# Prescient Multi-Asset

## Our systematic view

DECEMBER 2020

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> An end is in sight and markets have turned optimistic

## GLOBAL MACROECONOMICS

### Chasing the cure

At the time of writing, the first vaccine was being rolled out in the UK and a worldwide distribution pipeline for millions of dosages was in the process of being established. Russia and China also started rolling out vaccines a few months ago, but South Africa remains behind the curve in terms of acquiring vaccine contracts. This could be to our detriment if the current coronavirus wave continues to gather steam.

Nevertheless, an end is at least in sight and markets have turned optimistic due to a combination of this and a more stable geopolitical environment.

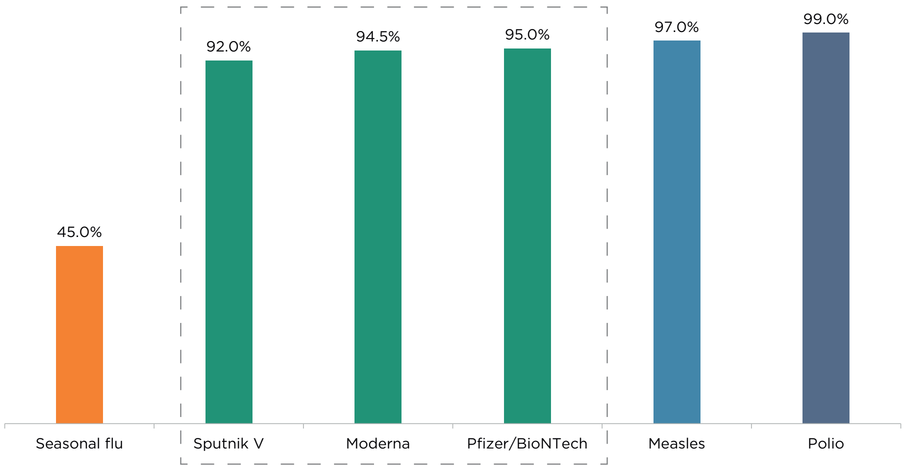
The economic shockwaves will continue well into the future though, with debt burdens that have risen both at sovereign and individual levels and unemployment remaining stubbornly high.

It's interesting to take a closer look at the vaccine, its effectiveness and the general life cycle to develop it. The current variation of coronavirus may have been solved, but there will be others and if we've learnt nothing else, at least we will understand the risks better in future.

To start with, Moderna's vaccine was developed on 13 January 2020, two days after the genome sequencing string had been made public. The vaccine was approved for public release after eleven months of clinical trials. This is important to note, because it highlights that while people are computationally brilliant at finding solutions for virus immunisation, bureaucratic ineptness probably delayed the process of rolling it out.

Bureaucracy no doubt exists for a reason and protects us against potential adverse side effects, but it can most certainly be streamlined going forward to reduce the lead time.

Vaccine effectiveness




*Sources: CDC, Moderna, Pfizer, Russian Gvt, AFPD*

The vaccines that have been released by mainstream pharmaceutical companies so far have proven to be highly effective – at around 95%. They are much more effective than vaccines for average seasonal flu, and have very few side effects to boot. As a result, the eradication of this variant of coronavirus is all but certain, albeit protracted because of the rollout time for pharmaceutical companies to cover several billion doses. South Africa can take its cue from the UK and WHO in terms of prioritising vaccination among the populace, with tranches ordered by age bracket and by any existing medical conditions that may increase risk profiles. So far, they haven't even included those under the age of 50 in their rollout plan.

For global markets, this indicates a positive outlook, and we must now turn our attention to global economic growth and its support to underlying asset classes after an incredibly tumultuous year. Coupled with this, the next US President has been established, the Senate is still undecided (more on this later), and we've seen a return to the global trade dynamics that dominated the first half of the Trump presidency.

## Our systematic view on global markets

At the moment, the dominant theme for us in the current outlook across global markets is a short dollar bias, with the US dollar seen as unattractive compared to our four major currency pairs. This stems from a collection of different signals for each currency pair, but the common denominator is that the value case for the US dollar no longer exists in any of the major pairs, suggesting carry-trade opportunities that are too attractive for US investors to not take up in other countries.

> Growth assets remain largely neutral, with a positive bias persisting in the real assets space

South Africa in particular has one of the highest cases for carry trade (borrow dollars, buy rands, earn SA Government Bond yields and harvest the difference) in the world. Growth assets remain largely neutral, with a positive bias persisting in the real assets space such as property, preference shares and inflation linkers.

| | Strong Underweight | Moderate Underweight | Neutral | Moderate Overweight | Strong Overweight |
|---|---|---|---|---|---|
| **Equities** | | | | | |
| South Africa | | | Neutral | | |
| United States | | | | Overweight | |
| European Union | | | Neutral | | |
| Emerging Markets | | | Neutral | | |
| DM Small Caps | | | | Overweight | |
| EM Small Caps | | | Neutral | | |
| **Bonds** | | | | | |
| South Africa | | | | Overweight | |
| United States | Underweight | | | | |
| European Union | Underweight | | | | |
| EM (USD) | | | Neutral | | |
| EM (Local) | | | | Overweight | |
| **Credit** | | | | | |
| South Africa | | | Neutral | | |
| DM Investment Grade | | | | Overweight | |
| DM High Yield | | | | Overweight | |
| EM (USD) | | | Neutral | | |
| **Real Assets** | | | | | |
| SA Property | | | | Overweight | |
| SA Preference Shares | | | | Overweight | |
| SA ILBs | | | | Overweight | |
| DM Property | | | | | Overweight |
| **FX** | | | | | |
| Euro | | | | | Overweight |
| British Pound | | | | | Overweight |
| Japanese Yen | | | | | Overweight |
| SA Rand | | | | | Overweight |

For geographies like the European Union and Japan, the question becomes: once investors buy into the currency, where is the best spot to park their money? For both of these regions, the yield on risk-free bonds is negative, so investors begin to look further down the risk spectrum into assets like corporate debt (investment grade and high yield), and eventually equities.

Fiscal stimulus from a Biden presidency, combined with tax hikes, may certainly lead to the latter funding the former, but where there's a gap (as could very well be the case if corporate and individual tax revenues decrease due to the growth concern), the country must borrow their way out. This increase in the levels of government debt can be seen as a potential risk to US credibility and devalue the dollar. While it's not always true, scenarios like these are important to consider at the beginning of a new presidential term.

## UNPACKING OUR SYSTEMATIC VIEW ON THE POUND BEFORE BREXIT

### Where we currently stand

All four of our currency pairs are showing strong overweights vs the US dollar, primarily as a result of a weak value case for the latter. We thought it best to focus on the pound, given the current uncertainty around the looming Brexit deadline. Britain officially left the European Union in January this year, although significant portions of the trade agreements remained in place until 31 December 2020. Come 1 January 2021, if the UK hasn't struck up a trade deal, they'll be heading into unchartered waters. This theme has been prominent in global newspapers for the past few months, even if secondary to pandemic news on the front page. Now that the end-of-year exit deadline is almost upon us, it has come to the fore.

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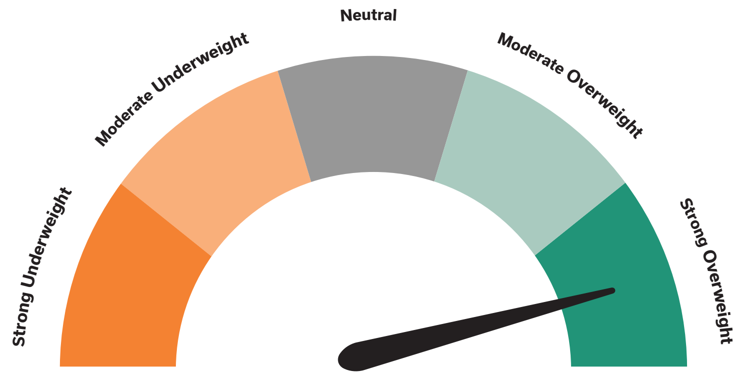



> Prescient takes views not on political speculation, but rather on numbers

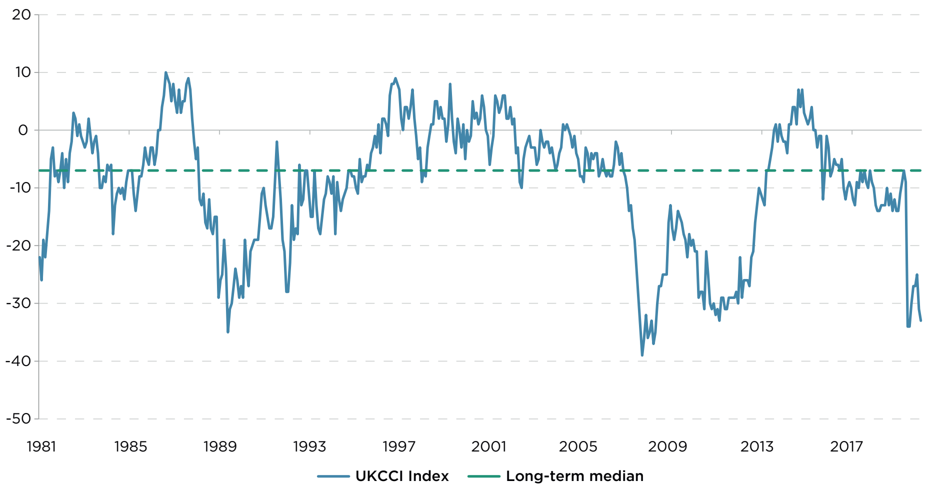
You may ask how can we be bullish on the pound, given the uncertain outlook described above? Prescient takes views not on political speculation, but rather on numbers. Those include hard numbers like interest rate differentials, as well as soft numbers like consumer sentiment surveys. The broad picture is an optimistic one, with the only real laggard being the labour market as a result of COVID-19-related unemployment.

| Value | Economics | Financial Conditions | Sentiment |
|---|---|---|---|
| Real Effective Exchange Rate | Prescient Economic Indicator | Monetary Policy | Business Sentiment |
| Real Interest Rate Differential | Economic Surprise Index | Credit Spreads | Consumer Sentiment |
| | Yield Curve | Funding Pressure | Investor Sentiment |
| | Labour Market | Cross-Currency Basis | |

The real effective exchange rate shows that according to purchasing power parity, GBP buyers have cheaper prices than USD buyers. Over the long run, we expect this arbitrage to revert, leading to a strengthening in the pound.

Taking a deeper dive into one of the more interesting factors, if we look at UK Consumer Confidence, it's easy to see that compared with the longer run, the current levels of sentiment are near all-time lows. Logically, consumers are pessimistic given the uncertainty around both COVID-19 and Brexit. The silver lining is that for this factor, we find the *change* to be a more accurate indicator for the currency than the level. The level can be seen as something that's priced into the currency, whereas the change reflects new information. Over the last 6 months, the level has remained roughly flat, giving a neutral score. We would expect this consumer confidence to pick up in the coming months as more certainty emerges around both Brexit and COVID-19.

**Consumer sentiment - GFK Consumer Confidence Index**




*Source: Bloomberg (as at November 2020)*

## WHAT TO LOOK OUT FOR

### Risks and fortifications to our views

#### *Swing dancing in Georgia*

President Trump has exhausted all of his options to argue foul play in the elections, and the deadline for state submissions of official results has come and gone. However, keep in the back of your mind that he's currently the Republican presidential frontrunner for 2024.

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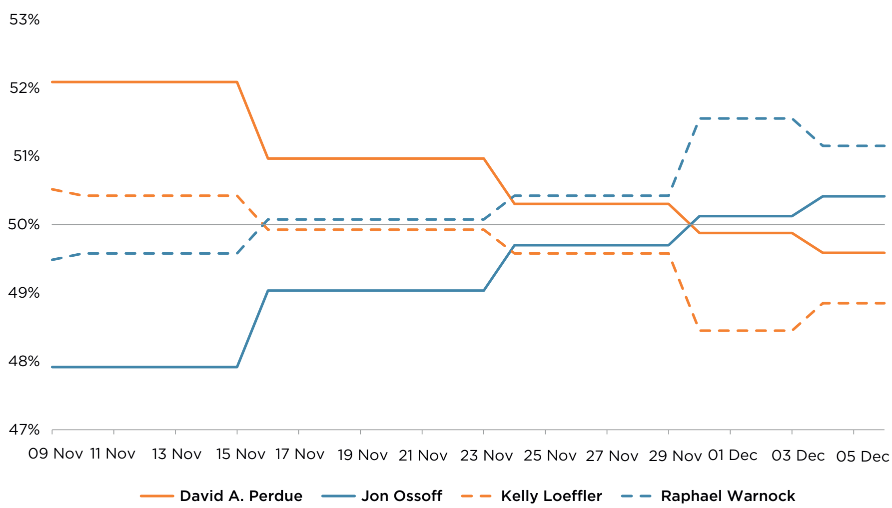
> The tides have turned in favour of both of the Democrat candidates

All the focus in the US now turns to the State of Georgia, where two senate seats stand for election, and could decide the Democratic full sweep. Under Georgia election law, the winner must receive more than 50% of the vote in order to win. During the first round of elections, there were more than two candidates in the running, implying a diluted vote and no winner. In the runoffs scheduled for early January, only the top two candidates from the first round are allowed to run, with one of those taking the win. To complicate matters further, Georgia had an existing Senator retire due to health issues, which called for a second special election for the additional seat.

Coming out of the US elections both of the Republican candidates were ahead, but neither had more than the 50% required to take the Senate seats. If polling is anything to go by, the tides have turned in favour of both of the Democrat candidates, which could mean that Biden gets the Senate as well as his already confirmed Presidency and House of Representatives. This so-called "blue wave" would mean policy decisions would flow through the US government with relative ease, which is very similar to the early days of Trump's presidency.

**Georgia state senator election**




*Source: https://projects.fivethirtyeight.com/georgia-senate-polls/ (as at 06 December 2020)*

For markets, this means a higher degree of certainty in policy direction, versus a hung vote with little progress if the Senate remains Republican. Whether that leftward-leaning policy direction would be supportive for equity markets remains to be seen. If anything, it would bring a degree of calm to otherwise frenetic markets of late.

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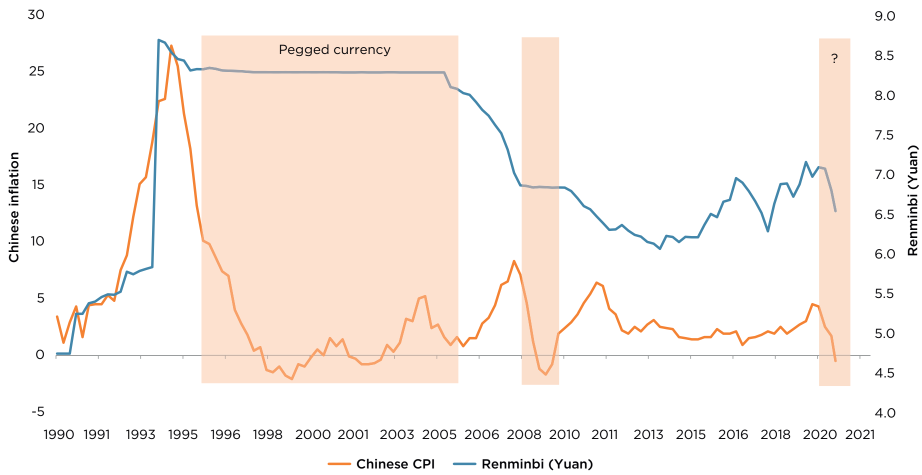
### *Looking to the East*

China is generally underreported in the West, including here in the Southwest. There's been an interesting macroeconomic development for China's inflation that we're keeping an eye on – especially since China now makes up the lion's share of emerging market indices. While the US may still be the kingmaker for Emerging Market equities, China is now playing the Queen's Gambit – sacrificing pieces early on to gain an advantage in the future.

China published a -0.5% year-on-year inflation figure for November – its first period of deflation since 2008. Added to this, the recent tumble in the dollar makes the dollar/yuan pair less attractive for dollar exports from China. This is important to note, because China now has a possible play to devalue – or at least stabilise – its local yuan currency to bring that deflation back to inflation, while simultaneously improving on its terms of trade. It's unlikely, as the People's Bank of China (PBOC) continues on its path toward "policy normalisation", with fewer interventions and a more flexible currency with borders opening to investors. However, if the deflationary environment persists, it becomes more and more probable. The outcome could be renewed squeamishness from offshore investors as USD-priced Chinese equities fall in value from the devaluation in the Renminbi (assuming Chinese equity prices don't adjust upwards to counter this).

### Chinese inflation and the Renminbi




*Source: Bloomberg (as at 30 November 2020)*

## BRINGING IT ALL TOGETHER

### Navigating through the uncertainty

Thankfully, we end 2020 – the year we'd all like to forget but never will – on a more positive note. Asset class performance has picked up and the funds are back on track towards their long-term objectives. There is now an end in sight to the pandemic, although the timelines remain uncertain, particularly for South Africa. We can shift our focus back towards macroeconomic policy and the cleanup after the storm.

It will be a while until the global economy is back on course, but it's important to remember that even before this black swan event, the global bull market was seen as being long in the tooth. The pandemic could prove to have been the catalyst we needed to reset and rebalance towards new targets, with the emergency stimulus pre-empting what could've been a normal bear market correction.

We are keeping a keen eye on the outcome of the US Senate race, which could very well determine the difference between a stalemate or a progressive US government over the next few years.

The funds remain cautiously optimistic in their positioning, with a value case still existing for real assets such as property. The US dollar shows weakness against the four currency major pairs we follow, and the funds are tilted towards underweighting naked offshore exposure by implementing currency hedging. In other words, we aim to participate in rand selloffs and then bank that performance when it slowly climbs back to pre-crisis stability.

As always, we stick to our process and don't get sidetracked by the noise.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