MARKET MATTERS

JEROMICRON JITTERS

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Market volatility increased sharply in recent days as investors digested the implications of two separate developments. The first is that the global growth outlook potentially faces a new headwind in the form of a new variant of the coronavirus. Omicron, as it is called, was first sequenced in South Africa, but is already present in many countries despite a knee-jerk travel ban on southern African countries.

OH MY OMICRON

Apart from the fact that it features a large number of new mutations that could render it more transmissible, little else is known about how serious it is. The big question of course is whether existing vaccines offer protection against hospitalisation and death. Anecdotal reports suggest they do and that most cases are mild or asymptomatic, but more reliable evidence will hopefully emerge during the next few weeks.

Even without Omicron, Covid cases were rising rapidly in parts of Europe and the US. Daily new cases in the US were averaging 136 000 on the eve of Omicron's announcement, while in Germany they stood at 62 500. In Russia, where only 44% of the population has been vaccinated despite (or perhaps because of) a home-grown jab, daily new cases were averaging 34 000. The UK, the very first country to ban travellers from South Africa, had 45 000 new cases while South Africa itself only had 5 000. Various types of lockdowns have therefore been implemented across Europe. While these will not be anywhere nearly as damaging to the economy as was the case in early 2020, they can act as a drag on economic activity.

The impact falls hardest on the travel and leisure sector as we've seen over the past year or so. While travel to and from southern Africa has ground to a virtual halt, travel between other regions might also suffer if holidaymakers decide that the risk of being stranded somewhere is too great. Some countries like Japan shut their borders completely when news of a new variant broke.

More Covid-related disruptions in global supply chains could also add to existing inflationary pressures. US inflation hit a 30-year high of 6.2% in October, while the usually inflation-shy Germany saw its consumer prices increase by 6% from a year ago, the fastest pace since 1992.

In particular, China remains committed to a "zero Covid" policy that aims to snuff out all local outbreaks, instead of primarily trying to manage the disease through vaccination. This means Chinese authorities will quickly shut down any factory or transport facility where even a single case is identified, while it maintains very strict limits on the movement of people in and out of the country, including crews on cargo ships. Fewer passenger flights between countries adds to the supply chain problem, since these are a source of moving high-value, low-weight items. These all add to upward pressure on goods prices. However, some of the upward pressure on prices will probably be offset by lower energy prices in a scenario where global Covid cases worsen. Already the oil price is around 13% below its recent peak.

If fear of the new variant (which has already been found in many countries outside South Africa) reduces people's ability or willingness to work, the labour shortages in places like the US and UK might become more intense, putting upward pressure on wages. The much-watched November US employment report sent mixed signals. The unemployment rate fell to 4.2% in November, which would normally indicate a tight labour market, but more people are also looking for work which argues for the opposite to be true.

This takes us to the second big shift that emerged in the past week. Policy is already tightening across the world, but the US Federal Reserve looks set to tap the brakes even harder. The Fed is the world's most important central bank and its decisions reverberate through all financial markets. When the pandemic hit, it cut interest rates to zero and started buying enormous amounts of Treasury and mortgage bonds, $120 billion a month in total. This emergency support is no longer needed and the Fed took the first step back to normality at its November monetary policy meeting by announcing that bond buying would be pared back by increments of $15 billion per month. This was not a surprise to investors and markets barely moved.

JEROME'S JOLT

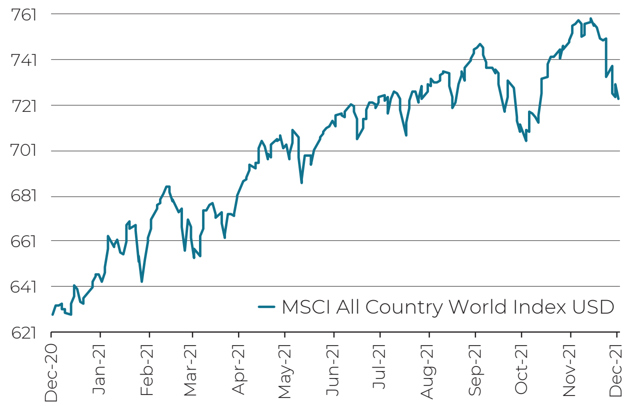
However, subsequent comments from Fed Chair Jerome Powell indicated that a faster pace of tapering would be considered, as the risks to the inflation outlook had increased. This could also bring forward the expected start date of interest rate increases, since the Fed previously noted it will only hike rates once it has stopped buying bonds.

Powell's unexpected hawkish turn has backing from several notable economists, including the International Monetary Fund (IMF) which argued last week that it saw grounds for

US monetary policy to place greater weight on inflation risks, given that the economy has largely returned to pre-pandemic trends, labour markets are tight and inflationary pressures appear broad-based. This is in contrast to other advanced economies, particularly the Eurozone. "It would be appropriate for the Federal Reserve to accelerate the taper of asset purchases and bring forward the path for policy rate increases," the IMF's Chief Economist Gita Gopinath noted.

However, markets were not impressed. The one-two punch from Omicron and Powell means the global equity benchmark MSCI All Countries World Index is 5% off its mid-November peak. This is not cause for concern by itself. Corrections and pull-backs happen from time to time as investors assess new information and attempt to price in new risks. Moreover, global equity returns for the year so far remain robust at 14% in dollar terms.

CHART 1: GLOBAL EQUITIES IN 2021



Source: Refinitiv Datastream

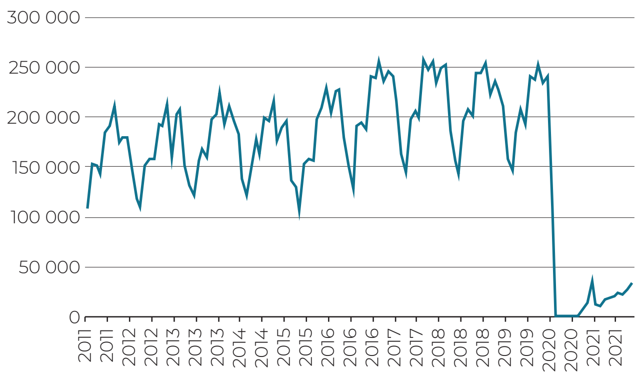
None of this is to say that we are facing a global recession like we saw in early 2020. The growth outlook remains positive and policymakers will be sensitive to how their actions impact their respective economies. Growth forecasts for the global economy and major individual countries remain quite robust for 2022, but the risks have increased that these forecasts might end up revised lower. As always, the question investors should ask themselves is "what is priced in?" If too much good news is discounted in financial markets, a correction is likely, as expectations need to adjust lower at some point. The converse is also true. If investors are excessively pessimistic in their expectations, the upward adjustment will lead to higher prices.

SHOOTING THE MESSENGER

For South Africa, the discovery of the Omicron variant is the latest addition to a recent list of headwinds for the local economy. The sudden – and unfair – imposition of travel bans by several countries on the eve of the festive season is a devastating blow for South Africa's beleaguered tourism industry. In such a seasonal industry, many companies in this sector would have been hoping for a good December and January to stay afloat financially. Even if the travel bans are lifted tomorrow, other countries will still likely require quarantines, which are extremely unattractive to holidaymakers.

StatsSA data shows that 33 362 overseas holidaymakers arrived in the country in September. This was well above the 7 448 arrivals reported in October 2020 (no data was released during the lockdowns from April to September), but only a fraction of the 192 762 overseas visitors in September 2019. As the chart shows, arrivals typically peak in the summer months.

CHART 2: SA TOURIST ARRIVALS FROM OVERSEAS (UNADJUSTED)



Source: StatsSA

Fortunately for the sector, the government has not taken any steps yet to curb domestic travel despite a surging case count, focusing instead on increasing the rollout of vaccines. Vaccine mandates at workplaces and public spaces are also on the cards.

The other headwinds are extended load-shedding, which was experienced during October and November, and elevated food and fuel prices are eating into the purchasing power of households (the petrol price hit a record R20.35 in Gauteng last week). Since there is no job growth – in fact the latest data shows 571 000 formal jobs were lost in the third quarter with the unemployment rate hitting a record 34.9% – consumer spending growth rests entirely on real wage growth. Inflation reduces real wage growth.

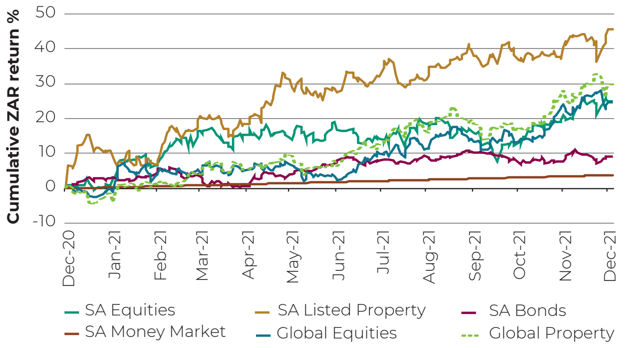
Softer commodity prices are meanwhile denting the export performance (along with Transnet's inefficiencies). The trade surplus narrowed slightly in October to R19 billion as exports declined more than imports. The trade surplus for the first 10 months of the year is still at a record R369 billion, compared to R202 billion and R3.7 billion for the same period in 2020 and 2019 respectively. However, South Africa's terms of trade – export prices relative to import prices – has definitively worsened in recent months as the PGM and iron ore prices have declined, while the oil price has moved higher.

Finally, the Reserve Bank has started raising interest rates, focusing on global inflation concerns rather than the local growth outlook.

Despite all this, South African equities have been resilient and the FTSE/JSE All Share Index even posted a new record high of 71 198 along the way. It is very rare for news from South Africa to impact global markets. It usually works the other way around. It is even rarer for local equities to largely escape such a global event, but here we are. The All Share has returned 24% in the year so far.

A big reason of course is that the recent rand weakness supported rand hedges on the JSE. It also largely offset the dollar declines in global markets. From the point of view of local investors, all the major asset classes were positive in November and this has largely continued into the first few days of December. Therefore, despite all the uncertainty and numerous headwinds, we are still on track for very good returns for the calendar year 2021. We don't know what 2022 holds, but we do know that if markets move higher, the only way to benefit is to be invested (with sensible diversification). It is no good reading about returns that you do not participate in.

CHART 3: ASSET CLASSES IN RAND TERMS OVER THE PAST YEAR



Source: Refinitiv Datastream

HORSES AND STABLE DOORS

It is hard to escape the conclusion that governments in the UK, Europe and elsewhere overreacted in slapping travel bans on South Africa. Faced with a new and uncertain threat, a knee-jerk response is very natural. It can also have devastating consequences. What makes it worse is that the horse has probably already bolted. Omicron has probably been circulating in many countries for some time before it was formally identified. Similarly, investors often have the same fight or flight response to bad news, often with negative consequences to their long-term wealth. Moreover, selling after the market falls amounts to locking in losses – and closing the stable door too late.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	3 086.0	-1.47%	-0.52%	14.72%	17.74%
United States	S&P 500	US$	4 538.0	-1.24%	-0.63%	20.82%	23.75%
Europe	MSCI Europe	US$	1 970.0	-0.51%	0.31%	7.07%	9.51%
Britain	FTSE 100	US$	9 427.0	0.33%	0.38%	6.77%	7.96%
Germany	DAX	US$	1 609.0	-0.74%	-1.17%	-1.14%	6.27%
Japan	Nikkei 225	US$	248.5	-2.03%	-0.60%	-9.23%	-3.75%
Emerging Markets	MSCI Emerging Markets	US$	1 225.0	0.16%	1.07%	-5.11%	-1.13%
Brazil	MSCI Brazil	US$	1 422.0	0.00%	1.35%	-24.20%	-20.51%
China	MSCI China	US$	85.3	-2.86%	-1.30%	-21.30%	-19.92%
India	MSCI India	US$	825.1	0.49%	1.24%	22.23%	31.38%
South Africa	MSCI South Africa	US$	442.0	7.02%	1.38%	-1.78%	2.55%

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	70 808.0	3.20%	0.47%	19.19%	20.12%
All Share	All Share (Total Return)	Rand	11 492.0	3.30%	0.58%	24.01%	25.10%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	28 510.6	4.88%	1.46%	22.97%	25.79%
TOP 40/Large Caps	Top 40	Rand	10 387.0	3.10%	0.44%	23.04%	23.61%
Mid Caps	Mid Cap	Rand	19 116.0	5.98%	1.98%	26.04%	31.28%
Small Companies	Small Cap	Rand	25 939.0	4.74%	1.93%	51.06%	58.20%
Resources	Resource 20	Rand	5 068.1	3.79%	-1.11%	24.02%	26.11%
Industrials	Industrial 25	Rand	19 222.0	1.06%	0.82%	22.11%	19.55%
Financials	Financial 15	Rand	9 071.0	7.59%	2.87%	20.19%	27.29%
Listed Property	SA Listed Property	Rand	1 613.3	6.82%	3.35%	31.16%	45.47%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
US Aggregate Bond Index	Bloomberg Barclays	US$	534.9	0.31%	0.33%	-4.26%	-3.45%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	806.5	2.08%	0.67%	6.27%	9.15%
Government Bonds	BESA GOVI	Rand	796.1	2.07%	0.68%	6.16%	9.07%
Inflation Linked Bonds	BESA CILI	Rand	299.9	0.30%	0.19%	10.66%	12.71%
Cash	STEFI Composite	Rand	480.8	0.07%	0.03%	3.50%	3.79%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	69.9	-3.85%	1.28%	34.38%	42.61%
Gold	Gold Spot	US$	1 783.0	-0.56%	-0.56%	-5.86%	-3.15%
Platinum	Platinum Spot	US$	936.0	-2.09%	-1.78%	-12.52%	-8.68%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	16.05	1.53%	-1.04%	-8.49%	-5.50%
ZAR/Pound	ZAR/GBP	Rand	21.28	2.02%	-0.70%	-5.64%	-4.09%
ZAR/Euro	ZAR/EUR	Rand	18.20	1.44%	-1.03%	-1.36%	1.27%
Dollar/Euro	USD/EUR	US$	1.13	0.00%	0.35%	8.14%	7.08%
Dollar/Pound	USD/GBP	US$	1.32	0.78%	0.48%	3.51%	1.99%
Dollar/Yen	USD/JPY	US$	0.01	-0.50%	-0.30%	9.18%	8.63%

Source: I-Net, figures as at 3 December 2021