

# *Discovery Money Market Fund*

## *Market background*

The fourth quarter got off on the back foot in October as fears of another round of lockdowns swept through markets amid surging coronavirus (COVID-19) infections throughout Europe and the US. November, however, saw a tidal shift in sentiment as the outcome of the US presidential elections, positive news on the vaccine front, better-than-expected corporate earnings, and encouraging economic data combined to fuel risk appetite. With the US election event risk out of the way, the start of COVID vaccine programs across the developed world and abundant central bank liquidity proved a powerful combination for anything cyclical or high yield. South Africa, as one of the higher beta emerging markets, benefited from this mix despite local COVID-19 data pointing to an imminent second wave. The JSE All Bond Index ended the quarter a strong +6.7%. One-year fixed-rate negotiable certificates of deposit (NCD's) sold off 47 basis points (from 3.5% to 3.97%) post the South African Reserve Bank (SARB) MPC meeting. The SARB had room to cut, but chose to keep the repo rate on hold and the market slowly started to factor in that rate cuts were off the table. We also witnessed inflation surprising to the upside and liquidity conditions began to tighten as we moved into a traditionally illiquid month of December, all contributing to higher yields. Cash, as measured by the STeFI Composite Index, returned +0.97% for the quarter. In currencies, the rand rallied 13.6% against the US dollar over the quarter, 9.4% against the euro and 7.8% against sterling.

The US economy continued to grapple with an unrelenting surge in COVID-19 cases over the quarter, which continued to dampen the outlook for the economic recovery. The labour market is expected to show a contraction for the year when jobs report is released on 7 January. October also saw a marked deterioration in consumer spending while jobs growth in November also reflected a significant

slowdown. Congressional lawmakers finally reached an agreement on the long and desperately awaited pandemic-relief bill in the final days of the quarter, with an expected \$900 billion teed up for pandemic-stricken firms and households to help them through the first half of this year. On the monetary front, the US Federal Reserve (Fed) Federal Open Market Committee (FOMC) kept the Federal funds target range at 0.00% - 0.25% throughout the quarter. Going forward, the incoming Fed presidents who have made it to the Fed's interest-rate setting panel have given the FOMC a marginally more dovish tilt and further strengthened the 'lower-for-longer' mantra – even in the likely event that vaccinations and fiscal stimulus provides a shot in the arm for the US economy in the second half of 2021. In politics, Joe Biden comfortably secured victory in the presidential elections, securing 306 electoral votes to Donald Trump's 232.

Europe remained a large contributor to global COVID-19 infections in recent months, and the impact of the resultant lockdowns reflected in frequent data emanating from the region, with the bloc poised to end the year in double-dip recession. The German economy has fared relatively better given softer restrictions at the outset of the pandemic and its exposure to the Chinese economy, while France and Italy, which are heavily reliant on tourism suffered severe consequences on account of lockdowns. The gap between services and manufacturing purchasing managers' indices (PMIs) was a theme throughout the quarter, as the former suffered from pronounced weakness in travel, hospitality and other consumer-facing sectors, with service providers reporting extremely weak demand. On the monetary front, the European Central Bank (ECB) announced several policy adjustments on the back of persisting headwinds from the second wave of infections sweeping across the currency area. The central bank increased its asset purchases by €500 billion to €1,850 billion and also extended the purchase period by a further nine months to end of March 2022. In politics, European Union (EU) members eventually reached a détente on the union's landmark post-pandemic recovery package after Hungary and Poland (which had initially vetoed the package) eventually withdrew objections to a new mechanism which tied payments to upholding the rule of law. On the eve of Christmas, the UK's Boris Johnson and European Commission's Ursula von der Leyen finally reached a Brexit trade deal following nine months of excruciating negotiations.

In emerging markets, China's economic recovery stayed the course throughout the fourth quarter, setting the world's second largest economy on course to be the only positive growth story in 2020. Economic indicators pointed to strong growth in fixed investment, consumer spending, and industrial output, which further bolstered labour markets. The manufacturing PMI fell to 53 in December from the decade-high 54.9 in November, coming in below consensus expectations of 54, but still marking the eighth consecutive month of expansion in factory activity. The country's economic recovery continued to gather steam on the back of robust global demand for exports heading into the festive season and credit-easing policy by the People's Bank of China (PBoC). With the economic recovery well on track, policymakers have recalibrated their focus to long-term growth objectives and discussions on potentially unwinding the stimulus measures introduced in 2020. The PBoC announced in a report late in November that it would keep "normal" monetary policy for as long as required, while the Chinese Communist Party's Politburo has urged government to bolster domestic demand and to maintain growth within reasonable range.

South Africa emerged from its longest recession in almost three decades, with GDP expanding by an annualised 66.1% in the three months ended September 2020 following a spectacular 51.7% free-fall

over the April-June period. The reported figure by StatsSA was the biggest rate of expansion since South Africa's transition from Apartheid to a liberal democracy. Under the bonnet, trade, manufacturing and mining did most of the rowing following the relaxation of lockdown restrictions. The country's current account posted its biggest surplus over the same period as exports rebounded following the easing in restrictions and muted import activity at the ports. Consumer sentiment, however, remained relatively subdued (especially the high-income category) over the fourth quarter despite the economic rebound and lifting of restrictions. Following an uptick in COVID-19 cases, President Cyril Ramaphosa announced on the night of 28 December that the country will move to an "adjusted" Level 3 lockdown following a second wave of infections driven by the new COVID-19 variant, while also citing a lack of compliance to regulations by businesses and households as a key contributor to the rise in infections. The president also announced that vaccines would likely only be rolled out in the second quarter of 2021.

On the monetary front, the SARB MPC left key policy rates unchanged when it convened at its final meeting of the year back in November. The voting was consistent with the September MPC decision, with two members voting for a 25bps cut and three members voting to keep rates unchanged.

## *Portfolio activity*

We continued to add exposure to Government Treasury Bills and debentures (which are attractive relative to bank NCDs), selectively increasing duration in the process.

## *Outlook and strategy*

### **Global**

The year 2020 was traumatic for the vast majority of the globe. The combination of the large number of deaths, deep recessions and widespread mental depression means that 2020 will long be remembered as one of the worst years since World War II. Unfortunately, the effects are likely to be long-lasting. The IMF recently estimated where the level of overall GDP output would be in a range of countries in 2024 relative to what they had expected for that year prior to the onset of COVID-19. Although South Africa would have recovered to 2019 levels by then, it will still be 8.3% lower than they had previously projected for 2024. Shortfalls of between 7% to 10% are forecast for a host of large emerging markets including Brazil, Chile, Mexico, Indonesia and Thailand. Add in the massive increase in borrowing during the year, and there is a growing concern that debt burdens are in danger of becoming unsustainable for many countries. The most notable damage will no doubt be the ballooning in government debt, however, assessing the sustainability of debt in any given country is a complex question. Most of the world's largest economies will emerge from the pandemic with modest damage to their economies due to unprecedented support from governments and central bankers – the Sherpas who have helped us navigate this challenging terrain. We do not believe that governments are about to start lowering spending or raising taxes any time in the near- to -immediate term. In our view, fiscal austerity will only come into play once bond yields begin to shoot up (as vaccines jumpstart the recovery but muted

inflation should keep a lid on this) and investors begin to question the sustainability of government debt levels. For bond investors, government bond yields have only nudged slightly higher, notwithstanding the improved outlook of a global recovery and this has largely been underscored by monetary stimulus largesse.

Looking ahead, yields and rates are likely to remain 'lower-for-longer' and we expect the Fed to stay the course, reinforced by its adoption of allowing inflation to run above target. Unlike across the Atlantic, we do not expect any further easing from the Fed as seen by the BoE's additional injection in November and the ECB's additional easing in December. We believe the Fed will now let the incoming Biden administration do most of the rowing going forward. Europe's second waves has scuppered the V-shaped recovery seen in the third quarter, and the region is now on course for a record contraction in the final quarter of 2020. The post-pandemic recovery for the currency area should be robust given its exposure to global trade compared to the US economy, while the continued recovery in Chinese demand should also be a shot in the arm. The UK economy is poised for a double-digit contraction in 2020 but the early distribution of vaccines and the conclusion of a Brexit deal are great launch pads for a robust post-pandemic rebound in 2021. We expect the bank of England to maintain an ultra-accommodative monetary policy stance throughout the recovery and gilt yields under control – further supporting government efforts on the borrowing front.

Loose monetary policy and US dollar weakness will remain supportive for EM assets and should provide shade for EM central bankers to keep rates elevated due to price stability and foreign capital needs. We expect negative growth for emerging market economies this year, excluding China. We believe the contraction from COVID-19 bottomed in the first half of the year, and emerging economies are on track to recover some of that lost ground in the second half of 2020. That said, these economies will follow a 'K-shaped' recovery (sharp fall, followed by wide divergence) which will see the gap between richer and poorer nations widen further, this divergence proving more pronounced in Asia. EM economies are currently tracking at various speeds; on account of exogenous shocks, the disruption to trading-partner economies and the effectiveness of fiscal policy in these countries. China's economic output has risen back to pre-pandemic levels and consumption has made up significant ground to production in the process, which should give Beijing impetus to accelerate the rebalancing of China's economy from its heavy reliance on exports and fixed investment towards domestic demand. Investor eyes will be peeled for the first meeting between Biden and Xi and discussions surrounding tariffs and the Phase One trade deal, but Sino-American relations under the Biden-Harris administration should be less raucous than they were under the Trump years.

## **Local**

The picture in South Africa has dimmed somewhat since the second waves of infections and subsequent reintroduction of an "adjusted Level 3 Lockdown". Furthermore, power utility Eskom has reinstated national rolling power outages. South Africa implemented some of the strictest lockdown restrictions in 2020 which was a massive shock to the economy from both demand and supply sides as the economy came to a complete stand-still for weeks during the second quarter of 2020. The resurgence of infections and new lockdowns will only make the climb out of this economic calamity even harder, and should further illuminate the desperate need for long-overdue structural reforms. Following years of fiscal erosion, ratings agencies remain on high alert and high-risk premia has meant very limited scope for Keynesian fiscal policy in the current crisis to pull the economy out of the current

depression. The political economy has time and time again failed to deliver credible macroeconomic reforms necessary to create a fertile environment which can spur fixed investment and set the economy on a sustainable growth path. We have drawn countless plans and made countless announcements, but the implementation gap is yet to narrow and a lack of clarity on reforms is arguably the greatest danger to the economic outlook. We have witnessed a persistent contraction in private-sector fixed investment, resulting in a decline in potential GDP growth, anaemic realised growth, rising unemployment, weak tax revenues and an unfolding fiscal crisis.

Despite no shortage of negative newsflow, we have witnessed some greenshoots rising to the surface amid the doom and gloom. We have seen an improvement in mining and manufacturing production data, as well as a rise in retail and vehicle sales in August, while PMI data has also trended in expansionary territory for most of the second half of 2020. We have also witnessed forward momentum in certain areas, such as an acceleration in corruption investigations and more guidance on 5G spectrum auctions. The currency remains well-supported by the boost from our terms of trade and favourable current account. 2020 turned out to be a great year for agriculture, owing to bumper crops (citrus, maize and wheat) and above-average rainfall, while prices of our mineral exports are also charting well. These have all given the rand a boost relative to peers and the country's current account posted its biggest surplus in the third quarter as exports rebounded following the easing in restrictions and muted import activity at the ports. Going forward, the key focus areas in the coming months that will be a sentiment booster will be how quickly we can roll out vaccines and traction on structural reforms.

### **Positioning**

The resurgence of COVID-19 cases across the globe and locally has seen a return to lockdown restrictions and continued disruption to supply chains and demand. This will no doubt keep a lid on inflation expectations and outcomes in the immediate to medium term. Locally, the inflation outlook is balanced. We expect inflation to remain well-anchored around the mid-point of the SARB's target range over the short -to medium-term; we expect food inflation to remain muted, while pressure from depreciation in the rand also remains muted alongside limited pass-through and weak local demand should ensure this muted inflation environment to persist for some time.

Headline inflation rose to 3.2% in November, from 3.2% the previous month in line with consensus expectations; core inflation however surprised marginally higher than expected at 3.4% albeit comfortably below the midpoint of the SARB's inflation band. The SARB is unlikely to reduce rates in the upcoming January MPC meeting despite the recent deterioration in COVID statistics (and potential further restrictions). There remains a majority on the MPC that appears to believe that a lot of easing has already been done and further time is needed before reassessing the monetary stance.

The SARB downwardly revised their 2020 inflation forecasts to 3.2%, in line with our expectations; they revised the 2021 forecast from 4.0% to 3.9% in 2021. The revision in their 2021 core inflation forecast was more pronounced, decreasing by 30bps from 3.7% to 3.4%. For 2021, our expectation is for an average of 3.7% for headline inflation and 3.3% for core inflation. Even though our forecasts are lower than the SARB, the differences are not that wide.

With short-dated yields having already kicked substantially higher and liquidity conditions likely to ease up once more, we believe rates will stabilise for now around these levels.

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