MARKET MATTERS

THE MADNESS OF CROWDS

DAVE MOHR AND IZAK ODENDAAL | OLD MUTUAL MULTI-MANAGERS
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Once again, South Africa is the country that see-saws from one extreme emotion to another. Two weeks ago, the robustness of our rule of law was being celebrated. Now we are grieving the loss of many lives and widespread destruction and looting. This just as the devastating third wave of Covid-19 infections seems to have peaked.

WHAT JUST HAPPENED?

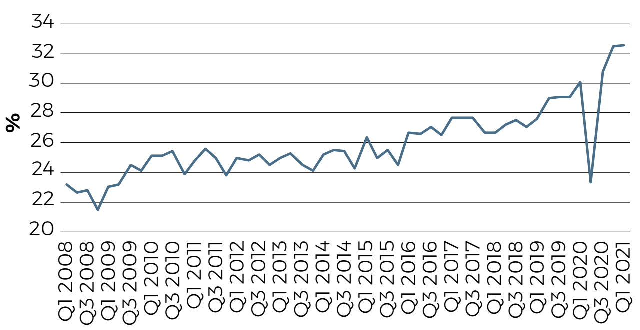
What may have started out as a political protest – to the jailing of former president Jacob Zuma – quickly descended into widespread violence and pillaging on an unimaginable scale in KwaZulu-Natal and townships around Johannesburg. Perhaps because phone cameras are ubiquitous now, many harrowing images were circulated this week.

The military has now been deployed and a semblance of order is returning. The next major challenge is to restore supply chains so that food, fuel and medicines remain accessible in affected areas.

While we have never experienced anything on this scale before, South Africa does have a history of violence stretching back centuries, but particularly in the 1980s and early 1990s. Crime is rife in our society and there are frequent outbreaks of public violence. These range from violent strikes and service delivery protests to battles between rival taxi operators and xenophobic attacks against foreign nationals.

Order needs to be restored and maintained, but the underlying issues and social ills also need to be addressed as a matter of urgency.

CHART 1: SA UNEMPLOYMENT RATE



Source: Refinitiv Datastream

However, there is footage showing that it was not only desperately poor people who looted. Many of the stolen goods were loaded into upmarket vehicles. This unjustifiable lawlessness is deeply worrying and calls for serious soul-searching as a nation.

Trust in the security services will have to be rebuilt, as well as trust in one another. There is no other alternative for people who want to stay in South Africa. As is always the case in our country, there was also good news amid the chaos. There were, for example, many encouraging scenes of communities standing together to protect shopping centres and neighbourhoods, and there was also no shortage of volunteers keen to help clean up and rebuild.

CAN THE CENTRE HOLD?

South Africa has been on the brink many times, but somehow always managed to veer away from a descent into complete anarchy. It's as if we are always peering over the edge, stepping back only at the last minute.

This recalls Yeats' Second Coming which former President Mbeki was fond of quoting: "Things fall apart; the centre cannot hold." The events of the past few days will convince many that the country has finally spun out of control, its centrifugal forces no longer strong enough.

But their pessimism is likely to be misplaced. What is crucial is that South Africa has a framework within which to rebuild social trust and repair the economy.

The big philosophical questions of representative democracy have long been settled. What seemed like intractable conflict in the 1980s gave way to our constitutional order: all adults can vote, everyone is equal before the law, and our basic rights and freedoms are enshrined in the Constitution. The problems we are faced with today are largely practical, not conceptual or ideological. They are big, and we have failed to address many of them, but progress is possible.

Failed states cannot even begin to address their problems because there is no consensus on the basic rules of the game. In contrast, most of South Africa's 60 million citizens want peace. Most are fed up with crime and corruption. Most want shared prosperity and hope for all.

So the centre can hold. It is held together by ordinary people and key institutions such as our free and fair elections, a parliament with opposition parties, our Reserve Bank, businesses and business organisations, civil society, trade unions, and of course the courts.

WHAT WILL THE ECONOMIC IMPACT BE?

The combination of Level 4 lockdowns and the violence and looting means July is likely to see steep declines in economic activity across a number of sectors, and the third quarter as a whole could see negative GDP growth. The losses will run into billions, some of it insured, much of it not. Some smaller businesses therefore might have to close for good.

The biggest impact will be on the retail sector, followed by transport and logistics, and manufacturing. Retail is an important sector at around 7% of GDP, but clearly an economy is much bigger than its shops and malls. South Africa is a R5 trillion economy, some of it informal and fragile, but much of it sophisticated, flexible and robust.

Depending on how soon calm can be restored and shelves restocked, activity can rebound fairly quickly as we saw a year ago when the economy emerged from hard lockdown. People still need to buy food, clothing and other household items. The rebuilding and restocking efforts will add to economic activity, giving a boost to fourth quarter growth numbers. The exact timing is of course is up in the air at this stage.

While it is easy to overstate the short-term damage, it is also possible to underestimate the long-term consequences. These are likely to extend well beyond the retail sector, dealing a blow to already fragile business and consumer confidence. The blow can be softened if government deals more decisively with the violence and also adapts its policies to boost the economy.

As the looting intensified, the World Bank released a report highlighting some of the steps South Africa should take to grow the economy and create jobs. While important economic reforms have been announced – most notably the deregulation of electricity production – there is more that can be done to make it easier to do business. Listening to the expert economic advice of global institutions like the World Bank is an important start, just like the government has relied on expert advice in dealing with the pandemic.

Crime and unrest have long impacted the economy negatively in a number of ways. Last week's riots were in many respects an acute flare-up of a chronic condition. Injury and loss of life cost the economy billions (and unquantifiable anguish). Diverting scarce resources to security measures is extremely costly. Small businesses, particularly in townships, are very vulnerable to theft and often don't survive as result. Stolen goods can be replaced, but it drives up insurance premiums, sometimes to unaffordable levels for informal entrepreneurs.

What we can't measure is the investment that does not take place because of crime and violence, when global businesses and investors overlook the country, or when locals decide to emigrate and take their skills and capital with them. Or simply when a business that wants to expand finds it impractical to do so (as was recently the case with Rio Tinto's Richards Bay mineral sands operation).

HOW DID MARKETS RESPOND?

The rand is the country's financial pressure valve, and it lost about 2% against the US dollar in the past week. Neither local nor foreign investors like to see scenes of anarchy, but if short-lived they are unlikely to count as a dramatic event in the context of the currency's history. Foreign investors are more likely to dump South African equities, bonds and the currency when they are concerned about global economic growth than in response to events on the ground here. In fact, some of the weakness in the rand was due to a stronger dollar in response to firmer US inflation.

CHART 2: RAND DOLLAR EXCHANGE RATE

Source: Refinitiv Datastream

South Africa has long been better at attracting portfolio flows than foreign direct investment (FDI). In other words, foreigners are more likely to buy bonds and equities that they can quickly trade in and out of thanks to our sophisticated financial markets than buying businesses that they have to operate. There are substantial FDI flows, but portfolio flows are bigger. Portfolio investors also tend to have short memories and most often trade on global financial considerations

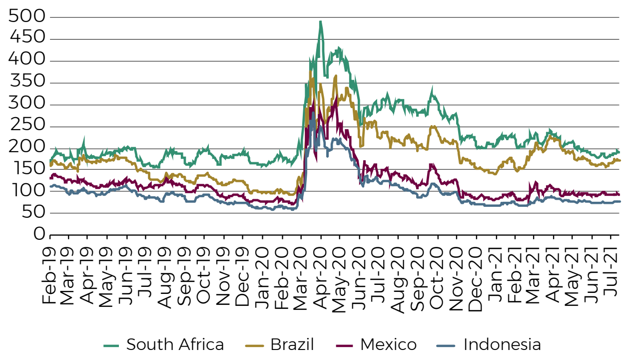
Foreign investors in emerging markets accept that there is less social stability and weaker government control than in developed markets. It ends up being built into the valuations and the higher return expectations. Violent protests are not unique to South Africa. Just in the last year, Chile, Colombia, Brazil and Mexico have experienced widespread riots. In fact, according to the latest Global Peace Index, the number of riots, strikes and anti-government protests worldwide jumped 244% percent in the last decade. The frustrations and depravations of Covid-19 lockdowns have been fuel to the fire in many cases.

Even the US was engulfed by protests against police brutality and discrimination last year. And of course it doesn't take much for football supporters in Europe (the UK especially) to become unruly.

The JSE as a whole was largely unchanged, but that is because it is mostly a global index and rand hedges rose. Retail and bank shares were quite a bit weaker, as could be expected.

Bonds were weaker, but South Africa's dollar credit default spread (its market-based credit rating) has moved in line with its emerging market peer group. The rising bond yields therefore do not reflect a fundamental change in the assessment of the government's creditworthiness, but rather the weaker rand.

CHART 3: SOUTH AFRICAN DOLLAR CREDIT DEFAULT SWAPS VS PEERS



Source: Refinitiv Datastream

It is ultimately global financial developments that matter most to our markets. And as things stand, the global environment remains very supportive. Commodity prices are still elevated, and capital still abundant.

HOW SHOULD INVESTORS RESPOND?

If you have a diversified portfolio, there is no reason to take any immediate action. As citizens we are saddened and angered by the events of the past few days, but as investors we can spread our eggs over many baskets. Global markets are unaffected by what happens in South Africa.

A knee-jerk reaction would be to sell out of South African investments completely and take all the money offshore. However, remember that the local assets are already pricing in a lot of bad news hence the surprisingly small market reaction to these events. It is sensible for local investors to have substantial global exposure to manage risks and to access different return opportunities, but be careful of throwing out the baby with the bathwater. It is generally better to be a buyer when others are selling in a panic. If you are aiming to increase offshore exposure, do not attempt to be too clever in timing the rand. Focus on what you want to buy on the other side.

We can't ignore what is happening around us. We are all shaken. Ultimately, however, what happens in Beijing and Washington and the trading floors in New York and London matters more for your portfolio than chaos on the streets of Durban or Soweto.

EQUITIES – GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	3 025.0	-0.92%	0.27%	12.45%	32.15%
United States	S&P 500	US$	4 327.0	-0.98%	0.67%	15.20%	34.55%
Europe	MSCI Europe	US$	2 025.0	-1.07%	-0.05%	10.05%	25.70%
Britain	FTSE 100	US$	9 649.0	-2.57%	-0.88%	9.29%	22.96%
Germany	DAX	US$	1 735.0	-1.48%	-0.17%	12.75%	26.83%
Japan	Nikkei 225	US$	254.4	0.26%	-1.83%	-4.24%	19.84%
Emerging Markets	MSCI Emerging Markets	US$	1 340.0	1.67%	-2.55%	3.80%	28.11%
Brazil	MSCI Brazil	US$	1 987.0	3.87%	-1.88%	5.92%	27.86%
China	MSCI China	US$	104.1	2.28%	-5.04%	-4.01%	11.98%
India	MSCI India	US$	761.4	1.30%	0.84%	12.79%	48.12%
South Africa	MSCI South Africa	US$	485.0	-0.21%	-1.42%	7.78%	25.00%

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	66 530.0	0.22%	0.42%	11.99%	19.38%
All Share	All Share (Total Return)	Rand	10 538.0	0.22%	0.46%	13.72%	22.49%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	26 249.0	-0.42%	-0.08%	13.22%	22.96%
TOP 40/Large Caps	Top 40	Rand	9 523.0	0.36%	0.50%	12.81%	20.67%
Mid Caps	Mid Cap	Rand	17 565.0	-1.32%	-0.02%	15.81%	28.18%
Small Companies	Small Cap	Rand	22 138.0	-1.76%	-1.53%	28.93%	63.46%
Resources	Resource 20	Rand	4 718.5	-0.82%	2.51%	15.47%	25.38%
Industrials	Industrial 25	Rand	17 730.0	2.79%	0.10%	12.63%	18.07%
Financials	Financial 15	Rand	8 122.0	-4.18%	-2.71%	7.62%	21.41%
Listed Property	SA Listed Property	Rand	1 443.1	-5.01%	-1.63%	17.33%	16.29%

FIXED INTEREST – GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
US Aggregate Bond Index	Bloomberg Barclays	US$	544.2	0.16%	0.63%	-2.60%	2.06%

FIXED INTEREST – SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	794.2	-0.60%	-0.34%	4.64%	13.84%
Government Bonds	BESA GOVI	Rand	784.4	-0.58%	-0.32%	4.59%	13.80%
Inflation Linked Bonds	BESA CILI	Rand	293.9	-0.15%	0.70%	8.44%	17.17%
Cash	STEFI Composite	Rand	473.9	0.07%	0.16%	2.00%	3.95%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	73.6	-2.59%	-1.88%	41.52%	71.14%
Gold	Gold Spot	US$	1 830.0	1.50%	2.87%	-3.38%	1.33%
Platinum	Platinum Spot	US$	1 142.0	5.64%	4.20%	6.73%	37.76%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	14.46	-1.79%	-1.28%	1.60%	15.78%
ZAR/Pound	ZAR/GBP	Rand	19.86	-0.45%	-0.55%	1.11%	5.84%
ZAR/Euro	ZAR/EUR	Rand	17.04	-0.86%	-0.63%	5.36%	11.88%
Dollar/Euro	USD/EUR	US$	1.18	0.85%	0.51%	3.56%	-3.39%
Dollar/Pound	USD/GBP	US$	1.38	0.99%	0.23%	-0.50%	-8.49%
Dollar/Yen	USD/JPY	US$	0.01	-0.03%	-0.92%	6.55%	2.62%

Source: I-Net, figures as at 16 July 2021