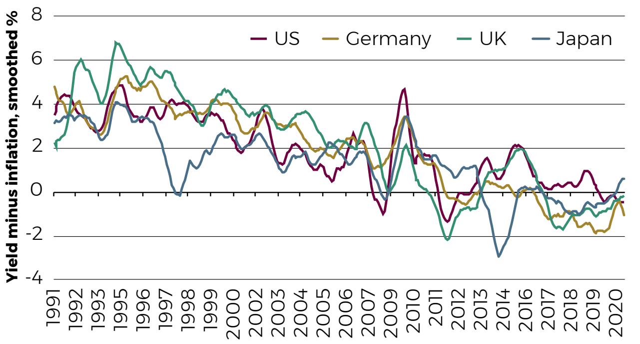
Firstly, will households really go on a spending spree? Moody's estimates that households in the rich world (again, particularly the US) have boosted savings by $5.4 trillion from 2019 levels. How much of this will be spent and over what timeframe? Or will the memory of the pandemic prompt households to maintain healthy rainy day funds?

Part of the answer depends on the distribution of these savings. The more affluent you are, the less likely you are to spend each additional dollar you earn. If you are poor, however, you have to spend every dollar just to stay alive, and saving is a luxury. The rising level of inequality in the developed world is probably one of the reasons behind the slow recovery from the 2008 financial crisis.

SECULAR STAGNATION

The post-crisis, pre-Covid era was characterised by interest rates and inflation persistently lower than expected, while GDP growth in the major countries was below long-term averages.

CHART 2: REAL GOVERNMENT BOND YIELDS, %



Source: Refinitiv Datastream

The overhang of private debt meant there was little appetite to borrow even at record low interest rates, while tightened banking regulations meant that the supply of credit was tight even where there was demand. It was a world of excess capacity, excess savings and sluggish growth, what some termed "secular stagnation" or "Japanification".

Moreover, even before former US president Donald Trump's trade wars, it appeared that global trade was slowing relative to underlying economic growth. Perhaps the world had reached a natural saturation point beyond which it does not make much sense to stretch supply chains. Post-pandemic, supply chains are increasingly being redirected closer to home with a greater focus on reliability than efficiency.

DEVELOPED MARKET OUTPERFORMANCE?

The IMF's forecast is that developed countries will rebound strongly and make up for lost ground relatively quickly. The US is even expected to end up somewhat better than in a no-pandemic scenario. This is of course thanks to its tremendous fiscal firepower and its pushing to the front of the vaccine queue. Developing countries will take longer to recover due to slower vaccine roll-outs and less fiscal support.

This is a reversal of the post-2008 experience when developing countries recovered quickly and strongly, at least initially. And while developing countries will benefit from stronger growth in the rich world, their central banks could be forced to hike interest rates sooner than they would want to if their peers in the developed countries, specifically the US Federal Reserve, decides it's time to raise rates from near zero levels.

China is expected to grow 8% to 9% this year, but its growth rate will drift back down towards 5% to 6% in the coming years, perhaps even lower. The economy is so large already that such rapid growth rates cannot be sustained without adding more and more debt every year.

The Chinese government specifically wants to move away from reliance on debt-fuelled real estate and infrastructure spending and focus more on services and high-tech manufacturing. It no longer wants to be the world's factory for cheap junk. It also wants greater reliance on internal demand, as part of President Xi's "dual circulation" theory. China also faces a unique problem among emerging markets (if we can still call it that) of a declining work force due to its previous one-child policy. All this implies slower growth in the years ahead. Meanwhile the risk of a conflict with the US over Taiwan and other issues remains the biggest geopolitical threat.

Demographics is also at the heart of slower economic growth in the developed countries. Older populations spend less. Labour force growth is now driven almost entirely by immigration, and immigration has become a huge political hot potato.

Policy will be crucial. The Great Depression need not have become "Great". It would have been a run-of-the-mill recession had it not been for a series of policy blunders across the world. Certainly, the Depression was not caused by the stock market collapse.

The post-2008 Great Recession was also characterised by a number of policy mistakes. The European Central Bank (ECB) hiked rates very prematurely in 2011, mistaking a higher oil price for sustained inflation. Another epic mistake was the turn to fiscal austerity in the US, UK and Eurozone around the same time.

By 2016, these mistakes had contributed to a shift to political populism, which led to a new round of policy headwinds (notably Brexit and Trump's trade battles).

Today policy is extremely loose and supportive. Interest rates are low, central banks are buying bonds, and governments are spending. The IMF reckons there will be $16 trillion in fiscal spending in the wake of the pandemic, mostly borrowed. This is a giant experiment and we don't know yet how it will play out. The key metric is not debt-to-GDP ratios, but debt service ratios, the portion of national income that is spent on interest payments.

Apart from expansionary countercyclical fiscal policy (providing money to fill the hole left by Covid), there is also a renewed sense that governments can and should lead the way to "build back better". The US Biden administration has been at the forefront with an ambitious social, infrastructure and climate change agenda. If implemented and replicated by other countries, it could boost global expansion and wellbeing.

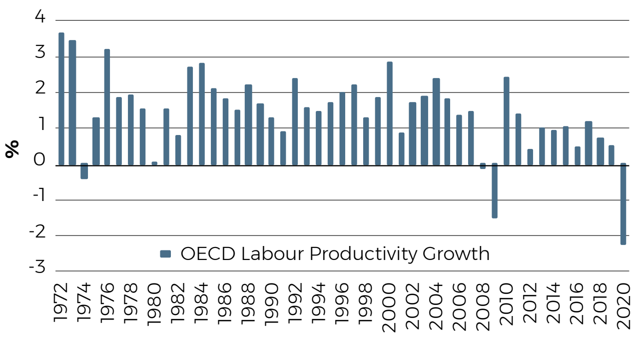
PRODUCTIVITY PUZZLE

Finally, productivity growth is key. Productivity is what allows growth without inflation. Growth without productivity means the prices of resources (workers, raw materials, and equipment) are pushed up. Productivity means doing more with less inputs.

It remains a puzzle why all the technological progress of the past few years has not really boosted productivity growth, which is measured as output per worker, and which has only grown by about 1% per year in the rich world over the past decade, half the previous decade.

There are several plausible theories. One is that companies, faced with uncertainty and sluggish demand, have not invested enough in new technology and equipment. Another is simply that it can take time to work out how best to implement new technology to make a difference. For instance, the personal computer is a product of the 1980s, but only in the 1990s did it really change the nature of work. Commercial aviation, as mentioned earlier, only became widespread several decades after the Wright Brothers first took off at Kitty Hawk in 1903.

CHART 3: PRODUCTIVITY GROWTH FOR THE DEVELOPED COUNTRIES, %



Source: Refinitiv Datastream

To summarise, a Roaring Twenties scenario would require sustained productivity growth, policy tailwinds (or at least the absence of headwinds) and rising confidence. One would also expect somewhat higher, but not runaway, inflation which in turn implies higher interest rates.

From an investment point of view, a Roaring Twenties scenario sounds great for equity investors locally and globally as growth boosts corporate revenues, and productivity gains keep cost pressures in check and margins healthy.

But as in the 1920s, investors will need to be careful to avoid bubbles and be wary of using debt to gear up returns. This scenario sounds bad for bond investors. Even modestly higher inflation will erode developed market bond and cash returns given how low yields still are. South African bonds would be at some risk from upward pressure on global yields, but high starting yields provide a cushion, while stronger economic growth should allow the government to reduce borrowing.

MEOW

The opposite scenario of a continuation of the secular stagnation symptoms – let's call it the Meowing Twenties – should place persistent downward pressure on bond yields as excess savings look for a safe home. The 10-year US Treasury at 1.6% currently might be a good buy. It certainly was a good buy when the Japanese yield was at that level 15 years ago.

How this impacts the equity market is not straightforward. The previous decade showed how low bond yields benefited equities, but only those companies with an in-built growth momentum, specifically large technology platform shares in the US and China. Outside the US equity returns were nothing to write home about. Certainly South Africans should prefer the Roaring to Meowing Twenties. Another decade of sluggish growth should push government debt levels into even more worryingly high levels, though it should also continue to grind both inflation and short-term interest rates lower.

These are all big questions that lack clear answers. While some of these trends seem distant compared to the closer and noisier local politics, they ultimately matter more for longer-term investment returns. That said, one thing to remember is that equity markets are always changing anyway. The ten biggest listed companies in the world today are all technology companies (broadly speaking) apart from JPMorgan, the bank.

This is very different to the era before the financial crisis (when it was commodities and banks that dominated), or the 1980s (Japanese stocks), or the 1970s (industrials). Going all the way back to the early 1900s, the railway industry was by far the biggest global sector. Locally, our market is now also dominated by tech (Naspers), while gold mining is small. The top performing economic sectors tend to naturally find their way into equity indices, and it has usually paid to have broad long-term exposure.

While it is important to ponder how the world will change (or not) over the next few years, we need to accept that the future is inherently unpredictable. However, this should not put investors who need long-term growth off from investing in equities. It is quite possible that we will see elements of both Roaring and Meowing in the years ahead, and as always it will be diversification that ensures portfolios can benefit either way.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	2 946.0	-0.24%	4.77%	9.52%	49.24%
United States	S&P 500	US$	4 180.0	-0.12%	5.21%	11.29%	49.39%
Europe	MSCI Europe	US$	1 994.0	-0.20%	4.67%	8.37%	45.02%
Britain	FTSE 100	US$	9 631.0	-0.80%	4.10%	9.08%	33.88%
Germany	DAX	US$	1 738.0	-0.17%	5.40%	3.12%	63.19%
Japan	Nikkei 225	US$	269.0	-1.40%	2.08%	-4.23%	49.03%
Emerging Markets	MSCI Emerging Markets	US$	1 353.0	0.30%	2.81%	4.80%	51.68%
Brazil	MSCI Brazil	US$	1 767.0	1.96%	5.87%	-5.81%	45.67%
China	MSCI China	US$	111.3	1.74%	3.14%	2.68%	39.80%
India	MSCI India	US$	679.2	-2.85%	-4.21%	0.62%	54.35%
South Africa	MSCI South Africa	US$	515.0	-2.46%	2.79%	14.44%	71.10%

EQUITIES - SOUTH AFRICA (TOTAL RETURN UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	67 296.0	-2.04%	1.22%	13.28%	35.67%
All Share	All Share (Total Return)	Rand	10 639.0	-2.03%	1.47%	14.81%	39.13%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	26 452.0	-2.02%	1.32%	14.09%	40.17%
TOP 40/Large Caps	Top 40	Rand	9 671.0	-2.25%	1.20%	14.56%	37.98%
Mid Caps	Mid Cap	Rand	16 974.0	-1.66%	2.34%	11.91%	38.18%
Small Companies	Small Cap	Rand	21 872.0	0.61%	5.08%	27.38%	73.49%
Resources	Resource 20	Rand	5 039.3	-1.59%	3.85%	23.32%	62.14%
Industrials	Industrial 25	Rand	17 634.0	-2.66%	-0.34%	12.02%	24.65%
Financials	Financial 15	Rand	7 712.0	-2.60%	-0.12%	2.19%	30.51%
Listed Property	SA Listed Property	Rand	1 435.2	3.59%	9.72%	16.68%	39.47%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
US Aggregate Bond Index	Bloomberg Barclays	US$	542.5	0.35%	1.63%	-2.91%	5.39%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	765.2	-0.92%	2.61%	0.82%	18.98%
Government Bonds	BESA GOVI	Rand	756.2	-0.89%	2.59%	0.83%	19.01%
Inflation Linked Bonds	BESA CILI	Rand	289.0	0.34%	1.98%	6.63%	14.15%
Cash	STEFI Composite	Rand	469.9	0.07%	0.23%	1.13%	4.39%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	66.1	-0.99%	4.94%	27.13%	214.81%
Gold	Gold Spot	US$	1 784.0	1.13%	5.88%	-5.81%	3.84%
Platinum	Platinum Spot	US$	1 208.0	0.92%	4.32%	12.90%	58.95%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	14.28	0.19%	3.45%	2.85%	33.73%
ZAR/Pound	ZAR/GBP	Rand	19.82	-0.05%	2.77%	1.31%	19.02%
ZAR/Euro	ZAR/EUR	Rand	17.27	-0.69%	0.35%	3.94%	19.23%
Dollar/Euro	USD/EUR	US$	1.21	-0.83%	-3.06%	0.99%	-10.74%
Dollar/Pound	USD/GBP	US$	1.39	-0.35%	-0.58%	-1.30%	-11.38%
Dollar/Yen	USD/JPY	US$	0.01	-0.84%	-2.57%	4.41%	0.23%

Source: I-Net, figures as at 23 April 2021

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